BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

21st November 2016

Car Part Manufacturers

What if market went too far down on auto suppliers?

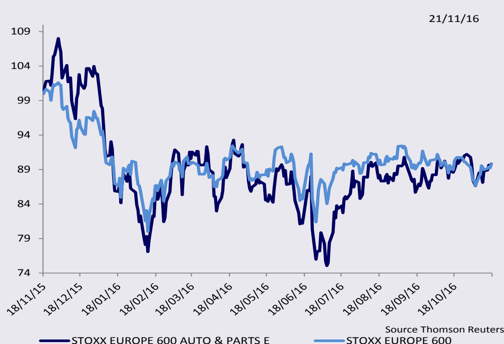
Car Part Manufacturers

FAURECIA		BUY	FV EUR47
Bloomberg	EO FP	Reuters	EPED.PA
Price	EUR32,05	High/Low	37,295/27,16
Market cap.	EUR4,419m	Enterprise Val	EUR5,227m
PE (2016e)	8.9x	EV/EBIT (2016e)	5.6x

HELLA		BUY	FV EUR45
Bloomberg	HLE GR	Reuters	HLE.DE
Price	EUR34,35	High/Low	39,3/27,73
Market Cap.	EUR3,817m	Enterprise Val	EUR3,841m
PE (2016e)	10.7x	EV/EBIT (2016e)	8.6x

PLASTIC OMNIUM		BUY	FV EUR36
Bloomberg	POM FP	Reuters	PLOF.PA
Price	EUR28,39	High/Low	31,185/24,45
Market Cap.	EUR4,329m	Enterprise Val	EUR4,807m
PE (2016e)	13.4x	EV/EBIT (2016e)	9.0x

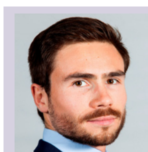
VALEO		NEUTRAL	FV EUR49
Bloomberg	FR FP	Reuters	VLOF.PA
Price	EUR51,43	High/Low	54,42/34,8663
Market Cap.	EUR12,299m	Enterprise Val	EUR14,382m
PE (2016e)	13.8x	EV/EBIT (2016e)	11.4x



In this report, we come back on most of the fears investors are starting to price into the automotive sector, and, most importantly, with the suppliers subsector. Risk of a stronger market slowdown exists yet these risks are not new and, even if this risk occurs, it should further reinforce our preference for suppliers vs. carmakers given inventories seems under control and given innovation will continue to drive sales growth.

- **The end of suppliers' supremacy?** Since end September, investors started favouring the carmakers within the auto sector to the detriment of suppliers, after almost three years of market overperformance from the latter vs. their own customers, reflecting their ability to outperform worldwide market growth easily. Given the recent market perception change, we assume investors now believe this overperformance will progressively soften, a perception we do not share given innovation will continue to drive the sales growth of most technological suppliers.
- **Market fears over a massive slowdown in demand next year are unjustified we believe**: Despite Brexit and Trump's election, global worldwide demand in mature markets remains relatively solid despite an unfavourable base comparison. It is not that new market growth should slowdown next year in the main markets, but that we judge investors' fears on suppliers' share prices as being excessive.
- **Even after simulating a massive fall in 2017 we still find upside**: We simulated a **4%** market fall for 2017 vs. the **+1.7%** we currently have in our model and found that, after the recent share price drops, **we still have upside** on three of the four stocks we cover (*Valeo being the exception*) vs. the latest share price, after cutting our 2017/18 estimates by **14%** on average. We believe the market has been too harsh on auto suppliers.

  We still favour Faurecia and Plastic Omnium among our coverage: We keep unchanged our estimates for 2016-18 (*except for Plastic Omnium as we integrate recent disposal*) but still believe our four auto suppliers will outperform the market by around **4-5pp** over 2016-18 while raising EBIT margin. Faurecia and Plastic Omnium remain our best preferred stocks offering respectively **48%** and **27%** upside. *It is Black Friday in advance!*



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Please see the section headed "Important information" on the back page of this report.

1. What if the market went too far down on auto suppliers?

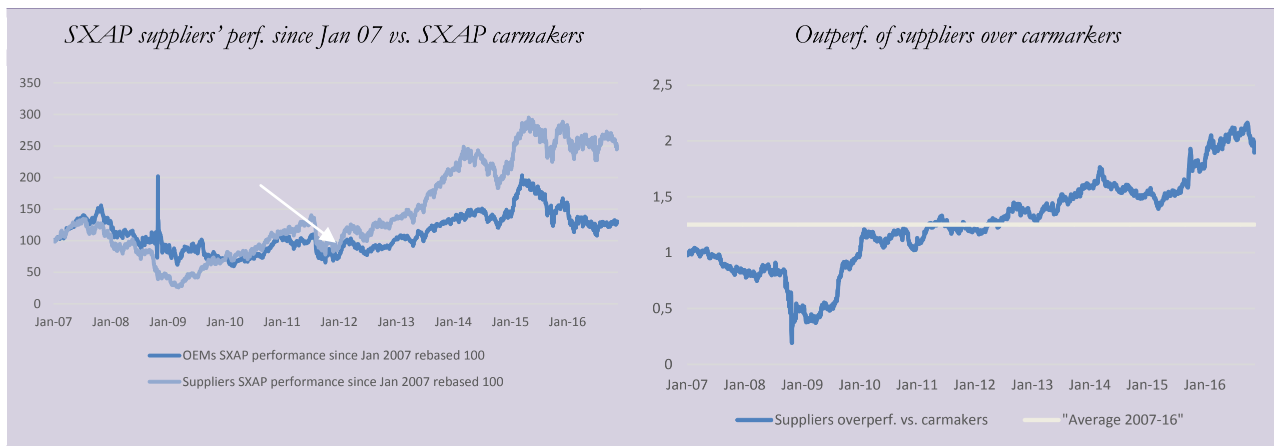
In this report, we try to answer some of the questions investors may have regarding the automotive sector and the potential risks that may affect the year-end trend and, most importantly, that may affect growth in **2017** and **2018**.

While we admit Brexit and Trump's election may at a certain point affect growth linked to the automotive sector assuming tariff barriers are re-installed in the U.K. and the U.S., and assuming the global economy softens due to excessive protectionism from the U.S., we also believe investors have overestimated these potential negative risks in recent days, especially when looking at auto suppliers. Cautious tones from most automotive industrials (*carmakers and suppliers*) on a potential slowdown in market growth for 2017 are not new, with such potential excessive prudence observed in Q3-16 potentially leading actually to strong cuts in auto inventories, **reducing in our view the risk of massive destocking effects for suppliers during 2017.**

1.1. The end of suppliers' supremacy?

Since end September, investors **had started favouring carmakers again within the auto sector to the detriment of suppliers**, after almost three years of market overperformance from the latter vs. their own customers, reflecting their ability to outperform worldwide market growth easily. Given the recent market perception change, we assume investors now believe this overperformance will progressively soften, a perception **we do not share given innovation will continue to drive the sales growth of most technological suppliers**. *(see our initiation report: 13/09/2016 : Car parts manufacturers: Innovation the only way to stand out!)*.

Fig. 1: Suppliers' stocks started to outperform carmakers in 2012



Source: Datastream; Bryan, Garnier & Co ests.

Fig. 2: But, since end September, investors started favouring carmakers again

SXAP suppliers' perf. since August 2016 vs. SXAP carmakers — *Outperf. of suppliers over carmarkers*

Source: Datastream; Bryan, Garnier & Co ests.

Since September, **European carmakers have started to outperform European suppliers** for no "specific reason" given the risks linked to a market slowdown will also affect carmakers.

Fig. 3: Stock performance since August 1st on SXAP index *(% change)*

Source: Datastream; Bryan, Garnier & Co ests.

Interestingly, while Trump's election negatively affected European suppliers' stocks exposed to the US market through Mexican production sites, US autos strongly outperformed auto stocks despite all the risks linked to the potential end of the North American Free Trade Agreement. **Ford** is up **5%**, **Visteon 9%**, **FCA 6%** and **GM** up **5%,** while European auto suppliers are **down 2-3%.**

We explain below why we see the recent derating as excessive even if we see most of market's fears on the sector as justified.

Please see the section headed "Important information" on the back page of this report.

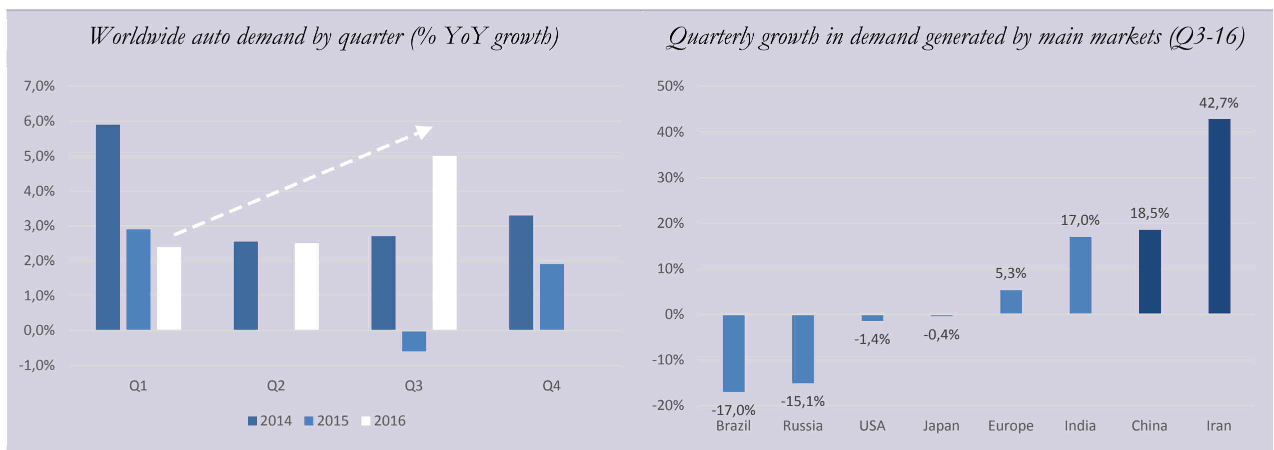
1.2. Q&A section

1.2.1. Were the Q3-16 earnings publications on the auto sector bad?

No, actually both automotive production & registrations strongly surged during the third quarter, helped by a favourable base effect

Helped by a favourable base effect in Asia (*China mainly*), by still significant demand in Europe and by the recovery in the Iranian market following the reopening of commercial trades, global automotive demand accelerated during the third quarter compared with Q2-16 and compared with Q3-15. Worldwide demand was therefore up by **5%** after being only up by **2.4%** in H1-16 and by **1.5%** in Q1-16, leading to an upward revision of the two largest automotive data providers' 2016 guidance for auto demand (*LMC and IHS*).

Fig. 4: Worldwide automotive growth in demand accelerated during Q3-16

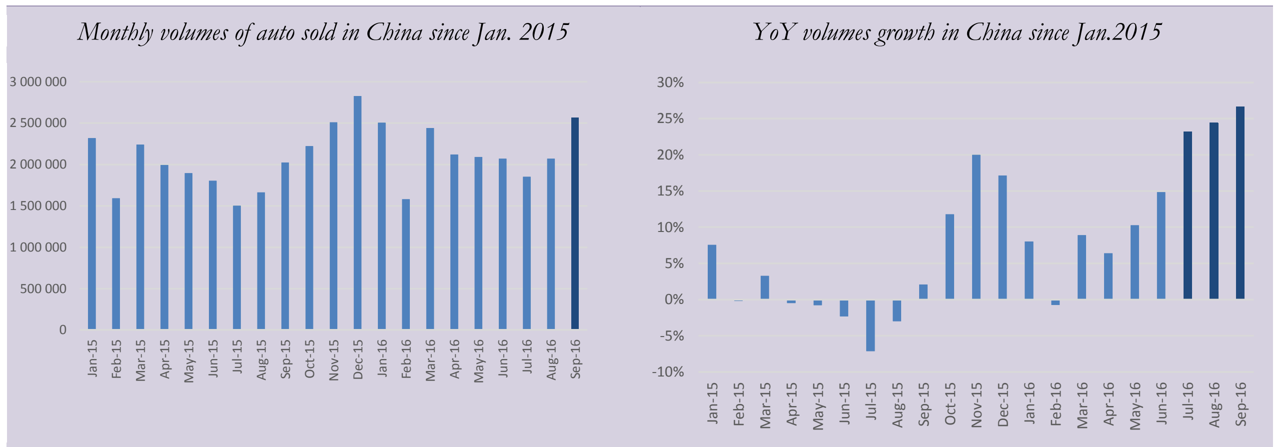


Source: Renault; Bryan, Garnier & Co ests.

Most of the surge in automotive demand was driven by Asia with demand in China being up by **18.5%** during the quarter (*positive base effect compared with Q3-15*), while demand in India and in Iran also accelerated (*respectively +17% and +43% over the quarter*) contrary to the Russian and Brazilian markets which continued to plunge as they did in Q1 and Q2 with both markets still expected to reach a low point in demand this year.

It is important to keep in mind that the Chinese automotive market is still benefiting from the tax cut mechanism (*5% tax vs. a traditional tax rate of 10% on all vehicles below 1.6L engine size*) implemented by the government during Q4-15 to soften the market slowdown observed back then. The 2016 Chinese demand is therefore in a way "artificial" and should further accelerate during Q4 given "officially" this tax cut is still expected to be raised or even **disappear** as soon as 1st January even though government, under lobbying pressure, is currently reviewing the mechanism. We continue to assume either the mechanism will be renewed until 2017 or there would be a progressive return to 10% (*by passing through a 7.5% level during the first half year)* limiting the potential downturn in demand one could expect assuming the incentive package is fully abandoned. **We therefore expect the Chinese automotive market to remain solid during the fourth quarter and to still generate growth in 2017-18.**

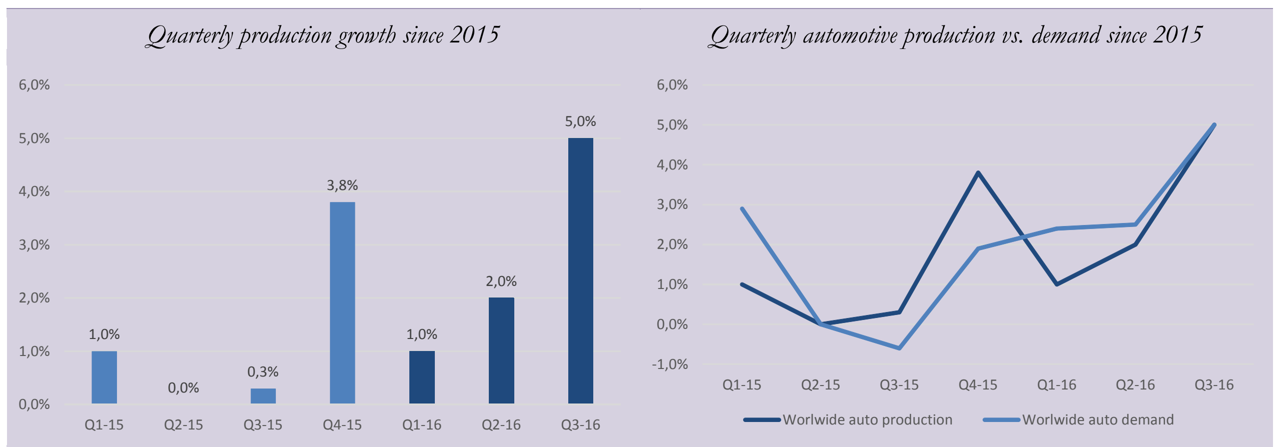
Fig. 5: Chinese automotive market accelerated during Q3-16



Source: CAAM; Bryan, Garnier & Co ests.

Interestingly, production development was strongly correlated to automotive demand, with production also being up **5%** during the third quarter, with most of additional production coming from China and North America, the two biggest markets.

Fig. 6: Worldwide automotive growth in production accelerated in 2016



Source: LMC; Renault; Bryan, Garnier & Co ests.

The recovery effect in China positively affected worldwide automotive production during the fourth quarter, like for demand. Production in Europe was, however, affected by risks linked to Brexit, with large-masse carmakers adjusting production on some models to prevent building up inventories, while in the U.S. almost all the "Big 3" started to adjust down production to face the slowdown in demand expected in 2017.

Production and demand should remain strongly correlated during the fourth quarter even if we anticipate in Europe and in U.S. some minor discrepancies driven by production cuts coming from carmakers willing to further optimise inventories before entering 2017.

Please see the section headed "Important information" on the back page of this report.

Most of carmakers positively surprised and revised up 2016 guidance despite unfavourable FX effects

Fig. 7: Summary of carmakers Q3-16 publication

Group	Country	Pub. Date	Share perf. over next two days after pub.	2016 Guidance	Q3 volumes growth	Q3 YoY sales growth	Q3-16 EBIT margin	Q3-15 EBIT margin
BMW	Germany	04-nov	2,40%	Unchanged	7,1%	13,8%	11,0%	10,2%
Daimler	Germany	21-oct	-1,6%	Revised down	11,0%	12,0%	11,4%	10,4%
FCA	Italy	25-oct	10,6%	**Revised up**	-1,3%	0,1%	5,6%	4,3%
Ferrari	Italy	07-nov	0,0%	**Revised up**	1,5%	8,3%	22,0%	19,4%
Ford	U.S.	27-oct	-1,3%	Unchanged	-4,0%	-7,0%	3,3%	7,7%
GM	U.S.	25-oct	-5,0%	**Revised up**	3,8%	10,3%	8,3%	8,0%
Honda*	Japan	31-oct	-5,4%	**Revised up**	6,9%	-9,9%	7,0%	4,6%
Nissan*	Japan	07-nov	-5,0%	Unchanged	0,4%	-12,1%	6,1%	6,6%
Peugeot	France	26-oct	3,4%	Unchanged	10,6%	-5,1%	na	na
Renault	France	25-oct	3,5%	Unchanged	16,0%	13,0%	na	na
Suzuki*	Japan	04-nov	7,0%	**Revised up**	4,0%	-3,6%	7,7%	6,5%
Toyota*	Japan	08-nov	-6,0%	**Revised up**	1,2%	-8,8%	7,3%	11,6%
VW	Germany	27-oct	0,80%	**Revised up**	4,20%	1,0%	7,2%	6,2%
Average	-	-	**0,26%**		**4,7%**	**0,92%**	**8,81%**	**8,68%**

*Source: Company Data; Bryan, Garnier & Co ests. (*Q2-16/17)*

…while suppliers continued to strongly outperform market and carmakers

Interestingly, suppliers continued **to easily out-perform the market and carmakers during the third quarter**, as already observed since 2007. We estimated, based on our automotive panel, that suppliers, on average outperformed the market and carmakers by **2pp** during the third quarter thanks mainly to a positive mix effect. On average, total sales from automotive suppliers were up **7%** LfL while volumes from carmakers were up **4.7**%. When comparing YoY sales growth (*integrating FX and pricing effects for carmakers),* the gap is even stronger, as on average carmakers only posted **1%** sales growth vs. **7.7%** for suppliers.

Within our coverage, the outperformance is slightly lower during Q3 compared with Q1 and Q2 mainly due to the country mix as the Chinese market performed strongly during the third quarter while the European market was more under pressure. Yet this trend will continue over Q4 and, most importantly, over 2017, given the main important markets are expected to either fall or slowdown compared with 2016.

We are therefore quite surprised by the recent fall in the share prices of auto suppliers observed since end September.

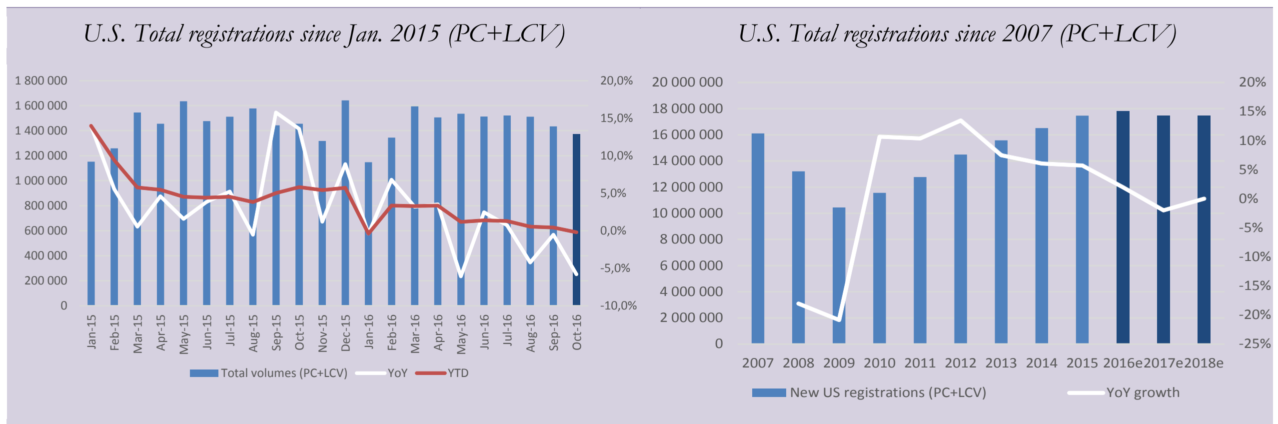
1.2.2. Is the slowdown of the cycle really new?

No, as nearly all automotive industrials had already warned several months ago that the global market would soften after the 2011-16 rally

Recent indications from US OEMs on the slowdown in the US market are not new

Back in February 2016, during its 2015 earnings presentation, Ford already indicated market growth in the U.S. would be limited, in the range of **-2%/+4%,** while GM was already communicating on a potential downturn risk after a cycle of **7 years** of market recovery. Since the beginning of the year, the market has resisted quite well, still favoured by the relatively low Brent price and by low interest rates, and is therefore flat on a YTD basis.

Fig. 8: US market is close to its peak level, but this is not new…



Source: Goodcarbadcar; Bryan, Garnier & Co ests.

This well-known risk on the U.S. market even obliged carmakers to adjust production to optimise inventory levels and to avoid having to offer too massive and too numerous discounts on car prices to attract customers to dealerships. We obviously observed some usage of discounts, but most importantly we had already observed production cuts from Ford and GM, the two markets leaders, implying inventory level in U.S. remain at **this stage under control**, to the profit of suppliers which slightly suffered from lower than expected outputs during Q3 yet which **will not suffer from a massive destocking effect in 2017 if market deceleration accelerates**.

1.2.3. Are Brexit & Trump's elections real risks for the sector?

Yes, some risks exist for carmakers addressing the U.S. market with imports…

Trump said many things during his presidential campaign about protectionism and job protection in the automotive sector, which today still represent **3-3.5%** of global US GDP despite all delocalisation processes that have affected the sector over the past 10 years.

What matters the most for the automotive sector is that Trump promised job protection for U.S. automotive workers, and threatened all carmakers addressing the U.S. automotive market by producing in Mexico that entry barriers could be re-implemented *(35%)* obliging them to produce locally again as was the case **15 years ago** before the NAFTA signature. When looking at votes from US auto states, it appears that workers took him at his word and predominantly voted for him, partly for his promises to protect their jobs by scrapping NAFTA and to reject or renegotiate other trade-opening deals. The states of Michigan and Wisconsin, historically in favour of the Democrats, voted for Trump during this election. **Pressure to respect his announcements on this subject are therefore important in our view.**

Fig. 9: How the auto stated voted?

U.S. states	2016 auto production	Winner
Michigan	**1,857,357**	**Trump**
Ohio	**1,206,171**	**Trump**
Indiana	**1,027,335**	**Trump**
Kentucky	1,001,211	Trump
Alabama	813,803	Trump
Tennessee	604,304	Trump
Missouri	573,114	Trump
Illinois	534,838	Clinton
Texas	456,181	Trump
Mississippi	414,583	Trump
South Carolina	343,696	Trump
Georgia	285,96	Trump
Kansas	136,385	Trump
California	58,935	Clinton

Source: Associated Press, Automotive News Data Center; Bryan, Garnier & Co ests.

To understand the situation and fully assess how Trump's election could alter the North American auto industry, it is important to bear in mind that:

- Between **1994** and **2013**, the number of auto factory jobs dropped by a third in the US and rose almost five-fold in Mexico as lower-wage production boomed, with the signature of **NAFTA** between **Canada** and **Mexico** in **1993** (*pushed by former President Bill Clinton)* being the main driver. According to *Wards Auto*, the average hourly labour costs for auto workers in Mexico is **USD3.29** vs. >**USD24** in the US (*2015 based*).

- Mexico now accounts for **20%** of all vehicle production in North America, has attracted more than **USD25bn** in investment from the industry since 2010, and has difficulties to find workers while, at the same time, the unemployment rate in Detroit is close to **10%**.

- On average, >**80%** of exported vehicles from Mexico are dedicated to the US market, which implies today that around **20%** of the vehicles (*PC+LCV*) sold in the US are produced in Mexico.

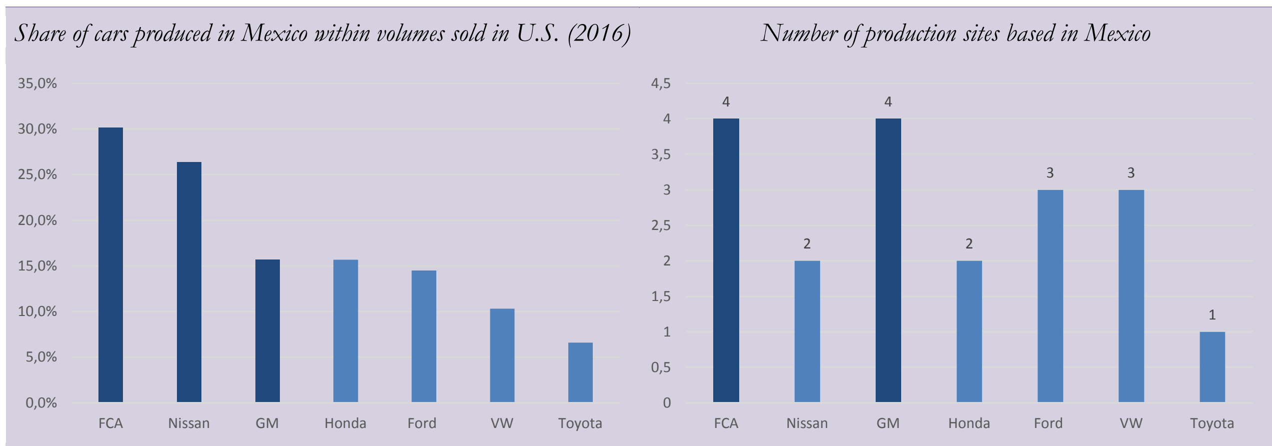
- Before Trump's election, **Toyota, BWW, Ford** and several other auto makers committed to spend a combined **USD15.8 billion** to build new assembly plants or expand existing factories in Mexico.

Labour costs are 7 times more expensive in the US than in Mexico

Any cancellation of NAFTA or renegotiation process between the U.S., Canada and Mexico, imposed by Trump, could therefore drastically change the industrial footprint of major carmakers addressing the U.S. market by producing outside the country, to the detriment of margins and profits, given labour costs are **7 times** more expensive in the US than in Mexico.

Within the automotive sector as a whole, we assume **Nissan**, **FCA** and **GM** are the carmakers which are most at risk given a large part of U.S. automotive volumes are today coming from Mexican plants.

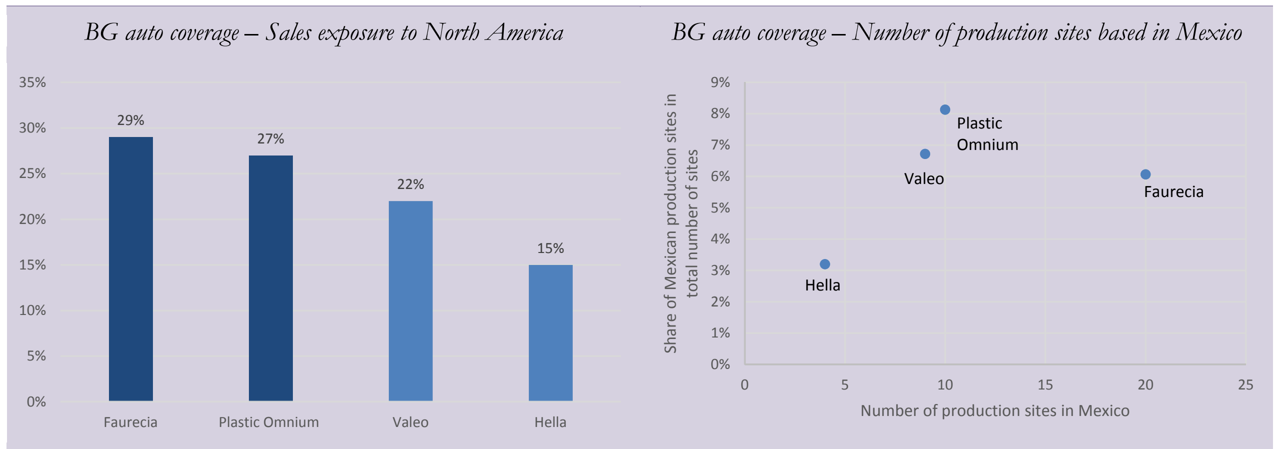
Fig. 10: Nissan, FCA & GM are among the most at risk in our view



Source: Automotive Industry Association of Mexico; Bryan, Garnier & Co ests.

In our BG automotive coverage, **Faurecia** and **Plastic Omnium** are the most exposed to the North American automotive market, and more specifically to the US automotive market with most of the risks being forced relocations from their customers, leading to extra costs linked to imposed site closures and site reopenings. Depending on the size of the production site and the type of the business, the building of a new plant could cost from **EUR30m to >EUR100m**, costs that will be at the expense of the suppliers, on top of the dismantling costs.

Fig. 11: BG automotive coverage – Exposure to North America (%)



Source: Company data; Bryan, Garnier & Co ests.

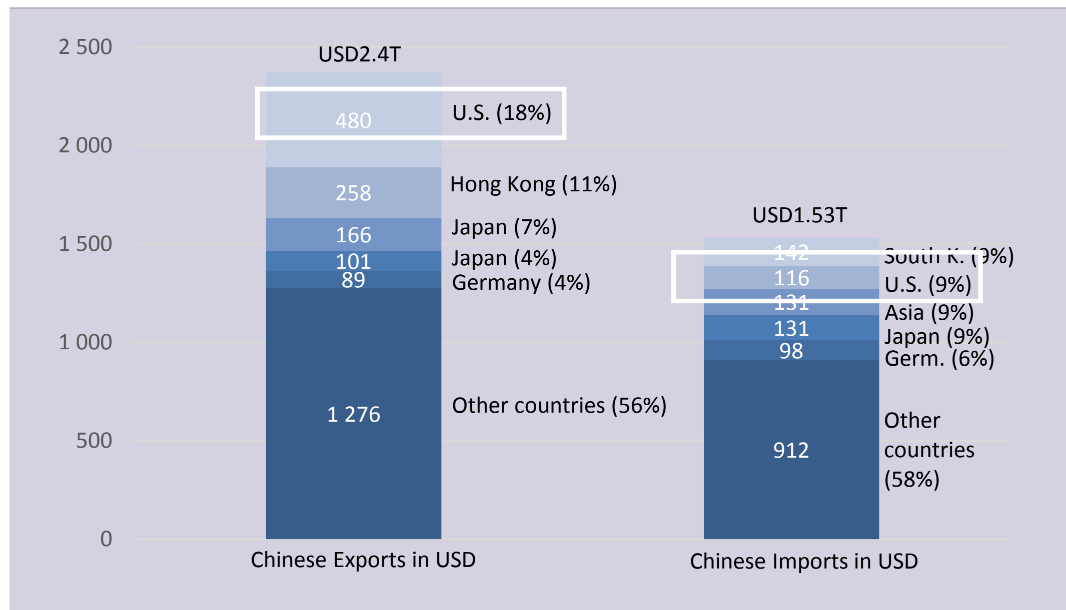
Indirectly all four suppliers could also suffer from a potential more than expected slowdown in automotive demand in both the **US** and **Mexico** assuming consumers' confidence is affected and assuming the US economy softens.

While an excessive protectionism from the US could lead potentially to a slowdown of global economy

Assuming the U.S. adopts a more protectionist approach than before, as for international trades, this could have a negative impact on the global economy and so potentially on the global automotive market. With the U.S. importing around **USD480bn** of products from China when the US was only exporting **USD116bn** to China, the trade balance between both countries remains unprofitable for the US, making the country less dependent on China than China on the U.S. The short-term risk for U.S. consumers is seeing higher inflation on some products (*assuming a new tax is implemented*), while for China the risk is a cut in demand for Chinese products from the U.S., to the detriment of Chinese production and China's trade balance.

Please see the section headed "Important information" on the back page of this report.

Fig. 12: 2015 China trade balance in USD



Source: USTR.GOV; Bryan, Garnier & Co ests.

Given that global automotive demand is **80%** correlated to worldwide GDP growth, it is fair to assume the sector's growth could be affected in 2017 and 2018, assuming international relationships between the U.S. and foreign countries are affected by tax barriers.

We simulated the potential impact of a lower worldwide automotive demand on our auto stocks on **page 15**.

Given Faurecia is the only auto supplier in our universe which is **100% exposed to the OE market** (*Valeo and Hella are also exposed to the aftermarket business while Plastic Omnium is exposed to the environmental business*), it is fair to assume it will be the most impacted by a general slowdown in the worldwide economy.

1.2.4. Why so anxious?

Respecting all electoral promises will be difficult, especially ones concerning international trades given negotiations with other countries will be uneasy and given it could impact negatively U.S. economy. With Trump already walking away from some campaign promises (*on Obamacare & Muslim ban notably)* we assume real threats on auto sector coming from potential NAFTA renegotiation remain at this stage limited.

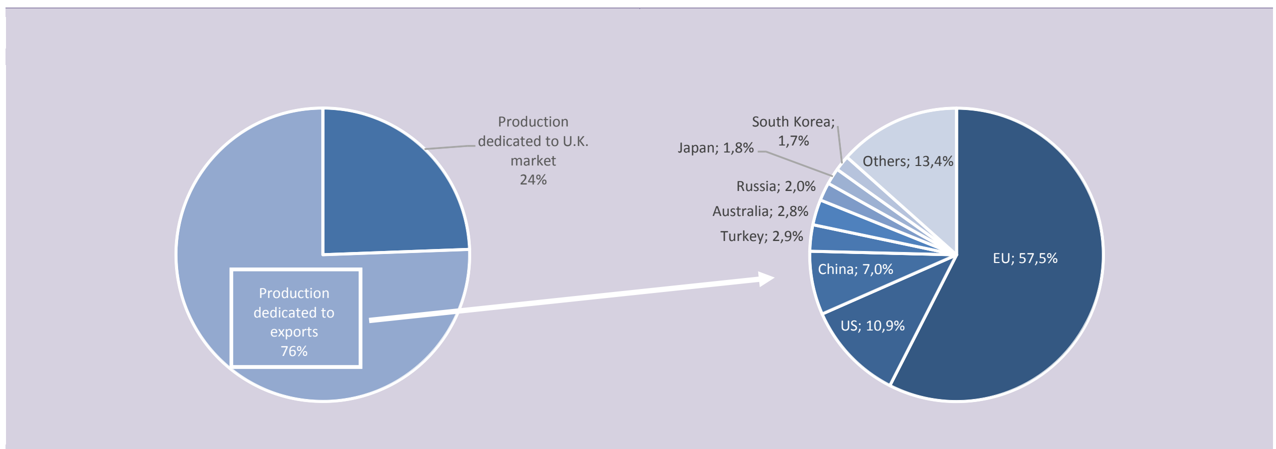
The recent comment from **Ford** which reiterated (*after Trump's victory*) its intention to relocate the production of the next **Ford Focus** from **U.S. to Mexico by 2018** arguing it is very difficult to be profitable on small car segment in U.S. if vehicle is produced locally, **is reassuring**. To reduce the risk of political interference Ford indicated this relocation will have no job impact in U.S. given this production shift will make room for two very important products the group will produce into Michigan plants.

Yes, some risks exist for carmakers addressing the European market by importing from UK …

Similar to the U.S. and Trump's election, the recent Brexit decision could also alter UK car production assuming tax barriers are re-imposed for all vehicles produced in the UK and dedicated to EU countries (*France and Germany mainly*).

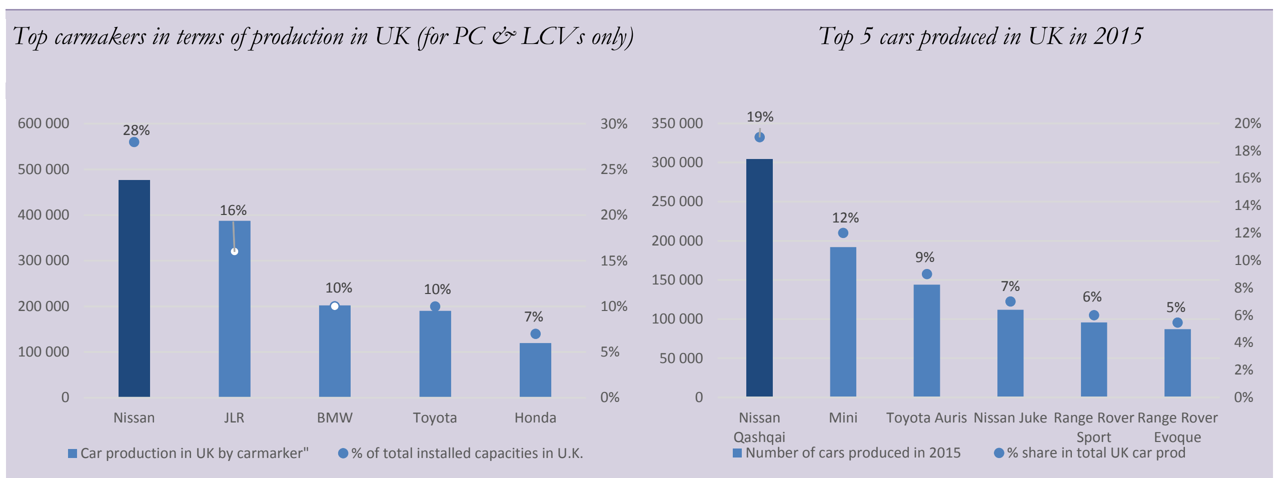
As a reminder, out of all car production in the UK *(1.6m in 2015)*, **1.2m units** *(>75%)* are exported and **57%** of the vehicles exported are shipped to other EU countries *(i.e. 684k units)*. We identified the most exposed carmakers to any potential change in trade conditions between the UK and other countries as **Nissan, Jaguar Land Rover (JLR), BMW** (*the Mini brand*), **Toyota** and **Honda,** given of the majority of the cars produced in UK by these groups are dedicated to serve EU markets. **Nissan** is, for instance, exporting more than **two-thirds of its production outside the UK**, like **BMW** (*the Mini brand*), while **JLR** is exporting around **80%**. Assuming a tax will be imposed to import into the EU vehicles coming from the UK, then this would mechanically raise the implied selling price within the final market leading to market share losses for carmakers importing vs. carmakers producing locally.

Fig. 13: >75% of cars produced in U.K. are exported



Source: SMMT; Bryan, Garnier & Co ests.

Fig. 14: Carmakers mostly exposed to U.K. market in terms of production



Source: SMMT; Bryan, Garnier & Co ests.

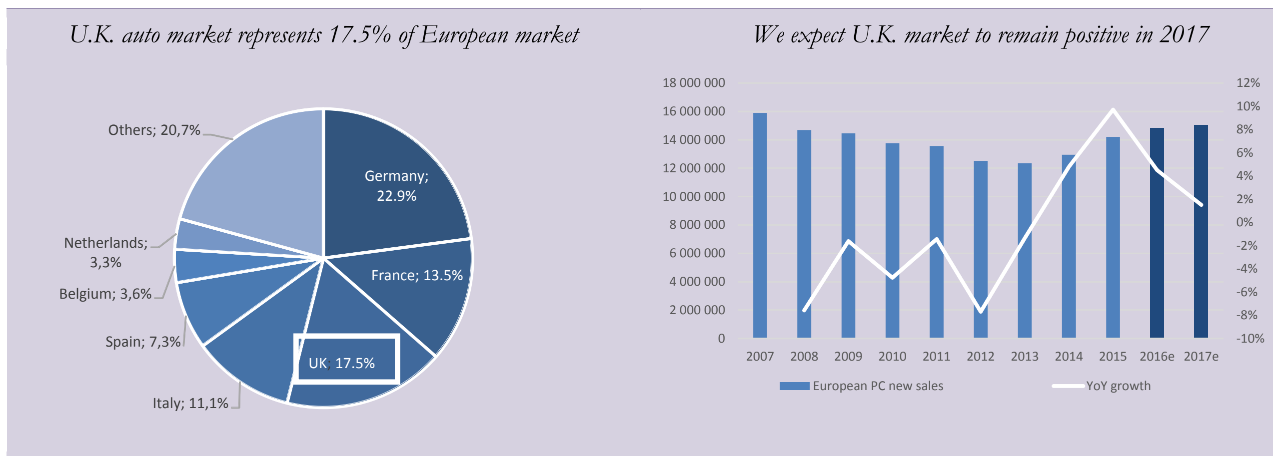
Please see the section headed "Important information" on the back page of this report.

On top of this risk, the sector could also suffer from **lower GDP growth in U.K** as a result of the Brexit, leading to decline in U.K. automotive demand for 2017-18 compared with 2016. While in our model we continue to assume market will remain stable next year, with recent reassuring statistics for September and October comforting our position, **we admit a risk of massive market deterioration exists**.

Carmakers exporting cars from EU to U.K. could also be affected by tax mechanisms as for carmakers exporting from U.K. and could also suffer from GBP depreciation, **obliging them to rise prices to protect margin to the detriment of market share**.

As a reminder, U.K. market represents today **17.5%** of the European market implying a **10%** cut in demand will affect European market by **-1.8/1.9%.**

Fig. 15: U.K. is an important market for Europe



Source: SMMT; Bryan, Garnier & Co ests.

Within our BG auto universe, the direct exposure to the UK market remains quite limited with this market representing less than **4-5%** of the groups' total sales on average. Production sites located in the UK and which could then suffer from lower output following the implementation of a tax barrier on imported products from the UK represent less than **3%** of the total number of the groups' worldwide sites.

At this stage we continue to think most of fears linked to Brexit on automotive market are excessive.

Please see the section headed "Important information" on the back page of this report.

2. We still see upside on our stocks even assuming a worldwide automotive demand fall next year

At this stage, and despite all market fears linked to Brexit, Trump's election and a potential slowdown in the Chinese automotive market, we continue to assume worldwide automotive demand will be up by **1.4%** next year and by **1.9%** in 2018 after being up **3%** on average since 2007.

Fig. 16: Global automotive demand - BG estimates (*thousands of vehicles*)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016e	YoY	2017e	YoY
Total Europe	**17 926**	**16 574**	**15 998**	**15 305**	**15 247**	**14 102**	**13 737**	**14 544**	**15 910**	**16 625**	**4,5%**	**16 875**	**1,5%**
o/w Germany	3 376	3 320	3 982	3 119	3 413	3 170	3 271	3 271	3 449	3 604	4,5%	3 658	1,5%
o/w UK	2 752	2 431	2 190	2 262	2 208	2 544	2 806	2 086	3 014	3 120	3,5%	3 151	1,0%
o/w France	2 525	2 510	2 644	2 652	2 633	2 282	2 155	2 168	2 295	2 433	6,0%	2 481	2,0%
Total Eurasia/Euromed	**4 669**	**5 041**	**2 908**	**3 504**	**4 522**	**5 836**	**6 478**	**5 885**	**5 057**	**4 692**	**-7,2%**	**4 828**	**2,9%**
o/w Russia	2 497	2 896	1 585	1 898	2 678	2 905	2 763	2 471	1 606	1 413	-12,0%	1 484	5,0%
o/w Turkey	594	494	452	765	862	780	853	769	968	920	-5,0%	938	2,0%
Total Americas	**5 394**	**5 484**	**5 128**	**5 524**	**6 503**	**6 993**	**6 478**	**6 495**	**5 664**	**5 072**	**-10,5%**	**5 252**	**3,6%**
o/w Brazil	2 340	2 661	2 702	3 329	3 424	3 589	3 576	3 341	2 479	1 859	-25,0%	1 952	5,0%
o/w Mexico	1 108	1 025	758	820	906	968	1 070	1 135	1 352	1 487	10,0%	1 561	5,0%
o/w Argentina	534	574	519	634	818	819	917	656	626	638	2,0%	651	2,0%
Total Asia/Africa	**23 079**	**23 079**	**27 180**	**33 087**	**36 444**	**38 477**	**38 094**	**39 173**	**39 931**	**41 780**	**4,6%**	**42 771**	**2,4%**
o/w China	6 354	8 614	9 433	14 062	16 700	18 209	20 586	22 395	23 609	26 565	8,0%	27 097	2,0%
o/w Japan	5 072	4 849	4 574	4 907	4 130	5 138	5 272	5 490	4 943	4 695	-5,0%	4 766	1,5%
o/w South Korea	1 271	1 214	1 366	1 554	1 577	1 522	1 528	1 636	1 805	1 869	3,5%	1 906	2,0%
o/w India	1 674	1 710	1 968	2 649	2 879	2 995	2 960	2 931	3 118	3 258	4,5%	3 339	2,5%
Total North America	**17 837**	**14 826**	**11 863**	**13 056**	**14 374**	**16 147**	**17 361**	**18 373**	**19 371**	**19 834**	**2,4%**	**19 508**	**-1,6%**
o/w Canada	1 717	1 613	1 404	1 480	1 596	1 650	1 779	1 850	1 902	2 016	6,0%	2 046	1,5%
o/w USA	16 121	13 213	10 460	11 576	12 778	14 497	15 582	16 524	17 469	17 818	2,0%	17 462	-2,0%
Total PC & LCV market	**66 609**	**69 782**	**63 078**	**70 476**	**78 257**	**81 679**	**82 148**	**84 471**	**85 933**	**88 004**	**-**	**89 223**	**-**
YoY growth	-	4,8%	-9,6%	11,7%	11,0%	4,4%	0,6%	2,8%	1,7%	**2,4%**		**1,4%**	

Source: Renault; Bryan, Garnier & Co ests.

Yet to assess fully the implications of a real fall in new demand next year on our estimates and FV for **Faurecia**, **Hella**, **Plastic** and **Valeo**, we decided to simulate a decline of **4%** in our models for 2017 and a slight recovery in 2018 *(+1.9%)*. As a reminder all our FVs are calculated using: **1/ historical multiples** and **2/** a **DCF** with the weight of multiples on the FV calculation being intentionally overweight *(75% of FV)* **to the detriment of the DCF valuation** *(25%)* in order to reflect the cyclical nature of the segment and the industry, and sharp volatility in the sector.

Please see the section headed "Important information" on the back page of this report.

For our simulation we decided to:

We simulated a 4% fall in worldwide volumes for 2017.

- Cut our 2017e estimates for **U.S.** market from **-2%** to **-10%**
- Cut our 2017e estimates for **UK** market from **+1%** to **-8%**
- Cut our 2017e estimates for **France** and **Germany** from respectively **+1.5%** and **+2%** to **-5%** and -**4%**
- Cut our 2017e estimates for **Chinese** market from **+2%** to **-8%**

All in all, these changes modified our 2017e worldwide expectations for demand for new autos from **+1.4%** to **minus 4%.** We, however, kept our **2018e growth estimates unchanged** at **+1.9%** and therefore did not factor in the massive recovery effect that could affect new demand positively after an important market decline.

We modelled this change in market estimates for 2017 in our Hella, Faurecia, Plastic Omnium and Valeo models, based on each one's geographic mix. We also assumed these four suppliers will continue to outperform the underlying market demand, each differently in the same way as when we estimated the market will go up by **1.4%** in 2017.

Below are the impacts of the simulation on our estimates and FV. We assumed 10-15% operating leverage to simulate the impact of lower sales to groups' operating margin, in function of groups' costs base.

Fig. 17: Impact of our simulation on our 2017/18 estimates and FV

	Faurecia	Hella	Plastic Omnium	Valeo	Average
2017e Sales change	-5,1%	-6,3%	-4,5%	-5,1%	-5,2%
2018e Sales change	-5,2%	-6,3%	-4,2%	-5,2%	-5,1%
2017e EPS change	-21,6%	-12,8%	-14,8%	-10,9%	-15,0%
2018e EPS change	-19,7%	-9,1%	-14,2%	-10,7%	-13,4%
FV change	**-19,1%**	**-11,1%**	**-11,1%**	**-8,2%**	**-10,4%**
Implied FV	**38**	**40**	**32**	**45**	**-**
Upside/downside implied	20,6%	19,8%	11,1%	-9,8%	10,4%

Source: Company Data; Bryan, Garnier & Co ests.

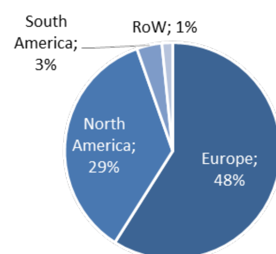
2.1. Faurecia – market went definitively too far down

Fig. 18: Faurecia – Current estimates vs. simulation (*EURm*)

Faurecia	Current BG estimates			Current consensus			Simulation BG estimates			Change BG estimates			Change vs. consensus		
	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e
Sales	**18 749**	**19 532**	**20 368**	**18 866**	**19 582**	**20 332**	**18 749**	**18 529**	**19 307**	**-**	**-5,1%**	**-5,2%**	**-0,6%**	**-5,4%**	**-5,0%**
YoY sales growth	-0,1%	4,2%	4,3%	0,5%	3,8%	3,8%	-0,1%	-1,2%	4,2%	-	-	-	-	-	-
EBITDA	**1 547**	**1 588**	**1 768**	**1 579**	**1 637**	**1 735**	**1 547**	**1 430**	**1 595**	**-**	**-9,9%**	**-9,8%**	**-2,0%**	**-12,6%**	**-8,1%**
EBITDA margin	8,2%	8,1%	8,7%	8,4%	8,4%	8,5%	8,2%	7,7%	8,3%	-	-5,1%	-4,8%	-1,4%	-7,7%	-3,2%
EBIT	**929**	**1 034**	**1 146**	**966**	**1 004**	**1 073**	**929**	**866**	**874**	**-**	**-16,3%**	**-23,8%**	**-3,9%**	**-13,7%**	**-18,5%**
EBIT margin	5,0%	5,3%	5,6%	5,1%	5,1%	5,3%	5,0%	4,7%	4,7%	-	-11,3%	-15,8%	-3,3%	-8,4%	-10,2%
Net income	**697**	**536**	**624**	**512**	**541**	**603**	**697**	**420**	**501**	**-**	**-21,6%**	**-19,7%**	**36,1%**	**-22,3%**	**-17,0%**
Dividend	1,01	1,09	1,26	0,88	0,94	1,03	1,01	0,85	1,02	-	-21,6%	-19,7%	15,0%	-9,3%	-1,2%
Net debt	127	48	(140)	181	31	(130)	127	361	231	-	-	-	-	-	-
FV		**47**						**38**			**-19,1%**				
Last price		31,8						31,8			-				
Upside/Downside		47,6%						19,5%			-				

Source: Datastream; Bryan, Garnier & Co ests.

Faurecia sales 'exposure by market (*2016e*)



In our automotive universe at BG, Faurecia is the automotive supplier **most exposed to the OE market** (*100% of its sales*) and the most exposed to **North America** (*29% of its sales*), making it the most at risk when we simulate a rapid turnaround in worldwide demand as we did for 2017.

In our simulation, we expect a **-2.0%** in LfL sales growth on the group's auto business vs. 2016 vs. **+7%** in our current model. We therefore expect Faurecia to outperform the automotive market by around **2pp next year despite this sales growth we simulated.**

All in all, we simulated Faurecia will post a **minus 1.2% YoY sales fall in 2017**, leading to **4% EBIT** fall vs. 2016.

This simulation implies a discount of 22% vs. current consensus estimates for 2017 and 18% for 2018 but, most importantly, a 19.5% upside vs. the latest share price as our model gives us a FV of EUR38/share post simulation.

Please see the section headed "Important information" on the back page of this report.

2.2. Hella – the most defensive stock in our universe

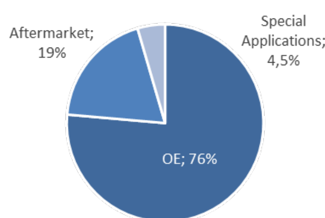
Fig. 19: Hella – Current estimates vs. simulation (*EURm*)

Hella	Current BG estimates			Current consensus			Simulation BG estimates			Change BG estimates			Change vs. consensus		
	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e
Sales	**6 611**	**6 940**	**7 288**	**6 705**	**7 147**	**7 611**	**6 514**	**6 506**	**6 827**	**-**	**-6,3%**	**-6,3%**	**-2,8%**	**-9,0%**	**-10,3%**
YoY sales growth	4,1%	5,0%	5,0%	5,6%	6,6%	6,5%	2,6%	-0,1%	4,9%	-	-	-	-	-	-
EBITDA	**875**	**944**	**1 037**	**921**	**1 009**	**1 094**	**868**	**888**	**985**	**-**	**-5,9%**	**-5,0%**	**-5,7%**	**-12,0%**	**-10,0%**
EBITDA margin	13,2%	13,6%	14,2%	13,7%	14,1%	14,1%	13,3%	13,4%	14,4%	-	-1,5%	1,2%	-3,0%	-5,1%	2,0%
EBIT	**513**	**548**	**609**	**495**	**549**	**588**	**506**	**494**	**567**	**-**	**-9,8%**	**-6,9%**	**2,3%**	**-9,9%**	**-3,5%**
EBIT margin	7,8%	7,9%	8,4%	7,4%	7,7%	7,7%	7,8%	7,6%	8,3%	-	-3,8%	-0,6%	5,3%	-1,0%	8,3%
Net income	**356**	**386**	**436**	**340**	**385**	**428**	**352**	**336**	**396**	**-**	**-12,8%**	**-9,1%**	**3,4%**	**-12,8%**	**-7,4%**
Dividend	0,96	1,04	1,18	0,92	1,04	1,22	0,95	0,91	1,07	-	-12,8%	-9,1%	2,7%	-13,1%	-12,3%
Net debt	189	113	0	255	202	246	170	159	-16	-	-	-	-33,4%	-21,4%	-106,4%
FV		**45**						**40**			**-11,1%**				
Last price		33,9						33,9			-				
Upside/Downside		32,6%						18%			-				

Source: Datastream; Bryan, Garnier & Co ests.

Like Valeo, **Hella** benefits from a natural buffer when OE market starts to slow down or even worst when it enters into an important declining phase. As a reminder, aftermarket at Hella represents today still **20%** of group's sales, while special applications (*businesses not linked to automotive business*) account for **5%** implying direct group's exposure to OE market is only **75%**.

Hella has a limited direct exposure to OE market



In our simulation we expect a **-1.2%** in LfL sales growth on group's auto business for 2018e (*the group reports from June 1st to May 31st*) vs. **+5.5%** in our current model. We also integrated a decline in group's 2017e accounts given the group will be affected during last three months of its fiscal year by the market fall we factored in our simulation.

All in all, we simulated Hella will flat **YoY sales growth fall in 2018**, leading to **3% EBIT** fall vs. 2017.

This simulation implies a discount of 13% vs. current consensus estimates for 2018 and 7% for 2018 but most importantly a 18% upside vs. latest share price given our model gives us a FV of EUR40/share post simulation.

Please see the section headed "Important information" on the back page of this report.

2.3. Plastic Omnium – market is a bit too pessimistic

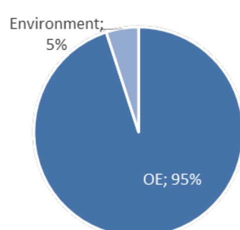
Fig. 20: Plastic Omnium – Current estimates vs. simulation (*EURm*)

Plastic Omnium	Current BG estimates			Current consensus			Simulation BG estimates			Change BG estimates			Change vs. consensus		
	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e
Sales	**5 813**	**6 720**	**7 113**	**5 879**	**7 076**	**7 391**	**5 813**	**6 442**	**6 843**	**-**	**-4,1%**	**-3,8%**	**-1,1%**	**-9,0%**	**-7,4%**
YoY sales growth	16,0%	15,6%	5,9%	16,0%	18,3%	6,3%	16,0%	10,8%	6,2%	-	-	-	-	-	-
EBITDA	**774**	**977**	**1 046**	**755**	**905**	**985**	**774**	**900**	**967**	**-**	**-7,8%**	**-7,6%**	**2,5%**	**-0,5%**	**-1,9%**
EBITDA margin	13,3%	14,5%	14,7%	12,8%	12,8%	13,3%	13,3%	14,0%	14,1%	-	-	-	-	-	-
EBIT	**533**	**631**	**702**	**537**	**602**	**690**	**533**	**549**	**615**	**-**	**-12,2%**	**-11,5%**	**-0,6%**	**-8,7%**	**-10,9%**
EBIT margin	9,2%	9,2%	9,6%	9,1%	8,5%	9,3%	9,2%	8,5%	9,0%	-	-8,5%	-8,0%	0,5%	0,3%	-3,8%
Net income	**324**	**400**	**452**	**331**	**387**	**430**	**324**	**340**	**389**	**-**	**-14,8%**	**-13,8%**	**-2,2%**	**-11,9%**	**-9,5%**
Dividend	0,53	0,65	0,74	0,53	0,62	0,70	0,53	0,56	0,64	-	-15,1%	-14,2%	0,2%	-9,5%	-9,2%
Net debt	842	456	266	853	633	364	842	562	381	-	-	-	-	-	-
FV		**36**						**32**			**-11,1%**				
Last price		28,3						28,3			-				
Upside/Downside		27,0%						13,1%			-				

Source: Datastream; Bryan, Garnier & Co ests.

In our simulation we logically only cut group' estimates on automotive division and kept unchanged sales growth on environmental services business which represents today still **5-6% of group's total sales.** Its strong exposure to North America *(27% of its automotive sales*) makes the group more sensible to the potential downturn that may affect U.S. market in 2017 yet its recent acquisition of FAE should allow it to still generate positive YoY sales growth next year.

Auto represents 95% of group's 2016e sales



In our simulation we expect a **-0.6%** in LfL sales growth on group's auto business vs. 2016 vs. **+7%** in our current model. We then expect Plastic Omnium to continue to outperform the automotive market by around **3.5pp**.

All in all, we simulated Plastic Omnium will generate a **11%** YoY sales in 2017 thanks to the positive perimeter effect coming from FAE integration, and thanks to its exposure to environmental business, leading to **5%** EBIT growth (*dilutive impact from FAE integration*).

Our simulation on Plastic Omnium is based on our new estimates as we integrated the disposal of group's heavy duty truck business to the German mutares Group announced last Friday (*deconsolidation of around EUR200m sales and around EUR7m of EBIT – BGe – with very limited impact on EPS*).

This simulation implies a discount of 12% vs. current consensus estimates for 2017 and 9.5% for 2018 but most importantly a 13% upside vs. latest share price given our model gives us a FV of EUR32/share post simulation.

Please see the section headed "Important information" on the back page of this report.

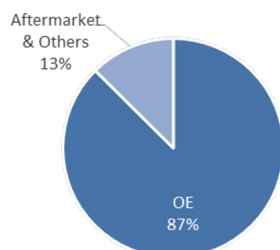
2.4. Valeo - Further 8% downside risk

Fig. 21: Valeo – Current estimates vs. simulation (*EURm*)

Valeo	Current BG estimates			Current consensus			Simulation BG estimates			Change BG estimates			Change vs. consensus		
	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e
Sales	**16 372**	**17 942**	**19 045**	**16 327**	**17 920**	**19 093**	**16 372**	**17 028**	**18 052**	**-**	**-5,1%**	**-5,2%**	**0,3%**	**-5,0%**	**-5,5%**
YoY sales growth	12,6%	9,6%	6,2%	12,3%	9,8%	6,5%	12,6%	4,0%	6,0%	-	-	-	-	-	-
EBITDA	**2 071**	**2 364**	**2 523**	**2 068**	**2 326**	**2 534**	**2 071**	**2 256**	**2 398**	**-**	**-4,5%**	**-4,9%**	**0,1%**	**-3,0%**	**-5,3%**
EBITDA margin	12,7%	13,2%	13,2%	12,7%	13,0%	13,3%	12,7%	13,3%	13,3%	-	0,6%	0,3%	-0,1%	2,1%	0,1%
EBIT	**1 320**	**1 486**	**1 602**	**1 265**	**1 438**	**1 586**	**1 320**	**1 379**	**1 487**	**-**	**-7,2%**	**-7,2%**	**4,4%**	**-4,1%**	**-6,2%**
EBIT margin	8,1%	8,3%	8,4%	7,7%	8,0%	8,3%	8,1%	8,1%	8,3%	-	-2,0%	-1,8%	4,1%	1,2%	-0,6%
Net income	**880**	**1 011**	**1 102**	**870**	**997**	**1 099**	**880**	**901**	**984**	**-**	**-10,9%**	**-10,7%**	**1,2%**	**-9,6%**	**-10,4%**
Dividend	1,12	1,29	1,40	1,15	1,31	1,43	1,12	1,15	1,25	-	-10,9%	-10,7%	-2,5%	-12,2%	-12,4%
Net debt	1 266	973	599	1 022	914	589	1 266	1 200	738	-	23,3%	23,2%	23,8%	31,3%	25,3%
FV		**49**						**45**			**-8,2%**				
Last price		50,4						50,4			-				
Upside/Downside		-2,80%						-11%			-				

Source: Datastream; Bryan, Garnier & Co ests.

OE represents 87% of group's 2016e sales



Thanks to its exposure to the automotive aftermarket which still represents more than **10%** of its total sales and **>15%** of its EBITDA (*BGe*), Valeo is less at risk than some other auto suppliers when the automotive cycle softens, as in our simulation. In our simulation, we expect a **-0.3%** in LfL sales growth on the group's OE business vs. 2016 vs. **+5.9%** in our current model. We therefore expect Valeo to continue to outperform the automotive market by around **3.7pp**.

All in all, we simulated Valeo will generate a **4.0%** YoY sales in 2017 thanks to the positive perimeter effect coming from the FTE integration, and thanks to its exposure to the aftermarket, leading to **4.3%** EBITDA growth (*accretive impact from the FTE acquisition which, besides this, is generating around one third of its sales on the aftermarket business*).

This simulation implies a discount of 10% vs. current consensus estimates for 2017 and 11% for 2018 but, most importantly, an 11% discount vs. latest share price as our model gives us a FV of EUR45/share post simulation.

Please see the section headed "Important information" on the back page of this report.

3. It's Black Friday in advance!

Given we do not see the recent fall back over past months on European auto suppliers as justified, we see at current share prices very attractive upsides on **Faurecia**, **Hella** and **Plastic Omnium**.

Our long-term view on auto suppliers remains unchanged since our initiation of coverage (most technological suppliers will continue to outperform the global automotive market easily), as well as our FV and estimates. We continue to bet on positive market growth next year despite most investors' fears.

At the current share price, Faurecia currently trades at **5x** its 2017e EBIT and at **8x** its 2017e EPS reflecting a **30% discount vs. historical multiples**, while Hella trades at **7.8x** and at **10x** its 2017e EBIT and EPS *(20% discount*) and Plastic Omnium trades at **7.9x** and at **10.8x** (*25% discount*). Valeo in our universe is the stock trading at a minimum discount *(9%)* at respectively **9.9x** and **11.7x**.

Fig. 22: BG Auto suppliers – Valuation table (2015-18e)

Valuation	Faurecia	Hella	Plastic Omnium	Valeo	Average suppliers
EV/EBIT 2015	9,1x	10,8x	11,6x	12,0x	10,9x
EV/EBIT 2016e	5,9x	8,6x	10,6x	11,5x	9,1x
EV/EBIT 2017e	5,0x	7,8x	7,9x	9,9x	7,7x
EV/EBIT 2018e	4,3x	6,7x	6,7x	8,9x	6,6x
Average 16-18	**5,1x**	**7,7x**	**8,4x**	**10,1x**	**7,8x**
Premium/Discount	**-35,3%**	**-1,4%**	**7,7%**	**29,0%**	**-**
P/E 2015	12,1x	14,3x	16,7x	14,2x	14,3x
P/E 2016e	8,7x	10,8x	13,3x	13,4x	11,6x
P/E 2017e	8,1x	9,9x	10,8x	11,7x	10,1x
P/E 2018e	6,9x	8,8x	9,5x	10,7x	9,0x
Average 16-18	**7,9x**	**9,8x**	**11,2x**	**11,9x**	**10,2x**
Premium/Discount	**-22,5%**	**-3,7%**	**9,6%**	**16,6%**	**-**
PEG 2015	0,12x	-2,21x	1,06x	0,49x	-0,14x
PEG 2016e	0,44x	0,33x	0,52x	0,66x	0,49x
PEG 2017e	0,96x	1,18x	0,45x	0,78x	0,84x
PEG 2018e	0,43x	0,67x	0,72x	1,20x	0,75x
Average 17-18	**0,61x**	**0,73x**	**0,56x**	**0,88x**	**0,69x**
Premium/Discount	**-12,9%**	**4,8%**	**-19,0%**	**27,0%**	**-**

Source: Company Data; Bryan, Garnier & Co ests.

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Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY — Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

NEUTRAL — Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

SELL — Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 56,1% NEUTRAL ratings 32,5% SELL ratings 11,5%

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