Indian Tiles Sector

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Domestic tiles volumes in doldrums, faster recovery in export market; margin contraction expected by ~100 - 200 bps

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Executive Summary

HIGHLIGHTS – KEY INDUSTRY UPDATES

India continues to be the second largest tiles producer and consumer in the world

Global consumption of tiles stood at 12818 million square metre (msm) in CY2018, which grew at a CAGR of ~3% over CY2012-CY2018. India continues to be the second largest producer and consumer of tiles in the world after China. India's production volumes grew at a CAGR of ~9% over 2012 – 2018, from 691 msm in CY2012 to 1145 msm in CY2018. On the other hand, the consumption growth slowed down in CY2015 and CY2016 to 0.9% and 2.9% respectively from ~5% growth in CY2013 and CY2014. In CY2017 and CY2018, the conumption declined by ~3% and ~1% respectively on a YoY basis, owing to a prolonged slowdown in the real estate. The increasing gap between production and consumption has been largely neutralised by rising exports and consequently falling imports. The export volumes grew at a robust CAGR of ~44% from 33 msm in CY2012 to 274 msm in CY2018, thereby pushing India to the position of the fourth largest exporting nation from the eleventh in CY2011.

Slowdown in domestic real estate sector impacted industry growth in the last two-three fiscals

The domestic industry size was estimated at around Rs. 280-300 billion, with the share of organised and unorganised players (majority of them based out of Morbi cluster) at ~50% each. The Morbi cluster in Gujarat is the largest tiles manufacturing zone in India, accounting for ~75-80% of India's tiles and sanitary-ware products in volume terms, with more than 900 tile factories in the region. The overall competitive intensity for the industry remains high because of the fragmented industry structure with a large number of unorganised players, resulting from low entry barriers with respect to easy access to the latest technology and moderate regulatory requirements.

The Indian tiles industry grew at a CAGR of ~9% in the last 10-year period over FY2008-FY2019, with an increase in real estate construction activity and overall infrastructure development, in line with the rising urbanisation. However, industry growth slowed down to the lower single digit in the last two to three years, primarily due to a slowdown in real estate, its key consuming sector. The domestic demand has been impacted over FY2018 - FY2020, with the implementation of the Goods and Services Tax (GST) and the Real Estate Regulation and Development Act (RERA), which resulted in a significant drop in new launches in residential real estate for the period. In volume terms, domestic consumption declined by ~3% and ~1% in CY2017 and CY2018. Despite poor housing demand, the industry managed to control any significant downturn, because of the rising exports, replacement demand and spending by the Government on infrastructure under various schemes. The revenues of the tile players were also affected due to a decline in sales realisations, especially in the vitrified tile segment, owing to large capacity additions in the recent past and muted domestic demand. Nevertheless, the industry players are now cautious and going slow on new capacity addition. As per the Morbi Tile Association, the number of upcoming units in the region was down to ~20-25 in FY2020 compared to ~120 units in FY2017-FY2018.

Covid-19 to exacerbate the weakness in domestic demand in the near term

The domestic tiles demand was already under pressure over the last two to three fiscals amid a prolonged slowdown in the real estate sector, with the overall domestic consumption declining for the first time in CY2018 in the last decade. The pandemic is expected to further exacerbate the weakness in domestic demand, following the *negative* impact on its end-consumer industry, real estate sector, given the slowdown in project execution and new launches. The replacement demand is also expected to remain muted due to weak consumer sentiments. Given that the demand recovery is expected to be gradual, domestic sales are likely to be severely impacted in H1 FY2021. Industry wide revenues in Q1 FY2021 declined by almost ~55-65% on a YoY basis, due to lower demand and supply chain disruptions.

The plants were also shut for almost two months (April and May) due to the lockdown and labour shortage during the quarter. The operations resumed from June 2020 and witnessed a gradual recovery in both domestic and export demand, with current capacity utilisation of ~60-70% industry wide. As per the industry players, recovery, post the lockdown is better-than-anticipated due to incremental order inflows from Tier 2 and Tier 3 cities, wherein the impact of Covid-19 was short-lived and construction activity is back to normalcy. Nevertheless, sustainability of such recovery, will largely hinge on a sharp recovery of the key consuming sectors and absence of any further disruption in the near future.

Exports continued to grow at a healthy rate

India's tiles exports (in value terms) grew at a CAGR of ~42% from Rs. 374 crore in FY2011 to Rs. 10030 crore in FY2020. Export growth increased to ~33% each in FY2019 and FY2020 against ~21% in FY2018. The healthy export growth in the past was supported by increased competitiveness due to large investments in technology upgradation by domestic tile players and the imposition of anti-dumping duty on Chinese imports by some European countries and North and South American countries. Export sales contributes around ~20-25% of India's total production and India's share in world's exports is about ~10%, which has doubled in the last five years. India exports to more than 150 countries, with the Middle East currently being the key export market for Indian tile manufacturers. The top five export markets for India are Saudi Arabia, the UAE, Mexico, Iraq and Oman with the Gulf Cooperation Council (GCC) countries forming ~35-40% of India's total exports.

In June 2020, the GCC countries imposed anti-dumping duty (average rate of 41%) on Indian tile players, which may adversely impact the export volumes and profit margins in this region. However, our channel-check suggests that in the ongoing pandemic situation, the demand recovery in the export market is faster compared to the domestic market. In the first two months of the fiscal 2021, exports sales stood at ~Rs 800 crore, about 50% lower on annualised basis (monthly average of ~Rs. 830 crore in FY2020). While in the month of June and July 2020 exports were at ~Rs. 2500-2700 crore, which almost doubled as per the industry estimates, primarily attributable to pent-up demand post lockdown across the world. ICRA believes that pent-up demand, coupled with growing acceptance of India as an alternate source, compared to China and a push in the less penetrated markets like the US, Europe, Australia and African countries will keep export growth in positive territory in FY2021 and going forward.

Sustained decline in tile imports over FY2016-FY2020

Till FY2016, cheaper imports from China was a major threat for the domestic tile industry. Domestic manufacturers paid high custom duty on importing raw material of tiles, while, finished tiles from China had a lower custom duty. This inverted duty structure provided an incentive to import tiles, vis-a vis discouraging local manufacturing, restricting manufacturers and fresh investments. In 2015, India levied the anti-dumping duty (ADD) of US$1.87/sqm on imports of tiles, thereby boosting the competitiveness of the Indian manufacturers. Moreover, basic custom duty was hiked from 10% to 15% in the 2019 Budget, which further improved the competitiveness of the domestic tile industry. From FY2008 there was a sustained increase in imports and it peaked at Rs. 1438 crore in FY2016, wherein the contribution of Chinese imports was at 85%. However, total imports declined significantly by ~80% to Rs. 286 crore in FY2020 from its peak level, post the imposition of the anti-dumping duty on Chinese imports. The imports from China fell from Rs. 1226 crore in FY2016 to Rs. 106 crore in FY2020, with the share of Chinese imports out of overall imports falling from 85% to 37% in FY2020.

Brand building, distribution network primary focus

Major players have, over the years invested in brand establishment, expanding the distribution network and on research and development. Strong brand equity has helped the players increase their presence in the retail segment, which in turn keeps them immune from any project-specific risk. Leading tile companies like Kajaria Ceramics Limited, H & R Johnson (India), Somany Ceramics Limited and Asian Granito India Limited had expanded organically by entering into joint ventures or outsourcing their requirements to smaller unorganised players. However, in the recent past Kajaria and Somany have divested their stake from some of the JVs/subsidiaries and focused on improving their own capacity utilisation to support the cost structure amid muted demand conditions. The total installed capacity of five large listed players have increased to ~247 million square metre (msm) in FY2019 from ~152 msm in FY2014, reflecting an increase of 95 msm, out of which ~55% of the incremental capacity is through joint venture or associates. At present, ~47% of the installed capacity of large listed players has been acquired through a JV or a subsidiary. Majority of the JVs and contract manufacturing tie-ups have been made with Morbi-based players.

Profitability susceptible to fluctuation in raw material prices and fuel cost

Raw material and power & fuel costs are key cost determinants for a tile manufacturing company forming ~40%-50% and ~15%-20% respectively of the total operating income of a typical tile player. Piped Natural Gas (PNG) prices witnessed an uptrend, in line with the increase in international LNG prices and rupee depreciation, with the prices having increased from Rs. 24-25/scm in December 2017 to reaching a peak of Rs. 41/scm in H2 FY2019. The rising fuel costs, in the light of heightened competitive pressures and subdued domestic demand, were detrimental to the profitability of the companies operating on natural gas in FY2018 and FY2019. In March 2019, the National Green Tribunal passed an order for the immediate shutdown on captive coal gasifier plants for Morbi-based ceramic players citing environmental concerns, resulting in companies operating on multi-fuel/coal-based gasifier shifting to natural gas. The impact on profitability owing to the shift to a costlier fuel was limited, given the softening of natural gas prices (average price of ~Rs. 36 per/scm in FY2020) coupled with industry-wide upward price revisions of up to ~3-5% undertaken across product categories. Gas prices dropped further by ~20% to Rs. 29 per/scm in the current fiscal, which is likely to provide some respite to the tiles players. Nevertheless, the expected decline in sales volumes will not let the tile players garner much benefit out of these in the near term.

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