

# **MACRO & MICRO**

14 March 2023

## Clear mass premiumisation trends

- Our analysis indicates that India is witnessing mass premiumisation across several discretionary categories
- Higher-end items are growing faster than their basic alternates; companies exploiting this trend will grow ahead of the industry
- We believe select pockets in the FMCG, industrial and BFSI sectors stand to gain from this trend

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Middle class growing at 6% CAGR vs. all-India CAGR of ~1.3%: Income tax filings show that only 66mn, or less than 5% of India's population (7% of the working class), filed tax returns in FY21. However, we note that the tax net covers only a small percentage of the consumer base, and several surveys point to a far larger middle-class demographic. As per a survey cited by the Times of India, India's middle class has swelled from 14% of the population in 2005 to ~31% now. This growing class of aspirational buyers is fuelling mass premiumisation demand trends given the availability of quality products at affordable prices and the easy flow of consumer credit.

What are mass premium items: We define mass premium items as those that have cheaper alternates which meet basic needs but lack certain desirable (real or perceived) features. We also include certain categories (such as general insurance) that typically have higher penetration in mature markets owing to better standards of living.

**Secular premiumisation trends:** In India's auto sector, Maruti's cheapest offering – the 'Alto' – was the bestselling car in the country for the better part of 15 years before being recently unseated by the higher end 'Wagon R'. In FMCG, the industry saw faster growth in personal care items than basic hygiene products over 2000-15, while packaged foods and beverages are now outpacing personal care products (which will further support QSRs). Similarly, paints and adhesives companies have led industry growth as they successfully branded their chemical/industrial products.

Though gold consumption in India has fallen at a  $\sim$ 1% CAGR over the last decade, Titan's (Not Rated) operating profit in the branded jewellery business logged a robust 18% CAGR. In insurance, the ratio of general insurance premium over life insurance premium has been inching up in most mature markets – a trend we now see in India. Similarly, retail loans form a larger part of the credit profile in seasoned markets, and we now find India's retail growth outstripping corporate credit.

**Beneficiaries:** We would prefer food-based FMCG over hygiene/personal care players, branded over traditional jewellery, paints over chemicals, and retail lenders over corporate lenders, plus auto OEMs that successfully upgrade product lines.





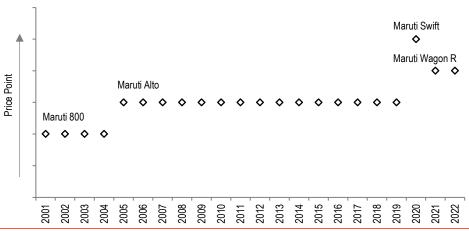
# **Clear mass premiumisation trends**

India's burgeoning middle class, the availability of affordable, quality products, and easy access to credit are catalysing a demand shift in favour of mass premium items – defined as those that have cheaper but less desirable alternatives. We examine the changing demand trends across key sectors.

### **Automobiles**

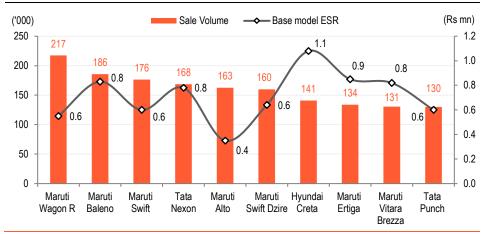
For close to two decades, the bestselling car in India was the smallest car available from Maruti which was also the cheapest in its lineup. This changed in 2020. The smallest car is no longer the biggest selling.

Fig 1 - Mass premiumisation in Passenger Vehicles: Bestselling PV model



Source: Company, BOBCAPS Research

Fig 2 - Top 10 passenger vehicles sold in 2022



Source: Company, BOBCAPS Research, Media Reports | ESR: Ex-Showroom

As illustrated in the exhibits above, demand for premium cars is gradually rising. Thus, carmakers who can offer premium models at affordable prices will likely register better sales growth than the industry, in our view. Mahindra & Mahindra and Maruti both appear to be working on such a strategy.



We see similar trends in two-wheelers as well. Sales of premium motorcycles are rising faster than that of entry-level products. Eicher Motors (EIM) exclusively sells premium bikes and has clocked a much higher growth rate than the industry – at a 24% CAGR over FY11-FY22 vs. 2.6% for the industry. Even if we reduce the analysis period to FY15-FY23E, EIM's two-wheeler sales have logged an ~11% CAGR vs. flat sales for the industry.

('000 units) EIM (units) - Industry (R) 900 22,500 800 20,000 700 17,500 600 15,000 500 12,500 400 10,000 300 7,500 200 5,000 100 2,500 0 0 FY15 FY16 **FY17** FY18 FY23E FY19 FY20 FY22 FY21

Fig 3 – Sales of premium two-wheelers are growing faster than industry

Source: Company, BOBCAPS Research

## **Energy**

Diesel and petrol are the two popular transportation fuels in India. Diesel has been the dominant fuel and is used mainly by commercial transporters whereas petrol is largely used by personal vehicles. Note, the price of petrol has been kept higher than that of diesel owing to higher taxes on the former.

Diesel constituted ~42% of India's oil consumption in 1997-98 while petrol accounted for a mere 6%. The share of diesel has remained largely similar at ~39% in FY23, even as that of petrol has increased to 16% of oil consumption, further underscoring premiumisation in the mobility space.

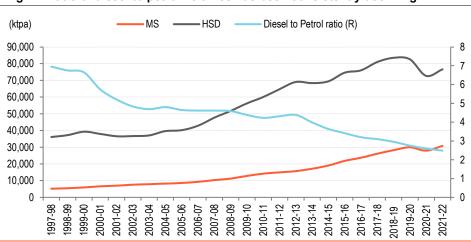


Fig 4 – Ratio of diesel to petrol volumes has been consistently declining

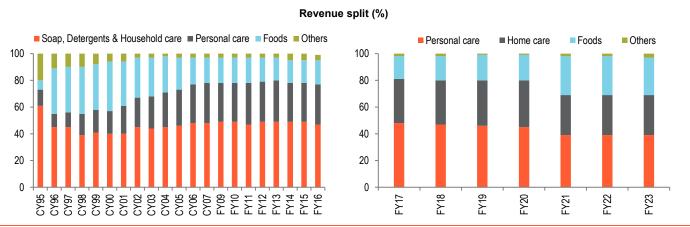
Source: PPAC, BOBCAPS Research



### **FMCG**

Premiumisation is most evident in India's FMCG industry where sales of personal care items grew faster than hygiene products over 2000-15, only to be overtaken by packaged foods and beverages. The latter trend is also lending an impetus to quick service restaurants (QSR). Sales of industry bellwether Hindustan Unilever (HUL) clearly reflect the demand shift.

Fig 5 – Mass premiumisation in FMCG: Uptick in personal care sales over the last decade but packaged foods now taking over

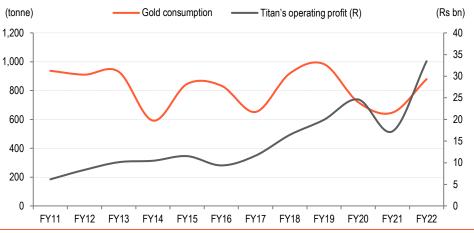


Source: BOBCAPS Research | Note: HUL changed its product classification from FY17 due to a change in accounting standard

Individual brands reflect similar shifts in demand. As per our estimates, sales of lowerend detergent 'Wheel' logged a ~7% CAGR over the last decade compared to over 15% growth for the more expensive 'Surf Excel' during the same period. Growth at the lower end dips further if we consider 'Rin' – a hitherto household brand for HUL in the mid-tier detergent segment.

Another indicator of premiumisation is the nature of gold consumption in India. While the country's gold consumption has actually declined at a ~1% CAGR over the last decade, operating profit for branded jewellery player Titan has increased at a robust 18% CAGR over this period (adjusted for sales on account of gold exchange and non-jewellery items).

Fig 6 - Sales of high-end jewellery have grown faster than gold



 $Source: BOBCAPS\ Research,\ CMIE,\ Company,\ Bloomberg$ 



Customers are also paying a premium for perceived product quality. We are seeing faster growth in industrial products (paints, adhesives) that companies such as Asian Paints and Pidilite Industries have been able to successfully brand as being high on quality. Note, companies selling these products are largely treated as chemicals/industrials in most developed markets and not clubbed with FMCG.

### Credit

Although credit to non-financial corporations is higher in India than in mature markets as a percentage of respective GDP, household debt shows the opposite trend. Emerging markets have much lower credit to households as a percentage of GDP. Each country has its own growth trajectory, rendering a comparison of credit to non-financial corporates misleading, but we believe credit to households is comparable given its linkage to better financial inclusion, financial literacy and higher standards of living.

We note a low level of household debt in emerging markets in general and India in particular, but this metric is now on an upward trajectory (Fig 7). Note, India's financial inclusion has improved significantly over the last decade. We will likely see continuing outperformance from retail-focused lenders.

Fig 7 – Household debt as a percentage of GDP on the rise in EMs  $\,$ 

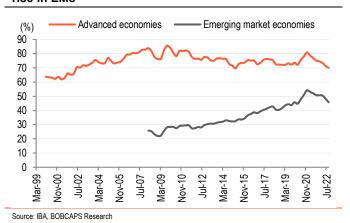


Fig 8 – Non-financial sector debt as a percentage of GDP



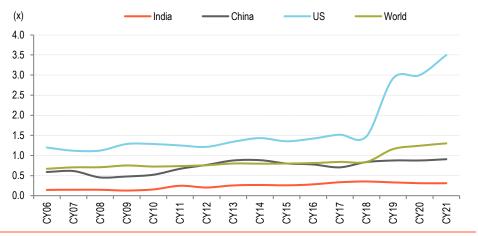
Source: IBA, BOBCAPS Research



### Insurance

Data shows that general insurance premium far exceeds life insurance premium in mature markets. Better life and social security could be one of the primary drivers. While general insurance premium in India is still far lower than that for life policies, it is growing well ahead of the latter – a trend we expect will continue.

Fig 9 – India's ratio of general to life insurance premium is inching up



Source: IRDA, BOBCAPS Research

# India's middle-class consumption engine

Income tax filings show that only 66mn, or less than 5% of India's population (7% of the working class), filed tax returns in FY21. However, we note that the tax net covers only a small percentage of the consumer base, and several surveys point to a far larger middle-class demographic.

As per a survey carried out by People Research on India's Consumer Economy (cited by both the Business Standard and the Times of India), India's middle class has swelled from 14% of the population in 2005 to ~31% now. This growing class of aspirational buyers is fuelling mass premiumisation demand trends given the availability of quality products at affordable prices and the easy flow of consumer credit.

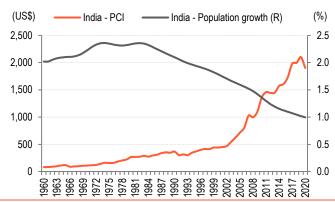


## Market outlook

## 2024E: Onset of a sustainable growth phase

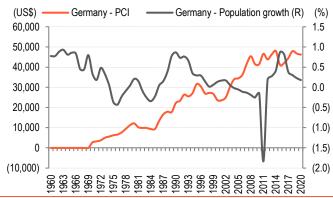
We believe India is on track for a secular rise in per capita income given that its population growth has now moderated to ~1%, a level at which several developed economies have witnessed an acceleration in their per capita income levels. For details, see our strategy note, 2023: Precursor to a breakout, dated 9 Jan 2023.

Fig 10 - India



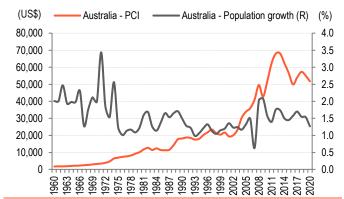
Source: World Bank, BOBCAPS Research | PCI: Per Capita Income

Fig 12 - Germany



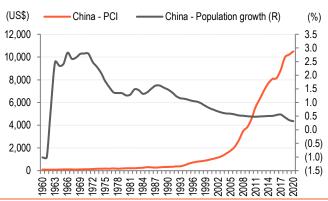
Source: World Bank, BOBCAPS Research | PCI - Per Capita Income

Fig 14 - Australia



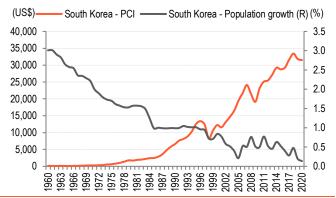
Source: World Bank, BOBCAPS Research

Fig 11 - China



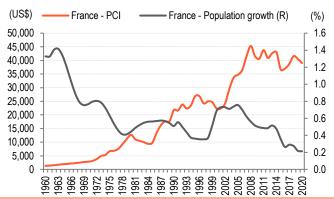
Source: World Bank, BOBCAPS Research

Fig 13 - South Korea



Source: World Bank, BOBCAPS Researc

Fig 15 - France



Source: World Bank, BOBCAPS Research



Fig 16 - Argentina

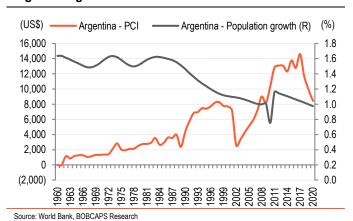
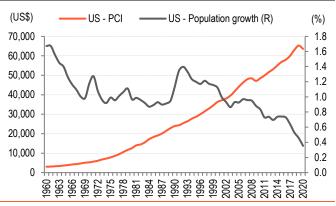


Fig 17 - United States



Source: World Bank, BOBCAPS Research

While higher population growth has its own demographic dividends, we believe a country's populace should be proportional to its resources and hence moderation in India's curve is a positive. This coupled with improvement in several socioeconomic parameters over the last decade could herald a swifter uptick in per capita income this decade.

Fig 18 - Improvement in structural parameters

Parameter	FY10	FY22
Peak electricity deficit (%)	12.6	0
Access to electricity (%)	86	99
Mobile internet users (mn)	2.3	825
Roads (mn km)	4.6	6.4
Basic saving bank deposit account (mn)	73	663
Number of medical seats (MBBS)	35,200	91,927

Source: Various GOI Ministries, Media Reports, BOBCAPS Research

That said, key structural impetus is needed to propel India to a higher growth trajectory. We believe a combination of the China-Plus-One strategy, production-linked incentive schemes and trade agreements with large consumption-based economies, along with India's domestic consumption growth, can catalyse a broad-based capex cycle. In our view, 2024 will be the first year of a sustainable growth phase that could spur a bull market for the mid-to-long term. We believe this bull run will be initialled by earnings upgrades but will also accompany a valuation uptick once the long-term growth outlook improves further.



# 2023E: A study in contrasts

2023 will likely be a study in contrasts. We expect H1CY23 to see signs of structural slowdown in China and rate uncertainty in Europe and the US, in turn prompting earnings cuts globally, including in India. However, once the market is able to absorb these downgrades, we believe the stronger global growth outlook for 2024 coupled with limited downside to valuation multiples will gradually encourage a risk-on mindset in H2.

The Nifty50 has largely hovered within one standard deviation (+/-1SD) of its five-year mean over the past several months, barring Covid-related volatility. The Nifty50 12-month forward P/E multiple is currently below its five-year mean and is only marginally higher than its -1SD level, indicating limited downside from current levels.

Nifty 12M fwd P/E --- +/-1SD 24 22 20 18 16 14 12 10

Fig 19 - Nifty valuation has inched up

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Sep-Source: BOBCAPS Research, Bloomberg

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However, the Indian market will likely be adversely impacted by any sudden volatility in global markets. High interest rates have not been fully absorbed by global economies, as evident by the recent collapse of Silicon Valley Bank (SVB) in the US. We, therefore, also provide a bear market portfolio.

Jun-20

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### Bear market portfolio

We have evaluated various portfolios for a bear market scenario and found that the following market-weighted selection has beaten the broader index during bear market events. We define bear market events as a 20% correction from peak. For the longer term, we remain constructive on staples, capital goods and retail-focused lenders.

Fig 20 - Consistent outperformers during downturns

Company			
RIL IN	HDFC IN	HUVR IN	ACC IN
MM IN	SBIN IN	LT IN	APNT IN
INFO IN	ITC IN	SUNP IN	TATA IN
NEST IN			

Source: Bloomberg, BOBCAPS Research | \*Given corporate governance concerns, it may be worthwhile to replace ACC with UltraTech Cement (UTCEM)



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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

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