ONYX
STRATEGIC INSIGHTS

AUTOMOTIVE | CHINA | MEXICO

Chinese auto firms follow Tesla to Mexico

July 2023

Auto and auto parts makers setting up nearer Tesla's main EV market — North America — must navigate challenges to avoid U.S. barriers.

By Olivia Tan

In February, Mexican President Andrés Manuel López Obrador announced a new Tesla Gigafactory would be built near Monterrey in the northern state of Nuevo León. Investment in the plant will exceed $5 billion and have an annual production capacity of 1 million electric vehicles (EVs), Mexican officials said.

The move allows Tesla to sidestep tariffs imposed on imports from China and uncertainty in logistics costs.

The new gigafactory in Mexico presented a choice to Chinese auto suppliers servicing Tesla's Shanghai plant — move to Mexico, too, or risk losing orders worth hundreds of millions of dollars. And the opportunity was massive: the Shanghai and Monterrey plants would each contribute around half of Tesla's annual vehicle production capacity.

Chinese suppliers across Tesla's supply chain began packing up. Upstream, JL Mag Rare-Earth, a producer of magnets used in EVs, said it would build a recycling plant in Monterrey to aid in the manufacturing of its magnets. Similarly, Xusheng Group said it would replicate its industrial chain to make aluminum alloy auto parts about an hour from Monterrey.

JL Mag and Xusheng are not isolated investments, nor are Chinese original equipment manufacturers (OEMs) brand new in Mexico. At least 26 already have boots on the ground in Mexico or have announced plans to expand their presence in the auto sector, mainly in the Monterrey area.

Larger manufacturers such as Xusheng Group set up in Mexico in 2015, while smaller OEMs began to establish subsidiaries in 2020.

SELECTED INVESTMENTS BY CHINESE AUTOMOTIVE OEMS IN MEXICO

Company	Main Lines of Business	Presence/Plans in Mexico	Investment Amount
Ningbo Tuopu Group (拓普集团)	Supplies heat management systems	• Announced in Sep 2022 it will set up a wholly-owned subsidiary and construct a factory in Mexico	USD$200M
Jiangsu Xinquan (江苏新泉)	Supplies automotive interior and exterior parts	• Factory completed and operational in 2022	USD$86M
Bethel Automotive Safety Systems (伯特利)	Manufactures safety system components	• Announced establishment of subsidiary in 2021 • Aims to produce 4 million lightweight components annually in Mexico; production to start in 2023	USD$49M
Xusheng Group (旭升集团)	Manufactures refrigeration and air conditioning control components	• Raised $100M in 2015 IPO to build a factor for microchannel heat exchangers • Constructed three production lines from 2015 to 2017 • Opened phase two of the Sanhua Mexico Industrial Park in Yucatan at the end of 2022	-
Joyson Electronics (均胜电子)	Manufacturers automotive safety systems	• Multiple subsidiaries in Mexico • Its subsidiary, Preh, will construct an engineering development centre in Yucatan	-
Zhejiang Yinlun Machinery (银轮机械股份)	Manufacturers heat exchangers	• Plans to construct a factory producing vehicle thermal management models for North American market; estimate production to start in 2023	USD$38M

Source: Eastmoney; Various company reports

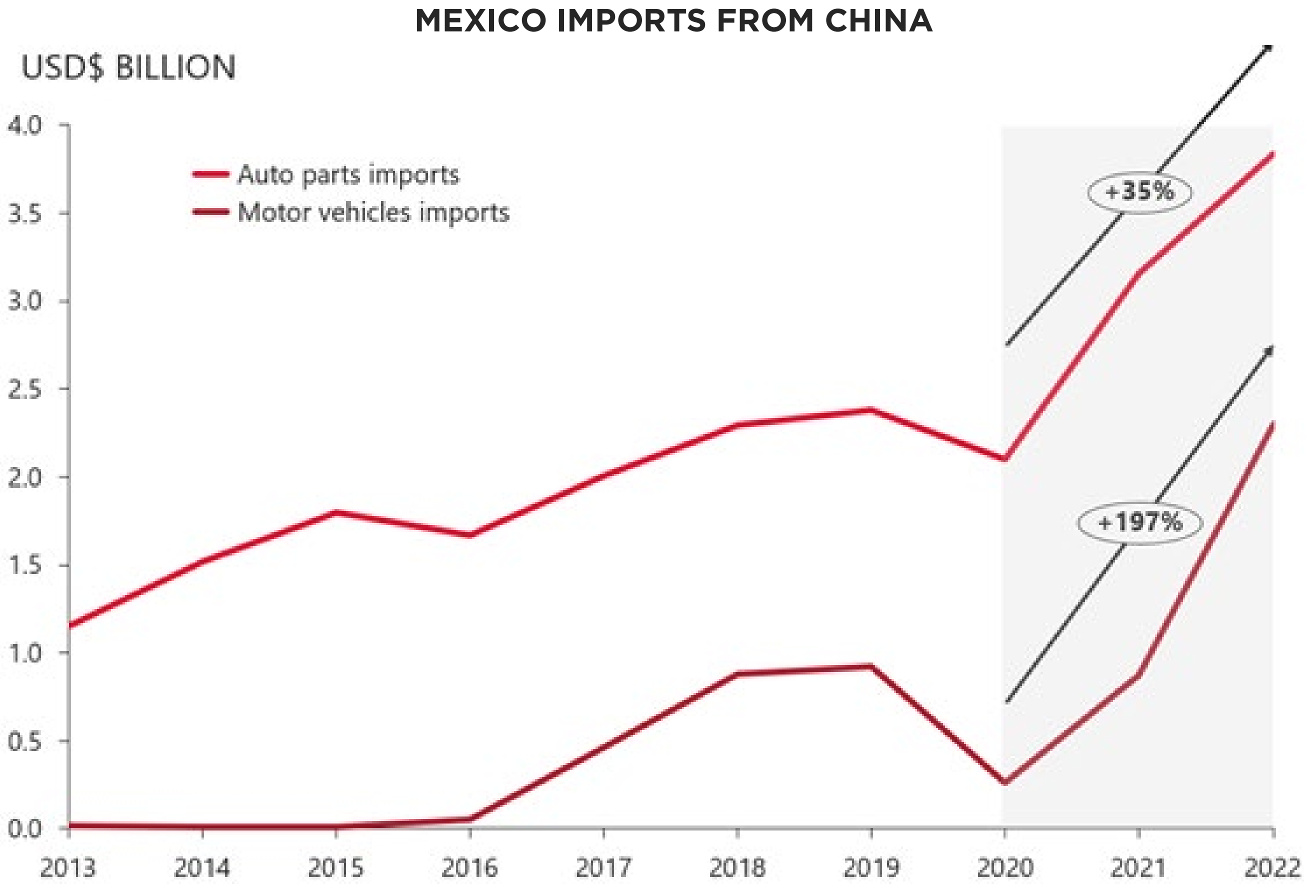
PANDEMIC BUSINESS

The influx of Chinese auto suppliers into Mexico following Tesla's announcement is not a new trend. From around 2020, Chinese automakers and auto suppliers have been relocating production to Mexico, driven in part by short-term hikes in logistics costs and long-term considerations of trade barriers.

At the end of 2019, it cost around less than $2,000 to ship a twenty-foot equivalent unit (TEU) container from Shanghai to the U.S. West Coast. A little more than two years later, in early 2022, the same route quadrupled to around $8,000/TEU. Dramatic increases in shipping costs during the pandemic provided substantial motivation for Chinese firms to produce much closer to their customers.

Even as shipping prices begin to bottom out in early 2023, Chinese auto OEMs continue to enjoy substantial cost savings by leveraging tariff advantages from the U.S.-Mexico-Canada Agreement (USMCA) and to bypass tariffs on Chinese made goods imposed by the Trump Administration and extended to today.

As such, Mexico's imports of Chinese auto parts grew over 30% from 2020 to 2022, feeding into Chinese production in Mexico, while imports of motor vehicles nearly doubled to service Mexico as an end market for Chinese automakers.



Source: Eastmoney; Various company reports

STIFF COMPETITION

While trade diversion and lower shipping costs seem to influence the relocation of Chinese auto firms to Mexico, strong competition within China's domestic auto market seems to be the strongest factor. China's auto market is fragmented — around 20% of its 148 car brands hold 90% of the market; an ongoing price war led to only 10 companies turning a profit in the first quarter of 2023.

The intensity of this competition means that 60-70% of auto brands in China will be eliminated in the coming two to three years, according to Zhu Huarong, chairman of Changan Automobile.

In contrast, the growing U.S. EV market presents an alternative for survival. EV sales are predicted to rise to 52% of all U.S. auto sales by 2030 from around 5% in 2022, buoyed by Inflation Reduction Act (IRA) incentives. Chinese EVs cost less than their American and European counterparts, appealing to price-sensitive consumers in the North American market.

Presented with this opportunity, Chinese automakers have begun moving. In April, Chinese truck maker Foton announced it will partner with Chinese battery producer CATL to manufacture traditional cars and EVs for export to the U.S. NIO, another Chinese EV maker, plans to enter the U.S. market in late 2025, leveraging its lower price point to compete with pricier brands such as Tesla.

The Chinese automakers' efforts could face substantial headwinds from the political climate in the U.S. Since March, U.S. IRA consumer tax credits for EVs mandate that at least 50% of the components of an EV battery must be made in North America, and 40% of minerals used to make the batteries must come from domestic sources or from countries with free trade agreements with the U.S. Both hurdles will rise incrementally through 2029, effectively shutting out Chinese carmakers that source Chinese batteries and minerals.

However, Chinese automakers could technically still qualify for IRA credits if they choose to lease their EVs to U.S. consumers, even if the vehicles contain non-IRA compliant materials. This loophole means that Chinese automakers could pursue a leasing strategy in the U.S. market going forward.

EASING THE PROCESS

For Chinese auto firms who have decided to move, relocation is not an easy endeavor. They grapple with a substantially different work culture and a whole new set of regulations on top of a language barrier. While these difficulties are not new, they may not be insurmountable. In previous years, U.S. auto firms used shelter services for their maquiladoras — factories set up in Mexico to make cars or export to the U.S. These shelter services manage the administrative and legal burdens for their clients, foreign companies, and reduce the red tape that comes with entering the Mexican market.

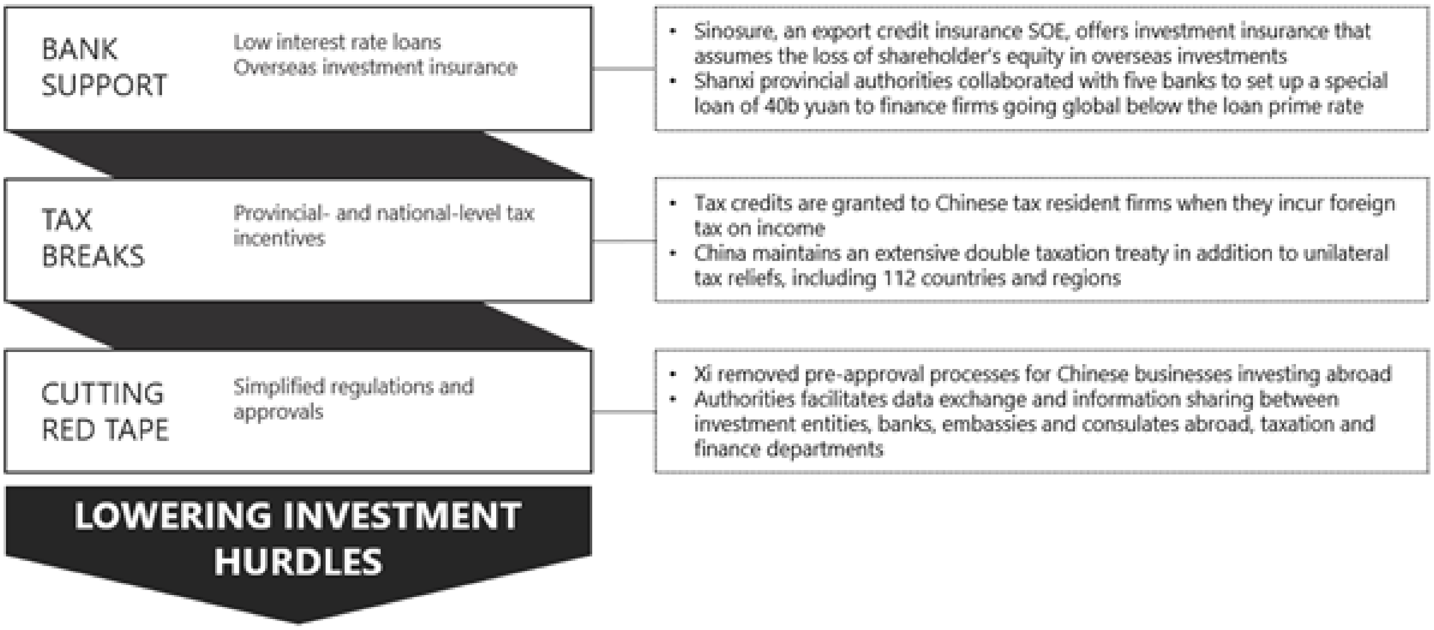
In this age of Chinese relocation, commercial firms have also sprung up to pave the way for interested automakers, furniture builders, and other enterprises. Hofusan, a sprawling 850-hectare industrial park in the state of Nuevo León, is perhaps the most well-known of the Chinese shelter services. Formed as a joint venture between China's Holley Group, Futong Group, and Mexico's Santos family, Hofusan offers accounting, labor management, expat support, and import and export services to its clients.

Its services seem to be relevant for this new wave of Tesla suppliers. In March this year, Anjie Technology, an electronics manufacturer, said it would purchase land in Hofusan, following the entry of other furniture and electronics firms.

Beijing has also buttressed available commercial support. Although not directed specifically towards the auto sector, the central government offers financial incentives that reduce risk and lower cost hurdles for Chinese firms to expand overseas. These include favorable loans and overseas investment insurance, tax breaks, and simplified regulations that create a conducive environment for internationalization.

These measures suggest that reshoring to Mexico and other locations is at least sanctioned, if not actively encouraged by China's central government.

GOVERNMENT ASSISTANCE FOR CHINESE FIRMS EXPANDING OVERSEAS



Source: Onyx Strategic Insights

BRINGING IN AND GOING OUT

Just as geopolitical considerations and industrial incentives have long shaped the supply chains of major Western multinationals with decades of experience offshoring production, Chinese firms now are learning to respond to the same pressures.

"Industries in China are already walking on the two legs of 'bringing in' and 'going out'", according to Peng Peng, executive chairman of the Guangdong Society of Reform, a government-affiliated think tank. Armed with the dual objectives of diversifying their revenue sources (bringing in) and expanding overseas (going out), the presence of Chinese automakers in Mexico is poised to grow exponentially in the coming years.

ONYX
STRATEGIC INSIGHTS

Build strategy and manage risk through the lens of geopolitics and macroeconomics.

Understand the forces shaping the future of your organization

Assess their economic impact

Separate noise from signal

Find better options

OUR DIFFERENTIAL

We see the world differently.

100+

countries

350

locations

A unique global network

We are a division of Expeditors, one of the world's foremost supply chain companies. Our core team of global, regional and industry experts is complemented by our extended network of logistics and supply chain practitioners on the ground in 350 locations in 100+ countries globally.

Quantifying impact is at the heart of our value

We believe that geopolitics and macroeconomics can shape any business. But understanding them is only half the story: we combine qualitative analysis and proprietary data to quantify impact on your business and produce actionable insights.

We focus on what matters

We fully integrate macroeconomic and geopolitical analysis, unlike any other consulting firm. Our approach is tailored to the issues, geographies and industries you care about, and not boiling the ocean. We focus on getting to the so-what of politics – so you don't have to.

OUR SERVICES

We meet you where you are.

Consulting engagements

Tailored projects to identify insights, risks, and value drivers. Our experts collaborate with you to incorporate findings into your organization's strategy and planning.

Retainers

An ongoing relationship to ensure decisions remain aligned with emerging events.

www.

WEBSITE
www.onyxsi.com

@

EMAIL
info@onyxsi.com

ONYX
STRATEGIC INSIGHTS

Build strategic resilience and adaptability

Strengthen risk management

Improve competitive positioning

HOW WE CAN HELP

Our capabilities help you address critical issues on global and regional strategy, supply chain resilience and risk management, including if you are:

01 Considering changing your global, regional or country-level strategy
02 Contemplating new market(s) for your products or services
03 Planning sourcing from new markets
04 Concerned about anticipating geopolitical risks to our existing strategy
05 Evaluating a potential partnership/JV
06 Conducting M&A due diligence

GLOBAL, REGIONAL, AND INDUSTRY EXPERTISE

Strength in numbers

Our project teams include experts in economics, geopolitics, policy and industry, drawn from our in-house practices and extended expert network covering a wide range of topics:

- Global, regional and country analysts
- Industry experts, including technology, retail/consumer, industrials and mobility/auto
- Energy and commodities
- ESG

PROPRIETARY DATA AND ANALYTICS

Data is at the heart of our work.

With proprietary data and analytics we quantify scenarios, assess future impact on client businesses, and elicit real trade-offs among strategic options.

We focus on the intersection of global, regional, country and client-level data to produce unique insights.

Our strength lies in the uniqueness of our data and modelling. We invest in analyzing and forecasting strategic variables typically overlooked by traditional data providers.

UNIQUE GLOBAL NETWORK

On the ground, in real time.

Covering 350 locations in 60+ countries, our network of on-the-ground supply chain and logistics experts is unique.

It allows us to develop unique strategic perspectives based on real-time developments on the ground. It adds strength to our client work by connecting strategic-level analysis with operational realities.

We keep our feet firmly on the ground and bring in our own field experience to produce unique insights.

www.
WEBSITE
www.onyxsi.com

@
EMAIL
info@onyxsi.com