FIRST LIGHT

13 May 2022

RESEARCH

BOB Economics Research | CPI and IIP

Inflation spikes, IIP inching up

BOB Economics Research | Investment Scenario

Have investment intentions turned around?

Voltas | Target: Rs 1,250 | +28% | BUY

Strong strategy for southern market holds the key

Ceramics | Expert call

Demand moderation, cost inflation to hit Q1 margins

Daily macro indicators

Indicator	10-May	11-May	Chg (%)
US 10Y yield (%)	2.99	2.92	(7bps)
India 10Y yield (%)	7.3	7.22	(9bps)
USD/INR	77.32	77.24	0.1
Brent Crude (US$/bbl)	102.5	107.5	4.9
Dow	32,161	31,834	(1.0)
Hang Seng	19,634	19,825	1.0
Sensex	54,365	54,088	(0.5)
India FII (US$ mn)	**09-May**	**10-May**	**Chg ($ mn)**
FII-D	35.3	(201.3)	(236.6)
FII-E	(373.7)	(449.4)	(75.7)

Source: Bank of Baroda Economics Research

SUMMARY

India Economics: CPI and IIP

India's CPI rose to 7.8% in Apr'22 from 7% in Mar'22, reaching the highest level since May'14. This was driven by continued increase in food and fuel inflation. We expect RBI to hike repo rate by another 25-35bps in response to curtail spiralling prices. Industrial out in Mar'22 picked up by 1.9% from manufacturing output up by 0.8%. CPI inflation rose to 7% in Mar'221.5% in Feb'22. On an annual basis, production was up by record 11.3% in FY22, after registering a decline in the previous 2 years.

Click here **for the full report.**

India Economics: Investment Scenario

New project announcements in the manufacturing sector have improved significantly to Rs 6.2 lakh crore in FY22 versus Rs 3.2 lakh crore in FY20. This was led by improvement in machinery, chemicals and textiles. Services and construction sector still seem to be lagging from losses suffered during multiple waves of Covid-19 pandemic, with new project announcements running below their pre-pandemic levels.

Click here **for the full report.**

BOBCAPS Research
research@bobcaps.in

Voltas

- Analysis of AC/cooler ownership shows higher product penetration in North India while the South lags
- South India is VOLT's Achilles' heel where it has seen competitors pull ahead this summer, depleting market share in Q4FY22
- Formulation of a strong strategy for southern markets is paramount for VOLT to spur growth and regain ground. Maintain BUY

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Ceramics: Expert call

- Rising gas costs driving Morbi ceramic manufacturers to switch to propane which is 5% cheaper
- Tile exports is expected to improve in Q2FY23 led by lower freight costs; exports to double in four years
- Ceramic players to face near-term margin pressure owing to domestic demand slowdown and rising commodity cost inflation

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CPI and IIP

12 May 2022

Inflation spikes, IIP inching up

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Sonal Badhan
chief.economist@bankofbaroda.com

CPI climbs further up: CPI inflation rose to nearly 8 year high (8.3% in May'14) to 7.8% in Apr'22 (est.: 7.5%) from 7% in Mar'22. With this, the CPI print has surpassed RBI's mandate for the third consecutive month now. Food inflation rose further by 8.4% in Apr'22 (17-month high) from 7.7% in the previous month. Within food, prices of vegetables, fruits, spices, cereals and milk rose the most. Vegetable inflation remained elevated and in double-digit at 15.4% in Apr'22 (highest since Nov'20) compared with 11.6% in Mar'22. Fruit prices also rose by 5% from 2.5% last month and milk prices were up by 5.5% versus 4.7% in Mar'22. Price of cereals inched up by 6% from 5%, while that of spices were up by 10.6% from 8.5%. On the other hand, prices of protein based items (eggs, meat & fish), pulses and sugar moderated, albeit marginally. Continued disruption in global supply chain due Russia-Ukraine war and lockdowns in China are likely to keep food inflation higher.

Core inflation hardens: Core inflation rose by 66bps to 7% in Apr'22. The increase was board-based (barring personal care and effects). Significant jump was seen in fuel light component (10.8% versus 7.5% in Mar'22) and transport and communication (10.9% versus 8%). Apart from this, increase was also visible in prices of clothing and footwear (9.9% versus 9.4%), education (4.1% versus 3.6%), recreation & amusement (7.3% versus 7%)), health (7.2% versus 7%) and housing (3.5% versus 3.4%). Only personal care and effect index showed slight moderation (8.6% versus 8.7%).

Imminent rate hike: Given the trajectory of retail inflation with food and core inflation remaining elevated, we see a case for RBI hiking repo rate by another 25-35bps. Rising global inflation, depreciating rupee (contributing to imported inflation) and looming threat over EU's embargo on Russian oil makes our case stronger for a repo rate hike by RBI.

IIP growth inch up: Industrial output rose to 1.9% in Mar'22 from 1.5% in Feb'22 led by improvement in manufacturing electricity sectors. Manufacturing output rose by 0.9% in Mar'22 following 0.5% rise in Feb'22, while electricity production was up by 6.1% from 4.5% in the previous month. On the other hand, mining output eased to 4% in Mar'22 from 4.5% in Feb'22. On an annual basis, overall industrial production was up by 11.3% in FY22 compared with a decline of (-) 8.4% in FY21. This is the highest print in the current (2011-12) series. Notably, over a 2-year horizon, IIP index is 26.5% above the pre-pandemic level, signally recovery in economic activity. All sub-sectors have performed well with manufacturing output up by 29.6%, electricity by 30% and mining by 10.4%.

Primary goods strengthen: Within use-based classification, primary and consumer goods have registered an improvement. Primary goods clocked to 5-month high at 5.7% in Mar'22 from 4.6% in Feb'22. Consumer durables and non-durables also fell at slower pace of (-) 3.2% (-8.7% in Feb'22) and (-) 5% (-5.8% in Feb'22), respectively. However, output of capital, intermediate and infra goods moderated. Out of capital goods eased to 0.7% from 2% in Feb'22, while that of intermediate goods eased to 0.6% from 3.7%. Output of infra goods was down to 7.3% from 9.1% last month. On an annual basis, barring primary and consumer non-durables, all the other sectors registered double digit growth in FY22.

INVESTMENT SCENARIO

11 May 2022

Have investment intentions turned around?

Sonal Badhan
Economist

New project announcements in the manufacturing sector have improved significantly to Rs 6.2 lakh crore in FY22 versus Rs 3.2 lakh crore in FY20. This was led by improvement in machinery, chemicals and textiles. Services and construction sector still seem to be lagging from losses suffered during multiple waves of Covid-19 pandemic, with new project announcements running below their pre-pandemic levels.

Industry-wise investment analysis

New projects announced by non-financial companies, which includes manufacturing, mining, electricity, non-financial services, and construction & real estate, had jumped nearly 7x by FY09 to Rs 26.7 lakh crore from Rs 4.1 lakh crore in FY96. New projects announced since then have not been able to cross this peak, even though they had reached Rs 23.7 lakh crore by FY16. Between FY17-FY20, cost of new projects announced had averaged Rs 17.5 lakh crore. New project announcements had fallen to Rs 8.4 lakh crore in FY21 but recovered to Rs 14.3 lakh crore in FY22. However, this print is still below the pre-pandemic (FY20) level of Rs 18 lakh crore and also below FY15/16 levels.

Over the period, some notable deviations have been observed in the change in share of non-financial companies. In case of manufacturing, share of new projects announced had peaked at 54.4% in FY05, and since then has hovered at an average of 25.8% between FY06 to FY20. In FY20, new projects announced in the manufacturing sector had fallen to 17.8%, but rose sharply to 38.3% in FY21 and further to 43.5% in FY22. FY22 print is the highest since FY05. This could be the case as manufacturing sector was less hit by the subsequent waves of Covid-19, compared with services sector.

Within manufacturing, FY21 was a good a year (new projects announced increased) for all, except chemicals. Sharpest pick up in new projects announced (% share of non-financial companies) was witnessed in metals and metal products (18.4% versus 4% in FY20), followed by machinery (2.5% versus 0.9%), transport equipment (3.2% versus 1.7%) and consumer goods (1.8% versus 0.4%). However in FY22, results were mixed. While a significant increase in new projects announced was seen in machinery (8.3% versus 2.5% in FY21), chemicals (10.1% versus 8.7%) and textiles (1.3% versus 0.6%); a decline was visible in transport equipment (1.6% versus 3.2%) and consumer goods (0.8% versus 1.8%).

BUY

TP: Rs 1,250 | ⮝ 28%

VOLTAS | Consumer Durables | 12 May 2022

Strong strategy for southern market holds the key

- **Analysis of AC/cooler ownership shows higher product penetration in North India while the South lags**
- **South India is VOLT's Achilles' heel where it has seen competitors pull ahead this summer, depleting market share in Q4FY22**
- **Formulation of a strong strategy for southern markets is paramount for VOLT to spur growth and regain ground. Maintain BUY.**

Vinod Chari | Tanay Rasal
Someel Shah
researchreport@bobcaps.in

South India lags in cooling product ownership: Data from the latest National Family Health Survey (NFHS) 2019-21 pegs the national average penetration of ACs/ coolers at 23.7%, rising to 39.5% for urban areas but at just 15.8% in rural areas. Northern regions such as Chandigarh, Delhi, Haryana and Punjab have over 60% penetration, ~3x the national average. However, all the key southern states (Andhra Pradesh, Karnataka, Tamil Nadu, Kerala) are well below average, with Telangana, Goa and Puducherry being exceptions (Fig1). While the data doesn't separate ACs and coolers, our interaction with industry experts indicates AC penetration at 7-8%.

Market spread data holds the key for Voltas: VOLT's market share declined in Q4FY22 as South India, which has an early summer, formed a higher proportion of sales. The company's market share fell to 23.4% vs. 25.2% in FY21 as it ceded ground to Lloyd, Samsung and LG. VOLT has been traditionally strong in northern markets. However, going by the NFHS data, South India becomes a more important geography due to its lower ownership and resultant long runway for growth. We, thus, believe VOLT must formulate a more robust strategy for the southern markets.

Longer-term strategy for the South could rejuvenate growth: VOLT is optimistic of recouping its original market share of 25-26% by the end of summer, as sales in the North kick in. It has already gained share in the West and East this season. While the company is a leader at the pan-India level, we believe it must address its market share decline in the South, where growth potential appears higher. The company has mentioned redressing the issue through pricing, incentives and better subventions to take on competition.

Established leader; maintain BUY: VOLT has been a longstanding market leader commanding market share in the range of 21-26% for the past eight years (Fig 2). We believe its Q4 market share print of 23% is a blip and expect the company to recover some share as the season progresses. VOLT also enjoys the highest margins among peers and is better positioned to weather the ongoing supply chain constraints and input cost inflation, making it our top pick in the AC space. We value the stock at 50x FY24E EPS, a 40% premium to its 5Y average. BUY, TP Rs 1,250.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	VOLT IN/Rs 978
Market cap	US$ 4.2bn
Free float	70%
3M ADV	US$ 22.9mn
52wk high/low	Rs 1,357/Rs 953
Promoter/FPI/DII	30%/26%/28%

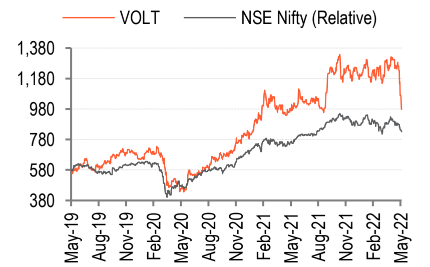
Source: NSE | Price as of 11 May 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	78,411	91,792	1,10,200
EBITDA (Rs mn)	5,861	8,308	10,902
Adj. net profit (Rs mn)	4,107	6,130	8,210
Adj. EPS (Rs)	12.4	18.5	24.8
Consensus EPS (Rs)	12.4	23.8	29.6
Adj. ROAE (%)	7.8	10.6	12.6
Adj. P/E (x)	78.8	52.8	39.4
EV/EBITDA (x)	54.3	38.3	28.9
Adj. EPS growth (%)	(3.6)	49.3	33.9

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

CERAMICS

13 May 2022

Expert call: Demand moderation, cost inflation to hit Q1 margins

- **Rising gas costs driving Morbi ceramic manufacturers to switch to propane which is 5% cheaper**
- **Tile exports is expected to improve in Q2FY23 led by lower freight costs; exports to double in four years**
- **Ceramic players to face near-term margin pressure owing to domestic demand slowdown and rising commodity cost inflation**

Ruchitaa Maheshwari
researchreport@bobcaps.in

We interacted with Tapan Jena, Founder of SANVT Ceramics, to gain a perspective on the ceramic industry's growth prospects and gas cost outlook. Key takeaways:

Long-term gas costs up by ~30%: Gas forms 30-35% of the total production cost for ceramic manufacturers. Long-term gas cost has risen from Rs 52-53/scm levels over the last 3-4 months to Rs 68/scm plus taxes currently and forms 80% of contractual quantity. The additional 20% is purchased on spot basis. The industry has been able to pass on 60% of the cost inflation. Going forward, however, companies will find it difficult to take price hikes and will thus face margin pressure in Q1FY23.

Morbi industry enhancing gas-to-propane switching facilities: With propane prices at a 5% discount to gas currently, many players have switched to this alternative fuel to curb rising fuel costs. Propane costs are expected to fall by a further 5-7% next year which will, in turn, push down gas prices.

Tile industry expected to grow 12-15% in FY23: India is the second largest tile manufacturer after China with a Rs 500bn market (up >10% from last year), of which Rs 13bn-14bn is branded (40% met through Morbi) and the balance is unbranded. The industry is expected to grow at 12-15% in FY23.

Tile exports to double in four years: Tile exports have risen to Rs 12.7bn now compared to Rs 12.5bn in FY20, supported by a 15% jump in volumes even as realisations declined. While Q1FY23 will likely face sluggishness in exports and realisations, Q2 should see a revival as freight costs expects to ease. Further, tile exports are expected to double in the next four years.

Ceramic players to face margin pressure in Q1: Post Covid, the ceramic industry witnessed strong pent-up demand which allowed players to take multiple price hikes. Real estate demand has been robust which increased the churning of old inventory. Though, the rising cost inflation have hindered new construction activity over the last six months. However, players have been unable to fully pass on the rising commodity costs. Margins will thus remain under pressure.

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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

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