

# VIS

Credit Rating Company Limited

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## AUTOMOBILE INDUSTRY RISK ANALYSIS

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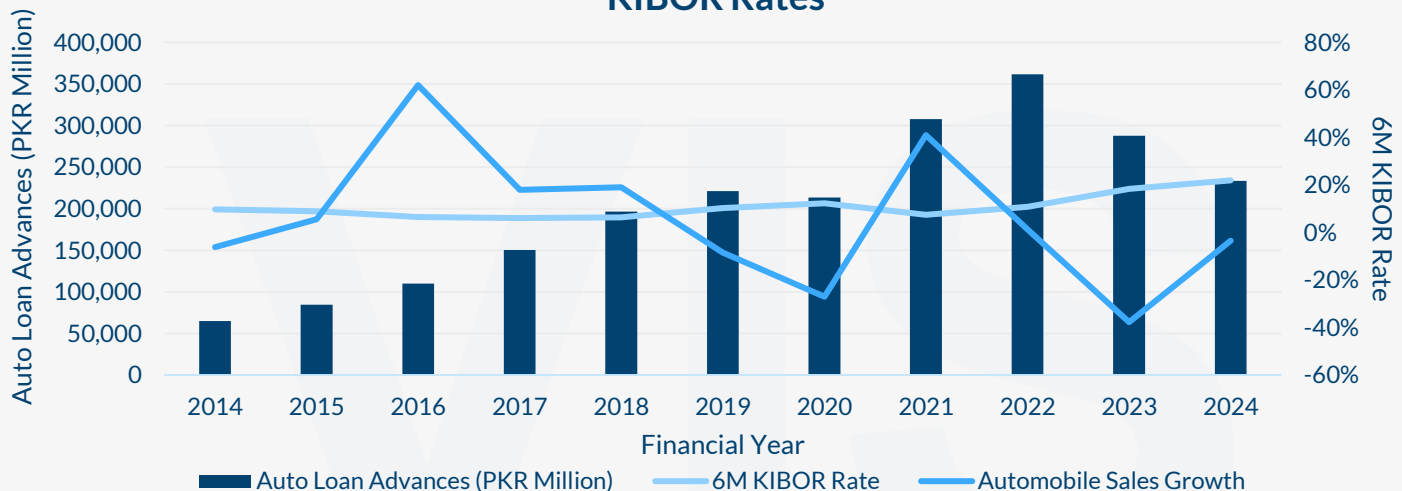
Assessment of industry risk is an essential part of the credit rating process. The industry risk assessment sets the ceiling for ratings of individual entities within a given industry. It focuses on the degree of cyclicity and the strength of competitive forces along with the extent of capital intensity, vulnerability to technological change, level of regulatory interference and energy sensitivity. All these factors are assessed on a scale ranging from High to Low to assign an overall risk level to each industry. Industry risk categorization for different industries is available on our website under Sector Updates “Industry Risk Analysis” (<https://docs.vis.com.pk/docs/Industryrisk062021.pdf>).

This report analyses the risks faced by the automobile industry considering the current state of the Pakistani economy and the policies adopted by the government to support the industry.

## OVERVIEW OF AUTOMOBILE INDUSTRY FOR FY 2024

In FY23, the automobile sector faced severe challenges due to import restrictions imposed by the State Bank of Pakistan (SBP) and the Government of Pakistan (GoP). Restrictions on Completely Built Units (CBUs) and Completely Knocked Down (CKD) kit imports led to unavailability of imported cars and limited raw materials for local assemblers, causing a contraction in vehicle production and sales. The industry reported a decline of 38% during FY23. In FY24, although import restrictions eased, other economic challenges persisted, including reduced demand due to weakened purchasing power amid heightened inflation. Additionally, auto-financing was adversely affected by tightened monetary policy. As per the latest data released by the central bank, auto financing stood at Rs. 233.6b in March 2024, a drop of 25% from Rs. 312.3b in March 2023. Consequently, car sales continued to report negative growth of 15.7% during FY24. However, overall automobile industry witnessed a negative growth of 3% mainly due increase in sales of tractors during FY24.

### Correlation between Auto Loan Advances, Auto Sales Growth & KIBOR Rates



Source: PAMA, VIS Database  
 Note: The auto loan advance for 2024 is up to March.

## COMPETITION

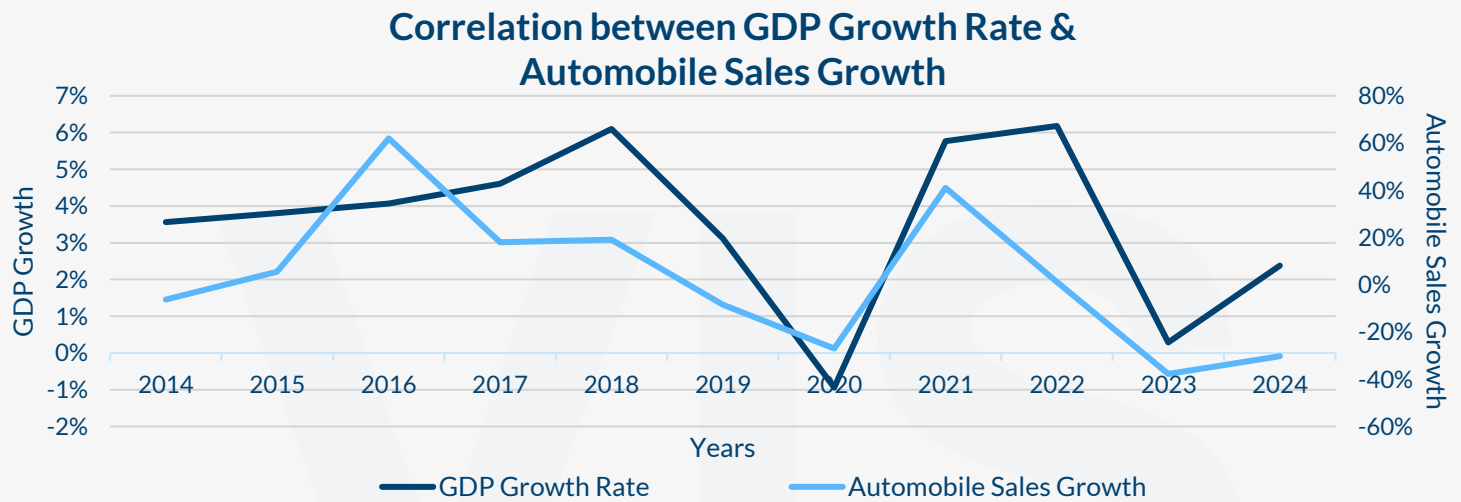
Competition in the automotive sector has increased with new entrants such as KIA gaining market share and Chinese manufacturers establishing their presence in recent years. Despite this, Japanese manufacturers continue to dominate

the market due to consumer preference for established brands. The reduced purchasing power of consumers has shifted competition primarily to the premium segment, with manufacturers introducing new cars in the Compact SUV and sedan segments. Additionally, new hybrid vehicles have been launched targeting the upper-middle and upper-class groups. The industry also faces competition from imported vehicles, which often offer enhanced features and superior build quality compared to locally assembled vehicles. Imported vehicle sales reported sharp recovery during FY24 as import restrictions eased off. To counteract increased competition, some companies have cut down prices of their products mainly in the premium segment.

## INDUSTRY RISK FACTORS

### CYCLICALITY

The automobile industry exhibits inherent cyclical nature, with consumer spending typically increasing during periods of economic growth due to improved employment rates and incomes, leading to higher consumer confidence and vehicle purchases. Conversely, during economic downturns, vehicle sales tend to decrease. This is evident by the performance of the industry in FY23 and FY24. The situation in FY23 was exacerbated by foreign exchange reserve shortages and resultant import restrictions that confined production and sales. However, FY24 remained subdued as economic activity was constrained by tightened monetary and fiscal policies adopted by the government amid high inflation, though decreasing lately. This resulted in slowdown of the economy and contracted the purchasing power of the consumer. The overall contribution of the automobile sector to the GDP is minimal, however, the movement of the automobile sales growth is almost in congruence with the movement of the GDP growth rate as illustrated in the graph below.



### BARRIERS TO ENTRY

The automobile industry is dominated by a few key players namely, Pak Suzuki, Indus Motor and Honda Atlas. Under the previous Auto Development Policy (ADP) 2016-2021, Kia, Hyundai, Changan, Peugeot, BAIC, MG, DFSK and Proton entered the market with various local partners. Recently, Sazgar Engineering expanded its portfolio by adding the Haval brand alongside its existing BAIC brand and added another Chinese option into the market.

With the rise in preference for imported used cars as indicated by the recent trends, new companies will find it challenging to acquire a significant market share. As a result, the risk of barriers to entry is low.

## SUBSTITUTES

The substitution risk for conventional vehicles remains low as Hybrid Electric Vehicles (HEVs) and Electric Vehicles (EVs), the primary alternatives, face challenges in market penetration. Despite government incentives for the introduction and production of electric vehicles, adoption rates remain low due to high prices and an underdeveloped infrastructure and supply chain landscape. This situation is expected to gradually change as more vehicles are introduced and the necessary infrastructure and supply chain develop.

## GROWTH TREND

The risk in growth trends is low as the motorization rate in FY23 was 18.9 vehicles (excluding 2-3 wheelers, taxis, buses and trucks) per 1,000 individuals. The population of Pakistan is young, as 62.58m individuals are aged 15-29 with the urban population growing at 3.65%, higher than the rural population growth at 1.90%. The higher urbanization rate indicates the future growth of the industry as these individuals will seek to purchase vehicles soon, leading to an increase in sales.

## CAPITAL INTENSITY

The automobile industry is fundamentally capital intensive and considered high as it requires considerable CAPEX to even begin operations. Much of the parts still used for car assembly in Pakistan are imported, and the industry suffers from low localization levels, resulting in higher car prices and burden on the country's trade balance. This is mainly due to the high capital requirement of import technology required for localization. Furthermore, new entrants to compete against the current players of the industry would need to invest in marketing and advertisement to form a brand identity yet provide their vehicles at a price point affordable for the Pakistani population.

## TECHNOLOGICAL RISK

One of the objectives of the Auto Industry Development & Export Policy (AIDEP) 2021-2026 is to promote new technologies specifically, HEVs and EVs. Local manufacturers namely, Indus Motor and Sazgar Engineering Works have introduced locally assembled HEV models, Toyota's Corolla Cross HEV and Sazgar's Haval H6, Jolion and Tank 500 HEV.

Furthermore, 34 licenses have been granted to manufacturers under the EV policy 2020-2025 though the adoption of EVs will be challenging due to a lack of infrastructure available. A critical component of EVs is lithium which is imported creating a supply chain risk as international demand is on the rise which can cause availability issues.

As a result, technological risk has been assigned as medium, as the industry is exploring new technologies and is moving towards product innovation.

### REGULATORY FRAMEWORK

**Imports:** the recent budget 2024-2025 has brought some changes to support the local industry and reduce reliance on imports. Regulatory duty has been increased for imported vehicles as seen below:

Engine Capacity	Regulatory Duty on Petrol Cars	
	2023-2024	2024-2025
0-1300 cc	-	-
1300 - 1800 cc	-	15%
Above 1800 cc	70%	70-90%

The increase is in response to the increase in imported used vehicles. Furthermore, custom duty concessions previously provided to HEV CBUs have been withdrawn to support the local production. This change may encourage consumers to opt for locally manufactured/assembled vehicles as imports will be relatively expensive.

**Local:** locally there have been changes in tax implications. Previously, a fixed tax was being charged for vehicles with up to 2000 cc engine capacity while for vehicles with an engine capacity of above 2000 cc, tax was being charged based on the value of the vehicle. Now, tax on all vehicles is being charged based on their value.

The regulations aim at protecting the local industry. However, due to the inconsistent import policies over the past few years, the regulatory risk has been assigned as medium.

### ENERGY SENSITIVITY

The different energy resources used by the automobile industry are primarily electricity, diesel and gas with electricity being supplied through the national grid and diesel along with gas required for backup generators.

In addition, companies have been focusing on establishing solar power energy to reduce their reliability on the national grid, decrease carbon footprint and to cut down on their operational costs. Therefore, the overall risk of energy sensitivity is assigned as medium.

The automobile industry risk after assessing the risk factors has been assigned as medium.

Automobile									
Cyclicity	Competition				Capital Intensity	Technology Risk	Regulatory Framework	Energy Sensitivity	Overall Industry Risk
	Risk of barriers to entry	Risk of substitutes	Risk in growth trends	Overall					
High	Low	Low	Low	Low	High	Medium	Medium	Medium	Medium

Table 1: Summary of Industry Risk Factors

### RESEARCH & PUBLICATIONS

Madiha Mohammad Ilyas – Research Analyst

madiha.ilyas@vis.com.pk