M&A Activity in the Supply Base
Conway MacKenzie is a global management consulting and financial advisory Firm with expertise in strategic financial and operational restructurings, transaction services, real estate services, fiduciary services, and litigation support services. Serving clients in both the private and public sectors, our Firm focuses on delivering value in a changing landscape. Linking business plans to operating performance, financial results, and investor expectations, we help ensure today’s performance correlates to tomorrow’s returns.

**Turnaround Management Services**
- Interim executive management
- Restructuring & reorganization
- Analytical & financial services
- Debtor & creditor advisory

**Transaction Services**
- Operational & performance improvement
- Buy-side due diligence
- Sell-side due diligence
- Post-merger integration

**Private Fund Services**
- Private capital advisory services
- Fund management services

**Real Estate Services**
- Retailer advisory support
- Lease restructuring advisory
- Strategic advice and due diligence

**Fiduciary Services**
- Chapter 11 trustee
- Receivership
- Financial advisory

**Litigation Services**
- Expert testimony
- Economic damage analysis
- Bankruptcy litigation valuation
- Fraud & forensic analysis

*The most active financial advisory firm delivering value in a changing landscape*
Conway MacKenzie’s automotive cross-functional teams link business plans to operating performance, financial results, and investor expectations, ensuring today’s performance correlates to tomorrow’s returns.

### Debtor Advisory Services
- Viability analysis
- 13-week cash flow
- Forbearance agreement negotiation
- Restructuring alternatives
- Product and plant footprint rationalization
- Supply chain advisory

### Transaction Services
- Operational & performance improvement
- Buy-side due diligence
- Sell-side due diligence
- Post-merger integration
- Quality of earnings / systems & reporting

### Creditor Advisory Services
- Detailed credit and portfolio review
- Strategic assessments and recommendations
- Financial reporting and controls
- Lender amendments and refinancing
- Trustee and receivership appointments

### Interim Management Services
- Cash flow management
- Cost reduction measures
- Revenue enhancement
- Forbearance negotiations
- Re-allocation of resources
- Monetization of non-core assets

### Select Automotive Industry Advisory Experience

### Recent Automotive Awards
- **M&A DEAL OF THE YEAR**: (Over $250 million to $500 million), Acquisition of US Manufacturing Corporation by Dana Inc.
- **TURNAROUND DEAL OF THE YEAR**: (Over $25 million to $50 million), Acquisition of Product Portfolio and Technologies of Fabco Automotive Corporation by Meritor

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### Recent Scenario (2018) vs. Outlook (2019)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Recent Scenario</th>
<th>Outlook (2019)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>3.1%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Unemployment Rate</td>
<td>3.8%</td>
<td>3.6%</td>
</tr>
<tr>
<td>Federal Rate</td>
<td>2.4%</td>
<td>3.0%</td>
</tr>
<tr>
<td>Gas Price</td>
<td>$2.26/gallon</td>
<td>Neutral (at best)</td>
</tr>
</tbody>
</table>

#### Impact on Automotive Industry

- Loans to become costlier
- Stagnation or decline in automotive unit sales
- High number of buyers to remain in the market

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**U.S. macroeconomic scenario is likely to pose a challenge for the automotive sector; which is likely to worsen, as many analysts have predicted onset of economic recession in the U.S. by 2020**

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**Automotive Industry Overview**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales (Global)</td>
<td>Expected to witness decline in 2019 due to low growth in key economies such as China, Europe, and the U.S.</td>
</tr>
<tr>
<td>Sales (U.S.)</td>
<td>Expected to decline by 1.1% in 2019 to below 17 million – first time since 2014</td>
</tr>
<tr>
<td>Return on Capital</td>
<td>Return on Capital remained low (in 4–5% range) during 2017–2018; no significant improvement is expected in 2019</td>
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**Impact on Automotive Industry**

- Inventory levels to rise
- Revenue likely to stagnate or decline
- Margin improvement to be dependent on new products and effective cost management

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Environmental costs, weaker-than-expected automotive demand in China, high pressure from competition, increasing R&D cost, escalating trade war, expected disruptive Brexit, elevated inventory levels are likely to be significant headwinds for the automotive sector
### Key Highlights

**Automakers’ Approaches to Face Headwinds**

<table>
<thead>
<tr>
<th>Cost Management</th>
<th>M&amp;A</th>
<th>R&amp;D</th>
<th>Electric Vehicles</th>
<th>Business Model</th>
</tr>
</thead>
</table>
| • Downsizing and elimination of non-profitable product lines are likely to be a key cost management strategy for automakers | • Automakers to focus on M&As to lower costs, increase purchasing power and share technology  
• Technology driven M&As are witnessing significant growth, (accounting for 11% of the total number of automotive deals in 2017 – a growth of ~60% (by volume) since 2015) in order to develop more advanced vehicle | • R&D expenditure is expected to remain strong as car makers invest heavily in new technologies – primarily in developing eco-friendly cars that operate on electricity and alternate fuels  
• For example, Tesla invests ~50% of its Capex on R&D | • Momentum for electric vehicles is building among OEMs due to increasing regulatory pressure and accelerating technology advancement  
• Overall, EV sales are expected to grow; by 2030, EVs are expected to account for 44% and 50% of the overall new vehicle sales in EU and China, respectively | • Companies will increasingly focus on reinventing their business models to reduce costs and improve margins  
• For example, Tesla moved much of its sales online in March 2019 – success of this model may lead other players to focus on online sales as well |

*Driven by regulatory pressures, the companies are expected to shift from manufacturing combustion-based vehicles to electric vehicles to drive future sales; investments in R&D and technology initiatives will be imperative for the long-term growth and success of automotive companies*
Factors Affecting M&A

Macro-economic Factors

- Trump’s trade policies led to high import tariffs raw material imports of steel and aluminum, thereby negatively impacting automotive market growth
- US tax reform lead to positive impact on M&A activity in 2018 as corporate tax dropped to 21% from 35%

Automotive Electronic Sector

- Automakers are moving towards in-house design and engineering work, leading to a rise in deals in electronics and technological sectors
- Increasing focus towards lightweight, miniaturization, intelligence and electrification in vehicles is driving growth of automotive electronic sector
- Changing design and material requirements is driving M&A activity as interior component suppliers collaborate with consumer electronics companies to design futuristic integrated concepts

Automated, Connected, Electric, and Sharing Automotive Technologies (ACES)

- Increasing trend towards electric and self-driven vehicles, and collaboration of automakers with technology providers present opportunities for future M&As
- Shift in procurement focus for automotive companies from Motor and chassis to batteries and smart sensors, indicates the future of M&A opportunities in ACES space

Government Regulations

- Push towards the usage of lightweight materials by government regulations to control vehicle emissions
- Increasing focus on safety and performance improvement of vehicles by the U.S. government, enabled functions such as driver-assist sensors and infotainment features will also help boost deal activity in 2019

Note: 1) NAFTA stands for North American Free Trade Agreement
Source: Deloitte; Foley
The upcoming strategic acquisitions in the automotive industry indicate the move towards alternative powertrains, better technological usage, and improvement in hardware parts and components.
Product activity remains robust at most major automakers, as OEMs strive to introduce fresh differentiated product; however, abundance of new models in a declining market is likely to result in overcrowding and profit pressure.

Compared to previous projections, the number of projected new model launches for 2019 and 2020 has decreased while the number in 2021 and 2022 has increased.

Source: BofA Merrill Lynch Global Research
President Trump’s signing of an executive memorandum in March 2018 to protect the interest of domestic producers through trade tariffs has created disturbance in the domestic economy.

This kicked-off trade wars with trading partners such as China, the EU, Canada, Turkey and Mexico who have imposed retaliatory tariffs.

<table>
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<tr>
<th>Tariffs</th>
<th>Description</th>
<th>Impact</th>
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</table>
| Section 232 | Under this section, tariffs were imposed on steel (25%) and aluminum (10%) imports from all countries to protect national interests | - Domestic steel and aluminum producers are likely to increase prices, due to higher prices charged by foreign competitors subject to tariffs  
- U.S.-based energy firms that heavily rely on steel and aluminum industry (for pipeline construction, etc.) likely to face the impact of increasing prices and lower demand for clean energy in the long term  
- Auto parts suppliers are also likely to face added distress |
| Section 301 | Involves imposition of tariffs on ~$50 billion worth of Chinese imports particularly in aerospace, ICT, and machinery industries to restrict unfair technology transfer practices from China | - According to S&P’s PD Market Signal Model, ~60% of the U.S. and China-based public companies experienced escalation in credit risk  
- Further, it impacted the short-term perceived credit quality of the U.S.-based firms  
- Diversified banks and investment banking and brokerage companies are reexamining their business investment and lending decisions sighting potential negative repercussions on economic growth |
- We have several clients that have had to increase wages by $2 to $4 per direct labor hour in order to attract and retain employees.

- Employer paid healthcare costs have risen significantly over the past decade.
  - The average cost of employer health coverage offered to workers rose to nearly $20,000 for a family plan.

**Average annual worker and employer contributions to premiums for family health coverage**

*Source: Kaiser Family Foundation*
Although trade tariffs can be a considerable hurdle for the automotive industry, players need to capitalize on current auto-tech trends and should pursue lucrative M&A opportunities.

- Buyers across sectors are leveraging strong balance sheets, relatively low borrowing costs, and keen outside investors to further establish this new ecosystem.
- The emergence of automated, connected, electric and sharing (ACES) automotive technologies and business models is a primary driver of M&A activity.
- We can expect the auto-tech convergence to continue as the industry progresses toward a new technology-centric automotive ecosystem.
- Light-weighting to achieve government emission standards is also gaining importance and the acceptance of lightweight materials is expected to grow; the demand for advances in this space should drive deal activity and valuations in 2018 and beyond.
Summary and Q&A

**Prediction for the Next 2 to 5 Years**

<table>
<thead>
<tr>
<th>SELLERS</th>
<th>BUYERS</th>
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<tbody>
<tr>
<td><strong>Low to mid market suppliers will become Sellers</strong></td>
<td><strong>Large companies will be strategic and opportunistic buyers</strong></td>
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<tr>
<td>- Anticipated headwinds discussed earlier will cause entrepreneurs and sponsors to sell “while they can”</td>
<td>- More focus on operating profit</td>
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<tr>
<td>- Failed launches, rising material prices, increased labor costs, etc. will cause distress in the supply base and lower valuation sales</td>
<td>- Sustaining/increasing margins</td>
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<td></td>
<td>- Technology will drive strategic acquisitions</td>
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<td>- Disruption and distress will drive the opportunistic acquisitions</td>
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