

INDIAN COMMERCIAL VEHICLE SECTOR

Moving to slower speed but not hitting speed breakers yet

QUARTERLY REVIEW | JULY 2011



ICRA RATING FEATURE

Summary

After registering a strong 30%+ growth over the past two fiscals, the growth in the commercial vehicle (CV) sector appears to be slowing down in line with the trends being witnessed by the broader automobile sector. During April-May 2011, the domestic CV sector posted a modest 12% growth on YoY basis compared to 27% in FY11. Rising interest rates, slowing industrial output, substantial increase in vehicle prices coupled with high-base effect of previous years are the main factors impacting growth in the sector. Over the past six months, OEMs have taken successive price increases to pass on the impact of emission norms changes and increase in commodity prices. The rising diesel prices have also impacted the operating economics, being a major part of a freight operators' cost structure. This coupled with higher interest rates (averaging 13% at present for large fleet operators) have substantially increased the cost of vehicle ownership for fleet operators. At the same time, freight rates on major routes have remained relatively stagnant thereby indicating that fleet operator's profitability and cash flows are coming under pressure.

In contrast to the previous downturn, the slowing growth rates at present are largely prompted by cost-based headwinds rather than over-capacity, which resulted in sharp decline in volumes during H2 FY09. Our channel check suggests that several operators have postponed/deferred their expansion plans in view of rising interest rates and expectation of slowing economic/industrial growth. Capacity utilisation is gradually declining since April 2011 and freight rates continue to remain stagnant despite rise in operating expenditure for operators. On financing front, while interest rates have moved by 50-100 bps in the past three months, credit availability continues to remain adequate and financiers have not tightened lending norms.

Given the current scenario, we expect some moderation in the growth in the CV sector in FY12. The M&HCV segment, which tends to be more vulnerable to slowdown, is likely to experience a much lower growth, while the LCV segment could continue to witness relatively better growth. The proposed changes in priority sector lending by banks to NBFCs w.e.f from 1st July 2011 may however push financing rates for First Time Users (FTUs) and impact viability for LCVs, particularly SCVs to some extent. Competitive pressures are set to rise as Mahindra Navistar is expected to ramp up M&HCV production in the current year and Daimler expected to launch its products in 2012. In the LCV segment as well, Ashok Leyland-Nissan JV is expected to launch its LCVs in the sub-5T segment in Q2 FY12.

Domestic Industry Segment	Volumes				YoY Growth (%)			
	FY09	FY10	FY11	FY12e	FY09	FY10	FY11	FY12e
M&HCVs	183,495	244,944	322,788	342,155	-33.2%	33.5%	31.8%	6.0-7.0%
LCVs	200,699	287,777	353,620	403,126	-7.0%	43.4%	22.9%	14.0%

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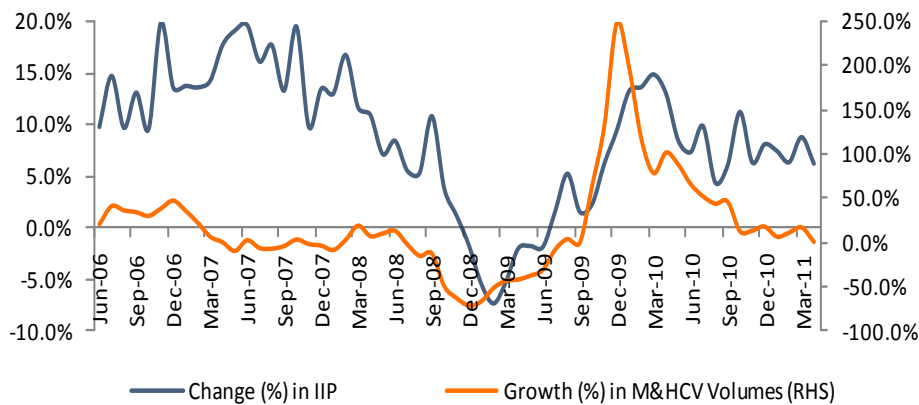
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Key Trends in Growth Drivers

Slowdown in M&HCV sales maps deceleration in IIP growth

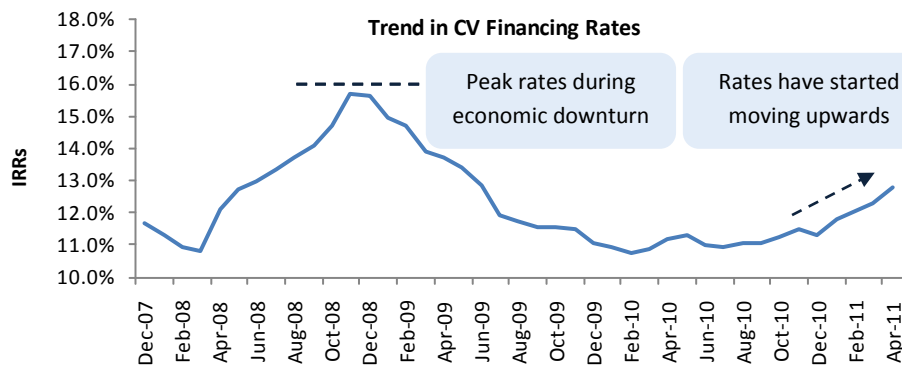


Source: MOSPI, SIAM, ICRA Estimates

Though the IIP data has been highly volatile - the trend points to a slowdown in economic activity, which in turn indicates a potential slowdown in demand for M&HCVs going forward. ICRA's channel check suggests, while slowdown is being witnessed across segments in M&HCVs, the higher tonnage, long-haulage vehicles are expected to be more vulnerable to demand slowdown given their strong linkage to industrial freight availability. The diesel price increase also has a dampening effect due to its significant weightage on operating costs of fleet operators.

Additionally, the lower demand from construction segment and mining ban in some regions has also impacted demand for tippers in some markets. Within M&HCVs, the passenger segment has been posting lower volumes in absence of new orders for buses under JNNURM. Given the current scenario, we expect the M&HCV segment to post a moderated 6-7% growth in FY12.

Rising interest rates may adversely impact CV demand in FY12



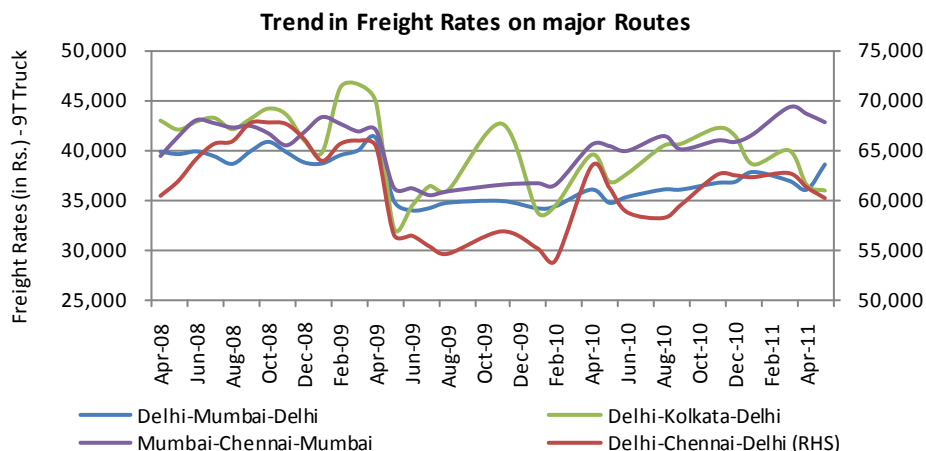
Source: ICRA Estimates

Apart from IIP growth and GDP, availability of financing and interest rates remains another key factor that impacts CV demand. Over the past six months, with increasing inflationary pressures and credit tightening measures implemented by RBI, the interest rates for CV financing have inched up to almost 12.5-13.0% for new M&HCV financing.

The increase in interest rates coupled with the successive prices increase taken by OEMs to combat the impact of commodity prices has substantially increased the ownership cost for fleet operators. However, at the same time, the freight rates, which are largely demand-supply driven, have not increased in line with increase in capital cost.

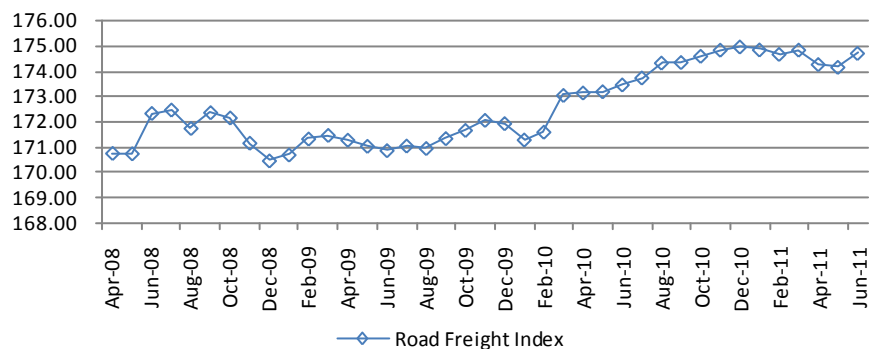
Key Trends in Growth Drivers

Freight rates have not moved up in line with higher operating costs for fleet operators



Source: CMIE, ICRA Estimates

Road Freight Index has largely remained flat over the six months;



Source: TCI, ICRA Estimates; Road Freight Index (RFI) is an index based on weighted average freight rates originating from 24 major stations

The freight rates on major routes have remained largely flat over the past six months and have not moved upwards in line with rising operating cost for fleet operators, thus indicating building pressure on fleet operator's viability. While freight rates are largely a function of overall economic activity, demand-supply mismatch in particular region can impact local freight rates.

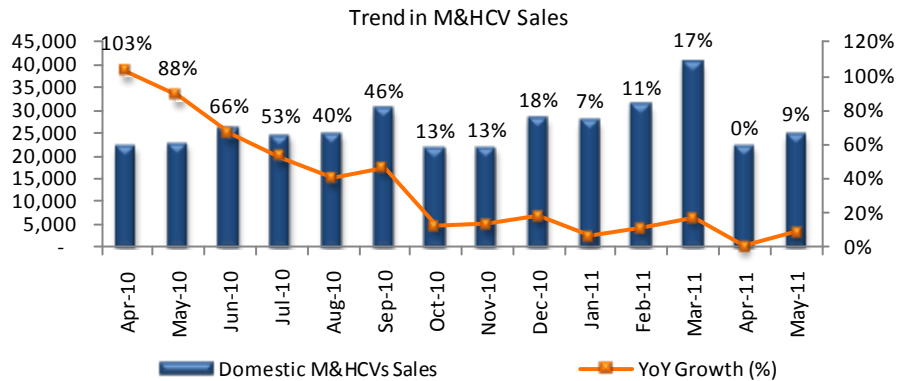
With major part of the road freight segment comprising of unorganized players, pricing power remains limited and linked more to demand-supply scenario. Large fleet operators are however well placed on account of in-built escalation clauses in their long-term contracts with their customers for fuel and other expenses.

Barring some seasonal impact, road freight index continues to remain flat. For instance, in the recent months, freight rates on Chennai-Kolkata route have witnessed the highest increase (i.e. ~24%) due to higher demand for truck during the mango season and less availability to an extent. Among four metros, Ex-Kolkata witnessed an increase of 6% due to less inflow of trucks and higher demand, rates on all other routes remained almost flat.

With the recent 9% hike in diesel prices, the operating costs for fleet operators is likely to increase by 4-5%, which we expect would be passed on over a period of time, resulting in higher freight rates. Further, the potential de-regulation of diesel prices remains a concern for the industry as it may result in significant increase in operating cost for operators.

Commercial Vehicle Industry: M&HCVs

Growth rates have started decelerating; trend indicators hint at a slowdown ahead in M&HCVs



After two years of steady volume growth, the M&HCV volumes have started decelerating in line with the weakening underlying demand indicators.

While the April-June quarter is considered to be traditionally a weak period, the actual impact of weakening economic activity is likely to be felt from July-August onwards, when demand from seasonal freight picks up

Within the M&HCV goods segment, the higher tonnage (25T+) have been growing at faster pace in line with the structural trend indicating a shift towards multi-axle vehicles that offer better operating economics

Tata Motors continues to dominate the segment

Exhibit 2: Trend in market share in Domestic M&HCV – Goods segment

M&HCV Goods	Q1 FY11	Q2 FY11	Q3 FY11	Q4 FY11	FY 11	YTD FY12
Tata Motors	61.5%	61.1%	67.3%	60.2%	62.3%	65.2%
Ashok Leyland	25.2%	24.9%	15.6%	24.6%	22.8%	18.0%
Eicher Motors	9.2%	9.6%	11.4%	10.1%	10.1%	10.7%
Others	4.1%	4.4%	5.8%	5.1%	4.9%	6.1%

Source: SIAM, ICRA Estimates

Exhibit 3: Trend in market share in Domestic M&HCV – Passenger segment

M&HCV Passenger	Q1 FY11	Q2 FY11	Q3 FY11	Q4 FY11	FY 11	YTD FY12
Tata Motors	47.3%	44.9%	40.9%	40.9%	43.5%	44.4%
Ashok Leyland	36.1%	41.5%	49.9%	45.1%	43.0%	38.9%
Eicher Motors	7.7%	5.6%	2.5%	4.5%	5.1%	9.5%
Others	8.8%	8.0%	6.7%	9.4%	8.4%	7.2%

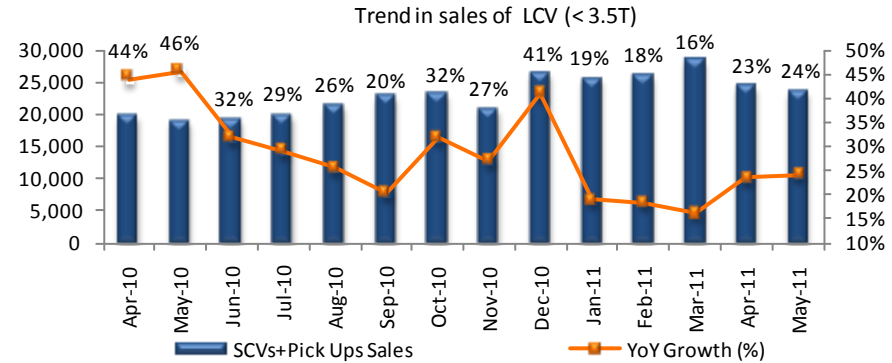
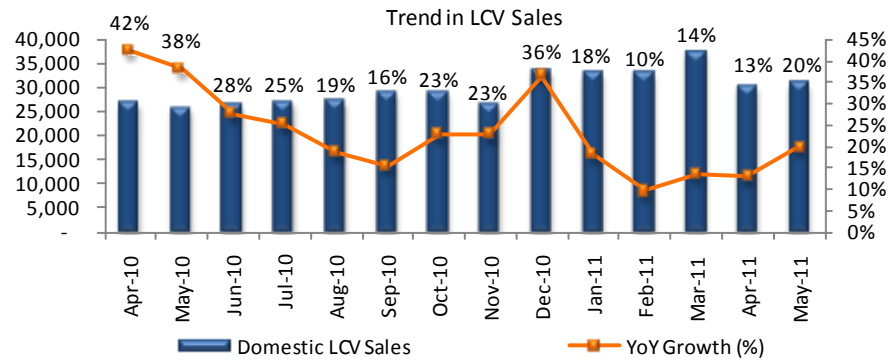
Source: SIAM, ICRA Estimates

With Mahindra Navistar expected to ramp up production in the current year and Eicher Motors expected to increase its focus on the higher tonnage trucks, competitive intensity is likely to increase going forward

Players have added capacities over the last two years i.e. Ashok Leyland (50k), Mahindra Navistar (50k) and Daimler (100k); new players are now in a position to expand product offerings and sales network

Commercial Vehicle Industry: LCVs

Insulated so far; growth momentum in the SCV segment continues to drive growth



Source: SIAM Data, ICRA Estimates

Exhibit 4: Trend in market share in Domestic LCV – Goods segment

LCV Goods	Q1 FY11	Q2 FY11	Q3 FY11	Q4 FY11	FY 11	YTD FY12
Tata Motors	55.8%	57.3%	58.9%	58.8%	57.9%	62.6%
M&M	36.1%	34.6%	34.0%	33.8%	34.4%	30.6%
Others	8.1%	8.1%	7.1%	7.4%	7.7%	6.9%

Source: SIAM, ICRA Estimates

Exhibit 5: Trend in market share in Domestic LCV – Passenger segment

LCV Passenger	Q1 FY11	Q2 FY11	Q3 FY11	Q4 FY11	FY 11	YTD FY12
Tata Motors	53.1%	42.3%	46.3%	49.9%	48.4%	42.7%
Force Motors	16.3%	25.2%	27.0%	23.1%	22.2%	30.7%
M&M	15.0%	14.8%	11.0%	9.5%	12.8%	11.0%
Others	15.7%	17.7%	15.7%	17.5%	16.6%	15.6%

Source: SIAM, ICRA Estimates

The LCV segment continues to grow steadily despite headwinds building up. The sub 1T goods segment, which accounts for over 3/4th of LCV segment, is supporting the growth driven by demand for transportation of consumer goods within cities, migration from upper-end three wheelers and healthy viability offered by this segment for FTUs to gain employment.

In the initial phase, the growth in this segment was primarily driven by tier I cities, but now tier II & III cities are catching up; passenger variants (in sub IT segment) are also gradually replacing the clumsy upper-end three wheelers, which traditionally cater to traffic in outskirts of cities

Despite new product offerings, Tata Motors continues to maintain market leadership; Force Motors, traditionally a strong player in passenger segment has been gaining market share

Key Extracts from Channel Check

We interacted with a host of CV dealers, financiers and a few fleet operators to get a view on the ground reality and build our near-term outlook on CV sector. The consensus view suggests the demand for new CVs is slowing down with higher vehicles prices and interest rates being the main deterrent at present.

Interaction with Fleet Operators

- In line with the weakening industrial production, load availability has started coming down since April 2011; while demand slowdown is being witnessed across industries, slowdown is more pronounced in container applications, in bound traffic into automobile OEMs, steel, and construction material such as cement
- Freight rates have remained largely stagnant on major routes and in fact have declined on certain routes as well
- With the recent hike in diesel prices, the profitability for fleet operators is likely to get further impacted; overall with rising cost pressures, the fuel price hike may get gradually passed on to end consumers resulting in a ~4-5% hike in freight rates
- With increase in vehicle costs and hike in interest rates, EMI on truck loans have gone up by 15-17%; besides fuel costs, sharp increase in tyre cost (a major cost component), driver salaries, and increase in toll charges are also putting pressure on profitability

Interaction with Financiers

- There are some early signs of slowdown in new CV sales; as compared to the previous year, there is no rush among operators to purchase vehicles
- Sharp increase in overall cost of ownership for fleet operators coupled with almost stagnant freight rates have put pressure on operator's cash flows
- Liquidity tightening measures implemented by RBI and inflationary pressures have pushed up CV financing rates by 50-100 bps over the three months; While interest rates depend on customers' credit track record and fleet size, interest rates for new M&HCVs have moved up to 12.5-13%
- However, some financiers in attempt to chase growth in disbursements/market share are still offering competitive rates to large operators
- The proposed change in priority sector lending norms (from banks to NBFCs) could inch up lending rates for SCVs and LCVs, a segment which has so far been insulated and growing steadily at ~20%+
- Despite expectation of slowing freight availability, financiers have not tightened lending norms; LTVs for new M&HCVs continue to be above 90-95% for large fleet operators with a credible track record and at 75-80% for the industry as a whole
- Potential slowdown in freight availability and freight rates remains a key concern at present and could impact delinquencies

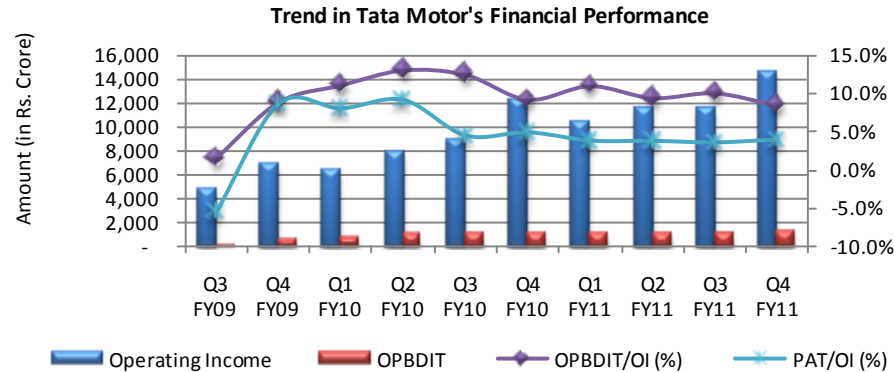
CV Dealers views

- There is a slowdown in new enquiries in the market, fleet operators both SFOs as well as large operators have been deferring new vehicle purchases
- Successive increase in vehicle cost, higher interest rates and expectation of slowing economic growth are the main factors weighing on customers' mind
- While slowdown is being felt across segment/applications, multi-axle vehicles (MAVs) appear to be more vulnerable; lower demand from construction segment and mining ban in some regions has also impacted demand for tippers
- Fleet operators are now pursuing lower cost variants in the same tonnage category to combat the impact of higher vehicle prices
- Demand for SCVs continues to remain steady as intra-city transportation requirement for consumer goods remain unaffected

Financial Performance of CV OEMs

Tata Motors Limited (Standalone)

Higher input material prices putting pressure on profitability indicators despite strong volume growth

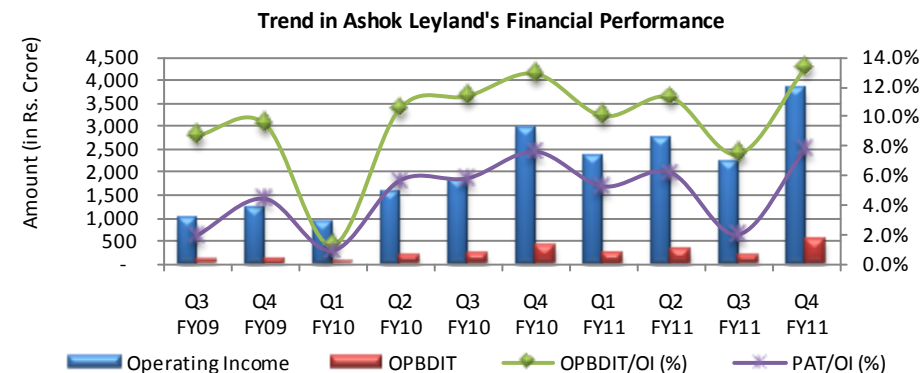


Despite the operating leverage on account of higher volumes (CV volumes up 16% YoY in Q4FY11), Tata Motors standalone OPBDIT margins deteriorated in Q4FY11 largely on account of higher raw material cost increases.

While the company took a cumulative increase of 5.3% in CV prices during FY11, the impact of higher material prices was not completely offset by the price increases; as a result, the margins dipped to 8.5% in Q4 FY11 compared to 9.3% (in Q4FY10) and 10.1% (in Q3FY10). Overall, Tata Motors continues to maintain its market dominance in almost all segments. Its strong brand image, wide product offerings, extensive distribution and service network continues to support its position

Ashok Leyland Limited (Standalone)

Strong volume growth + higher realisations + improving product mix + higher sales from Pantnagar (fiscal benefits) contribute to better performance

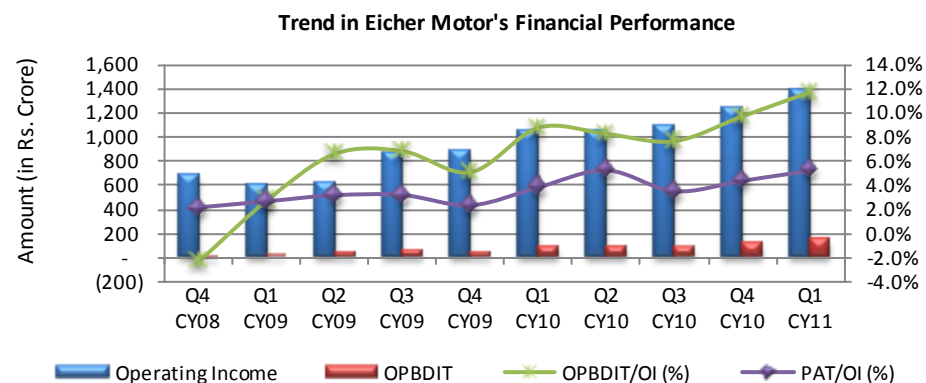


ALL reported a strong performance in Q4FY11 driven by healthy growth in volume, higher realisations on back of price hike (1.5-2.0% in January 2011), and higher sales coming in from Pantnagar plant, which attracts incentives of upto Rs. 35,000 per vehicle.

Aided by strong volume growth and improving operating leverage, ALL's OPBDIT margins improved to 13.3% in Q4FY11, witnessing an improvement of 590 bps over the previous quarter (Q3FY11). However, during the April-May'11 period, Ashok Leyland's volumes declined by 17% in the domestic market; according to management, shortage of drivers to push out stocks from plants and elections in Tamil Nadu were the main reasons impacting volume growth. ALL is expected to launch its product offerings in the LCV segment through its JV with Nissan

Eicher Motors Limited (Consolidated)

Operating leverage + improving operating efficiency measures continue to drive margins upwards



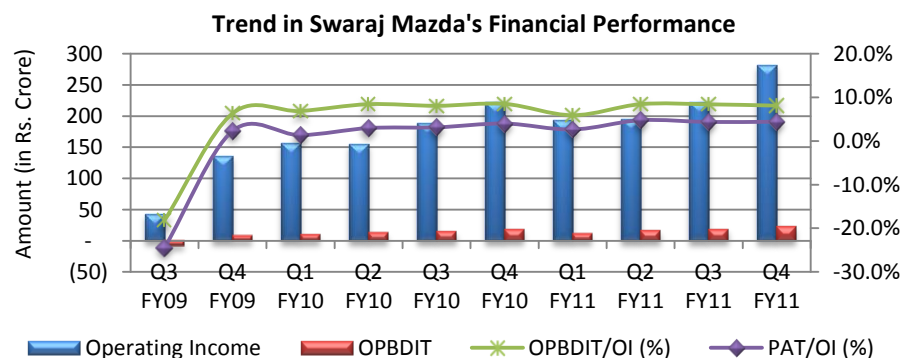
Contrary to the industry-wide trend, Eicher Motors continues to witness a sequential improvement in its operating margins on back of higher volumes, resulting in operating leverage, favourable impact of successive price increases and operating efficiency improvement measures.

In Q1CY11, the company reported a growth of 34% on YoY basis in operating income aided by 18% volume growth in commercial vehicles sales, and 36% in motorcycles. Operating margins at 11.7% were the highest in the past ten quarters

With increasing focus on heavy duty commercial vehicles and healthy traction in the light & medium commercial vehicles, Eicher Motors gained 110bps market share in the April-May'11 period and its overall market share stood at 10.5% for the period compared to 9.4% in FY11

SML Isuzu (Standalone)

Health volume growth supports margin expansion



Helped by strong volume growth during Q4FY11, SML Isuzu continued to report steady operating performance benefitting from higher operating leverage, however impact of higher raw material prices started impacting operating margins as reflected in a marginal drop both YoY and QoQ basis

During the quarter, the company's operating margins stood at 8.1%, compared to 8.5% (in Q4 FY10) and 8.4% (in Q3 FY11)

Volume growth during the current fiscal (April-May) has however been almost flat on YoY basis for SML Isuzu.

Annexure

ICRA's Ratings in Commercial Vehicle Sectors

Company Name	Long-Term Rating	Outlook	Short-Term Rating	Last Rating Action
Tata Motors Limited	LAA-	Stable	A1+	January 2011
Ashok Leyland	LAA-	Positive	A1+	February 2011
Mahindra & Mahindra	LAA+	Stable	A1+	January 2011
Eicher Motors	LAA-	Stable	A1+	December 2010
VE Commercial Vehicles	LAA-	Stable	A1+	December 2010
SML Isuzu Ltd.	LA+	Stable	A1+	April 2011
Mahindra Navistar	LA+	Stable		August 2010

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