Executive Summary

• Fiat Chrysler Automobiles (FCA) and Groupe PSA have announced that they are working together towards creating one of the world’s largest automotive groups, with the aim of reaching a binding agreement in coming weeks.

• The new entity would see global scale and resources owned 50% by Groupe PSA shareholders and 50% by FCA shareholders, with Carlos Tavares the merged group’s CEO.

• This news follows on from the breakdown in merger discussions between FCA and Renault earlier this year.

• LMC Automotive believes that there is a strong business case for such a consolidation; this latest merger announcement once again highlighting the cost pressures faced by the industry.

• The high R&D expenditure relating to platform development, electrification, and other technologies, is expected to remain a drag on industry profitability over the course of the next decade, and further consolidation is likely.

• A combined FCA-PSA group would become the fourth-largest OEM globally, with an annual production volume exceeding 8 million Light Vehicles per year. On that basis, it would surpass Hyundai Group, General Motors, Ford and Honda.

• In Europe, the new group would challenge Volkswagen Group as the region’s number one OEM in sales volumes terms; however, in the world’s single largest vehicle market, China, FCA and PSA have both struggled to gain a footing, which this tie-up would not readily resolve.

• Assuming a binding agreement is reached to create a new automotive giant, there remain significant execution risks associated with combining two sizeable entities.
Background

Revenue (2018)

<table>
<thead>
<tr>
<th>FCA (FIAT CHRYSLER AUTOMOBILES)</th>
<th>PSA (GROUPE)</th>
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<tr>
<td>€110bn</td>
<td>€74bn</td>
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Net Income (2018)

<table>
<thead>
<tr>
<th>FCA (FIAT CHRYSLER AUTOMOBILES)</th>
<th>PSA (GROUPE)</th>
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<tr>
<td>€3.3bn</td>
<td>€2.8bn</td>
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199,000 employees

FCA

4.75mn vehicles produced in 2018

211,000 employees

PSA

3.95mn vehicles produced in 2018
Why a FCA-PSA merger?

A cursory glance at most automotive OEMs’ financial statements reveals that it is currently difficult to make healthy profit margins in the sector and, with a slowing global market, and ongoing trade war concerns, headwinds remain ever-present. Moreover, as we head into a new decade, industry challenges are only set to intensify. Legislation to curb industry emissions will crank up through the decade — with the decline in diesel share and seemingly relentless move towards SUVs making forthcoming EU CO₂ emissions targets even more challenging. In order to combat this, there is an ever-greater requirement for R&D spending to focus on new technologies, in particular electrification. However, that area of R&D spend is itself in competition with other research, in particular autonomous driving technology. To that end, we continue to see various alliances formed between OEMs to share these major financial outlays.

On the spectrum of new technology investors, FCA is one that has made limited progress so far. In order to overcome the challenges ahead, FCA has been looking for a suitor for some time, and the PSA match-up has come hot on the heels of the FCA-Renault discussions that made headlines earlier this year. That latter proposed merger failed to lead anywhere due to a number of complicating factors including French government involvement and the already well-established partnership between Renault and Nissan.

Why does the FCA-PSA marriage look a more promising prospect? The lack of another partner on the scene (such as Nissan) is clearly an advantage here, and whilst John Elkann, FCA Chairman, broke off talks with Renault after French government officials intervened to push Renault to resolve issues with Nissan, a major collaboration is clearly a top priority for the Italian-American group. In terms of fit, both FCA and PSA operate predominantly in the mass market, with clear benefits from sharing technology, purchasing and other resources. The match up is also somewhat more balanced than the previously considered FCA-Renault tie-up (notably, when Nissan was included in the calculations). The newly proposed combined entity would leapfrog the likes of Hyundai Group, General Motors, Ford and Honda, to become a true volume competitor to the big three of Volkswagen Group, Toyota and Renault-Nissan-Mitsubishi.

Of course, mega-mergers can often lead to rationalisation, in this case potentially including plants, platforms and model lines. There are many instances of product overlap (see Segment Footprint below) that the new entity would have to take a view on, though brands such as Maserati and Alfa Romeo do add breadth to the current PSA portfolio, for example. Moreover, the capacity discussion below indicates plant closures would be expected.

On a global footprint basis, both FCA and PSA are well represented in Europe, with exposure to North America’s market via FCA, which the PSA side could benefit from greatly. However, one issue that this merger seemingly does not address is the lack of penetration in Asia, most notably China.
Geographical Footprint

The chart below illustrates the importance of Europe to FCA and PSA, both now, as separate entities, and even more so if the proposed merger completes. With PSA’s only representation in North America coming via modest sales in Mexico, there is a complimentary nature to the tie-up, given FCA’s US presence.

Within Europe (including the region of CIS), in sales volumes terms, separately PSA and FCA are the third and sixth largest groups, respectively. Combine the two and that would have the new entity vying for the number one spot (on 2018 figures, FCA-PSA would have been ahead of Volkswagen Group by 30k units). Inevitably though, given that the bulk of the volume is focussed on Non-Premium vehicles, the risk of cannibalisation within the merged group remains significant — clever marketing and brand management would be essential to minimise this. To some extent, there is a complimentary element, with FCA dominant in Italy and PSA strong in France (though with reasonable market presence in Germany, Spain and the UK). However, it is likely to be on the production side that efficiency gains in Europe will be the focus.

The chart also highlights the lack of market penetration from either group with regard to Asia, and primarily China. There is clearly great potential here, not least because, on a total market basis, Asia accounts for nearly half of global sales, but only 6% of combined FCA-PSA sales. A stronger presence in the world’s largest car market is surely critical to building on the clearly desired scale FCA and PSA are looking for. However, achieving any meaningful volume penetration in such a fiercely competitive mainstream part of the market will continue to present significant challenges for both FCA and PSA brands.

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Source: LMC Automotive
From a segment point of view, both FCA and PSA are much more active in the smaller segments (A to C). This is clearly evident from the chart below, highlighting each OEMs size segment footprint within Europe (including CIS). The new group would also have relative strength in Light Commercial Vehicles, particularly through PSA.

This provides both opportunities and risks. Platform sharing would support the reduction of unnecessary cost duplication between group brands. However, with products eventually sharing underlying componentry and platforms, the risk is that the brands within the group end up competing with one another, as much as with external competitors. With Fiat, Citroen and Peugeot all under one group, the drive for profitability might well see that some model lines are dropped.

Moreover, with around 50% of FCA-PSA volume in Europe coming from the A and B segments, this exposes a vulnerability of both partners. The smallest segments are indirectly under pressure from the necessity to lower emissions; however, because of weaker margins, they do not lend themselves to incorporating expensive technology to help support further CO₂ reductions, well not profitably anyway.
Capacity

Based on current manufacturing footprints, the merged FCA-PSA group would have a combined estimated global capacity of almost 14 million units*. However, the utilisation rate would be low at 58%, which would leave the group with almost 6 million units of spare capacity worldwide.

With cost reduction identified as one of the principle drivers for this merger, capacity reduction through plant optimisation is likely to be high on the agenda. While Mr Tavares has been successful in generating margin growth at PSA/Opel without yet resorting to plant closures, it is likely that there will be pressure to follow engineering and purchasing synergies with the more politically sensitive operational rationalisation.

With control of both FCA and PSA Asian facilities shared with JV partners, Europe is likely to bear the brunt of any potential plant closures. Both FCA and PSA already have plants earmarked as ‘at risk’: Fiat’s Kragujevac facility in Serbia, as well as PSA’s UK facilities, may now find their medium term future even less secure.

However, in parallel to the PSA-Opel tie-up, the potential wind down of existing European FCA JVs may be pursued to help boost volumes for FCA-PSA factories. For example, the Renault-built and derived Fiat Talento mid-sized LCV could be replaced by a PSA-based model, and built ‘in-house’.

Additionally, Tavares may feel it prudent to spin-off FCA’s underperforming Alfa Romeo/Maserati operations which, in turn, may provide funds for the new FCA-PSA group while improving its utilisation rate.

FCA, PSA and merged FCA-PSA
Estimated Capacity Utilisation, 2019

<table>
<thead>
<tr>
<th>Region</th>
<th>FCA</th>
<th>PSA</th>
<th>FCA-PSA</th>
<th>Utilisation (%)</th>
<th>Spare Capacity (mn)</th>
<th>Utilised Capacity (mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>EMEA</td>
<td>46%</td>
<td>73%</td>
<td>63%</td>
<td>58%</td>
<td>14.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Asia-Pacific</td>
<td>21%</td>
<td>14%</td>
<td>17%</td>
<td>85%</td>
<td>5.8</td>
<td>4.1</td>
</tr>
<tr>
<td>North America</td>
<td>85%</td>
<td>-</td>
<td>17%</td>
<td>85%</td>
<td>11.0</td>
<td>9.5</td>
</tr>
<tr>
<td>South America</td>
<td>42%</td>
<td>17%</td>
<td>37%</td>
<td>58%</td>
<td>12.0</td>
<td>7.1</td>
</tr>
<tr>
<td>Global</td>
<td>59%</td>
<td>59%</td>
<td>58%</td>
<td>59%</td>
<td>15.0</td>
<td>9.0</td>
</tr>
</tbody>
</table>

Notes:
* Capacity includes wholly-owned PSA and FCA plants, 50:50 owned specific Chinese JV facilities and the Tofas operation in Turkey.

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The ongoing, and accelerating, shift to electrification is a clear driver of the proposed merger. The sheer level of resource required to support conventional technologies through ever-tougher exhaust emission standards, while at the same time preparing for the expected electrification revolution, is putting even the largest OEMs under pressure. Fallout from this activity is already beginning to emerge in the form of cost savings: rationalisation of model complexity and the removal of layers of management. FCA may simply not regard itself as big enough to survive this unprecedented level of change.

PSA would benefit from economies of scale by adding more volume on its electrified platforms, while FCA is somewhat lagging in development and needs a partner. An obvious opportunity for sharing is in electric LCVs. While FCA has its own plug-in hybrid powertrain, it would make sense to adopt PSA's multi-technology eCMP platform going forward.

There is very little in the way of commonality in engine and transmission families between the two groups, although most of the models are of a FWD-transverse architecture. The most likely, albeit uncertain, scenario of powertrain commonalisation is that they draw on the strengths of PSA's small gasoline engines while the Premium cars retain FCA's larger engines with longitudinal architecture. The merger would use Punch Powertrain’s upcoming electrified dual clutch transmission for 48V mild hybrids on the compact models, while FCA could offer its belt-integrated starter generator system for larger models. On the face of it, it does not seem that FCA has much to offer PSA in terms of powertrain families, apart from continuing to fit its own models.

In terms of engine plants, it is likely that in the long term, one or two FCA plants in Europe would no longer be needed as PSA ramps up production in several former GM plants, but FCA plants in North America could provide PSA with a springboard for its plans to enter that market.
Strengths Weaknesses, Risks and Opportunities

A new FCA-PSA Group would inherit a number of characteristics of the existing entities, in addition to new aspects created by the merger.

**Strengths**
- Increased market coverage in relatively stable mature markets.
- Strong management credentials
- Improved balance to global market and production footprint
- Scale through optimised shared technologies (platforms, powertrains, R&D)
- Purchasing leverage of the combined group
- Good SUV portfolio mix including global ‘Jeep’ brand
- Strong position in ‘higher-margin’ LCV segment
- Presence in mainstream, Premium and Super-Premium segments

**Weaknesses**
- Competitively weak product portfolio in China: failure of FCA and PSA brands to gain traction
- Product overlaps and duplication between FCA-PSA
- Lagging technology portfolio
- Chronic capacity underutilisation in China as well as in some European and S American facilities.
- Excessive dependency on European and US markets
- Ownership structures: potential interference
- Disappointing Premium segment penetration
- High exposure to low-margin small car segments

**Opportunities**
- Scale-related benefits: new global giant with over 8 million units of Light Vehicles
- Significant potential cost saving through operational rationalisation, beyond the projected €3.7bn/year in mid-term
- Refocus on China: review strategy to improve penetration
- Spin-off Alfa Romeo/Maserati to raise funds and cut spare capacity?
- Revive Alfa Romeo/Maserati to capitalise on high-growth high-margin Premium segments?
- PSA brands to re-enter N American market

**Risks**
- Interference from external stakeholders: JVs/Governments sensitivity to rationalisation
- Core markets are characterised by longer term slow market growth
- Speed and cost of engineering and operational integration
- Clash of entrenched cultures and systems
- Cannibalisation in Europe, if future products converge too much
- Regulatory pressures threaten margins particularly in smaller car segment
- US trade policy threatens export flows between Europe and US
Next steps…

How should we consider the OEM groups now? For the time being, until the announced completion date of the FCA-PSA merger, we will continue to show the groups separately. Users of LMC’s Compass platform can readily combine groups and brands in order to immediately analyse and visualise the implications of consolidation.

Once the merger date has been confirmed, we will consolidate the FCA and PSA brands under one, as-yet-unnamed, group. At that point, we will incorporate any new forecast assumptions that appear to be more likely than not as a result of the tie-up. As further information becomes available, we will update the forecasts accordingly. We will also incorporate other implications this may have for competitors/partner groups.

<table>
<thead>
<tr>
<th>Light Vehicle Production by OEM (2018)</th>
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<tbody>
<tr>
<td>Volkswagen Group</td>
</tr>
<tr>
<td>Renault-Nissan-Mitsubishi</td>
</tr>
<tr>
<td>Toyota Group</td>
</tr>
<tr>
<td>FCA-PSA</td>
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<tr>
<td>Hyundai Group</td>
</tr>
<tr>
<td>General Motors Group</td>
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<tr>
<td>Ford Group</td>
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<tr>
<td>Honda Group</td>
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About LMC Automotive

LMC Automotive is the premier automotive forecasting company and has an exclusive focus on the industry and an understanding of the dynamics that drive it. With offices in Oxford, Detroit, Shanghai, Bangkok and representation in Germany, Brazil, Japan and Korea, we combine more than 30 years of experience in macroeconomics and demand analysis, with a global network of ground-level, intelligence-gathering expert analysts creating unique perspectives and insights. We help our clients make sense of what is happening today, while planning for tomorrow.

LMC’s principal area of activity is the global forecasting of vehicle sales, production and powertrain, and coverage is provided of both Light and Heavy vehicles.

The automotive industry is facing an extraordinarily rapid period of technology evolution, particularly in the area of alternative propulsion systems. LMC is taking the lead in the analysis of the impact of these changes and is unique in offering several services that specifically forecast future demand and production for hybrid, electric and fuel cell powered vehicles.

Our core services include:

- **Global Automotive Production Forecast** *(monthly)* by model, plant, platform, SOP/EOP with a 7-year forecasting horizon
- **Global Automotive Sales Forecast** *(monthly)* by model, bodytype with a 12-year forecasting horizon
- **Global Light Vehicle Powertrain Forecast** *(quarterly)* by model, engine (IC, BEV etc.), transmission, driven wheels with a 7-year forecasting horizon
- **Global Hybrid & EV Forecast** *(quarterly)* sales by model and propulsion system with a 12-year forecasting horizon; optional **Battery & eMotors Module** (model level, xHEV technologies)

Special Reports

- **Long-Term Outlook for AV and Electrification to 2050**

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