

Consolidation in the Global Automotive Supply Industry 2013

This study looks at the ability and the willingness of global automotive suppliers to acquire other suppliers.

We found that global automotive supplier M&A activity is declining in 2013 by potentially as much as 25%.

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Executive summary

2013 auto supplier M&A activity is expected to be down 25% while the average deal size could be increasing.

Top consolidators in 2013 will likely be again the largest North American suppliers in the Global 100 list.

Most distressed suppliers in 2013 are again European suppliers, for the second year in a row.

The consolidation in powertrain and chassis subsystems is accelerating.

Korean suppliers revenue grew the fastest at about 20% and increased profitability the most, while Japanese suppliers declined by 5% and Chinese suppliers tanked in profitability by 19%.

Even though the global auto industry hit record production numbers in 2012 and is poised to repeat the same in 2013, automotive supplier merger and acquisition (M&A) activity was significantly down from 2011 levels. PwC estimates that about 180 auto supplier transactions will likely close this year globally, down from almost 303 in 2011. We attribute that to the fact that the North American auto recovery is nearing the end of the road in terms of its double-digit growth, and European suppliers are mostly still dealing with the European auto recession.

Winners and losers

Twenty-seven of the world's largest 100 suppliers are from North America and are looking particularly strong as potential consolidators. This is the third year in a row where this is the case. In fact, of the top 14 global consolidators that PwC identified in its study; 8 are North American while only 4 are European, 1 is Japanese and 1 is Chinese. European suppliers, for the second year in a row, are again the most distressed in 2013. Smaller European suppliers are particularly suffering and additional bankruptcies are expected among them.

Over the past 2 years, M&A activity in the Powertrain and Chassis systems have and will likely continue to be the strongest with 53% of global M&A deals now taking place in these largely unconsolidated segments.

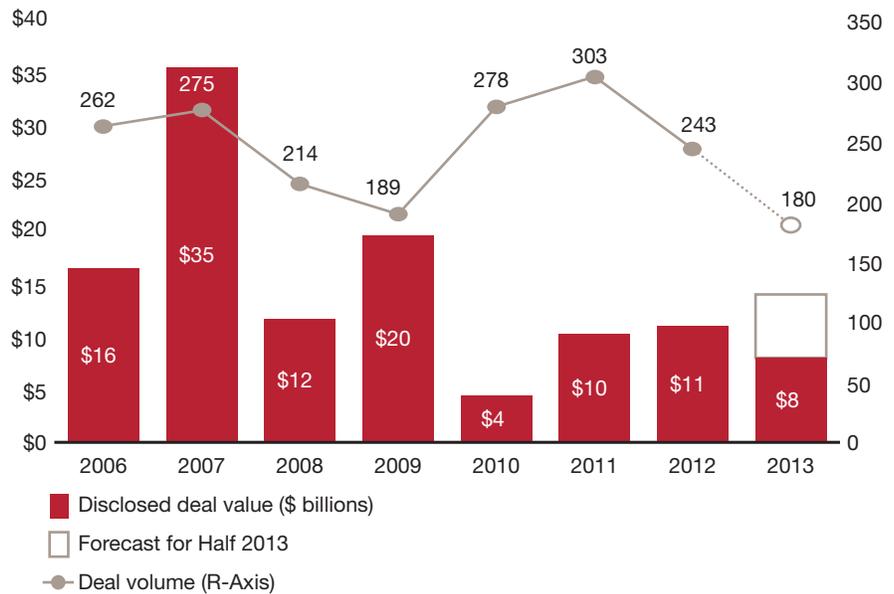
Significant growth from South Korea vs. China's slowing

Our study shows that Korean suppliers grew revenue 20% in 2012 over 2011, largely based on Hyundai's success, whereas Chinese suppliers' profitability took a significant 19% drop, due to slowing growth in China's light vehicle assembly and declining production in the commercial vehicle segment. North American suppliers grew at 1% and shored up profitability by 1%.

2012 trends persist in 2013

Automotive supplier M&A activity is pausing after some record seasons, with deal volume down 25% in 2013

Chart 1: Component suppliers M&A activity (only closed deals) 2007–2012 YTD



Source: Thompson Reuters and other publicly available sources

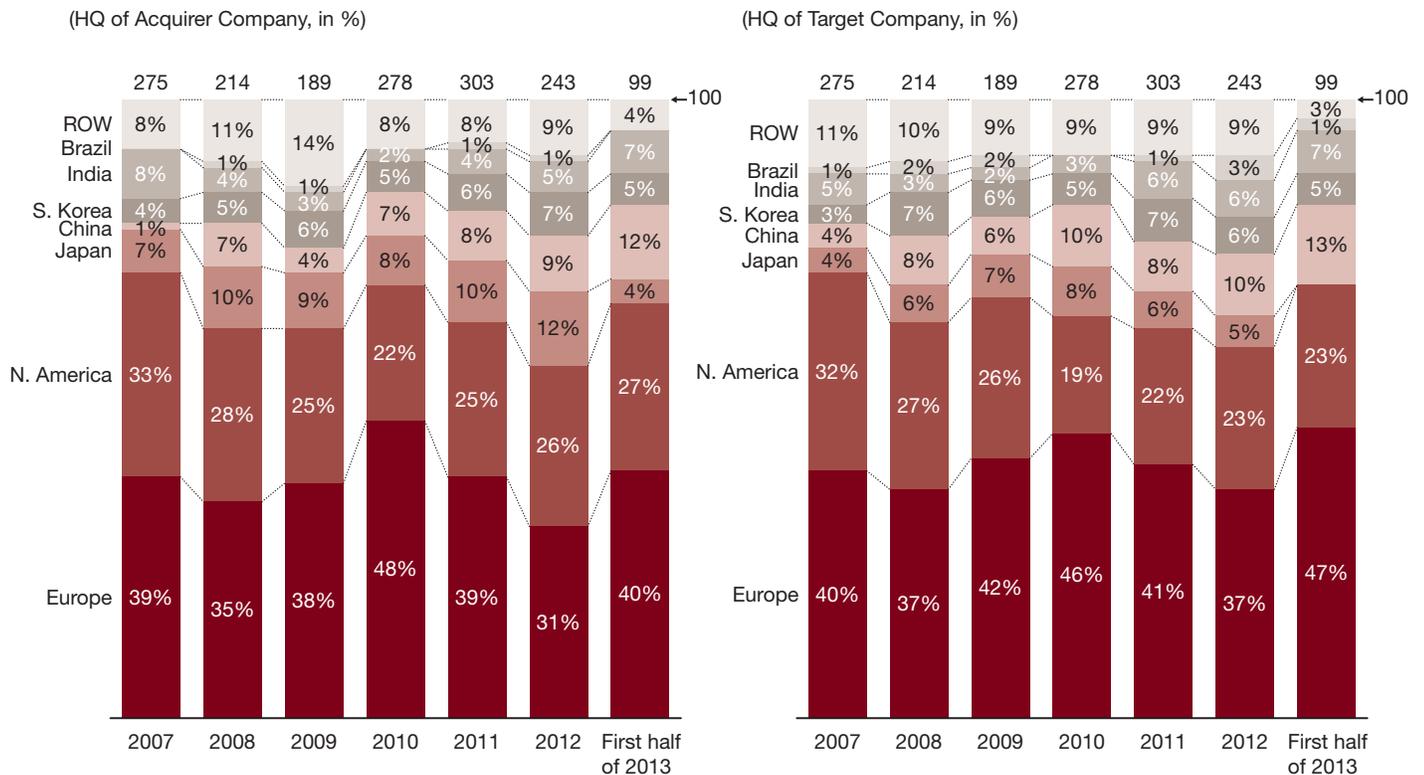
Only 99 automotive supplier deals closed in the first six months of 2013. This decline in M&A activity will likely continue, with the total number of closed deals in 2013 topping out at around 180 globally compared to 303 deals in 2011 and 243 in 2012 (see chart 1). Given that we saw the pace of consolidation accelerate between 2009 and 2011, this decline is big news.

While deal *volume* is low, surprisingly deal *value* is increasing. To cite just one example, the carve out acquisition of DuPont Performance Coatings by a large private equity firm finally closed this year, valued at over \$4 billion. This transaction alone accounts for more than a third of the combined transaction value of all deals closed in 2012. And several other high profile and formidable transactions are currently being negotiated or considered, likely causing the deal value of 2013 transactions to exceed 2012 figures.

The big picture

Looking at the regional distribution of auto supplier deals, it becomes clear that Chinese suppliers have grown their share of acquisition activity and look poised to be even more active in 2013 (see chart 2). In 2013, Chinese suppliers represent 12% of all acquirers, while they also account for a 13% share of all acquisitions targets. European suppliers have become the number one target in the auto supply world, representing 47% of all acquisition targets.

Chart 2: Number of supplier M&A deals by region 2007–2013 YTD (Only closed deals, by year closed)



Source: Thomson Reuters, PwC Analysis

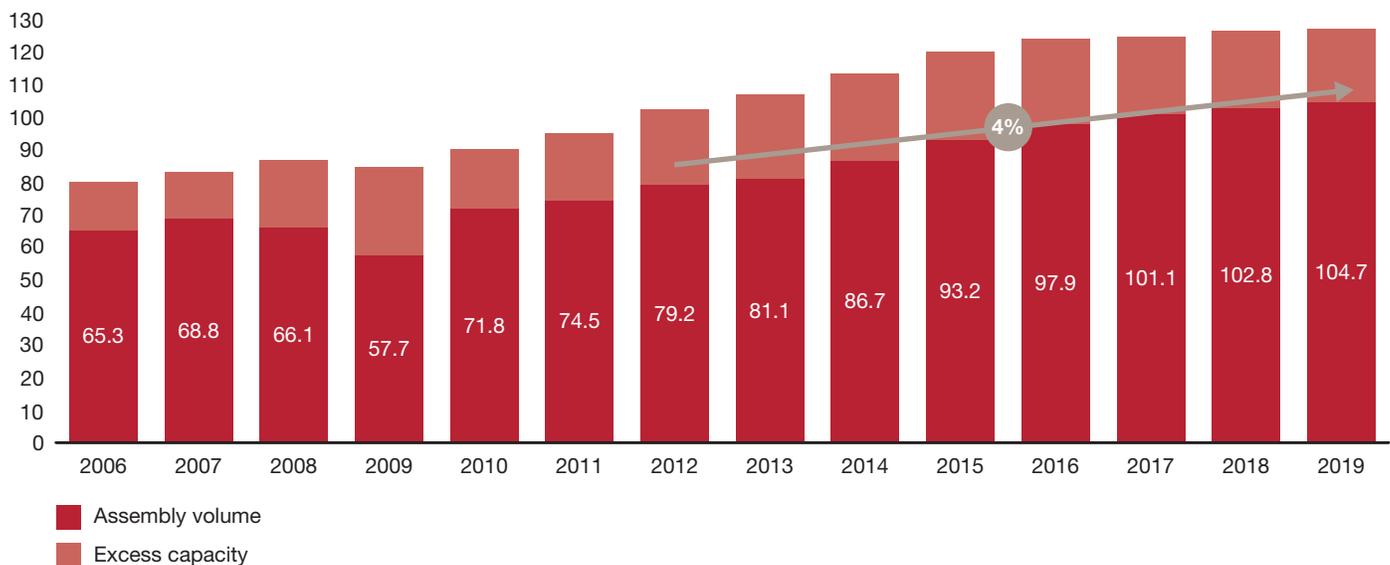
Caution in the face of growth

Vehicle production is at record levels, numerous potential targets exist, but deal volume is down—what is fueling this disconnect between market growth and M&A deceleration?

Clearly, automotive is a growth market. Global vehicle production will likely reach a high in 2013, with over 81 million units produced and is forecasted to grow at an approximately 4% compound annual growth rate (CAGR) likely reaching 100 million units as early as 2017 (chart 3). In North America, vehicle production steadily has been climbing—up from 13.1 million vehicles in 2011 to a projected

16.2 million in 2013 and a high of more than 18 million by 2017. This volume has not been seen since the recession took a heavy toll on the industry. China, who is now the world's largest automobile producing nation, is also expected to continue to lead the global growth with 10 million more vehicles added to today's already large production base over the next decade.

Chart 3: Light vehicle assembly outlook 2013 vs. 2019: Global (millions)



Source: Autofacts 2012 Q3 Data Release

Global vehicle production is estimated to grow at a rate of

***4%** CAGR, and is likely to surpass 100 million units around 2017.*

So why is consolidation among automotive suppliers slowing down?

Since most buyers are either larger North American or European suppliers, we see a few key factors putting the brakes on consolidation: 1) European suppliers, historically strong contributors to global auto M&A, in their current distressed environment, are not financially positioned to acquire other businesses, and 2) North American suppliers, seeing the end of the runway approaching after enjoying four years of 10%+ growth in their home market, are becoming more cautious and throttling back on deal activity. 3) Chinese suppliers, even though growing in significance as consolidators, are not quite there yet to fill in the void, particularly as their home market growth slowed.

Where is this going?

Although deal volume is down, deal value is up, and a number of huge deals are being mulled right now. We expect the current dip in M&A activity to reverse itself before long. The recent wave of consolidation was fueled by huge shifts in volume globally and a recession that made valuable targets available at bargain prices. As the European market improves in 2015 and beyond, European suppliers will likely be more willing and able to re-engage in pursuing deals. The next wave of consolidation is expected to be driven by technology trends and the need to support OEM's increasingly global platforms. Further, as we are beginning to see more transactions involving Chinese suppliers, such as the recent acquisition of A123 Systems by Wangxiang, we expect Chinese suppliers to play an even bigger role in consolidations going forward. All told, we could be back up at about 300 deals by 2015.

Fueling up for the race to the marketplace of the future

How are the suppliers doing around the globe?

From 2011 to 2012, only North American, South Korean and Indian suppliers increased their average profitability and Brazilian, Chinese, European and Japanese suppliers showed declines (chart 4). The Chinese companies suffered a 19.3% drop in profitability, but only a 3.6% decline in sales revenue. More than 100 Chinese suppliers were reviewed in our study, 56 were counted with sufficient data in this analysis.

- **South Korea, leading the pack:** In terms of sales growth, South Korean auto suppliers were outstanding. From 2011 to 2012

South Korean companies that were reviewed in our study grew average sales revenue by 19.7% and average profitability by almost 23%! We attribute this remarkable improvement to Hyundai's success in marketing its vehicles worldwide and bringing its suppliers along with it.

- **Japan, lagging behind:** In contrast, Japanese automotive suppliers lost an average 5.6% in revenue during that same time frame. This downturn is likely being fueled by the decline in Japanese auto sales as well as

the massive restructuring taking place as Japanese OEMs shift gears—moving a large part of their vehicle production from Japan to the markets where they sell their vehicles in order to escape the Yen exchange rate risk.

Take Toyota, for example: Historically, the company imported 35% to 40% of all the vehicles it sold in North America. Now it is shifting its vehicle production, with the ultimate goal of localizing 85% to 90% of the assembly for vehicles sold in North America.

Chart 4: Sales and EBITDA performance of auto suppliers by region

	Sales**				EBITDA**					Avg. 2012 (\$B)	EBITDA as % of Sales 2011	EBITDA as % of Sales 2012
	Total 2011 (\$B)	Total 2012 (\$B)	Δ%	Count	Avg. 2012	Total 2011 (\$B)	Total 2012 (\$B)	Δ%				
Global 100*	661	668	1.0%	83	8	70	69	-0.6%	0.8	10.6%	10.4%	
Brazil	4	4	-7.3%	8	0.4	0	0	-28.5%	0	12.7%	9.8%	
China	32	31	-3.6%	56	0.5	4	3	-19.3%	0.1	12.1%	10.1%	
Europe	297	307	3.6%	69	4.5	34	34	-0.2%	0.5	11.6%	11.2%	
India	22	24	5.7%	44	0.5	2	3	5.0%	0.1	10.7%	10.6%	
Japan	208	196	-5.6%	34	5.8	20	19	-5.3%	0.6	9.7%	9.8%	
North America	236	238	0.9%	71	3.4	25	25	0.9%	0.4	10.5%	10.5%	
S. Korea	51	61	19.7%	46	1.3	5	7	22.9%	0.1	10.4%	10.7%	

*Global 100 Companies Also Counted in Regional Numbers

**Financial figures include revenue resulting from automotive sales only

Source: CapIQ, Publicly available financial data, PwC Analysis

Who's buying, and who's not? A look at the results of our study

For the third consecutive year, North American automotive suppliers—especially those in the Global 100—are the strongest consolidators

A word about our scoring methodology...

We assigned each of the 773 suppliers in PwC's study the following scores:

- **A Buyer** score to measure their ability to buy (see box below)
- **A Buyer-Attitude** score to measure their intent to buy
- **A Divestor** score to reflect their intent to divest certain assets and
- **A Potential Distress** score to indicate financial problems



Who's Who? A primer on the players

Global 100 suppliers: Companies whose automotive revenue is typically above \$2.5 billion. Today, 27 North American suppliers rank among the Global 100, where as 38 are from Europe and 24 from Japan

Potential buyers: Suppliers with the financial and operational ability to make acquisitions, as measured by their Buyer score

Consolidators: Potential buyers most inclined to make acquisitions, based on their Buyer-Attitude score

Divestors: Suppliers that are considering selling a business unit or the entire business due to liquidity problems or an opportunity to optimize their portfolio

Potential distressed companies: Suppliers that may need financial assistance or restructuring or become vulnerable to acquisition

A number of global 100 suppliers have been making acquisitions, but may not be in the best position to do so.

Our 2013 study scores paint a holistic picture of the global automotive supplier industry.

Global 100 North American suppliers earned the highest average Buyer score—6.7 on a scale of 0 to 10—outpacing 38 European companies and 24 Japanese companies, also in the Global 100 (chart 5). Aside from the Global 100, all of the 132 North American automotive suppliers in our study averaged a Buyer score of 5.7, topping the other regions. (In contrast, the 109 Chinese suppliers averaged a score of 5.0). But it’s not just a matter of financial viability. Many suppliers also maintain high Buyer Attitude scores, meaning that their mindset is on acquisition mode.

Of the 38 European Global 100 suppliers, only three made the 2013 Top Ten Consolidators list (compared to six North American suppliers and one Chinese), which brings to light the challenging situation in that region. For the second consecutive year, a Divestiture score of 6.1 for the European Global 100 suppliers is the worst score in that category for any region, while a Potential Distressed score of 5.7 ranked all 217 European suppliers highest on our scale of vulnerable suppliers with potential distress.

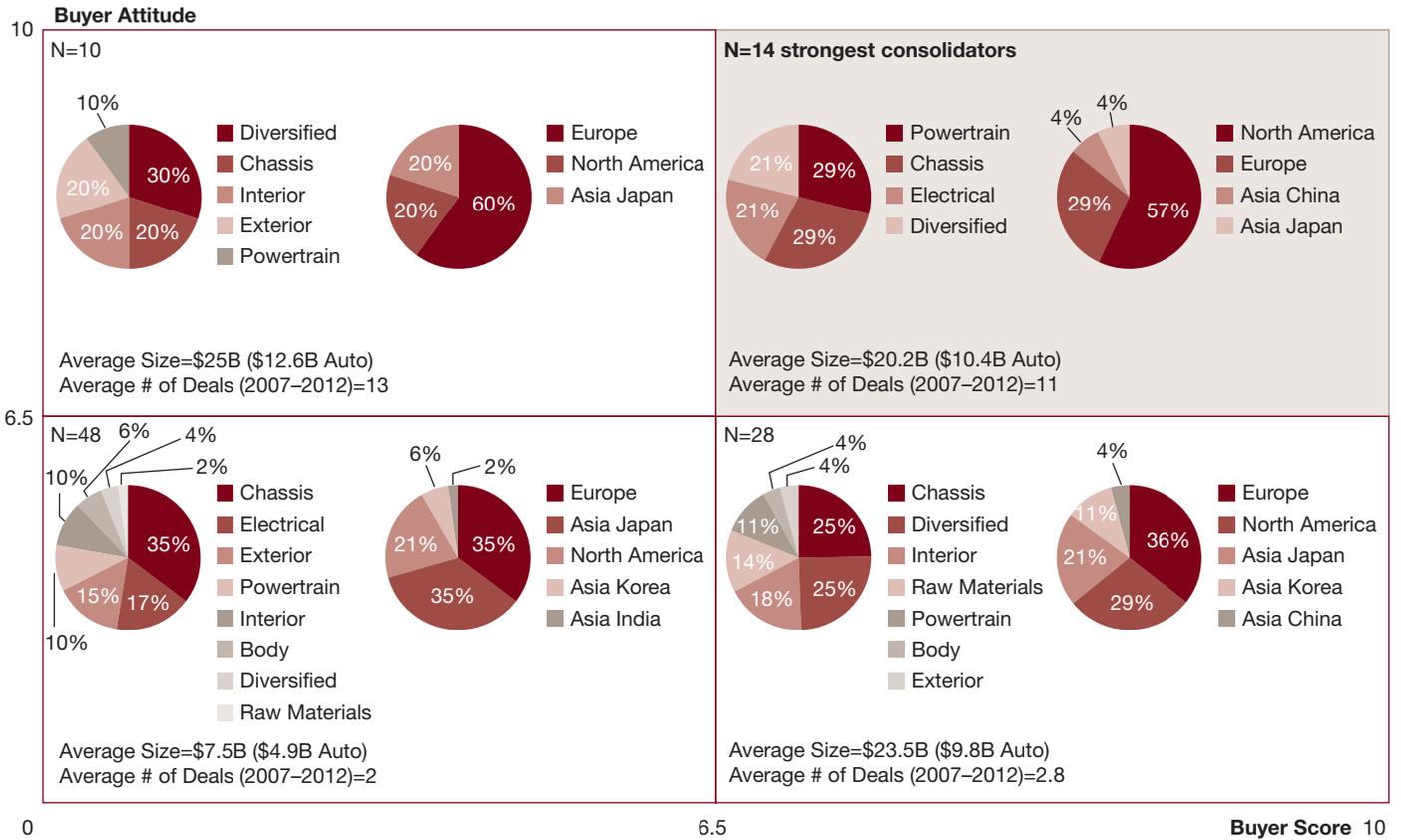
Chart 5: Average scores by region

	# of companies	Buyer score	Divestor score	Potential distress score
China	109	5.0	5.5	5.6
India	68	4.5	5.4	5.8
Japan	136	5.2	5.5	5.5
S. Korea	68	5.1	5.2	5.4
Europe	217	4.9	5.3	5.7
N. America	132	5.7	5.0	5.1
S. America	24	4.6	6.0	6.0
Global 100*	100	6.3	5.9	5.4
Global 100 Japan	24	6.1	5.8	5.5
Global 100 Europe	38	6.0	6.1	5.6
Global 100 North America	27	6.7	5.9	5.0
Total (Average of all)	773	5.1	5.3	5.5

■ Strongest in category ■ Least strength in category

Source: Publicly available financial data, PwC Analysis

Chart 6: Buyer and buyer attitude scores for the Global 100 suppliers



Source: PwC Analysis

Taken together, high buyer and high buyer attitude scores reveal that North American suppliers are the strongest likely consolidators in our study this year. 8 of the 14 strongest consolidators within the Global 100 list with Buyer-Attitude and Buyer scores exceeding 6.5, are North American, while only 4 are European companies and 1 each from China and Japan (chart 6, upper right quadrant). We also found that there

are a number of Global 100 suppliers with high buyer attitude scores, but low buyer scores—meaning they have been and appear to continue to do deals, but are at risk that they are not properly positioned to financially or operationally digest these acquisitions (upper left quadrant of chart 6).

The strongest consolidators consumed an average of 11 acquisitions each over the last 6 years, a staggering

pace! But these suppliers also represent the leading suppliers in the world and are financially healthy. More concerning is, that the companies in the upper left quadrant of chart 6, with high buyer attitude, but low buyer score executed 13 acquisitions each in the last 6 years, a clear indication that they went too far, too fast. Here we find a number of European suppliers, many of which are now in trouble.

The Powertrain and Chassis segments are consolidating rapidly

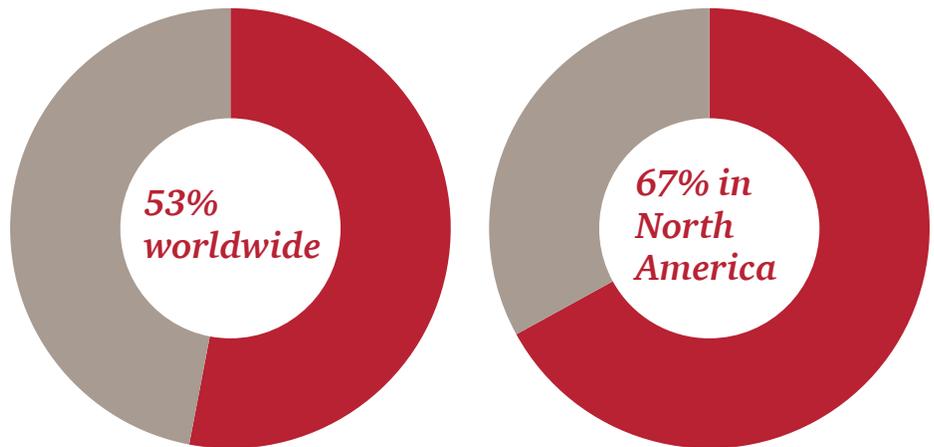
Among the Global 100 suppliers, 8 of the strongest 14 consolidators are Powertrain and Chassis suppliers

Worldwide, 53% of all deals were in Powertrain and Chassis systems, and in North America this number is even higher (67%). The supply base in these segments is not yet as consolidated as for example the Interior or Exterior subsystems, and they are subject to significant technology trends. In light of the very substantial emissions regulations as well as fuel economy requirements that confront automotive OEMs

in many jurisdictions around the world, the industry has embarked on the development of numerous technologies to address these. In Powertrain these are, among several others, the increase in direct injection and turbo charging technologies, as well as lower displacement engines and transmissions with 7, 8 or even 9 gears. In Chassis systems some of the advancements include the increased use of high strength steel, aluminum and carbon fiber.

Over the past 20 years, robust M&A activity streamlined the automotive Exterior and Interior segments, but there are still several hundred companies producing Powertrain and Chassis components. For some time, we have been forecasting increased consolidation in those areas, and our study shows that this is now happening.

Powertrain and Chassis deals



Our view of the road ahead

What we see as the industry steers toward 2014 and beyond

Recovery of the European vehicle industry is likely to happen from 2015 onwards. We attribute this to the continued localization of production from Japanese and Korean OEMs in Europe as well as some modest sales growth. Additional light passenger car production could exceed 3 million units, delivering much needed relief to suppliers heavily invested in Europe.

China is revving up for future growth. Despite the slow down in vehicle sales this year in China, PwC and several other experts believe that vehicle production in that country could grow by another 10 million units in the next 7 years. Both, Chinese domestic OEMs and international joint venture OEMs are expected to build more plants. More than 10 vehicle assembly plants are forecasted to open between now and 2019. Interestingly, almost all major JV OEMs are forecasted to try to establish a low cost brand in China to compete with the Chinese domestic players. Further, the share between Chinese domestic and international OEMs is likely not changing much. PwC also expects that the Chinese luxury market will grow rapidly. The auto supply industry in China is still in its infancy in terms of developing really large global suppliers, but it is likely that we will see the Chinese suppliers playing a far bigger role in both, the consolidation of their own supply industry, as well as global consolidation. China has already two suppliers in the Global 100 list. Ten more are gearing up to be part of this leading supplier club over the next 2 to 3 years.

India, Brazil and Russia will increase vehicle production substantially over the next 7 years as well. When taken together, the vehicle production of these three countries adds up to only half of China's assembly volumes, and that situation should continue into 2019. Localization of vehicle content in Brazil and Russia is required to avoid large import duties from 2016 onwards. Many suppliers are dragging their feet to aggressively move into Russia due to uncertainty related to government intervention.

Technology trends will continue to be relevant for global automotive suppliers. OEMs are expected to continue to focus on rolling out their global platforms. Suppliers will likely have fewer but larger opportunities to win new business, driving increased focus in core business areas. Vehicle life cycles will continue to shorten toward 5 years. Refreshes for high volume segment cars will keep on coming every 2 to 3 years. This is particularly relevant for interior and exterior suppliers, as well as automotive mold makers, as most refreshes focus on the fascias and certain interior components. We expect to see product variations increase as well, especially among European manufacturers, generating an even greater need for new tooling investments. Corporate average fuel economy (CAFE) requirements and other emissions requirements will continue to drive rapid technology advancements and innovation in light weight materials and advanced powertrain technologies, such as direct fuel injection or turbo charging. This should create intense competition in the Powertrain and structures segments, and laggards will be left behind.

Our methodology

PwC collected and analyzed 30 metrics for 773 suppliers globally

Consolidation in the Global Automotive Supply industry, in its sixth consecutive year, is based on financial, operational, and strategic data collected by a global team of automotive specialists representing all of the major automotive markets. We looked at 773 suppliers from key regions, such as Brazil, China, Europe, India, Japan, North America, and South Korea. Total automotive and non automotive revenues were US \$2,842 Billion in 2012. Suppliers included in the study are tier 1, tier 2, tier 3 and raw material suppliers.

Relying on data from public information sources and proprietary research, including interviews with industry observers, select suppliers and OEMs, our team runs a model that utilizes 30 variables, weighted appropriately for each category. The variables assess suppliers' financial, operational, and strategic performance across eight categories:

- Size and criticality
- Capital structure and health
- Segment commodity structure
- Business health
- Business flexibility
- Customer base
- Ownership structure and management
- Acquisition history

Scores were then developed that reflect each supplier's vulnerability to acquisition or breakup, and its likelihood of acquiring part or all of other companies. Although many of the companies covered in the study are privately held, we gathered sufficient data to score 80% of all suppliers in the study.

About us

PwC's automotive practice

Our global automotive practice leverages its extensive experience in the industry to help companies solve complex business challenges with efficiency and quality.

One of our practice's key competitive advantages is PwC's Automotive Management Consulting team of global industry specialists with unique expertise in automotive product development, manufacturing, supply chain and sourcing. The Automotive Management Consulting Team, which conducted the underlying research for this study, provides our team of more than 4,800 automotive professionals and our clients with insights and analyses to assess implications, make recommendations, and support decisions to effectively compete in the global marketplace.

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