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# The Future of the European Automotive Industry

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## Trends, challenges, risks and opportunities from an equity market perspective

*INTERVIEW WITH LARS MOGELTOFT AND ARMAN ARSHAKYAN*

One of our key strengths lies in the fact that our investment department is comprised of experts from various backgrounds and disciplines, allowing us to pool their knowledge to build a robust, well-rounded investment strategy. In our focus series, we will hone in on these teams, harnessing their expertise in order to present their angle on different market themes and trending topics.

In our first extensive interview, we spoke to Lars Mogeltoft, Head of Equity, and Arman Arshakyan, Equity Associate, in order to gauge what is happening inside of the European car industry. The content of the interview will be rolled out in three parts.

The first sets the scene, detailing the current state of the industry, the key trends shaping the landscape. It also outlines the vital role that this sector plays within the European economy. The second part delves deeper into the challenges faced by automakers. The third will give a more market-based view, discussing margins, profitability and future prospects.

## Part 1: Growth in the European Car Industry – Neither fast, nor furious

### CONTEXT: WHY IS THE AUTOMOBILE SECTOR KEY FOR EUROPEAN INDUSTRY AND MORE BROADLY THE EUROPEAN ECONOMY?

Europe is the cradle of the car industry. When the first automobile was invented in Europe around 130 years ago, very few understood the broader implications. As Germany's last Kaiser Wilhelm II infamously said, 'The automobile is only a temporary phenomenon. I believe in the horse'.

Since then, a lot of things have changed. Europe's automotive industry has grown and flourished to become an essential part of our continent's industrial fabric. It is inextricably linked to other sectors, exerting an important multiplier effect in the economy, directly influencing upstream industries such as steel, chemicals, and textiles, as well as downstream industries such as Information & Communication technology, repair, and mobility services.

According to the European Automobile Manufacturers Association (ACEA), the sector (1):

- represents nearly 7% of EU GDP
- indirectly employs (incl. auto manufacturing, services and construction) 13.3 million people (6.1% of the EU workforce)
- directly employs 3.4 million people (11% of EU manufacturing employment)
- is the largest private investor in R&D within Europe (almost €54Bn annually)
- was granted over 8700 patents in 2017 alone.

In terms of production, Europe churned out 23% of the 99 million motor vehicles produced globally in 2017. This puts the continent in second place after Greater China (30%), but well ahead of North America (18%).

The European auto industry delivers a €90.3 billion trade surplus for the continent with the main destination for European cars being North America, which represents 22.5% of total sales volumes, and 32.1% of market share value.

In 2017 alone, the EU exported more than 5.3 million passenger cars globally (5.9 million motor vehicles). While the value of those exports has been growing mostly continuously, volumes are on a clear downtrend.

To sum-up, the automobile industry is a key ingredient for European growth, but domestic markets are highly mature (in Germany 85% of households own at least one car). On top of this, the market share of European manufacturers is shrinking with Chinese firms looking poised to edge in on the territory. In a 2019 industry survey by KPMG, two-thirds of respondents said they expect the Western European share of production to drop to 5% by 2030, on a global scale (2).

## HOW WOULD YOU SUMMARIZE THE CURRENT STATE OF DEMAND FOR VEHICLES?

Last year global car sales declined for the first time since 2009. Though small, the decrease may represent the first cracks in the macro-backdrop, given that the auto industry is such an important catalyst for global economic activity.

In terms of sales, light vehicle registration was estimated at around 94.6 million units in 2018 worldwide. China was in the lead with around 28 million registrations, followed by the USA with around 17 million and then Western Europe with around 16 million.

| | Sales (units) | | Selling rate (units/year) | | |
|---|---|---|---|---|---|
| | June 2019 | % change since June 2018 | YTD 2019 | Year 2018 | % change |
| WORLD | 7,793,607 | -6.4% | 89,929,721 | 94,622,115 | -5.0% |
| USA | 1,514,844 | -2.4% | 16,923,147 | 17,301,160 | -2.2% |
| WESTERN EUROPE | 1,544,214 | -8.1% | 16,383,522 | 16,148,853 | 1.5% |
| CHINA | 2,010,315 | -9.3% | 24,458,573 | 27,748,555 | -11.9% |

Source: LMC Automotive, *BIL*

The factors which weighed on sales last year still linger, and only last week was it announced that European car sales in June had declined by a substantial 7.8%.

## WHAT ARE THE KEY TRENDS INSIDE OF THE EUROPEAN AUTOMOBILE INDUSTRY?

There are significant differences between the automotive markets of the various European countries, but all have faced similar developments in recent years. It was only in 2015 that production went back above pre-financial crisis levels. Registrations are, nevertheless, still below the peak observed in 2007.

## Bigger is better?

By
market segment, 2017 was the year when SUVs achieved the same sales penetration as small and medium cars inside the EU. It was also in 2017 that petrol fell back into favour as the preferred fuel type, ahead of diesel and other alternatives (electricity, hydrogen and so on…).

## Rising C02 levels

According
to figures published by the European Environment Agency (EEA), average carbon dioxide (CO2) emissions from new cars went up (by 0.4%) to 118.5g/km in 2017. This is significant as it is the first annual rise in CO2 emissions since records began in 2010. The 'demonisation of diesel' and the subsequent shift to petrol anlongside the rising SUV count seem to be the key drivers behind this. Clearly, If this trend continues and the adoption of alternative fueled vehicles doesn't accelerate, the industry will need to take more drastic measures in order to comply with new legislation.

## The rise of the gadgetmobile?

As
cars have become equipped with ever more features to make them safer, (supposedly) cleaner and smarter, the complexity of vehicle production has increased. This increase in complexity affects energy demand. Nevertheless, manufacturers have been working continuously to improve the energy efficiency of production. As a result, the energy consumption per car produced has decreased by 15.7% over the last decade. (1)

As
an interesting side note, with 89 passenger car registrations per 1,000

inhabitants in 2017, Luxembourg stands out as the European Union champion, in terms of the most registrations per person. The EU average was 30 new cars per 1,000 habitants. Luxembourg's cars are also newer: the average age of passengers cars in Luxembourg was 6.3 years vs. the EU average of 11 years.

*This bird's eye view of the European auto industry depicts an industry that is at best coasting in the slow lane. In the* next piece *we look at the various challenges faced by Europe's automakers at a more granular level.*


1. https://www.acea.be/uploads/publications/ACEA_Pocket_Guide_2018-2019.pdf
2. https://home.kpmg/be/en/home/insights/2019/01/the-future-of-the-automobile-industry.html

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