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Industry Update

IAA Cars Conference – Feedback and post summer update

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The industry spreads optimism heading out of summer break

We hosted a broad range of OEMs, suppliers and tire companies at the IAA Cars Conference in order to discuss key messaging for the sector coming out of summer break. In general, we observed optimism across all sub sectors – although there is obviously some deviation in regional trends and margin developments. Demand for OEMs still seems solid, AutoParts production trends are largely in line with expectations (aside from the impact of a potential UAW strike and the flooding in Slovenia) and for tires, pricing is still sound, with the first improvements being seen in passenger car replacement volumes. We came away encouraged that trends are actually better than what current share prices reflect – although we acknowledge potential macro risk ahead.

Key OEM feedback: An encouraging return from summer break

We hosted several European and Chinese OEMs for fireside chats in order to discuss the market environment and trends coming out of summer break. Overall, we received an encouraging confirmation of messages ahead of the summer, with trends also being in line with guidances (apart from a potential UAW strike and supply chain issues from the flooding in Slovenia). The key messages were that volumes are slightly weaker sequentially (but following the usual seasonality), new car pricing remains strong (and partially moving higher while residuals continue to normalize), the mix is largely unchanged and the order backlog easily covers 2023 sales for most OEMs. September remains the most important month in the quarter, so Q3 is not done and dusted yet, but trends warrant some cautious optimism. Overall, despite soft macro data, the first message from OEMs is rather constructive post summer break. Of the OEMs present today, we believe that RNO sent the most bullish message on the near-term earnings outlook, while VW was perhaps the most cautious regarding Q3 messaging (albeit stating that it is in line with expectations). Mercedes generally confirmed positive trends. Outside of RNO, BMW gave the most optimistic impression for Europe, stating that overall order intake (and even more so for BEVs) is up by double digits y/y.

Key AutoParts feedback: some prod. vol., but overall trends in line with targets

Apart from the impact on volumes from a potential UAW strike in North America and the impact of flooding in Slovenia on European production rates, the post-summer-break restart is well in line with expectations ahead of summer. In some cases, momentum in China is improving again in Q3, while others are witnessing in-line trends. Production volatility has picked up slightly (due to the effects mentioned above), but for now, it remains quite manageable. Following the usual seasonality, Q4 margins are expected to be above those of Q3. Hence, the overall year remains back-end weighted. Inflation recovery discussions remain tough, but most suppliers have closed out the majority of negotiations ahead of the summer. It seems that recoveries for BEV-related components and systems have been easier to achieve, while ICE-related recoveries have been tougher to negotiate. Overall, however, all suppliers are on track to hit their recovery targets. We expect limited change in trends for the sub sector, but we sense general optimism for 2023 and margin potential heading into 2024.

Key Tires feedback: first signs of replacement improvement, pricing holds

During the conference, messaging on Tires has been sound and supportive of our view that tiremakers should enjoy a decent 2023 overall. According to management comments, as dealer orders increase, the first signs of an improvement in replacement demand have been seen within pass car tires. Moreover, sell out continues to trend above sell in, which is seen as an indication that sell in rates should improve as soon as inventories are normalized. Moreover, pricing remains sequentially stable in premium tires, and there is little to no pressure to change the pricing policy, despite falling raw material prices. In our view, this points to a decently positive net price to cost in H2, and it is quite supportive for earnings. Regarding truck tires, the recovery is expected to come with a delay, but we believe that this could provide a tailwind heading into 2024. Overall, we confirm our positive view on tiremakers.

Key takeaways by company

BMW

We hosted a fireside chat with Ritu Chandy, Senior Vice President, Finance & Group Treasurer at BMW. Here are our key takeaways:

- **FY23 guidance:** Orders were rather strong in Q2, and that trend continued in July and August. In order to fulfill this demand, inventories had to be increased amid supply bottlenecks (e.g., ports in Mexico, truck drivers in the US and train capacities in Germany). Moreover, some capex planned for 2024 was pulled forward to this year – although the capex peak is still expected in 2024. These two factors were the main reasons for the lower FCF guidance. Post 2024, BMW strives to return to the 5% capex target.
- **Used cars:** A quadruple-digit dollar gain is still being made on every car that returns in the US, and used cars are delivering a positive result per unit in Europe as well. The inventory level in the US is less than 20 days, far below the industry average at 45 days.
- **Demand** was described as rather robust – especially in the US. The X1 saw very good momentum in Europe, and the new 5 Series has had a good start. The order bank will carry the company well into 2024.
- **China:** Localizing the long version of the X5 has been an important model for the market in terms of volumes and profitability. The new 5 Series will be launched in October. The price war in the EV segment (with prices below 200k RMB) continues, shedding a negative light on the premium EV segment.
- **Q3:** The company seemed rather confident heading into H2. Q3 seems fair, while Q4 will depend a bit more on China. Logistic costs could be higher, while lower lithium prices are a tailwind and FX a drag.
- **Neue Klasse:** With the Neue Klasse, the X1 will be the entry model for BEVs, (i.e., no electric 1 series). BMW will switch from prismatic to cylinder cells, which should increase range and charging speed by 30% and overall energy density by 20%, with a 50% cost reduction. BMW will use LFPs (lithium iron phosphate batteries) for the entry segment.
- **Contribution margin and EBIT margin parity:** The Neue Klasse targets contribution margin parity for ICEs and BEVs in 2028/2029. EBIT margin parity is instead a question of scale, and it will take time for the entire BEV portfolio to be in place.
- **BEV share:** BMW was confident about its targets (15% in 2023, 20% in 2024 and 25% in 2025). With the launch of the i5, the company will have a BEV in every relevant segment. In 2030, it aims to have a 50% share (likely getting there earlier). The Neue Klasse should play a fundamental role achieving this target.
- **Industrial net debt:** The industrial business is generally debt-free, and it is cash generating. The debt raised on capital markets is specific for the FinCo. The company ensured that it has a three-month runway as a safety net (which amounts to c.EUR 20bn). The industrial net cash figure is also relevant for the rating agencies.
- **Warranties:** Ms. Chandy made it clear that the warranty accounted in H1 was a non-recurring effect, and that it should be done now.

Continental

We hosted a fireside chat with Christian Kötz, CEO of Continental Tires. We took away a decent message on pricing as well as an incremental positive on passenger car replacement volumes. Our key takeaways are as follows:

- **Volumes:** Pass car replacement volumes recorded an initial improvement in August, while truck tire replacement volumes are still lagging. Sell out is still trending above sell in, pointing to decent fundamental demand. Dealers have started ordering again, as inventory levels in the channel are normalizing.
- **Pricing:** Due to indexation clauses, OE pricing will come down in H2-23, following the trend in raw materials. On the other hand, replacement pricing is trending flat, and there is no pressure on premium pricing currently, as the market is acting rational. Hence, net price to cost should be a positive in H2-23.
- **Raw mats:** As indicated with the reduction of the company's cost headwind guidance in Q2-23, the headwind of raw material price inflation is easing. Raw mats should turn into a tailwind by 2024 at the latest.
- **Margin ambitions:** During times of inflation, the focus has been on absolute EBIT generation, as the company's margin had been diluted by the pass through of inflation. The relatively wide margin target range has proven to be reasonable in recent years, but the clear ambition going forward is to improve margins and outperform industry peers again. Management is confident of being able to reach a EUR2bn absolute EBIT number in the near term.
- **ContiTech synergies:** Currently, synergies between the two divisions are especially purchasing related. The Automotive part of Contitech is seeing a shift from rubber-based materials to other materials, which is weakening synergies currently being generated between the divisions. That said, in the case of a disposal of that part of the business, dyssynergies are small and would not impact the tire business much.
- **BEV tires:** BEV tires are seen as an opportunity for premium tiremakers, given technical challenges that are difficult to master. The technical requirements are driving OE adoption, and currently, the OEMs are largely focusing on premium tiremakers. Overall, BEV tires are seen as mix-positive.
- **Automotive Technology:** inflation recoveries are continuing, and they remain tough. Moreover, the focus remains on long-term price adjustments over one-time payments.

Forvia

We attended a group meeting with Olivier Durand, CFO of Forvia. We took away a confident message on H2 margins and 2024 earnings improvement potential. Our key takeaways are as follows:

- **UAW and flooding impact:** Management is monitoring the situation closely, and it will implement immediate actions in case of a strike, such as stop of purchasing, temporary leave of staff and via trying to seek compensation for any volumes/revenues lost. The Big 3 US OEMs in North America account for about 12% of group revenues. Any volume impact in Europe is currently tough to assess, but the impact is expected to be only moderate, as there is catch-up potential.
- **Current trading:** Momentum in July and August was a continuation of pre-summer momentum. China is tracking OK so far in Q3, and overall, management expects to see the usual seasonality of the quarters. Some pricing is still yet to come through, which also supports outperformance and margins in H2. Overall, however, Forvia remains somewhat more cautious than the latest IHS numbers.
- **Disposals:** Hitting the EUR1bn target and closing the respective transactions should be achieved in the coming month. Management sees potential for more disposals until 2025.
- **2024:** Earnings improvements should be driven by synergies with Hella, resolving Highland park, raw mats easing and logistical costs coming down. On the other hand, there will likely be a headwind from wages and energy, which the company will try to pass through to OEMs (to the extent possible).

Mercedes-Benz

We hosted a fireside chat with Mercedes CFO Harald Wilhelm. Here are our key takeaways:

- **Product update:** Mercedes unveiled the CLA concept, which will be the first model on the new entry level MMA (Mercedes Modular Platform). The range was stated with over 750km (WLTP), thanks to very efficient energy consumption of 12kWh per 100km. The vehicle features an 800V architecture, enabling 250 kW DC charging, allowing the addition 400km within 15 minutes. The digital brain of the car will be MB's proprietary MB.OS system, which is generally ready for SAE Level 3, although the initial model will have L2 capabilities.
- **Demand** was described as being in line with expectations, as China and the US are stable, while Europe saw a bit of a seasonal slowdown. Management reiterated that September is the most important month in Q3. The sales momentum in H1 should translate to H2. The latter will benefit from the launch of the all-new E-Class as well as a better GLC availability.
- **Pricing:** The softening in used cars is in line with guidance and expectations, and not a cause for concern. MB still expects a triple-digit €m EBIT contribution this year, compared to a quadruple-digit contribution last year. Management reiterated that it will accept lower volumes in order to maintain pricing.
- **ASP:** Considering the new model launches, a higher customizing share and lifted prices in the entry model, the company expects to further increase ASPs. The TEV and the new AMG platform will also offer new opportunities for new models.
- **Agency model:** The market roll-out across Europe was executed without major disruptions. Customers will gain more transparency, and dealers will benefit from lower inventory risks. This should help with ASPs, and the company will likely host an event next year to provide more color on this.
- **Order book**: A bit of scarcity is beneficial, and Mercedes targets to remain a 2m+ unit sales company. Waiting times for the entry and core should be reasonable, while this could be a bit longer for TEV's. 2023 sales volumes are essentially covered by the order book, which is also lasting into 2024.
- **The MMA platform** is not margin-dilutive. Hence, it will support double-digit margins. Heavily dilutive models have been cut from the portfolio. The Level 3 take rate was stated as being decent, despite the absolute number of vehicles still being rather small.
- **China:** MB could consider exporting from China as well, but it is unlikely to partner with a Chinese OEM to use their platform (similar to Audi and VW). ICE demand is still healthy, and MB will not push EVs into the market.
- **Balance sheet:** Net industrial cash sits at €25.8bn post Q2, and management stated that the company could be run with much less, even on a net debt basis. Management shares the view that cash inside the company is currently not properly reflected in market cap.

Renault

We hosted a fireside chat with Renault's CFO, Thierry Piéton. Here are our key takeaways:

- **Demand** in Europe is seasonally low in Q3, but it should improve in September, post summer break. That said, the order backlog is still elevated, and it should normalize early in 2024 with easing supply chain and logistic issues.
- **Order intake** should be supported with new models launches. While the Megane has a market share of 2.5% in the European EV market, new models will be placed more in core markets which target higher market shares.
- **H2** should be stronger than H1 due to new model launches and ongoing cost reductions supporting the margin. The CFO stressed that this is not reflected in the current consensus. For **2024**, consensus is below 2023 expectations, which, in the company's view, should also not be the case with the introduction of 12 new models.
- **Models:** Although the new models might have lower ASPs (depending on the model), this should support the company's mid-term margin target via cost reduction in the organization. The CFO stressed that the 40% cost reduction until 2027 is a linear process that should be observable in all coming models.
- **Chinese OEMs** entering the European market are observed closely. However, the company is confident that it will be competitive due to strong vehicle content, but also due to cost reduction programs, as well as having a full ecosystem in place (including an attractive aftermarket and financing options).
- **Suppliers**: Negotiations with suppliers on cost compensations are still ongoing, but the CFO underlined that discussions are "far away for the targeted 80% by the suppliers".

Schaeffler

We hosted a presentation and fireside chat with Matthias Zink, CEO of Schaefflers Automotive Technologies division. We took away a confident message on H2 margins and the flexibility of the footprint to address volatility in ICE and BEV customer take rates. We took away the following key messages:

- **UAW and flooding impact:** Schaeffler is actively looking at the situation, both in North America and Europe, and it is actively preparing countermeasures.
- **Current trading:** Management stressed that the mood is positive, and that volumes across the globe are trending in line with its plan. China is finally showing more activity in Q3. With regard to margins, management stressed that it should be a solid H2-23, as pricing will help to some degree and outperformance is improving – although on the negative side, wage increases are kicking in. We take this as a sign of comfort that the margin profile of H2-23 should not be drastically different from that of H1-23, with potential upside in case volumes actually catch up faster and if the aforementioned risks do not materialize.
- **EV business:** The order intake ambition of EUR2-3bn was confirmed again, and management indicated that Q3 already marks a decent step forward toward the target. A precise year for the break-even of the EV business was not provided, but this is clearly the focus. Currently, investments are still very high, but they will fade going forward (as R&D, for example, is coming down). Management was firm on not accepting orders below a critical margin, and Schaeffler is not buying business or accepting loss-making contracts.
- **Footprint structure:** Schaeffler's footprint is relatively flexible for switching from ICEs to EVs and back (if needed), as some of the machines can be used for both. Aside from that, the powertrain-agnostic business does not need to change overproduction if the mix changes. The company will continue to work on the cost structure of the business and optimizing its footprint for future setup.
- **Product portfolio:** Management is continuously reviewing the portfolio for additions and potential disposals. For now, there is nothing that Schaeffler would actively seek to dispose, but there is also nothing that the division would actively seek to buy to broaden its regional reach or portfolio.

Valeo

We attended a group meeting with Thierry Lacorre, Investor Relations of Valeo. The company confirmed the guidance and trends communicated with the Q2 release. Our key takeaways are as follows:

- **UAW and flooding impact:** For Valeo, North America-based revenues make up 18% of the group, and about 60% of that is linked to the Big 3 US OEMs. While the impact is currently tough to assess, Valeo will seek to implement measures right away in order to lower cost of operations. There was no dedicated comment on the European supply chain's impact on financials, but the company is working to source from other suppliers where it is directly impacted.
- **Current trading:** Outside of the above, volumes are trending well in line with company comments from the H1-23 earnings release. Stated outperformance will increase in H2-23, but it will be below the adjusted number shown in Q2-23.
- **Inflation recoveries:** There is still a small number of customers missing where negotiations are not yet closed, but discussions are progressing.
- **High voltage:** Growth rates will slow in H2-23 due to the base effect, but also as volumes of a customer are trending below initial indications. However, absolute revenues will also be up sequentially. That said, Valeo stressed that the business is well on track to hit mid-term revenue targets. Moreover, the company sees decent project opportunities in North America. Near-term growth will be driven mostly by Europe and China, while North America will contribute at a later stage.
- **Disposals:** Valeo is looking to reach the EUR500m target by year-end.

Vitesco

We hosted a fireside chat with Thomas Stierle, CEO of Electrification Solutions, and we took away an encouraging message on the EV momentum, for both orders as well as margin trajectory. Our key takeaways are as follows:

- **UAW and Slovenia flood impact:** Vitesco sees a high likelihood of a strike in the US, but the magnitude remains uncertain. The company is actively taking measures to prepare for any potential impact. It is applying insights from previous strikes, and it views the cost base in North America as relatively flexible compared to that of Europe. The impact of supply chain issues from the flooding in Slovenia should be relatively minor, and for any production stoppages, there is an opportunity to catch up on volumes later.
- **Volumes:** Aside from the two aforementioned issues, the business is trending as expected, post summer break. There is a slowdown in PHEVs, which is well in line with expectations. Growth in BEVs remains strong overall, as is reflected in the company's guidance/business plan.
- **Inflation recovery:** Discussions with OEMs are ongoing, but the majority has been fixed by now. There is a clear focus on sustainable price hikes (which has been more difficult to reach an agreement on, compared to one-time payments). EV-related recoveries seem to be somewhat easier to negotiate, also due to business volumes compared to ICEs. Negotiations are on track to hit the recovery target.
- **Order intake:** The company pointed to strong EV order intake in H2, and Q3 should show a strong run rate as well. Hence, Vitesco confirmed its goal to reach an EV order intake level that is roughly in line with that of 2022. Management clearly steers order intake by margin, as the books are decently already filled for the mid-to-long term. The current backlog is well spread across regions, systems versus components, as well as customers. Taking a certain haircut to OEM volume indications, the current backlog easily supports the company's mid-term margin ambitions.
- **Electrification margin trajectory:** The Electrification business is on track to hit a high-single-digit gross margin in Q4-23, due to efficiency efforts and scaling up volumes. Management was very firm on its ambition to hit break-even in 2024, helped by scale as well as R&D efficiencies. Moreover, a positive cash contribution is expected to be reached 1-2 years after the earnings break-even.

Volkswagen

We hosted a fireside chat with VW CFO Dr. Arno Antlitz. Here are our key takeaways:

- **Demand:** July and August unit sales were in line with the updated guidance. Inventories peaked in June and have since improved. The current order book in Europe stands at 1.55m units, which will carry the company into next year. BEV orders in August were described as rather soft.
- **Supplier disruption:** Due to a supplier issue in Slovenia, VW's production could be impacted to the tune of around 100k vehicles.
- **Balance sheet:** Management views VW's balance sheet as a strength. A sound balance sheet is supporting the business.
- **China:** VW plans to gain speed and reduce costs by cooperating with Chinese OEMs (especially for the SUV B segment).
- **Pricing:** VW has increased prices by 3-4% for ICE models, which should positively impact P&L in about six months. Residuals are trending ok, and they continue to normalize, but this is not concerning.
- **2024:** Market estimates call for up to 5% y/y volume growth next year. VW could grow in line with the market. There will be a normalization of incentives, not comparable to that of 2019, but higher versus the last two years.
- **Model momentum:** The new Audi Q6 on the PPE (Premium Platform Electric) has been unveiled, and the electric Porsche Macan could follow soon. Another key model for the VW brand will be a new VW Passat.
- **Q3** is trending in line with expectations. The margin could be at the lower end of the guidance, but this is due to the seasonality of the quarter.

Xpeng

We hosted a fireside chat with Vice Chairman and Co-President, Brian Gu. Here are our key takeaways:

- Price competition will remain intense, but the company is starting to see the market consolidate as weaker OEMs give up or run out of capital (from hundreds to dozens); we believe that the EV landscape will have structurally fewer players than the ICE landscape.
- The G6 ramp-up is progressing well, with production increasing MoM and a healthy order book, on track for deliveries of 10k/month in 4Q
- The key technological advantage is not only about performance, but rather driving down cost (e.g., putting an advanced ADAS system in a RMB 250k car); the company is aiming to reduce BoM 25% by the end of 2024, including 50% lower ADAS hardware costs.
- VW is a deep collaboration, using the G9 platform and tech stack; high-margin tech service revenue will start next year, with economics being driven by volume in 2026/beyond.
- The company is not aiming to sell the XNGP (ADAS) system to a lot of OEMs. Instead, its focus is on cultivating close partnerships with industry leaders (i.e., avoiding being a Tier-1 supplier).
- The Didi deal leverages the existing, low-cost, A-class, RMB150k platform where ~$1bn has already been spent over the past three years; Didi has incentive to funnel big B2B volume through its ecosystem, and its initial target is >100k units/year
- The vehicle margin will certainly be weak this year, due to legacy models selling for a negative margin, but we see several drivers of improvement going forward (volume, mix, VW's TSR revenue stream, structural cost reduction).
- The company plans to sell cars in Germany next year, starting with three models (P7, G9, G6).

Estimate changes for Suppliers & Tiremakers

With this note, we update our models for AutoParts and Tires in light of Q2-23 results and the latest market data. Our key forecast changes are as follows:

Figure 1: Estimate changes 2023/2024

	TP old	TP New	Rec old	Rec	DB EBIT 2023e old	DB EBIT 2023e new	% Change	DB EBIT 2024e old	DB EBIT 2024e new	% Change
Auto Suppliers										
ElringKlinger	**8.0**	**8.0**	**Hold**	**Hold**	**94**	**102**	**8%**	**125**	**125**	**0%**
FORVIA	**27**	**27**	**Buy**	**Buy**	**1,562**	**1,620**	**4%**	**1,930**	**2,014**	**4%**
Gestamp	**4.5**	**4.5**	**Hold**	**Hold**	**736**	**752**	**2%**	**879**	**902**	**3%**
Plastic Omnium	**18**	**18**	**Hold**	**Hold**	**385**	**400**	**4%**	**485**	**485**	**0%**
TI Fluids Systems*	**145**	**145**	**Hold**	**Hold**	**163**	**193**	**18%**	**213**	**231**	**8%**
Valeo	20	20	Hold	Hold	750	753	0%	1,095	1,095	0%
Vitesco Technologies	78	78	Buy	Buy	312	312	0%	516	516	0%
Tiremakers										
Michelin	**40**	**40**	**Buy**	**Buy**	**3,220**	**3,392**	**5%**	**3,635**	**3,754**	**3%**
Nokian Tyres	**9.0**	**9.0**	**Hold**	**Hold**	**73**	**75**	**3%**	**93**	**99**	**7%**
Pirelli	**6.0**	**6.0**	**Buy**	**Buy**	**1,002**	**1,011**	**1%**	**1,073**	**1,073**	**0%**

Source : Deutsche Bank estimates

Appendix 1

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*Other information available upon request

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TSR = Total Shareholder Return. Percentage change in share price from current price to projected target price plus projected dividend yield

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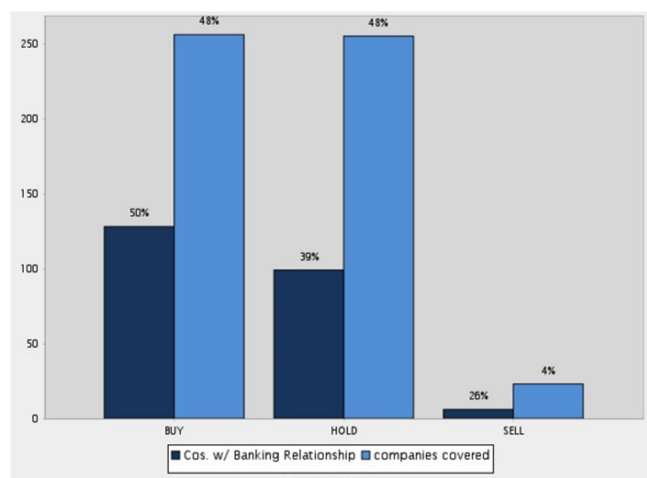

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