Research

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Stage set for private investment cycle

New growth triggers are in place

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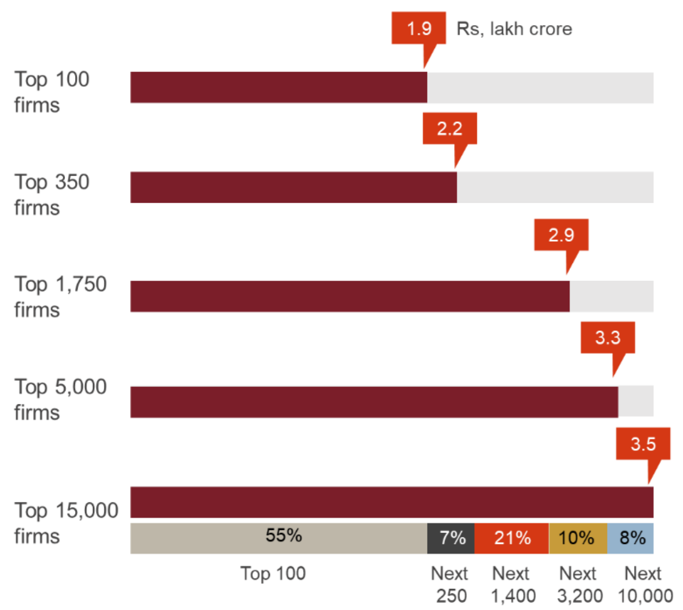
Industrial capex slows, large companies save the blushes…

Last fiscal, the top 350 of the ~15,000 manufacturing firms (non-infra – listed and unlisted) on CRISIL's Quantix platform deferred capital expenditure (capex) because of the Covid-19 pandemic. This led to an estimated 14% contraction in their capex, albeit less than a 21-23% decline for the entire industry.

Typically, the ~15,000 manufacturing firms spend Rs 3.2-3.5 lakh crore annually, with a chunky part of the capex being invested by large firms. The dispersion analysis of the capex spread shows that 62-65% is spent by the top 350, 20-22% by the next 1,400 firms, and a meagre 15-18% by the next 13,000+.

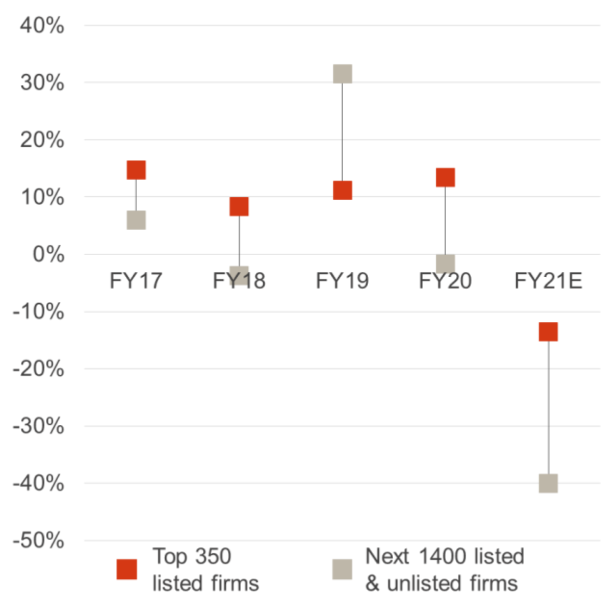
To be sure, the past decade witnessed a relatively muted private industrial capex cycle, especially during fiscals 2013-2017, on weak demand, strong supply and leveraged balance sheets. While fiscals 2018-2020 did see a revival, it was largely led by regulatory capex in the oil & gas and automotive space (emission norms compliance) and large metal firms. Then the pandemic struck, causing sector-wide capex deferral.

Industrial capex: ~15,000 manufacturing firms



Source: CRISIL Quantix

Capex differential between large and small firms widened in FY21



Source: CRISIL Quantix, CRISIL Research

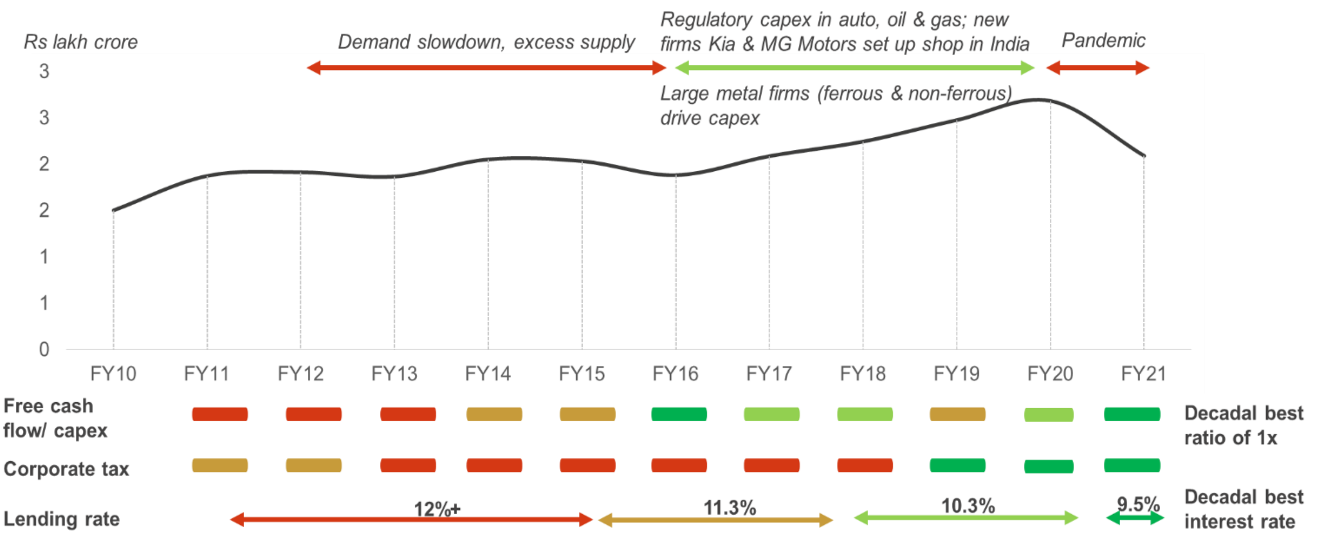
…but macro and micro triggers are set for a recovery

We expect industrial capex to pick up, driven by:

- Conducive government support through policy measures such as the Production-Linked Incentive (PLI) scheme and reduced tax rates
- Accommodative monetary policies and lower interest rates
- Commodities upcycle, which has benefitted metal and cement players by repairing their balance sheets
- Rising merchandise exports
- Supply chain diversification
- Healthy balance sheets
- Global liquidity

The external environment for the capex cycle in the current decade will more likely resemble that seen in the first decade of the century (2000's) in terms of global liquidity, monetary policies, liquidity, and healthy balance sheets.

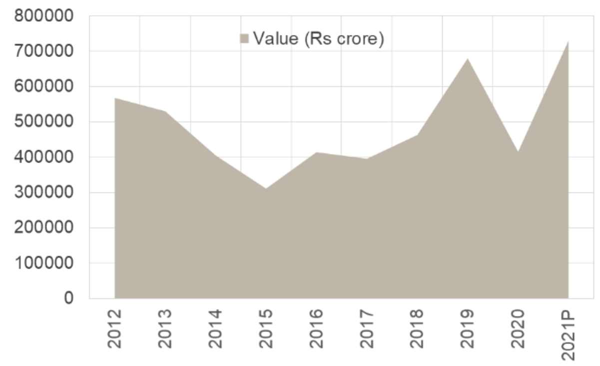
Decadal capex cycle: falters after recovery seen in recent years

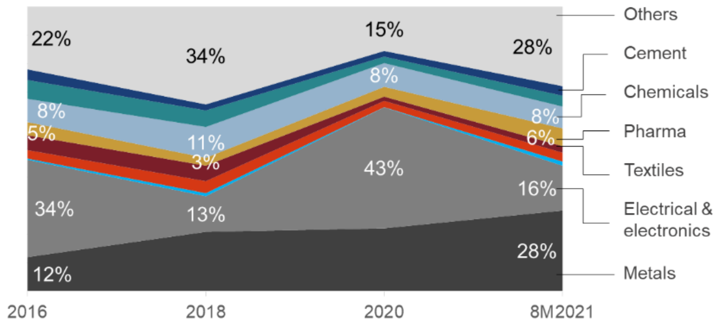


Note: data for 730+ firms
Source: Industry, company reports, RBI, CRISIL Research

Leading indicators, too, confirm a recovery. The Industrial Entrepreneur Memorandum (IEM) filings with the government, the pace of environmental approvals, and the surge in foreign direct investments (FDI) investments have already crossed pre-pandemic levels.

Capex intentions: IEM part A filings up, led by metals, pharma, and electrical/ electronics sectors

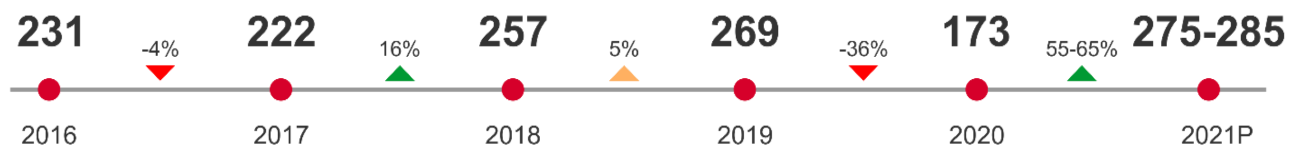




Note: All firms above Rs 250 crore revenue are mandated to file capex intention as IEM part A filings with the government for a greenfield/ brownfield plant. Value for 2021 has been estimated based on YTD performance.

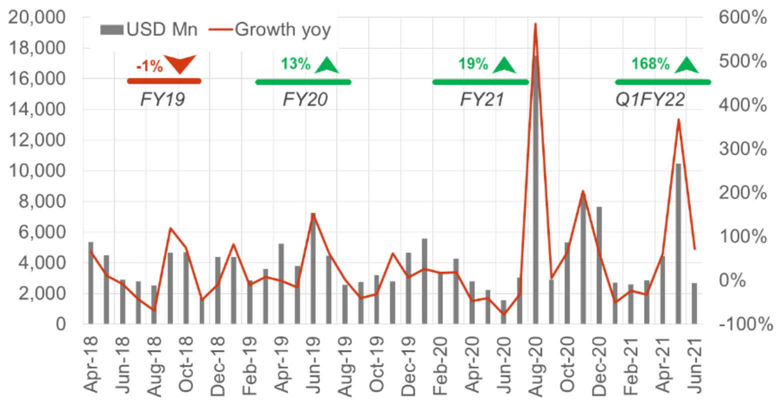
Source: DIPP, CRISIL Research

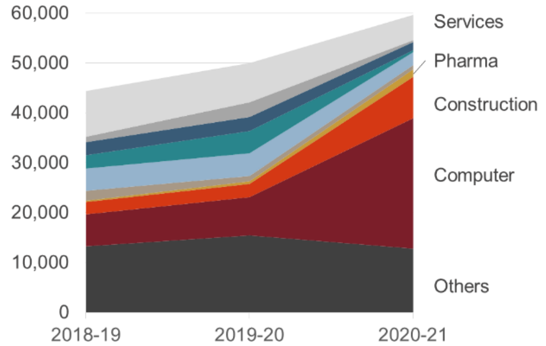
Environmental approvals on the rise



Note: EC approval for 2021 estimated basis YTD performance for 8-9 months.

FDI investments up, led by computers, pharma, and construction sectors





Source: DPIIT, CRISIL Research

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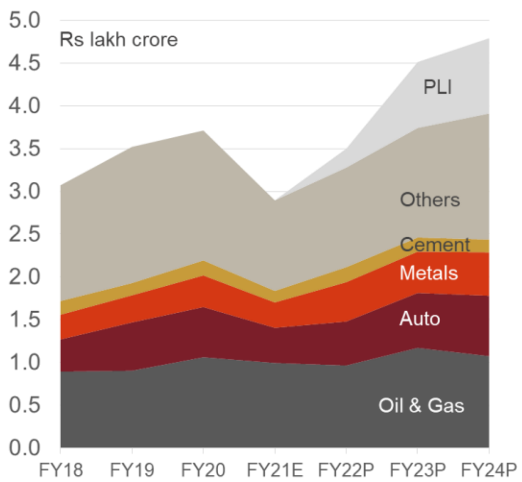
Industrial investments to rise 30% in FY22-24; PLI a booster shot

The PLI scheme has given a much-needed booster dose to flailing capex. Without it, capex would have likely taken nearly two years to touch pre-pandemic levels. Actualisation of the scheme will result in aggregate industrial capex rising 1.3 times through fiscals 2022-2024 in comparison to fiscals 2018-2020.

The new capex cycle will be relatively distinct compared with earlier cycles on several counts. First, asset-heavy sectors such as metals, cement, and mining will see more localised investments, led by large players at their existing sites (brownfield capex). In comparison, asset-light ones such as pharma, telecom equipment, mobile, and electronics will see more greenfield capex, led by PLI as well as supply chain diversification. Second, the pandemic-induced focus on digital and automation will spur growth. Third, rising emphasis on environmental, social, and governance (ESG) compliance will trigger green capex towards energy transition, especially for core industrial sectors.

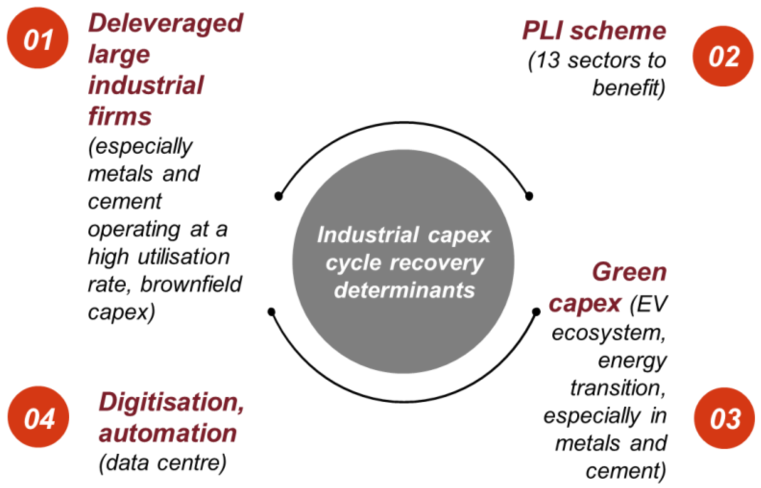
Industrial capex to rise 1.3x over FY22-24 vis-à-vis FY18-20



Note: Others include FMCG, pharma, chemicals, paper, textiles, etc

Source: CRISIL Research

Different catalysts for industrial capex



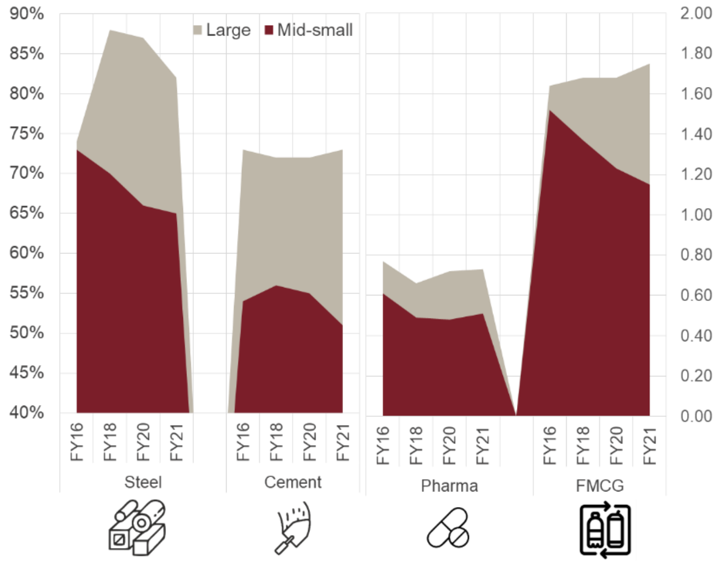
Large firms in core industrial sectors (steel and cement) as well as consumption sectors (fast moving consumer goods or FMCG and pharma) have gained significant market share over the past few years, especially during the pandemic, necessitating further investments.

- In the steel sector, large and small players operated at a similar utilisation rate of 73-74% in fiscal 2016, but the gap has widened over the years. Large players operate at 82%+ vis-à-vis smaller firms' 65% as of fiscal 2021

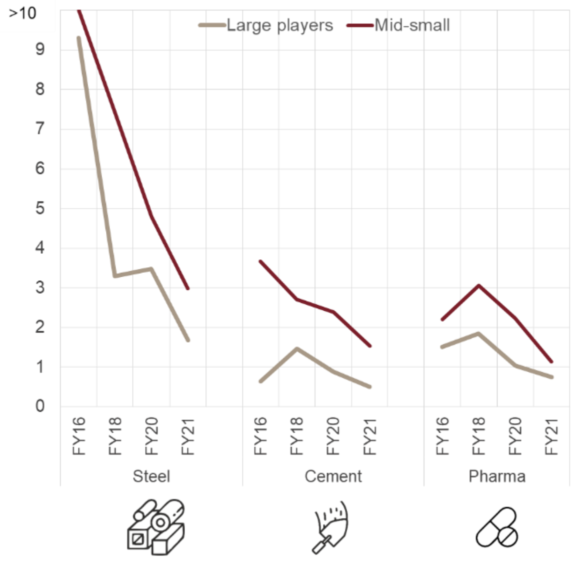
- The top five FMCG companies versus smaller players have seen the differential in their asset turnover leap from 8% in fiscal 2016 to 52% in fiscal 2021

Further, healthy volumes and rise in commodity prices (especially for metals) have helped repair the leveraged balance sheets. Resolution of series of assets under the National Company Law Tribunal (NCLT) has also helped large players gain market share. This has resulted in large players announcing a series of expansion plans for the next three years followed by greenfield capex from fiscal 2024 onwards.

Large players operate at high utilisation rates, making room for capex



Improved balance sheets to spur capex

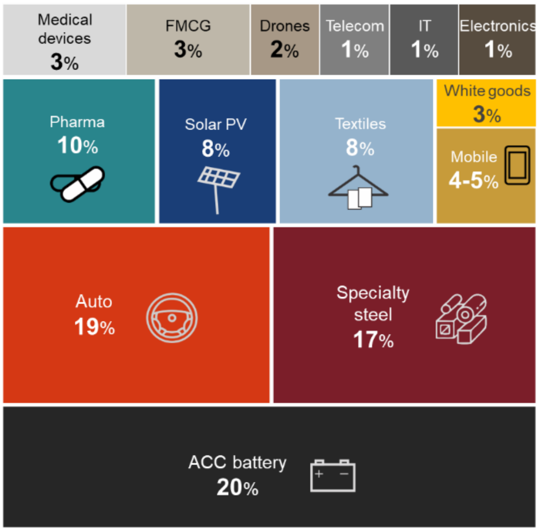


Note: Large players include the top 4-5 players in the sector.
Source: Industry, company reports, CRISIL Research

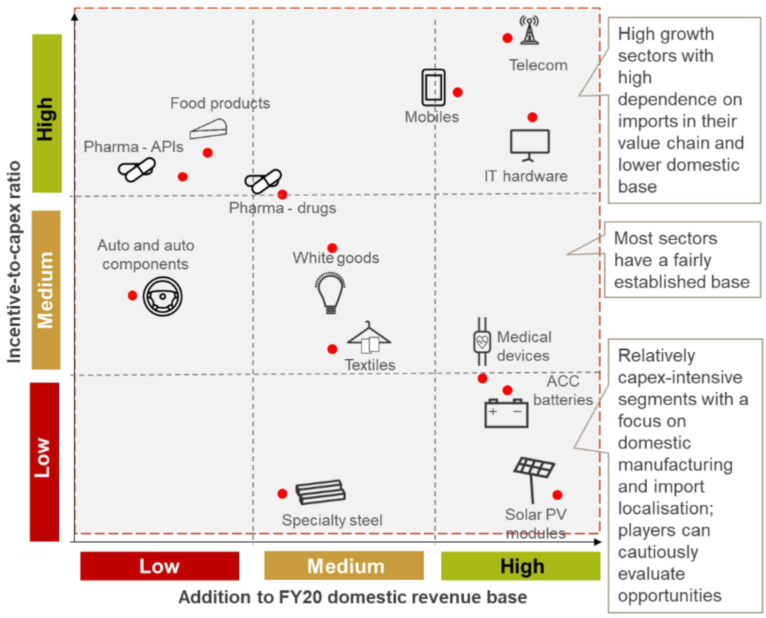
PLI, covering 13 sub-sectors, holds the potential to generate Rs 2.2 lakh crore worth of capex over the scheme period (3-4 years). Of this, nearly 55% of the capex would be concentrated in the three sectors of ACC (advance chemistry cell) battery, automotive, and specialty steel.

Asset-light sectors such as telecom, mobile, and IT hardware are expected to incur lower capex. However, many incentives have been doled out to attract investments in order to plug the import bill in these high growth segments. Further, the back-end value chain of these segments will eventually set up shop locally in the medium term.

PLI to generate capex of Rs 2.2 lakh crore



Scheme most attractive for mobile, telecom and IT hardware

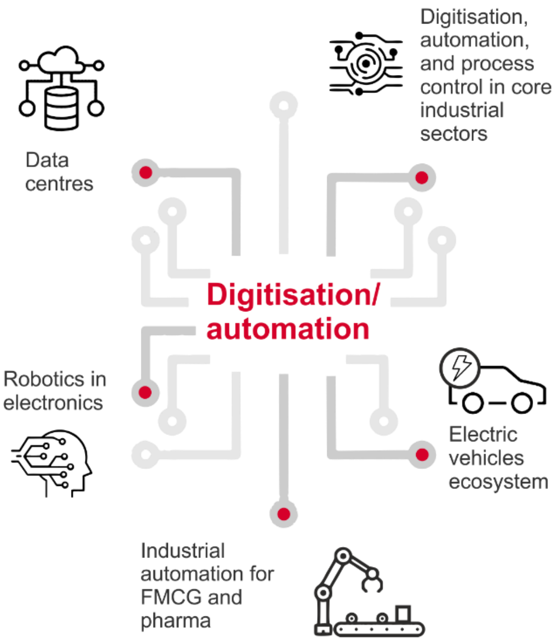


Note: Incentive-to-capex ratio: High: >1x, medium: 0.5-1x, low: <0.5x
Revenue addition from PLI to FY20 domestic revenue base: High: >50%, medium: 25-50%, low: <25%
Source: CRISIL Research

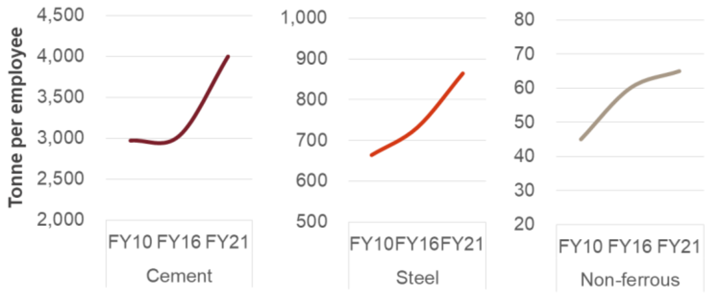
Digitisation, automation and ESG will help, too

The potential benefits of **digitisation and automation** in terms of increasing productivity and quality cannot be ignored. For instance, productivity of the top 4-5 cement players improved from 3,000 tonne per employee in fiscal 2016 to 4,000 tonne per employee in fiscal 2021, because of improved process efficiency and control derived through digitisation and automation. Amid the pandemic, the need for digitisation has become more urgent. Thanks to such evolving technologies, leading players like Siemens and ABB recorded healthy revenue and order book growth in the past three quarters despite it being a pandemic impacted year.

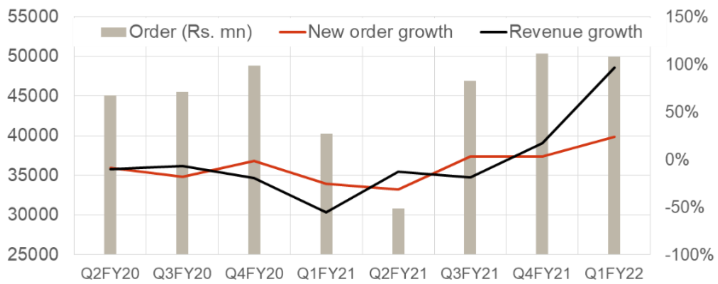
This will not only drive growth for new age sectors such as data centres, but also for players present in the electrical, automation, engineering, and IT/ITeS space. Digital spend across manufacturing and services sectors has climbed sharply.



Digital and automation: productivity rises across core industrial sectors

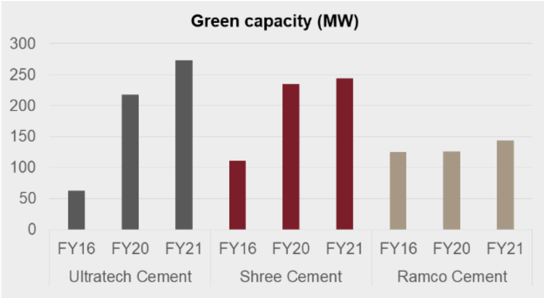


Digital and automation: Siemens and ABB India report sharp jump in revenues and order book



Source: Industry, Company Reports, CRISIL Research

The focus on ESG and energy transition will open green capex avenues in India. Transitional strategies such as power and resource efficiency will play a big role in the near term before deep radical decarbonisation technologies such as hydrogen and HIsarna become commercially attractive for domestic mills. This will require immediate capex to switch to green power, set up scrap units, for battery storage, and to experiment with technologies such as carbon capture.



Resource efficiency:
Blend scrap in steel; blend waste for cement making, water recycling

Radical decarbonisation technologies

Recycling units, scrap shredders to be set up for metal scrap and waste water recycling

Tata Steel recycling unit

Mahindra Shredders

Power efficiency:
Green energy transition through renewable power, battery storage, waste heat recovery in cement, and top gas capture in steel

Radical decarbonisation technologies such as **carbon capture, hisarna, and hydrogen** to pick up in long term

Tata Steel CCU plant (5T/ day)

Reliance electrolyser unit

Conclusion

Overall, private industrial capex appears to be getting into a whole new cycle after the pandemic hiccup – this time around armed with a new set of growth drivers.

First, PLI will potentially will induce capex growth in new age sectors where we are largely import dependent (telecom equipment, mobile, IT hardware, battery, etc).

Second, large players in metals and cement, where utilisation levels are elevated and balance sheets healthy, will continue on their capex plans (brownfield in near term and greenfield in medium to long term).

Third, pandemic-induced digitisation and focus on ESG / energy transition will drive green capex.

That said, the new capex cycle will depend on government support and policy measures, implementation thereof.

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