

## MACRO & MICRO

09 January 2023

### 2023 – Precursor to a breakout

- Building blocks largely in place for a faster rise in India's per capita income but key macro catalysts awaited
- 2023 likely to be a tale of contrasting halves for the stock market with high volatility in H1 and focus on growth in H2; best to be stock-specific
- Capex rally set to gather pace in H2CY23, aiding a breakout in 2024E; prefer retail lenders and consumption plays in the short term

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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 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.

**...but structural impetus awaited:** Our analysis indicates that most countries which saw a faster rise in income levels benefited from added structural tailwinds – be it global manufacturing outsourcing for China, digitisation for South Korea, or the post-war construction boom in the US and Germany. Such tailwinds are currently missing for India given the clouded global outlook. We believe a combination of the China-Plus-One strategy, PLI schemes and FTAs with large economies can catalyse a broad-based capex cycle along with consumption growth. 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.

**2023 a study in contrasts:** We expect H1CY23 to see signs of structural slowdown in China and a further growth taper 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. Note, energy concerns will ebb from Q2 as winter ends in the West. This apart, we will likely see more domestic projects under implementation six months down the line given the ramp up in new project announcements – a key metric for sustained economic growth, in our view.

**Stock-specific approach preferred in near term:** We believe a stock-specific approach along with a largely defensive stance will help investors outperform the wider market. Our preference for retail-focused lenders and consumption themes continues. We also reiterate a portfolio from our previous study that tends to outperform in bear markets (Fig 28). Overall, we expect modest low-double-digit returns for the Nifty 50 in 2023.



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## Foundation laid for sustainable growth

We believe the requisite building blocks for a sustained high-growth phase in the Indian economy are largely in place. We had discussed our thesis in detail in our report of 11 Jan 2022, [India at takeoff point](#), and provide a summary below to set the context.

### Macro building blocks in place

Industrialisation opened the door to per capita income growth in western countries, further boosted by post-war recovery, even as export-led manufacturing spurred growth in China and a boom in digitisation drove incomes in South Korea. However, a common theme for many of the countries that witnessed a swift uptick in per capita income was the shift in demographics – population growth moderated to just ~1%, a level that India has recently achieved.

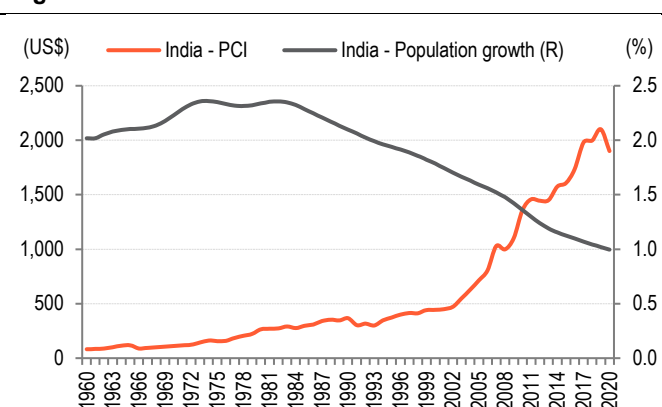
Note that the crucial building blocks now largely in place for India include 24-hour electricity, road/rail connectivity, affordable housing, food security, basic healthcare facilities and improved hygiene. Rollout of potable water connectivity is underway and will further raise the standard of living. Education levels and school availability have also risen significantly. The other key structural change has been rapid digital adoption in India, including digital finance and the unified payments interface (UPI).

That said, a secular rise in India's per capita income can only follow a combination of a sharp capex upcycle and growth in consumption. Accordingly, we believe structural factors such as the China-Plus-One strategy, ongoing production-linked incentive (PLI) schemes and free trade agreements (FTAs in place or in process) can emerge as tailwinds for the proverbial take-off of the Indian economy.

### Population growth nearing optimum levels

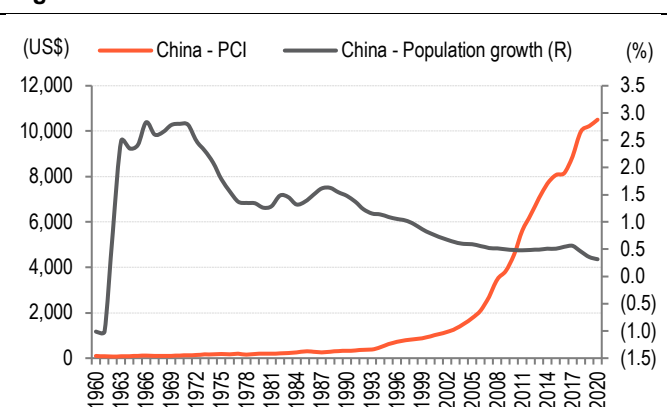
One of the strengths of the Indian economy has been its demographic dividend, with the adult population forming about two-thirds of the total. However, population growth has been moderating and is now at just ~1% per annum. Interestingly, the experience of several countries shows that the trajectory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

**Fig 1 – India**

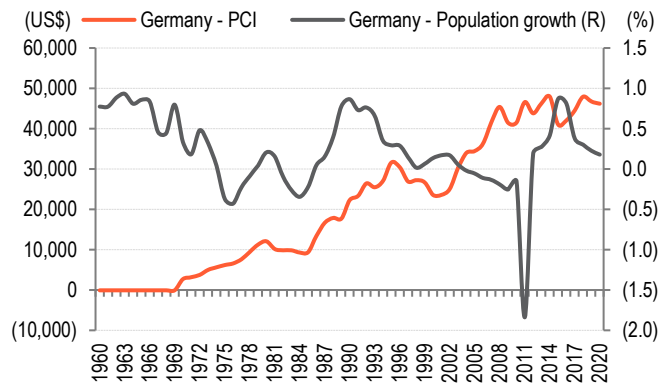


Source: World Bank, BOBCAPS Research | PCI: Per Capita Income

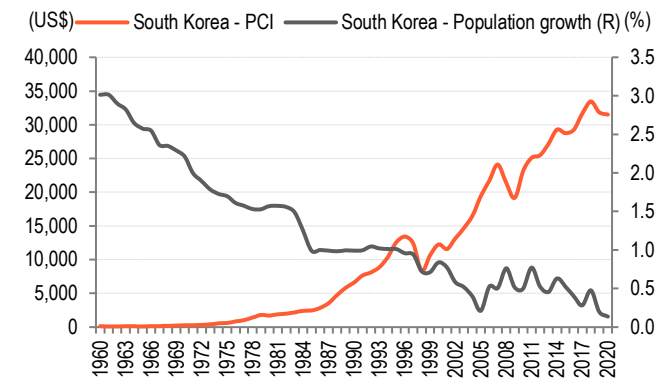
**Fig 2 – China**



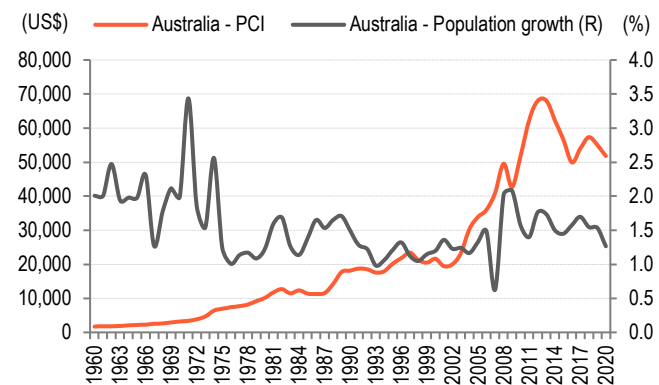
Source: World Bank, BOBCAPS Research

**Fig 3 – Germany**

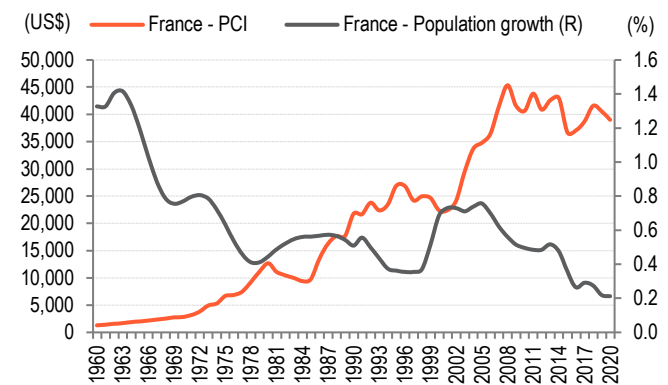
Source: World Bank, BOBCAPS Research | PCI – Per Capita Income

**Fig 4 – South Korea**

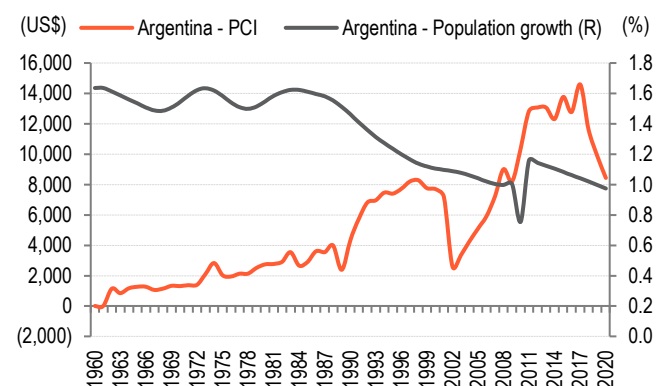
Source: World Bank, BOBCAPS Research

**Fig 5 – Australia**

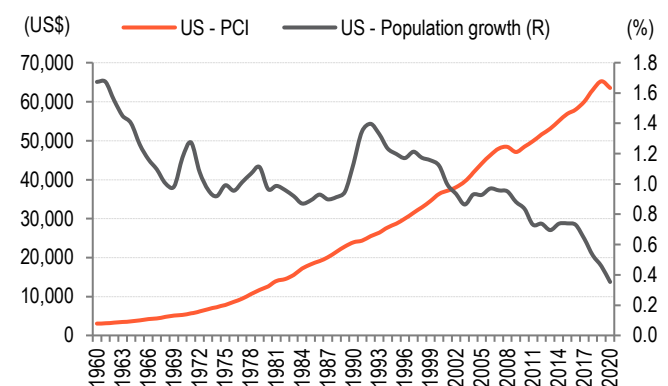
Source: World Bank, BOBCAPS Research

**Fig 6 – France**

Source: World Bank, BOBCAPS Research

**Fig 7 – Argentina**

Source: World Bank, BOBCAPS Research

**Fig 8 – United States**

Source: World Bank, BOBCAPS Research

## Economic indicators looking up

Several reforms undertaken in India over the last decade have created a sustainable framework for economic growth, as evidenced by the improvement in various important macro indicators (outlined below).

**Fig 9 – Building blocks for growth**

Parameter	FY10	FY22
Peak electricity deficit (%)	12.6	0
Access to electricity (%)	66	99
Mobile internet users (mn)	2.3	825
Roads (mn km)	4.6	6.4*
Basic saving bank deposit account (BSBDA) (mn)	73	663
Number of MBBS seats	35,200	91,927

Source: Various GoI ministries, Media reports, BOBCAPS Research | \*Dec'19

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 metros has been decreasing, further indicating that local employment opportunities are on the rise. Effective welfare programmes run by the government have also eased the living conditions in rural areas.

## Labour costs remain competitive

India has among the lowest minimum wages in the world – currently a mere 30% of that in China and ~60% of that in Vietnam. On purchasing power parity basis, India's minimum wage is ~60% of that in China, which still suggests a sustainable wage advantage over other countries in the near-to-medium term.

**Fig 10 – Minimum wage comparison**

Country (US\$/month)	Minimum wage	Minimum wage (PPI-based)
India	96	408
China	300	717
US	1,376	2,695
UK	1,827	7,177
Germany	1,466	4,197
Vietnam	163	707
Indonesia	174	699

Source: Picodi, World Bank, BOBCAPS Research,

## Trade agreements to spur manufacturing

Trade agreements have the potential to further boost India's growth given the country's cheap but skilled manpower. India is currently negotiating FTAs with the UK and EU, both of which have the potential to catalyse local manufacturing. Existing treaties account for a mere 22% of India's exports.

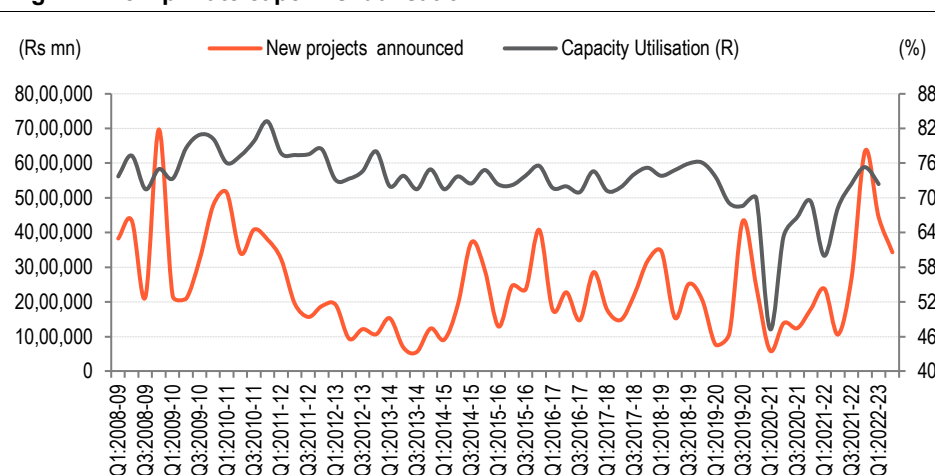
**Fig 11 – Key trade agreements in place**

Agreement	Indian exports (US\$ bn)
India-Thailand FTA – Early Harvest Scheme (EHS)	5.5
India-Singapore Comprehensive Economic Cooperation Agreement (CECA)	10.7
India-ASEAN CECA – Trade in Goods, Services and Investment Agreement (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam)	40.7
India-South Korea Comprehensive Economic Partnership Agreement (CEPA)	7.0
India-Japan CEPA	6.1
India-Malaysia CECA	6.7
India-UAE CEPA	25.5
India-Australia Economic Cooperation and Trade Agreement	7.0

Source: GoI, Bloomberg, BOBCAPS Research

## India on the cusp of a potential capex supercycle

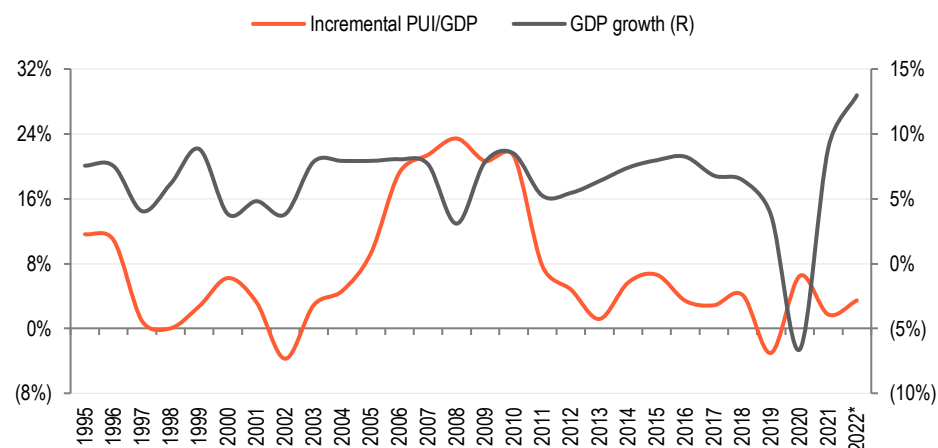
Current data points to a modest resurgence in both utilisation and new private capital expenditure. Another data point of import is the 45% YoY increase in new project announcements to Rs 6tn in Q3FY23. We believe these are early signs of a sustained capex rally that is likely to gather pace by H2CY23, once tailwinds from new trade agreements and improvement in global sentiment set in.

**Fig 12 – New private capex vs. utilisation**

Source: RBI, CMIE, BOBCAPS Research

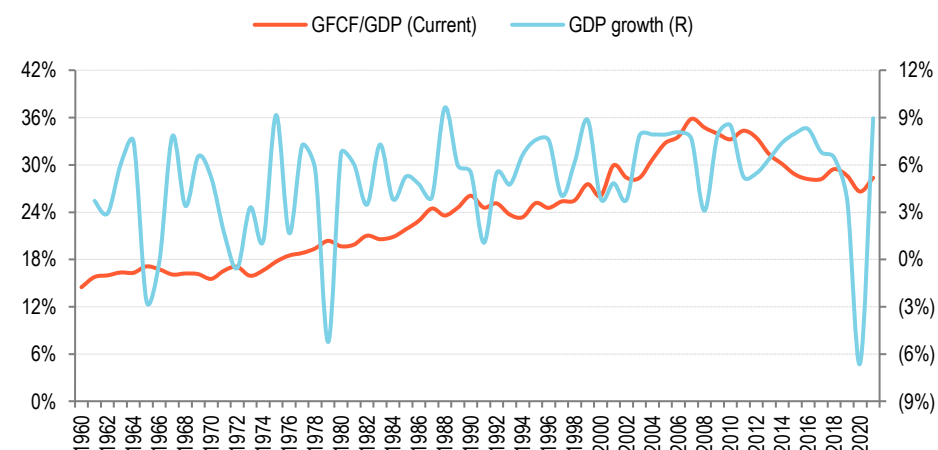
## Early signs of capex momentum

Q3FY23 saw impressive new project announcements worth Rs 6tn. While projects under implementation (PUI) increased by just ~Rs 1.3tn QoQ, should new announcements continue at the current pace, we will likely see a meaningful increase in PUI in a few quarters. Thus, though capex is still short of the threshold necessary to recalibrate India's growth trajectory, we are headed in the right direction. Our analysis of historical GDP growth vs. new projects indicates that we will need a sustained 5%+ new project/GDP ratio to sustain growth momentum, for both private and public sectors, which would mean an average run-rate of >Rs 6tn a quarter.

**Fig 13 – PUI vs. GDP growth**

Source: CMIE, Bloomberg, BOBCAPS Research | \*Data till Sep'22

Note, we would also need to see the level of gross fixed capital formation (GFCF) as a percentage of GDP start plateauing and moving up from its current downward trajectory as a precursor to economic liftoff.

**Fig 14 – GFCF vs. GDP**

Source: Gol, Bloomberg, BOBCAPS Research

### Strong policy support to spur spends

Though public and private capex in India has undershot targets several times in the past, we note that the government's Rs 111tn National Infrastructure Pipeline (NIP) and Gati Shakti schemes appear to be meticulously planned with a particular thrust on debottlenecking project approvals and funding – this should lend a strong impetus to the domestic capex cycle.

- We believe the **NIP is more focused** than its earlier Five-Year Plan avatars, with considerably more emphasis towards on-the-ground execution.
- **States have bought into this plan** and have largely met their capex targets even during the pandemic (only a 5% slippage from budgeted capex in FY22).

- For the first time ever, the government has **addressed the financing** of new projects via the National Monetisation Pipeline (NMP) which entails the planned monetisation of cash flows from existing assets.
- **Project coordination** through Gati Shakti is intended to cut across ministerial lines which should aid faster turnaround. Execution is likely to be buttressed by policy support related to land acquisition, right of way, and addressing tariff gaps in electricity pricing.

### Private capex cycle also kicking off

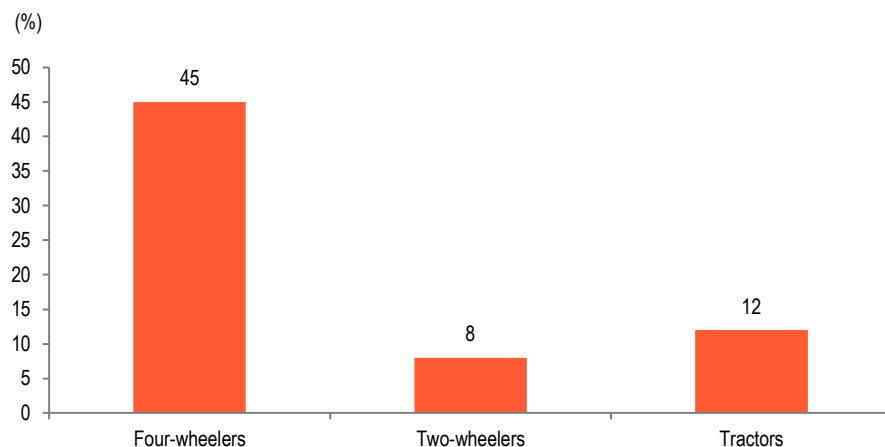
The private capex pipeline in India has been boosted by energy transition, participation in PLI schemes, and new technology areas such as data centres and automated warehouses. While capacity utilisation in the capital goods sector is conventionally the foremost indicator of impending capex, we believe the current wave of new-age projects is largely decoupled from existing utilisation levels.

For a detailed analysis of India's capex outlook, please refer to our Nov'22 report by capital goods analyst Vinod Chari: [On the cusp of a capex supercycle](#).

### Consumption – Can 2023 be a year of rural recovery?

Key consumption trends in 2022 included (1) an unusual tilt in demand towards relatively big-ticket products (for instance, four-wheeler sales grew while two-wheelers faltered and tractors sold better than television sets in rural areas), and (2) a marked downturn in rural demand.

**Fig 15 – Growth trend in auto sales, FY23 YTD**



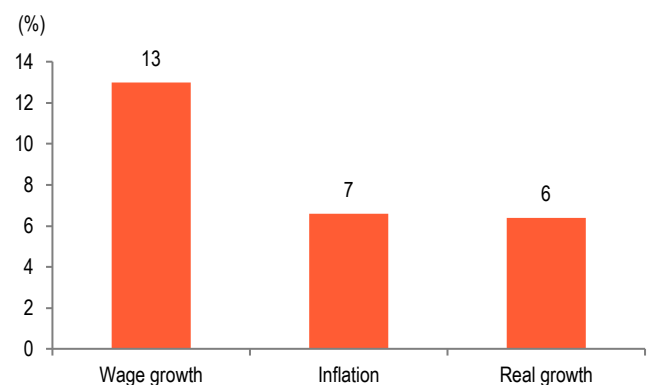
Source: Companies, BOBCAPS Research

Urban India has been able to escape a slowdown as wages in the organised sector beat inflation. According to CMIE's Consumer Pyramids Household Survey, the average wage for all companies has gone up from Rs 263,000 in FY21 to Rs 300,000 in FY22, an increase of 14% which comfortably beats the average inflation rate of ~7%.

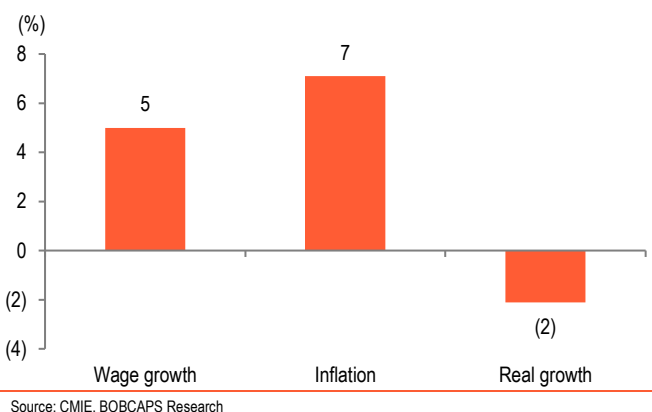


In contrast, inflation has eaten into rural incomes. As per data from the Ministry of Statistics and Programme Implementation (MoSPI), rural inflation was 7.1% in FY23 YTD vs. average wage growth of 5%, which means a real decline of 2% in rural wages. Also, the ongoing food and LPG (cooking gas) subsidy programmes have helped stem the return of migrant workers to urban centres post pandemic, in turn implying lower urban-to-rural remittances.

**Fig 16 – Urban income growth has been able to overcome inflation, FY23 YTD**

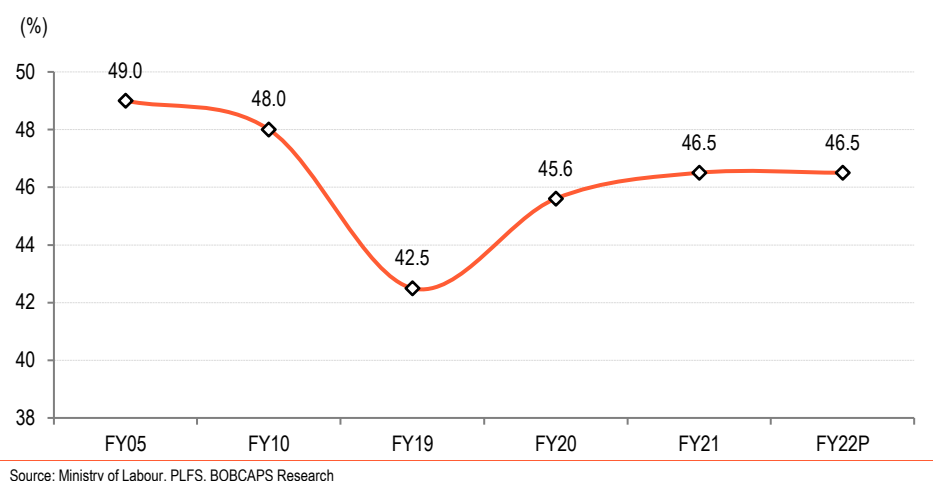


**Fig 17 – Rural income is negative in real terms, FY23 YTD**



India which had 49% of its workforce in agriculture in FY05 saw this number steadily decline to 42.5% in FY19, before inching back to 46% in FY21, as some of the migrants who returned to their villages following the pandemic stayed back. However, this could change in 2023 given expectations of a pickup in capex, which will also have a positive impact on rural wages, in turn boosting consumption.

**Fig 18 – Labour participation in agriculture has moved up**



**Potential dampeners to capex outlook**

While we anticipate an upturn in capex over the medium term, various structural impediments could pose a risk to our outlook.

- The implementation of a stronger debt resolution framework (IBC) 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.
- The removal of margin protection on discretionary/preferential allocation of natural resources, which in the past granted the licensee a visible commercial advantage, could weaken project bids.
- Parliamentary elections in Q1FY25 will likely lead to a modest slowdown in infrastructure projects for 3-5 months post polls, as has been the case during prior elections.

## Market view

### One quarter at a time

While there are long-term underlying themes (energy transition, premiumisation of consumer goods) that would remain relevant, we believe the global market has become much more volatile over the last few years and 2023 is unlikely to be any different. Therefore, we would recommend a combination of (a) an anchor long-term portfolio (as shown in Fig 28) that would grow steadily in a bull market and lend protection in a bear market, and (b) a short-term portfolio carrying an investment outlook of not more than a quarter at a time.

Over the next three months, we expect a resurgence in cyclical sectors such as financials and industrials. While predicting outcomes beyond a quarter is fraught with risk given the heightened global volatility, we do believe H1CY23 will see signs of a structural slowdown in China and a further growth taper in Europe and the US – in turn prompting earnings cuts globally, including in India.

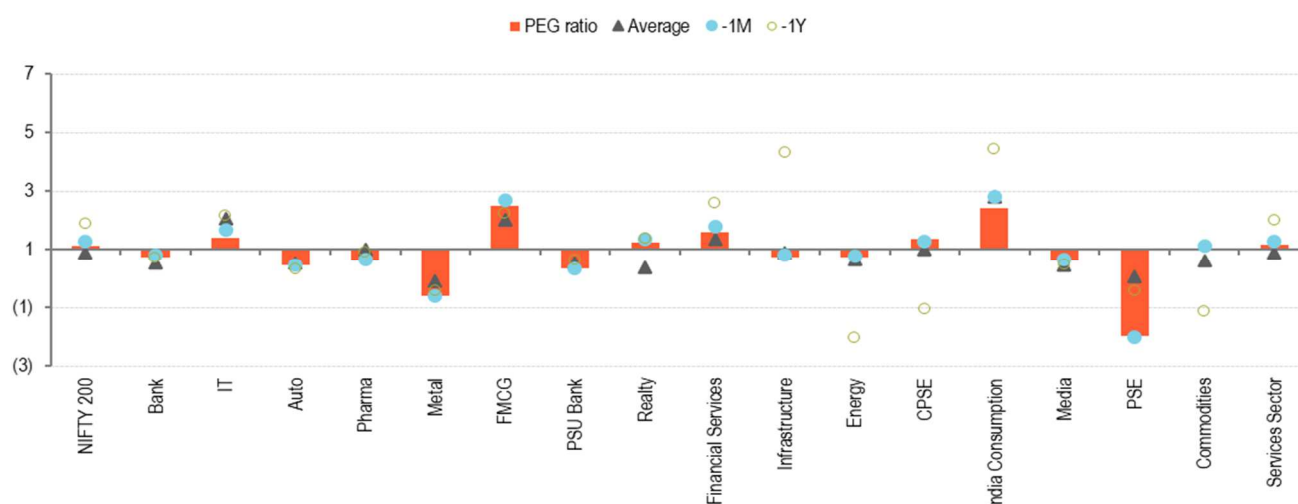
However, once markets are able to absorb these earnings downgrades, the stronger global growth outlook for 2024 coupled with limited downside to valuation multiples should gradually encourage a risk-on mindset globally from H2, in our view.

### 2023 – A study in contrasts

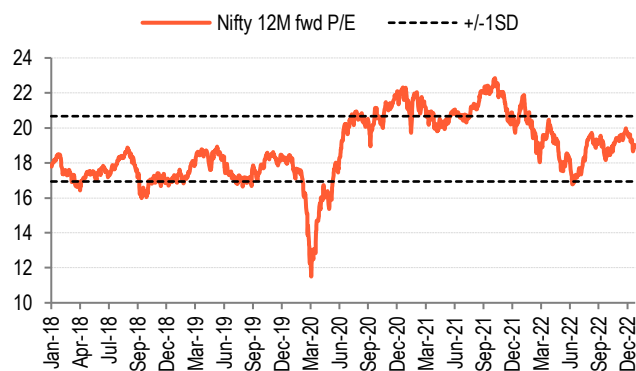
We believe 2023 will be a story of contrasting halves. In H1, we expect markets to remain volatile as the world comes to grips with the renewed Covid scare in China as well as the full extent of recessionary trends in Europe and the US. H2, however, should be a phase of modest growth, barring unforeseen geopolitical shocks. Overall, we expect modest low-double-digit returns for the Nifty 50 in 2023.

The first half of the year is also likely to see higher volatility, including sector rotation, in our view. We have, therefore, analysed sectors that are likely to see more interest from investors globally.

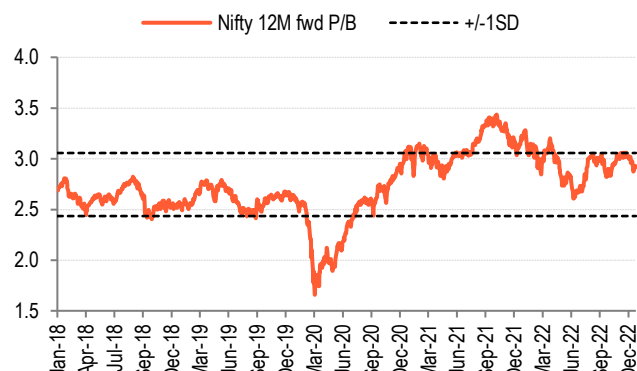
Fig 19 – PEG ratio



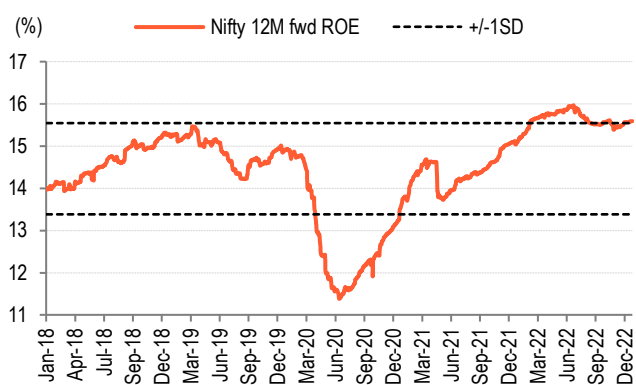
Source: Bloomberg, BOBCAPS Research

**Fig 20 – Nifty 12M fwd P/E**

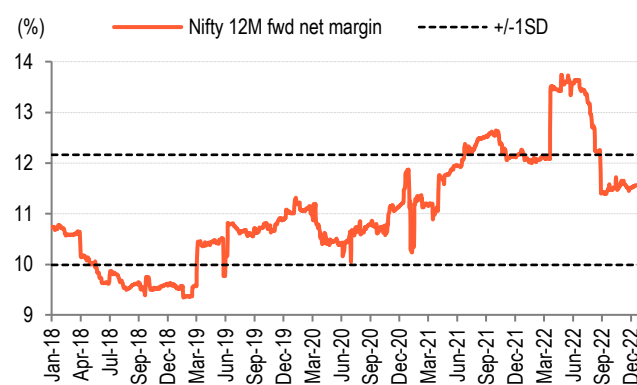
Source: Company, BOBCAPS Research

**Fig 21 – Nifty 12M fwd P/B**

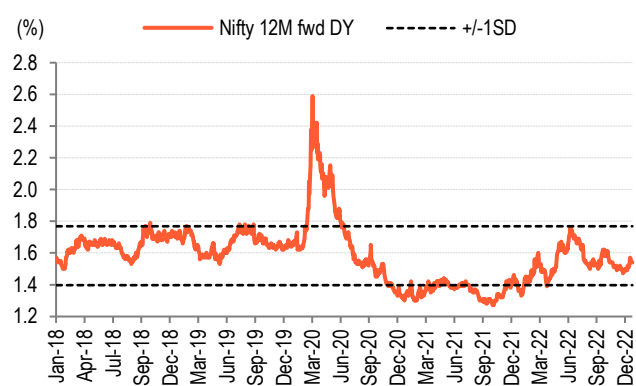
Source: Company, BOBCAPS Research

**Fig 22 – Nifty 12M fwd ROE**

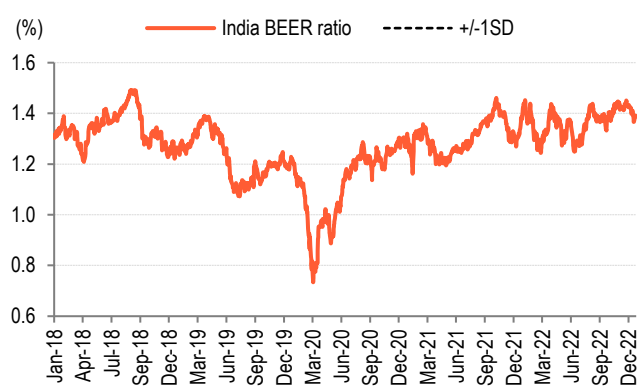
Source: Company, BOBCAPS Research

**Fig 23 – Nifty 12M fwd net margin**

Source: Company, BOBCAPS Research

**Fig 24 – Nifty 12M fwd DY**

Source: Company, BOBCAPS Research

**Fig 25 – India BEER ratio**

Source: Company, BOBCAPS Research

## Sector rotation to favour consumption

A good way to inform our sector outlook is to analyse the sales of products that are used by a range of industries. Certain chemical companies sell goods that are used across industries and, therefore, their sales commentary is a reasonable reflection of the prognosis for each underlying sector. We further juxtapose our outlook for the Indian economy against this data to formulate an overall view on each sector (Fig 26). Accordingly, we would expect a positive rotation towards the consumption sector in the Indian context.

**Fig 26 – Near-term sectoral outlook**

Sectors	Global outlook	India outlook
Consumer Goods	Modest	Robust
Consumer Durables	Challenging	Modest
Transportation	Robust	Modest
Energy & Resources	Modest	Challenging
Healthcare	Modest	Modest
Hardware & Electronics	Modest	Modest
Chemicals	Modest	Robust
Agriculture	Robust	Robust
Information Technology	Modest	Modest
Real Estate	Challenging	Modest
Infrastructure	Challenging	Modest
Cement & Building Materials	Challenging	Modest

Source: Company data, BOBCAPS Research

## Bear market portfolio for India

Given that recession risks could drive a steep correction in the global market in H1CY23, we've identified a set of 13 leaders that have outperformed the index in various bear market scenarios (Fig 28). We define a bear market as one where 12-month rolling returns (Sensex) are less than or equal to minus 20% (for details, see our note of 13 Sep 2022, [Bear up: Stick to the leaders](#)).

Our study compared a portfolio of market leaders with the benchmark indices and found that a market-weighted index of leaders, though a tad more expensively valued, has outperformed the broader indices. While a diversified portfolio, as reflected by popular indices, is widely acknowledged as offering more efficient risk-adjusted returns, our analysis indicates that the portfolio of sector leaders consistently outperforms during downturns, beating the index in each of the last 10 bear markets.

**Fig 27 – Overall portfolio performance**

Period (%)	SENSEX Index	NIFTY Index	NSE500 Index	NSE50EW Index	Leaders		Top 10 2000		Top 10 Rebalanced	
					MW	EW	MW	EW	MW	EW
5Y	13.4	12.4	12.0	10.7	18.2	17.3	19.9	12.4	16.3	15.7
10Y	13.1	12.9	14.0	11.6	15.8	14.3	16.5	14.2	13.3	13.6
15Y	9.5	9.6	9.9	9.6	12.6	14.7	12.0	8.6	8.8	9.1
20Y	15.8	15.4	16.4	16.3	19.7	21.2	18.3	14.7	15.1	15.3
Overall	12.0	12.0	13.5	13.1	17.5	21.5	16.3	19.0	13.7	19.5

Source: Bloomberg, BOBCAPS Research | MW: Market-weight, EW: Equal-weight

**Fig 28 – Portfolio constituents for our study: Option 1 basket of leaders has consistently outperformed during downturns**

Option 1	Option 2	Option 3				
Leaders	Top 10: 2000	Top 10: 2000	Top 10: 2005	Top 10: 2010	Top 10: 2015	Top 10: 2020
RIL IN	HUVR IN	HUVR IN	ONGC IN	RIL IN	TCS IN	RIL IN
MM IN	INFO IN	INFO IN	RIL IN	ONGC IN	ONGC IN	TCS IN
INFO IN	RIL IN	RIL IN	INFO IN	NTPC IN	ITC IN	HDFCB IN
NEST IN	Z IN	Z IN	WPRO IN	INFO IN	RIL IN	HDFC IN
HDFC IN	ITC IN	ITC IN	BHARTI IN	TCS IN	SBIN IN	HUVR IN
SBIN IN	SCS IN	SCS IN	SBIN IN	SBIN IN	HDFCB IN	ICICIBC IN
ITC IN	MTNL IN	MTNL IN	ITC IN	BHARTI IN	INFO IN	KMB IN
HUVR IN	SBIN IN	SBIN IN	HUVR IN	BHEL IN	ICICIBC IN	INFO IN
LT IN	ICICIBC IN	ICICIBC IN	ICICIBC IN	LT IN	HDFC IN	SBIN IN
SUNP IN	NIIT IN	NIIT IN	RBXY IN	WPRO IN	SUNP IN	ITC IN
ACC IN	-	-	-	-	-	-
APNT IN	-	-	-	-	-	-
TATA IN	-	-	-	-	-	-

Source: Bloomberg, BOBCAPS Research

## Sector view

### Automobiles – On the road to normalcy

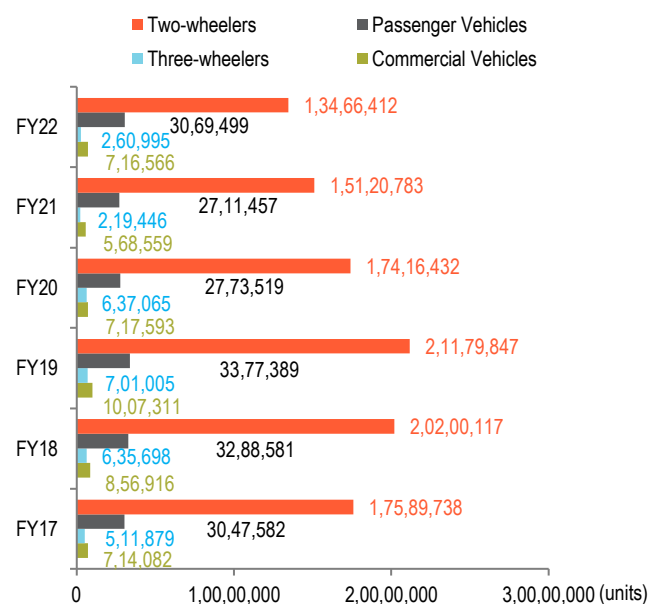
We believe a combination of premiumisation and ebbing supply chain issues will enable passenger (PV) and commercial vehicles (CV) to outperform India's broader auto market in the near term. In two-wheelers (2W), we expect rural demand to gain momentum as both kharif (monsoon crop) and rabi (winter crop) seasons have progressed well. Note, we are yet to return to the pre-pandemic run-rate for 2Ws.

### Strong growth in FY23 YTD

The Indian auto industry has performed well in FY23 YTD – the first year of relative normalcy after Covid-related headwinds in FY21-FY22 and implementation of GST and demonetisation in earlier years. We note that value growth has significantly outpaced volume growth due to a shift in segmental mix towards high-end models coupled with price hikes undertaken by original equipment manufacturers (OEM).

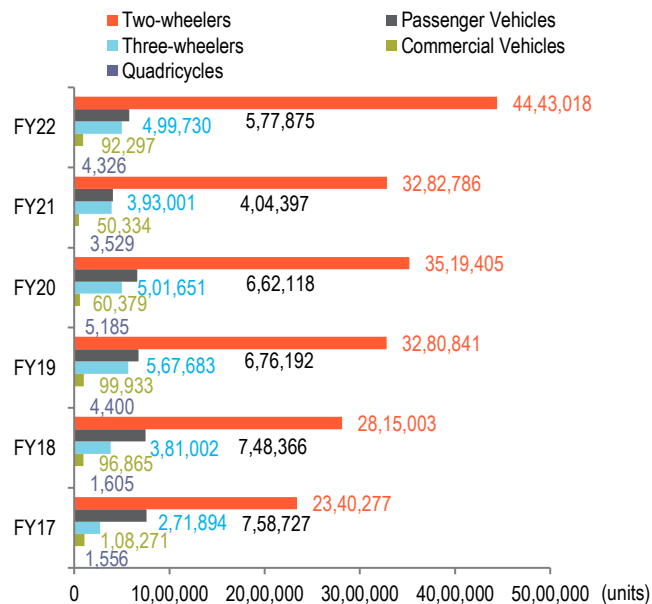
That said, FY23 has been affected by raw material availability as the global semiconductor shortage impacted production. Though supply chain concerns are waning, constraints are yet to recede fully and chip availability remains a key aspect to monitor. Further, while auto demand (CV/PV segments) has seen healthy recovery, it has not reached its full potential on account of the rising fuel costs.

**Fig 29 – Domestic auto sales**



Source: Company, BOBCAPS Research

**Fig 30 – Export auto sales**



Source: Company, BOBCAPS Research

### Expect PV/CVs to outperform near term

We believe the PV segment will reach an all-time high in the current fiscal (21-24% YoY volume growth). The CV segment has seen some volume recovery and is expected to deliver a steady to strong print. In 2Ws, sales have declined from all-time highs as demand waned; we bake in flattish numbers to mild declines YoY in FY23.

In our view, replacement demand should hold supported by higher ageing of vehicles – the average ageing of PVs increased to ~7.3 years in FY22, the highest in the past two decades. Capacity utilisation is likely to remain at comfortable levels (~70% in FY23E) vs. 59% in FY22.

Inventory across dealerships is estimated to have reached near-normal levels of 35-40 days from 10-12 days (H2FY22) as production is normalising following smoothening of the supply chain.

### EV outlook

The timeline to pricing parity for EVs (with conventional vehicles) has moved back due to hikes in key mineral prices that have delayed a softening of battery costs (25-30% drop from current levels needed to enable pricing parity in PV segment).

Government subsidies, demand aggregation by government-backed entities, lower running costs and improved charging infrastructure are factors that will support EV adoption over the medium term. Our estimates for EV penetration by FY25 are: e-LCV and electric cars 4-6% of respective market size, electric bus 11-13%, e-2W 13-15%, and e-3W 14-16%. Per ICRA, India could be a leader in shared mobility by CY30, providing opportunities for electric and autonomous vehicles.

### Export outlook

On the exports front, the Indian automotive industry is targeting a five-fold increase in sale volumes during CY16-CY26.

**Fig 31 – Auto stock matrix**

Company	EBITDA margin FY24E (%)	1Y fwd P/E (x)	Key Investment theme
Mahindra & Mahindra	13.5	17.9	Premiumisation
Maruti	11.7	21.6	Coverage
TVS	11.0	25.5	Premiumisation
Ashok Leyland	9.4	21.8	Geographical expansion
Eicher	25.4	24.7	Brand strength
Hero	13.0	15.1	Market positioning
Bajaj	17.9	16.2	Market positioning
Tata Motors	12.4	13.0	Too many moving parts

Source: Bloomberg, BOBCAPS Research

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## Banks – Marching ahead

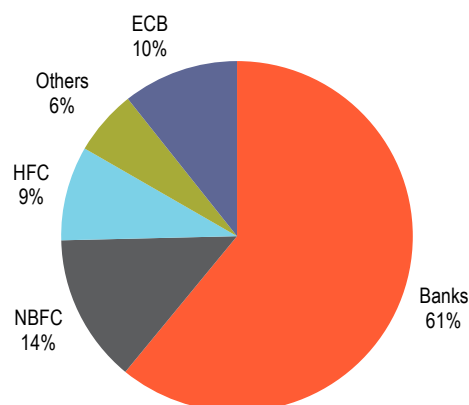
### Low credit penetration offers ample scope for growth

Despite multiple challenges faced by the Indian banking sector in recent years, a combination of enabling regulations, customer stickiness, access to low-costs deposits and preferential access to government business has meant that the sector has emerged stronger, save for some public sector banks that had to be restructured, merged or consolidated due to their stressed assets.

Non-banking finance companies (NBFC) have largely filled the gaps left by banks due to limitations of the latter's reach. Banks preferred lending to these intermediaries, 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.

We note that India's credit market currently totals ~Rs 190tn 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 32 – India's credit market**



Source: RBI data, BOBCAPS

### Outlook

We expect domestic banks to clock credit growth of 14-15% YoY with deposit growth of 12-13% in FY24, a mild moderation over FY23E given a higher base. However, deposit mobilisation will not be seamless, in particular CASA deposits given their lower interest rates. Note, deposit rates are yet to catch up with the increased lending rates, and we expect the two to align over the next 1-2 quarters.

We, therefore, expect banks' non-core income to witness an upward trajectory with no major mark-to-market (MTM) losses in treasury operations. This was a drag in the last two quarters considering an increase in benchmark interest rate. However, we believe that banks' constant focus on market penetration through digitisation, while continuing to build on traditional branch expansion, will likely keep their cost-to-income ratios elevated (+40% level).

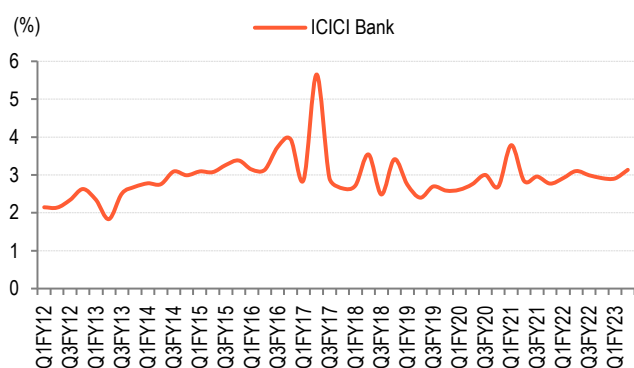
Note, RBI's quick and timely policy measures, including a resolution framework to fight Covid-19, has lent banks greater resilience against asset quality deterioration. The restructuring of stressed loans during the pandemic along with additional provisioning gives banks a strong foothold in terms of coverage ratio.

The overall outlook for the sector is positive as we believe the benchmark interest rate is close to its peak and major asset quality concerns are behind us (overall GNPA ratio down to 5.8% from high single digits in FY16-FY17). That said, a continuing focus on lending to the small and medium (SME) and micro, small & medium (MSME) enterprise segments post pandemic (growing faster than other segments at 20%+), along with increasing unsecured retail loans (personal loans and credit cards), may pose new asset quality challenges in future. Cost-to-income ratio will be a key monitorable for FY24.

### Prefer players with strong PPOP

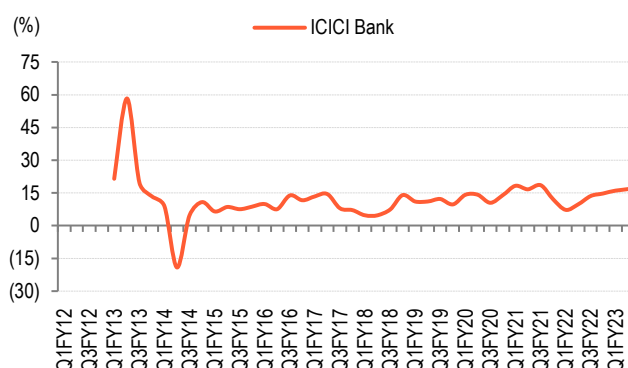
The last few quarters have seen robust credit growth, in part due to pent-up demand in the wake of the pandemic. We expect credit growth to moderate but remain higher than pre-pandemic levels. In our view, the retail book will deliver higher credit and net interest margin (NIM) growth and hence better 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 simultaneously grow assets.

**Fig 33 – ICICI Bank – PPOP/Assets**



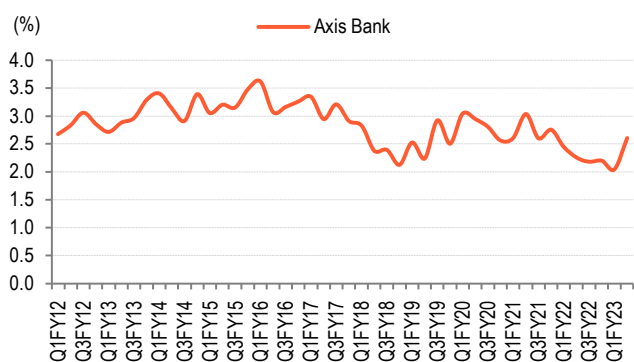
Source: Company, Bloomberg, BOBCAPS Research

**Fig 34 – ICICI Bank – Asset growth**



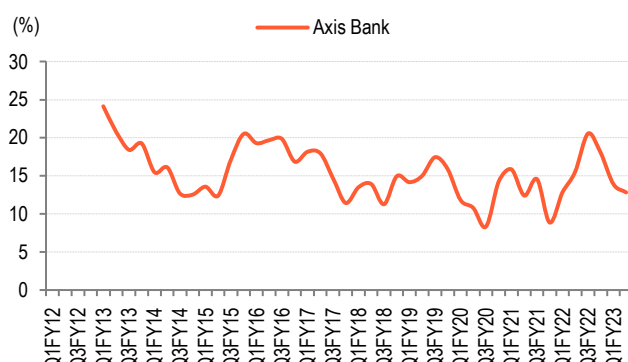
Source: Company, Bloomberg, BOBCAPS Research

**Fig 35 – Axis Bank – PPOP/Assets**

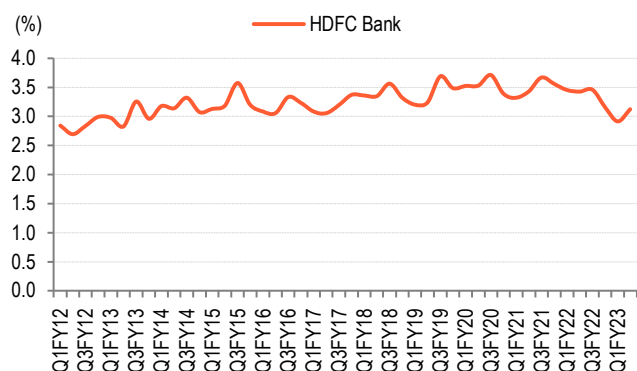


Source: Company, Bloomberg, BOBCAPS Research

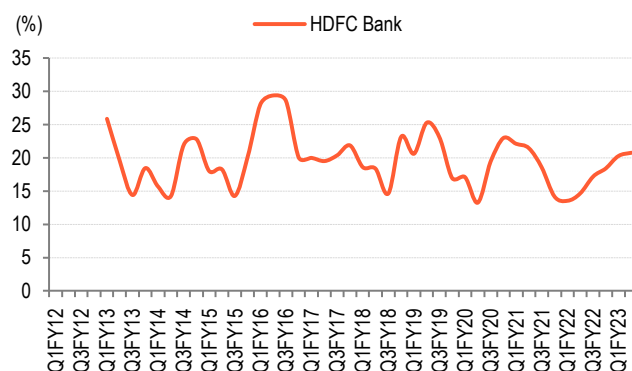
**Fig 36 – Axis Bank – Asset growth**



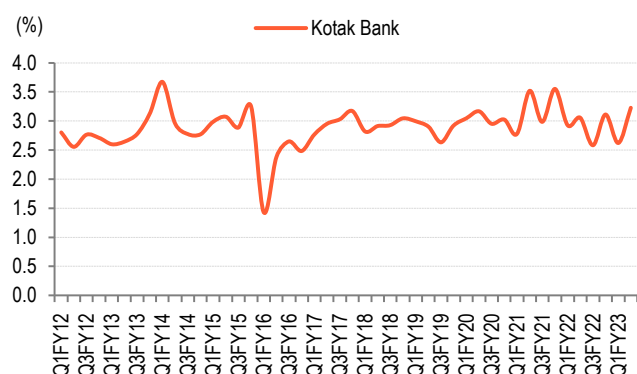
Source: Company, Bloomberg, BOBCAPS Research

**Fig 37 – HDFC Bank – PPOP/Assets**

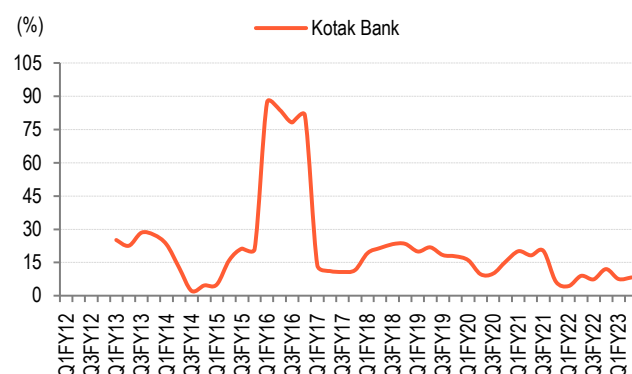
Source: Company, Bloomberg, BOBCAPS Research

**Fig 38 – HDFC Bank – Asset growth**

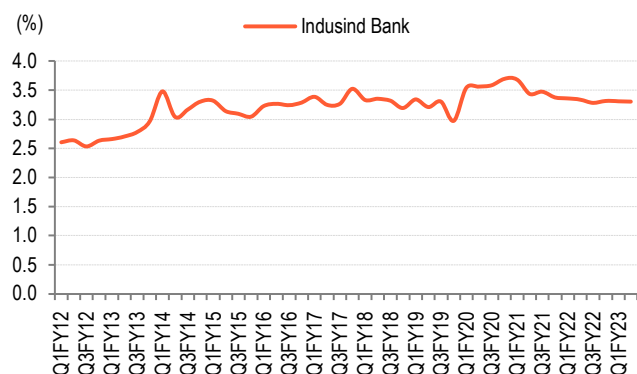
Source: Company, Bloomberg, BOBCAPS Research

**Fig 39 – Kotak Mahindra Bank – PPOP/Assets**

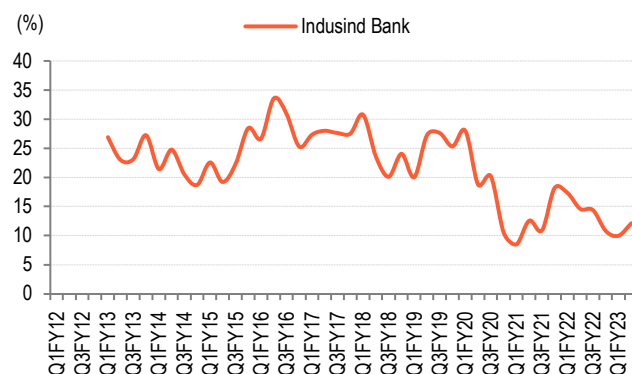
Source: Company, Bloomberg, BOBCAPS Research

**Fig 40 – Kotak Mahindra Bank – Asset growth**

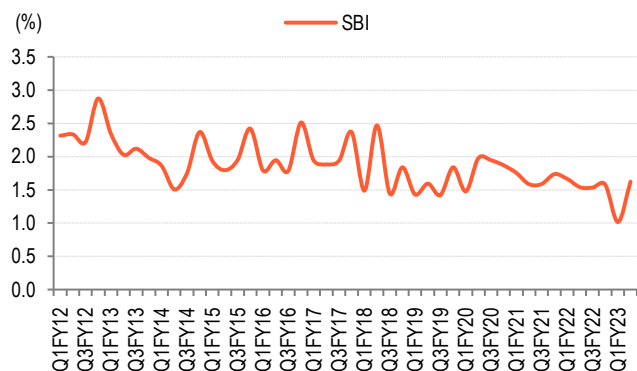
Source: Company, Bloomberg, BOBCAPS Research

**Fig 41 – IndusInd Bank – PPOP/Assets**

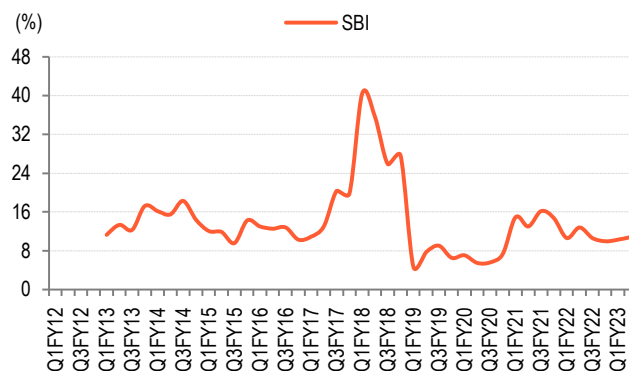
Source: Company, Bloomberg, BOBCAPS Research

**Fig 42 – IndusInd Bank – Asset growth**

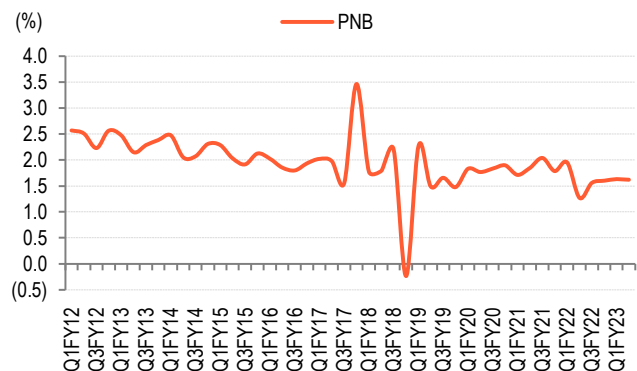
Source: Company, Bloomberg, BOBCAPS Research

**Fig 43 – SBI – PPOP/Assets**

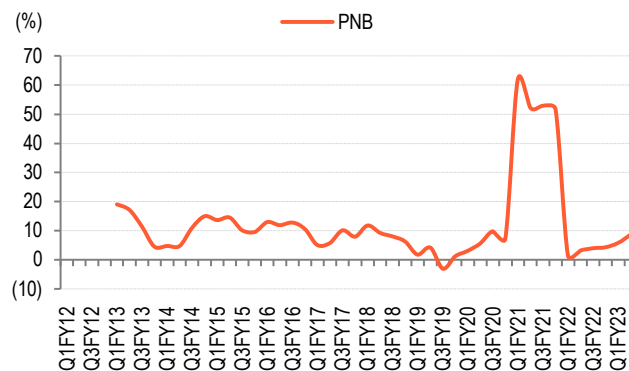
Source: Company, Bloomberg, BOBCAPS Research

**Fig 44 – SBI – Asset growth**

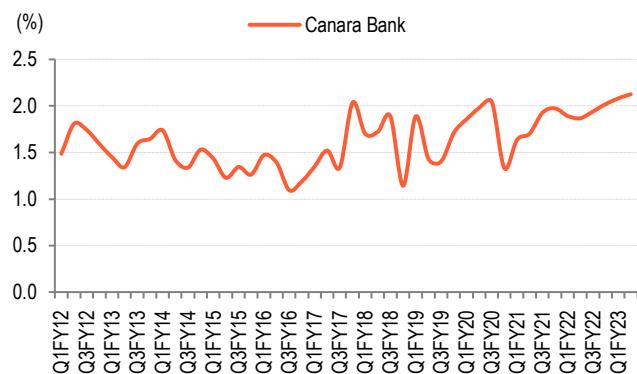
Source: Company, Bloomberg, BOBCAPS Research

**Fig 45 – Punjab National Bank – PPOP/Assets**

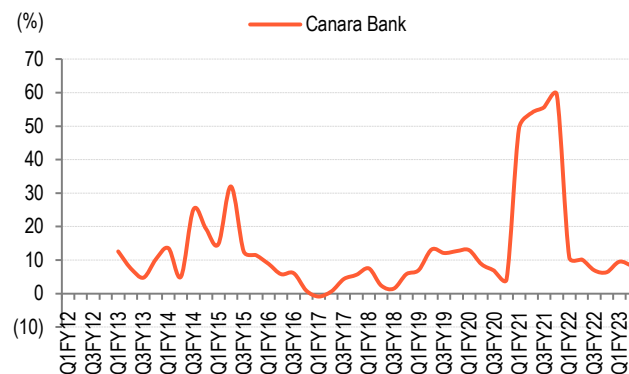
Source: Company, Bloomberg, BOBCAPS Research

**Fig 46 – Punjab National Bank – Asset growth**

Source: Company, Bloomberg, BOBCAPS Research






**Fig 47 – Canara Bank – PPOP/Assets**

Source: Company, Bloomberg, BOBCAPS Research

**Fig 48 – Canara Bank – Asset growth**

Source: Company, Bloomberg, BOBCAPS Research

**Fig 49 – Banking stock matrix**

Company	Portfolio mix	Credit discipline	Network effect	Digitisation	Future proofing	ROA Q2FY23 (%)	P/B 1Y fwd (x)
HDFC Bank						2.0	2.8
ICICI Bank						2.1	2.4
Axis Bank						1.8	2.0
State Bank of India						1.2	1.5
Kotak Bank						2.4	3.1
IndusInd Bank						1.7	1.5
Federal Bank						1.2	1.1
Canara Bank						0.8	0.8
Bandhan Bank						0.6	1.6
RBL Bank						0.8	0.8
DCB Bank						1.0	0.9
AU Small Finance Bank						1.8	3.5
Punjab National Bank						0.1	0.7

Source: Bloomberg, BOBCAPS Research

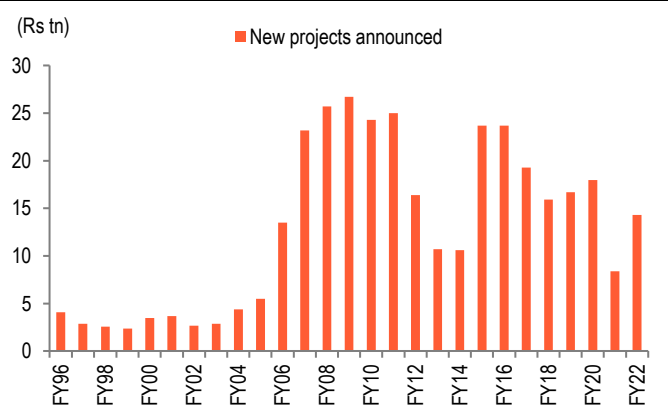


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## Capital Goods – Gaining strength

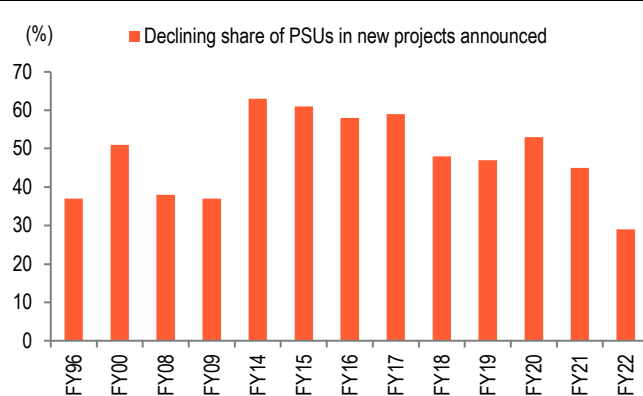
We believe India is on the cusp of a capex supercycle backed by a combination of strong government and private expenditure. The last decade witnessed limited private sector participation and investments were largely government-led. In contrast, we now expect a new wave of private capex driven by (1) ESG-led (environment, social, governance) spends in renewables, EVs, battery technology and hydrogen, (2) PLI and China Plus One-led manufacturing outlay, and (3) technology disruptions such as 5G and e-commerce, fuelling capex in areas such as data centres and logistics (read our detailed capex analysis in our Nov'22 report: [On the cusp of a capex supercycle](#)).

**Fig 50 – New projects announced expected to gather traction...**



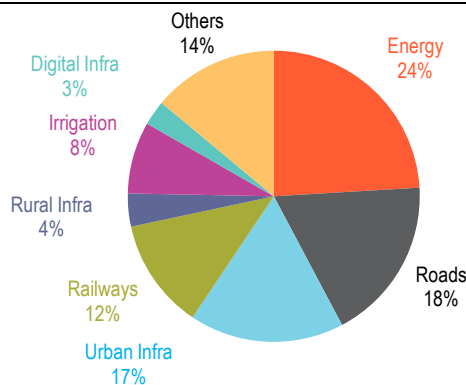
Source: BOB Economics Research, BOBCAPS Research

**Fig 51 – ...along with buoyancy in private capex independent of utilisation**



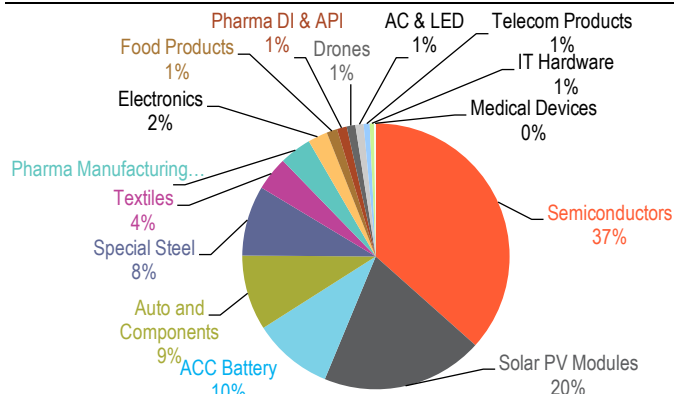
Source: BOB Economics Research, BOBCAPS Research | PSU: Public Sector Units

**Fig 52 – NIP sector-wise breakup**



Source: dea.gov.in, BOBCAPS Research | NIP: National Infrastructure Pipeline

**Fig 53 – Spread of PLI investments**
























Source: MEITY, BOBCAPS Research | DI: Drug Intermediates, API: Active Pharmaceutical Ingredients

While private capex provides a tailwind to existing government spends, we also believe that the execution of government capex will improve, led by:

- state buy-in of the National Infrastructure Pipeline (NIP) with states competing for new projects,
- attention to financing of the NIP via the National Monetisation Pipeline (NMP), and
- project coordination through Gati Shakti which is intended to cut across ministerial lines and should aid faster turnaround times.

**Fig 54 – Capital goods stock matrix**

Company	Entry barrier	Industry tailwinds	Competitive Moat	EPS CAGR FY22-24E (%)	P/E FY24E (x)	ROE FY24E (%)
POWERINDIA				31.4	48.7	20.4
LT				25.0	22.0	14.2
AIAE				20.3	27.3	15.2
ABB				27.7	54.5	18.4
TMX				38.2	39.1	14.9
SIEM				16.1	48.7	15
KKC				8.8	35.1	19.1
KECI				51.7	16.8	18.2

Source: Bloomberg, BOBCAPS Research


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## Cement – Utilisation remains the key

Supply in the cement industry continues to outpace demand, a situation unlikely to change over the near-to-medium term, in our view, given the spate of capacities planned by incumbents. That said, we expect some regional pockets to have a better demand-supply balance.

We believe western and central India will lead margins while other regions will likely lag. Note, moderation in raw material price is a tailwind for the sector, but a supply surplus across regions will mean limited pricing power.

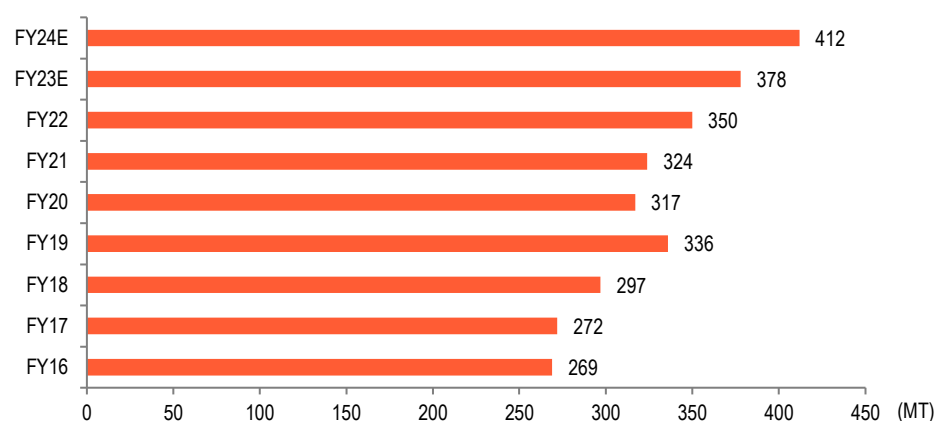
### Expect demand to grow at 8% through FY25

India consumes ~350mn tonnes (mt) of cement annually and has adequate capacity (~550mt) to meet demand. Rural housing and infrastructure remain the top two demand pockets. We expect a cement demand CAGR of 8% over FY23-FY25 (with ~10% growth in election year FY24). Government spending ahead of the 2024 elections will likely boost infrastructure development and affordable housing, which in turn will drive cement consumption in our view. We believe companies that clock higher utilisation levels and have a better cost optimisation strategy, including for power and fuel costs, will likely outperform the sector.

The following factors would aid demand growth in India over the medium term:

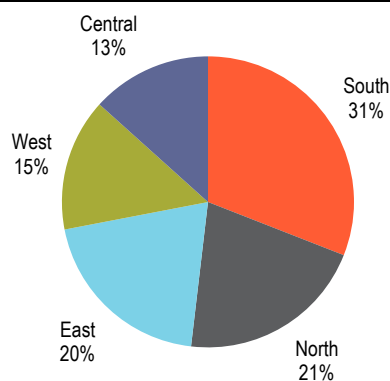
- Rise in infrastructure budget – infrastructure has accounted for ~50% of the incremental demand for cement in FY22 led by a 36% rise in budgeted capex for the sector in FY23BE (Rs 7.5tn: budgeted estimates) over FY22RE (revised estimates)
- PLI scheme boost of Rs 2.4tn for industrial and commercial sectors over the next five years
- Capex announcements by large players amid healthy demand prospects
- A sharp uptick in warehousing and data centre investments
- Rural housing: PMAY-G scheme to drive demand with ~4.5mn houses under various stages of development
- Urban housing: Affordable and mid-income segments to fuel demand in the near term; rising urbanisation and affordability to further support property sales

**Fig 55 – Cement demand trend**



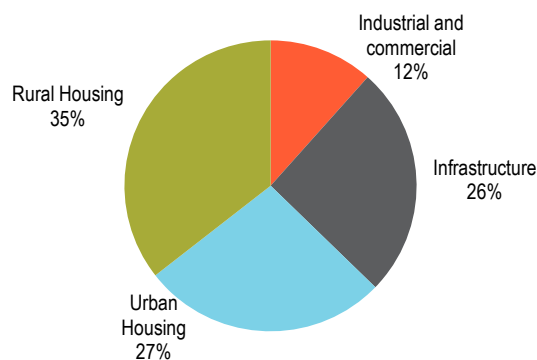
Source: Industry, BOBCAPS Research

**Fig 56 – Regional capacity spread**



Source: Industry, BOBCAPS Research

**Fig 57 – Sources of demand**



Source: Industry, BOBCAPS Research



**Fig 58 – Cement stock matrix**

Company	Operational Efficiency	Capital Allocation	Balance Sheet Strength	P/E 1 yr fwd (x)
Ultratech				27.5
J K Cement				24.6
Shree Cement				35.1
ACC				28.3
Ambuja				34.2
Dalmia Cement				30.8
Star				21.8
Orient				10.3
Ramco				24.6
J K Lakshmi				16.3
Heidelberg				14.5
India Cements				29.9

Source: Bloomberg, BOBCAPS Research

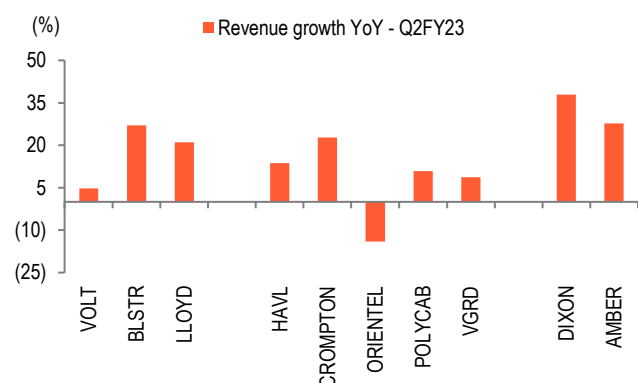
 Very high
  High
  Moderate
  Weak

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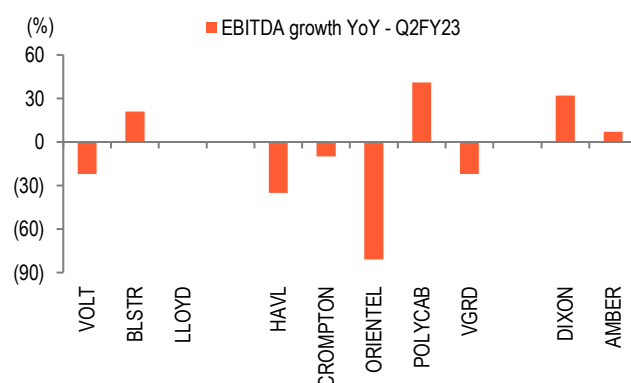
## Consumer Durables – Challenging times

The consumer durables industry continues to face the twin challenge of flagging demand due to inflation and higher commodity prices compared to a year ago. Demand perked up briefly during the festive season before retreating, and our industry and channel interactions indicate that consumption remains lacklustre. This apart, industry players deferred price hikes to H2FY23, but current demand trends suggest such pricing action will remain difficult. While commodity deflation did provide some respite in Q2FY23, prices have begun to rise once again.

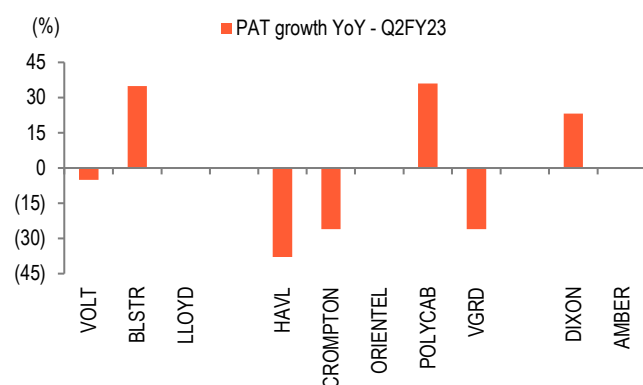
The other challenge for the consumer durables sector has been the transition phase to new energy norms for products such as room ACs (RAC), refrigerators and fans in the current financial year. However, we believe that while this phase will pose a temporary challenge, it will prove beneficial for the industry in the long term. The RAC transition occurred in Jul'22 and fans will come under the new framework from Jan'23. We believe this shift could expand the opportunity size in the fans business by 0.3x (for details, see our note of 22 Dec 2022: [Fan industry: Dynamics set to change post BEE ratings change](#)).

**Fig 59 – Revenue growth in Q2FY23**

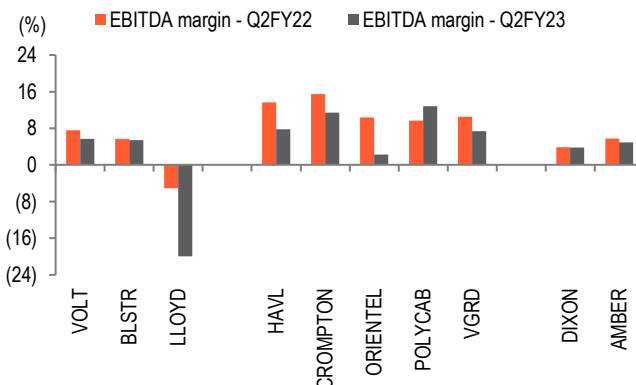
Source: Company, BOBCAPS Research

**Fig 60 – EBITDA growth in Q2FY23**

Source: Company, BOBCAPS Research

**Fig 61 – PAT growth in Q2FY23**







Source: Company, BOBCAPS Research

**Fig 62 – EBITDA margin change YoY in Q2FY23**

Source: Company, BOBCAPS Research

**Fig 63 – Consumer durables stock matrix**

Company	Diversification	Supply chain security	Revenue CAGR FY22-24E (%)	EBITDA CAGR FY22-24E (%)	PAT CAGR FY22-24E (%)	ROCE FY24E (%)	P/E FY24E (x)
CROMPTON	▲	▲	22.4	20.3	13.7	23	28.9
POLYCAB	▲	▲	13	23.5	20.8	19.1	29.1
BLSTR	▲	▲	20.1	31.1	45.8	26.9	32.4
VOLT	▲	▲	17.1	17.5	21.4	12.2	35.8
HAVL	▲	▲	15.8	14.7	15.3	22	43.7
ORIENTEL	▲	▲	13.4	14.2	17.3	25.9	32.2
KEII	▲	▲	17.9	16.3	23.7	20.7	23.2
VGRD	▲	▲	15.5	17.4	17.2	18.2	36.4

Company	Diversification	Supply chain security	Revenue CAGR FY22-24E (%)	EBITDA CAGR FY22-24E (%)	PAT CAGR FY22-24E (%)	ROCE FY24E (%)	P/E FY24E (x)
Dixon Tech			39.6	49.2	60.7	31.6	47.6
Syrma SGS			39.5	48.3	54.4	11	26.6
Amber Enterprises			31.4	40.6	52.2	12.7	25.5

Source: Bloomberg, BOBCAPS Research



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## Energy – Supportive policies

### Oil – Slow decline in prices amid continued volatility

We expect oil price to decline from an average of US\$ 95 in FY23 to US\$ 80/bbl by FY25 although pricing volatility could persist. Slowing demand in the developed world amid a tighter monetary policy is likely to weigh on prices. We believe OPEC will manage supply to avoid any sharp reduction in oil prices.

- The oil price cap allows for Russian crude flow to continue, and we see a good possibility that Russia will use its own carriers to transport crude in order to overcome the European insurance ban on vessels flouting the price cap. Nevertheless, we see a risk of supply disruption when the ban on product tankers comes into effect from March. A key unknown is the extent of Russia's access to a fleet of clean tankers to transport products to circumvent the ban.
- The refilling of strategic petroleum reserves could add support to crude prices. While the US is looking to start refills towards the end of CY23, this date can be brought forward depending upon the economic situation and physical market balance.

### Refining margin to see support near-term

Disruptions to Russian product barrels have tightened gasoil spreads despite a significant pickup in refining capacity. The European ban on insurance for product tankers violating the price cap from 5 Feb 2023 has the potential to tighten the market further, particularly given limited availability of clean tankers for rerouting trade flow to Asian buyers. This together with the upcoming US driving season could shore up refining margins through H1CY23.

### Global gas prices likely to remain elevated through FY25

Though international gas prices have eased amid a warmer European winter, we expect a tightening once again as Europe enters the summer season and the focus shifts towards refilling of gas stores prior to winter of 2023-24. The absence of Russian flows in CY23 implies the European market will have to secure additional LNG in the face of resumed Chinese competition for volumes. We expect international gas prices to remain elevated through 2025 till the next wave of LNG projects starts adding material capacity.

### CGD – Implementation of Parikh Committee recommendations key

The Indian government has been encouraging the city gas distribution (CGD) sector so as to lower consumption of costly LPG and to tackle pollution in urban areas. Implementation of Parikh Committee recommendations such as a price cap of US\$ 6.5/MMbtu with an annual US\$ 0.4/MMbtu escalation can help CGD companies restore the price advantage of CNG/PNG over competing fuels.

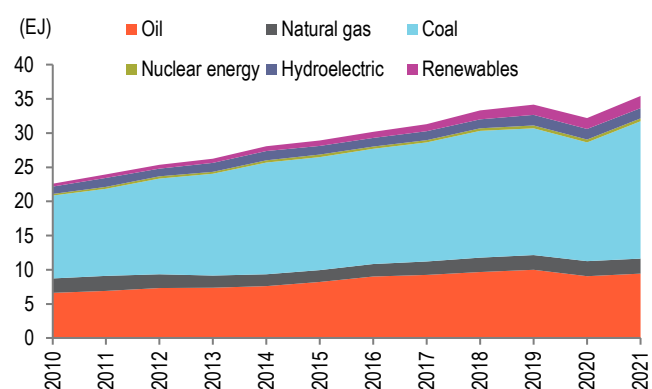
### OMCs – Lower oil price needed to recoup losses

Oil marketing companies (OMC) have incurred significant losses in H1FY23 due to the surge in crude prices and product cracks. While implementation of windfall tax has limited refining margin upsides, the pullback in oil price below US\$ 90 has limited incremental losses. Oil prices need to remain in a lower zone to allow OMCs to recoup their losses. Consumer acceptance of the current retail price allows OMCs to be profitable under our base case scenario where we expect oil to see a slower decline, from an average of US\$ 95 in FY23 to US\$ 80/bbl in FY25.

### Upstream – In a sweet zone

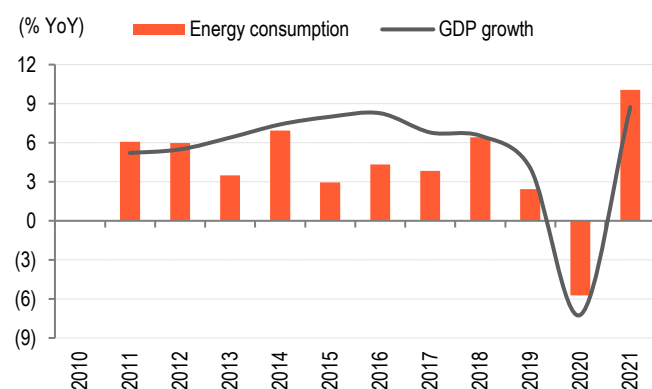
Current policy changes have significantly improved earnings for upstream companies which can translate into healthy dividend payout. The implementation of windfall tax is allowing oil realisation closer to US\$ 75/bbl, whereas Parikh Committee recommendations (price cap with escalation) can also keep natural gas realisation in a healthy range of US\$ 6.5-7.5/MMbtu over FY24-FY25 for administered price (APM) gas.

**Fig 64 – India's energy consumption**

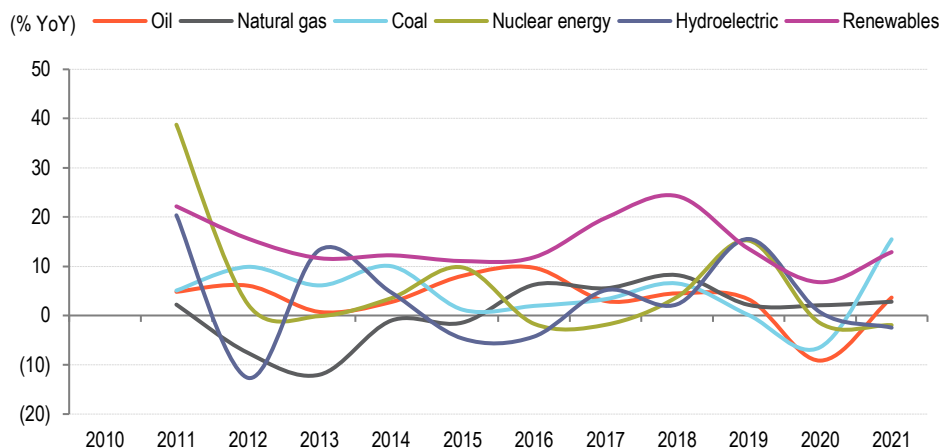


Source: BP Statistical Review 2022, BOBCAPS Research | EJ: Exajoules

**Fig 65 – India's growth in energy consumption vs. GDP**



Source: BP Statistical Review 2022, BOBCAPS Research

**Fig 66 – Fuel-wise growth in India's energy consumption**

Source: BP Statistical Review 2022, BOBCAPS Research

**Fig 67 – Oil & Gas stock matrix**

Company	Regulatory risk	Margin outlook	ROE FY24E (%)	EPS growth FY24E (%)	P/E FY24E (x)
Gujarat Gas	Very high	High	21.1	18.2	19.9
Mahanagar Gas	High	High	18.6	12.4	10.4
Gujarat State Petronet	High	Moderate	16.8	11	7
Indraprastha Gas	High	High	20.2	12.1	17.7
Petronet LNG	High	Moderate	21.3	12.9	10
GAIL	High	Moderate	12.4	4.8	7
BPCL	Moderate	Moderate	15.8	NA	7.9
HPCL	Moderate	Moderate	16.6	NA	5.3
IOCL	Moderate	Moderate	12.2	NA	5.5
Oil India	High	High	16.3	0.9	3.3
ONGC	High	High	15.6	-1	3.8
MRPL	High	Moderate	14.6	(52.5)	7.4

Source: Bloomberg, BOBCAPS Research | NM: Not Meaningful



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## FMCG – Growth and behold

We believe FMCG players will continue to build on the winning themes of premiumisation, growth in modern trade, and enhanced rural penetration in 2023. Additionally, companies with a consistent track record of market share gains will remain the preferred choice of investors.

### Strong premiumisation trends

Premium products are growing faster, benefiting from improved savings and higher pent-up demand in select categories. In particular, urban demand for premium products has seen strong traction in the recent past. Most FMCG companies have, therefore, been launching new products/brands in this category to drive growth. Hindustan Unilever recently introduced 'Acne Squad' and 'Find Your Happy Place' in the premium beauty segment. Nestle India has expanded its premium portfolio in the toddler segment and launched 'Gerber'. It has also entered the premium pet care segment.

Penetration-led volume growth has been another focus area for most consumer companies. Players including Britannia Industries, Nestle India and Tata Consumer continue to deepen their rural presence. For Britannia, the number of preferred rural dealers in FY18 stood at 8,000 which has now increased to 28,000 in Sep'22.

So far, volumes have been under pressure in both urban and rural markets due to price hikes and grammage reduction. However, we believe there are early signs of revival in demand from rural India, though inflation remains a significant challenge.

### Innovation and new product launches remain key for growth

For FMCG companies, product launches and entry into new categories have been proven growth drivers. Nestle India has launched more than 100 products in the last five years and the company has 15 products in the pipeline. Similarly, Britannia Industries entered into newer categories, namely 'Croissants' cake and wafers, besides strengthening its biscuits segment with new rollouts. Hindustan Unilever, on the other hand, is augmenting its premium portfolio with the addition of new brands in existing categories.

### Market share gains



















The demand environment remained tepid for the sector in the current fiscal largely due to unprecedented inflation and muted growth in rural India. Despite multiple challenges, however, some companies have managed to gain market share. Q2FY23 was the 38<sup>th</sup> consecutive quarter of market share expansion for Britannia Industries. Hindustan Unilever continues to gain volume and value market share on more than 75% of its business. Tata Consumer also continues to add market share in the tea (in volume) and salt portfolio.

### Digital platforms in focus

India's retail landscape is rapidly evolving as technology continues to influence consumer behaviour. Consumer shopping is increasingly moving online with the Covid-19 pandemic accelerating the transition. Companies such as Hindustan Unilever, ITC and Marico have started investing in D2C platforms, acquiring D2C brands and launching new products on their digital platform first.

Nestle India recently launched its first D2C platform 'MyNestle' in Delhi NCR and will gradually expand to other parts of the country. Hindustan Unilever has D2C platforms for its premium brands such as Lakme, Indulekha and Simple, and a multi-brand platform UShop.

**Fig 68 – FMCG stock matrix**

Company	Premiumisation	Higher growth trajectory	Incremental distribution points	ROE FY25E (%)	EPS CAGR FY22-25E (%)	P/E FY25E (x)
Nestle India				108	16	56
Britannia Ind				60	17	42
ITC Ltd				31	13	18
HUL				25	15	45
Godrej Consumer				18	12	36
Tata Consumer				10	23	41

Source: Bloomberg, BOBCAPS Research



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### IT – Near-term challenges but long growth runway

The IT industry has been under stress globally due to an increase in cost of capital. India's IT sector typically has a high correlation with the Nasdaq and has corrected sharply over the past couple of the quarters. However, fundamentally, the sector has a consistent earnings trajectory riding on robust deal wins across categories, further helped by global digitisation trends.

**Fig 69 – Deal wins**

(US\$ mn)	Particulars	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
TCS	Order book	8,100	7,600	7,600	11,300	8,200	8,100
Infosys	Large TCV	2,570	2,152	2,525	2,257	1,700	2,700
HCL Tech	New Deal (TCV)	1,660	2,250	2,135	2,260	2,054	2,400
Wipro	TCV	715	580	600	405	1,100	725
Tech Mahindra	Net New Deal (TCV)	815	750	704	1,011	802	716

Source: Company, BOBCAPS Research

### Expect deal wins to slow near term

Near-term, we anticipate a moderation in the pace of deal wins as:

- Rising interest rates weigh on the mortgage segment, potentially slowing financial services deals. Further, capital markets have not done well globally which may impact IT spends
- High inflation, supply chain issues and geopolitical tensions are affecting retailers, as reflected in their tech budget cuts.
- Capex in the manufacturing sector is falling due to the rising interest rates.

### Cautious commentary from global tech vendors

- Pegasystems has lowered its growth guidance for average contract value (ACV) citing macro headwinds.
- ServiceNow and Duck Creek have highlighted elongation of the sales cycle.
- Mongo DB indicated that pressure in the SMB (small and medium businesses) segment is likely to continue. The cloud hyperscaler expressed concerns that the ability of clients to spend more has been impacted in the recent volatile macro environment.
- Accenture continues to focus on enterprise business, cybersecurity and the Metaverse.

### Digitisation to the rescue

- Despite macro headwinds, clients are prioritising their tech spends without compromising on digital initiatives. However, due to the rising cost pressures, we are seeing a change in customer preferences, wherein companies are scaling back tech budgets for cutting-edge solutions, which leads to higher tech intensity in the enterprise business alongside increased offshoring work for Indian IT companies.
- Positive traction is likely to continue in Horizon-1 deal activities, but we expect slower traction in Horizon-3 wins, especially large deals due to the longer payback period. Automation and cost-efficient projects remain focus areas in the near term.
- Apart from digitisation, lower attrition and better utilisation of resources are other tailwinds for the sector.

### Key monitorables

- We await management commentary on wage hikes, targeted increments, attrition rate, backfill cost, utilisation levels and subcontracting cost.
- SG&A leverage, currency impact, cost of living allowance (COLA) structure, pyramid structure, repricing of new deal wins/renewals, and onshore/offshore mix are other key metrics to watch for.



**Fig 70 – Subcontracting cost (as a % of Revenue)**

(%)	FY19	FY20	FY21	FY22	Q1FY23	Q2FY23
TCS	7.3	8.0	7.7	8.7	9.7	9.6
Infosys	7.3	7.4	7.0	10.3	11.3	10.1
Wipro	16.2	14.8	13.5	13.7	13.7	12.9
HCL Tech	16.2	15.1	13.5	14.6	15.3	15.0
Tech Mahindra	12.5	14.7	13.2	15.6	16.3	15.4













Source: Company, BOBCAPS Research

**Fig 71 – Company-wise sectoral outlook**

Company	Weak	Strong
TCS	Healthcare Manufacturing (mainly in Europe) Mortgage (due to rising interest rates)	Retail Telecom (5G rollout) Travel/Hospitality BSFI (Ex-mortgage)
Infosys	Retail Mortgage Telecom Hi-Tech	NA
Wipro	Tech Mortgage Retail (US)	Insurance Healthcare
HCL Tech	Mortgage	NA
Tech Mahindra	BFSI Hi-Tech Manufacturing	Telecom Retail (seasonal tailwinds)

Source: BOBCAPS Research

**Fig 72 – IT stock matrix**

Company	Guidance	Margin	Book to Bill	Digital	TCV/ Renewal	P/E 1Y fwd (x)
Infosys						21.9
TCS						26.3
HCL Tech						17.7
Tech Mahindra						15.5
Wipro						17.1
LTI Mindtree						24.1

Source: Bloomberg, BOBCAPS Research

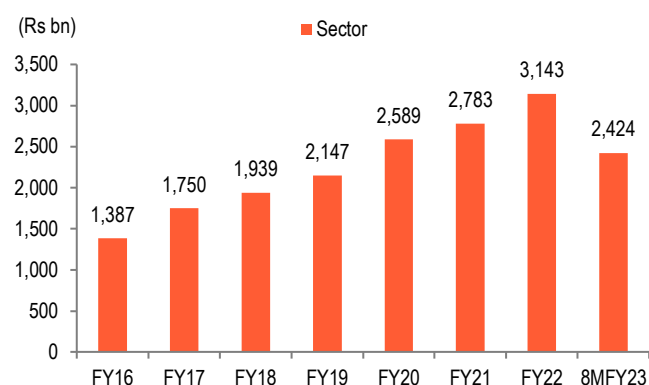
 Very high
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## Life Insurance – On a secular growth trajectory

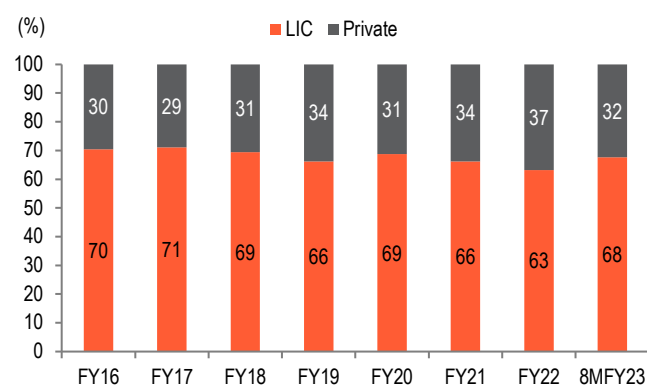
India has a total of 23 private sector life insurance companies and one public life insurer (LIC) as of CY22-end. LIC has consistently held onto a market share of above 60%. The new business premium (NBP) of industry and private players posted CAGRs of 15% and 19% respectively over FY16-FY22. After Covid-19, greater awareness of threats to health has spurred demand for term products. Premiums of retail protection plans have risen and rate hikes by reinsurers have also been passed on to customers.

**Fig 73 – Insurance premium**



Source: Company, BOBCAPS Research

**Fig 74 – Insurance market share**

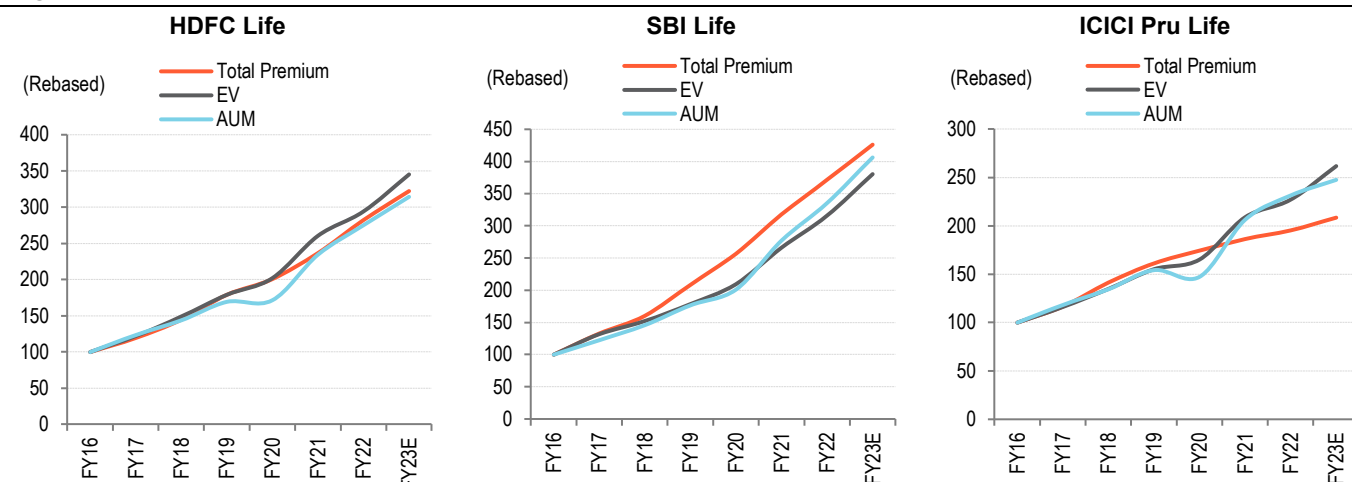


Source: Company, BOBCAPS Research

## Growth in embedded value (EV) is key

We believe companies that expand their embedded value while also raising premiums will fare better than peers. Based on our analysis of growth in EV, AUM and gross premium (all rebased to FY16), we find that HDFC Life and ICICI Pru Life have clocked higher growth in EV compared to the increase in their gross premium. SBI Life, however, has recorded the highest EV growth (absolute and CAGR) among the three life insurers over the last six years.

**Fig 75 – Growth in premium, embedded value and AUM (rebased to FY16)**



Source: Company, BOBCAPS Research

**Fig 76 – Life insurance stock matrix**

Company	EV CAGR 6Y FY16-22 (%)	EV Growth/GWP Growth (x)	EV/AUM FY22 (%)	P/EV FY23E (x)
SBI Life	21.1	0.9	14.8	2.6
HDFC Life	19.7	1.0	14.7	3.5
ICICI Pru Life	14.6	1.2	13.2	1.8

Source: BOBCAPS Research | GWP: Gross Written Premium

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## Metals – Stabilisation underway

### China steel demand may see uptick as Covid restrictions ease

In H2CY22, steel margins in China dipped below the 10-year historical average as supply readjusted to lower demand fundamentals. We expect margins to move up only modestly from Q2 and stabilise over H2CY23 as opening up of the Chinese economy with softer Covid restrictions should support moderate YoY improvement in steel demand through the year.

While the downtrend in steel consumption by the real estate sector is likely to continue (albeit at a slower pace), higher demand from China's infrastructure and automotive sectors should partly offset the weakness. On the supply side, the need for market-driven adjustments would continue, which would cap margins.

Outside China as well, steel demand is likely to weaken during H1CY23 as major economies slow or go through a recessionary phase exacerbated by the impact of tightened monetary policy. While the demand outlook is positive in the US given government initiatives to boost domestic manufacturing, such as the CHIPS Act and Inflation Reduction Act, global economic slowdown is a risk.

Though production outside China has been adjusting to flagging demand, we expect margins to soften during H1CY23. Support for steel demand could emerge from stimulus-driven large infrastructure rollouts and industrial recovery over H2CY23.

### India steel margins have bottomed out

In the Indian context, we believe steel margins have bottomed out in the Sep'22 quarter and are likely to rise in Q3FY23 as lower coking coal costs feed through the cost base. We are seeing initial signs of a steel price uptick with a pickup in China export prices and improving sentiment in the Indian market. Over FY24, we expect steel margins to gradually stabilise to a mid-cycle level of Rs 11-12k/t. We believe a key driver of stock performance hereon would be delivery on earnings growth driven by completion of planned capex.

### Aluminium prices to remain range-bound over CY23

We expect aluminium prices to be range bound with downward pressure during H1CY23 as the western world goes through recessionary impacts. Even in the US where activity levels were healthy, the aluminium demand pull has reduced as distribution channels and consumers avoid any excess stock build. However, with

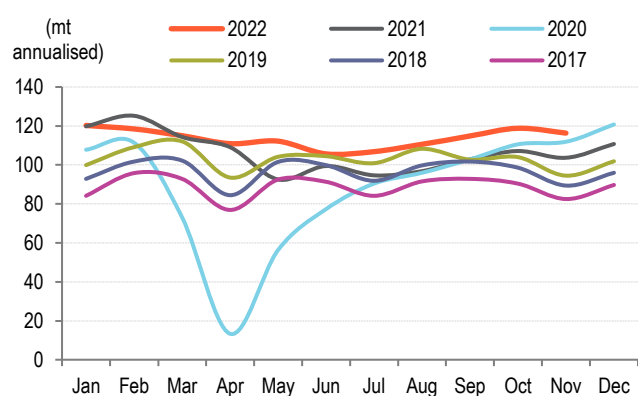
closure of capacities in Europe and China and additional supply at risk of closure, as well as relatively lower inventory levels in the system, the physical market remains tight. The cost curve has turned steeper given soaring energy prices and favours aluminium producers in the first half of the cost curve.

We anticipate a stabilisation of aluminium prices and margins over H2CY23 along with economic recovery. While near-term upside is capped by demand uncertainty, we expect aluminium prices to find support in the medium term as closures are likely to be sticky and supply could lag demand recovery.

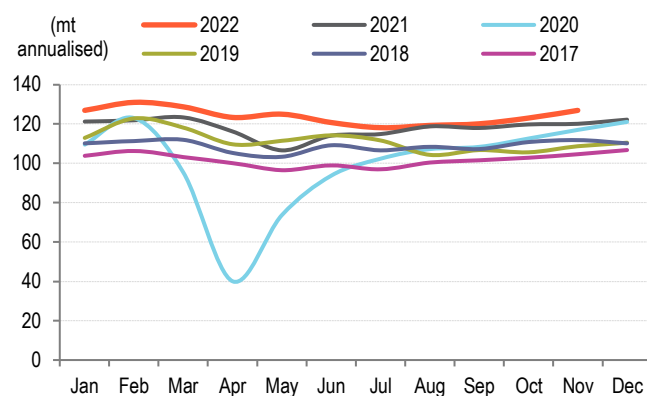
Over the longer term, the outlook on aluminium demand growth remains healthy, with Hydro forecasting a global aluminium consumption CAGR of 2.8% over CY22-CY30. The metal also remains a beneficiary of the green transition as usage in electric vehicles, solar panels and wind farms accounts for two-thirds of incremental demand. However, with a strong ramp-up in recycling projects (Hydro estimate at 16mt over CY22-CY30), the aluminium market is likely to remain largely balanced by CY30. As per latest estimates from Hydro and Alcoa, the residual market gap or primary aluminium needed over CY22-CY30 is ~3-4mt after accounting for likely and probable projects.

This implies that long-term aluminium prices would continue to be determined by the marginal cost of existing supply and not that of new supply. With the market still largely balanced, margins for primary aluminium suppliers are likely to remain healthy over the next decade.

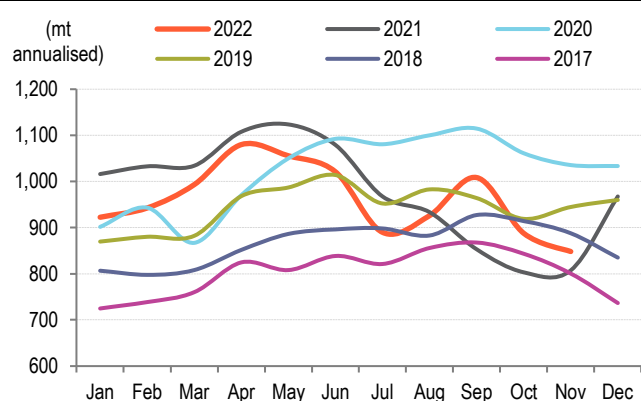
Hindalco (Not Rated), with its strategic positioning, plans to meaningfully expand its downstream operations across India, and Novelis (Not Rated) appears well placed to leverage on the cycle strength.

**Fig 77 – India steel consumption**


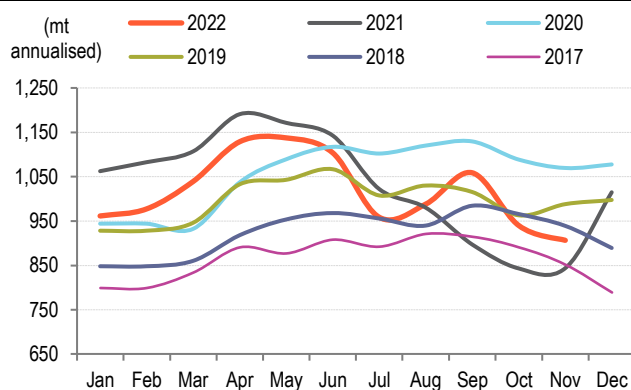
Source: Bloomberg, BOBCAPS Research

**Fig 78 – India steel production**


Source: Bloomberg, BOBCAPS Research

**Fig 79 – China steel consumption**

Source: Bloomberg, BOBCAPS Research

**Fig 80 – China steel production**

Source: Bloomberg, BOBCAPS Research

**Fig 81 – Metals & Mining stock matrix**

Company	Expansion	Gross margin outlook	Capital efficiency	Climate change	ROE FY24E (%)	EV/EBITDA FY24E (x)
Tata Steel	Very high	High	High	Moderate	12.1	5.2
Hindalco	Very high	High	High	Moderate	12.3	5.4
JSPL	Very high	Moderate	High	Moderate	13.3	5.8
Hindustan Zinc	High	High	High	Moderate	27.6	7.3
SAIL	Moderate	Moderate	Moderate	Weak	8.5	3.8
JSW Steel	Very high	Moderate	High	Moderate	17.4	7.4

Source: Bloomberg, BOBCAPS Research



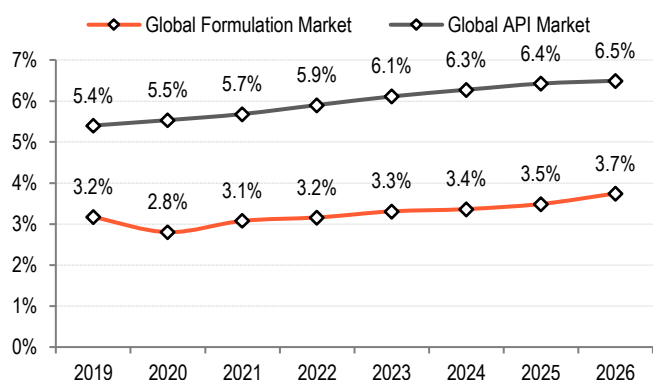
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## Pharmaceuticals – Domestic market is key

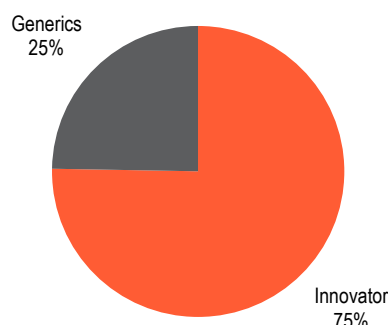
### Global pharma market to grow at ~3%

The global formulation market was estimated at US\$ 1,137bn in CY20 and is expected to log a 3.4% CAGR (CY20-CY26) to US\$ 1,386bn. Growth in the market is likely to stem from the launch of novel therapies, expansion of existing therapies, and growing demand for generics, biologics and personalised medicines as well as global formulations. In the global market, innovator formulation sales totalled ~US\$ 856bn in CY20 and are expected to clock a 3.5% CAGR over CY21-CY26 to US\$ 1,050bn.

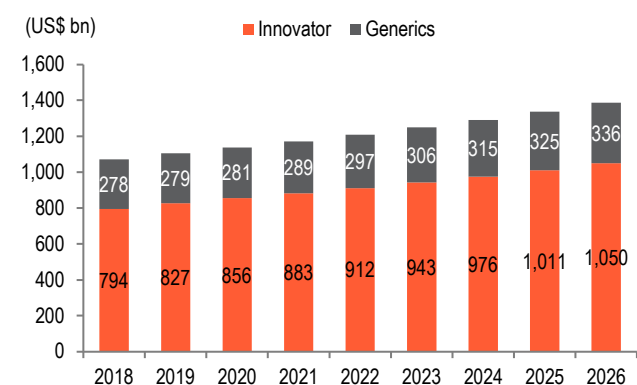
Generics, which are ~25% of the current market, are forecast to increase from US\$ 281bn in CY20 to ~US\$ 336bn in CY26, a CAGR of 3.1%.

**Fig 82 – Global pharma market growth**

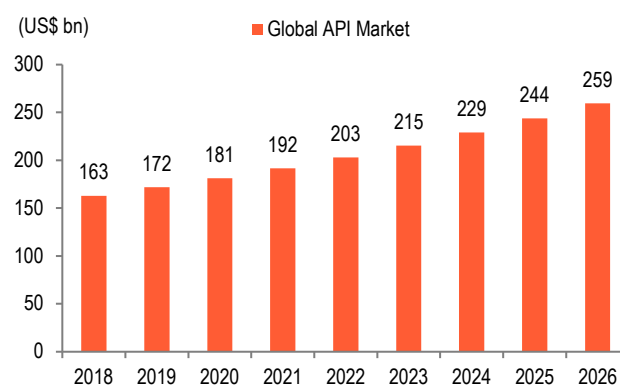
Source: Glenmark Life Annual Report FY22, BOBCAPS Research

**Fig 83 – Global formulation market, CY20**

Source: Glenmark Life Annual Report FY22, BOBCAPS Research

**Fig 84 – Global formulation market**

Source: Glenmark Life Annual Report FY22, BOBCAPS Research

**Fig 85 – Global API market**

Source: Glenmark Life Annual Report FY22, BOBCAPS Research

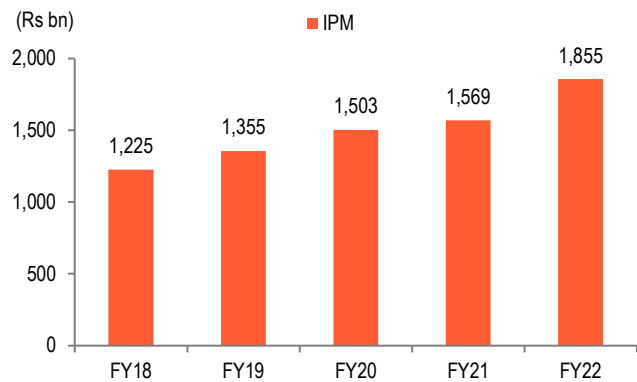
### Indian pharma market steady

After a phase of supernormal growth supported by Covid-driven tailwinds, Indian pharma companies are once again focusing on their core business in the domestic as well as US market. Domestic business continues to grow steadily, but the most lucrative pharma market in the world, the US, remains beset by challenges. Hence, several companies are now looking to emerging markets for growth.

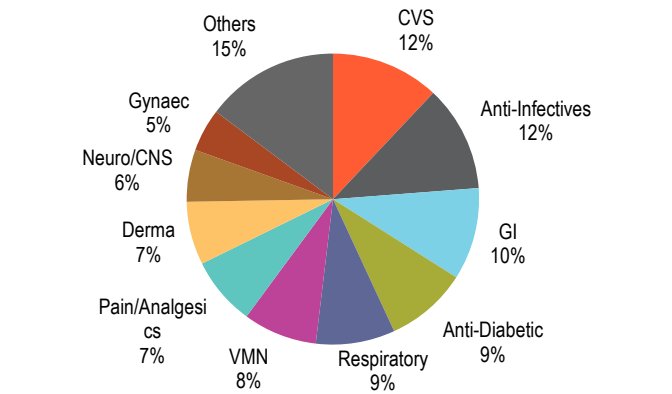
- **Pricing pressure and regulatory hurdles pose a challenge:** Indian companies are facing headwinds in the US market due to pricing pressure amid increased competition and a lack of new sizeable product approvals (apart from gRevlimid). After a hiatus in regulatory inspections due to the pandemic, re-inspections by the USFDA have intensified. Indian companies continue to draw adverse observations from the regulator, further hampering new approvals from affected sites. Thus, although the restart of physical inspections has paved the way for approval of pending products, it is currently a double-edged sword.

We prefer companies that have specialty/complex product portfolios in the US with some degree of exclusivity, which would shield them against the sharp price erosion visible in plain-vanilla oral solid dosage forms.

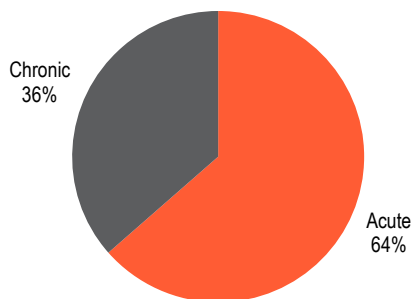
- Domestic branded generic market on a steady growth path:** The Indian pharma market (IPM) grew at 11% over FY18-FY22 to Rs 1.9tn. We expect growth to hold at these levels given the branded generics nature of the business which insulates key products from additional competition given their strong brand equity with doctors. Lower R&D expenditure, higher return on investments and better margins compared to other markets all bode well for the Indian pharma sector.

**Fig 86 – Indian pharma market**

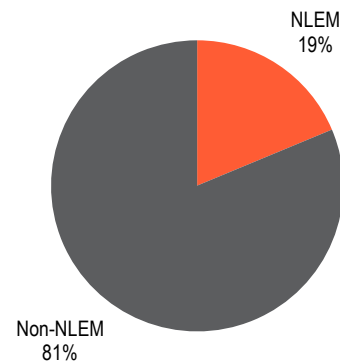
Source: Mankind Pharma DRHP, BOBCAPS Research

**Fig 87 – Indian pharma market: Breakup by therapy, FY22**

Source: Glenmark Life AR FY22, BOBCAPS Research

**Fig 88 – Chronic-Acute split, FY22**

Source: Mankind DRHP, BOBCAPS Research


**Fig 89 – Price-controlled drugs (NLEM) form ~20% of IPM, FY22**

Source: Mankind DRHP, BOBCAPS Research | NLEM: National List of Essential Medicines

**Fig 90 – Pharma sector matrix**

Company	Branded Portfolio/ CDMO	India Exposure	EBITDA Margin FY24E (x)	EPS growth FY24E (x)	P/E 1Y fwd (x)
Eris			33.7	21.8	18.2
Cipla			24.0	25.4	22.9
Sun Pharma			28.4	16.3	25.5
Torrent			30.8	27.9	32.1
Divi's Labs			37.6	13.6	36.8
Dr Reddy's			25.1	13.7	17.8
Laurus Labs			29.5	14.4	17.5
IPCA Labs			21.5	35.7	24.3
Abbott			23.3	15.9	47.3
Pfizer			33.8	10.3	30.7
Glaxo			23.9	16.5	32.6
Sanofi			26.0	10.3	22.3
Lupin			16.3	109.0	26.0
JB Chemicals & Pharma			24.9	30.9	28.0
Indoco			21.1	28.8	15.3
Glenmark Pharma			18.3	16.0	11.0
Zydus Lifesciences			21.7	15.4	18.9
Alkem			16.9	33.0	23.5
Alembic Pharma			17.1	52.8	19.3
Ajanta Pharma			26.3	20.2	18.7
Biocon			25.5	75.8	23.0
Gland Pharma			33.2	26.7	18.9
Aurobindo			18.2	27.2	9.5
Granules India			21.2	26.9	12.6
Natco Pharma			44.3	40.3	9.8

Source: Bloomberg, BOBCAPS Research

 Very high
  High
  Moderate
  Weak

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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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