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Industry Update and insights

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Automobiles

Chart 1: Auto sales - Q1 (in numbers)

Sales Q1	FY16	FY17	FY18	Y-o-Y Growth	
				FY17	FY18
Passenger cars	795,188	856,748	908,634	7.7%	6.1%
Commercial Vehicles	172,154	193,220	169,133	12.2%	-12.5%
2W & 3W	4,840,821	5,325,601	5,745,696	10.0%	7.9%
Tractors	162,415	182,018	196,582	12.1%	8.0%

Source: CMIE

- PV manufacturers started the year with strong sales as most of the car players reported double-digit growth in sales on a y-o-y basis in April and May 2017. However, in June 2017, sales slowed down and saw a decline of about 6% y-o-y as most of the manufacturers and dealers realigned their inventories ahead of the nationwide implementation of GST (Goods & service Tax) from July 1, 2017.
- However, in CV segment, sales saw a sharp de-growth of about 29% in medium and heavy vehicles (M&HCV) while sales of small CVs remained stable during the quarter. This was on account of a transition to GST during the quarter and uncertainties related to it, which kept buyers away from making purchases.
- Tractors demand is expected to pick up on back of normal monsoon and stable interest rates

GST Impact:

- The tax incidence for most categories of vehicles has gone down post GST implementation in July 2017

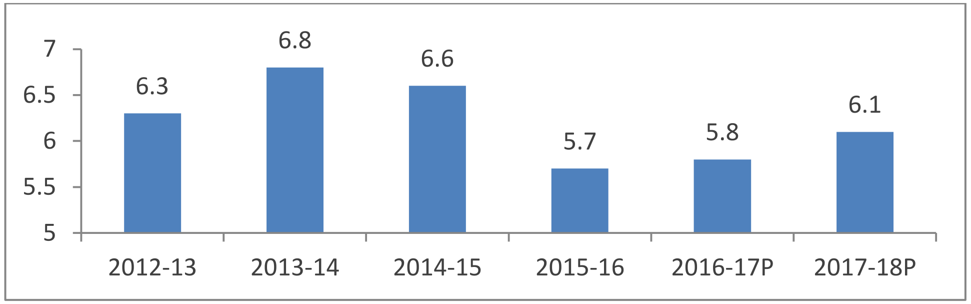
- This is considered to have a positive impact on the automobile industry, with key beneficiaries of GST being especially the utility vehicle (premium cars) segment buyers who will enjoy the reduction in the total tax incidence despite a cess of 15% with GST rate of 28%.
- Prices of small cars have more or less been the same with a minor change in tax rate. Two wheelers on the other hand may see some increase in overall tax on back of the cess.
- Going forward, CARE Ratings expects the automobile industry to witness gradual pick-up in demand (starting Q3 FY18 – festival season), post the systematic implementation of the GST process. Also, demand is expected to improve on back of various initiatives taken by the government in the Union Budget 2018. Higher allocation for infrastructure and transportation segment is likely to benefit the commercial vehicles demand during the year. Allocation to farm credit has been increased which is expected to fuel demand for the tractors segment. Also, reduction in tax burden for individuals with income below Rs 5 lakhs is likely to have positive impact on the two-wheelers and small cars demand.

Cement:

- Cement manufacturers have cut prices of cement by up to 3% on the back of implementation of GST. The manufacturers have extended the price cut to dealers in the month of July which in turn would be passed on to the end consumers. Cement has been taxed at 28% under the GST as compared to a higher 30-31% in the previous system of taxation.
- The reduction in prices varies from state to state. Due to GST implementation, the cement offtake by dealers had slowed down due to lack of clarity over tax rates. But given the reduction in prices post GST, the same should gradually get back to normal.
- Demand for cement is expected to pick up in the coming quarters given picking up of infrastructure projects especially the ones implemented by Central Government. Demand from real estate would remain to be on the low given the dual impact of GST and RERA having slowed down the industry.

Cotton & Cotton Yarn:

Chart 2: Cotton production (Billion Kgs)



Source: Cotton Advisory Board and International Cotton Advisory Committee (ICAC)

Chart 3: Domestic Cotton prices (CS – Oct-Sept)

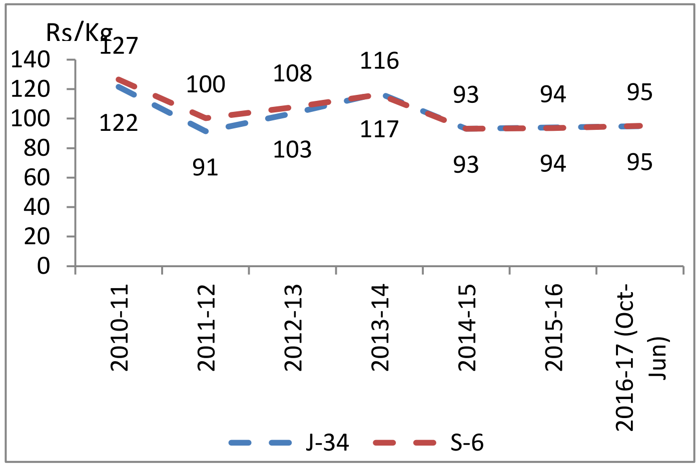
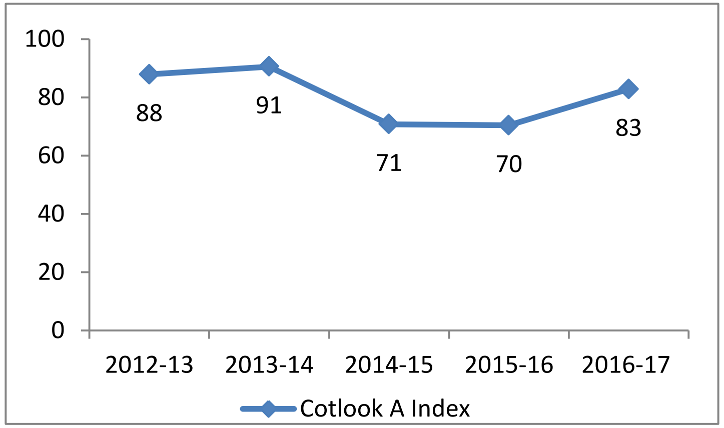


Chart 4: International Cotton prices (CS – Aug –Jul) (US cents/pound)



Source: CMIE

- India will likely be the world's largest producer for the third consecutive season with production by about 6% to 6.1 billion kgs.
- An early and normal monsoon, a higher minimum support price, and the prospect of better returns from cotton compared to competing crops have encouraged farmers in India to expand area by 8% to 11.3 million hectares.
- Domestic prices of the cotton of S-6 and J-34 category remained stable during cotton season 2017. However, during the last 2-3 months period, cotton prices have increased by a double digit number backed by increased demand along with higher international prices. However, as estimated by CARE Ratings, despite the temporary surge in prices, it is expected to stabilize or increase only marginally in CS 2017 on back of surplus production and weak international demand especially from China.

Edible oils:

- According to the Solvent Extractor's Association of India, the total edible oil imports declined by a marginal 0.6% to 9.6 million tonnes in the first eight months (November-June) of the ongoing oil year 2016-17 on a y-o-y basis. The fall in imports was largely driven by a 29.4% fall in imports of crude soybean oil to 1.98 million tonnes. An increase in domestic soybean oil production backed by a bumper soybean crop is the prime reason for the fall in imports.
- For the year 2016-17, CARE Ratings expect edible oil imports to remain more or less stable compared to the previous oil year 2015- 16. This will be primarily backed by a surge in edible oil production during the year on account of higher availability of oilseeds for crushing.
- In the current oil year 2016-17, CARE Ratings expect edible oil production to grow by 17.4% to 7.68 million tonnes. This will be driven by a rise in production of groundnut oil, soybean oil and mustard oil. According to Department of Agriculture Cooperation & Farmers Welfare, domestic edible oil output is likely to rise by 19.5% on a y-o-y basis in oil year 2016-17.

Pharma:

- In the financial year 2016-17, the industry faced slew of issues with increased scrutiny of regulatory authorities, increase in competition in generics market of one of its primary export destination, United States of America. This, in turn, resulted in marginal 1.3% growth in exports to USA at USD 5.6 billion. Also, the stricter enforcement of Drug Price Control Order impacted revenue growth rate of the industry in domestic market.
- In 2017-18, the industry is expected to continue to see pricing pressure in both the markets: domestic and exports. However, CARE Ratings believes that the steady growth in demand from domestic market coupled by a likely increase in export volumes to North American and African markets will support the industry’s growth.
- In the first quarter of the current financial year 2017-18, exports to USA declined by 19.2% y-o-y to USD 1,144.8 million. The prime reasons for weak exports were price erosion in the generic market in USA due to consolidation among customers i.e. the distribution channels, increase in competition and regulatory issues faced by Indian Pharma companies. The total exports from India during the same period fell by 6.5% to USD 3.9 billion.
- The pharma export volumes from India to US however are expected to rise. This will be backed by about USD 55 billion expected sales gain to generics drugs on account of branded drugs going off patent during 2017-19 which will create an opportunity for CRAMS segment. We expect growth rate for CRAMS to be higher compared to average growth rate of the industry. These factors are likely to support pharma exports from India.

Power Sector:

In a move aimed at improving the operational efficiency of DISCOM’s, the Union ministry has recently come out with following directives and policies-

- The Union power ministry has asked states to slash electricity losses due to theft and technical reasons to below 10% within six months. The target was put before the states in a review, planning and monitoring meeting held on July 22nd by Union Power minister and power secretaries of states.

- The government is planning new norms to remove the contractual requirement for the buyer to pay a fixed cost to the generation company even if no power is purchased. This in short would encourage state discoms to sign new PPAs which will in turn help stranded Coal based generators to get fuel supply from Coal India. The proposal however will mandate the state discoms to buy a minimum capacity of electricity from these stressed power plants.

CARE Ratings View: The policy changes proposed suggest governments push to achieve the operational efficiency targets as laid down under the UDAY Scheme. Reducing electricity loss would in turn reduce revenue under-recovery by state discoms. Additionally, the state discoms won't have to pay for the fixed costs of power plants under PPAs, hence paying for the electricity bought, which in turn would help cut expenses and improve financials of DISCOMs. For the Power Gencos, especially stranded coal fuelled ones, PPAs under the new norms would ensure linkage to coal from Coal India.

Real Estate:

- **RERA compliance status**: Real Estate (Regulation and Development) Act, 2016 came into effect on May 1, 2016, and the rules were to be notified by October 31, 2016. This deadline was further extended up to July 31, 2017.
- Out of the 29 states, only 15 states have notified the state rules under the Act, while all the 7 union territories have notified. While it was decided that the deadline for notifying would be July 31, 2017, the same is yet to be fully complied with. Few states have notified further extension to the July-end deadline to implementation which would mean further delay for realtors and agents to register.
- RERA authorities have been appointed in 6 states which include Maharashtra, Jharkhand and Kerala and 2 Union Territories. Goa, Karnataka, Uttar Pradesh and Telangana have given an extension to builders to register their ongoing projects.

Sugar:

- The small grade sugar prices in Mumbai hovered in the range of Rs.38.2-Rs.39.9 per kg during the period February-June 2017 and averaged at Rs.37.3 per kg in July 2017. We expect the prices to remain stable in the near term backed by the government's recent move to raise import duty on sugar to 50% from 40% earlier. This, in turn, will keep a check on cheap sugar imports in India thus supporting the prices.
- In the upcoming sugar year October 2017-September 2018, India is likely to produce around 25.1 million tonnes of sugar as per the preliminary estimates released by the Indian Sugar Mills Association (ISMA), growth of 23.6% on a y-o-y basis. Along with this, India is expected to have 4.5 million tonnes of opening stock for 2017-18 to meet the domestic requirements. CARE Ratings estimates consumption for the year to stand at around 24.6 million tonnes.
- For 2016-17, the domestic availability of sugar is estimated at 28.5 million tonnes. This includes opening stock of 7.7 million tonnes, production of 20.3 million tonnes and imports of 0.5 million tonnes. The government had allowed import of a restricted quantity of 0.5 million tonne of raw sugar at zero duty through open general license in April 2017.
- The stock available with the country is sufficient to meet the expected consumption of about 24 million tonnes during the year 2016-17. This estimate is lower compared to our earlier estimate of 24.5-25 million tonnes of consumption.

Steel:

- As per market data, finished steel output in India grew by 6.7% on a y-o-y basis in the first quarter of the current financial year 2017-18. The production stood at 26.3 million tonnes during April-June 2017.
- On a y-o-y basis, exports rose by 66% and imports declined by 6.4% to 1.7 million tonnes during April-June 2017. Consumption of finished steel increased by 4.6% on a y-o-y basis during the period April-June 2017 under the effect of rise in production.

- Steel production remained positive for the first three months of the current financial year and is expected to continue on the back of various initiatives undertaken by the government. The recent approval given by the Union Cabinet for National Steel Policy is an indication of government's support towards the industry.
- In addition to this, the government gave nod for the policy that provides preference to domestically produced steel to be procured by the government for its projects. A likely improvement in pace of construction and infrastructure in the country post monsoon will also support production. CARE Ratings thus expects production of steel to grow by 8-10% during the financial year 2017-18.

Telecom:

- According to TRAI, the growth in subscriber additions has been primarily driven by Reliance Jio after August 2016. Of the 151.9 million subscribers added during the period between September 2016 and May 2017, 117.3 subscribers were added by Reliance Jio, followed by Airtel, Idea and Vodafone who added 21.1 million, 19.3 million and 10.8 million subscribers, respectively, while companies like Reliance Communications, Tata Teleservices saw erosion in their subscriber base.
- As on May 2017, Reliance Jio (which launched its services in September 2016) had a market share of 9.9% which represents subscriber base of 117.3 million users. The company now holds fourth position in terms of subscriber base led by Airtel, Vodafone and Idea Cellular. Airtel leads with 23.6% of the total wireless subscriber base as on May 2017, while Vodafone and Idea Cellular had a share of 17.9% and 16.6%, respectively. The total wireless subscriber base was at 1,180.8 million as on May 2017.
- The entry of Reliance Jio created intense competition in the industry and resulted in fall in industry's sales and profits. Apart from this, the industry is under financial stress on account of increase in debt and hugely priced spectrum acquisition. Subsequently, the industry has asked for government's support and so the decision of inter-ministerial group with respect to industry's demand remains of much importance to watch for.

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