Automotive Component Industry - Key Success Factors

BUSINESS RISK ASSESSMENT

Market Position
The assessment includes deep reviews on the company's competitive advantage of its market and business position. Auto parts suppliers with significant market shares and scales are able to spread overhead costs, better serve customers globally, and more efficiently leverage their Research & Development (R&D) expenditures over a wider range of products. Strong market share is important in positioning the company during negotiation with automakers, vendors, distributors, and regulator. The strong market position can also give a company the flexibility to adjust selling prices and ability to survive towards every business cycle better than others with lower market position. Smaller parts suppliers are vulnerable, given their relatively weak negotiating leverage and their lack of scale to manufacture at a low cost. In-depth analysis is also performed to examine several factors affecting the company's market position such as brand name, brand extensions, target market, sales and volume growth. The company's ability to create innovation and its technical cooperation/assistance with the Principal are also assessed given the increasing complexity of today's part and vehicles.

Diversification
The assessment will include a deep examination on how well the company's ability to provide various products that enables it to grasp broader market segment with different demand characteristics. Broad product lines lessen business risk and can mitigate cyclical pressures. New products and/or models offering which gives a value increase to customers will enable the price base to be adjusted. In terms of customer base, customer diversity can ease price pressures and protect against a sudden loss of demand. To protect against unpredictable customer's preference, the vehicle platform and market segments (original equipment manufactured or replacement parts) are also analyzed. Geographic diversity is also important. Regions may be in different stages of the business cycle and experience different severity of cyclicality (local versus export market).

Operating Management
The assessment includes in-depth review on the company's margin management in order to perform its business in a very efficient way. Research & Development (R&D), design and engineering capabilities, and investment are critical to measure the Company's ability to serve orders from the automakers and to win new business. Companies that have the ability to fund the R&D activities and to manufacture complete systems that combine various vehicle components have a competitive advantage over less-sophisticated parts suppliers focused on component manufacturing. To lower their costs, large auto parts suppliers have outsourced more parts and components to other smaller suppliers. This enables the larger players to limit their fixed-capital investment in non-core activities and take advantage of the product specialization of smaller players. The analysis on the company's plant utilization is also performed as it is one of the main factors to measure production efficiency. Excess capacity in a down cycle can also put pressure on operating margins, given the high operating leverage in the industry. A healthy profitability is also critical for auto parts suppliers because of their need to invest heavily in R&D and innovation including quality control system.

Companies that manufacture goods with a meaningful amount of engineering and technical content generally have greater pricing flexibility and yield higher gross margins (GPM, EBIT and EBITDA margins). The analysis on operating margins (EBIT and EBITDA) is also assessed by comparing the company's ratios with other players in the same industry or other industry with similar characteristic, which is important in analyzing the company's competitiveness. The analysis is helpful to measure operating efficiency. The company's working capital management measured by its days receivable, inventory, and payable period.
are also analyzed to determine the level of efficiency and its ability to perform the business. As part of the working capital, raw material procurement is also assessed. Fluctuating raw material costs can pressure the earnings and cash flow generation of auto parts suppliers. Some parts suppliers participate in automaker pass-through programs that provide some protection against higher raw material costs. Others have entered long term contracts with commodity producers or have found alternative sources of supply.

**Marketing and Distribution**
The assessment will include a diligent review on the company's marketing and distribution network that enable it to grab broader customer base. The company's capability, policy, and commitment to advertising activities including to strengthen brand awareness are carefully analyzed. Selling expense over revenue and compensation system to marketing teams/distributors/wholesalers as part of the company's marketing strategy is also assessed. Further assessment involves any control over distributors to see whether the company has full access to serve particular marketing area. Number of owned-warehouse and its location are also reviewed to see the company’s support on the length of distribution. Wide distribution channel to ascertain product availability in the market is expected to lessen the instability of revenue from some of marketing regions.

**FINANCIAL RISK ASSESSMENT**

**Financial Policy**
The analysis includes a review of management's philosophy, strategy and policies toward financial risk (historical, current and future). It also includes examination of management's financial targets (growth, leverage, debt structure and dividend policy), hedging and other policies in an effort to reduce the company's overall financial risk (historical vs. future). The company's track record on fulfilling its previous financial obligations is also examined to determine the degree of its commitments and willingness and consistency to pay obligations on a timely basis.

**Capital Structure**
The analysis covers careful examination of the company's historical, current and projected leverage (total and net debt in relation to equity and EBITDA), debt structures and composition (rupiah vs. foreign currencies, short-term debt vs. long-term debt, fixed rate vs. floating rate). Management of its liabilities is also thoroughly reviewed.

**Cash Flow Protection And Liquidity**
The analysis covers thorough reviews of the company's cash flow generation and capability to meet its short-term and long-term financial obligations. The degree of its debt-servicing capability level is measured by the company's interest and debt coverage ratio. The degree of its liquidity in fulfilling its short-term liabilities relative to its sources of cash is also thoroughly assessed. The sources of cash are assessed, which include cash balance, estimated cash from operations, unused credit facilities, and other sources of cash. The uses of cash other than short-term liabilities, such as capital expenditure, are also assessed.

**Financial Flexibility**
The analysis covers combined evaluations of all the financial measures above to arrive at an overall view of the company's financial health. Analysis of other related factors or figures that are not specifically examined above, such as insurance coverage, restrictive covenants in loan/bond agreements or parental linkage and support, are also covered. Other analytical tasks covered are the evaluation of the company's options under stress, including contingency plans and other capabilities and flexibility to deal with various adverse scenarios. Shareholder support and commitment are also greatly considered.