Strategy

Capacity utilisation of cyclicals rising faster than headline number, positive for capex cycle

Capacity utilisation stood at a robust 74% during Q2FY24, although it has likely risen sharply going by the rise in manufacturing PMI during Q4FY24. Also, headline capacity utilisation number provides little insight into some of the 'offsetting effects' at sector level, except for a few where utilisation levels have been disclosed such as steel, cement, etc. However, implied capacity utilisation trends across sectors can be observed using sector level IIP data (reflects 'volume growth') and 'asset turnover' ratios. The **latest trends indicate cyclical and capital intensive sectors related to auto, metals, capital goods, cement, petroleum products etc. are currently driving higher utilisation levels**. However, headline utilisation levels have been dragged down by relatively asset light sectors, largely related to consumption (apparel, food, furniture, electronic, wood, tobacco, chemicals, etc.) although pharma and beverages have grown their utilisation levels at a faster pace.

Larger listed players have higher capacity utilisation than sector average

Anecdotal evidence of large listed players indicates higher capacity utilisation levels than that suggested by the system. For example, Ultratech is at 77% vs system utilisation number of 68% and NTPC is at 76% vs system utilisation number of 68%. Similarly, top 3 steel makers have capacity utilisation of >90% against system utilisation of ~80%.

Implications and top picks: Aforementioned implied capacity utilisation trends are positive for private capex cycle along with rising animal spirits, upward GDP revisions, cycle high CFO/capex and cycle low capex/depreciation ratio.

Top picks from our coverage universe from a manufacturing theme perspective:

BHEL, L&T, Genus Power, JSPL, JSL, Astra Microwave, HPCL, Ambuja, Grasim, Greenpanel, Cipla, Aurobindo, Balkrishna, Craftsman, Syrma, Cello.

Granular IIP data and listed corporates' 'asset turnover' ratio provide cues for sectoral capacity utilisation trends

- Headline capacity utilisation number provides little insights into some of the 'offsetting effects' at sector level, except for a few where utilisation levels have been disclosed such as steel, cement, etc.
- Granular IIP data provides trends of 'volume growth' within various sectors and, hence, provides key insights into sectors where incremental utilisation levels are either rising or falling. The aforementioned trends can be corroborated by observing the 'asset turnover' ratio of listed stocks while keeping in mind the inflation / deflation of prices within respective sectors **(refer Exhibits 7-12)**.
- **Cyclicals are largely driving improving capacity utilisations** - Combining granular IIP data and asset turnover ratios, it is clear cyclical sectors related to auto, metals, capital goods, cement, petroleum products etc. are driving much of the improvement in 'capacity utilisation' in the economy. The above inference is also corroborated by the fact that private corporate capex cycle is at a nascent stage and has just started to rise beyond 'maintenance capex,' thereby indicating that the role of fresh capacities in driving volume growth is limited.
- **Consumption segments weak** - Pharma and beverages amongst defensive sectors are showing robust volume growth as per IIP data, thereby indicating rising utilisation levels. On the flip side, volume growth related largely to consumption categories is weak with some sectors showing a sharp decline in growth (apparel, furniture, electronic, wood, tobacco, chemicals etc.).

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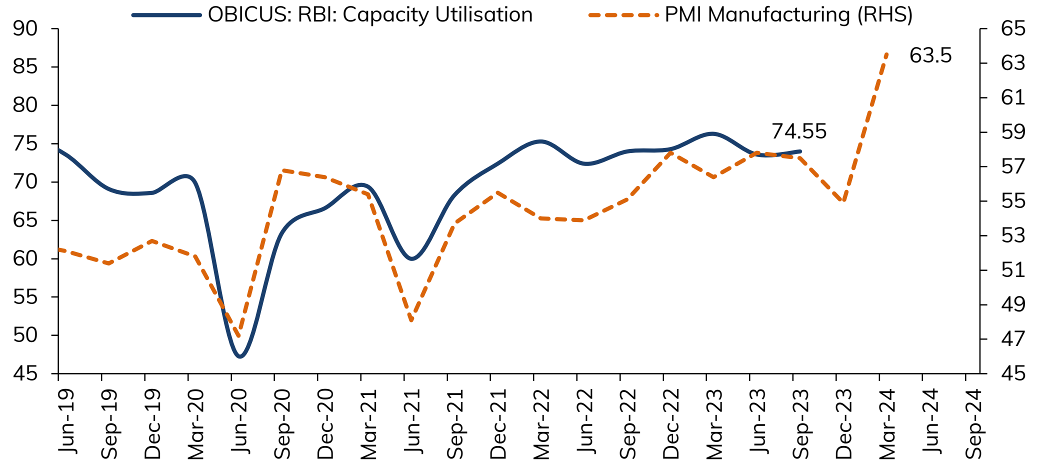
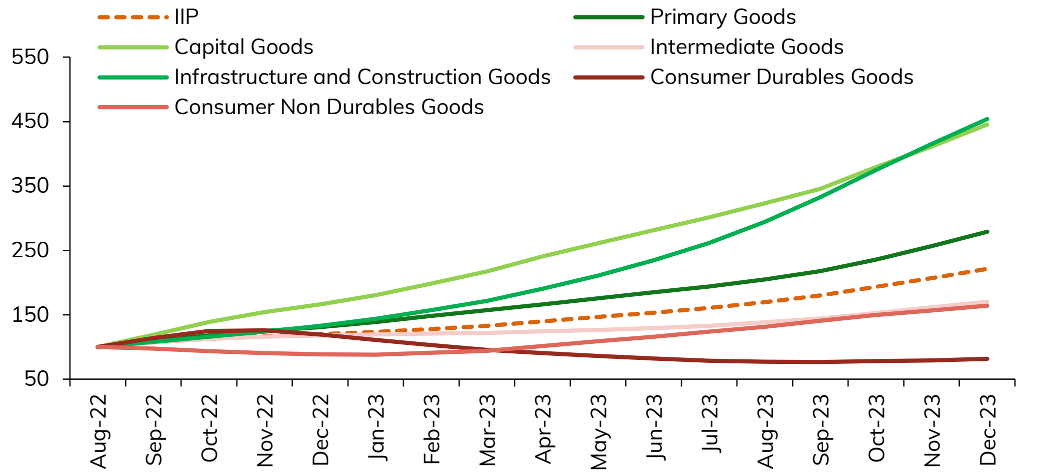
Story in charts

Exhibit 1: Headline capacity utilisation while robust at 74% in Q2FY24 has likely risen sharply during Q4FY24



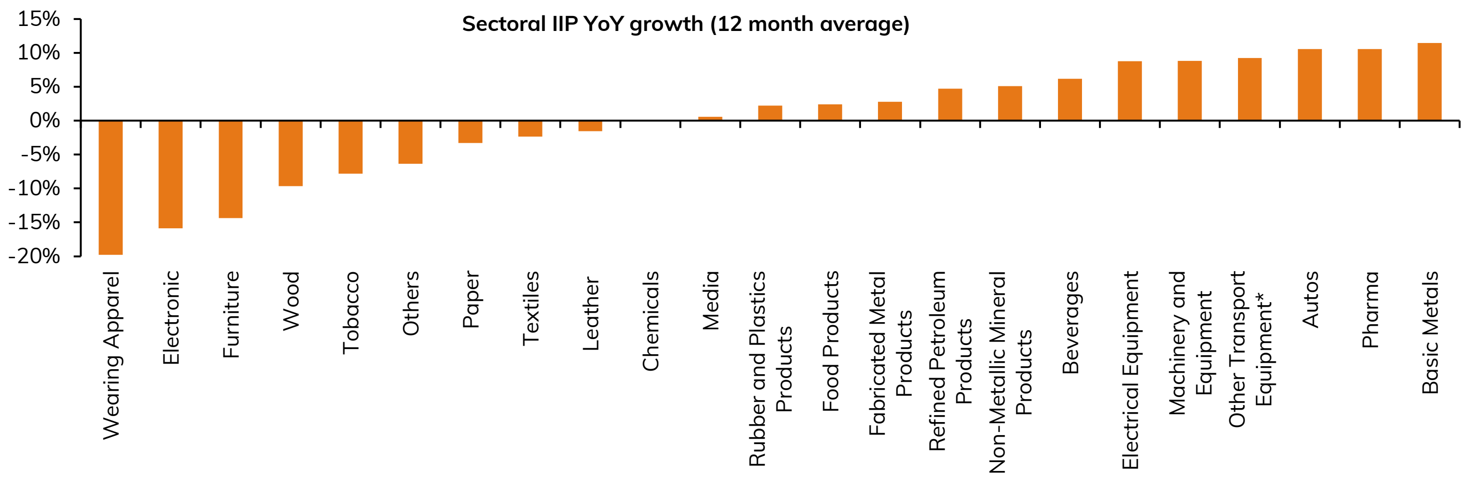
Source: CEIC, I-Sec research. Note: For March'23, we have considered flash PMI data.

Exhibit 2: Sectors related to capex cycle are growing at above average volume growth, implying rising utilisation levels (IIP break up)



Source: CEIC, I-Sec research. Note: Base has been reset to 100

Exhibit 3: Sub-sectors largely related to capex cycle are growing at above average volume growth offset by consumption-based sectors (granular IIP data)

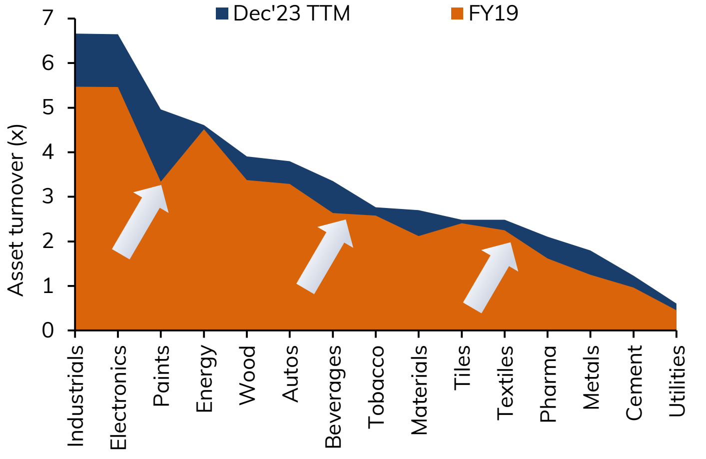


Source: CEIC, I-Sec research

Note: Other Transport Equipment includes manufacturing of boats, ships, railway locomotives, aircraft, spacecraft, military fighting vehicles, etc.

'Asset turnover' ratio of listed stocks corroborates the trend provided by granular IIP data

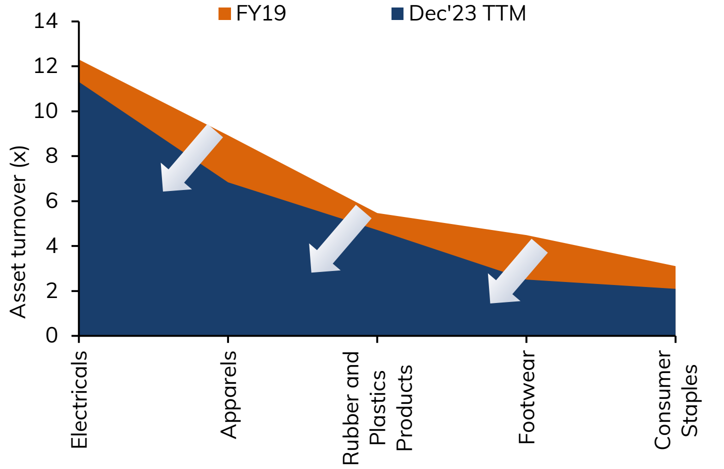
Exhibit 4: Capital intensive sectors improve 'asset turnover'...



Source: Capitaline, I-Sec research

Note: We considered 259 manufacturing companies excluding service companies and companies with outlier data from NSE500 plus I-sec coverage universe.

Exhibit 5: ...while consumption sectors decline



Source: Capitaline, I-Sec research

Note: We considered 259 manufacturing companies excluding service companies and companies with outlier data from NSE500 plus I-sec coverage universe.

Exhibit 6: Median sectoral distribution of asset turnover (x) (based on capital intensity)

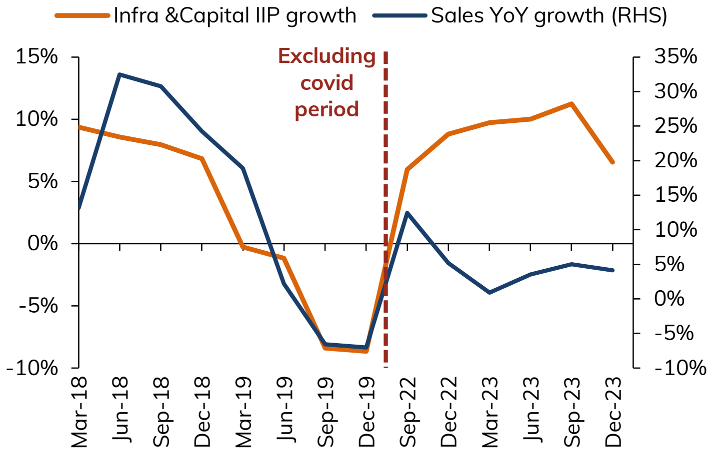
Sectors	No of companies	FY19	FY20	FY21	FY22	FY23	Dec'23 TTM
Utilities	13	0.47	0.47	0.44	0.54	0.67	0.66
Cement	13	0.94	0.94	0.93	0.98	1.06	1.16
Pharma	26	2.07	1.92	1.94	2.13	1.90	2.19
Materials (includes chemicals)	31	2.35	2.33	2.33	2.53	2.75	2.39
Textiles	3	2.15	1.86	1.92	2.75	2.57	2.42
Tiles	1	2.41	2.07	2.18	2.79	2.44	2.48
Footwear	2	5.98	2.34	2.02	2.32	2.45	2.52
Metals	24	1.71	1.57	1.58	2.30	2.73	3.11
Tobacco	2	3.05	2.53	2.25	2.59	3.25	3.61
Beverages	4	3.29	3.32	2.57	3.27	3.30	3.66
Autos	32	3.50	2.62	2.56	3.14	3.45	3.99
Wood	2	4.16	3.74	3.29	4.17	3.72	4.14
Consumer Staples	19	3.72	3.99	3.54	4.72	4.35	4.28
Energy	12	3.01	2.47	2.18	3.54	5.04	4.47
Paints	5	3.68	3.22	3.34	4.01	4.05	4.71
Industrials	51	3.94	4.19	3.73	4.56	5.05	5.81
Rubber and Plastics Products	2	12.00	5.99	4.52	5.74	5.28	5.95
Apparels	4	9.06	6.84	4.39	6.64	7.54	7.58
Electronics	2	7.89	7.10	7.18	6.73	6.46	8.03
Electricals	11	10.62	8.45	8.34	7.29	6.83	8.11

Source: Capitaline, I-Sec research

Note: We considered 259 manufacturing companies excluding service companies and companies with outlier data from NSE500 plus I-sec coverage universe.

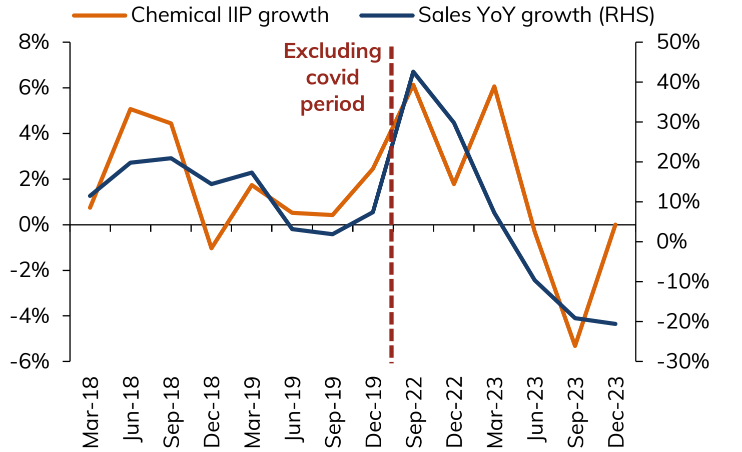
Granular IIP data and listed corporates' 'asset turnover' ratio provide cues towards sectoral capacity utilisation trends

Exhibit 7: Capex-related stocks show robust utilisation levels as indicated by IIP and corporate sales growth…



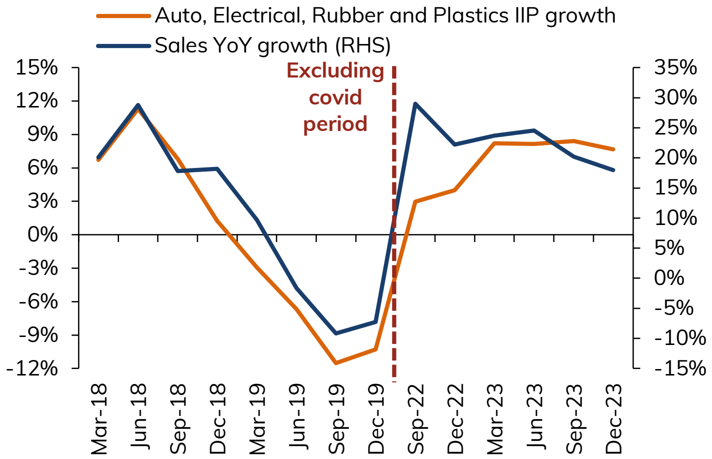
Source: Capitaline, CEIC, I-Sec research
Note: Sales growth pertains to industrials, cements and metals. IIP growth is 3month YoY average.

Exhibit 8: …although chemicals sector stocks are showing a slump in utilisation levels



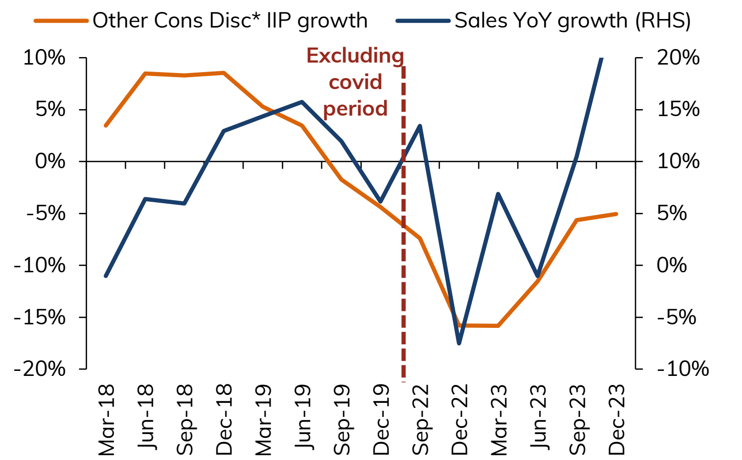
Source: Capitaline, CEIC, I-Sec research
Note: IIP growth and Sales growth pertains to chemical and chemical products. IIP growth is 3month YoY average.

Exhibit 9: Improving utilisation is visible in auto, electrical, rubber and plastic sectors within consumer discretionary…



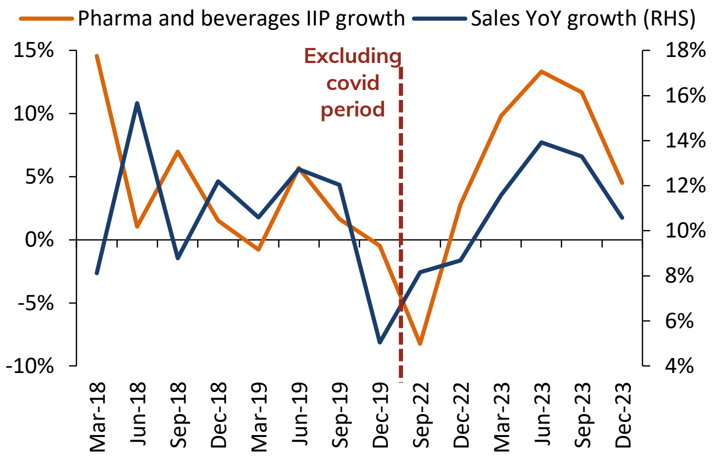
Source: Capitaline, CEIC, I-Sec research
Note: Sales & IIP growth pertains to Auto, Electrical, Rubber and Plastics. IIP growth is 3month YoY average.

Exhibit 10: …while apparels, textiles, wood and electronics sectors lag growth



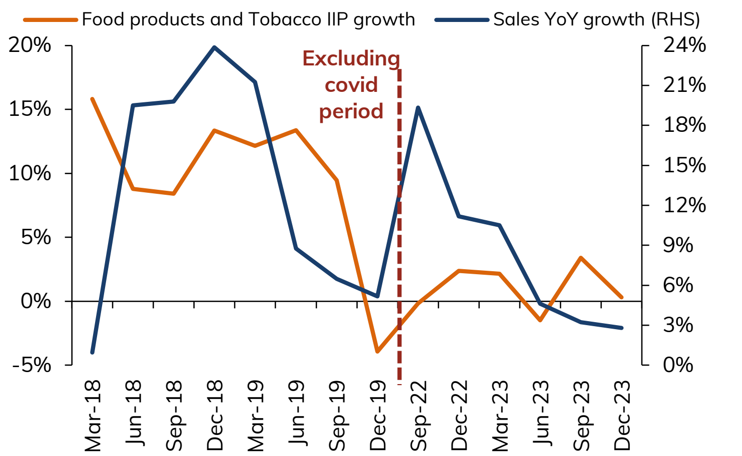
Source: Capitaline, CEIC, I-Sec research
Note: IIP growth and Sales growth pertains to apparels, textiles, wood and electronics. IIP growth is 3month YoY average.

Exhibit 11: Growth is visible in pharma and beverage sectors…



Source: Capitaline, CEIC, I-Sec research
Note: IIP growth is 3month YoY average.

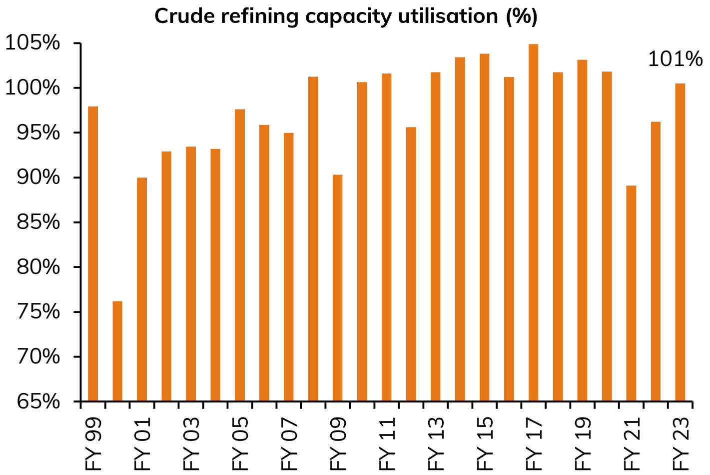
Exhibit 12: …while food products and tobacco lag growth within staple segment



Source: Capitaline, CEIC, I-Sec research
Note: IIP growth is 3month YoY average.

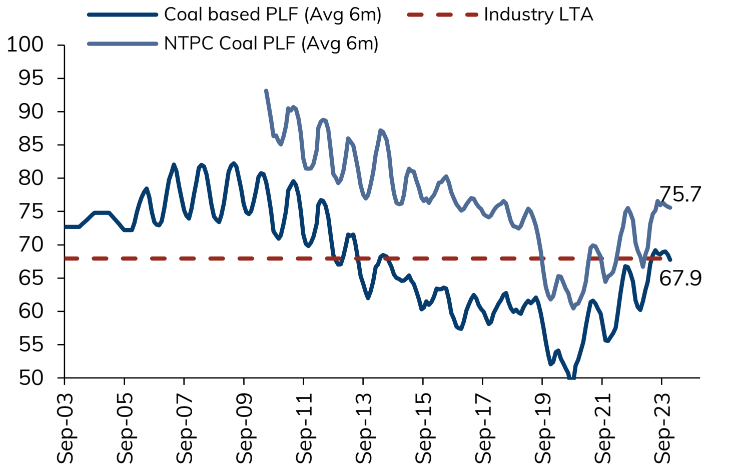
Larger listed players have higher capacity utilisation than sector average

Exhibit 13: Crude refining capacity is running past 100%



Source: PPAC, I-Sec research

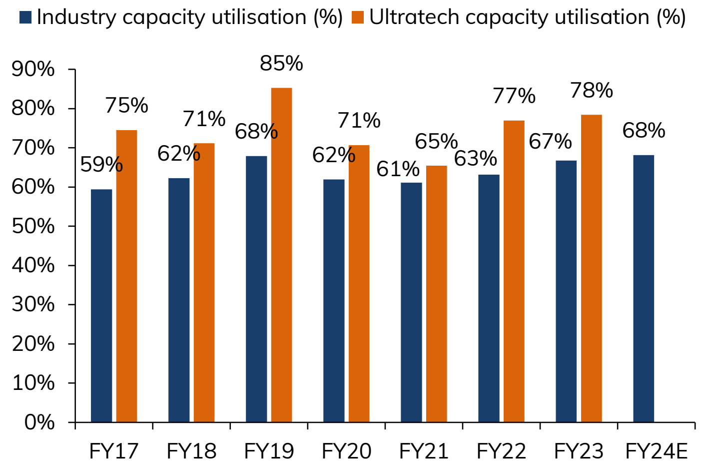
Exhibit 14: Coal-based PLF of industry leader stands at 76% while industry is at long-term average



Source: National power portal, I-Sec research

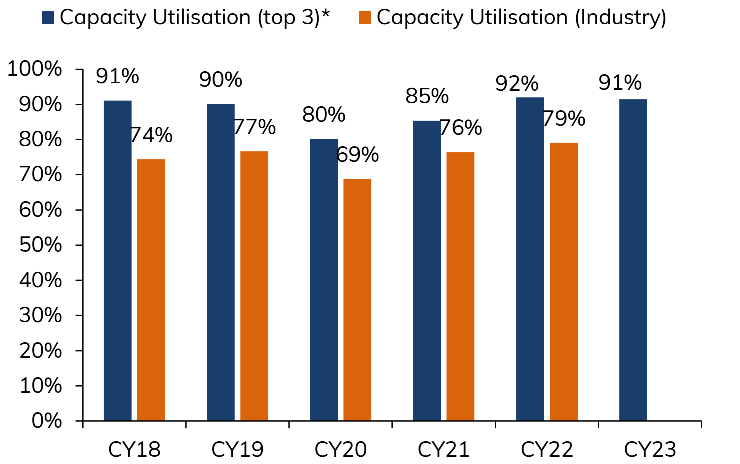
Note: NTPC data is available from Jun'10.

Exhibit 15: Cement capacity utilisation is improving but higher supply likely going ahead



Source: Company data, Ultratech investor presentation, I-Sec research

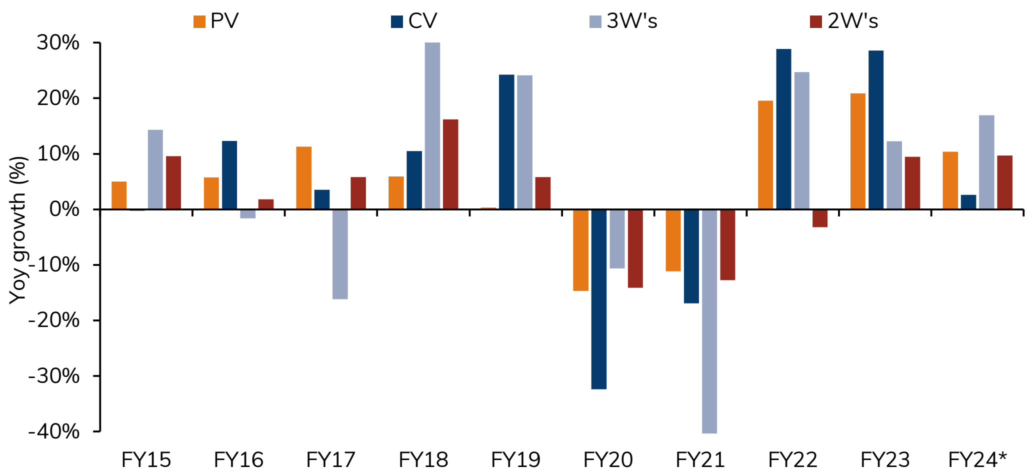
Exhibit 16: Top 3 steel makers are running above 90% capacity



Source: Company data, Ministry of steel, I-Sec research

Note: JSW steel, Tata steel and SAIL are the top 3 steel markers.

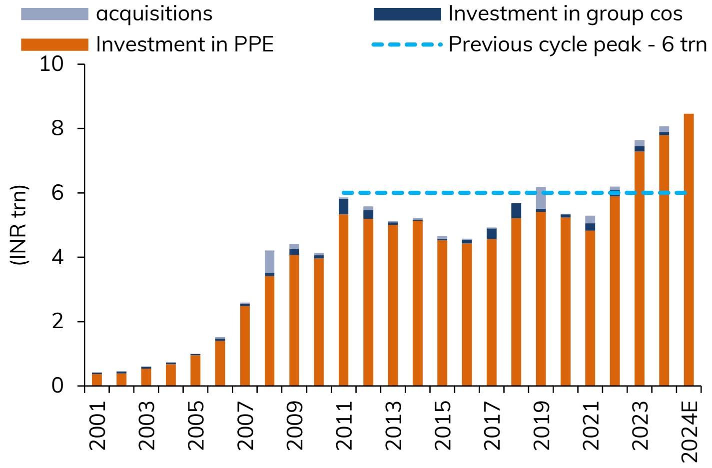
Exhibit 17: Robust auto sector volume growth except CVs



Source: SIAM, I-Sec research. Note: FY24 YoY growth is based on data available till Feb'24.

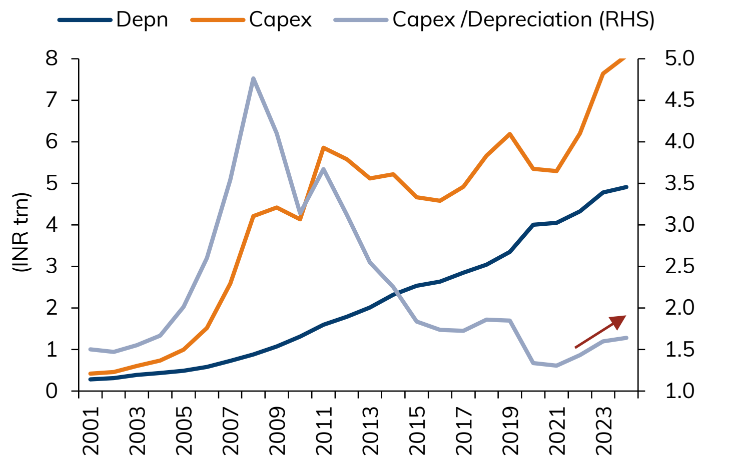
Aforementioned implied capacity utilisation trends are positive for private capex cycle along with cycle high CFO/capex and cycle low capex/depreciation ratio.

Exhibit 18: Listed space corporate capex is clearly breaking out of the previous capex cycle peak of ~INR 6trn



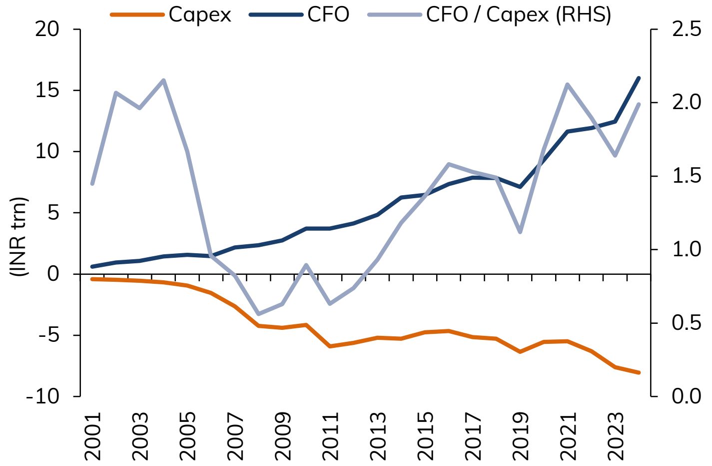
Source: Capitaline, I-Sec Research. Note: TTM represents Sep'23 TTM.

Exhibit 19: Capex has begun to depart from depreciation line –indicating the start of the transition from 'maintenance capex to discretionary capex'



Source: Capitaline, I-Sec Research. Note: TTM represents Sep'23 TTM.

Exhibit 20: CFO/capex at ~2x is near two-decade high, limiting growth in industry at an inflexion point



Source: Capitaline, I-Sec Research.

Exhibit 21: Capital-intensive sectors drive TTM Sep'23-end capex in the listed space

Source: Capitaline, I-Sec Research.

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