Industry Prognosis: FY18

Industry Outlook FY18

Contents

1. Automobiles
2. Auto Ancillaries
3. Tyres
4. Cotton & Cotton Yarn Industry
5. Sugar
6. Steel
7. Telecommunications
8. Cement
9. Real estate
10. Roads

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1. Automobiles

In 2017-18, CARE Ratings expects the industry to witness gradual pickup in demand as the effect of demonetization begins to moderate.

- 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.

Major challenges

- The investment required in order to ensure improved emission standards is likely to pose a challenge for the players.
- Also, apart from demonetization, car manufacturers are also unsure about the uncertainties surrounding the implementation of the GST.

Table 1: Growth in sales

Category	FY18 E*
CVs	12-13%
PVs	12-13%
Two & Three wheelers	10-12%

E - Estimated

Main drivers for these growth rates:

- Common assumption is that GST will be neutral in cost and price impact
- GDP growth to be higher at 7.6-7.8%
- Repo rate may be stable to begin with and could be lowered if inflation remains range-bound
- Good monsoon and farm income

Segment	Driver
Passenger vehicles	Higher growth in GDP, income levels and stable prices, IIP
Two and three wheelers	Higher GDP growth, good monsoon, higher disposable income
Commercial vehicles	Pick up in industrial production, GDP, stable interest rates

Factors to watch for in 2017-18:

- Higher outlay in Budget 2018 for infrastructure and transportation segment, which had been volatile of late, is expected to be positive for the commercial vehicles demand.
- With the decline in the holding period of a vehicle from 5-6 years to 3-4 years, the inflow of used cars and commercial vehicles has gone up considerably. Also, easy access to finance options, greater participation of

organized OEM backed players in used vehicle markets; higher number of aspiring buyers with improvement in standard of living and increased industrial activities, etc. is likely to create higher demand for the used-vehicle segment. This in turn is expected to impact the demand for new passenger vehicles and commercial vehicles in the future.

- Reduction in the tax burden of individuals with an income of Rs 2.5 lakh to Rs 5 lakh is seen as a big positive with higher disposable income in hands of buyers. This will increase demand for the small cars and two wheelers. Two-wheelers demand is also expected to improve on back of steady urban demand.
- Demand for three-wheelers could be under pressure in near term. However, the segment is likely to register growth on back of rising urbanization and migration to cities boosting intra-city transportation.
- Auto exports from India is expected to show strong growth as many companies like Volkswagen, Ford Motors, General Motor are focusing on exports and expansions in newer markets such as South America, North America and Asia will only add to the growth.
- With BS-IV norms coming into effect, the vehicles cost is expected to be relatively higher than the previous BS-III compliant vehicles. The auto players overall cost of production will increase leading to impact on the overall demand of the automobile industry. Also, the fuel used in BS-III compliant vehicles cannot be used in the BS-IV vehicles.
- However, with GST being implemented in 2017-18 (July 2017), raw materials cost is expected to be marginally lower and prices will follow improving the demand.
- With higher cost of production on one hand and marginally lower input cost, the change in net cost is expected to remain neutral for the auto players. However, it will take some time for things to normalize after the impact of demonetization drive on the sector.

2. Auto Ancillaries

Over the past decade, OEM market demand of auto components (80% of the overall demand) has been 1.5 times that of the automobile sales, whereas, replacement market (20%) has moved by about 1.2 times of the automobile market. Therefore, with expectations of the automobile industry to grow by about 10-20% across various categories, *CARE expects the demand for overall auto components to improve by about 15-18% in FY18*.

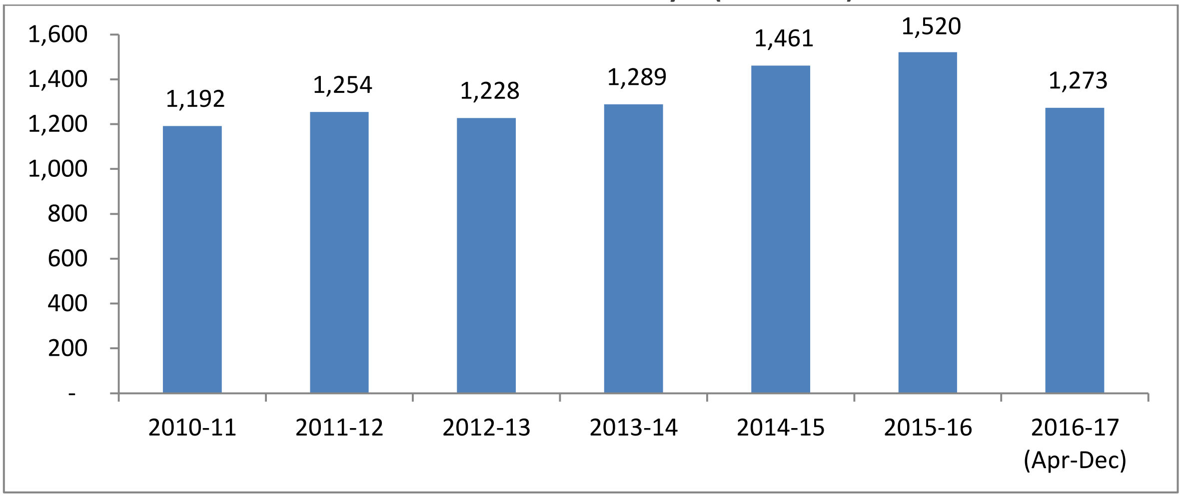
- Capacity utilization rates are also estimated to improve over the previous period which shall impact operating efficiencies favourably with most of the key input costs expected to remain largely stable or increase marginally.
- Both, domestic and export demand for auto components is expected to remain robust during this period on the back of strong growth prospects for Auto OEMs.

As per the Automotive Mission Plan 2016-26 (AMP), the Indian auto component industry may attain an impressive USD 200 billion in revenue by 2026, with exports of USD 80 billion. The Indian Automotive Industry will be among the top three of the world in the area of engineering, manufacturing export of vehicles and components. It is estimated that the demand of vehicles will reach 66.3 to 75.8 million units in the same year. Contribution of Auto component industry in India's GDP will account to as much as 5% to 7% by 2026. Exports of auto components grew at a CAGR of 14% to USD 10.8 billion in 2015-16 from USD 3 billion in 2005-06.

3. Tyres

Indian tyre industry is highly competitive with the presence of a large number of global and Indian auto-companies. However, top 10 companies account for about 80% of the market. Tyre demand is directly proportional to the automobiles demand. Therefore, demand swings in automobiles have an impact on the demand for tyres. India's annual automobiles production registered a sluggish growth of 2.6% y-o-y in 2015-16. This led to decline in demand for tyres as well during the year. Tyres production (in volume terms) increased only marginally by about 4% in 2015-16 after increasing by about 13% in the preceding year.

Chart 4: Production of Tyre (Lakh units)



Source: ATMA, CMIE

Over the past few years, the trend in tyre production and sales for OEM market has been in line with the automobile sales for the period i.e., production of tyres has been about 1.5 times that of a vehicle produced while the demand from replacement market has comparatively been higher. *Sales are expected to grow in the range of 10-11% per annum during 2017-18.*

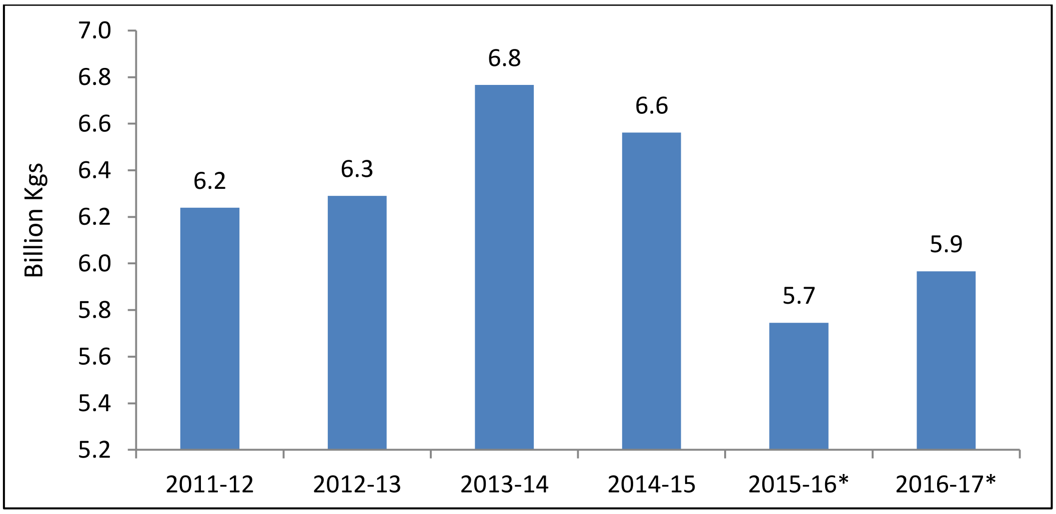
- Both, domestic and export demand for tyres is expected to remain robust during this period on the back of strong growth prospects for Auto OEMs as well as the stable replacement market.
- Capacity utilization levels for manufacturing TBRs have come down to 60-65% from 80-85% in couple of years ago due to increasing dumping of TBR tyres from China which pose a threat to the domestic players. However, there is no significant increase witnessed in the imports from China, as the Chinese players are shifting focus to higher margins in US market. Also, the tyres and tubes industry was expected to witness completion of about 5 projects worth Rs 45.9 billion in 2016-17 adding an incremental capacity of about 13.7 million units to the industry.

- In the next two years (FY18 and FY19) about Rs 70 billion worth projects are to be completed adding another 12 million unit capacity to the industry. Going forward, significant capex will put pressure on the utilization levels and is expected to hamper the operational margins of the players.

4. Cotton & Cotton Yarn

Cotton production: In CS 2015-16, India surpassed China to become the largest producer of cotton. Acreage for cotton in the country is estimated at 11.9 million hectares in cotton season 2015-16. India has the highest acreage for cotton as compared with the other major cotton producing nations in the world. Cotton production was estimated to be 5.7 billion kg in domestic cotton season (October to September) 2015-16. In CS 2016-17, India's production is estimated at 5.9 billion kg, higher by about 4% on a y-o-y basis due good rainfall and satisfactory sowing of the crop despite reduction in acreage.

Chart 1: Cotton production



Source: Cotton Advisory Board

Cotton: Firm prices this season are likely to encourage farmers in India to return to cotton and cotton production is projected to grow in FY18. According to ICAC, India's cotton production is projected to increase by about 2.2% and reach 5.93 billion kgs and the area under cultivation is expected to increase by about 7% and reach 11.2 million hectares in 2017-18. However, world cotton mill use is expected to remain unchanged in CS 2016-17 due to largely weak global economic growth and competition from polyester, which has significantly competitive prices this season.

Cotton yarn Demand: In CS 2016-17, demand is expected to be sluggish as derived demand and direct yarn exports will be under pressure. Also, with alternatives being explored for crude oil such as shale, prices of crude oil are largely expected to be stable during the year. Hence, demand for cotton yarn will face stiff competition from its easily available substitute – manmade fibres (synthetic yarns).

In 2016-17 (Apr-Feb), cotton yarn production declined by about 2.2% to 3,713 million kgs on back of sluggish derived (Domestic yarn demand) demand with distressed direct yarn exports due to lower demand from China. Yarn demand in other export markets is expected to remain healthy. However, on a y-o-y basis demand will be lower. Production of non-cotton yarn on the other hand increased by about 4% during the same period on account of substitution taking place from MMF with prices of polyester being comparatively lower.

Capacity addition is expected to slow down as the industry will be adding only around 3 million new spindles between FY2016 and FY2021 due to overcapacity, subdued demand and lower central government benefits due to changes in the Technology Upgradation Fund Scheme (TUFS). Most new capacity is to be added in Maharashtra, Gujarat and Telangana.

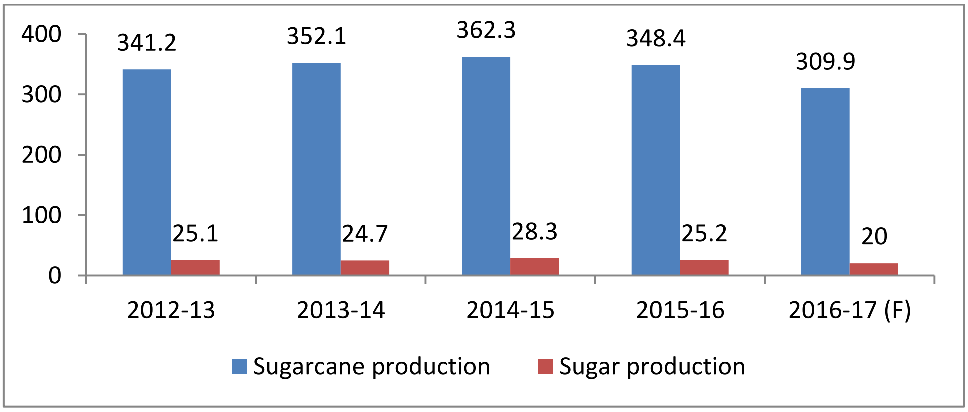
Conclusions:

- Cotton prices are expected to remain largely stable or increase only marginally on y-o-y in CS 2016-17.
- Cotton yarn demand is projected to be lower on back of weak demand from China which is the world's largest consumer. However, in medium to long term decrease in demand from China will be offset by improvement in demand from Bangladesh, Pakistan and Vietnam.
- However, cotton yarn demand will be closely monitored due to China's cotton policy as well as stable crude oil prices leading to stiff competition from its substitute – manmade fibres (synthetic yarns).

5. Sugar

In the sugar year October 2015-September 2016, production in India declined by 11% to 25.2 million tonnes. Lower sugarcane production due to drought situation in the states of Maharashtra and Karnataka pulled down sugar output during the year. This fall was after a strong 14.8% rise in sugar output to 28.3 million tonnes during the year 2014-15 backed by a growth in sugarcane production. Earlier, the country's production had touched a high of 28.4 million tonnes of sugar only in 2006-07.

Chart 1: Sugarcane and sugar production in India



Source: Ministry of Agriculture and ISMA

Outlook for sugar year 2016-17

Sugar production will be declining for the second year in a row. In the ongoing sugar year 2016-17, CARE expects sugar output to stand at around 20 million tonnes. This is mainly on account of lower sugarcane crushing in Maharashtra and Karnataka due to back to back drought situation that affected the availability of sugarcane in these states. On the other hand, Uttar Pradesh witnessed bumper sugar production.

As per the Indian Sugar Mills Association (ISMA) latest production figures, sugar output in Uttar Pradesh jumped by 17% to 6.2 million tonnes during October 2016-February 2017 on a y-o-y basis, while the production declined by a sharp 41.7% to 4.1 million tonnes in Maharashtra and 43.3% to 2.1 million tonnes in Karnataka during the period. ISMA estimates sugar output to stand at around 20.3 million tonnes in 2016-17.

Considering the annual output of 20 million tonnes, India will have 27.7 million tonnes of sugar supply for the year 2016-17. This also includes opening stock of 7.7 million tonnes for the current year. In addition to this, the government permitted import of a restricted quantity of only 5 lakh tonnes (0.5 million tonnes) of raw sugar at zero duty through open general license on 5th April 2017. The deadline allowing imports have been extended to 30th June from 12th June, 2017.

This will bring the total availability of sugar to 28.2 million tonnes for the year 2016-17. The supply will be sufficient to meet the expected domestic requirement of about 24.5-25 million tonnes of sugar during the year. Thus, considering consumption, India will be left with 3.2-3.7 million tonnes of sugar for the coming year. This stock is expected to be sufficient to meet the domestic requirement of sugar of around the first two months of the next sugar year 2017-18.

It however does not meet the criteria of fulfilling the normative requirement of three months stock for the next year 2017-18. India generally keeps a normative requirement of three months to deal with supply shocks. The announcement made by the government with respect to imports sends a signal that it may allow more import of sugar if the need be.

Sugar prices

After much debate, the imports were allowed to meet the regional production gaps and also to maintain domestic prices at reasonable levels. The prices remained in the range of Rs.39-Rs.40.1 per kg during the period 1 February 2017 to 24 April 2017. The move made by government is expected to keep the prices stable. The prices mentioned are small grade sugar prices in Mumbai.

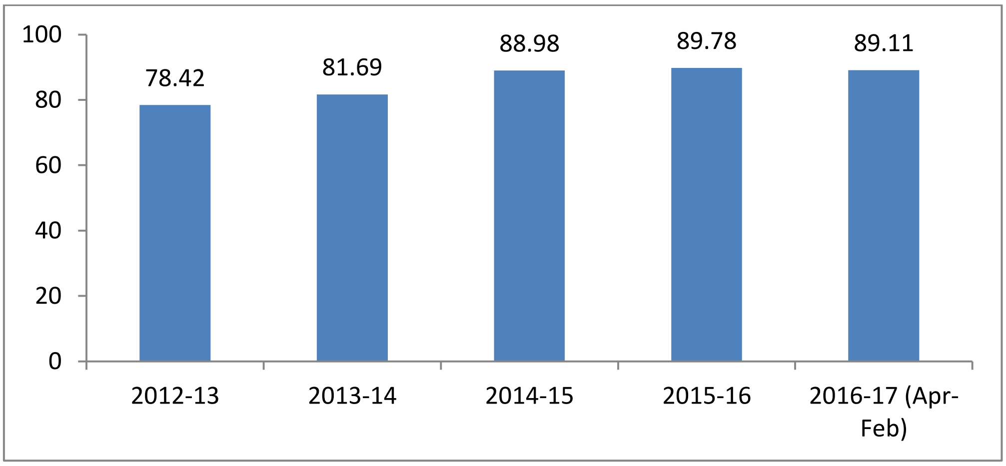
We expect the prices to remain firm but stable in the coming months as well as we believe that the government may allow more import of sugar if the situation demands so. In addition to this, likely early sugarcane crushing for 2017-18 season will also aid the prices to remain stable.

6. Steel

The crude steel production in India grew by 4-5.5% during the financial years 2012-14 on a y-o-y basis. It stood at 78.42 million tonnes and 81.69 million tonnes in 2012-13 and 2013-14, respectively. In 2014-15, the production growth accelerated and the output increased by 8.9% to 88.98 million tonnes.

The growth in crude steel production however remained subdued in the year 2015-16 where the output increased marginally by 0.89% to 89.78 million tonnes. After this, the growth momentum improved and the output rose by 9.4% to 89.11 million tonnes during the period April 2016-February 2017 compared with the corresponding period a year ago. This was on account of higher output by the major Indian steel companies. The imposition of Minimum Import Price (MIP) encouraged the producers to increase their output.

Chart 1: Crude steel production in India (million tonnes)



Source: CMIE

Outlook

In the current financial year 2017-18, the domestic steel production is expected to remain higher and is likely to rise by 8-10%. This will be backed by an increase in infrastructure allocation by the government in the Union Budget 2017-18 which is expected to drive the pace of construction and infrastructure in the country. Apart from this, the National Steel Policy 2017 released by the government also aims to increase steel production.

Various initiatives undertaken by the government are likely to increase domestic steel consumption and thereby production. Some of the initiatives are mentioned below:

- Pradhan Mantri Awas Yojna
- Make in India campaign
- Encouraging the use of Made in India steel for various projects

- Spending in areas of railways, roads and urban development

The domestic steel producers are also increasing their steel producing capacities expecting an increase in demand for steel on account of several initiatives undertaken by the government stated above.

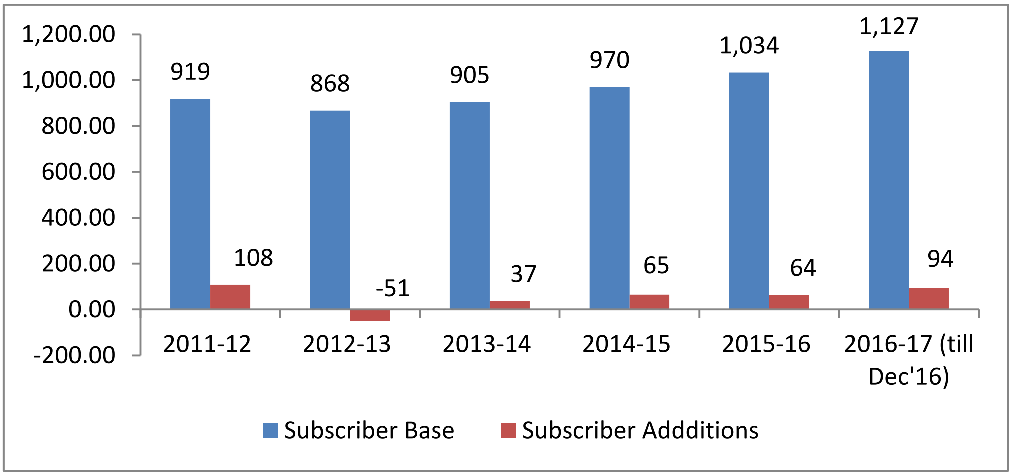
Steel prices

The surge in coking coal prices on account of cyclone Debbie that disrupted major mines and ports in Australia towards the end of March 2017 is expected to increase the cost pressure for producers, in turn, leading to a rise in steel prices. The cyclone distorted coking coal exports from Australia. Around 70% of India’s coking coal requirements are fulfilled through imports.

7. Telecom

During 2012-13, the total wireless subscriber base declined to 867.8 million from the base of 919 million in 2011-12. This was mainly on account of removal of inactive telephone connections by the telecom service providers. Following 2012-13, the subscriber base grew over the years and crossed the one billion mark and stood at 1,033.6 million in 2015-16, implying a growth rate of 6.6% on a y-o-y basis. A total of 63.74 million wireless subscribers were added during the year.

Chart 1: Wireless Subscriber Base and Additions (in million)



Source: CMIE

In the first three quarters (April-December 2016) of the current financial year 2016-17, 93.74 million wireless subscribers were added. This is 128.7% higher compared to the corresponding period a year ago. The strong growth in subscribers was driven by Reliance Jio Infocomm Ltd which entered the telecom market on 5th September 2016. During the period April-December 2015, 41 million subscribers were added.

Of 93.74 million subscribers added, 72.16 million customers subscribed to Reliance Jio's wireless telecom service. This was on account of the telecom company's 'Welcome Offer ' that provided free data services, free voice calls and no roaming charges across the country till the end of December 2016. Moreover, Reliance Jio extended the offer till 31st March 2017 with introduction of Happy New Year offer in place of Welcome Offer with data limit being reduced to 1 GB from 4GB earlier.

The company continued with its spree of offers even in the financial year 2017-18 to increase its subscriber base. In a surprise move, the company extended the deadline for buying Jio's Rs.303 (and other) plans till 15th April 2017. Those subscribers who buy Rs.99 prime membership till 15th April 2017 and subscribes to plans of Rs.303 or higher will be eligible for the Summer Surprise offer. However, the Telecom Regulator Authority of India (TRAI) asked the operator to withdraw the offer. The telco followed the order but those subscribers who signed up will still get the benefits of the offer till July.

Outlook

Some moderation is likely in the number of wireless telecom subscribers as Reliance Jio started charging for its services. This is because a very high percentage of the subscribers added by Reliance Jio are dual sim users and these users may surrender one of the connections.

CARE's view on next round of spectrum sale

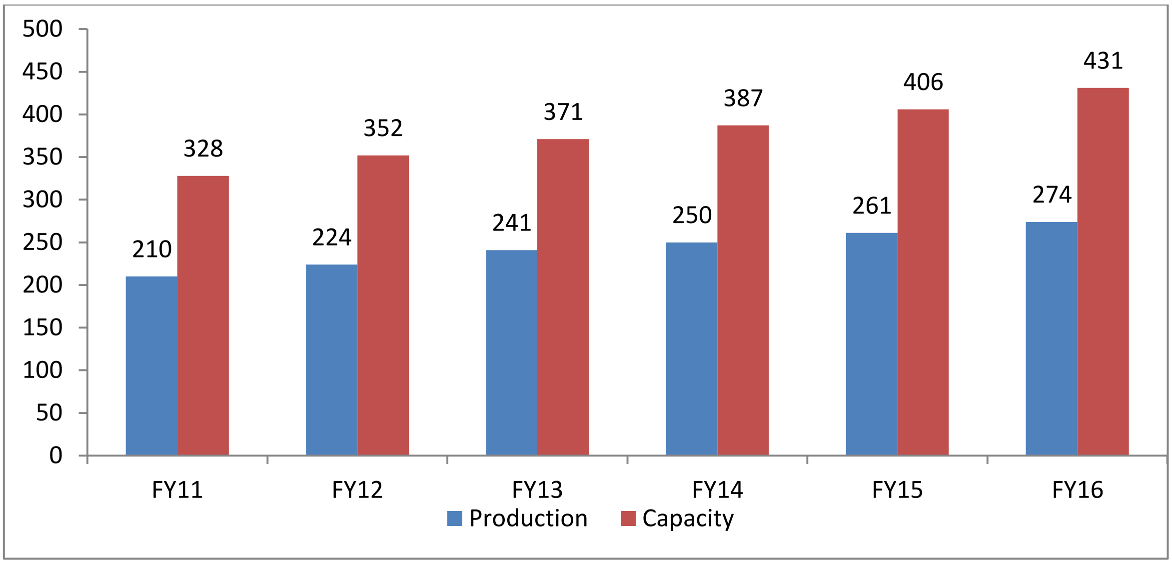
Recently, the government asked the telecom regulator to work on the reserve prices for the spectrum that remained unsold in October 2016. It asked the regulator to give suggestions on the starting prices for airwaves in the 4G bands of 700 MHz, 800 MHz, 1800 MHz, 2300 MHz and 2500 MHz, and for spectrum in the 3400 MHz to 3600 MHz bands that are used for 5G services.

This comes at a time when the telecom industry is facing tough competition and is dealing with price wars. We thus believe that the auctions are unlikely to take place this year either for the 4G services or 5G services especially if the price for each unit of 700 MHz for 4G band is kept unchanged at Rs.11, 475 crore as it was in the October 2016 auction. Also, the ecosystem is not developed for 5G airwaves.

8. Cement

Cement production grew by 4.7% y-o-y in FY16 compared with 5.6% in FY15 and 3.1% in FY14. Capacity addition has grown at CAGR of 4.4% between FY11 and FY16. Capacity increased at a CAGR of 5.7% from 328 mn tonnes in FY11 to 431 mn tonnes in FY16. For the same period, production increased at a CAGR of 5.5% from 210 mn tonnes in FY11 to 274 mn tonnes in FY16.

Chart 1: Production and Capacity in Cement industry (million tonnes)



Source: CMIE

Outlook

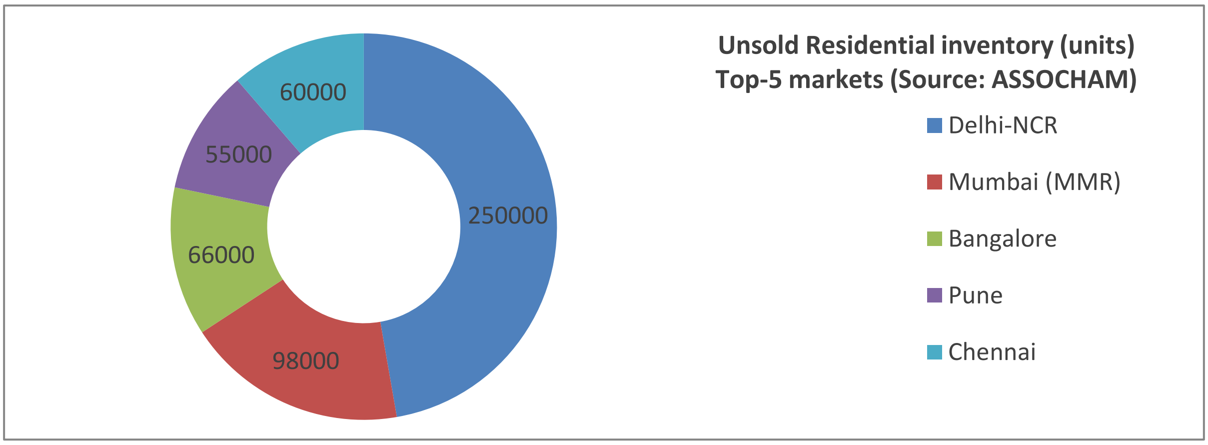
- Governments push on infrastructure is expected to be one of the biggest incremental growth drivers for the cement industry. The Budget Outlay for infrastructure and roads sector has been the highest ever in the Union Budget 2017. This could lead to strong demand from the infrastructure and roads sector during 2017-18.
- Along with infrastructure, Governments "Housing for all" initiative, especially in the rural areas would partially compensate for the otherwise sluggish activity in real estate sector in 2017-18. Housing sector alone constitutes for 2/3rd of the total consumption for cement at present. The demand from housing segment for cement may see some decline during the year.
- *Cement consumption is expected to witness a growth of 3.0-4.5 % during the year which translates to 285-290* mn tonnes of total consumption during 2017-18.
- The capacity utilization is low with excess capacity already in place across regions. This suggests against any capacity addition except for small manufacturers augmenting for incremental demand in particular regions.
- In terms of capacity utilization by region, Central region is expected to witness higher capacity utilization compared to other regions.
- Coking coal is used as a fuel in the process of cement manufacturing. The prices of coking coke have been firming up and this may put pressure on the manufacturer's margin, which in turn would lead to rise in price of cement during the year as the manufacturers would pass on the same to the consumers.

9. Real Estate

The Real has three segments, namely residential, commercial and retail. Year 2016-17 witnessed lowest ever launch of residential properties across the top-8 cities in the country and the sales seemed to have been higher than launches for the second consecutive year, but has been steadily on the decline for 6^{th} year in a row.

Commercial properties witnessed healthy absorption but scarcity in quality A-Grade office spaces meant deferral in some leasing activity. In terms of launches, Commercial real estate witnessed healthy addition of inventory, mainly in Bengaluru, Chennai and Pune.

Retail space demand witnessed a sudden surge on the back of foreign apparel and fashion brands entering Indian markets and in terms of supply, 5.32 msf of retail space was added to approximately 70msf retail space already existing in the top-8 cities.



Outlook

Residential real estate: The segment would remain subdued in terms of absorption and launches, with huge pre-existing inventory across markets. Implementation of Real Estate (Regulation and Development) Act 2016 would be a major deciding factor for the overall industry. Sales may remain stable with government providing interest subsidy for first time home buyers in the affordable housing segment. Affordable housing may outperform other segments of housing in terms of launches due to it being given infrastructure status and may see more developers taking interest in development of this segment of housing.

Commercial Real Estate: During the year 2017-18, the Commercial Real Estate segment may witness a fall in demand due to consolidation and slowdown in high-growth sectors, namely Information Technology, Telecom and E-commerce apart from Banking and Financial Services. In terms of inventory addition, the same is expected to remain stable during the year and listing of REIT's would lead to higher activity in terms of investment in this segment of real estate.

Retail Segment: Retail segment may see addition of up to 5-7 msf in inventory due to completion of projects across cities namely Chennai, Mumbai, Hyderabad and Bengaluru. These projects had been delayed due to stagnant inventory addition and sluggish demand for retail spaces in the past 3 years. The demand for quality spaces is expected to remain stable from foreign fashion and apparel brands, electronics and entertainment (multiplex) segment as well as e-commerce stores looking to mark their presence in brick and mortar stores.

10. Roads

During 2016-17, as per Union Road Transport Ministry statement, a record 16,271 kms of national highways were awarded and 8,231 km constructed. The Minister had set a target of 25,000 km of National Highways to be awarded in 2016- 17 as against the 10,000 km awarded in 2015-16. The construction target was set at 15,000 km in 2016-17 as against the 6000 km constructed in 2015-16.

Indian Road Network Growth		
Particulars	**FY03**	**FY16**
Length of national highways(kms)	58,112	100,475
Passenger vehicles sales (million)	0.71	2,864.50
NHDP Toll Collection (USD million)	64.5	1,078.3
Highway Projects awarded by NHAI (kms)	677	6,397

Source: NHAI

Outlook

- The Union Budget 2017 made highest ever allocation of INR 64,900 crore towards roads and highway development which is a sizeable growth of 12% over previous budget.
- The Government is looking to monetize over 75 toll road projects through the "Toll-Operate-Transfer" mode in order to fund its financial commitment wherein it would auction toll projects to prospective institutional and foreign funds and investors and raise capital to fund future projects.
- With the Government taking a cautious approach in terms of selection of PPP models for major road projects in order to ensure maximum participation from the industry, the year may well see higher award of road projects compared to previous years.
- We expect approximately 20,000 km of road projects to be awarded in 2017-18 compared to 16,271km during 2016-17 with Bharat Mala Project, Multi-modal Hubs, Road project in J&K and North East in the pipeline; and Mumbai-Vadodara, Bangalore-Chennai and Delhi-Amritsar-Katra Expressways to be tentatively sanctioned by June 2017.

- We also expect completion of road projects of length close to 9,500-10,000km as compared to 8,231km of highways roads completed during 2016-17. This would include conversion of 2 lane highways to 4 lane highways and as well as new highways.

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