China: Automotive Industry

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Summary
China is set to become the world's second largest new automobile growth market by the end of 2006 and this growth is spurring demand for U.S. automotive parts, services, and aftercare products. The East China region in particular has tremendous opportunities as new car drivers become more sophisticated and demand better vehicle quality and better repair and maintenance service. U.S. exporters should be aware that while industry revenue is increasing, profit margins are slowly falling to international averages. Infringement of intellectual property remains a very serious issue.

Market Demand

China is set to become the world's second largest new automobile growth market, following the United States, as new vehicle sales have grown 40% to an expected USD seven million total by 2006-year end. As the total number of vehicles in China continues its double-digit growth, analysts expect China to become the number one growth market by 2015. Key factors for this growth include:

- A decrease in prices for vehicles and automotive parts due to increased competition and China's compliance with WTO regulations
- An increase in number of new vehicle models spurring consumer purchases
- A continued rise in income of Chinese consumers

The explosive growth of the OEM market has created a $149 billion market (2005) for the entire industry, as well as many opportunities for U.S. automotive parts and aftermarket suppliers, specifically in the areas of high-end automotive parts, service station equipment, and auto care chemicals.

However, even as automotive OEMs are seeing significant sales revenue growth for new vehicles, all tiers of the industry are also seeing falling profit margins because increased competition has driven vehicle prices down, while the constant influx of new models makes it difficult for OEM manufacturers to meet economies of scale. Profit margins have dropped from an industry average of 22% in 2001 to 5-6% in 2005 and are expected to fall to international averages of 2-3% in the next few years.

East China, which is comprised of the Shanghai municipality, Zhejiang Province, Jiangsu Province, and Anhui Province, plays a significant role in China's automotive industry because 44% of China's auto parts manufacturing revenue are generated in this area. As seen from the *Snapshot* on the right, East China is one of the wealthiest and fastest growing regions in China. In Shanghai alone, the city's GDP rose 13.6% for its 14th year of double-digit growth, and now has a per capita GDP of $6,200 for a population of 17.5 million people. This overall growth has helped spur private vehicle ownership and the automotive aftermarket in the region.

SNAPSHOT

East China and the Automotive Sector (2005)

Population:	**202 million**
	16% of total
GDP:	**25% of total**
Exports:	**37% of total**
Imports:	**34% of total**
FDI:	**45% of total**

East China Auto Parts Manufacturing Revenue

% of China total:	**44%**
% in Shanghai:	**21%**
% in Zhejiang:	**16%**
% in Jiangsu:	**7%**

Market Data

Automobiles manufactured in China are made predominantly for the domestic market, and only 3.4% (Aug. 06 figures) are sold for export. Imports into China only account for 2.5% of new vehicle sales. China's automotive industry is divided into regional markets; for example, East China manufacturers like Shanghai General Motors and Shanghai Volkswagen dominate car sales in this region.

The Chinese government is encouraging the growth of the automotive sector and in 2005 there were approximately 33 million civilian vehicles in China, which represents a 22.5% growth over 2004. By the end of 2006, there are expected to be approximately 40 million civilian vehicles in China, which would represent a 22% growth rate over last year.

Civil Vehicle Growth Rate 2003 to 2006 (est.) in China and East China Region

	2003	2004	% Growth '03-'04	2005	% Growth '04-'05	2006	% Growth '05-'06	2007 (est.)	% Growth '06-'07 (est.)
China (Total)	23.83	26.94	22.5%	33.00	21.2%	40.00	21.9%	47.53	21.9%
East China (Total)	3.93	4.76	21.2%	5.79	21.6%	7.04	21.6%	8.63	21.6%
Shanghai	0.72	0.84	16.7%	0.95	13.3%	1.08	13.3%	1.22	13.3%
Zhejiang	1.24	1.62	30.9%	2.11	30.0%	2.74	30.0%	3.57	30.0%
Jiangsu	1.32	1.61	22.3%	1.92	19.1%	2.29	19.1%	2.72	19.1%
Anhui	0.65	0.68	5.5%	0.81	17.9%	0.95	17.9%	1.12	17.9%

Source: China State Statistical Bureau, Statistical Yearbooks for China, Shanghai, Zhejiang, Jiangsu, and Anhui

The automotive market is primarily driven by the growth of China's passenger vehicle market, which accounts for 55% of China's privately owned vehicles. In the passenger vehicle market, the greatest area of growth will be for sub-compact to medium-sized models that demonstrate good fuel economy. These passenger vehicle owners are also the most promising target for aftermarket auto products and services.

East China's total number of civilian vehicles is 17.6% of China's total, which is lower than expected considering the region's economic strength. Strong growth in Zhejiang and Jiangsu provinces is counteracted by regulatory restrictions in Shanghai and poorer economic conditions in Anhui Province. The difference between Shanghai and Beijing is especially striking as Beijing has 2.55 million vehicles for a population of 15 million, while Shanghai has only 950,000 cars for 17.5 million people (2005 figures), despite Shanghai's higher per capita GDP. The difference is due to Shanghai being the only city in China to auction off license plates in order to control the number of new cars on the streets. The cost for a plate in Shanghai can run from $4,000 to $5,000, while the national average is a few hundred RMB (1 USD = 7.9 RMB). As a result, while Beijing has 10 to 11,000 new vehicles registered every month, Shanghai "only" has 5 to 6,000.

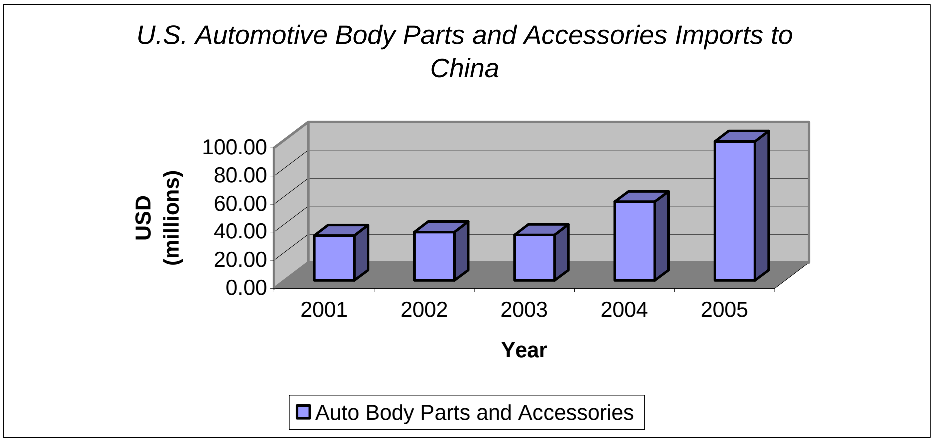
Best Prospects

The growth of the automotive vehicle market is driving the automotive parts, service facility, and automotive accessory product sub-sectors. A description of the opportunities for U.S. exporters in these sub-sectors appears below.

Automotive Parts

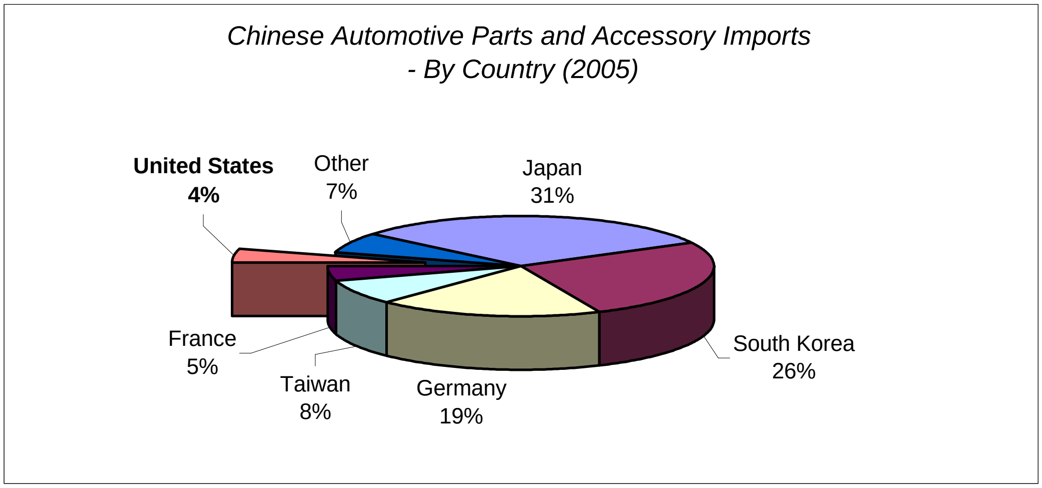
The automotive parts sector in China is highly fragmented, with 4447 automotive parts producers combining for 43.66 billion USD in revenue in 2005, a 4.5% rise over 2004. Total profits were $2.53 billion, or about 5.7% of total revenue. As a whole, revenue for the parts sector made up 29% of the entire industry.

Growth of the automobile industry has led to an increased demand for United States imported vehicle body parts and accessories (HS Code 870829). United States annual sales in this market have risen over 72% in each of the last two years (please see table below) after stagnant growth from 2001 to 2003, as seen on the following table.



Source: World Trade Atlas, 2006

This growth can be mainly attributed to WTO compliance and the boom in new vehicle sales.



Source: World Trade Atlas, 2006

The above table indicates U.S. imports to China compromises about four percent of China's total automotive parts and accessory imports. While American exports only account for a fraction of the total market share, they have increased by 1% over 2004 and as the Chinese automotive sector continues to expand, we expect to see growing opportunities for United States firms.

Presently, the strongest areas of U.S. auto parts sales include gearboxes, vehicle body parts, steering wheel related products, mounted brake linings, and other sophisticated components for car assembly. Future trends indicate a need for environmental-related products and testing equipment as Chinese cities begin to enact Euro III emissions standards, and fuel economy-related equipment as oil prices continue to rise.

<u>Service Facilities</u>
China's service market is expected to grow significantly as 70% of China's cars have less than 4 years of usage and demand for service facilities is highest between 4 to 9 years of usage. Overall, Chinese passenger vehicle owners are relatively uneducated about the service and maintenance requirements for

car ownership. One of the greatest challenges that American firms face when entering the Chinese automotive aftermarket is how to educate their customers in proper vehicle maintenance and care.

In East China, some of the fastest growing automotive facilities focus on oil change and general maintenance. According to the Chinese Ministry of Communication, there are nearly 300,000 maintenance and repair shops in China and these numbers are expected to grow 10-15% annually over the next few years. Among these various entities, 10% can provide a full range of heavy repair and maintenance services, 20% can provide routine maintenance services, while the majority can only provide quick-repair for certain items. This demonstrates the vast difference between maintenance facilities in China, which is often exacerbated by gaps in technology and industry know-how.

The expansion of quick-lube and oil change chains offer export opportunities for United States companies that supply products involved in these automotive services. Although some products will be sourced locally, export opportunities may exist for the following products: motor oil, filters, lubricants, fluids (transmissions, brake, power steering, windshield washer), batteries, and wiper blades.   Recently, major U.S. service companies like Valvoline and Jiffy Lube have entered the market, however, the present market leader is 3M, which, while not having any service operations in the U.S., is leveraging their strong brand reputation in China to successfully attract PRC customers.

Another provider of oil change services and general maintenance products are automotive original equipment manufacturers (OEM). OEM shops are expected to grow and take a larger portion of aftermarket sales in China as they expand their 3S and 4S model stations. 3S stations are involved in auto sales, parts and components supply, and repair and maintenance operations. 4S stations typically have spaces for car displays, maintenance workshops, warehouses, and staff-training centers.

With the increased variety and service selection of well-organized automotive oil change and maintenance facilities, it is estimated that local Chinese “mom and pop” style service shops will lose a significant part of the market by 2010. Speed-service chains, auto parts dealers, and OEM shops are expected to dominate the market by ensuring consistently high quality auto service and brand loyalty.

Additionally, service facilities are importing and increasingly large number of maintenance and repair equipment. According to a report by Auto Maintexpo China, half of all maintenance and repair equipment in China is imported from abroad, with some large and medium sized entities importing nearly 80% of their equipment from abroad. Untied States companies with exports involved with such service facilities should find increased opportunity in the Shanghai Consular region.

<u>Automotive Accessory Products</u>
The automotive aftermarket reached nearly $12 billion in revenue by the end of 2005 and is expected to reach $23 billion by 2010. Chinese consumers show strong interest in automotive outfitting and vehicle accessories, including products such as seatback video displays, neon lights, and leather upholstery.

For the aftercare market, Auto Maintexpo China reports that the greatest growth sectors for auto products exists in auto care chemicals such as lubricant additives, paint, car accessories, tires, and electrical and electronic parts. Of these, the following show strong opportunity for U.S. exporters:

1) Lubricant Additives: Imports of lubricant additives (including lubricant oils, wax, rust proofing, and paint coating) grew by nearly 10% through the course of 2005 and are projected to increase annually at nearly 9% until the year 2010. China will continue to be a large importer of such products in the future due to the increasingly large domestic automotive market and insufficient local supply. United States exporters of lubricant additives into the Chinese market should consider working with the expanding service facility market to supply and distribute their products.

2) Vehicle Paint: Demand for automotive vehicle paint in China is also on the rise. By 2010 it is expected that China will require 300,000 tons of vehicle paint with 220,000 tons being used for new vehicle

production and 80,000 used for makeovers and repair. There is also a large developing market for automotive repair coating.

3) Tire Testing Equipment: China's production of passenger and heavy-duty tires will reach 100 million by 2020. In the past few years, significant portions of highway accidents in China have been caused by tire blowouts, a result of general tire wear. To improve this standard, more advanced manufacturing and testing technology is needed on the mainland, which should present growing opportunity for United States companies in China.

4) China's automotive electronics products is another key sector as market value reached approximately $56 billion in 2005, up 21.9 percent from 2004. Both electronics products and testing equipment are opportunities for U.S. exporters.

Key Suppliers

The top five auto parts manufacturers in China have 20% of China's market share, while 40 of the top 100 Sino-foreign joint ventures have 30% of the market share. Wanxiang Group, based in Shanghai, is China's largest auto parts manufacturer with $3.19 billion in revenue.

Top Automotive Parts Suppliers in China

Rank in China	Chinese Companies	Province	Revenue in China (USD billion)
1	Wanxiang Group	Shanghai	$3.19
2	Weichai Power (Weifang Diesel)	Shandong	$2.14
3	Yuchai Machinery Guangxi	Guangxi	$1.54
4	Dongfeng Honda Automobile Co., Ltd.	Wuhan	$1.36
5	Torch Automotive Group	Hunan	$0.95

Of the top five automotive parts revenue generators in China, the highest ranked joint venture is Yanfeng-Visteon, which, if listed, would rank 5th on this list of Chinese companies, with revenue of $980 million in China in 2005.

Top Foreign Automotive Parts Suppliers in China

Rank	Foreign Companies	Country	Global Revenue (USD billion)
1	The Bosch Group	Germany	$48.56
2	Delphi Corporation	U.S.	$26.95
3	Denso Corporation	Japan	$26.20
4	Visteon Corporation	U.S.	$17.00

Prospective Buyers

Key OEMs in the East China region (out of approximately 37 nationally) are listed below with a short description of each one:

Automotive OEM leaders in the East China region

OEM Brand Name	Brand Rank in China	Brand Market Share in China (As of July 2006)
Volkswagen (VW)	1	16%
General Motors (GM)	2	11%
Chery Automotive	5	7%
Ford (Changan Ford Mazda)	13	3%
Nanjing Automotive (FIAT)	20	1%

Source: Automotive Resources Asia, July 2006

1) Shanghai Automotive Industry Co Ltd (SAIC) (http://www.saicgroup.com/saic01/fore/english/index.htm) is the largest automotive conglomerate in East China. SAIC has successful partnerships with major automotive firms like GM, VW, and Visteon. SAIC announced at the beginning of 2006 that they would begin manufacturing their own automobile brands. Their first test vehicle is expected soon.

2) Shanghai Volkswagen (SVW) (http://www.csvw.com/csvw/en/index.htm) is the oldest equity joint venture (50-50 split between VW and SAIC) in China and maintains a leading share of the market with its Santana, Polo, and Passat models.

3) Shanghai General Motors (SGM) (http://www.shanghaigm.com/www/html/index_en.html) is an equity joint venture with SAIC, also a 50-50 shareholding split, and is one of the market leaders for OEM sales in China. SGM's Buick line is considered one of China's premier high-end vehicle lines. SGM's headquarters and main assembly plant are located in Shanghai.

4) Chery Automobile (http://www.cheryglobal.com) has recently been in the news for its partnership with Malcolm Bricklin of Visionary Vehicles to bring high-end luxury Chinese vehicles to the U.S. market. Presently Chery is the largest Chinese brand in the market and its headquarters are located in Wuhu, Zhejiang.

5) Nanjing Automobile Group Corporation (NAC) (http://www.nanqi.com.cn/indexe.asp) represents the Italian brands of Iveco and Fiat, and just recently purchased the British brand MG Rover. NAC, historically, has focused on the heavy and light truck market, with 1.2 million sold over its history and 15% to the export market.

6) Ford China (www.ford.com.cn) is building a plant in Nanjing, Jiangsu. This large plant, expected to open in 2007, will operate under the moniker of Changan Ford Mazda Automobile Corp. The Nanjing plant will be Ford's second production operation, following its successful joint venture with Changan Automotive in Chongqing Municipality in Southwest China.

Market Entry

United States manufacturers and service providers looking to sell their products in the Chinese automotive market have three options:

1. Direct product distribution;
2. Establish a joint venture; or
3. Find a qualified agent or distributor with a vast sales network.

Before entering the market or choosing a Chinese partner, US companies are advised to conduct thorough market research and due diligence. Companies should also prepare a market entry strategy for managing and enforcing intellectual property rights. If deciding to distribute goods directly, companies should be aware of the problems with distribution rights and should work to understand the licensing process in China.

For many US small to medium sized companies, the best way to enter the Chinese market is through a reputable or well-known agent or distributor. These companies typically have large sales networks and are located regionally. They can help US clients gain a better understanding of the overall Chinese market and assist with distribution strategies for China's various markets and regions.

Another possible mode of entry into the Chinese automotive aftermarket is through OEM sales to Chinese automotive manufacturers. Through this channel US companies can enter the market by way of technical cooperation, licensing, or export with local auto parts manufacturers.

Market Issues & Obstacles

With final implementation of WTO obligations as of July 1, 2006, United States exporters of automotive aftermarket services, parts, and products have obtained greater access to the Chinese market. Automotive tariff levels, once at 80%, have already been reduced to 25%, while auto parts tariffs have been reduced to 10%.

China's WTO accession package also included legal stipulations governing distribution rights for foreign-invested enterprises in automobiles and related parts. These rights have given foreign companies authorization to distribute their products throughout China and have allowed them to sell imported products to wholesalers, retailers, and end-users on the mainland. China recently cleared a large backlog of distribution licenses and created a guide for businesses seeking to acquire distribution rights, helping ensure that US products can be freely distributed in China

A major obstacle for the automotive industry is intellectual property right infringement. The U.S. Embassy and Consulates in China have seen numerous cases of U.S. automotive companies having significant copyright/patent issues in China. Our offices have seen many trademark squatting and infringement cases as well. We highly recommend any company that is or plans on doing business in China, to immediately begin the patent/trademark registration process for their products and logos, as China doesn't recognize U.S. or international patents, copyrights, or trademarks. For detailed information on how to protect your interests, please visit the Beijing embassy's IPR Toolkit website: http://beijing.usembassy-china.org.cn/ipr.html

Trade Events

2006 China Auto Part & Component Supplier Convention
September 16-17, 2006
Suzhou High & New Int'l Auto Exhibition Center
http://www.cnssz.com/cnssz/xqyw/xwnews.asp?newsid=412

2006 Nanjing Intl. Auto Exhibition
September 29-October 4, 2006
Nanjing Int'l Exhibition Center
http://www.njae.net

2006 Formula 1 Sinopec Chinese Grand Prix
September 29-October 1, 2006
Shanghai International Circuit
http://www.icsh.sh.cn/english/node/node_9603.htm

Shanghai International Re-Fitting Auto Expo 2006
October 4-7, 2006
Shanghaimart Expo
www.rachina.org

Shanghai International Special-Purpose Vehicle and Parts Exhibition
October 28-30, 2006
Shanghai Automobile Exhibition Center
http://www.hyspv.com.cn

Auto China 2006
November 19-27, 2006
Beijing Int'l Exhibition Center & China Agricultural Exhibition Hall
http://www.auto-fairs.com

6th China Intl. Tire & Rubber Technology Exhibition
November 20-22, 2006
Shanghai Int'l Exhibition Center
http://www.tyresandrubbertech.com/

Automechanika Shanghai 2006
November 30-December 2, 2006
Shanghai New International Expo Center
http://www.automechanika.messefrankfurt.com/

Fourth China Automotive Roundtable
February 7-8, 2007
Shanghai, China
http://www.economistconferences.com/roundtable/public/con_common.asp?rtid=931&rtRegion=2&area=1

Auto Shanghai 2007, The 12th Shanghai International Automobile Industry Exhibition
April 22-28, 2007
Shanghai New International Expo Center
http://www.autoshanghai.com.cn/news_en.aspx

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TIMER-AUTO Consulting (Shanghai) Co., Ltd (China Auto Consulting Center)
Contact: Peter Li, Consultant Director/Partner
www.viewautonet or www.timeroute.com

Newspapers and Magazines:
Auto Intelligence (China Oriental Auto Publishing House)
www.oauto.com

Automotive News
http://www.autonews.com/apps/pbcs.dll/section?category=CHINA

China Business Update (CBU)
http://www.cbuauto.com

Shanghai Auto News
www.shautonews.com

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