



Prepare for the aftershock

What's in store for Australia's automotive industry?

Australian component manufacturers heavily reliant on Ford or Toyota may have serious problems.

Almost half of Japan's 6,000 automotive suppliers have been affected by the recent earthquake and tsunami sending automotive supply chains across the world into turmoil.

The response from global original equipment manufacturers was rapid with many, if not all, putting supply chain teams on the ground within days of the earthquake. However substantial power issues, lack of water, gas, transport, significant damage to infrastructure and continued aftershocks has meant that the recovery process is slow. And an additional threat of an increased radiation exclusion zone could impact a further 200 suppliers.

While the damage and ensuing uncertainty in Japan is clear, the knock on effect on the Australian automotive industry is unknown.

With Australian suppliers typically carrying around two month's of inventory they have so far been buffered from the blow. But the impact is now looming dangerously close and suppliers need to be ready to respond.

Potential impacts to Australia's automotive industry

Domestic production cut-backs

Toyota Australia has recently announced it will cut domestic production by 50% at least during May and June 2011 due to parts supply disruptions from Japan. In addition, domestic market conditions have caused Ford Australia to announce it will cut production by 20% due to decreased demand for its larger cars. These production cut-backs will have a direct impact on local component manufacturers and reduced demand may push some already stressed suppliers into an unsustainable position.

Supply chain interruptions

Many Australian component manufacturers don't have visibility of the damage caused by the earthquake to their own supply chain. Interruptions at the tier three and tier four level may not yet have been identified meaning severe consequences could be hiding just around the corner.

Japanese companies supply 19% of semiconductor supplies, 60% of silicon, and 90% of BT resin¹ – all critical components of electronic circuit boards used in cars. These and other products such as plastics and paints will be in short supply over the coming months.

With already stressed businesses in Australia holding lower than usual levels of inventory their vulnerability to shocks in supply is greatly increased.

Finished product limitations

Automotive dealers in Australia may face difficulties due to limitations on finished product supply. Fewer cars mean fewer sales, indicating tough times ahead.

It is estimated that globally, 2.1 million units will be lost through quarter two of 2011, with only 50% of that volume being made up within 2011.² Of this lost production, approximately half will occur in the Asia-Pacific region.

Domestic output by Japan's eight largest carmakers plunged 58% in March 2011, while exports dropped 26% year over year.³



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What should you be asking your automotive customers?

1. Are you prepared? What plans have you put in place?
2. Do you have full visibility of the supply chain for the components making up your bill of materials?
3. Have you modeled production volume sensitivity and what it would mean for your profitability and working capital over the next 12-18 months?
4. How will reduced production levels impact your foreign exchange hedge books? What is your ability to close out positions?
5. For those in the dealer network – do you understand the supply limitation and how it could impact your sustainability?
6. What are your insurance options?
7. Do you know what government grants or assistance programs might be available to you?

Ernst & Young's response

Clear visibility of the supply chain past tier one and tier two suppliers is difficult for those in the Australian automotive industry. Our global automotive centre has spent the last month working with our automotive teams on the ground in Japan and across Asia-Pacific to compile a comprehensive list of Japanese automotive suppliers, their customers and the components that are likely to have been affected (some 2,350 suppliers and 5,492 customers). This list may prove to be invaluable to you and your customers in order to identify and prepare for potential supply chain problems.

To request a copy of our Japanese automotive supplier impact list please email lyndsey.hollywood@au.ey.com.

Australia is about to feel the aftershock – make sure that your customers are well prepared.

Contacts

Asia-Pacific Restructuring
Adam Nikitins
Partner
Tel: +61 3 8650 7528
adam.nikitins@au.ey.com

Australian Automotive Leader
Jacob Gossan
Partner
Tel: +61 3 9288 8523
jacob.gossan@au.ey.com

1. Economist Intelligence Unit
2. JD Power Automotive Forecasting
3. autobeat.com

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