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Indian Two-Wheeler Industry

Quarterly Update

March 2020

What's inside…

Highlights

- With a 16% YoY decline in wholesale dispatches, the domestic two-wheeler industry witnessed the worst volume contraction in more than a decade during YTD FY2020. This is expected to get further aggravated over the near term with the ongoing and rapidly spreading COVID-19 pandemic.
- Over the past 18 months the two-wheeler demand has been reeling under multiple headwinds, including rising cost of ownership amidst slowing macroeconomic growth and liquidity constraints in rural segment.
- With muted retail offtake, the 2W OEMs had scaled down production during FY2020 to rationalise inventory prior to transition to BS-VI emission norms in April 2020. Since the transition to BS-VI entailed a significant technology change and increase in vehicle prices, industry had anticipated certain level of pre-buying in Q4 FY2020, and support arrest the decline in volumes.
- However, COVID-19 outbreak leading to lockdowns and travel restrictions have caused significant fall in customer walk-ins at dealerships in March 2020, exposing many to possible of inventory loss on unsold BS-IV stock.
- ICRA expects that demand headwinds would continue over the near-term, with BS-VI related price hikes amidst weak global and domestic economic sentiments, which have been further aggravated by the fast spreading COVID-19 pandemic. Demand may revive, albeit at muted pace, in later half of FY2021, assuming waning impact of the pandemic, supported by pickup in economic activity and improvement in agri-cash flows (from a good rabi season).

Summary

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2W industry likely to witness another year of contraction weighed down by COVID-19 outbreak

- FY2020 has been all about inventory correction in the domestic two-wheeler (2W) industry as Original Equipment Manufacturers (OEMs) tried to counter the subdued demand during a year of transition to the new emission norms. With weak retail offtake and the inventory build-up at the dealerships, the 2W OEMs resorted to production cuts and sharp reductions in wholesale dispatches in order to rationalize inventory in the system. As the unsold BS-IV vehicles would be rendered obsolete post March 2020, wholesale dispatches contracted by 16% during YTD FY2020.
- In addition to the inventory correction exercise undertaken by 2W OEMs, the underlying demand sentiment in the industry also remained weak, given multiple headwinds. This included (a) sharp rise in 2W prices due to regulatory changes in insurance norms and adoption of ABS/CBS safety standards (b) slowdown in the economy impacting wage hikes and employment levels and (c) liquidity crunch in rural India caused by weak rabi realizations and uneven monsoons damaging Kharif crop in FY2020.
- With COVID-19 outbreak leading to lockdowns and travel restrictions have caused significant fall in customer walk-ins at dealerships in March 2020 (and likely in April-20). The 2W OEMs also shut-down production in the last week of March, inline with government advisory. Given the rapid spread of pandemic coronavirus, recovery from the downcycle is expected to be delayed by at least a few quarters.
- Going forward, the volume outlook for the next fiscal rests upon the pace of recovery in economic environment post COVID-19 crisis (whose severity remains uncertain at present), government's fiscal stimulus and agri-trends. A good rabi season and revival in rural sentiments, coupled with a low base, may support domestic 2W volume growth in the latter half of the year but would only help to offset the adverse impact of COVID-19 outbreak in H1 partially. Given the expectation of sharp decline in pace of India's GDP growth, lower job creation both in urban and rural markets, two-wheeler demand will most certainly be adversely impacted. The industry was already likely to witness muted growth because of rising cost of ownership. On the export front, while any long-term predictions are difficult, volatility in crude oil prices could be a near term negative. However, increasingly diversified markets being served by the OEMs are expected to be a long-term positive for Indian 2W industry.

Summary

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Earnings and profitability of 2W OEMs expected to moderate in the near-term albeit financial profile to remain stable

- It is expected that demand headwinds would continue over the near-term, especially with price increases on account of BS-VI transition in April 2020 and weak macroeconomic sentiments, as a fallout of COVID-19 pandemic. Volumes are likely to contract by 11-13% on YoY basis in FY2021.
- While the sharp volume contraction exerted pressure on earnings of 2W OEMs during FY2020, price escalations, moderating commodity prices and depreciating rupee coupled with continuous cost rationalisation initiatives, supported improvement in their operating margins.
- However, disruptions to supply chains originating from COVID-19 impacted geographies had forced production cuts by OEMs in Feb 2020. With pandemic spread in India, most 2W OEMs have also shut their operations during later half of March-2020. This would impact channel filling with BS-VI inventory. Given the high operating leverage of the industry, weak demand and rise in cost due to migration to BS-VI technology, the OEM operating margins are likely to deteriorate by 200-250 bps in fiscal 2021.
- Furthermore, any unsold BS-IV inventory at the dealerships and their write-off could impair the financial ability of the channel partner and subdue the pace of BS-VI inventory uptake. Accordingly, ICRA expects credit metrics of 2W OEMs to remain subdued over the next few quarters.

Thank You!

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