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MACRO & MICRO

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India at takeoff point

- **India poised for secular uptick in per capita income as underlying building blocks now largely in place**
- **Capex cycle still about two years away – initial recovery likely to be led by the consumption sector with industrial revival back-ended**
- **Recommend careful stock selection and a sector-led investment approach; prefer consumer and IT**

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India on track for secular rise in per capita income: India's population growth has moderated to ~1% – a level at which several developed economies have seen an acceleration in per capita income levels. While higher growth has its own demographic dividends, we believe the population of a country should be proportional to its resources and hence moderation in India's population curve is a positive. This coupled with several government-led reforms over the last 7-8 years indicates that India will likely see a faster uptick in per capita income during this decade.

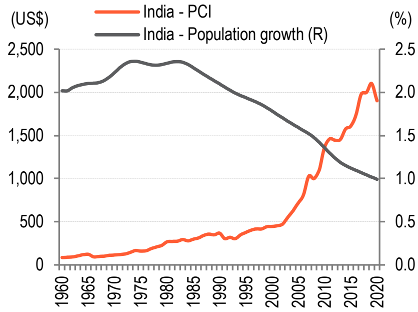
Capex cycle delayed: Our analysis indicates that the country's capex cycle could remain muted for another 18-24 months amid excess capacity in several sectors. Capex will continue to be dominated by the Centre, states and public sector till private sector capex picks up. Our channel checks suggest that several corporates are now contemplating large-scale expansion but remain in the planning stage. We expect a bulk of this outlay to be incurred over FY24-FY26. The consumption sector will likely continue to grow ahead of GDP in the near term given a rebound arising from Covid-related easing, robust agri production, rising employment and subsidy payouts.

IPO conundrum: A spate of listings has raised ~Rs 1.3tn over the last two years but just about 1.3% of the proceeds are earmarked explicitly for new capex. This doesn't augur well for a quick, near-term recovery in the capex cycle.

Time to be selective: Given lingering worries over inflation-induced tapering and tightening globally, we believe it is time to be selective and to focus on stocks with better risk-reward tradeoff. Moreover, given global headwinds, we would prefer large-caps over small-caps near term.

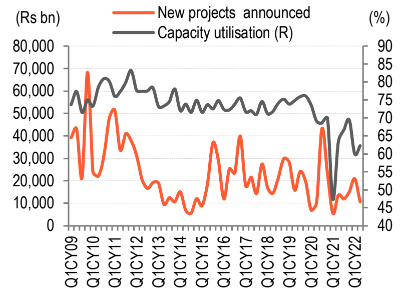
Prefer consumer and IT sectors: We have built a sector-wise investment matrix capturing both fundamental and financial parameters to aid in stock selection. We believe near term, consumption-led GDP growth will have a better outcome for consumer discretionary players and retail-focused lenders. The IT sector will continue to gain from digitisation. Commodities are likely to start reverting to their mid cycle while banks should see limited near-term impact from fintech firms.

India per capita income vs. population growth



Source: BOBCAPS Research, World Bank

Capacity utilisation vs. private capex



Source: CMIE, BOBCAPS Research

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Sustainable growth round the corner

Industrialisation opened the door to per capita income growth in western countries, manufacturing spurred growth in China, while a boom in construction and digitisation drove incomes in Korea. We believe a combination of these factors coupled with moderation in population growth, large-scale reforms and expansion of the digital ecosystem will launch India onto a new growth trajectory.

Note that basic building blocks now largely in place include 24-hour electricity, road/rail connectivity, affordable housing, food security, basic healthcare facilities and better hygiene. Rollout of potable water connectivity is currently underway and will further raise the standards of living. Education levels and school availability have also risen significantly.

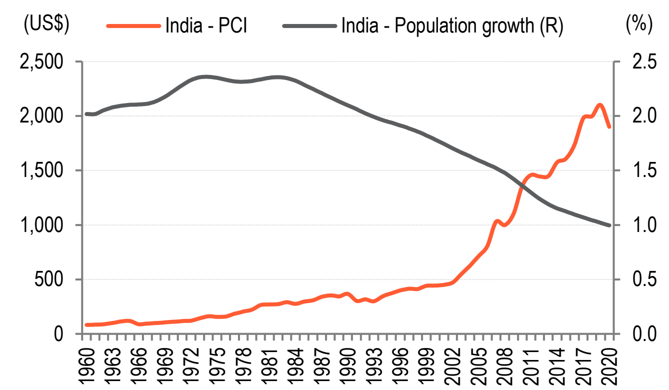
That said, a secular rise in India's per capita income can only follow a sharp capex upcycle. Given excess capacity, we believe conditions will be ripe for a new wave of capex once utilisation touches 75% – likely in about two years from now. Till such time, we expect continued buoyancy in consumer discretionary and export-related sectors such as IT and chemicals. We remain positive on the broader index but believe it would move only slightly ahead of nominal GDP, with Nifty returns in the low teens during FY23 and FY24.

India at the cusp of a secular income uptick

Population growth reaching an optimum level

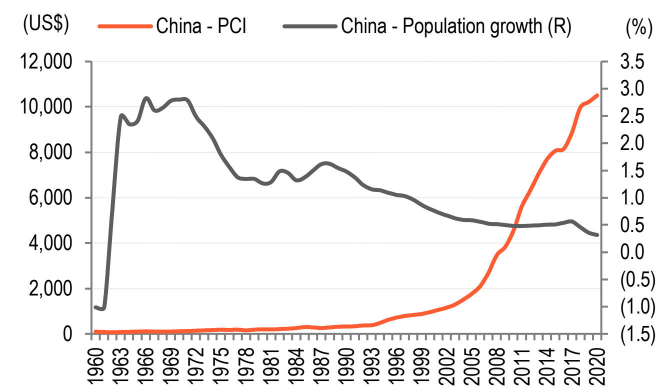
One of the strengths of the Indian economy has been its demographic dividend, with the adult population forming about two-thirds of the total. However, population growth has been moderating and is now at just ~1% per annum. Interestingly, the experience of several countries shows that the trajectory of per capita income rises sharply after annual population growth moderates to roughly 1%.

Fig 1 – India



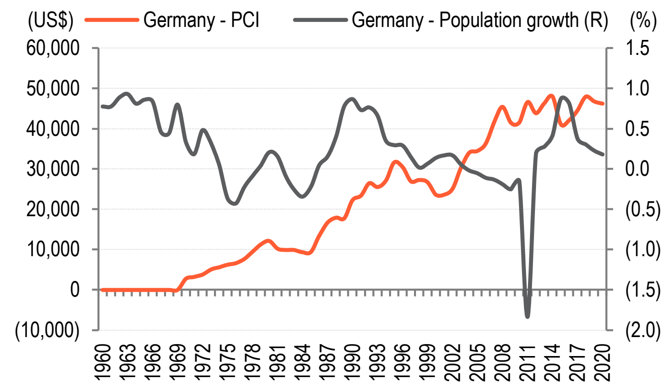
Source: BOBCAPS Research, World Bank

Fig 2 – China



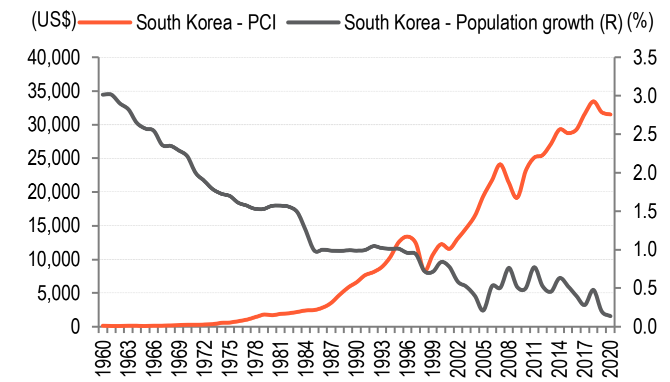
Source: BOBCAPS Research, World Bank

Fig 3 – Germany



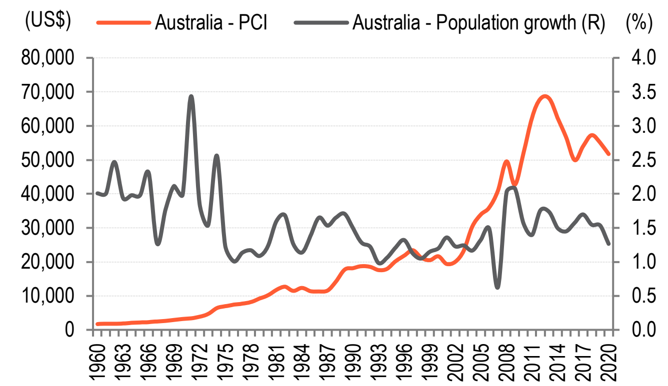
Source: BOBCAPS Research, World Bank | PCI – Per Capita Income

Fig 4 – South Korea



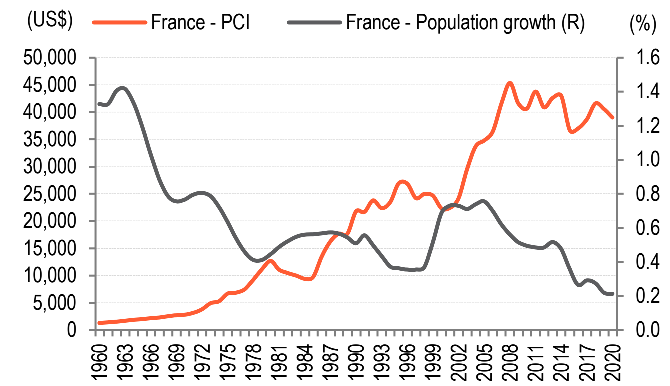
Source: BOBCAPS Research, World Bank

Fig 5 – Australia



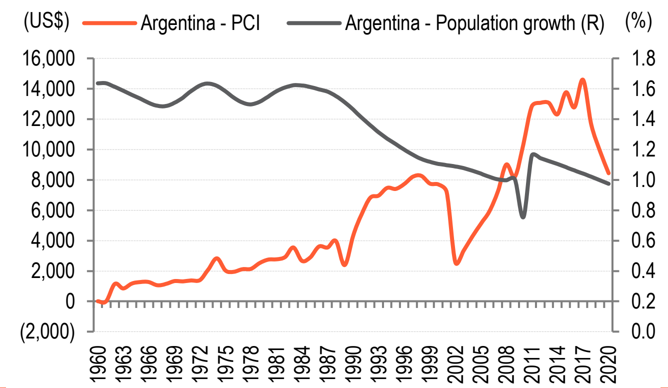
Source: BOBCAPS Research, World Bank

Fig 6 – France



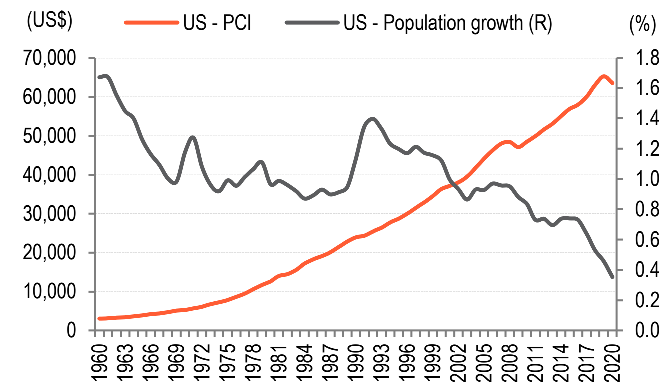
Source: BOBCAPS Research, World Bank

Fig 7 – Argentina



Source: BOBCAPS Research, World Bank

Fig 8 – United States



Source: BOBCAPS Research, World Bank

Improving indicators

Several reforms undertaken in India over the last decade have created a sustainable framework for economic growth with the relevant building blocks for expansion in income levels now largely in place. Evidence of improvement in some of the important indicators are outlined below:

Fig 9 – Building blocks for growth

Parameter	FY11	FY21
Electricity deficit (%)	10	0
Mobile internet users (mn)	2.3	825
Roads (mn km)	4.3	5.3
Rail ('000 km)	65	68
Bank account penetration (%)	52	85
CBSE Class 10 candidates (nos.)	1,061,566	2,097,128
Secondary schools (nos.)	128,370	151,459
Number of MBBS seats	38,400	88,150*

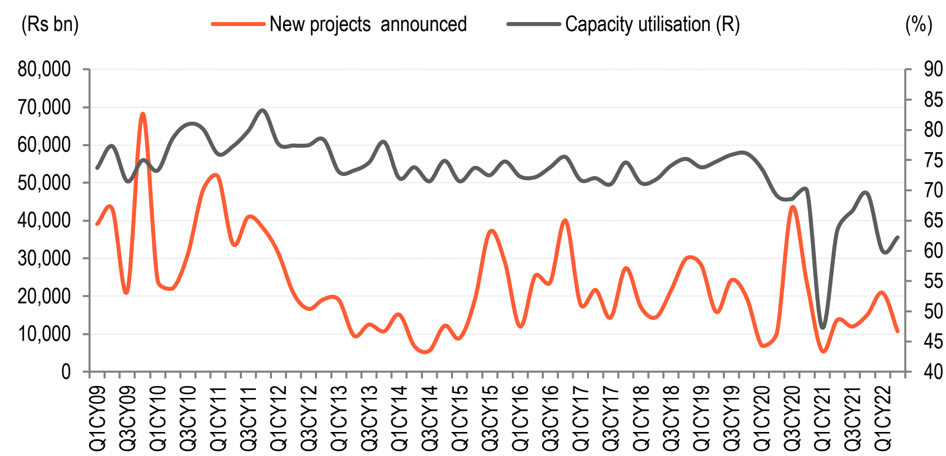
Source: BOBCAPS Research (*FY22)

Rural India forms ~65% of the total population but the percentage of people depending on agriculture has steadily declined from more than 60% before the 1991 reforms to just ~42% now. Interestingly, overwhelming anecdotal evidence suggests that migrant labour availability in metro has been decreasing, further indicating that local employment opportunities are on the rise.

Capex cycle still a few years away

As per RBI data, current capacity utilisation across manufacturing sectors is ~65%, well below the 75% level we believe is needed for a resurgence in the capex cycle. Further, data from CMIE indicates that private capex has largely stagnated. The bulk of new capital expenditure is coming from the state and central governments and PSUs.

Fig 10 – Capacity utilisation vs. private capex



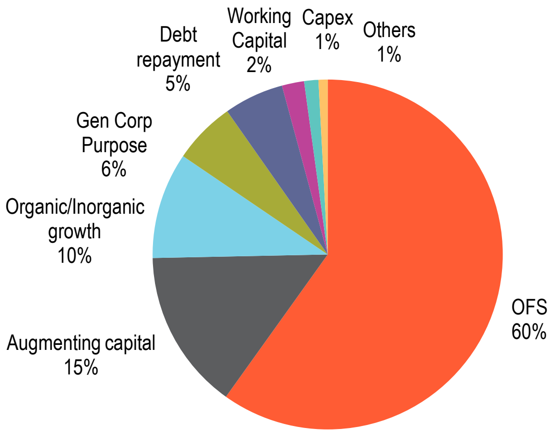
Source: CMIE, BOBCAPS Research

We believe implementation of a stronger debt resolution framework that favours a change of promoter as a precondition for resolution has lowered the incentives for new, large-scale projects with higher risk. Though a healthy reform, it comes at the cost of animal spirits in the capex cycle. Another key change that has acted as a dampener is the absence of protected margins that can be traced to the discretionary/preferential allocation of natural resources in the past that granted the licensee visible commercial advantages.

IPO conundrum

Our analysis of initial public offerings since 2020 shows that companies and promoters have raised ~Rs 1.3tn, but a mere 1.3% of the proceeds has been explicitly earmarked towards new capex.

Fig 11 – Use of IPO proceeds

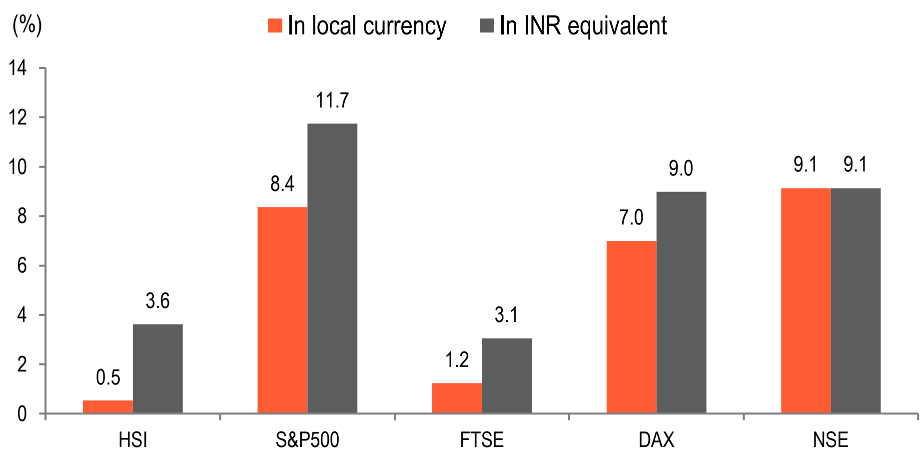


Source: BOBCAPS Research, Company

Broader market has pockets of excesses and moderation

The Nifty's one-year forward P/E multiple is about +2 standard deviations above its last 10-year average, putting the index in the overvalued zone. However, other major global indices, particularly US-based ones, have also seen their forward multiples rise due to the influx of liquidity, nominal cost of funds and substantial stimulus, most of which has found its way into equity markets. We remain constructive on the Nifty but believe it would move only slightly ahead of nominal GDP, with returns in the low teens over FY23E and FY24E.

Fig 12 – Indian markets have consistently outperformed most major global indices (10-year CAGR)



Source: BOBCAPS Research, Bloomberg

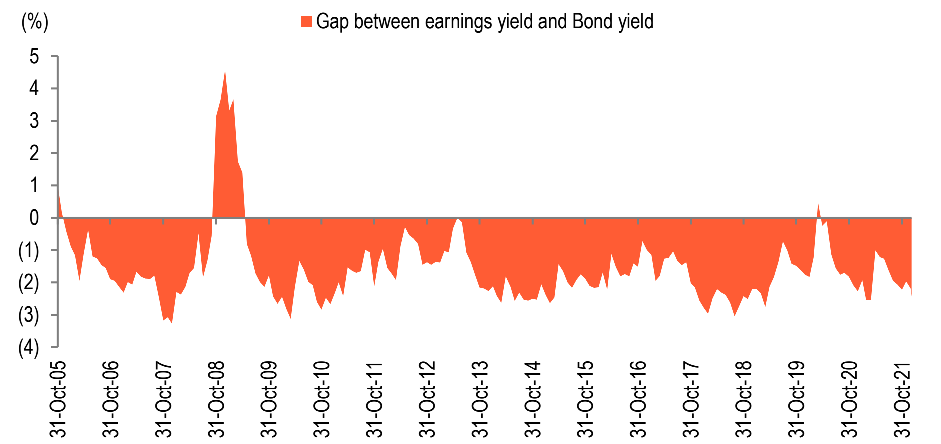
IT valuations have soared while infrastructure lagged

IT and consumer durables are among the sectors that have seen multiples move well ahead of their historical averages. We believe earnings visibility in the IT space is higher than that in most other sectors given the exponential rise in digitisation across industries. As such, despite a muted capex cycle, we expect to see continued buoyancy in hygiene-related sectors such as healthcare and consumer durables and export-related sectors such as IT and chemicals.

Gap with bond yield has worsened further

Earnings yield has trailed bond yield for most of the last 15 years. However, the gap has further widened though is still above all-time lows.

Fig 13 – Gap between earnings yield (Nifty) and bond yield (10Y GoI)



Source: BOBCAPS Research, Bloomberg

Stock selection is key

India's market capitalisation as a percentage of GDP is now close to 120%, higher than previous peaks. This, coupled with the likelihood of an increase in interest rates, implies it is time to be selective while picking stocks. We also believe that given these headwinds including global ones, it is prudent to prefer large-caps over small-caps.

Risks to market performance

Slowdown in China

A combination of pandemic-related shutdowns, a troubled real estate sector, moves towards a distributive economy, and energy transition has resulted in a perceptible slowdown in China. Many businesses are facing regulatory headwinds designed to rein them in. The World Bank has lowered China's 2022 GDP growth forecast to 5%, the lowest in 30 years (excluding pandemic impacted 2020).

Another aspect to note is the impending Winter Olympics in China scheduled from 4 Feb to 20 Feb 2022. Given several controversies in the run-up to the games, China would want to steer the event in a seamless manner. This would mean the strictest of Covid-related restrictions and also environment-related ones. We expect China to revoke some of these restrictions after the Winter Olympics which will potentially stimulate the wider economy. This would mean an inflationary impact on fuels and metals and a deflationary impact on finished goods and intermediates such as chemicals.

In our view, China's growth will soften this year, posing headwinds to global growth including that of India. However, a slowing China also gives India an opportunity to contain its negative trade balance and tap into the now popular 'China Plus One' strategy.

Tapering and liftoff

Most major central banks have either started raising rates or intend to do so. Consumer inflation in the US, which was labeled "transient" by the US Fed, is proving sticky due to pandemic-led supply chain issues, ample liquidity and hefty stimulus. Consequently, the Fed has already accelerated tapering and is likely to end bond purchases by Mar'22. The dot plot indicates three hikes totaling 75bps during FY22 as per median projections, with the federal funds rate at 75bps by the end of 2022, 150bps by end-2023, 200bps by end-2024 and 250bps over the longer term.

One of the consequences of rising interest rates would be an increase in cost of capital and hence lower valuation multiples. A winding down of bond purchases will compress liquidity with the attendant impact on risk-on trades, in turn dulling investment appetite for emerging markets. This could impede FII inflow into India.

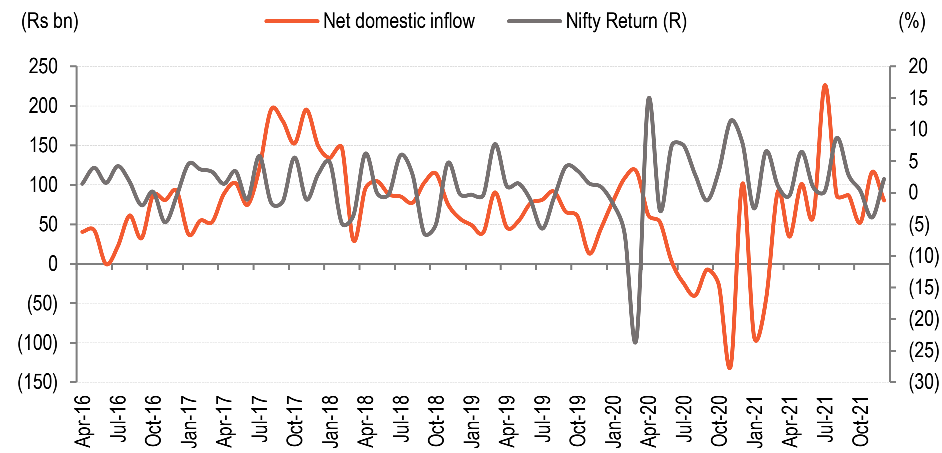
We believe there are four possible scenarios related to the US macro climate:

Scenario 1	In this scenario, interest rate rises in the US, but the extent of the increase is limited by carry trade with major currencies such as the euro and yen. If the US dollar continues to strengthen against the euro, the Fed may not be required to pursue aggressive rate hikes.
Scenario 2	The US Fed's narrative of considering quantitative tightening and an aggressive rate liftoff is believed by the market and has the desired impact on inflation, yield moves up moderately in the interim, the USD strengthens and the Fed therefore does not need to tighten aggressively.
Scenario 3	Inflation remains high and forces the Fed to tighten sharply. Note the regulator has already indicated not only a liftoff but also higher likelihood of tightening. This scenario is currently a base case for several market participants.
Scenario 4:	Inflation rises and remains sticky at higher levels. The Fed's monetary actions fail to combat inflation. Interest rate climbs significantly and the USD depreciates against major global currencies. The US economy faces strong headwinds and slows down appreciably with a domino impact on global markets. This is a black swan event and we ascribe low probability to this scenario.

Our base case is Scenario 1, implying we see upside risk to the market's base case.

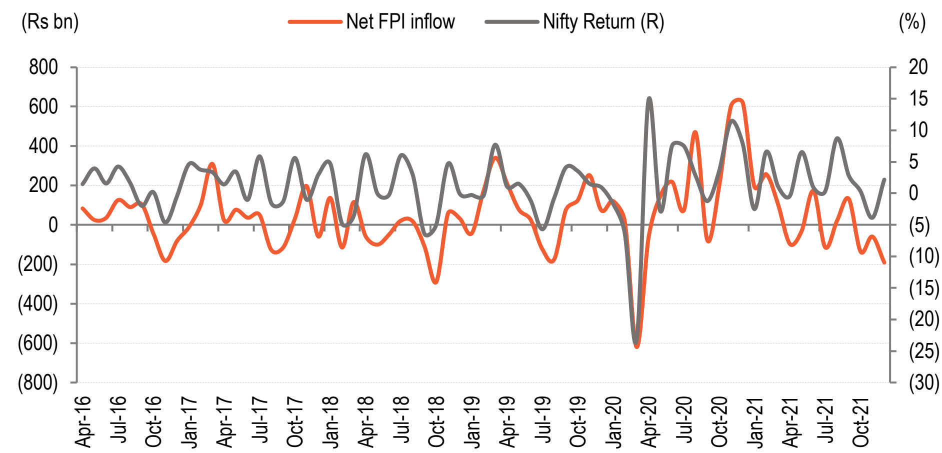
Note that domestic money is steadily flowing into equity in India, in part due to a lack of other viable investment options. We believe investments in mutual funds and direct purchases of equity will remain robust, partly offsetting lower FII inflow in 2022, if any.

Fig 14 – Net domestic inflow and Nifty return



Source: BOBCAPS Research, AMFI, NSDL

Fig 15 – Net FPI inflow and Nifty return



Source: BOBCAPS Research, AMFI, NSDL

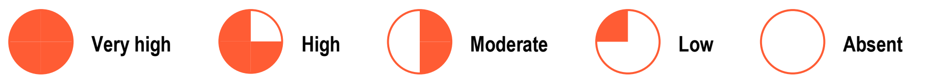
Sector view

As Covid-19 restrictions ease, we expect a rebound in consumption-led GDP growth, which will offer better outcomes for consumer discretionary players and retail-focused lenders. The IT sector will continue to gain from the digital ecosystem. Commodities should start reverting to their mid cycle while the banking sector will likely see limited impact from fintech players in the near term, in our view.

Given global inflation and taper headwinds, we prefer a stock-specific investment approach over a macro-led theme. We have, therefore, created a sector-wise investment matrix that captures both fundamental and financial parameters for the stocks in various sectors – in turn lending insights into their risk-reward profiles and enabling stock selection.

Our matrix uses a five-point scale (as shown in Fig 16 below) to rate various business/ subjective parameters. We have also included relevant numerical values for other metrics, wherever appropriate. Investors may deploy a combination of these two sets of parameters to rate/grade stocks based on their individual risk tolerance.

Fig 16 – Five points scale



Source: BOBCAPS Research

Automobiles – new launches and EV are key

India's US$ 75bn automobiles sector represents one of the economy's best success stories. The sector gains not only from underlying economic growth but also from an increase in per capita income in the country. As a result, it has grown ahead of nominal GDP over the last decade and we expect this trend to continue.

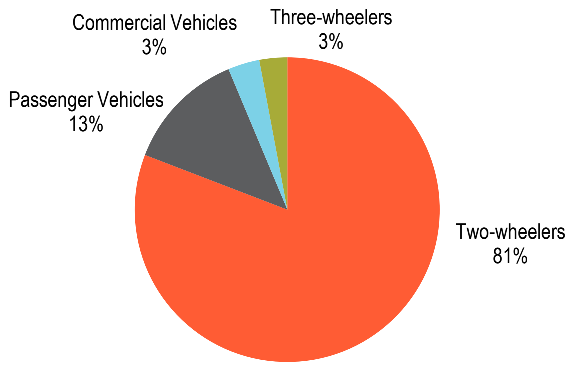
The auto industry sells ~26mn vehicles in India (and exports 5mn), including passenger vehicles, commercial vehicles, three-wheelers and two-wheelers. Industry volumes are dominated by two-wheelers. Nevertheless, we estimate that passenger vehicles account for over 40% of industry revenue with commercial vehicles and two-wheelers at almost similar levels of 25-27% each, while three-wheelers account for a low single-digit percentage.

In terms of the ongoing transition to e-mobility, most OEMs have indicated their preparedness for the shift. We note that automakers have consistently been able to improve product quality to meet relevant regulatory requirements.

Expect sustained growth over mid-to-long term

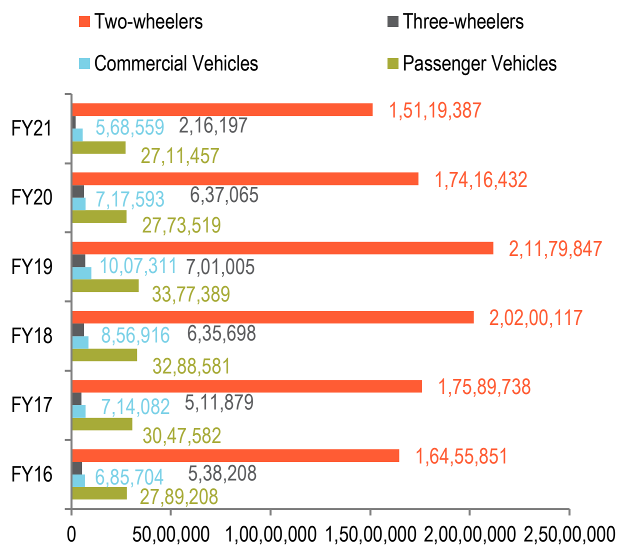
While transition to the EV ecosystem is likely to progress smoothly with little risk to the sector's outlook, electrification of public transport does carry long-term headwinds for the sector. Nevertheless, we expect sustained growth for the auto industry over the medium-to-long term buttressed by rising income levels, a post-pandemic rebound and the growing availability of green vehicles. In our view, a robust pipeline near term and an effective shift to EVs over the medium-to-long term will be key success factors.

Fig 17 – Domestic sale volumes by vehicle type



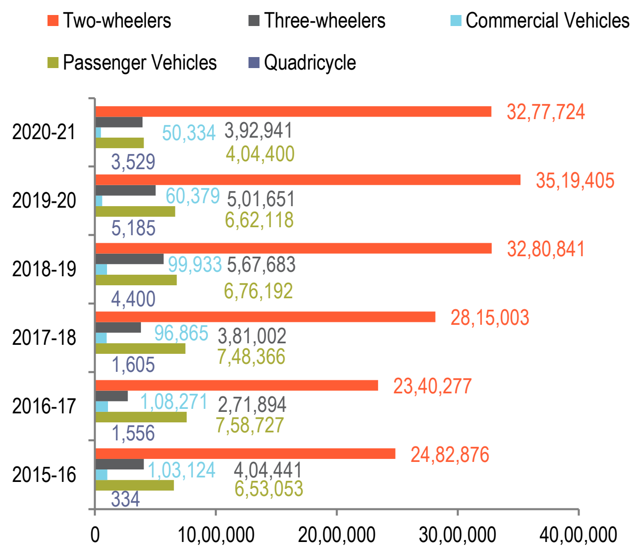
Source: SIAM, BOBCAPS Research

Fig 18 – Domestic auto sales



Source: SIAM, BOBCAPS Research

Fig 19 – Auto exports



Source: SIAM, BOBCAPS Research

Fig 20 – Auto stock matrix

Company	Product suite	Distribution	Pipeline	Brand	EBITDA Margin FY23E (%)	EPS FY24E YoY (%)	P/E 1Y fwd (x)
Tata Motors	Very high	Very high	Moderate	High	13	40	19
Hero MotoCorp	Moderate	Very high	High	High	13	13	13
Maruti Suzuki	High	Very high	High	High	10	25	30
Bajaj Auto	High	Very high	Moderate	High	17	15	16
Eicher Motors	Moderate	Moderate	Low	Very high	24	17	27
Mahindra & Mahindra	High	Very high	High	High	17	5	18
Escorts	Moderate	High	Low	High	14	18	22
TVS Motor	Moderate	High	Moderate	High	10	18	24
Ashok Leyland	Moderate	Moderate	Absent	High	8	5	27

Source: Bloomberg, BOBCAPS Research

Very high High Moderate Low Absent

Banks – leaving stress behind

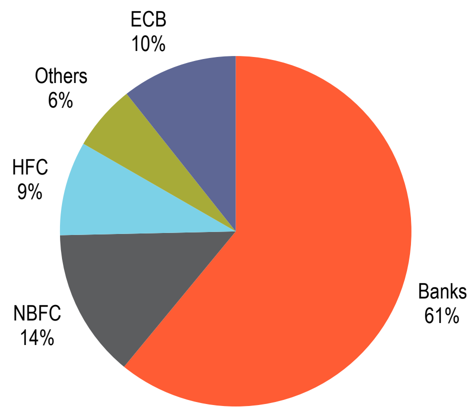
Low credit penetration

Indian banks have played a key role in formalising the economy. However, their business model has faced challenges every few decades, initially from development finance institutions, then from non-banking finance institutions (NBFC) and now financial technology (fintech) startups. Nevertheless, a combination of enabling regulations, customer stickiness, access to low-costs deposits and preferential access to government business has meant that the banking sector has emerged stronger, save for some public sector banks that had to be restructured, merged or consolidated due to their stressed assets.

NBFCs have largely filled the gaps left by banks due to limitations of the latter's reach. Banks preferred lending to NBFCs rather than taking direct exposure to end borrowers in such cases. NBFCs have also helped create a robust retail credit ecosystem (excluding mortgage), which banks are now gradually expanding into.

India's credit market currently totals ~Rs 180tn or ~0.8x of GDP, which is substantially lower than most large economies, implying low credit penetration and significant scope for loan growth. In contrast, most developed economies have private debt at 150-200% of GDP with some notable exceptions.

Fig 21 – Credit market



Source: RBI data, BOBCAPS Research

Fintech – friend or foe?

Banks and investors are grappling with the increasing use of technology across the monetary system. New-age fintech companies have gained substantial market share in the payment ecosystem, though their efforts to expand into credit have not succeeded due to the high cost of funds and heavy dependence on digital appraisal.

Thus far, fintech players have helped expand the payment ecosystem significantly and actually made the task of managing cash far easier for banks. Our discussions with several branch managers indicate that the cash component in business-to-business payments has decreased significantly while cash flow in rural branches has surged thanks to direct benefit transfers.

Therefore, as long as fintech players steer clear of banks' core business, i.e. deposit taking and lending, they will help incumbents to expand service levels at lower costs. We also believe both deposit taking and lending will remain under strict regulations that would continue to favour traditional banks, limiting the impact of startups on these core banking operations. However, we expect fintech to have a larger impact on retail-focused NBFCs.

In our view, fintech firms will continue to dominate the payment system given the scope for innovation, ease of implementation and wider ecosystem support. They are also likely to have a bigger impact on wealth management and products distribution, thereby impacting fee-based businesses such as mutual fund distribution and bancassurance. Over the longer term, we believe these startups will help increase competition among banks by (a) making transactions across banks seamless, and (b) reducing information arbitrage related to interest on deposit and lending rates.

Relative strengths of Banks and Fintech

Parameter	Who has edge
Reach	Fintech
Sourcing of customers	Fintech
Product innovation	Fintech
Cost of funds	Banks
Monitoring & Collection	Banks

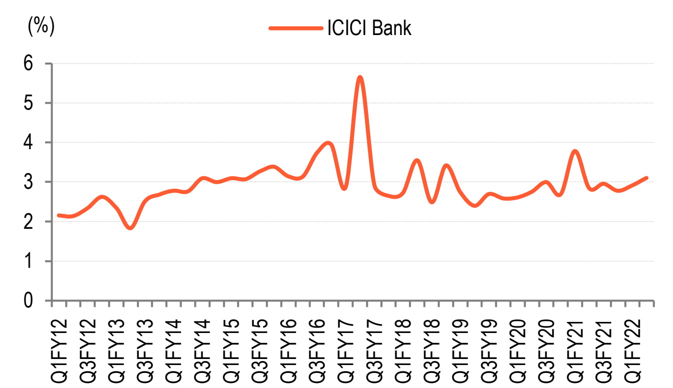
Source: BOBCAPS Research

Over the long term, we believe the use of technology by banks and NBFCs will only grow, though it would be difficult for banks to be as nimble footed as fintech on product innovation. We see space for both and believe that the overall financial ecosystem will benefit from fintech. Banks will need to adopt successful features of fintech while the latter will need to adopt the practices and regulatory structure of banks.

Prefer players with strong PPOP

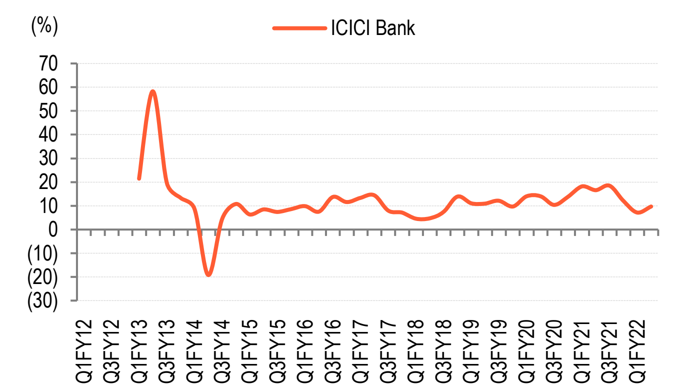
Credit growth has moderated and we believe a sustained, robust capex cycle is about two years away. In the interim, we expect banks with a growing retail book to deliver higher credit and NIM growth and hence better profitability. With concerns over credit quality ebbing, we prefer players that have a better trajectory of pre-provisioning operating profit (PPOP), as reflected by the ratio of PPOP over assets (PPOA). In the exhibits below as also in our sector investment matrix, we look at each bank's ability to maintain PPOP versus their asset size and to grow assets simultaneously.

Fig 22 – ICICI Bank – PPOP/Assets



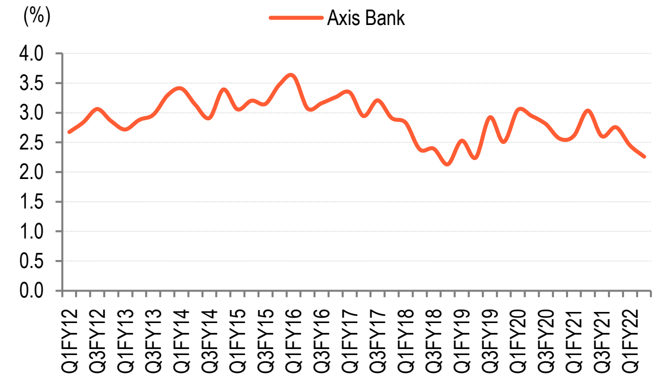
Source: Company, Bloomberg, BOBCAPS Research

Fig 23 – ICICI Bank – Asset growth



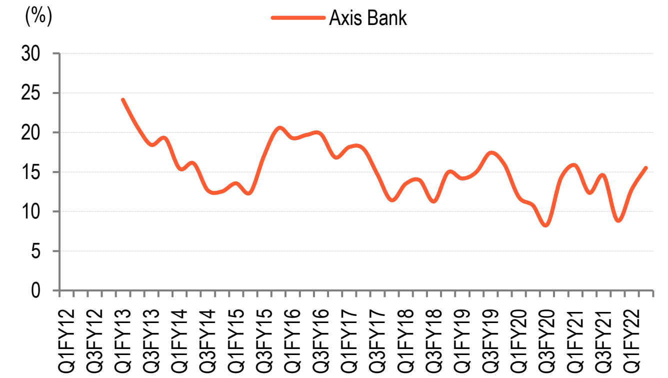
Source: Company, Bloomberg, BOBCAPS Research

Fig 24 – Axis Bank – PPOP/Assets



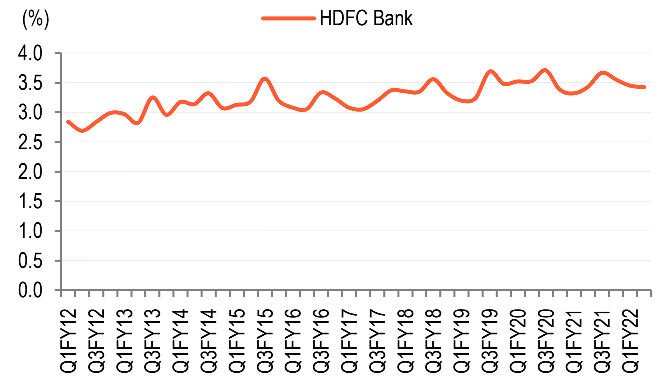
Source: Company, Bloomberg, BOBCAPS Research

Fig 25 – Axis Bank – Asset growth



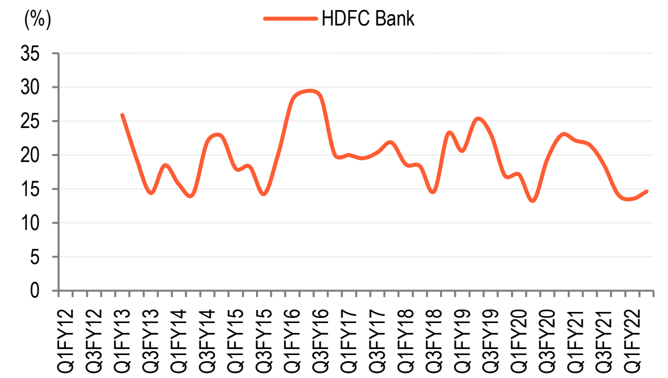
Source: Company, Bloomberg, BOBCAPS Research

Fig 26 – HDFC Bank – PPOP/Assets



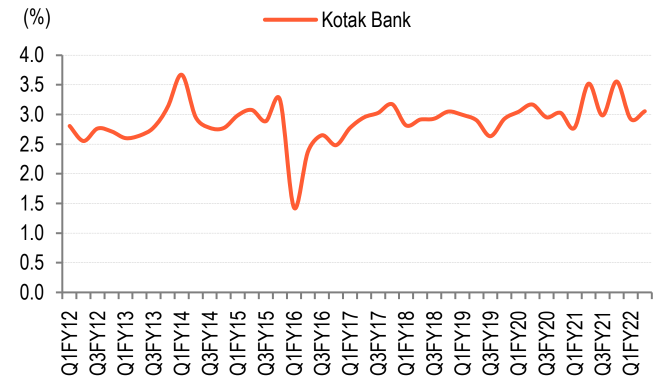
Source: Company, Bloomberg, BOBCAPS Research

Fig 27 – HDFC Bank – Asset growth



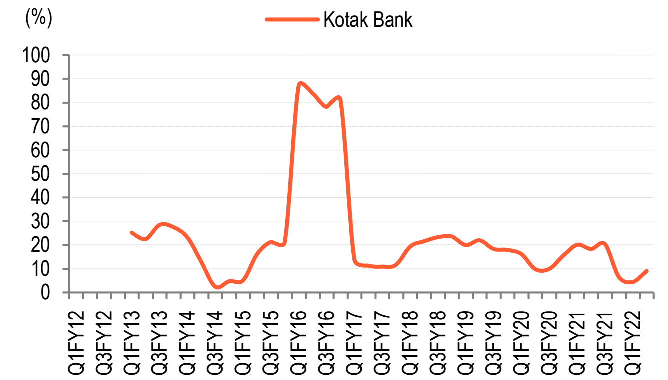
Source: Company, Bloomberg, BOBCAPS Research

Fig 28 – Kotak Mahindra Bank – PPOP/Assets



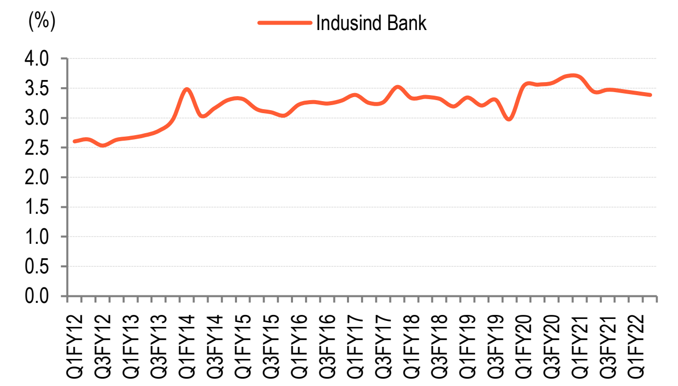
Source: Company, Bloomberg, BOBCAPS Research

Fig 29 – Kotak Mahindra Bank – Asset growth



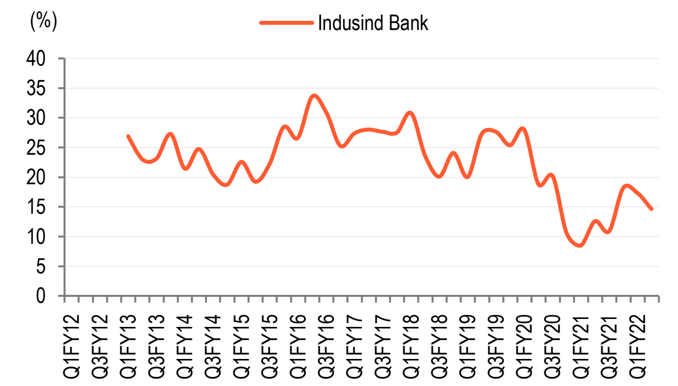
Source: Company, Bloomberg, BOBCAPS Research

Fig 30 – IndusInd Bank – PPOP/Assets



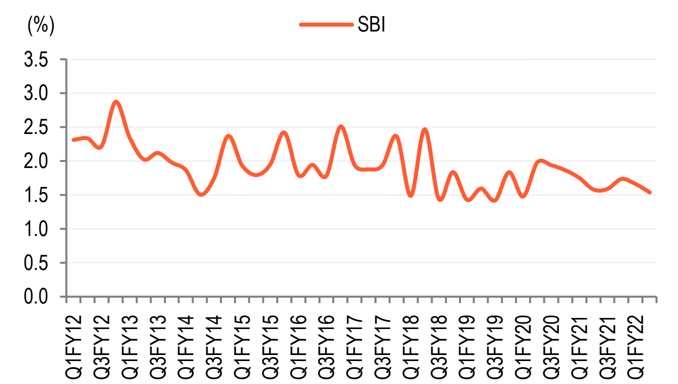
Source: Company, Bloomberg, BOBCAPS Research

Fig 31 – IndusInd Bank – Asset growth



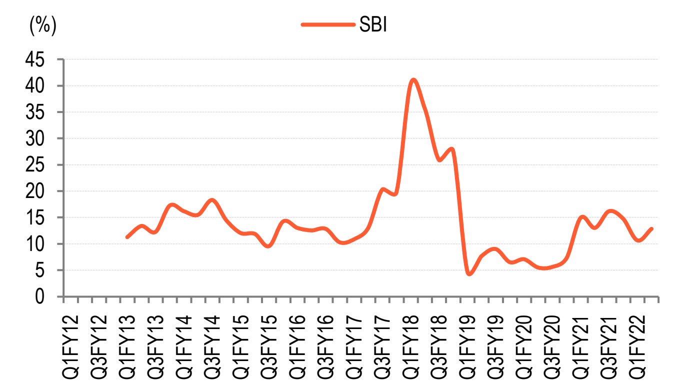
Source: Company, Bloomberg, BOBCAPS Research

Fig 32 – SBI – PPOP/Assets



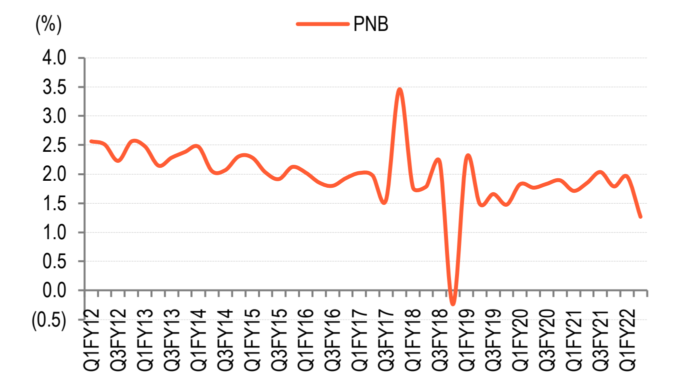
Source: Company, Bloomberg, BOBCAPS Research

Fig 33 – SBI – Asset growth



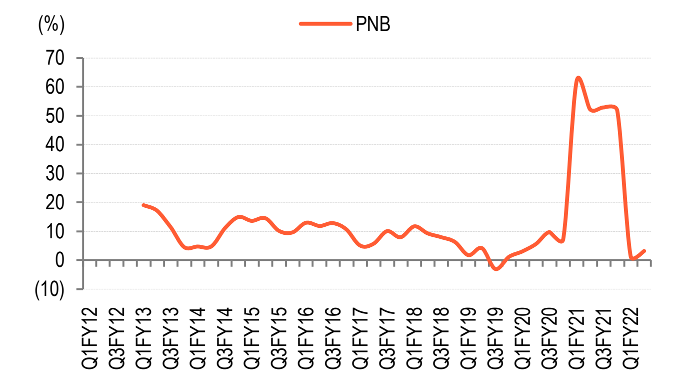
Source: Company, Bloomberg, BOBCAPS Research

Fig 34 – Punjab National Bank – PPOP/Assets



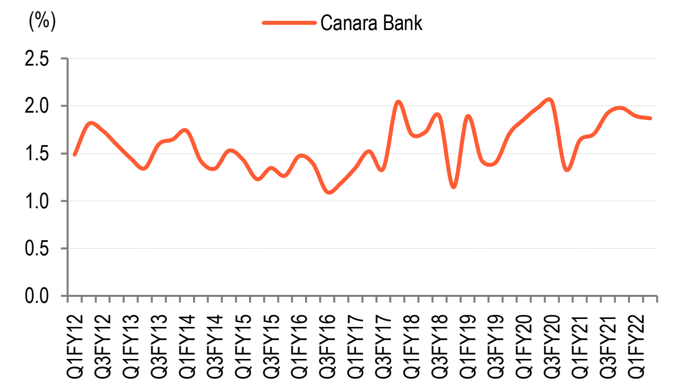
Source: Company, Bloomberg, BOBCAPS Research

Fig 35 – Punjab National Bank – Asset growth



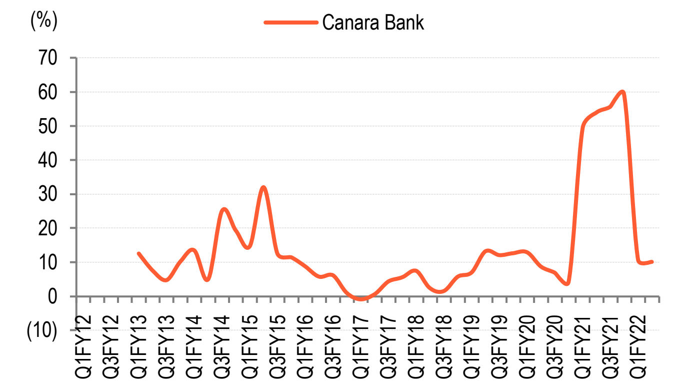
Source: Company, Bloomberg, BOBCAPS Research

Fig 36 – Canara Bank – PPOP/Assets



Source: Company, Bloomberg, BOBCAPS Research

Fig 37 – Canara Bank – Asset growth



Source: Company, Bloomberg, BOBCAPS Research

Fig 38 – BFSI stock matrix

Bank	PPOA trend	Asset growth trend	NNPA H2FY22 (%)	P/B 1Y fwd (x)
HDFC Bank	Very high	Very high	0.40	3.20
Axis Bank	High	High	1.08	1.75
Kotak Bank	High	Very high	1.06	3.00
ICICI Bank	High	Moderate	0.99	2.50
SBI	Moderate	Moderate	1.59	1.41
IndusInd Bank	High	Very high	2.00	1.35
Federal Bank	Moderate	Moderate	1.12	0.95
IDFC First	Moderate	High	2.09	1.36
DCB Bank	Moderate	Moderate	2.63	0.69
Canara Bank	Moderate	Moderate	3.21	0.69
Bandhan Bank	High	High	3.04	2.02
AU Small Finance Bank	High	High	1.65	4.38
RBL Bank	High	High	4.00	0.58

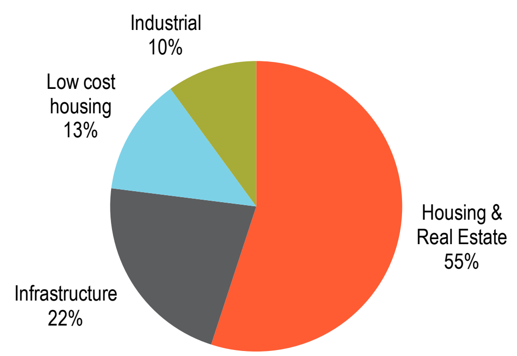
Source: Bloomberg, BOBCAPS Research

Very high High Moderate Low Absent

Cement – robust demand despite pandemic

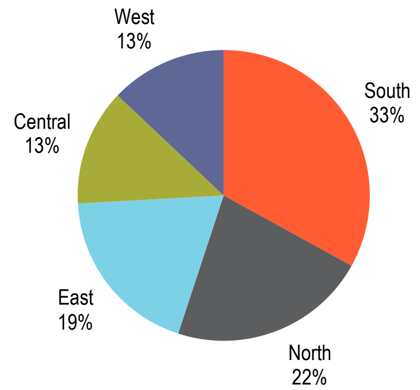
India consumes ~325mn tonnes (mt) of cement annually and has adequate capacity (~500mt) to meet demand. Demand has been robust despite Covid-related lockdowns. The industry is constructing another 80mt of capacity to meet incremental demand.

Fig 39 – Underlying demand for cement



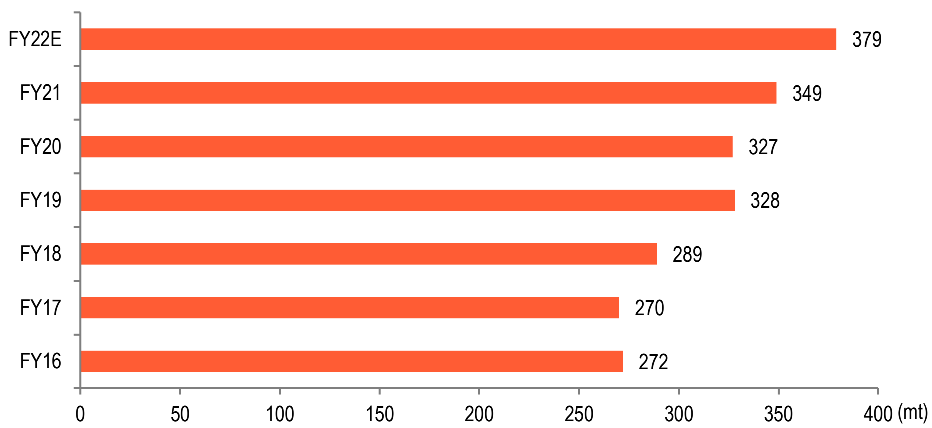
Source: IBEF, BOBCAPS Research

Fig 40 – Capacity distribution



Source: IBEF, BOBCAPS Research

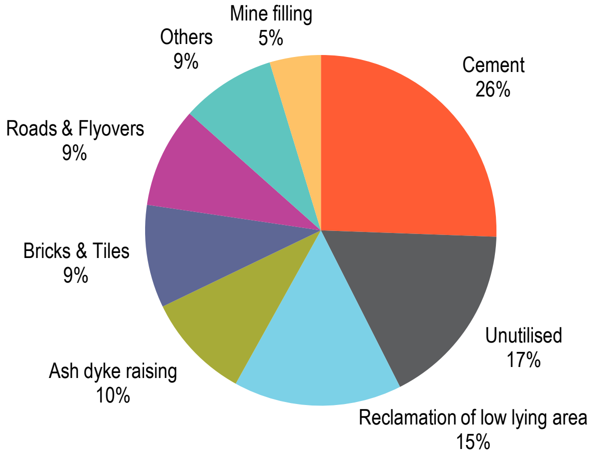
Fig 41 – Cement demand trend



Source: IBEF, BOBCAPS Research

The cement sector also uses ~60mtpa of fly ash from coal power plants and ~10mtpa of slag from steel plants as inputs. Note that the Indian power sector generates ~225mtpa of fly ash, roughly 80% of which is utilised by various industries. The cement sector accounts for ~25% of this consumption and is constrained from using more due to competition from other sectors.

Fig 42 – Fly ash utilisation



Source: Ministry of Power, GoI, BOBCAPS Research

Healthy volume outlook; margins could moderate medium term

India's cement sector grew at 13.7% over the last decade, which was higher than growth in nominal GDP, underscoring strong demand drivers that gain not only from underlying growth in the economy but also from a rise in per capita income.

While cement will be a major beneficiary of any sharp uptick in per capita income, the sector is among the top two emitters of carbon (after steel) and will likely need to invest in green technology to address this. Therefore, while the industry will continue growing near term, we expect moderation in margins over the medium term. We do not expect volume risk given the strong demand drivers.

Fig 43 – Cement stock matrix

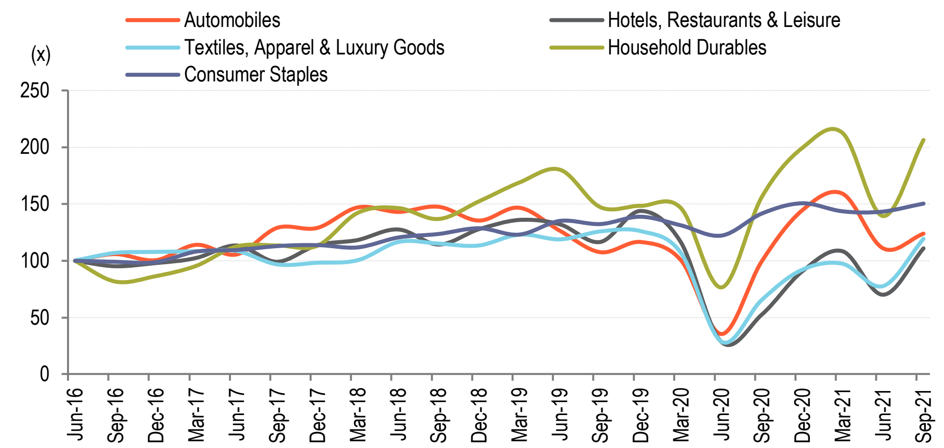
Company	EPS CAGR FY21-FY24E (%)	EBITDA/t FY24E (Rs)	EV/EBITDA FY23E (x)
Ambuja Cements	23	1,211	9.4
Dalmia Bharat	25	1,106	10.9
Ultratech Cement	24	1,523	14.7
ACC	22	1,095	10.1
Shree Cement	20	1,465	18.0
Ramco Cements	18	1,485	13.7

Source: Bloomberg, BOBCAPS Research

Consumer Durables – long runway ahead

Consumer durables have had the strongest upcycle among various consumption items pre-Covid and have demonstrated resilience during the pandemic as well. The sector is likely to be the biggest beneficiary of a combination of higher per capita income and improvement in India's electricity supply. For details, please see Tarun Bhatnagar's sector report **Consumer Durables – Ride India's middle-class boom** of 26 Nov 2021.

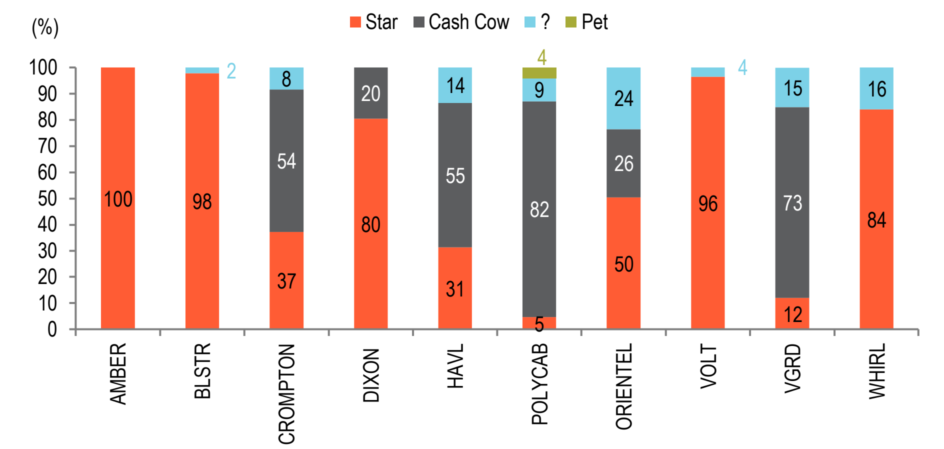
Fig 44 – Consumer durables – relative growth (rebased)



Source: BOBCAPS Research

The following chart displays the portfolio of various durable companies. We prefer players that have a higher proportion of stars and cash cows. Note that 'stars' refer to products that are growing fast and have robust market share, 'cash cows' are the ones that aren't growing fast but have strong market share, 'pets' are those that aren't growing and have low market share, and 'question marks' represent products that can grow but will require management bandwidth and investments.

Fig 45 – Product portfolio: Contribution of different categories of products



Source: BOBCAPS Research

Fig 46 – Consumer durables stock matrix

Company	Product suite	Distribution	EBIT margin (%)	P/E (x)	ROE (%)	ROIC (%)
			FY24E	FY24E	FY24E	FY24E
Crompton	High	Very high	15.5	31.5	29.7	41.8
V-Guard	High	High	10.5	28.2	19.0	24.5
Whirpool India	High	High	10.9	28.0	17.5	52.1
Voltas	Very high	Very high	11.4	36.8	16.4	21.7
Havells	Very high	Very high	12.7	55.8	21.4	35.2
Blue Star	High	High	5.4	30.6	25.1	40.3
Polycab	High	High	9.7	37.5	15.1	17.7
Orient Electric	High	Very high	7.8	43.7	24.9	63.6

Source: BOBCAPS Research

Very high High Moderate Low Absent

Fig 47 – Consumer durables stock matrix (for manufacturers)

Company	Product suite	Manufacturing	EBIT margin (%)	P/E (x)	ROE (%)	ROIC (%)
			FY24E	FY24E	FY24E	FY24E
Amber Enterprises	High	Very high	6.9	39.6	13.1	14.0
Dixon Tech	Very high	Very high	3.2	66.9	32.4	29.6

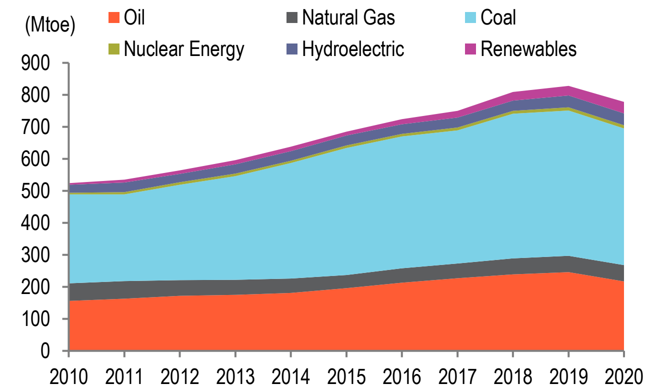
Source: BOBCAPS Research

Very high High Moderate Low Absent

Energy – it's all about green transition

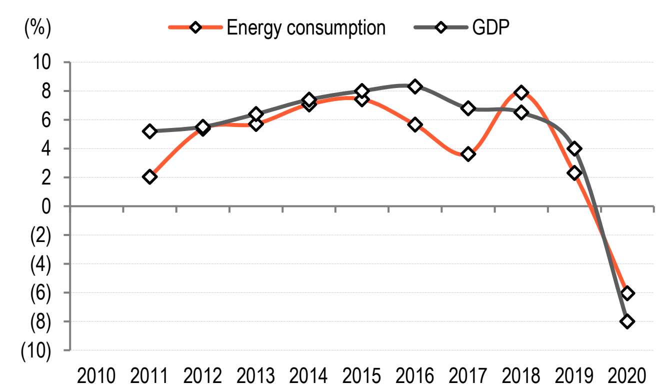
India is a net importer of all forms of fuel despite being the lowest per capita consumer of energy globally. But given the sheer size of India's population, its absolute consumption is among the top 5 in the world for most forms of energy and so is its carbon emission.

Fig 48 – India's energy consumption



Source: BP Statistical Review 2021, BOBCAPS Research | Mtoe – mn tonne oil equivalent

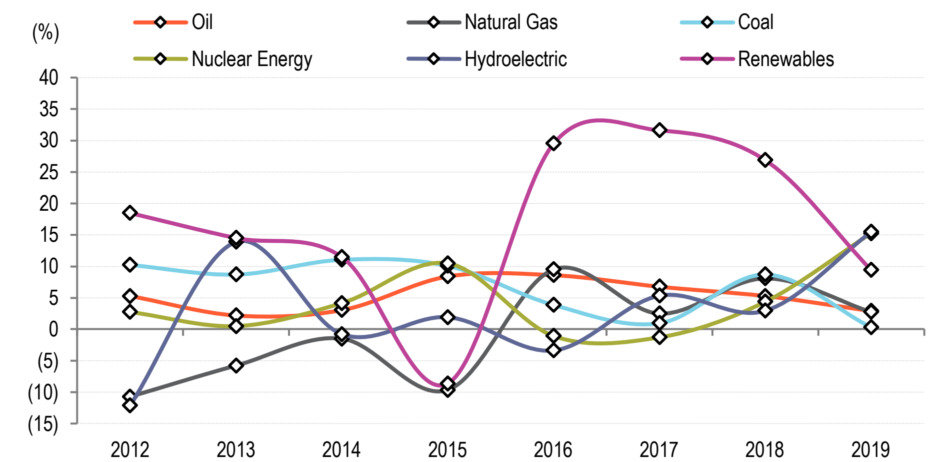
Fig 49 – Growth in energy consumption vs. GDP growth



Source: BP Statistical Review 2021, BOBCAPS Research

India's energy consumption has increased at ~0.8x of GDP over the last ten years. Natural gas consumption has been impacted by supply constraints and hence shows inconsistent growth.

Fig 50 – Fuel-wise growth in domestic consumption



Source: BP Statistical Review 2021, BOBCAPS Research

Expect renewables and city gas distribution to show consistent growth

We expect India's energy consumption to grow moderately lower than 0.8x GDP growth thanks to improving energy efficiency. The energy mix is likely to favour renewables and, to some extent, natural gas. Coal consumption has largely peaked, in our view, given climate concerns. At the same time, we expect city gas distribution to show consistent growth on the back of steady network expansion and lower cost than other fuel alternatives.

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India's dependence on imports makes input prices volatile for energy companies, which cannot always be seamlessly passed along to end consumers. Consequently, margin protection is a difficult endeavour for most energy companies. We expect refining margins to remain volatile and cyclical. We prefer companies that are able to manage their margin without impacting growth. City gas distribution companies stand out in this context. We also believe that players in the renewable chain will have meaningful growth, though their margins may remain inconsistent given multiple regulatory challenges.

Fig 51 – Energy stock matrix

Company	Climate change	Margin outlook	Avg ROCE (%)	EPS FY24E YoY (%)	P/E 1Y fwd (x)
Indraprastha Gas	Moderate	High	24	13	17.2
Mahanagar Gas	Moderate	High	27	6	8.8
Petronet LNG	Moderate	High	29	7	10.4
Gujarat State Petronet	Moderate	Very high	38	1	6.7
HPCL	Low	Moderate	20	13	5.9
IOCL	Low	Moderate	15	10	5.5
GAIL	Moderate	Moderate	13	6	6.7
Power Grid	Very high	Very high	11	1	9.8
BPCL	Low	Moderate	18	8	7.9
Gujarat Gas	Moderate	Moderate	34	15	25.2
NTPC	Low	High	9	8	7.2
CESC	Low	Moderate	13	8	7.5
Tata Power	High	Moderate	7	20	29.9
MRPL	Low	Low	(1)	18	9.4

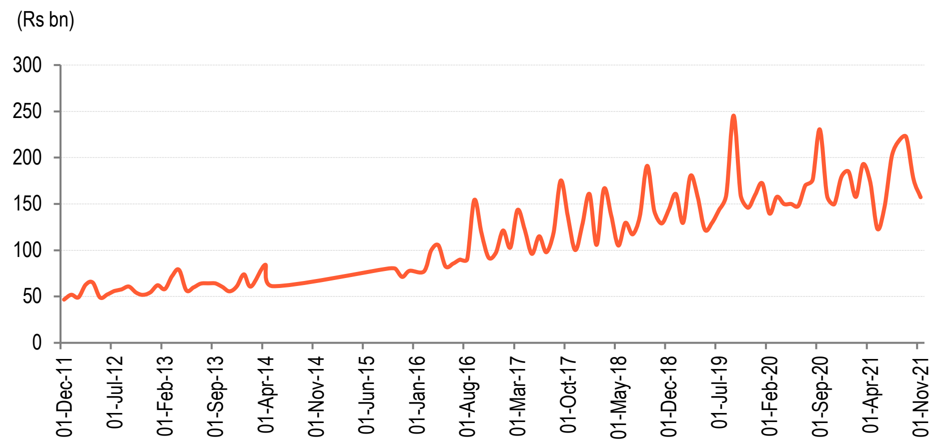
Source: Bloomberg, BOBCAPS Research

Very high High Moderate Low Absent

Insurance – secular growth story

Insurance remains a secular growth story due to low penetration and increasing awareness of risk protection. While saving products dominate, we believe events such as the ongoing Covid-19 pandemic will spur pure risk products such as term insurance. Insurance premiums have increased at a ~14% CAGR over the last decade, much higher than nominal GDP growth of ~10% during the same period.

Fig 52 – Gross insurance premium

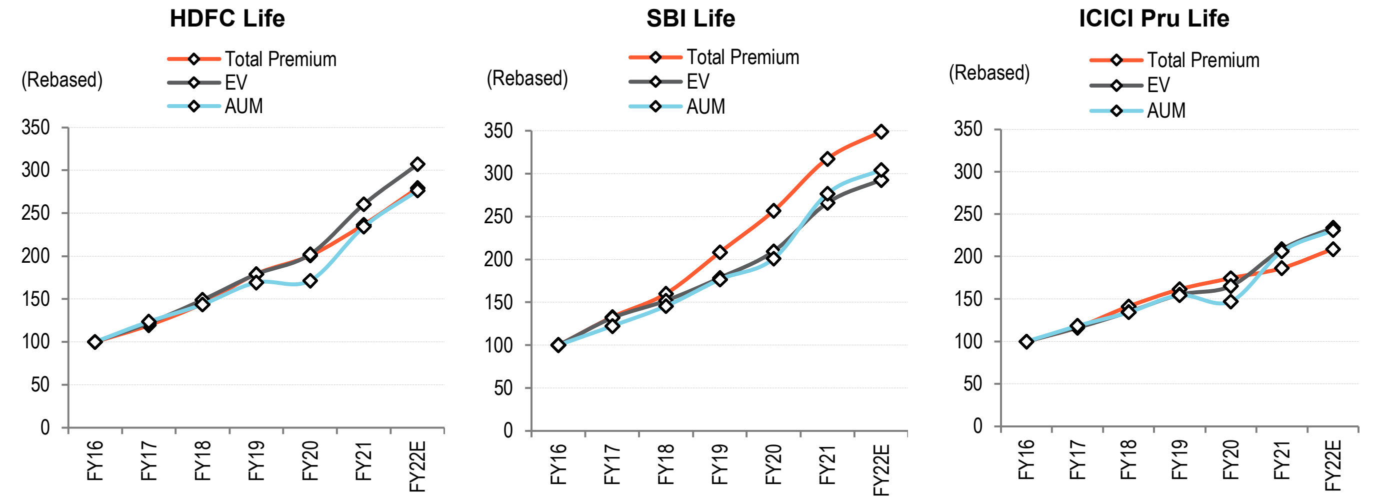


Source: Company, IRDA, BOBCAPS Research

Growth in embedded value more important than premium growth

We believe companies that expand their embedded value while also raising premiums will fare better. Based on our analysis of growth in embedded value, AUM and gross premium (all rebased to FY16), we find that HDFC Life and ICICI Pru Life have clocked higher growth in embedded value compared to the increase in their gross premium. However, absolute growth for SBI Life was the highest among the three life insurers.

Fig 53 – Growth in premium, embedded value and AUM (rebased to FY16)



Source: Company, BOBCAPS Research

Fig 54 – Insurance stock matrix

Company	EV CAGR 6Y (%)	EV Growth/ GWP Growth (x)	EV/AUM (%)	P/EV H2FY22 (x)
SBI Life	19.8	0.8	14.5	3.4
HDFC Life	20.0	1.1	15.0	4.8
ICICI Pru Life	15.4	1.2	12.7	2.8

Source: Company, BOBCAPS Research | GWP – Gross Written Premium

IT Services – pandemic-led tailwinds

The Indian IT sector derives its business predominantly from the US followed by Europe. The pace of digitisation, already robust pre-Covid-19, received a fillip from the pandemic, as companies across sectors felt the need to accelerate their digital footprint. This is in addition to the sustained minimum business that comes from merely updating IT systems to keep pace with changing content, features and data speed.

A key outcome of the pandemic has been to engender a change in mindset for both IT companies and their clients, enabling the shift from a large onsite presence to more remote working. This shift augurs well for Indian IT service providers who otherwise face visa impediments every time a new US administration takes over.

Expect 8.5% CAGR through FY25

The Indian IT sector clocked revenue of ~US$ 200bn in FY21, posting a 7% CAGR over FY16-FY21. We expect the sector to grow at 8.5% CAGR over FY21-FY25 and believe that companies which can better mine existing client accounts and quickly upscale their services stand to offer industry-leading growth.

Fig 55 – IT stock matrix

Company	Product/ Platform	Service – EU market	Service – Digital	Mining ability	Gross margin	Attrition level	Skill level	EPS FY24E YoY (%)	P/E 1Y fwd (x)
TCS	Very high	Very high	Very high	Very high	Very high	Very high	Very high	12	32
Infosys	Very high	High	Very high	Very high	Very high	High	Very high	13	32
Wipro	High	Very high	High	Very high	Moderate	Moderate	Very high	12	29
HCL Tech	Very high	High	High	High	Very high	Very high	High	12	24
Tech Mahindra	High	High	Moderate	Moderate	Low	Moderate	Moderate	11	26
Coforge	Moderate	Very high	High	Moderate	Moderate	Very high	Moderate	20	43
L&T Info	High	Moderate	Very high	High	Moderate	High	High	17	49
Mindtree	Moderate	Moderate	Moderate	High	High	High	High	15	47
Mphasis	Low	Low	Moderate	Moderate	Low	Moderate	Moderate	20	38
Persistent	Moderate	Low	Moderate	Moderate	High	Moderate	Low	20	47

Source: Bloomberg, BOBCAPS Research

Very high | High | Moderate | Low | Absent

Fig 56 – Internet stock matrix

Company	Product/ Platform	Gross margin	Segment growth	TAM	Network effect	EPS FY24E YoY (%)	1Y fwd P/E (x)
Affle (India)	Very high	Moderate	Very high	High	Moderate	44	66
IndiaMart	High	Very high	High	Moderate	Very high	16	50
Info Edge	Moderate	Very high	Moderate	Very high	Very high	25	126
Just Dial	Low	Low	Low	Moderate	Low	15	27

Source: Bloomberg, BOBCAPS Research | TAM – Total Addressable Market

Very high · High · Moderate · Low · Absent

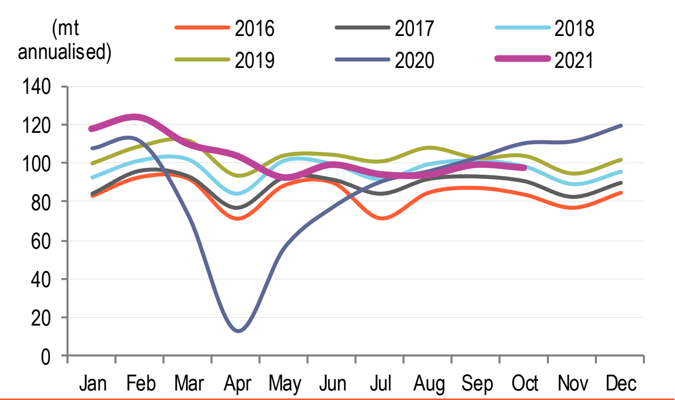
Metals – robust margins

Steel margins to moderate in medium term

Global steel margins have corrected from record highs, in part due to deceleration in demand from China's real estate sector. High energy cost has also been a dampener. At the same time, we expect production cuts in China to continue to constrain exports. Thus, steel margins will likely stabilise once Chinese demand gradually steadies and coking coal sees reversal to mean price levels over 6-9 months. Construction demand from other parts of the world has offset weaker offtake from the auto sector.

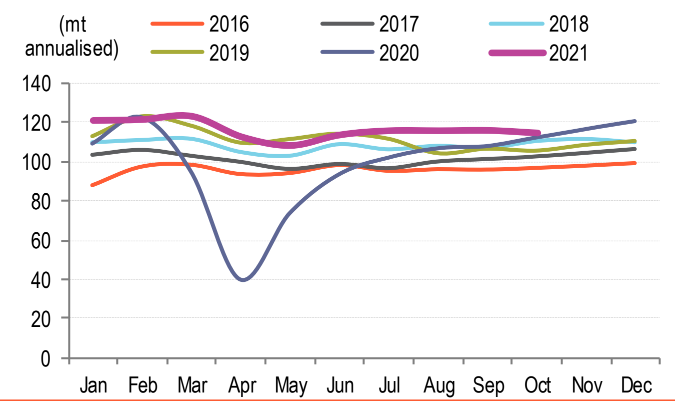
Indian steel margins too are likely to gradually revert to mean in the medium term. We believe demand in India will remain robust and absorb a significant part of incremental capacity under construction. For details, please see Kirtan Mehta's report **Ferrous Chartbook – Margins to gradually stabilise at healthy cycle average** of 23 Nov 2021.

Fig 57 – India steel consumption



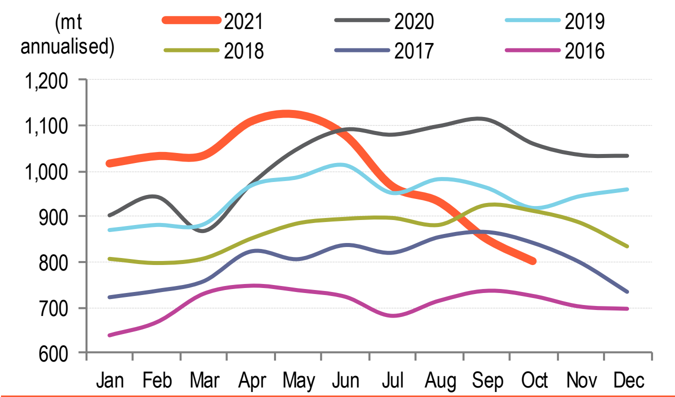
Source: CMIE, BOBCAPS Research

Fig 58 – India steel production



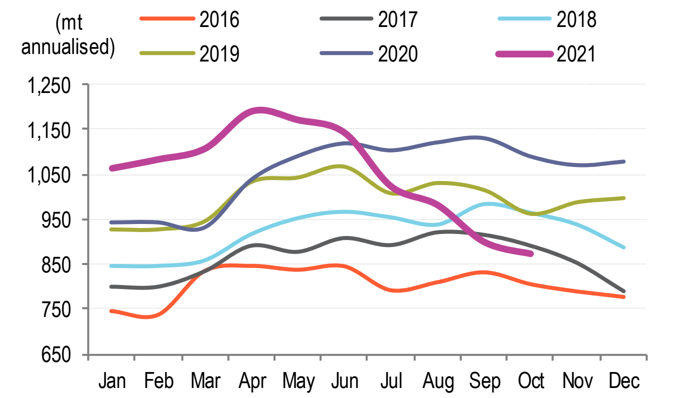
Source: CMIE, BOBCAPS Research

Fig 59 – China



Source: Bloomberg, China Customs, National Bureau of Statistics, BOBCAPS Research

Fig 60 – China production



Source: Bloomberg, China National Bureau of Statistics, BOBCAPS Research

Aluminium margins to remain elevated near term

Aluminium continues to replace steel in several applications, including automobiles as the industry strives to reduce vehicle weight. Chinese supply remains impacted by local restrictions while demand is robust. Despite muted growth in global auto sales, we believe aluminium margins will remain elevated near term and will move towards mid-cycle levels over the longer term.

Fig 61 – Metals stock matrix

Company	Expansion	Gross Margin outlook	Capital efficiency	Climate change	ROE FY23E (%)	EV/EBITDA FY23E (x)
Hindustan Zinc	Very high	Very high	Very high	Moderate	30	7.3
JSW Steel	Very high	Very high	Very high	Moderate	21	6.2
JSPL	Very high	Very high	High	Low	13	3.9
Hindalco	High	High	Moderate	High	13	5.9
Tata Steel	High	High	High	Low	15	5.0
SAIL	High	Very high	High	Low	16	3.6

Source: BOBCAPS Research

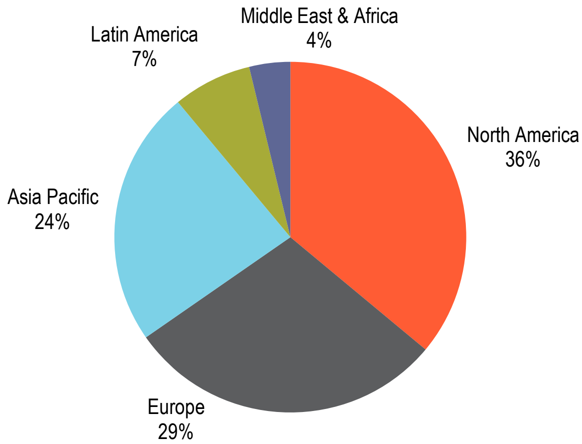
Very high High Moderate Low Absent

Pharmaceuticals – India market is key

India a key player in US generics

The global generics pharma market is worth ~US$ 400bn and we expect annual growth of 5-6% over the near-to-medium term, with the US accounting for about a third of this market. Indian companies in turn account for roughly a third of the US generics market.

Fig 62 – Global generics market



Source: GlobalNewswire, Precedence Research, BOBCAPS Research

The Indian pharma market (IPM) is roughly worth US$ 45bn, growing in double digits and almost equally distributed between branded and pure generics. We believe a combination of growing per capita income, better availability of medicines across the country and expansion of healthcare facilities will continue to boost the domestic pharma sector.

Further, India supplies ~20% of global drugs and had ~US$ 25bn worth of pharma exports in FY20. The US generics market, however, is competitive with steady erosion in pricing. Companies need to constantly identify, produce and supply molecules going off-patent to maintain growth.

IPM can sustain 12-15% growth

We expect Indian pharma companies to report sustainable 12-15% annual growth led by a combination of volume and pricing. Ceteris paribus, companies with larger exposure to India stand to deliver better earnings growth. The global demand shift from China to India as part of the 'China Plus One' strategy also has the potential to increase the API and intermediate (KSM) markets for Indian API manufacturers. A combination of cost-effective manufacturing, ability to adhere to USFDA norms and consistent identification of unique business opportunities will likely determine the winners.

Fig 63 – Pharma stock matrix

Company	Branded molecules/ Portfolio	Effective API sourcing	India exposure	New ANDA/ NDA pipeline	Gross margin	IPM reach	Better USFDA cGMP record	ROE FY23E (%)	EBITDA margin Q2FY22 (%)	EPS FY24E YoY (%)	P/E 1Y fwd (x)
Eris Lifesciences	Very high	Very high	Very high	Absent	Very high	Moderate	NA	23	39	14	22
Dr Reddy's	High	High	High	Very high	Very high	High	High	16	23	20	24
Laurus Labs	Absent	High	Low	Moderate	High	Absent	Very high	32	29	15	23
Cipla	High	Moderate	High	High	Moderate	Very high	High	15	22	21	24
Ipca	High	High	High	Absent	High	High	Absent	20	24	15	23
Sun Pharma	High	High	Moderate	Very high	Very high	Very high	High	14	28	16	25
P&G Health	Very high	Moderate	Very high	Absent	High	Moderate	NA	70	29	15	57
Divi's Labs	Absent	Very high	Low	High	Very high	Absent	High	25	42	17	42
Alkem Labs	High	High	High	Moderate	High	High	Moderate	21	22	13	23
Abbott	Very high	Moderate	Very high	Absent	High	Very high	NA	27	21	20	43
Glaxo	Very high	Moderate	Very high	Absent	Moderate	High	NA	33	27	21	45
Pfizer	Very high	Moderate	Very high	Absent	Moderate	High	NA	17	30	10	34
Alembic	High	Moderate	High	Moderate	Moderate	Moderate	Moderate	28	20	15	20
Zydus Cadila	Moderate	Moderate	Moderate	High	Moderate	High	Moderate	15	23	14	21
Ajanta Pharma	High	High	High	Low	High	High	Moderate	22	30	11	24
Lupin	Moderate	Moderate	High	High	Moderate	High	Moderate	12	14	29	25
Torrent Pharma	High	High	High	Low	High	High	Moderate	22	31	18	35
Biocon	Low	Moderate	Low	High	High	Low	High	14	24	32	37
Gland Pharma	Absent	Very high	Absent	Very high	Very high	Absent	Very high	20	35	16	41
Glenmark	Moderate	Moderate	High	Moderate	Moderate	High	High	13	19	15	13
Aurobindo Pharma	Absent	High	Low	Very high	High	Absent	High	13	21	15	12
Jubilant Life Sc	Absent	Moderate	Moderate	Low	Moderate	Absent	High	33	19	27	75

Source: Bloomberg, BOBCAPS Research

Very high **High** **Moderate** **Low** **Absent**

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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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