



# OPPORTUNITIES AND CHALLENGES IN CHINA'S AUTOMOTIVE INDUSTRY



April 2013

- Chinese consumers are expected to play an increasingly important role in the development of the economy as China rebalances from an export driven to a domestic consumption driven model.
- As the growth of new passenger vehicle sales relative to past years slows, China is still expected to remain the world's largest producer and consumer of automobiles. It will outperform both the European and US markets in the midterm with its projected high single digit growth.
- Expansion in manufacturing capacity continues at an unabated speed and with overcapacity already showing, manufacturers threatened most are expected to increase industry competitive pressure by entering into new segments with low-price market penetration strategies.
- The aftermarket on the other hand, still finds itself at a very early stage of development and provides a myriad of opportunities for component manufacturers and service providers who are able to develop and implement the right strategies to capitalize on the significant growing aftermarket demand with the aging of existing passenger vehicles base.
- As China's automotive market enters its next stage of development, both challenges and opportunities await. Companies that develop the right strategies and contingent plans will be ensured continued success in this dynamic market.



# CHINA AUTOMOTIVE INDUSTRY TRENDS

China Automotive Industry Trends

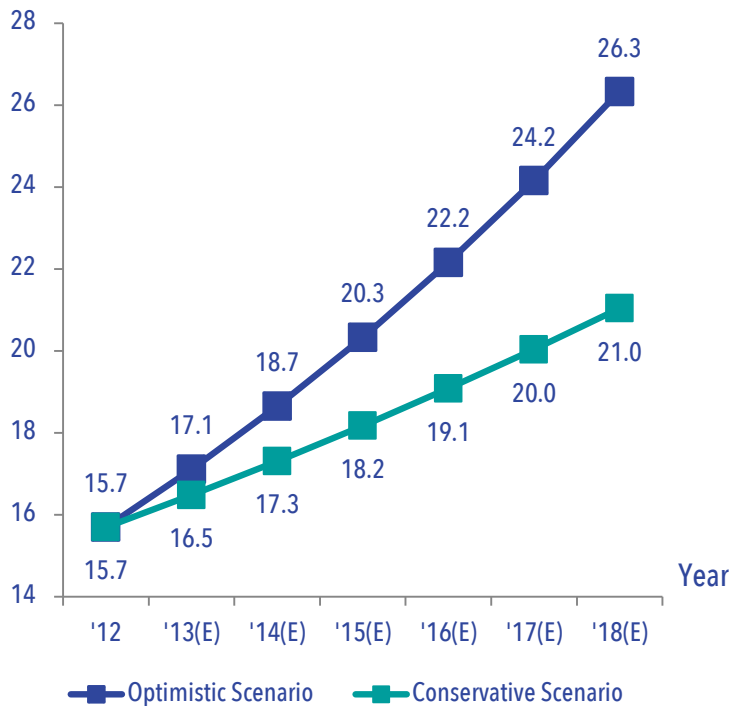
# NEW PASSENGER VEHICLE MARKET TRENDS



# THE GROWTH RATE OF NEW PASSENGER VEHICLE (PV) IS EXPECTED TO SLOW TO SINGLE DIGIT GROWTH BETWEEN 5%-9% OVER THE NEXT FEW YEARS

## New PV Sales Forecast

Unit: Million



CAGR  
'12-'18

9%

5%

## Positive Impact

**Per-capita disposable income**

- Is expected to increase at CAGR of 10% over the next years

**Fast urbanization**

- Urbanization rate is expected to grow from 52.6% in 2012 to 55% in 2015

**Auto finance penetration rate**

- Is expected to increase from 15% in 2012 to 30% by 2022

## Negative Impact

**Economic slow down**

- 2013 GDP growth target has been lowered to 7.5%

**Negative policy impact**

- More cities may implement policies to restrict the number of new automobile registrations
- Discontinuation of subsidies for new vehicle purchases
- Potential negative impact of rising fuel cost and potential new taxation such as traffic congestion and pollution fees

Note: The statistics includes the domestic produced vehicle and imported vehicle sold in China  
Source: China Association of Automobile Manufacturers (CAAM), Ipsos Business Consulting analysis

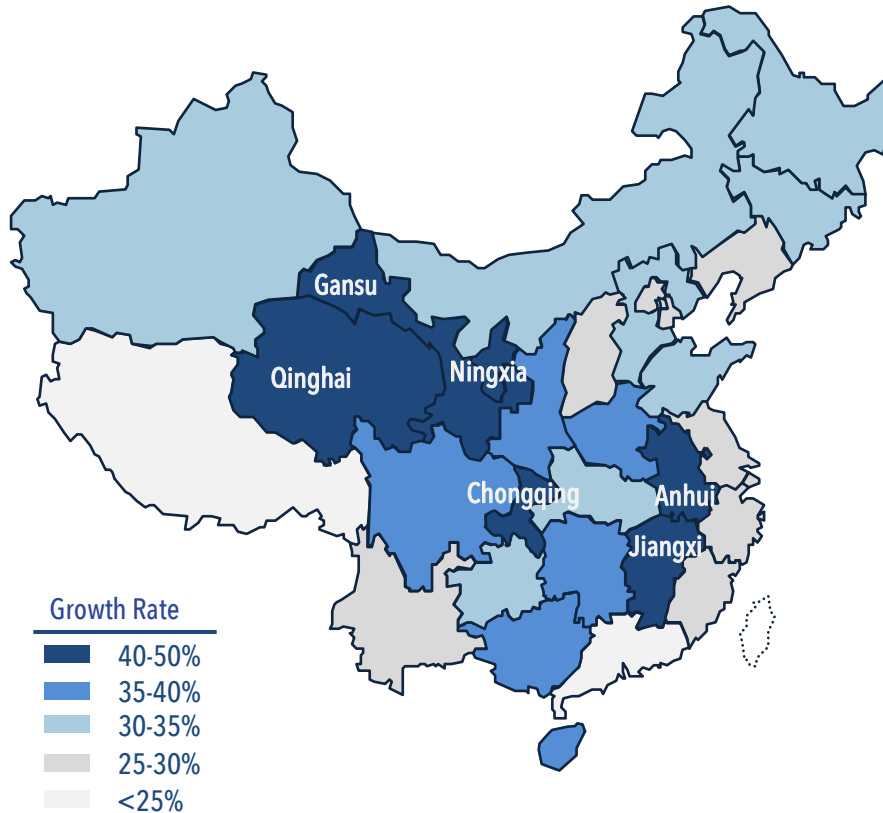


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# WHILE PAST PV GROWTH HAS PREDOMINATELY COME FROM COASTAL CITIES, MID AND WESTERN REGIONS HAVE BEEN EMERGING AS THE NEW GROWTH REGIONS

## China New PV Sales 2006 - 2011 CAGR (%) By Region

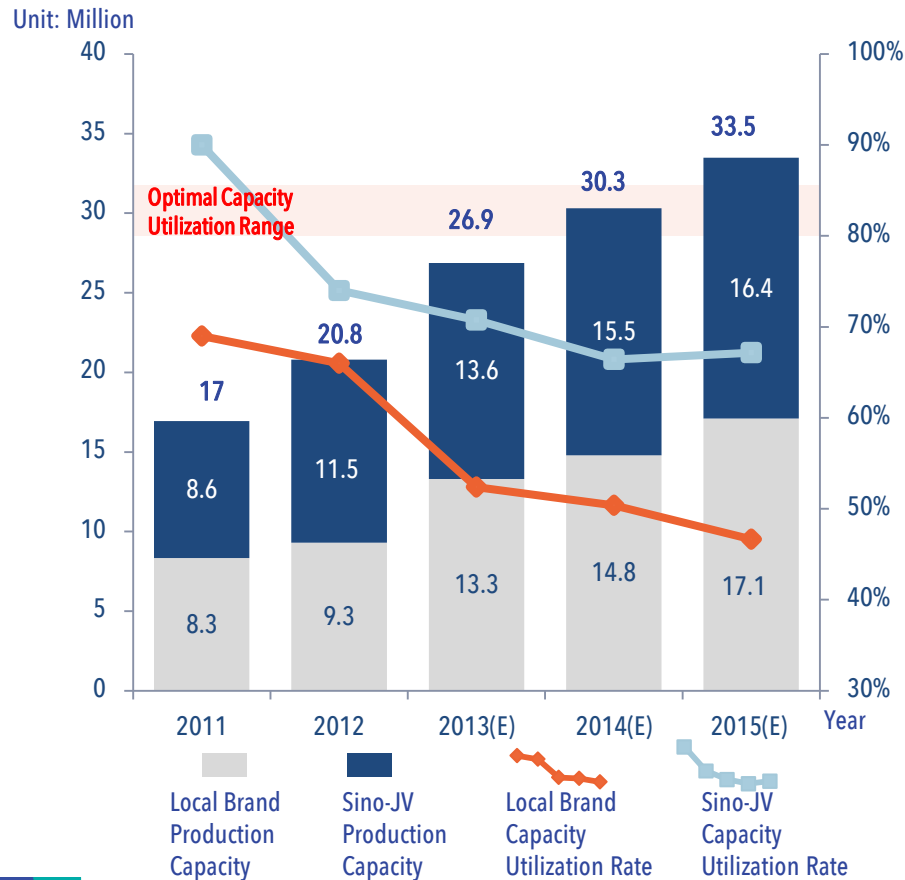


## Comments

- The mid-west regions are receiving more attention and investments from auto OEMs as the government is focusing development on these regions
- Due to the relatively high price sensitivity of first time car purchasers in these regions, low-to-mid-end segments are expected to drive sales
- Increasing number of auto OEMs have begun to adjust their organization structure to decentralize marketing related decision-making to regional business units in order to adapt to various and changing demand within each region

# BESIDES THE SLOWER DEMAND GROWTH, STRUCTURAL OVERCAPACITY IS ANOTHER CHALLENGE FACING AUTO OEMS AND AUTO PARTS MANUFACTURERS

## Planned PV Production Capacity and Forecasted Capacity Utilization Rate of Auto OEMs

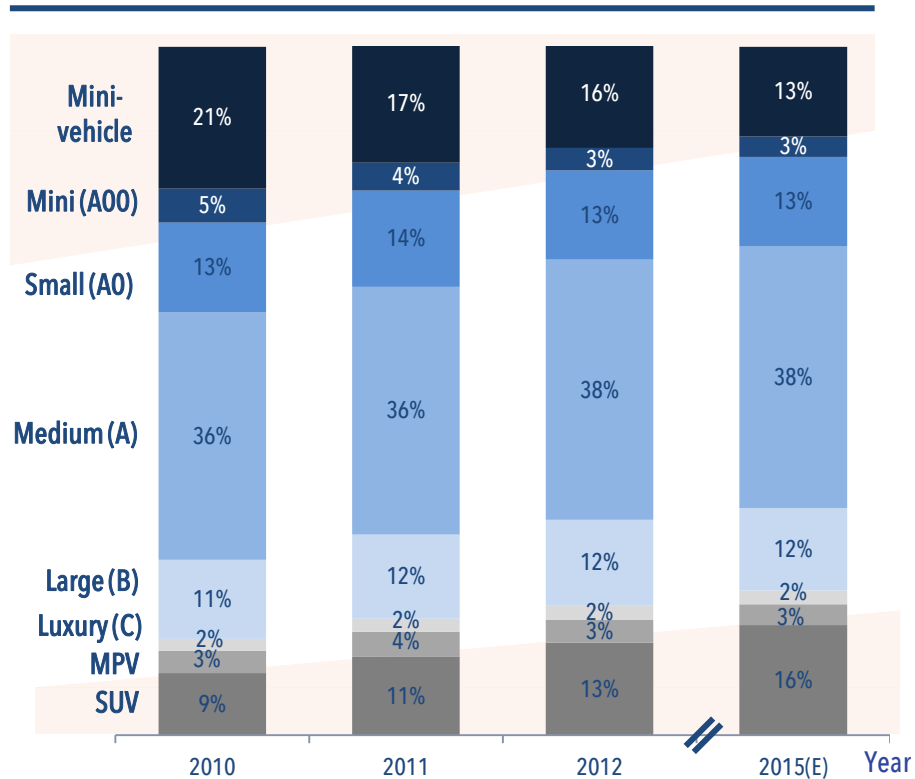


## Comments

- While utilization rates may differ between OEMs, the overall industry trend of overcapacity is clear
- Slower growth in the domestic PV market will also push both domestic OEMs and auto parts manufacturers to focus on export markets
- With continued overcapacity and slowing demand growth, some forms of industry consolidation and streamlining can be expected over the coming years
- Price pressures will also become more apparent for auto parts manufacturers in order to remain competitive

# AS CAR REPLACEMENT BECOMES A KEY DRIVER OF NEW PV SALES, OEMS WILL FACE MORE PRESSURE TO QUICKLY ADAPT TO CHANGING CUSTOMER EXPECTATIONS

## New PV Sales by Car Segment



Note: Sedan is mainly segmented based on the wheelbase and engine displacement.

Segment examples: Mini(A00): Chery QQ; Small(A0): Kia K2; Medium(A): Chevrolet Cruze; Large(B): VW Passat; Luxury(C): Audi A8

Source: China Passenger Car Association(CPCA), Ipsos Business Consulting analysis

## Comments

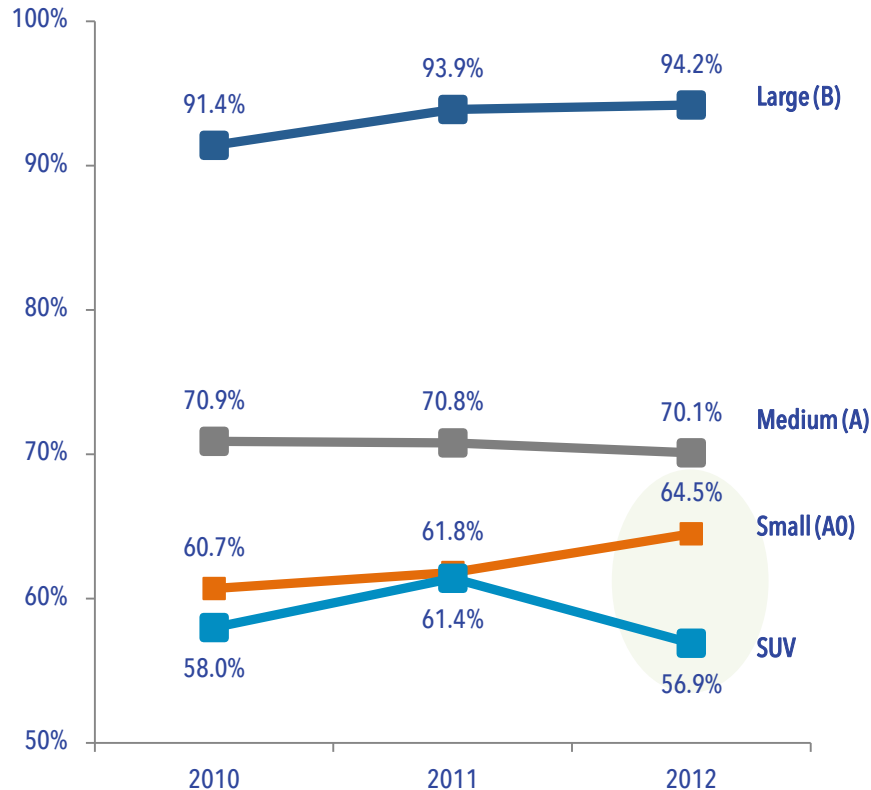
- Mid-size sedan, full-size sedan and SUV segments are expected to gain more market share, among which SUV will become the most promising segment with a CAGR of 20% over the next three years
- The competition in the SUV segment is expected to remain fierce with 28% of all new models presented during the Guangzhou car exhibition in Nov. 2012 being SUVs
- Development of more fuel-efficient and low-emission SUVs by means of adopting small-displacement turbocharged engines and lighter materials will be necessary for this segment to remain attractive





# THE BATTLE FOR MARKET SHARE RAGES ON AS SINO-JVS INCREASE THEIR FOCUS ON SMALL SIZED SEDANS AND LOCAL OEMS SHIFT THEIR FOCUS TO THE MID AND UPPER SEGMENTS

Proportion of Sino-JV Sales to Total Sales by PV Segment



Source: China Passenger Car Association(CPCA), Ipsos Business Consulting analysis

## Sino-JVs will continue to push into smaller and cheaper segments

- Increasing number of foreign brands are planning to introduce new models targeting the mini (A00) segment
- Examples include an upcoming brand from VW, the K1 from KIA, the new Alto from SUZUKI

## Domestic brands will continue to upgrade to meet the more upscale image aspirations of Chinese consumers

- During the Beijing Auto Show in April 2012, 84 of 120 new models premiered were independently developed by domestic brands, most of which targeted the middle and upper segments (e.g. Roewe 950 from SAIC and the Hongqi H7 from FAW)
- New regulations on government car procurement favoring domestic brands pose a good opportunity for domestic players to elevate their brand image

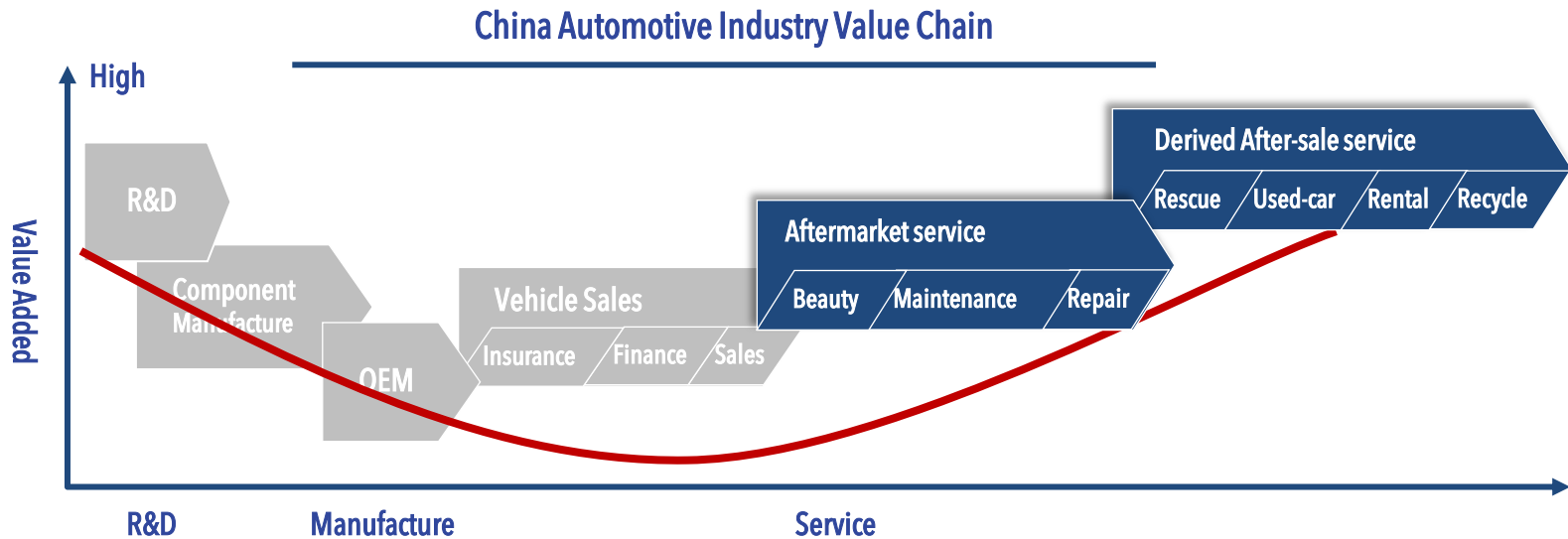


China Automotive Industry Trends

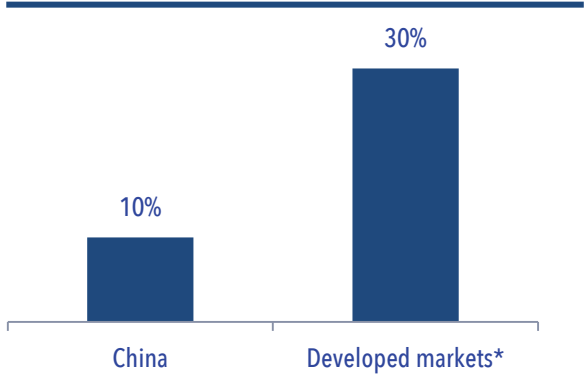
# PASSENGER VEHICLE AFTERMARKET TRENDS



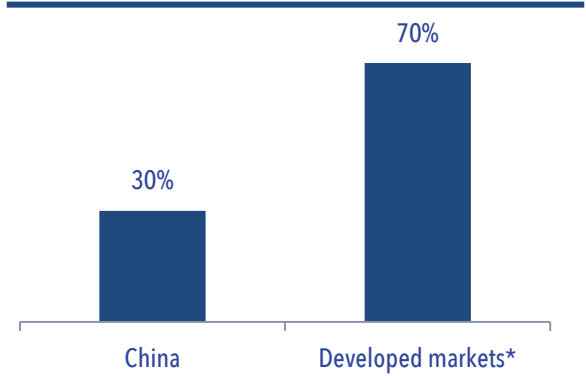
# THE DEVELOPMENT OF CHINA'S AUTOMOTIVE AFTERMARKET PROVIDES A MYRIAD OF OPPORTUNITIES FOR BOTH PRODUCTS AND SERVICES



**Aftermarket's Contribution to Overall Automotive-related Sales**



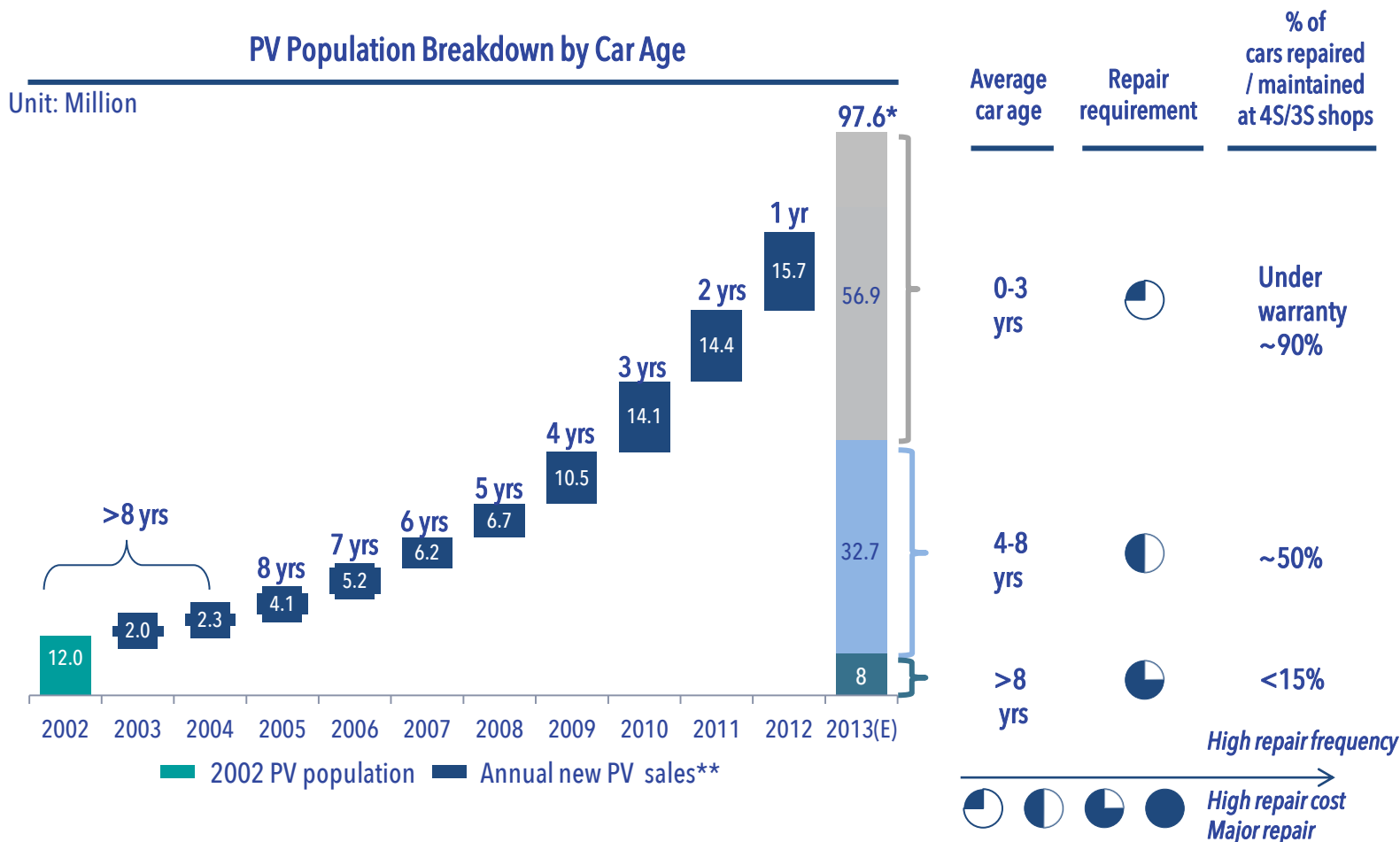
**Aftermarket's Contribution to Overall Profit Margins of 4S shops**



Note\*: Developed markets include countries such as U.S., Japan and Europe  
Source: Ipsos Business Consulting analysis

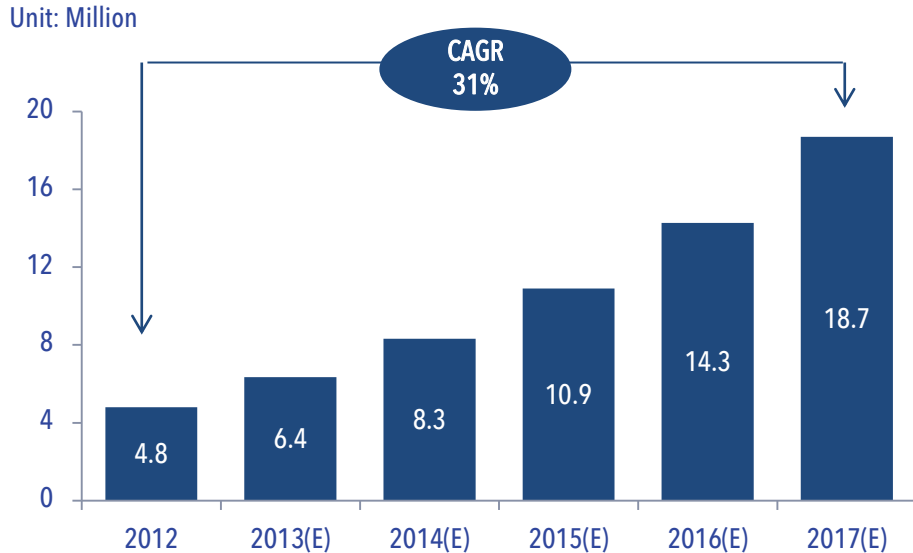


# VEHICLES SOLD DURING CHINA'S AUTO BOOM ARE BEGINNING TO AGE, WHICH PRESENTS SIGNIFICANT OPPORTUNITIES IN CHINA'S UNDERDEVELOPED AUTOMOTIVE AFTERMARKET

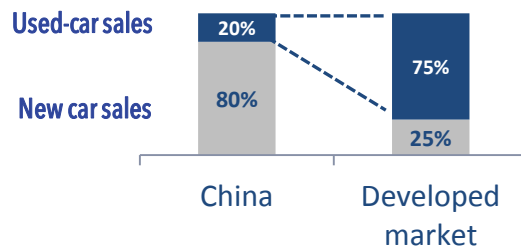


# THE HIGH GROWTH EXPECTED IN CHINA'S USED-CAR MARKET WILL FURTHER DRIVE THE DEMAND FOR AFTERMARKET PARTS AND SERVICES

## Used-Car Sales Forecast



## Proportion of used-car and new car sales as a percentage of total vehicle sales in volume



## Comments

- The demand for aftermarket parts and service will not only be driven by the size of the car population, but also by the development of the used-car market
- The aim of the upcoming technical standards for used-car evaluation will regulate the market by standardizing the evaluation process and items
- Greater transparency in used-car conditions will in turn support the development of the used-car market
- Opportunities for auto parts manufacturers to work closely with used-car dealers to provide parts as well as related service such as core parts evaluation are emerging



# IN COASTAL REGIONS GROWTH OPPORTUNITIES ARE SHIFTING TOWARDS LOWER TIER CITIES, WHILE WESTERN REGIONS STILL LAG BEHIND IN OVERALL DEVELOPMENT OF NETWORKS

China PV park size by regions in 2011

### West China Region

- Consisting of Xinjiang, Gansu, Qinghai, Tibet, and Ningxia
- Accounts for very small share of total China PV population size with each province representing around 1% of the total



### East China Region

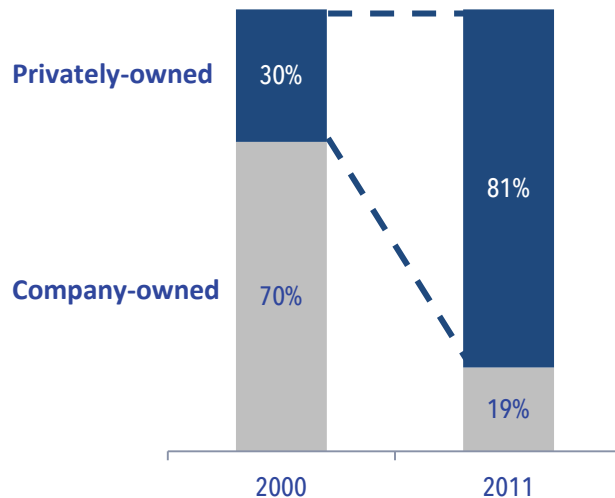
- Consisting of Guangzhou, Zhejiang, Shanghai, Jiangsu, Beijing, Shandong and Hebei Provinces
- Accounts for almost 50% of total China PV population size

- East coast regions will remain dominant in the consumption of auto related goods while middle and west regions are expected to embrace the sales boom in auto related products over the next 3-5 years
- Auto parts manufacturers will need to differentiate their channel strategy by region as auto parts and service demand differs in regions due to various terrain / road conditions, car model and maintenance preferences
- Distributor network expansion and partnerships will help auto parts manufacturers cope with the low brand awareness and low accessibility of auto parts in lower-tier cities in east coast regions, and lower-tier provinces in middle and west China

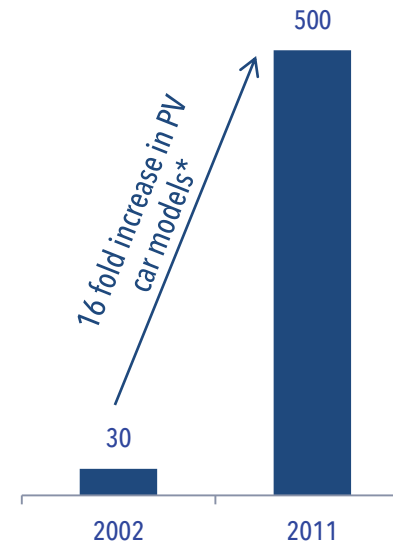


# PV AFTERMARKET SERVICE IS A HIGHLY FRAGMENTED MARKET DUE TO THE DIFFERENT NEEDS AND REQUIREMENTS OF PRIVATE CAR OWNERS

## PV Population Breakdown by Ownership



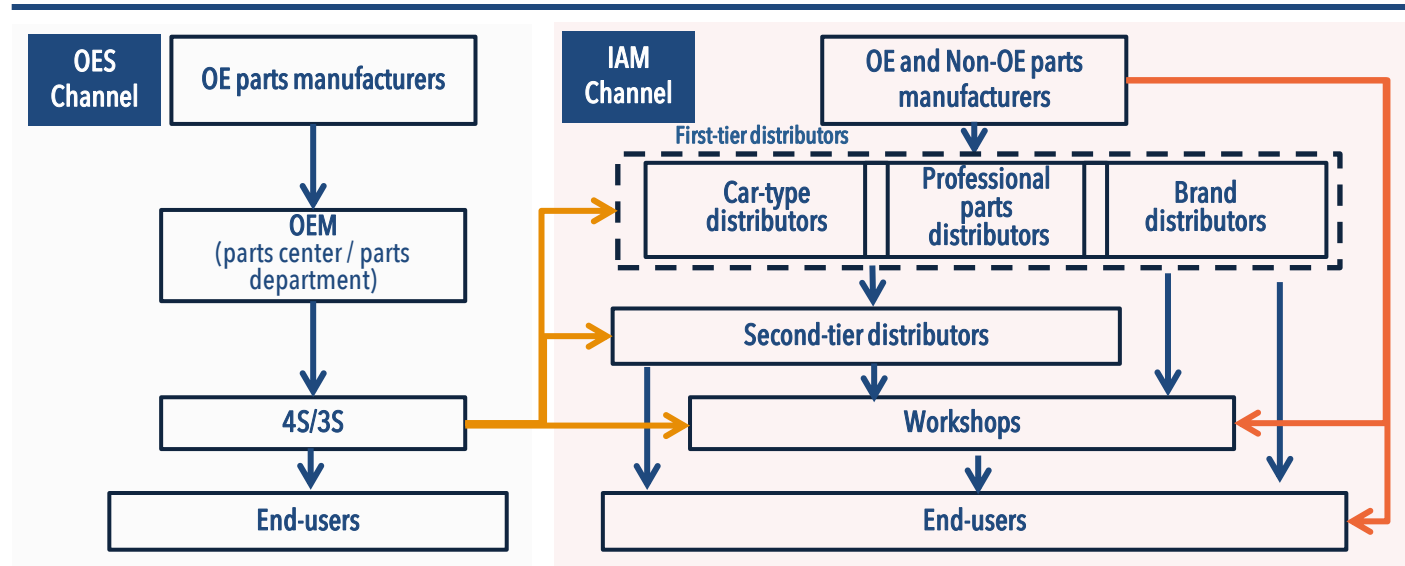
## Number of PV Car Models 2002 vs. 2011



- Aftermarket services for PVs is primarily a business to consumer (B2C) market due to the high percentage of privately owned vehicles
- The increase in variety of car models made available over the past decade in China has also led to a diversification in aftermarket needs of car owners based on price points of cars owned in addition to personal preferences
- Channels for aftermarket parts and services have had to evolve in order to serve the different customer segments, with workshops of different classes offering spare parts of varied price points and quality

# AUTO PARTS MANUFACTURERS WILL NEED TO DEVELOP NEW STRATEGIES TO CAPTURE GROWTH OPPORTUNITIES IN THE INDEPENDENT AFTERMARKET (IAM) CHANNEL

Distribution Channel Map of the PV Aftermarket in China



Note: OES - Original Equipment Service Channel, OEM - Original Equipment Manufacture, OE - Original Equipment

→ Common flow  
→ Rare flow  
→ Emerging flow

## Shifting Channel Focus

- Increasing number of OE-brand parts manufacturers have been shifting focus to the IAM channel, with the IAM channel expected to capture more share of the maturing PV aftermarket

## Emerging Business Model

- New business models in the IAM channel are appearing to enhance auto parts manufacturers' competitiveness as well as cope with the counterfeiting issues. For example, Bosch started running directly-managed workshops in China and is also in midst of promoting genuine parts by establishing on-line stores



# WITHIN THE IAM CHANNEL, THE FAST FITTER SEGMENT HAS EXPANDED RAPIDLY OVER PAST YEARS AND IS OFTEN CONSIDERED AS AN ATTRACTIVE CHANNEL FOR AFTERMARKET

## IAM Sub Channels

Workshop type	2012 store number	Future growth	Market position*
Traditional workshop	125,700		
Fast fitter	104,800		
Beauty shop	74,500		
Lubricants and Tire	56,800		
Others	8,800	N/A	N/A



## Parts Availability

- Service efficiency is a key success factor for fast fitters
- It is essential for parts manufacturers to manage their product inventory and provide short lead times in order to support distributors to serve fast fitters' needs

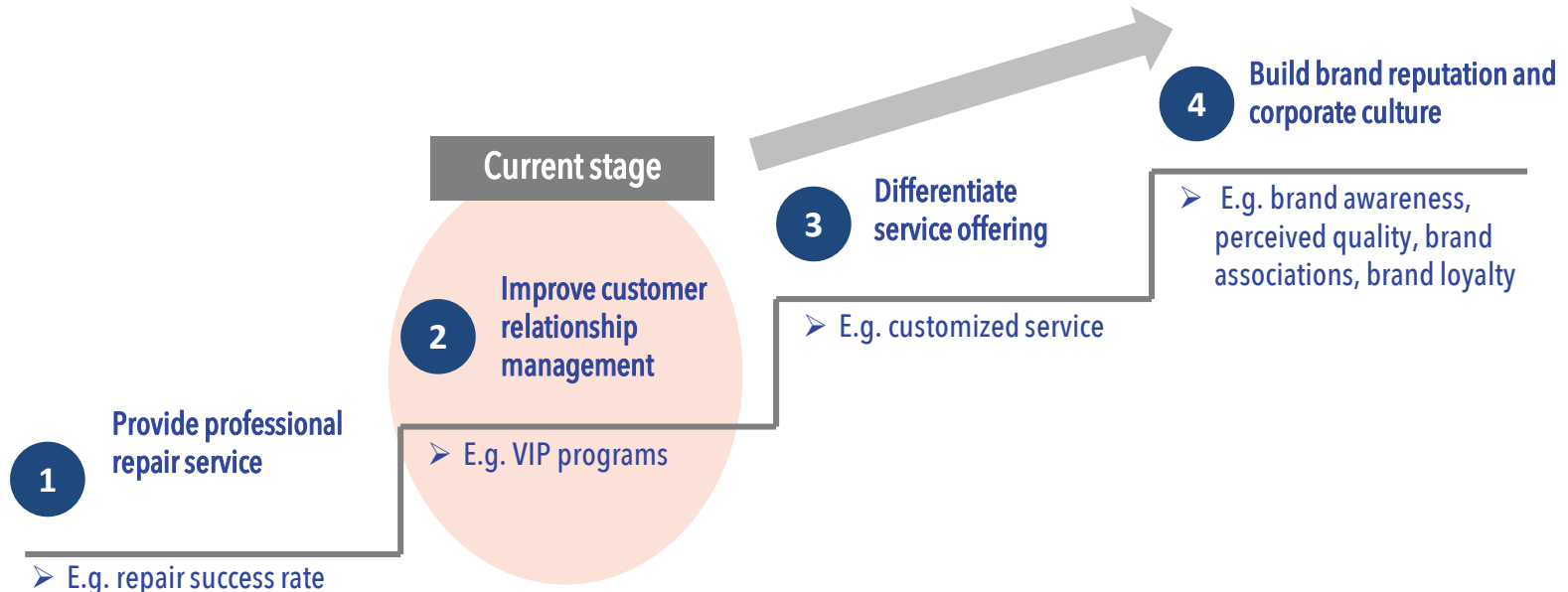
## Parts Requirements

- Parts are expected to possess easy-replacement features to enhance repair efficiency as well as lower skill requirements of technicians
- As parts repair rates are relatively high in the IAM channel, it is necessary for parts manufacturers to provide a full range of spare parts to address the needs of the repair market



# SIMILAR TO FOREIGN MARKETS, THE PV AFTERMARKET IS EXPECTED TO EVOLVE FROM ITS CURRENT PRICE COMPETITION BASED MODEL TO A BRAND COMPETITION BASED MODEL

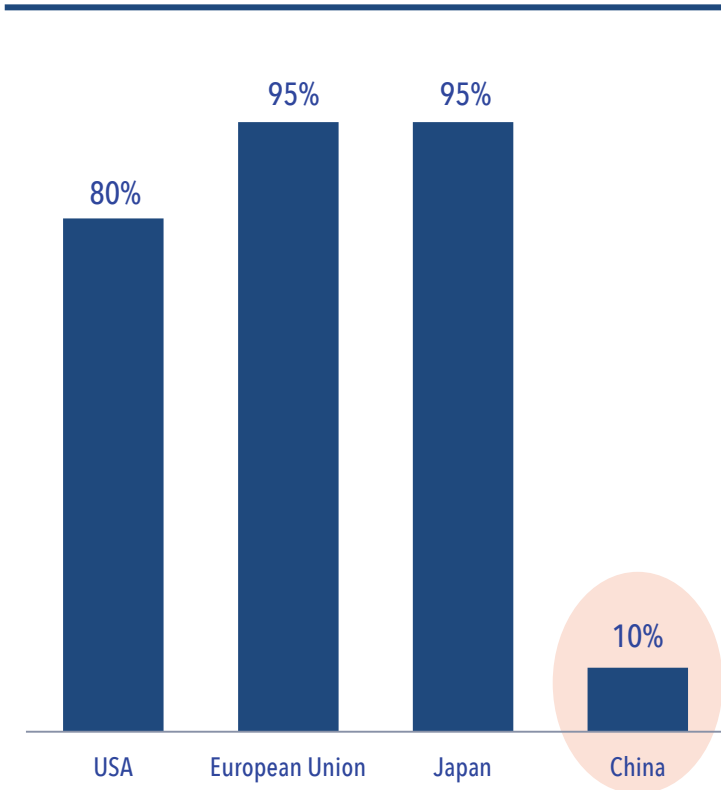
## The Four-Stage Evolution of the PV Aftermarket Service Model



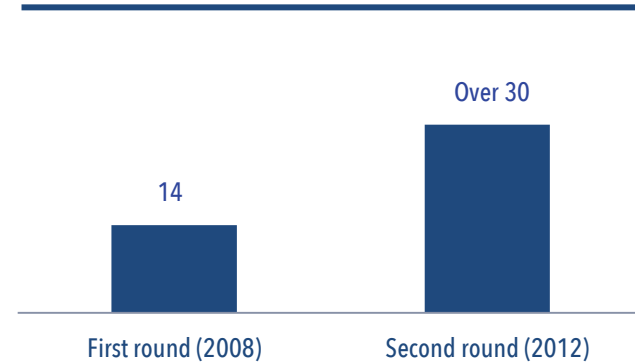
- Closer cooperation between aftermarket franchise stores and will-fit brands is expected as franchise stores leverage the cost-effectiveness of will-fit brands as a unique selling point, while will-fit brands utilize the existing franchise network to increase brand awareness and speed to market
- Besides parts quality and price, auto parts manufacturers are placing more emphasis on technical support, product training, claim policy and warranty period as a result of higher expectations from customers

# WITH GOVERNMENT SUPPORT, CHINA'S UNDERDEVELOPED REMANUFACTURING INDUSTRY IS EXPECTED TO GREATLY PROFIT FROM THE GROWING AFTERMARKET DEMAND

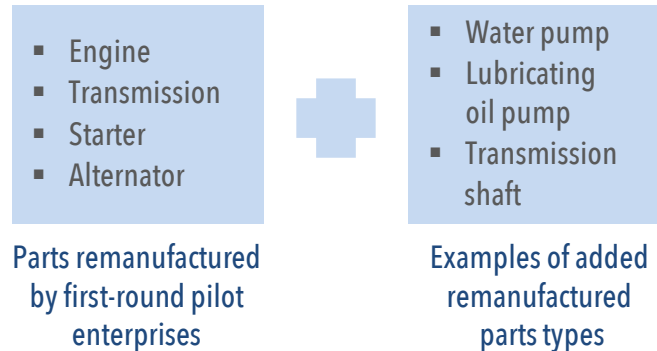
## Proportion of Vehicle Parts being Recycled in Different Countries



## No. of Remanufacturing Pilot Enterprises



## Types of Remanufactured Products



# POSITIONING WILL PLAY AN ESSENTIAL ROLE IN ORDER FOR COMPONENT MANUFACTURERS TO SUCCESSFULLY ESTABLISH REMANUFACTURED PRODUCTS IN THE MARKET

	Price of Spare Parts	Target Market Features	Remanufactured Product Advantage	Comments						
High-value parts	Average price range from 10,000~50,000 CNY/unit	<table border="1"> <tr> <th>Feature</th> <th>Percentage</th> </tr> <tr> <td>Replacement</td> <td>1%</td> </tr> <tr> <td>Repair</td> <td>99%</td> </tr> </table>	Feature	Percentage	Replacement	1%	Repair	99%	Advantage in comparison to overhauled parts: <ul style="list-style-type: none"> <li>Lower price</li> <li>Lower breakdown frequency</li> <li>Shorter repairing hours</li> <li>Longer lifespan</li> <li>Longer warranty period</li> </ul>	Improving awareness of remanufactured parts will be essential to develop potential customer segments
Feature	Percentage									
Replacement	1%									
Repair	99%									
Low-value parts	Average price range from 200~1,000 CNY/unit	<table border="1"> <tr> <th>Feature</th> <th>Percentage</th> </tr> <tr> <td>Replacement</td> <td>70%</td> </tr> <tr> <td>Repair</td> <td>30%</td> </tr> </table>	Feature	Percentage	Replacement	70%	Repair	30%	Advantage in comparison to will-fit parts: <ul style="list-style-type: none"> <li>Longer lifespan</li> <li>Lower breakdown frequency</li> </ul>	Pricing strategy is required to compete with will-fit parts due to customers' high price sensitivity Distributors will play an important role in promoting remanufactured products
Feature	Percentage									
Replacement	70%									
Repair	30%									



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