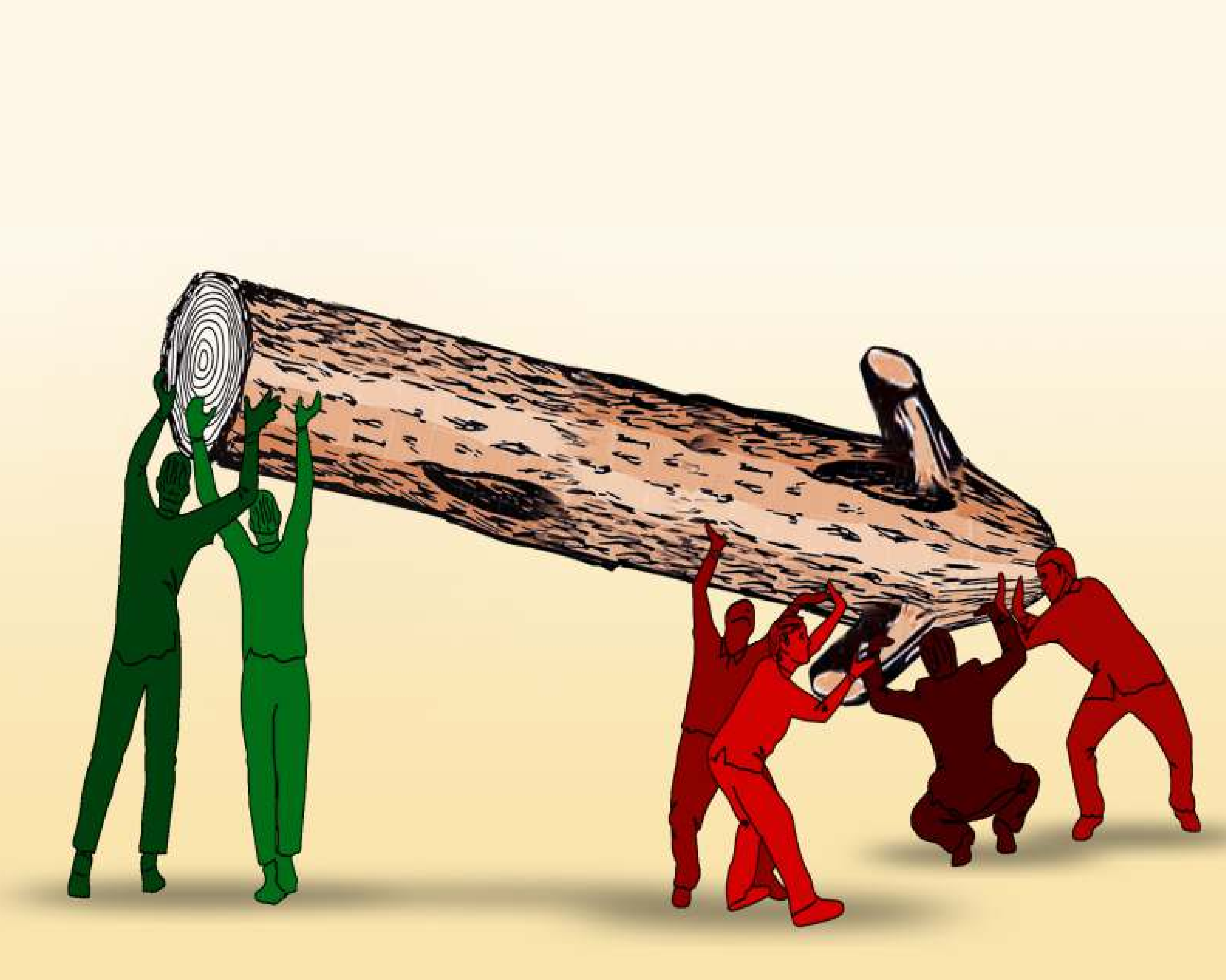
August 2015

CRISIL Opinion



Investment slide to continue

5-year low utilisation rate thwarts capex revival

About CRISIL Limited
CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research
CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 5,000 primary sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

5-year low utilisation rate thwarts capex revival

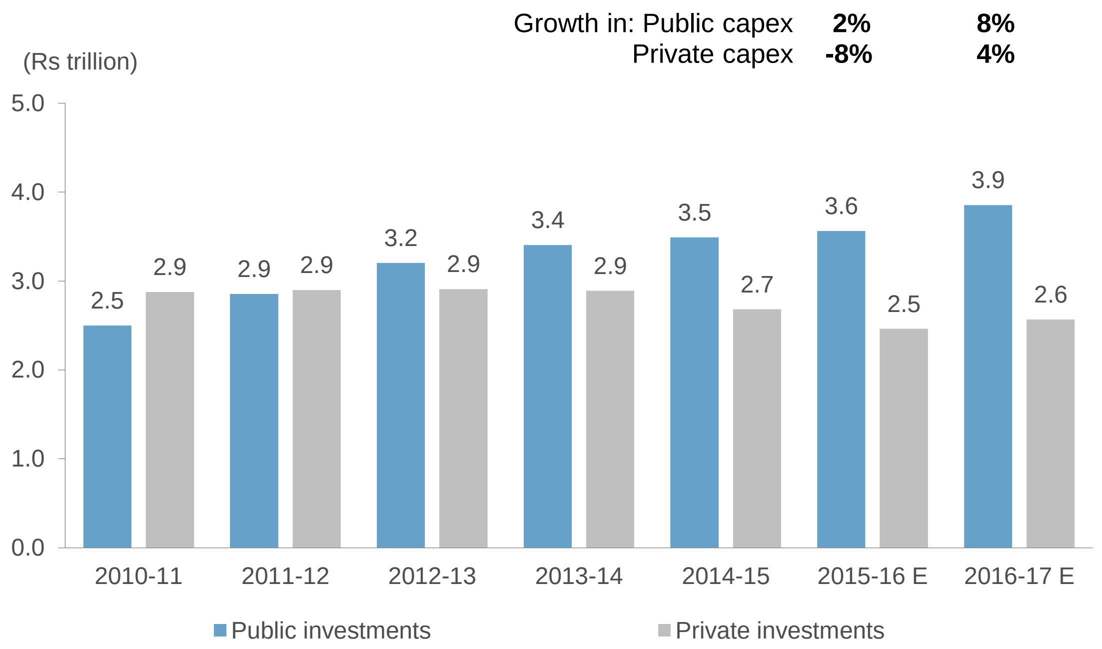
Private investments to see hat-trick of declines, fall 8% this fiscal: CRISIL Research

CRISIL Research's analysis of capital investments across 22 large sectors shows that the slide in investments continues and we expect a 2% decline in the current fiscal. What's more worrying is that private investments – on skid row since the last couple of years – are expected to decline another ~8% this fiscal.

Utilisation rates in 10 out of 12 large industrial sectors are wallowing at 5-year lows causing new project announcements to dry up. Consequently, fresh investments (projects announced / awarded in past 1 year) are expected to account for a mere 20 per cent of total investments.

As a result, we believe that a meaningful recovery in capital investments will only be visible from fiscal 2017 -- when we expect to see a 7% increase.

Aggregate capital investments



E: Estimated

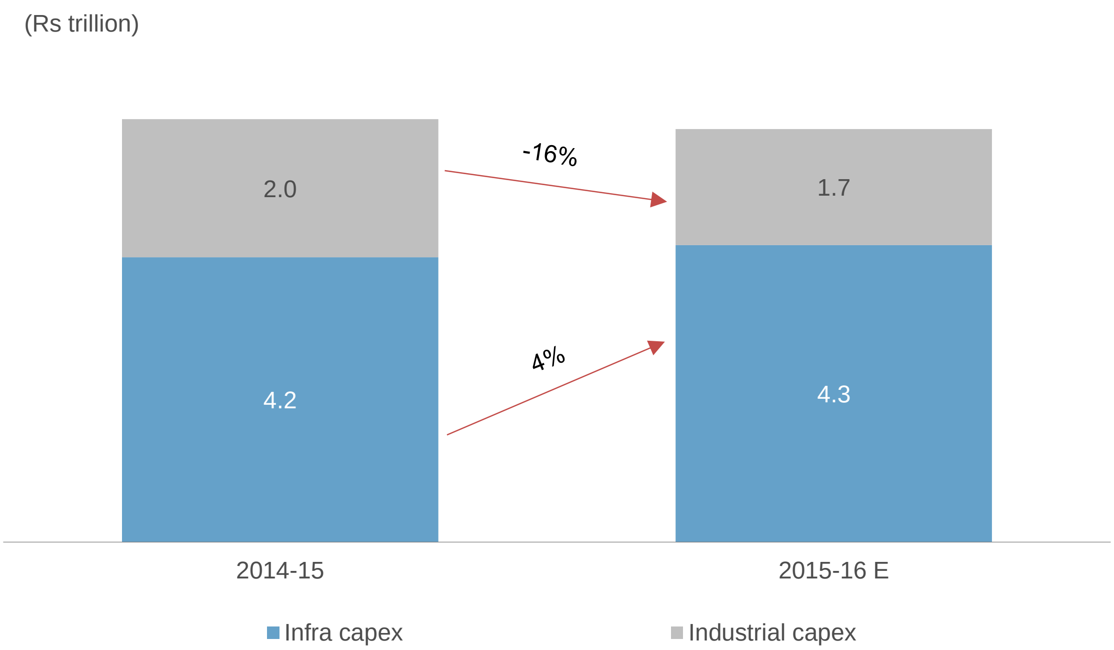
Note: The sectors analysed are steel, aluminium, cement, refining & marketing, petrochemicals, power generation, pharmaceuticals, cotton yarn, sugar, oil & gas (upstream & downstream), power T&D, telecom, paper, irrigation, automobiles, coal mining, urban infra, airports, national highways, renewable energy, ports and fertilisers.

Source: CRISIL Research

Industrial sectors will be the drag

Industrial capex, which accounts for close to 30% of aggregate capital investments, is expected to decline sharply by 16% this fiscal, mainly due to low utilisation rates. On the other hand, infrastructure investments will grow at a moderate 4% helped by favourable policy changes and higher budgetary allocations (there was a 50% increase in allocation towards infrastructure in the last budget.).

Investment split by infra and industrial sectors



E: Estimated

Source: CRISIL Research

The chart below provides a sector-wise snapshot of investments. As evident, large sectors such as power generation, aluminium, steel, cement and refining & marketing are weighing on investments, while the infrastructure segments such as urban infrastructure, national highways and renewable energy are preventing a bigger decline in overall investments.

Sector-wise investment expectation

Investments over next 2 years	Low	Moderate	High
Increase	Fertilisers Coal mining Ports	Automobiles National highways Renewable energy	Irrigation Urban infra
Stable	Cotton yarn Sugar		Power T&D Oil & Gas Telecom
Decline		Steel Cement Refining & Marketing	Aluminium Power generation

Share in overall investments (5 year average)

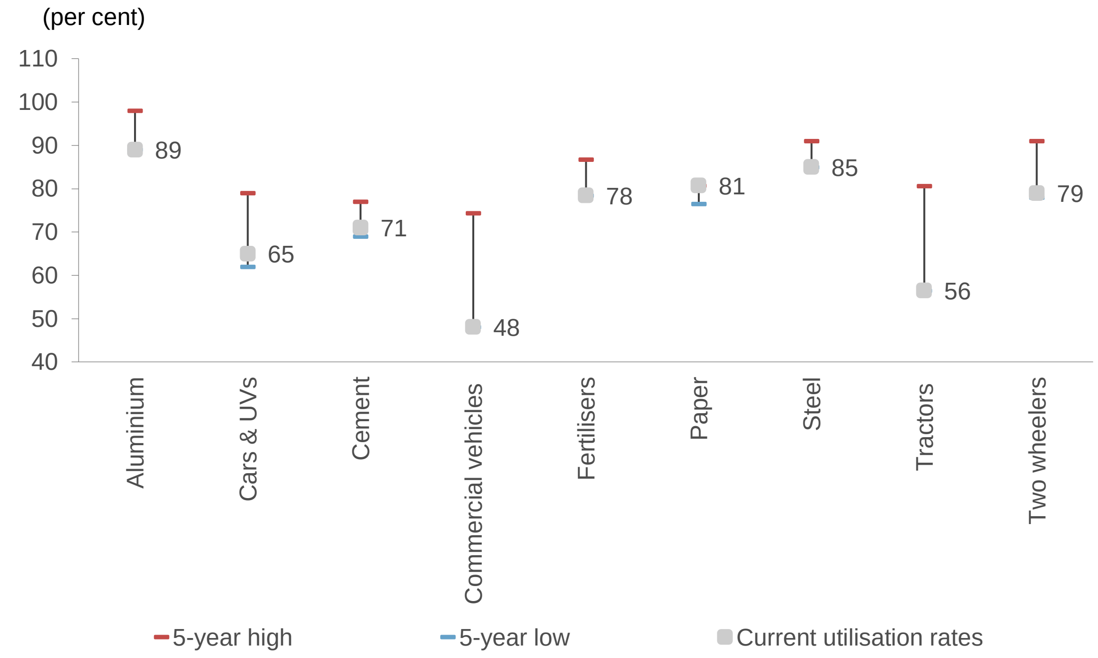
Source: CRISIL Research

Utilisation rates at 5-year lows

Low capacity utilisation is the key challenge faced by most industrial sectors. For 10 out of 12 large industrial sectors analysed, current capacity utilisation is lower than their 5-year average. For instance, in the metals space – particularly steel and aluminium – India has created surplus capacities in the last few years and is turning into a net exporter from being a net importer. In addition, sectors such as refining & marketing and petrochemicals are also being affected due to the global decline in commodity prices.

Apart from paper, most sectors are very close to their 5-year lows in term of capacity utilisation (see chart below), and still some time away from their peak utilisation rates. Till the gap narrows, it very difficult to envisage a broad-based pick-up in the capex cycle.

Utilisation rates across sectors



Source: CRISIL Research

New project announcements have dried up completely for these sectors. As a result, fresh investments (projects announced or awarded in the last one year) are expected to account for a mere 20% of total investments in the next couple of years with the rest flowing towards ongoing or legacy projects.

Probably the two exceptions among industrial sectors are automobiles and fertilisers, where we expect investments to witness a healthy increase. In the case of fertilisers, private announcements have increased after a long lull as the new urea investment policy provides a higher upside to project returns. For automobiles, especially the passenger cars segment, the demand outlook has improved with a drop in fuel prices and interest rates.

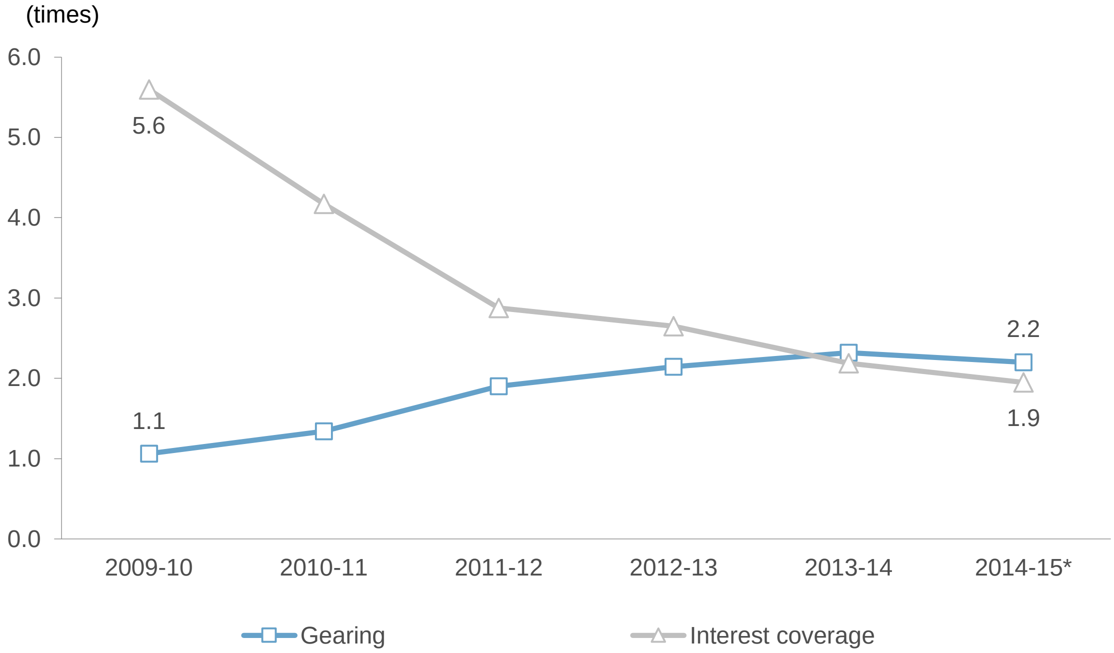
Infrastructure to benefit from the government push

In case of infrastructure, the scenario is quite the reverse – with power generation being the only segment expected to see a decline in investments. Thermal power capacity additions are expected to decline from 40,000 mw in the last two years to 36,000 mw in the next two. No new project announcements are being made because of stretched financials of private developers and lack of fresh power purchase agreements on account of the weak financial health of discoms.

On the other hand, road building, renewable energy and urban infra are expected to benefit from sharper government focus and policy changes. For national highways, the pace of execution has picked up significantly following a slew of policy changes that ease rules regarding environmental clearances. Similarly, renewable energy (wind and solar) benefits from the fiscal incentives and favourable policies that are expected to result in a doubling of capacity additions in the next two years from about 6,000 mw to 11,000 mw.

While the government is putting all its muscle to improve infra creation in the country, private participation remains lacklustre; the poor financial health of infra developers and construction companies is the limiting factor. Average gearing for infra and construction companies has doubled in the last five years to 2.2 times as of March 2015. At the same time, their interest coverage has come down to just about 1.9 times in fiscal 2015 from 5.6 times in 2010.

Gearing and interest coverage for infra and construction companies



Note: Based on aggregate financials for 40 infrastructure development and construction companies. 2014-15 numbers are based on unaudited financials.

Source: Company reports, CRISIL Research

As a result, developers are looking to deleverage balance sheets by selling operational projects. We believe it will take about a year to clean up and private participation to begin, which would be the real propeller of the investment cycle.

(Please note that the views expressed here are those of CRISIL Research and not of CRISIL's Ratings division. CRISIL Research operates independently of and does not have access to information obtained by CRISIL's Ratings Division.).

Analytical Contacts:

Prasad Koparkar
Senior Director, CRISIL Research
Email: prasad.koparkar@crisil.com

Miren Lodha
Associate Director, CRISIL Research
Email: miren.lodha@crisil.com

Media Contacts:

Tanuja Abhinandan
Media Relations
Email: tanuja.abhinandan@crisil.com
Phone: +91 22 3342 1818

Jyoti Parmar
Media Relations
Email: jyoti.parmar@crisil.com
Phone: +91 22 3342 1835

Our Capabilities

Making Markets Function Better

Economy and Industry Research

- Largest team of economy and industry research analysts in India
- Acknowledged premium, high quality research provider with track record spanning two decades
- 95% of India's commercial banking industry by asset base uses our industry research for credit decisions
- Coverage on 86 industries: We provide analysis and forecast on key industry parameters including demand, supply, prices, investments and profitability, along with insightful opinions on emerging trends and impact of key events
- Research on sectors and clusters dominated by small and medium enterprises covering analysis of relative attractiveness, growth prospects and financial performance
- High-end customised research for many leading Indian and global corporates in areas such as market sizing, demand forecasting, project feasibility and entry strategy

Funds and Fixed Income Research

- Largest and most comprehensive database on India's debt market, covering more than 18,000 securities
- Largest provider of fixed income valuations in India
- Provide valuation for more than Rs.70 trillion (USD 1,167billion) of Indian debt securities
- Sole provider of fixed income and hybrid indices to mutual funds and insurance companies; we maintain 38 standard indices and over 100 customised indices
- Ranking of Indian mutual fund schemes covering 73% of assets under management and Rs.7.2 trillion (USD 120 billion) by value
- Business review consultants to The Employees' Provident Fund Organisation (EPFO) and The National Pension System (NPS) Trust in monitoring performance of their fund managers

Equity and Company Research

- Largest independent equity research house in India,; coverage exceeds 140 companies
- First research house to release exchange-commissioned equity research reports in India; covered 1,488 firms listed and traded on the National Stock Exchange
- Assigned the first IPO grade in India; graded more than 100 IPOs till date

Executive Training

- Conducted 1000+ training programs on a wide spectrum of topics including credit, risk, retail finance, treasury, and corporate advisory; trained 20,000 more than professionals till date
- Training programs being conducted in India, Sri Lanka and Bangladesh through an extensive network of well-qualified financial professionals

Our Offices

Ahmedabad
706, Venus Atlantis
Nr. Reliance Petrol Pump
Prahladnagar, Ahmedabad - 380015, India
Phone: +91 79 4024 4500
Fax: +91 79 2755 9863

Bengaluru
W-101, Sunrise Chambers
22, Ulsoor Road
Bengaluru - 560 042, India
Phone: +91 80 2558 0899
+91 80 2559 4802
Fax: +91 80 2559 4801

Chennai
Thapar House
43/44, Montieth Road, Egmore
Chennai - 600 008, India
Phone: +91 44 2854 6205/06
+91 44 2854 6093
Fax: +91 44 2854 7531

Gurgaon
Plot No. 46
Sector 44
Opp. PF Office
Gurgaon - 122 003, India
Phone: +91 124 672 2000

Hyderabad
3rd Floor, Uma Chambers
Plot No. 9&10, Nagarjuna Hills
(Near Punjagutta Cross Road)
Hyderabad - 500 482, India
Phone: +91 40 2335 8103/05
Fax: +91 40 2335 7507

Kolkata
Convergence Building
3rd Floor, D2/2, EPGP Block
Sector V, Salt Lake City
Kolkata - 700 091, India
Phone: +91 33 4011 8200
Fax: +91 33 4011 8250

Pune
1187/17, Ghole Road
Shivaji Nagar
Pune - 411 005, India
Phone: +91 20 2553 9064/67
Fax: +91 20 4018 1930

Stay Connected | Twitter | LinkedIn | YouTube | Facebook

CRISIL Limited
CRISIL House, Central Avenue
Hiranandani Business Park, Powai, Mumbai - 400 076. India
Phone: +91 22 3342 3000 | Fax: +91 22 3342 8088
www.crisil.com

CRISIL Ltd is a Standard & Poor's company