ATLANTIC
FINANCIAL GROUP

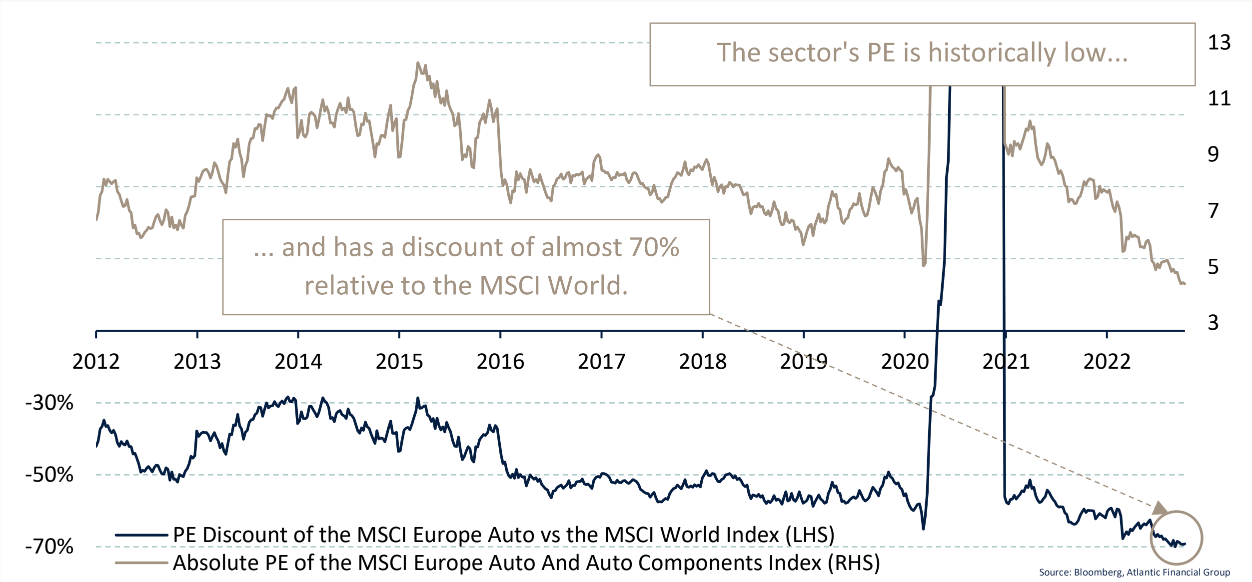
Weekly Investment Focus

17 October 2022

"UNITY MAKES STRENGTH"

- Porsche enters the race against Ferrari as a luxury brand
- Alliances between manufacturers help to avoid stalling in the face of multiple challenges
- There are many motivations: cost reductions, innovation and sustainability
- Is the sector ready for the next crisis?

CHART OF THE WEEK: "The sector discount reflects investors' fears".



STOCK MARKET ANALYSIS

The automotive sector has massively underperformed the market since the beginning of the year, down 28.6%. Most manufacturers are even showing a correction of around -30%, with the Stoxx Europe 600 Automotive index being offset by Renault's remarkable performance of +0%. Despite the sector headwinds, Volkswagen has raised funds through the IPO of its Porsche subsidiary. Can changes in scope and alliances bolster an industry in turmoil?

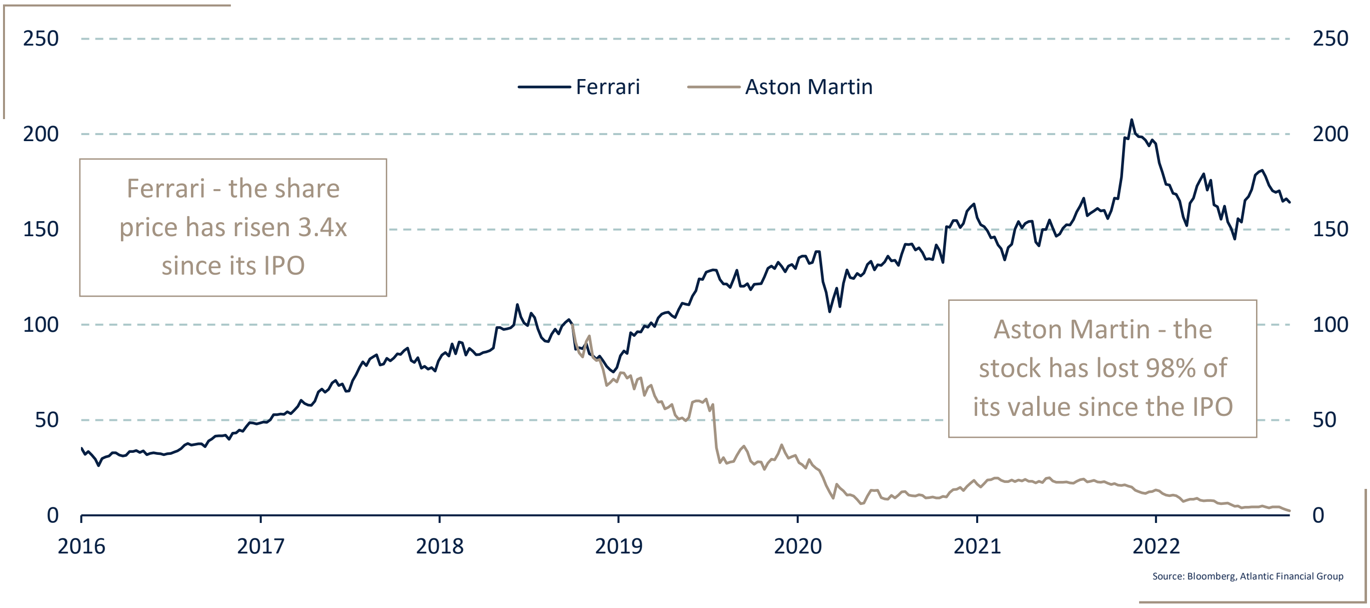
◆ Porsche enters the race against Ferrari as a luxury brand

Following Porsche's IPO, the luxury car sector now has one more listed player. What are Porsche's chances of joining Ferrari in pole position or risking a near miss like Aston Martin? **This niche sector shows divergence in terms of valuation and stock market performance** (see Fig.2). Ferrari is down 30% and Aston Martin is down 82% year-to-date (-98% since its IPO in October 2018!). Porsche is trading at 15x 2023 PE compared to over 34x for Ferrari. In terms of EV/EBITDA, the gap is even wider with multiples for 2023 of 5.8x for Aston Martin, 7.9x for Porsche and 17.6x for Ferrari.

The luxury car sector, like the rest of the industry, is moving towards greater sustainability and the production of electric vehicles, which requires heavy investment. Porsche and Ferrari have committed to investing in electric models, while keeping their beloved combustion engine models for as long as possible. **Part of the cash generated by the Porsche IPO will be used to finance Volkswagen's transition to electric vehicles.** The rest will be returned to shareholders in the form of a special dividend.

These transformations are costly, and this is what is currently weighing on Aston Martin's share price, which is burning cash month after month. **In addition to the transition to electric cars, the brands are facing an exceptionally difficult context following the Covid-19 pandemic, supply issues and pressure on margins due to raw material and wage inflation.**

Fig. 2 - The post-IPO pathway may diverge within the same sector



The brands have very different marketing strategies. Ferrari has focused exclusively on expensive sports cars, raising prices and limiting supply, a hallmark of the luxury business. Porsche, on the other hand, has expanded into the more affordable market and embarked on a major expansion of sports utility vehicles (SUVs), pushing sales above 300,000 units sold per year, close to Jaguar and Land Rover. Sales of its Taycan electric sports car alone are four times Ferrari's total annual deliveries.

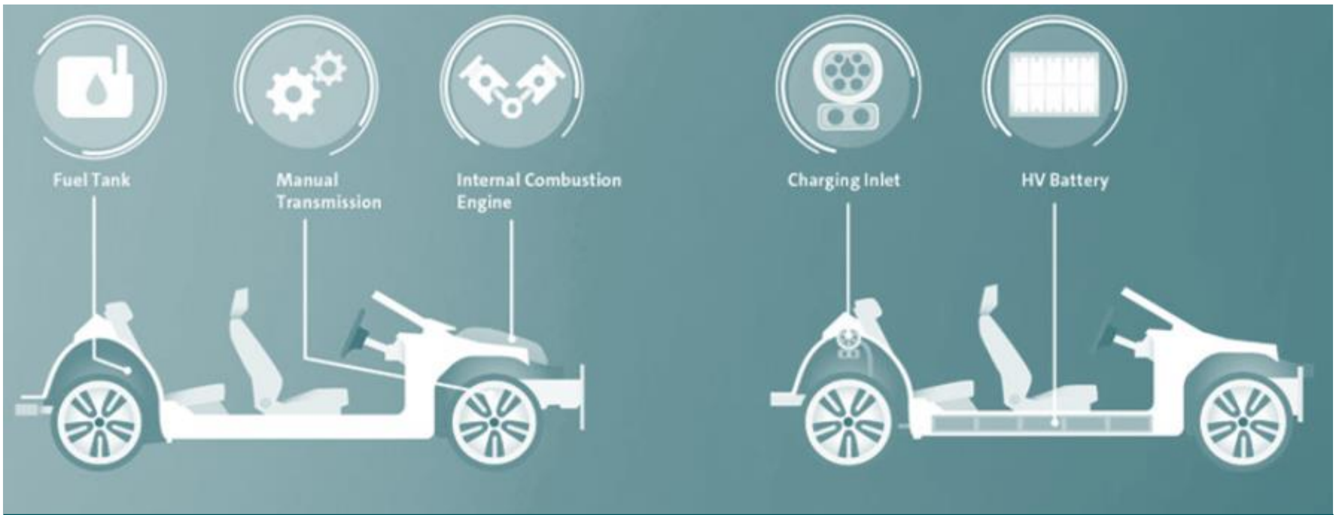
These differences have implications for the profitability of the companies. Porsche is aiming for a profit margin of 20% in the long term (16% in 2021), which is much lower than Ferrari's 25% in 2021. The Italian manufacturer claims to increase this margin even further by 2030.

In terms of governance, the Porsche group remains closely linked to Volkswagen, sharing the same CEO and relying on the Volkswagen group for certain projects. For example, Porsche already had to postpone the launch of the electric version of its Macan SUV due to delays in software development but separating from Volkswagen would mean paying compensation and starting from scratch. Ferrari is completely independent of Fiat and the Agnelli family and is developing in a Hermes-like fashion, justifying high valuation multiples.

♦ Alliances between manufacturers help to avoid stalling in the face of multiple challenges

In the 1980s and 1990s, the automotive industry evolved from a multitude of independent companies to a handful of global consortia. The intensification of the price war led manufacturers to ally with each other to gain access to technology, global markets and to achieve economies of scale. In this context, **capital-intensive and risky mergers and acquisitions have given way to strategic alliances.** These have focused primarily on building common platforms to reduce costs. Indeed, **of the most expensive elements to design, the platform is certainly the most pricey.** The platform, the basic structure of the car, is composed of a chassis (a rigid structure to which all the components of a vehicle are attached) and some non-visible parts. Platforms vary according to the type of energy that powers the car (see Fig. 3).

Fig. 3 - Automotive platforms



An e-car doesn't require a large combustion engine, manual transmission or fuel tank.
Some things are added such as a HV Battery and Charging Inlet. This alters the production.

Source: Image courtesy of Volkswagen AG, Atlantic Financial Group

A car model with an internal combustion engine, an electric motor or a hybrid does not share the same platform but three distinct platforms. The cost is therefore considerable for manufacturers who choose to make the energy transition. It is therefore easy to understand why some manufacturers, such as Toyota, have concentrated, perhaps wrongly, on hybrid models, ignoring the all-electric model, which requires yet another different platform.

Competition between brands is intense but working together allows them to take on larger projects and shorten their timelines. The aim is therefore often to share costs, innovate and strengthen the companies' balance sheets. Examples of major alliances include Renault/Nissan, Fiat/Chrystel, Hyundai/Kia and Toyota/Tesla (see Fig. 4).

Fig. 4 - Table of selected alliances

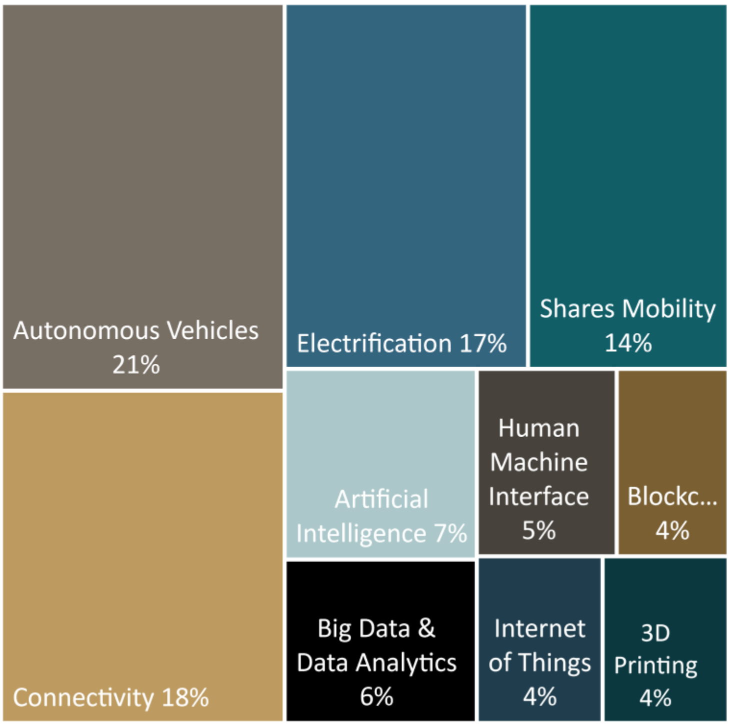
RENAULT- NISSAN	RENAULT-GEELY	HYUNDAI -KIA
In 1999, Renault bought a 43% stake in Nissan and Nissan bought a 15% stake in Renault. This cross-shareholding led to a collaboration to produce similar platforms and powertrains or to share manufacturing facilities. Mitsubishi joined this alliance in 2016. Today, this Alliance needs to be revisited. Nissan is pressuring its partner Renault to reduce its stake in the Japanese carmaker from 43% to 15% as much as possible. These demands were made in exchange for Nissan agreeing to invest in Renault's new unit being created to house its electric vehicle (EV) assets.	In January 2022, Geely and Renault had jointly announced a new collaboration to offer an all-new range of hybrid electric vehicles (HEV) and internal combustion engine (ICE) models for the South Korean market as well as for export. The new products will use Geely's Compact Modular Architecture (CMA), while leveraging Geely Group's advanced hybrid powertrain technologies. Renault will contribute its advanced technologies and expertise in design and customer experience.	Hyundai holds a 38% stake in Kia and the two companies form the Hyundai Kia Automotive Group. In the late 1990s, Kia was facing bankruptcy when Hyundai stepped in. Hyundai then turned a competitor into an ally, with the two companies sharing platforms, powertrains and production capabilities as needed. Together, the two companies are now the world's fourth largest automaker by volume.
FIAT-CHRYSLER / STELLANTIS	**FORD-VOLKSWAGEN**	**TOYOTA-MAZDA**
In 2009, when Chrysler was threatened with closure, Fiat stepped in to save the American automaker. Strategic changes allowed Chrysler to not only survive, but to thrive by taking advantage of Fiat's platforms to build new cars.	Starting in 2019, the two automotive giants, Ford and Volkswagen Group, announced that the duo will start making pickup trucks and commercial vans together for the global markets. Additionally, the two companies are also exploring collaborations on autonomous and electric vehicles as well as new mobility services.	Last year, Mazda and Toyota entered into a business and financial alliance aimed at creating new types of value for future mobility, including electrification and connectivity projects. Toyota took a 5% stake in its much smaller rival.

Source: Image courtesy of Volkswagen AG, Atlantic Financial Group

♦ There are many motivations: cost reductions, innovation and sustainability

Companies are striving to stay on top of the latest technology trends through a range of ecosystems, alliances and collaborations. These new combinations often involve players from outside the automotive world, such as Silicon Valley start-ups or semiconductor companies, **who bring new skills.** They allow car manufacturers to **accelerate the development of autonomous driving, electrification and mobility as a service - and to share the huge financial burden that this entails** (see Fig. 5).

Fig. 5 - Top 10 trends and innovations in 2022



Source: StartUS Insight, Atlantic Financial Group

Unusual relationships are being created such as BMW/Spotify playing music in vehicles, Jaguar/PayPal/Shell partnering to offer in-car fuel payments, or Audi China, through its FAW-Volkswagen joint venture, cooperating with Alibaba, Baidu and Tencent in the areas of data analytics, vehicle internet platforms and intelligent urban transport.

The consumer trend to view mobility more and more as a service makes it even more difficult for manufacturers to differentiate themselves. Today, if car ownership is still a mode of identity expression, tomorrow the vehicle on demand as a service will become more of a commodity.

Finally, the **industry's commitment to sustainability involves the entire value chain: manufacturers, dealers, suppliers, services and aftermarket retailers.** This is why networks of automotive suppliers and technology companies are coming together to address challenges such as supply chain issues, secure data transfer and management, industry electrification including vehicles and charging stations, battery life cycle management and sustainable business practices that reduce carbon footprints. Companies cannot manage the whole cycle alone; they need industry collaboration to develop effective long-term solutions.

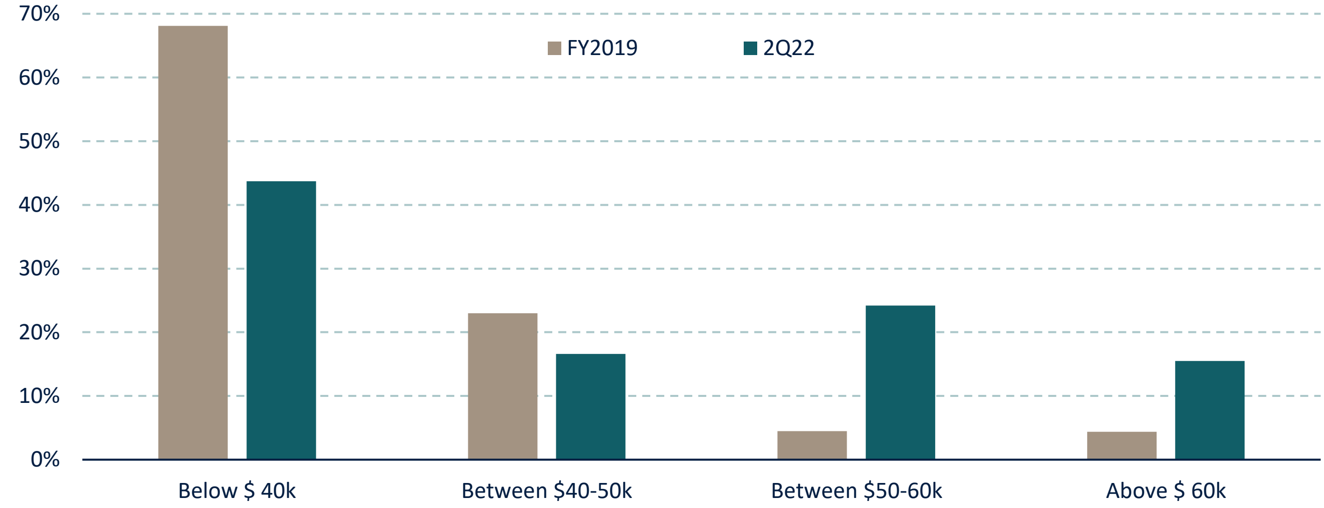
♦ Is the sector ready for the next crisis?

With the risk of recession increasing, investors have shifted away from cyclical sectors such as automobiles. **Stocks are already trading at deep discounts to their historical valuation multiples** (see chart of the week).

The industry is engaged in a costly energy transition while maintaining an obsolete production system of internal combustion engine cars. Surprisingly, this transition and **the shortage of electronic components has allowed many brands to change their product mix and sell more higher value cars,** such as electric cars, pick-ups and SUVs (see Fig.6). **Sales volumes have declined but margins have increased.** It is likely that the sector will continue to play on this picture to mitigate the effects of the crisis. The sector remains sensitive to both demand and cost pressures, particularly raw materials and energy.

Consumers are beginning to suffer from inflation and rising interest rates. If inflationary pressure becomes too strong, repayment of car loans or the writing of new loans could dwindle, putting pressure on finance services companies owned by the automobile manufacturers.

Fig. 6 - Distribution of US vehicle sales by price range



Source: Company Data, Edmunds.com, Bloomberg Intelligence, Atlantic Financial Group

Conclusion:

The sector remains sensitive to economic downturns as competition from China intensifies. Valuations already seem to reflect the most alarmist outlook, with historically low multiples. Adapting, investing in the future and joining forces is the way forward to a sustainable automotive industry - for the climate, workers and investors too.

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2022 Year-to-Date (%)	2021 (%)	2020 (%)
Equities							
World (MSCI)	552.1	35.67	-1.9%	-9.2%	-25.5%	19.0%	16.9%
USA (S&P 500)	3 583	38.04	-1.5%	-9.1%	-23.9%	28.7%	18.4%
USA (Dow Jones)	29 635	44.43	1.2%	-4.8%	-17.1%	20.9%	9.7%
USA (Nasdaq)	10 321	34.57	-3.1%	-11.9%	-33.6%	22.2%	45.0%
Euro Area (DJ EuroStoxx)	369.8	43.81	0.1%	-6.1%	-20.4%	23.5%	0.8%
UK (FTSE 100)	6 859	34.93	-1.9%	-5.6%	-4.2%	18.4%	-11.4%
Switzerland (SMI)	10 329	45.22	0.2%	-3.8%	-17.5%	23.7%	4.3%
Japan (Nikkei)	26 749	50.11	-0.1%	-1.9%	-4.1%	6.7%	18.3%
Emerging (MSCI)	863	31.90	-3.8%	-10.2%	-28.0%	-2.3%	18.8%
Brasil (IBOVESPA)	112 072	48.18	-3.7%	1.4%	6.9%	-11.9%	2.9%
Russia (MOEX)	1 951	34.75	5.2%	-15.5%	-44.3%	21.9%	14.8%
India (SENSEX)	58 171	49.12	-0.5%	-4.0%	0.5%	23.2%	17.2%
China (CSI)	3 839	43.19	1.0%	-5.4%	-20.6%	-3.5%	29.9%
Communication Serv. (MSCI Worl	68.04	32.06	-2.5%	-10.5%	-37.6%	10.9%	24.2%
Consumer Discret. (MSCI World)	269.5	28.61	-4.1%	-13.9%	-33.7%	9.2%	37.0%
Consumer Staples (MSCI World)	240.6	34.44	0.3%	-6.2%	-15.8%	11.7%	8.8%
Energy (MSCI World)	222.8	51.78	-2.3%	-3.7%	23.0%	37.5%	-27.7%
Financials (MSCI World)	117.3	40.19	-0.6%	-7.6%	-19.8%	25.1%	-3.1%
Health Care (MSCI World)	308.4	45.47	0.4%	-3.3%	-15.3%	18.0%	15.4%
Industrials (MSCI World)	245.5	38.15	-1.1%	-8.2%	-24.7%	16.6%	11.8%
Info. Tech. (MSCI World)	366.0	34.12	-3.6%	-11.7%	-35.7%	27.6%	46.2%
Materials (MSCI World)	269.6	38.61	-2.3%	-7.9%	-23.3%	15.4%	21.6%
Real Estate (MSCI World)	155.3	25.68	-2.8%	-15.9%	-32.1%	23.6%	-5.7%
Utilities (MSCI World)	132.1	27.69	-2.6%	-16.7%	-16.6%	11.1%	4.8%
Bonds (FTSE)							
USA (7-10 Yr)	3.98%	31.51	-0.9%	-4.2%	-16.1%	-2.4%	9.3%
Euro Area (7-10 Yr)	3.11%	32.78	-0.8%	-4.9%	-18.8%	-2.9%	4.5%
Germany (7-10 Yr)	2.35%	29.94	-1.3%	-4.7%	-16.9%	-2.7%	3.0%
UK (7-10 Yr)	4.34%	35.09	-0.3%	-8.4%	-21.6%	-4.9%	5.4%
Switzerland (7-10 Yr)	1.39%	43.04	0.3%	-2.0%	-12.3%	-2.3%	0.4%
Japan (5-10 Yr)	0.25%	41.59	-0.2%	-0.2%	-1.4%	0.0%	-0.1%
Emerging (5-10 Yr)	9.05%	23.59	-2.0%	-6.6%	-25.0%	-2.3%	5.2%
USA (IG Corp.)	5.97%	27.64	-1.6%	-4.9%	-19.9%	-1.0%	9.9%
Euro Area (IG Corp.)	4.50%	26.98	-0.4%	-3.4%	-15.5%	-1.0%	2.8%
Emerging (IG Corp.)	9.25%	17.68	-1.7%	-5.3%	-20.9%	-3.0%	8.1%
USA (HY Corp.)	9.70%	34.82	-1.1%	-2.8%	-14.5%	5.3%	7.1%
Euro Area (HY Corp.)	8.97%	29.29	-0.6%	-3.7%	-15.0%	3.4%	2.3%
Emerging (HY Corp.)	12.90%	25.76	-1.9%	-6.4%	-21.7%	-3.2%	4.3%
World (Convertibles)	342.0	32.62	-2.2%	-6.7%	-22.0%	2.4%	38.8%
USA (Convertibles)	460.4	33.43	-2.7%	-7.3%	-22.4%	3.1%	54.5%
Euro Area (Convertibles)	3 379	36.34	-0.2%	-4.1%	-17.7%	-0.3%	6.1%
Switzerland (Convertibles)	169.4	45.01	0.5%	-0.6%	-8.9%	-0.5%	0.5%
Japan (Convertibles)	198.8	53.64	0.0%	-0.4%	-1.0%	3.3%	2.8%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	728	58.41	n.a.	-0.7%	n.a.	8.2%	6.4%
Distressed	935	59.44	n.a.	-0.5%	n.a.	12.5%	3.8%
Event Driven	744	50.07	n.a.	-2.5%	n.a.	12.9%	7.0%
Fixed Income	381	50.18	n.a.	-0.8%	n.a.	5.2%	3.6%
Global Macro	1498	79.07	n.a.	2.0%	n.a.	9.6%	6.5%
Long/Short	828	48.41	n.a.	-2.7%	n.a.	8.3%	7.9%
CTA's	421	76.35	n.a.	3.5%	n.a.	8.2%	1.9%
Market Neutral	284	54.99	n.a.	-1.0%	n.a.	6.2%	1.7%
Multi-Strategy	691	58.78	n.a.	-0.4%	n.a.	7.0%	5.6%
Volatility							
VIX	32.02	58.87	2.1%	22.4%	85.9%	-24.3%	65.1%
VSTOXX	29.77	51.86	-0.5%	13.4%	54.5%	-17.6%	67.5%
Commodities							
Commodities (CRB)	558.2	n.a.	-0.2%	-2.4%	-3.5%	30.3%	10.5%
Gold (Troy Ounce)	1 652	41.06	-1.0%	-1.4%	-9.7%	-3.6%	25.1%
Oil (WTI, Barrel)	85.61	48.00	-6.1%	-3.2%	11.2%	58.7%	-20.5%
Oil (Brent, Barrel)	92.16	49.15	-7.3%	-2.9%	17.9%	51.4%	-23.0%
Currencies (vs USD)							
USD (Dollar Index)	112.89	57.84	-0.2%	2.8%	18.0%	6.4%	-6.7%
EUR	0.9749	44.41	0.5%	-2.7%	-14.3%	-7.5%	9.7%
JPY	148.73	23.81	-2.0%	-3.7%	-22.6%	-10.2%	5.1%
GBP	1.1282	50.46	2.1%	-1.3%	-16.6%	-1.0%	3.1%
AUD	0.6240	30.92	-1.0%	-7.2%	-14.1%	-5.6%	9.6%
CAD	1.3823	36.75	-0.3%	-4.1%	-8.6%	0.7%	2.1%
CHF	1.0021	36.97	-0.2%	-3.8%	-8.9%	-3.0%	9.4%
CNY	7.1971	26.70	-0.6%	-2.7%	-11.7%	2.7%	6.7%
MXN	20.007	52.38	-0.2%	-0.4%	2.6%	-3.0%	-5.0%
EM (Emerging Index)	1 584.2	31.89	-0.8%	-2.5%	-8.7%	0.9%	3.3%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)

DISCLAIMER