FIRST LIGHT

23 January 2023

RESEARCH

INDIA STRATEGY | FY24 BUDGET PREVIEW
Trade-off between capex and consolidation

HDFC LIFE | TARGET: Rs 741 | +25% | BUY
Strong growth momentum; maintain BUY

POLYCAB INDIA | TARGET: Rs 3,300 | +20% | BUY
Buoyant quarter

360 ONE | TARGET: Rs 2,365 | +23% | BUY
Resilient model; high ROE - maintain BUY

OIL & GAS
Expert call - Morbi gas volumes under pressure near-term

Daily macro indicators

Indicator	18-Jan	19-Jan	Chg (%)
US 10Y yield (%)	3.37	3.39	2bps
India 10Y yield (%)	7.32	7.31	(1bps)
USD/INR	81.25	81.36	(0.1)
Brent Crude (US$/bbl)	85.0	86.2	1.4
Dow	33,297	33,045	(0.8)
Hang Seng	21,678	21,651	(0.1)
Sensex	61,046	60,858	(0.3)
India FII (US$ mn)	**17-Jan**	**18-Jan**	**Chg ($ mn)**
FII-D	17.4	15.4	(1.9)
FII-E	166.2	6.7	(159.5)

Source: Bank of Baroda Economics Research

SUMMARY

INDIA STRATEGY | FY24 BUDGET PREVIEW

- Fiscal normalisation post Covid expected to remain a core theme of the FY24 budget; fiscal glide path likely to be maintained
- Budget could stay geared towards improving living standards of the poor while continuing to build necessary infrastructure
- In line with past trends, we do not expect the budget to spark a significant move in the stock market

Click here **for the full report.**

HDFC LIFE

- Robust momentum in gross premium to Rs 146bn in Q3; NBP market share climbs to 20.9%
- Exide Life merger guided to be VNB margin-neutral on full-year basis; we expect 28% margins through to FY25
- We raise estimates for the merged entity and increase our TP to Rs 741 (vs. Rs 691), based on 2.9x FY25E P/EV; retain BUY

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POLYCAB INDIA

- Upbeat performance in wires & cables aided Q3 topline growth of 10% YoY despite a higher base
- FMEG remains a laggard with operational losses; management maintained long-term (FY26) margin forecast at 10%
- FY23/FY24 EPS revised by +6%/-5%; on rollover, our TP remains unchanged at Rs 3,300 – retain BUY

Click here for the full report.

360 ONE

- ROAE up 160bps YoY and 60bps QoQ to 23.5% in Q3, showing a consistent expansion trend
- Business model resilient with a focus on recurring revenue streams; overall ARR flows strong, including alternatives
- Maintain BUY with a revised TP of Rs 2,365 (vs Rs 2,206) as we roll valuations forward

Click here for the full report.

OIL & GAS

- Morbi gas demand under pressure due to significant drop in ceramic manufacturing plant utilisations and initiation of price cuts
- Ceramics market recovering but remain sub-par, branded players to clock double digit growth in FY23; near-term decline in margin likely
- While medium-term outlook is healthy for gas demand from Morbi on export competitiveness, propane price to now act as a cap

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FY24 BUDGET PREVIEW

20 January 2023

Trade-off between capex and consolidation

- **Fiscal normalisation post Covid expected to remain a core theme of the FY24 budget; fiscal glide path likely to be maintained**
- **Budget could stay geared towards improving living standards of the poor while continuing to build necessary infrastructure**
- **In line with past trends, we do not expect the budget to spark a significant move in the stock market**

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Trade-off between capex and consolidation: The government has reiterated its commitment to India's fiscal glide path which targets a 4.5% fiscal deficit by FY26. We thus expect a lower figure in the FY24 budget estimate (BE) vs. the 6.4% deficit in FY23BE. Additionally, for India to become a US$ 5tn+ economy from the current ~US$ 3tn, continued momentum in the investment cycle is vital. Therefore, we believe the capex support seen in the past two budgets will continue.

The FY23BE of Rs 7.5tn capex is likely to be met and should see a bump up of 10-15% to Rs 8.5tn-9tn in FY24BE, with outlays in the usual sectors of roads, highways, defence and railways. We believe the production-linked incentive (PLI) scheme could be extended to newer sectors, while affordable housing would also stay in focus.

Subsidy burden likely to lighten…: Given moderating commodity prices, we expect the subsidy burden to be lower than last year. Revenue growth in FY23 is likely to beat nominal GDP growth on greater tax compliance. Note, food subsidy in FY23BE was Rs 2.9tn, including Rs 1.5tn for free food. We expect the food subsidy as a percentage of GDP to be lower in the FY24 budget with no expansion in scope envisaged. Similarly, fertiliser subsidy which overshot FY23BE of Rs 1.1tn to more than Rs 2tn is expected to moderate. These savings offer leeway for higher capex as well as better rural outlay without unduly upsetting the fiscal math.

…while rural India gets a pre-election boost: Being the penultimate year before general elections, we expect measures to boost agriculture, rural infrastructure and rural income through transfer schemes such as MNREGA which can see higher allocation.

Ease of living another focus area: We believe the government's thrust on ease of living will continue. This will include investments to improve potable water supply, health infrastructure and urban transportation infrastructure.

Market factoring in a balanced budget: Market swings over the fortnight spanning the pre- and post-budget weeks haven't exceeded 3% in the past 11 years (barring 4). We believe the market is already factoring in a balance between a pro-capex and pro-welfare budget, though individual sectors may see higher swings.

Returns 1W pre- to 1W post-budget date

Budget date	Nifty50 returns (%)	S&P500 returns (%)
1-Feb-22	1.70	4.50
01-Feb-21	6.85	3.63
01-Feb-20	(0.17)	2.59
05-Jul-19	(2.38)	1.20
01-Feb-19	3.83	2.35
01-Feb-18	(5.87)	(6.02)
01-Feb-17	1.47	(0.16)
29-Feb-16	5.29	4.10
28-Feb-15	2.09	(0.41)
10-Jul-14	(1.64)	(0.42)
17-Feb-14	1.53	0.91
28-Feb-13	(0.54)	1.71
16-Mar-12	(2.45)	1.58
28-Feb-11	1.27	0.43

Source: Bloomberg, BOBCAPS Research

RESULT REVIEW

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BUY
TP: Rs 741 | ⮝ 25%

HDFC LIFE | Insurance | 20 January 2023

Strong growth momentum; maintain BUY

- **Robust momentum in gross premium to Rs 146bn in Q3; NBP market share climbs to 20.9%**
- **Exide Life merger guided to be VNB margin-neutral on full-year basis; we expect 28% margins through to FY25**
- **We raise estimates for the merged entity and increase our TP to Rs 741 (vs. Rs 691), based on 2.9x FY25E P/EV; retain BUY**

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Strong quarter: At end-Q3FY23, HDFC Life's gross premium post-merger with Exide Life stood at Rs 146bn (Rs 379bn at end-9MFY23). The combined entity will benefit from Exide Life's branches in tier-2 and tier-3 cities of the southern region. Although there may be short-term costs, the long-term benefits of this merger look significant. We, therefore, raise our gross premium estimates by 1-2% over FY23-FY25. Combined EV stood at Rs 377bn as at end-9MFY23 and we expect a 17% CAGR over FY22-FY25 to Rs 549bn (vs. Rs 483bn projected earlier).

Balanced product mix: HDFC Life is focused on a balanced product mix with par/non-par savings forming 25%/33% of APE (merged entity), ULIP/protection at 18%/15% and annuity/group products at 8%/2% as at end-9MFY23. Although the company acknowledges weakness in retail protection (also an industry phenomenon), growth in its group credit life and annuity business has moved up.

VNB margins high: At end-9MFY23, VNB stood at Rs 21.6bn with a margin of 26.5%. Management believes the merger would be margin-neutral on a full-year basis. We now factor in a 19% CAGR in VNB over FY22-FY25 to Rs 45bn (Rs 41bn earlier), with margins of ~28% over our forecast period although FY23 may see some shortfall. The opex ratio remained high at 14.5% in Q3 and commission ratio stood at 4.8%.

Agency channel gains momentum: Based on individual APE, the agency channel had an 18% share in distribution whereas the direct channel looked low at 15%. Bancassurance share at 59% was stable with non-HDFC Bank partners generating strong business. The partnership with AU Small Finance Bank is also aimed at fortifying the bancassurance channel.

Retain BUY: HDFC Life is trading at 2.3x FY25E P/EV. We remain positive on the company owing to market share gains, high persistency ratios, and its positioning as a top-3 life insurer. Based on our revised estimates and rollover of valuations to FY25E, we have a new TP of Rs 741 (vs. Rs 691). Our target multiple at 2.9x P/EV (average of -1SD and -2SD) considers the growth prospects of the combined entity partially offset by the parent's impending merger with HDFC Bank. BUY.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	HDFCLIFE IN/Rs 591
Market cap	US$ 15.6bn
Free float	48%
3M ADV	US$ 23.4mn
52wk high/low	Rs 647/Rs 497
Promoter/FPI/DII	52%/26%/8%

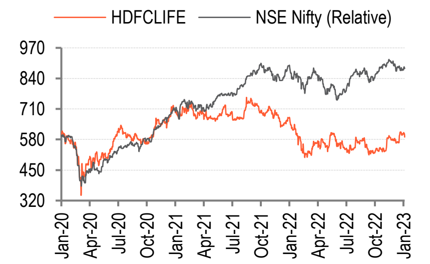
Source: NSE | Price as of 20 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
NBP (Rs mn)	2,41,548	2,74,798	3,16,670
APE (Rs mn)	97,580	1,19,601	1,37,709
VNB (Rs mn)	26,737	32,232	39,171
Embedded Value (Rs mn)	3,00,470	4,02,682	4,69,632
VNB margin (%)	27.4	26.9	28.4
EVPS (Rs)	146.8	187.3	218.5
EPS (Rs)	5.9	5.9	6.6
Consensus EPS (Rs)	5.9	7.7	9.7
P/EV (x)	4.0	3.2	2.7

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

BUY
TP: Rs 3,300 | ⮝ 20%

POLYCAB INDIA | Consumer Durables | 20 January 2023

Buoyant quarter

- **Upbeat performance in wires & cables aided Q3 topline growth of 10% YoY despite a higher base**
- **FMEG remains a laggard with operational losses; management maintained long-term (FY26) margin forecast at 10%**
- **FY23/FY24 EPS revised by +6%/-5%; on rollover, our TP remains unchanged at Rs 3,300 – retain BUY**

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Resilient performance: Polycab's Q3FY23 results beat our estimates on all fronts led by an upbeat performance in the wires and cables (W&C) division. The company's topline grew 10% YoY to Rs 37.2bn (Rs 36bn est.), clocking a 3Y CAGR of 14.1%, amidst recent commodity deflation and a higher base. EBITDA margin improved to 13.6% (+280bps YoY) on stronger operating leverage, and adj. PAT rose 46% YoY to Rs 3.6bn (Rs 2.9bn est.) on a lower base and buoyant sales.

W&C strong but FMEG muted: The robust demand environment aided highest ever quarterly volumes for the W&C business, taking segmental revenue up 11% YoY to Rs 33.4bn. EBIT margin expanded to 13.7% (2Y high) on a better product mix and judicious price revisions. In contrast, weak consumer demand and a thrust on market share gains weighed on the fast-moving electric goods (FMEG) business, which saw flat YoY sales and EBIT losses. With FMEG distribution alignment being completed by FY23-end, we expect margins to turn positive from FY24 onwards.

Fans grow amid rating transition: Restocking at the distributor level ahead of new BEE rating norms has boosted the fans vertical. Demand has risen for lower variants (destocking in premium products), which benefited Polycab. While prices were cut in Q3, management sees scope for hikes once BEE norms are implemented in Q4FY23.

Margin uptrend continues: Better operating leverage in W&C and healthy pricing action took EBITDA margin 180bps ahead of our estimate to 13.6% (+70bps QoQ), amid inflationary pressures and higher A&P spends. We believe Polycab is leveraging its improving margin trend to aggressively chase market share in the FEMG business.

Maintain BUY: Weakness in the FMEG business and a volatile commodity environment remain challenges in the near term, but a resilient performance in W&C is auguring well for the company. We remain positive on Polycab given its leadership position in the core W&C business and a growing FMEG segment that has structural growth opportunities from infrastructure development. We alter our FY23/FY24 EPS estimates by +6%/-5% to bake in the Q3 print. On rolling valuations over to Dec'24E, our TP remains at Rs 3,300, based on an unchanged 35x P/E. BUY.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	POLYCAB IN/Rs 2,761
Market cap	US$ 5.1bn
Free float	34%
3M ADV	US$ 13.7mn
52wk high/low	Rs 3,025/Rs 2,044
Promoter/FPI/DII	67%/8%/9%

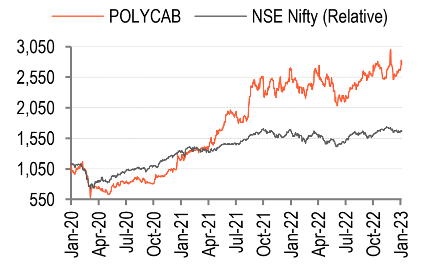
Source: NSE | Price as of 20 Jan 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	122,038	138,722	156,626
EBITDA (Rs mn)	12,652	17,919	19,156
Adj. net profit (Rs mn)	8,365	12,161	12,849
Adj. EPS (Rs)	55.9	81.3	85.9
Consensus EPS (Rs)	55.9	73.1	86.0
Adj. ROAE (%)	16.2	20.1	18.1
Adj. P/E (x)	49.4	34.0	32.2
EV/EBITDA (x)	32.7	23.1	21.6
Adj. EPS growth (%)	(0.2)	45.4	5.7

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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BUY
TP: Rs 2,365 | 23%

360 ONE | Diversified Financials | 20 January 2023

Resilient model; high ROE – maintain BUY

- **ROAE up 160bps YoY and 60bps QoQ to 23.5% in Q3, showing a consistent expansion trend**
- **Business model resilient with a focus on recurring revenue streams; overall ARR flows strong, including alternatives**
- **Maintain BUY with a revised TP of Rs 2,365 (vs Rs 2,206) as we roll valuations forward**

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Return ratios expand: 360 One's (formerly IIFL Wealth) ROAE stood at 23.5% in Q3FY23, rising 160bps YoY and 60bps QoQ. We observe consistent expansion in return ratios over the long term as well (from 11% in Q1FY21). The company declared an interim dividend of Rs 17 for the quarter, in line with its policy of distributing 70-80% of profits to shareholders. Net profit rose 16% YoY and 4% QoQ to Rs 1.8bn, beating our estimate by 4%. The cost-to-income (C/I) ratio declined to 45.5% vs. 52.9% in Q3FY22 but increased 120bps sequentially due to technology and rebranding charges.

Resilient model: With a diversified product suite, 360 One remains fairly insulated against adverse changes in the macro environment. The company generated Rs 60bn of net flows (ex-custody) in Q3. Notably, among these, AIF net flows at Rs 20bn were the highest in the last seven quarters. Within the wealth segment, ARR net flows of Rs 78bn soared 98% YoY and 8% QoQ. However, we saw net outflows of Rs 44bn on the transactional side, with some movement to the ARR bucket. AUM grew 5% YoY (vs. 9% expected) and operating revenue rose 10% YoY (8% QoQ).

AUM and net profit expected to clock 17% CAGR: Based on the Q3 performance, we now factor in a 17% CAGR in AUM over FY22-FY25 to Rs 4.2tn from Rs 4.4tn earlier. Owing to the sturdy business model, the negative macro environment is unlikely to have a major impact on profitability as (a) flows into IIFL One remain strong given that large clients favour the advisory model over distribution, (b) the NBFC business earns robust margins, and (c) traction in AMC business continues. Our net profit CAGR stands revised to 17% over FY22-FY25 to Rs 9.3bn (vs. Rs 9.4bn earlier). We expect ~29% ROAE and ~7% ROAA by FY25.

Maintain BUY: The stock is trading at 19x FY25E EPS and appears undervalued, in our view. Following our estimate revisions and rollover to FY25E valuations, we have a new TP of Rs 2,365 (vs. Rs 2,206), valuing the stock at 23x FY25E P/E multiple – in line with the 3Y average given a robust model and strong fundamentals. BUY.

Key changes

Target	Rating
▲	◄ ►

Ticker/Price	IIFLWAM IN/Rs 1,922
Market cap	US$ 2.1bn
Free float	78%
3M ADV	US$ 2.9mn
52wk high/low	Rs 1,950/Rs 1,236
Promoter/FPI/DII	22%/23%/2%

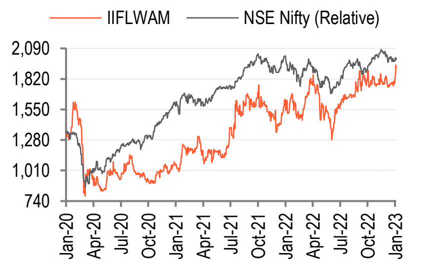
Source: NSE | Price as of 20 Jan 2023

Key financials

Y/E 31 Mar (Rs mn)	FY22A	FY23E	FY24E
PBT (Rs mn)	7,513	9,019	10,633
PBT growth (%)	54.9	20.0	17.9
Adj. net profit (Rs mn)	5,818	6,854	8,081
EPS (Rs)	64.1	75.6	89.2
Consensus EPS (Rs)	64.1	78.4	91.1
P/E (x)	30.0	25.4	21.6
MCap/AUM (%)	0.0	0.0	0.0
ROE (%)	20.0	22.6	25.9

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

20 January 2023

Expert call: Morbi gas volumes under pressure near-term

- **Morbi gas demand under pressure due to significant drop in ceramic manufacturing plant utilisations and initiation of price cuts**
- **Ceramics market recovering but remain sub-par, branded players to clock double digit growth in FY23; near-term decline in margin likely**
- **While medium-term outlook is healthy for gas demand from Morbi on export competitiveness, propane price to now act as a cap**

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We interacted with Tapan Jena, founder of SANVT Ceramics, to gain a perspective on the ceramic industry and natural gas outlook in Morbi. Key takeaways:

Morbi natural gas demand under pressure near-term: Despite natural gas now at parity with propane, demand is under pressure due to stress in the ceramic industry at Morbi. Utilisation has dropped below 70% with ~300 units shut, and another 60-100 units operating in start-stop mode out of a total of 900 units. Recovery in ceramics production may take another 4-5 months, and will require uptick in ceramics demand and stabilisation of prices after recent 5% cut.

Medium-term outlook healthy for Morbi natural gas demand: Export is now recovering gradually with Rs15bn monthly run-rate over past two months. Exports could double over next three years to Rs30bn. Note, Morbi has bounced back several times in past from difficult market conditions driving innovation in business.

Propane price to act as a cap: ~40% of units including large ones now have propane switching ability. Therefore, propane price will likely act as a cap for natural gas prices. That said, propane switching capacity build-out is largely over.

Ceramics market recovering: Domestic market is also recovering gradually, though growth remains sub-par. Branded players/ organised market will clock higher growth but will likely fall short of their initial targets.

Morbi players have initiated price cuts: Over past two weeks, Morbi based producers have initiated average price cut of 5%, largely in line with reduction in gas prices. While price cut is less than 5% on commodity products, it exceeds 5% on premium products. Branded players/ organised markets will have to follow through on these cuts to keep their premium over Morbi producers in a desirable range.

Branded players at near-term advantage: With Morbi players under pressure from dealers on pricing and inventory clearance, Branded players hold advantage near-term.

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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

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