YES MSME Dialogue

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Foreword

The second Covid-19 wave has thrown cold water over the Indian economy that was beginning to warm up after the most severe contraction since Independence. The rash of afflictions that followed forced states to lock down, hurting consumer and business confidence yet again. Mercifully, daily cases seem to have peaked for now, though they remain above the peak of the first wave. But the risks of another wave and tardy vaccinations mean states would be chary of fully unlocking anytime soon. Further, the full extent of economic impact of second wave and potential third wave of pandemic will be determined by covid caseload, nature of lockdowns, structural composition of output and pace of vaccination. The second half of fiscal is expected to be led by better-spread economic growth, owing to increased inoculations and better adaptability to the pandemic, which would support sectors that are lagging. Globally, pace of vaccination has acted as one of the key driving factor for recovery with US and UK recording GDP growth owing to faster vaccination while Japan witnessed decline in GDP owing to resurgence of cases and slow pace of vaccination.

In this edition of YES- MSME Dialogue, the focus is on the ‘Auto Components’ sector and the MSME outlook of the same in the present scenario. Post two fiscals of consecutive demand decline, an expected global and domestic recovery in automobile demand is projected to drive revenue for MSME players in fiscal 2022.

EV adoption and PLI scheme presents opportunity for auto component MSMEs. They have the opportunity to realign their product strategy to suit the requirements of electric vehicles. The government has earmarked Rs 570 billion towards the automotive and auto-components sectors under PLI scheme. Though, large players will be major beneficiary of the scheme, PLI presents an indirect opportunity for MSMEs with greater domestic production and subsequent higher demand from sub-contracting owing to import substitution and export growth.

Macro Monitor

INDUSTRIAL OUTPUT (y-o-y %)

	Feb-21	Mar-21	Apr-21
Industrial (IIP)	-3.4	22.4	134

CRUDE OIL (y-o-y %)

	Feb-21	Mar-21	Apr-21
Brent Crude	9.2	93.5	171.3

Exchange Rate

	Mar-21	Apr-21	May-21
Rs/$	72.8	74.5	73.3

Inflation (y-o-y %)

	Feb-21	Mar-21	Apr-21
CPI	5.0	5.5	4.3
WPI	4.2	7.4	10.5

TRADE (y-o-y growth %)

	Mar-21	Apr-21	May-21
Exports	60.3	201.5	67.4
Imports	53.7	167.6	68.5
Trade balance	39.6	118.1	74.7

GDP (y-o-y %)

	Q2FY21	Q3FY21	Q4FY21
Private consumption	-11.3	-2.8	2.7
Government consumption	-24	-1.0	28.3
Fixed investment	-6.8	2.6	10.9
GDP	-7.3	0.5	1.6

India’s growth next fiscal to be a story of two halves

Macroeconomic outlook	FY18	FY19	FY20	FY21	FY22F	Rationale for FY22 outlook
GDP growth (%)	6.8	6.5	4.0	-8	11	The second wave and the resultant localised lockdowns has impeded the path to economic recovery, leading us to revise down our growth forecast for this fiscal to 9.5%, from 11.0% earlier. That said, expected pick-up in economic activity post-vaccination and support from global growth would act as positives.
Inflation CPI (%)	3.6	3.4	4.8	6.2	5.0	Upside risks on inflation are growing from surging international commodity prices. While producers are bearing a greater burden of rising input costs for now, these could get passed to retail prices once demand recovers. Food inflation could also face pressure from disruptions to rural economy due to the pandemic’s spread, and rising global prices.
Exchange rate (Rs/$, March)	65	70	74	74	75	Soaring Covid-19 cases posing a strong downside risk to India’s growth forecast may weaken the rupee more against the dollar. Impact of a second wave amid inflationary pressures and stress on government finances are expected to weigh on sentiment.

Global Snapshot

US

Robust Q1 GDP growth in the US, but inflation concerns remain

- $1.9 trillion fiscal stimulus finally passed in the US to positively impact demand.
- US CPI rose 1.6 percentage points to 4.2% on-year in April 2021. Sharp rise in inflation intensified concerns over the tapering of the quantitative easing policy implemented by the Fed, going ahead, implying demand–push inflationary pressures.
- US jobs data showed encouraging signs, with non-farm payrolls rising 260,000 in April, though down from massive gain in March.

UK

Faster vaccination and fewer Covid-19 cases propel economic activity in the UK

- GDP is estimated to have grown 2.1% in March 2021 as country eased restrictions, the fastest monthly pace since August 2020.
- Annual CPI rose by 1.5% in the 12 months to April 2021, up from 0.7% growth in March. Price movements for household utilities, clothing, and motor fuels are the main reasons for the higher monthly rate this year than a year ago.
- The services sector grew 1.9% in March, as schools re-opened and retail trade sales continued to show strength.

China

China's Q1 GDP numbers at record highs

- Q1 GDP grew by a record 18.3% on-year, driven by external and domestic demand recoveries and low base of last year.
- Manufacturing PMI came in at 51.1, 0.8pp lower on-month, since supply bottlenecks stifled production.
- Consumer prices continued to decline on-year, with deflation at -0.3%, slightly higher than -0.5% in the previous month. On a monthly basis too, inflation inched up, after three months of consecutive slowdown.

Japan

Private consumption remains a weak spot for Japan

- Private consumption remained weak, and export pace slowed in April. Consumption trends based on card spending showed goods spending remained stable, but services spending was weak.
- Trade exports were faster to grow than exports at 38% in april while the imports improved 12.8% on-year. Japan had trade surplus of ¥253,072.
- Deflation eased slightly, with CPI inflation declining 0.4% on-year and on-month in April.

MSME News & developments

Auto components; Post marginal recovery, exports estimated to be under pressure again with second wave of COVID-19. MSME to feel the blow too

On - year Growth	%share to Auto component OEM segment	Mar-20	Apr-20	May-20	Jun-20	July-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21
	51%	-38%	-100%	-90%	-58%	-24%	-2%	20%	35%	8%	28%	-2%*	13%	79%	-11%*
	26%	-28%	-99%	-86%	-50%	-28%	0%	15%	40%	4%	9%	13%	17%	68%	-23%*
	16%	-83%	-88%			-17%			12%			51%			
	5%	-18%	-100%	-53%	51%	14%	24%	29%	59%	46%	86%	42%	40%	85%	-15%*

Source: SIAM, TMA, CRISIL Research | Note: *: m-o-m change in production data; Passenger Vehicle data for January-April 2021 does not include Tata Motors

Textiles RMG: Low base and ban of imports from China to fracture supply chain; textile MSMEs too expected to see some gain

On - year Growth (in value terms)	Apr-20	May-20E	Jun-20	July-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21E	Apr-21E	May-20E
RMG (in %)	-90.1%	-63.4%	-28.9%	-15.0%	-9.8%	13.7%	10%	2.7%	-12.2%	-8.6%	-7.1%	26.4%	927.1%	-29.4%

Source: Department of Commerce, Ministry of Commerce & Industry, CRISIL Research | Note: *: RMG stads for Readymade garments

Engineering & capital goods; export demand estimated to increase in Q1 FY22 over a lower base which is positive for MSMEs

On - year Growth (in value terms)	Mar-20	Apr-20	May-20	Jun-20	July-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21E	Feb-21	Mar-21E	Apr-21E
Engineering and Capital Goods export (in %)	-27.4%	-75.8%	-32.2%	-4.3%	14.2%	-2.8%	8.5%	0.1%	-13.8%	-1.2%	14.5%	-1.3%	70.3%	234.6%

Source: Department of commerce, CRISIL Research

Demand rebound from all automotive segments to propel growth in auto component SMEs, second wave to dampen demand growth

Auto component industry poised for double digit growth

Rs bn	Auto Comps market size
FY 15	2415
	6%
FY 20	3200
	-6 to -8%
FY 21E	2975 - 3040
	16-18%
FY 22P	3490 - 3550

Exports,	Replacement,	OEM
18-20%	20-22%	59-61%

Note: The break-up is in value terms for fiscal 2021. Source: Industry, CRISIL Research

Second wave to limit the recovery in OEM production growth in fiscal 2022

Production (in volume terms)	%share to OEM segment volume	FY15-20 CAGR	FY21	FY22 P
	14%	1%	-11%	18-20%
	79%	3%	-13%	10-12%
	3%	2%	-17%	26-28%
	4%	4%	28%	8-10%

Auto Components review & outlook

FY21: Decline in fiscal 2021 on account of subdued demand across all automobile asset classes in the first half of fiscal 2021 amid continued weakness in the economy, decline in exports amid COVID-19 outbreak in key export destinations and lower demand from replacement market owing to less movement of vehicles.

FY22: Low base coupled with improved demand across all segments to propel growth to 16-18% for auto components. This can be further attributed to a 22-24% increase in OEM demand, which would be driven by strong recovery in commercial vehicles (CV) and passenger vehicle (PV) production.

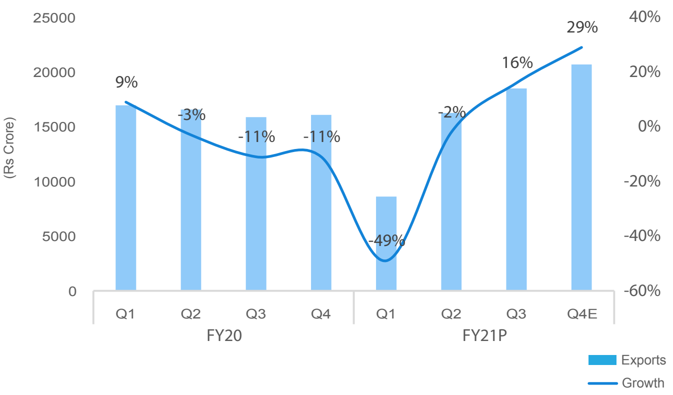
Domestic production of all automobile segments increased on a low base in Q4 FY21 led by healthy demand which benefitted auto component players

Growth (y-o-y, %)	Q1FY21	Q2FY21	Q3FY21	Q4FY21
Two-wheeler production	-78%	-5%	18%	29%
Cars and UV production	-84%	-3%	23%	27%
Petrol consumption	-36%	-5%	6%	10%
Diesel consumption	-33%	-16%	-1%	4%
Toll traffic	84%	249%	195%	74%
Steel production	-41%	-3%	7%	10%

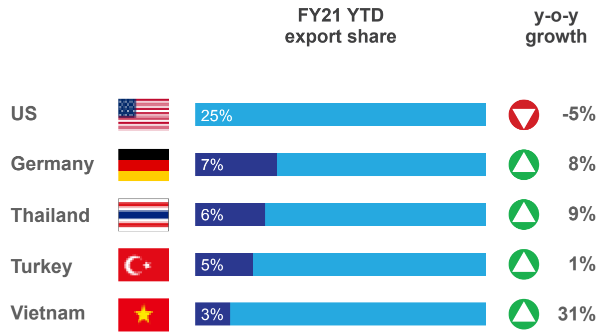
Source: Industry, CRISIL Research

- Domestic production of all automobile segments increased on a low base in Q4 FY21 led by healthy demand. In Q1 FY22, production is likely to be impacted as several leading original equipment manufacturers have temporarily suspended production activities in the wake of second wave of COVID-19.
- Petrol and diesel consumption, which act as a proxy for the aftermarket demand, continue to remain in the positive territory in Q4 FY21 with increased movement of vehicles. In Q1 FY22, demand for petrol and diesel consumption is expected to be expected to be impacted due to imposition of partial lockdowns/curfews across various states.

Demand from auto component exports revived at a faster pace than domestic market despite second wave of COVID-19



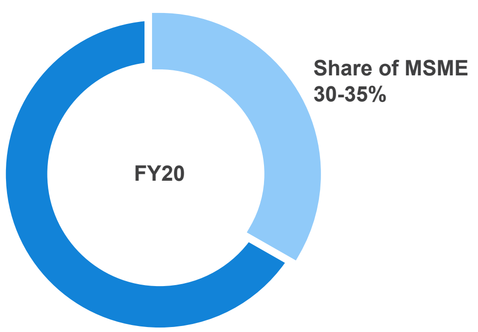
Source: DGFT



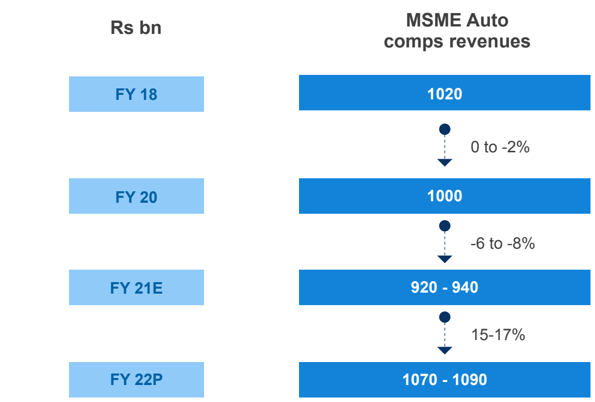
Source: DGFT, CRISIL Research | Note: YTD is from Apr-Feb

Demand is expected to grow by 6-8% backed by global recovery. An uptick in freight demand amidst economic recovery in the USA and expected revival in passenger vehicle markets across Europe is expected to bolster demand for auto component exports.

Double-digit growth likely next fiscal for auto comps SME led by demand recovery from all segments



Source: CRISIL Research



Source: Industry, CRISIL Research

Auto Components MSME revenue outlook

FY21: Though demand from most vehicle segments picked up sequentially in H2FY21, impact of Q1FY21 is estimated to have led to the revenue of auto component SME players remaining in red for entire fiscal 2021. Covid-19 outbreak in export destinations especially in Europe and USA is likely to have led to export demand falling by ~6%. Thus overall revenue declined in fiscal 21 as utilisation level of players were below normal.

FY22: Post 2 fiscals of consecutive double-digit decline, an expected global and domestic recovery in auto demand coupled with improvement in utilisation levels is projected to drive revenue for SME players.

Margin outlook for MSME Auto Components

FY21: Operating margin expected to contract by ~140-190 bps in FY21 due to lower capacity utilisation levels of majority players.

FY22: Improved capacity utilisation levels on the back of expected better demand sentiment is likely to aid margin expansion by 90-120 bps; to be lower than pre-slowdown levels (before fiscal 2020).

Opportunities galore for MSME Auto Components

1. EV adoption provides opportunities for auto component SMEs

Auto component SMEs have the opportunity to realign their product strategy to suit the requirements of electric vehicles. For example, the opportunities would be in lithium ion cell, battery manufacturing and battery management solutions.

New auto-components would be needed at the expense of some traditional components

IN

Battery
BMS, Li ion cells, internal cell support

Electricals and electronics
Motors, sensors, controllers, Onboard charger

Miscellaneous
Plastics and composites, invertor, temp control

OUT

Drive transmission
Clutches, Gears, Gear housing

Engine
Piston, Crankshaft, Cylinder head/ block, Fuel injection

Exhaust Mgmt systems
Catalytic convertors, Lean Nox trap, SCR

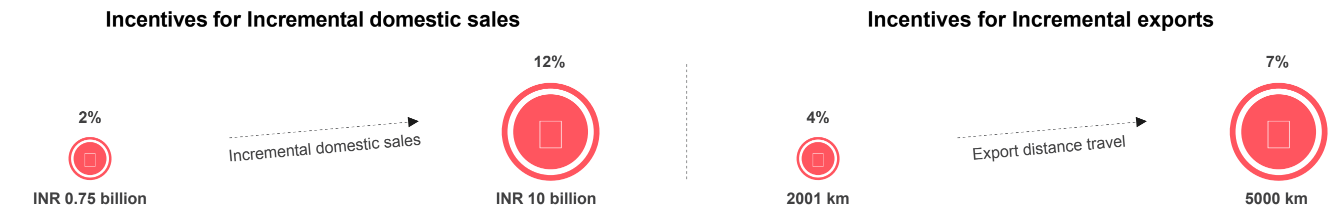
Vehicle segment	EV penetration		
	FY20E	FY21E	FY26P
	0.1% (~3,000)	0.1% (~4,600)	3-5% (~1,72,500)
	0.9% (~1,52,000)	0.9% (~1,43,900)	8-12% (~24,87,000)
	0.6% (~600)	0.6% (~500)	2-4% (~3,100)
	0% (~50)	0% (~30)	3-5% (~26,800)

Source: CRISIL Research

2. PLI presents opportunity in sub-contracting for Auto Component SMEs

The government earmarked Rs 570 billion towards the automotive and auto-components sectors. Though, large players will be major beneficiary of the PLI scheme, PLI presents an indirect opportunity for SMEs with greater domestic production and subsequent higher demand from sub-contracting owing to import substitution and export growth.

Benefit may range from 2-12% of incremental revenues over the base year



Source: Industry

Key risks / monitorable

Ability to realign in light of regulatory changes

- E-vehicles will reduce up to 20% of the number of auto component products used
- SMEs will have to realign their product strategy

Rising raw material prices

- Prices of commodities are expected to rise in fiscal 2022, in turn leading to a double digit increase in raw material index.

YES BANK MSME solution

Solution provided to a leading auto-ancillary component exporter for capacity expansion

Challenge faced by the customer / Client Requirement :

A leading auto-ancillary component exporter was planning to expand its existing manufacturing unit for increasing the production capability of the company. Since capacity expansion would be capital intensive, client was looking for Term Loan from the Bank for meeting their funding requirements.

Solution offered by YES BANK :

Considering that the client was into exports and would have a natural hedge against their Foreign Currency Exposure, LIBOR linked Foreign Currency Term Loan (FCTL) was offered to the client at competitive rates.

How it has helped the customer :

The client was able to

- Save on interest costs due to Foreign currency lending.
- Improve their cash-flow and reduce their cost of capital.
- Able to use it as a natural hedge against their future exports.

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