ICRA

ICRA RESEARCH SERVICES

INDIAN COMMERCIAL VEHICLE INDUSTRY

Subdued optimism among fleet operators dampen BS IV related pre-buying

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Industry Update

As per ICRA's estimates, industry-wide inventory levels stood at 74K units equivalent to 1.3x of average monthly sales

Industry expects greater clarity on to liquidate BS-III vehicles

Channel check suggests that pre-buying was minimal till February and growth has been supported by certain specific industry segments

Subdued optimism among fleet operators dampen BS IV related pre-buying

- The Indian CV industry is expected the end the fiscal 2017 with a marginal growth of 5-6% in comparison to 11.5% witnessed in the prior year. Confluence of factors including waning replacement-led demand, weak cargo availability from industrial sectors and uncertainty related to effective taxation on CV industry under the GST regime were the key factors that contributed to slowdown. The domestic CV volumes took a further hit after November 2016 when GOI's demonetisation move put brakes on the operations of road logistics sector which depends heavily on cash transactions.

- With transition to new emission norms (i.e. BS-IV) from April 2017, the industry was expected to witness pre-buying in the last quarter as vehicles complying with new emission norms can be 6-10% more expensive because of technology upgradation. Although the industry growth recovered in Jan-Feb 2017 but the extent of recovery has been below expectations. ICRA believes that subdued economic activity along impending GST implementation in the near-term has prompted fleet operators to defer fleet expansion or renewal plans.

- In addition, there has also been uncertainty related to ability of OEMs to sell BS-III compliant vehicles post April 2017. As a result of these factors, industry-wide inventory levels have inched up as OEMs had scaled up production in Q4 FY 2017 while sales have been below expectations. As per ICRA, the total inventory of CV OEMs is estimated to have been approximately 74K units, which is around 1.3x the average monthly sales.

- In ICRA's view, clarity on sale of BS-III vehicles will help OEMs to align their production schedule in the remaining days and liquidate existing inventory. Further, companies will also be able to route unsold inventory of BS-III vehicles to near-by export markets where emission norms have not progressed to Euro IV or equivalent.

Growth supported largely by stricter compliance with respect to vehicle dimensions and certain contracts placed by specific industries

- As per ICRA's channel check, the extent of lower pre-buying has been partly offset by demand from car carrier segment (on account of implementation of stricter norms related to vehicle dimensions) and new contracts floated by Oil Marketing Companies (OMCs) for carrying petroleum products in the recent months.

- Within the M&HCV (Truck), the growth has been driven primarily by the Tipper segment, which witnessed a growth of 31% (till 9m FY 2017) on back of strong demand from both construction as well as mining segment.

OEMs had scaled up production post December anticipating strong pre-buying

However, pre-buying has been below expectations

Leading to higher inventory levels at ~1.3x of average monthly sales

Pre-buying has been below expectation on account of subdued optimism among fleet operators

In anticipation of pre-buying in the last quarter, CV OEMs had scaled up production in Jan-Feb 2017

Exhibit 1: Segment-wise Trend in Domestic Commercial Vehicle Sales

CV Production	7m FY17	Nov-16	Dec-16	Jan-17	Feb-17	11m FY17
Total (in Units)	461,373	68,306	52,996	70,988	71,889	725,562
Growth (%) – YoY	6.6%	15.6%	(19.3%)	(0.3%)	(4.8%)	3.0%
Domestic Sales	**7m FY17**	**Nov-16**	**Dec-16**	**Jan-17**	**Feb-17**	**11m FY17**
Total (in Units)	399,000	45,773	53,966	61,239	66,939	626,977
Growth (%) – YoY	6.9%	(11.6%)	(5.1%)	(0.7%)	7.3%	3.5%
Export Sales	**7m FY17**	**Nov-16**	**Dec-16**	**Jan-17**	**Feb-17**	**11m FY17**
Total (in Units)	66,172	8,932	7,999	8,147	7,722	98,972
Growth (%) – YoY	12.3%	25.2%	(9.7%)	(13.5%)	(6.4%)	6.9%

Source: SIAM, ICRA research

However, as sales have been below expectation primarily because of subdued optimism among fleet operators, system wide inventory levels had increased to ~1.3x average monthly sales by February

Exhibit 2: System-Level Inventory Estimates

Estimated Inventory Levels	As on February 2017
System Level Inventory at the end of FY 2016	~75,000
CV Production (in 11m FY 2017)	725,562
Domestic CV Sales (in 11m FY 2017)	626,977
Export CV Sales (in 11m FY 2017)	98,972
System Level Inventory at the end of February 2017	**~74,500**
Inventory (in No. of Months)	**1.3x**

Source: SIAM, ICRA research

In addition, the industry is expecting clarity on approvals to sell BS-III vehicles manufactured before April-17. OEMs may also explore option of selling unsold inventory in some of the near-by markets

Domestic CV industry growth has moderated from 11.5% in FY 2016 to 3.5% in 9m FY 2017

M&HCV (Truck) segment has witnessed the most slowdown as reflected by a decline of 2.2% during the same period

Domestic CV sales slowed down during FY 2017

After strong recovery in FY 2016 on back of replacement-led demand, the Commercial Vehicle (CV) industry started on strong note in fiscal 2017 However, after witnessing healthy growth of 13% in the first quarter, the growth momentum came to a grinding halt from June onwards as M&HCV (Truck) started witnessing sudden contraction. Waning replacement demand along with uncertainty related to the impact of GST on vehicle prices put brakes on M&HCV (Truck) sales as fleet operators held back on their fleet renewal or addition plans on expectations that vehicles prices may fall once GST is implemented. Along with these factors, the industrial activity has also not improved during the current fiscal to support cargo availability and in turn demand for M&HCVs.

With transition to new emission norms (i.e. BS-IV) from April 2017, the industry was expected to witness pre-buying in the last quarter as vehicles complying with new emission norms may become 6-10% more expensive because of technology upgradation. Although the industry growth recovered in Jan-Feb 2017 but the extent of recovery has been below expectations. ICRA believes that subdued economic activity along with impending GST implemention in the near-term has prompted fleet operators to defer fleet expansion or renewal plans to some extent.

In contrast to M&HCV (Trucks), the LCV has registered healthy growth in volumes (up 7.2% in 11m FY 2016) on back of low-base effect (i.e. sales declined by 30% between FY 2013-16) and improving demand for SCVs aided by pick-up in consumption-driven sectors. Among the three segments of the CV industry, the bus segment has been the least impacted by the demonetisation move in the near-term owing to a higher proportion of sales to institutional clients (i.e. SRTUs, Schools & Colleges and Travel Operators).

Exhibit 3: Segment-wise Trend in Domestic Commercial Vehicle Sales

Unit Sales	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	11m FY 2017
Domestic CV Sales	809,499	793,211	632,851	614,948	685,704	626,977
M&HCV (Truck) Sales	299,334	221,776	161,909	195,918	258,488	222,202
LCV (Truck) Sales	411,415	476,695	389,434	337,377	334,371	320,219
Buses	98,750	94,740	81,508	81,653	92,845	84,556
Growth (%) - YoY						
Domestic CV Sales	18.2%	-2.0%	-20.2%	-2.8%	11.5%	3.5%
M&HCV (Truck) Sales	8.8%	-25.9%	-27.0%	21.0%	31.9%	(2.2%)
LCV (Truck) Sales	29.8%	15.9%	-18.3%	-13.4%	-0.9%	7.2%
Buses	6.5%	-4.1%	-14.0%	0.2%	13.7%	5.7%

Source: SIAM, ICRA research

Industry is likely to witness 6-8% growth in FY 2018 aided by higher budgetary allocation towards infrastructure and rural sectors; Potential implementation of scrappage program will also trigger replacement demand

Exhibit 4: ICRA's Growth Estimates for FY 2017e & FY 2018p

Growth Outlook	FY 2015	FY 2016	FY 2017e	FY 2018p	Near-to-Medium-Term Growth Drivers
M&HCV – Trucks	21.0%	31.9%	0-2%	6-8%	▪ Higher budgetary allocation towards infrastructure and rural sectors ▪ Scrappage program + NGT's ban to drive replacement demand ▪ Stricter compliance with respect to overloading and vehicle dimension (for specific applications i.e. car carriers etc.) to drive demand for additional vehicles
LCV – Trucks	(13.4%)	(0.9%)	6-8%	7-8%	▪ Replacement demand to continue following 3 years of declining trend ▪ Pick-up in demand for consumption-driven sectors, rural markets and e-commerce ▪ Financing environment to ease as delinquency subside
Buses	0.2%	13.7%	7-9%	5-7%	▪ Order from SRTUs to support sales in M&HCVs; Smart Cities Initiatives etc. ▪ Demand from schools and staff carrier segment remains stable

Source: ICRA research

Profitability indicators of CV OEMs to moderate marginally because recovery in material prices and gradual pass through of BS-IV cost

Exhibit 5: Key Estimates for FY 2018e

Key Parameters	Estimates for FY 2018
Industry Growth (in Volumes)	Domestic CV segment is expected to register a growth of 6-8% in FY 2018 CV Exports are expected to grow by 8-10% in FY 2018
Revenue Growth	Revenues of CV OEMs will grow at a faster pace compared to volume growth on account of a) price hikes (initiated by OEMs because of increase in commodity prices and changes in technology related to new emission norms), b) diversification into other segments like defense, engine sales and higher focus on aftermarket
EBITDA Margins	CV OEMs are likely to face margin pressure on account of a) increase in raw material prices and increase in content per vehicle because of BS-IV emission norms, which may not be fully passed on to customers. In addition, the discount levels remain high on account of stiff competition among OEMs
Capital Expenditure	Despite adequate production capacity, CV OEMs would continue to have sizeable capital expenditure plans to the tune of Rs. 31-33 billion p.a. because of ongoing investments in upgradation of existing platforms, new models & emission norms
Credit Metrics	Expected to remain stable

Source: ICRA research

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