

Most automotive suppliers performed well and remain optimistic.
Almost half of respondents expect their revenue to grow.

Automotive Suppliers Survey

Slovakia, 2013



PwC in co-operation with the Automotive Industry Association of the SR (ZAP) surveyed the current situation, key factors and the outlook for the coming years in the car suppliers industry in Slovakia.





Dear Friends and Business Partners



Jens Hörning
Automotive Industry Leader
PwC Slovakia

PwC has been carrying out the Global CEO Survey for 16 years and every year it is officially presented at the World Economic Forum in Davos. In the 2013 edition of the Survey, we asked CEOs which countries they consider most important for their overall growth prospects. It is not surprising that five of the CEOs' top ten choices are growth markets (BRIC and Indonesia), and five are mature economies which are too big to ignore (US, Japan, Germany, Canada and the UK).

What about growth prospects for Slovakia? We conducted the 2013 Slovakia CEO Survey in cooperation with the Slovak edition of Forbes magazine, and 180 top representatives of companies operating in the Slovak market participated in the survey. Growth prospects are highly dependent on global economic conditions and since Slovakia is dependent on exports, we have to look at the markets that Slovak companies are serving. This year's survey shows that the longer the crisis period lasts, the less optimistic are CEOs' expectations in general.

However, when analysing the results a little bit deeper, it can be seen that automotive companies in Slovakia belonged to the category of relative winners in 2012. And also that prospects for the automotive industry are, compared to other sectors, more optimistic and this applies to both car manufacturers and suppliers.

This report from the Slovak Automotive Suppliers Survey you hold in your hands is the first to have been carried out. The results were presented during a press conference in April 2013 and had great resonance in the media and press. Automotive suppliers are the backbone of the Slovak automotive industry and the results present a good overview of the key issues and priorities of Slovak suppliers. There is one issue, however, to which I would like to draw particular attention; it appears to be clear that innovation will be key for future success.



Ing. Jaroslav Holeček
President
Automotive Industry Association of the Slovak Republic

In April 2012, our Automotive Industry Association adopted a new vision and strategy aimed at ensuring the competitiveness and long-term sustainability of the automotive industry in Slovakia. The strategy mainly follows on the need for change in technical education at secondary schools and universities, the improvement in the effectiveness of cooperation with universities in educating skilled professionals for the segment and, last but not least, our wish to help our suppliers become higher level suppliers to the car producers in Slovakia and other countries. Our strategic objective is to be actively engaged in preparing environmental legislation so that, together with the car producers and their representatives, we will be able to ensure that up to 95% of end-of-life vehicles can be recycled or reused by 2015 in accordance with the EU Directive.

Within our R&D activities, we have defined the requirements for applied research that need to be optimized and innovated in the areas of materials, development of technologies, production and logistics. People are also key for us and therefore, we have to initiate sociological research which has not been in place in previous years. This includes issues like staff fluctuation, absence from work, people's health, as well as remuneration, etc. In all these areas, we work with the ministries, the Slovak Academy of Science and universities, and we seek to make applied research a priority for the industry. Our aim is to establish an applied research and development organization similar to the Fraunhofer Institute, which would be partially financed by the government in the way it is in Germany.

The automotive industry is built on good foundations, and conditions for it to be successful are favorable, too. Within their groups, Volkswagen, KIA and PSA will continue striving for the leading positions and so they will fill their production lines with innovative or new products. Producing vehicles for the global market, as well as having an all-size portfolio, is a competitive advantage of car manufacturers during the crisis period.

Main responses of the Survey

According to the Survey, most suppliers performed well – and this corresponds with the higher production volumes of the Slovak based OEMs. Besides that, they focused on productivity and cost reductions. The key questions of our Survey, however, look to the future. Are Slovak automotive suppliers well positioned in Central Europe to win new projects, to respond to rapidly changing trends and to compete on cost? At the same time, can the Slovak economy offer enough skilled labour, educational reforms and support for R&D? Although the general view of respondents is positive for 2013 as well as in the mid-term future, major challenges are whether Slovak production capacities for supplies to growing markets are sustainable in the long-term, and what competitive advantages must be developed and maintained locally to continue production in a stagnating European market.



The Slovak automotive suppliers' market continues to be a highly dependent industry segment, and this dependency was a good thing for business in 2012 – the segment continues to benefit from supplies to customers in Western Europe, but more importantly enjoys the growing demand of Slovak, Hungarian and Czech based car manufacturers. The former represents a basis for their mid-term stability in the market, the latter resulted in enormous growth for most suppliers in 2012. Our Survey analyses sources of growth in the past year, and shows the expectation for the future.

Peter Mrnka, Director
Automotive Industry Specialist

Record year 2012

In 2012, Global motor vehicle production grew by 5% compared to 2011, and reached more than 84 million vehicles. The global increase in production is not only attributable to China, as one might think, but is present in most key territories, led by the USA, Japan, and Russia. The only exception to this trend was noted in Europe, where the four largest countries lost 9% of manufacturing output or 1.3 million vehicles, compared to 2011. In contrast to an overall production decrease in Europe, the Slovak production of 900 thousand cars in 2012 represents a 40% gain YoY, one of the highest growths globally and an increase comparable to that in Russia.

The global sales' statistics of 2012 correlate nicely with global production figures. The USA, China, Japan, India and Russia were the markets with an upward demand, whereas EU sales fell by 1.3 million. A quick comparison of sales and production by region clearly shows the main focus markets of global automotive players – the largest net importers in 2012 included the USA, Russia, Western Europe and Brazil. These markets, therefore, represent key opportunities and challenges for the Slovak automotive industry.

Western Europe (and in particular Germany) remains the Slovak automotive industry's main export market although the continuing Eurozone crisis, low demand, legislative changes in tax systems and other regulations result in significant uncertainties for the automotive suppliers. In spite of this situation, cost pressures in Western Europe support OEMs' strategies to transfer existing capacities to – or build new ones in – CEE. The latest example is the opening of a Mercedes plant for the B-Class vehicle in Hungary in 2012.

New opportunities arise in Russia with its growing automotive sales (up 8% from 2011 and 50% since 2005/06). Governmental subsidies for Russian-based OEMs, decreasing car import tariffs and other macroeconomical changes contribute to the long-term focus of European producers and suppliers on this market. China also became a major export market for Slovakia in the past year, and will further influence the magnitude of future growth.

| Production – cars (in thousand of units) | 2011 | 2012 | Change | |
|---|---------------|---------------|--------------|-----------|
| EU15 & EFTA | 14 122 | 12 827 | -1 294 | -9% |
| EU12 (new members) | 3 401 | 3 413 | 13 | 0% |
| of which: Slovakia | 640 | 900 | 260 | 41% |
| Russia | 1 990 | 2 232 | 242 | 12% |
| USA | 8 662 | 10 329 | 1 667 | 19% |
| Brazil | 3 408 | 3 343 | -65 | -2% |
| China | 18 419 | 19 272 | 853 | 5% |
| India | 3 927 | 4 145 | 218 | 6% |
| Japan | 8 399 | 9 943 | 1 544 | 18% |
| All other | 17 553 | 18 638 | 1 084 | 6% |
| Total sales | 79 880 | 84 141 | 4 261 | 5% |

Source: OICA, World Motor Vehicle Production, by country 2011–2012

Strengths of the Slovak automotive industry can be summarised as follows:

- ▶ Three modern OEM plants with continuous capital expenditures
- ▶ New models (small cars and SUVs) launched recently and enjoying still high demand in Western Europe and outside the EU
- ▶ Productivity of work and quality of output

Risks:

- ▶ R&D investments and decisions about production plants made abroad
- ▶ Transfer of new capacities to Russia
- ▶ Production costs' benefits eroding
- ▶ Availability of skilled labour.

Main characteristics of respondents

Respondents of the Survey were located in all regions of Slovakia, however the majority of them came from the Bratislava and Žilina regions where OEMs are located. The majority of the companies represent subsidiaries of larger international corporations (74%) as well as Slovak owned entities (26%), all usually running one production plant. Three respondents confirmed that they operate more than two plants. Half of the respondents established their sites more than 10 years ago, and the other half started less than

10 years ago with the foundation of PSA and KIA manufacturing locations. The slow-down in the arrival of new automotive investors in Slovakia after 2007 is proven, with only 5% of respondents having started less than five years ago. The future investments of suppliers appear to be dependent on OEMs' decisions in the close V4 region and on governmental support in each country.

Chart 1: Please select a location of your production site. Respondents could mark all that applied.

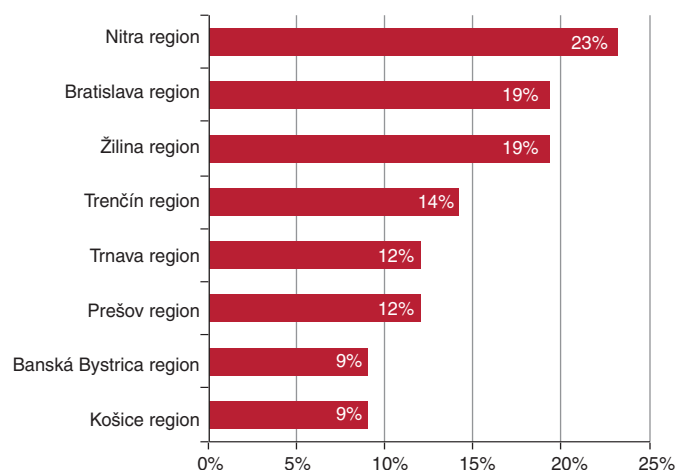
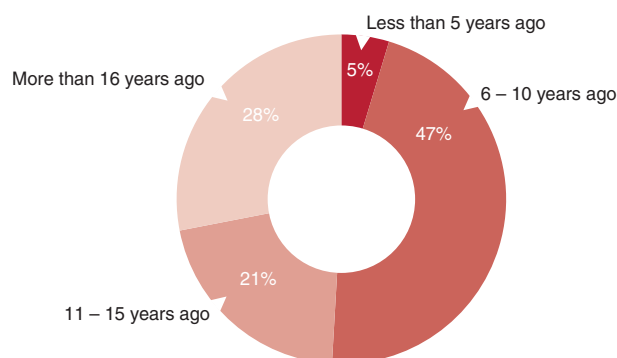


Chart 2: When did your company in Slovakia start its operations?



Approximately 70% of respondents deliver components to one or more of the Slovak OEMs. As expected, more than 80% of the suppliers' production ends up in cars sold in Western Europe and CEE. The markets in China and Eastern Europe account for 23 – 30% of Slovak based supplies. It was interesting to see that some 20% of respondents also transport their goods to North or South America. Looking at the diversity of the final geographical

markets from another perspective – 18% of suppliers focus on a single territory, 33% supply products to two territories (usually Western and Central Europe), and 49% of suppliers cover the demands of three and more territories. We believe this is a significant competitive advantage in the region which helps to decrease companies' dependence on a single market.

Chart 3: What are the final foreign markets for your output? Respondents could mark all that applied.

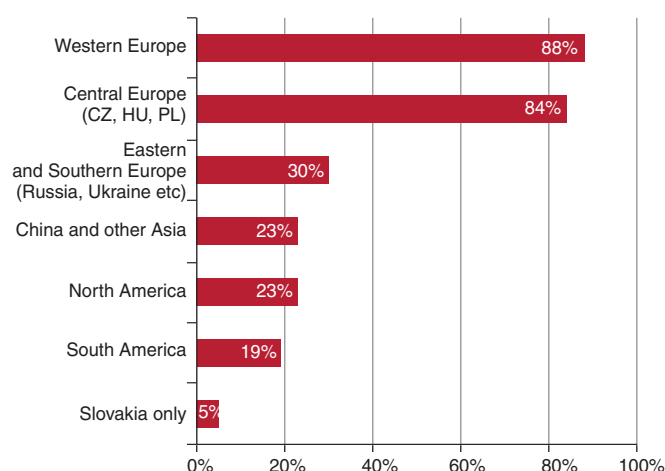
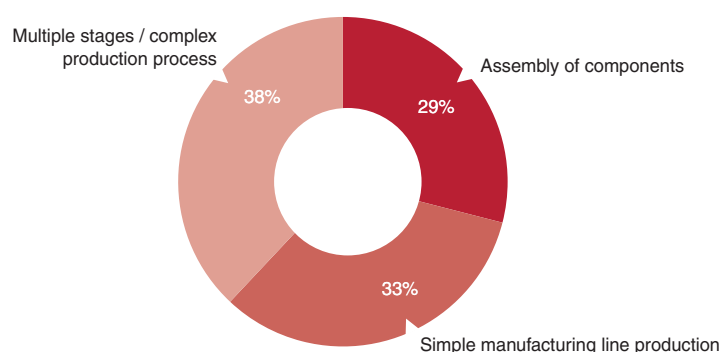


Chart 4: How complex is the production process?

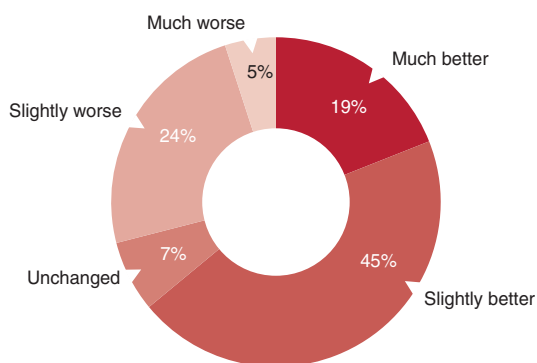


Economic results of 2012

Two thirds of respondents confirmed that the year 2012 was slightly or much better than 2011, which is in line with the boost in production in Slovakia and growing demand in Eastern Europe and Asia. It is worth mentioning that besides 51% responses confirming volume driven growth, 33% of the companies improved mainly due

to efficiency measures and cost reduction programmes. There were, however, 29% of companies which recorded a worse financial position than in the prior period as a result of a drop in sales volume or prices.

Chart 5: What was your company's overall financial situation in year 2012 compared to the previous year?



Two main areas of cost reductions were material and energy costs, and administrative expenses. Only one of ten respondents stated that labour costs were subject to cost optimisation.

The year 2012 was the most successful for companies with more than 500 employees and the companies in Tier 1 level which are directly linked to the OEMs.

Chart 6: What is the main reason for the improvement in your financial position? Respondents could mark up to 3 areas.

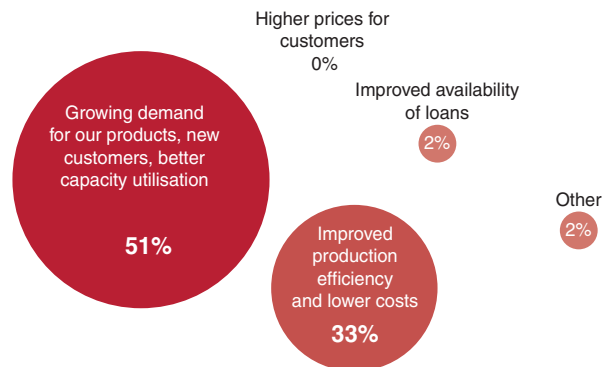


Chart 7: If you reduced the costs of your business, which of the following areas would be most affected?

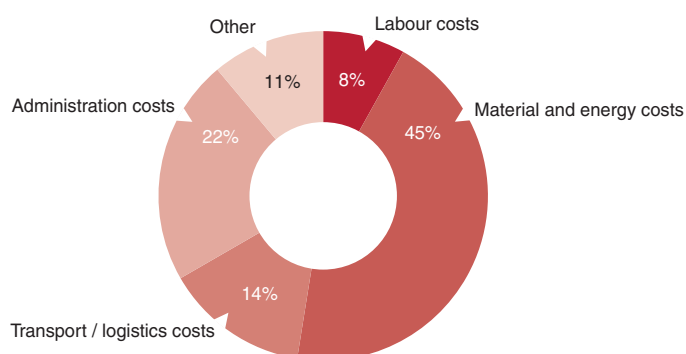
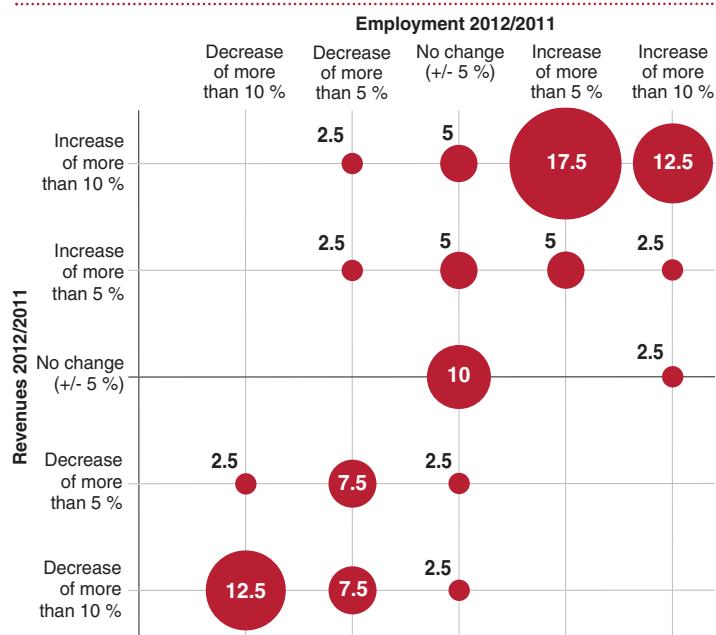
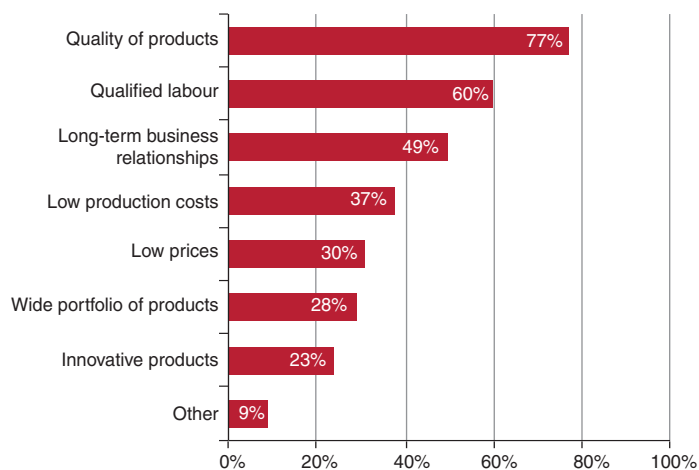


Chart 8: Relationship between changes in revenues and changes in employment (in %)

Another common and very promising feedback of the Survey is that the key competitive advantages of suppliers are in non-financial areas – product quality, highly qualified labour and long-term relationships. These areas scored 50–77%, compared to product pricing and manufacturing costs representing 30–37% of responses. However, the Survey shows that only 23% of respondents consider innovation to be a competitive advantage for their business, although considered to be key for future success.

A positive conclusion that can be drawn from the Survey is the relationship between revenue trend and workforce changes. Approximately half of the firms which grew by more than 10% recruited only 5–10% of staff. On the other hand, firms with a downwards revenue trend were more flexible and could adjust their workforce in line with production changes.

Chart 9: What do you consider to be your competitive advantage? Respondents could mark all that applied.

An optimistic outlook for 2013

Chart 10: What do you think the development of your revenues will be in 2013?

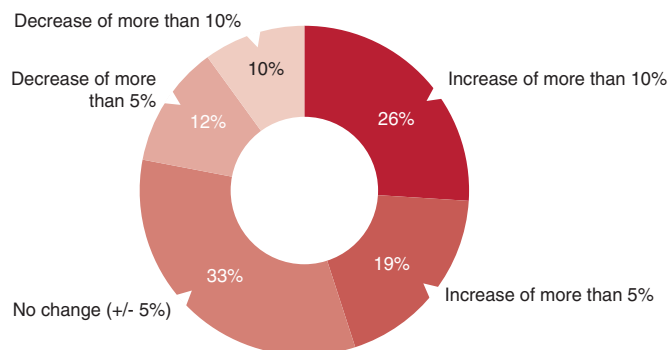


Chart 11: What do you consider to be the main factors in driving change in the supply chain sector in the future? Respondents could mark up to 3 areas.

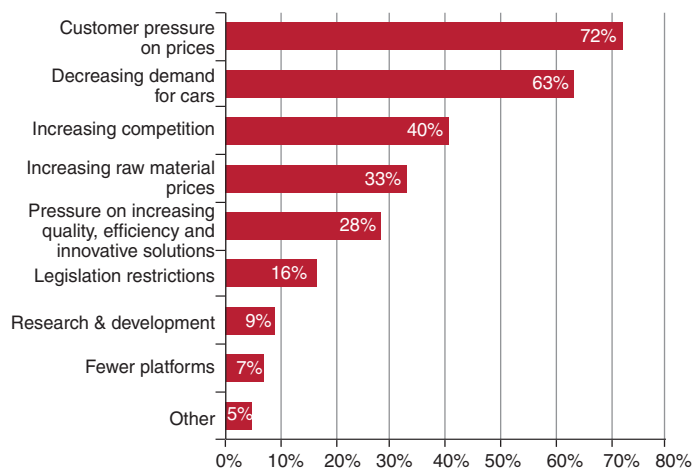
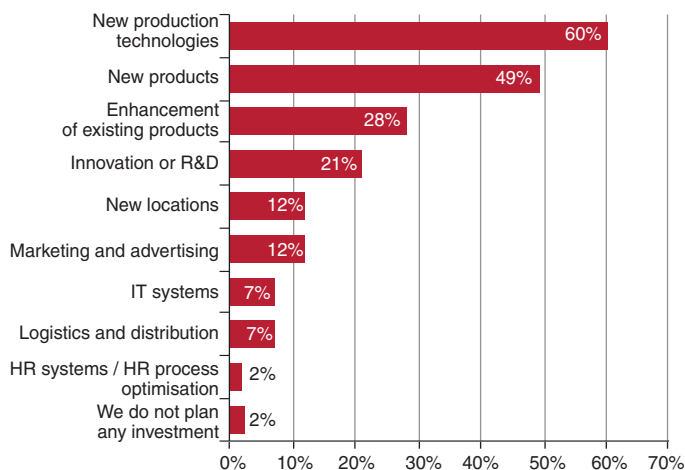


Chart 12: What are your top investment priorities in the near future? Respondents could mark all that applied.



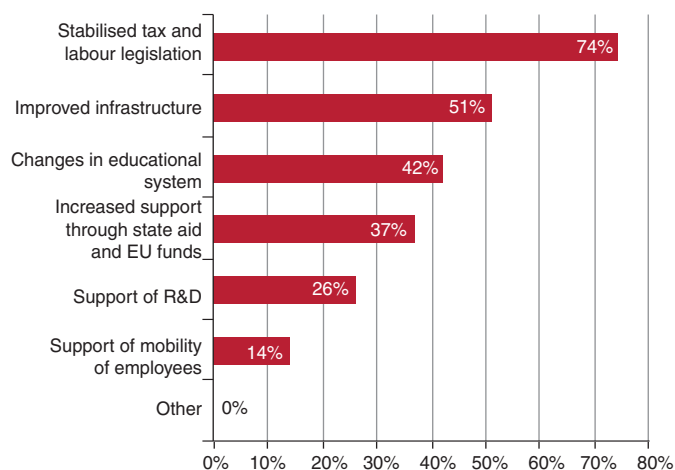
Slovak automotive suppliers remain optimistic for 2013. Almost half of respondents expect their revenue to grow by more than 5% and by more than 10%, whereas one third predicts a stable business without any growth potential. These optimistic expectations are in contrast to the expectations of 72% of respondents who foresee customer pressure on prices and a decreasing demand for cars.

Surprisingly, according to suppliers the key factors for future changes in the supply chain are not consistent with their competitive advantage profile. They expect the changes primarily to be a decreasing demand for cars and even higher pressure on prices. R&D and changes in platform models are not viewed as a driver of change in the supply chain.

Companies plan to expand their product range and further invest in development of new products and acquiring new technologies in response to positive experience of foreign customers with Slovak automotive suppliers. This turns into a positive outlook of suppliers (almost 80%) who believe in rather a small but continuous growth over a long term period – a good signal of confidence in current uncertain situation. Such forecasted increase in sales is connected with the European market recovery and still a high demand in Asia.

Respondents listed three main areas that can improve the automotive industry sector. These include changes in the educational system, improved infrastructure and changes in legislative environment.

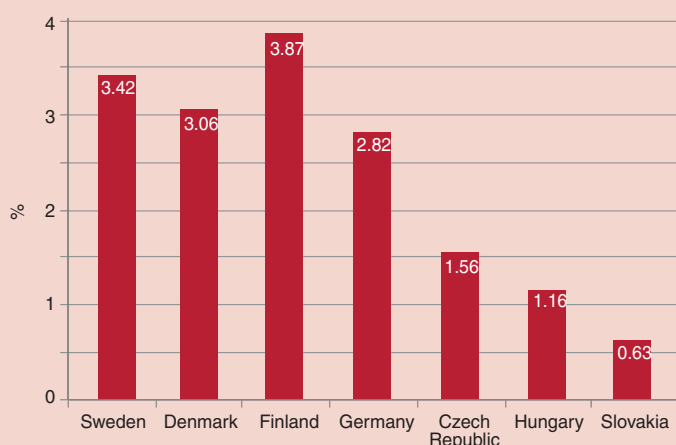
Chart 13: What legislative and economic changes could improve the current situation in your sector? Respondents could mark up to 3 areas.



Opportunities for R&D in Slovakia

According to Eurostat, Slovakia's domestic expenditure on R&D as a percentage of GDP amounted to 0.63% in 2010. This was behind the R&D levels of the Czech Republic, Hungary and Poland with 1.56%, 1.16% and 0.74%. Compared to Germany (2.82%) or the Scandinavian countries (above 3%), the deficit

Chart 14: Gross domestic expenditure on R&D (% share of GDP)



of R&D investment in Slovakia is much more apparent. Whereas in EU27 54% of R&D expenditure in 2010 came from business and some 35% were governmental spending, the structure in Slovakia was just the opposite with 35% and 50% respectively. This indicates that there is further potential for the current investors to increase R&D activities in Slovakia, and may indicate that also the general landscape for R&D activities can be improved going forward.

(Source: Eurostat)

Chart 15: Sources of R&D expenditure in 2010

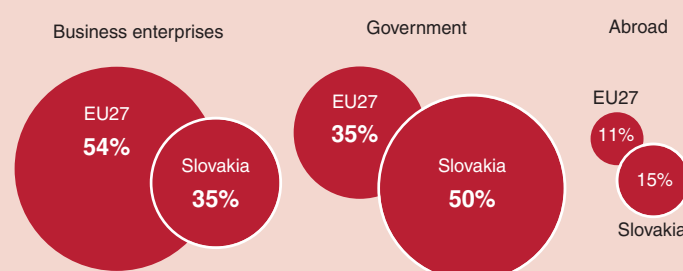


Chart 16: Do you have local research and development activities?

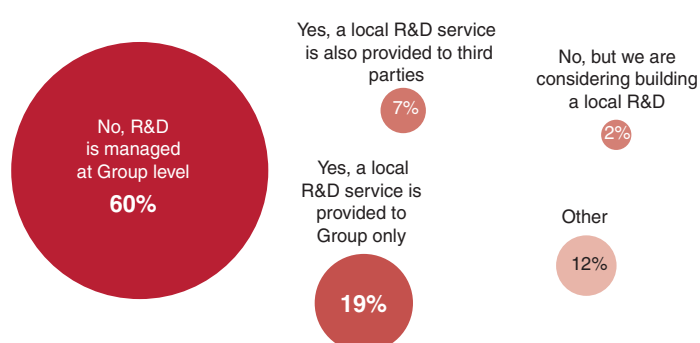
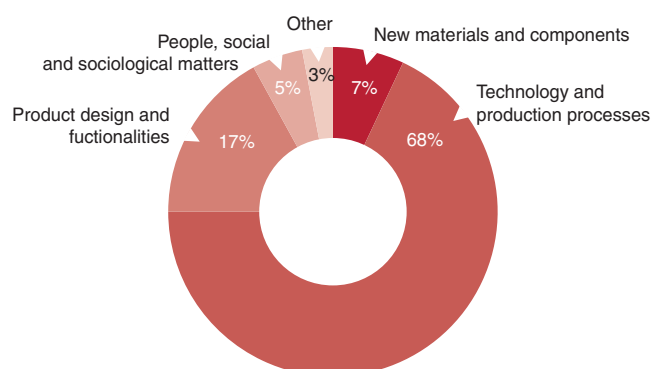


Chart 17: Which area of R&D is of interest to your company?



More than 80% of respondents consider Slovakia to be an attractive country for establishing R&D centres. The unanimous argument for this point of all those respondents is the availability of qualified labour and salary costs. In contrast, the remaining 20% of respondents believe that there is a lack of qualified labour, R&D activities do not have adequate legislative support and no financial support that would attract investments.

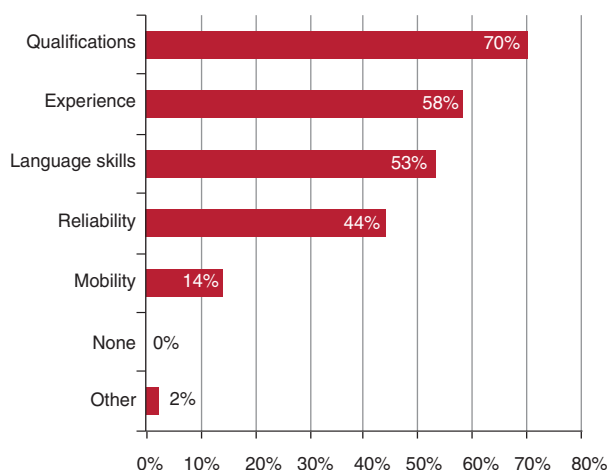
Despite the human potential and talent observed by most of the respondents, R&D initiatives have not been in focus in the past, governmental support was focusing more on the support of mass employment in industry. When taking into account the volume of R&D spending, Slovakia is currently behind the EU average. Recently, several R&D support initiatives and measures have been implemented by several Ministries individually with the aim of attracting R&D investments. As has already been suggested by several renowned institutions, unification of the national system of R&D support, increase of the R&D spending, closer and more efficient cooperation with entrepreneurs might further push and help to turn from mass industrial production to high-tech and innovative activities.

Approximately 26% of suppliers do have some R&D activities in Slovakia and some 60% continue to have R&D functions centralised at Group level or elsewhere in the region – an indication that opportunities for R&D investment in Slovakia are quite high. However, only a few suppliers (2%) are currently considering projects for establishing R&D centres in the country.

The major focus of existing and potential R&D activities is on technology and the manufacturing process (68%). Product design and new materials attract 24% of suppliers' attention within R&D. Companies are generally positive about changes in platform policies of large OEMs which they believe could create new production capacities in Slovakia. These may become the drivers for new R&D investment and for a shift in the operational profile of Slovak suppliers.

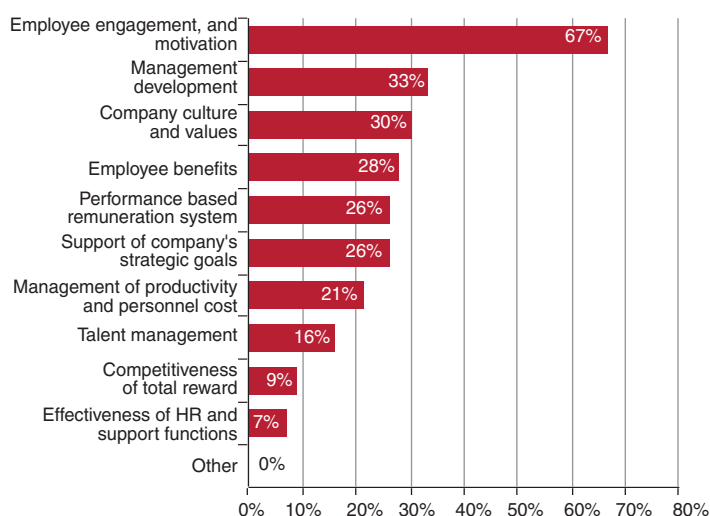
Suppliers experience success through motivation, corporate culture and employee education

Chart 18: What key characteristics do you lack in your new employees?
Respondents could mark up to 3 areas.



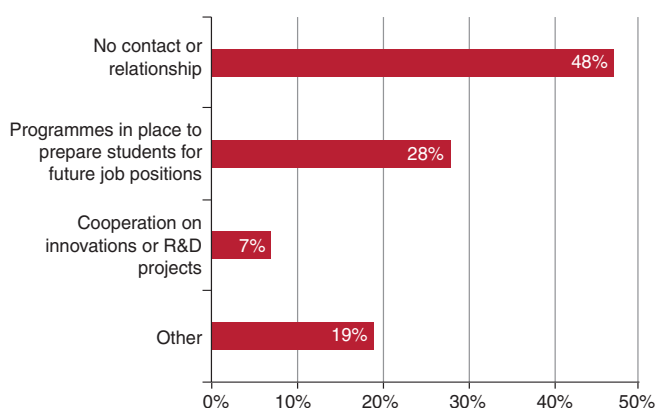
The majority of companies have concluded that there is enough workforce in the country, however workers usually have only limited skills. More specifically, suppliers expect newly hired staff to have the right skills, including language and qualifications. This may be difficult to fulfill when profiles of candidates and those unemployed are significantly different from companies' expectations.

Chart 19: Which of the following HR areas are most critical for your success? Respondents could mark all that applied.



Motivation and engagement of employees is considered to be the most critical HR area for suppliers' success (67%). Considering the limited availability of skilled workforce, employee retention is a key factor to success. Motivation and engagement is not only a question of well structured remuneration, but other factors such as learning and development, career opportunities and also the work environment or company culture itself play a very important role in securing motivated and engaged workforce. This is also confirmed by the CEOs, when they identified corporate culture (30%) and management development (33%) at 2nd and 3rd most critical HR areas for the company success.

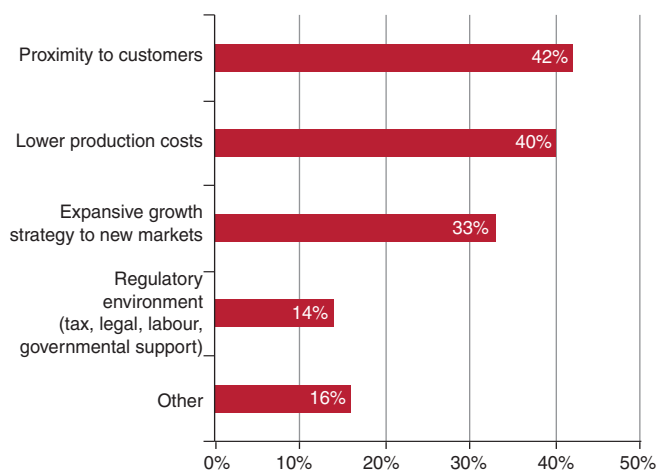
Chart 20: How does your company cooperate with schools and universities?



Approximately one third of Slovak suppliers have already set up some (usually very limited) form of cooperation with schools and universities. Most of the arrangements are about training students on the job and preparing them for future positions. Few companies already cooperate in the field of R&D and innovations. Almost 50% of companies, however, still have no programmes in place – this is an opportunity on both sides, a) to bring real life experience to students and b) to provide future candidates with improved levels of skill. Some companies have recognised such cooperations as part of their social responsibility programme in their region, and benefit from a better image in the community.

Slovakia remains an attractive country for the automotive industry

Chart 21: What are the reasons for your Groups/shareholders to invest outside Slovakia? Respondents could mark all that applied.



In addition to the R&D potentials mentioned above, companies have commented on the importance of state aid for their future investment decisions. This benefit still plays a significant role in the decision making of many investors, however 41% of respondents actually confirmed that this is not a critical decisive factor any more. Other factors, such as distance to the customer/OEM, labour costs and production quality, are also important.

Almost all participants in the Survey consider Slovakia to be attractive for the automotive industry sector, however, half of them believe this position will diminish in the mid-term. It is an important task for all stakeholders in the automotive industry to sustain the positive image and attractive conditions and attract to new investors.

It is fact that global automotive players will continue to expand on other foreign markets. Some 40% of respondents explain that the driving forces are proximity to customers and lower production costs. In the longer term perspective, the industry must identify and develop those regional competitive advantages which result in their growth of supplies in the EU and eastern Europe. (Chart 21)

Trends of future cars have already been defined. The survey confirms that one third of suppliers participates on manufacturing of new components leading to reduction of weight, fuel consumption and emissions. Still there are opportunities in the future to also apply for manufacturing and supplies of new transmission technologies and of drive assistance and communications systems.



About Survey

The Survey was conducted by PwC in co-operation with the Automotive Industry Association of the SR. Addressed automotive suppliers replied via on-line questionnaire from 13 February to 25 March 2013 and 43 car suppliers operating on Slovak market participated in the Survey.

This report looks at the key findings in the car suppliers market, gives a comprehensive analysis of the business model, and provides an assessment of the 2012 results and its key factors, and an outlook for the coming years.

About PwC

PwC firms help organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with more than 180,000 people who are committed to delivering quality in assurance, tax and advisory services. Tell us what matters to you and find out more by visiting us at www.pwc.com/sk.

About ZAP

Automotive Industry Association of the Slovak Republic is a voluntary association of legal entities doing business and involved in the automotive industry association. The main aim of ZAP SR is the sustainability and competitiveness of automotive industry in Slovakia and its strategic objectives for 2013 are especially focused to improving and shaping the business environment, to promote the creation and R & D base for the automotive industry, to improve cooperation with OEMs and subcontractors, to create environmental legislation. See www.zapsr.sk for more information.

Contact

Jens Hörning, Partner

Automotive Industry Leader
+421 2 59350 432
jens.horning@sk.pwc.com

Peter Mrnka, Director

Automotive Industry Specialist
+421 2 59350 416
peter.mrnka@sk.pwc.com

Peter Sedlák, Manager

Automotive Industry Specialist
+421 2 59350 260
peter.sedlak@sk.pwc.com



Contact

PwC, Park One, Námestie 1. mája 18, 815 32 Bratislava
tel.: +421 (0)2 59350 111, fax: +421 (0)2 59350 222

PwC, Aupark Tower, Protifašistických bojovníkov 11, 040 01 Košice
tel.: +421 (0)55 3215 311, fax: +421 (0)55 3215 322



www.pwc.com/sk/automotive