Client Alert

Analysis of the proposed acquisition of Opel by PSA

15 February 2017

Executive summary

The reported potential acquisition of GM's European Opel unit by PSA offers an opportunity for both parties.

GM has been unable to stem losses in Europe, even as key European markets have recovered most of the volume lost over the 2009-2013 period and this move marks a decision to cut losses now.

The market share within non-CIS Europe of the new group would be close to 17%, with 10.5% coming from PSA brands and 6.3% coming from Opel, based on 2016 sales. PSA-Opel would become the second largest group in these markets behind Volkswagen Group (22.4% share).

PSA can benefit from the increased scale that was unavailable to Opel, but faces a number of years of major upheaval in order to achieve what would be defined as a success, namely, improving the financial performance and long-term viability of the enlarged group.

The biggest challenges for PSA-Opel will be in the execution of manufacturing changes alongside management of three brands mainly operating in the same segments in the same market. Execution risks in these areas are significant so, while the strategic logic of the acquisition appears sound, proof of success will only be visible as the integration proceeds over the coming years. A further challenge for the group relates to the increased concentration, globally, of its sales within one region. PSA-Opel will rely on the region for close to 70% of its sales by volume, so its fortunes will rest heavily, at least initially, on the European market level.

GM's departure from Europe, albeit with some remaining presence in Russia through Chevrolet, could be seen as a retreat. However, given the financial burden of continuing as it is, the decision seems to be a logical one, and something which may ultimately strengthen the company globally.

Background

The now widely reported development that PSA is at a late stage in discussions to acquire the European operations of General Motors – specifically, activity related to the Opel and Vauxhall brands – creates the likelihood of a significant shift in the European Light Vehicle industry.

The combined volume of the groups would exceed current second-placed Renault-Nissan, excluding Russia and the CIS countries, taking the regional European total to over 3 mn units (full-year 2016). Comparative numbers for market leader Volkswagen Group are just over 4 mn units.

GM has been unable over many years to make its European branch, operated mainly through Opel, profitable and now appears ready to cut losses in the region.

The groups already share development and production of some vehicles that are then sold under their respective brands. For Opel these are: the Crossland X and, in future, the Grandland X and next Combo.

An examination of Opel's recent history reveals a number of points during which the long-established company might have changed ownership. Overtures from FCA to GM, with respect to Opel, failed as the US company was unable to agree on compelling logic for such a deal. Similarly, signals that GM was pursuing PSA also then reversed, with the company selling a small stake in PSA in 2013, after the acquisition of that stake in 2012. During the 2009 financial crisis, the sale of Opel to Magna also reached an advanced stage, but then fell through as vehicle markets showed signs of recovery. Such a history, and the complexity of Opel's entanglement within GM more globally, should give rise to some caution over whether the deal will complete.

Notwithstanding this cautionary note, analysis of the current situation reveals some useful insights.

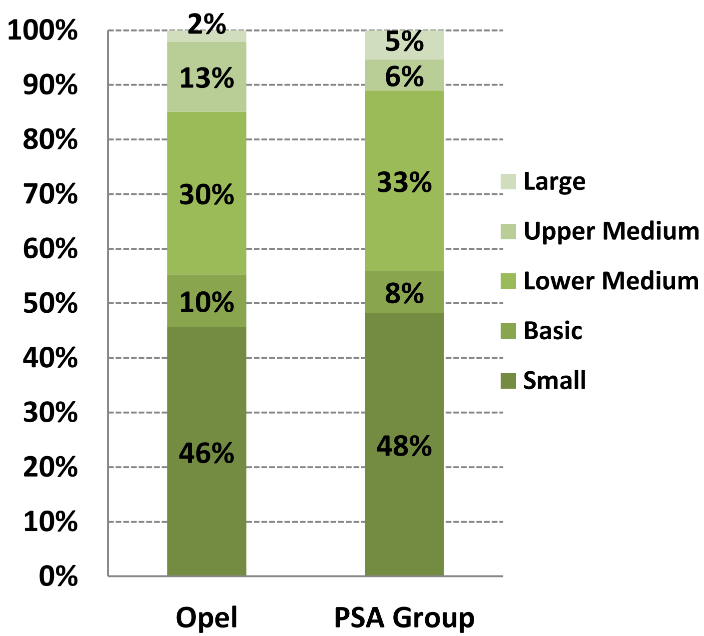
Source: LMC Automotive

Market positions of PSA and Opel in Europe

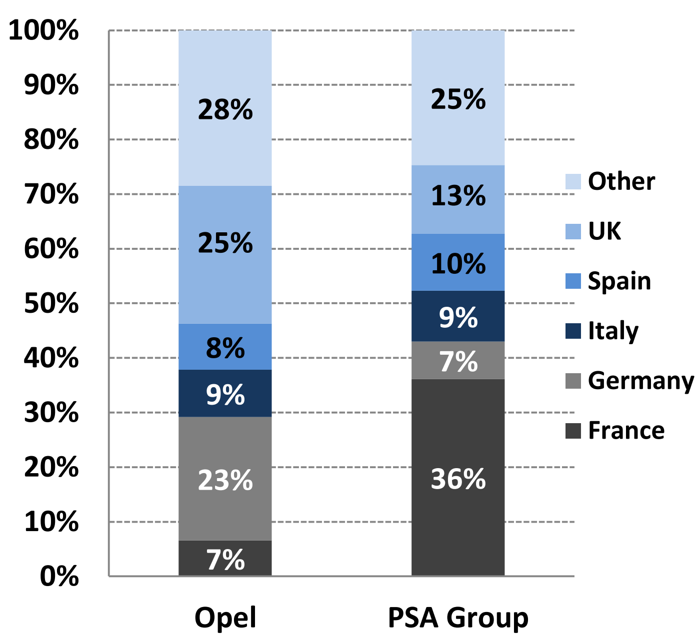
PSA and Opel operate in very similar segments in the volume segment of the market – they already compete directly with many key models.

Both are well represented across European markets, with heavy emphasis on the larger markets, though Opel relies more on the UK (through Vauxhall) and Germany, while PSA has a strong home presence in France.

Share of 2016 sales in non-CIS Europe by vehicle size segment (regardless of bodystyle)



Share of each group's 2016 sales in key (non-CIS) European markets



Source: LMC Automotive

European plant summary of combined group

A likely driver of the acquisition is the cost-reducing opportunity in consolidating some European capacity, where that flexibility is at least feasible, if politically difficult. Full plant closure is, of course, a politically fraught process and could be hard to achieve. A number of plants are well utilised and, therefore, do not appear under threat of closure – or other specific operational reasons imply their continuation.

But several other assembly plants could now be seen to be at risk, at the appropriate point in the cycle of models produced in them (possibly some years away in some cases).

GM's **Ellesmere Port** plant, already at risk as a consequence of Brexit when the current Astra comes up for replacement in 2021, looks even more vulnerable. The next Astra could be produced elsewhere.

The two large-car plants (serving the difficult D segment) in **Rüsselsheim** and **Rennes** also could be seen as one too many. With Rüsselsheim the location of Opel's HQ and its historical home, the PSA Rennes plant may be the more vulnerable of the two.

PSA's **Villaverde** plant, now just a single-model plant in any case, could also be under threat.

Source: LMC Automotive

Note: excludes niche LCV plants and/or those operated with other joint ventures

Implications for future model development

One of the critical operational objectives of a combined PSA-Opel entity would be the consolidation of future models onto common platforms where this is possible. This would follow a review of the model ranges of both companies, with particular emphasis placed on those models not already too far down the development path at the point of completion.

Our analysis suggests that, while there are many models that overlap in terms of segmentation (in terms of vehicle size, bodystyle and market status position), there are a number of Opel models that are already due for replacement in the relatively near future; that is, up to and including 2019. It is possible that such imminent models could be delayed, but that would place a strain on Opel's market share if existing models were forced to age in Europe's hyper-competitive market, where many new and fresh alternative models are available on continuous launch schedules, and with the modern technological features that are increasingly in demand.

The switch of future Opel models to PSA platforms seems far more likely than the other way around, as continued use of GM platforms would make the arrangements between the companies far more complicated and lead to deep ongoing involvement for many years to come. PSA would also gain much greater control in achieving scale efficiency savings it would naturally seek to benefit from when deriving more models from its own platforms. A small number of models are, of course, already running off shared PSA-GM platforms (as noted in the preceding Background comment).

Upcoming Opel models and consolidation opportunities

New Insignia – imminent (2017). This is unlikely to be consolidated, but future lifecycle is aligned with PSA 508, so could follow later on.
Mokka X – 2019. Possible overlap with Crossland X, could be repositioned or cancelled.
Opel D-CUV – 2019. Considered to be the Antara replacement, this could use 5008 underpinnings, or may be cancelled.
Adam – 2019. Similar position to 108/C1 (also Toyota Aygo), so could consolidate to same platform, but this may be complicated by existing sharing relationship with Toyota and unique market positioning of the vehicle.
Corsa – 2019. Already facelifted and showing signs of age. Could be based on the future 208/C3 platform (EMP1), but may require delay to implement.
Astra – 2021. Could be derived from the next Peugeot 308 platform (next EMP2).
Vivaro – 2025. Recently renewed large van, could be aligned with Expert/Jumpy in relatively distant future.

Source: LMC Automotive

Strategic considerations

The attractions of the acquisition are clear for both PSA and GM. For PSA, the increase in volume creates a clear opportunity to increase scale efficiencies in manufacturing, vehicle design and in procurement. For GM, the European operations have been consistently loss-making and cutting those losses once and for all would, initially at least, boost margin for the globally consolidated company. It would also be able to focus on core markets, such as the US and China, where vehicle preferences and market conditions are somewhat different from those in Europe.

GM's near-complete departure from Russia in 2015 (some Chevrolet sales linger on) marked a large step towards recognition of the difficulties it faced in what was then a market heading into a slump. The judgement that was made – that the slump could last for a long time and therefore represented the near-inevitability of years of further losses there – now looks like a sound one, if success is measured in years and not decades. The near-simultaneous withdrawal of Chevrolet from Western Europe was also a sign that the importing model was not working well – Chevrolet used to sell around 150k vehicles per year to Western European markets – though that decision is now coloured less favourably by the potential loss of all Opel volume from GM's totals.

In Western Europe, market size is no longer the issue, but recent GME financial results imply that, even in a market getting closer to its trend level, making sustainable returns is going to be very difficult indeed for Opel. After persisting in these efforts over a significant period of time, the conclusion has clearly been drawn that Europe will not be profitable for GM and the argument for Europe's continued inclusion in the global operation must be from a non-financial viewpoint. Specifically, Opel's important role in vehicle development for GM globally is not so easily dismissed and could be disruptive for the group at a global level. The company will now have to relocate development to other locations, most likely the US, China and South America. GM has made the clear strategic choice that it will prioritise margin over volume – not usually a bad decision for a business – and will see its global ranking fall from 4th to 5th in the world, with Hyundai/Kia moving up one, once Opel volumes are subtracted. The resulting 7 mn-unit entity is still clearly large enough to benefit from all of the scale economies available to a global Light Vehicle giant.

PSA may, and should, be able to map out a rationalisation programme that cuts costs through capacity optimisation (plant closure or trimming of capacity), model/platform consolidation and procurement – though plant closures in France could be politically very difficult. What could be more difficult for the enlarged group to achieve will be management and maintenance of three separate brands, the vast majority of whose sales are in the same segments of one vast regional market with some national differences. The DS brand is well differentiated, so the core task relates to the Peugeot, Citroën and Opel brands. Differentiation will be key and, as Volkswagen Group has found over the years, running three mass-market brands successfully in the same market (VW, Škoda and SEAT) can be difficult. PSA also now faces the return of an older challenge. The 2009-2013 period was difficult for Western European markets and exposed the group's reliance on one key geography, resulting, for PSA, in the need for a bailout in 2014. Things have improved since, both in Western European volume terms, and through diversification into other important markets, specifically China. In 2009, PSA relied on Europe for over 70% of its sales and this had fallen, by the end of 2016, to under 60%, even as Europe recovered. With Opel added into the group, the exposure rises again almost to 70%. Continued market diversification will therefore become an important strategic target for the expanded group if it is not to fall foul of the next downturn in Europe.

Our view on the transaction is that it presents significant opportunities to both groups, but that they come, as is almost always the case in such large-scale integrations, with high execution risk, especially for PSA, which will need to manage many key changes with skill. For GM, the exit from Europe could be seen as a retreat, but it is an entirely logical one.

Source: LMC Automotive

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