Rough road ahead
CRISIL webinar on automotive and automotive components sector

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Speakers

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Director, CRISIL Research
Key messages

- **Auto OEM volumes to dip to decadal lows in FY21; recovery expected in FY22 as consumer sentiment and GDP improves**
  - Buyers to be less prone to taking loans, replacement likely to be postponed - impacting passenger vehicles (PV) and commercial vehicles (CV)
  - PV retail sales most vulnerable - since major buying regions have high COVID case load
  - Urban income sentiments muted, some respite from rural side - providing cushion to tractor and two-wheeler sales

- **Component revenue growth to decline 16% in FY21 (-11% in FY20) with all segments impacted; 22% growth expected in FY22**
  - OEM segment (62% of component sales) to witness sharp de-growth for second year in a row in FY21; CV segment to lead recovery in FY22
  - Exports (20% of component sales) to show sharp contraction with ~50% exports to countries deeply impacted by the pandemic; recovery in FY22 to be supported by OEMs and replacement demand in key markets
  - Replacement market to register de-growth due to lower vehicle movement - personal and commercial; demand to stabilize in FY22

- **Credit quality to remain ‘moderately negative’ in near term; to be stable thereafter**
  - Operating profitability to moderate by ~200-250 basis points (bps) resulting in ~30-35% EBITDA drop in FY21
  - Cushion in balance sheets being tested; players with segmental concentration, especially to CVs, may face higher credit pressure
  - Credit pressures seen abating over medium term as demand rebounds

*OEMs: Original Equipment Manufacturers*
Automotive sector – demand pressures exacerbate
Compared to earlier downturns, current slowdown is deeper - supply as well as demand hit

Recovery across most segments to take twice the amount of time

Fiscal stimulus, farm loan waiver, pay commission payouts and excise duty cut

Excise duty hike on large cars and SUVs

Consecutive below normal monsoon in FY15 and FY16

Better rainfall and crop output from FY17

Weak economy, high cost of ownership, high inflation

Note: Color of the arrows are in sync with the color of the line graph. For example green arrows represent period of negative growth for tractors, Y-axis represents quarterly growth on year

Source: CRISIL Research

nQ = ‘n’ consecutive quarters of decline in sales

nQ forecast for decline in sales
## Demand sentiments to remain weak for second year in row; reversal in FY22

<table>
<thead>
<tr>
<th>Domestic Volumes</th>
<th>Demand</th>
<th>Supply</th>
<th>Finance</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY20 (in mn units)</td>
<td>Income sentiment</td>
<td>Primary demand</td>
<td>Secondary demand</td>
<td>Supply constraint (in Q1FY21)</td>
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<tr>
<td>2.77</td>
<td>2.77</td>
<td>Personal usage</td>
<td>Cab aggregator / Taxi</td>
<td>More UVs than cars</td>
</tr>
<tr>
<td>17.41</td>
<td>17.41</td>
<td>Personal usage</td>
<td>Delivery value chain</td>
<td>More motorcycles than scooters</td>
</tr>
<tr>
<td>0.63</td>
<td>0.63</td>
<td>Fresh purchases</td>
<td>Replacement</td>
<td>ICV with high deck length</td>
</tr>
<tr>
<td>0.71</td>
<td>0.71</td>
<td>Farm</td>
<td>Commercial demand</td>
<td>Model launches in the low hp range</td>
</tr>
</tbody>
</table>
25 clusters account for 70% of COVID cases, retail sales in these regions to be sluggish

More than one-fourth of PV demand comes from these 25 clusters, tractors expected to be least impacted

COVID Cases as of 8th May, 2020, 25 clusters account for 34 districts in India
Note: COVID cases are as per Ministry of Health and Family Welfare.

• Auto-component availability remains an aspect to monitor
Urban income sentiments to be muted, some respite from rural India

Severe deviation in FY21 from decadal revenue growth, for sectors that account ~80% of employee cost, to keep urban income growth muted

Analysis for around 26,000 companies which account for Rs 7 lakh crore in employee cost

Rural per hectare profit to be lower for current rabi season, overall profits to increase by 6% due to 10% higher sowing

Source: CRISIL Research

Number in box indicates change in profit on year (RHS)
Higher cost of acquisition to further hurt PVs and 2Ws; Axle norm to hinder CV demand despite being buoyed by inventory buildup

18-20\% increase in cumulative cost of acquisition for TWs and PVs between FY19-21

A normal 3 year period sees about a 10\% increase in cost vs. 20\% from FY19-20

Higher replacement demand share to hurt PVs and CVs

~800 bps higher demand due to inventory buildup

Axle norm increased freight capacity by 20\%; lower freight demand added to the woes
CVs to have second year of near 30% sales erosion in FY21, expected to bounce back in FY22

Note: Numbers in legends represent FY20 domestic sales. Dark blue bars denote forecast, Source: SIAM, CRISIL Research;
All segments of auto-component demand to remain weak in FY21, no respite even for diversified firms, recovery expected in FY22

Despite sales at decadal lows, some benefit on account of higher component intensity due to BS VI norms

- PVs which account for over half the OEM segment demand, to show a sharp decline
- CVs which de-grew by over 30% last year to continue to be under pressure in the current fiscal
  - Bounce back expected in fiscal 2022 due to pent-up un-replaced demand and improvement in freight demand drivers
- Tractors with its high rural share, to show lesser decline viz. other sub-segments
- Auto-component industry to be aided by higher component intensity due to BS VI emission norms

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<table>
<thead>
<tr>
<th>Production (in volume terms)</th>
<th>%share to OEM segment revenue</th>
<th>FY15-20 CAGR</th>
<th>FY19</th>
<th>FY20 E</th>
<th>FY21 P</th>
<th>FY22 P</th>
</tr>
</thead>
<tbody>
<tr>
<td>OEM</td>
<td>51%</td>
<td>1%</td>
<td>0%</td>
<td>-15%</td>
<td>-23%</td>
<td>16%</td>
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<tr>
<td>Replacement</td>
<td>26%</td>
<td>3%</td>
<td>6%</td>
<td>-14%</td>
<td>-21%</td>
<td>14%</td>
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<tr>
<td>Exports</td>
<td>16%</td>
<td>1%</td>
<td>24%</td>
<td>-33%</td>
<td>-24%</td>
<td>37%</td>
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<tr>
<td>Total Production</td>
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<td>5%</td>
<td>8%</td>
<td>-10%</td>
<td>-9%</td>
<td>14%</td>
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<th>Growth (in value terms)</th>
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Source: CRISIL Research
CRISIL’s coverage, rated portfolio trends and credit outlook on automotive component suppliers
CRISIL has extensive coverage of Indian automotive industry

- CRISIL has ratings on over 300 component manufacturers across sub-segments
- CRISIL’s rated portfolio accounts for ~35-40% of sector
- CRISIL also has ratings on 12 OEMs and more than 400 automotive dealers as well

Above represents distribution of ~300 companies rated by CRISIL as of March 31, 2020
Source: CRISIL Ratings
Sector’s low operating leverage to help moderate margin decline; however, sharp fall seen in absolute profits

- Over 80% of cost structure is variable, with material cost (completely pass through) alone accounting for 60-65%.
- ~30-35% of workforce is contractual, offering flexibility in managing employee costs
- Some marginal benefit to accrue on account of higher value of BS VI components
- Despite high share of variable costs, sharp demand contraction for two consecutive years to impact overall margins by at least ~200-250 bps in FY21; also ~30-35% absolute EBITDA erosion in FY21.

~200-250 bps margin decline in FY21 likely, moderate recovery in FY22

For companies with consistent data from FY08

Source: CRISIL Ratings
Low utilisations to lead to curtailed capital spend until FY22; working capital to witness limited stretch, remain under control

- ~50-60% of the capital spends in the industry directly demand linked
  - Hence no major capacity additions expected for next 2 years due to low capacity utilisations

- Working capital to see some stretch, but remain under control
  - Components suppliers form an integral part of the supply chain, hence OEM support in the form of credit, advances or timely payments to help cash flow

Source: CRISIL Ratings
Credit metrics to moderate in FY21 and recover from FY22; pruned capex will ensure moderate impact on gearing

For companies with consistent data from FY08

- Revenue and margin decline will impact credit metrics in FY21; leverage though will remain adequate as players have been prudent with capex and managing debt in recent years.
- Gradual recovery in cash flows and metrics are expected from FY22 with anticipated revival in demand across segments
Credit outlook to remain moderately negative in FY21

- Depth of COVID-19 led slowdown renders diversity irrelevant.; also cushion in balance sheets seeing coming under stress following back-to-back double digit revenue decline

- Credit metrics will face steeper pressure in case of suppliers with concentration to CV OEMs and exporters of CV components

- Suppliers to two-wheeler and PV will see cash-flow pressures easing as volume gradually pick up from Q3 of FY21

- Demand revival to lead to improved credit metrics in FY22
Thank you

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