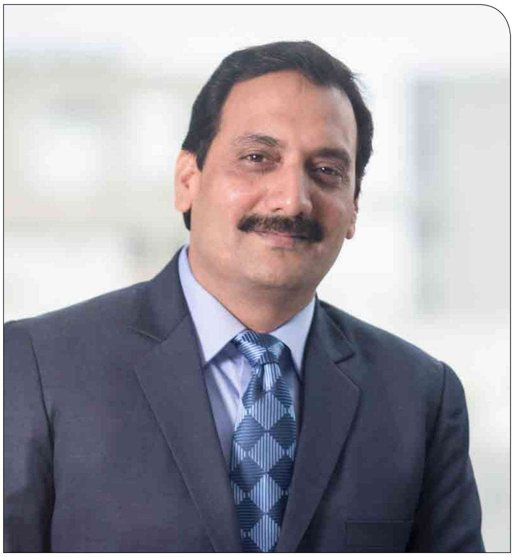
CONSTRUCTION MIRROR
An Outlook of the Construction Equipments & Infrastructure Industry

GUEST ARTICLE



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Trends in the Equipment Financing Industry in India

Introduction of GST has led a major boost to the leasing industry, signaling a movement towards a more mature financing market. Reduction of GST rate for construction equipment from 28 to 18% will also boost equipment sales in the future. Another important reform in the banking sector has been the introduction of Insolvency and Bankruptcy Code ("IBC").

Infrastructure – The driver of Indian Economy

The government is earnestly working towards enhancing India's attractiveness as an investment destination. In order to sustain the growth momentum and to create jobs, the government has been proactively spending on infrastructure creation. Sectors such as railways, housing and urban affairs, and roads and highways have witnessed increased year-on-year (y-o-y) interim budget allocations (excluding IEBR) for FY 2020 by 21%, 12%, and 6% respectively. The north east sector has received a special focus in the Interim Budget 2018-19 with an allocation of Rs 58,166 crore, an increase of 21% over the previous budget. These investment plans and projects have the potential to create requirement of capital goods on a large scale and increase in the number of contractors executing these projects.

The government has been continuously pushing forward for the infrastructural development in the country. MoRTH is actively trying to resolve all issues with stakeholders to bring back the Public Private Partnership ("PPP") model on track. Hybrid Annuity Model ("HAM"), an improved version of the PPP model in which the government bears 40% of project costs are being increasingly used by National Highways Authority of India (NHAI). The entry of new contractors in the sector also affirms that road sector is on the highway to progress. Likewise, many initiatives have been taken to fast track Railways with redevelopments and modernization of stations, dedicated freight corridors, focus on safety, high-speed rails, etc., all of which will bring huge opportunities for the construction, mining, and allied equipment ("CME") industry. The Irrigation sector is being revived with renewed vigour, as seen in the states of Telangana and Maharashtra. Capacity additions in ports, and green-field airport projects in MOPA and in Navi Mumbai, have brought hope to these sectors.

The government has taken important steps to streamline the economy. New policy measures were announced to make the business environment more conducive and transparent. Goods and Services Tax ("GST"), the biggest reform, is no doubt, a game changer in our taxation system as it will bring the much-needed ease of doing business, and catalyse growth of the infrastructure sector. Further, introduction of GST has led a major boost to the leasing industry, signalling a movement towards a more mature financing market. Reduction of GST rate for construction equipment from 28 to 18% will also boost equipment sales in the future. Another important reform in the banking sector has been the introduction of Insolvency and Bankruptcy Code ("IBC"). The new framework has made resolution of stressed assets a time-bound process unlike earlier when it resulted in interminable delays in the courts.

The whole debtor-creditor relationship has undergone a massive change, resulting in improved credit culture of the country and thereby leading to improvement in ease of doing business. The government has also passed many laws and policies pertaining to arbitration, coal linkage, HAM, easing of FDI norms, off-take of stressed assets, and so on. It is natural that when new policies are introduced, there will be some hiccups, however; we have already started seeing positive impacts on the ground; especially because the intention is to create a conducive business environment.

Overview of CME Market and CME Financing Market

According to Feedback Consulting, the CME industry has witnessed a good revival since FY 2015-16, preceded by a decline in the previous three years.

CME industry which grew by upwards of 20% in FY'18 (101,900 units) compared to FY'17 (83,600 units) in terms of unit sales and is expected to see heightened business activities as the government is likely to invest heavily in infrastructure sector thereby lifting business prospects in construction equipment sector.

As the construction segment requires large capital expenditure, financing accounts for approximately 80–85% of the total equipment purchased, and in the case of overseas purchases, it accounts for approximately 90%. Most financing is procured through loans while leasing is the second most common mode of financing. Traditionally, India has been an outright equipment purchase market for project requirements. However, this could change. Large contractors who previously outsourced only earthwork and other non-essential activity have begun subcontracting more activities and modules. Consequently, leasing options with their associated tax benefit opportunities are becoming more attractive. There are signs among finance companies that the market is becoming more receptive to alternate financing options.

According to Feedback Consulting, the CME industry is expected to grow at a CAGR of 14-15% for next three years until Fiscal 2021 to reach a volume of 153,000 units. Going forward, there may be some disruptions in the industry both from a product and service perspective. Some likely developments include growth in pre-fabricated concrete business, increase usage of specialized equipment, rising manual labour costs, and digital drive.

The construction equipment finance industry is expected to reach a value of INR 660 billion in Fiscal 2021 with a CAGR of 20-21% between Fiscal 2018 and Fiscal 2021. The overall construction equipment industry is expected to reach 153,000 units by Fiscal 2021 and the market for new equipment finance market will continue to have a share between 85-87% for the next three years. With the current announced projects which mostly have started from the third quarter of Fiscal 2018, demand will continue for the earthmoving equipment industry, which will have a share between 68-70% of the overall CME finance market. Banks and NBFCs are expected to have an equal share in the CME finance industry for the next one to two years with the equipment leasing industry expected to grow at a CAGR of 15-16% until Fiscal 2020.

Major Trends in the CME Industry

Going forward, there may be some disruptions in the industry both from a product and service perspective. Some likely developments include:

Growth in Pre-fabricated Concrete Business

- This could lead to reduced use of concrete equipment like transit mixers, concrete pumps and boom placers.
- Concrete equipment like batching plants could see an increase in sales.

Increase Usage of Specialized Equipment

- A movement towards more specialised equipment may have a minor impact on the backhoe loaders business through competition from excavators under 14 tonne capacity and wheel loaders under three tonne payload capacity.

Rising Manual Labour Costs

- Despite considerable mechanisation across key infrastructure project segments (for example real estate, and rural roads), there will be a considerable need for manual labour. Projects will face inflationary pressures due to rising labour costs.
- The stagnant or low volume sales of products, for example of the skid steer loader, could see increased demand due to increasing manual labour costs.

Digital Drive

- Higher penetration of e-commerce is increasing acceptance among customers. This in turn is slowly penetrating the construction industry. In addition, there are e-commerce portals providing men and material for the construction industry.
- According to Feedback analysis, an exclusive equipment financing institution which caters to the need of the entire ecosystem may emerge.

Major Trends in the CME Financing Industry

Going forward, revolutionary trends appear to be emerging in the equipment financing sector. These include:

- Integrated offerings: Dealers and original equipment manufacturers ("OEMs") are expected to offer customers integrated choice which will include the equipment finance (and could also cover the life cycle financing of the equipment).
- Automation of process: Current equipment financing takes anywhere between 5-30 days before the machine is handed over to the customer. Equipment financing companies to need to move to the automation route, to sustain and survive in this technology-led market. A major differentiator could be

transparency with a process to manage documentation, including, for example, equated monthly instalments payments.

- Platform-based offering: Currently, there are few companies which provide a platform for equipment owners and customers to interact and avail of equipment services. This could be a good opportunity for finance companies to participate and ensure that all finance needs are met.
- Managed services: Customer demand for greater flexibility and convenience will augment the use of non-standard financing agreements. Shifts in customer preference for managed services (bundling equipment, services, supplies and software), pay-per-use leases and alternative financing will encourage equipment finance companies to find innovative ways to meet the demand.
- OEM Tie-ups: Another trend worth noticing is tie up of construction equipment majors with banks and non-banking financial institutions exclusively for their customers. This arrangement helps the OEMs to meet the level of financing support expected by their customers. Preferred financiers collaborate with OEMs and their dealers to offer enhanced quote and credit approval turnaround, allied with competitive financial solutions. The OEM and financier tie-up can be exclusive alliance or preferred financier tie-ups with the OEMs to avoid risk/loss pool arrangement, loss sharing arrangements, subvention and credit days. ■