Automobile Industry: Review 2016-17

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Overview:

India's annual production stood at 25.31 mn vehicles (including passenger vehicles, commercial vehicles, three wheelers, two wheelers and quadricycle) in 2016-17 as against 23.96 mn in 2015-16, registering a growth of 5.6% y-o-y.

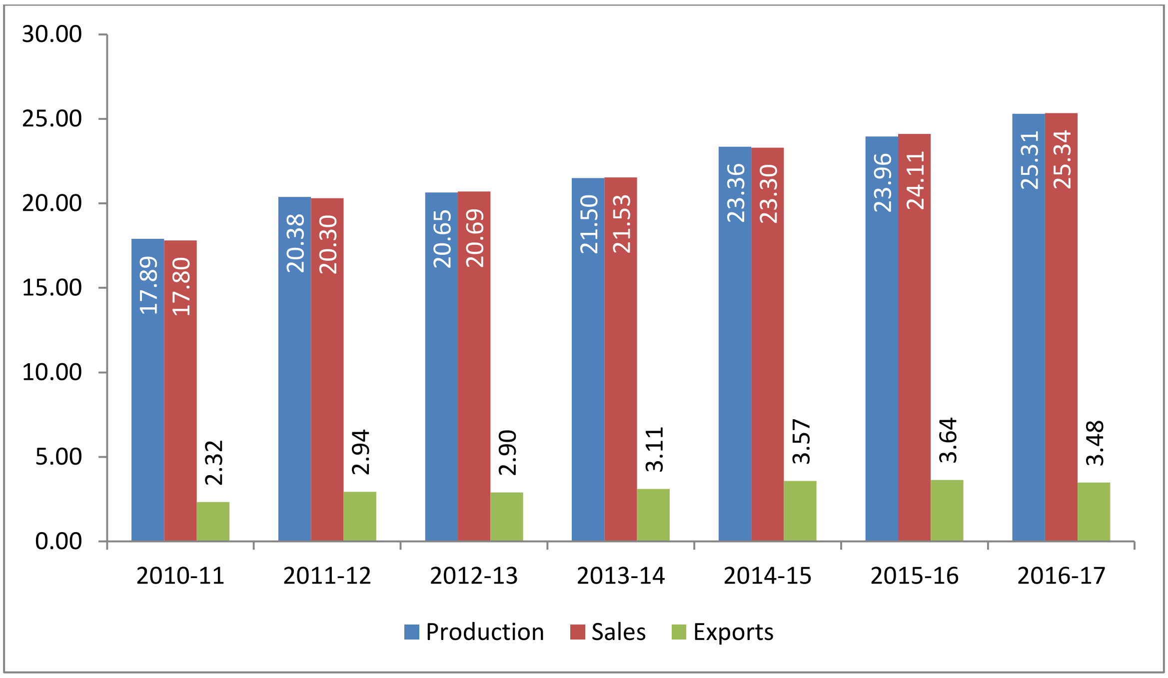
The industry accounts for 7.1% of the country's Gross Domestic Product (GDP). ***The Two Wheelers segment is the leader of the Indian Automobiles market with 79%*** *market share owing to a growing middle class and a young population. Moreover, the companies growing interest in exploring the rural markets further aided the growth of the sector.* ***The Passenger Vehicle (PV) segment has 15% market share.***

India, being a prominent auto exporter, the exports stood at about 14% of the automobiles produced annually. However, exports declined by 4.5% in 2016-17 after growing marginally by about 1.9% y-o-y in 2015-16. In 2016-17, exports of Passenger vehicles and Commercial Vehicles slowed down and grew by about 16.2% and 6.4% y-o-y. On the other hand, exports of Three-wheelers declined by a sharp 32.8% and exports of Two-wheelers declined by about 5.9% y-o-y during the same period due to currency issues in key global markets (Africa and Latin America) along with low crude prices.

Performance review:

Trends in Automobiles industry:

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



Source: SIAM

2016-17 has been an eventful year for the auto industry.

- The early part of the year saw a revival trend in the automobile sales which was plagued due to massive demand fall in the rural market owing to uneven and delayed monsoon in the previous year.
- The ban on diesel cars further hurt the automobile industry.
- Second half of 2016 had started witnessing strong positive sentiment this was backed by factors such as improved consumer sentiments post the Seventh Pay Commission, normal monsoon after two successive years of deficit rainfall in most regions, lower financing costs (banks base rates have declined from 10.75% in December 2011 to 9.65% in December 2016) fuel prices and healthy replacement demand due to diesel car ban.
- As soon as the industry was about to pick up speed, demonetization was announced by the government in November 2016. This led to de-growth in the auto industry during December 2016.

Performance of the industry in FY17

Table 1: Growth in sales

Category	Actual FY17
CVs	4.4%
PVs	10.5%
Two & Three wheelers	4.2%

In FY17, total auto sales increased by about 5.6% y-o-y after increasing marginally by about 2.6% in FY16.

Passenger Vehicles:

- The passenger vehicle segment sales increased by 10.5% y-o-y on account of new launches, stable crude oil prices, reduction in interest rates and improvement in the economic scenario that boosted the industry demand.
- As estimated, a strong sales growth of about 29% was registered in sales of utility vehicles (UVs), while the growth in passenger car segment was 5.8% and growth in the van sales was 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 nearly 50% of the overall TW demand. On account of favourable monsoon in most parts of the country for 2016, the two & three wheeler segment sales increased by 4.2% y-o-y.
- However, the growth was restricted on account of lower sales of three wheelers. The three wheeler segment sales declined by about 17% y-o-y led by a sharp dip in exports during the period. Exports declined by a sharp 33% during the period on back of combination of factors such as regulatory moves by countries like Sri Lanka (hike in import duty) and Bangladesh (as per new regulation three-wheelers not allowed to operate on highways), currency fluctuation and reduction in export incentives. Also, in the domestic market, demand for three-wheeler goods carriers' remained under pressure due to competition from Small Commercial Vehicles (SCVs).
- In two wheeler segment, scooters and moped sales grew at a faster pace of about 14% while motorcycle sales grew at a slower pace of over 2% during the year.

Commercial Vehicles:

- Commercial vehicles segment sales grew by about 4.4% with uncertainty revolving around the migration of CV manufacturers to Bharat Stage (BS) IV emission norms from April 2017 by the government.
- While we expected demand to be higher for CV segment as the BS IV vehicles will relatively be more expensive and pick up in industrial activities, growth was restricted on account of cash crunch in Q3 and Q4 as the fleet owners postponed their purchase.

Outlook:

In 2017-18, CARE Ratings expects the industry to witness gradual pickup in demand as the effect of demonetization begins to moderate. Also, demand is expected to improve on back of various initiatives taken by the government in the Union Budget 2018. Higher allocation for infrastructure and transportation segment is likely to benefit the commercial vehicles demand during the year. Allocation to farm credit has been increased which is expected to fuel demand for the tractors segment. Also, reduction in tax burden for individuals with income below Rs 5 lakhs is likely to have positive impact on the two-wheelers and small cars demand.

The investment required in order to ensure improved emission standards is likely to pose a challenge for the players. Also, apart from demonetization, car manufacturers are also unsure about the uncertainties surrounding the implementation of the GST.

Table 2: Growth in sales

Category	FY18 E*
CVs	12-13%
PVs	12-13%
Two & Three wheelers	10-12%

E - Estimated

Main drivers for these growth rates:

- Common assumption is that GST will be neutral in cost and price impact
- GDP growth to be higher at above 7.5%
- Repo rate can only decrease and hence rates to be stable
- Good monsoon and farm income

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
Commercial vehicles	Pick up in industrial production, GDP, stable interest rates

Factors to watch for in 2017-18:

- Higher outlay in Budget 2018 for infrastructure and transportation 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 impact the demand for new passenger vehicles and commercial vehicles in the future.
- Reduction in the tax burden of individual with an income of Rs 2.5 lakh to Rs 5 lakh is seen as a big positive with higher disposable income in hands of buyers. This will increase demand for the small cars and two wheelers. Two-wheelers demand is expected to improve on back of steady 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.
- With GST being implemented in 2017-18, raw materials cost is expected to be lower and prices will follow improving the demand. This will thereby support the margins of the automobile players. However, it will take some time for things to normalize after the impact of demonetization drive on the sector.

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