PRESS RELEASE
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ICRA: Recent headwinds likely to be offset by pre-buying ahead of BS-IV adoption and infrastructure recovery

The growth momentum in commercial vehicle (CV) demand appears to have slowed down over the past couple of months as reflected by only 1.9% growth in June 2016 and a decline of 7.6% in July 2016 (on YoY basis). The sudden contraction in M&HCV (Truck) sales can be explained by a confluence of factors including a) waning of replacement-led demand, weak cargo generation from industrial sectors and slowdown in construction & mining activity owing to severe rainfall in some parts of the country. The recent correction in CV demand also appears to be on account of higher channel inventory, which is expected to correct in the next few months. As per our channel check with CV dealers, the primary sales (i.e. from OEMs to Dealers) had outpaced underlying demand between February and May 2016, suggesting that inventory levels in the system had gone up.

'Given the weak industrial activity and seasonal impact (on account of monsoon), the demand for CVs is likely to be subdued in the near-term. In addition, the growth in percentage terms would also be influenced by high-base effect as sales in Q2 FY 2016 benefitted from pre-buying due to the implementation of ABS from October 2015 onwards', says Subrata Ray, Senior Group Vice President at ICRA ratings.

As a result of low demand from key sectors, freight rates have also not kept pace with the increase in diesel prices over the past 4-6 months. For instance, since April 2016, diesel prices have recovered by 16%, while freight rates have remained largely stable. The Index of Road Freight (RFI) indicates a marginal decline in freight rates during this period. As a result of higher diesel cost, the profitability of fleet operators has also come under pressure on a sequential basis. However, in comparison to the past couple of years, the current situation in much better.

'We believe that demand would revive from H2 FY 2017 on account of a) pre-buying ahead of the implementation of BS-IV norms (due to 6-10% price differential between BS-III & BS-IV) across India from April 2017, b) pick-up in construction & mining activity post the monsoon season and c) expectation of revival in consumption-driven sectors owing to rural recovery as well as favorable impact of 7th pay commission and OROP on disposable incomes' says Subrata Ray, Senior Group Vice President at ICRA ratings.

The CV demand is also likely to benefit from stricter compliance with respect to overloading (i.e. Government is proposing to implement norms with respect to load carrying capacity of trucks to be in line with rated payload). As per our channel check, strict adherence to dimensions of vehicles in the "automobile carrier" segment has also resulted in healthy demand for tractor trailers. In ICRA's view, the National Green Tribunal (NGT's) ban on old diesel vehicles together with Government's proposed scrappage program (if

implemented) would also contribute to replacement demand over the medium-term. Accordingly, we are maintaining our outlook for M&HCV (Truck) segment at 13-15% for FY 2017.

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