

Strategic Study to Upgrade Egypt's Automotive Sector

Presentation of Findings and Results

29 January 2005
Conrad Hotel, Cairo

Agenda

- Introduction
 - Objectives of the project
 - Approach and assumptions
 - Global automotive industry trends
- Key characteristics of the Egyptian industry
- Implications for Egypt
 - Potential future scenarios
 - Strategy and actions
 - Conclusion

Peter Cooke

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Study objectives

- Develop greater understanding of Egyptian automotive sector dynamics and performance.
- Identify lessons to be learned and implemented from other comparable countries.
- Determine implications for development of the Egyptian automotive sector.
- Create a development strategy and pragmatic action plan to enable sustainable growth.

Presentation content

- The presentation is a high level review of selected key headlines from the full study.
- Details and the discussions are shown in the full reports for the individual project phases.

KPMG Methodology

Methodology used is a best practice approach to establish and evaluate key pragmatic issues. Methodology included;

- Review similar countries developing automotive sectors
- Face to face management interviews;
 - Egyptian automotive industry
 - Senior management in global players
 - Trade associations & other interested parties
- Inputs from KPMG global network.
- Review published & unpublished research.
- University and business schools reviews.

Objectives and findings reviewed with IMC and Steering Committee as the programme developed.

KPMG Approach

Key Elements and Assumptions

- There is fundamental support for the industry in Egypt.
- Focus on issues affecting the industry's overall competitiveness.
- The automotive industry is governed by the decisions of profit-seeking companies based globally.
- Governments provide supporting frameworks for industries and companies – not micro-management.
- Other countries can provide important lessons but not “blueprints”.

Global automotive industry trends

Vehicle Assembly

- 20-25% excess installed manufacturing capacity globally.
- Part of capacity is in the wrong place.
- Cost reduction – globally – is the key issue.
- Manufacturing/assembly is moving to low cost countries with growing long term market potential and available quality labour force.

Global automotive industry trends

Components

- Cost pressure created globalisation – benefits low cost/new players.
- Global sourcing from Tier 2 players to Tier 1 suppliers and then to manufacturers.
- Tier 2 players are taking a bigger role in design/manufacture.
- Tier 2 components suppliers operate globally/locally.
- Aftermarket is also showing signs of globalising.

Duncan Mackay

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Characterising the Egyptian industry

Similar characteristics to other countries

Egypt has a vehicle assembly industry.
And a developing component supply base.
It has labour and a skills supply.

But there are key differences with developed markets

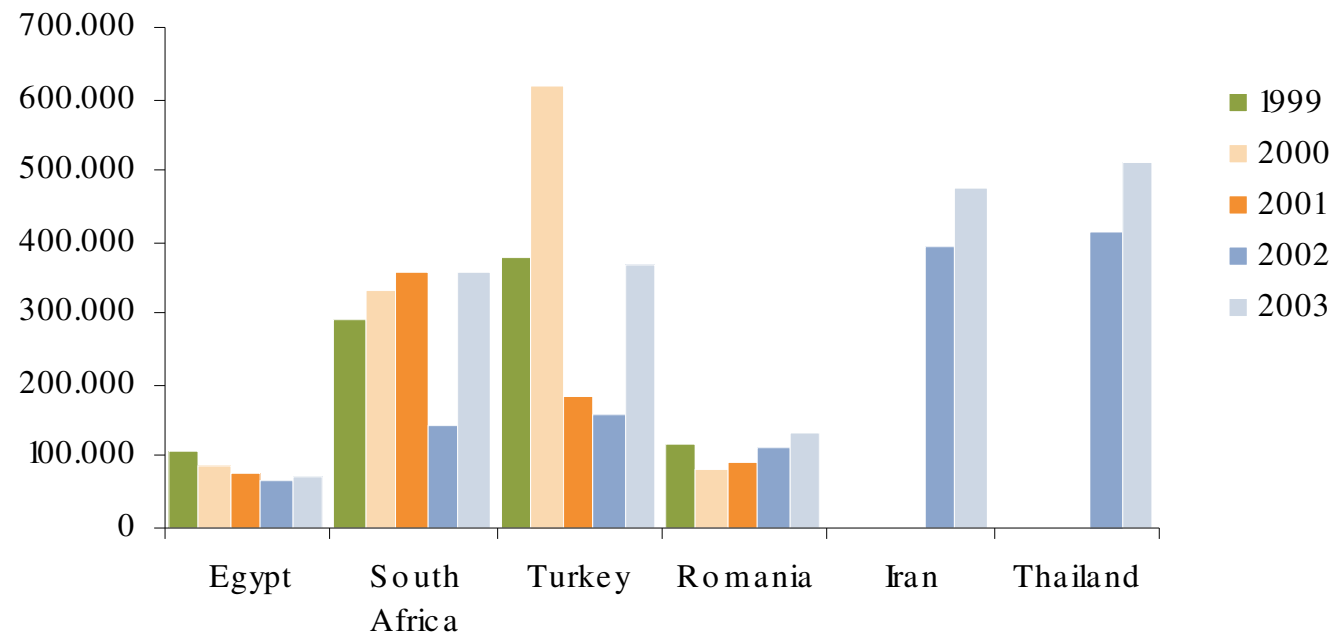
The market is very underdeveloped.
There is very low demand and a low purchasing power.
Virtually no foreign players and therefore very few
linkages with global companies.
Egypt's industry operates as a **local** industry in a **global**
market

The Egyptian vehicle market is small and underdeveloped

- Manufacturers are looking for sales potential.
- Egypt does not have a large enough vehicle market to convince companies that it is worthwhile committing to Egypt.
- Companies are investing in Iran for example, because of large current demand and huge forecast growth rates.
- The Egyptian vehicle market is not realising its potential and is not forecast to grow significantly.

The Egyptian vehicle market is small and underdeveloped

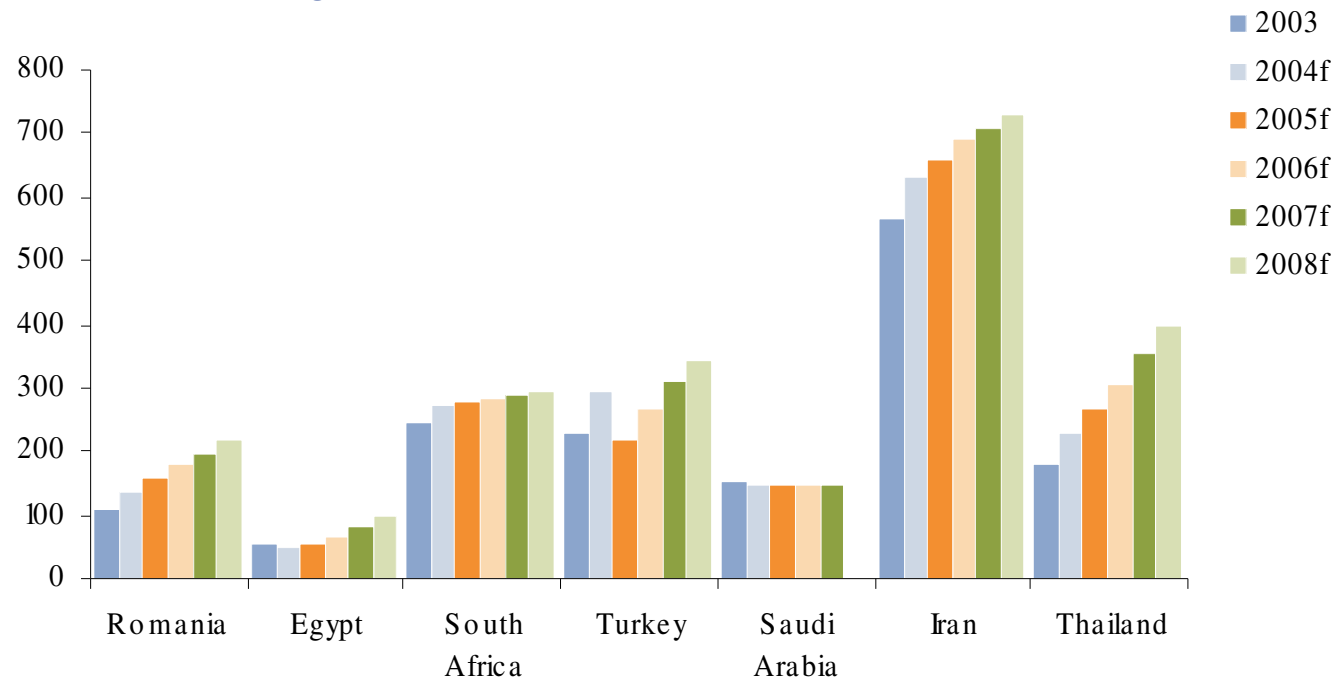
Vehicle sales by country



Source: World markets research centre

The Egyptian vehicle market is small and underdeveloped

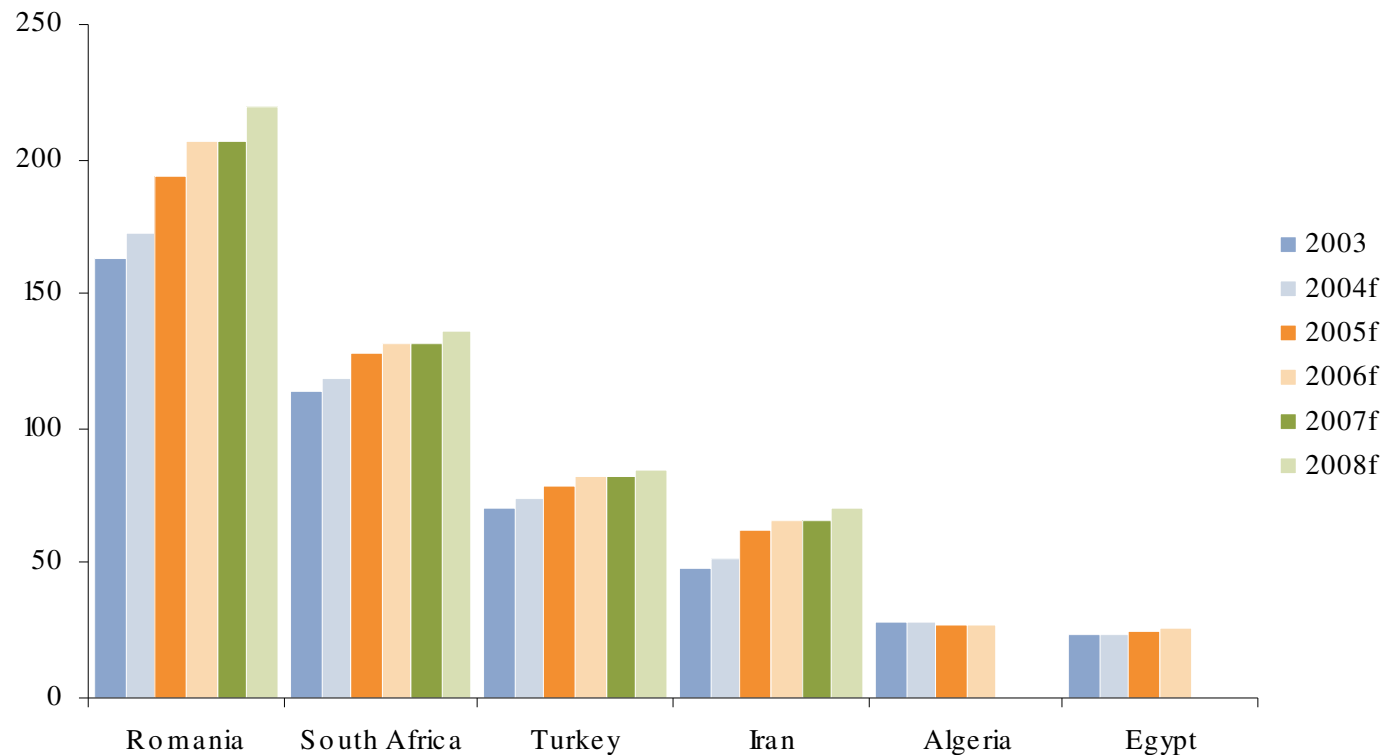
Forecast new car registrations 2003-2008, '000s



Source: Economist Intelligence Unit, 2004

The Egyptian vehicle market is small and underdeveloped

Number of cars per 1,000 population



Source: Economist Intelligence Unit, 2004

There is very little automotive foreign direct investment

- There is one example of a foreign owned vehicle assembler.
- Most of the assembly facilities are joint ventures with local partners.
- This is a low risk strategy for foreign manufacturers reflecting their perception of the market.
- Most component suppliers are Egyptian owned.
- There is one example of a foreign owned component supplier that is successfully assembling and exporting out of Egypt.

There is very little automotive foreign direct investment

Level of Foreign Direct Investment in Automotive Component Industry, Selected Countries

Egypt	S. Africa	Turkey	Tunisia	Thailand
1 foreign owned component manufacturer 1 foreign capital partnership/JV	Over 60 wholly owned subsidiaries of multinational auto component manufacturers	Over 190 foreign capital partnerships and JVs	At least 18 wholly or majority-owned foreign automotive component manufacturing plants.	287 majority foreign owned producers

Exports of vehicles and components are minimal

- Successful countries are exporting a large proportion of their vehicle production.
- These percentages have increased over time, as tariffs have been relaxed and countries have been focused and proactive.
- Exports of vehicles from Egypt are very low.
- Egyptian exports were dominated by buses, accounting for 63% of total vehicle exports.
- Although some component companies are exporting, the majority are entirely dependent on the local market, including sales to other industries in Egypt.

Exports of vehicles and components are minimal

Completed Vehicle Exports for Selected Countries (all vehicles), 2000 - 2003

Vehicle exports	2000	2001	2002	2003
Turkey	96,489	198,233	257,744	347,119
South Africa	73,545	116,841	135,793	144,092
Egypt	-	743	2,109	1,379
Iran		??	??	??

Exports of vehicles and components are minimal

Automotive Component Exports, Selected Countries

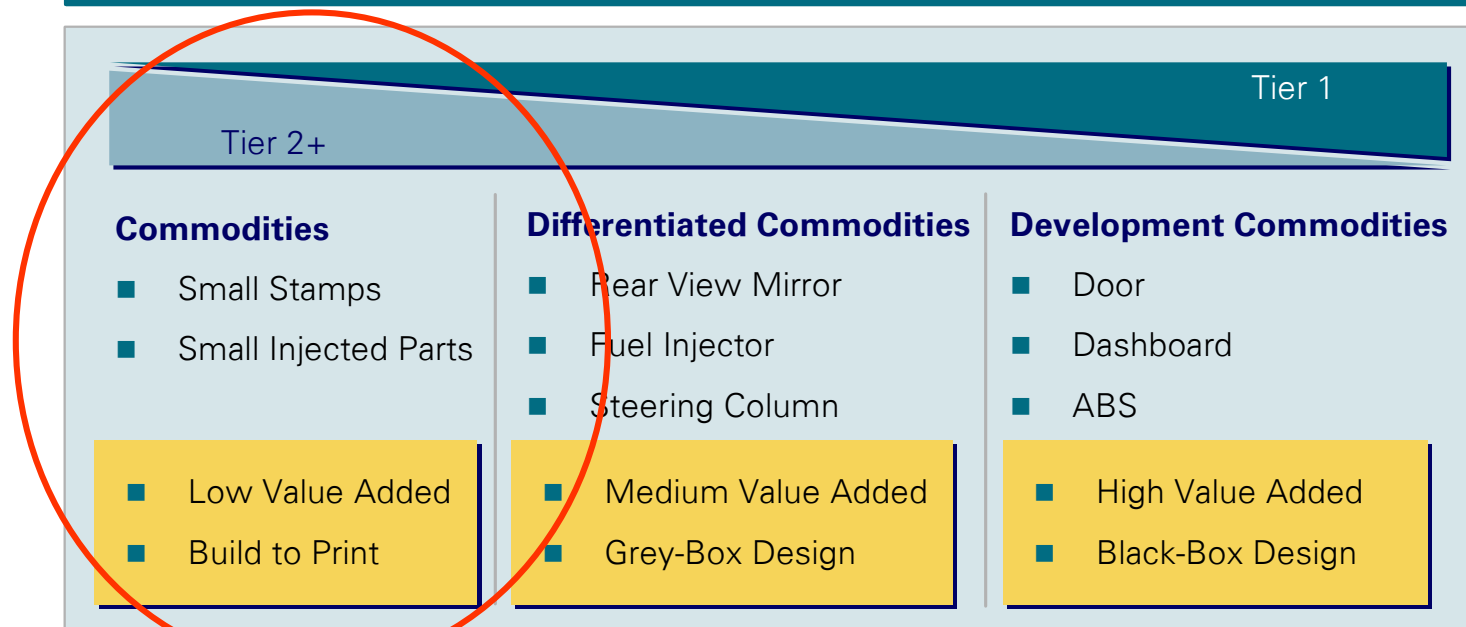
Country	Year	Total Component Production	Total Component Exports	Exports as % of Total Production
Turkey	2002	\$3.2 billion	\$1.9 billion	60%
Turkey	2003	\$4.3 billion	\$2.4 billion	56%
India	2002/3	\$5.4 billion	\$760 million	14%
India	2003/4 (est.)	\$6.7 billion	\$1 billion	15%
China	2001	\$6.1 billion	\$1.6 billion	26%
China	2003	\$8 billion	\$3.7 billion	46%
Thailand	2001	\$5 billion	\$1.5 billion	30%
Egypt	2003 (est.)	\$100 million	\$13 million	13%

Local value added is low

- Despite local content regulations, local content is low in most vehicle assembly operations (except buses).
- Component companies also source most parts and materials from overseas.
- Manual processing and tooling account for most of the local value added in both vehicles and components.
- Egyptian components are generally more expensive than imported ones – tariffs contribute to this higher cost.

Local value added is low

SUPPLIER POSITIONING IN THE VALUE CHAIN



Source: Massachusetts Institute of Technology

There is a large diversity in standards

- Quality and production standards vary significantly amongst manufacturers and component suppliers.
- Assemblers exhibit globally competitive quality standards – from JV parent companies - for the volumes they produce.
- Companies with the best standards are those with the greatest links to foreign parents, partners or customers.
- There are no more than 2 or possibly 3 “world-class” component suppliers and accreditation is varied.

Egypt offers advantages as a location for production

- Overall conditions in Egypt are not unfavourable compared to other countries that have attracted automotive FDI (e.g. Tunisia, Romania, Iran).
- Labour availability and costs are a major advantage at this stage.
- Significant improvements must be made for Egypt to offer a world-class environment for FDI.

BUT:

- The market must grow first.

Andreas Dressler

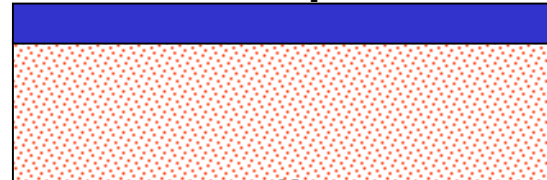
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Protection for the industry will gradually disappear

Tariffs on raw materials and industrial equipment reduced



Tariffs on components reduced



Tariffs on trucks reduced



Tariffs on cars and buses reduced



2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019

Future scenario - threats

- Vehicle assembly in Egypt is volatile.
- Egyptian component companies are dependent on the local market.
- Egypt's market is not large enough.
- Other countries in the region are attracting automotive investment.
- The Egyptian automotive industry is not sufficiently integrated in the global automotive supply chain through exports and foreign direct investment.

Future scenario - negative case

- As tariffs on components are lowered, it will become cheaper to import (some) components than to buy them locally despite local content regulations.
- Many component companies in Egypt will lose significant business.
- As tariffs on vehicles are lowered, a point will be reached where it is more profitable for OEMs to export cars to Egypt than to assemble there.
- Many assembly operations in Egypt will close down leading to the demise of their local suppliers.

Future scenario – opportunities

- The MENA Region is an attractive vehicle market for international companies.
- No clear hubs have yet emerged for regional production of specific vehicles.
- Strong regional demand for buses.
- Global sourcing of components creates opportunities for low cost suppliers.
- Cost pressure is driving relocation of labour intensive component production to low cost locations.

Future scenario – positive case

- A few OEMs assume ownership of their Egyptian operations and invest in modernisation and expansion.
- Egypt becomes a regional hub for assembly of buses and other vehicles types.
- Egyptian component companies realise new sources of revenue through exports and are able to survive and expand.
- Foreign component companies establish plants in Egypt to supply worldwide markets.
- The Egyptian industry becomes integrated in the global automotive supply chain.

Strategy

- The strategy focuses on the key issues affecting the industry's ability to become sustainable while laying the foundation for future development.
- The immediate goal for the Egyptian automotive industry is to reach a sustainable position by 2010.
- Working towards and achieving this goal will create a base for further development beyond 2010:
 - Specialisation
 - Increased scale
 - Innovation

Action plan

- Prerequisites - key requirements that must be met to achieve the development strategy.
- Action steps – specific actions that must be completed to meet the prerequisites.
- Other requirements - other issues that should be addressed to support the development strategies.
- The action steps are mutually reinforcing.
- Should be seen as part of integrated effort to be implemented simultaneously between now and 2010.

Prerequisites and action steps

- The Egyptian vehicle market must grow to persuade OEMs to invest and expand.
 - Provide tax incentives to stimulate domestic vehicle demand and purchases.
 - Facilitate access to vehicle financing for consumers and businesses.

Prerequisites and action steps

- Key automotive companies must be encouraged to invest in Egypt.
 - Approach major automakers regarding assembly operations in Egypt.
 - Implement a targeted investment attraction programme for automotive component FDI.

Prerequisites and action steps

- Exports of automotive products from Egypt must be encouraged and facilitated.
 - Provide enhanced export incentives for vehicle exports.
 - Make foreign markets more accessible and remove barriers to exporting.

Prerequisites and action steps

- Egyptian products must be price competitive.
 - Reduce the price paid by Egyptian companies on imported parts and materials.
- Egyptian companies must have access to international buyers.
 - Identify key buyers internationally for the types of products made in Egypt.
 - Assist Egyptian companies to meet international procurement requirements.

Prerequisites and action steps

- Egyptian companies must gain internationally recognised quality standards.
 - Provide support in receiving international certification.
 - Egypt becomes signatory to Geneva agreement on automotive standards.

Prerequisites and action steps

- Egyptian companies should be using leading international production processes.
 - Train labour force & management in quality and production techniques.
 - Provide financial support for capital investment and modernisation.

Other requirements and action steps

- Egypt must offer a world-class environment for FDI.

Review and enhance key factors:

- Customs procedures
- Incentives
- Security risks
- Company registration
- Local content rules

Other requirements and action steps

- Egypt's automotive industry must become known internationally.
 - Arrange joint presence of Egyptian suppliers at major industry trade shows.
 - Promote the Egyptian industry through key industry publications and events.
 - Produce a directory of Egyptian component companies that can be distributed internationally to potential buyers (and foreign investors).

Other requirements and action steps

- There should be increased cooperation among all industry players to raise overall industry standards.
 - Establish a focused automotive industry technology centre.
 - Create a professional trade association for the entire industry.

Critical success factors and next steps

- High level support and commitment.
- Concerted effort and collaboration among all stakeholders.
- Leadership and immediate action.
- Creation of a single entity to drive implementation.
- Effective implementation and tracking.
- Dedicated resources and decision making authority.