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

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Overview

As FY19 has come to an end, we provide a quick recap of performance of major industries in the manufacturing & service sector during the year compared with the previous year. Performance of the industries is based on the production and sales as major indicators. Besides, the study also covers other indicators such as consumption, prices, trade data, etc. for relevant industries.

Industry wise performance FY19 & outlook FY20

The following industries have been covered in the study:

1. Auto & Auto ancillary (including tyres)
2. Consumer durables
3. Hospitality & Tourism

Automobiles

Table 1: Automobiles sales & exports

(Numbers)	Auto Sales			Auto Exports		
	FY18	FY19	Growth (%)	FY18	FY19	Growth (%)
A. Passenger vehicles	**4,038,552**	**4,058,656**	**0.5**	**749,971**	**680,593**	**(9.3)**
Passenger cars	2,754,177	2,732,461	(0.8)	580,153	513,912	(11.4)
Vans	194,131	221,455	14.1	1,896	4,029	112.5
MUVs	1,088,639	1,099,713	1.0	166,317	158,252	(4.8)
Quadricycles	1,605	5,027	213.2	1,605	4,400	174.1
B. Commercial vehicles	**953,781**	**1,107,250**	**16.1**	**96,865**	**99,931**	**3.2**
M&HCVs	384,874	439,414	14.2	44,093	48,674	10.4
LCVs	568,907	667,836	17.4	52,772	51,257	(2.9)
C. Two & Three Wheelers	**24,031,820**	**25,730,931**	**7.1**	**3,196,005**	**3,848,530**	**20.4**
Two-wheelers	23,015,120	24,462,231	6.3	2,815,003	3,280,841	16.5
Three-wheelers	1,016,700	1,268,700	24.8	381,002	567,689	49.0
Total (A+B+C)	**29,024,153**	**30,896,837**	**6.5**	**4,042,841**	**4,629,054**	**14.5**

Note: MUVs - Multi utility vehicles, M&HCVs – Medium & heavy commercial vehicles, LCVs – Light commercial vehicles
Source: CMIE

- In FY19, automobile industry witnessed a y-o-y lower sales growth of about 6.5% y-o-y (vis-à-vis 14.5% in FY18) **led by liquidity crunch, uneven monsoon, increased insurance cost, higher fuel costs and growing influence of shared mobility in the country** while the exports grew by about 14.5% during FY19 vis-à-vis a growth of 16.1% in FY18.
- In terms of sales, the sharpest growth of over 16% was witnessed in commercial vehicle sales followed by a 7.1% growth in two & three wheelers. Passenger vehicles registered a meagre growth of about 0.5% y-o-y in sales during the period.
- Two & three wheelers witnessed the sharpest growth of 20.4% in exports during the year followed by commercial vehicles that registered a growth of about 3.2% y-o-y.
- Exports of passenger vehicles, however, declined sharply by 9.3% y-o-y during FY19 led by decline in exports of passenger cars and MUVs. Overall exports witnessed a y-o-y subdued performance led by slowdown across many key foreign markets such as Mexico, South Africa, Peru and UK.

Major policies announced during FY19:

- Load carrying capacity of heavy vehicles (including trucks) raised by 20-25%
- The Insurance Regulatory and Development Authority of India (IRDAI) introduced two new sets of rules in October 2018 where the total outflow towards insurance has gone up in 2 ways –
  - upfront payment of insurance premium and
  - increase in compulsory personal accident cover for owner under motor insurance policies from Rs 2 lakh to Rs 15 lakh.
- FAME II scheme gets a Rs 10,000 crore clearance from the Union Cabinet

Outlook FY20

Table 2: Growth in sales

Vehicle Category	FY20*
Passenger Vehicles	4-6%
Commercial Vehicles	12-13%
Two & Three Wheelers	10-12%
Tractors	11-13%

Note: * – Estimated

- In FY19, with a high base of FY18 post demonetization and GST and implementation of BS IV norms in April 2017, the auto industry witnessed a slower growth of about 6.5% in sales (including PVs, CVs and two & three wheelers) vis-à-vis a double-digit growth of 14.5% during FY18.
- Going forward in FY20, a revival in demand is expected during H2 with various planned product launches in the passenger vehicle segment along with pre-buying on account of BS VI emission norms to be implemented on April 1, 2020.
- Manufacturing cost is expected to increase by about 12-15% for passenger vehicles and about 15-20% for commercial vehicles to meet the new BS VI emission norms along with the new safety norms. Also, with introduction of electric vehicles, the cost of production is expected to increase significantly. However, the OEMs will not be able to pass on this increased total cost burden immediately on account of subdued market conditions.
- Also, demand is expected to remain muted during H1 FY20 with general elections to be held in the country during April – May 2019. Post this, the demand is expected to increase on back of various initiatives taken by the government for the Agriculture and Infrastructure sectors along with increased disposable income in the hands of rural populace. Also, festive season during FY20 is expected to comparatively better than in FY19.
- The pickup in construction and mining activities along with increased inter-state movement of goods with the streamlining of e-commerce and FMCG and pre-buying of commercial vehicles is expected to further boost demand for the segment. However, the recent policy revision by the government (increasing the load carrying capacity for heavy vehicles) could weigh on CVs demand and the high growth witnessed in FY19 could slightly moderate going forward.
- The government has announced to totally skip Bharat Stage (BS)-V norms and adopt BS-VI norms by April 2020 for cars for fighting pollution, poses a challenge to the domestic manufacturers. Many manufacturers have already started setting up plants for production of BS-VI complaint vehicles. However, the availability of auto components and higher grade fuel for these vehicles is of high concern as using BS-VI fuel in the current BS-IV engines or running BS-VI engines on the current-grade fuel, may be not be effective in curbing vehicular pollution, and may wreck the engine in the long run. Manufacturers are also setting up units for manufacturing electric vehicles (EVs) and many EVs are planned for launches (mostly in two & three wheelers segment) in the coming months during FY20.
- Over the past few months with the liquidity crisis in NBFCs and resultant slowdown in credit financing, disbursements for automobile industry is expected to remain slightly under pressure during H1 FY20.

- However, with RBI bringing down the repo rate to 5.75% from 6% in June 2019, the lower interest cost is expected to provide some stimulus to the auto demand.

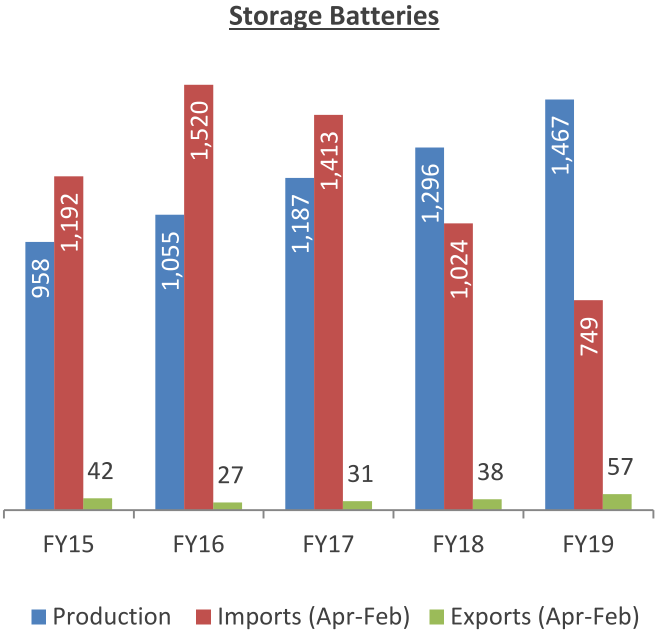
Main drivers for these growth rates:

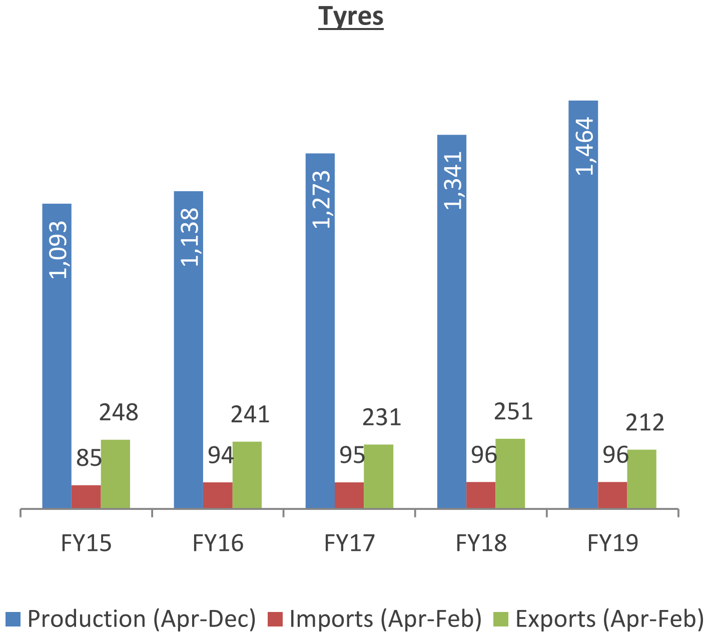
- GDP growth to be higher at 7.2% in FY20 vis-à-vis 6.8% in FY19 (CARE Ratings Estimate)
- Expected normal monsoon and improved farm activities
- Repo rate reduced third time in a row by RBI to 5.75% (June 2019) with further possibilities given the accommodative stance taken this time
- Increased infrastructure and industrial activities

Segment	Principal Drivers
Passenger vehicles	Higher growth in GDP, higher disposable income
Two and three wheelers	Higher GDP growth, normal monsoon, higher disposable income, higher farm incomes
Commercial vehicles	Pick up in industrial production, higher GDP growth
Tractors	Normal monsoon, higher farm incomes

Automobile components

Chart 1: Production, Imports & exports of auto components (Lakh units)

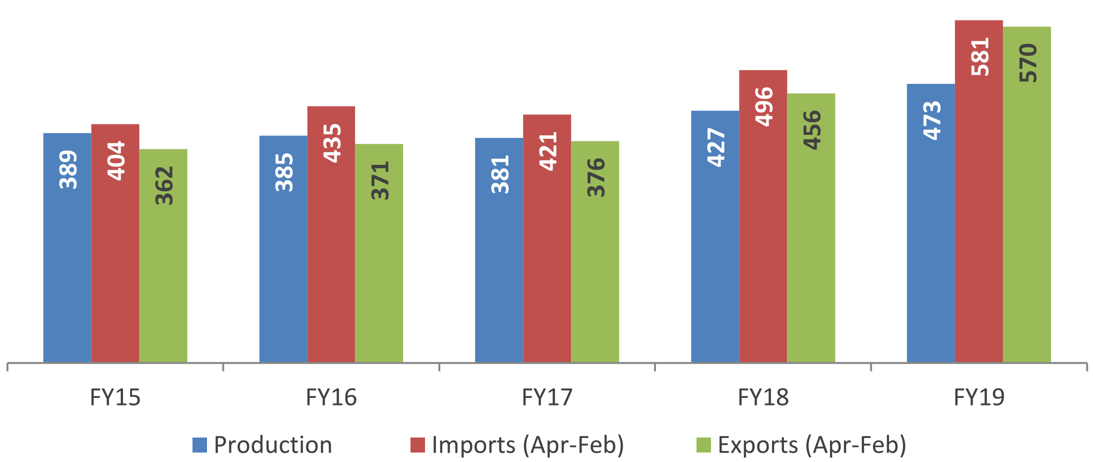




Source: CMIE

Production of all auto components witnessed an increase during FY19 led by increased production of automobiles during the year. Production of automobiles increased by about 6.3% y-o-y (vis-à-vis 14.8% in FY18) in FY19. The slower growth in automobile production was on account of weak demand in the domestic market led by liquidity crunch, higher interest and insurance costs.

Chart 2: Production, Imports & exports of other auto components (Rs Billion)



Note: Other auto components include – Parts and Accessories of the Motor Vehicles, Drive Transmission and Steering Components, Suspension & Braking Parts, Pumps for Internal Combustion Piston Engines, Bumpers for Tractors, Parts of Spark-ignition Engines, Starter Motors & Dual Purpose Starter Generators
Source: CSO, DGCIS, CMIE

Outlook FY20

- Going forward, auto comp industry is expected to witness a growth of **about 12-14% going forward on back of increased demand from domestic as well as exports market**. Also, with new stringent emission norms and electric vehicles production in the domestic market, a range of updated as well as new auto comps is expected to enter the market driving the demand.
- Also, demand from replacement market and exports is expected to register a healthy growth during led by these change in various norms in the country

Investments & developments in Auto & auto ancillary industry

- Hyundai is planning to invest US$ 1 billion in India by 2020. SAIC Motor has also announced to invest US$ 310 million in India
- Mercedes Benz has increased the manufacturing capacity of its Chakan Plant to 20,000 units per year, highest for any luxury car manufacturing in India
- As of October 2018, Honda Motors Company is planning to set up its third factory in India for launching hybrid and electric vehicles with the cost of Rs 9,200 crore (US$ 1.31 billion), its largest investment in India so far
- In November 2018, Mahindra Electric Mobility opened its electric technology manufacturing hub in Bangalore with an investment of Rs 100 crore (US$ 14.25 million) which will increase its annual manufacturing capacity to 25,000 units
- Mahindra & Mahindra (M&M) to invest Rs 10 billion over the next 12 months to upgrade its portfolio to BS-VI technology
- As of January 2019 Lite Auto Components Pvt Ltd, a part of Hindustan Magnesium Products Pvt Ltd plans to invest Rs 500 crore (US$69.30 million) to set up Magnesium-based manufacturing plant in Andhra Pradesh
- As of December 2018, German automotive major Continental has planned investments of Rs 180 crore (US$ 25.65 million) for setting up a premium surface materials facility in Pune. The facility will have an initial capacity of five million square metres and is expected to start production in 2020

Source: IBEF, Industry

Consumer Durables

Table 3: Production of consumer durables

(000 Numbers)	FY18	FY19	Growth (%)
Air- conditioners	3,808	3,524	(7.5)
Refrigerators	13,495	15,614	15.7
TV Sets	5,261	3,315	(37.0)
Telephones & mobile instruments	67,206	65,919	(1.9)
Washing & laundry Machines	6,245	6,891	10.3
Fans	25,443	27,755	9.1
Electric cooking appliances	2,024	2,340	15.6
Electric water heaters	103	59	(42.5)
Electric filament type lamps	839	564	(32.8)
Fluorescent tubes & CFLs	229,921	162,279	(29.4)
Incandescent lamps	634,770	545,488	(14.1)

Source: CMIE

- With weather fluctuations in FY19, extended heavy rainfall in some parts of the country, extreme cold weather in the North, demand for air-conditioners and electric heaters and lamps was hit registering a decline of about 7.5%, over 40% and over 30% respectively in production during FY19. However, demand for refrigerators witnessed a y-o-y growth of over 15% during the year.
- Demand for consumer durables has remained largely subdued during the year on back of overall weak consumer sentiments. Rural demand lagged due to lower incomes during harvest time in some regions.
- Production of television sets (TVs) was minimal in India with majority of players importing TV sets or parts and assembling them to sell in India. However, after the change in the duty structure earlier in FY19 it would make local manufacturing cheaper by about 5-7%, local production of high end premium category OLED and 4K models at component stage has been started. Companies are also locally assembling panels and making printed circuit boards (PCBs) and moulds.

Major policies announced:

- The Ministry of Electronics & Information Technology released a draft National Policy on Electronics Policy in October 2018
- New ‘Consumer Protection Bill, 2018’ has been approved by the Union Cabinet in December 2018 and will replace the existing Consumer Protection Act of 1986 ("Act")
- GST on Monitors and TVs of up to screen size of 32 inches, power banks of lithium ion batteries, digital cameras and video cameras brought down to 18% from 28%

Investments

- A global design and development centre by Johnson Controls-Hitachi Air Conditioning India is expected to be set up in India with an expected investment of Rs 1.4 billion, June 2019

- Blue Star is aiming to double its capacity to one million units per annum by 2022. This increase in capacity will happen post the commissioning of the proposed plant in Andhra Pradesh. The company is targeting to start work on the Rs 1.8 billion plant in Andhra Pradesh by 2021
- Livpure is set to venture into the air-conditioners market in India. The company plans to launch a range of smart air-conditioners with air purification functions in FY20
- Daikin India is in the final stages of commissioning its third manufacturing facility in South India
- Unilever-owned company Blueair aims to expand in the Indian indoor air purification market by utilising the distribution and sales strength of Hindustan Unilever (HUL)
- Blue Star plans to commission its greenfield plant in Sri City, Andhra Pradesh by the FY22, according to the company's JMD B Thiagarajan. He further stated that the company aims to commence construction of the plant by FY21. The installed capacity of the unit is expected to be 500 thousand units per annum

Source: IBEF, Industry

Outlook FY20

- Historically, growth in consumer durables has closely related with the growth in GDP. Going forward, as country's GDP is expected to improve to 7.2% in FY20 (CARE Ratings expectations) from 6.8% in FY19, we expect the consumer durables market to register growth of about **6.5-8.5%** on back of improvement in domestic consumption.
- Demand for durables like refrigerators and other consumer electronic goods are likely to witness growing demand in the coming years in the rural markets with the government planning to invest significantly in rural electrification. Under the Budget Scheme FY19, the government retained its focus on rural economy by continuing the pro-poor and pro-farmer schemes.
- The government's focus on **rural electrification** under the Deendayal Upadhyay Gram Jyoti Yojana (DDUGJY) with total outlay of Rs 756 bn (US$ 12 billion) over FY14-19 and **Power For All** (a joint initiative by Government of India (GoI) and state governments) with the objective to make power available to all and facilitate 24X7 power supply has been one of the key drivers for strong growth in the consumer durables industry. With increasing number of villages being electrified each year and the government's target to achieve Power for All by FY19; ***CARE Ratings expects demand for consumer durables to register a growth rate of about 6.5-8.5% on back of expected improvement in GDP during the year.***
- The previously underserved regions in India have come into coverage now with government initiatives towards urbanization and transmission network augmentation along with electric supply channels. Also, the wide usage of online sales among the youth and working age population has boosted the demand for durables. Not to miss, consumer durable is one of the most sought-after products, especially during the festive season. Furthermore, when it comes to TV, the digital disruption of the television industry is at its peak. Streaming video is changing every existing relationship in the TV value chain, redefining the role of TV from the traditional eco system.
- *Also, with* ***growing awareness, easier access to credit and lower interest rates****,* ***improving standard of living and changing lifestyles, higher disposable incomes*** *in the hand of rural population on back of possible* ***higher MSPs for kharif crops*** *to be announced this season and expectations of* ***normal monsoon*** *during FY20, the consumption is expected to register a growth going forward.*

Hospitality & tourism

At the close of 2018, the country saw macroeconomic stability owing to a decline in inflation, current account deficit etc. However the expected growth in economic activity tended to be slower with industrial production slowing down. Corporate activity was stable in terms of overall growth in sales which had a positive bearing on the hospitality industry.

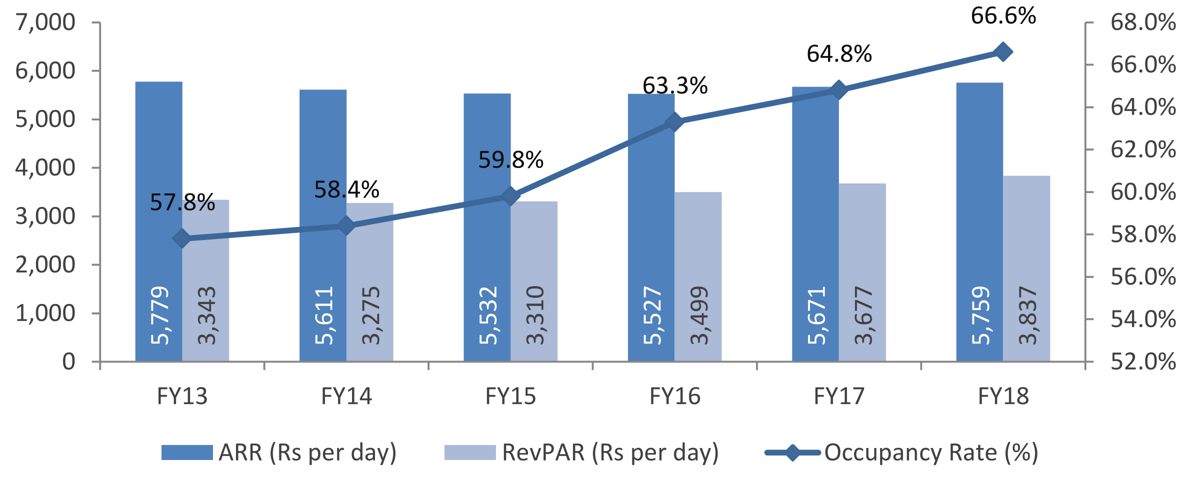
Performance of major markets in India (11 cities)

The Overall average Occupancy rates (ORs) increased by about 180 basis points y-o-y during FY18 in 11 major cities in India. ORs increased from 64.8% in FY17 to 66.6%% in FY18 on back of increased demand from domestic and foreign travellers for business and leisure activities. However, the average room rates (ARRs) increased by only about 1.6% during the same period to Rs 5,759 per day due to stiff competition faced by players in the market. This increase in ORs and ARRs led to the all India RevPAR performance of major markets to record a growth of about 4.4% over the preceding fiscal and reach Rs 3,837 per day in FY18. This rate was last achieved in the year FY11.

Occupancy rates (OR):
ORs for 5 star hotels witnessed the sharpest growth of about 240 basis points y-o-y during FY18. This was followed by 3 star hotels that registered a growth of about 200 basis points and 4 star hotels that registered a growth of 180 basis points during FY18 while the 5 star D hotels witnessed lower growth of only 110 basis points y-o-y. 2 star hotels however, witnessed a decline of about 10 basis points in their occupancy rates during the year.

Average Room Rates (ARR):
Despite registering a decline in occupancy rates, 2 star hotels witnessed the maximum growth in the group in average room rates increasing by about 8.5% y-o-y during FY18. This was followed by 3 star hotels that registered a growth of about 5% y-o-y in FY18. 4 star and 5 star D hotels recorded a growth of 3% y-o-y each in average room rates. 5 star hotels, however, registered the lowest growth about 1.8% y-o-y in the group during the year. This may be attributed to the gradual escalation of commercial activity in Tier II and Tier III cities as well as increased domestic travel.

Chart 3: Performance of Hotels – Overall average



Source: Hotelivate

RevPAR:

Each star category witnessed a y-o-y increase in RevPAR in FY18, with the 3 star category leading the pack, recording a 8.2% growth during the year. The improvement in RevPAR across all star categories can be attributed to both occupancy and average rate, with the exception of 2 star hotels.

Table 4: Existing inventory (Major cities and across categories – Only branded)

Sr no.	City	Existing inventory at the end of			Y-o-y Growth	CAGR
		2012-13	2016-17	2017-18		
1	New Delhi*	16,738	20,981	22,159	5.6%	5.8%
2	Mumbai	12,807	13,494	13,726	1.7%	1.4%
3	Bengaluru	8,536	11,995	12,659	5.5%	8.2%
4	Chennai	6,330	8,332	9,211	10.5%	7.8%
5	Hyderabad	5,411	6,254	6,772	8.3%	4.6%
6	Goa	4,406	6,400	6,741	5.3%	8.9%
7	Pune	5,317	6,445	6,330	-1.8%	3.5%
8	Jaipur	4,129	5,058	5,426	7.3%	5.6%
9	Kolkata	2,163	3,199	3,860	20.7%	12.3%
10	Ahmedabad	2,477	3,117	3,393	8.9%	6.5%
11	Agra	1,299	2,092	2,260	8.0%	11.7%
	Total	**69,613**	**87,367**	**92,537**	**5.9%**	**5.9%**
12	Other Cities**	24,642	31,852	35,626	11.8%	7.7%
	Total	**94,255**	**119,219**	**128,163**	**7.5%**	**6.3%**

Note: *NCR includes New Delhi, Noida and Gurugram

** Other cities includes all other hotel markets across India

Source: Hotelivate

Upcoming Supply

The future supply landscape is ever-changing and subject to several external forces that may often delay project openings. It is noteworthy that the pipeline for proposed supply totaled 114,466 rooms back in FY08 – the highest in a decade, whereas in FY18 it contracted significantly to just 49,380 rooms.

Table 5: Proposed Branded Hotel Rooms across Major Cities and Categories (FY18 – FY23)

	Existing Supply (FY18)	Proposed Supply*	Increase in Future Supply	Luxury	Upscale	Upper-Midmarket	Mid-market	Budget
Agra	2,260	428	19%	0.0%	0.0%	7.5%	65.0%	27.5%
Ahmedabad	3,393	1,343	40%	22.9%	27.4%	37.7%	4.3%	7.7%
Bengaluru	12,659	5,698	45%	17.3%	28.0%	22.8%	13.3%	18.6%
Chennai	9,211	978	11%	11.2%	12.0%	50.0%	26.8%	0.0%
New Delhi	14,724	1,492	10%	14.3%	26.3%	28.6%	5.6%	25.2%
Gurgaon	5,920	1,727	29%	0.0%	34.9%	9.7%	19.3%	36.1%
Noida	1,515	1,174	77%	0.0%	0.0%	51.6%	26.6%	21.8%
Goa	6,741	3,028	45%	0.0%	24.4%	28.1%	30.0%	17.5%
Hyderabad	6,772	1,149	17%	25.2%	0.0%	41.7%	10.4%	22.7%
Jaipur	5,426	1,086	20%	4.3%	23.0%	38.6%	30.5%	3.6%
Kolkata	3,860	1,768	46%	27.7%	8.9%	35.4%	10.3%	17.7%
Mumbai	13,726	4,039	29%	16.4%	13.4%	39.7%	11.4%	19.1%
Pune	6,330	894	14%	28.0%	15.5%	30.1%	11.2%	15.2%
Other cities	35,626	24,576	69%	4.7%	16.1%	31.3%	28.8%	19.1%
Total	128,163	49,380	39%	9.1%	17.9%	31.3%	22.8%	18.9%

Note:*Proposed Supply includes 7,210 rooms which have been open for less than six months, and therefore, not included in the existing supply
Source: Industry, Hotelivate

Foreign Tourist arrivals (FTA)

Chart 4: FTA trend (in million)

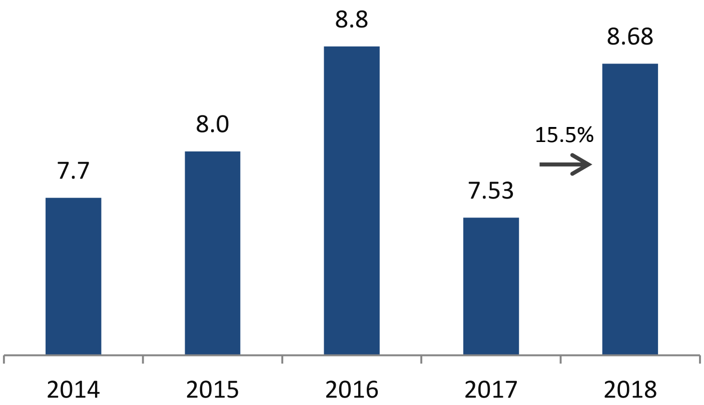
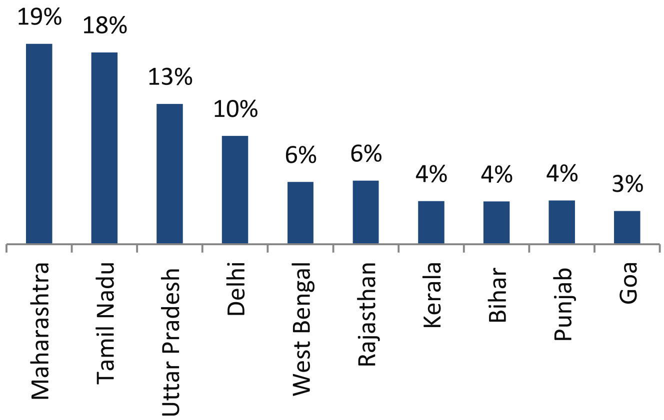


Chart 5: State-wise Percentage share of Total FTA



Source: Ministry of Tourism

Outlook FY20

- Going forward, CARE expects the industry to register an overall healthy growth on back of economic growth due to recovery in the global conditions resulting in higher movement in the MICE segment and consistently growing middle class along with increasing disposable income. There are various other key factors that drive the market, including

India's attractiveness as a medical tourism destination; steadily growing Meetings, Incentives, Conferences and Exhibitions (MICE) segment; and, an increasing fondness among millennial to travel.

- On back of positive sentiments and expected pickup in demand, **we expect the momentum to pick up and the industry to register a growth of about 7-9% in revenues for FY19 & FY20.**
- The expected future inventory in 11 major markets (across categories - only branded) is lower at around 49,380 rooms for the next 5 years (FY18 to FY23). Therefore, with increasing demand on back of improvement in economic activities and lower room additions, **we expect the major markets in the industry to sustain the average room rates (ARRs) going forward and grow at an average of 3.5-4.5% per annum. Also, we expect the occupancy to inch up to an average of about 68-70% by the end of FY23 compared with 66.6% in FY18.**
- **Accordingly, the hotels industry is expected to see an increase in room revenue at the rate of about 10-12% CAGR over the next 5 years.**
- The sector also faces several challenges in terms of complex regulatory environment and inadequate tourism infrastructure.
- Goods and Services Tax (GST) has been implemented from July 1, 2017, with the aim of replacing the indirect taxes on all goods and services. Initially, room tariff above Rs 5,000 was to attract the higher tax rate of 28%, however, this has been revised now and only tariff above Rs 7,500 would fall in the highest tax slab under the GST regime. Accordingly, we at CARE Ratings believe that the effective tax rate would not have any major impact on the Average room rates (ARRs) and Occupancy rates (ORs) of the hotels given GST players would be able to avail the input tax credit for both goods and services.