

Overall demand to record a growth of 12-14% in fiscal 2019 on back of healthy OEM sales and exports

Overall domestic auto-component production grew at 7% in fiscal 2017

- In fiscal 2017, overall automotive component industry has grown moderately on account of slower growth in replacement market due to demonetization, however healthy offtake from OEM (Original Equipment Manufacturer), and revival in exports due to the recovery in global economy had driven the growth.

Overall domestic auto component production to grow at 11-13% in fiscal 2018

- In fiscal 2018, we estimate that the OEM offtake has increased at healthy pace of 13-15% on account of expected growth in the two-wheeler due to improving rural sentiment; PV (passenger vehicle) due to increasing affordability, easier access to finance and various new model launches and in CV (commercial vehicle) space due to improvement in freight demand from sectors such as infrastructure.
- Exports is estimated to record a growth of 7-9% on account of improvement in global economy such as USA, stable growth in European countries and higher exports to emerging nations such as SAARC (South Asian Association for Regional Cooperation) countries.
- From April 1st, 2017 BS IV was implemented. The transition from BS III to BS IV led to the higher average realisation particularly for the commercial vehicle component manufacturer.

Overall auto component production to grow at 12-14% in fiscal 2019 supported by better growth in the domestic market and a healthy growth in exports

- We expect the industry to grow on the back of higher domestic demand across the vehicle segments over a high base of fiscal 2018. Higher demand is expected to be seen from CV segment because of the Government push towards end use segments such as infrastructure, support from Government in the form of MSP (Minimum Support Price) to aid the profitability of the farmers and boost tractor demand.
- Exports is expected to register a growth of 8-10% in fiscal 2019 due to improvement in Global scenario. Growth will be seen from countries such as USA and Euro zone. However, issues on global trade by Trump Administration remains a key monitorable. Our other export partners, such as Latin American and countries like Brazil are expected to recover from recession. Crude oil price is expected to move north which signals improvement in Middle east economy.

Uptick in exports from fiscal 2018

Segments	2015-16	2016-17	2017-18 E	2018-19 P
OEM	7%	8.6%	13-15%	14-16%
Replacement	8%	7.5%	7-9%	7-9%
Exports	4%	1.0%	7-9%	8-10%
Imports	8%	3.0%	6-8%	7-9%

EBITDA margin to decline marginally by 40 bps in FY 2018 and remain stable in FY 2019

Prices of raw materials of automotive component manufacturers bottomed out in fiscal 2016 and began to rise in fiscal 2017, putting pressure on EBITDA (earnings before interest, tax, depreciation and amortization) margins. The auto raw material index rose from the second quarter of fiscal 2017 - leaving the year with a ~13% rise. We project the raw material index to increase further by 7-9% in fiscal 2018. We estimate margins to slightly decline by about 40 bps on-year to 13.5% by the end of fiscal 2018 for a sample set of 107 companies (representing 35% of the industry). Further in fiscal 2019, we expect the raw material index to grow marginally by 0-2%, thereby the operating margin to remain stable at 13.5% due to cost optimization techniques adopted by the players.

Capital expenditure to pick up in view of regulations and uptick in demand

In fiscal 2018, auto component players are estimated to have incurred a higher capex on account of Bharat Stage VI (BS-VI) norms which are to be implemented from fiscal 2021. Many players are also investing in new technology on the possibility of hybrid and electric vehicles hitting the ground soon. However, due to healthy outlook on the cash flow, we expect the debt protection metric to remain comfortable.

Healthy credit quality with improving cash accrual

Auto-component players have healthy credit quality metrics because of better operating efficiency and higher sales. During the past year, ratings for 37 companies were upgraded, whereas ratings for 26 companies were downgraded, with total outstanding amount of Rs 268 billion. Upgrades were due to the robust cash accrual, led by cost optimization efforts, moderate capex, prudent working capital management, and steady accretion to reserves. Operating profitability improved, driven by healthy demand, and triggered healthy cash generation. Companies with superior technical know-how and those well-positioned to take advantage of the business opportunities presented by the changing regulatory environment, have seen upgrades as they began to significantly scale up the volume.

Over the medium term, we believe automotive-component firms will have to make additional investments to upgrade their technology to meet the changing dynamics of the auto industry. Steady margins and higher turnover will maintain healthy returns despite higher capex spending. Healthy balance sheets and better cash flows will provide the necessary cushion to absorb higher capex requirement, without denting key credit metrics.

Long-term prospects remain robust

Long-term prospects are better than near-term numbers

- We expect domestic auto-component production to grow at a CAGR of 11-13% to ~Rs 4,717 billion between fiscal 2017 and fiscal 2022. In the long run, OEM demand is expected to grow at 11-13%, exports will grow at 10-12%.
- Higher realisation is expected across vehicle segments over the long term, as regulatory norms raise the cost of components.

- Higher cost of vehicles due to BS-VI implementation is expected to lower automobile demand and lead to temporal slowdown in component offtake in fiscal 2021, as prices are expected to rise sharply.
- Prospects of the auto-component industry will be guided by changes in products (a reduction in the weight of vehicles, by replacing metals with plastics and increasing electronic content) and regulations (emission and safety norms). Emerging technologies, such as automated manual transmissions, anti-lock braking systems, electronic control units/sensors, and advance engine designs hold immense medium-term growth potential. Requirement for safety systems such as lane assistance, distance control, and vehicle-to-vehicle communication is also rising.

Long term prospects remain healthy

Segments	FY 2012 to FY 2017	FY 2017 to FY 2022
OEM	5%	12-14%
Replacement	7%	6-8%
Exports	7%	10-12%
Imports	6%	6-8%

Source: CRISIL Research

- Exports will record a 10-12% CAGR between fiscal 2017 and fiscal 2022, as India serves as a hub for global OEMs to cater to the underlying markets. The rise will be higher than over the past five years exports growth because of India being positioned as a low-cost country.
- Auto-component imports (of which over 70% are estimated to cater to replacements) are forecast to expand at 6-8% CAGR between fiscal 2017 and fiscal 2022. Government in the recent budget of fiscal 2019 have raised custom duty on various components such as engine parts, electrical parts, steering and suspension parts. This will further boost the localization of the components.

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