

# Automotive Parts

## Sector Study

# Table of Contents

Contents	Page No.
Introduction	3
Global Industry   Overview	4
Global Industry   Exports	5
Global Industry   Imports	6
Local Industry   Overview	7
Production	8
Imports & Exports	9
Major Trading Countries	11
Business Risk	12
Margins & Cost Structure	13
Raw Materials	14

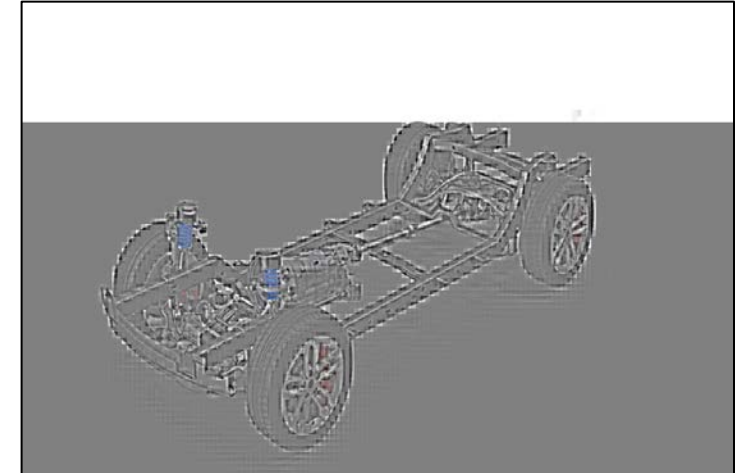
Contents	Page No.
Duties & Sales Tax Structure	16
Working Capital Management	17
Financial Risk	18
Rating Curve	19
SWOT Analysis	20
Outlook & Future Prospects	21
Bibliography	22

---



## Introduction

- Automobile parts and accessories are complex components which make up all automobiles and ensure their ability for efficient and long-term functioning.
- While there are a large number of individual auto parts, they can be broadly categorized according to certain functions -
  1. The Chassis: includes the frame, suspension system, axles and wheels.
  2. The Engine: includes exhaust system, cooling system, ignition, pistons and valves.
  3. The Transmission System: includes the clutch, gearbox, propellor shaft and axle.
  4. The Body: consists of the the external structure usually made from steel or aluminium. It also includes the bumpers, mirrors and windshield.
  5. The Control Systems: consists of the steering and braking system.
  6. The Auxiliaries: these components are not essential but add comfort for passengers such as the air-conditioning system.

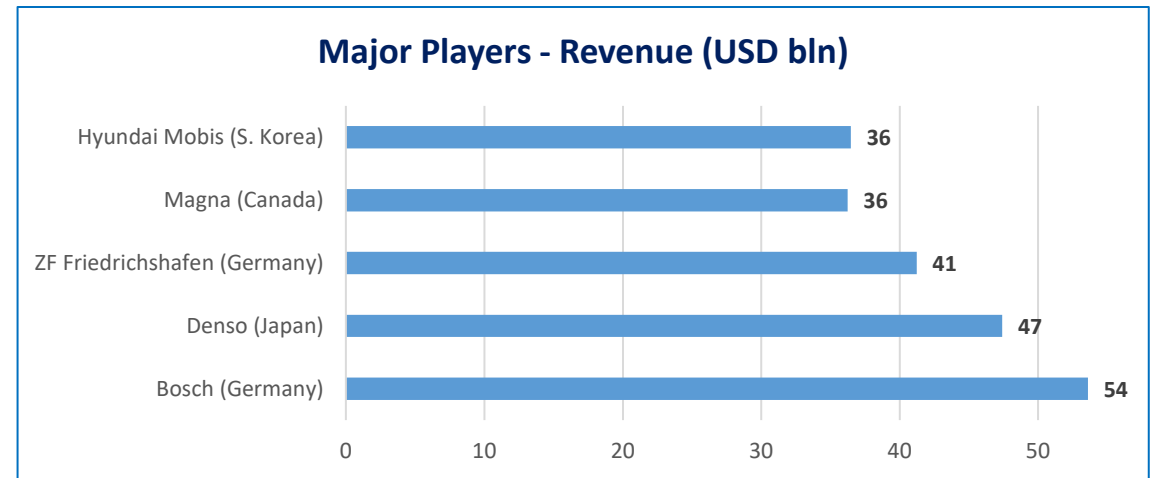
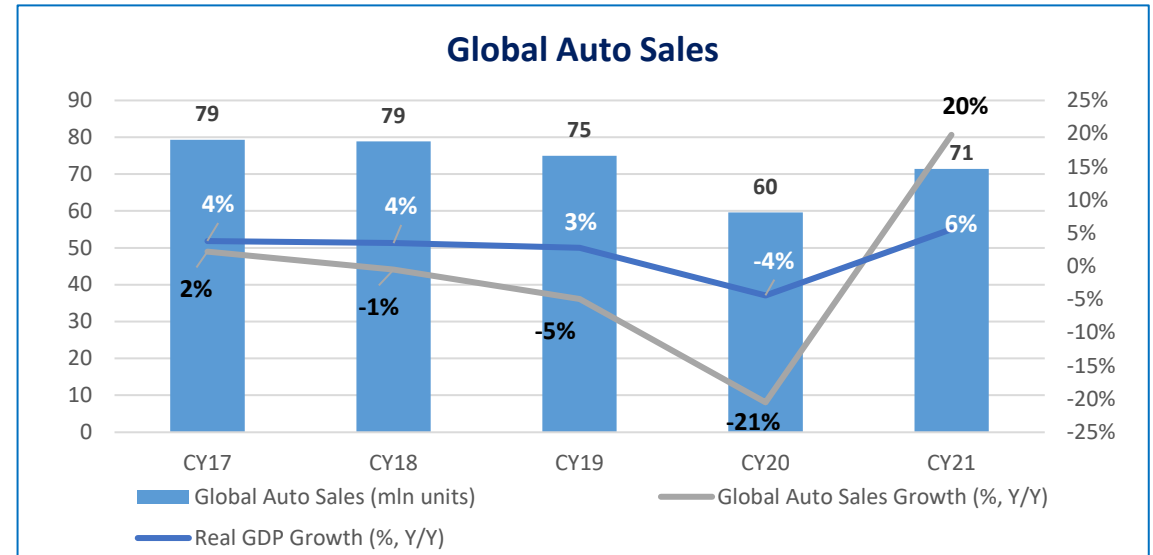




# Automotive Parts | Local Industry

## Overview

- The global demand for auto parts is derived from the international automobile industry.
- The annualized sales for automotive parts recorded at ~71.4mln units for CY21 demonstrating a YoY gain of ~20%, slightly below pre-pandemic levels, with the majority of the increase coming from a robust resurgence in China.
- In the upcoming year CY22, consumer demand should still be reasonably strong. Pent-up demand may partially be offset by higher inflationary trends and subsequent central bank rate hikes. Although the popularity of shared vehicles has led to a fall in the sales of private automobiles, this decline is likely to be compensated by rising sales of shared vehicles, which require more frequent replacement due to higher utilization and associated wear and tear.
- The market size for global automotive parts industry stood at USD~1.9trn in CY21 (CY20: USD~1.8trn), growing by ~6%. The industry has experienced an average decline of ~1% per year from CY17 to CY21, owing largely due to slowdown brought on by COVID-19 and the recessionary pressures left in its wake.
- The 5 largest players occupy ~11% of the total market share. Germany and Japan both have 2 players each in the top 5 list, while the 5<sup>th</sup> one is from South Korea.

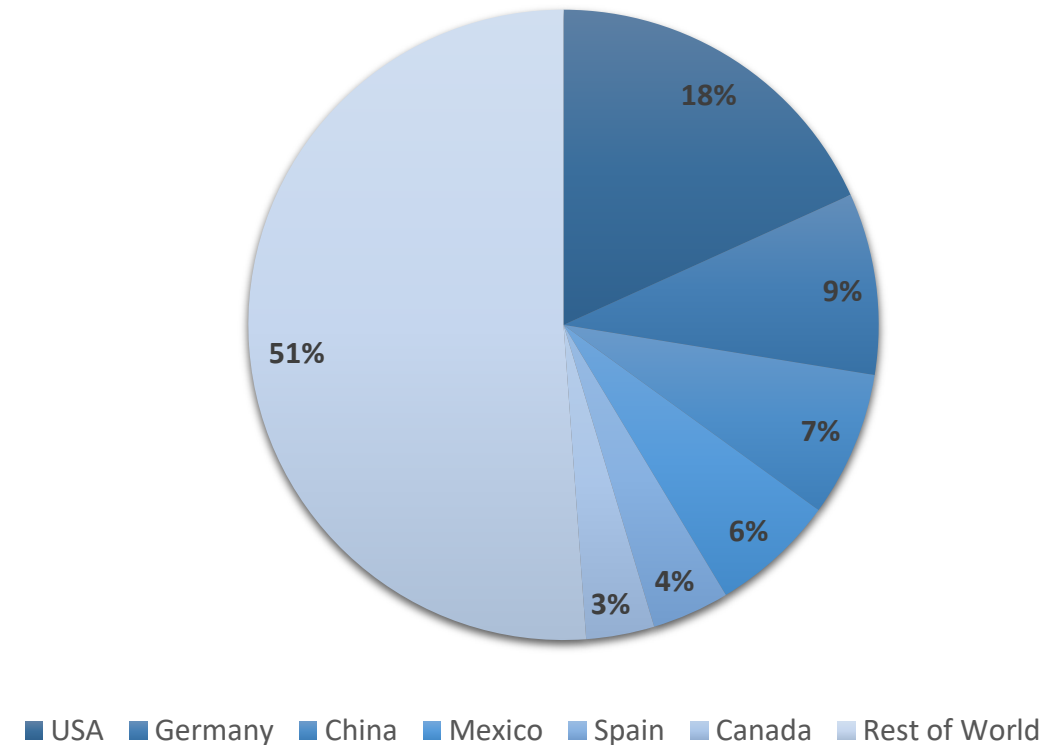




## Imports

- International purchases of imported automotive parts cost a total of USD~404bln in CY21.
- The cost of automotive parts imported worldwide increased by an average of 4.3% since CY20 when international purchases of auto parts were valued at USD~387bln.
- The top importing countries of automotive parts collectively generated ~45.2% of international spending on imported auto parts or accessories.
- Buyers in European countries spent the most on imported auto parts during CY21 with purchases amounting to USD~187bln (~46.4% of the world total).
- In second place were North America importers at ~28.3% while ~19.7% of automotive parts imported worldwide was delivered to Asia.
- The fastest-growing markets for automotive parts since CY20 were Russia (up ~39.5%), France (up ~26.6%), Poland (up ~24.7%) and Italy (up 24.5%).

World Imports (USD mln) | CY21

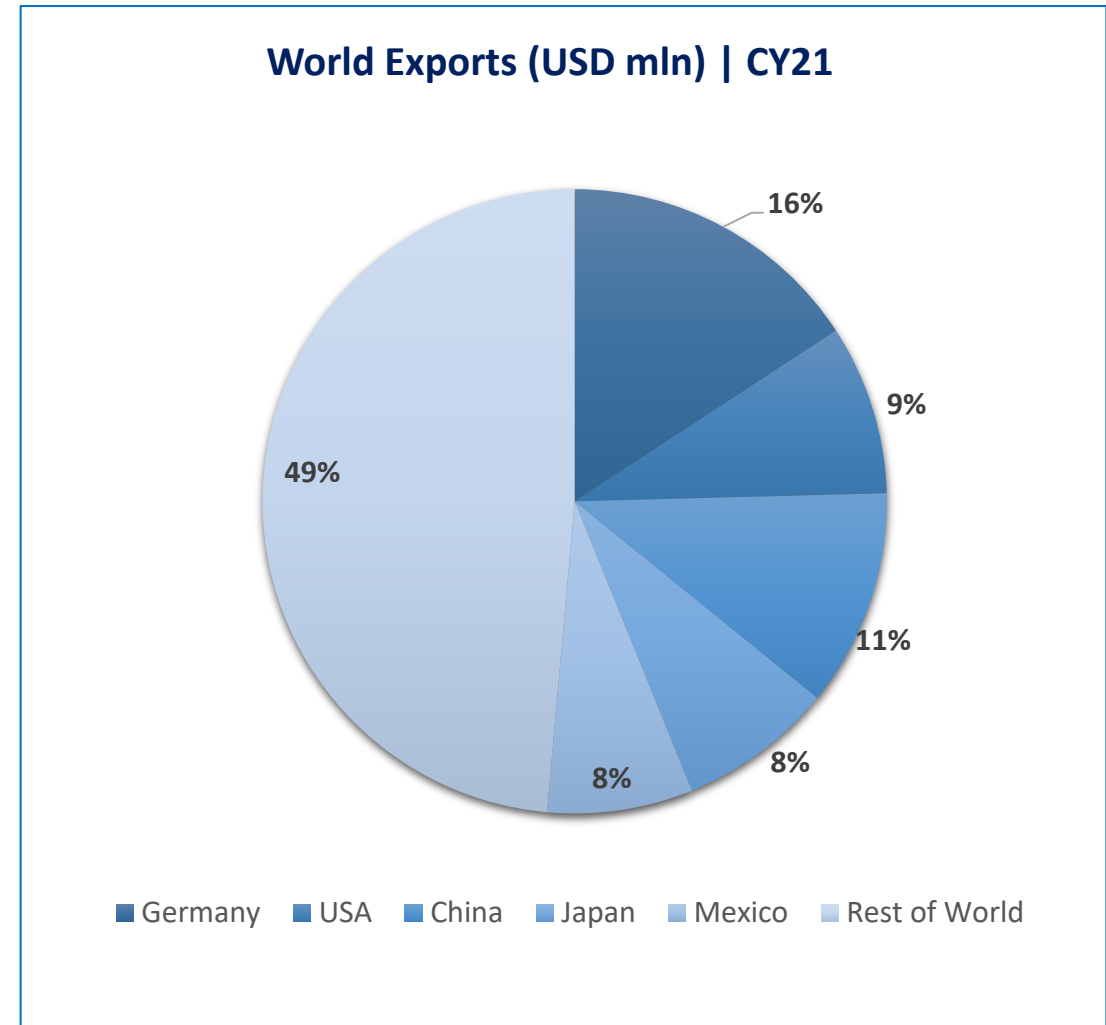




# Automotive Parts | Global Industry

## Exports

- CY21 brought about an increase in global trade of automotive parts by USD~406bln (~19% YoY) from USD~340bln in CY20. This increase is driven by rising demand for passenger vehicles. Aided by the rapid technological advancements, the market is expected to witness a further growth of ~2% in CY22..
- The top 5 exporting countries contributed ~51% to total exports in CY21. Germany was the largest automotive market in Europe; it ranked first in terms of production and sales, accounting for over 25% of all manufactured passenger automobiles.
- China ranked second in terms of automotive exports and is expected to take fair share of German exports on the back of growing overseas demand for its new energy vehicles. Electric cars are becoming the new driver of China’s auto exports.
- Among the top exporters in CY21, the fastest-growing auto parts exporters, compared to CY20, were Thailand (up ~31%), China (up ~26%) and South Korea (up ~22%), while the top countries that posted decline in their sales of auto parts were United States (down ~7%), France (down ~10%), Spain (down ~11%).



# Automotive Parts | Local Industry

## Overview

- Pakistan’s automotive parts industry is fairly fragmented with a large numbers of players. There are over 2,000 auto parts vendors in Pakistan, out of which ~400 vendors belong to Tier-1 category and are suppliers for the OEM market.
- Demand in the local automotive parts industry emanates largely from three sources:
  - Original Equipment Manufacturers (OEMs): these are local assemblers of bikes, passenger cars, LCVs, buses, trucks and tractors. Major players include Pak Suzuki, Indus Motor, Honda Atlas and Millat Tractors.
  - Replacement Market: this is the secondary market consisting of distributors, wholesalers and retailers of auto parts and accessories.
  - Export Market: only a limited number of auto parts manufacturers are catering to demand from the export market due to high quality standards and lack of cost competitiveness.
  - Imports: Remaining demand of the OEM segment is met through imports. During FY22, Pakistan imported automotive parts worth USD~33mIn (~12% YoY decrease) which was ~0.43% of total imports in FY22. Major import destinations included Thailand, Japan, China and Indonesia. This expansion coincided with construction of production facilities by new industry participants.

Sector Overview		
Year	FY21	FY22
Estimated Market Cap (PKR mIn)	65,479	38,956
Estimated No. of Players	>2,000	
Workforce	>140,000 people	
Import Value (USD mIn)	38	33
Export Value (USD mIn)	14	27
Industry Association	Pakistan Association of Automotive Parts & Accessories Manufacturers	

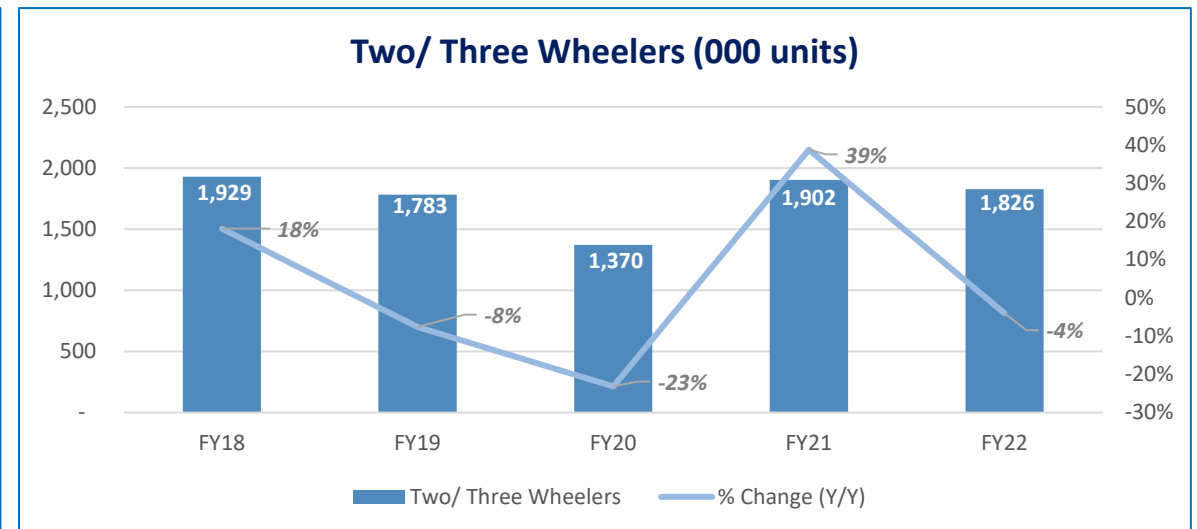
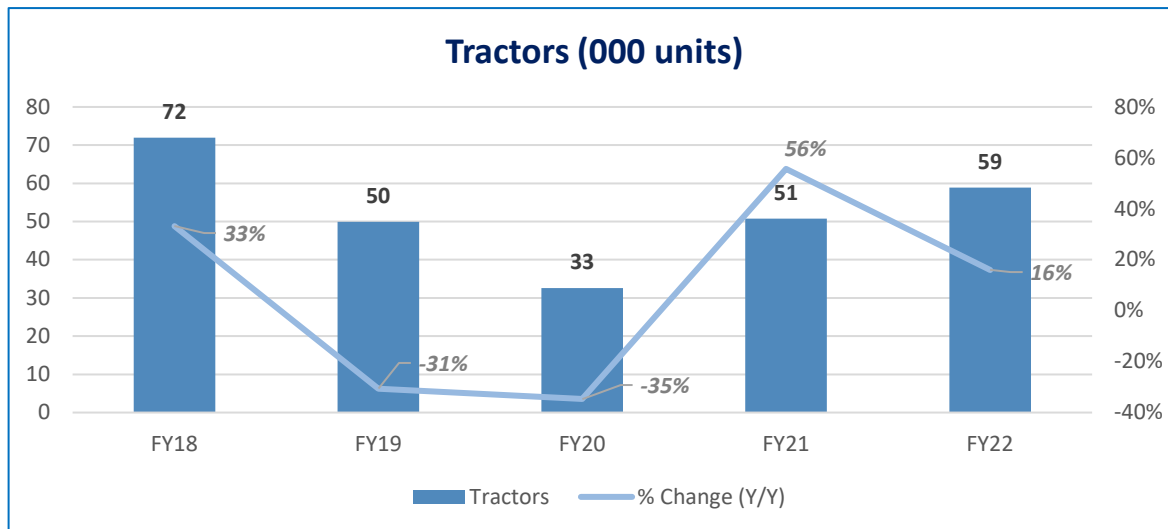
*Tier-1 suppliers are companies that supply parts or system directly to OEMs.*



# Automotive Parts | Local Industry

## Production

- During FY22, industrial production of automotive parts had a general upward trend. The YoY growth rate, however, was sluggish owing to factors like policy rate hikes and massive rupee depreciation against the greenback.
- Tractor segment experienced a ~56% climb in FY21, owing largely to farmers' improved liquidity, as lending institutions disbursed equivalent to ~63.6% of the overall annual target of Rs 1,500 billion and ~4.6% than the disbursement made the preceding year.
- The tractor segment saw Fiat growing at the expense of Massey Ferguson, albeit not by much. The former saw a ~58% increase in FY22 over preceding year, whereas the latter saw a 1% contraction due to 522 lesser unit sales in FY22 than last year.
- Two/Three wheelers offer most economical public transport alternate for lower income groups, however, at the same time, they are extremely price sensitive. Massive exchange rate losses kicked off inflationary conditions resulting inevitable price increase. The two-and three-wheeler industry exhibited a ~4% decline in production in FY22 compared to FY21.

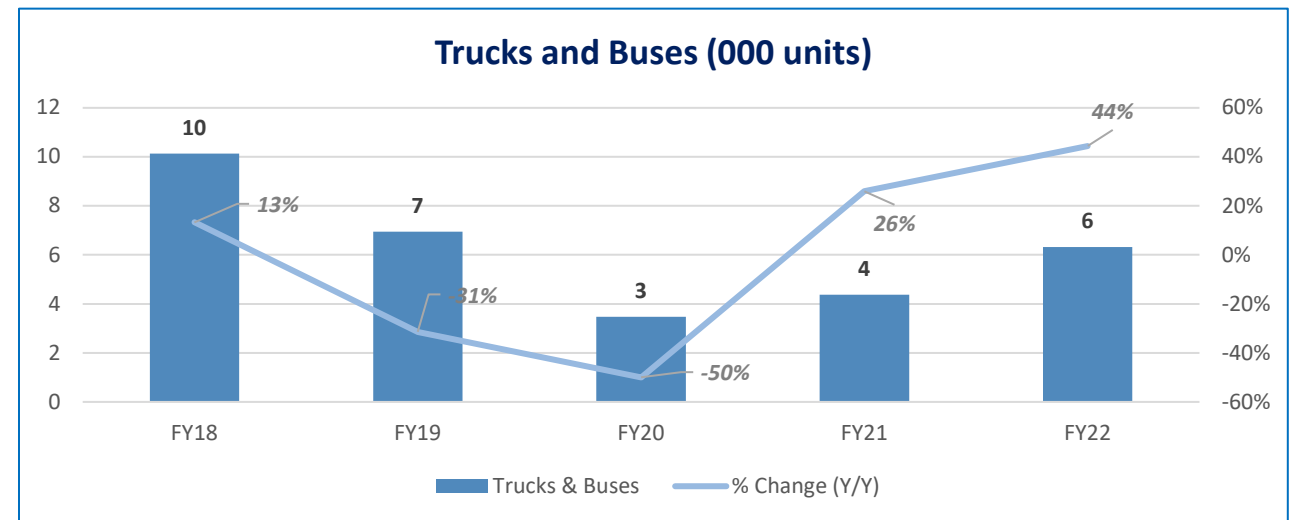
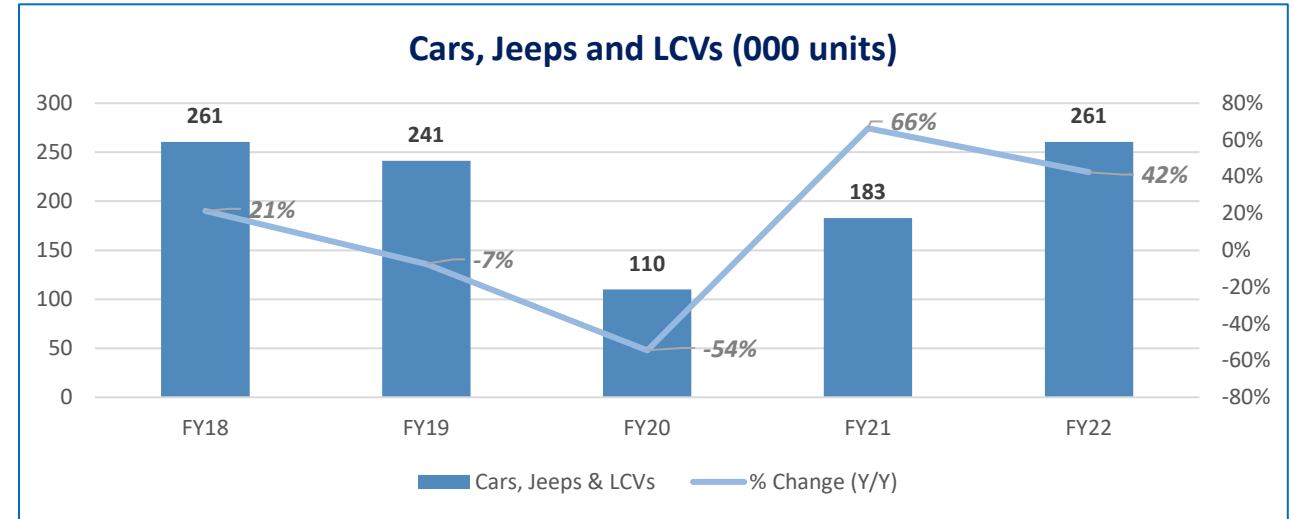






## Production

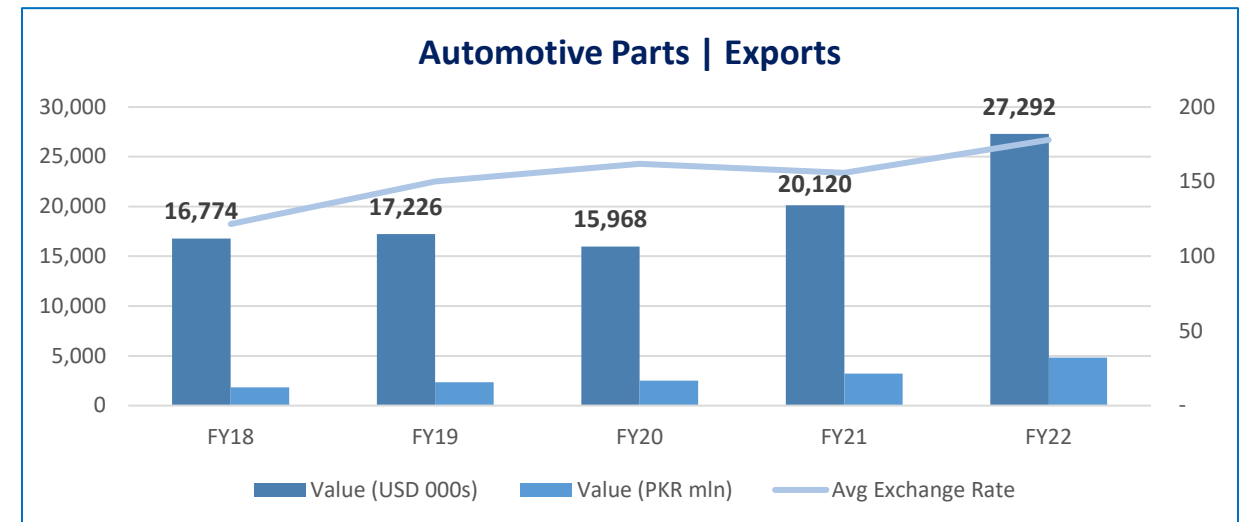
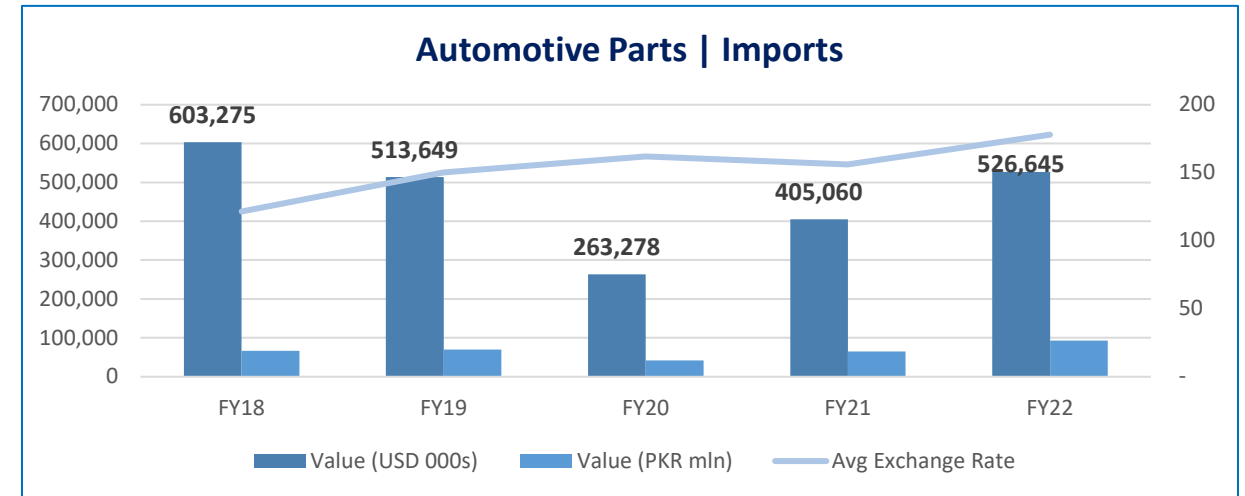
- In case of passenger cars, segments comprising units of up to 800cc and 1000cc have experienced greater growth, with rates of ~77% and ~65%, respectively. Growth in the segment for engines over 1000cc, for the period 9MFY22 was ~35%, while YoY growth clocked in at ~43% (increase of 78,000 units in FY22 compared to FY21).
- Another factor impeding the sector's growth is the fact that where cars with engines under 1000cc can be financed for 5 years, those with engines larger than 1000cc can only be financed for 3 years and for only up to PKR~3mln. SUV and light commercial vehicle (LCV) production and sales also saw increases of 44% and 46%, respectively, for comparable reasons.
- Additionally, there has been a substantial increase in the number of trucks used in the heavy commercial vehicles category since medium-sized trucks, which weigh roughly 5 tons, have become popular due to affordability and the growth of e-commerce.





## Imports & Exports

- During FY22, imports of automotive parts stood at PKR~94bln (USD~527mln ) as compared to PKR~64bln (USD~405mln) in FY21.
- This rise in imports by ~47% in PKR terms and ~30% in USD terms, YoY, has come cumulative of rupee devaluation against dollar and growth in demand pie which can be seen through PKR depreciation of ~14% against USD.
- In FY22, the exports clocked in at PKR~4.8bln (USD~27mln) as compared to PKR~3.1bln (USD~20mln) in FY21.
- Despite monetary tightening, there were more local and imported car sales in FY22, which put pressure on foreign exchange reserves and contributed to a significant rise in the current account deficit. As a result, the government had to act quickly to contain the rising import bill. Due to the low level of localization, the majority of local automobiles use imported automotive parts.
- Policy incentives, as introduced in Auto Policy 2016-2021, of allowing local assembly by new entrants at a 5% localization rate caused a big hit to the national exchequer due to a whopping import bill of both kinds of kits. CKD/SKD import figures for FY22 amounted to USD~2.4bln, which was a ~54% increase compared to FY21. This also reflected thriving demand for locally produced vehicles.

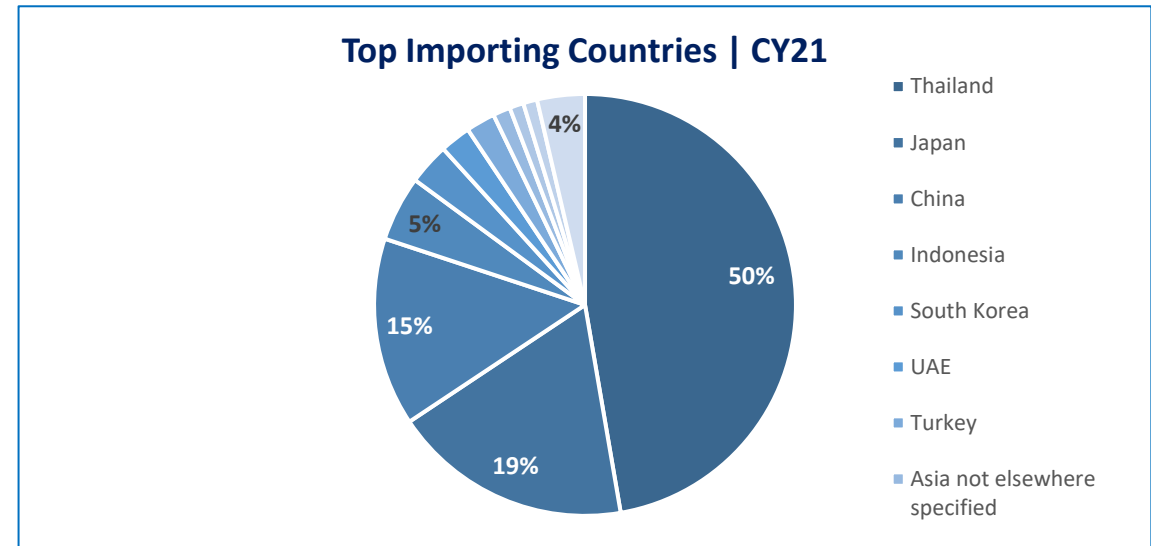
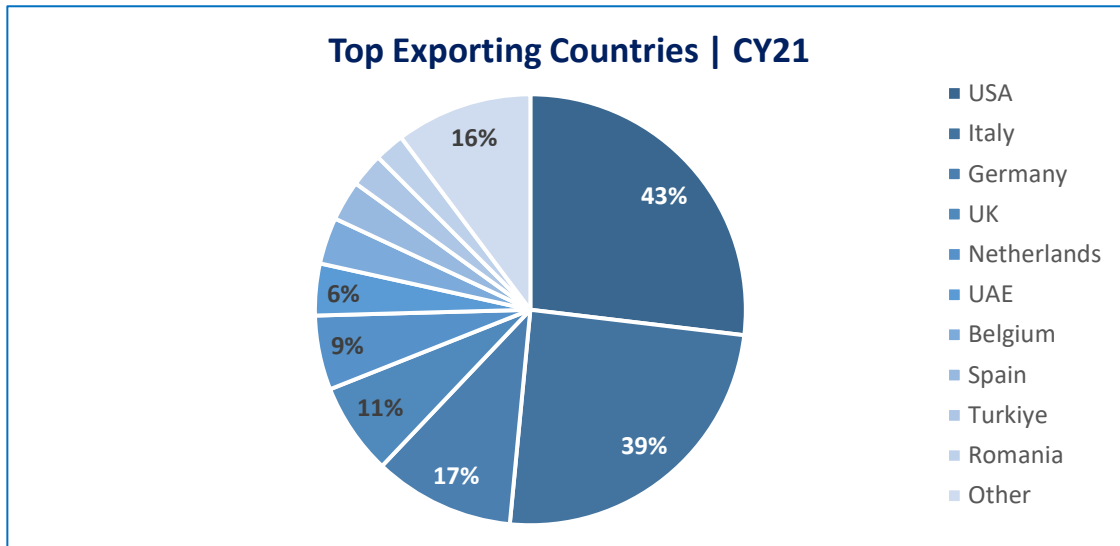




# Automotive Parts | Local Industry

## Major Trading Countries

- Only a small share of locally produced automotive parts are sold in the export market. These majorly include bumpers, radiators, and batteries. In CY21, exports to the USA formed the major chunk of total exports, constituting ~43% of total exports, while Italy was the second biggest export destination. Total exports for CY21 amounted to USD~23mln (this was an approximately 50% increase compared to CY20).
- Other export destinations are spread across Europe along with a few Asian countries.
- The import market for automotive parts and accessories is dominated by Asian countries. Thailand occupied the largest share with ~50% of the country's total imports during CY21 of USD~308mln. Total automotive parts imports witnessed a YoY growth of ~5%.
- Japan and China have also continually held a sizable portion of the import market, accounting for 19% and 15% of all imports for CY21.
- Major import items include engine and suspension parts.



## Business Risk

- The demand for automotive parts comes exclusively from the automotive sector. As a result, the difficulties experienced by the automotive industry have had a negative effect on the supply of automotive parts.
- The demand for automobiles has been trending downward due to an increase in automobile prices brought on by burgeoning inflation and exchange rates in FY22. During the year under consideration there has been persistent supply chain interruptions due to chip shortages and skyrocketing freight costs.
- Additionally, the import sector, which commands a sizeable market share in both the OEM and replacement markets, presents fierce competition to the sector. Due to its reliance on imported raw materials, the industry is also at risk from exchange rate fluctuation.
- Exchange rate risk, cyclicity in sales due to slowdown in GDP growth and political uncertainty remain the key business risk factors
- The table on the right summarizes category-wise average localization levels in terms of units in the automotive industry. Although these levels have improved on the back of favorable government policies as big automobile giants such as KIA and Hyundai have started establishing their manufacturing units in Pakistan. With this level of localization will increase and would labor force in developing new skills.

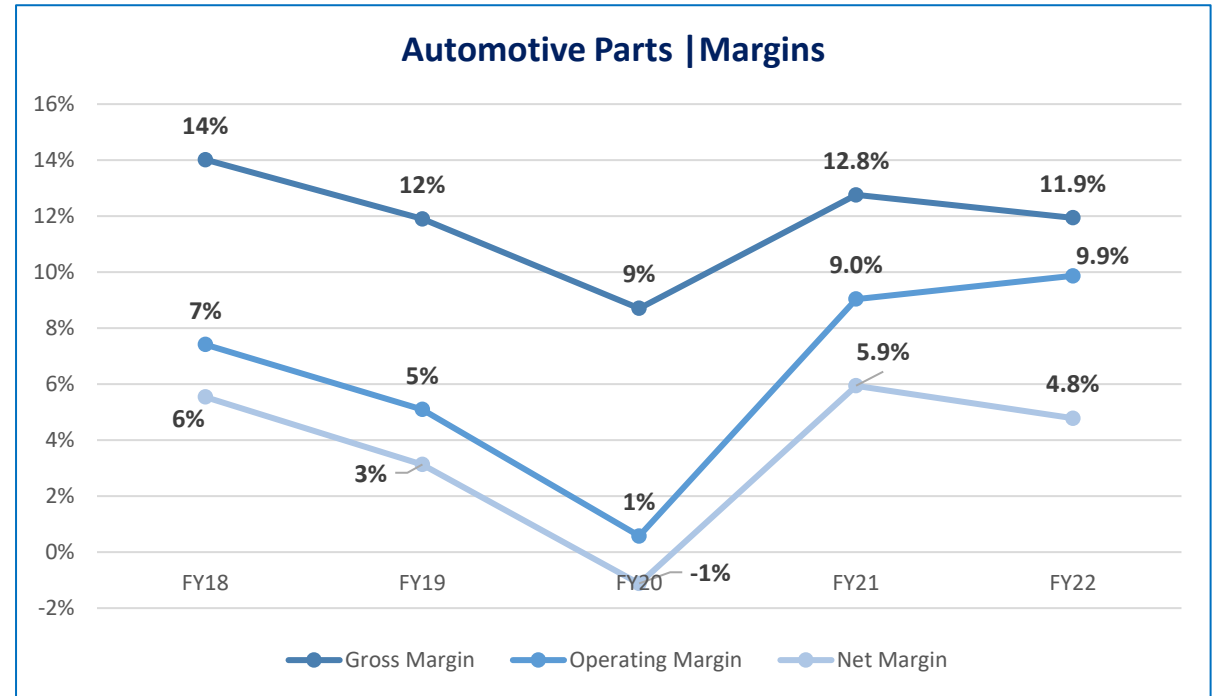
Average Localization Levels	
Passenger Cars & LCVs	~55%
Trucks/ Buses	~30%
Tractors	~85%
Motorcycles	~85%



# Automotive Parts | Local Industry

## Business Risk | Margins & Cost Structure

- Major part of the industry's direct costs (~70%) are made up of imported raw materials. Cost behavior is therefore influenced by changes in the exchange rate and global price trends.
- For the period ranging FY18 – FY20, average margins in the car components business declined by ~12% on average. A more pronounced dip was observed in FY20, most likely due to COVID-19 restrictions and decline in demand.
- Post-pandemic economic recovery (FY21) witnessed a YoY ~12.8% growth in gross margins, signaling a tentative rebound in sales. On average, gross margins decreased by ~0.8% during FY21 – FY22, due primarily to supply chain disruptions caused by ongoing Russia-Ukraine conflict.
- Net margins witnessed a decline of ~1.2% over the last year (FY21-FY22). This can be attributed to increasing finance costs, which can be explained by policy rate hike of ~8% in the last one year.
- The trend of low margins is expected to continue in the upcoming year (FY23) in the absence of any prompt actions on both monetary and fiscal fronts. The automotive parts industry is suffering as a result of recent SBP restriction on LCs for CKD imports.

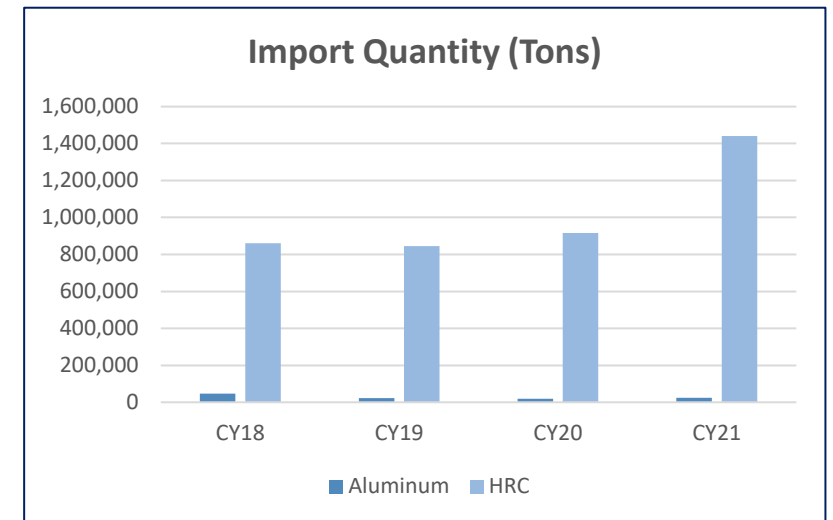
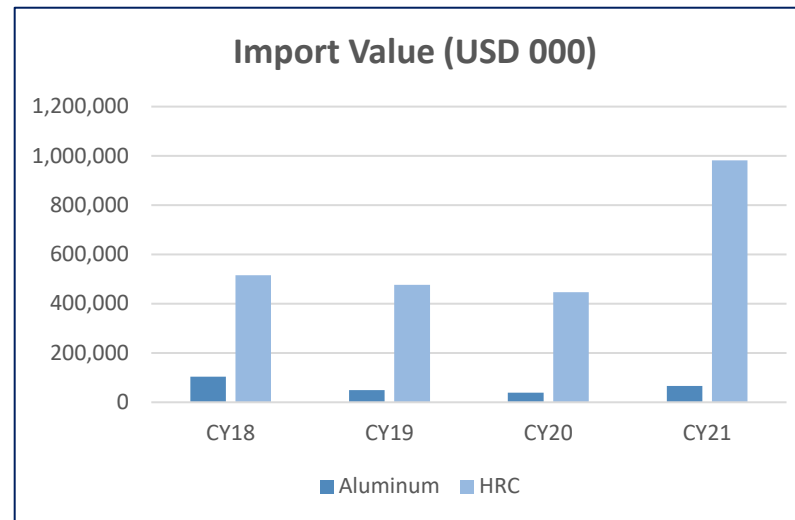
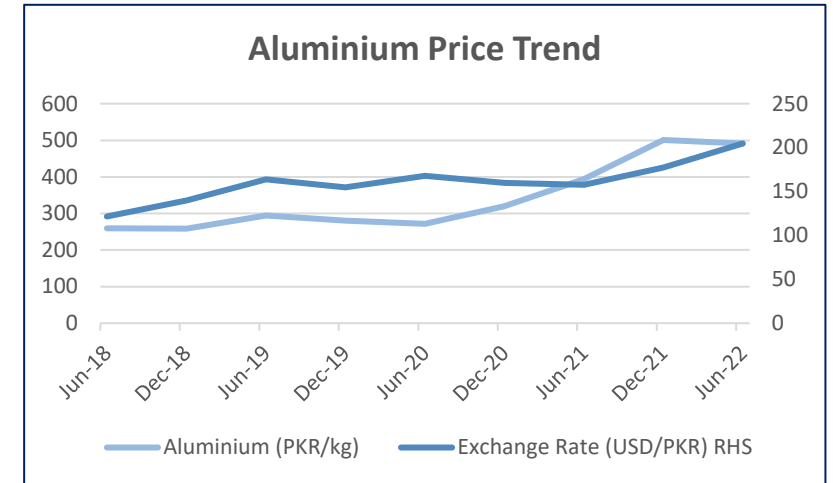
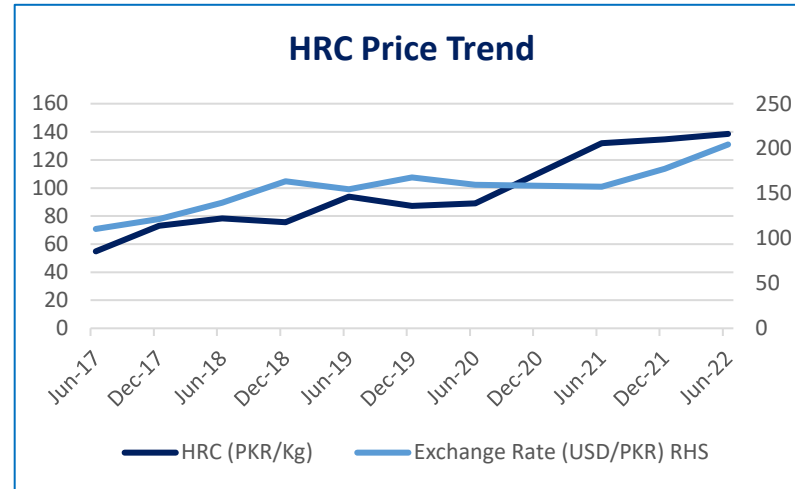


\*These figures are representative of 6 listed companies.

# Automotive Parts | Local Industry

## Raw Materials

- There are a large variety of materials used in the production of automotive parts. The most significant ones are steel and aluminum which are used alongside other metals and alloys.
- There has been significant increase of ~152% in prices of **Hot Rolled Coil (HRC)** during a 5-year period. HRC imports in quantitative terms have remained relatively stable until CY20, and grew exponentially by ~57% in CY21.
- Aluminum prices have also seen a rising trend with a ~145% increase in prices over the past 5 years although this is majorly attributable to the increase in exchange rate.
- Aluminum is also available through local suppliers who in turn import it from the international market.

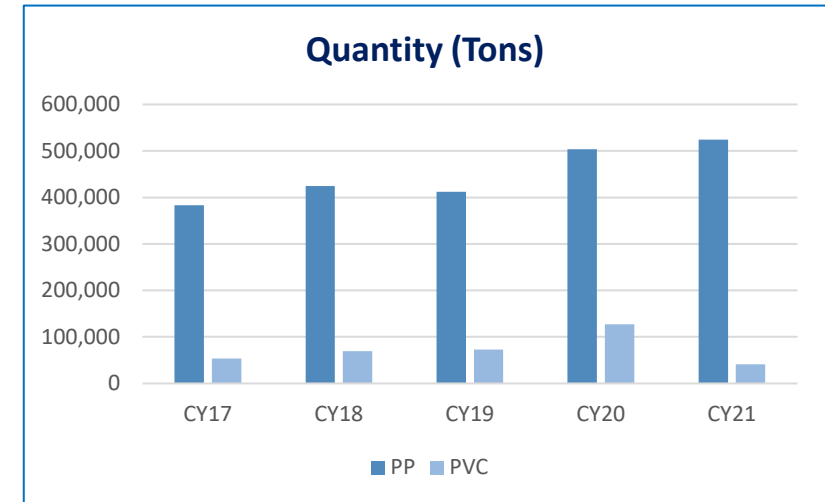
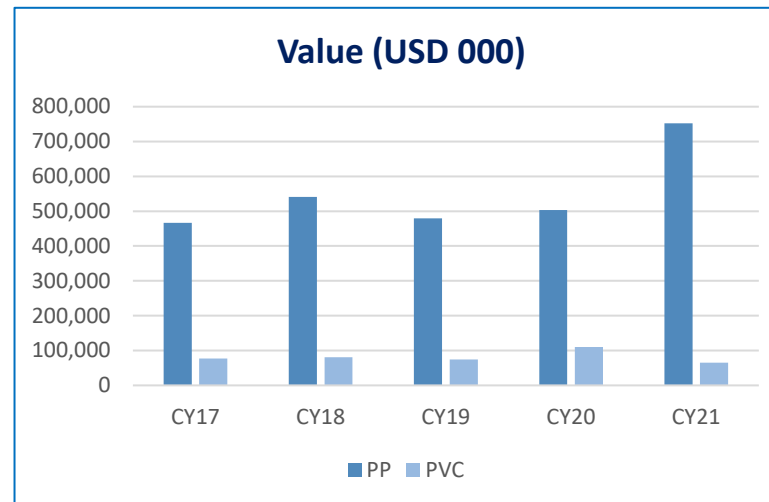
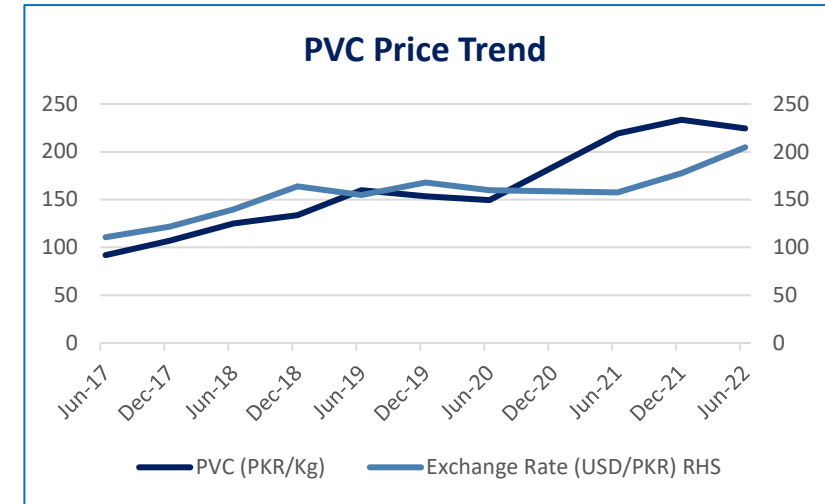
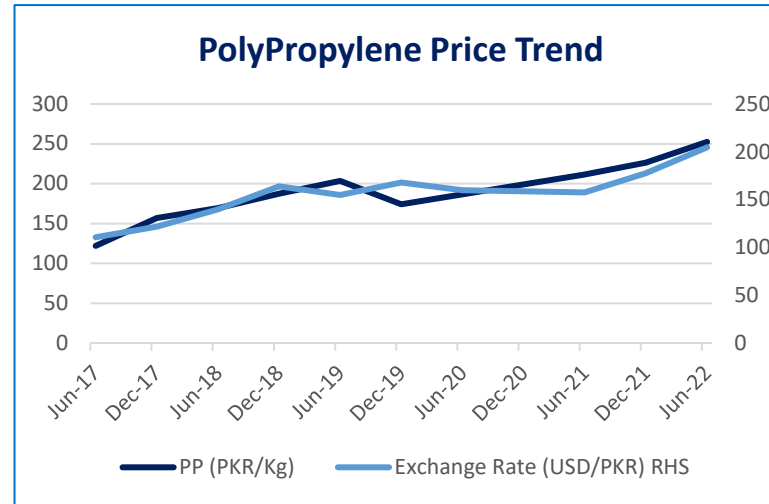




# Automotive Parts | Local Industry

## Raw Materials

- Another major raw material is plastics. There are various types of plastics that offer different qualities suitable for auto parts such as durability and heat resistance. The use of plastics reduces overall vehicle weight which improves fuel efficiency.
- **Polyvinyl Chloride (PVC)** and **Polypropylene (PP)** are two commonly used plastics. They can be found in bumpers, cable insulation, instrument panels and door parts.
- PVC is the world's third most widely used synthetic plastic polymer. PVC and PP prices have, on average, increased by ~144% and ~107%, respectively, over a 5-year period mostly due to a surge in crude oil prices on a global scale, which remained extremely volatile during this time.



# Automotive Parts | Local Industry

## Duty & Sales Tax Structure

- The Pakistan Association of Automotive Parts & Accessories Manufacturers (PAAPAM) was formed in 1988 and has represented the auto parts industry for over three decades. It is recognized by the Government of Pakistan and is also a member of the Federation of Pakistan Chamber of Commerce & Industry (FPCCI).
- The government is providing protection to local auto parts manufacturers through the imposition of custom duty and additional custom duty on the import of parts and accessories for motor vehicles.
- With respect to Income Tax, the auto parts industry is under the Normal Tax Regime (NTR). Further, the sector is also subject to Minimum Tax @ 1.5% of turnover, if tax liability under NTR is lower than minimum tax. However, the additional tax paid under minimum tax is adjustable against future tax liabilities for the next 5 years
- In addition, sales tax of 17% is also applicable.

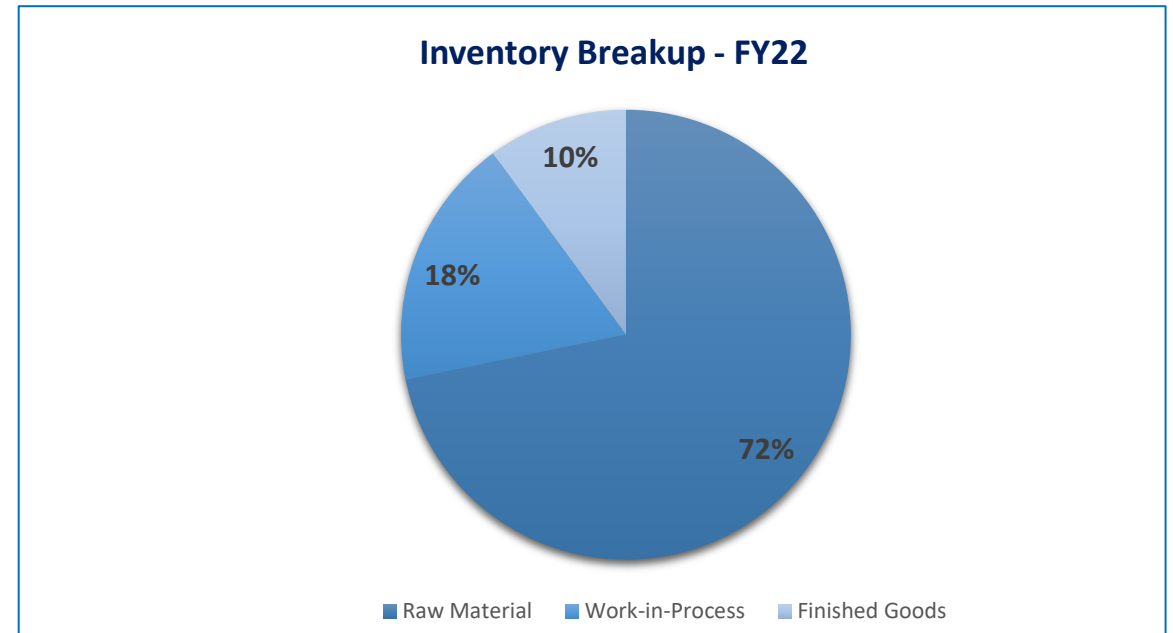
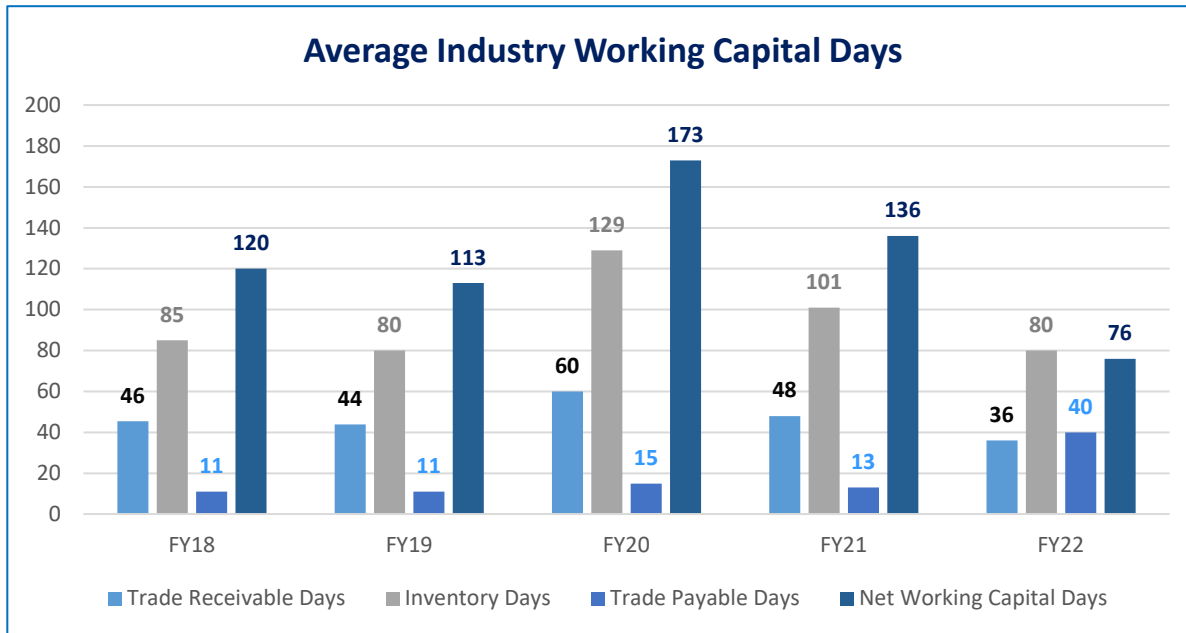
PCT Code	Description	Additional Custom Duty		Custom Duty		Regulatory Duty		Total	
		FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21
<b>Raw Materials</b>									
76.01	Unwrought Aluminum	2%	2%	0%	0%	10%	10%	12%	12%
76.04	Aluminum bars, rods and profiles	2-7%	2-7%	3-20%	11-20%	0%	0%	5-27%	13-27%
76.06	Aluminum plates, sheets and strips	2%	2%	0-11%	0-11%	0%	0%	3-11%	3-11%
72.08	Flat- rolled products of iron or non-alloy steel, of a width of 600 mm or more, hot- rolled, not clad, plated or coated. (HRC)	2-7%	2-7%	11-20%	11-20%	12.50%	12.50%	25-40%	24-33%
39.04	Polymers of vinyl chloride or of other halogenated olefins, in primary forms. (PVC)	2-7%	2-7%	11-20%	11-20%	0%	0%	13-27%	11-20%
3902.1	Polypropylene	2%	2%	11%	11%	0%	0%	13%	11%
<b>Finished Goods</b>									
87.08	Parts & Accessories for Motor Vehicles	7%	7%	35%	35%	0%	0%	42%	42%



# Automotive Parts | Local Industry

## Working Capital Management

- The automotive parts industry’s working capital cycle is generally a function of inventory and trade receivables.
- Due to rising payable days and dropping inventory and receivable days, net working capital days declined to ~76 days in FY22 from ~136 days at the end of FY21 primarily because of the significant volatility of raw material prices on the global market since the majority of it is imported due to which low inventory levels were kept.
- Working capital is partially financed through short-term borrowing which is the largest component of the industry’s total borrowing (~59% of total borrowings).



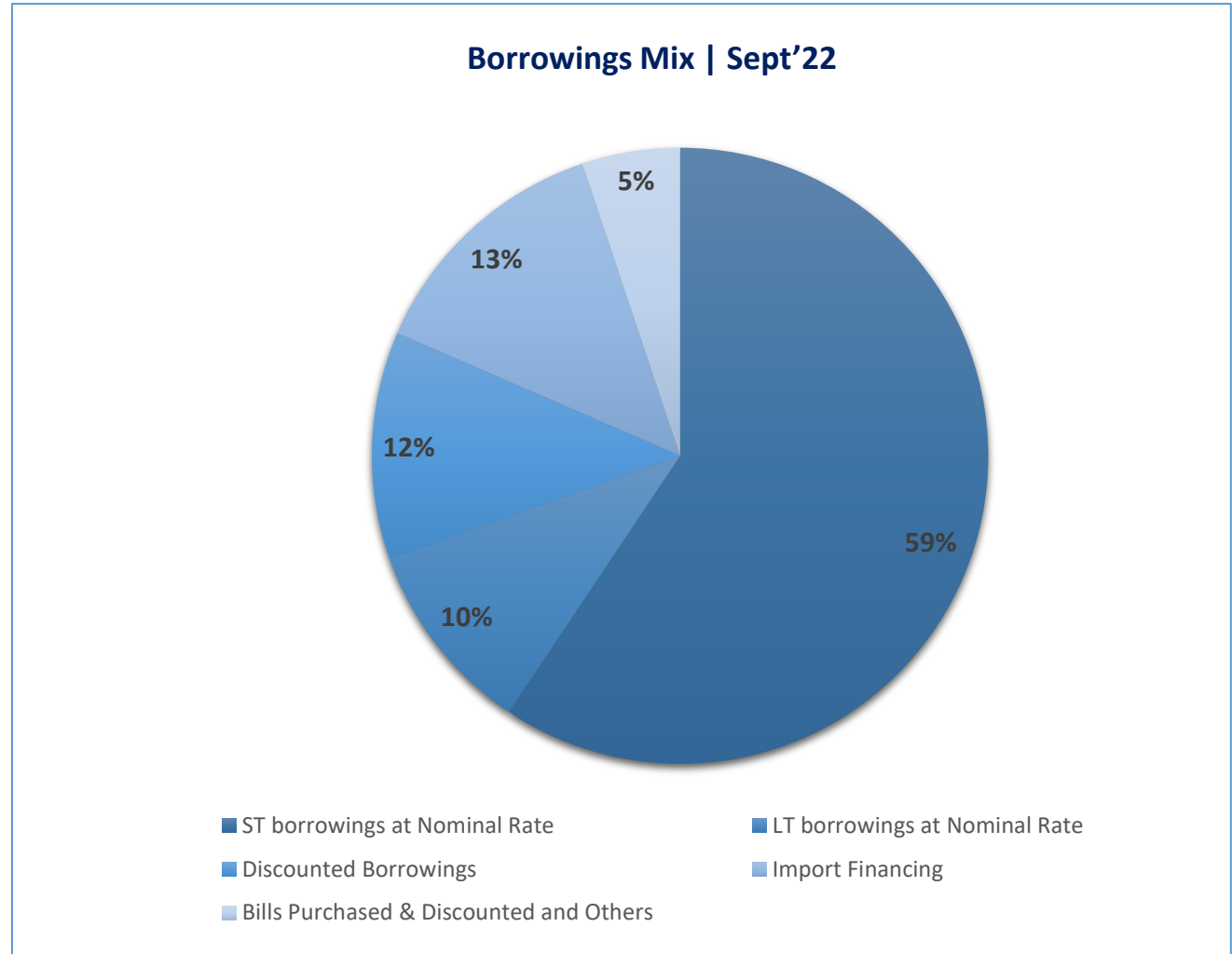
\*These figures are representative of 6 listed companies.



# Automotive Parts | Local Industry

## Financial Risk

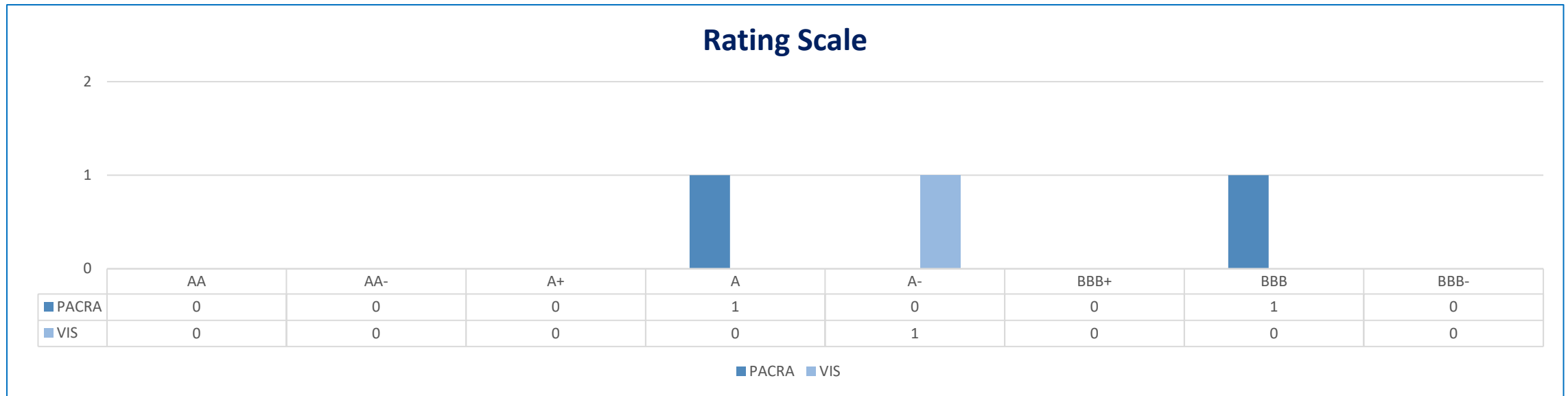
- The Automotive Parts industry has generally exhibited low levels of leverage, and in FY22, the average debt capital as a share of total capital fell even further to ~17.5%.
- Total borrowings of the industry stood at PKR~24,674mIn as at End-Sep'22 as compared to PKR~16,669mIn in Sep'21 (YoY).
- Short-term borrowings constitute the majority of total borrowings and stood at PKR~14,653mIn as at End-Sep'22. They comprise ~59% of total borrowings.
- Another major category is import financing which stood at PKR~3,291mIn and comprises ~13% of total borrowings.





## Rating Curve

PACRA rates 2 players from Automotive Parts Industry, with a long-term rating bandwidth ranging from BBB to A.





# Automotive Parts | Local Industry

## SWOT Analysis

- Diversified product mix.
- Product innovation.
- Availability of cheap labor and lower production and material cost.
- Strong industry association (PAAPAM) resulting in high lobbying power.

- Low localization resulting in higher import bills.
- Decline in per capita income and thus reduced purchasing power of end consumers.
- Supply chain issues such as raw material and cargo container shortages.
- Rising geo-political tensions and protectionism.



- Increase in exchange rate and volatility of imported raw material prices.
- Availability of high quality imports which reduce opportunity for localization in OEM market.
- Changing consumer behavior due to technological advancements.

- Product development to complement EVs.
- Potential for technological collaborations with OEMs to improve quality of products and introduce latest technology.
- Unutilized potential and untapped markets in the automobile sector.

## Outlook: Negative

- Demand for automotive parts is driven by automotive sales. About 15% of LSM is the automotive sector. Due to its significance, the automotive industry has a strong correlation with industrial growth. The main variables to consider when assessing the sector's growth and performance in the upcoming days are inflation, interest rates, and exchange rate stability.
- Inflation at ~23.2% (Sep'22), compared to ~8.9% (Sep'21), a 158% YoY increase, has a significant impact on disposable incomes. Almost ~40% of car sales are financed by auto loans, hence, interest rate stability is essential for generating sustained demand.
- The fact that most raw material components are imported makes the exchange rate essential as well. When compared to the quantity being imported, imports have mostly increased in value. Localization rates remain low and the industry still confronts fierce competition from imported automotive parts. This is one of the main issues impeding the growth of the local market.
- Mainly because of the relatively relaxed automotive policies, the passenger vehicle category experienced a large increase in demand in 9MFY22 (~41% YoY). However, due to restrictions put in place by SBP on the import of CKDs, automotive sales have declined dramatically in the 1QFY23.
- The 7-year car finance term has been cut to 5 years, and for engines larger than 1000cc, only 3 years and PKR~3mIn in financing are required. Initial car down payment increased from 15% to 30% of the car price. Car alternatives have been limited as automotive prices have soared.
- Due to recent flash floods, automotive sales are being impacted in rural areas of Punjab and Sindh. The majority of automotive assembly companies, including Indus, are particularly prevalent in rural areas.
- Motor cars contributed ~0.5% to FBR tax revenues in 1HFY22. Limits on CKD imports would not assist to reduce the current account deficit because while automotive sector makes up ~6% of the entire import bill (FY22), CKD imports only account for a meager ~3% of imports in the same period.
- Based on the aforementioned factors, it is believed that the forecast for the automotive parts industry over the next six months is dismal and that the automotive parts industry is far from meeting the targets for automotive sales set forth in the most current automotive policy (FY21–FY26).

# Automotive Parts | Bibliography

- Pakistan Bureau of Statistics (PBS)
- International Monetary Fund (IMF)
- Pakistan Stock Exchange (PSX)
- Trade Map
- Pakistan Automotive Manufacturers Association (PAMA)
- Pakistan Association of Automotive Parts & Accessories Manufacturers (PAAPAM)
- Federal Board of Revenue (FBR)
- Business Insider
- IBISWorld
- Business Insider
- Mecathon
- Science Clarified

<b>Research Team</b>	<b>Saniya Tauseef</b> <i>Manager - Research</i> <a href="mailto:saniya.tauseef@pacra.com">saniya.tauseef@pacra.com</a>	<b>Ayesha Wajih</b> <i>Supervising Senior – Research</i> <a href="mailto:ayesha.wajih@pacra.com">ayesha.wajih@pacra.com</a>	<b>Shahmir Saad</b> <i>Senior Research Analyst</i> <a href="mailto:Shahmir.saad@pacra.com">Shahmir.saad@pacra.com</a>
<b>Contact Number: +92 42 35869504</b>			

## DISCLAIMER

PACRA has used due care in preparation of this document. Our information has been obtained from sources we consider to be reliable but its accuracy or completeness is not guaranteed. The information in this document may be copied or otherwise reproduced, in whole or in part, provided the source is duly acknowledged. The presentation should not be relied upon as professional advice.