# Capital Requirements Drive Seismic Shifts in Auto Competitive Landscape

From the boardrooms of auto original equipment manufacturers (OEMs) and suppliers around the globe, the geographic landscape of the automotive industry is being continuously reshaped. Archnemeses are forming unlikely alliances. Two of Detroit's Big Three are retreating from major foreign markets. Newly formed global OEM giants are putting pressure on supply chains for consolidation, and supply chain risks have also led OEMs to apply a more domestic lens to their choice of suppliers.

What is driving this seismic shake up in the very geography of the automotive industry? Capital requirements to build the cars of the future. The race toward electrification, autonomous driving and smart vehicles has forced OEMs and suppliers to reassess their footprints, their business portfolios and their balance sheets to free up the capital to position their businesses for tomorrow.

Under this pressure to compete, Lincoln International sees four business strategies reshaping the auto industry.

### 1. Divest from Mature Markets to Shed Losses

In 2017, the largest OEM in the United States, General Motors, withdrew from Europe with the sale of Opel and Vauxhall to Groupe PSA. Rival Ford recently announced that they will retire their last mid-sized sedan in Europe, Mondeo, in 2022, raising further questions about the company's intentions in Europe long-term. This news comes only two months after Ford announced their exit from Brazil after more than 100 years in the country.

GM and Ford are pulling back from their global operations largely because these operations are struggling. With emphasis on electrification and technologies for autonomous driving soaking up huge amounts of capital, OEMs are employing discipline to their global footprints, pulling back from loss-making regions and redirecting that capital. One exception to the rule? Tesla, with access to far cheaper capital than the legacy OEMs, has invested in a German Gigafactory scheduled to open this year.

> **M&A Takeaway:** We expect to see more divestment in Europe as automakers and tier 1 suppliers realign footprints with higher growth areas. Correspondingly, we will see dynamic supply chain divestitures as global players collect cash to invest in the build up of software capabilities and electric vehicle (EV) investment.

> "In Germany, initially no one could understand why GM would exit Europe. But from a global perspective, the mature European market was becoming relatively small and overregulated. You have a European continent with 12 different languages and countries with very different tastes—making it difficult to successfully cater to the European market. After 12 years of losses, it was a black and white decision for GM.
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> **Patrick von Herz**
> *Managing Director | Frankfurt*

### 2. Realign with Growth Markets to Boost Revenue

With just under 15 months of construction, EV leader Tesla opened Gigafactory 3 in Shanghai, a plant that could ultimately manufacture as many as 1 million EVs a year. With a growing middle class in China and strong emphasis on electrification premiumization of Western brands, Tesla has capitalized on the growth opportunity in the Chinese market, deftly winning the support of the Chinese government and evading the need for a local partner. Despite a few years of slowed growth, China remains a strong auto market. Even the nation's 6.8% decline in car sales can be viewed as a win in the context of the pandemic—and in relation to other countries. The China Association of Automobile Manufacturers expects China to see 4% growth to 26 million new vehicle sales in 2021.

> **M&A Takeaway:** We expect further reshuffling as global automakers from Japan and South Korea to Europe emphasize a presence in North America and China. Lincoln recommends prioritizing investment in North America, where there is momentum and growth with less political risk than China. As Japanese, South Korean and EU suppliers become more present in North America, we will see increased competition.

> "Even for German players—Daimler, BMW and Volkswagen—two markets are most important for sales and development: North America and China. In contrast, the European outlook is flat with no new plants in Germany or mid-Europe in recent years. The Beijing plant has become Daimler's largest assembly plant in the world, bringing about a new way of thinking and a new center of gravity in a group that used to be very German.
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> **Joerg Brunner**
> *Managing Director | Frankfurt*

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### 3. Localize Supply Chains to Mitigate Risks

From a blockage in the Suez Canal to a global semiconductor shortage bringing production to a standstill, the global trade infrastructure has become increasingly challenging. Cost of and delays in shipping have heightened concerns. U.S.-China trade tensions escalated in 2018 when the U.S. enforced a 25% tariff on steel and a 10% tariff on aluminum imports from China. This rise in nationalism and global tariffs has further accelerated a trend toward securing a localized supply chain.

> **M&A Takeaway:** OEMs will seek the best local suppliers near the end-market, driving consolidation amongst suppliers.

> Following Brexit, the new agreement with the EU stipulates that by 2027 55% of components must be sourced from the UK or Europe to avoid getting hit with tariffs. OEMs in the UK are having to invest in local suppliers to make these sites viable.
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> **Matthew Buck**
> *Director | London*

> Between heightened tariffs and increased Chinese wages, there is no cost differential nudging automakers to import from China. We've entered a protectionist trade environment characterized by increased supply chain risks. OEMs are looking for the best domestic supplier in each region. In the U.S. market, that means OEMs want suppliers with a presence in North America.
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> **Robert Satow**
> *Managing Director | New York*

### 4. Forge Alliances to Pool Capital

2021 saw the creation of Stellantis, a global behemoth bringing together Italian-American Fiat Chrysler Automobiles and French Groupe PSA. The company takes the position as the fourth largest automaker globally. CEO Carlos Tavares paints the new alliance as a path to "open new opportunities for a company that... [does] not want to be cornered in a legacy or a dinosaur position." With the pooled revenue of FCA and PSA, Stellantis can funnel earnings into EV investments—potentially moving from a laggard to leader position. The carmaker aims to launch electric or hybrid versions of their full fleet of vehicles in Europe by 2025.

> **M&A Takeaway:** We will continue to see a combination of OEM consolidation to fuel EV innovation and auto-tech joint ventures to develop new technologies for autonomous driving. A byproduct of OEM consolidation will be the rationalization of each OEM's supply base. Previous suppliers of the two companies will have to compete for business, creating consolidation pressure.

> We're seeing increased consolidation among OEMs driven by the capital requirements they need to meet given auto-tech demands.
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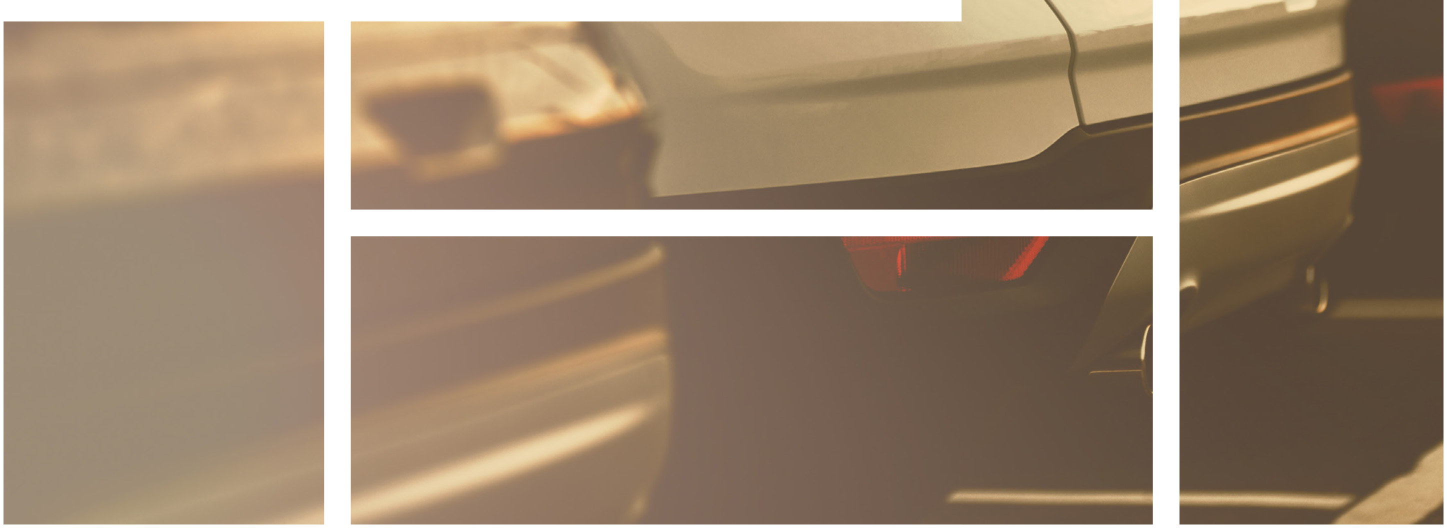
> **Joe Robinson**
> *Director | Chicago*



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