Press Release

Euler Hermes Economic Outlook: The Auto World Championship

Global vehicle sales to reach 100 million in 2019 as innovation drives major change

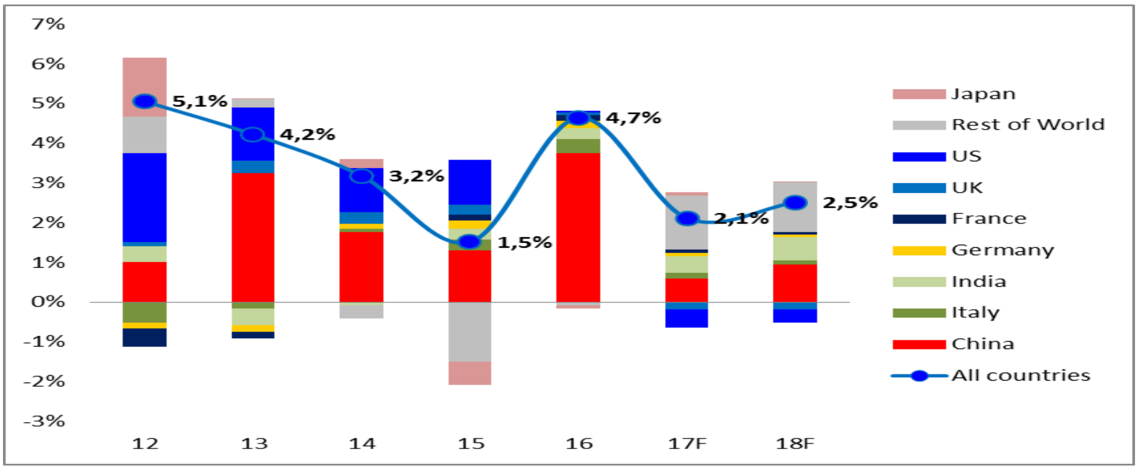
- China followed by India, are forecast to boost worldwide sales growth in 2017 and 2018, more than offsetting U.S. and UK sales decline.
- China, France, Germany, the UK and the U.S. lead the world on electric vehicle sales with strong growth set to see global stock exceed 3 million cars in 2017.
- Japanese car manufacturers and Italian suppliers have the highest profitability. With the exception of American and Italian car makers, manufacturers' debt burdens now lower than pre-crisis levels.
- Germany, Japan and the U.S. lead the world on R&D and patented technology. Aggressive growth makes China's automotive sector the leader in new technologies M&A: U.S. $6.2bn of deals between 2012-17.

PARIS – 12 SEPTEMBER 2017 – China and India are in pole position as the race intensifies for global vehicle sales in a rapidly shifting industry set to exceed 100 million annual sales in 2019, according Euler Hermes, the world's leading trade credit insurer.

In its latest Economic Outlook report, titled "The Auto World Championship", the company's economic research department analyzed global data and trends across the auto sector, focusing on 'the race for sales, electric cars, profitability and innovation'. The report also assesses the auto industry in eight key countries – China, France, Germany, India, Italy, Japan, the UK and the U.S.

"New vehicle registrations are expected to grow globally +2.1% this year, as Europe is on the mend and manufacturers worldwide are making cars "cool" again," said Ludovic Subran, chief economist at Euler Hermes. "However, this is only half the growth of 2016, as new registrations in the U.S. and UK decline while used-car sales boom, and as China stopped tax breaks for car sales earlier this year."

Chart 1 - Contribution to Growth in Global Vehicle Sales *Source: Euler Hermes*



Euler Hermes forecasts that worldwide vehicle sales will reach 95.8 million in 2017 (+2.1% annual growth) and 98.2 million in 2018 (+2.5%) before topping 100 million vehicles in 2019. China will lead the way as the largest contributor to sales growth with India coming in second, more than offsetting the decline in U.S. and UK sales. Three reasons explain this mixed forecast:

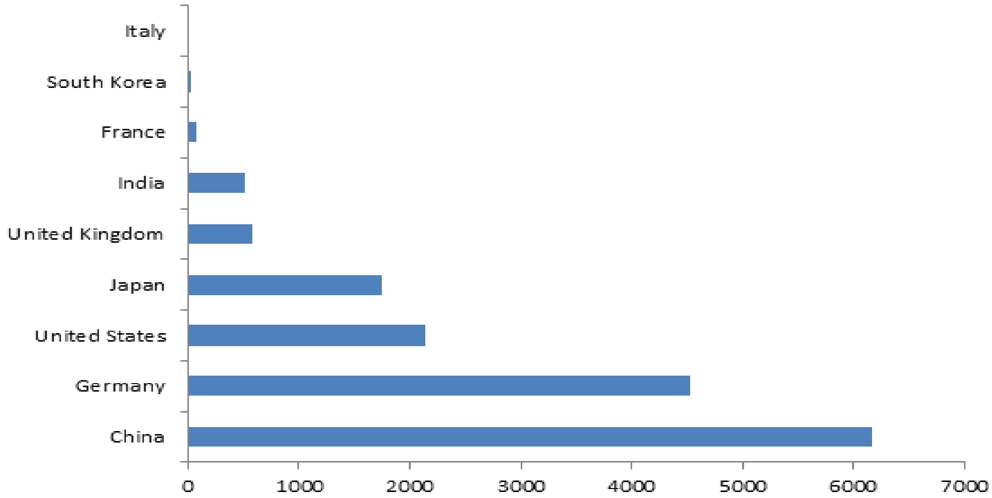
1. **Market risks** - China halted tax incentives in early 2017, financial conditions tightened in the US and a looming Brexit is adversely impacting UK purchasing power. Positive momentum in Europe and the rest of the world will not offset the deceleration. And tightening global financial conditions in 2018 will raise the cost of household borrowing and manufacturers' inventories.
2. **Booming used-car markets** - A burgeoning second-hand market in the U.S. and the UK, and an expansion in China, contribute to decelerating sales growth of new vehicles on a global scale.
3. **Making cars "cool" again** - The demand for new mobility services and the rise of autonomous driving are making cars fashionable again.

In addition, although still a small part of the total car fleet, the number of electric vehicles (EV) worldwide could exceed 3 million cars in 2017, after crossing the 2 million threshold in 2016 and the 1 million one in 2015. While sales of battery-powered cars remain a small proportion of the global market, China, France, Germany, the UK and the US are market leaders. By the end of 2017, China and the US are expected to account for more than two-thirds of global EV sales. The magnitude of government subsidies, expansion of the charging network, and falling battery prices (due to technological progress) are the key drivers of growth in the electric car market.

As for the broader industry, the financial health of the automotive sector diverges greatly across borders and industry sub-sectors. Nevertheless, profitability remains strong across the entire sector, with an average EBIT margin of 6.0% in 2016, up from 5.5% in 2015. With the exception of American and Italian car makers, the debt burden of manufacturers is lower than their pre-crisis levels. Liquidity and capital expenditures remain stable.

“The report identified three levers for innovation: R&D expenditure, patentable technology and external growth. Traditional manufacturers in Germany, Japan and the U.S. lead the first two categories, while China and India exhibit aggressive growth. China is the world leader in Information and Communications Technology M&A, with deals totaling US$6.2 bn over 2012-2017,” explains Maxime Lemerle, head of sector research, and lead author of the report.

Chart 2 – Information Computer Technology M&A in Car Industry (in million US$, 2012-2017)



Including deals completed and pending until August 2017. *Sources: Bloomberg, Euler Hermes*

The Top 8 Global Competitors

China: New Technologies, Old Challenges

The world’s largest auto market is forecast to expand by +2.0% in 2017 and +3.2% in 2018. By 2019, more than 30 million vehicles are expected to be sold each year in China. Despite slowing growth from tax hikes on pollutant emissions and the lifting of used-car trading restrictions in January 2017, new sales are expected to grow at a moderate pace due to demand in smaller cities and rural areas. The emerging used-car market in China is forecast to double to 24 million vehicles in 2020 - which could dent new car sales in the medium-term. While leading the way with the world’s largest electric vehicle fleet, consumer demand is supported by a generous 23% government subsidy. Aside from battery technology, however, China’s R&D and patented technology lags most advanced countries. Aggressive growth has made China the world leader on Information Computer Technology M&A, with US $6.2bn of deals between 2012 and 2017.

France: Revving Up

Domestic economic recovery boosted sales growth by +4.4% y/y in the first seven months of 2017, Sales are forecast to grow +3.0% in 2017 and +2.0% in 2018, to 2.5 million and 2.6 million new vehicles respectively. French manufacturers and suppliers maintain their strong financial standing with the second most efficient operating cycle in the country panel. French suppliers remain proactive in forging strategic partnerships on connectivity and autonomous driving technologies. In July 2017 the government announced diesel and petrol cars would be banned by 2040. EV sales, including 20,000 in the first six months of 2017, are expected to continue at double-digit growth --- currently underpinned by generous subsidies.

Germany: Down with Diesel?
Despite the emissions scandal and cartel allegations seeing diesel market share drop from 46.9% in H1 2016 to 41.3% in H1 2017, new vehicle sales totaled 2.4 million in the first six months of the year, up +2.1% y/y. Sales are forecast to grow +2.2% in 2017 and +1.7% in 2018. The flexibility of German manufacturers, which remain among the most profitable in the world, to switch to diesel alternatives will determine medium-term growth, especially for European sales. As a global leader in engine patents and R&D spending – in 2015 the German automotive industry invested $37.0bn compared to Japan's $29.4bn – electromobility and hybrid driving systems have been a major focus of this shift. Electric car sales, boosted by the diesel scandal, surged by +115.5% to 22,453 cars in H1 2017 and are forecast to exceed 50,000 this year.

India: Engines On
With one of the fastest growing automotive markets in the world, India's vehicle sales are expected to increase by +10.7% in 2017 and +13.5% in 2018 (4.1 million and 4.6 million units respectively). Boosting short-term sales, the harmonization of tax form the *Goods and Sales Tax* launched in July 2017 led to downward pricing in some car segments. Government commitment to infrastructure investment, combined with rising demand from a large and young population, support India's favorable medium-term growth prospects. Nevertheless, India lags on innovation and R&D spending, while the lack of energy and transport infrastructure has hindered electric car adoption – 10% of China's EV fleet, at 115,000 vehicles by the end of 2017.

Italy: In the Fast Lane
As Western Europe's fastest growing automotive market, Italy's new vehicle sales are set to jump by +7.0% in 2017 and +5.0% in 2018 (2.2 million and 2.3 million units respectively). Driven by an intense battle for market share and improved consumer and business confidence, high levels of government debt and a looming banking crisis could rein in credit provision and dampen consumer confidence in the medium term. In an industry primarily consisting of SMEs and thus limited financial resources, just 4% of worldwide automotive patents were secured by the Italian industry in 2015. R&D totaled 5bn EUR compared to Germany's 37bn EUR and France's 6.1bn EUR. With little government promotion and a slowly evolving charging infrastructure, electric cars are at an early stage of adoption in Italy.

Japan: Safe and Sound
After two years of contracting sales, Japan's vehicle market is expected to grow +2.0% in 2017 and +0.2% in 2018 at some 5.0 million units per year. Despite the lingering effects of the 50% increase in ownership tax for minicars in 2015, sales growth will be fueled by the extension of "eco-car" tax benefits. Global economic recovery and a weak Yen could also boost Japanese car exports in the short-term. Japanese manufacturers are the most profitable car makers worldwide, while being heavy investors in the sector spending 29.4bn EUR on R&D in 2015 and filing 1,854 patents in 2016 – second only to Germany. With generous subsidies to competing technologies from hybrid to hydrogen fuel cell, electric car sales are subdued and in 2016 accounted for just 0.5% (24,000) of new registrations.

The UK: Confidence Brakes
Marking the end of five years of strong sales growth fueled by cheap financing deals, new vehicle sales growth is forecast to plunge by -5.0% in 2017 (to 3.0 million vehicles) and -6.0% in 2018 (to 2.8 million). While plummeting used car prices have had a dampening effect on new vehicle sales, both markets have slowed markedly since last year under persistent Brexit uncertainty, the weak exchange rate and waning business and consumer confidence. With half of cars produced in the UK exported to Europe potentially impacting sales already, there may be secondary consequences with the bulk of the sector's funding provided by EU R&D investment. It appears Brexit will continue to loom large, particularly in a sector where British R&D totaled just 1.8bn EUR in 2015 – the lowest of the countries reviewed. Nevertheless, electric vehicle sales, subsidized at a below-average 15%, have benefited

from the government's ban on the sale of diesel and petrol cars by 2040. Despite a patchy charging network, EV sales are expected to expand at a solid double-digit growth rate.

The U.S.: **Growth Sputters**

Facing a major shift, the U.S. auto market is expected to shrink by -2.5% in 2017 (17.4 million sales) and -1.8% in 2018 (17.1 million). Auto loan defaults have been surging, denting credit lending and sales; a booming used car market is putting downward pressure on pricing and declining consumer demand for new cars. Swelling inventories are also contributing to declining profit margins for car manufacturers. The U.S. remains a global innovation leader, especially for battery technology patents. In 2015 R&D totaled 16.8bn EUR, putting the country third after Germany and Japan but ahead of both on worldwide patents - at 29% compared to 23% and 15% respectively. Below average government support for electric vehicles and varied adoption across states has left California far out in front with significant tax incentives and fast charging networks.

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