

Car and LCV production in Europe, prospects and challenges for suppliers

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AutoAnalysis & The SMMT

- Since 2005, AutoAnalysis has provided SMMT members with a detailed review of car and LCV production in Europe
- Data provided at model and plant level, for current years and a forward view for 3-4 years' ahead
- Next issue due out June 10

Overview of current market conditions

- Since Q3/2008, the auto market has been in flux, facing unprecedented uncertainty:
 - *Mature markets down by $>1/3$, with a notable shift to small cars, especially in North America*
 - *Global truck sales down by $>2/3$...*
- Conventional assumptions regarding market dynamics do not apply just now:
 - *Traditional, recent demand drivers less significant and relevant*
 - *Much recent demand driven by cheap and easy finance, job security, property prices engendering feeling of wealth ...*

Overview of current market conditions (2)

- VMs and suppliers caught unaware, and were shocked by scale and speed of collapse, especially in Europe:
 - *Some forecasters predict 2010 sales will be lower than in early 1990s recession, possibly as low as the peak pre-1970s oil crisis*
- Market correction had been expected, but no one had anticipated the sudden nature of the collapse:
 - *Some markets' year-on-year declines have been over 50%*

Fundamental structural change is happening – where will it end?

- Analysts have discussed over-capacity and the need for fewer VMs for many years
 - *Finally, re-structuring & re-alignment has begun*
- Chrysler will eventually disappear inside Fiat, GM will become at least two separate entities
 - *Numerous brands will disappear*
- What will happen in Europe?
 - *How many plants will close?*
 - *Which VMs/brands will disappear?*
 - *Will capacity really be reduced?*

Over-capacity – the elephant in the room; but will it be taken outside?

- Auto industry has substantial over-capacity, but has barely started to tackle the problem:
- 2003-2008, total European car & LCV production grew from c18m to c20m units pa
- 2009 will fall to <16m, possibly less:
 - *Even with a stabilising economy, production will not reach 18mn again until 2012, possibly later*
- *At peak of production, there was general recognition that Europe had around 20% over-capacity*

Dealing with over-capacity?

- Capacity exists for 24-25m cars and LCVs in greater Europe, even more if Russia is included
- Capacity added recently and is still being added:
 - *New Fiat plant in Serbia*
 - *New Mercedes plant in Hungary*
 - *Recent BMW plant in Germany*
 - *Acquisition and expansion by Ford in Romania*
 - *Expansion of Dacia, in Romania and globally*
 - *All new plants for Toyota/PSA JV, PSA alone, Hyundai & Kia in Czech/Slovakia*
 - *Most major VMs opening new plants in Russia or helping domestic plants expand*

Amount of over-capacity

- European auto industry can make at least 7m vehicles pa above the recent level of regional demand:
 - *“Failure” of Fiat-GM “merger” meant the “opportunity” to cut capacity quickly has been missed*
- Regional imports and exports broadly balance:
 - *Global focus on local production for local markets means exports will not represent a solution to the overcapacity problem*

What does 7m units excess capacity mean?

- If demand permanently exceeds supply, VMs cannot justify maintaining excess capacity.
- Ways to cut capacity: *cutting shifts, slowing line speed, short-term working, temporary shut downs or ultimately closing plants.*
- But VMs have closed very few plants:
 - Vauxhall Luton, Renault Belgium, Opel Portugal
 - *In fact more plants have opened than have closed*
- *If optimal car plant size is 250-350k pa, in theory we have >20 excess car plants!*

20 plants will NOT close

- But some will close if demand settles at lower level than recent peak
- Up to half excess capacity could be “solved” by cutting shifts etc, but some plants will be uneconomic at lower production levels:
 - *Premium brands’ plants in Germany likely to see permanent loss of shifts*
- There are at least 8 plants facing severe challenges and as many again which could be threatened:
- *The “good” news is they are not all in the UK*

Several plants will downsize and change focus

- Renault Sandouville:
 - *Shifting from large cars to vans*
- Nissan Barcelona:
 - **Simplifying complex product portfolio**
- Ford re-aligning Fiesta, Fusion, Focus and variant production between 5 plants
- Can single platform plants survive?
 - *Russelsheim will make Insignia and Astra*

There is some good news!

- Bonus/malus scheme in France, scrappage incentives in Germany and elsewhere boosted small car production:
 - *Dacia Logan, VW Polo, Fiat/Ford in Poland, new Fiesta, Clio /Clio 3*
- Honda re-starting production, adding a new model ...
- GME saved? Astra production about to start ...

Economic indicators improving?

- There are some positive signs:
 - *Sterling appreciating, FTSE up*
 - *Increasing belief that depth of downturn has been reached*
 - *Have house prices stopped falling?*
 - *May be it cannot get any worse ...*
- But:
 - *Companies still report difficulties getting finance*
 - *Will the major economies be able to afford support given to finance and auto sectors?*

Implications for suppliers

- Increasingly tough market conditions for 2009 and beyond are a fact of life:
 - *Production volumes will be permanently lower than recently*
 - ***10-20% fall in car sales = 20-40% fall in supplier revenues!***
 - *Fixed capacity and low profitability at most suppliers means many will go into the red, if they are not there already*
- Price pressures will increase, raw material prices will rise, credit terms will worsen!
 - Obtaining finance will be tougher

Implications for suppliers (2)

- At the same time, VMs' technology expectations & requirements will increase:
 - CO2 emissions pressure, hybrids
 - New materials to cut weight
 - Safety and security features
- Relations between VMs and suppliers will become more strained ...

Consequences ...

- **Bankruptcies will increase:**
 - Average 10 automotive supplier insolvencies pa in Germany 2005-2007
 - 30 actual insolvencies 11/08-03/09
 - >150 more expected by end of 2009
- *Source: Roland Berger/Rothschild*

Suppliers' reactions?

- Further consolidation or simply exiting industry?
- Big players likely to be bigger or maintain size as competitors fail as demand falls
- Restructuring essential, refinancing inevitably required, if difficult to obtain for survivors:
 - *More debt for equity swaps*
 - *Loss of ownership/control*
- Shift production away from Europe, to lower cost locations?

In conclusion

- Current demand down by over 1/3; *likely to be cut permanently by 20% at least*
- Recent market drivers no longer apply
- Restructuring now happening: *so far more in US than in Europe ...*
- Europe yet to address over-capacity issue
- At least 8 very vulnerable plants, another 10+ facing serious challenges
- The economy may have stopped falling:
 - The recovery from injuries sustained will be slow
 - And painful; *the patient has yet to face up to reality*