UK Production Outlook: WAF meeting at Hensol Castle

Ian Henry, AutoAnalysis

Thursday, December 5, 2019

Outline

- UK production in Q1-3/2019
- Exports
- Production Outlook for 2019 and beyond
- Brexit assumptions and scenarios
- Changing geography of production in Europe
- Industry restructuring
- Global perspective: tariffs and trade
- Electric vehicles
- Conclusions

UK production Q1-3/2019

Car production down c15% to c989k

Decline due to:

- All round decline at Nissan (-23%), Vauxhall (-21%), Land Rover (-13%)
- End of life: Infiniti
- Fall ahead of model change: Juke & Qashqai
- Continued Brexit uncertainty, incl. April and November shutdowns
- European slowdown; China market fall; Diesel issue
- Negative atmosphere compounded by Ford closing Bridgend and long term loss of 225k units a year through end of Civic, X-Trail & Infiniti

Some positives:

- New Evoque (+26%)
- Strong start for Corolla
- Start of Aston DBX and new vans at Luton
- Stable Mini hatchback volumes
- Juke SOP, imminent electric Mini SOP
- Commitment to electric XJ replacement and probably other EVs at Castle Bromwich (although no production impact yet)
- INEOS to assemble SUV in Wales

Exports account for c80% of UK production

2016-2018 has seen:

- EU27 decline as % of UK exports
- US % rise
- China rise, then fall, which has continued in 2019

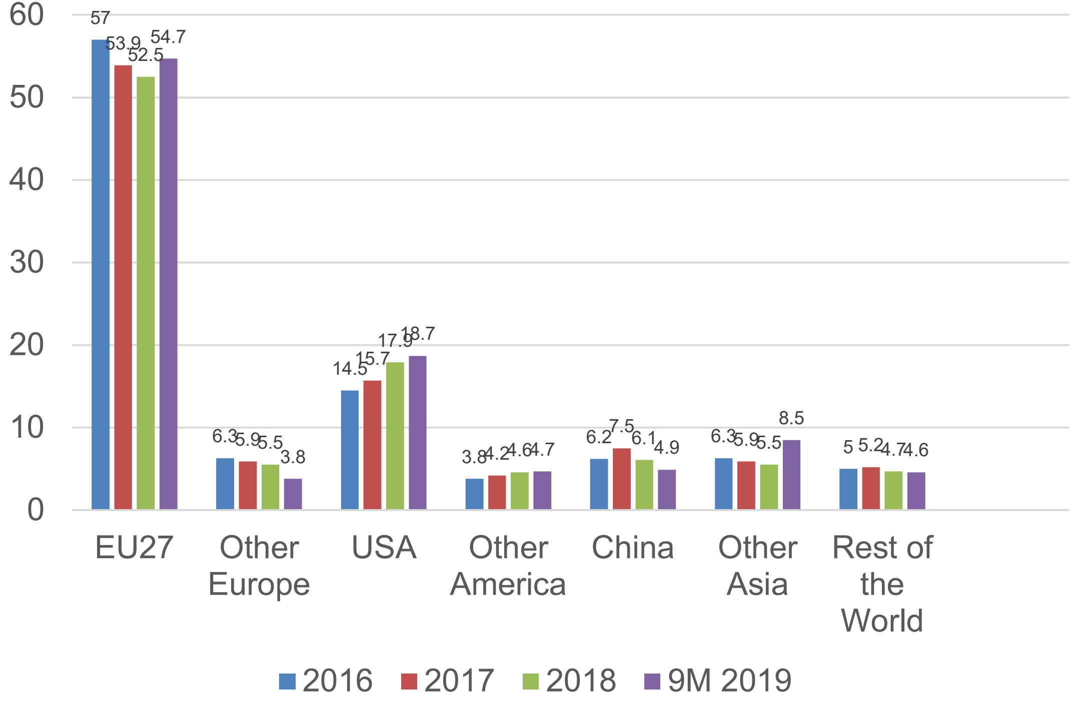
EU's % of UK exports has risen in Q1-3/19 – a warning for Brexit!

Europe likely to become increasingly important as Chinese market slows and Civic exports finish

Recent US exports rise was driven largely by Honda Civic and Infiniti QX:

- QX exports already lost

2016-2018 UK exports by destination (%)



Ian Henry, AutoAnalysis
December 2019

Outlook for 2019 and beyond

Key assumptions behind Base Outlook:

- Agreement reached with EU, incl. transition period to December 2020, with possible extension for FTA to be concluded
- Transition period would see auto industry operate as now
- Zero tariffs and regulatory alignment would continue from January 2021

Some customs friction and disruption to JIT systems are likely even with zero tariffs:

- Non tariff barrier costs will emerge
- **Estimates vary from 0.5 to 1.5 times the cost of tariffs – more likely to be at bottom end of this range**

Also assumed that current, planned, committed UK model introduction plans will continue:

- **2019**: Nissan Juke, MINI EV and new PSA vans
- **2020:** Nissan Qashqai
- **2021**; new Range Rover programme, including electrified versions
- Post 2021 model decisions and production allocations **still** yet to be made: Next MINI, Vauxhall Astra replacement, Jaguar full BEVs (only XJe confirmed, although others are highly likely)

Brexit: what happens next depends on the GE

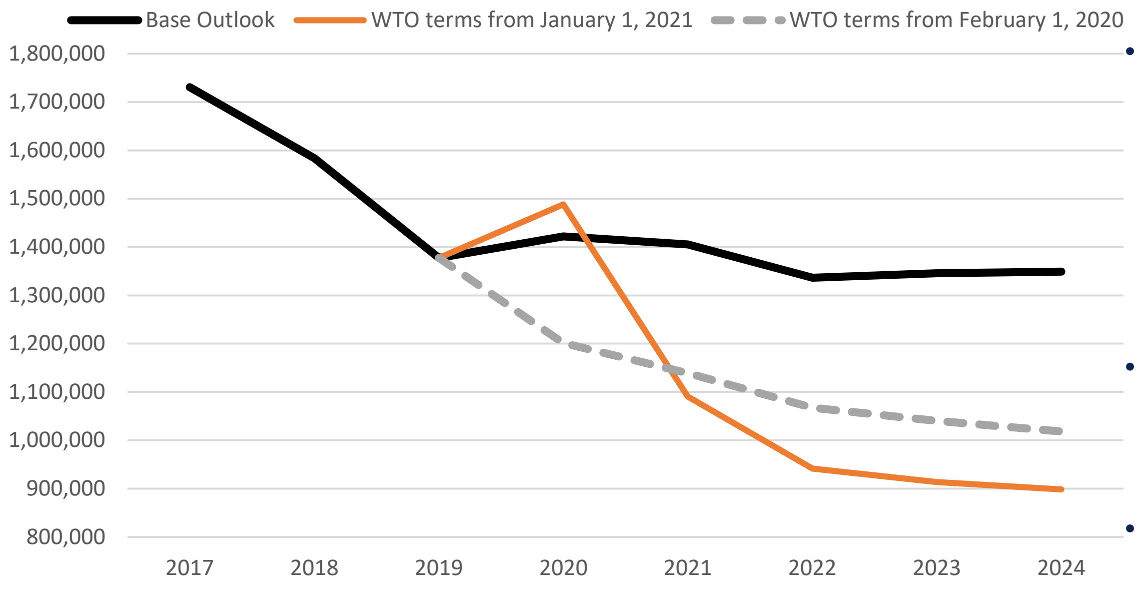
Conservative majority would see Withdrawal Agreement Bill proceed quickly into statute
Followed by intensive FTA negotiations through 2020 …

But potential cliff edges remain real

1. Base Outlook assumes WAB passed, with transition to December 2020 and:
    - Rapid agreement on Free Trade Agreement to come into effect in January 2021
    - Trade experts don't think this is practical
    - Outgoing government has said no to extending transition period beyond December 31, 2020
2. No Deal departure remains possible for January 1, 2021 or even February 1, 2020 if WAB does not pass through Parliament … in either case, implications for UK vehicle production are severe:
    - Heading towards or below 1m, a very far cry from the potential of 2m a few years ago

Bare Bones FTA for January 2021 or even an extension to transition remain possible (even if officially denied). Either of these would produce results better than a No Deal but equally still below the Base Outlook

UK car and LCV production to 2024: Three potential outcomes



- Base Outlook (**dark blue**), with EU deal/transition/zero tariffs post 2021 would see production fall to 1.3-1.4m
- WTO terms from January 2021 with no FTA agreement **(orange)** would see production boost in H2/2020 with some 2021 production pulled forward, followed by a sustained decline, with loss of new model allocations and unrestricted EU market access, to below 900k
- WTO terms from February 2020 **(dotted grey)** would see immediate production fall to c1m and probably below this in longer term
- UK production would be hit by over £3bn in tariff costs, making vehicle and component production uneconomic in many cases

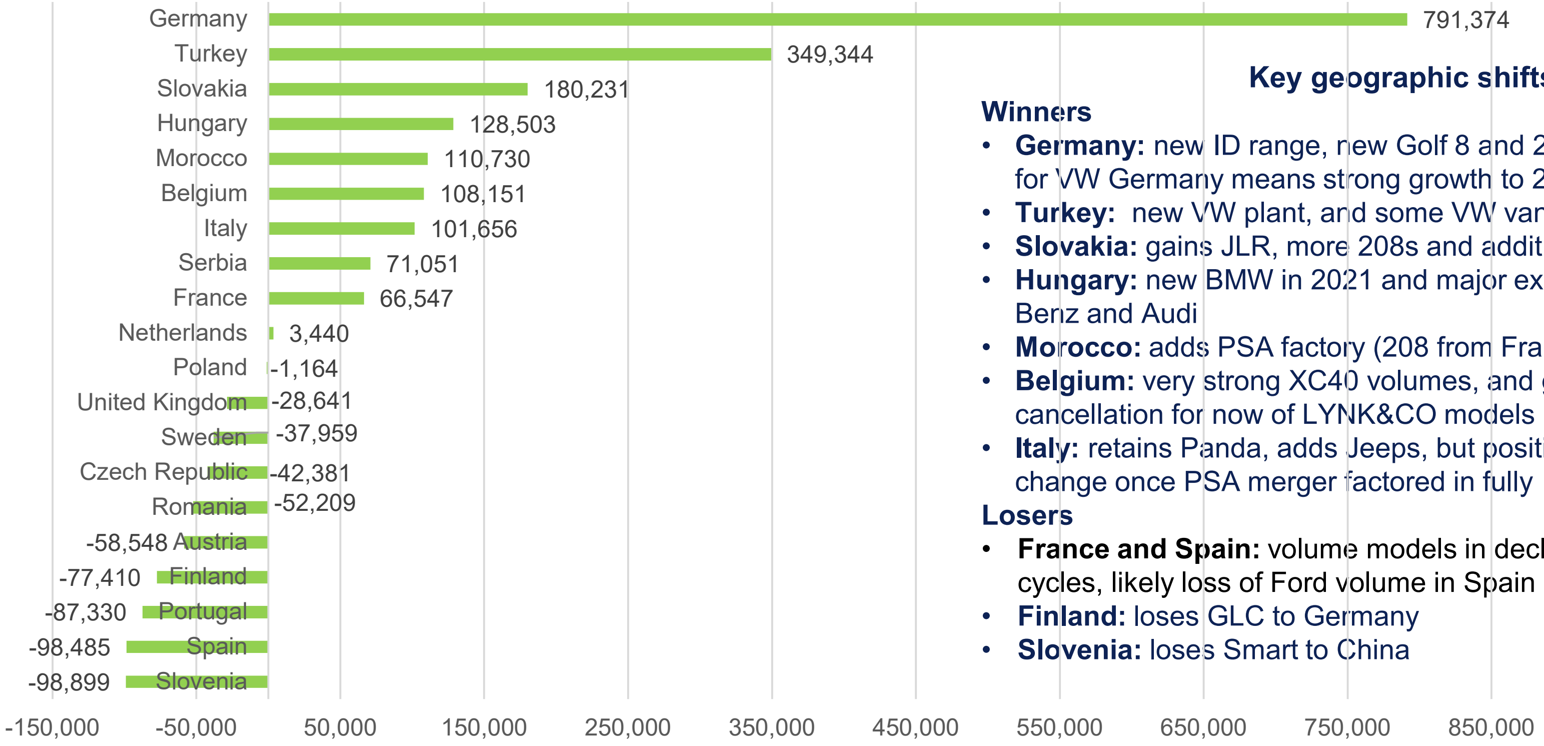
Ian Henry, AutoAnalysis
December 2019

Meanwhile in Europe

Investment in new models/plant renewals continue …

- Growth in EV product lines accelerates, especially at German VMs:
  - 3 VW factories switching to EVs
  - New plant for Passat and Skoda Superb, probably in Turkey
  - Moving some van production to Ford and taking on some van production for Ford
- PSA and FCA due to merge:
  - FCA in process of slimming Alfa range and repositioning small cars
  - PSA still optimising production network, post Opel acquisition, expanding in Morocco and France
- BMW and Mercedes expanding in Hungary; Smart brand sold to Geely, production moving to China
- Ford expanding Romanian factory, while cutting jobs in Spain, Germany and UK:
  - Will add van production in Turkey for Volkswagen and moving Spanish van production to own plant in Mexico and (probably) VW plant in Poland
- Volvo Belgium plant can't make enough XC40s
  - Geely/LYNK&Co. production in Europe postponed

Changing geography of European production 2019-2024



Key geographic shifts

Winners

- **Germany:** new ID range, new Golf 8 and 2019 being low point for VW Germany means strong growth to 2024, especially EVs
- **Turkey:** new VW plant, and some VW vans move to Ford
- **Slovakia:** gains JLR, more 208s and additional Kia volumes
- **Hungary:** new BMW in 2021 and major expansion at Mercedes-Benz and Audi
- **Morocco:** adds PSA factory (208 from France)
- **Belgium:** very strong XC40 volumes, and growth despite cancellation for now of LYNK&CO models
- **Italy:** retains Panda, adds Jeeps, but positive picture could change once PSA merger factored in fully

Losers

- **France and Spain:** volume models in decline of phases model cycles, likely loss of Ford volume in Spain
- **Finland:** loses GLC to Germany
- **Slovenia:** loses Smart to China

Ian Henry, AutoAnalysis

December 2019

Industry restructuring continues …

- **PSA should merge with FCA soon; implications for FCA brands to be determined:**
  - PSA has yet to close any plants, including at Opel, despite many operating well below normal expectations of scale …
  - How will it change tack with addition of so many Fiat plants?
  - Implications for Vauxhall plants?
- **Ford and Volkswagen JV for in LCVs in Europe and pick-ups in US:**
  - Ford will use VW MEB EV platform, on one model initially, but on more in due course
- **Renault-Nissan merger seems unlikely given recent senior management changes:**
  - Future of the Renault-Nissan Alliance, and especially broader alliance with Daimler, in question
- ***Geely has taken over Smart brand, following earlier c10% stake in Daimler***
- ***Which Chinese VMs will make next move into Europe?***
  - Who will they target?

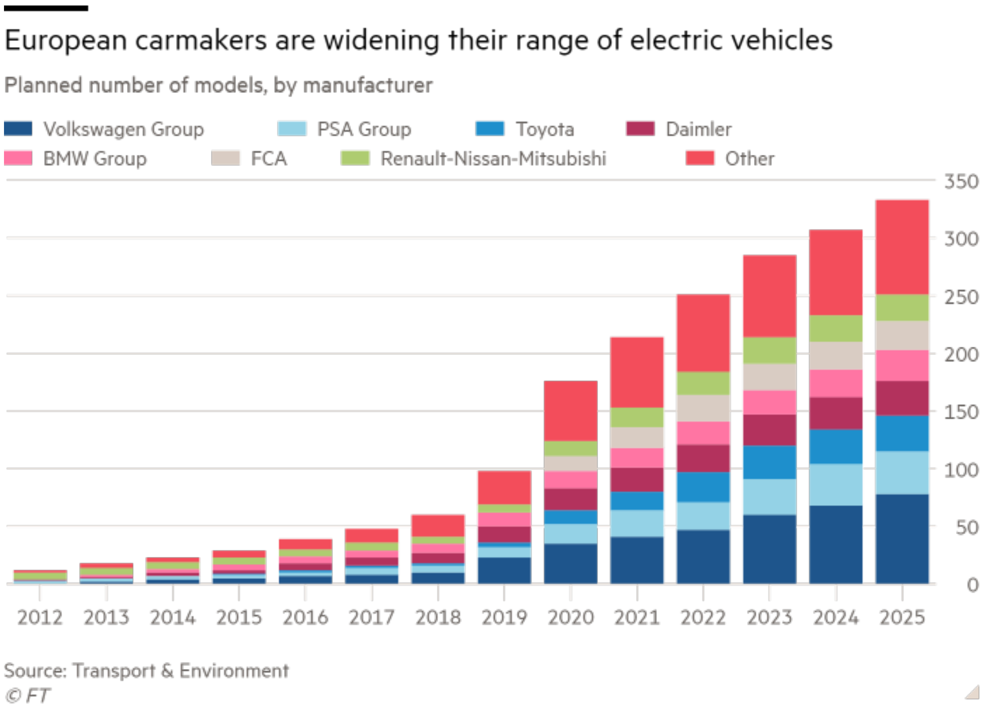
Global perspective: tariffs and trade

- UK focus on Brexit outcome understandable, but wider trade issues cannot be ignored
- Tariff “war” between US and China and US/EU remain major risks:
  – Some changes already made to production activities in China and US factories could also lose some production for China in due course
- **Impact on auto industry clear:**
  - JLR saw delayed sales ahead of tariff change but Chinese market then dipped significantly, with direct financial impact
  - Volvo changing production locations from China to Europe
  - German VMs reconsidering US model allocations…
- US-EU tariff skirmishes not entirely resolved:
- EU-Japan FTA will eventually mean zero tariffs for auto industry:
  – **Implications for UK car plants post-Brexit already clear in closure of Honda Swindon and switch of Nissan X-Trail to Japan**

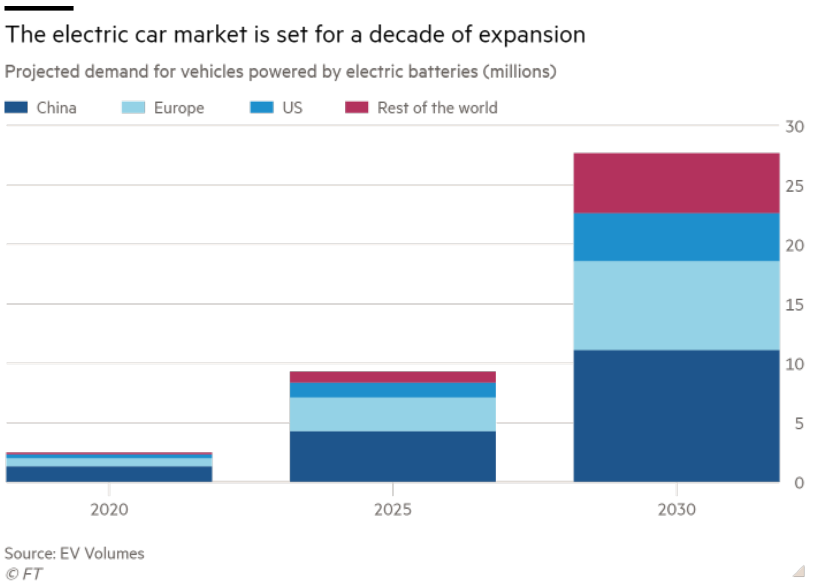
Electric vehicles: what's happening?

- **National governments "committed" to banning sales of new ICE vehicles by 2030 or 2040 or 2050:**
  - Lack of consistency between or even within countries
  - Lack of legislative commitment – general statements or lofty ambitions prevail
- **EU emissions targets effectively mandate VMs to offer EVs throughout vehicle size range:**
  - Or face multi-billion euro fines
  - EU targets mean that >7m EVs need to be in use in Germany alone by 2030 …
- **VMs committing significant sums – 40bn euros by German VMs in next 3 years alone:**
  - But VMs lose money on every EV sold … and will likely do so for some time
  - Ford will use VW EV technology – Key reason for FCA seeking PSA merger is for access to EV technology
- **2020 will be a tipping point in terms of widespread product availability:**
  - Corsa & 208; VW ID range; Mercedes EQ; full electric Volvo XC40
  - Tesla coming to Europe
- **EVs are going to transform the industry:**
  - Conventional engine and transmission plants will be redundant
  - Significant job losses inevitable – VDA expects 70,000 "in near future", 100k euros per job lost
  - Major retraining/re-skilling required
  - Switch to EVs accompanied by change in buying habits – will consumers stop buying cars and instead buy mobility solutions …

EV offering about to grow substantially ….



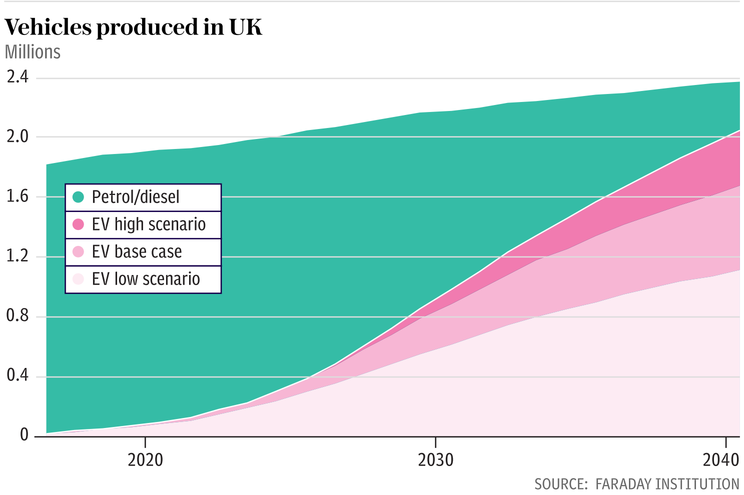
China and Europe will lead the way – meeting this demand will require massive expansion in battery making capability



Charts from: Financial Times, December 3, 2019

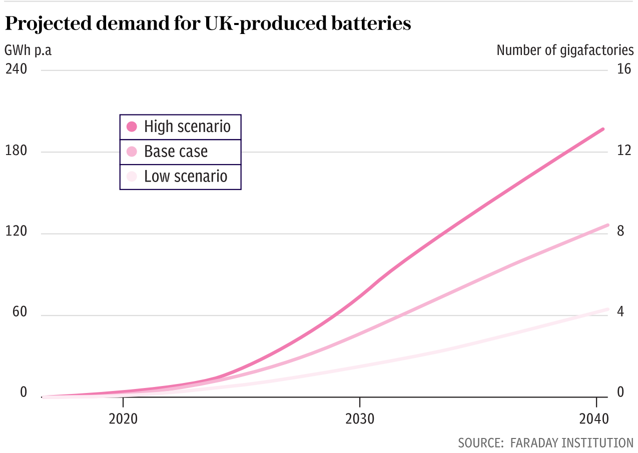
Ian Henry, AutoAnalysis
December 2019

Are EVs the saviour for UK auto production?



- *A somewhat optimistic view*
- ***Who will produce the 1m+ EVs projected here?***

- ***Who will build and operate the proposed/required battery plants?***
- ***Commentators rarely mention electric motors and attendant supply chain?***



Charts from: Daily Telegraph, October 30, 2019

Ian Henry, AutoAnalysis
December 2019

Electric vehicles: some challenges and issues to consider

- **UK is not especially well positioned to lead EV switch:**
  - Lack of major players here
  - APC and other government initiatives are well-intentioned but …
- **Major battery suppliers are Chinese, Korea and Japanese:**
  - Tesla is reliant in Asian technology
  - Does it make sense for UK to "go it alone"?
- **Building a giga factory or 2 or 3 is a good idea, if…. :**
  - There are vehicles built in the UK to use the batteries …
  - Labour plans for 3 giga factories lack market understanding …
- **What about electric motors?**
  - They are as essential to EVs as batteries …
  - But lack of attention here … electric steel production, specialist stampers, motor assemblers
- **EVs need infrastructure for consumers to switch:**
  - Charging points at home, in offices, in car parks, on streets, at motorway service stations
  - Incentives to install charging points at home
  - Power distribution network needs improvement
    - ***How much of this falls under devolved powers?***
  - Education programme to overcome range anxiety

In conclusion

- UK vehicle production is in steady decline, continuing pattern of last 2.5 years; no realistic sign of this being reversed
- Even with current Withdrawal Agreement and quick FTA. UK will do well to keep production at 1.5m pa in the long run: and probably lower than this
- Decline ameliorated by production boost from new Corolla, Evoque, Juke, PSA vans and MINI EV. **But:**
  - Most other models now in decline phases of life cycles
  - Slowdown in domestic and global export markets mean production will fall in 2019, 2020, and beyond
  - Threat of No Deal departure in January 2021 ***could*** see production boost in H2/2020, with large fall immediately after
- Major questions remain:
  - Decisions on Vauxhall Astra replacement and next MINI production allocations awaited
  - What will be made at JLR Castle Bromwich apart from electric replacement for XJ?
  - When will Brexit actually happen and on what terms for the long term?
  - Will industry get customs and tariff free access to EU?
  - How to attract investors in battery and motor production in order to make major switch to EV production in the UK?
- Optimism of 2016-17 Outlooks replaced by uncertainty and concern:
  - With a reasonable Brexit deal, 1.4-1.5m upa might be possible, but even that may be optimistic
  - Long-term volumes under WTO terms would likely fall towards 1m and probably below, accompanied by production shifts to EU locations and Japan
  - Challenges faced by UK taking place in a European or global context of major change, economic contraction and technological shift … EVs are an opportunity for the UK – but will it be taken?