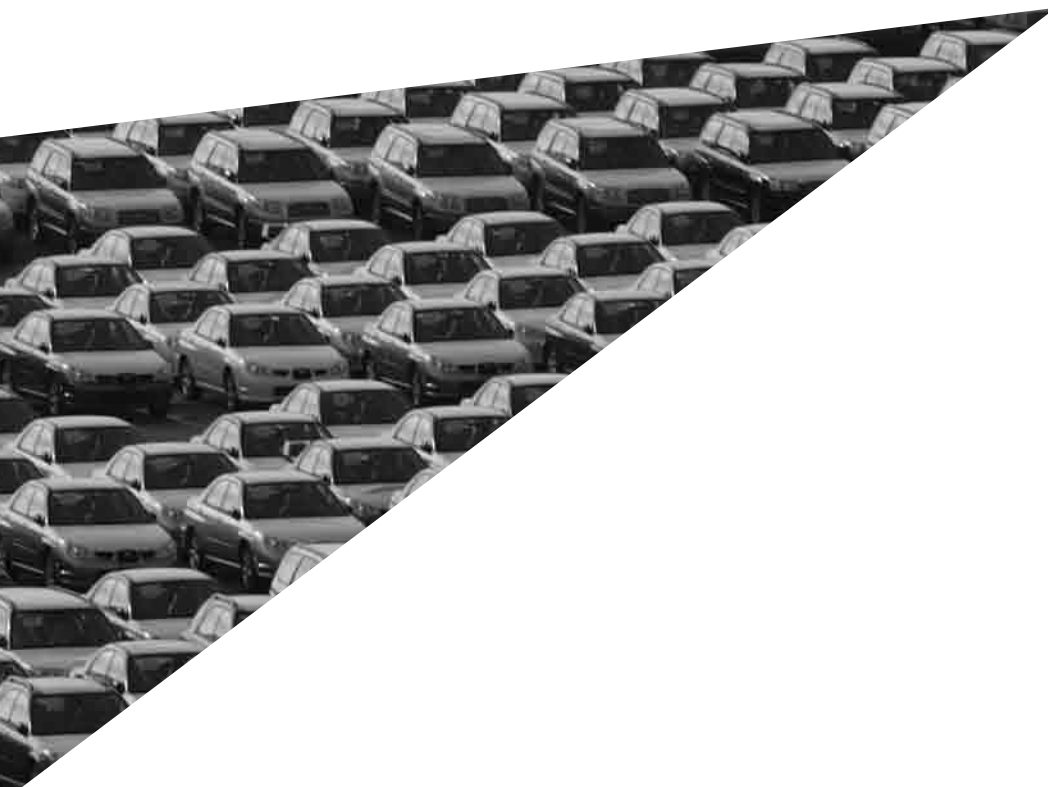
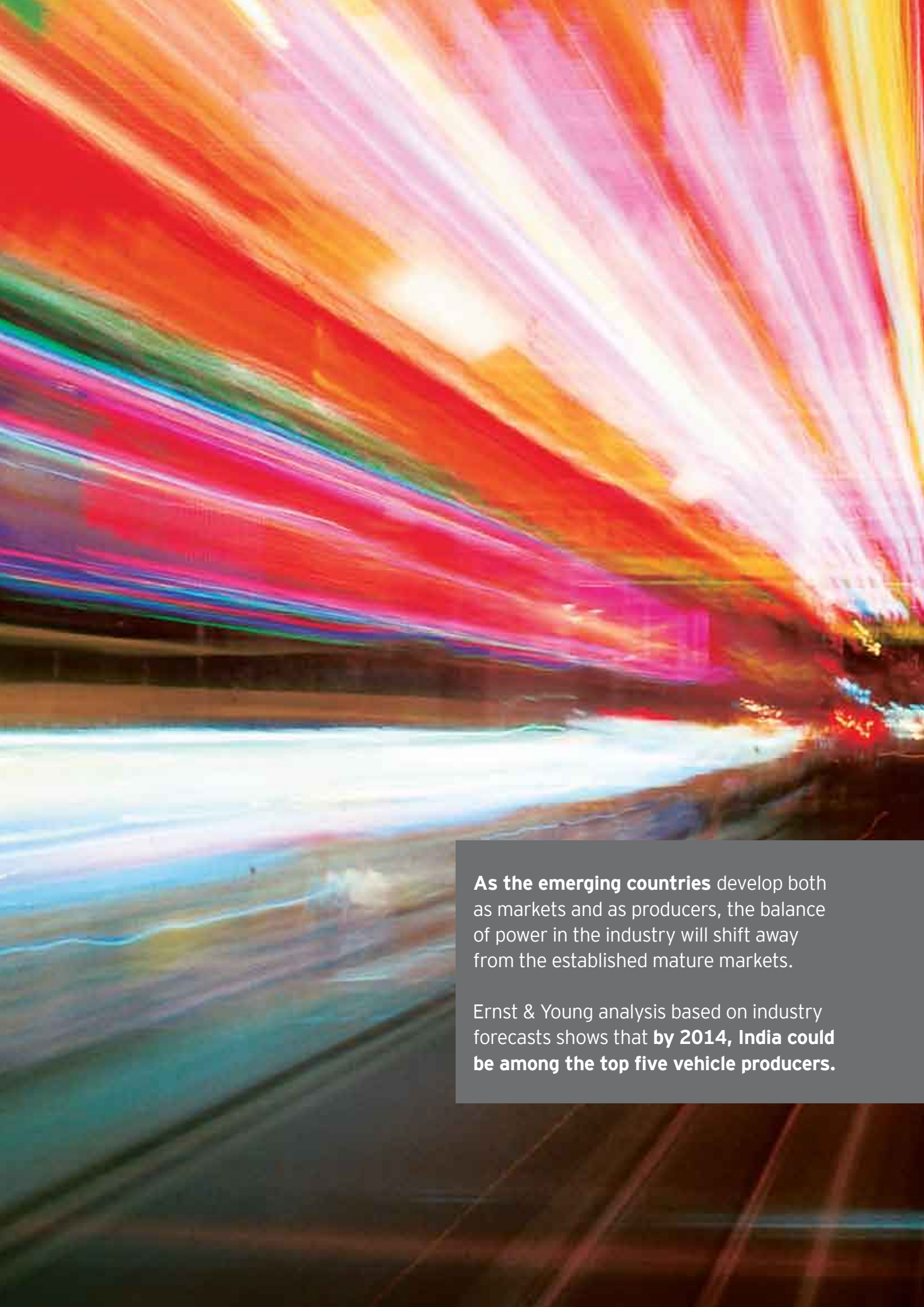


Revving up!

Indian automotive industry - a perspective





As the emerging countries develop both as markets and as producers, the balance of power in the industry will shift away from the established mature markets.

Ernst & Young analysis based on industry forecasts shows that **by 2014, India could be among the top five vehicle producers.**

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Foreword



The year 2008 has been a defining year in some aspects for the Indian auto industry, with the unveiling of the world's lowest-cost car, the Nano,

in January and the acquisition of the Jaguar and Land Rover brands in March - both events heralding India's presence on the global stage. Domestically, we saw a lot of activity with new product launches, including many new offerings in the luxury segment and the announcement of Carnation entering the market as an independent multibrand automobile sales and service network. The industry has witnessed an influx of both global OEMs as well as Tier 1 component manufacturers, who are setting up their manufacturing bases in the country. This has fueled automobile production in the country, taking it to a level of 11.2 million units during FY09.

Over the last five years, India has established itself as one of the favored global destinations for automobile manufacturing. Changing consumer spending pattern, a cost advantage that the country offers in terms of R&D, skilled labor, high-quality engineering and abundant software have reshaped the industry structure, making India a preferred destination for global players, even as demand slows in the Triad markets of US, Western Europe and Japan.

The last quarter of 2008 has been no less than a crisis for the industry, with slowing demand led by the depressed consumer sentiments and the impact of the global credit crisis. Clearly, the

industry is facing an unprecedented combination of cyclical and structural issues. However, the Indian market has proven resilient and the first five months of 2009 have shown positive growth trends, particularly in passenger vehicles and two-wheelers, which should be sustainable as the economy recovers and the new government settles in.

The industry will likely see a lot of change globally in 2009 as vehicle manufacturers and component suppliers evaluate and implement strategies to restructure their businesses even as governments around the world consider more requests for bailouts. We have just witnessed General Motors and Chrysler emerging from bankruptcy as leaner organizations but with a radically new set of major shareholders. Some Tier 1 suppliers have also filed for bankruptcy, and some others are expected to follow in the months ahead. We anticipate a changing landscape with smaller US vehicle manufacturers, "Europeanization" of the US auto industry and more global players emerging out of Asia in the years ahead.

Despite the recent slowdown, the prospects of growth for the Indian auto industry remain enormous, given that the country has a middle class larger than the population of the US and a much lower vehicle population as compared to other developed nations. With its proven low-cost product development and manufacturing capabilities, the country is all set to become an integral part of the global automotive chain as the demand shifts toward smaller, cheaper and environment-friendly fuel-efficient vehicles. One clear distinction

that differentiates India from the other major emerging markets, and positions the country in a unique situation globally, is that India has a strong set of indigenous automotive and component manufacturers. With the recent global developments, today more than ever before, there is a significant opportunity for the Indian auto industry. India is expected to emerge as the world's seventh-largest automobile market by 2016 and third-largest by 2030, behind only the US and China.

In this report, we present an overview of the latest market developments and automotive statistics over the past few years. We hope this will provide you with relevant insights on the key trends, current capabilities and shifting dynamics within the industry and equip our readers to effectively harness the opportunities available. We would be glad to share with you our detailed experience in the automotive sector, in India and globally, to help you enhance the value of your current and future investments.

I would also like to take this opportunity to thank the large and dedicated team at Ernst & Young in India, Detroit and the UK across our Automotive practice and Global Automotive Centers that has worked together to complete this report, often juggling many other priorities.

Rakesh Batra
India Automotive Leader

Acronyms

Key to abbreviations used in this report

| | |
|-------|---|
| ACMA | Automotive Component Manufacturers Association of India |
| AMP | Automotive Mission Plan |
| BRIC | Brazil, Russia, India and China |
| CAGR | Cumulative Annual Growth Rate |
| CBUs | Completely Built Units |
| CKD | Complete Knocked Down |
| CNG | Compressed Natural Gas |
| CRR | Cash Reserve Ratio |
| CV | Commercial Vehicle |
| FDI | Foreign Direct Investment |
| FMS | Focus Market Scheme |
| GDP | Gross Domestic Product |
| M&HCV | Medium and Heavy Commercial Vehicle |
| INR | Indian Rupees |
| IIP | Index of Industrial Production |
| JV | Joint Venture |
| LCV | Light Commercial Vehicle |
| LPG | Liquefied Petroleum Gas |
| LTV | Loan To Value |

| | |
|-------|--|
| M&A | Merger and Acquisition |
| M&M | Mahindra & Mahindra |
| MCV | Medium Commercial Vehicle |
| MNC | Multinational Company |
| MoU | Memorandum of Understanding |
| MPV | Multi Purpose Vehicle |
| MUVs | Multi Utility Vehicles |
| NBFCs | NonBanking Financial Companies |
| OEM | Original Equipment Manufacturer |
| PPP | Purchasing Power Parity |
| PV | Passenger Vehicle |
| R&D | Research and Development |
| SCV | Small Commercial Vehicle |
| SIAM | Society of Indian Automobile Manufacturers |
| SKD | Semi Knocked Down |
| SMEs | Small and Medium Enterprises |
| SUV | Sports Utility Vehicle |
| ULCC | Ultra Low Cost Car |
| UV | Utility Vehicle |

India's position in the global automotive industry landscape

Key insights

- As the emerging countries develop both as markets and as producers, the balance of power in the industry will shift away from the established mature markets
- Ernst & Young analysis based on industry forecasts show that by 2014 India could be among the top five vehicle producers
- The Indian auto components industry has grown more than fivefold over the past decade
- The Nano has demonstrated India's world-class capabilities in R&D, engineering and manufacturing as well as its ability to innovate

Within the global automotive industry, the markets group into two broad categories: the established, mature markets of North America, Western Europe and Japan (often called the "Triad") and the emerging markets, within which the largest are often grouped together as the "BRIC" countries (Brazil, Russia, India and China).

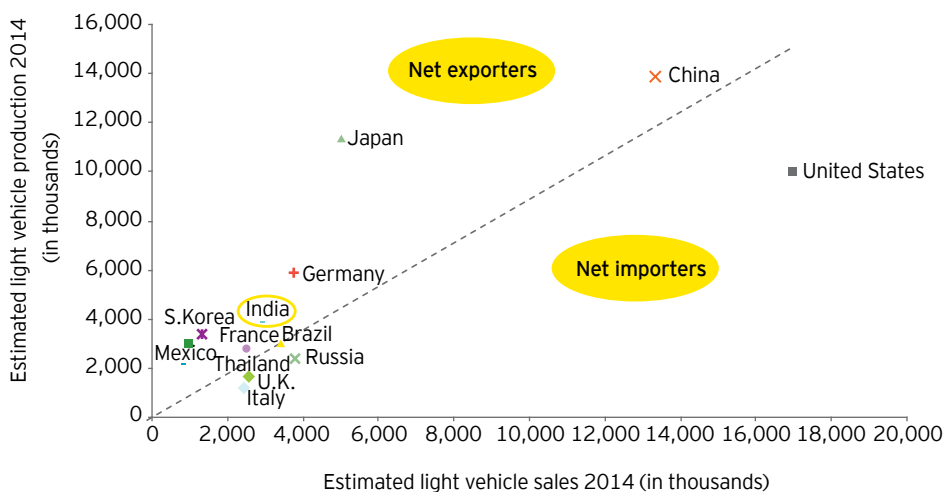
The impact of the economic downturn on the global automotive industry

The current global crisis has reshuffled the positions of the players on the global canvas. The giants of the industry are facing problems such as bankruptcies, and others are being forced to reduce their global output by more than one-third. As a consequence, there is going to be a reduction in capital expenditure by foreign car makers in emerging markets. Under various stimulus packages, governments around the globe have

laid stressed upon environment-friendly vehicle incentivizing for both customers and manufacturers. While there has been a correction in nearly all markets, emerging automotive markets are expected to be more resilient and continue to gain more importance on the global stage.

India's position in the global car industry, as a market and as a producer

Only a very few players will continue to produce over 10 million cars per year: China, Japan and the United States. The US is to become a significant net importer of cars, owing to the higher cost of domestically manufactured products. Beneath this is a second layer of significant producers, with outputs of 4 million to 7 million units per year: Germany, India and South Korea. Of these, only India is forecast to continue to grow significantly.



Source: Global Insight, Ernst & Young analysis

India's strength in CV and two-wheelers

In CVs, India is the fourth-largest global market. Tata Motors, M&M, Ashok Leyland and Eicher Motors are the major players, sharing 90% of the total market between them. International players like Volvo are also planning to enter the market by forming JVs with suitable local players to cater to the Indian as well as export markets. Though currently down due to severe slowdown in economic activity around the globe, the CV market is expected to pick up again in infrastructure-led growth.

India is the second-largest two-wheeler producer globally, with a domestic market of around 7.5 million units. It is also dominated by local players, with Hero Honda, Bajaj Auto and TVS Motors sharing more than 80% of the total segment. Hero Honda is the world's largest two-wheeler company. India has significant two-wheeler exports as well, exceeding 1 million units in FY09. Two-wheelers are mainly purchased to meet the need for regular mobility. This, accompanied by low levels of vehicular penetration in the country, offers sustained growth for two-wheelers in India.

India's developing auto components industry

India has a strong indigenous auto components industry, and a number of these players are making their mark on the global industry through acquisitions in Western Europe and North America. Attracted by lower cost of operations, India has also received considerable inward investment in the sector from many global Tier 1 suppliers.

| 2007 | Population (millions) | Passenger car population (million) | Car density (cars per 1,000 people) |
|----------------|-----------------------|------------------------------------|-------------------------------------|
| Germany | 82.2 | 46.81 | 565 |
| UK | 61.0 | 31.34 | 521 |
| US | 302.8 | 136.01 | 450 |
| Czech Republic | 10.2 | 4.31 | 424 |
| Poland | 38.1 | 14.21 | 369 |
| South Korea | 48.9 | 9.65 | 246 |
| Russia | 142.3 | 26.79 | 188 |
| Brazil | 189.4 | 19.80 | 107 |
| Turkey | 75.1 | 6.24 | 85 |
| China | 1,322.1 | 21.43 | 16 |
| India | 1,135.6 | 12.06 | 9 |

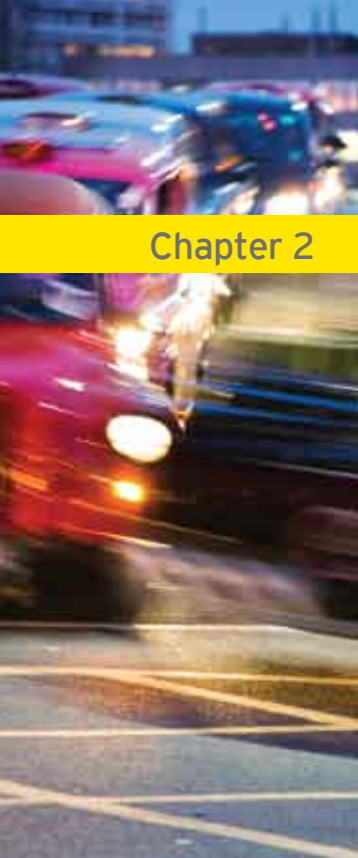
Source: Global Insight, Rosstat

"The way you have seen the global auto industry over the years, I do not think it is ever going to be the same in times to come. Also, the government is now involved in running the auto industry. Further, the value proposition for all supply chains is going to be grossly changed. Technology driven by legislation both on consumption & emission is going through a major change specifically in relation to the drive train. Usage of a lot of the new composites, the process with which bodies are made and the way materials are put together is also going to transform."

Deep Kapuria
Chairman, Hi-Tech Group

Ernst & Young viewpoint

In terms of current market size, India is relatively small compared to other emerging auto markets of the world like Russia, Brazil, Korea and China. However, India will be an active contributor to the industry's growth in the next few years. Considering the low-cost manufacturing capability, along with the increased focus on quality and designing capabilities, India is gaining importance in the global automotive landscape.



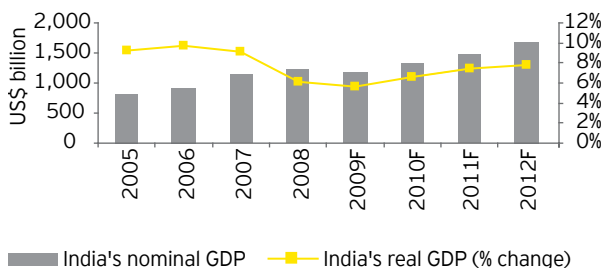
India's economy

Key insights

- India is the fourth-largest economy in the world on a PPP basis
- India was at the center of the investing world with SENSEX securing CAGR of 43% between 2003 and 2007 before nose-diving in 2008
- Going forward, growth in India is expected to remain higher than all other economies of the world except China

India entered the league of US\$1 trillion economies in 2007. The rate of growth has been more than 9% in the last four years, making it the second-fastest-growing economy in the world behind China. Growth in per capita income (~14%) has been higher than GDP growth, signaling the the growth's inclusive nature.

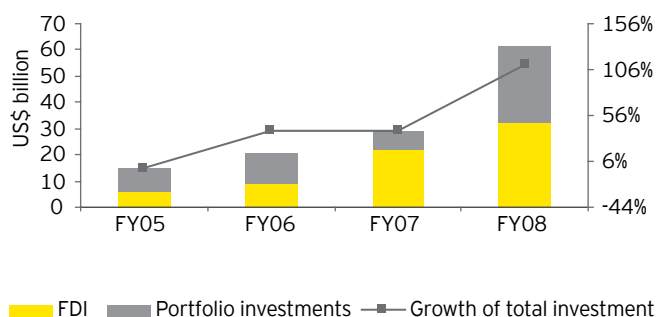
Nominal GDP and real GDP growth



Source: Global Insight update - June 2009

The services sector has grown at a CAGR of 9.5% in the last six years, while the industry and agriculture sectors have grown at a CAGR of 9.1% and 2.7%, respectively. The total investment in infrastructure in FY07 was estimated to be around 5% of GDP and it is projected to increase to 9% by FY12.

Investment trend in India



Source: Ernst & Young analysis

| Contribution of auto sector to GDP (in %) | |
|---|------------------------|
| Year | Share in country's GDP |
| 2006 | 5.2% |
| 2010E | 7.2% |
| 2016E | 10.4% |

Source: Automotive Mission Plan (Ministry of Heavy Industries & Public Enterprises, Department of Heavy Industry, Government of India)

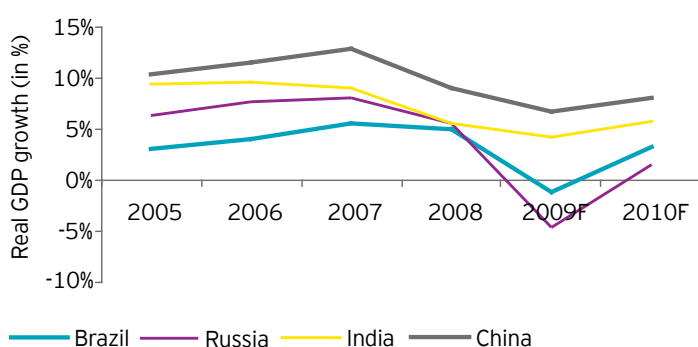
| Macroeconomic indicators | | | | | |
|---|---------|---------|---------|---------|---------|
| | 2005 | 2006 | 2007 | 2008 | 2009F |
| Real GDP (% change) | 9.3 | 9.7 | 9.1 | 6.1 | 5.6 |
| Nominal GDP (US\$billion) | 813.3 | 911.4 | 1,142.3 | 1,223.2 | 1,180.9 |
| Nominal GDP per capita (US\$) | 717 | 791 | 977 | 1,031 | 981 |
| Industrial index of production (% change) | 7.9 | 10.3 | 10.3 | 3.9 | -0.4 |
| Population (million) | 1,134.4 | 1,151.7 | 1,169.0 | 1,186.1 | 1,203.2 |
| Population (% change) | 1.6 | 1.5 | 1.5 | 1.5 | 1.4 |
| Unemployment rate (%) | 9.7 | 9.3 | 9.2 | 9.3 | 9.9 |
| BOP exports of goods (US\$billion) | 94.1 | 116.7 | 140.4 | 169.8 | 137.6 |
| Trade balance (% of GDP) | -4.9 | -5.7 | -6.0 | -9.1 | -6.7 |
| Exchange rate (LCU/US\$, end of period) | 45.0 | 44.2 | 39.4 | 48.4 | 47.7 |
| Consumer price index (% change) | - | 5.8 | 6.4 | 8.4 | 6.9 |

Source: Global Insight update - June 2009

Note: Figures for 2009 are forecasted

Most would agree that 2008 was the year of change. While soaring crude and commodity prices stoked inflation to 13-year-high levels in August 2008, it has fallen to 0.48% toward end of May 2009. In 2008, the phenomenal growth of SENSEX turned into a nosedive, with a drop of 52% during the year. There has been a demand slowdown leading to fall in manufacturing output. Expansion plans have been put on hold. Players are exploring niche markets for volume growth.

Real GDP growth for BRIC countries

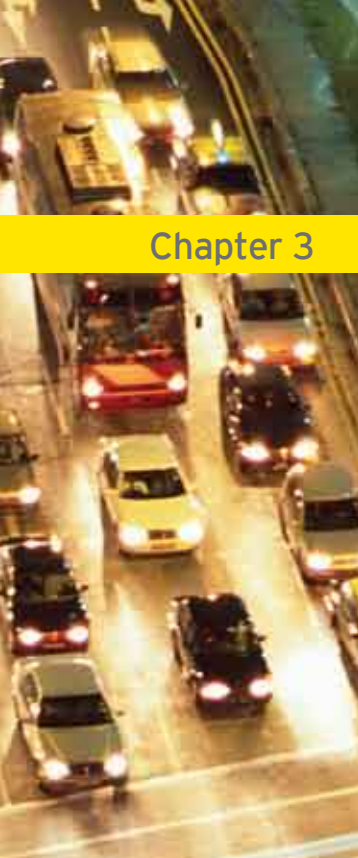


Source: Global Insight update -15 May 2009

Note: figures for 2009 and 2010 are forecasted

Ernst & Young viewpoint

There is no denying the global downturn and its impact on the Indian economy. However, after five years of spectacular performance, a year of correction should not be looked at with surprise or dismay. What differentiates India from the rest of the world is the resilient nature of the domestic economy and the inclusive nature of growth, which will bring the country back on a growth trajectory faster than its peers. Though some early signs of economic revival are already showing, we expect the sustainable recovery to start toward the end of FY10.



Chapter 3

Passenger vehicles

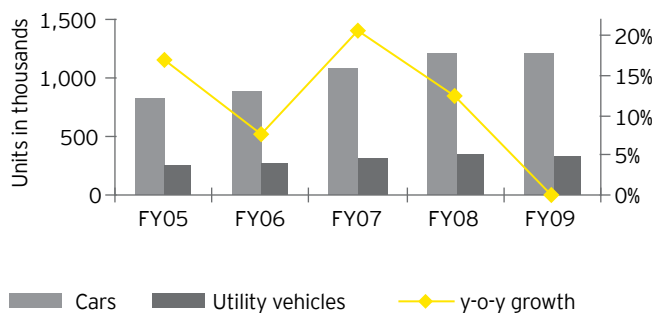
Key insights

- The production of PVs in India has grown more than threefold over the last decade
- India is primarily a small-car market, with more than 75% of total volume being small cars
- According to estimates, by 2014 India is expected to become the sixth-largest PV market and fifth-largest PV producer in the world

The last five years have been exceptionally good for the car industry wherein PV sales grew at a CAGR of 11.5% domestically during the period FY05-09, while exports grew at a CAGR of 21% during the same period.

However, toward the end of 2008, the segment started witnessing a slowdown impacted by depressed consumer sentiments and postponement of purchases due to a weak income outlook, resulting in a weak domestic demand. In FY09, domestic sales in the segment grew marginally by 0.13% year-on-year (y-o-y) to 1.6 million units. Financing has also been a concern for the segment; lending norms in relation to weak customer profiles have become more stringent. The tightening of credit norms and the repossession rule¹ reinforced from January 2008 has impacted the domestic PV sales in FY09. To cushion the loss in liquidity, OEMs are teaming up with more finance companies and some are planning to set up a captive financing arm.

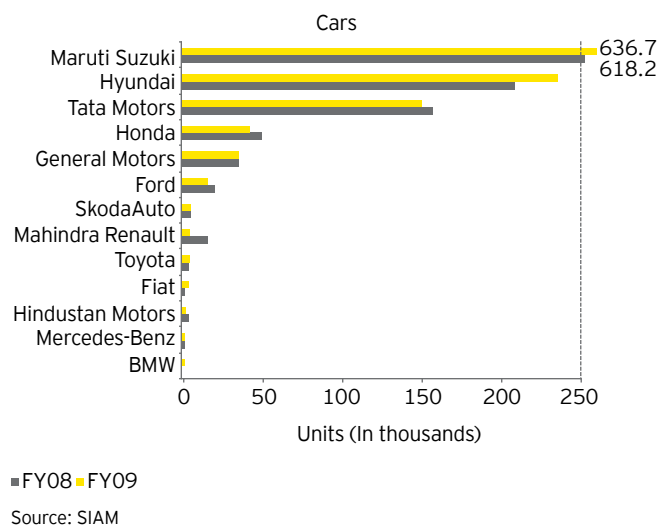
PV: domestic sales trend



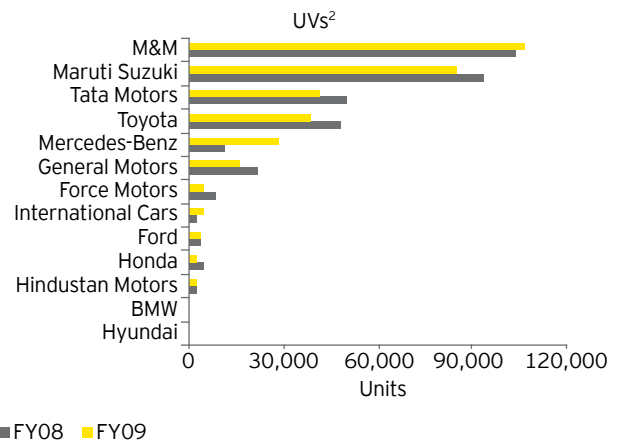
Source: SIAM

1. According to the rule, in vehicle financing cases involving delinquencies, the financiers are not allowed to repossess the vehicle that was financed without a court intervention.

PVs: domestic sales by manufacturers



Source: SIAM



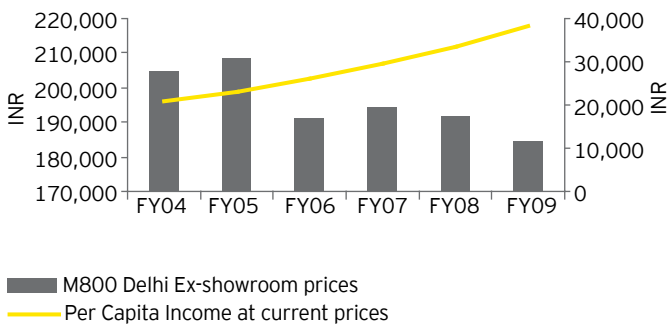
Source: SIAM

2. UV segment also includes MPVs; Maruti Suzuki offers Omni and Versa, and Tata Motors offers Ace Magic in this segment.

For years, India has primarily been a small-car market, mainly due to the high demand for a cost-effective mode of transportation. However, there has been an upward movement by the consumers, driven by the increased personal disposable incomes, changing consumer preferences and the desire to upgrade.

While the nominal prices of the passenger vehicle have remained same or have come down in the last few years, there has been an increase in per capita income in India signaling increase in the vehicle affordability.

Car prices and personal disposable income



Source: Company information, Central Statistical Organization

Innovative capabilities

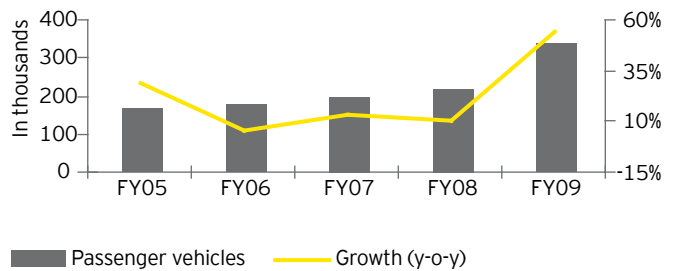
The launch of the Tata Nano (a US\$2,250 car) is set to revolutionize the industry, not just in India but internationally, by creating a new ULCC segment. Looking at the growth opportunity this segment offers, a number of foreign players are considering developing their offerings in this segment. The used car segment

The used car market is estimated to be almost equal to the new car market. With a car parc of 11 million cars, only 10% of this total market is organized. The used car business not only facilitates new car sales but also adds to the bottom line of the dealerships. Maruti Suzuki has been the first mover in this segment through its TrueValue network, but lately other OEMs have also made their way into this segment.

Exports

Driven by India's low cost base and growing market, global players are setting up their manufacturing facilities in the country to cater to domestic demand and also tap export markets.

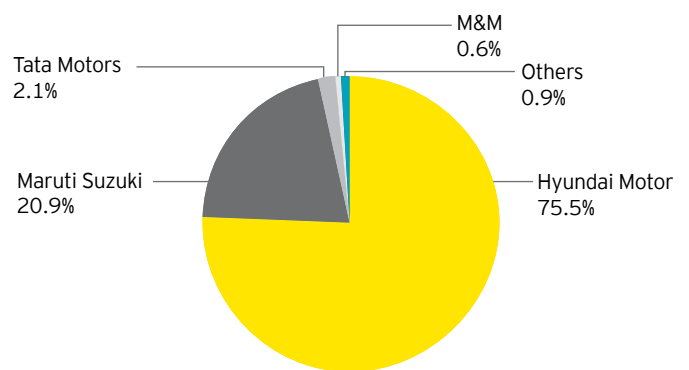
PVs: export trend



Source: SIAM

During FY09, exports accounted for 17.8% of the total PVs sold, compared to 9.2% in FY03, with small cars comprising around 90% of total passenger vehicle exports in FY09. Hyundai is the largest exporter with an export volume of 253,345 units for FY09, compared to 144,439 in FY08. Major export destinations for PVs, which accounted for more than 50% of India's exports, included Algeria, Italy, Mexico, South Africa and Sri Lanka.

PVs: manufacturer's exports share (FY09)



Source: SIAM

"The companies that are most flexible will be the most successful in riding out the current economic slowdown."

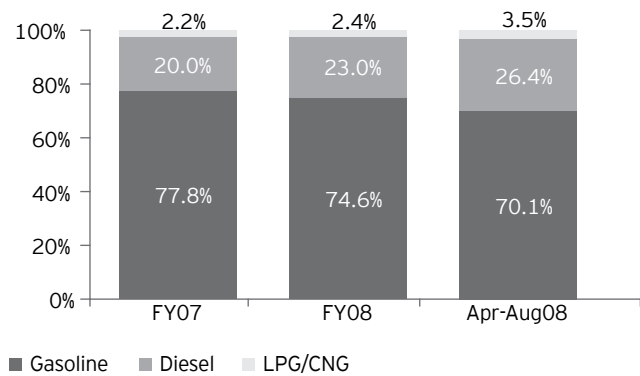
Ajay Seth
Chief Financial Officer, Maruti Suzuki India Limited

The government of India has been promoting exports in the automobile segment through Focus Market Scheme (FMS) and Focus Product Scheme (FPS) under which automakers receive cash incentives of up to 5% upon shipping specified vehicles to specified countries, most of which are located in Africa, Eastern Europe, Latin America and the Commonwealth of Independent States.

Increasing penetration of CNG

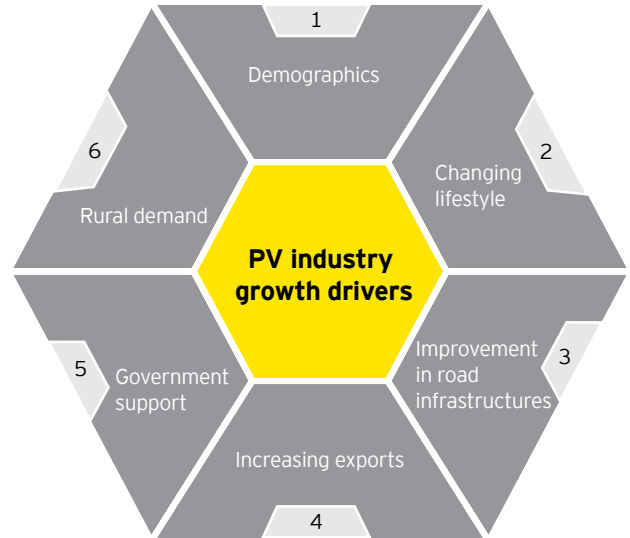
Driven by the large price differential between gasoline and CNG and the introduction of CNG variants, there has been an increase in the number of CNG vehicles that has been growing at a CAGR of 60% in the last two years. But most of this is through retrofitment done at local garages without any OEMs' warranty. CNG penetration in countries like Argentina, Brazil and Pakistan is 20%.

Share in new passenger car sale by fuel type



Source: CRIS INFAC

Apart from CNG, there is some development in the field of advanced powertrains like hybrid and fuel cells. However, the size of this segment is currently very small given the high cost of technology. Government is trying to promote these by offering some incentives to the consumers. However, it is likely to be a sizable market in the next three to five years.



Source: Ernst & Young analysis

Ernst & Young viewpoint

Growth slowed down over the last two years. Manufacturers will have to focus on niche segments like rural markets using smart marketing in order to tap the potential. New model launches have been successful in securing volumes, and the product pipeline looks busy for the short term. We expect 2010 to be a moderate growth year for domestic markets. In global markets, total demand has fallen; however, small and fuel-efficient products are growing. India has a strong low-cost fuel-efficient product range, which has a good potential in such a scenario.

Commercial vehicles

Chapter 4

Key insights

India is the fourth-largest CV market in the world

Presently, commercial vehicles account for more than 60% of the total freight movement in the country

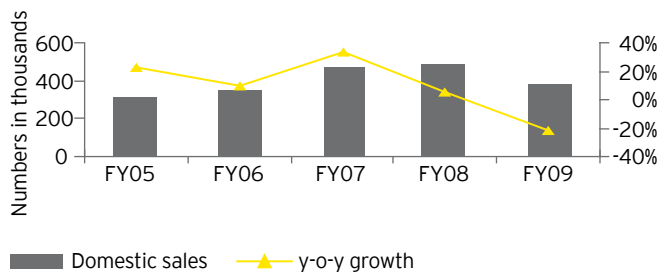
The Indian CV industry is dominated by domestic players, with more than 90% of the total segment being held between Tata Motors, Ashok Leyland, M&M and Eicher Motors

Increasing economic activity, especially the infrastructure, construction and mining activities, has been the principal growth drivers



In 2008, the CV segment was hit hard due to a slowdown in the economy and industrial activities. In FY09, domestic sales in this segment dropped by 21.7% y-o-y. Financing has also been a concern for the segment because of tight credit norms and the unwillingness of financiers to lend.

CVs: sales trend



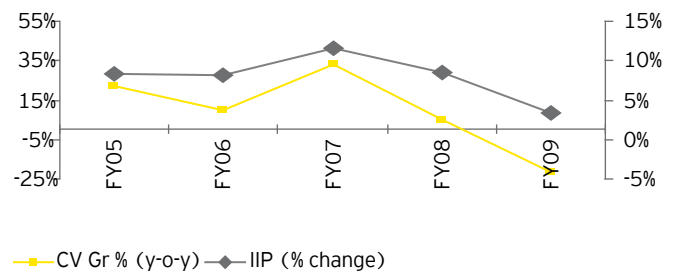
Source: SIAM and Centre for Monitoring Indian Economy (CMIE)

Domestic sales and export of CVs have increased at a CAGR of 8.1% to 19.6% during FY05 to FY09, respectively.

| Five-Year CAGR (FY05-09) | Domestic | Exports |
|--------------------------|----------|---------|
| LCV | 15% | 23% |
| M&HCV | 3% | 15% |

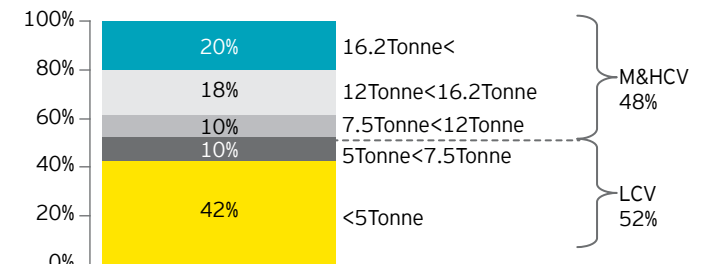
Source: SIAM

Correlation between CV growth and IIP



Source: SIAM and Ministry of Statistics and Programme Implementation

CV: segment sales share by tonnage (FY09)

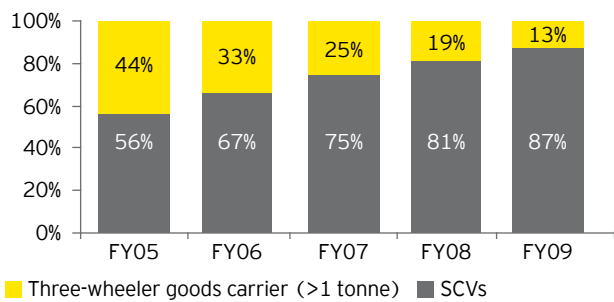


Source: SIAM



With the evolution of the hub-and-spoke model, large tonnage vehicles are being used for long-distance travel, while lower tonnage vehicles are used for last-mile distribution. Further, the growth in construction and mining activities is driving the demand for tipplers. The demand for SCVs, used for last-mile distribution, is also set to rise.

Product mix between SCVs and three-wheeler goods carriers (>1 tonne)



Source: SIAM and Ernst & Young analysis

CV: usage-wise segmental growth (y-o-y) in domestic market



Source: SIAM

Passenger carrier segment

The passenger carrier segment comprises of buses used for transportation of people for both interstate and local transportation. In FY09, this segment decreased by 7% and accounted for 16% of total domestic CV sales. The exports of passenger carriers decreased by 21% as compared to the previous year.

Market structure

The CV market in India is dominated by domestic manufacturers. The LCV and M&HCV segments both exhibit duopoly, with Tata Motors and M&M holding 88% of the LCV segment and Tata Motors and Ashok Leyland holding 88% of the M&HCV segment.



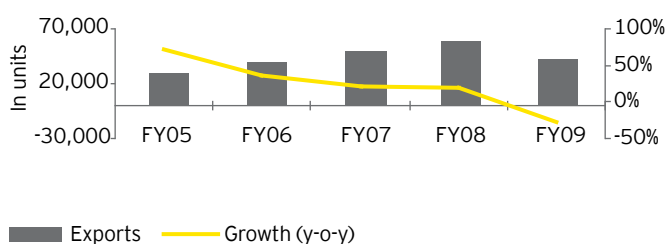
| Summary of recent JVs | | | | | | |
|-------------------------|------------------|-----------------|-----|-------|-------------------|-----|
| International players | Domestic players | Vehicle segment | | | Others | |
| | | SCV | LCV | M&HCV | Engine/powertrain | Bus |
| Nissan | Ashok Leyland | ✓ | ✓ | X | ✓ | X |
| Volvo | Eicher Motors | X | ✓ | ✓ | X | ✓ |
| Navistar (Through ITEC) | M&M | X | ✓ | ✓ | ✓ | ✓ |
| MAN AG | Force Motors | X | X | ✓ | X | ✓ |

Source: Ernst & Young analysis

Exports

Major export destinations for this segment include Bangladesh, Middle East countries, Mauritius, Nepal, South Africa, Sri Lanka and the Gulf countries. Trucks are mainly exported to Bangladesh, Nepal and Africa and passenger carriers to Sri Lanka and the Gulf countries. In FY09, LCVs accounted for an export share of 60% and M&HCVs for the remaining 40% of CV exports.

Export trend in CVs



Source: SIAM

Ernst & Young viewpoint

Fiscal 2010 may be a tough year for CVs given a strong correlation of CV sales with level of economic activity. Though we expect that the economy is likely to start looking up after first half of FY10, we do not expect the recovery to immediately translate into higher sales of CVs. Exports per se will be under severe pressure due to the slowdown in global markets, which is not expected to recover in the short term. LCVs are expected to outperform M&HCV in both domestic and export markets.

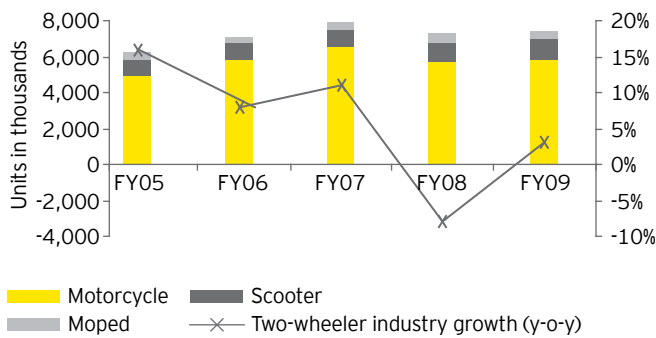
Two-wheelers

Key insights

- The country's two-wheeler industry is the second-largest in the world after China's
- Indian market leader Hero Honda is the world's largest two-wheeler company
- Driven by rural demand, low dependence on financing, new product launches and lower interest rates, two-wheelers have been able to better handle the downturn

The Indian domestic two-wheeler industry has grown at a CAGR of 7% during FY05-09. However, industry growth slowed down in FY08, with sales falling by 8% largely due to the credit squeeze and rising interest rates. In FY09, the industry has grown by 2.6%.

Domestic sales of two-wheelers

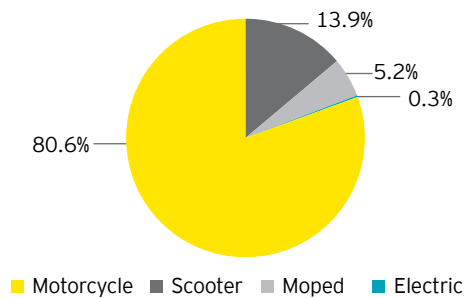


Source: SIAM

Segments

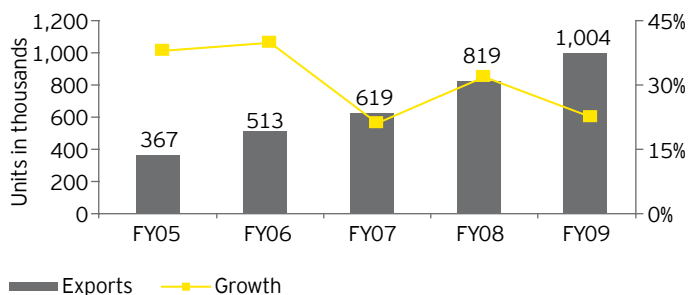
Until the late 1990s, scooters dominated two-wheeler sales, with motorcycles accounting for less than 40% share. On the back of better fuel efficiency and faster mobility, there has been a structural shift, with motorcycles holding 80% of the segment. However, with the launch of the fuel-efficient gearless scooters with contemporary technology, which target young women, teenagers and the elderly, scooter sales have been rising.

Segment share in two-wheelers (FY09)



Source: SIAM

Exports of two-wheelers

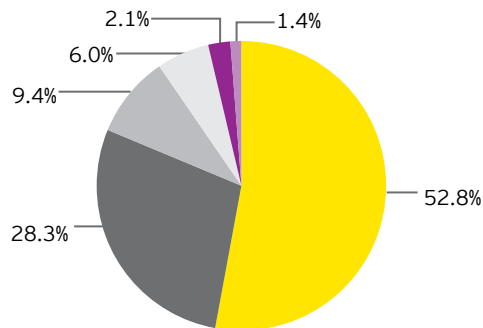


Source: SIAM

Export

The export of two-wheelers from India had a CAGR of 31% in FY05-09, crossing the 1 million mark in FY09. Motorcycles constitute 96.7% to the total export of two-wheelers. The primary markets have been the developing economies of South Asia and Latin America.

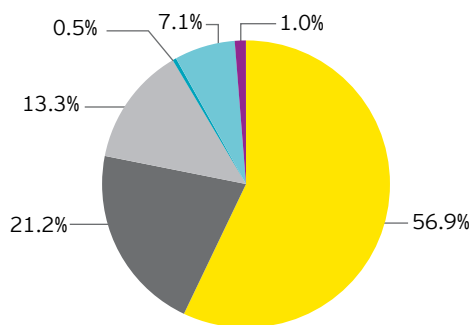
Motorcycles: market share – FY09 (by volume)



■ Hero Honda
 ■ Bajaj Auto
 ■ TVS Motors
■ Yamaha
 ■ Honda Motorcycle and Scooters
 ■ Others

Source: SIAM

Scooters: market share – FY09 (by volume)



■ Honda Motorcycle & Scooters
 ■ Hero Honda
 ■ TVS Motors
■ Mahindra Two-wheelers
 ■ Suzuki Motorcycles
 ■ Bajaj Auto

Source: SIAM



Ernst & Young viewpoint

Though FY09 was a tough year for two-wheelers like it was for other automotive sectors, the variation in growth with respect to the five-year CARG was the lowest comparatively. Considering the demographics and income levels in the country, the purchase of two-wheelers for regular mobility is very high, thus the domestic potential needs no reaffirmation. We believe that focusing on rural potential will pay dividends for the domestic market and the export volume growth should remain intact.

In comparison with other countries, Indian government cannot focus only on wealthy people. They have to take care of the people of lower income which occupy the majority. This will support the bottoming up of these people who will appear the customer of two wheelers. So, two wheelers market in India has a long way to go."

Yoshihito Konishi
 Chief Operating Officer, India Yamaha Motor Pvt Ltd

Three-wheelers



In a developing country such as India, three-wheelers are a low-cost means of transport in cities and towns. They also enable cost-effective means of intracity transportation of goods.

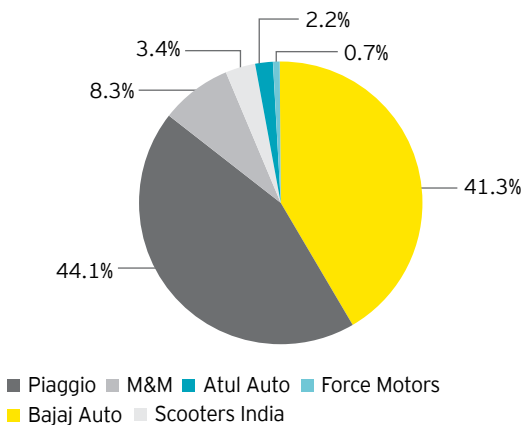
Sales of three-wheelers witnessed a 2% decline in FY09, with that of passenger carriers growing by 12% and goods carriers declining by 38%.

Domestic growth % for segment on the basis of usage



Source: SIAM

Domestic market share: FY09 (by volume)



Source: SIAM

Ernst & Young viewpoint

Three-wheelers have played an important role in the last-mile connectivity both for passenger as well as commercial purposes. The existence of a large number of small-scale businesses promises a sustained demand in the domestic market. Very little has been done in terms of product innovation, and manufacturers will have to focus on it. Going forward, this segment will face competition from SCVs in the commercial space, for which the manufacturers have to rethink their product positioning and marketing strategies.

Auto components

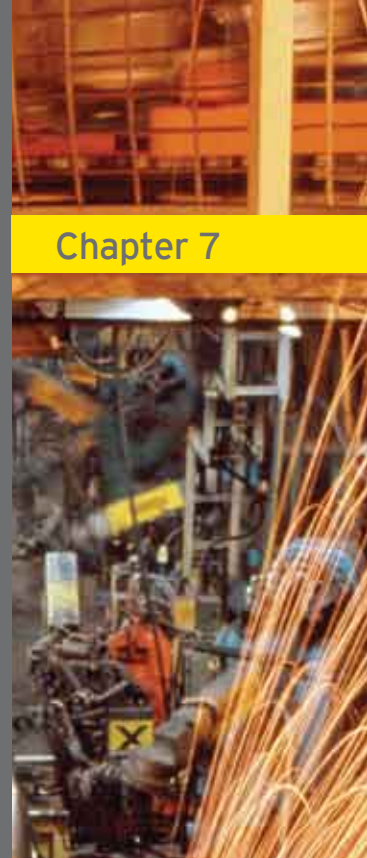
Chapter 7

The Indian auto components industry is highly fragmented, with over 2,500 players operating in the country

The Indian auto components industry has grown more than fivefold over the past decade

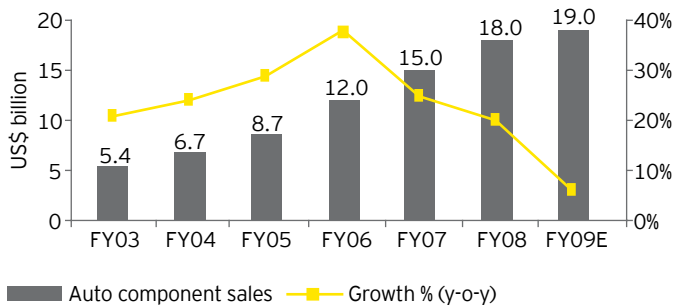
Exports have grown more than tenfold in the past decade

Key insights



As per the ACMA, the auto component industry has reached US\$19 billion by FY09 from US\$3.2 billion 10 years back. Local OEMs constitute around 58% of total sales in the segment, with exports and the aftermarket contributing 13% and 29%, respectively.

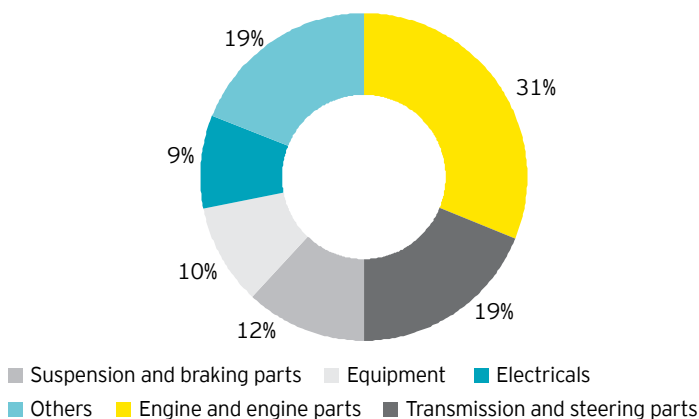
Sale of auto components



Source: ACMA

Note: Figures for 2009 are estimated

Product breakdown in FY08 (by value)

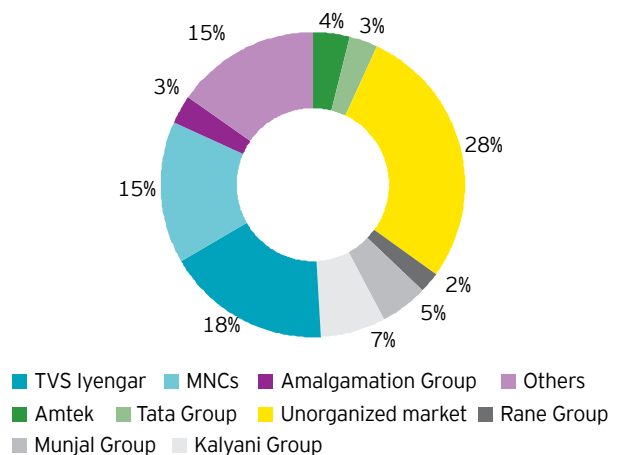


Source: CRIS INFAC

Out of 2,500 players, only 500 players constitute the organized sector and contribute more than 70% of total auto component production. The sector is dominated by large Indian promoter groups, which contribute 43% of the total production while MNCs contribute 15%.

MNCs from across the regions are present; this group includes Magna, Visteon, Valeo, Denso among others. Out of these, Bosch and the Federal-Mogul Corporation were the first movers and have been in the country for more than four decades.

Market share: FY08 (by production)



Source: CRIS INFAC

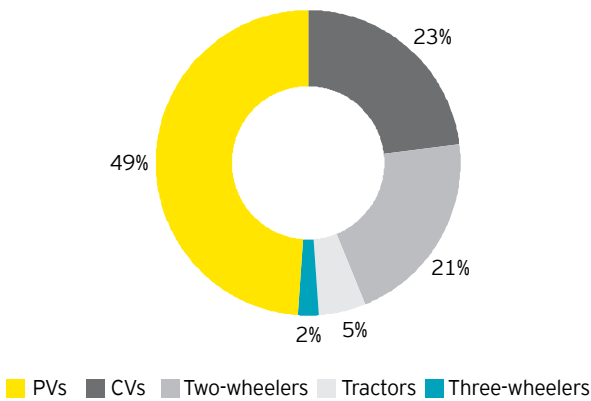
“The auto component industry in India is using this time of economic crisis to improve efficiencies, eliminate waste and reduce their overall cost structure. The industry is confident that it will emerge as an even stronger global contender when the economy recovers.”

Vishnu Mathur
Executive Director, ACMA

| Share of component players based on the size of the company (FY08) | | |
|--|---------------------|-----------------------------|
| Revenues | Number of companies | Share of organized industry |
| Less than US\$11m | 288 | 2% |
| More than US\$11m up to US\$22m | 33 | 5% |
| More than US\$22m up to US\$110m | 69 | 37% |
| More than US\$110m | 25 | 56% |

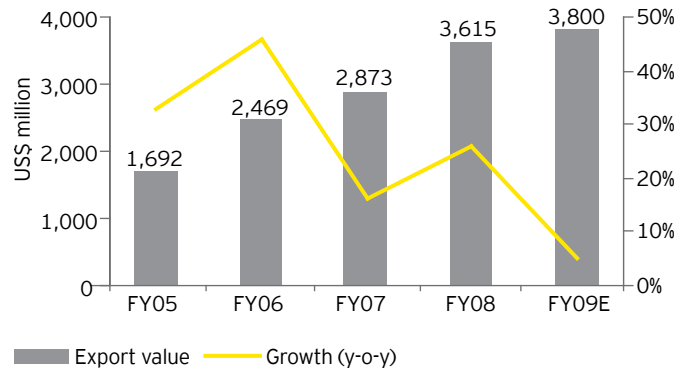
Source: CRIS INFAC
Note: Exchange rate used for above calculation 1US\$= INR 45.45

Share of various segments in auto component sales (FY08)



Source: CRIS INFAC

Auto component exports

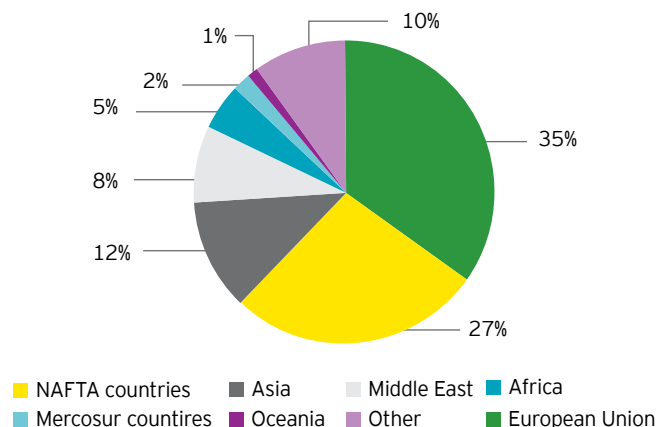


Source: ACMA
Note: Figures for 2009 are estimated

The total auto component exports from India grew at a CAGR of 24% in the period FY05-09 to reach US\$3.8 billion. The main driving element was the cost advantage due to factors such as low labor costs and increasing emphasis on the quality.

However, the slowdown in global markets and the weak financial health of global OEMs/Tier 1 suppliers has impacted amount of orders for exports. Indian suppliers have also acquired companies globally and, due to the slowdown, are currently facing challenge to sustain overseas operations.

Share of major export destinations for auto components in FY08

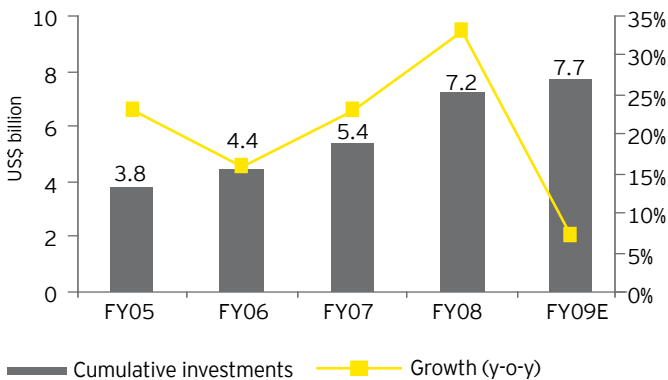


Source: CRIS INFAC
* Mercosur countries include Brazil, Argentina, Paraguay, Uruguay and a few other South American nations

Investment in auto components

According to the Automotive Mission Plan of the Indian government, auto component production worth US\$20 billion to US\$25 billion is expected to be outsourced to India by 2015. This would require an additional investment of US\$15 billion.³

Investments in auto component industry



Source: ACMA

Note: Figures for 2009 are estimated

“Since the establishment of the BMW International Purchasing Office in mid 2007 we managed to nominate a number of export projects to Indian suppliers. India offers several competitive advantages not only compared to Europe but also to other Emerging Markets.

We identified a number of well developed suppliers with quality awareness as well as manufacturing facilities of global competitiveness and partly with extensive export experience.

Thomas Thym

Director, International Purchasing Office India, BMW

Ernst & Young viewpoint

For all concerned, 2008 was a year of considerable distress for suppliers. And though one cause was slowing domestic demand, it was due more to the rapid expansion and acquisitions done in the last three years in anticipation of growth. Vendor financing was a challenge in FY09, but has been easing gradually. Growth in exports will be moderate in the short term amid the slowdown in the global markets. Going forward, we expect the level of M&A activity to be much lower during the previous two years.

³Source: CRISIL research

Auto financing

Key insights

- There are more than 35 financiers in the market today, with the State Bank of India being the leader
- Easy availability of finance has been one of the most important growth driver for the auto industry from FY03 to FY07

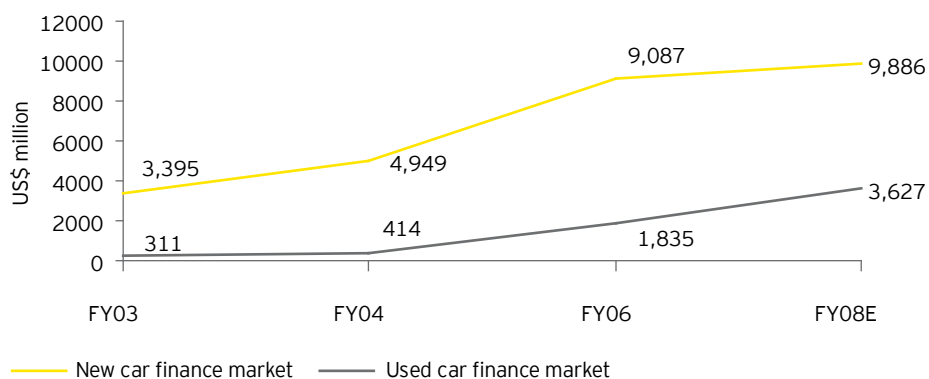
The action started in 2000 when Citibank started to offer loans for automobile purchases. Post-2000, a number of banks entered the market. ICICI was the market leader in the auto loan business before HDFC took the lead in FY08. Among the public sector banks, State Bank of India is the market leader given its vast branch network.

Auto finance was doing relatively well until the Reserve Bank of India, the country's central bank, reinforced the repossession rules in January 2008, which withdrew the right to repossess from the financier in cases of default by the customer. That led to reluctance by finance companies and credit started drying up. A bigger jolt came when the global subprime situation started spilling into the Indian financial system and defaults started increasing. Although the situation has improved since then, accessing finance remains a challenge for certain customer profiles and market segments.

| Sector | CAGR Sales (FY03-08) | CAGR Finance Market (FY03-08) |
|-------------|----------------------|-------------------------------|
| Two-wheeler | 8% | 7% |
| PVs | 17% | 18% |
| CVs | 21% | 24% |

Source: SIAM and CRIS INFAC

PV finance market in India⁴



Source: CRIS INFAC

Note: Figures for 2008 are estimated

4. The INR to US\$ conversion is done using the yearly average exchange rate.

OEMs are teaming with regional rural banks and local NBFCs to overcome the challenge of credit shortage. In addition, some manufacturers are also planning to set up their own financing arms.

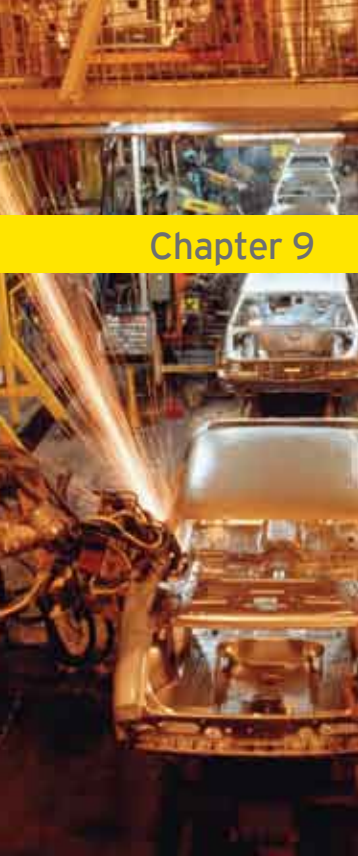
| Outlook for auto financing | | | | | |
|----------------------------|-------|-------|-------|--------------------------|---------------------------|
| Segment (US\$ billion) | FY08E | FY09F | FY13F | Five-year CAGR (FY03-08) | Five-year CAGR (FY08-13F) |
| Total PV finance market | 13.5 | 11.6 | 21.9 | na | 13.3% |
| New PC finance market | 7.3 | 6.2 | 11.5 | 18.2% | 12.5% |
| New UV finance market | 2.6 | 2.1 | 4.1 | 21.2% | 13.0% |
| Used PV finance market | 3.6 | 3.3 | 6.4 | na | 15.1% |
| New CV finance market | 6.6 | 5.7 | 7.6 | 24.0% | 5.7% |
| Two-wheeler finance market | 2.8 | 2.1 | 3.4 | 7.4% | 7.2% |

E: estimated; F: forecasted
Source: CRIS INFAC

Ernst & Young viewpoint

We are witnessing a transition in the auto financing industry. A large number of public sector banks have started to consider auto financing as a lending avenue. There has been an increase in the number of captive finance companies owned by OEMs. Financiers will be cautious in selecting the credit profiles they want to include in their portfolio, and there is a general tightening of lending norms. In the last six months, the Reserve Bank of India has reduced the policy rates to ignite the growth and initial response has been positive. Once the economic outlook starts brightening, availability of finance will also increase.





India as a manufacturing hub

Since the government allowed foreign players to set up 100% owned subsidiaries, the industry has seen an increased number of global players moving into India.

Increased design and development capabilities of the local manufacturers have made them apt partners for global players who are planning to meet local demand and cater to global requirements by setting up a manufacturing base in India.

Auto components

India's low cost of operations has led to an increase in outsourcing of auto components from the local players. Some companies are looking at sourcing components from local suppliers and others are setting up their own manufacturing units; some are opting for a mix of both. During the last two years, more than 100 projects have been announced in the auto components industry, with investments worth more than INR100 billion (US\$1.9 billion). Currently, North America and Europe are the two primary export destinations for the components industry.

| Examples of companies sourcing components either from local suppliers or one's own manufacturing facilities | |
|---|---|
| Company | Sourcing plans |
| Fiat | ▶ Opened a global sourcing office in New Delhi and is exploring possibilities of making India its sourcing hub |
| Volkswagen | ▶ Plans to increase local sourcing to 70% ▶ Plans to source components worth US\$1.3 billion by 2010 |
| Ford | ▶ Seeks to expand the engine production capacity at its Chennai plant to 250,000 per annum by 2010 ▶ Plans to make India its manufacturing hub for engines for Asia Pacific and Africa |
| Honda | ▶ Set up a powertrain facility project in Rajasthan with an investment of INR6 billion (US\$115 million) ▶ Will be an export base for certain key engine components |
| Hyundai | ▶ Plans to source gasoline and diesel engines from its Indian manufacturing operations for its domestic and global operations |

Source: Ernst & Young analysis

"India has the foundations in place and is rapidly establishing itself as a global small car manufacturing hub with significant potential to further increase exports and penetration of overseas markets."

Dilip Chenoy
Director General, SIAM

| Examples of global component suppliers with (or planning to have) their own manufacturing units in India | |
|--|--|
| Manufacturer | Expansion announcement details |
| Bosch | <ul style="list-style-type: none"> ▶ Currently has four subsidiary companies in India and manufactures various components for domestic and export markets ▶ Plans to invest further in India for capacity expansion |
| Delphi | <ul style="list-style-type: none"> ▶ Currently has four manufacturing facilities and a technical center in India ▶ Entered into several JVs with local component manufacturers ▶ Recently announced an investment of US\$57.8 million to manufacture automobile electronic components |
| Federal-Mogul Corporation | <ul style="list-style-type: none"> ▶ Currently has six manufacturing facilities in India that cater to the domestic and export markets ▶ Plans to set up a new facility to manufacture friction components |
| Magna International | <ul style="list-style-type: none"> ▶ Operates three plants in India and caters to domestic and export markets ▶ Plans to establish a manufacturing facility for window systems in India |

Source: Ernst & Young analysis

Completely built units

Currently, small cars are the front-runner in the CBU sourcing space. The cost of manufacturing of these cars is lower in India due to economies of scale, low design and research costs, local sourcing of tooling and components, and low labor costs. India-made small cars are now increasingly being exported to markets such as Latin America and Europe.

Hyundai currently exports around 40% of its small-car production from India, including the Santro which sells in 97 countries across the world and is produced only in India. The company also produced i30s exclusively for export from the same plant.

Indian companies such as Bajaj Auto and TVS Motors have also been exporting to the African, South Asian and Latin American markets.

| Companies sourcing/planning to source CBUs from India | |
|---|--|
| Volvo | <ul style="list-style-type: none"> ▶ Currently has a plant at Hoskote (near Bangalore) and exports buses to Bangladesh and Sri Lanka ▶ Plans to start exports to other markets, including Africa and Middle East, by the end of 2009 |
| Ashok Leyland and Nissan's JV | <ul style="list-style-type: none"> ▶ Plan to manufacture and export LCVs from India |
| Ford and General Motors | <ul style="list-style-type: none"> ▶ Plan to produce small cars in India for the domestic and export markets |
| Maruti Suzuki | <ul style="list-style-type: none"> ▶ Plans to export more than 100,000 units of its recently launched small car, A-Star, by FY10 |
| Nissan | <ul style="list-style-type: none"> ▶ Plans to produce its Micra, a compact car, at its upcoming plant in Chennai and export it to other markets |
| Skoda Auto | <ul style="list-style-type: none"> ▶ Plans to start local production with manufacturing target of 50,000 units ▶ Seeks to make India its regional manufacturing hub |
| Toyota | <ul style="list-style-type: none"> ▶ Plans to increase its production capacity in India more than tenfold and make it a hub for the company's small car production |

Source: Ernst & Young analysis

Ernst & Young viewpoint

India has established itself as a fully integrated and competitive manufacturing base offering R&D, engineering, manufacturing and a supplier base with high quality standards. We expect sourcing of components and CBUs to continue to grow as India also offers a location advantage with proximity to East Asia, Africa, Europe and CIS. Infrastructure needs to be further developed, particularly logistics and ports, to enable and support this growth.

Acquisitions in the automotive space

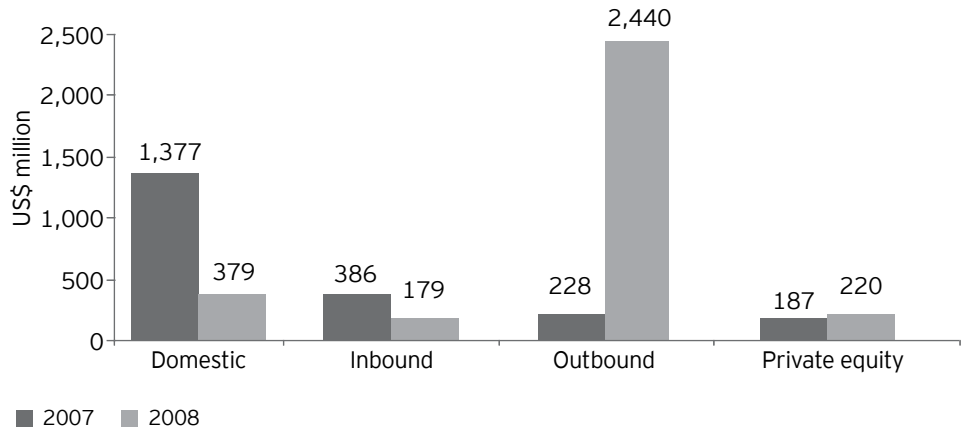
Key insights

- The domestic automotive sector recorded a deal value of US\$3.2 billion in 2008 (US\$2.2 billion in 2007)
- More deals were reportedly done with an objective of expansion in the global markets than for acquiring technical know-how
- The downturn in the automotive industry has had an impact on the global automotive M&A deal values as well; Global M&A activity fell by over 40% in 2008 to US\$27 billion, with component supplier deal activity down by over 60%

Recent years have witnessed a spate of acquisitions undertaken by the Indian automotive companies. With an aim to expand in terms of markets and products, domestic companies have aggressively adopted the inorganic growth route by acquiring assets and companies outside of India.

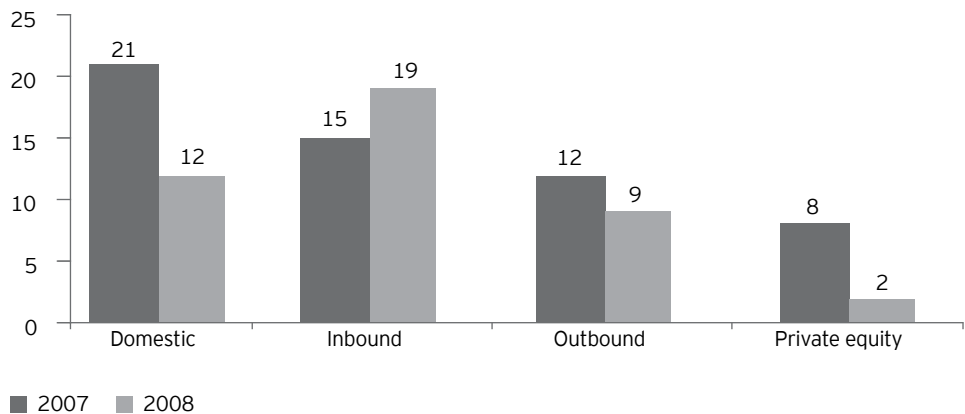
OEMs, including Tata Motors, M&M and Ashok Leyland, have been fairly active in acquiring companies in other geographies. The largest number of deals have taken place in the component industry space where a number of promoter-run businesses, like Amtek Group, M&M Systech, Minda Group and Sona Group, have been the frontrunners in the acquisition race.

Value of deals in Indian automobile industry



Source: Ernst & Young research

Number of deals in Indian automobile industry



Source: Ernst & Young analysis

The sudden and sharp reversal of the trading environment has seen the international operations of many firms running into losses, which is over and above the pressures on the domestic operations.

These deals were done during a phase of rich valuations and were funded through a large debt component. With banks pulling back their lending activity, the sector is witnessing decreased M&A activity. Companies that have opted for larger deals in the past two years are facing challenges in refinancing bridge loans.

| Deals: segment-wise (January 2007-December 2008) | | | | | | | | | | |
|--|------------|----------------|------------|---------------|------------|----------------|----------------|---------------|------------|----------------|
| Business Segment | Domestic | | Inbound | | Outbound | | Private Equity | | Total | |
| | Deal count | Value (US\$m) | Deal count | Value (US\$m) | Deal count | Value (US\$m) | Deal count | Value (US\$m) | Deal count | Value (US\$m) |
| CV | 3 | 320.5 | 10 | 97.0 | 1 | na | 2 | 195.1 | 16 | 612.6 |
| PV | 2 | 747.5 | na | na | 3 | 2,317.8 | 1 | 51.0 | 6 | 3,116.3 |
| Two-wheelers | 2 | na | 1 | na | na | na | na | na | 3 | na |
| Auto components | 26 | 688.3 | 23 | 467.2 | 17 | 349.6 | 7 | 161.0 | 73 | 1,666.1 |
| Total | 33 | 1,756.3 | 34 | 564.2 | 21 | 2,667.4 | 10 | 407.1 | 98 | 5,395.0 |

Source: Ernst & Young analysis



| Recent outbound deals primarily driven by expansion of international business | | |
|---|---|---|
| Acquirer | Target company | Rationale |
| Amtek Auto | UK-based J.L. French's (Witham) for US\$37.05 million | The acquisition will enable the company to foray into the aluminum case components business and provide it access to the European Union market (June 2007). |
| Ashok Leyland | Czech Republic-based truck-manufacturing business of Avia for US\$35 million | The acquisition will enable the company to widen its geographical presence and strengthen its product range (August 2006). |
| M&M | Majority stake in a JV with China-based tractor company, Yancheng Tractor, for US\$26 million | The deal will strengthen the company's tractor business as it aims to become the world's number one tractor company (August 2008). |
| Sandhar Technologies | Spain-based auto components manufacturer, Tecfisa, for EUR14.5 million | The acquisition will give the company access to the European market (November 2007). |
| Sona Okegawa Precision Forgings | Germany-based ThyssenKrupp Prazisions Schmiede | The acquisition will enable Sona Okegawa to expand its capacity and international exposure (January 2008). |
| Tata Motors | UK-based Jaguar and Land Rover for US\$2.3 billion | This will enable Tata Motors to expand its automotive business across the globe (June 2008). |

Source: Ernst & Young analysis

| Recent outbound deals primarily driven by acquisition of technological know-how | | |
|---|---|---|
| Acquirer | Target company | Rationale |
| Amtek Auto | UK-based Triplex Ketlon Group for US\$39.9 million | The acquisition will provide Amtek with access to superior technology and expand its precision machining operations (November 2007). |
| Bajaj Auto | Increased its stake to 30% in Austria-based KTM Power Sports | The acquisition will give the company access to KTM's technology and distribution network across Europe (February 2009). |
| M&M | Italy-based motorcycle design-developing company, Engines Engineering, for EUR8.5 million | The acquisition will provide M&M with access to technological expertise to widen its engineering and design services and an exposure to the international markets (June 2008). |
| Tata Motors | 50.3% stake in Norway-based Miljo Grenland for INR94 million | The acquisition is in line with the company's strategy of developing convenient, affordable and sustainable mobility solutions through electric and hybrid vehicles (October 2008). |

Source: Ernst & Young analysis

Ernst & Young viewpoint

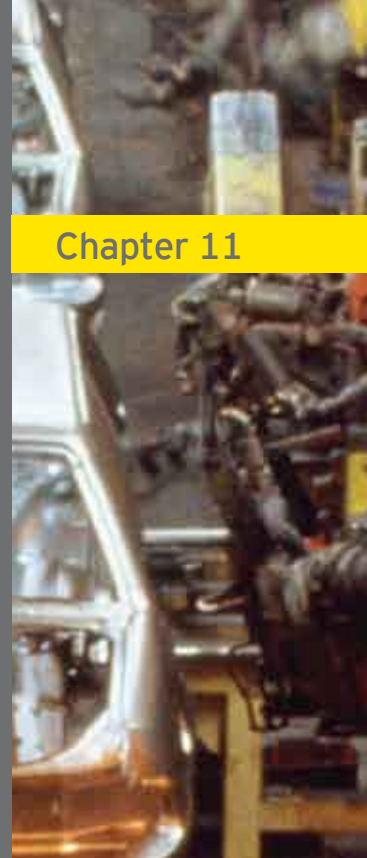
Globally, we are likely to see a number of assets and businesses being put on the block as players realign their business to the trading environment. In the domestic industry, the previous two years witnessed some unprecedented levels of M&A activity within the auto sector. Players, mainly suppliers, took the inorganic route to acquire technology or customer base. Many players are facing challenges in sustaining the overseas acquisitions. Cost of capital has increased significantly. In the very short term, the scale of activity in the M&A space will be much lower compared to the previous two years even if economic outlook improves, as players will follow a cautious approach. However, this is expected to improve from 2010 onward.

India as an emerging R&D destination

Over the past four years, the cumulative R&D expense of 10 major players⁵ across segments has increased at a CAGR of 47%, from INR4.3 billion in FY04 to INR20 billion in FY08

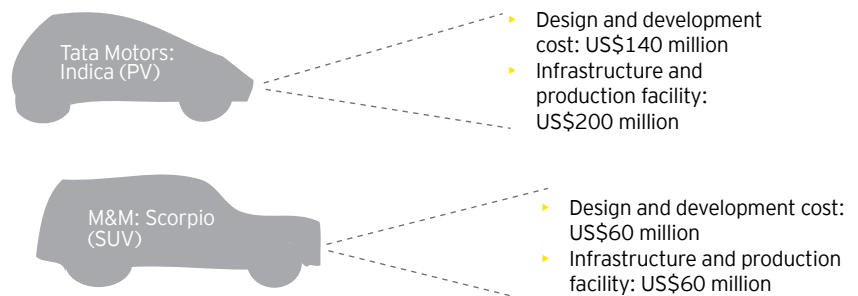
Maruti Suzuki is planning to set up an R&D center in India of equal size and capability as the R&D center of its parent Suzuki Motor Corporation in Japan

Key insights



The Indian automobile industry was traditionally dependent on imported technology. Over the years, domestic players entered collaborations with foreign players in the automobile and auto components space to gain technological expertise and engage in joint product development. A major breakthrough came in 1998 when Tata Motors launched India's first indigenous passenger car, the Indica.

Examples of indigenous product development capability



Source: ACMA

Recent product developments

The development of the Nano, the innovative US\$2,250 car, has showcased India's ability to innovate and design. Reva, India's first electric car, is also an example in this case. Companies like M&M and the Hero Group are planning to develop electric vehicles. In the commercial vehicles space, Tata Daewoo, a subsidiary of Tata Motors, has recently developed an LPG-based MCV (4.5 ton), the Novus, which conforms to Euro V emission norms. Ashok Leyland has developed India's first six-cylinder CNG engine for buses, which uses the multipoint fuel injection system and conforms to Euro IV emission standards. Two-wheeler manufacturers Bajaj Auto, Hero Honda and Mahindra Two-wheelers are in discussions with Energetek, a provider of absorbed natural gas products, for technology that will enable two-wheelers to run on natural gas instead of gasoline.

Indian government promoting R&D

Government policies, including a weighted tax deduction of up to 150% for in-house R&D activities in the country, have given a boost to investment in R&D. Over the past four years, the cumulative R&D expense of 10 major players⁵ across segments has increased at a CAGR of 47%, from INR4.3 billion in FY04 to INR20 billion in FY08. The average R&D spent, as a percentage of the net sales of these players, has gone up from 1.2% to 2.1% during this four-year period.

5. Ten players are Tata Motors, M&M, Bajaj Auto, TVS Motors, Eicher Motors, Ashok Leyland, Maruti Suzuki, Hero Honda, Bosch and Bharat Forge.

Drivers for international players setting up their R&D center in India

Increasing production costs, shorter product lifecycles and the increasing trend of geographic expansions to derisk dependence on one market are, among the factors, driving outsourcing. Greater importance is being accorded to India by global players. Apart from serving as a manufacturing/outsourcing destination, the country is also finding acceptance as a favored

R&D destination, benefitting from the availability of low-cost skilled and educated manpower, proven product development capabilities and location advantage due to its proximity to emerging markets. The Frugal engineering showcased in the Nano is a leading example of India's increasing R&D capabilities.

| Examples of R&D plans of foreign players | |
|--|--|
| OEMs/Tier 1 suppliers | R&D plans in India |
| Hyundai | Plans to make its Indian R&D center a hub for the development of small cars such as the i10 and the i20 for global markets at an investment of US\$50 million. |
| General Motors | Set up an R&D center in Bangalore, the first outside the US, at an investment of over US\$21 million. This will cater to the needs of countries in the Asia Pacific region. |
| Volkswagen | Plans to set up its global R&D center in India and produce vehicles for the global market in five to six years. |
| Bosch | Currently has an R&D facility at Bangalore, its largest technology center outside Germany. It plans to set up another center in the country and make India its technology hub. |

Source: Ernst & Young analysis

“In order to gain access to technology foreign technical collaboration appears to allow the best of both developed and emerging worlds. Over the last decade or so India has rapidly absorbed technologies from across the world and implemented them in a very cost efficient manner. Clearly there will be situations where outright acquisition makes more sense.”

Ashok B. Ramaswamy
 Managing Director, Delphi Automotive Systems Pvt. Ltd.

Ernst & Young viewpoint

International players are setting up R&D facilities due to the strength and depth of skilled people in India. In addition to giving international players access to resources, this will also give enriching exposure to the country's manpower, allowing workers to hone their skills. While there has been adequate seriousness among the OEMs toward R&D, auto suppliers have to focus more on building the capabilities required to take Indian R&D to the world. We expect to see increased investments in R&D by vehicle manufacturers, and this will also help the component manufacturers enhance their technology footprint.

Vehicle retailing in India

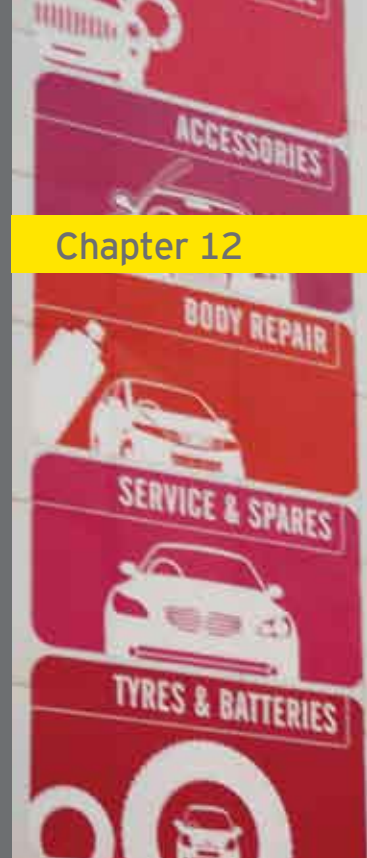
Chapter 12

Key insights

The industry has grown to more than 30 two-wheeler and four-wheeler manufacturers offering a range of over 100 models across various segments

Exchange penetration ranges from 15% to 20% in India; in some developed economies, it is as high as 90%

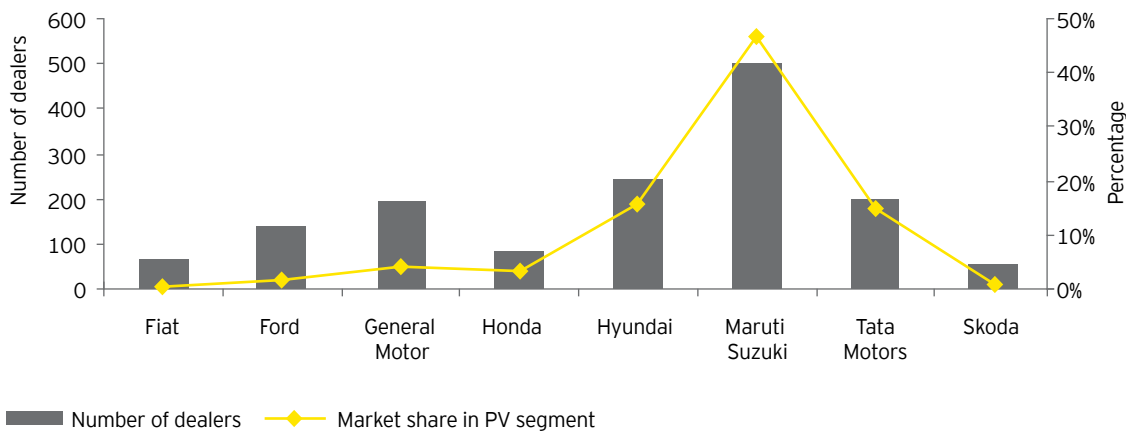
Taking auto retail to the next level is the concept of a brand center that has started to evolve in India



The organized sector of the Indian auto retail market comprises a network of 6,500 automobile dealerships and their workshops, which employ more than 0.4 million people directly. The segment is estimated to have a turnover of US\$40 billion

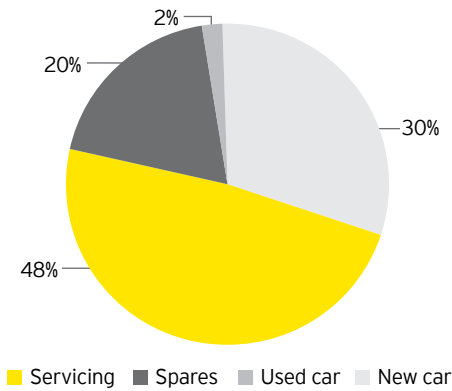
with the combined investment of US\$5.3 billion. In India, the automobile sector has the concept of exclusive dealerships where selling products from different OEMs through a common store is not allowed.

PV manufacturers: number of dealers and market share (FY09)



Source: Factiva and SIAM

Segment-wise contribution to total profits of a PV dealer



Source: Ernst & Young analysis

Changing retail formats

Historically, dealerships in India have been characterized as large, family-owned, single-brand outlets. However, there has been an improvement in terms of professionalization of management. Operationally, dealerships have undergone a change with the concept of one-stop shop evolving. This allows customers to obtain services such as vehicle financing and insurance at the dealership itself.

The world’s largest two-wheeler manufacturer, Hero Honda, has opened an alternate channel of dealerships targeted at female customers under the brand ‘just for her’. These dealerships are staffed by female sales personnel to better connect with the target clientele.

Brand centers

Brand centers are the display showrooms where all the products of the company are showcased in a manner that will attract young and trendy customers and increase brand awareness.

A beginning in this direction has been made by the German automaker BMW, which has established a brand studio. Market leader Maruti Suzuki is also planning to invest in this area and has plans to open such showrooms across the country. Yamaha India has recently launched its lifestyle store Bike Station to create excitement among urban customers. Bajaj Auto has set up its Probiking outlets for its premium performance bike segment to offer a whole new buying experience.

Servicing: a growing revenue source

In the last decade, a change has occurred in customers’ attitude toward servicing. While previously having their vehicles serviced at a local garage, customers now want specialized technical treatment for their vehicle. With an expanding vehicles population in the country that has already reached 11 million cars and 70 million for two-wheelers, vehicle servicing certainly looks to be a promising business opportunity.

Authorized service stations in India are brand exclusive. However, there has been a change in the trend with the recent entry of multibrand servicing outlets like Carnation Auto.

Rural markets

Until a few years ago, the demand for passenger cars was largely concentrated in urban areas, with the four metropolitan cities (Chennai, Delhi, Kolkata and Mumbai) accounting for a third of total sales. Today, with improved road connectivity, players are increasingly exploring and expanding their reach in nonurban areas to cater to the rising demand.

A rural environment is very different from the traditional metropolitan environment. It is more decoupled from the global factors and thus diversifies the business risk in case the traditional metros are caught in the spiral of slowdown. Some other points of difference are as follows:

- ▶ Players use smart marketing like rural events, fairs, etc., to engage the rural customer around the harvesting season.
- ▶ In place of opening full-fledged dealerships, OEMs are resorting to extension counters that act as a satellite to some of the main dealers in the city. Inquiries generated are channeled to the main city dealers for future deliveries.
- ▶ Customers prefer to have low-cost products from the product range available. There is a preference for an MPV that can be used to transport people as well as goods.
- ▶ OEMs are teaming with regional rural banks and local NBFCs that have local intelligence and cater to this segment.

Used vehicle segment

Automobile dealers are also increasingly entering the business of used vehicles. In addition to providing leads for the new car business, this also provides them with an alternative revenue channel and helps them to diversify their risks. According to the latest estimates, the used car segment is as big as the new car market. But only 10% of the used vehicle market is organized. To exploit the potential this segment offers, a number of players, including Ashok Leyland, Ford, Honda, Hyundai, Maruti Suzuki, Tata Motors and M&M, have entered this business.

| Dealership expansion plans for a few PV manufacturers in the short term ⁶ | | |
|--|---------|--------|
| Player | Current | Target |
| Maruti Suzuki | 600 | 1,000 |
| Hyundai | 242 | 300 |
| General Motors | 195 | 250 |
| Toyota | 80 | 150 |
| Honda | 51 | 91 |
| Volkswagen | 15 | 100 |
| Audi | 12 | 17 |
| BMW | 8 | 18 |
| Nissan Motor | 5 | 55 |
| Volvo | 4 | 9 |

Source: Factiva

Challenges

- ▶ Auto retailing is being compared with other retailing experiences. Creating customer loyalty will be a challenge going forward.
- ▶ Land cost, as a percentage of the total dealership, accounts for approximately 60% to 70% of setup costs, which is among the highest in the world.
- ▶ As there is a wider and more varied product range in the market, the requirement for enhanced technical and knowledge capabilities is increasing.
- ▶ Restriction of FDI in retail has discouraged international players.

Ernst & Young viewpoint

Retail is going to play a more important role as competition shifts toward differentiated customer experience. Significant investments will be made as players expand their distribution network in the short term to meet their growth plans. Urban markets are getting saturated and expensive, and this will propel a shift toward rural areas and new retail models. Emergence and viability of multibrand formats in vehicle servicing need to be tested.



6.Short term may vary from end of 2009 to 2012.

Ernst & Young's involvement in the automotive industry

As a leading professional services provider to the automotive sector, we have been at the forefront in advising our clients on the demanding challenges faced by industry players.

In these difficult market conditions, a “business-as-usual” approach is no longer a viable response. While individual organizations have limited influence over macroeconomic factors, a proactive approach with a sharp focus on managing the evolving scenarios should enable your organization to minimize the impact of the economic slowdown and protect the business in these uncertain times. We work with many of the world's leading automotive companies in tackling their key strategic and operational challenges. At a time when forward thinking and actionable insights are needed, Ernst & Young is positioned to help.

We bring together a worldwide team of professionals with deep industry and technical experience in providing advisory, assurance, tax and transaction services. Our team engages with industry stakeholders through research, thought leadership and events to develop insights and services that meet your industry's evolving requirements. Our Global Automotive Centers enable us to address the specific challenges your organization faces. Operating between Detroit, Stuttgart, Shanghai and Tokyo, the Centers focus on the megatrends driving the changes within the industry.

We can help you build the capabilities you need to compete profitably in your markets and to transform your organization to achieve its full business potential.

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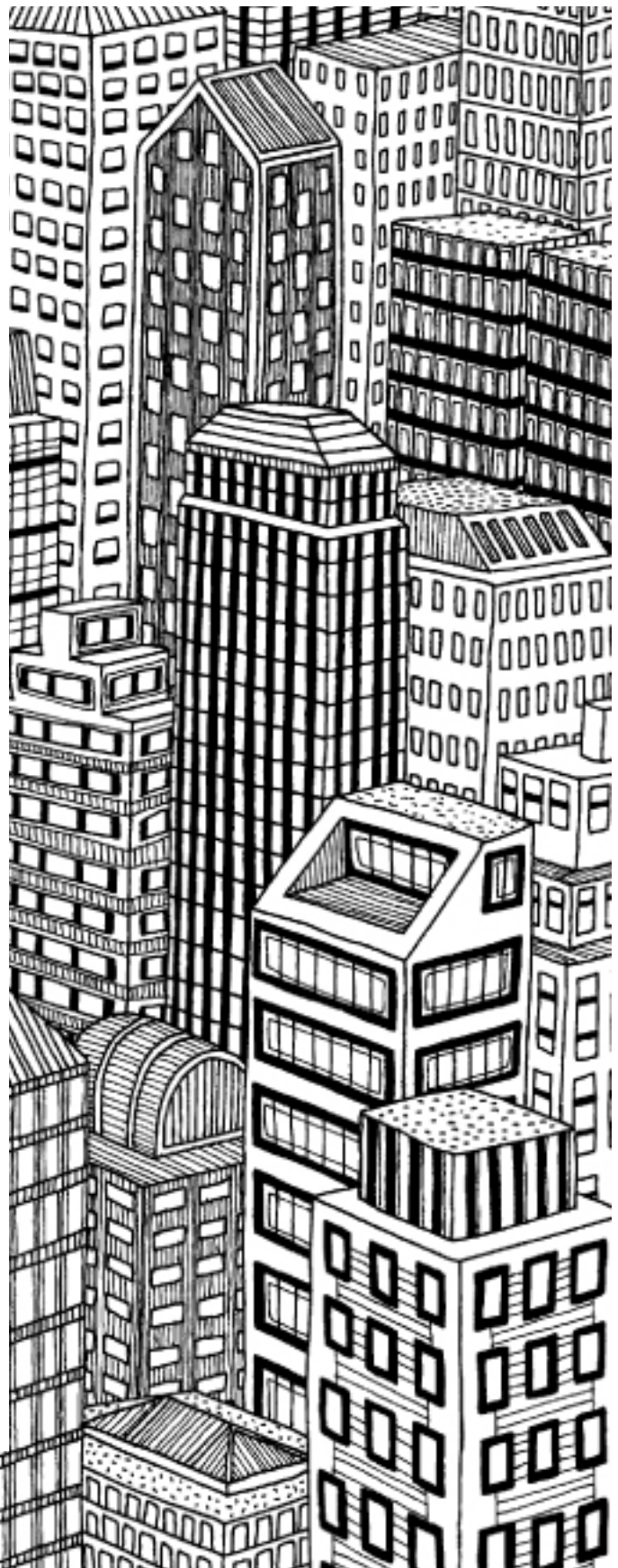
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