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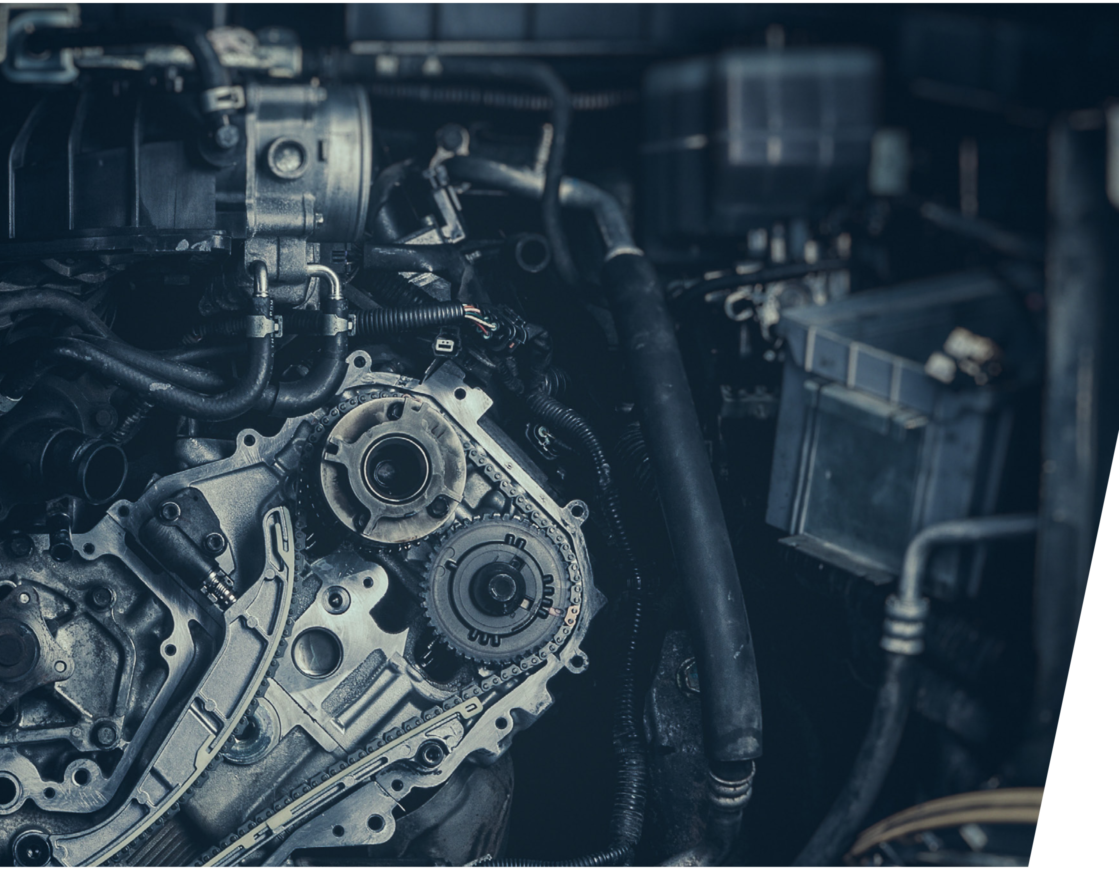
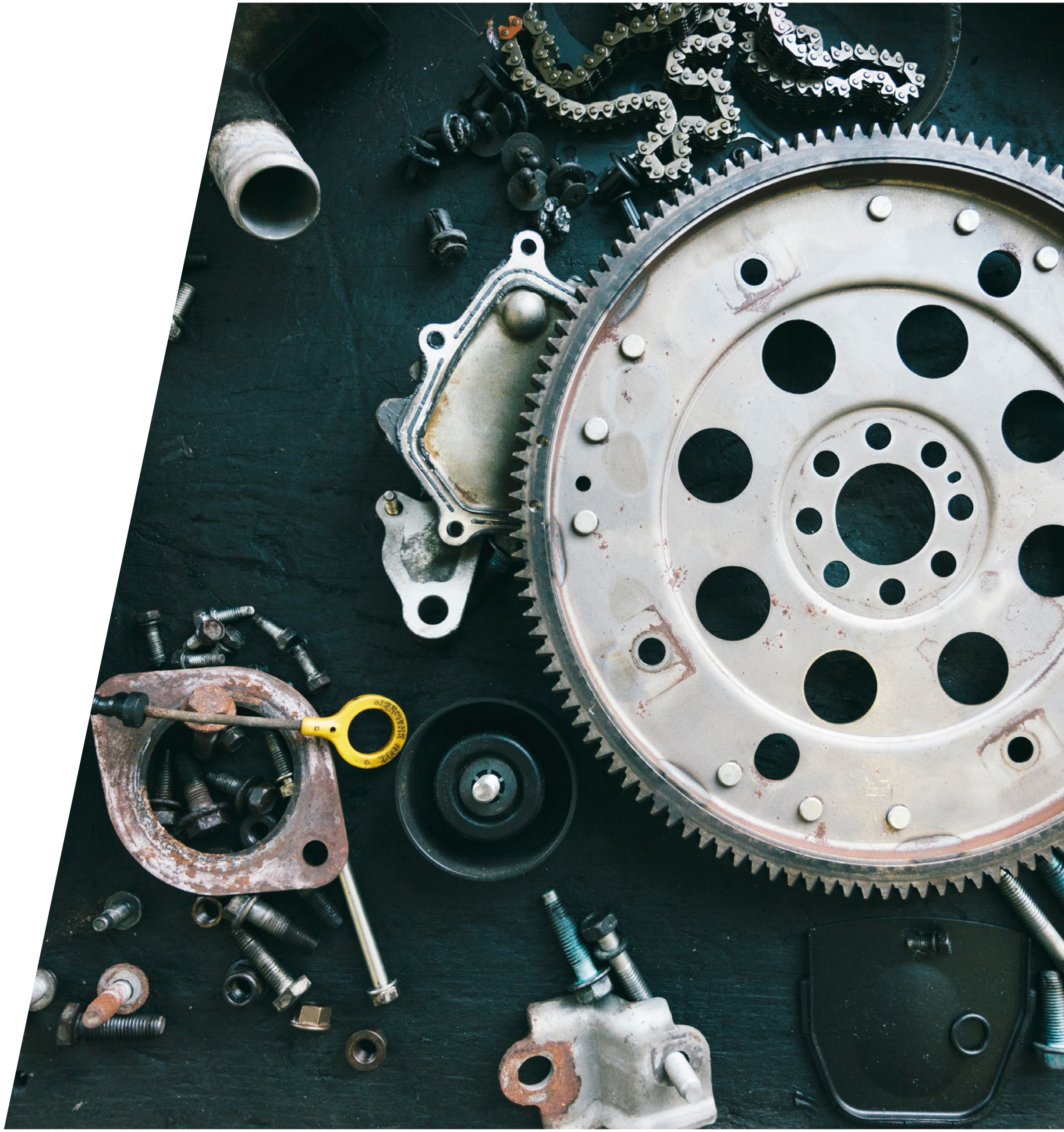


Automotive Market Insights

July 2023

Rothschild & Co

Contents



Introduction

The drive towards the car of the future – electrified, autonomous, shared, connected, yearly updated – may not be 'eascy' for the industry but it presents significant opportunities for OEMs and their supply chain partners who are committed to innovating.

OEMs and parts manufacturers which have been well-positioned to serve the trend towards electric and hybrid vehicles have outperformed the broader sector. The same is true for players that are indirectly supporting this shift, such as producers of lightweight materials, technologies that improve fuel efficiency, and battery and electric motor suppliers.

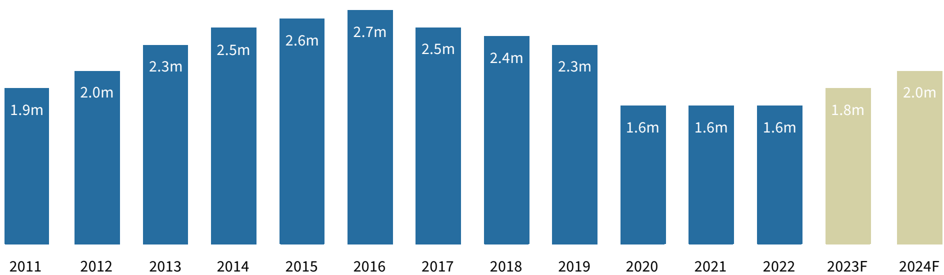
As we look forward through the remainder of 2023 and into 2024, this paper contemplates the impact of three key dynamics on the sector:

1 The easing of supply chain constraints

2 Macroeconomic outlook and interest rates

3 'Eascy' cars

Number of new car registrations (UK)



Source: SMMT

"Over the last ten years, valuations across the automotive sector have fluctuated considerably as consumer behaviour, government regulation and technological advancement have challenged market participants to adapt or be left behind."

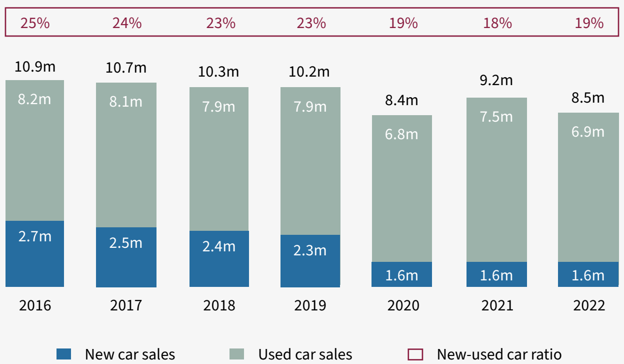
The easing of supply chain constraints in the Automotive sector

The UK's exit from the EU, the Covid-19 pandemic and Russia's invasion of Ukraine have each contributed meaningfully to a challenging supply-side environment for the automotive sector. There are, however, green shoots of recovery present.

New car registrations in the UK, a proxy for overall automotive sector activity, and one which fell by ~30% between 2019 and 2020, are forecast to return to long-term trend levels through 2023 and 2024. Whilst the recovery is expected to be progressive rather than a bounce-back, the sector can take encouragement from the fact that supply of new vehicles is increasingly able to meet demand - a significant challenge for the sector since 2020.

While supply-chains were under pressure from Q1 2020 onwards, it was not until Q2 2021 that the well-publicised acceleration in used car prices began. It is highly unlikely that these will feel a shock from the volume of new cars being released onto the market; however, consumers will be wise to keep an eye on the value of their used cars as the volume of substitute goods increases.

Number of new and used car registrations UK (2016 – 2022)



Source: SMMT

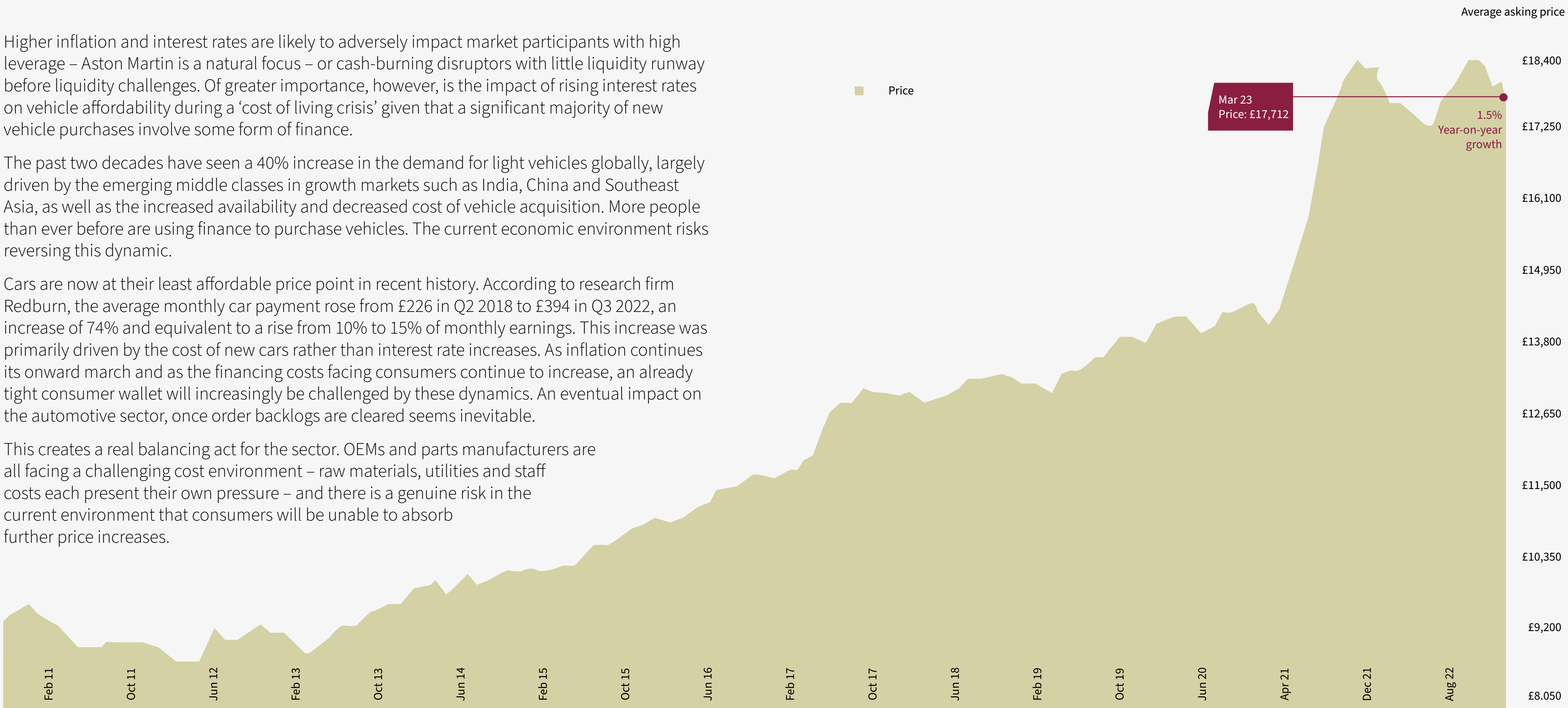
Automotive macroeconomic conditions and inflation

Higher inflation and interest rates are likely to adversely impact market participants with high leverage – Aston Martin is a natural focus – or cash-burning disruptors with little liquidity runway before liquidity challenges. Of greater importance, however, is the impact of rising interest rates on vehicle affordability during a 'cost of living crisis' given that a significant majority of new vehicle purchases involve some form of finance.

The past two decades have seen a 40% increase in the demand for light vehicles globally, largely driven by the emerging middle classes in growth markets such as India, China and Southeast Asia, as well as the increased availability and decreased cost of vehicle acquisition. More people than ever before are using finance to purchase vehicles. The current economic environment risks reversing this dynamic.

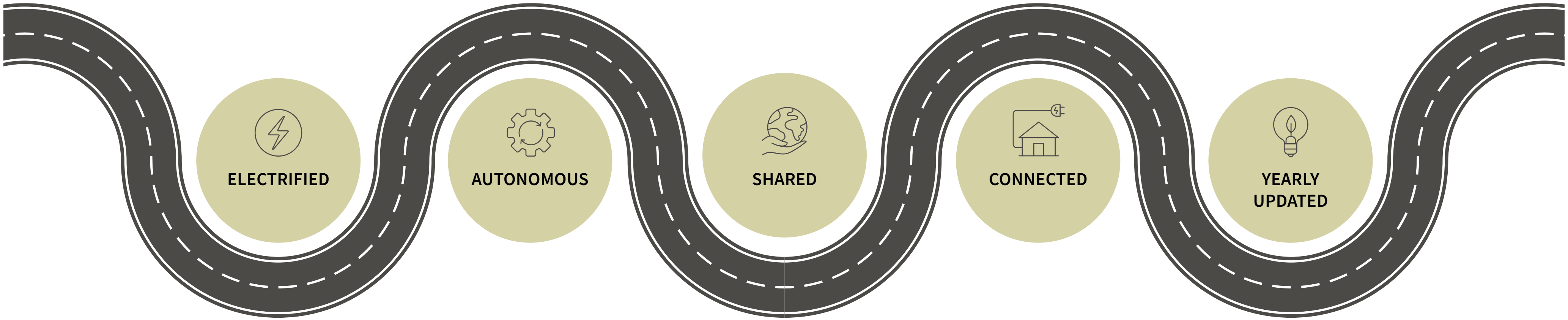
Cars are now at their least affordable price point in recent history. According to research firm Redburn, the average monthly car payment rose from £226 in Q2 2018 to £394 in Q3 2022, an increase of 74% and equivalent to a rise from 10% to 15% of monthly earnings. This increase was primarily driven by the cost of new cars rather than interest rate increases. As inflation continues its onward march and as the financing costs facing consumers continue to increase, an already tight consumer wallet will increasingly be challenged by these dynamics. An eventual impact on the automotive sector, once order backlogs are cleared seems inevitable.

This creates a real balancing act for the sector. OEMs and parts manufacturers are all facing a challenging cost environment – raw materials, utilities and staff costs each present their own pressure – and there is a genuine risk in the current environment that consumers will be unable to absorb further price increases.



Notes: 1. Electrified, Autonomous, shared, connected, yearly updated.
Source: Autotrader Retail Price Index.

Spotlight on Eascy cars



The steady flow of incremental new technologies has long-defined the automotive sector but the environment today is one of more fundamental changes and plentiful opportunities, across the value chain. Indeed, looking forward, the shape and structure of the entire sector in 10 years' time has never been less predictable.

Whilst Eascy cars are reasonably defined today, the future state of the sector will remain dynamic and certain cogs in the car of the future are more certain than others.

Sustainability as an imperative from from consumers and governments alike is here to stay but to what extent are we clear on what sustainable mobility means for the automotive sector? EVs do appear the most likely outcome but given recent movements in the EU, it would be wise to consider the role that sustainable or synthetic fuels may play in the future.

Formula 1 has long-served as the test ground for high end automotive innovation. Traction control, active suspension, and regenerative breaking are just three technological developments - originally created with speed in mind - that are now common in road cars. In recent years, Formula 1 has pushed forward the rapid development of hybrid engine technology that is in widespread production in cars across leading OEMs.

By 2026, all Formula 1 cars will use synthetic fuel in the race for speed and sustainability. The implication of new entrants to the sport, such as Audi (part of the Volkswagen Group), is that OEMs see a possibility that synthetic fuels, as well as batteries, have the potential to share the future of mobility.

This is already accepted within aviation where the barriers to EV adoption are much higher. In March, the UK Government announced a further £165m of funding for the advancement of sustainable aviation fuels – but as of now the UK has retained its focus on EV for the auto sector.

Another sustainability consideration is the trade-off associated with increasingly disposable cars. To what extent are highly software/electronic-driven EVs with shorter useful economic lives a sustainable alternative to vehicles powered by internal combustion engines with longer lives, and to what extent will advancements in engine efficiency and sustainable fuels shift the balance of thought?

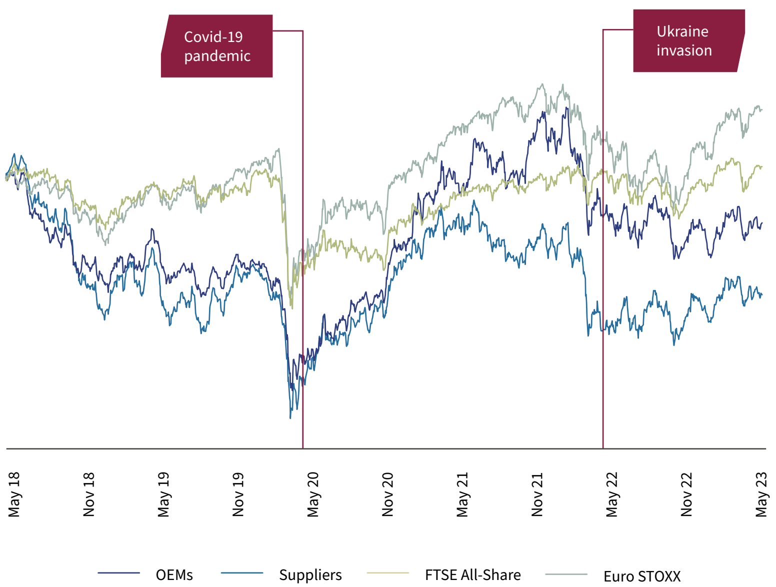
Clearly, there are a number of questions facing the sector in its move towards this uncertain future. Companies aligned to the most certain technological themes will be most-likely to succeed – EV-supporting infrastructure and technologies, lightweight materials for use in manufacturing and technology supporting the future of mobility are safe bets – but with an outlook influx, sector participants which boldly lead the way and define the future of the sector, even if this is not consensus, may reap even greater rewards.

Valuation and share price context

Share price performances through the cycle for OEMs and suppliers have lagged the broader stock market over the last five years. This trend manifested itself prior to the outset of the Covid-19 pandemic and has been a sustained theme throughout the period.

Share prices for OEMs have fared well relative to their suppliers, 12% down compared to a 31% drop for suppliers. This may reflect the perceived comparative strength of the OEMs in a tighter commercial environment vs. their suppliers. Broader equity markets have risen 18% in Europe and 4% in the UK in the same period.

Indexed share price progression (May 2018=100)

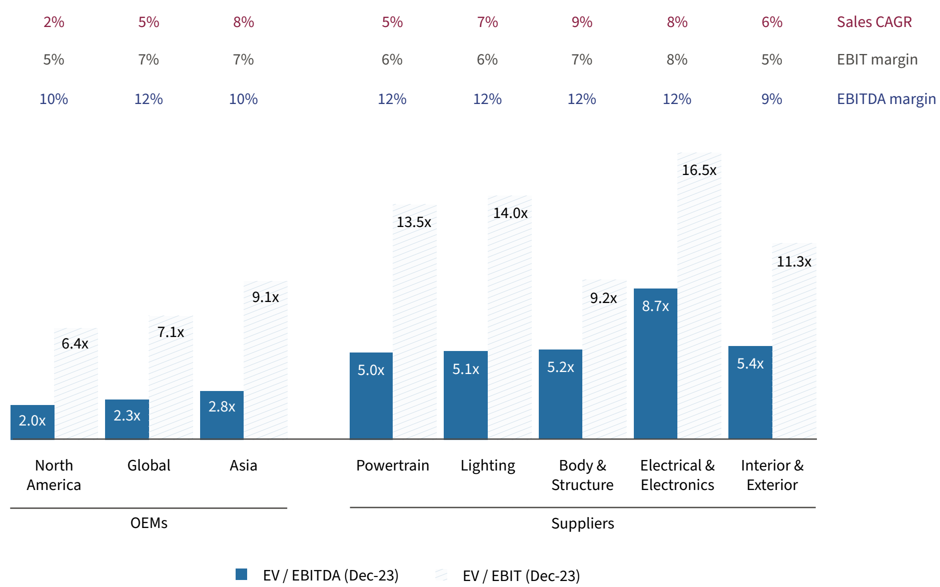


Source: Factset, Rothschild & Co analysis

However, total valuation relative to profit tell a different story. The valuation of automotive suppliers consistently exceed those of OEMs, with Electrical & Electronics suppliers trading at the highest valuation across the sector.

Whilst there is limited differentiation in EBIT or EBITDA margins across categories, consensus estimates for top-line growth amongst suppliers is generally higher than for OEMs, again with Electrical & Electronics suppliers showing most promise.

Valuation context



Source: Factset, Rothschild & Co analysis

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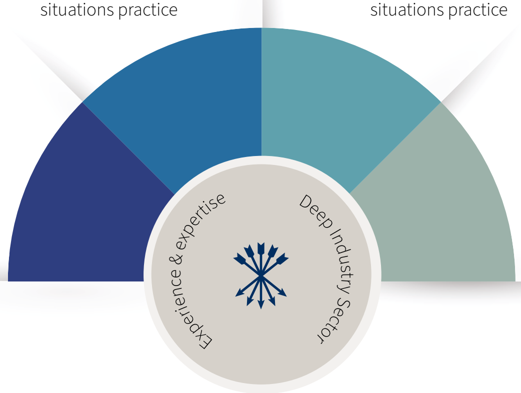

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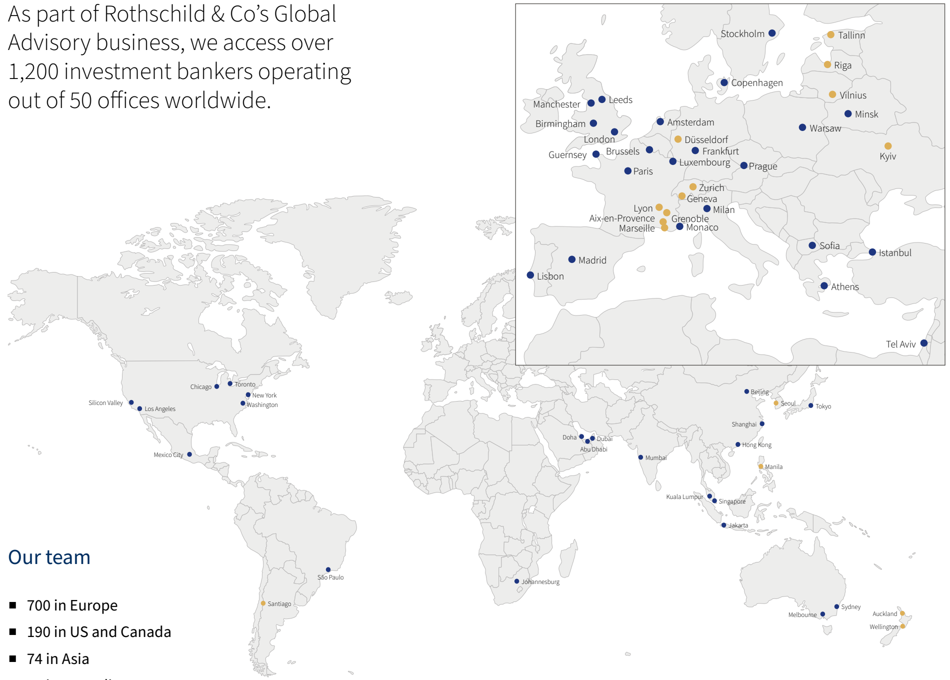

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Our selected credentials

TE Connectivity
Sale of Hirschmann Car Communication to USI and Phi Zoyi

Curernt

Porsche Automobil Holding
Up to €10.1bn acquisition of a 25%+1 voting stake in Porsche AG

2023

Jardine Matheson
Sale of Jardine Motors Group to Lithia

2023

Johnson Matthey
Divestment of Advanced Glass Technologies (AGT) business

2022

Coryton Advanced Fuels
Sale of specialist and sustainable fuels business to Lantmannen

2022

Volkswagen
€9.4bn IPO of Dr. Ing. h.c. F. Porsche AG on Frankfurt Stock Exchange

Financial Adviser

2022

Aramis
Acquisition of Cazoo Italy (brumbrum)

2022

Apollo Global
US$7.1bn Acquisition of Tenneco

2022

Kongsberg Automotive
Sale of specialty products business to BRP

2022

BMW and Mercedes-Benz
Sale of SHARE NOW to Free2move

2022

Dayco
Sale to Hidden Harbor Capital Partners

2022

Varroc Engineering
Divestment of its NA and EU Automotive Lighting Systems business to Plastic Omnium for €600m

2022

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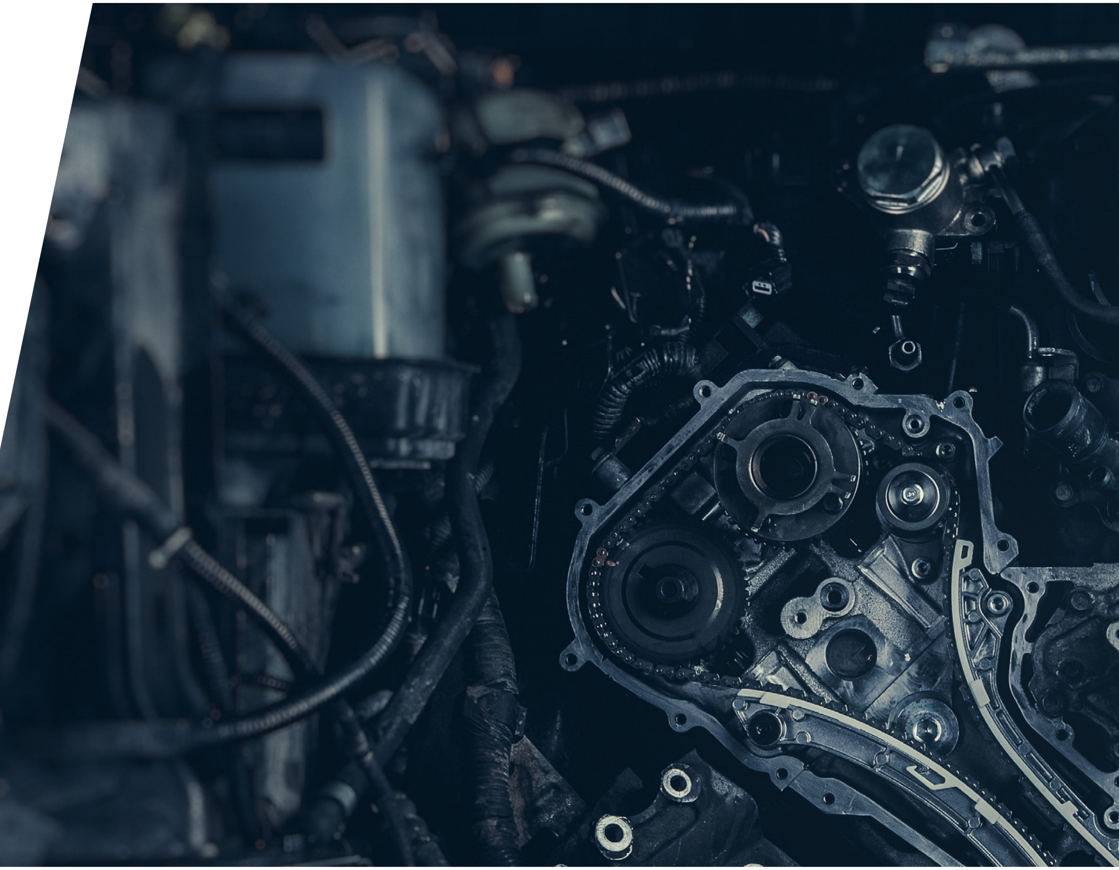

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