MERatings
Middle East Credit Rating Agency

Qatar Automotive Sector

Sector Analysis

April 2019

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1. Market overview:

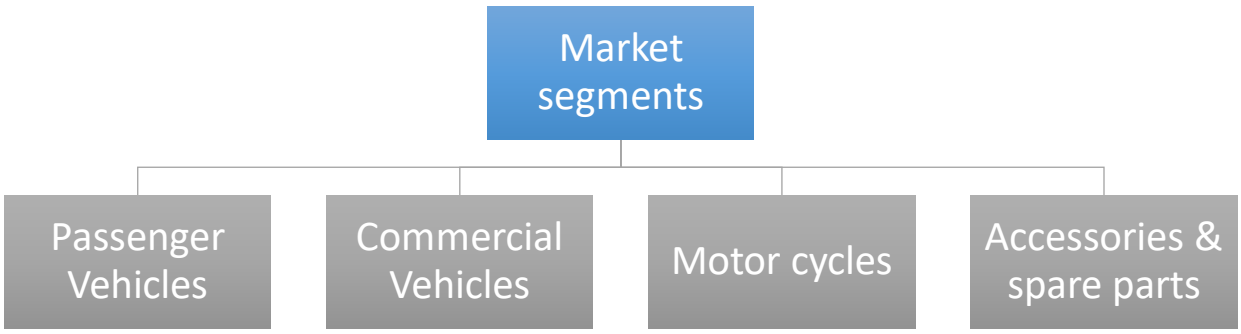
Qatar, an oil-based economy, is one of the richest countries with GDP per capita being the highest in the world. With a population of only about 2.7 million, out of which almost 88% comprises expatriates, Qatar has the highest human development index amongst the Arab countries. With considerable demand for vehicles emanating from oil as well as non-oil sectors. The Government of Qatar is also focusing on boosting the country's tourism industry, which is catapulting demand for commercial buses in the country. According to the 'Qatar National Vision 2030', the Government of Qatar is aiming at transforming Qatar into a leading urban settlement by 2030, which would result in continuing growth in construction activities in the country, thereby propelling the demand for vehicles over the next decade (Techsciresearch.com, 2015).

The Qatar automotive Industry experienced a slowdown in 2017, with a decline in sales of 47% on average across all automotive brands. The largest market share is enjoyed by Japanese brands including Toyota, Nissan and Hyundai (51% in 2017). American brands (GMC, Cadillac, Chevrolet and Ford) follow with an approximate market share of 12% as of 2017. Demand for used spare parts such as brake pads, transmission controls, AC functions, coolant, wipes and belts continue to prevail in this sector with demand for spare parts increasing substantially during the summer period as many people tend to go on vacation using their vehicles, preferring road trips to neighbouring countries. As such, people purchase spare parts in sets and carry out the necessary vehicle checks and repairs before they leave for the summer. The reliance and demand for spare parts for motor vehicles are set to remain in the years ahead. (Export.gov, 2018).

Demand for trucks and utility vehicles decreased in 2017 given the slowdown in construction activity. European brands continue to enjoy the highest market share in trucks segment with brands such as Mercedes Benz dominating the market, followed by MAN, IVECO and Renault. (Export.gov, 2018). In the commercial vehicle segment, Toyota is the leading commercial vehicle seller in the country with the majority of its sales comprising light commercial vehicles. Other prominent commercial vehicle manufacturers include Nissan, Mitsubishi Fuso Truck & Bus Corporation, Mercedes Benz, MAN and Hyundai. Doha, being the capital of the country as well as the economic, commercial and cultural centre of Qatar, accounts for the highest share of commercial vehicle sales in the country. (Techsciresearch.com, 2015).

2. Qatar Automotive Market Segmentation:

The automotive manufacturing industry comprises of the production of passenger vehicles, commercial vehicles, motorcycles, buses and trucks. The automotive industry can be divided into four broad segments, and they are as follows:



Growth in new vehicle sales is forecasted at 5.1%, with commercial vehicle (CV) sales growth of 5.4% to outperform passenger vehicle (PV) sales growth of 5% (Marketresearch.com, 2018). The number of passenger cars in use in Qatar is expected to reach about 912,000 units by 2020 (Perumal, 2016). Although new passenger vehicle sales have remained under pressure in the last few years, the economic environment in Qatar stabilized in 2018 and is expected to improve in 2019, thereby contributing positively towards passenger vehicles sales growth. Growing construction activities and expanding tourism sector will drive commercial vehicles demand in Qatar through 2022. Qatar's commercial market is forecast to grow at CAGR of over 10% during 2017-2022 (Research, 2017). Moreover, as far as the after-sales market (accessories & spare parts) is concerned, an increasing number of vehicles coupled with hot climatic conditions and a rugged terrain, which affects the lifespan of tires and batteries, has created a thriving after-sales market. (AMEInfo, 2017).

The accessories and spare parts segment would be the focus of attention for car dealers as the market matures, with profitability centres shifting from conventional areas such as new vehicle sales to parts, service & accessories.

3. Automotive Industry Analysis:

Qatar Automotive Industry includes manufacturers of cars, trucks, and buses, etc. as players. The key buyers will be taken as car, truck & buses dealerships whereas manufacturers of raw materials (steel, copper, aluminium) and readymade components as key suppliers. The table below summarizes the outcome of porter five forces analysis:

Sr.#	Industry factor	Overall Impact (Low/Moderate/High)
1	Competitive Rivalry	High
2	Bargaining power of Buyers	Low
3	Bargaining power of Suppliers	Moderate
4	Threat of new entrants	Low
5	Threat of substitutes	Moderate

3.1. Competitive Rivalry:

The competitive rivalry in Qatar Automobile market is high as the presence of several strong dealers makes automobile market highly competitive, resulting in price sensitivity and low brand loyalty among consumers. While Japanese car brands remain popular, the high-end market continues to be dominated by European makes. Chinese brands are fast closing the gap with low pricing and less maintenance cost (ArabianBusiness.com, 2016), although their market share at present remains low. Growing competition means that it will be harder to retain existing and future customers. However, there are several tools available to car dealers to assist them increase retention rates, e.g. customers expect instant communication with car dealers using their preferred channel of communication including phone, emails, internet messengers etc. Therefore, providing timely and accurate information to the customer can enhance customer experience and improve the retention rate.

3.2. Bargaining power of buyers:

Primary buyers in this industry are dealerships, and they tend to have exclusive contractual agreements with manufacturers. Therefore, dealers act as distribution channels for the manufacturers. Buyer's power is low as the dealers are highly dependent on manufactures as the product is almost completely indispensable to them, which undermines buyer power. There is a relatively large number of buyers in the Qatar automotive industry, coupled with a high level of

product differentiation, thereby further diluting buyer's power. Dealerships are also forced to sell brands and models preferred by customers which also tends to reduce their power (Wmotors.ae, 2014).

3.3. Bargaining power of suppliers:

Key inputs required by automotive manufacturers are typically commodity items, such as metals, and more differentiated inputs like fabricated components. These items are often produced by other companies rather than being manufactured in-house, although some of the larger players operate their own component production factories. When this is the case, reliance on third-party suppliers is reduced and so supplier power is weakened. With fairly low differentiation of raw materials, there is often little to distinguish between suppliers, which reduces supplier power. Typical suppliers are likely to sell to a wide variety of manufacturing companies, with the automotive industry likely to be contributing only a small share of total supplier revenues. This further strengthens the position of suppliers. Overall supplier power is moderate (Wmotors.ae, 2014).

3.4. Threat of new entrants:

Brand strength and reputation are highly important in the automotive industry, and it is therefore quite difficult for new players to enter the country's market. When a single automobile manufacturer has several brands under license, the strength of this particular player in term of branding may serve to dissuade potential new entrants. Due to the high fixed costs in automotive design and manufacture, as well as the economies of scale gained from mass production, new start-up companies are rare: the capital requirements for a manufacturing facility of feasible scale are simply too high. In addition to this, the global tightening of emission standards is ramping up costs further as vehicle redesigns are required to conform to new emissions laws. Such a trend can trigger the demand for newer, more economical engines, involving higher costs of R&D spending (Wmotors.ae, 2014). Therefore overall, the threat of new entrants is low.

3.5. Threat of substitutes:

The main substitutes threatening players in this industry are used vehicles. Dealerships, which sell both: new and used vehicles, are likely to have sold more of the latter during the global economic downturn as consumers avoid making expensive purchases, e.g. new cars. On the other hand, new

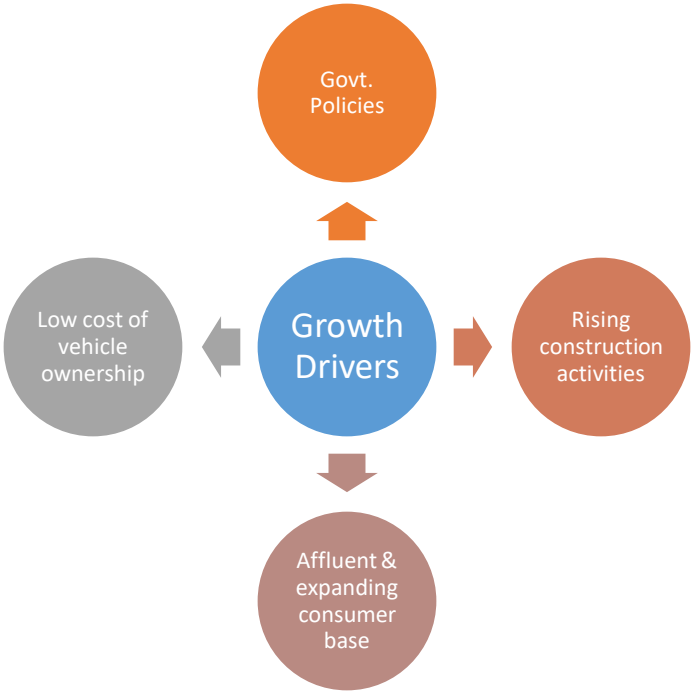
emission standards, together with technological solutions, may lead to a situation where it may be more economical in the long run (e.g. in terms of tax, fuel costs etc.) to purchase a new vehicle.

Alternative modes of transport also pose a threat of substitution. For public transport can be used by individual consumers, as opposed to having a personal vehicle; similarly, for businesses road or rail transport of goods is an alternative to owning a truck. However, in terms of the relationship between manufacturers and dealerships, there are fewer potential substitutes.

Vehicle manufacturers should be wary of the possibility of dealerships agreeing to sell cars from rival manufacturers. Indeed, car manufacturers that have long-standing contractual agreements with loyal car dealerships will be better protected from this threat. It is, however, difficult for car dealers to switch between manufacturers, not least because of contractual agreements, but also because of the switching costs which would involve completely re-branding the showroom and physically removing existing stock and replacing it. In fact, new vehicle dealerships are generally franchises associated with only one manufacturer, which reduces this threat to some extent. Additionally, manufacturers can stipulate in contracts with dealers that only new vehicles may be sold, eliminating the threat posed by used cars. Overall, the threat of substitutes is moderate (Wmotors.ae, 2014).

4. Automotive sector growth drivers:

Automotive growth in a country is dependent upon various factors including GDP growth, government policies and affluent consumer base. These are generic factors that contribute towards the growth in the Automotive Industry in any country. In the case of Qatar, the specific factors that have a major impact on the growth of Qatar Automotive Industry include the following:



4.1. Government Policies:

The government policies geared towards economic diversification in response to volatile oil prices and to reduce dependency on oil & gas based revenues indicate that the automotive sector is going to be one of the beneficiaries. The government push towards economic diversification will lead to investments in various sectors of the economy including infrastructural development, travel & tourism, transportation etc. Investment in economic sectors will generate employment opportunities and drive demand for various types of vehicles including passenger vehicles, trucks, buses etc. Moreover, since self-sufficiency is also one of the objectives of the government, therefore Government support can also be in the form of subsidized loans and land allocations for the establishment of automotive parts manufacturing setup or even automotive manufacturing setup depending upon regional market demand. (AMEInfo, 2017).

4.2. Increasing construction activities

The rising number of development projects coupled with growing building and construction activities is anticipated to drive the demand for medium and heavy commercial vehicles over the next few years. Moreover, the hosting of FIFA World Cup-2022 by Qatar is also expected to fuel the need for sustainable infrastructure for accommodating a large number of incoming tourists and sports enthusiasts in the country (Techsciresearch.com, 2015).

4.3. Low cost of vehicle ownership:

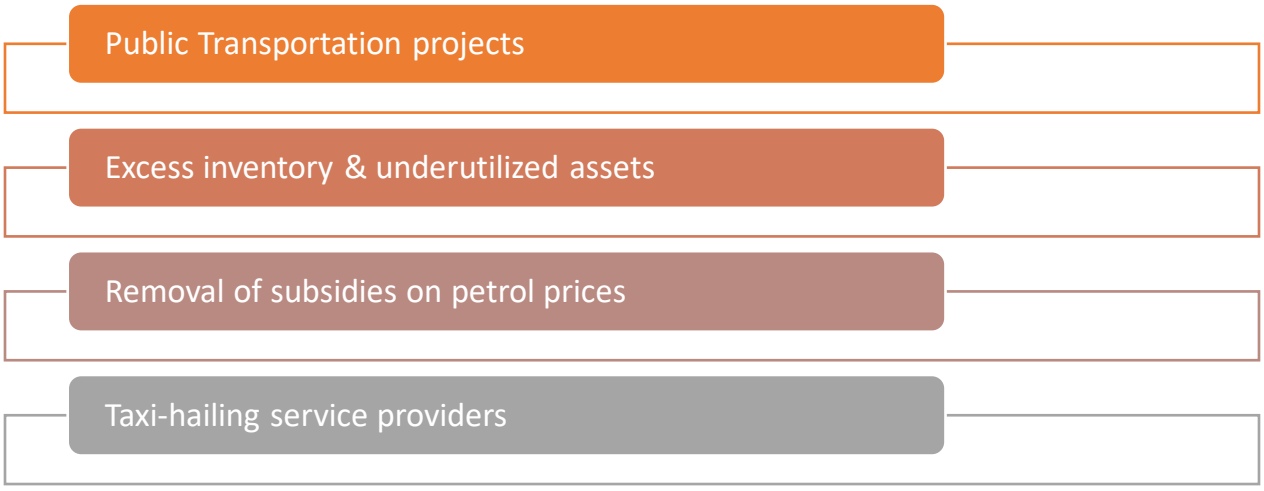
The cost of vehicle ownership in Qatar is low compared to other countries globally due to a favorable tax structure. Availability of attractive insurance and financing options also makes it convenient to own a car. Moreover, the lack of public transport system means that the availability of alternative means of transportation is limited.

4.4. Affluent & expanding consumer base:

Growth in automobile sector will be supported by an expected increase in population and tourist arrivals in the build-up to the mega football event in 2022. Qatar population is set to grow at a CAGR of 3.1% between 2015 and 2020 an increasing population base is expected to further support demand for automobiles in the country. The government is investing $200bn on infrastructure projects to prepare itself for hosting the mega event. Additionally, the government is developing the National Museum of Qatar, beaches, shopping malls, and entertainment facilities to attract an estimated 7 million tourists by 2030. Such factors act as demand catalyst for vehicle sales in the country (Perumal, 2016).

5. Qatar Automotive Industry Challenges:

The Qatar Automotive Industry is facing challenging times. The industry performance has remained sluggish in the last few years. New vehicle sales kept falling in 2018 with a decline of 6.3%, despite a government decision to postpones VAT (Value added tax) introduction by one year (https://focus2move.com, 2019). Following are some of the major challenges faced by Industry:



5.1. Public Transportation Projects:

An underdeveloped public transportation network means that the vehicle demand will keep on increasing with expanding consumer base and rise in population as an alternative mode of transportation would be limited. However, recent public transportation projects like Qatar Rail would directly affect the automobile industry by providing an alternative means of transport to the local population and tourists.

5.2. Excess inventory & underutilized assets:

Excess inventory due to higher supply & demand has kept retail prices under pressure and led dealers to carry out heavy promotional activities and innovative financing schemes to attract car buyers. Economic uncertainty due to various global events e.g. US-China trade war and regional economic downturn will adversely affect automobile industry as consumers postpone purchasing decisions, forcing firms to increase their marketing & promotional budgets to increase showroom traffic.

5.3. Entry of taxi-hailing service providers:

Mobile application-based taxi-hailing service providers such as Uber are gaining prominence. The entry of Uber in Qatar could lead to slow down in vehicle sales as it expands across key cities in Qatar. Ride-sharing mobility solution providers provide alternative means of transportation.

5.4. Removal of subsidies on petrol prices:

One of the primary drivers of the automobile industry is the availability of low-cost fuel. However, oil base economies including that of Qatar has started to raise prices in an effort to reduce subsidies. Removal of subsidies on petrol prices will lead to higher cost of vehicle ownership. Rising fuel prices coupled with the option of public transport and taxi-hailing services will lead to a decrease in attractiveness of car ownership.

6. Sector outlook:

The automobile sector outlook is moderately positive with significant changes expected going forward. The two primary themes driving the automobile sector will be environment-friendly fuel-efficient cars and focus on local manufacturing of vehicle components. Shifting consumer preferences, climate-related policies and advancements in technology are driving the demand for environment-friendly, fuel-efficient and smart vehicles (markets.businessinsider.com, 2018).

The first plant for the production of electric cars in Qatar is planned to be built on an area of 6 sq. km, with an estimated cost of about $9bn. The full production capacity of the plant will be reached after 7 years, with 12 production lines running 24 hours a day. The initial production capacity of the plant will reach 500,000 cars till 2025, to reach 1 million cars by 2035. The establishment of the first plant for the production of electric cars in Qatar is one of the economic projects that support the national economy to preserve the environment and achieve the Qatar National Vision 2030. Electric cars will significantly reduce carbon emissions, and help in preserving the environment and limit climate change. The first car will be launched in conjunction with the FIFA World Cup Qatar 2022 and it will be named Katara (The Peninsula Qatar, 2018).

Establishment of a new automotive component manufacturing set up in Qatar can be the first step towards local vehicle manufacturing. The demand in Qatar is limited given the market size; therefore, local manufacturing plants will be expected to serve the GCC region as well. Access to regional markets will be determined by the resolution of political disputes amongst the GCC members and any such development in this regard will be a boon to the automobile sector.

Competition in the Qatar automobile market is expected to intensify as the market moves towards maturity. That means pricing wars will drive transaction prices down and lead to constant re-adjustment of after sales package prices (regular maintenance and servicing, parts etc.) in line with competition. The market is characterized by relatively low price elasticity in demand, underdeveloped public transportation network and lack of alternative fuels means that recent fuel price increases are not likely to have a significant impact on the industry. But as new vehicle sales are expected to remain moderately positive in the medium term, automotive companies will look for alternative profit sources. There are still several untapped areas, which offer significant profit margins but will require more effort in order to reap them. Such opportunities include used car sales, F&I (finance and insurance) as well as car accessories (Bielski, 2017).

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