

Sustainability, high capacity utilisation and huge capex plans are the key drivers for the growth of India Inc



CORPORATE INDIA is surging ahead. In every field, companies are vying to outdo each other and aiming to attain global size and stature. Even as companies globally are struggling to survive the crisis, companies in India, like elsewhere in Asia, are back on the growth track. Higher consumer demand and investments are, in turn, translating into more wealth being generated in the country.

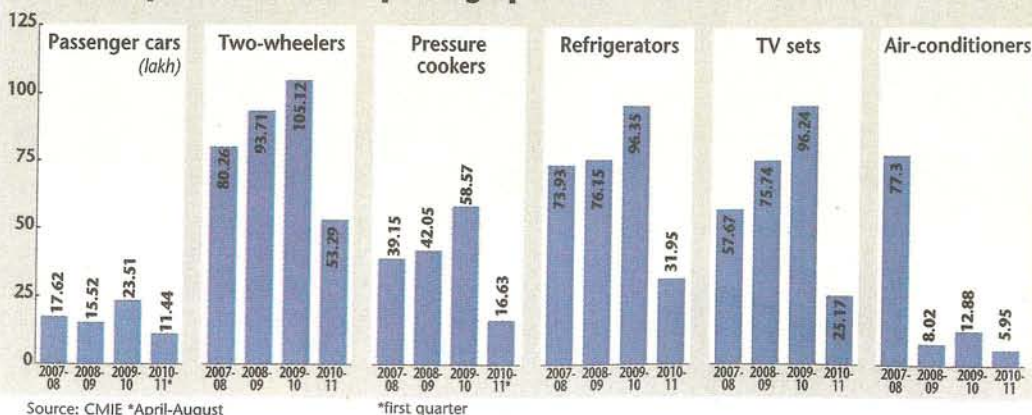
This year's *Business India Super 100* study focusses on high growth companies and what drives them; whether it is sunrise areas, technological innovation, financial planning, productivity and product push, capacity utilisation, capital expenditure or management skill – all rolled into one. We looked at CAGR (compounded annual growth rate), but let us reiterate that past results may not be the best indicator of future performance. The exercise was not just to find the drivers of growth but

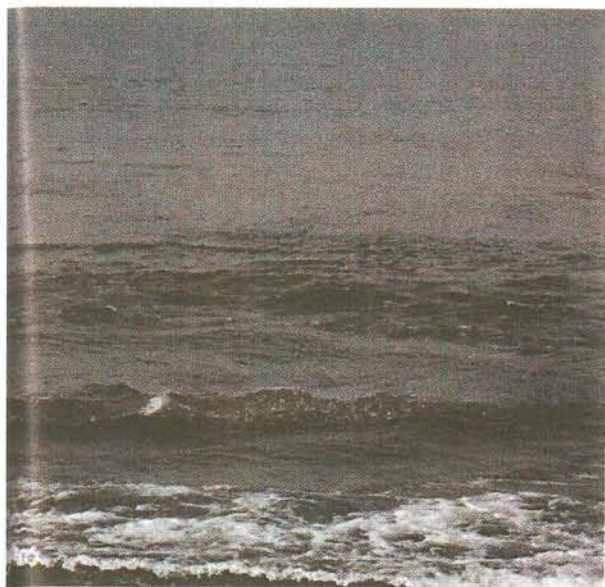
whether they are sustainable.

First, let us look at overall corporate performance. The aggregates of India Inc (covering the performance of roughly 2,400 companies) during 2009-10 showed that the topline grew by 18.2 per cent to about ₹6,41,800 crore but the bottomline surged 35.4 per cent to ₹85,600 crore. This indicates that the rise in input costs is getting negated by an increase in selling price. In addition, companies have been concentrating on productivity, cost cutting and optimality in scale.

The subsequent quarters have been even more encouraging. "After a sluggish 2008-09, all the macro-economic indicators showed robust growth, including healthy topline and bottomline growth by companies during 2010 and the first half of 2011. The Index of Industrial Production (IIP), a barometer of the manufacturing activity in the country, has shown

Consumption demand is picking up....





PALASHRANJAN BHADURICK

growth of 11.6 per cent in the first quarter of 2010-11 as against 3.9 per cent in the corresponding quarter last year. The strong performance of IIP in the past few months and the improving business sentiment underscores that the Indian economy is firmly on the recovery path," says D.R. Dogra, managing director and CEO of rating agency Care.

But is this growth rate sustainable? Ratan Tata, chairman of Tata Steel, in his annual statement, pointed out that the concentration of economic growth rates, manufacturing capacities, market size and control over natural resources will shift markedly towards Asia, Latin American and the CIS countries. China, India and Brazil will become important centres of economic growth in the coming decade.

There is a general consensus that this will be the best decade for India. "India is on a strong growth trajectory," said Kumar

Mangalam Birla in his communiqué to shareholders, adding that, "consumer spending is gaining momentum. Private investment is gaining steam."

Lalit Kumar Dangi, chairman, Libord, a financial service group, concurs. "It (growth) is sustainable at least over the next 3-5 years because the forces and factors that kept the growth momentum high all these years are likely to continue in the coming periods and may even work better." According to him the key drivers for maintaining the momentum are the growing consumer markets, improvement in quality consciousness, increase in demand for Indian products in the overseas markets, improved capacity utilisation rates contributing to lower production costs thereby leading to improved profit margins for several companies. V.V.L.N. Sastry, India head and CEO, Firstcall India Equity Advisors agrees, "With Indian companies concentrating on cost cutting measures and sweating of plants, these factors are proactively working in favour of them. I feel that the scenario will be a continuing one for some time to come."

According to the Reserve Bank of India's annual report for 2010 also, the outlook for GDP growth in 2010-11 has improved significantly as suggested by the broad-based, robust recovery seen in the last quarter of 2009-10. The prospects of a continuation of momentum are good, driven by the buoyant performance of the industrial sector, a better monsoon relative to last year, and sustained resilience of services. CMIE is even more bullish. In its October review of the economy it has predicted a GDP growth rate of 9.2 per cent. With the economy having already grown by over 8.5 per cent in the two quarters ended June 2010 it expects this growth to be sustained in the coming quarters as well.

Besides a smart recovery in agriculture, manufacturing and services sectors it is the prospects of this sustainability of consumer demand which has buoyed confidence amongst promoters, leading to more investments by Indian companies.

Investment demand had already witnessed a sharp acceleration by the fourth quarter of 2009-10 and trends in the growth of production of capital goods in the first quarter of this year suggest continuation of the momentum. Private consumption demand, going by the recent pattern in sales, the production of consumer durables and auto sales suggest a gradual pick-up, which could accelerate to make the growth process self-sustaining.



"Consumer spending is gaining momentum. Private investment is gaining steam."

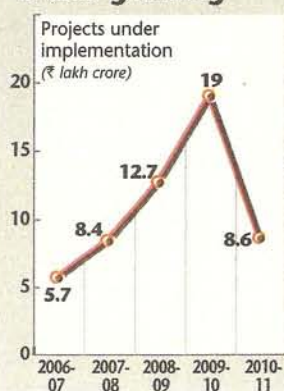
Kumar Mangalam Birla
Chairman,
Aditya Birla group



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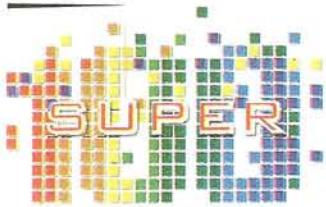
Ratan Tata
Chairman, Tata Steel

...Investment demand is also growing



Source: CMIE





"Our goal is to make RIL one of the most innovative companies in the world and to achieve breakthrough growth in revenues and profits by creating and implementing sustainable solutions"

Mukesh Ambani
CMD, Reliance Industries

Although there are concerns about a possible weakening of global recovery prospects, domestic risks to growth have receded significantly. However, in order to continue the growth story, India will have to address the problems at the supply side such as shortage of raw materials and accessories, giving rise to the possibility of cost-push inflation. India will also have to be alert to the dangers of sudden movements by capital in either direction which could make its currency highly volatile. The ability of the Indian industry to continue to respond to the changes in environment in an efficient and strategic way will be a test of its ability to sustain the growth momentum generated in the past 4-5 years to a newer and larger scale going forward.

"Our goal is to make RIL one of the most innovative companies in the world and to achieve breakthrough growth in revenues and profits by creating and implementing sustainable solutions," Mukesh Ambani, CMD of Reliance Industries, India's largest company, told his shareholders. It is this confidence and ambition of Indian entrepreneurs which is attracting foreign investors, especially those interested in participating in the India growth story. Foreign financial institutions (FIIs) have brought in close to \$29 billion this year, which is the highest in any year India has received. This is one of the reasons for the Indian bourses to bloom. Thanks to the huge FII inflows, the liquidity and depth in the Indian capital market has definitely helped the Sensex bounce back to 2008 levels. The Sensex in the past one year has risen by almost 27.3 per cent from 16440 levels to the recent Diwali period of 21005 and a stone's throw away from the intra day peak of 21206, touched in January 2008.

The BSE Sensex has crossed the 21000 mark for the first time in 2010 after a gap of about 32 months. One can expect the same momentum to continue in 2011, laced with intermittent corrections, provided FIIs continue to believe in India's growth story. It is also likely that due to the huge \$700 billion package given by the US government a portion of the easy

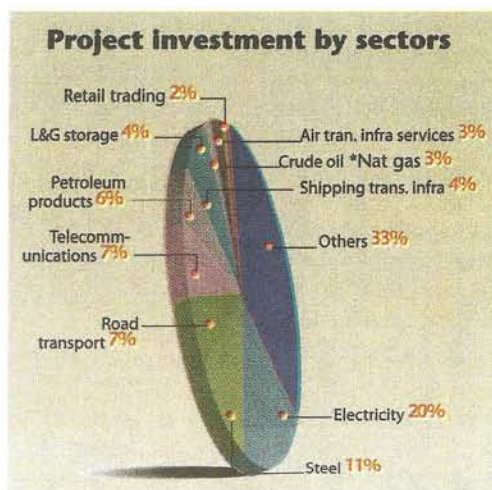
money could find its way into India. The interest rates that central banks are charging in many developed economies, for example, the US, is close to zero and therefore it is cheaper for FIIs to borrow money in their home-countries and then invest in emerging countries like India, particularly if the returns on investment are significantly higher in India compared to what they can get back home in their debt and equity markets.

So given the current market scenario, where small and retail investors are largely conspicuous by their absence, how does one lay hands on hidden gems? Investors ought to look at companies that are high on capacity utilisation, those that have embarked on capital expenditure plans and those with strong brands, which allow them greater pricing power.

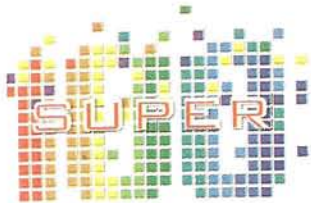
Consider this: with most industries humming at close to 85-90 per cent capacity utilisation, they would have to ramp up capacity if the economy is going to grow at 8.5 per cent during the current year and 9 per cent in 2011-12. Analysts feel the strong demand for automobiles would see the likes of Tata Motors benefiting from higher capacity utilisation and a series of price increases. Maruti is expanding its Manesar capacity from 300,000 units to 550,000 units over the next two years.

Currently, four cars are being sold in the country every minute and the surge in demand is likely to push up this rate. The waiting list for certain models is already being felt. Auto ancillaries are expected to move in tow. With easier finance options, the demand for autos is bound to move up. Or take the case of cement. Despite 30 million tonnes of additional cement capacity added during 2010, the capacity utilisation is around 85 per cent. With the government emphasising infrastructure development in terms of roads, highways and ports, together with the realty sector looking up, there will be increased demand for cement.

Capacity utilisation in sectors such as steel and oil refining are almost at 90 per cent. And robust sales in housing, demand for paints, consumer durables and white goods are on the rise. With higher disposable incomes, companies in fast moving consumer goods, with strong brands such as Hindustan Unilever, Procter & Gamble and GlaxoSmithKline (GSK) Consumer Healthcare have seen and are likely to see strong growth in earnings.



Projects to be commissioned during 2011-13
Total value of Projects ₹22 lakh crore. Source CMIE



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That brings us to the last major point on growth drivers. According to CMIE's Capex database, projects worth ₹5.5 lakh crore are scheduled to be commissioned in 2010-11. This is going to gather pace in the following two years. It expects projects worth ₹8.5 lakh crore to be commissioned in 2011-12 and a further ₹8 lakh crore the following year. The process of commissioning these projects would, in turn, push up demand for machinery, metals, cement, glass, paints, tiles and other construction-related products. "The commissioning of these projects will lead to fresh employment and bring more income in the hands of the households. This in turn would push up demand for food products, beverages, textiles, consumer electronics and automobiles," states the report.

A sector-wise break-up shows an investment of ₹4.5 lakh crore is to be made by 2013 in the electricity sector adding a power generation capacity of 82,000 MW. Companies like Adani Power, Reliance ADAG, Tata Power, JSW Energy and Essar are planning capacities of up to 10,000 MW. There are other players like Lanco, Torrent and Monnet Ispat that have huge ambitions. Public sector undertakings like NTPC, Damodar Valley Corporation and NHPC are also planning to add 5,040 MW, 4,200 MW and 1,861 MW respectively by March 2013.

Ditto for the steel industry! It is going to add 729 lakh tonnes of fresh production capacity at a cost of ₹2.4 lakh crore by March 2013. Jindal Steel & Power is likely to be the largest contributor to this (128 lakh tonnes), to be followed by JSW Steel (85.6 lakh tonnes), SAIL (72.6 lakh tonnes), Tata Steel (33 lakh tonnes) and Bhushan Steel and Essar Steel (27.2 lakh tonnes each). Likewise, other industries such as road transport/allied services (₹1.6 lakh crore), telecommunication services (₹1.5 lakh crore) and petroleum products (₹1.4 lakh crore) are also scheduled to make huge capacity additions by March 2013.



"Growth is sustainable at least over the next 3-5 years"

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Chairman, Libord

ONCE THESE investment cycles begin to kick in, these companies will move into a different league. According to Dogra, the capex plan is one of the good indicators of the confidence of Indian companies in the economy and a lead indicator of growing market size and growth rates of companies and industries. "However, macro-economic parameters like savings rate, interest rates, global inflation and employment rates should be seen in conjunction with capacity expansion plans to gauge the potential of increasing

market size."

If we see the capital rising plans by Indian companies, they are estimated to raise about ₹80,000 crore from equity and debt issues over the next three to six months. This is through direct market raisings. Besides this, companies are also aggressively tapping foreign markets and PE funds. This, according to sources, could be an additional ₹40,000 crore in aggregate for the coming one-year period. "The total capex combined indicates that companies are nicely using the capital and debt markets to their advantage in scaling up their operations, which itself is an indication that these projects fructifying into revenue generating ones will further add to the capacities and add to the growth momentum," says Sastry.

Consolidation and mergers and acquisitions have also been drivers of high growth rates for some companies. In 2010, the acquisitions by Indian companies in the global space continued to overshadow domestic acquisitions. A lot of Indian companies have seen value in expanding territories at a time when the global economy is still recuperating. Acquisitions have been in the space of oil & gas, telecom, metals, auto and IT. Domestic acquisitions have also picked up in the recent past. However, the value of such acquisitions remains small in comparison with global acquisitions.

Organic growth takes its own time and it ranges from 10 to 15 years, whereas with inorganic growth it can be achieved within a period of 2 to 3 years. In India, most of the companies are in the same business, hence there are possibilities that a lot of acquisitions will take place for inorganic growth. The acquisitions in pharmaceuticals and the financial sector and in chemical, cotton, consumer items and FMCG sectors are likely to be several. This way they will be able to decrease the cost of marketing and cost of production through various synergies arising out of such strategic acquisitions which will make them more competitive in the market. Of course, there have also been cross-border acquisitions where Ranbaxy was acquired by Daiichi and a unit of Piramal Healthcare bought over by Abbott, where the foreigners have their own plans to pump growth.

All in all, with corporate performances expected to be better for the rest of the year, and with Corporate India humming at near rated capacity, it will be interesting to follow how companies go about their capex plans, both in terms of funding and timely execution.

♦ ROY PINTO