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FIRST LIGHT

21 August 2023

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Chronic therapies continue strong streak

Daily macro indicators

Ticker	16-Aug	17-Aug	Chg (%)
US 10Y yield (%)	4.25	4.27	2bps
India 10Y yield (%)	7.21	7.25	4bps
USD/INR	82.96	83.15	(0.2)
Brent Crude (US$/bbl)	83.5	84.1	0.8
Dow	34,766	34,475	(0.8)
Hang Seng	18,329	18,327	0.0
Sensex	65,539	65,151	(0.6)
India FII (US$ mn)	**11-Aug**	**14-Aug**	**Chg ($ mn)**
FII-D	152.4	42.3	(110.2)
FII-E	(306.2)	1,042.0	1,348.2

Source: Bank of Baroda Economics Research

SUMMARY

INDIA ECONOMICS: CURRENCY OUTLOOK

INR closed at a record low of 83.15/$ yesterday, just short of an intra-day low of 83.24/$ in Oct'22. Pressure on the domestic currency has come from exogenous factors, even as domestic macros continue to remain supportive. It appears that expectations of a peak in Fed rates have been pushed back. With growth on a strong footing, another rate hike is now a possibility. On the other hand, weak growth in China has weighed on CNY. We expect some short-term pressure on USD/INR but remain positive on the currency pair in the long-run. A range of 83-84/$ looks reasonable for the next fortnight. Further upside is also possible, given the volatility in global financial markets.

Click here **for the full report.**

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INDIA ECONOMICS: BOND YIELDS

US 10Y yield has risen considerably post the last Fed policy meeting (26 Jul). Though the 25bps rate hike was priced in by the market, what contributed to the bull run of yield has been the strong macro data in the US especially demand driven components. FOMC member's reiteration of an uncomfortably higher and above target inflation and relatively stable growth indicators have further resulted in sell off in the bond market. The last close has been the highest since 8 Nov 2007, amidst expectation that another rate hike by Fed is on the cards. The ripple effect has been felt in case of other AEs such as UK and Germany's 10Y yield.

Click here for the full report.

CONSUMER STAPLES: Q1FY24 REVIEW

- FMCG sector grew 12.2% YoY in Q1 with volumes rising 7.5%; regional competition intensified during the quarter
- Urban volumes grew in double-digits; rural consumption continued to rise, growing 4% YoY in Q1
- Expect volume growth to improve further in H2FY24; prefer DABUR, NEST, TCPL, ITC and GCPL

Click here for the full report.

CONSUMER DURABLES: Q1FY24 REVIEW

- Q1 a middling quarter for the consumer durables sector, barring cables, wires and EMS players
- Input cost eased but higher A&P spends prevented gross margin expansion from percolating to EBITDA margins
- Upcoming festive season could lend a fillip to demand; HAVL and SYRMA are our preferred names

Click here for the full report.

CAPITAL GOODS: Q1FY24 REVIEW

- Our capital goods coverage grew 30% YoY in Q1 on strong execution (+20% ex-LT); EBITDA margin stayed flat (+260bps ex-LT)
- Order inflows swelled 40% YoY (flat ex-LT); FY24 outlook upbeat with structural tailwinds from rail, power and digitalisation segments
- We continue to prefer LT, KKC and AIAE in the sector

Click here for the full report.

PHARMACEUTICALS

- IPM saw subdued 6% YoY growth in July as sluggish demand for acute therapies (+4%) offset stronger chronic revenue (+10%)
- Growth on MAT basis robust at 11% with price hikes contributing 5% and both chronic and acute therapies faring well
- ERIS and AJP are our top picks in the sector

Click here for the full report.

CURRENCY OUTLOOK

18 August 2023

INR at record low - What's next?

Aditi Gupta
Economist

INR closed at a record low of 83.15/$ yesterday, just short of an intra-day low of 83.24/$ in Oct'22. Pressure on the domestic currency has come from exogenous factors, even as domestic macros continue to remain supportive. It appears that expectations of a peak in Fed rates have been pushed back. With growth on a strong footing, another rate hike is now a possibility. On the other hand, weak growth in China has weighed on CNY. We expect some short-term pressure on USD/INR but remain positive on the currency pair in the long-run. A range of 83-84/$ looks reasonable for the next fortnight. Further upside is also possible, given the volatility in global financial markets.

What is driving the rebound in dollar?

DXY, measuring the dollar's value against a basket of currencies, has risen to a more than 2-month high. Inherent strength of the US economy along with the uncertainty over Fed rate hikes has been driving the movement in DXY. Despite a cumulative 525bps increase in policy rate, US economy has remained resilient, indicating that a "soft landing" narrative remains intact. Recent indicators from the US, such as housing starts, retail sales, industrial production and jobless claims, suggest that growth has held ground. Labour market conditions remain tight with unemployment rate still below the pre-pandemic levels. Fed staff projections too do not foresee a recession this year.

Inflation though moderating, remains above Fed's target. Minutes of Fed's last policy meeting show that given the uncertainty around the inflation outlook, rates may have to remain higher for longer. Post the release of Fed minutes, expectations of another 25bps rate hike have risen, which is fueling a rally in dollar. It must be noted that the Fed has been at the forefront of the synchronized global monetary policy tightening cycle being witnessed this year. With US policy rates already at a 22-year peak, and another rate hike expected, the dollar is likely to see further upside.

US treasury yields have also moved up, which is further contributing to the strength in dollar. US 10Y yield rose to its highest level since Dec'07 at 4.27% on 17 Aug 2023. Yields on other tenures have also moved up, drawing the attention of investors. Apart from this, DXY also gained as its appeal as a safe-haven asset has remained intact despite a rating downgrade.

Oil prices on an upward trajectory

Another factor which has been weighing on the domestic currency is a persistent increase in global oil prices. Oil prices and INR are negatively related as higher oil prices imply a higher import bill. This translates into a higher trade deficit. With export growth remaining weak due to global factors, higher oil prices pose a threat to India's external balance, which is also putting depreciating pressure on INR.

BOND YIELDS

18 August 2023

Why Bond yields are inching up

US 10Y yield has risen considerably post the last Fed policy meeting (26 Jul). Though the 25bps rate hike was priced in by the market, what contributed to the bull run of yield has been the strong macro data in the US especially demand driven components. FOMC member's reiteration of an uncomfortably higher and above target inflation and relatively stable growth indicators have further resulted in sell off in the bond market. The last close has been the highest since 8 Nov 2007, amidst expectation that another rate hike by Fed is on the cards. The ripple effect has been felt in case of other AEs such as UK and Germany's 10Y yield.

Dipanwita Mazumdar
Economist

China's 10Y yield on the other hand showed moderation amidst mired growth conditions. On the domestic front, India's 10Y yield have gained considerable momentum post upside surprise in the CPI data. Though sharp volatility towards the long end part of the curve would not be visible, it shouldn't also shy off to touch the 7.3% mark in this month. Short end yields however might witness fair degree of pressure due to RBI's surprise move of imposing incremental CRR on NDTL.

Quite an upsurge in US 10Y yield:

- Since 26 Jul 2023, US 10Y yield has risen from 3.87% to 4.27%, which translates to a sharp 41bps jump. Most of the increase in yield was concentrated in the first fortnight of Aug'23, (23bps increase). Few of the macro data prints such as 1) ADP employment data (324K increase against estimated 190k increase). 2) Buoyant factory order (2.3%, MoM SA increase matching estimates). 3) Average hourly earnings increasing by 0.4% on MoM basis against estimate of 0.3%, posing inflationary concerns. 4) In fact both CPI and PPI data also maintained its same MoM pace in Jul'23. 4) Advance retail sales data also rose more than expected by 0.7% against estimates of 0.4% for Jul'23, on MoM basis. 5) Housing starts, capacity utilization all pointed towards recovery.

- Adding to these were the comments from FOMC participants. Statement such as "further evidence would be required for them to be confident that inflation was clearly on a path toward the Committee's 2 percent objective", buoyant consumer spending on the back of tighter labour market conditions clearly gave hawkish signals to market. Even members have stressed upside risks to inflation might occur due to supply side disruptions and near term risks to lower commodity prices.

- All in all, the minutes could be read out as a restrictive one where focus was on bringing down inflation to the 2% level. Post the release of the minutes, US 10Y yield rose by 4bps.

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CONSUMER STAPLES | Q1FY24 Review | 18 August 2023

Rural growth visibility improves

- **FMCG sector grew 12.2% YoY in Q1 with volumes rising 7.5%; regional competition intensified during the quarter**
- **Urban volumes grew in double-digits; rural consumption continued to rise, growing 4% YoY in Q1**
- **Expect volume growth to improve further in H2FY24; prefer DABUR, NEST, TCPL, ITC and GCPL**

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Volume growth in Q1: As per industry data, the FMCG sector registered 12.2% YoY value growth on the back of 7.5% volume growth in Q1FY24. Urban demand continued to grow ahead of rural markets with volumes rising 10.2%. Rural markets posted positive volume growth for the second straight quarter at 4%. Most FMCG players took price cuts to pass on the benefits of lower input costs and maintain market share. Thus, growth in Q1 was largely driven by volumes – a trend that companies expect will continue. FMCG players also posted robust margin expansion during the quarter despite increased A&P spends.

Increased competition from regional players: Most FMCG companies did see higher competition from regional players in respective categories during Q1 due to price moderation in key commodities. In the wake of competitive headwinds, companies cut prices to protect market share. BRIT's Q1 volume growth was impacted by fierce local competition, though the company expects a rebound in H2FY24. Similarly, HUVR indicated that it seeing a resurgence of small and regional players, which could explain its market share loss in select categories.

Rural markets see volume pickup: Rural markets grew during the quarter but continued to show a decline (of 4%) on a two-year CAGR basis. Elements behind the ongoing recovery include moderating inflation, increased rural expenditure and higher government capex. DABUR's strong rural penetration supported higher volume growth as the company benefited from the revival in rural markets.

Outlook upbeat: We expect consumer players to sustain their growth trajectory in H2FY24 despite increased competition. Demand continues to improve with easing inflation aiding sustained volume growth in rural markets. Consumer staples players have started cutting prices in the wake of softening input costs, which will encourage volume growth with a lag of a couple of quarters. We expect companies with a strong product slate, large rural presence, robust pipeline, and localised marketing strategies to continue to grow and gain market share in their respective categories. Post earnings, we believe DABUR, NEST, TCPL, ITC and GCPL are well placed.

Recommendation snapshot

Ticker	Price	Target	Rating
BRIT IN	4,502	5,844	BUY
DABUR IN	561	669	BUY
GCPL IN	1,025	1,159	BUY
HUVR IN	2,543	3,069	BUY
ITC IN	441	523	BUY
MRCO IN	558	646	BUY
NEST IN	21,668	26,430	BUY
TATACONS IN	844	994	BUY
ZYWL IN	1,529	1,556	HOLD

Price & Target in Rupees | Price as of 17 Aug 2023

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CONSUMER DURABLES | Q1FY24 Review | 18 August 2023

EMS, wires and cables segments shine

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- Input cost eased but higher A&P spends prevented gross margin expansion from percolating to EBITDA margins
- Upcoming festive season could lend a fillip to demand; HAVL and SYRMA are our preferred names

Vinod Chari | Swati Jhunjhunwala
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C&W, EMS businesses shine: Though our consumer durables coverage grew 16.5% YoY on average in Q1FY24, a bulk of the upside came from players in the cables & wires (C&W: +27% YoY) and electronics manufacturing services (EMS: +21% YoY) businesses. If we were to exclude AMBER which declined 7%, our EMS coverage grew 34% YoY on average.

Lower raw material costs negated by A&P spends: Players did not take major price hikes during Q1. Also, though raw material costs moderated, A&P spends normalised at higher levels. Thus, aggregate gross margin expansion of ~100bps YoY was offset by higher other expenses and A&P spends, translating to EBITDA margin expansion of just ~40bps.

Headwinds across product lines: Sales of summer products such as air conditioners were dampened by unseasonal rain even as competition remained intense. In fans, the energy rating change implemented last quarter led to higher channel inventory that dampened sale volumes while price discounts weighed on margins. Lighting products saw volume growth but significant price erosion to the tune of 20% mainly due to pass-along of lower raw material cost. Kitchen appliances exhibited slow demand trends and sedate margins for players such as CROMPTON.

EMS and C&W bright spots: In addition to healthy order books, our EMS coverage added new clients and incurred capex to cater to future demand, reflecting demand traction. C&W players showed continued resilience.

Upcoming festive season could trigger demand: Players engaged in the C&W and EMS industries maintained an upbeat growth outlook, whereas other consumer durable players are now pinning their hopes of demand recovery on the upcoming festive season in October-November.

Top picks: Our preferred names are HAVL (BUY, TP Rs 1,600) for overall demand recovery and SYRMA (BUY, TP Rs 600) in the EMS subsegment.

Recommendation snapshot

Ticker	Price	Target	Rating
AMBER IN	2,837	2,500	HOLD
BLSTR IN	744	880	BUY
CROMPTON IN	290	360	BUY
DIXON IN	4,683	4,300	HOLD
HAVL IN	1,296	1,600	BUY
KEII IN	2,415	2,300	HOLD
ORIENTEL IN	239	250	HOLD
SYRMA IN	462	600	BUY
VGRD IN	312	290	HOLD
VOLT IN	826	910	HOLD

Price & Target in Rupees | Price as of 17 Aug 2023

Consumer durables: Result reviews

Company	Result review links (Apr-Jun'23)
AMBER IN	Topline wavers, margins progressing
BLSTR IN	In-line numbers, steady growth ahead
CROMPTON IN	Mixed quarter
DIXON IN	Good quarter; cut to HOLD on limited upside
HAVL IN	Margins falter
KEII IN	Capacity constraints mar quarter; lower to HOLD post runup
ORIENTEL IN	Reasonably healthy quarter
POLYCAB IN	Strong momentum continues
SYRMA IN	Margin miss an aberration; guidance intact
VGRD IN	Strong quarter all through
VOLT IN	UCP growth above industry, EMP losses continue

Source: BOBCAPS Research

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CAPITAL GOODS | Q1FY24 Review | 18 August 2023

Robust execution continues

- **Our capital goods coverage grew 30% YoY in Q1 on strong execution (+20% ex-LT); EBITDA margin stayed flat (+260bps ex-LT)**
- **Order inflows swelled 40% YoY (flat ex-LT); FY24 outlook upbeat with structural tailwinds from rail, power and digitalisation segments**
- **We continue to prefer LT, KKC and AIAE in the sector**

Vinod Chari | Swati Jhunjhunwala
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Growth momentum robust: Capital goods players under our coverage displayed impressive project execution in Q1FY24, which underpinned revenue growth of 30% YoY (20% ex-LT). Aggregate order inflow surged 40% YoY, albeit propelled mainly by LT which attracted flows of Rs 655bn (+57% YoY). Excluding LT, order inflow for the rest of our coverage was flat.

Margins buoyant: Our capital goods universe demonstrated operating leverage on the back of improved project execution. Ex-EPC (engineering, procurement, and construction) players, gross margin expanded by 83bps YoY in Q1. The aggregate EBITDA margin was flat YoY while the ex-EPC margin increased 260bps YoY.

Strong FY24 outlook: Most management commentaries pointed to a strong ordering environment for capital goods companies. LT has retained its guidance of revenue and order inflow growth of 12-15% YoY and 10-12% YoY respectively for FY24 despite it being the run-up to election year. In fact, LT's addressable pipeline has swelled 34% YoY to Rs 10tn, above the prospective level of Rs 9.7tn at end-FY23, driven by demand for hydrocarbons. Similarly, other players such as KECI and AIAE retained the FY24 guidance given at the beginning of the fiscal. TMX too indicated a much stronger-than-usual pipeline.

New emission norms deferred: From KKC's perspective, the government recently extended implementation of the new CPCB-IV emission norms for power generation engines by a year to Jun'24. Thus, for this duration, both existing CPCB-II and newer CPCB-IV products can simultaneously be sold by KKC.

Retain positive sector stance: The capital goods sector has strong growth visibility considering the government's capex thrust and carries scope for gradual margin improvement as supply bottlenecks ease. We anticipate structural demand tailwinds in the areas of automation, digitalisation and electrification, and retain our bullish view on key players LT (BUY, TP Rs 3,000), KKC (BUY, TP Rs 2,110), and AIAE (BUY, TP Rs 4,000).

Recommendation snapshot

Ticker	Price	Target	Rating
ABB IN	4,314	4,400	HOLD
AIAE IN	3,534	4,000	BUY
KECI IN	638	630	HOLD
KKC IN	1,744	2,110	BUY
LT IN	2,653	3,000	BUY
POWERIND IN	4,328	4,400	HOLD
SIEM IN	3,576	3,900	HOLD
TMX IN	2,579	2,600	HOLD

Price & Target in Rupees | Price as of 17 Aug 2023

Capital goods: Result reviews

Company	Result review link (Apr-Jun'23)
ABB IN	Strong quarter, margins shine
AIAE IN	Strong quarter, guidance maintained.
KECI IN	Healthy inflows, margin improvement ahead
KKC IN	Strong quarter; primed for rating transition
LT IN	Stellar quarter; solid outlook
POWERIND IN	Supply side constraints persist; cut to HOLD
SIEM IN	All-round growth; clarity awaited on LV motors hive-off
TMX IN	Good quarter, healthy order flows

Source: BOBCAPS Research

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PHARMACEUTICALS

18 August 2023

Chronic therapies continue strong streak

- **IPM saw subdued 6% YoY growth in July as sluggish demand for acute therapies (+4%) offset stronger chronic revenue (+10%)**
- **Growth on MAT basis robust at 11% with price hikes contributing 5% and both chronic and acute therapies faring well**
- **ERIS and AJP are our top picks in the sector**

Saad Shaikh
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IPM Jul'23 growth subdued; MAT growth strong: The Indian pharma market (IPM) grew just 6% YoY in Jul'23, similar to the 5% seen in June. Chronic therapies grew handsomely at 10% YoY but acute therapies fared poorly, rising just 4% as delayed onset of the monsoon led to lower sales of anti-infective/respiratory therapies. Other acute segments such as gastrointestinal, pain, and vitamins, minerals & nutrients (VMN) were also weak. On MAT basis, IPM reported a strong 10.5% uptick in July (3Y CAGR 11.4%), with 5% contributed by price increases, 3% by volume growth and 3% by new introductions. Chronic/acute therapies grew 11%/10% on MAT basis.

Chronic sales outpace acute therapies for third straight month: The underperformance in acute therapies for the month was led by the anti-infective (-5% YoY) and respiratory therapies (-7%), while other categories grew in mid-single-digits. The chronic segment was bolstered by 11% YoY growth in cardiac therapy, whereas other therapies saw mid-to-high single-digit growth.

AJP leads growth on monthly, 3M and MAT basis: From among the top 10 companies by market share, Intas (+11% YoY) posted the highest revenue growth in July, followed by Macleods (+9%). On MAT basis, Intas (+15%) and Macleods (+15%) were the fastest growing. From our coverage, AJP (+12%) and ERIS (+10%) were in the lead for the month, while a MAT tally reveals AJP (+15%), ALKEM (+14%) and CIPLA (+12%) as leaders. ALPM (flat YoY), ALKEM (+2%) and DRRD (+3%) were laggards on a monthly basis while DRRD (+7%) and LPC (+8%) underperformed in MAT terms from among our coverage universe.

Top picks: ERIS (BUY, TP Rs 955) and AJP (BUY, TP Rs 1, 860) are our top picks in the pharma sector.

Recommendation snapshot

Ticker	Price	Target	Rating
AJP IN	1,770	1,860	BUY
ALKEM IN	3,801	3,300	SELL
ARBP IN	858	880	HOLD
DIVI IN	3,655	3,200	HOLD
ERIS IN	830	955	BUY
GLS IN	631	620	HOLD
LAURUS IN	381	340	HOLD
LPC IN	1,068	800	SELL
SUNP IN	1,135	1,160	HOLD

Price & Target in Rupees | Price as of 18 Aug 2023

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BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

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