

Impact Analysis: Ban on sale of BS-III vehicles

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In what could be a major setback to the Indian automotive industry, Supreme Court has banned sale of Bharat Stage III (BS-III) vehicles after March 31, 2017.

The automobile industry has an unsold BS-III vehicles inventory of ~8.24 lakh units (Commercial vehicles – 96,700, Passenger vehicles – 16,198, Three-wheelers – 40,000 and Two-wheelers – 671,000). **As per our estimates the value of these BS-III vehicles is around Rs 14,000 crore.** Of the total two wheelers, Hero Motocorp has close to half of BS-III vehicles in its inventory.

The Supreme Court in its ruling held that it is important for the industry to move away from commercial losses and focus on environmental norms given deteriorating pollution conditions. BS IV emission norms come into effect from April 1, 2017. While most passenger vehicle makers have shifted to producing BS IV-compliant vehicles, two-wheeler, three-wheeler and commercial vehicle manufacturers were producing BS III vehicles with government notifying March 31, 2017 as the last date for manufacturing of such vehicles. An appeal was, however, filed before the Supreme Court stating that continuation of sale of BS III vehicles beyond March 31, 2017 would adversely affect the environment as usage of BS IV fuel in BS III vehicles would fail to resolve concerns over air pollution.

Earlier, the centre had come out in support of the auto-makers, requesting the apex court to allow companies to exhaust the BS-III stock post the deadline. The manufacturers also conveyed to the court that it was technically and financially impractical to convert BS-III vehicles to BS-IV.

Due to the court's ruling, automobile manufacturers have two choices: one being pushing sales in the next 2 days with various alluring offers and second, exporting the stock.

As per CARE Research, considering the average per day sales for 2016-17 (Apr-Feb), the new inventory comes down to 6.84 lakh units in case sales are enhanced by 2 additional day's volume of sales (that is for 30th and 31st March). This would reduce the inventory to zero for passenger vehicle stock. **However, the cost of the unsold inventory of CV & Two & Three wheelers would be around Rs 12,500 crore as on 1st April, 2017.**

For the manufacturers/dealers, the cost of working capital (taken at 10%) is calculated to be 1,250 crore per annum. If the players export the remaining stock, it will take about 10 months to clear the CV stock and about 3 months to clear the Two & Three wheelers stock (considering the category wise monthly average export sales in 2016-17). Therefore, the additional cost of holding the inventory post the ban will be about Rs 105 crore per month. The normal holding period of stock is about 1 month and hence the additional holding of stocks would amount to **around Rs 800-1000 crore as interest cost assuming all this stock is exported over a period of time.**

Also, with BS-IV norms coming into effect, the vehicles cost will be relatively higher than the present BS-III vehicles. The auto players overall cost of production will increase leading to impact on the overall demand of the automobile industry. For eg: Costs for the truck (MHCVs) segment are expected to be higher by 10-12% of the existing cost. In value terms, the cost could increase by Rs 1-2 Lakh according to market sources. Also, the fuel used in BS-III compliant vehicles cannot be used in the BS-IV vehicles.

The S & P BSE Auto index lost 108 points today even while the Sensex was up by 122 points. Quite clearly the impact of this move is taken to be negative for this sector, with stocks of Hero Motoco, Tata Motors, M & M, Maruti Suzuki, Ashok Leyland being affected.

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