SECTOR RESEARCH

Automobiles

www.brickworkratings.com

Brickwork Ratings

Auto sales to surpass pre-pandemic levels in FY23

Contact

Rajee R
Chief Ratings Officer

Chintan Lakhani
Director – Ratings

Tanu Sharma
Director – Ratings

Anita Shetty
Sr Research Analyst

Diya Roy
Jr Research Analyst

Investor & Media Contact
91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

Executive Summary

After facing the pandemic-led slowdown in FY21, the automobile sector began to recover in FY22. Although the sector continues to face a semiconductor chip shortage, automobile segments such as Passenger Vehicles (PVs) and Commercial Vehicles (CVs) witnessed growth in sales in FY22. In FY21, automobile sales figures were impacted not only by the pandemic, but also by the economic slowdown, revised axle norms and deferred buying due to the implementation of the Bharat Stage Emission Standards in FY20.

In FY22, while the Two-Wheeler (TW) segment declined 11%, PVs and CVs grew y-o-y by 26% and 13%, respectively. Going forward, Brickwork Ratings (BWR) expects the growth momentum to continue for PVs and CVs at a rate of 12-14% and 16-18%, respectively, in FY23, largely supported by the deferred sales from FY22. With the revival of the economy, rising requirements for public transportation and logistics would help boost CV sales. Additionally, PV sales would be supported by customers' shifting preference towards Utility Vehicle (UV) and Electric Vehicle (EV) models. The increase in the number of trips and vacations following the relaxation in travel restrictions, and customers' changing preference towards personal mobility post-pandemic have led to an increase in demand for higher-end models. TWs remained the only automobile segment to witness subdued demand due to the rise in ownership and commodity costs in FY22. In addition, rising inflation rates further dampened consumers' disposable income, which led to a decrease in demand for PVs' entry-level models and TWs. Yet, mainly due to a lower base, BWR expects TW sales to grow by 6-8% in FY23.

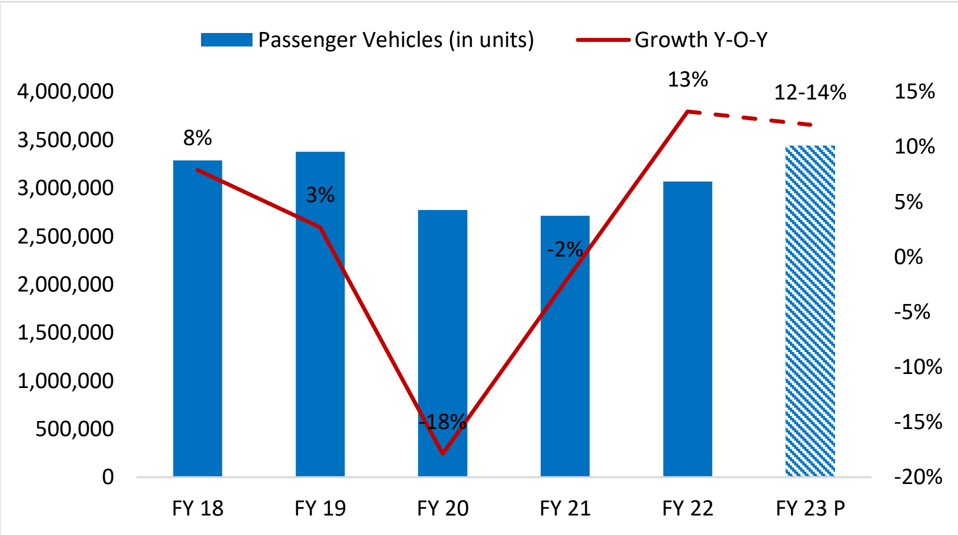
In line with the domestic market, the overall exports also increased by 36% y-o-y in FY22 on account of the subsiding pandemic effect and rising demand from ASEAN, African and Latin American countries. BWR expects the exports to further increase at 14-16% y-o-y in FY23, supported by continued growth in demand from ASEAN, African and Latin American countries, but the looming global recessionary threat could act as a dampener. Although domestic sales and exports increased in FY22, profitability of the players remained stressed due to high input costs. Although the prices of raw materials such as plastic, rubber and aluminium still remain elevated in FY23, the reducing steel (which accounts for ~50%-55% of the raw material cost) price could improve the EBITDA margins of automobile players up to a certain level in FY23. Hence, BWR expects a decrease in the steel price with the recent export duty hikes and rising demand for automobiles to support the EBITDA margins to reach 15-17% in FY23.

PV sales to increase in FY23, backed by rising demand for UVs and EVs

Overcoming the semi-conductor shortage, along with deferred sales, would drive PV sales in the near future.

Even before the pandemic hit, the automobile industry had been under stress in terms of a fall in sales, including in the PV segment. However, with the opening up of the economy during FY22, PV sales grew by 13% (y-o-y) owing to pent-up demand, as well as a higher offtake during the festive season. Despite the semiconductor shortage, the UV and EV segments' market share strengthened, backed by the launch of various models and changing preference towards personal mobility. In recent times, the preference for personal mobility has increased not only for day-to-day movement, but also for long road trips and vacations, which has encouraged customers to purchase more spacious vehicles. Rising concerns over the increase in air pollution and global warming have helped EV models gain a market share of 1-1.5% in FY22. However, entry-level PV models have continued to suffer from rising ownership costs following the hike in the interest on car loans and fuel costs, which discouraged lower-income-level buyers to invest in PVs.

Trend in Sale of Passenger Vehicles (in units)



Note: P - Projected

Source: SIAM, CMIE, BWR Research

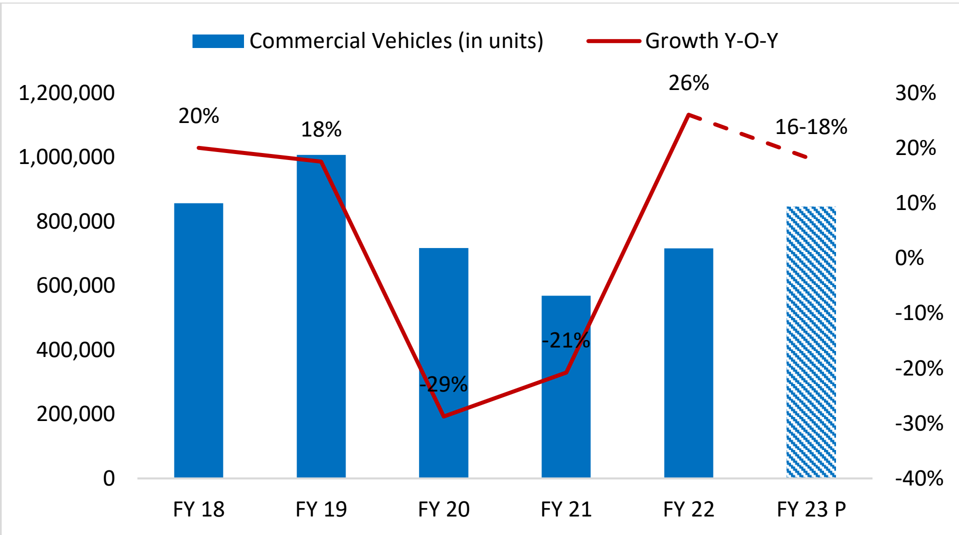
While the overall demand for PVs increased in FY22, PV manufacturers continued to face supply constraints, thereby creating a gap between demand and supply. With EVs gaining market share, the deferred sales figure has also risen as EVs require more semiconductor chips than Internal Combustion Engine (ICE) models. Although OEMs have been constantly focusing on solving problems, the semiconductor chip shortage has continued to negatively impact the industry in FY23. Amid the expectation of some gradual easing in the semiconductor chips supply, BWR estimates PV sales to go up by 12-14% in FY23, supported by deferred sales from the previous year. In addition, the scrappage policy could also be an influencing factor in increasing the sales. At present, of the total number of registered vehicles, around 34% are PVs older than 20 years, 22% are light motor vehicles older than 15 years and the percentage of CVs older than 15 years without a valid fitness certificate is approximately 11%. Therefore, with the implementation of the scrappage policy, the sales figure is expected to increase.

CV sales to see faster recovery with increase in logistic requirements and public transportations

Increase in public mobility and business operations would drive CV sales in FY23.

After two years of consecutive y-o-y falls in FY20 (-29%) and FY21 (-21%) due to the economic slowdown, amendments in the axle norms and the pandemic, the CVs saw a robust increase in demand by 26% in FY22, backed by the revival of economic activities, healthy demand from sectors such as logistics and e-commerce and a lower base. However, the sales number is yet to reach its pre-pandemic level as CV manufacturers are also facing semiconductor shortages, resulting in insufficient supply to meet demand. Since FY21, due to the geopolitical tension with China, coupled with the sudden rise in demand, not only India, even other countries faced severe semiconductor supply shortages. In FY23, the whole automobile industry still continues to face supply-chain constraints. Although Indian companies have already started to invest in the development and manufacturing of semiconductor chips, the gap in demand and supply still continues to be enormous. In addition, the ongoing Russia-Ukraine war, which started towards end-FY22, has worsened the situation as Russia is one of the exporters of palladium, and Ukraine, of neon and helium, which are the key requirements for manufacturing semiconductor chips. Eventually, this has been hampering the production of CVs, thereby delaying sales.

Trend in Sale of Commercial Vehicles (in units)



Note: P - Projected

Source: SIAM, CMIE, BWR Research

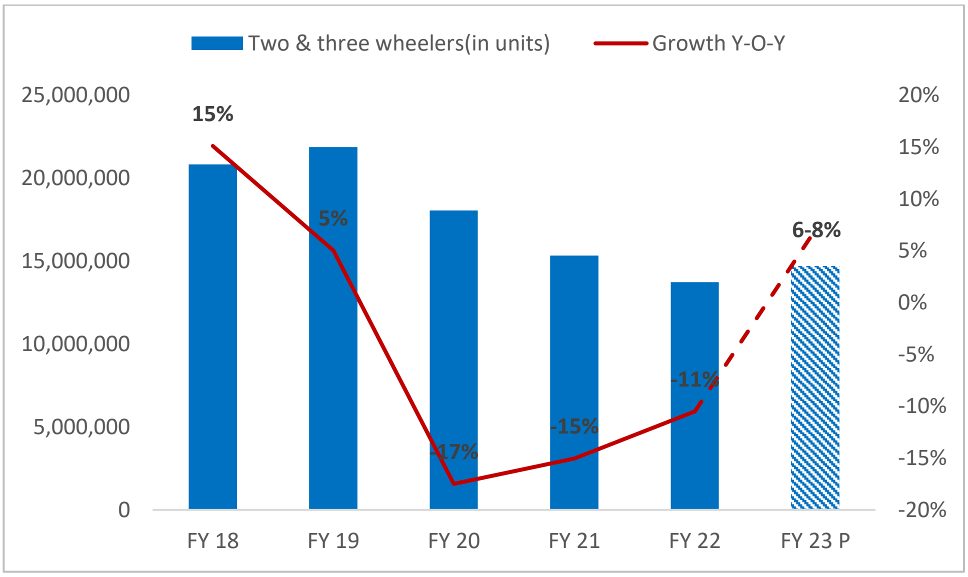
While supply-chain constraints may still continue, demand for CVs would been increasing with the revival of real estate, infrastructure and manufacturing activities, which have led to an increase in logistics activities. In addition, the opening of companies, schools and colleges has led to increased requirements for public transportation. In addition, on account of delayed sales from FY22, changing emission norms and the implementation of the scrappage policy, BWR expects CV sales to witness an uptick of 16-18% in FY23.

Healthy growth expected in TW sales in FY23 owing to low base

After consecutively dipping for three years, TW sales are expected to recover in FY23 due to a lower base.

The TW segment dominates the automobile industry with a market share of 80%. During the previous years, the automobile industry as a whole was adversely impacted by the economic slowdown, NBFC crisis, BS-VI norms in FY20 and then the pandemic in FY21. The situation was no different for the TW segment in FY22. While CV and PV sales improved in FY22, demand for the TW segment continued to witness negative growth due to higher ownership and maintenance costs.

Trend in Sale of Two and Three Wheelers (in units)



Note: P - Projected

Source: SIAM, CMIE, BWR Research

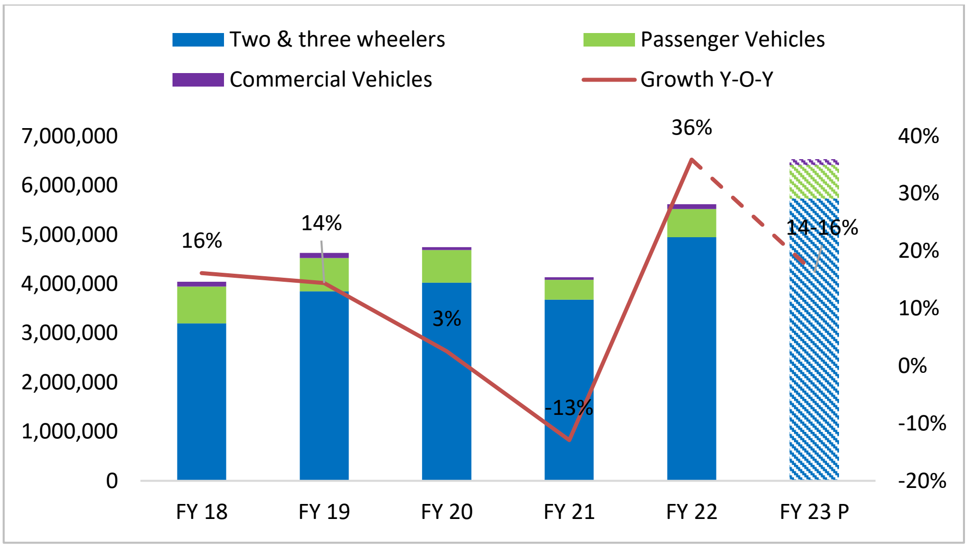
The main reason for decline in sales was that the TW segment is more cost-sensitive compared to other segments as the end user mostly belongs to the low- to middle-income group. Therefore, with the increase in ownership and fuel costs for the ICE models, there was a decrease in demand, especially in rural areas, which have a major influence on the TW sales figures. In addition, the cost-efficient and environment-friendly electric TWs have also been capturing the decreasing market share of the ICE models at a robust rate. While in the recent past, numerous battery explosion cases have negatively impacted the production of the electric TWs, the Government of India's plans of issuing standard operating procedures to certify and regulate the quality of the battery would help revive customer trust. Hence, BWR expects demand for the TW segment to witness healthy growth in FY23, backed by rising demand for electric TWs, and demand for the ICE model of TWs is also expected to increase at a rate of 6-8%, backed by the lower base and customers continuing to prefer ICE models due to inadequate EV infrastructure in the major parts of the country.

Exports to further increase in FY23, albeit at a lower rate due to higher base

The positive growth momentum of automobile exports could be hindered by the probability of a global economic slowdown in FY23.

In FY22, the Indian automobile exports increased y-o-y at a strong rate of 36% after witnessing a y-o-y fall of 13% in FY21. TWs, which faced affordability challenges in the domestic market, performed well in the international market. The TW segment accounts for 85-88% of the total automobile export and witnessed y-o-y growth of 34% in FY22, backed by rising demand from key export destinations such as Mexico, ASEAN and African countries.

Trend in Automobile Industry Exports (in units)



Note: P - Projected

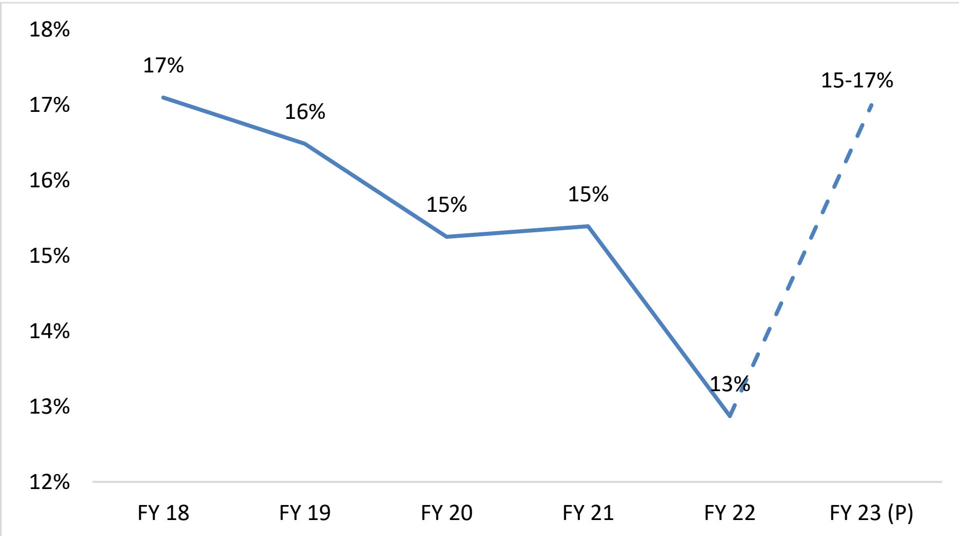
Source: SIAM, CMIE, BWR Research

BWR expects TW players to continue expanding the international market share in FY23. In line with the TW's segments, the exports of CVs and PVs also increased at a robust rate after consecutively declining in the past couple of years. CVs and PVs accounting for 12-15% of the total export grew by 83% and 43%, respectively. The export market performed better in comparison with the domestic market as there was minimal impact of the chip shortage in the export models. BWR expects automobile exports to grow by 14-16% in FY23 with some downside risks emanating from the rising probability of the global economic slowdown, which may hinder demand for domestic exports.

Profitability to remain under pressure, with rising inflation rate leading to increase in input costs

The profitability of the automobile sector has been range-bound over the years due to an uneven variation in price hikes and input costs. In FY22, with improved sentiments, apart from TWs, sales across all the segments recovered, but the margins still remained under pressure. Considering increasing input costs, automobile entities refrained from hiking vehicle prices to protect volumes. However, in FY23, BWR expects the EBITDA margins of the automobile players to improve to 15-17%, backed by the improved demand and supply scenario. With the ongoing supply-chain constraints such as the semiconductor shortage and rising demand, automobile players have hiked the prices of their vehicles, which would in turn improve their revenue generation. The improvement in margins would still be limited due to the rise in input costs, apart from steel prices, given that the prices of other raw materials such as aluminium, rubber and plastic would continue to remain elevated in FY23. Other factors impacting profitability would be an increase in fuel prices and interest rate hikes, which will continue to increase the overall cost of ownership.

Trend in EBITDA Margins



Note: P – Projected, Margin is calculated based on aggregated financials of Top 7 players having presence across the segments.

Source: Company Reports, BWR Research

ABOUT BRICKWORK RATINGS

Brickwork Ratings (BWR) is India's home-grown credit rating agency built with the superior analytical prowess of the industry's most experienced credit analysts, bankers and regulators. Established in 2007, BWR aims to provide reliable credit ratings by creating new standards for assessing risk and by offering accurate and transparent ratings. BWR provides investors and lenders timely and in-depth research across the structured finance, public finance, financial institutions, project finance and corporate sectors. BWR has employed over 339 working professionals including credit analysts and credit market professionals across 8 offices in India. Our experienced analysts have published over 13200 ratings across asset classes. BWR is committed to providing the investment community with products and services needed to make informed investment decisions. BWR is a registered credit rating agency by Securities and Exchange Board of India (SEBI) and a recognised External Credit Assessment Agency (ECAI) by the Reserve Bank of India (RBI) to carry out credit ratings in India. BWR is promoted by Canara Bank, India's leading public sector bank. More information on Canara Bank is available for reference at www.canarabank.com

BWR Rating Criteria are available at https://www.brickworkratings.com/ratingscriteria.aspx

Brickwork Ratings, a SEBI-registered credit rating agency, has also been accredited by the RBI, and it offers rating services for bank loan, NCD, commercial paper, bonds, securitised paper etc. BWR has Canara Bank, a nationalised bank, as its promoter and strategic partner.

BWR has its corporate office in Bengaluru and a country-wide presence, with offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi, along with representatives in 150+ locations. BWR has rated debt instruments/bonds/bank loans, securitised paper of over ₹19,02,200Cr. Additionally, fixed deposits and commercial papers, among others, worth over ₹83,555 Cr have been rated.

DISCLAIMER

 In issuing and maintaining its ratings, Brickwork Ratings relies on factual information it receives from issuers and underwriters and from other sources Brickwork Ratings believes to be credible. Brickwork Ratings conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Brickwork Ratings' factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Brickwork Ratings' ratings should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Brickwork Ratings relies on in connection with a rating will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Brickwork Ratings and to the market in offering documents and other reports. In issuing its ratings Brickwork Ratings must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

THE INFORMATION IN THIS REPORT IS PROVIDED "AS IS" WITHOUT ANY REPRESENTATION OR WARRANTY OF ANY KIND. A Brickwork Ratings rating is an opinion as to the creditworthiness of a security. This opinion is based on established criteria and methodologies that Brickwork Ratings is continuously evaluating and updating. Therefore, ratings are the collective work product of Brickwork Ratings and no individual, or group of individuals, is solely responsible for a rating. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Brickwork Ratings is not engaged in the offer or sale of any security. All Brickwork Ratings reports have shared authorship. Individuals identified in a Brickwork Ratings report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Brickwork Ratings rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time, for any reason in the sole discretion of Brickwork Ratings. Brickwork Ratings does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Neither Brickwork Ratings nor its affiliates, third party providers, as well as their directors, officers, shareholders, employees or agents (collectively, "BWR Reps") guarantee the accuracy, completeness or adequacy of the Report, and no BWR Reps shall have any liability for any errors, omissions, or interruptions therein, regardless of the cause, or for the results obtained from the use of any part of this publication. In no event shall any BWR Reps be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of any part of the Report even if advised of the possibility of such damages. Brickwork Ratings receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities.