KPMG

Indian auto components industry post COVID-19

June 2020

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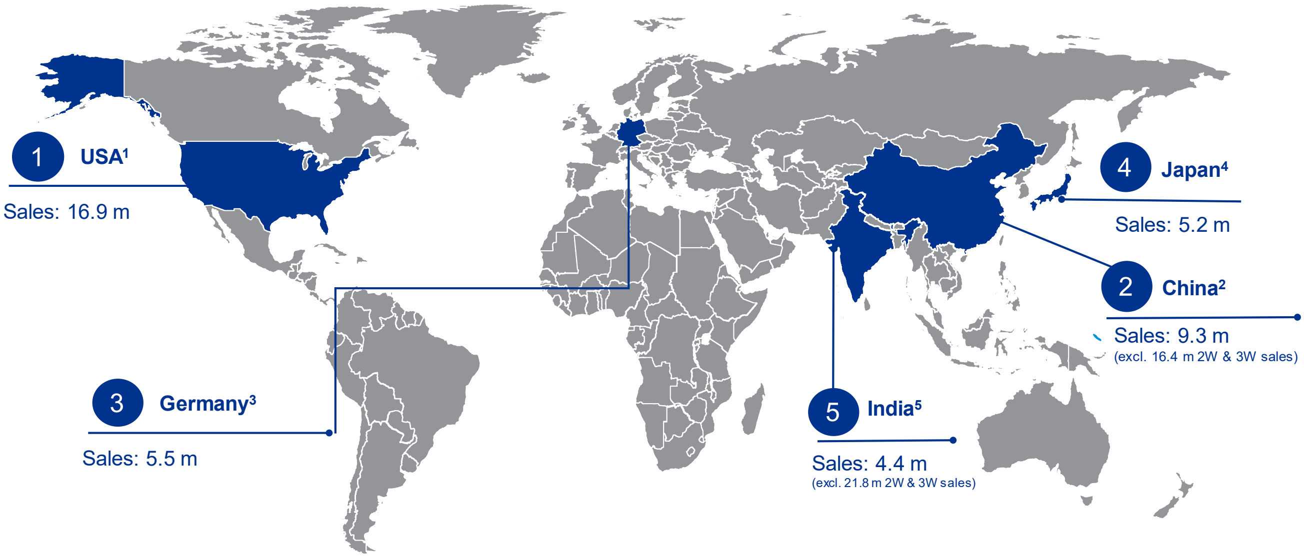
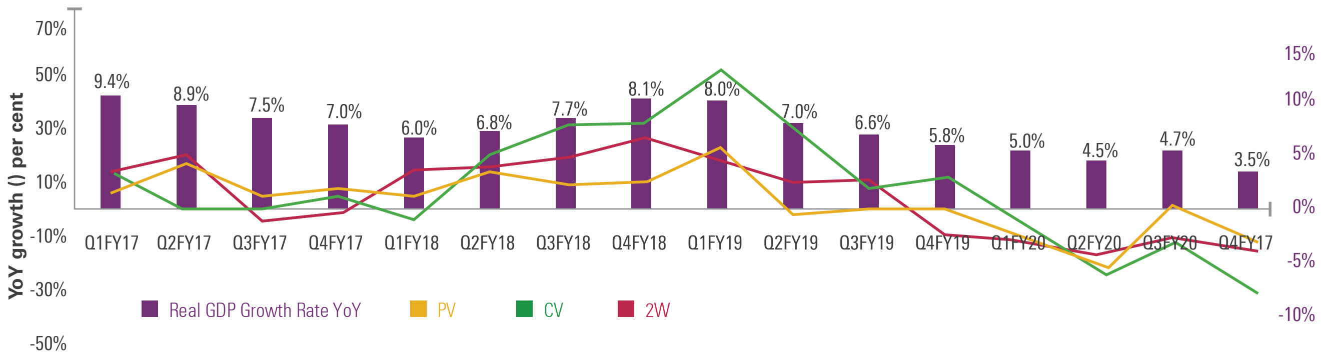
India - a key auto market globally

India is the amongst the top five auto markets globally

Vehicle (excluding two wheelers) sales across key nations/regions, 2019



Vehicle sales[7] in India have historically shown a strong correlation with GDP[7] and over the last six quarters have witnessed a sharp fall driven by a host of systemic issues and weak customer sentiment



01. CNBC Publication "US-auto-sales-down-in-2019-but-still-top-17-million"; accessed on 20 Apr 2020
02. Publications "Salesfig_China_2019"; Publication "Chinese Motorcycles Market""; accessed on 20 Apr 2020
03. GTAI Publication "Industry Overview Automotive Industry""; accessed on 20 Apr 2020
04. Focus2move publication "Japan-Auto-Market" accessed on 20 Apr 2020
05. SIAM Database "; accessed on 20 Apr 2020
06. Stastics Times Data "Quarterly GDP growth of India" "; accessed on 29 Apr 2020
07. SIAM Database and Press Released "; accessed on 29 Apr 2020

COVID-19 impact – economic stress and liquidity crisis across the world

COVID-19 has resulted in lockdowns across the globe, leading to plant closures, job losses, economic contraction and consequent decline in demand

Lockdowns

- Containment measures have resulted in an average lockdown of 2-3 months
- Lower availability of manpower (20 to 50 per cent[8]) for operations resulted in limited output
- India, following a 70 day lockdown and movement of migrants out of production centres, is likely to see a delayed recovery of production to pre-COVID-19 levels.

Economic contractions

- IMF estimates a decline of 3 per cent[9] in global GDP with a likely rebound only by Q3 2021
- A 10.5 per cent deterioration[10] (as compared to pre-crisis levels in Q42019) in employment levels is expected globally impacting livelihoods and spending power
- Postponement of purchase decisions likely at least by a few quarters

Demand slowdown

- Discretionary spends such as auto are expected to face postponement, trading down and even cancellation
- Job losses, pay cuts, reduction in household incomes and weak sentiment expected to further reduce demand

Liquidity crisis

- A liquidity crunch in the immediate term is likely to push a number of companies towards the brink in servicing their debt obligations
- Stimulus packages announced by the government are expected to help in the short term; long term sustainability will require revival of demand and resumption of economic activity.

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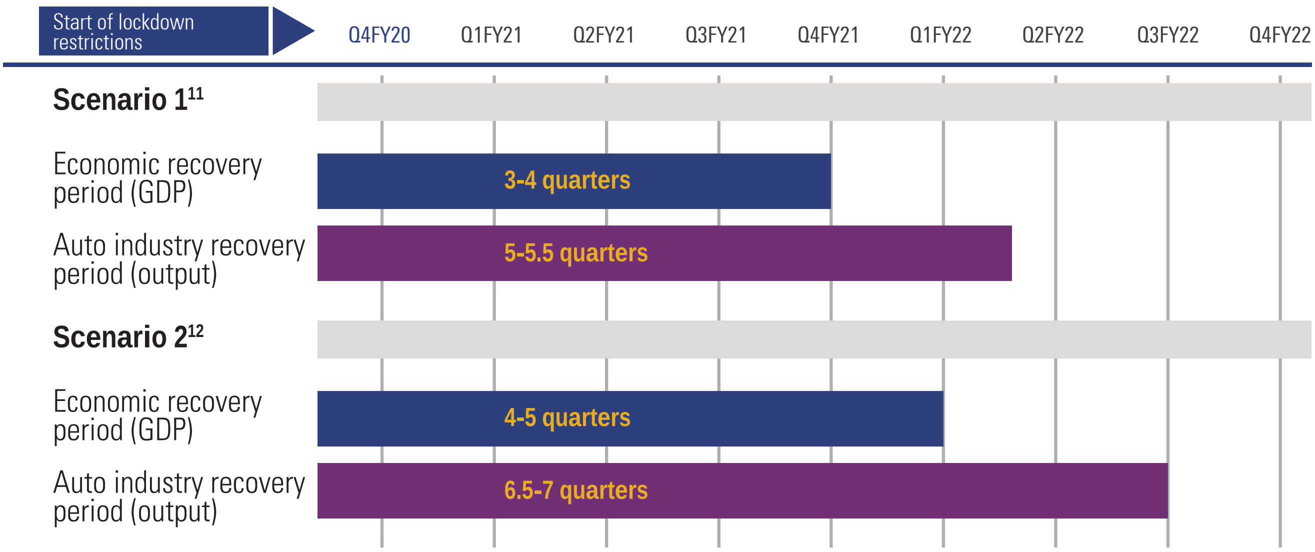
08. Industry discussions by KPMG in India
09. FAS Global Report "Global Economic Effects of COVID-19" "; accessed on 9 May 2020
10. Financial Express Publication "Half of global workforce at risk of losing livelihoods: ILO"; accessed on 29th May 2020.

Indian economy, auto industry entering rebuilding phase

The auto industry is expected to take five to seven quarters to recover from the impact of COVID-19



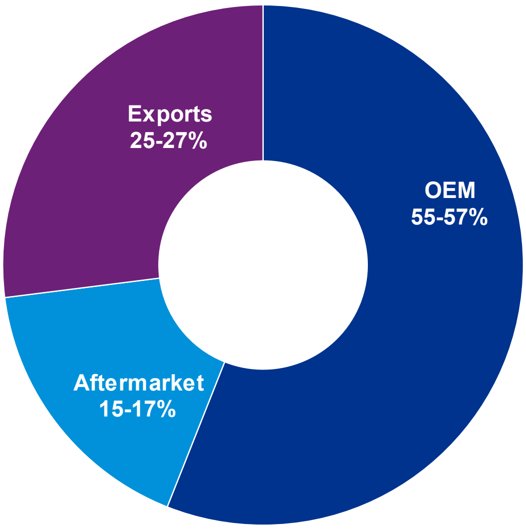
- A steady recovery post September 2020 is foreseen, led by a gradual rise in economic activity across sectors and consequently improving consumer confidence supported by easier access to credit
- The recovery is expected to vary by vehicle categories given varying underlying demand drivers – two wheelers (2Ws) and entry level passenger vehicles (PVs) are expected to lead recovery, premium cars and commercial vehicles (CVs) are expected to take longer
- Given health and hygiene concerns, preference for personal mobility is expected to be higher than before. Shared mobility may see a delay in reaching pre COVID-19 levels and subscription models are likely to benefit most from commitment phobic consumers who don't wish to incur large spends on vehicle purchase

11. KPMG in India analysis based on discussions with automotive industry stakeholders
12. KPMG in India analysis based on discussions with automotive industry stakeholders

Testing times for the auto component industry

- **Auto components in India is a USD48 billion industry[13] (organised sector only) which has a strong dependence on performance of auto OEMs**
- **Auto components account for ~2.3 per cent of India's GDP.[14]**

Turnover segmentation by customer/channel – organised sector FY20[15]



- The auto component market is highly reliant on the performance of auto OEMs
- Most large and mid-sized players have strong OEM relationships and/or export focus
- Product innovation is generally OEM driven; technology partnerships are common in the industry to leverage global innovations for the local market
- Most organised players have a limited independent aftermarket (IAM) play.

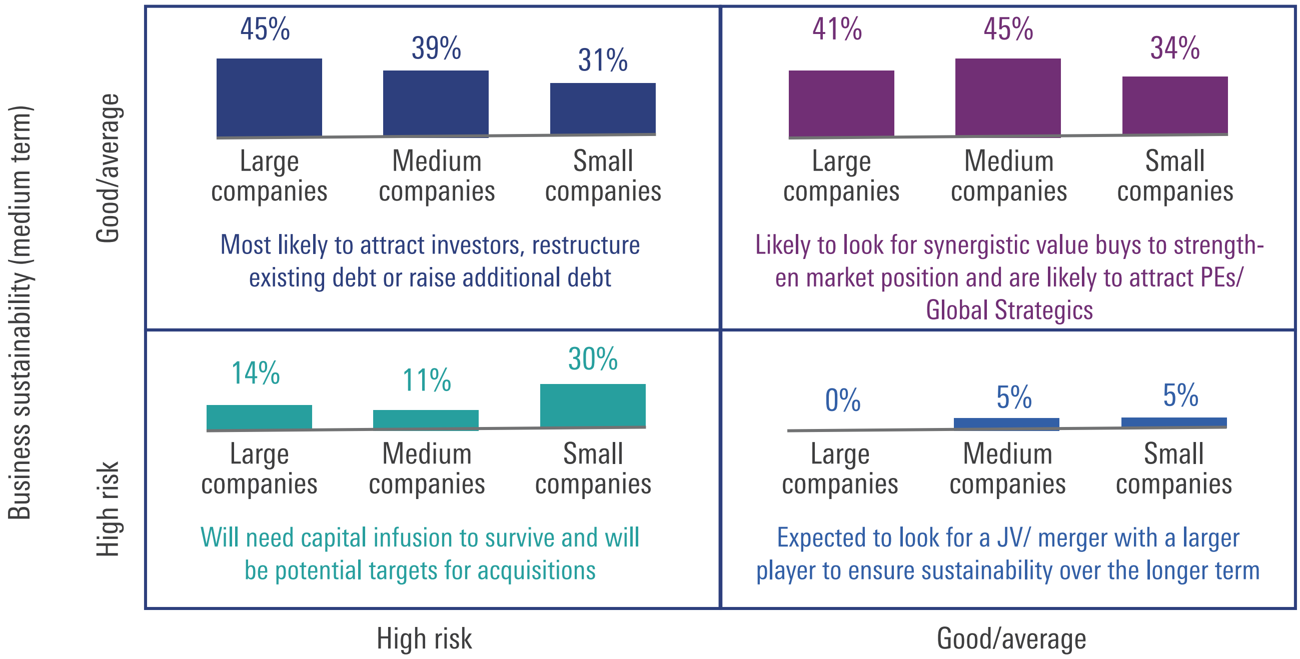
Impact of COVID-19 on auto component industry

- According to discussions with automotive industry participants, the domestic auto industry is expected to take five to seven quarters to recover. Auto components are expected to follow a similar timeframe
- India is a recognised hub for global sourcing of auto components. However, as a fallout of global production cuts, a slump in export sales is expected over the next few quarters
- This demand decline will have an adverse effect on the industry over the next few quarters leading to weakened financial position amongst auto component manufacturers
- Most companies are likely to face liquidity pressures due to high fixed costs, low capacity utilisation till production ramps up and high levels of inventory and receivables
- Postponement of new vehicle purchases by customers and reduced exports are likely to result in the aftermarket receiving increased attention from auto component suppliers.

13. CARE Ratings Report on " Indian Auto Comp Industry – Jan 2020; Indian Express Publication on Indian Auto Ancillary Sector – Jan 2020; KPMG Analysis; accessed on 22nd Apr 2020
14. ACMA Publication "ACMA-Presentation_press-conference_2019"
15. CARE Ratings Report on " Indian Auto Comp Industry – Jan 2020; Indian Express Publication on Indian Auto Ancillary Sector – Jan 2020; KPMG Analysis; accessed on 22nd Apr 2020

Mid and large auto component players to weather the storm

- **We analysed 125[16] companies in the auto component industry to understand their financial position in immediate and medium to long term using the following parameters:**
- **Interest Coverage Ratio, Quick Ratio and Cash Cover to meet short term obligations and ensure survival in the immediate term**
- **Debt Service Coverage Ratio, EBITDA, RoCE and Debt/Equity Ratio for medium to long sustainability to weather immediate challenges and consolidate for the future.**



Liquidity position (immediate term)

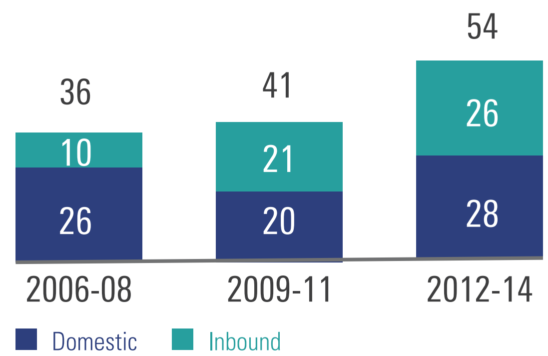
- Most large companies fare favourably on sustainability parameters
- Players with strong balance sheets will be best positioned to benefit from this revival; hunt for value buys to consolidate their position in the industry, diversify their product portfolio and acquire new OEM relationships
- Those with capital requirements but have strong market presence or OE relationships would be attractive targets for overseas investors looking at a strong foothold into India or as an alternative to China
- Cohort of mid-sized companies with strong fundamentals and established domestic presence could see consolidation and interest from domestic and global investors
- Smaller companies are expected to struggle with liquidity; capital infusion will be critical for over 60 per cent of this cohort to survive in the immediate term.

16. Company Financials from Capital IQ Database accessed on 29 Apr 2020

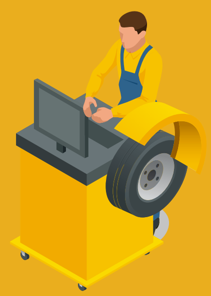
M&A activity - much to learn from the 2008 financial crisis

An evaluation of the M&A scenario in auto components pre and post the 2008 financial crisis reveals an opportunity in a crisis, which allows players with financial muscle to create a position of strength for themselves.

M&A deals in auto components industry[17]



Auto components industry witnessed an increase in M&A deals post 2008 compared to the pre 2008 period, especially the inbound investments (witnessed a sharp increase from 10 in 2006-08 to 21 in 2009-11)



Valuations became attractive post 2008 period

- Average EV/EBITDA multiples for M&A deals saw a decline from 16.7 in pre 2008 period to 12.6 in post 2008 period.

Inbound deals witnessed an increase in number of control deals in the 2009-11 period

- The number of control deals (>50 per cent stake acquired) for inbound transactions increased from two in 2006-08 period to six in 2009-11 period, signaling a willingness on part of sellers to part with a controlling stake to ensure survival.

M&A transactions helped investors outperform the marketn

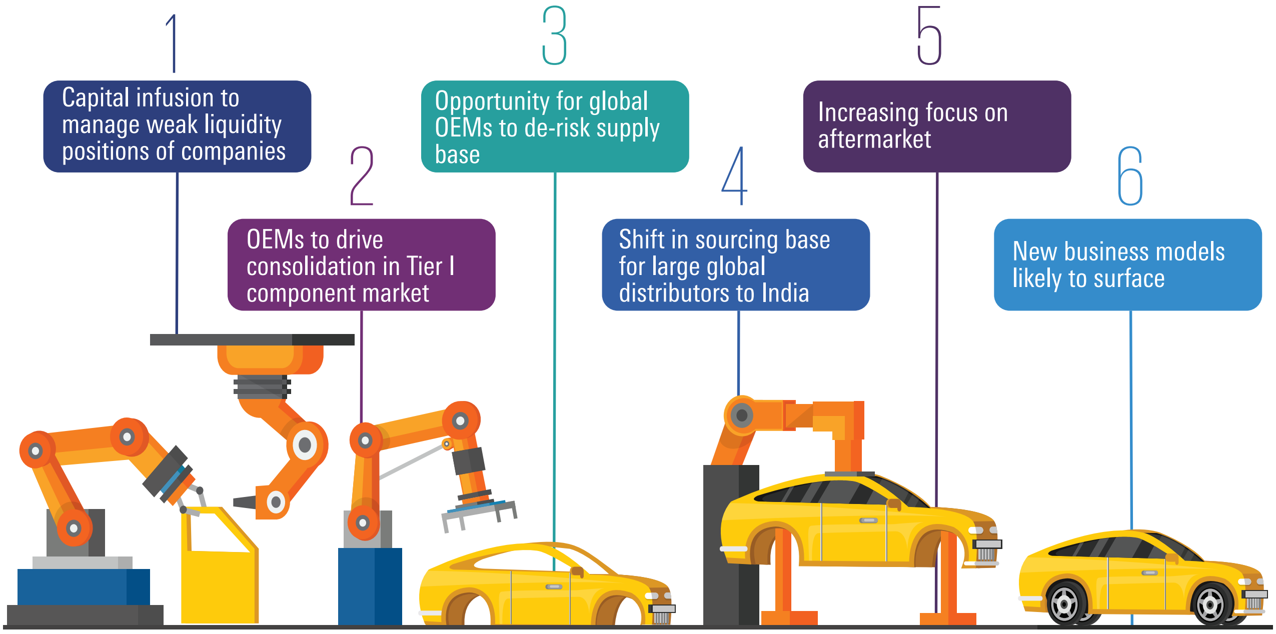
- Companies which made acquisitions in 2009-11 period grew at 2x the market average between FY12-18 (6.1 per cent CAGR vs 3.1 per cent CAGR for the industry)
- Several international players who invested in India, outperformed the market substantially.

Private equity investments garnered better returns

- PE investments in the sector between 2009-11, resulted in greater value creation and returns for investors with an average return of c.40 per cent (vs 1.6 per cent for pre 2008 period)
- In terms of yields, only 1 out 10 deals that saw exits for 2009-11 period yielded a negative return (vs 12 out of the 32 deals yielding negative returns for 2006-08 period)

17. Deals in Auto Components, VCC Edge Database, accessed on 27 April 2020

Six trends are expected to unfold in the sector post COVID-19



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- Opportunity for more equity infusion as raising debt will likely be a challenge for players given the stress in the sector
- Increasing requirement of mezzanine/structured debt in the short-term especially by mid-sized companies to sustain the business.

2

- OEMs will drive the consolidation in the Tier I component market, push critical global suppliers to strengthen local presence
- OEMs to drive local suppliers to partner with global players to get access to better technology.

3

- India offers strong credentials, established relationships and a competitive cost proposition to become an alternative sourcing venue to China for global OEMs, hence de-risking the supply base.

4

- Following the OEMs, distributors will de-risk their sourcing base; domestic players to leverage the technology tie-ups to compete in global market
- Brand, product quality and supply chain support will drive supplier selection.

5

- Aftermarket to remain relatively insulated resulting in increased focus by suppliers until a recovery is seen in the OEM market.

6

- New asset light business models are expected to gain prominence - automotive leasing and subscription models likely to attract interest from global specialists
- Consolidation of automotive dealerships, automotive rentals / self-drive platforms, increased penetration of organised used car platforms likely to expand the scale and attract investors.

KPMG in India contacts:

Rohan Rao
Partner
M&A Consulting
E: rohanrao@kpmg.com

Jeffry Jacob
Partner
Management Consulting
E: Jeffry@kpmg.com

Ashish Gulati
Partner
Corporate Finance
E: ashishgulati@kpmg.com

Thanks to:
Raghavan Viswanathan
Priya Banga

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