India Strategy

Nifty scaling towards a new high

- Macroeconomic indicators continue to improve qoq, beating consensus estimates of economists in recent months on growth as well as cost fronts.
- The Mar 2023 quarter results season recorded the best-ever beat in terms of the number of companies' PAT outperformance in the last two years (Fig. 43).
- Reiterate Overweight rating on Nifty-50 index with a roll-forward target of 20,331, as the EPS momentum takes over from the valuation comfort earlier.

Impressive turnaround in macroeconomic indicators - GDP & CAD

The economic data points indicate an impressive turnaround, as seen in India's GDP growth momentum reversing the slowdown witnessed till Dec 2022, surprising consensus estimates of economists by a huge margin of 100bp to 6.1% in the Mar 2023 quarter and vs. 4.5% in Dec 2022. With the Goods and Services Tax or GST collections scaling a new peak, the current account deficit or CAD is expected to turn positive for the first time in the last six quarters, and the Consumer Price Index or CPI inflation easing mom providing big comfort. The areas of concern are the slow credit growth to industry and import weakness.

Mar 2023 quarter results provide hope

The Mar 2023 quarter results improved sharply in the second half vs. a weak start made by the IT sector at the beginning of the season. The reported EPS rose 2% yoy while the normalized EPS recorded an 8% yoy growth, marginally above consensus estimate. The sectors that witnessed major PAT growth momentum were financial services, automobile, FMCG and infrastructure. However, the major sectors that lagged on the PAT front were metals, chemicals, healthcare and power. Consensus Nifty-50 EPS got downward adjusted only marginally, as the benefits from sectors like financial services and automobile helped.

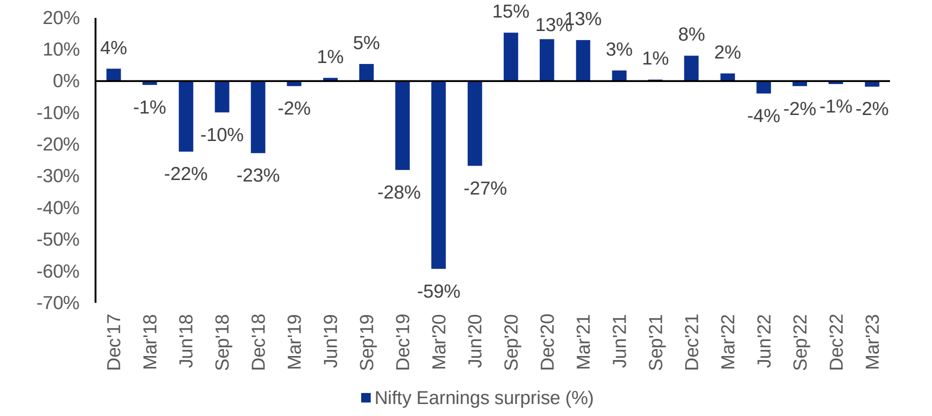
Easing interest rates to give support to our investment themes

The CPI inflation easing and fresh loan lending rates beginning to decline from their recent peak (Fig. 29) provide hopes of sustaining the revival witnessed in the Mar 2023 quarter. We maintain our investment themes of housing and infrastructure capex, which benefit from this. We have introduced Bharat Electronics in our high-conviction stock ideas list. With the recent rally making the valuations stretched, we have more downgrades like Finolex Cables, NCC, Cera Sanitaryware and Aavas Financiers vs. a few upgrades like HDFC Bank, Astral and Dr. Lal Pathlabs.

Raise Nifty-50 target to 20,331;remain Overweight

With the comfort level improving in respect of economic growth recovery supporting the Nifty-50 Bloomberg consensus EPS outlook, we roll forward our target to 1-year forward EPS methodology, from Mar 2024F earlier. To incorporate the uncertainty that lies ahead, we have reduced our bull-case probability to 30%, yielding a blended Nifty-50 target of 20,331 (Fig. 51). The Nifty Midcap Index, scaling a new high as a proportion of market capitalization, may demand consolidation (Fig. 50).

Figure 1: Quarterly EPS beat/miss vs. Bloomberg consensus estimates



SOURCE: BLOOMBERG, INCRED RESEARCH

India

InCred India Sector rating

Overweight	Neutral	Underweight
Aluminum	Building Materials	Agribusiness
Automobile	Consumer staples	Auto Ancillary
Cement	Information Technology	Aviation
Consumer Electricals	Pharma	Chemicals
Defence	Ports & Logistics	Diagnostics
Financial Services		Metals & Mining
Infrastructure		
Oil and Gas		

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Figure 2: Our high-conviction stock ideas

Company	BLOOMBERG TICKER	Reco.	Market Capital (Rsbn)	Market Capital (US$bn)	Price	Target Price	Up/down (%)	EPS				3yr EPS CAGR (FY22-FY25F)	P/E (x)			P/BV (x)		EV/EBITDA (x)	Dividend Yield (%)	ROE %
								FY22A	FY23A	FY24F	FY25F		FY23	FY24F	FY25F	FY23	FY24F	FY23	FY23	FY23
Ashok Leyland	AL IN	ADD	446	6.1	152	181	19%	0.3	4.4	6.8	8.8	217%	32.3	22.4	17.2	5.3	4.8	13.9	171%	16.5
BCL Industries	BCLIL IN	ADD	11	0.2	475	790	66%	35.1	26.1	65.9	80.7	32%	18.2	7.2	5.9	4.0	2.6	13.6	16%	25.5
Bharat Electronics	BHE IN	ADD	863	11.9	118	140	19%	3.2	4.1	4.7	5.7	21%	28.7	25.3	20.8	6.4	5.6	19.3	152%	23.5
Bharat Forge	BHFC IN	ADD	376	5.2	808	918	14%	22.6	10.5	19.7	25.6	4%	93.3	41.0	31.6	5.6	4.2	23.2	99%	8.3
Camlin Fine Sciences	CFIN IN	ADD	28	0.4	169	300	78%	4.2	6.2	15.1	21.8	72%	27.1	11.2	7.8	2.8	2.1	14.4	37%	11.5
Container Corp. of India	CCRI IN	ADD	410	5.6	673	940	40%	19.1	20.2	25.9	42.1	30%	33.4	26.0	16.0	3.5	3.2	19.5	90%	11.0
Dalmia Bharat	DALBHARA IN	ADD	406	5.6	2,167	2,250	4%	43.3	64.4	59.8	72.9	19%	30.6	36.2	29.7	2.6	2.4	17.8	23%	7.5
Globus Spirits	GBSL IN	ADD	34	0.5	1,184	3,014	155%	65.0	46.0	120.6	140.5	29%	25.7	9.8	8.4	3.8	2.8	13.9	23%	15.9
Home First Finance Company	HOMEFIRS IN	ADD	70	1.0	796	950	19%	21.2	26.1	31.6	38.0	21%	30.6	25.2	21.0	3.8	3.3	NA	0%	13.5
InterGlobe Aviation	INDIGO IN	REDUCE	933	12.8	2,420	1,600	-34%	-141.9	6.5	-16.0	-9.3	-60%	-34.4	-151.4	-260.9	-10.7	-10.0	16.6	0%	-3.4
Kajaria Ceramics	KJC IN	ADD	200	2.8	1,255	1,376	10%	23.7	22.0	27.6	36.2	15%	58.0	45.5	34.7	8.6	7.8	33.6	72%	21.1
KEC International	KECI IN	ADD	135	1.9	527	571	8%	14.3	6.8	25.1	38.0	38%	76.9	21.0	13.8	3.6	3.2	19.8	76%	4.8
Mahindra & Mahindra Finance	MMFS IN	ADD	360	5.0	292	350	20%	8.0	16.1	19.2	23.2	43%	18.1	15.2	12.6	2.1	1.9	NA	206%	12.1
Maruti Suzuki	MSIL IN	ADD	2,932	40.4	9,708	11,061	14%	128.1	266.5	373.4	466.3	54%	36.4	26.0	20.8	4.9	4.3	22.8	93%	14.1
Reliance Industries	RIL IN	ADD	16,902	232.8	2,498	3,369	35%	100.7	162.2	178.7	NA	NA	15.4	14.0	NA	1.8	1.7	8.7	32%	12.7
Spandana Sphoorty Financial	SPANDANA IN	ADD	50	0.7	699	850	22%	10.1	1.7	65.6	90.3	107%	399.8	10.7	7.7	1.6	1.3	NA	0%	0.4
Sun Pharmaceutical Industries	SUNP IN	ADD	2,434	33.5	1,015	1,187	17%	32.4	32.8	36.2	42.2	9%	31.0	28.0	24.0	4.6	4.1	21.0	99%	15.5
Tata Motors	TTMT IN	REDUCE	2,036	28.0	568	401	-29%	-22.8	-9.3	20.2	39.4	-220%	-64.6	28.2	14.4	4.8	4.2	8.3	35%	-7.9
Tata Steel	TATA IN	REDUCE	1,363	18.8	112	70	-37%	34.2	10.3	5.3	NA	NA	10.8	21.2	NA	1.1	1.1	6.4	18%	10.6
Titan Company	TTAN IN	ADD	2,581	35.5	2,907	3,150	8%	24.9	36.5	44.1	53.6	29%	79.6	66.0	54.3	22.3	18.1	52.8	38%	31.1
UltraTech Cement	UTCEM IN	ADD	2,355	32.4	8,158	8,530	5%	248.9	175.4	239.2	290.6	5%	46.5	34.1	28.1	4.3	3.9	22.5	56%	9.7
Zydus Lifesciences	ZYDUSLIF IN	ADD	521	7.2	515	593	15%	23.4	22.9	29.0	34.4	14%	22.5	17.7	15.0	2.9	2.6	14.5	116%	13.3

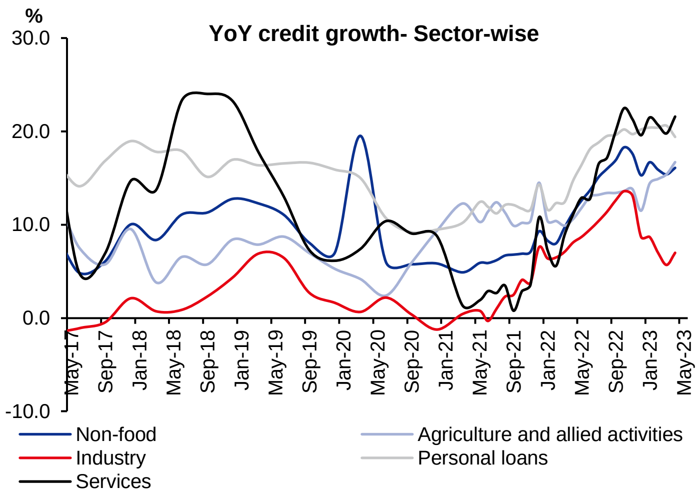
SOURCE: INCRED RESEARCH, COMPANY REPORTS

Performance scaling towards a new high

Strong economic recovery in Mar 2023 quarter is impressive ➤

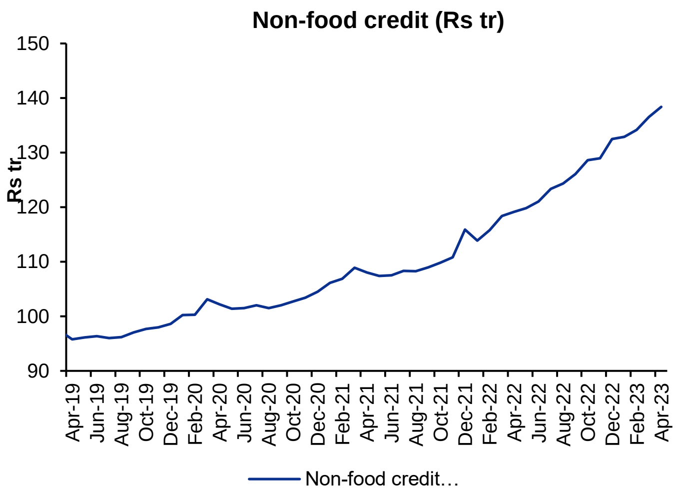
Domestic economic activity showed a strong recovery in the Mar 2023 quarter, after a muted performance in Sep and Dec 2022 quarters on the gross domestic product or GDP growth front. The sustained growth momentum in GST collections, E-way bills, Purchasing Managers' Index or PMI and consumer sentiment provide comfort. Easing inflation also provides comfort in respect of interest rates peaking, raising hopes of a recovery in private consumption. However, the areas of concern are a slow credit growth to industry, weakness in imports and El Nino's adverse impact on India's rural economy. While the fiscal consolidation path followed by the Government of India's recent budget is impressive, the recent loss of the ruling Bharatiya Janata Party in Karnataka assembly elections may raise government spending in rural areas ahead of the general elections scheduled in May 2024.

Figure 3: Loan growth is strong except for industry



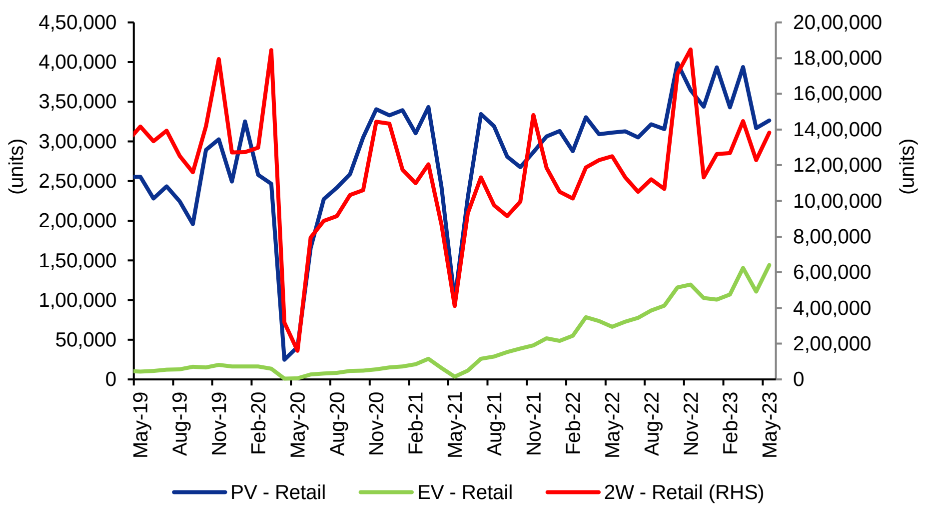
SOURCE: RBI, INCRED RESEARCH

Figure 4: The improvement in non-food credit growth in recent months is encouraging



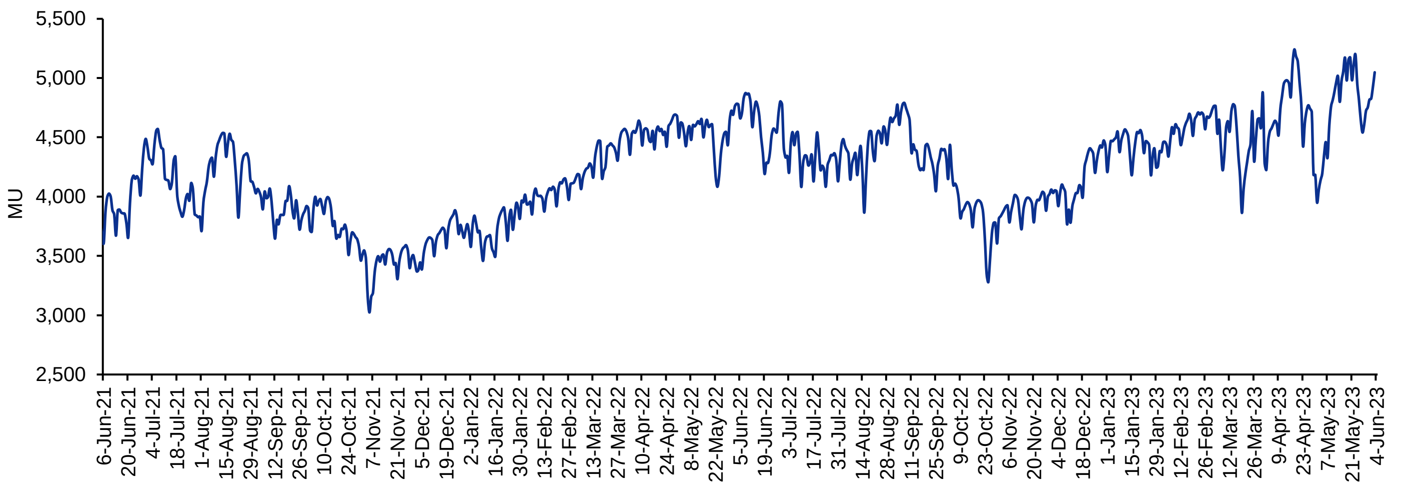
SOURCE: RBI, INCRED RESEARCH

Figure 5: Car sales registrations – EVs seem to be at short-term peak as subsidies cut sharply



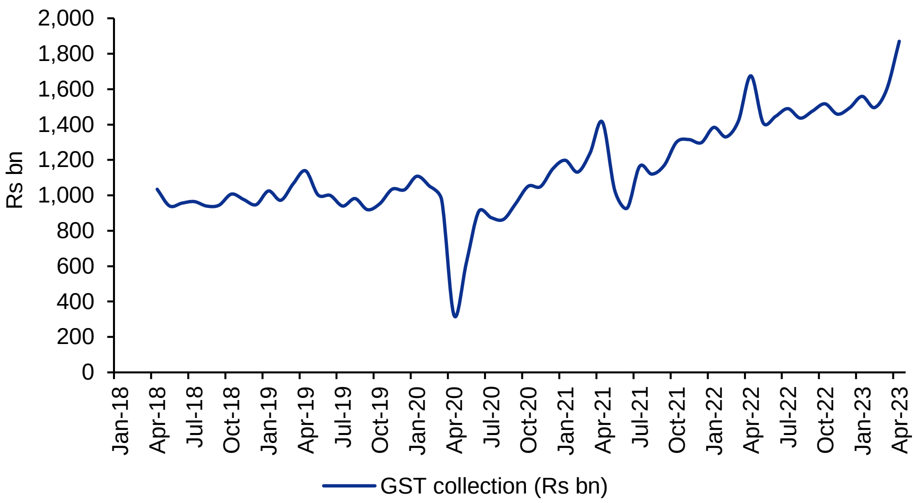
SOURCE: VAHAN.COM, INCRED RESEARCH, COMPANY REPORTS

Figure 6: Electricity generation rising to a new high (in MU)



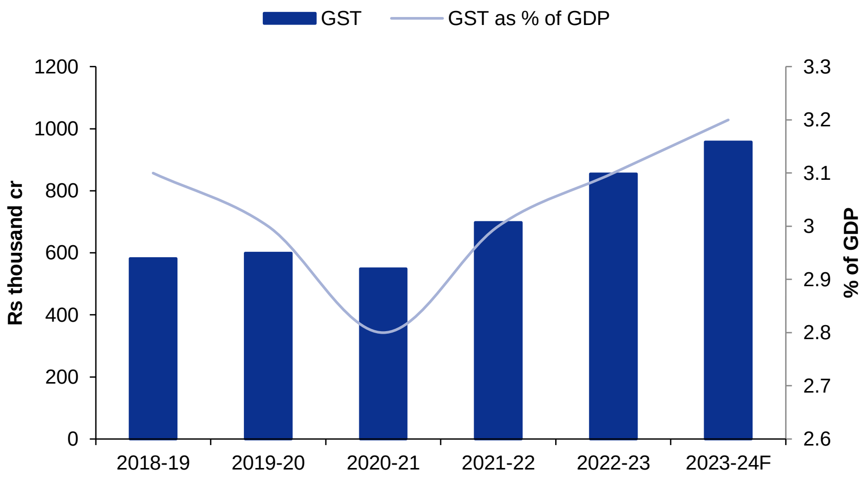
SOURCE: POWER SYSTEM OPERATION CORPORATION LIMITED, INCRED RESEARCH

Figure 7: The buoyancy in GST collections is impressive



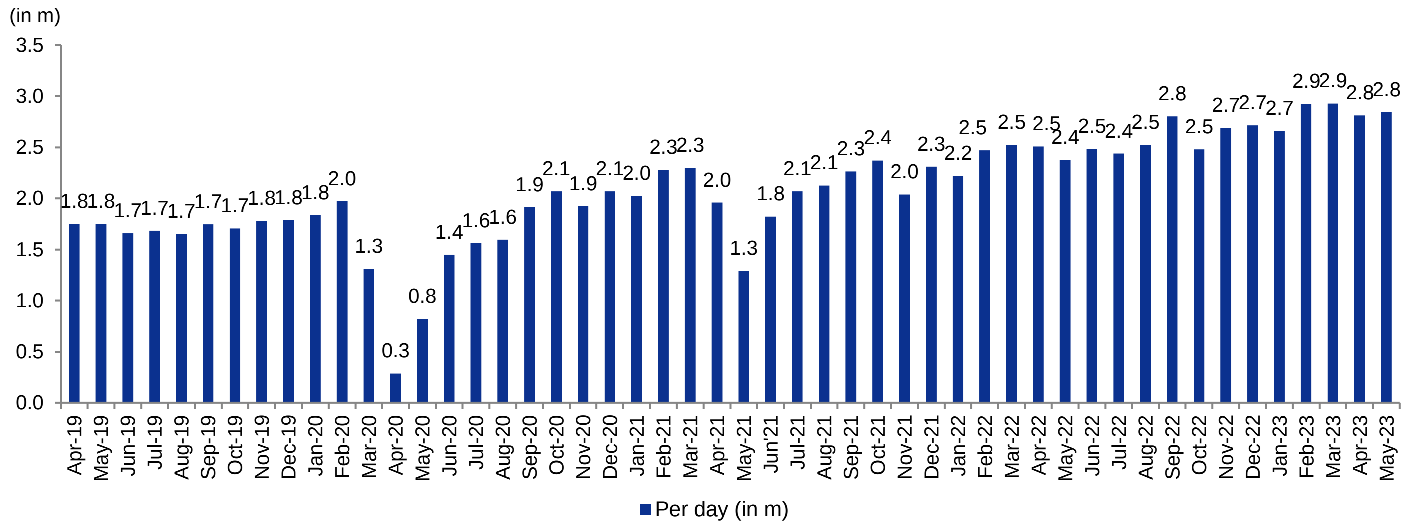
NOTE: GST IS GOODS AND SERVICES TAX
SOURCE: GST COUNCIL, INCRED RESEARCH

Figure 8: GST collection buoyancy is likely to sustain but the pace to be slower



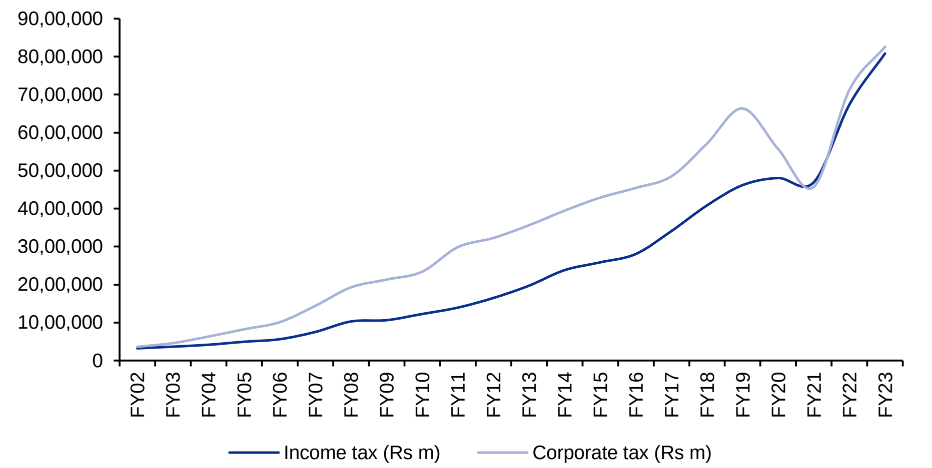
NOTE: GST IS GOODS AND SERVICES TAX
SOURCE: GST COUNCIL, INCRED RESEARCH

Figure 9: E-way bills' growth momentum



SOURCE: GOODS AND SERVICES TAX NETWORK (GSTN), INCRED RESEARCH

Figure 10: Tax collection buoyancy



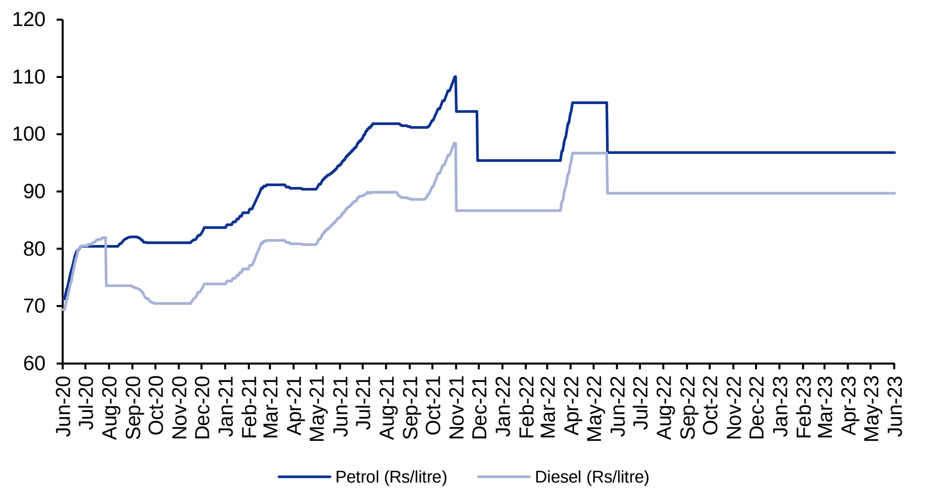
SOURCE: CENTRE FOR MONITORING INDIAN ECONOMY (CMIE), INCRED RESEARCH

Consumer sentiment remains strong

The consumer sentiment, as per the Reserve Bank of India or RBI data continued to improve in Mar 2023, rising by 220bp to 87%, on account of improved perception on the general economic situation, employment, and household income. With an uptick in the current perception, the sentiment on employment is nearing the level seen around mid-2019; consumers are also optimistic about the employment outlook as more than half of the respondents in the RBI's household survey expecting the employment scenario to improve over the next one year.

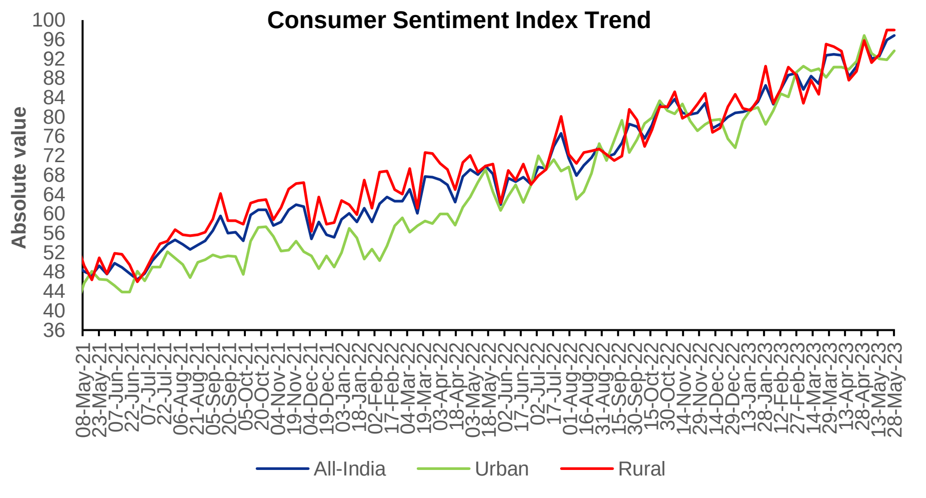
The Index of Consumer Sentiment (ICS) tracked by the Centre for Monitoring Indian Economy or CMIE improved marginally in May 2023. The ICS inched up by 90bp during the month. This was the fifth consecutive month of an improvement in consumer sentiment in India. During these five months, consumer sentiment scaled up cumulatively by 17.4 percentage points. In the coming months of 2023F, the ICS could face challenges from the monsoon which is already quite delayed, and precipitation is expected to be below the long-period average (as per the India Meteorological Department or IMD). Assembly elections in large states of the country towards the end of this year could also cause some volatility in consumer sentiment as political parties are inclined to give/promise freebies. Interestingly, while the uncertainty regarding the prospects on the agricultural front has increased in the past two months, rural consumer sentiment fared quite well. Rural consumer sentiment increased by 1.2 per cent in May 2023 while the urban consumer sentiment increased by only 0.5 per cent.

Figure 11: Stable fuel prices provide comfort to customers



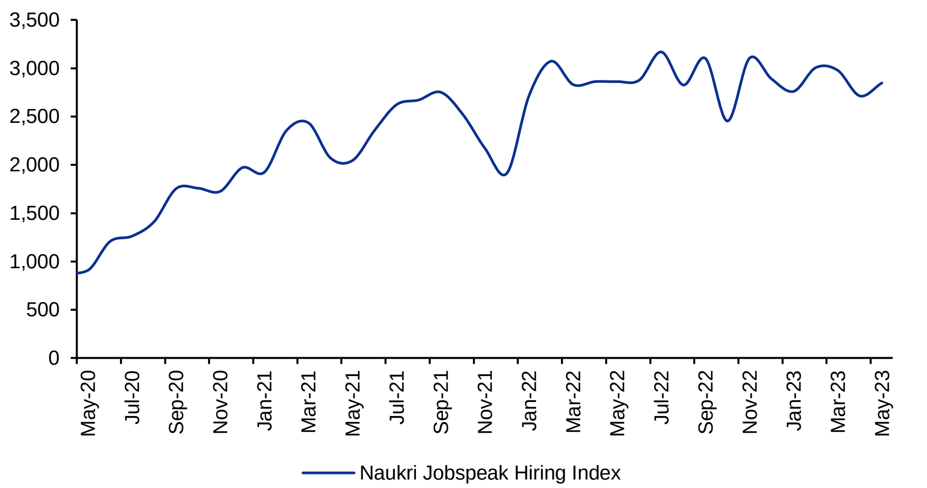
SOURCE: INDIAN OIL CORPORATION (IOC) PRICES FOR DELHI, INCRED RESEARCH

Figure 12: The Consumer Sentiment Index continues to scale a new high (nos)



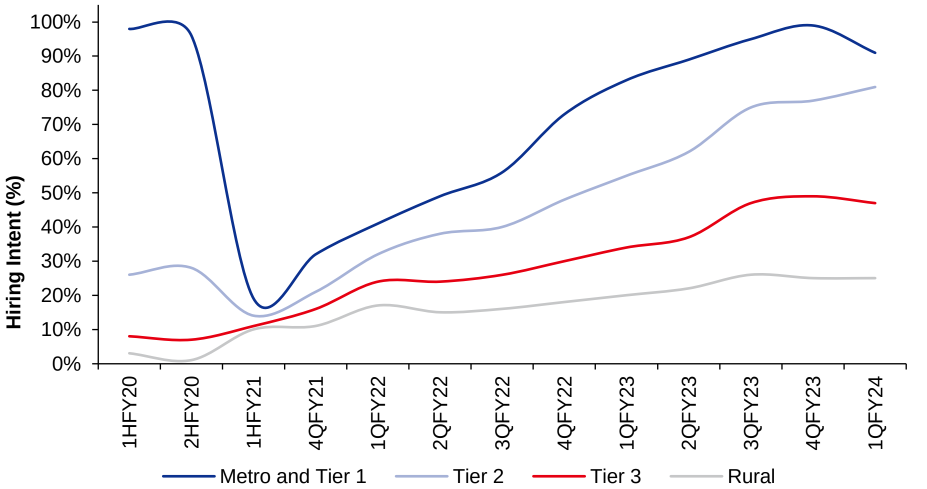
SOURCE: RESERVE BANK OF INDIA (RBI), INCRED RESEARCH

Figure 13: Naukri Jobspeak Hiring Index is stable



SOURCE: INCRED RESEARCH, NAUKRI JOBSPEAK REPORT

Figure 14: Hiring Intent Index of Team Lease – Tier 1&3 cities ease from their peak levels



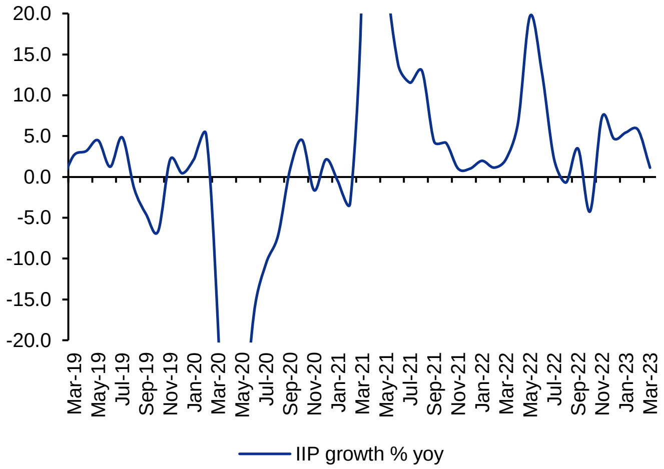
SOURCE: TEAM LEASE, INCRED RESEARCH

GDP growth outperformance in Mar 2023 quarter is impressive

India's Mar 2023 quarter GDP growth surprised positively at 6.1% yoy vs. consensus estimate of 5%. Sequentially, in seasonally adjusted annualized terms, the growth in the economy rose to 10%, helped by most segments on the supply side. The main reason for the better-than-expected performance has been a significant traction in fixed investments and exports on the demand side and the growth in construction and trade, hotel & hospitality sectors on the supply side. The sharp decline in imports also helped. Private consumption remains the main source of disappointment.

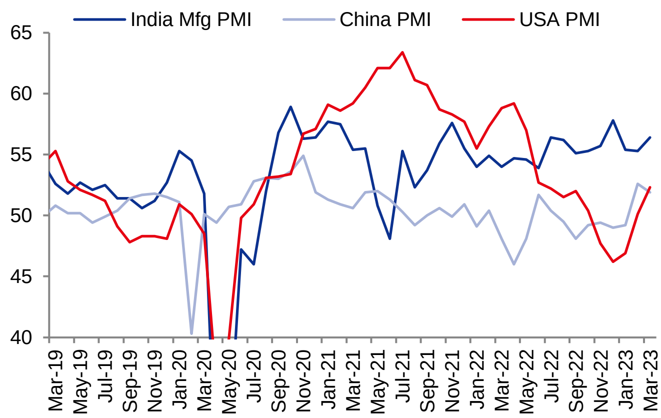
With inflation beginning to ease, we expect private final consumption expenditure growth to provide support to GDP growth. In the upcoming monetary policy, the RBI is expected to raise GDP growth outlook, as seen from a few economists already raising their estimates by 50+bp to near 6% for FY24F. However, the full benefits of Bloomberg consensus estimates are yet to flow through.

Figure 15: Index of Industrial Production growth weakens



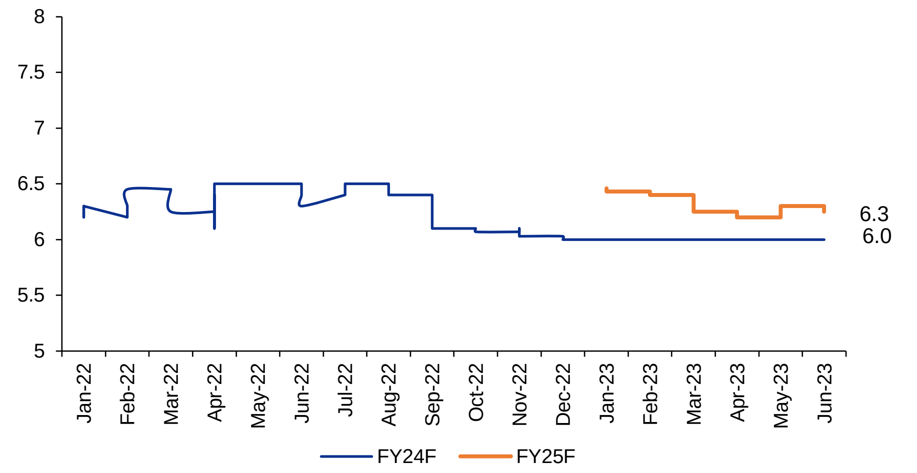
SOURCE: NATIONAL STATISTICS OFFICE (NSO), INDEX OF INDUSTRIAL PRODUCTION (IIP), INCRED RESEARCH,

Figure 16: India PMI (updated till data available)



SOURCE: IHS MARKIT, PURCHASING MANAGERS' INDEX (PMI), INCRED RESEARCH

Figure 17: Bloomberg's India GDP growth consensus estimate seems to be bottoming out (%)



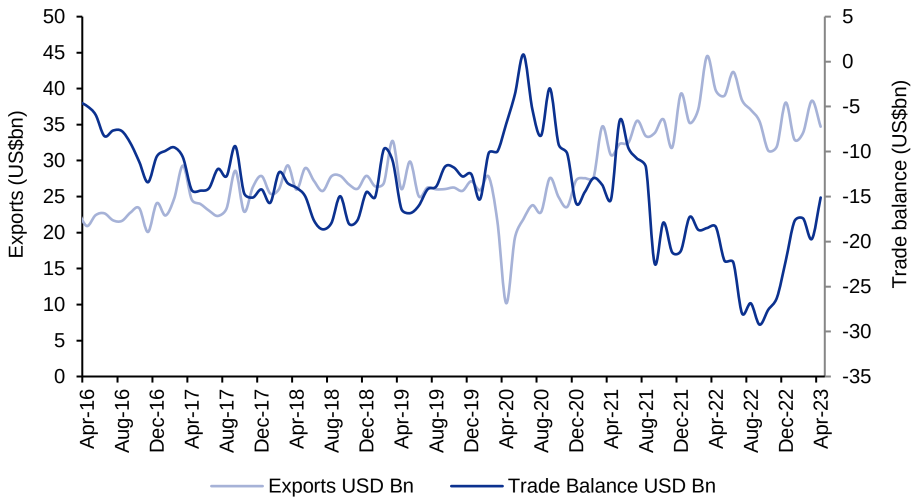
SOURCE: BLOOMBERG, INCRED RESEARCH

Positive CAD hopes in Mar 2023 quarter

India's external sector was buffeted by deteriorating global macroeconomic conditions following the ongoing Russia-Ukraine war that impacted trade and capital flows adversely. Even as domestic economic recovery kept import demand high, the slowdown in global demand weighed on India's exports. These, together with the adverse net terms of trade shock associated with record-high global commodity prices, expanded India's merchandise trade deficit during the year. Notwithstanding a robust growth in services exports and higher remittance receipts, the widening of merchandise trade deficit and higher outgo on the primary income account led the current account deficit (CAD) to widen during the year, which peaked in 2QFY23. While net capital inflows dominated by foreign direct investment (FDI) and banking capital supported financing of CAD, significant foreign portfolio outflows during the year necessitated the drawdown of foreign exchange reserves. Valuation losses, primarily due to a large appreciation of the US dollar (USD) against non-USD reserve currencies, constituted a major part of the depletion of foreign exchange reserves during the year. Nonetheless, the external sector stood resilient against global spillovers, with India's vulnerability indicators faring better than its peer emerging market economies.

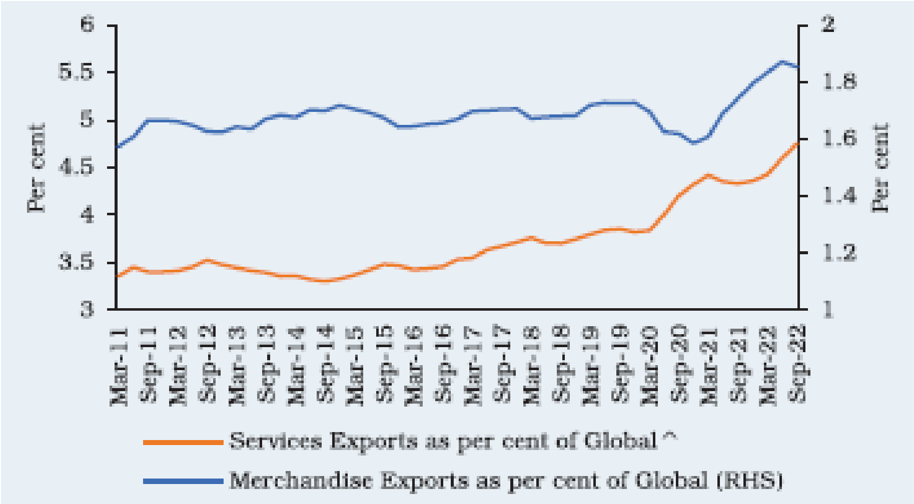
Record-high merchandise exports were observed in FY23 at US$449.9bn, a growth of 6.5% yoy. The CMIE projects merchandise exports to be around US$ 440bn in FY24F due to the global slowdown. India is expected to post a current account surplus in the quarter ended Mar 2023, driven by declining commodity prices, robust services exports and rising remittances from overseas Indians. If realized, this surplus would be the first in six quarters. India Ratings and Research (Ind-Ra) estimates the current account surplus at US$6bn or 0.7 per cent of GDP for Jan-Mar 2023.

Figure 18: Trade deficit eases from its recent peak (updated till data available)



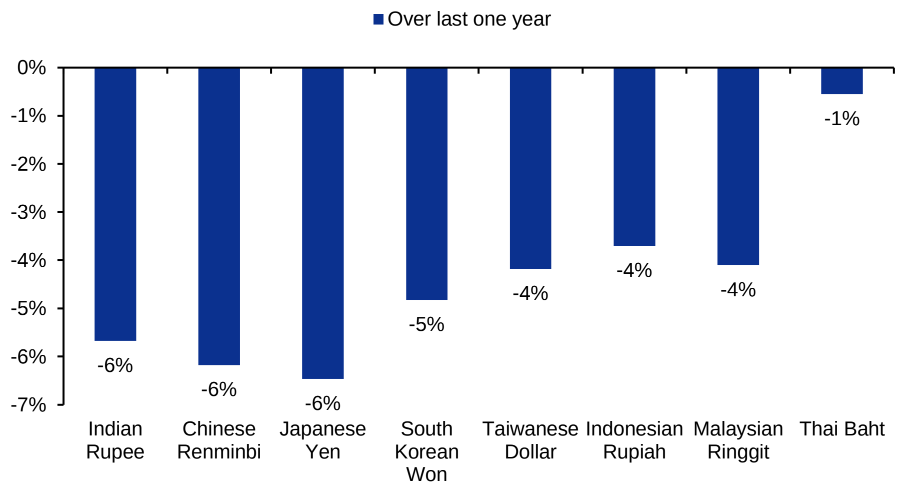
SOURCE: MINISTRY OF COMMERCE AND INDUSTRY, INCRED RESEARCH

Figure 19: India exports, as a proportion of global market share, are rising but still small



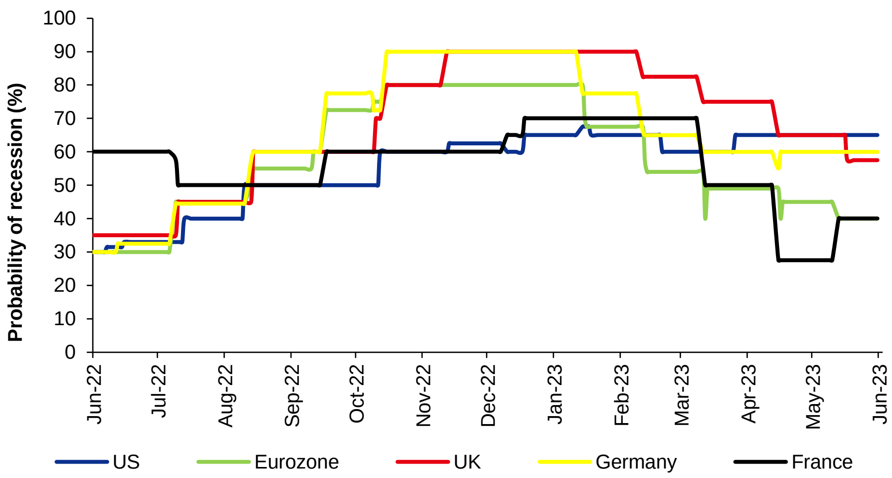
SOURCE: WORLD TRADE ORGANIZATION AND RBI STAFF ESTIMATES, INCRED RESEARCH

Figure 20: INR's performance vs. Asian peers over the last one year (against USD)



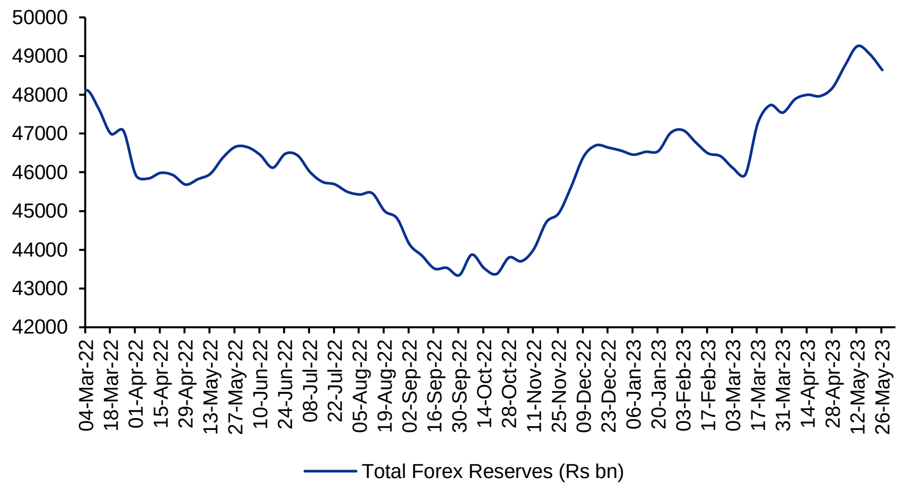
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 21: Consensus estimates on probability of a recession in developed countries



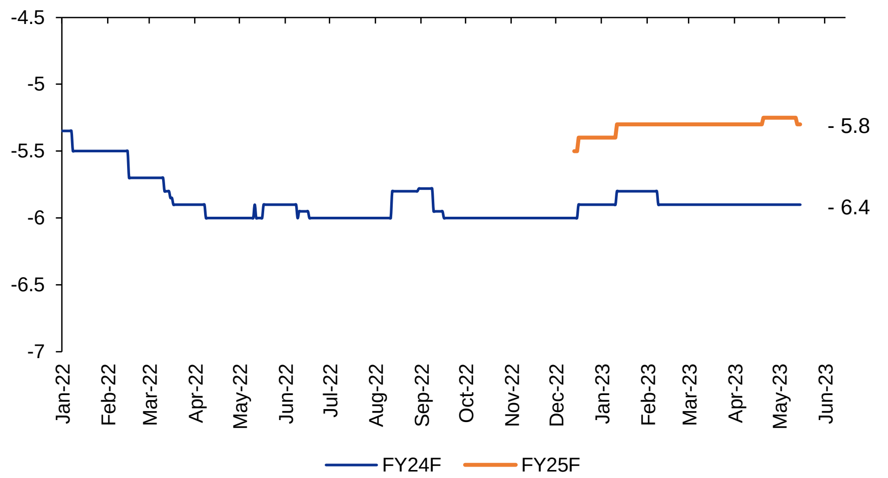
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 22: Total forex reserves (US$ bn) ease from their historic high



SOURCE: RBI, ACE EQUITY, INCRED RESEARCH

Figure 23: Bloomberg consensus estimates on GoI's fiscal deficit (as a % of GDP) may be at risk post Karnataka assembly election loss for the BJP

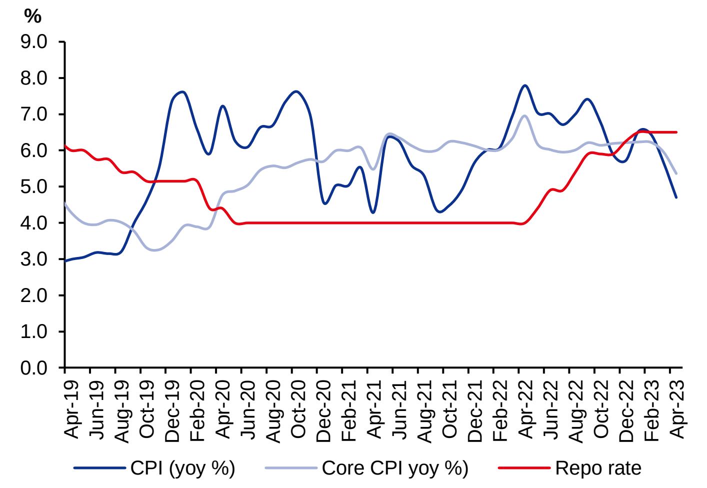


SOURCE: BLOOMBERG, INCRED RESEARCH

RBI's accomodative stance to continue

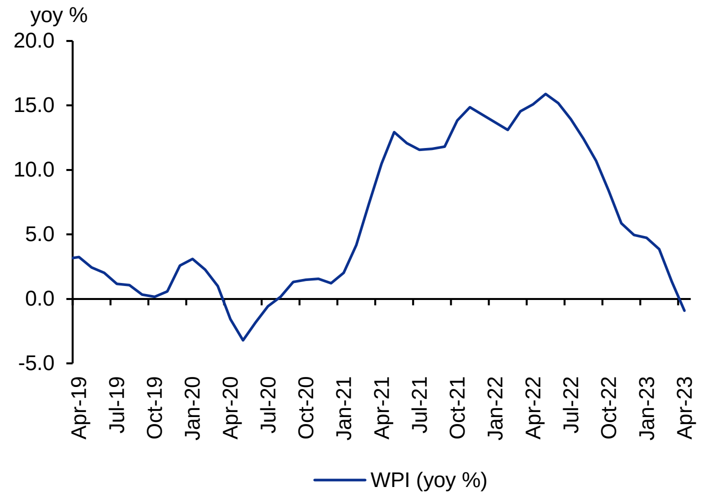
Economists' survey indicates that RBI will maintain the repo rate at its 8 Jun 2023 monetary policy meeting. Their expectation is driven by the recent decline in Consumer Price Index or CPI-based inflation. Retail inflation eased to an 18-month low of 4.7 per cent in Apr 2023, well within the RBI's target range of 2 to 6 per cent. The consensus among economists is that the central bank will maintain its current stance of withdrawing accommodation. A few economists expect a downward revision of the inflation forecast and an upward revision in the RBI's growth forecast for FY24F.

Figure 24: Core Consumer Price Index or CPI (updated till date)



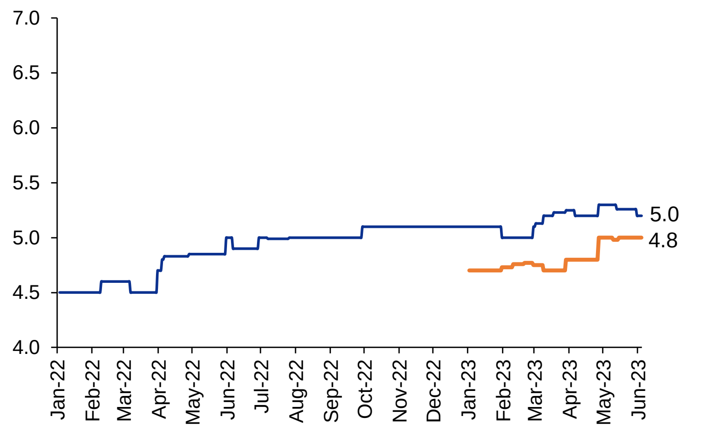
CONSUMER PRICE INDEX (CPI)
SOURCE: RBI, CENTRAL STATISTICS OFFICE, INCRED RESEARCH

Figure 25: Wholesale Price Index or WPI inflation (updated till date)



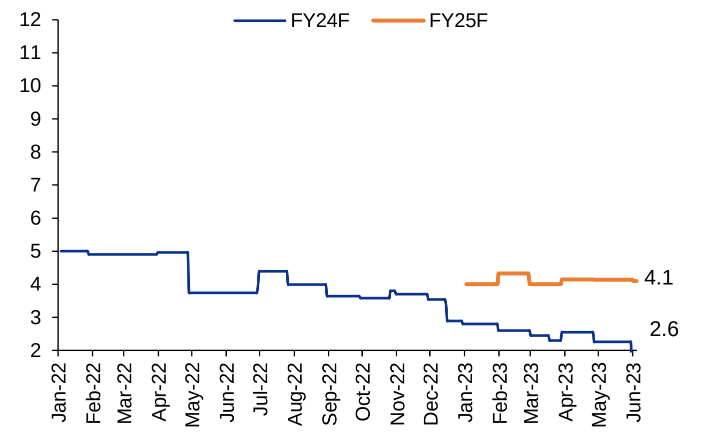
SOURCE: RBI, INCRED RESEARCH

Figure 26: Bloomberg CPI inflation consensus estimates



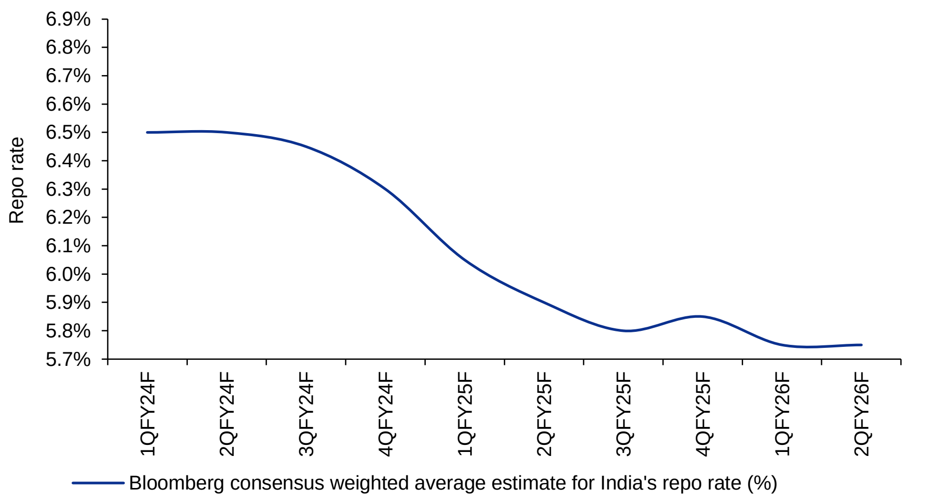
NOTE: CPI ISCONSUMER PRICE INDEX
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 27: Bloomberg consensus estimates on WPI inflation



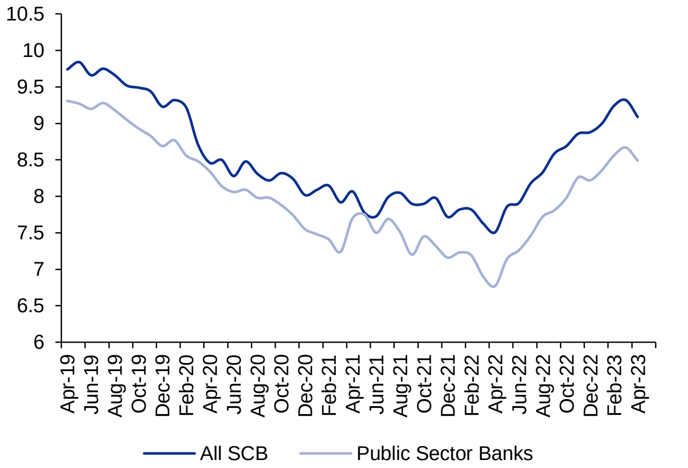
NOTE: WPI IS WHOLESALE PRICE INDEX
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 28: Bloomberg consensus estimate expects the repo rate to be cut by 75bp in the next one year



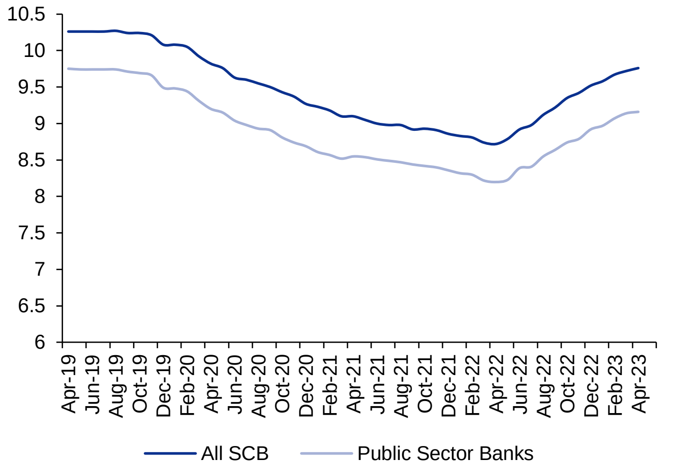
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 29: Weighted average lending rate of banks begins to ease from their peak (fresh INR loans)



SOURCE: RBI, INCRED RESEARCH

Figure 30: Weighted average lending rate of banks (outstanding rupee loans - updated till data available)



SOURCE: RBI, INCRED RESEARCH

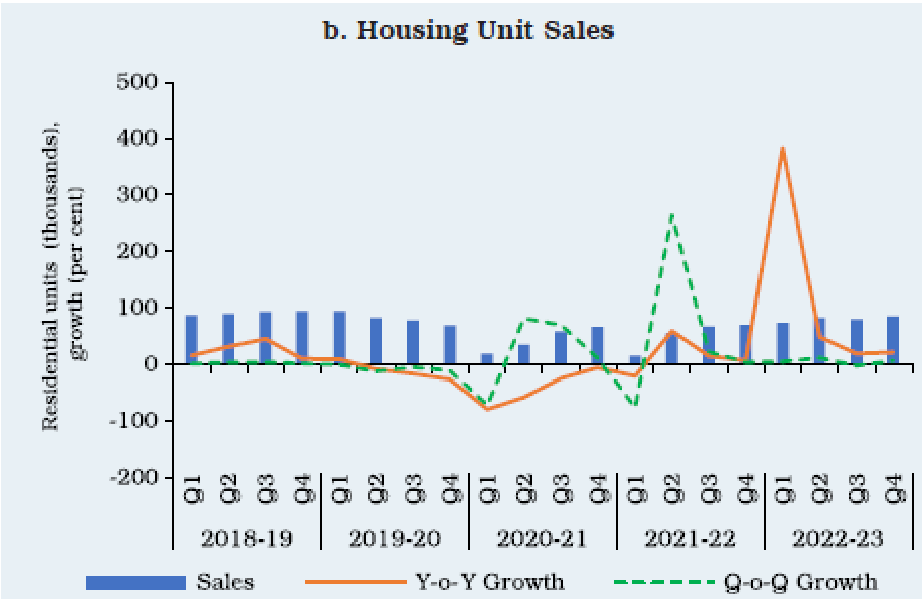
Investment themes

We continue to like housing and infrastructure capex investment themes as a top-down approach, with management commentaries during the recent results season supporting them. Except for a few stretched valuation-led downgrades, we maintain our stock picks. The gross margin expansion of our inflation-proof theme stocks is more visible, as input cost inflation started easing in the Mar 2023 quarter.

Sustained housing demand uptrend is impressive ›

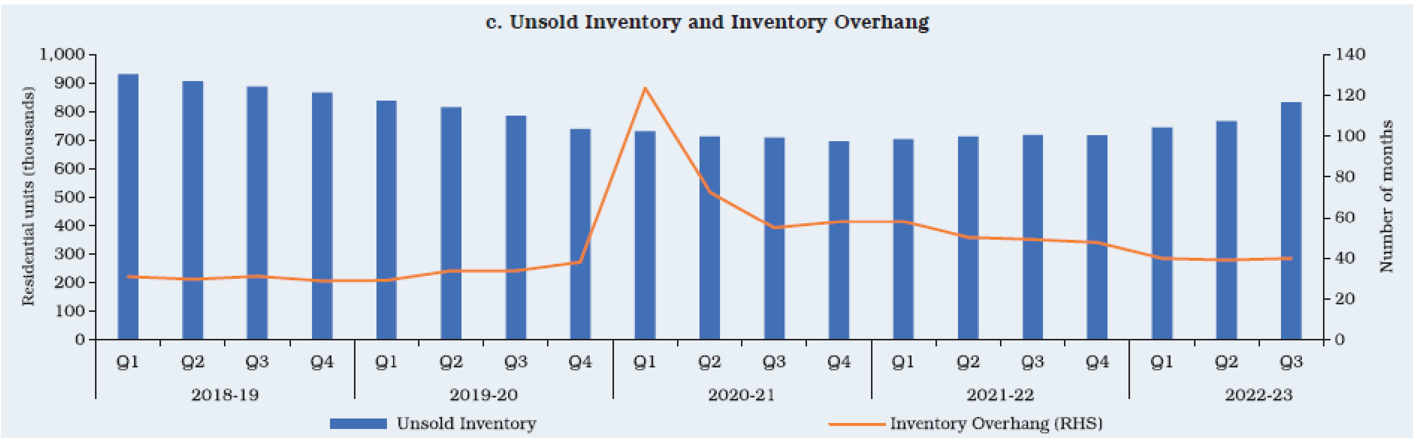
The residential real estate sector in India is witnessing a remarkable transformation, driven by evolving consumer preferences, changing lifestyles, and demographic shifts. A record-breaking number of 247,000 new residential units were launched in 2022 (+81% yoy), marking the second-highest number of launches in a decade, falling behind only the peak of 281,000 units in 2010. As the country's economy continues to recover and urbanization remains a vital driver, the real estate sector's growth potential will remain robust, offering immense opportunities. The home loan rates peaking at 9.02% and their gradual decline expected in the rest of FY24F, in our view, should help sustain the demand growth momentum.

Figure 31: Housing sales trend for eight prime housing markets in India scale to pre-Covid peak



SOURCE: PROP TIGER, INCRED RESEARCH

Figure 32: Increase in new launches raises absolute inventory but in terms of the number of sales/month, its static and healthy



SOURCE: PROP TIGER, INCRED RESEARCH

Figure 33: Beneficiaries of revival in housing demand

Company Name	Bloomberg Ticker	Reco.	Price	Target Price	Market Capital	Market Capital	EPS (Rs)		P/E (x)		P/BV (x)		EV/EBITDA (x)	Dividend Yield (%)	Upside/ Downside	ROE (%)
			Rs	Rs	(Rs bn)	(US$ bn)	FY23	FY24F	FY23	FY24F	FY23	FY24F	FY23	FY23	(%)	FY23
Astral	ASTRA IN	ADD	1,910	1,978	583	7.1	17.7	21.6	108.6	88.5	18.9	16.1	62.9	0.1	4%	25.0
Century Plyboards	CPBI IN	ADD	573	734	145	1.8	16.5	19.0	34.7	30.1	6.7	5.5	23.7	0.2	28%	28.5
Crompton	CROMPTON IN	ADD	278	320	202	2.5	7.0	8.8	40.0	31.6	6.6	6.0	23.8	1.1	15%	22.6
Kajaria Ceramics	KJC IN	ADD	1,243	1,376	225	2.7	22.0	27.6	57.4	45.0	8.5	7.7	33.2	0.7	11%	21.1
UltraTech Cement	UTCEM IN	ADD	8,110	8,530	2,660	32.2	175.4	239.2	46.2	33.9	4.3	3.9	22.3	0.6	5%	9.7
V-Guard Industries	VGRD IN	ADD	253	290	125	1.5	4.4	6.3	58.0	40.4	6.8	6.1	35.4	0.5	15%	17.0
Voltas	VOLT IN	ADD	803	942	302	3.7	11.4	20.5	70.3	39.3	4.9	4.4	41.4	0.7	17%	6.9

SOURCE: INCRED RESEARCH ESTIMATES, BLOOMBERG, COMPANY REPORTS
NOTE: PRICES AS ON 7 JUN 2023

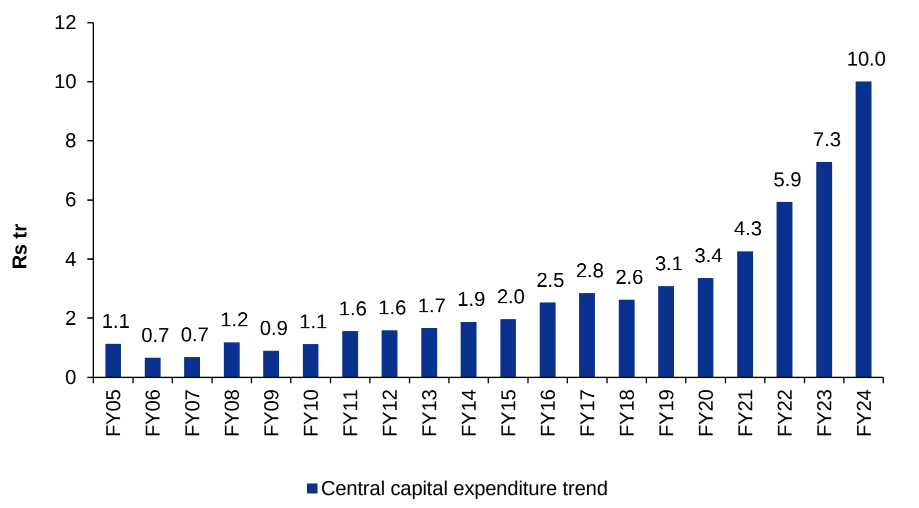
Strong order inflow from infrastructure capex

Aggregate order inflow in FY23 was robust for capital goods companies under our coverage at +36% yoy, led by Siemens (+600%) and KEC International (+121%). New investments announced by the manufacturing sector in FY23 grew 23% yoy. We expect a new trend of private sector spending led by energy transition including renewables, electric vehicles, battery technology, and hydrogen. We expect the order inflow of our coverage companies to clock a 14% CAGR over FY24F-25F.

The GoI's budget allocation to the infrastructure sector is expected to rise by 28% yoy to Rs8.9tr in FY24F, with the thrust on railways and roads. An average order book or OB-to-sales ratio at a healthy ~2.8x for construction & infrastructure companies in our coverage augurs well for sales growth in FY24F-25F.

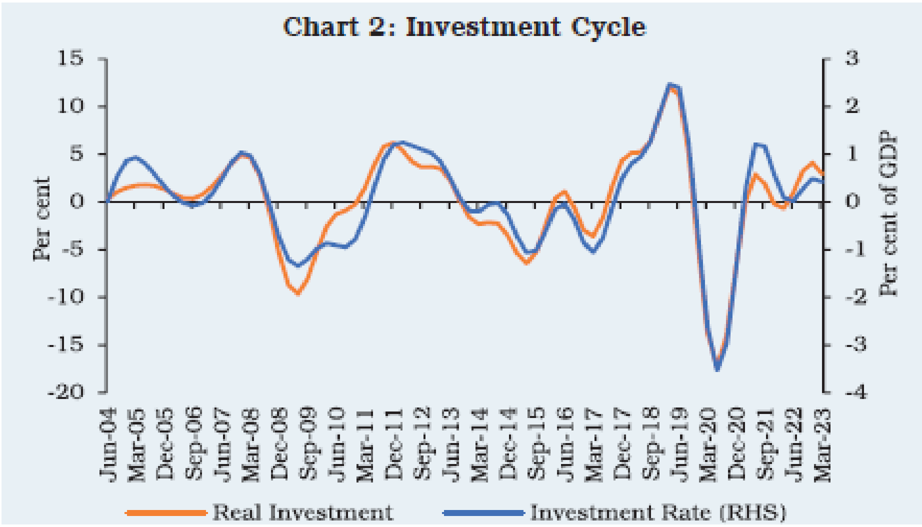
Private sector capex recovery may be gradual to flow through because of debt challenges faced by a few large groups like the Adani Group and the recent credit rating challenges witnessed in a rising interest rate environment.

Figure 34: Central capital expenditure to sustain its 32% CAGR over FY21-24BE



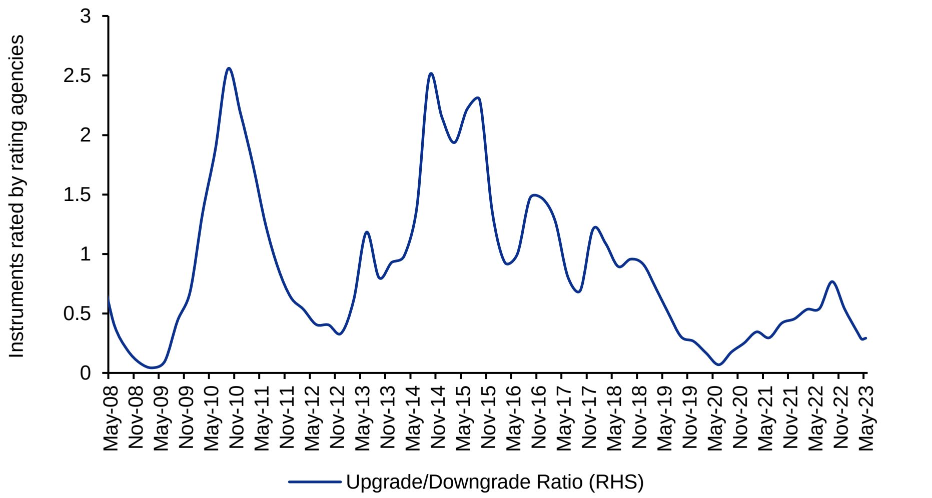
SOURCE: CMIE, INCRED RESEARCH

Figure 35: Investment cycle on the recovery path



NOTE: CYCLES ARE CALCULATED BY EMPLOYING ASYMMETRIC BAND-PASS FILTER ON GROWTH OF REAL GROSS FIXED CAPITAL FORMATION (GFCF) (ORANGE LINE) AND NOMINAL GFCF AS A PER CENT OF NOMINAL GDP (BLUE LINE).
SOURCE: RBI STAFF ESTIMATES, INCRED RESEARCH

Figure 36: Corporate ratings ease due to the rising interest cost impact



SOURCE: CMIE, INCRED RESEARCH

Figure 37: Beneficiaries of spending on infrastructure

Company Name	Bloomberg Ticker	Reco.	Price Rs	Target Price Rs	Market Capital (Rs bn)	Market Capital (US$ bn)	EPS (Rs) FY23	EPS (Rs) FY24F	P/E (x) FY23	P/E (x) FY24F	P/BV (x) FY23	P/BV (x) FY24F	EV/EBITDA (x) FY23	Dividend Yield (%) FY23	Upside/ Downside (%)	ROE (%) FY23
Adani Ports	ADSEZ IN	ADD	745	823	1,830	22.2	34.1	41.0	21.9	18.2	3.5	3.0	15.4	0.6	0.1	22.1
Container Corp.	CCRI IN	ADD	670	940	464	5.6	20.2	25.9	33.2	25.9	3.5	3.2	19.4	0.9	0.4	11.0
KEC International	KECI IN	ADD	533	571	156	1.9	6.8	25.1	77.8	21.2	3.6	3.2	19.9	0.8	0.1	4.8
Larsen & Toubro	LT IN	ADD	2,278	2,515	3,639	44.1	73.6	93.8	31.0	24.3	3.6	3.2	21.0	0.9	0.1	12.0
UltraTech Cement	UTCEM IN	ADD	8,110	8,530	2,660	32.2	175.4	239.2	46.2	33.9	4.3	3.9	22.3	0.6	0.1	9.7

SOURCE: INCRED RESEARCH ESTIMATES, COMPANY REPORTS
NOTE: PRICES AS ON 7 JUN 2023

Inflation-proof stocks show fast gross margin expansion as inflation eases

While corporates have been eager to raise product prices and pass on the inflation in input cost to their consumers, very few have a long-term track record of resilient gross/EBITDA margins. Our stock picks on this theme not only limited the inflation impact on gross margin but with the inflation easing in 4QFY23, the bounce-back in their gross margin was impressive.

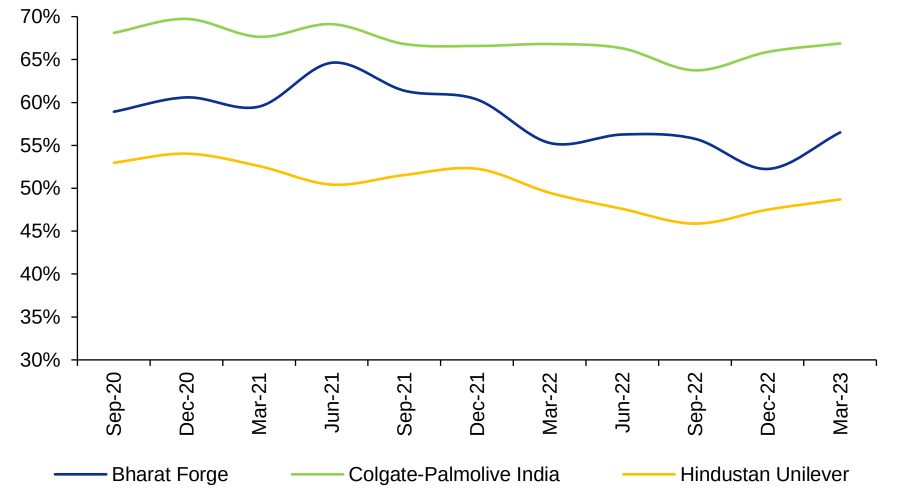
Companies operating in sectors like mining and metals, oil & gas, utilities, and pharmaceuticals stand out with a high gross margin.

Figure 38: Companies better positioned to handle a high-inflation environment

Company Name	Bloomberg Ticker	Reco.	Price Rs	Target Price Rs	Market Cap (Rs bn)	Market Cap (US$ bn)	EPS (Rs) FY23	EPS (Rs) FY24F	P/E (x) FY23	P/E (x) FY24F	P/BV (x) FY23	P/BV (x) FY24F	EV/EBITDA (x) FY23	Dividend Yield (%) FY23	Upside/ Downside (%)	ROE (%) FY23
Bharat Forge	BHFC IN	ADD	803	918	425	5.1	10.5	19.7	92.6	40.7	5.6	4.1	23.0	1.0	0.1	8.3
Colgate-Palmolive India	CLGT IN	HOLD	1,620	1,645	501	6.1	38.9	43.8	41.6	37.0	25.7	24.8	27.9	2.4	0.0	61.3
Hindustan Unilever	HUVR IN	ADD	2,691	2,720	7,186	87.1	42.4	47.4	63.8	56.8	12.6	12.0	45.8	1.3	0.0	20.2

SOURCE: INCRED RESEARCH ESTIMATES, COMPANY REPORTS, PRICES AS ON 7 JUNE 2023

Figure 39: Gross margin of our inflation-proof universe of stocks



SOURCE: ACE EQUITY, INCRED RESEARCH, COMPANY REPORTS

4QFY23 EBITDA margin recovery provides comfort

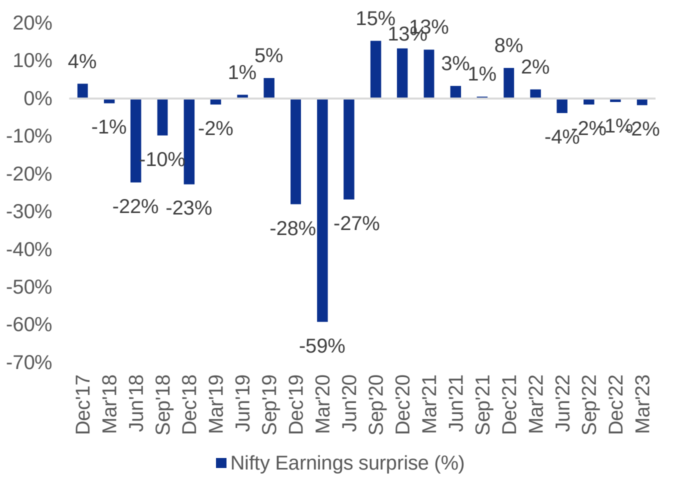
Consensus EPS miss trend stabilizes

The Mar 2023 quarter EPS posted a muted 2% yoy growth, after being in the negative zone for previous two quarters. The sharp deceleration in EPS momentum seems to have turned around in the Mar 2023 quarter, as gross margin continued to improve qoq. Adjusted for one-offs, Nifty-50 companies' profits rose by 7.5% yoy in the Mar 2023 quarter, driven by financial services, automobile, FMCG and infrastructure sectors. However, the major laggards on the PAT front were metals, chemicals, healthcare and power sectors.

In terms of PAT beat distribution, nearly 46% of Nifty-50 companies extended their beat, the highest since the Dec 2020 quarter. Considering that a smaller proportion of companies extended their sales beat during the quarter, the PAT beat seems to have come from the EBITDA margin improvement. The EBITDA margin of non-financial services sector companies improved by 40bp qoq to 15.4%.

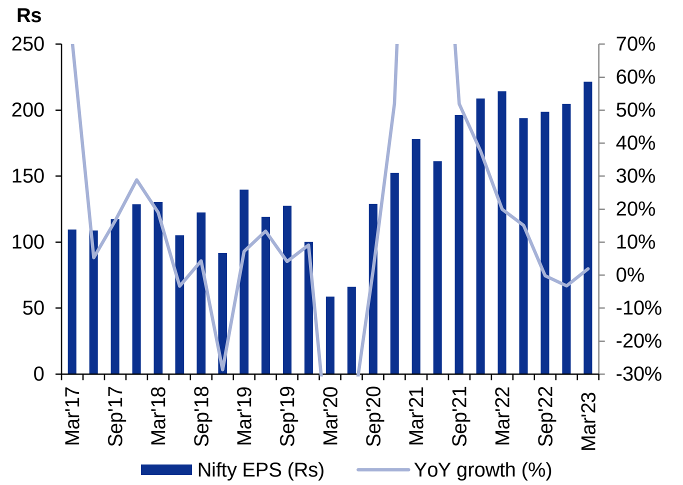
The reduction in FY23-25F Bloomberg EPS estimates continued in the recent results season as well, to the extent of 0.5-1%, as downgrades in the IT sector were overcome by upgrades in automobile and financial services sectors.

Figure 40: Nifty-50 companies' quarterly EPS trend



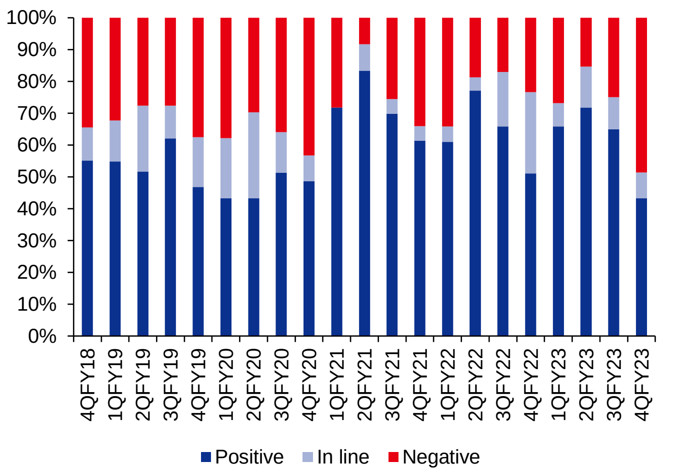
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 41: Nifty-50 companies' reported EPS growth



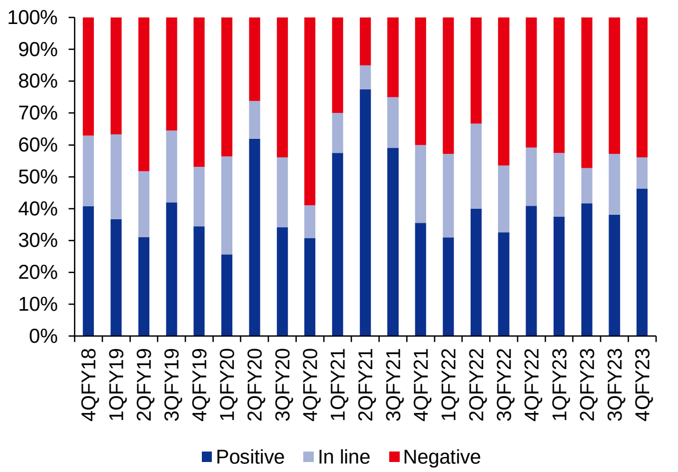
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 42: Nifty-50 companies' revenue beat/miss proportion mix



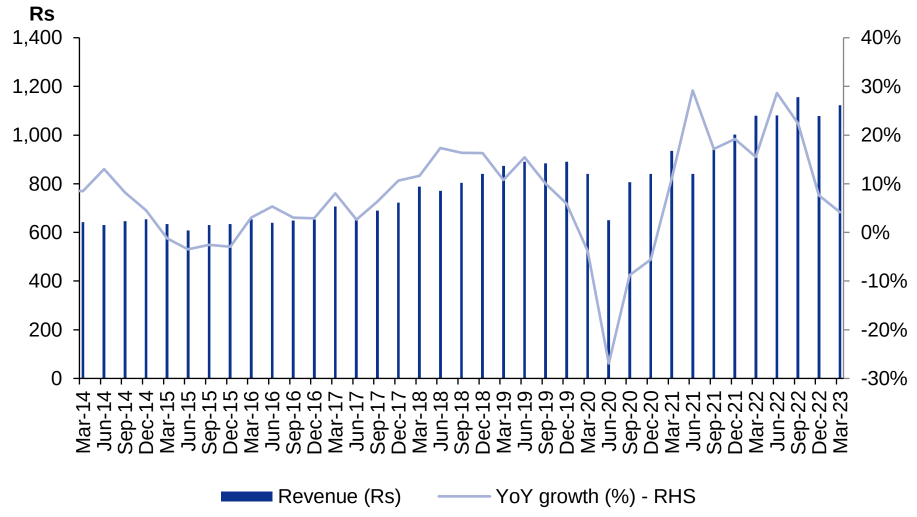
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 43: Nifty-50 companies' EPS beat/miss proportion mix



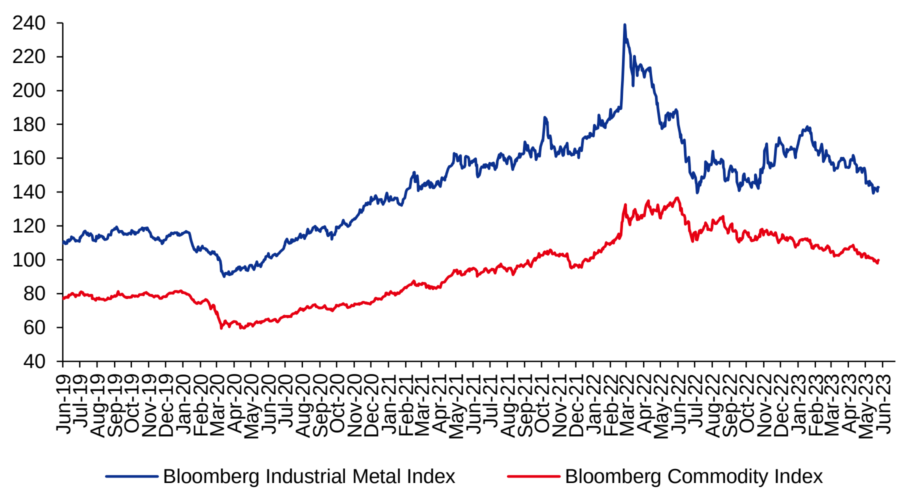
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 44: Nifty-200 companies' sales growth momentum continues to ease



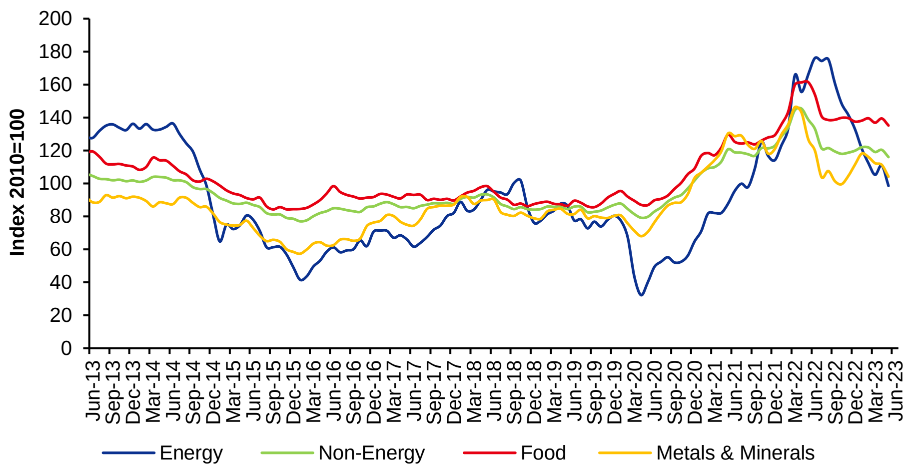
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 45: Bloomberg Industrial Metal Index on the rise but Commodity Index slides



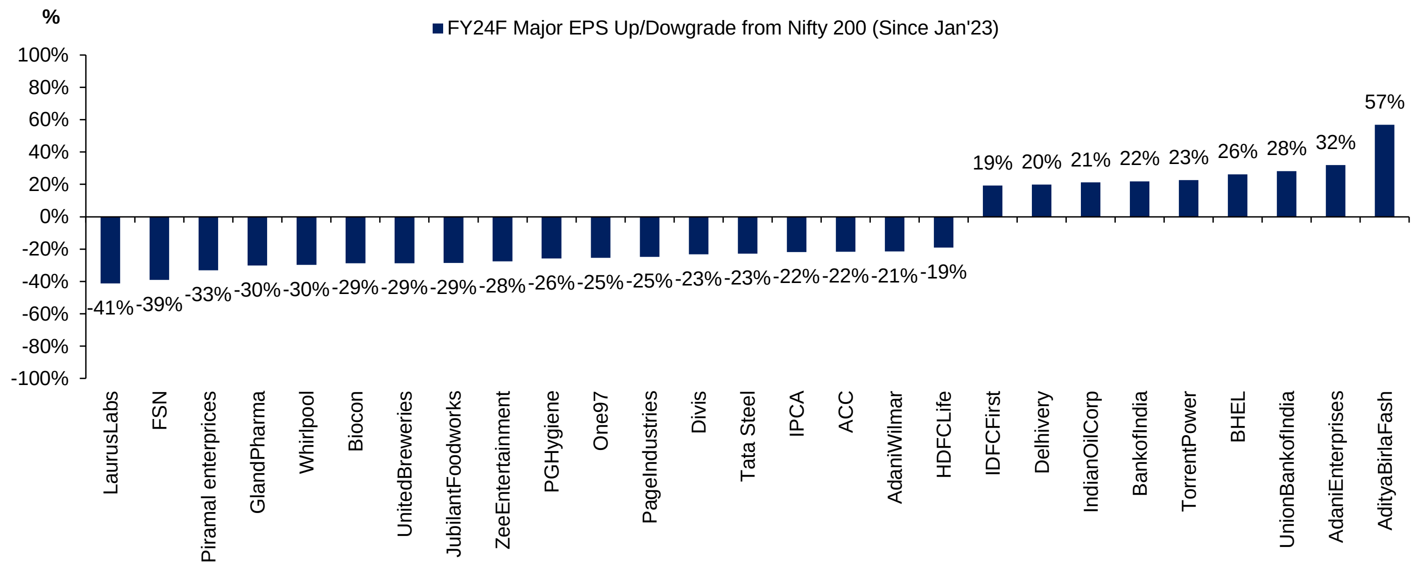
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 46: Global Commodity Index trend correction continues, except in case of metals



SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 47: Public sector banks continue to record EPS upgrade while the pharma sector witnesses a cut (from 1 Jan 2023)



SOURCE: BLOOMBERG, INCRED RESEARCH

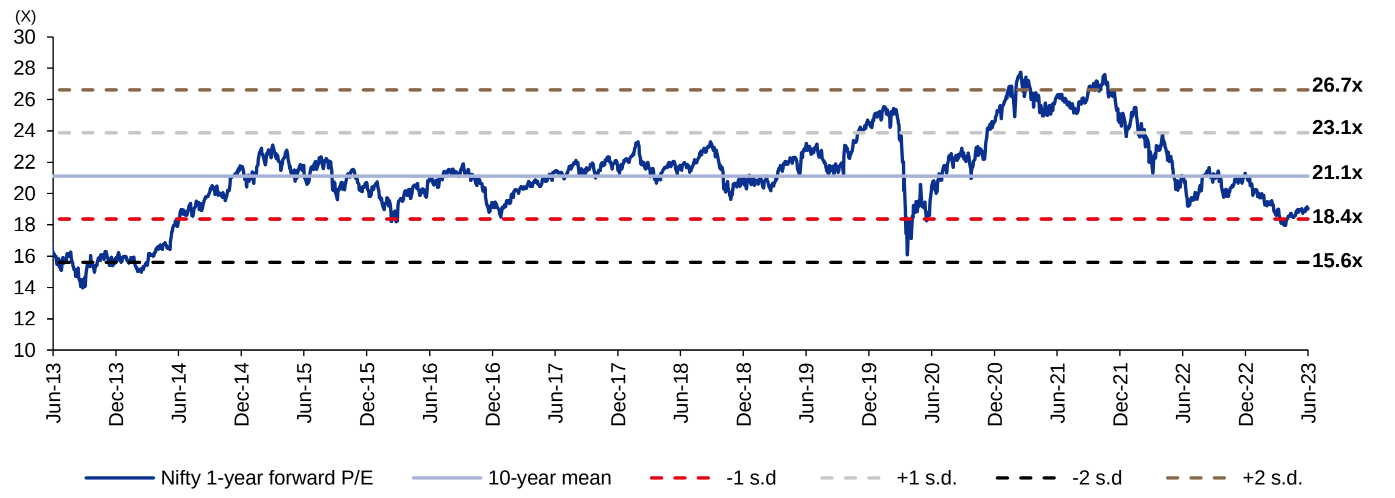
Nifty valuation and outlook

Index valuation easing to below mean level provides comfort

The Nifty-50 Index took support at -1SD of the 10-year mean level in recent monthly lows to bounce back marginally above this valuation zone but is still below the mean level. The tailwinds from improving domestic macroeconomic factors from the lows of Dec 2022 and stability in the global macroeconomic environment provides comfort. The Nifty Mid-cap Index scaling a new high already and stocks in the basket of Rs251-500bn market capitalization range scaling a new peak in the proportion to form 9.6% of total India stock market capitalization are areas of concern.

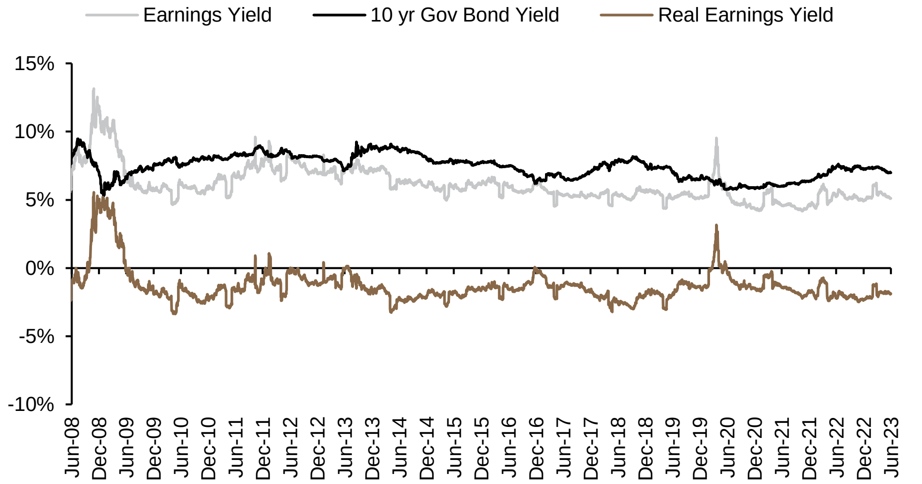
We expect high volatility in the index to continue, considering the wide swing in macro variables globally influencing the estimates/sentiment. We continue to maintain our base-case, bull-case, and bear-case Nifty P/E targets at 20x,18x and 16x, respectively. But improved tailwinds from macroeconomic factors and visibility on corporate earnings led us to roll forward our target EPS to the one-year forward methodology, from Mar 2024F earlier. The roll forward to a future period, where the uncertainty can be higher, led us to have a lower probability of a bull-case scenario at 30% now vs. 40% earlier, while we have raised the bear-case scenario probability to 20% from 10% earlier. With the earnings roll-forward benefit being stronger, we have lifted our blended Nifty-50 index target to 20,331, an upside of 9% from the current levels.

Figure 48: Nifty-50 companies' forward P/E valuation



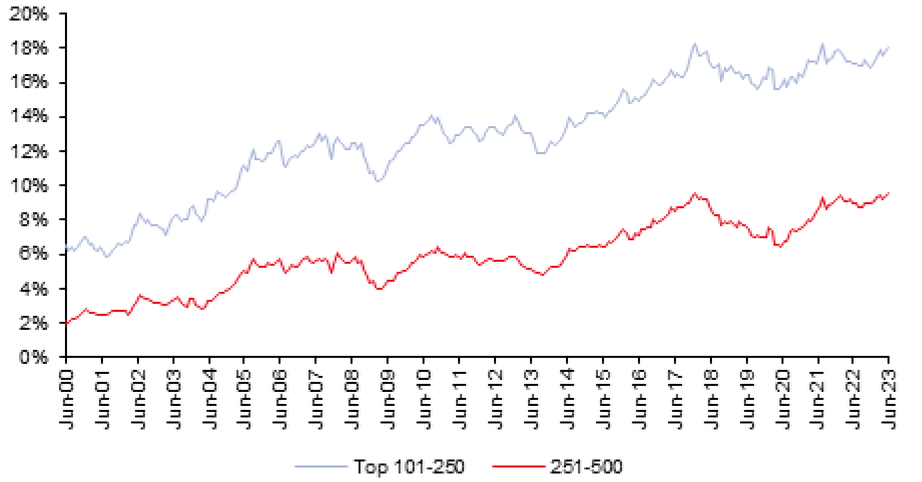
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 49: Real earnings yield trend for Nifty-50 companies remains in an uncomfortable zone



SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 50: Market cap distribution of stocks in top-500 stocks indicate excess fizz in the mid-cap rally, as stocks in the basket of Rs251-500bn market-cap list scale a new-high proportion at 9.6% of total market cap



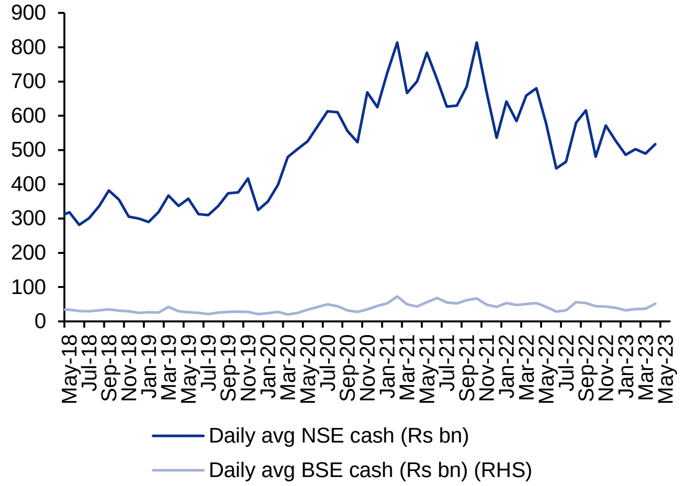
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 51: Weighing Nifty index against economic scenarios

	Bull Case	Base Case	Bear Case
Economic variables for FY24F	GDP growth >7%, Brent crude oil <US$105/bbl, inflation <5%, repo rate hike <75bp, above-normal monsoon	GDP growth >6%, Brent crude oil <US$120/bbl, inflation <6%, repo rate hike <100bp, normal monsoon	GDP growth <6%, Brent crude oil >US$125/bbl, inflation >7%, repo rate hike >100bp, below- normal monsoon
Probability of event	30%	50%	20%
EPS (FY24F)	1,117	1,117	1,117
Target P/E (x)	20.0	18.0	16.0
Target index	22,342	20,107	17,873
Nifty-50 now	18,600	18,600	18,600
Up/ downside	20.1%	8.1%	-3.9%
Blended Index target		**20,331**	

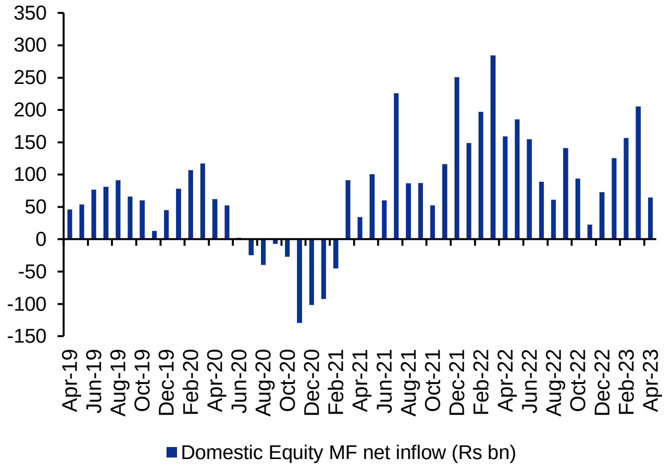
NOTE: FY24F EPS IS OF BLOOMBERG CONSENSUS
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 52: Stock market trade volume recovers in CY23



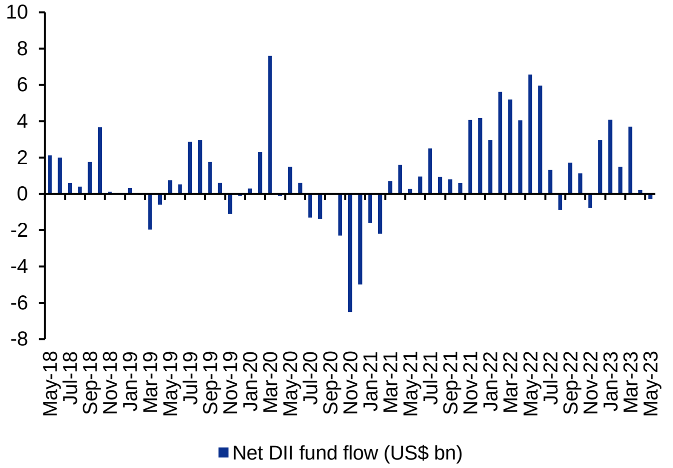
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 53: Domestic mutual fund inflows ease from their peak levels



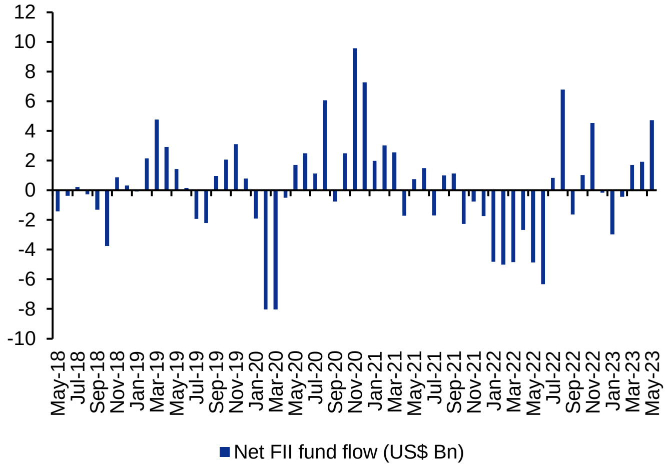
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 54: Domestic funds book profit



SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 55: FII inflows build the growth momentum



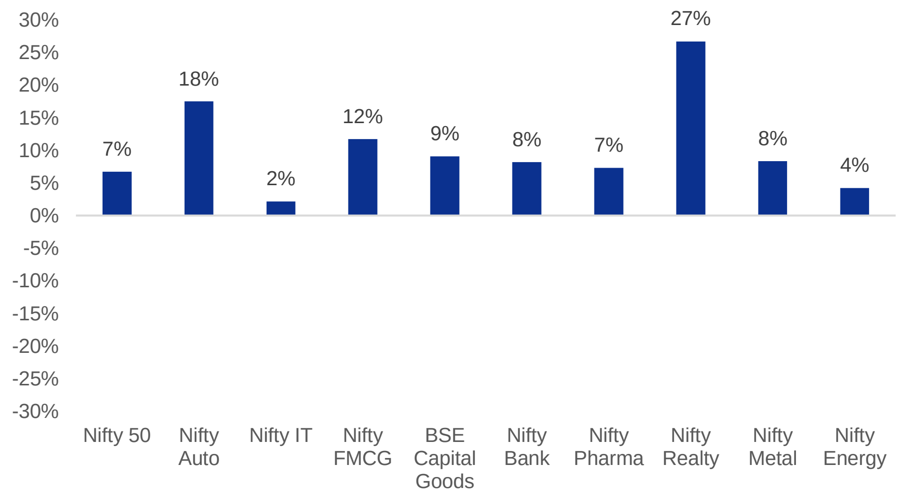
SOURCE: BLOOMBERG, INCRED RESEARCH

Sector-wise rating and stock ideas ➤

The Nifty-50 index witnessed a sharp rise in recent months aided by acceleration in foreign institutional investor or FII inflow in May 2023, good Mar 2023 quarter corporate results and improving macroeconomic data points. The key sectors driving the outperformance are realty, automobile and FMCG in the YTDCY23 period.

Last few weeks, the companies in our coverage universe witnessed more downgrades driven by valuation challenges like Finolex Cables, NCC, Cera Sanitaryware, Aavas Financiers and PNC Infratech vs. a few upgrades like HDFC Bank, Astral, and Dr.Lal Pathlabs.

Figure 56: Sectoral index performance vs. Nifty-50 (YTDFY24)



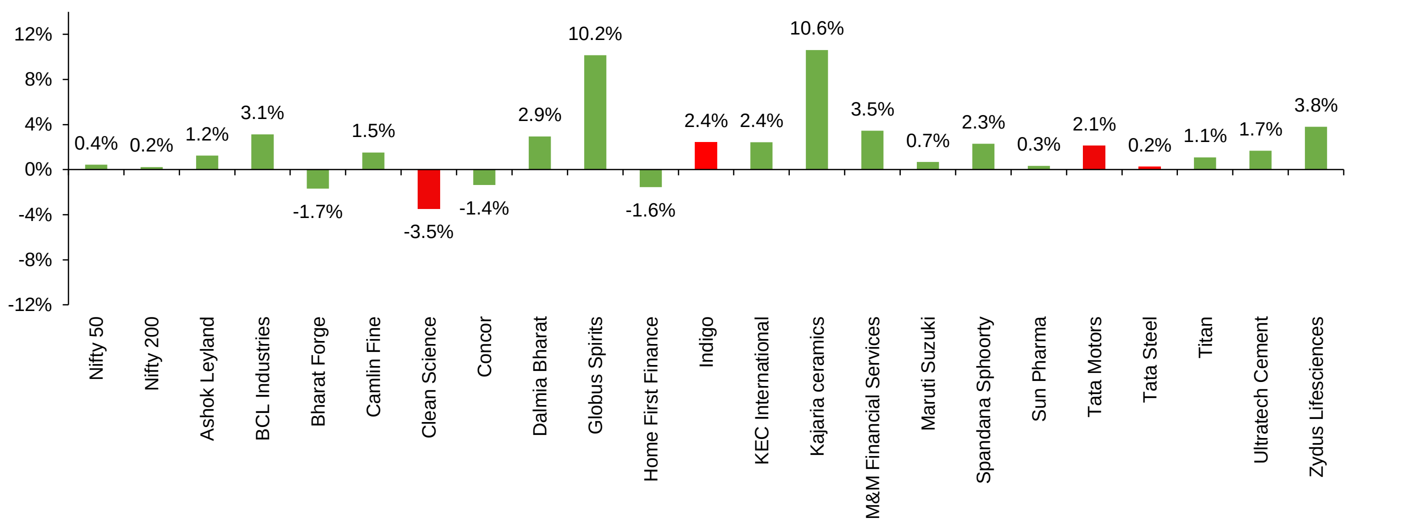
SOURCE: BLOOMBERG, INCRED RESEARCH, YTD TILL 2023

Figure 57: Our sector-wise ratings

Overweight	Neutral	Underweight
Aluminium	Building Materials	Agribusiness
Automobile	Consumer staples	Auto Ancillary
Cement	Information Technology	Aviation
Consumer Electricals	Pharma	Chemicals
Defence	Ports & Logistics	Diagnostics
Financial Services		Metals & Mining
Infrastructure		
Oil and Gas		

SOURCE: INCRED RESEARCH

Figure 58: High-conviction stocks' price performance since their introduction on 10 Sep 2022



NOTE: PERFORMANCE IS BASED ON COMPOUNDED MONTHLY GROWTH RATE, FROM THE DAY THE STOCK WAS ADDED TO THE PORTFOLIO
SOURCE: BLOOMBERG, INCRED RESEARCH

Figure 59: Non-consensus stocks with a REDUCE rating in our coverage universe (removed GAIL as its rating upgraded from REDUCE to HOLD)

Company Name	Bloomberg Ticker	Reco.	Price	Target Price	Market Capital	Market Capital	EPS (Rs)		P/E (x)		P/BV (x)		EV/EBITDA (x)	Dividend Yield (%)	Upside/ Downside	ROE (%)
			Rs	Rs	(Rs bn)	(US$ bn)	FY23	FY24F	FY23	FY24F	FY23	FY24F	FY23	FY23	(%)	FY23
Apollo Tyres	APTY IN	REDUCE	392	256	283	3	14.3	17.5	27.3	22.3	2.0	1.9	9.3	1.5	-0.3	7.6
Ami Organics	AMIORG IN	REDUCE	1,195	714	49	1	21.3	24.7	56.2	48.3	7.6	6.8	37.1	-	-0.4	14.2
Avanti Feeds	AVNT IN	REDUCE	389	353	60	1	15.5	22.1	25.7	17.6	2.6	2.3	17.0	0.8	-0.1	10.8
Balrampur Chini Mills	BRCM IN	REDUCE	392	229	90	1	13.4	24.9	29.4	15.7	2.7	2.3	17.6	0.2	-0.4	13.7
Clean Science and Technology	CLEAN IN	REDUCE	1,407	660	170	2	26.8	29.4	52.6	47.9	15.6	12.9	39.4	-	-0.5	33.0
Delhivery	DELHIVER IN	REDUCE	355	263	294	4	(17.6)	(11.5)	(19.9)	(30.7)	2.9	3.3	(26.4)	-	-0.3	(16.4)
Dhanuka Agritech	DAGRI IN	REDUCE	778	704	40	0.5	45.6	48.2	17.0	16.1	3.3	2.9	(0.6)	1.2	-0.1	21.0
Eicher Motors	EIM IN	REDUCE	3,705	3,284	1,152	14.0	106.6	122.2	34.8	30.3	7.7	6.7	25.6	1.0	-0.1	22.6
Gujarat Gas	GUJGA IN	REDUCE	479	410	375	4.5	15.7	17.8	30.5	27.0	5.1	4.4	17.3	0.4	-0.1	18.2
Hero MotoCorp	HMCL IN	REDUCE	2,905	2,238	660	8.0	137.7	183.0	21.1	15.9	3.5	3.3	12.1	3.4	-0.2	17.0
InterGlobe Aviation	INDIGO IN	REDUCE	2,410	1,600	1,056	12.8	6.5	(16.0)	(34.2)	(150.8)	(10.6)	(9.9)	16.5	-	-0.3	(3.4)
Polycab India	POLYCAB IN	REDUCE	3,595	3,126	612	7	80.2	86.8	44.8	41.4	8.1	7.1	28.1	0.6	-0.1	19.7
SRF	SRF IN	REDUCE	2,533	1,540	853	10	60.9	53.7	41.6	47.1	7.4	6.4	24.5	0.2	-0.4	19.2
Tata Motors	TTMT IN	REDUCE	556	401	2,266	27.5	(9.3)	20.2	(63.3)	27.6	4.7	4.1	8.2	0.4	-0.3	(7.9)
Tata Steel	TATA IN	REDUCE	109	70	1,514	18.3	10.3	5.3	10.5	20.7	1.1	1.0	6.3	1.8	-0.4	10.6
UPL	UPLL IN	REDUCE	694	754	592	7.2	53.6	61.9	14.7	12.5	1.9	1.7	7.6	1.8	0.1	18.4
VRL Logistics	VRLL IN	REDUCE	698	426	69	1	19.7	11.3	19.7	61.9	7.0	6.6	14.7	0.7	-0.4	16.4

SOURCE: INCRED RESEARCH ESTIMATES, BLOOMBERG, COMPANY REPORTS

NOTE: PRICES AS ON 7 JUN 2023

Figure 60: Our key mid-cap and small-cap stock recommendations

Company Name	Bloomberg Ticker	Reco.	Price	Target Price	Market Capital	Market Capital	EPS (Rs)		P/E (x)		P/BV (x)		EV/EBITDA (x)	Dividend Yield (%)	Upside/ Downside	ROE (%)
			Rs	Rs	(Rs bn)	(US$ bn)	FY23	FY24F	FY23	FY24F	FY23	FY24F	FY23	FY23	(%)	FY23
Apex Frozen Foods	APEX IN	ADD	214	385	8	0.1	14.4	25.7	14.9	8.3	1.3	1.1	12.5	0.7	0.8	12.2
Balkrishna Industries	BIL IN	REDUCE	2,297	1,730	505	6.1	55.9	69.3	41.1	33.2	5.9	5.2	24.5	0.7	-0.2	14.9
Coastal Corp	CTW IN	ADD	202	990	3	0.0	14.5	55.3	13.9	3.6	1.0	0.8	12.3	1.3	3.9	10.7
Crompton	CROMPTON IN	ADD	278	320	202	2.5	7.0	8.8	40.0	31.6	6.6	6.0	23.8	1.1	0.2	22.6
Cyient	CYL IN	ADD	1,339	1,204	168	2.0	50.0	65.5	28.6	20.4	4.2	3.9	14.7	1.9	-0.1	22.1
Endurance Technologies	ENDU IN	ADD	1,483	1,647	237	2.9	34.5	50.3	43.5	29.5	4.7	4.2	20.3	0.5	0.1	11.7
Globus Spirits	GBSL IN	ADD	1,119	3,014	37	0.4	46.0	120.6	24.3	9.3	3.6	2.6	13.2	0.2	1.7	15.9
Gujarat Pipavav Port	GPPV IN	ADD	111	148	61	0.7	6.7	8.3	16.5	13.4	2.6	2.4	8.2	5.0	0.3	15.8
Home First Finance company	HOMEFIRS IN	ADD	780	950	78	0.9	26.1	31.6	29.9	24.7	3.8	3.3	NA	-	0.2	13.5
KEC International	KECI IN	ADD	533	571	156	1.9	6.8	25.1	77.8	21.2	3.6	3.2	19.9	0.8	0.1	4.8
Meghmani Finechem	MEGHFL IN	ADD	1,097	2,151	52	0.6	86.6	107.5	12.7	10.2	3.5	2.6	9.1	-	1.0	39.7
Mphasis	MPHL IN	ADD	1,914	1,981	410	5.0	86.2	93.5	22.2	20.5	4.6	4.2	14.3	2.6	0.0	22.0
Persistent Systems	PSYS IN	ADD	4,981	5,100	435	5.3	120.5	155.0	41.3	32.1	9.6	8.0	24.5	1.0	0.0	33.8
PI Industries	PI IN	REDUCE	3,587	2,417	618	7.5	82.2	85.2	43.7	42.1	7.4	6.4	32.3	0.1	-0.3	18.6
Supreme Industries	SI IN	ADD	2,825	3,247	408	4.9	68.1	80.0	41.5	35.3	8.2	7.1	29.3	0.9	0.1	27.0
Zydus Lifesciences	ZYDUSLIF IN	ADD	515	593	593	7.2	22.9	29.0	22.5	17.7	2.9	2.6	14.5	1.2	0.2	13.3

SOURCE: INCRED RESEARCH ESTIMATES, BLOOMBERG, COMPANY REPORTS

NOTE: PRICES AS ON 7 JUN 2023

Automobile sector

- A good results season for our coverage universe stocks, as 81% of them beat on the EBITDA front. The big beat was in commercial vehicle or CV, two-wheeler or 2W OEMs and tyre makers. Battery makers and a few companies with international exposure disappointed in the auto ancillary segment.
- Among original equipment manufacturers or OEMs, gross margin qoq improvement was across companies except Maruti Suzuki. A major upmove was in case of 2W makers. The auto component segment saw a qoq upmove, barring Bosch and Exide Industries.
- We raise our EBITDA estimates across OEMs, barring Escorts and TVS Motor. We have raised CV makers' EBITDA estimates sharply. In the auto ancillary segment, we have cut EPS estimates for Balkrishna Industries and Bharat Forge because of slow global market recovery.
- We reiterate Overweight rating on the auto sector as the NSE auto P/E valuation trades below the 10-year mean level and volume surprises flow in. With benign volume growth expectations due to a high base and a peak interest rate scenario, we have kept expectations at check. Subject to good rainfall distribution and interest rate cut prospects, we feel there is scope for volume surprise in 2HFY24F. New model launches, and pricing power benefit leads to our ADD rating on Maruti Suzuki, Ashok Leyland, Bajaj Auto and Mahindra & Mahindra. While 2W demand looks promising and the electric vehicle or EV risk eases from demand incentive cut, we prefer Bajaj Auto as our top pick, followed by our REDUCE rating on Hero MotoCorp, Eicher Motors and TVS Motor.

- We reiterate REDUCE rating on Tata Motors and TVS Motor as global operation challenges overrule domestic recovery benefit at current rich valuations. In the auto ancillary segment, we have an ADD rating on Bharat Forge, Endurance Technologies and Exide Industries, and a REDUCE rating on Bosch and Balkrishna Industries. We have a HOLD rating on Apollo Tyres.

Building material and consumer electrical sectors

- **Durables:**
  - B2C sales continued with a weak demand trend (real estate inventory time lag, inflation, exhaustion of replacement demand post Covid-19 pandemic) while B2B sales supported revenue growth. Summer product sales were negatively impacted due to unseasonal rains in North/West India in Mar 2023. This continued in May/Jun 2023. Secondary sales of room ACs, fans, coolers and related electronic products have been sub-optimal throughout Mar-May 2023, and channel inventory higher than the long-term average. Cable and wire companies continued to report a higher revenue growth vs. consumer durables and small domestic appliance companies. Havells (C&W division), Polycab, KEI Industries and Finolex Cables reported higher revenue growth vs. CG Consumer, Orient Electric and V-Guard. As regards the margins, the impact of old high-cost raw materials is fading and most durable companies reported an improvement in gross/EBITDA margins qoq. Advertising and marketing expenses are trending back to pre-Covid levels.
  - **Outlook**: There is a lot of hope on summer sales recovery in 1QFY24F, given expectations of an elongated summer season in India. The ECD segment's margins are expected to fully recover to pre-Covid levels. C&W companies are expected to report good sales volume growth, but revenue growth could be lower due to falling realization because of declining copper prices.
  - **Preferred stocks**: Continue to like Havells, CG Consumer and KEI Industries among the companies in our consumer durables companies' universe. We have downgraded Finolex Cables to a REDUCE rating.
- **Building materials:**
  - Steel pipes, plastic pipes, sanitaryware, faucets, plywood and MDF saw good sales volume in 4Q. Tiles and laminates saw demand compression among our coverage companies. Input prices have corrected from their peaks, except timber that continues to impact gross margin for wood panel companies. Most companies have created new capacities that are under-utilized. Management expects significant demand pick-up across products, given the robust pipeline of private and public sector construction projects.
  - **Outlook**: Building material is witnessing a much better demand trend vs. other consumer discretionary items. We expect meaningful sales volume growth across products over FY23-25F.
  - **Preferred stocks**: Continue to like APL Apollo and Kajaria Ceramics. We have upgraded Astral to an ADD rating, given the favourable risk-reward ratio at current valuations.

Banking/NBFC sector

- **4QFY23 results review**: Banks/NBFCs under our coverage reported strong credit growth during the quarter (State Bank of India, HDFC Bank, and Cholamandalam remain outliers). During the quarter, corporate growth was also supportive in addition to retail and SME segments. Margin expansion for banks continued, but banks indicated peak margins in 4Q, as deposit repricing will now impact the cost of funds & margins. While NBFCs saw margin pressure but now, due to increased rates on fixed-rate loans, they witness better margins. The asset quality trend continued to improve, with lower slippage across segments resulting in lower provisioning.

- **Eye on consumption and interest rates**: Most banks/NBFCs, in their post-results commentary, remained optimistic on future credit demand and indicated strong credit demand in FY24F. We believe credit demand will remain strong for private sector banks and NBFCs.
- **Liability augmentation to determine the future course of action**: Banks have indicated repricing of deposits which will assist in liability augmentation in the coming quarters, as we witnessed overall deposit growth remaining relatively weak (SBI, Axis Bank & IndusInd Bank remain at the lower end) compared to the expansion in credit. The loan-deposit ratio for most banks already remains stretched (ICICI Bank, Axis Bank & HDFC Bank at the upper end). However, State Bank of India or SBI with a low loan-deposit ratio, is well positioned. Raising liabilities (deposits as well as borrowings) continue to remain an expensive affair, especially for NBFCs as well as small- and mid-size banks compared to large banks. Banks like HDFC Bank & ICICI Bank have indicated strong branch expansion plans for the next fiscal, which will also assist in acquisition of liabilities.
- **NBFCs to outperform banks**: We expect consolidation in India's financial sector to continue as efficiency and technology will play a key role in future. We expect NBFCs to report margin improvement in FY24F, while banks to face margin compression and expect NBFCs to outperform banks during the year. We prefer either lenders with superior growth outlook and premium return ratios like HDFC Bank, Bajaj Finance, or else lenders providing attractive risk-reward like SBI, MMFS & Spandana Spoorthy.

Capital Goods

- **Healthy revenue-led growth**: Capital goods companies under our coverage universe reported healthy execution in 4QFY23 with a revenue growth of 13.4% YoY (23.5% ex-L&T). All companies reported double-digit YoY revenue growth in the range of 10% to 29%, with strong revenue growth seen in Cummins India (29%), KEC International (29.2%), Siemens (28.8%), and ABB (22.5%). The EBITDA margin of our capital goods coverage universe declined by 47bp YoY due to lower margins in L&T, KEC International and Voltas. The PAT of our coverage universe increased by 16.4% YoY and 47% QoQ.
- **Management commentary on the margin front**: Management commentary was positive on the margin expansion front for most companies. L&T expects its margins in the project business to improve by 50bp to 9%, with 2HFY24F likely to be better than 1H. KEC International expects its EBITDA margin to improve from 4.8% in FY23 to 7% in 1HFY24F and to ~8% in 2HFY24F, as legacy projects of SAE Brazil got completed, and margin recovery in the standalone T&D segment. Voltas is likely to recover input cost escalation due to time extension by negotiating with clients, which is likely to lead to the margin recovery. Management has given guidance of 4-5% margin in FY24F-25F in projects business and 9% in the unitary cooling products segment. Thermax is likely to sustain its higher margins at 8-9% based on the current order book. ABB expects the PBT margin of 10%+ to sustain, given softening commodity prices while maintaining the overall pricing level. Cummins India went for multiple price hikes in the last 12 months. The pricing action and prudent cost management resulted in a record profit in FY23.
- **Order inflow momentum sustained**: Aggregate order inflow was robust, up by 36% YoY, led by a 5.8x jump in Siemens' order inflow at Rs450bn while KEC International's order inflow grew 121% to Rs68bn, L&T's order inflow grew 3% YoY, despite a high base. Thermax is the only company which reported lower order inflow on a YoY basis. New investments announced by the manufacturing sector during FY23 grew 23% YoY. We expect a new trend of private sector spending led by energy transition including renewables, electric vehicles, battery technology, and hydrogen. We expect manufacturing capex led by productivity-linked incentive or PLI schemes, supply chain diversification and China+ strategy. Industry has witnessed strong demand for data centres led by 5G/6G rollout and e-commerce growth. We expect the order inflow of our coverage universe to clock a 14% CAGR over FY2-25F.

- **Maintain positive stance on the sector**: We remain Overweight on the industrial sector as valuations currently factor in strong capex recovery led by various schemes like NIP, Gati Shakti, and Make in India, while the special focus on capex to provide several opportunities for companies going ahead. We reiterate our ADD rating on L&T, KEC International, Thermax, Voltas and Siemens with their order backlog providing revenue visibility along with reasonable valuations. We have a HOLD rating on ABB and Cummins India as export demand is likely to be hit in the event of a recession in the US and European countries, concerns over long-term growth of the powergen segment and rich valuations leaving limited upside from current levels.

Cement sector

- **Summary of 4QFY23 results**: Our analysis of India's top-15 listed cement companies shows that overall volume improvement for the industry was ~12% yoy (+17% qoq) in 4QFY23, a 4-year CAGR of ~5.5%. In our coverage, TRCL, UTCEM, JKCE and DALBHARA posted industry-leading growth, largely driven by ramp-up in their respective new capacity. On a qoq basis, the industry posted ~0.4% fall in average realization in 4Q. Total cost/t for players analyzed by us fell by ~3% qoq. On a per/t basis, avg. P&F cost was down by ~8% qoq, driven by lower benchmark prices. EBITDA/t for 15 companies analyzed by us improved by ~Rs120 qoq. The highest qoq improvement in EBITDA/t was reported by HEIM, BCORP and ORCMNT while DALBHARA posted a qoq decline. We saw profitability recovering in 2HFY23 from a multi-year low in 1HFY23, driven by lower P&F cost and the benefit of operating leverage. We feel there will be substantial improvement in 2HFY24F.
- **Management commentary**: On demand, management commentary from most companies indicated that cement demand (growth of 7-8% in FY24F) in the medium term is encouraging in view of the promising factors like a good monsoon, strong infrastructure spending and supported by the housing sector on higher pre-election spending. On pricing, management commentary highlighted stable prices so far in 1QFY23, given the focus on volume, and there are indications that a price hike is only post monsoon. On costs, in the medium term, a sharp drop in global fuel prices (pet-coke/coal prices are down >60% from their peak) over the last two-three months should lead to a fall in fuel cost for most players in 1HFY24F (unless there is some high-cost inventory; a few companies highlighted that major benefits of fuel cost decline will come from 2QFY24F) which, in turn, will improve the margin profile of the industry if the trend sustains.
- **Unit EBITDA**: We expect a material reduction in 1HFY24F as most companies indicated (likely from 2QFY24F) another ~15-20% drop in P&F cost in the next few quarters. Recently, with a higher correction in global pet-coke and coal prices (~17-26% from Mar 2023 exit levels), we feel the industry could improve EBITDA/t by Rs200-250 in FY24F.
- **Pricing**: Our channel checks suggest that pan-India average cement prices remained flat mom in May 2023 while cement prices declined ~1.5% mom in the East and South, while marginally improving in the northern, western and central regions. Historical data analysis reveals that pre-election years are not great for prices. Price hikes were attempted by producers in 4Q and even in Apr-May 2023, but they didn't sustain. We stay cautious on the pricing front.
- **Preferred picks**: With the benefit of low-cost fuel and better demand conditions, we believe the margins will continue to improve in FY24F, despite muted cement prices. We retain our Overweight stance on the sector with UTCEM, DALBHARA and BCORP as our top stock picks.
- Our 4QFY23 review note: https://tinyurl.com/4nejwbr6

Chemicals sector

- Chemical players were disappointed in 4QFY23 as revenue was under pressure due to subdued demand, Near-term demand concerns persist for specialty chemical players with higher exposure to exports/discretionary segments, given the talk of a global economic slowdown. Please note that most Indian chemical companies can report higher gross margin, but PAT will be destroyed by falling volume. We have seen this in the case of Atul and amine-makers last quarter.

- HFC-125: Volume is dipping as the US gears up to stringent emission norms from CY24.
  - The US is going to reduce the HFC emission quota from Jan 2024 by 93mt of CO2 equivalent. Hence, the demand for the highest GWP (global warming potential) product, i.e., HFC-125 (R-125) was supposed to decline. The same has started happening now. CO2 equivalent is a direct measure of GWP. An HFC with a higher CO2 equivalent will have a higher GWP; hence, its usage will decline when the quota comes into force. Please note that HFC-125 has the highest GWP (1 Kg= 6t CO2 equivalent to around 6x of R-32). HFC-125 had been the mainstay for Gujarat Fluorochemicals or GFL's and SRF's profits in the past few quarters and hence, volume decline doesn't bode well for the profits in the coming quarters. Sell GFL and SRF.
- Camlin Fine Sciences has an advantage over Clean Science and Technology in the MEHQ market.
  - The global market for MEHQ is around 13,000t and is growing at the rate of 1-2%. Primarily. MEHQ is used in SAP (super absorbent polymer), which is used in diapers. Clean Science and Technology alone has ~7,000t capacity; another 2,500t is with Camlin Fine Sciences. Vinati Organics is also entering this market, but it is likely to be less competitive than Clean Science and Technology or Camlin Fine Sciences. Camlin Fine Sciences' diphenol plant had not stabilized. Hence, it was not at all competitive with Clean Science and Technology in MEHQ and BHA. However, as its diphenol plant has now stabilized, which is shown by rising exports of HQ (earlier, its India business was importing HQ) Camlin Fine Sciences has turned competitive in the MEHQ market and is consistently cutting prices. The cost of production of MEHQ for Camlin Fine Sciences is at least Rs150/ kg lower than in the case of Clean Science and Technology, if it uses captive HQ and doesn't need to take the losses of catechol. Hence, it's likely that Camlin Fine Sciences will cut the prices of MEHQ to as low as 550-600/ kg, and Clean Science and Technology will have to follow suit. The pricing trend in May 2023 indicates the same as Camlin Fine Sciences has reduced its prices. For Camlin Fine Sciences, we have valued its stock at 20x FY24F EPS to arrive at our higher target price of Rs300.
- Market is betting that Anupam Rasayan will be the next PI Industries
  - Flupyroxystrobin is the new insecticide by Syngenta which was in the R&D stage till 2022. Anupam Rasayan (as well as other Indian companies) appears to have got the contract to manufacture flupyroxystrobin for Syngenta. However, please note that till now, sales of Flupyroxystrobin are 0. While it can become like what pyroxasulfone became for PI Industries, please note that it took 10 years for pyroxasulfone to achieve US$250m in sales. Moreover, insecticides like flupyroxystrobin are facing serious headwinds from gene-edited seeds. The market appears to be desperately looking for its second PI Industries, but that rarely happens. Please note many names that were touted as a second BHEL or L&T in the 2005-07 bull market don't exist anymore! We had a painful experience with Suzlon, BHEL, Lanco, etc. when after putting a SELL these stocks doubled and later plunged 99%, 80%, and 100%, respectively. So, stock prices can still go up, but risk management needs that one should steer clear of names like Anupam Rasayan, Astec LifeSciences, Ami Organics, etc.

Consumer staples sector

- Our FMCG coverage universe delivered an 11.1% yoy sales growth in 4QFY23. Urban markets grew ahead of rural markets. Rural markets have likely bottomed out and are expected to gradually recover while urban markets are expected to continue their growth momentum. We expect the pricing growth to taper off at a faster pace while volume growth recovery will be gradual.

- Our paints coverage universe reported a sales growth of 10.8% yoy in 4QFY23 with decorative paint volume growing in the range of 12-16% yoy. Demand conditions remained stable during the quarter, with broad-based growth across cities and towns. Adjacent segments like waterproofing and construction chemicals continued to grow at a faster pace while exterior paints were impacted due to the monsoons. Distribution expansion continued at an accelerated pace in FY23, with a similar aggression expected in FY24F. Asian Paints' management believes that the unorganized segment's contribution is expected to inch back to 30% (given normalized supply chains) which had fallen to 25%. Paint companies sounded sanguine on near-term demand with expectations of a double-digit volume growth continuing in 1QFY24F as well.
- Our FMCG pack reported EBITDA growth of 14% with EBITDA margin expansion of 55bp yoy (-22bp qoq) in 4QFY23. With overall inflation easing sequentially, we expect the companies under our coverage to step up ad-spends and pass on some pricing benefits to consumers, thereby limiting sequential margin expansion. For our paints pack, with input cost inflation moderating, stable outlook on raw material prices in the near term, and complete price hikes coming through in the industrial segment, gross margin expansion on a sequential basis was strong (up 390bp/510bp qoq for APNT/BRGR, respectively), resulting in a healthy EBITDA margin expansion as well (up 260/300bp qoq to 21.2%/16% for APNT/BRGR, respectively). Excluding one-off, BRGR's EBITDA margin would have been 100bp higher. KNPL's margins lagged peers as gross margin expansion was limited to 150bp qoq while the EBITDA margin declined by 100bp qoq. The industrial division's EBITDA margin was still in the single digit in 4Q (vs. APNT's 11.2% PBT margin in the industrial segment). Despite healthy margin expansion and no cost headwinds coupled with normal rebating intensity, the EBITDA margin guidance remains cautious (APNT has given guidance of 18-20%, while BRGR has given guidance of 16-17% level for FY24F). KNPL's EBITDA margin outlook of low double digits (10-11%) for the industrial segment was weak, in our view, and leads us to believe that KNPL will operate at a lower EBITDA margin band for a sustained period.
- Maintain our Neutral stance on the FMCG sector with HUL (ADD, TP: Rs2,720) as our top pick. In the discretionary space, we retain our positive stance on Titan Company (ADD, TP: Rs3,150) and have a cautious outlook for paints and allied products with a REDUCE rating on APNT (TP:Rs2,820) and KNPL (TP: Rs395). We maintain our HOLD rating on BRGR (TP:Rs640) and PIDI (TP:Rs2,360).

Defence

- **Financial performance**: Defence companies' sales in 4QFY23 - Hindustan Aeronautics (HAL) and Bharat Electronics (BEL) - were largely in line while Bharat Dynamics or BDL's sales missed estimates. While HAL and BEL showcased strong EBITDA growth due to lower raw material expenses, BDL's performance was impacted due to supply chain problems.
- **Order book**: The order book for companies continues to remain strong. HAL has an order book of over Rs800bn (3x TTM sales) and a further order pipeline of Rs480bn for FY24F. Similarly, BEL has a healthy order book worth Rs607bn (3.5x TTM sales). Going ahead, BEL expects a robust order book worth more than Rs200bn in FY24F. The order backlog for BDL stands at approximately Rs240bn (~9.6x FY23 sales).
- **Guidance**: HAL has given guidance of revenue growth of 10-12% in FY24F/25F, with EBITDA margin expected to improve by 100bp yoy. BEL projects a top line growth of ~17% in FY24F and an EBITDA margin in the range of 23%-24% for the year.

- While defence companies' numbers are volatile on a quarterly basis, 4Q is usually a strong execution and order finalization quarter for these companies. Hence, a strong order pipeline, the government's focus on indigenization and export growth, in our view, bode well for defence companies.
- **Our view**: We maintain our positive stance on the defence sector. Our top stock pick is BEL. Post sharp run-up in public sector defence share prices in YTDFY24, we remain cautiously optimistic, and maintain an ADD rating on HAL and BDL.

Diagnostics

- Companies continued to slowly recover non-Covid test volume over Jan-Mar 2023. However, the double-digit revenue growth recovery is still missing. 4Q was the last quarter with a high Covid revenue base and starting 1QFY24F, the revenue growth historical comparison will be much transparent and easier to understand. Margins were largely maintained qoq.
- **Outlook**: We expect non-Covid patient volume growth to keep recovering gradually towards the double-digit yoy level, no meaningful dilution of EBITDA margin, recently acquired large labs to start delivering on higher-than-industry revenue growth combined with integration benefits from cost savings, and all acquisition debt to be repaid by Mar 2024F. We see turnaround in the sector's growth and cash flow, and incrementally turn positive on the sector.
- **Preferred stocks**: We like Dr. Lal Pathlabs over Metropolis and Thyrocare and unrated regional diagnostic labs.

Infrastructure – ports, logistics and aviation

- **Ports**: Major ports (MPs) + APSEZ cargo grew 5% yoy in Apr 2023. We expect a 7-8% yoy growth in ports' cargo in FY24F.
  - **APSEZ** (ADD; TP Rs823): Strong volume (up 10% yoy) and rise in EBITDA/t (mainly at Mundra) drove 4QFY23 performance. Ex-acquisitions, we expect a 12% EBITDA CAGR (FY20-24F). Our target price implies 11.6x FY25F EV/EBITDA (10% discount to 5-year avg.).
  - **GPPV** (ADD; TP Rs148): Strong container volume and tariff offset weak bulk cargo in 4QFY23. Connectivity to the Dedicated Freight Corridor or DFC may boost GPPV in FY24F, while JNPT could be connected to the DFC in 1.5-2 years. We forecast an 18% EBITDA CAGR (FY23-25F). We feel that at CMP, GPPV is factoring in (a) a tepid volume growth, and (b) no concession extension post FY29F.
- **Logistics**: In Apr 2023, rail export-import (EXIM) container cargo rose by 13.4% yoy (vs. 9% yoy growth in 4QFY23).
  - **Concor** (ADD; TP Rs940): In 4QFY23, despite a 5% yoy dip in originating cargo, and EBITDA rose by 13% yoy. We expect a sharp volume growth for Concor over FY23-25F, driven by the shift in cargo from road to rail after the start of the DFC.
  - **BlueDart Express** (HOLD; TP Rs6,250): In 4QFY23, weak volume growth and margin led to a 13% qoq EBITDA decline. This was the fourth consecutive quarter of margin decline, but the silver lining is that the pace of qoq decline abated from 351bp in 1Q to 68bp in 4Q. We expect BDE's EBITDA margin to decline to 16.7% due to intense competition in the air cargo business (like in 3-4QFY23). We value BDE at 14x EV/EBITDA FY25F.
  - **VRL Logistics** (REDUCE; TP Rs426): In 4QFY23, EBITDA margin (16.3%) dipped 172bp yoy due to a 348 bp yoy fall in GT EBITDA margin. We expect VRL Logistics' GT segment's EBITDA margin to fall from 16.4% in FY23 to 14% in FY25F due to commissioning of the DFC in FY24F-25F. We factor in a 7% GT volume CAGR (FY23-25F). We value VRL at 10x EV/EBITDA FY25F.
  - **Delhivery** (REDUCE; TP Rs268): 4QFY23 saw dwindling growth for the second consecutive quarter as the losses kept mounting. We have

concerns about Delhivery's profitability as a tariff hike in the near term is unlikely, capping the operating leverage. We feel the losses may continue for the next two years.

- **Aviation**: Traffic in Apr 2023 – we did not compare with Apr 2020 as the Covid-19 pandemic started in Mar 2020, but we compared with daily Feb 2023 numbers: Daily total revenue passenger km (RPK: domestic + international for Indian carriers ex-Alliance Air) was 3.7% lower than in Feb 2023 (which was 5% above Feb 2020). Industry passenger load factor (PLF: 84.8%) is like the average of Apr 2018 and Apr 2019 (85.8%). Despite its aircraft on ground from Oct 2022, industry's daily ASK rose by 13% over Sep 2022 to Apr 2023.
    - **IndiGo** (REDUCE; TP Rs1,600): The super-normal profit in 3Q petered out in 4QFY23. IndiGo's adj. PAT declined by 62% qoq. We factor in a yearly growth of 13% in ASK and RPK over FY23-25F. We consider a decline in tariff in FY24F because of higher tariff in 3QFY23 due to industry capacity constraints (unlikely to sustain). We value the business at 9.5x FY25F EV/EBITDAR.
- **Infrastructure**: Average order book or OB-to-sales is healthy at ~2.8x and companies in our coverage reported steady EPC sales growth in 4QFY23. The companies in our coverage universe must fund 21% of their latest OB (like in Mar 2019). Most of the stocks in our coverage trade at fair valuations and we believe the near-term upside is limited.

Information technology sector

- **4QFY23 earnings summary**: 4QFY23 revenue performance of companies under our coverage was impacted by moderation in the financial services (FSI) vertical, persistent weakness in retail & hi-tech verticals, and ramp-down as well as delayed ramp-up of projects. This, coupled with macroeconomic uncertainty, led to a wide revenue guidance range (4%-7% in constant currency or CC terms in FY24F) by Infosys, qoq revenue decline guidance by Wipro (-3% to -1%) and 6%-8% CC growth guidance by HCL Technologies, despite a relatively better 4Q, BFSI vertical outlook, and healthy yoy new deal wins & pipeline commentary. Across Tier-2 companies, Persistent Systems (PSYS), Coforge, L&T Technology Services (LTTS) and Cyient's performances were better, but soft in the case of LTIMindtree and weak for Mphasis. Incremental moderation in FSI spending remains a key downside risk to our FY24F estimates while the conclusion of delayed deals in Europe and better ramp-up in the existing book could surprise positively.
- **YoY growth of LTM order book moderates with low roll-off visibility**: Barring Wipro, last 12-month or LTM deal win growth moderated across Tier-1 companies. TCV was down 36.4% qoq and 8.7% yoy for Infosys (BFSI large deal count at 4 vs. 6 in 3Q), new deal wins total contract value or TCV declined 25.5% qoq and 41.4% yoy for Tech Mahindra, TCS' BFSI deal wins declined by 6% qoq, adjusting for a mega deal, while HCL Technologies' new deal wins TCV fell for the second consecutive quarter. LTM order book growth moderated across Tier-2 companies, barring LTIMindtree. Management commentaries suggest that although the deal velocity has accelerated (especially in Europe) select discretionary projects could be cancelled if the sentiment deteriorates further while the rising mix of vendor consolidation and cost take-out deals could exert pressure on margins, in our view.
- **Margins could remain volatile in the near term**: EBIT margin performance was aided by improving billability of freshers, easing attrition, and moderation in sub-contractor expenses while the impact from project ramp-down, higher onsite wage cost and company-specific one-offs were key offsets. Wage hike could be a key headwind in 1HFY24F, and despite that the quantum could significantly be lower than in the previous years. Although moderating sub-contractor and backfilling cost, improving deployability of freshers and right-sizing of employee pyramid are key margin tailwinds, complex deal structuring and upfront investments to support large deals are key headwinds which could limit the FY24F EBIT margin expansion thesis.

- **We remain selective as performance divergence is broadening**: We continue to be selective and prefer structural stories, given that performance divergence across our coverage universe is broadening. Though the shift in the CY23F IT spending landscape, from growth to cost take-out, favours the scale of operations of Tier-I companies in a market with rising competitive intensity, recent earnings performance suggest that select Tier-II companies continue to defend their wallet share better. Finally, though we would have liked better entry points for our Tier-II coverage universe given the average entry P/E multiple (24.6/21x FY24F/25F consensus EPS) is still higher than that of Tier-I companies at 19x/16.9x for FY24F/25F, respectively, we highlight that broadening performance divergence in the backdrop of waning sectoral tailwinds of CY20/21 suggest that select Tier-II names may continue to attract a scarcity premium

Metals & mining sector

- The supply chain-filling rally in steel is over, as are the xl sheet-based dreams of debt-free steel companies. In most cases, deleveraging was artificial as big companies had delayed payments to small vendors, and, in turn, those vendors got those invoices discounted on the SIDBI trade discount window. It was also indeed magical that steel companies had customer advances amounting to US$800m (Tata Steel in FY21) in their balance sheets. All these led to massive artificial deleveraging, and the same is reversing.
- Please note that steel spreads still need to collapse, and if the world is slowing and Chinese exports are rising fast, then it's a matter of time before we will have at least -1SD spreads over raw material. In that scenario, most Indian steel stocks (barring JSW Steel – which is beyond our comprehension) will start trading near 0.5x book value. That's the time to buy steel stocks, not now.
- We remain sellers in steel names. You will hear a plenty of noise in the coming months of a) China cutting steel production (it never does- unless demand has collapsed there), b) Chinese exports coming down (it has never happened at a sustained level), and c) there is never a first time vis-à-vis China. So, investing based on Chinese announcements or promises, is fraught with risk. Use the bounce, if any, to come out of steel names. In metals, keep Hindalco.

Oil and Gas

- A significant slowdown in Europe and continued softness in China led to low gas prices in Europe, it's not a supply issue but just a demand decline playing havoc with our call on strong LNG prices. Till now, we have gone wrong on our strong LNG thesis. However, some sectors will gain in the current scenario – it's the evergreen pharma sector. The chemical sector will face headwinds by way of demand decline and hence, while spreads may rise, the top-line decline will lead to a fall in earnings. However, generic API-makers will enjoy benefits at both ends - lower raw material costs and bottoming-out API prices.
- European gas storage is nearing its all-time high as imported gas consumption in Europe is declining by approximately 20% YoY every week. This is leading to a fall in power, gas, and base chemical prices. Please note that most Indian chemical companies can report higher gross margin, but PAT will be destroyed by falling volume. We have seen this in the case of Atul and amine-makers last quarter. B2B businesses like Clean Science and Technology, etc. will take a hit in the coming quarters. On the other hand, API-makers will benefit as costs can decline by 5-10%. Various companies in their commentaries have indicated that price erosion is bottoming out. In fact, there are a few hints of rising API prices as well.
- **CGD firms; growth is reliant on domestic output, and the lower APM is unlikely to be of significant assistance**
    - Given crude oil prices of US$80/bbl, a 12.67% slope long-term contract is not feasible for Indian CGD and PNG players, necessitating their dependence on domestic APM natural gas. Limited to an increase of 4-4.5bcm in the next three to four years, the growth of Indian natural gas

output will limit CGD volume growth to a 10% CAGR over FY23F-26F. Achieving the government's aim of 100% indigenous urea production by 2025F hinges on international urea and LNG prices. If urea prices remain subdued, it may not be profitable to import costly LNG and produce urea from it. Although CNG stations are expected to double over the next three years and PNG connections to increase by 50%, a decline in CNG sales per station by 25% to 2mmscm from 2.7mmscm/station/annum (FY23 sales) is anticipated due to the above reasons. We remain cautious on Indian CGD companies.

Pharma

- **US generics – recovery limited to a few players**: Against general optimism on US pricing dynamics (portfolio rationalization by larger players/competitor exits), commentary from most managements has broadly remained unchanged (cautious) with price erosion guided to remain in high single digits. We believe there have been very specific beneficiaries (Aurobindo, Zydus) and a broad-based recovery is still elusive. gRevlimid continues to be one the key near-term drivers in the US market for most companies and is likely to continue the momentum with a higher volume share in FY24F. SUNP expects its specialty portfolio to scale up steadily, although generics revenue is likely to be hit due to Halol import alert and Mohali regulatory issues. Zydus (35+ launches including transdermals, gVascepa and a couple of REMS products) and Aurobindo (double-digit growth in Eugia, pick-up in oral solid sales in 1HFY24F and gRevlimid launch in Oct 2023F) sounded the most bullish in the near term.
- **Domestic growth was healthy, price hikes/productivity improvement to drive FY24F growth**: India growth was relatively stronger, with most companies reporting between 10-12% YoY growth (ex-Covid). NLEM revisions in Jan 2023 impacted 4Q to some extent but will be mitigated with price hikes that started in Apr 2023. Almost all companies added field force, either to expand their geographical coverage or to ensure better product focus with the creation of new divisions. Some companies also expanded their sales force in the consumer health business (Cipla, Torrent Pharma). FY24F domestic growth should be strong led by higher-than-normal price hikes and productivity improvement from the recently added field force.
- **One of the worst quarters for margins in recent times**: 4QFY23 was probably one of the worst quarters in recent history, in terms of margins, as companies suffered from higher channel inventory at the client's end, higher raw material inflation, higher freight cost and negative operating leverage. Ajanta Pharma, Gland Pharma, Alkem, Dr. Reddy's Labs, Laurus Labs , IPCA and Divis Labs sharply missed consensus margin expectations (by 10-20%). 4Q probably marked the trough for margins with improvement likely from softening raw material prices, reduction in freight cost and receding inventory levels. Additionally, productivity improvement from the recently added field force should help. SUNP alluded to a sharp increase in R&D spending, which should limit the margin expansion. With a likely recovery in revenue in 2HFY24F, CDMO players (Divis, Laurus, Gland) are likely to post a recovery in margins.

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