

Repair Coatings – Profile of a Tier Two Paint Specialist



GCiS China Strategic Research
May, 2013
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Presentation Overview

Tier two shops are important for foreign and domestic suppliers: they buy both foreign and domestic paint, they buy a lot of it, and there are many of them tier two repair shops. The tier two market will account for a large proportion of sales despite the influx of 4S and the expansion of insurance over the past ten years.

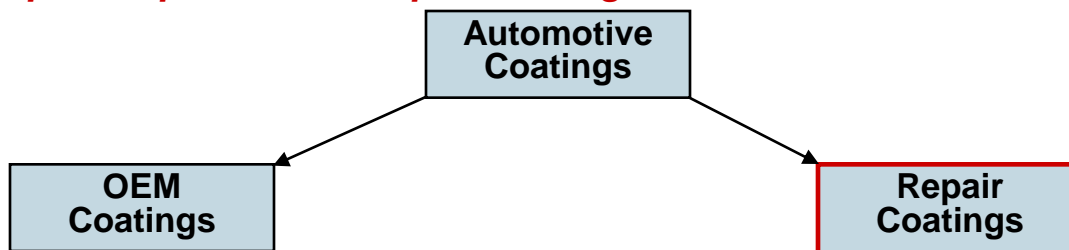
A Typical Tier 2 Repair Shop Company

- 1) China' s Auto Coatings Market
- 2) Types of Repair Shops
- 3) Many Tier Two Shops
- 4) Joe' s Business Model
- 5) Purchasing Process
- 6) Distribution Network
- 7) Opportunities and Threats
- 8) Joe' s Place in the Market
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China's Auto Coating Market

There are two very different markets within the automotive coatings market: OEM and Repair. OEMs coating market is large, closely linked to car sales, clean, and mainly foreign owned. By comparison, repair coatings market is growing quickly, but half the size, and has a large range of applications. Today, we are going to explore a piece of the repair coatings market.



Market Size

- Much larger, about 313,000 tons

Foreign and Domestic

- Mainly foreign controlled (about 80% by output)

Growth and future development

- Linked to the car industry, which has had its ups and downs. Right now in a more modest phase of development

Market Dynamics

- Clean Market – Closely linked to number of cars manufactured, limited number of buyers. Low number of suppliers, about 40.

- Smaller – about half the size
- Large domestic production market (about 40% foreign)
- Faster Growth. Repair coatings will grow strongly for the next decade or so
- Messy Market – Repair coatings can be used almost everywhere. Many distributors and applications. Poor product definition. Many suppliers, about 140.

Car Service Centers

There are many entities which offer services to cars, making differentiation somewhat difficult. Each coatings companies have their own segmentation methods. One method used by GCiS is below.

Car Service Centers Overview

Repair Shop Type	Cars Serviced per month	Paint Jobs Per Month	Mix on Site	Main business Car Age	Main Business Type	Inventory	Insurance Cooperation
4S	300	100	Y	1-2 years	Their specialty	15 days	Y
Chain (加盟连锁店)	80	80	Y	3 years	Mid-range (does do all)	2-3 cars	Y
Tier 1	300	75	Y	2-3 years	Mid-range (does do all)		Y
Large tier 2 (coatings specialty)	120	120	Y	3-5 years	Low to high	2-3 liters (1 car)	Y
Car City (汽配城, 修理部)	800	150*	At specialties	3-5 years	Low to mid	None	Y

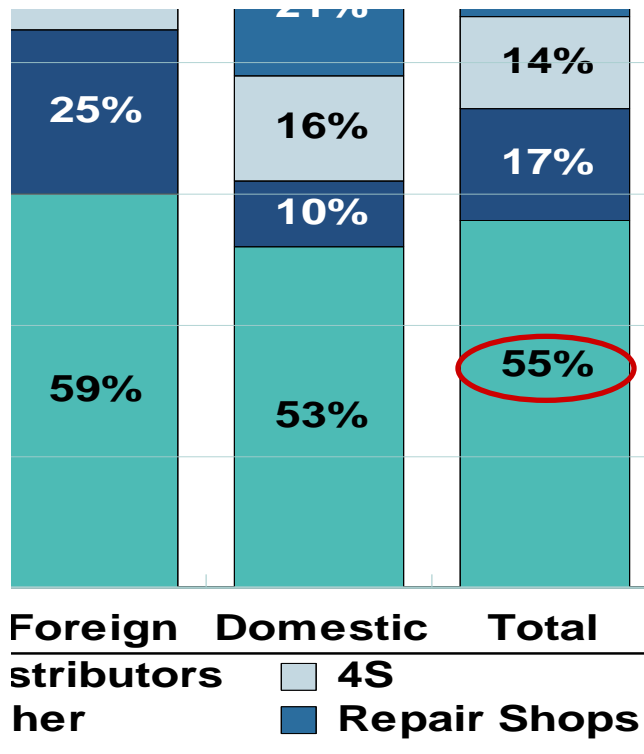
* Sent to coatings specialists

- Large shops can handle about 10 cars a day, or about 300 a month.
- Car cities do small repairs but many in a day. Called “ants” by competitors.
- All shops, except car cities, mix their own paint on site.
- 4S shops carry about 15 days of inventory, whereas coatings specialists only about 1 car worth (this makes their supply network important, as we will see).
- All cooperate with insurance.

Many Tier 2 Repair Shops

There several car service shops within every square kilometer of Beijing, the large majority are repair shops like Joe's. Joe buys from distributors which account for the majority of supplier sales.

Breakdown of Sales Channels by Ownership



- The number of cars which visit tier two shops is much larger than 4S shops (cheaper, closer, faster).
- Tier two still buys foreign paint.
- Joe does not purchase directly from suppliers because the quantity he orders is not large enough.
- Foreign companies sell close to 60% of paint from distribution sales, with a significant portion going to tier two repair shops like Joe's.

Location of Tier 2 Car Service Shops in a small Northeastern Section of Beijing



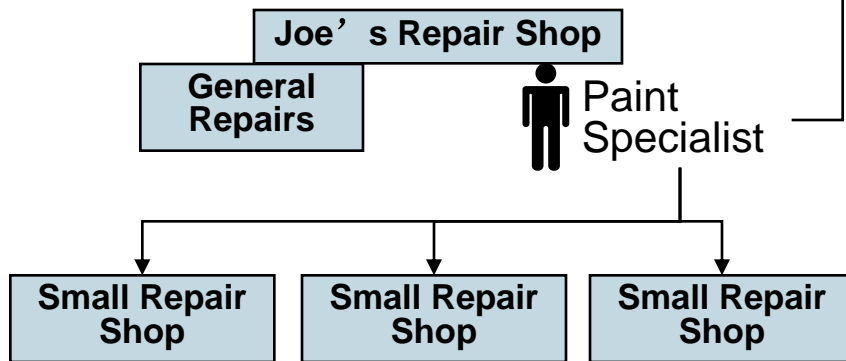
Source: Baidu Maps

Source: GCiS

Business Model

One paint specialist will buy, mix and supply the colored paint to three to four nearby repair shops. This is a one-man operation and brings in about RMB 15,000-25,000 per month for the company.

Business Organizational Chart

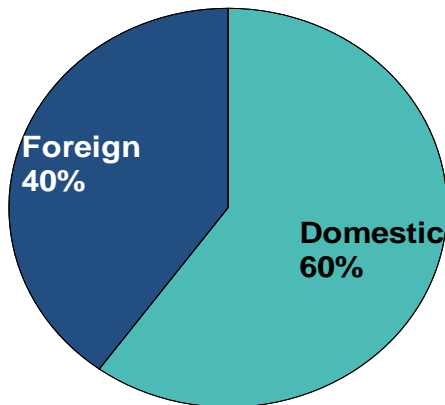


Paint Specialist's Business

Overview

Number mixes and jobs	5-10 per day
Typical Car Age	3-5 years. About 15-20% are new cars (less than a year old)
Typical Car Type	All
Inventory	Less than 1 liter
Revenues	RMB 15,000 - 25,000 / month
Paint Expenses	RMB 5,000 - 6,000 / month
Paint Purchases	About once every 2-3 days

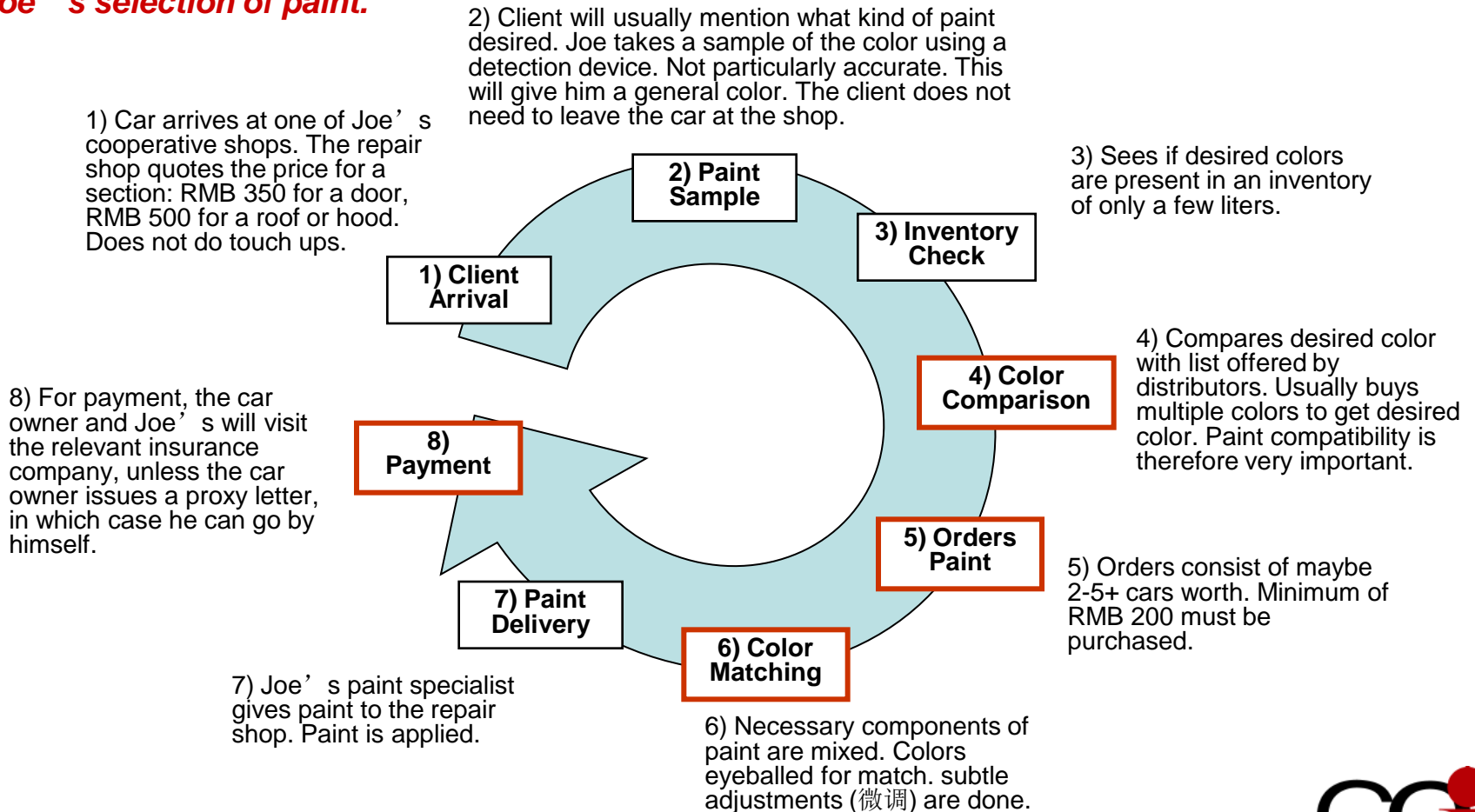
Proportion of Paint used by Paint Specialist



- Cooperates with other nearby smaller repair shops. He provides coloring and mixing services, the repair apply the paint. In this way, he is a kind of distributor with services.
- These smaller shops are the main source of his business.
- Small shops do not have means to pay for a paint specialist, which might earn RMB 5,000-6,000 a month.

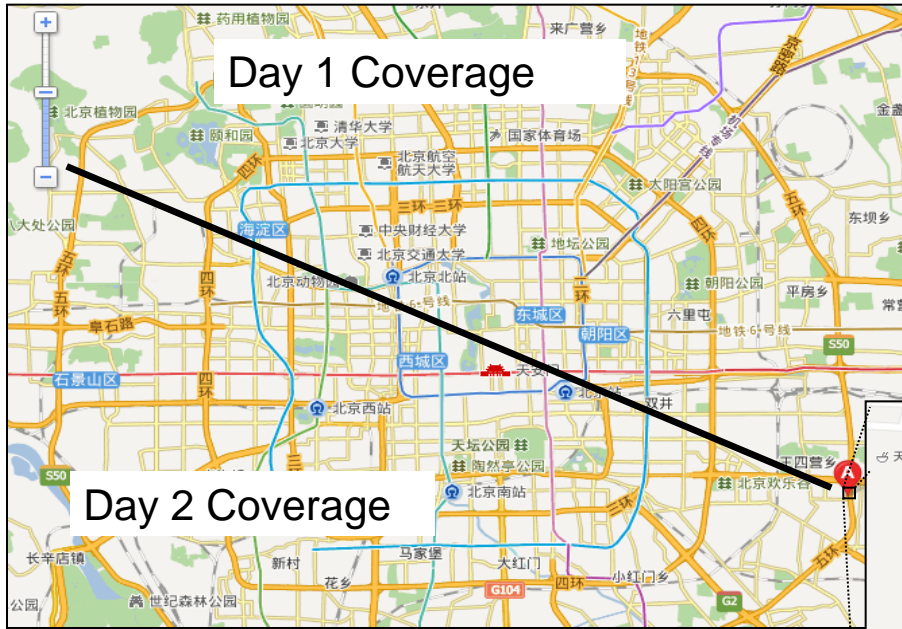
Purchasing Process

Since color matching sheets (配方) are not available, paint specialists must mainly rely on their eyes for matching colors. To help the imperfect color scheme, whole sections of a car must be replaced. Payment is made directly from the insurer to Joe, but the insurer has no influence over Joe's selection of paint.



Distribution Network

Joe's paint is mainly sourced from concentrated distribution areas such as Wufang (below) and Dahongmen. Joe is constantly looking for better prices and cheaper paint.



Local Distributors: Main source is local distributor. Two clusters in Beijing: Wufang and Dahongmen which are his main source of paint. Can source from others around Beijing as well.

4S: An old apprentice of his can supply him with paint. This is off-the-record.

Out-of-Town Distributors: To keep their trading license, distributors must meet a quota. They will sell at a discount (15% off, as oppose to his usual 10% off) to get rid of their stock. This could be as far as Heilongjiang.



Joe's Purchasing Preferences:

Minimize Costs

Availability of Paint: Which supplier is willing to sell to him (i.e. such a low amount)

Paint Attributes: Compatibility with other paints (About 80% of the foreign paint they purchase is from Dupont because of its extensive compatibility with other brands of paint.)

Opportunities and Threats

Traffic is a problem for Beijing’ s citizens, but is also the lifeblood of repair shops. Most accidents are small and do not require much body work outside of the paint.

Opportunities...

...for both Joe and suppliers:

Number of Accidents Increasing: There are an increasing number of new drivers, kilometers driven, and concentration of cars. All increase the number of accidents on the road.

Insurance: It is very easy for scratches to get written off by their insurance, with little repercussions to the insurance holder for having multiple accidents. Repair shops also assist in filing the necessary documents. Everyone in Beijing has insurance.

Past Car Sales Boom: Cars purchased during the spike in sales in 2009 and 2010 are aging and increasingly in need of Joe’ s services

...for suppliers

Personalization: Cars becoming more personalized, more recoating/color changes. Believes there will be more body shops in the future (Joe only gets business like this once or twice a year).

Threats...

...for foreign suppliers:

Underground: A small portion of 4S shops sometimes use cheaper paint when foreign paint is contractually necessary. If unchecked, more domestic coatings will be secretly used in 4S shops.

Better Domestic Suppliers: More domestic brands. Domestic paint’ s color fastness is comparable. There is a trend for increased use of domestic paint in the future.

...for Joe:

10-Year Scrap Policy: Noted by Joe, this affects the number of older cars on the road. Older cars are more likely to go to a tier two repair shops than a 4S shop after the warranty is met. Older cars are a major portion of their business.

4S Shops: Joe thinks that these 4S shops were models brought from abroad intended to allow them to “monopolize” the market. This model has failed because of “our ability to mimic colors.”

Joe's Place in the Market

Unlike tier one and 4S companies, Joe is too small to source his paint directly from the supplier.

Joe's Place in the Market

Automotive Coatings 463,000 Tons				
Repair Coatings 150,000			OEM Coatings 313,000	
Foreign 57,000	Domestic 93,000		Foreign 244,000	Domestic 69,000
Distributors 83,100	Other 25,500	Repair 42,000	Direct 275,000	Distributor 38,000

Source: GCiS

In Conclusion...

Sales through distributors to low tier suppliers will remain a major source of foreign companies' revenues in the near future. However, foreign companies are expected to lose market share to domestic players if there is no way to draw back or control prices.

Summary

In sum...

- **Tier Two Market is Very Large:** Shops like Joe' s account for a significant amount of both foreign and domestic paint sales. They have the advantage of being convenient, fast and cheap relative to 4S shops, which keep them competitive.
- **Business Scope is 3-4 Small Repair Shops:** The paint specialist can handle the painting volume of three or four small repair shops.
- **Experimentation with Colors:** Does not have the coloring sheet, so must match colors himself. This has an element of experimentation which costs him time and money.
- **Insurance has Zero Influence on Type of Paint used:** The repair shops work closely with insurance companies. The insurance companies pay the repair shops directly but have no direct say on what paint is used and can only offer their recommendations and price coverage to repair shops.
- **Distribution and Supplier Willingness is Important:** Besides price, paint and proper delivery, distribution is important when considering what paint to purchase. Joe typically buys paint at a 10% discount.
- **Growing Repair Coatings Market:** Joe (and GCiS) expect the repair coatings market to continue to grow as the number of cars, new drivers, and kilometers travels increases in China.

Other Comments

To Purchase More Foreign Products...

Nippon' s Color Matching Sheet...

More Domestic Paint in Future...

About GCiS

Some Background

Who we are. GCiS China Strategic Research is an American and Chinese-owned business-to-business research company. We provide value-added analysis and strategic recommendations on a range of market issues, based upon first-hand field research. Our focus is completely on China.

History. Founded in 1997, in Beijing, and 1998 in Shanghai, by 3 Partners, who continue to own and operate the company.

Industry Focus. GCiS has extensive experience in power & energy, chemicals & materials, capital goods & machinery and medical devices markets.

Clients. Our clients are large multinationals, foreign SMEs, and forward-looking domestic companies.

Team. GCiS has over 50 researchers and analysts, and offices in Beijing and Shanghai, and a large network of experts throughout China.

Custom and Multi-client Studies. The focus of GCiS is on custom projects, and we also publish a range of multi-client studies related to our target industries, both of which are done with the same systematic methods.

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