ICRA

INDIAN CAPITAL GOODS SECTOR

Sustained order inflow reflects continued expansion in domestic investment; international orders gain traction in select segments

APRIL 2023

Highlights

The order book expansions reached multi year high as of December 31, 2022, reflective of the momentum in capex outlays in domestic sector as well as benefits from global markets flowing in.

The strong order book position is likely to be maintained in the near term with private sector capex expected to pick up supported by Government capital outlay, capacity enhancement across sectors, investments towards decarbonization, digitalization and exports demand.

Investment outlays paced up in FY2023 – While recovery in domestic capex across sectors was evident in FY2022, the momentum picked pace in FY2023, led by order intakes for capital goods players. While the Government continued to remain the key driver, capital outlays from states, as well as private sector, at varied paces across industries, coupled with higher overseas orders, aided expansion in order books.

Pick-up in orders from international market – Enhanced investment outlays in global markets, especially the US, Europe and the Middle East for infrastructure upgrade/ expansions, decarbonisation, electrification, digitalisation brought in order flows for some sectors like electrical equipment, turbines, cables, etc. Technology transfers, enabling capability building in the backdrop of cost competitive operations and supply chain realignment, aided order flows for select multinationals.

Strong order intake and comfortable order book position– The strong order intake momentum continued in 9M FY2023, which in turn allowed the order book to expand at the highest levels in the last six years thus providing healthy revenue visibility with Order Backlog/Operating Income ratio (OB/OI) of 1.06 times for OEMs in ICRA's sample set as on December 31, 2022 (typical order tenure 6-18 months) and 1.71 times for EPC companies (typical order tenure 12-24 months) in the sample set. However, any delay in capex amidst recessionary conditions or supply chain challenges could result in moderation in order inflow and affect the revenue visibility.

Capital goods – OEMs – ICRA's sample of OEMs reported healthy growth in revenue during 9M FY2023 driven by robust order inflow with strong execution and order books. Besides scale economies, softening of the commodity prices along with favourable product/ service mix with improved value addition aided margin expansion. This improvement in profit margins resulted in improved coverage indicators, which remained comfortable during H1FY2023. The working capital intensity of ICRA's sample of OEMs displayed a consistent improvement in the past five years with increase in customer advances, given the higher order intake and focus on collections.

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Higher revenue witnessed for ICRA sample OEMs in 9MFY2023 driven by healthy execution levels with margins improving to nearly 14% for this period on account of softening of commodity prices (especially in last two quarters) and favorable product mix.

Despite the abatement in supply side challenges, the margin profile for ICRA sample of EPC players remained at 7-8% with recovery expected with a lag in Q4 FY2023 characterised by longer execution cycle for these players.

Increased focus on diversification in product basket and geographies coupled with improved penetration in end user industries has continued over the nine-month period in FY2023.

Capital goods - EPCs – Notwithstanding strong order inflows and execution, margin pressures (partially on account of relatively higher vulnerability to commodity inflation, especially for over one year order execution cycle) and higher working capital intensity characterised the performance of ICRA's sample of EPC companies. Higher debt in their books as the scale expanded and rising interest rates resulted in moderated coverage ratios relative to their OEM counterparts. With relatively longer execution cycles, these companies remain more vulnerable to changes in input prices as well as time and cost overruns.

Supply-side challenges abating – While the order books expanded appreciably during FY2022, softening of commodity prices as well as logistics costs positively impacted the operating margins of capital goods OEM companies in 9M FY2023. However, margin recovery in capital goods EPC companies is expected to play out over Q4 FY2023-FY2024, given the majority contracts under execution being fixed price in nature, which restricts the ability to pass on price hikes to customers, despite revenue growth expectations.

Technology transfers for localisation capability enhancement and diversification focus continues – Major players focus on higher value addition and localisation, improved penetration in end-user verticals and diversification of product basket and geographies to reduce lumpiness in revenues. Persistent efforts to scale after-sales services/ refurbishment revenues and operations and maintenance contracts (O&M) (predominantly OEMs) through organic and inorganic routes continue. Investments in capability-building and technology partnerships with global majors gained traction. Additionally, consolidation (including acquisition) to expand/ complement product basket/ end user/ geographies also continued in FY2023.

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Thank You!