Global Economy and the Situation of the Foundry Industry

Dr. Heinz-Jürgen Büchner
Dresden, September 23rd, 2016
## Agenda

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Appendix
World Economy: Asia is the Market Driver

**Population in million**

- India
- China
- EU-28
- USA
- Brazil
- Russia

**GDP in bn. US-$**

- India
- China
- EU-28
- USA
- Brazil
- Russia

Source: 1) United Nations  2) IMF
US Economy: Improvement with some Risks

**Consumer Confidence**

![Graph showing consumer confidence index](image)

**Real GDP: in % qoq s.a. ann.**

![Graph showing real GDP growth](image)

**New orders, durable goods, in % mom, s. adj.**

![Graph showing new orders growth](image)

**In detail**

- The US economy shows a slightly positive development. The GDP grew annualized by only 1.2 per cent in the 2nd quarter of 2016, significantly lower than expected.
- But we expect a strong growth in the manufacturing sector: In July 2016, the new orders for durable goods jumped up by 4.4 per cent mom. Risks for the US economy could result from the stronger US-Dollar and a lacking demand from Asia.
- The consumer confidence stabilizes, but a steadily declining unemployment rate and a lot of newly created jobs should stimulate the private consumption even in the second half of 2016.

**Sources:** Bloomberg; BEA
Euro Zone: Back on the Growth Path

**Real GDP growth in %, qoq**

- Slovakia
- Cyprus
- Spain
- Netherlands
- Belgium
- Germany
- Latvia
- Finland
- Estonia
- Greece
- Portugal
- Lithuania
- Austria
- Latvia
- Germany
- Spain
- Italy

**Euro-Zone:**
- Q1 2016: 0.6 %
- Q2 2016: 0.3 %

**In detail**

- The recovery of the economy in the Euro zone is ongoing. During the second quarter of 2016 we saw a lower growth in relation to the first quarter, but on a higher level than expected.
- None of the member countries showed a decline in their economic activity. Spain profits from a strong recovery in the tourism industry, which should result in a high growth in the current year.
- For 2016 in total, we only see a very limited impact of the Brexit for the European economy.

**Sources:** Eurostat, IKB research (seasonally adjusted)
UK: Gloom after Vote for Brexit

**GDP; qoq; in %**

<table>
<thead>
<tr>
<th>Quarter</th>
<th>GDP Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Q 2013</td>
<td>0.4</td>
</tr>
<tr>
<td>1. Q 2014</td>
<td>0.6</td>
</tr>
<tr>
<td>1. Q 2015</td>
<td>0.2</td>
</tr>
<tr>
<td>1. Q 2016</td>
<td>0.8</td>
</tr>
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</table>

**PMI Composite**

- The British economy did very well in the second quarter of 2016: Total GDP increased by 0.6 % qoq. But the good results were not influenced by the expected negative impact of the Brexit vote at the end of June 2016.
- But the economic sentiment changed very quickly: The results of the PMI Composite (Purchase Manager Index) declined sharply in July 2016 (lowest level since April 2009).
- The consumer confidence dropped significantly.
- The British Pound depreciated against the US-Dollar and the Euro as well as some other major currencies.

**Sources:**
1) ONS  
2) Markit  
3) ECB

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**1 EURO = … GBP**

![Graph showing EUR/GBP exchange rate from 2011 to 2016]
Crude Oil: The golden Days of low Prices?

**Brent oil price; US-$/barrel**

- The global crude oil market shows an oversupply mainly driven by a high production of the OPEC countries and the production in the United States in the current year.
- After an oversupply of above 2 mbd (million barrel per day) last year, the oversupply declined to around 1 mbd in 2016.
- The reduction in the number of active rigs in the US came to an end. But since October 2014 around three quarters of all rigs became inactive.
- From the end of 2016 on, Iran is able to raise its crude oil production by another 1 mbd (million barrel per day).
- We forecast a fluctuation of the crude oil price of around 50 US-$/bbl Brent by the end of the fourth quarter of 2016.
- For 2017, we see the crude oil price fluctuating between 50 and 60 US-$/bbl Brent, WTI will be on average 2 US-$ below the Brent quotation.

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**North America rig count: oil**

**A temporary oversupply**

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*Sources: Baker Hughes North America Rotary Rig Count; Bloomberg; IKB Research*
Economic Crisis with Influences on the Exchange Rates

1 EURO = … US-Dollar

1 EURO = … Yen

1 EURO = … Renminbi

In detail

- After a sharp decline in 2014, the US-Dollar fluctuated against the Euro around the level of 1.10 US-$ / € during the last eighteen months.

- Against the Yen we saw a strong depreciation of the Euro. The result is surprising, if we take the slow growth of the Japanese economy into account.

- With the beginning of lower than expected Chinese growth rates the Euro appreciated against the Renminbi. During the next twelve months we expect a stabilization.

Source: ECB
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Production of Light Vehicles

The European automotive industry recovers. The growth is stronger in the Eastern European countries.
The market share of German OEM increases.
Within the NAFTA we see a rising importance of Mexico: New manufacturing plants of several global OEM's are under construction or in extension.
Japan and Korea lose production volume to new manufacturing plants in China.

Source: IHS
CO₂ Emission Standards induce Improvements of the Combustion Engine …

**CO₂ emission targets for newly registered passenger cars**

1. **China**
   - (32.0%) CAGR (4.7%)
   - China displays the highest emissions among the three presented regions
   - The CO₂ reduction of 30% between 2015 and 2020 is very ambitious
   - No official 2025 target has been defined yet

2. **The USA**
   - (42.9%) CAGR (3.6%)
   - The USA succeeds at continuously reducing emissions and targets 93g/km by 2025
   - However, this is only slightly lower than the target the EU is aiming to achieve already by 2021

3. **Europe**
   - (40.7%) CAGR (4.6%)
   - Europe pursues the most ambitious CO₂ emission targets worldwide on its way to a low-carbon economy by 2050
   - The definitive 2025 targets will not be decided until 2017, however, they are expected to range between 68 and 78g/km

- The emission targets currently discussed in Europe for 2025 will require hybrid and other non-conventional drive-train technologies at the expense of conventional combustion engines

Sources: European Commission, Greenpeace European Unit, IKB Research, RWTH Aachen
... and will also require Non-conventional Technology

The emission targets currently discussed in Europe for 2025 will require hybrid and other non-conventional drive-train technologies at the expense of conventional combustion engines.

Sources: European Commission, Greenpeace European Unit, IKB Research, RWTH Aachen
In a more realistic long-term scenario the IEA expects sales below 18 million units per year in 2025. This equals a market share below 20 per cent. This forecast is more in line with some other studies.

The strong increase in production between 2025 and 2035 is only possible with a lot of innovations in battery technologies and infrastructure investments.

Source: IEA; pictures: BMW i8, Tesla model S; Toyota Auris
Stronger emission regulation in the European Union and the US induces a reduced fuel consumption.

This stimulates investments in a new generation of trucks and commercial vehicles.

Source: IHS
Commercial Vehicles: Declining Importance of Diesel

**Small Trucks: Diesel dominates (Stock January 2015)**

- Diesel 91%
- Gasoline 7%
- Other 2%

**Development of Energy Demand; in 1,000 Petajoule**

**New Registrations 2040 by Mode of Drive**

**In detail**

- **Until now, diesel is still the dominating fuel for trucks, busses and other commercial vehicles**
- **During the next 25 years different types of electrical vehicles will gain market shares mainly in the segment of smaller trucks and busses**
- **We see a limited chance for LNG mainly in the segment of heavy trucks**
- **In an optimistic scenario for electric and hybrid gears as well as other types of fuels only half of the total energy demand will be allotted to diesel**

*Sources: Shell Commercial Vehicles Outlook 2016*
Mechanical Engineering: Slight Recovery in Europe, Growth in Asia

Worldwide sales in mechanical engineering (in € bn.)

- **North America**
  - 2022: 337
  - 2020: 322
  - 2018: 337
  - 2016: 342
  - 2014: 354

- **Europe**
  - 2022: 709
  - 2020: 706
  - 2018: 734
  - 2016: 754
  - 2014: 768

- **China**
  - 2022: 826
  - 2020: 720
  - 2018: 764
  - 2016: 794
  - 2014: 818

- **Rest of the world**
  - 2022: 62
  - 2020: 54
  - 2018: 56
  - 2016: 57
  - 2014: 61

- **Rest of Asia**
  - 2022: 396
  - 2020: 457
  - 2018: 462
  - 2016: 473
  - 2014: 482

- **Sources:** VDMA, IKB estimates

- Globally, we expect a further increase in demand for mechanical engineering products.
- Sales in China will recover after a drop in the current year. Chinese sales will nearly equal the combined sales of the rest of Asia and North America.
- In Europe, Germany and Italy will gain market share compared to other western European states.
- As in the automotive industry there is a movement towards lightweight construction (robotics, machine tools, etc.)

During the next six years a stable growth is expected. The growth rate in China will come down to around 5 per cent (in previous years: double-digit rates!)

We expect an increasing production in all major sub-segments of the market.

Sources: ZVEI, IKB forecast
Construction Sector: Improvement in the US, China still with strong Potential

**Global construction industry; in US-$ trillion**

- The US construction industry is expected to see a strong increase in construction starts.
- Today, more than half of the Chinese population lives in rural areas. Further migratory movements into urban regions are expected within the next ten years.
- The construction sector in the European Union is also likely to revitalize. Eastern European EU members are likely to show significantly higher growth compared to Western European countries. Even the Spanish construction industry seems to show a slight recovery after some years of significant decline.

**Boom through urbanization**

- GDP vs Construction output (EC-Countries); yoy in %

- Urban population share; in %

**Sources:** CIC; ifo Euroconstruct; Worldbank
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Iron and Steel Cast: Asia outgrows global Market

Global grey iron, ductile iron and steel cast production (in million tons)

- The production in Western Europe is mostly stable during the decade between 2012 and 2022 with a slight decline from 2020 on.
- NAFTA states profit from the re-industrialization due to lower energy costs, inducing significant growth especially in Mexico.
- China dominates the world market, but India catches up. Japan and Korea lose casting production to these countries.

1) Includes Australia
Sources: World Census, CAEF, IKB
Iron and Steel Cast in Europe: Stable Outlook

European grey iron, ductile iron and steel cast production (in million tons)

- A major part of Eastern European growth takes place in Turkey, however we forecast a temporary decline in the current resp. next year.
- Western European production on the other hand stabilizes only. Spain is more likely to grow and gain market shares.
- For Germany we predict a competitive advantage in the recovery of the mechanical engineering sector.

Sources: World Census, CAEF, IKB
Aluminum Cast: China dominates its Competitors

Global aluminum cast production (in million tons)

- Germany gains market shares within Europe at the expense of Western European competitors. We expect a recovery process in Eastern Europe (Russia, Ukraine) and a catching-up of Turkey.
- Most of the growth in the NAFTA region happens due to investments of foreign OEMs and global foundry groups.
- Korea und Japan lose market shares to China. China surpassed the 6-million-ton production-mark for the first time in 2015.

1) Includes Australia
Sources: World Census, CAEF, IKB
For Eastern Europe we forecast a slight decline in the current year (e.g. Russia, Ukraine). In the medium-term an expansion of aluminum wheel production in Turkey and expanded capacities in Slovakia, Czech Republic and other countries will drive European production.

After a strong growth during the last years, the German aluminum foundries will surpass the 1.2 million ton mark.

Sources: World Census, CAEF, IKB
Copper Cast: China significantly ahead of other Regions

The global copper cast production will only increase slightly between 2012 and 2022. We forecast a recovery in Eastern Europe (Russia, Ukraine) and an improvement in Western Europe but not reaching former levels.

China and Nafta will stabilize while Latin America will need some years to come back to the 2014 production level. Within Asia, we see a stronger growth outside of China.

1) Includes Australia
Sources: World Census, CAEF, IKB
We saw a strong growth in the Chinese iron and steel cast production during the last fifteen years: The total volume of foundry products quadrupled.

During the industrialization process the shift from grey cast to grades like ductile iron cast (including vermicular cast iron) simultaneously occurred.

Source: Census
The rising Importance of Lightweight Production

Iron and Steel Cast; CAGR in %

In detail

- During the last few years we saw high investments from OEM’s into aluminum cast:
  - **Audi** opened a new aluminum die casting foundry at Münchsmünster, around 30 km away from its main plant Ingolstadt in Bavaria, Germany
  - **BMW** expanded its aluminum foundry capacity in Germany by around 50 per cent
  - **General Motors** announced the closure of an iron cast foundry and the expansion of an aluminum foundry
  - **Ford** produces two of its Pick-ups completely in aluminum
  - **Geely** bought Hazelwood and the UK-based Emerald Automotive to develop a lightweight vehicle
  - The new generations of electric vehicles include a higher portion of lightweight materials e.g. carbon fibers, magnesium, aluminum and thin high-tensile steel grades

Source: Census; CAEF; IKB Forecast
Strategic Challenges of the global Foundry Industry

Globalization
- Major part of the demand growth will occur in emerging markets
- Especially the automotive industry is increasingly demanding local presence outside of Europe
- Increases the need for a global footprint

Technological leadership
- Keeping the technological leadership is of great importance for the casting industry
- Pressure on unit weights will continue (e.g. automotive, mechanical engineering, packaging)
- This changes the material mix and increases the requirements for the alloy competence

Retain qualified personnel
- Many qualified workers will retire within the next few years (holds for several Western European countries)
- Competition for staff intensifies due to changing age structure
- Requires new worker loyalty programs (pension schemes, profit-sharing, flexibility regarding family & job)

Investment requirements
- Growing trend towards surface treatments will necessitate respective investments
- Complexity of alloys will grow and will cause respective investments
- Globalizing market will trigger increased investments in logistics

Margin pressure
- Growing international competition in the vehicle manufacturing industry
- This limits the possibility of passing on cost increases to end consumers
- On the part of OEMs this pressure could be passed on to suppliers

Industry consolidation
- Thus the industry consolidation is expected to continue
- Main reasons, beside the pressure for globalization, are increasing investment requirements
- From our point of view many family businesses also face succession-related problems

➢ The global foundry industry will face rising investment requirements. Together with succession-related problems in mid-sized companies, this might increase industry consolidation
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**Trends in the Customer Industries**

**Consequences for the global Foundry Industry**

**Appendix**
Your contact

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Autonomous Driving – expected to have significant Market Share in 20 Years

Sales forecast for self-driving cars

<table>
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<tr>
<th>Year</th>
<th>Global unit sales (in m)</th>
<th>Share of global sales</th>
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<tbody>
<tr>
<td>2020-24</td>
<td>0.2</td>
<td>0.0%</td>
</tr>
<tr>
<td>2025</td>
<td>0.3</td>
<td>0.2%</td>
</tr>
<tr>
<td>2030</td>
<td>3.8</td>
<td>3.2%</td>
</tr>
<tr>
<td>2035</td>
<td>11.8</td>
<td>9.4%</td>
</tr>
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Selected current and future self-driving cars/trucks

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<tr>
<th>Vehicle</th>
<th>Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>Google</td>
<td>▪ Fully autonomous car, without acceleration/breaking pedals and steering wheel&lt;br&gt;▪ Space for two passengers&lt;br&gt;▪ Speed of 40km/h</td>
</tr>
<tr>
<td>DAIMLER</td>
<td>▪ Fully autonomous truck&lt;br&gt;▪ Warns driver to take over control if situations for the autopilot occur too complex&lt;br&gt;▪ Available for purchase by 2025</td>
</tr>
<tr>
<td>Audi</td>
<td>▪ Traffic-jam pilot for autonomous driving on motorways at speeds between 0 to 60km/h&lt;br&gt;▪ Autonomous Audi A8 to be released in 2017</td>
</tr>
</tbody>
</table>

In recent months, numerous developers have continued to move forward with the development/testing of self-driving cars.
While the technology is already well-developed, ethical, legal and insurance questions remain unaddressed.
By 2020 several fully self-driving cars will be launched with low expected sales initially that will increase rapidly until 2035.

Sources: EY study: „Autonomes Fahren – die Zukunft des Pkw-Marktes”; IHS Automotive; IKB research
The International Energy Agency (IEA) has created a very optimistic scenario for the further development of the market for Electric Vehicles (EV) and Plug-in Hybrid Vehicles (PHEV). They assume that the car manufacturers will roll-out around 40 PHEV and another 20 EV models until 2020. These number of new models seems reachable, but we are not that sure, that each model will reach annual sales figures of up to 100,000 units. But a quick ramp-up in annual sales figures per model is necessary to achieve economies of scale. Therefore in our point of view the IEA scenario seems to be too optimistic.

Source: IEA projections; picture: BMW i8
IKB – “Bank for the Mittelstand”

At a glance

- Financing partner for SMEs for 90 years
- c. 1,100 client groups in Germany and Europe and c. 20,500 leasing client groups
- Shareholders: Lone Star 91.5%
  - Free float 8.5%
- 1,554 employees (FTE), thereof 497 at IKB Leasing
- Total assets: € 19.6 billion
- Common Equity Tier 1 ratio$: 11.59%

Regional presence

Wide range of corporate finance products

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<th>Financial Markets</th>
<th>Advisory</th>
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<td>Debt Capital Markets</td>
<td>M&amp;A</td>
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<td>Bilateral Financing</td>
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<td>Syndicated Loans</td>
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<td>Institutional Sales</td>
<td>Corporate Finance</td>
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Key figures as at 31 March 2016

$ The CET 1 ratios were calculated in accordance with the current legal status of the CRR as at the respective reporting date, including transitional provisions and the interpretations published by the regulatory authorities and the interpretation thereof. The possibility that future EBA/ECB standards and interpretations or other regulatory action will lead to a retrospective change in the CET 1 ratio cannot be ruled out.
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