



# Finding value as ICE melts

Auto parts makers have some difficult strategic decisions to make as they prepare for a post-ICE industry. Focus on EV parts? Exit traditional parts? Try to be the last man standing? Now is the time to act.

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# Introduction

The transition from vehicles powered by internal combustion engines (ICE) to electric vehicles (EVs) is accelerating, creating challenges and opportunities for companies across the industry. By 2030, EV production is expected to hit 30 million units per year.<sup>1</sup> In 2040, 37 percent of all vehicles on the road in the U.S. and Western Europe will be electric, KPMG estimates.

As EVs catch on, global production of ICE vehicles is expected to peak in the mid-2020s and then start to decline in Europe, the U.S., and China. Meanwhile, new approaches to design and manufacture EVs will limit the number of crossover components that work for all types of vehicles. Cars of all kinds may be built with fewer, more valuable parts—narrowing the opportunities for suppliers.

Profit pools, inevitably, will shift. As the market for ICE-related parts begins to shrink, investor interest would also likely decline. Valuations for ICE parts makers already lag those of EV parts manufacturers.

This is an existential moment for the parts industry. Companies need to choose strategies to survive and thrive as the industry transitions. They must quickly make decisions that could fundamentally alter their businesses—exiting some segments, investing in new ones, divesting assets, winding down plants.

Leaders can start by taking a clear-eyed, dispassionate look at the business and act quickly. The companies that make the difficult decisions soonest will likely be best positioned to build value in a post-ICE market.

In this paper, we outline several strategic options for parts suppliers, ranging from divesting low-margin, low-growth businesses to playing the consolidator—becoming the efficient “last man standing” in a declining ICE parts business. We offer a framework for evaluating the impact of EVs on specific kinds of parts businesses. Finally, we outline strategies to help companies profitably navigate operations as the world shifts away from ICE and that business ultimately becomes secondary to serving the needs of EV makers and buyers.

<sup>1</sup> Source: LMC dataset, KPMG analysis

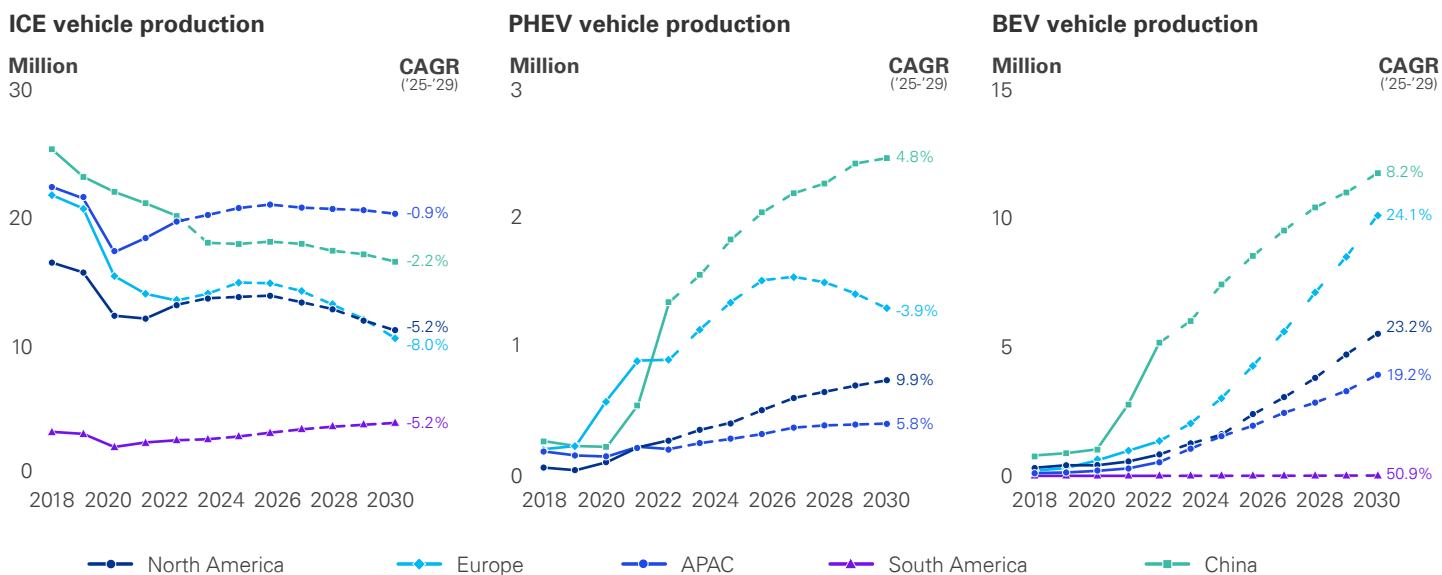


# The EV transition is here

KPMG analyses show that production of ICE vehicles could peak in Europe, North America, China, and the Asia-Pacific region by around 2025. Meanwhile, production of battery-electric and plug-in hybrids will soar (Exhibit 1).

We estimate that ICE production volumes could decline by 5 percent CAGR in North America in 2025 and 8 percent CAGR in Europe. In China, where 5 million EVs (battery electrics) were sold in 2022, ICE production has already begun to flatline.

**Exhibit 1. ICE vehicle sales are expected to peak as electric models proliferate**



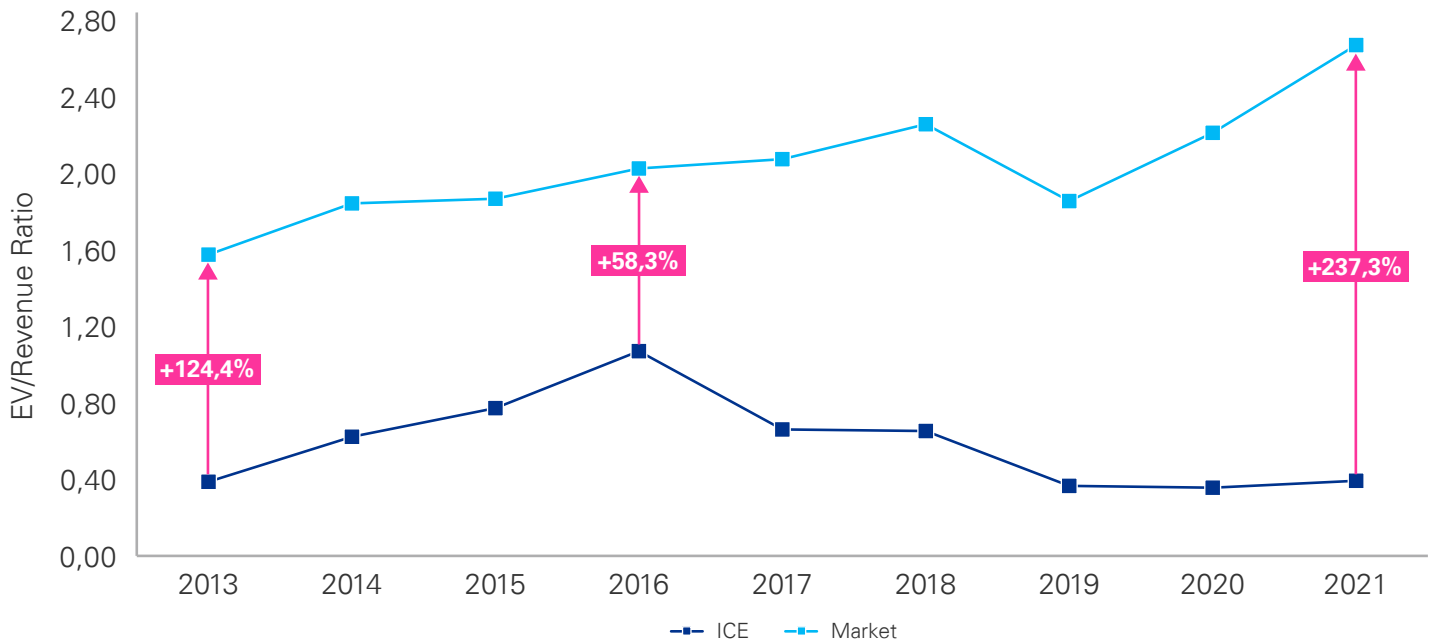
Source: LMC, KPMG analysis

The profitability and value of auto parts manufacturers have already taken a hit. With limited growth prospects, analysts have consistently cut valuations on parts suppliers that are too concentrated in the ICE business, while rewarding those that are positioned to ride the EV hockey stick, such as battery suppliers. In our analysis of

9 years of enterprise value-to-revenue (EV/R) multiples for ICE-focused suppliers, KPMG found that since 2013 ICE-supplier EV/R has held steady, with some fluctuations, while EV/R grew by 51 percent for the rest of the market through 2021. (Exhibit 2).

## Exhibit 2. Multiples for ICE-related companies have declined relative to the broader market

EV/Revenue ratio of ICE focused companies vs. the global market



Sources: Aswath Damodaran, Professor of Finance at Stern School of Business, NYU, datahistory.com (47,913 companies across 135 countries), KPMG analysis

Given these realities, companies will face increasing pressure to rethink their strategy and pursue operating improvements, which will be needed regardless of the strategic path they choose. Suppliers that wait risk missing the boat with potential partners who could help them survive the industry shakeup or losing out on opportunities to build share. Although the market has sent a clear message to the industry about future asset risk, some investors still see pockets of under-appreciated value in suppliers that are willing to adapt to the new market realities created by the EV transition.



# Navigating melting ICE

To understand where individual parts companies can play in this rapidly shifting industry, it is critical to start with a realistic understanding of current strengths and vulnerabilities. Not all ICE suppliers are on equal footing, nor will they be equally affected by the EV transition. Makers of parts that go into all kinds of cars—seating, for example—may not be affected at all. Three factors will determine how soon and how much EV will impact your business:

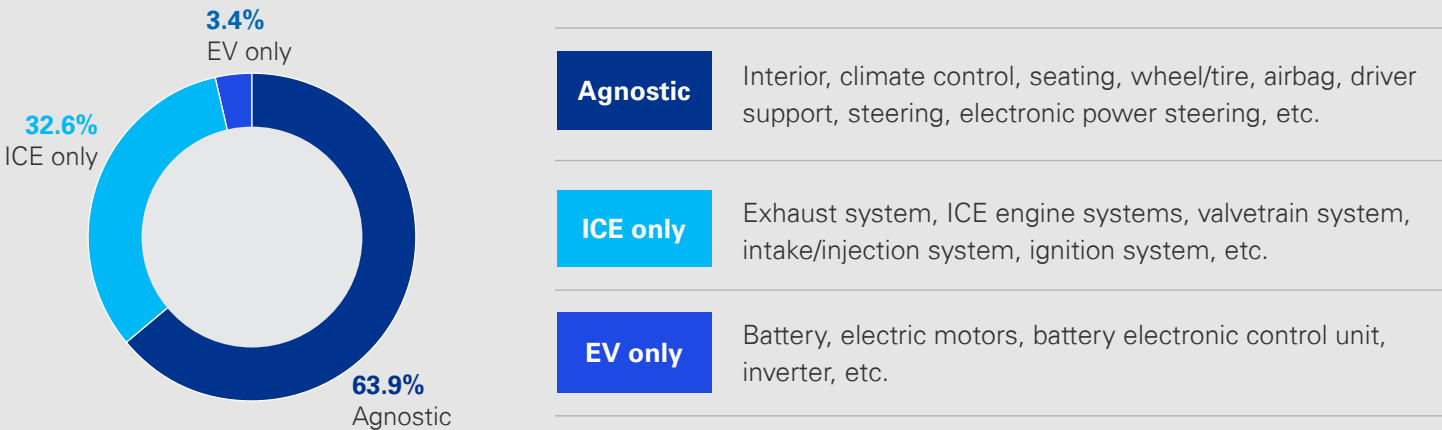
## 01 Geography

What markets do you serve? Countries and regions where with mature markets and government-sponsored incentives are driving a more rapid shift to EV. Companies with heavy exposure in these regions should expect the operating environment to change rapidly. They will need to respond quickly and change their market strategy. Norway, for example, is the world’s definitive leader in EV adoption and is ahead of its goal to eliminate all ICE vehicle sales by 2025.

## 02 Type of parts (ICE, electric, propulsion agnostic)

Do your current products work with EVs? A KPMG analysis of automotive subsystem manufacturing found that 68 percent of components can function in either vehicle type. Electronic power steering systems, for instance, are agnostic. ICE fuel system, obviously, are not (Exhibit 3). Evaluate your product mix to determine your path to value in both markets.

**Exhibit 3. Nearly a third of automotive subsystems will only be relevant for ICE power trains.**



Source: KPMG analysis based on MarkLine definitions

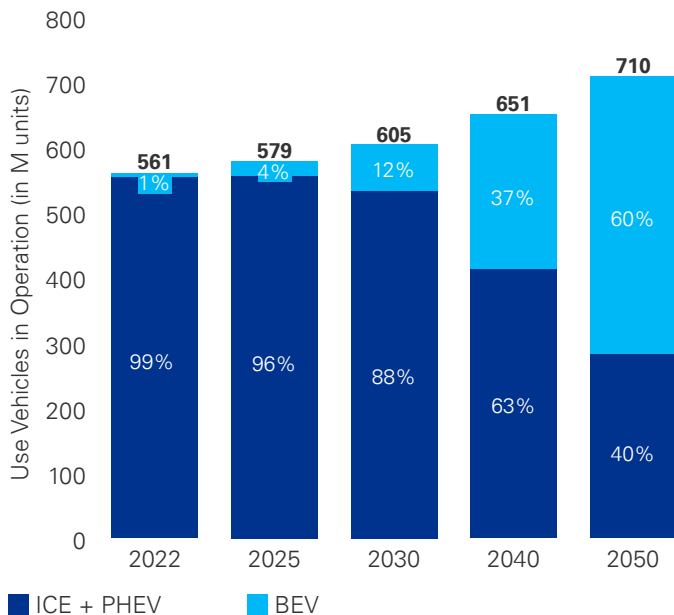
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## Customer base (OEM or aftermarket)

How much of your business is original equipment vs. aftermarket? For the next 15 years, ICE vehicles will continue to dominate as a percentage of vehicles in operation (VIO), creating ample revenue opportunities for suppliers to OEMs and manufacturers of aftermarket parts. EVs will account for just 12 percent of VIO by 2030 (Exhibit 4). Still, companies should be mapping their value trajectory to paint a compelling picture for investors or future buyers.

**Exhibit 4. In 30 years, EVs will overtake ICE vehicles on the road in the U.S. and Western Europe.**

### U.S. and Western Europe



Source: RBC Capital, KPMG analysis

Add to these factors other trends related to EV production such as light-weighting and greater use of giga presses (see “Product requirements are changing across automotive markets”) and ICE suppliers have plenty to consider when deciding on future product and strategic direction.



## Product requirements are changing across automotive markets

Parts suppliers have more to consider than just the shift to EVs when evaluating the future viability of their products and strategies. New manufacturing methods are changing what components are made and how they are fabricated. Across vehicle types, the push for energy efficiency and sustainability is spurring the industry to design parts differently and more simply.

Light weighting, for example, involves substituting aluminum, carbon fiber, and other lightweight materials for heavy material such as steel. Light weighting is also important in EVs, to make up for the extra weight of batteries.

The development of machines like the giga press, enable vehicle makers to reimagine components and cast simpler parts. Tesla has pioneered the use of the giga press, the world’s largest die casting machine, to make large single pieces for its vehicles, streamlining assembly in the process.

As design concepts change and parts are reimaged—especially those that today are heavy or overly complex—legacy parts companies may face: a market with fewer parts and simpler components.



# Determining how to play in a post-ICE world

For auto parts suppliers to find their optimum position in a changing market, they can use a two-step analysis. First, they should assess what market they are in, who is the competition, and how the shift to electric propulsion will impact plant-level economics.

## Market structure

**Define the market:** First, define your market at the component level. Does the component have viable substitutes? For a given component can the manufacturing processes be modified to serve both EV and ICE customers? Is capacity easily shifted between the two?

**Define the geography:** Also consider geographic boundaries and the number of plants that serve your end market. If supply to your market is regional, consider that as the geographic boundary for the analysis of market structure.

**Define minimum scale:** What is the minimum efficient scale for your business? How many units must your plant produce to remain profitable? Consider whether demand might fall to this level in the next five years and your ability to shift capacity to continue operating profitably.

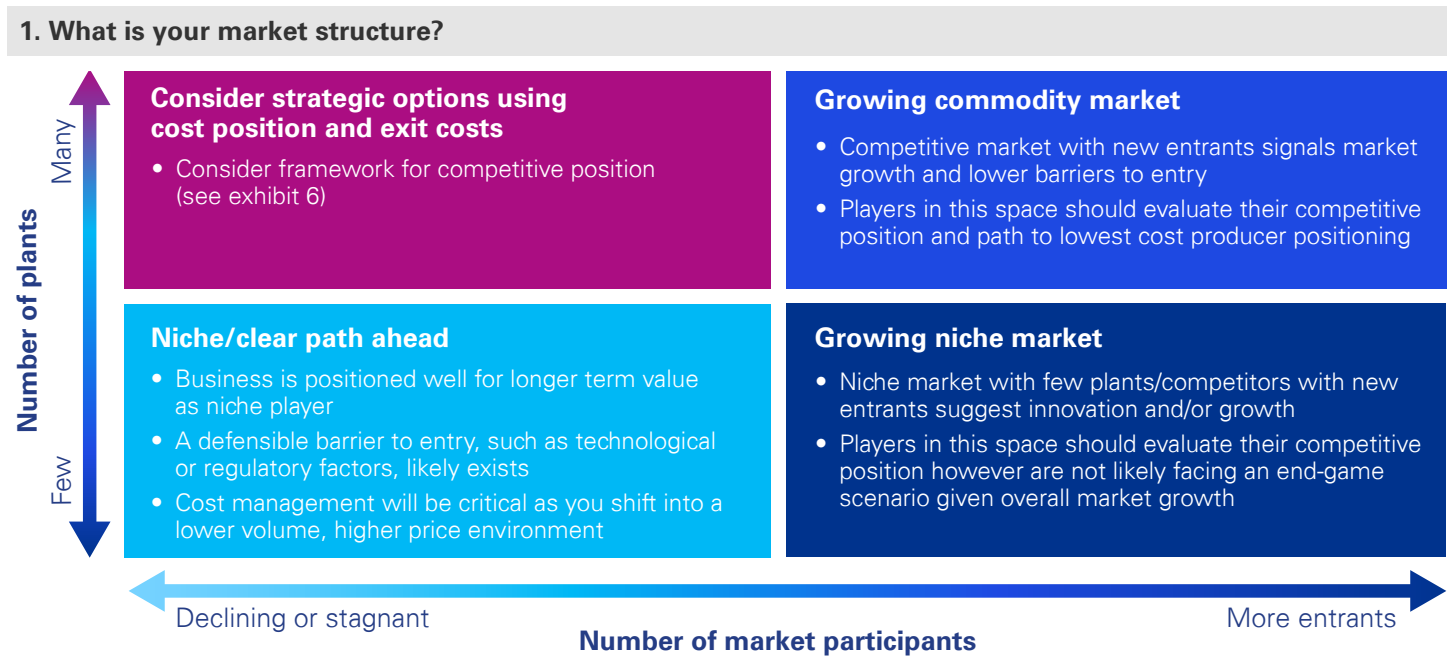
## Competitive position

**Assess your cost position:** A company that beats rivals on cost could continue to prosper, even as the market contracts. Do you have advantages in fixed or variable costs that allow your plant to operate at a lower efficient scale? Do you have the ability to flex your cost structure effectively to stay profitable despite declining demand?

**Estimate exit costs:** Exit costs will impact how and when an exit is possible and may impact how your competition responds to similar challenges. If you need to exit, how many entanglements and liabilities do you have—customer contracts, warranty commitments, future part availability commitments, labor or lease commitments, shared manufacturing facilities, etc.? These should all be considered as you evaluate your options.



## Exhibit 5. Plot your position



Then evaluate at the strategic response that best fits your situation (Exhibit 6). For example, a manufacturer with low exit costs and a strong cost position should consider divesting to capture the most value (“Divest to improve returns,” upper right). An efficient manufacturer that faces high exit costs, might do better playing the “last man standing”—consolidating more share in a shrinking market as competitors exit or fail.

## Exhibit 6. Determine the appropriate strategy







## When to divest?

Determining the best time to sell assets can be tricky. Selling too soon may mean selling into a buyer's market. Waiting too long could mean the assets are no longer relevant. These decisions are particularly complicated for private equity investors, who typically have a six-year holding period for portfolio companies. Today, buyers should model the business 10 to 15 years out to estimate the exit multiples that the next buyer may be willing to pay. What looks like gold in the next six years could look like pyrite a decade from now. Timing does matter.

A critical exercise is to identify potential inflection points for component markets as far out as possible and as soon as practical. What looks like a slow, manageable decline today may accelerate as faster EV adoption impacts even relatively insulated segments, such as aftermarket parts.<sup>2</sup> Companies that do this analysis early and decide on a course of action are more likely to preserve enterprise value and be well positioned to pursue new opportunities.

**It's important to note that these strategies can be used in combination or sequentially. A supplier, for instance, might pursue a last-man-standing approach for a while, then shift to a niche strategy later on. Another approach could be to harvest cash flow in a market while working toward divesting or shutting down the business.**

<sup>2</sup> See "[Automotive aftermarket outlook](#)," KPMG 2022

# Conclusion

Parts manufacturers have options as they face the challenges of adapting to a declining market for ICE products. Ultimately, the winners will be those that can recognize and assert leadership in segments with long-term profitability potential, while carefully managing costs as the ICE parts market shrinks. It will take courage and the ability to overcome institutional biases to assess the business soberly and determine what the long-term strategy should be.

## How KPMG can help

Faced with this epochal shift in the automotive industry, parts suppliers must confront with urgency an uncertain future and develop thoughtful plans of action to adapt. Leaders must carefully evaluate their business model, their organizational capabilities, and their ability to change

with the markets to position themselves for a profitable tomorrow. Our KPMG Strategy team can help executives successfully navigate the challenge ahead by offering insights and applying innovation and analytics to build customer strategies for your company.



### Active Portfolio Management

To evaluate buy/sell/hold implications for existing lines of business



### Analysis of industry structure, customers, and competition

To understand future opportunities for business



### Performance Improvement

To transform the cost structure and focus of business to make them resilient to the changing landscape



### Divestiture Services and corporate finance

To maximize the value of assets in a sales process

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