

Equities

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European Autos

Alert: Japan Earthquake: No easy answers on potential European Auto supply disruption

■ Industry Overview

Philip Watkins

+44-20-7986-3949

philip.watkins@citi.com

John Lawson

+44-20-7986-4095

john.lawson@citi.com

- **There are no easy answers** – Attempting to determine whether the supply chain will be disrupted for European Autos with limited production facilities in Japan and for how long is extremely difficult we believe. The complexity of vehicles means they incorporate 1000s of components with OEMs working with multi-suppliers from the large global players to a range of specialised operators. And though OEMs will have relatively clear sight of their primary suppliers, these suppliers will in turn be reliant on Tier 2 and 3 providers where there may be no direct commercial relationship with OEMs. So OEMs are not always going to have, at this stage in our view, full insight into the provenance of components supplied to their own suppliers and therefore the impact of the tragic events in Japan.
- **Japan sourced components may be limited but still vital for production** – It may be that the value of any components that are used in vehicles with an origin in the affected areas of Japan are very limited and of low monetary value. But each component has its place however small so disruptions to supply have the potential to disrupt the production of vehicles globally.
- **OEMs feel it is too early to tell** – Our conversations with European Autos and parts makers suggest no near-term supply disruptions outside of Japan which reflects the reality of ready component inventory with predictable supply also currently in transit. But there is, we sense, very limited visibility about whether there might be supply chain disruption further down the line with it being too early to tell about the impact in Japan directly and crucially there being uncertainties about whether Tier 2 and 3 suppliers source vital input, however modest, from Japan.
- **Any supply disruptions are likely to be in Q2 and beyond** – As suggested earlier any relevant components dispatched before the earthquake are likely to be currently seaborne, so there is likely to be 5-6 weeks of logistics in the system. This means that any disruption to vehicle production outside of Japan is unlikely to occur until Q2 and beyond. Much depends on the unfolding situation but if conditions prolong and then revert to normal it may be that OEMs need to incur additional freight costs (or at least bear these costs for their own suppliers) with potentially the use of more expensive though faster air freight for a short period of time to ensure production runs smoothly. We understand why OEMs and parts makers are reluctant to provide more detail on the potential impact as this simply isn't known at this stage, nor is there good disclosure on the very extensive network of suppliers that OEMs use. That makes it very difficult to differentiate the potential impact on European OEMs. This is likely to suggest that investors will remain nervous about the sector for some time.

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