

Strategies & Trends in Capital Allocation

AUTOMOTIVE

October 2020





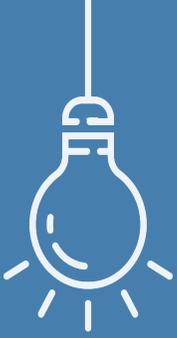
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Now Trending

- **EV Incentives in jeopardy:** There will be an estimated 600 battery electric vehicles (BEV) by 2025, representing 8.5 million in global sales; existing and future incentive programs for buyers, however, may be in jeopardy with states under intense pressure as a result of the pandemic.
- **Emerging Mobility as a Service (MaaS) Industry:** As autonomous vehicle technology evolves eyes are on the market potential of meeting the needs of more than three billion people without a driver's license; this could have material impact on the average number of cars per household in developed countries.
- **Political uncertainty:** European Union Emissions Standards established in 2019 puts pressure on manufacturers to pivot from internal combustion engines; in the U.S., climate change politics are unsettled but will likely become clearer in January.
- **Changing regional and segment supply patterns:** OEMs must adapt to production and supply base footprints, supply chains and product portfolios.
- **Diverging markets:** "OEMs need to adapt to changing regional and segment patterns of supply and demand with respect to their production and supply base footprints, supply chains, and product portfolios." [McKinsey]
- **Factory capacity:** Automakers worldwide had at least 20% more factory capacity than they needed before the coronavirus hit; closing underused plants may be required to survive.
- **Rethinking globalization:** Business implications of the pandemic, and the interconnectedness of the global economy, forces executives to rethink logics and supply chains and provide greater flexibility to withstand disruption.
- **Platform shift:** "In 2020, OEMs will shift their platform strategy to a four-layered platform approach as the industry progresses towards CASE mobility." [Frost & Sullivan]



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CAPEX Considerations

- **Technology/Connectivity Investments:** Initiatives such as meeting the consumer demand for communication between cars, an emerging traffic management infrastructure, and autonomous vehicle technology all require strategic capital investment.
- **Adoption of Blockchain Technology:** OEMs, suppliers and dealers have opportunity to improve operational efficiency and develop transformative services utilizing blockchain. For example: connected supply chains, verifying suppliers and parts, and improving transaction processes.
- **Increased Role of IT:** The IT department is becoming more active in the innovation and production process as vehicles become increasingly digitized. Adaption of agile techniques is central to that innovation.
- **Need for Cross-Functional Teams:** To provide greater agility in dealing with uncertainty in times of crisis, cross-functional management teams, including Finance, HR and Supply Chain, will be increasingly important in facilitating decisions that impact working capital, and make it possible to enable product portfolio shifts.
- **Taking a Longer-Term View of Capex:** Management teams take measures to preserve cash as a result of the impact of the pandemic, including delaying non-essential Capex and R&D. Companies poised to emerge more successfully from the downturn are careful to cut "fat, not muscle" in doing so.
- **Shift to Cloud-Based Infrastructure:** The pandemic has been a "wake up" call for CFOs and vice presidents of finance to support a seamless transition to remote work. 72% ranked cloud-based applications as a top priority over the next 12 months, and 17% ranked cloud-based applications as the most important finance priority for their organizations to address – a jump from 8% in the 2019 survey.
- **Suppliers Face Deteriorating Free Cashflows:** Given comparably high working capital and Capex requirements alongside shrinking operating profits necessitates more strategic allocation.



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Industry Snapshot

- Global sales of passenger cars are forecast to fall to 60 million units in 2020, down from a peak of 79.6 in 2017. Overall, a decline of 14% in sales is anticipated.
- Global vehicle sales totaled 5.55 million units in March 2020, down by 39% from March 2019.
- China is the world's largest auto market. China's auto sales in Q1 2020 suffered one of the worst periods in history.
- The Ford F-Series was the best-selling US car with 896,526 units sold during 2019. In 2019, 17 million vehicles were sold in the US.
- Key global players: Volkswagen AG (Germany), General Motors (US), Toyota Motor Corporation (Japan), SAIC Motor Corporation Limited (China), Ford Motor Company (US), Nissan Motor Corporation (Japan), Hyundai Motor Company (South Korea), Fiat Chrysler Automobiles (US), Honda Motor Corporation (Japan), and Daimler AG (Germany).
- M&A activity in the automotive sector has bounced back significantly with 64 transactions completed from Q2 2019 through the second quarter of 2020. With 26 transactions, Q3 2019 represented the most robust quarter by deal volume since 2016. With concerns arising around COVID-19 in H1 2020, volumes dropped significantly to only 14 transactions compared to 34 in H1 2019. [Duff & Phelps]
- Global movement is towards a "mega platform" (modular technology). Silicone is replacing steel, and technology advances are outpacing basic automotive structures. In 2005 there were an estimated 277 individual platforms from the leading producers. It is believed that by 2021, that figure will drop to 195.

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