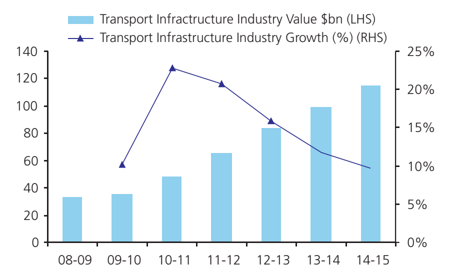
Infrastructure Sector

BMI estimates India's transport infrastructure industry at USD 33.2bn in 2008-09

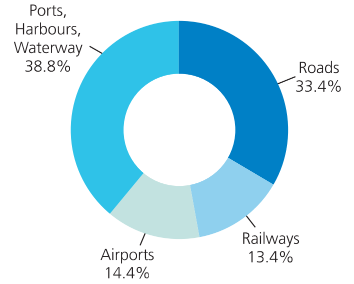
Business Monitor International (BMI) broadly classifies the India Infrastructure sector into two: a) transport and b) Energy and Utilities. Since we are discussing the power and energy sectors in separate sections, this section will focus on the transport infrastructure segment. We will also discuss a related segment, 'telecom infrastructure', given the high investor interest in that space as India's telecom market booms.

The Indian Transport Infrastructure industry was pegged at USD 33.2bn in 2008-09 by BMI. The major Industry segments are Roads, Railways, Airports and Ports & Waterways. With all segments expected to grow at a CAGR of over 20% between 2008-09 and 2014-15, we estimate the overall transport infrastructure industry to expand at a CAGR of 23% to USD 114.9 bn.

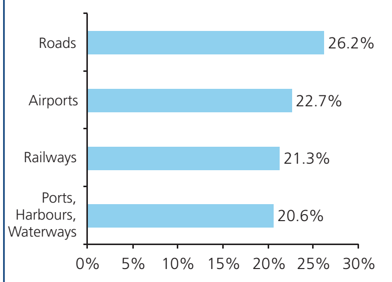
Transport Infra Industry



Transport infra – Segments 08-09



Segment CAGR (08-09)-(14-15)



Source: BMI India Infrastructure Report Q1 2010

Indian government plans to award contracts worth USD 20bn by June 2010

Roads: Despite having the second-largest road network in the world (3.3 million km), India is faced with the acute problem of inadequate road network and poor road quality. From November 2009 until January 2010, the government has awarded contracts worth USD 12bn. It has a target of building 7,000 km per year (20 km per day) of roads, and plans to award additional contracts worth USD 20bn by June 2010. According to IBEF and industry sources, the country's road sector would require an investment of USD 80bn in the next 3-4 years, of which USD 45bn is anticipated from the private sector.

Railways: The Indian Government stepped up its investments in the sector as reflected in the three-fold increase in planned expenditure to USD 50bn over 2007–12. Investment opportunities primarily exist for laying new tracks, gauge conversion, new rail bogies, safety and signalling systems, IT, and setting up infrastructure facilities at and near railways stations.

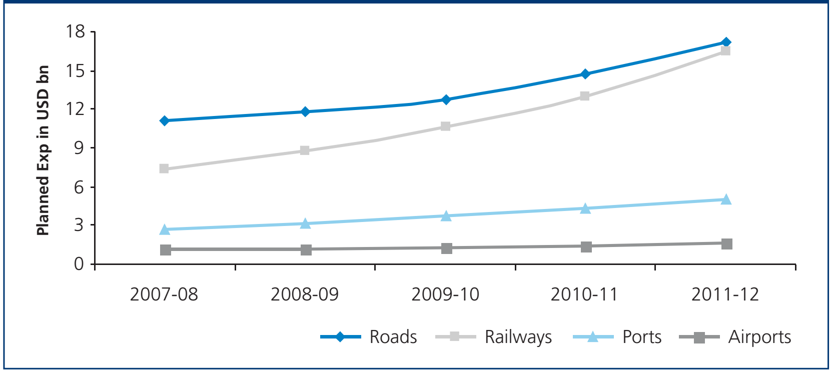
Domestic & international passenger volumes estimated to grow at a CAGR of 18% and 14%, respectively, between 2008–2009 and 2016–17

Airports: In 2009, domestic passenger traffic grew 7.9% to 44.5 million. Domestic and international passenger volumes are estimated to expand at a CAGR of 18% and 14%, respectively, between 2008–2009 and 2016–17. To cater to the burgeoning air traffic, India would need to modernise and upgrade airports, presenting an estimated USD 10bn a year investment opportunity. Investment plans also include setting up Greenfield airports (nearly 11), and maintenance, repair and capacity overhaul projects.

Ports: In 2008-09, cargo traffic at major ports increased to 530.4 million tonnes (MT) from 519.24 (MT) of cargo in 2007-08[1]. The ongoing global economic recovery also brightens the prospect of greater investment in ports. The National

Maritime Development Programme (NMDP) for modernising the port sector includes 276 ports, and 111 shipping and inland projects at a total investment of approximately USD 22bn by 2012. These include construction and upgrade of berths, procurement of equipment, and dredging and deepening of approach channels and berth areas.

Projected 11th Five Year Plan expenditure on Transport sector

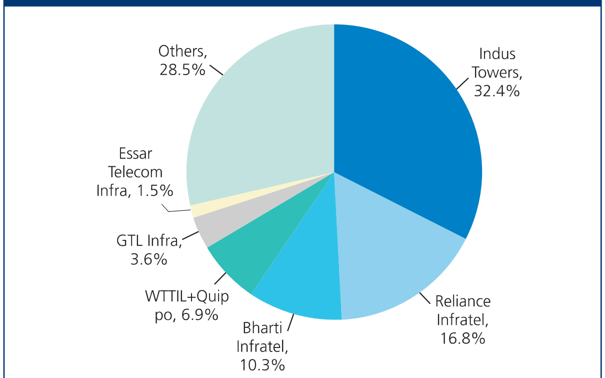


Source: Deloitte India Infrastructure Summit 2009

India's tower infrastructure industry is estimated to be worth USD 250bn in 2008-09

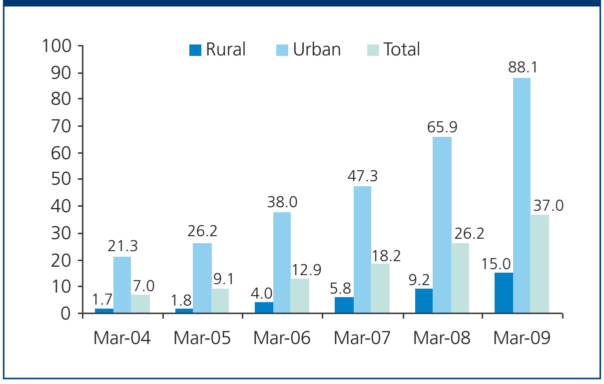
Telecom infrastructure: With mobile telephony in India experiencing rapid growth with subscriber numbers rising from 33.7 million in March 2004 to 391.8 million in March 2009[2], tower infrastructure has assumed the status of an independent industry during the past few years. Increasing competition led telecom companies to expand coverage. Alcatel Lucent estimated the market size of India's tower infrastructure at INR 250 bn in 2008-09. The market share estimates of major players in the segment are given in the chart below.

Market share – Tower Infrastructure Industry



Source: ICRA

India Teledensity – Urban and Rural



Source: TRAI. Teledensity is number of phones per 100 inhabitants

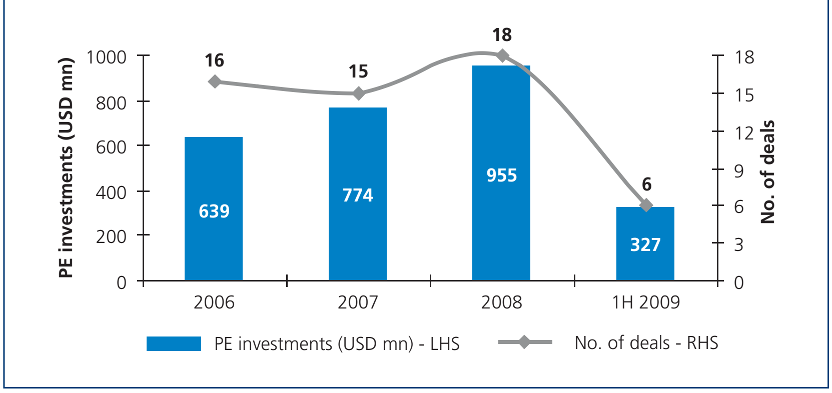
Looking at the wide disparity in urban and rural tele-density, we expect the next stage of growth in telecom infrastructure deployment to be propelled by Rural India.

Infrastructure continues to be the big investment theme among PE investors. Although, the sector did feel the heat of the global economic crisis, with PE investments being hit hard in the first half of calendar year 2009. PE deals during the period fell to USD 327 mn from six deals compared to USD 955 mn (18 deals) in 2008 and USD 774mn (15 deals) in 2007[3]. Nevertheless, we expect PE investments

PE investments in the infrastructure sector likely to revive

in the sector to increase in the near-to-medium term, led by the renewed buoyancy in the global macro economic environment and revival of investor sentiment. In April 2009, State Bank of India (SBI) and Macquarie Capital launched an USD 1bn infrastructure fund – Macquarie-SBI Infrastructure Fund – with plans to increase the fund's corpus to over USD 2-3bn. Furthermore, according to the data released by Perqin, a UK based PE research firm, of the total USD 1.8bn funds in the process of being raised as on 30 September 2009, USD 1.5bn was by India dedicated infrastructure funds.

PE investments in Infrastructure sector

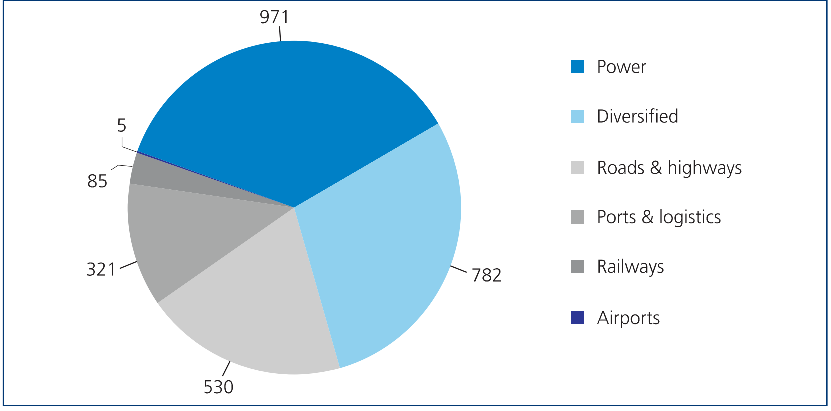


Source: Ernst & Young

Power sector attracted 36% of the total PE investments in the infrastructure sector

According to Ernst & Young data, based on total amount raised, the Power sector attracted a majority of the PE funds in the infrastructure space from 2006 to the first half of the calendar year 2009, followed by diversified infrastructure projects. Of the total number of deals recorded during the period, diversified infrastructure projects accounted for 18, roads and highways, and power 15 and 14, respectively.

PE investments – segmental breakdown 2006-1H 2009 (USD mn)



Source: Ernst & Young

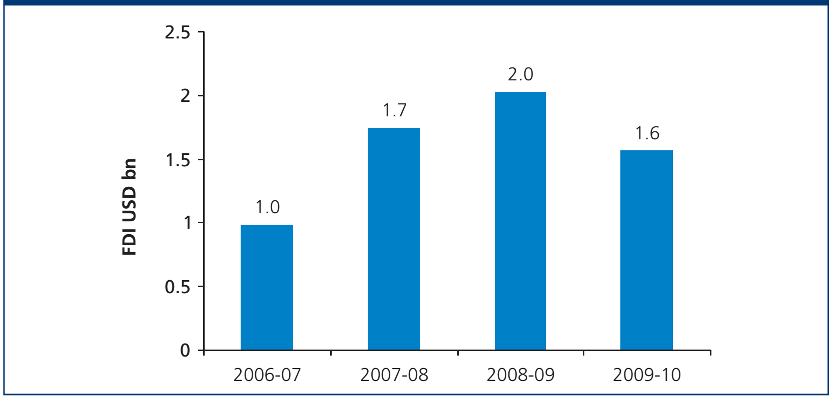
Growth drivers:

- **Strong economic growth** – Clearly, the most important factor influencing growth of the infrastructure sector is India's economic ascendancy. Across both services and manufacturing, robust domestic and export demand implies a need for upgrading infrastructure across the country.

Cumulative FDI in the construction sector between April 2000 and October 2009 totalled USD 6.7 bn

- **Govt initiatives including FDI** – The Indian government has launched initiatives to mobilise resources for infrastructure development and overcome fund deficit. It opened most infrastructure sectors to FDI and granted tax holidays to companies. The government is also encouraging PPPs in development projects. These government initiatives are likely to boost growth in the infrastructure sector. According to DIPP data, cumulative FDI in the construction sector between April 2000 and October 2009 totalled USD 6.7bn.

FDI into Indian Construction sector (USD bn)



Source: FIPB Note: 2009-10 is April to Oct 2009

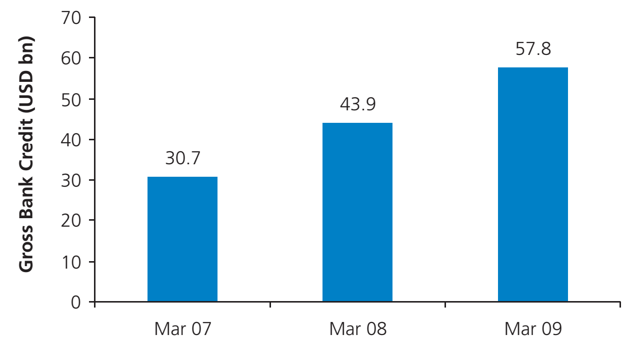
The government also announced that state-owned Indian Infrastructure Finance Co. (IIFC) will increase its lending to the commercial banking sector, which, in turn, is expected to pass on the extra liquidity to the private sector. In addition, IIFC will guarantee to refinance 60% of total commercial bank loans for PPP projects over the next 15 to 18 months.

Outstanding lending to infrastructure increased from USD 30.7bn in 2007 (March ending) to USD 57.8bn by 2009

- **Incresaed lending to sector by banks** – To increase credit to infrastructure lending, Reserve Bank of India (RBI) has initiated a number of measures, such as allowing banks to enter take-out financing arrangements, issue long-term bonds for funding infrastructure projects, relax single and group borrower limits for additional credit exposure in the infrastructure sector, and invest in unrated infrastructure bonds within the ceiling of 10% for unlisted non-Statutory Liquidity Ratio securities. These measures have helped in increasing infrastructure lending in India. According to RBI data, banks' outstanding lending to infrastructure increased from USD 30.7bn in 2007 (March ending) to USD 57.8bn by 2009.

By 2012, the Indian government is targeting total investments of USD 150bn by private sector

Gross Bank Credit - Infrastructure sector outstanding (USD bn)

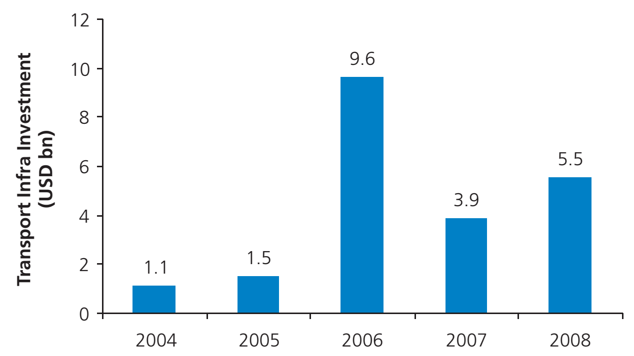


Source: RBI

To help infrastructure firms meet their massive fund requirements, RBI, in October 2009, also created a new non-banking finance company category. The new category would help NBFCs raise more money from overseas markets, as the Government has raised the cap to USD 500mn from USD 100mn under the approval route. This could lower the lending rate for the sector.

- **Increased private sector participation** – To tap the growth opportunities, major companies have increased their infrastructure investments in India. World Bank data estimated cumulative private sector investment in India's transport sector at USD 21.7bn. According to the report by PricewaterhouseCoopers (PWC), by 2012, the Indian government is targeting total investments of USD 150bn by private sector. This is likely to be a key growth driver for the sector in the medium-to-long term.

Private sector investment in India Transport infra sector (USD)



Source: Worldbank

Key challenges:

- **Long gestation period and high value of investment** – Projects in the infrastructure sector are characterised by a long gestation period and high value of investments. Hence, systemic or other delays could adversely affect return on investments.

- **Underdeveloped bond market** – Although the government has announced its intention to harness investments through insurance and pension funds, the performance of the bond market would have a direct impact on its efforts. In India, the bond market is not as established as the equity market and would need to be significantly revamped to support the government's long-term plans.
- **User charges** – Improper and ineffective levy of user charges due to political pressure results in longer recovery periods. This deters investors from investing in infrastructure projects.
- **Improper implementation** – Although the government has allowed private companies to participate in containerised goods transport, the Department of Industrial Policy and Promotion states that railways is a public sector entity and amendments are required to facilitate private sector participation. Concerns related to inefficiency might act as deterrents to growth.

Outlook:

Infrastructure investment in India is set to grow significantly. The country has become a major outbound investor and Indians are being lured by other countries to seek investment opportunities there. Investment banking company Goldman Sachs estimates the Indian infrastructure sector's investment requirement over the next 10 years at USD 1.7tn. It adds that more investments would come from the domestic market than overseas. Recognising the need of a well developed infrastructure for achieving robust economic growth, the government has unveiled a USD 320bn investment plan for upgrading ports, railroads, highways and airports over the next 15 years. Liberalised FDI norms and tax holidays, coupled with banks' increasing willingness to lend to the infrastructure sector, have accelerated private participation in the sector. While an undeveloped bond market and improper levy of user charges are impediments to growth in the sector, progressive action can be expected in light of increasing investor interest in the sector. Consequently, it is estimated that India's transport infrastructure industry to expand at a CAGR of 23% to USD 114.9bn by 2014-15.

[1] Indian brand equity foundation report on Ports. Jan 2010
[2] Telecom Regulatory Authority of India (TRAI) Annual report 2009.
[3] VC Circle, Business news article

Important Notice