Grant Thornton
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Automotive and Manufacturing

Brand visibility

Opportunity

Auto Track

Quarterly update

April-June 2017

Contents

Foreword

The industry is now on the road to high growth with new launches and macroeconomic factors like a fillip to exports, introduction of GST, and a continuous thrust to infrastructure. In fact, industry experts and insiders are optimistic about double-digit growth this year.

Automobile is one of the focus sectors for Grant Thornton, given its importance both in the developed and developing nations.

The auto sector grew steadily over last eight years with exception of two-year turbulence resulting from global downturn, primarily in sales of commercial vehicles. After the growth slowed in 2015, the sector saw a revival in 2016 as sales were driven with improved economic growth, robust demand from rural and semi-urban markets and lower cost of ownership, bringing in a much-needed recovery for the industry. The industry is now set to continue the momentum this year with demand picking up across all segments. Thus, with its strong performance, the Indian economy has been able to instill confidence in a larger section of business.

As the industry prepares for immediate changes like the implementation of GST and long-term improvements through Industry 4.0, the key expectation from the government is the creation of a clear and stable policy environment that can facilitate long-term business and investment planning. Tax incentives for Industry 4.0 investments have emerged as a common theme in terms of support expected from the government in the coming years.

In FY18, the Indian auto sector is expected to grow moderately with a near double digit growth in passenger vehicles, primarily driven by utility vehicles, and a moderate 0-2 per cent growth in commercial vehicles. Two-wheelers are also expected to clock double-digit growth. Further, the outlook for the auto components industry is extremely optimistic as industry analysts expect to register a turnover of USD 100 billion by 2020, backed by strong exports.

Planned new launches and macroeconomic factors like an export fillip, introduction of GST, and a continuous thrust to infrastructure by the Indian government has made a bulk of the auto and auto components respondents indicate the possibility of achieving double-digit growth this year.

While the auto industry has much to look forward by way of growth in both domestic and export markets, by contribution towards GDP with the major growth drivers and also in the amount of Investments in terms of FDI; there are some clear road blocks accompanying with the simultaneous opportunities in the sector too.

It has been an exciting exercise to present this report with comprehensive analysis and examination of industry sales trend developing in automotive market with regulatory updates and key insights of the operation of the Industry across all segments.

We hope that you find it interesting and insightful too.

Saket Mehra
Partner
Grant Thornton India LLP

Sector overview

Sector overview

As one of India's major sectors, the auto industry accounts for 49 percent of the country's manufacturing (GDP). The Indian auto industry, comprising passenger cars, two wheelers, three wheelers and commercial vehicles, is the seventh-largest in the world.

India's annual production stood at 25.31 mn vehicles (including passenger vehicles, commercial vehicles, three wheelers, two wheelers and quadricycle) in 2016-17 as against 23.96 mn in 2015-16, registering a growth of 5.6 per cent y-o-y.

The industry accounts for 7.1 percent of the country's Gross Domestic Product (GDP). The two-wheelers segment is the leader of the Indian Automobiles market with 79 percent market share owing to a growing middle class and a young population. Moreover, with more companies showing interest in rural penetration, the sector is expected to attract synergies through rural markets.

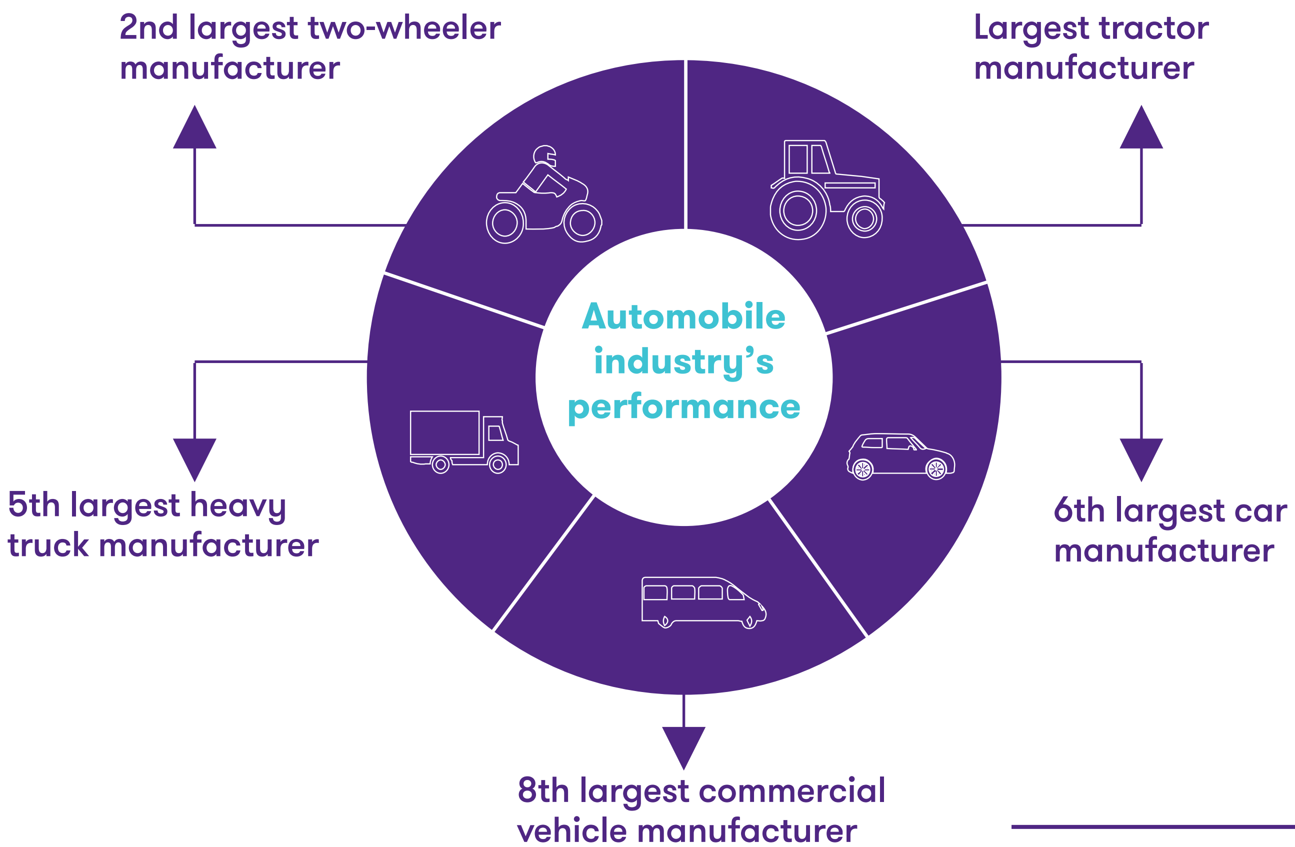
The Indian automobile industry has a significant growth potential given its existing low penetration levels and a fast growing economy, with a rising income group of consumers. In terms of manufacturing base, India offers some significant advantages:

- large pool of skilled manpower;
- availability of land;
- and other natural resources like iron ore, coal, bauxite and a well-defined legal environment.

Sector composition:

Organised sector, which accounts for over 77 percent of overall production, dominates the automotive sector; however, auto components space remains highly unorganised.

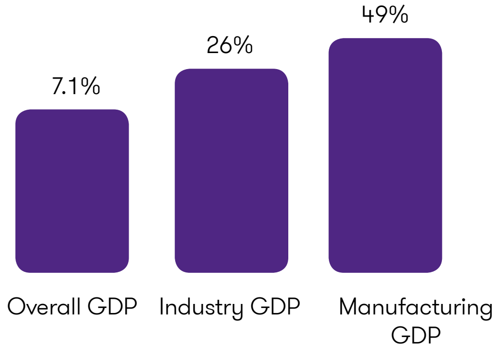
The automotive industry boasts of well-established companies while the auto components industry is largely unorganised (accounts for over 90 per cent of the total companies).



Highlights of the industry

Policy initiatives:

As per the current statistics, the auto industry's turnover is estimated to be equivalent to following numbers as depicted in Figure1 below:



Source: Society of Indian Automobile Manufactures (SIAM)

Figure1

Major growth drivers

Demand fundamentals:

- Rising per capita income and rural income.
- High demand for commercial vehicles due to increased road construction in urban and rural areas.
- Easy auto financing by private banks.

Favourable policy:

- Automatic approval of foreign equity in the sector.
- Encourage rebates on auto companies' R&D expenditure.
- National Automotive Testing and R&D Infrastructure Project (NATRiPs) started to implement global performance standards. This initiative offers support to small car manufacturers with reduction of excise duty.

Emphasis on infrastructure:

Capacity additions for power generation and an increase in infrastructure spending in India

Sector overview: Contribution to GDP

The bar diagram in Figure2 below gives the contribution of major industries in India's GDP for the year 2016-17:

- Automobile industry which is growing at a very high rate every year contributed about 7.1 percent to India's GDP in the year 2016.
- While on the other hand coal which was earlier the major contributor to India's GDP had the least share in India's GDP with a contribution of just about 2.5 percent.
- Iron and Steel which was earlier a major industry also contributed to India's GDP, it's contribution in India's GDP reduced to just 6 percent in 2016.
- Electronics was the major contributor in India's GDP in industrial sector with a contribution of around 25 percent.
- Along with electronics, consumer durables also contributed majorly to India's GDP. Its contribution to India's GDP was around 22-23 percent in 2016.

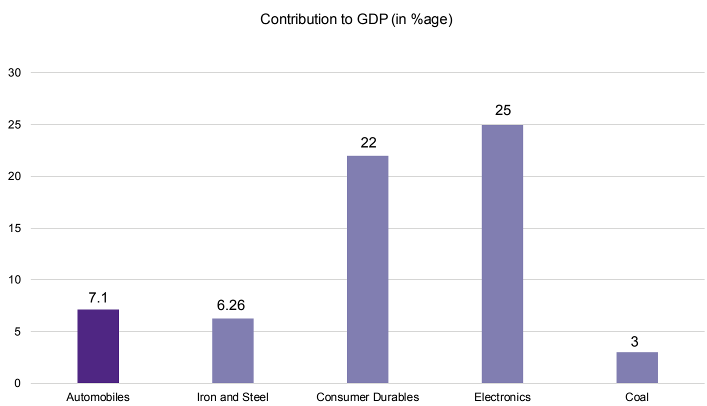


Figure2

Opportunities in the sector

1. Global R&D

With India fast becoming a hub for R&D, it already boasts of more than 30 automotive R&D centres, 85 percent of which have headquarters in Europe. The result has been a steady increase in patent filings, which has resulted in increased investments in R&D every year. Stress on R&D is what will differentiate India as a global hub for innovation and cutting-edge ideas, going beyond mere cost effectiveness.

The Government of India's supportive initiatives such as National Automotive Testing and R&D Infrastructure Project (NATRiP) test centres have increased chances for the country to achieve its mission to put India on the global map as a preferred destination for automotive R&D.

2. Small manufacturing hub

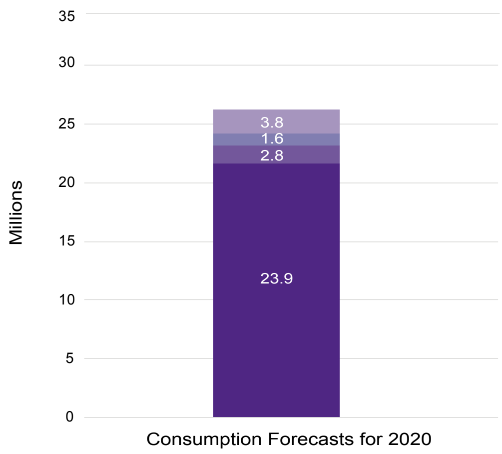
India, increasingly seen as a global technology outsourcing centre is taking rapid strides towards becoming the world's manufacturing hub for compact cars.

As depicted in Figure 3, the demand for passenger car segment to be 3.8 million in the next 10 years. Small car segment is expected to grow to 2.66 million by 2020.

Small cars manufactured in India are being exported to countries such as UK, Italy, Germany, Netherlands, South Africa, Latin American and other East Asian Countries.

Singapore is fast rising as a big market where the demand for Indian cars has grown seven times over the last four years. (SIAM)

The experience of indigenous small car development, excellence in manufacturing sector, strong auto component industry are the three major pillars that form the ecosystem of the small car industry in India.



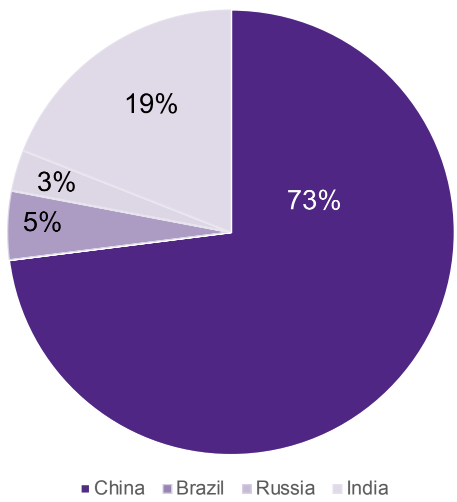


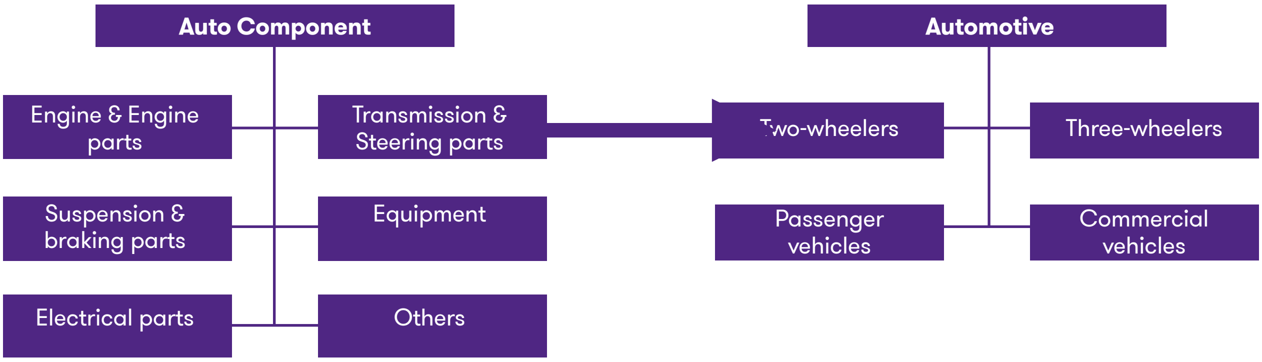
Figure 3: Consumption of cars in BRIC countries by 2020 and the share of each country among the incremental consumption.

Source: Organisation Internationale des Constructeurs d'Automobiles (OICA)

3. Indian components manufacturers are moving up in value chain

Indian auto component manufacturers are moving up the value chain and delivering complex products as per the needs of global clients.

The industry's value chain consists of the auto components segment and automaker segment. The segment can be further divided into many subsegments such as engine and parts, transmission and steering parts, suspension and braking parts, and others as shown in Figure 4 below.



Source: IBEF

Figure4: Value chain of the auto sectors

'The automobile industry is considered to be a job-engine for India, and simultaneously, India is upgrading its existing contribution in the automobile Global Value Chains (GVC) to reap higher economic benefits. In general, high-value activities are skill intensive and low-value activities are labour intensive. Since bulk of India's thrust till now has been sustenance for its people – much of our GVC participation in automobiles is along labour intensive assembly, components, and basic manufacturing.

High-value activities like R&D, design, standards-development, specifications, and market development are performed in India, though at lower scales comparable to developed nations. Thus, the viciousness of the cycle is that upgrading India's GVC contribution will lead to a developed India, and a developed India will attract upgradation of GVC contribution.

Roadblocks for the sector

- Total tax incidence on auto products
- High and varied rate of road taxes
- Embedded tax structure
- High interest rates
- Overloading on commercial vehicles
- No certainty over exclusion of automobiles in the Free-trade agreements and Preferential Trade Agreements being negotiated to protect existing investment or to encourage future investment
- Low growth of export markets

Source: Society of Indian Automobile Manufacturers (SIAM)

Trend of investments in the industry

The automobile industry in India gained momentum after the liberalisation in 90s. Since then, the industry has continued to grow consistently, also strengthening its position in the global market. Recently, India has seen an upsurge in the performance of the automobile industry, thanks to its relaxed restriction on the investment policies in the sector. India's overall economic growth has also played a significant role attracting foreign investors to the automobile sector.

The automobile sector in India has displayed agility to deal with uncertain times and high receptivity towards new technology.

Both the Central and State Governments have taken several measures to draw investments in the sector. The government has liberalised the norms for foreign investment in the sector. Presently the government is allowing 100 percent foreign direct investment in the sector.

The automotive industry lifecycle

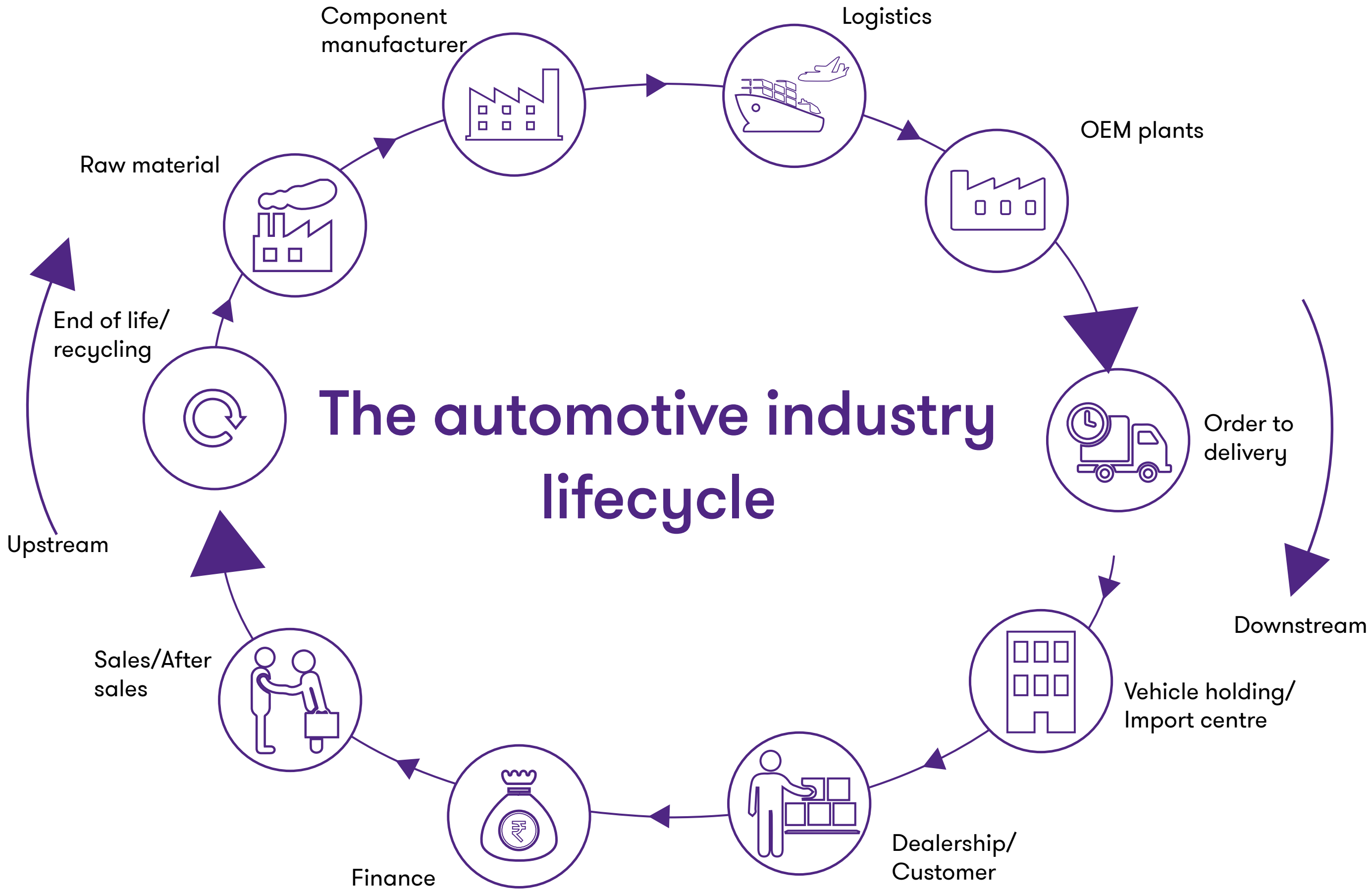


Figure5

- The automotive industry has a 'tiered' supply chain structure, which is best illustrated by way of the diagram shown above. Upstream from the car manufacturer or Original Equipment Manufacturer (OEM) are the Tier 1 suppliers. These companies typically supply some of the largest components or sub-systems for the cars, such as a suspension assembly or gearbox. Moving upstream, the Tier 2 suppliers typically provide components to the Tier 1 suppliers and these could be pump units, electric motors or bearing assemblies. Then further upstream you have the Tier 3 suppliers who will provide the Tier 2 suppliers with anything from brackets, seals to machined components etc.

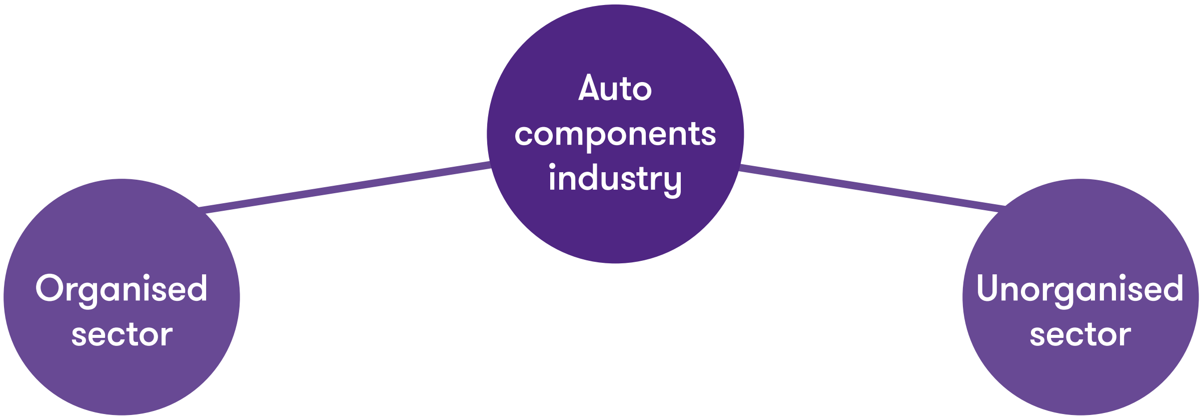
- The automotive components and downstream markets represent a large mix of activities whose production and service areas form a part of other industry and service sectors. These economic activities play a key role for the Indian economy as they cover a large number of sectors, in particular small and medium enterprises (SMEs) and independent agents, and play an important role in providing employment.

- The upstream stage in the production process may also manifest itself as a supplier providing raw materials to manufacturers or other businesses that ultimately process the materials.

- As the Tier1 suppliers are the most important to the vehicle manufacturers, they typically have a plant close to the car manufacturers to support just-in-time type production processes. Tier2– suppliers could be based anywhere in the world and many companies in this particular sector have established a manufacturing presence in low cost countries around the world, for example China and India. In addition to the tiered suppliers, there are also raw material providers, such as the steel manufacturers who provide sheet products directly to the vehicle manufacturers.

- Downstream from the OEMs, the third party logistics (3PL) providers distribute finished vehicles to storage compounds and vehicle distribution hubs located around the world. These will then get shipped to the dealer networks as and when required.

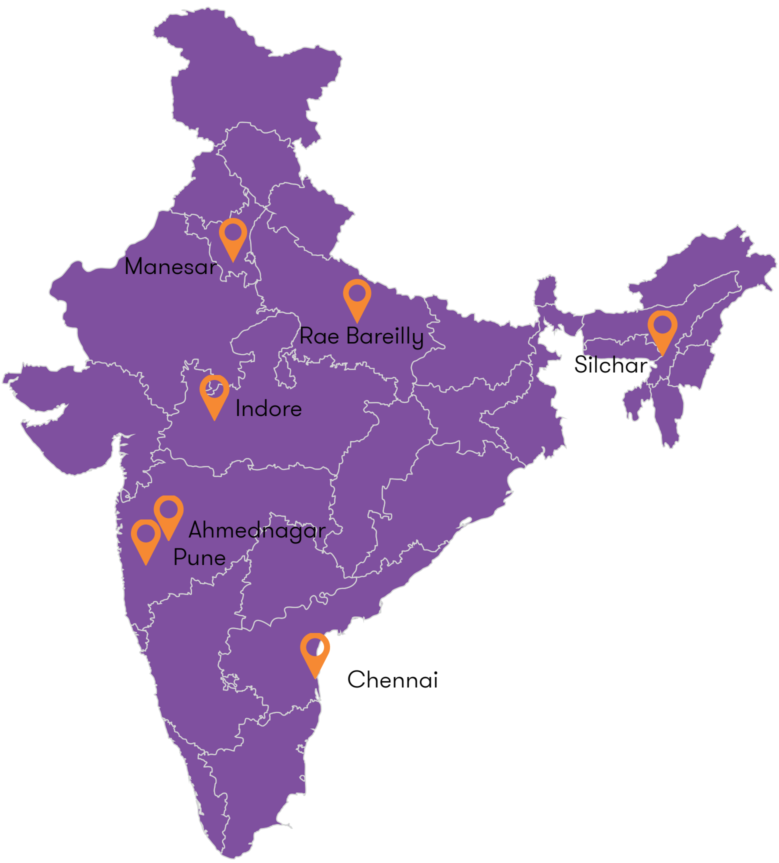
About Auto Component Industry



Caters to the Original Equipment Manufacturers (OEMs) and consists of high-value precision instruments

Sector comprises low-value products and caters mostly to the aftermarket category

Auto Component Clusters



- India is emerging as a global hub for auto component sourcing. A cost-effective manufacturing base keeps costs lower by 10-25 percent when compared to operations in Europe and Latin America. India is also geographically closer to key automotive markets like the Middle East and Europe. Global auto component players are increasingly adopting a dual-shore manufacturing model, using overseas facilities to manufacture few types of components and Indian facilities to manufacture the remaining components.

- As per the Automotive Mission Plan 2016-26, prepared jointly by the Society of Indian Automobile Manufacturers (SIAM) and the Government of India in 2015, the Indian automotive after-market is estimated to grow at around 10-15 percent and has the potential to generate up to USD 300 bn in annual revenue by 2026. It will create 65 million additional jobs and contribute over 12 percent to India's GDP.

- Investments through FDI in the auto components sector reached USD 0.5 bn in FY16 in comparison to USD 0.4 bn in FY15. According to the Automotive Component Manufacturers Association of India (ACMA), the Indian auto-components industry is expected to register a turnover of USD 100 bn by 2020 backed by strong exports ranging between USD 80-100 bn by 2026, from USD 11.2 bn currently.

- The Indian auto component industry is expected to grow by 8-10 percent in FY 2017-18, based on higher localisation by OEMs, higher component content per vehicle, and rising exports from India, as per ICRA Limited.

Industry sales trends – FY 17

2016-17 was an eventful year for the auto industry. The Indian auto market started business on a promising note in FY 16-17, encountering bumps on the way in the second half. The early part of the year saw a revival trend in the automobile sales which was plagued due to massive demand fall in the rural market owing to uneven and delayed monsoon in the previous year. The ban on diesel cars further impacted the automobile industry.

Second half of 2016 witnessed strong positive sentiment backed by factors such as improved consumer sentiments post the Seventh Pay Commission, normal monsoon after two successive years of deficit rainfall in most regions, lower financing costs (banks base rates have declined from 10.75 per cent in December 2011 to 9.65 per cent in December 2016) fuel prices and healthy replacement demand due to diesel car ban.

As soon as the industry was about to pick up speed, demonetisation was announced by the government in November 2016. This resulted in de-growth in the auto industry during December 2016.

Production - The industry produced a total 25,316,044 vehicles including passenger vehicles, commercial vehicles, three wheelers, two wheelers and quadricycle in April-March 2017 as against 24,016,599 in April-March 2016, registering a growth of 5.41 percent over the same period last year.

Sales:

Passenger vehicles - The sales of Passenger Vehicles grew by 9.23 percent in April-March 2017 over the same period last year. Within the Passenger Vehicles, Passenger Cars, Utility Vehicles and Vans grew by 3.85 percent, 29.91 percent and 2.37 percent respectively during April-March 2017 over the same period last year.

Commercial vehicles - The overall Commercial Vehicles segment registered a growth of 4.16 percent in April-March 2017 as compared to the same period last year. Medium & heavy commercial vehicles (M&HCVs) grew by 0.04 percent and light commercial vehicles grew by 7.41 percent during April-March 2017 over the same period last year.

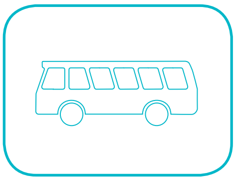
Three wheelers - Three wheelers sales declined by (-) 4.93 percent in April-March 2017 over the same period last year. Passenger Carrier sales declined by (-) 8.83 percent and Goods Carrier sales grew by 12.75 percent in April-March 2017 over April-March 2016.

Two wheelers - Two wheelers sales registered a growth at 6.89 percent during April-March 2017 over April-March 2016. Within the two wheelers segment, scooters, motorcycles and mopeds grew by 11.39 percent, 3.68 percent and 23.02 percent respectively in April-March 2017 over April-March 2016.

Sector snapshot: Automobile sales

FY 2016-17

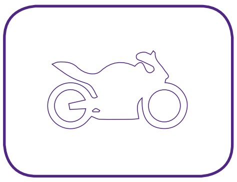
Market size of automobiles estimated to touch USD 260 bn to 300 bn by 2026



Sale of passenger vehicles was 3.04 mn

Sale of commercial vehicles was 0.71 mn

Sale of three wheelers was 0.5 mn



Sale of two wheelers was 17.58 mn

Passenger vehicle sales grew 9.24% to 3.04 million units during the year, the fastest growth since FY11 and crossed the 3 million-mark for the first time in India in 2016-17

	Sales in 2016-17	Change (year-on-year in %)
Passenger cars	2,102,996	3.85
Utility vehicles	761,997	30
Vans	181,734	2.37
Total PVs*	3,046,727	9.24
Total CVs	714, 232	4.16
Total 3-wheelers	511,658	-4.93
Total 2-wheelers	17,589,511	6.89
Grand total	21,862, 128	6.81

PVs: Passenger vehicles; CVs: Commercial vehicles
Total PVs are inclusive of cars, utility vehicles and vans

Source: SIAM

Industry exports trend

Automobile export trends

Category	2015-16	2016-17
Passenger Vehicles	6,53,053	7,58,830
Commercial Vehicles	1,03,124	1,08,271
Three Wheelers	4,04,441	2,71,894
Two Wheelers	24,82,876	23,39,273
Grand Total	36,43,494	34,78,268

Source: SIAM

Analysis

Being a prominent auto exporter, India's exports stood at about 14 percent of the automobiles produced annually. However, exports declined by 4.5 percent in 2016-17 after growing marginally by about 1.9 percent y-o-y in 2015-16.

In 2016-17, exports of passenger vehicles and commercial vehicles slowed down and grew by about 16.2 percent and 6.4 percent y-o-y.

On the other hand, exports of three-wheelers declined by a sharp 32.77 percent and exports of two-wheelers declined by about 5.9 percent y-o-y during the same period due to currency issues in key global markets (Africa and Latin America) along with low crude prices.

Sector quarterly snapshot

Quarterly snapshot

Quarter-wise comparison – Sales					
January 2017 - March 2017					
Date	**Passenger Vehicles (PVs)**	**Commercial vehicles (CVs)**	**3 Wheelers (3Ws)**	**2 Wheelers (2 Ws)**	**Total Sales**
Jan-17	265320	61239	31345	1262141	1620045
Jan-16	232016	61683	43662	1382881	1720242
YoY (%)	14.35	-0.72	-28.21	-8.73	-5.82
Feb-17	255359	66939	35356	1362045	1719699
Feb-16	234154	62359	44956	1362219	1703688
YoY (%)	9.06	7.34	-21.35	-0.01	0.94
Mar-17	282519	87257	39000	1471576	1880352
Mar-16	256920	79862	51127	1467760	1855669
YoY (%)	9.96	9.26	-23.72	0.26	1.33

Key insights - January 2017

The first month of the New Year brought good tidings followed by the aftermath of demonetisation in the last two months of 2016. What also helped numbers was the preference of vehicle buyers to have a new vehicle registration in the new year, which means some pent-up demand from the previous month, December 2016, was carried forward to January.

- While passenger vehicle sales rose 14.35 percent to 265,320 units, CV demand at 61,239 units was flat (-0.72 percent).
- Two-wheelers were down by 8.73 per cent to 1,262,141 units as compared on y-o-y basis of Jan 2016.

January 2017 sales numbers, particularly for the passenger vehicle (PV) segment, indicate a sharp rebound. With total sales of 265,320 units across the passenger car segment, utility vehicle and van segments, the PV segment had notched 14.35 percent y-o-y growth, enough to spread cheer among PV players. The numbers compare very favourably versus December 2016's de-growth of 1.36 percent.

The two-wheeler segment seem to had borne the brunt of the cash crunch. January 2017 numbers were very heartening – demand for cars had risen by 10.83 percent to 186,523 units, UV sales surged by 24.47 percent to 62,264 units and van sales rose 21.65 percent to 16,533 units.

The uptick in January sales was also due to pent-up demand from December 2016. Usually, the last month of a year sees consumers delaying purchase decisions, preferring to buy a new set of wheels that are registered in the new year, ensuring better resale value down the line.

Key insights - February 2017

Industry was back on growth path, with UV segment leading the pack.

Total sales at 1,719,699 units, across all vehicle segments in February 2017, point to flat growth (0.94 percent) but an improvement over January 2017 (1,620,045 units, -4.71 percent).

Various segments fared in February as below:
With 255,359 units sold in February 2017 (9.01 percent), the PV segment continued to maintain growth albeit volumes were down compared to January 2017 when 265,320 units (14.40 percent) were sold. Usually, the first month of the year sees pent-up demand from December fructifying. Passenger car sales rose 4.90 percent to 172,623 units while surging consumer demand for SUVs saw numbers grow 21.79 percent to 65,877 units. 16,859 vans were sold, up 8.10 percent y-o-y.

The commercial vehicle (CV) which, like the two-wheeler segment, will have to adhere to BS IV emission norms, saw a surge in sales. In fact, with 66,939 units, it clocked its best-ever monthly sales for the fiscal year 2016-17.

Sales of two wheelers, which like CVs, were hit by demonetisation, are limping back to normalcy. Although sales at 1,362,045 units indicate flat y-o-y growth (-0.01 percent), they are much better than January 2017 numbers (1,262,141, -7.39 percent) and the low of December 2016 (910,235, -22 percent) and November 2016 (1,243,251, -5.35 percent).

Three wheeler sales were down 21 percent at 35,356 units.

Key insights - March 2017

Indian automobile industry witnessed 1.33 percent growth in its domestic sales for the month of March 2017 and stood at 1,880,352 units, according to data released by SIAM.

Vehicle sales were flat, crawling up by just 1.3 percent to 1,880,352 units from 1,855,623 units a year ago.

Passenger vehicles maintain growth momentum
The passenger vehicle segment sold 282,519 units as against 256,920 units during March 2016, thereby registering growth of 9.96 percent. In this segment, while passenger cars grew by 8.17 percent, sales of utility vehicles jumped by 20.91 percent. Healthy sales in March 2017 helped passenger vehicles cross 3 mn domestic sales-mark in a year for the first time.

Two-wheeler sales were flat
The two wheelers segment registered marginal growth of 0.26 percent with 1,471,576 units. In this segment, only scooter sales witnessed positive growth of 8.13 percent at 486,604 units. At 1,471,576 units, domestic two-wheeler sales in March 2017 ended up flat, vis-à-vis 1,467,710 units a year back, inching up by measly 0.3 per cent. Retail sales were, however, better due to heavy discounts and freebies offered by the OEMs and dealers for distress clearance of the BS III stock on the last two days of the month, necessitated by the Supreme Court order.

Commercial vehicles sales disrupted by the Supreme Court order
With 87,257 units, the commercial vehicle segment grew by 9.26 percent. While total domestic sales reported by OEMs in March 2017 showed a 9.3 percent uptick compared to March last year, the retail sales were hit by the Supreme Court order of 29 March, leaving a huge pile-up of inventory with the dealers.

Total three wheelers sales decreased 23.72 percent at 39,000 units.

Quarter-wise comparison – Sales					
April 2017 - May 2017					
Date	Passenger Vehicles (PVs)	Commercial vehicles (CVs)	3 Wheelers (3Ws)	2 Wheelers (2 Ws)	Total Sales
April-17	277602	41490	36588	1674796	2030476
April-16	242060	53835	44645	1560308	1900848
YoY (%)	14.68	-22.93	-18.05	7.34	6.82
May-17	251642	53457	36066	1694325	2035490
May -16	231640	57088	46477	1514277	1849542
YoY (%)	8.63	-6.36	-22.40	11.89	10.05

Key Insights - April 2017

How Domestic Sales Stack up in April 2017

After creating history by crossing the 3 million mark in domestic sales and growing 9.23 percent, during 2016-17 and 9.96 percent during March 2017, passenger vehicles have continued their growth streak during April, starting the financial year FY18 on a promising note. Sales of passenger cars, utility vehicles (UVs) contributed to the growth of the Indian automobile industry in April 2017.

SUVs continue to be the prime sales drivers for most manufacturers.

Domestic passenger vehicles sales rose 14.68 percent to 2,77,602 units in April from 2,42,060 units in the same month last year. With the numbers, the Indian passenger vehicle (PV) industry seems on track to record consistent gains in the coming year.

The two-wheeler industry has started off the new financial year on a good note by recording a YoY growth of 7.34 percent in April 2017. According to the latest SIAM data, the two-wheeler industry has registered total domestic sales of 1,674,796 units in April 2017 as against total sales of 1,560,308 units in April last year.

The growth was led by the rapidly expanding scooter segment, which has registered an impressive growth of 25.30 percent y-o-y at total domestic sales of 586,886 units last month. (April 2016: 468,368 units)

The commercial vehicle industry has taken a huge hit in the first month of the new fiscal. Total CV sales were 41,490 units, down 23 percent year on year (April 2016: 53,835 units). Both the M&HCV and LCV segment sales plunged. Heavy discounting in March 2017 to clear BS III stock, implementation of BS IV emission norms from April and the subsequent price increase in vehicles have resulted in the sharp fall.

As per the monthly sales numbers in the domestic market, revealed by industry body SIAM, overall sales across vehicle segments totaled 2,030,476, up 6.82 percent year on year.

Key insights - May 2017

Automobile sales in India grew by 10 per cent in May 2017

Passenger vehicles (Cars, UVs, Vans) sold a total of 251,642 units reporting a growth of 8.63 per cent. Total passenger vehicles sold in May 2016 were 231,640 units.

Slowdown in domestic sales of commercial vehicles continue after the pre-buy season last year.

Scooters have added to the overall two-wheeler growth in the domestic market as the two-wheeler space boomed by 11.89 percent. Introduction of new models and BS-IV variants is sighted as one of the main reason for the fresh demand of two-wheelers.

Key insights - June 2017

An outlook of June 2017- Way Forward

Industry analysts expect the April-June quarter of FY2018 to be slow for the commercial vehicle sector albeit growth would likely pick up with GST in place from July 2017.

Industry is likely to witness 6-8 percent growth in FY2018 aided by higher budgetary allocation towards the infrastructure and rural sectors; potential implementation of scrappage program will also trigger replacement demand.

ICRA estimates that during FY2018, M&HCV trucks will grow by 6-8 percent by higher budgetary allocation towards the infrastructure and rural sectors, LCV trucks by 6-8 percent on replacement demand to continue following 3 years of declining trend and pick-up in demand for consumption-driven sectors, rural markets and e-commerce. Buses are likely to grow by 5-7 percent on orders from SRTUs to support sales in M&HCVs; and smart cities initiatives. Exports are likely to grow by 8-10 percent.

Profitability indicators of CV OEMs will moderate marginally because of recovery in material prices and gradual pass through of BS-IV costs.

Regulatory updates

1. The Auto industry looks forward to introduction of GST

Key highlights

With the introduction of Goods and Services Tax (GST) in India, the government is further accelerating the conduciveness of domestic manufacturing activities. After the introduction of GST on 1 July, 2017, the date set for the rollout of the new all-encompassing indirect tax, no additional tax will be levied.

Any change, if required, in future (for specific needs like calamity, education, infrastructure, etc.) would be done through modifying the rate of taxation under the GST regime and not through any additional levy/tax/cess etc.

Tax rates would be uniform across states and there would be one authority to which payment would be made by way of one challan. Thus, a common base would be adopted for taxation of both Central and State GST.

The current scenario

Under the present taxation system, interstate sales tax and local sales tax is levied on excise duty in respect of the manufactured goods resulting in cascading of taxes.

The current excise duty structure in the automotive sector ranges from 6 to 30 percent.

When goods are transferred from the factory, excise duty has to be paid but no VAT/CST is applicable under current tax laws.

Importers and dealers currently are ineligible for the CVD and excise duty paid by OEMs (Original Equipment Manufacturer) and presently, sales of used cars attract VAT, and in some states a composite rate and excise/VAT are not applicable on advance received for supply of goods.

The vehicles which are exempted from the Nccd/auto cess are: electrically operated vehicles, three-wheeled vehicles, hydrogen vehicles based on fuel cell technology, vehicles used solely as taxis, the ones used by physically handicapped persons, hospital ambulances.

Under the current tax system, there are several taxes applicable on this sector like excise, VAT, sales tax, road tax, motor vehicle tax, registration duty which will be subsumed by GST.

Impact overview

- GST will have a positive impact on the automobile industry because of the efficiency and the removal of cascading.
- Presently, luxury vehicles attract taxes as high as 55 percent; but luxury car sales may surge ahead with applicable rate under GST of 43 percent, including a 15 percent luxury cess.
- The importers/dealers would be able to claim the GST paid on goods imported/sold whereas currently, they are ineligible to claim the excise duty and VAT paid.
- Dealers are expecting a loss of 2.5-5 percent of the basic price of inventory at their premises from July 1, 2017 onwards as several levies that have already been paid on the vehicles lying at dealerships will not be refunded, as they aren't GST-creditable, but sales will have to be taxed under GST from next month.
- GST would help the manufacturers in procuring auto parts at a cheaper cost due to an improved supply chain mechanism under GST.
- Both CGST and SGST would be applicable, when goods would be supplied locally by principal to the job worker and in case of interstate supply, IGST would be applicable. Job worker would be eligible to take credit of input GST and set-off against output GST resulting from him supplying the goods back to principal after applying tax.
- Currently, there are a lot of free services/warranties offered by the car manufacturers due to the competitive nature of the industry. These free goods or services are not taxed under current tax laws. Under GST, the free services/warranties would also be eligible for taxation.

Recommendations

Clarity around tax implication on the sale of used cars under GST is required. Clarification is also required regarding the state provided incentive based schemes and their transition.

Implementation of GST would reduce the cost of manufacturing of cars due to the subsuming of different taxes levied currently. Under GST, the taxes would be charged on consumption state rather than the origin state, which would give a boost to the growth rate of the automobile industry.

“With GST council having recently finalised the rates and exemption on goods and services, cars will be taxed at the highest rate plus a cess in the range of 1 percent to 15 percent. GST rate of 12 percent on Electric vehicles (including two and three wheelers) clearly indicates the government’s ambition to achieve complete conversion to electric vehicles by 2030 while maintaining tax revenue target. Buyers of premium segment will benefit due to reduced effective duty on such models while buyers of small and mid-sized cars will benefit marginally (2 percent to 6 percent).”

Saket Mehra
Partner
Grant Thornton India LLP

2. Emission norms effective 1 April 2017

Key highlights

BS or Bharat Stage are the emission norms set by the Central Pollution Control Board (CPCB). The BS norms set certain specifications for the release of air pollutants from the combustible engines of vehicles and with each increase of the numeral beside it, the norms get stricter.

Auto companies were offered hefty discounts in a bid to sell as many BS-III vehicles as possible before the 1 April deadline and for other vehicles, companies tried to upgrade them or export them to countries where emission norms similar to the BS III standard were still existing.

Impact overview

- BS IV emission standards call for reducing evaporation of fuel when the vehicle is parked. Hence, two wheeler manufacturers would have to fit evaporative emission control unit while manufacturing BS IV compliant vehicles.
- Sricter emission norms are expected to reduce pollution but vehicle costs may increase due to improved technology.
- Reduction in pollution levels is one of the primary target area. India has some of the most polluted cities in the world and automobiles are often considered responsible for it.
- Dealers claim that the total worth of inventory that cannot be sold due to the ban of BS III vehicles in the Indian market after 1 April is over Rs 12,000 crore. Unsold BS-III inventory stood at 8,24,275 as of 20 March.

Recommendations

The need of the hour is to control the pollution levels by all means possible and since globally, countries are implying Euro 6 levels of emission regulations, India needs to step up its game.

As per Ministery of State for Road Transport and Highways, the Ministry will introduce BS-VI fuel norms all over the country by April 2020, after consultation with Ministry of Petroleum and National Gas, Department of Heavy industry and Ministry of Environment and Forest.

India is making a concerted effort to reach the global standards and hence, a lot of changes in the trends, sales and choices made by customers are expected in the coming years.

3. CBDT issues clarification on General Anti Avoidance Rules (GAAR)

Key highlights:

The Finance Act, 2012 incorporated General Anti-Avoidance Rule (GAAR) in the Income-Tax Act, 1961 (the 'Act') which has come into effect from FY 2017-18. 'GAAR' is being increasingly adopted in tax laws internationally to target unacceptable tax avoidance practices. Investors and business stakeholders had raised concerns on overreach of GAAR provisions and consequently in January 2017, the Central Board of Direct Taxes (CBDT) issued a clarificatory circular, key highlights of which are summarised below:

- Impact on foreign investors: GAAR shall not be invoked if the jurisdiction of investment is finalised based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit. Further, if Limitation of Benefits (LoB) provisions in a tax treaty sufficiently addresses a case of avoidance, GAAR shall not apply.
- Grandfathering provisions: Grandfathering protection from GAAR in respect of investments made prior to 1 April 2017 shall be available to compulsorily convertible instruments, bonus issuances or split/consolidation of holdings in the hands of same investor.
- Clarifications to minimise litigation: Instances specified for non-application of GAAR include:
  - If at the time of sanctioning an arrangement, the Court has explicitly and adequately considered the tax implications;
  - If an arrangement is held as permissible by the Authority for Advance Rulings (AAR);
  - If an arrangement has been held to be permissible in one year by the specified authorities and the facts and circumstances remain the same, GAAR will not be invoked for that arrangement in a subsequent year.

Impact overview:

The auto and manufacturing sector contributes significantly to both inbound investments in India as well as outbound investments from India by way of greenfield ventures as well as acquisitions (as per RBI statistics, the manufacturing sector accounted for over 25 percent of outbound investments from India in the 3 year period from 2013-16). With GAAR taking effect from 1 April 2017, it would be prudent for businesses and investors to run a fine tooth comb through their current and upcoming investment structures and transactions in order to first identify tax exposure, if any, on account of GAAR and to effect appropriate mitigation strategies to mitigate its implications. Illustrative examples of arrangements that should be looked to examine GAAR impact are as follows:

- Group restructuring plans such as hive-off, consolidation schemes, conversion of company into LLP.
- Use of special purpose vehicles (SPVs) and holding companies in inbound/outbound investment structures.
- Locating entities in jurisdictions that are perceived astax-payer friendly.
- Any intra-group and inter-company transactions that are primarily driven by tax benefits

In conclusion, it would be critical to demonstrate commercial rationale as the key driver for any arrangement/transaction/ structure such as availability of raw material, availability of skilled and cost-effective manpower, proximity to consumers, access to technology, supply chain efficiencies, etc. in order to mitigate adverse income tax consequences on account of GAAR.

4. Guiding principles for determination of Place of Effective Management (PoEM)

Key highlights:

The Finance Act, 2015 introduced the concept of Place of Effective Management ('PoEM') for determination of tax residency of a company in India from FY 2015-16. In January 2017, CBDT issued guiding principles to be followed for determination of PoEM of an entity. Key highlights of the guidelines are encapsulated below:

Determination of PoEM for a company engaged in Active Business Outside India ("ABOI"):

- ABOI test provides four cumulative tests with 50 percent threshold i.e. passive income vs total income test, assets situated in India vs total assets, employees located in India vs total employees and payroll expenses on Indian employees vs total payroll expenses.
- PoEM of a company satisfying the ABOI test shall be presumed to be outside India if majority meetings of the board of directors of the company are held outside India (unless, on the basis of facts and circumstances, it is established that the powers of management are exercised by some other person).

Determination of PoEM for a company engaged in passive business outside India:

- For such companies, PoEM determination shall be a two stage process:
  - First stage would be identification of or ascertaining the person(s) who actually make the key management and commercial decision for conduct of the company's business as a whole.
  - Second stage would be determination of place where these decisions are in fact being made.
- Detailed guidance has been provided on various criteria for determination of PoEM such as location of board/senior management/head office/shareholders, use of information technology for decision-making, etc.

The guidelines also provide some illustrative examples and prescribe the procedure to be followed by the tax authorities for invoking PoEM provisions.

Impact overview:

While the guidelines provide an insight to the approach of tax authorities with regard to PoEM regulations, they are silent on critical aspects such as what constitutes 'key management and commercial decisions'. There is also currently a lack of clarity on consequences of a foreign company's (FCo) PoEM being deemed to be in India for example, would such FCo need to comply with Indian withholding tax compliance and transfer pricing provisions, availability of earlier losses for set off against taxable income, etc.

The Indian auto industry which accounts for more than 7 percent of the country's GDP, is increasingly focusing on diversifying into international markets and shifting from an export model to wider manufacturer based model. In context of their overseas operations, it is advisable for sectoral players to undertake a PoEM impact assessment with a view to ensuring that such overseas ventures (which are tax resident overseas) are not also brought into the Indian tax net. Some aspects that should be looked at are:

- Nature of overseas business – active vs. passive.
- Composition of the board of directors of the foreign entity.
- Distinguish between day-to-day operations and strategic management to determine where the "head and brains" are located.
- Role of Indian head office/employees in the overseas operations.
- Place of decision-making with respect to an SPV's investment activity.
- Maintenance of bank account and books of account overseas.

5. Cross-border mergers: Now a possibility

The Ministry of Corporate Affairs (MCA) in March 2017 notified the long awaited provisions under the Companies Act, 2013 (Cos Act) and the rules thereunder, for cross-border merger of an Indian company into a foreign company (Outbound Merger) and vice-versa ("Inbound Merger"). As per the Companies Act regulations, such cross-border mergers would be subject to prior approval of Reserve Bank of India (RBI).

RBI has recently released draft regulations laying down detailed provisions that would govern such cross-border mergers. Practical implementation of cross-border mergers would need to await notification of RBI's final regulations.

The draft regulations look progressive as they suggest general permission/deemed approval to cross-border mergers coupled with allowing both the company and the shareholders to hold and transfer assets and securities that are otherwise allowed under the prevailing provisions of foreign exchange laws. It would be helpful if, while finalising these draft regulations, RBI could detail out the factors that it would take into account for considering applications for cross-border merger in cases which do not fall within the ambit of deemed approval, for example, where Indian resultant company ends up holding overseas assets/loans which are currently not permitted under foreign exchange laws.

It should be noted that a cross-border merger would be feasible only where the local laws of the overseas entity also permit such cross-border consolidation. In this context, several jurisdictions that have contributed to both inbound and outbound investments into/from India such as Mauritius, USA, Jersey Islands and Isle of Man permit cross-border mergers. However, domestic laws of countries like Singapore, UK and Netherlands do not allow cross-border mergers.

Cross-border mergers can be considered by both Indian corporates as well as foreign investors to achieve varied strategic objectives such as achieving cost reductions and synergies, facilitating externalisation to tap low cost financing arrangements, tapping overseas monetisation opportunities and exit planning. There are several aspects that would require considerable evaluation for successful implementation of cross-border mergers including but not limited to stamp duty and registration costs and evaluation of impact under other tax provisions such as GAAR and PoEM, may not be required. This needs to be retained as practical feasibility of cross-border mergers hinges on this.

Top stories

India gets ready to pay different prices for petrol, diesel every day

In a recent decision, the Government of India (GoI) has decided to extend dynamic pricing of auto fuels across the country on daily basis from June 16, 2017.

The move will introduce international standards in the Indian retail fuel market and may help ensure the benefit of even the smallest change in international oil prices is passed down the line to the dealers and end users.

Oil marketing companies (OMCs) had implemented daily revision of retail selling prices (RSP) of petrol and diesel on a pilot basis in Udaipur, Jamshedpur, Puducherry, Chandigarh, and Vishakhapatnam from May 1, 2017 earlier.

Post deregulation of auto fuels, the oil marketing companies have been revising retail prices of auto fuels every fortnight to pass on to the consumers, the impact of change in product prices in the international market and Rupee US Dollar exchange rates.

The OMCs would further take steps to establish an appropriate mechanism for conveying the prices to consumers every day, including daily publishing of the prices in newspaper, prominent displays of prices at the retail outlets, sending of price related data/SMS from the centralised locations, mobile apps etc.

Consequently, daily price revisions of petrol and diesel will make the retail prices more reflective of the current market conditions, minimising the volatility in the RSP of Petrol and Diesel. Further, it will lead to increased transparency in the system which would also enable smoother flow of products from refinery/depots to retail outlets. Many developed countries are already revising the prices of Petrol and diesel on a daily basis.

Impact of scrapping policy

Scrappage scheme can boost commercial vehicle sales

Ministry of Road Transport and Highways unveiled a voluntary vehicle modernisation programme that could boost commercial vehicle (CV) sales by a cumulative 65 percent between fiscal 2018 and 2020.

Crisil research: Close to 680,000 CVs were sold in fiscal 2016. The scheme could lead to incremental sales of 440,000 units, primarily heavy-duty trucks. In addition, around 200,000 CVs would get scrapped and replaced in the normal course through the three fiscal years, given the current junking rate of around 67,000 units annually. Hence, total vehicles opting for the scheme would be 640,000.

More than 85 percent of the incremental sales would be of medium and heavy trucks because of their lifespan of around 20 years. Hence, many of them bought before the March 2005 cut-off date for the scheme, would still be plying.

Intermediate CVs and tractor-trailers, too, have a similar lifespan, but those purchased before March 2005 are comparatively fewer. Pick-ups, upper light CVs and medium and heavy commercial vehicles, which have a lower lifespan of 15-17 years, will have a smaller share in vehicles being scrapped and most of them would anyway be scrapped.

Latest in April 2017

Impact of ban

- After the Supreme Court ordered a ban on sale of BS-III vehicles, as many as 6.71 lakh two wheelers, out of over 8 lakh BS-III vehicles, were impacted by the ban. The dealers tried to clear the BS-III inventory as fast as possible by offering massive discounts.
- The two-wheeler industry is estimated to have incurred a loss of Rs 600 crore due to the three-day discount offered to customers.
- The major chunk of the loss is expected to be borne by the Original Equipment Makers (OEMS) even as retro-fitment of the unsold vehicles to make them BS IV-compliant is also an alternative as suggested by Indian Credit Rating Agency (ICRA).

Key headlines

Key Headlines

SUV growth pushes passenger vehicle sales to its highest in six years

11 April 2017- Livemint

Sales of passenger vehicles (PV) in India during the fiscal year ended 31 March grew at its fastest pace in six years, largely propped up by sales of sports utility vehicles (SUVs), according to data released by industry lobby Society of Indian Automobile Manufacturers (Siam).

Utility vehicle sales grew 30% to 7.61 lakh units, Siam data showed.

Auto industry all set to roll out BS-IV vehicles from 1 April: SIAM

9 March 2017

The Indian automobile industry will commence the production of the Bharat Stage IV (BS-IV) norms compliant vehicles from 1 April 2017, according to the Society of Indian Automobile Manufacturers (SIAM). The BS-IV emission norms will be applicable to all vehicles across the country from 1 April, 2017. The Indian auto industry has been the fastest in the world to upgrade its emission norms, said President, SIAM. It will also be the first in the world to upgrade from BS-IV to BS-VI emission norms by 2020.

Auto Industry divided on Taxation under GST regime

1 March 2017- Economic Times

The auto industry seems to be divided on the rate structure under GST regime. Society of Indian Automobile Manufactures has suggested twin rate structure to the Finance Ministry.

Tata Motors partners with Microsoft for new car products

17 February 2017- Business Standard

TAMO, the open platform from domestic automaker allows collaboration with various technology partners to launch low-volume niche products that can prove Tata Motors product development capabilities. This is a part for revamping product strategy of the company for the passenger car segment to safeguard itself from competition coming from other technology giants.

NGT Reserves Its Judgment On The Ban On 10-Year-Old Diesel Vehicles In Delhi-NCR

27 April 2017

Centre asks NGT to remove the ban on 10-year-old diesel vehicles in Delhi.

NGT reserves its judgment even after the second hearing.

Government says CNG & petrol also cause pollution in different capacities.

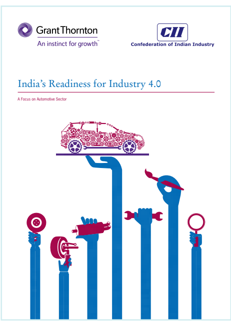
Snapshot of our earlier publications

It highlighted the impact of demonetisation on the industry. The initial spurt in sales on account of the hike in income rise due to Seventh Pay Commission, subsequent good monsoon and rise in demand in urban and rural areas of the country, was subdued due to the shortage of legal tender. There was decline in sales of cars and two wheelers across the country.

- Demonetisation has impacted the sales of vehicles across the Automotive Industry
- Sale for cars without waiting period was down 30-50%.
- Overall, month on month 25% fall in the sales was witnessed.

It highlighted the differentiated purchase decisions of consumers for passenger vehicles and the factors impacting their preferences. The buying trend in all segments was evaluated and Sports Utility Vehicles (SUVs) were witnessed to be the favourite segment for consumers including the youth.

- The lure of off-roaders remained high on account
- Hatchbacks ruled the growing car market share
- Sales of MPVs had nosedived
- OEMs of luxury cars faced challenges



"India's Readiness for Industry 4.0 – A focus on Automotive Sector" in association with industry body CII brought light of the dynamic era of new disruptive technologies which are likely to change the way industry players/ government look at manufacturing.

- Industry 4.0 started with Germany and is gaining momentum in the United States, Japan, China, Nordic countries and the United Kingdom
- To capitalise on the opportunity presented, private sector companies have already taken steps to adopt Industry 4.0.
- Industry 4.0 is all about optimisation of smart, flexible supply chains, factories and distribution models where machines capture and convey more data via machine-to-machine communications and to human operators.

It highlighted the role and impact of rural markets on the automotive sector. While auto industry recognises the hidden potential of the rural market in next 5-15 years, continuous research and development and effective implementation of government policies can pave the way for auto sector boom in India.

- Infrastructure- a major driver of growth for auto industry
- Availability of after-market services and spare parts to boost rural auto sales
- Smaller towns and rural areas are a gold mine that foreign automakers are yet to tap efficiently
- A comparison between 2W and 4W segment share in the rural sector
- Rural demand for Original Equipment Manufacturers (OEM)
- Future prospects of rural share on the demand of automotive products

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