

Autos

Va tutto bene #17

Exactly a year ago, we wrote ‘Andra tutto bene’ (everything is going to be alright!) in which we analysed the likely changes to consumption, industry structures etc. We revisit the thoughts, look beyond the noise, and present potential changes in operating environment and likely beneficiaries – Va tutto bene (everything’s fine!). A root-cause-analysis of every trend indicates that it’s a consumer / customer behaviour change. “Andra tutto bene #9” is [here](#).

Key long-term trends witnessed in auto sector are: 1) Rural demand resilience amidst weakening urban ownership (2) mass-market segment (e.g. entry level 2Ws/PVs) demand recovery is stuttering while premium segment continues to steadily improve (3) Covid has led to structural acceleration of digital adoption (OEMs/dealers) for all customer outreach programmes; Covid also led to cost savings (e.g. optimisation of A&P spends) (4) strong policy measures (e.g. increase infra investments, scrappage policy) lay down strong foundation for potentially multi-year growth for commercial segments (e.g. M&HCV) (5) a well-structured PLI scheme could lead to meaningful TAM expansion for exports, localisation of new technologies (e.g. EV cells) (6) significant challenges due to supply-chain bottlenecks (e.g. semiconductor chips shortage) could lead to change in the traditional “Just-in-time” manufacturing process and (7) persistence of Covid is leading to increasing adoption of work-from-home in major cities which could result in reduced *miles travelled per personal vehicle*, thereby, elongating vehicle replacement cycles. As a theme, we prefer economy facing segments (e.g. CVs/Tractors) over consumer segments (e.g. 2Ws/PVs).

Beneficiaries: Tata Motors, Ashok Leyland, M&M

Potentially negatively impacted companies: Hero Motocorp

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- ▶ **Rural demand continues to outshine its urban counterpart:** Consumer facing auto demand has witnessed yet another year of strong outperformance (e.g. economically weaker states like West Bengal, Jharkhand have outperformed stronger states like Gujarat, Karnataka [Link](#)). The growth surprise is likely to continue via rural segments due to healthy outlook for agrarian cashflow and restarting of government spending on infrastructure projects. On the urban side, Covid risk is already leading to employers turning cautious, this could hurt consumer sentiment (e.g. lower than expected salary hikes/job fears).
- ▶ **Premium segment shining while mass-market facing headwinds:** Premiumisation trends had paused immediately post Covid onset as mass-market segments benefitted from lack of public transportation leading to increased need for affordable mobility. However, over the past few quarters, premiumisation trends have started to improve across PVs/2Ws (UVs outgrowing cars; >250cc motorcycle’s outgrowing <125cc segment). OEMs are also recognising the change with a slew of new launches (e.g. 4 new SUV launched in 4Q) happening across the premium segment.

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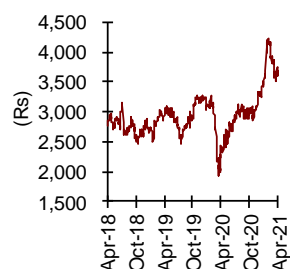
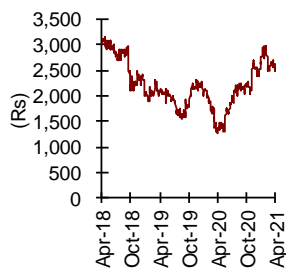
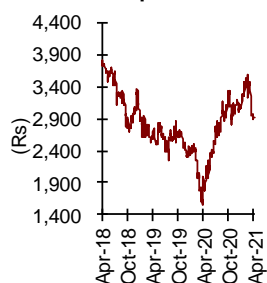
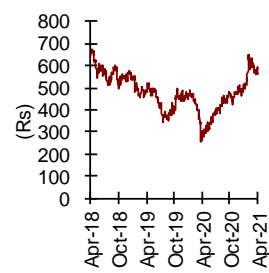
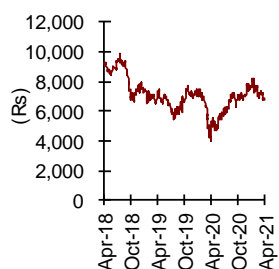
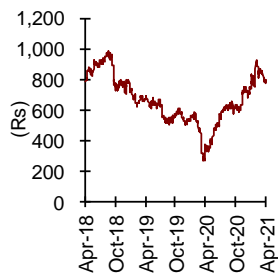
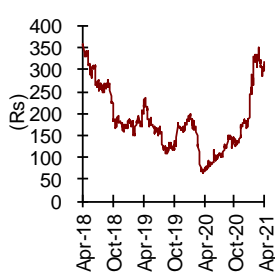
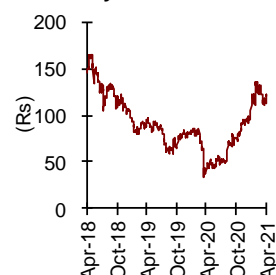
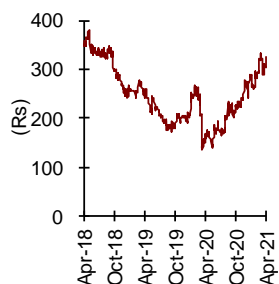
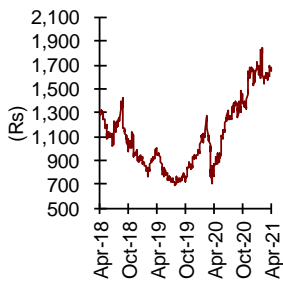
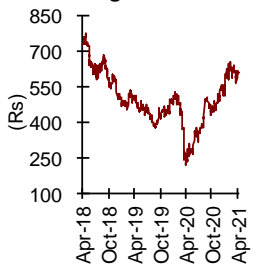
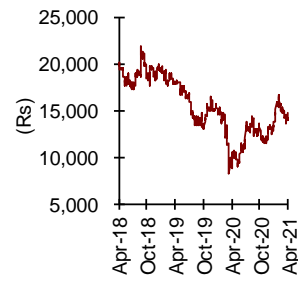
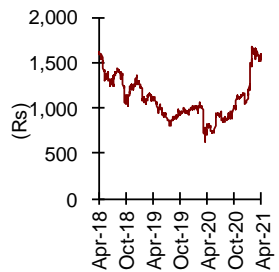
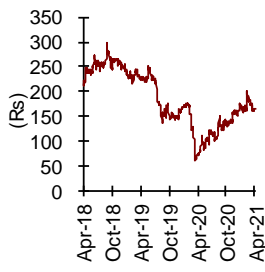
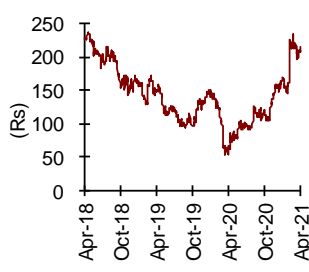
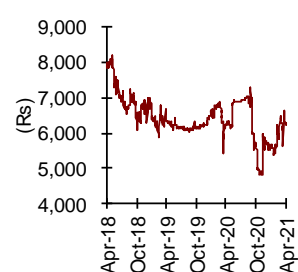
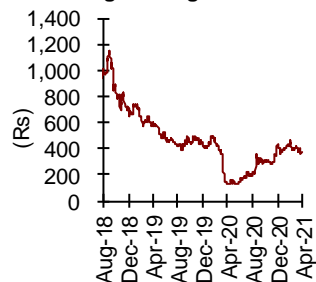
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- ▶ **Rapid digital adoption leading to overhaul of sales & marketing:** FY21 has led to structural changes in the consumer interaction model for the industry with digital becoming the mode of choice. Everything ranging from new vehicle launches to lead generation (~2/3rd of new leads are digital) to vehicle loan issuance has become digital. As consumers increasingly use internet as a de facto search/knowledge tool, OEMs have also raised their digital marketing spending significantly (yet leading to savings in A&P spends).
- ▶ **Commercial vehicle segment to retain high growth visibility:** The various policy measures for infrastructure development announced in the Union Budget 2021, coupled with scrappage policy, may aid freight demand. This could lead to multi-year growth cycle in the M&HCV segment. Similarly, demand in last mile delivery is also a key long-term growth driver for LCV segment. We also expect the tractor segment to benefit from infra investments as >1/3rd of tractor usage is towards load-bearing activities.
- ▶ **PLI scheme is likely to boost exports, new technology adoption:** Exports and electric vehicles are two major focus points for policy makers; hence, a well-structured PLI scheme could significantly aid industry. We expect 2W segment to be a key beneficiary of export-oriented policy measures (proposed PLI outlay: Rs570bn) due to strong global presence of leading domestic OEMs. EV cell manufacturing is another key area which has a strong capital outlay (Rs180bn) in the PLI scheme, thus, could lead to global leaders establishing manufacturing capacities in India, thereby, localising the knowledge.
- ▶ **Semi-conductor shortages make OEMs realise “JIT” might not always be optimal:** Covid induced sudden demand fall caused OEMs to slash growth forecast, thereby, causing a bull-whip effect across the supply chain including semi-conductors. The recent semiconductor shortage is largely self-induced, created due to OEM quest for precise demand/supply planning so as to maintain lean stock levels (JIT manufacturing philosophy). We expect change from OEMs on future supply chain planning considering increasing need for computational/semi-conductor requirements in future vehicles (read EVs). Cost-benefit of JIT vis-à-vis smoother manufacturing planning is likely to be re-evaluated.
- ▶ **Work from home permeation likely to elongate vehicle replacement cycle:** Currently, most companies are adjusting their employee pyramid to the new work-from-home culture and we believe Covid could be the trigger for its sustained adoption across businesses. We believe increased adoption of this trend is likely to elongate replacement cycles as miles driven on personal vehicles could go down significantly. Currently, for segments like PVs, replacement demand is >55% of the overall annual sales and possible elongation of replacement cycles could hurt long-term growth trends.

Unappreciated short-term challenges:

- We believe, with the emergence of second Covid wave, people who started travel or the ones who have to travel for work would again be cautious of the possible recurrence of health scares. On one side these concerns remain dampeners for fragile consumer sentiment while on the other vehicle prices are rising (up >4-8% across categories) due to continued input cost inflation. Thus, during the upcoming period, we believe, new vehicle demand (PVs/2Ws) might witness softening. Upcoming marriage demand (prevalent in North India) remains key for mass-market segments as inventories in these categories remain relatively elevated.
- Industry is likely to witness significant margin pressures in the next few quarters as incremental capacity headroom remains limited (read operating leverage) while cost inflation continues to run ahead of vehicle price increases.
- Industry also continues to be impacted by supply-chain issues which are likely to disrupt new product launch timelines for most OEMs. Already, we have witnessed delays in product launches across OEMs (e.g. M&M-XUV700, Skoda-Kushaq etc.)

Price charts**Bajaj Auto****Eicher Motors****Hero Motocorp****TVS Motors****Maruti Suzuki****M&M****Tata Motors****Ashok Leyland****Asahi India****Balkrishna Ind****Bharat Forge****Bosch****CEAT****Mahindra CIE****Motherson Sumi****Wabco Ltd****Varroc Engineering**

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