INDIRA Gateway to Prosperity

Sector Automobile

Auto industry on recovery path; outlook cautiously positive for FY15

OCT 31, 2014

With early signs of economic recovery, India's Auto industry appears on path of strong recovery after a grim period of falling sales and chronic overcapacity. Improved consumer sentiment along with government's initiatives to bring in more foreign direct investment into the country and create jobs could be attributed as key factors towards the slow but steady momentum of Indian auto industry's performance. This along with the recent cut in fuel prices and the extension of the excise duty cut also is positive for the industry. In a major and much awaited reform, the government de-regulated retail prices of diesel, which will now reflect international movement in oil prices. The development brought an immediate respite of about Rs 3.50 per litre on diesel prices, making the first reduction in diesel rates in over five years after 2009.

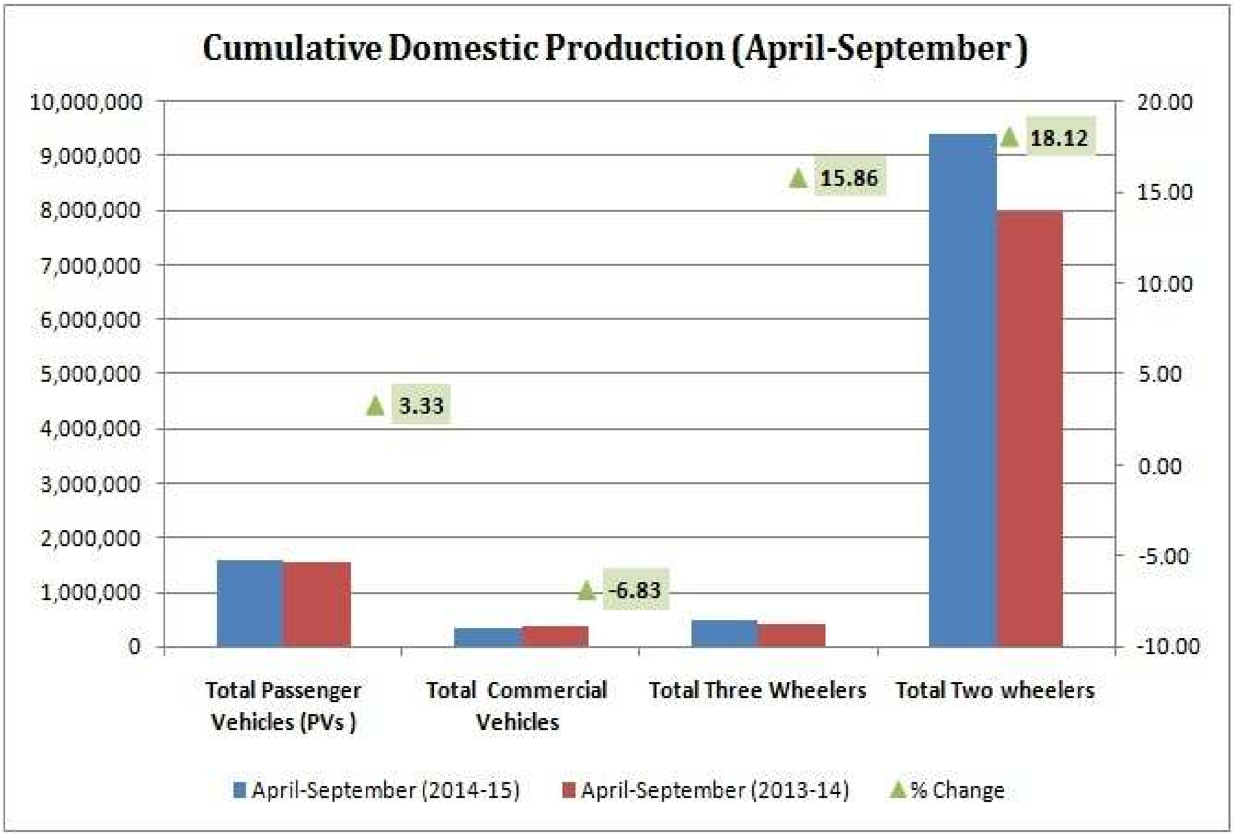
Further, the new found confidence of the industry is also being reflected from slew of launches made by the companies. While the new generation of Mahindra's Scorpio and Skoda Auto's Rapid, Maruti Ciaz has already been launched and have turned out to be success, Mercedes Benz GLA Class, a classy SUV, also has made its debut.

Performance of the Industry:

The first six months of FY15 have been fairly decent for Auto Industry, which has mostly witnessed growth almost on all the fronts including production, sales and exports. However, it would yet take some time for the industry to completely stabilize since the production of commercial vehicles segment continues to show de-growth indicating lack of demand for this segment of vehicles.

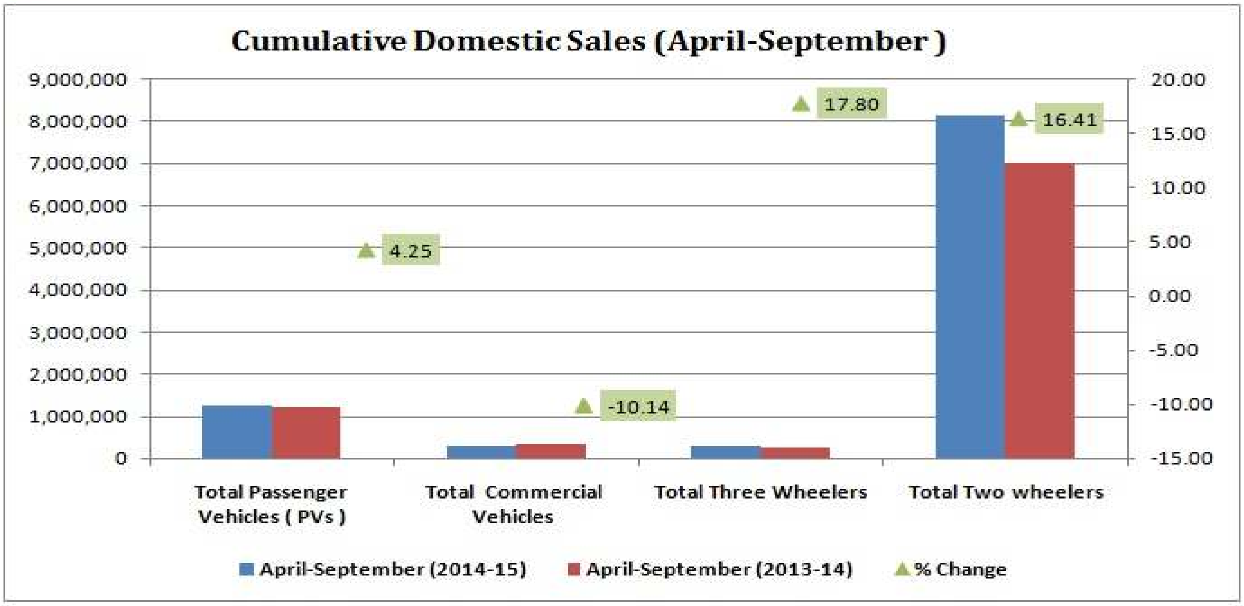
Production: April - September FY15

In the first six month of FY15, a total of 11,831,693 vehicles were produced which is 14.95% more than that produced in the same period in 2013-14. Barring the commercial vehicle segment, all the other segments recorded growth in their production in the run up to festive season, improving consumer sentiment and declining prices of fuel. However, Commercial vehicle sales continue to perform poorly in the face of India's industrial slowdown, with sales of vans and trucks declining once for sixth straight month in the month of September. The total production of passenger vehicles in the first six months of FY15, i.e. April-September has declined by 6.83% at 338,909 vehicles as compared to 363,745 in the same period of the previous year. On the flipside, the production of two-wheeler segment registered 18.12% growth at 9,429,850 vehicles as compared to 7,982,963 vehicles in the same period the previous year; this was followed by total Three Wheelers segment, which produced 478,733 vehicles against 413,194 in the same period the previous year, up by 15.86%. Lastly, passenger vehicle segment recorded 3.3% growth by producing 1,584,201 units as compared to 1,533,131 units produced in the corresponding period of 2013-14.



Domestic Sales: April - September FY15

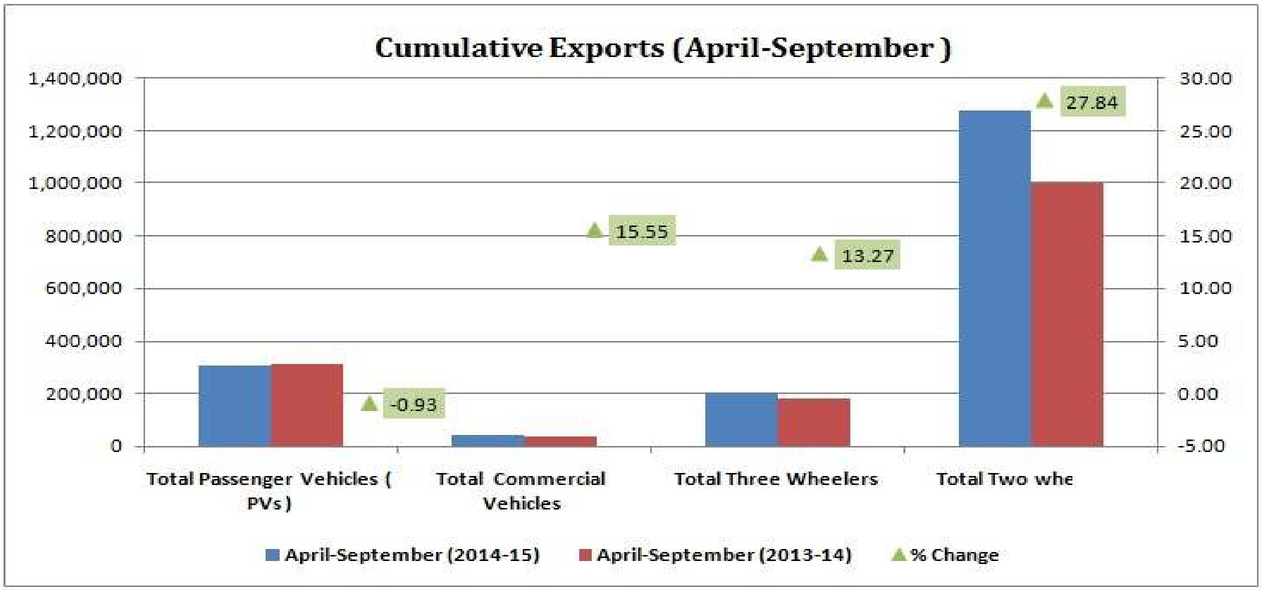
So far, in FY15, total sales of the Auto industry has gone up by 13.80% at 9,997,438 vehicles as compared to 8,784,957 vehicles during the previous financial year on higher demand, helped by the change in the government and improved sentiments. Among all the categories, only sales of commercial segment dropped by 10.14%, while those of two wheeler and three wheeler segment recorded growth of 17.80% and 16.41% respectively. Also, passenger vehicle segment recorded growth of 4.25% at 1,252,318 vehicles for the period under review, as compared to 1,201,254 vehicles in the April- September period in the previous year. Further, month of October, comprising of more than half a dozen festivals, is likely to be a bumper month for auto manufacturers. It is expected to provide a new lease of life to an industry on the road to recovery after two years of dismal sales.



Exports: April - September FY15

The industry has recorded growth of 19.99% in exports for the first six month of FY15 at 1,826,831 vehicles as against 1,522,445 vehicles in the previous financial year. Out of the total, exports from Passenger Vehicles segment has only fallen, but by a modest 0.93%, while all the other segments including Two wheelers, Three Wheelers and commercial vehicles registered growth of 27.84%, 13.27% and 15.55% respectively.

Presently, India is the world's third largest exporter of two-wheelers after China and Japan. The country is increasingly gaining market share in Africa and Latin America from their Chinese counterparts, which are struggling with rising labour costs and quality issues.



Positive Developments for Auto Industry:

Green signal to the long-due Goods and Services Tax (GST): The finance Minister during the budget affirmed that they were looking forward at resolving issues relating to the comprehensive indirect tax, within this year. Introduction of GST would ensure that all the other direct taxes levied on goods and services by the Central and State government were abolished and GST would be applied concurrently by the Centre and States. Further, the government has prepared a revised Constitution Amendment Bill for the Goods and Services Tax (GST) that largely accommodates the demands made by states. According to the revised Constitution (115th Amendment) Bill, the proposal of dispute settlement authority has been dropped as demanded by the states and it has also been agreed to include a floor rate with bands to allow them the freedom to have a high or low rate. This revised Constitution Amendment Bill to roll out goods and services tax (GST) would be introduced in the forthcoming winter session of parliament.

The government proposes to implement the goods and services tax (GST) from April 1, 2016, and the new Finance Commission may be set up ahead of its schedule to look into the issues related with the new indirect tax regime. Introduction of GST, which has been pending for some time now will also ensure higher revenue collection for the states and in turn would help the tax administration to avoid any sort of harassment of business.

Sanction of 15% allowance for a three-year period to manufacturing SMEs that look to invest over Rs 25 crore in plant and machinery: This announcement in turn is expected to encourage the automotive SMEs in India and also allow global auto-units to operate locally soon. With this, SMEs which manufacture cars, would be able to invest more, which in turn would led to improve the product quality and labour conditions. Furthermore, it will also decrease the price of car components and make cars and its components affordable for buyers.

Extension for Excise Duty Cuts: Notably, before the new government announced budget, it decided to extend the excise duty perks, which were announced by the previous government in February this year, till December in order to boost the sluggish sales of the industry. The excise duty cut otherwise was set to expire on June 30.In the interim Budget, excise duty on small cars, scooters, motorcycles and commercial vehicles were cut to 8% from 12% earlier. The same for SUVs (sports utility vehicles) was slashed to 24 per cent from 30 per cent, while on large cars it was reduced to 24% from 27% earlier and mid-sized cars to 20% from 24% previously.

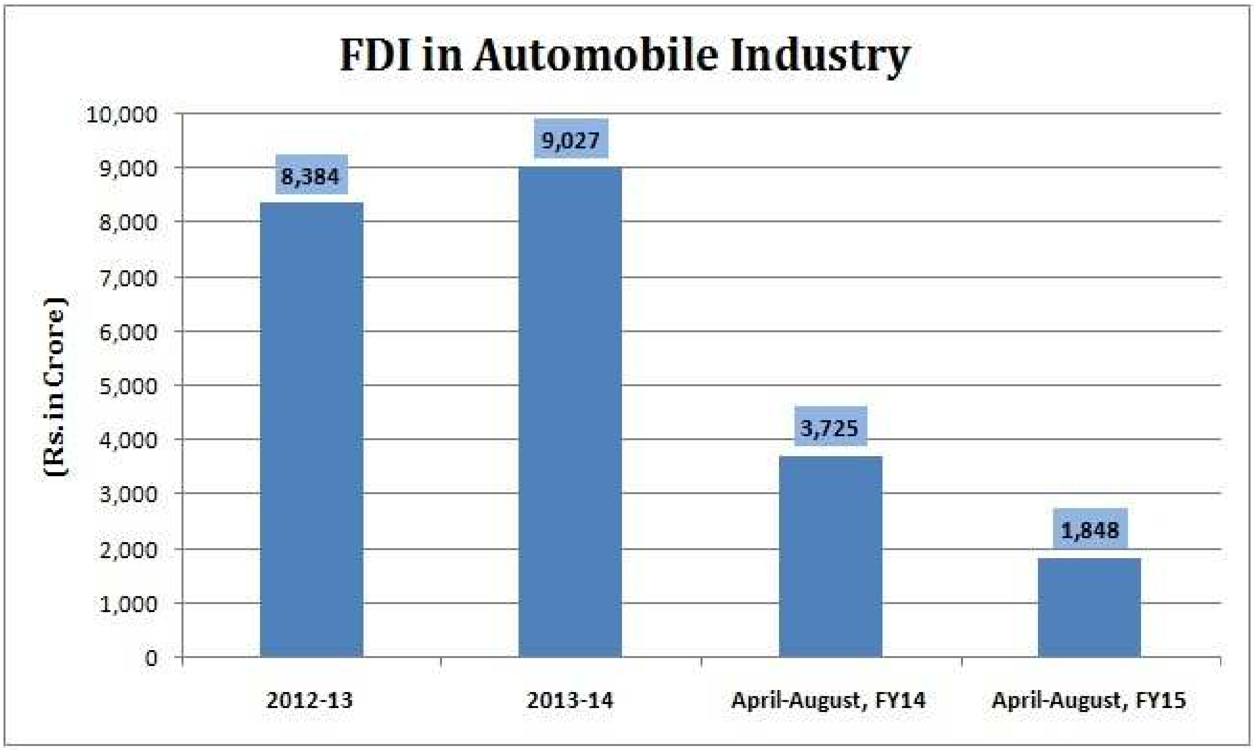
Declining fuel prices: Marking the second reduction in the month, Oil marketing companies yet again cut petrol prices by Re 1 per litre in mid of October. The companies had last cut petrol price by 54 paise on October 1. However, after accounting for the incidence of local sales tax, petrol rate in Delhi was reduced by Rs 1.21 a litre to Rs 66.65 per litre, while in Mumbai, it was cut from Rs 75.73 to Rs 74.46 per litre.

Further, with crude prices dipping to four-year low and the over-recovery or profit on diesel sales climbing higher, a cut of Rs 3.50 per litre in diesel prices was made effective in right after the state election as slump in international oil prices had helped nearly doubling of profit on India's most consumed fuel.

The consistent fall in international oil rates led to situation where state-owned oil firms started making profit on diesel sales, the first time in history. This situation definitely is positive for the industry, which was also witnessing sluggishness in its sales on account of burgeoning fuel cost.

Negatives/ Challenges of Auto Industry

Dwindling FDI in Auto: In a sign of worry, Foreign Direct Investment (FDI) in the Automobile sector dropped by 50.39% decline at Rs 1848 crore in April-August period of 2014 as against Rs 3725 crore in the same period of the previous year, i.e April- August period of 2013. Meanwhile, FDI in the sector stood at Rs 9027 crore in FY14.The cumulative foreign direct investment (FDI) inflow into the Indian automobile industry during April 2000 to August 2014 was recorded at Rs 50,044 crore, amounting to 4% of the total FDI inflows, as per data published by Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce.



Infrastructure Challenge: Road infrastructure is a crucial factor that affects the automobile industry. India's road infrastructure is not properly developed and lags way behind the pace at which the sector is growing. While, the conditions of the highways are not up to the mark, a large number of the roads are single lane roads built almost 50 years ago. Further, the condition of the roads would only worsen with increasing number of vehicles. Repair work is expected to incur expenses up to $30 billion. The privatization of the road infrastructure is not enough to solve the problem, which has attained large proportions. Bad roads slow down the speed of vehicles, which in turn lead to higher fuel consumption.

Human resources: One of the major challenges of the auto sector is the creation of highly skilled human resource required for the auto industry. The industry, like many other industries is facing severe shortage of skilled technical as well as managerial manpower. This challenge becomes all the more daunting because faults lie at a more fundamental level of training infrastructure and the social perception.

Lack of World Class/ Alternate fuel Cars: Most cars produced in India are way behind the Europe and American car standards, as far as the safety and features are concerned. This is seen mostly in low to mid-end range of 4-wheelers in India. Also there is limited option of the cars that use alternate fuels like CNG, with Maruti Suzuki being the only manufacturer in the country that gives CNG variants for passenger cars as for the rest, the consumers usually have to get CNG Kit fitted.

Outlook:

With signs of economic recovery, Auto industry is definitely on path of revival, supported by improved consumer sentiment and measures taken by new government like pushing for the continuation of excise duty concessions, allocation of Rs 37,880-crore-fund for the expansion of road networks, while the recent cut in fuel price also is an added advantage of the industry.

However, most of the industry growth is being led by two wheeler and three wheeler segment, while performance of passenger and commercial vehicles continues to remain dismal on subdued industrial activity, therefore it would take some time for the industry to come completely out of woods and stabilize.

Nevertheless, this appears likely in the second half of the fiscal since sales of four wheeler segment could pick up during festive and wedding season. With this, the outlook for the industry for FY15 remains to be positive, though with bit of caution, provided that economic recovery should continue to stage momentum.

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Companies Financial Data In Industry

Company Name	CMP	MCAP	BOOK VALUE	DIV. YEILD %	TTM EPS	TTM PE
Eicher Motors Ltd.	12583.45	34104.65	413.94	0.24	158.68	79.30
Hero MotoCorp Ltd.	3041.45	60733.95	310.59	2.14	120.45	25.25
Bajaj Auto Ltd.	2549.85	73784.25	379.34	1.96	103.65	24.60
VST Tillers Tractors Ltd.	1330.05	1149.10	383.20	1.13	97.39	13.66
Maruti Suzuki India Ltd.	3205.45	96830.25	719.69	0.37	96.45	33.23
Force Motors Ltd.	1324.00	1744.54	962.82	0.23	61.92	21.38
Mahindra & Mahindra Ltd.	1296.35	80515.31	282.39	1.08	59.61	21.75
Maharashtra Scooters Ltd.	932.50	1065.71	251.44	2.68	45.09	20.68
SML Isuzu Ltd.	1015.10	1469.02	207.18	0.30	21.15	47.99
Atul Auto Ltd.	363.95	798.62	47.35	1.03	16.02	22.71
Escorts Ltd.	169.20	2074.00	149.48	1.06	12.65	13.37
TVS Motor Company Ltd.	254.35	12083.84	31.31	0.55	5.87	43.30
Scooters India Ltd.	29.25	249.74	9.84	0.00	2.14	13.65
HMT Ltd.	39.50	4756.16	3.78	0.00	0.85	46.28
Ashok Leyland Ltd.	45.55	12962.97	11.40	0.00	0.43	105.24
Tata Motors Ltd.	525.95	143937.43	71.07	0.38	0.09	0.00
Hindustan Motors Ltd.	9.05	188.84	-2.21	0.00	-0.88	0.00
LML Ltd.	9.46	77.56	-77.82	0.00	-8.66	0.00
Majestic Auto Ltd.	99.90	103.87	122.24	0.00	-17.51	0.00
Kinetic Engineering Ltd.	52.90	71.76	-41.66	0.00	-42.11	0.00
Tata Motors - DVR Ordinary	328.95	15854.30		0.00		

Source – Ace Equity