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# All time record profits! So why are investors so worried about the auto industry?

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**See Disclosure Appendix of this report for important Disclosures and Analyst Certifications**

# You've never had it so good!

## The historic perception

- The auto sector is historically low margin, incredibly capital intense, value destructive
- State influence, family influence, poor investment decisions, cyclical and volatile
- Most long standing investors have had bad historic experiences and lost money in these stocks
- 'Early cycle' stocks – buy them when in financial distress, ahead of upturn - then sell quickly

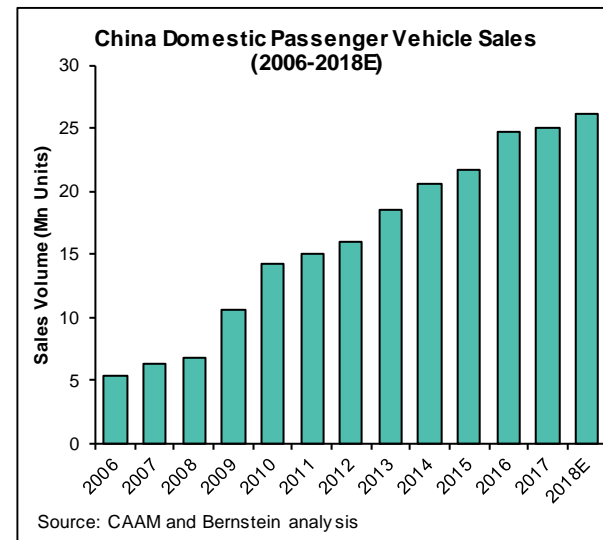
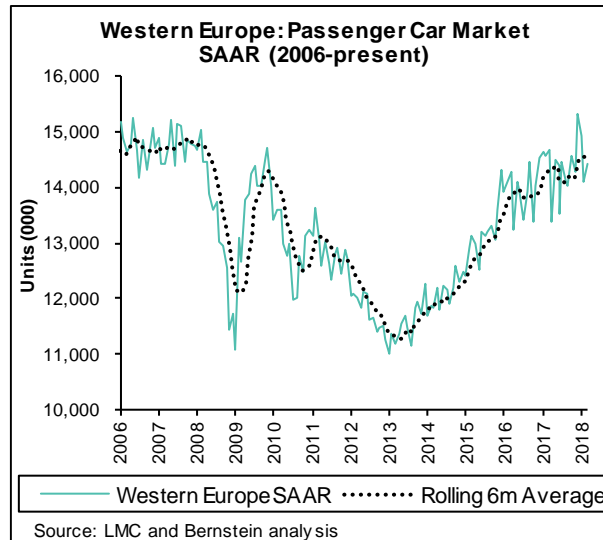
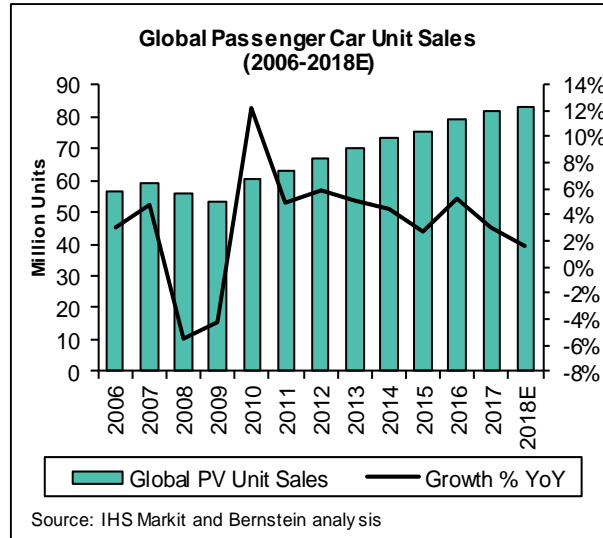
## The reality this decade

- One of the longest periods of economic expansion in history (9 years and counting)
- US industry restructured in 2008-09 – reset pricing; European industry also subtly reshaped
- China: like finding another planet on which to sell cars, totally transformed many OEMs' economics
- OEMs far more focused, more capital disciplined

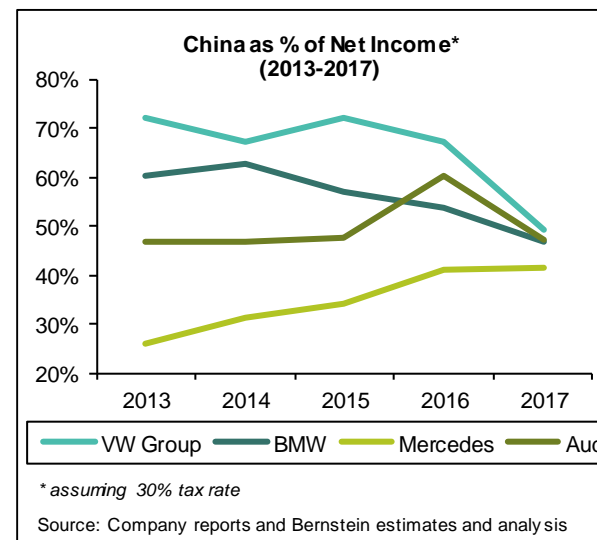
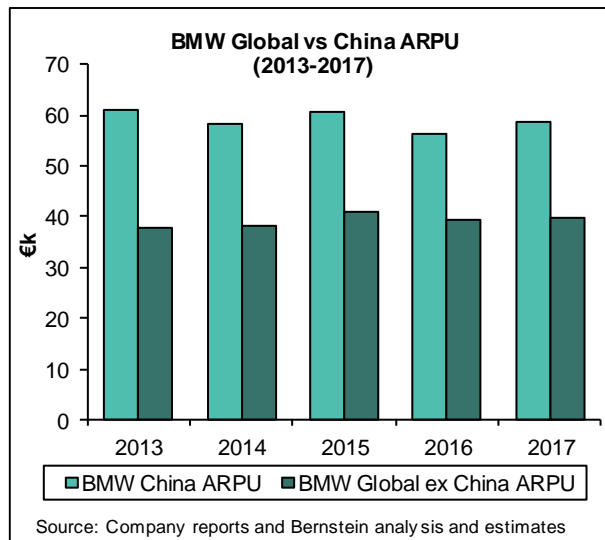
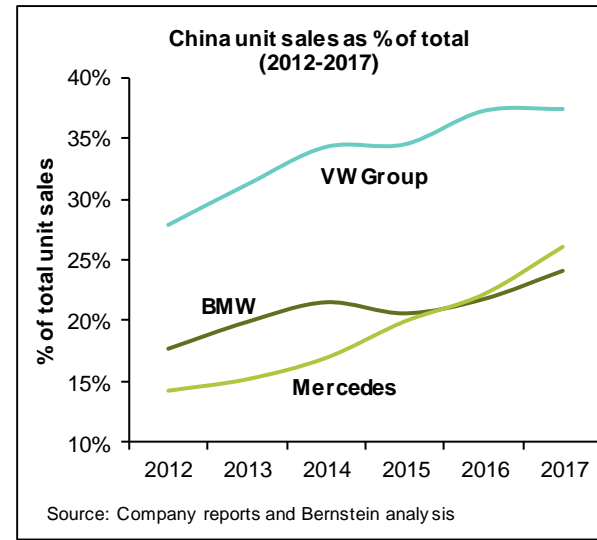
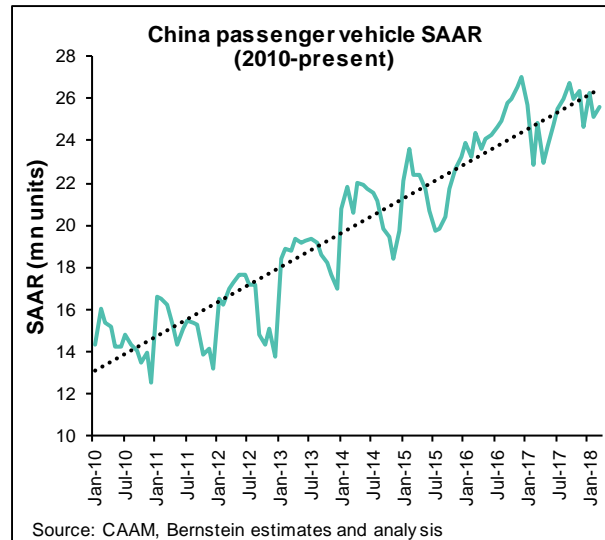
## The result

- Almost a decade of profit expansion – total OEM industry earnings now over \$120bn p.a.
- Vast premium segment earnings, NAFTA profits at record, European margins highest in 30 years
- Supplier margins the highest in modern history
- Huge cashflows, many being returned to shareholders
- But stock valuations imply investors believe it simply won't last much longer

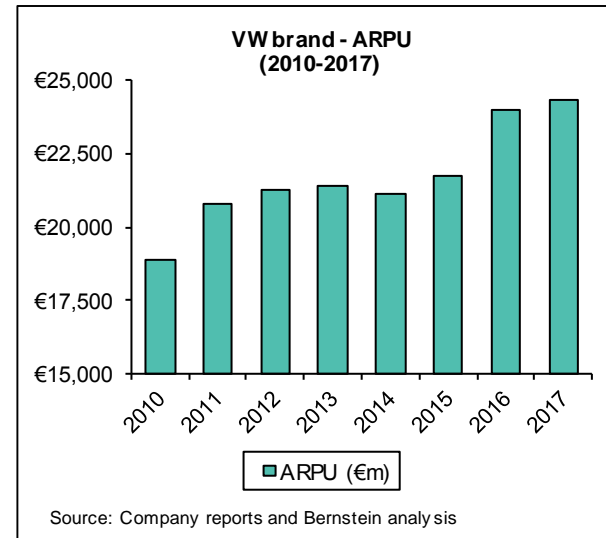
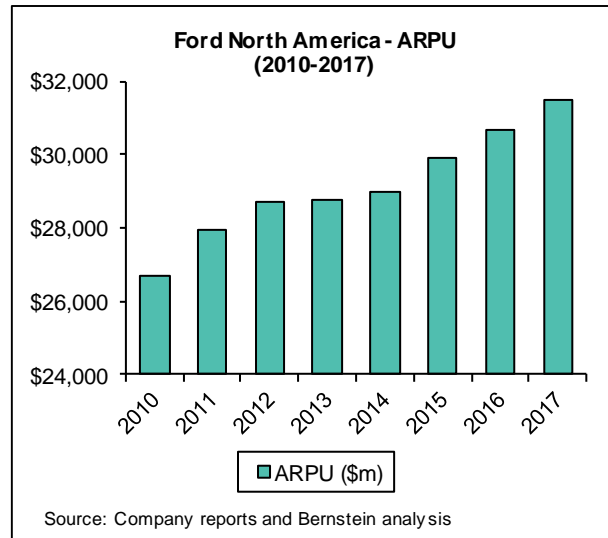
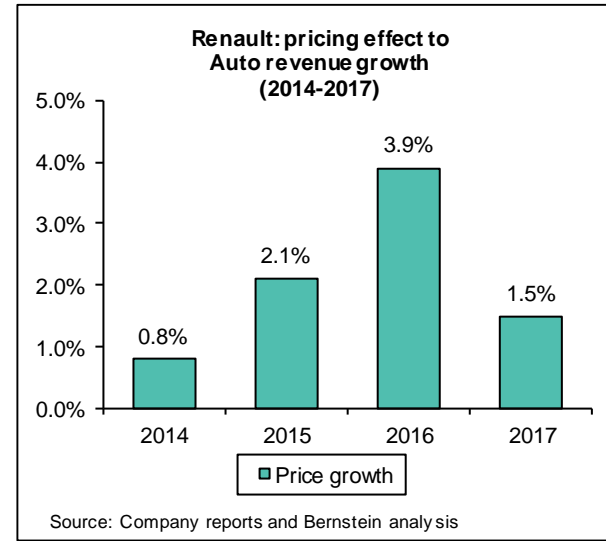
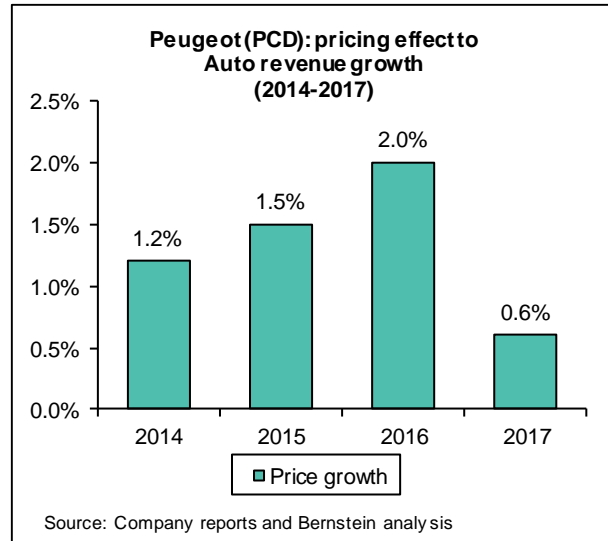
# Let the good times roll: 9 years of global expansion



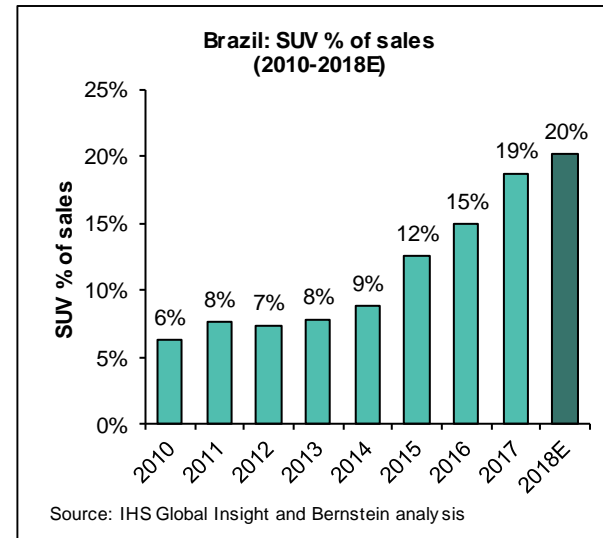
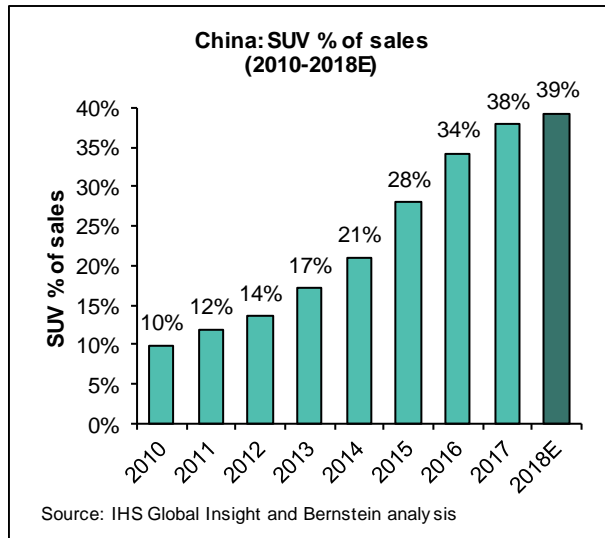
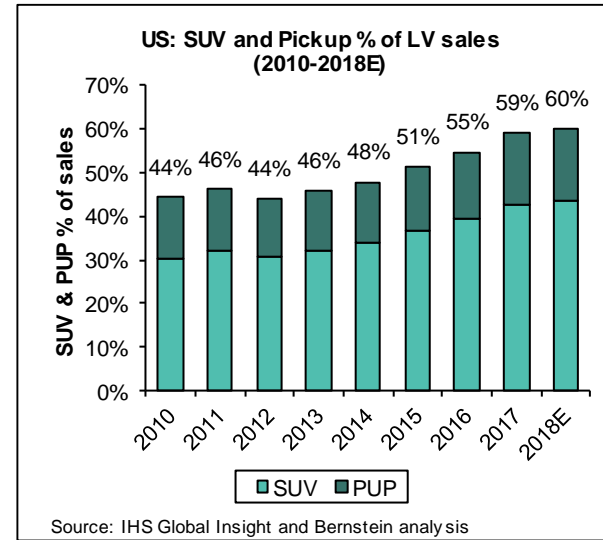
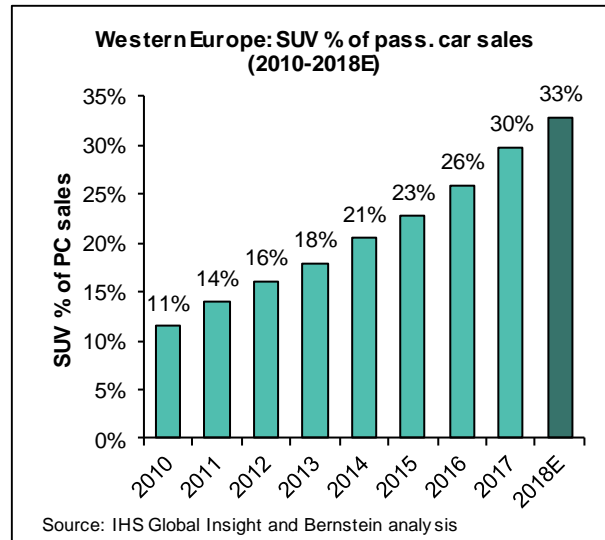
# China has been hugely transformative: profitability under-reported



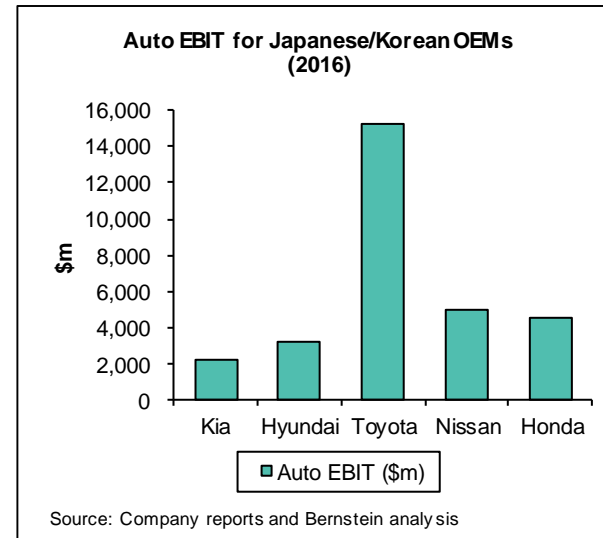
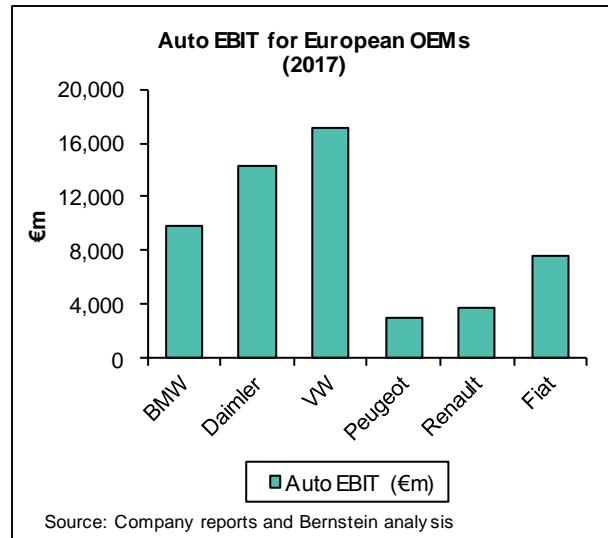
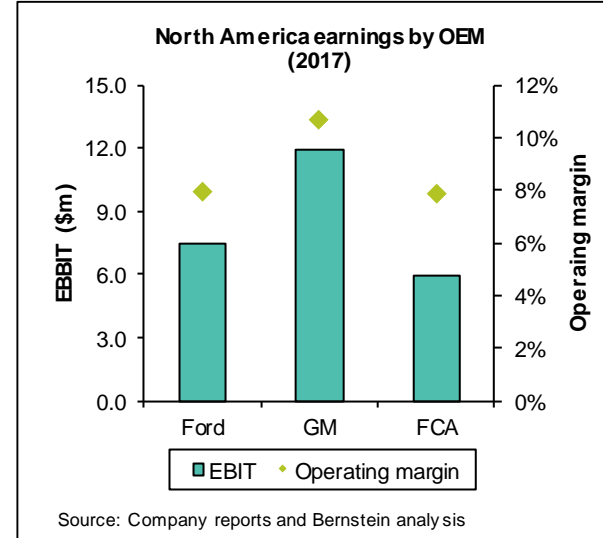
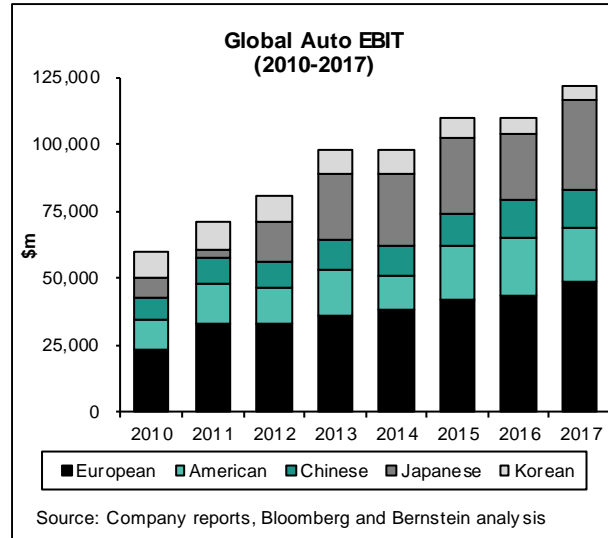
# Global pricing: significant discipline, at last



# Global mix: everyone wants to drive an SUV (heading to 100% share?)

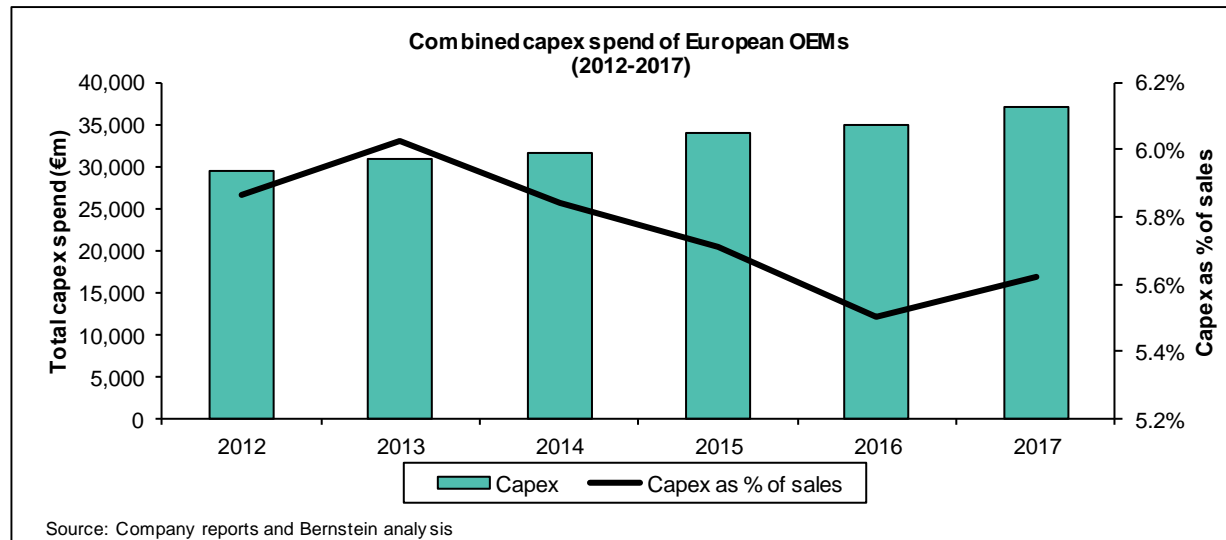
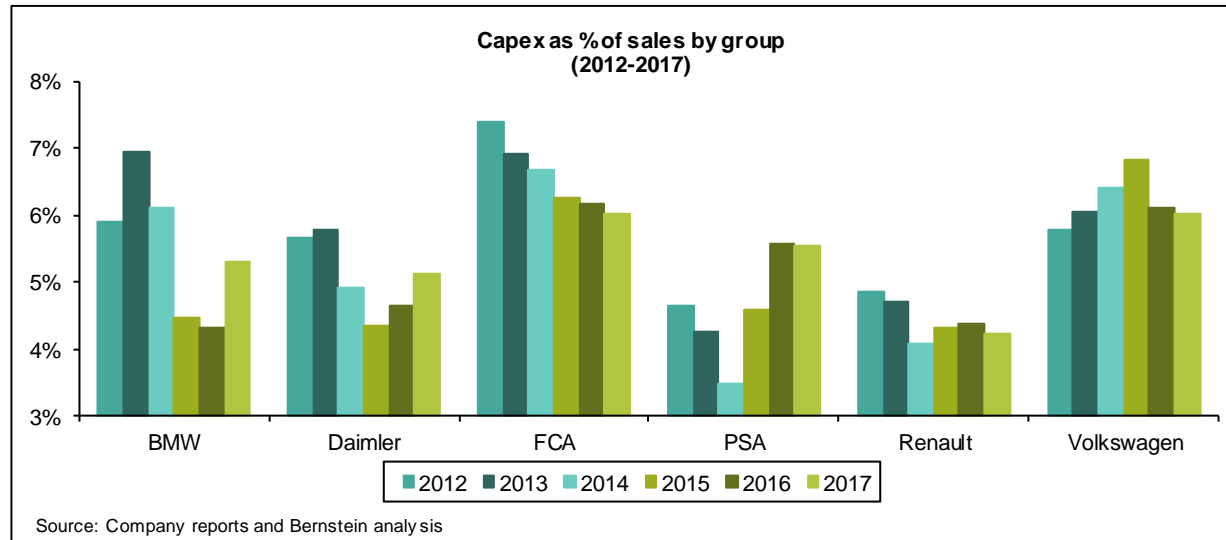


# All time record profits – in nearly every region

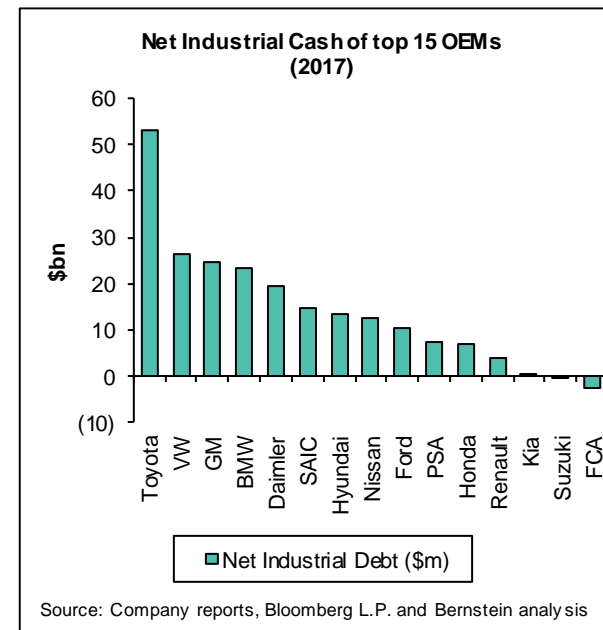
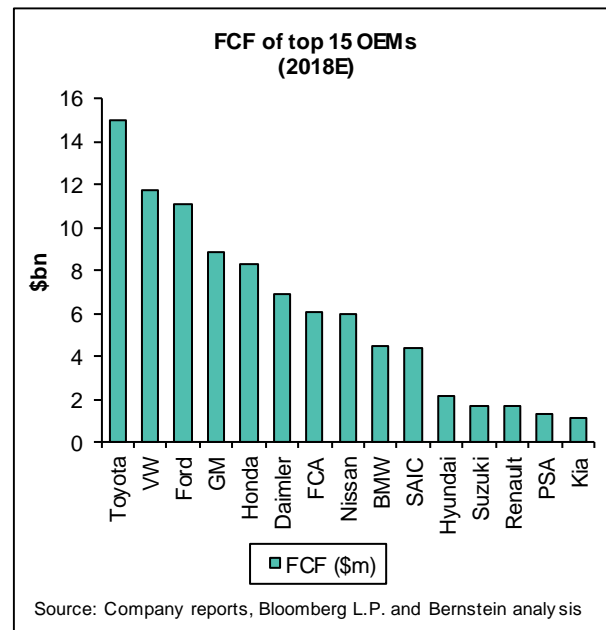




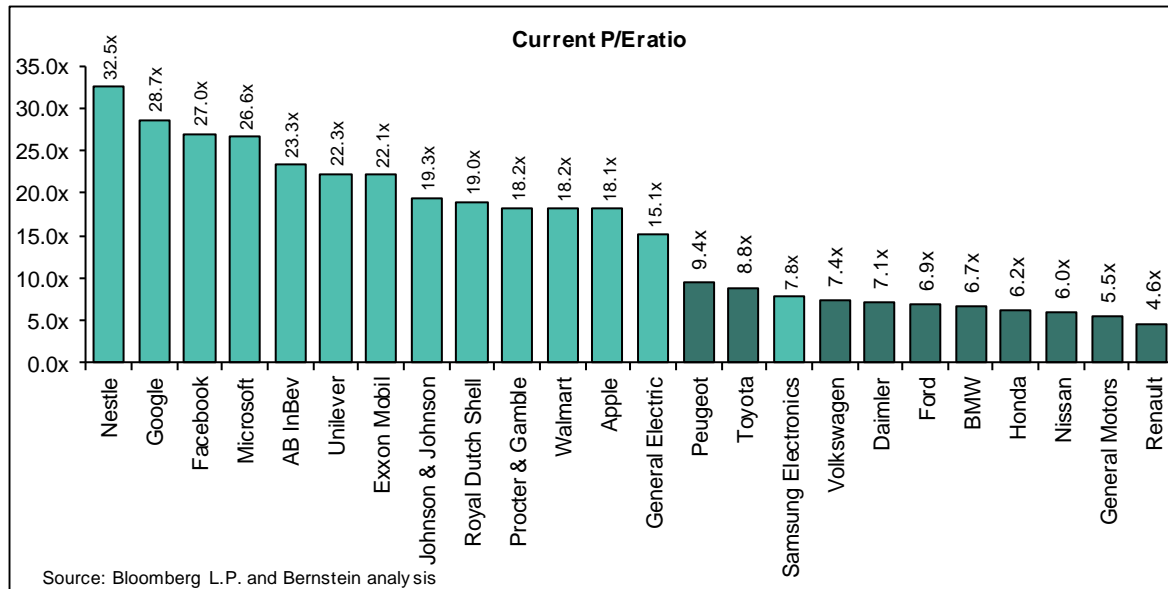
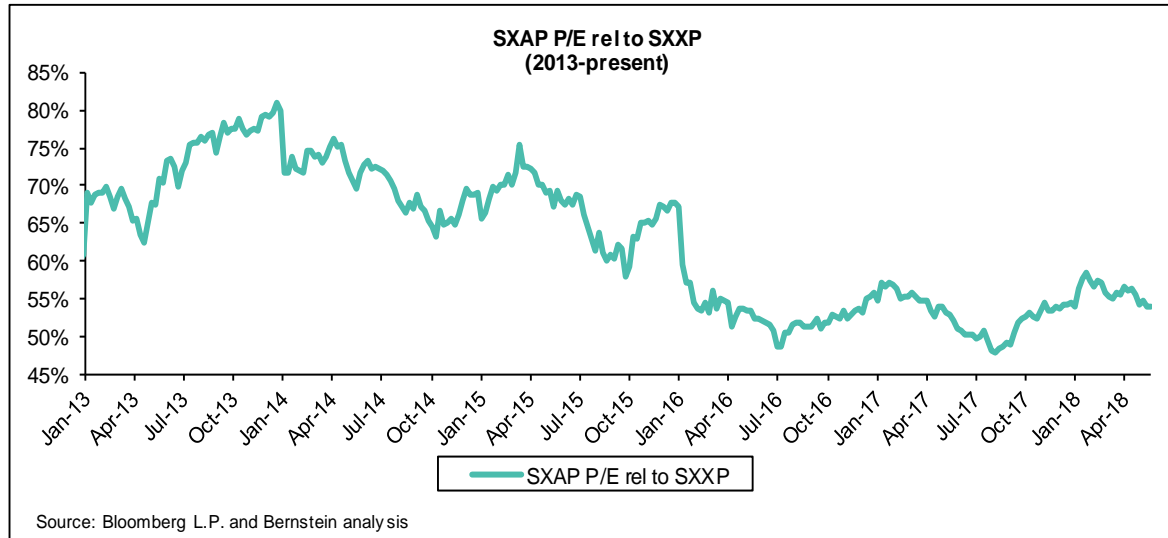
# Capital discipline: spending control is evident in the core businesses



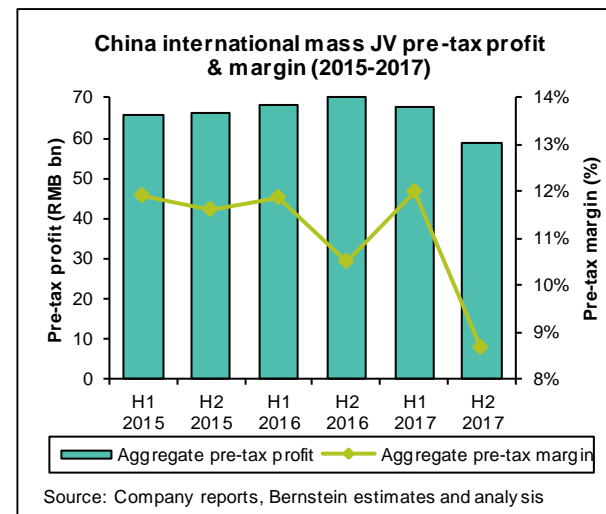
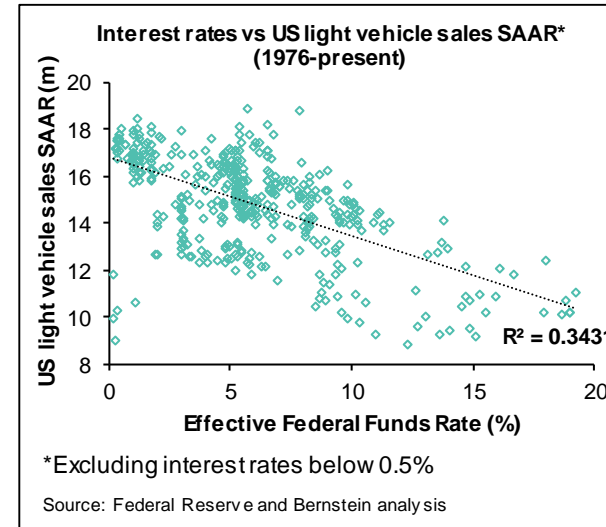
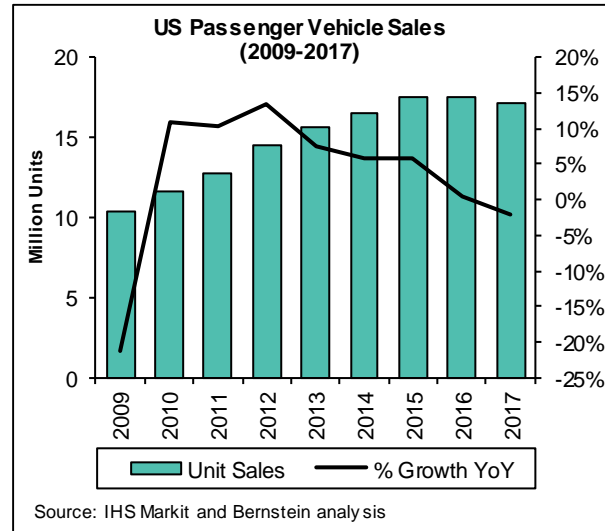
# Awash with cash: flush after a decade of recovery – but what will it be spent on? Cyclical protection? Restructuring? Technology?



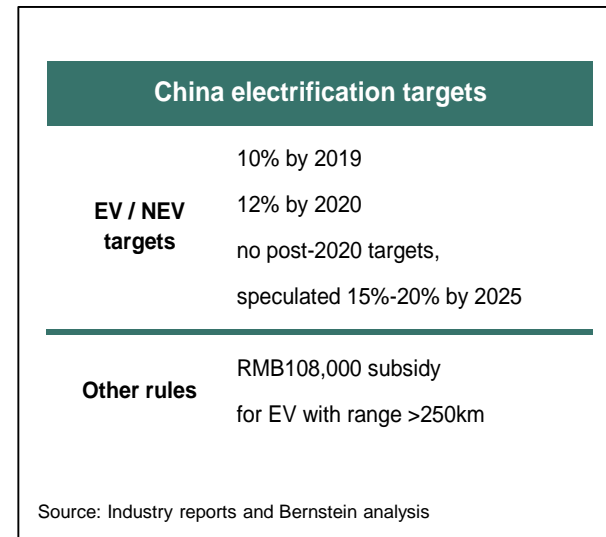
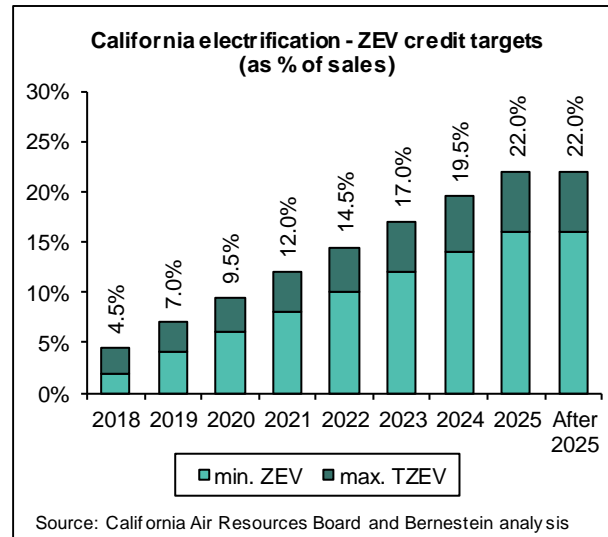
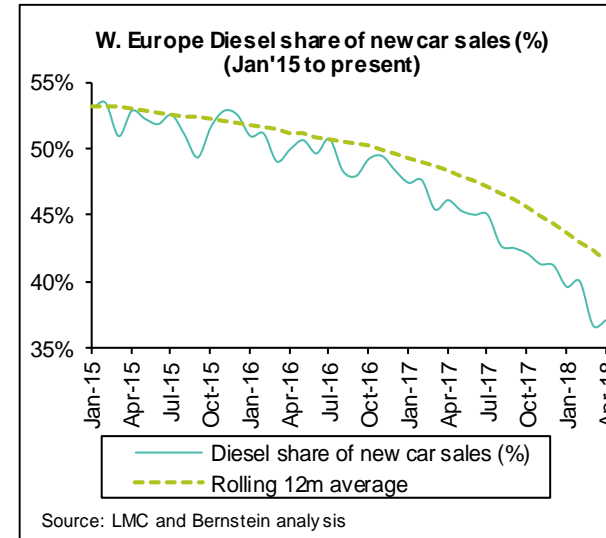
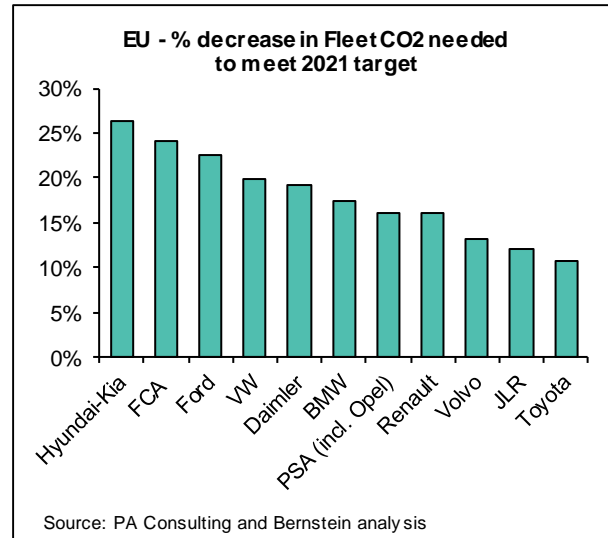
# So why are investors so worried?



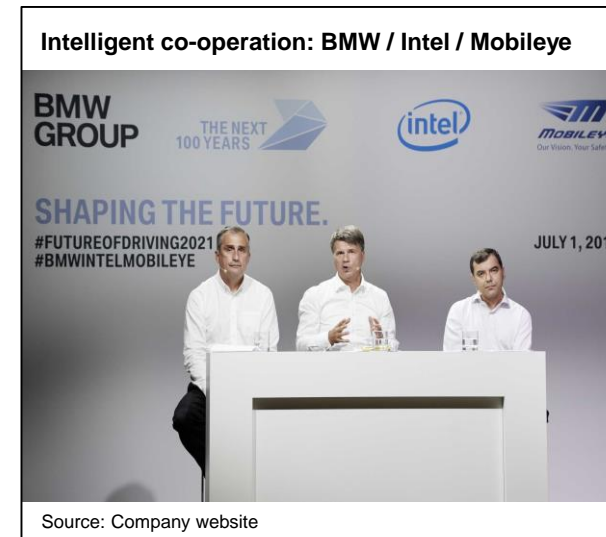
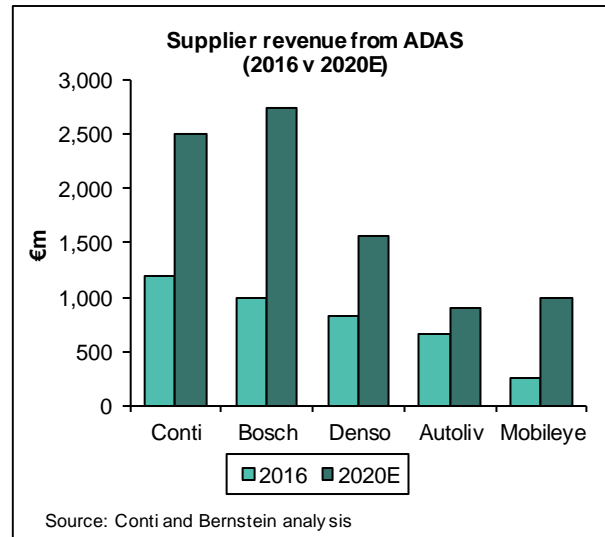
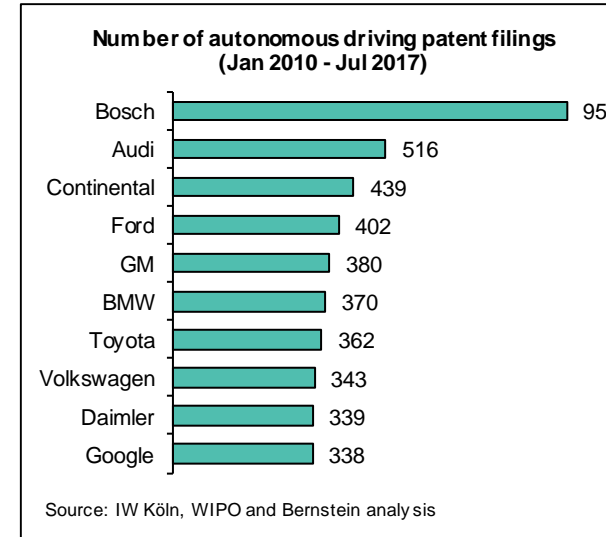
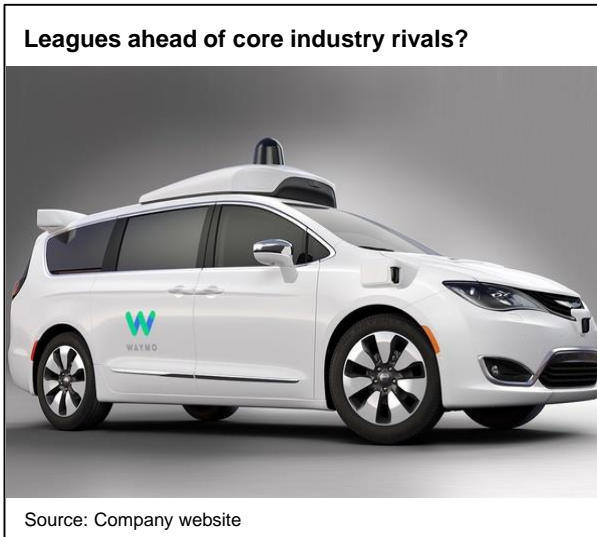
# No. 1: Old fashioned cyclical fears



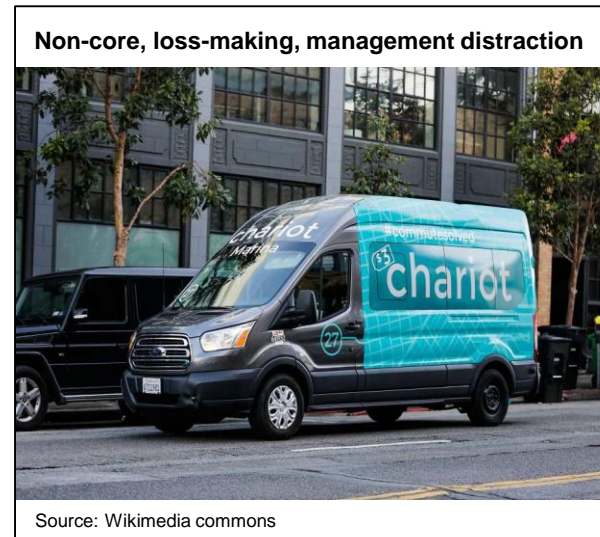
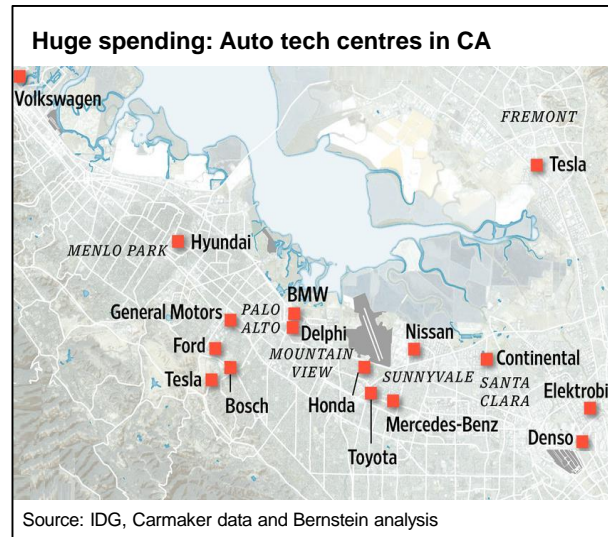
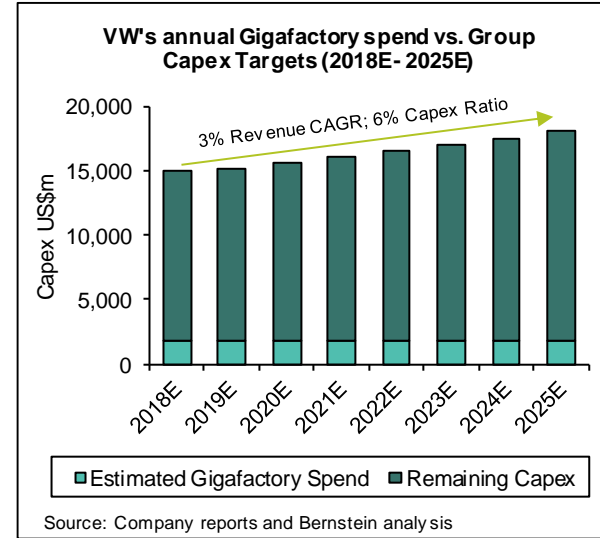
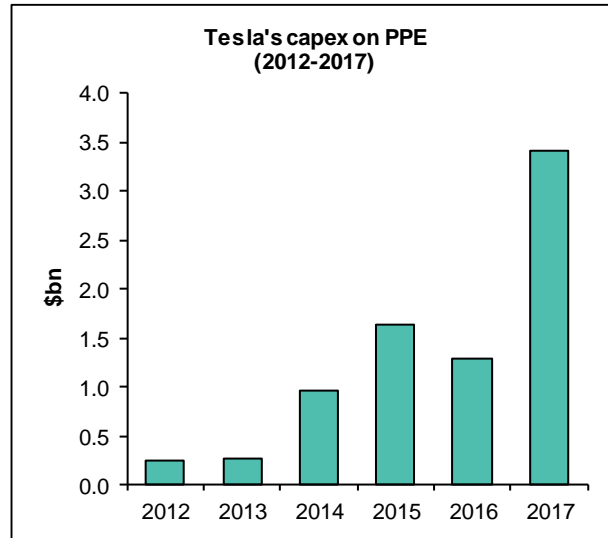
## No.2: Regulatory driven powertrain change enormously expensive



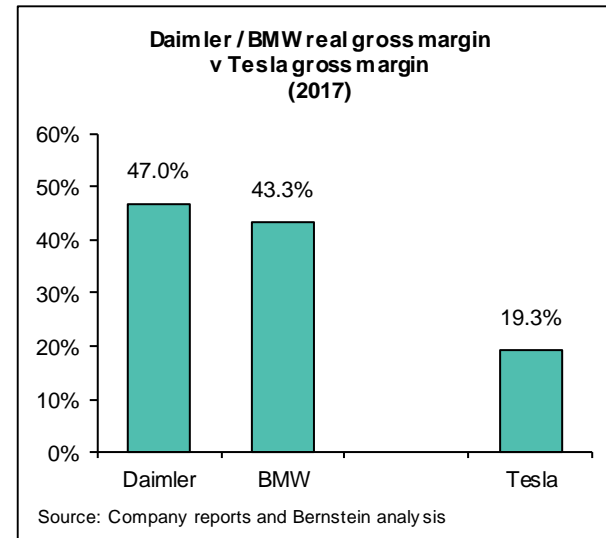
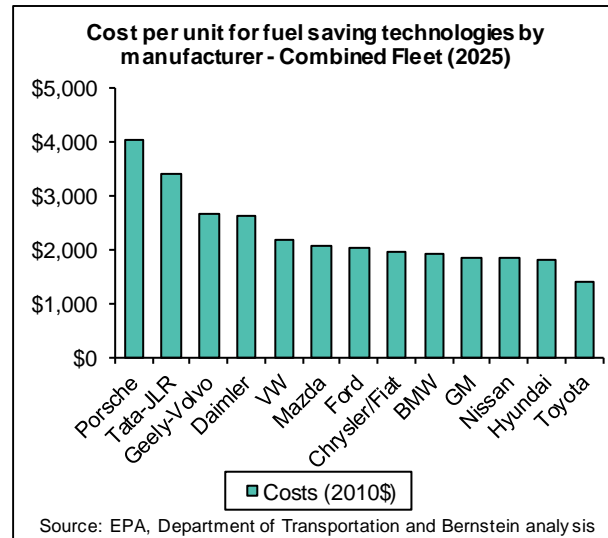
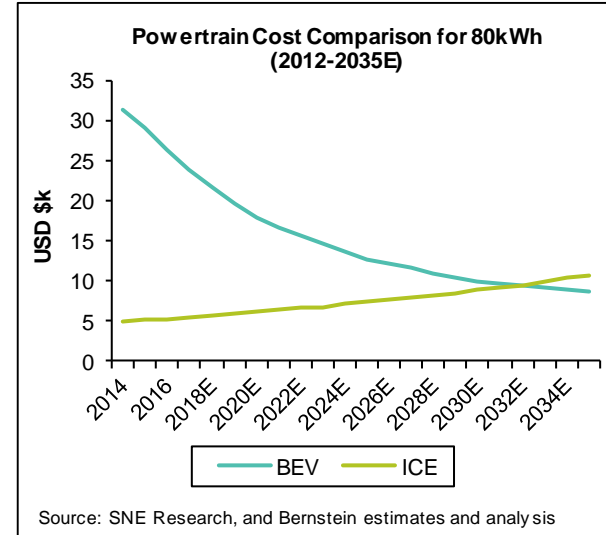
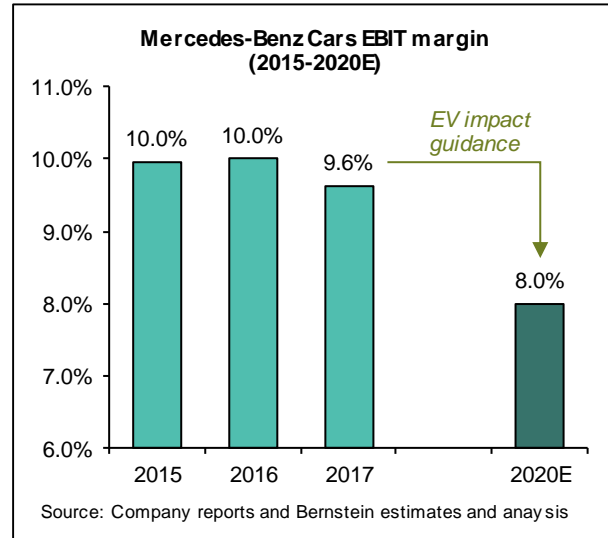
# No. 3: Profound new technology, huge spending, uncertain impact



# No. 4: Outside of the core business, capital discipline now at risk



# Modelling the impact





# Winning investor confidence

## The cycle may well prove extended

- Interest rate hikes likely modest, employments trends still strong, licensed driver numbers growing
- Financial services risk control firm, loss ratios modest, upside in EMs

## Pricing and capital discipline remain within the industry's control

- Industry has a record of damaging margins even with stable volumes – this time it's different?
- Encouraging evidence from US market; consistent pricing discipline in EU, China uncertain

## Managing powertrain shift and regulatory pressure

- Name any regulatory driven content that has ever helped margins?
- Diesel share shift surprising manageable so far; lobbying still effective, regulators pragmatic (even in China)

## Demonstrating that EV technology is easily mastered; remaining in the race on AV

- Many investors worry traditional OEMs 'don't get it' – new products will prove otherwise (but will hurt margins)
- OEMs assembling resources to pursue AV – JVs/consortiums, start-up investments (Aurora etc.)

## Barriers to entry greater than understood, manufacturing as a 'moat'

- Some concern about Chinese OEMs going global (Lynk & Co, GAC) and pushing tech (NIO, Byton etc.)
- But Tesla's problems are resetting expectations about the complexities of this industry
- Average life of an S&P500 company now 19 years....many OEMs now 100 years old and still thriving

Source: Company reports and Bernstein analysis.