Industry feature: Auto components sector

The domestic auto components industry,composed of more than 700 organised players and about 5,800 unorganised players, is largely dominated by small and medium enterprises (SMEs). Production of auto components is expected to grow at a CAGR of 13-15 per cent over 2014-15 to 2019-20. Growth in the sector is mainly driven by the original equipment manufacturer (OEM) segment (for passenger cars, commercial vehicles and tractors) which is likely to post a CAGR of 11-14 per cent from 2014-15 to 2019-20.With the upstream demand for automobiles, replacement demand is also likely to increase. This would augur well for small players in the industry, catering primarily to the replacement market. The sector is also poised to record a 10-12 percent CAGR in exports as India serves as a hub for global OEMs to cater to neighbouring markets.

Industry predominated by SME players

The auto components industry comprises engine parts, electrical parts, suspension and braking parts, body and chassis, drive transmission and steering gear systems and parts. Engine parts and drive transmission account for majority of the auto components sector. Key auto components that are exported include steering gear systems and parts, gear boxes and parts, parts of diesel engine, suspension system, brakes, and transmission parts.
The auto components industry consists of organised players contributing 70-75 per cent of the total industry's turnover and unorganised SME playersaccounting for 25-30 per cent.Most of these unorganised players cater to the replacement market.

Industry slowdown

After rising strongly in 2009-10 and 2010-11, growth in auto component production slowed consistently until 2013-14. Lacklustre demand from automobile OEMs pulled down growth. Growth in exports also slowed owing to lower demand from key markets as sluggish economic growth in the EU, and inventory cuts by truck manufacturers in the US curbed offtake. Replacement demand growth remained stable over the years, while growth in cheaper imports continued to increase. However, in 2014-15, production posted a modest recovery of 8 per cent with a revival in domestic automobile demand and growth in the key export markets such as Europe and the US. Margin also improved due to decline in input costs.

Pressure on margin and working capital

Profit margin was under pressure in 2013-14 owing to high raw material and employee costs and inadequate capacity utilisation. However, we expect margin to improve in 2016-17 due to improvement in capacity utilisation and a sharp decline in commodity costs. The cost of raw materials is expected to decline by 3-5 per cent in 2016-17, thus improving margin further.
Receivables rose between 2013-14 and 2014-15 owing to the increasing share of exports, which tend to have a longer recovery cycle, relative to domestic recoveries. This had a cascading effect on the payables as well during the said period.

Outlook

India has emerged as an auto-component hub (particularly for small/compact cars) for automakers across the globe, given its relatively lower manufacturing cost. Superior product quality and a shift to high-tech products have helped Indian componentmakers compete better with other low-cost destinations, and boosted exports.

Original equipment manufacturer (OEM) segment to boost in the long-run: The demand in OEM segment is expected to grow at a 12-14 per cent CAGR between 2015-16 and 2020-21 led by robust vehicle production. Among OEMs, demand will be primarily from cars and utility vehicles (11-13%

CAGR), commercial vehicles (MHCVs 8-11%, LCVs 11-14% and buses 8-10%) and two-wheelers (8-10%). The proportion of manufacturing activity outsourced to auto-component makers is the highest for cars and utility vehicles at about 60% of a car's total price tag; this explains this segment's prominence. On the other hand, outsourcing accounts for about 40% of the manufacturing cost for CVs - this is expected to increase further with the growing technological spending by auto-component players, fetching higher realisation from CVs for auto-component manufacturers.

Long-term prospects:
With respect to long-term growth, CRISIL expects auto component production to grow at a CAGR of 13-15 per cent over 2014-15 to 2019-20. The share of OEM demand in overall auto component production, though, will decline marginally to about 62 per cent during the period as exports will increase at a faster pace. However, with stiff competition from imports and other segments (exports and OEMs) sourcing a higher proportion of auto components, the share of domestic after-market sales will decline to 14 per cent of overall production by 2019-20, as against the current 16 per cent.

Export prospects

We expect exports to pick up in the long term as key target markets recover and Indian manufacturers achieve greater technological expertise. Moreover, global automobile manufacturers will aim to save on costs by establishing manufacturing centres in low-cost countries such as India. Growth will be aided by European countries where demand is expected to grow faster than in the last 5 years (growth in trucks is expected to accelerate from 3 per cent to 6 per cent and that in cars by ~4 per cent compared with 2 per cent in the last 5 years). Additionally, auto-component makers are expected to tap new export markets, given the huge penetration potential of Indian players.

End-user industry prospects

- **Domestic passenger vehicles**
  Growth in the domestic passenger vehicles industry is expected to accelerate slightly to 8-10 per cent in 2016-17 vis-a-vis a 7 per cent growth in 2015-16. The long-term picture is bright, given the current lower penetration levels and the likelihood of stable crude oil prices.
- **Medium and heavy commercial vehicles (MHCV)**
  Medium and heavy commercial vehicle (MHCV) sales are projected to rebound over 2014-15 to 2019-20, growing at a healthy 10-12 per cent CAGR, as industrial activity improves, agricultural output steadies and infrastructure project execution receives greater focus. Capacity constraints faced by the railways will add support.
- **Light commercial vehicles (LCVs)**
  Demand for light commercial vehicles (LCVs) is expected to expand at 11-14 per cent CAGR during 2014-15 to 2019-20 owing to higher consumption expenditure.
- **Tractors**
  Also, tractor sales are expected to increase at a healthy pace due to a shorter replacement cycle, stable farm income and increased focus of the government on agricultural and rural development.

Conclusion

The auto components industry has adapted well to the changes and needs of the customers over the years. With further upgradation in technology, increased investment in R&D operations and laboratories, and innovation, SMEs can meet the industry requirements as they have the advantage of relatively less complicated operations and flexibility to adapt.Improving quality standards in India have helped reduce product defects. Consequently, the confidence of international buyers in Indian auto-component companies has also improved, boosting auto-component exports.