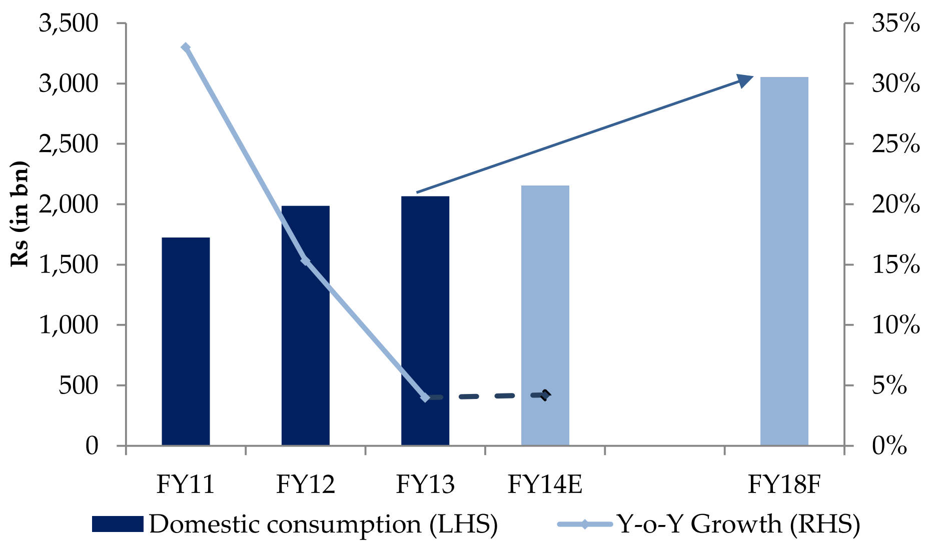
"Revival in OEM demand remains an elusive dream in short term"

The sluggish demand scenario in most of the segments in automobile industry impacted the growth levels of the auto component industry during last two fiscals. The growth of auto component industry turnover dropped considerably from around 35 per cent in FY11 to around 15 per cent in FY12 and further to around 4 per cent in FY13. The OEM demand which constitutes around 62 per cent of industry turnover was the worst hit. However, strong rise in exports supported by healthy growth in replacement demand helped industry to remain afloat in FY13. CARE Research foresees FY14 is not expected to bring substantial respite in demand for most of the segments in automobile industry, which would in turn pose testing times for the component manufacturers. CARE Research believes auto component manufacturers have to derive new strategies like expanding product offering to cater larger end user industry base, focusing on exports markets, improving technology, etc. to negate the impact of demand slowdown.

CARE Research estimates industry demand to grow at moderate levels in FY14. This growth would be driven by buoyant exports supported by healthy rise in replacement demand. CARE Research foresees the industry would also be benefited on the back of increasing localisation drive by global OEMs in order to cut down cost.

Outlook on domestic component market

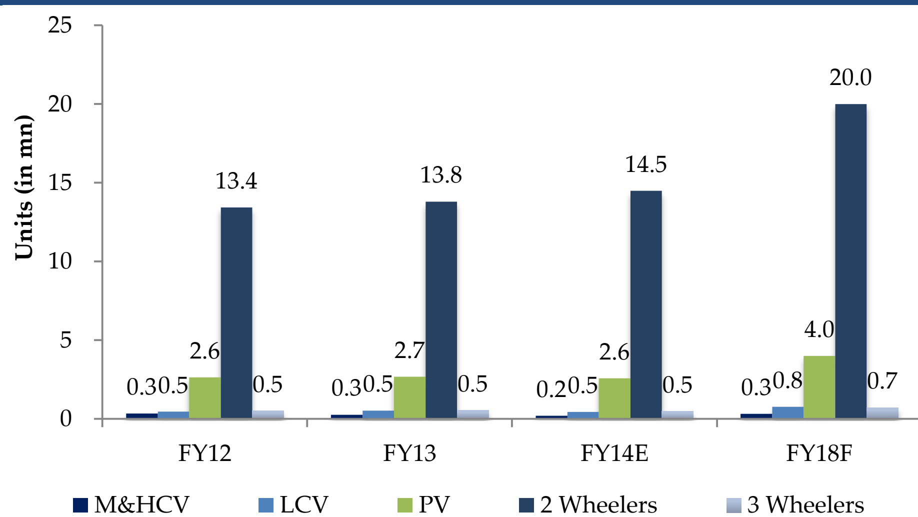


Source: ACMA and CARE Research
Note:
E: Estimates
F: Forecast

Sluggish demand in key segments in automobile industry affected OEM demand

FY13 and FY14 were the most challenging for the automotive industry in the last decade. All the segments in automotive industry (i.e. commercial vehicles, passenger vehicles, two wheelers, three-wheelers and tractors) witnessed significant drop in growth levels. Commercial vehicle goods carriers (GCs) demand was affected the most, as slowdown in the economic activities considerably pulled down the demand. Persistent retardation in economic growth finally took a toll on PV domestic volumes in FY14. Prior in FY14, impressive rise in utility vehicle demand kept PV sales afloat; however slip in UV sales this fiscal pulled down PV domestic sales. Slowdown in new job creation coupled with rising inflation and spiralling fuel prices considerably also constrained PV demand during last two fiscals. Two wheeler (TW) segment was the lone performer in the automobile industry, as it managed to show a modest rise during both FY13 and FY14, mainly driven by healthy growth observed in scooter segment.

Outlook on segment wise domestic automobile sales



Source: CARE Research
Note:
E: Estimates
F: Forecast

OEM demand to remain subdued in short term, however, exports and replacement demand would continue to grow

OEM demand constitutes round 62 per cent of total auto component turnover. This segment witnessed a strong growth of around 30 per cent in FY11, on the back of robust automobile sales. However, slowdown in the growth levels in automobile sales also led to moderation in OEM demand to around 15 per cent in FY12 to around Rs 1,474 bn. Since FY13, OEM demand plunge even further as it dropped by around 8 per cent to around Rs 1,354 bn in FY13. CARE Research estimates OEM demand would continue to remain under strain in FY14. However, as the economic concerns are expected to fade away in the medium term, vehicle demand will revive gradually, providing support to OEM segment demand.

CARE Research believes huge pile up of vehicles owing to strong demand scenario during last one decade has fuelled demand from the replacement market during last 3-4 years. During FY08-FY13 period replacement demand has increased at a CAGR of around 18 per cent. Even in FY13, replacement market has clocked growth of around 8 per cent on y-o-y basis to Rs 320 bn. CARE Research foresees replacement demand would continue to remain healthy.

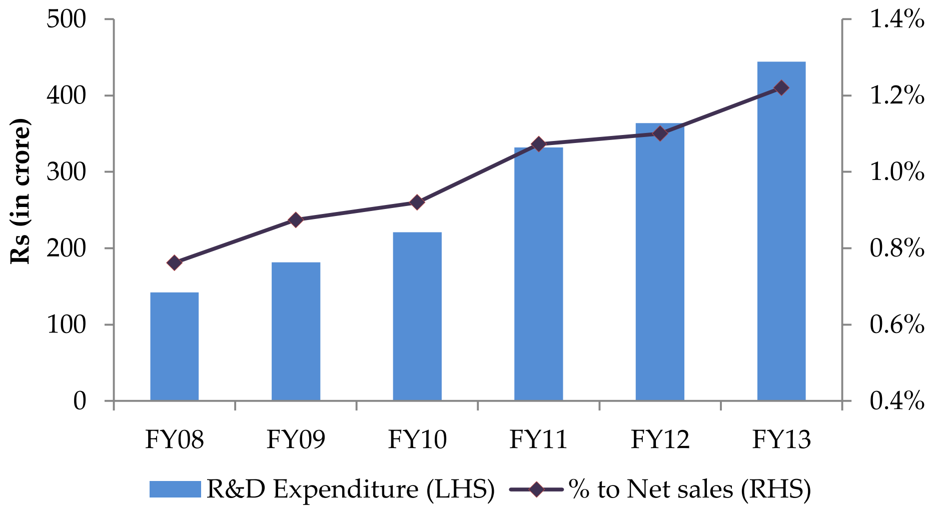
Exports have been driving industry growth since last few years. During FY08-FY13 period, auto component exports have increased at a CAGR of around 27 per cent to Rs 506 bn. In FY13, strong growth of around 51 per cent observed in exports kept industry demand afloat. CARE Research projects auto component exports would continue to remain strong on back of cost effectiveness of Indian auto component suppliers.

Increased investments towards technology would benefit component suppliers to reap the benefit of indigenization drive among global OEMs

CARE Research has observed that R&D and technical knowhow expenditure of the major players although miniscule (i.e. less than 2.0 per cent of net sales) have been gradually increasing. Further, analysing the investment pattern of the key players in recent past, it is evident that players are incurring substantial capital expenditure towards developing or expanding new product lines.

As imports form substantial portion of inputs in automobile manufacturing, uncertainties arising out of sharp currency fluctuation are adding to the woes of OEMs. Hence, in order to curtail the burden of growing import bill almost all global OEMs are resorting to increased local sourcing. The indigenization level of domestic players was already around 95 per cent in FY12, indigenization level of foreign OEMs (barring recent entrants) stands between 65-70 per cent. CARE Research expects due to focussed efforts to cut down the cost by global OEMS, the localization levels are estimated to reach around 80 per cent in near term. Indian auto component manufacturers offer advantages like low-cost and adequate production capacity and ability to absorb advance technological changes. Further, cost cutting drive amongst all major OEMs across the globe has led substantial rise in component sourcing from low cost destinations like India during last 5-6 years. This presents a significant growth opportunity for the domestic manufacturers to become a part of the supply chain of global OEMs.

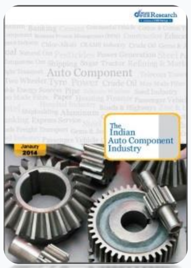
Trend in R&D expenditure for major auto component manufacturers



Source: ACE Equity and CARE Research

Increase in R&D has also helped in enhancing global footprints through increase in exports

Growing thrust of domestic component manufacturers to expand their footprints globally has led to rise of exports in past couple of years. Further in FY13, exports were also benefited owing to sharp devaluation of rupee against US dollar. Rising exports acts as natural hedge for the players from the volatility of domestic market. Hence, CARE Research believes mounting export is an encouraging factor that has influenced increasing number of domestic component players to indulge in international best practices in order to improve their product and manufacturing technology. Hence in last few years some of the domestic component manufacturers have gradually started to enjoy level field with global auto component manufacturers in terms of quality and scale. Further, cost competitiveness and ability to effectively absorb changes in technology have led increasing number of domestic auto component players to become a part of the global supply chain of some of the leading OEMs.



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