FY20 Outlook: OEM & Replacement Demand, Regulatory Advancements to Favour Auto Ancillaries

Ind-Ra-Mumbai-xx February 2019: India Ratings and Research (Ind-Ra) has maintained a stable outlook for the auto ancillaries sector for FY20, based on the expectations of 1) a moderate demand from original equipment manufacturers (OEMs), a continued replacement demand and a likely rise in content per vehicle amid evolving regulatory norms.

Ind-Ra expects moderate sales volume growth in the passenger vehicle segment, high single-to-low double-digit growth in the commercial vehicle segment and steady growth in the two-wheeler segment in FY20 on a year-on-year basis. Furthermore, the adoption of new safety and emission norms, technological advancements along with a trend towards premiumisation and digitalisation are likely to increase the content of auto components per vehicle, thus driving growth among auto ancillaries.

Auto ancillaries would be looking at increasing their capacities to cater to the new regulatory norms and higher replacement demand. Ind-Ra thus expects the credit metrics to moderate in FY20; however, adequate cash flows and healthy balance sheets are likely to give comfort. Also, although margins in the sector will remain sensitive to raw material prices and forex volatility, the economies of scale and ability of major suppliers to partly pass on price rises to OEMs will keep margins stable.

Ind-Ra expects the sector companies to embrace inorganic growth in the medium to long term. Such acquisitions could also be debt-funded partially. However, Ind-Ra opines higher rated companies (IND AA- and above) in the sector are better placed to fund any inorganic growth opportunities without materially impacting their leverage positions, owing to comfortable cash flows and liquidity.

Sub-sectors	**Key highlights - FY20**
Tyre	Credit metrics to deteriorate over FY19-FY21, amid high expansionary capex, though a sufficient replacement demand over the next five years to absorb new capacities.
Forging	Revenue growth to normalise in line with slower growth in domestic commercial vehicles and US truck sales compared to last year’s
Battery	Players eyeing to capture lithium-ion opportunity. New product development, technology upgradation and capacity addition capex likely over the next two to three years
Diesel engine	Capex will come down in FY20 as Bharat Stage VI (BS-VI) related capex will peak out. Companies will continue to diversify in other fuel agnostic products.

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