

## **Japanese automotive suppliers get ahead of European competitors**

In its annual study "Automotive Benchmarking 2007", Droege & Comp. investigated the TOP 100 automotive suppliers worldwide. A cross-regional analysis was made with the major result that Japan-based companies have been able to extend their global lead while European companies have not been able to advance and North American companies had to suffer severe setbacks.

The study was based on public available data and annual reports for the fiscal years 2002 to 2006 on the one hand and a written survey with regard to qualitative aspects on the other hand. For Europe, 43 companies were in scope in comparison to 34 for North America and 23 for Asia (all of them are based in Japan). Effects of fluctuations in exchange rates were eliminated by the use of consistent conversion rates at the end of each respective year. Having collected and aggregated the data, a set of internationally accepted performance ratios was applied and thus the authors put themselves in a position to legitimately evaluate every company in scope and identify major differences in performance.

Oliver Weirauch, Managing Partner and Head of the Automotive Practice at Droege & Comp., highlights eight significant conclusions of the investigation:

First, sales are still growing considerably. Although the TOP 100 automotive suppliers could not keep up with the pace of 10.5% CAGR identified in the 2005 study, the current growth rate of 7.7% is significantly above other industries and most OEMs. A major reason is the increased tendency of OEM to outsource production as well as research and development capacities and projects to system suppliers.

Second, a high level profitability was once again more important than capital expenditures. For 2006, the average capital expenditure ratio was down to 4.6% in comparison to 5.8% for 2005. For the whole period of time investigated, the annualized increase is only 2.4% and thus well below sales growth.

Third, earnings are increasingly under pressure. The global EBT average for 2006 amounted to 2.2% only, clearly below the 2005 average of 6%. A comparison of the TOP 25 automotive suppliers with their customers leads to the conclusion that despite the heavy decline, the profitability level of the suppliers is at 8.6% considerably higher than the respective weighted average of the OEMs at roughly 3%. A look at the regional figures reveals that only the Japanese companies show a slight EBT increase of 0.1% based on their ratio of 5.4% for the year before. Both European companies (reduction of 5.6% to 3.5%) and in particular North American companies (reduction of 7.1% to -1.4%) had to report reductions of earnings.

Fourth, and corresponding to the shrinking earnings, return on capital employed is on an unsatisfactory level. On average, the TOP 100 achieved a ROCE of 3.3%, that is considerably short of the requirements of the capital market. Regarding the other figures investigated, the Japanese companies lead the group with 10.4%, leaving the European companies (8.3%) clearly behind. The average ratio of -6.3% for the North American suppliers is a reflection of the endangered state of their operations. Besides, current total equity ratios continue to be above the level of 5 years ago. Thus, the average for the TOP 50 is a convenient 49.3%, while even the TOP 100 is able to display equity of 26.8%.

Fifth, the heterogeneity of the field is increasing. In addition to the above mentioned regional differences, one is able to identify distinct performance clusters. As an example, the EBT ratio of the TOP 25 automotive suppliers did in fact decline from 11% to 8.6%. In comparison to the overall group, the distance has nevertheless increased from 5% to 6.4% as the TOP 100 moved from 6% to 2.2% on average.

Sixth, working capital management is one of the few areas where North American companies could improve in 2006. Their respective average of 38 days is significantly better than the 2005 average of 53 days. Both the Asian suppliers (49 to 58 days) and the European companies (38 to 78 days) had to report major room for improvement. Characteristically, the best European automotive supplier (18 days) within the scope of the study is not able to reach the average of the TOP 25 global suppliers (17 days).

Seventh, the major reasons for the significant sales growth of the analyzed time frame according to the responding companies were product innovation and development of fast growing economies (FGE). Reflecting the instable state of big parts of the industry, the importance of M&A-activities has grown in comparison to formerly conducted studies.

Eighth, the most important levers aiming at improvement of operating results are site optimization and relocation and supply-chain-optimization. Furthermore, other options such as Low Cost Country R&D as well as Lean Administration Concepts are accentuated. Companies intend to investigate all areas of SG&A and significantly reduce relating costs. "For 2008, beside value engineering and procurement initiatives, we expect projects to optimize the organizational setup as well as efforts to reduce SG&A to be the performance drivers of the industry. Our customers have to focus on profitable growth and that includes e. g. working capital optimization programs" concludes expert O. Weirauch.

**CONCLUSION:** Key players of the global automotive supplier industry need to cope with major challenges for the next years. An intensive pressure to produce successful innovations, as well as apparent consolidation tendencies present additional financing burdens, whilst the operational situation will remain tight. The North American companies as a group appear to be in a serious condition and only few examples can currently present a sound balance sheet. The high number of companies operating under Chapter 11 will presumably not decline in the near future and reorganization efforts will have to remain on top of the agenda. Looking at other areas of the globe, the Asians currently excel in most categories and operate on a long-term basis. As these companies are leading the European companies in most important categories and continue to focus on sound financials and high capex rates, their global competitors are facing troubled times ahead.