

Ratings criteria for the two-wheeler industry

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Executive summary

The Indian two-wheeler industry—comprising motorcycles, scooters, and mopeds—is fairly developed, with a large network of manufacturers, vendors, ancillaries, dealers, retailers, and spare parts dealers. The market for two-wheelers is under-penetrated and is expected to clock modest growth despite the change in emission norms.

Scope

The broader criteria for manufacturing companies¹ apply to entities in the two-wheeler industry as well. The business risk analysis of two-wheeler players covers market position and operating efficiency. This article² gives a brief insight into industry-specific risk factors, which impact the operations and financial flexibility of entities in two wheeler industry.

Business risk

Market position

Product profile & sales break-up

Each product category in the two-wheeler industry (motorcycles, scooters, and mopeds) has a different growth rate. Increasing competition has resulted in proliferation of products with differing features and aesthetic qualities, and forced manufacturers to introduce products at various price points, particularly in the motorcycle market, and to focus on export. CRISIL's analysis of the market position of a company in the two-wheeler industry takes into account its presence across product categories and price points, and track record of product launches. Export initiatives and sales trends are studied to understand the extent of risk diversification and potential for revenue growth.

Demand-supply dynamics

The domestic demand-supply dynamics constitutes an important part of CRISIL's analysis of companies. The two-wheeler industry has done well in the past few years, driven by 'right products' in terms of utility, price (capital), and operating cost to meet the demand from middle-class consumers in urban, semi-urban, and rural areas. The steady growth has resulted in many players increasing capacity. As part of its analysis, CRISIL arrives at future demand-supply scenarios to better understand the business pressures each company and its competitors will face at various times.

¹ For the detailed criteria, refer to the documents, 'Rating Criteria for Manufacturing and Services Sector Companies'

² For accessing the previous published document on "Rating Criteria for the two-wheeler Industry" kindly follow the below mentioned link: https://www.crisil.com/content/dam/crisil/criteria_methodology/consumer-discretionary/archive/CRISIL-Ratings-criteria-two-wheeler-industry_2007.pdf

Competition

Competitor analysis and positioning is an important constituent of CRISIL's market analysis. CRISIL identifies the various market segments the company is present in, and its current and future market position compared to rivals. The ability of the company and its competitors to regularly introduce products/variants is taken into account, given the decreasing life cycles of models, and increasing demand for replacement. This helps CRISIL form a view of the company's present and expected competitive position.

Distribution network

An effective service network is an important requisite for the two-wheeler industry. CRISIL analyses how effective the network is, in terms of reach, availability of spare parts, support extended by the company, exclusivity, service provided, and credit period extended. CRISIL takes into account the performance of the competitors' distribution networks as well on each of these parameters.

Price and margins trends

To estimate the extent of a company's pricing flexibility, CRISIL analyses its pricing strategy and cost competitiveness by studying profitability margin at the operating level across entities and across the years. The company's market position assessment also factors its pricing power.

Operating efficiency

Location

CRISIL considers locational importance from the standpoint of proximity to major vendors, ancillaries, and customer markets. Each of these factors has implications for the financial viability of the business and incidence of freight costs on an ongoing basis.

Level of integration

CRISIL also assesses the extent of integration in a company's manufacturing operations. This helps form a better view of the cost structure and return on investment. It also helps estimate and assess capital expenditure decisions. The fixed cost on a company's balance sheet will also have an important implication for break-even analysis.

Capacity utilisation and flexibility in manufacturing

CRISIL assesses a company's capacity utilisation as a means of evaluating the efficiency of its operations. CRISIL also assesses the versatility of operations by analysing flexibility to switch between various ranges of products.

Ancillary and vendor network

In conjunction with the extent of integration, CRISIL analyses and assesses ancillary and vendor network. These are examined from the point of view of available capacity, ability to deliver on time, maintain quality, and upgrade with changes in the basic models. For small players, CRISIL also analyses level of indigenisation and vendor rationalisation. For big players, benefits accruing from global sourcing of components and economies of scale are considered.

Raw material

To form a better view of a company's cost structure, CRISIL analyses its raw material requirement from the perspective of price movement and availability. CRISIL also assesses the import content, both of the company and its major vendors. The geographical spread of vendors and import content may have a bearing on the company's inventory and stocking policy. Working capital requirement will directly follow from any such policy decision.

Technology

CRISIL analyses a company's product development ability in terms of technological capability and styling skills. Technological capability is assessed on the basis of ability to launch models with different performance characteristics (such as power and fuel efficiency), while styling skills are judged by market response to the aesthetic features incorporated in models introduced in the past. Access to a parent's technology or in-house research and development capability, and ability to comply with regulations are also taken into account. This becomes especially critical, since emission norms are expected to evolve from BS³-IV to BS-VI from April 2020 and will require significant upgrade in the manufacturing ecosystem.

Productivity and quality issues

Productivity and labour relations are integral to the operations of a company. Poor labour relations can lead to stalling of operations, and consequently, loss of productivity. CRISIL also analyses factors such as consistency and improvement in quality in terms of usability and costing.

CRISIL's analysis, therefore, captures a mix of factors that are important from the business risk perspective in determining the cash flow generating ability of the business from its core operations. The focus is on analysing the basic factors that contribute to such cash flow and its sustainability.

Financial risk

For the analysis of the financial risk profile of a two-wheeler company, CRISIL follows the standard criteria used for all manufacturing companies. This criterion is presented in detail in our publications 'Rating Criteria for Manufacturing and Services Sector Companies' and 'CRISIL's Approach to Financial Ratios'.

Management risk

For this analysis CRISIL follows the standard measures elaborated in 'Rating Criteria for Manufacturing and Services Sector Companies'.

³ *Bharat Stage*

Conclusion

Thus, in CRISIL's opinion, the key success factors for the two-wheeler sector are:

- Capability to introduce new products/variants based on consumer preference
- Efficiency of distribution network
- Diversity in geography and product mix
- Efficiency of ancillary and vendor network

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