

Commercial Vehicle Financing Companies

**Fuel prices and freight availability
key risks for CV fleet operators in the
near term**

MARCH 2022





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AUM Growth expected to pickup in FY2023

Increasing fuel prices pose downside risks to recovery prospects.

Ability to pass through the price increases and improve fleet utilization at the operator level would be key determinants of asset quality performance of CV financiers



- Commercial vehicle (CV) financiers are estimated to have grown their assets under management (AUM) by 2-4% in FY2022 vis-à-vis the estimates of 5-7% for the entire non-banking financial company (NBFC)-Retail (NBFC-Retail) industry. The disbursement and AUM trend revived in Q2 and Q3 of FY2022 and the same is likely to have continued in Q4 FY2022 as the impact of the third wave of the Covid-19 pandemic was limited; the setback witnessed in Q1, on account of Covid-related disruptions, weighed on the overall growth in the current fiscal. Within the CV segment, disbursements were more stable for used vehicles, given the lower cost of ownership, than for new vehicles. ICRA expects the growth to improve to 7-9% for CV financiers and 8-10% for the NBFC-Retail industry in FY2023.



- Since the start of the pandemic and associated lockdowns in March 2020, CV fleet operators faced multi-dimensional headwinds from factors such as depressed freight availability, increasing cost of truck ownership, and sharp increase in fuel prices. This led to a deteriorated operating environment for these operators with diminished ability to generate surplus cash flows.



- However, intermittent spurts of buoyant economic/industrial activity following the first and second waves of the pandemic in H2 FY2021 and H2 FY2022, respectively, provided a much-needed respite to the fleet operators, enabling them to recoup some of the losses faced during the earlier quarters. Individual truck owners and small fleet operators, who were more reliant on the spot freight market, were more exposed to market volatility since March 2020 and would have faced difficulties in servicing their EMIs.



- Given the capacity utilisation levels and freight rates seen in FY2022, used vehicles could have generated higher post-EMI cash flow surpluses compared to new vehicles. However, operators who have not been able to maintain utilisation in line with the industry are likely to have faced significant cash flow problems.



- The asset quality has deteriorated for most of the CV financiers with headline delinquencies and restructuring increasing sharply. Downside risks emanating from macroeconomic and geopolitical uncertainties remain key factors to watch out for in the near term.



- Oil marketing companies also started hiking petrol/diesel prices from March 2022. Over the next quarter (Q1 FY2023), diesel prices could be expected to increase by 15-25% from the levels witnessed in the beginning of Mar-2022, given the current indications of crude oil prices remaining at elevated levels. If freight availability remains at the current levels, operators would need to pass through 45-65% of the incremental fuel costs to be able to meet their EMI servicing obligations.

Business Growth | Growth trends for Retail-NBFCs remain modest in FY2022

- Credit growth started slowing in FY2020 and moderated sharply in FY2021 and FY2022 vis-à-vis the long-term growth rate
- Vehicle finance share has moderated steadily and stood at ~45% in December 2021 compared to ~55% in March 2016

Exhibit: Retail-NBFC Credit Growth

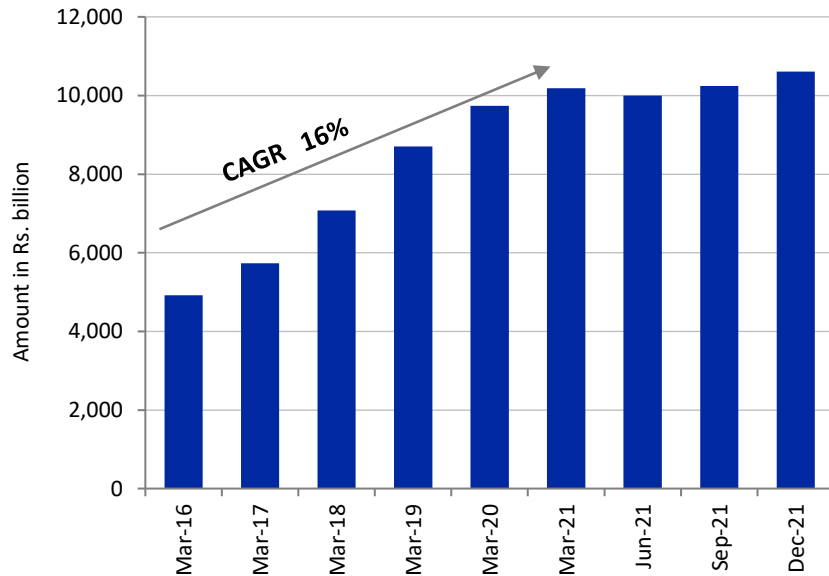
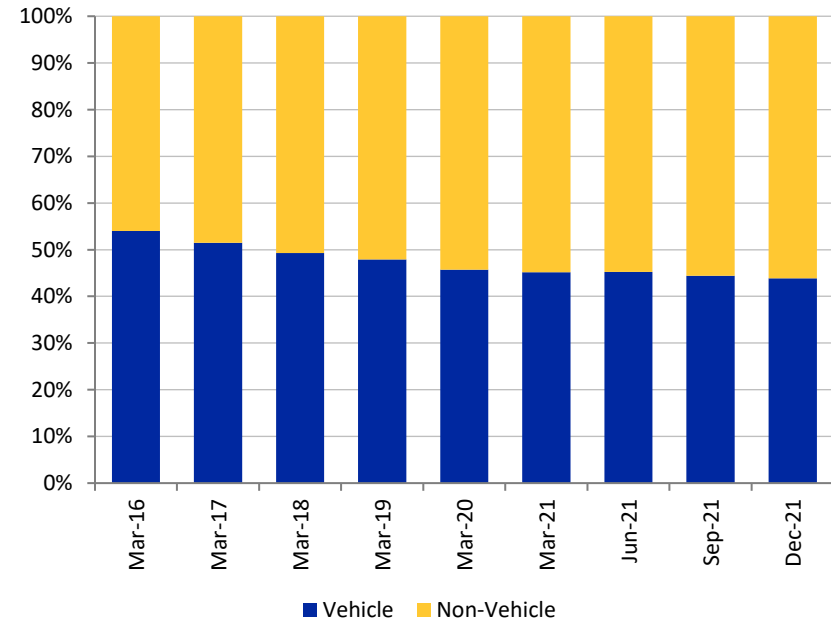


Exhibit: Share of Vehicle and Non-vehicle Book in Retail-NBFC AUM



Source: ICRA Research; Amount in Rs. billion; CAGR – Compound annual growth rate; Vehicle finance includes Passenger vehicle (PV), Two-wheeler (TW), Three-wheeler (3W), Construction equipment (CE) and Tractors

Business Growth | Vehicle financiers continue to lag overall industry growth trends

- Vehicle finance grew at slower pace of 12% (CAGR over FY2016 to FY2021) vis-à-vis NBFC-Retail credit growth of 16%
- CV book grew in line with overall vehicle finance; slower growth of PV book (~6%) led to increase in share of other constituents

Exhibit: Vehicle Credit Growth-Retail NBFC

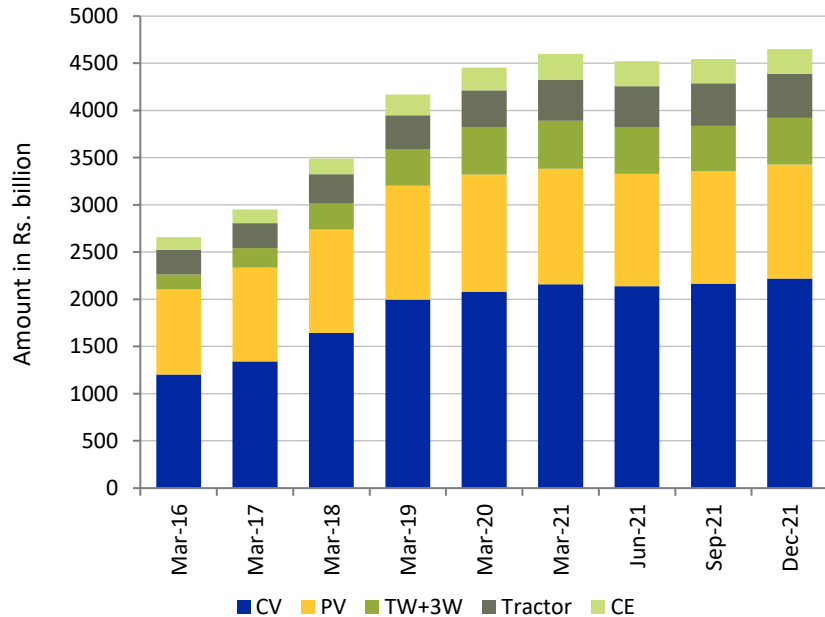
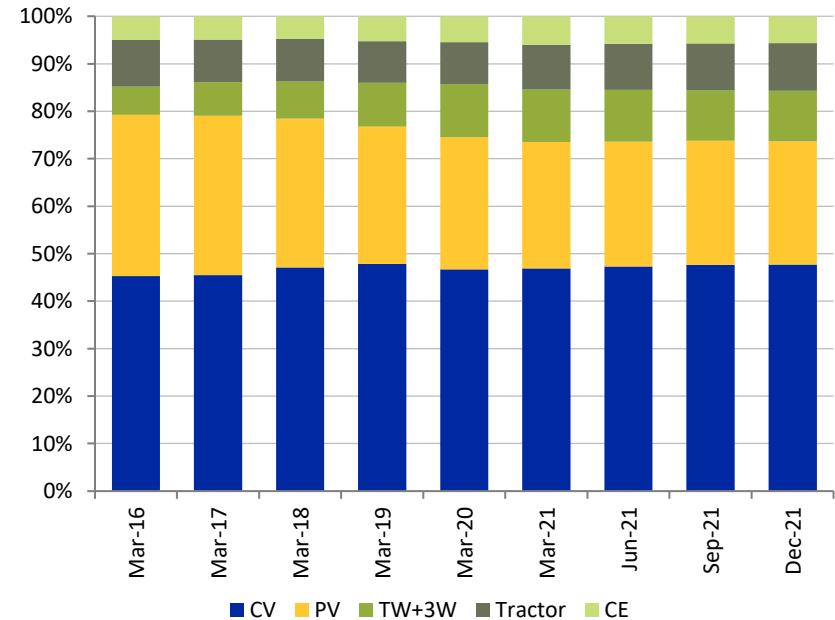


Exhibit: Share of Various Asset Classes in Vehicle Finance AUM



Source: ICRA Research; Amount in Rs. billion

Business Growth | CV financiers continue to face headwinds

- Sharp correction in new CV book growth rate from FY2020 on the back of fall in sales and increased competition from banks
- Share of used CV book increased, growing at a CAGR of 15% vis-à-vis the new CV book growth of 10% from March 2016 to March 2021

Exhibit: AUM and Growth Trends in CV Book

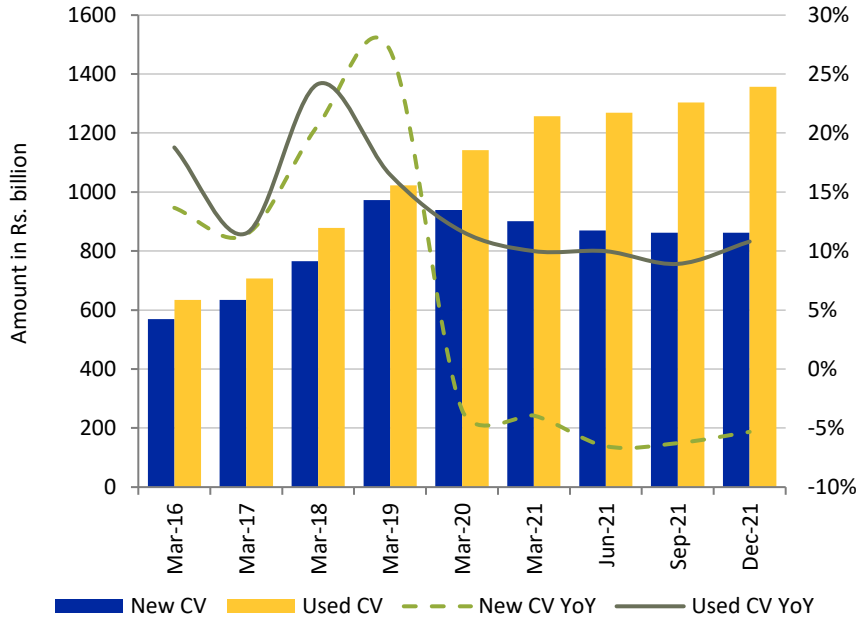
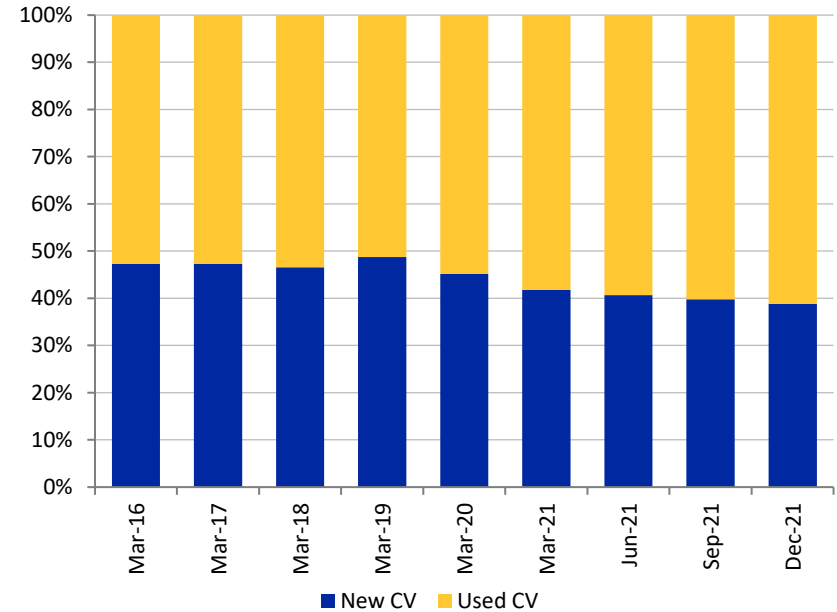


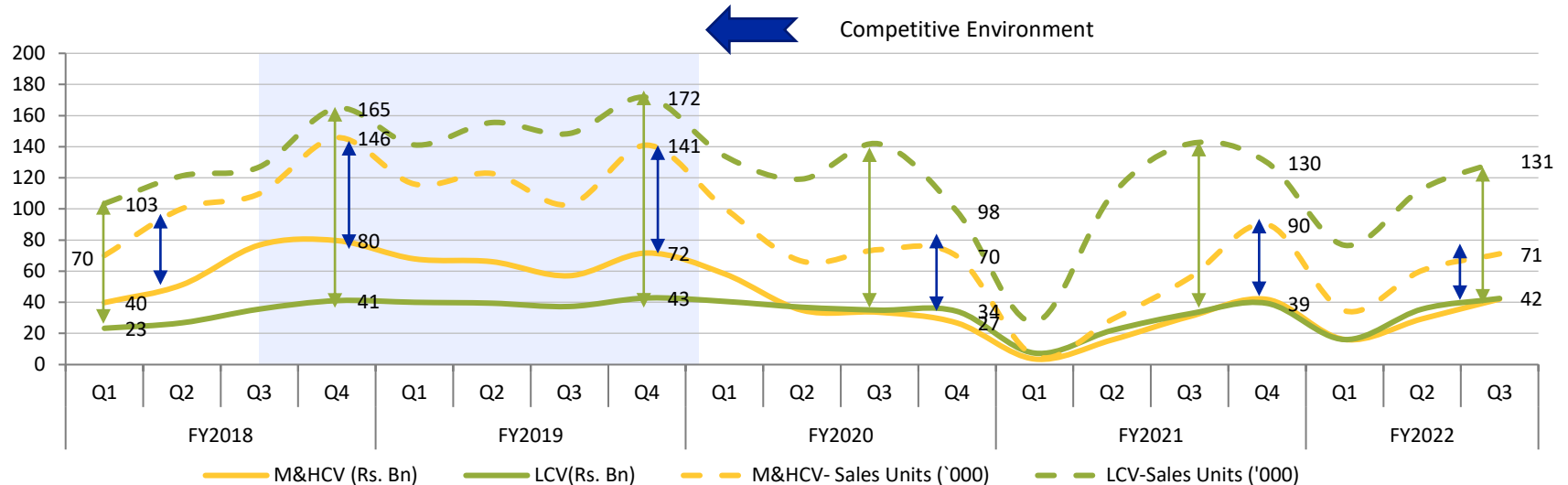
Exhibit: Share of Used and New CV



Source: ICRA Research; Amount in Rs. billion

Business Growth | CV sector yet to scale back to highs of FY2019

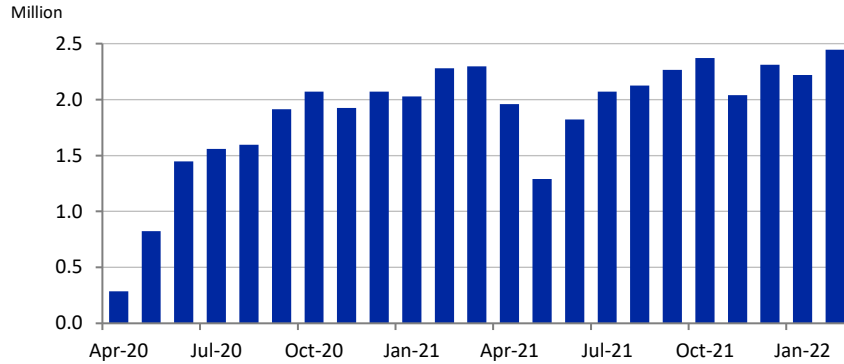
Exhibit: Trend in NBFC Disbursement and CV Sales



- After multiple quarters of sharp volume contraction, recovery finally began setting in H2 FY2021, before the second wave derailed the momentum again in Q1 FY2022. However, healthy recovery has been seen subsequently. The recovery in the light CV (LCV) segment started before the medium & heavy CV (M&HCV) segment, supported by robust demand from agricultural and allied sectors as well as the e-commerce sector.
- However, the increasing cost of new vehicles could be a drag on the recovery process. As per ICRA's channel checks, most of the CV dealers surveyed opined that the costs have increased up to 20% over the last 18 months to pass on the impact of BS-VI transition as well as commodity price inflation.

Source: SIAM and ICRA Research; Disbursement data based on six leading CV financiers; Estimates applied where data not available

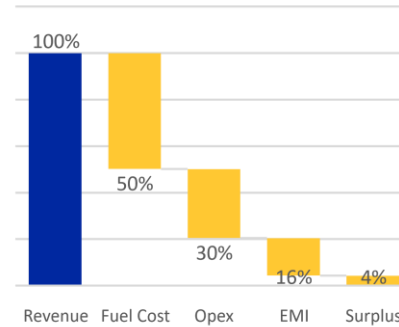
Exhibit: Smart Recovery in Freight Movement as seen in GST E-way Bill Volumes



Data for Feb 2022 is available up to Feb 27, 2022 only; Source: GSTN, CEIC, ICRA Research

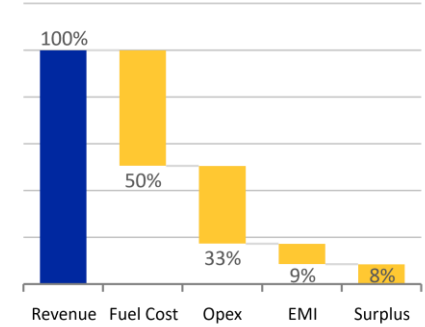
- Freight availability has been a key concern for fleet operators since the start of the pandemic. After witnessing a significant dip in Q1 FY2021 amid the nationwide lockdown, road freight volumes recovered gradually and reverted to pre-Covid levels by the end of Q2 FY2021. However, the industry was adversely affected again during the second wave with a contraction in volumes during April-May 2021.
- Freight movement has recovered smartly since Q2 FY2022, not significantly affected by the third wave during January-February 2022.

Exhibit: New M&HCV Cash Flow Analysis



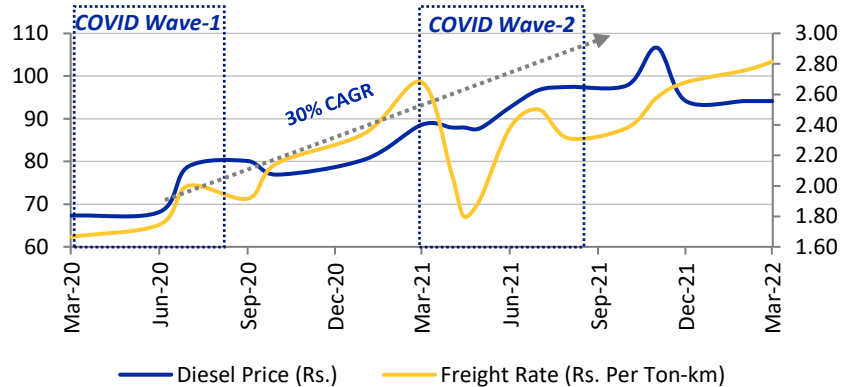
Source: ICRA Research

Exhibit: Used M&HCV Cash Flow Analysis



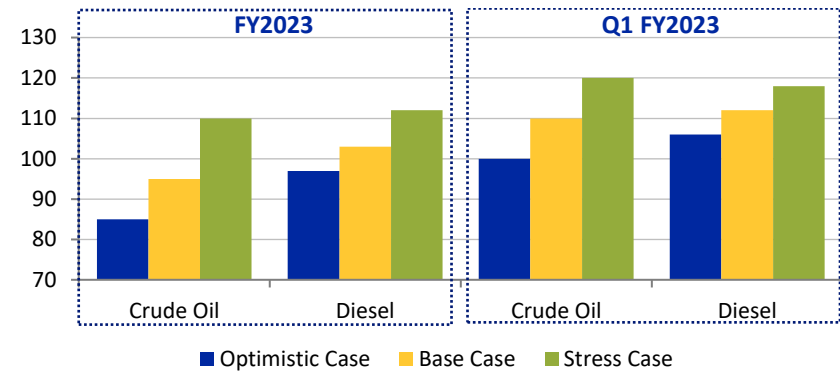
- With lower cost of ownership, used vehicles were seen to be more resilient to the shocks in demand and freight rates during the last two years.
- As per ICRA Research, given the capacity utilisation levels and freight rates seen in FY2022, used vehicles could have generated almost double the post-EMI cash flow surplus compared to new vehicles.
- However, operators who have not been able to maintain utilisation in line with the industry are likely to have faced larger cash flow problems.

Exhibit: Trend in Diesel Prices and Road Freight Rates



Source: ICRA Research, PPAC, IFTRT

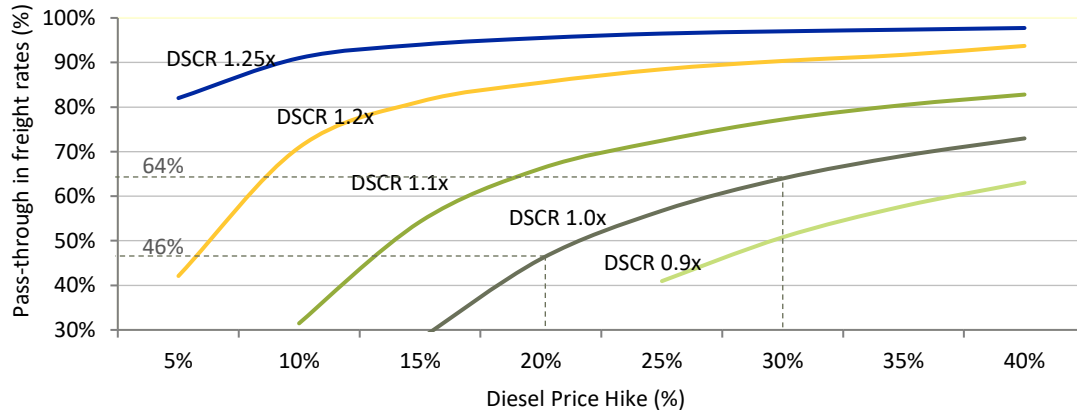
Exhibit: Crude Oil and Diesel Price Outlook



Source: ICRA Research

- Crude oil prices have been on an upward trend over the last two years since the sharp decline witnessed during the beginning of the pandemic. After a brief respite during November-December 2021, oil prices have moved up sharply again due to the ongoing armed conflict between Russia and Ukraine. Accordingly, oil marketing companies have also started hiking petrol/diesel price from March 2022. Over the next quarter (Q1 FY2023), diesel prices could be expected to increase by 15-25%, given the current indications of crude oil prices remaining at elevated levels.
- Spot freight rates, while exhibiting strong correlation with fuel prices over a longer term, are adversely affected during periods of weak economic activity. Typically, this affects individual truck owners and small fleet operators disproportionately as they may not have long-term contracts and are largely dependent on the spot market. Cash flows of such operators were under stress during the first and second waves of the pandemic due to the combination of restricted freight availability and competitive freight rates. Recovery of economic activity in H2 FY2021 following the first wave and H2 FY2022 following the second wave provided intermittent support to the freight rates.

Exhibit: DSCR sensitivity to Diesel prices and Freight rate pass-through



Source: ICRA Research

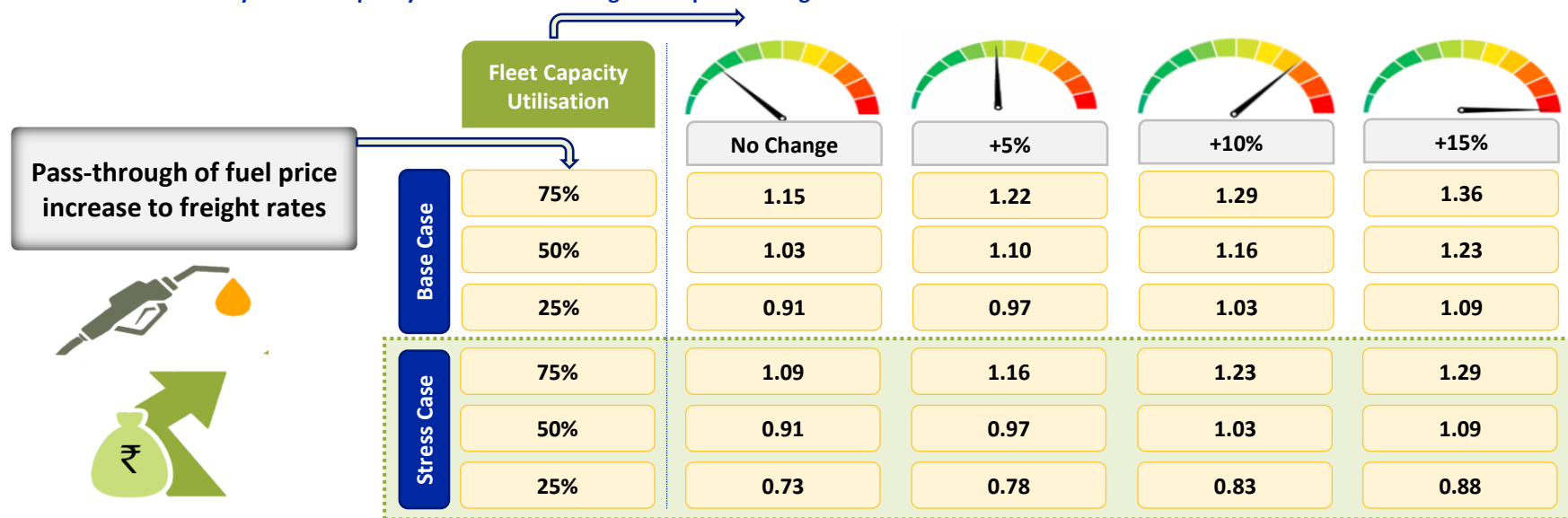
How to read the chart:

If diesel price increase by 30% from the March 1, 2022 level, 64% of the incremental fuel cost needs to be passed through to the customer to maintain a debt service coverage ratio (DSCR) of 1.0x

Fleet utilisation levels are assumed to remain at current levels

- For fleet operators to continue maintaining viable operations, it would be crucial for them to be able to pass through the upcoming fuel price hikes to their customers. The extent of pass-through required would vary, depending on the extent of the fuel price increase as well the changes in capacity utilisation.
- As freight rates have increased at a CAGR of 30% over the last two years, the ability of fleet operators to implement sharp increases in a one-quarter timeframe could be constrained.
- As per ICRA's estimates, assuming freight availability and fleet utilisation remain at the current levels, the operators would require to pass through 45-65% of the incremental fuel costs to be able to meet their EMI servicing obligations.
- On the other hand, a pass-through of almost 85-90% would be required for the entities to maintain the current level of cash flow.

Exhibit: DSCR sensitivity to fleet capacity utilisation and Freight rate pass-through



- If industrial activity continues to pick up without any further disruptions over the next few quarters, fleet operators would be able to absorb a larger portion of the incremental fuel cost increase without affecting the viability of operations. For e.g., in ICRA's base case with diesel prices of Rs. 105-110 per litre in Q1 FY2023, operators could maintain their current cash flow if the fleet utilisation levels increase by 10% from the current levels.
- On the downside, the global geopolitical and macroeconomic scenario continues to pose a significant risk to trade and industrial activity, and consequently freight availability in the near term. In such an adverse scenario, the debt servicing ability of small freight operators could be affected significantly.

Source: ICRA Research; Base Case and Stress Case refer to the Diesel Prices as mentioned in the 'Crude Oil and Diesel Price Outlook' on Page 9 of this note

Asset Quality | Sharp increase in delinquencies in FY2022

New CV overdues increased sharply from historical levels, as loan servicing was impacted by the fall in demand and freight rates in H1 FY2022

Exhibit: M&HCV/LCV 90+dpd Trend

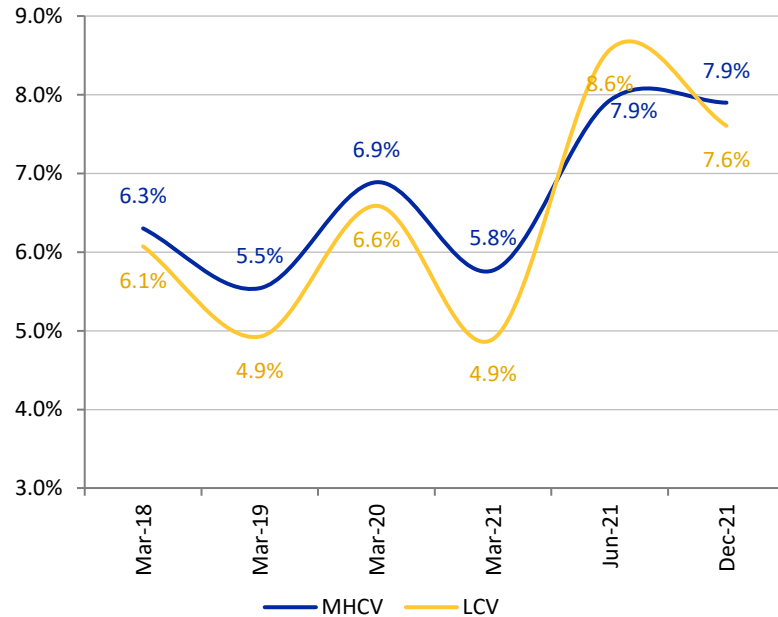
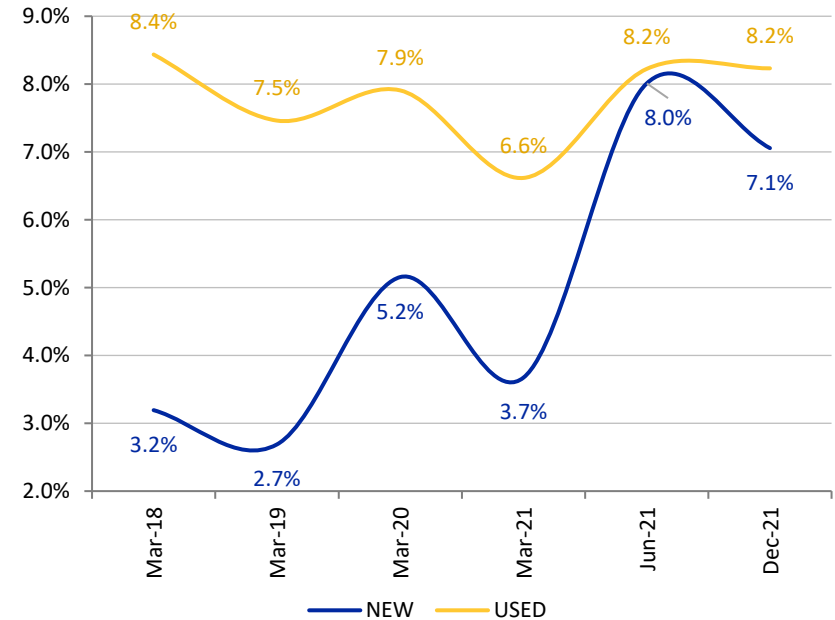
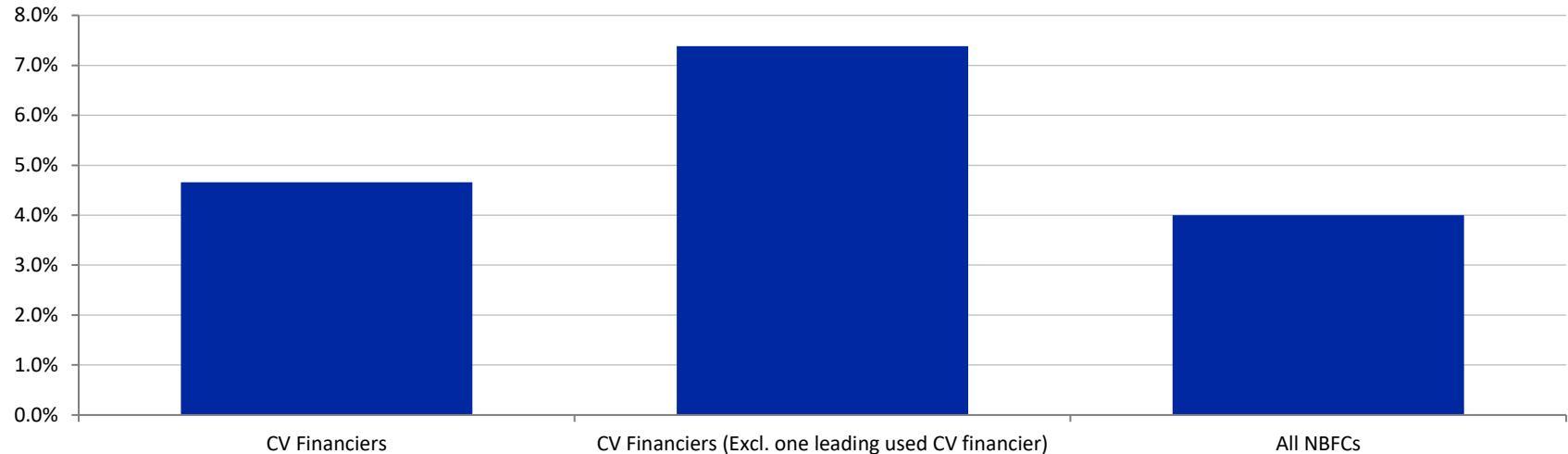


Exhibit: Used and New CV 90+dpd Trend



Source: ICRA Research, data of 6 leading financiers; dpd – Days past due

Exhibit: Restructured Book Outstanding for Key CV Financiers (Dec-2021)



- CV financiers have undertaken significantly higher restructuring than others in the overall NBFC industry on average. Taken together with the elevated headline delinquencies, this clearly demonstrates the operational stress faced by CV fleet operators since the onset of the pandemic.
- Restructuring in the current fiscal was largely done in Q2 FY2022, generally with a moratorium of 3-6 months. With the commencement of repayments from these accounts during Q3/Q4 FY2022, the performance of the same remains to be seen.
- Based on the performance of the book restructured in the last fiscal, slippage from the NBFC restructured book is expected to be higher at 20- 25%.

Source: ICRA Research; based on entity-level restructuring data of six leading CV financiers



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