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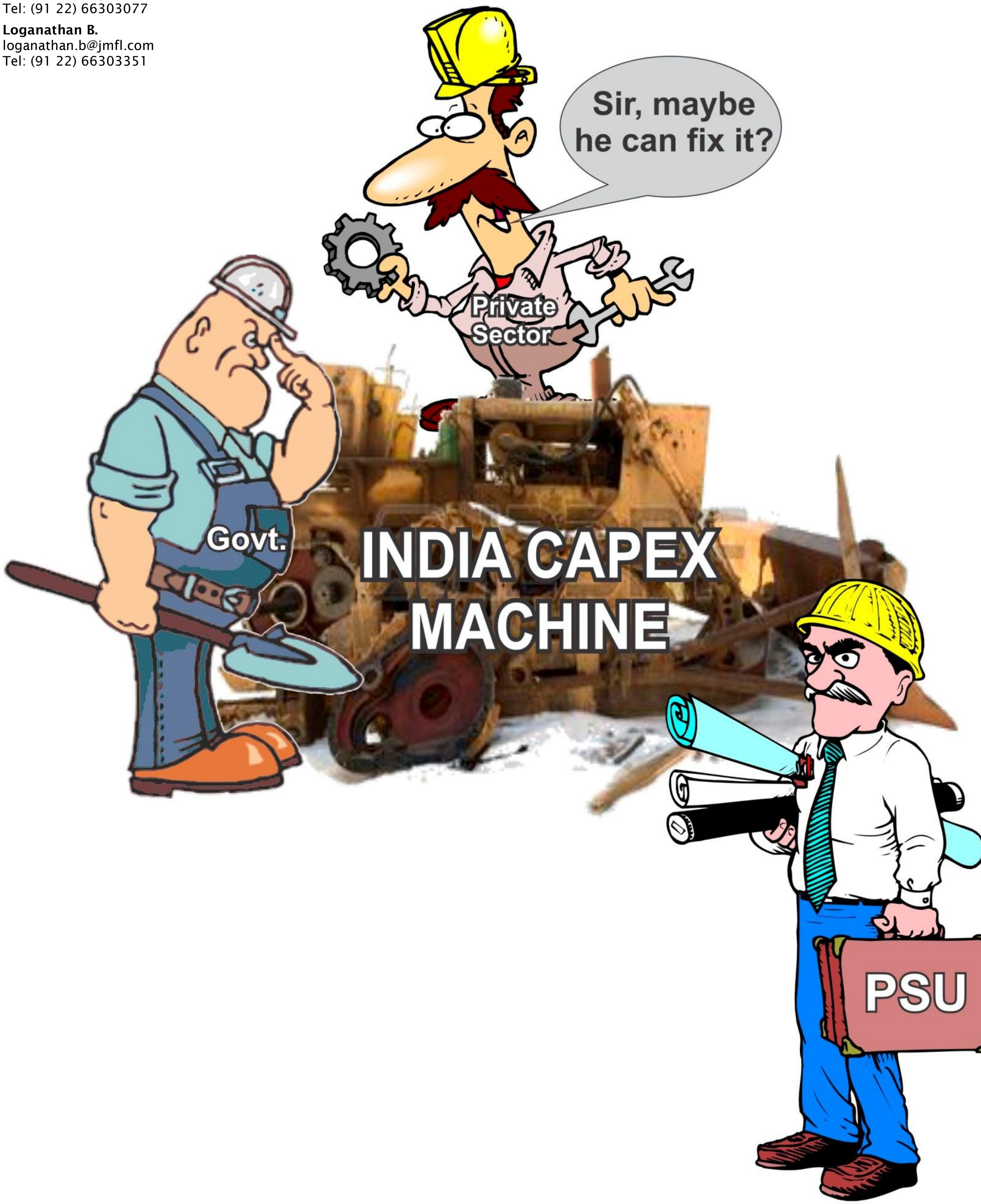

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India Strategy

The Great Indian Capex Conundrum

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Our proprietary capex model shows that spending by PSUs needs to increase by a 1.3x-1.6x from current estimates to help India maintain a "hygiene" level of 7% GDP CAGR. This is based on our detailed study of the planned capex across private sector, PSUs and the budgeted capex for central and state govts. As per our estimates a) Private sector capex is estimated to see decline of 15-20% CAGR over next 2 years b) capex by govt sector (non-PSU but govt. budgets) is estimated to increase by 16% CAGR that increases share of govt capex from 50% to 2/3rds of overall capex. While it is a trite that power, metals and oil capex is giving way to roads, railways and select utilities, we believe even govt-led capex would fall short of what is needed to meet the twin objectives of jobs and productivity and PSU corporates will have to step in to bridge the gap. Until that takes place, we expect industrial recovery to remain in the "early to mid-cycle" stage and an "aspirational" story for India.

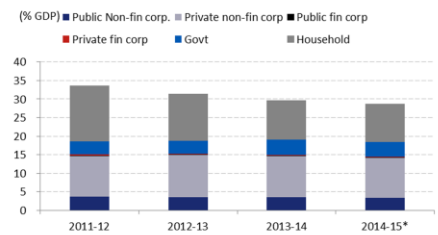
- **Project capex was led by power and metals over FY05-11:** Gross Fixed Capital Formation (GFCF) witnessed 24% CAGR over FY04-08 and led the GDP (nominal) CAGR of c.15%. Private corporate GFCF saw 43% CAGR (FY04-08) and was 43% of GFCF (FY08). GFCF growth slowed over FY08-14 to c.13% as private corporate GFCF grew slower at c.10% CAGR and was c.38% of GFCF. As per a RBI study, over FY05-11, project cost of institutionally funded projects (banks and FIs) saw 26% CAGR led by power and metals, whereas over FY11-15, total project capex declined at 30% CAGR indicating weak private corporate capex.

- **Expectations around capex:** We estimate private sector capex (JMF universe) to witness -17% CAGR over FY15-17E with big drops in metals (-8.4%) and oil/gas(-35%) sectors driven by low commodity prices, low capacity utilisations and strained balance sheets. Capex by government sector is estimated to increase by 16% (FY15-17E) led by transportation sector (52%). Public corporate capex is estimated to witness 19% CAGR (FY15-17E). Overall, Government:PSU:Private corporate spending share should change from 56:24:20% to 65:24:11%.

- **Govt, cash rich PSUs can offset private sector capex shortfall:** Based on the above estimates, and going by historical trends, we estimate the current level of fixed asset formation may not lead to a steady state 7%+GDP growth given the shortfall in private sector capex. While increased government spending partly makes up for this short fall, we believe cash rich PSUs will have to step up investments (30-60% above current estimates). From our coverage universe, Coal India, NMDC, NTPC and GAIL seem likely PSU companies to kickstart capex. Alternatively, higher dividend payout may be on the cards if appropriate opportunities are lacking to enable higher govt spending.

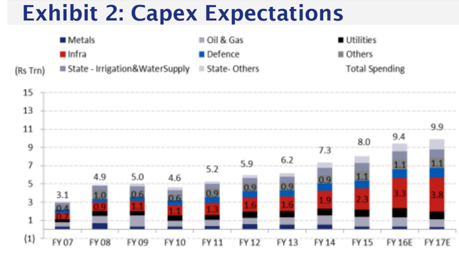
- **Our views on stage of industrial recovery:** Until the PSU capex picks up, we see domestic recovery to remain stuck in the "early to mid-cycle" stage, given that tepid industrial recovery was led by replacement demand in certain sectors and exports until now. Based on our capex study, we continue to favor retail focused companies and only a few select capex themes in India: Smaller contractors (Ashoka Buildcon, Sadbhav), TEEC (power T&D capex), midcap cement (North based JKLC).

Exhibit 1: GFCF % GDP



Source: MOSPI,JM Financial;* estimates

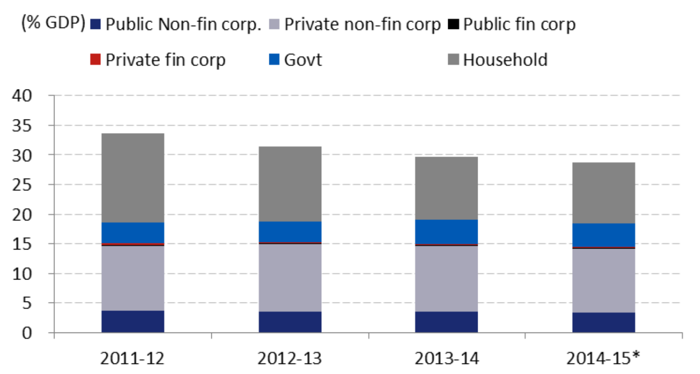
Exhibit 2: Capex Expectations



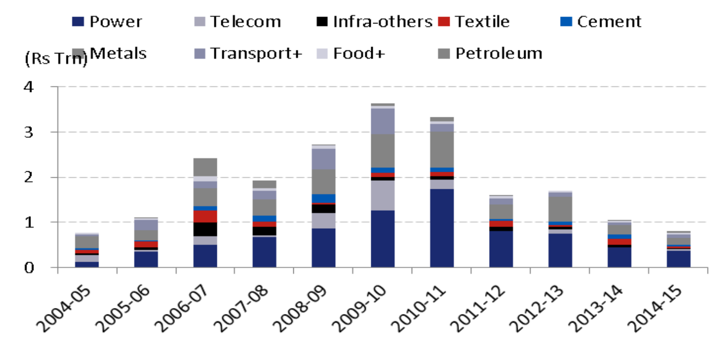
Source:MOSPI,RBI,Union budgets, JM Financial

Exhibit 3. GFCF has been on a declining trend

Private corp capex has been flat while household has declined



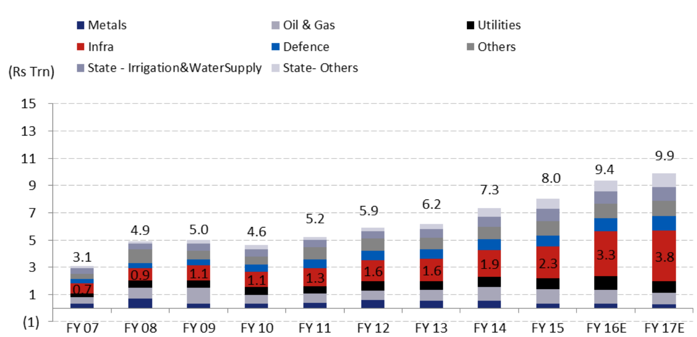
Project cost of institutionally funded projects in select sectors



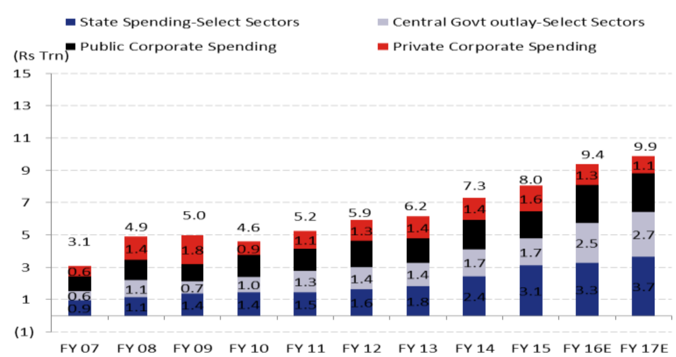
Source: CMIE, National Accounts-CSO, RBI study Corporate Investment: Growth in 2014-15 and Prospects for 2015-16, JM Financial; *estimates for 2014-15

Exhibit 4. Where is capex happening

Spending in infra (roads, railways) to see a sharp pick up



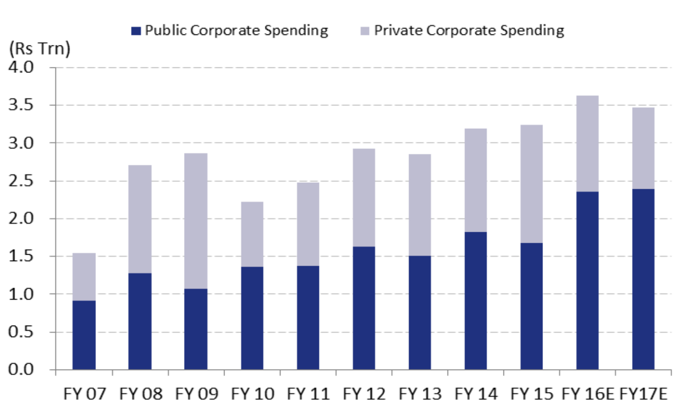
Weak private corporate spending, strong government and PSU spending



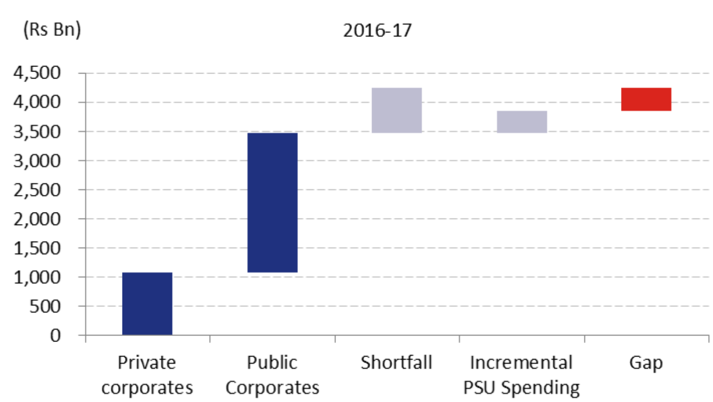
Source: RBI Annual report 2014-15, RBI study Corporate Investment: Growth in 2013-14 and Prospects for 2014-15,JM Financial ; * incomplete data

Exhibit 5. Who is funding the shortfall

Weak private corporate spending; strong public corporate spending



No big spending gap in FY16, FY17 bigger challenge



Source: Bloomberg, PPAC,JM Financial

Exhibit 6. Valuation Table

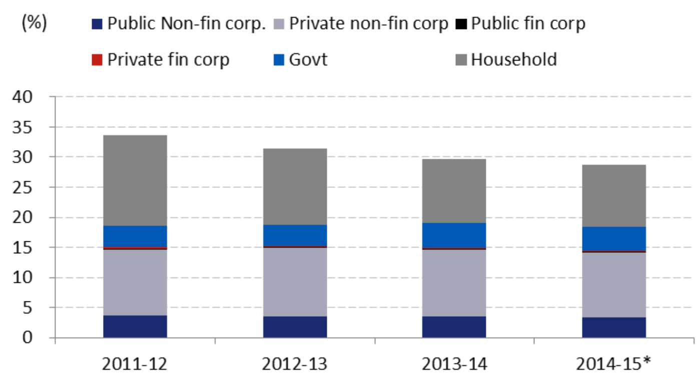
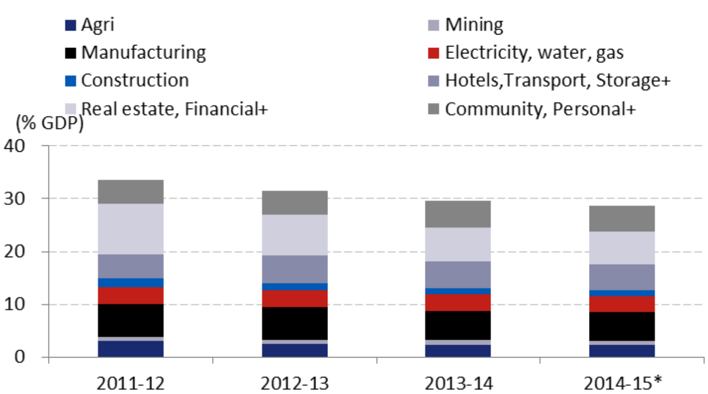
Company	Reco	Mkt Cap (₹ bn)	CMP	EPS Gr (%) 15-17	PE (x) FY15E			PEG	EV/EBITDA FY16E		P/BV FY16E		ROE FY16E	
					FY15E	FY16E	FY17E		FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Cement														
JK Lakshmi Cement	BUY	44	371	32.6	26.0	69.0	14.8	2.1	15.1	8.6	3.2	2.7	4.7	19.8
Industrials														
AIA Engineering	BUY	90	959	6.6	21.0	20.0	18.5	3.0	13.4	12.1	3.7	3.2	20.0	18.6
BHEL*	SELL	507	207	55.9	35.5	34.0	14.6	0.6	18.0	7.4	1.4	1.4	4.3	9.6
Cummins India*	SELL	310	1,119	12.7	39.5	36.0	31.1	2.8	33.8	28.3	9.5	8.3	28.1	28.6
Techno Electric	BUY	30	519	25.5	28.2	21.7	17.9	0.9	13.2	11.0	2.8	2.5	13.8	14.7
Thermax	HOLD	107	899	43.2	51.1	31.0	24.9	0.7	17.3	13.8	4.6	4.1	15.4	17.2
Voltas	BUY	86	259	13.2	24.6	25.7	19.2	1.9	20.5	14.5	3.7	3.2	15.0	17.8
Transmission & Distribution														
ABB India*	SELL	235	1,107	60.1	NA	69.0	40.1	1.1	39.9	24.4	7.7	6.6	11.6	17.7
Alstom T&D*	HOLD	130	509	88.9	NA	56.7	30.3	0.6	26.6	16.1	9.0	7.4	16.6	26.7
Crompton Greaves	BUY	111	178	93.0	60.9	23.2	16.3	0.2	12.9	9.9	2.7	2.4	11.9	15.3
KEC International	HOLD	39	150	11.9	24.0	22.9	19.2	1.9	8.9	7.9	2.6	2.3	12.0	12.8
Infrastructure/Construction														
Ashoka Buildcon	BUY	26	166	41.2	32.2	28.8	16.2	0.7	8.9	6.8	1.5	1.3	6.3	8.7
Sadbhav Ent.	BUY	47	274	NA	NA	NA	NA	NA	14.4	10.5	2.6	2.6	NA	NA
Metals & Mining														
NMDC	BUY	411	104	-15.7	6.3	9.2	8.9	NA	4.4	4.1	1.2	1.1	13.2	12.7
SAIL	SELL	214	52	-65.6	9.5	NA	80.2	NA	21.3	12.6	0.5	0.5	NA	0.6
Oil & Gas														
Bharat Petroleum*	BUY	630	871	10.9	12.4	10.2	10.1	0.9	6.4	5.9	2.4	2.1	25.2	22.0
GAIL*	BUY	369	291	19.1	12.2	10.2	8.6	0.5	6.1	4.9	1.2	1.1	12.0	13.3
Indian Oil*	BUY	938	386	38.2	17.8	8.9	9.3	0.2	7.2	6.2	1.3	1.2	14.8	12.9
Oil India*	HOLD	261	435	17.5	10.4	9.8	7.5	0.6	2.7	1.9	1.1	1.0	11.9	14.2
ONGC	BUY	2,044	239	30.9	11.2	9.1	6.5	0.3	3.9	2.9	1.0	0.9	12.0	15.2
Utilities														
Coal India	BUY	2,161	342	20.9	15.7	12.5	10.8	0.6	8.1	6.5	5.2	4.7	42.0	45.8
NTPC*	BUY	1,045	127	-4.8	10.2	12.2	11.2	NA	10.2	9.5	1.2	1.1	10.1	10.2
Power Grid Corp.*	BUY	714	137	18.4	14.7	12.0	10.5	0.7	9.3	8.2	1.7	1.5	14.8	15.4

Source: JM Financial, Bloomberg

Capex drivers in the current cycle

GFCF (current prices) witnessed 24% CAGR over FY04-08 and led the GDP (nominal) CAGR of c.15%. Of the GFCF, private corporate GFCF led the growth with 43% CAGR (FY04-08) and accounted for 43% of GFCF (FY08) while public sector GFCF grew by 20% and accounted for 24% of GFCF (FY08). However, private corporate GFCF growth has declined from a peak of 32% YoY in FY08 to 10% YoY in FY14 and 7% YoY (estimates) in FY15. This fall in investment rate due to slackening capex by private non financial corporations has been largely on account of weak domestic and external demand, policy uncertainties, low commodity prices, strained balance sheets and other structural factors.

Exhibit 7. GFCF has been on a declining trend

Private corp capex has been flat while household has declined	Manufacturing, Construction in GFCF have fallen
	

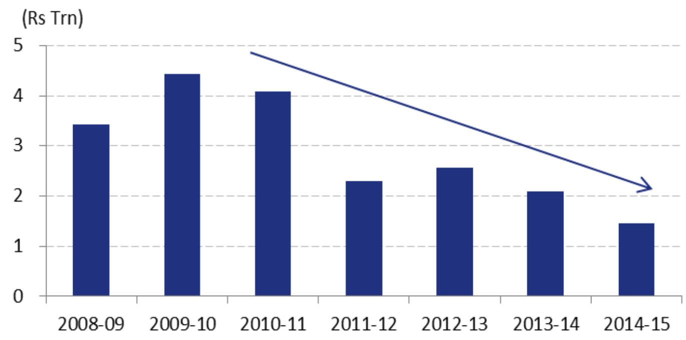
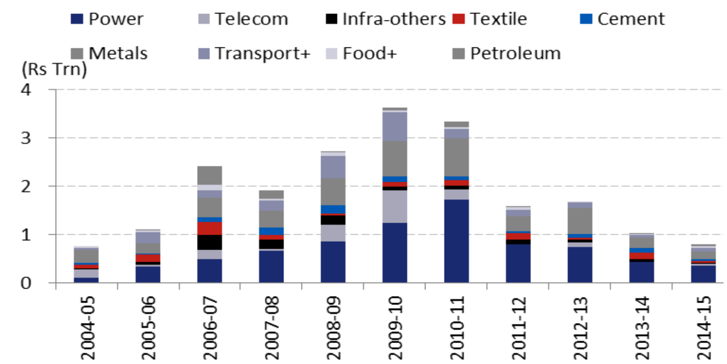
Source: CMIE, National Accounts-CSO,,JM Financial; *estimates for 2014-15 based on historic ratios

Project capex sanctions down

According to RBI, for new projects that were sanctioned financial assistance by banks or ECB/equity/other means, project capex intention was down from ₹2.1trn in FY14 to ₹1.46trn in FY15. Incidentally the increase in govt spending on infrastructure is about ₹700bn, making up for the gap.

Considering sector wise project capex, as per RBI, during 2014-15, 328 projects with envisaged cost of ₹876bn were sanctioned financial assistance by banks/FIs as against 481 projects with an outlay of ₹1,340bn (revised: ₹1,273bn) in 2013-14. There has been a secular decline in total value of projects (-27% CAGR FY10-15) sanctioned since FY10 indicating weak private corporate capex (Exhibit 8). We believe, new private sector capex may be limited to a few select sectors going ahead

Exhibit 8. Project capex on the decline

Project capex funded through Banks/IPO/ECB/FCCB	Project cost of institutionally(Banks) funded projects in select sectors
	

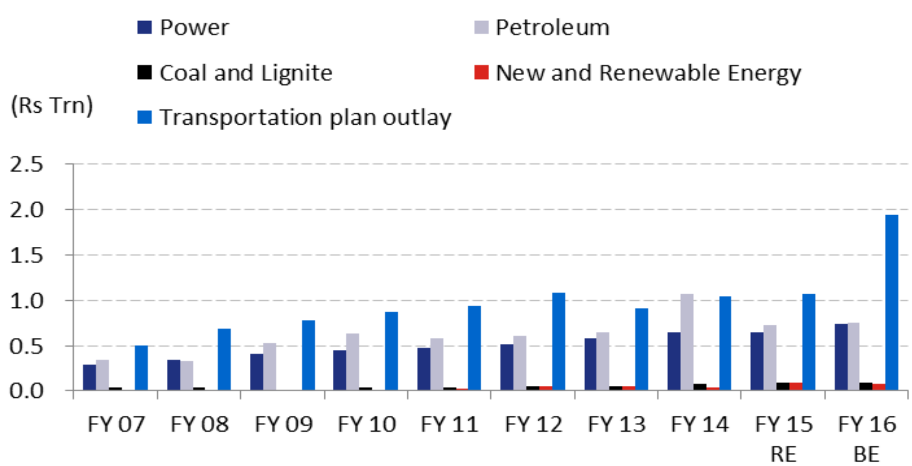
Source: RBI Corporate investment for 2014-15, JM Financial; Transport includes transport services, equipment and construction

Central government spending a key driver of capex

Government spending is expected to be a key driver of capex in this cycle. Overall, Government:PSU:Private corporate spending share should change from 56:24:20% to 65:24:11% (FY17E). As seen from the central outlay, transportation outlay has seen maximum growth (82%YoY FY16BE) whereas petroleum and other sectors have witnessed moderation in growth, signifying government thrust towards infrastructure investment.

Transportation outlay is expected to grow by 36% (FY14-16BE) even as power outlay sees slower 7% CAGR (FY14-16BE) and petroleum declines by 16% CAGR (FY14-16BE).

Exhibit 9. Central outlay of select sectors indicates government intent to increase infra capex

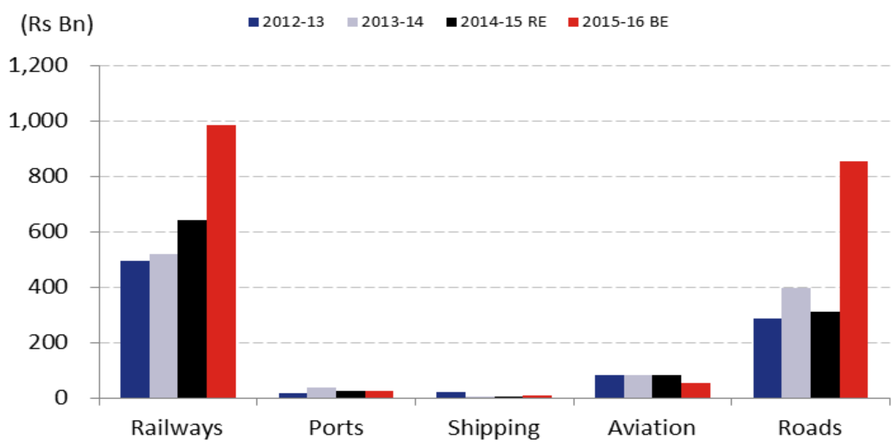


Power sector plan outlay growth has moderated over the years whereas transportation led by railways and roads has increased

Source: JM Financial, Union budget; includes Internal and extra budgetary resources of PSE's; includes revenue expenditure

Within the transportation plan outlay, roads and railways have grown (38% CAGR FY14-16BE) much higher than the past years, showing central government's clear intent to boost capital spending in transportation infrastructure and de-bottlenecking vital infra needs to revitalize the economy.

Exhibit 10. Roads and Railways remain key drivers in the Transportation plan



Source: JM Financial, union budget

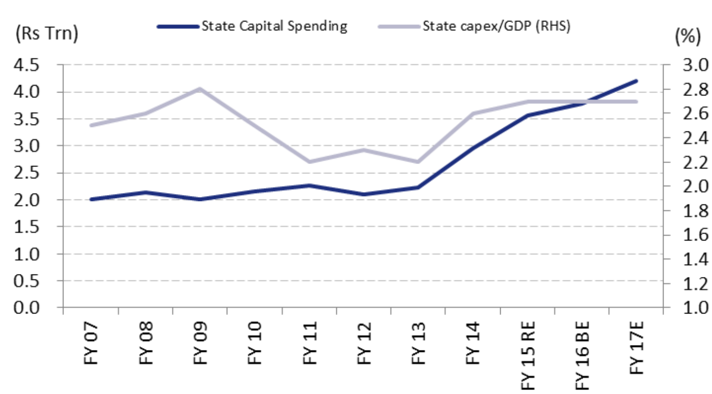
Railways plan outlay has grown by 53%YoY in FY16BE and Roads outlay by 174%YoY in FY16BE

State capital spending sees a concomitant rise…

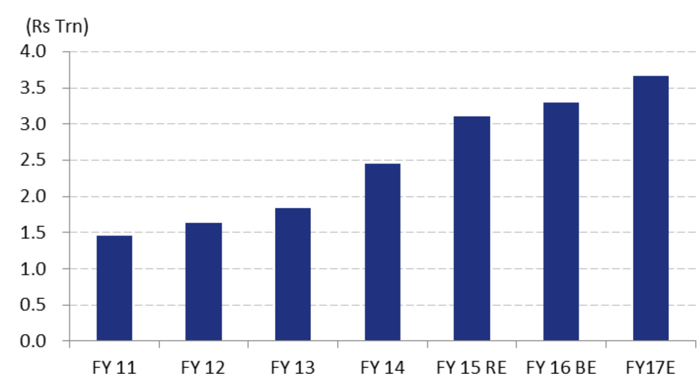
Total Capital spending by states has seen a rapid rise since FY12 (19% CAGR FY12-FY15). Post the fourteenth finance commission recommending higher devolution (42% of tax revenues) and fiscal autonomy to states, the states are expected to further step up capex.

Exhibit 11. State Capital Spending on the rise

Total state capital spending has risen



State capital spending excluding non-development and loans and advances

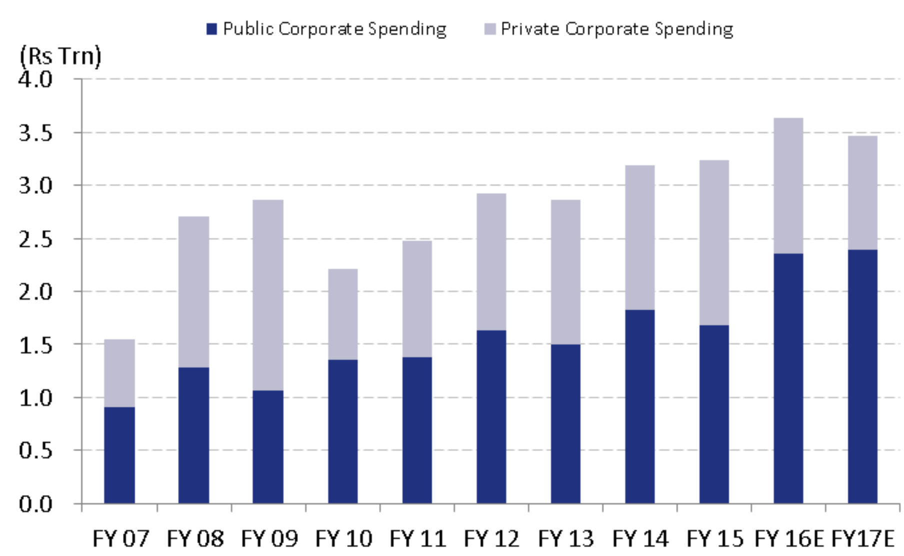


Source: RBI - Study of state finances, 14 Finance commission, JM Financial

…whereas private capex remains weak

Meanwhile private corporate capex spending has been declining and is expected to be weak in wake of muted domestic demand and a volatile external environment. We estimate private corporate spending to lag public corporate spending over FY15-17E

Exhibit 12. Public corporate spending to exceed private corporate spending



Source: JM Financial, Union budget; private corporates- JMF universe; public corporates- JMF coverage+select others

We estimate public corporate spending to outgrow (+19% FY15-17E) private spending (-17% FY15-17E)

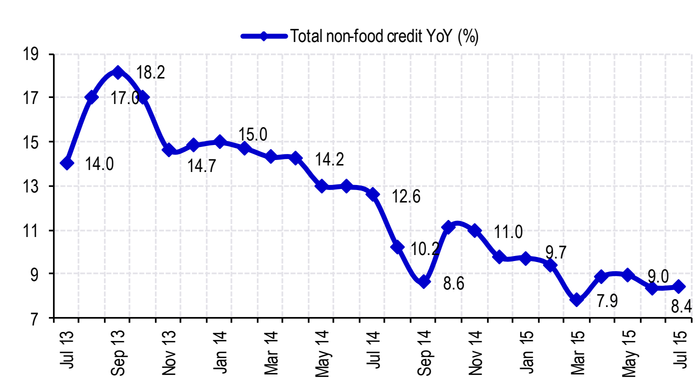
Within the private corporates (JMF universe), we expect big drops in metals (-8.4% FY15-17E) and oil and gas (-35% FY15-17E) sectors driven by already prevailing low commodity prices, low capacity utilisations and strained balance sheets.

Credit growth corroborates weak capex spending

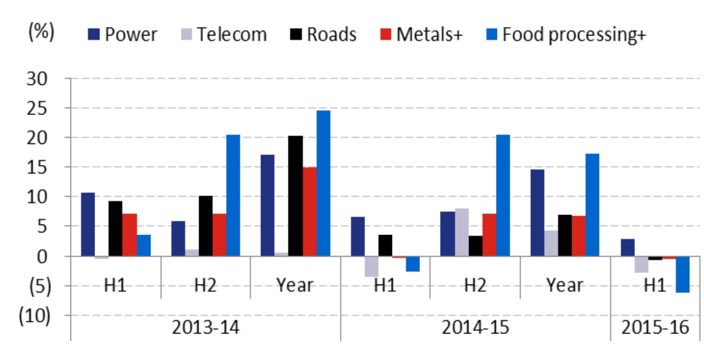
Non food credit growth has been weak (8.4% in July 15) further bolstering our case of weak private corporate capex spending.

Exhibit 13. Weak credit growth in key sectors

Non food credit growth to the productive sectors has been weak



Credit growth has been declining in key sectors



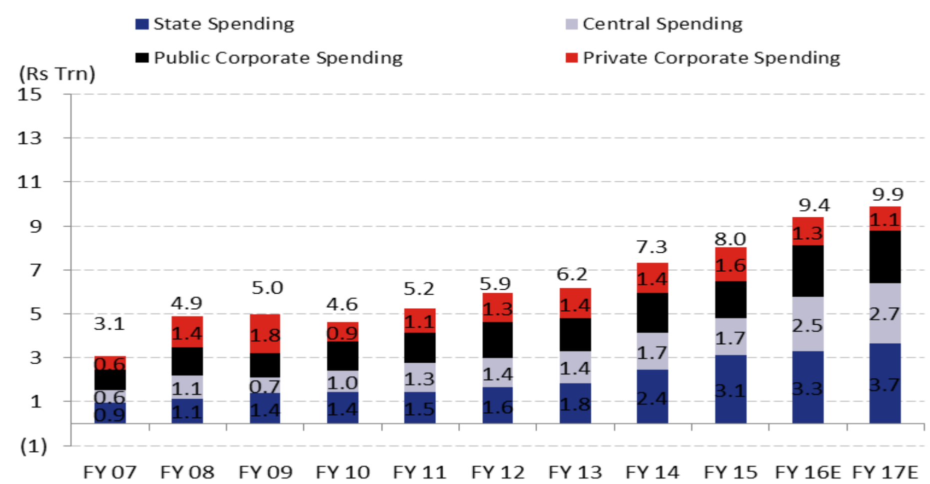
Source: RBI Annual report 2014-15, JM Financial

PSU Spending a key lever for capex

We estimate public corporate capex to see 19% CAGR (FY15-17E). The public:private corporate (excluding govt) spending share estimated to increase from 52%:48% to 69%:31%.

Exhibit 14. Private capex expected to weaken even as govt+PSUs pick up

Central plan outlay and State spending indicates incremental capital spending to be largely driven by govt and PSU



Source: JM Financial, RBI, union budget *JM coverage; Estimates are shown for State- FY16E & FY17 E and Center-FY17E

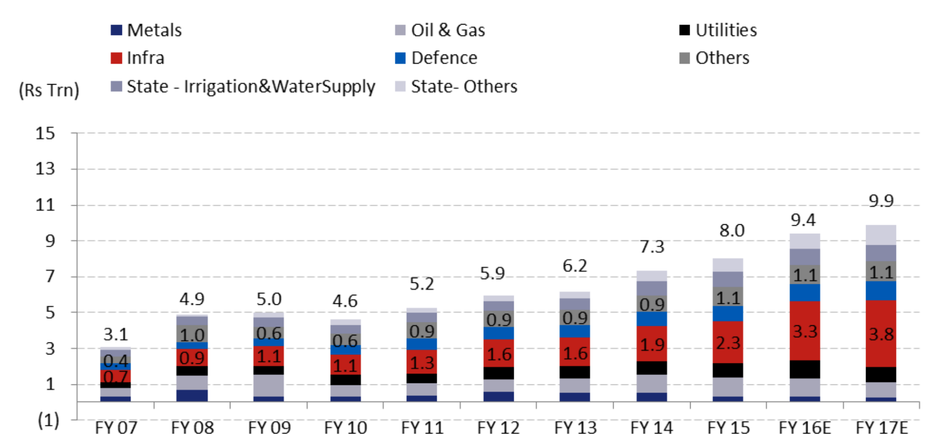
Sector wise capex expectations

We expect infra to be the key driver of capex while investment in T&D and state expenditure to positively impact overall capex.

Infra capex including corporate spending and government spending is expected to witness 27% CAGR (FY15-17E) while capex in metals (-9% CAGR FY15-17E), Oil and gas (-11% CAGR FY15-17E) is expected to decline.

Exhibit 15. Infra to be the key sector to watch out for

With the government push in infra, we expect a sizable portion of incremental capex in infra and related sectors

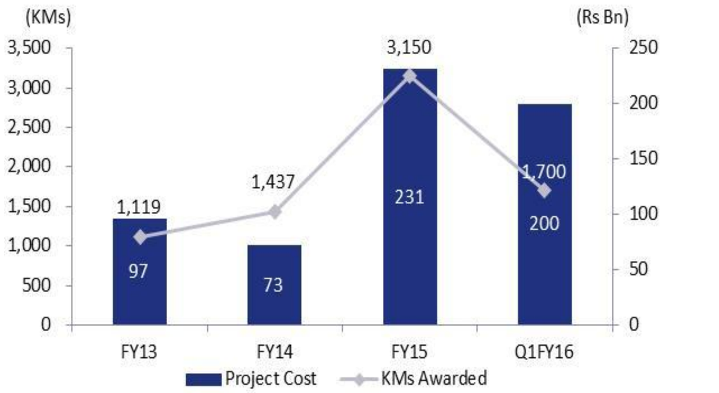


Source: JM Financial, RBI, union budget *JM Financial coverage universe

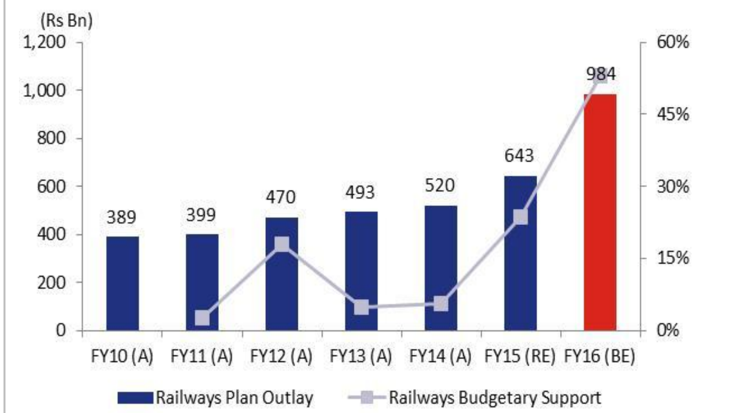
Within infra, we have already seen pickup in roads with project awards gaining momentum. Further, there is a high visibility of projects in the pipeline over the next 12-18 months (Exhibit 16). Railways is another important area of capex. After years of under-investment, railways got its due in the last budget with an extensive five year plan envisaging ₹8.5trn investment (Exhibit 16).

Exhibit 16. Momentum picking up in Roads and Railways

Accelerating road projects award momentum



Sizable expenditure plan lined up for Railways

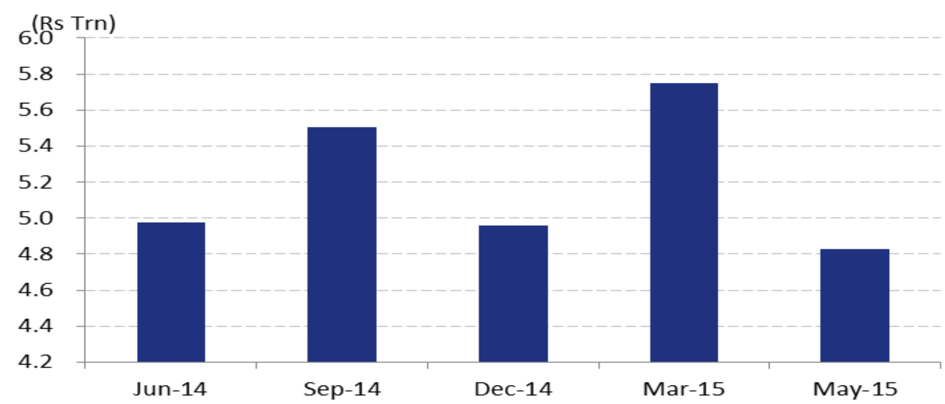


Source: Ministry of Railways, NHAI, MORTH, JM Financial

As per RBI, value of delayed projects dropped sequentially (May15) due to the sustained govt efforts to improve investment climate. If the delayed projects continue to decline, this could further boost investment sentiments

Exhibit 17. Drop in value of delayed projects

Any secular decline in delayed projects will positively boost investment sentiments



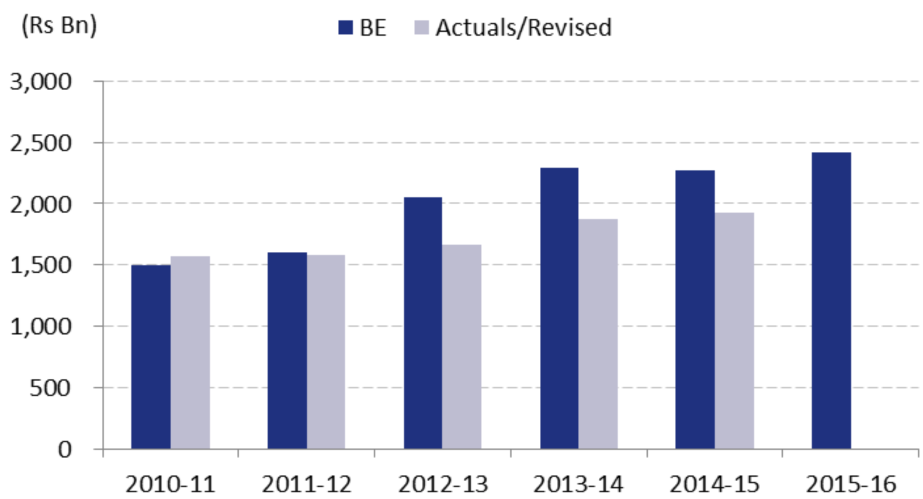
Source: JM Financial, RBI

Tight Fiscal rope walk limits govt spending

While central government capital outlays indicate significant capex growth (26% YoY FY16BE vs FY15RE), the sources of funding are unclear. In the past we have seen sharp downward revisions from budgeted estimates.

In the recent years, actual central government capex has been falling short of budgeted estimates

Exhibit 18. Actuals Vs Budgeted capex

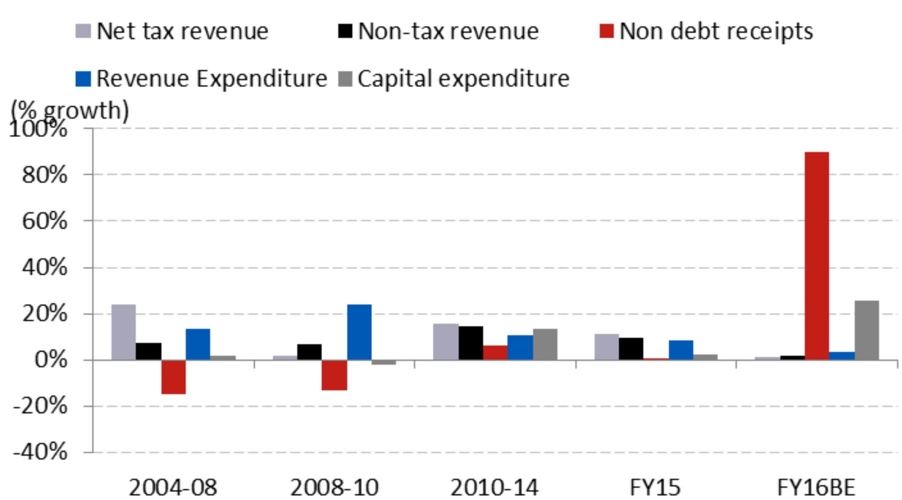


Source: JM Financial, Union budgets; Includes loans and advances

Growth in net tax revenue has been weak YTD (4.8% YTD) and hence non debt capital receipts (viz, disinvestment) had to support the government spending plan. The central government has budgeted a disinvestment target of ₹695bn in 2015-16, of which ₹285bn is expected to be mobilised through strategic disinvestments. The projected increase of 122% despite a track record to the contrary further adds to our fears.

Revenue growth seen muted. It is to be seen if the government can mobilise the ₹695bn disinvestment target

Exhibit 19. Growth in revenues and expenditure

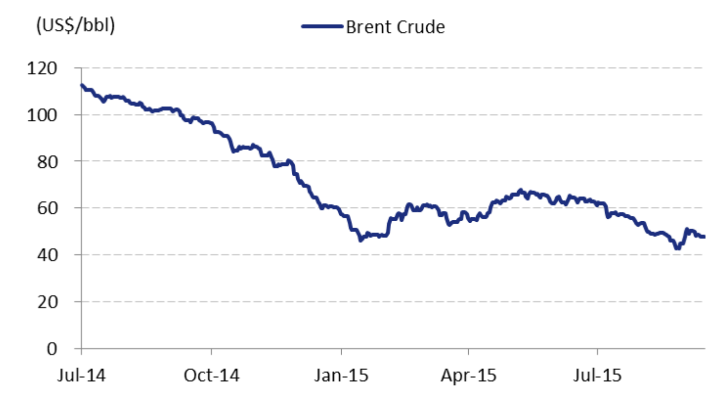


Source: JM Financial, RBI Annual report; %YoY for FY15 and FY16BE

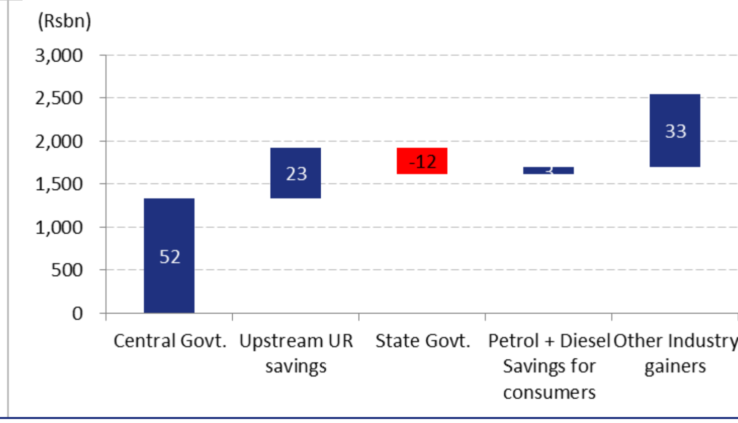
The fall in crude price and the resultant lower share of government subsidies has given additional room for increased capex. While the crude price has fallen by more than 50% YoY government has raised excise duty on petroleum products to mop up additional income.

Exhibit 20. Fall in crude augurs well for government intent to step up capital spending

Crude oil has dropped by more than 50%YoY



Government share of savings in crude

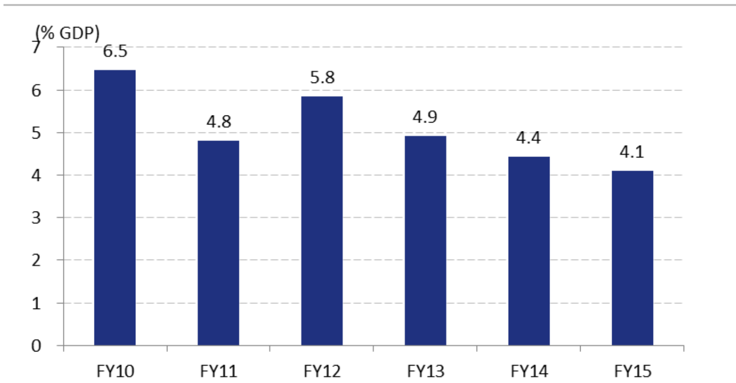


Source: Bloomberg, PPAC,JM Financial

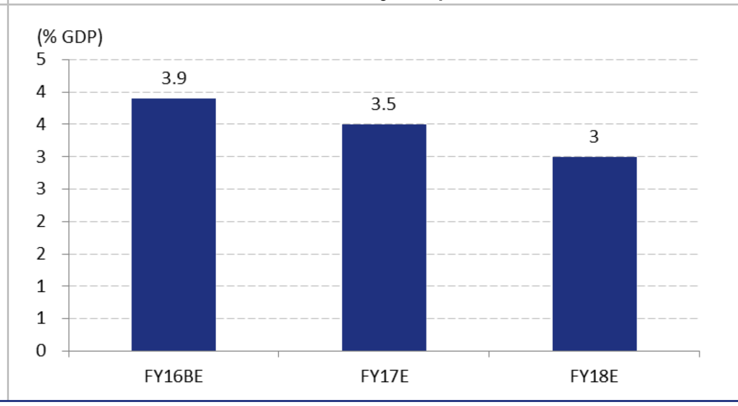
However, additional capex spending by central government much above the budgeted estimates may not be possible given fiscal constraints and committed FRBM trajectory.

Exhibit 21. Fiscal deficit could be strained

Historical fiscal deficit



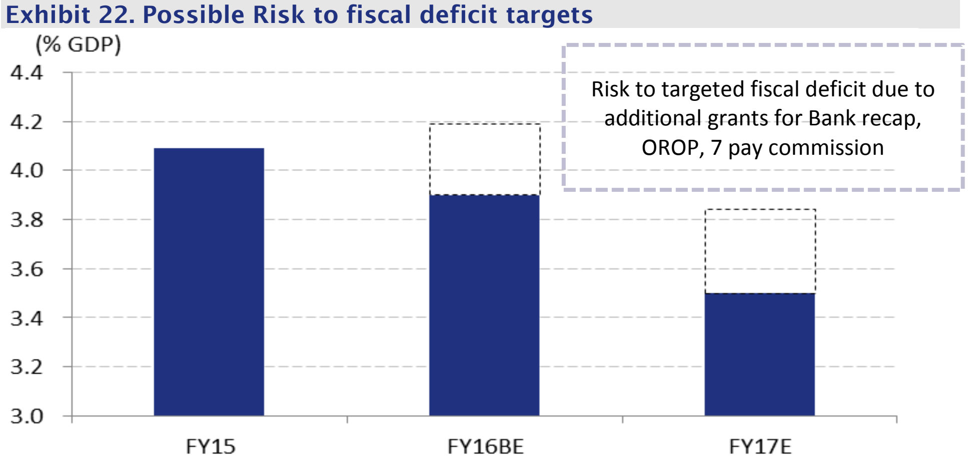
FRBM trajectory



Source: CMIE, Union Budget, JM Financial; FY10,FY11- fiscal deficit ratios based on old GDP series

Additional grants in terms of Bank recapitalization, SEB restructuring, Pay commission, OROP amongst others could possibly impact FRBM trajectory for fiscal deficit thereby limiting central spending. In addition, as outlined before, targeted state capital spending can also support capex

Exhibit 22. Possible Risk to fiscal deficit targets



Source: JM Financial, RBI, Finmin

We estimate c.30-35 bps risk to fiscal deficit due to bank recapitalization, OROP, pay commission, SEB restructuring

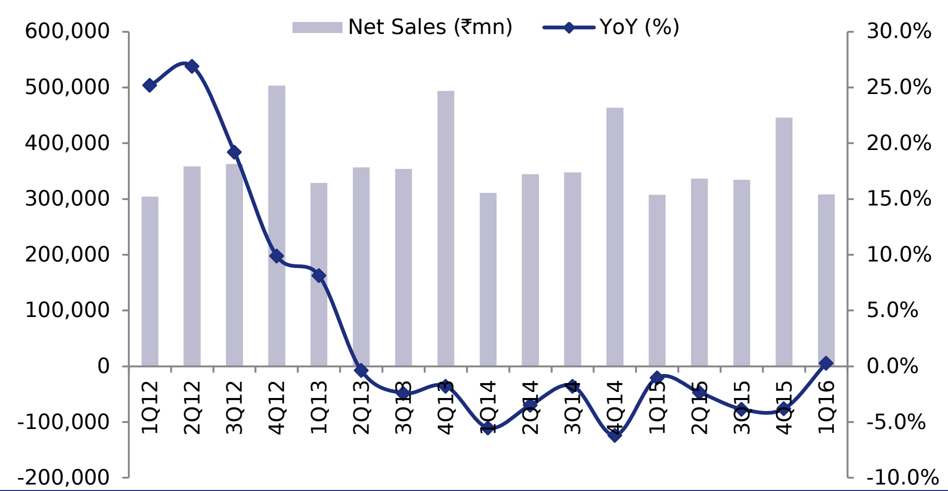
Broad Industrial recovery to drive capex? - Unlikely

We believe capex is unlikely to be as broad based as in the past and the leaders too are set to change. Our bottoms-up analysis on 42 industrial companies in 1QFY16 presents some interesting trends: a) sales growth turned positive after 12 consecutive quarters of decline, led by exports, small ticket industrial products and EPC companies in small project segments, b) signs of improved ordering is visible (led by PSUs) in select pockets of transmission, roads, renewables, railways, but core sectors like power generation, steel, cement, petrochemicals remain muted, c) commodity prices have taken a knock, but intense competition has deteriorated pricing scenario, keeping gross margins flat.

Power transmission, renewables, railways and defence leads order flow

Project execution ramped up as customers abstained from deferring deliveries, which was a positive change compared to previous quarters. Execution continued at scheduled pace in most mid and small sized projects companies (BGR Energy, Thermax and Alstom T&D), while larger projects faced delays (BHEL power projects, HVDC link – Alstom T&D). Companies are positive on improved ordering in tender based competitive bidding in power transmission, renewable energy, mining, railways and defence and metros, led by government capex in these segments. However, core sector spends in segments like power generation, metals, cement and petrochemicals will remain weak.

Exhibit 23. Sector sales growth saw a minor green shoot after 12 quarters



Source: JM Financial. Data represents combined sales of 42 industrial companies.

Net exporters reported resilient sales and improved capacity utilisations

While domestic sales growth improved only in select segments, most companies reported an improvement in sales from international region, primarily exports. We highlight few companies (Exhibit 24) where share of international income (including exports) stands above 30%. While net exporters like Cummins India, AIA Engineering, Timken, Thermax, ISGEC and TD Power saw an uptick in exports demand for existing and new product lines, companies like KEC International and Carborundum Universal, that have higher share of international income (from subsidiaries), saw an improvement in project execution in Middle East region and better sales mix.

Exhibit 24. Sector sales growth saw a minor green shoot after 12 quarters

	Net Sales (`mn)			EBITDA Margins (%)			Adj PAT (`mn)		
	1Q15	1Q16	YoY (%)	1Q15	1Q16	Change (bps)	1Q15	1Q16	YoY (%)
Thermax	8,394	10,012	19.3	6.9	9.1	220bps	414	617	49.0
Timken India	2,262	2,620	15.8	17.7	15.8	-190bps	260	274	5.6
KEC International	17,207	18,780	9.1	5.9	7.5	160bps	114	304	167.5
TD Power	864	994	15.0	-9.2	0.0	920bps	-92	-47	-49.4
ISGEC	7,028	6,607	-6.0	7.0	8.4	140bps	252	293	16.2
Carborundum Universal	5,160	4,875	-5.5	13.3	14.7	140bps	274	333	21.5
AIA Engineering	4,921	5,271	7.1	25.9	27.7	180bps	951	1,028	8.1

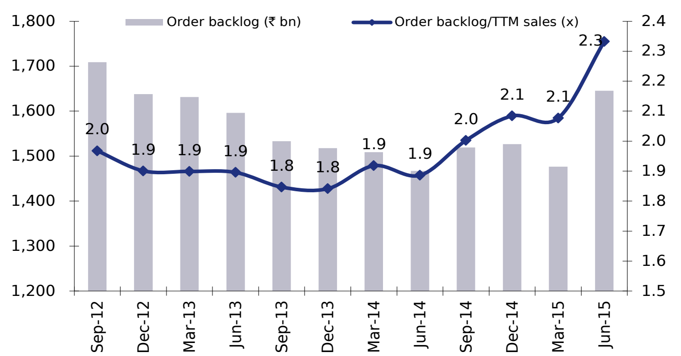
Source: JM Financial. Data represents combined sales of 42 industrial companies.

Ordering revival hopes pushed back further

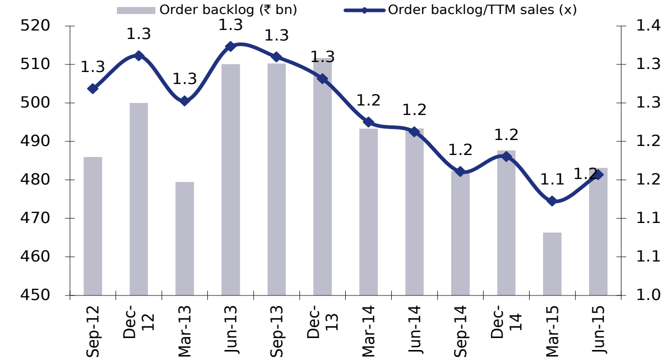
Sector order book (combined book of 8 large companies) grew by 12% YoY, after witnessing decline for 14 consecutive quarters. However, the improvement is due to **a)** booking of ₹180bn worth power orders by BHEL in 1Q16, **b)** release of green energy corridors by Power Grid, and **c)** shrunk base of sales. Barring BHEL, Alstom T&D and Techno Electric, revenue visibility for most companies remains weak and a continued weakness in inflows is likely to result in further contraction in sales over next few quarters.

Exhibit 25. Order book looks better as BHEL books Telangana orders

Order backlog trend

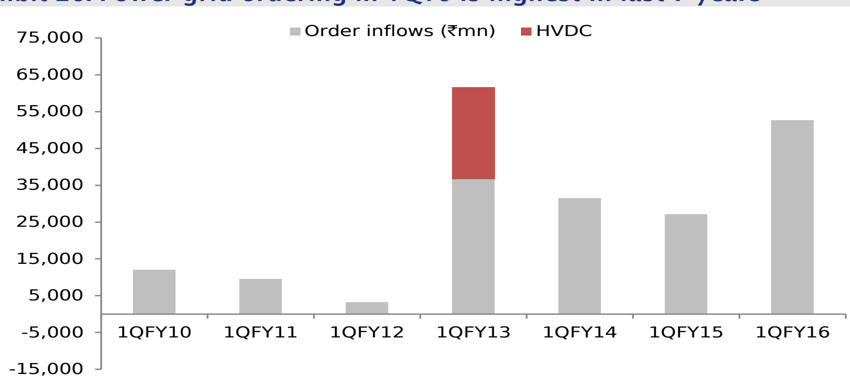


Order backlog trend (Ex-BHEL)



Source: JM Financial

Exhibit 26. Power grid ordering in 1Q16 is highest in last 7 years



Source: PGCIL website, JM Financial

Domestic sales point to an early to mid-cycle stage?

While sector sales growth was flat YoY, we saw an improvement in sales of industrial products like bearings, pumps, engines, industrial automation, abrasives, motors, defence equipment and earth moving equipment. Though growth in some cases is due to low base effect, management commentary amongst these companies pointed towards minor uptick in industrial products led by increased ordering from segments like roads (off-highway equipment), railways, renewables, general engineering, mining.

Exhibit 27. Domestic sales growth trend for industrial products improving

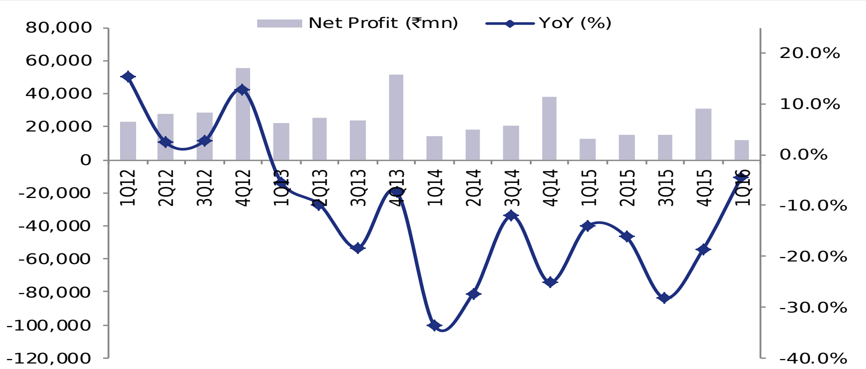
Sales Growth YoY (%)	1Q15	2Q15	3Q15	4Q15	1Q16
Kirloskar Brothers – products	-11.2	11.0	25.8	22.5	27.4
Cummins India – industrial seg	-27.1	-4.2	8.6	14.5	22.5
Bharat Bijlee – industrial seg	4.5	3.0	1.0	7.8	16.5
Timken India	34.4	31.8	31.6	19.6	15.8
Honeywell Automation	3.0	17.5	33.8	6.4	14.8
Grindwell Norton – abrasives seg	15.1	11.0	18.7	20.9	11.7
SKF India – industrial seg				5.8	10.6
ABB – industrial	0.5	4.8	5.9	0.6	10.4
Crompton - standalone ind seg	-6.4	6.9	-1.9	6.0	10.2
Bharat Electronics	12.7	25.4	34.9	-7.3	7.3
TIL	19.9	-9.8	16.5	21.7	7.1

Source: Company, JM Financial

Profitability growth still under doldrums

Net profit continued to contract over past 13 quarters, led by fall in order booking in core sectors and lower margins due to competitive intensity. Though, competitive intensity remains high, we believe net profit decline has bottomed out and may see an improvement, led by gradual improvement in capacity utilizations and lower commodity prices.

Exhibit 28. Net profit growth is gradually moving towards positive zone

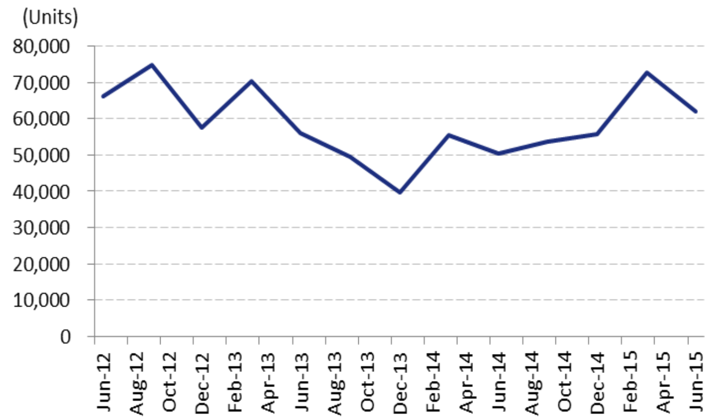


Source: JM Financial. Data represents combined sales of 42 industrial companies.

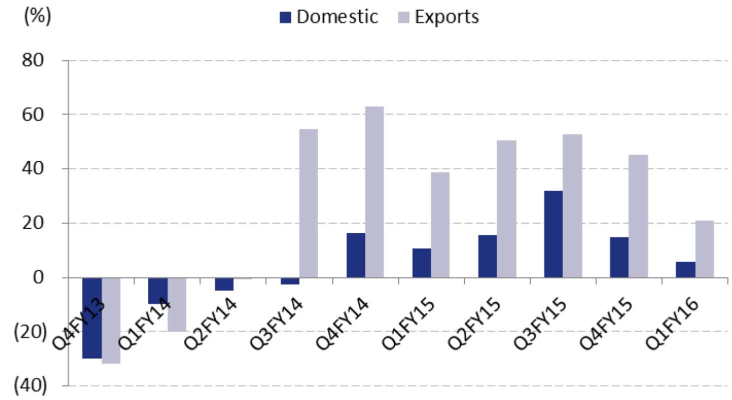
Exports in early to mid-cycle sectors and replacement demand in India (MHCVs and related parts) typically led sales growth in the past two years.

Exhibit 29. Exports in select sectors and MHCV replacement demand led sales growth

MHCV volumes picked up on replacement demand



Exports picked up sharply for Bharat forge



Source: JM Financial

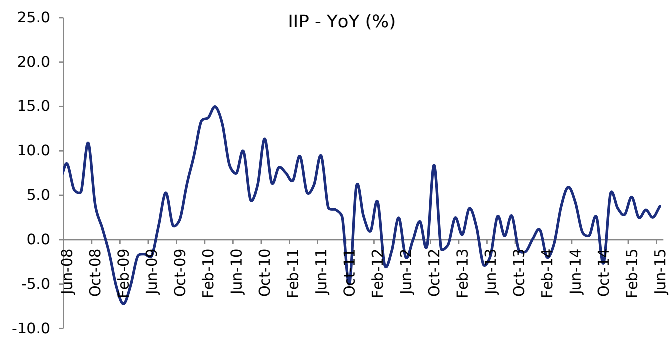
Show me the money – Who can drive Capex?

Private capex weak and government spending constrained

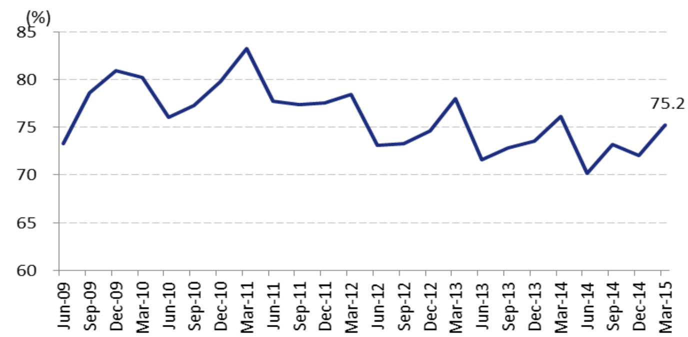
While government spending is constrained by fiscal limits, private capex will continue to suffer in the wake of weak industrial pick up even as RBI OBICUS survey points to capacity underutilization.

Exhibit 30. IIP has been muted even as OBICUS survey points to capacity underutilisation

IIP weak with downward bias



OBICUS survey points to excess capacity



Source: MOSPI, RBI, JM Financial

Leveraged balance sheets of private sector provides limited room for spending

Within the JMF coverage universe, private corporates in select sectors that have highly stretched balance sheets led by Infra companies (net D/E:~3x), utilities (~2.5-3x), metals (~1.5-2x) amongst others will not be able to take up additional capex in the near term

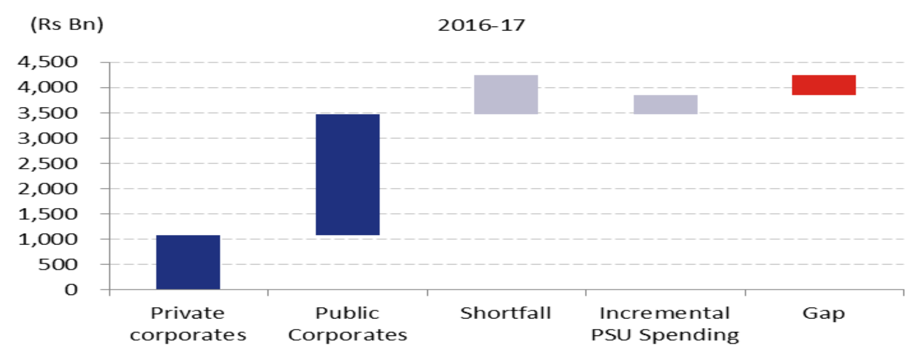
Although, historically, private corporate capex (c.37% of GFCF) has been a strong driver of GFCF, we expect the incremental contribution from private sector capex to GFCF (and hence GDP) to decline in FY17E.

Who can fill the gap?

The falling private corporate GFCF poses risk to targeted GDP growth rate. We estimate GDP to fall by 50-60bps (FY17E) due to fall in corporate spending. In such a weak demand environment, and constrained fiscal spending, we expect PSUs to step up capex from the current levels to cover the shortfall in private investment expenditure.

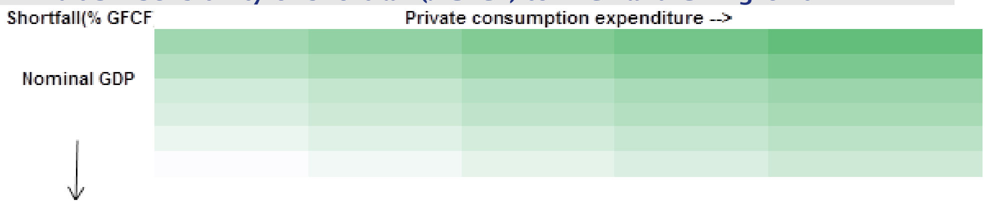
We estimate PSUs (including railways and other IEBR) may have to incrementally spend c.30-60% over current estimates to completely cover the shortfall and maintain the GDP at targeted 7%+ (FY17E). In the below exhibit we show the incremental PSU spending required to cover 50% of the shortfall.

Exhibit 31. Incremental PSU spending to cover 50% of the shortfall



Source: CMIE, CSO, JM Financial.

Exhibit 32. Sensitivity of shortfall (%GFCF) to PFCE and GDP growth- FY17



Source: JM Financial

Least Shortfall | Highest Shortfall

Source: JM Financial

PSUs that can help fill the gap

Since, additional central government spending appears constrained, incremental spending will have to come from PSUs, in our view. In the PSU space, we have analyzed companies in utilities, oil and gas and metals space on their ability to undertake incremental capex, comfort on debt/equity, pricing (regulated vs market) and return on equity (capital efficiency). Based on our analysis, NTPC, Coal India, NMDC and even GAIL can drive incremental capex.

Exhibit 33. PSU- Capex Play

	Capex Play	D/E	Incremental Capex over current estimates	Pricing	Historical ROE	Expected ROE	Comments
Utilities							
NTPC	◕	◕ ~1x	◕ Incremental capex Rs1600bn	◕ Regulated	◑ 9.1% 14.3%	◑ 9%-10%	ROE impacted due to CERC regulations. Comfortable D/E that can be stretched to 2.33x
Power grid	◔	○ 2.33x	○	◕ Regulated	◑ 9.0%-16.0%	◑ 14%-15%	D/E stretched. Competitive bidding poses risk to ROE
Coal India	●	● Net cash	● Max capex:	◕ Semi-regulated	● 26-36%	● 40-45%	Accelerating capex. High ROE. Cash rich
Oil and Gas							
OMC's	◑	◑ ~0.7x	◕	◑	◑ 5%-24%	◑ 19.0% - 25.0% IOC: 13%-17%	Low D/E gives room for capex.
ONGC	○	◑ ~0.2x	○	○ Market	◑ 13.0% - 27.0%	◑ 14.0% - 17.0%	Keen to invest abroad. Low commodity prices limit capex
GAIL	◕	◕ 0.3x	◔	◕ Regulated	◑ 11.0% - 22.0%	◑ 12.0% - 14.0%	Enough pipeline capacity. Can be asked to form JV for fertiliser or other non core areas
Oil India	◔	◑ 0.4x	◔	◕ Market	◑ 12.0% - 14.0%	◑ 12.0% - 14.0%	Small player. Limited impact
Metals							
NMDC	◕	● Net cash	●	○ Market	● 20%-40%	◑ 11%-13%	High ROEs. Net cash. Low commodity prices may impact capex
SAIL	◑	◑ 0.6-0.7x	◔	○ Market	◔ 4-32%	◔ -20%	

Source: JM Financial; Most favorable: ●, Moderately favorable: ◕, Average: ◑ ,Least Favorable: ◔

In other sectors, we favor smaller contractors (Ashoka Buildcon, Sadbhav), TEEC (power T&D capex), midcap cement (North-based JKLC).

Exhibit 34. Smaller players likely to benefit

Company	Why we like?
Contractors	**EPC players to benefit from govt infra push**
Ashoka Buildcon	Ashoka buildcon has done timely fund raising and is almost debt free (at net debt level). With the current balance sheet strength, we believe the company is one of the best placed to build strong order book and growth in the road sector, which is flushed with significant opportunity in the near term. ABL has strategically chosen BOT assets along the NH-6 corridor. ABL has presence in 4 out of the 6 states covered by NH-6. High growth states of Gujarat and Maharashtra and mineral rich states of Chhattisgarh and Orissa are expected to drive the traffic volume growth over NH-6.
Sadhbav	Sadbhav has been following a disciplined bidding strategy of: (1) selecting projects with lower execution hurdles, (2) avoiding bidding during high competition period, and (3) securing assets that complement its existing portfolio. As a result, it has consistently exhibited an ability to execute projects ahead of schedule. Current order book stands strongly at ₹84bn and is well placed to utilize the upcoming opportunities in the road sector.
Power T&D	**Power T&D continues to witness growth**
TEEC	Niche player in T&D space with robust order book, strong return ratios and cash flows
Cement-Midcap	
JK Lakshmi	JKLC is set to more than double capacity from 5.3MT in FY13 to 12.1MT by FY17E. We estimate strong 15% volume CAGR over FY15-17E, with strong visibility beyond FY17 (FY17E CU at meager 66%). JKLC's cost/tonne is one of the lowest in the industry driven by low power and fuel cost and extremely low overheads. With the benefits of operating leverage from strong volume growth, we expect the company to gain significant jump in EBITDA/t from c.₹550 in FY15E to over ₹850 by FY17E. As expansion programme draws near completion over next 1 year, the company will generate significant FCF from FY17 onwards and reduce debt from current peak levels.

Source: JM Financial

APPENDIX I

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(Formerly known as JM Financial Institutional Securities Private Limited)

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