Press Release

India's automobile sector on cusp of a transformation

Low single digit growth new normal over the medium term due to structural factors

Acuité believes that the Indian automobile sector will undergo transition pains over the medium term before witnessing the next phase of robust growth driven by electric vehicles (EVs). In our opinion, the average annual growth in passenger vehicles (PVs) is unlikely to exceed 3%-5% over the medium term, the government incentives notwithstanding. While there is almost a saturated demand in the larger cities along with an infrastructural challenge in absorbing a larger volume of vehicles, the demand in the smaller urban and rural areas continues to be constrained due to lower affordability and income levels. Clearly, the low growth in vehicular demand is not just a cyclical trend but also reflects several structural factors namely lack of a clear scrappage policy, slower growth in income levels, increasing availability of alternative modes of transport, higher cost of ownership particularly in metros and not the least, the expectation of affordable EVs over the next 2-3 years. With the government's announcements on significant corporate tax cuts up to 10% and a likely moderate reduction in vehicle prices, Acuité expects a near term pullback in PV volumes; however, the structural challenges will continue to constrain its volume growth over the next 2-3 years.

Acuité's analysis of the passenger vehicle segment in India over the last two decades highlights that there has been a significant drop in the average PV volume growth to 6.8% in the FY15-19 period as compared to the previous market expansion period FY00-15 where the long term average CAGR stood at 8.8%. Clearly, there were early warning signs of a weakening demand in the PV segment over the last few years but a drop of over 30% yoy in the April – Aug 2019 period has particularly attracted attention. In the opinion of Acuité Ratings, there are quite a few structural factors at play apart from the cyclical downturn in demand.

- The absence of a formal scrappage policy has also been an impediment in generation of replacement demand. In India, used vehicle sales have picked up significantly over the last few years and transfers continue from large cities to towns and further to rural areas beyond their useful lifecycle. India not only needs a scrappage policy that will incentivise the scrapping of old vehicles in favour of a new vehicle but also adequate scrappage infrastructure in the organised sector.
- Only Bharat Stage (BS) VI vehicles can be sold in India from April 2020; while the government has confirmed that BS IV vehicles currently on sale would be permitted to operate for the full registration period, there is a likely postponement behavior from the buyers due to two factors (i) a concern that BS IV vehicles will not be efficient on BS VI fuel, making them wait for BS VI vehicles (ii) customer

expectation that BS IV vehicles will be available at a discount over the next few months as manufacturers push to liquidate their BS IV inventory.
- The purchase decision particularly for a passenger vehicle in India is increasingly driven by the factor of convenience rather than affordability. The alternative models to vehicle ownership such as the car rental services (primarily the app based) are clearly popular in the larger cities as the costs thereof compare favourably with the ownership and maintenance costs for self-owned and self-driven vehicles. The ownership costs among others also include the high costs of parking in metros. The improving public transportation systems in the major cities of India and the expected expansion of the metro rail network therein is also a factor in lower demand for individual vehicles.
- India has also witnessed a gradually expanding used car market. This has been largely driven by the emergence of organized players in this market who are providing warranty and quality certification that increases the buyers' comfort. While the used car market is still not that significant as compared to the OEM sales, it has clearly grown over the years supported by increasing availability of financing from the NBFCs.

Acuité therefore, believes that the automobile sector is currently in a transition period which may last over the next 2-3 years and will continue to constrain volume growth. The measures being undertaken by the government may lead to a moderation in the extent of volume de-growth in the current year and low single digit growth in the medium term. In the opinion of Acuité, a well designed scrappage policy may, however, succeed in pushing up PV volume growth by an additional 2%-3%.

India is the fourth largest automobile market in the world with sales of 26.3 million vehicles (including PVs, CVs and 2/3 wheelers) in FY19. While the majority of the volumes (i.e. 83% as in FY19) accrue from 2/3 wheelers, over 51% in value terms is accounted by the PV segment that has seen volumes multiply over 4.5 times over the period FY 1999-2019 with sales of 3.38 million vehicles in FY19.

Acuité has undertaken a comprehensive analysis of the passenger vehicle segment in India over the last two decades by splitting the intervening period into four distinct phases, FY00-05, FY05-10, FY10-15 and FY15-19. It has been observed that a slowdown or negative growth in volumes happened only twice before the current period. While the domestic PV market was taking shape in the 1990s, the first slowdown was triggered by the Asian Crisis and the Dot Com bubble with a drop of 5.3% followed by another 8.0% in volumes in FY99 and FY01-02 respectively. However, this was followed by a long period of robust market expansion supported by development of the vehicle finance market and lower interest rates; the PV market size actually doubled from 0.69 million vehicles to 1.38 million vehicles in the period FY01-07 before almost doubling again to 2.60 million vehicles during FY07-15. A transient disruption emerged with the global financial crisis with almost stagnant PV sales in FY08 but the recovery was quick and strong growth continued till

FY14. The penetration in vehicle ownership in India witnessed a significant jump from 53 in 2001 to 167 in 2015. (Source: Niti Ayog).

Acuité's study further indicates that the PV growth pattern between FY00-15 and in the period FY15-19 have been significantly different. In the former period there has been brief downward cycles (as outlined above) but it has been a larger story of sustainable expansion in the auto market despite the steady rise in fuel prices (particularly diesel due to progressive removal of cross subsidies) with a healthy CAGR of 8.8%. This had been driven by increasing urbanization, better incomes and access to financing along with inadequate development of efficient public transportation systems. However, the last four year period has been increasingly marked by gradual ownership saturation in the large cities, expansion of the used vehicle market, impact of demonetization and GST implementation on cash incomes and of late, the expected migration to BS-VI and EVs. This has lowered the CAGR of passenger vehicle (PV) volumes in the FY15-19 period to 6.8% and in particular, the year-on-year growth fell sharply to 2.7% in FY19. Given the trends in the first half of FY20, a significant de-growth can be expected which will be partly offset by the price discounts and the launch of new vehicle models.

About Acuité Ratings & Research Limited:
Acuité Ratings & Research Limited *(Erstwhile SMERA Ratings Limited)* is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 7500 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.

Media Contacts:

Suman Chowdhury President – Ratings Ph: + 91-9930831560 suman.chowdhury@acuite.in	Karan Mehrishi Lead Economist Ph: + 91-9910810569 karan.mehrishi@acuite.in

***Disclaimer**: This release is sent to you for the sole purpose of dissemination through your newspaper / magazine / media / website / agency. The release may be used by you in full or in part without changing the meaning or context thereof but with due credit to Acuité. However, only Acuité has the sole right of distribution of its releases through any media. Acuité has taken due care and caution for writing this release. Information has been obtained by Acuité from sources which it considers reliable. However, Acuité does not guarantee the accuracy, adequacy or completeness of information on which this release is based. Acuité is not responsible for any errors or omissions or for the results obtained from the use of this release. Acuité has no liability whatsoever to the users / distributors of this release.*