Gearing up for spectacular growth

India's automobile component sector, which is attracting international auto majors, is all set to catapult into the big league, even as domestic players are eyeing international acquisitions.
A report by **Darrel Philip**

M&A players are falling over themselves to get a piece of the action. With India becoming a hot sourcing destination for global automobile biggies like Ford, General Motors, Suzuki, Honda and Fiat, domestic auto components manufacturers - wooed by a bevy of private equity investors - are making all out efforts to acquire a global profile through greater focus on exports and acquisitions.

The Indian automobile industry has been clocking an average growth rate of 10-12 per cent per annum. However, it is the less glamorous back-end sector to the automobile industry, the auto components sector that has been showing spectacular progress. Growing at 20 per cent per annum since 2000 it is projected to maintain the high-growth phase of 15-20 per cent till 2015. Production of auto components was estimated at $10 billion in 2005-06.

Till the 1990s, the domestic automobile industry was the main growth engine for this industry. However, global outsourcing and exports have emerged as significant drivers of growth, with demand emanating from global OEMs (original equipment manufacturers) and Tier I manufacturers.

The 24 per cent annual export growth of auto components (since 2000) if extrapolated to 2011 would result in the contribution of exports rising from $2 billion to $5 billion. A recent study by international consultancy McKinsey notes that exports of auto components from India could be in the region of $20-25 billion by 2015.

Although the growth rate is high, the Indian auto component market is representative of a typical emerging economy, with numerous players contributing to a highly entrepreneurial but fragmented production situation. While consolidation might happen over the long run, this might not be as easy as in other industries, due to the diverse nature of components, numbering about 20,000 in all, that contribute to the SKU (stock keeping unit) count for this industry.

Another 10,000 firms exist in the unorganised sector that operates in a tier-format. The firms in this segment operate in low technology products and cater to Tier I and Tier II suppliers and also serve the replacement market. Around four per cent of the companies operating in the auto component segment cater to 80 per cent of the demand emanating from OEMs.

Within the unorganised segment, apart from supplying in the aftermarket, a number of players are also involved in job work and contract manufacturing. While there are some mergers happening in the domestic industry these are anomalies rather than the norm. The key to competing in this industry is through specialisation by product-type and integrating operations across the related area of specialisation.

> Auto component manufacturers plan to invest about $1 billion on capacity expansion in the current year and most domestic companies are on an expansion mode

According to an auto analyst from a Mumbai based brokerage, average capex (capital expenditure) by domestic automotive component companies is estimated at about $449 million on an annual basis. Auto component manufacturers plan to invest about $1 billion on capacity expansion in the current year.

Even as foreign auto component majors have announced investment plans (Mico-Bosch will be investing $225 million), most domestic auto component companies are on an expansion mode, with majors such as Bharat Forge, Amtek Auto, Sona Koyo, Rico Auto, Goetze and Omax Autos charting extensive expansion plans. The fundamentals of the market are strong and India had in the last year seen the fastest increase in growth in passenger car production.

Domestic auto component makers are also investing huge sums. Bharat Forge invested $135 million in its Pune plant for increasing domestic capacity to 240,000 tons. Amtek Auto is expanding capacity of its castings unit to 70,000 tonnes per annum (tpa) from 30,000 tpa.

Sona Koyo plans to have capacity of three million pieces of manual steering gears, 500,000 units of hydraulic power steering and 250,000 units of electronic power steering (EPS), apart from doubling the capacity of steering columns from one million parts. Rico Auto is investing $23 million to expand capacity.

Indian component makers are ramping up capacity to keep pace with the sudden rush of new alliances and ventures – the Nissan-Mahindra-Renault, the Tata-Fiat alliance and Tata's Rs 1-lakh (about $2,500) car venture – being announced in the automobile industry. A huge demand for localised products by auto mak-

ZOOMING AHEAD: Global outsourcing and exports have emerged as significant drivers of growth for the auto components industry in India

ers to cut down on costs has led to a cramped order book position for the component industry.

Hemant Luthra, president, Mahindra Systems and Automotive Technologies (MSAT), the component arm of utility and tractor major Mahindra & Mahindra, points out that with firms like Nissan, Renault, Suzuki and Fiat stressing on stringent quality and sophisticated product technologies, design and development capabilities of Indian component makers are being carefully studied.

The Renault and Nissan alliance, which has set up a common buying company Renault-Nissan Purchasing Organisation (RNPO), has firmed up plans to source components and aggregates worth over $135 million from India in the next couple of years. A team is already in place at the Mahindra-Renault offices, scouting the market for potential suppliers for the mid-size car Logan, recently launched in the country.

It is simultaneously looking at RNPO's requirements. The move to kick start sourcing out of India comes from Renault group chairman Louis Schweitzer's belief that the country has the potential to emerge as a viable sourcing ground.

Likewise vendors will play an important role in the Tata small car project. About 300 acres have been earmarked for a cluster of component manufacturers and some of the top players in the business are interested in setting up shop here. The production model for the $2,500 car involves a feeder plant (which is Singur in Hooghly district, northwest of Kolkata) that will make the product and also supply CKD (completely knocked down) kits to several assembly locations across the country. Volumes are expected to be high and could touch a million units by 2010.

> As Indian auto component companies achieve higher scales of production and quality assurance, there would be an increased trend of inking acquisitions.

While low labour costs might have been the initial advantage cited for outsourcing production to India, the country's large pool of technically skilled workers and the industry's ability and willingness to move up the value chain to more complex and efficient production challenges will be the reason to stay over the medium to long term.

Indian auto component vendors (including Sona Koyo and Sundaram Fasteners) have achieved world-class quality certifications like QS-9000. Component majors like Amtek Auto, Bharat Forge, Sona Koyo and other domestic ancillary majors prefer to fall back on manufacturing and engineering systems in India even for their global acquisitions. However, front-end operations are retained in these markets to make inroads into existing global customers.

India's strength in exports has historically been in forgings, castings and plastics. Forging, casting, machining and foundry and other low volume components – where it's unprofitable to manufacture – are some of the operations being transferred to India.

Lower labour costs give Indian auto ancillary companies an absolute cost advantage. The value in sourcing auto components from India includes not only low labour cost but raw material availability, technically skilled manpower and quality assurance.

India's process-engineering skills, applied to re-designing of production processes, have enabled reduction in manufacturing costs of components.

ADVANTAGE INDIA: The low-cost manufacturing base in India helps meet targets while allowing for reasonable profits for the vendors

Just to put things in perspective, Auto Component Manufacturers Association (ACMA) numbers suggest that wage cost accounts for three per cent to 15 per cent of revenues for Indian manufacturers as compared to 20 – 40 per cent for US players.

The low-cost manufacturing base in India helps meet targets while allowing for reasonable profits for the vendors. Says Baba Kalyani, chairman and managing director, Bharat Forge, one of the largest auto component exporters in India and the second largest forging company in the world: “As more Indian auto component companies achieve higher scales of production and quality assurance, there would be an increased trend of inking acquisitions, particularly in the European region. This gives access to advanced technology, ready markets and global client base.”

Kalyani believes his acquisition in 2004 of the German operations of Carl Dan Peddinghaus GmbH (now renamed as CDP Bharat Forge GmbH), would strengthen Bharat Forge’s position in the global passenger car and chassis component business and help it attain global leadership.

“All global acquisitions may not follow this rule, it’s on a case-to-case basis,” says Kalyani. “We did this for one of the acquisitions, as we had the capacity, and production cost was lower here.”

Surinder Kapur, chairman, Sona Koyo, adds that the trend of overseas acquisition would only be strengthened further in the coming years.

In fact, if Amtek Auto decides to buy some business of the bankrupt US company Delphi, and if there is a substantial savings, it will shift the production lines back to India as labour cost is far cheaper here. “A technical team is doing the evaluation and we will consider the replacement cost,” notes an Amtek official in Delhi.

Top auto component manufacturers have already bagged 16 acquisitions in the last three years, mainly in Europe and North America, gaining entry into these key markets. Surprisingly, Indian companies have not shied away from making investments in China, considered one of the main competitors in this industry.

Examples include Sundaram Fasteners’ Greenfield facility in Zhejiang, Bharat Forge’s joint venture with the Chinese automotive major FAW Corporation and PMP Components.

Private equity investors such as Texco, the Pacific group, Carlyle, Blackstone and 3i are interested in picking up stakes in India’s booming auto component industry. Sources indicate that negotiations are going on between the private equity investors and Krishna Maruti, Amtek Auto, Motherson Sumi and other domestic component majors.

Ashok Kapur, chairman and managing director of Delhi-based Krishna Maruti, says this is a healthy sign and demonstrates the confidence in the Indian automotive component manufacturing industry. While most of these private equity investors are willing to invest, they need an exit option in two years.

“All of us need to expand, so funding by these private equity investors is essential for certain companies,” says Kapur of Sona Koyo. Investments into the sector have been growing at 14 per cent annually and touched $4.4 billion in 2005-06. The Investment Commission has set a target of attracting foreign investment worth $5 billion over the next five years, and to increase India’s share in the global auto component market from the present 0.4 per cent to 3 – 4 per cent. The global auto component industry is estimated at $1.2 trillion.

Global auto giants like Ford, General Motors, Suzuki and Toyota have already set up base in India to source auto components. Currently Indian OEMs source nearly 70-80 per cent of the global players’ component requirements and this is only set to rise say industry experts. With the entry of more international giants like Nissan-Renault, Volkswagen, Skoda, Volvo and BMW, the future of the Indian auto component industry seems assured.