Pinnacle Buzz

Inside the issue:

The Move to Low Cost Countries

Migrating costs to low-cost countries (LCCs) has moved from being an "interesting idea" to an imperative for most industrial companies, but it's a "must do" that too often is managed with ambivalence. On the one hand, companies see it as a critical piece of their cost strategy; on the other, too many firms seem to attempt it only half-heartedly. They aren't sure which costs to shift elsewhere, where to shift them or how to go about the organizational changes that such "cost migration" implies.

The concept seems straightforward: Companies need to decide which suppliers and work sites to migrate from high-cost countries, such as Germany or the United States, to low-cost countries like China, India, Mexico, etc. But identifying the right opportunities in your supply chain—which encompasses everything from materials supply to research to engineering to manufacturing labor—can be tricky, given the need to balance lowering cost with accelerating time to market and mitigating risk.

Indeed, manufacturing executives, in sectors ranging from automotive and chemicals to consumer products and technology, believe that moving costs to low-cost countries is a high priority. However, a small lot has made it a significant company initiative. Such incomplete efforts can shortchange the benefits that firms seek by moving costs abroad. To attack the problem from all sides, companies must get beyond "whether" to act and face the fact that cost migration is a competitive necessity. Our research finds that such moves are netting manufacturers in Europe and North America cost savings of 20% to 50%. When your competitors are realizing that kind of gain, whether to act is less a choice and more a matter of economic survival. The key to success lies in answering three other critical questions: what, where and how to migrate.

Getting started

Initiating yet another corporate wide program can seem daunting and exhausting to most organizations and executives. And despite the urgency, cost migration has to be treated as a marathon, not a sprint. As the best cost migration leaders have proved, this is a decade long process that ultimately becomes a regular way of doing business.

So where to begin? Our experience has shown us that there are a few useful tips for those initiating or trying to reenergize a cost migration program:

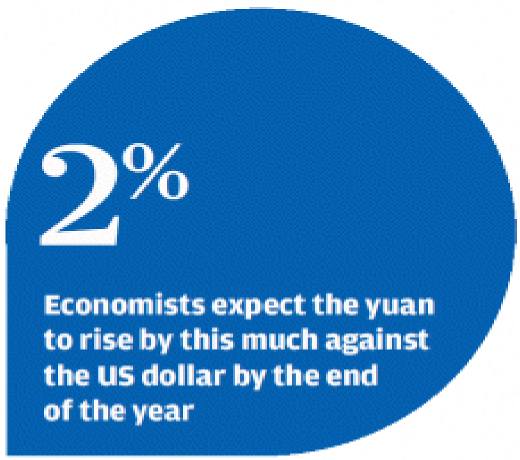
- Start with sourcing, not assembly. Much of the embedded labor for industrial products lies in the labor used to make purchased components and materials. Savings can be achieved by sourcing from low cost countries without disrupting a company's workforce. More important, a company needs to have a reliable local supply base in place before it moves assembly operations to a different location.
- Take a hard look at your "make or buy" choices for parts and components. Again, component costs often involve high labor costs and are easier to move.
- Don't export complexity to a foreign shore. Analyze your product line's complexity. Do you really need all the SKU variety you have? Simplify the product line before starting up a new factory overseas.
- Design production processes in low cost countries to exploit the labor cost differential. That may even mean going back to older, less automated production processes.
- Invest heavily to build capability and scale in a small group of low cost countries, especially in supplier selection and supplier development, operations and training. Use seasoned executives to set up operations, but drive to build local management talent rapidly.

Source: Pinnacle Research

Yuan on course to break 6 per dollar barrier in 2014

Economists expect Yuan to continue rising against greenback this year, even as it strengthens against other major currencies

The Yuan is on track to break through the level of 6 per US dollar this year, but the pace of gains is expected to be held back by concerns over China's export slowdown and reduced capital inflows as the United States tapers its monetary stimulus.



The Yuan will rise 2 per cent to 5.93 per US dollar by the end of this year, according to the median estimate of nine economists polled by the South China Morning Post. The forecast gain will see the Yuan pass through the psychologically important level of 6 to the dollar for the first time, even as the greenback strengthens against other major currencies.

Last year, the Yuan gained 2.9 per cent against the dollar. The Yuan reference rate, the onshore daily fixing rate set by the People's Bank of China, set record highs 41 times last year, helped by a strong trade surplus growth and a notable swing in capital and financial accounts back to a surplus amid the appeal of higher onshore interest rates.

The "redback" would remain the bright spot in regional currency markets this year, experts say, after the Yuan stood with the South Korean won as the only gainers against the dollar last year.

But concerns over falling exports could make Beijing more cautious in allowing the Yuan to appreciate too quickly in the short term because of the impact on jobs and exporters. Though fundamentally, the expected global economic recovery should support China's export sector.

Chinese policymakers have the means to provide support through fiscal or monetary measures if output growth slows more than the authorities envision, which markets increasingly expect.

The broader market environment of capital retreating from emerging markets would reduce the pressure of appreciation of the yuan this year. Meanwhile, as foreign investors hold a consensus view that China's economic growth would maintain at a low 7 per cent, that would somehow help curb the hot money inflows.

The Chinese Yuan’s (CNY) official trading band was widened in mid-March; the currency is now allowed to fluctuate ±2% (instead of ±1%) around the People’s Bank of China’s (PBoC) central parity for USDCNY. More two-way swings were widely expected to be seen throughout the year as the daily trading band for the currency has been widened.

The ongoing period of elevated volatility will likely be followed by a return to a gradual appreciating bias as the currency remains somewhat undervalued and capital flow dynamics continue to provide support.

Source: South China Morning Post and Pinnacle Research

Commodity Outlook: Zinc

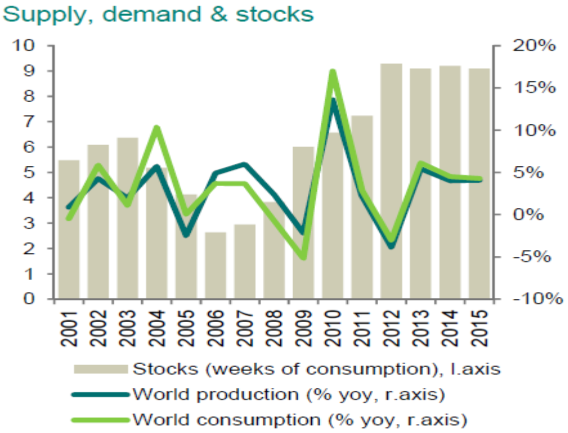
Zinc, the galvanizing metal, which was quite volatile in the year gone by, can witness choppy movement with the positive momentum in the year 2014.

During 2013, the price of zinc remained fairly stable. In February 2013, zinc prices reached its peak of USD 2,130 per ton, and touched a low of USD 1,785per ton in early May. The average zinc price in 2013 was USD 1,910 per ton. Zinc price stabilized on 31 December 2013 compared to where it began the year. This is in contrast to aluminum (-14%), copper (-7%) and nickel (-19%), which all declined. This made zinc the best performing base metal in 2013. In the same period, zinc stocks at London Metal Exchange (LME) warehouses declined by 24%, while stocks of all other base metals rose. Although the zinc market was oversupplied in 2013, for seven consecutive years demand from major zinc consuming regions has been solid.

In 2014, demand from the construction and auto sectors and the growth in steel sector will impact the zinc prices. And the Chinese demand in these sectors will be the most relevant factor directing the zinc price. International lead and zinc study group has predicted that Chinese zinc usage would increase by a further 7% in 2014 after increasing by a similar number in 2013.

Other indicators also show that conditions are improving in major zinc consuming nations, especially in US. In the US, it is expected that demand would increase by 1.2% in 2014 after an increase of close to 7% in 2013. Elsewhere, demand is forecasted to rise in Brazil, India and Turkey and to remain stable in Japan and the Republic of Korea.

Source: Thomson Reuters Datastream



Source: Metal Bulletin

European demand is forecasted to rise by 3.8% in 2014 after two successive year of fall primarily due to anticipated growth in Belgium, Italy and Poland.

According to International Lead Zinc Study Group "growth in the global demand for refined zinc metal is expected to increase in 2014 with a rise of 5% to 13.54 million tons respectively.

On the supply side, tightening global zinc mine production is expected to create a bullish trend in zinc prices in 2014.

Although the market is currently in surplus, data and forecasts show that a deficit is very likely in the coming years. There are a number of zinc mines set to be closed, which will add pressure to the future supply and demand balance.

We expect Zinc will face key support of $1750 at LME while key resistance will be $2400 in LME.

Source: Pinnacle Research

Engineering Industry in India

The Indian engineering sector is divided into two major segments - heavy engineering and light engineering. The total exports of Indian engineering sector stood at US$ 56.7 billion during FY13 and are expected to grow to US$ 125 billion by FY17. The engineering sector retained its 18 per cent share in overall exports from the country which is the maximum in terms of sectoral contribution.

The sector has a comparative advantage in terms of manufacturing costs, market knowledge, technology and creativity. Capacity creation in sectors such as infrastructure, power, mining, oil and gas, refinery, steel, automotives, and consumer durables are driving demand in the engineering sector along with Government backing with favorable policies.

Strong Policy Support

De-licensing

- The engineering industry has been de-licensed and 100 per cent FDI has been permitted in the sector.
- Foreign technology agreements are permitted under the automatic route

Tariffs and custom duties

- The government has eliminated tariff protection on capital goods.
- It has reduced custom duties on a range of engineering equipment.

Initiatives focused on power generation and infrastructure development

- The government has planned capacity additions of 120 GW in the 12th Five-Year Plan
- Governmental infrastructure projects such as Golden Quadrilateral and the

North-South and East-West corridors fuelled growth in the engineering sector.

Special Economic Zones (SEZs)

- The government approved a significant number of SEZs across the country for the engineering sector.
- Delhi Mumbai Industrial Corridor (DMIC) is being developed across seven states that is expected to bolster the sector.

National Manufacturing Policy (2011)

- Government of India launched the National Manufacturing Policy with the aim of enhancing the sector’s share in GDP to 25 per cent within a decade and creating 100 million jobs by 2022.

Budget FY14 to further Boost Investment

- The government would provide 15 per cent exemption on tax to manufacturing companies that invest more than USD18.4 million in plant and machinery over FY14–15
- The government has increased the allocation to JNNURM (Jawaharlal Nehru National Urban Renewal Mission) from USD1.3 billion in FY13 to USD2.6 billion in FY14; this is expected to benefit companies in capital goods, infrastructure and automobile sectors
- Allocation to the defence sector was raised to USD37.5 billion, which includes USD16 billion for modernization - related expenditure. This could further increase investments in the defence equipment industry

Engineering Services Outsourcing (ESO) to India is a huge opportunity for developed world over the next few years. By 2020, the ESO market in India is expected to reach US$ 40-50 billion, driven by the increasing onshore to offshore movement of services.

2009

- The global engineering services spending is estimated to be around USD850 billion
- About USD40 billion is expected to flow through the outsourcing channel into vendor countries
- India accounts for about 20 per cent of the outsourced market

2020

- The global engineering services spending is projected to reach USD1100 billion
- About USD180 billion is estimated to flow through the outsourcing channel into vendor countries
- India can account for about 25–30 per cent of this outsourced revenue

Source: IBEF & Pinnacle Research

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