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'Be the Bank of Choice for a Transforming India'

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UNDERSTANDING THE AUTO SLOWDOWN

The Automotive Industry is undergoing a serious slowdown for the past 4 quarters. The severity of the decline could be gauged from the fact that over a period of five years, the total quarterly production of automobile segment grew from 5.66 mn in Jun'14 quarter to 7.21 mn in Jun'19, a growth of 1.55 mn in a quarter. As against this, the quarterly registrations number recorded a YoY de-growth of 0.32 mn during June'19.

Our econometric decomposition exercise reveals the importance of 5 factors that may have resulted in declining auto sales :

- ***Decline in NBFC loans***: NBFC sector is currently facing liquidity issues since second half of FY19 after a few of the big NBFCs defaulted on their obligations. NBFCs were the major financers for customers who do not approach banks, hence, revival of lending by NBFCs is also critical. **The model assigns a 30% weightage to this factor in explaining the decline in auto sales.**
- ***Decline in Demand, particularly Rural:* A 20% weightage to this factor in explaining the decline in auto sales.**
- ***Higher Insurance & other Costs*:** Starting FY19 to FY21, vehicle prices are on an upward ride due to various safety, insurance and emission norms related compliance costs. This all put together will increase the acquisition cost by 2-5%. **A 10% weightage to this factor in explaining declining auto sales.**
- ***New Axle load norms enhancing capacity overnight by 20-25%*:** The decision to increase axle load helped increasing the carrying capacity of goods transport vehicles and bring down logistics cost. **Hence, a 10% weightage to increased axle norms in explaining declining auto sales, particularly CVs.**

There are several other factors too that have a combined weight of 30% in explaining declining auto sales**. These include a booming second hand car market.** In 2018-19, while new car sales were recorded at 3.6 million units, 4 million second-hand cars were bought and sold. **Car Rentals** and **EV policy** are also important factors in the Others Category. **Overall, it seems there has been a constellation of factors in explaining decline in auto sales but it seems declining rural demand and liquidity issues are explaining 50% of the reasons for such a fall.**

Customers could, however, be the ultimate beneficiaries! The automotive industry is currently undergoing a structural transformation like the insurance industry witnessed in 2010. The share of ULIP policies in total premium which then was 44% has now crashed to around 14%. This has been good for the customers, though the insurance industry went through a painful adjustment. In the same vein, we expect the automotive industry to perhaps painfully adjust to the new regulations.

AUTOMOBILE SECTOR IN LOW EQUILIBRIUM

- Almost all the auto manufacturers in India recorded decline in sales owing to weak consumer sentiments across all segments in Jun'19. Both rural and urban regions are going through demand distress. The automobile segment has been registering degrowth for the past 4 quarters. The broad reasons which could be associated with such sentiments generated in this sector are: (1) Cost increase owing to implementation of strict safety regulations etc., (2) Declining liquidity due to the NBFC crisis, (3) Overall slowing economy (4) Impacting of increased axle norms leading to suspending of purchase plans.

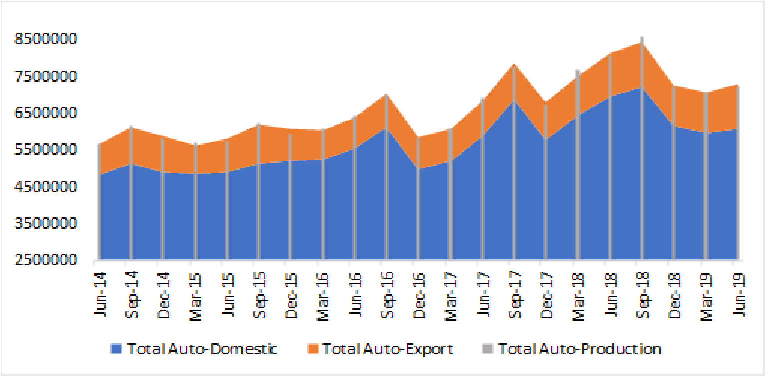
AUTOMOBILE SECTOR: STRONG BACKWARD LINKAGE TO GROWTH

- We believe that automobile is one such industry, which has strong backward linkage and is, therefore, critical for the growth of the economy. The increase in the automobile production increases demand for automotive parts and production of intermediary materials like steel, rubber, plastic, glass, paint, electronics and services.

OVERALL SLOWDOWN IN THE INDUSTRY

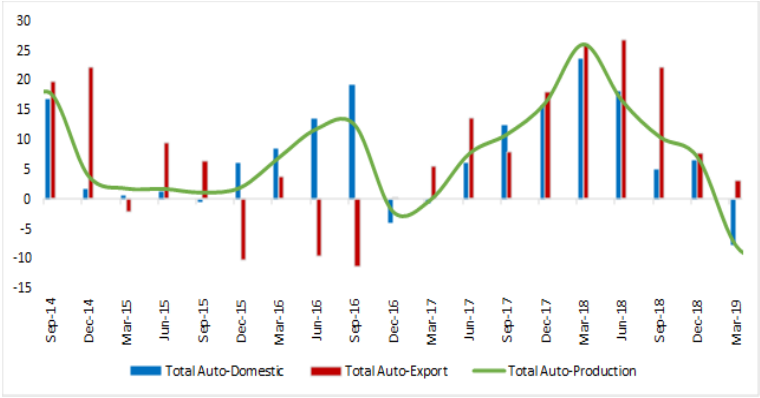
- There has been an overall slowdown in the industrial sector and the latest release of IIP number corroborates with such.
- Barring consumer non-durables, the slowdown has been felt in all the major segments. There looks to be a continuing slowdown and declining demand, which may keep the IIP growth at a lower side for a coming few months. The CPI has been marginally moving up, because it follows the movement of food prices with a lag.
- The low level of WPI and core WPI numbers, which are 31 month and 23 months low respectively indicates that the demand is tapering down.

Auto sale and production



Source: SIAM, SBI Research

Auto sale and production (YoY%)



Source: SIAM, SBI Research

PERFORMANCE OF THE AUTOMOTIVE SECTOR

- Over a period of five years, the total quarterly production of automobile segment grew from 5.66 mn in Jun'14 quarter to 7.21 mn in Jun'19, a growth of 1.55 mn in a quarter. As against this, the quarterly registrations number recorded a YoY de growth of 0.32 mn during June'19.
- It may be noted that during the period of five years domestic sales as a percentage of production has marginally come down to 84.35% from the Jun'14 level of 85.27%. On the other hand, exports have increased from 14.81% to 16.57%. The increase in exports by 42% in Jun'19 over Jun'14 corroborates with the increased share of exports in overall production. However, this still does not suffice for the significant decline in automotive production and registrations.

DETERMINANTS OF DOMESTIC AUTOMOBILE SALES IN INDIA

- We believe there are various factors that determine the sales of automobiles in India, i.e., the change in regulatory norms, declining rural demand, subdued global growth, increase in input cost etc, but domestic growth is one of key factor which largely drives growth in automobile sales.
- Interestingly, our econometric decomposition exercise reveals the importance of five factors that may have resulted in declining auto sales. These are in terms of their weightage, buckets.

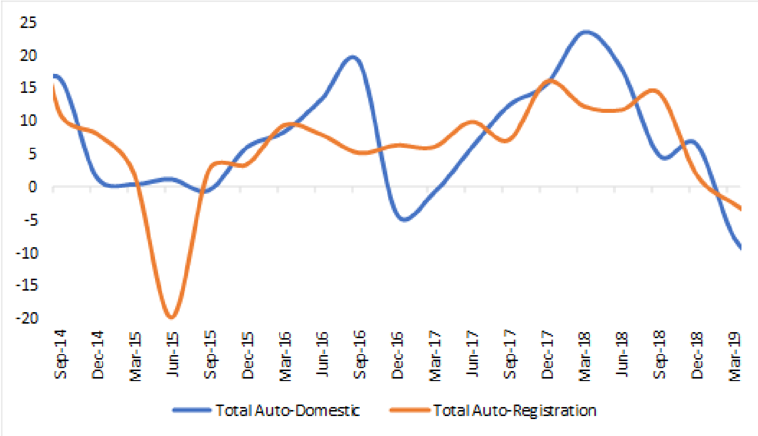
Decomposition of Factors for decline in Auto Sales	
Determinants	**Weight**
NBFC Loan	30%
Axle Norms	10%
Insurance Cost	10%
Rural Demand	20%
Other Factors	30%
Source: SBI Research	

- **Decline in NBFC loans (30%), Rural Demand proxied by Rural Wages (20%), Revised Axle Norms (10%), Higher Insurance Cost (10%) and other factors, like a jump towards second hand market, car rentals and EV policy (30%).**

COMPANY PERFORMANCE: MAJOR PLAYERS MICRO DETAILS

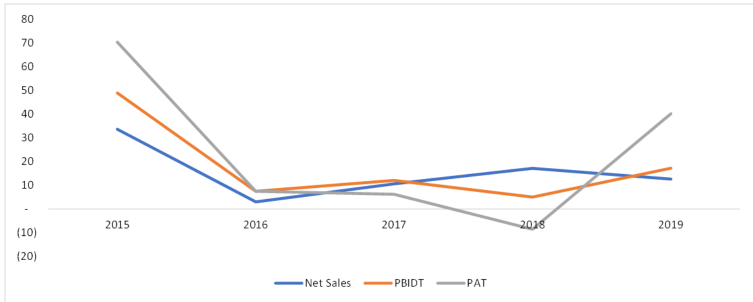
- Though, performance of the Auto and Auto Ancillary sector for the last 5 years, as reflected by the financials of the companies, report volatile trends, the declining growth in sales is common in FY19. While Auto has reported a lower y-o-y Net sales growth of 12% in FY19 against 19% of FY18, the Auto Ancillary sector has reported a lower y-o-y Net sales growth of 13% in FY19 against 17% of FY18.
- In PBIDT growth, however, the Auto sector registered a decline of 10 percentage point i.e. 11% in FY19 from 21% in FY18, PBIDT and PAT growth of Auto Ancillary improved during the same period.
- Revenue of Auto Ancillary has direct correlation with the Auto sector and a decline in unit sales number in Auto sector will also drag the Ancillary sector down in coming years.

Auto Sale and registration (YoY%)



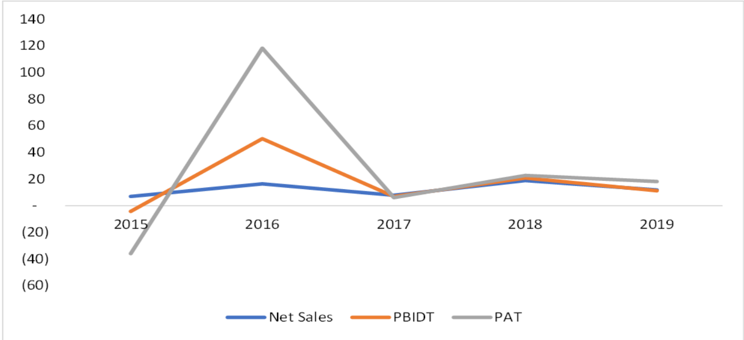
Source: SIAM, VAHAN, SBI Research

Auto Ancillary - Growth in Key Parameters (%)



Source: CLINE, SBI Research

Automobile - Growth in Key Parameters (%)



Source: CLINE, SBI Research

PROBABLE REASONS FOR THE SLOWDOWN IN AUTO SECTOR

NBFC CRISIS

- NBFC sector is facing liquidity squeeze since second half of FY19 after a few of the big NBFCs defaulted on their obligations. There has been a slowdown in Mutual fund flows who were a big supplier of credit to the NBFCs. Overall exposure of Mutual Funds to financial sectors decreased by Rs.64000 crore i.e. from Rs.2.66 lakh crore in July'18 to Rs.2.02 lakh crore in June'19. The percentage share also declined by 424 bps during the same period i.e. from 19% in July'18 to 14.8% in June'19. NBFC were the major financers for customers who do not approach banks, hence, revival of lending by NBFC is also critical and play an important role in Auto demand.

INCREASE IN ACQUISITION COST INCLUDING INSURANCE, GST ETC.

- Starting FY19 to FY21, vehicle prices are on an upward ride due to various safety, insurance and emission norms related compliance costs. For example, ABS for new model kicked in from April 2018, while insurance norms changed since Sept'18. Further ABS for all models was effected from 1st April 2019 while crash test and pedestrian safety norms will be kicking in from 1st Oct'19. This all put together will increase the acquisition cost by 2-5%. At the top of all this, BS IV norm will be applicable from April 2020 which will further make vehicle acquisition dearer by 2-8%. Impact will be higher on entry level vehicles and in PVs, significantly higher impact on diesel vehicles.

NEW AXLE LOAD NORMS ENHANCING CAPACITY OVERNIGHT BY 20-25%

- The Government on July'18, increased the official maximum load carrying capacity of heavy vehicles, including trucks by 20-25%. The gross vehicle weight of a two-axle truck (two wheels in the front axle and four wheels in the rear) has been increased to 18.5 tonne from the existing 16.2 tonnes, increasing the load carrying capacity by just over 20 per cent. For a five-axle truck, the vehicle weight has been increased from 37 tonne to 43.5 tonne, increasing the load carrying capacity by more than 25%.
- The decision to increase axle load will help in increasing the carrying capacity of goods transport vehicles and bring down logistics cost. The amendment increased the carrying capacity of goods vehicles by about 20-25% and lower logistics costs by about 2%, which ultimately has impacted the fresh sales.

OTHER FACTORS:

Increase in used car market

- Slowdown in new car sales also suggest that the demand is shifting towards the pre-owned market. The value of a car depreciates significantly in the first year itself, up to 50% for some models. From a buyer's perspective, the aspiration of owning a car is getting fulfilled at a lower price point.
- Over the past five years, the size of pre-owned market has expanded significantly, with higher share of organised players. In 2018-19, while new car sales were recorded at 3.6 million units, 4 million second-hand cars were bought and sold. India pre-owned car industry is expected to reach between 6.7 to 7.2 mn cars/year by FY22.

Impact of car rentals and mobility options

- With more number of options available in terms of car rentals etc. and increasing cost of acquisition of a vehicle coupled with high maintenance cost, there is a tendency of people to shift towards car rentals and other mobility options, especially in the metro and urban areas where there is availability of alternate mobility options.

EV policy

- In absence of clear migration policy towards EV and incentive towards migration to EV creates confusion amongst buyers and some are in wait and watch mode before taking a buying call.

THE OTHER ASPECTS OF DEMAND SLOWDOWN

- Overall the economy's exports seem to be lurching from triumph to despair with Jun'19 exports showing a marked decline as global trade tensions show no signs of easing. Lower exports, will affect the purchasing capacity of the economy, which is already struggling. Imports which are an indicator of the demand in the economy, have also gone down, though most of it is because of cooling crude oil prices. However, if we look at the other major imports, except Pearls, precious & Semi-precious stones, all of them have shown a negative m-o-m growth. On yearly terms as well, the decline is all-encompassing except for gold imports, which rose as risk aversion rears its head.
- When we look at the WPI numbers the manufactured products component has been sliding downward steadily since Nov'18, another sign of a slowdown. Within the manufactured products, the components like ready-made garments, basic metals (which include iron and steel and non-ferrous metals) are showing deflation. Inflation in manufacturing of machinery and equipment has remained more or less in range, while that of electrical machinery has come down.

India's Merchandise Trade picture

Top Exports	Value ($ bn)	M-o-M Growth Rate	Y-o-Y Growth Rate	Top Imports	Value ($ bn)	M-o-M Growth Rate	Y-o-Y Growth Rate
Engineering Goods	6.56	-12.0	-2.7	Petroleum, Crude & products	11.03	-11.4	-13.3
Gems & Jewellery	3.13	-8.2	-10.7	Electronic goods	4.81	-0.4	-1.7
Petroleum Products	2.73	-47.1	-32.8	Machinery, electrical & non-electrical	2.98	-12.8	-9.0
Drugs & Pharmaceuticals	1.84	9.0	16.2	Gold	2.70	-43.6	13.0
Organic & Inorganic Chemicals	1.64	-20.9	-8.2	Coal, Coke & Briquettes, etc.	2.15	-10.0	-3.4
RMG of all Textiles	1.23	-19.3	-9.2	Pearls, precious & Semi-precious stones	2.12	26.5	-23.6
Electronic Goods	0.93	2.3	43.8	Organic & Inorganic Chemicals	1.89	-13.0	-9.9
Cotton Yarn/Fab./made-ups, Handloom etc.	0.79	-10.5	-19.7	Iron & Steel	1.44	-4.9	-0.4
Plastic & Linoleum	0.67	-13.2	-6.5	Artificial resins, plastic materials, etc.	1.31	-8.0	-2.1
Marine Products	0.53	1.8	-4.2	Non-ferrous metals	1.14	-10.6	-12.4
Total Exports	25.01	-16.6	-9.7	Total Imports	40.29	-11.2	-9.1

Source: SBI Research

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