

FIRST LIGHT

05 January 2023

RESEARCH

CAPITAL GOODS | Q3FY23 PREVIEW

Momentum to continue

CONSUMER DURABLES | Q3FY23 PREVIEW

Expect a tepid quarter

SUMMARY

CAPITAL GOODS: Q3FY23 PREVIEW

- Investments resilient led by traction in private capex; manufacturing sector continues to dominate new project announcements
- Order momentum seen in H1 expected to continue in Q3 as well; operating margins to sustain
- Expect aggregate revenue/earnings growth of 11%/19% YoY. LT, SIEM, POWERIND and AIAE remain top picks

[Click here](#) for the full report.

CONSUMER DURABLES: Q3FY23 PREVIEW

- Q3 to remain lacklustre on muted demand post festive season and little scope for price hikes
- Expect 14% YoY topline growth for our coverage led by higher volumes, but a modest 9% YoY rise in bottomline as RAC players lag
- Maintain preference for category leaders – HAVL, POLYCAB and DIXON

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Daily macro indicators

Indicator	02-Jan	03-Jan	Chg (%)
US 10Y yield (%)	3.87	3.74	(14bps)
India 10Y yield (%)	7.33	7.32	(1bps)
USD/INR	82.75	82.89	(0.2)
Brent Crude (US\$/bbl)	85.9	82.1	(4.4)
Dow	33,147	33,136	0.0
Hang Seng	19,781	20,145	1.8
Sensex	61,168	61,294	0.2
India FII (US\$ mn)	30-Dec	02-Jan	Chg (\$ mn)
FII-D	13.2	(0.7)	(13.8)
FII-E	(430.0)	201.1	631.1

Source: Bank of Baroda Economics Research

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Investments remain resilient: New project announcements in India soared 45% YoY to Rs 6.1tn in Q3FY23, including private capex of Rs 5.6tn, per CMIE. Private sector investments have continued to pour in since Q2FY23, as evidenced by LT's order mix (29% from the private sector in Q3 vs. 18-20% historically). Further, CMIE indicated that fixed asset utilisation has spiked to 2.4x as of Sep'22 compared to an average of 1.9x since Mar'10, implying imminent capex.

Order momentum to continue: We expect the order momentum seen in H1FY23 to continue in Q3 as well. LT has a robust order pipeline of Rs 6.3tn for H2FY23, and KECI's stands at a healthy Rs 1.2tn. As for product-based players, SIEM and ABB remain positive on capex programmes marked by a focus on digitalisation, decarbonisation and energy efficiency solutions. LT has announced orders in the range of Rs 185bn-395bn for the December quarter. Assuming a 50% disclosure rate, this implies potential order inflow of Rs 550bn+.

Margins to remain stable: We pencil in revenue growth of 11% YoY for our capital goods coverage on the back of strong execution and sustained order inflows over the last year and a half. We expect a flat EBITDA margin YoY and QoQ at 11.1% as supply chain constraints linger. Working capital is likely to remain stretched as commodity prices haven't eased as much as expected, pushing up inventory levels. Higher interest cost is also likely to hurt EPC players.

Exports the weak link: Given the global slowdown, we expect exports to have weakened in the December quarter. KKC (export revenue share of ~25%) is likely to be impacted. ABB and SIEM would be relatively shielded due to their lower export mix and could indeed benefit from increased outsourcing to India as customers seek to optimise costs. Meanwhile, LT's hydrocarbon business remains strong in the Middle East, accounting for 22% of its order inflows in H1FY23.

Picks: LT, SIEM, POWERIND, and AIAE remain our top picks in the sector. For details, please refer to our initiation report of 21 Nov 2022, [On the cusp of a capex supercycle](#), and also our latest update on [SIEM](#).

Recommendation snapshot

Ticker	Price	Target	Rating
ABB IN	2,689	3,100	HOLD
AIAE IN	2,600	3,100	BUY
KECI IN	474	500	BUY
KKC IN	1,396	1,300	HOLD
LT IN	2,089	2,390	BUY
POWERIND IN	3,372	3,600	BUY
SIEM IN	2,837	3,500	BUY
TMX IN	1,956	2,100	HOLD

Price & Target in Rupees | Price as of 3 Jan 2023



CONSUMER DURABLES

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Tepid quarter: We expect a dull Q3FY23 for our consumer durables universe given lower volume offtake following the festive season. The initial phase of the season was strong but demand lacked vigour in the later phase, per our industry interactions. Premium products saw buoyant sales, but the entry-level segment remains distressed. Taking cognizance of competition, industry players refrained from price hikes and chased market share over margin gains. With uncertainty in China amid a surge in Covid cases, players are operating at high inventory levels (75-90 days vs. the usual 40-45).

Volumes over value: With no price hikes undertaken by the room AC (RAC) industry, topline growth for these players is likely to be volume-led in Q3. The scope for pricing action (post-Jan) has been dimmed by rising competition in the industry. Among electronics manufacturing services (EMS) players, we foresee a resilient topline with the highest YoY growth in our coverage, but the uncertainty rises near term on lower volume pickup from mid-Q3. Electrical players are expected to post a modest 3Y revenue CAGR, though the fans segment is likely to be muted due to the label change. We expect cables & wires players to witness better demand traction led by a capex push.

Margins likely to bottom out: Operating margins for our coverage stocks are likely to lag YoY but should post a sequential pickup led by lower commodity prices. We anticipate gradual sequential recovery in margins from Q4 onwards.

Long-term prospects bright: Most industry players anticipate a better H2FY23 marked by margin expansion and demand revival. This is corroborated by the Consumer Electronics & Appliances Manufacturers Association (CEAMA), which expects the upbeat growth rate of CY22 to continue in CY23 (value growth of ~35% in CY22). The sustained capex drive (by VOLT, BLSTR, AMBER) amidst uncertainty over Chinese supply suggests the ongoing concerns are transient in nature.

Maintain picks: We maintain our top picks of **HAVL** (BUY, TP Rs 1,500) – better placed for energy rating transition in fans with higher premium segment contribution, **POLYCAB** (BUY, TP Rs 3,300) – insulated from recent reversal in commodity price, and **DIXON** (BUY, TP Rs 5,200) – proxy to robust growth prospects in EMS sector.

Recommendation snapshot

Ticker	Price	Target	Rating
AMBER IN	1,873	2,100	HOLD
BLSTR IN	1,205	1,350	HOLD
CROMPTON IN	347	500	BUY
DIXON IN	3,922	5,200	BUY
HAVL IN	1,128	1,500	BUY
KEII IN	1,515	1,900	BUY
ORIENTEL IN	263	280	HOLD
POLYCAB IN	2,591	3,300	BUY
SYRMA IN	278	390	BUY
VGRD IN	262	250	HOLD
VOLT IN	808	950	HOLD

Price & Target in Rupees | Price as of 3 Jan 2023



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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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