![Fitch Ratings]



# Fitch Ratings 2020 Outlook: Asia-Pacific Automotive Manufacturers

## Environment Still Challenging, But Robust Financial Profiles

### Fitch's Sector Outlook: Stable

Fitch's outlook reflects expectations of weakening demand in markets such as the US, Europe and India, but a modest recovery in China after two consecutive years' of decline. We believe profitability and cash flow will be pressured by sluggish global demand and rising investments, but should be supported by the robust financial profiles of major Asia-Pacific (APAC) automakers, with most holding a net cash position.

### Rating Outlook: Stable

Most entities in our portfolio are on a stable outlook, and we therefore expect limited ratings movement in 2020. Tata Motors Limited (TML, BB-/Negative) is on Negative Outlook, which was also downgraded from 'BB' in July 2019 due to rising risks in both its Indian operations and fully owned UK subsidiary Jaguar Land Rover Automotive plc (JLR, BB-/Negative). The Negative Outlook reflects limited rating headroom in credit metrics, uncertainty over an orderly outcome of Brexit negotiations, and the evolving tariffs situation which poses risks especially to JLR.

### Rating Distribution Weighting: Investment Grade

The portfolio is largely investment grade, with all but TML in the high 'BBB' or 'A' categories. The larger Japanese and Korean groups are well established manufacturers, with a global presence, consistent earnings record and robust balance sheets.

The Chinese entities are either rated on a top-down basis from the sovereign/local municipality rating – Beijing Automotive Group Co Ltd (BBB+/Stable), China FAW Group Co., Ltd. (A/Stable) – based on Fitch's *Government-Related Entities (GRE) Criteria*, or equalised with parents rated on a top-down basis under the GRE criteria – Dongfeng Motor Group Company Limited (A/Stable), BAIC Motor Corporation Limited (BBB+/Stable).

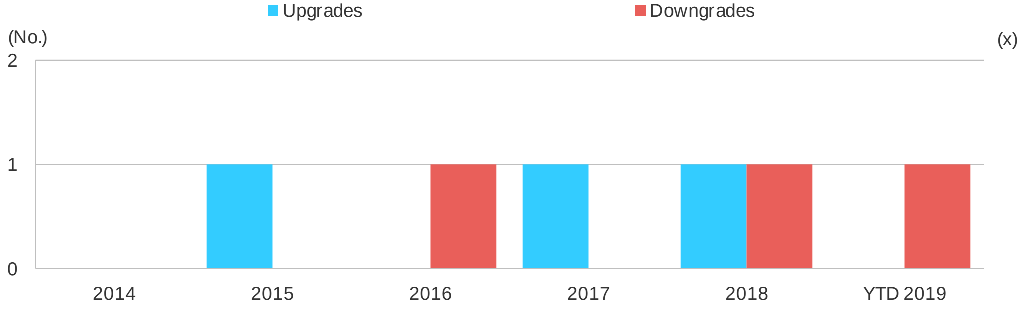
### What to Watch

- Extent of recovery in the China market after two consecutive years of negative growth
- Weaker sales in the US and European markets, with slower economic growth
- Lingering uncertainties on trade issues – US/China tension, potential US import tariffs
- Increase in EV sales to meet more stringent emission targets in major markets and to hurt automakers' profitability

### Jeong Min Pak, Senior Director

"Fitch expects weaker global demand and rising investments in clean-energy vehicles and new technology to continue to put pressure on APAC automotive manufacturers' profitability and cash flow generation in 2020. However, our stable outlook on the sector takes into consideration the robust financial profiles of major automakers, which should provide a sufficient buffer and flexibility to cope with these challenges."

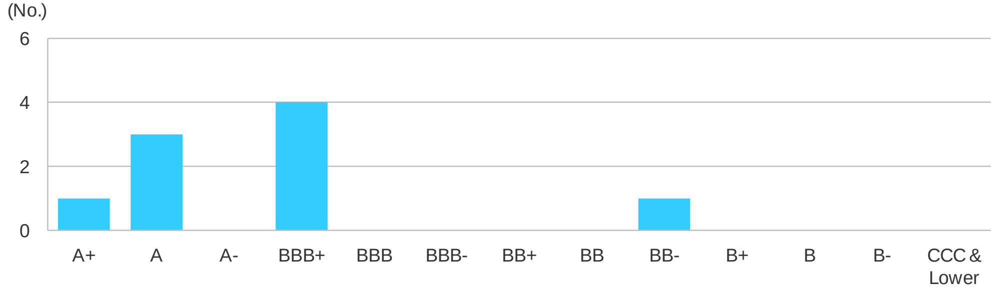
### Upgrades vs. Downgrades




Source: Fitch Ratings

### Distribution of Issuer Default Ratings - International Scale

(As of end-October 2019)




Source: Fitch Ratings

## Sector Forecast

### *Leverage Trend – Steady*

Fitch forecasts the median gross leverage (total debt/EBITDAR) to remain below 1.5x, and to improve over the next few years. Most of the large groups have a sturdy net cash position, and we expect median net leverage to remain negative in 2020.

### *Cash Flow Generation – Improving*

Fitch expects cash flow generation to improve despite rising capex. Median free cash flow (FCF) turned negative in 2018 as Chinese automakers grappled with the industry downturn and the rise in working capital. Hyundai Motor Company (HMC, BBB+/Stable) experienced reduced cash flow with increased inventory.

We expect cash flow generation to improve for the Chinese automakers, with a modest outlook on a market recovery in China – and at HMC, with improved earnings and working capital. We expect overall median FCF to revert to positive with improved cash flow at the Chinese and Korean automakers and as Japanese companies continue to generate steady FCF.

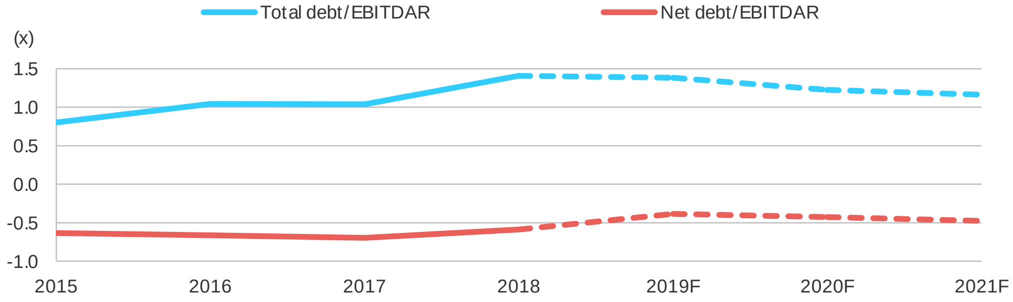
### *Liquidity Position – Solid*

Most APAC automakers continue to maintain a substantial net cash position and steady financial profiles, which should enable them to cope with potential slowing in major markets and rising investments. Fitch expects median liquidity ratios (cash/short-term debt and cash+CFFO+short term debt) to improve in 2020 with continued, positive FCF generation.

## Rising Investments

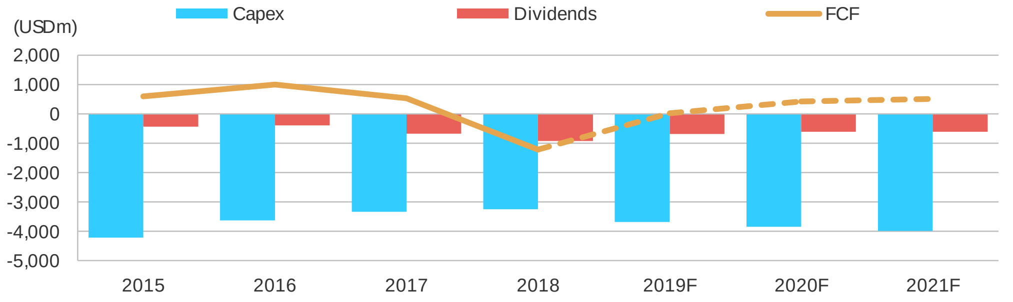
Automakers are accelerating investments in clean-energy vehicles, new technology and mobility trends which could exert pressure on cash flow and profitability. More stringent emission targets in major markets are pushing automakers to expand their electric vehicle (EV) line-ups to meet those targets, which could squeeze profitability – given the lower profitability than internal combustion engine vehicles (ICEVs). Automakers are also looking to alliances to reduce costs and mitigate uncertainties related to investment in new technologies.

### Median Leverage Actual and Forecast



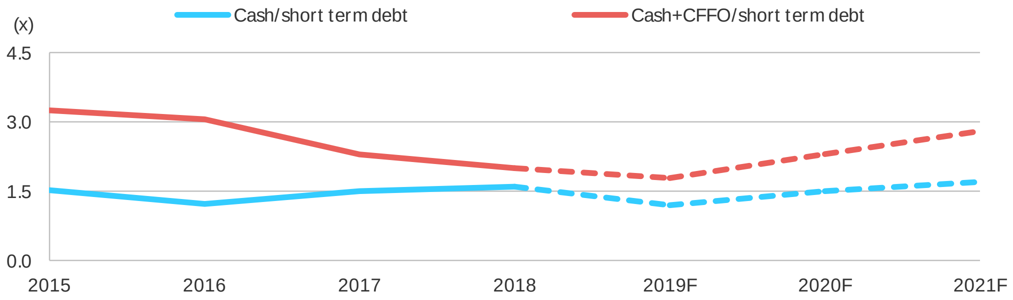

Note: Ratios are for non-financial operations
Source: Fitch Ratings, Fitch Solutions, Company reports

### Median Cashflow Performance and Forecast




Note: FCF for Hyundai Motor's non-financial operations are Fitch estimates
Source: Fitch Ratings, Fitch Solutions, Company reports

### Median Liquidity Actual and Forecast




Note: CFFO: Cash Flow From Operations
Source: Fitch Ratings, Fitch Solutions, Company reports

# Japanese Auto Manufacturers – Sector Outlook Stable

## Forecast

### *Leverage Trend – Steady*

Fitch expects Toyota Motor Corporation (A+/Stable) and Honda Motor Co., Ltd (A/Stable) to sustain strong leverage profiles over the next three to five years. Median gross debt to EBITDAR stood at 0.9x at financial year-end 2019 (FYE19, March 2019), and we forecast broadly stable leverage profiles in view of both carmakers' resilient earnings and conservative financial policies. This should also enable both to sustain significant net cash positions.

### *Cash Flow Generation – Resilient*

The ratings of Toyota and Honda are underpinned by strong FCF generation. Fitch expects both to boost capex spend to maintain technological competitiveness, but we forecast that wide margins will mean that both will maintain consistently positive FCF that compares favourably with global peers and contributes to strong liquidity buffers.

## Sector Fundamentals

### *Alliances Mitigate Risks*

The announcement by Toyota and Suzuki in August 2019 to strengthen their existing co-operation in technology and procurement with a capital tie-up reflects the growing trend towards alliances to reduce costs and mitigate the uncertainty related to high investment in new technologies. Toyota also cooperates with Mazda Motor Corp. and Subaru Corp. on electric cars, and owns stakes in both.

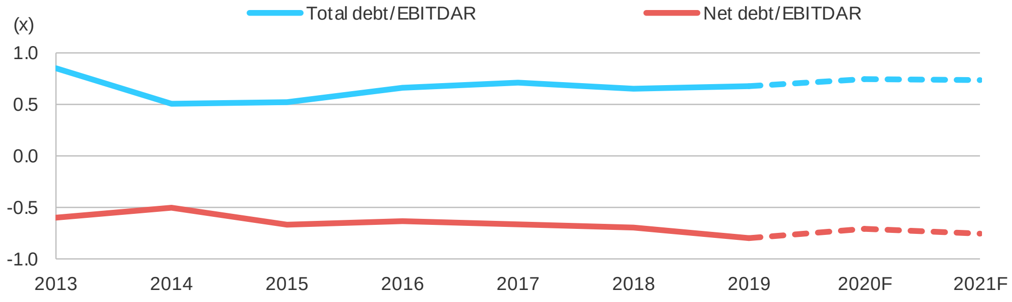
Honda, by contrast, has focused so far on technology partnerships without capital tie-ups. Its recent announcement to merge three of its suppliers with Hitachi Automotive Systems, a wholly owned subsidiary of Hitachi Ltd., underlines the pressure to reduce costs and could point towards a change in Honda's strategy towards deeper alliances.

### *Robust China Sales*

Firm sales in China despite the current market softness continues to support Toyota's and Honda's business profiles. According to Marklines, their new vehicle sales grew by 8.4% and 16.4% yoy, respectively, during the nine months from January to September 2019. This could help not only to offset weaker sales in other regions, but also to position them for further growth once the market recovers – at the expense of Western competitors.

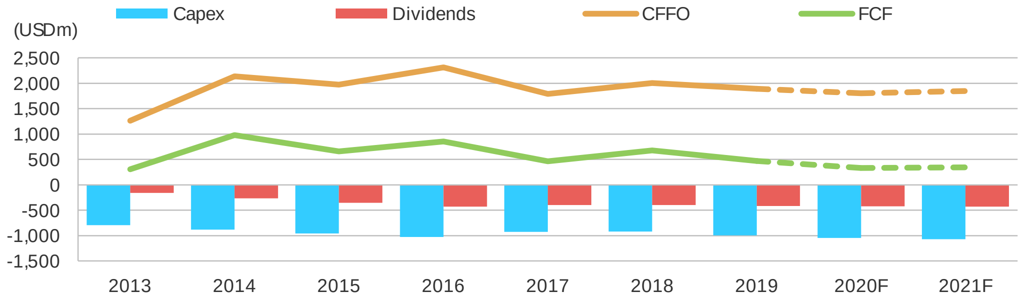
Downside risks could arise, however, from potential overcapacity, especially if the downward trend in the Chinese market should drag out further than anticipated.

### Median Leverage Actual and Forecast



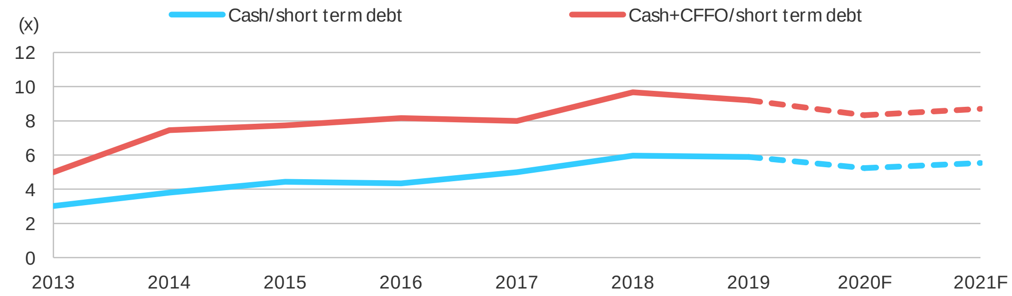

Note: Ratios are for non-financial operations
Source: Fitch Ratings, Fitch Solutions, Toyota, Honda

### Median Cash Flow Performance and Forecast




Note: CFFO - Cash Flow from Operations, FCF - Free Cash Flow
Source: Fitch Ratings, Fitch Solutions, Toyota, Honda

### Median Liquidity Actual and Forecast




Note: CFFO - Cash Flow from Operations
Source: Fitch Ratings, Fitch Solutions, Toyota, Honda

# Korean Auto Manufacturers – Sector Outlook Stable

## Forecast

### *Leverage Trend – Steady*

Fitch expects aggregate leverage of the Korean automakers to improve in 2020 due to higher earnings; 2018 and 9M19 earnings had been affected by one-off provisions related to quality issues as well as sluggish sales. We expect EBITDA generation to improve with a low base effect and full-year impact of a renewed model line-up, especially at HMC. Overall, we expect HMC and Kia Motors Corporation to maintain a combined net cash position of around KRW10 billion, and aggregate adjusted net debt/EBITDAR to remain negative over the next two to three years.

### *Cash Flow Generation – Resilient*

We expect capex to continue to increase due to rising investment in clean-energy vehicles and new technology, but cash flow to improve on higher operating cash flow and reduced working-capital burden.

### Sector Fundamentals

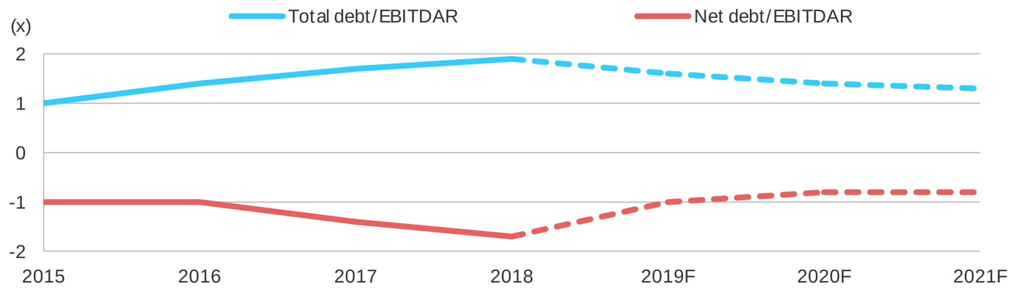
### *Sales Decline in the US and Europe but Modest Recovery in China*

Fitch expects growth in global light vehicle sales to be negative in 2019-2020. US light-vehicle sales are likely to decline slightly to around 16.6 million, and Europe is also likely to show negative growth. On the other hand, we expect Chinese passenger vehicle (PV) sales to resume growth, albeit very modestly, after negative growth in 2017 and 2018. Replacement demand is likely to drive the recovery. Overall, we expect growth in global light vehicle sales to be negative in 2019-2020.

### *Rising Investment*

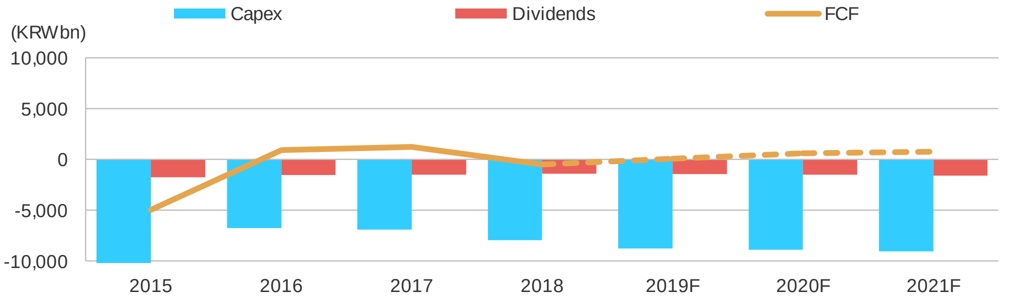
We expect the Korean automakers' capex to continue to rise with the expansion in the EV line-up and investment in new technology and mobility trends. HMC and Kia have aggressive plans to boost their EV portfolio in order to meet increasingly stringent emission targets in key markets. The two companies have recently announced the establishment of a JV with US Aptiv for autonomous driving, and have made investments in car-sharing companies such as Indian Revv and South East Asian Grab.

### Aggregate Leverage Actual and Forecast



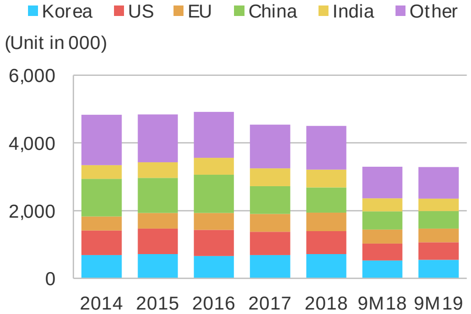

Note: Ratios for HMC are for non-financial operations
Source: Fitch Ratings, Fitch Solutions, Hyundai Motor, Kia Motors

### Aggregate Cashflow Performance and Forecast



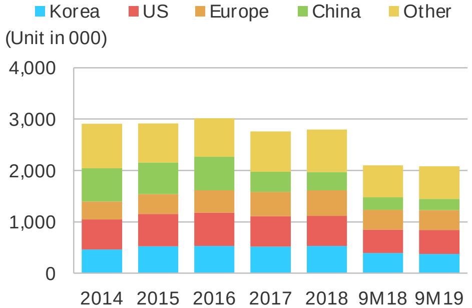

Note: FCF for Hyundai Motor's non-financial operations are Fitch estimates
Source: Fitch Ratings, Fitch Solutions, Hyundai Motor, Kia Motors

### Hyundai Motor Retail Sales Trend




Source: Fitch Ratings, Hyundai Motor

### Kia Motors Retail Sales Trend




Source: Fitch Ratings, Kia Motors

## Chinese Auto Manufacturers – Sector Outlook Stable

### Forecast

***Leverage Trend – Steady***

Fitch expects leverage for the Chinese auto groups to be mostly stable in 2020. These companies are supported by diversified brand and product portfolios, reducing overall business risks and volatility.

Fitch expects Dongfeng Motor Group Company Limited (A/Stable) and China FAW Group Co., Ltd. (A/Stable) to maintain their net cash positions. Beijing Automotive Group Co Ltd's (BBB+/Stable) leverage could rise further in the near term, due partially to its acquisition of a 5% equity stake in Daimler AG. Fitch expects leverage at its major operating subsidiary BAIC Motor Corporation Limited (BBB+/Stable) to remain stable.

***Cash Flow Generation – Recovery Expected***

Fitch believes deterioration in cash flow is cyclical in nature, and FCF should improve in the medium term. Sector-wide capex is likely to stabilise as companies adjust their investment plans to a maturing market.

### Sector Fundamentals

***Replacement Demand to Drive Modest Recovery***

The PV market is likely to resume low-single-digit growth, as the front-loading effect of the 2015-2017 purchase tax rebates dissipate and the supply-demand mismatch caused by the abrupt emission upgrades are resolved in 2H19. Vehicle replacement, rather than first-time purchases, will be the key growth catalyst, driven by an average four- to five-year replacement cycle. More cities may relax purchase restrictions on ICEVs to boost first-time demand, yet the impact should be offset by substitute effects between ICEVs and EVs.

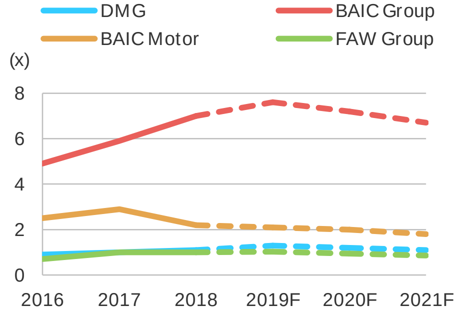
We expect sustained outperformance of luxury marques and also mass-market brands with strong images and high residual values (eg Japanese). Chinese brands are likely to diverge further with de facto market exits of weaker brands, as low-end demand should stay muted without aggressive subsidies/tax cuts and substantial improvements in the macroeconomic outlook.

***Foreign Brands to Roll out More EVs***

EV is likely to resume steady growth in 2020, although China's original 2020 annual sales target of 2 million units seems a stretch goal following sharp subsidy cuts since 3Q19. Retail demand could depend increasingly on the attractiveness of new EV outlays – in particular those from foreign brands such as Tesla and Volkswagen – while the sales contribution from institutional customers is likely to edge up due to year-end rush-buying ahead of a full-scale subsidy exit.

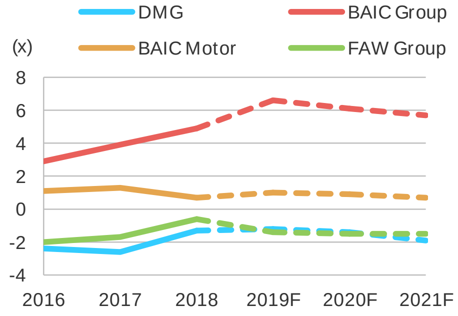
Foreign brands are likely to gain shares in the EV market, as they sacrifice profitability for volume to fulfil China's tightening fuel-efficiency requirements. Stiff competition in the consumer-oriented market could accelerate the shakeout of local EV start-ups and drive more domestic EV manufacturers to lean on institutional orders.

**Gross Leverage Actual and Forecast**



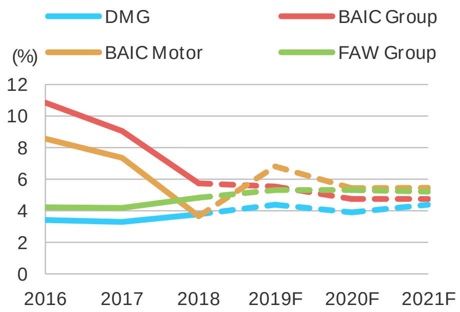

Source: Fitch Ratings

**Net Leverage Actual and Forecast**



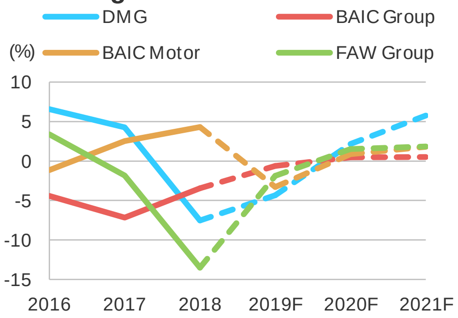

Source: Fitch Ratings

**Capex Intensity**



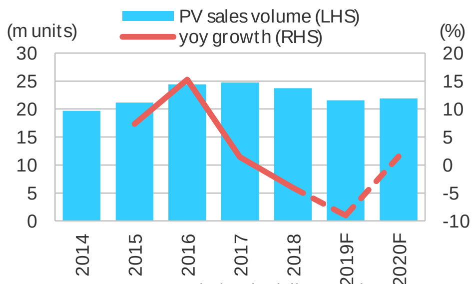

Source: Fitch Ratings

**FCF Margin**



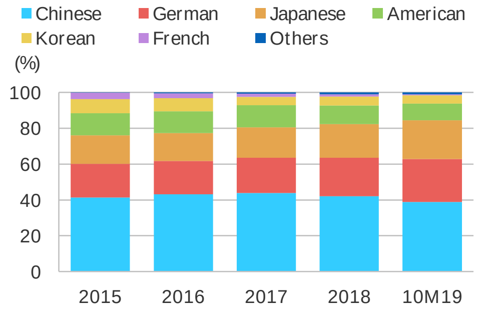

Source: Fitch Ratings

**China PV Market Forecast**




YoY – Year over year; wholesale delivery volume
Source: Fitch Ratings, CAAM

**PV Market Share by Brand Origins**




Source: Fitch Ratings, CAAM

# Indian Auto Manufacturers – Sector Outlook Negative

## Forecast

### *Leverage Trend – Negative*

Indian automakers' leverage will deteriorate over the next couple of years as weak demand over the last few quarters is likely to persist amid slowing domestic economic growth and higher cost of ownership under BS6 – the new emission framework – starting from 1 April 2020. Volume decline across vehicle categories will exert pressure on margins even as the competitive intensity remains high, and stricter safety and emission norms result in higher cost of production despite lower commodity prices.

Fitch expects investment to remain high as implementation of BS6 will require significant changes to vehicle platforms. Automakers will also need to invest in developing new models amid tough competition.

### *Cash Flow Generation – Negative*

CFFO generation will remain weak as the industry grapples with lower volumes amid a highly competitive landscape. In particular, implementation of BS6 will lead to around a 10%-15% increase in the cost of production, which is likely to put pressure on demand and margins. FCF generation is likely to remain negative over the next couple of years, because of lower CFFO and capex needed to comply with stricter emission standards under BS6 and new model development, including EV platforms.

### Sector Fundamentals

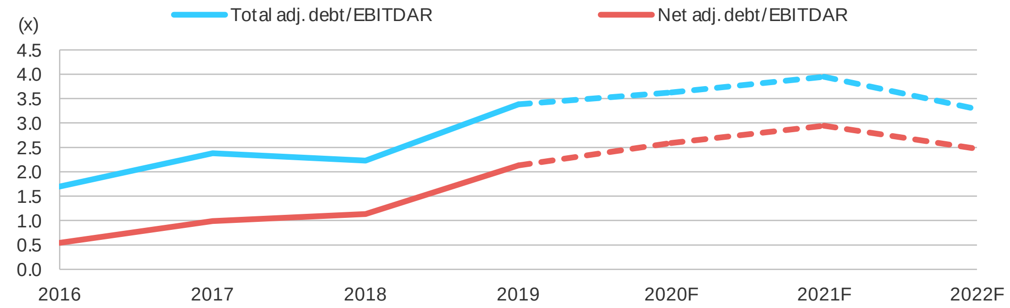
### *Weak Demand Prospects*

Fitch expects sales of PVs to shrink in the mid-to-high teens in the financial year to 31 March 2020 (FY20), following a sharp decline of 24% in 1HFY20 due to slowing GDP growth and constrained credit following a liquidity squeeze at non-bank lenders. We expect some stabilisation, as evident from a pick-up in retail PV sales during the festive season in October, but high dealer inventories coupled with weak consumer sentiment and deferment of purchase decisions ahead of BS6 will limit any significant boost. Higher vehicle costs under BS6 are likely to weigh on PV demand in FY21.

Within commercial vehicles (CV), we expect medium and heavy vehicles (MHCV) to experience a sharper decline than light vehicles (LCV) – considering the weak industrial /mining activity, muted level of private investments and slowing government spending on infrastructure. The decline in LCV sales was lower at 15% during 1HFY20, compared with 36% in MHCV, benefitting from growth in the e-commerce segment.

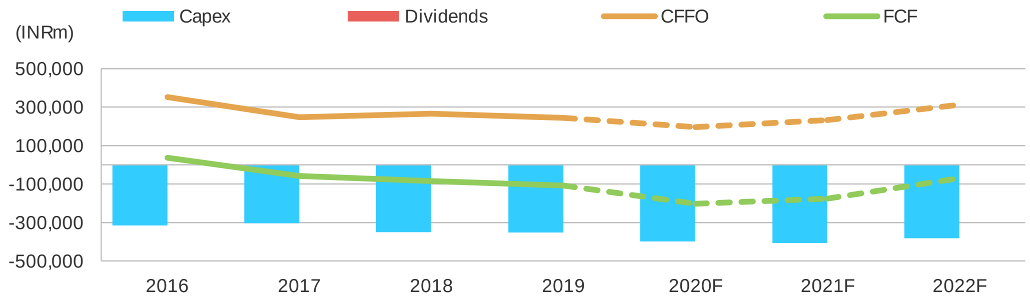
The decline in two wheeler volumes has been relatively less severe, at 16% in 1HFY20. Nonetheless, the ongoing weak availability of credit in rural areas and pressure on farm income due to uneven and irregular rainfall will weigh on demand.

**Tata Motors Limited - Leverage Actual and Forecast**



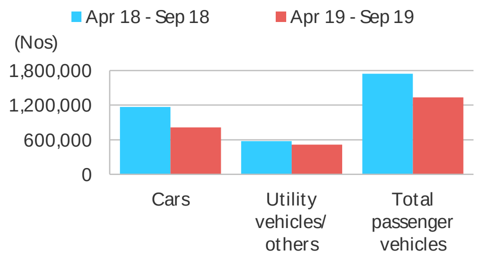

Source: Fitch Ratings, Fitch Solutions, Tata Motors

**Tata Motors - Cashflow Performance and Forecast**



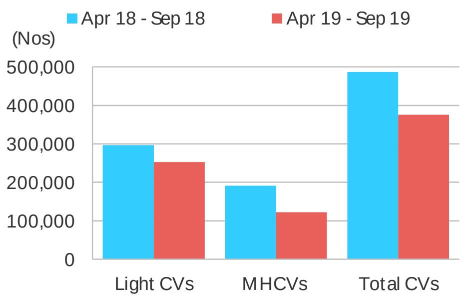

CFFO – Cash Flow From Operations
Source: Fitch Ratings, Fitch Solutions, Tata Motors

**Domestic Passenger Vehicle Sales**




SIAM: Society of Indian Automobile Manufacturers
Source: Fitch Ratings, SIAM

**Domestic Commercial Vehicle Sales**




SIAM: Society of Indian Automobile Manufacturers
Source: Fitch Ratings, SIAM

## Outlooks and Related Research

2020 Outlooks
Global Economic Outlook (September 2019)
Fitch Ratings 2020 Outlook: European Automotive Manufacturers and Suppliers (November 2019)

## Analysts

**Jeong Min Pak**
+82 2 3278 8360
jeongmin.pak@fitchratings.com

**Roman Schorr**
+81 3 3288 2673
roman.schorr@fitchratings.com

**Tyran Kam**
+852 2263 9909
tyran.kam@fitchratings.com

**Jing Yang**
+86 21 6898 7987
jing.yang@fitchratings.com

**Snehdeep Bohra**
+91 22 4000 1732
snehdeep.bohra@fitchratings.com