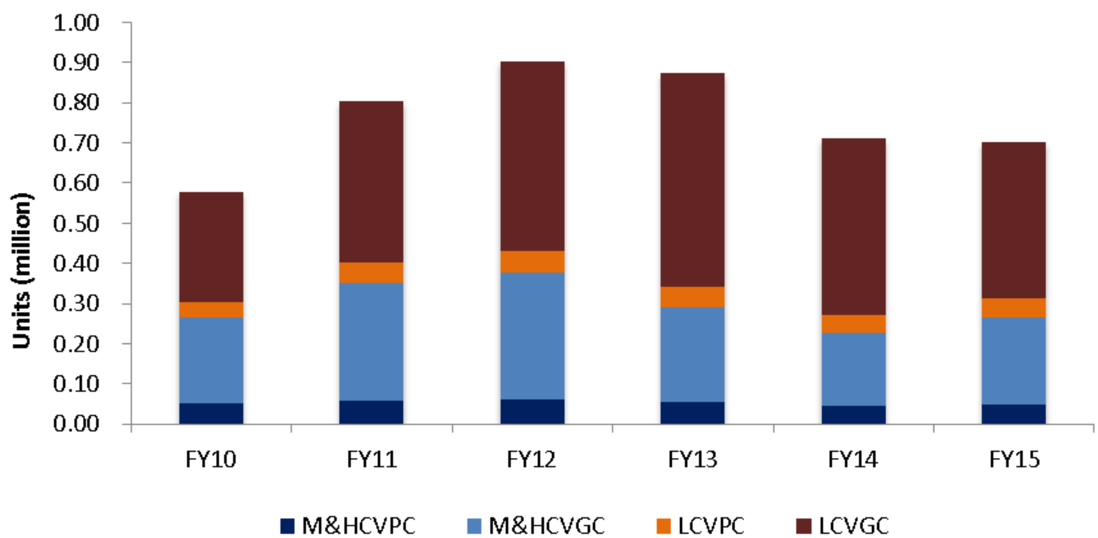
"Policy-fuel crucial for long haul journey of Goods Carriers"

India, at the end of CY12, was placed seventh among top global Commercial Vehicle (CV) producing countries, well set to break into the league of top five CV producing nations as CV production was growing by around 20% on CAGR basis (FY02-12 period[refers to the period April 1 to March 31]). Consequently, most of the global CV giants such as Daimler, Man Trucks, Navistar, Volvo, Hino, etc, forayed into India during FY05-10, citing low CV penetration and high growth potential for CVs in India. However, by the end of FY12, Indian CV industry was reeling under constant demand pressure on account of the prolonged economic slowdown. Consequently, India slipped to the eighth place as a producer of CV with production of around 0.68 million CVs during CY2014 as compared with around 0.88 million during CY12. Global giants were stunned to see their estimates go haywire as the slack in demand was extended and severe than expected. Waning industrial and mining activities combined with sluggish growth in agriculture activities due to erratic monsoon led to weakening CV demand post FY12. However, the change of government at Centre in May 2014, has led to improved business sentiments in anticipation of economic revival and easing of policy hurdles has led to recovery of M&HCV segment during FY15. Nonetheless, sustainable revival of CV industry is dependent on macro- economic stability in the long run.

Impact of slowdown was felt across segments of CVs during FY12-14

The economic slack prevalent during FY12-14, initially impacted Medium and Heavy Commercial Vehicles (M&HCV) segment, and gradually took Light Commercial Vehicle (LCV) in its stride(refer exhibit 1). While M&HCV sales plunged by around 23% during FY13; LCV sales registered a growth of around 11% during FY13. LCV segment continued to grow till FY13 before entering into the negative territory. The growth was fuelled by continuing expansion in the redistribution demand driven by increase in organized retail and growing urbanization. Growing preference of small fleet operators for LCV over three-wheelers also aided the demand till FY13. During FY14, both LCV and M&HCV sales declined by around 17% and 22% respectively. Although Passenger Carrier (PC) segment witnessed weak demand, the voluminous Goods Carrier (GC) segment was the worst hit during FY12-15 period on account of weak freight demand coupled with spiraling fuel prices and burgeoning financing cost.

Exhibit 1: CV sales trend



Source: CARE Research and Society of Indian Automobile Manufacturers (SIAM)

Global OEMs allured by low CV penetration; bitten by economic woes

Global giants ventured into India, lured by growth potential of CVs, underestimated the macro-economic stability necessary to sustain CV demand in the long run. The demand for CVs is highly reliant on the size of economy (refer exhibit 2); bigger the size of economy higher the freight demand and consequently, more CVs consumed by economy. In addition to the size of economy, penetration level (characterized by number of CVs per 1000 persons) is another driving force for CV demand in a country. Higher per capita income translates into higher spending which in turn leads to higher consumption of CVs as a result of high freight generation.

A developed economy such as USA has population one-fourth of population of India yet sells more than 10 times commercial vehicles sold in a developing economy such as India. However, on the other hand, CARE observed that Indonesia which has economy around half the size of Indian economy (in terms of GDP), has CV penetration double than India. CARE estimates India has one of the lowest CV penetration in the world at around seven CVs per 1000 persons, on the contrary other Asian counterparts like China and Japan have CV penetration of around 35 and 131 respectively(refer exhibit 3). Despite low penetration making a strong case for CV demand, India's dismal per capita income of around US$1,600 mars potential of CV industry in long run.

CARE believes in order to boost up CV consumption (freight demand); India requires policy push in the direction of easing of business environment, improvement of road infrastructure and proliferation of hub and spoke model.

Exhibit 2: CV sales vs GDP

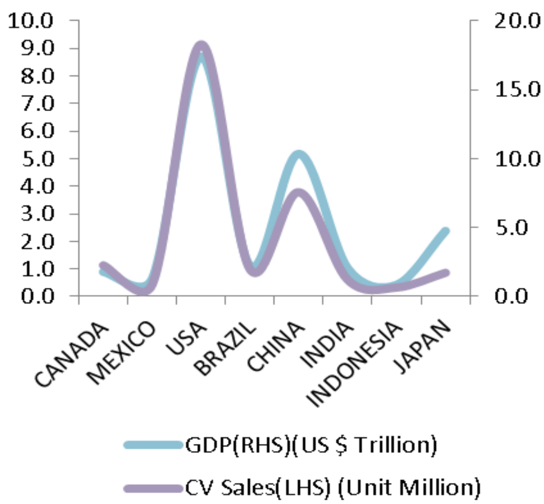
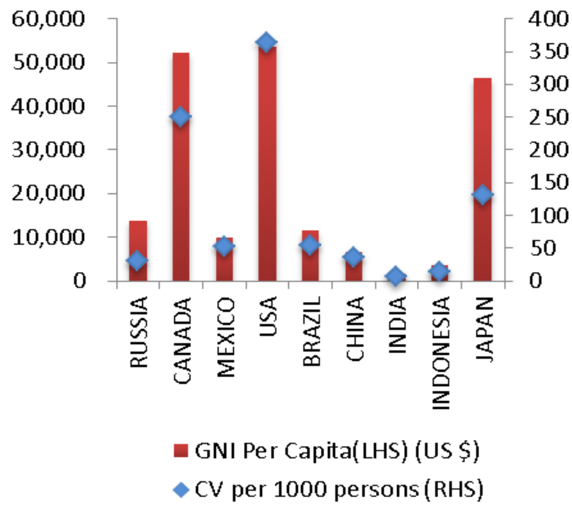


Exhibit 3: Global CV penetration

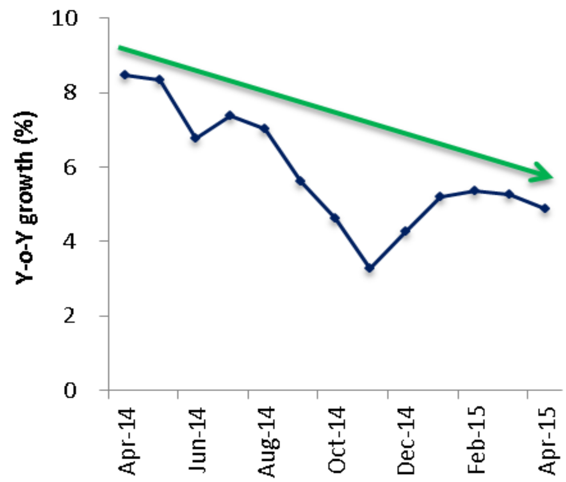


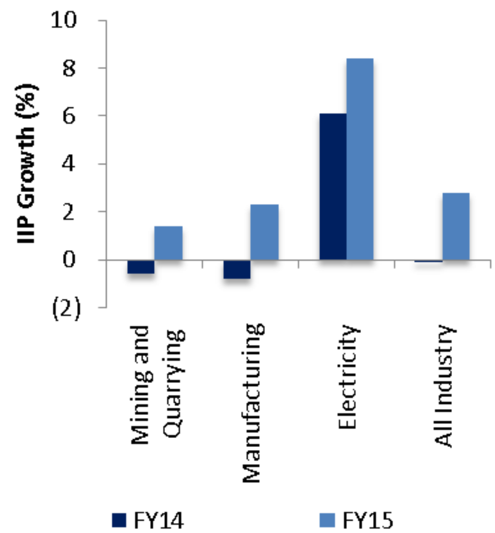
Source: CARE Research , OICA (International Organization of Motor Vehicle Manufacturers)and The World Fact-book-CIA

M&HCV GC segments gained momentum during FY15 sensing green shoots

Tepid economic activity during FY12-14 led to weak freight demand; moreover, profitability of transport operators (TOs) was squeezed due to spiraling diesel prices post partial de-regulation of diesel. Combined effect of low freight demand and lower profitability of TOs acted as deterrent for M&HCV GC sales during FY12-14. CARE believes that TOs restrained from fleet additions during FY13-14 period owing to low fleet utilization in absence of stable freight demand. However, the new government at Centre in May 2014 has spurred business sentiments. Although complete recovery of economy is still away, green shoots were witnessed in the form of lower inflation (refer Exhibit 4) and higher industrial activity (refer Exhibit 5) during FY15. Consequently, transport operators went ahead with fleet additions during FY15 which led to fillip in M&HCV GC demand. Domestic sales of M&HCV GC witnessed growth of around 21% during FY15, which were also aided by low base in previous years.

Exhibit 4: Trend in Consumer Price Index (CPI) Inflation	Exhibit 5: Trend in Industrial production



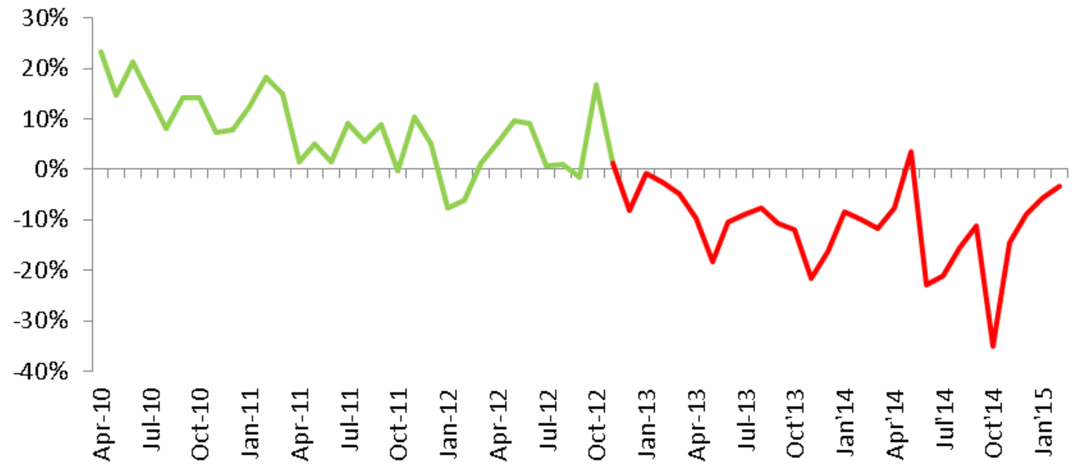


Source: MOSPI and RBI

LCV to mimic M&HCV revival with lag effect

Revival in the domestic sales in FY15 was confined to M&HCV GC segment. LCV GC segment which underwent colossal fleet additions during FY10-13 period saw decline since FY14. Due to dominance of operator owners, the LCV GC segment has observed unplanned buying in the past which resulted in huge fleet pile up of LCV GC in freight transport industry. CARE believes drop in income levels owing to lower job creation and spiraling inflation has considerably dented the non-discretionary spending of Indian consumer(refer exhibit 6) during FY12-15 period which in turn posed pressure on redistribution demand. Consequently, LCV GC witnessed decline of around 18% in FY14. LCV GC continued to decline during FY15 by around 13% in absence of revival in redistribution demand. LCV demand revival looks elusive unless redistribution freight demand improves depending on lag between economic recovery and revival in consumer spending. CARE expects that the demand for LCV to be in green post FY17.

Exhibit 6: Trend in growth levels in IIP Consumer durables



Source: MOSPI

"Make in India" and "Smart City" projects shot in the arm for CV Industry

Union government's decision for creation of 100 smart cities till 2022 would generate huge opportunity for CV OEMs in the long term. "Smart city" project would aid the organized retail sector to flourish in the country which in turn would lead to proliferation of hub and spoke model for transportation and better logistics infrastructure for improving efficiency. Increasing usage of hub and spoke model would create demand for more LCV GC per M&HCV GC in order to effectively redistribute freight from the nodal points to different end users. CARE analyzed the scenario in some of the key developed countries such as USA, UK, Canada, etc, and observed that the proportion of LCV GC sales in overall GC market in these selected countries is more than 80%. Consequently, leading to higher penetration of CV, around 200-300 CVs per 1,000 persons in these economies.

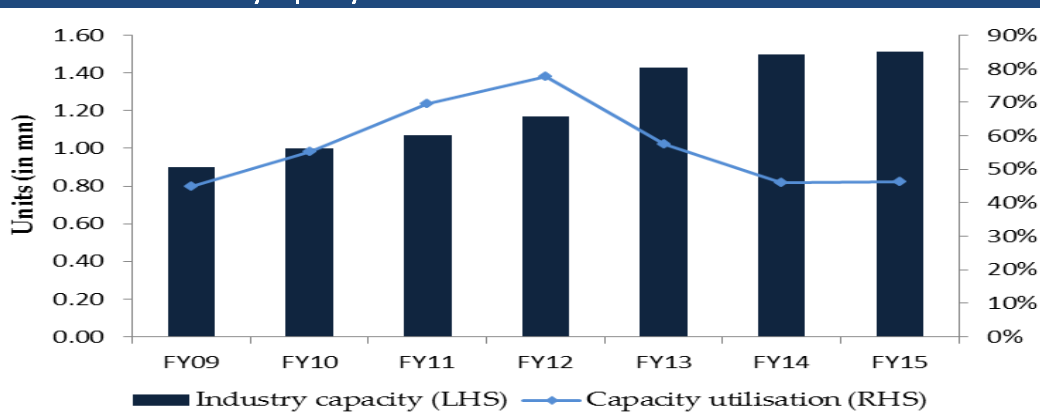
Moreover, government's commitment towards "Make in India" campaign has started showing results as the FDI (Foreign Direct Investment) during October 2014-February 2015 period (Since the launch of Make in India campaign on September 26, 2014) has surged by 56%. Global CV giants such as Scania Motors and Daimler Motors have already committed themselves to the "Make in India" projects and plan to increase exports out of India. "Make in India" initiative would not merely push export demand for CV but would also improve domestic CV demand on account of higher industrial output translating into higher freight demand.

CARE expects that the Rs.70,000 crore infrastructure push during the Union Budget 2015-16 and passage of the legislation that opened the doors to commercial mining would boost demand for M&HCV GC in the short term. Furthermore, lower fuel costs and reduced interest rates would assist demand for CV in FY16.

Credit profile of CV OEMs poised to improve in short term, successful implementation of policy initiatives to shape the future in long term

The credit risk profile of CV manufacturers is characterized by strong parent support, established track record of operation and high degree of financial flexibility. The CV makers rated by CARE are largely in the AAA or AA category (Ashok Leyland Motors, Tata Motors Ltd Mahindra & Mahindra constitute around 87% of CV sales). In the short term, the income of CV manufacturers is likely to improve owing to revival in CV demand. Furthermore, with inflation likely to be lower than RBI's target, expected rate cuts by RBI would translate into interest rate reduction by banks. Consequently, the profitability of CV manufacturers would improve. CARE estimated around 30-35% (both LCV and M&HCV together) of the present manufacturing capacity was added during FY10-FY13 period in anticipation of strong demand, however, demand slump since FY12 led to surplus manufacturing capacity. CARE estimates industry capacity utilization declined to around 50% during FY14 and FY15, (refer exhibit 7) consequently, no major long-term debt is expected to be raised for the purpose of capacity expansions.

Exhibit 7: Trend in CV industry capacity utilisation



Source: CARE Estimates

In light of the expected improvement in revenue and profitability coupled with no major increase in debt, overall credit quality of Indian CV manufacturers is expected to improve in near term with a stable outlook on industry. However, sustainable recovery of CV industry would depend on successful implementation of the initiatives like “Make in India”,” GST”, “Smart City” etc. combined with easing of business environment. In long-term, successful implementation of policy initiatives would be critical for credit profile of CV manufacturers.

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