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# **China's Automotive Market The US Perspective**

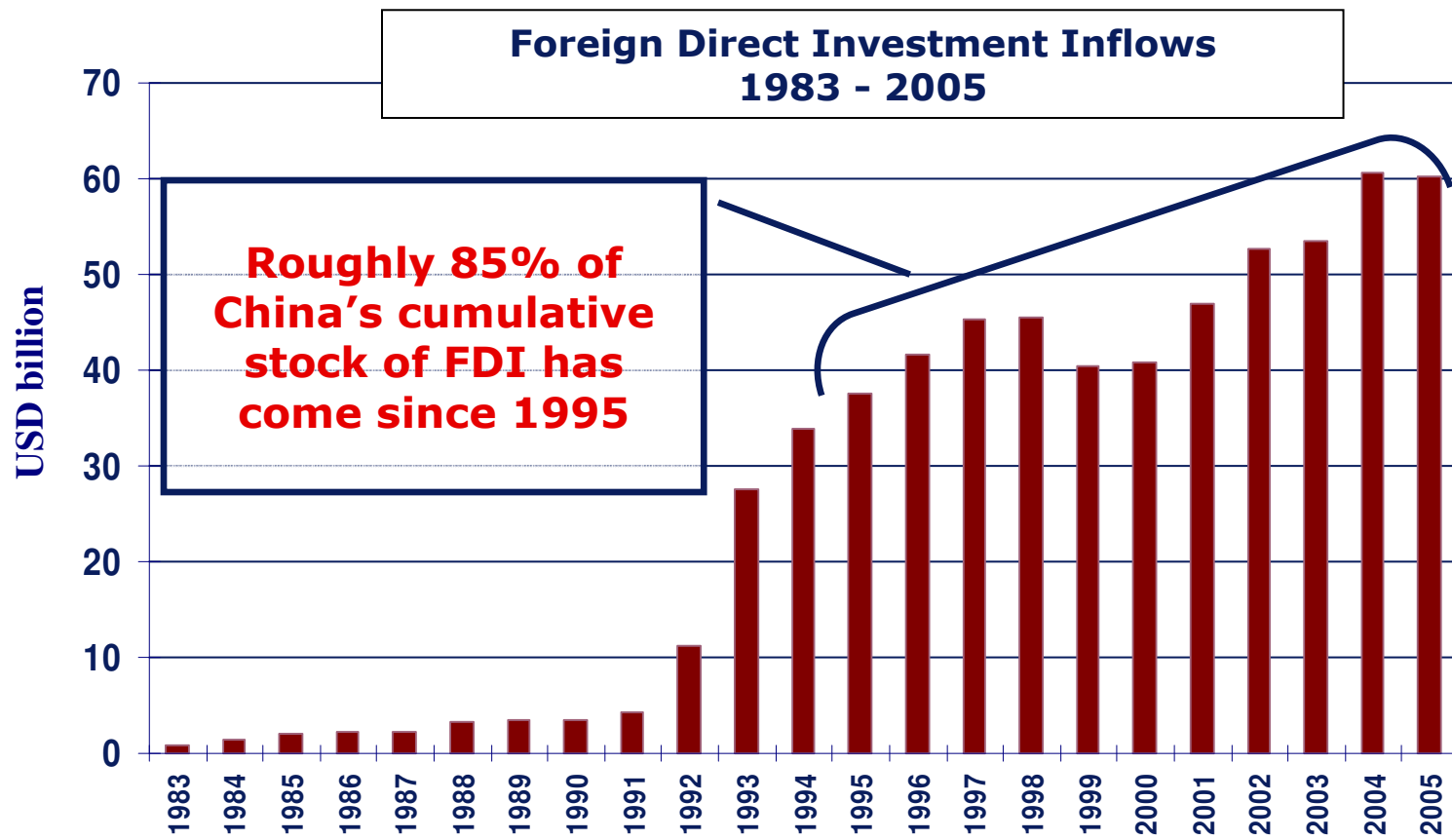
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**DCBA 2006 China Forum  
April 5, 2006**

**Audit . Tax . Consulting . Financial Advisory.**

# US Foreign Direct Investment in China

- China has attracted more than US\$615 billion in FDI since 1978
- US companies account for US\$51 billion, flowing in at the rate of approx. US\$4b a year since 2000



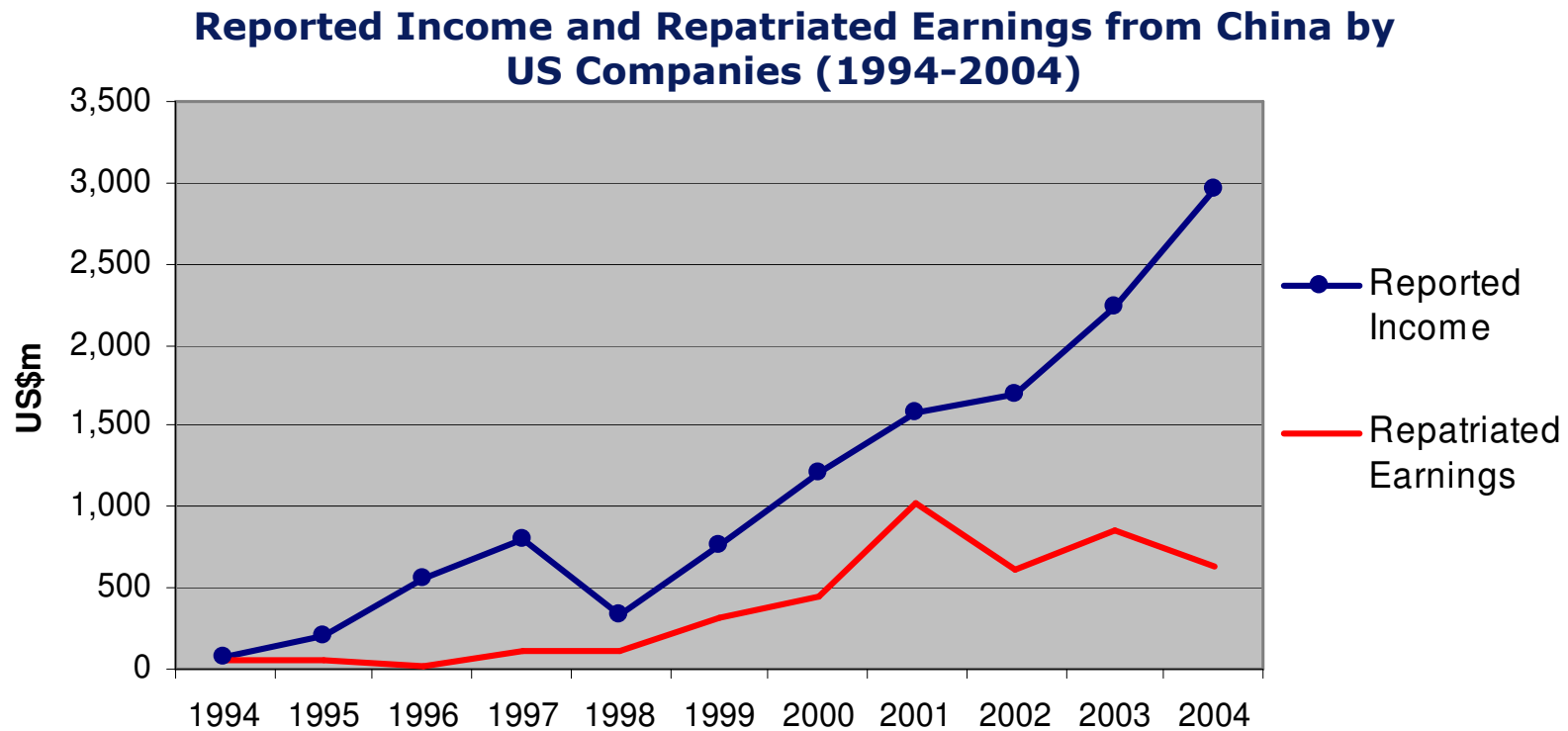
# US Companies – Leveraging Opportunity in China

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- 2005 US-China Business Council survey of member performance found that:
  - 67% of respondents' China revenues increased in 2004 and 68% expect further increases in 2005
  - 44% achieved profitability rates in excess of their global rates and 22% achieved profitability in line with global rates
  - 94% of respondents were optimistic about their China operations over the next five years
- 2005 American Chamber of Commerce in China survey of member performance found that:
  - 86% of responding companies reported higher revenues in 2004 than 2003
  - 68% reported being "profitable" or "very profitable" in 2004
  - 30% reported profit margins in China exceeding worldwide margins in 2004, slightly down from previous two years, largely due to "changes in market and commodity prices"

# US Corporate Income from China

- Between 1994-2004, US companies reported income of US\$12.4 billion from their operations in China (US Bureau of Economic Analysis)\*
  - Of this amount, 66% had been reinvested and 34% repatriated
  - Cumulative US direct investment in China stood at US\$48 billion at the end of 2004
- In 2004 alone, US companies reported income of US\$2.95 billion
  - Of this amount, 78% was reinvested and 22% repatriated



Sources: US Bureau of Economic Analysis  
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\* Income = US parents' returns on capital deployed in China, excluding royalties and license fees

# 10 Questions Your Board May Ask in the Year of the Dog

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Anything is possible.

Ten Questions Your Board Might Ask in the Year of the Dog



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## Notable Developments in the Year of the Rooster

### Investing in China

The world's largest express transportation company reached agreement in 2005 to buy out its Chinese partner.

In late 2005, the world's top shipmaker opened its second plant in Chengde, over 1,000 miles west of China's thriving coast; total investment exceeds US\$450 million.

A Fortune 500 company announced that 99% of the R&D for its latest medical imaging system for the global market was conducted in China.

### Sourcing from China

In 2005, the largest global retailer increased its sourcing from China to US\$22 billion, a 20% rise over 2004.

A global automotive firm announced plans to raise its China sourcing from US\$1.5 billion in 2005 to US\$10 billion by 2010.

### Selling to China

With 20% growth in China sales last year, a leading consumer products company announced plans to invest a further US\$1 billion to introduce new products.

The world's largest tire producer, long a manufacturer in China, opened the first of hundreds of planned storefronts to serve the replacement market.

By late 2005, nineteen overseas financial institutions had invested a combined US\$16.5 billion in sixteen Chinese banks.

### Competing with China

In 2005, China's largest PC company completed its US\$1.75 billion acquisition of one of the most recognized brands in the global IT sector.

In China's largest private equity (PE) deal yet (US\$375 million), a US PE group effected the first foreign buy-out of a major state-owned enterprise.

## Ten Questions Your Board Might Ask in the Year of the Dog

### Investing in China

Have we re-examined our business model and strategy in China to keep pace with the rapidly changing business and regulatory environment?

Are we taking advantage of the lower costs, more favorable government policies and fast-growing markets of China's interior?

Are we ready to move from a "Made in China" to a "Designed in China" strategy, particularly from a risk management standpoint?

### Sourcing from China

Do we have the right strategy and infrastructure to optimize and if need be, rapidly scale up our sourcing from China?

Have we adjusted our sourcing goals in China to take into account the increasing availability and variety of high-quality products?

### Selling to China

Are we fine-tuning our products, brands and distribution channels to target the increasingly segmented markets in China?

Now that China has extended full trading and distribution rights to foreign investors, are we thoroughly exploiting the potential?

Have we begun to assess how the full opening of China's financial services sector at the end of 2006 will impact our markets and operations in China?

### Competing with China

Are we preparing to compete with Chinese companies for market share, talent and capital - not just in their market but on a global basis?

Can we leverage PE investment to compete more effectively with Chinese companies?

2005 2006

成事在謀  
跋山涉水

Nothing is easy.

For more information, please contact Clarissa Kwan, National Managing Partner, US Chinese Services Group, Deloitte & Touche LLP at 212.406.4732 or ccg@deloitte.com

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# Investing in China

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## Developments in the Year of the Rooster

China's first *majority* foreign-owned auto JV began exporting cars to Europe in June 2005

## Question Your Board Might Ask in the Year of the Dog

Have we re-examined our business model and strategy in China to keep pace with the rapidly changing business and regulatory environment?



- **New regulations covering everything from auto financing to emission standards are opening new opportunities for investment**
- **China is seeking to consolidate its fragmented industries, including its 4,129 auto part, 128 vehicle and 49 engine manufacturers**
- **Increased transparency in M&A regulations helped spur US\$22.6 billion in inbound deals last year, including almost two dozen in the auto sector**

# Investing in China

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## Developments in the Year of the Rooster

A major US manufacturer announced plans to diversify its product line at its JV facility in Chongqing

## Question Your Board Might Ask in the Year of the Dog

Are we taking advantage of the lower costs, more favorable government policies and fast-growing markets of China's interior?



- **The government has pledged US\$90 billion to build roads, rail and waterways in China's interior through 2007**
- **Government incentives to invest in the West allow a 15% tax reduction for the first three years after any existing tax break ends**
- **Urban manufacturing salaries in the West are at least 1/3 less than the coast**

# Investing in China

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## Developments in the Year of the Rooster

In July 2005, the world's second largest auto parts supplier opened a US\$50m R&D center in Shanghai – first phase plans include 450 researchers

## Question Your Board Might Ask in the Year of the Dog

Are we ready to move from a "Made in China" to a "Designed in China" strategy, particularly from a risk management standpoint?



- **China is graduating almost 350,000 engineers annually – more than any other country in the world and nearly six times the US**
- **Since the late 1990s, MNCs have invested over US\$4 billion into some 750 R&D centers**
- **The government offers substantial incentives, including tax breaks, for foreign investment in R&D**

# Sourcing from China

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## Developments in the Year of the Rooster

A global automotive firm announced plans to raise its China sourcing from US\$1.5 billion in 2005 to US\$10 billion by 2010

## Question Your Board Might Ask in the Year of the Dog

Do we have the right strategy and infrastructure to optimize and if need be, rapidly scale up our sourcing from China?



- **As of December 2005, China's logistics market is now fully open to foreign investment**
- **The third-party-logistics market in China is growing at 30% per year**
- **China's logistics zones (ie. Waigaoqiao) offer substantial trade and customs advantages to foreign investors**

# Sourcing from China

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## Developments in the Year of the Rooster

In 2004, a global automotive company began importing 2.4-liter V6 engines from China for one of its US-produced sport utility vehicles

## Question Your Board Might Ask in the Year of the Dog

Have we adjusted our sourcing goals in China to take into account the increasing availability and variety of high-quality products?



- **In the 1970s, China's leading exports were unwrought alloys and animal bristles – by 2004, they were electrical machinery and power generation equipment**
- **In 2005, China overtook the US as the world's largest exporter of information and communications-technology goods**
- **China's chip-design industry grew almost fivefold between 2000-2005**

# Selling to China

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## Developments in the Year of the Rooster

With no new models and steep declines in China sales in 2004-05, a global auto company announced plans to introduce 12 new models in China by 2009

## Question Your Board Might Ask in the Year of the Dog

Are we fine-tuning our products, brands and distribution channels to target the increasingly segmented markets in China?



- **China's urban middle class is estimated at 175-200 million strong**
- **55-60% of China's 27.5m registered vehicles are now privately-owned, up from less than 1% in 1995**
- **Private car buyers are creating a much more complex and fragmented marketplace**

# Selling to China

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## Developments in the Year of the Rooster

The world's largest tire producer, long a manufacturer in China, opened the first of hundreds of planned storefronts to serve the replacement market

## Question Your Board Might Ask in the Year of the Dog

Now that China has extended full trading and distribution rights to foreign investors, are we thoroughly exploiting the potential?



- **As of December 2004, foreign companies are permitted to engage in wholesale and retail business without geographic or ownership restrictions**
- **Foreign-invested manufacturers have acquired similar rights, provided that earnings from distribution remain below 50% of total revenues**

# Selling to China

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## Developments in the Year of the Rooster

By late 2005, nineteen overseas financial institutions had invested a combined US\$16.5 billion in sixteen Chinese banks

## Question Your Board Might Ask in the Year of the Dog

Have we begun to assess how the full opening of China's financial services sector at the end of 2006 will impact our markets and operations in China?



- **China's domestic savings rate is estimated at 50%; once mobilized, this capital will have far-reaching effects**
- **Companies competing against loss-making SOEs with access to easy credit will be the real winners**

# Competing with China

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## Developments in the Year of the Rooster

The Chinese government expects 1 million vehicles to be exported by 2010 – virtually every Chinese carmaker has plans to sell, if not manufacture, abroad

## Question Your Board Might Ask in the Year of the Dog

Do we have a strategy for facing our China competitors in their own marketplace before they bring the competition to ours?



- **China became a net auto exporter in 2005**
- **While most auto exports are to developing countries, two of China's most famous domestic auto makers plan US market entry by 2008**

# Competing with China

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## Developments in the Year of the Rooster

To staff its new R&D center, a Chinese auto company hired 400 researchers in 2005, including former executives of global competitors

## Question Your Board Might Ask in the Year of the Dog

Are we sure we understand the full scope of China's challenge to our business?



- **Following the Hong Kong IPO of China's third largest automaker in 2005, five others have announced their intention to list overseas in 2006**
- **Whether you choose to be in China or not, the influence of China will be keenly felt in the global industry**

# Chinese Services Group - Your Connection to China

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