

Impact of demonetization on automobile sector: Special reference to commercial vehicle industry

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Abstract

Indian Demonetization has shaken the economy and lots of mix response has recorded, few industries are hoping to get positive impact whereas few fear to get hard hit. Automobile industry is one such which has negative impact. Sudden announcement of demonetization has resulted into insecurity and fear among automobile buyers where major part is cash sales. The commercial and passenger vehicles were the harder hit. Automobile industry lists into major industry contributing to economic wealth for country. In this conceptual study attempt is made to understand impact of demonetization on automobile industry.

Keywords: automobile, commercial vehicle, demonetization

Introduction

Major economic decision of demonetization of Indian currency notes of Rs 500 and Rs 1000 has posed many questions and challenges to several economic thinkers. Several guess in favor and against have floated since the Friday 8th November 2016 ever since demonetization initiative taken by BJP government. There are multiple reasons why Indian government has taken initiation to demonetize units of currency. Some reasons include combating inflation, to combat corruption, and to discourage a cash system. Government wanted accountability in every monetary transaction made so as to strengthen economic conditions.

Many earlier demonetization attempts made have resulted into good and few recorded adverse impact on economy. Most noted one is Zimbabwean government demonetization of its currency to curb the hyperinflation in 2006, 2008, & 2009. In 2015, the 3-month process involved expunging the Zimbabwean dollar from the country's financial system and solidifying the US dollar, Botswana pula, and South African rand as the country's legal tender in a bid to stabilize the economy. Adverse impact was recorded by, Coinage Act of 1873 demonetized silver in favor of adopting the gold standard as the legal tender of the United States.

The withdrawal of silver from the economy resulted in a contraction of the money supply, which subsequently led to a 5-year economic depression in the country. In response to the dire situation and pressure from silver miners and farmers, the Bland-Allison Act demonetized silver as legal tender in 1878. In the present Indian economic conditions, the long term impacts are yet to record and register.

The short term impact has brought the negative result to various economies of India. It has frozen the unaccounted and illegal transactions. And major problem was it has injected fear psychosis among buyers of luxury goods. As a result it has harder hit to luxury goods and bullion industry. Agriculture sector which got bad results due socioeconomic issues of demonetization. This study deals with impact of demonetization on auto industry, with special reference to commercial vehicles as most of the purchases are made through cash transactions.

Current Scenario of Automobile Industry

Over the past 3-4 months, CV sales, especially M&HCVs (Trucks) have been on a declining trend on account of waning replacement demand, weak industrial activity and uncertainty related to the impact of Goods & Services Tax (GST) regime on vehicle prices. With the recent demonetization move, the demand for CVs is expected to come under further pressure, which was otherwise expected to get a boost by the end of the fiscal from pre-buying following the implementation of BS-IV emission norms from April 2017 onwards. Demand for trucks has fallen by 15-30%; Market load operators have hit the most owing to high reliance on cash-based transactions to meet trip expenses, many of the organized fleet operators suggest that their own-fleet operations have not been hit as severely as the market load operators as they have moved to large part of their operations to cash-less transactions. However, certain expenses which can't be met through online payments etc are adding to the problems.

As far as the dealers of the commercial vehicles are concerned, they reported that the new vehicle enquiries have dried up; Customers have also put existing orders on hold according to them new enquiries have dried up and even ongoing transactions have been put on hold by fleet operators after the demonetization move. Although ~90% of commercial vehicles sales in India rely on external financing, but the sentiment has turned subdued and fleet operators are likely to put their fleet expansion or renewal plans on hold till the situation settles down.

The inventory levels in the system currently stands at around 4-6 weeks and is likely to go up in the near-term as OEMs would continue to dispatch vehicles already produced. However, to realign inventory levels with demand, OEMs are likely to take production cuts in the near-term till liquidity in the system improves.

The M&HCV (Truck) segment has been witnessing declining sales trend over the past 3-4 months on account of waning replacement demand, subdued industrial activity and its impact on freight rates. In addition, fleet operators had deferred purchase of new vehicles on account of expectations that vehicles prices may fall once GST is implemented. As a result

of these developments, we had revised our growth forecast for the segment from 12-13% earlier to 5-8% in September 2016. With recent demonetization move, the demand for M&CVs is likely to come under further pressure. Moreover, the support that was expected from pre-buying ahead of the BS-IV norms (from April 2016) would also weaken. In contrast to M&HCV (Trucks), the LCV has registered healthy growth in volumes

(up 12% in 7m FY 2016) on back of low-base effect (i.e. sales declined by 30% between FY 2013-16) and improving demand for SCVs aided by pick-up in consumption-driven sectors. These factors supported ICRA's forecast of 11-12% growth in volumes in FY 2017. However, following the demonetization, demand is likely to take a near-term hit and may prompt revision in outlook.

Segment	Q1 FY16	Q2FY16	Q3FY16	Q4FY16	Q1FY17	Q2FY17
M&HCV (Trucks)	24.3%	44.6%	23.9%	35.2%	17.5%	-17.3%
LCV (Trucks)	-7.4%	-11.4%	3.1%	11.3%	11.9%	12.8%
Buses	10.7%	21.5%	14.2%	13.0%	7.1%	4.9%
Total	4.7%	9.5%	11.0%	20.0%	13.0%	-0.2%

Source: SIAM Data, ICRA research

Growth Outlook	FY 2015	FY 2016	FY 2017e	Growth Drivers
M&HCV – Trucks	21.0%	31.9%	5-8%	<ul style="list-style-type: none"> Pre-buying ahead of the complete roll-out of BS-IV norms across India by April 2017 Pick-up in demand from infrastructure and mining related sectors Replacement-led demand is likely to continue if scrappage program is implemented
LCV – Trucks	(13.4%)	(0.9%)	~12-13%	<ul style="list-style-type: none"> Replacement demand to trigger in following 3 years of decline Pick-up in demand for consumption-driven sectors, rural markets and e-commerce Financing environment to ease as delinquency subsides
Buses	0.2%	13.7%	7-9%	<ul style="list-style-type: none"> Order from SRTUs to support sales in M&HCVs; Smart Cities Initiatives etc. Demand from schools and staff carrier segment remains stable

Source: ICRA research

Objectives of the Study

- To analyze the fluctuation in EPS, during the period of demonetization, for the selected companies,
- To study the effect of different factors that affect the price movement of shares.

Factors Causing Movements in Stock Price

i) Information

The latest Information regarding the price level of the stocks is very important for the valuation of the same this is because of the reason that the market will price the stock based on all the information that the public is aware of. Based on such information the market adjust the price up and down according to the perceived information of the future earning of the respective companies.

ii) Uncertainty

Whether a company will make profit in the future? The answer to this question is almost uncertain and based on some or the other assumed information. The uncertain future of the company will bring some volatility in share prices even during a period in which there is no new information. Now the amount of volatility is less in the case of the companies who have shown consistent performance in the past.

iii) Psychological factors

Humans are behind the activities of the trading market. That means human characteristics are also factors in how share prices move. Understanding human psychology is extremely important in evaluating investment opportunities because

human psychology creates and accentuates many of the opportunities that investors can capitalize on. For example greed often causes stocks to go higher than they deserve to go.

iv) Supply and Demand

The majority of the stocks that we can choose to invest do not have much liquidity. As a result stocks that trade smaller value of shares are subject to fluctuations more because of supply and demand. If a large shareholder wants to sell a large number of shares into the market with weak liquidity, the share holder can dramatically move share price.

Profile of Sampled Companies

i) Mahindra & Mahindra

- Type** : Public
- Traded as** : BSE: 500520
BSE SENSEX Constituent
- Industry** : Automotive
- Founded** : 1945 (Ludhiana)
- Headquarters** : Mumbai, Maharashtra, India
- Area served** : Worldwide
- Key people** : Anand Mahindra (Executive Chairman)
Pawan Goenka (MD)
- Products** : Automobiles, commercial vehicles, two-wheelers
- Revenue** : ▼ □ 72,474 crore (US\$11 billion) (2015)
- Operating income** : ▼ □ 8,793 crore (US\$1.4 billion) (2015)
- Net income** : ▼ □ 2,592 crore (US\$400 million) (2015)
- Total assets** : ▼ □ 61,239 crore (US\$9.5 billion) (2015)
- Number of employees** : 39,276 (March 2016)^[2]
- Parent** : Mahindra Group

Mahindra & Mahindra Limited (M&M) is a major automaker in India. It is the flagship company of the Mahindra Group. The company was set up in 1945 as Mahindra & Mahindra. It traded steel with suppliers in England and the United States. M&M soon branched out into manufacturing agricultural tractors and light commercial vehicles (LCVs). It later expanded its operations to secure a significant presence in many more important sectors. The company has now transformed itself into a group that caters to the Indian and overseas markets with a presence in vehicles, farm equipment, information technology, trade and finance related services, as well as infrastructure development.

ii) Ashoka Leyland

Type : Public
 Traded as : BSE: 500477 NSE: ASHOKLEY
 Industry : Automotive
 Founded : 7 September 1948
 Headquarters : Chennai, Tamil Nadu, India
 Area served : Worldwide
 Key people : Dheeraj Hinduja (Chairman)
 Products : Automobiles, engines, commercial vehicles
 Revenue : ▲ □ 206.58 billion (US\$3.2 billion) (2016)
 Net income : ▲ □ 10.98 billion (US\$170 million) (2016)
 Number of employees : 11,552 (2014)^[1]
 Parent : Hinduja Group
 Subsidiaries : Ennore foundries Limited
 Automotive Coaches and Components Limited
 Gulf-Ashley Motors Limited
 Ashley Holdings Limited
 Ashley Investments Limited
 Ashley Design and Engineering Services (ADES)
 Avia Ashok Leyland
 Ashok Leyland Defence Systems (ALDS)
 Ashok Leyland Project Services Limited
 Lanka Ashok Leyland PLC^[2]

iii) Tata Motors

Type : Public
 Traded as : BSE: 500570 (BSE SENSEX Constituent)
 NSE: TATAMOTORS, NYSE: TTM
 Industry : Automotive
 Founded : 1945
 Headquarters : Mumbai, India^[1]
 Area served : Worldwide
 Key people : Natarajan Chandrasekaran (Chairman)
 Chandrasekaran Ramakrishnan (President and Group CFO) Guenter Butschek (CEO)
 Products : Automobiles Sport Cars Commercial vehicles
 Coaches Buses Construction equipment
 Military vehicles Automotive parts
 Services : Automotive design, engineering and outsourcing services, Vehicle leasing, Vehicle service
 Revenue : ▲ □ 2.697 trillion (US\$42 billion) (2016)^[2]
 Operating income : ▼ □ 216.5 billion (US\$3.3 billion) (2016)^[2]
 Profit : ▼ □ 95.88 billion (US\$1.5 billion) (2016)^[2]
 Total assets : ▲ □ 2.619 trillion (US\$41 billion) (2016)^[2]
 Total equity : ▲ □ 763.5 billion (US\$12 billion) (2016)^[2]
 Number of employees : 60,000 (2016)^[2]

Parent : Tata Group
 Divisions : Tata Motors Cars
 Subsidiaries : Jaguar Land Rover Tata Daewoo Tata Hispano

Tata Motors Limited, formerly known as TELCO (TATA Engineering and Locomotive Company), is India's largest passenger automobile and commercial vehicle manufacturing company. It is also the world's 5th largest commercial vehicle manufacturer. It is part of the Tata Group. Tata Motors is widely credited for putting India on the automotive map by designing and developing its own range of cars. Tata Motors date back to 1945 when they started making Trains. Tata Motors was first listed on the NYSE in 2004. Tata Motors had created the wealth Rs 320bn during 2001-2006 and stood among top 10 wealth creators in India. Tata Motors and the Fiat group have signed a new memorandum of understanding (MoU) to establish a 50:50 joint venture to manufacture passenger vehicles, engines and transmission systems for both domestic and export markets.



Mahindra & Mahindra

Mahindra and Mahindra, one of the fastest growing CV brands in the country managed to sell only 12,644 CV units during November 2016 in comparison to 14,801 CV units it had sold in November 2015.

Tata Motors

Tata Motors, considered as the heavyweight champion of the Indian commercial vehicle industry, sold only 20,538 commercial vehicles in November 2016. It had sold around 24,030 commercial vehicles in the same month last year.

Ashok Leyland

Ashok Leyland has been quite busy carving more space for itself in the Indian CV industry. The brand, contrary to many expert forecasts, managed to register growth, despite Demonetization. It sold 9,574 units in November 2016 as compared to 8,971 units in November 2015.

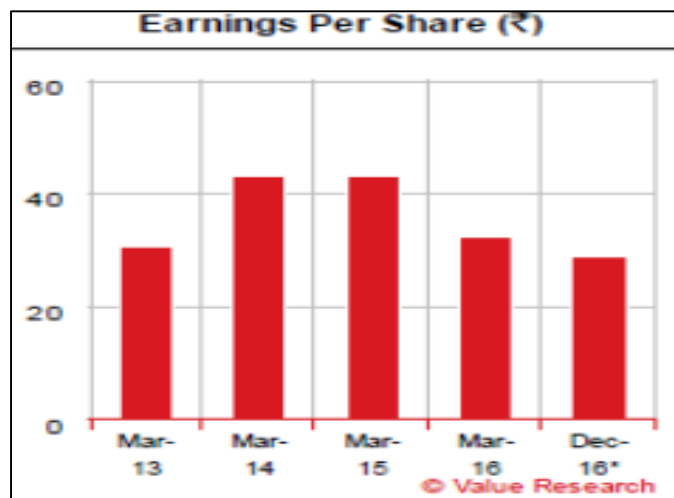
Analysis

Below are given the financial data as required for the study from the fourth quarter of 2016 and first quarter of 2017.

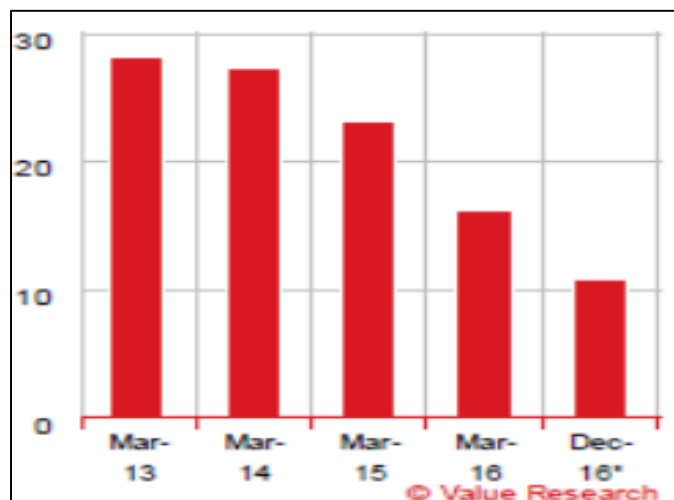
Table 1

	Market Cap (R Cr)	Revenue (R Cr)	Net Profit (R Cr)	Net Margin (%)	RoE (%)	Price to Book	Price to Earnings
Tata Motors	132,846.90	281,020.85	7,344.13	2.61	16.22	2.45	15.94
Ashok Leyland	24,474.54	19,267.43	848.10	4.36	29.47	4.97	28.86
Mahindra & Mahindra	71,055.10	8,910.17	1,499.49	16.46	48.56	14.63	46.08

**Comparison Based on Earning Per Share
Ashoka Leyland**



TATA Motors



Mahindra & Mahindra

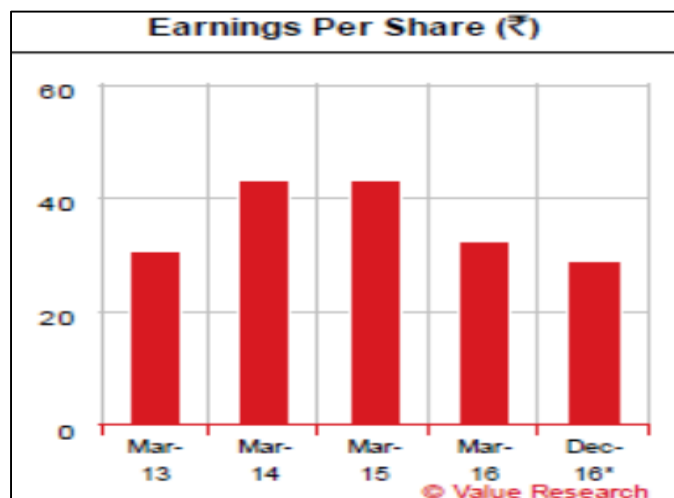


Table 2

Decline in the value of Sampled Companies For the period of Demonetization				
		Tata	M & M	Ashoka
Growth	Revenue	4.71	13.43	17.67
	Net Profit	-20.99	4.02	3.79
	EPS	-24.48	1.90	2.34
	Book Value	37.57	26.82	32.01
Average	Operating Margin	13.69	14.76	14.32
	Net Margin	4.02	5.11	5.74
	Return on Net worth	16.22	22.21	29.47
	Return on Investment	13.24	18.57	20.18

Table 3

Interim Growth Ratios (%)				
		Tata	M & M	Ashoka
Quarterly	Revenue	4.01	-4.29	-15.05
	Operating Profit	-17.54	-41.10	-54.20
	Net Profit	-146.70	-109.78	-105.15
	EPS	-88.68	-96.80	-98.19
TTM	Revenue	-1.08	7.54	2.48
	Operating Profit	-10.65	-12.66	-19.32
	Net Profit	-29.09	-9.29	-36.44
	EPS	-25.41	1.71	-28.02

Findings and Recommendations

The event of demonetization has not affected only the sampled companies, as all the sectors and respective companies. As a matter of fact the findings of the present study are as follows:

1. It is better to invest in companies with good market value, good performance in revenue and one should consider the various factors affecting the performance before investing.
2. Even though the industry may perform well, several ratios like, financial ratios, growth ratios, sales etc. should be properly analyzed with reference to that company and also with the industry.
3. As P/E ratio is directly related to market price per share and the Earnings per share while looking at the P/E ratio one should analyze the return and go for better portfolio.
4. A higher P/E ratio indicates that the stocks are extremely overvalued. If the firm does not earn a huge growth of earnings it will increase the amount paid by each investor to the share.
5. One should make use of quarterly financial results for fundamental analysis to get the reliable & relevant information which can prove to be vital in buying decisions.
6. Speculative news does play an important role in price movement. But, eventually company performance is the sole factor that matters. That is speculation makes changes for a very short term.

Hence, prudent investor should opt for fundamental analysis in order to have better results.

Conclusion

Investors are interested in predicting the future behavior of stock market. The investor should look at the price movements

of the particular company over the years and should go for better portfolio. The actual status, future plans of the organization, information which can affect buying decisions etc. is available in financial results which is very vital for analysis. Speculative or sentimental factors do play a role in price movement of shares. But, it is only a short-term effect, in long term annual performance is sole factor responsible for price movement.

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