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Automobile Industry on Fast-Track!

Review FY18 & Outlook FY19

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Overview

India's annual production stood at 29.08 mn vehicles (including passenger vehicles, commercial vehicles, three wheelers, two wheelers and quadricycles) in FY18 as against 25.33 mn in FY17, registering a growth of sharp growth of 14.8% y-o-y vis-à-vis a growth of 5.5% during the same period last year.

The industry is valued at around 7.1% of the country's Gross Domestic Product (GDP). The Two Wheelers segment leads the Indian Automobiles market with 80% market share owing to a growing middle class and a young population. Moreover, the companies growing interest in exploring the rural markets further aided the growth of the sector. This is followed by the Passenger Vehicle (PV) segment with 14% market share.

India, being a prominent auto exporter, the exports stood at about 14% of the automobiles produced annually. After declining by about 4.5% in FY17, exports witnessed a sharp growth of over 16% in FY18. Exports of two & three wheelers registered a sharp growth of over 22% y-o-y on back of gradual recovery in overseas demand. On the other hand, commercial vehicles exports declined by about 10% and that of passenger vehicles remained largely stable.

Outlook FY19:

Table 1: Growth in sales

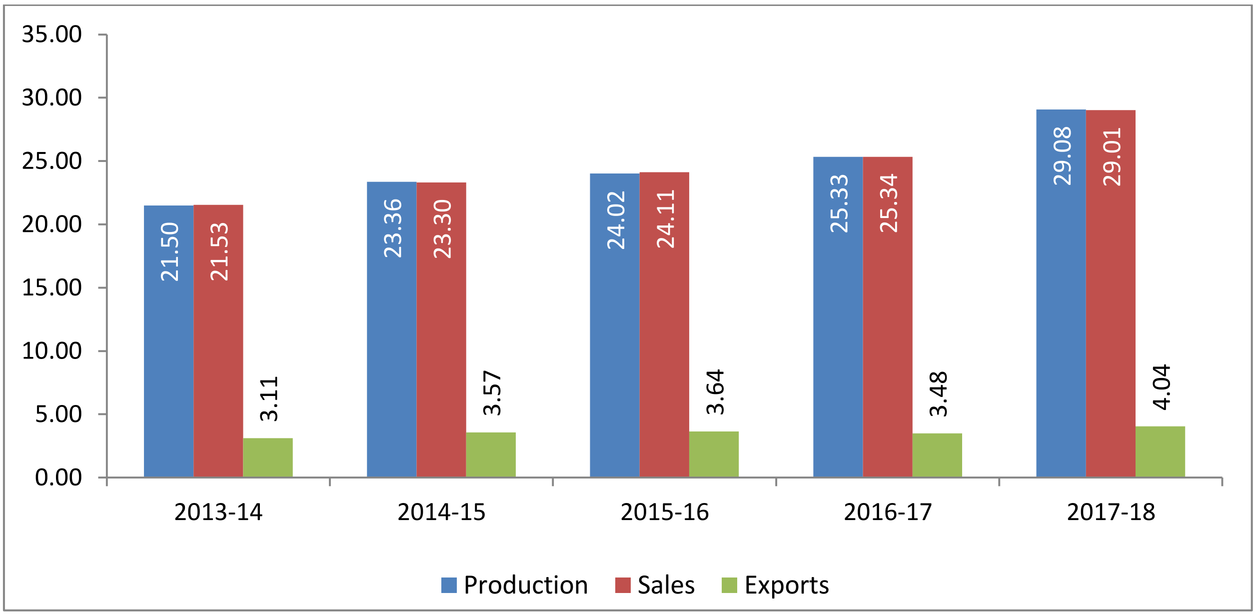
Category	FY19 P*
CVs	18-20%
PVs	8-10%
Two & Three wheelers	17-19%

P – Projected
Source: CARE Ratings

Performance review:

Trends in Automobile industry:

Chart 1: Production, Sales and Exports of Automobiles (Million units)



Source: CMIE

FY18 has been an eventful year for the automobile industry:

- Demonetization announced in November 2016
- Supreme court's BS-III vehicle ban came into effect on April 1, 2017
- Goods and Services Tax (GST) implementation on July 1, 2018
- Continued ban on diesel cars by National Green Tribunal (NGT), September 2018
- Cess increase in September 2017

- With release of pent demand post demonetization and BS-III vehicles ban, the demand for automobiles picked up in Q1 FY18. However, after registering a growth in April and May 2017, demand declined on back of uncertainties revolving around GST implementation.
- Automobiles were included in the highest tax slab (28%) under the GST regime. Additionally, cess of 1% (petrol)/3% (diesel) on small cars, 17% on mid-sized cars, 20% on large cars and 22% on SUVs and MUVs and 3% cess on two-wheelers have been levied. The rates pre-GST and post-GST are almost at par thereby eliminating any major impact of auto demand.
- However, demand started to pick up in Q2 FY18 as the uncertainties settled down and the pent up demand was released.
- Second half of FY18 had started witnessing strong positive sentiment backed by factors such as improved consumer sentiments with near normal monsoon in most parts of the country, higher MSPs for various crops and consequently higher farm incomes, new launches, implementation of seventh pay commission by Centre and salary revisions by states, lower financing costs (banks base rates have declined from 10.75% in December 2011 to 9.15% in December 2017) and healthy replacement demand due to diesel car ban.

Performance of the industry in FY18 vis-à-vis FY17

Table 2: Growth in sales

Category	Actual FY17	Actual FY18
CVs	4.2%	15.9%
PVs	10.6%	6.0%
Two & Three wheelers	4.2%	16.0%

In FY18, total auto sales witnessed a sharp double-digit growth of about 14.5% y-o-y after increasing by over 5% in FY17.

Passenger Vehicles:

- The passenger vehicle segment sales increased by a slower rate of 6% y-o-y. While new launches, reduction in interest rates and improvement in the economic scenario boosted the industry demand, higher crude oil prices restricted this growth. Crude oil prices increased by over 15% y-o-y in FY18.
- As estimated, a strong sales growth of about 19% was registered in sales of multi utility vehicles (MUVs) followed by a growth of 5.5% in sales of van. Passenger cars segment, however, registered only a marginal growth of 1.9% while the quadricycles sales grew by about 3% during the year.

Two & Three Wheelers:

- Of all the auto OEM categories, TW is a high-volume vehicle segment which is largely driven by extent of disposable income available, which in turn is a function of the state of economic turnaround especially in the rural areas that contribute to over 50% of the overall TW demand. On account of near normal monsoon in most parts of the country for 2017, the two & three wheeler segment sales witnessed a sharp double-digit growth of 16%.
- This growth was supported by 30% y-o-y higher sales of three wheelers and over 15% y-o-y growth in sales of two wheelers. Exports of three wheeler segment increased by over 40% y-o-y led by overall improvement in global economies.
- Also, two wheeler segment sales grew by about 15.4% where scooters sales grew at a faster pace of over 19% y-o-y followed by motorcycle sales that registered a growth of little over 15% y-o-y. On the other hand, sales of moped declined by 3.7% y-o-y during the year.

Commercial Vehicles:

- Commercial vehicles segment sales grew by a sharp 15.9% y-o-y post release of pent up demand led by uncertainty revolving around the migration of CV manufacturers to Bharat Stage (BS) IV emission norms from April 2017 by the government.
- Demand for CVs recovered on back of infrastructure development along with streamlining of logistics and e-commerce sectors post GST caused disruptions. M&HCVs demand got a push with restrictions on truck overloading in some states and high replacement buying during the year while LCVs sales improved on back of two consecutive good monsoon years along with higher disposable income in the hands of rural populace.

Outlook FY19:

- *Going forward in FY19, CARE Ratings expects the auto industry to continue witnessing healthy growth as the disruptions caused by various policy implementations (demonetization, ban on BS-III vehicles, GST, rate revisions) have almost moderated. Also, demand is expected to improve on back of various initiatives taken by the government in the Union Budget 2019 for the **Agriculture and Infrastructure sectors**.*

- Improved consumer sentiments post the **Seventh Pay Commission** by the Centre as well as **salary revisions by States** *and higher farm incomes* supported by **increased MSPs** for certain kharif crops in expected to further increase rural disposable income. This is expected to boost the demand for ***passenger vehicles and two-wheelers especially motor cycles***.

- *The government has also recently (October 2017) approved one of the biggest highway construction projects in India - **Bharatmala project**, worth Rs 7 lakh crores to build approximately 83,000 kms of road by 2022 along with **improvement in construction and mining activities and higher demand from e-commerce and FMCG industries** is expected to give a fillip to the **commercial vehicles segment** going forward.* Also, in order to take the polluting commercial vehicles (CVs) off road, the government may fix 20 years as the lifetime of the commercial vehicles. *The Vehicle scrapping policy is expected to come into force from April 1, 2020. This is expected to give further boost to CV sales in the country.*

However, on the other hand, increase in commodity prices and frequent policy changes are the key concerns for the growth of the industry. Also, the investment required in order to ensure improved emission standards is likely to pose a challenge for the players.

Table 3: Growth in sales

Category	FY19 P*
CVs	18-20%
PVs	8-10%
Two & Three wheelers	17-19%

P - Projected

Main drivers for these growth rates:

- GDP growth to be higher at about 7.5%
- Good monsoon and higher farm income
- Increased infrastructure and industrial activities

Segment	Driver
Passenger vehicles	Higher growth in GDP, income levels and stable prices, IIP
Two and three wheelers	Higher GDP growth, good monsoon, higher disposable income, higher farm incomes
Commercial vehicles	Pick up in industrial production, GDP, stable interest rates

Factors to watch for in FY19:

- Higher outlay in Budget 2018 for infrastructure, transportation and agriculture segment, which had been volatile off late, is expected to be positive for the commercial vehicles demand.
- With the decline in the holding period of a vehicle from 5-6 years to 3-4 years, the inflow of used cars and commercial vehicles has gone up considerably. Also, easy access to finance options, greater participation of organized OEM backed players in used vehicle markets; higher number of aspiring buyers with improvement in standard of living and increased industrial activities, etc. is likely to create higher demand for the used-vehicle segment. This in turn is expected to marginally impact the demand for new passenger vehicles and commercial vehicles in the future.
- Higher disposable income in hands of buyers with seventh pay commission by the Centre and salary revisions by the states is likely to increase demand for the small cars and two wheelers. Two-wheelers demand is expected to improve on back of steady rural as well as urban demand
- Demand for three-wheelers could be under pressure in near term. However, the segment is likely to register growth on back of rising urbanization and migration to cities boosting intra-city transportation.
- Auto exports from India is expected to show strong growth as many companies like Volkswagen, Ford Motors, General Motor are focusing on exports and expansions in newer markets such as South America, North America and Asia will only add to the growth. Export demand from African and Latin American countries is expected to pick up on back of stabilization of exchange rates and commodity prices in these regions
- The original equipment manufacturers (OEMs) are focused towards meeting the growing domestic demand for various auto segments going forward with elimination of demonetization effects in the economy. Also, the taxation processes have now been streamlined post the initial interruptions of GST implementation in FY18
- Also, the government has announced to totally skip Bharat Stage (BS)-V norms and adopt BS-VI norms by April 2020 for cars for fighting pollution, poses a challenge to the domestic manufacturers. Many manufacturers have already started setting up plants for production of BS-VI complaint vehicles. However, the availability of higher grade fuel for these vehicles is of high concern as using BS-VI fuel in the current BS-IV engines or running BS-VI engines on the current-grade fuel, may be not be effective in curbing vehicular pollution, and may wreck the engine in the long run.