Auto Bytes

September 2019

The changing financial risk management scenario for automakers

For the Indian automobile industry, this is the time of economic restructuring and transforming the financial risk structure of companies. The month of July saw the auto industry sink deeper into an abyss with the domestic sales of all vehicles recording their worst levels in two decades.

The World Economic Outlook by the International Monetary Fund (IMF) lowered India's growth outlook for FY20. As per Reserve Bank of India (RBI), the Economic Survey of the Ministry of Finance, and the Asian Development Bank, India's growth is likely to be slower and further expected to be down to 7%. This, followed by a fall in the rupee value, rigidity in global trade, and lack of liquidity in financing, may pose a downside risk for auto loans.

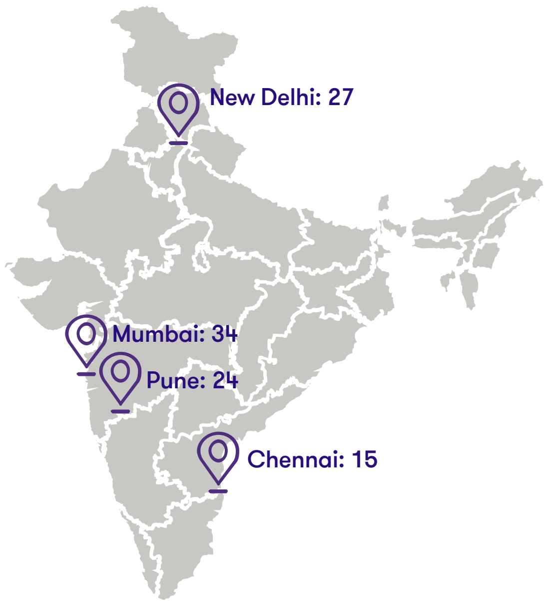
To avoid the risk of default, banks have become more cautious about lending to dealers and manufacturers. Auto companies, including dealerships, have a lower turnover ratio, which reflects poor sales and excess inventory, and ultimately accounts for an investment with a zero rate of return. These risks are a result of the auto industry's inclination towards Electric Vehicles (EVs), which are expected to completely change the way the industry manufactures and sells vehicles.

The government's EV thrust - which is coming at a time of a significant liquidity crunch, Non-Banking Financial Company (NBFC) crisis, increasing costs of raw materials, and Goods and Services Tax (GST) announcement - is resulting in severe cut-downs in the industry. Automakers are wrestling with disruptive forces, a financial crunch, followed by tightening of regulations and compliance standards. Due to the weak lending scenario in the industry, sale of new vehicles has been significantly affected. The tightening liquidity in NBFCs has made things even more difficult for the market, where over 80% of new cars are financed at the time of sale. Further adding to the economic sluggishness are high interest rates, cash crunch in state-run and shadow banks, high fuel costs and tightened insurance norms.

This has led to an uncertain trade environment in an otherwise strong industry with risks of lagging behind in advancements and getting commercially overtaken. According to RBI's data, vehicle loans grew by 11.3% to INR 1.89 lakh crore annually between FY13 and FY18, and the share of vehicle loans (as a percentage of total bank credit) rose to 2.47% in FY18.

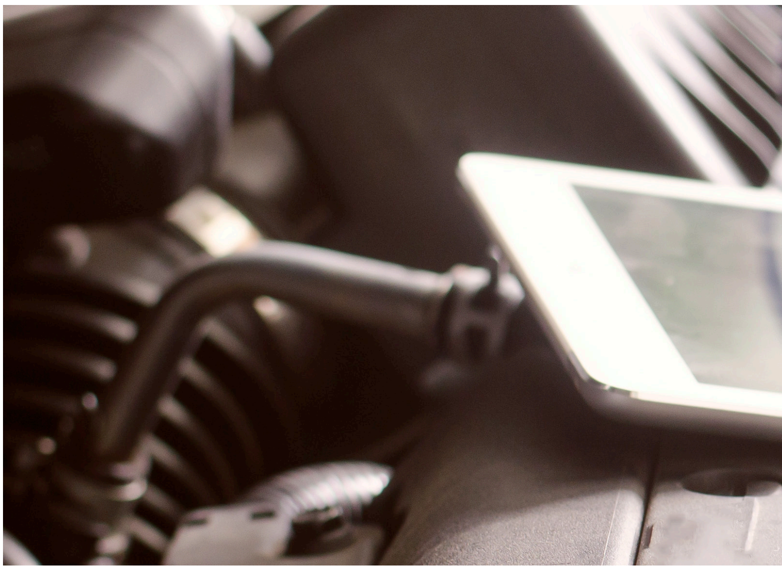
According to Federation of Automobile Dealers Associations (FADA), the finance penetration for Two-Wheelers (2W) rose to 50% in FY18 whereas in passenger cars, tractors, and Commercial Vehicles (CVs), it grew up to 5% as compared to FY14. The Indian automotive retail sector has incurred losses of at least INR 20 billion with dealerships turning non-viable.

Number of dealers that have shut down



Source: FADA

Given the waning confidence in the economy, consumers seem reluctant to spend. As a result, 2Ws and 3Ws have experienced a really poor retail sentiment, clocking in more production and less sale.



Our point of view

In the current scenario, production needs to be forecasted properly to meet consumer demands. Auto dealers need to look at rotating cash to liquidate inventories. The government needs to participate more proactively to improve the lending framework, especially for the CV segment. Steps taken by private and public auto companies will play a crucial role in reviving and reshaping auto financing.

Current analysis of liquidity and managerial efficiency of auto companies depicts a deficit which further represents possible difficulties in payment of current liabilities.

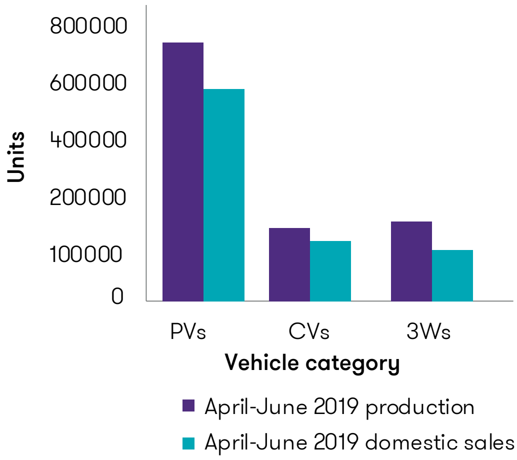
Original Equipment Manufacturers (OEMs) and automakers must subjugate the steep financial barriers to successfully overcome the current downtrends. They should also prepare better to mitigate their exposure to risk and market volatility. Leadership teams should develop a strategy by investing better, developing various options, and preparing for big bets.

Even though the road ahead looks bleak, it cannot be ignored that consumer sentiments are catalysts for consumption. An optimistic approach of a stable government and rising economic sentiment could reverse the tide for the industry.

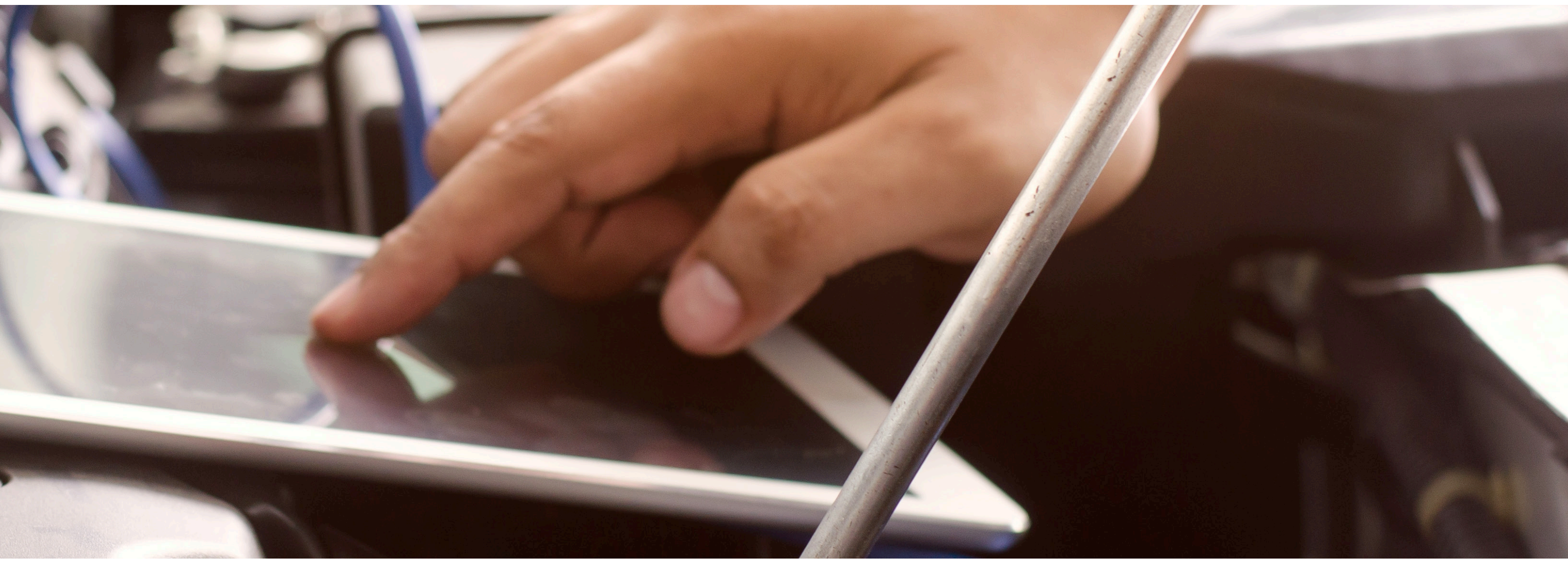
Fiscal year	2013-14	2014-15	2015-16	2016-17	2017-18
Total bank credit (non-food) (INR billion)	55,296	60,030	65,469	70,945	76,884
Personal loans (INR billion)	10,097	11,663	13,922	16,200	19,085
Vehicle loans (INR billion)	1,063	1,246	1,529	1,705	1,898
Vehicle loans as a % of total bank credit	1.92%	2.08%	2.34%	2.40%	2.47%
Vehicle loans as a % of total personal loans	10.50%	10.70%	11.00%	10.50%	9.90%

Source: RBI

Auto production in India exceeded sales in April-June 2019



Source: Grant Thornton analysis



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