ICRA

Compendium of ICRA's Annual Sectoral Outlook

'A Year of Challenges, Recoveries and Growth'

CONTENTS

Auto

ICRA maintains Stable year-end outlook for Commercial and Passenger vehicle segments

- Domestic CV segment is facing challenges in the nearterm; growth prospects appear muted for PV demand as well
- Credit profile of most industry players to be largely unaffected

ICRA has stable outlook for the commercial vehicle (CV) segment, in its year-end assessment of the Indian corporate sector. After strong growth in FY2018, the domestic industry continued its growth trajectory in the current fiscal as well, with a strong growth of 31% in domestic CV sales till 8M FY2019 over the corresponding period previous year. While the growth momentum remained intact till October 2018, the adverse impact of tightening financing environment, and weakening viability of small fleet operators (SFOs) because of a sharp increase in diesel prices along with subdued freight rates have started showing its impact on CV sales from November 2018. The road transportation segment is currently witnessing surplus capacity in the CV space because of a) significant capacity addition over the past 5-6 quarters and b) revision in axle load norms from July 2018, which led to an approximately 12-18% increase in capacity of existing fleet of trucks. This along with faster turnaround of vehicles post the implementation of the GST and E-Way Bills has contributed to surplus capacity. As a result of these factors, ICRA has revised the growth outlook for M&HCV (Truck) sales to 9-11% for FY2019. However, the outlook for FY-2020 remains supported by potential pre-buying ahead of the implementation of BS-VI emission norms (from April 2020).

As for the demand for ICVs and LCV (Trucks), ICRA has noted that the same has been well supported by healthy demand from consumption-driven sector as well as replacement cycle. While LCVs are on structural uptrend, the tightening of financing environment could derail the growth momentum in the near term. Given these factors, ICRA expects the LCV (Truck) segment to register a growth of 18-20% in FY2019. In the bus segment, growth is expected to recover in FY2019, aided by replacement-led demand following a year of sharp contraction in bus sales. The same is estimated to grow by 12-14% in the current fiscal.

Higher demand will lead to an improvement in earnings, which will allow companies to maintain their credit profile. Even otherwise, over the past few years, the credit metrics of leading CV OEMs have been supported by favourable determinants like a recovery in the CV cycle, decline in input costs and deleveraging initiatives. On the investment front, while step up in investments to meet BS-VI norms is expected, the same is unlikely to have any material impact on credit metrics of CV OEMs.

ICRA expects that, in addition to capacity augmentation, CV OEMs would invest in multiple avenues that would help them improve their business prospects, such as new product development, addressing portfolio gaps, technology upgradation related to next level of emission norms and investments in sales network. Many OEMs are also contemplating setting up their overseas assembly units with an eye to grow international business. Accordingly, CV OEMs are expected to spend about Rs. 50-60 billion annually.

ICRA has also given a stable outlook on the passenger vehicle (PV) industry. The domestic PV sales has slowed down to 4.9% during 8MFY2019, amid sluggish customer sentiments due to high fuel prices and rising interest rate. Moreover, factors like floods in Kerala (during the peak Onam season), delayed festive season and high base of Q2 FY2018 also weighed on the overall growth rate in Q2 FY2019, resulting in decline of domestic wholesale PV dispatch by 3.6%. Accordingly, the growth estimates for the PV industry has been revised to 5-6% for FY2019e, from the earlier guidance of 8-9%. Amid upcoming Lok Sabha elections, customer sentiments will continue to remain cautious which will weigh on performance during Q1 FY2020e. Political stability would be positive for the economy as well as the PV industry. Unlike the past trend, domestic PV segment may witness some pre-buying in H2 FY2020e ahead of BS-VI vehicle rollout, as incremental pricing difference will be substantial between BS-IV and BS-VI vehicles, especially for diesel PVs.

Despite subdued growth, the credit profile of most PV OEMs remains strong, supported by healthy cash accruals and financial flexibility provided by strong parentage. Overall capacity utilisation level in the industry remains modest, however, the statistics vary significantly across OEMs. ICRA notes that over the next two years, the PV OEMs are estimated to incur a combined capex of ~Rs. 350-400 billion on capacity addition, product development and localisation initiatives to comply with the upcoming BS-VI and safety-related norms.

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

Shamsher Dewan
Vice President & Sector Head-Corporate Ratings
shamsherd@icraindia.com

Ashish Modani
Vice President & Co-Head - Corporate Ratings
ashish.modani@icraindia.com

Auto

ICRA's outlook on Tractors and Two-Wheelers industry Stable

- Tractors demand to grow by 10-12% in FY2019, credit profile of players to stay healthy
- Two-wheeler likely to grow by 6-9%; high profitability and strong balance sheet supported by healthy capacity utilisation to keep credit profiles robust

ICRA has a stable year-end outlook on the Indian tractors industry.

The industry has maintained a healthy growth of ~16.3% during April-November 2018 and for the entire FY 2019, the sector is expected to grow at 10-12%. The Union Government continues with its initiatives towards enhancing farmers' incomes in addition to schemes aimed at improving irrigation and insurance coverage. The MSP hikes for the current kharif season have been better than previous years. The Government's thrust on rural spending, infrastructure creation and irrigation spending are also expected to support rural income over the short to medium term. ICRA expects the industry to continue with its double-digit growth despite somewhat weak and uneven monsoon precipitation, impacting the kharif crop. However, a major deficit in the post-monsoon rainfall has led to a weakening of the reservoir levels across regions and could impact the rabi sowing levels.

The tractors industry has registered a strong volume growth over the last three years and ICRA expects a CAGR of ~16% over the period FY2016-FY2019. Growth is, however, likely to moderate in FY2020 to 4-5%. In the backdrop of developing El Nino conditions in the Pacific, there are concerns on its influence on the south-west monsoon in the next fiscal that can result in further weakening of tractor volume growth. Over the long term, it is expected that the industry will maintain a CAGR of 8-9%, with the long-term industry drivers remaining intact.

The profitability of Original Equipment manufacturers (OEMs) remains linked to industry demand, with profitability expanding during industry up-cycle and contracting during downturns. Though the operating margins of the industry peaked in FY2018, benefitting from the economies of scale on expanding volumes, a hardening in raw material prices is expected to moderate the same over the near term. The financial profile of most OEMs remained healthy, even in the periods of downturn in the industry. The capacity utilisation levels in the industry remain at moderate levels. In the absence of any significant capital expenditure plans, the credit profile of the OEMs is expected to remain healthy.

ICRA also has a stable outlook on the Indian two-wheeler industry.

The domestic two-wheeler industry volumes are expected to grow at 6-9% in FY2019, supported by growing per-capita income, improved farm sentiment following near normal monsoon over the last three fiscals, higher MSP and farm loan waiver in select states. The two-wheeler industry has reported a 10.7% Y-o-Y volume growth during April-November 2018 – despite some one-off adverse events during the period like increase in insurance premium across the country, floods in Kerala in August 2018 and regulatory changes in West Bengal, mandating two-wheeler sale to only valid licence holders in July 2018.

While increase in rural income would support motorcycle demand, the demand for scooters is expected to be led by rapid urbanisation, increased affordability and greater penetration through targeted product launches.

Meanwhile, concerns which could affect demand are increasing cost of buying a two-wheeler due to rising raw material prices and hike in insurance premium, rising interest rates and somewhat unevenly distributed monsoon in FY2019 (moderate impact). However, some pre-buying in the second half of FY2020 due to implementation of BS-VI norms from April 1, 2020 is likely.

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

Anupama Arora
Vice President & Sector Head-Corporate Ratings
anupama@icraindia.com

Overall, in the medium term, the two-wheeler industry is expected to report a volume CAGR of 7-8% with positive structural factors like favourable demographic profile, growing middle class, participation of women in workforce and rapid urbanisation. ICRA also expects increasing penetration of organised finance into tier 2/3 cities as well as rural centres to support domestic demand as the current share of financed vehicles remains moderate. Additionally, the under-developed public transport system, in the backdrop of increasing road network in the past few years has steered personal mobility requirements, supporting the demand for two-wheelers. In addition to the robust demand drivers in the domestic market, improving quality and safety standards and under-penetrated and/or untapped overseas markets also provide growth opportunity for the two-wheeler OEMs.

The credit profile of two-wheeler OEMs remains strong, supported by healthy capacity utilisation (~77-80%), high profitability and strong balance sheet across most OEMs.

Auto

ICRA maintains Stable year-end outlook for the Auto Components sector

ICRA has a stable outlook on the auto component industry. The domestic auto components industry is on track for a 15% revenue growth in FY2019, supported by growing OEM volumes, improved realisation and content per vehicle. Growth is expected to moderate in FY2020 to ~10-12%, impacted by potential weaknesses in passenger vehicle segment, though CV volumes are expected to remain strong given the potential pre-buying ahead of the implementation of BS-VI emission norms (from April 2020). The operating margins are expected to remain in the range of 13.5%-14.5% over the medium term, despite modest pressure in the current fiscal (FY2019e). Sharp depreciation in the INR will weigh on imports, which along with pressure in commodity prices will impact the margins.

The industry has been witnessing a robust demand over the last 2-3 years. The demand has been supported by higher systemic capacity utilisation. Besides favourable demand prospects over the medium term has triggered capacity expansion by several ancillaries. Accordingly, the auto components industry (ex-tyres) is likely to sustain its capex investments at 6-7% of its operating income over the next two fiscals and will subsequently come down once the new capacity becomes operational. Nevertheless, ICRA notes that given the strong accruals, industry-wide credit profile is expected to be stable over the next three years.

ICRA expects some consolidation in the component industry as players gear up to tackle challenges emanating from rapidly evolving technology and shorter vehicle shelf-life. With enhanced active and passive safety requirements, tighter emission control norms and advanced driver assistance and infotainment requirements, electrical content in vehicles is set to increase. This could trigger higher imports for some time till local investments are made to indigenise the technology.

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

Ashish Modani
Vice President & Co-Head - Corporate Ratings
ashish.modani@icraindia.com

Pavethra Ponniah
Vice President and Sector Head-Corporate Sector Ratings
pavethrap@icraindia.com

ICRA: Indian Tyre industry outlook Stable, 7-9% demand growth likely over FY2019-23

- Sector likely to see a capital expenditure of over Rs. 200 billion in the next three years

ICRA has a stable outlook on the Indian tyre industry. Tyre demand is estimated to grow by 7-9% over the next five years (FY2019-23), supported by favourable outlook for the domestic automotive industry.

In FY2019, the domestic tyre industry benefitted from strong growth in both original equipment (OE) and replacement segments. While there have been some headwinds like Kerala floods, tightened financing, insurance related regulatory changes impacting two-wheeler demand, rising fuel and interest costs etc., the YTD sales growth across most segments have been robust, leading to healthy OE tyre demand growth. Replacement tyre demand too has recovered sharply in the last one year, supported by post-effects of the Goods and Service Tax (GST) implementation, pickup in infrastructure activities, and healthy consumption driven demand. Specifically, there was a strong demand rebound in truck and bus segment (where replacement share is high at ~70%). ICRA expects the tyre demand to grow by 9-11% in FY2019, followed by ~7-9% in FY2020.

Tyre exports from India have been steadily increasing in the last one year with recovery in demand from overseas markets and rising competitiveness of Indian tyre makers, both in terms of quality and pricing. Tyre imports have decreased in the last one year following the re-imposition of anti-dumping duty (ADD) on import of new Chinese truck and bus radial (TBR) tyres, for five years effective September 18, 2017 and increase in customs duty by 500 bps to 15%, effective April 1, 2018. This has supported the domestic TBR players as the large capacities added in recent years are now being effectively utilised.

The tyre industry in India has witnessed large capacity addition in the last one decade with a cumulative spend of ~Rs.278 billion, of which ~70% was spent in the last six years. With tyre demand remaining favourable, supply addition in the industry is expected to remain high, going forward. Based on the announcements, the tyre industry is likely to see a capacity addition of over Rs. 200 billion in the next three years (FY2019-21).

While tyre demand has been favourable, the industry margins have come under pressure in the recent quarters. During the period April to September 2018, domestic natural rubber (NR) prices were trading at Rs. 120-134 per kg, however, the prices of crude derivatives like synthetic rubber, carbon black, rubber chemicals etc. increased sharply with oil prices increasing by over 17% during this period. Accordingly, the industry profit margins declined by 120 bps in Q2 FY 2019 on a Y-o-Y basis. But with current NR prices being largely stable at around Rs. 120/kg levels and crude oil prices falling by over 30% in the last two months, the industry margins are expected to improve in H2 FY2019. Amid continued investments towards capacity addition (partly debt funded), the liquidity position, capitalisation and coverage indicators of the industry players are expected to remain comfortable, largely supported by stable earnings and healthy cash reserves available with most of the players.

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

K Srikumar
Vice President and Co-Head - Corporate Ratings
ksrikumar@icraindia.com

Aviation

ICRA gives Negative outlook for the Aviation industry

- However, domestic passenger traffic growth is expected to remain healthy at ~15-16% over the medium term

ICRA has a negative outlook on the airline industry. The strong passenger demand is offset by capacity additions leading to intense competition and continued pressure on yields. Many of the industry players have a weak balance sheet structure; and with rising losses in the near term, the industry would need ~Rs. 350 billion equity infusion over the next 3-4 years.

Rise in aviation turbine fuel (ATF) prices and Rupee depreciation has squeezed the revenue per available seat kilometer – cost per available seat kilometer (RASK-CASK) spread, exerting significant pressure on operating profitability of airlines. This will result in significantly higher losses (at net level) in FY2019 vis-à-vis FY2018, notes ICRA. Thereafter, the industry prospects can be expected to gradually improve, contingent upon the movement in ATF prices.

The airline industry maintains strong capacity addition plans, as reflected by the large order book of the domestic airlines. ICRA estimates domestic available seat kilometer (ASKM) growth at ~17-18% p.a. over the medium-term, off-setting demand growth. The domestic passenger traffic growth is expected to remain healthy at ~15-16% over the medium term, supported by low penetration levels, a favourable macro environment, the regulatory push towards regional connectivity and the development of new airports.

ICRA notes, while the passenger traffic growth remained strong during FY2018 and H1 FY2019, the industry faced a double whammy with increasing ATF prices and Rupee depreciation. The cost pressures are expected to continue during the rest of FY2019, resulting in further weakening of the financial health of the industry. The same is expected to improve gradually from FY2020 onwards as the pricing power of the airlines improve, coupled with ongoing cost rationalisation initiatives".

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

Kinjal Kirit Shah
Vice President-Corporate Sector Ratings
kinjal.shah@icraindia.com

ICRA: Upsizing of bank recapitalisation programme for FY2019 Positive for Public sector banks (PSBs)

- Tweaking of prompt corrective action (PCA) framework can lead to faster exit of some PSBs
- Deposit mobilisation to remain key challenge for growth of private sector banks

The recent decision of Government of India (GOI) to upsize the bank recapitalisation plan for FY2019 by Rs 410 billion to Rs 1.06 trillion is positive for PSBs, as many of the PSBs were not able to raise equity capital from markets as was originally envisaged under the PSB recapitalisation plan of Rs 2.11 trillion announced during October 2018. With this, the overall capital infusion by GoI into PSBs during FY2015-2019 stands at Rs 2.56 trillion.

As a part of capital allocation plan for FY2019, recently some PSBs have been allocated a relatively higher quantum of capital, which in our view, is to enable them to reduce their Net non-performing advances (NPAs) below the PCA threshold of 6.00% as well as achieving regulatory capital ratios (including capital conservation buffer – CCB of 1.875% required as on March 31, 2019). Despite additional capital infusion by GoI, ICRA expects most of the PSBs currently under the PCA framework to report second consecutive year of losses during FY2019. Two consecutive years of losses being a PCA criterion will hence constrain the exit of these PSBs, which otherwise will improve their Net NPA and capital ratios. Hence, ICRA expects, with some tweaking of PCA norms, some of the PSBs, can exit the PCA framework, thereby enabling them to pursue credit growth.

Notwithstanding a higher share of capital allocation to some PSBs under PCA, ICRA expects the capital allocation to other PSBs under PCA to be limited to enable them to meet regulatory minimum capital ratios, i.e. Tier 1 of 7.00% and CRAR of 9.00%. This will ensure that GoI can infuse growth capital into some PSBs to enable them to meet additional credit demands of the economy.

During November 2018, RBI also deferred the scheduled increase of 0.625% in CCB framework i.e. from existing 1.875% to 2.50% by one year, which will also reduce the capital requirements for some PSBs and enable others to support credit supply without fearing the capital breach. Another positive for the banking sector has been the recent softening in bond yields after a sharp decline in crude oil prices during Q3FY2019 and upsizing of open market operations (OMO) purchases of bonds by Reserve bank of India (RBI), which has resulted a sharp decline in bond yields during Q3FY2019.With ~65 basis points (bps) decline in bond yields during Q3FY2019, ICRA expects a reversal of mark-to-market (MTM) losses suffered by banks during H1FY2019 on their bond portfolios. As per our estimates, every 10-bps decline in bond yields reduces MTM losses of PSBs by Rs 30-35 billion and Rs 5-6 billion for private sector banks (PVBs) and hence a positive for the profitability of banks during Q3FY2019.

The asset quality for the banking sector continues to improve but remains weak for PSBs. The fresh NPA (PSBs and PVBs) continue to moderate during Q2FY2019 with slippages of Rs 0.70 trillion (3.6% of standard advances) as compared to Rs 0.90 trillion during Q1FY2019 (4.6%), however the provisions on the existing NPAs and MTM losses during H1FY2019 impacted their profitability. PSBs have reported a loss before tax of Rs 457 billion during H1FY2019 (Rs 242 billion during Q1FY2019 and Rs 232 billion during Q2FY2019 as compared to loss before tax of Rs 318 billion during H1FY2018. The private banks (PVBs) because of decline in their treasury income amid rising bond yields reported a 10% decline in their net profits to Rs 206 billion during H1FY2019 from Rs 229 billion during H1FY2018.

ICRA expects, the losses before tax for PSBs to decline in H2FY2019 as compared to H1FY2019, primarily supported by reversal of MTM losses on their bond portfolios; but overall losses to remain elevated at Rs 676-852 billion for FY2019, which in-turn will depend their credit provisioning levels on NPAs. Hence a large portion of the budgeted capital infusion of Rs 1.06 trillion by GoI for FY2019 will be offsetted against their losses. With scheduled increase in CCB during FY2020 and the need for the growth capital will pose fresh equity capital requirements for PSBs during FY2020. A budgetary announcement in this regard and improvement in the financial performance of PSBs will determine their ability to raise capital from other investors and will remain key drivers of the PSBs' capital position during FY2020 and inturn their ability to increase the credit supply to various sectors.

With declining fresh slippages, the stock of Gross NPAs (GNPAs) for the sector continues to decline with GNPAs declining to Rs 10 trillion as on September 30, 2018 or 11.0% (PSBs – 14.1% and PVBs 4.4%) as compared to peak of Rs 10.23 trillion or 11.68% as on March 31, 2018. Increase in provisioning on NPAs also led to improvement in provisioning cover to 53.2% as on September 30, 2018 as against 49.4% as on March 31, 2018 leading to Net NPAs declining to Rs 4.7 trillion or 5.5% (PSBs – 7.7% and PVBs 1.9%) as compared to Rs 5.17 trillion or 6.27% as on March 31, 2018. With ongoing resolution of stressed assets, we expect GNPAs and NNPAs for banking sector to decline further to ~10.2% and 4.3% respectively by March 2019.

The YoY credit growth of the banks in ICRA's sample set (21 PSBs and 18 PVBs) stood at 9.3% as on September 30, 2018 with YoY credit growth of 4% for PSBs and 21% for PVBs. With strong capital position for most of PVBs, their ability to pursue credit growth will continue to be driven by their abilities to mobilise deposits given their high credit/deposit (CD) ratio of 92% as on September 30, 2018 and incremental CD ratio of 104% during trailing twelve months ending September 2018. With steady growth of 15-20% in advances for PVBs during FY2019 and improvement in treasury income during H2FY2019, the profitability and return on equity is expected to remain better during FY2019 in comparison to last year levels. In our view, the net profits of PVBs can grow at 20-25% during FY2019 resulting in ROEs of 10.5-11.0% during FY2019 as against 10.2% during FY2018.

In absence of ability to support credit growth, PSBs have also refrained from chasing deposit growth which has also prevented a sharp increase in deposit rates during last two years. Depending on their capital position and ability to support credit growth, we expect PSBs will restart posing competition for private sector banks (PVBs) both on the deposit side and credit side leading to higher deposit rates and pressure on lending yields, which is likely to be negative for PVBs. Accordingly, we believe that the market share loss for PSBs will bottom out at 62-64% of advances (currently at 69%) and for PVBs to stand at 36-38% by end of FY2020. Overall, we expect with better capital position, asset quality and profitability by end of FY2020, the banking sector will be better positioned to kick-start the investment cycle in FY2021, even as the credit growth will be driven by the investment demand.

Analyst Contacts:

Karthik Srinivasan
Senior Vice President & Group Head-Financial Sector Ratings
karthiks@icraindia.com

Anil Gupta
Vice President & Sector Head-Financial Sector Ratings
anilg@icraindia.com

ICRA: Liquidity concerns to have multifaceted impact on near-term Retail-NBFC performance

The prevailing liquidity scenario is expected to impact NBFCs in multiple ways as they are faced with constrained fund availability since September 2018. While the incremental cost of funds has gone up by about 100-125 bps since H1FY2019, which would have an impact on their earnings profile, the expected moderation in portfolio growth could further accentuate it. Also, asset quality, especially for some select asset segments namely small business credit, loan against property etc, could weaken, in case incremental funding to these segments remain subdued for a prolonged period. Considering the target borrower segments of NBFCs, namely self-employed borrowers, increase in the borrowing cost would also impact their debt servicing capability, if the operating or demand environment weakens.

Given the prevailing scenario, we expect the Retail-NBFC credit, which stood at Rs.8.3 trillion as on September 30, 2018, to expand at a slower pace of 16-18% during FY2019, vis a vis the 25% year-on-year growth reported in H1FY2019. Retail-NBFC credit growth during H1FY2019 was highest in the last 5-6 years, while growth in H2FY2019 is expected to halve to about 12-13%. Retail-NBFC credit growth is expected to be about 16-18% in FY2020 with the expectation that fund availability would improve vis a vis prevailing trends. Among the key target segments of Retail-NBFCs, some would witness headwinds namely vehicle finance because of competitive pressures from banks while small enterprises and business credit would get hit as re-finance risk has increased for this segment post the liquidity squeeze. These segments together account for 70-75% of the Retail-NBFC credit.

As for Retail-NBFC asset quality, the same had improved with 90+ days past due (dpd, excluding microfinance) declining to about 4.2% in September 2018 from 4.4-4.5% in March 2018. Asset quality improvement was on the back of a relatively stable or improvement witnessed in some key asset classes, namely commercial vehicle (CV), small enterprise credit (including loan against property), tractor, gold loans and construction equipment (CE). The improvement could also be partly attributed to the sharp revival in portfolio growth observed since September 2017. 90+dpd (lagged by 6 months) also improved and stood at 4.5% in September 2018 compared to 4.8% in March 2018.

Asset quality of NBFCs, over the last 3-4 quarters, was uplifted by the improvement in operating environment of the borrowers as demonetisation and GST-related headwinds waned. ICRA, however, expects pressures to re-emerge due to the weakening in operating and demand environment for some asset segments, increase in systemic rates and tightening in market liquidity, which could impact credit flow to the small enterprises.

Retail-NBFCs are increasingly focussing on unsecured personal credit to improve product diversification and for higher business yields; considering the lower seasoning currently and higher underlying risk, asset quality in this segment would be a key monitorable. Share of unsecured personal credit (including microfinance) in Retail-NBFC credit increased to 17% in September 2018 from 13% in September 2016.

The asset liability maturity profile for Retail-NBFCs improved in September 2018 as compared to March 2018 as entities slowed-down disbursements and augmented on-book liquidity in the form of cash and liquidity investments. The cash and liquid investments as proportion of asset under management improved to over 4.5% from about 2.3% in March 2018. While this buffer would moderate as market liquidity eases and fund availability improves over the next few quarters, the impact of the above would be visible on their near-term return indicators.

The cumulative impact of the increase in the cost of funds, strain on business yields on the back of the increase in liquid investments, competitive pressures and expected weakening in operating efficiencies because of lower growth would impact operating profitability of Retail-NBFCs by about 30-50 bps in the current fiscal. Further, the envisaged re-surfacing of asset quality concerns could result in increased credit costs; thus, Retail NBFCs are expected to register return on average managed assets (RoMA) of 1.6-1.8% for FY2019 vis a vis 2.1% (on 12-month trailing basis) in September 2018.

The capital profile has been adequate with the net worth, in relation to assets under management (AUM), at 15-16%. ICRA expects the capital profile of Retail-NBFCs to remain adequate over the medium term. Mid and small-sized NBFCs with steeper growth plans, however, would be required to raise capital in the near term to support business growth.

Analyst Contacts:

Karthik Srinivasan
Senior Vice President & Group Head-Financial Sector Ratings
karthiks@icraindia.com

A M Karthik
Vice President & Sector Head-Financial Sector Ratings
a.karthik@icraindia.com

ICRA: Housing credit growth to slow down; asset quality a key monitorable going forward

- For meeting a growth target of 15%, HFCs would need Rs. 1.7-1.9 lakh crore in H2 FY2019

The domestic housing finance companies (HFC) may witness some slowdown in their housing credit growth during the period H2FY2019. As per an ICRA note this would be consequent to factors like tight liquidity, intense competition and other risks. The subdued credit portfolio growth is in contrast to the favourable period witnessed in H1FY2018. As per an ICRA note, the estimated total housing credit outstanding stood at around Rs. 17.8 lakh crore and grew 17% Y-o-Y for the period ended September 30, 2018 as compared to 15% Y-o-Y growth for the period ended September 30, 2017. The home loan portfolio of housing finance companies (HFCs) have continued its growth trajectory and have grown at a faster pace of 18% Y-o-Y till September 30, 2018 as compared to the home loan book of banks which grew at 16% Y-o-Y (13% Y-o-Y till September 30, 2017). The non-housing loan portfolio of HFCs grew at 29% Y-o-Y for the 12 months ended September 30, 2018 leading to an increase to 36% as on September 30, 2018 (34% as on September 30, 2017).

While long-term prospects for the segment continue to remain good, tight liquidity which impacted disbursements of HFCs is likely to pare the growth in H2FY2019 to 12-14% leading to moderation in the overall housing credit growth of 14-16% for FY2019. Further FY2020 growth is likely to be marginally better at 15-17% if the liquidity situation improves. A modest shift in market share is also likely with HFCs slowing down fresh disbursements in Q3 FY2019 and banks growing their portfolios at a faster pace through portfolio buyouts.

Overall the ticket sizes for all HFCs was around Rs 25 lakh as on September 30, 2018, more than 80% of the home loan portfolio for all HFCs taken together were in the Rs. 10 – 100 lakh bracket, which have reported better asset quality performance vis-a-vis lower and higher ticket sizes. While, Gross NPAs (stage 3 assets as per revised Ind-AS) as of September 30, 2018 were 1.3% (similar to June 2018 levels though slightly higher than 1.1% as on March 31, 2018), tight liquidity and slowdown in growth could impact the asset quality in the non-housing loan segment. Within the housing loans segment for HFCs, share of self-employed segment has increased to 29% as on September 2018. Though some of the larger HFCs can compete with banks in the salaried home loan segment, most of the HFCs target self-employed customer segments or the affordable housing segment to optimise their yields. While the segment offers good growth potential, the asset quality in this segment is inferior with GNPA of 1.5% as on September 30, 2018 (1.1% as on March 31, 2018) as compared with salaried segment GNPA of 0.5% as on September 30, 2018(0.4% as on March 31, 2018).

The increased number of players in the market has increased the competitive intensity in the industry leading to some dilution in lending norms. coupled with greater focus of the existing players. Overall the portfolio vulnerability of the home loan portfolios of HFCs has increased owing to an increased share of riskier sub-segments like self-employed and affordable housing within the housing portfolio of HFCs. Further, the share of portfolio lent at higher tenures and fixed obligation to income ratio has also increased which could impact asset quality indicators of HFCs over the medium term. Also, for around 15% of the portfolio, Loan to value ratios were higher than 80% which could lead to higher losses, in case delinquencies were to crystallise/property prices were to correct. These risks partly get mitigated by the strong monitoring and control processes of HFCs, borrowers' own equity in the properties and the large proportion of the properties being financed for self-occupation especially in the affordable segment.

In ICRA's opinion, gross NPAs for HFCs in home loan segment could increase to around 1.1-1.3% over the medium term from the current level of 1.0%. Moreover, higher Gross NPA% on the non-housing loan segment could lead to increase in gross NPAs for HFCs to around 1.4-1.8% by end of FY2020. The ability of HFCs to implement timely collection and recovery efforts in respect of the delinquent loans - repossess the property, wherever necessary, and sell the same in a timely manner - will be a key monitorable.

As for funding alternatives, commercial paper (CP) borrowings accounted for around 10% of the overall borrowings for HFCs as on September 30, 2018. With the tight liquidity witnessed in the debt markets since September 2018, HFCs used a combination of securitisation, utilisation of bank limits, rollover of CPs and curtailment of disbursement levels to repay their debt obligations in Q3FY2019. While the CP issuance volumes have gone up from the lows observed in September 2018, HFCs are working on reducing their reliance on short-term funding with increased focus on raising long-term funds as well as securitization. For meeting a growth target of 15%, ICRA estimates that HFCs would need Rs. 1.7-1.9 lakh crore in H2 FY2019. The timely availability of incremental funding at competitive rates would be crucial for meeting repayments as well as for normal business growth.

Earnings for H1 FY2019 remained good with return on equity (RoE) of 17%. A mix of factors could impact the earnings of HFCs in the current fiscal. Given that around Rs. 1.7-1.9 lakh crore of debt would be refinanced at higher rates in H2 FY2019, the cost of funds for HFCs is likely to go up by around 30-50 bps in FY2019. As most of the HFCs have increased their lending rates also by 20-30 bps, the overall impact on net interest margins (NIMs) could be lower at around 15-25 bps. Further, a slowdown in growth is likely to impact the operating expense ratios. While profitability indicators for FY2019 are likely to remain good with RoEs of 15-17%, supported by upfront income booking on assignments, a prolonged slowdown in growth could impact the operating expense ratios and asset quality of some asset classes, which could lead to moderation in profitability indicators.

Analyst Contacts:

Karthik Srinivasan
Senior Vice President & Group Head-Financial Sector Ratings
karthiks@icraindia.com

Supreeta Nijjar
Vice President & Sector Head-Financial Sector Ratings
supreetan@icraindia.com

Commodity

Despite subdued demand in FY2019, ICRA gives a Stable outlook to Gold Jewellery – Retail sector

- Over the medium to long term, the gold jewellery demand growth is projected at 6-7%

ICRA has assigned stable outlook on the gold jewellery retail industry. Following a strong 9% volume growth in FY2018, gold jewellery demand has been subdued in the current year. Jewellery sales during the critical festive period, August to November 2018, was relatively sluggish due to various factors like elevated gold prices, and floods in Kerala. Other factors impacting demand in the current year include lesser number of auspicious days and cautious lending by banks to the gems and jewellery sector, thereby curtailing the store expansion plans of the players.

Gold jewellery demand in India varies across rural and urban markets, right from the type of jewellery bought to timing of purchases. With ~65% of the population in India living in rural areas, favourable farm output in the last two years on the back of good monsoons has been a positive trigger for demand in the rural areas, where jewellery is a traditional reflection of wealth. On the other hand, urban demand has gained traction from rising per capita income and demographic dividend. Jewellery buying is spread throughout the year with increased skew towards September to January, led by festive and wedding seasons. This apart, factors like gold price, inflation, priority of needs etc. are the other key determinants while buying jewellery. Consumers time their purchases depending on price levels.

Being a price-sensitive market, higher gold prices result in deferment of purchases by consumers. Gold prices have increased by over 6% in the last one year, which has consequently impacted the consumption demand. This apart, financing to the gems and jewellery sector has been under increased scrutiny in the last one year following reports of fraud by a few lenders with exposures to leading diamond jewellers, and with exposures to a couple of gold jewellery retailers in South India. Lending to the sector remains cautious with enhanced due diligence and checks on credit quality and inventory quality. Tightened credit has affected store expansion plans and working capital position of industry players, especially the unorganised ones. Due to the rising prices and weak consumer sentiments, the gold jewellery demand is expected to decline by 2-4% in FY2019. However, with the pent-up demand and the expected improvement in credit availability, the demand is likely to recover and grow by an estimated 6-8% in FY2020.

While the overall demand has been largely subdued in the current year, the performance of organised players (ICRA's sample set) has been relatively better. Post currency demonetisation and implementation of Goods and Service Tax (GST), there has been a marked shift from unorganised to organised trade. This apart, assurances on quality, purity, and availability of wider design range and rising preference for fashion jewellery have further supported organised trade. Going forward, ICRA expects these regulatory measures to continue to accelerate the formalisation of the sector and in turn increase the market share of organised players.

Over the medium to long term, the gold jewellery demand growth is projected at 6-7%, supported by the cultural underpinnings, evolving lifestyle, growing disposable income, favourable demographic dividend and the growing penetration of organised sector.

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

K Srikumar
Vice President and Co-Head - Corporate Ratings
ksrikumar@icraindia.com

Commodity

ICRA maintains Stable year-end outlook for Cement sector

- Demand growth estimated to be around 7% in FY2019
- Despite some easing in input costs of petcoke, diesel and revised axle norms, cement price hike remains critical from profitability perspective

ICRA has assigned a stable outlook to the domestic cement manufacturing sector.

Cement production has witnessed a YoY growth of around 15% in 7M FY2019. This is driven by the demand in Andhra Pradesh and Telangana (driven by irrigation, low cost housing and infrastructure projects), the eastern and western markets (driven by low cost housing and infrastructure demand) and northern Indian markets (led by execution of infrastructure projects). Rural housing also saw a pick-up driven by improvement in rural economy, which supported the cement demand. However, the cement prices remained subdued during the same period due to capacity overhang. Coupled with the higher costs, this resulted in the YoY decline in the operating margins of most cement companies in H1 FY2019.

In FY2019 and FY2020, the demand growth is estimated at 7% and 8%, respectively, which is bolstered by a pick-up in the housing—primarily affordable housing—and improved focus on the infrastructure segment. Increased budgetary allocation for the rural economy, agricultural and allied sectors, is likely to support rural housing construction, and as a result, fuel cement demand. On the capacity side, we expect around 15–18 MTPA to get added in FY2019–FY2020, primarily in the eastern and central regions. The incremental cement demand is likely to be greater than incremental supply resulting in improvement in the capacity utilisation to 67% in FY2019 and 70% in FY2020, from 65% in FY2018.

As for production, at 84.9 million MT in Q1 FY2019, it was higher by 15.9% on a Y-o-Y basis and at 77.3 million MT in Q2 FY2019, it was higher by 12.5%. Production remained in the range of 27.7–28.8 million MT during the April 2018–June 2018 period, clocking the highest at 28.8 million MT in June 2018. During the monsoons when cement consumption is typically on the lower side, production declined to 25.5–26 million million MT in July–August 2018, compared to that in Q1 FY2019. In September 2018, the production remained at 25.6 million MT, higher by 11.9% on a YoY basis. October saw an increase in production by 11% to 28.4 million MT on an MoM basis and was higher by 18.5% on a YoY basis.

Cement prices in most markets in the North and South were lower by 5-10% in H1 FY2019 on a YoY basis. In addition, higher input costs, mainly power and fuel, and freight costs resulted in decline in the operating margins of most cement companies in H1 FY2019 on a YoY basis. However, there has been some easing in input costs in recent months, primarily petcoke and diesel prices. Further, increase in the truck axle load (announced by the GoI in July 2018) is likely to result in some reduction in freight costs, going forward. While easing cost pressures would provide some respite to cement companies, the players' ability to secure increases in cement prices remains critical from a profitability perspective.

Analyst Contacts:

Sabyasachi Majumdar
Group Head & Senior Vice President-Corporate Ratings
sabyasachi@icraindia.com

Anupama Reddy
Assistant Vice President
anupama.reddy@icraindia.com

Avneet Kaur
Assistant Vice President
avneetk@icraindia.com

Commodity

ICRA maintains Stable year-end outlook for Sugar sector

- Despite marginal decline in the expected sugar production in SY2019 on YoY basis, it remains healthy at around 31-31.5 million MT
- Surplus scenario likely to result in pricing and profitability pressures in near-term

ICRA has given a stable year-end outlook for the sugar sector. The estimated sugar production for SY2019 is 31-31.5 million MT, lower than 32.2 million MT in the previous year. This estimate is lower than the earlier estimate of 35 million MT given in July 2018. Despite the expected decline in sugar production, the surplus scenario is likely to prevail and the closing stock for the season is estimated at 11.3-12.3 million MT. The oversupply situation is likely to exert pressure on the margins in that year. However, the downward revision in the production estimate and the Government support measures are likely to provide some respite for this season.

The production is likely to be higher by at least 5.5 million MT than the estimated consumption for SY2019. Even after assuming 4-5 million MT of sugar exports in SY2019 on the back of an increase in the production subsidy, the closing stocks would remain high at around 11.3-12.3 million MT, given the high opening stocks of around 10.5 million MT from the previous season. Nonetheless, downward revision in production estimates along with sugar exports are likely to support sugar prices in the near term. However, with the commencement of cane crushing, the supply pressures on prices cannot be ruled out completely. High cane cost of production and supply induced pricing pressures are likely to put pressure on margins.

The downward revision in the production estimate was driven by a decline in sugarcane availability in all major producing states namely Uttar Pradesh (UP), Maharashtra and Karnataka. In addition, the sugar production could be further impacted by diversion of 'B' heavy molasses and sugarcane juice away from sugar into ethanol. Domestic sugar consumption is estimated to grow by 2-3% to around 25.8 million MT in SY2019.

The Cabinet Committee on Economic Affairs (CCEA) has fixed the fair and remunerative price (FRP) at Rs. 275/quintal for SY2019, an increase by Rs. 20/quintal, from the previous year. However, the cane price is linked to a basic recovery rate of 10.0%, against 9.5% the previous year, resulting in an effective increase in the FRP by 2.5% YoY in SY2019. The UP Government has announced state advised price (SAP) for sugarcane for SY2019 at Rs. 315/quintal for the normal variety, same as SY2018. While the non-increase in SAP and the modest increase in FRP are a saving grace for the mills, the cost of production continues to be high. This, along with supply induced pricing pressures, is likely to put pressure on the sugar industry's margins in SY2019. Thus, the Government intervention in support of the sugar mills and the farmers is likely to remain critical in the coming sugar season to protect the margins and the liquidity of the sugar industry and prevent an increase in cane arrears.

The Government of India (GoI) has taken various measures in support of the industry. In September 2018, the GoI has notified a cane production subsidy of Rs. 138.8/MT (as against Rs. 55/MT last year), which would be paid directly to farmers as part of the cane costs in SY2019 against the 5 million MT of sugar exports under minimum indicative export quota (MIEQ). This apart, the transport subsidy (for the mills not located in coastal states) of Rs. 3/kg has been provided on sugar exported. Given the prevailing international prices, the companies are likely to incur losses on sugar exports. The direct benefit from the production and transport subsidy would amount to around Rs. 1.50-1.65/kg of sugar produced (assuming 14% of sugar production is exported). Further, the mills would save on the interest and storage costs to the extent of sugar exported. In June 2018, the CCEA approved the creation of 3 million MT of buffer stock, fixed a minimum selling price of Rs. 29/kg and announced a Rs. 1,300-crore interest subvention to be provided on the loans for creating new ethanol capacity or expanding existing ones.

Analyst Contacts:

Sabyasachi Majumdar
Group Head & Senior Vice President-Corporate Ratings
sabyasachi@icraindia.com

Anupama Reddy
Assistant Vice President
anupama.reddy@icraindia.com

Avneet Kaur
Assistant Vice President
avneetk@icraindia.com

ICRA: Shortfall in GoI's indirect tax revenues to curtail Central tax devolution in FY2019; a key revenue risk for state governments, a key revenue risk for state governments

- SGST collections may modestly exceed the amount budgeted by states for FY2019

ICRA expects the Government of India's (GoI's) indirect tax revenues to fall short of its Budget Estimates (BE) for FY2019, driven by lower-than-budgeted collections of the Central GST (CGST) and the excise duty on fuels. The anticipated shortfall in these two indirect taxes, is likely to lead to a downward adjustment in the Central tax devolution (CTD) to the states in FY2019, relative to the level budgeted by the GoI, which has emerged as a risk to the achievement of the FY2019 BE for the revenue receipts of the state governments. However, the state GST (SGST) collection trend in April-November 2018, suggests that the aggregate SGST collections of all states may modestly exceed their combined FY2019 BE, providing a buffer to the lower CTD.

ICRA estimates that the CGST collections during April-November FY2019, were equivalent to around half of the Rs. 6.0 trillion included by the GoI in its FY2019 budget, which suggests an impending shortfall relative to the level budgeted for this fiscal. As of now, it appears that there would be a shortfall in the overall tax revenues of the GoI, relative to the budgeted target for FY2019, which is likely to lead to a downward adjustment in the CTD to the states in the ongoing fiscal. This has emerged as one of the key risks to the achievement of the budgeted level of revenue receipts of the state governments.

In October 2018, the GoI had cut the excise duty on petrol and diesel by Rs. 1.5/litre each, which is expected to have a revenue implication of Rs. 105.0 billion. This would impact the GoI's excise collections in H2 FY2019.

The GoI's direct taxes rose by 16.4% in April-October FY2019, nearly in line with the growth of 17.4% included in FY2019 BE. Notwithstanding concerns related to the inflows from the long-term capital gains tax, ICRA does not expect a meaningful shortfall in the GoI's direct tax collections, relative to the BE for FY2019.

The SGST and sales tax/VAT on petroleum and petroleum products form a large portion of the states' own tax revenues, which are in turn budgeted to account for ~43% of the aggregate revenue receipts of all 29 states in FY2019. ICRA expects the state governments' tax revenues from petrol and diesel to be dampened in H2 FY2019, reflecting the cut in the rate of VAT/ sales tax levied on such fuels by several states in the recent months, which was followed by a fall in the retail selling prices of such fuels.

ICRA also estimates the aggregate SGST collections of all 29 states at Rs. 3.4 trillion for the first eight months of the ongoing fiscal. This is equivalent to a healthy ~70% of the Rs. 4.9 trillion budgeted by all the states for FY2019, considerably higher than the level of CGST collections relative to the FY2019 BE of Rs. 6.0 trillion. The trend so far, suggests that the aggregate SGST collections of all states may modestly exceed the combined FY2019 BE, acting as a buffer to the lower CTD.

An analysis of the monthly provisional data available from the Comptroller and Auditor General of India (CAG) for 20 state governments reveals that the pace of growth of their aggregate revenue receipts stood at 13.7% in H1 FY2019, slightly higher than the 13.3% rise indicated in the BE for FY2019. Moreover, the combined revenue expenditure and capital outlay of these states increased by 12.5% and 16.8%, respectively, in H1 FY2019, higher than the growth of 10.8% and 9.9%, respectively, included in FY2019 BE.

The higher-than-budgeted pace of growth of revenue expenditure in H1 FY2019 could partly be because of the pre-election spending by Chhattisgarh, Rajasthan and Madhya Pradesh. Additionally, the massive flooding in Kerala and in parts of Karnataka in August 2018 and the cyclonic storm that hit TN in November 2018, may lead to these states incurring additional spending on rehabilitation work, leading to the aggregate revenue expenditure of the 20 states exceeding the budgeted level in FY2019.

Following the sharp 16.8% increase in capital outlay, the fiscal deficit of the 20 state governments stood at Rs. 1.6 trillion during H1 FY2019 or 36.5% of the FY2019 BE, higher than the trend in H1 FY2018 (33.9% of the FY2018 revised estimates). In ICRA's view, given the concerns related to the level of CTD and VAT/sales tax revenues from fuels, some states may have to curtail the pace of growth of their capital spending in H2 FY2019, to avoid a slippage relative to the budgeted level of the fiscal deficit for FY2019.

Analyst Contacts:

Jayanta Roy
Senior Vice President & Group Head-Corporate Sector Ratings
jayanta@icraindia.com

Aditi Nayar
Principal Economist
aditin@icraindia.com

Fertiliser

ICRA: Fertiliser industry's outlook Stable for urea players; P&K players performance under pressure

- High raw material prices and currency depreciation weighing down on performance of P&K players; urea volumes to remain stable

ICRA's outlook on the domestic urea industry is stable while the performance of the P&K players is expected to be under pressure in FY2019; Government policy actions to determine the performance in FY2020.

According to ICRA, the performance of domestic P&K players is expected to be under pressure in FY2019, given the increased raw material prices and depreciated INR. The P&K manufacturers are entirely dependent on imports to meet their raw material requirement. The recent currency depreciation and the increase in phosphoric acid prices have increase in the input costs which the players have passed on to the farmers. However, owing to poor monsoon in certain pockets of the country, several players have had to pass on higher discounts to the dealers. Additionally, a lag in passing on the price increase has eroded the profitability of these players. P&K manufacturers, which are backward integrated in manufacturing phosphoric acid and are operating in regions where monsoon has been adequate are expected to face a lower impact on their profitability. Going forward, ICRA expects the GoI to increase the Nutrient-Based subsidy (NBS) rates for P&K fertilisers for FY2020, in-line with the increase in raw material prices which should partly alleviate the pressure on the profitability of the P&K manufacturers in the upcoming fiscal year. However, with several agricultural regions facing drought like situation, the demand and pricing pressure on P&K fertilisers may continue in FY2020 unless GoI takes measures to alleviate the prevailing stress in the agri sector.

Urea demand is expected to grow at its long-term growth rate of 1.5-3% in the near to medium term. However, the industry continues to suffer from infrequent revisions in the policy parameters particularly the fixed costs for urea units, freight subsidy rates etc. which result in under-recoveries for fertiliser players. Urea players await the receipt of ~Rs. 4800 crore of revised fixed costs accrued over the last five years under Modified New Pricing Scheme-III (Modified NPS-III). Since government's focus will be on meeting its fiscal deficit commitments in FY2018-19, the possibility of revised fixed costs being paid out to the sector in the current fiscal remains low. The payment of the revised fixed costs will remain a key monitorable in FY2020 for urea players as it would lead to significantly improvement in the liquidity position of the companies.

Fertiliser industry continues to be buffeted by the delay in subsidy receivables from the government owing to inadequate subsidy provisioning, resulting in strained working capital cycle. The budgetary allocation for the fertiliser subsidy is expected to remain around Rs. 70,000 crore, resulting in the continuation of the subsidy backlog which as per ICRA estimates should be around Rs. 32,000-35,000 crore by the end of FY2018-19. The budgetary allocation for the NPK subsidy is expected to increase given the increase in raw material prices and currency depreciation. On the other hand, driven by lower domestic gas availability the share of R-LNG in the overall consumption mix for fertiliser sector has been on an uptrend resulting in higher pooled gas price. Though the R-LNG prices are expected to moderate and remain subdued particularly in the summer season in the Northern Hemisphere, the rising share of R-LNG in the overall gas mix will keep the pooled gas price firm for the urea sector. Higher gas costs result in higher cost of production for the urea players and higher subsidy outgo for the GoI as the retail price of urea remains fixed. Moreover, with three new urea plants expected to be operational in FY2019-20, subsidy on urea will also increase as the cost of indigenous production will be higher than imports. These will pose a challenge for the government to balance the subsidy allocation between urea and NPK fertilisers unless the budgetary allocation increases. Thus, the liquidity profile of the fertiliser companies will remain subdued in FY2020 as well, given the expectations of the budgetary allocation remaining the same. Although GoI's initiative of Special Banking arrangements (SBA) acts as a temporary relief by subsidising the interest costs for urea players, it is not sufficient. Moreover, DBT-related challenges still linger, resulting in elevated levels of working capital for the industry.

As for fertiliser sales volume, ICRA expects it to continue growth trajectory in the near to medium term, though, the rate will be in line with the long-term trend. Fertiliser sales have witnessed tepid growth in 9MFY2019 with overall volume growth of 1.7%. Urea sales have remained nearly unchanged Y-o-Y while DAP/NPK sales have witnessed ~6.5% Y-o-Y growth. MOP sales have witnessed a decline of 10.2% Y-o-Y partly due to non-availability of the material in the market and increase in the retail price for the rabi season. In FY2020, the volume growth is expected to remain in line with the past trends, with availability of domestic urea expected to increase given the commissioning of ~3.75 MMTPA of urea capacity and lowering of imported urea volume.

Contrary to the widely prevalent belief of monsoon being a driver of fertiliser sales, as ICRA is of the opinion fertiliser sales volumes have a very low correlation with monsoon. The sales volumes also depend on the beginning of the season's systemic inventory levels and water reservoir levels. Thus, the overall volume growth for the fertiliser sector should remain in-line with the long-term growth of 2%-4%, with urea sales growing at around 1.5%-3% Y-o-Y while P&K sales are expected to grow at ~4% Y-o-Y.

India is also adding nearly ~7.5 million tonnes of urea capacity over next four years which will lower the significant reliance on urea imports to a large extent. Around 3.75 MMT of capacity is expected to come online within next six-to-nine months while remaining 3.75MMT of capacity will be commissioned by April 2021. Setting up of the new urea plants is in line with the GoI's intent to be self-sufficient in urea production. These new plants will be highly energy efficient and will be governed by the New Investment Policy-2012. Currently, GoI pays subsidy to several urea plants that have very high cost of production. Once the new plants are commissioned, GoI may restrict its off-take beyond certain level from high cost urea plants.

Debt level of the urea units is also expected to increase given the capex to be undertaken to meet revised energy norms under New Urea Policy-2015 applicable for 14 units from FY2021. The capex for most of the players will be largely debt funded. While the capex will not result in incremental profits for the urea units, it will be necessary to meet the regulatory guidelines.

Analyst Contacts:

K. Ravichandran
Senior Vice President & Group Head-Corporate Ratings
ravichandran@icraindia.com

Varun Gogia
Senior Analyst
varun.gogia@icraindia.com

ICRA maintains Stable year-end outlook for Hospital sector

- Post multiple disruptions, performance of hospital sector is expected to recover in FY2020
- Credit profile of most industry players likely to pick up

The hospital sector witnessed challenging times in FY2018 and FY2019YTD with various regulatory restrictions from multiple authorities affecting the average revenue per occupied bed day (ARPOB) of the players. The latest quarter also witnessed a sub-par growth in ARPOB and a drop in the profitability margin across the players. Nonetheless, ICRA believes that the impact of these factors has peaked and without any additional measures, the worst is probably over. Further, significant bed additions in the last four years and their expected ramp-up, coupled with low planned bed additions and correspondingly low start-up costs, are expected to start showing marked results going forward.

The sector's revenues are expected to grow by 8-10% over the short-to-medium term, supported by a higher number of patients as well as better pricing. On the capex front, most of the players in ICRA's sample set have expanded rapidly over the last four years and the pace of capex is likely to be slower over the short term. The established players are also likely to continue to focus on increasing the share of higher value-added specialties and reducing the average length of stay (ALOS). This will help improve the ARPOB.

The launch of a Government-funded healthcare plan, Ayushman Bharat, has the potential to significantly increase the mandatory as well as discretionary healthcare spend in the country as the plan boosts the spending power of patients. The introduction of the scheme is likely to improve the occupancies at implementing hospitals, albeit with lower profit margins. The scheme is expected to be a major positive for hospitals in Tier II and III cities and smaller towns, particularly for healthcare facilities which have low occupancies and/or those that are positioned for affordable care. With an increase in patient volumes and occupancies, the viability of such hospitals is expected to improve. Ayushman Bharat may also incentivise smaller players to incur capex and increase capacities in Tier II or smaller towns.

Over the long term, the sector is expected to benefit from the underlying fundamentals including significant shortage of beds in the country, increase in disease burden, higher incidents of lifestyle diseases and an ageing demographic profile. Further, the demand for quality healthcare will be supported by rising per capita income, increasing penetration of medical insurance and double-digit growth in medical tourism.

The credit profile of the hospital sector has been deteriorating since the beginning of 2017 due to several factors that have adversely impacted its profitability. These include the implementation of the Goods and Services Tax (GST) , cap on the prices of stents and knee implants by the National Pharmaceutical Pricing Authority (NPPA) and stiff regulatory action by certain states, including putting restrictions on procedure rates, levying penalties and placing operational limitations on erring hospitals. The debt protection indicators had come under pressure primarily on account of lower profitability and increase in leverage to fund expansion. With the new capacity now stabilising and improvement expected in the performance because of the waning effect of the disruptive events of the last two years, ICRA expects the debt protection indicators to improve in FY2020. Thus, it maintains its Stable outlook on the sector.

Analyst Contacts:

Shubham Jain
Group Head & Vice President-Corporate Ratings
shubhamj@icraindia.com

Kapil Banga
Assistant Vice President
kapil.banga@icraindia.com

Health

ICRA assigns Stable outlook for Indian Pharma companies

- Domestic pharma companies expected to grow at a CAGR of around 8-10% between FY2018 and2021
- Productivity of R&D expenditure, increasing competition in the US generics space and operational risk related to increased level of due diligence by regulatory agencies are key concerns

ICRA has assigned a stable outlook for the Indian pharma industry. The headwinds from pricing pressure in large regulated markets, especially the US, and increased costs related to regulatory compliances are largely offset by the growing scale of business, increased focus on specialty/niche segments and comfortable balance sheet structures. The domestic pharma industry has gained adequate scale and generic drug development capabilities over a decade of growth, which will keep them in good stead to capture bigger opportunities in the regulated market. The FY2018-2021 CAGR is expected to be around 8-10% for domestic pharma companies.

The credit metrics of leading pharma companies are likely to remain stable in view of the steady growth prospects in regulated markets and limited dependence of Indian pharma companies on bank borrowings. The OPBITDA/ Interest and TD/OPBITDA for the ICRA set of 21 entities in the Indian pharma industry have been healthy at 10.2x and 2.3x, respectively for FY2018. They are expected to remain in a similar range in the medium term despite some pressure on profitability and a marginal rise in the debt levels, given the inorganic investments. The key sensitivity to our outlook remains the productivity of R&D expenditure, increasing competition in the US generics space and operational risk related to the increased level of due diligence by regulatory agencies.

The growth from the US has declined sharply to -13.1% in FY2018 from 14.4% in FY2016, 4.0% in FY2017. Going forward, the growth momentum would face continued headwinds given the relatively moderate proportion of large-size drugs going off patent, increased competition, generic adoption reaching saturation levels in the US market along with the base effect catching up for Indian exporters. Further, increased regulatory scrutiny, as reflected by the increased issuance of warning letters/ import alerts, and consolidation of the supply chain in the US market which has led to pricing pressures, have impacted the competitiveness of Indian pharma companies.

Though the industry's profitability is expected to remain healthy, pressure remains in the form of rising pricing pressure in the US, increased regulatory compliance costs, rising R&D costs for commercialising specialty product pipelines and currency volatility related to challenges in emerging markets (EMs).Overall, company-specific factors would continue to play a pivotal role with the quality of the product pipeline (i.e. higher share of limited competition launches in the US) being the single most differentiating factor. Companies with a growing portfolio comprising niche/complex products in regulated markets, diversified geographic mix and established brands in EMs would be better placed to manage some of the headwinds.

Over the last few years, pharma companies have increased their R&D budgets significantly in view of their growing focus on regulated markets and complex molecules/therapy segments. With R&D optimisation efforts underway, we expect aggregate R&D spend to remain at current levels despite requirements arising from the expanding presence of complex therapy segments such as injectables, inhalers, dermatology, controlled-release substances and even biosimilars.

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

Gaurav Jain
Vice President & Co-Head - Corporate Ratings
gaurav.jain@icraindia.com

Hospitality

ICRA gives a Stable outlook to the domestic Hotel industry

- Industry witnessed strong uptrend in revenues during Q2 FY2019, with quarterly growth at 28-quarter high
- Return of pricing power across key markets would be more evident from the next rate cycle in Jan’19

ICRA has assigned a stable outlook on the hotel industry.

This is backed by the fact that over the past 18 months, the Indian hotel industry has witnessed a recovery aided by a favorable demand-supply mix. While demand has ramped up, supply additions have slowed down considerably post the sharp ramp up witnessed during FY2008-2016, leading to strong recovery in occupancies in almost all key markets in the country. Nevertheless, in several cities, the return of pricing power has been relatively modest until the recent past.

Average Room Rates (ARRs) have increased by 2-4% annually during the past two years. However, return of pricing power across key markets is expected to be more evident from the next rate cycle in Jan’19. Aided by a muted supply pipeline, and robust domestic travel, a ~5-6% growth in RevPARs during FY2019 is likely, driven by ARR and occupancy improvement; the RevPARs for FY2019 are likely to be the highest since FY2012.

While demand prospects are robust, headwinds from weaker-than-expected corporate performance/economic growth; lower growth in foreign tourist arrivals (FTA), in line with the decline in international tourist arrivals (ITAs) growth rate, weakness in the global macro-economic conditions and country-specific concerns on India (pollution advisories against India, floods in Kerala) could throw up negative surprises.

Industry revenue growth of about ~5% (adjusted for some property closures for renovation) during FY2018 has been aided by the recovery in occupancy and ARR and increase in F&B income. While ARR’s have started recovering, sub inflationary growth, coupled with increase in employee and consumable costs, have capped margin expansions.

ICRA’s sample for the industry witnessed a strong uptrend in revenues during Q2 FY2019, with quarterly growth at 28-quarter high. While the base impact (weak Q2 FY2018 due to the GST rollout, demonetisation, liquor ban etc) has bumped up growth, reopening of a few hotels (Oberoi, New Delhi), growth in RevPAR, F&B income and new openings have also supported revenue growth.

Given the pickup in RevPARs and the prospects, ICRA expects revenue growth (for the industry sample) of strong 10-12% for FY2019. This growth momentum will be maintained in FY2020, with ~5% growth in RevPAR, again supported by strong demand and ~5% supply growth. Despite the higher-than-anticipated growth, margin expansions have been relatively muted in H1 FY2019; margins are likely to expand to 21-21.5% during FY2019, and to ~23-24% during FY2020, from 19.7% during FY2018. While debt reduction measures undertaken by certain large industry participants has resulted in a sizeable reduction in leverage levels as of March 31, 2018, the return on capital employed (RoCE), though improving, remains below cost of capital, and will remain so in FY2020 also.

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

Pavethra Ponniah
Vice President & Sector Head-Corporate Sector Ratings
pavethrap@icraindia.com

Infra

ICRA maintains Stable year-end outlook for Construction sector

- Road segment is expected to remain key contributor for construction activities
- Credit profile of most construction players to remain stable

ICRA has given a stable outlook for the construction sector, in its year-end assessment of the sector.

The order inflow for construction sector has been robust over the last few years, supported largely by increased Government spending towards infrastructure. As a result, the order-book position of most of the construction players is currently adequate to provide medium-term revenue visibility.

Exhibit 1: Order book movement for construction companies

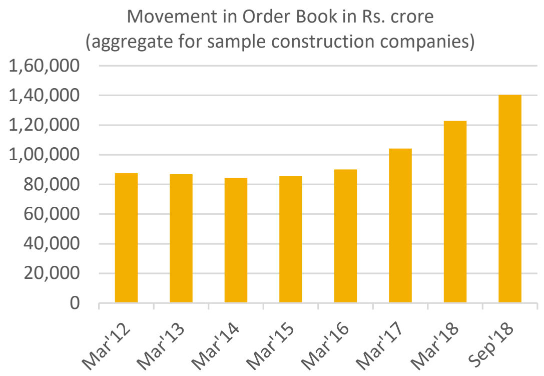
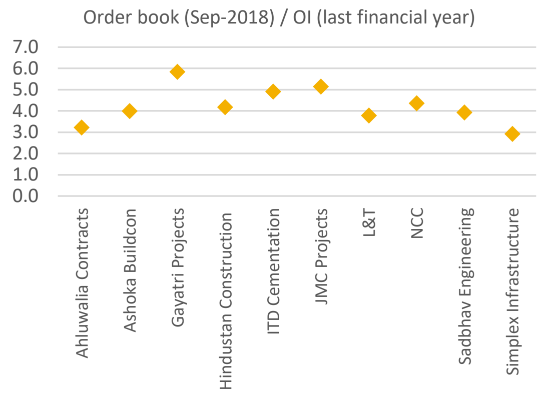


Exhibit 2: Order book to Operating Income (OI) Ratio for some construction companies



Sources: ICRA research

The construction companies are likely to witness significant opportunities from the railways, ports, urban infrastructure and airport segments. In the Railways segment, besides the core railway capex (doubling, new lines, signalling, electrification, etc), the station redevelopment, and the recently announced bullet train project are expected to provide significant opportunities to the construction companies. Similarly, in the road sector, adequate pipeline of projects for development/ upgradation of the national highways and state highways exists. The Bharatmala Pariyojana project itself is expected to provide large opportunities for the construction sector as the programme is the largest road development programme in India with a planned investment of Rs. 5.35 trillion.

With a huge pipeline of projects to be awarded in the infrastructure sector, ICRA expects the new order inflows for construction companies to remain healthy, albeit a slowdown in the pace of order tendering in the months closer to the Lok Sabha general elections due to be held in April/May 2019. Due to this, the order inflows in H1-FY2020 are expected to be muted. Besides this, delay in land acquisition also remains a risk to new order inflows, particularly in the transportation infrastructure sector. The order inflow from non-infrastructure segments like industrial and real estate (excluding affordable housing segment) is expected to remain muted, with weak private sector capex growth.

Exhibit 3: Development programmes in key infrastructure sub-sectors

Sector	Key Programmes	Estimated Capex size
Roads	National Highways - Bharamala Pariyojana	~Rs. 7 lakh crore over 5 years
	State Roads – Various state expressways	~Rs. 0.5-1 lakh crore per year
Railways	Station redevelopment, regular rail infrastructure development	~Rs. 1.5 lakh crore per year
Water and Irrigation	National River Linking Project (NRLP), Accelerated Irrigation Benefit Programme (AIBP)	~Rs. 4-5 lakh crore
Urban Infra	Metro Rail/ MRTS, water supply and sanitation, AMRUT, Smart Cities, Swachh Bharat, Namami Gange	~Rs. 3-4 lakh crore over 5 years
Airports	Development of 100 airports in next 15 years	~Rs. 3-4 lakh crore over 15 years
Ports	Sagarmala	~Rs. 7 lakh crore over 5 years

Sources: ICRA research

On the execution front, being an election year, ICRA expects strong focus on execution, which along with healthy order-book should support growth in the operating income of construction companies in FY2019, though it could witness moderation in H1-FY2020 post elections till stabilisation of new Central Government. Furthermore, many road projects awarded in 2018 and awaiting appointed date are likely to start execution in H2-FY2019, which will support execution. However, construction companies which have leveraged balance sheets and stalled or slow-moving projects, would continue to face challenges.

The operating profitability is expected to remain stable with the benefits of increased execution; though this would also be dependent on any steep variation in key raw-material and labour cost. However, with increased scale of operations, the capex and working capital requirement will consume most of the cash accruals. The working capital cycle for the larger construction players has remained at higher level, owing to slow realisation of receivables, and slow-moving legacy projects. This has been met partly by higher creditors, thus percolating to sub-contractor's working capital cycle as well. The working capital situation is not likely to see any major improvement in the near term. Further, with increased scale of operations, the bank guarantee requirement is also expected to increase, which will require additional collateral/margin money. In the absence of adequate bank guarantee limits, companies will not be able to unlock retention money or avail mobilisation advances, thereby having an adverse impact on their liquidity.

With healthy accruals, the balance sheet of many construction companies has improved over the last two-three years. With increased scale of operations, the debt of construction companies is expected to increase, albeit marginally, except in the case of increase in working capital intensity or investment in asset owning model like the Hybrid Annuity Model (HAM) based projects where the increase in borrowing will be higher. While the overall credit profile of construction companies has improved in last couple of years, many players in the sector still remain highly leveraged and their liquidity pressure is likely to persist in the short term as the lenders remain cautious towards the infrastructure/construction sectors. Their ability to raise funds via a stake sale in its subsidiaries, monetisation of assets, or dilution of equity will be key factors in improving liquidity and capital structure, particularly for companies that have been aggressive in the BOT space in the past.

Asset monetisation can also help in lowering the borrowing levels for companies which have operational assets. Many such transaction have taken place in the last few years, particularly in the road sector, with active interest from private equity, funds, and other long-term investors in acquiring operational projects. Infrastructure Investment Trust (InvIT) can also help to lower the leverage for construction companies that had ventured into asset-owning business and have multiple operational projects. With an improvement in the equity capital markets, equity-raising ability has also improved. Some construction companies have successfully raised funds through the equity route like IPO/QIPs/rights issue/warrants/preference shares, which have helped to improve their balance sheet and liquidity position.

Due to these factors, ICRA expects the credit profile of construction companies to remain stable in the short to medium term.

Analyst Contacts:

Shubham Jain
Group Head & Vice President-Corporate Ratings
shubhamj@icraindia.com

Abhishek Gupta
Assistant Vice President
abhishek.gupta@icraindia.com

Infra

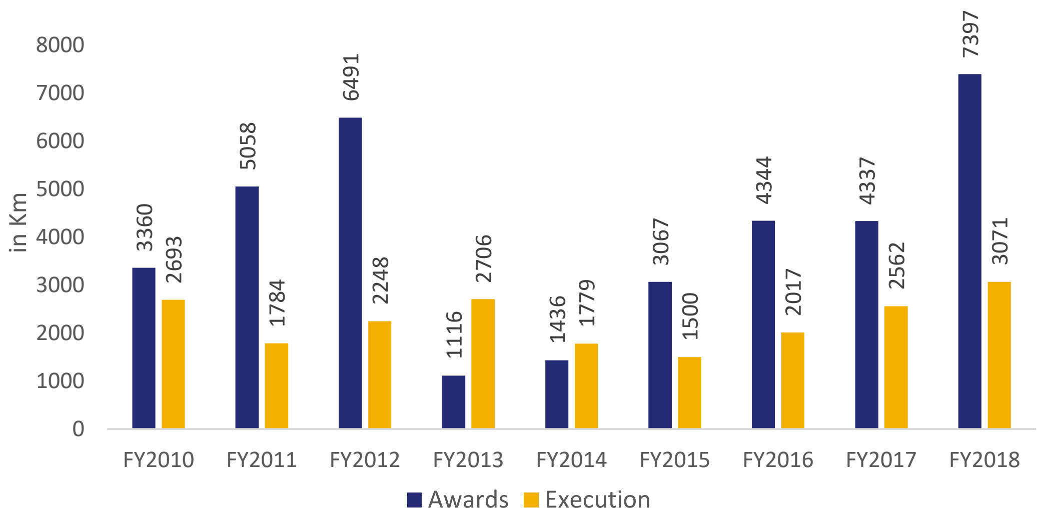
ICRA maintains Stable year-end outlook for Road sector

- Execution to remain strong while awards likely to remain subdued in 2019
- De-leveraging through asset sale by private developers may be affected due to crowding out by toll-operate-transfer awards

ICRA has given a stable year-end outlook for the road sector. While the engineering, procurement and construction (EPC) project executions may witness a temporary slowdown during the general elections; the build-operate-transfer (BOT) and hybrid annuity model (HAM) projects executions are expected to continue unabated. Overall, a strong unexecuted pipeline and concerted effort on the right of way puts the NHAI on a strong footing and is set to witness sustained growth in execution in 2019. In 9M FY2019, the execution witnessed 17% growth to 5,759 km for Ministry of Road Transportation and Highways as against 4,942 km in 9MFY2018.

The awards activity usually picks up substantially during the fourth quarter. Given the general elections in 2019, new award activity is likely to get affected in Q4 FY2019 and Q1 FY2020. Therefore, the awards will remain subdued owing to the General Elections in 2019.

NHAI - Awards and Execution



Source: NHAI, ICRA research

Credit profile of most industry players to be largely unaffected

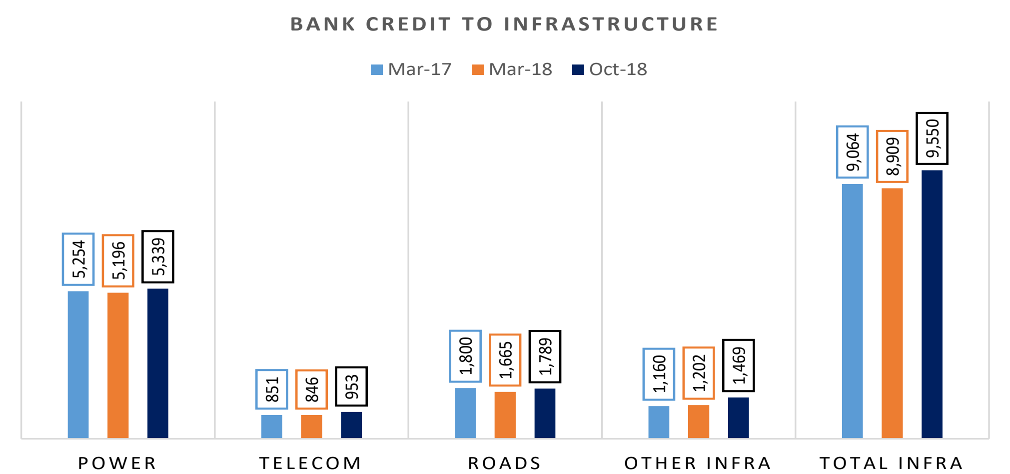
Toll collections are expected to witness high single digit growth in FY2019. The latest commercial vehicle (CV) sales trend is encouraging with the medium and heavy commercial vehicle (M&HCV) cargo segment witnessing robust growth of 38% during 8M FY2019. Further, the average increase in WPI (toll rates are linked to WPI) in FY2019 is expected to be around 4% (higher than FY2018 by 120 bps). The combination of high M&HCV sales and increased WPI would result in toll collections witnessing double digit growth in FY2020. However, high interest outgo due to leveraged balance sheets will continue to exert pressure on net profitability of the toll road projects. A significant pipeline of road projects to be awarded under the new Bharatmala programme in the next three years is likely to boost the order book of medium-large size developers. Awarding projects after receiving all approvals is likely to reduce delays in execution and reduced idling of resources thereby resulting in improved operating margins. Further, the toll-operate-transfer (TOT) awards are expected to crowd out the asset sale activity of private developers resulting in lower stake sale transactions. Therefore, efforts to de-leverage the balance sheets through asset monetisation route are likely to get impacted.

NHAI's to increase its borrowing to fund the Bharatmala Pariyojana programme

Over the years, the NHAI's expenditure increased primarily owing to the sharp increase in land acquisition cost. At the same time, budgetary support as a proportion of funding requirement for the NHAI steadily reduced thereby increasing the dependence on internal and external budgetary resources (primarily debt). The total market borrowings for the Bharatmala Project are estimated at Rs.209,279 crore till FY2022 (the total capital base including cess fund, toll collections and TOT proceeds is estimated at Rs.3,77,045 crore). At around Rs. 60,000 crore per annum, the annual debt requirement is in line with that raised in the recent past. A major part of this is likely to be sourced from LIC and the EPFO.

Credit challenges persist

With banks facing a huge stressed asset problem, their ability to extend credit to the already stretched sectors like infrastructure will remain constrained. Lenders, in some cases, are insisting on higher as well as upfront equity infusion, particularly in the case of smaller players and developers with leveraged balance sheets. Many infrastructure players have raised funds through the corporate bond market for completed projects (replacing bank credit with bonds) – which is also one of the reasons for subdued growth of banking credit to the sector.



Figures in Rs. billion; Source: RBI data, ICRA research

More than 90% of the projects awarded under the HAM have achieved financial closure within the stipulated timeframe as per the concession agreement. Although the private sector banks have taken the lead in funding HAM projects, the FC-related challenges resurfaced in the recent past given the stress in the banking system and with many PSU banks coming under prompt corrective action. Increasingly new developers are taking high exposure to HAM projects as achieving FC could be even more challenging in the current situation.

Analyst Contacts:

Shubham Jain
Group Head & Vice President-Corporate Ratings
shubhamj@icraindia.com

Rajeshwar Burla
Assistant Vice President & Associate Head-Corporate Ratings
rajeshwar.burla@icraindia.com

IT Services

ICRA's year-end outlook for Indian IT Services companies Stable

- Expected CAGR for FY2018-2021e to be around 9-12% compared to CAGR of 17.1% over FY2013-2017
- Lower deal sizes in digital technologies, cloud adoption and high competitive intensity could impact growth

ICRA has a stable outlook on the Indian IT services industry. The credit profile of the Indian IT Services companies remains stable underpinned by its ability to sustain free cash flows despite pressure on revenue growth and margins. With aggregate operating margins of ICRA sample set at 22.5% for FY2018 and coupled with moderate capex (organic as well as inorganic) and working capital requirements, the free cash flows have remained robust historically. Despite pressures on growth and margins over the medium term, these factors are unlikely to impact the free cash flow generation ability of Indian IT Services companies though there could be moderation in the quantum of such cash flows. The credit profile is also supported by net cash position with significant liquidity in the form of surplus investments generated from past cash flows. Our sample set (13 leading Indian companies) reported surplus liquidity (net of debt) of approximately Rs. 1,600 billion on March 2018 despite healthy dividend pay-out of approximately 30% (Rs. 206 billion) in addition to share buybacks (Rs. 73 billion).

ICRA expects most large IT services companies to maintain high dividend pay outs and share buybacks, as there are limited avenues for fund deployment. The investment requirements (organic and inorganic) for Indian IT Services in the past have been moderate relative to internal cash flow generation. Majority of the acquisitions done by Indian IT Services players have been to acquire competencies rather than achieve scale and size.

The growth of the Indian IT Services companies will be impacted by lower deal sizes in digital technologies, cloud adoption and high competitive intensity from local as well as international players. While companies have increased spending on digital technologies and awarding new contracts, the overall IT budgets have moderated, leading to lower incremental spends. Indian IT Services companies are re-orienting their business models, focusing more on high-end services such as IT consulting & emerging technologies (digital) and have made considerable progress so far, though they currently lag international peers. ICRA expects FY2018-2021e CAGR to be around 9-12% for the Indian IT Services companies compared to CAGR of 17.1% experienced over the FY2013-2017 period.

Margins will be supported by factors such as ability to modify cost structure with rational and variable salaries and gradually reduce high-cost resources. Besides, deployment of operating levers such as higher share of fixed-price-contracts, lesser idle resources and automation benefits will also help manage costs. However, these factors will provide limited cushion lowering the operating margin to 20.8% in FY2021e from 22.1% in FY2018 for ICRA sample companies (13 leading companies).

Analyst Contacts:

Subrata Ray
Senior Group Vice President
subrata@icraindia.com

Gaurav Jain
Vice President & Co-Head - Corporate Ratings
gaurav.jain@icraindia.com

Oil & Gas

ICRA maintains Stable year-end outlook for Oil and Gas sector

- Upstream sector expected to enjoy healthy realisations on crude oil sales even as downstream sector capacity utilisation would be dampened
- Credit profile of most industry players to be largely unaffected

ICRA has maintains a stable outlook for the oil and gas sector in its year-end assessment. The domestic demand for petroleum products grew at a rate of 4.0% YoY in 7M FY2019. The demand growth is expected to remain in the range of 4.0-6.0% in FY2019 and FY2020 owing to healthy GDP growth and moderate growth in all segments of the auto sector, notwithstanding the increase in the prices of petroleum products.

As for the upstream sector, even though the production of crude oil has declined by 4.7% YoY in 7M FY2019, ICRA expects oil production to grow in FY2020 over FY2019, albeit slightly, primarily due to ONGC commercialising some of its fields and Vedanta increasing production from its Rajasthan asset. It ought to be noted that the partial recovery in crude oil prices from the lows of 2016 continues to incentivise exploration and development activity leading to an increase in capex budgets, especially of private companies. Gas production, which has remained stable in 7M FY2019 vis-à-vis 7M FY2018, is expected to grow by 6-8% in FY2020 despite the depressed realisations governed by the modified Rangarajan formula. The growth in gas production is expected to be driven by ONGC commercialising several of its fields over the next few years. However, any debt-funded overseas acquisition will be a key monitorable.

With the robust growth in consumption of petroleum products, the capacity utilisation of refineries is expected to remain high though it will be dampened by the wave of shutdowns planned in FY2020 across refineries for the gasoline and gasoil producing units for BS-VI fuel specs. The outlook for GRMs remains positive owing to the uplift in gasoil cracks expected with the implementation of stricter IMO regulations for bunker fuel from January 1, 2020.

ICRA expects increasing shale oil production in the US to weigh on the price of crude oil. However, OPEC and Russia's increasingly active management of supply through production cuts is expected to keep the prices of crude oil elevated. Accordingly, barring any geo-political shocks, prices of crude oil should hover in the region of \$55/bbl-\$80/bbl. Consequently, the under-recoveries on sensitive products viz. SKO and domestic LPG are expected to be entirely borne by the GoI. However, the OMCs may be directed by the GoI to curtail a part of their marketing margins on the sale of auto fuels at the upper end of the aforementioned range. Nonetheless, the credit profile of E&P and R&M companies should remain stable given the headroom in key credit metrics.

ICRA expects the consumption of natural gas to grow at a healthy rate in FY2019 and FY2020 owing to the ban on petcoke as fuel, increasing coverage of city gas distribution (CGD) networks with a strong emphasis on expansion of PNG(d) coverage and start up of new fertiliser plants. The start up of several new LNG terminals in the next one year and increasing pipeline coverage would be a key enabler of natural gas consumption growth. However, the start up of several LNG terminals within a short span, amid increasing domestic gas production, is expected to challenge the ability of new terminals to achieve high capacity utilisation and meaningful returns in the initial few years. Additionally, some of the new pipelines are expected to be sub-optimally utilised in the initial years owing to lack of adequate volumes.

Due to increasing gas consumption, ICRA expects the outlook for pipeline transmission and gas marketing companies to remain healthy. Additionally, an increasingly accommodative approach towards gas transmission tariff revisions by the regulator (PNGRB) is expected to improve the profitability of gas transmission companies on their existing pipelines in FY2020.

ICRA expects the outlook for CGD entities to remain stable on the back of the GoI's push on increasing the penetration of CGD networks and provision of domestic gas for the CNG and PNG(d) segments. However, some of the entities that have won a large number of GAs in the ninth round of bidding in FY2019 will be exposed to increasing project execution risks as the statutory approval processes are protracted and could lead to potential delays in execution.

Analyst Contacts:

K. Ravichandran
Senior Vice President & Group Head-Corporate Ratings
ravichandran@icraindia.com

Prashant Vasisht
Vice President & Co-Head - Corporate Ratings
prashant.vasisht@icraindia.com

Ports

ICRA maintains Stable year-end outlook for the Port sector

- Rebound in coal volume and steady progress on the Sagarmala project acts as positives for the Indian port sector companies in the medium term
- Credit profiles of companies could come under pressure on account of any leveraged M&A related impact, cargo-related issues or any adverse movement on litigations

ICRA has given a stable outlook for the port sector, in its year-end assessment. Indian ports handled 1209 million tonne of cargo in FY2018, marking a growth of 7% over the previous year. The prospects for cargo growth at Indian ports is expected to remain healthy at 6-8%, supported by continuing healthy growth in cargo of major volume drivers – coal, crude and containers. Coal imports, which had become a concern over the last two years, have been witnessing a rebound and could continue with the momentum witnessed in the first half of FY2019. Demand revival from the power sector and key consumer industries would be critical for sustained pick-up in coal imports. ICRA expects that the revival in coal volume import growth would support the revenue growth for port players operating in the bulk segment in FY2019 and healthy growth should continue in FY2020 as well.

Besides coal, ICRA expects that over the medium to long-term, the overall cargo growth will gain further traction, driven by domestic requirements of crude oil, for meeting domestic petroleum requirements; and containers, given the cost and logistical advantages associated with containerisation. Iron ore exports, which increased in FY2017 and declined in FY2018, will see a further decline in FY2019 with higher domestic demand, coupled with continuing curbs on mining activities. Cash accruals for the major players in FY2019 and FY2020 will be supported by revival in coal volume, steadily rising handling rates, barring the projects where the tariff setting process is mired in litigations.

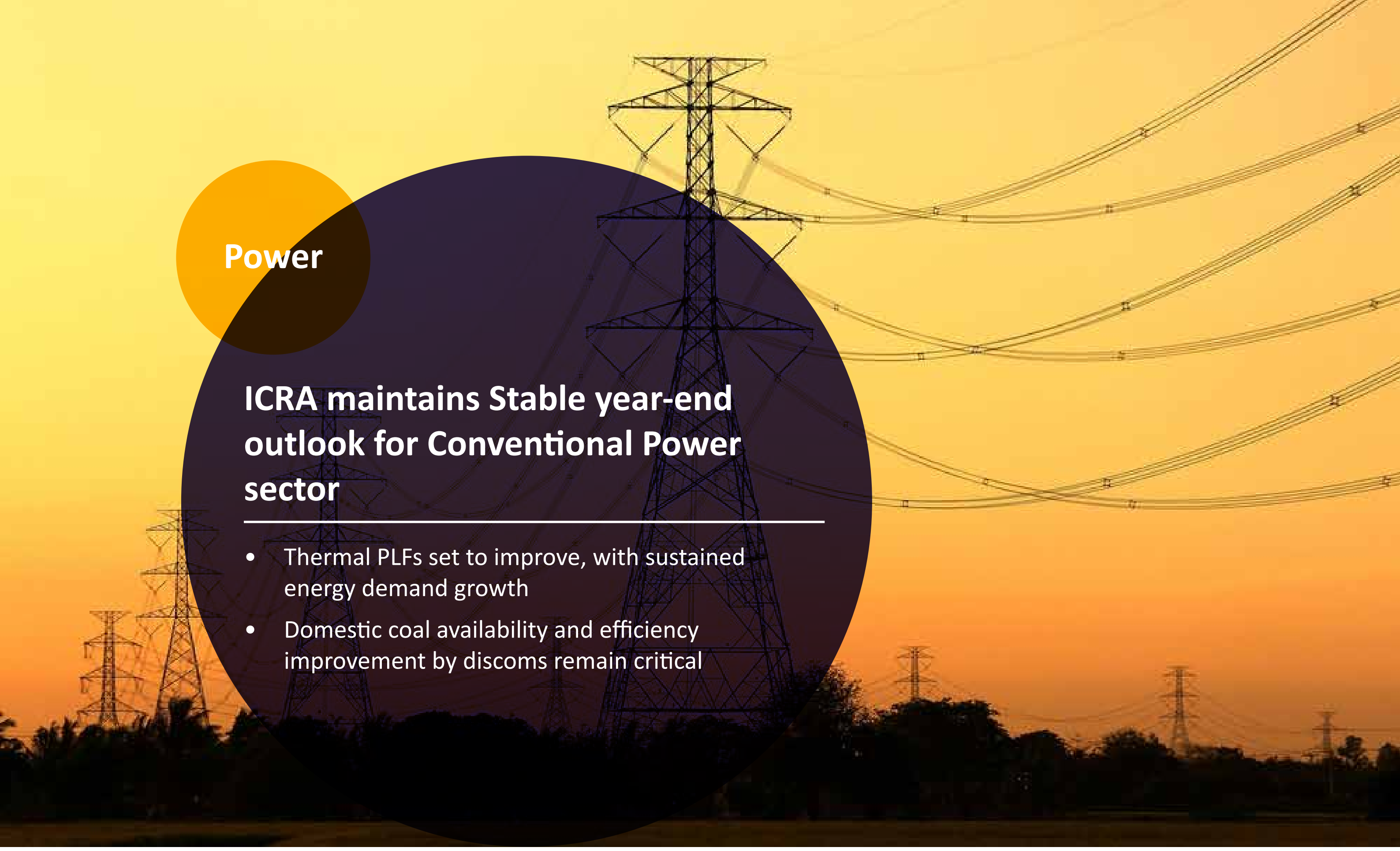
The MoS has chalked out a roadmap over the next five to ten years under the Sagarmala project, wherein significant investments would be made in the sector to boost trade and development. ICRA notes that the major ports are already being targeted for modernisation and efficiency improvement under the Sagarmala project. Over the last three years, there has been progress on the port capacity enhancement, efficiency improvement and port connectivity. Over FY2019 as well, there has been good progress and FY2020 should see further improvement in port capacity, efficiency and connectivity. In the long run, ICRA believes that the implementation of the Sagarmala project could lead to increased cargo for the ports, however, several challenges remain, given the vast scale of the project and the significant funding resources and PPP participation required to make the targets a reality.

Further, several non-major ports have underperformed owing to cargo ramp-up issues amidst stiff competition for hinterland cargo in the last few years. Given the low returns and high leveraging being faced by certain private sector port players, the sector could see further consolidation in FY2020. Credit profiles of companies could come under pressure on account of any leveraged M&A related impact, cargo-related issues or any adverse movement on litigations.

Analyst Contacts:

K. Ravichandran
Senior Vice President & Group Head-Corporate Ratings
ravichandran@icraindia.com

Ankit Patel
Assistant Vice President & Co-Head - Corporate Ratings
ankit.patel@icraindia.com



Power

ICRA maintains Stable year-end outlook for Conventional Power sector

- Thermal PLFs set to improve, with sustained energy demand growth
- Domestic coal availability and efficiency improvement by discoms remain critical

ICRA has maintained a stable outlook for the power sector, with demand growth expected to be healthy at about 6% in FY2019. This, coupled with the slowdown in addition of new capacity and slow progress in resolution of stressed thermal assets, would enable a steady improvement in the utilisation of the existing capacity. If the demand growth of 6% sustains over the next three years, the utilisation of the thermal capacity would improve to about 63% in FY2020 and further inch upwards to about 67% by FY2022.

In 7M FY2019, the all-India electricity demand growth has remained healthy at 6.5%, which is higher than the 5.5% reported in 7M FY2018 and the full-year growth of 6.2%, reported in FY2018. The rising demand is being met through higher generation by both thermal and renewable energy plants. This is reflected in the improvement in thermal power plant load factor (PLF) to 61.1% in 7M FY2019 against 59.0% in 7M FY2018, and 29.5% higher generation from renewable energy sources on YoY basis.

ICRA notes that the increased demand for electricity, coupled with the shortfall in coal supply from domestic sources, has led to higher dependence on costlier coal imports in FY2018 and FY2019. The higher dependence on coal imports is augmented by the rising international coal prices and depreciation of rupee against dollar. The Indonesian coal price index increased by about 16% in 11M CY2018 on a YoY basis. This resulted in an upward pressure on the cost of power purchase for the distribution utilities. Hence, augmentation of domestic coal supplies through both higher mining activity and improved rail infrastructure, remains crucial for the sector from a cost control perspective.

The relatively higher energy demand growth due to the Central and the state government elections over the next 6-months and domestic coal shortages have led to a sharp rise in spot power tariff in the recent months. ICRA, however, notes that the high spot energy prices are unlikely to sustain in the medium term, given the significantly unutilised thermal power capacity available and the rising generation from renewable sources.

On the distribution front, the implementation of the Ujwal DISCOM Assurance Yojana (UDAY) scheme enabled a reduction in losses for the discoms at all-India level, by about 43% for FY2018, mainly because of reduction in interest costs. Estimates of the Ministry of Power suggest that the aggregate losses of all discoms have fallen below Rs. 20,000 crore for FY2018. However, the improvement in the operational profile of the discoms remains slow, given that the reduction in aggregate technical and commercial (AT&C) losses is much lower than expected in most of the states. Further, the tariff revision approved by the state regulators remains lower than the revisions agreed in the UDAY MoUs. Going forward, improvement in the operating efficiencies as well as securing timely and adequate tariff hikes, and subsidy support from the respective state governments remain important for improving the discom finances.

Analyst Contacts:

Sabyasachi Majumdar
Group Head & Senior Vice President-Corporate Ratings
sabyasachi@icraindia.com

Girishkumar Kadam
Vice President & Sector Head-Corporate Ratings
girishkumar@icraindia.com

Power

ICRA maintains Stable year-end outlook for Renewable Energy sector

- About 9 GW of renewable capacity addition estimated in FY2019
- Near-term challenges arise from cost impact of safeguard duty, rising interest rate and transmission network availability for the viability of bid tariffs

ICRA has maintained a stable year-end outlook for the domestic renewable energy sector. The share of RE-based generation in the overall generation mix at the all-India level is rising, as seen from an increase from an increase to 7.8% in FY2018 from 5.6% in FY2015. This is owing to the large-sized capacity addition in the wind and solar power segments during this period, driven by policy support from the Central and the state governments as well as the significantly improved tariff competitiveness of wind and solar power vis-a-vis conventional power sources.

ICRA notes, that the project awards by the Central nodal agencies and state distribution utilities in CY2017 and CY2018 on a YTD basis provide a reasonably healthy visibility for RE capacity addition of about 9W in FY2019 and about 10GW in FY2020. This is expected to increase the share of RE in the all India generation to 10% by FY2020 and further to 13% by FY2022 based on capacity addition forecasts, as per ICRA.

Nonetheless, the RE sector, especially wind and solar segments, remain exposed to near-term challenges arising due to cost impact of safeguard duty, rising interest rate, and transmission network availability. . The average bid tariffs discovered in the auctions for wind and solar power projects in CY2018 have so far remained at Rs. 2.6-2.7 per unit, increasing slightly from the low of Rs. 2.4 per unit. This uptrend in bid tariffs has been partly driven by factors such as cost headwinds arising from rising interest rates, increase in capital costs due to imposition of taxes/ duties, rupee depreciation against dollar for imported equipment, and rising equipment costs. Notwithstanding these cost pressures, wind and solar PV energy projects are likely to remain cost competitive against conventional power sources. On the other hand, the viability of bid tariffs for wind and solar independent power producers (IPPs) remains critically dependent upon the capital cost, long tenure debt availability at competitive cost and plant load factor (PLF) level.

Amidst the imposition of safeguard duty, the recent order issued by the Central Electricity Regulatory Commission (CERC) approving the GST claims raised by solar power developers is a positive development for the sector. However, a time lag in implementation of such pass through of cost increases cannot be ruled out, given the resistance shown by the end offtakers in such cases in the past.

With respect to the counterparty credit challenges, the payment cycle for wind and solar power projects remains mixed. While the projects having Central nodal agencies and discoms in states such as Gujarat as offtakers are receiving payments in a timely manner, the projects having discoms in most of the other states as offtakers are facing delays in receiving payments. ICRA, however, notes that there has been a visible improvement in payment cycle from utilities in Rajasthan post the implementation of UDAY and also recently by the utility in Maharashtra. The sustainability of these trends, however, remains a challenge given that the progress on improving operating efficiencies and reducing gap between tariff and cost of supply remains slow in most of the states.

Analyst Contacts:

Sabyasachi Majumdar
Group Head & Senior Vice President-Corporate Ratings
sabyasachi@icraindia.com

Girishkumar Kadam
Vice President & Sector Head-Corporate Ratings
girishkumar@icraindia.com

Real Estate

ICRA maintains Negative outlook for Residential Real Estate segment and Stable outlook for Commercial Real Estate

- Housing segment faces sluggish demand recovery and funding challenges; however, larger developers to further consolidate market share
- Commercial real estate benefits from stable demand and strong investor interest

In its assessment of the real estate sector, ICRA has maintained a negative outlook for the residential real estate (RRE) segment and a stable outlook for the commercial real estate (CRE) segment.

The RRE has witnessed a prolonged downcycle owing to high inventory, muted demand, weak affordability and declining investor interest. However, with the structural changes over the last two years with the form of implementation of Real Estate Regulation and Development (RERAD) Act, 2016 and Goods and Services Tax (GST), along with increased Government focus on affordable housing, have raised expectations of demand revival in the industry. While these expectations have played out to some extent in certain property segments and micro-markets, a broad-based recovery in demand across the country appears to be some time away. States such as Maharashtra and Karnataka, which have seen relatively better implementation of the RERAD Act are benefiting from increasing confidence of end-users. Demand in the premium and luxury housing segments are likely to remain suppressed for under-developed projects due to the increasing preference for completed properties under the GST regime.

New project launches had been severely curtailed in FY2018 due to the impact of demonetisation and transition issues in Real Estate Regulation and Development (RERAD) Act, 2016 implementation. While certain cities like Bengaluru, Mumbai and Pune have witnessed a notable pick-up in new project launches during FY2019, other markets like the Delhi National Capital Region (NCR) may take longer for major uptick in project announcement due to existing inventory overhang. Due to the high compliance obligations imposed by Real Estate Regulation and Development (RERAD) Act, 2016 new launches from small developers have reduced,thus larger developers who are better placed to operate under the new regulatory framework are garnering greater market share.. This process of market share consolidation is only likely to strengthen over the coming years.

The residential realty segment has been increasingly relying on non-banking financial companies (NBFCs) and housing finance companies (HFCs) to raise debt financing, owing to the risk perception attached with the segment by banks. The liquidity crunch faced by the NBFC and HFC segment towards the mid of FY2019 has impacted the funding availability and cost for many real estate developers. If the current scenario persists in FY2020 as well, it may cause credit stress in developers who are reliant on refinancing to support balance sheets heavy on land assets or slow-moving inventory.

In the coming year, ICRA expects residential real estate developers to maintain a cautious stance towards new project launches and land acquisition transactions, especially due to the constrained debt funding scenario. The upcoming elections in FY2020 may also keep fresh project launches in check, considering the uncertainties developers may face with timeliness of regulatory approvals for projects. With the RERAD Act limiting the ability of small-scale developers to launch projects, the industry is likely to see more of development management or joint development models of project implementation. The existing gaps in the implementation of RERAD Act in many states need to be corrected for customer confidence to be fully reinstated and the full benefits to be realised. Demand growth is likely to be sustained in the affordable and mid-income category of projects in tier I markets, especially those where fresh leasing of commercial office space continues to be robust creating fresh employment opportunities.

As for the CRE segment, ICRA has given a stable outlook. In contrast to the residential segment, the commercial realty sector has been growing at a steady pace and has garnered the major share of the institutional investors' interest in the real estate space over the last 4-5 years. Some of the factors that have supported the growth prospects of the sector include stable demand for office space from various multi-national and domestic corporations, calibrated supply of stock, a more organised industry structure and availability of adequate capital for projects, backed by healthy investor appetite for rental yielding assets.

Most of the tier I markets have seen stable levels of fresh leasing and supply additions, resulting in either a declining vacancy (in cities like Bengaluru and Pune) or a status quo in vacancy levels (in cities like Delhi NCR and Mumbai). The Hyderabad market is in the midst of a boom in office space absorption with resolution of earlier political uncertainties and relatively lower costs along with high quality of living indices. Nonetheless, with significant supply of stock lined up over the medium term, occupancy levels and rentals in this market may come under pressure if the current demand trends are not sustained. The upcoming sunset clause for SEZ units will result in some bunching up of SEZ stock completions during FY2020, which may temporarily create pressure on the vacancy rates in certain markets like Bengaluru and Chennai.

Some of the other key trends that have been witnessed in the commercial segment include strong interest from institutional investors in building commercial real estate portfolios, consolidation of office spaces by large tenants resulting in increased demand for large-format office parks. Other trends include healthy rental appreciation in certain micro-markets in cities like Bengaluru and Hyderabad, which has encouraged some amount of speculative construction, rapid growth of co-working format of leasing, and the expected launch of the first Real Estate Investment Trust (REIT) in the country by Embassy and Blackstone.

Going forward, ICRA expects similar demand and supply levels to continue in leading cities in FY2020, which will support a further expansion of the asset portfolios of the established incumbents. Developers and micro-markets, which have more diversified sectoral exposure would be more resilient in weathering any near-term challenges due to the decline in demand from any particular sector, such as IT services. Apart from the broader macro-economic trends, a conducive political environment, continued favourable investment outlook and improvement in the quality of living indices in the cities would be the key monitorables for the sector. The response to the forthcoming first domestic REIT will be an interesting barometer for the appetite of domestic institutional and retail investors towards this asset class.

Analyst Contacts:

Shubham Jain
Group Head & Vice President-Corporate Ratings
shubhamj@icraindia.com

Mathew Kurian Eranat
Assistant Vice President
mathew.eranat@icraindia.com

Shipping

ICRA expects Shipping sector to continue to face challenges in the near term arising from geopolitical tensions and tighter IMO regulations, though recovery in charter rates a Positive

- The tanker segment saw a sharp recovery in charter rates in the current fiscal, after witnessing steep decline last year
- Dry bulk segment continued to witness moderate recovery, in line with past two years

ICRA expects the challenging environment to continue for the domestic shipping sector in the near term, in its year-end assessment of the sector. In line with trends in the global shipping industry, the domestic shipping sector too has been under pressure since the financial crisis in 2008. This is mainly because of capacity additions in anticipation of uptick in charter rates, which did not fully materialise leading to subdued return indicators and debt coverage indicators. In recent times, the increase in bunker fuel costs also added to the profitability pressure.

The charter rates are a function of global demand-supply trends for the major segments- dry bulk, tankers, containers and the offshore segment. The tanker rates had witnessed a moderation during 2016 and 2017 and reached lows of ~$3,000/day during May 2018 (for VLCC) mainly on account of high order-booking by the shipping companies in the prior years when VLCC rates were above US$50,000/day in 2015. The industry saw close to 100 VLCCs delivered in 2016 and 2017, while scrapping remained relatively muted, resulting in excess supply in the market.

Nonetheless, there has been a much-awaited recovery in the tanker charter rates over the last 3-4 months with the rates crossing $50,000/day in November 2018. The increase in rates has been driven by the lower net additions of ships in the current year and increase in US exports of crude oil to newer geographies, resulting in higher tonne-mile demand, apart from seasonal variations with rates after being higher during winter. Further, with contango being witnessed in crude oil future prices, there has been increased usage of tankers for crude storage, which has also aided in charter rate improvement. Sustainability of the charter rate recovery could, however, face challenges in the event of oil production cuts by OPEC and geopolitical tensions.

The dry bulk segment has been witnessing improvement in rates since 2016, driven by improvement in demand, moderation in order booking and increased scrapping leading to better supply-demand situation. The container freight segment has also witnessed oversupply in the last few years adversely impacting the rates. Consequently, the near-term outlook remains muted. The offshore vessel segment has also remained under pressure in the last few years since the decline in oil prices in 2015 and has been impacted by excess supply and underutilisation. In the last one year, there has been slippages in new deliveries, which has led to some supply correction and pick up in some sub-segments like jack-up rig and OSVs. However, the charter rates are expected to remain subdued in the near term, till there is meaningful supply correction and pickup in demand.

The shipping sector is also getting prepared to implement the revised IMO norms for bunker fuel. In 2008, IMO set a global limit for sulphur content in the fuel oil used onboard at 0.5% mass by mass (m/m) to be effective from January 1, 2020. The new limit is significantly lower than the current limit of 3.5% m/m, which has been in effect since January 1, 2012. With only about a year left for the IMO regulations to come in force, most of the shipping entities are yet to finalise on the strategy to adopt to meet the new low-sulphur norms. The ships can choose to use low-sulphur compliant fuel oil, though the availability of the fuel from the refineries within the prescribed timeframe could be a challenge. The new fuel would also come at a premium in the initial years, which would increase the operating costs for the shipping companies. Ships may also meet the sulphur emission requirements by installing exhaust gas cleaning systems or “scrubbers”, which clean the emissions before they are released into the atmosphere, though it would lead to high upfront capital costs.

Overall, despite recovery in rates in tanker and dry bulk segments in the current fiscal, improvement in the shipping sector is contingent upon supply correction arising from scrapings, delayed deliveries/order cancellations and improvement in demand, which may spill over the medium term. The charter rates could also benefit from the implementation of stricter IMO regulations concerning ballast water management (which was effective from September 2017 and is to be phased in over 1-2year period) and use of fuel with lower sulphur content (effective from January 2020) which would lead to scrapping of older vessels that would reduce the supply side pressures at least for the immediate future.

ICRA expects domestic shipping companies with diversified mix of vessels and adequate liquidity to change vessel mix, depending on dynamic market trends. They are likely to withstand the slowdown compared to players with high exposure to a single segment and high leverage, who may witness pressure on their credit profile.

Analyst Contacts:

K. Ravichandran
Senior Vice President & Group Head-Corporate Ratings
ravichandran@icraindia.com

Abhishek Dafria
Vice President & Co-Head - Corporate Ratings
abhishek.dafria@icraindia.com

Steel

ICRA maintains Stable year-end outlook for the Steel sector

- Temporary pricing pressures to be partially offset by favourable domestic demand
- Despite likely moderation in profitability, credit profile of most industry players to be largely stable

ICRA has given a stable outlook for the steel sector, in its year-end assessment of the Indian corporate sector. The Government's thrust on infrastructure, in particular towards affordable housing, power transmission, and the Railways in the Union Budget 2018-19 is likely to keep domestic steel consumption growth favourable in the medium term, which is expected to grow by 7.0% during FY2019 as well as FY2020.

Despite healthy demand, domestic steel production growth is likely to remain low at about 2.5-3.0% in FY2019 due to increased threat from cheaper imports, combined with a considerable de-growth in steel exports because of rising trade tensions globally. However, in FY2020, as export volumes stabilise at a lower level, domestic steel production is likely to grow by a higher 5.5-6.0%, supported by healthy domestic demand. ICRA notes that moderation in Chinese steel demand and consequent oversupply concerns remain key near-term challenges for the domestic steelmakers. Notwithstanding some support to international prices from a typical pick-up in Chinese demand from April 2019, a flat demand growth forecast for China in CY2019 would keep average international prices and in turn domestic prices lower in FY2020, than the current year levels.

ICRA states that the Chinese hot rolled coil export offers have declined from US$ 560/MT in the first week of October 2018 to US$ 476/MT in the first week of December 2018. ICRA believes that the steep reduction in international steel prices recently would make domestic steel imports cheaper in the coming weeks, when these shipments start hitting the Indian shores, and this would in turn exert pressure on domestic steel prices in the fourth quarter of FY2019.

On the raw material scenario, contrary to steel prices, input costs for domestic steelmakers have remained relatively firm. Domestic iron ore prices witnessed a sharp increase of 22% between April and December of FY2019. Notwithstanding an expected weakening in steel prices in the next quarter, the ongoing supply shortage in Karnataka following the closure of NMDC's Donimalai mine is unlikely to lead to a significant reduction in domestic ore prices from the prevailing levels. However, over a longer period, as Indian steel prices witness a moderation from the current year highs, domestic iron ore prices are expected to ease somewhat in FY2020, especially following a resolution of the current supply crunch in Karnataka.

Like iron ore, coking coal prices too have remained firm in FY2019, and recent issues like port congestion and seasonal weather disruptions in Australia are likely to keep the prices high in the near term. This, coupled with lower steel prices, is expected to lead to a sequential contraction in gross contribution of a domestic blast furnace-based flat steel player by around US$20/MT in Q3 FY2019, and by a sharper US$45/MT in Q4 FY2019, unless raw material prices start softening. However, given the longer-term price linkages between coking coal and steel, ICRA expects the pricing anomaly between steel and coking coal to correct going forward.

As for the bottomline performance, Despite an expected reduction in margins in H2 FY2019 over H1 FY2019, the domestic steel sector's overall profitability in FY2019 is likely to remain higher than the previous year levels on the back of superior performance in the first half. As the industry moves into FY2020, and steel prices look poised for a sequential moderation, mill margins are likely to register a sequential weakening. Notwithstanding the same, the steel industry's FY2020 absolute earnings are expected to remain at a similar level as FY2019, as lower margins would be largely compensated by higher despatches supported by a strong domestic demand. In ICRA's view, this would allow companies to maintain their credit profile.

ICRA expects domestic steelmakers to increase the capacity further by about 16 million tonne over FY2019 - FY2021 which, in addition to investments towards a ramp-up and debottlenecking of stressed assets taken over recently, would lead to industry capex estimates of Rs. 750-800 billion between FY2019 and FY2021. However, notwithstanding these incremental capacities, the industry's capacity utilisation level is expected to remain at a healthy 82-83% between FY2019 and FY2021, supported by a favourable domestic demand and low greenfield capacities coming up in the medium term.

Analyst Contacts:

Jayanta Roy
Senior Vice President & Group Head-Corporate Sector Ratings
jayanta@icraindia.com

Priyesh Ruparelia
Assistant Vice President & Co-Head - Corporate Ratings
priyesh.ruparelia@icraindia.com

Ritabrata Ghosh
Assistant Vice President & Associate Head-Corporate Sector Ratings
ritabrata.ghosh@icraindia.com

Telecom

ICRA maintains Negative year-end outlook for Indian Telecom industry

- Woes for the industry to continue with stabilisation still not in sight

The telecom industry woes, according to ICRA, are expected to persist well into FY2020 amid intense competition and pricing pressures. The recovery in the pricing power of the telcos, which was anticipated on the back of a consolidated industry structure and data usage with greater price inelasticity, has been prolonged. While the improvement in average revenue per user (ARPU) levels is essential for the health of the industry, ICRA expects the same to manifest only by the latter half of FY2020.

The sector has been going through a phase of turbulence over the last few years, with intense competition and pricing pressures leading to a decline in revenues and profitability. Consistent downward revision in prices has resulted in one of the steepest falls in the industry ARPU levels with the estimated blended ARPU falling from Rs. 169 in Q1 FY2017 to Rs. 116 in Q1 FY2019 and the industry adjusted gross revenue (AGR) falling from Rs. 44,570 crore to Rs. 25,580 crore in the same period. The overall high operating leverage of the industry means that the decline in revenues has created pressure on profitability and cash flows. Further, the industry is weighed down by high debt levels and capital expenditure (capex) requirements.

The industry debt remains elevated owing to reduction in organic cash flow generation and consistently high capex requirements. As per ICRA estimates, the industry debt stood at Rs. 4.7 lakh crore as on March 31, 2018. The telcos are looking at infusion of funds through monetisation of tower assets and promoter support in order to deleverage. While this would provide some relief, the total debt levels are not expected to reduce materially given the limited upside to revenue generation and continued capex requirement. ICRA expects the industry debt levels to be in the range of Rs. 4.5-4.6 lakh crore by March 31, 2020 with debt/ EBITDA estimated at more than 9.0x.

These factors have resulted in poor return on investments for all the operators. The inherent unsustainability of this for longer a period implies that both the revenue generation as well as the profitability will have to improve substantially. While the subscriber base growth potential is limited, the key drivers would be: a) pricing improvement, and b) identifying and implementing new use cases for the telecom services. The latter is a longer term goal and would require more investments. At present, however, it is the push for higher realisation which is achievable. However, the competitive headwinds remain strong with most operators looking for greater entrenchment. Thus, the outlook for pricing restoration remains unclear.

Greater proliferation is expected in the home broadband and Direct-to-Home (DTH) services. While these services have been provided by several telecom players for many years, a new entrant with plans for widespread penetration, is likely to provide a greater fillip to these segments. Another emerging trend is greater focus on content by the telecom operators to increase customer stickiness. These developments would mean greater convergence of various means of mobility and entertainment, with telecom networks serving as the foundation.

The rate of capex has remained high for most operators in last the few quarters and no major let-up is envisaged in the medium term. The industry needs to expand in terms of technology and reach, strong growth in data usage being an important contributor. The capex requirement is being driven by network expansion, technology upgrades, and greater fiberisation which is essential for data-heavy usage.

The capex-to-sales ratio for the telcos has increased significantly to around 30% against the average of 15-20% seen in the past. Going forward as well, the operators would need to invest to develop newer technologies for increasing use cases of telecom networks and services. On top of this, the likelihood of spectrum auctions is increasing with the passage of time, as the existing spectrum is getting exhausted with usage expansion, and spectrum-intensive use cases are being introduced. Payouts for spectrum would be an additional financial burden for the industry.

Analyst Contacts:

Sabyasachi Majumdar
Group Head & Senior Vice President-Corporate Ratings
sabyasachi@icraindia.com

Harsh Jagnani
Vice President & Sector Head-Corporate Ratings
harshj@icraindia.com

NOTES

ICRA

BUSINESS CONTACTS

Mr. L. Shivakumar
E-mail: shivakumar@icraindia.com
Tel: +91 22 6114 3406 / +91 98210 86490

Mr. Jayanta Chatterjee
E-mail: jayantac@icraindia.com
Tel: +91 80 4332 6401/ +91 98450 22459

MEDIA & PUBLIC RELATIONS

Ms. Naznin Prodhani
E-mail: communications@icraindia.com
Tel: +91 124 4545 860

Ms. Shreya Bothra
E-mail: communications@icraindia.com
Tel: +91 124 4545 840

BRANCHES

Registered Oce:

1105, Kailash Building, 11^{th} Floor
26, Kasturba Gandhi Marg
New Delhi - 110 001
Tel: + 91 11 2335 7940-45

Corporate Oce:

Building No.8, 2nd Floor
Tower A, DLF Cyber City Phase II
Gurgaon- 122 002
Tel: +91 124 4545300

Ahmedabad
907 & 908, Sakar – II
Ellisbridge, Opp. Town Hall
Ahmedabad - 380 006
Tel: +91 79 4027 1500/01

Bengaluru 1

'The Millenia', Tower- B,
Unit No. 1004, 10th Floor
1 & 2 Murphy Road
Bengaluru - 560 008
Tel: +91 80 4332 6400

Bengaluru 2

2nd Floor, Vayudooth Chamber
15-16, Trinity Circle, M.G. Road
Bengaluru - 560 001
Tel: +91 80 4922 5500

Chennai

5^{th} Floor, Karumuttu Centre
634, Anna Salai, Nandanam
Chennai - 600 035
Tel: +91 44 4596 4300

Hyderabad 1

No. 7-1-58, 301, 3^{rd} Floor,
'CONCOURSE', Above SBI-HPS
Branch, Ameerpet
Hyderabad - 500 016
Tel: +91 40 4920 0200

Hyderabad 2

4A, 4^{th} Floor, SHOBHAN
6-3-927, A&B Somajiguda, Raj
Bhavan Road
Hyderabad – 500082
Tel: +91 40 40676500

Kolkata

A-10 & 11, 3rd Floor, FMC
Fortuna 234/3A, A.J.C. Bose Road,
Kolkata -700 0202
Tel: +91 33 7150 1100/01

Mumbai

3^{rd} Floor, Electric Mansion
Appasaheb Marathe Marg,
Prabhadevi, Mumbai - 400 025
Tel: +91 22 6169 3300

Pune

5A, 5^{th} Floor, Symphony, S. No.
210 CTS 3202 Range Hills Road,
Shivajinagar, Pune - 411 020
Tel: +91 20 6606 9999

Email: info@icraindia.com
Helpdesk: 124 2866928
Website: www.icra.in | www.icraresearch.in
Follow us on Twitter @ICRALimited | ICRA LinkedIn
