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Analyzing Automotive Investment Opportunities in a Volatile Environment

June 4, 2020

With You Today

Moderator:

Alexander Stevenson, Lincoln International

Panelists:

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Robert Satow	Timothy Stallkamp
Sanjeev Varma	Steve Wybo
Brent Williams	

Agenda

A panel discussion led by Lincoln International's investment banking advisors and Conway MacKenzie's consultants who specialize in the automotive supply industry. These experts will provide valuable insights regarding the current industry outlook and recovery underway, issues unique to suppliers and where M&A opportunities could arise.

- Current Outlook | Recovery
- Operational | Supplier Issues
- Distressed M&A | Restructuring Issues
- Opportunities for Private Equity Groups
- Q&A

Current Outlook | Recovery

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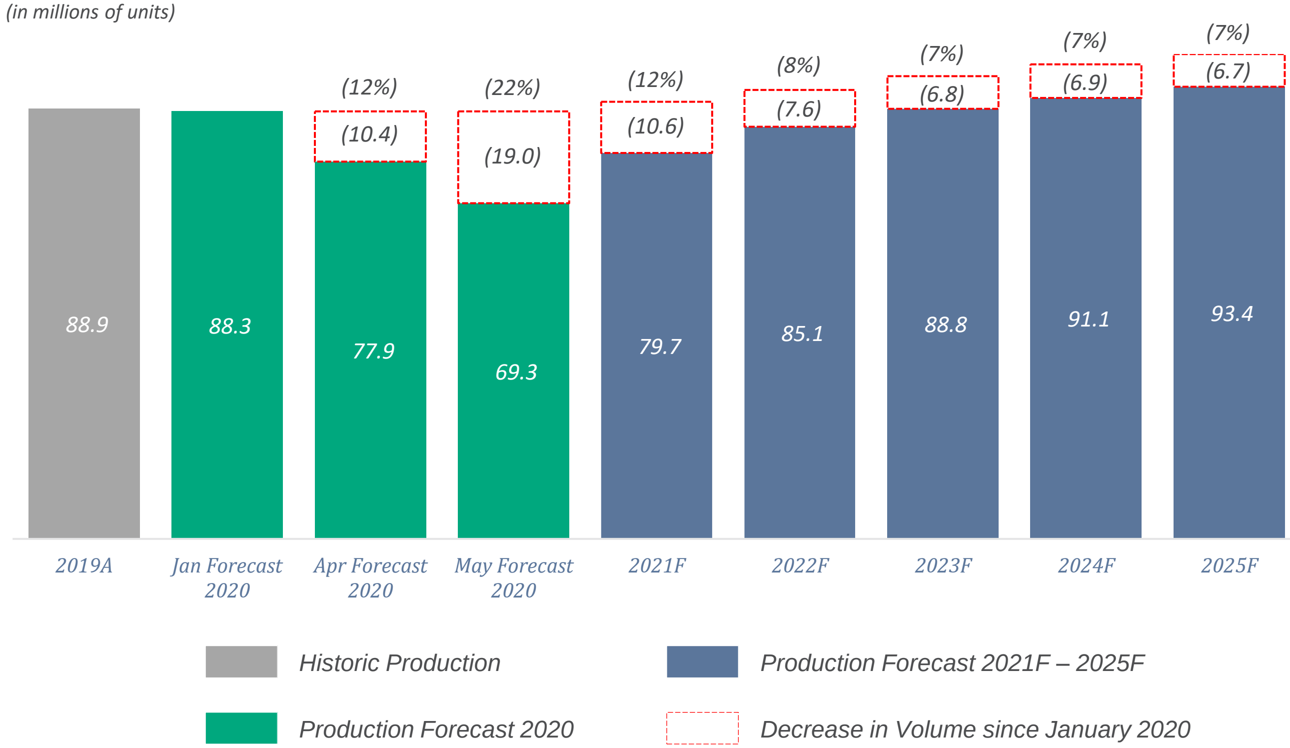
Current Outlook | Recovery – Global Production

Commentary

- Global real GDP is expected to drop 3% in 2020
- Q2 production volumes in North America are expected to be down ~70%
- North American assembly plants are restarting slower than expected
  - Significant restart issues driven by growth of new COVID-19 cases, supplier and component shortages and extended delays in Mexico
- China's light vehicle production is expected to drop 11.5% to ~21.6 million vehicles in 2020
  - Forecast factors in the supply chain disruptions created by the extended shutdown of auto plants in the Hubei Province
- European auto production forecasts were downgraded 1.9 million units to 15.6 million units in 2020, representing a decline of 14% when compared to initial forecasts prior to COVID-19

Global Light Vehicle Production Forecast Development

(in millions of units)



2.2%
CAGR (%) pre-COVID-19
2019A – 2025F

1.0%
CAGR (%) incl. COVID-19
2019A – 2025F

2021 should see a recovery in global production volumes approaching 15%; however, COVID-19 is expected to decrease global production volumes by some 60m units versus January 2020 forecasts over the next six years

Source: IHS Markit – May 2020

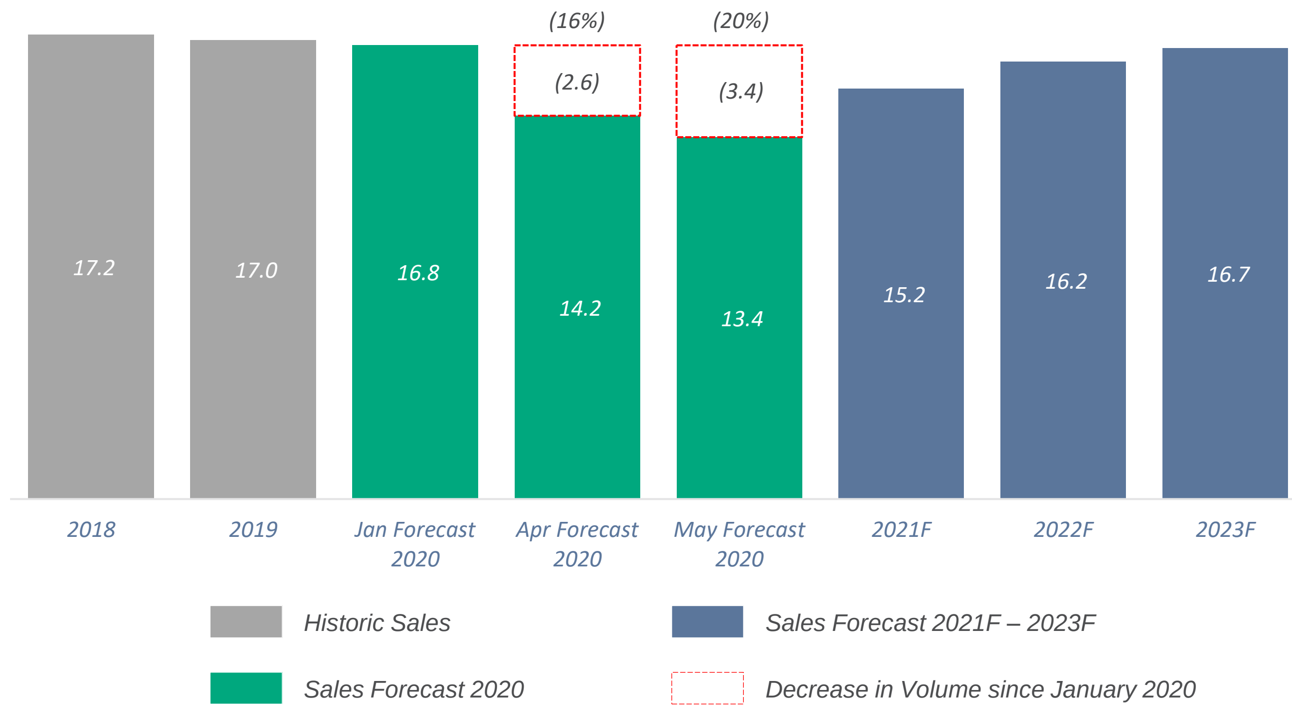
Current Outlook | Recovery – U.S. Sales

Commentary

- U.S. real GDP is expected to fall 5.4% in 2020 and more than 40 million people have filed jobless claims in the last two months
- The Seasonally Adjusted Annual Rate (“SAAR”) for U.S. auto sales in May dropped to 12.2M units, representing a 29.5% decrease compared to May 2019 but a 41.9% improvement over prior month’s SAAR of 8.6M units
- OEM incentives in May were up 21.3% year-over-year, with most OEMS posting double-digit growth in incentive spending
- Inventory levels are extremely low, putting pressure on the supply chain as demand is returning faster than production has ramped up
    - Total U.S. auto inventory at the end of April 2020 was around 3.2 millions units or ~9% below the 5-year average; with no or very little production in May, inventory could fall another 1.1 million units at the end of May

U.S. Light Vehicle Sales Forecast Development

(in millions of units)



(0.4%)
CAGR (%) incl. COVID-19
2019 – 2023F

2020 U.S. light vehicle sales are expected to decrease by ~20% versus January 2020 forecasts with a 13.5% recovery expected in 2021

Source: Wards Intelligence / LMC Automotive – May 2020

Takeaways from the Chinese Auto Industry Recovery

The automotive industry is forging a way forward as China recovers, turning auto sales positive for the first time in two years sparked by innovative incentives and a quick restart of production following a prolonged shutdown

Current State of the Market

- ~95% of Chinese automotive suppliers as of May are operating at 80 – 100% of pre-COVID-19 levels; in line with budgets set at the beginning of the year and with expectations 2H 2020 production volumes will bounce back or increase slightly over 2019 levels

Incentives

- Extension of New Energy Vehicles subsidies and tax exemptions for two years as an attempt to expand domestic demand, assist business re-openings and sustaining employment
- Releasing restriction on plate quotas in an attempt to accelerate sales of electric vehicles
- Launching subsidies for vehicles with the China 6 emission standard and delaying the implementation of the China 6 until January 2021 allows for the continued sale and registration of in-stock China 5 cars, in regions that have not implemented China 6
- Launching scrappage incentives for car owners to scrap their old vehicles in favor of upgrades

Effect on Demand

- April sales grew 4.4% YoY to 2.1 million vehicles showing growth after overcoming the COVID-19 induced collapse and ending a 21-month streak of automotive sales declines

The European market is beginning to show signs of recovery as individual countries act to sustain the automotive industry while a broader European Union plan begins to unfold

Current State of the Market

- Vehicle registrations in May fell 50% year-over-year in France following an 89% drop in April
- Similarly, the Spanish market recorded registrations down 73% in May versus a 96.5% year-over-year fall in April
- OEMs may take this opportunity to eliminate capacity with Renault announcing a €2 billion restructuring to reduce capacity from 4 million vehicles to 3.3 million vehicles
- ZF has announced plans to shed 15,000 jobs by 2024

Incentives

- The French government is leading the wave of potential government support and stimulus of the automotive industry with a package of €8 billion
  - Incentives increased for Electric Vehicle ("EV") purchases
  - The package includes €5 billion of bailout support to Renault
- More broadly, the European Union is working on a comprehensive plan to boost the sale of Green Vehicles
  - The proposal is ~ €20 billion of subsidies for consumers who choose to purchase more environmentally friendly vehicles

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Operational | Supplier Issues

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COVID-19 Presents Many New Challenges to the Automotive Supply Base Never Seen Before

Restarting from the abrupt stop could create financial stress, staffing and production issues, and future profitability challenges

Restarting the Auto Supply Chain: Risks and Challenges

Near-term Liquidity

OEMs and suppliers alike are taking actions to bolster their cash positions as they try to survive now and anticipate increased spending associated with a restart of production

Legal Issues

Suppliers will face a wide range of legal and business challenges in managing COVID-19 impacts and coordinating / executing a restart

Consumer Sentiment

It is unclear when consumers will feel comfortable making large purchases in this "not normal" environment

Lender Concerns

In addition to supporting suppliers, Lenders will need to remain cognizant of their own risks in this environment

OEM/Tier 1 Expectations

While some OEM and Tier 1 support is anticipated, many suppliers will remain at risk

Government Aid

Emergency government funding programs are providing some relief; however, many automotive suppliers remain heavily exposed

How and When?

A coordinated approach to a restart appears to be the preferred path, however many complications / inefficiencies may lie ahead in the execution

Labor / Workplace Safety & Costs

New safeguards will need to be implemented by employers to ensure the safety of employees

Economic Recovery & Vehicle Build Projections

Overall economic recovery timing and regional volume projections remain fluid

Near-Term Liquidity

OEMs and suppliers alike are taking actions to bolster their cash positions as they try to survive now and anticipate increased spending associated with a restart of production

Lear drew down $1.5B on its revolver	*Visteon drew down $400M on its revolver*	*AAM, Cooper Standard, Dana, Delphi, and Faurecia all recently increased liquidity*	*Nissan and its alliance partner Renault have pursued additional loans*	*GM and Ford have tapped additional credit lines*

- Do suppliers have sufficient liquidity to weather the storm, stretching their cash reserves to offset current limited operating cash flow?

- Are near-term cash requirements being underestimated?

  Cutting costs and funding losses is one thing but having sufficient working capital to support a restart is a major concern. This problem could be exacerbated the further down the tiered supply chain you go.

- Small Tier 2 & 3 suppliers are the hardest hit due to diminished liquidity (i.e., they rely the most on A/R for borrowing, which is diminished due to the length of the shutdown).

- Will restart volumes be sufficient for suppliers to operate profitably?

"Every supplier is going to be facing a cash crunch because they're the ones who are going to have to front the labor, be buying the material, paying for the logistics to bring up their assembly lines"
- Mark Fields (former Ford CEO)

Long-Term Outlook

Volumes likely won't fully recover to pre-COVID-19 SAARs until after 2023, and some suppliers won't have the balance sheets to bridge to a better day leading to more consolidation

- Consumer demand for new vehicles will ultimately determine how much industry consolidation will occur, but larger suppliers (Delphi Technologies/Borg Warner example) were already contemplating M&A before COVID-19 to address the large capital needs of the "ACES"
- In addition to lower production volumes over the next couple of years, manufacturing efficiencies (OEE) will decline as suppliers implement the "COVID-19 playbooks", leading to reduced margins in an already low margin industry (9% EBITDA)
- Many new platform launches will be delayed, and some may be cancelled, stretching working capital further for suppliers that have cash tied up in tooling and unamortized capex
- OEMs will assist with liquidity enhancements, subordinated loans, etc., but will likely force more consolidation and require stronger suppliers to takeover the weaker suppliers
- OEM accommodation agreements will likely be difficult to obtain and only with a threatened production interruption

So is There Any Good News?

The vast majority of suppliers will weather the storm, and many will benefit from more reasonable valuations of target companies with weaker balance sheets

- During the last financial crisis, the industry lost approximately 1,000 suppliers as volumes declined from north of 16mm SAAR to around 9mm
- Excess capacity in the industry has been taken out, and the companies that remain are generally well run with strong value propositions for their customer base
- The remaining supply base, until about 2 months ago, was running at near full capacity.
- Suppliers with weaker balance sheets that won't weather the storm will not be liquidated, but rather be consolidated into stronger, well capitalized companies; people and PP&E will be needed and we won't see "massive liquidation sales" like during the last crisis
- We are seeing signs of a stronger recovery in China and Europe than originally contemplated
- Interest rates and gas prices are very low, both of which factor heavily into consumer buying decisions
- New attractive product on many major platforms (GM, Ford and FCA trucks and SUVs) will bring the consumers back to the dealerships

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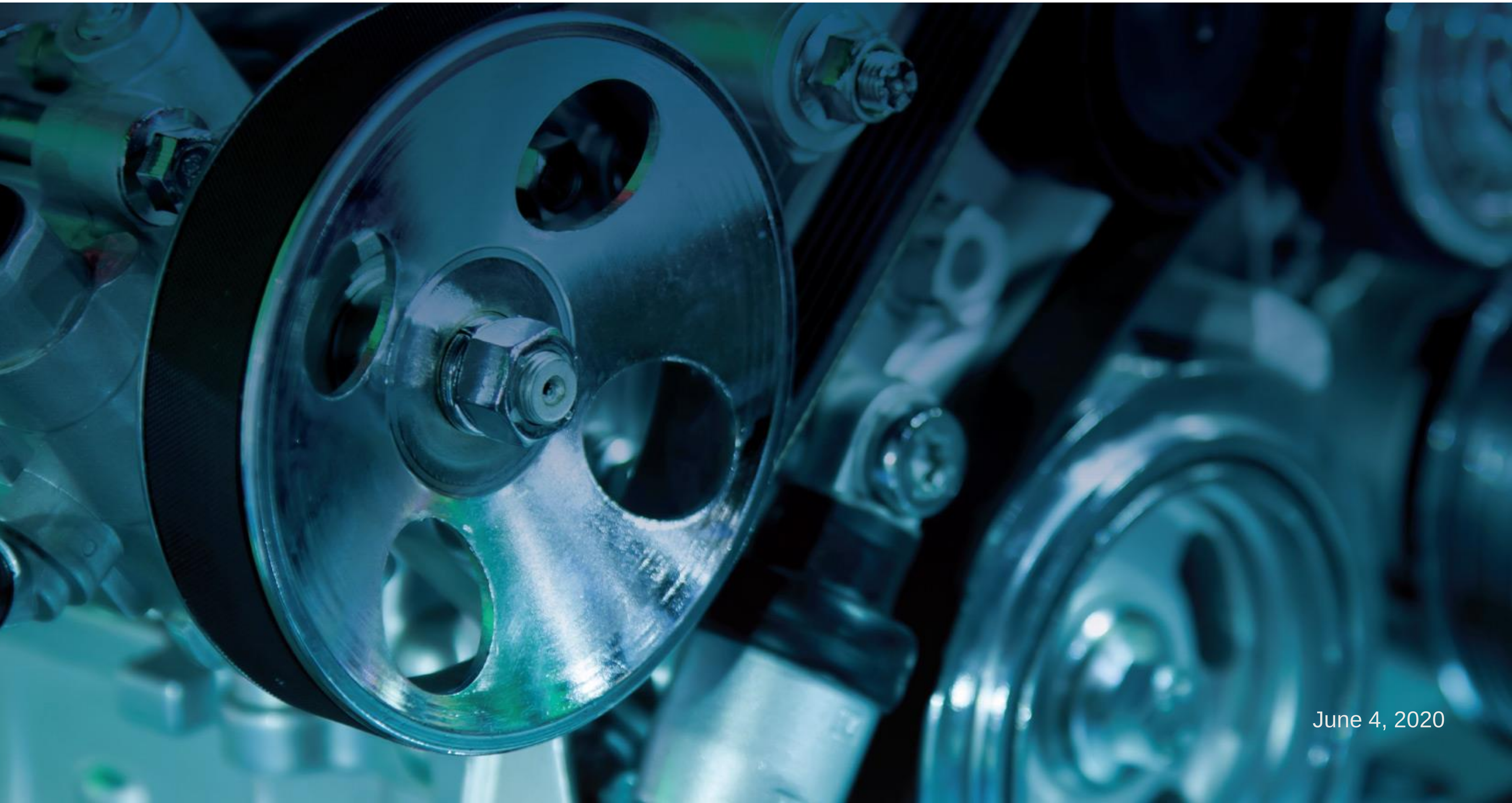
Distressed M&A | Restructuring Issues



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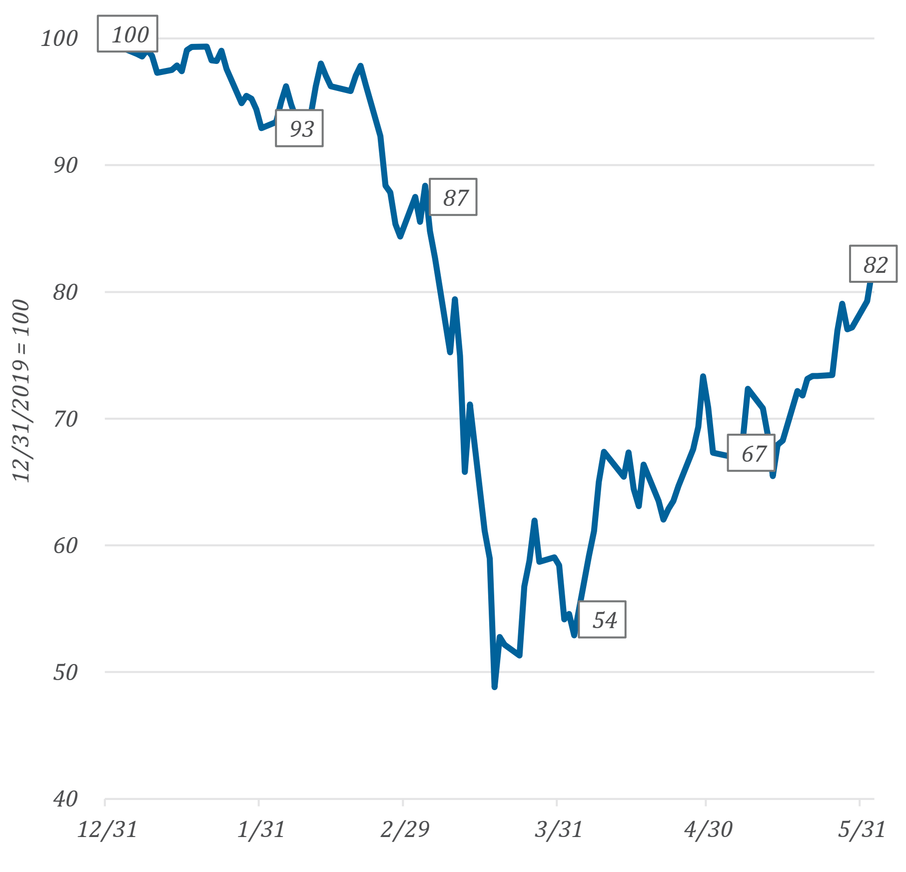
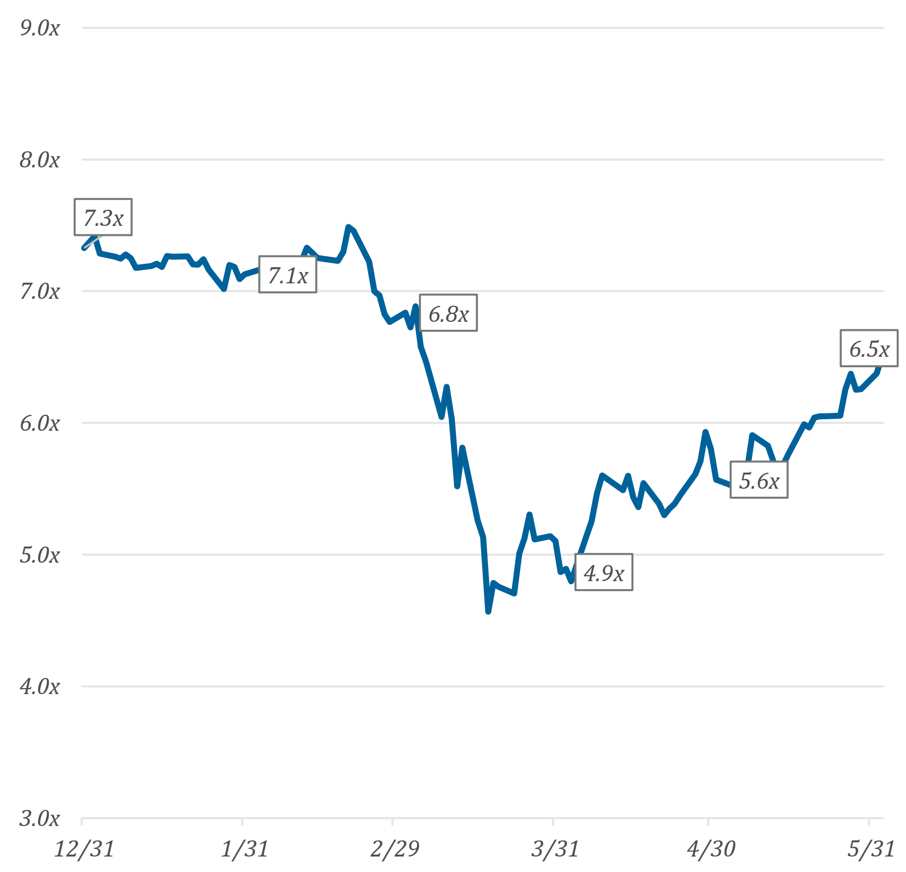
An index of North American publicly traded suppliers is down ~18% YTD with EBITDA trading multiples down nearly 1 turn

North American Automotive Supplier Stock Price Index



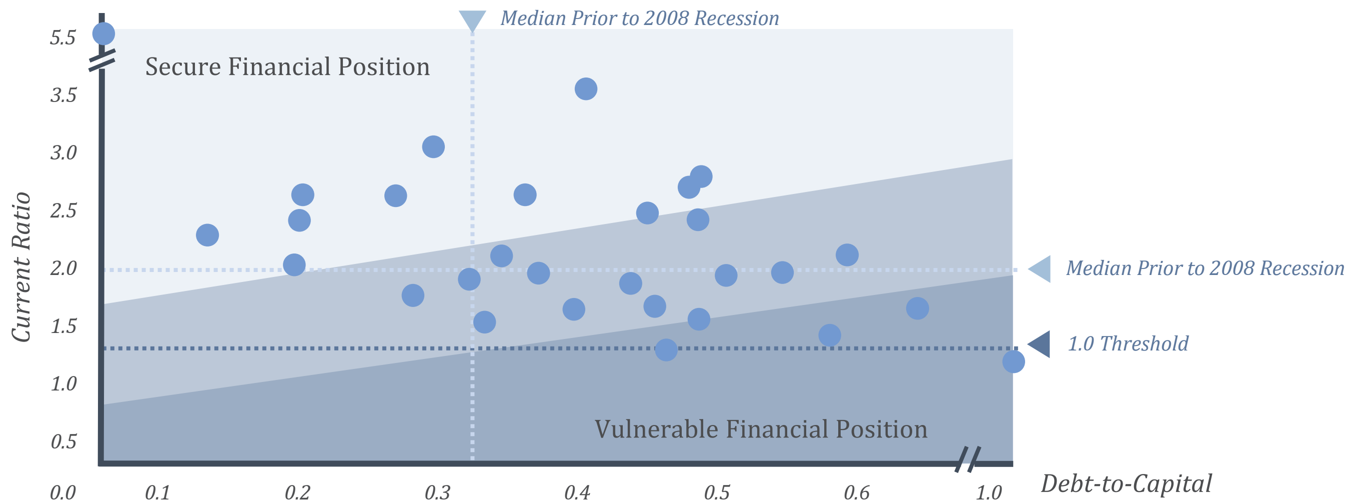
Enterprise Value / LTM EBITDA Multiple



North American Automotive Supply Index: Adient, American Axle & Manufacturing, Aptiv, BorgWarner, Delphi, Flex, Johnson Controls, Lear, Magna International, Martinrea, Tenneco and Visteon
Source: Public Filings and Capital IQ as of June 2, 2020

Many suppliers are entering the COVID-19 pandemic in a less secure financial position than the median supplier in 2008, where the median current ratio was 1.75x and the median debt-to-capital ratio was 0.3x

Latest Reported Financial Position of North American Suppliers[1]



1) The supplier index is comprised of 29 companies satisfying three criteria: Listed in the top 100 auto suppliers by Automotive News in 2019, publicly traded, and over 50% of revenue from automotive. Companies include BorgWarner, Cooper Tire & Rubber, Cooper-Standard Holdings, Cummins, Dana, Donaldson Company, Drew Industries, Eaton, Garrett Motion, Gentex, Gentherm, Goodyear, ITT, Lear, Linamar, Lydall, Magna, Martinrea, Methode Electronics, Modine Manufacturing, Nemak, Shiloh Industries, Standard Motor Products, Stoneridge, Superior Industries, Spartan Motors, STRATTEC, Timken and WABCO

Financial Position

- Automakers saw the industry's default odds rise above 20% in April from less than 5% at the beginning of the year
- A large number of auto suppliers do not appear to have enough cash to cover their financial obligations for more than 120 days
- Global light-vehicle sales are expected to fall 22% in 2020 compared with 2019 because of the pandemic

Current Capital Markets

- Borrowers and lenders are taking a 'wait and see' approach to see where spreads settle
- Amid deep macroeconomic uncertainty, the deal activity has slowed while lenders are busy tending to existing loans with portfolio management as the new focus
- However at the same time, private equity funds are sitting on more dry powder than ever before, with almost $2.6 trillion in unspent capital

Given the size of the automotive industry and the thousands of parts used throughout the manufacturing process, distress within the automotive supply chain will effect a broad array of stakeholders and market participants

Supply chains effects to a

Tier 1 Automotive Supplier

Lenders

- ▼ Events of default, covenant violations, restrict use of funds
- ▲ Likely willing to negotiate
- ▲ Modifications to existing credit terms
- ▲ Covenant and/or interest holidays

Equity Holders

- ▼ Possibility no longer willing to provide capital
- ▼ Unwilling to negotiate with lender
- ▲ Source of incremental capital
- ▲ Seeking to preserve initial investment
- ▲ Believe in long-term vision

Customers / Auto Manufactures

- ▼ Reducing order flow from suppliers
- ▼ Attempting to negotiate contract pricing
- ▲ Dependent on suppliers to maintain viable business
- ▲ High switching costs

Critical Vendors / Suppliers

- ▼ Stretched payables coming due
- ▼ Goods and serves are critical to operations
- ▼ Increases costs of products/services
- ▲ Willing to modify trade terms
- ▲ Facing similar distress and need the business to support finances

Employees

- ▼ Leave/seek new employment
- ▼ Supported by Labor Union that may initiate challenges
- ▲ Loyalty to employer and trust management
- ▲ Rest of the industry is also experiencing distress

Other Tier 2 / 3 Suppliers

- ▼ Stretched payables coming due
- ▼ Increases costs of products/services
- ▲ Good and serves are not critical to operations
- ▲ Facing similar distress and need the business to support finances

Competitor Tier 1 Suppliers

- ▼ Potentially better positioned to weather the storm
- ▼ Seeks to steal business from customers
- ▲ Facing similar distress

Regulatory / Governmental Agencies

- ▼ Passes regulation to protect industry that limits maneuverability
- ▼ Increases input costs through tariffs
- ▲ Understands the importance of the industry
- ▲ Provides incremental liquidity to support the industry

Illustrative Contingency Planning

Given the uncertainty and disruption in economic activity and capital markets created by the Coronavirus, the following contingency plan(s) may be considered in case a "regular way" capital raise and/or sale process is no longer available or feasible as a result of financial distress or underperformance

Potential Contingency Plans (If Needed)

Secure Interim Financing
Secure additional commitments from existing lenders and/or seek alternative sources of capital such as "stretch ABL" lenders, credit arms of private equity firms or alternative asset managers

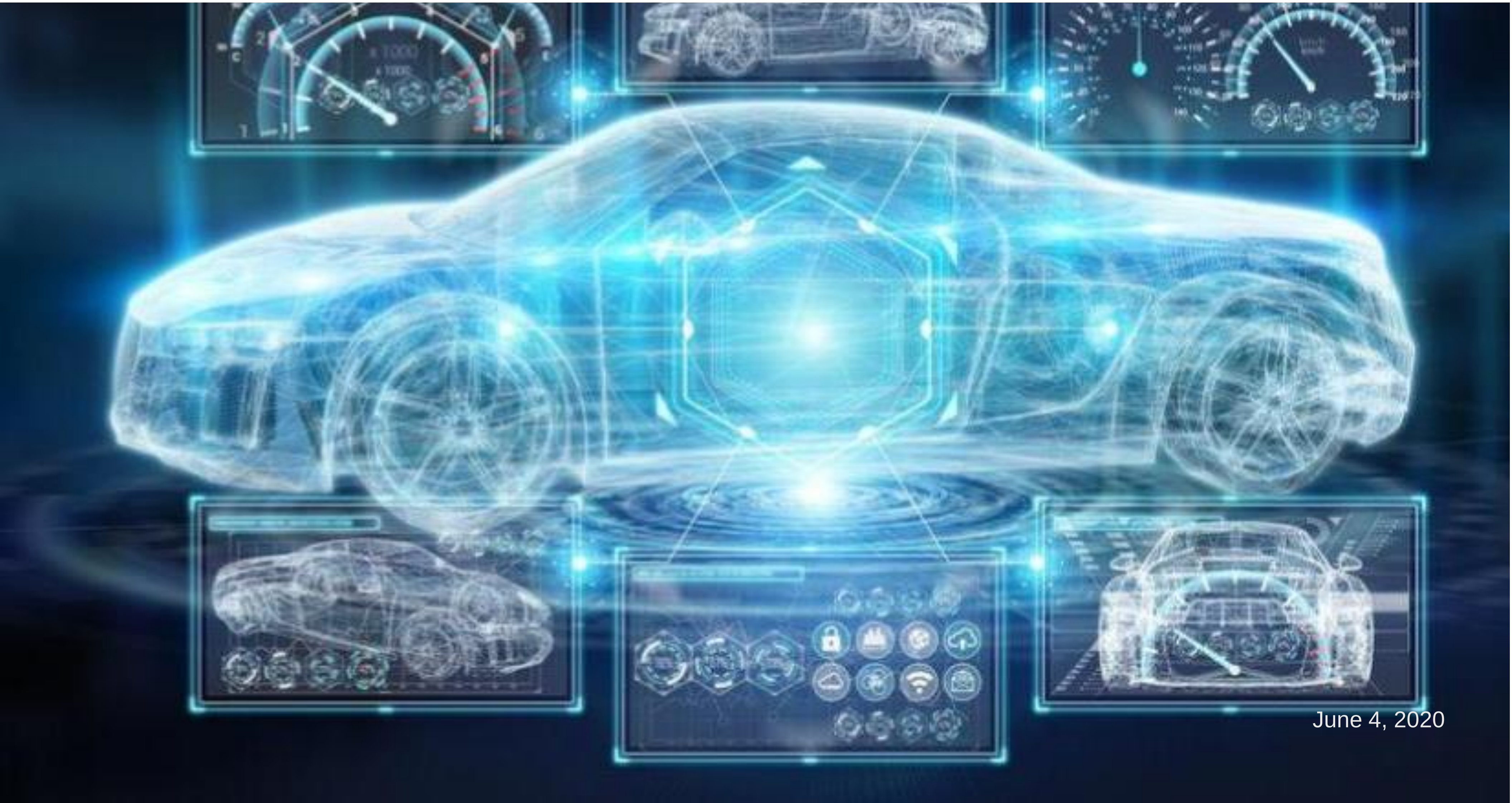
Develop Transaction Alternatives
Work with Lincoln to evaluate the cost/benefit of any/all transaction structure(s)

Incremental Equity Capital
Evaluate feasibility of raising additional capital through the public issuance of common shares or a direct offerings to large existing shareholder(s)

Sale Timing
Evaluate feasibility of a near-term sale (likely at a distressed valuation)

Consider Financial / Operational Consultants
Work with Conway MacKenzie to stabilize the supply chain and provide additional comfort to lenders and customers

Opportunities for Private Equity Groups



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What are the opportunities for PE in today's market?

- Stress will increase during Q2 & Q3
  - Requirements for capital will increase
- Many verticals are distressed
- Possibilities include the following:
  - Casting & Machining
    - Already seen distress: Pace and JD Norman
    - Many other companies showing signs of vulnerability
  - Seat Structures
    - Substantial stress because of fluctuating raw material prices
    - Vertical in need of consolidation
  - Plastics
    - Novares
    - Techniplas
  - Fuel and Hydraulic Lines, Tubes, Cables
    - Veritas
- M&A vs Restructuring transaction opportunities
- Matching buyer/seller expectations given uncertainty on volume outlook

Verticals Where There May Be Opportunities

	Capacity	Competition	Capital Intensity	Commoditization	Pricing Pressure	Technology Trend	Market Trend
Casting & Machining	●	◑	●	◑	◕	◕	◔
Seat Structures	◕	●	◕	●	●	◑	◔
Plastics	◕	●	◕	●	●	◑	◑
Fuel and Hydraulic Lines, Tubes, Cables	◑	◕	◔	●	●	◑	●

Legend
Capacity: higher indicates more excess capacity
Competition: higher indicates more competition
Capex Intensity: higher indicates higher capex requirements
Commoditization: higher indicates trend towards that segment products becoming a commodity
Pricing Pressure: higher indicates more pressure on supplier to reduce prices
Technology Trend: higher indicates more technological intensity in that product segment
Market Trend: higher indicates market is moving away from these kinds of products

Verticals Where There May Be Opportunities (Cont'd)

	Casting & Machining	Seat Structures
Description	▪ Suppliers of precision machined components to systems integrators / OEMs ▪ Transmission, engine, structural and other components	▪ Suppliers of rolled tubes, stamped and fine blanks seat frames with precision welding ▪ Assembled seat structures for front and back rows ▪ Latches and mechanisms - independently supplied or integrated
Key Trends	▪ Vertical integration of casting / forging and machining ▪ Lightweighting and ongoing penetration of aluminum ▪ Highly fragmented market ▪ Increase in amount of machining per component	▪ Japanese keiretsu suppliers have formed their own JV in the U.S. ▪ Lightweighting ▪ Competition with Tier 1 seat suppliers with captive seat structures capacity
Challenges	▪ Extent of powertrain / ICE related business ▪ Operational excellence is key ▪ High capital intensity ▪ Managing scrap	▪ FMVSS requirements impose significant challenges on design and manufacturing ▪ Operational excellence is key ▪ Latch and mechanism competence is a must to maintain pricing
Recent Distressed Transactions	Weber; PACE Industries; ShaktiGroup	Gill Industries

Verticals Where There May Be Opportunities (Cont'd)

	Plastics	Fuel and Hydraulic Lines, Tubes, Cables
Description	▪ Suppliers of injection molded plastic components for vehicle interiors and exteriors ▪ Highly designed and engineered products like instrument panels and fascias ▪ Commodity like "shoot and ship" products like knobs, bezels, cladding and moldings	▪ Suppliers of stamped and rolled tubes and lines, associated cables ▪ Assemblies using clamps and ties ▪ Critical safety components for all vehicles
Key Trends	▪ Plastics usage steadily increasing as automakers seek lightweighting solutions ▪ Recent applications in powertrain products such as engine valve covers ▪ Vehicle designers getting more creative with plastics applications	▪ Industry moving to brake by wire, steer by wire ▪ Hybrids and EV penetration expanding and getting deeper ▪ Fuel systems technologies changing with smaller displacement turbo charged engines
Challenges	▪ Highly competitive, particularly among commodity producers ▪ Pricing demands are intense from OE's and Tier 1's ▪ Painted plastic components require significant investment and compliance with EPA regulatory requirements	▪ Significant cost pressure ▪ Hybrid powered vehicles require differentiated fuel delivery systems ▪ Race to fully electric will significantly disrupt the business model of the segment
Recent Distressed Transactions	IAC International Automotive Components	Veritas

Q&A