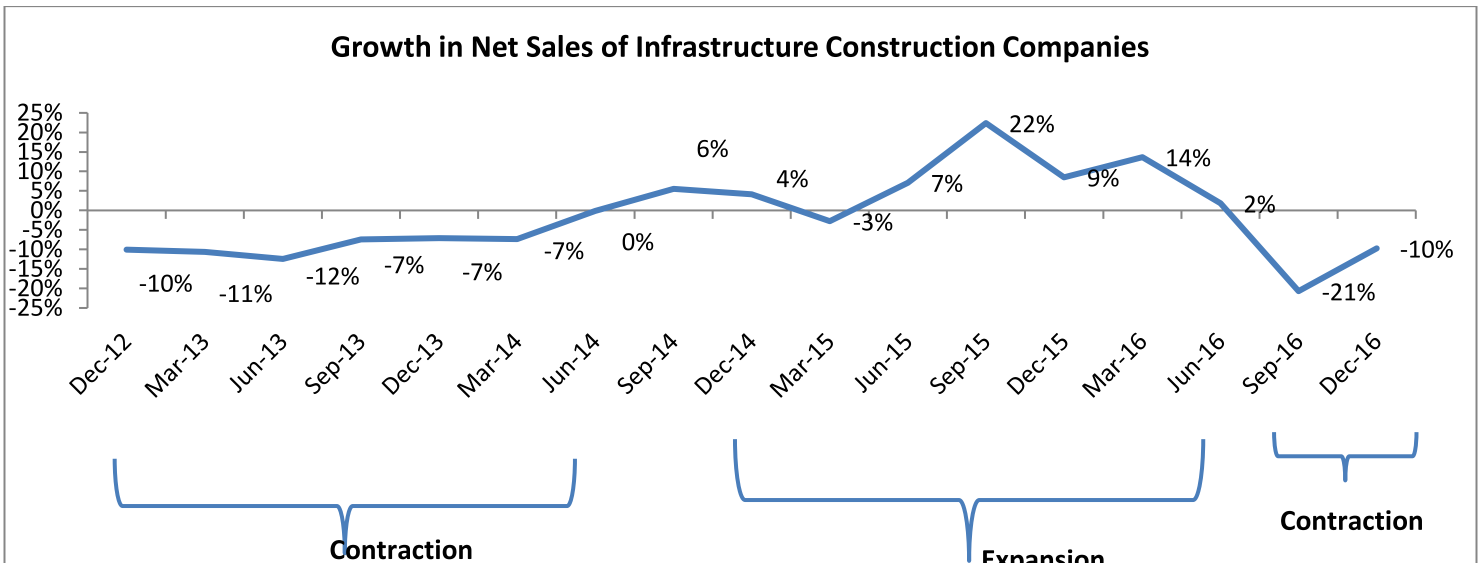
Sales Growth in infrastructure and construction sector enters negative territory

Delay in project implementation affects net sales of infrastructure companies in recent quarters

Growth in the net sales of more than 50 infrastructure companies has nosedived to the negative territory since the quarter starting June 2016. Till June 2016, infrastructure companies reported positive growth in net sales. However, in the quarter ending September 2016 and December 2016, net sales of these firms declined 21% and 10% respectively.

Analysing trend in net sales of infrastructure companies over a four-year time horizon shows that these companies pass through cycles of expansion and contraction. Between December 2012 and September 2014, net sales of these companies witnessed contraction. This was followed by expansionary cycle from December 2014 to June 2016, when net sales of infrastructure companies were growing, except for a temporary contraction in March 2015. In September 2016, the cycle of expansion reversed and net sales started declining for infrastructure companies.



Source: CMIE Industrial Outlook

One of the reasons for the contraction in net sales since September 2016 could be delay in the execution of infrastructure projects. Ministry of Statistics and Programme Implementation monitors the implementation status of infrastructure projects worth Rs 150 crore and above across 17 sectors including roads and highways, ports and shipping, railways, urban development, steel, coal, telecommunication and so on.

Data from the ministry shows that the number of projects reporting additional delays has increased in road, petroleum and urban development sectors between June 2016 and December 2016. However, in the railways and power sectors, the number of projects reporting additional delay has declined during this period.

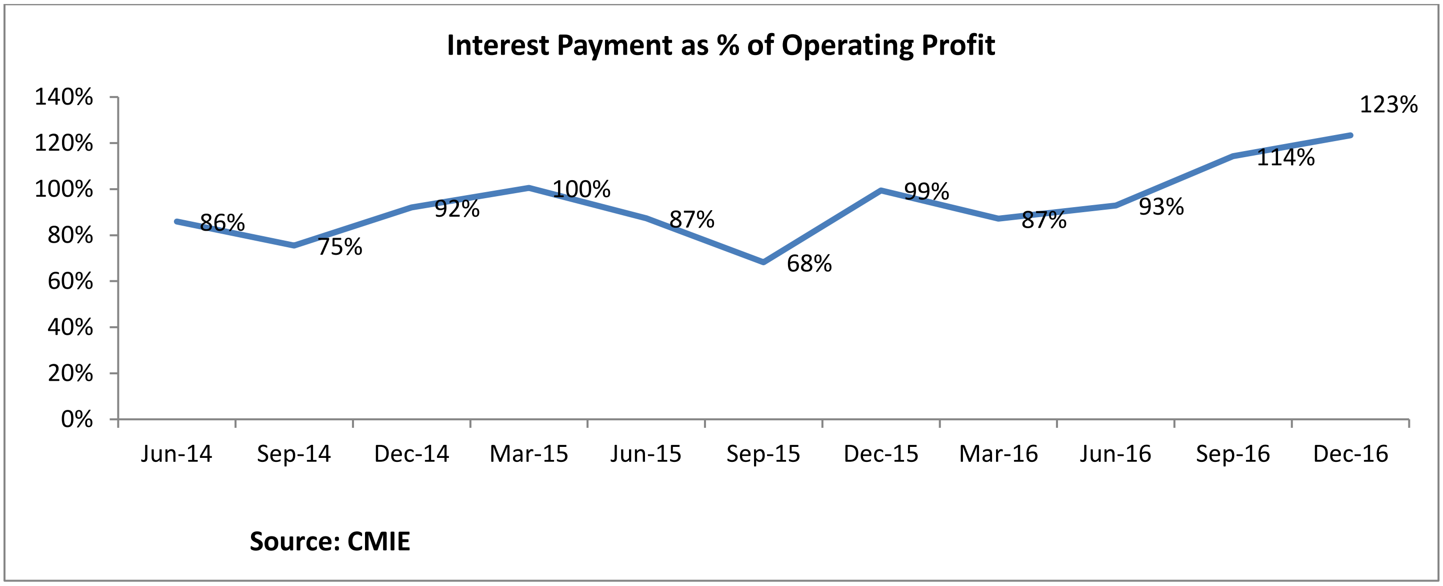
Number of projects reporting additional delays		
Sector	**Dec-16**	**Jun-16**
Road Transport and Highways	37	30
Railways	5	9
Power	9	16
Petroleum	16	10
Urban Development	6	4
Source: Ministry of Statistics and Program Implementation		

The following data shows the range of delay (in terms of months) in commissioning infrastructure projects. the data shows that out of 17 sectors, five sectors witnessed increase in the range of delay between June 2016 and December 2016. These sectors are atomic energy, steel, power, ports and shipping and urban infrastructure. For instance, in urban infrastructure, the maximum delay in project commissioning increased to 70 months in December 2016 from 65 months in June 2016. Similarly, in the power sector, maximum delay has risen to 134 months from 128 months during this period.

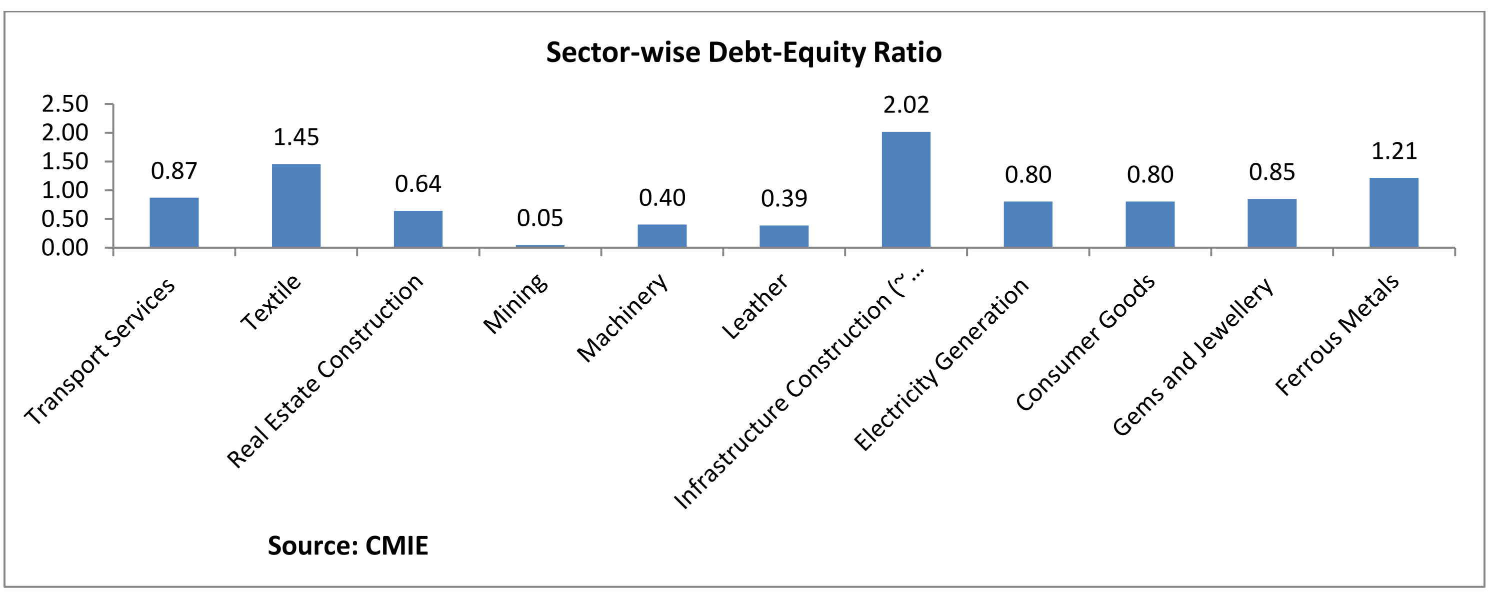
However, in road transport sector, the maximum delay in commissioning has declined to 114 months from 138 months. However, this data is only indicative and it does not provide the complete picture of project implementation status as it considers only those projects facing maximum delay and minimum delay to compute the range.

Range of Delay (months) w.r.t. Original Date of Commissioning				
S No.	**Sector**	**No. of projects on monitor**	**Delay in Dec 2016**	**Delay in June 2016**
1	ATOMIC ENERGY	4	47-98	35-89
2	CIVIL AVIATION	4	0-80	0-80
3	COAL	85	0-132	(-48)-132
4	FERTILISERS	2	0-10	0-10
5	MINES	3	(-2)-31	0-31
6	STEEL	33	0-51	0-45
7	PETROCHEMICALS	1	0	44
8	PETROLEUM	78	(-8)-71	(-6)-74
9	POWER	122	(-10)-134	0-128
10	HEAVY INDUSTRY	1	75	75
11	HEALTH AND FAMILY WELFARE	13	0-35	0-35
12	RAILWAYS	349	(-2)-263	(-2)-263
13	ROAD TRANSPORT AND HIGHWAYS	449	(-1)-114	0-138
14	SHIPPING AND PORTS	8	0-129	0-124
15	TELECOMMUNICATIONS	2	0-30	0-30
16	URBAN DEVELOPMENT	30	(-1)-70	(-10)-65
17	DEFENCE PRODUCTION	2	0-0	
Total		1186		
Source: Infrastructure and Project Monitoring Division, Ministry of Statistics and Programme Implementation, GoI Figures in bracket indicate preponement of commissioning date				

The falling net sales of infrastructure companies has affected their ability to service their debt. The decline in net sales has reduced the operating profit, so much so that the interest payment of 57 infrastructure companies is higher than their operating profit. As can be seen from the following graph, the interest expense of these infrastructure companies has exceeded 100% of their operating profit since the September quarter. Operating profit is the excess operating revenue after meeting operating expenses such as salary to employees, cost of raw materials, electricity, transportation etc. The revenue left after meeting these operating expenses is also called earnings before interest tax depreciation and amortization. This leftover revenue is used to pay interest on loans, taxes to government and allocate funds for depreciation and amortization.



The huge interest payment burden is also because of the high debt levels in this sector. As can be seen from the following chart, the debt-equity ratio of infrastructure companies is the highest at 2.02 as of September 2016 among 11 sectors.



Companies in the infrastructure suffer from huge debt and consequently high interest payment burden. Reserve Bank of India allowed companies that are unable to repay their bank loans because of temporary liquidity problem to restructure their debt in co-ordination with the lending banks. Infrastructure sector tops the list of sectors where companies have applied for flexible repayment of loans under the Corporate Debt Restructuring (CDR) mechanism. As can be seen from the following table, Rs 40,349 crore worth of debt in the sector is being restructured under the CDR mechanism. Infrastructure is followed by iron and steel, engineering procurement and construction, engineering, construction and other sectors where companies are saddled with huge debt burden.

Industry-wise live cases in Corporate Debt Restructuring (CDR) as of December 2016

Sectors	Number of Cases	Aggregate Debt (in Rs Crore)	Share (in %) in total cases
Infrastructure	16	40349	19.49
Iron & Steel	37	40269	19.46
EPC	5	23522	11.37
Engineering	8	22082	10.66
Construction	11	18644	9
Ship-Breaking/Ship Building	3	11449	5.53
Textiles	18	10558	5.1
Telecom	5	7040	3.4
Total (all sectors)	168	207060	

Source: Corporate Debt Restructuring Mechanism

Policy Recommendation

Effective Resolution of Non Performing Assets – Infrastructure sector constitutes 35% of the total bank credit. Of the total bank loan to the infrastructure sector, 18.6% has been identified as stressed assets. The government has set up an oversight committee to resolve bad loans that are taken up under the under S4A (scheme for sustainable structuring of stressed assets) scheme. The scope of the oversight committee must be expanded to resolve even those bad assets that do not fall under this scheme. Also, the decision taken by this committee should not be subject to investigation by Comptroller and Auditor General (CAG), Central Bureau of Investigation and Chief Vigilance Commissioner. In many instances, resolution of bad loans is delayed because public sector bankers hesitate to book losses on these loans for fear of being questioned by the above government agencies. Therefore, in order to expedite the resolution of bad assets, the decision of the oversight committee must be free from review of these agencies.

Guidelines for Renegotiation of Contracts – Timely resolution of bad loans in the infrastructure sector is a short-term solution. In the long run, the government must introduce effective mechanism for renegotiation of public private partnership contracts in infrastructure sector. In the past, private companies have bid aggressively to win contracts in infrastructure sector. In the course of time, some of these companies have realized that the projects are not viable under the existing terms and conditions of the contract. Therefore, these contracts need to be renegotiated by taking into consideration the new realities.

In the Union Budget 2017-18, the government said it would amend the Arbitration and Conciliation Act 1996 for resolution of disputes in Public Private Partnership Projects. Besides amending the act, the government must also introduce guidelines for renegotiation of contracts