

BFSI

Road trip to South India: CV growth driven by replacement demand

India Equity Research | Banking and Financial Services

During our road trip to South India's commercial vehicle (CV) hub in Tamil Nadu (Namakkal, Sankagiri and Salem) we met lorry owner associations, CV dealers, financiers & fleet operators. Key highlights: a) Demand scenario: Underlying CV sales growth is led by replacement demand where operators are upgrading fleet to higher tonnage trucks. Load availability & business activity levels are modest (refer to our auto analysts note "Replacement demand drives MHCVs"); b) Operators' profitability: Freight rate growth lagging diesel price hike is taking a toll on operators' cash flows (dipped by 15-20% in past 3 years); c) Financing dynamics: Region has an active financing market and rates are extremely competitive at 8.5-9.5%. However, there is no dilution in underwriting standards in form of higher LTV or over leveraging via top-up loans. Asset quality is steady (negligible delinquency levels). Among financiers, while Sundaram Finance (SUF) & IIB are leaders in new vehicles, SHTF & Chola lead in used vehicles. New entrants IndoStar, Citi Finance & Equitas are making inroads.

Active market feeding into competition and aggressive rates...

Competition is intense amongst lenders in this dominant CV hub in South India. Lending rates are in narrow range of 8.5-9.5% - HDFC Bank, ICICI Bank and SUF are more aggressive, while IIB and Kotak Mahindra Bank (KMB) are relatively at upper end. The trend is further exacerbated by new entrants like Citi Finance (lending at 7.7%), Yes Bank (new vehicle player), Indostar (aggressive in building franchise over past 3 months) and Equitas (a used vehicle player). Overall, SUF dominates with >40% market share followed by IIB (>20%), HDFC Bank (12-13%), ICICI Bank (8-9%) and KMB (5-6%). In used CVs, Shriram Transport dominates followed by Chola and IndusInd Bank.

...but, discipline maintained in underwriting standards...

We did not get any indication of dilution in underwriting standards. Discipline on LTV front is maintained – eg, 100% chassis financing and partial body financing depend on customer track record & relationship with financiers. Few players continue to offer top-up loans & working capital finance, but there is no overleveraging by customers as such.

... higher replacement value leads to pristine asset quality

Sanity in underwriting standards, higher replacement value and strong customer behaviour (tendency to default is low) reflects in robust asset quality. Our interaction suggests that delinquencies are negligible across segments.

Our view

CV financiers have sustained strong growth momentum is now becoming a trend. However, this bullishness was missing among fleet operators as it's largely replacement led. In fact, active replacement cycle will benefit used financiers like SHTF. Intense competition among CV financiers coupled with entry of new players will keep pricing power under check.

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Operators' profitability stretched on cost escalation

Operators' cash flows are taking a knock as the rise in freight rate is not commensurate with cost hike. Modest load availability (leading to under utilisation) with gradual upward pressure on diesel price, drivers' salaries, etc., is impacting profitability. Broadly, an operator earns INR55-60k per truck per month which goes towards payment of EMI. Thus, to improve profitability, they are moving towards higher tonnage trucks.

Fig. 1: Lorry Association at Sankagiri



Over 45 years of history with 3350 members and over 20k vehicle

"South growth driven by replacement cycle, North by overloading ban"

Fig. 2: Fleet owner at Salem



Fleet operator at Salem having 20 vehicles.

"Cost rise is more than the freight hike, the profitability has come down over last few years"

Fig. 3: Lorry Association at Namakkal



Have 4500 members and over 30k vehicle

"Financing is very competitive, banks are offering rates at 8.5-9.5%"

Source: Edelweiss research

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Recent Research

Date	Company	Title	Price (INR)	Recos
09-Apr-18	BFSI	VUCA returns; <i>Sector Update</i>		
26-Mar-18	Capital First	Retailisation, the growth mantra; <i>Visit Note</i>	619	Buy
19-Mar-18	State Bank of India	Subsidiaries' Day: Focus on leveraging synergies; <i>Company Update</i>	248	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
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Reduce	depreciate more than 5% over a 12-month period

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