European Car Makers in Pole Position: PSA Group to Acquire GM's European Businesses for €2.2bn

Peugeot SA (EPA: UG) – market cap as of 11/03/2017: €15.79bn
General Motors Co. (NYSE: GM) – market cap as of 11/03/2017: $55.17bn

Introduction

On March 6, 2017, PSA Group announced an agreement with General Motors Co. whereby the French holding will acquire GM's Opel and Vauxhall subsidiaries, together with GM Financial's European operations in a transaction valuing these businesses at €1.3bn and €0.9bn respectively.
The transaction will establish PSA Group as the second largest car maker in Europe, with a 17% market share. Furthermore, it will strengthen the European foundation of PSA as a stepping stone to support its worldwide growth.

About PSA Group

PSA Group (previously known as PSA Peugeot Citroën) is a French automotive company that was founded in 1976 as the result of the merger between Citroën SA and Peugeot SA. It owns three car brands in its portfolio - Peugeot, Citroën and DS - as well as a wide array of mobility services under its Free2Move brand, a product line aimed to meet the growing needs of automobile users. The group is the European leader in terms of CO2 emissions and an early innovator in the field of autonomous and connected cars, with 2.3 million such vehicles distributed worldwide.

Under the current CEO - Carlos Tavares - PSA has undergone a great strategic overhaul which led to a significant turnaround for the company after the French government bailout in 2012. Mr. Tavares managed to lead the company from net losses to profits in just 3 years and 2017 will be the first year in which PSA will be paying dividends after 6 years. His management style has been focused on cost cutting, slashing unprofitable products, freezing pays, and shutting down unnecessary factories. It is therefore expected that he will start pursuing an expansion strategy now that the French group is in a healthy financial condition.

In FY2016, the Group has indeed increased nominal sales for the third consecutive year (5.8% YoY growth) to more than 3 million vehicles worldwide. The Group also reported €54.03bn in revenues, relatively flat year on year. The operating income reported was €2.61bn (32% YoY growth) and the net income amounted to €2.15bn (78% YoY growth), which shows an improvement in efficiency compared to past years.

About Adam Opel AG

Opel was founded in 1862 in Rüsselsheim, Germany, by Adam Opel. Purchased by General Motors in the 1930s, it is now one of Europe's largest automakers with a 5.73% market share.
The company designs, engineers, manufactures and distributes passenger vehicles, light commercial vehicles and vehicle components for distribution. It offers German engineering expertise available at affordable prices combined with innovative premium-class features.

In 2016, the company sold approximately 1.2 million vehicles, which is an increase of 4% YoY and highest sales volume since 2011. From 2016 to 2020, the brand plans to bring 29 new models to the market, 7 of which are expected to be introduced in 2017.

About Vauxhall Motors

Vauxhall Motors (General Motors UK Ltd) is one of the oldest car manufacturers and distribution companies in the UK, which traces its history back to more than 100 years and that has engineered and produced some of the UK's most popular vehicles. It was acquired in 1925 by General Motors for $2.5bn and acted as main GM's UK distributor.

Together with Opel, Vauxhall Motors employs over 38,000 people in Europe and is currently present in over 50 countries around the globe. Together, the two car manufacturing companies generated €17.7bn in revenues in FY2016.

Deal structure

The deal involves two different transactions: (1) PSA Group acquiring Opel and Vauxhall, (2) PSA and BNP Paribas jointly acquiring GM Financial's operations in Europe.

The acquisition of Opel/Vauxhall will involve a consideration of €670m paid in cash together with PSA share warrants worth €650m, for a total transaction value of €1.3bn. The warrants have a maturity of 9 years and are exercisable after 5 years with a strike price of €1. Based on a reference price of €17.34 for the PSA share, the warrants correspond to 39.7 million shares of PSA, or 4.2% of its fully diluted share capital. GM has agreed to sell the PSA shares obtained from the exercise of the warrants within 35 days and has stated it will not enjoy governance or voting rights during the holding period.

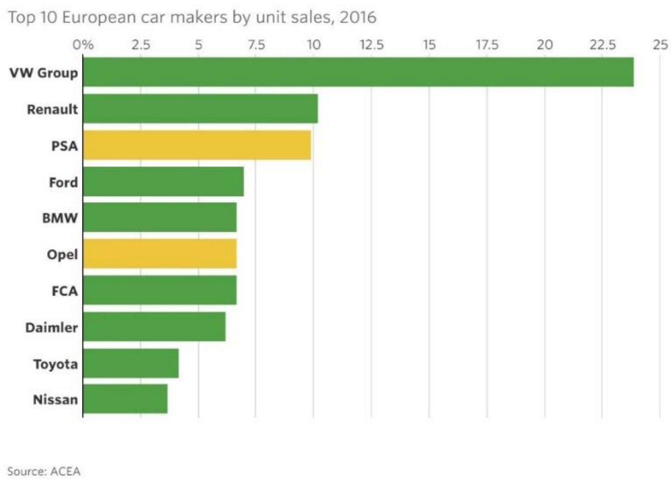
With regards to the second transaction, PSA and BNP Paribas will pay €0.9bn for GM Financial's European business.

The deal has a combined value of €2.2bn, of which PSA will bear €1.8bn while BNP Paribas will cover the remaining part. In addition, GM will take on a non-cash special charge of c. $4bn to $4.5bn as it books a paper loss from the deal.

The transaction is subject to various closing conditions, including regulatory approvals and reorganizations, and is expected to close before the end of 2017.

Deal rationale

The rationale for the deal rests on the premise that size and scale are paramount for success in a mature industry characterized by overcapacity and thin margins. After the transaction closes, PSA will enjoy a 17% market share in Europe and it will become the second largest player in the region. The French group will be able to negotiate better prices with suppliers and it will also be able to leverage on Opel and Vauxhall's brands in other European markets.

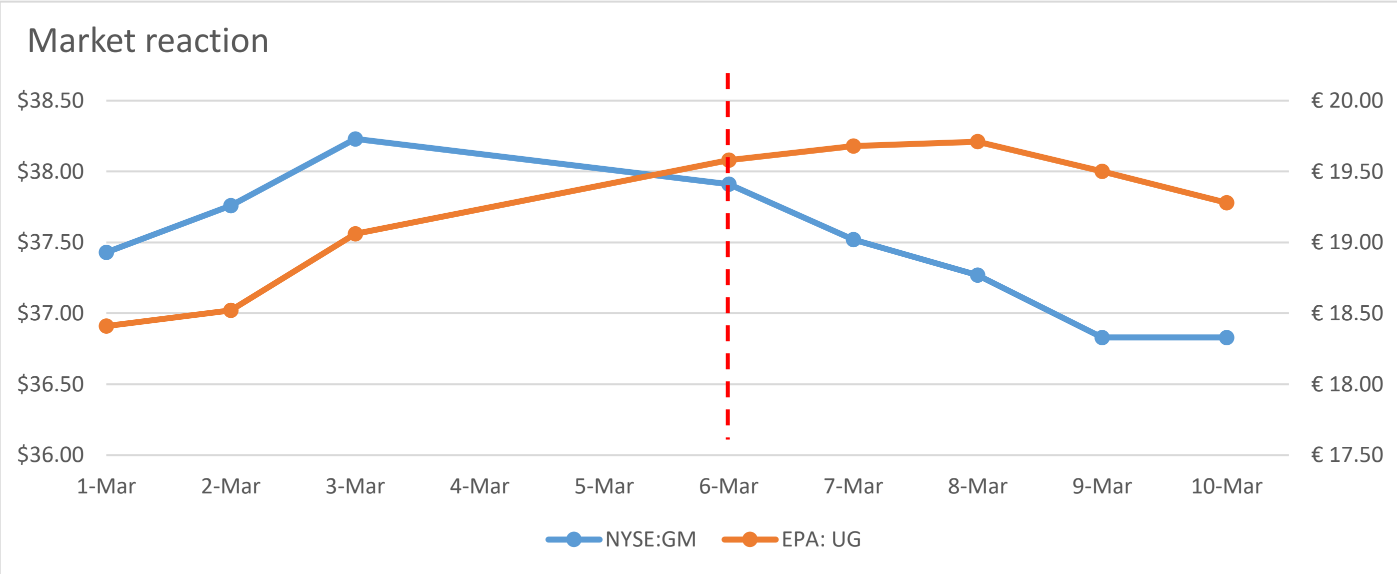


PSA expects annual synergies of €1.7bn, realized starting in 2026 and being concentrated in the next four years. In 2020, the French group sees Opel and Vauxhall with a positive operational free cash flow and a margin of 2%. Moreover, PSA will gain access to GM's electrification technologies and fuel cell systems developed by the GM/Honda joint venture. This is significant because, due to regulatory complexity, car-makers have been establishing joint-ventures and partnerships so that the technology necessary for regulatory compliance can be shared between companies faster and more easily.

However, PSA and Mr. Tavares are likely to face a difficult time implementing their strategy. The automotive market is notably cyclical and analysts believe the European car market is at its peak. Given that this transaction puts PSA's European exposure at over 70%, its management will have to worry about its production capacity in the case of any market downturn. Moreover, there are political concerns in both Germany (where workers' unions are very strong) and the UK that Mr. Tavares' cost cutting will have negative political consequences for the current administrations. Therefore, PSA might not be able to pursue its intended cost slashing strategy, as it must pay heed to such political concerns. Mr. Tavares himself recognizes anyways that all workers will have a chance to adapt to his benchmark of efficiency and that it might not be necessary to close production and assembly facilities.

Market reaction

After the announcement of the deal, PSA shares rose nearly 3% to €19.58 at the close, the highest price since July 2011, while GM shares fell approximately 1%, closing at $37.91 on the date of the announcement.



Following the initial announcement that GM was close to selling Opel, most analysts shared positive views about it. However, the price slightly decreased in the following days probably because in the fine print of GM press release, it is specified that GM is taking a "primarily non-cash special charge of $4.0-$4.5 billion" to make the deal more attractive for PSA.

What is left for General Motors? FCA keeps knocking at the door

With the disposal of its European operations by means of the deal above, General Motors eventually withdraws from a market which had not been profitable for the American behemoth since the 90s. By reducing its global presence and by focusing on its most profitable brands, General Motors aims at a rigid refocusing strategy which would let the company survive the ongoing wave of consolidation in the industry. On the other hand, GM's global competitors like Fiat Chrysler Automobiles have been showing interest for the American company for a long time. FCA CEO Sergio Marchionne has indeed underlined in multiple occasions how a tie-up with General Motors could be beneficial to both parties, but none of his multiple proposals have apparently been successful so far. Starting in 2015, the American car maker has indeed rejected any talks on a potential merger with FCA, pledging that such a deal was not in the best interest of its shareholders.
Regardless of a potential 15% reduction in expected synergies (deriving from a GM-FCA merger) after the GM-PSA deal, during the Geneva Motors Show on March 7, 2017 Marchionne stated: "I never close any doors […] I may shamelessly try knocking on the GM door again, or any door, if I thought it was a good thing to do for the

business". Therefore, it is clear that General Motors represents a privileged target for the Italian car manufacturer but the question is: Will such a deal ever happen?

Tags*:*

PSA, Opel, Vauxhall, GM, General Motors, FCA, Fiat, automotive, industrials, Europe, merger, acquisition, M&A, deal