



Global M&A: Outlook for Automotive

KPMG INTERNATIONAL



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Global Automotive: where to for M&A?

Challenge and opportunity

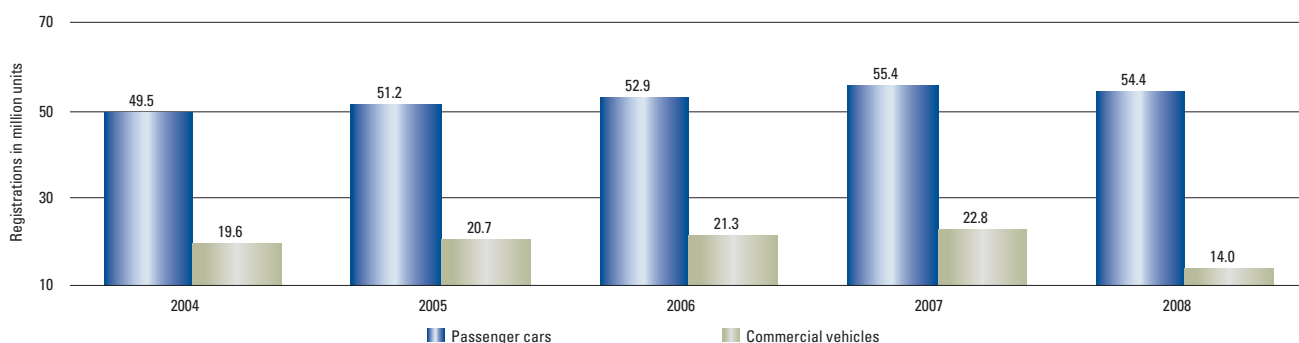
Deepening economic recession, a sharp decline in sales, restricted access to financing, and significant uncertainty over which businesses will survive; the lot of the global automotive industry is not a happy one. Arguably however, the economic downturn has merely exacerbated a number of serious challenges already facing the industry, such as excess production capacity, fundamental shifts in technology, changing consumer preferences, and an ever-tougher regulatory regime, to name but a few.

Based on available data and the insights of KPMG firms' professionals, what might one expect going forward? Should pessimism prevail? There may be good reason to believe that a period of austerity may hasten much needed consolidation and spawn a stronger, healthier automotive industry.

Trouble ahead?

A few years of strong growth in global automotive sales ended in 2008, with passenger and commercial vehicle sales down 1.6 percent and 38.6 percent respectively over 2007.

Figure 1: Global vehicle registrations (2004 – 08)



Source: World automotive outlook: The crunch, Economic Intelligence Unit – as accessed on 13 February 2009

The effects of the US government's rescue package for automakers are yet to be seen. Although the automakers' crisis is the focus of much attention, the US is not the only country whose automotive industry is deeply troubled. EU Vice President Günter Verheugen has stated that 20 percent of Europe's automotive companies are in danger of collapsing¹. Toyota Motor, the world's largest auto

manufacturer, has estimated its operating loss for the year ending 31 March 2009 to be US\$4.6 billion – three times more than it previously predicted. This is also the group’s first ever operating loss in its 72-year history – echoing concerns expressed by the other top Japanese automakers Honda, Nissan, Mitsubishi, Mazda and Suzuki^{2, 3}.

“There were circa 4,500 auto suppliers globally in 2008 compared to around 30,000 ten years previously.”

The impact on suppliers is dramatic. While consolidation among suppliers was already gathering pace before the economic downturn took hold, Karl-Thomas Neumann, CEO of Continental AG expects it to accelerate. It is notable already that there were circa 4,500 auto suppliers globally in 2008 compared to around 30,000 ten years previously.⁴

In 2009 – 2010, automotive businesses are likely to retrench in order to achieve the inter-dependent objectives of enhancing the performance of their core activities and raising badly-needed funds from disposals. Strategic divestments will come to the fore, but would-be sellers will still face the dual problems of low sales prices and a lack of buyers. However, despite not being able to depend on the same number of bidders as in the auction processes of recent years, one thing is clear: M&A and alliances are likely to be central to any upcoming restructuring.

Global M&A trends

2008 saw a slight decline in the number of automotive deals over the previous year and a fall in the average deal size to US\$160.5 million compared to US\$177.1 million in 2007. Disclosed deal value in the fourth quarter of 2008 was particularly depressed, down 39.3 percent year-on-year.

Figure 2: M&A (2004 – 08): number of deals

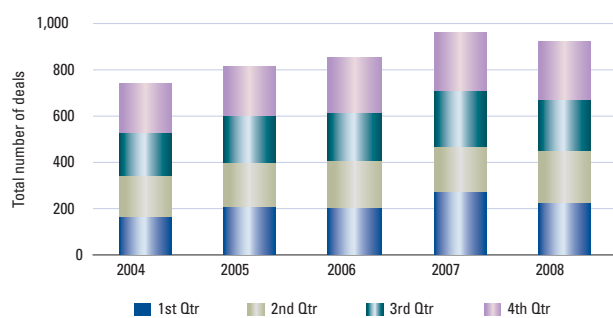
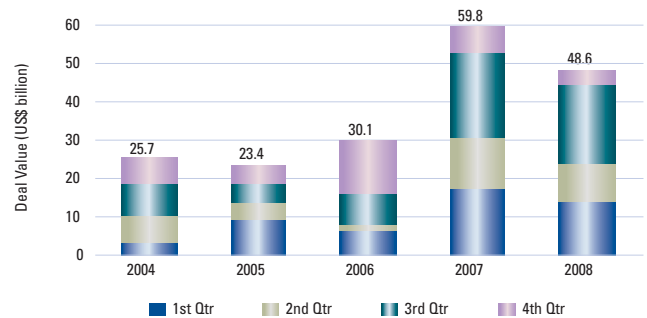


Figure 3: M&A (2004 – 08): disclosed deal value



Source: Thomson One Banker

2007 – Cerberus acquisition of Chrysler for US\$7.4 billion accounted for around 12.4 percent of the total value of deals in 2007.

2008 – Schaeffler KG acquisition of Continental AG for US\$16.3 billion accounted for around 33.5 percent of the total value of deals in 2008

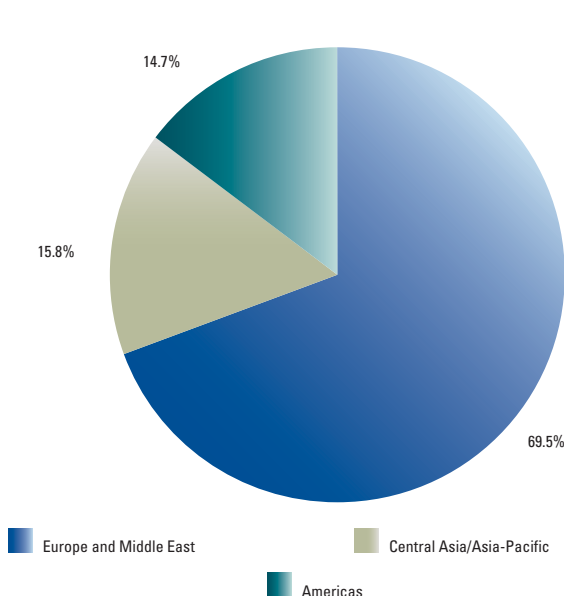
Europe and the Middle East retained their dominant positions in 2008, with Germany alone representing 35 percent of global activity in the sector (up from almost 30 percent in 2007).

Industry dynamics appeared to play to the current advantages of India, China and South Korea, with outbound deal flow from these three countries amounting to US\$3.4 billion in 2008. Even after removing Tata Motors' US\$2.3 billion acquisition of Jaguar Land Rover,⁵ this represented an increase over 2007's US\$0.9 billion deal flow. Asia was a net M&A investor in 2008, responsible for 19.9 percent of global deal spends vs receiving 15.8 percent (deal value of targets based in Asia).

The Americas played catch-up in 2008 in terms of attracting investment, accounting for less than 15 percent of disclosed deal values. The lion's share of this activity (69 percent) involved US-based targets and totaled US\$4.98 billion, the lowest value since 2001. The disparity between 14.7 percent of targets being in the Americas and 10.9 percent of acquirers coming from the Americas in 2008 clearly shows that the Americas were a net recipient of M&A investment.

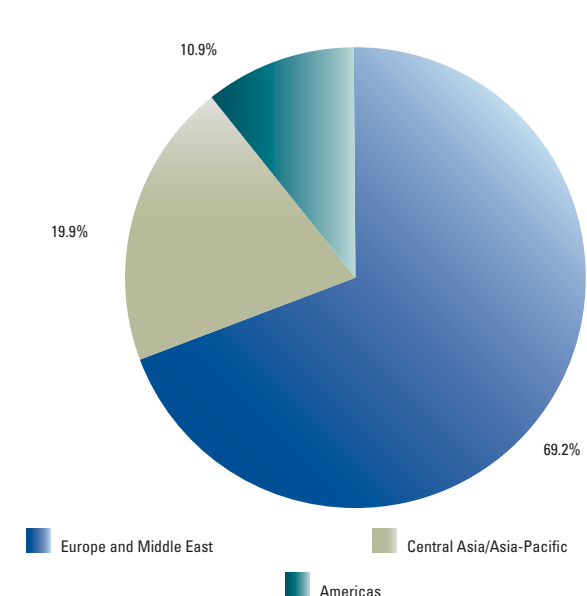
“Emerging market companies are using their financial muscle to make strategic and/or opportunistic cross-border acquisitions.”

Figure 4: Breakdown by target region – 2008 (by value)



Source: Thomson One Banker

Figure 5: Breakdown by acquirer region – 2008 (by value)



Source: Thomson One Banker

The data supports the general trend towards emerging market companies (especially China and India) becoming net exporters of capital as they flex their financial muscle and take advantage of their relatively easy access to funds. Their positions may be further enhanced by upcoming opportunities to make strategic and/or opportunistic cross-border acquisitions at “bargain” prices.

Sub sector focus⁶

Of the four sub sectors – automakers, component manufacturers (suppliers), dealers, and after-market service providers – suppliers have seen the highest rates of consolidation in recent years. This sub sector is, however, particularly vulnerable in the current economic conditions due to both a lack of credit and ongoing pressure from automakers to control costs. Late 2008 saw a slowdown in M&A activity (with disclosed deal values down more than 30 percent) as financing has proven much more difficult.

Despite this, suppliers are likely to remain the backbone of the M&A market in terms of deal volumes as consolidation continues (assuming access to financing can be secured). Nevertheless insolvencies are expected to become more commonplace.

“Suppliers are likely to remain the backbone of the M&A market, assuming access to financing can be secured.”

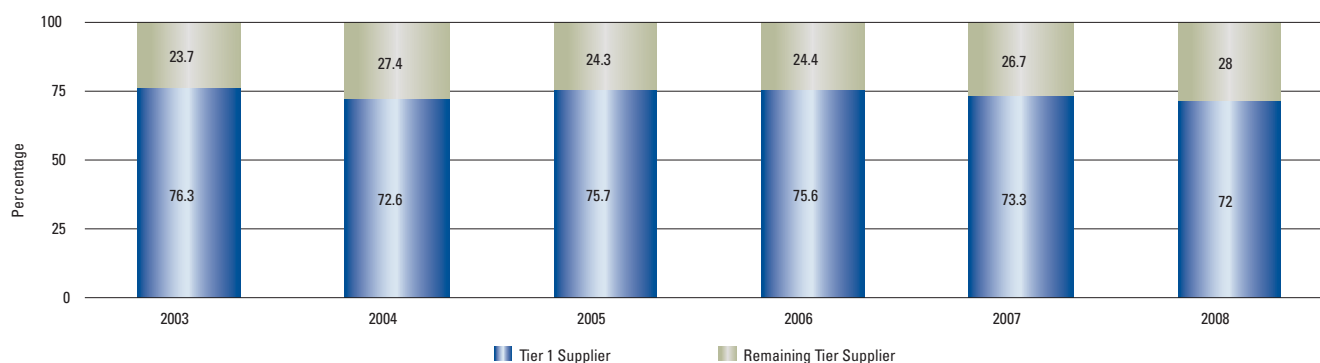
With regard to automotive dealers, the total value of disclosed deals (US\$4.4 billion) was higher in 2008 than in 2007 but still much lower than the US\$8.6 billion experienced in 2006. The aftermarket service providers witnessed deals worth US\$1.9 billion – down 36 percent from 2007.

Figure 6: Breakdown of global M&A deals by sub sector (percentage share)



Source: Thomson One Banker

Among component manufacturers, Tier 1 suppliers accounted for 31.4 percent of the total number of deals, while the remaining Tier suppliers contributed only 12.2 percent to the total number of deals in 2008. The ratio of deals of Tier 1 suppliers and of those of other tiers have hovered around 3:1 during 2003 – 2008.

Figure 7: M&A in global automotive suppliers: by deal volume

Source: Thomson One Banker

A question of technology

2009 – 2010 may see stronger moves towards more environmentally-friendly technology and a continued polarization away from mid-sized vehicles towards either premium or low-cost autos.

Consumer preferences are combining with stricter regulatory regimes to place a much greater emphasis on fuel efficiency. At the same time, legislative and other pressures are creating a divergence in geographical markets around the world in terms of the type of engine preferred locally – i.e., gasoline, diesel, electric or hybrid. This move is adding to the cost and complexities of production, as different engines may be required to fit the same vehicle models, depending on where in the world the vehicle is to be sold.

The implication is that economies of scale from vast production volumes may no longer be the most significant factor in cost control. Rather, access to best practices and the latest available technologies will become a bigger factor in driving M&A and alliances, the latter being a popular means of sharing R&D capabilities.



Are PE firms investing in the automotive industry?

Some manufacturers appear better placed to adapt to these fundamental shifts. German businesses, for instance, may find it relatively easier to focus more on premium or low-cost vehicles as a result of their existing market niches. The major US manufacturers, by contrast, seem less prepared to take on the challenge of producing smaller, more environmentally-friendly vehicles.

End of the road for investors?

After being the primary deal-makers in 2007, investors were relegated to the sidelines in 2008, with their share of total deal value falling by almost three-quarters, from 41.6 percent to 13.9 percent. This reflects the difficulty in raising capital to undertake acquisitions – a theme most likely to remain valid throughout 2009.

Table 1: Deals by acquirer type (2007 – 08)

Acquirer type	Total disclosed value of deals (US\$ million)		Percentage share of total	
	2008	2007	2008	2007
Automakers and component manufacturers	18,393.7	23,922.8	37.8%	40.0%
Automotive dealers	2,085.1	758.5	4.3%	1.3%
Financial investors	6,780.8	24,900.3	13.9%	41.6%
Others	21,350.9	10,291.1	43.9%*	17.2%
Total	48,610.5	59,872.7	100%	100%

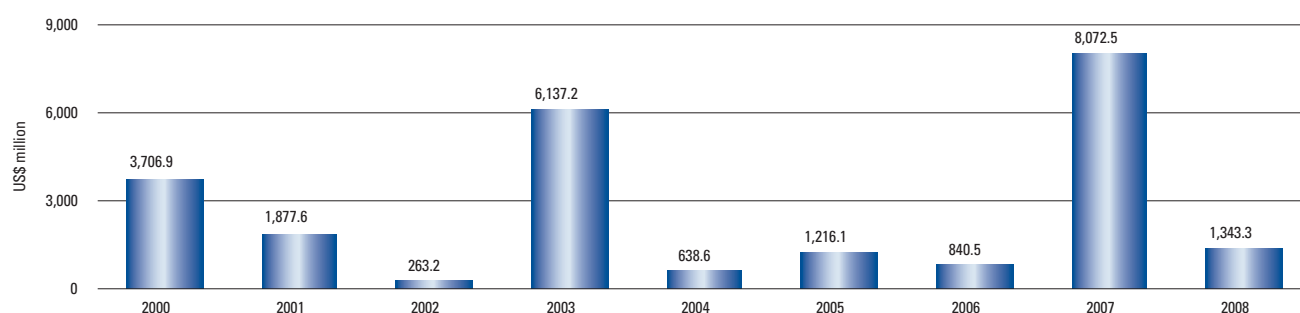
Source: Thomson One Banker

*Schaeffler KG's acquisition of Continental AG in Germany accounted for approximately 33.5 percent of the total deal value in 2008. Schaeffler KG is an industrials company headquartered in Germany.

“Financial investors share of total deal value fell from 41.6 percent in 2007 to 13.9 percent in 2008.”

According to Thomson One Banker, private equity (PE) investment in the automotive sector was US\$8.1 billion in 2007 and US\$1.3 billion in 2008. Excluding Cerberus' investment in Chrysler⁷, which accounted for more than 90 percent of the 2007 figure, PE investment (by value) remained relatively flat over 2007 and 2008. The economic crisis made PE “mega-deals” difficult in a year in which the number of PE deals fell to 116 from 137 in 2007.

As long as the credit market remains tight and fund-raising on a large scale is unfeasible, it is unlikely that financial buyers will look to the automotive sector. However, considerable scope remains for their involvement in the medium term. Indeed, PE firms are showing a particular interest in more environmentally-friendly technologies (far more so than in more traditional parts of the automotive industry), but are being held back predominantly by a lack of available targets and a lack of funds.

Figure 8: Private Equity investment in the automotive industry (2000 – 08)

Source: Thomson One Banker

Where next?

A summary of likely key trends in 2009 – 2010

- Significant restructuring not only in the US and Western Europe but also in China, South Korea and elsewhere to address production overcapacity and underlying profitability concerns
- Consolidation will take place particularly among auto component manufacturers, but is restricted while access to financing remains difficult
- Depressed sales prices continue due to lack of financing, prohibiting many businesses from pursuing acquisitions
- M&A activity dominated by small and medium-sized deals
- Emerging market companies become more acquisitive, particularly opportunistic deals at “bargain” prices
- Increase in supply of available targets as businesses seek to divest non-core activities
- Ongoing lack of PE activity may provide a window of opportunity to corporate or other investors with sufficient resources to acquire while prices are depressed
- Continued interest in alliances in order to share R&D and gain access to leading practice technologies.

FURTHER INFORMATION

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Companies mentioned in this issue

Atradius	10, 11, 12
BMW	13
Cerberus	4, 8
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