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M&A Views

Deloitte M&A Views podcast:
Driving performance: The future of automotive M&A

Transcript

Greg Jarrett: Welcome to Deloitte M&A Views, a Deloitte podcast series exploring the latest trends and topics in mergers and acquisitions (M&A). I'm Greg Jarrett. Today we're discussing M&A activity in the automotive industry, specifically around the automotive ecosystem. The industry has seen a blurring of traditional industry lines. We'll explore how new entrants are transforming the industry and how companies can position themselves for success in this new environment. We're joined by Marc Holzer, a partner with Deloitte & Touche LLP and Deloitte's M&A practice, and Neal Ganguli, a principle with Deloitte Consulting LLP and leader of the automotive supplier practice. Gentlemen, thanks for taking the time with us today.

Mark and Neal, the topic of M&A in the automotive industry and the transformation we're seeing around the future of mobility seems to be causing a major shift—and that's putting it lightly. Let's take a high-level look at the automotive industry and how M&A is playing a role. Marc, how about you give us your thoughts first?

Marc Holzer: I think you nailed the circumstances of today quite well. There's really a historically high level of M&A, partnership activity, and collaboration activity in the automotive marketplace right now. We're seeing disruption everywhere. Traditional roles, the hundred-year relationship between the vehicle manufacturers and the supplier, is being disrupted. Internally, from the suppliers themselves, from new entrants—primarily from the technology industry—and the original equipment manufacturers (OEMs) themselves as they try to develop new business models based on the notion of mobility and services, as opposed to just selling vehicles. From the traditional automotive supplier perspective, we're also seeing continued consolidation around certain vehicle segments, like in automotive interiors, and a continued effort and focus within the supplier community to build scale on a global basis to meet their customers' needs.

I think the other really interesting thing that we're seeing lately is the effect of electrification and electric vehicles. A number of large suppliers have announced plans to split themselves apart, in effect putting part of their business that's focused on supplying internal combustion engines and transmissions in one silo and the piece that's agnostic to that in another. Also, you've seen a number of governments—China and most recently the UK and France—announce plans to potentially phase out the internal combustion engine. I think these type of macro trends will really have a profound impact on strategic choices for a number of suppliers.

Obviously, the elephant in the room is the impact of new entrants, particularly from the technology industry, trying to stake out a piece of the automotive value chain. We've seen multi-billion-dollar acquisitions in the past year, as traditional technology players have tried to enter the automotive supply chain. So in short, I think the game, the rules, the players, and the scoring are all changing very rapidly in the automotive ecosystem.

Greg Jarrett: Interesting and complex, Marc. Let's get back to the players on this. Back to the end of the horse and buggy and the evolution of the auto industry into just the few key players we all recognized in the 20th century. Now we're way past that. It has been upended extending well beyond those traditionally in the space. Neal, what does all this mean?

Neal Ganguli: So right now, the industry lines are blurring, and a lot of new players from technology, from the chemical space, and so on are getting into the automotive value chain that we know and are wanting to own pieces of the value chain that probably will create new opportunities for themselves, as well as for other players in the industry, including traditional suppliers. We've already seen new suppliers emerge that challenge traditional conventions in areas like electronics, software, and service spaces. To give you a few examples: connected services, cyber security, data analytics, and so on. New players are starting to form partnerships, not only with other players from outside the industry but also the traditional suppliers, as well as with OEMs themselves, to reshape the value chain and the content platform ownership. Given the proliferation of software that is going on and is going to continue—in fact, I would say exponentially increase.

The new entrants sometimes bring different capital structures and operate at different paces. You're aware of how electronics move in days and weeks, versus the automotive value chain or the automotive product development cycle that move in years. On top of that, these new players often hold huge cash reserves, which they have been willing to spend to acquire companies, to acquire talent. And these kinds of strengths may help them flourish in the segments where they want to own. I think, in addition, they bring a different mindset to the product development cycle. In many respects, we're looking at the electronic and software agile product development cycle to come and meld in with the traditional linear three-to-five-year automotive value chain and product development cycle. We believe there's going to be a melding of the two, but we're going to have to see how these players evolve and attack these complex issues.

Greg Jarrett: Mark, listening so far, I'm thinking back to my first car. And the biggest thing I was concerned about was if the water pump was going to go out in the middle of the road. Now I'm worried about all sorts of other complex things. So, could you help me? Could you be more specific about where all these players are coming from and what they're bringing to the table?

Marc Holzer: I think there's an overall set of strategic considerations and strategic implications, particularly for the incumbents, to think about with all these moves. First, just thinking about it from the perspective of a traditional supplier. As I mentioned earlier, global scale and size are becoming more critical than they ever were. The ability to leverage R&D, SG&A costs, and product development costs over a large revenue base will be key to a supplier's success.

If you go back to the time when you were worried about your water pump, 15 or 20 years ago, the play was a supplier conglomerate, individual suppliers supplying components all over the vehicle. Now the play is focus, size, and scale. And with that, that drives an ability—on the part of the suppliers who figured that out—to deliver high-quality components around the world in a very cost-competitive manner. That's going to be tough to deal with if you're not making those moves from a strategic perspective. Now shifting outside of the traditional supply base, I think the entrance of these new competitors, particularly from the technology industry, brings an even broader set of disruptive capabilities. I think first, the R&D and engineering capabilities are substantial and significant. Designing software and electronics is what they do, and it's what they do well.

Second, we all know the financial capability these firms bring, unencumbered by a legacy industrial base, is significant. Certainly the average technology company has more financial capital and wherewithal than the typical automotive supplier. Competing in a financial race with these players will be difficult.

Third, I think they bring a knowledge of consumer preferences and a connection with the consumer that the typical automotive supplier may not have. They also have an ability to rapidly shift business models to meet demand. Again, not something that's been required historically in the automotive value chain. I think probably more important, they're eager to play. As I talked about earlier, we've seen billions of dollars in capital deployed by these companies to enter automotive. They're aggressive. They see value in playing in automotive. And I think given all these dynamics, they'll be formidable competitors.

I think the other area to think about, just in terms of the ecosystem, is around startups. We talked a little bit about things that aren't in the vehicle now but will be in five years. Or things that are here now that weren't five years ago—whether it's around battery technology, connected vehicles, new methods of selling services into the car. The impact of startups, and their ability to disrupt and take share, is something that shouldn't be underestimated.

So in short, the playing field is crowded. There are a lot of opportunities. There are a lot of challenges. From the standpoint of being a traditional player in the ecosystem, a traditional automotive supplier, or even an OEM, there's a lot of looking over your shoulder to see who's coming after you. So it's a tough place to be and a very competitive field.

Greg Jarrett: Well, we've got a lot of information coming in here. We've heard a lot of opportunity for growth. But along with that, a lot of disruption to the industry continuing to impact how companies can stay competitive. So Neal, is there one thing, or one group of things, that automotive suppliers should be focusing on?

Neal Ganguli: We recently released our third global automotive supplier study, where we look at exactly that question: What will drive future performance? We've done this study over the last decade, and looking at the last decade, the top performers tended to follow strategies that are cost focused and improve profitability and cash flow, product portfolio leadership, market focused R&D investments, and so on. Looking to the future, we've identified some how-to-win strategic choices to consider for suppliers.

Now while this cost focus is going to be key to be able to create the capital to invest at higher growth segments in innovative businesses for the future, suppliers can execute a variety of strategies, many of which include M&A as well, to win in the future. Such as suppliers in the traditional segments could go at look at scaling up and consolidation. We've seen a number of companies do that. There are traditional players that go and partner and acquire new technologies to be able to shape or move into new business model ecosystems that are emerging. Overall, there's a move from a very asset-heavy company, and particularly we need to think about how much capital it takes to run businesses. This is a very asset-intensive business historically, but we see that changing.

In fact, referring back to that third global study, we see that 70 percent of the value created in shareholder value over the last decade are by companies that are relatively more asset light. So dealing with this capital intensity, either by scaling up or consolidating, or acquiring or partnering with new talent and new companies that bring the services and new business models, is going to be key for the suppliers to think about.

Greg Jarrett: Marc, with the blurring of industries, competitive market, and the high M&A activity, can you summarize what we should be prepared to see out of all this?

Mark Holzer: I think the next five years, and certainly the next decade, are going to be incredibly exciting in the automotive ecosystem. So if you come back to today, and if you're a supplier or an OEM, you really have two challenges. One, you need to adapt to the future. You need to figure out what it is, and you need to develop the capabilities and skillsets needed to win in this undefined environment. But you also have to deal with reality of your business today.

We all know automotive is cyclical. Volumes have been on the rise for the last decade, but they're slowing. So a lot of the traditional issues, capacity, fixed costs, the need to maintain vehicle volumes both for the OEM and the supplier, capital requirements, regulatory pricing, those are all still here. And they all still need to be dealt with. But at the same time, these companies need to deal with the entrance of large technology companies, startups, and developing strategies for new business models. So I think with all this happening at the same time, it's really a fascinating time to be in and around the automotive and mobility ecosystem. We can all sit back and see what happens over the coming years.

Greg Jarrett: Thanks, Neal. And thank you, Marc. We've learned an awful lot today. Deloitte's put together a brief presentation on some of the many services offered in the automotive sector.

I'm Greg Jarrett. Thanks for listening to Deloitte M&A Views, sponsored by Deloitte's M&A Institute. For more information around insurance M&A, download the latest report at www.deloitte.com/us/insurance-ma-outlook. We also release new podcasts regularly, and if you subscribe, you won't miss a single one. To stay connected and receive more information on Deloitte's M&A service offerings, visit www.deloitte.com/us/MAsubscribe, and follow us on Twitter @DeloitteMnA. Until next time.