InvAsset's Voice



CAPEX
CAPITAL EXPENDITURE

23rd May, 2024

INVASSET

India's Best Performing and Most Customer Centric PMS

Capital expenditure, often abbreviated as CapEx, refers to the funds used by a business or a government to acquire, upgrade, and maintain physical assets such as property, industrial buildings, or equipment. It is distinct from operational expenditures (OpEx), which are short-term expenses required for the daily operation of a business.

HERE'S *Why* CAPITAL EXPENDITURE *is crucial*

Long-term Asset Creation: Capital expenditures are used for acquiring fixed and intangible assets. These purchases typically provide utility to the business for many years, making them fundamental for long-term planning and growth.

Upgrades and Repairs: Investing in existing assets through upgrades or repairs can enhance efficiency, extend the asset's useful life, and improve overall performance, which can lead to cost savings and increased productivity over time.

Economic Impact: On a larger scale, capital expenditure plays a significant role in the economy by creating assets that boost productivity and operational efficiency. This leads to higher labor participation and can elevate the overall economic output.

Debt Management: Including the repayment of loans as part of capital expenditure might seem unusual since it doesn't create physical assets. However, it is considered a CapEx because it reduces financial liabilities and improves the entity's balance sheet health, thereby enhancing its ability to fund future projects and investments.

Understanding and managing capital expenditures is essential for sustaining growth and competitiveness in the long term for both businesses and economies.

The interim budget, revealed on February 1, provided a further boost to central capital expenditure, raising the allocation for infrastructure projects to ₹11.11 trillion for the fiscal year starting April 1. This represents a continuation of the recent trend of increasing investments to drive economic growth.
In an effort to enhance India's aging infrastructure, generate employment, and expedite economic progress, the government has consistently increased its capex budget. This year, the Centre's capex expanded by 37%, following increases of 24% in FY23 and 40% in FY22.
The latest budget proposal indicates an 11.1% increase in capex over the previous year's ₹10 trillion, maintaining strong growth momentum from past years with rates of 37% in the current year, 24% in FY23, and 40% in FY22.

The capital expenditure as a share of nominal GDP for India from the fiscal year 2016-17 to the budget estimate for 2024-25. Capital expenditure has increased over the years, with a noticeable upward trend in effective capital expenditure, which includes both capital expenditure and grants for the creation of capital assets.
In 2016-17, the total effective capital expenditure was at 3.0% of the GDP, with a base capital expenditure of 1.8%. The share declined slightly over the next three years, reaching a low of 2.6% in 2018-19. However, from 2019-20 onwards, there is a clear upward trajectory, peaking at 4.6% in the budget estimate for 2024-25. The base capital expenditure also increased substantially during this period, indicating a strong emphasis on infrastructure and asset creation as part of the country's economic strategy. The 2024-25 budget estimate shows an effective capital expenditure share of 4.6% of the GDP, which is the highest in the displayed period, signaling a robust allocation towards capital spending.

At 3.4%, the capital expenditure share of India's GDP is the most substantial it has been since the fiscal year 2004-05, this is true regardless of whether the older GDP series with the base year of 2004-05 or the newer series with the base year of 2011-12 is referenced. The central government's capital spending has been a pivotal factor in propelling the overall economic growth. In FY24, the proportion of investment, as indicated by the Gross Fixed Capital Formation (GFCF), has escalated to 34.9% of the real GDP, which is a peak within the 2011-12 GDP series. While the Union government's capex forms just a part of this investment, specifically 10.8% of the nominal GFCF for FY24, its significance is magnified by the context in which it occurs: a period marked by hesitant private investment and consumer spending that has yet to achieve a wide-ranging recovery.

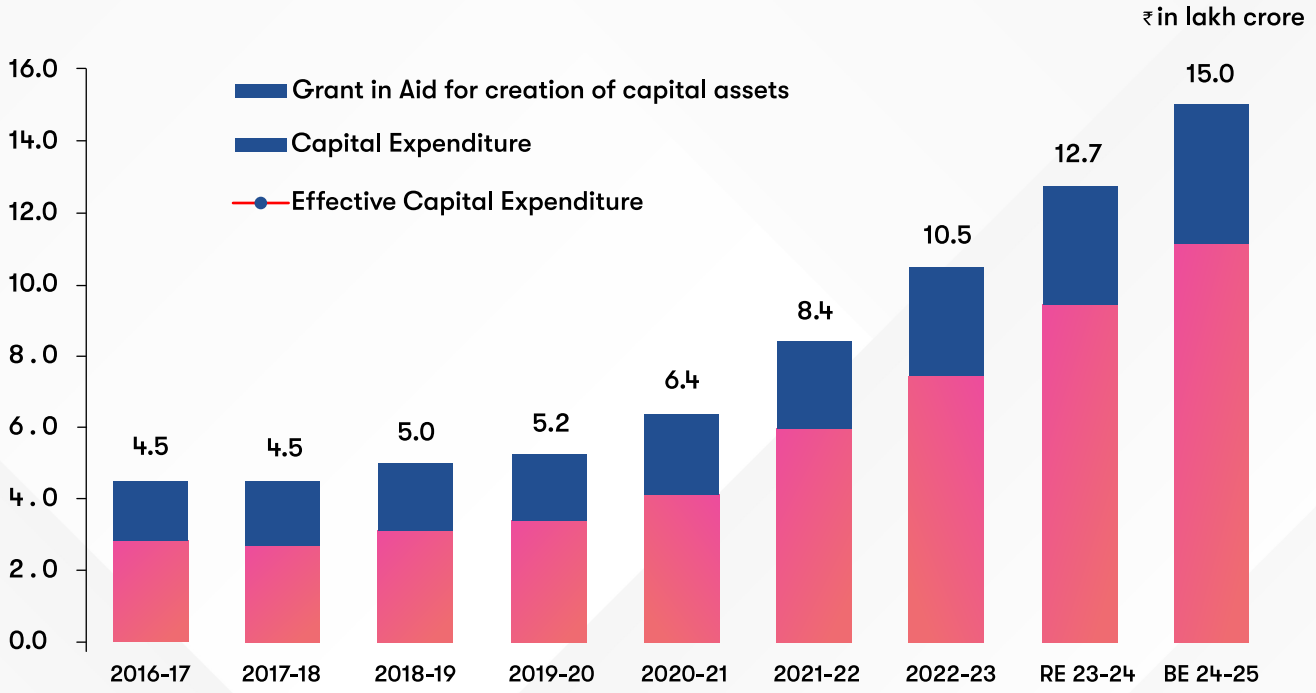
Trend analysis of Capital Expenditure over several fiscal years, from 2016-17 to the budget estimate for 2024-25, reveals three components:

Grant in Aid for Creation of Capital Assets – This component reflects the grants allocated for the creation of capital assets, demonstrating a steady rise annually. It begins at 2.8 lakh crore in 2016-17 and is projected to escalate to 15.0 lakh crore by the 2024-25 budget estimate.

Capital Expenditure – This metric represents the actual capital expenditure by the government. The amount has seen a consistent increase over the period, starting at 1.7 lakh crore in 2016-17 and rising to a revised estimate of 3.9 lakh crore in 2023-24. However, data for the 2024-25 budget estimate is not provided.

Effective Capital Expenditure – This appears to be a sum or another related aggregate of the previous two measures, displaying an ascending trend over the years. The figure starts at 4.5 lakh crore in 2016-17 and reaches 15.0 lakh crore in the revised estimate for 2023-24.

TREND IN CAPITAL EXPENDITURE



Advance estimates of national income and expenditure components of GDP 2023-24-

	2021-22	2022-23	2023-24
GROSS FIXED CAPITAL FORMATION (Rs in CR)	69,79,647	82,86,979	92,07,604
PERCENTAGE SHARE IN GDP	29.6	30.7	31.3

- The estimation for Gross Capital Formation (GCF) in current prices is projected to be ₹86.78 lakh crore for the fiscal year 2022-23, which shows an increment from ₹76.48 lakh crore in the preceding year, 2021-22. The GCF's percentage of the GDP is 32.2% for 2022-23, marginally down from 32.4% in 2021-22. From 2011-12 to 2019-20 and again from 2021-22 to 2022-23, the rates of capital formation outstripped the rates of savings, aided by a positive net capital inflow from the rest of the world.

- When examining the distribution of the total GCF at current prices for 2022-23, Non-Financial Corporations are the primary contributors with 44.2%, followed closely by the Household sector at 41.8%.

- The GCF to GDP ratio, calculated at the constant prices of the base year 2011-12, was 36.7% in 2021-22 and has decreased slightly to 34.9% in 2022-23.

The fiscal policy statements underscore that the capital expenditure (capex) for FY 2023-24 is anticipated to be triple that of FY 2019-20. Leading the surge in capital expenditure for the fiscal year 2023-24 are pivotal infrastructure and strategic ministries, such as those overseeing Road Transport and Highways, Railways, and Defence. The fiscal policy underscores this increase as a reflection of the government's intensified focus on bolstering infrastructure development, ensuring a balanced and equitable distribution of these investments nationwide. This approach aligns with the government's dedication to the Four I's—Infrastructure, Investment, Innovation, and Inclusion—over the next quarter-century. Furthermore, to empower states within the framework of cooperative fiscal federalism, the initiative to provide financial support to states for their capital expenditure, commenced in FY 2022-23, will continue into FY 2023-24. The scheme's budget has been boosted to ₹1.30 lakh crore, marking a 30% rise from the Budget Estimate of 2022-23 and constituting nearly 0.4% of the GDP for FY 2023-24.

India shifts gears: boosting eco friendly manufacturing in capital goods

In light of the current emphasis on capital expenditure, the government's prior investments have largely centered on road and railway sectors. However, there is a growing inclination to pivot towards more sustainable initiatives. This could involve broadening the scope of Section 35AD of the Income Tax Act, which allows deductions for capital expenditure, to encompass sectors focused on renewable and eco-friendly energy, like solar, wind, and hydro projects. Such sectors necessitate significant capital investment for the establishment and development of power plants.

India's manufacturing industry of capital goods forms a robust foundation for its involvement in a variety of sectors including Engineering, Construction, Infrastructure, and Consumer goods, among others.

The predominant export subdivisions within the capital goods domain are heavy electrical and power equipment, earthmoving and mining machinery, and process plant equipment. These subsectors collectively contribute to 85% of India's overall exports in capital goods.

In an effort to bolster domestic manufacturing prowess, IIT Madras has inaugurated an advanced manufacturing technology development center. This initiative is collaborating with India's capital goods sector on multiple fronts, encompassing a smart manufacturing platform designed to optimize production processes.

The capital goods sector saw its order book expand by 9% in the first half of the current financial year, reaching INR 3.9 trillion, and experienced a year-on-year growth of approximately 14% in FY22.

- **Heavy electrical equipment**
- **Process plant equipment**
- **Earth-moving and mining machinery**
- **Printing machinery**
- **Food processing machinery**
- **Dies, Moulds, and press tools**
- **Textile machinery**
- **Machine tools**
- **Plastic machinery**
- **Metallurgical machinery**

The capital goods industry encompasses ten leading distinct sub-sectors, with Electrical equipment being the predominant one, succeeded by Plant equipment and Earthmoving/Mining machinery.

Catalysts for Growth:

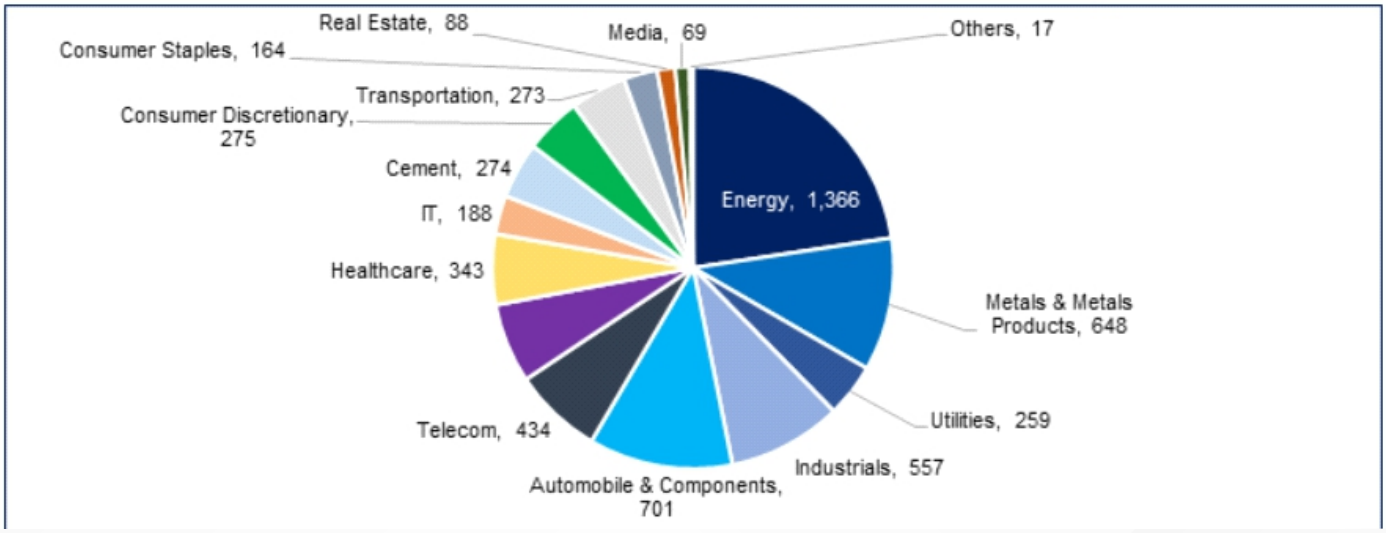
- Replacement needs for aging equipment, with prospects for the Transmission & Distribution (T&D) sector.
- Opportunity to bridge the import-export divide, noting that Capital Goods imports to India are threefold compared to exports.
- Anticipated extensive power capacity expansions in sectors such as Infrastructure, Power, Mining, Oil & Gas, Steel, and Automotive.
- Expansion in nuclear capacity presenting a considerable business opportunity.

RECENT DEVELOPMENTS

- Gujarat inks a Memorandum of Understanding with American semiconductor manufacturer Micron for a new chip-making facility.
- International automation leader Diebold Nixdorf broadens its footprint in India by establishing a facility in Bengaluru.
- The Minister for Agriculture of the Union opens M&M's new Agricultural Machinery Plant located in Pithampur.
- NSIC enters into a Memorandum of Understanding with Phillips Machine Tools India Pvt. Ltd.
- The government has announced the second phase of the initiative aimed at boosting the competitiveness of the Indian Capital Goods Sector. This scheme is endowed with a financial layout of INR 1207 crores, comprising INR 975 crores of budgetary support and an industry contribution of INR 232 crores.
- HAL and Rolls-Royce agree on a deal to manufacture Adour engine components in India for international markets.
- The Department for Promotion of Industry and Internal Trade has issued the Boiler Operations Rule for the year 2021.
- Moglix, a supplier of industrial goods, is extending its business reach to include the regions of Goa and Assam.
- BHEL has established a new division known as the 'Make in India (MII) Business Development Group,' tasked with scouting manufacturing prospects within India and collaborating with international Original Equipment Manufacturers (OEMs) to champion the 'Make in India, Make for the World' initiative.
- The Central government is set to allocate $459.7 million to execute diverse initiatives as part of the National Capital Goods Policy.
- China's Sany Heavy Industry, a top global engineering machinery manufacturer, plans to invest $9.8 billion.

Investments in fixed assets by publicly listed companies reached ₹8.1 lakh crore in the trailing 12 months as of September 2023, marking a 17% increase compared to September 2022 levels. This upsurge is predominantly attributed to key sectors like energy, automotive, and industrials. With listed private companies contributing nearly 75% of the capital expenditure among listed companies (which constitutes 25% of the total capital expenditure), this resonates with the government's objective of promoting domestic manufacturing and fostering self-reliance as envisioned in the concept of Atmanirbhar Bharat.

Chart 2: Private Capex breakup by Sector (in ₹ billion)



This pie chart displays the breakdown of private capital expenditure (Capex) by sector in billions of the Indian Rupee (₹). Each sector is represented by a slice of the pie with varying sizes indicating the amount of investment. For instance, the Energy sector has the largest slice with ₹1,366 billion, while sectors like Media and Others have much smaller allocations, ₹69 billion and ₹17 billion respectively. Other notable sectors include Automobile & Components with ₹701 billion, Telecom at ₹434 billion, and Healthcare with ₹343 billion. The chart is a visual tool for understanding the distribution of private investment across different sectors of the economy.

There is a growing optimism about Private Capex due to several positive economic indicators and policy support:

- Robust GDP Growth: The Real GDP growth rate of 7.6% in the second quarter of FY2024 and investment growth measured by Gross Fixed Capital Formation (GFCF) growing at 9.5% in the first half of FY24, and even higher at 11.0% in the second quarter, demonstrate a robust economic environment.

- Significant Private Sector Contribution: The Centre for Monitoring Indian Economy (CMIE) data shows that the private sector accounted for 86% of the new project announcements in terms of value over the past year. Additionally, capital expenditure by listed companies has surged, more than doubling from the FY2017-19 period to ₹23.9 lakh crore in the FY2024 trailing 12-month period.

- Improved Capacity Utilization: Although there's a slight dip from the previous quarter, capacity utilization in manufacturing increased to 73.6% in Q1FY2024 from 72.4% the prior year. Seasonally adjusted capacity utilization also improved, signaling that companies may be gearing up to expand their capacity.

- Higher Corporate Profitability and Lower Leverage: Indian corporates have been experiencing rising profitability, with trailing 12-month profits reaching 4.7%. With large listed companies having low leverage ratios, they are in a good position to finance Private Capex through borrowing.

- Increased Flow of Resources to the Commercial Sector: As per the RBI Governor's statement, the total resources available to the commercial sector, including funds from banks and other sources, increased by 21%, amounting to ₹17.6 lakh crore in the current financial year, facilitating more investment opportunities.

Conclusion

• Capital Expenditure Growth underscores a commitment towards enhancing infrastructure and driving economic expansion. Grants allocated for creating capital assets show a consistent upward trend, indicating a concerted effort to invest in critical infrastructure projects.

• The projected increase to 15.0 lakh crore by 2024-25 reflects ambitious plans for infrastructure development. Actual capital expenditure and effective capital expenditure have both witnessed significant growth over the years This indicates substantial investments made by the government in various sectors to stimulate economic growth and development

• Notable investments and expansions across sectors such as engineering machinery, semiconductor manufacturing, automation, agriculture machinery, and industrial goods supply signify confidence in the respective sectors and contribute to overall economic progress.

• The data underscores a positive outlook for capital expenditure trends and investments, reflecting a commitment towards infrastructure development, innovation, and economic growth. The diverse range of investments across sectors indicates opportunities for expansion and development, both domestically and internationally.

• Moving forward, continued investments and strategic initiatives will be crucial in driving sustainable economic growth and fostering competitiveness in the global market.

• Capital expenditure, or Capex, involves investments in durable assets like infrastructure, manufacturing plants, buildings, educational institutions, and irrigation facilities. These investments typically yield economic benefits, including growth in demand and income, over an extended period.

• An increase in Capex from the private sector is particularly encouraging because it is often targeted at the most efficient and productive areas of the economy, which are anticipated to generate the highest returns. This trend is promising for the continuous economic advancement of the nation and could further contribute to the upward trajectory of corporate eamings in India.

Disclaimer: This report has been prepared by the research department of Invasset, is for information purposes only. This report is not construed as an offer to sell or the solicitation of an offer to buy or sell any security in any jurisdiction where such an offer or solicitation would be illegal. Invasset have exercised due diligence in checking the correctness and authenticity of the information contained herein, so far as it relates to current and historical information, but do not guarantee its accuracy or completeness. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice.

The opinions expressed are our current opinions as of the date appearing in the material and may be subject to change from time to time. Prospective investors are cautioned that any forward looking statement are not predictions and are subject to change without prior notice. Recipients of this material should rely on their own investigations and take their own professional advice. Invasset or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. Invasset. or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

Invasset and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavour to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. This report is not directed to or intended for display, downloading, printing, reproducing or for distribution to or use by any person in any locality, state and country or other jurisdiction where such distribution, publication or use would be contrary to the law or regulation or would subject to Invasset or any of its affiliates to any registration or licensing requirement within such jurisdiction. Invasset may or may not hold any securities discussed in the article in its portfolios. Invasset may or may not take decisions based on the information contained in the article while curating portfolios for its clients. Without limiting any of the foregoing, in no event shall Invasset, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

This research has been done by the Core Fundamental Research Team of InvAsset PMS Desk.

Anirudh Garg
anirudhgarg@invasset.com

Harshal Dasani
harshaldasani@invasset.com

Bhavik Joshi
bhavikjoshi@invasset.com

INVASSET

India's Best Performing and Most Customer Centric PMS

MUMBAI
911 One Lodha Place,
Lower Parel, Mumbai 400013

GURUGRAM
4th Floor Two Horizon Centre,
DLF Phase 5, Gurugram,
Haryana 122002

LUDHIANA
1401, Aspen 2, Centara Greens,
Pakhowal Road, Opp. Riviera Resort,
Ludhiana 141001

1800-309-2172
98158-10172

info@invasset.com

www.invasset.com