

# Facing current uncertainty and embracing the future

## PwC China Consulting

The normal operation of the automotive industry has been challenged and affected by the epidemic, especially on consumer demand, followed closely by marketing, operation and supply chain. Many OEMs, dealer's group and parts suppliers have taken a number of steps to ensure the bottom line. The crisis has prompted many practitioners and managers in the industry to re-examine and plan for the medium-and long-term development of auto industry, accelerating industry transformation and upgrade.

In this article, the PwC Automotive Team will analyze the epidemic from three perspectives: short-term challenge, current initiative focus and long-term development, hoping to give some inspirational idea to the practitioners in the industry.

### Section I: Short-term challenge

PwC believe the short-term challenge of the outbreak to the auto industry are mainly reflected in four areas:

#### 1. Sluggish customer demand

Affected by the outbreak, overall customer confidence is weak. New car sales are expected to fall sharply in the short-term, but may return to last year's level in spring and summer hopefully. Combined with multi-agency researches and trend of the outbreak, the impact on the new car sale is likely to exceed expectations, and full-year sales are expected to decline by about 6%~13%.



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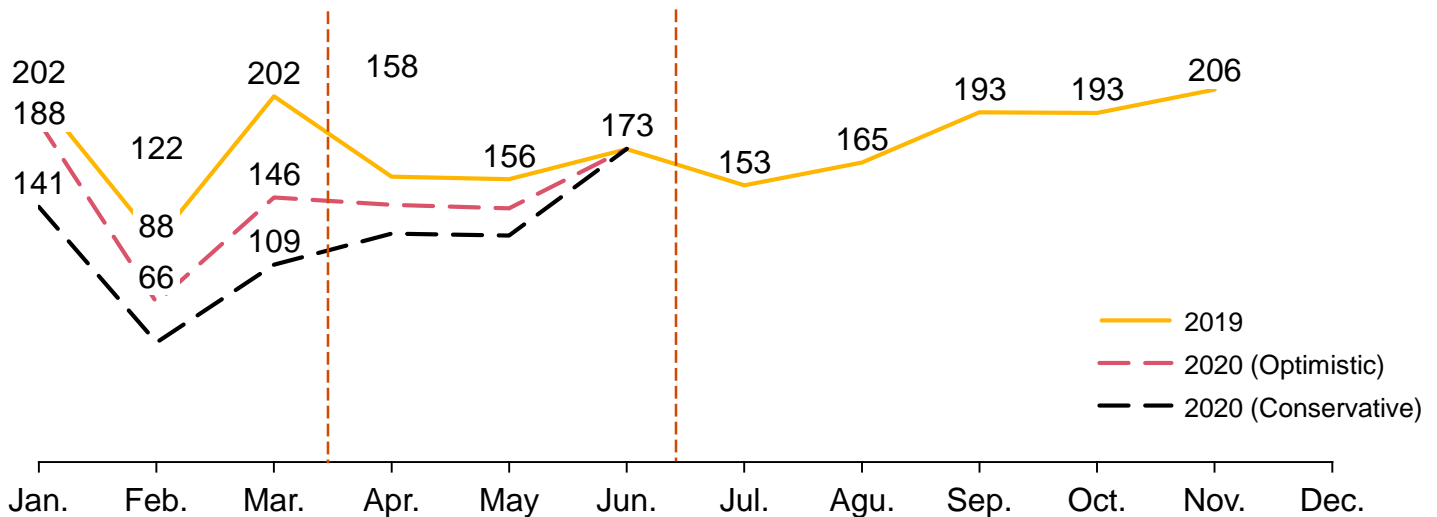
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## 2020 China Vehicle Sales Forecast

Hypnosis:

(10,000 units)

- Optimistic:80% ( 2020 Q1 vs. 2019 Q1) 90% (2020 Q2 vs. 2019 Q2)
- Conservative:60% ( 2020 Q1 vs. 2019 Q1) 80% (2020 Q2 vs. 2019 Q2)
- Get back into the same level after 2020 June



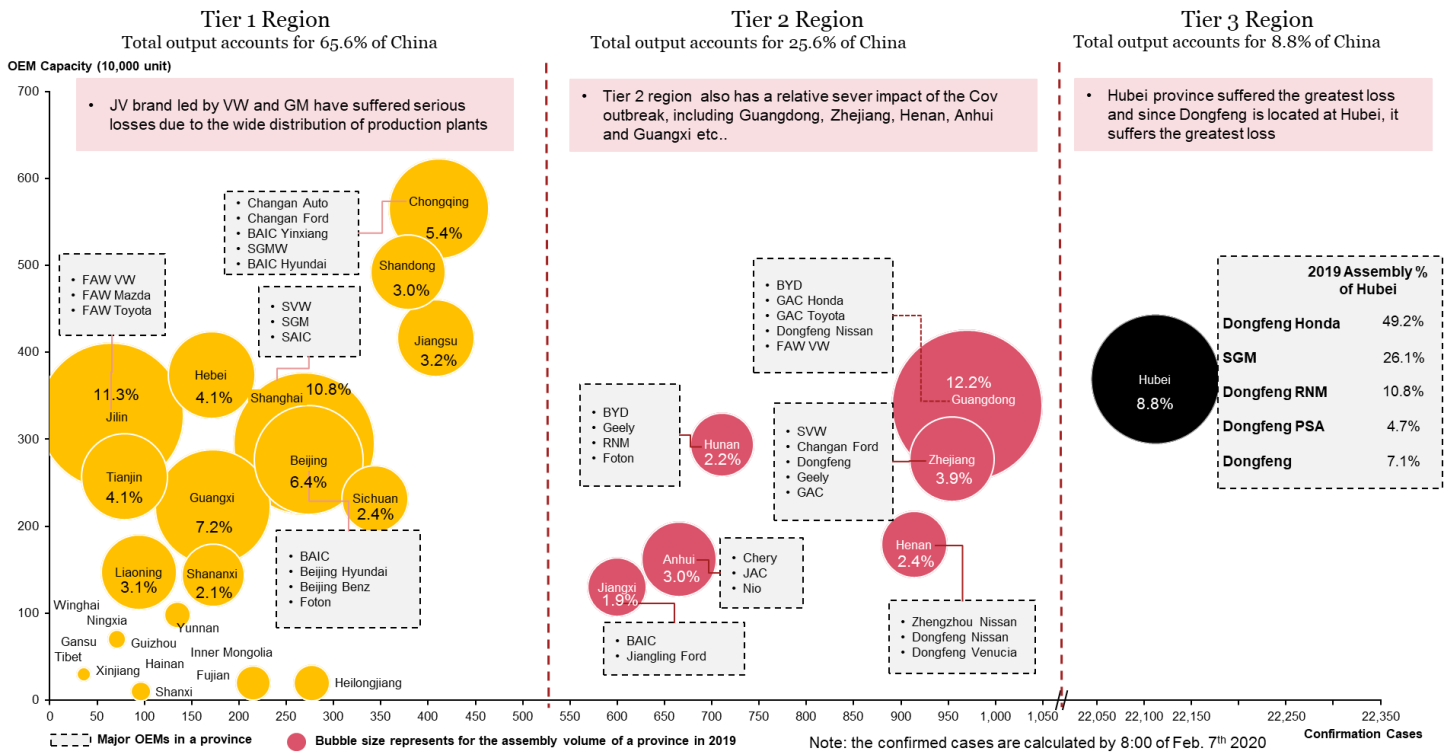
Three points to explain the projection:

- 1) Most of the car purchase demand will not disappear because of the epidemic, but it will lead to the postponement of purchase behavior, some to Q2~Q4 and some might to 2021.
- 2) The epidemic might stimulate the demand for first-purchase opportunity, but the precise demand remain unknown.
- 3) The epidemic has greatest impact on service industry and dispensable income for a number of industry, thus lead to shrinking purchase power.

## 2. Disrupted supply chain

Both OEMs and auto parts suppliers are facing the challenge. Based on number of confirmed affected patients, different provinces can be divided into three regions:

**1) Affected Region:** Hubei has been deeply affected and the production volume accounted for 8.8% of the country's output in 2019. Outbreak has the greatest impact on OEMs that located in this region. Region II provinces including Guangzhou, Zhejiang, Jiangsu, Anhui and Henan should be affected as well.



Source: CAAM, PwC Autofacts, IHS Markit, Strategy& analysis

**2) Supply of auto parts is also affected by the epidemic.** In China about 40% of the production plants and R&D centers of world's top 10 suppliers are in the affected regions. Due to the high degree of integration and interdependence of upstream and downstream value chain, replacement of suppliers is not practical, and the impact on upstream enterprise will gradually transmit downward. A number of domestic and foreign OEMs have announced that they have been forced to postpone or stop production due to the shortage of parts supply.

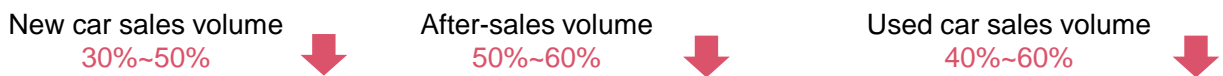
Region	Province	# of BU	Bosch	Denso	Magna	Continental	ZF	Aisin	Hyundai Mobis	Faurecia	Valeo	Lear
Tier 1	Hubei	20	1	1	1	2	1	0	0	10	4	Has
	Guangdong	41	1	8	2	0	0	11	0	7	12	Has
	Zhejiang	18	2	1	3	2	4	4	0	2	0	Has
Tier 2	Jiangsu	40	7	5	4	4	1	5	3	6	5	Has
	Anhui	8	2	1	1	0	1	2	0	0	1	Has
	Hunan	6	1	0	3	0	0	0	0	1	1	0
	Henan	2	0	0	0	0	1	0	0	1	0	0
Tier 3	Others		16	21	19	19	27	17	8	46	28	Has
<b>Total</b>			<b>30</b>	<b>37</b>	<b>33</b>	<b>27</b>	<b>35</b>	<b>39</b>	<b>11</b>	<b>73</b>	<b>51</b>	
<b>Tier 1 &amp; 2 BU # Proportion of China</b>			<b>47%</b>	<b>43%</b>	<b>42%</b>	<b>30%</b>	<b>23%</b>	<b>56%</b>	<b>27%</b>	<b>37%</b>	<b>45%</b>	<b>No data</b>

### 3. Huge cash flow pressure on both upstream and downstream

**1) Revenue decline, expenditure as usual:** Under that impact of the epidemic, dealers not only face the decline in sales, but also to face high fixed costs and operating costs of next quarter. In the situation that OEMs' rebate payment lags behind, most of the dealers will have to face capital risks. It has been estimated that the average funding gap for luxury brand dealers in the first quarter was about 6 million to 8 million yuan, and the funding gap of the mass consumer brand was about 3 million to 5 million yuan. Dealers are advised to reserve about 3 months of working capital to ensure normal operation during the outbreak. Recent research results show that less than 30% of dealers have enough fund to operate functionally and rest of dealers can only maintain normal operation for less than 3 months.

#### 2020 Q1 Dealer's operational cash flow may drop heavily

**Due to the impact of COVID-19, business revenue and profit of dealers are expected to drop heavily in 2020 Q1**



#### 2020 Q1 4S store average cash flow forecast (unit: RMB )

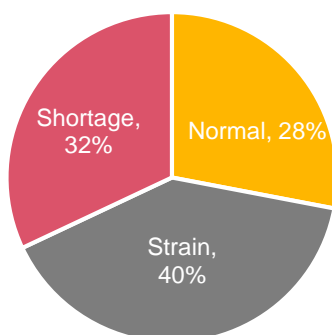
##### Luxury Brand Dealer



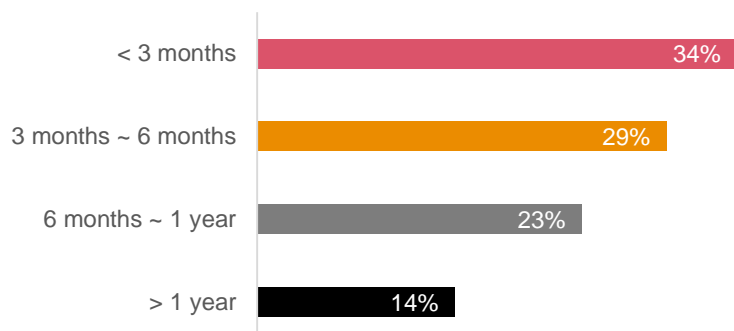
##### Volume Brand Dealer



Cash Flow Performance



Cash Flow Duration



Source: Wind, desktop research, Strategy& analysis

**2) Inventory depth impact:** Based on the inventory depth and sales forecasts, on average, dealers can only support first quarter sales. From the perspective of car models, certain models in certain regions may face supply shortage and bestselling models will face bigger pressure until resuming normal operation.

## 4. Suspended offline marketing activities

Most of offline marketing activities have been cancelled due to the outbreak. OEMs and dealers will face huge operation pressure in the short-term.

**1) Impact on new launch plan:** If the outbreak continues, OEMs have to postpone the new product launching date, and may also report additional losses due to the discontinues of operation.

**2) Suspended offline promotion activities and after-sales services:** During the spread of the epidemic, all kinds of offline promotion activities were temporarily closed. And due to the shutdown of cities, after-sale service may delayed as well.

## Section II: Current initiatives focus

To tackle these challenges, we will provide recommendations from following perspectives: first-purchase opportunity, online marketing and digital management, dealer management and innovative after-sale service, supply chain risk management and ecosystem support.

### 1. Seize the first-purchase opportunity

The outbreak not only bring a short-term crisis, but also bring potential new car purchase opportunities. The key is to response market demand quickly and stimulate customers buying desire when the epidemic has just dispersed and consumer sentiment and memories have not faded.

**1) The proportion of first-time buyers will be higher than originally predicted:**

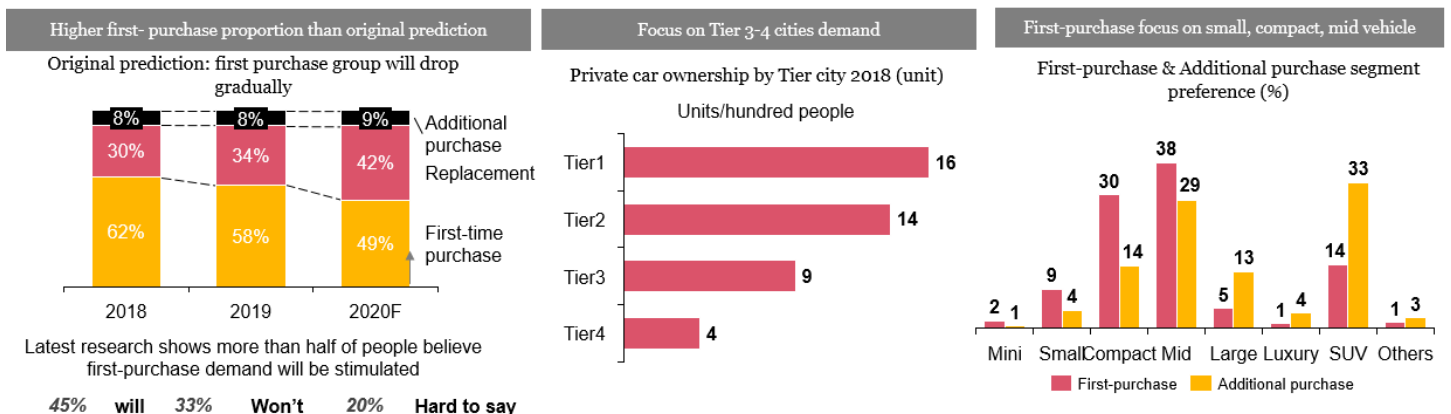
According to the Economic Observers and Sina Automobile research statistics, 55% of the respondents have travel inconvenience in the area where they lived, and 46% of them were due to lack of means of public transportation. That implies, 84.6% of respondents believe that it is necessary to purchase a private car after the epidemic.

## 2) Develop marketing strategy to address consumers' current emotions:

- On one hand, a lot of consumers have experienced inconvenience in the epidemic due to lack of private vehicle. Those who decide to commute via public transportation and ride-sharing may reconsider their decisions.
- On another hand, consumers may compensate the depression via irrational purchase behaviors.

**3) Focus on third and fourth-tier cities' demand:** 3rd and 4th tier cities still show high potential based on low rate of private car ownership compared to tier 1 and tier 2 cities.

**4) Focus on compact model:** First vehicle buyers are more likely to buy relatively compact models than upgraded models. OEMs and dealers should focus sales on compact.



Source: Economic Observers and Sina Automobile research, CADA, iResearch, Strategy& analysis

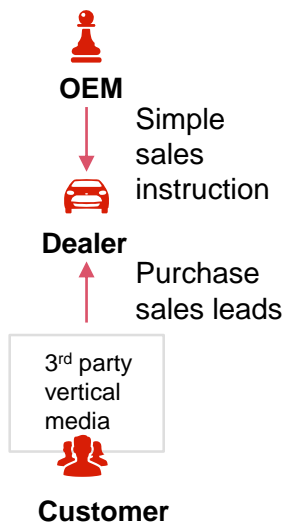
## 2. Promote online marketing and digital management

OEM and dealers could promote more new channels of online marketing and increase the conversion rate via active engage with potential customers.

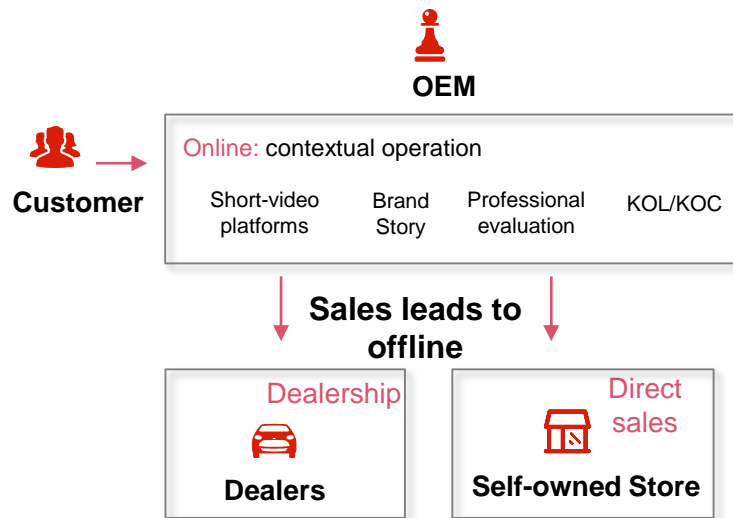
OEM should have a clear understanding of clear role of effort on digital marketing: unlike digital trend of consumer goods, offline experience in auto industry still remain critical to potential buyers to complete the transactions. The role of new media is to cultivate customers interest and lay a solid foundation for branding, and try to convert potential sales leads to dealers to improve the conversion rate.

Mobile video streams is new channel to attract young generations. Classic third party vertical media has become less cost-effective in obtaining and converting sales leads. Along with the development of mobile internet, short-video platforms gain its popularity and users traffic has rapidly migrated to these platform. OEMs might take this opportunity to build their own content operation capabilities and obtain more higher-quality sales leads through the new channel.

Traditional sales leads gathering



OEM promotion generates sales leads



Source: Strategy& analysis

### 3. Strengthen the support and management of dealers during the outbreak and introduce innovative after-sales service

OEMs and dealers can promote work from home, sort out inventory resources and optimize cash flow management, and launch innovative cleaning and disinfection services to provide customers with a more hygienic and safe ride environment.

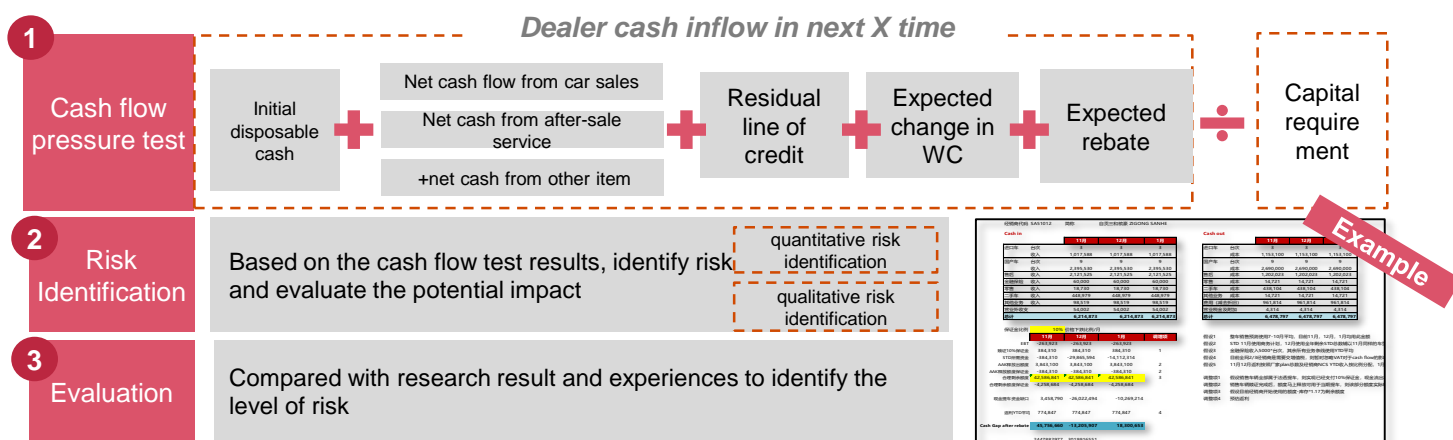
**1) Increase and support online office:** Through the digital platform, real-time online communication, to provide remote support and after-sales service.

**2) Sort out inventory resource:** Due to the different degree of impact in various regions, sales recovery and supply recovery time might be different. OEMs and dealer group should pay attention to real-time inventory in different regions. Meantime, matching the potential customer sales leads, forecasting sales in the real time basis and finally improve service quality.

**3) Increase financial support and subsidy incentive policy:** OEMs can give dealers certain financial support and incentive policies, such as flexible payment policy, adjust the account period. Dealers could reduce unnecessary capital expenditure and make timely risk assessment by reducing capital expenditure, giving priority to short-term maturing liabilities and forecasting cash flow through stress test.

**4) Strengthen cash flow forecast:** OEMs should conduct cash flow stress testing, including quantitative and qualitative risk identification and industry research results, comprehensive assess the risk of dealers. OEMs could provide certain supportive policy to dealers who have huge cash flow pressure. In terms of rebate policies, OEMs could accelerate the rate of rebate payment and even pre-pay partial rebates. In addition, OEMs could actively leading communication with financial institutions on financial policy, helping dealers to obtain favorable financing terms. Besides, dealers can also look for private capital investment and other ways to help themselves out of troubles.

### Cash flow forecast method



Source: Strategy& analysis

**5) Launch innovative cleaning service:** For private car users, dealers can provide professional disinfection service and safe after-sales service. For ride-hailing, company could provide cleaning and disinfection tools to driver and require drivers to clean up vehicle after ride. The goal is to reduce the probability of spread of the virus.



## 4. Enhance the construction of supplier risk prevention system and build ecosystem to resist risk together

**1) Supplier risk assessment and prevention:** Establish multi-dimension early risk warning mechanism and excess capacity to prevent sudden shutdown of production caused by nature disaster. The moderate excess capacity may help to against risks and cut inventory. The newly added excess capacity should be located in other areas to prevent the force majeure risks in the same area.

**2) Build ecosystem to resist risk:** Upstream and downstream enterprises can form interest alliances and enhance their ability to resist risks through the construction of ecosphere. In times of crisis, the ability to resist risks is formed by helping each other in the ecosystem. For example, during the epidemic, an OEM used the industrial fund to take 10 initiatives to help its partners, including setting up a special fund pool, providing short-term cash flow, providing deferred repayment services and insurance protection programs, and so on.

## Section III: Long-term development

Although the outbreak of the epidemic has brought certain impact and challenges to China's automobile industry in the short term, it has also provides an opportunity to rethink the whole industrial chain in order to accelerate the transformation of industry.

### 1. Enhance innovative product features and build up health + vehicle ecosystem

**1) Launch innovative product:** Both private cars and ride-hailing will have higher cleanliness standards for car usages. OEM will incorporate healthy product concepts at the product definition stage.

**2) Accelerate vehicle-based health ecosystem:** OEMs may start to develop the concept of “car + health”, from small but warm-hearted designs to 5G-based intelligent connected service. Various market participants will accelerate the creation of active health care assistant from different dimensions and expand the application scene of the car.

## 2. Promote multi-circumstance applications

The demand of automobile as an expandable mobile space is accelerated, which will drive the car to go beyond the mobility function and realize the service function of flexible moving space in the future. OEMs can work with leading technology companies to innovate on car extension functions. In an epidemic scenario, the car can be transformed into a space for emergency diagnose and medical treatment, and can be used as a leisure space in normal times. For example, One of the Japanese OEM has introduced the concept of format change, which can flexibly change the form according to the demand. Applications including making online medical appointments, transporting tool in community, etc. and it also can perform online face-to-face consultation with doctors, effectively isolate patients and reduce cross-infection during transportation.

## 3. Enhance data management skill and realize last mile application

**1) Enhance data management capability:** During the epidemic, a lot of offline research cannot be carried out and OEMs need to rethink the direct touch point with consumers going forward. One way is to enhance data collect and analyze capability in the future.

**2) Bridge the digital connection between auto industry and authorities.** Online promotion and application cannot be separated from the actual implementation. And actual implementation has to depend on the digitalization of government's management system. Leading OEMs and automobile industry associations should promote the digital process construction of relevant government departments.

## 4. Accelerate the R&D of autonomous driving technology

During the epidemic, self-driving robots and logistics cars played an important role in isolating people. Many well-known hospitals have introduced robots to deliver meals and supplies to patients in the quarantine area, blocking the transmission chain of the virus.

To conclude, we recommend OEMs and suppliers pay close attention to both the market demand and supply, take positive measures to overcome the difficulties, help the whole industry recover as soon as possible, and make a contribution for China's economy to get out of the shadow of the epidemic.