

Q2FY23 REVIEW

15 November 2022

Raw material costs cool off

- Nifty 200 earnings came in moderately ahead of consensus in Q2FY23, but only ~40% of companies delivered a beat, similar to Q1
- Raw material cost/sales ratio declined as anticipated; higher other costs kept net profit margin flat at 7.5% of sales
- Moderating global inflation may lend a short-term boost to cyclicals, but we continue to favour a conservative investment approach

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Financials sector leads Q2 earnings beat: Nifty 200 companies beat consensus revenue and net profit expectations by 4.8% and 6.3% respectively in Q2FY23. In all, 38% of the companies reported revenue above consensus expectations (vs. 42% in Q1FY23), while 41% were ahead of consensus at the PAT level (40% in Q1). On the flip side, 44% of companies missed estimates (42% in Q1).

Energy and steel weigh on NSE-listed universe: Aggregate revenue for the NSE-listed universe grew 26.7% YoY but net profit dipped 2% YoY (-4.8% QoQ). The fall in profit was led by the materials (-64% YoY) and energy (-40%) sectors, mainly due to global margin correction. Financials posted net profit growth of 36% YoY, industrials 30%, and consumer discretionary and staples 76% and 30% respectively. As indicated in [our last earnings review](#), operating cost pressures declined this quarter as raw material cost, finished goods cost and freight charges all moderated. Interest expense rose but remained modest by historical standards. Salary, wages and power cost stayed elevated.

Sector summary: Life insurance premium growth continued in Q2FY23 albeit at a slower pace than Q1 while VNB margins expanded in H1FY23. Credit card spends continued to grow, crossing Rs 1tn per month in H1FY23 for the first time.

Consumer durables saw a softer operating performance. For pharma, challenges persisted in the US market whereas India remained a steady growth driver with stable margins. Energy had a mixed performance with export duty adversely impacting earnings despite high global margins. Demand was weak across building products as inflation led to a slowdown in construction activity and higher product prices continued to hurt consumer affordability.

Investment view: A slowing Europe and moderating China will continue to pose near-term challenges to the Indian stock market, in our view. However, easing global inflation should offer a short-term boost to cyclicals. We expect the Nifty 50 to be largely range-bound near term, but remain bullish over the longer term given several extant growth levers in the Indian economy. We continue to favour a conservative investment approach (see our report of 31 October: [Global headwinds plateauing](#)).

India reporting season trends

Q2FY23	QoQ (%)	YoY (%)
Net Sales	2.4	26.7
Raw materials	(3.4)	43.6
Salaries and wages	3.9	14.8
Interest expenses	7.4	16.3
Net Profit (after tax)	(4.8)	(2.0)
Q2FY23 Surprise	Revenue (%)	Income (%)
Weighted	4.8	6.3
Average	4.9	(3.2)

Source: Bloomberg, BOBCAPS Research



Q2FY23: Sector-wise review

Automobiles

Auto companies reported a steady Q2FY23 performance with margin improvement QoQ (but declines YoY). Volumes picked up, partially owing to the unlocking of pent-up demand during the festive season. Passenger vehicles and high-end two-wheelers saw the strongest demand revival, followed by light/medium commercial vehicles. With semiconductor availability steadily returning to normal and raw material prices easing, the QoQ fall in gross margins was limited. However, higher advertisement and marketing spends to support increased volumes and new launches kept EBITDA margins under pressure. Fuel cost escalation was also a factor.

The revival in demand provides a boost for new launches and new capex, essentially in the electric vehicle segment. We expect a strong performance in H2FY23 which could support YoY growth in FY23 (despite a weak H1). A normal monsoon and continued demand revival beyond the festive season remain key for a sustained recovery.

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Cement

The cement sector's earnings performance was expectedly weaker in Q2FY23, with EBITDA margins and EBTIDA/t softening by an average of ~800bps/Rs 700 YoY. Revenue growth was steady, backed largely by volume gains off a weak base. However, realisations remained tepid. Pressure mounted further on the cost structure (inflation of 15-20% YoY on per-tonne costs) led by energy and logistics. Limited pass-through opportunities and inflated cost depressed earnings in Q2, with some companies (southern region) posting PAT/EBITDA losses.

Following the dull quarter and softer cash flows, a few cement players have postponed planned capacity expansion. Price revival in Q3 is likely to be delayed though we expect cost inflation to recede from the peak, providing some respite to margins during the quarter. However, this moderation may be short-lived in the event of a reversal in energy prices following an escalation of geopolitical tensions. Ultratech, JK Cement and Star Cement (all Not Rated) were relatively better performers in Q2.

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Consumer Durables

The narrative for Q2FY23 revolved around the absorption of inflation by the industry in order to maintain market share and topline, resulting in a softer operating performance. Commodity deflation didn't have much of a positive impact on Q2 margins. Players are banking on a better H2FY23 aided by continued commodity deflation, demand revival and smooth transition to new energy efficiency norms, though rupee depreciation remains a concern.

A key factor to watch will be the impact of energy norms on the electrical consumer durables business, particularly fans. We expect channel stocking in H2FY23 following the transition, in turn allowing for price hikes. In the air conditioning business, demand was tepid during the quarter and most players saw YoY margin contraction (except **BLSTR**), with a dim margin outlook for H2FY23 as well.

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Credit Cards

Credit card spends continued to grow, crossing Rs 1tn per month in H1FY23 for the first time ever. This bodes well for the industry as it comes amid concerns of a potential slowdown in spends owing to other available payment methods. Moreover, online spending remains high. Although the share of revolvers has reduced in the industry's receivables mix, credit cards remain a profitable and high-margin business. The RBI's order to withdraw cards inactive for over a year has led to a steep reduction in cards outstanding for the industry as a large number of inactive cards were weeded out of the system – a move that sharpens clarity on actual growth in the business.

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Life Insurance

In the life insurance sector, H1FY23 saw private market leaders – **SBI Life** and **HDFC Life** – as well as **LIC** witnessing over 20% YoY growth in premiums. However, Q2FY23 saw a comparatively lower uptick YoY compared to Q1. VNB (value of new business) margin for H1 expanded YoY across our coverage as companies maintained their focus on non-participating products which gained traction in the product mix. With credit growth improving in the banking sector, life insurers witnessed stronger momentum in credit life and protection policies. Companies reiterated their goal of maintaining higher margins by building a balanced product mix with a thrust on high-margin products.

Operating expense ratios remained elevated owing to greater efforts expended to increase business. Persistency across 13th-month and 61st-month cohorts improved YoY for major life insurers in H1FY23. The bancassurance distribution channel remains a significant driver of growth.

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Metals & Mining

Steel majors

Q2FY23 earnings were weak as costs lagged commodity price declines. Margins have likely bottomed out as lower coal prices feed through the cost base. However, players are guiding for steel prices to remain muted in Q3. With domestic prices in China declining through October and Indian steel at a 5-7% premium to landed rates, we now look for prices to stabilise over FY24 post the lunar holidays in China.

We have a constructive view on the sector as we expect margins to stabilise over FY24 with recovery in Chinese demand as policy pivots come through. China recently announced the recalibration of its zero-Covid policy to lower the social and economic impact and more comprehensive measures to stabilise the real estate sector. Looking to FY24-FY26, we believe the Indian steel industry is poised to deliver volume-driven earnings growth as competitive brownfield expansion projects come onstream. We prefer **TATA** as the company looks well positioned to weather this downturn and deliver on its earnings-accretive projects.

Base metal players

Q2 results reflected weaker margins on the back of price declines and high energy cost inflation. Management guidance suggests only marginal cost reduction in Q3 due to the presence of high-cost inventory. From our discussion with Alcoa's Investor Relations Head, we believe an aluminium price floor is building up given a tighter physical market and prices significantly dipping into the cost curve. However, the near-term price upside is capped by high demand uncertainty (for details see our reports: [Aluminium price floor emerging: Alcoa](#) and [Aluminium market in need of supply rebalancing](#)).

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Oil & Gas

RIL – Windfall tax limits cyclical upside; consumer business shines

Q2 EBITDA normalised with pullback in oil-to-chemical profits from record levels following the levy of windfall tax. Consumer business continued to deliver strong YoY growth. With a sharp rise in net debt to Rs 932bn in Q2FY23, we marginally lowered our estimates and target price for **RIL** to factor in the results. We continue to expect 17% annual growth in EBITDA over FY22-FY25 driven by a 6% CAGR in the cyclical business and a 27% CAGR in the consumer business. Key growth catalysts over the medium-to-long term include the roadmap for new energy, market share and tariff increases in Jio post 5G launch, and the digital and retail listings.

OMCs – Crude price level governs profitability

Oil marketing companies (OMC) have beat consensus estimates in Q2 on the back of reimbursement of LPG under-recovery despite reporting losses and negative marketing margins. In the current scenario, OMCs more or less achieve cash breakeven on an integrated basis when crude is below US\$ 90/bbl. Near-term, these companies need some form of government support to cover fuel under-recoveries for FY23. Medium-

term, we expect margins to return to the healthy zone as consumer acceptance of the current elevated petrol/diesel prices should allow OMCs to remain profitable even at oil prices of ~US\$ 90/bbl.

City gas distribution (CGD) – Margin and volume pressures visible

Q2FY23 saw lower margins for IGL and MAHGL with price increases failing to match the cost of purchased gas. Both players also felt some impact on volume growth from higher compressed natural gas (CNG) prices. Whereas IGL's new CNG vehicle additions slowed, MAHGL experienced muted CNG volume growth during the quarter, reflecting a reduction in per-capita consumption.

LNG prices remain high and hence the sector needs policy support to maintain its competitiveness against liquid fuels where we have seen price freezes. The sector has received some policy support in the form of larger allocation of cheaper administered price mechanism (APM) gas. Listed CGD players have also tied up term contracts to lower the impact of soaring gas purchase costs. We look forward to the Kirit Parekh committee report (due in the next few weeks) as we anticipate the introduction of a floor and cap price mechanism to improve natural gas competitiveness and support higher penetration of this fuel in the economy.

Upstream – Rising expectations of healthy dividend

Q2 earnings reflected the benefits of higher oil and gas prices, although the special excise duty capped upsides from crude at a healthy level of US\$ 75-76/bbl. While the domestic gas price hike implemented on 1 Oct 2022 has the potential to further improve revenue for upstream players, the risk remains that the upside will be limited by the introduction of a floor-cap mechanism to limit the adverse impact on consumer industries.

Given healthy profitability, we believe attention is shifting to the quantum of dividend from upstream companies. We understand from ONGC that it looks at a typical payout range of 40-55%, its capex needs and market environment, while deciding on dividend payouts. Historical payouts for the company average closer to 45%.

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Pharmaceuticals

Pharmaceutical companies under our coverage reported aggregate revenue growth of 7% YoY and 5% QoQ in Q2FY23. EBITDA grew modestly by 2.7% YoY on account of margin pressure in the US portfolio, elevated raw material prices, high logistic costs and other expenses. Sequentially, EBITDA increased 25% for our coverage which can be attributed to one-off expenses in the previous quarter as well as QoQ margin recovery for some companies that had limited-exclusivity launches. Aggregate EBITDA margin contracted 100bps YoY but improved 360bps QoQ. Net profit dipped 7% YoY while rising 30% QoQ.

Among our coverage, **LAURUS** and **ERIS** reported the highest revenue growth of 31% and 28% YoY respectively, whereas **GLS** and **DIVI** were laggards with declines of 13% and 7%. In terms of EBITDA growth, **DRRD** (+42%) and **LAURUS** (+30%) led the way, in contrast to **ARBP** (-30%) and **ALKEM** (-27%) who slipped the most. On the net profit front, **SUNP** (+18%) and **LAURUS** (+15%) outperformed peers, while **LPC** (-75%) and **ALKEM** (-40%) were at the bottom of the pack.

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Mid-caps

During Q2FY23, demand was weak across building material categories in the months of July-August as inflation led to a slowdown in construction activity and higher product prices over the past year continued to hurt consumer affordability. However, the weakness during the first two months of the quarter was offset by a strong recovery in September ahead of the festive season.

Plastic pipes

Pipe companies witnessed a difficult Q2 due to a sharp decline in PVC prices to Rs 88/kg (-19% QoQ, -39% from 31 Mar 2022), lower pipe volumes (as plumbing segment demand was hit by a slowdown in construction and renovation activity during July-August), and inventory losses (led by **FNXP**, **ASTRA** and **SI**).

Players like **FNXP** and **SI** with high agriculture exposure witnessed volume growth in pipes on the back of a low base and improving demand. However, **ASTRA** reported a 4% YoY decline. Once stable, the lower PVC prices would aid channel restocking and boost demand in the medium-to-long term given better affordability, especially in the agriculture segment. We expect margins to improve gradually from Q3FY23 onwards as much of the high-cost inventory was liquidated in Q2.

Ceramics

A demand and supply mismatch coupled with elevated costs of production led ceramic players based in Morbi (Gujarat) to cut production by taking a month-long break during Aug-Sep'22, though leading players continued manufacturing through owned and joint-venture plants at Morbi. **KJC** reported flattish YoY volume growth in Q2 while **SOMC** posted a 2% decline due to weak demand, although superior average realisations in all categories (tiles, sanitaryware, faucets) saw **KJC**, **SOMC** and **CRS** report topline growth.

Gas costs remained high during the quarter, rising 8-17% QoQ for **SOMC** and **KJC** and inducing EBITDA margin contraction of 420bps and 650bps YoY for these players respectively. **CRS** reported better margins on the back of a favourable product mix and lower costs. Leading companies in the segment hope to achieve over 15-20% volume and revenue growth in FY23, supported by traction from the real estate industry and easing competition from the export-focused Morbi players. Companies also anticipate a softening of gas prices and freight rates, enabling margins to expand gradually in H2FY23.

Wood panels

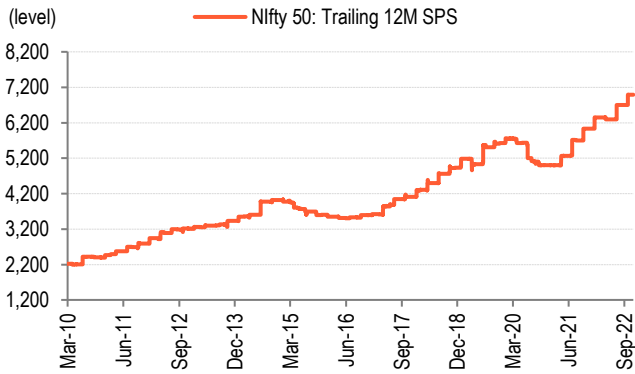
Wood panel companies delivered a relatively better performance on a three-year CAGR basis on the back of sector tailwinds and price hikes taken during the last 10-12 months. Lower exports of MDF coupled with increasing import momentum had hurt MDF volumes in Q2. However, domestic demand remains strong on the back of a lower base, robust offtake from both OEM and retail segments, and an increase in applications.

During Q2, easing chemical costs were offset by higher timber prices. Companies refrained from taking price hikes during the quarter, which dampened margins QoQ though realisations remained higher YoY. Nevertheless, the MDF segment continues to post a superior performance to plywood/laminates. We expect MDF export volumes to remain flat for FY23 while domestic volumes grow 10-12% with stable blended operating margins of ~30%.

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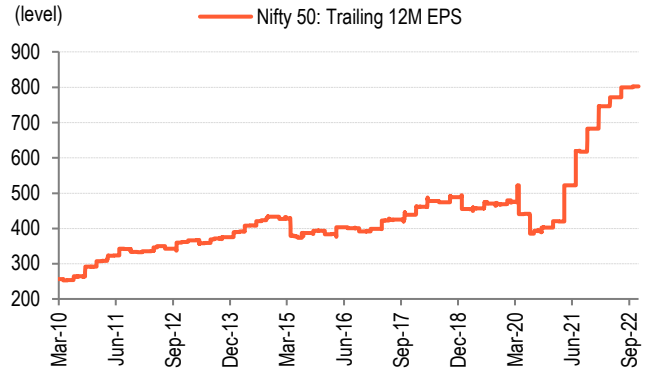
Q2FY23 performance trends

Fig 1 – Nifty 50: Sales per share



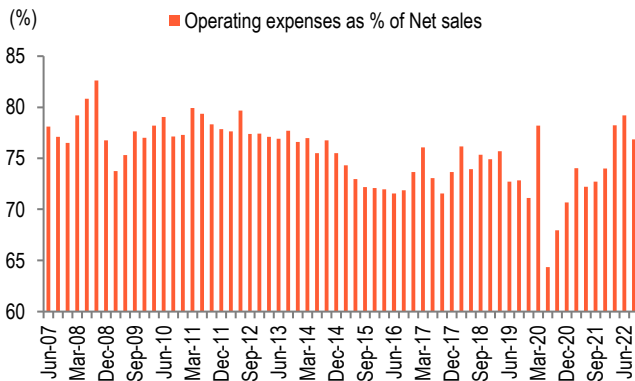
Source: Bloomberg, BOBCAPS Research

Fig 2 – Nifty 50: Earnings per share



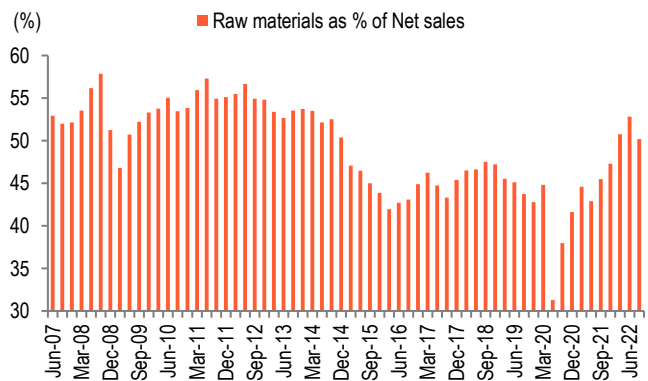
Source: Bloomberg, BOBCAPS Research

Fig 3 – Cost pressures have come down...



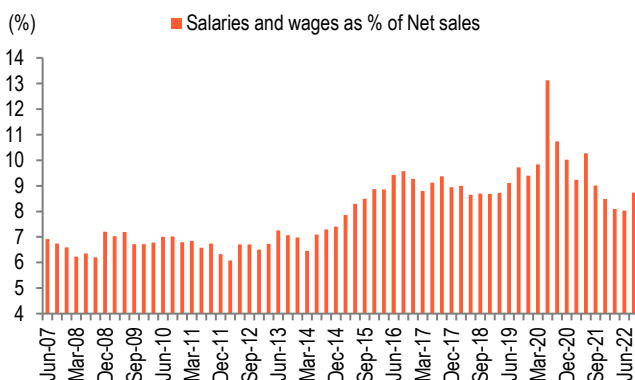
Source: CMIE, BOBCAPS Research | EN = Energy, UT= Utilities, MT=Materials

Fig 4 – ...as raw material prices eased



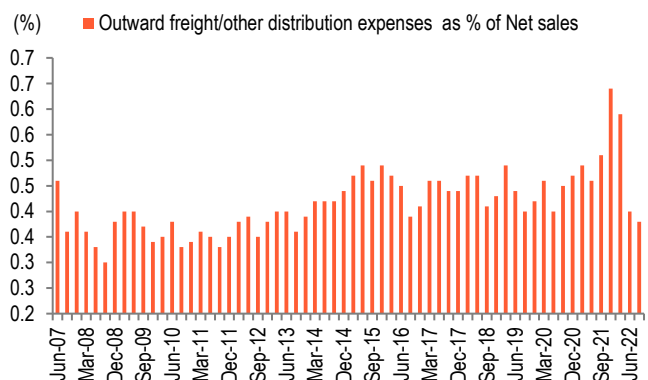
Source: CMIE, BOBCAPS Research | ID=Industrials, IT= Information Technology, RE= Real Estate

Fig 5 – Salary cost increased due to annual payouts



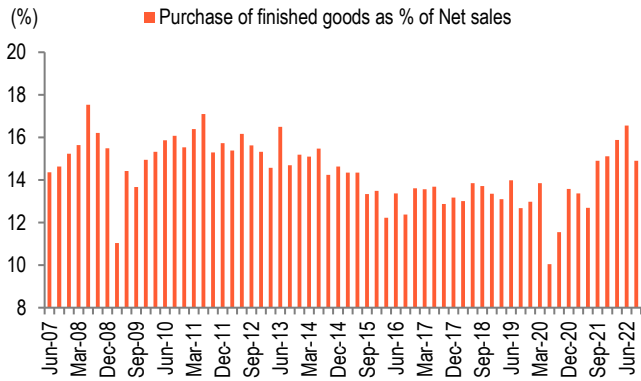
Source: BOBCAPS Research, CMIE

Fig 6 – Freight cost continued to decline



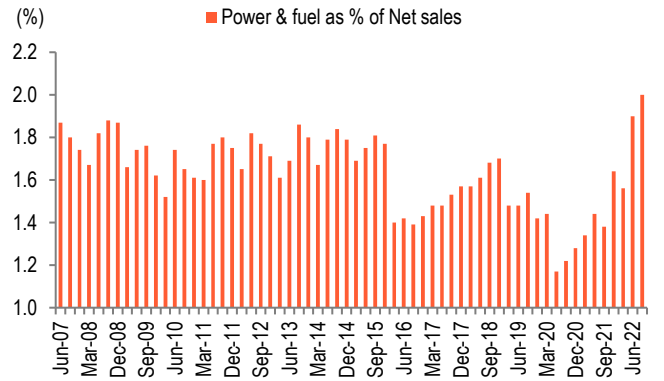
Source: BOBCAPS Research, Bloomberg

Fig 7 – Cost of finished goods also cooled off



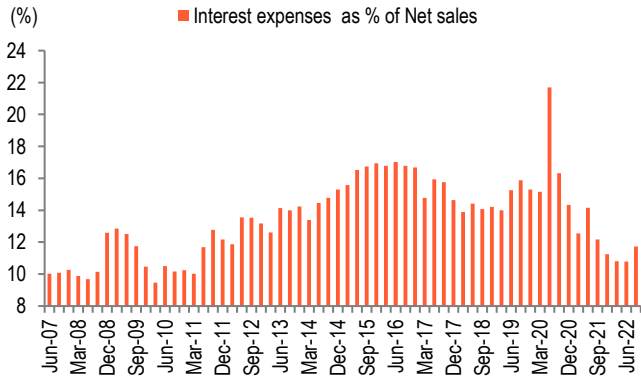
Source: CMIE, BOBCAPS Research

Fig 8 – Power and fuel cost remains elevated



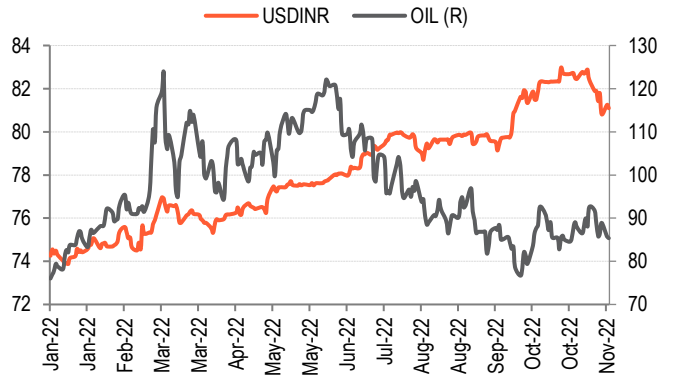
Source: CMIE, BOBCAPS Research

Fig 9 – Interest cost rising with central banks hike but still modest



Source: CMIE, BOBCAPS Research

Fig 10 – Moderating oil is good for India



Source: Bloomberg

Fig 11 – Q2FY23: Beats and misses – NSE 200 by aggregates

Sector	# Cos	Mkt Cap (Rs bn)	Reported	% Mcap reported	Reported (Rs bn)		Consensus Estimate (Rs bn)		Weighted Q2 Beat (%)		Average Q2 Beat (%)	
					Revenue	Income	Revenue	Income	Revenue	Income	Revenue	Income
Financials	43	32,420	43	100	3,032	715	2,654	665	14.2	7.6	23.0	1.4
Information Technology	13	11,282	13	100	1,637	246	1,682	252	(2.7)	(2.0)	(1.9)	(1.4)
Energy	8	8,968	8	100	6,164	197	6,006	92	2.6	114.4	7.4	38.1
Materials	27	9,505	27	100	3,073	152	2,807	196	9.5	(22.2)	4.9	(20.8)
Consumer Discretionary	28	9,191	28	100	1,913	97	1,849	81	3.4	20.3	1.4	(7.9)
Consumer Staples	17	8,888	17	100	837	118	854	111	(1.9)	6.2	0.1	(0.2)
Industrials	21	6,969	21	100	840	66	800	69	5.0	(4.0)	2.3	(6.0)
Health Care	19	4,613	19	100	547	84	557	81	(1.9)	4.0	(3.0)	2.2
Communication Services	8	2,810	8	100	493	(33)	486	(22)	1.3	NM	(6.3)	(1.6)
Utilities	12	5,151	12	100	865	114	800	125	8.1	(8.6)	4.6	0.3
Real Estate	4	526	4	100	36	10	49	13	(26.8)	(23.5)	(32.5)	(23.5)
Total	200	1,00,323	200	100	19,438	1,768	18,545	1,662	4.8	6.3	4.9	(3.2)

Source: Bloomberg, BOBCAPS Research | Note: We have excluded Vodafone Idea and Tata Motors from income aggregates as the numbers were not meaningful.

Fig 12 – Q2FY23: Beats and misses – NSE 200 by company count

Sector	Reported	Mcap reported (%)	Revenue				Income			
			Beat	Miss	In-line	No Data	Beat	Miss	In-line	No Data
Financials	43	100	19	4	10	11	19	7	7	11
Information Technology	13	100	0	3	9	1	5	3	4	1
Energy	8	100	3	2	1	2	5	1	0	2
Materials	27	100	12	3	9	3	6	18	0	3
Consumer Discretionary	28	100	10	3	11	4	8	12	5	3
Consumer Staples	17	100	4	3	6	4	7	4	3	3
Industrials	21	100	6	3	6	6	7	8	2	4
Health Care	19	100	3	8	5	3	5	11	2	1
Communication Services	8	100	1	2	3	2	3	4	0	1
Utilities	12	100	4	4	1	3	4	4	2	2
Real Estate	4	100	0	4	0	0	1	3	0	0
Total	200	100	62	39	61	39	70	75	25	30

Source: CMIE, BOBCAPS Research | Note: In line is +/-3% vs. consensus

Fig 13 – Earnings trends YoY (Q2FY23 vs. Q2FY22)

Sector	Net sales	Raw materials		Salaries and wages		Interest expenses		Net profit (after tax)	
	YoY (%)	YoY (%)	% of Net sales	YoY (%)	% of Net sales	YoY (%)	% of Net sales	YoY (%)	% of Net sales
NSE listed companies	26.7	43.6	47.4	14.8	10.5	16.3	10.1	(2.0)	7.5
Materials	16.0	35.3	50.9	2.1	5.7	21.9	2.2	(63.7)	4.5
Information Technology	20.2	13.0	0.2	22.1	55.2	32.3	0.4	10.5	15.0
Industrials	20.6	19.6	42.8	16.1	10.8	25.8	5.1	29.9	6.5
Financials	17.3	43.8	4.9	10.6	12.0	13.9	41.0	35.8	16.2
Communication Services	18.2	21.0	1.6	24.8	18.1	20.5	14.0	NM	(2.8)
Consumer Discretionary	35.5	41.9	68.2	13.6	7.7	21.4	2.7	75.8	4.0
Consumer Staples	19.3	17.3	58.6	16.9	5.5	20.0	0.9	29.7	12.0
Health Care	8.4	5.4	30.7	10.5	17.5	38.0	1.7	17.1	11.9
Real Estate	(0.8)	170.1	18.5	29.7	8.3	(0.9)	18.6	NM	(6.7)
Energy	45.4	55.4	82.4	10.5	2.9	54.1	1.3	(40.4)	2.5
Utilities	41.9	65.5	68.4	5.4	3.2	18.0	5.6	5.9	9.5
Ex-Metals, Energy and Financials	25.1	70.4	44.9	18.3	14.3	21.7	3.6	9.4	7.5

Source: CMIE, BOBCAPS Research

Fig 14 – Earnings trends QoQ (Q2FY23 vs. Q1FY23)

Sector	Net sales	Raw materials		Salaries and wages		Interest expenses		Net profit (after tax)	
	QoQ (%)	QoQ (%)	% of Net sales	QoQ (%)	% of Net sales	QoQ (%)	% of Net sales	QoQ (%)	% of Net sales
NSE listed companies	2.4	(3.4)	47.5	3.9	10.5	7.4	10.1	(4.8)	7.5
Materials	(0.5)	(1.1)	50.9	(2.0)	5.7	15.7	2.2	(54.3)	4.5
Information Technology	5.0	(17.0)	0.2	5.0	55.2	9.2	0.4	7.7	15.0
Industrials	6.1	4.4	42.9	4.8	10.7	(7.9)	5.1	0.9	6.5
Financials	12.6	17.3	5.1	6.0	12.0	7.8	41.0	16.5	16.2
Communication Services	5.9	8.8	1.6	5.5	18.1	6.9	14.0	NM	(2.8)
Consumer Discretionary	4.9	0.6	68.2	1.0	7.7	1.9	2.7	73.6	4.0
Consumer Staples	1.6	(6.3)	58.6	7.4	5.5	11.0	0.9	13.7	12.0
Health Care	6.6	3.0	30.7	2.2	17.5	41.1	1.7	7.0	11.9
Real Estate	(16.5)	12.9	18.5	6.9	8.3	2.2	18.6	(147.8)	(6.7)
Energy	(4.6)	(8.2)	82.4	2.7	2.9	14.9	1.3	(20.6)	2.5
Utilities	(3.8)	(1.1)	68.4	0.8	3.2	12.2	5.6	(30.4)	9.5
Ex-Metals, Energy and Financials	2.8	0.7	45.0	4.1	14.3	4.0	3.6	(6.1)	7.5

Source: CMIE, BOBCAPS Research

Fig 15 – Change in consensus earnings estimates

(%)	1M	3M	6M
Nifty 50	(1.96)	(3.16)	(5.12)
Nifty 200	(2.85)	(5.18)	(9.87)
Nifty 500	(2.65)	(4.55)	(9.33)
NIFTY Midcap 100	(2.71)	(17.23)	(26.32)
NIFTY Smallcap 100	(0.33)	(0.46)	(10.21)
Nifty Bank	3.13	1.92	3.42
Nifty IT	0.02	(1.04)	(3.75)
Nifty Auto	(6.89)	(8.05)	(5.21)
Nifty Pharma	(0.04)	(1.83)	(9.88)
Nifty Metal	(13.89)	(14.51)	(35.14)
Nifty FMCG	1.20	1.01	1.89
Nifty PSU Bank	20.83	22.33	8.69
Nifty Realty	(10.08)	(9.90)	(10.58)
Nifty Financial Services	(0.96)	(2.22)	(4.62)
Nifty Infrastructure	(2.11)	(6.00)	(11.86)
Nifty Energy	(2.14)	(7.76)	(11.72)
Nifty CPSE	1.27	(0.82)	7.64
Nifty India Consumption	(0.90)	(4.40)	1.79
Nifty Media	(6.52)	(17.90)	(31.16)
Nifty PSE	(1.51)	(10.61)	(19.15)
Nifty Commodities	(5.58)	(8.02)	(19.53)

Source: Bloomberg, BOBCAPS Research

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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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