



Transfer Pricing Study Report

FINANCIAL YEAR 2015-16

<Client Name>

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1 Executive Summary

1.1 Background

ABC India Private Limited (“ABC India”) [\[brief profile\]](#)

ABC Group [\[brief profile of group\]](#)

ABC India is a part of ABC Group. Its equity share capital is held by ____ and ____, which are ultimately held by _____. <<equity share capital>>

During FY 2015-16, ABC India has undertaken international transactions / Specified domestic transaction with its Associated enterprises (AE) / related party.

Sections 92 to 92F of the Act govern and regulate the transfer pricing provisions in India. The Rules for interpretation and implementation of the provisions are Rules 10A to 10E of the Rules.

Accordingly, to the above mentioned provisions, ABC India is required to maintain prescribed documentation to substantiate that its international transactions / specified domestic transaction with its AE(s) / related party are at arm’s length.

1.2 Summary of the international transactions/ Specified domestic transactions

International transaction	Method selected	ABC India (Tested party)		Comparable Companies	
		Transfer Price (INR)	Rate/ margin	Type of companies	Arm's Length Price/Margin 35th percentile to 65th percentile
Import / Purchase of raw material, intermediaries, components etc.	Combined Transaction approach:	<<amount from Form 3CEB>>	<<margin earned by ABC India>>	Indian companies engaged in manufacturing of similar products	On Net Sales : 7.04% to 10.78%
Payment of Royalty	TNMM Using OP/ Net Sale and OP / Operating Cost	<<amount from Form 3CEB>>			
Payment of Technical know-how		<<amount from Form 3CEB>>			
Payment of Management Fee		<<amount from Form 3CEB>>			
Export / Sale of finished products		<<amount from Form 3CEB>>			

2 Corporate background

2.1 Associated Enterprises

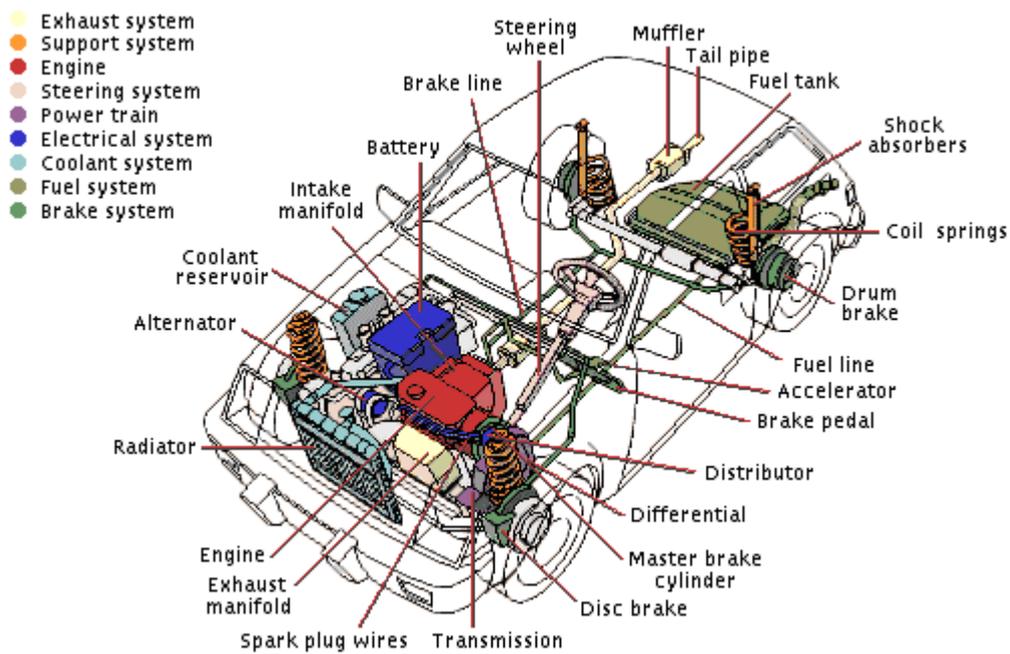
The name, address, legal status and country of tax residence of each of the AE/ Related party with whom international transactions/ specified domestic transactions have been entered into by ABC India: <<Please fill as per Form 3CEB>>

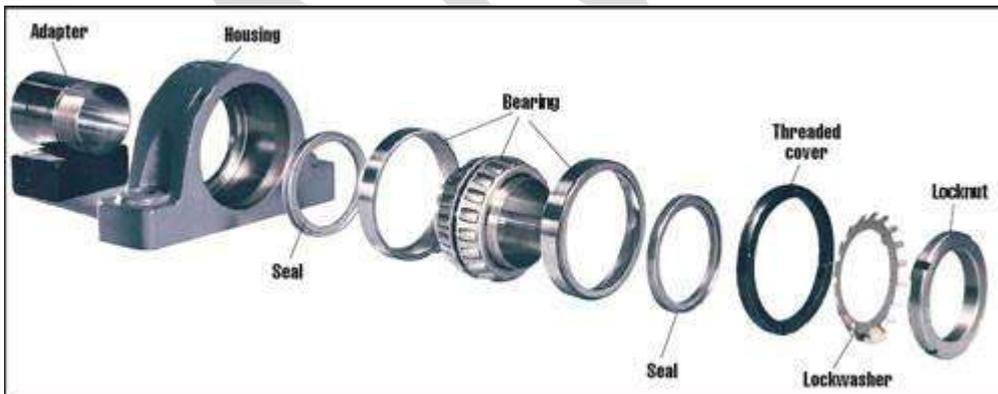
S.no.	Name of Enterprises/ Party	Associated Related	Address	Ownership linkage	Country
1					
2					
3					
4					

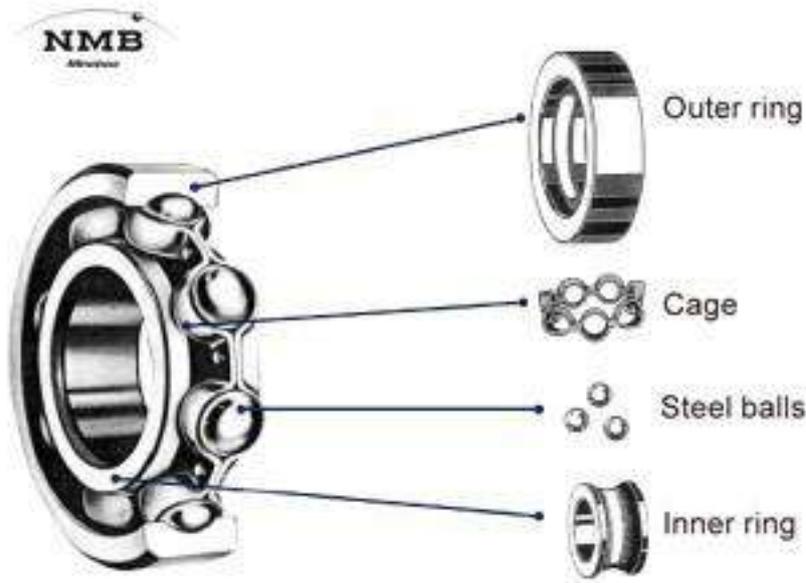
2.2 ABC India

Incorporation year, Business objective and Brief description of each line of business describing the main activity/ products. <<Please mention>>

3 Products - Auto Components







4 Analysis of Transactions

4.1 Transaction – Import of raw material, components, etc.

During FY 2015-16, ABC India has imported / purchase raw material, components and intermediaries etc. from the following entities: <<Please fill from Form 3CEB>>

Associated Enterprise	Amount (INR)
Total	

4.2 Transaction – Export / Sales of finished products

FY 2015-16, ABC India has exported / sale finished products to following entities: <<Please fill from Form 3CEB>>

Associated Enterprise	Amount (INR)
Total	

4.3 Transaction – Payment of royalty and Technical know-how

FY 2015-16, ABC India has paid royalty and technical know-how to following entities: <<Please fill from Form 3CEB>>

Associated Enterprise	Amount (INR)
Total	

5 Industry Overview

5.1 Executive Summary

5.1.1 Introduction

The Indian auto-components industry has experienced healthy growth over the last few years. Some of the factors attributable to this include: a buoyant end-user market, improved consumer sentiment and return of adequate liquidity in the financial system.

The auto-components industry accounts for almost seven per cent of India's Gross Domestic Product (GDP) and employs as many as 19 million people, both directly and indirectly. A stable government framework, increased purchasing power, large domestic market, and an ever increasing development in infrastructure have made India a favourable destination for investment.

5.1.2 Market Size

The Indian auto-components industry can be broadly classified into the organised and unorganised sectors. The organised sector caters to the Original Equipment Manufacturers (OEMs) and consists of high-value precision instruments while the unorganised sector comprises low-valued products and caters mostly to the aftermarket category.

Over the last decade, the automotive components industry has scaled three times to US\$ 40 billion in 2015 while exports have grown even faster to US\$ 11 billion. This has been driven by strong growth in the domestic market and increasing globalisation (including exports) of several Indian suppliers.

The Indian Auto Component industry is expected to grow by 8-10 per cent in FY 2017-18, based on higher localisation by Original Equipment Manufacturers (OEM), higher component content per vehicle, and rising exports from India, as per ICRA Limited.

According to the Automotive Component Manufacturers Association of India (ACMA), the Indian auto-components industry is expected to register a turnover of US\$ 100 billion by 2020 backed by strong exports ranging between US\$ 80- US\$ 100 billion by 2026, from the current US\$ 11.2 billion.

5.1.3 Investments

The cumulative Foreign Direct Investment (FDI) inflows into the Indian automobile industry during the period April 2000 – March 2016 were recorded at US\$ 15.07 billion, as per data by the Department of Industrial Policy and Promotion (DIPP).

Some of the major investments made into the Indian auto components sector are as follows:

- JK Tyre and Industries Ltd, India's leading tyre manufacturer, has acquired Cavendish Industries Ltd (CIL) for Rs 2,200 crore (US\$ 329.2 million), which will enable JK's entry into the fast-growing two-wheeler and three-wheeler tyre market.

- Japanese auto major Honda is planning to step up supply and target exporting of auto components worth Rs 1,500 crore (US\$ 224.45 million) from India to its various international operations.
- Auto components maker Bharat Forge Ltd (BFL), the flagship company of the US\$ 3 billion Kalyani Group, has formalised agreement with Rolls-Royce Plc which will supply BFL with critical and high integrity forged and machined components
- Canada's Magna International Incorporated has started production at two facilities in Gujarat's Sanand, which will supply auto parts to Ford Motor Co in India
- Everstone Capital, a Singapore-based private equity (PE) firm, has purchased 51 per cent in Indian auto components maker SJS Enterprises for an estimated Rs 350 crore (US\$ 51.35 million).
- ArcelorMittal signed a joint venture agreement with Steel Authority of India Ltd (SAIL) to establish an automotive steel manufacturing facility in India.
- German auto components maker Bosch Ltd opened its new factory at Bidadi, near Bengaluru, which is its fifth manufacturing plant in Karnataka. The company has also signed a memorandum of understanding (MoU) with Indian Institute of Science (IISc), Bengaluru with a view to strengthen Bosch's research and development in areas including mobility and healthcare thereby driving innovation for India-centric requirements.
- French tyre manufacturer Michelin announced plans to produce 16,000 tonnes of truck and bus tyres from its Indian facility this year, a 45 per cent rise from last year.
- Amtek Auto Ltd acquired Germany-based Scholz Edelstahl GmbH through its 100 per cent Singapore-based subsidiary Amtek Precision Engineering Pte Ltd.
- MRF Ltd plans to invest Rs 4,500 crore (US\$ 660.231 million) in its two factories in Tamil Nadu as part of its expansion plan.
- German luxury car maker Bayerische Motoren Werke AG's (BMW's) announced it will start sourcing parts from at least seven India-based auto parts makers in response to promote 'Make in India'.
- Hero MotoCorp is investing Rs 5,000 crore (US\$ 733.59 million) in five manufacturing facilities across India, Colombia and Bangladesh, to increase its annual production capacity to 12 million units by 2020.

5.1.4 Government Initiatives

The Government of India's Automotive Mission Plan (AMP) 2006–2016 has come a long way in ensuring growth for the sector. It is expected that this sector's contribution to the GDP will reach US\$ 145 billion in 2016 due to the government's special focus on exports of small cars, multi-utility vehicles (MUVs), two and three-wheelers and auto components. Separately, the deregulation of FDI in this sector has also helped foreign companies to make large investments in India. The Government of India's Automotive Mission Plan (AMP) 2016–2026 envisages creation of an additional 50 million jobs along with an ambitious target of increasing the value of the output of the sector to up to Rs 18,89,000 crore (US\$ 282.65 billion).

5.1.5 Road Ahead

The rapidly globalising world is opening up newer avenues for the transportation industry, especially while it makes a shift towards electric, electronic and hybrid cars, which are deemed more efficient, safe and reliable modes of transportation. Over the next decade, this will lead to newer verticals and opportunities for auto-component manufacturers, who would need to adapt to the change via systematic research and development.

The Indian auto-components industry is set to become the third largest in the world by 2025. Indian auto-component makers are well positioned to benefit from the globalisation of the sector as exports potential could be increased by up to four times to US\$ 40 billion by 2020.

Exchange Rate Used: INR 1 = US\$ 0.0149 as on May 16, 2016

5.2 Detail Report

5.2.1 Key Factors

India is world's sixth largest vehicles manufacturer globally. Further, India is the Asia's second largest two wheeler manufacturer and fifth largest producer of commercial vehicles, fourth largest manufacturer of passenger car and the largest manufacturer of tractors

Large number of products available to consumers across various segments; this has gathered pace with the entry of a number of foreign players • Reduced overall product lifecycle have forced players to employ quick product launches • After the success of Maruti S-Cross, Honda City, Hyundai Verna, Toyota Fortuner, Ford EcoSport in 2015, the companies have announced to launch upgraded versions of the same cars in late 2016 or early 2017 in Indian market

Robust growth in Auto component: Turnover of the Indian auto component sector stood at USD39 billion in FY15-16; the industry is expected to reach USD115 billion by FY20-21

Rising Indigenisation: The growth of global OEM sourcing from India and the increased indigenisation of global OEMs is turning the country into a preferable designing and manufacturing base

Growing automobile industry: The Indian automobile market is estimated to become the third largest in the world by 2016 and will account for more than 5 per cent of the global vehicle sales; India is expected to become the fourth largest automobiles producer globally by 2020 after China, US and Japan

Demographic advantage: The total working population (between ages 15–64) in India was around 825 million in 2015; it is expected to increase to nearly 900 million by 2030

Expanding middle class: The middle class population in India will increase from 160 million people (over 50 per cent of the total US population) in 2011 to 267 million by 2016, equivalent to more than three times the population of Germany, the largest economy in Europe

Among top steel producers: In 2015, India overtook USA to become the third-largest producer of steel in the world and among the lowest-cost ones as well; Steel is a key raw material used in automobiles

Improving product development capabilities: Increasing R&D investments from both the government and the private sector • Private sector innovation has been a key determinant of growth in the sector; two good examples are Tata Nano and Tata Pixel; while the former has been a success in India, the latter is intended for foreign markets

Alternative fuels: The CNG distribution network in India is expected to increase due to the new geographical areas allocated through 5th and 6th round of CGD bidding by Petroleum and Natural Gas Regulatory Board(PNGRB) • Number of CNG stations in India increased from 142 stations in 2005 to 1010 stations in FY15, which further increased to 1,081 stations in FY16, across 12 major states of the country.

New financing options: Carmakers such as BMW, Audi, Toyota, Skoda, Volkswagen and Mercedes-Benz have started providing customised finance to customers through NBFCs • Major MNC and Indian corporate houses are moving towards taking cars on operating lease instead of buying them

Between April 2000 to March 2016, Indian automobile industry attracted foreign direct investment (FDI) of around USD15.06 billion.

Investments: Honda Cars India Limited is planning to invest around USD59.24 million to increase its production capacity by 50 per cent (to 180,000 units). Also, Honda Motorcycle & Scooter India is planning to invest around USD91.2 million to expand production at the Karnataka plant, by the end of 2016.

General Motors announced plans to invest about USD1 billion for capacity expansion of Pune plant, with the production expected to increase from 130,000 units to 220,000 units annually, by the end of 2025.

Notable trends: Government of India heavily promotes foreign investment in the automobile industry by allowing 100 per cent FDI, under automatic route. The industry is delicensed and allows free import of automotive components. Also, the Indian government does not lay down any minimum investment criteria for this industry.

Under Union Budget 2016-17, the government has announced plans to make amendments in Motor Vehicle Act to enhance road transport sector, mainly in passenger segment.

The government plans to encourage use of eco friendly automobiles such as hybrid vehicles, electrical vehicles, CNG based vehicles in India.

Capacity addition: Considering low cost of production, prominent auto companies are increasing their production capacity in order to capture a dominant share in Indian automobile industry. • Most of the automobile companies are eyeing India as an outsourcing hub. • With the total investment of around USD163.7 million, Honda Motorcycle and Scooter India expanded its production of Activa in three variants at Ahmedabad plant.

Launch of new models: In 2015-16, few of the newly launched cars were Volkswagen Ameo, Mahindra e-Verito, Toyota Land Cruiser 200, Maruti Baleno, Honda BR-V, Tata Tiago, Toyota Innova

Crysta and Maruti Ciaz and under premium range Audi Q7 (New Generation), Audi S5 Sportback, Ford Mustang, Rolls-Royce Dawn and Porsche 911.

Catering Indian needs: India boasts a large population of middle class • Most of the firms including Ford and Volkswagen have adapted themselves to cater to this class by dropping their traditional structure and designs • This allows them to compete directly with domestic firms making the sector highly competitive

Some of the Key figures are:

- Third-largest automobile industry by 2016
- World's second-largest two wheeler manufacturer
- By 2020, India's share in the global passenger vehicle market to touch 8 per cent from 2.40 per cent in 2015
- Two wheeler production to rise from 18.8 million in FY16 to 34 million by FY20E
- Passenger vehicle production to nearly triple by 2020E
- Passenger vehicle production to increase from 3.4 million in FY16 to 10 million in FY20E
- Domestic sales of passenger vehicles to grow from 2.8 million in 2016 to 9.4 - 13.4 million by 2026
- Domestic sales of passenger vehicles in India is expected to increase at a CAGR of 12.87 per cent during 2016-26
- Domestic sales of commercial vehicles to grow from 0.7 million in 2016 to 2.0 - 3.9 million by 2026
- Domestic sales of commercial vehicles in India is expected to increase at a CAGR of 11.07 per cent during 2016-26
- Domestic sales of three wheelers will grow from 0.4 million in 2010 to 0.5 million in 2016
- Domestic sale of three wheelers in India increased at a CAGR of 3.79 per cent during 2010-16
- Domestic sales of two wheelers is the most growing segment, with domestic two wheeler sales expected to grow from 16.46 million in 2016 to 50.60 55.5 million by 2026
- Domestic sales of two wheelers in India is expected to increase at a CAGR of 11.9 per cent during 2016-2026
- Production of Passenger Vehicles, Commercial Vehicles, Three Wheelers and Two Wheelers grew at a CAGR of 2.74 per cent, 0.57 per cent, 3.16 per cent and 7.12 per cent, respectively during FY1116
- Automobile exports to grow at a CAGR of 3.05 per cent during 2016-2026

- Auto sales across categories domestically rose by 3.78 per cent in FY16 from 19.72 million units in FY15.
- Sale of passenger vehicles grew by 7.24 per cent in FY16, from 2.6 million units in FY15.
- Sale of passenger cars increased by 7.87 per cent in FY16
- In FY16, sale of UVs increased by 6.25 per cent
- Sale of vans grew by 3.58 per cent in FY16
- Commercial vehicle sales expanded by 11.51 per cent in FY16
- LCV sales declined by 0.3 per cent in FY16
- Sale of M&HCVs increased by 30 per cent in FY16
- In FY16, three wheeler sales grew by 1.03 per cent
- Two-wheelers registered a growth of 3.01 per cent during FY16
- Two wheelers dominate production volumes; in FY16, the segment accounted for about 78.6 per cent of the total automotive production in the country.

5.2.2 Strong Policy Support has been crucial in developing the sector

5.2.2.1 Auto Policy 2002

Automatic approval for foreign equity investment up to 100 per cent; no minimum investment criteria • Encourage R&D by offering rebates on R&D expenditure

5.2.2.2 NATRiP

Setting up of R&D centers at a total cost of USD388.5 million to enable the industry to be on par with global standards • Nine R&D centers of excellence with focus on low-cost manufacturing and product development solutions • The government has extended the timeline of NATRiP from 2014 to 2017.

5.2.2.3 Dept. of Heavy Industries & Public Enterprises

- Worked towards reduction of excise duty on small cars and increase budgetary allocation for R&D
- Weighted increase in R&D expenditure to 200 per cent from 150 per cent (in-house) and 175 per cent from 125 per cent (outsourced)

5.2.2.4 Union Budget FY16-17

- Certain amendments in Motor Vehicle Act to enhance the passenger segment under road transport sector • Applicability of 1 per cent Infrastructure cess on small petrol, LPG, CNG cars; 2.5 per cent cess on diesel cars (to a certain capacity); 4 per cent cess on other higher engine capacity vehicles and SUVs.

5.2.2.5 The Automotive Mission Plan 2016-26 (AMP 2026)

- AMP 2026 targets a fourfold growth in the automobiles sector in India which includes the manufacturers of automobiles, auto components and tractor industry over the next ten years

5.2.2.6 FAME (April, 2015)

- Planning to implement Faster Adoption & Manufacturing Of Electric Hybrid Vehicles (FAME) till 2020 which would cover all vehicle segments, all forms of hybrid and pure electric vehicles

5.2.2.7 Indian government is negotiating FTAs/PTAs with following countries:

- China, Korea, Japan
- Agreement on South Asian Trade Free Trade Area (SAFTA), Sri Lanka, Mauritius
- The Economic and Social Commission for Asia and the Pacific (ESCAP) / Generalized System of Preferences (GSP)
- Southern African Customs Union (SACU), Egypt
- India-Singapore Comprehensive Economic Cooperation Agreement (CECA)
- India-Sri Lanka Bilateral Free Trade Area and the Proposal for Comprehensive Economic Partnership Agreement
- Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) - FTA
- Thailand / Association of Southeast Asian Nations (ASEAN) / Singapore / Malaysia
- Framework Agreement on Comprehensive Economic Co-operation between the Association of South East Asian Nations (ASEAN) and India

5.2.3 *Boost to R&D in the Auto Components Sector - NATRIP CENTRES*

5.2.3.1 Vehicles Research & Development Establishment (VRDE), Ahmednagar

- Research, design, development and testing of vehicles • Centre of excellence for photometry, Electromagnetic Compatibility (EMC) and test tracks

5.2.3.2 Indore — National Automotive Test Tracks (NATRAX)

- Complete testing facilities for all vehicle categories • Centre of excellence for vehicle dynamics and tyre development • In October 2014, Powertrain LAB facility has been inaugurated to support R&D

Automotive Research Association of India (ARAI), Pune

- Services for all vehicle categories • Centre of excellence for power-train development and material

5.2.3.3 Chennai Centre, Tamil Nadu

- Complete homologation services for all vehicle categories • Centre of excellence for infotronics, EMC and passive safety

5.2.3.4 Rae Bareilly Centre

- Services to agri-tractors, off-road vehicles and a driver training centre • Centre of excellence for accident data analysis

5.2.3.5 International Centre for Automotive Technology (iCAT), Manesar

- Services to all vehicle categories • Centre of excellence for component development, Noise Vibration and Harshness (NVH) testing • Setting up of Vehicle and Engine Test Cells in 2015

5.2.3.6 Silchar Centre, Assam

- Research, design, development and testing of vehicles • Centre of excellence for photometry, EMC and test tracks • First batch of driving training project has been completed in August, 2015

5.2.4 Increasing investments by Global Car Manufacturers

Global car majors have been ramping up investments in India to cater to the growing domestic demand. Also, these manufacturers plan to leverage India's competitive advantage to set up export-oriented production hubs

5.2.4.1 Nissan

Planning to double its current investment level of about USD2.5 billion over the next five years • Aims to raise its market share from 1.5 per cent in FY13 to 10 per cent by FY19 • To increase the Chennai Plant capacity to 400,000 units a year in a few years time

5.2.4.2 Ford

• On 10th September 2015, Ford has signed a MoU with the Tamil Nadu government for increasing the manufacturing capacity of its plant and for establishing new engineering and technology center at Chennai. • Long term strategy to export 25 per cent of vehicles and to make India compact car global production base

5.2.4.3 Volkswagen

• Volkswagen announced launch of its first Made-in-India & Made-for-India compact sedan, Ameo in June 2016 • The company plans to increase its production volume by 15 per cent in 2016 over 123,000 units in 2015 at Pune plant. • Plans to launch up to eight models over the next 5–6 years

5.2.4.4 Honda

- Honda is planning to invest USD160 million in India to expand its capacity for cars and bike by the end of 2016 • This will include a new diesel engine component production and a forging plant •

5.2.4.5 Toyota

Expects to invest another USD163 million at Bidadi plant near Bengaluru • Toyota is planning invest USD165 million on its new engine plants and projects

5.2.4.6 Hyundai

- Plans to invest USD552-737million over the next two to three years to develop new products

5.2.4.7 Mercedes

- Increased the plant capacity of 20,000 units per year in Chakan Plant, which is the largest for any luxury car manufacturer in India. • Expansion of MIDC and MoU, and to invest USD244 mn for capacity expansion in Chakan, Pune • Mercedes-Benz will introduce 15 products in 2015, including products without any predecessors in India. These 15 new products are Mercedes-Benz India's biggest product initiative till date.

FDI equity inflows in the automobile industry aggregated to USD11.8 billion over FY2010-16. Whereas, in FY16, FDI inflow automobile industry accounted for 6.3 per cent of total FDI equity inflow in country.

5.2.5 *Increasing investments by Global Car Manufacturers*

5.2.5.1 India is fast emerging as a global R&D hub

Strong support from the government; setting up of NATRiP centres • Private players, such as Hyundai, Suzuki, GM, keen to set up R&D base in India • Strong education base, large skilled English-speaking manpower • Comparative advantage in terms of cost • Firms both National and Foreign are increasing their footprints with over 1,165 R&D centers • Indian automobile industries invest s USD100 billion for R&D sector annually

5.2.5.2 Opportunities for creating sizeable market segments through innovations

Mahindra and Mahindra targeting on implementing digital technology in the business • Bajaj Auto, Hero Honda and M&M plan to jointly develop a technology for two-wheelers to run on natural gas • Considering the potential of auto market, new models of hybrid & electric cars launched at Auto Expo 2016 • Tata Motors to launch MiniCAT, a car running on compressed air, thereby stepping into the next era where cars would not require any fossil fuel and emissions would be almost nil

5.2.5.3 Small-car manufacturing hub

General Motors, Nissan and Toyota announced plans to make India their global hub for small cars • Passenger vehicle market is expected to touch 10 million units by 2020 • Strong export potential

in ultra low-cost cars segment (to developing and emerging markets) • After the successful execution of Tata Nano, the company is testing the electric variant of the small car, Nano in India

- Maruti Suzuki launched facelift version of Alto 800, after the success of earlier model

5.2.5.4 Advantage in India

Strong growth in demand due to rising income, middle class, and a young population is likely to propel India among the world's top five auto manufacturers by 2015

- Growth in export demand is set to accelerate
- Government takes Initiatives to set up manufacturing plants through Make in India
- Innovation opportunities • Tata Nano and the upcoming Pixel have opened up the potentially large ultra lowcost car segment
- Innovation is likely to intensify among engine technology and alternative fuels
- India has significant cost advantages; auto firms save 10-25 per cent on operations vis-à-vis Europe and Latin America
- A large pool of skilled manpower and a growing technology base would induce greater investments
- The government aims to develop India as a global manufacturing as well as R&D hub
- There has been a wide array of policy support in the form of sops, taxes and FDI encouragement
- The Automotive Mission Plan 2016-26 (AMP 2026) targets a fourfold growth in the automotive industry.

Source: Ministry of Petroleum & Natural Gas Note: NBFCs - Non-Banking Finance Companies

Source: SIAM, NEMMP 2020 (National Electric Mobility Mission Plan), TechSci Research; Note: 20161 – Data till March 2016, E – Estimate

Source: Department Of Industrial Policy & Promotion, News Articles

Source: SIAM, TechSci Research, News articles Notes: E – Estimate, UV – Utility Vehicle LCV – Light Commercial Vehicle M&HCV – Medium & Heavy Commercial Vehicle

6 Functional Analysis

In the Automobile Industry, automobile manufacturers (commonly referred to as 'Original Equipment Manufacturers' or 'OEMs') cannot virtually manufacture all (or every) spare part that are required in a vehicle / automobile manufactured, assembled and/or repaired/serviced by them. Generally, every such automobile manufacture (or OEM) makes the body, frame and major engine components the rest they outsourced to components manufacturers. The OEM(s) provide detailed specifications to its suppliers which ensure / commit timely supply to these automobiles manufacturing companies as well as cater to requirement of consumers through the replacement market. These auto ancillary companies ensure the supply of all such components and parts which are required (as per the technical specifications) provided by the OEMs.

The spare parts and components required in the replacement market are generally supplied by auto ancillary companies (i.e. suppliers) developed by OEMs, supply spare parts and components in the replacement market (and even after certain models are discounted). It is essential to note that availability of spare parts and components in the replacement market is a much larger and long drawn commitment between the auto ancillary companies and OEMs, for users / end-customer using the vehicles manufactured by the OEMs.

Thus by and large the trends in auto-components industry are dependent on the trends in the automobile and power products industries. The auto components industry is largely influenced by demand of product manufactured by OEMs, and other factors such as globalization, economic and technological trends. Even though demand in replacement market is largely erratic and is based on road conditions / related infrastructure, but the trends in the automobiles and power product industries have a huge impact on the growth of auto components industry.

The demand in the OEM market is dependent on how new vehicles fare in the market. The suppliers to OEMs have to adhere to requirements of high quality, tight delivery schedules and lower margins. OEMs are increasingly focusing on vendor development. Players like Telco, Maruti and Ashok Leyland are in the process of building long-term relationships with ancillaries by closely interacting with them for quality improvements and technology absorption. Demand for auto components is mainly driven by a demand for automobiles, although auto components do find usage in non-automotive industries as well.

Smaller players which recondition and sell refurbished spare parts, components and accessories pose a huge challenge for the traders operating in the replacement market, as refurbished spare parts are available at much lower prices and serve as cheaper alternatives for many consumers. Since, the small-scale sector which is mostly unorganized and which has a considerable presence in the replacement segment enjoys huge cost advantage over the corporate players. The dealer or the 'repair workshop', therefore play a very important role as far as influencing end-consumer's purchase decision is considered.

6.1 Description of international transactions of ABC India

ABC India is engaged in the manufacturing of <<Product Name>> in India. For the purpose of manufacturing <<Product Name>>, ABC India also imports capital goods such as machine and other equipments from its AE(s). Further, for the purpose of manufacturing the <<Product Name>>, ABC India receives continuous technology and technical know-how from its AE(s). The <<Product Name>> manufactured by ABC India uses the AE(s) technology, know-how, expertise provided by

its AE(s), along with the inherent trademarks, label, branding, etc which are essential for ABC India in its operation in India.

6.2 Functions Performed

6.2.1 Strategic Management

6.2.1.1 Corporate strategy

Corporate strategy provides the basis for selecting lines of business, choosing organization structure and operating procedures, analyzing and undertaking acquisitions and disinvestments, responding to competitors and to market forces.

Strategic management decisions and control for ABC India are the responsibility of the local management of ABC India. However, the holding company is responsible for developing the group's overall global corporate strategy. ABC India determines and formulates the strategy to be employed in its local markets and this is consistent with the AE group's global strategy. The global policy forms the basis for deciding what markets the group companies should target and sets out the broad framework for the local companies to penetrate the local markets.

6.2.1.2 Corporate Services

6.2.1.3 Administration

Corporate service functions assist in the day-to-day management of the organization (e.g. finance, human resources, information systems etc.).

With respect to human resources, financial management, routine administration etc., ABC India is responsible for arranging the necessary resources required for its manufacturing activities as well other line functions such as management, administration, finance, HR etc. ABC India is also responsible for managing its own cash flows, accounts payable, accounts receivables, employee management, management information system, and training and hiring of employees.

Though ABC India drafts its policies within the broad framework of AE group, it receives nil or little support from its overseas entities in terms of implementation of those policies. Also all resourcing functions like hiring, training and allocation of funds and support functions like administration, finance and human resources will also be undertaken by it.

6.2.2 Product development functions

6.2.2.1 Product strategy and design

Product strategy and design is the process by which a firm decides which market segment to pursue, what products to produce to meet the market demand, determine product characteristics, select material and design process that will create these products.

Requirement of OEM i.e. Car manufacturers is paramount while introducing new products and improving existing products. Each manufacturer has their own unique design accordingly other auto components would need to adhere to the particular design etc.

Once the analysis of the information collected is complete, a Development Request Sheet is sent by ABC India to AE, which then starts analyzing the relevant information and conceptualizing the products <<Product Name>> which may fulfil the specific needs.

The design, drawings and die are shared with the ABC India's engineering team by the AE(s). All the technical designs and drawings for every single component and part is developed and provided by AE(s), and these are shared with ABC India. The AE(s) send their team of technical experts to ABC India's facilities to assist in conducting the trials, tests, and monitor the results thereof.

6.2.2.2 Research & development

At the firm level, the direction and conduct of R&D and the resulting technology form the basis for new products, product improvements, distribution systems and manufacturing processes.

Design or Development activities at AE(s) constitute all R & D operations. R&D is undertaken to develop new technologies and products as well as more equally importantly to improve the existing technologies and products to cater to the consumer and market needs. AE(s) are not only developing technologies that improve quality, safety and the environmental performance of the <<Product Name>>, but also conducting creative R & D related to mobility, based on a long-term perspective.

AE group undertakes research and development in relation to the various products (including, but not limited to <<Product Name>>. The existing R & D activities of the group currently accommodates all requirements related to necessary modification and improvisation of its existing products, for the markets catered by the group around the globe.

ABC India support its group entities in specific requests in testing existing <<Product Name>>, providing recommendations for increasing the efficiency of the processes, methods and materials used in manufacture of specific products. In certain cases, ABC India may also assist its Group entities in assessing the optimum supply chain for <<Product Name>> in a designated market for a particular type of product.

Role of AE(s)

ABC India is dependent on AE(s) for the manufacturing technology, and relies principally on technological inputs from AE(s). AE(s) are responsible for development of new technology and upgrading the existing technology, process and product. Any product and process related development in terms of new product, better processes, inputs for producing the <<Product Name>>, advance machines etc. are provided by the AE(s) to ABC India.

Role of ABC India

ABC India primarily relies on AE(s) for all technology related aspects, however ABC India also employees certain technical engineers for managing and taking care of its day to day manufacturing operations. Such engineers coordinate with the AE(s) and ABC India in respect of ongoing research and development endeavour of AE, and also to provide inputs to AE(s) in relation to any technical requirements or enhancement in process/products.

6.2.3 Procure / Sourcing Functions

6.2.3.1 Purchasing

Procure functions are those activities related to the purchase of raw materials and other inputs to the production process.

ABC India procures components and raw materials from two sources:

1. **Imports from AE(s):** All imports undertaken by ABC India are sourced from AE entities. ABC India has access to the prices offered by AE group entities for the components or raw materials. The AE(s) duly guide and provide their suggestion in identifying the best available sources of raw material available within the AE group entities.
2. **Local third party vendors:** ABC India identifies potential local third party vendors from its existing members, or suppliers to its competitors. The final selection of a vendor is done in consultation with OEM in the form of team visits by OEM's engineers and samples sent to OEMs for quality approval. The prices of components and raw materials are negotiated by ABC India with the vendors.

6.2.4 Make functions

Make functions are activities that impact the manufacture of a company's products including production planning and control and process improvement.

6.2.4.1 Equipment procurement

Equipment procurement activities include the selection and purchase of equipment used to manufacture, store and distribute the company's products.

ABC India is responsible for identifying the equipment required by it for carrying out the manufacturing process. Since ABC India relies on technological support from the AE(s), the equipment requirements are finalized in consultation with its AE(s). Thereafter, ABC India procures the equipment directly from the AE(s) or from the identified vendors which are approved by the AE(s) as the case may be. The vendors are identified through a detailed process of quotation and market worthiness as well as conformity to the quality standards / specifications required to be met by each vendor.

6.2.4.2 Production scheduling

Production scheduling and inventory activities involve determining the type and quantity of product lines to be manufactured in order to meet customer delivery requirements.

After determining the budget estimates, and finalising the source of raw materials, components, market demand, ABC India's production team decides the schedule of production of its various types of <<Product Name>>. The production scheduling is done based on guidance provided by the marketing team, which prepares long term, mid-term and short term plans. Such production plan is then communicated to the AE(s) for determining the ensuring the timely supply of raw material. The AE(s) schedule their production/procurement in accordance with their local budget and as per the requirement schedule communicated by ABC India.

6.2.4.3 Product fabrication and assembly

Product fabrication and assembly activities involve the manufacture and assembly of products that will be sold to customers as an input in manufacturing products, for distribution to final consumers, or for the customer's own consumption. These activities generally involve conversion of raw materials into finished goods through a series of physical, chemical or biological manipulations that may be carried out through any combination of the following ways: 1) the introduction of further material inputs, 2) the employment of labour and 3) the use of capital equipment.

Product fabrication and assembly activities involve the manufacture and assembly of products that will be sold to final consumers.

ABC India is responsible for conversion of locally procured and imported raw material and intermediaries into finished products which are sold in Indian market. For this purpose, ABC India has established a factory, where indigenous as well as imported raw material is processed / assembled into the finished products.

6.2.5 Quality control

Quality Control activities involve establishing and enforcing minimum standards to ensure that inferior goods are not sold to consumers. This process involves testing and analyzing raw materials and other material inputs, work in process, and finished goods. Quality control can be pursued by employing a combination of automated quality control equipment and qualified inspectors.

ABC India monitor the operations to ensure that the quality of <<Product Name>> produce is in accordance with the international standards of the AE Group. For this function, ABC India has implemented various quality control mechanism and regular tests / checks, as per the AE's global standards with the help of AE(s).

6.2.6 Move Functions

6.2.6.1 Inventory management

Inventory management/warehousing includes all functions to keep and manage stock of raw materials, semi-finished products and finished products efficiently to maintain the lowest possible cost levels and effectively to minimize lost orders.

Inventory management in India, including all decisions made in relation to the level of inventory maintained, is the responsibility of ABC India, although the supplying companies (or AE(s)) may provide management insights in relation to minimum order level and other inventory stock which needs to be maintained based on global standards and specific market needs.

6.2.6.2 Warehousing

Once <<Product Name>> are manufactured, ABC India stores division / team is responsible for the proper warehousing / storage till the time these <<Product Name>> are dispatched to dealers / distribution centres. The raw material / components procured from local suppliers as well as from the AE(s) are also separately stocked to ensure that adequate supply is available for the assembly

operations. ABC India is solely responsible for carrying out the warehousing operations with the broad guidelines provided by the AE(s).

6.2.6.3 Logistics

Inbound Logistics refers to the functions undertaken to administer the arrival of raw materials, work in progress, or finished goods purchased from vendors.

Outbound Logistics refers to the functions undertaken to administer the shipment of finished goods from the supplier to the purchaser.

Function of ABC India

Raw materials are sold to ABC India predominantly on a “Free on Board” (“FOB”) basis, which means ABC India bears all costs and risks associated with the imported products from the time of shipment, including freight charges, transportation insurance and customs duties.

The logistics activities undertaken by ABC India include:

- Arranging shipment of the products to India from countries where its AE(s) are located;
- Handling customs clearance at the time of import of raw materials and export of <<Product Name>>;
- Coordinating delivery from/to ABC India’s central warehouse upon arrival/export;
- Distributing products to other ABC India warehouse locations when appropriate;
- Delivery of finished products (<<Product Name>>) to distributors;
- Coordinating and managing third party transport providers and freight companies; and
- Handling of all insurance matters relating to loss and /or damage

ABC India’s business unit coordinates and reviews the supply chain process in respect of the raw materials, capital goods imported from the AE(s). ABC India engages customs agents to make appropriate payment of taxes and custom duties together with the documentation required for the clearance of products at the ports, etc. Once the goods have arrived in India, they are received and reviewed by the customs agent, who prepares the respective customs documentation and carries out the procedures necessary for the importation. The goods are then delivered to ABC India’s central warehouse.

6.2.7 Sales and Marketing activities

6.2.7.1 Marketing

The Holding company of ABC India designs the global sales and marketing strategy. The main factors driving the strategy are the local market conditions, the business strategy of the company, and the local marketing policy of ABC India. ABC India performs the typical sales and marketing functions like identification of potential customers, developing and maintaining relationships with existing customers, creating awareness about the <<Product Name>>, etc.

ABC India conducts marketing activities such as performing market research, creation of product brochures, monitoring market demand, formulating marketing strategies and budgets, etc. ABC India is responsible for deciding the types of marketing activities performed and the timing of these activities in India purely from a local sales and distribution perspective. ABC India determines the appropriate advertising and marketing mix to be used in the media. All of these activities are purely aimed at stimulating the customer demand and pushing sales of <<Product Name>> in India in a highly competitive market.

6.2.7.2 Pricing

Product pricing has both strategic and tactical components. Strategic pricing involves a trade-off between product margins and sales volume. Tactical aspects involve price adjustments to meet local or temporary market conditions, to establish prices for product improvement or to assist distributors / sales organizations in meeting competitive challenges.

Function of ABC India

ABC India is responsible for setting the price of products sold to customers. The main factors impacting the price of products sold to customers in India are:

- Sales volume;
- Market share;
- Strategic segmentation,
- Level of competition, and channel capability.

Pricing of any product is influenced by price of the existing product which the new product shall replace in the market. Further, determining the level of rebates, discounts or any promotional schemes to be provided to customers is also an active function of ABC India.

Function of AE(s)

The AE(s) plays no role is determining the local prices for the finished product sold in India.

6.2.7.3 Sales

The sales function refers to all activities associated with direct customer contact and negotiations to bring about purchases by the customer of the firm's products.

Functions of ABC India

ABC India is responsible for identifying and developing new business opportunities, as well as maintaining the existing customer base in India, in addition to exporting goods to AE(s). It develops the sales budget in coordination with the OEM/dealers and sets sales forecast and sales target on an annual basis for each customer account to assist in the product planning and budgeting process. ABC India's sales and marketing team is actively involved in exploring new customer segments and business opportunities which may help ABC India in expanding its business and market share in India.

Functions of AE(s)

The role of AE(s) in respect of sales function is limited to providing guidance and suggestions to ABC India on specific requests made by ABC India on specified occasion such as dip in sale of particular <<Product Name>> or for any segment etc.

6.2.7.4 Distribution channel

Distribution networks enable the firm to locate customers, determine their needs and provide services or products to meet those needs.

One of the key strategies of business concerning sale of products is to have efficient distribution channels. Therefore, ABC India continuously develops the distribution channel to make it robust enough in order to sustain competition and increase its market share for <<Product Name>>.

Functions of AE(s)

The AE(s) helps and guide ABC India in drafting their sub-distributorship agreement as per the Indian market and in line with the global standards. The AE(s) has no role in determining/drafting the discount and incentive schemes for various dealers. The same is decided as per ABC India's local Indian target and market forces.

6.3 Risk Assumed

Briefly summarised below are some of the key business risks that are faced by ABC India and its AE(s) with respect to the international transactions undertaken by them.

ABC India is responsible for undertaking core business development and is directly impacted due to a decline/reduction in business arising out of economic circumstances or business exigencies or due to competition. Therefore, ABC India directly bears the business risk of manufacturing <<Product Name>> in India. ABC India bears the corresponding cost and rewards associated with such business risk.

The AE(s) bear limited business risk insofar as a decline in business of ABC India would result in a decrease in the market share of AE(s) in the Indian market which may impact its future business plans for India. Further, a decline in ABC India's sales would also directly impact royalty paid by ABC India to its AE.

6.3.1 Inventory risk

This risk relates to the potential for losses associated with carrying product or component inventory. Losses include obsolescence, shrinkage, or market collapse such that products are only saleable at prices that are inadequate to cover the company's product costs.

ABC India procures raw materials and consumables both locally (if any) and from AE(s) on the basis of production schedule. ABC India is responsible for ensuring safe storage of such raw material/finished goods and to protect the inventory against any theft, natural calamity, rain etc.

or any other loss due to improper storage. The risk of carrying excess inventory or shortage on account of inaccurate forecast is borne by ABC India.

6.3.2 Scheduling risk

Scheduling risk relates to the uncertainty involved in scheduling production in response to unpredictable fluctuations in demand. Scheduling risk is of particular concern for companies with highly volatile demand or demand that is extremely sensitive to timing of product delivery.

ABC India primarily bears the scheduling risk as it would be responsible for the final sales made to the customer. Further, ABC India places the order on suppliers/AE(s) along with delivery schedules. While suppliers (including AE(s)) would be responsible to meet the orders provided by ABC India within the stipulated timeframe, they also bear the scheduling risk with respect to demands made by ABC India

6.3.3 Utilisation risk

This risk relates to the possibility of non-recovery of fixed costs being incurred. This may happen due to circumstances such as, lack of production, to lack of demand, inability to recover prices etc.

For the purpose of setting up a manufacturing / assembling plant to manufacture <<Product Name>>, ABC India has invested a large amount into capital assets which are depreciated over the fixed period of time. Since, ABC India acts as an autonomous entity; it is responsible for its business and sales in India. Thus, it bears the risk of insufficient revenue or production to cover the fixed costs of maintaining the manufacturing facility. Hence, ABC India bears the under-utilisation risk that may arise due to a decrease in the sale of <<Product Name>> in India. The demand of <<Product Name>> may decline due to adverse economic conditions, market dynamics, stiff competition, labour problems, etc which may lead to a situation where ABC India's sales revenue may not be enough to absorb the excess capacity.

6.3.4 Product liability risk

Product liability risk refers to the risk associated with the possibility of facing legal action from customers due to defects in the products provided.

In respect of the <<Product Name>> manufactured by ABC India, it bears the product liability risk for the products sold in the Indian market as well as to overseas entities. Further, the instances of defects are rare, given the fact that the products are subject to stringent quality standards/ checks before being sold/exported.

6.3.5 Price Risk

- Price risk arises as a result of price pressures in the market.
- Factors of production

The factors of Production are the inputs used to manufacture the <<Product Name>>. Such factors primarily comprise raw material, labour and capital goods. In order to mitigate from the risk of rise in the price and ensuring the best price of raw material meeting the quality standard, ABC India is

getting support from the AE(s) for identifying the global vendor from where various raw material and machines could be imported. In terms of labour cost, ABC India is getting support from the AE(s) for drafting the salary and wage policy, the compensation structure and other perquisite in cost efficient and effective manner. However, the final risk in relation to rise in cost of factor of production is rest with ABC India.

- Final products

Further it is pertinent to note that AE <<Product Name>> would also bear the risk of loss of customer on account of rise in price.

6.3.6 Credit and collection risk

When an entity supplies products or services to a customer in advance of customer payment, the firm runs the risk of default of such payment.

ABC India transacts with unrelated customers in the Indian market along with transacting with its AE(s). Hence, in respect of sale of goods to third parties, ABC India bears the credit and collection risk. However in relation to the transactions with the AE(s), such risk is negligible or insignificant.

6.3.7 Foreign exchange risk

Exchange rate risk relates to the potential variability of profits that can arise because of changes in foreign exchange rates and arises whenever the transacting currency of an entity is different from its functional currency.

All payments/receipts to/from the AE(s) are made in foreign currency. Hence, ABC India bears the risk of foreign exchange rate fluctuation between the foreign currency and the Indian Rupee due to the inherent fluctuations in the exchange rates between these currencies.

6.3.8 Manpower risk

Every organisation has to employ people, train them adequately so as to suit the requirements of the company and thereby converting them into assets of the company. There always exists a risk of the trained staff leaving the organisation and other factors affecting productivity and efficiency.

ABC India assumes the manpower risk as it employs trained personnel for its manufacturing business.

ABC India is responsible for employing the required number of people (worker and, administration staff) ensuring the minimum bench strength and their training. In this regard, the support is also extended by the AE(s) for providing requisite training to the employees as per the request of ABC India, such training courses are available online and offline as per the requirement. The cost of recruitment and training is borne by ABC India and the risk of shortage of manpower is rest with the ABC India.

6.3.9 Technological risk

Technological risk arises if the market in which the company operates is sensitive to introduction of new products and variants. In a sensitive market, the business may face loss of potential revenues arising from obsolete infrastructure and tools as well as obsolescence of manufacturing processes or due to requirement of making further investment to cope with changing preferences of the customers.

Role of AE(s)

ABC India is dependent on AE(s) for the manufacturing technology, and relies principally on technological inputs from AE(s). AE(s) are responsible for development of new technology and upgrading the existing technology, process and product and thus, AE(s) bear the risk associated with the same. Any product and process related development in terms of new product, better processes, inputs for producing the <<Product Name>>, advance machines etc. are provided by the AE(s) to ABC India.

Role of ABC India

ABC India primarily relies on AE(s) technology related aspects, however ABC India also employs various technical engineers for managing and taking care of its day to day manufacturing operations. Such engineers coordinate with the AE(s) in respect of ongoing research and development endeavour of AE, and also to provide inputs to AE(s) in relation to any technical requirements or enhancement in process/products. Such engineers also ensure the implementation of AE's defined processes and act as a communication channel between ABC India and AE(s).

6.4 Characterisation of entity

Based on the results of the functional, risk and asset analysis, it is concluded that ABC India can be characterised as a manufacturer of _____ <<product>> bearing all the risks typically borne by a full-fledged manufacturer operating in these industries.

7 Economic Analysis

7.1 Choice of tested party

The tested party is usually the participant in a transaction for which profitability can be ascertained most reliably and for which reliable data on comparables can be found. The tested party will also typically be the party with the least intangibles.

For the class of international transactions under consideration, ABC India has been chosen as the tested party due to the fact that it does not own any significant intangible and its profitability can also be reliably ascertained.

7.2 Selection of most appropriate method

7.2.1 *Applicability of the prescribed methods*

Net margins earned by comparable companies performing activities similar to those of ABC India are available in the public domain and can be easily established, thus facilitating a more reliable comparability analysis. Further, it is a well accepted principle that net margins are less affected by transactional differences than are prices (as in the case of CUP) and gross margins (as in the case of RPM/CPM). In this case, since the functions performed by comparables identified by us were broadly similar to the functions performed by ABC India, the TNMM, which involves net margin comparison, was considered as the most appropriate method for testing the above-mentioned transaction of ABC India.

7.2.2 *Combined Transaction Approach*

There are situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on an individual basis. In such a situation, rather than assessing the arm's length terms of the transactions individually, these transactions should be evaluated taken together using the most appropriate arm's length method (Combined Transaction approach).

The transactions were analysed together using combined transaction approach, wherein if the margins earned by ABC India could be considered to be at arm's length, as a consequence, it could also be concluded that the value of international transactions with AE(s) is also at arm's length.

7.3 Search for comparable uncontrolled data

Based on the provisions of Rule 10B of the Rules, comparables for the international transaction would have to be companies which are engaged same or similar activity as ABC India, and are comparable in terms of functions performed, risks assumed and assets utilised. Further, such companies should themselves be independent and should not have significant controlled transactions, which could affect the arm's length nature of their operating margins.

Based on above, the search has been carried out on publicly available financial databases (ACETP, CapitalinePlus and Prowess) to identify the comparable companies which are further reviewed against following categories:

- Companies for which only one year financial data is available to undertake analysis;
- Companies that ceased business operations or were currently inactive;
- Companies having turnover less than 1 crore;
- Companies having negative networth;
- Companies having Manufacturing sales/ Total Sales < 50%;
- Companies that were engaged in non-comparable activities;
- Companies that had substantial (in excess of 25 percent) transactions with related parties;
- Companies that experienced persistent operating losses.

Based on above, 6 companies are selected as comparable companies. A brief business description of the comparable companies is provided as below.

7.4 Brief business description of the comparable companies

7.4.1 *Bimetal Bearings Ltd.*

As per the Annual report, the company is engaged in the manufacture of engine bearings, bushings, thrust washers, alloy powder and bimetallic strips.

As per website, the company is engaged in the manufacture of engine bearings, bushings, thrust washers, alloy powder and bimetallic strips.

(<http://www.bimite.co.in/>)

7.4.2 *Menon Bearings Ltd.*

As per the Annual report, the company is engaged in the manufacturing of bearing, bushes and thrust washers etc and aluminium die casting components

As per website, the company is engaged in the manufacturing of auto parts. It is also engaged in the manufacture of bearings, bushes, thrust washers and other auto parts.
(<http://menonbearings.in/>)

7.4.3 *A B C Bearings Ltd.*

As per the Annual report, the company is engaged in the manufacture and sale of bearings including taper roller bearings and cylindrical roller bearings among others.

As per website, the company is engaged in the manufacture of taper roller bearings, cylindrical roller bearings and slewing bearings. (<http://www.abcbearings.com/index.php/about-us/company-profile/>)

7.4.4 Galaxy Bearings Ltd.

As per the Annual report, the company is engaged in the manufacture of ball and roller bearings.

As per website, the company is engaged in the manufacture of taper roller bearings & cylindrical roller bearings.

(<http://www.galaxybearings.com/>)

7.4.5 N R B Bearings Ltd.

As per the Annual report, the company is engaged in the manufacturing of ball and roller bearings.

As per website, the company is engaged in the manufacturing of ball and roller bearings. It offers needle roller bushes and cages, ball and roller bearings and automobile components. (<http://in.reuters.com/finance/stocks/companyProfile?symbol=NBEA.BO>)

7.4.6 J M T Auto Ltd.

As per the Annual report, the company is engaged in the manufacture of auto components mainly gear and transmission parts.

As per website, the company is engaged in the manufacture of auto components such as engine components, gears, shafts, pins, bushes and idler bearings. (<http://www.jmtauto.com/company.html>)

7.5 Financial Analysis – Profit level Indicator

7.5.1 Selection of PLI

The TNMM apportions the total operating profit arising from the transaction on some appropriate basis like sales, costs, assets, etc.

Operating Profit

Operating Cost

Or

Operating Profit

Net Sales

Wherein;

- Operating Profit = Net Sales – Operating Cost

- Net Sales = Sales less excise duty
- Operating Cost = Total Cost excludes finance cost.

7.5.2 Comparable adjustments

The comparables selected for analysis could also include companies that may perform additional functions in addition to the comparable activity. Further, independent companies may undertake additional risks vis-a-vis ABC India. The effect of these functional and risk differences on profit margins, needs to be factored while determining the arm's length price. However, no adjustments have been made to account for such functional and risk differences between the tested party (ABC India) and the comparable companies and ABC India reserves the right to undertake an adjustment for such differences (including differences in the risks assumed and working capital employed), if warranted.

7.6 Margin computation of comparable companies

Based on the above analysis, the average of unadjusted operating margins of the comparable companies, works out as follows.

Table 2 – Computation of Margin of comparable companies – on Net Sales

S.no.	Comparable Companies	Operating Profit / Net Sale			Weighted Average of Operating profit/ Net sales
		2016	2015	2014	
1	Bimetal Bearings Ltd.	2.87%	1.26%	0.14%	1.41%
2	A B C Bearings Ltd.	8.23%	6.04%	4.99%	6.55%
3	J M T Auto Ltd.	7.42%	6.66%	7.19%	7.04%
4	Galaxy Bearings Ltd.	NA	13.07%	8.60%	10.78%
5	N R B Bearings Ltd.	10.73%	13.19%	11.33%	11.76%
6	Menon Bearings Ltd.	21.93%	17.74%	12.22%	17.70%
Arithmetic Mean					9.21%
Computation of Range					
35%					7.04%
65%					10.78%

Table 2 – Computation of Margin of comparable companies – on Operating Cost

S.no.	Comparable Companies	Operating Expenditure 2016	Profit/ 2015	Operating 2014	Weighted Average of Operating profit/ Operating Expenditure
1	Bimetal Bearings Ltd.	2.96%	1.28%	0.14%	1.43%
2	A B C Bearings Ltd.	8.97%	6.43%	5.25%	7.01%
3	J M T Auto Ltd.	8.01%	7.13%	7.75%	7.58%
4	Galaxy Bearings Ltd.	NA	15.03%	9.40%	12.08%
5	N R B Bearings Ltd.	12.02%	15.19%	12.77%	13.33%
6	Menon Bearings Ltd.	28.09%	21.57%	13.93%	21.51%
Arithmetic Mean					10.49%
Computation of Range					
35%					7.58%
65%					12.08%

7.7 Computation of margin of ABC India

The margin computation of the tested party is as below: <<Please fill>>

Particulars	Formula	Amount (In INR)
Income		
Net Sales	A	
Add: Other Income	B	
Total Income	C= A +B	
Expenses		
Add: Manufacturing Expenses		
Material Consumed		
Employee Cost		
Depreciation		
Other Expenses		
Operating Expenditure	D	
Operating Profit	E= A-D	
Add : Other Income	B	
Less : Finance Cost	F	
Profit before Tax	G = E+B-F	
Operating profit / Net Sales	E/A	
Operating profit / operating expenditure	E/D	

7.8 Conclusion

<<In case of Export / Sales>>

Since, ABC India's operating margin of ____ percent on operating cost is below or within the range of 35th to 65th (7.04% to 10.78%) to be at arm's length from an Indian transfer pricing perspective.

or

<<In case of Import / purchase>>

Since, ABC India's operating margin of ____ percent on Net sales is above or within the range of 35th to 65th percentile (7.58% to 12.08%) margins of comparable companies, all the transaction between ABC India and its AE(s) can be considered to be at arm's length from an Indian transfer pricing perspective.