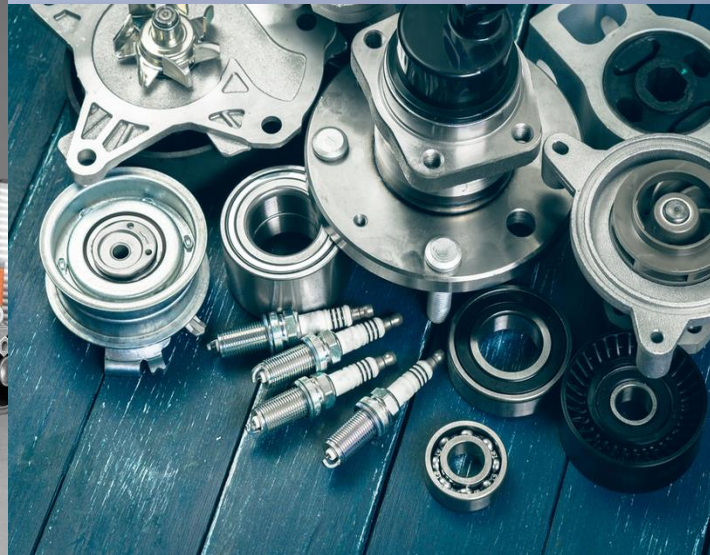




AUTOMOTIVE PARTS

An Overview





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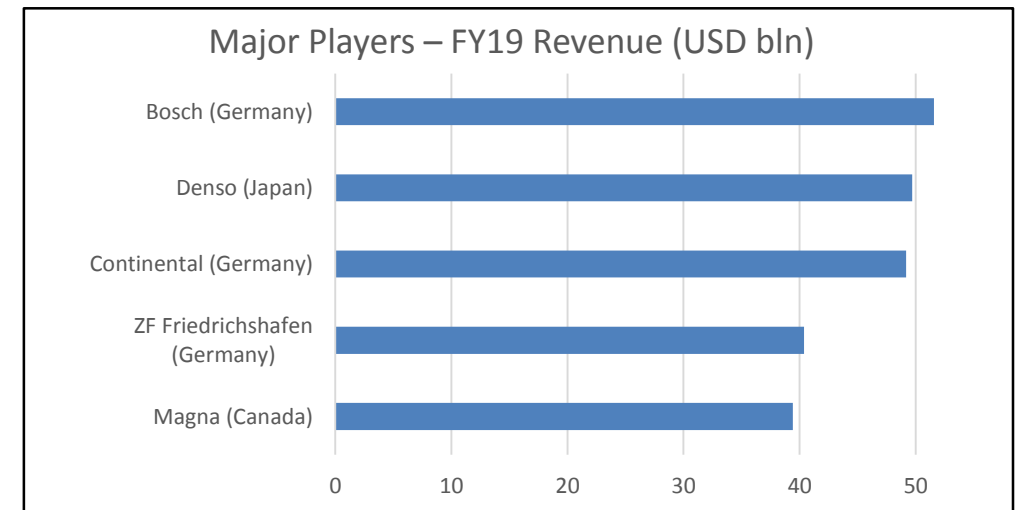
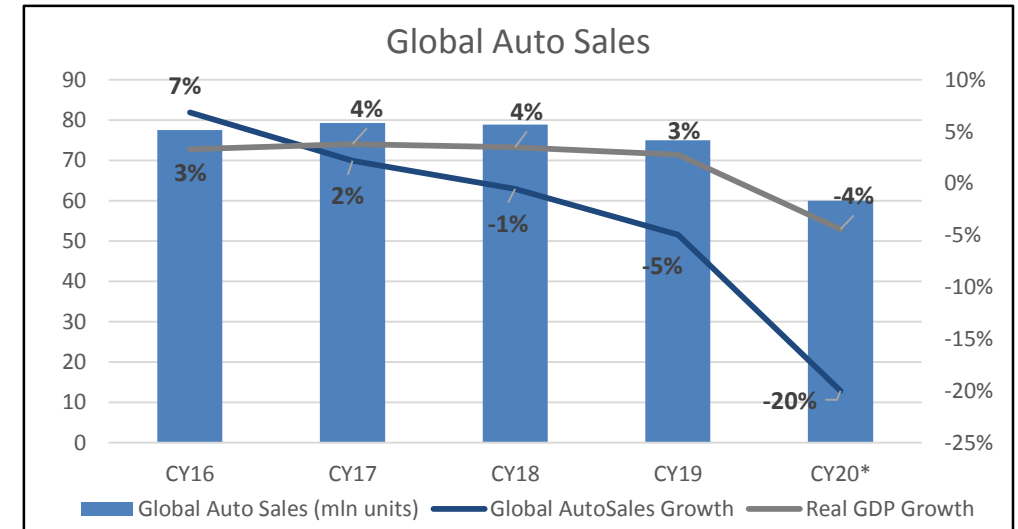
- Automobile parts and accessories are the complex components which make up all automobiles and ensure their ability for efficient and long-term functioning.
- While there are a large number of individual auto parts they can be broadly categorized according to certain functions:
 1. The Chassis: includes 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 system and braking system.
 6. The Auxiliaries: these components are not essential but add comfort for passengers such as the air-conditioning system.



AUTO PARTS | GLOBAL INDUSTRY

Overview

- The global demand for auto parts is derived from the international automobile industry.
- In previous years, automobile demand has been driven by rising per capita incomes and growing middle class, particularly in the Asia-Pacific region.
- During CY19, the auto industry witnessed a YoY decline of ~5% due to a decrease in demand as a result of automobile saturation in developed markets and increasing availability of ridesharing alternatives.
- From CY16 to CY19, the auto industry's sales experienced negative CAGR of ~1% as a result of ~5% YoY decline in auto sales during CY19.
- However, in CY20 auto sales are estimated to decline by ~20% due to the COVID-19 pandemic and the resulting economic fallout. Therefore, sales of auto parts and accessories is also expected to decline significantly.
- The estimated market size of the global auto parts and accessories industry stands at USD~1.9trn in CY20 (CY19: USD~2.2trn). The industry has experienced a CAGR of -3.2% from CY15 to CY20.
- The 5 largest players occupy ~12% of the total market share and 3 out of the top 5 players are based in Germany which is a major hub of the international automobile and auto parts industry.



Imports & Exports

World Imports (USD mln)	CY16	CY17	CY18	CY19	1HCY20
USA	66,411	66,308	71,436	69,635	25,183
Germany	37,212	41,603	43,871	39,542	13,877
China	25,458	27,076	29,319	25,221	10,880
Mexico	22,751	25,310	27,365	27,159	8,078
Canada	20,553	20,537	20,169	19,828	6,038
Rest of World	189,863	208,096	224,099	212,136	52,986
Total	362,248	388,931	416,258	393,521	117,042

World Exports (USD mln)	CY16	CY17	CY18	CY19	1HCY20
Germany	56,419	62,452	67,426	61,796	22,908
USA	43,182	45,199	45,703	43,019	14,105
China	29,370	31,050	34,850	33,626	13,893
Japan	31,700	34,538	35,873	32,697	11,704
Mexico	26,193	26,897	29,727	30,660	9,119
Rest of World	175,385	188,796	202,680	191,723	45,312
Total	362,248	388,931	416,258	393,521	117,042

- There was a ~5% decline in global trade during CY19. During 1HCY20, there was decline of ~35% in global trade as compared to 1HCY19. The global trade of auto parts accounted for ~18% of the total consumption of auto parts in CY19.
- The top 5 importing countries collectively contribute to ~45% of total imports, while the top 5 exporting countries contribute to ~51% of total exports.
- Germany and Japan have consistently maintained the largest positive trade balance with net trade balances of USD~22,255mln and USD~24,569mln respectively during CY19. Meanwhile, USA had the largest negative net trade balance of USD~26,616mln during CY19.

Overview

- Demand in the local auto parts industry emanates 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.
- There are approximately 1,600 auto parts vendors in Pakistan, out of which ~400 vendors belong to Tier-1 category and are suppliers for the OEM market.
- Pakistan's domestic auto parts and accessories industry has an approximate size of USD~2,920mIn (PKR~460bIn) in FY20 as compared to USD~3,056mIn (PKR~417bIn) in FY19.
- Remaining demand of the OEM segment is met through imports. During FY20, Pakistan imported auto parts and accessories worth USD~263mIn (PKR~41,594mIn). Major import destinations include Thailand, Japan, China and Indonesia.
- The adjacent table shows category wise average localization levels in terms of units in the auto industry.

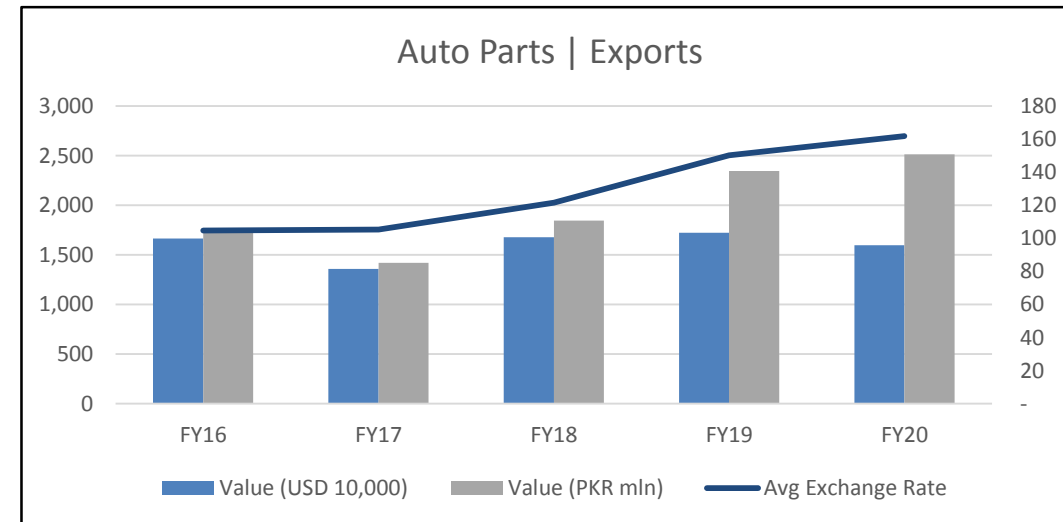
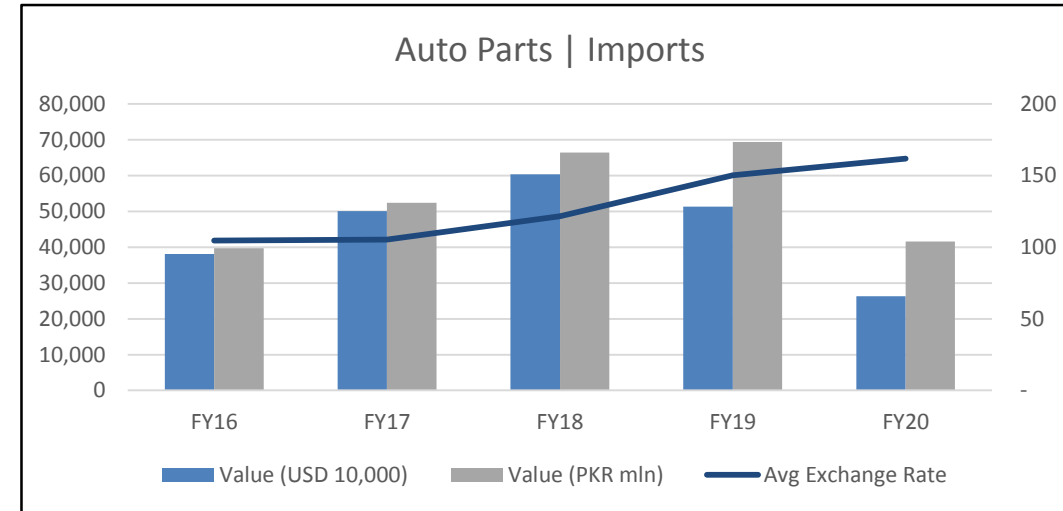
Localization Levels	
Passenger Cars & LCVs	50-60%
Trucks/Buses	~30%
Tractors	~85%
Motorcycles	~90%



AUTO PARTS | LOCAL INDUSTRY

Imports & Exports

- During FY20, imports of auto parts stood at USD~263mln (PKR~42bln) as compared to USD~513mln (PKR~69bln) in FY19.
- This decline of ~49% is largely attributable to the spread of COVID-19 pandemic and resulting economic challenges, including the disruption of supply chains and suspension of operations during lockdown period.
- The overall CAGR of imports in dollar terms stands at -7% due to the declining import trend for the last two fiscal years. In rupee terms, the CAGR stands at ~1%.
- In FY20, the exports clocked in at USD~16mln (PKR~2,514mln) as compared to USD~17mln (PKR~2,345mln) in FY19.
- The YoY growth of exports by 7% in rupee terms in FY20 is reflective of the rising exchange rate, while in dollar terms there was a YoY decline of ~7% in exports of auto parts during the period.
- Exports of auto parts have remained relatively stable in the last 5 years with CAGR, in USD terms, of -1% and in PKR terms of ~8%.



Imports

- The import market for auto parts and accessories is dominated by Asian countries.
- Thailand occupies the largest share with ~35% of total imports during 2019.
- Japan, China and Indonesia have also consistently occupied significant share of the import market with ~19%, ~18% and ~13% of total imports respectively during 2019.
- Engine and suspension parts are the components which are most commonly imported to Pakistan.

Pakistan Import Destinations	FY18		FY19		FY20	
	Amount (USD 000)	%	Amount (USD 000)	%	Amount (USD 000)	%
Thailand	204,189	34%	208,919	41%	91,043	35%
Japan	98,318	16%	82,027	16%	49,842	19%
China	90,656	15%	66,363	13%	47,334	18%
Indonesia	98,183	16%	74,766	15%	34,819	13%
Other	111,928	19%	81,575	16%	40,240	15%
Total	603,275		513,649		263,278	

Note: Import Figures are based on Trade Map estimates

Exports

- Only a small share of locally produced auto parts and accessories are sold in the export market.
- In 2019, exports to USA constituted ~23% of total exports.
- Other export destinations are spread across Europe along with a few Asian countries.

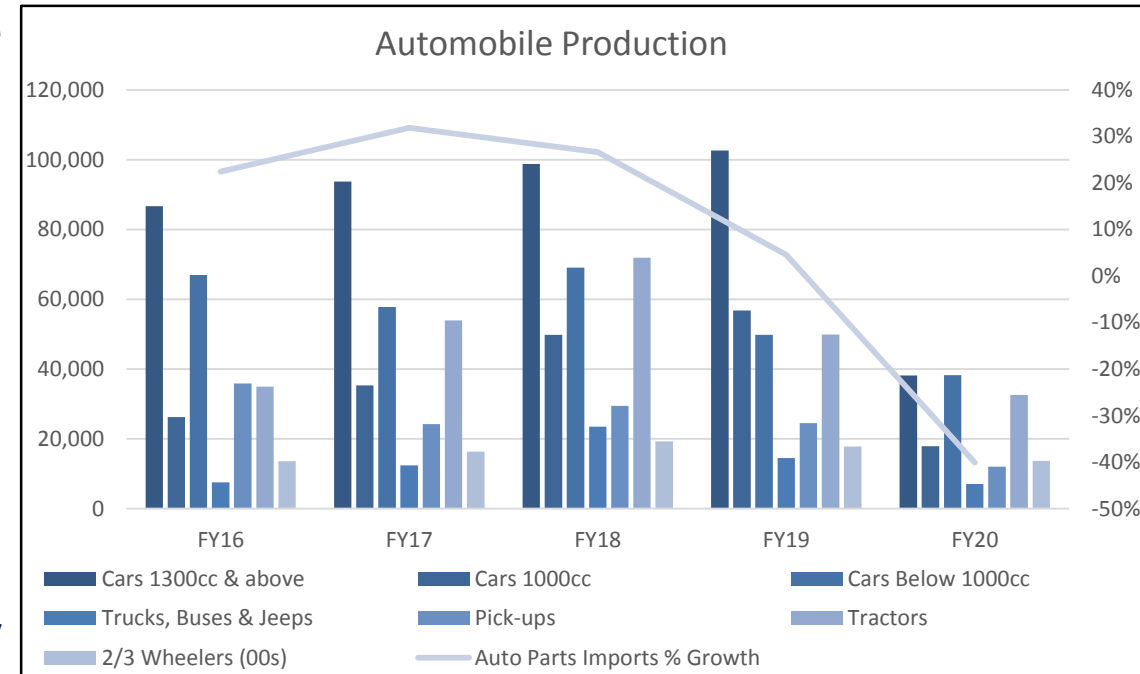
Pakistan Export Destinations	FY18		FY19		FY20	
	Amount (USD 000)	%	Amount (USD 000)	%	Amount (USD 000)	%
USA	2,795	17%	3,461	20%	3,698	23%
Italy	3,057	18%	3,827	22%	3,031	19%
UK	1,923	11%	1,772	10%	1,219	8%
Other	9,000	54%	8,166	47%	8038	50%
Total	16,774		17,226		15,986	

Note: Export Figures are based on Trade Map estimates



Business Risk

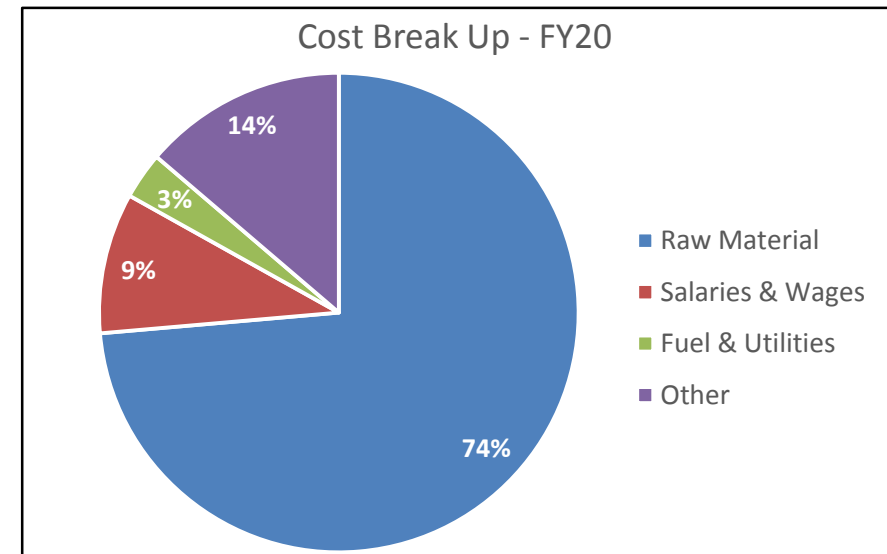
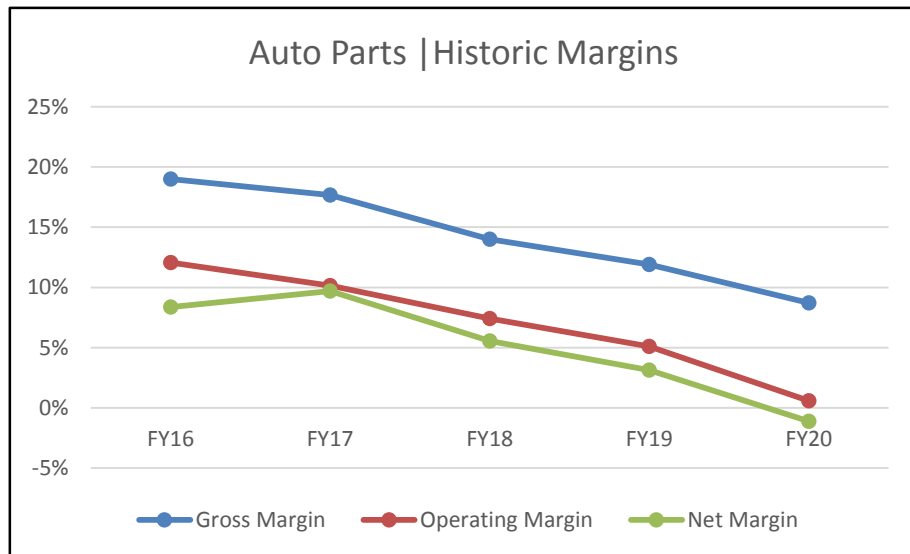
- The auto parts industry derives its demand entirely from the automobile industry. As a result, the challenges faced by the automobile manufacturers have also had a detrimental impact on the sale of auto parts.
- Increase in automobile prices on the back of rising inflation and exchange rates, combined with the decline in consumer purchasing power resulted in a decline in automobile demand in FY19 and 1HFY20. Moreover, increase in interest rates and introduction of regulation regarding tax non-filers by the government also had a negative impact.
- The spread of COVID-19 and resulting lockdown had a further negative impact on demand during FY20.
- The industry also faces stiff competition from the import segment which occupies significant market share in both OEM and replacement market.
- Moreover, the industry faces risk due to exchange rate volatility as it mostly relies on imported raw material.
- The localization levels remain low, specifically in trucks and buses segment, due to the industry's requirement for heavy capital expenditure which acts as a barrier to entry for new players. Meanwhile, localization of tractors and motorcycles is high while localization of passenger cars and LCVs is adequate.
- Finally, international investor's have not opened production facilities in the country as their confidence in the Pakistani market remains low.



AUTO PARTS | LOCAL INDUSTRY

Margins & Cost Structure

- The industry’s direct costs largely comprise imported raw materials (~74%). Therefore, cost behavior is subject to fluctuations in exchange rate and International price trends.
- The average margins of the auto parts industry have observed a declining trend since FY16, with average gross margins having fallen from ~19% in FY16 to ~9% in FY20. This is majorly attributed to demand contraction and rising cost of sales. Additionally, pressure is exerted on the bottom-line due to challenge in fixed cost absorption. Rising interest rates have been an added pressure factor. However, the recent reduction in benchmark rate by 625bps should provide some relief.

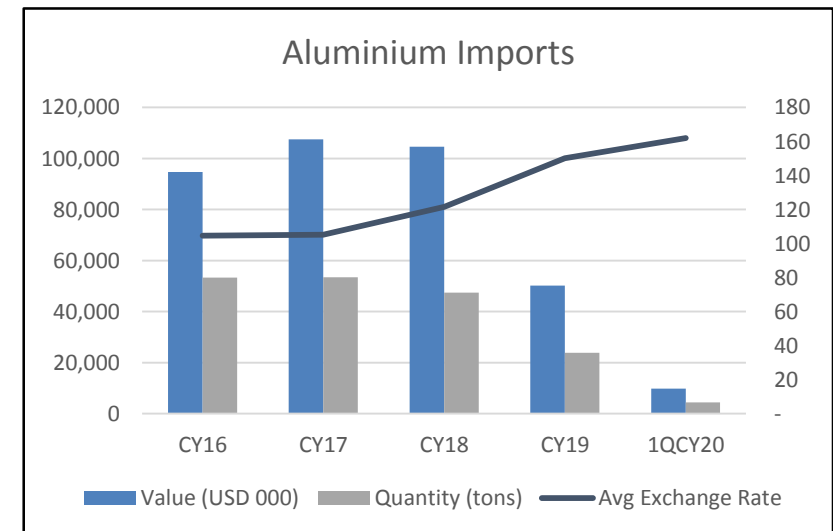
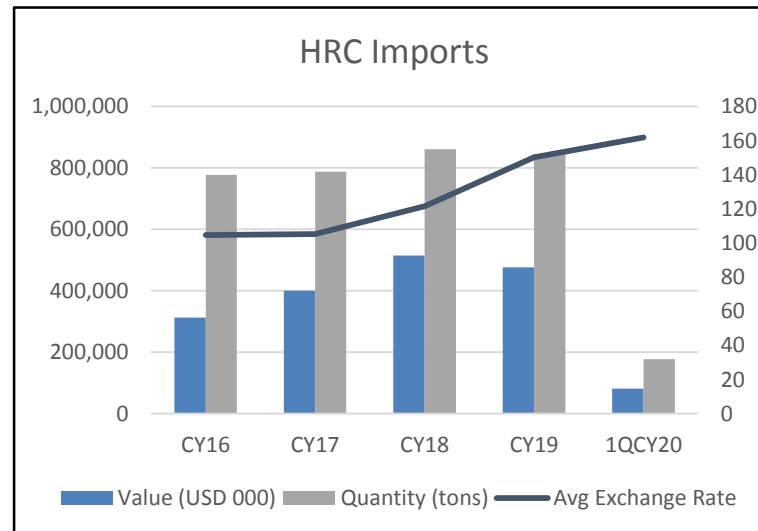
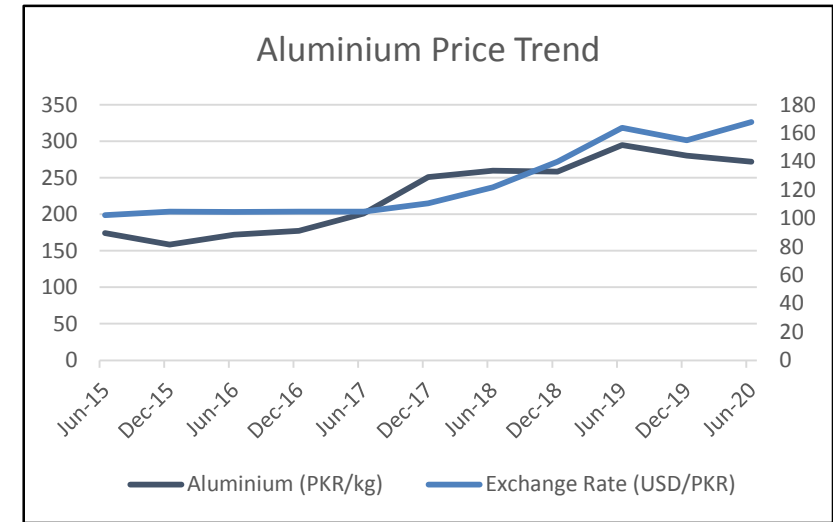
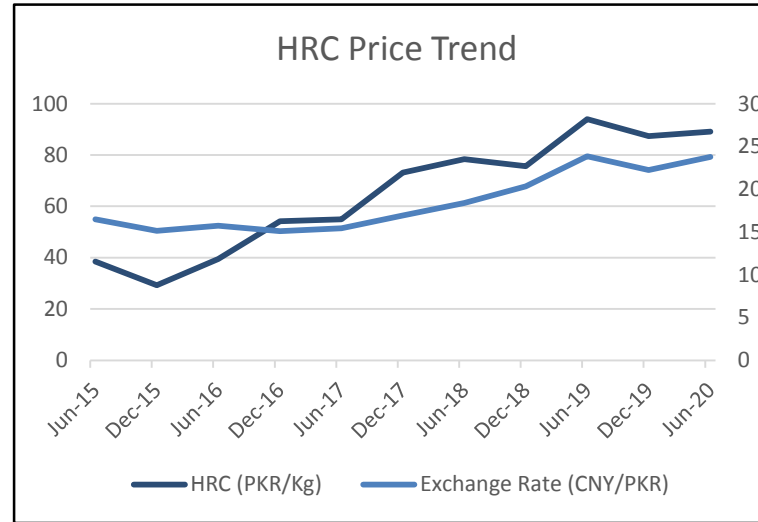


*Cost break up and margins are representative of 6 listed companies

AUTO PARTS | LOCAL INDUSTRY

Raw Materials

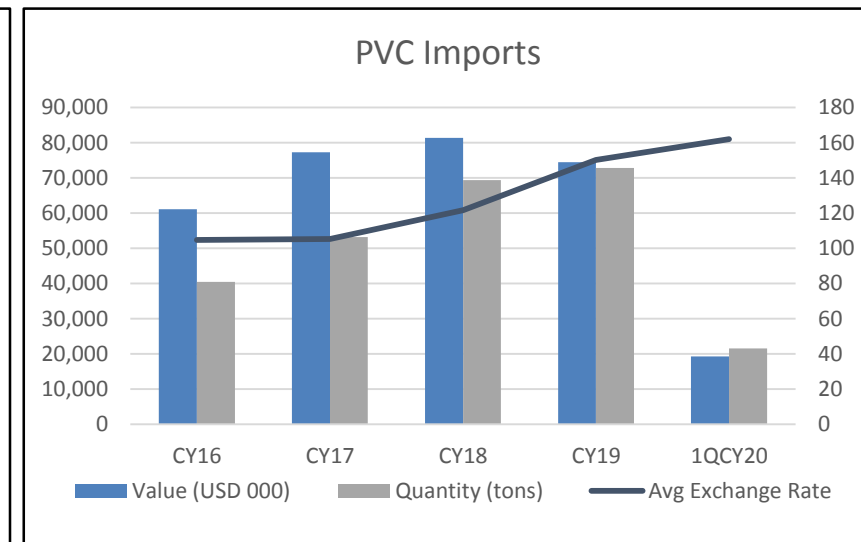
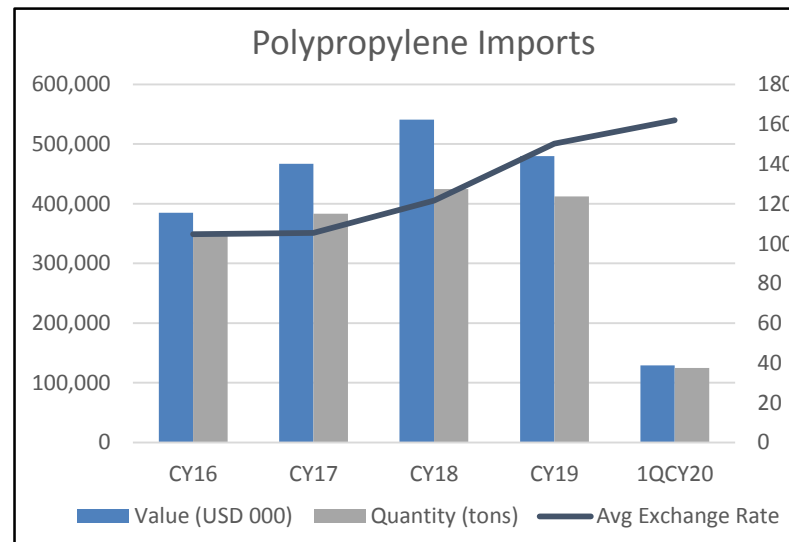
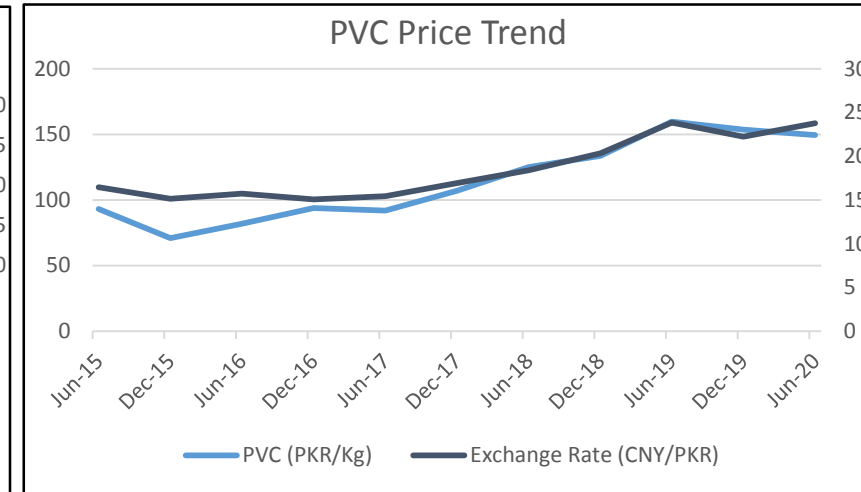
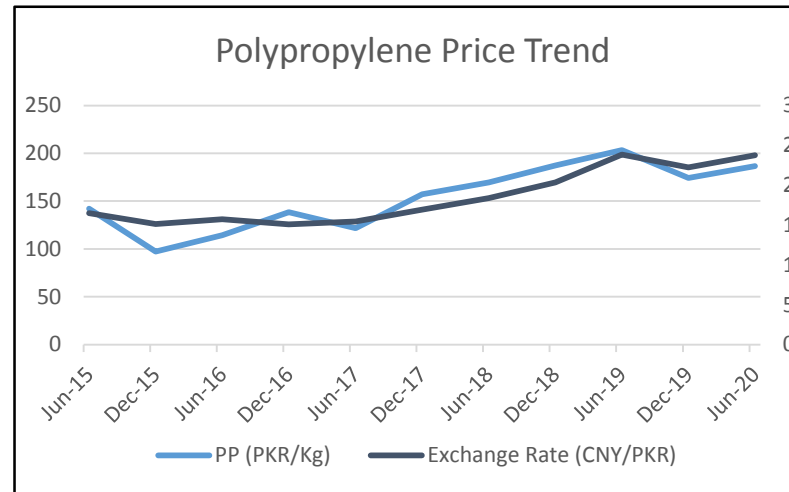
- There are a large variety of materials used in the production of auto parts and accessories. The most significant are steel and aluminium which are used alongside other metals and alloys.
- There has been significant increase of 132% in prices of Hot Rolled Coil (HRC) during a 5 year period. HRC imports in quantitative terms have remained relatively stable until 2019.
- Aluminium prices have also seen a rising trend with a 56% increase in prices over 5 years although this is partially attributable to increase in exchange rate.
- Aluminium is also available through local suppliers who in turn import it from the international market.



AUTO 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 and PP prices have increased ~60% and ~31% respectively in a 5 year period. Meanwhile, imports of both plastics have increased in both value and quantitative terms, with the exception of 2020.



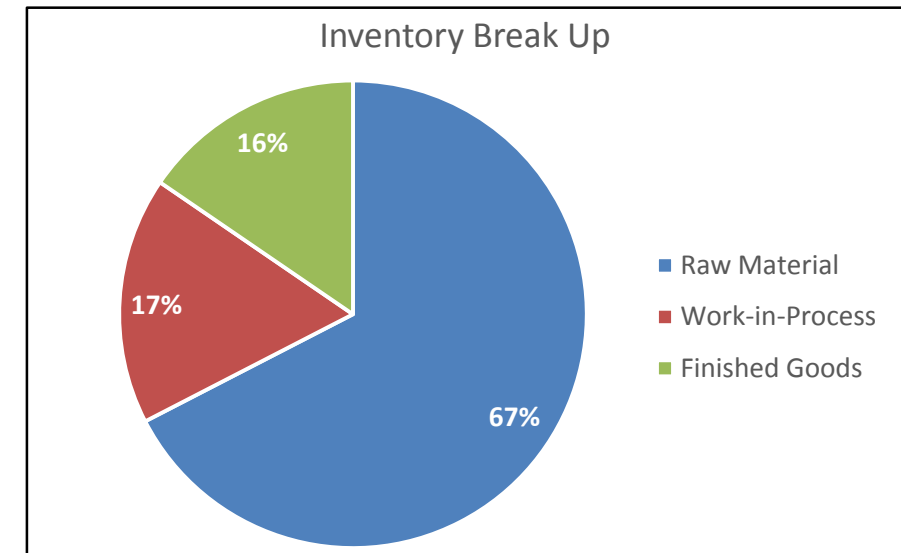
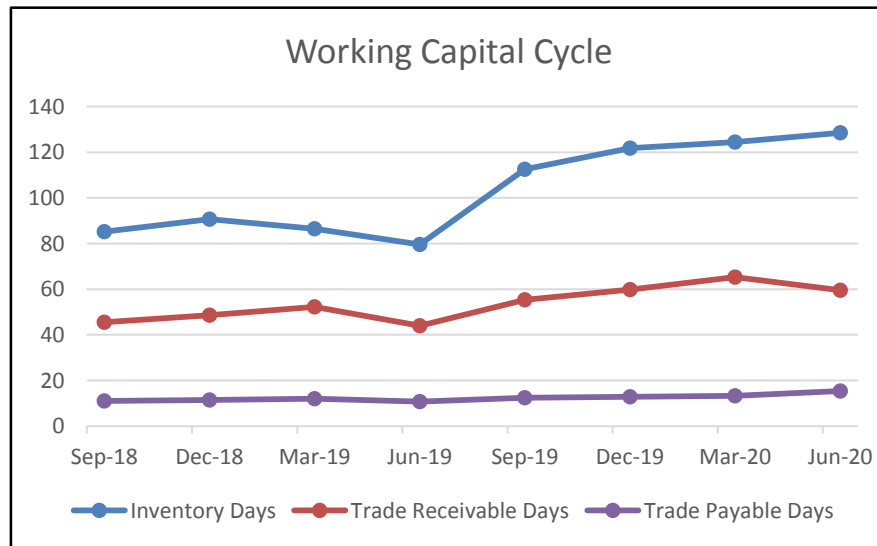
Duty & Sales Tax Structure

- 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	
		FY20	FY19	FY20	FY19	FY20	FY19	FY20	FY19
Raw Materials									
76.01	Unwrought Aluminium	2%	0%	0%	3%	10%	10%	12%	13%
76.04	Aluminium bars, rods and profiles	2-7%	0%	11-20%	11-20%	0%	0%	13-27%	11-20%
76.06	Aluminium plates, sheets and strips	2%	0%	0-11%	3-11%	0%	0%	2-11%	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%	0%	11-20%	11-20%	12.5%	12.5%	25-40%	24-33%
39.04	Polymers of vinyl chloride or of other halogenated olefins, in primary forms. (PVC)	2-7%	0%	11-20%	11-20%	0%	0%	13-27%	11-20%
3902.10	Polypropylene	2%	0%	11%	11%	0%	0%	13%	11%
Finished Goods									
87.08	Parts & Accessories for Motor Vehicles	7%	0%	35%	35%	0%	0%	42%	35%

Working Capital Management

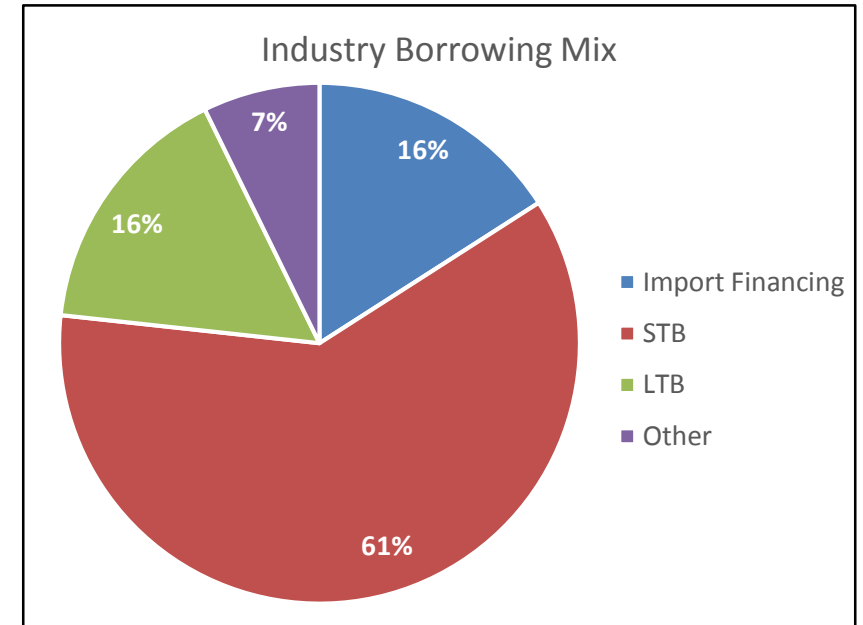
- The auto parts industry’s working capital cycle is a function of inventory and trade receivables.
- There has been an overall increase in the working capital cycle of the industry during FY20 with average net working capital days standing at 173 days as compared to 113 days at the end of FY19.
- This is due to the significant decline in demand in the period resulting from the COVID-19 pandemic which caused suspension of production activities for non-essential industries.
- Working capital is partially financed through short term borrowing which is the largest component of the industry’s total borrowing.



*Working capital cycle and inventory break up are representative of 6 listed companies

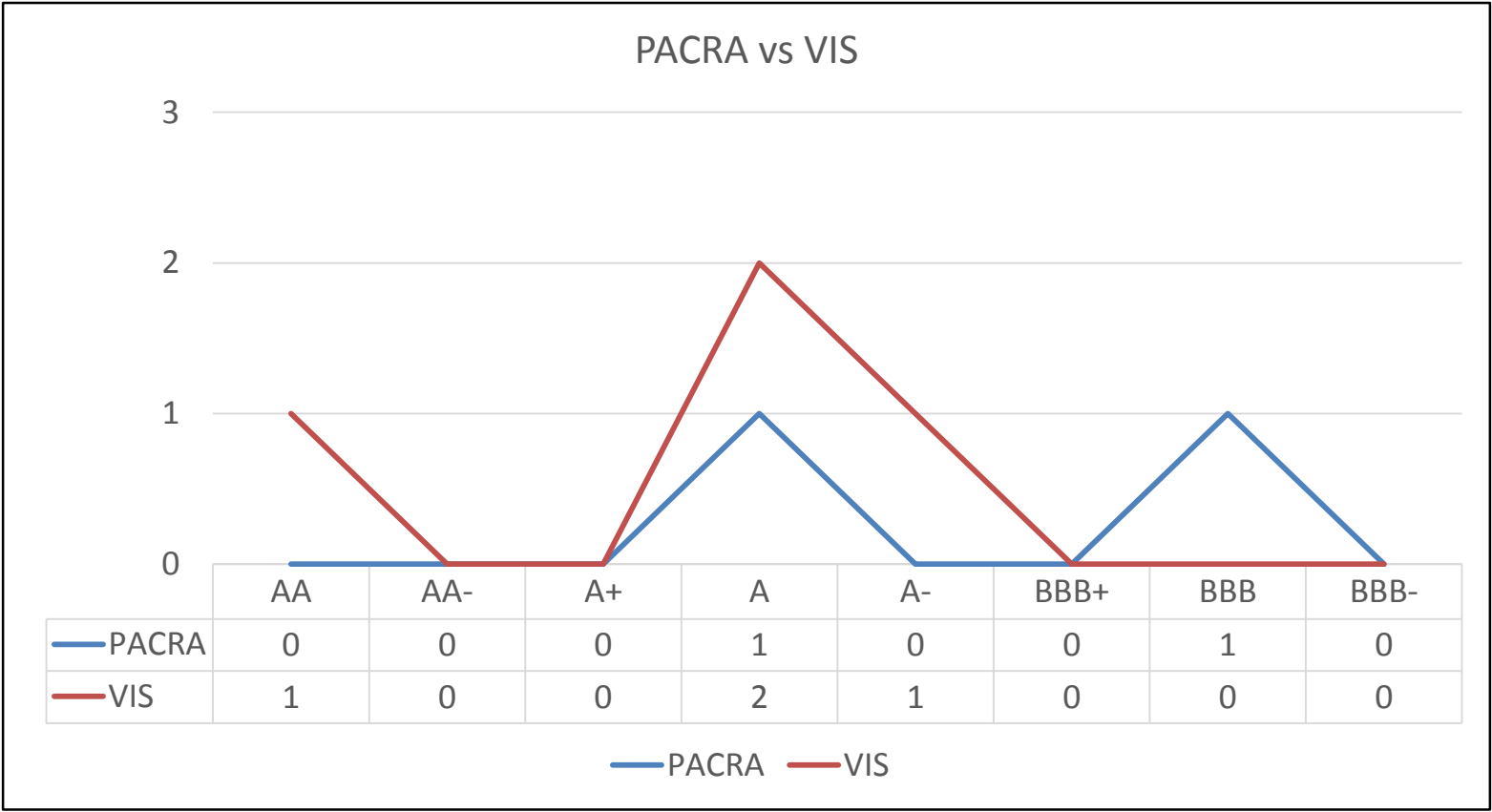
Financial Risk

- Overall, the auto parts and accessories industry has low leveraging with average borrowings standing at ~23%* of total capital.
- Total borrowing of the industry stood at PKR~14,787mln at the end of August 2020 as compared to PKR~21,319mln in August 2019.
- Short term borrowings constitute the majority of total borrowings and stands at PKR~8,989mln. They comprise ~61% of total borrowings.
- Another major category is import financing which stands at PKR~2,356mln and comprises ~16% of total borrowings.



*Average leveraging figure is representative of 6 listed companies

Rating Curve



COVID-19 | Impact & Relief Measures

- The demand from OEM market suffered due to the spread of COVID-19 as the automobile production was suspended during the lockdown period. In addition, replacement market demand also declined as the purchasing power of end consumers was reduced due to adverse economic conditions.
- As a result of the declining demand and therefore sales, the industries working capital cycle was extended significantly.
- The demand has been recovering in recent months as economic activity has picked up and the automotive industry has resumed productions.
- Prices of raw materials initially declined after the COVID-19 outbreak which would have provided some benefit to the industry. However, prices have recovered and stabilized in recent months.
- The government introduced various measures to ease pressure on the industry.
- SBP allowed one year deferment of principal repayments to the corporate sector. In addition, restructuring of loans was allowed up to 30 June 2020.
- In addition, SBP allowed authorized dealers to extend the maximum limit allowed for settlement of import loans by 180 days, therefore increasing the total tenor of the loan to 360 days. This extension was applicable for loans maturing up to September 30, 2020 and subject to satisfactory explanation by the importer.
- The benchmark rate was reduced by a total of 625bps to 7% which should reduce interest cost by ~PKR 900mln for the industry. This will greatly reduce pressure on margins.



AUTO PARTS | LOCAL INDUSTRY

SWOT Analysis

- Diversified product mix.
- Government support for local manufacturers in the form of import duties.
- Availability of low cost labor.
- Strong industry association (PAAPAM) resulting in high lobbying power.

- Restricted demand for automobile sector in previous two years.
- Decline in per capita income and thus reduced purchasing power of end consumers. This negatively impacts both OEM and Replacement markets.



- Increase in exchange rate and volatility of imported raw material prices.
- Availability of high quality imports which reduce opportunity for localization in OEM market.

- Entrance of new auto players provides opportunity for local auto parts players to increase their market shares.
- Potential for technological collaborations with OEMs to improve quality of products and introduce latest technology.
- Decrease in interest rates should improve demand for auto financing.

Outlook: Stable

- The auto parts and industry's potential for growth remains intact despite significant challenges emanating from a difficult economic environment and the COVID-19 pandemic.
- The automotive industry has entered a recovery phase after a ~27% decline in production during FY20. In the month of Sep-20, sales of passenger cars increased by 8.6% as compared to Sep-19.
- In addition, production levels of auto industry in 1QFY21 have increased massively from the last quarter of FY20, with passenger car production increasing ~384% and 2/3-wheeler production increasing 148%. This is due to resumption of activity post COVID-19 restrictions. In some categories production levels have even surpassed 1QFY20 levels, with production of 2/3-wheelers and tractors in 1QFY21 increasing ~21% and ~17% respectively as compared to last year.
- Similarly, with respect to demand for automobiles, there was a ~3% YoY increase in passenger car sales during 1QFY21 alongside ~14% increase in sale of tractors and ~22% increase in sale of 2/3-wheelers as compared to 1QFY20.
- The entrance of new players in the automotive industry on the back of Automotive Development Policy 2016-21 has increased opportunities for local auto part manufacturers to improve their market shares.
- However, the industry faces stiff competition from imported auto parts and localization levels remain relatively low.
- The reduction in benchmark rate by 625bps is expected to improve demand for auto financing, thus increasing automotive industry sales and demand for auto parts. Moreover, the decline in interest rates is expected to reduce finance costs and ease pressure on margins.
- The exchange rate is expected to remain stable in the near future thus reducing risk associated with the import of raw materials.
- Going forward, these factors point towards the gradual increase of demand for auto parts and accessories industry in line with the recovery of the automotive industry indicated by the improvement in production and sales of various automobiles.

- Pakistan Bureau of Statistics (PBS)
- International Monetary Fund (IMF)
- Pakistan Stock Exchange (PSX)
- Statista.com
- Trade Map
- Pakistan Automotive Manufacturers Association (PAMA)
- Pakistan Association of Automotive Parts & Accessories Manufacturers (PAAPAM)
- Business Insider
- Sunsirs.com/uk
- <https://www.exchangerates.org.uk/>
- <https://www.ibisworld.com/global/market-research-reports/global-auto-parts-accessories-manufacturing-industry/>
- <https://mechathon.com/components-parts-of-automobile/>
- <http://www.scienceclarified.com/As-Bi/Automobile.html>
- <https://www.azom.com/article.aspx?ArticleID=17014>
- <https://markets.businessinsider.com/news/stocks/auto-industry-shrinking-at-peak-car-dragging-global-economy-lower-2019-10-1028644883#>

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