Press release

"The future of the global automobile industry to be shaped by mergers and alliances"

Analysis by Euler Hermes SFAC

In a study entitled "The automobile industry confronted with a decline in global demand," Euler Hermes SFAC reviews the outlook for the sector. A plunge in global demand and massive destocking are such that in future, the industry will need to find ways to share certain costs through tie-ups and alliances. Subcontractors in France are being hard hit by plummeting automobile production, and redundancies and bankruptcies stand to go mounting. The impact on the sector will be lasting, with volumes only recovering to the 2007 level toward 2012.

1- Crisis in demand

Up until 2007, vehicle registrations grew at an average annual rate of around 5%, driven exclusively by emerging countries. Between 2007 and 2009, global vehicle registrations are expected to drop by close to 25%, corresponding to a 15 to 16 million decline in vehicle sales.
"Some 80% of vehicles are purchased on credit, so between the economic crisis and financial crisis triggered by the collapse of Lehman Brothers, the primary source of financing has dried up", says **Yann Lacroix, manager of the sector studies department at Euler Hermes SFAC.**

- United States: vehicle registrations down 40% over two years, production declining

Historically the world's largest car market with close to 17 million sales a year, the US market began to trend lower early in 2008 before collapsing in the summer of that year. Average annual registrations are expected to reach just 10 million in 2009, implying a 40% drop over two years. The introduction of a scrappage incentive would not boost vehicle sales by more than one million in 2009-2010.
"Automobiles nonetheless remain the main means of transport in the US. The market should thus gradually rebound to average registration levels of 15-16 million vehicles a year, but not before 2011-2012," says **Yann Lacroix**. "*Production volumes, which have to be adjusted to demand until recovery takes hold, have been declining steadily since early 2008. It is estimated that 6.5 million cars will be produced in all of 2009, down from 9 million in 2008 and almost 11 million in 2007*."

- Japan, the world's leading exporter, caught off guard by downturns in main markets

The Japanese market had been contracting for several years, and the downturn has accelerated since the summer. Over the longer term, it should level off at about 4.5-5 million units.
While production continued to ramp up over the first three quarters of 2008, Japan being by far the world's leading car exporter, the crisis began to be felt in the last quarter of the year and became a very brutal reality in the first quarter of 2009, when massive destocking hit.
"Over the 2009 full year, vehicle production will reach around 9 million, down from 11.5 million in 2008," says **Yann Lacroix**.

- European market (27 countries) a mixed bag in terms of registrations and production

It seemed that 2008 was set to be a record year in terms of registrations, but the financial crisis had an immediate impact starting in September 2008: sales volumes fell off sharply, especially in countries where household debt is high and the economic crisis was particularly violent (e.g. Spain and England).

Registrations have fallen by 12 to 13% on an annual average, which corresponds to 2 to 2.5 million fewer cars on an annual basis.
"Several countries – France, Germany, Italy and Spain – have introduced scrappage incentives to boost demand. A sudden elimination of such incentives in 2010 would cause the market to contract by 5 to 10%. The collapse in car sales is even more severe in new member states (-30%) and Eastern Europe (-50% in Russia). Across the European continent as a whole, sale are likely to fall by 20 to 25%," says **Yann Lacroix**.

- Severe consequences on production in Germany and France
Germany, an export-driven market like Japan, had a somewhat delayed reaction to the crisis, with production volumes crashing by 55% in the first quarter of 2009 alone. In all of 2009, the country is expected to produce 5 million vehicles, down from 6 million in 2008.
In France, massive destocking in the last quarter of 2008 and first quarter of 2009 affected the entire industry. With 2.5 million units produced in 2008 for a market of 26 million, France became a net importer. In 2009, production could fall below 2 million.

"Unlike in older industrialised countries, automobile production in China began trending upward again early in 2009. China stands to become the world's leading market in 2009, with close to 11 million vehicles. Because car ownership rates remain very low, growth should carry over to 2010 and 2011," notes **Yann Lacroix.**

2. Profitability being put to the test

Plunging demand and massive destocking will clearly have an impact on sector margins.

- In the US, restructuring since 2000 reduced employment levels by half but did not spare Chrysler and General Motors filing for bankruptcy protection.

- In Asia, carmakers have been thrown into turmoil after "outperforming" the market. The three main culprits are: a contraction of their domestic market, which is closed and highly profitable; the collapse of the US market, of which Asian manufacturers account for 40%; and a drop in the euro/yen exchange rate in the summer of 2008 that wiped out five years of productivity gains in three months. Most carmakers (Toyota, Nissan) have slipped into the red.
"Honda is the only manufacturer that has yet to post a loss, but its profits are down 80%", notes **Yann Lacroix.**

- In Europe, the downturn did not begin until the fourth quarter of 2008, so profitability levels for the 2008 full year were decent. The relative weighting of German carmakers helped make this good showing possible. The industry is nonetheless in crisis, and activity levels are likely to contract by 10% in 2009 (i.e. not as much as the global market) with net margins coming in negative (-1.5% of sales). This "smaller" decline, notably compared with Japanese manufacturers, is explained by lesser exposure to the US market, and for some players – especially VW – by solid positions on emerging markets.

French carmakers appear to be much more at risk. Their profitability is starting from a significantly lower level, with no premium positioning and insufficient exposure to growing markets. Renault's accounts will be affected by negative contributions from Nissan (40% Renault), which has announced losses, and from AB Volvo, of which Renault owns more than 20%.
"As the crisis continues, more carmakers and equipment vendors are going under. The number of bankruptcy filings in the large European countries and the US in the first five months of 2009 (87) has almost matched the full-year 2008 level (94)," notes **Yann Lacroix.**

3. Subcontractors hit by decline in automobile production in France

Stimulus schemes (ecological bonuses and scrapping incentives) can have a downside by favouring entry-level models production of which is largely offshored. Production has been declining in France since 2006 when manufacturing first began to be transferred abroad. Underutilised production capacity will require further restructuring if not site closures.

Staff levels will continue to be cut and the trend will accelerate in 2009. Redundancies exceeded 13,000 in 2008, bringing the total to 33,000 since 2005, and 6,000 jobs were cut in the first quarter of 2009. Euler Hermes SFAC estimates that the industry will shed between 20,000 and 30,000 jobs in 2009.
In May of 2009, subcontractor bankruptcies were up 65% on an annual average, and 141% higher in the first five months of the year than in the comparable 2008 period. Over the full year, there could be 400 failures. *"The magnitude of the crisis, and a sharp increase in claims, are seriously threatening France's industrial fabric,"* observes **Florence Lecointe, Euler Hermes SFAC arbitrator.**

"The future of the global automobile industry will depend on companies sharing certain costs via mergers and alliances, enabling them to establish solid positions in emerging countries with adapted products and to fund research and development for new technologies (including hybrid and electric). Industrial facilities will also have to be adjusted to limit excess production capacity. As of today, the landscape of players has not yet begun to change in earnest," concludes **Yann Lacroix.**

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