Press Release

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Auto-component sector balance sheets strongest in a decade

Credit quality to sustain, even as capital investments restart, says CRISIL

CRISIL believes balance sheets of automotive components suppliers it rates are the strongest in a decade, which, along with steady profitability and higher demand, will enable them to sustain their credit quality over the medium term. That's despite capital expenditure likely to be incurred because of better prospects in fiscal 2018 for most segments - barring commercial vehicles (CVs) and exports - and tighter regulations.

CRISIL rates more than 300 automotive component suppliers and the credit risk profiles of a majority of them have displayed good stability since fiscal 2015. Modest capital expenditure in the past few years has helped offset the impact of cyclical slowdown in demand, demonetisation and weak exports, leading to healthier balance sheets, and therefore improved credit metrics. Gearing for automotive component suppliers has halved over the last decade to an average 0.7-0.8 time in fiscal 2017. The ability to pass on cost increases to customers has also helped maintain profitability.

The Rs 2.7 lakh crore Indian automotive components sector is set to see a moderate 100-200 basis points growth to 8-10% in fiscal 2018, on increasing supplies to original equipment manufacturers (OEMs) of passenger vehicles (PVs), two-wheelers, and tractors, and improving aftermarket demand as the impact of demonetisation wears off. Softer interest rates and new model launches are expected to provide additional impetus to growth.

CV sales, however, will be weighed down by sluggish replacement demand and industrial production. Exports growth is foreseen to be listless in fiscal 2018 due to plateauing car sales in the US (even as truck sales will see a modest improvement), slower growth in Europe, and demand deceleration in China. The domestic automotive component sector draws ~67% of its sales from original equipment makers (OEMs), with the balance split almost equally between exports and the aftermarket.

Midway through fiscal 2017, the sector drove into rough weather both at home and abroad, which would pull down growth to 7-8% compared with 9-11% expected earlier. Sales in the cash-dependent segments such as two-wheelers and tractors, and the aftermarket, were impacted by demonetisation. And for the first time since 2010, exports are likely to de-grow in fiscal 2017 on plunging US truck sales and benign demand from Europe. The US and Europe account for about 50% of automotive component exports from India.

Better demand growth in fiscal 2018 is likely to kick-start capital investments, though not uniformly across business segments.

Says Anuj Sethi, Senior Director, CRISIL Ratings: ***"The investment cycle will be led by suppliers to PV and two-wheeler OEMs. Both segments are expected to see good growth. Suppliers to CVs will need to wait till at least fiscal 2019, given excess current capacity and sluggish demand. Also, capital spending and investment in R&D will rise over the medium term to conform to tighter regulations."***

The scope for mergers and tie-ups in select categories is also likely to get a fillip, and new emission norms and safety standards present opportunities for domestic collaboration. Further, Indian component makers could acquire firms overseas to access technology and widen customer base.

CRISIL expects the credit risk profiles of component suppliers to remain stable despite expected increase in capex and firming up of commodity prices.

Says Akshay Chitgopekar, Director, CRISIL Ratings: ***"The automotive component sector has been more resilient than several other cyclical sectors such as steel, construction and capital goods, as reflected in its higher credit ratio across business cycles. The sector's credit ratio has remained above 1.2 times since fiscal 2015. Going forward, demand recovery and this decade's best financial positions will further support credit profiles, even as suppliers concentrated in CVs and exports, especially those with large capacity enhancement or acquisition plans, will require close monitoring."***

For further information contact:

Media Relations	Analytical Contacts	Customer Service Helpdesk
Saman Khan Media Relations **CRISIL Limited** D: +91 22 3342 3895 M: +91 95 940 60612 B: +91 22 3342 3000 saman.Khan@crisil.com **Tanuja Abhinandan** Media Relations **CRISIL Limited** D: +91 22 3342 1818 M: +91 98 192 48980 B: +91 22 3342 3000 tanuja.abhinandan@crisil.com **Jyoti Parmar** Media Relations **CRISIL Limited** D: +91 22 3342 1835 B: +91 22 3342 3000 jyoti.parmar@crisil.com	**Anuj Sethi** Senior Director - CRISIL Ratings **CRISIL Limited** D: +91 44 6656 3100 anuj.sethi@crisil.com **Akshay Chitgopekar** Director - CRISIL Ratings **CRISIL Limited** D: +91 22 4097 8309 akshay.chitgopekar@crisil.com	Timings: 10.00 am to 7.00 pm Toll free Number:1800 267 1301 For a copy of Rationales / Rating Reports: CRISILratingdesk@crisil.com For Analytical queries: ratingsinvestordesk@crisil.com

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