Manufacturing & Service industries FY19 Review & FY20 outlook (Part III): Paper, FMCG & IT

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This Report covers FY19 performance and FY20 outlook for three industries, namely Paper and paper products, Fast Moving Consumer Goods (FMCG) and Information Technology (IT).

Paper & Paper Products

Review of FY19

Imports of paper and paper products displayed an increasing trend till FY17 but subsequently declined in FY18. The growth in overall imports has been 13.7% for the FY05-FY17 period and 11.3% for the FY05-FY18 period. YTD (up to Jan) FY19 imports have also been subdued fell by 11.7% to 2,761 thousand tonnes and increased by 8.6% in value terms to Rs 183.3bn. The decline in quantitative terms is expected to sustain for overall FY19 in the near term as the increase in international pulp price made imports costlier thereby changing the cost economics in favour of domestic paper. Paper and paper products exports grew by 51.5% to 1,599.7 thousand tonnes and by 52.4% to Rs 113.2bn for the April -January 2019 period as compared to the year ago period.

Table 1: Paper and Paper Products Trade (April – January)

	000 Tonnes			Rs billion		
	FY18	FY19	% change	FY18	FY19	% change
Imports						
Paper	1,773.7	1,509.0	-14.9%	108.7	105.3	-3.2%
Newsprint	1,274.8	1,175.9	-7.8%	43.6	59.1	35.6%
Paper Products	78.4	76.1	-2.9%	16.5	18.9	14.7%
Total	3,126.8	2,761.0	-11.7%	168.8	183.3	8.6%
Exports						
Paper	824.8	1,321.7	60.2%	42.6	66.8	56.9%
Newsprint	5.2	11.3	115.1%	0.2	0.5	179.4%
Paper Products	225.7	266.7	18.2%	31.5	45.8	45.6%
Total	1,055.7	1,599.7	51.5%	74.3	113.2	52.4%

Source: CMIE

Table 2: Import of Recovered (Waste and Scrap) Paper or Paperboard (April – January)

	FY18	FY19	% change
Imports (Rs cr)	4,658.1	7,825.7	68.0%
Imports (million tonnes)	3.0	5.5	84.9%
Realization (Rs/kg)	15.6	14.2	-9.1%

Source: Department of Commerce (Ministry of Commerce and Industry)

The Chinese regulatory modifications in mid-2017 resulted in an increase in imports of recovered paper. Imports for April January period in FY19 have already increased by 68% and 84.9%, respectively in value and volume terms as compared to April November period in FY18. As a result, the impact of the decrease in the prices of this key raw material which roughly constitutes approx. 45-48% of the revenues is substantial and thereby has led to substantial margin expansions in the recent period for most paper players.

Table 3: International Prices ($/tonne)

	CY2017	CY2018	% change	Mar-19
NBSK Pulp	898	1,184	31.8%	1,080
Newsprint	557	669	20.1%	715
Softwood Chips	154	179	16.2%	188

Source: Economic Services Division, Govt. of BC, Canada

Domestic paper prices have risen marginally till date. For CY18, international pulp prices remained elevated due to 1) continued steady demand, 2) producer downtime and unplanned shutdown of some mills in Europe, 3) low inventories incl. unusually warm weather in Nordic countries have led to tighter supplies and 4) lower recovered fibre availability in China due to import restrictions of waste paper leading to less pulp from recycled material. However, in opening months of CY19, the prices have eased from their erstwhile high levels.

Other Developments:

- DGAD has recommended anti-dumping duty of difference between the landed value and $ 855 per tonne on uncoated paper imports. DGAD has also opined that this duty should continue for a period of three years from the date of notification by the central government.
- JK Paper acquired The Sirpur Paper Mills Ltd. through the IBC process during the financial year.

Outlook

Overall global demand is expected to remain subdued, with only demand in the packaging paper & board segment slated to increase, while other segments are expected to either grow slowly or remain at similar levels. For the Indian paper and paper products industry, growth is expected to be driven by a combination of factors such as 1) rising income levels, 2) growing per capita expenditure, 3) rapid urbanization and 4) a larger proportion of earning population which is expected to lead consumption. Despite increasing digitization, CARE Ratings expects that the overall paper demand to grow at 6 -7%.

- WPP segment demand is expected to grow at 4-5%. The demand is expected to grow on account of 1) improving literacy rates, 2) growing enrolment and 3) increasing number of schools and colleges.
- Packaging paper & board segment caters to industries such as FMCG, food & beverage, pharmaceutical, textiles, etc. Demand for Packaging Paper & Board segment is expected to grow at 8-9% due to 1) rise of e-commerce, 2) requirement of better quality packaging of FMCG products marketed through organized retail, 3) increasing demand for consumer durables, and 3) increasing preference for packaged food.

Going forward, wood prices and waste paper prices are expected to remain stable. The profitability of the players is expected to be healthy in the medium term due to 1) eased out cost side pressures, 2) improved realizations of finished goods, 3) comparatively lower imports of finished paper due to higher pulp prices, and 4) the ability of larger players to source local pulp at a competitive rate. Further, with healthy balance sheets of most players, capex plans have been announced which would commit internal accruals of the companies towards their capex plans and increase debt levels; though the capital structure and cash flow position for most players is expected to be comfortable. But it is also crucial that the industry dynamics remains favourable in the next 2-3 years as it will determine how the absorption of the enhanced capacities happens as they come on-stream. Also the continuation of the favourable pricing environment in the Indian context would enable a healthy generation of internal accruals that are required to be committed for the capex.

Fast Moving Consumer Goods (FMCG)

Review of FY19:

- Healthy performance was seen in sales and volume growth during the year, however it decelerated in the last few months of the year due to factors such liquidity crunch, slowdown in demand due to agrarian distress and slow job creation.
- With low rural penetration levels, growth in rural markets is usually ~30% higher than urban, however in the last quarter of FY19 it declined to ~10% due to the ongoing rural stress.
- Adversity in currency and crude prices impacted material costs, while inflation was offset up to a certain extent by price hikes in products.
- 'Premiumization' was one of the key strategies implemented to tap the growing middle-class segment. While this strategy is margin-accretive, it has limitations on volume creation.
- In the homecare category, increased penetration of dish washing bars was seen in rural markets and urban markets saw an upgrade to liquids.
- With seasonality playing a big role in this business, a prolonged winter season in certain parts of the country benefited sales of skin care products such as moisturizers and body lotions, while adversely impacted demand for certain food items such as ice creams and beverages in the last quarter of the year.
- Commodity prices have been benign, which led companies to reduce prices on certain items like soaps and pass on benefit to consumers.
- FMCG players increased their digital advertising spends, albeit traditional spends still remained sizeable.
- Several FMCG players are increasing presence in E-commerce space, to strengthen supply chain network by expanding in new markets.

Food products witnessed steady production growth of ~12% in FY19, compared with 9.4% in FY18. Production performance of essential food products is as below:

- Dairy products - Milk power, ice-cream, milk and butter grew ~7.2%, 5.9%, 4.5% and 1.2% respectively in FY19. However, such growth is almost half when compared with FY18. Ghee saw a marginal fall of ~1%, though better than the decline of ~8.3% in FY18.

- Tea - ~1.34 million tonnes (MT) of tea was produced in CY18, out of which ~1.1 MT were domestically consumed and ~0.27 MT was exported; imports were marginal at 0.02 MT. FY19 witnessed the lowest production as well as consumption growth of ~1.3% and 1.1% respectively in past three years. All India monthly average tea prices remained in the range of Rs.100-150/kg in CY18.

  High labor costs and significant rise in realizations to cover increased expenses impacted margins of organized bulk tea players during recent months. While input costs rose, tea companies were unable to raise prices, due to built-up stock existing in the market.

- Coffee - From Oct-17 to Sept-18, ~0.32 MT of coffee was produced in India, which includes 70% of Robusta and rest of Arabica. This is a yearly growth of ~1.3%, compared with a fall of 10.3% in same period last year. During the year, imports grew 6% to 0.08 MT, while exports declined 1.6% to 0.29 MT.

- Sugar – Sugar mills across the country produced 32.12 MT of sugar from Oct-18 to Apr-19, growth of 3% over CPLY. With drop in number of working sugar mills to 100, sugar production from May to Sept-19 will be much less than what was produced from May to Sept-18.

  However, in northern India and other states like Maharashtra and Karnataka, sugar recovery has been substantially better than what was achieved in the last season. Therefore, even though the quantum of sugarcane crushing in the current season is less than that of last season, the sugar production in Oct-18 to Sept-19 is expected to be marginally more than last year.

- Vegetable oils - Import of vegetable oils including edible and non-edible summed to 7.5 MT from Nov-18 to Apr-19, a growth of 3.1% over CPLY. This includes 7.2 MT of edible oils and rest of non-edible oils.

- Confectionery – Manufacture of chocolate and cocoa powder grew by 3.1% in FY19, against 1.7% in FY18, while, sweetmeat and sugar confectionery grew 1.9% in FY19 compared with decline of 2% in prior year.

- Processed food – Among processed food items, yearly growth was seen in products such as honey, fruit pulp and fruit juices, spices and instant food (ready to eat). While, de-growth was witnessed in bottled water, aerated drinks and soft drinks, pickles and sauces, jams, jellies, marmalades and puree and molasses.

- Bakery products – Breads, buns and croissant production declined 0.9%, biscuits and cookies grew marginally 0.2% and cakes, pastries and muffins fell by 6.3%.

- Meat and edible meat offal – This category which include poultry, buffalo and goat meat showed a negligible growth of 0.03% during the year. The exports of poultry products posted 7-year high growth rate of 24.5% in FY19.

- Milling products – Maida, wheat flour (atta), wheat bran, gram flour (besan) and rawa (sooji) saw a fall in production in FY19 by 3.1%, 1.3%, 1.3%, 11.7% and 2.7% respectively. Except for rawa, production of all other products is on a decline since past three years.

- Consumer goods – Growth in production of hair oil, hair dye, creams and lotions has plummeted further during the year, however shampoo, fragrances and oil essentials posted double digit growths. Soaps and detergents registered low single digit growth, while toothpaste and agarbatti saw a fall. Prolonged winter season in north India and category slowdown impacted growth of hair oils.

Table 4: Annual growth in production of consumer goods (%)

Item	FY18	FY19
Soaps	-3.1	3.3
Detergents	-6.1	2.2
Toothpaste	-26.4	-3.2
Hair dye	-7.1	-34
Hair oil	-0.5	-4.1
Hair shampoo	9.6	15
Creams and lotions	-29	-62.7
Agarbatti	-13.1	-5.3
Fragrances and oil essentials	7.2	14.2

Source: CMIE

Outlook for FY20

Given the possible headwinds in macro-environment linked with economic growth including monsoon prospects, we expect near-term moderation in growth, while medium term outlook remains positive for the FMCG industry. The industry is expected to grow by 11-13% in FY20. However government initiatives for boosting rural income and improving consumer sentiments, along with a good monsoon shall play a pivotal role for performance of FMCG industry during this year.

With rural markets contributing a significant portion of 45% of the industry's revenues, initiatives such as rise in Minimum Support Price (MSP), direct income distribution, etc. shall help boost demand of rural and semi-rural consumers.

India Meteorological Department's (IMD) forecast of near-normal monsoon at 96% of long period average is expected to bring better yield of crops for farmers and thereby improve their spending power (especially in H2-FY19) which will benefit sales of non-durable goods.

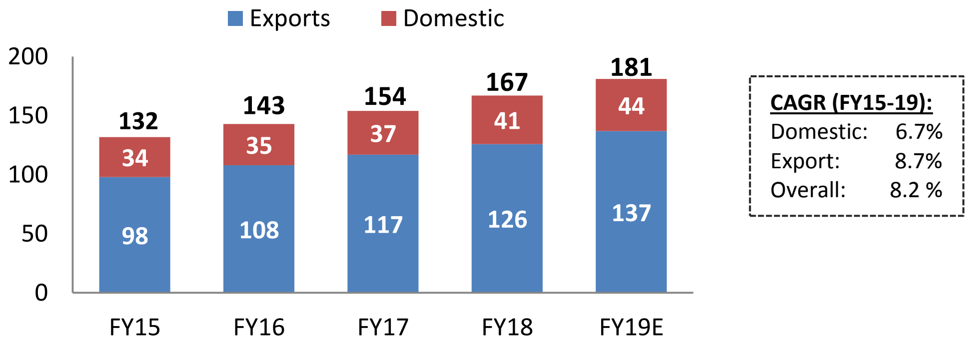
In addition to this, factors such as improvement in distribution network, increased presence of FMCG players in E-commerce space, robust advertising spends, affordable and smaller packaging, etc. shall help uplift sales of FMCG in the coming months.

Information Technology (IT)

Review of FY19:

- Indian IT-ITeS industry is estimated to have grown by 8.4% to USD 181 bn in FY19. Export revenues have ~76% share, with Americas continuing being the largest contributor followed by Europe, India and rest of the world. As seen in chart 1, the industry has clocked a healthy CAGR of 8.2% in the past five years. Strong deal wins, broad-based growth across verticals and geographies, in addition to favorable currency movement helped drive positive growth for the industry in FY19.

Chart 1: Indian IT-ITeS industry revenue (USD bn)



- About 51% of the industry's revenues came from IT services, followed by Business Process Management (20%), engineering R&D (16%), hardware (8%) and products (5%).

- Digital has been one of the biggest drivers of revenue growth for companies. In FY19, digital revenues of the industry accelerated to USD 33 bn, sharp growth of ~30% Y-o-Y.

- Largest industry verticals by revenue generation are BFSI, manufacturing, retail and consumer business, life sciences, communication, media and tech, however BFSI has lately showed signs of deceleration and expect lower spending from clients in US and Europe in the coming year.

- With IT services companies wining work contracts worth billions of dollars, the industry added ~170,000 new hires (net) during the year. Alongside, there is an increasing demand for individuals who can work on new-age technologies such as data science, machine learning, artificial intelligence, Internet of Things (IoT), cyber security, etc. and companies are willing to pay premiums salaries to hire such skills. Also, companies have increased their emphasis to skill existing employees and therefore, raised their learning and development budgets by ~20-25% during the year.

- With clients looking for digital transformation of their businesses, the following technologies are in high demand:
  - Artificial Intelligence and advanced analytics
  - Blockchain
  - Cloud and cyber security
  - Devices and Internet to Things (IoT)
  - Augment Reality (AR) / Virtual Reality (VR) / Mixed Reality (MR), etc.

- For many years India has been one of the biggest beneficiaries of the H-1B visa, which allows foreign workers to be employed in US in specialty occupations. The US administration has of late imposed several restrictions on non-immigrant visas, to protect wages and job opportunities of US workers. This has compelled Indian IT majors to increase local hiring in US, leading to an escalation in employee costs and adversely impacting their cost structures. In FY18 (Oct-17 to Sept-18), three out of top five companies with highest H-1B visa denials were Indian. For this, companies shall have to materially reduce their dependency on work visas and go for increased local hiring and use contractors.

Outlook for FY20:

According to World Bank, global economy growth is projected to soften to 2.9% in 2019, amid rising downside risks in the coming months and with the Indian IT industry being largely export driven, any adverse changes in the global macro-environment is bound to have an impact on its revenues.

Clients derive a material portion of their revenues from customers' discretionary spending which is linked to their business outlook. Political disruptions or volatile economic conditions shall lead to reduced spending, which could restrict revenue growth opportunities for Indian IT companies.

We expect Indian IT industry growth to moderate between 7-9% in FY20, owing to macro uncertainties and expectation of lower spending growth in budgets in verticals like BFSI. Increasing restrictions on H-1B visas in the US and rising cost of delivering on-site services shall impact margins in FY20.

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