

Automotive Parts

Sector Study



Contents	Page No.	Contents	Page No.
Introduction	3	Duties & Sales Tax Structure	15
Global Industry Overview	4	Working Capital Management	16
Global Industry Imports & Exports	5	Financial Risk	17
Local Industry Overview	6	Rating Curve	18
Production	7	SWOT Analysis	19
Imports & Exports	8	Outlook & Future Prospects	20
Business Risk	11		
Margins & Cost Structure	12		
Raw Materials	13		



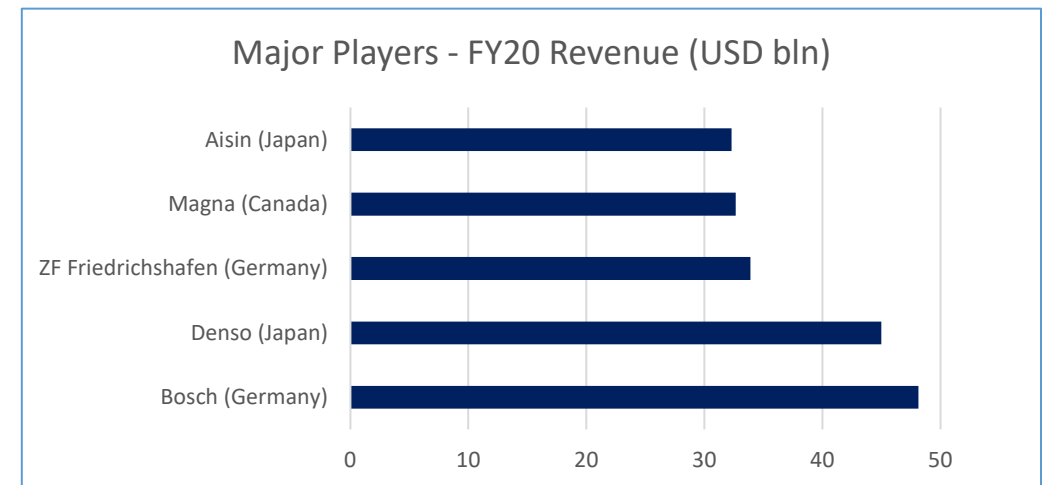
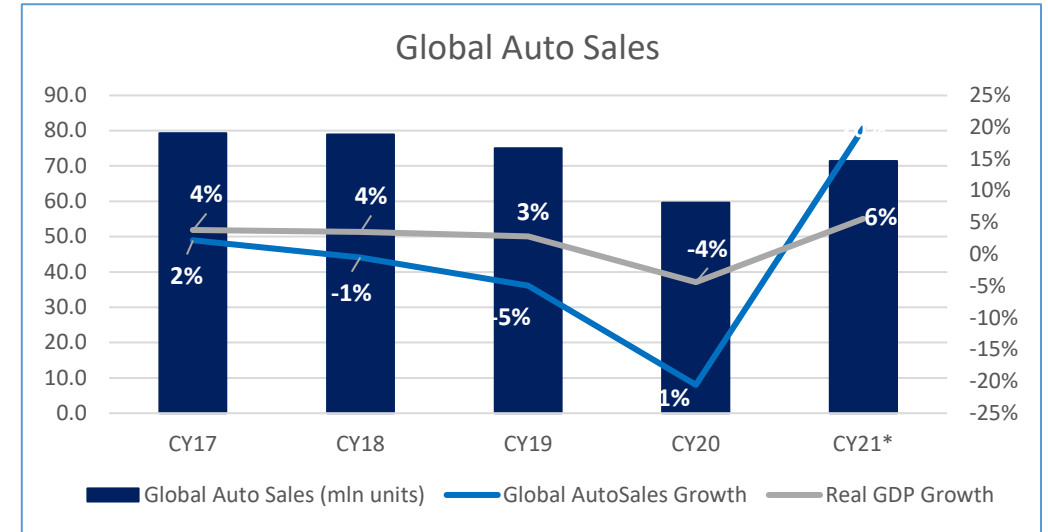
- Automobile parts and accessories are the complex components which make up all automobiles and ensure their ability for efficient and long-term functioning.
- While there are a large number of individual auto parts, they can be broadly categorized according to certain functions:
 1. The Chassis: includes 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.



Automotive Parts | Global Industry

Overview

- The global demand for auto parts is derived from the international automobile industry.
- Historically, automobile demand has been driven by rising per capita incomes and growing middle class, particularly in the Asia-Pacific region.
- The auto industry has been witnessing a declining trend since CY18 as a result of automobile saturation in developed markets and increasing availability of ridesharing alternatives coupled with the economic fallout due to COVID-19 in CY20 when the global auto sales declined by 21%.
- However, the auto sales are expected to increase by 20% in CY21 due to the increase in demand fueled by better economic prospects.
- The estimated market size of the global auto parts and accessories industry stands at USD~1.8trn in CY21 (CY20: USD~1.9trn). The industry has experienced an average decline of ~2.4% per year from CY16 to CY21.
- 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 5th one is from Canada.





Imports & Exports

World Imports (USD mln)					
	CY16	CY17	CY18	CY19	CY20
USA	66,411	66,308	71,436	69,635	59,896
Germany	37,212	41,603	43,871	39,542	33,444
China	25,458	27,076	29,319	25,221	25,767
Mexico	22,751	25,310	27,365	27,159	21,933
Spain	16,675	17,296	17,790	16,816	14,542
Canada	20,553	20,537	20,169	19,828	14,409
Rest of World	173,188	190,800	206,309	195,320	170,269
Total	362,248	388,931	416,258	393,521	340,260

World Exports (USD mln)					
	CY16	CY17	CY18	CY19	CY20
Germany	56,419	62,452	67,426	61,796	54,445
USA	43,182	45,199	45,703	43,019	33,264
China	29,370	31,050	34,850	33,626	32,942
Japan	31,700	34,538	35,873	32,697	27,042
Mexico	26,193	26,897	29,727	30,660	26,702
Rest of World	175,385	188,796	202,680	191,723	165,865
Total	362,248	388,931	416,258	393,521	340,260

- There was a ~5% decline in global trade during CY19. During CY20, the global trade declined further by ~14% as a result of suspension of business activities worldwide imposed by lockdown.
- The top 6 importing countries collectively contribute ~50% to total imports, while the top 5 exporting countries contribute ~51% to total exports.

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 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.
 - Remaining demand of the OEM segment is met through imports. During FY21, Pakistan imported auto parts and accessories worth USD~405mln (PKR~64,397mln). Major import destinations include Thailand, Japan, China and Indonesia.

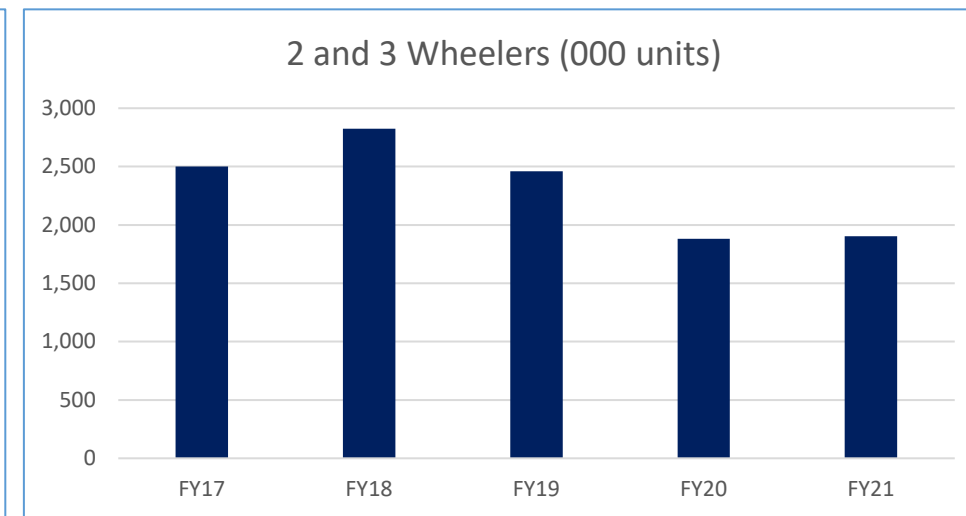
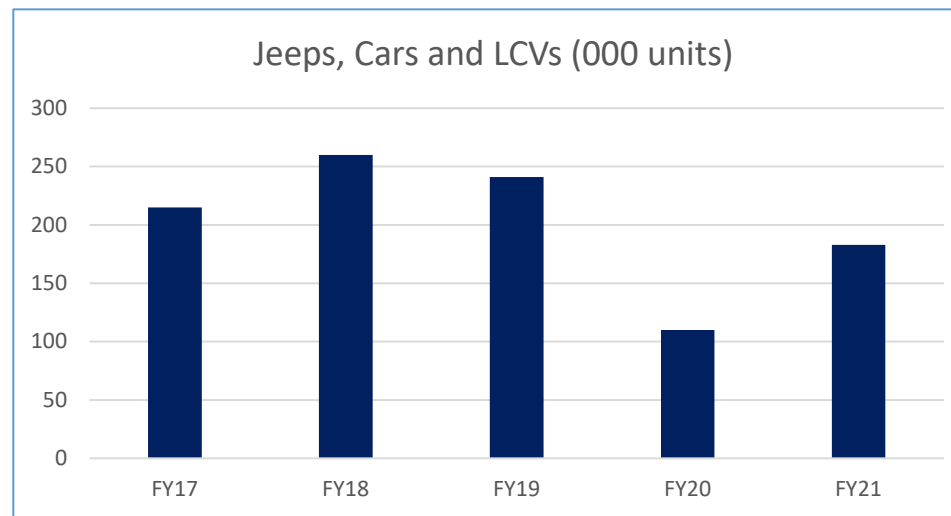
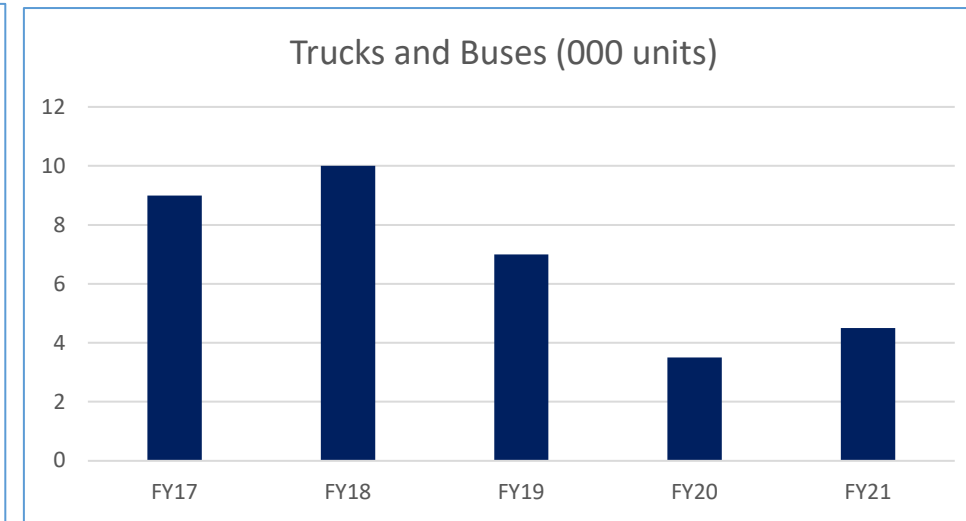
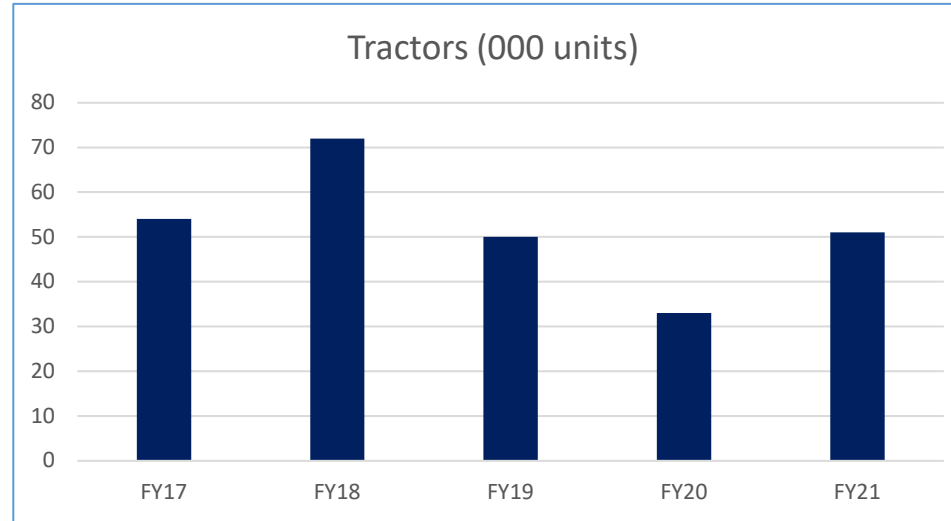
Sector Overview			
Year	FY19	FY20	FY21
Estimated Market Cap (PKR mln)	35,991	48,280	56,319
Estimated No. of Players	>2,000		
Workforce	>140,000 people		
Import Value (USD mln)	514	263	405
Export Value (USD mln)	172	160	201
Industry Association	Pakistan Association of Automotive Parts & Accessories Manufacturers		



Automotive Parts | Local Industry

Production

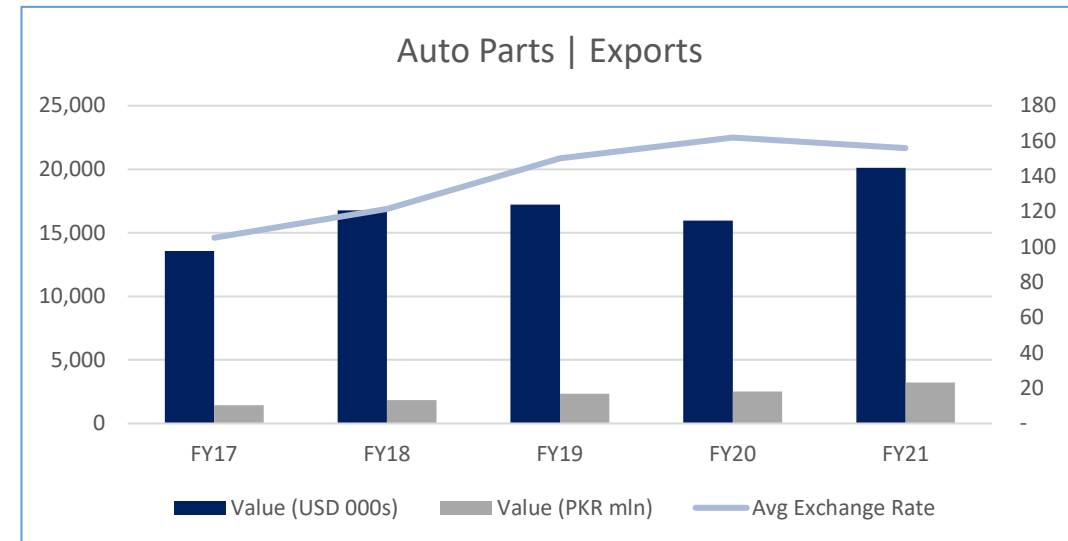
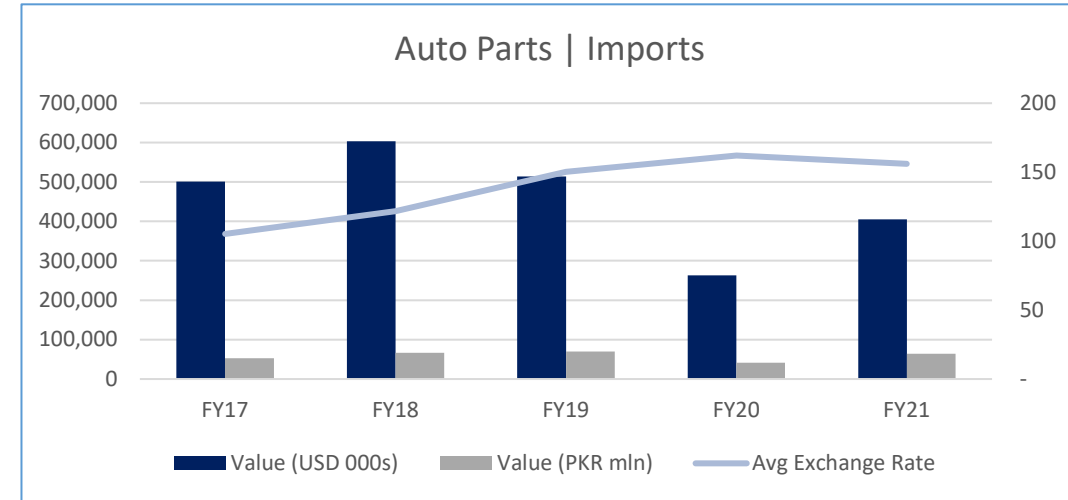
- The industrial production of automobiles in the country showed an overall positive trend during FY21. However, the production figures are still yet to reach to the pre-pandemic levels. New taxes like FED, ACD and minimum value addition that were imposed in FY19 also had a negative impact on the growth of the sector.



Automotive Parts | Local Industry

Imports & Exports

- During FY21, imports of Automotive parts stood at USD~405mln (PKR~64bln) as compared to USD~263mln (PKR~42bln) in FY20.
- This rise in imports by ~55% in PKR terms and ~54% in USD terms has come cumulative of rupee devaluation against dollar and growth in demand pie. Considering the base effect of FY20, the growth is largely attributable to the dilution of impacts of COVID-19 pandemic and the related resumption of operations.
- In FY21, the exports clocked in at USD~20mln (PKR~3,210mln) as compared to USD~16mln (PKR~2,514mln) in FY20.
- Exports of Automotive parts have grown in the last 5 years with CAGR in USD terms, of 8% and in PKR terms of ~18%. The highest growth was seen in FY21 with YoY growth of exports by 28% in PKR terms and 26% in USD terms.
- Overall, the imports in FY21 still lag behind the pre-pandemic levels and were 7% lower than FY19. However, the exports hiked by 37% during FY21 as compared to FY19.



Imports

- The import market for Automotive parts and accessories is dominated by Asian countries.
- Thailand occupied the largest share with ~34% of the country's total imports during CY20.
- China and Japan have also consistently occupied significant share of the import market with ~22%, and ~19% of total imports respectively during CY20. The imports from Indonesia fell from 18% to 5% in CY20.
- Engine and suspension parts are the components which are most commonly imported to Pakistan.

Pakistan Import Destinations								
CY18	Amount (USD 000)	%	CY19	Amount (USD 000)	%	CY20	Amount (USD 000)	%
Thailand	140,841	41%	Thailand	63,560	35%	Thailand	45,122	34%
Japan	55,298	16%	Japan	34,796	19%	China	29,215	22%
Indonesia	50,403	15%	China	33,045	18%	Japan	25,541	19%
China	44,738	13%	Indonesia	24,308	13%	Indonesia	6,331	5%
UAE	7,821	2%	UAE	4,448	2%	UAE	5,187	4%
Malaysia	6,502	2%	South Korea	4,044	2%	South Korea	4,079	3%
Philippines	5,935	2%	Turkey	2,907	2%	Turkey	3,960	3%
South Korea	5,828	2%	Malaysia	2,559	1%	Malaysia	2,258	2%
Turkey	4,263	1%	Bulgaria	1,534	1%	Taipei	1,804	1%
UK	3,521	1%	Australia	1,478	1%	Bulgaria	1,717	1%
Other	21,123	6%	Other	11,123	6%	Other	167,192	6%
Total	346,273		Total	183,802		Total	292,406	

Exports

- Only a small share of locally produced auto parts and accessories are sold in the export market. These majorly include bumpers, radiators, and batteries.
- In CY20, exports to Italy constituted ~21% of total exports.
- Other export destinations are spread across Europe along with a few Asian countries.

Pakistan Export Destinations								
CY18	Amount	%	CY19	Amount (USD 000)	%	CY20	Amount (USD 000)	%
Italy	4,116	22%	USA	3,950	23%	Italy	2,993	21%
USA	3,723	20%	Italy	3,237	19%	USA	2,689	19%
UK	1,906	10%	UK	1,302	8%	UAE	1,705	12%
Japan	1,014	5%	Spain	1,251	7%	Germany	1,046	7%
UAE	787	4%	UAE	977	6%	UK	926	6%
Spain	769	4%	Bangladesh	725	4%	Netherlands	888	6%
Bangladesh	758	4%	Germany	723	4%	Tanzania	493	3%
Belgium	711	4%	Netherlands	682	4%	Belgium	487	3%
Netherlands	671	4%	Belgium	655	4%	Spain	351	2%
Germany	542	3%	Nigeria	332	2%	Kenya	339	2%
Other	3,531	19%	Other	3,240	19%	Other	2,439	17%
Total	18,528		Total	17,074		Total	14,356	

Business Risk

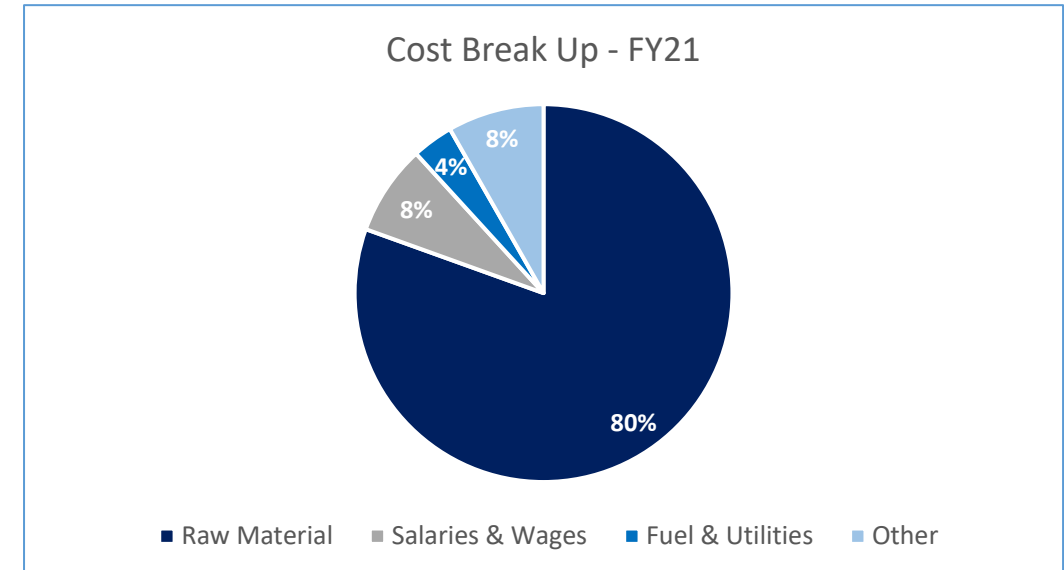
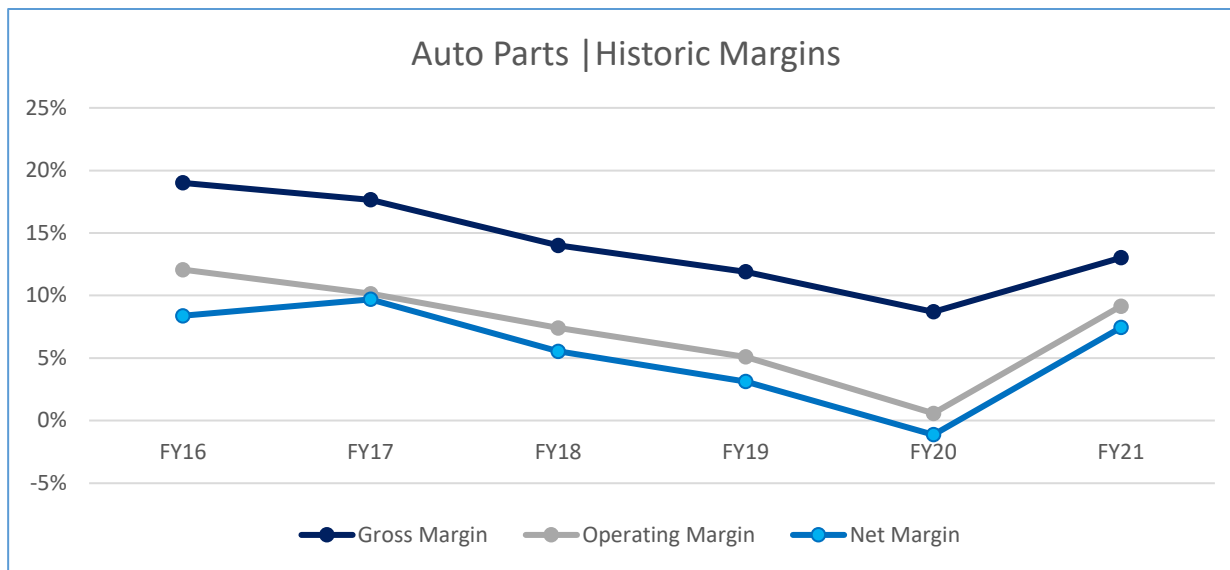
- The auto parts industry derives its demand entirely from the automobile industry. As a result, the challenges faced by the automobile manufacturers have also had a detrimental impact on the sale of auto parts.
- Increase in automobile prices on the back of rising inflation and exchange rates resulted in a declining trend in automobile demand. However, reduced interest rates coupled with new investments in automobile sector had a positive impact.
- 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.
- Finally, the accommodative policies have improved the confidence and the market is expanding. The government has granted greenfield status license to 21 investors as a part of its Auto Development Policy 2016-21. Resultantly, 6 new manufacturing units have established bringing an investment of USD~475mln.
- The adjacent table shows category wise average localization levels in terms of units in the auto industry. Although these levels have improved on the back of favorable government policies, they still remain low as compared to international counterparts.

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

Automotive 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. However, the margins showed recovery signs in FY21 and improved to 13%. This was majorly due to the resumption in business activities post lockdown and lower interest rates.
- The sector suffered from higher operational costs during FY21 due to disruptions in supply chain and increased freight charges. However, since the prices of auto parts were increased as well, the effect of higher costs was largely passed on.

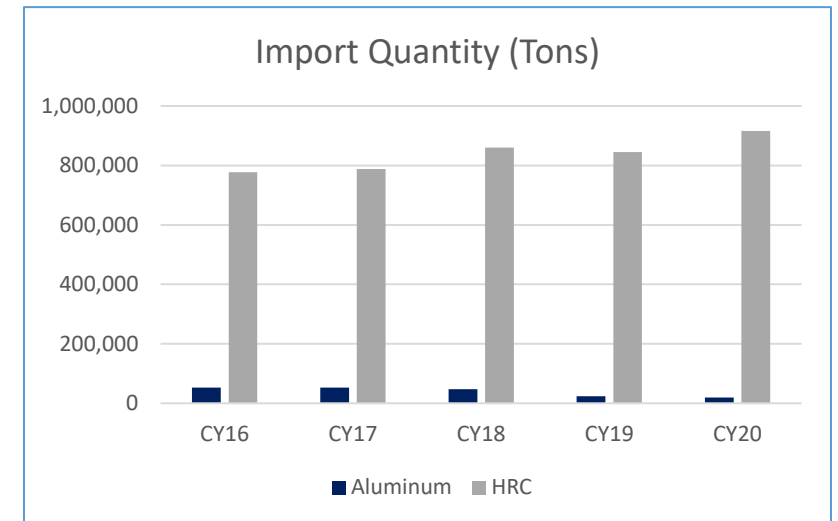
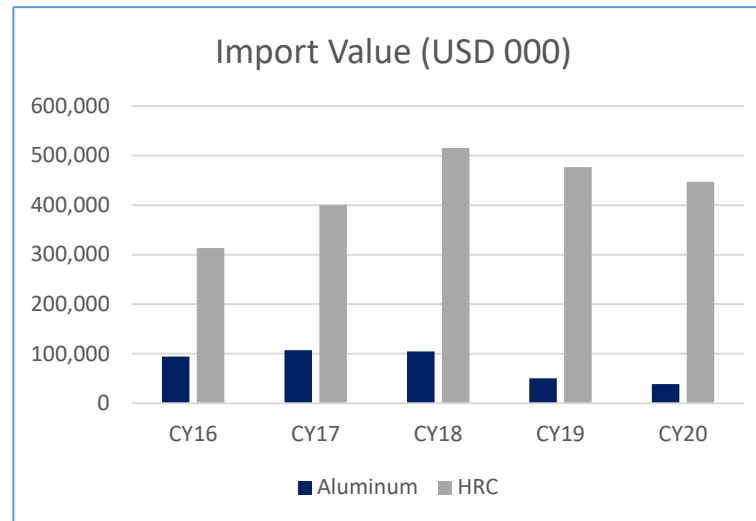
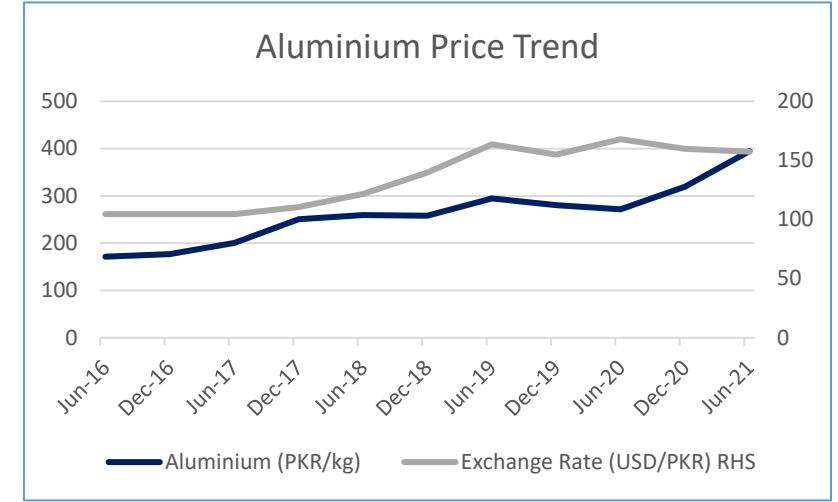
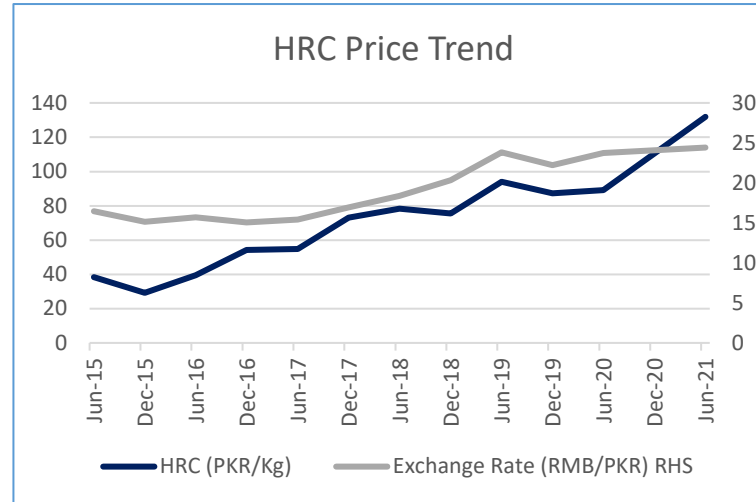


*Cost break up and margins are representative of 6 listed companies

Automotive 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 aluminum which are used alongside other metals and alloys.
- There has been significant increase of 234% in prices of Hot Rolled Coil (HRC) during a 5 year period. HRC imports in quantitative terms have remained relatively stable until 2019, and grew by ~8% in CY20.
- Aluminum prices have also seen a rising trend with a 130% 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.

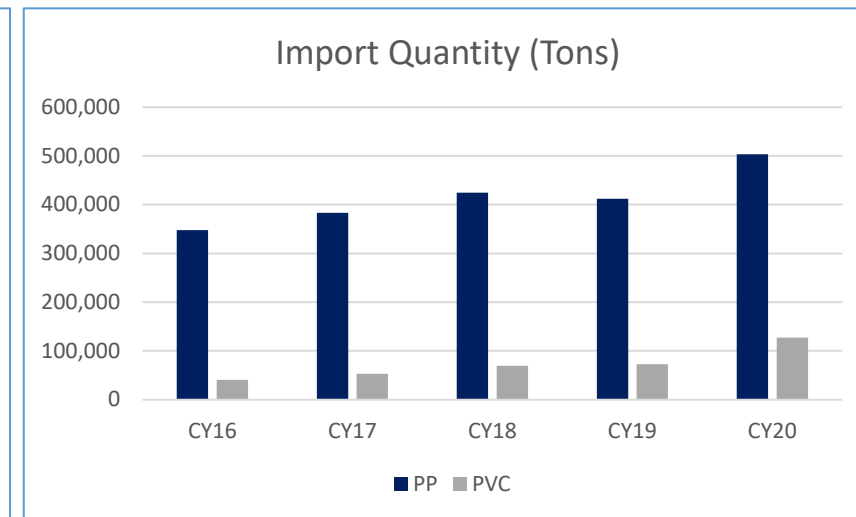
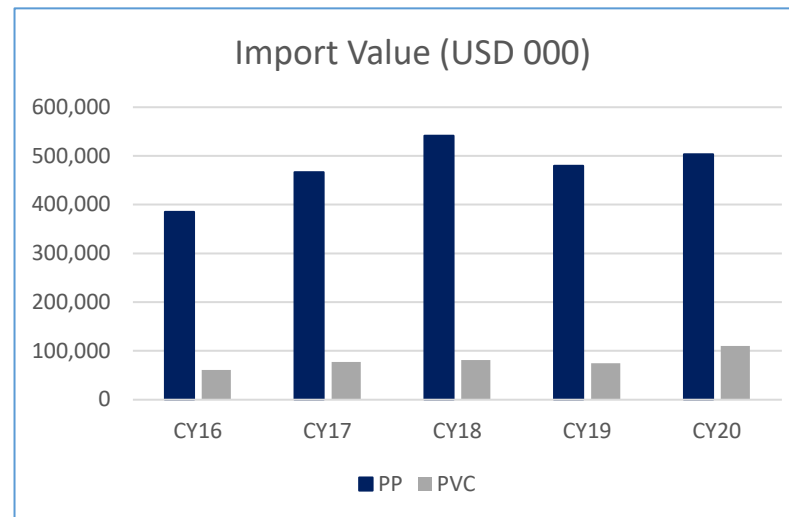
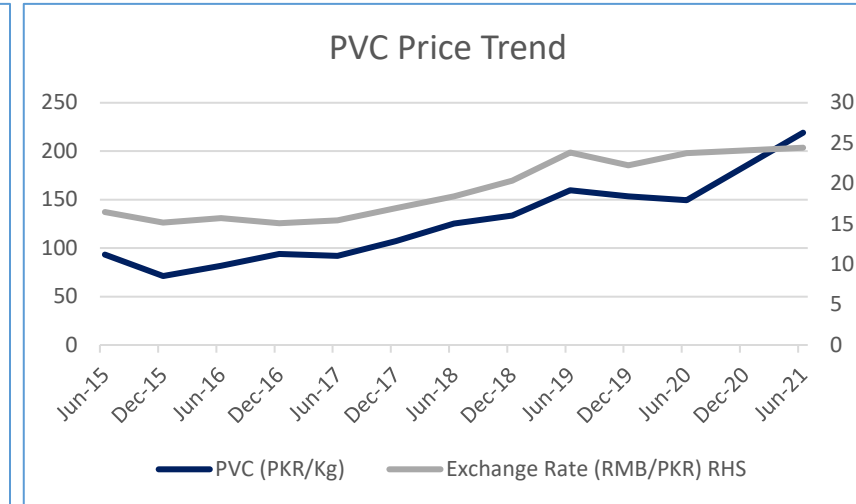
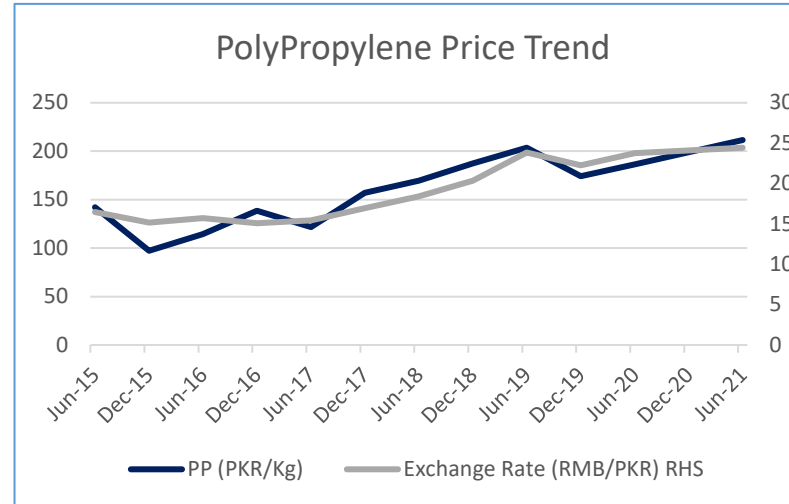




Automotive Parts | Local Industry

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 and PP prices have increased ~168% and ~85% respectively in a 5 year period. Meanwhile, imports of both plastics have increased in both value and quantitative terms, with the exception of CY19.



Automotive Parts | Local Industry

Duty & Sales Tax Structure

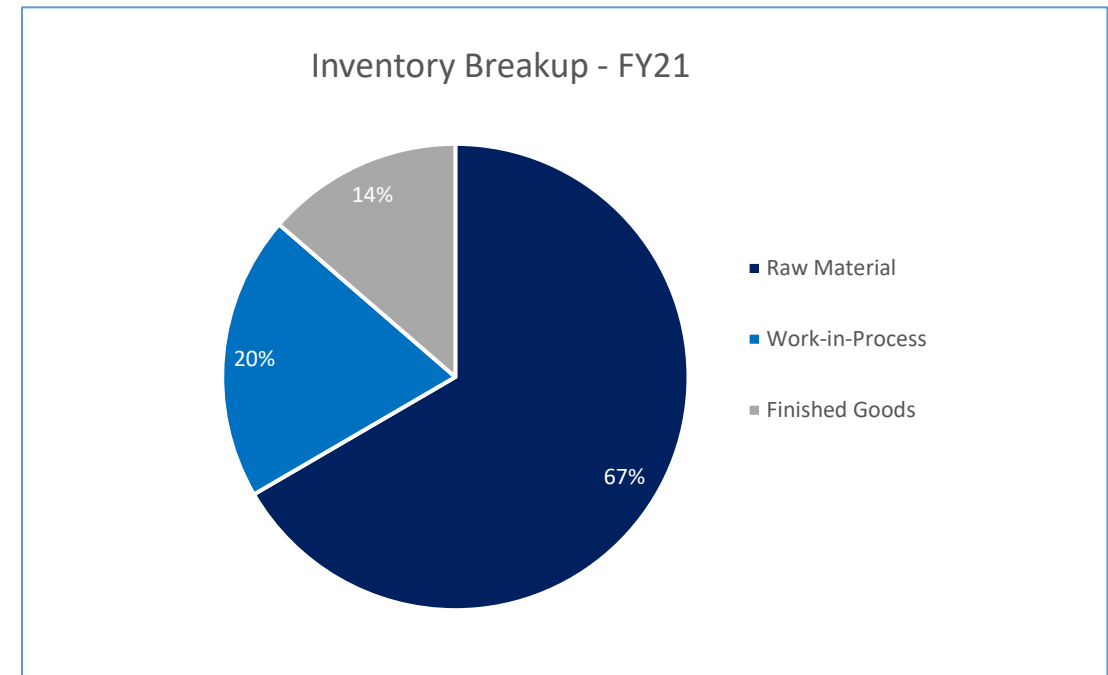
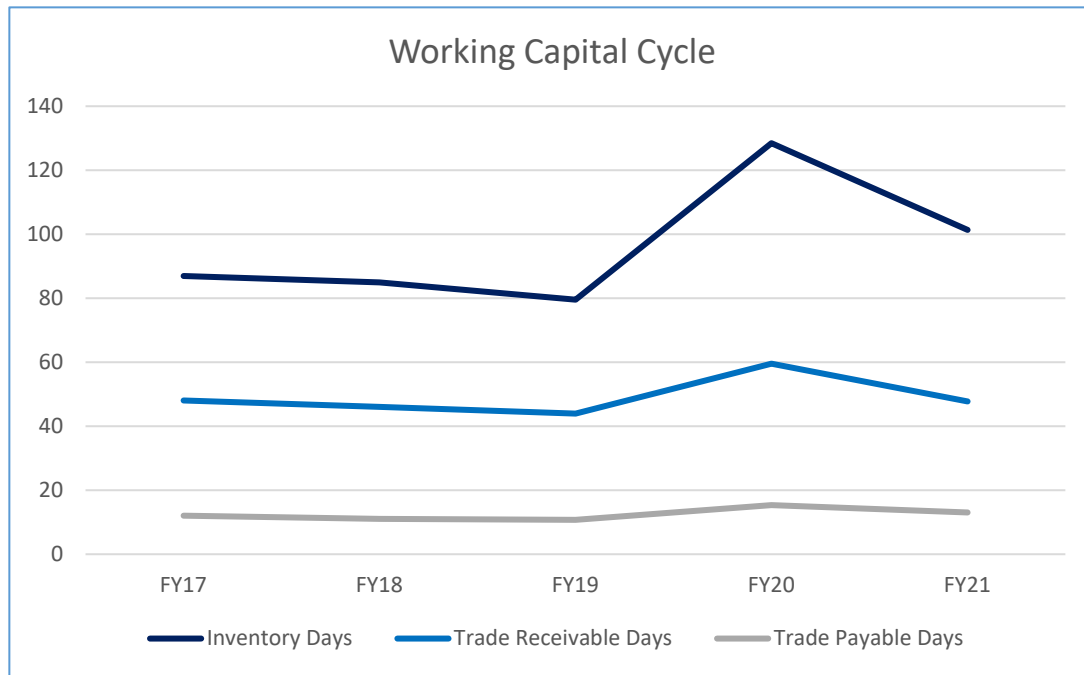
- The Pakistan Association of Automotive Parts & Accessories Manufacturers (PAAPAM) was formed in 1988 and has represented the auto parts industry for over three decades. It is recognized by the Government of Pakistan and is also a member of the Federation of Pakistan Chamber of Commerce & Industry (FPCCI).
- 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	
		FY21	FY20	FY21	FY20	FY21	FY20	FY21	FY20
Raw Materials									
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%
Finished Goods									
87.08	Parts & Accessories for Motor Vehicles	7%	7%	35%	35%	0%	0%	42%	42%

Automotive Parts | Local Industry

Working Capital Management

- The auto parts industry’s working capital cycle is a function of inventory and trade receivables.
- Net working capital days increased to 173 during FY20 from 113 at the end of FY19 due to suspension of production activities for non-essential industries. However, as the business activities resumed in FY21, net WC days for the automotive parts sector recovered and stood at 136 at the end of FY21.
- Working capital is partially financed through short term borrowing which is the largest component of the industry’s total borrowing.



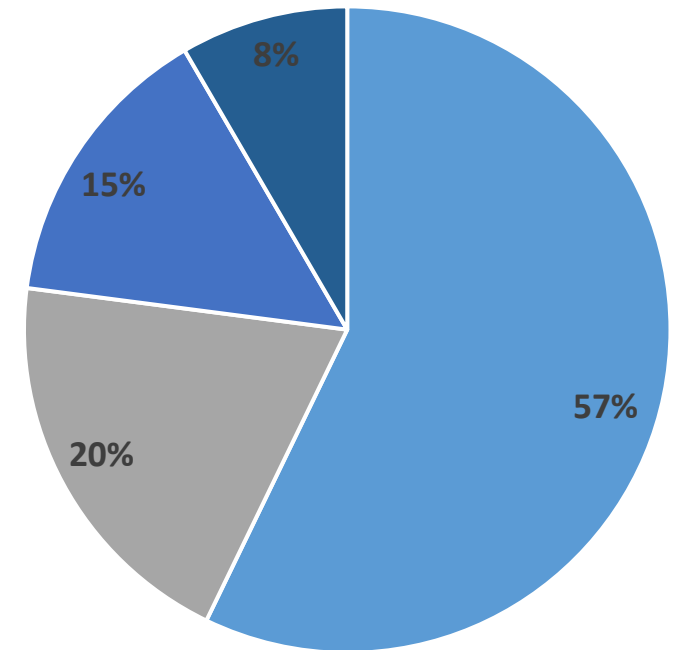
*Working capital cycle and inventory break up are representative of 6 listed companies



Financial Risk

- Overall, the Automotive Parts industry has historically been low leveraged and the average debt capital as a percentage of total capital decreased further to ~17% of total capital in FY21.
- Total borrowings of the industry stood at PKR~16,669mIn as at End-Sep'21 as compared to PKR~14,687mIn in Sep'20.
- Short term borrowings constitute the majority of total borrowings and stood at PKR~9,531mIn as at End-Sep'21. They comprise ~57% of total borrowings.
- Another major category is import financing which stood at PKR~2,425mIn and comprises ~15% of total borrowings.

Industry Borrowing Mix

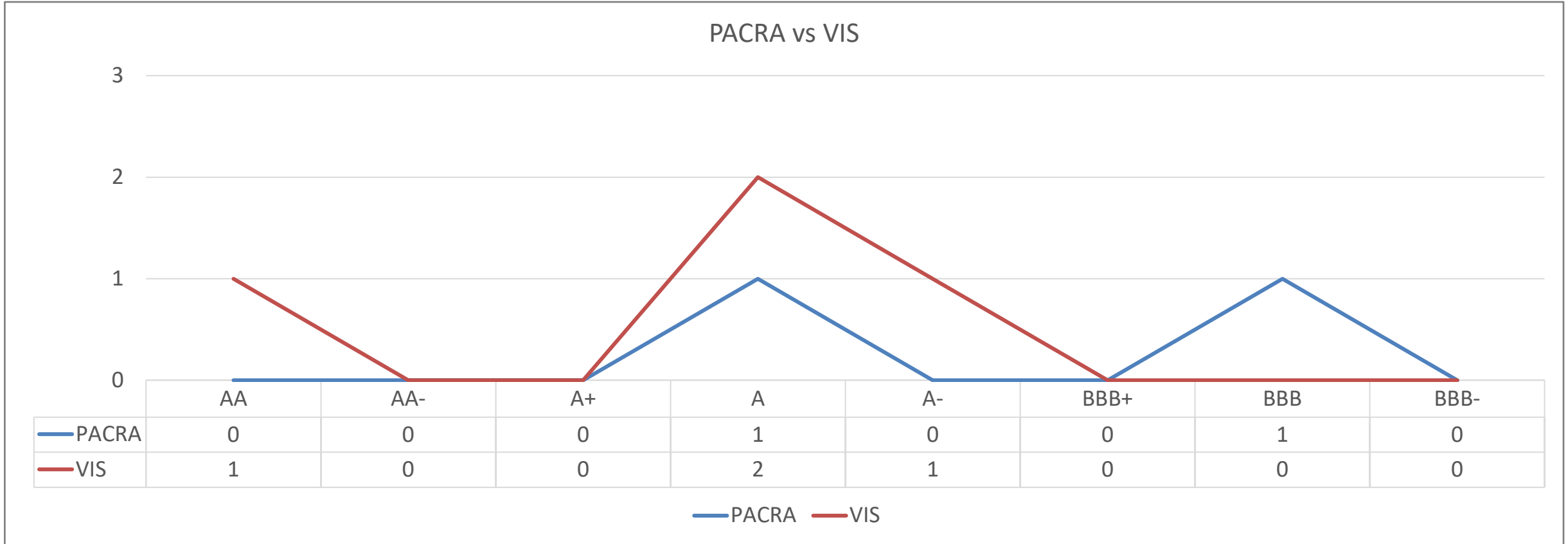


■ ST ■ LT ■ Import Financing ■ Others

*Average leveraging figure is representative of 6 listed companies

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.
- Tax reliefs in Budget 2020-21 to control automobile prices.
- Availability of low cost labor.
- Decreased interest rates and improved auto financing demand
- Strong industry association (PAAPAM) resulting in high lobbying power.

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



- Low localization resulting in higher import bills
- Decline in per capita income and thus reduced purchasing power of end consumers. This negatively impacts both OEM and Replacement markets.
- Supply chain issues such as raw material and cargo container shortages

- 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.
- Unutilized potential and untapped markets in the automobile sector

Outlook: Stable

- FY21 proved to be a recovery year for Automotive parts and accessories sector despite a difficult economic environment. However, the industry is expected to face challenges in maintaining this growth during the coming year because of hike in shipping and logistic costs, history of delays in shipments from China and Thailand and unstable exchange rate.
- Sales of locally manufactured cars hiked by 56.7% in FY21 and clocked in at 151,182 units. The sales of tractors grew by 54.9% where as the trucks and buses segment also witnessed an increase of 19.2% over the previous fiscal year. Similarly, the sales of two and three wheelers increased to 1,903,932 units, registering an increase of 39%. All these growing segments have been in favor of the Automotive parts Industry. Going forward, though, the growth momentum is expected to dilute due to the key prevalent risks, the overall Industry is expected to remain stable. The path of recovery would continue in the ongoing fiscal year on revival of economic activity and low interest rates led by introduction of new car models and showing up of the latent demand.
- The introduction of Auto Industry Development and Export Policy (AIDEP) 2021-26 is expected to strengthen the local automobile sector along with increasing the exports of auto accessories sector. The policy aims at providing high quality vehicles at lower costs.
- The industry still faces stiff competition from imported Automotive parts and localization levels remain relatively low. This is one of the key concerns hindering the development of domestic sector.
- Inflation, Interest rates and exchange rate stability are the key factors to gauge the growth and performance of the Sector in the days to come. While headline inflation is expected to rise, changes in Interest rates are expected to come gradual and informed. Meanwhile, exchange rate stability is vital for sustainable demand generation.

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