Automotive: unlocking opportunities

Adapting your business in a changing industry

2021

Automotive

Global

Trends

Introduction

The automotive industry has been significantly impacted by the disruption and supply chain restrictions resulting from the COVID-19 pandemic. While the industry is expected to partially recover in 2021, the levels of uncertainty surrounding demand and investment will remain difficult to successfully predict.

From liquidity to debt and restructuring, we address the diverse and complex challenges faced by upstream and downstream automotive companies alike. We also consider implications for employers and how financial planning for the medium and long term will be affected.

We will cover:

- Debt and restructuring
- Operating costs
- Transactions and funding
- Operational changes
- Tax services
- What Grant Thornton is doing to help upstream and downstream automotive companies

Rising revenues, rising debts: exploring an increasing trend

The next decade is set to be a period of transition for many automotive Original Equipment Manufacturers (OEMs) and the industry in general. Emerging technological innovations, government policy around sustainability and changing business models mean that OEMs cannot afford to sit still.

Oliver Bridge, Head of Automotive in Business Consulting at Grant Thornton UK, also heads up the global automotive group which consists of industry professionals from Grant Thornton member firms. "We looked at the company financial and volume data of 24 major global OEMs[1] to identify current trends in revenue, profitability and debt," Oliver shared.

Across the last four financial years, while financial performance is varied across the sector, there are some clear trends. In particular, rising debt levels among OEMs and rising levels of R&D spending could indicate what shape the industry could take and what relationships with Tier 1 and Tier 2 suppliers will be like over the next decade.

Rising debts across the automotive sector
As of the last financial year, total global revenue for automotive OEMs was over £1.68 trillion. But the picture is not an even one. While Toyota and Volkswagen remain the two industry leaders with growing revenue, over half of the OEMs we looked at have seen a decline in the last two years. Many of those with growing revenue also had a growing normalised EBITDA and EBIT too. Over 70% have experienced a drop in operating profit in the last year. There are few extremes here, with Changan seeing an 880% rise in operating income, while Nissan dropped 320% in its last financial year.

There is also a clear trend of rising debts among OEMs. As of the last financial year, total debt across the sector stood at £1.07 trillion. Toyota, Daimler, Honda, BMW, Hyundai, Renault, Tata and Dongfeng are among those that saw a rise in debt from last financial year to the current one. Volkswagen, Ford and General Motors all saw a drop in the same period, although all had increased their debts over the preceding three financial years. Many OEMs have a growing debt burden which may hinder their ability to take on additional liabilities as required. While Mitsubishi and Dongfeng were the only OEMs with a negative net debt to EBITDA ratio, Honda, Toyota, Renault and Tata all showed a growing positive ratio.

"From our analysis, there are number of potential factors that could be leading these companies to take on additional levels of debt," Oliver said.

Is this increase in debt due to falling vehicle volumes?
Another interesting feature of the current OEM landscape is that in many markets, vehicle purchasing volumes have fallen in the last few financial years. General Motors, Ford, Honda, Tata and Mazda are just some that saw a drop in vehicle volumes in 2019, while Hero, BMW and Toyota bucked the trend by remaining steady or seeing a slight rise. One potential factor behind this could be lower numbers of diesel vehicles, but this is unlikely to explain the entire picture.

But while the number of models being sold around the world dropped in 2019, average revenue per vehicle continued to grow.

This trend is being driven by a number of factors. Vehicles are becoming more expensive for several reasons as consumers look to own bigger vehicles with modern technology and more value adds. In the US, for example, there has been a drop in small vehicles like sedans towards a favour of pickups and bigger SUVs. These larger vehicles come at a higher price

Changing business models mean that OEMs cannot afford to sit still.

1. Grant Thornton UK LLP 2020.

point, but additional features such as parking assist and increased mobile connectivity are also very popular with consumers. Another reason for higher revenues could be a growth in non-car items such as leasing and insurance.

Is debt being used to fund increased levels of R&D spending?

The data also shows that there has been an increase in R&D spending among many OEMs over the last four years. Western and Japanese companies in particular have been dedicating more spend than ever before into developing new solutions and harnessing emerging technologies. R&D expenditure as a percentage of revenue has increased for many OEMs over the last two financial years, with Toyota, Volkswagen and BMW all reaching around 4%. Tata and SAIC on the other hand, are currently at between 1% and 2%. Overall, more than 60% of the companies we looked at are investing more into R&D, with Toyota and Ford both dedicating just under £9 billion each to R&D expenditure. Total R&D spend across the 24 OEMs rose from around £51.7 billion in 2016 to around £61.9 billion in 2019.

Alongside standard development projects relating to design, comfort and vehicle lightweighting, there are a number of major focus areas for OEM R&D. Vehicle electrification remains a priority for many, particularly in the light of evolving government policy across the world. BMW, for example, is aiming to bring 25 electrified models to market by 2025. Mobility as a Service (MaaS) is another important area, with many OEMs looking to develop applications and architectures to allow customers to access a range of transport options. Toyota in particular is looking to take ownership of this space and move its focus from being a primarily manufacturing-based company to a mobility one. Autonomous driving is a long-term focus for many OEMs too, with General Motors emerging as an early leader. The company plans to roll out its Super Cruise hands-free highway driving feature to all its Cadillac models.

"Are these increased levels of R&D spending being funded through a mixture of debt and reduced profitability?" asks Oliver. "While we can't say for certain, the data seems to point in that direction. And it is clear that harnessing innovation will be an important element of OEM success over the coming decade."

Positioning for the next decade

The automotive industry looks set to change drastically over the next decade, and OEMs are rushing to position themselves in the right way to take advantage. Investing in technology is likely to be a key component of business success in saturated markets like the EU, as well as developing markets in other regions. OEMs could be taking on increased amounts of debts to ensure they are able to adapt to a rapidly shifting technological landscape.

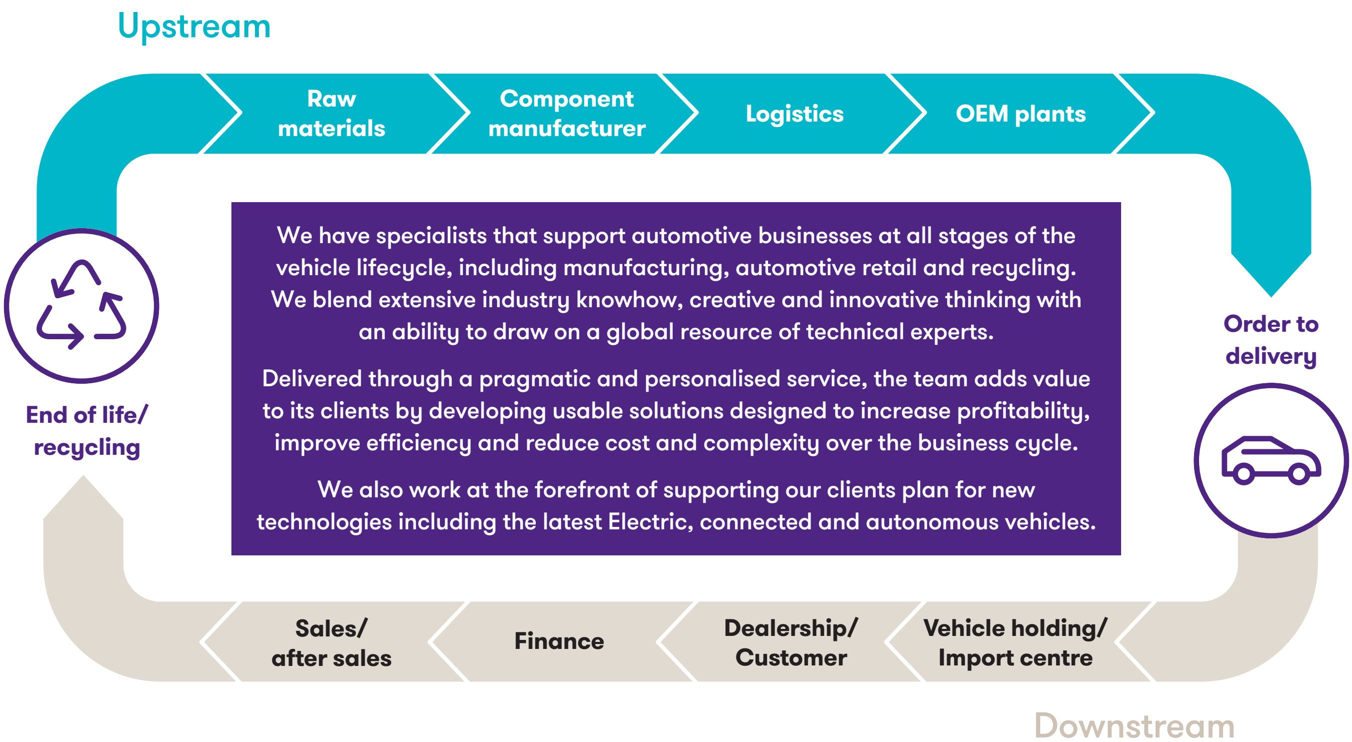
Tier 1 and Tier 2 suppliers are monitoring the OEMs performance closely to make sure they pick sustainable partners for the future. Many are also choosing to diversify and engage with R&D, so may look to prioritise those OEMs that are seen to be driving innovation.

While fully autonomous driving is still some way off, and testing is difficult in some regions, MaaS looks set to match the huge growth in digitalised, data-driven services we have seen in other sectors over the next five to ten years.

It is clear that harnessing innovation will be an important element of OEM success over the coming decade.

How Grant Thornton's solutions can help you

Our automotive value chain roadmap



We have specialists that support automotive businesses at all stages of the vehicle lifecycle, including manufacturing, automotive retail and recycling. We blend extensive industry knowhow, creative and innovative thinking with an ability to draw on a global resource of technical experts.

Delivered through a pragmatic and personalised service, the team adds value to its clients by developing usable solutions designed to increase profitability, improve efficiency and reduce cost and complexity over the business cycle.

We also work at the forefront of supporting our clients plan for new technologies including the latest Electric, connected and autonomous vehicles.

Our solutions

Our automotive team is global. We are a network of automotive practitioners with a range of skills that you would expect from our Grant Thornton member firm advisors.

Our key differentiator is our experience in both upstream with suppliers, manufacturers and Original Equipment Manufacturers (OEMs), and downstream including national sales companies and dealerships. We are at the forefront of supporting businesses that are involved in areas such as battery technology, Mobility as a Service (MaaS), connectivity and the transition away from the combustion engine.

On a global basis, our services include:

Transactional advisory
We are specialists in making deals happen and we provide advice and due diligence services to create effective transactions. We have worked on both sell-side and buy-side in a mixed size of transactions from single site to multi-locational.

Tax
We have a strong international tax practice and understand in–country and cross border tax issues. We advise on business tax and VAT, plus customs duties and personal taxes as they impact the corporate world. We believe in providing a proactive taxation service which helps our clients to minimise their tax burden without creating unnecessary risk.

Audit
We are one of the leading providers of audit services specifically to the automotive industry. Across the Grant Thornton network, our audit practices and procedures are standardised throughout the world, thus giving confidence that we can bring a robust approach to audit and client relationships in the dealer space.

Operations improvement
We help companies across the supply chain to improve performance. We have supported manufacturing companies, national sales companies and dealerships to generate end-to-end efficiency and cost savings.

Business planning and cashflow forecasting
We work with automotive brands globally to help build achievable business plans and to model cashflow and balance sheet impacts. Our cashflow model is proven to be effective in a space where very few products exist. For example, we have also worked closely with dealers to improve their working capital and increase their cashflow.

Finance raising
We work to assist in the raising of capital either for acquisitions, investments or when a business has been in financial distress. We have strong connections with banks and investment houses who are looking to invest in the automotive sector. We also provide specialist advice on the raising and refinancing of debt.

Strategic advisory
We work with OEMs, dealerships and to instigate change and create a stronger manufacturing and distribution base that can deliver real growth. We have professionals who have worked within parts manufacturers, distributors and dealer networks in many different countries and understand how to get the best return for an investment decision.

Leasing and contracting
We have deep involvement in the automotive leasing sector (both corporate and retail) and have individuals who are well known for their operational advisory skillsets and ability to help generate better profitability.

Compliance
We understand banking and financial compliance across the globe. Our team is unrivalled and can provide services to captive, independent and dealer side finance companies and operations.

Operational and financial restructuring
Our multi-disciplinary operational and financial restructuring specialists provide support to realise significant business process improvement, implement new business strategies, divest noncore businesses and design new capital structures aligned to the dynamics of the business. Our team also has significant experience in supporting renegotiations of lease/rent terms and in helping businesses access government support which may be available.

Credentials

Operational improvement advisory

Client Business description: The automtive manufacturing client is a Tier 1 supplier to multiple major OEMs.

Engagement description: Our client was in financial distress and wanted to request a price increase from the OEM for the parts made.

Challenge: The client did not know which parts where profitable and the size of the price increase from each OEM.

Solution: We analysed the operations and allocated cost by part to create a pricing tool for the client. The client was able to recognise which products where profitable. In advance of the OEM discussion, we identified cost reductions to allow savings to help facilitate the price negotiations

Value created: The client achieved the price increases and also reduced their cost base in excess of the OEM target.

Financial due diligence

Client Business description: The client works in the field of cold stamping and assembly of steel and aluminium parts for automotive manufacturers.

Engagement description: Grant Thornton was engaged to conduct a sell side financial and tax due diligence of the client for potential acquisition by strategic investors.

Challenge: The client was looking to identify potential investors and therefore required an accounting, financial and tax analysis to identify critical issues that could arise during negotiations with potential buyers.

In addition, the management required an analysis of the client's business to understand the effect of the current strategy on the future economic performance of the client.

Solution: A cross-service team of Grant Thornton advisory, audit and tax professionals ensured full coverage of all the material aspects of the client.

Value created: Successful delivery of the due diligence report to a satisfied client.

Direct tax compliance

Client Business description: The client is an automobile manufacturer based in Europe.

Engagement description: Grant Thornton was engaged to provide VAT compliance services (domestic and international).

Challenge: The client lacked the expertise to identify and manage any VAT risks coming from business activities carried out by the client in Eastern Europe.

Solution: Grant Thornton managed the indirect tax affairs and reports on the status of mandatory VAT filings required to be completed.

Value created: The client's VAT compliance processes are now well established, tax risks are continuously observed, assessed and managed. The client is aware of any upcoming changes in indirect taxes, which might affect their business.

M&A advisory

Client Business description: The client is a leading manufacturer of machine parts and precision materials.

Engagement description: Grant Thornton was engaged to provide transaction advisory services to the client.

Challenge: To realise the further growth of the client's group due to an increasing contract volume, additional investments were necessary. The investments in part were financed with equity by way of a capital increase as well as by disposing of part of the company's shares.

Solution: We identified and approached potential investors and supported the financing and transaction process. Specific advisory services included the development of an integrated financial planning model and of an information memorandum to present the potential growth as well as the capital requirement.

Value created: Disposal of the majority of shares of the owning family to an independent investment company.

Governance and risk management

Client Business description: The client is an automotive distributer/retailer based in South America.

Engagement description: Grant Thornton was engaged to evaluate the operations based in South America, to assess whether the international requirements were being met.

Challenge: The client wanted a review of internal controls completed by an external party to ensure it was meeting procedures required by the international partner in relation to supplies.

Solution: We surveyed the existing procedures and controls in place and compared these to the requirements of the international partner. Following this, we summarised findings and made a number of recommendations for improvement.

Value created: The evaluation we conducted resulted in the reformulation of procedures and internal controls to comply with requirements of the international partner. This helped the client improve the internal control environment.

Financial restructuring

Client Business description: Well known automobile manufacturing group.

Engagement description: Grant Thornton's corporate finance team conducted a restructuring option review prepared for the client during the course of an intended transaction. Following the client's decision not to proceed with the transaction, we assisted the client in the review of its own restructuring options to arrange refinancing for their group.

Challenge: The client required an independent review of restructuring options. The target had a very complex structure, which needed to be analysed in a short time frame. Restructuring measures planned had to be challenged not only against the market and competition environment, but also against the feasibility in terms of internal operations.

Solution: Grant Thornton provided an independent review of the restructuring options.

Value created: The client successfully managed a turnaround that strengthened the position of its European market presence.

Helping your business respond to COVID-19

We are immersed in the automotive industry and our professionals are uniquely positioned to assist you in all aspects of the creation and execution of your business plan.

1. You are supported by fully integrated, highly experienced teams, who are recognised for their quality and ability to flex to the sensitive needs of our clients' individual circumstances

2. We will take a holistic view of the challenges you face and deliver targeted solutions throughout the various elements of the automotive value chain including ownership and funding

3. We will work closely with you to implement performance and working capital improvements and drive effective business strategies. These include providing independent critique of refinancing proposals and acting as a respected bridge between lenders and the senior management team

4. Our experience of effective divestment/investment strategies for investors, funders and corporates will help you identify and maximise opportunities for value creation or protection and to improve liquidity availability if necessary

5. Regardless of the complexity of your group structures, or the international footprint, we have automotive hubs as well as a global network of Grant Thornton member firms and market-leading teams in all the key offshore financial centres, to be able to advise on all leading practices

6. We are at the heart of the development of cross-border restructuring legislation, giving our clients access to leading-edge and best practice restructuring solutions

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EPI.442