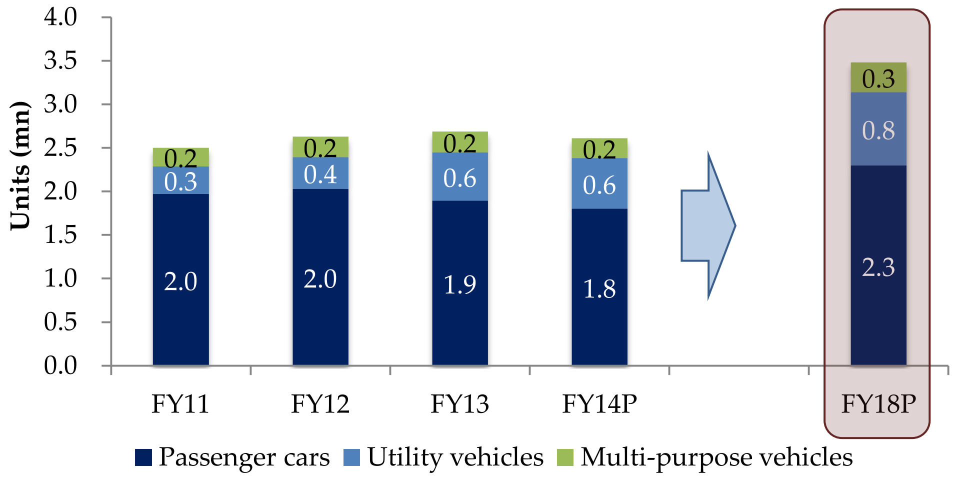
"Economic headwinds make ride difficult for Passenger Vehicles"

The previous two fiscals FY12 and FY13 were one of the most challenging periods for the passenger vehicle (PV) industry in last one decade as the sector managed to pose a modest rise of 5 per cent and 2 per cent respectively. CARE Research believes scenario to worsen in FY14, as PV industry is expected to witness drop in its domestic sales, which would be first time since FY01. CARE Research estimates drop in the domestic sales would be in a range of 3-4 per cent in FY14. Current concerns over slowdown in economy is suppressing jobs creation in the country and thereby straining purchasing power. Moreover, factors like high inflation, increasing fuel prices coupled with firm interest rates has considerably raised ownership cost of the vehicles in past couple of years. However, one of the lowest penetration levels among the key developed and developing countries still presents healthy growth opportunity for the industry in India in long term.

Outlook of domestic PV industry



Source: CARE Research and Society of Indian Automobile Manufacturers (SIAM)
Note: - P: Projected

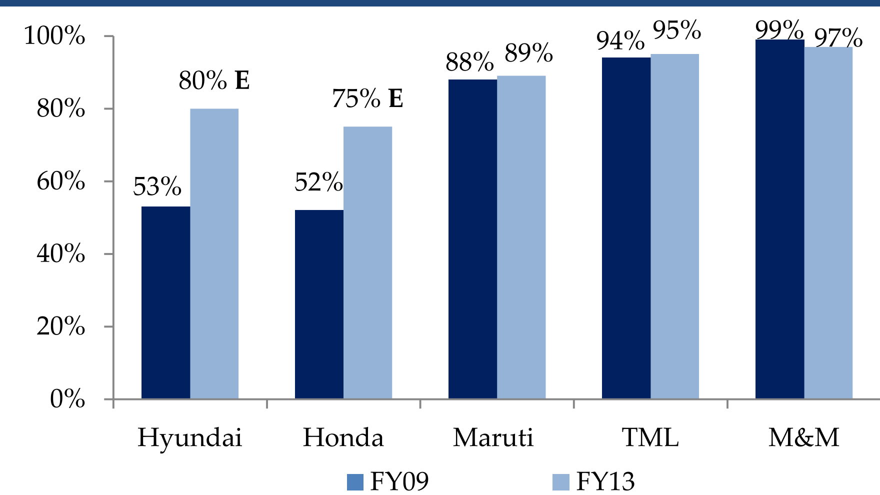
High ownership cost coupled with declining per capita income hurting PV sales

Ownership cost of vehicles has witnessed a surge in past few years on the back of rising fuel prices and firm interest rates. Fuel cost constituted around 35 per cent of ownership cost in FY10 whereas the same in FY13 stands at around 45 per cent. Similarly, repo rates, which were around 4.5 per cent in FY10, are hovering around 7.5 per cent in FY13, which has thereby increased the interest rates on car loans from around 10-11 per cent in FY10 to around 12-13 per cent in FY13. The rise in the income levels on the other hand could not keep abreast with rising ownership cost. Weak economic environment due to slump in infrastructure, construction activities combined with slowdown in agricultural production in past couple of years led to drop in income levels. Furthermore, spiraling inflation levels drilled a hole in consumer's pocket leading to strained purchasing power of urban as well as rural consumers and thereby impacting the consumer confidence levels. High ownership cost coupled with decline in purchasing power has led to considerable slump in the growth levels of PV demand during last fiscal.

Rupee depreciation - eroding industry profitability

According to federation of Indian chambers of commerce and industry (FICCI), Indian automotive industry imports around 30 percent of auto components used in the domestic market. Major components imported by PV players are brakes, gears, airbags, fuel tanks, suspension system, steering systems and seat belts. Thailand and Japan are the main exporters of auto components to India. Imports by OEMs can be directly or indirectly routed through vendors. In both the cases rupee depreciation with respect to dollar leads to higher input cost which in turn results in depletion in bottom line. In addition to increased input cost, depreciation of currency also leads to negative impact on bottom line of the players with foreign borrowings and royalty liabilities towards the parent. Input cost fluctuation due to currency movement can be mitigated by increasing level of indigenization; however, increasing localization levels is time consuming and cannot be altered in the short run. Moreover, some cost and technological advantages of foreign vendors makes it beneficial to import irrespective of import duties and currency disadvantages.

Indigenisation levels across key players



Source: CARE Research & Industry

Note:-E: Estimates

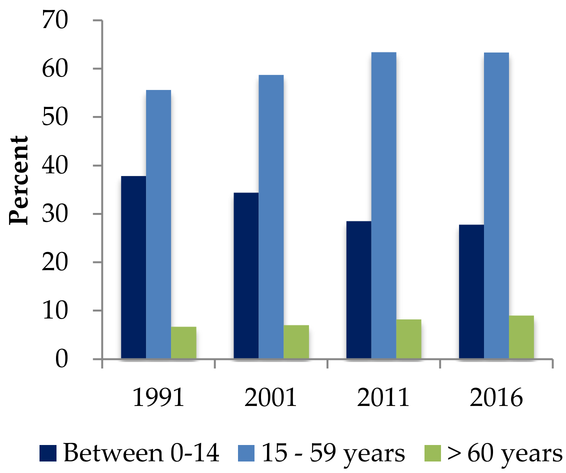
While the indigenization level of domestic players is very high, the indigenization level of foreign OEMs is still less than 80 per cent. In case of some global OEMs like Toyota Kirkloskar, Ford, FIAT, etc CARE Research estimates localization levels is as low as 70 per cent. CARE Research expects foreign OEMs to gradually increase level of indigenization from current levels to 80-85 per cent in 2-3 years period thereby decreasing their dependence on imports.

However in the short term, CARE Research expects OEMs to hike prices in order to arrest the impact of depreciating currency on bottom line which can cause drop in demand for already slowdown hit passenger vehicle industry. In addition to the above, depreciating rupee is also resulting in rise in fuel prices. Fuel prices being major ownership cost component comprising 40-45 per cent of annual cost of owning a vehicle in FY13, high fuel prices would also discourage people from buying vehicles in the short term. Hence depreciating rupee is causing double whammy for OEMs as on the one hand currency depreciation is resulting in increased vehicle prices and on the other hand it is leading to high ownership cost.

Strong fundamentals like growing young population, low penetration indicate a healthy future for PV industry, however economic revival holds the key for recovery

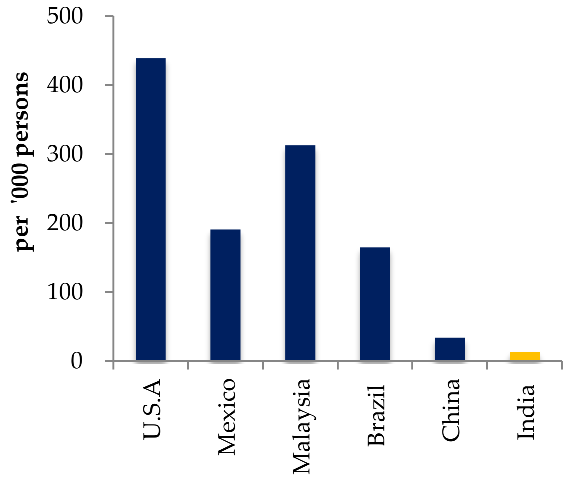
India’s large pool of young population is a strong fundamental driver for domestic PV demand. With rise in the income levels in last one decade the PV penetration has almost doubled from 2001 levels; however penetration still remains one of the lowest when compared to other countries with similar economic stature. The low penetration along with high percentage of working population would boost growth for PV industry in the future. However, revival of economy remains pre-requisites for the PV demand growth.

Chart: Age composition as percentage of the total population



Source: National population commission

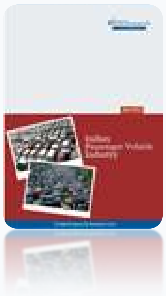
Chart: Global PV penetration



Source: MORTH and CARE Research

Economic uncertainties to fade away and growth to revive at a healthy level in medium to long-term period...

After successfully weathering the liquidity crises of FY08 and FY09, the economy again witnessed slowdown in beginning FY12 because of spiralling inflation and high lending rates. However, the demand drivers like higher working class population, high percentage of literate workforce, low cost of skilled labour, low supply as compared to demand etc; together still make a compelling case for the healthy economic scenario in the future, subject to policy implementation & good governance by the government. CARE Research expects economy to revive after 2014 general elections. Newly elected government would be in a better position to take decisions and take policy stands that would give desired impetus to slowing economy and would attract higher investment. CARE Research expects short-term economic uncertainties to fade away and growth to revive at a healthy level in medium to long-term period that would in turn fuel the rise in income levels and consumer confidence levels.



To subscribe to our report on '**Indian Passenger Vehicle Industry – 2013**', please contact careresearch@careratings.com.

Click on the icon to see the ***Table of Contents*** and ***Brochure*** of the report.

Contact:

Revati Kasture	*Vishal Srivastav*	*Samay Ganhar*
Head - CARE Research	***Manager***	***Analyst***
revati.kasture@careratings.com	*vishal.srivastav@careratings.com*	*kunal.maheshwari@careratings.com*