FIRST LIGHT

24 August 2022

RESEARCH

BOB Economics Research | Industry and Capacity Utilization

Turnover to Asset ratio FY22

SUMMARY

India Economics: Industry and Capacity Utilization

India's economy has grown by 8.7% in FY22 after contracting by 6.6% in FY21. This does reflect a significant improvement on a negative base. However, the economy had only grown by 6.5% in FY19 and 3.7% in FY20 in pre-pandemic times; implying that while the revival story does remain intact the pace of growth may not be robust. To understand how industries have fared during these years, this study focusses on identifying possible alternatives to the concept of capacity utilization which is an indicator of optimal level of functioning of any company or industry. It is hence more indicative of progress than growth in production or net sales which are subject to base effects.

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Daily macro indicators

Indicator	21-Aug	22-Aug	Chg (%)
US 10Y yield (%)	2.97	3.01	4bps
India 10Y yield (%)	7.26	7.27	0bps
USD/INR	79.78	79.87	(0.1)
Brent Crude (US$/bbl)	96.7	96.5	(0.2)
Dow	33,707	33,064	(1.9)
Hang Seng	19,773	19,657	(0.6)
Sensex	59,646	58,774	(1.5)
India FII (US$ mn)	**17-Aug**	**18-Aug**	**Chg ($ mn)**
FII-D	11.2	0.7	(10.5)
FII-E	434.0	192.1	(241.9)

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

INDUSTRY AND CAPACITY UTILIZATION

23 August 2022

Turnover to Asset ratio FY22

Jahnavi Prabhakar
Economist

India's economy has grown by 8.7% in FY22 after contracting by 6.6% in FY21. This does reflect a significant improvement on a negative base. However, the economy had only grown by 6.5% in FY19 and 3.7% in FY20 in pre-pandemic times; implying that while the revival story does remain intact the pace of growth may not be robust. To understand how industries have fared during these years, this study focusses on identifying possible alternatives to the concept of capacity utilization which is an indicator of optimal level of functioning of any company or industry. It is hence more indicative of progress than growth in production or net sales which are subject to base effects.

What is Capacity Utilization and its alternative?

One of the important determinants of economic growth is Capacity Utilization, which is defined as ratio of actual output to capacity installed. It is also indicative of potential investment that can be invoked by a company as an optimal level when reached requires expansion in capital for future growth in output. Information of capacity utilization is however not easy to get as companies no longer need to reveal the same in their Annual Reports.

The only source of information is the OBICUS (order books, Inventories and Capacity Utilization) Survey conducted by RBI on a quarterly basis that sheds light on aggregate CU level. RBI indicates that higher CU levels along with higher order book highlights strong demand in the economy. Fig1 reflects the latest round of the OBICUS survey by RBI, wherein the Capacity Utilization in the manufacturing sector has risen to 75.3 in Q4FY22 from 72.4 in Q3FY22. It also need to be noted the CU levels have improved consecutively for 3-quarters in a row. In Q1FY21, the Capacity utilization in the manufacturing sector had fallen sharply to 47.3 led by lockdown restrictions imposed the government. However, with easing off restrictions and reopening of the economy, the capacity utilization began to improve steadily.

Alternatively an indicator that signals strength in the economy or can be used to determine CU levels can be the –fixed assets turnover ratio. This ratio measures the net sales (turnover) to fixed assets and estimates the ability of a company to generate sales from the fixed assets. While there can be no ideal level, an increase in the ratio of sales/GFA will indicate that companies or industries are operating at higher levels with a given level of capital stock. This study attempts to analyze the same comparing the ratio levels from 2019 onwards to 2022. The sample size of over 1365 firms have been taken and includes over 40 sectors. To maintain parity in terms of sectors relevant for capacity utilization, banks, insurance firms and rating firms have been excluded from the exercise.

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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