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FIRST LIGHT

14 June 2022

RESEARCH

Pharmaceuticals

Management meet: Rising Covid cases cast cloud over FDA approvals

BOB Economics Research | CPI

Favourable base supported CPI

Consumer Durables

A case for larger companies

SUMMARY

Pharmaceuticals

- Managements of DRRD, ARBP and LAURUS confident of near-term growth drivers but see many moving parts in long run
- Growing Covid cases could spell trouble for Indian players with sizeable US exposure as key drug approvals may be delayed further
- We maintain our view on ARBP (BUY) and DRRD (HOLD); raise LAURUS from HOLD to BUY post correction

Click here for the full report.

India Economics: CPI

Headline CPI in May'22 edged down from its current peak of 7.8% (last seen in Oct'14) to 7%, supported by favourable base. However, what has stood out in this current print is the sequential pickup in food inflation. On the other hand, core inflation has provided some comfort. But going forward we expect CPI to remain elevated at 6.5% in FY23. Keys risks are uneven distribution of monsoon, supply side hindrances and demand picking pace on the back of recovery. Thus RBI is likely to be watchful of these factors and be hawkish regarding future rate hikes.

Click here for the full report.

Daily macro indicators

Indicator	09-Jun	10-Jun	Chg (%)
US 10Y yield (%)	3.04	3.16	11bps
India 10Y yield (%)	7.5	7.52	2bps
USD/INR	77.77	77.84	(0.1)
Brent Crude (US$/bbl)	123.1	122	(0.9)
Dow	32,273	31,393	(2.7)
Hang Seng	21,869	21,806	(0.3)
Sensex	55,320	54,303	(1.8)
India FII (US$ mn)	**08-Jun**	**09-Jun**	**Chg ($ mn)**
FII-D	13.7	(0.6)	(14.3)
FII-E	(309.8)	(180.1)	129.7

Source: Bank of Baroda Economics Research

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Consumer Durables

- FY22 sales of larger companies outpaced medium/small/micro players, per a BOB Economics study of 2,000+ companies across sectors
- This corroborates our view that larger players have potentially stronger pricing power, implying resilience amid inflationary stress
- We reiterate our preference for leaders with a proven record on pricing as well as cost control – BUY VOLT, HAVL, POLYCAB

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PHARMACEUTICALS

13 June 2022

Management meet: Rising Covid cases cast cloud over FDA approvals

- **Managements of DRRD, ARBP and LAURUS confident of near-term growth drivers but see many moving parts in long run**
- **Growing Covid cases could spell trouble for Indian players with sizeable US exposure as key drug approvals may be delayed further**
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Key takways from our Hyderabad visit: DRRD, ARBP and LAURUS:

India better prepared for potential fourth wave: Regarding the rising Covid-19 infections in some states, the pharma players we met all felt that India is now better prepared with a sizeable part of the population doubly vaccinated and vaccine supply is no longer an issue (unlike the first and second waves). While the concern now is the poor uptake of booster doses, on the positive side, improving collective immunity means symptoms do not appear to be very serious and long lasting.

Rising cases may further delay resumption of inspections: Several companies are awaiting clearance of their facilities and product approvals. If Covid cases continue to rise globally, the resumption of normal USFDA inspections may be impeded and the agency could prioritise warning letters and OAI (official action indicated) over other less serious inspections.

Pricing pressure in the US unlikely to abate: Increased competition and a higher number of approvals per product would continue to intensify pricing pressure in the US market over the medium term, especially in the absence of new, high-value products in the pipeline (ex-DRRD's Revlimid). Companies would need to find an edge either in terms of limited-competition products or complex/biosimilar launches, find a niche in terms of physician/distributor connect or scale-up low-cost manufacturing.

Inventory stock-up slow: Covid-led inventory stocking at the distribution channel and patient level remains weak in FY22 and this trend will continue to some extent in FY23, especially in areas such as antiretrovirals.

BUY ARBP and LAURUS; HOLD DRRD: We retain BUY on ARBP and HOLD on DRRD with unchanged TP of Rs 680 and Rs 4,450 respectively. For LAURUS, we retain our TP of Rs 645 based on an unchanged 17x FY24E EV/EBITDA multiple, but upgrade to BUY (from HOLD) following the 10% stock correction over the past three months.

Recommendation snapshot

Ticker	Price	Target	Rating
ARBP IN	517	680	BUY
DRRD IN	4,267	4,450	HOLD
LAURUS IN	527	645	BUY

Price & Target in Rupees | Price as of 13 Jun 2022

CPI

13 June 2022

Favourable base supported CPI

Dipanwita Mazumdar
Economist

Headline CPI in May'22 edged down from its current peak of 7.8% (last seen in Oct'14) to 7%, supported by favourable base. However, what has stood out in this current print is the sequential pickup in food inflation. On the other hand, core inflation has provided some comfort. But going forward we expect CPI to remain elevated at 6.5% in FY23. Keys risks are uneven distribution of monsoon, supply side hindrances and demand picking pace on the back of recovery. Thus RBI is likely to be watchful of these factors and be hawkish regarding future rate hikes.

CPI print supported due to base: India's headline CPI edged down to 7.04% against our expectation of 7% and compared to 7.8% in Apr'22. This was driven by favourable base (6.3% in May'21). Food inflation moderated to 8% from 8.3% in Apr'22. CPI excl. food and fuel edged down to 6% from 7% in Apr'22.

Food inflation accelerates on a MoM basis: If we see the sequential momentum of food inflation, the narrative shows price pressure is building up. On a sequential basis, food inflation increased by 1.6% in May'22 from 1.5% in Apr'22. Among major items which noted a considerable MoM jump within food includes vegetables (5.2% against -0.4% in Apr'22), meat and fish (2.5% versus 0.5% in Apr'22) and sugar (0.6% versus 0.2%).

Core inflation showed some moderation: Supported by transport and communication inflation (9.5% against 10.9%, YoY; 0.3% versus 3%, MoM), CPI excluding food and fuel moderated both on MoM and YoY basis. Within the miscellaneous component, governments' excise duty cut and lower gold prices supported lower print in transport and communication and personal care and effects inflation.

Our forecast on inflation: We expect CPI to be ~ 6.5% in FY23. Significant risks emanate from rising crude prices, which are currently at +US$ 120/bbl. Even the spatial distribution of monsoon plays a significant role in the upcoming days on cereal inflation. Further on a sequential basis, some items of food inflation are still inching up. So a combination of these factors along with supply side bottlenecks will continue to pose upward pressure on headline CPI print. Apart from this depreciating currency will also pose risks in terms of imported inflation Thus, RBI will be more hawkish and aggressive in its pace of rate hikes in the coming months.

CONSUMER DURABLES

13 June 2022

A case for larger companies

- **FY22 sales of larger companies outpaced medium/small/micro players, per a BOB Economics study of 2,000+ companies across sectors**
- **This corroborates our view that larger players have potentially stronger pricing power, implying resilience amid inflationary stress**
- **We reiterate our preference for leaders with a proven record on pricing as well as cost control – BUY VOLT, HAVL, POLYCAB**

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Corporate performance lends credence to our view: In our FY22 earnings review of the consumer durables sector titled **Margin gains elusive**, we had highlighted our belief that larger companies are better able to handle pricing pressure and cost control. This is corroborated by research from the Bank of Baroda Economics team, which covered a detailed study of the financial performance of over 2,000 companies.

FY22 saw strong growth: As per the BOB Economics study, aggregate turnover across the sample set grew by 27.5% in FY22 compared to declines of 1.9%/0.8% in FY21/FY20. Even on a pre-Covid base of FY20, growth was healthy at 25.1%. However, inflation played a dampening role on operating profit which increased by 17.3%. PAT was stronger, rising 57.4% due to a combination of lower interest, taxes and employee cost, though lower employee cots would have benefited operating margins. Ex-BFSI, the performance was even better with sales/EBITDA/ PAT growth of 35%/25%/65%.

Deleveraging uplifted PAT growth: Interest payments declined in FY21 and FY22 on account of a slowdown in borrowing and reduction in interest rates amid pandemic measures by the RBI. Further, several companies have been deleveraging over the last couple of years. This has led to a high interest cover of 7.7x, supporting the strongest PAT margin of 9.2% in four years.

Larger companies have outperformed: Further unravelling of the data shows that larger companies (turnover above Rs 2.5bn; ~80% of sales for the sample size) grew by 28% in FY22, with medium/small/micro players lagging at +21%/+7%/-25%. This suggests relatively stronger pricing power for bigger companies and explains the anecdotal market share gains for most of these players during the pandemic.

Reiterate preference for bigger players: Given that pricing power and cost control are vital in the current inflationary environment, we reiterate our preference for leaders with a strong track record in these areas, viz. VOLT (BUY, TP: Rs 1,250), HAVL (BUY, TP: Rs 1,500) and POLYCAB (BUY, Rs 3,000).

Recommendation snapshot

Ticker	Price	Target	Rating
AMBER IN	2,227	3,500	HOLD
BLSTR IN	948	1,200	HOLD
CROMPTON IN	328	500	BUY
DIXON IN	3,490	4,600	BUY
HAVL IN	1,093	1,500	BUY
ORIENTEL IN	270	350	HOLD
POLYCAB IN	2,232	3,000	BUY
VGRD IN	218	250	HOLD
VOLT IN	981	1,250	BUY

Price & Target in Rupees | Price as of 13 Jun 2022

Disclaimer

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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