

The outlook for 2014 remains optimistic. The key to success will be innovation and R&D, the key to survive will be skilled labour.

Automotive Suppliers Survey

Slovakia, 2014

Consultancy firm PwC in cooperation with the Automotive Industry Association of the SR (ZAP) surveyed the current situation, key factors and the outlook for the coming years in the automotive suppliers industry in Slovakia.





Dear Friends and Business Partners



Jens Hörning
Automotive Industry Leader
PwC Slovakia

PwC has conducted the Annual Global CEO Survey for the 17th consecutive year and the results have been recently published and discussed in Davos. Automotive CEOs are more optimistic this year, despite concerns about a wide range of threats. They see a need to respond to global trends, but many are just getting started and only a minority think that their key departments are well prepared.

There is strong belief that the global economy will improve, but there is concern about exchange rate volatility, increasing energy costs, raw material prices and supply chain disruption, as well as about the increasing tax burden.

Automotive CEOs express the recognition that global trends are about transforming business, and there is belief that the digital economy, social media, mobile devices, demographic fluctuations and global shifts in economic power will impact the automotive business.

What is the impact on Slovakia? The Slovak automotive supplier industry is not only serving Slovak car manufacturers, but it is delivering to the global supply chain and therefore is, and will be, affected by global trends. Slovak suppliers confirm a positive outlook; they performed well in 2013 and are optimistic for the future. The Slovak supplier industry is the backbone of the Slovak automotive industry and Slovakia will have to compete with other countries to stay successful. The platform strategy of the car manufacturers is offering high volume opportunities, but the competition and the risks are increasing. The advantage of cheap labour, adequate productivity and skill sets worked well in the past but will not be sufficient to cope with global trends. Innovation and respective skilled labour will be key to success, there is a need to improve the education system, and the responses from suppliers confirm that.

This is the second Slovak Automotive Supplier Survey and the results have been published in April 2014. In many respects, the responses confirm global perceptions. I trust you will find the results and conclusions interesting and value added.



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

In 2013, the Slovak automotive industry consolidated its performance and we have recorded another successful year when our three car manufacturers produced a record 987,718 passenger cars, whilst all three shared in a 6.6% growth compared to 2012. Our local automotive suppliers have also recorded a growth in the sale of car components, modules and systems - not only to our three car manufacturers, but over 60% of them exported their products to other countries.

The production capacities of car manufacturers have reached their boundaries which can only be extended if significant investment is made into production extension. However, we see great potential in supplier network development through localisation of components and module manufacturing along the entire supply chain. When we, at the Automotive Industry Association, contemplate the long-term growth and sustainability of the Slovak car industry competitiveness, we see that, in particular, this issue is closely connected with supplier development. The suppliers, as well as the increase of their share of local car manufacturers, are essentially dependent upon the ability of the education system to prepare skilled people who are able to perform demanding tasks in the automotive sector well. We are also aware that there is a need to develop a functional system that will provide scientific and research capacities to cover the needs of the industry and to institutionalise it so as it produces new or innovative products, technologies, materials and processes which will improve the competitiveness of each producer and supplier, as well as the competitiveness of the most significant sector in Slovakia.

The study, prepared by one of our members and our partner organisation, PwC, has been inspiring for us as it includes automotive suppliers' views, needs and requirements. On the other hand, it supports the fact that the steps that have been defined in 2012 and that we currently implement in order to meet strategic objectives aimed at ensuring competitiveness, are in concord with the needs of the majority of Slovak suppliers. It is important that we continue the way we started and take the opportunities offered by car manufacturers and the overall developments in automotive industry.

Main conclusions of the 2014 Survey

The 2nd annual survey amongst Slovak automotive suppliers, that PwC organised and executed in cooperation with the Automotive Industry Association of the Slovak Republic, identifies trends and the continuous challenges of the Slovak automotive sector. The main message of the survey is that the automotive industry in Slovakia, with its wide spectrum of suppliers, remains strong and shows positive performance results for 2013 in spite of stagnating European economies. It thus represents a key component of the Slovak economy and of its growth. The outlook for 2014 is - based on suppliers' responses in the survey - optimistic, and in line with the long expected recovery of European automotive production and car sales in the current year. These forecasts are very promising for Slovak automotive suppliers since their key strengths have been proven over time – labour productivity, modern manufacturing plants and production of components for car models that are selling well on global markets. However, the risks and challenges of this industry sector become more important over time and the suppliers named them again in this survey – a focus on innovation, the availability of skilled labour and the competitive edge of production in Slovakia. We are glad to report that some positive trends were noted by the respondents in this area.



The Survey shows that the year 2014 will be successful again for Slovak automotive suppliers. There are two responses that represent a challenge for the industry sector – some 23% of suppliers expect transfer of production to Slovakia, and 71% of suppliers consider skilled labour to be a problem. That turns into a strategic task for all stakeholders – changes in technical education that reflect the actual needs of the commercial sector.

Peter Mrnka, Director
Automotive Industry Specialist

Year of change

The Slovak automotive suppliers are depending not only on 3 domestic car manufacturers but, to a large extent, also on car production in the European Union, and indirectly on car sales in global economies. Let's have a look at the year 2013 and the forecasts for 2014:

Production

In 2013, global motor vehicle production grew by 4% compared to 2012 to more than 87 million vehicles. Similar to the prior year, the key growth territories were again China and USA, with Brazil in 3rd place. However, the most important regions for our Slovak suppliers are also, and in particular, the EU and Russia - car production in Western Europe and in the new member states (new EU12) was flat in 2013 compared to a 9% drop in the preceding period, whilst the 2013 output in Russia fell by 3%. These results are consistent for Slovakia, where three OEMs produced approx. 988 thousand cars in 2013, 7% more than in 2012. PwC Autofacts® forecasts that 2014 will, after a period of stagnation, be a year of change for car production in the EU. Volume will grow by 4%, pulled up by the top 5 countries (Germany, France, Spain, UK and the Czech Republic); significant recovery is also expected in Italy, Hungary and Slovenia. The longer term outlook shows continuous growth to 19 million vehicles by 2020, i.e. 18% above the 2013 level.

Production – all vehicles (in thousands of units)	2011	2012	Change	2013	Change
EU15 & EFTA	14 122	12 791	-9%	12 766	0%
EU12 (new members)	3 401	3 447	1%	3 418	-1%
of which: Slovakia	640	927	45%	988	7%
Russia	1 990	2 233	12%	2 175	-3%
USA	8 662	10 333	19%	11 046	7%
Brazil	3 408	3 403	-0%	3 740	10%
China	18 419	19 272	5%	22 117	15%
India	3 927	4 175	6%	3 881	-7%
Japan	8 399	9 943	18%	9 630	-3%
All other	17 553	18 612	6%	18 527	0%
Total production	79 880	84 208	5%	87 300	4%

Source: OICA, World Motor Vehicle Production, by country 2011–2013

Sales

The global sales statistics for 2013 correlate well with global production figures. The USA (+7%) and China (+14%) were the key growth markets, whereas sales in Japan, India, Russia and the EU were falling or stagnating. A comparison of sales and production by region identifies the largest net importers in 2013 - USA, Russia and Western Europe - the main markets of global automotive players. Whilst China and USA reported increasing sales in 2013, an even more important trend for the Slovak automotive industry is visible in the EU. After 6 consecutive years of declining car sales in the EU, this trend has slowed down and the new car registrations started to grow in the last few months in all large EU countries as well as in Central Europe. This positive trend also continues in Q1 2014. Based on PwC Autofacts® forecast, passenger car sales in EU should grow by 4% this year to app. 12.3 million. Passenger car sales are expected to grow also in 2015 and 2016 by 5% p.a.

An expected 2014 increase in car production in the EU, continuous strong demand in USA and China, as well as recovering car sales in the EU, confirm the positive expectations of Slovak automotive suppliers as further shown in our survey.

Sales – all vehicles (in thousands of units)	2011	2012	Change	2013	Change
EU15 & EFTA	14 684	13 420	-9%	13 182	-2%
EU12 (new members)	934	905	-3%	913	1%
of which: Slovakia	78	78	0%	75	-4%
Russia	2 902	3 142	8%	2 950	-6%
USA	13 041	14 786	13%	15 884	7%
Brazil	3 633	3 802	5%	3 767	-1%
China	18 505	19 306	4%	21 984	14%
India	3 288	3 596	9%	3 241	-10%
Japan	4 210	5 370	28%	5 376	0%
All other	16 894	17 840	6%	18 096	1%
Total sales	78 091	82 167	5%	85 394	4%

Main characteristics of respondents

Respondents of the Survey were located in all regions of Slovakia and the majority of them represent subsidiaries of larger international corporations (90%). Most suppliers produce components as Tier 1 and also have a more complex production process. There were almost 50% of respondents with over 500 employees and one fourth of companies who employ more than 250 staff. (Chart 1 and Chart 2)

Some 27% of suppliers are linked to one Slovak car manufacturer and 31% ship their products to more than one Slovak car manufacturer. However, more than 40% of companies also deliver their products directly to customers outside Slovakia. This represents growth potential whilst Slovak OEMs are already running at high utilisation. (Chart 3)

There are 2 key trends in the current year - 1) the level of demand in Western Europe and 2) the wide range of other markets with a high growth factor. Based on the forecasted growth of car production in Western Europe in 2014 and in the following years, as well as the recovery of car sales in the EU, the outlook for Slovak automotive suppliers remains positive.

Around 90% of the Slovak suppliers' production ends up in cars sold in Western and Central Europe. The markets in China and Eastern Europe account for 23 – 31% of Slovak based supplies. Similar to 2012, demand for cars in North and South America is relevant for 15-20% of respondents. Looking at the diversity of the final geographical markets from another perspective – 25% of suppliers focus on a single territory (mostly Western Europe), 33% supply products to two territories (mostly Western and Central Europe), and 42% of suppliers cover the demands of three and more territories. This diversity did not change from the prior year and we believe this is a significant competitive advantage in the region that helps to decrease companies' dependence on a single market. (Chart 4)

Chart 1: How many people (own staff and external) work in your plants?

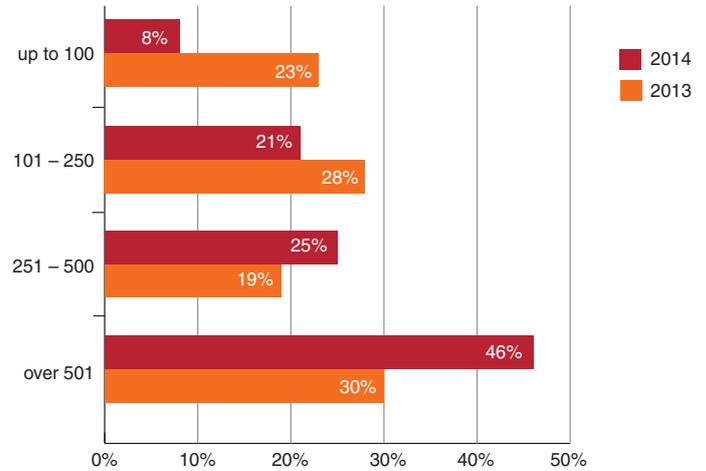


Chart 2: Based on the supply chain, what is your company considered to be?

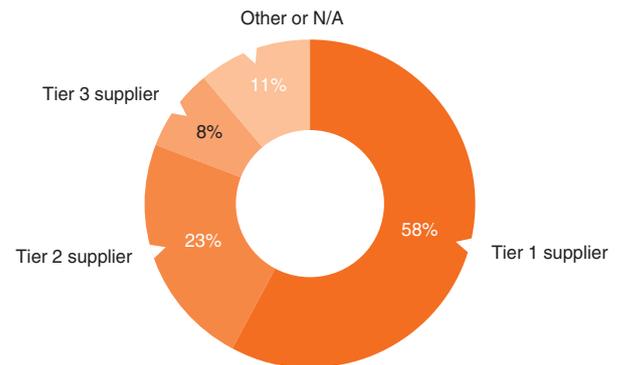


Chart 3: Direct customers of Slovak automotive suppliers

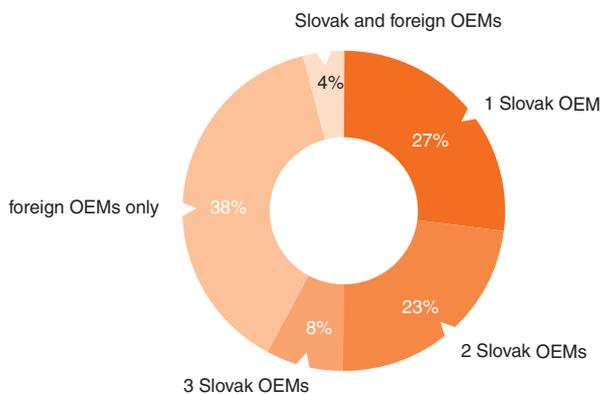
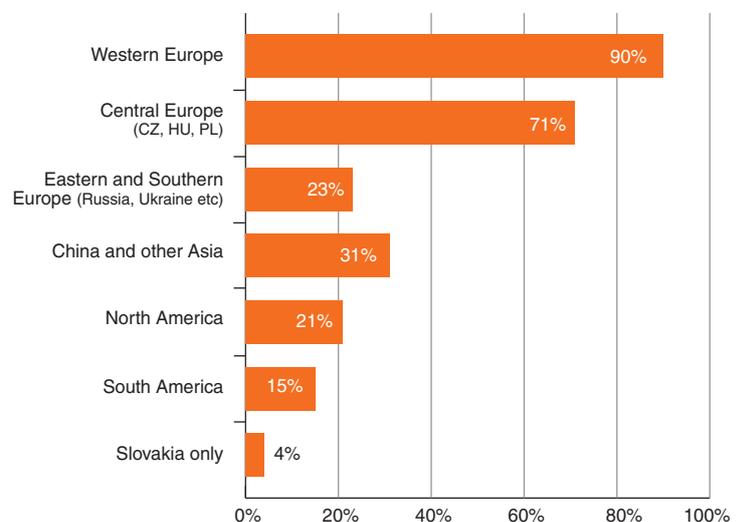


Chart 4: What are the final foreign markets for your output?
Respondents could mark all that apply.



Economic results of 2013

Some 52% of suppliers reported an improved financial position in 2013. Even though in 2012 there were 64% companies with revenue growth - that was also linked to a huge production rise at the 3 Slovak OEMs - there is still a majority of suppliers with either an improving or stable financial position. In contrast, the number of companies with a worse financial position dropped from 29% in 2012 to 21% in 2013. (Chart 5)

Overall, the production of Slovak automotive suppliers, together with the car producers, represents 26% of Slovak exports.

Suppliers that were more successful in 2013 than in the preceding period stated the key reasons being higher sales volumes and better prices for their products. Suppliers with a worsening financial position commented this was due to falling sales volumes, product prices and higher production costs. (Chart 6)

Chart 5: What was your company's overall financial situation in year 2013 compared to the previous year?

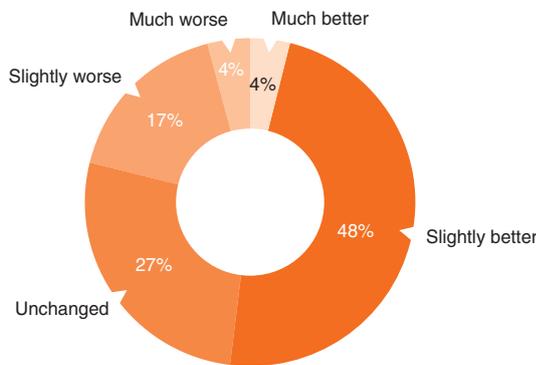
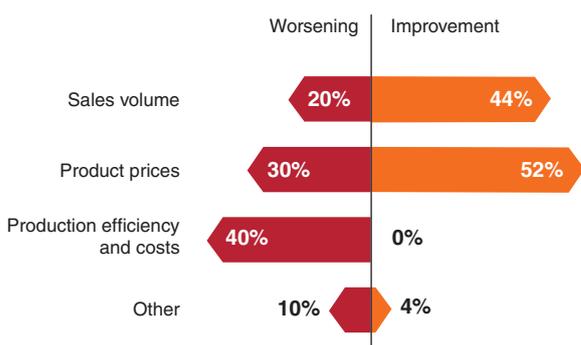
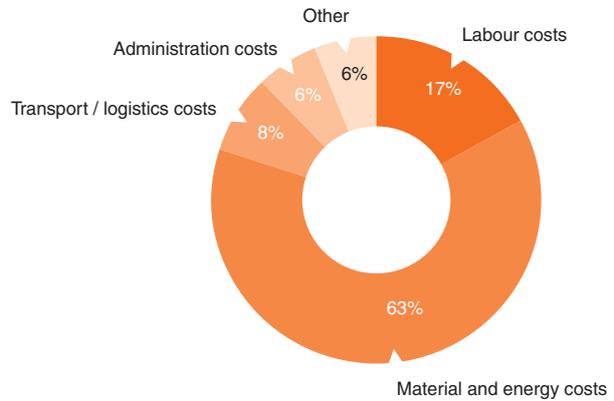


Chart 6: What is the main reason for the improvement/worsening of your financial position?



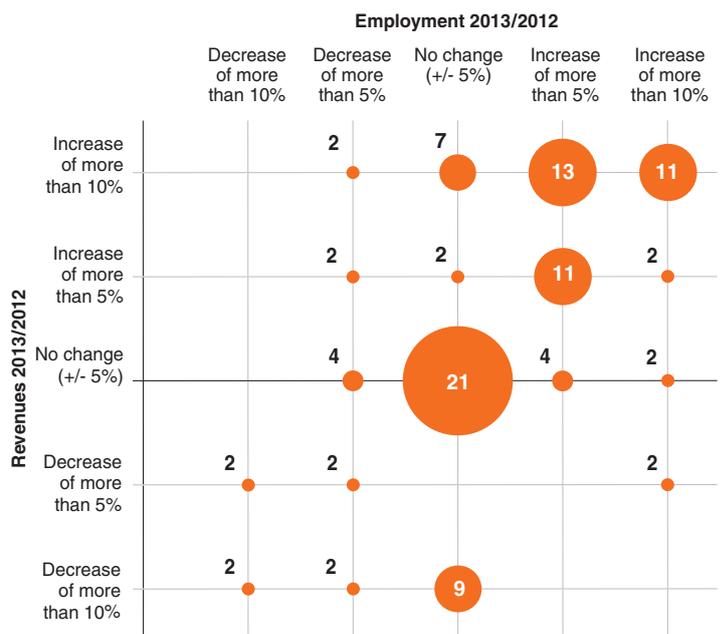
Companies have primarily focused on cost reduction in the area of raw material and energy costs (63%), which represent the key elements of production costs. Cost cutting of staff costs was the second main area of focus (17%), very likely due to labour law changes. Savings of transport and logistics costs and of admin overheads showed a decreasing trend in 2013 (14%) compared to 2012 (36%) as a result of major savings achieved in previous periods. (Chart 7)

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



A positive message of this survey is that of the ongoing revenue growth and revenue stability at automotive suppliers, even in spite of the slowdown of car production growth in Slovak OEMs. This confirms the ability of Slovak automotive suppliers to sell their products also in foreign markets. The number of suppliers with decreasing revenue dropped down from 37% in 2012 to 19% in 2013. Another piece of good news from the respondents was an increase of staff in 2013 (45% of the responses), although personnel costs were one of the main areas of cost cutting. Only every sixth supplier noted a year on year staff reduction. When comparing revenue change to the change in personnel, the ratio continues to indicate increasing productivity. This may result in a further opportunity to relocate production from other countries into Slovakia and create new jobs. (Chart 8)

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



An optimistic outlook also for 2014

The majority of suppliers are optimistic for 2014 - 44% expect their revenues to grow and 40% expect a flat trend compared to 2013. Expected revenue increases correlate with forecasted car sales growth in Europe (3.2% rise in 2014), which would stop the six year decline of car sales. An upward trend in car sales is also anticipated in CEE (+7%), in USA (+4%) and China (+10%), whereas sales in Russia might decrease. (Chart 9)

According to the survey, 30% of companies predict the number of jobs to increase in line with revenue growth and half of the companies expect no change in staff numbers for 2014.

In spite of the positive economic outlook in USA, EU, China and other key markets, several concerns are stated by the suppliers in the survey. Key risks affecting automotive suppliers' growth in Slovakia are almost identical to the risks noted by representatives of global automotive companies in the recent PwC Global CEO Survey. Some 2/3 of respondents see a risk of slowdown of the high growth emerging economies as well as the delayed recovery of mature economies. These responses, however, also confirm the successful focus of Slovak suppliers on both types of economies. Increasing tax burdens and customs processes are a further issue. In the Global CEO survey, other major risks also included high material and energy costs, over-regulation of industry, governments' response to the debt crisis, changes in customer preferences etc.

Some 2/3 of suppliers confirm no changes in the production capacities in the near future and approx. 1/4 expect an inbound transfer of production to Slovakia in the short-term. According to our previous year's survey, productivity, the proximity of final customers and overall economic stability were all in favour of production in Slovakia. (Chart 10)

A positive signal for the suppliers is an increasing trend of localisation of purchases to Slovakia. Approx. 1/4 of suppliers generate up to 20% of purchases locally, a further 7% have local purchases exceeding 20%. More than half of suppliers have a stable ratio of local purchases. From that perspective, there is a high potential to further localise purchases from Slovakia. (Chart 11)

Chart 9: What do you think the development of your revenues will be in 2014?

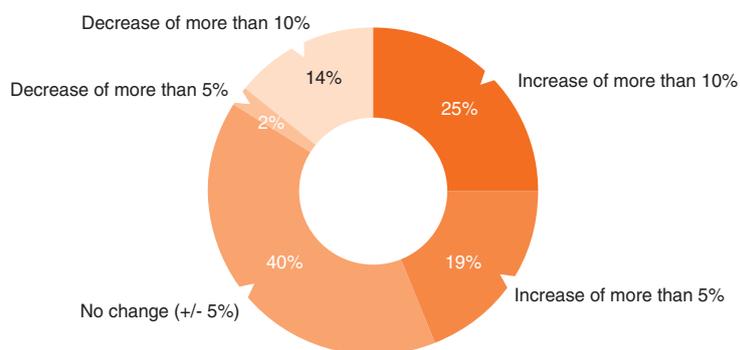


Chart 10: Is the Group/shareholders planning to transfer production in the short-term period?

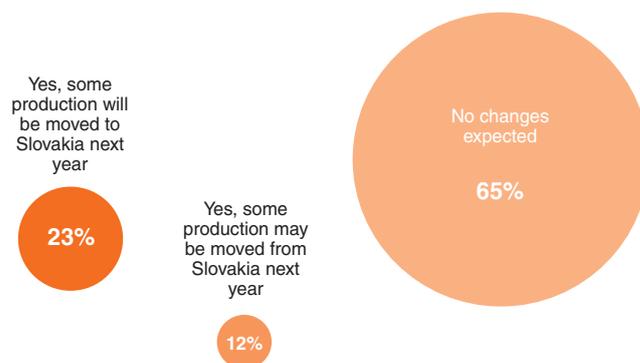
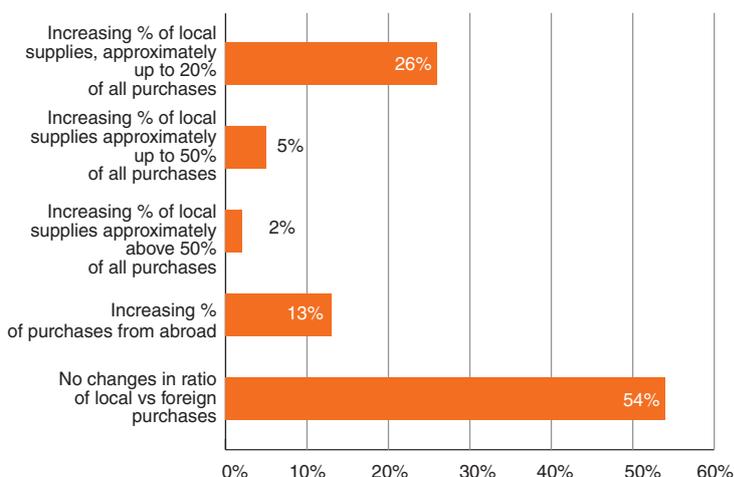


Chart 11: What is the trend of localisation of purchases (of materials and services) in Slovakia?



The key to success - innovation and R&D in Slovakia

The majority of Slovak car suppliers expect the industry focus to be on materials (costs, innovation, substitutes and weight reduction). This results from strong competition in the automotive industry where materials represent the key cost element, and also because environmental compliance requires innovation in the field of materials. Other important future trends are technology changes (infocomm, alternative fuels) and environmental and other regulatory compliance. However, only less than half of the respondents are actively involved in future trends. (Chart 12)

According to the survey and comparing to the previous year's data, an increasing number of companies (24%) have already provided R&D services to their parent companies. Also, more companies (13%) now consider setting up local R&D activities or having a higher level of involvement in their groups' R&D projects. This interest creates a significant opportunity, but also a necessity for the Slovak economy to develop an effective strategy and implementation plan in order to rank Slovakia amongst innovative countries. (Chart 13)

Chart 12: What do you consider to be the key focus areas of the automotive industry in future? Respondents could mark up to 3 areas.

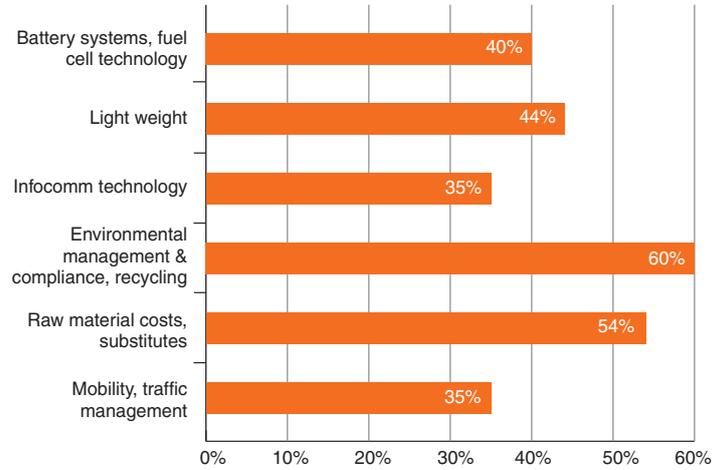
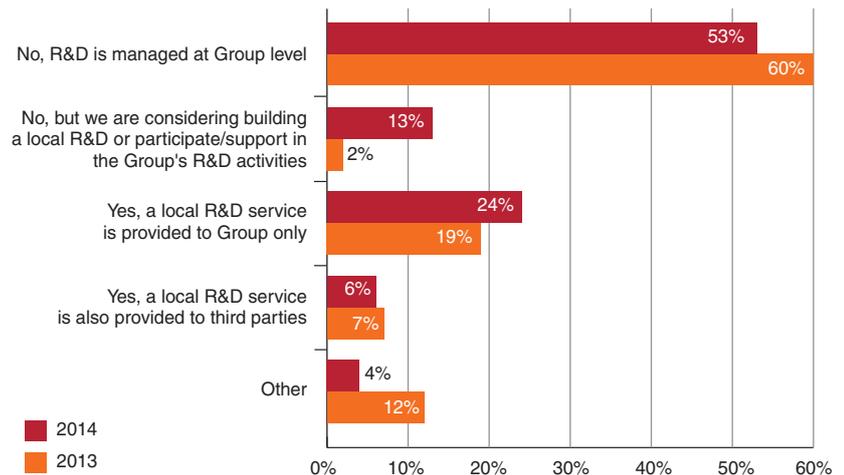
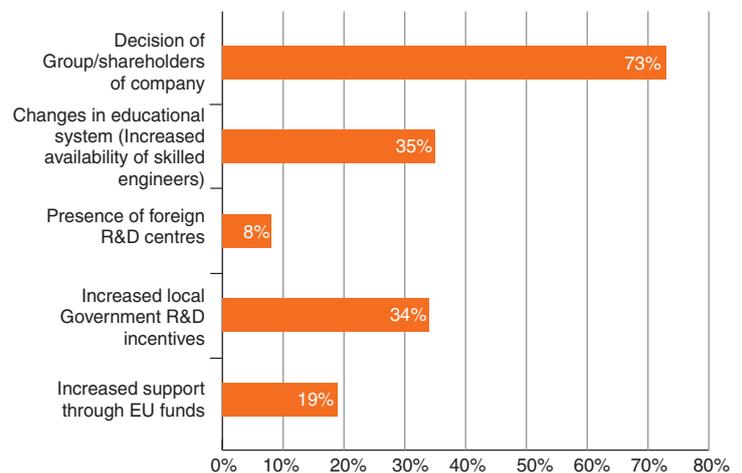


Chart 13: Do you have local research and development activities?



The key driver to start R&D activities in Slovakia is the decision of a supplier's shareholder or of Group management. An important driver for such change would also include better availability of skilled engineers and governmental incentives e.g. in the form of tax relief. One of the drivers for innovation may be the ongoing introduction of new platform strategies by OEMs. These continue to create opportunities for new projects for Slovak suppliers, at the same time they significantly increase pressure on production costs, quality and productivity. (Chart 14)

Chart 14: What changes would start / increase R&D activity in your company? Respondents could mark all that applied.

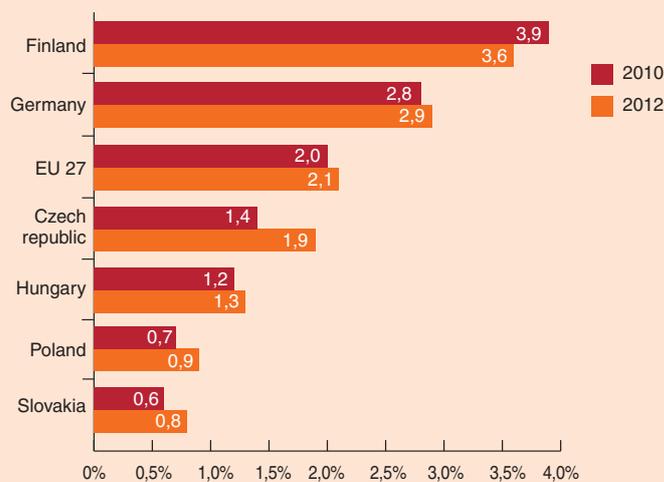


The suppliers being active in R&D in Slovakia have respective expenses usually below 1% of total revenue. A surprising result of the survey is that 7% of respondents incur R&D costs of more than 5% of their revenues. In comparison, R&D expenses of EU automotive companies in 2012 represented some 4% of total revenue.

Where as in the EU, 63% of R&D is financed by the commercial sector, in Slovakia it represents only 41%.



Chart 15: Share of corporate R&D on GDP



Source: Eurostat

79%

of Slovak automotive suppliers plan to launch new product or technology innovations



The key to survive - skilled labour, education and cooperation with schools

Availability and quality of skilled labour is one of the biggest challenges for Slovak automotive suppliers. 71% of the companies confirmed this in the Survey, consistent with the vast majority of global CEOs of automotive companies. This is also a big challenge for the reformation of the educational system in Slovakia. (Chart 16)

Initial training of new staff takes between 2 to 8 weeks, it usually takes a further 3 to 6 months to achieve the required skills, and some 16% of suppliers state that the required skills for certain jobs are achieved only after a year. In order to enhance the future development of existing production capacities in Slovakia and to win the competition advantage in the region, it is necessary to synchronise the educational system with companies' needs. (Chart 17 and Chart 18)

There are already some projects in place for cooperation between schools and automotive suppliers, the number of such collaborations has been increasing compared to the previous year. On the other hand, more than 42% of companies state that they have no contacts or relationship with schools. The continuous gap between the educational system and the needs of companies in the market results in a high percentage (71%) of job positions covered by employees from personnel agencies and from labour law offices. Only some 42% of new job positions are staffed with adequately qualified graduates from schools and universities. It is obvious that there is a much higher need for skilled labour in technical professions. (Chart 19 and Chart 20)

Chart 16: Do you consider the availability and quality of skilled labour an issue of your business?

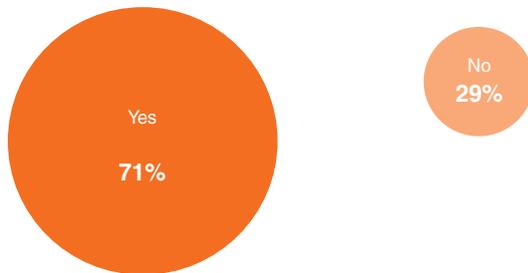


Chart 17: How long does it take to provide initial training to new hires in your company?

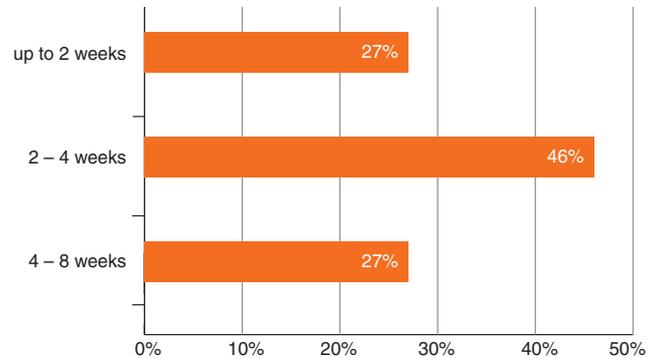
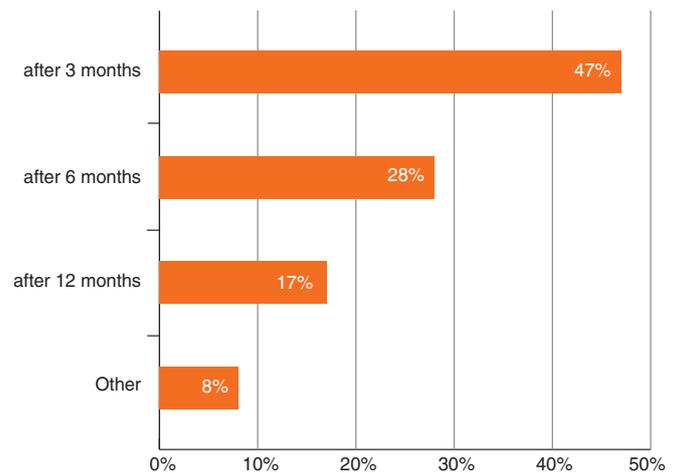


Chart 18: How long does it take your new employees to achieve the required technical / professional performance or skills?



In 2013, around 20% of automotive companies considered education and recruitment to be one of their priorities in HR management. The most important priorities included the development of their managers (60%) and the improvement of internal communications (30%). Source: HR Controlling 2013, PwC

Chart 19: What is the level of cooperation with schools and universities?

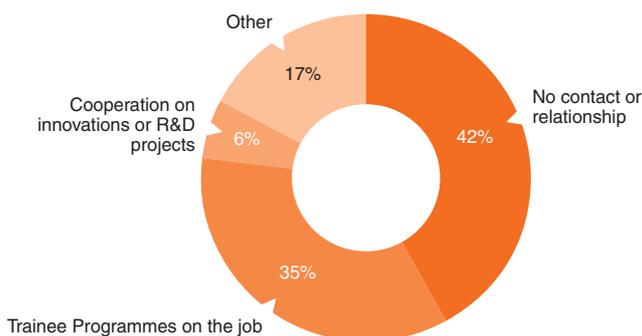
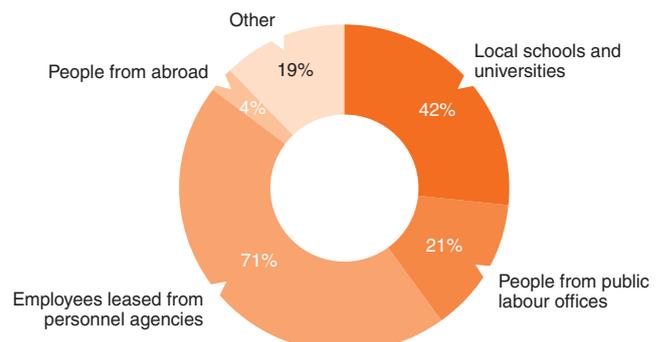


Chart 20: What are the key sources of new labour? Respondents could mark up to 3 areas.



71%

consider the lack
of skilled labour as a problem

23%

expect transfer of production
to Slovakia

44%

expect their revenues
to grow this year

71%

employ people leased
from personnel agencies

79%

plan to launch new product
or technology innovations



About Survey

The Survey was conducted by consultancy firm PwC in cooperation with the Slovak Automotive Industry Association. The automotive suppliers we contacted replied via on-line questionnaire from 5 March to 31 March 2014 and 48 automotive suppliers operating in Slovakia 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 2013 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 157 countries with more than 184,000 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 2014 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.

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