Commercial vehicle industry: Slowdown prolongs due to COVID-19

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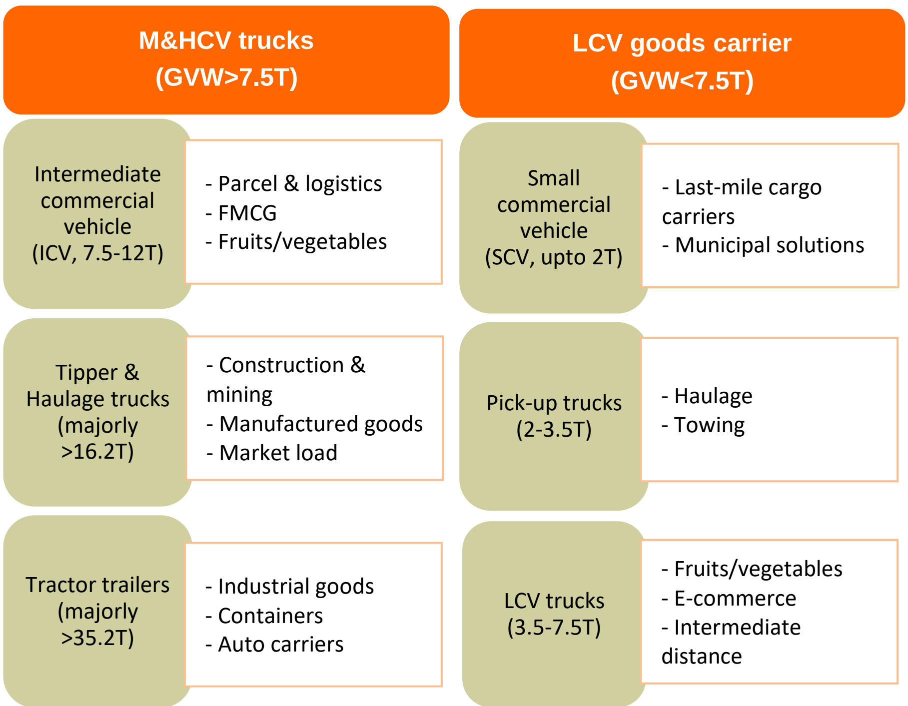
Overview

The Indian commercial vehicle industry is one of the largest domestic industries with strong backward and forward linkages with other allied sectors. As per various estimates, India ranks among top 5 manufacturers of commercial vehicles (CV) globally. CVs are primarily involved in transportation of goods and passengers and hence it is considered to be the lead indicator of economic activity in the country. In India, domestic freight transportation is dominated by road accounting for about 60% of the total freight movement followed by rail (32%), waterway (7%) and air (1%).

In India, CVs are broadly categorized into (i) Medium & Heavy Commercial Vehicles (M&HCV -Trucks & Buses) and (ii) Light Commercial Vehicles (LCV – goods carrier & passenger vehicles) based on the Gross Vehicle Weight (GVW). M&HCVs are generally used for carrying loads over longer distances, while LCVs are generally used for carrying passenger and goods within cities having shorter distances.

Chart 1: Commercial vehicle classification



During FY20, in terms of unit volume, M&HCV accounted for 31% of the total commercial vehicle sales, while LCV accounted for the rest of sales in domestic market.

Chart 2: FY20 domestic sales segment-wise break-up

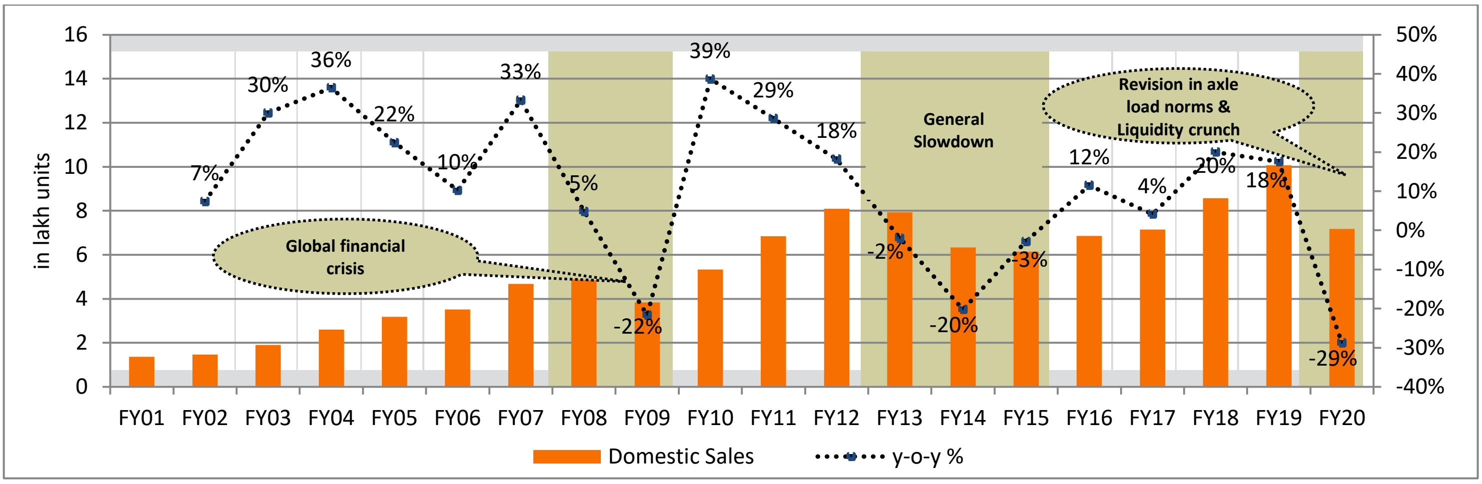
Source: CMIE, CARE Ratings

Major players in the CV industry are Tata Motors Ltd (TML), Ashok Leyland Ltd (ALL), Mahindra & Mahindra Ltd (M&M), VE Commercial Vehicles Ltd, etc. Top 3 players, namely, TML, M&M and ALL, command majority of the domestic market share. During FY20, TML accounted for 42%, M&M for 28% and ALL for 16% of the total domestic CV sales volume. TML and ALL dominate the M&HCV segment, while TML and M&M dominate LCV segment.

Domestic Commercial Vehicle industry performance in the last two decades

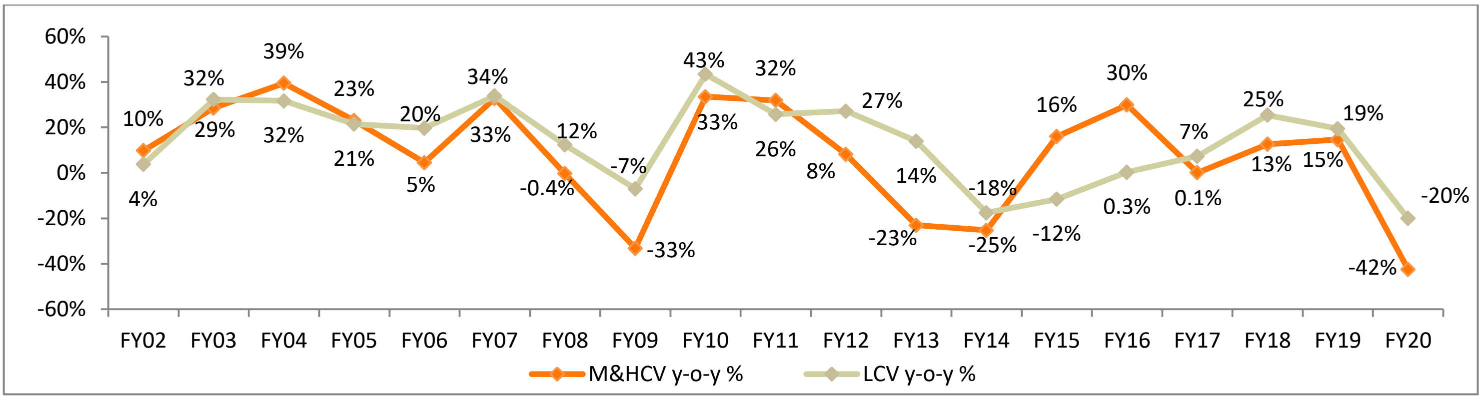
Since FY01, CV industry has grown at a CAGR of 9% from a total domestic sales volume of 136,585 units in FY01 to 717,688 units in FY20 (after peaking at 1,007,311 units in FY19), despite witnessing multiple downtrends due to its inherent cyclical nature.

Chart 3: Domestic CV sales



Source: CMIE, CARE Ratings

Chart 4: M&HCV and LCV domestic sales trend



Source: CMIE, CARE Ratings

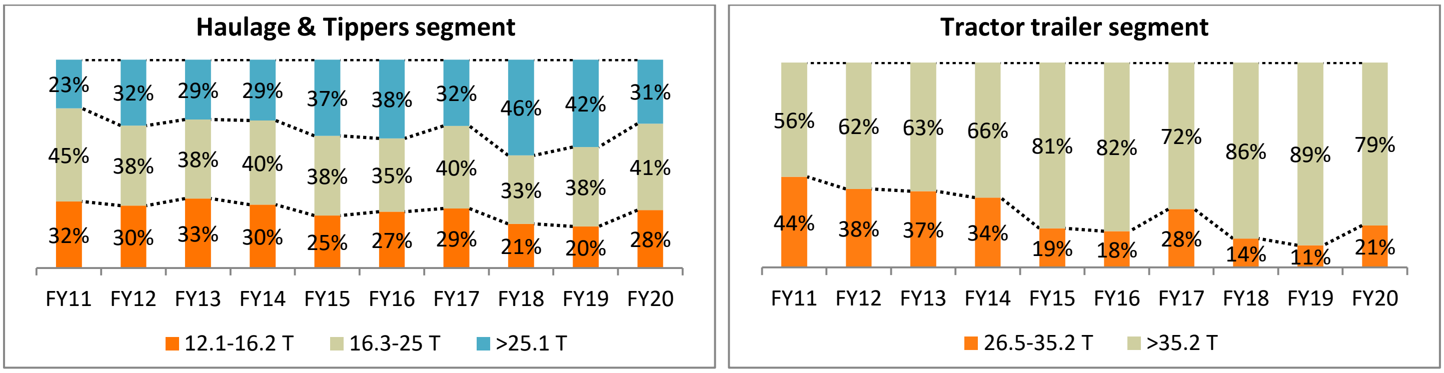
As witnessed historically, the sales of commercial vehicles had rebounded sharply and reached new heights after every period of downturn. During the period FY01-FY20, there were three instances when the industry witnessed sharp decline in the sales volume – (i) During FY09, due to global financial crisis, (ii) During FY14-FY15, due to slowdown in economic growth and ban on iron ore mining, and (iii) In FY20, due to excess freight capacity on account of improved turnaround time post GST & implementation of revised axle load norms, overall slowdown in the economy and planned transition to BSVI. As it can be observed from above chart, trends in M&HCV are relatively sharper as compared to LCV.

Key trends in the last decade

i) *Strong shift towards higher tonnage segment in M&HCVs industry*

In the past decade, owing to various factors, customer's preference has been shifting towards higher tonnage trucks. Improvement in the road infrastructure, hub-and-spoke model, overloading restrictions, shortage of drivers and increased product portfolio from the manufacturers have aided in this transition. During FY18, the trend was further accentuated with enforcement of strict overloading norms and increased adoption of hub-and-spoke model for movement of goods post implementation of GST. Further with GST, productivity of truck fleet operators witnessed a jump as state-level border checks were removed leading to faster turnaround times. During FY18, within Haulage & Tippers segments, >25.1 T vehicle volumes grew 51% y-o-y, while that of 12.1-16.2 T and 16.3-25 T declined by 22% and 13%, respectively, as compared to overall M&HCV trucks y-o-y growth of 19%. Similarly, in Tractor trailers segment, sales of >35.2 T vehicles increased 85% y-o-y, while sales of 26.5-35.2 T category declined by 24% y-o-y.

Chart 5: M&HCV segment sales composition



Source: CMIE, CARE Ratings

As observed from above, within Haulage & Tipper trucks segment, the share of >25.1 T trucks in total Haulage & Tipper trucks sales increased from 23% in FY11 to 31% in FY20. On the other hand, 12.1-16.2 T and 16.3-25 T segment trucks witnessed decline in share of total Haulage & Tipper trucks sales. Similar trend could be observed in the Tractor trailer trucks segment also, as the share of >35.2 T trucks in total Tractor Trailer trucks witnessed a jump from 56% in FY11 to 79% in FY20.

ii) LCV segment volume growth outpaced that of M&HCVs

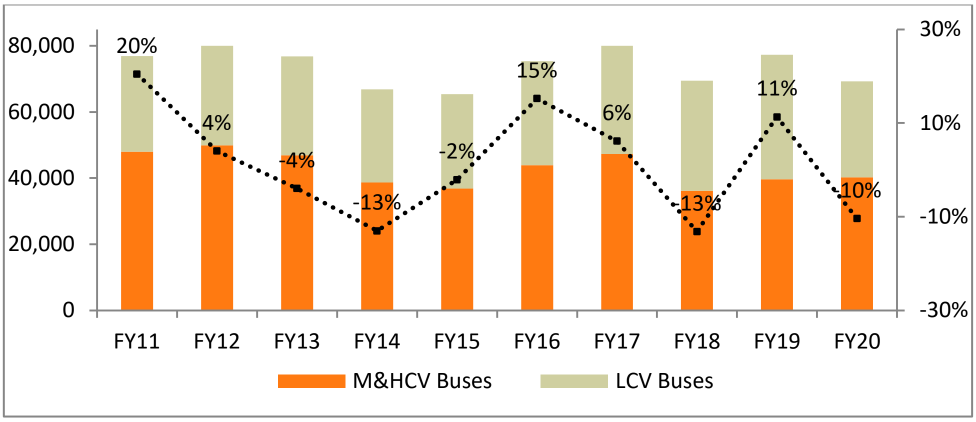
In the last decade, sales growth of LCVs in the domestic market had outpaced the sales of M&HCVs. Since FY10, LCV sales had grown at a CAGR of 9% until FY19 and reached a peak volume of 616,579 units in FY19 before dropping to 492,889 units in FY20. In contrast, M&HCV sales grew at a CAGR of 5% until FY19 and reached a peak volume of 390,732 units in FY19 before dropping to 224,806 units in FY20. It is also evident from the change in composition of the domestic CV sales mix, wherein M&HCV, which accounted for 46% (LCV: 54%) of the total domestic CV sales in FY10, gradually declined to 31% (LCV: 69%) of the total sales in FY20. Outperformance of LCVs could be attributed to rise in rural consumption and increase in last-mile connectivity.

However, as per CARE estimates in terms of total tonnage sold, both LCV and M&HCV segments grew almost at a similar rate during the FY10-FY19 period. During the said period, M&HCVs total tonnage sold grew at a CAGR of 8%, while LCVs grew at a CAGR of 7%. With respect to M&HCVs, higher growth witnessed in terms of tonnage sold than that of unit volume growth could be attributed to shift in customer's preference towards higher tonnage vehicles due to various reasons as stated earlier.

iii) Passenger carrier including bus sales remained stagnant in the last decade

In the last decade ended March 2020, passenger carrier segment (including both M&HCVs and LCVs) has marginally de-grown at a CAGR of -1%. Sales of buses remained stagnant due to weak demand from the state road transport undertakings and other segments (schools/colleges/staff carriers).

Chart 6: Passenger carrier segment domestic sales trend



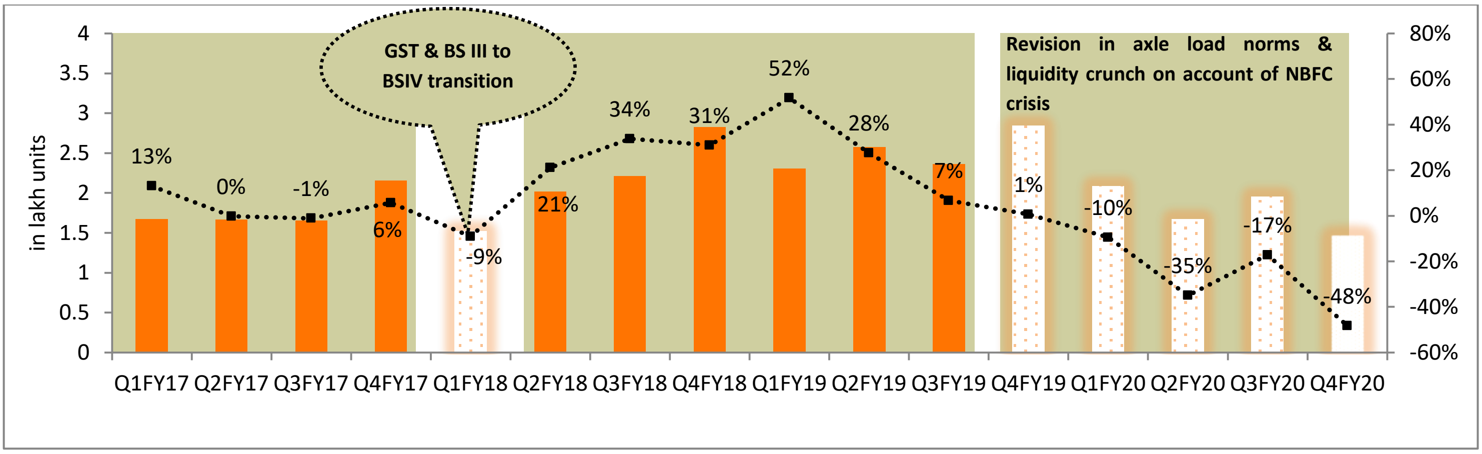
Source: CMIE, CARE Ratings

Genesis of the crisis

Sharp decline in CV sales during FY20 after two successive years of high growth

In the last few years, the industry has endured several supply-side and demand-side challenges, which includes (i) Transition from BSIII to BSIV (April 2017) and implementation of GST (July 2017) after demonetisation, (ii) Excess CV capacity created due to revision of axle load norms (July 2018), liquidity crunch experienced by NBFC sector which is a major lender in vehicle financing and (iii) Planned transition from BSIV to BSVI amidst COVID-19-induced economic slowdown (April 2020).

Chart 7: Quarterly trend in domestic sales



Source: CMIE, CARE Ratings

After witnessing a slump in the sales during Q1FY18 due to implementation of GST and BSIV transition, the industry rebounded sharply in Q2FY18 with a sales growth of 21.1% on y-o-y basis. The sales growth continued to maintain the momentum reporting double-digit growth until Q2FY19 led by (i) strong pickup in infrastructure-related activities leading to strong growth in M&HCV and (ii) recovery in rural demand driving the growth in LCV segment. From Q3FY19, the sales growth began to lose steam and started to decline on account of combination of factors - revision in axle load norms, improved turnaround time post GST implementation, liquidity crunch experienced by vehicle financiers due to NBFC crisis and overall slowdown in the economy.

During FY20, demand for CVs nose-dived to multi-year low, as domestic sales dipped 29% y-o-y. Within CV sub segments, M&HCVs sales declined 42% y-o-y and LCVs declined 20% y-o-y in FY20. The improved turnaround time post GST increased availability of trucks by an estimated 40%-45% in some of the routes across the country. Additionally, as per various industry estimates, the excess capacity created out of increase in axle load norm was expected to get absorbed in about 2-3-year period, had the economy sustained higher growth (7%-8% GDP growth). However, as the economy continued to slowdown, demand for CVs remained weak. Furthermore, prevalence of tight vehicle financing environment as NBFCs face credit squeeze added to the challenges.

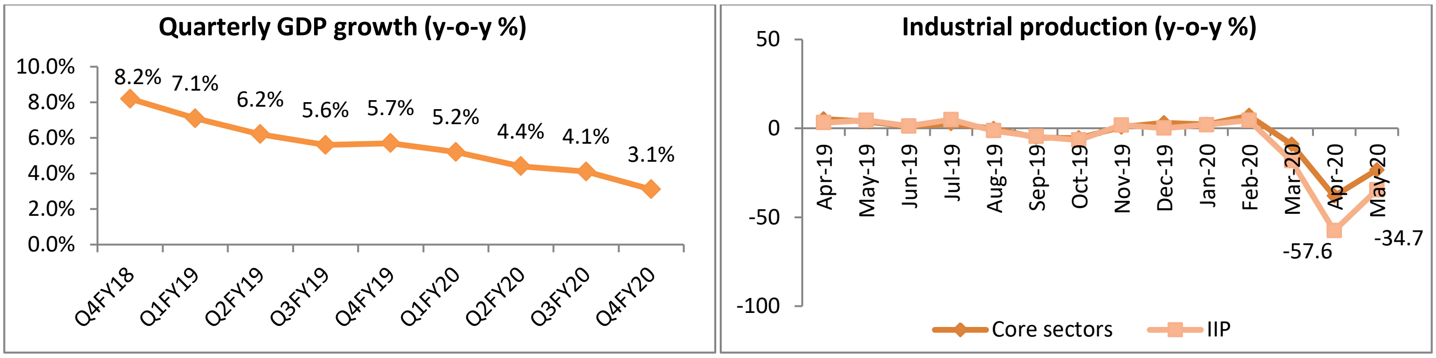
During last quarter of FY20, lower-than-anticipated pre-buying prior to BSVI transition and COVID-19 outbreak dampened the sales. Further, on account of transitioning to BSVI emission norm standards, prices of vehicles have gone up by around 10%-15% since April 2020.

Current challenges

COVID-19 pandemic induced slowdown extending downtrend in FY21

As per Indian Foundation of Transport Research and Training (IFTRT), about 60% of the road freight is from the manufacturing sectors, 10%-15% from infrastructure and export-oriented sectors and rest from transport of essential commodities. Slowdown across sectors is evident from the decline in the GDP growth and industrial production (IIP) growth rates in the last few quarters.

Chart 8: The macro disappointment

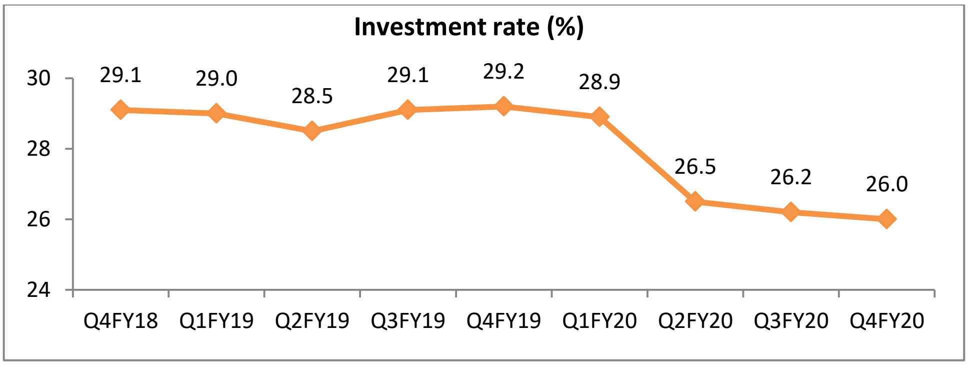


Source: MOSPI

India's GDP grew 3.1% in Q4FY20, the slowest rate in 11 years indicating slowing economy amid COVID-19 led lockdown. Core sectors manufacturing and construction contracted 1.4% and 2.2%, respectively, during Q4FY20, on account of the lockdown imposed in March 2020. The COVID- 19 pandemic extended the downtrend further in Q1FY21. Most of the industries witnessed substantial loss of economic activity during Q1FY21 with continuing lockdown at varying degrees across the country. Industrial production (IIP) contracted by 55.5% in April 2020, while 8-core sectors production contracted by 23.4% in May 2020, indicating sharp contraction in economic activities owing to industries closure and subdued demand.

Also, Gross Fixed Capital Formation (GFCF) which is a proxy for investment activity has witnessed sharp drop during FY20 on account of tepid demand. The investment rate, measured as GFCF as a percentage of GDP fell to 26% in Q4FY20, the lowest in the past 8 years.

Chart 9: Clogged investment tap



Source: MOSPI

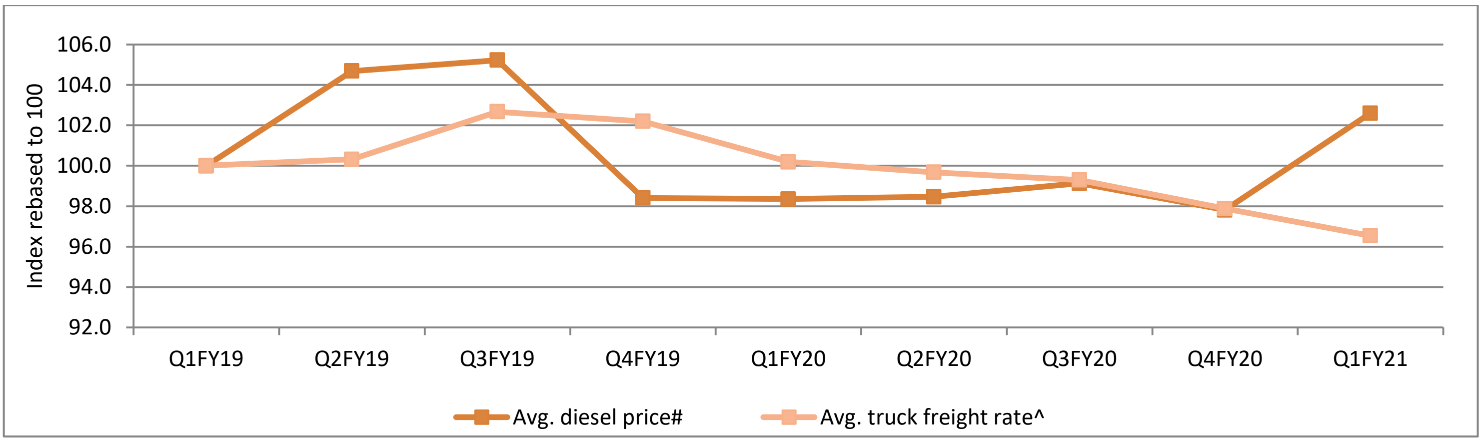
With outbreak of COVID-19 pandemic, economic activities across the country remain disrupted since March 2020 due to lockdown. During April to June 2020 period, domestic CV sale was negligible due to lockdown. On account of continuing lockdown and continuation of several restrictions on movement of people, Indian economy is expected to contract during FY21. Recovery across sectors is expected to remain slow and gradual as COVID-19 crisis continue to evolve. As per CARE's estimations, GDP is expected to contract by -6.4% in FY21. Slowing economy and industrial output is expected to result in sluggish demand for CVs in near-to-medium term.

Unfavourable economic scenario leading to lower demand and declining truck freight rates

The road freight transportation sector is highly fragmented and unorganised given the presence of large number of small truck operators. Around 70%-75% of truck owners in India have a fleet size of 1 to 5 trucks (small fleet operators). Given the unorganised and competitive nature of the sector, small fleet operators lack pricing power and the ability to pass on any increase in fuel or other operational costs. Only the remaining 25% of truck owners (large fleet operators) have escalation clauses linked in their annual contracts with customers. Fuel cost (diesel) alone constitutes around 50%-60% of the freight rate, being the largest cost head for the fleet operators.

Truck rentals on some of the major routes in the country have been under declining trend since Q4FY19 more or less in-line with declining trend of diesel price. However, from the beginning of FY21, diesel price has started firming upwards while the freight rates have declined further. During Q1FY21, average truck freight rates have declined in the range of 2%-10% y-o-y across major routes, while diesel price witnessed 4% y-o-y rise. Currently, diesel prices in the country are at all-time high amidst lower demand for trucks.

Chart 10: Trend in truck freight rates and diesel prices



Source: CMIE, PP&AC, CARE Ratings
^: Worked out as average truck freight rates for various commodities from Delhi to 6 major states
#: Retail selling price of diesel at Delhi

Furthermore, truck utilization levels remained under pressure during Q1FY21 due to lockdown and various restrictions on movement across the country. As per industry body associations, fleet utilization among operators were around 30%-35% during May 2020 and has gradually risen up to 50%-60% during June 2020, as more sectors opened up after relaxation of lockdown restrictions. Also, currently truck fleet operators are witnessing shortage of drivers, as most of them had returned to native places in view of the nationwide lockdown in March-April 2020. Demand environment is expected to remain low in coming months as well due to slowing economy on account of COVID-19 impact.

Given the overcapacity situation, freight rates are expected to remain under pressure despite increase in diesel prices, which could impact the profitability of fleet operators during FY21. Therefore, it is expected that fleet operators might defer their new CV purchases in the near term.

The grim near term outlook

The Indian CV industry continues to exhibit cyclicality as witnessed in the last two decades but the slump witnessed in FY20 was sharp and historic. During FY20, CVs sales volume after growing briskly in the last few years declined 29% y-o-y to 7.2 lakh units against selling more than 10 lakh units for the first time during FY19, as a series of events and factors hit the brakes on the industry growth. The industry is staring at further de-growth as COVID led economic downturn adds to the negative sentiment.

As the macro numbers continue to disappoint and likely to weaken further, it is threatening to take the CV industry on a prolonged slowdown. For FY21, overall domestic CV sales is expected to decline by 30%-35% with more severe hit in M&HCV segment than LCV segment. Contraction in LCV segment is expected to be limited as the demand from rural and semi-urban markets is expected to recover faster on account of higher agriculture output on the back of good monsoons during the current year.

The overall volumes are expected to gradually pick up during H2FY21 from the current lows; however, any meaningful demand recovery is expected from FY22 only. While this is likely to impact the financial performance of various domestic CV players, majority of them are better placed to manoeuvre the downtrend than in the past.

The industry needs revival measures that address both short-term and long-term demand. Despite no direct stimuli to boost CV demand being announced under 'Atmanirbhar Bharat' package, reforms being carried out in certain sectors are expected to improve CVs demand in the medium term. Measures including commercialization of coal mining, introduction of seamless composite exploration-cum-mining-cum production regime for minerals, liquidity boost to NBFCs and measures to improve agriculture and allied sectors infrastructure, could have a positive impact on CVs demand in medium term. Demand revival could be hastened in case of implementation of long due scrappage policy, reduction in GST rates from the current 28% along with substantial economic measures including government's push towards additional infrastructure projects.

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