Is the automotive sector on road to recovery?

December 16th, 2020 I Industry Research

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Overview

The automotive sector assumes immense importance as the driver of India's economic growth as it has linkages with multiple industries. For instance, manufacturing vehicles require steel, iron, aluminium, paint, plastic, glass, leather, electronics, rubber, etc. Alongside, this sector is a significant contributor to the banking/NBFC industry in the form of automobiles financing which is one of the most common forms of retail loans (nearly all commercial vehicles are bought on credit). The sector is also one of the largest spenders on advertising and among the main end-user of oil and gas.

The automotive sector's vast value chain present across the entire Indian economy, contributes nearly 40% to India's manufacturing GDP. Hence, this sector has the potential to bring inclusive growth and community development along with enhancing employment. Naturally, when the automotive sector witnesses a downward trend, it is a clear depiction of the present state of the country's economy.

In the initial few weeks of FY21, the automobile OEMs, dealers and ancillaries suffered due to the nationwide lockdowns as manufacturing came to a sudden halt, dealer showrooms were shut, all of which translated to a huge loss in revenue for the sector. According to a recent study*, the automotive sector suffered Rs 2,300 crore loss per day and an estimated job loss of about 3.5 lakh. However, as the months progressed, supply chains gradually restored, consumer demand picked pace and hence the sector's grievances lessened up to an extent. September onwards, the trends in production, domestic sales and exports started showing signs of improving.

Out of all the segments, tractors, passenger vehicles and two wheelers have outshone this year (up to November 2020). Due to slow economic growth, demand for commercial vehicles gained pace lately in September 2020. Three wheelers is still a laggard with fewer signs of recovery.

The following sections of this report are an analysis of:

- Global scenario
- Indian scenario
- Prevailing GST rates
- Outlook for FY21

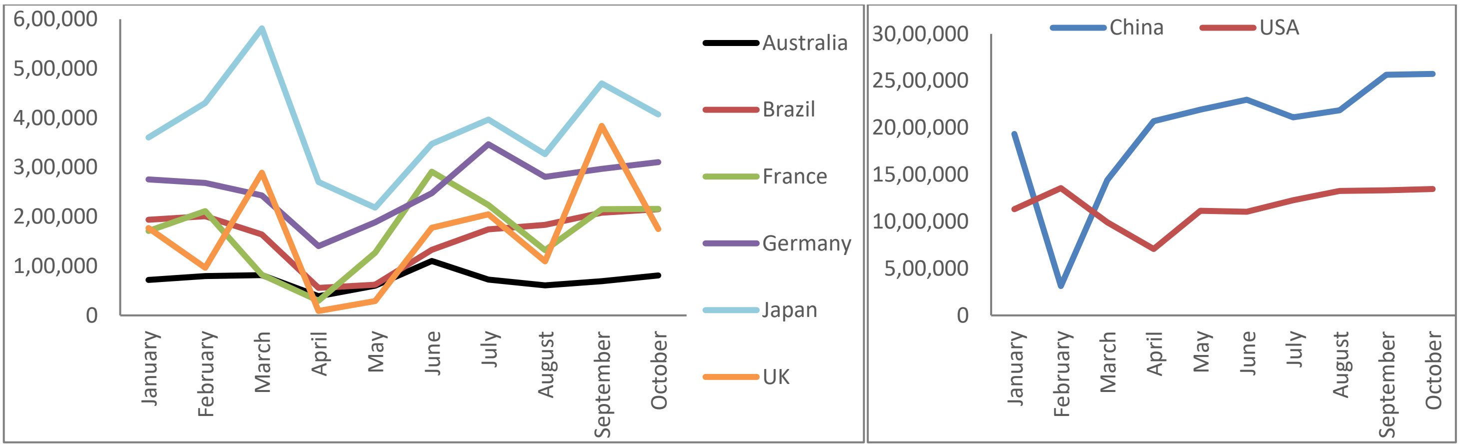
*- parliamentary panel report submitted to Rajya Sabha Chairman M Venkaiah on 15th December 2020

Global scenario

The below charts elucidate that automobiles sales/registrations in most markets witnessed a dent March 2020 onwards – the month when most nations started a nation-wide or region-wise lockdown due to the outbreak of Covid-19. UK and Japan saw a downward trend in automobile sales in April 2020, while China was the only nation that witnessed a contrary trend of uptick in automobile sales March 2020 onwards.

June 2020 onwards, most nations witnessed relaxations in lockdowns which helped their economies to start stabilizing. Henceforth, automobile production and sales started to recover and the sector started to show some progress. For January to October 2020, the cumulative automobile sales for all nations (depicted in below charts) declined on a Y-o-Y basis, with China being the outperformer at -4.8% growth YoY. Growth in other markets during January to October 2020 were Japan (-14.7% YoY), USA (-17.1% YoY) and Australia (-18.8% YoY). Nations where decline in automobile sales/registrations stood higher during the same period were Germany (-22.9% YoY), France (-25.5% YoY), Brazil (-30.4% YoY) and UK (-30.4% YoY).

Chart 1: Automobiles sales/registrations globally (Jan to Oct 2020)



Source: OICA
Note : Refers to Passenger cars, LCV, HCV, buses and coaches

Indian scenario

Passenger vehicles

- **Performance in November 2020:** In November 2020, production of passenger vehicles rose to 3.2 lakh units, out of which 13% were exported. Nearly 2/3rd of these exports comprised of passenger cars (mini, compact and mid-sized cars), while the remaining 1/3rd were of multi utility vehicles of upto 4,400 mm length which are priced below Rs. 20 lakhs. During the same month, the factory dispatches for domestic market stood at 2.85 lakh units, while the retail sales were marginally higher at 2.91 lakh units. The elevated consumer demand during this festive month was met by the high inventory lying with dealers since past few months.

- **Trends in 8M-FY21:** In the initial two months of FY21, manufacturing came to a near halt due to Covid-19 induced lockdowns and hence output of passenger vehicles tumbled more than 90%. Similarly, exports fell more than 70% as most countries sorted to import of only essential items. However, June 2020 onwards as the lockdown restrictions eased, production gained pace and the output of cumulative eight months of FY21 reached ~70% of previous year's levels. Similarly, the domestic wholesales picked momentum as the festivities in India began.

September 2020 onwards, OEMs increased their domestic wholesales and pushed inventories forward in the value chain to dealers, to ensure no dealer falls short of supply during the high demand period. The retail sales witnessed an impressive recovery during October and November 2020, which narrowed the gap between previous and current year's retail sales levels to ~32% for 8M-FY21.

Two wheelers:

- **Performance in November 2020:** Production of two wheelers in November 2020 stood at 19.36 lakh units, which is a marginal improvement of 3.5% over November 2019. Nearly 20% of this output was exported. October 2020 saw a sharp pick up in factory dispatches in anticipation of a high demand during the festivities, however, as retail sales during the same month were below expectations, domestic wholesales in November 2020 declined by 22% m-o-m and 13.4% YoY. The consumer demand for two wheelers dint witness much buoyancy during November 2020 and hence retail sales declined 21.4% YoY.

- **Trends in 8M-FY21:** Production of two wheelers in 8M-FY21 was lower by 26.8% when compared with same period last year. Most of this decline was in April and May 2020, which were periods of lull for the automotive industry. Nearly 17% of the total output of 8M-FY21 was exported, of which motorcycles formed the major component with 88% share. The motorcycles with lower engine capacity of 75 to 110 cc and 110 to 125 cc witnessed the highest demand from export markets, compared with motorcycles having higher engine capacities. Within the scooter category, 91% of the export demand came for 75 to 125 cc, followed by <75 cc. Exports of mopeds did not witness much traction during the same period.

  Domestic wholesales of two wheelers during 8M-FY21 has reached 75% of previous year's levels. Most of the vehicles sold were of the lower end category of 75 to 110 cc and 110 to 125 cc and both these categories formed ~80% of the total domestic wholesales in 8M-FY21. The 150 to 200 cc was the next big category with 10% share in domestic wholesales. The overall retail sales for two wheelers in 8M-FY21 were nowhere close to last year's levels, as they stood lower by 44.1% YoY.

Three wheelers:

- **Performance in November 2020:** The three wheelers segment can be considered as a laggard for the automotive sector as production, sales as well as exports have not shown much signs of recovery in FY21 (up to Novemeber 2020). In November 2020, production declined 38.4% YoY, while exports were lower by 22.1% YoY. Wholesales as well as retail sales for this month were not even half of previous year's levels.

- **Trends in 8M-FY21:** Production of three wheelers in 8M-FY21 declined 56.8% YoY, while exports fell 33.4% YoY. Within the passenger carrier segment, exports of four-seaters fell by 1/3rd, while that of seven-seaters have nearly doubled. Within the goods carrier segment of up to 1 tonne, exports declined 36% YoY, while demand for three wheelers goods carrier of more than 1 tonne did not witness any demand from importing nations.

  The lack of demand from the passenger carriers segment during 8M-FY21 led to domestic wholesales of three wheelers declining by 76.1% YoY to 1.08 lakh units. The retail sales of three wheelers fell 74.2% YoY to 1.16 lakh units in 8M-FY21. Hence, the three wheelers segment is expected to be the last segment to recover.

Tractors:

- **Performance in November 2020:** Tractors has been the best performing segment of FY21 (up to November 2020). In November 2020, production witnessed a strong jump of 46.3% YoY to ~90,000 units and 8% of these units were exported. Factory dispatches for Indian market surged 51.3% YoY, while retail sales expanded 8.5% YoY in November 2020.

- **Trends in 8M-FY21:** Tractors has outshone all other segments of automobiles in 8M-FY21 with a satisfactory performance in production, sales as well as exports. Output grew 8% YoY, while domestic wholesale and retail sales were up by 15.2% and 22.6% YoY respectively and exports were at nearly same levels as last year. USA, Nepal, Bangladesh, Sri Lanka and South Africa were the top five markets to which India exported tractors.

  The peak season demand for tractors usually ranges from March to June and September to October, however, in April and May due to covid-19 induced lockdowns, domestic sales fell 64% YoY. This pent-up demand was met in June 2020, as domestic wholesales rose sharply by 22.4% YoY. As expected, sales lowered in following two months of July and August and regained pace in September and October, where domestic wholesales grew to new highs and crossed 1 lakh units in both months.

Commercial vehicles:

- **Trends in 8M-FY21:** Due to a fall in infrastructural spends, low mining and construction activities, migration of labourers to villages, fall in freight movement, the commercial vehicle industry faced a sudden blow in H1-FY21. The production declined 56.9% YoY, domestic wholesales fell 56% YoY and exports dropped 55.7% YoY in H1-FY21. It is noteworthy that such decline has come on an existing low base, as the industry was already on a downward trend since FY20, even before the pandemic hit the country.

  Within the commercial vehicles industry, the Medium and Heavy Commercial Vehicles (MHCV) segment suffered the most as production, domestic wholesales and exports declined 74.2%, 76.3% YoY and 65.5% YoY respectively in H1-FY21. The domestic wholesales of trucks fell to ~4,000 units in Q1-FY21 compared with ~64,000 units in Q1-FY20. However, an increase in transportation of FMCG, perishable agricultural items, poultry, durables, etc. led to a rise in demand for MHCV in Q2-FY21, which rose to ~24,000 units, but still was at just half the level of Q2-FY20. Mid-September 2020 onwards, domestic wholesales of tipper trucks and haulages improved due to a gradual pick up in construction and mining activities, increased infrastructural projects and movement of products like coal and iron ores. A quick revival in demand for steel and cement, which is directly proportional to the growth in the country's infrastructural projects, also plays a key role in performance of the MHCV segment.

  Bus is another segment which suffered due to the ongoing pandemic, as it created a shift in preference from public to private mode of transportation. This is evident from the pace of recovery witnessed in passenger vehicles and two wheelers, in comparison with buses and three wheelers. A quick recovery in demand of buses in near future is not very likley, as domestic wholesales in H1-FY21 dropped to just 852 units, compared with ~18,000 in H1-FY20. Closure of schools, continuation of work from home practice for many corporates, negligible tourism, restricted inter-city and state travel are the factors that dragged down bus sales during H1-FY21 and hence recovery for bus category is elusive until H2-FY22.

The Light Cmmercial Vehicles (LCVs) industry recorded its lowest domestic wholesales in history by selling just ~27,000 units in Q1-FY21 (-79.7% YoY). In the successive quarter of Q2-FY21, LCVs witnessed a sharp uptick to 1.09 lakh units (-8.5% YoY), which can mainly be attributed to the growth in E-commerce sector that aids last mile delivery, among others. Within the LCV industry, demand for passenger carriers dropped to negligible levels in Q1-FY21 and marginally rose in Q2-FY21, whereas, goods carriers has been the driving segment for the LCV industry as it quickly recovered in Q2-FY21 to 1.05 lakh units, from ~26,000 units in Q1-FY21. The demand for goods carriers is expected to improve in following months, while recovery of passenger carriers is distant as social distancing continues to prevail.

Table 1: Production, sales and exports of automobiles

		Production		Domestic wholesales		Retail sales		Exports	
		Units	YoY growth	Units	YoY growth	Units	YoY growth	Units	YoY growth
Passenger vehicles	November 2020	3,18,070	12.7%	2,85,367	12.7%	2,91,001	4.2%	41,405	-29.2%
	8M-FY21	15,82,758	-29.3%	14,05,519	-21.5%	12,29,578	-32.3%	2,38,522	-50%
Two wheelers	November 2020	19,36,793	3.5%	16,00,379	13.4%	14,13,378	-21.4%	3,80,611	27.2%
	8M-FY21	1,11,71,495	-26.8%	96,37,871	-25.1%	61,94,607	-44.1%	18,57,702	-22.2%
Three wheelers	November 2020	64,982	-38.4%	23,626	-57.6%	24,185	-65%	37,279	-22.1%
	8M-FY21	3,42,322	-56.8%	1,08,475	-76.1%	1,16,489	-74.2%	2,32,721	-33.4%
Tractors	November 2020	90,327	46.3%	82,330	51.3%	49,313	8.5%	7,200	21.6%
	8M-FY21	5,77,865	8%	5,99,092	15.2%	3,70,301	22.6%	49,696	-2.3%
MHCV	6M-FY21	35,515	-74.2%	28,987	-76.3%	98,649	-75.3%	4,133	-65.5%
LCV	6M-FY21	1,41,011	-48.5%	1,36,205	-46.2%			9,405	-49.4%

Source: CMIE, SIAM, FADA, CARE Ratings
Note: SIAM releases quarterly data for LCV and MHCV

Prevailing GST rates in India

The Government of India moved away from the excise duty regime and introduced the Goods and Services Tax (GST) from July 1st 2017. According to this, passenger vehicles (petrol, diesel, CNG, electric hybrid), commercial vehicles, two and three wheelers are taxed at the highest GST rate of 28% and a cess in the range of 1-22% is added, which takes the effective tax rate to up to 50%. Electric vehicles in India attract a lower GST rate of 12%, in order to increase in penetration in the country.

Table 2: Automotives tax rates in India		
Vehicle category	**Cess (%)**	**Total applied rate (%)**
Small passenger vehicles (petrol, CNG, LPG) < 4m in length and < 1,200cc engine	1	29
Small passenger vehicles (diesel) < 4m in length and < 1,500cc engine	3	31
Mid-size passenger vehicles (> 4m in length with < 1,501cc engine)	17	45
Large passenger vehicles (> 4m in length with > 1,500cc engine)	20	48
UVs/SUVs (> 4m in length with > 1,500cc engine & >169mm ground clearance)	22	50
> 350cc two-wheelers	3	31
10 – 13 seater public transport vehicles	15	43

Source: European Automobile Manufacturers Association

The Indian automotive sector has been demanding a cut in GST rates for automobiles since long, with an argument that such a move could reverse the prevailing low demand and hence could increase sales, which can lead to a growth in tax contribution towards the government from this sector. These taxes are levied before the vehicle leaves the showroom, and later, the vehicle owner incurs additional charges in the form of road tax, registration charges, insurance charge, etc.

Automotive tax rates globally: Globally, different nations have varied tax rates for automobiles. In the United States, most vehicle taxes and fees are imposed at the state rather than at the federal level. It follows a system of average mileage-based gas guzzler tax. All US states impose vehicle registration fees on all vehicles regardless of vehicle age and are generally collected annually. In the European Union, the VAT rate varies from 19 to 27% and a registration tax is added that differs across countries. In China, a consumption tax ranging between 1 to 40% is applicable differing based on the cyclinder capacity. Japan levies a tonnage tax related to the vehcile weight along with an environment performance levy and consumption tax.

Revised outlook for FY21

- **Passenger vehicles:** The pace of growth in domestic wholesales are expected to sequentially taper in December 2020, but still be higher than Decemebr 2019. Q4-FY21 is expected to witness lower demand for passenger vehicles sequentially as the pent up demand and festivities would end. Also, January 2021 onwards, OEMs are expected to hike prices for their models, to offset the rise in the input and commodity prices, which could negatively impact consumer demand. Domestic wholesales of passenger vehicles are expected to decline 9 to 14% YoY in FY21.

- **Two wheelers:** Since the festive season of Novemebr 2020 dint bring much joy to the two wheeler manufacturers, outlook for Q3-FY21 has been lowered to 17 to 23%, from 28 to 33% expected earlier. A further sequential fall in domestic wholesales is expected in Q4-FY21. Domestic wholesales of two wheelers is expected to decline 13 to 18% YoY in FY21.

- **Three wheelers:** The monthly domestic wholesales of three wheelers have not reached even half of last year’s levels. Hence this industry is considered to be a laggard and recovery seems unlikely until atleast H2-FY22. The domestic wholesales of this industry is expected to decline 68 to 73% in FY21.

- **Tractors:** Tractors have undeniably been the best performing segment in FY21 (up to Novemebr 2020). A resilient rural economy has spured demand for this agricultural machinery this year. Domestic wholesales are expected to lower between Decemeber 2020 to Febrauary 2021 and pick pace March 2021 onwards. CARE Ratings expects domestic wholesales of tractors to grow in the range of 11 to 16% in FY21.

- **Commercial vehicles:** MHCV is typically the first segment to decline and last to recover when a country witnesses a downward trend, due to its high linkages with the country's economic activities. However, the segment also witnesses a sudden jump in demand as manufacturing and infrastructural activity picks up in the country. The MHCVs showed an impressive recovery mid-September 2020 onwards, as infrastructural and mining activities rose. However, a sustained demand for MHCVs will depend on implementation of the scrappage policy, reduction in GST, rationalization of infrastructural projects, quick auction of coal mines, rise in mining activities, among others. Additionally, domestic transportation of covid-19 vaccines could act as a new demand drivers for CVs in near future.

  The LCV segment has performed relatively better than the MHCV industry in 8M-FY21 and is hence expected to reach pre-covid levels earlier. We expect domestic wholesales of LCVs to decline by 13 to 18% YoY, while MHCVs are expected to decline 50 to 55% YoY in FY21. The entire commercial vehciles industry is expected to contract 25 to 30% YoY in FY21.

Table 3: Domestic wholesales (YoY growth)

	CARE Ratings' expectation		
Category	Q3-FY21	Q4-FY21	FY21
Passenger vehicles	10 to 15%	4 to 9%	-9 to -14%
2-wheelers	17 to 22%	3 to 8%	-13 to -18%
3-wheelers	-58 to -63%	-50 to -55%	-68 to -73%
Tractors	24 to 29%	-3 to +2%	11 to 16%
Total Commercial vehicles	-5 to -10%	18 to 23%	-25 to -30%
MHCV	-25 to -30%	-15 to -20%	-50 to -55%
LCV	-2 to +3%	38 to 43%	-13 to -18%

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