AUTOMOBILES

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Channel check takeaways – Dismal demand climate for MHCVs

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We interacted with some multi-axle truck fleet owners – key takeaways below:

Demand far lower than commonly perceived; rising diesel cost denting profits: Freight demand has reached just 35-40% of pre-Covid levels pan-India. Agri demand is strong but offtake from other sectors lags. The steep 15-17% rise in diesel cost (40% of operational costs) since unlocking began in June has not been covered by the meagre 2-3% rise in freight rates, denting profitability and hence vehicle demand from fleet operators.

Driver shortage adds to woes: About 75-80% of drivers hail from Uttar Pradesh and Bihar now vs. Punjab and Haryana in the past. Mass migration of labour to rural areas during the pandemic has caused a severe paucity of drivers, stalling 30-35% of fleet operations. Even so, available capacity is ahead of demand.

Threat from railways real but not immediate: The adverse impact on roadways will depend on the pace of infrastructure buildup around the rail links. The biggest challenge of converting goods from road to rail is door-to-door delivery – costs will increase due to building of the desired infrastructure, loading and unloading from factories to railway wagons, and then last-mile transport. Thus, though rail will be faster, it may not be as cost effective.

Growing second-hand demand to impede new CV sales: Discounts on newer models remain far higher than average to lure buyers (Rs 300k-400k on a Rs 1.8mn-2mn multi-axle truck). The slowdown has forced many fleet owners to cut capacity by selling into the replacement market. Also, used truck prices are down by Rs 200k-300k from pre-Covid levels, leaving little incentive for fleet owners to add new assets. This may delay recoveries in new truck sales.

Scrappage policy unlikely to buoy demand: The wait for a scrappage policy has been more at the manufacturers' end rather than the users' end. Fleet operators cite demand and profitability as prime motives for fleet additions, rather than discounts or scrappage incentives. Fleet addition is feasible only when demand and freight rates are strong and steady, supporting aggressive finance availability.

Our view – SELL AL: In FY21 YTD, Ashok Leyland's (AL) M&HCV sales are down 86% YoY. We model for a mere 18% YoY drop in FY21 (strong recovery in H2) and a 50% YoY jump in FY22. Overall, we expect a 10% volume CAGR for FY20-FY23 with 250bps margin gains. Our aggressive growth assumptions yield EPS of Rs 3.4 for FY23. Valuations look rich at 29x FY22E EPS. We continue to value AL at 16x Sep'22E EPS and retain SELL with a Sep'21 TP of Rs 44.

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KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
AL IN	70	44	SELL

Price & Target in Rupees

BACKGROUND OF CHANNEL CHECK PARTICIPANTS

Fleet owner #1

- Now operates on an asset-light model vs. ownership model earlier (built over last 10yrs)
- Sold entire fleet of >170 multi-axle trucks over the last two years, given operational and profitability issues
- Converted the business into consignment-wise contracting of trucks
- Offers 60 days' credit to corporate customers; makes advance payment of ~80% of freight cost to truck operators

Fleet owner #2

- Midsized multi-axle fleet owner with newly built fleet of 22 trucks
- 10 and 6 trucks added respectively in CY18 and CY19; only 1 truck added in CY20
- Does not plan to expand the fleet further this year given weak market conditions

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BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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