

CONSUMER DURABLE INDUSTRY IN INDIA

March, 2012

1. OVERVIEW OF INDIA'S CONSUMER DURABLES MARKET

India's Consumer Market

India's consumer market is riding the crest of the country's economic boom. Driven by a young population with access to disposable incomes and easy finance options, the consumer market has been throwing up staggering figures. The market share of MNCs in consumer durables sector is 65 per cent. MNC's major target is the growing middle class of India. MNCs offer superior technology to the consumers whereas the Indian companies compete on the basis of firm grasp of the local market, their well acknowledged brands, and hold over wide distribution network.

India officially classifies its population in five groups, based on annual household income (based on year 1995-96 indices). These groups are: Lower Income; three subgroups of Middle Income; and Higher Income. Household income in the top 20 boom cities in India is projected to grow at 10 per cent annually over the next eight years, which is likely to increase consumer spending on durables. With the emergence of concepts such as quick and easy loan, zero equated monthly installment (EMI) charges, loan through credit card, loan over phone, it has become easy for Indian consumers to afford more expensive consumer goods.

Key Industry Dynamics

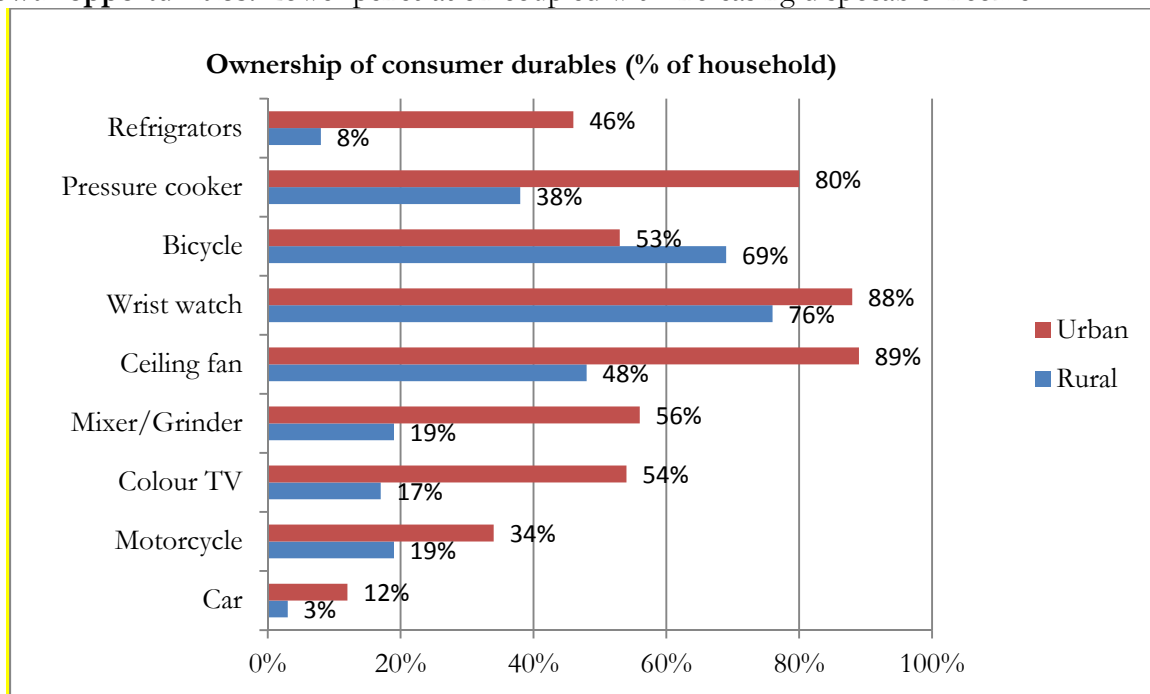
Industry Size: Rs. 350 billion

Key Categories: White Goods, Brown goods and Consumer electronics.

Competitive landscape: Dominated by Korean majors like LG and Samsung in most of the segments

Margin Profile: Low margin, dependant on volumes

Growth opportunities: Lower penetration coupled with increasing disposable income



Consumer Classes

Even discounting the purchase power parity factor, income classifications do not serve as an effective indicator of ownership and consumption trends in the economy. Accordingly, the National Council for Applied Economic Research (NCAER), India's premier economic research institution, has released an alternative classification system based on consumption indicators, which is more relevant for ascertaining consumption patterns of various classes of goods.

There are five classes of consumer households, ranging from the destitute to the highly affluent, which differ considerably in their consumption behavior and ownership patterns across various categories of goods. These classes exist in urban as well as rural households both, and consumption trends may differ significantly between similar income households in urban and rural areas.

The rapid economic growth is increasing and enhancing employment and business opportunities and in turn increasing disposable incomes. Middle class, defined as households with disposable incomes from Rs 200,000 to 1,000,000 a year comprises about 50 million people, roughly 5% of the population at present. By 2025 the size of middle class will increase to about 583 million people, or 41% of the population. Extreme rural poverty has declined from 94% in 1985 to 61% in 2005 and is projected to drop to 26% by 2025.

Affluent class, defined as earning above Rs 1,000,000 a year will increase from 0.2% of the population at present to 2% of the population by 2025. Affluent class's share of national private consumption will increase from 7% at present to 20% in 2025.

Overview of India's Consumer Durables Market

The Indian Consumer Durables segment can be segmented into three groups:

White goods	Brown goods	Consumer electronics
<ul style="list-style-type: none">· Air conditioners· Refrigerators· Washing Machines· Sewing Machines· Watches and clocks· Cleaning equipment· Other domestic appliances	<ul style="list-style-type: none">· Microwave Ovens· Cooking Range· Chimneys· Mixers· Grinders· Electronic fans· Irons	<ul style="list-style-type: none">· TVs· Audio and video systems· Electronic accessories· PCs· Mobile phones· Digital cameras· DVDs· Camcorders

Most of the segments in this sector are characterized by intense competition, emergence of new companies (especially MNCs) and introduction of state-of-the-art models, price discounts and exchange schemes. MNCs continue to dominate the Indian consumer durable segment, which is

apparent from the fact that these companies command more than 65 per cent market share in the color television (CTV) segment.

In consonance with the global trend, over the years, demand for consumer durables has increased with rising income levels, double-income families, changing lifestyles, availability of credit, increasing consumer awareness and introduction of new models. Products like air conditioners are no longer perceived as luxury products.

Growth of Consumer Electronics Production in India

The biggest attraction for MNCs is the growing Indian middle class. This market is characterized with low penetration levels. MNCs hold an edge over their Indian counterparts in terms of superior technology combined with a steady flow of capital, while domestic companies compete on the basis of their well-acknowledged brands, an extensive distribution network and an insight in local market conditions.

One of the critical factors those influences durable demand is the government spending on infrastructure, especially the rural electrification programme. Given the government's inclination to cut back spending, rural electrification programmes have always lagged behind schedule. This has not favored durable companies till now. Any incremental spending in infrastructure and electrification programmes could spur growth of the industry.

The digital revolution is shaking up the consumer durables industry. With the advent of MP3 music files, personal video recorders, game machines, digital cameras, appliances with embedded devices, and a host of other media and services, it is no longer clear who controls which part of home entertainment. This has set off a battle for dominance, and the shakeup is spanning the entire technology spectrum.

Microsoft Corp. is spending billions on entertainment initiatives such as its Xbox video game console. Compaq and HP sell MP3 music players that plug into home-stereo systems. Apple Computer is positioning its new iMac as a digital-entertainment device. Sony is building Vaio computers that focus on integrating multimedia applications.

Philips sells stereos that hook into a high-speed Internet connection to play music from the Web. More startups are trying to carve out profitable niches in digital music, video, and home networking. The industry is witnessing a number of strategic alliances, to develop a range of capabilities - electronic hardware, software and entertainment content.

As more consumers grow comfortable with technology, companies need to build simpler devices that offer more entertainment and convenience. These new machines need to work together readily, and should be as easy to set up and use as a telephone or a television. Consumerization of technology could be a major phenomenon over the next 5 to 10 years. This could hasten industry consolidation, as healthy companies gain market share by buying out weaker ones at attractive prices.

Apart from steady income gains, consumer financing has become a major driver in the consumer durables industry. In the case of more expensive consumer goods, such as refrigerators, washing machines, color televisions and personal computers, retailers are joining forces with banks and finance companies to market their goods more aggressively. Among department stores, other factors

that will support rising sales include a strong emphasis on retail technology, loyalty schemes, private labels and the subletting of floor space in larger stores to smaller retailers selling a variety of products and services, such as music and coffee.

Consumer electronics- key products-

Colour TVs	<ul style="list-style-type: none">• CTVs are the largest contributors to this segment; market size estimated at 18 million units in 2010. During this period, 21-inch CTVs dominated the market with a 65 per cent share
Liquid crystal displays (LCDs)	<ul style="list-style-type: none">• LCDs are perceived as high-end products• Indian LCD market in 2010 was about 3.2 million units• The price decline due to relatively low import duty on LCD panels and the introduction of small entry-size models have triggered growth in LCD sales
Digital video discs (DVDs)	<ul style="list-style-type: none">• The Indian DVD market was estimated at 6.2 million units in 2009• The organised market accounts for 80 per cent of the total DVD market
Direct-to-home (DTH)	<ul style="list-style-type: none">• The set-top box (STB) market is growing rapidly, due to the expansion of DTH and introduction of the conditional access system (CAS) in metros• During 2010-2012, the subscriber base is expected to grow from 23 million to 42 million, making India the largest DTH market in the world
Refrigerators	<ul style="list-style-type: none">• The Indian refrigerator market was estimated at 6.5 million units in 2010, the largest in this segment• Reduction in prices and high demand for frost-free segment are driving growth

Growth Scenario

India, with its huge middle-class population and rapid economic growth, is one of the largest spenders in consumer electronics in Asia. Double-income families, rising income levels, availability

of credit, changing lifestyle, introduction of new models, and increasing consumer awareness led to the surging demand of consumer electronics in India. The digital technology revolution has enabled the industry to earn profit from the growing interaction of digital applications, such as LCD TVs, mobile phones, etc. Thus, our research foresees that the Indian consumer electronics market will grow at a CAGR of around 18% during 2011-2014. The Indian consumer electronics market today stands at over Rs.400 billion.

Moreover, another important factor that has contributed significantly to the expanding consumer goods market is the phenomenal growth in the Indian media. Even consumers in the remotest areas are equally aware of the latest products launched in the market due to the increasing penetration of television channels and cinemas. In addition, aggressive marketing efforts of the domestic majors are also helping the industry. Even Internet explosion is contributing significantly towards its successful achievement.

Air conditioners (including industrial and office conditioners) constituted 38 per cent of the consumer appliances market, followed by refrigerators at 14 per cent, electric fans at 7.5 per cent, washing appliances at 7 per cent and sewing machines at 5 per cent.

The consumer durables market recorded revenues of USD6.3 billion in FY10. During FY 03-10, the industry expanded at a CAGR of 11.7 per cent.

Value growth of durables is expected to be higher than historical levels as price declines for most of the products are not expected to be very significant. Though price declines will continue, it will cease to be the primary demand driver. Instead the continuing strength of income demographics will support volume growth.

Market Size

(in million units)

Consumer Durables	Market Size (2010)	Market Size (2011E)	Growth (%)
Flat Panel TV	2.8	4.5	61
Refrigerator	9.0	12.0	33
Washing Machines	5.0	6.0	20
Air Conditioners	3.4	4.4	29
Microwave	1.0	1.5	44

2. COMPETITION OVERVIEW

Videocon, India's third largest consumer durables manufacturer, plans USD333 million capex for setting up a LCD manufacturing plant in Chennai by the end of 2011

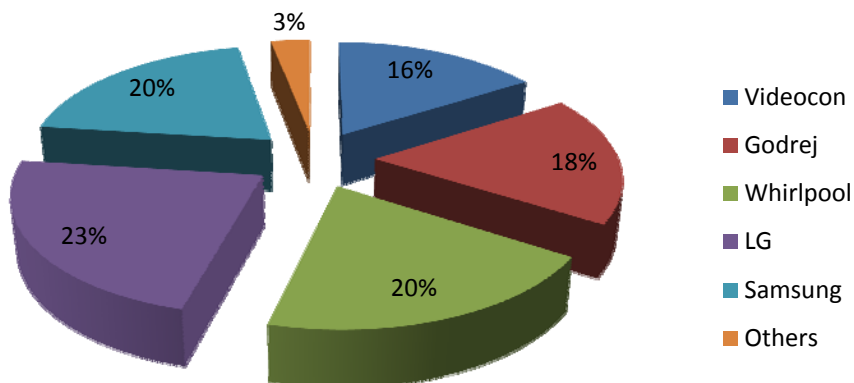
- Market leader LG has earmarked around USD292 million for enhancing production capacity and strengthening its LG brand shop network by 2012
- Japan's Panasonic plans to invest USD208 million by 2014 in setting up manufacturing units and an advanced R&D centre
- Samsung, India's second largest consumer durables maker, plans to invest USD94 million to expand capacity by 2015
- LCDs are expected to be one of the fastest growing segments, growing at a phenomenal CAGR of 87.6 per cent during 2009-12

Samsung India

Samsung India commenced its operations in India in December 1995, today enjoys a sales turnover of over US\$ 1 billion in just a decade of operations in the country. Samsung design centres are located in London, Los Angeles, San Francisco, Tokyo, Shanghai and Romen. Samsung India has its headquartered in New Delhi and has a network of 19 Branch Offices located all over the country. The Samsung manufacturing complex housing manufacturing facilities for Colour Televisions, Colour Monitors, Refrigerators and Washing Machines is located at Noida, near Delhi. Samsung 'Made in India' products like Colour Televisions, Colour Monitors and Refrigerators are being exported to Middle East, CIS and SAARC countries from its Noida manufacturing complex. Samsung India currently employs over 1600 employees, with around 18% of its employees working in Research & Development.

Market share of major players in refrigerator market

Refrigerators- Market sales



Whirlpool of India

Whirlpool was established in 1911 as first commercial manufacturer of motorized washers to the current market position of being world's number one manufacturer and marketer of major home appliances. The parent company is headquartered at Benton Harbor, Michigan, USA with a global presence in over 170 countries and manufacturing operation in 13 countries with 11 major brand names such as Whirlpool, KitchenAid, Roper, Estate, Bauknecht, Laden and Ignis. Today, Whirlpool is the most recognized brand in home appliances in India and holds a market share of over 25%. The company owns three state-of-the-art manufacturing facilities at Faridabad, Pondicherry and Pune.

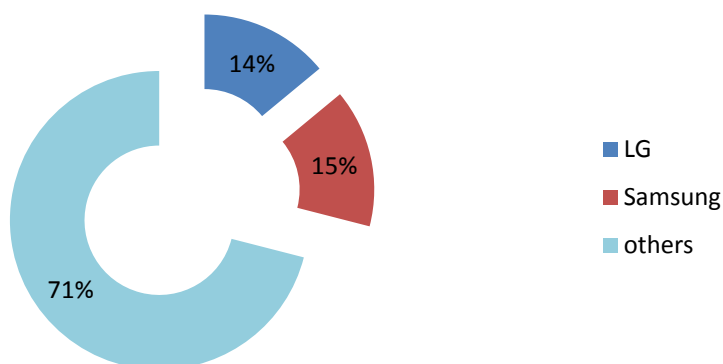
In the year ending in March '06, the annual turnover of the company for its Indian enterprise was Rs.13.75 billion. According to IMRB surveys Whirlpool enjoys the status of the single largest refrigerator and second largest washing machine brand in India.

LG India

LG Electronics was established on October 1, 1958 (As a private Company) and in 1959, LGE started manufacturing radios, operating 77 subsidiaries around the world with over 72,000 employees worldwide it is one of the major giants in the consumer durable domain worldwide. The company has as many as 27 R & D centers and 5 design centers. It's global leading products include residential air conditioners, DVD players, CDMA handsets, home theatre systems and optical storage systems.

Market share of Mobile phones market

Mobile Phones-Market sales

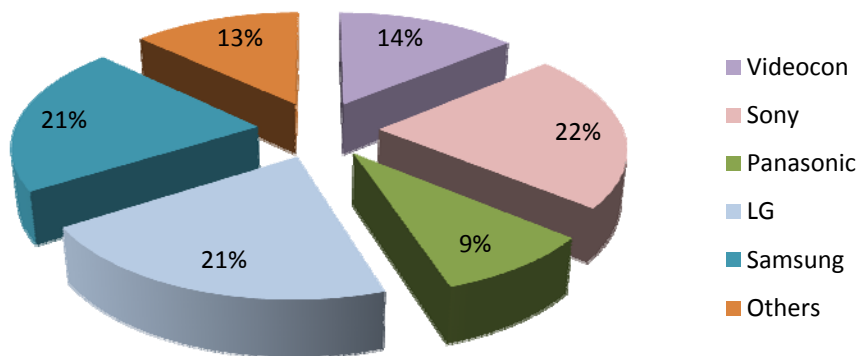


In FY10, LG and Samsung comprised of about one-third of the consumer durables and mobile phone markets combined

- Between the two, Samsung leads the mobile handset and premium flat panel TV market
- LG has a stronger presence in other consumer durables, including refrigerators, washing machines, microwave ovens, air-conditioners and televisions.

Market share of Flat panel TV market

Flat panel TV- Market sales



Sony India

Sony Corporation, Japan, established its India operations in November 1994. In India, Sony has its distribution network comprising of over 7000 channel partners, 215 Sony World and Sony Exclusive outlets and 21 direct branch locations. The company also has presence across the country with 21 company owned and 172 authorized service centers.

Sharp India Ltd

Sharp India Ltd was incorporated in 1985 as Kalyani Telecommunications and Electronics Pvt Ltd, the company was converted into a public limited company in the same year. The name was changed to Kalyani Sharp India in 1986. The company was entered into a joint venture with Sharp Corporation, Japan - a leading manufacturer of consumer electronic products to manufacture

VCRs/VCPs/VTDMs. The company manufactures consumer electronic goods such as TVs, VCRs, VCPs and audio products. The products were sold under the Optonica brand name. Sharp has a production base in 26 countries with 33 plants, and its products are used in 133 countries. The company was accredited with the ISO-9001 certification in the month of February, 2001.

Hitachi India

Hitachi India Ltd (HIL) was established in June 1998 and engaged in marketing and sells a wide range of products ranging from Power and Industrial Systems, Industrial Components & Equipment, Air Conditioning & Refrigeration Equipment to International Procurement of software, materials and components. Some of HIL's product range includes Semiconductors and Display Components. It also supports the sale of Plasma TVs, LCD TVs, LCD Projectors, Smart Boards and DVD Camcorders.

3. POLICY AND INITIATIVES

Foreign investment up to 100 per cent is possible in the Indian consumer electronics industry to set up units exclusively for exports. It is now possible to import duty-free all components and raw materials, manufacture products and export it.

EHTP (Electronic Hardware Technology Park) is an initiative to provide benefits to companies that are replacing certain imports with local manufacturing. EHTP benefits include export credits, no duties on imported components or capital equipment, business tax incentives, and an expedited import-export process.

The government, in an attempt to encourage manufacture of electronics in India has changed the tariff structure significantly.

Customs duty on Information Technology Agreement (ITA-1) items (217 items) has been abolished from March 2005. All goods required in the manufacture of ITA-1 items are exempt from customs duty.

Customs duty on specified raw materials / inputs used for manufacture of electronic components or optical fibres / cables has been removed. Customs duty on specified capital goods used for manufacture of electronic goods has been abolished. Excise duty on computers has been removed. Microprocessors, hard disc drives, floppy disc drives and CD ROM drives continue to be exempt from excise duty.

3.1 Intellectual Property Rights

Protection of Intellectual property rights (IPR) is a prime requisite for development of R&D and innovation in the consumer electronics sector. The Government of India has developed a robust IP act to facilitate innovation, growth and development. Several amendments to the Copyright Act, creation of a new Trademark Act, a new Designs Act and amendments to the Patents Act show India's continued effort to protect IPR.

The country has already made several changes in its IP acts over the years.. Several amendments to the Copyright Act, creation of a new Trademark Act, a new Designs Act and amendments to the Patents Act show India's desire to change and adapt. New acts have also been enacted to cover semiconductors and layout designs which will be of considerable importance to the electronic industry.

In the current WTO regime, India is a party to the "Trade Related Aspects of the Intellectual Properties (TRIPs) Agreement" and has accordingly, amended most of its IPR Acts and Rules to conform to the said Agreement. The Indian Copyright Act 1957 was amended in 1999; the patent Act 1970 was amended in 1999 & 2003 and

Trademarks and Merchandise Marks Act 1959 was overtaken by a new Trademark Act 1999. The Industrial Design Act 1911 was effectively replaced by The Design Act 2000, and the Layout Design of Semiconductor integrated Circuit Act 2000 was enacted.

The agreement on TRIPs takes care of the intellectual property rights by enforcing the patent rights, copy rights and related rights, and the protection of industrial designs, trade marks, geographical indications, layout designs of integrated circuits and undisclosed information. Accordingly, the member nations are asked to modify their existing laws. Once these laws come into force, unauthorised use of the patented innovations, trade marks, etc. becomes difficult. Enforcement of

the TRIPs agreement makes the production of any product possible either through internal innovation or through formal transfer of technologies.

The consumer electronics and durables sector is expected to continue to benefit from supportive policies and become globally competitive.

3.2 Regulations

3.2.1 Free Trade Agreement

WTO regime which came in force in 2005, results in zero customs duty on imports of all telecom equipment. 217 IT/electronic items were covered under the Information Technology Agreement (ITA) of the WTO for complete customs tariff elimination by 2005.

Out of these 217 items, several items were already at NIL customs duty. In fact, IT/electronics was the first sector in India to face complete customs tariff elimination. The ITA-1 would result in intensifying competition as more imported products will be easily available at lower prices.

3.2.2 Foreign Investment Policy: FDI

Foreign investment up to 100 per cent is allowed in Indian electronics industry set up exclusively for exports. The units set up under these programmes are bonded factories eligible to import, free of duty, their entire requirements of capital goods, raw materials and components, spares and consumables, office equipment etc. Deemed export benefits are available to suppliers of these goods from the Domestic Tariff Area (DTA).

A part of the production from such units is permitted to be sold in the DTA depending upon the level of the value addition achieved. The FDI approval for electrical equipment (including computer software and electronics) from April 2000 to January 2010 was US\$ 21.24 billion, which was 2.01 per cent of the total Foreign Direct Investment (FDI) approved. During the same period the FDI inflow for electrical equipment (including computer software and electronics) was US\$ 96.30 billion.

3.2.3 Procedure for approval

Once the investment in equity has been approved, the import of capital goods, components and raw materials or the engagement of foreign technicians for short duration does not require any additional approvals.

Approval of Ministry of Home Affairs is not needed for hiring foreign nationals holding valid employment visa.

Approval for setting up units in Export Processing Zones (EPZs) is given by the Board of Approvals in the Ministry of Commerce. Approval for setting up export-oriented units (EOUs) outside the zones is given by the Ministry of Industry.

Approvals for setting up Electronic Hardware Technology Park (EHTP) and Software Technology Park (STP) units are cleared by the Inter Ministerial Standing Committee (IMSC) set-up under the Chairmanship of the Secretary, Department of Information Technology.

Proposals involving foreign direct investment not covered under the automatic route are considered by the Foreign Investment Promotion Board (FIPB).

3.2.4 FDI/ Foreign Technology Collaboration Agreement

The government facilitates FDI and investment from Non- Resident Indians (NRIs) including Overseas Corporate Bodies (OCBs), predominantly owned by them, to complement and supplement domestic investment. Foreign technology induction is encouraged through FDI and foreign technology collaboration agreements. FDI and foreign technology collaborations are approved through automatic route by the Reserve Bank of India.

4 OPPORTUNITIES AND CHALLENGES

4.1 Challenges

Heavy taxation in the country is one of the challenges for the players. At its present structure the total tax incidence in India even now stands at around 25-30 per cent, whereas the corresponding tariffs in other Asian countries are between 7 and 17 per cent.

About 65 per cent of Indian population that lives in its villages still remains relevant for some consumer durables companies. This India, at least a large proportion of its constituents, still buys black and white TVs and doesn't know what flat screens are. Also, foraying into these rural markets has a considerable cost component attached to it.

Companies not only have to set up the basic infrastructure in terms of office space, manpower, but also spend on transportation for moving inventory. Even LG and Samsung, which are touted as having the largest distribution network in the country, have a direct presence only in 15,000 to 18,000 of the around 40,000 retail outlets (for consumer durables) in the country.

Poor infrastructure is another reason that seems to have held back the industry. Regular power supply is imperative for any consumer electronics product. But that remains a major hiccup in India.

Along with these few major challenges are:

- Intense competition among players - leading to higher ad spends and lesser pricing power, thereby lowering margins
- Increase in raw material prices – major raw materials (metals) are exhibiting increasing trend posing margin pressures; however, shift in product mix to partially offset increase in input costs over the medium term
- Changes in technology - making product lifecycles short
- Rural distribution - availability of products to masses is difficult as 68 per cent of India's population still lives in rural areas.
- Entry of cheap products - as private labels in organized retail

4.2 Opportunities

The rising rate of growth of GDP, rising purchasing power of people with higher propensity to consume with preference for sophisticated brands would provide constant impetus to growth of white goods industry segment.

Penetration of consumer durables would be deeper in rural India if banks and financial institutions come out with liberal incentive schemes for the white goods industry segment, growth in disposable income, improving lifestyles, power availability, low running cost, and rise in temperatures.

While the consumer durables market is facing a slowdown due to saturation in the urban market, rural consumers should be provided with easily payable consumer finance schemes and basic

services, after sales services to suit the infrastructure and the existing amenities like electricity, voltage etc.

Currently, rural consumers purchase their durables from the nearest towns, leading to increased expenses due to transportation. Purchase necessarily done only during the harvest, festive and wedding seasons — April to June and October to November in North India and October to February in the South, believed to be months 'good for buying', should be converted to routine regular feature from the seasonal character.

Rural India that accounts for nearly 70% of the total number of households, has a 2% penetration in case of refrigerators and 0.5% for washing machines, offers plenty of scope and opportunities for the white goods industry. The urban consumer durable market for products including TV is growing annually by 7 to 10 % whereas the rural market is zooming ahead at around 25 % annually. According to survey made by industry, the rural market is growing faster than the urban India now. The urban market is a replacement and up gradation market now.

The increasing popularity of easily available consumer loans and the expansion of hire purchase schemes will give a moral boost to the price-sensitive consumers. The attractive schemes of financial institutions and commercial banks are increasingly becoming suitable for the consumer. Consumer goods companies are themselves coming out with attractive financing schemes to consumers through their extensive dealer network. This has a direct bearing on future demand.

The other factor for surging demand for consumer goods is the phenomenal growth of media in India. The flurry of television channels and the rising penetration of cinemas will continue to spread awareness of products in the remotest of markets.

The vigorous marketing efforts being made by the domestic majors will help the industry. The Internet now used by the market functionaries that will lead to intelligence sales of the products. It will help to sustain the demand boom witnessed recently in this sector. The ability of imports to compete is set to rise. However, the effective duty protection is still quite high at about 35-40 per cent. So, a flood of imports is unlikely and would be rather need based.

Reduction in import duties may significantly lower prices of products such as microwave ovens, whose market size is quite small in India. Otherwise, local manufacturing will continue to stay competitive. At the same time, there will be some positive benefits in the form of reduction in input costs. Washing machines and refrigerators will also benefit from lower input costs.