

**RESEARCH**
**Automobiles | Q3FY21 Preview**

Margins to remain stressed despite healthy volume uptick

**BOB Economics Research | Wholesale Inflation**

Food inflation drives WPI lower

**SUMMARY**
**Automobiles: Q3FY21 Preview**

Given higher quarterly dispatches, we expect Q3FY21 revenues to expand for our auto universe. Most segments – PVs, 2Ws, tractors and LCVs – have reported strong double-digit volume growth. MHCV declines also moderated YoY. But the spike in prices of commodities, rubber and crude derivatives will put substantial pressure on margins and earnings. Most auto stocks have rallied sharply in recent months on robust dispatches and continue to be richly valued – much ahead of long-term P/E multiples. We remain negative on the sector.

[Click here for the full report.](#)

**India Economics: Wholesale Inflation**

WPI eased to a 4-month low of 1.2% in Dec'20 from 1.5% in Nov'20 led by moderation in food inflation to 0.9% in Dec'20. Both vegetable and cereal prices fell. However, rising international oil and commodity prices meant that fuel and power index declined at a slower pace of 8.7% in Dec'20 and core inflation increased to 4.2% (2.6% in Nov'20). Vegetable prices tend to be volatile and rising international oil and commodity prices are likely to exert upward inflationary pressure in coming months. RBI to remain on hold.

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**TOP PICKS**
**LARGE-CAP IDEAS**

Company	Rating	Target
<a href="#">Cipla</a>	Buy	900
<a href="#">GAIL</a>	Buy	155
<a href="#">Petronet LNG</a>	Buy	330
<a href="#">TCS</a>	Buy	3,710
<a href="#">Tech Mahindra</a>	Buy	1,040

**MID-CAP IDEAS**

Company	Rating	Target
<a href="#">Alkem Labs</a>	Buy	3,600
<a href="#">Greenply Industries</a>	Buy	150
<a href="#">Laurus Labs</a>	Buy	410
<a href="#">Transport Corp</a>	Buy	300
<a href="#">Mahanagar Gas</a>	Sell	750

Source: BOBCAPS Research

**DAILY MACRO INDICATORS**

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.08	(5bps)	19bps	(70bps)
India 10Y yield (%)	5.91	(1bps)	1bps	(72bps)
USD/INR	73.15	0.1	0.7	(3.3)
Brent Crude (US\$/bbl)	56.06	(0.9)	12.2	(12.4)
Dow	31,060	0	3.4	7.0
Shanghai	3,599	(0.3)	7.5	16.5
Sensex	49,492	(0.1)	7.4	18.2
India FII (US\$ mn)	12 Jan	MTD	CYTD	FYTD
FII-D	(181.4)	(355.9)	(355.9)	(4,449.5)
FII-E	128.3	1,923.8	1,923.8	31,899.6

Source: Bank of Baroda Economics Research

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**AUTOMOBILES**

| Q3FY21 Preview

| 14 January 2021

**Margins to remain stressed despite healthy volume uptick**

Given higher quarterly dispatches, we expect Q3FY21 revenues to expand for our auto universe. Most segments – PVs, 2Ws, tractors and LCVs – have reported strong double-digit volume growth. MHCV declines also moderated YoY. But the spike in prices of commodities, rubber and crude derivatives will put substantial pressure on margins and earnings. Most auto stocks have rallied sharply in recent months on robust dispatches and continue to be richly valued – much ahead of long-term P/E multiples. We remain negative on the sector.

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**OEMs:** Led by 13% higher volumes, we expect a 17% YoY increase in Maruti's (MSIL) Q3 revenue. However, the sharp upswing in commodity prices makes us skeptical on margins. 2W volumes are up ~20% YoY for Hero (HMCL) & TVS Motor (TVSL) and ~9% for Bajaj Auto (BJAUT) & Eicher Motors (EIM – RE). 2W EBITDA margins are forecast to decline QoQ due to the rising commodity prices. Discounts remain high – typical for the festive season. We expect HMCL and TVSL to report lower profits QoQ despite festive demand purely due to lower gross margins. For BJAUT, higher 3W volumes QoQ should aid earnings.

In the CV segment, MHCV volume declines moderated to ~8% YoY on lower economic activity and uncertainty over the scrappage policy. But with a 19% YoY jump in average realisation per unit (low base in Q3FY20 and BSVI transition cost), we expect Ashok Leyland (AL) to report >27% YoY revenue growth. We raise our target P/E for AL from 16x to 20x on an expected MHCV upcycle.

**Tractors & Tillers:** Tractor volumes have risen ~20% YoY for M&M (MM) and ~26% for Escorts (ESC) in Q3. Swaraj Engines (SWE) and VST Tillers (VSTT) are expected to report >50% revenue growth. Margins for all these agri-related players are forecast to decline QoQ on higher raw material cost. We upgrade tractor industry growth estimates and hence those for MM, ESC and VSTT.

**Tyres:** OEMs have seen sequential growth in MHCV tyre sales. Our channel checks suggest that replacement demand for truck tyres (radial) remains steady. The farm subsegment (tractors) has clocked strong growth. We expect higher capacity utilisation in 'bias' tyres and project overall revenue growth of ~5% QoQ from the tyre pack. The sharp jump in rubber prices (from ~Rs 120/kg to Rs 145/kg) and higher crude derivative costs (up ~10% QoQ) are expected to shave 400bps of Q3 gross margins QoQ and also impact Q4. We cut estimates and recommend a strong SELL on the entire tyre pack.

**RECOMMENDATION SNAPSHOT**

Ticker	Price	Target	Rating
AL IN	120	60	SELL
BJAUT IN	3,572	2,800	SELL
EIM IN	2,890	2,200	SELL
ESC IN	1,345	1,150	SELL
HMCL IN	3,265	2,900	SELL
MSIL IN	8,154	6,900	SELL
MM IN	830	630	SELL
TVSL IN	511	350	SELL
VSTT IN	1,921	2,300	BUY
APTY IN	190	140	SELL
BIL IN	1,709	1,340	SELL
CEAT IN	1,188	780	SELL
JKI IN	88	70	SELL
MDA IN	90	110	BUY
MRF IN	89,936	67,000	SELL
SWE IN	1,382	1,300	SELL
SRTY IN	1,904	1,200	SELL

Price &amp; Target in Rupees



## WHOLESALE INFLATION

14 January 2021

### Food inflation drives WPI lower

WPI eased to a 4-month low of 1.2% in Dec'20 from 1.5% in Nov'20 led by moderation in food inflation to 0.9% in Dec'20. Both vegetable and cereal prices fell. However, rising international oil and commodity prices meant that fuel and power index declined at a slower pace of 8.7% in Dec'20 and core inflation increased to 4.2% (2.6% in Nov'20). Vegetable prices tend to be volatile and rising international oil and commodity prices are likely to exert upward inflationary pressure in coming months. RBI to remain on hold.

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**Food inflation eases further:** Food inflation moderated to a 2-year low of 0.9% in Dec'20 from 4.3% in Nov'20. This was led by 13.2% YoY contraction in vegetable prices in Dec'20 compared with an increase of 12.2% in Nov'20. Within vegetables, onion prices fell by 54.7% in Dec'20 compared with a 7.6% drop in Nov'20. Potato prices also rose at a slower pace of 37.7% in Dec'20 from 115% in Nov'20. Cereal prices declined by 6.5% in Dec'20, all-time low in this series, from a decline of 5.5% in Nov'20 driven by contraction in wheat prices (11.1% in Dec'20 from 10.1% in Nov'20). Pulses inflation too fell to 9.7% in Dec'20 from 13% in Nov'20. Prices of eggs, meat and fish edged upwards to 1.4% in Dec'20 (0.6% in Nov'20). The avian flu seen in a number of states is likely to put upward pressure on fish and mutton prices.

**Contraction in fuel and power eases:** Fuel and power index fell by 8.7% in Dec'20 from a 9.9% drop in Nov'20 led by 10.7% fall in electricity index compared with 4.3% decline in Nov'20. Even mineral oil index fell by 11.2% in Dec'20 compared with a 16% drop in Nov'20. This is driven by pass-through of higher international oil prices which were at US\$ 50/bbl in Dec'20 compared with US\$ 44/bbl in Nov'20. International oil prices have risen further in Jan'21 to US\$ 55/bbl implying fuel deflation will be a lower drag on WPI index.

**Core inflation inching up:** Core inflation rose to 4.2% in Dec'20 from 2.6% in Nov'20 led by basic and fabricated metals, electrical and other transport equipment. Notably, international commodity prices have increased further in Jan'21. Of the 22 commodities in manufactured products, prices of 15 commodities rose. The pace of global economic recovery implies there is room for further increase in global commodity prices which will put upward pressure on wholesale inflation.



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### Recommendations and Absolute returns (%) over 12 months

**BUY** – Expected return >+15%

**ADD** – Expected return from >+5% to +15%

**REDUCE** – Expected return from -5% to +5%

**SELL** – Expected return <-5%

**Note:** Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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