



# WIRING

## for the Future

be the right equation for success.

While quality of the product is a prime consideration, cable manufacturers need to be flexible enough to respond quickly to shifting levels of demand. Being a cyclical industry, it is highly sensitive to the consumption patterns of the power, infrastructure, communications and automobile industries. The power sector, in fact, is the largest consumer of cables in India closely followed by the telecom sector. Both these sectors are hugely dependent on government policies on regulations, and public sector spending for growth.

In our recently published report on the Indian Electric Wire and Cable market, we discussed that this market is growing at a steady pace as government as well as the private sector continues to invest heavily in infrastructure projects. The report highlights that commissioning of the new power plants and enhancing capacity of the existing ones have boosted demand for electric wires and cables. Additionally, the roll out of 3G and broadband should provide further impetus to demand for cables. We also think growing urbanization and industrialization are other important drivers. Almost all manufacturing companies need cables, and increased government focus on refinery and fertilizer sectors should further drive growth in the cable industry. Demand from increased housing and commercial building projects are identified important additional sources

of revenue. Other large scale consumers of electric wire and cables include the auto sector and railways. The report also highlights the major challenges of the industry as well as the rules and regulations the industry needs to adhere to.

As discussed earlier, government regulations and spending are critical determinants of industry growth. The recent union budget elicited mixed responses from the industry. We think the budget's focus towards fiscal consolidation is an essential step in containing the vicious challenges of low economic growth, high interest rates and high inflation. The budget purported meaningful reforms that should boost growth across multiple sectors. The agriculture, power and infrastructure sectors were primarily beneficiaries of the budget. Below, we discuss the impact of the budget on these industries and the changing dynamics for the electric wire and cable industry.

### Growth in infrastructure spending

Investments in the infrastructure sector will directly help in driving growth for cables. The government is investing heavily into sectors such as fertilizers and refineries – these sectors all require significant volumes of electric cables and wires.

The government's ambitious 'Power for All by 2012' project will require huge amounts of generation, transmission and distribution cables. This step will also be instrumental in clocking GDP growth of 7.6% as expected in the current budget. The government recently announced

**T**he dynamic electric wire and cable industry in India has its own unique fundamentals. First, with approximately 60-80% of the total costs related to raw materials, it can be considered a conversion industry. As typical to such industries, the un-proportionate raw material cost results in specific challenges such as managing the transformation process to ensure optimal utilization of financial resources. Besides, buyer requirements are continually adjusting to changing lifestyle demands including, energy efficiency, environmentally friendly, health and safety, etc. making innovation critical to survival.

Technological innovation is therefore by far the greatest need, as well as the biggest growth driver, for the industry. Technology will help in managing buyer expectations as well as in making processes robust. More recently we have noticed a rush among Indian firms to collaborate with established industry players in the industrially advanced countries. The blend of technology competency of foreign partners along with lower resources cost in India could well

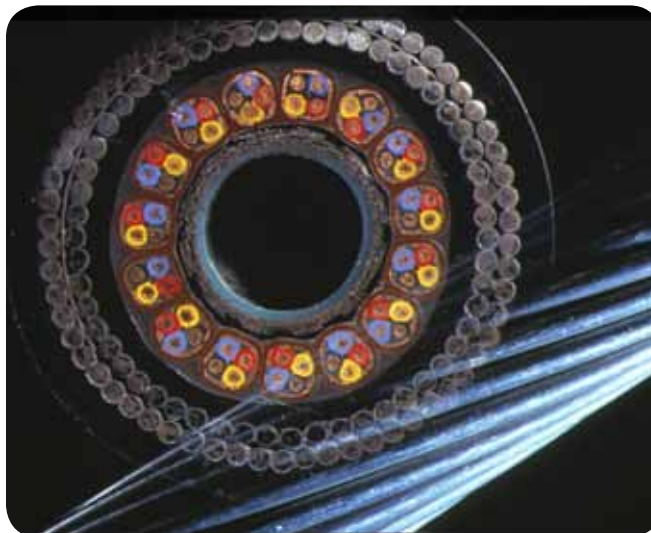
that 2011-12 growth moderated to approximately 7.5% against the 9% projected earlier. The global economic environment remains soft with recession in the Eurozone, China's slowing growth engine and structural issues with America's financial system slowing recovery. The government hopes to support its current 7.6% forecast with robust infrastructure spending. The current budget gives the infrastructure & real estate sector plenty of scope for growth. Infrastructure investment is slated to be increased to around 10% of the GDP from 8% earlier. For this to happen, investment in this sector will have to be upwards of Rs. 45 lakh crore (\$1 trillion) in next five year period. The Budget thus, promises a lot to the infrastructure sector which in turn will positively impact the wires and cables industry, provided things are well executed.

### The power sector lights up

The government has increased its focus on the power sector as well as the development of infrastructure. We are into the final stages of our current five year plan – the eleventh. The plan has seen an investment of Rs.10,000 billion into the power sector. As we prepare for the 12th plan to kick off, investments in the power sector are expected to increase to the tune of Rs. 11,350 billion.

Under the 2012 Union Budget, the government estimated that the power sector required an investment of Rs. 236,006 lakh crore in 2012-2013. The major problem is that India runs the risk of having to deal with an energy deficit of 11% couple with a 142 million tones shortfall of coal – which is one of the main sources of energy. And after months and months of lobbying by power manufacturers, Finance Minister Pranab Mukherjee in the new budget granted power plants two year customs duty exemption on coal purchases. This should help address input scarcity issues for power manufacturers.

He also accepted the fact that lack of infrastructure was weighing down overall economic growth and thus he took measure to pass on more funds to the sector. The Government put forward



**Cross Section View of Wire used in Telecom Sector**

External Commercial Borrowings ('ECB') as an option for part financing of rupee debts. The power sector also expects to gain from reduced tax withholding rates to 5% from 20% on interest on ECB. Additionally, the sector can now raise funds through Infrastructure Tax Free Bonds to the tune of Rs 10,000 crores. These measures should bring financial relief to power players and boost growth in the sector.

But perhaps, one of the most welcome points for the power sector was the extension of tax exemption by one more year for power generating companies. While increased focus on Transmission and Distribution losses by preventing cheaper imports would have helped domestic manufacturer competitiveness, we see these positive developments in the power sector as a pertinent driver for the wire and cable industry.

### Telecom in expansion mode with 3G

The telecom sector is on the cusp of another change with the arrival of 3G services in India. The country is on the brink of witnessing a high growth in the demand for high end data and communication services with adoption of 3G services picking up pace in the country. That essentially requires an extensive network of high-end cables to make it a reality.

The government has decided to operate as well as own a nationwide broadband network with an optical fibre base

which will allow providers to supply a diverse range of services. Broadband usage in India, at the moment, has immense scope given the low adoption rates presently. According to a Gartner report, India is trailing well behind other emerging telecom markets when it comes to fixed broadband penetration. In India the household broadband incursion was only 6% in 2011. Compare that with a 16% penetration in emerging market and we better understand the significant available market potential.

Fixed-line broadband connections stand at below 13 million at present with downstream speed around 250 Kbit/s. The government anticipates this number to rise significantly by 2017. In National Telecom Policy drafted by the government, it states that it targets to achieve 175 million broadband users by 2017 and 600 million by 2020 – with all having a minimum download speed of 2 Mbit/s. This ambitious venture is going to require significant volume of transmission towers and fibers/cables.

With concepts such as Fiber-to-the-home making headways, broadband subscribers are slated to increase as well. Also, the government is trying to promote 'gigabit-capable passive optical network' (GPON) technology – which are designed to provide high speed broadband services. The GPON technology can provide broadband connectivity to the 70% Indian which live in rural areas and the government is looking to extend the fibre network to village Panchayats by



2014. Thus, there huge potential waiting to be unearthed in this space for those involved, which includes cable and wire producers.

## Growth in transportation and automobiles

Manufacturing and heavy industries extensively use cable and wires and growing demand in these industries will lead to a rise in the demand for electric wires and cables as well.

Projects to develop or extend metros are in full swing in the cities of Mumbai, Chennai, Bangalore, Jaipur, Kolkata as well as Delhi. The demand for cables will rise with these projects being implemented.

The automobile sector has also seen steady growth in the last two years. The ever rising petrol prices has resulted a perceptible shift towards diesel vehicles. We think if hybrid cars enter the market, in earnest, the demand for them is sure to rise as well. Pranab Mukherjee has reduced the excise duty on specific hybrid vehicle components to 6% from the earlier 10%. These incentives are designed to help boost the production of hybrids. A regular automobile requires around 25 kgs of cables while it is 37.5 kgs for hybrids. We think vehicle ownership is fast turning into a need from luxury even in the Tier I and II cities and expect increasing urbanization to further boost demand for automobiles.

## Growing urbanization

Growing urbanization provides a great opportunity for the overall growth in the economy. By 2030, it is expected that 68 cities will have a population of over 1 million, higher than 42 cities at present. Indian cities are thus expected to generate a staggering 70% of net new employment and in turn that is expected to contribute to more than 70% of India's GDP and quadruple the nation's per

capita income.

With expected growth in urbanization, the real estate market is set to take off – which includes demand for office spaces as well as residential properties. In fact, the demand for the urban premium housing is set to rise to Rs. 757 billion by fiscal 2020 from Rs.116 billion in 2009. More houses and offices mean more demand for wires and cables.

## Challenges

While the prospects are interesting, the viability largely depends on the industry's ability to overcome its challenges and capitalize on the opportunities. One of the primary chal-



lenges is the excessive manufacturing capacity in the industry resulting in expensive products. Besides, cheaper imports from China aggravate the situation rendering domestic manufacturers uncompetitive. To deal with the same, manufacturers are creating joint ventures with their European and Japanese counterparts to leverage their technology and gain a competitive advantage. A case in context is the Birla Furukawa Fibre Optics Limited, which is a joint venture between Japanese company Furukawa Electric and Universal Cables Limited. Encouraging import of technology and imposing regulations on compulsory R&D setup in the country should further boost growth and bring stability to the industry.

As we discussed earlier, raw materials comprise 60% + of the input cost for cable manufacturers. Copper and

Aluminium are the primary raw materials for producing cables and wires. Any fluctuation in the prices of these commodities will adversely impact the margins and profitability of manufacturers. From 2008-2009 to 2010-2011, copper prices have shot up by 55%, adversely impacting profit margins.

## Positive outlook

The power industry is a direct beneficiary of the new budget and outlook looks promising. While there are noteworthy reforms, one aspect that will likely result in greater profitability for all stakeholders of the power industry – manufacturers, component providers, distributors, consumers – is preventing transmission and distribution losses.

Using better quality cables that come with superior technology may well be the solution, both power distributors and cable manufacturers can gain from. The move will likely reduce price per unit and have a positive impact on consumers as well. This may be in the next budget, which may be a populist one given it's the last year of the 5 year term for the Congress government.

Over one year horizon, we think that the electric wires and cables industry is well poised to gain from the new budget reforms. Relaxation of laws coupled with more investments should bring cheer to Indian manufacturers – such as Eon Electric, Finolex Cables, Havells India and KEI Industries ■

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