



The Great Indian Capex Cycle

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India's Best Performing and Most Customer Centric PMS

Covid 19 pandemic is almost over, but it has changed world order for good. Companies all over the globe realized that for their production, they cannot rely on single source. This turning point in the mindset of global majors and the initial liquidity provided by the central banks all over the world, proved as the required catalyst for Private sector capex to breakthrough the resistance it was facing for many years. From the exemplary boost in Capex Targets to Make in India, Aatma Nirbhar Bharat and the timely introduction of Production Linked Incentive Schemes (PLI), the Indian Government has provided the required base for launching the **Great Indian Capital Goods Cycle**.

Build up of the Investment cycle seems positive.

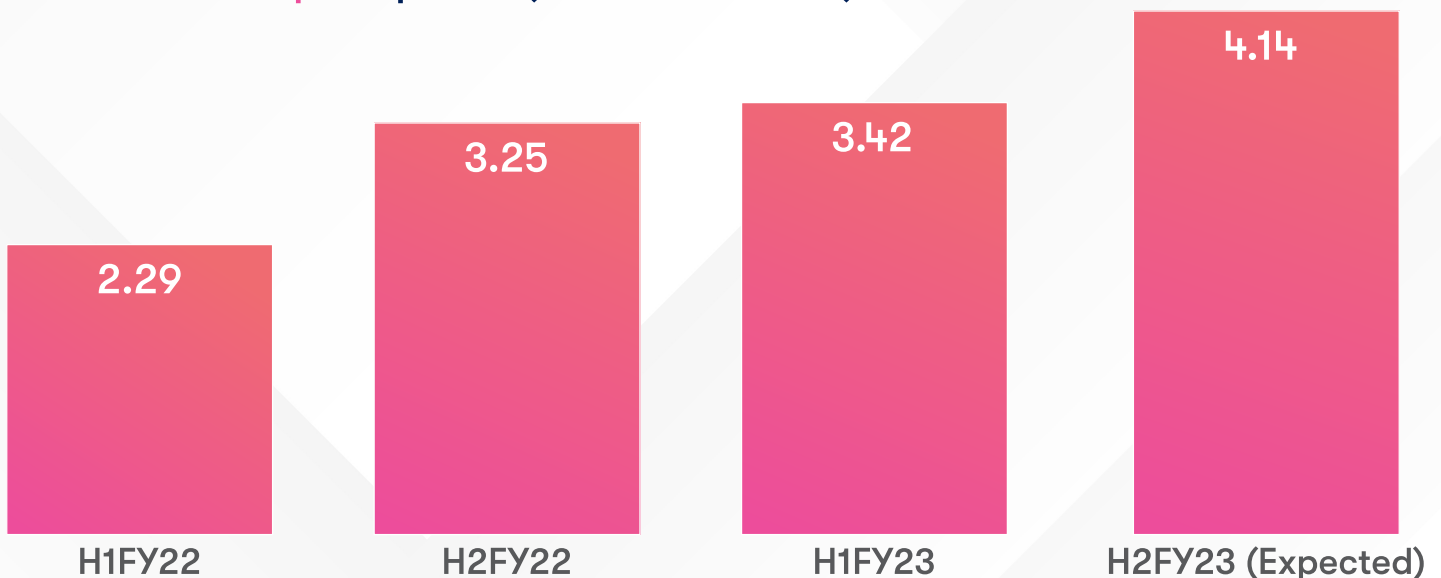
Capital expenditure by the Indian government as well as listed private companies has risen to an all-time high in the trailing 12 months and is expected to touch ₹21 lakh crore in FY23.

As the nature of the Capex Cycle is, it is difficult to start, but once it starts, it picks up steam and gains momentum. Indian companies are planning huge Capex to increase capacity and upgrade technology to gain market share under opportunities presented by China+1 and Europe+1. Order inflow, Short term revenues of machinery & consumables and capital goods imports show that investment cycle build-up is positive.

The government also is planning a heavy infrastructure and manufacturing push, and with COVID not being the area of concern, the Government will be looking for meeting the ambitious targets it has set for itself in the Union Budget. The infra and capital goods sector received a big boost, with the government increasing the Capex spend target sharply by 35.4% from Rs 5.54 lakh cr. in FY22 to Rs 7.50 lakh cr. in the FY23 Union Budget. It works out to 19.02 per cent of the total expenditure of Rs 39.45 lakh cr. The last time that the capital expenditure share touched a similar figure was when it came in at 19.32 percent for the financial year 2004-05 (FY05) leading to a massive rally of in BSE Capital Goods Index of 40%+ in FY05 and 150% in FY06. Capital expenditure during the April-September 2022 period reached Rs 3.42 lakh crore compared to Rs 2.29 lakh crore in the corresponding period last year.

Volatility in commodity prices amid Russia Ukraine war did affect the investment decisions of major players in Q1FY23; however, with softening of commodity prices, the momentum has again picked up in Q2FY23.

GOI Actual Capex Spends (INR Lakh Crores)



What are the key drivers of CAPEX?

Private Sector Capex

National Infrastructure Pipeline

National Infrastructure Pipeline (NIP): In the NIP, roads, railways & power are the primary sectors where Capex is planned. Roads & urban infra assume importance to meet the needs of a growing economy & large-scale investments are being made to improve urban infrastructure, water supply, developing smart cities, etc. Companies like L&T, Dilip Buildcon, Rail Vikas Nigam Ltd, IRCON, SJVN Ltd., and Va Tech Wabag are likely to benefit.

Private Sector Capex: The private sector Capex is planned with a special focus on multiple sectors. Clean Tech & PLI-driven schemes in mobile, EVs, Battery technology, Solar auto, pharma, etc. Many mid and small companies are applying for the PLI scheme, having strong balance sheets with more than 80% capacity utilisation; the PLI scheme is quite supportive for companies, and from the long-term point of view, India's share in export will increase. Companies like Tube Investments of India Ltd, and KPIT Tech, will benefit from the PLI scheme. Allied Industries like bearings and speciality products, which cater to multiple sectors will keep on gaining traction. Companies like CG Power and Industrial Solutions Ltd, RHI Magnesita India Ltd, Schaeffler India Ltd, Timken India Limited, Elgi Equipments Ltd. etc should be the ones to look out for in the next one year.

Key Beneficiaries of CAPEX

Engineering Construction	Cap Goods High Precision	Defence	Bearings	Cap Goods Non Electric	Railways
Larsen and Toubro	ABB	BEL	Timken	Cummins	RVNL
	Siemens	HAL	Schaeffler	AIA Engineering	IRFC
	BHEL				

Defence Industry: The defence industry will drive major Capex as India aims to significantly reduce \$3 billion+ of direct and component imports replaceable market out of the total \$7.8 billion. Companies like BEL, BDL HAL etc. will benefit. Considering government support for the defence sector, many companies have announced huge Capex plans. BEL announced a Capex of INR 30,000 mn, out of which Rs 12000-13000 mn is already spent and the remaining is expected to be spent in remaining FY23. Similarly, other companies like HAL, BDL etc., have also announced Capex plans.

Logistics Industry: Logistics, warehouses and data centres are also areas which require a high Capex, a stronger manufacturing ecosystem, and tax reforms & the rise of e-commerce would aid more investments in logistics and warehousing. At the same time, increased data handling with localisation norms would aid data centres. The government announced the first outlay of Rs 20,0000 mn in budget 2022 under Gati Shakti national master plan to spur logistic infrastructure. Companies like Allcargo Logistics, Aegis Logistics, and TCI Express will benefit from the government Capex plan for the logistics sector.

Renewable energy: Renewable energy is also likely to witness huge Capex momentum as capacity addition has to be done to meet rising demand. The concentration on the renewable energy sector has led to consistent growth of India's renewable energy capacity over the years, crossing the 100 GW mark in FY22, with the renewable-based capacities share increasing from 12% in FY12 to 28% in FY22, mainly driven by solar. The government initiatives, along with the consistent decrease in the cost of solar technology, provided the impetus to the solar energy sector, making it attractive for domestic as well as global players. Tata Power is planning to scale up its generation capacity to over 30 GW by FY27 from the current 13.5 GW, with an increased clean energy portfolio from current levels of 34-60 % by 2027 and 80% by 2030. Green energy companies like Reliance and Adani green are likely to benefit from the government Capex plan for green energy.

Other capital-intensive sectors such as power, mining, infrastructure, construction materials, digital infrastructure, and PLI-incentivised sectors may also see a major boost during this period.

Allied Manufacturing Sectors: Allied manufacturing sectors are bound to witness CAPEX because they are the substructure of the manufacturing industry. Factory output in November continued to expand after October's robust growth. Manufacturing Companies made higher input purchases to create an inventory that could match the expected demand and predict increased sales. Business optimism was the highest in almost eight years, which has added volumes to the allied manufacturing companies. Bearing Companies & Speciality Products. Companies like CG Power and Industrial Solutions Ltd, RHI Magnesita India Ltd, Schaeffler India Ltd, Timken India Limited, and Elgi Equipments Ltd. would be the biggest beneficiaries. By 2028, it is expected that India will reach 1 trillion in manufacturing exports. Manufacturing's share of GDP in India is estimated to increase from 15.6% currently to 21% by 2031—and, in the process, double India's export market share. The government also launched an interest equalisation scheme to make credit available for cheaper exporters in India.

Top picks in capital good space.

Larsen & Toubro (L&T) L&T has a strong order book of Rs. 3,72,000 crores (as of 31st September), 2022), indicating good revenue visibility in the coming years. The company has come out with a five year plan called "Lakshya 2026". In that, the company will focus on emerging portfolios like Green EPC, manufacturing electrolyzers, battery & cell manufacturing, data centres, and platforms (Sufin & Edutech). L&T has become more selective in choosing business opportunities along with a strong backlog gives comfort to the company to use discretion for winning relatively profitable orders going forward.

Siemens: It operates mainly in 5 key segments, including energy/gas & power, smart infrastructure, digital industries, and mobility. The order book has grown by 61%, coupled with the order backlog at an all-time high at Rs 17856 (as of 30th June, 2022) crore is seen improving revenue growth visibility going ahead. The company has a main focus on technology leadership in digitisation & automation products to further strengthen its market share. Strong demand for short-cycle products with clear traction from steel, cement, chemical, pharma, and fertiliser industries to drive healthy growth and rise in the margin in smart infrastructure and digital industries segments.

Timken: Timken India is engaged in the manufacturing, distribution and sale of anti-friction bearings, mainly tapered roller bearings and cylindrical roller bearings. It is in the power transmission product brands & also offers products to the defence, mining, aerospace, agriculture, rail, energy & automotive industry. 75% of revenue comes from domestic sales & 25% from export. Timken has a strong balance sheet along with decent growth prospects led by strong growth in railways, wind & exports. The announcement of 400 Vande Bharat trains and 90,000 wagons in the next three years will help the company to utilise the railway's segment capacity, which is around 55-60%. The domestic market is also robust on the back of the Capex cycle; power, infra, and mining look brighter.

Bharat Electronics: Bharat Electronics (BEL) is a leading aerospace & defence electronics company. It mainly manufactures advanced electronic products. The company's order book stands at Rs.57,570 crores as of March 2022, ending after getting contracts of ~ Rs.19,200 crores in FY22. The company is well placed to take benefit from the government's strong push in the defence sector. The healthy order backlog provides strong earnings visibility. Moreover, the company has a strong order pipeline and expects big-orders in the coming period. BEL's plan to diversify its product portfolio into non-defence & focus on increasing exports and services share would further aid long-term growth & help to de-risk its business.

Cummins India: Cummins India (CIL) has reported a good set of numbers with its highest-ever sales in Q2FY23. Revenue /EBITDA/PAT grew 13%/12%/15% YoY to Rs16.8b/Rs2.9/Rs2.5bn, respectively. This was led by both volume growth and inflation-led price hikes. Exports and domestic segments grew 21% and 11% YoY. Higher inventory lead time and supply-chain issues limited revenue growth while demand remained high across industries. EBITDA margin was stable at ~15% (improved 220bps QoQ) despite 120bps drop in gross margin at 31.8%. We expect gross margin to see an uptick on improving the supply chain and further price hikes. The increasing availability of electronic and other components would also result in higher utilisation from 70-80% currently. Strong growth is likely to sustain in data centre, commercial realty, pharma, biotech and manufacturing sectors which may drive growth in Powergen segment. Implementation of CPCB IV+ from Jul'23 could result in pre-buying during H1CY23.

Rail Vikas Nigam Ltd (RVNL): Rail Vikas Nigam is engaged in the business of implementing various types of Rail infrastructure projects assigned by the Ministry Of Railways, including doubling (including 3rd/4th lines), gauge conversion, new lines, railway electrification, major bridges, workshops, Production Units and sharing of freight revenue with Railways as per the concession agreement entered into with Ministry of Railway. The company's major client is the Indian Railways. Its other clients include various central and state government ministries, departments, and public sector undertakings. During the year 2021-22, Company commissioned 1020.90 km of project length, which included 704.80 km of Doubling and 316.10 km of Gauge Conversion, thus crossing the 1000 km commissioning barrier. 1525.45 km project length was completed, including 66.75 km of New Line, 908.07 km of Doubling, 25.63 km of Gauge Conversation, and 525 km of Railway Electrification.

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