

Auto Industry Report



6th May, 2020

Industry Outlook

The Auto industry is going through the most difficult times from last six quarters. Almost all OEM players saw a decline in trend across all the segment. According to the Siam data, In FY20, the industry sales witnessed a sharp decline of 14.8% YoY from a growth of 6.4% in previous year led by factors such as increased insurance costs, uneven monsoon, high ownership costs, curtailed lending by the NBFC segment, weak festival demand, weak consumer sentiments. Furthermore, the country-wide lockdown announced by the Prime Minister in March 2020 to restrict the spread of Covid-19 has blown away the hopes for recovery of sales as supply chain of major OEM's have been disrupted while facing a liquidity issue of existing inventory. The expectation of a decent performance for FY21 has been dented the demand due to coronavirus pandemic which created more headroom for economic slowdown with a deferment of growth for auto industry which was already in a bleeding condition.

COVID-19 & its impact on Auto & auto ancillary industry

India's maximum dependence on imports especially for the two-wheeler and passenger vehicle industry component wise is in steering and braking systems, engine parts, alloy wheels and lighting systems. Moreover, most of the OEMs are dependent on Chinese supply chains for the BS-IV as well as BS-VI components such as fuel injection pumps. In the current scenario, with the overall slowdown in the Indian economy, shifting to other alternate countries (such as Germany, Japan, Korea) for supply may not be feasible in terms of both cost and time. Also, the gestation period and the huge investment requirements for the auto component industry remain the restricting factors for such immediate shift. In case of subsegment tyres, the local industry is expected to benefit as cheap Chinese imports (about 25-30% of total tyre imports) are expected to drop. As per the industry experts, most OEMs were covered to continue sales and production operations till March – April 2020. However, with the spread of the virus and at request of Society of Indian Automobile Manufacturers (SIAM) and Auto Component Manufacturers Association of India (ACMA), most of the OEMs and auto component players have initiated work from home for its non-manufacturing work staff and have announced temporary shutdown of manufacturing units and put local productions on hold.

In overseas, China is currently operating at below average capacities and given the conditions, is expected to fully recover only by Q2 FY21, provided the spread of Covid 19 is curtailed. Therefore, the Indian component industry is expected to witness supply chain disruptions in the domestic market during Q4 FY20 and Q1 FY21. while local sourcing is expected to increase going forward. The investments of the industry have also been put on hold due to prolonged slowdown in the already existing subdued market during FY20.

Current scenario

OEMs have not commenced actual production at factories despite receiving permission and also don't expect meaningful improvement in production after May 17 when the lockdown is expected to be lifted. There are limitations at every stage of the supply chain. OEMs are grappling with issues in raw material availability, sourcing of components workforce availability (most workers have reverse migrated and permissions are to source locally), transportation and driver availability, and lastly most dealerships are closed. Most of the OEMs believe that actual production will ramp up only when the dealers are allowed to open, and vendor network is restored to ensure continuous supply of components. Therefore, currently they are focusing on facilities by carrying out maintenance works, laying out safeguarding measures, taking year end stock counts, prepping the supply chain etc. However, since rural areas are relatively less affected and tractor dealerships are allowed to open, M&M and Escorts has started dispatching factory inventory to their respective dealers. Also, OEMs with pending export orders, like Bajaj Auto, will be focusing on accomplishing export orders given the uncertain domestic demand in the near term.

Conclusion

With the already existing slowdown, the industry is likely to suffer huge losses going forward. also, the employment of the industry is at risk as the contractual workers accounts for about 50% of the workforce in the industry. We expect an unfavourable consumer sentiments and muted demand in H1 FY21 led by volatile economic conditions even if pandemic is shortened. Even the government spending on infrastructure is expected to be low during the period, further impacting the demand for commercial vehicles.

Company	Outlook
Ashok Leyland	Positive
Atul Auto	Neutral
Bajaj Auto	Positive
Eicher Auto	Positive
Escorts	Neutral
Hero Motocorp	Neutral
M&M	Negative
Maruti Suzuki	Positive
Tata Motors	Neutral
TVS Motors	Positive

Stock Price Performance	1M	3M	1 Yr
Ashok Leyland	29	-38	-44
Atul Auto	15	-33	-52
Bajaj Auto	6	-23	-20
Eicher Motors	8	-29	-32
Escorts	15	-19	2
Hero Motocorp	26	-18	-22
M&M	27	-38	-44
Maruti Suzuki	32	-19	-27
Tata Motors	19	-56	-60
TVS Motors	22	-31	-36

Price Chart



Research Associate

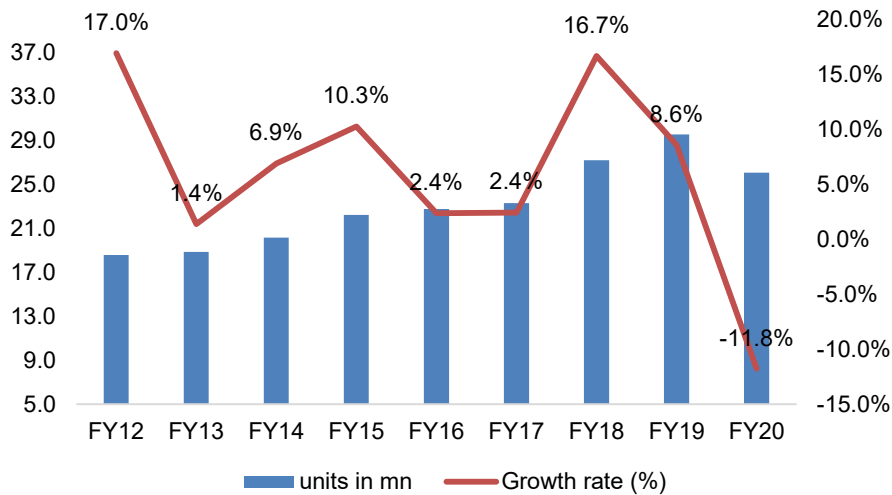
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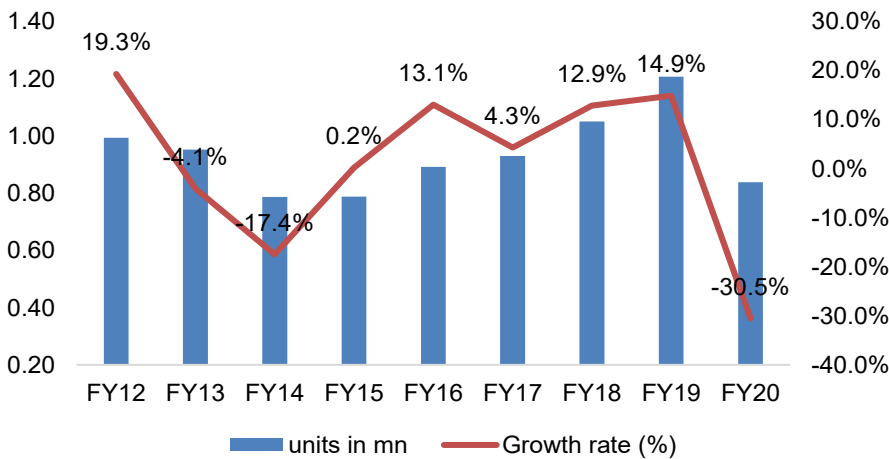
Two & Three Wheeler



Source: Companies, BP Equities Research

Two & three wheeler declined by 11.8% YoY in FY20 led by decline in sales of two wheelers by ~14.2% YoY followed by ~10.2% YoY basis in three wheelers. Demand remained under pressure on the account of high ownership costs, higher outlay in insurance cost, increased fuel costs and price hike on back of new safety norms starting April 1, 2020 which all together led to slower movement in the segment sales. However, we expect 2Ws to be the first one to show some signs of recovery led by a revival in rural demand, low interest rates, change in customer preference towards owning a personal vehicle and an uptick in rural income in H2FY21.

Commercial Vehicles

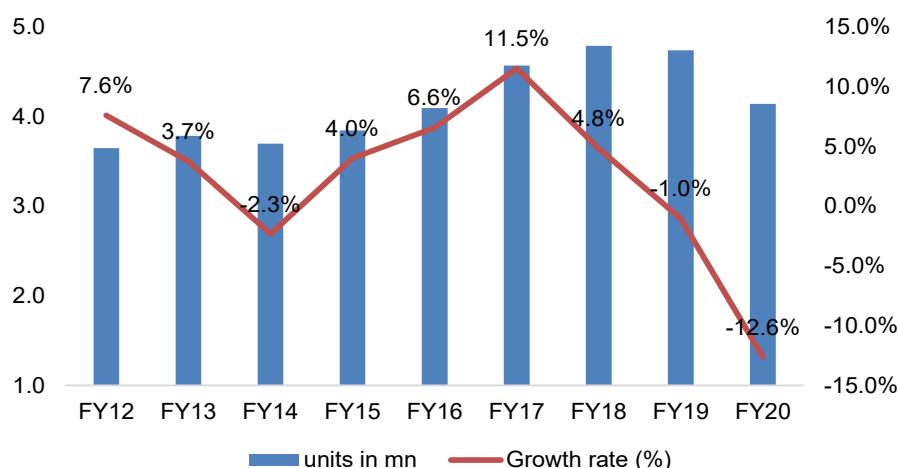


Source: Companies, BP Equities Research

The Commercial vehicles sales declined sharply by ~30% during the year with Medium and Heavy Commercial Vehicles (M&HCVs) sales declining by ~43% and Light Commercial Vehicles (LCVs) sales by ~21% YoY on the back of revision in axle load norms for M&HCVs by 20-25% which led to a deferment of purchase by fleet owners while on the other hand the volatility in freight rates and increase in fuel prices impacted the demand sentiments severely. Moreover, the nationwide lockdown has impacted the freight demand severely. Going ahead, weak demand and slowdown in infrastructure activities during the lockdown and post it is likely to impact the revenue pockets of OEM players. We expect a demand for commercial vehicle segment to revive post FY21.

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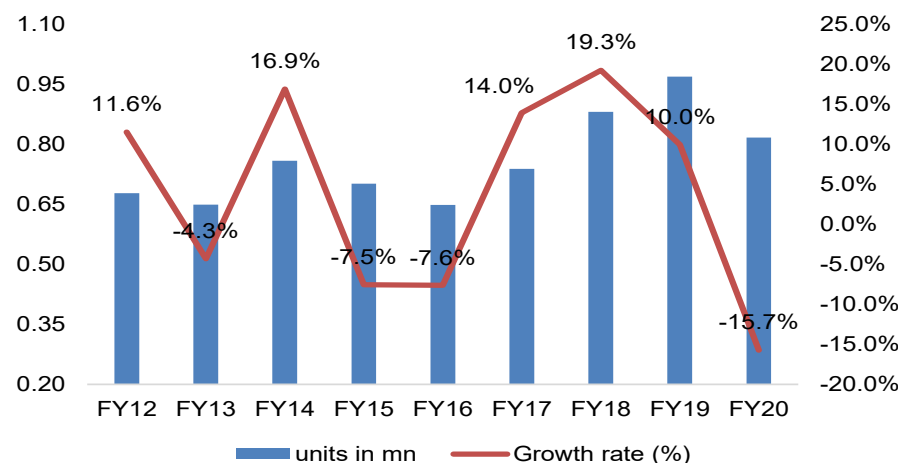
Passenger Vehicle



Source: Companies, BP Equities Research

Overall passenger vehicle sales witnessed a decline of 12.6% YoY in sales during FY20 with maximum decline of ~39% YoY in the vans segment followed by ~20% decline. Multi-Utility Vehicles (MUV) segment sales on the other hand, witnessed a marginal growth of about 3% YoY during the period led by various new model launches along with additional deals and discounts offered by the dealers and OEM players. The Increased insurance cost, high ownership cost, high fuel costs and price hike due to new safety norms which started from April 1, along with the liquidity crunch has continued to drag the industry. Therefore, we expect gradual recovery in this segment, ahead of commercial vehicles.

Tractors



Source: Companies, BP Equities Research

Tractor sales witnessed a decline of 15.7% YoY in sales during FY20 led by uneven monsoon, weak demand in most of the regions and deferment of purchase. Moreover, tractor industry looks positive in near future led by higher yield on seasonal crops, higher discounting, good harvesting season and positive agri sentiments. Therefore, We remain optimistic in terms of future outlook the post lockdown. We expect growth momentum to continue across regions unlike past with the Northern and Central regions were driving the growth. Looking ahead, we expect the Southern and Eastern regions to witness meaningful revival over the next 2 years, We expect next phase of growth would be backed by expectation of good crop production in FY21, supported by favourable monsoon and reasonable hike in the MSPs of the key agricultural produce.

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Few triggers to uplift overall demand

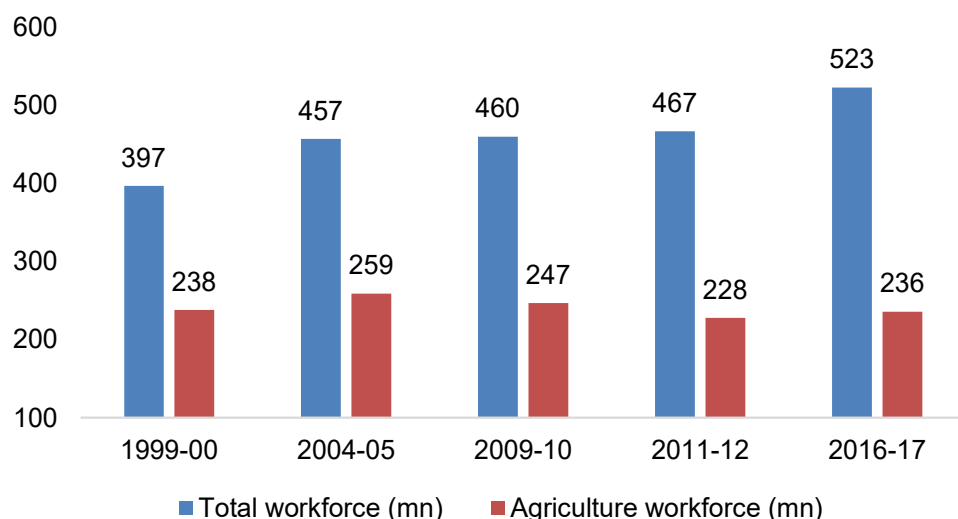
- **Higher disbursement of loans by central bank**

INR in bn	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
Vehicle loans	1285	1529	1705	1898	2022	2216
		19.0%	11.5%	11.3%	6.5%	9.6%
Vehicles, Vehicle Parts & Transport Equipment	682	690	736	787	798	831
		1.2%	6.7%	6.9%	1.4%	4.1%

Source: RBI, BP Equities Research

Vehicle loans to individuals as of March 2020 have witnessed a growth of 9.6% over March 2019. However, in terms of finance to the industry, bank loans to the industry have witnessed a growth of 4.1% YoY in March as compare to same month corresponding previous year. With such disbursement of loans, RBI is putting all its efforts to push the automotive sector back on track. Therefore, lower interest rate and increase in disbursement of loans will encourage and facilitate consumers to purchase vehicles.

- **Inclination of workforce towards rural regions**



Source: NSSO, Census of India

As per the census data of India, Total employment as well as agriculture workforce has been increased substantially. Therefore, such increasing workforce will enable to enhance rural sector. Therefore, We expect a healthy kharif and rabi crop and normal monsoons this year to help boost to boost rural economy. This in turn should make it the growth engine that will help revive the economy. We expect 2Ws and tractor industry to be the first to bounce back, led by a revival in rural demand. Hence, we believe the change in customer preference towards owning a personal vehicle and healthy rural income will boost consumer sentiments in the rural economy post Q3FY21.

- **Softening of Commodity prices**

	2018	2019	Jan-Apr '20
Crude Oil (\$/barrel)	71	64	35
Steel (\$/tonne)	569	493	440
Aluminium (\$/tonne)	2227	1892	1650

Note: Prices taken on an average basis*

Source: Crisil Report

In the last two years, major commodity prices such as crude oil decline by ~50 % due to weak demand, oversupply and full capacity at refineries, steel prices fell by ~22% and aluminium by ~24% led by weak exports and slowdown in production. Therefore such reduction in commodity prices will enable OEM players to act as a supportive base which will reduce the procurement cost resulting increase in operating margins at a gradual pace for a longer term.

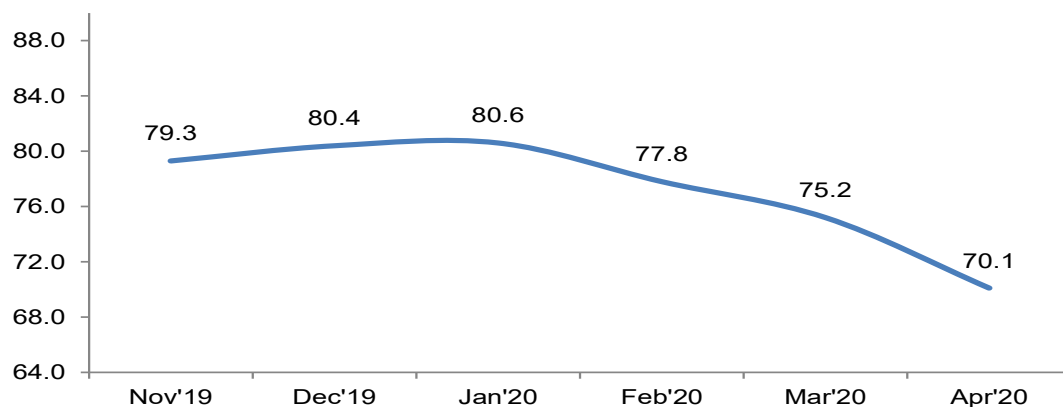
- **Implementation of Scrappage policy**



Source: Google, BP Equities Research

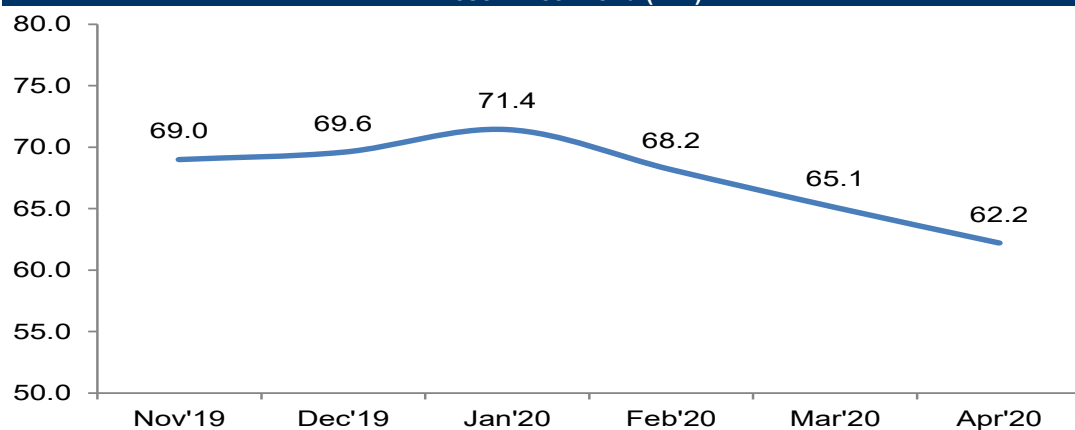
With a prevailing sluggish economy, the auto industry in general has been in a grip of a cyclical slowdown. When it comes to particularly in Commercial Vehicle segment, CV industry is going through a turbulent time due to the muted economy activity, increase in axles load that led to release of 25% additional capacity, and soft freight rates. All these have impacted the profitability of fleet operators. Currently, the government is reportedly to be in the final stage of the approval for a scrappage policy for all classes of vehicles (is proposed to cover all categories of vehicles – two wheelers (2W), cars and commercial vehicles (CV). The scheme proposes to provide financial incentives to the owners of vehicles to scrap outdated models (+15 years) and replace them with newer models. Hence, with strict implementation can make the scheme work effectively which will ultimately pent up demand by driving volumes up by 12-15% in commercial vehicles respectively.

Petrol Price Trend (INR)



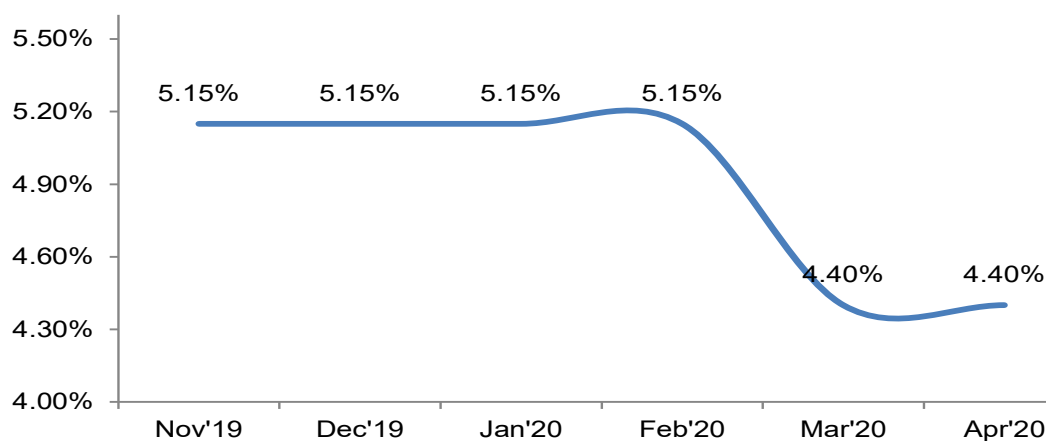
Source: IOCL *The trend shows monthly average price

Diesel Price Trend (INR)



Source: IOCL *The trend shows monthly average price

Interest Rate Trend



Source: RBI



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Disclaimer Appendix

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