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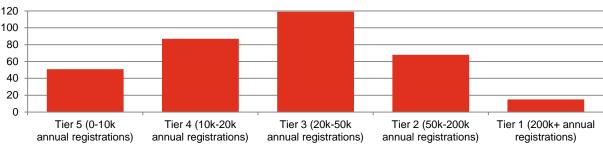
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# City Tier Analysis of Light Vehicles in China What is the growth potential for different Tier Cities?

Acceleration of urbanization is the mega trend driving automotive growth. Pollution, traffic congestion, city inefficiency and car sales restriction still loom as metropolitan area growth remains unprecedented. However, doors are beginning to open up for OEMs in small and medium cities as they consider these cities' growth potential and the driving factors of development.

### China: Tier City\* Passenger Vehicle Registrations

Number of Tier Cities 2014 (hundreds)



Note: The definition of city tier applies to a combination of vehicle registrations and macro economic indicators and city refers to a county level city

#### In the beginning...

China's urbanization movement has given rise to a steady migration from rural to urban areas and in some cases what was once a rural area has now become a new city. According to The Washington Post in 1978, less than a fifth of China's population lived in cities. By 2020, that proportion is expected to be 60 percent. This movement has also started to fundamentally shape the transportation structure, and is likely to increase the demand for more modes of transportation.

Meanwhile, serious challenges such as environmental pollution, traffic congestion and city inefficiency still loom as metropolitan areas grow at unprecedented speeds. A crucial practice introduced by the government is to restrict the growth of vehicles currently on the road, which in turn has dampened the growth potential of the Chinese auto market. However, doors are beginning to open up for foreign investors and Chinese auto market entrepreneurs in small and medium cities as they begin to consider these cities' vast growth potential.

#### Tier 1 City: saturation and more challenges

Tier 1 cities have shown strong purchasing power and growth capabilities given the fact that most wealthy Chinese consumers live in large cities. In the past 10 years (2004-2014), 15 Tier 1 Cities have contributed 26% to the light vehicle sector in China and increased the CAGR by 18%. However, growth of Tier 1 Cities has been largely restrained due to market saturation and government regulation, currently 6 out of 15 Tier 1 Cities have issued restrictions on car sales. As a result, in Tier 1 cities from 2011-2014, it is estimated that the number of car purchases limited by more than 6.6 million and the growth rate fell to 8.9%, which is much lower than the national average.

Purchase restrictions amongst Tier 1 Cities are expected to be further restrained in 2015 and subsequently the automotive market as a whole may suffer, however, it is expected to give premium automotive products like medium or large SUVs and luxury vehicles room for growth.

In addition, since consumers in Tier 1 Cities have a higher level of digital literacy, car-sharing and car leasing is expected to become a new experience for them and car ownership may no longer be the only method to obtain the car experience. In 2014, the fastest growth of electric vehicle sales were in Shanghai, Beijing and Shenzhen.

#### Tier 2 & Tier 3 City: Lead Market Growth

Between 2010-2014, 184 Tier 2 and Tier 3 Cities contributed about 65% to incremental growth in the light vehicle sector in China, boosting the CAGR by 25%. Tier 2 and Tier 3 cities will continue to be the main driving force behind the growth of the Chinese auto market. It is anticipated that first time car purchasers in these cities will generate a huge demand for small and compact vehicles as well as low priced middle size vehicles. International OEMs have already adjusted and optimized their product lines accordingly, a fully competitive market complete with price wars will become the new norm.

Thanks to key OEMs industrial layout, these cities have adequate capacity to satisfy the rising demand. Therefore, the new focus of the automotive industry in Tier 2 and Tier 3 cities will change from pre-sales to sales and after-sales service. As a result, in an over supplied market, OEMs should develop a new business model to boost sales, such as E-commerce and auto financing.

#### Tier 4 & Tier 5 City: Suffer Growth Difficulty

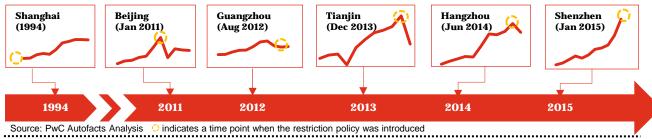
As for Tier 4 and Tier 5 cities, rapid growth is achieved by their relatively low standard of living. However, the combination of lower consumption levels and low sales volumes means that the contribution by Tier 4 & 5 Cities will likely remain unchanged.

Although, favourable factors such as the vast population base and the lower average vehicle ownership ratio will encourage the development of the automotive industry, economic hardship brings with it an inevitable wave of difficulties, making most Tier 4 and Tier 5 Cities the most difficult market to be developed. Therefore, these cities mainstream products are likely to be minivans and mini to small vehicles in conjunction with aggressive sales promotions which should help stimulate the purchasing demand in these areas.

Recently, an international OEM announced a new low-cost vehicle plant will be constructed with a capacity of 360k in the Jilin province where multiple Tier 4 and Tier 5 cities are located. These low-cost vehicle projects should help stimulate the vehicle ownership ratio in Tier 2 and Tier 3 cities and possibly even in Tier 4 and Tier 5 Cities.

To learn more or to have a deeper discussion on this issue, please visit www.pwc.com/auto www.autofacts.com

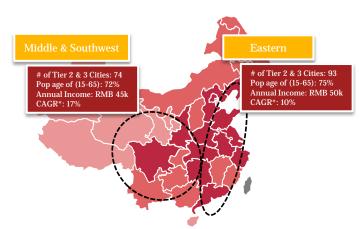




**China: Passenger Vehicle Sales by Providence** Estimated Registrations 2014 (millions)



#### **Tier 2 & Tier 3 Cities by Select Region**



\* CAGR = Compound Annual Growth Rate 2010-2014 Source: PwC Autofacts Analysis