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Navigating a New Reality

June 2020

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Automotive Advisory
Leveraging Analysis, Relationships and Insight Into Unique Engagements

Unparalleled combination of industry-leading SMEs, ongoing forecasts and analysis integrated into critical client engagement. Structured to drive actionable insight amidst our shifting automotive environment.
The COVID Automotive Supplier Journey

Pre-COVID
Jan - March
• Fall GM Strike Rebound
• China then EU then NA Output Ceased
• Liquidity consolidation starts

Prod Shutdown
Late March to mid-May
• System development slows
• A/R revenue continues
• Fixed costs continue
• Balance sheet fortification

Prod Restart
Mid-May to July
• PPE startup costs
• Low efficiency/ premium freight
• A/R receipts end
• Liquidity in focus
• OEMs fund most desperate suppliers

New Reality
Next 4-6 Quarters
• Erratic demand & lower utilization
• R&D reduced and rescoped
• Reduced margin renewal
• Future programs delayed/ cancelled
• Debt-burdened suppliers seek funding beyond traditional banks

Pressure on supplier liquidity will be highest in the July/August timeframe.
Navigating the Shifting Landscape – Seeking Sustainable Differentiation

Mega Tier 1s: Multiple System Capability & Global
- Multiple systems, global capability – focused on next generation differentiation
- Seeking consolidation opportunities …
  - Expanding capabilities into EV and AV adjacencies
  - Strengthening ‘systems’ capability in key sectors
  - Exerting leverage & global capability

Midsize T1 & 2: Super-regional or Solo multi-region
- Limited system capability, major region coverage or significant regional player
- Searching for optimal channel strategy as markets evolve …
  - Lack multi-system leverage and true global capability
  - Possible strategic lethargy – difficult to pivot
  - Seeking sustainable differentiation and channel strategies

Small & Start-up: Specialty Players
- Specialists - Closely-tied to a specific capability – with limited capital risk
- Able to pivot quickly …
  - Lack of inertia – can shift to new sectors/capabilities
  - Ability to assume higher risk profiles
  - Multiple channels strategies are possible

Small/mid-market suppliers are most exposed to liquidity/debt service issues through the balance of the year
Supplier Strategy - Post COVID

Suppliers Re-Evaluate Their Position

1. Take Stock
   - Trajectory of current/sourced programs
     - Volumes, timing, scope changes, capital commitments
     - Enterprise risk review
   - State of your competitive set
     - Fiscal position, OEM sourcing deck status

2. Intersect New Market Dynamics w/Capabilities
   - Key takeover and re-source opportunities
   - Weakened competitors, JV and acquisition possibilities
   - M&A into new sectors, vertical integration or geographies

*How to differentiate, build margin & reduce risk?*

New Focus – New Strategy

- Options to build/sustain margin amid risk reduction?
- How will regulatory and market shifts alter strategy?
- Competitive, customer & system analysis – Finding long-term differentiation?
- Impact of production co-location & globalization

Capital & Enterprise Risk

Relevance

ICE to BEV, L0 to L3
The COVID-19 virus pandemic will depress global output throughout 2020

Global real GDP and industrial production

Source: IHS Markit © 2020 IHS Markit
# Real GDP growth in major economies

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</tbody>
</table>

* Fiscal years starting 1 April

Source: IHS Markit

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Crude will begin to recover when demand revives and production is cut

We expect a record decline in world oil demand of 10.3 million barrels per day (MMb/d) in 2020. In response, crude oil prices fell to below USD20/barrel in May.

On 12 April, major oil-producing countries agreed to cut output by 9.7 MMb/d and manage supply through the demand cycle.

A massive supply surplus has materialized in the 2nd Qtr, when global demand will be more than 20 MMb/d below its year-earlier level.

Strong rebound in China and US is supporting prices through June.

Source: IHS Markit

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Global Production Output Scenarios

Scenario-based Strategy
- Significant shifts in competitive sets, upstream supplier viability and financial structures
- Success is driven by differentiation, scale improvement and reducing enterprise risk
- Less is more – suppliers which focus on fewer sectors/systems – striving for technology and cost leadership
- Electrified propulsion will continue – transition from ICE to Hybrid to BEV
- Regulatory regimes will be highly variable.
Top OEM Cooperative Groups by Production Volume 2020 vs. 2025

OEM Partnerships Enable Greater Scale, Risk Reduction and Cost Savings

- Toyota maintains strong domestic OEM partnerships
- VW & Ford: EU scale & AV
- R-N-M alignment redefined
- FCA & PSA drive scale
- GM & SAIC GM & Honda EV
- GM & Honda EV
- VW & Ford: EU scale & AV
- Geely & Volvo consolidate
- BMW & JLR e-motor JV
- Better relations w/Daimler
- Tata (JLR) urgently seeking partners
- Collaboration with GM

Global Production Volume

Millions

Toyota/ Suzuki/ Mazda/ Subaru
VW
Renault/ Nissan/ Mitsubishi
PSA/FCA
Hyundai
GM & SAIC
Honda
Ford
Geely
Daimler
BMW
Great Wall
Changan
Tata
SAIC
Capacity Utilization Becomes Critical

- Weakness which started in China in late 2018 has continued into 2020 with COVID. Rebound through 2024 will not be sharp – consolidation required.
- Europe pullback in 2020 driven from COVID is significant, utilization improvement occurs with rationalization.
- North America dips below 70% in 2020 though the rebound into 2024 will be muted by new capacity by German and Asian OEMs.

Normalized Capacity rates all facilities at 8 hours, 2 shifts and 235 days no matter what the working pattern is.
Production Outlook: Europe – Light Vehicle
Recovery quickly gives way to saturation

- Trends
  - Uncertainty within EU about further destabilization – Hard Brexit and slow growth
  - Export under pressure due to regionalization of supply
  - Currency neutrality and focusing more resources on BEVs for the EU will pressure volumes (affordability)

- Mid-term Shifts
  - Localization will remain a competing trend to exports; Shift of volume to Middle East and Central/Eastern Europe - expansion
Production Outlook: China – Light Vehicle

Trends
- 2020 will be the third straight year of declining volume for China – off 26% from the peak of 2017.
- Top 5 OEMs declined as a group by 15% last year – next five – only 10%.
- Western OEMs using their financial resources to drive near-term volume.

Long-term
- The number of domestic OEMs is likely to decrease as winners emerge and scale rises in importance.
- Long-term growth opportunities remain strong – A significant opportunity for vehicle sales growth exists in still “untouched” regions within China.
US light vehicle sales
Inventory self-correction amid COVID-19 related shutdowns

Inventory update
- Inventory to Sales Index
  - May 2020: -3.1%
  - COVID-19 shutdowns from retail to production affecting inventory
- Inventory: May 2020
  - Stock: 2.63M units or 62 days’ supply
  - Inventory/Sales Ratio: 2.35
  - Y/Y: -1.25M units or -32.2%
  - M/M: -676K units or -20.4%
- Inventory levels decreased despite US sales falling 30.1% in May 2020
- COVID-19 related shutdowns led to inventory self-correction in two months
- Stronger production needed across a variety of products and segments
US: Since 2010 fleet has averaged 2.6m units, pandemic having disproportionate impact on rental demand

Fleet outlook by sector

CPI used car/truck not showing price impact yet

Source: IHS Markit © 2020 IHS Markit
North American Production Scenarios

- **Optimistic (20%)**: Stimulus measures and low interest rates improve vehicle affordability in North America and boost demand.
- **Pessimistic (30%)**: Renewed lockdowns cause US sales to slip 10% versus baseline or about 1.3m units in 2020.

**Global Production Volume**

- Pre-COVID
- COVID Impact
- Post COVID

- Millions
- Global Production Volume

- Optimistic (20%)
- Base (50%)
- Pessimistic (30%)
NA Production: Monthly Volumes are Highly Variable – Supply Then Demand

- In 2019, Q1 & Q2 each accounted for 26% of output. 2020 H1 volume is forecast to be off 41% from 2019
- June and July volumes come back quickly – inventory issues emerge in 4Q for several vehicles.
Despite an expectation of ~4 mil fewer units produced in 2020, slower economic activity, increased debt and a lack of fleet volume will impact 2021.
North American Light Vehicle Production Outlook
Demand Dictates a Slow Climb Towards a New Norm

North America Light Vehicle Production

COVID Resets The Market
- Capacity utilization, risk mitigation and shifting priorities dominate
  - Incentives rise
  - Fleet volume unavailable short-term
  - Consolidation is possible
- OEMs favor well-capitalize & global suppliers in critical sectors
- Component localization (especially from China) to rise
- Export share declines & S/CUVs approach 50% share of production by 2024.
North America – Program Launch by OEM

OEMs delay several launches into 2021 – restage several launches over the mid-term

Launch Definition: New Region+OEM+Platform+Program Combination
Electrified Propulsion in the POST-COVID Era

North America

- New ‘SAFE’ emissions structure calls for a 1.5%/yr stringency rate vs. ~5% for ‘CAFE’.
- Lower oil and affordability reduces BEV rate with a more positive HEV and PHEV forecast.

Europe

- Electrified propulsion forecast largely unchanged as little relief expected for CO2 compliance
- Most electrified propulsion investment considered safe

China

- CAAM may loosen CAFC/NEV credit requirements and delay new emissions standards to 2021
- EV incentives may be extended to 2022
North America Autonomous Sales Forecast

North America Autonomous Technology outlook

- NA has higher penetration for Autonomous technology compared with global levels.
Summary

- The rebound from COVID will be slow and regionally even in this multi-speed world.
- Growth in electrified propulsion and ADAS will continue albeit at adjusted speeds driven by reduced capital.
- Already emerging as an issue pre-COVID, capacity utilization and risk mitigation is front and center.
- Number of launch opportunities is declining though content integration rises – propulsion, safety and ADAS.

Consolidation of OEMs and suppliers will accelerate
Thank You

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Thank You