Rough road ahead

CRISIL webinar on automotive and automotive components sector

May 28, 2020

Speakers

Anuj Sethi
Senior Director, CRISIL Ratings

Hetal Gandhi
Director, CRISIL Research

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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

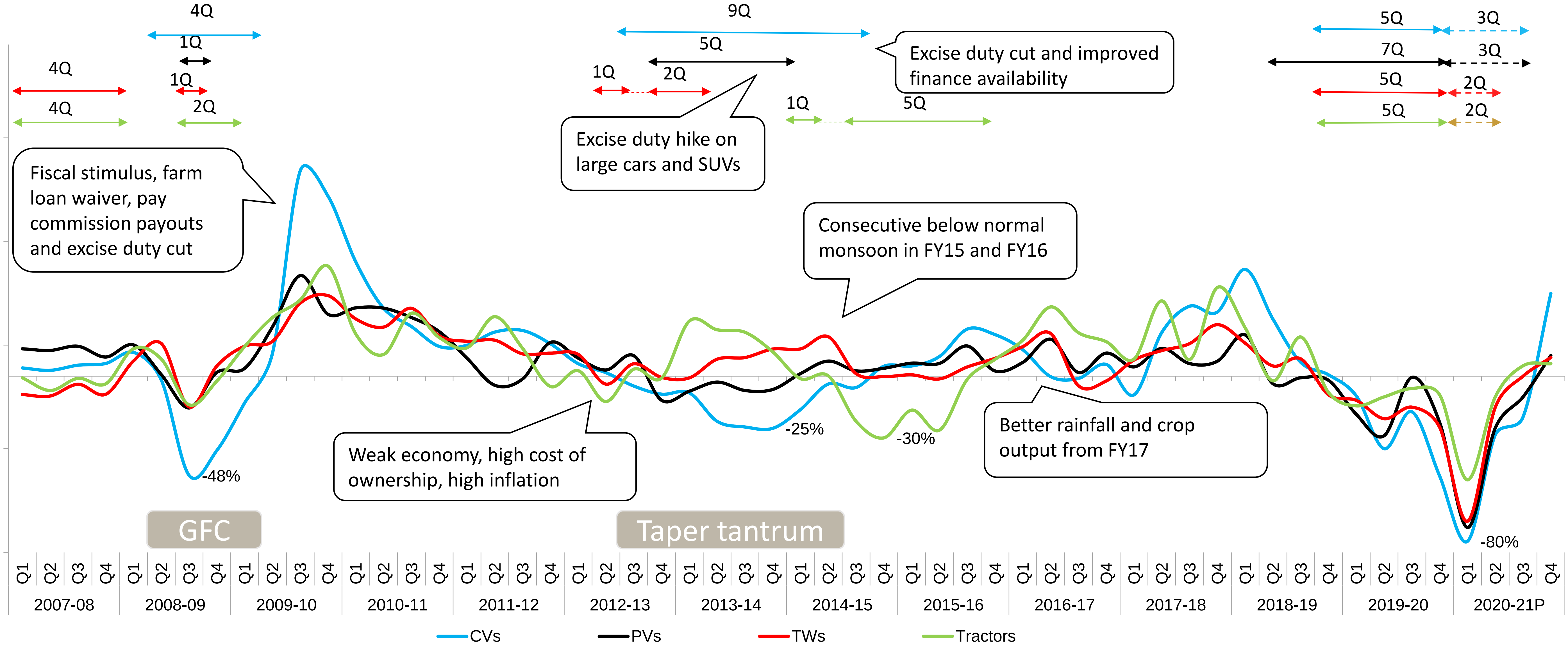
- **Credit quality to remain 'moderately negative' in near term; to be stable thereafter**
  - Operating profitability to moderate by ~200-250 basis points (bps) resulting in ~30-35% EBITDA drop in FY21
  - Cushion in balance sheets being tested; players with segmental concentration, especially to CVs, 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



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

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Demand sentiments to remain weak for second year in row; reversal in FY22

	Domestic Volumes	Demand			Supply			Finance		Cost	
	FY20 (in mn units)	Income sentiment	Primary demand	Secondary demand	Supply constraint (in Q1FY21)	New model launches (share in FY21P)	Inventory build-up	Finance penetration	Non-captive NBFC share	Increase in Cost of acquisition FY21	Increase in Cost of acquisition FY22
	2.77		Personal usage	Cab aggregator / Taxi		More UVs than cars	0%	75-80%	10-15%	3-4%	3-4%
	17.41		Personal usage	Delivery value chain		More motorcycles than scooters	0%	35-40%	18-23%	4-6%	4-6%
	0.63		Fresh purchases	Replacement		ICV with high deck length	8%	92-97%	23-28%	4-6%	4-6%
	0.71		Farm	Commercial demand		Model launches in the low hp range	1%	75-80%	25-30%	2-3%	2-3%

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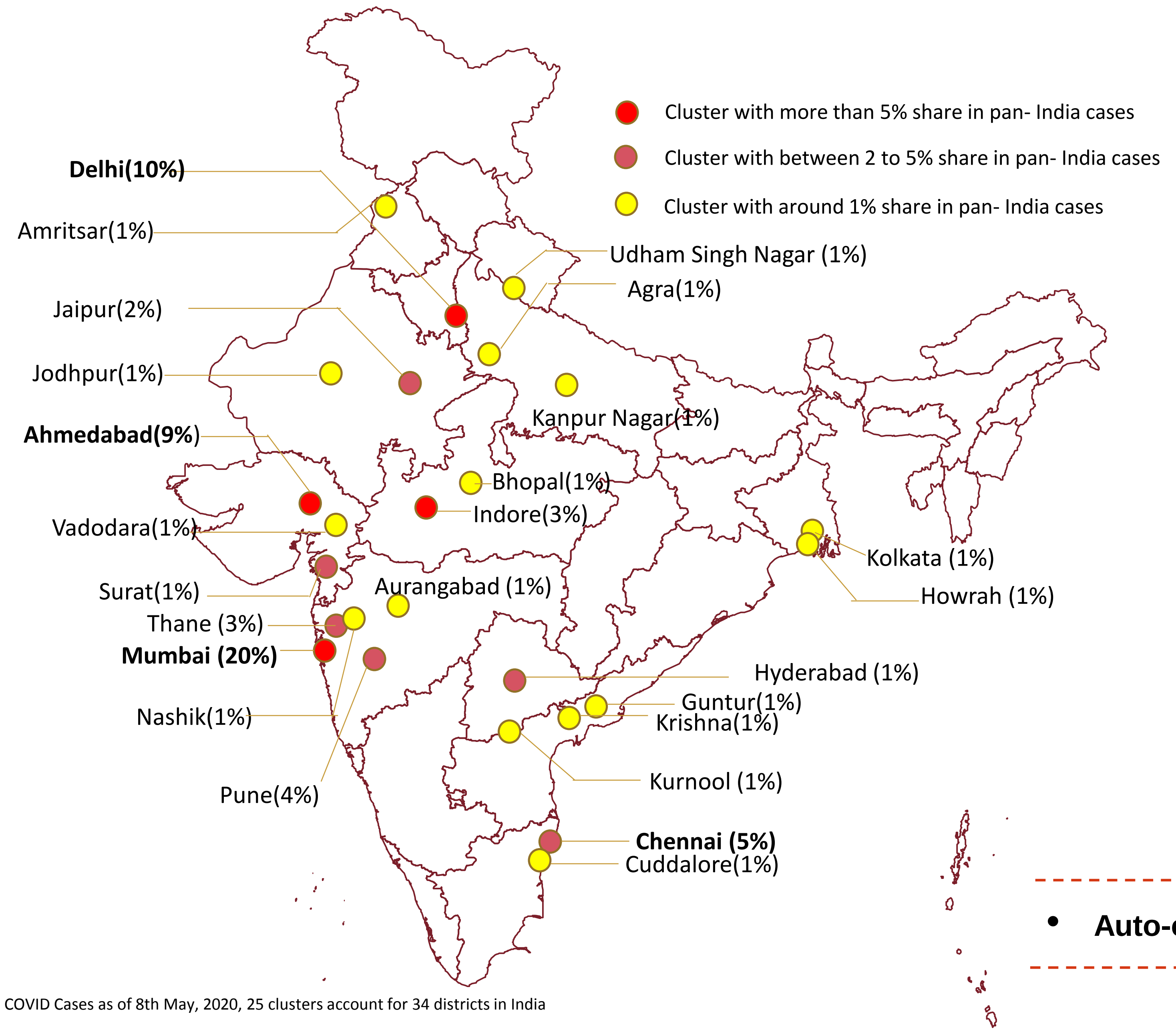
25 clusters account for 70% of COVID cases, retail sales in these regions to be sluggish

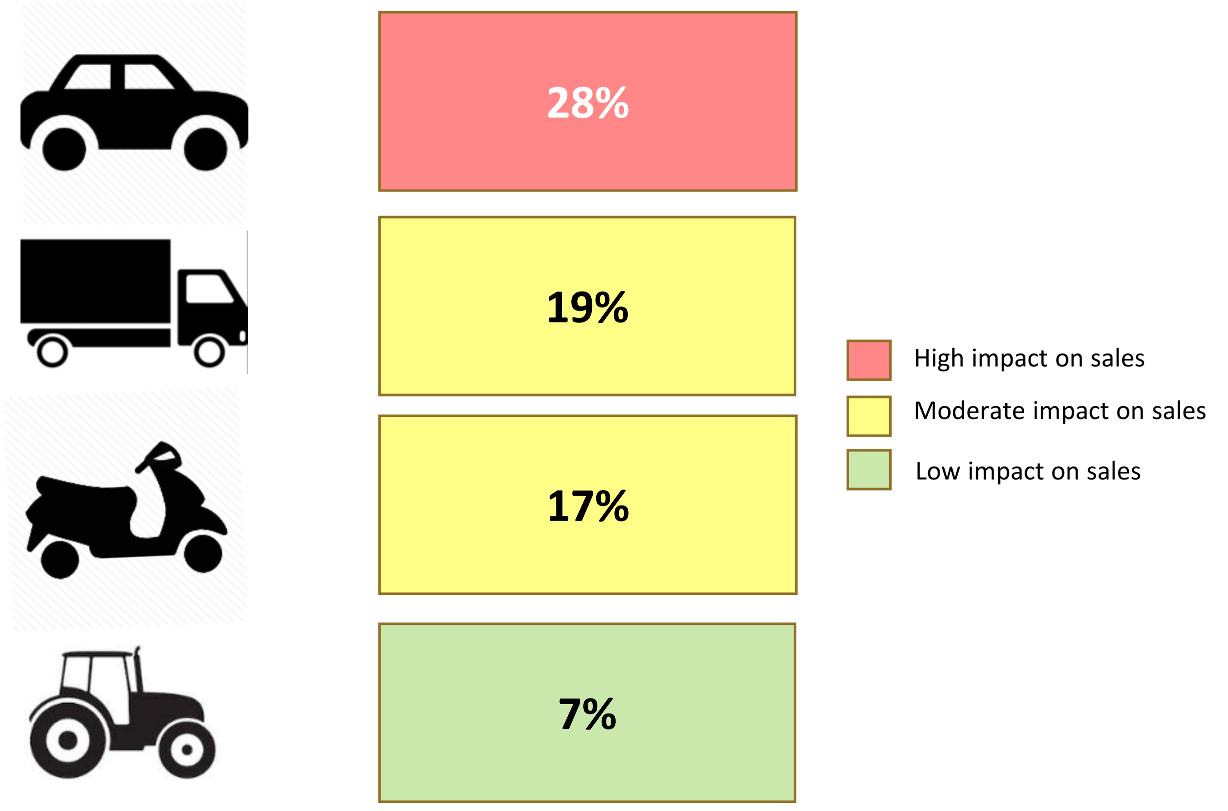
More than one-fourth of PV demand comes from these 25 clusters, tractors expected to be least impacted



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.

Share of 25 clusters in Pan India retail sales



- **Auto-component availability remains an aspect to monitor**

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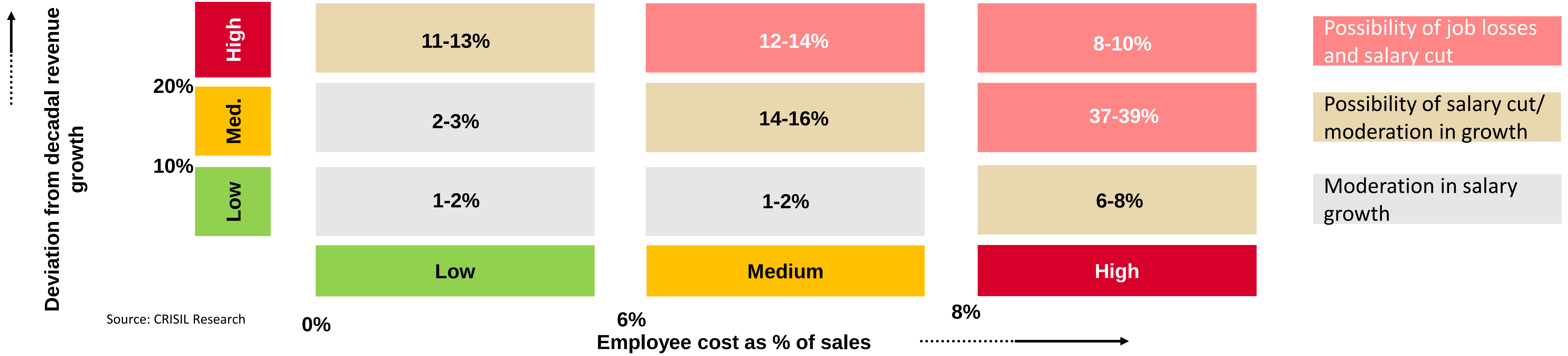
Urban income sentiments to be muted, some respite from rural India

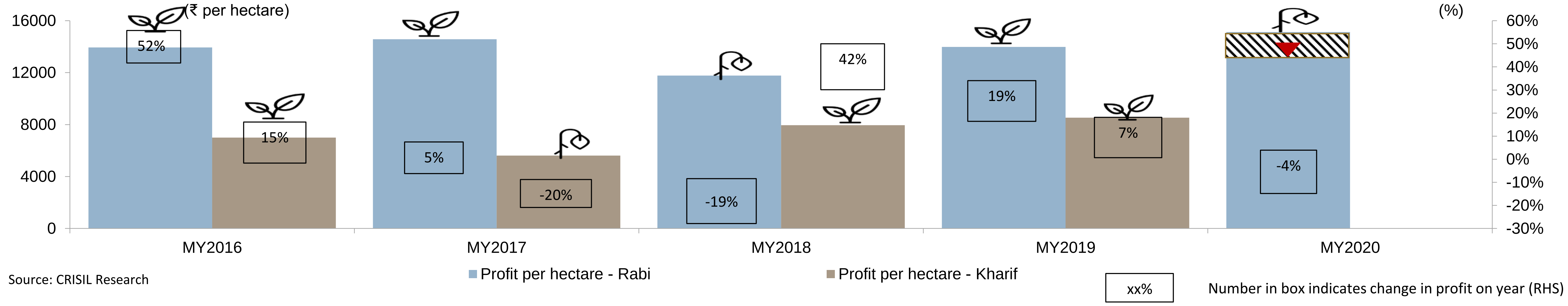
Severe deviation in FY21 from decadal revenue growth, for sectors that account ~80% of employee cost, to keep urban income growth muted

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



Source: CRISIL Research

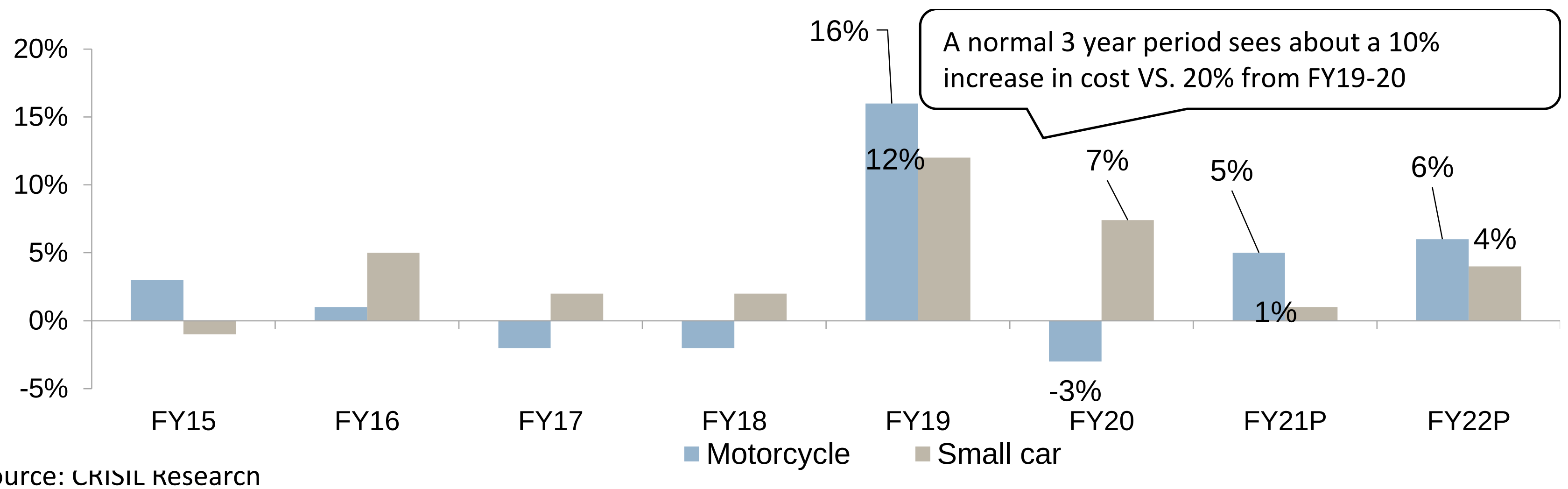
Rural per hectare profit to be lower for current rabi season, overall profits to increase by 6% due to 10% higher sowing



Source: CRISIL Research

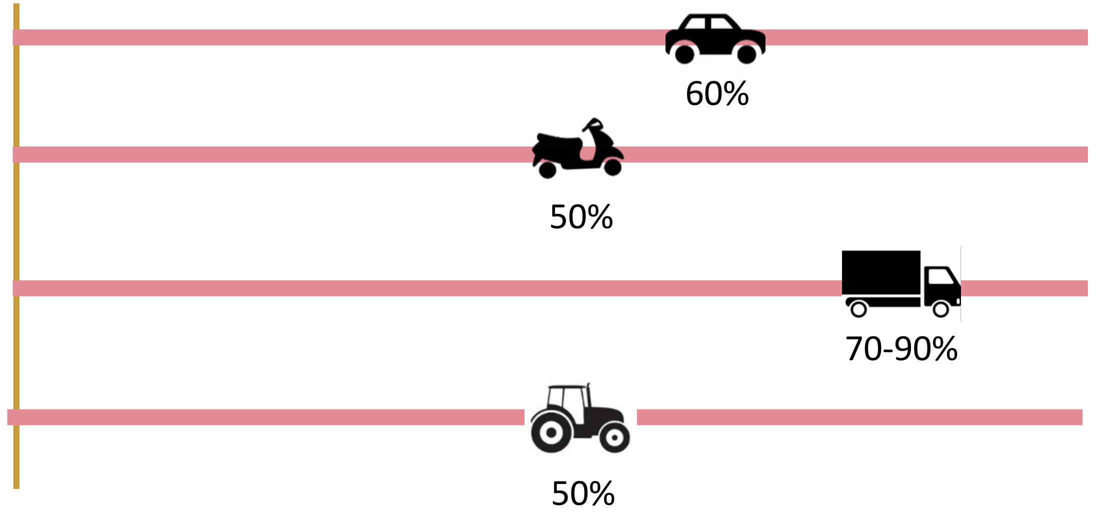
Higher cost of acquisition to further hurt PVs and 2Ws; Axle norm to hinder CV demand despite being buoyed by inventory buildup

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

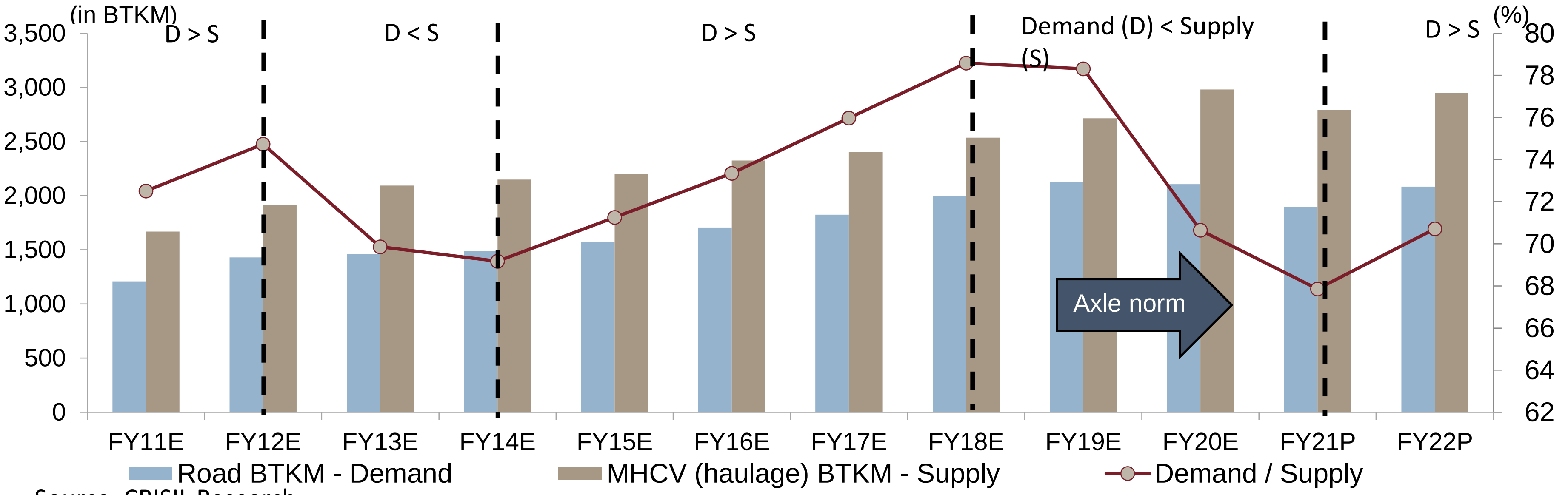


Source: CRISIL Research

Higher replacement demand share to hurt PVs and CVs

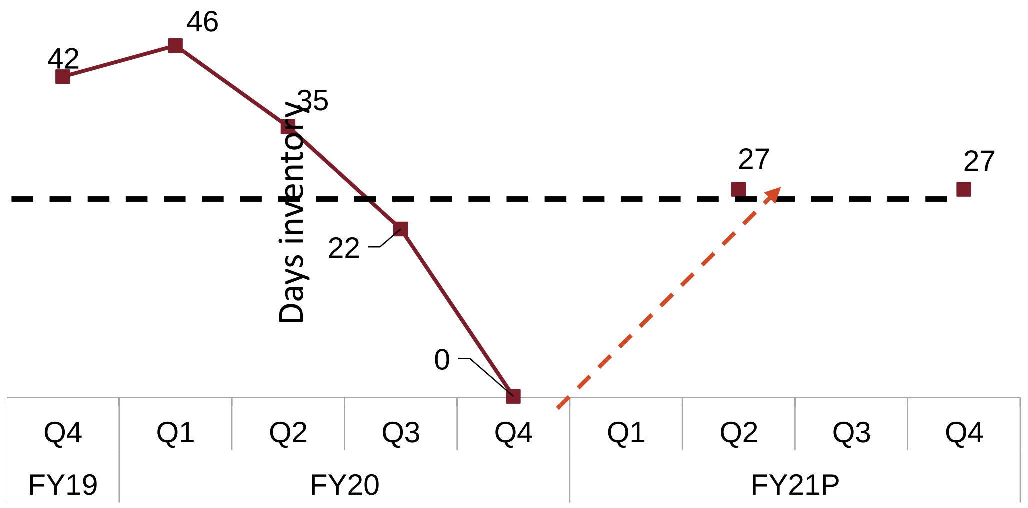


Axle norm increased freight capacity by 20%; lower freight demand added to the woes



Source: CRISIL Research

~800 bps higher demand due to inventory buildup



Source: CRISIL Research

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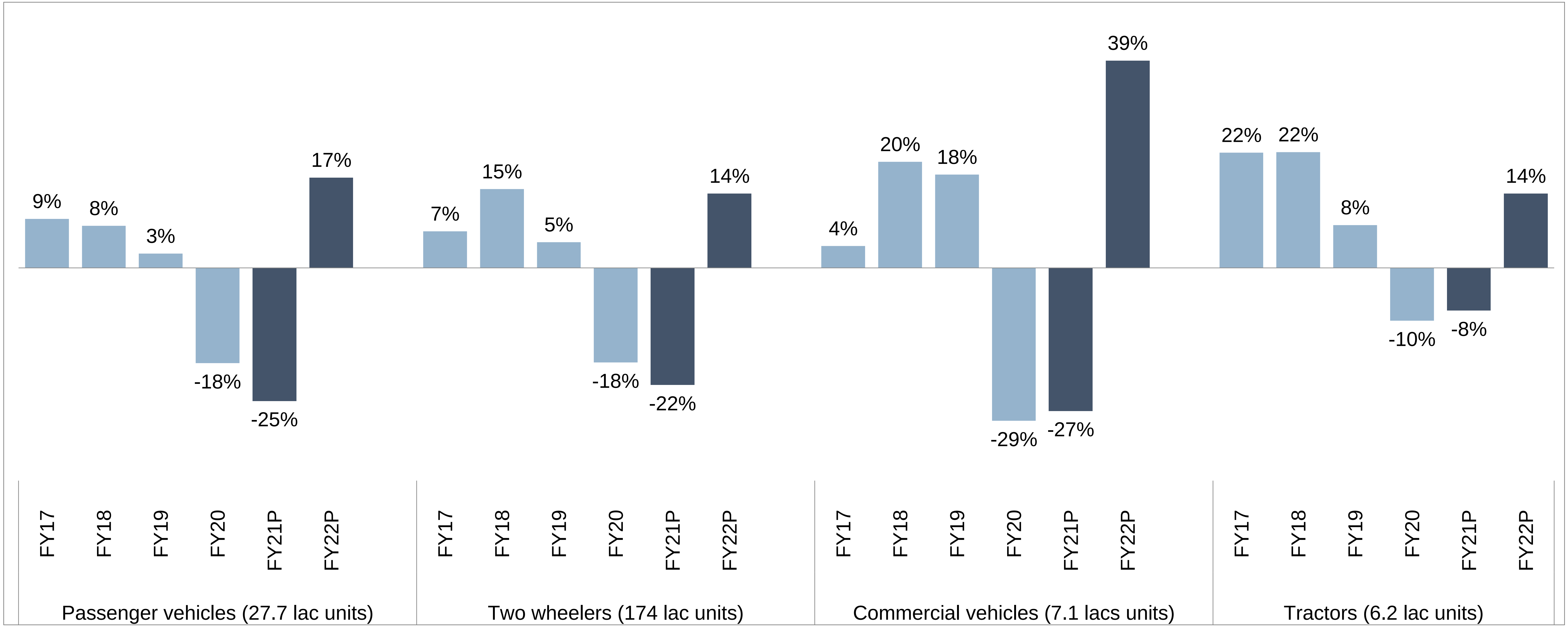
CVs to have second year of near 30% sales erosion in FY21, expected to bounce back in FY22



Note: Numbers in legends represent FY20 domestic sales. Dark blue bars denote forecast, Source: SIAM, CRISIL Research;

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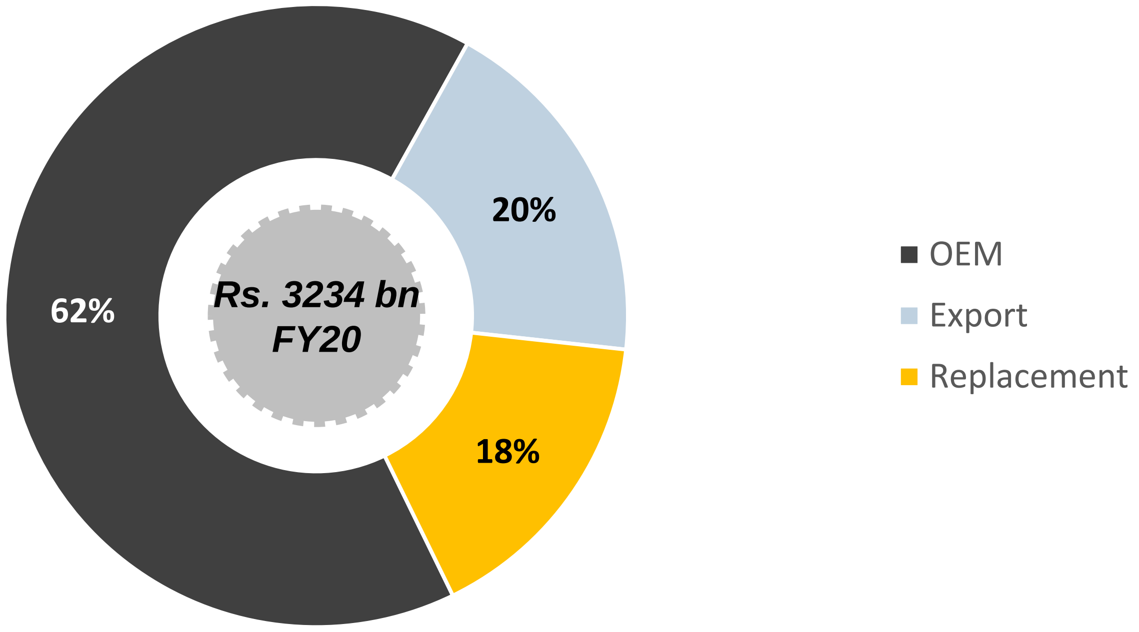
All segments of auto-component demand to remain weak in FY21, no respite even for diversified firms, recovery expected in FY22

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



Production (in volume terms)	%share to OEM segment revenue	FY15-20 CAGR	FY19	FY20 E	FY21 P	FY22 P
	51%	1%	0%	-15%	-23%	16%
	26%	3%	6%	-14%	-21%	14%
	16%	1%	24%	-33%	-24%	37%
	5%	5%	8%	-10%	-9%	14%

- 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

Growth (in value terms)	FY15-20 CAGR	FY19	FY20 E	FY21 P	FY22 P
OEM	5%	14%	-17%	-16%	26%
Replacement	8%	9%	7%	-13%	16%
Exports	7%	22%	-6%	-20%	16%
Total Production	6%	15%	-11%	-16%	22%

Source: CRISIL Research

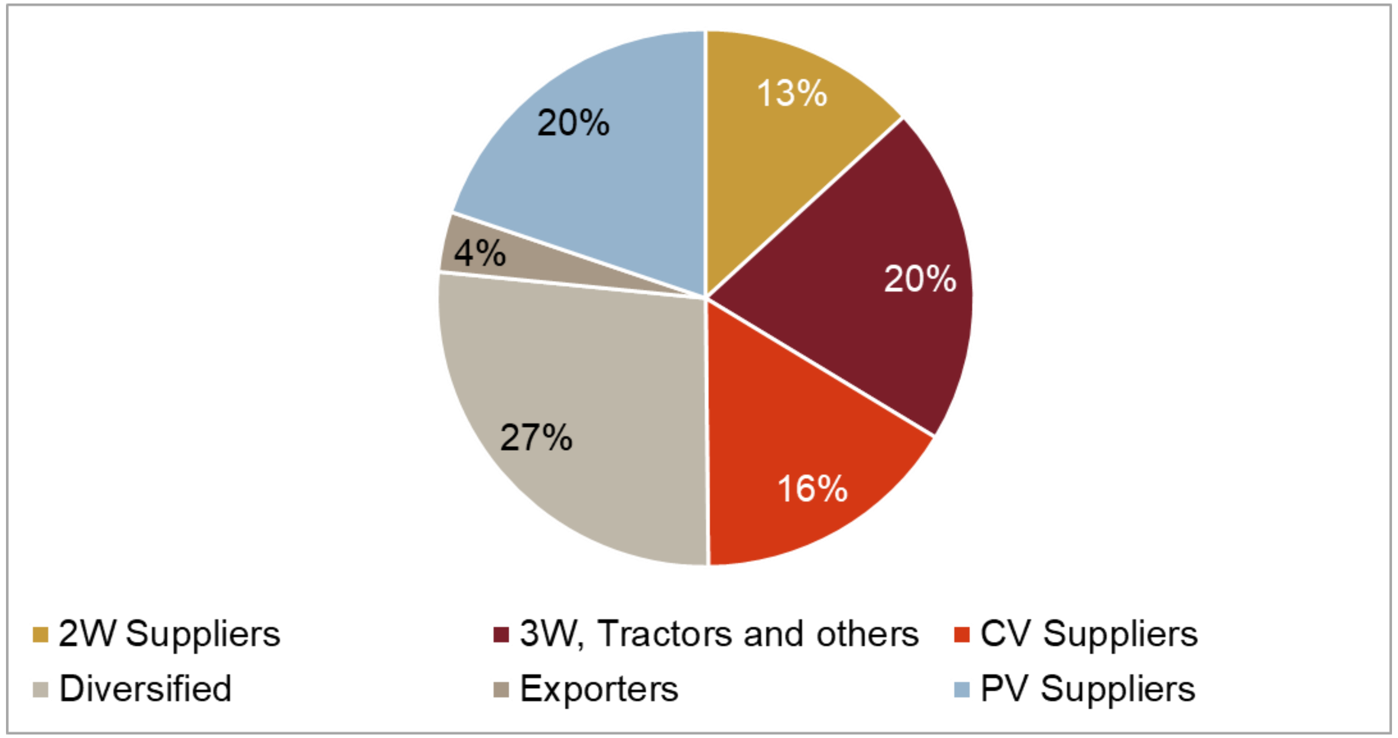
E: Estimated, P: projected

CRISIL's coverage, rated portfolio trends and credit outlook on automotive component suppliers

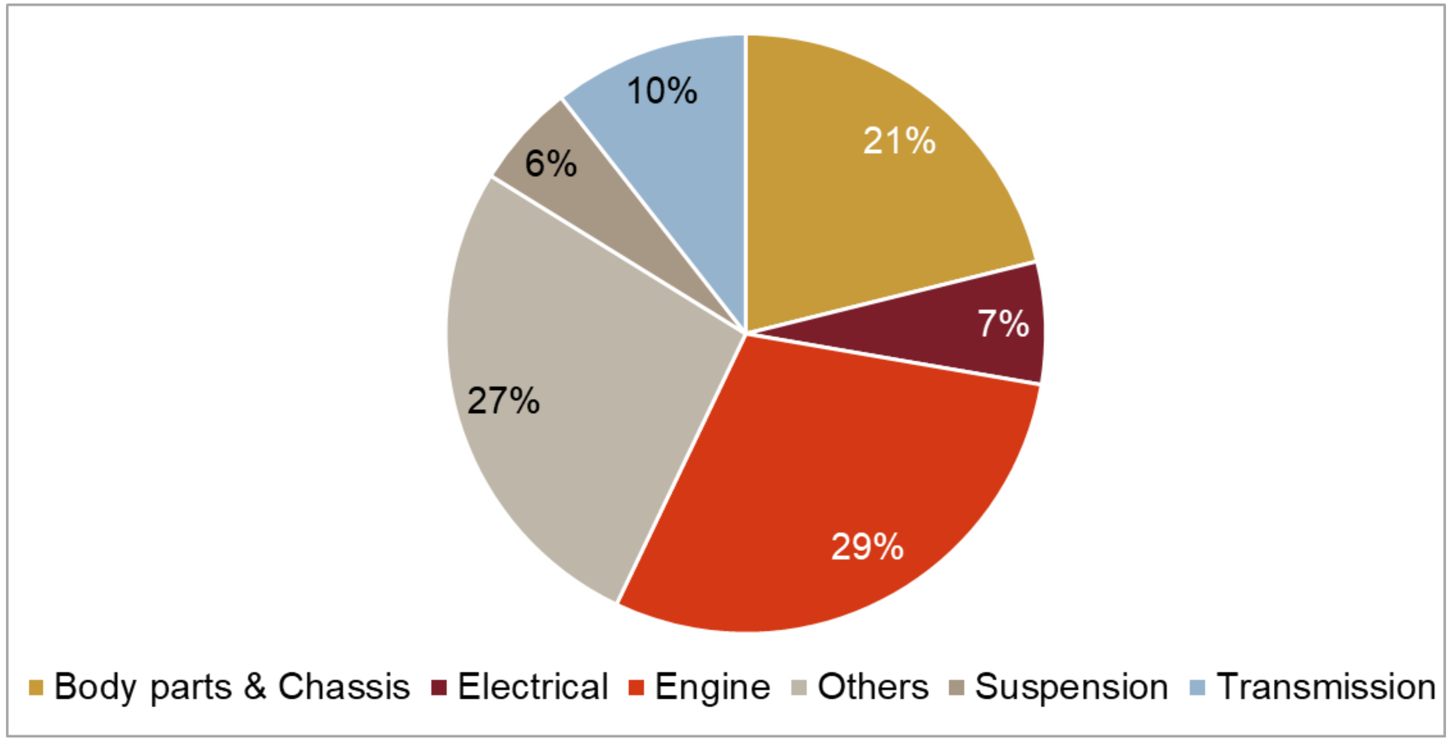
CRISIL has extensive coverage of Indian automotive industry

- 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

Diversified across OE segments



Diversified across product segments



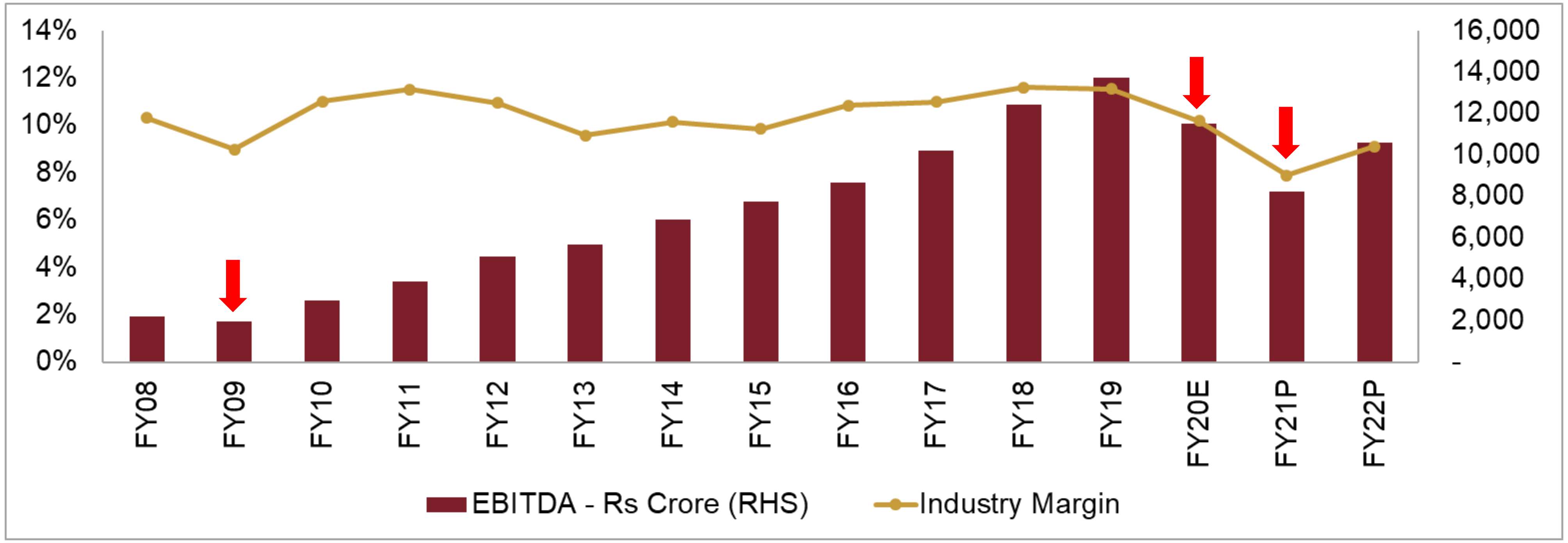
Above represents distribution of ~300 companies rated by CRISIL as of March 31, 2020

Source: CRISIL Ratings

Sector's low operating leverage to help moderate margin decline; however, sharp fall seen in absolute profits

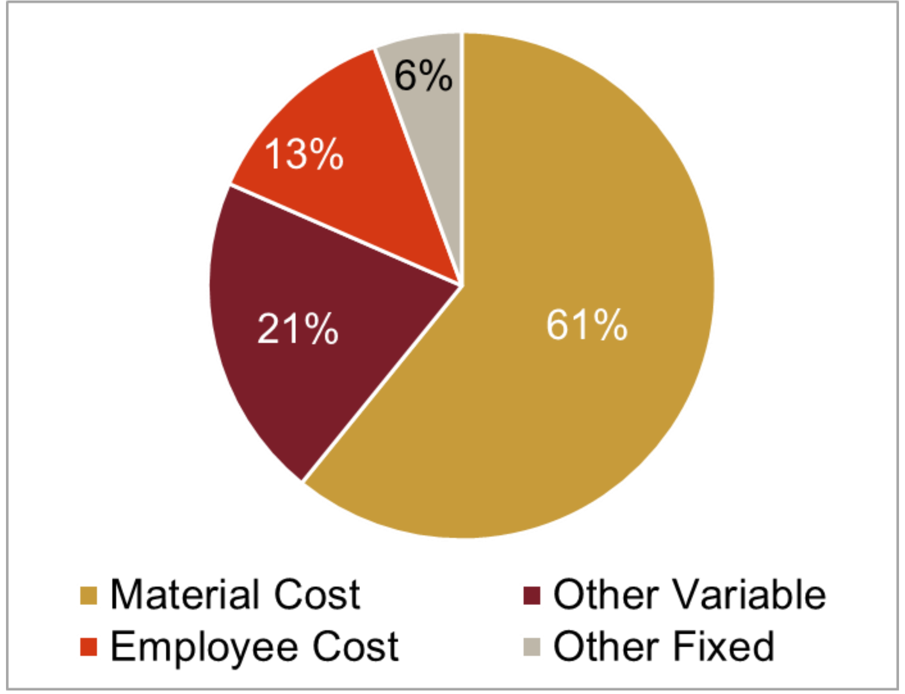
- Over 80% of cost structure is variable, with material cost (completely pass through) alone accounting for 60-65%.
- ~30-35% of workforce is contractual, offering flexibility in managing employee costs
- Some marginal benefit to accrue on account of higher value of BS VI components
- Despite high share 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

Variable cost >80%



Source: CRISIL Ratings

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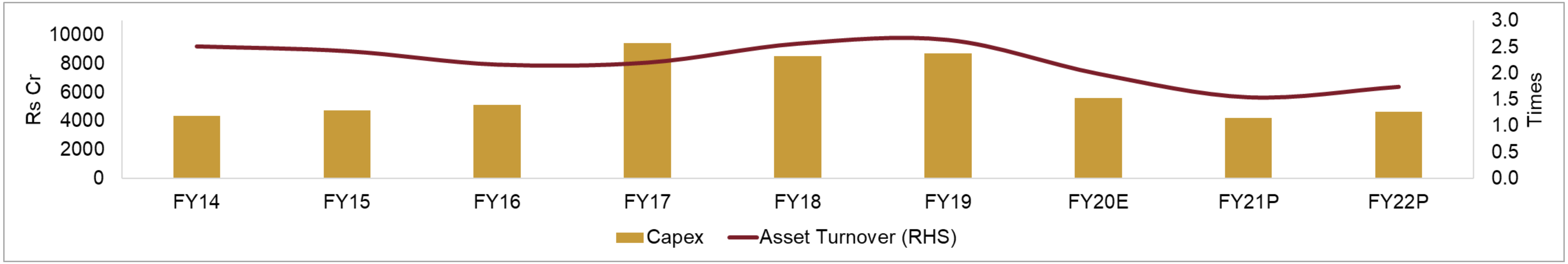
Low utilisations to lead to curtailed capital spend until FY22; working capital to witness limited stretch, remain under control

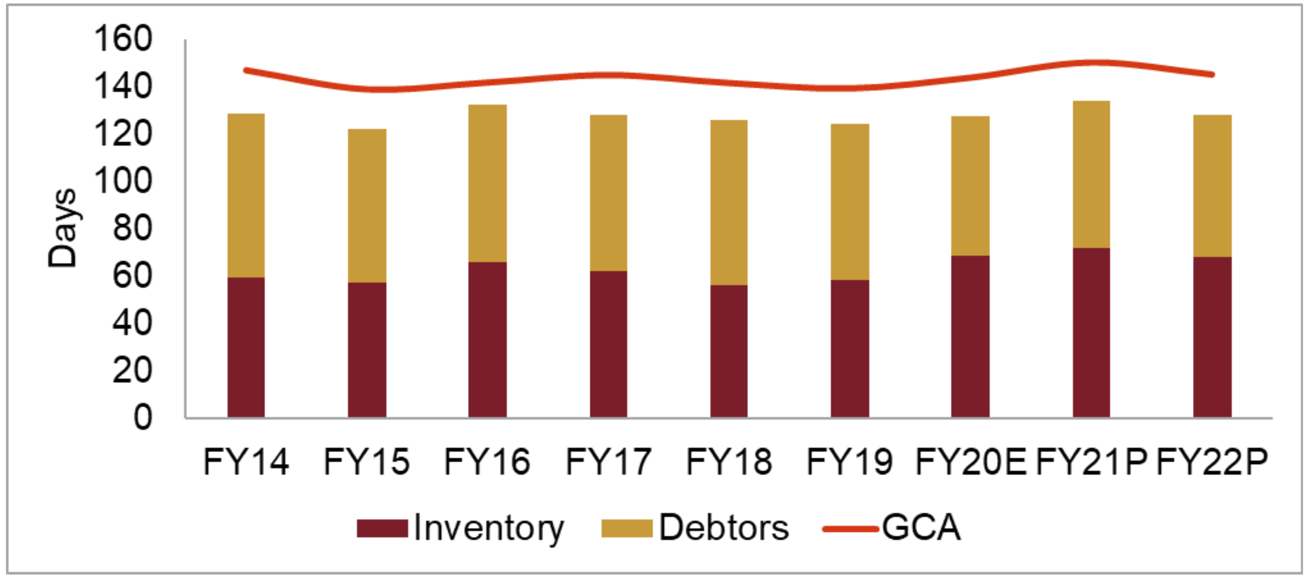
Capital spends to be curtailed; as demand slowdown to keep utilisation levels moderate



For companies with consistent data from FY08

- ~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

Working capital levels to remain largely under control

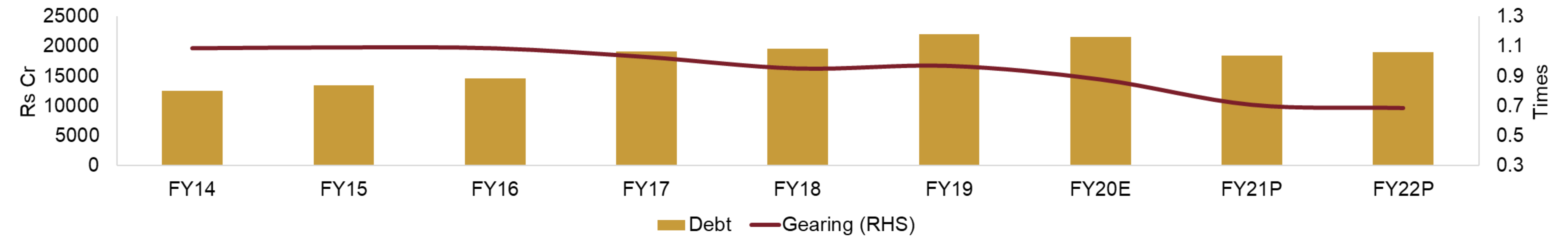


GCA – Gross Current Assets

Source: CRISIL Ratings

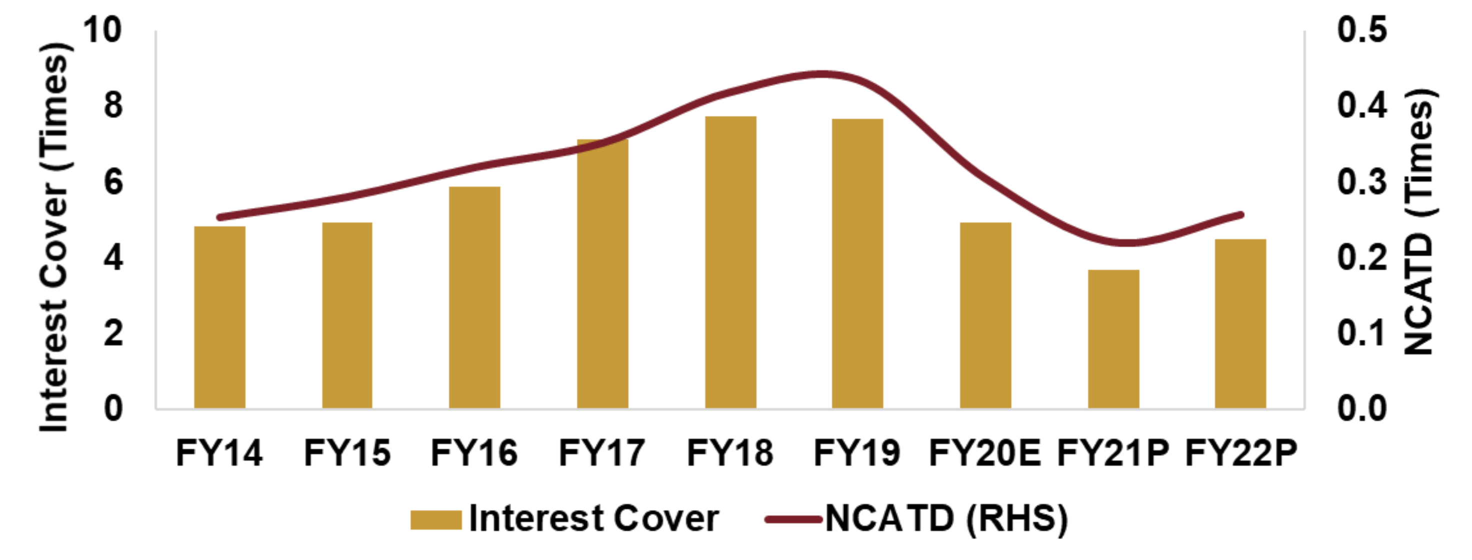
Credit metrics to moderate in FY21 and recover from FY22; pruned capex will ensure moderate impact on gearing

Pruned capex and limited stretch in working capital to help sustain capital structure



For companies with consistent data from FY08

However, credit metrics to be impacted in FY21; gradual recovery thereafter



NCATD – Net Cash Accruals to Total Debt

Source: CRISIL Ratings

- 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

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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

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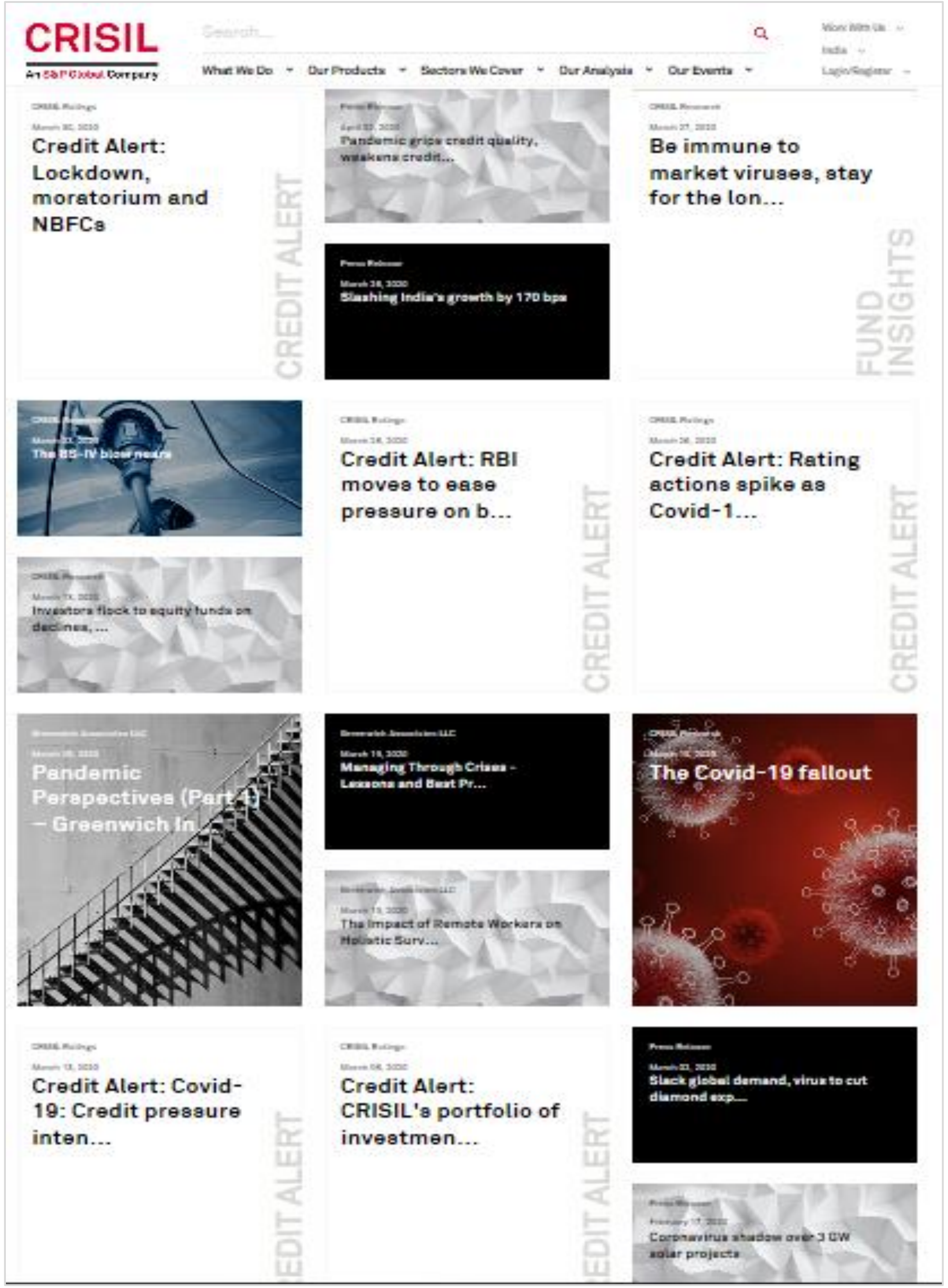

For additional queries or feedback, please reach out to:

Saman Khan | +91 95 940 60612 | saman.khan@crisil.com
Hiral Jani Vasani | +91 982003 9681 | hiral.vasani@crisil.com
Naireen Ahmed | +91 90 040 84769 | naireen.ahmed@crisil.com

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