Domestic freight transport services
IMPACT ANALYSIS

Transporter profitability to remain stable despite increase in diesel prices

Summary

- Transporters are expected to pass on the hike in diesel prices effective from June 26, 2010 by Rs 2 per litre following a 3-4 per cent increase in freight rates.
- Large fleet operators (LFOs) will increase freight rates immediately; however, small fleet operators (SFOs) might slightly delay the hike in prices, depending on the demand-supply situation.
- The overall increase in freight rates will be 11-13 per cent in 2010-11, while the rise in diesel prices since March 2010 till date has been 19 per cent (translating into a 10-12 per cent increase in transporters' costs).
- CRISIL Research estimates stable profitability for transporters in 2010-11.

This report analyses the impact of the hike in diesel prices on the domestic freight transport services sector.

June 2010

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About CRISIL Limited

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Hike in diesel prices to result in increase in freight rates

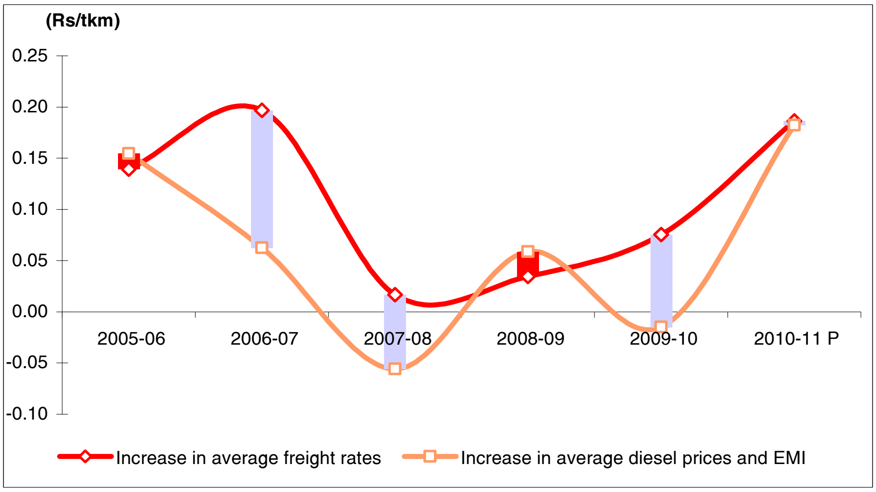
The Empowered Group of Ministers (EGoM) decided to raise the retail selling price of petrol by Rs 3.7 per litre, diesel by Rs 2 per litre, LPG by Rs 35 per cylinder and kerosene by Rs 3 per litre. Prices of petrol have been deregulated and shall henceforth, be determined by the market.

Operating costs for transporters are estimated to increase by 5 paise per tkm (tonne-kilometre) from June 2010 with the Rs 2 per litre increase in diesel prices. Given the fact that fuel prices account for 55-60 per cent of the total costs for a transporter, the hike in diesel prices is expected to lead to an immediate hike in freight rates by LFOs. The flexibility of passing on the hike is currently high, on account of healthy freight availability. Also, as most of the LFO business is contractual in nature, with a built-in escalation clause, it allows them to pass on the hike in diesel prices to the clients. (LFOs control 80-90 per cent of the freight capacity.)

Given the SFOs have limited bargaining power, they may not increase prices immediately in order to improve utilisation levels. However, given their thin margins, it would be difficult for them to sustain at lower freight rates over the long term. Hence, we expect the industry to align to an overall hike of 3-4 per cent in freight rates over the next 1-2 months.

Since March 2010, the total increase in freight rates is estimated at 11-13 per cent, the rise in diesel prices till date has been 19 per cent (translating into a 10-12 per cent increase in transporters' costs). Therefore, CRISIL Research estimates overall transporter profitability to remain stable in 2010-11. In case the transporters increase freight rates higher than 3-4 per cent, their profitability would improve in line with freight rate hike.

Transporter profitability to remain intact



Source: CRISIL Research

The above analysis considers two factors that determine pricing flexibility of road transporters - competition from railways and demand-supply of truck fleet. Assuming no increase in railway freight rates, road freight will become further less cost-competitive. However, the inter-modal shifts will continue to be driven more by structural advantages, and the impact of relative pricing on growth in road freight is expected to be marginal.

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