SECTOR RESEARCH

AUTO COMPONENTS

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Recovery momentum in auto components industry halted due to component shortage and potential risks from Omicron variant

Automobile Sector Analysis

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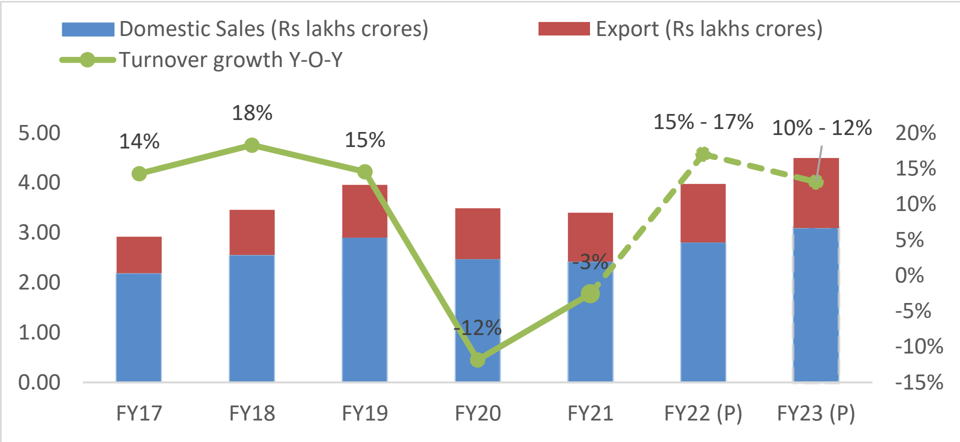
Executive Summary

BWR expects the auto component industry to witness a 15%-17% revenue growth revival in FY22 and 10%-12% in FY23 owing to a recovery in automobile sales, after having remained subdued in the last couple of years. Pent-up demand and a preference for personal mobility due to safety concerns led the recovery in automobile sales post relaxations in the lockdown. Additionally, a pick-up in economic activity augurs well for commercial vehicle sales. In addition, the scrappage policy and strict inspection of Pollution under control (PUC) certificates would boost the aftermarket of the auto component industry. The industry may again see double-digit growth in FY23, given that the impact of the omicron variant is limited and for a short term and that there is no further risk of new variants.

Demand is expected to increase in the next couple of years; however, intermittent state and national lockdowns imposed in the past had caused disruptions in the supply chain for the sector. The industry is facing challenges such as an unprecedented shortage of semiconductor chips, high costs, as well as the unavailability of raw materials and logistical issues related to exports. This may restrict the growth momentum to a certain extent. On the other hand, the export market, which was expected to gain momentum, may again face some pressure owing to the unprecedented impact of the omicron variant in Europe and North America.

Trend in auto component industry domestic sales and exports



P-Projected, Source: ACMA, BWR Research

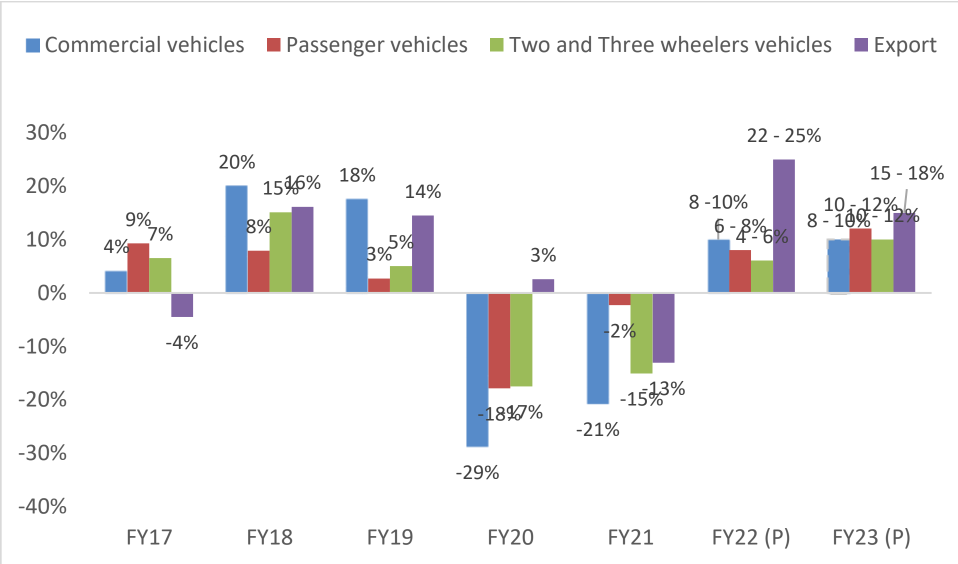
In FY22, BWR expects the profitability of auto component players to decline on account of high raw material prices. Additionally, the shortage of components such as semiconductors has created supply-chain issues and further driven up prices. Auto component suppliers generally pass on price hikes to OEMs; however, in the current scenario, it will take some time, and auto component players will have to take a hit on their profitability to safeguard volume growth.

Domestic auto components' revenues to increase by 16%-18% in FY22 and 11%-13% in FY23, backed by pent-up demand from the automobile industry and a low base

Decline in the sales of automobiles in the past couple of years due to the economic slowdown in FY19, price hike and anticipation of BSVI in FY20, and outbreak of covid-19 in FY21, among other reasons, had a severe impact on the auto components industry. However, in H1FY22, automobile sales recovered strongly on account of pent-up demand and a preference for personal mobility. This led to an increase in demand for auto components during H1FY22. However, there has been a setback on the supply side, with the shortage of semiconductor chips hampering the production schedule of OEMs, thereby restricting recovery in the overall automotive value chain. Moreover, renewed concerns around the pandemic will further act as a speed-breaker for recovery in the industry.

Automobile sale, which was recovering well post lockdown, suffered a setback due to supply-chain bottlenecks on account of semiconductor chip shortages. This scenario was pertinent across the globe.

Growth trend in automobile domestic sales and exports

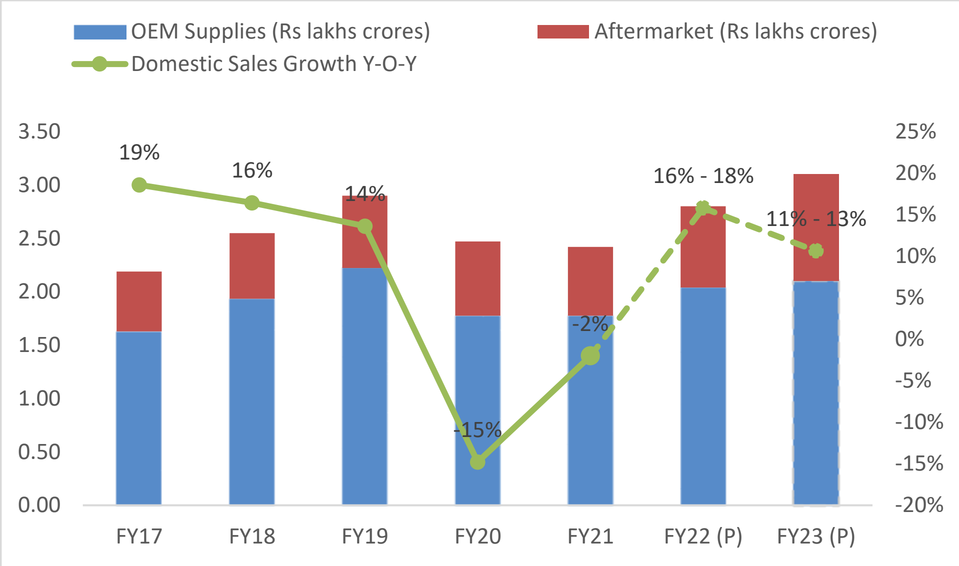


P-Projected

Source: SIAM, CMIE, BWR Research

Hence, sales forecasts for automobiles have been significantly revised downwards from our earlier projections. The semiconductor chip shortage and concerns emanating from the omicron strain worldwide are expected to restrict growth in automobile sales to a large extent. In addition, higher fuel prices, along with disruptions in the market due to electric vehicles, will result in demand shifting towards such vehicles, especially in the two-wheeler segment.

Trend in domestic OEM supplies and aftermarket turnover of auto components



P-Projected

Source: ACMA, BWR Research

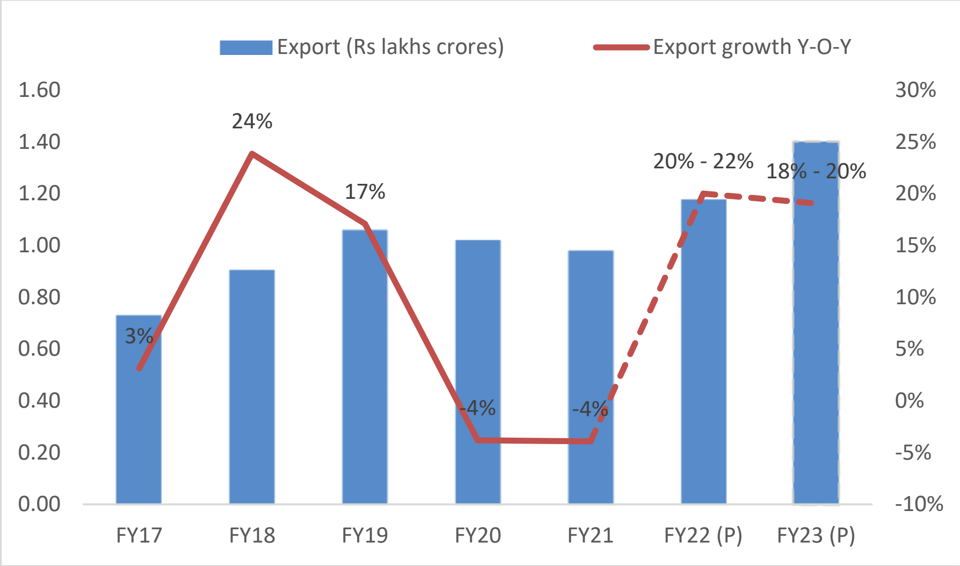
As more people postpone buying new vehicles in the present scenario, repairs on the current and second-hand vehicles will provide a window of opportunity for the automotive aftermarket.

The domestic sales of auto components saw a dip in FY21, and the situation was no different for the aftermarket, with the latter witnessing 7% degrowth. However, BWR views significant growth potential in FY22 and FY23 for the aftermarket that mainly caters to the unorganised sector (unlike OEMs, which cater to the organised sector). In an era of fast-paced technological improvements, older vehicles would require modernisation to sustain. Many features such as keyless entry and back cameras are missing in the older versions of vehicles, which would provide development opportunities for older cars. In addition, the strict examination of PUC certificates and scrappage policy would result in the regular repair and maintenance of vehicles.

Exports to grow >20% in FY22 and FY23 after two consecutive years of degrowth

Indian automotive companies mainly export items such as engine components, transmission and steering, body and chassis, suspension and brake. Export for the auto components industry in FY21 saw 4% y-o-y degrowth. Europe, the largest export destination for the Indian auto components industry and accounting for 32%, witnessed a 4% fall y-o-y in FY21. Similarly, North America and Asia, accounting for 30% and 26%, saw a 7% and 8% dip y-o-y, respectively.

Trend in export of auto components



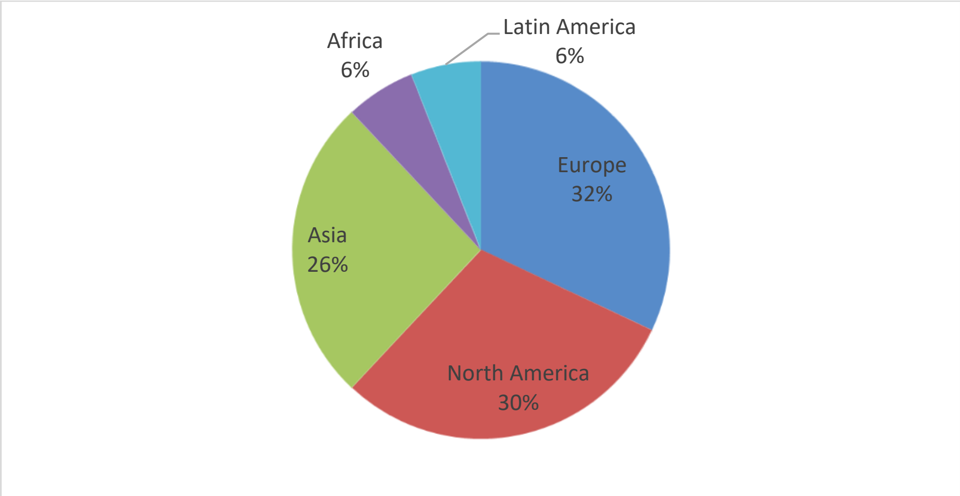
P-Projected

Source: ACMA, BWR Research

The Indian auto components industry manufactures and exports a wide variety of products, including engine parts, drive transmission and steering parts, body and chassis, suspension and braking parts.

While the domestic market is gaining pace in FY22 amid uncertainty related to the rising number of Covid cases on account of the omicron variant, BWR expects export markets to follow a similar trend and grow by 20%-22% mainly on account of a low base. In the long term, we can expect growth to increase as with the new investment under the Production Linked Incentives (PLI) scheme, the supply chain of the Indian automotive industry would improve. This would allow the industry to explore new markets by taking advantage of the prevailing anti-China sentiments and given the fact that India is the second largest steel producer globally. However, the growth projections will hold true only if there is a limited and short-term impact of omicron and no major disruptions happen worldwide on account of pandemic.

Export destinations for auto component industry (FY21)



Source: ACMA, BWR Research

OEMs are facing challenges to bridge the demand- supply gap; government actions to help in the long run

The Indian auto components industry is active in three major regions, i.e., the western region (Mumbai, Pune, Nashik and Aurangabad), southern region (Chennai, Bangalore and Hosur) and northern region (Delhi and Gurgaon). In FY22 and FY23, demand for auto components is likely to increase on the back of an expected rise in demand for automobiles after degrowth in the last 2 years. However, auto component manufacturers are finding it challenging to bridge the gap between demand and supply. The lockdowns imposed during the first and second waves of the pandemic caused huge disruptions for supply chains as manufacturing units had to stop their production process. This led to a shortage of auto components, of which, the scarcity of semiconductor chips was more prominent. Since it takes three months to manufacture a semiconductor, the shutdown of factories during the lockdown led to a huge shortage of semiconductors in India, as well as globally. While on the one hand, semiconductor chips supply has taken a hit, demand has seen substantial increase post the easing of restrictions, resulting in a huge demand-supply gap.

While the shortage of chips is the major concern for the industry, other auto components made of natural rubbers are facing a raw material crisis. Apart from tires, natural rubbers are used in the production of air bags, rubber floor mats, rubber seal, rubber bumper and dust cover. Therefore due to the 4,40,000 tonnes of demand-supply gap of natural rubber, the production of these auto components is disrupted. While supply-chain issues are expected to continue in the short term, government support and incentives may bring in fresh capex in the auto components space, thereby reducing the dependence on imports and in turn, reducing the gap.

The production-linked incentive (PLI) scheme launched by the GoI for automobile and auto components in September 2021, is expected to increase the capex by Rs 42,500 crore over the next five years. This would also increase the production capacity by more than Rs 2.3 lakh crore. Additionally, the GoI, with the aim of making India the global hub for electronic system design and manufacturing, plans to invest Rs 2,30,000 crore, based on a recent announcement. Of this, Rs 76,000 crore would be utilised for the development of semiconductors and a display manufacturing ecosystem. It will further encourage Foreign Direct Investments (FDIs) in the sector, especially in the EV space.

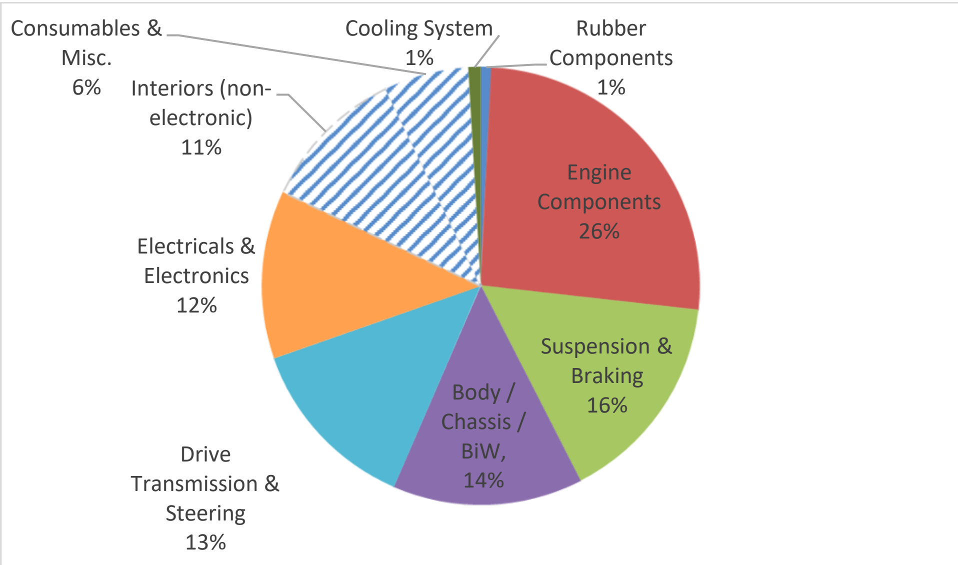
These schemes, if implemented timely and in spirit, would go a long way in reducing India’s dependence on imports, especially from China, and help the sector (and in turn, the economy) become self-reliant in sourcing key components.

Proliferation of auto manufacturing base and supply chain via Auto PLI

The Auto PLI scheme with an outlay of Rs 57,042 crore is expected to boost the domestic manufacturing of auto and auto components, and particularly the EV supply chain. The Auto PLI scheme has two components, viz., the Champion OEM Incentive Scheme and Component Champion Incentive Scheme, which are sales-value-linked incentive schemes. This scheme is applicable on the advanced automotive technology components of two-wheelers, three-wheelers, passenger vehicles, commercial vehicles and tractors, and incentives ranging from 8%-13%, with an additional 5% incentive for electric and hydrogen fuel cell vehicles. Recently, around 115 domestic and global companies have applied for availing benefits under the Auto PLI scheme. Of this, around 86 companies have applied for auto component manufacturing. Under the auto PLI scheme, incentives will be granted for the incremental sales of advanced automotive technology products, including auto components. The eligibility criteria for auto component manufacturers are a minimum revenue of Rs 500 crore and fixed asset investment of Rs 150 crore to qualify for the benefits.

Annexure -

Share of components in domestic sales (FY21)



Note: The share for FY21 is based on historic movement in share as actual data is available only till FY20

Source: ACMA, BWR Research

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