Manufacturing & Service Industries: Review FY19 & Outlook FY20: PART II

June 12, 2019 I Industry Research

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In this Report, we provide an update or review for the year FY19 and give an outlook for the year FY20 for certain industries. List of the industries covered in this report are mentioned below:

1. Drugs & pharmaceuticals
2. Gems & jewellery
3. Paints
4. Telecom
5. Cement

1. Drugs & pharmaceuticals

Review FY19

Exports form a significant portion of the Indian pharma industry and accounts for about half of the industry's sales. During FY19, export sales of the Indian pharma industry increased by 10.8% to $19.2 billion compared with FY18. This was largely backed by 13.9% growth in exports to USA, which stood at $5.8 billion on account of stabilization or moderation in price erosion. Exports to USA account for about 30% of the total outbound shipments. Apart from this, shipments to other parts of the world except USA grew by 9.6% in FY19. Drug launches by Indian pharma companies is also believed to have aided the rise in export sales during the year.

Table 1: Pharma exports by India

	FY19		FY20*	
	$ billion	% change	$ billion	% change
Exports	19.2	10.8%	20.7-21.1	8%-10%

Source: CMIE
FY20* numbers are estimates

Outlook FY20

Pharma exports are expected to grow by 8%-10% and are likely to reach the level of $20.7 billion-$21.1 billion during FY20. The increase in exports will be backed by higher exports to USA, pharmemerging nations, developed nations and other nations. A stabilising price erosion environment is likely to aid pharma exports to USA. Moreover, the need for affordable healthcare in pharmemerging and developed nations are likely to support exports of branded generics to these countries. Also, rising per capita incomes in pharmemerging nations will contribute to the rise in branded generics exports from India.

In addition to this, patent expiry or loss of brand exclusivity is also expected to result in higher exports of generic drugs. Besides, the Indian pharma companies are likely to focus on development of specialty medicines or complex generics to augment their portfolio which will help increase the Indian companies to gain share in world exports.

On the domestic front, the industry is expected to grow at around 10%-12% and reach the level of $20.4 billion-$20.8 billion during FY20. This will be backed by growth in presence of chronic diseases, increasing per capita income, improvement in access to healthcare facilities and penetration of health insurance. These factors are expected to increase the volumes of Indian pharma industry and the volumes are likely to grow faster compared to total domestic market growth rate. However, bringing new drugs under Drug Price Control Order (DPCO) and National List of Essential Medicines (NLEM), imposing price ceiling on drugs and government focus to make medicines affordable are likely to restrict the growth in prices of drugs and, in turn, constrain the rise in value of Indian pharma industry during the year.

Considering the growth in domestic and export pharma market, we expect the Indian pharma industry to rise by 9%-11% to $41.1 billion-$41.9 billion by FY20.

2. Gems & jewellery

Review FY19

Table 2: Gems & Jewellery Trade

	Rs. billion			$ billion		
	FY18	FY19	% change	FY18	FY19	% change
Export	2,107.9	2,164.5	2.7%	32.7	31.0	-5.3%
Import	2,030.2	1,839.8	-9.4%	31.5	26.3	-16.4%

Source: Gems & Jewellery Export Promotion Council, CMIE

Imports of gems & jewellery declined by 16.4% to $26.3bn in FY19 compared with $31.5bn in FY18, while the fall in imports in rupee terms was lower at 9.4%, to Rs 1,839.8 bn in FY19 as compared to Rs 2,030.2 bn in FY18. The fall in imports was primarily due to lower imports of rough diamonds, which was marginally offset by higher imports of gold bars and jewellery.

The exports of gems & jewellery fell by 5.3% to $31bn in FY19 as compared to $32.7bn in FY18, while a rise in rupee denominated exports was marginally higher by 2.7% to Rs 2,164.5 bn in FY19 compared to Rs 2,107.9bn in FY18. The decline can be primarily attributed to lower gold (Medallions & Coins) and silver exports, which was mitigated by higher C&P diamonds and jewellery exports.

Table 3: Precious Metal Prices

	FY18	FY19	% change
Gold (Rs./10 gm)	29,304.3	31,191.1	6.4%
Gold ($/troy oz)	1,284.6	1,262.9	-1.7%
Silver (Rs./kg)	38,836.9	38,371.5	-1.2%
Silver ($/troy oz)	16.9	15.4	-8.9%

Note: Silver Prices ex Delhi
Source: CMIE

Gold prices for FY19 increased by 6.4% domestically but dropped by 1.7% internationally. Local gold prices rose due to domestic demand and a volatile rupee which has depreciated against the US dollar by around 6-7%. International prices fell due to the relatively strong dollar and higher global equity markets. In FY19, domestic and international prices of silver fell by 1.2% and 8.9%, respectively. This reduction could be attributed to reduced purchases by industrial units and coin makers.

Other Developments

- According to World Gold Council, central banks purchased 145.5 tonnes of gold in Q1CY19. Diversification and a desire for safe, liquid assets were the main drivers.
- RBI purchased 8.4 tonnes in Q1CY19 and its gold reserves reached 608.8 tonnes at the end March 2019.
- GJEPC plans to set up 'India Jewellery Park' in Navi Mumbai with investment of Rs 144.7bn.
- A spot gold exchange has been proposed to be set up and hallmarking is to be made compulsory
- Outstanding bank credit to the Gems & Jewellery industry stood at Rs 720 bn as of March 2019 which was lower by 0.9% compared with Rs 727 bn as on March 2018, O/s credit as of March 2018 had witnessed an increase of 5.3% over March 2017.

Outlook FY20

Even as the long term demand is expected to remain steady, short demand is expected to remain tepid as credit restrictions by banks; geopolitical tensions would continue to impact the diamond sector. Overall demand would see a growth of 6% - 7% in volume terms over a medium term.

The domestic gems & jewellery demand is expected to grow due to 1) safe haven appeal of gold due to volatility in equity markets, 2) anticipated near normal rainfall and hence harvest, 3) onset of festivals and wedding occasions

Fast changing lifestyle pattern and mall culture in Tier II and III locations as well as growing consciousness of branded jewellery in these locations is shifting demand from unorganized to organized players, thus paving the way for organized gems and jewellery companies to increase their penetration level in these markets.

- Share of national and regional players is expected to increase and the organized retail players are expected to maintain their margins with the help of changes in sales mix. Online sales are expected to account for a small share of the jewellery segment by FY22. Additionally, the relaxation of restrictions of gold import is likely to provide a fillip to the industry.

Exports are unlikely to witness significant growth in FY20 and would probably either remain flat or could even continue to fall as was the case in the past two years.

CARE Ratings believes the pressure on the profit margins for cut & polished diamond players would continue, as globally supply of rough diamonds is expected to continue to remain tight going ahead which could cause rough diamond prices to remain at elevated levels in the face of slowing funding lines from banks. Consequently, integrated players with strong sourcing relationships, better operating efficiencies, established marketing network, geographically diversified clientele and a conservative forex/working capital management policy are likely to benefit.

International gold prices could rise in FY20 as no increase is anticipated in the US Fed rate coupled with a relatively weaker US dollar. Tracking the international prices, domestic prices, too, are expected to rise even further on account of a depreciating rupee.

3. Paints

Review FY19

Sales of the paints industry companies increased by 11.3% during FY19 compared with FY18. This sales growth is based on the result of five paints companies. The rise in sales was on account of an increase in both, volumes and prices. The paint companies had undertaken price hikes during the year due to a rise in the prices of crude oil which averaged higher by 21.8% to $70.1 per barrel in FY20. A number of the inputs used in the manufacturing of paints are crude oil derivatives.

The sales growth of the paints companies however was restricted due to supply chain disturbances on account of a cut in GST rate on paints to 18% from 28% in July 2018. Besides this, a slowdown in automotive segment also constrained the rise in sales of paints companies during the year. Sales growth of auto industry slowed to 5.2% during FY19 as against 14.3% during FY18. The automotive segment drives the demand for industrial paints.

Outlook FY20

The paints industry is expected to grow by about 8%-10% during FY20. This will be backed by a normal monsoon, schemes for affordable housing, expected improvement in industrial output and revival in automotive segment during H2FY20. Moreover, with the BJP led government retaining power, the focus will continue to remain on infrastructure development in the country which will also augur well for the industry.

While the outlook for demand remains positive for paints industry for FY20, a cause of worry for the industry would be on the raw materials front given the volatility in prices of crude oil.

4. Telecom

Review FY19

The telecom industry's ARPU averaged Rs 69 during the first three quarters of FY19. This implies a fall of 15.2% compared with April-December 2018 when the ARPU was Rs 81. The prime reason for the decline in ARPU was the price war among the telecom companies which resulted in cheap availability of data services. The price for per GB data declined by a sharp 44.4% and averaged at Rs 10.5 during April-December 2018 compared to the average of Rs 18.9 during April-December 2017. The low prices, in turn, resulted in surge in average data usage per subscriber per month. Resultantly, the average data usage rose by a stupendous 337% to 8.7 GB as on December 2018 on a yearly basis.

The low-priced service is also believed to have added more subscribers to the broadband base. The broadband subscriber base grew by a strong 36.5% on a yearly basis to 563.3 million at the end of March 2019.

Outlook FY20

The industry ARPU averaged at Rs.69 during the first three quarters of FY19. Nevertheless, the ARPU is estimated to have improved to around Rs.109 for the March 2019 quarter primarily backed by minimum recharge plans introduced by the incumbents since Q3FY19. These plans have resulted in discontinuation of incoming-only customers or minimal ARPU customers thus reducing the subscriber base of incumbents.

The subscriber base of Airtel and Vodafone Idea fell by 4.3% to 329 million and 5.7% to 395 million, respectively, on a q-o-q basis during the March 2019 quarter. Despite the fall in subscriber base, the revenue continued to come from the revenue generating customers. This, in turn, pushed up the ARPU of Airtel and Vodafone Idea sequentially by 18.3% to Rs.123 and 16.3% to Rs.104, respectively, during the March 2019 quarter. Thus, the industry ARPU is estimated to have been more for the March 2019 quarter on a q-o-q basis.

For FY20, we expect the minimum recharge plans to stay and the trend in ARPU for March 2019 quarter to continue**. Thus keeping the base as Rs.109 we estimate the industry ARPU level to increase by 10%-12% to Rs.120-Rs.122 during the year FY20.** Also going ahead we expect tariff hikes to be undertaken by telcos which, in turn, will also support the rise in ARPU. In April 2019 release, we had estimated industry ARPU to average at Rs.76-Rs.77 for FY20.

In addition to this, the broadband subscriber data base is also expected to see an upward movement during FY20 backed by strong data consumption trend in India. Resultantly, **the broadband subscriber base is likely to reach the level of 685-695 million by March 2020, growth of 30%-32%.**

5. Cement

Review FY19

Production: Cement production grew by 13.3% to 337.3 million tonne (MMT) during FY19 vs 6.3% growth in FY18. This has been the fastest growth in production of cement recorded in one single year over the last decade. Overall capacity utilization for the sector was around ~71% during the year, which is a positive for the sector and is expected to drive investments over the next 3 years.

Key demand and prices drivers:

- Governments thrust on development of urban infrastructure, roads and highways, ports etc. coupled with steady demand from real estate especially segments like commercial realty, rural and affordable housing were the key demand drivers of cement.

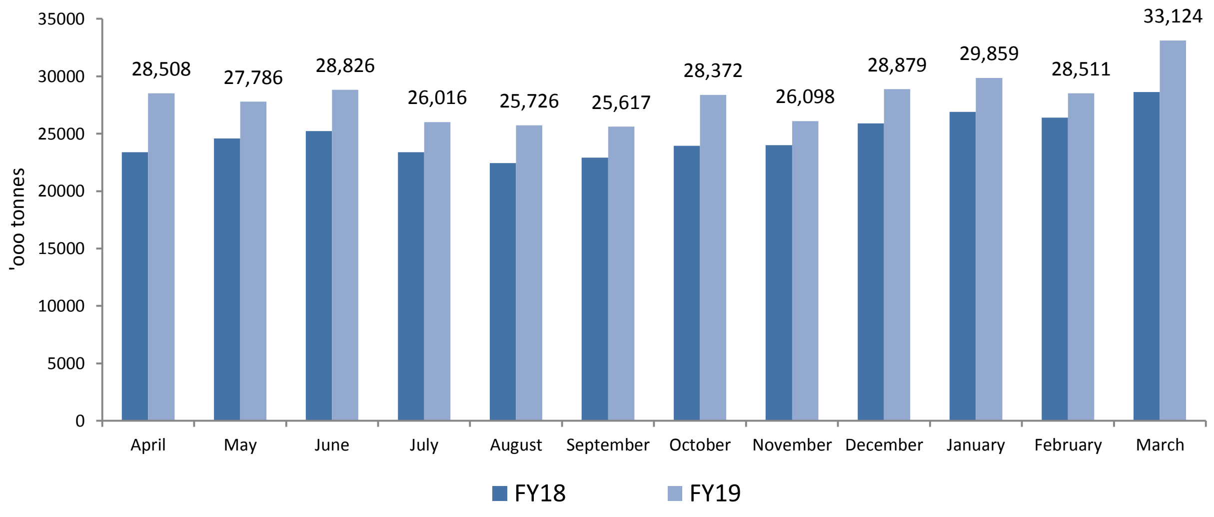
Table 4: Cement Production and Growth

(in million tonnes)	FY18	% change	FY19	% change
Total Cement Production	297.7	6.3%	337.3	13.3

Source: Office of The Economic Advisor

- The institutional demand for cement (infra and real estate) remained strong during the year. Implementation of key projects across infrastructure segments like roads, urban infrastructure and rural by the Government prior to General Elections led to strong cement demand. Cement volume growth from these segments of construction was strong across states like UP, MP, Delhi-NCR, Odisha, Bihar and Rajasthan etc.
- Retail segment demand was strong in the Southern States especially Kerala and Tamil Nadu. These states were affected by natural disasters which led to large-scale reconstruction in Q3 and Q4 of FY19. Demand from retail segment led to increase in prices of cement across these markets.
- In other regions especially northern and central, cement producers chose to partly pass-on increased costs of input materials like limestone, coke and coal, to consumers. A 2-5% increase in 50 kg bag has been reported across these regions.

Graph 1: Monthly Production (FY19 vs FY18 in '000 tonnes)



Source: Office of the Economic advisor

- Production growth sustained throughout FY19 over FY18 (month-on-month). Retail segment demand picked-up post monsoon/H2FY19.
- Destruction due to Cyclone Fani is also expected to drive demand in the coastal region of Eastern states namely Odisha and West Bengal in Q1 FY20.

Outlook FY20

- **We expect the cement production to remain steady with total production expected to grow by 5-7% during FY20.** Roads, Urban Infrastructure and Commercial realty would continue be the key demand drivers for cement. Southern and Eastern Region would continue to be major regional demand drivers.
- Prices are expected to remain stable. Retail segment demand would be key to strengthening of cement prices. **Eastern region may witness strengthening of cement prices followed by Western and Central Region.**