PRESS RELEASE
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Revenue growth in auto component industry to moderate to 5-7% in FY2025: ICRA

- ***Operating margins to see YoY improvement of 50-100 bps each in FY2024 and FY2025, returning to pre-Covid levels in the current year***

- ***Industry likely to incur capex of at least Rs. 20,000-25,000 crore in FY2025 towards capacity expansion and technological developments***

ICRA projects its sample of 45 auto ancillaries (with aggregate annual revenues of Rs 2,70,000 crore in FY2023) to grow by 9-11% in FY2024, driven by healthy domestic demand despite a high base and moderate growth in exports. For FY2025, the growth is expected to be relatively lower to 5-7%, with likely moderation in domestic volume growth and a weak outlook for exports. However, factors like rising supplies to new platforms because of vendor diversification initiatives by global original equipment manufacturers (OEMs), higher value addition, partly stemming from an increase in outsourcing by global Tier-Is and the OEMs, and aftermarket demand potential in overseas markets with the ageing of vehicles and increased sale of used vehicles augur well for Indian auto component suppliers. Over the medium to long term, ICRA expects EV opportunities, premiumisation of vehicles, focus on localisation, and changes in regulatory norms to support stable growth for auto component suppliers aided by higher content per vehicle.

Aided by the benefits of operating leverage, increase in content per vehicle, easing of cost pressures, and improvement in the supply-chain scenario, ICRA expects YoY improvement of 50-100 bps in operating margins in FY2024, reaching pre-Covid levels of 11.0-11.5%. The FY2025 margins are expected to witness a further improvement of 50-100 bps on a YoY basis to 11.5-12.0%, aided by operating leverage, higher content per vehicle, and value addition. Nevertheless, the earnings remain exposed to sharp volatilities in commodity costs, if any, and foreign exchange rates, the latter especially for companies exposed to significant imports. Further, the ongoing disruption along the Red Sea route has resulted in a surge in container rates by 2-3x in January 2024, while shipping time has also increased by ~2 weeks. Given that close to two-thirds of the auto component exports are to North America and Europe, and one-third of the imports are from these regions, a sharp and sustained increase in freight rates could have a bearing on margins for these players over the next few quarters.

Giving more details, **Ms. Vinutaa S, Vice President and Sector Head – Corporate Ratings, ICRA Limited,** said: *"Domestic OEM demand constitutes over 50% of sales for the Indian auto component industry, and this is expected to moderate in FY2025, especially for passenger and commercial vehicles. Replacement demand is expected to remain stable in FY2025, growing at 5-7%, supported by underlying demand drivers, including an increase in mobility, healthy vehicle parc, and used car sales, among others. Exports, which account for 29% of the industry revenues, are likely to remain weak in FY2025, impacted by expectations of low growth in end markets. However, ancillaries will benefit from supplies to new platforms as the global OEMs diversify their vendor base and increase outsourcing."*

At present, only 30-40% of the EV supply chain is localised. Chassis components that require minimal technology upgradation are manufactured locally. There has been substantial localisation in traction motors, control units and battery management systems over the years, while battery cells, which constitute 35-40% of the vehicle cost, are still entirely imported. The relatively low localisation levels give rise to manufacturing opportunities for domestic auto component suppliers. For parts that are already used in ICE, there could be technological advancements in certain cases, resulting in higher content per vehicle.

The EVs are expected to account for around 25% of domestic 2W sales and 15% of passenger vehicle sales by 2030. This would translate into strong market potential for EV components by 2030. The Indian e-2W component market potential is expected to be over Rs. 1,00,000 crore by 2030, while the e-PV component is expected to be another Rs. 50,000 crore at least, in terms of revenue potential for ancillaries. The EV transition process is likely to affect the engine and drive transmission components and could also have a bearing on the aftermarket demand because of fewer moving parts. However, supplies to alternative applications, new products, and export opportunities are likely to mitigate the impact to an extent. Also, the EV migration is expected to be gradual, and ICE components will continue to have a sizeable demand over the medium term.

Imports are an integral part of the auto component industry, especially with the increase in electronics and advanced technology components. While forex volatility is a worry for net importers, forex hedging measures and alternate local sources have mitigated the risk to an extent. In the case of components that are not available in India, ancillaries are exploring alternate materials and localisation options as measures to mitigate forex and supply-chain risks going forward.

The industry liquidity position remains comfortable, especially across tier-I players. ICRA expects coverage metrics for the sector to remain comfortable going forward as well, aided by healthy accruals and relatively low incremental debt funding despite an increase in the cost of borrowings. Most auto ancillaries rated by ICRA are in the investment grade, reflecting a healthy credit profile stemming from healthy cash accruals and relatively low debt levels. Upgrades have been higher than downgrades since FY2022, indicating improvement in the credit profile of auto ancillaries in the last 30-36 months.

On investments by auto component suppliers**, Ms. Vinutaa** added**,** *"ICRA's interaction with large auto component suppliers indicates that capex towards capacity enhancements and technological development resulted in a capex upcycle in FY2024, which is expected to continue in FY2025. The industry is expected to incur a capex of at least Rs. 20,000-25,000 crore in FY2025, with incremental investments being towards new product additions, product development for committed platforms, and development of advanced technology and EV components, apart from capex for capacity enhancements and upcoming regulatory changes. The PLI scheme will also contribute to accelerating capex towards advanced technology and EV components over the medium-term."*

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