Press Release

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Sales plunge to dent auto dealers' credit metrics this fiscal

Cash accrual set to halve and operating profitability to shrink 50-100 bps

Two consecutive years of double-digit decline in sales volume and a 50-100 basis points (bps) moderation in already-thin operating profitability are expected to materially dent the credit metrics of automotive dealers this fiscal, a study of 205[1] CRISIL-rated dealers indicates.

After declining 18% in fiscal 2020, vehicle sales volume is expected to fall another ~25% this fiscal because of the Covid-19 pandemic and weak business environment (*refer annexure for details*) that's curtailing mobility and discretionary spending.

Moreover, the ability of automotive dealers to withstand such demand contraction has reduced because of lower sales volume per dealer, given the aggressive dealership expansions adopted by original equipment manufacturers (OEMs) over the past six fiscals. For instance, while OEM sales volume[2] was 17% higher last fiscal compared with fiscal 2015, average sales volume per dealership was ~30% lower.

Says Gautam Shahi, Director, CRISIL Ratings, "In fiscal 2021, a sharp decline in vehicle sales volume and ancillary income (through service, spare parts and insurance, amounting to 10-12% of revenue) will lead to a 50-100 bps moderation in operating profitability because of suboptimal coverage of fixed costs. This drop is substantial, considering the thin operating margin of 3-4% of dealers and ~50 bps moderation already seen last fiscal. Dealers with own showrooms and those with higher mix of the more profitable ancillary services will be better placed to withstand the shock though."

Among business segments, commercial vehicle (CV) dealers, are expected to be the most impacted due to the sharpest drop expected in sale volumes and lower profitability of 2-3%, compared with passenger vehicle (PV) and two-wheeler (2W) dealers.

Tepid sales, carry-over stocks of BS IV vehicles (mainly 2Ws and PVs), and squeeze in profitability will lead to net losses in the first half of the fiscal, increasing their reliance on working capital lines, and impacting liquidity position for most dealers.

The moratorium offered by the Reserve Bank of India and support from OEMs in the form of early payment of incentives or part interest cost funding are expected to provide some respite on liquidity, but only temporarily.

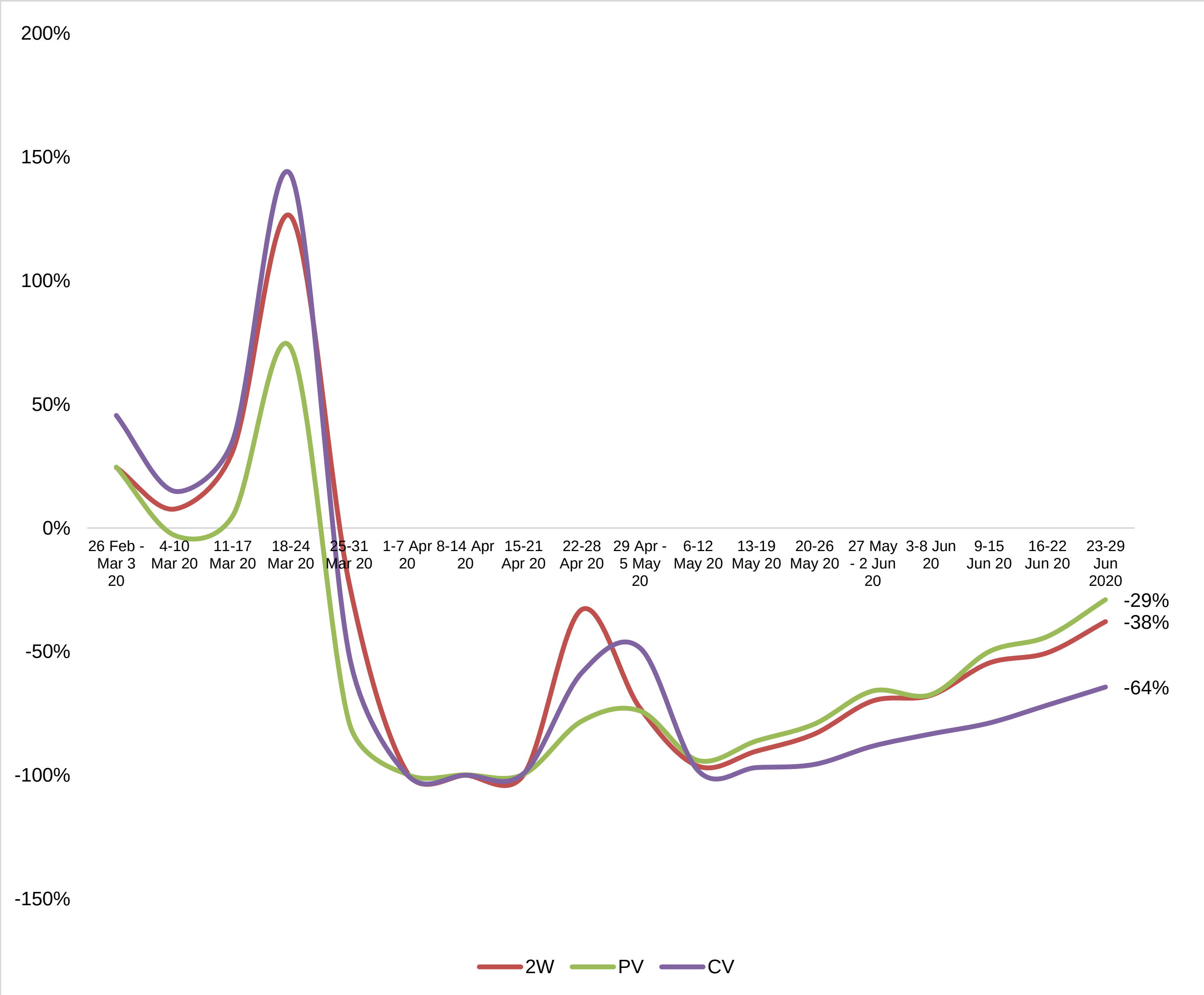
Says Sushant Sarode, Associate Director, CRISIL Ratings "With stress rising due to weak vehicle sales, credit metrics of automotive dealers are already deteriorating. With cash accrual expected to halve, credit metrics such as interest coverage ratio will moderate to ~1.1-1.2 times this fiscal from 1.5 times in fiscal 2020 and ~2 times in fiscal 2019."

Since automotive dealers are a critical link in the overall supply chain, support from OEMs and their financing arms has been forthcoming, and this is critical for them to navigate the current stress. Moreover, increasing preference for personal vehicles to maintain social distancing may gradually revive sales from the second half of this fiscal, and will remain a monitorable.

[1] 107 in passenger vehicles [PV], 20 in commercial vehicles [CV] and 13 two-wheelers [2W] and 65 diversified).
[2] For top five OEMs representing 65% of automobile volumes across CV, PV and 2W segments.

Annexure

Weekly vehicle registrations (yoy growth) slumped with the lockdown, but have recovered gradually in May and June



Source: Vahan database

Forecast of segment-wise OEM vehicle production growth

Production volume growth	FY19	FY20 E	FY21 P	FY22 P
Passenger vehicles	0%	-15%	-23%	16%
Two-wheelers	6%	-14%	-21%	14%
Commercial vehicles	24%	-32%	-24%	37%

Source: CRISIL Research, CRISIL Ratings
Note: E=estimated, P=projected

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