ICRA

PRESS RELEASE
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Auto component industry's revenues to grow by 5-7% in FY2025, after a strong FY2024: ICRA

- ***Operating margins to see a YoY improvement of ~50 bps in FY2025***
- ***Industry likely to incur capex of Rs. 20,000-25,000 crore in FY2025; capex to hover around 8-10% of operating income over the medium term***

ICRA expects the growth in the revenues of the Indian auto component industry (represented by sample of 46 auto ancillaries with aggregate annual revenues of over Rs 3,00,000 crore in FY2024) to ease to 5-7% in FY2025, from the highs of ~14% in FY2024. Operating margins are set for a YoY improvement of ~50 bps in FY2025, benefitting from better operating leverage, higher content per vehicle, and value additions, while remaining exposed to any sharp volatility in commodity prices and foreign exchange rates. Further, ICRA projects the industry to incur capex of Rs. 20,000-25,000 crore in FY2025 towards capacity expansion and technological developments. Capex is anticipated to hover around 8-10% of operating income over the medium term, with the PLI scheme also contributing to accelerating capex towards advanced technology and EV components.

Giving more details, **Vinutaa S, Vice President and Sector Head – Corporate Ratings, ICRA Limited,** said: *"Demand from domestic original equipment manufacturers (OEM) constitutes over 50% of sales for the Indian auto component industry and the pace of growth in the segment is expected to moderate in FY2025. Growth in replacement demand is pegged at 5-7%, after two to three years of healthy growth, following a relatively weak Q1 in the current fiscal. Exports, which account for close to 30% of the industry's revenues, are likely to be impacted by subdued growth in end-user markets. Nevertheless, ancillaries will benefit from supplies to new platforms as the global OEMs diversify their vendor base and increase outsourcing."*

The projected moderation in revenue growth in FY2025 stems from the expected moderation in the growth pace of the domestic OEM segment. On the exports front, new vehicle registrations in Europe and the US are expected to remain tepid over the next few quarters, impacted by the weak global macroeconomic environment and geopolitical tensions. Nevertheless, factors like rising supplies to new platforms because of vendor diversification initiatives by global OEMs/Tier-I players and higher value addition, partly stemming from an increase in outsourcing, augur well for Indian auto component exporters. Further, there would be opportunities for Indian players in metal casting and forgings with the winding up of plants in the European Union due to viability issues. The aging of vehicles and increased sales of used vehicles in global markets are also expected to aid in the export of components for the replacement segment in overseas markets. Over the medium-to-long term, ICRA expects electric vehicle (EV) linked opportunities, premiumisation of vehicles, focus on localisation, and changes in regulatory norms to support stable growth for auto component suppliers.

Further, the disruption along the Red Sea route has resulted in a surge in container rates by 2-3 times in YTD CY2024 compared to CY2023, while shipping time has also increased by ~2 weeks. Given that close to two-thirds of the auto component exports are made to North America and Europe, and one-third of the imports is made 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.

The industry's liquidity position remains comfortable, especially across tier-I players supported by stable cashflows and earnings. ICRA expects coverage metrics for the sector to remain comfortable going forward, aided by healthy accruals and relatively low incremental debt funding despite an increase in the cost of borrowings. Most of the auto ancillary players rated by ICRA are in the investment grade, reflecting a healthy credit profile stemming from stable cash accruals and comfortable debt levels. Rating upgrades have been higher than downgrades since FY2022, indicating improvement in the credit profile in the last several quarters.

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 vehicle cost, are still entirely imported. The relatively low localisation level gives rise to manufacturing opportunities for domestic auto component suppliers. The EV policy 2024 for electric four wheelers would also help generate incremental demand for component makers, because of the domestic value addition mandated. For parts that are already used in internal combustion engine (ICE) vehicles, there could be technological advancements in certain cases, resulting in higher content per vehicle. There could also be opportunities for ancillaries in manufacturing components from other alternate fuel vehicles, as their penetration increases.

ICRA expects EVs to account for around 25% of domestic 2W sales and 15% of passenger vehicle sales by 2030. This would translate into a strong market potential for EV components by 2030. 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.

On investments by auto component suppliers**,** **Vinutaa** added**,** "*ICRA's interaction with large auto component suppliers indicates that the industry has incurred a capex of over Rs. 20,000 crore in FY2024 and is estimated to spend another Rs. 20,000-25,000 crore in FY2025. The incremental investments would be made towards new products, product development for committed platforms, and development of advanced technology and EV components, apart from capex for capacity enhancements and upcoming regulatory changes. R&D, though, is still at an average of 1-3% of operating income, significantly lower than the global counterparts. ICRA expects auto ancillaries' capex to hover around 8-10% of operating income over the medium term, with the PLI scheme also contributing to accelerating capex towards advanced technology and EV components."*

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