ICRA RESEARCH SERVICES

Indian Commercial Vehicle Industry

"Demand trends turning favorable"

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What's Inside

Executive Summary

All segments of CV industry are witnessing an improving trend with M&HCVs Trucks leading from the front

Emerging from a two year down cycle

After two years of down cycle, some segments of the domestic Commercial Vehicle (CV) industry have shown signs of recovery in FY 2015. In the first ten months of the fiscal, the pace at which domestic CV sales have been declining has reduced to 4.6% compared to a contraction of 20.2% witnessed during FY 2014. Within the CV space, the Medium & Heavy Commercial Vehicle (M&HCV) Truck segment has in fact posted a positive growth of 19.0% in 10m FY 2015 while the HCV (16T+) segment, which accounts for almost half of total M&HCV (Truck) sales has been witnessing strong demand (up 42.6% in 10m FY 2015) on back of replacement demand (following two years of deferment) and capacity addition by organized fleet operators to some extent. While the M&HCV Truck segment seems to have bottomed out, the LCV Truck segment is still experiencing sluggish trends (down13.8% YoY) as significant capacity addition over the past few years and constrained financing environment amidst rising delinquencies remains a challenge for the segment. The bus segment, which contributes nearly 13% to industry sales, has also started witnessing an improvement from Q3 FY15 onwards after various State Road Transport Undertakings (SRTUs) started placing orders for new buses as part of the JNNURM II programme.

Gradual improvement in fleet utilization levels and freight rates along with cut in diesel prices is likely to ease pressure on cash flows of transporters

Operating environment for fleet operators is gradually improving

From fleet operator's perspective, the operating environment over the past 6-9 months has also stabilized owing to sharp drop in diesel rates and relatively firm freight rates, implying improvement in their cash flows. Our channel check with a wide spectrum of fleet operators based in the Northern & Western markets suggest that fleet utilization levels are gradually improving on back of higher load availability from some of the key freight generating sectors such as Automobiles, Cement and other general industries. These factors may also aid in improving the financing environment which has turned challenging (at least for Small Fleet Operators (SFOs) and First Time Buyers (FTBs) on back of sharp rising delinquency levels. Although asset quality indicators continued to deteriorate till Q3 FY 2015, most of the financiers expect that they are unlikely to deteriorate further. While the overall environment seems to be improving, there are still pockets of challenges. For instance, the demand for tippers is likely to remain subdued in view of delays in pick-up in mining activities in the affected states and sizeable idle capacity. Secondly, the subdued trend in re-sale values of second-hand vehicles (apart from ageing of existing fleet) suggest that demand recovery is still in the initial stages.

We expect M&HCV (Trucks) to grow by 12-14% in FY 16

M&HCV segment is likely to post a growth 12-14% in FY 2016

In ICRA's view, the M&HCV (Truck) segment is likely to register a growth of 12-14% in FY 2016 driven by continuing trend towards replacement of ageing fleet and expectations of pick-up in demand from infrastructure and industrial sectors in view of reforms being initiated by the Government. Over the medium term, the demand for new CVs will also be driven by gradual acceptance of advance trucking platforms, progression to BS-V emission norms (possibly by 2017 onwards) and introduction of technologies such as Anti-Lock Braking System (ABS), which may lead to some advance purchases by fleet operators.

LCV segment would however continue to witnessed subdued demand on back of over capacity issues and challenging financing environment

While LCV segment is expected to grow marginally

Unlike M&HCVs, we expect the LCV segment will grow at modest pace (i.e. 4-6%) in FY 2016 as segment's prospects continue to be influenced by overcapacity issues and constrained financing environment amidst rising delinquencies. Nevertheless, driven by certain structurally favorable factor, the segment's growth prospects over the medium-term remain intact. Some of the factors that are likely to support steady demand for LCVs going forward include a) further proliferation of "Hub-n-Spoke" logistics model with the implementation of GST, b) relatively untapped potential in semi-urban and rural areas and c) improving urbanization levels. Moreover, the emergence of SCVs has also been a source of attractive employment opportunities for FTBs, which along with an established financing market will also support demand for LCVs. Accordingly; we expect demand for LCVs will grow at CAGR (%) 11-13% over the longer-term.

Competitive intensity likely to increase across segments with new model launches and expanding coverage by new OEMs

Competitive Landscape: Interesting times ahead as new OEMs enter LCV segment and others launch refreshed models in HCVs

The competitive intensity in the domestic CV industry has increased over the past five years as new OEMs have entered the market while existing players have ventured into new segments and expanded their sales-cum-service network. For instance, some of the recent entrants in the M&HCV space like VECV (JV between Volvo & Eicher), Bharat Benz (Indian unit of Daimler) and M&M together now account for ~17% of M&HCV segment in India. Accordingly, market share of Tata Motors has declined by 4.5% over the past four years; while that of Ashok Leyland has remained relatively stable (i.e. 25-26%). While competition in the M&HCV space has come largely from foreign OEMs, in the LCV space, M&M and Force Motors have been the key players who have gained share on back of increasingly acceptability of Pick-Up Trucks and *'Traveler'* range of buses, respectively. We believe that while competition from OEMs like VECV and Bharat Benz is likely to be formidable, the strong brand equity of incumbents with fleet operators, well-established product portfolio and wide spread servicing network would continue to pose a challenge for new players in gaining meaningful market share especially in the HCV segment.

However, in the LCV segment competitive intensity is likely to increase as 2-3 new players are expected to enter the segment over the near-to-medium term. While some of them are established OEMs with deep understanding of the Indian market, others have large scale globally in the LCV space and experience of operating in markets similar to India. In addition, we believe that entry barriers in the LCV space are relatively less stringent (in contrast to M&HCVs) as having a wide spread service network is not so much of a compelling requirement as their span of commute is limited to localized area. Secondly, sizeable proportion of LCV buyers generally tend to be First-Time Buyers (FTBs), which are easier to tap into vis-à-vis large fleet operators who tend to have higher brand loyalty towards incumbent players.

The Indian CV industry is also witnessing sizeable investments by OEMs towards upgrading their product portfolio, introducing new models and expanding manufacturing capacities. These investments are likely to allow some of the new players in strengthening their positioning in the market.

^ Bharat Benz has garnered market share of ~6% in 9-49t segment of the domestic M&HCV Truck market (as on 9m FY 2015)

CV OEMs EBITDA margins improved in 9m FY 2015 on back of pick-up in sales, better product mix and favorable impact of cost rationalization measures

Improvement in profitability indicators of CV OEMs is likely to be gradual

In line with pick-up in sales of HCVs, improving realizations and favorable impact of cost-reduction measures, the profitability indicators of CV OEMs have also started improving since the beginning of current financial year. As per ICRA's estimates, the EBITDA margins of CV OEMs have improved by almost 180 bps to 3.6% (in 9m FY 2015) compared to 1.8% (in FY 2014). We believe, with recovery in the M&HCV segment, the margins of CV players are likely to expand further in FY 2016 compared to previous couple of years. The extent of improvement in margins would also been driven by increasing focus of OEMs to scale-up their exports volumes, which have grown by 14.7% in 10m FY 2015 (vis-à-vis -3.7% in FY 2014). In addition, an increasing trend towards factory built vehicles (FBVs) following the implementation of uniform bus body norms will also support margin expansion. However, we believe that the extent of improvement would remain sensitive by a) continuation of high discounts being offered by OEMs, b) likely increase in expenses related to new model launches and c) inflationary pressures on account of rising manpower costs. Accordingly, a meaningful recovery in M&HCVs sales will be critical for industry's earning trajectory to improve going forward.

Capital expenditure by CV OEMs will be largely focused on new product development rather capacity expansion

Credit profile of CV OEMs is likely to improve

With recovery in CV sales and improving earnings, we expect credit profile of CV OEMs to also improve in the near to medium term on back of higher internal cash flow generation and relatively limited capital expenditure requirements. Although OEMs would continue to invest in developing new advanced trucking platforms, engines and other technologies, investments in new capacity expansion are expected to be negligible given the low (50-55%) capacity utilization levels at present. The credit profile of OEMs in the CV space differs sharply with some of the OEMs having sizeable debt, while others maintaining healthy cash balances. For instance, while Tata Motors has sizeable debt (at a standalone entity level), its credit profile continues to derive benefit from its holdings in Jaguar Land Rover (JLR), its strong refinancing capabilities and position within the Tata group. On the other hand, Ashok Leyland too has initiated steps to reduce its debt burden by raising cash from equity dilution, divestment of non-core investments and scaling back capital expenditure plans. The other two OEMs – VECV and SML Isuzu continue to maintain strong credit profile on back of staggered investments and healthy cash reserves.

Exhibit 1: Trend in Domestic Commercial Vehicle Volumes & Growth Rates by segments

	Domestic Commercial Vehicle Sales (in Nos)						YoY Growth (%)					
Segments	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**10m FY15**	**FY 2010**	**FY 2011**	**FY 2012**	**FY 2013**	**FY 2014**	**10m FY15**
LCV Bus Sales	34,413	44,816	48,868	47,827	42,799	35,182	27.7%	30.2%	9.0%	-2.1%	-10.5%	0.8%
LCV Truck Sales	253,364	317,030	411,415	476,695	389,312	280,130	45.8%	25.1%	29.8%	15.9%	-18.3%	-13.8%
Total LCV Sales	**287,777**	**361,846**	**460,283**	**524,522**	**432,111**	**315,312**	**43.4%**	**25.7%**	**27.2%**	**14.0%**	**-17.6%**	**-12.4%**
M&HCV Bus Sales	43,083	47,938	49,882	46,913	38,709	27,687	23.5%	11.3%	4.1%	-6.0%	-17.5%	-12.2%
M&HCV Truck Sales	201,861	275,121	299,334	221,776	161,918	153,696	35.8%	36.3%	8.8%	-25.9%	-27.0%	19.0%
Total M&HCV Sales	**244,944**	**323,059**	**349,216**	**268,689**	**200,627**	**181,383**	**33.5%**	31.9%	8.1%	-23.1%	-25.3%	**12.9%**
Total CV Sales	**532,721**	**684,905**	**809,499**	**793,211**	**632,738**	**496,695**	**38.7%**	**28.6%**	**18.2%**	**-2.0%**	**-20.2%**	**-4.6%**

Source: SIAM, ICRA's Estimates

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