STEMMING UNCERTAINTY

CLEARING THE ROAD FOR UK AUTOMOTIVE RECOVERY

A BREAL ZETA INDUSTRY FOCUS PAPER

Specialists in structured asset-based lending
facilities for UK automotive companies.

www.brealzetacf.com

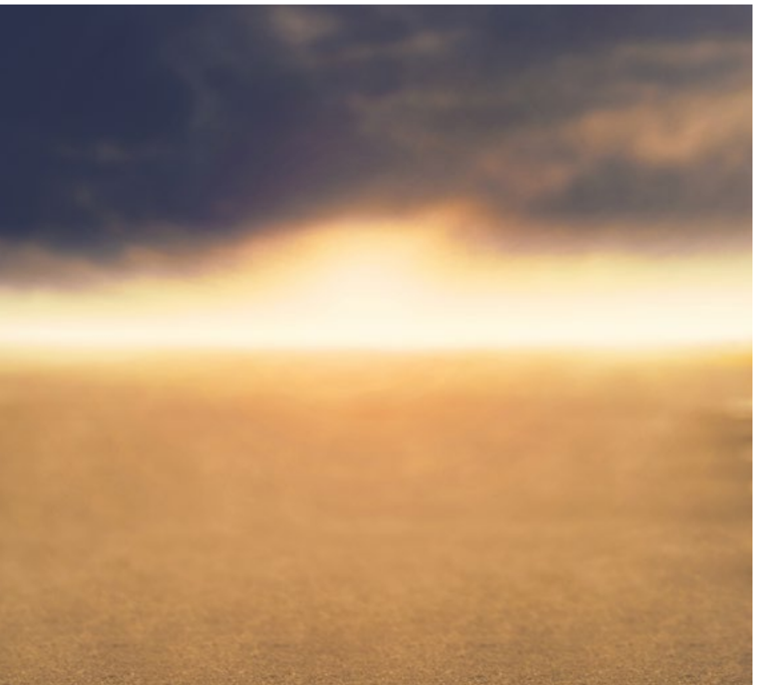
INSIGHT INTO AUTOMOTIVE

Executive Summary

"The automotive industry is a key part of the UK economy and is fundamental to the regional economies of the Midlands and the North of England. Competition within the supply chain has historically always been strong, both domestically and internationally, although this will only intensify further as the OEMs drive for further efficiencies and continue to consolidate their supply chains."

"If the UK automotive industry is to survive and indeed flourish again in future years, the whole industry needs to be appropriately supported by the UK Government, the financial services industry and indeed the consumer."

Geraint Regan FCA
Regional Business Development Director, Midlands



There have been many highs and lows for the UK automotive industry over the last twenty years, however, there has never been a more critical time for the sector than now.

The OEMs and in particular their supply chains, many of whom are owner managed SMEs, are facing a near perfect storm of uncertainty.

PRODUCTION RECOVERY

With social distancing measures/restrictions in place and concerns regarding short and medium term demand for new vehicles (domestically and globally) there is significant concern regarding how quickly production will be able to ramp up to historic levels and, more importantly, sustained, leading to the strong likelihood of further redundancies in both the OEMs and their supply chains.

FUTURE DEMAND

With dealerships suffering from national lockdowns, the lowest annual new car registration levels for over a decade and a tough January 2021 for new car registrations (down 39.5%), the automotive industry will be waiting with anticipation for the release of new registration data over the coming months.

UK GOVERNMENT SUPPORT

With the French and German governments taking the lead in supporting their automotive industries there was increasing pressure for the UK government to deliver its own stimulus to support the UK automotive sector.

CASH AND FUNDING

While the Bank of England acted quickly by reducing the base rate to 0.1% and the UK Government has tried to support businesses through a variety of schemes such as Furlough and CBILS, these initiatives have addressed their immediate short term cash needs and not the longer-term funding challenges.

BREXIT INVESTMENT

The UK car industry is facing unprecedented levels of global competition for investment. The uncertainty caused by the Brexit negotiations is a stark reminder that for many industries, and not just the automotive industry, being able to trade freely with the EU is fundamental to global investment decisions.

THE TIME FOR ACTION IS NOW

This is a critical time for the UK automotive industry and swift and decisive action needs to be taken in order to support the sector, protect jobs and position the UK for further investment:

- Create sustained demand through government supported schemes to generate new car sales
- Further investment into research, development and production of electric vehicles
- Government support for the major OEMs through incentives and tax breaks
- Support for the supply chains by the OEMs
- Access to funding for the supply chains from a range of finance providers (Mainstream and Alternative Funders)
- Smooth implementation of the new trade agreement between the UK and the EU

Recovery from Near Zero Production

As UK car factories shut down, due to the lockdown measures related to COVID-19, production of engines and vehicles fell off a cliff. Indeed, according to the SMMT, engine production fell from 178,022 units in April 2019 to just 830 units in April 2020 (a drop of 99.5%) and only 197 cars rolled off production lines compared to 70,971 the previous year (a drop of 99.7%).

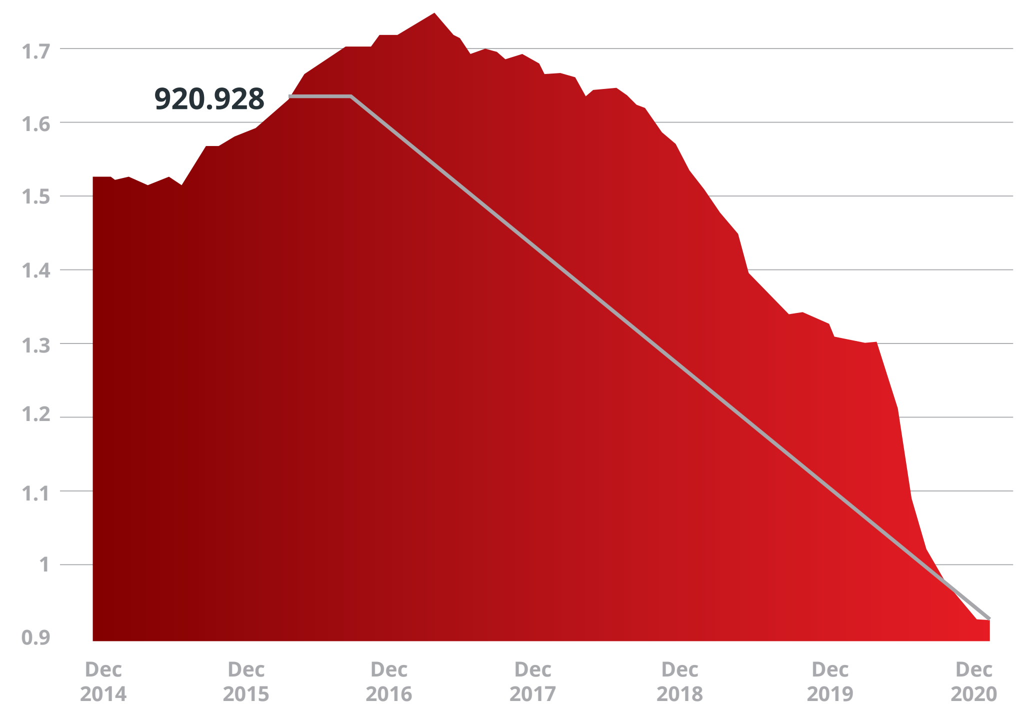
This came at a time when luxury brand manufacturer, Aston Martin, announced 500 job cuts to "right-size the organisational structure and bring the cost base into line with reduced sports car production levels". In order to support its long-term product expansion plans and to underpin the brand's future, Aston Martin subsequently signed a new technology partnership with Mercedes which will see its shareholding reach up to 20%.

Effects of the slowdown were also being felt in the supply chain where key suppliers were being forced into making strategic decisions on staffing levels. Sertec, a key Midlands supplier to Jaguar Land Rover, Nissan and Toyota, announced in June 2020 that it was forced to put an estimated 400 jobs at risk.

Despite production ramping up in the second half of the year, UK car and engine production is still in its recovery phase with only 920,928 new vehicles produced in 2020 (a fall of 29.3% year on year) and engine production falling by 27% year on year (c.680,000 fewer engines were produced in 2020).

With a second wave of COVID-19 being experienced both here and abroad and a lack of clarity over the speed of vaccine rollouts, consumer and business confidence is being affected, which in turn is putting further pressure on the car industry.

CAR OUTPUT – ROLLING YEARS TOTAL (millions)



BREAL ZETA CF COMMENT

With social distancing measures/restrictions in place and concerns regarding short and medium term demand for new vehicles (domestically and globally) there is significant uncertainty regarding how quickly production will be able to ramp up to historic levels and more importantly sustained, leading to the strong likelihood of further redundancies (in both the OEMs and their supply chains).

"With COVID-19 restrictions looking likely to continue well into 2021, there is risk that an outbreak anywhere in the supply chain could disrupt production. This could then ripple back and impact the entire supply chain, creating inevitable volatility in production volumes. Supplier failures could lead to a period of consolidation and OEMs being forced to take more control of the supply chain to safeguard critical components."

Jimmy Saunders, Duff & Phelps

Unpredictable Levels of Demand

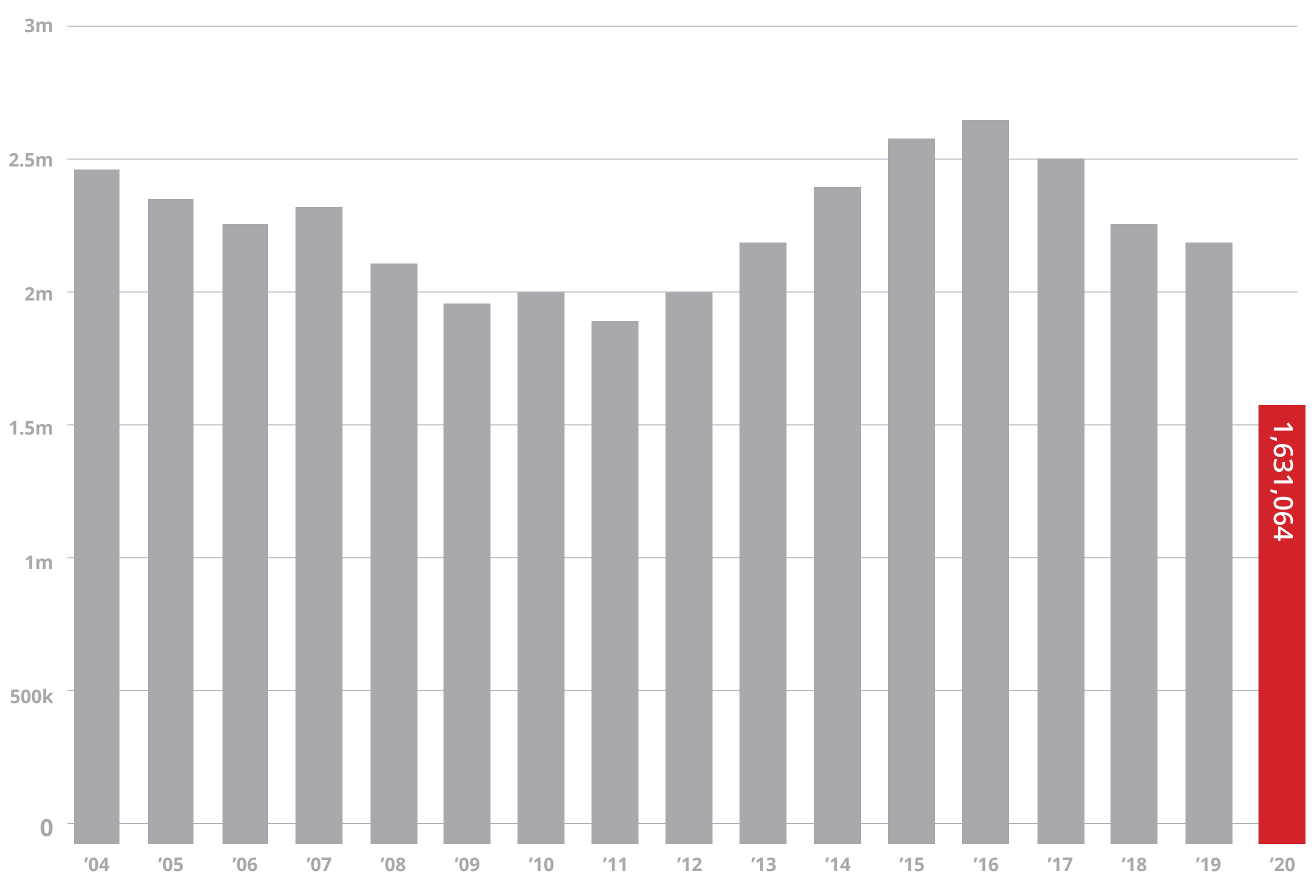
A combination of the temporary closure of car dealerships in April and May combined with a general concern from the UK public regarding take home income and job security drove the UK car registrations to unprecedented low levels.

The SMMT reported figures of 4,321 vehicles being registered in April 2020 recovering to 20,247 in May 2020. However, these figures are in stark contrast to 2019 where 161,040 vehicles were registered in April and 183,724 in May.

While many car dealerships re-opened on 1st June 2020, car retailers were faced with having to look to restructure their businesses in order to position themselves for a sustainable future. On 4th June 2020, Lookers announced it had identified 12 dealerships for either closure, consolidation or refranchising (in addition to 15 sites already identified for closure in 2019) and was seeking to make 1,500 redundancies across its group.

The second half of the year provided no respite for the dealerships as both local and national lockdowns continued to affect new car sales. Despite dealers trying to maximise sales through 'click and collect' and 'home delivery' services, the industry experienced the lowest annual new car registrations for over a decade, a period that included the financial crisis of 2008!

ANNUAL NEW CAR REGISTRATIONS 2004 to 2020



BREAL ZETA CF COMMENT

In 2020, the UK automotive industry experienced unprecedented levels of stress and uncertainty due to the COVID-19 pandemic resulting in annual new car registrations continuing the decline from 2016. With the start of 2021 showing further weakness with January new car registrations showing a year on year decline of 39.5%, the automotive industry will be waiting with anticipation for the release of new registration data over the coming months to assess the impact of the latest national lockdown, the effect of the COVID-19 vaccine rollout and falling consumer confidence.

"In light of the significant reduction in new car sales in 2020 which followed a sustained period of softening sales, demand is difficult to forecast. Adding further uncertainty to the industry has been the acceleration towards electric vehicles, and this has caused consumers to delay the purchase of new vehicles."

Jimmy Saunders, Duff & Phelps

Foreign Government Support

Following the outbreak of COVID-19, the French government quickly stepped in to support its car industry with a €8bn rescue plan. The speed and focus of the rescue plan aims to improve France's position in the global automotive marketplace both now and in the future. In addition, the French government sought to support Renault, for which it holds a 15% stake, with a €5bn rescue package.

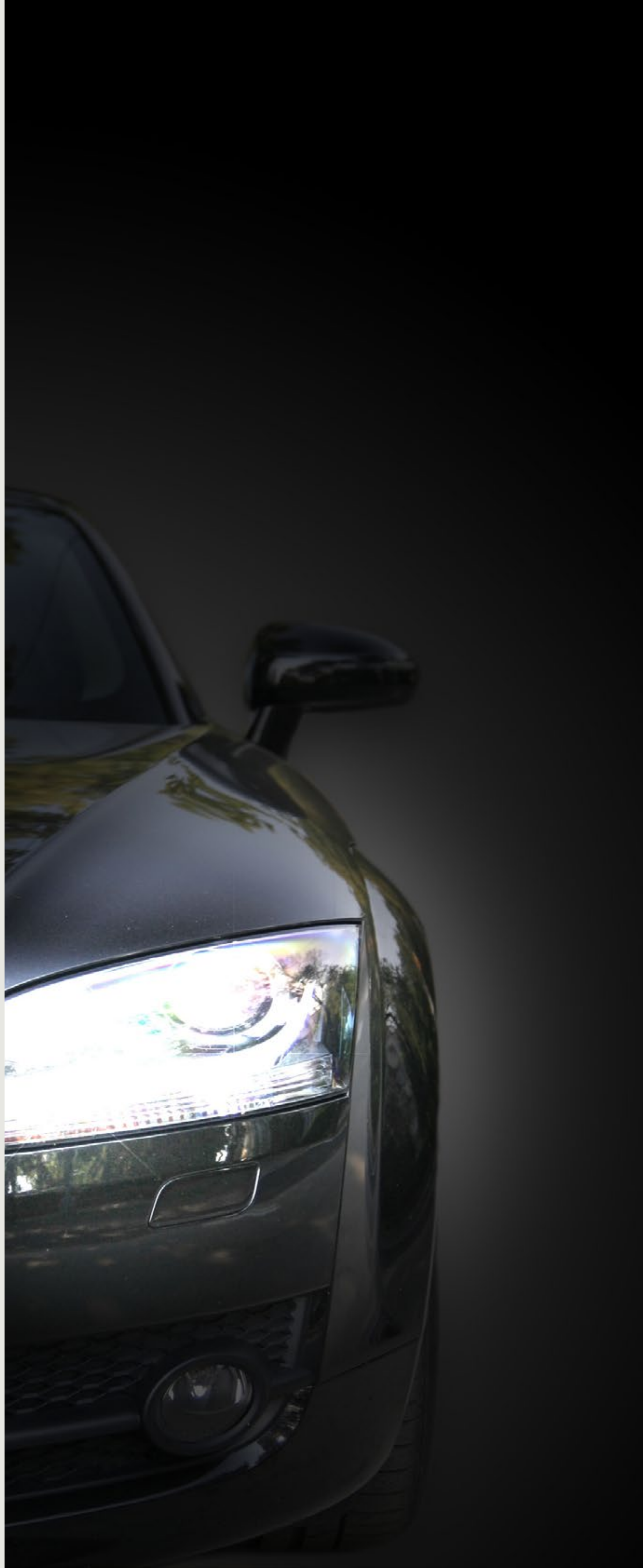
The initiatives, among others to help dealerships clear dealership stock, included €1bn euros to encourage consumers to purchase electric vehicles and further investment to make France the centre for electric vehicle output. President Macron made the following statement of intent: "We need a motivational goal – make France Europe's top producer of clean vehicles by bringing output to more than one million electric and hybrid cars per year over the next five years."

Following President Macron's announcement German Chancellor Angela Merkel has also stepped in to support the German automotive industry by increasing grant funding for electric vehicle buyers as part of its €130 billion COVID-19 economic stimulus package. The German Chancellor has effectively doubled the existing purchase incentive for electric cars to €6,000, in addition to an OEM-backed subsidy of €3,000. Additionally, the German government announced plans to reform its tax system to ensure that higher-emitting vehicles attract higher taxes from January 2021.

BREAL ZETA CF COMMENT

With the French and German governments taking the lead in supporting their automotive industries there was increasing pressure for the UK government to deliver its own stimulus to support the UK automotive sector.

In November 2020 the UK government announced c. £2.4bn of funding to support electrification of vehicles (and their supply chains), the roll out of EV charging infrastructure and an extension to Plug In Van, Taxi and Motorcycle Grants as part of "The Ten Point Plan for a Green Industrial Revolution". However, if the UK automotive industry is to thrive over the coming years, the UK government needs to formulate (and importantly implement) a clear and detailed strategy to create domestic consumer demand in the short term, develop the infrastructure to support further development (and use) of electric/hybrid vehicles and to encourage and drive innovation.



Cash and Funding Challenges

In an effort to support both business and the consumer, on Thursday 19th March 2020, at a special meeting of the Bank's Monetary Policy Committee, the Bank of England reduced its base rate to 0.1%, its lowest ever level. This was just eight days after the Bank had reduced the base rate from 0.75% to 0.25% in response to the global COVID-19 pandemic.

Similarly, the UK government sought to support business through a range of initiatives, including the following:

- The implementation of a Coronavirus Job Retention Scheme ("Furlough"), which initially sought to pay employers up to 80% of employees' salaries who might otherwise be made redundant
- Through approved lenders (including the high street banks) the Coronavirus Business Interruption Loan Scheme (CBILS) provided SME businesses (up to £45m turnover) with loans where the government would pay the arrangement fees and interest for the first year and provide the lender with an 80% government backed guarantee.
- Coronavirus business interruption loans were also made available to larger businesses (up to £500m of turnover) under a separate scheme (CLBILS) which also benefited from an 80% government guarantee.
- Various HMRC deferrals and time to pay arrangements for PAYE, NI, VAT and CT.

With the continuing impact of the pandemic and the start of a second wave of COVID-19, the Chancellor announced additional support measures including:

- The deadline for taking out a coronavirus business interruption loan was extended until 31 March 2021, with the government guarantee on them extended to up to 10 years
- The "Furlough" scheme was extended until April 2021
- VAT deferred due to COVID-19 can now be paid interest free through 11 installments instead of paying the full amount by the end of March 2021.

BREAL ZETA CF COMMENT

Whilst the Bank of England acted quickly by reducing the base rate to 0.1% and the UK Government has tried to support businesses through a variety of schemes such as Furlough and CBILS, these initiatives have supported businesses with their immediate short term cash needs rather than addressing longer term funding challenges.

Over the coming months, companies will need to reassess their cash flow forecasts and funding requirements in order to ensure they can pay their HMRC liabilities (which have grown significantly under the deferral scheme), fund growth in working capital and continue to invest in capex. Many businesses in the car industry, whose balance sheets are asset rich, might need to consider leveraging more cash using alternative lenders (as mainstream banks restrict limits on invoice financing lines and are unwilling to support additional lending).

"The sector faces working capital challenges from increased debt servicing costs, HMRC and landlord arrears. Compounding this will be the CAPEX required to re-purpose, in particular powertrain facilities, to meet the increasing demand for electric vehicles. These factors alongside market uncertainty will place unprecedented pressure on cashflow."

Jimmy Saunders, Duff & Phelps

Brexit

With the global pandemic dominating the news over the last year, the issues surrounding the UK's departure from the EU and its trading relationship seemed to have dropped down the news editors' priority lists. Then in December when the thought that a 'No Deal' Brexit was a real possibility the issue came to the forefront of people's minds once again.

A free trade agreement was fundamental for the UK car industry as outlined by Nissan's global chief operating officer, Ashwani Gupta, who in an interview with the BBC warned that the company would not be able to stand by its commitment to the Sunderland plant if the UK left the European Union without a trade deal that enabled tariff-free EU access.

It cannot be overestimated how key the trade agreement was to the UK based OEMs, their supply chains and indeed the UK economy as a whole. After all, in 2019 c. 1.3 million cars were built in the UK and c. 1.06 million of those vehicles were exported (with 54.8% of those exports being sold to countries in the EU).

As such there will have been a huge sigh of relief from the industry when the announcement was made. That being said, there are still many issues for the industry to come to terms with including:

- Disruption to "Just in time" deliveries
- Additional customs declarations and compliance procedures
- Proof of origin requirements
- Ability for EU staff to work in the UK and vice versa
- Potential loss of customers to competitors situated in the EU

BREAL ZETA CF COMMENT

The UK car industry is facing unprecedented levels of global competition for investment. The situation at Nissan is a stark reminder that for many industries, and not just the automotive industry, being able to trade freely with the EU is fundamental to global investment decisions. Britain's new trade agreement with the EU will be key to protecting automotive jobs across the country (not least the c. 7,000 people employed by Nissan's Sunderland factory). In the short term, however, the UK automotive industry needs to continue to improve productivity, foster innovation and demonstrate that trading with the EU can operate effectively, if the UK is to continue to attract global investment from the major OEMs.

"There are also wider challenges for the UK automotive sector; notably during 2020 ambiguity around Brexit and tariffs led to a number of manufacturers announcing the transfer of production away from the UK. Significant investment in the sector will be necessary during the next five years."

Jimmy Saunders, Duff & Phelps

Conclusion

This is a critical time for the UK automotive industry and swift and decisive action needs to be taken in order to support the industry, protect jobs and position the UK for further investment:

- Create sustained demand through government supported schemes to generate new car sales
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"If the UK automotive industry doesn't continue to invest in research and development, drive innovation and improve productivity, the UK will quickly fall behind its European competitors, which would be devastating for the regional economies. In order for the industry to be in a position to respond to these challenges, it must be supported both financially and politically by both the UK government and financial institutions alike."

Geraint Regan FCA
Regional Business Development Director, Midlands

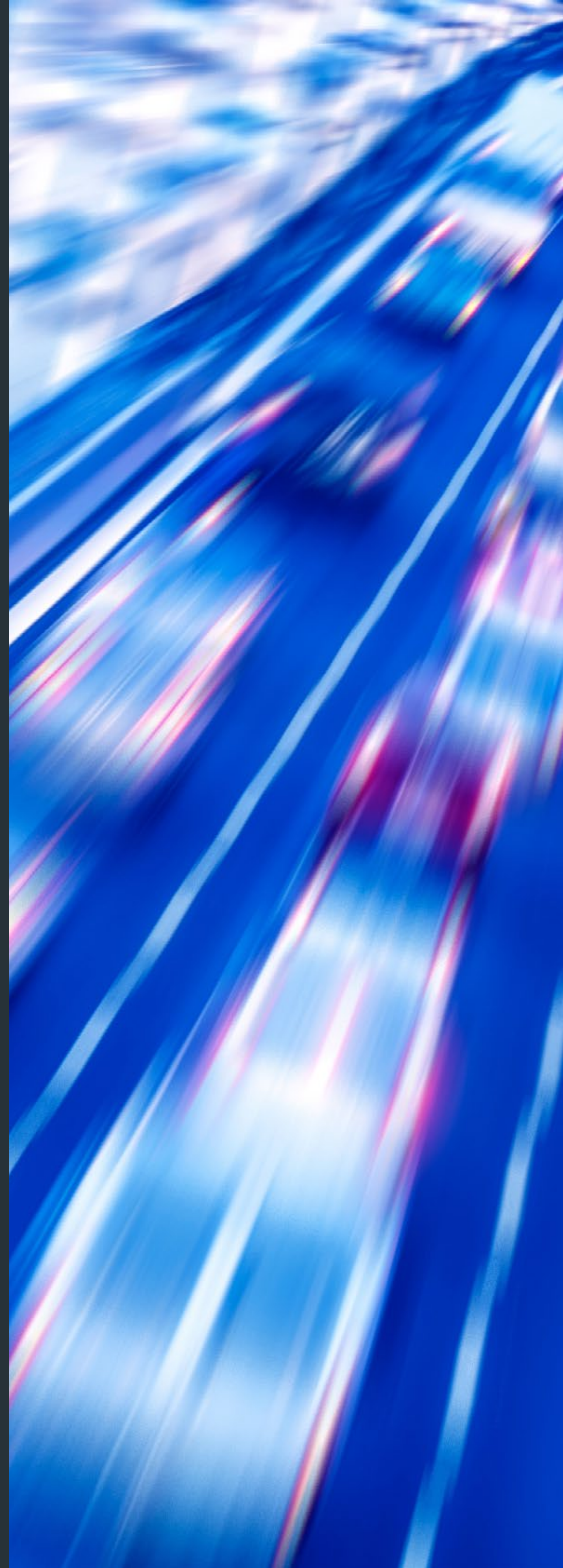
About Us

BREAL Zeta CF offers structured asset-based lending facilities up to a £150m hold level that provide working capital solutions to mid-market businesses. BREAL's team has extensive and proven experience delivering lending that supports a business's requirements. In addition, operational turnaround support can be provided as required.

BREAL Zeta CF is looking to work with midmarket businesses seeking funding facilities up to £150m. Funding situations include supporting transactions, restructuring and additional working capital.

The funding will be secured against any balance sheet assets with additional cash flow loans considered where required.

- Up to £150M full underwrite and hold
- Funded asset classes include
  - Receivables
  - Inventory
  - Plant & Machinery
  - Real Estate
- No asset class mix restrictions
- Sector agnostic
- Additional cashflow lends considered
- UK, Europe, Scandinavia & North America
- Flexible facility term



Latest Automotive Sector Lending News

BREAL ZETA PROVIDES £16M ABL FACILITY TO SUPPORT THE ACQUISITION OF EVTEC AUTOMOTIVE OUT OF ADMINISTRATION, SAVING 100 JOBS AND CREATING UP TO 50 MORE

In January 2021, BREAL Zeta structured and delivered a £16m asset-based lending (ABL) facility to enable David Roberts, industrialist and former group chairman of Arlington Industries until 2014, to acquire Arlington Engineered Systems out of administration.

The acquisition and working capital finance package, which comprises funding against receivables and real estate, as well as a £3m term loan, has secured the acquisition out of administration of a critical supplier to the automotive industry.

The deal, which sees David Roberts take on the role of Chairman, will enable newco, Evtec Automotive ('Evtec'), to recommence its operations and make further investments in its team and core services. As part of its growth strategy, Evtec will seek to drive turnover from £55m to £70m over the next three years.

The move will save up to 110 jobs and will create 50 more. David Roberts plans to return the business to its Remploy heritage, ensuring opportunities for disabled people across the West Midlands.

Headquartered in Coventry, Evtec Automotive specialises in manual assembly for the automotive sector, including the provision of electrical, fluid and air, mechanical and aftermarket module assemblies. The business will continue to work with clients such as Jaguar Land Rover and Ford as they gear up production following the coronavirus pandemic.

Commenting on the deal, David Roberts, Chairman of Evtec Automotive, said: "When we kicked off the process, it felt like the debt markets were no longer there for the automotive industry as they had been in the past. It quickly became apparent that we would need to explore alternative funding options away from the traditional banks. When we met with the team at BREAL Zeta, I explained precisely where we were with the potential acquisition and what we needed and they asked all the right questions. They responded quickly with an innovative deal structure that would not only fund the immediate acquisition but would also provide on-going working capital to help the business to secure further growth. There were many twists and turns along the way and BREAL Zeta managed their way through each of them diligently and responsively."

He continued: "BREAL Zeta is an entrepreneurial lender with a refreshing and creative approach to deal structuring. From speaking to their team, I knew that they would come through and deliver the deal in spite of the challenges facing the industry as a whole and they showed real flexibility in terms of the concentration levels we have with some of our major clients. The team at BREAL Zeta was absolutely phenomenal to work with. They approached the transaction as a true partner, not just as a lender, and we genuinely couldn't have done the deal without them."

"Arlington Engineered Systems was a strong and cash generative business, however, the immediate result of the coronavirus pandemic impacted the firm in a way no one could have predicted. Now that production across the automotive sector has kicked back into gear, I believe there is still a strong future for the firm and with the right leadership and financial support I'm confident that we can drive future growth."

"My immediate focus is to support the team and established customer relationships, and I will then be looking to refocus the business by taking it back to its roots. Evtec Automotive is based on driving innovation through integration. We are particularly excited at the prospect of working with the leading EV marques as we offer the most complex and flexible 'poka-yoke' assembly processes that robots just can't. We look forward to driving the business forward with the continued support of BREAL Zeta."

"At BREAL Zeta we always look to support good businesses; not least within Britain's automotive sector. We apply our insight and understanding of the sector, including knowledge of both its opportunities and challenges, to support strong management teams to achieve their goals."

Geraint Regan FCA
Regional Business Development Director, Midlands

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