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FIRST LIGHT

11 August 2022

RESEARCH

BOB Economics Research | Interest Cover

What does interest cover of India Inc. indicate?

BOB Economics Research | Monthly Chartbook

RBI frontloads rate hike

Amber Enterprises | Target: Rs 2,300 | +1% | HOLD

Mixed quarter; challenges ahead

Somany Ceramics | Target: Rs 835 | +30% | BUY

Good quarter; long term outlook remains positive

Consumer Durables | Q1FY23 Review

A bumpy quarter

Daily macro indicators

Indicator	08-Aug	09-Aug	Chg (%)
US 10Y yield (%)	2.76	2.78	2bps
India 10Y yield (%)	7.3	7.35	5bps
USD/INR	79.25	79.65	(0.5)
Brent Crude (US$/bbl)	96.7	96.3	(0.4)
Dow	32,833	32,774	(0.2)
Hang Seng	20,046	20,003	(0.2)
Sensex	58,388	58,853	0.8
India FII (US$ mn)	**04-Aug**	**05-Aug**	**Chg ($ mn)**
FII-D	48.8	95.8	47.0
FII-E	217.3	252.8	35.5

Source: Bank of Baroda Economics Research

SUMMARY

India Economics: Interest Cover

We have in this study examined financial performance of 3180 companies (excluding financial companies) and noted the trend in interest coverage ratio defined as Operating profit to Interest. This indicator reflects the comfort level of companies in debt servicing.

Click here **for the full report.**

India Economics: Monthly Chartbook

In its latest policy, RBI hiked repo rate by 50bps taking the cumulative rate hike in repo rate to 140bps in the current cycle. Repo rate at 5.9% is now above the pre-pandemic level of 5.15%. Underlying strength in the economy prompted RBI to take a more stringent action on inflation. Growth and inflation projections were maintained at 7.2% and 6.7% respectively for FY23. Notably, RBI expects inflation above its upper target of 6% in the next two quarters as well, which suggests that more rate hikes may be forthcoming. We expect another 50bps hike in repo rate, implying that repo rate may end the year close to the 6% mark. Thus, 10Y yield is likely to remain elevated. INR is likely to find support from the rate-hike even as rising trade deficit remains a key concern.

Click here **for the full report.**

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Amber Enterprises

- Q1 EBITDA margin down 100bps QoQ to 5.4% and adj. PAT below estimates at Rs 429mn
- Management confident of surpassing AC industry growth in FY23, but we see challenges from rising competition and OEM capacity adds
- TP revised down to Rs 2,300 (vs. Rs 3,500) as we pare FY23/FY24 EPS by 2%/8% and scale back our FY24E P/E multiple from 40x to 30x

Click here for the full report.

Somany Ceramics

- Q1 revenue growth at 67% YoY due to 42% increase in tile volumes (+20% vs Q1FY20) &15.5% rise in blended realisation (+17% vs Q1FY20)
- EBITDA margin improved 240bps YoY to 6.8% owing to better operating leverage and price hikes of 2.5-3%
- Retain BUY with an unchanged TP of Rs 835 given an improving mix, demand tailwinds and capital allocation towards the core business

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Consumer Durables | Q1FY23 Review

- Durables players had to negotiate waning demand, RM inflation and SG&A cost normalisation; cooling of RM cost in late-Q1 offered some respite
- Aggressive competition in ACs, for which Q1 is a peak quarter, came as a key negative surprise
- Focus now shifts to festive demand. Our picks are HAVL, CROMPTON, POLYCAB and DIXON

Click here for the full report.

INTEREST COVER

10 August 2022

What does interest cover of India Inc. indicate?

Dipanwita Mazumdar
Economist

We have in this study examined financial performance of 3180 companies (excluding financial companies) and noted the trend in interest coverage ratio defined as Operating profit to Interest. This indicator reflects the comfort level of companies in debt servicing.

Some interesting results:

- In response to falling interest rate cycle, interest coverage ratio of companies has improved in FY21 following 40bps drop in repo (plus 75 bps in March 2020) and 79bps drop in WALR.
- In FY22 as well, interest cover of companies continued to show significant improvement to 5.76 from 4.56 in FY21.
- Notably, in FY22, despite a moderation in operating margin (Operating profit/Net sales), interest coverage of companies improved, clearly reinforcing the view that RBI's accommodative policy supported this trend.
- Industry wise, aviation, consumer durables and hospitality are still facing considerable risk, post Covid induced slowdown. However, few infra sectors such as capital goods, iron and steel, construction have better interest coverage ratio.
- Micro, small and medium enterprise have still interest coverage below 1, large enterprises have comparatively better financial health.

Interest payment has fallen in line with falling rate cycle:

- In the past 5 years, operating profit of companies has grown at the compound annual growth rate of 8.4%, while interest has increased by 4.8%.
- The 5-year average of interest cover of companies has been 4.8. However, excluding industries such as FMCG, industry gas and fuels, IT and mining which inherently have a higher interest coverage ratio, the 5 year average of interest cover turns out to be 4. Notably, 49% of the companies have interest cover below the long run average in FY22.
- Some interesting results which can be traced from this data is that, improving interest coverage of companies has been in line with the accommodative policy of RBI. Since FY20 onwards, in response to falling policy rate (115bps cumulatively in FY20-22), interest coverage of India Inc. has improved significantly. From 4.04 in FY20, it has improved to 5.76 in FY22.
- Notably, interest of companies on an average has declined by 2.2% in the past two years of favourable rate cycle. The weighted average lending rate has also fallen by 90bps cumulatively, during this easing cycle.

RBI frontloads rate hike

In its latest policy, RBI hiked repo rate by 50bps taking the cumulative rate hike in repo rate to 140bps in the current cycle. Repo rate at 5.9% is now above the pre-pandemic level of 5.15%. Underlying strength in the economy prompted RBI to take a more stringent action on inflation. Growth and inflation projections were maintained at 7.2% and 6.7% respectively for FY23. Notably, RBI expects inflation above its upper target of 6% in the next two quarters as well, which suggests that more rate hikes may be forthcoming. We expect another 50bps hike in repo rate, implying that repo rate may end the year close to the 6% mark. Thus, 10Y yield is likely to remain elevated. INR is likely to find support from the rate-hike even as rising trade deficit remains a key concern.

Mixed trend in consumption demand: Economic activity continues at a robust pace as signalled by steady google mobility indices. Some green shoots can be seen emerging led by improvement in non-oil-non-gold imports. Consumers also remain optimistic about future (RBI future index: 77.3 from 75.9) as confidence levels strengthened with housholds expecting inflation to moderate. However, other consumption demand indicators such as PV sales, electricity demand registered a dip in Jul'22, suggesting a wind of caution. On the agricultural front, south-west monsoon is 6% above LPA (cumulative-5 Aug 2022). Kharif production continues to be lower compared with last year, with concerns emerging on rice sowing. However, higher storage levels augur well for rabi sowing.

Centre's Q1 finances strengthen: Supported by robust revenue growth (despite high base), centre's fiscal deficit (% of GDP, 12MMA) in Jun'22 came in at 6.6%, down from 6.7% in May'22. In Q1FY23, centre's gross tax revenue was up by 22% and reached Rs 6.5 lakh crore, up from Rs 5.3 lakh crore last year. This was helped by direct tax collections (Rs 3.3 lakh crore versus Rs 2.5 lakh crore last year). Indirect taxes too maintained steady growth (Rs 3.2 lakh crore versus Rs 2.9 lakh crore). Centre's net revenues were also up by 5% in Q1FY23, over a high base of 260% in Q1FY22. Front-loading of expenditure growth continued (15.4% in Q1 versus 0.7% last year), albeit it witnessed some slowdown (22.6% in Apr-May'22). Both capex (57% in Q1 versus 70% in Apr-May) and revenue spending (8.8% versus 15.3% in Apr-May'22) showed signs of easing. Going forward, we expect central government to meet budgetary spending targets and we maintain our forecast for fiscal deficit at 6.6-6.7%.

RBI's hawkish policy impacted yields: Post RBI's repo rate hike of 50bps and hawkish statement reflecting the focus on price stability, India's 10Y yield rose by 14bps. We expect frontloading of another 50bps in the current cycle. Going forward, we expect India's 10Y yield to hover around 7.5% till Sep'22. Some pressure on short end yields may be visible due to tight financial conditions and withdrawal of liquidity. Hence, some flattening of yield curve in terms of falling spread between short end and long end papers may be visible.

Higher trade deficit to weigh on INR: INR depreciated to a fresh record-low of 79.99/$ in Jul'22, amidst a stronger dollar and FPI outflows. With a decline is DXY index and reversal in FPI outflows in the later part of the month, INR recouped some losses and closed Jul'22, lower by 0.4%. However, with trade deficit continuing to track at record-highs, INR may come under pressure. INR trajectory in the short-term will be dependent on Fed's rate path and FPI flows.

Note: The source for all exhibits is 'CEIC and Bank of Baroda' unless otherwise specified

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HOLD
TP: Rs 2,300 | ⮝ 1%

AMBER ENTERPRISES | Consumer Durables | 10 August 2022

Mixed quarter; challenges ahead

- **Q1 EBITDA margin down 100bps QoQ to 5.4% and adj. PAT below estimates at Rs 429mn**
- **Management confident of surpassing AC industry growth in FY23, but we see challenges from rising competition and OEM capacity adds**
- **TP revised down to Rs 2,300 (vs. Rs 3,500) as we pare FY23/FY24 EPS by 2%/8% and scale back our FY24E P/E multiple from 40x to 30x**

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Disappointing quarter: In Q1FY23, Amber's room AC volumes was 1.28mn units vs. 1.5mn in Q4FY22, while realisations rose 33%. EBITDA margin declined 100bps QoQ to 5.4% owing to a 19% rise in other expenses related to forex loss (Rs 230mn), loss on fixed assets, and MTM (bonds) loss. As a result, adj. PAT came in sequentially lower at Rs 429mn (-28% QoQ. Margins reflect Q4FY22 costs as pass-along of costs typically occurs with a quarter's lag. Management has a cautious maring outlook given the soft demand season for ACs in Q2 and Q3, as well as the recent change in BEE (energy efficiency) ratings.

Confident of outperforming industry growth…: Management anticipates industry volumes at 8.2-8.4mn in FY23 vs. 7mn/5.2mn/6.4mn in FY20/FY21/FY22, implying 28-30% growth. Amber expects its RAC volume growth to surpass the industry by 2ppt-4ppt in FY23. It also expects 30%/35% growth in its motor/electronic businesses and 25% growth each in mobility solutions and new acquisitions (Amber PR, Pravartaka).

…but structural growth headwinds emerging: A primary overhang for Amber is the capacity addition implemented by most OEMs in the AC segment under the PLI scheme. The implications could be significant because OEMs would want to utilise their capacity first, before outsourcing to companies like Amber. Nevertheless, management remains optimistic of raising market share by 200bps from the current 26.6% (in value terms). Key to watch, in our view, would be the contribution of components (business to subsidiaries at relatively high margins) and traction in exports.

Capex in place to diversify revenue stream: Management has maintained its FY23 capex guidance of Rs 4bn, of which Rs 1.5bn (subject to approval) will be spent on brownfield capacity, primarily for room ACs and consumer durables. The Sri City greenfield plant is scheduled to begin commercial production mid-Dec'22.

Maintain HOLD: In view of intensifying competition in the AC industry as well capacity addition by OEMs, we cut our target FY24E P/E multiple from 40x to 30x (10% discount to 4Y average) and pare our FY23/FY24 EPS estimates by 2%/8%. This yields a revised TP of Rs 2,300 (vs. Rs 3,500) – retain HOLD.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	AMBER IN/Rs 2,272
Market cap	US$ 962.7mn
Free float	60%
3M ADV	US$ 4.2mn
52wk high/low	Rs 4,026/Rs 2,040
Promoter/FPI/DII	40%/27%/9%

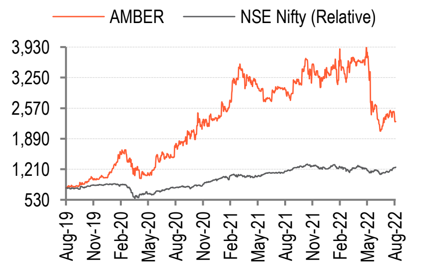
Source: NSE | Price as of 8 Aug 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	42,064	57,971	73,795
EBITDA (Rs mn)	2,754	4,193	5,647
Adj. net profit (Rs mn)	1,113	1,849	2,634
Adj. EPS (Rs)	33.0	54.9	78.2
Consensus EPS (Rs)	33.0	58.5	90.7
Adj. ROAE (%)	6.7	10.1	12.8
Adj. P/E (x)	68.8	41.4	29.1
EV/EBITDA (x)	27.8	18.3	13.6
Adj. EPS growth (%)	33.7	66.1	42.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

BUY
TP: Rs 835 | ⮝ 30%

SOMANY CERAMICS | Construction Materials | 10 August 2022

Good quarter; long term outlook remains positive

- **Q1 revenue growth at 67% YoY due to 42% increase in tile volumes (+20% vs Q1FY20) &15.5% rise in blended realisation (+17% vs Q1FY20)**
- **EBITDA margin improved 240bps YoY to 6.8% owing to better operating leverage and price hikes of 2.5-3%**
- **Retain BUY with an unchanged TP of Rs 835 given an improving mix, demand tailwinds and capital allocation towards the core business**

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Higher realisations and volumes buoy topline: SOMC's Q1FY23 revenue grew 67% YoY (-11% QoQ) to Rs 5.4bn off a low base, aided by a 42%/16% rise in tile volumes/ blended realisation. Despite 320bps YoY gross margin contraction, EBITDA margin rose 240bps to 6.8% due to operating leverage, with EBITDA up 158% YoY. Consolidated revenue grew 70% YoY to Rs 5.6bn and EBITDA margin was up 105bps to 8% on lower employee and other costs, which offset higher fuel cost (+790bps YoY to 31% of sales).

Gas price on the rise…: Rising gas cost is putting pressure on margins – prices in the northern region have risen from Rs 48/scm in Q4FY22 to Rs 58/scm in Q1FY23 and Rs 64/scm currently, and in the south from Rs 71/scm to Rs 90/scm (SOMC is in the process of acquiring cheaper gas from a third party). In Morbi, prices are up from Rs 65/scm in Q1 to Rs 67/scm currently. The company took price hikes of 2.5-3% in Q1 to mitigate the impact of rising cost inflation. It has a three-month contract with Gujarat Gas for gas currently priced at Rs 65/scm vs. Rs 36/scm in Q1FY22.

…fuelling a shift to propane: As per management, propane is Rs 7-8/scm cheaper than gas and many plants are converting to this fuel, though the conversion rate is low as the capex required is +Rs 10mn per plant. SOMC, however, is migrating to propane and has already converted two plants with one more being readied by August-end. Per the company, 150 out of 800 plants in the Morbi ceramic cluster have moved to propane.

Growth getting back on track: SOMC's growth hit a roadblock in Q4FY22 due to a host of macro (subdued demand and pricing pressure) and micro issues (stretched receivable days). However, we expect a revenue CAGR of 14% over the next two years led by ramp-up of new capacities and traction in the bathware segment. Given price hikes by tiles players to offset higher gas cost, a rising share of own manufacturing post completion of expansion, and higher contribution from glazed vitrified tiles (GVT: +35% in FY24E vs. 30% in Q1FY23), we expect SOMC to sustain 11-12% margins.

Maintain BUY: The stock is trading at 18x FY24E EPS vs. its 5Y median of 27.5x. We retain BUY with an unchanged TP of Rs 835, based on 23x FY24E EPS, given an improving mix, demand tailwinds and capital allocation towards the core business.

Key changes

Target	Rating
◄►	◄►

Ticker/Price	SOMC IN/Rs 642
Market cap	US$ 342.0mn
Free float	45%
3M ADV	US$ 0.1mn
52wk high/low	Rs 970/Rs 511
Promoter/FPI/DII	55%/2%/43%

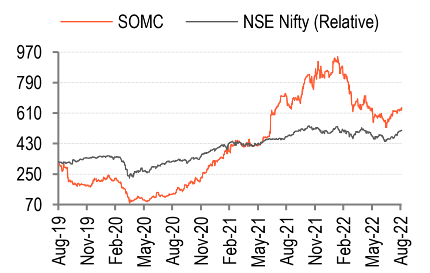
Source: NSE | Price as of 10 Aug 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	20,945	23,167	27,140
EBITDA (Rs mn)	2,065	2,442	3,212
Adj. net profit (Rs mn)	888	1,000	1,530
Adj. EPS (Rs)	21.0	23.6	36.1
Consensus EPS (Rs)	24.6	34.7	45.2
Adj. ROAE (%)	13.0	12.9	17.1
Adj. P/E (x)	30.6	27.2	17.8
EV/EBITDA (x)	14.7	12.3	9.4
Adj. EPS growth (%)	24.8	12.6	53.0

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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CONSUMER DURABLES | Q1FY23 Review | 10 August 2022

A bumpy quarter

- **Durables players had to negotiate waning demand, RM inflation and SG&A cost normalisation; cooling of RM cost in late-Q1 offered some respite**
- **Aggressive competition in ACs, for which Q1 is a peak quarter, came as a key negative surprise**
- **Focus now shifts to festive demand. Our picks are HAVL, CROMPTON, POLYCAB and DIXON**

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Demand patchy in Q1: Most consumer durables companies were unanimous in their view that demand had waned progressively over Q1FY23, with an animated April, a middling May and an erratic June. All the commentaries cited June as the worst of both worlds as inflation hobbled demand amid high raw material costs.

RM softening a respite…: Fears of global inflation led to a cooldown in commodity prices, with key inputs down in the range of 15-25% since April. This has reduced the compulsion on companies to raise prices and, to that extent, should support demand.

…but more of an H2 story: Anticipating strong demand in Q1 amidst supply and logistical uncertainties, most companies had increased the carrying inventory of raw materials, as evidenced from their elongated working capital cycles. Hence, much of Q2 will be spent liquidating this high-cost inventory before relief on input costs begins to reflect on margins from Q3FY23 onwards.

Ferocity of competition in ACs surprised us: The competitive intensity in the air conditioning segment during Q1 caught us by surprise. We saw aggressive growth from VOLT and Lloyd, both of which gained market share at the cost of margins, whereas BLSTR was more balanced in its approach. Overall, however, the industry focus is on market share. The next two quarters are off-season and thus the real impact will only become apparent three quarters down the line.

All eyes on festive demand: With softening RM costs obviating the need for further price hikes, companies are looking to festive demand in August and September as a means to liquidate their high-cost inventories across categories, barring ACs.

VOLT downgraded post Q1; other picks intact: Following the Q1 results, we have maintained ratings on our durables coverage, barring VOLT (moved from BUY to HOLD on 4 Aug), as the focus shifts to festive demand for categories other than ACs. Our current picks are HAVL, CROMPTON, POLYCAB and DIXON.

Recommendation snapshot

Ticker	Price	Target	Rating
AMBER IN	2,272	2,300	HOLD
BLSTR IN	1,010	1,100	HOLD
CROMPTON IN	375	500	BUY
DIXON IN	3,798	4,500	BUY
HAVL IN	1,305	1,500	BUY
ORIENTEL IN	261	310	HOLD
POLYCAB IN	2,360	3,000	BUY
VGRD IN	239	250	HOLD
VOLT IN	982	1,100	HOLD

Price & Target in Rupees | Price as of 8 Aug 2022

Consumer durables: Q1 result reviews

Company	Result review link
AMBER IN	Mixed quarter; challenges ahead
BLSTR IN	Commendable margin performance
CROMPTON IN	Temporary margin miss; expect swift recovery
DIXON IN	Strong Q1 topline; remains the best PLI play
HAVL IN	Short-term margin blip, better road ahead
ORIENTEL IN	Headwinds in core portfolio, maintain HOLD
POLYCAB IN	Resilient margins offset moderation in revenue
VGRD IN	Margin blip in Q1
VOLT IN	Competitive edge appears blunted; downgrade to HOLD

Source: 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

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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