

CONSTRUCTION EQUIPMENT LEASING REPORT, INDIA - 2016

By Vinod Kothari Consultants P. Ltd.

VK
SINCE
1988

FINANCIAL CONSULTANTS

Preface

We have pleasure in presenting our report, Construction Equipment Leasing Report, India - 2016.

This Report, for the first time focuses on leases of construction equipments, is a significant addition to our research products – including India Leasing Report, 2014.

The inspiration for doing a specific report on construction equipment leasing in India comes from our observation that there is a huge need for the development of infrastructure in the country. Both the non-banking financial and banking companies are actively engaged in leasing and financing of construction equipments.

Reports such as these not only fill an information gap, they also help to create a platform for collective thinking about the product. In course of preparing this Report, we called upon several contacts and friends in the leasing and banking industry to understand the present state of the market and the projected growth in leasing of construction equipments in the coming types considering the growing impetus on infrastructure development.

We hope the Report will prove to be of value. We look forward to constructive critique from readers.

02nd April, 2016

Vinod Kothari

Table of Contents

Contents

Objective of the Report	9
Methodology	10
Limitations.....	10
State of Infrastructure Industry and Construction Equipment segment	12
Major Segments	15
Market Players	19
Construction Equipment Acquisition.....	20
Various acquisition options.....	20
Own funds acquisition	20
Suppliers' credit	20
Loan financing.....	20
Leasing	20
Renting.....	20
Construction equipment financing market.....	22
Introduction.....	22
Market segmentation	22
Market players.....	23
Construction equipment leasing and rental market	26

Introduction.....26
Types of lease options.....26
Opportunities and Challenges ahead.....28
Upcoming trends in construction industry.....29
Disclaimer30

List of Tables

Table 1: Growth of Earthmoving Construction Equipment (ECE) industry around the globe for FY 2014-18	13
Table 3 : Sales (units) of construction equipment	17
Table 4: Revenue of some construction equipment players	19

List of Figures

Figure 1: Infrastructure spending over the five year plans	12
Figure 2: Infra spending in sub segments	12
Figure 3: Revenue from construction equipment.....	13
Figure 4: Share of various segments in the industry.....	16
Figure 5: Market share of various equipment in terms of sales volume.....	16
Figure 6: Construction equipment finance market trend	22
Figure 7: Share of banks and NBFCs in the construction equipment financing market.....	23
Figure 8: Financing market share of various market players for FY 2012-13.....	23
Figure 9: Market share of various NBFCs.....	24
Figure 10: Market share of various banks.....	24
Figure 11: Construction equipment rental penetration rates.....	26

About Vinod Kothari Consultants Private Limited

Vinod Kothari Consultants Pvt. Ltd. (VKC) is a company focussed on providing consultancy and training services in the field of housing finance, affordable housing finance, housing microfinance, leasing, asset backed lending, securitisation, mortgage lending and venture capital funds. The company has been in existence for over 25 years, catering to the needs of public and private sector clients. Our team operates from Kolkata, Mumbai and Delhi.

We have been closely associated with the private sector, serving some of the leading names in the non-banking financial sector. We have substantial experience in the field of affordable housing finance, and have worked closely with various international organisations.

VKC has also been associated with multilateral organisations like International Finance Corporation and Asian Development Bank for devising and implementing funding solutions of low income housing projects, structuring of low income housing finance mortgage securitisation, covered bonds, housing microfinance and micro mortgage lending. Moreover, we have also worked with various market regulators like National Housing Bank, Securities and Exchange Board of India, Government of India on matters

like alternative funding solutions for the low income housing finance segment, mortgage lending laws etc

In addition to the above, the Company has an illustrious past record in conducting training workshops. We have conducted over 500 workshops till date on various subjects of finance and corporate laws in more than 20 countries across the world besides India. Lastly, VKC is also a prolific producer of literature on the subject- every year our books and articles are published by various prominent publishing houses and specialist journals.

About the Authors



Ms. Nidhi Bothra
nidhi@vinodkothari.com
Executive Vice President

Ms. Nidhi Bothra is an associate member of the Institute of Company Secretaries of India (ICSI). She is an author on several books pertaining to law and finance. She specializes in areas of leasing, securitization, covered bonds and other financial instruments, mortgage lending, affordable housing finance, housing microfinance, asset reconstruction business etc. She is one of the directors of Indian Securitization Foundation, the only association body steering growth and development of capital market instruments in India.



Mr. Saurav Malpani
saurav@vinodkothari.com
Senior Manager

Mr. Saurav Malpani is an associate member of the Institute of Company Secretaries of India (ICSI) and is a CA Final aspirant. His area of expertise lies in the areas of direct and indirect taxation, accounting and financial disclosures, corporate laws, leasing, funds structure such as REITs, AIFs etc.

Objective of the Report

Infrastructure development in a country is sine-quo-non to the growth of any economy. The need for infrastructural development brings necessary growth in several industries thereby causing an incremental need for finances and financial intermediation to support the development.

Adequate and sound infrastructure cushions the entire economic activity in the country and thus leads to overall progress. Need for the Indian economy to have a sound infrastructure can be sensed from the budget speech¹ of Shri Arun Jatley, Honourable Finance Minister, wherein he stated that among five big challenges, one of them is the weak investment in infrastructure segment by private players. In order to meet the requirement of India infrastructure industry, Government in its Budget 2015, proposed to establish a National Investment and Infrastructure Fund (NIIF) with an annual flow of Rs. 20,000 crores. Further it was also provided that the investment in the infrastructure sector would be Rs. 70,000 crores more than the investment in the preceding financial year. Considering the above targets there is no doubt that Indian construction industry would be on a roll for the coming few years.

¹ <http://pib.nic.in/budget2015/budgetdoc/gbEngRelease.pdf>

With the above background we present the Construction Equipment Leasing Report, India -2016. This Report intends to capture the current state of affairs of the financing market of the construction equipment in India and leasing in particular. The Report also provides list of major players in the financing market (i.e. both banks and NBFCs), penetration level of the financing industry, and major segments in the construction equipment segment along with their share in the financing volumes.

Methodology

We have carried out both primary and secondary research to provide insights on the construction industry equipment segment in India.

In terms of primary sources, we have contacted various professionals from NBFCs, some of the manufacturers, bank officials etc. We mobilised an extensive network of contacts in the construction equipment financing space to speak to over dozen professionals. The interview method was by way of personal interaction, rather than using a preformatted questionnaire.

Some of the data for the current market size, market shares, etc are based on interviews with several survey respondents.

In addition to our primary research, we browsed through lots of other research and publications on the subject.

Limitations

The report only deals with the construction equipment financing market in India. The report also takes into consideration both the financing and leasing aspect.



State of Infrastructure Industry and Construction

Equipment segment

Being a developing country, building infrastructure is critical to the growth of the nation.

India's need for infrastructural development is also supported by government's initiative as envisaged by the 12th five year plan for FY 2012-17. Infrastructure is one of primary areas of planned expenditure of about Rs. 55 lakh crores which covers around 8.20% of the total GDP over the plan period. The total expenditure earmarked and amount spent over the last three five year plans has been shown below:

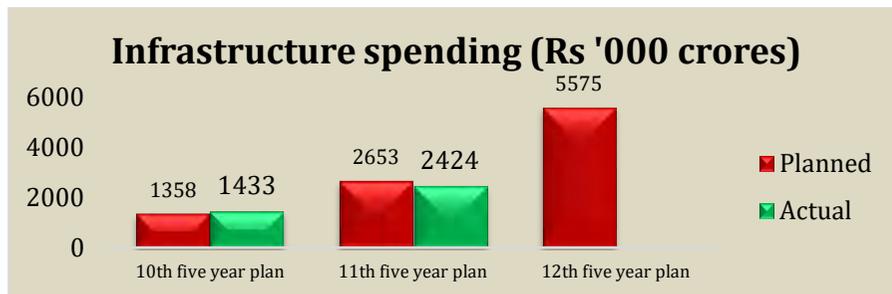


Figure 1: Infrastructure spending over the five year plans²

² http://www.atkearney.cz/transportation/ideas-insights/article/-/asset_publisher/LCcgOeS4t85g/content/road-map-to-success-for-the-construction-equipment

Out of the above total spending, major sub-segments spending in the 12th five year plan in the infrastructure segment are provided below:

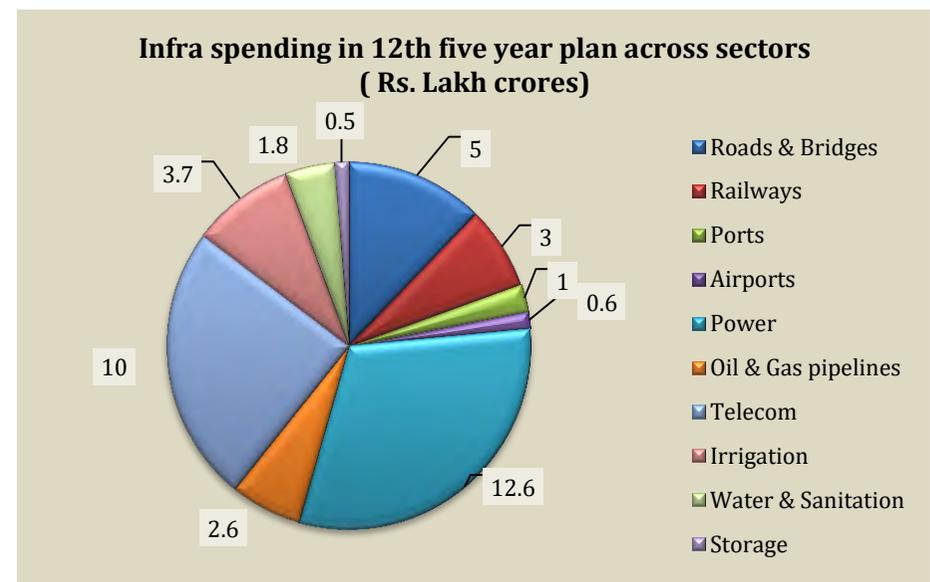


Figure 2: Infra spending in sub-segments

http://www.atkearney.cz/transportation/ideas-insights/article/-/asset_publisher/LCcgOeS4t85g/content/road-map-to-success-for-the-construction-equipment

In order to meet the robust demand of the infrastructure sector, need for construction equipments will be on a higher trajectory. The sale of construction equipment forms around 7% to 8% of the total GDP of the nation and accounts for around 60% of the total infrastructural investments.

Significant factors driving the growth of the industry includes increasing investment in infrastructure, growing public private partnership and growing housing and construction market. The construction equipment industry revenue is expected to reach USD 22.70 billion in FY 2020 from USD 6.50 billion in FY 2014 growing at a CAGR of about 8.38% during FY 07-14 which is expected to increase at a CAGR of 13.10% during the coming years. The industry is expected to provide employment to around three million people by FY 2020.³ The figure below indicates revenue trajectory over the years from sale of construction equipment.

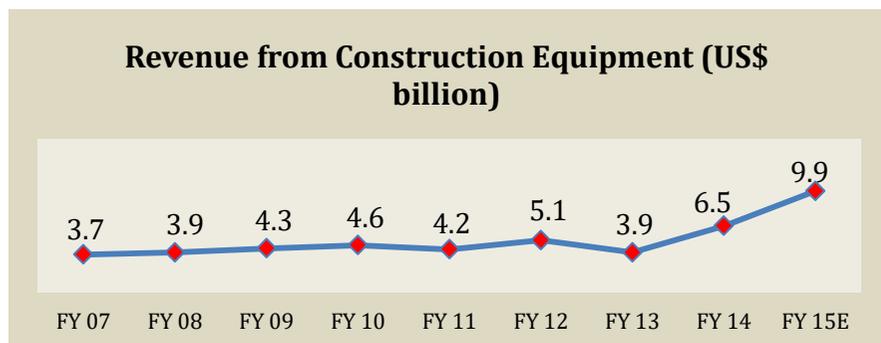


Figure 3: Revenue from construction equipment⁴

³ Details pertaining to GDP, forecasted revenues, etc. are from IBEF report on construction equipment. <http://www.ibef.org/industry/infrastructure-presentation>

⁴ <http://www.ibef.org/industry/infrastructure-presentation>

When compared to the global expected growth rates for the construction equipment industry, India seems to top the rankings in terms of CAGR for the period 2014-18. The table below shows the expected CAGR of the industry for various countries around the globe for the period between FY 2014-2018:

Country	Expected CAGR
India	20%-25%
Egypt	14.50%
South Africa	8.93%
China	9.72%
Brazil	9.60%
USA	7.12%

Table 1: Growth of Earthmoving Construction Equipment (ECE) industry around the globe for FY 2014-18⁵

Note: On account of varied methodology applied by different research team, there exists numerous growth rate for ECE segment. The growth rate for India as provided in the above table is an indicative number as expected by Indian Construction Equipment Manufacturers' Association (ICEMA).

⁵ <http://www.worldhighways.com/categories/auctions-equipment-supply-servicing-finance/features/demand-diversity-in-the-construction-equipment-sector/>



Major Segments

Construction equipment industry offers wide variety of products which may be categorized into four broad classifications namely:

- a) **Earth moving equipment** – This forms the largest segment of the whole industry covering nearly 56.23% share of the industry's revenue. The various equipment under this segment are backhoe loaders, excavators, dumpers/tippers, steer loaders etc. Among others backhoe loaders contributed 49.46% of the total unit sales of equipments.
- b) **Material handling equipment** - Material handling equipment can be further categorized into storage and handling equipment, engineered systems, industrial trucks and bulk material handling. The segment occupied 13.22% of total industry's share in 2014. The segment consists of around 50 manufacturing units in the organized sector and many small scale enterprises.
- c) **Concrete Equipment** – These equipment are mainly used to mix and transport concrete. It includes equipment like concrete pumps, aggregate crushers, transit mixers, batching plants etc. This segment occupies the second position in terms of revenue share covering about 19% of the industry's total share. The concrete equipment segment has also shown remarkable growth growing at CAGR of 22% for the period between FY 2010-14. The main reason behind the spurt is the rapidly growing real
- d) estate sector which in turn is driven by the growth of population, urbanization and rising income levels⁶.
- e) **Road building equipment** – These are used in road construction. Widely used road building equipment are excavators, diggers, loaders, scrapers and bulldozers etc. This segment contributed 8.51% of the total revenue share of the industry in FY 2014.

Apart from the above segments, the industry also consists of material processing equipment which covered 3.04% of the total revenue.

The revenue share of various segments can be depicted through the following figure:

⁶ IBEF Construction Equipment Report 2015

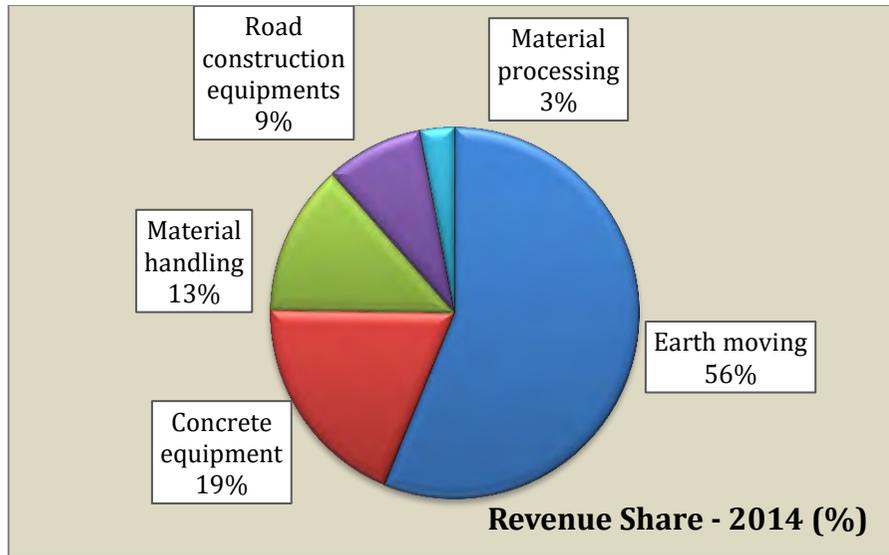


Figure 4: Share of various segments in the industry⁷

Among the various equipment in the segments, backhoe loaders lead the revenue share in terms of sales unit volumes followed by crawler excavators and mobile cranes. The position of sales for various equipment across the segments is presented hereunder:

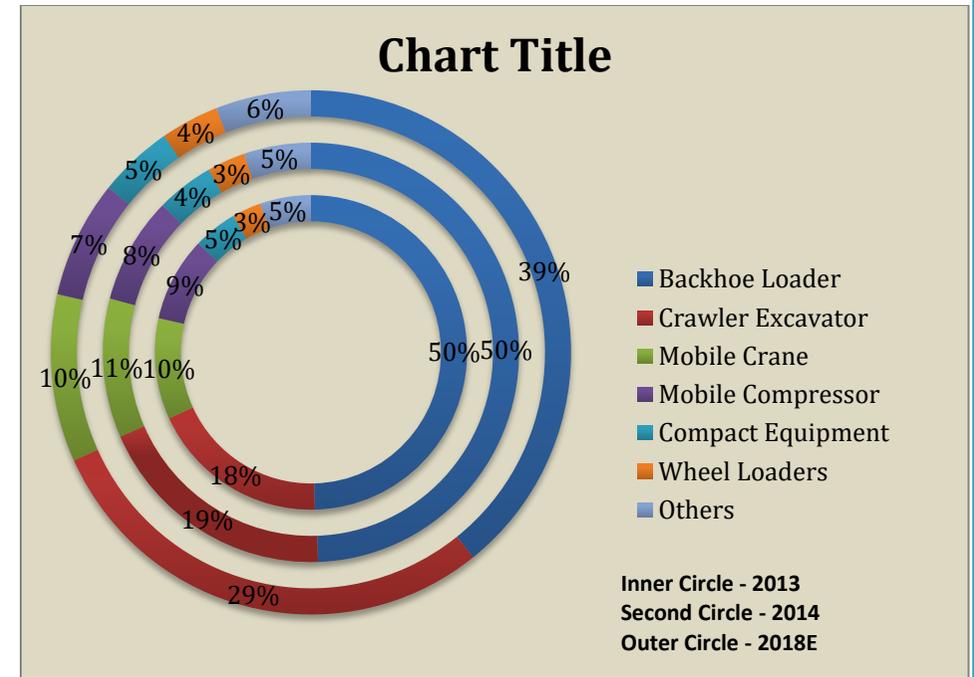


Figure 5: Market share of various equipments in terms of sales volume

The total sale of construction equipment in 2013 was 55,946 units which increased by 8% in 2014 totalling to 60,655 units and estimated to grow at a rate of 59% to 96,730 units in 2018 as compared to 2014. The segregation of equipment sale in quantity terms has been tabulated below:

⁷ IBEF report on construction equipment

<i>Equipment type</i>	<i>2013</i>	<i>2014</i>	<i>% change</i>	<i>2018</i>	<i>% change 2014-2018</i>
Articulated dump trucks	10	10	-	10	-
Asphalt finishers	705	750	+6	1100	+47
Backhoe loaders	27748	30000	+8	38000	+27
Compaction equipment	2536	2700	+6	4500	+67
Crawler dozers	335	350	+4	700	+100
Crawler excavators	10352	11500	+11	28000	+143
Crawler loader	1	5	+400	10	+100
Mini excavator	449	550	+22	1200	+118
Mobile compressors	4867	5000	+3	7000	+40
Mobile cranes	5814	6500	+12	10000	+54
Motor graders	276	300	+9	750	+150
Rigid dump trucks	555	550	-1	850	+55
RTLs	24	30	+25	100	+233
Skid steer loaders	582	600	+3	1000	+67
Wheeled excavators	7	10	+43	10	-
Wheeled loaders	1685	1800	+7	3500	+94
Total	55946	60655	+8	96730	+59
Annual % change	-15	+8	-	+10	-

Table 2 : Sales (units) of construction equipment⁸

⁸<http://nbmcw.com/reports/equipment-machinery/31683-indian-construction-equipment-market-a-report.html>



Market Players

During early 1960s the demand for construction equipment was entirely met by imports. Bharat earthmovers ltd. was the first entity to begin domestic production of construction equipment in India. Gradually many big private sector players also entered the industry led by Hindustan motors, L&T, Telcon and JCB. The overseas technology leaders like Hitachi, Terex, Volvo etc. are also present in India either as joint ventures with the Indian players or have set up their own manufacturing units in India.

A lot of vendors have set up their financing arms to be able to boost the sales of construction equipments in India.

At present the key players of the industry are L&T, JCB India Ltd., BEML Ltd etc. The revenue figures for some of the big players have been presented in the table below:

Entity	Revenue (USD MN)
L&T (For FY 2015)	15262.94
JCB India Ltd. (For FY 2014)	836.64
BEML Ltd. (For FY 2015)	466.02
McNally Bharat Engineering Co Ltd. (For FY 2015)	359.99
Greaves Cotton Ltd (For FY 2015).	281.64
Elecon Engineering Co Ltd (For FY 2015)	220.45

Table 3: Revenue of some construction equipment players

Source: IBEF Construction Equipment Report 2015

Construction Equipment Acquisition

Various acquisition options

As construction equipments require a huge capital outlay, the market is endowed with a variety of acquisition options. The various options include – buying from own funds, suppliers' credit, loan financing and leasing. The rental option ranges from short and medium term rental to long term rentals. These are individually discussed below:

Own funds acquisition

As the capital outlay is very high, acquiring construction equipment from owned funds may lead to blockage of huge amount of equity resulting in dilution of funds for other business needs which may not be a prudent business decision, so this is the least preferred mode of funding construction equipment requirements. However a lot of tenders for construction contracts require contractors to own assets and also the assets to reflect on the balance sheet. Therefore while ownership of assets results in immediate cash outflow, several infrastructure development companies opt to own the assets.

Suppliers' credit

This refers to mainly short term financing option ranging from 30 days to 180 days given by the suppliers themselves. This mode is famous for acquisition from foreign countries. However, under this option the buyer is required to provide guarantees or letter of credit in favor of the supplier.

Loan financing

This is the most favored method of financing construction equipment requirement in India. The major players in the financing markets are banks and NBFCs. Further, the captive financing wings of manufacturers are also gaining prominence.

Leasing

Leasing is by far the fastest growing financing option for construction equipment segment. Cross border leasing are very common now a days due to technological advancements. Construction equipment leasing market offers both operating and finance lease products. However, the penetration of leasing as a mode of financing in India is low compared to other nations. The major players in this market are banks, NBFCs and captive financiers.

Renting

Rental is also prevalent in the construction equipment space, wherein the small time contractors would take the assets on rental based on the works contracts they would have in hand. Rental schemes allow them to use the asset without having to own the assets either immediately or over a period of time. However in India rental market is still stagnant and underdeveloped when compared with other developing countries. The largest players in the rental market are Quippo and Sanghvi Movers. Globally

Sanghavi Movers ranks 6th in the rental space for crane segment⁹. However, there are thousands of players in the unorganized sector with small fleets of two to fifty machines.

⁹ As per Cranes International, June 2015 issue.

Construction equipment financing market

Introduction

As the construction equipment requires large capital expenditure, financing is a good way for the industry to spark demand and increase the customer base. In 2011, Indian construction equipment finance industry was valued at Rs.23,000 crores. Financing accounts for about 80% of the total equipment purchased and in case of overseas purchase it is even higher with about 90% of equipment purchased being financed. Most financing is through loans and leasing is still a second distant option. 80% of ECE users who opt for finance are MSMEs with transaction size varying between Rs. 20 lacs for a backhoe loader to Rs. 20 crores for bulk equipment purchases. The financing market is expected to grow at a CAGR of 22% upto 2016. Figure 6, shows the trend of construction equipment finance market.

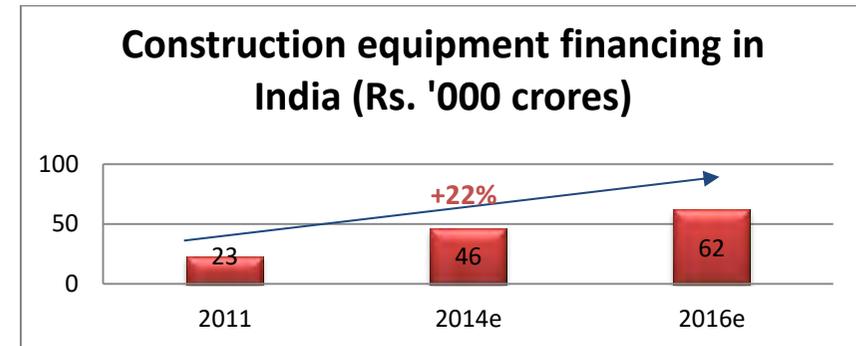


Figure 6: Construction equipment finance market trend¹⁰

Market segmentation

The construction equipment financing market can be segmented into three parts on the basis of financiers involved viz Banks, NBFCs and Captive financiers. Of the three NBFCs control the major portion of the market. The banks mainly cater to the needs of large players and are reluctant to cater the needs of the small and medium sized players whereas NBFCs fulfil the fund requirements at all levels of the market. The MSME sector is

¹⁰http://www.atkearney.cz/transportation/ideas-insights/article/-/asset_publisher/LCcgOeS4t85g/content/road-map-to-success-for-the-construction-equipment-industry/10192?_101_INSTANCE_LCcgOeS4t85g_redirect=%2Ftransportation%2Fideas-insights

inclined mainly towards the NBFCs for the equipment financing. The market share of banks and NBFCs in the construction equipment financing market for the year 2014-15 and September, 2015 has been clearly shown in the following figure:

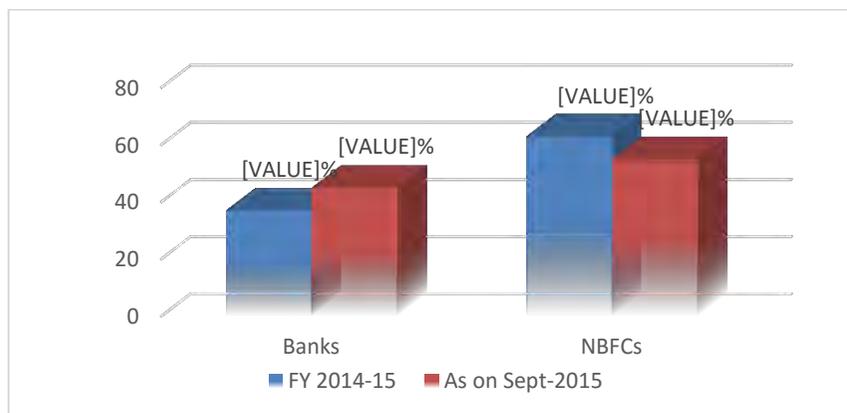


Figure 7: Share of banks and NBFCs in the construction equipment financing market

Market players

SREI Equipment Finance Ltd leads the construction equipment finance market with a market share of around 27% in FY 2012-13 followed by HDFC bank, Tata Capital and L&T. The share of various market players for the FY 2012-13 can be depicted through the following figure:

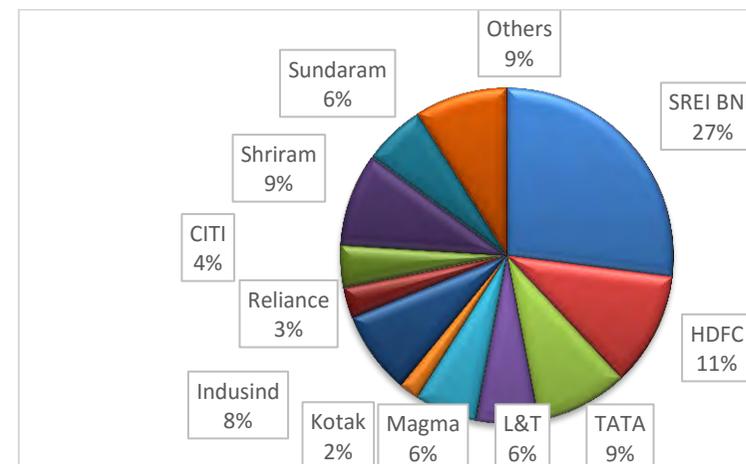


Figure 8: Financing market share of various market players for FY 2012-13

Among the NBFCs, as stated above SREI Equipment Finance Ltd continues to hold the largest share (about 30%) in the ECE financing market for the FY 2014-15 followed by Tata Capital and Sundaram Finance occupying 7% and 6% share of the market respectively. The financing market share for few major NBFCs for FY 2014-15 and estimated figures for FY 2015-16 have been shown in the figure below:

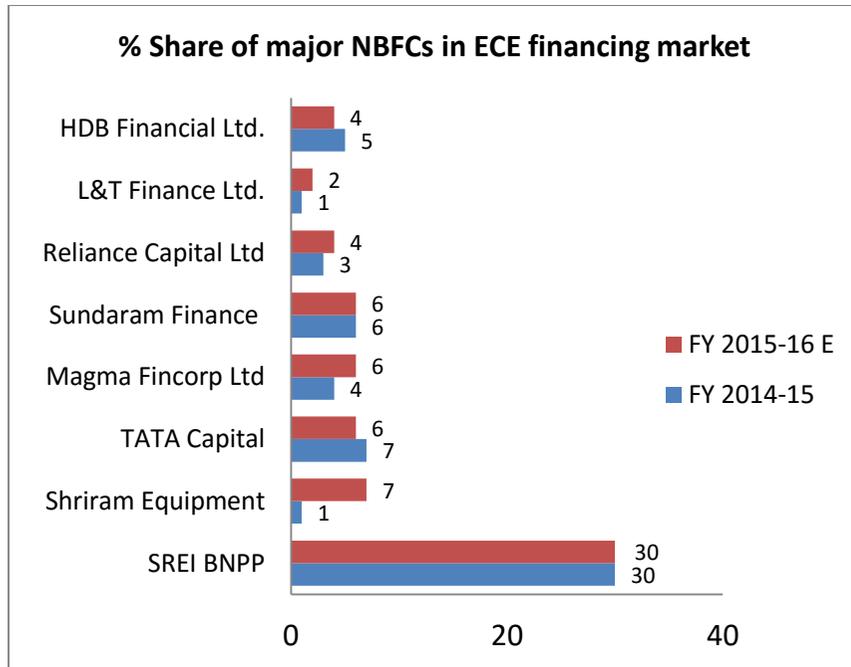


Figure 9: Market share of various NBFCs

Among the banks, HDFC bank leads the market with a market share of around 15% for FY 2014-15 followed by Indusind and ICICI bank having market share of 8% each for the FY 2014-15. The market share of major banks in the ECE financing market has been shown in the following figure below:

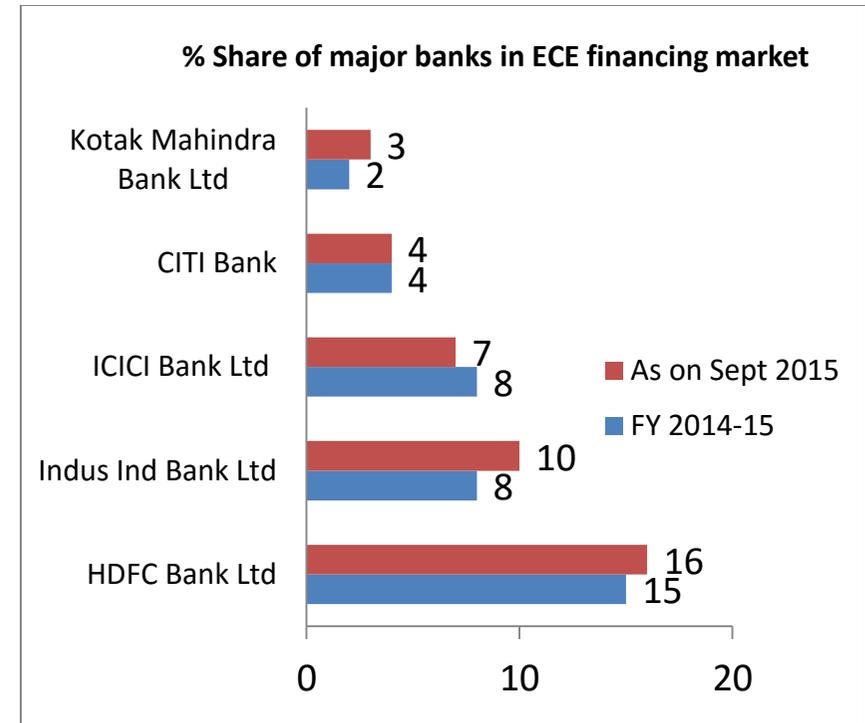


Figure 10: Market share of various banks



Construction equipment leasing and rental market

Introduction

Globally, leasing/rental of construction equipment is a well-established market as it is simple and cost effective way of financing. However, India's construction equipment rental market is underdeveloped as compared to other developing economies of the world. Earthmoving and construction equipment rental penetration rates in various countries around the globe have been shown below¹¹:

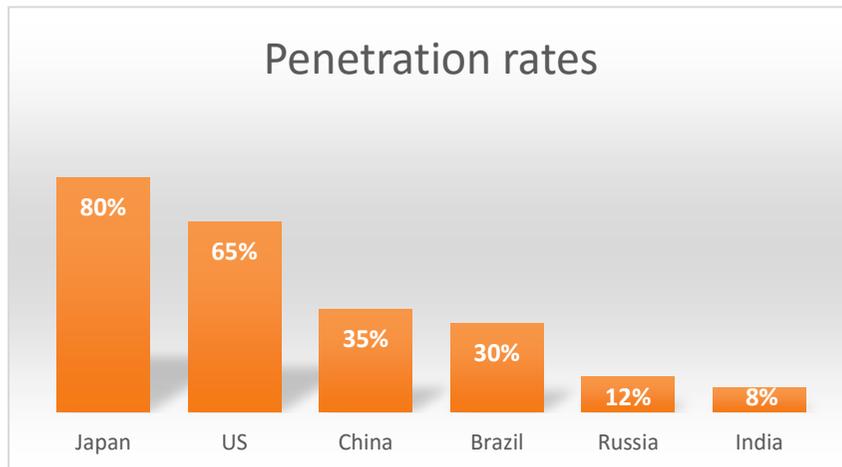


Figure 11: Construction equipment rental penetration rates

¹¹http://www.atkearney.cz/transportation/ideas-insights/article/-/asset_publisher/LCcgOeS4t85g/content/road-map-to-success-for-the-construction-equipment-industry/10192?_101_INSTANCE_LCcgOeS4t85g_redirect=%2Ftransportation%2Fideas-insights

Leases are gaining popularity because of tax benefits. There are two options available namely finance lease and operating lease. Only 3% of the total lease transactions are operating lease as the financial firms often cannot maintain the asset.¹²

Types of lease options

There are three types of products available in the equipment leasing market. They are as follows:

- a) **Fair market value lease** - This is the most common type of lease option which is used by an entity for acquiring equipment that tends to quickly depreciate in value. There are various options available to the lease at the end of the lease period like returning the equipment, renewing the lease or purchasing the equipment at its current fair value. Using this option, construction businesses can upgrade quickly to new equipment in an easy and cost effective manner.
- b) **Dollar buyout lease** - This option allows the lessees to purchase the equipment at the end of lease term for one dollar and is very effective for the entities who wish to retain the asset after lease term.

¹²<http://www.atkearney.in/documents/10192/4399341/Road+Map+to+Success+for+the+Construction+Equipment+Industry.pdf/44777e2a-7556-4da1-b07d-c6f0220a04e3>

- c) **Wrap lease** - Entities engaged in construction business often requires acquiring new equipment and this option provides an opportunity to simplify the process. Under this option, the lessees who have already taken an asset on lease for which the lease term has not yet expired can consolidate their remaining payments and roll them over to a new lease with additional equipment.

Opportunities and Challenges ahead

The construction equipment financing market in India is still developing. There are various reasons which act as a deterrent in its orderly growth which includes lack of easy access, unfavourable regulations and high NPA experiences by the lenders.

- a) **Lack of easy access** - Most equipment manufacturers do not have their captive financing arms and they engage in short term tie ups with banks and NBFCs. The first time buyers are prone to high margin requirements (nearly 20-30%) and shorter payback periods which worsens the situation.
- b) **Bad collection experiences** - Most of the finance users are MSMEs that depend on third party payments for repayment of the borrowed amount which leads to delay in collection and defaults. Further, the maximum finance business comes from NBFCs which suffers from bad collection experiences due to lack of regulatory support.
- c) **Unfavorable regulations** - According to CII report, indirect taxes on construction equipment in India are as high as 21-38% compared to 20% in France and Germany. Further lease
- d) transactions in India are also subject to Value added tax (VAT). Further the depreciation allowable on the equipment is 15% which is also low compared to falling asset life because of technological changes. Moreover, taxes are to be deducted at source on payments received by NBFCs which is not in the case of banks.
- e) **Lower rental penetration** - As discussed before rental penetration in India is as low as 7-8%. Used equipment and secondary sales is also very unpopular in India because of lack of established trading platforms and buyback schemes from OEMs. Above all the preference of ownership of asset also leads to lower penetration for rentals in India.

As construction equipment industry is very much dependent on the finance option for its growth, it becomes imperative to find solutions to overcome the various challenges posed by the financing market. Thus, initiatives shall be taken to bring about uniformity in the tax regulations, OEM supported financing should be encouraged and innovative products for financing shall be introduced. The purview of regulations like SARFAESI Act shall be increased to cover NBFCs so that they can get regulatory support to ease the collection process.

Upcoming trends in construction industry

The construction industry in India is on the path of growth driven by increase in infrastructure spending, increased investment in real estate projects etc. The upcoming trends in construction industry can be summarized as follows:

- a) **Growth pockets** - Earthmoving equipment will remain the biggest contributor in terms of value and volume. Road construction and real estate will remain the key growth drivers. Augmentation of highways and formation of smart cities across India will provide further thrust to the sector.
- b) **Shift in purchasing criteria** - There has been paradigm shift in the purchasing criteria from buying on the basis of upfront price to buying on basis of total cost of ownership (TCO). The buyers now look at the productivity capacity, comfort and fitness for use for the purpose of his business. Thus, owning, operating cost, fuel efficiency, availability of long term maintenance contracts and excellent after sales service will be critical purchasing criteria.
- c) **Technology trends** - The entry of global players in the industry has led to the need for upgradation of technology like remote access, more efficient machines etc. The IOT (Internet of things) could impact construction equipment industry considerably. IOT signifies a system in which objects can communicate internally or with outside entities. According to AEC Big data, equipment repairs represent the third largest cost in the industry. IOT helps to reduce this cost by enabling machine to detect the imminent need for repairs before it becomes a bigger problem.
- d) **Increased automation** - Social sector schemes and other factors are causing shortage of labour and increased cost of skilled and semi-skilled labour in the country. This has impacted the construction equipment industry and only if half the gap is filled up there will be a rapid increase in the demand for construction equipment.
- e) **Rise in equipment renting/leasing** - Construction companies are under a lot of pressure to trim their capital outlay and so there has been a spurt in demand for renting and leasing of construction equipment. Construction equipment leasing industry is expected to grow at the

rate of 30% over the next few years over the medium term. Several OEMs have already started dedicated teams for the rental/leasing services.

Disclaimer

The data collated is based on author's estimates, interviews conducted with the market participants and various publically available reports. Should there be any value addition you would like to do on perusal of the data or discrepancy on the information published, please write back to the authors to make necessary insertions/ deletions.

Vinod Kothari Consultants P Ltd

Kolkata

1006-1009, Krishna

224, A.J.C. Bose Road

Kolkata – 700 017



033 2281 1276/3742/7715



info@vinodkothari.com



www.vinodkothari.com/ www.india-financing.com

Mumbai

601-C, Neelkanth

98, Marine Drive

Mumbai – 400 002



022 2281 7427



bombay@vinodkothari.com

New Delhi

B-49, Panchsheel Enclave

New Delhi – 110 017



011 4131 5340



delhi@vinodkothari.com