SECTOR RESEARCH

AUTOMOBILE INDUSTRY

www.brickworkratings.com

Brickwork RATINGS

Auto sector set to recover H2FY22 onwards; third wave could act as 'speed breaker' and play spoilsport

Automobile Sector Analysis

Contact

Rajee R
Chief Ratings Officer

Chintan Lakhani
Director - Ratings

Tanu S
Director – Ratings

Shivam Bhasin
Sr Ratings Analyst

Praveen Pardeshi
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

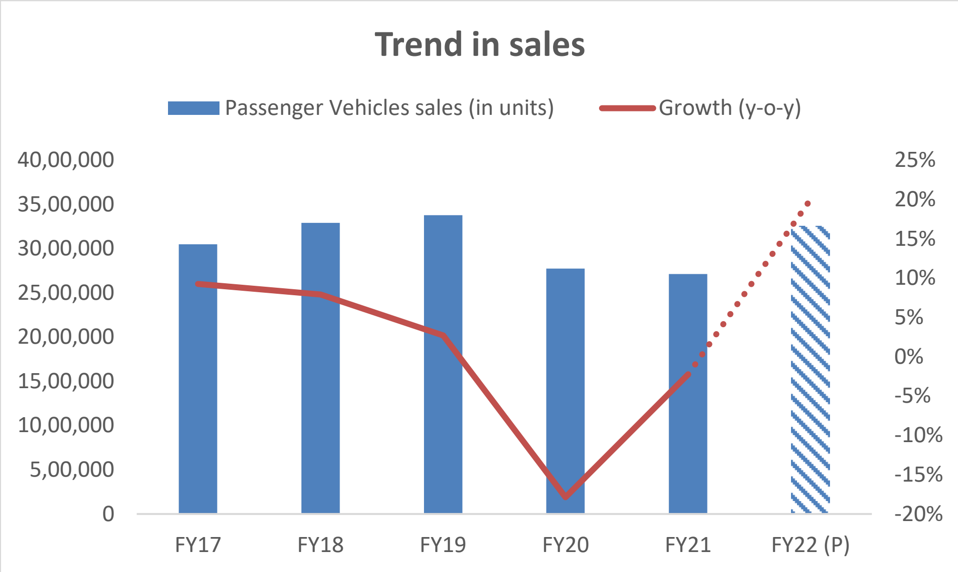
The Indian automobile sector witnessed robust growth over the last decade (during pre-Covid times) due to lower penetration historically and increased disposable incomes among the masses. However, the last couple of years have been an exception, with sales plummeting on account of an overall slowdown in the economy, the rising cost of vehicle ownership, revised axle norms impacting commercial vehicle sales, deferred buying due to the implementation of Bharat Stage Emission Standards and lastly, the pandemic when green shoots were becoming visible.

The sales of all the segments, namely passenger vehicles (PVs), commercial vehicles (CVs) and two wheelers (TWs), were overall lower by 14.69% in FY20 and 14.32% in FY21. Going forward, sales are expected to recover H2FY22 onwards. On the one hand, PVs and TWs are likely to improve on account of the expectation of improved sentiments H2FY22 onwards, along with a preference for personal mobility due to safety concerns heightened by the pandemic. Additionally, a normal monsoon (which is highly anticipated) could spur rural demand for TWs. On the other hand, the overall slowdown in the economy both domestically and globally resulted in a drastic reduction of around 20.45% in CV sales in FY21 and is likely to see faster recovery owing to the expectation of pent-up demand and on-ground implementation of the scrappage policy. A pick-up in economic activity in the country will also support this growth. Exports are also expected to gain momentum on account of the subsiding pandemic effect and improved economic prospects in the major markets such as the US and EU nations. The downside risks to these expectations could be a third wave of Covid-19 and a prolonged weak consumer sentiment.

While sales are expected to recover, the profitability of players, which took a hit during FY21 due to high input costs, will continue to be under pressure. With steel prices witnessing an increasing trend, players' input costs will be on the higher side, and with a not-so-robust recovery in sales, players may not be able to increase their realisations. Hence, rising input costs and limited price hikes would be the key monitorables in the near term since these will impact the profitability of automobile players. The ongoing semiconductor chip shortage also continues to impact automakers' production schedules.

PV sales to remain lower in H1FY22; improved sentiments in H2FY22 will help recovery

The automobile industry witnessed a difficult FY20 (before the pandemic) in terms of sales, with the PV segment being no exception. In FY20, sales in terms of PV volumes was down by 18% on a y-o-y basis due to the macroeconomic slowdown, high vehicle prices and anticipation of BS-VI norms. This situation aggravated further in H1FY21 with sales declining due to the nationwide lockdown amid the pandemic. There was no vehicle registration and sale during Q1FY21, and the same continued to remain low in Q2FY21. However, with the economy opening up during H2FY21 and the pandemic subsiding, there was increased business activity, which also led to an improvement in automobile sales. PVs saw increased pick-up owing to pent-up demand, as well as higher offtake during the festive season. In addition, preference for personal mobility due to safety concerns supported growth in PV sales.



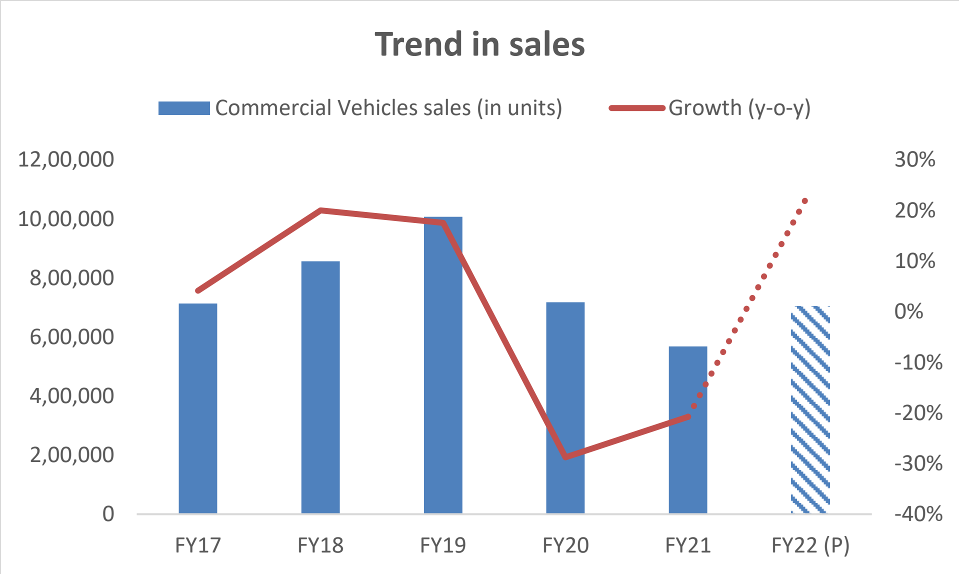
Note: P - Projected
Source: SIAM, CMIE, BWR Research

Just as the automobile sector, much like others, was starting to look optimistic due to the improvement in sales after 2 years, the segment was hit by the spike in the Covid-19 cases towards the fag end of FY21, which appeared more like a replay of FY20 (decline by 15.20%). Due to restrictions, many Original Equipment Manufacturers (OEMs) and automobile dealers' showrooms were temporarily closed. While the situation was not as bad as the previous year, sales were muted. Furthermore, with an increase in vaccination efforts by the government, the resultant decrease in the number of Covid cases in H2FY22 would help reopen showrooms and OEMs due to reduced restrictions. Additionally, online platforms could play a major role in the revival of automobile sales as people are accustomed to online shopping under the present conditions, and these online platforms could provide fruitful results for the automobile industry. Therefore, considering all the above possibilities, we could witness a double-digit sales figure again, albeit on the back of a lower base in the previous year.

In the medium term, the scrappage policy could also be an influencing factor for increasing 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 are approximately 11%. Therefore, implementing the scrappage policy would in turn increase the sales figure in the medium term.

CV sales have bottomed out; faster recovery expected on low base

The economic slowdown and amendments in the axel norms hugely impacted the production and sales figures of CVs, with negative growth of 32% and 29%, respectively, in FY20. The changes in axle norms led to an increase in the maximum official load carrying capacity by 20-25%, thereby resulting in a significant drop in the offtake of CVs.



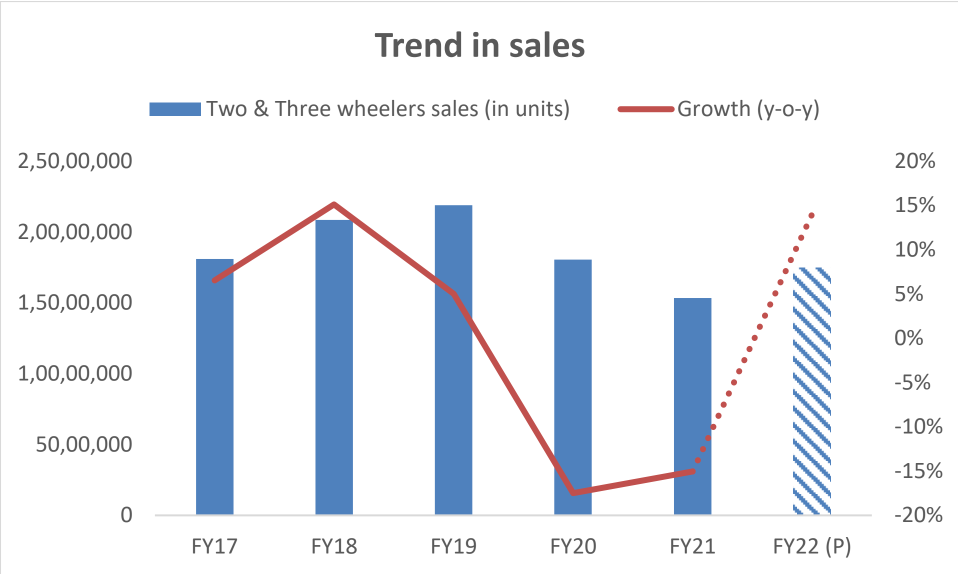
Note: P - Projected
Source: SIAM, CMIE, BWR Research

While H1FY21 was a near-wash-out due to the global pandemic, Q3FY21, with a reduced number of cases, provided some hope of an improvement in sales while still remaining in the negative territory for the second consecutive year. As CVs majorly consist of buses, trucks and three wheelers, with restrictions on public transportation, demand for these vehicles lowered.

In H2FY22, there could be a turnaround in the sales figures, backed by an acceleration in the vaccination programme, the scrappage policy, pent-up demand and economic growth. The economy showing signs of recovery would have a significant positive impact on the revival of CV sales as it would be driven by growth in various sectors such as agriculture, e-commerce, consumer durables, construction and manufacturing.

TW sales expected to witness healthy growth in FY22 owing to low base, preference for personal mobility

The TW segment dominates the Indian automobile market, accounting for over 80% of the industry's total sales. Therefore, considering the automobile industry has been going through one of its worst phases in history, the situation is no different for the TW segment. In FY20, the economic slowdown, NBFC crisis and BS-VI norms had tremendously impacted TW sales. The sales again showed degrowth in FY21 owing to the pandemic situation. However, although the sales recovered during H2FY21, the second wave again derailed recovery.

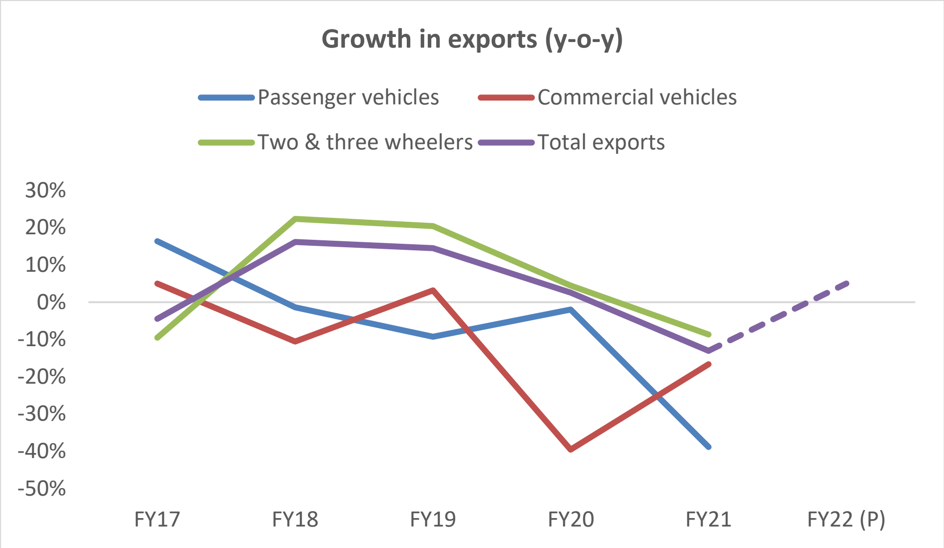


Note: P - Projected
Source: SIAM, CMIE, BWR Research

Given the declining number of cases and increased vaccination coverage, the TW segment could see a recovery in H2FY22. Factors that would positively influence TW sales include healthy rural demand on account of the anticipation of good monsoons. Additionally, preference for personal mobility due to safety concerns is likely to support growth in sales in the TW space.

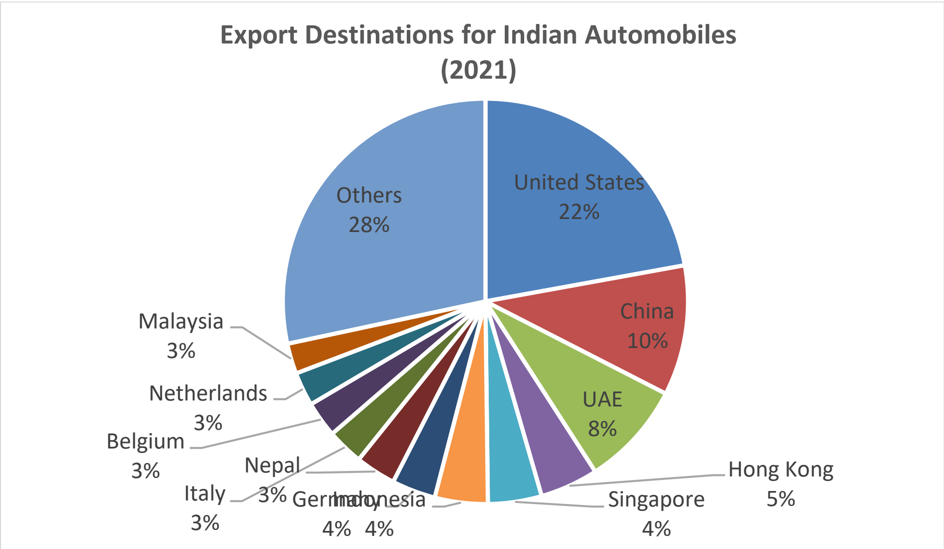
Exports would rebound in FY22 due to better growth prospects in major markets such as US, Europe

The exports of the automobile industry had crashed 13% y-o-y in FY21 when the world, along with India, was facing the pandemic. Nonetheless, at the start of FY22 when the domestic market is coping with the continuation of the lockdown and restrictions imposed due to the second wave, the export market has already started to witness an upward trend. The reason for the same is the improved sentiment in the US and EU nations where vaccination coverage has gone up considerably. Hence, better prospects in the US and EU nations would support growth in automobile exports in FY22, assuming the much talked about third Covid-19 wave stays at bay.



Note: P - Projected

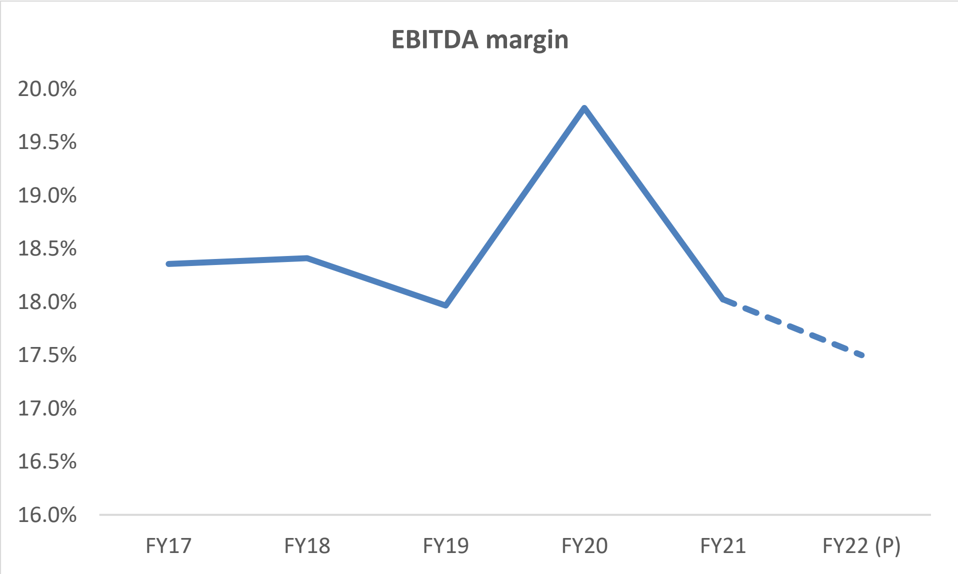
Source: SIAM, CMIE, BWR Research



Source: CMIE, BWR Research

Rise in input costs and subdued recovery in sales will limit players' profitability in FY22

The profitability of the automobile sector has been range-bound over the years on account of robust sales and increasing realisations in proportion to rising input costs. In FY20, the margins improved substantially on account of significantly low input costs in terms of lower steel prices. Steel prices were down by 14% y-o-y in FY20. These gains were washed out in FY21 due to the double whammy of declining sales amid the lockdown and rising input costs (steel prices were up by 18%). Entities were not able to increase vehicle prices to cover the rise in input costs due to declining sales. This strategy of keeping prices stable despite rising costs to safeguard volumes directly affected the companies' profitability.



Note: P – Projected, Margin is calculated based on aggregated financial of Top 6 players having presence across the segments
Source: Company Reports, BWR Research

In FY22, with the second wave of the pandemic hitting the country hard, the sales outlook for automobile players looks bleak, at least during H1FY22. With the anticipation of improved sentiments in H2FY22 and also the festive season coming up, BWR expects sales across all the segments to recover. This will give automobile companies some breathing space, and they may be able to raise prices to cover the increasing input costs. However, the realisation still may not go up in proportion to the rising cost due to not-so-fast recovery in sales, and entities may still take a hit on their margins to protect volumes.

EVs’ offtake not as expected earlier, but may pick up if challenges addressed

Since the last decade, issues such as global warming, rising pollution in the environment and oil imports have been troubling the world and India alike. Therefore, keeping these concerns in mind, the Government of India has been taking various initiatives such as the National Electric Mobility Mission Plan, Faster Adoption and Manufacturing of (Hybrid &) Electric Vehicles in India-I and II, National Mission for Transformative Mobility and Battery Manufacturing, Phased Manufacturing Program and Advanced Chemistry Cell Production-Linked Incentive Scheme to boost the sale of electric vehicles (EVs). Of all these, FAME- I & II have been the most significant ones; FAME I majorly concerned infrastructure development, and FAME II with an investment of Rs 10,000 crore was focused at demand creation. However, these efforts did not yield desired results; although sales figures grew at a CAGR of 13%, it accounted for less than 1% of the overall sales of the automobile industry. The foremost reason for the same was the lack of infrastructure facilities such as charging stations. Presently, there are only 1,800 charging stations in our country, which is way less than sufficient. Therefore, measures should be taken to set-up a minimum of one charging point every 100 kms or allocate a space for EVs in existing petrol pumps. The other reason was affordability; an EV costs around thrice as much as normal vehicles, even though in the long run, the maintenance costs of electric vehicles would be lesser than normal petrol-operated vehicles.

Moreover, to boost the adoption and manufacturing of EVs by creating EV manufacturing capacities of a global scale and competitiveness, the firm's capex requirement is crucial at the initial stage. Apart from multiple factors such as price, charging infrastructure, mass acceptability and evolving technology, setting-up manufacturing units for EVs is a significant requirement for the EV market. Therefore, meeting required investment levels to accommodate EV manufacturing capacities also looks challenging as the automobile sector is already grappling with huge losses, given that sales were already weak before the pandemic hit and were then further exacerbated due to the lockdown.

Even if at present, the scenario does not look promising due to the various challenges discussed above and the second wave of Covid-19 further hampering the manufacturing of EVs and infrastructure development, BWR expects to see a turnaround by end- FY22. With growing concerns towards climatic changes and proper measures being taken to bridge the gap between the infrastructure and supply chain, EVs could easily penetrate the automobile industry and account for a major part of the sales figures.

About Brickwork Ratings

Brickwork Ratings (BWR), a Securities and Exchange Board of India [SEBI] registered Credit Rating Agency and accredited by Reserve Bank of India [RBI], offers credit ratings of Bank Loan, Non- convertible / convertible / partially convertible debentures and other capital market instruments and bonds, Commercial Paper, perpetual bonds, asset-backed and mortgage-backed securities, partial guarantees and other structured / credit enhanced debt instruments, Security Receipts, Securitisation Products, Municipal Bonds, etc.

BWR has rated over 11,400 medium and large corporates and financial institutions' instruments. BWR has also rated NGOs, Educational Institutions, Hospitals, Real Estate Developers, Urban Local Bodies and Municipal Corporations.

BWR has Canara Bank, a leading public sector bank, as one of the promoters and strategic partner. BWR has its corporate office in Bengaluru and a country-wide presence with its offices in Ahmedabad, Chandigarh, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi along with representatives in 150+ locations.