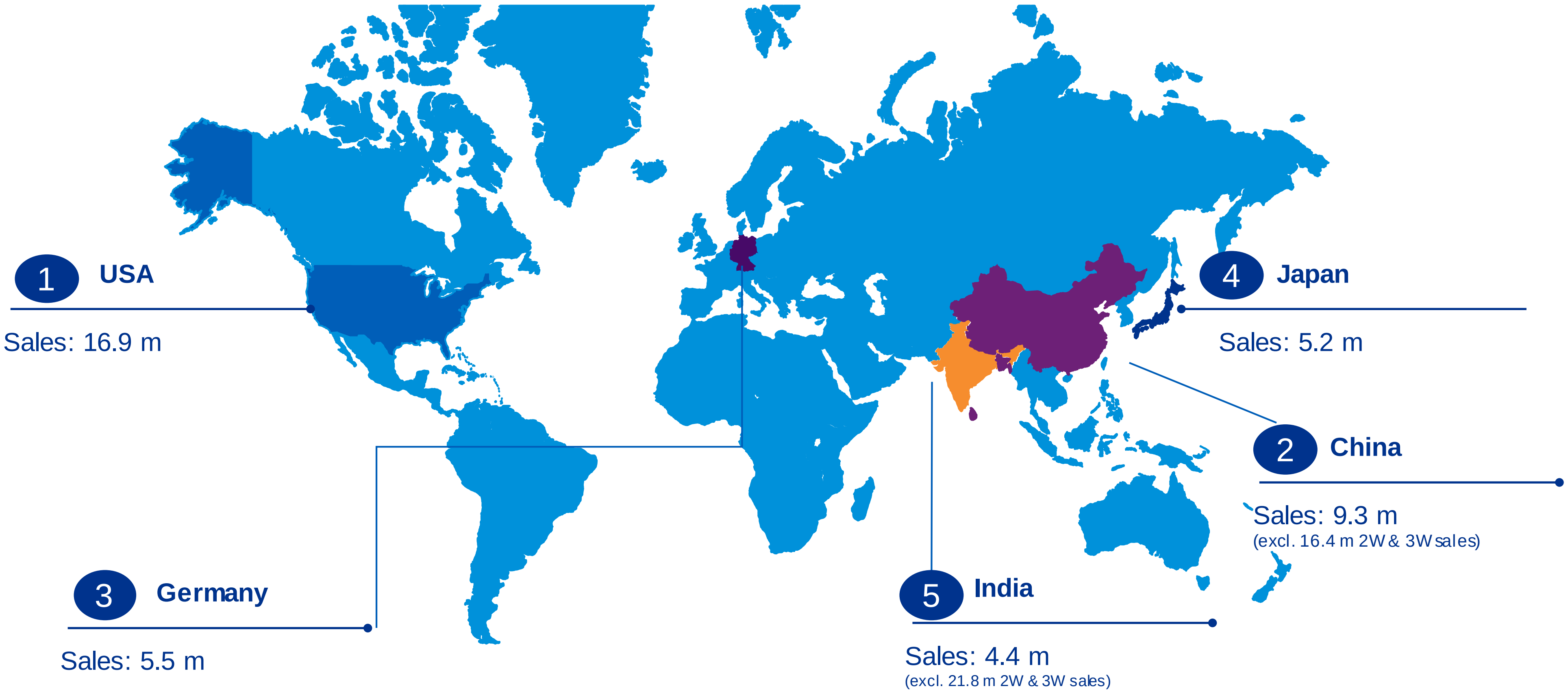
KPMG

Outlook for the Indian Auto Components Industry post COVID-19

May 2020

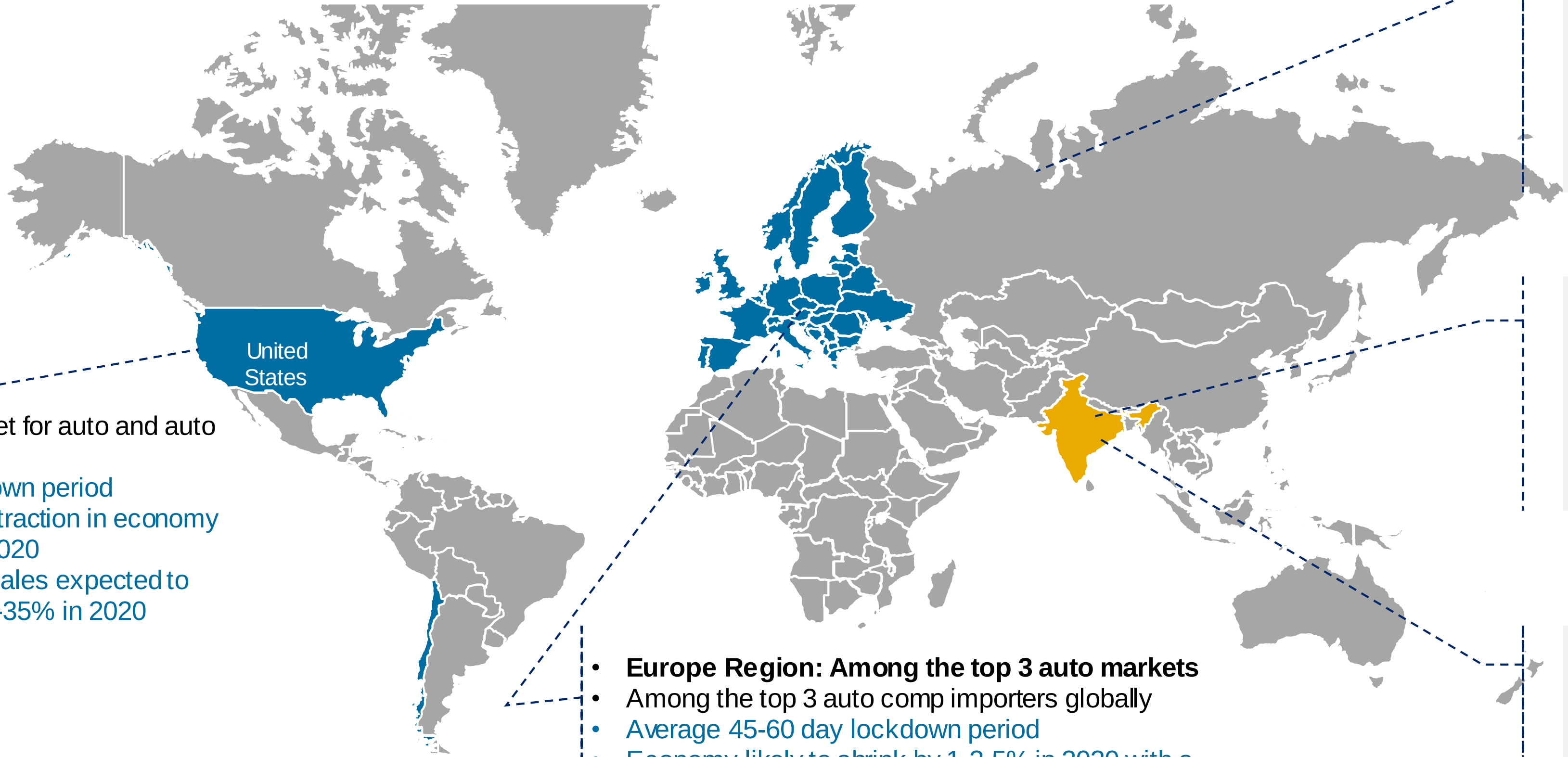
India is the amongst the top 5 Auto markets globally with annual PV+CV sales of 4.4 m units

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



Source: Automotive Industry Reports

Covid-19 has impacted the globe; lockdowns are expected to be followed by economic contraction and consequent decline in demand



- IMF projects a -3% global real GDP growth for 2020
- Global impact is expected to be worse than 2008 crisis

- Largest market for auto and auto components
- 60 day lockdown period
- 3.6-7.4% contraction in economy expected in 2020
- New vehicle sales expected to decline by 30-35% in 2020

- **Domestic demand is expected to decline in immediate term in India**
- ~60-day lockdown period
- GDP growth expected to be between 1-2% in FY21

- **Europe Region: Among the top 3 auto markets**
- Among the top 3 auto comp importers globally
- Average 45-60 day lockdown period
- Economy likely to shrink by 1-2.5% in 2020 with a partial rebound in 2021
- Only select OEMs such as Daimler, Hyundai, Volvo have resumed part operations; Others have postponed plans given the uncertainty in market

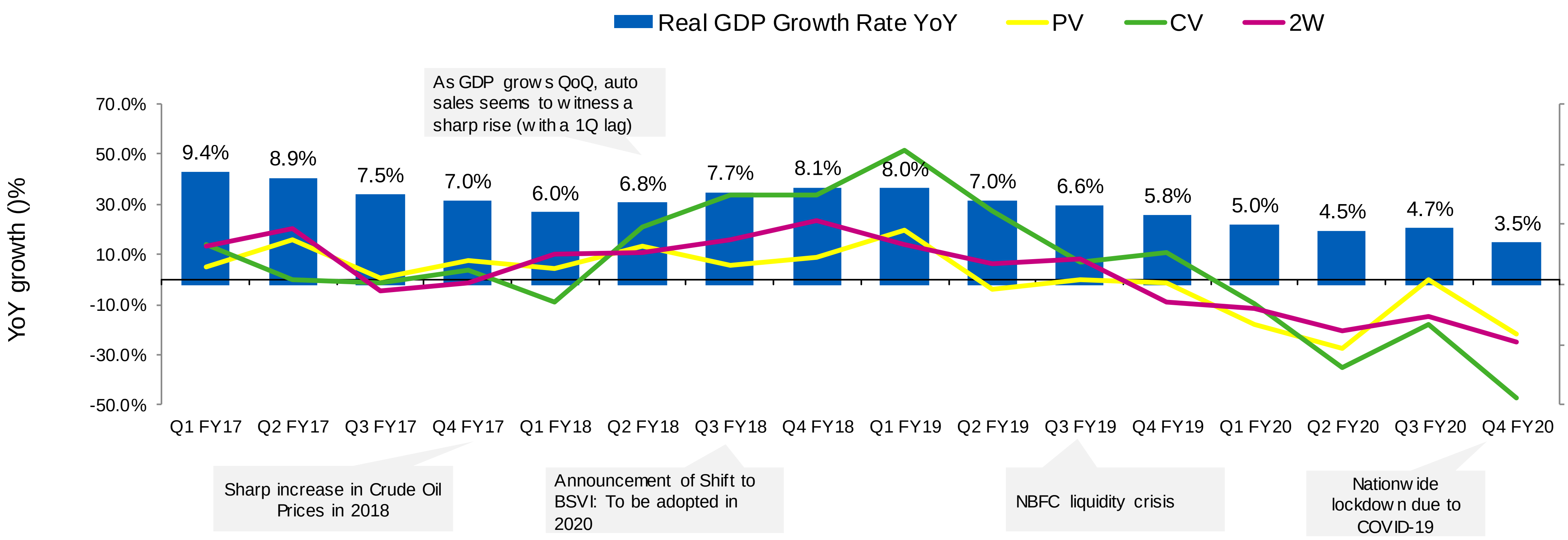
- **Export market of India is adversely impacted**
- US and EU account for c.30% and 60% of PV and Component exports from India

Status as on 9th May 2020

Source: Automotive Database, IMF, Secondary research

Vehicle sales in India have historically shown a strong correlation with GDP growth

YoY growth rates in Real GDP, PV, CV and 2W sales [%]

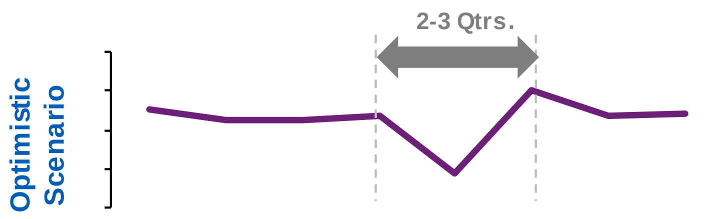


Auto sales across vehicle segments have seen a sharp fall over the last 5 quarters driven by systemic factors and weak customer sentiment; Consequently, the Indian auto component industry has also been impacted adversely

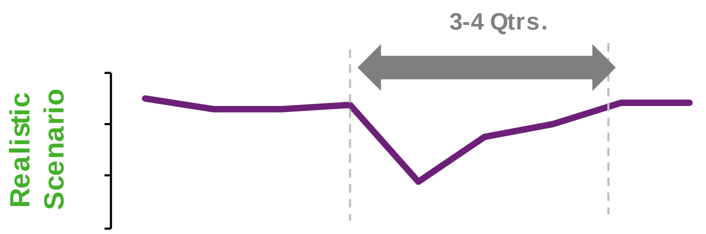
Source: SIAM, Industry Reports

A 10-12 month slowdown appears inevitable even in the most optimistic scenario

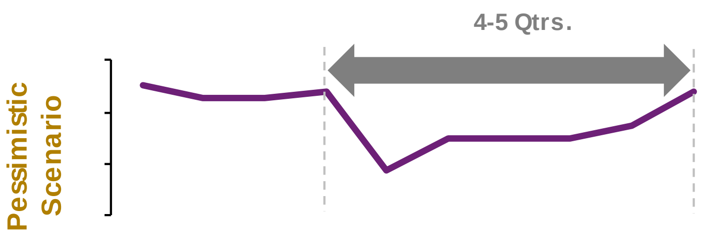
Economic Recovery Curve



Impact on Economy & auto industry
- Rapid recovery with minimal loss of output
- Plant and factory output ramps up to 70% of capacity
- Cost pressures in the short term but an early rebound expected in auto demand



Impact on Economy & auto industry
- Delayed recovery with a loss of output
- Plants & factories able to resume only 50% of capacity; Expected job losses
- Loss in consumer sentiment leading to a delayed purchases further impacting the sector



Impact on Economy & auto industry
- Prolonged recovery with a major loss of output; Large scale unemployment
- Plants & factories are able to resume <50% of capacity
- Severe impact on auto industry

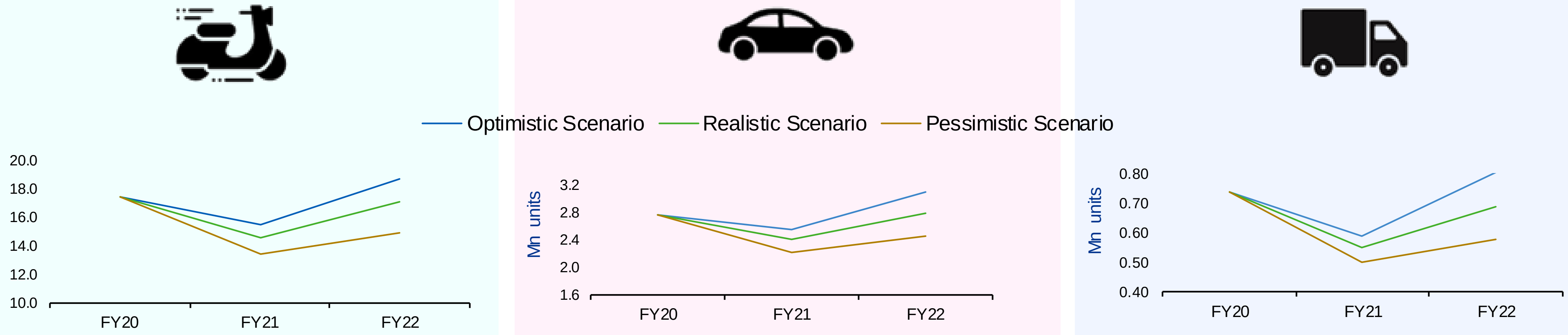
Expected recovery period to pre-COVID levels

Economy (GDP growth)		Auto/Auto Comp Industry
Q4FY21	Lag of 1-1.5 Qtr. →	Q2FY22
Q1- Q2 FY22	Lag of 1.5-2 Qtr. →	Q3-Q4 FY22
Q4FY22	Lag of 2-3 Qtr. →	Q2-Q3 FY23

Source: KPMG Analysis

The recovery curve is expected to vary by vehicle category given the different underlying demand drivers

Impact of various scenarios on Vehicle Segments



FY19-20 Sales (mn)	% Change for FY21	% Change for FY22
17.4	*(10-11)%*	*20-21%*
	(15-16)%	*16-17%*
	(21-23)%	*10-11%*

FY19-20 Sales (mn)	% Change for FY21	% Change for FY22
2.8	*(7-8)%*	*20-22%*
	(13-14)%	*15-16%*
	(20-21)%	*11-12%*

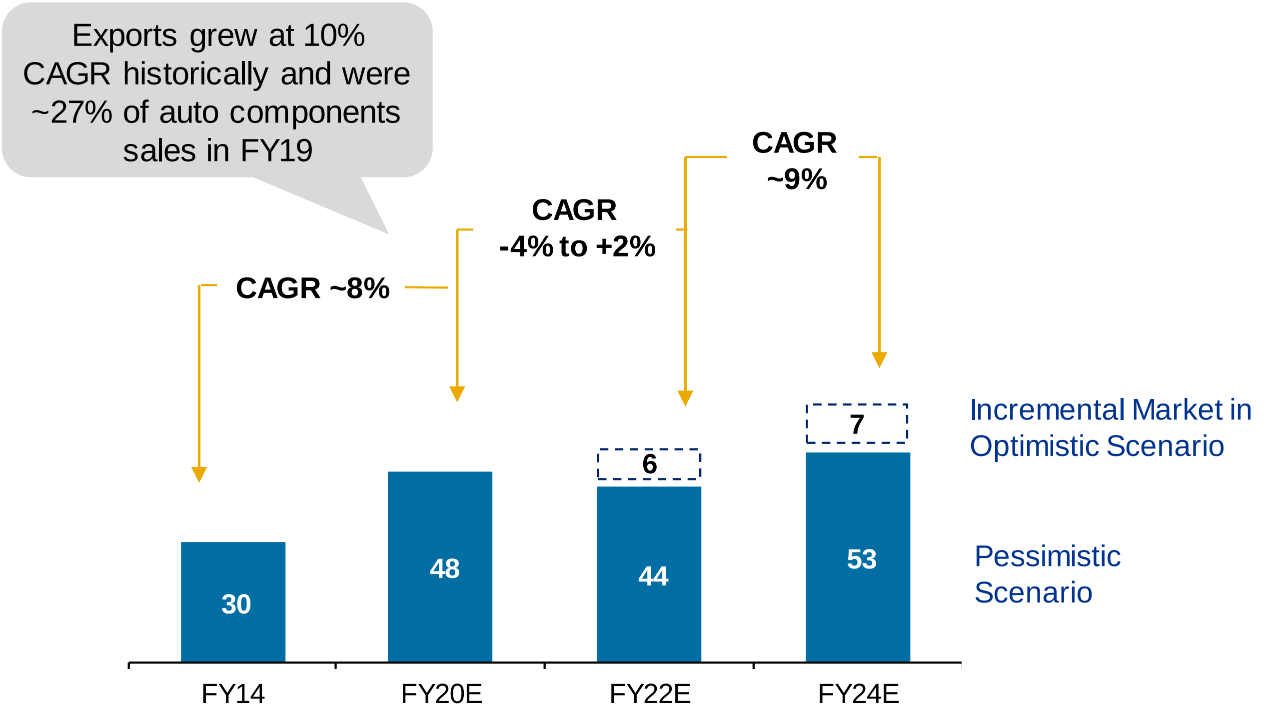
FY19-20 Sales (mn)	% Change for FY21	% Change for FY22
0.7	*(19-20)%*	*35-36%*
	(25-26)%	*24-25%*
	(31-32)%	*15-16%*

Suffocating demand because of COVID-19 and subsequent lockdown coupled with plant shutdowns are expected to hit the industry adversely (overall 16-18% decline in FY21 expected in realistic scenario)

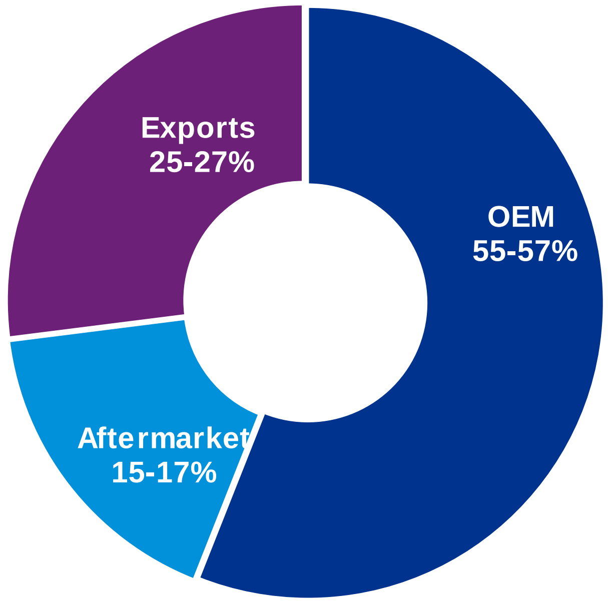
Source: SIAM, KPMG Analysis

Auto components in India are a c. USD 48 bn industry (INR 340k cr); While OEM volumes drive the industry, exports form a sizeable share of overall sales

India Auto Components Market by value
FY 14-26, USD bn



Turnover segmentation by Customer/ Channel
FY19



Constant Exchange Rate- USD/INR: 70

Source: Automotive Industry Reports

We expect a few specific trends to play out in the sector post Covid

01 Companies with weak liquidity positions will need capital infusion

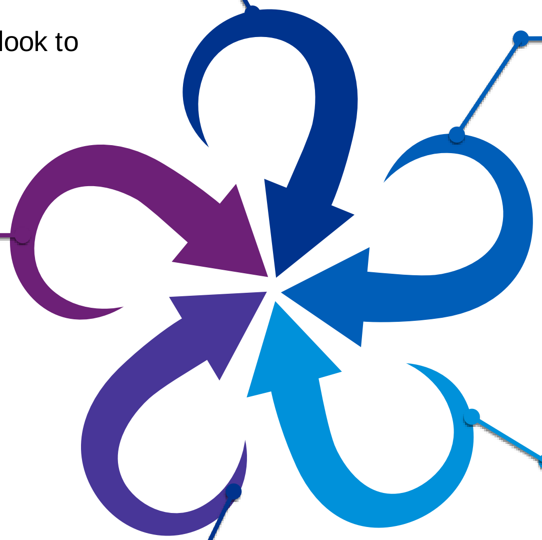
- Raising additional debt will be a challenge
- PE investments to gain traction amongst companies with strong product portfolio and OEM relationships
- International auto comp companies looking at the Indian market will look to invest in companies with strong OEM relationships

02 Consolidation expected in the domestic market

- Companies with strong balance sheets may evaluate acquisitions of financially stressed counterparts to gain access to products, technology or customer relationships
- PEs could opt for a platform play with a portfolio of companies (**string of pearls**) to leverage synergies w.r.t. products, customers and technology
- Mergers likely amongst players to improve balance sheet positions

03 Global OEMs will look to de-risk supply base

- Establish alternative sourcing base to China. India is a strong contender with credentials, established relationships and a competitive cost proposition
- JVs/ acquisitions of existing overseas suppliers to OEMs by Indian players likely
- Companies with existing relationships and strong balance sheets will have a definite advantage



04 Large global distributors will look to source from India

- Distributors will follow OEMs in de-risking their supply base
- Brand, product quality and supply chain support will be additional key drivers for selecting alternate suppliers
- Technology tie ups with global companies could help domestic players compete in the global market

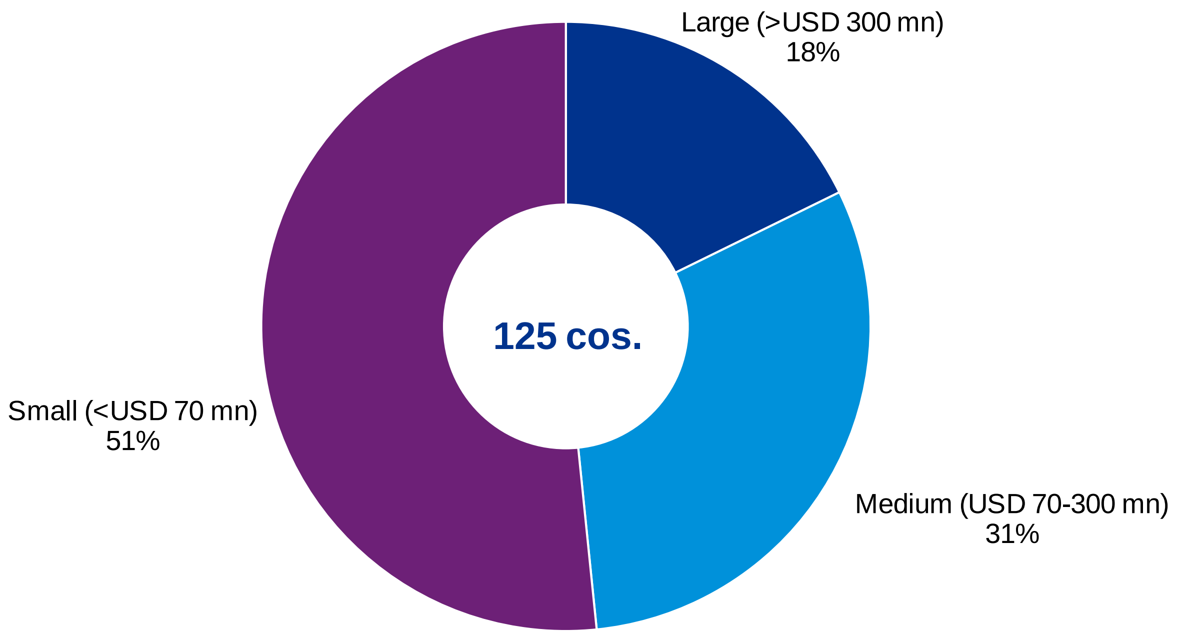
05 Aftermarket relatively less affected

- Limited impact of the Covid crisis is expected on a highly robust and profitable aftermarket
- Focus of major companies is likely to shift to aftermarket sales till a recovery is seen in the OE market

Source: KPMG Analysis

We analyzed 125 auto component companies in India to determine their immediate and medium term priorities

Auto Component firms analyzed FY20* (Turnover)



*Note: Sample of 125 companies covers >90% of listed auto comp companies and c.70% of industry revenue

Focus Areas

Immediate: Liquidity and Solvency

- Meet short term financial obligations
- Cash for Operations

Medium Term: Sustainability and Growth

- Profitability and Returns
- Availability of Funds for growth

Constant Exchange Rate- USD/INR: 70

Source: CapIQ, KPMG Analysis

*Q2/Q3 revenues for FY20 for companies extrapolated to full year FY20 revenues

A comprehensive framework was used to evaluate position of companies on parameters relevant to immediate and medium term performance

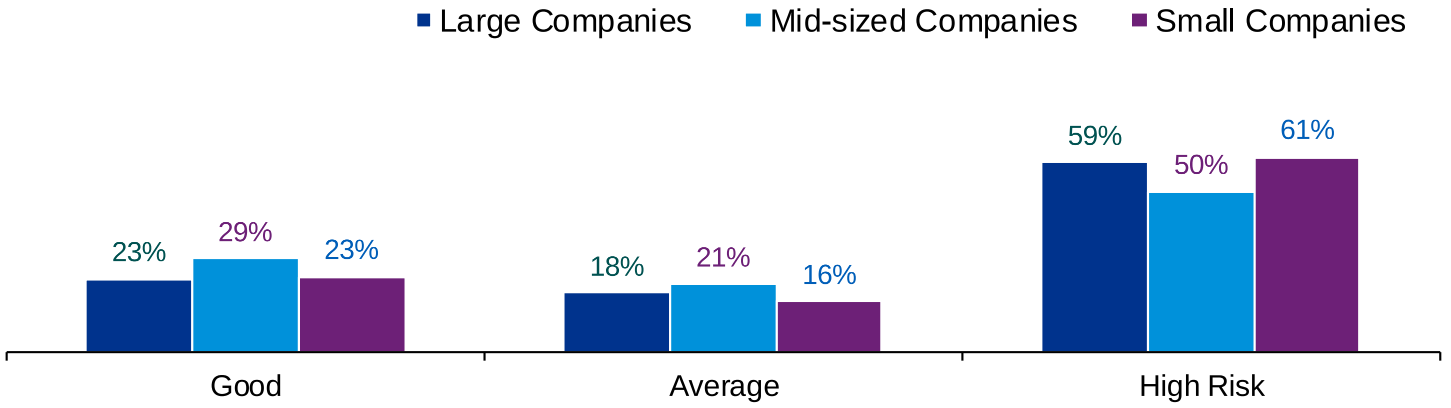
Ratings scale for parameters that determine immediate and medium term focus

	Parameter	Ratings		
		Good	Average	High Risk
Immediate	**Interest Coverage Ratio**	>6.0	2.0-6.0	<2.0
Immediate	**Quick Ratio**	>1.5	0.5-1.5	<0.5
Immediate	**Cash Cover**	>0.15	0.08-0.15	<0.08
Medium Term	**Debt Service Coverage Ratio**	>1.3	0.6-1.3	<0.6
Medium Term	**EBITDA Margins %**	>12.0%	8.0-12.0%	<8.0%
Medium Term	**Return on Capital Employed %**	>12.0%	8.0-12.0%	<8.0%
Medium Term	**Debt to Equity Ratio**	<0.5	0.5-1.5	<1.5

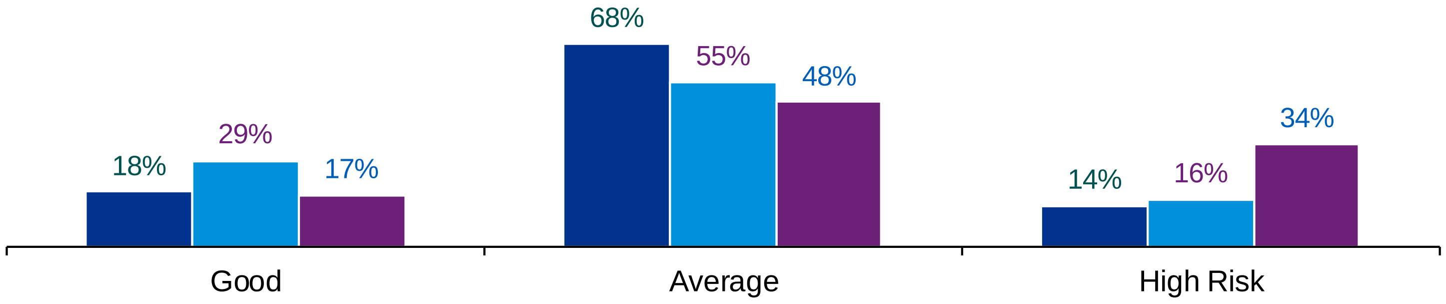
Source: Industry Reports, KPMG Analysis

Overall, most companies are expected to face liquidity crunch in the immediate term

Performance of company cohorts– Liquidity position in the Immediate Term



Performance of company cohorts – Business sustainability in the Medium Term



Key Observations

- Majority of companies, regardless of size are expected to struggle with liquidity in the immediate term
- Several of these companies with weak liquidity positions will need capital infusion to tide over
- Raising additional debt, likely to be a challenge, hence PE funding/ strategic partnerships expected to be the most likely route for such companies
- Given reasonably robust fundamentals amongst large and mid sized players in particular, attracting funds appears a realistic prospect

Source:, CapIQ, KPMG Analysis

Most large companies fare favourably on sustainability parameters; those with strong balance sheets could look to strengthen their market position through acquisitions

Financial Outlook for Large Companies

Business Sustainability (Medium Term) ↓ / Liquidity Position (Immediate Term) →	High Risk	Good/ Average
Good/ Average	***45%*** *Companies with strong fundamentals but likely to face liquidity issues in short term; likely to raise additional debt*	***41%*** *Companies well placed to further strengthen their market position*
High Risk	***14%*** *Companies which will need capital infusion to survive given their weak balance sheet position*	***0%*** -

- Over 40% of the large companies have strong fundamentals and are well positioned from liquidity and business sustainability perspective
- Such companies may evaluate acquisitions of financially stressed counterparts or partnerships with global players for portfolio and geographical expansion
- c.14% of large companies are expected to face continued financial stress and may need to evaluate an infusion of funds through the PE route or through strategic investments to improve balance sheet positions
- These companies with strong market presence and OE relationships would be attractive targets for overseas strategics looking at a strong foothold into India or even as an alternative to China

Source:, CapIQ, KPMG Analysis

Cohort of mid-sized companies with strong fundamentals and established domestic presence could see consolidation and interest from PEs and global strategics

Financial Outlook for Mid-sized Companies

Business Sustainability (Medium Term)	Liquidity Position (Immediate Term): High Risk	Liquidity Position (Immediate Term): Good/ Average
Good/ Average	**39%** *Companies which are likely to attract investments from PEs/ global players*	**45%** *Companies which could look for synergistic value buys to strengthen market position*
High Risk	**11%** *Companies will need capital infusion or investment by a larger player*	**5%** *Companies are expected to look for a JV/merger with a larger player to sustain operations in longer term*

- Though half of the companies in this cohort face a liquidity crunch in the immediate term, over 80% of them demonstrate strong fundamentals over the medium term
- Hence, this cohort appears well positioned for consolidation from both PEs and international auto comp players
- PEs likely to adopt a string of pearls strategy to create a platform play across products, technologies and OEM relationships
- Global players with India entry plans could evaluate the inorganic route and pursue companies with OEM relationships and aftermarket presence
- Domestic companies with strong balance sheets could look for value buys to strengthen market position

Source:, CapIQ, KPMG Analysis

Most small companies are expected to struggle with liquidity; capital infusion will be critical for over 60% of this cohort to survive the in the immediate term

Financial Outlook for Small Companies

Business Sustainability (Medium Term) \ Liquidity Position (Immediate Term)	High Risk	Good/ Average
Good/ Average	**31%** *Companies to look for restructuring existing debt or raising additional debt*	**34%** *Companies which are likely to attract investors given their strong fundamentals*
High Risk	**30%** *Acquisition targets for players looking to consolidate market position*	**5%** *Companies whose businesses are under threat in the long term*

- Over 60% of the small companies will suffer from severe liquidity positions - poor ICR and cash balances to cover fixed expenses
- Over a third of these have business models which makes their sustainability over the long term a question mark – typically in commoditized products or with heavy dependence on a single OEM resulting in poor margins and returns on capital
- Those with sustainable businesses – attractive product portfolio, strong OEM relationships or aftermarket presence are likely targets for consolidation/ additional debt funding

Source:, CapIQ, KPMG Analysis

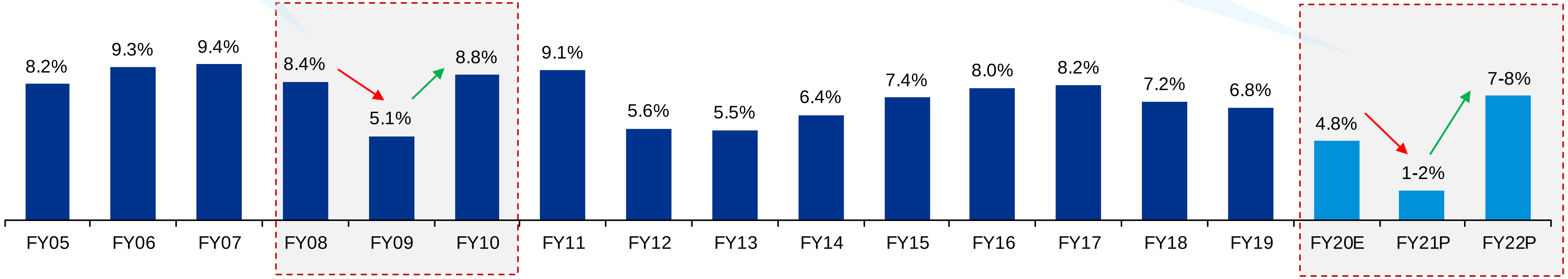
Learnings from deals post the 2008 financial crisis

The current economic headwinds are fairly similar to the situation post 2008 financial crisis

Real GDP growth YoY (FY05-FY22)

2008 financial crisis impacted the GDP growth in FY09 before the recovery started from FY10

- Current situation is similar to the 2008 crisis and FY21 is likely to be impacted, resulting in a downturn
- Post FY21, Indian economy is expected to see a similar recovery path as witnessed post 2008 financial crisis

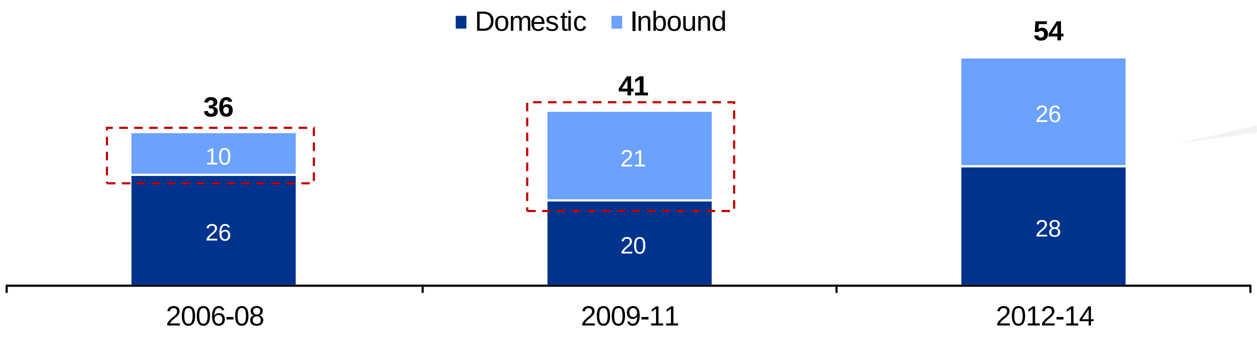


An evaluation of the M&A scenario in Auto Components pre and post the 2008 financial crisis could help understand deal making in the sector post-Covid

Source: EIU, Fitch, Industry Reports, KPMG Analysis

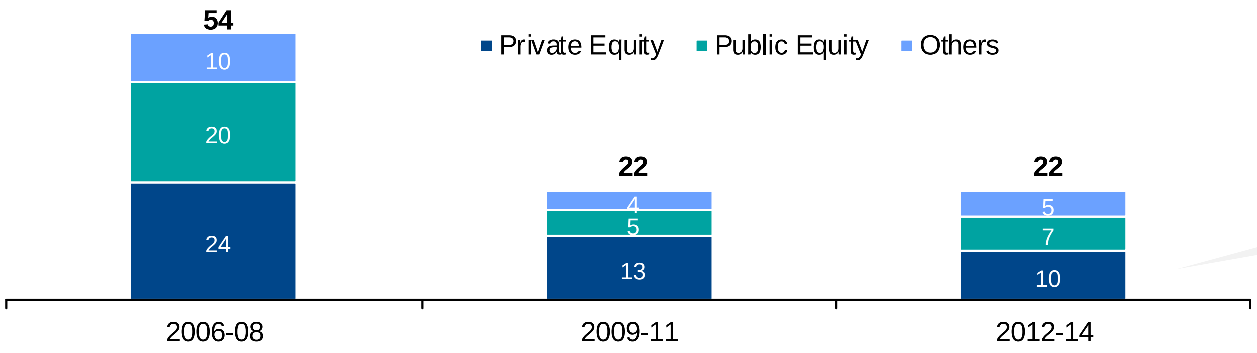
Auto components industry witnessed an increase in M&A deals post 2008 compared to the pre 2008 period, especially inbound investments

M&A Deals in Auto Components Industry



Number of **inbound transactions more than doubled** during the **2009-11** period (from 10 to 21) as compared to **2006-08 period**

Private Equity Deals in Auto Components Industry



Private Equity deals in India in auto components saw a dip post 2008

Source: VCCEdge, KPMG Analysis

Valuations across the M&A spectrum became attractive post 2008 esp. amongst financially stressed players leading to a rise in control transactions

M&A Deals		2006-08	2009-11
No. of Deals	Domestic	26	20
	Inbound	10	21
	Total	**36**	**41**
Average EV/ EBITDA	Domestic	21.8	7.5
	Inbound	9.0	15.8
	Average	**16.7**	**12.6**
Average Stake Bought	Domestic	69.3%	70.6%
	Inbound	36.6%	45.2%
No. of control deals*	Domestic	17	13
	Inbound	2	6
	Total	**19**	**19**

*: Control deals refers to acquiring more than 50% stake

Key Observations

01 **Valuations became attractive post 2008 period**

- Average **EV/EBITDA** multiples for M&A deals fell from **16.7 in pre 2008 period** to **12.6** in **post 2008 period**
- Fall was steeper in domestic deals as compared to inbound deals
- Value buys increased, given the stress in the domestic market

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

- Number of inbound deals saw a sharp increase from **10 in 2006-08 period to 21 in 2009-11 period**
- Average stake for the inbound transactions **increased from 36.6% in 2006-08 period to 45.2% in the 2009-11 period**
- **During 2009-11 period**, sellers were more open to offer a controlling stake which lead to a **higher number of control deals* for inbound transactions** (6 vs 2 in 2006-08 period)

Source: VCC Edge, KPMG Analysis

M&A investments post 2008 helped industry players expand product portfolio and outperform the market; PEs saw far greater value creation and returns in deals between 2009 and 2011

Auto components industry size (USD bn)	**42.7** *(FY12)* → **51.2** *(FY18)*
Auto components industry CAGR	**3.1%** *(FY12-18)*
CAGR for companies that invested in M&A during 2009-11 period	**6.1%** *(FY12-18)*

Private Equity Deals	2006-08	2009-11
No. of deals stuck in the period that saw exits	32	10
Average returns (IRR)	1.6%	40%
No. of negative returns	12	1

Key Observations

03 M&A transactions helped investors outperform the market

- Companies which made acquisitions in 2009-11 period grew at 2x the market average
- International players like NHK Automotive, KSPG and Faurecia Emissions, which grew at a CAGR of 29%, 20.5% and 19%* resp. between FY12-18, outperformed the market growth substantially

04 Private Equity investments garnered better returns

- PE investments in the sector between 2009 and 2011, resulted in greater value creation and returns for investors
- Average returns for the investments made in 2006-08 period was 1.6%. 12 of the 32 deals that saw exits yielded negative returns
- On the other hand, average returns for the 22 investments made in 2009-11 period was 40% with only one of the 10 deal exits yielding negative return

Constant Exchange Rate- USD/INR: 70

Source: VCC Edge, ACMA, EMIS, KPMG Analysis

*: Faurecia's CAGR for FY13-19

Potential transaction themes post Covid

Potential transaction themes - OEMs

Target characteristics/ universe

Passenger Vehicle Players

- Indian owned PV players likely to seek global partners, especially for transition to EV technology to lower investments and get access to global technology
- Global PV players struggling to capture market share in India to either exit the market or form partnerships with Indian owned PV players
- Toyota Suzuki global realignment to further strengthen Japanese presence across the entire value chain

Commercial Vehicle Players

- CV players with stretched balance sheets could look at partnerships with global CV players who don't have a presence in India
- CV players in need of global technology and access to global markets via exports to form partnerships with global players
- Weak players in CV market could look at exiting from the business altogether

2-Wheeler Players

- Traditional IC engine players to acquire niche global players for access to better technology
- Specialist EV players to raise funding from long term patient investors

3-Wheeler Players

- Specialist EV players to raise funding from long term patient investors

Source: KPMG Analysis

Potential transaction themes - Auto suppliers - for financial investors (1/2)

Provide capital to large auto component players for consolidation

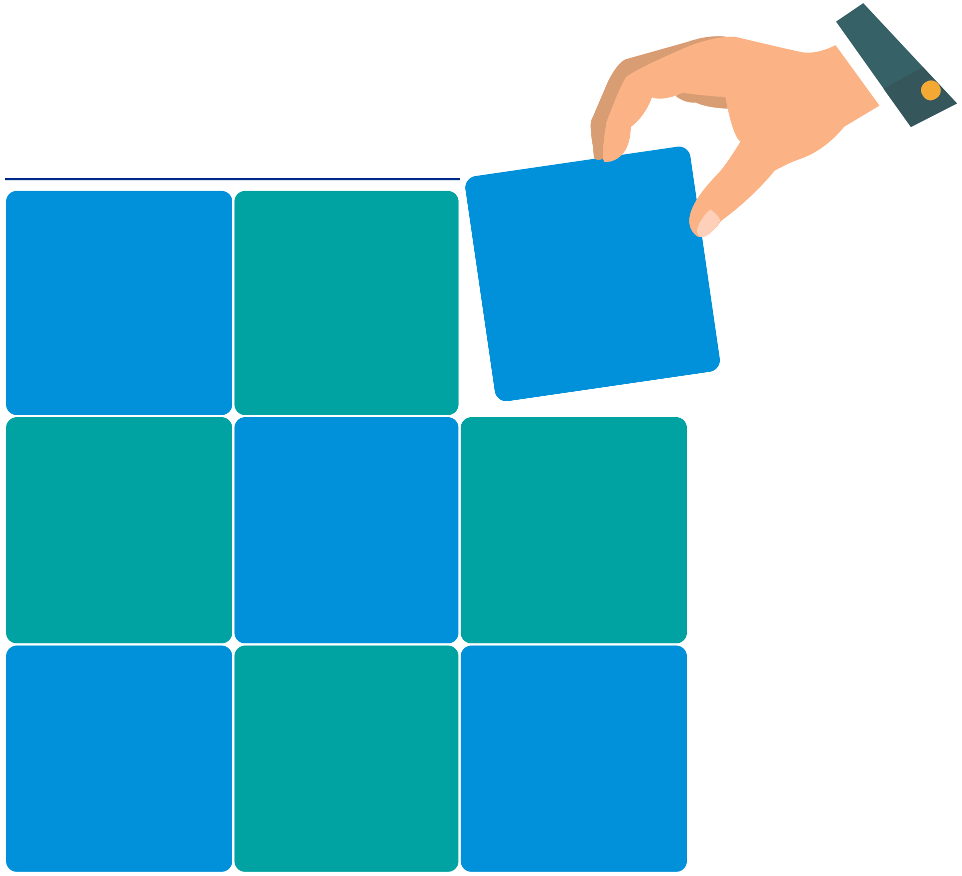
Target characteristics/ universe

- OEMs likely to push large auto component players to consolidate by
  - acquiring weaker competitors
  - acquiring Tier 2 suppliers
  - Diversifying into new product segments
- Acquiring auto component players would need capital (equity/ mezzanine/ debt)
- Universe of investible targets includes listed as well as unlisted players
- Such investible targets should have size, relationships with multiple OEMs, well diversified product portfolio, as well as strong balance sheets

Mezzanine capital/ structured debt for mid sized suppliers

Target characteristics/ universe

- Fundamentally good businesses with wrong capital structure, high promoter leverage, short term cash flow mismatch
- Pure play equity deals difficult due to gap in valuation expectations
- Generally mid sized companies, listed as well as unlisted



Source: KPMG Analysis

Potential transaction themes - Auto suppliers - for financial investors (2/2)

Platform plays

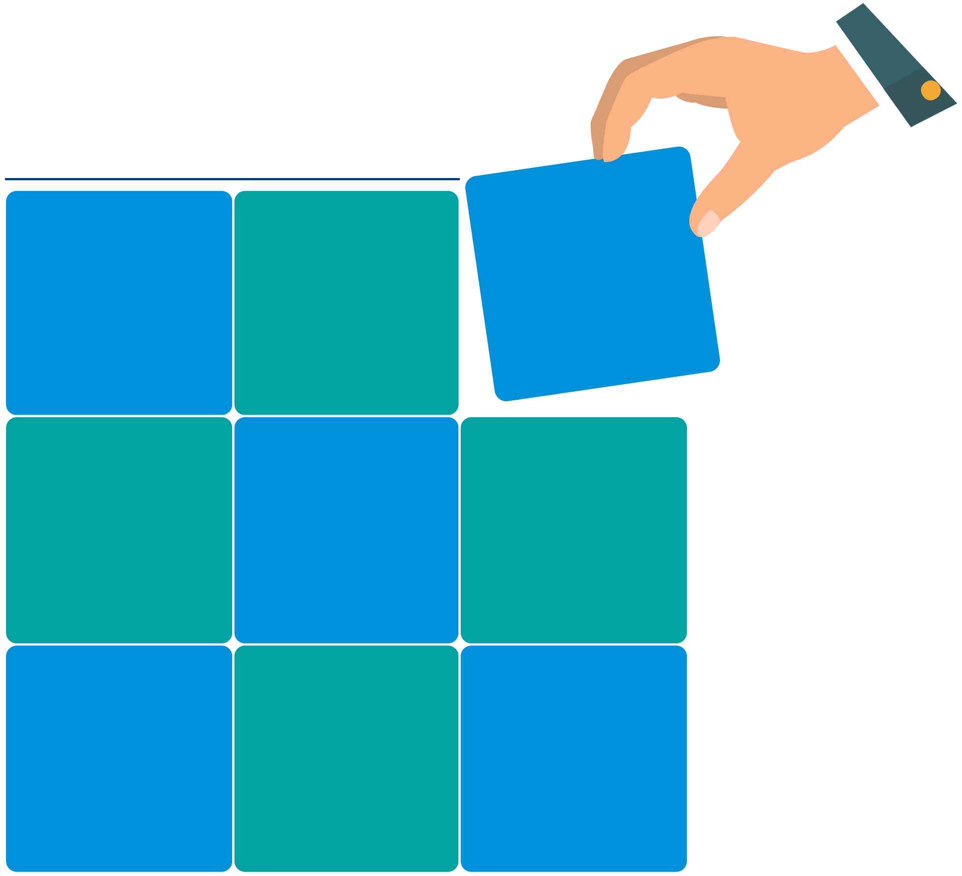
Target characteristics/ universe

- Good, profitable, growing businesses – EBITDA margins 15% plus, ROCE 20% plus, 15% plus revenue CAGR over last few years
- Good mix of domestic as well as export customers, no significant IC to EV transition impact, well positioned to capture supply chain shifts from China to India
- Control deals available due to shareholder issues (leverage, business non core to the group, succession, family settlements etc.)
- Valuation expectations likely to be more reasonable than earlier
- Aftermarket consolidation could be an interesting theme to pursue

EV related businesses

Target characteristics/ universe

- EV market in India not yet mature for classic PE investments
- Interesting opportunities (OE/ aggregators/ infrastructure providers) available however, for long term patient and Green energy mandate investors



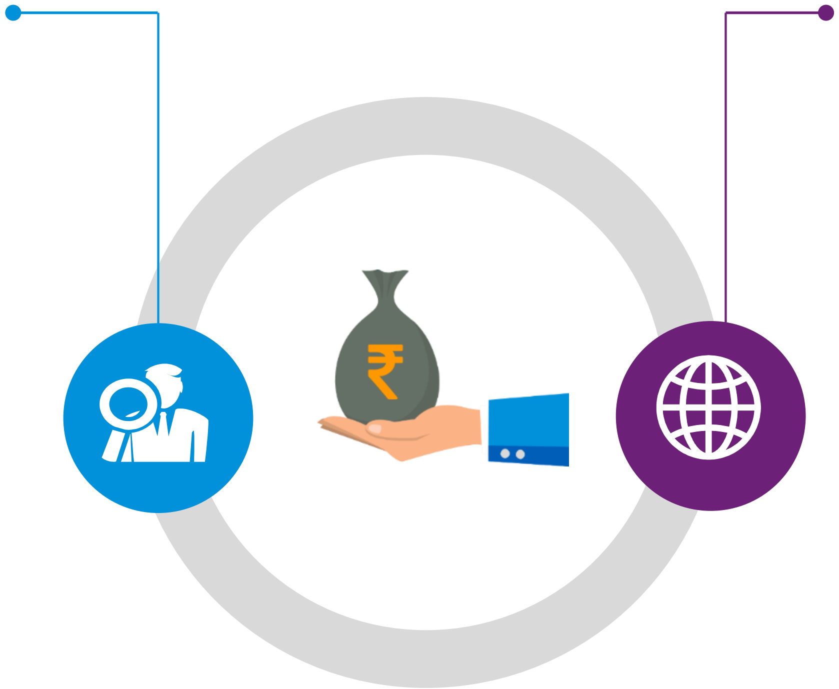
Source: KPMG Analysis

Potential transaction themes - Auto suppliers - for Indian strategic investors

Consolidation

Target characteristics/ universe

- OEM led consolidation of weaker competitors, Tier 2 suppliers or diversifying into new products
- Valuations should be more realistic than earlier; also OEM led and hence certainty on business continuity post acquisition
- Transaction structures could include "Stock for Stock" swaps especially where the acquirer is listed
- Large players should be able to attract external capital to back this consolidation



Global partnerships

Target characteristics/ universe

- Several BS 6 components/ systems being supplied by global players, either through their 100% subsidiaries in India or imports
- In 2 to 3 years, resourcing for BS 6 will happen in an effort to reduce costs – this is an opportunity for Indian players to form partnership with global players and acquire some of these businesses
- Similarly, EV supply chain needs to be developed in India to reduce dependence on China – this will need global partnerships
- Global partnerships also likely to facilitate shift of supply chain for traditional forging/ casting/ machining/ precision engineering components from China to India
- Partnerships in services businesses such as automotive design/ engineering/ connected car systems/ ADAS/ telematics given India' strong engineering services base

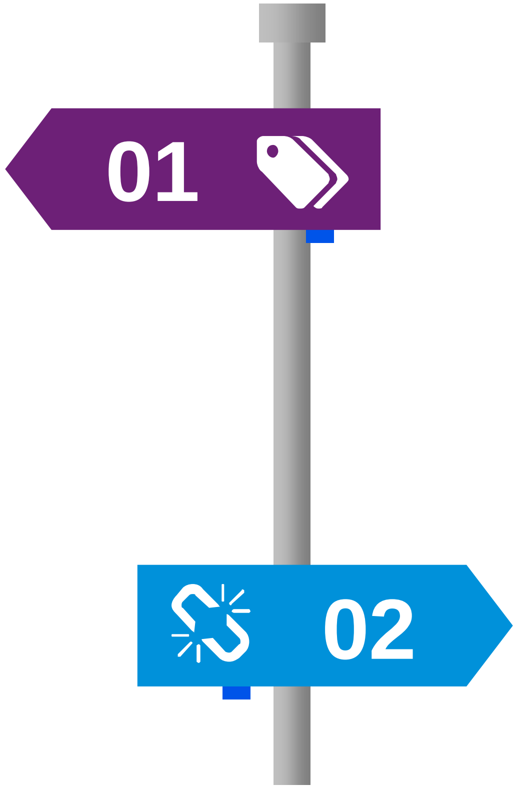
Source: KPMG Analysis

Potential transaction themes - Auto suppliers - Global investors

Strengthening India presence

Target characteristics/ universe

- Existing JVs of global companies with Indian partners may need to be restructured, particularly where Indian partner is not financial strong to fund the business
- OEMs also likely to ask critical global suppliers who don't have a base in India and components are imported, to set up a manufacturing presence in India to reduce costs as well as localize supply chain to minimize COIVD like disruptions
- IPOs of global suppliers likely to increase sourcing from India in an effort to shift from India; some of these sourcing relationships could lead to investments where Indian supplier needs capital to ramp up capacity



Bolt on acquisitions for portfolio firms of global PE investors

Target characteristics/ universe

- Portfolio companies of global PE investors to look at investing in Indian companies to de risk Chinese supply chains
- Low cost manufacturing of traditional forging/ casting/ machining/ precision engineering components likely to be attractive

Source: KPMG Analysis

Potential transaction themes - Retail/ servicing

01

Consolidation of automotive retail (new cars)

Target characteristics/ universe

- Automotive retail (new cars) is extremely fragmented and historically a “real estate” play
- In Phase 1, existing dealerships would need to consolidate, downsize and get funding support from OEMs
- Once first round of consolidation has happened in Phase 2, financial investors/ global players could come and invest in multi OE, multi geography platforms with professional management and reasonable return profiles
- Part of new car sales business to move online either through OEM owned platforms or third party platforms

02

Pre owned cars

Target characteristics/ universe

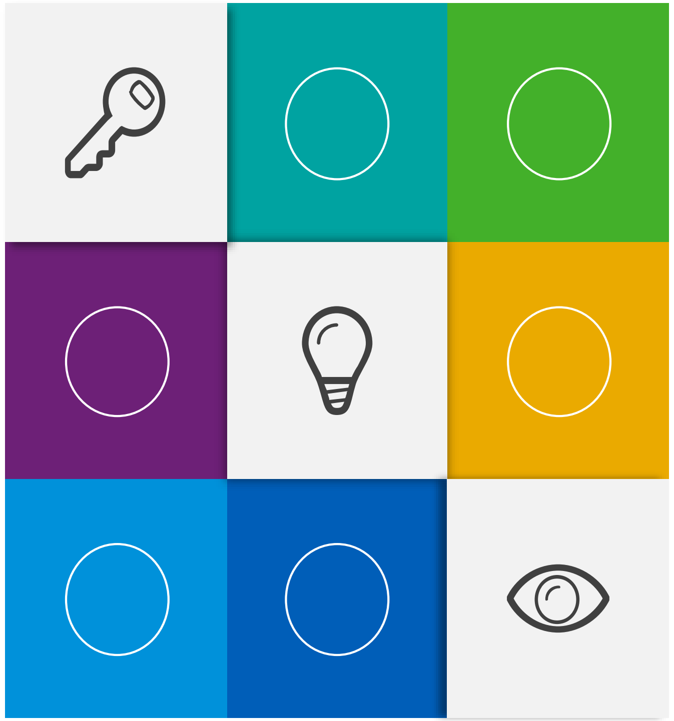
- Existing online players to further consolidate their presence in pre owned car sales market
- Such players would continue to attract strong investor interest (VC/ PE and strategic)

03

Automotive servicing

Target characteristics/ universe

- Historically a nascent business in India
- Given health concerns on ride sharing/ ride hailing, should increase in scale and attract investors



Source: KPMG Analysis

Potential transaction themes - Financing/ leasing

01

Captive or quasi captive finance

Target characteristics/ universe

- Captive or quasi captive automotive finance business to gain more importance to facilitate new sales
- Some of these financiers would need local partners for on ground business execution – this would lead to strategic partnerships

02

Automotive leasing

Target characteristics/ universe

- Historically a nascent business in India
- Leasing both for corporate as well as individual use should increase and attract global specialists

03

Automotive rentals/ self drive platforms

Target characteristics/ universe

- Historically a nascent business in India
- Given health concerns on ride sharing/ ride hailing, should increase in scale and attract investors

Source: KPMG Analysis

Key Takeaways

Key takeaways

01 Domestic demand recovery to pre-Covid levels is at least 10-12 months away

02 India is a strong contender for alternative source of auto components among global OEs and distributors looking to de-risk their China supply base

03 Liquidity is an issue for most auto component players; capital infusion through additional debt or PE investments seems inevitable

04 PE and inbound investments to gain traction amongst mid and small sized companies with strong product portfolio and OEM relationships

05 PEs could adopt a string of pearls strategy to facilitate a platform play

06 Large and Mid-sized players with sustainable businesses could look for value buys in products/ markets synergistic to their long term strategy

07 Deals post Covid could resemble the scenario post the 2008 financial crisis – control deals could see an uptick, especially among inbound deals

08 Future transactions would rally around specific themes for different cohorts within the auto industry

Source: KPMG Analysis

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