



European Automotive Newsletter

- State of the Industry – Quo Vadis Automotive
- The Supplier Reduction Dilemma – OEM Challenges
- The U.S. Post-Election Industry Outlook
- Transaction Activity
- Quarterly Update of Financial KPIs

December 2024

State of the Industry - Quo Vadis German Automotive Industry?

The second half of 2024 saw further headwinds for the automotive industry, with announcements of redundancies, plant closures, profit warnings and insolvencies becoming the order of the day. This affected small suppliers, global SMEs and manufacturers alike. We take a look at the facts and figures to understand the state of the industry throughout 2024.

Negative headlines in the automotive industry are nothing new. Since 2016, the industry has been in permanent crisis mode. WLTP standards, Dieselgate, COVID-19, e-mobility, CO2 fleet targets, the Ukraine conflict and the associated material price- and energy-crisis as well as increased financing costs are the constant buzzwords automotive managers are confronted with.

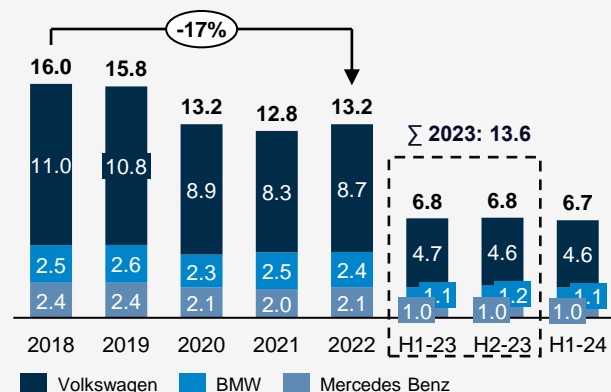
In addition, new competitors and new car manufacturers, especially from the Far East, are increasing competitive pressure.

What are the key drivers further challenging the automotive industry in 2024?

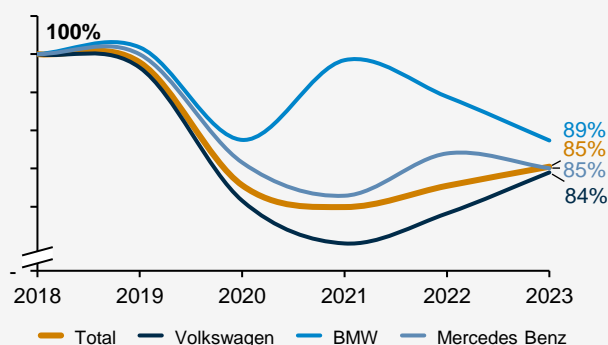
Our hypotheses on current market developments:

1. Demand in the "old markets" is weak
2. The Chinese market is maturing and its competitive products have reduced demand of traditional OEMs
3. The financial pressure on the supplier base is high with reduced room for manoeuvre
4. The need to re-dimension the supplier base becomes more evident, but it is complex and cost-intensive
5. Significant uncertainties in the market outlook make reliable medium-term planning almost impossible

Production volume (#m) – Selected OEMs



Indexed production vol. (%)



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1. Demand in the "old markets" is weak

Consumer restraint is currently characterized by:

- Uncertainty regarding the future of the dominant powertrain technology: While combustion engines widely seen as being "phased out", Battery Electric Vehicles (BEVs) remain in the early-adopter phase; with use cases not yet suitable for the broader mass market. A big hurdle in this respect is that the charging technology and infrastructure are facing significant development challenges. As a result, resale values for BEVs are volatile.
- Cost-out programs across the German economy led to significant savings in the vehicle fleets of corporate customers.
- Current economic headwinds and uncertainty leads to fundamental reluctance and postponement of purchases among private individuals.
- Increased financing costs make car purchases more expensive for both corporate and private customers, leading to "downsizing".

2. China has arrived in a tough and competitive reality

The Chinese market, which used to be important for German manufacturers, is now dominated by local manufacturers. Patriotism as well as advanced technological features are major selling points for local manufacturers, while the status appeal of European brands is diminishing.

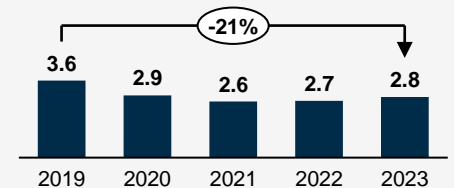
Chinese manufacturers offer a wide and deep range of alternatives, from luxury to budget vehicles. From a customer perspective, quality becomes comparable and prices are competitive.

While the global market for BEVs continues to surge, European manufacturers are facing challenges in catching up with the pace of electrification set by the Chinese OEMs e.g. BYD. China is emerging as a key producer of BEV in the global e-mobility market, with a very broad e-mobility offering that is tailored to local market needs.

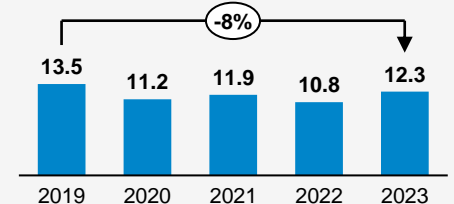
European automakers' share of the global BEV market has been shrinking, with companies from the U.S. and China capitalizing on the shift toward electrification. China is taking the lead in both production and sales of electric vehicles, outpacing Europe in volume and innovation cycles.

A return to known sales volumes and margins for European automotive manufacturers seems currently unlikely.

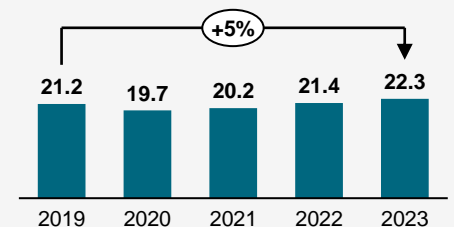
New car reg. (#m) – Germany



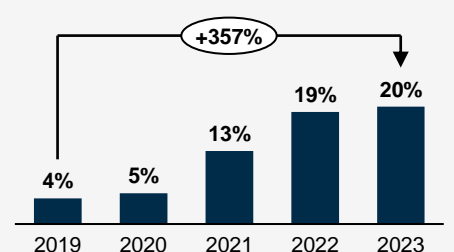
New car reg. (#m) – US



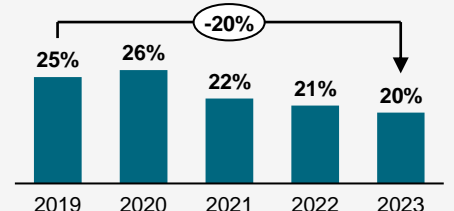
New car reg. (#m) – China



BEV ratio new car sales (%) - China



German OEM mkt. share (%) – China





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3. The financial pressure on the supplier base is high, with reduced room for maneuver

There is substantial production overcapacity across the entire value chain as manufacturers grapple with steadily declining volumes and falling margins. Suppliers that have made significant investments in transforming from ICE to BEV are now struggling with their business cases due to shrinking volumes.

Cost-out programs, which are in some cases already implemented, can mitigate the lost volumes only partially, while the supplier's ability to solve the crisis without external help is very limited. Access to external financing is also limited as most financiers are reluctant to extend their exposures in the automotive industry. Therefore, OEMs purchasing and risk management departments are increasingly confronted with support request from suppliers which they need to react to, to secure their own production.

4. Re-dimensioning the supplier base is complex and cost-intensive

While short-term financial support is in many cases unavoidable to ensure continuous supply, the transformation from ICE to BEV combined with the current volume downturn will require longer-lasting and more radical measures.

In the long-term, a strategic selection and reduction of the supplier base would strengthen the remaining suppliers: with the consolidation and allocation of the remaining volumes to fewer and stronger players. However, this is de facto associated with holistic volume transfers and substantial corresponding costs, bringing competitive disadvantages in terms of pricing.

Due to the number of impacted suppliers and the numerous relationships between the supplier base and the OEM, an efficient consolidation only driven by market mechanism seems almost impossible. We analyzed this issue further on page five of this newsletter ("The dilemma of supplier reduction - challenges from the manufacturer's perspective").

5. Uncertainties in the market outlook make reliable medium-term planning almost impossible

The global automotive landscape is undergoing significant transformation with the key drivers being a technological shift to BEV, new manufacturers entering the scene, volatile regional political requirements, likely protectionist economic policy in the U.S. and China and general economic headwinds, especially in Europe.

All these changes obviously have a negative impact on volume forecast, but the exact impact and the timing of a potential recovery is extremely difficult to forecast. This uncertainty also leads to the challenge of how to right-size restructuring initiatives to achieve the required result and not cut too deep.

Fact-box German Automotive Industry (2023/24):

- > 4 OEMs are headquartered in Germany and in total >900 suppliers are active
- > ~780k employees (1.7% of the total German workforce) are directly employed in the industry, thereof c.1/3 associated to suppliers
- > German OEMs hold a global market share of 18%, German suppliers of 25%
- > The total automotive industry contributes ~10% of annual gross value added of the German economy

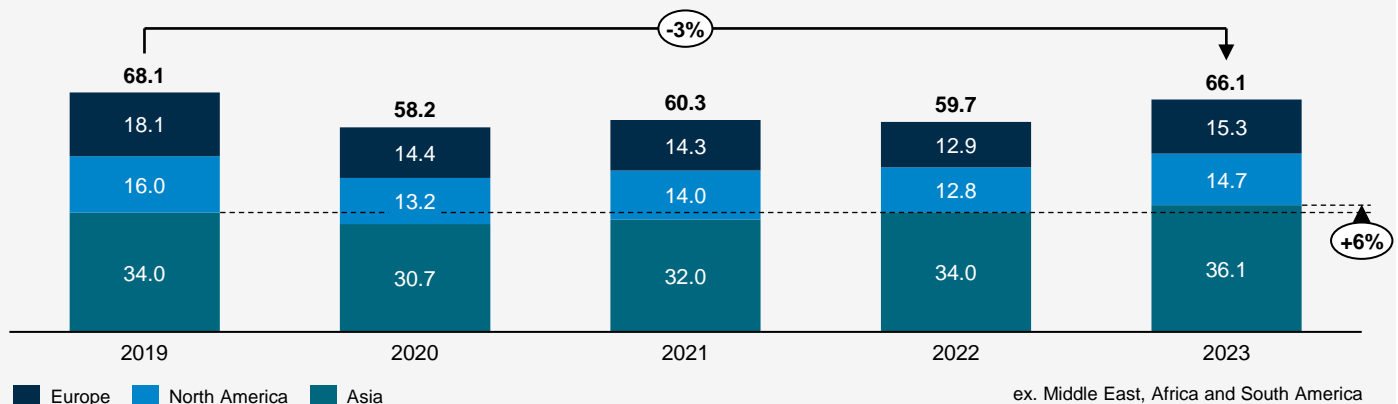
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What steps can be taken to mitigate the challenges faced by the industry?

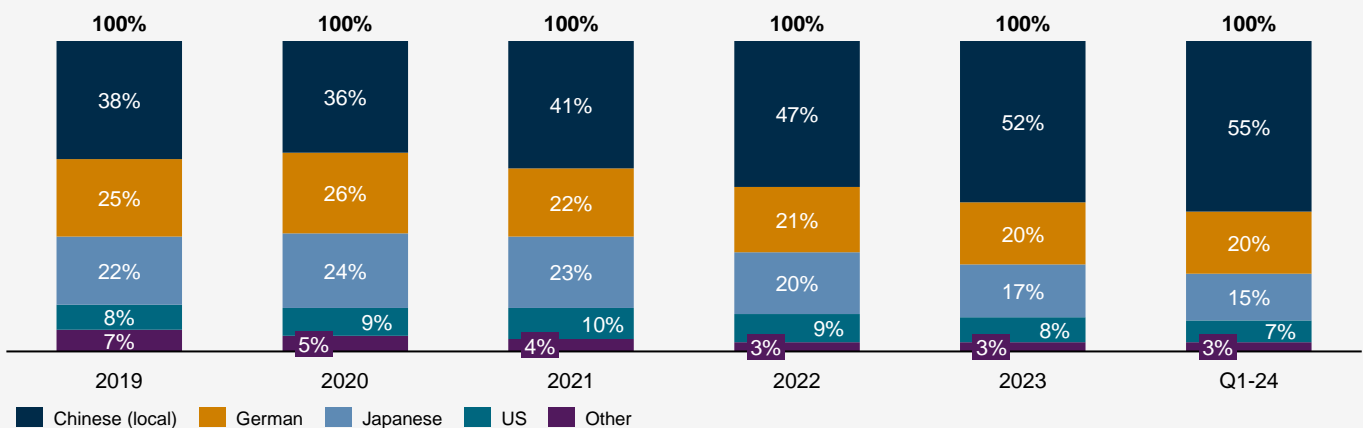
Suppliers need to prepare themselves for another challenging year in 2025 and focus on tight liquidity-, margin- and cost-management.

- Early and consequent escalation of issues and the ability to act quickly is key to avoid insolvency proceedings
- Implementation of continuous forecasting covering different scenarios and maintenance of contingency planning are key to staying ahead
- Increased focus on regional customer demand to avoid further demand disruption
- Improved solution-based communications with relevant stakeholders (trade unions, financiers, policymakers, manufacturers) to find far-reaching strategic options in the current regulatory environment
- Increased political pressure to enable options for economic policy solutions to avoid competitive advantages of other economic regions (e.g., the U.S.)

Global New Passenger Car registrations (#m) – Key Regions



China Passenger Car market share (%) – Country of origin of OEM



Source: ACEA, S&P Global, A&M analysis

The Supplier Reduction Dilemma - OEM Challenges

Why the necessary consolidation of suppliers is so challenging in practice.

The second half of 2024 saw further headwinds for the automotive industry, with announcements of redundancies, plant closures, profit warnings and insolvencies becoming the order of the day. At the same time, suppliers faced relentless pressure to optimize costs in the battle for new orders. The toxic environment of declining sales, however, is undermining their ability to achieve savings through economies of scale.

A changing supplier landscape

The supplier environment of a car manufacturer is complex. An ICE vehicle consists of about 20k to 30k individual parts, which are usually provided by 1,000 to 2,000 direct and indirect suppliers. For an e-vehicle (BEV), the number of individual parts to be used decreases by approximately 30% to 50% (10k to 15k).

The complexity reduction driven by BEV transformation will lead to overcapacities at suppliers and the need to transform within the industry or expand to new business areas. The current volume decline due to lower demand for cars from EU OEMs is accelerating overcapacity in the market.

OEMs are often in favour of a broader supplier landscape as competition improves the technological and economic options available. Consequently, even unprofitable and strategically irrelevant suppliers are often retained and supported, given the high costs and technical risks of volume relocations. In addition, partial volume transfers lead to further financial destabilization and increase the risk for the remaining production. Therefore, the termination of a supplier relationship needs to be regarded as a binary decision, as partial transfers and no new business nominations will lead to financial instability.

In recent years, most consolidation among supplier was largely driven by insolvency activity. In these cases, the main OEM priority is still short-term cost optimization and production security, rather than a long-term supplier strategy. Such processes regularly end with a takeover and continued operation instead of the necessary market adjustment.

How can a consolidation of the supplier base be driven?

OEMs were able to manage the supplier crises in the past professionally and could handle the economic impact due to their own profitability. The question now is, whether this is still possible in the future with a drastically increased number of financially and strategically struggling suppliers, alongside economic pressures on the OEM side. A more sustainable, long-term solution on the overall situation will be required.

- > The number of suppliers where a positive business case due to declining volumes can't be maintained will increase. A market exit of such suppliers will be the expected reality. Substantial funding will be required for continuation, relocation, end-of-life storage, spare part production etc.
- > While the main consolidation trigger will most likely be financial distress or insolvency of a supplier, OEMs should include strategic considerations to a higher extent in their nominations, compared to short-term cost optimization
- > OEMs with a low volume exposure towards a certain supplier have a lower transfer barrier, all others face a prisoner's dilemma, not knowing the other customers strategy related to a specific supplier
- > A consolidation just relying on the market mechanisms under the constraints of the anti-trust law will be lengthy and costly. It can be expected to harm all suppliers and increase the pressure within the industry even more
- > Given the economic and social importance of the industry, especially in Germany, it is questionable whether such lengthy process is affordable by the industry itself
- > A broader framework, potentially supported by state regulatory processes, should be considered to increase efficiency and reduce transition costs for all stakeholders of such process



U.S. Post-Election Outlook

With the Trump administration securing a second term in the 2024 U.S. presidential election, the automotive industry is preparing for potential shifts, spanning from global supply chains to the trajectory of EV adoption. Favoring domestic manufacturing, reducing regulatory burdens and the promotion of traditional energy sectors could be the result.

Trade Policy: Tariffs and Supply Chains

One of the most immediate areas of focus is trade policy, with considerations of 10% to 20% tariffs on all imports and higher tariffs on imports from China and Mexico. Higher tariffs on imported vehicles and parts could significantly raise costs for automakers reliant on global supply chains. While some companies may pass these costs onto consumers, others could use this as an impetus to ramp up domestic production. However, these shifts could bring growing pains, especially for manufacturers that have invested heavily in overseas operations (e.g. plans for Tesla's \$10 billion gigafactory in Mexico currently set on pause).

A renewed push to renegotiate trade agreements, such as the United States-Mexico-Canada Agreement (USMCA), might further encourage reshoring, creating more localized supply chains in North America.

Furthermore, Chinese EV automaker BYD is contemplating building a production facility in Mexico. BYD has previously been identified as a potential threat to the competition for EV market share in North America, so consideration of BYD's plant in Mexico will likely play a role in shaping the USMCA negotiations.

Shifts in Regulatory Environment

Besides the changes in trade policy, the incoming Trump administration plans to target the requirements and weaken standards on fuel efficiency and tailpipe emissions introduced in the Biden era, such as requiring automakers to shift nearly 35% of their production to EVs by 2032. Reduced fuel efficiency standards could mean a reprieve from the steep costs associated with transforming production to meet compliance. It might also allow manufacturers to extend the sales outlook for ICE vehicles without incurring additional penalties. Further, the possibility of relaxed fuel efficiency standards could provide automakers more time to roll out EV fleets and tackle profitability issues. However, States like California maintain their own strict environmental standards and thus may create a fragmented regulatory landscape.

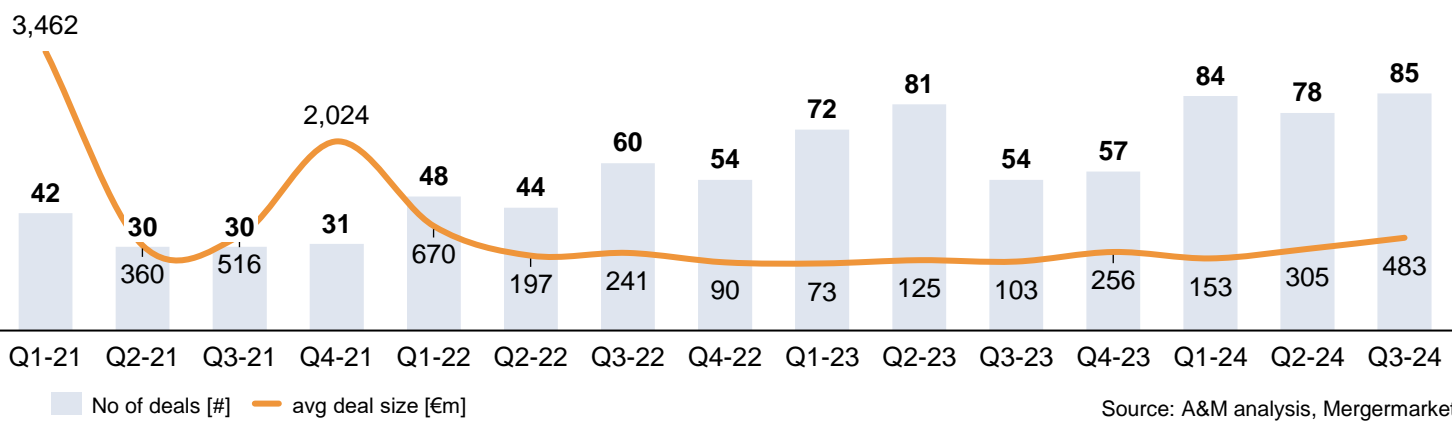
Electric Vehicles: Tug of War Continues

Under the Biden administration, the U.S. made significant strides in laying the groundwork for incentivizing EV adoption, from consumer tax credits to investments in charging infrastructure. Trump's return to office could signal a reversal of these policies and slow the progress in EV adoption. Specifically, the expected removal of the \$7,500 consumer tax credit for EV purchases may lead to declining demand and automakers re-evaluating their short- and near-term strategies.

Trump's administration is also likely to emphasize traditional energy sources, potentially rolling back federal support for renewable energy and EV infrastructure.

For the automotive industry, Trump's second presidency represents both an opportunity and a challenge. While a less stringent regulatory environment and policies favoring domestic production could reduce costs and create jobs, a potential slowdown in the EV transition and tensions from trade policies could complicate long-term strategies.

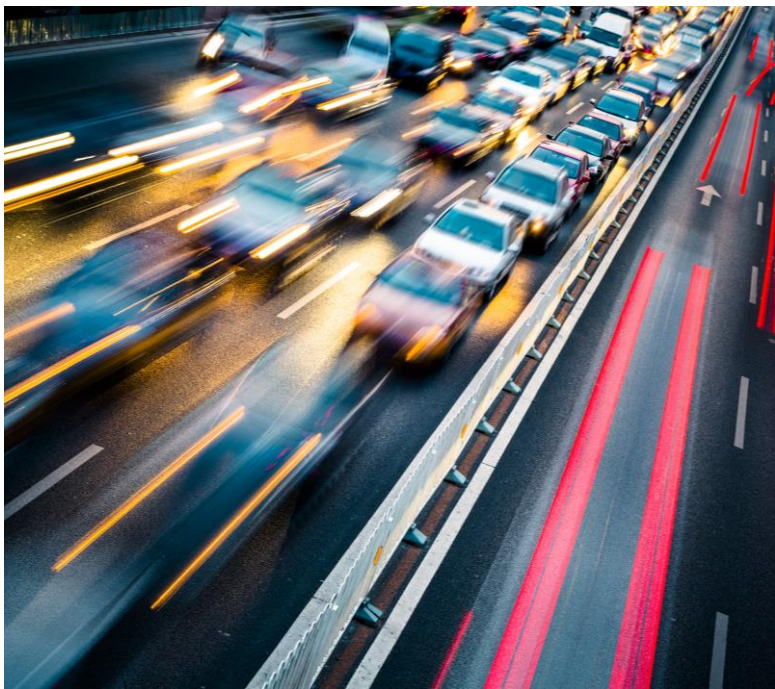
European M&A activity – Automotive



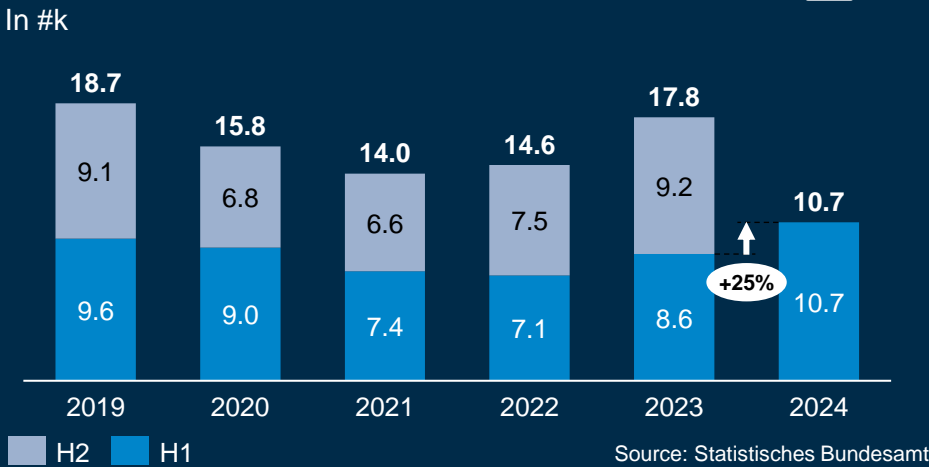
Faced with economic headwinds, the European automotive sector has shown remarkably stable activity in the number of M&A transaction in the first three quarters of 2024. Uptick in the average deal size in Q3-24 driven by few significantly larger M&A deals (Median deal size with €50m on a comparable level to the previous quarters).

Automotive companies are increasingly utilizing M&A as an option to remain competitive and innovative amid a changing regulatory landscape, with the EU's impending ban on ICE vehicles by 2035 driving a shift towards electrification.

As this disruption roils the market, it is exposing the industry's vulnerability. The current economic climate, characterized by instability and uncertainty, is causing a financial crisis for a growing number of companies.



Insolvency filings in Germany



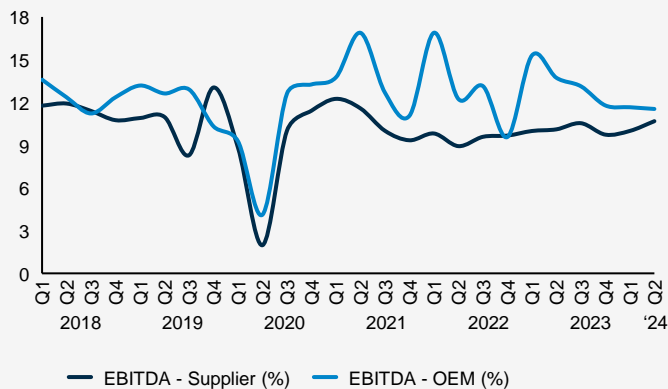
After a notable decline in insolvency filings in Germany from 2019 to 2021, financial strain has become increasingly apparent. A sharp 22% year-on-year increase in insolvencies in 2023 pointed to mounting pressures, likely driven by rising financing costs and concerns over a looming recession.

This trend has only intensified in 2024. During the first half of the year, insolvency filings surged by an additional 25% compared to the same period in 2023, reflecting a heightened level of distress among German businesses.

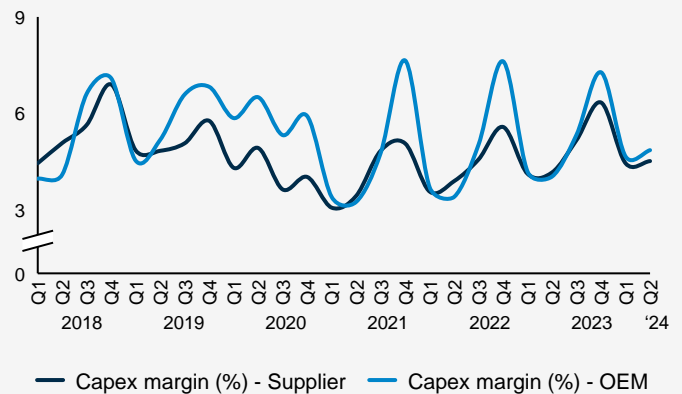
KPIs: automotive performance update

- This industry snapshot of financial KPIs compares the quarterly published results of c. 20 OEM and c. 70 automotive suppliers since 2018
- OEMs managed to operate at an EBITDA margin above the suppliers' EBITDA margin almost continuously since 2018. The OEM EBITDA margin shows a steady decline over the last four quarters, indicating an arising profitability issue
- Equity ratios for OEMs and suppliers increased after Q4 2020. While OEMs show a higher average equity ratio than they had before the corona pandemic, suppliers still did not fully recover from the hit they had to take in 2020
- OEM inventory levels increase to an historically high degree (except corona), reaching a DIO level of ~60 days

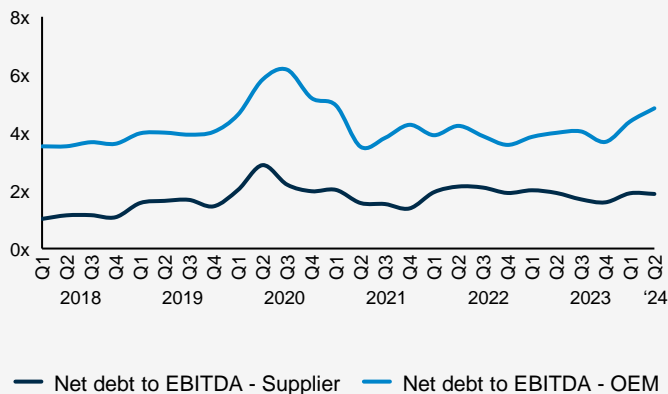
EBITDA margin (%) – Supplier vs. OEM



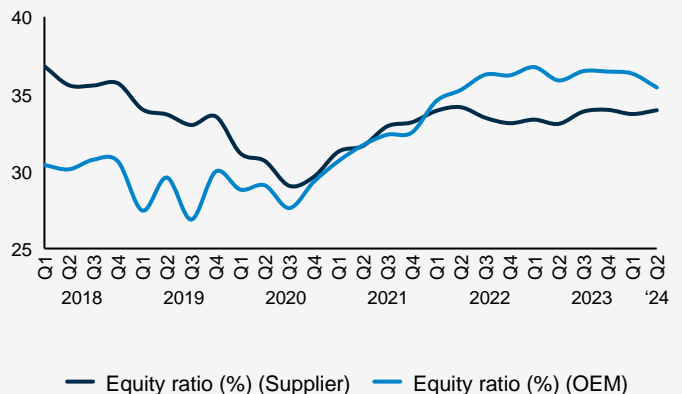
Capex margin (%) – Supplier vs. OEM



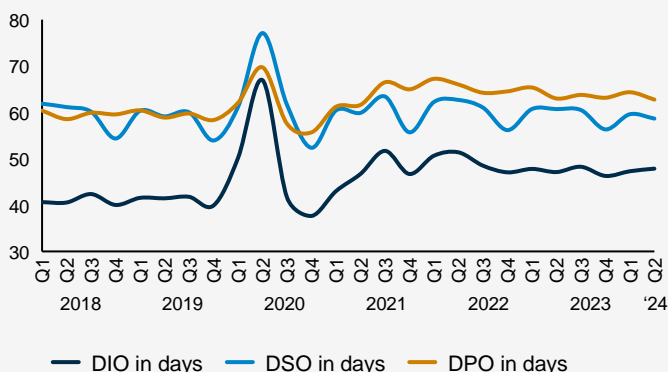
Net debt to LTM EBITDA ratio – Supplier vs. OEM



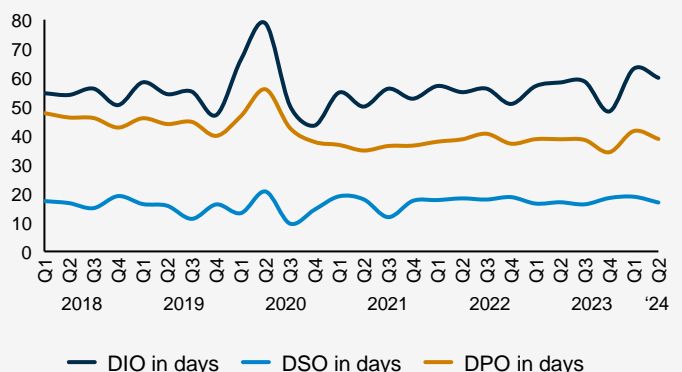
Equity ratio (%) – Supplier vs. OEM



Quarterly WC KPIs in days – Supplier



Quarterly WC KPIs in days – OEM





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