FIRST LIGHT

02 November 2022

RESEARCH

SUN PHARMA | TARGET: Rs 1,100 | +6% | HOLD

Strong Q2 but valuations full – cut to HOLD

BOB ECONOMICS RESEARCH | CURRENCY OUTLOOK

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Fortnightly review

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Sectoral deployment of credit

BOB ECONOMICS RESEARCH | INTEREST RATES

Pace of deposit and lending rates in H1FY23

TATA STEEL | TARGET: Rs 125 | +24% | BUY

Integrated Indian operations to weather downturn

CONSUMER DURABLES

Gujarat electronics policy to boost localisation of appliances

Daily macro indicators

Indicator	28-Oct	31-Oct	Chg (%)
US 10Y yield (%)	4.01	4.05	4bps
India 10Y yield (%)	7.42	7.45	3bps
USD/INR	82.47	82.79	(0.4)
Brent Crude (US$/bbl)	95.8	94.8	(1.0)
Dow	32,862	32,733	(0.4)
Hang Seng	14,863	14,687	(1.2)
Sensex	59,960	60,747	1.3
India FII (US$ mn)	**27-Oct**	**28-Oct**	**Chg ($ mn)**
FII-D	45.9	(240.8)	(286.7)
FII-E	424.7	191.5	(233.2)

Source: Bank of Baroda Economics Research

SUMMARY

SUN PHARMA

- Brisk Q2 revenue growth at 14% YoY to Rs 110bn backed by ramp-up in global specialty business and healthy India/EM sales
- EBITDA margin up 375bps QoQ (110bps YoY) on a higher share of specialty products in the mix
- Valuations full post ~20% rally in the last 2M; downgrade from BUY to HOLD with TP unchanged at Rs 1,100

Click here **for the full report.**

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INDIA ECONOMICS: CURRENCY OUTLOOK

INR depreciated by 0.5% in the last fortnight even as DXY retreated from a 20-year high. While expectations of a likely slowdown in pace of Fed rate hikes drove DXY lower, slowdown in pace of FPI flows and dwindling macro fundamentals drove INR lower. Fed decision and commentary will determine the trajectory of the dollar, which in turn will determine the movement in INR. In the absence of any shocks, we expect INR to trade in the range of 82.5-82.95/$ in the near-term.

Click here for the full report.

INDIA ECONOMICS: BONDS WRAP

Global bond market was in a trap trying to untangle growth-inflation dynamics. High frequency indicators in the US and Eurozone reflected slowdown in growth; while inflation worries were aggravated. In the Eurozone inflation again reached a new high. Among the most notable yield movement has been the complete reversal of direction in UK's 10Y yield which fell by 58bps in Oct'22 against 129bps increase seen in Sep'22. This was supported by growing sentiments over fiscal credibility under the newly elected PM. US Fed in its upcoming policy is expected to go for a 75bps hike, yet some slowdown with regard to future pace of rate hike is expected, as impact of frontloading on macro data points are already visible.

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INDIA ECONOMICS: CREDIT TRENDS

RBI has recently released its data on sector-wise credit growth till Sep'22. Data indicates that despite increase in lending rates (owing to RBI's rate hikes), credit growth remains robust. In YoY terms, it is higher even than pre-pandemic times (Sep'19), supported by higher non-food credit demand. Within this, credit to industry and services has picked up the most. Going forward, we expect credit demand to remain steady even as RBI continues to hike rates. While personal loan and services sector will be supported by pent-up consumption demand, credit to industry will be buoyed by improvement in investment climate.

Click here for the full report.

INDIA ECONOMICS: INTEREST RATES

In the given landscape, the Central Bank has been on policy tightening spree with liquidity crunched up. The lending rates have risen making the borrowing costlier. Deposit rates though lagging are quickly catching up with higher rates as banks revamp the rates further. The note examines the changes in the deposit and lending rates over the last 6-months.

Click here for the full report.

TATA STEEL

- Weak Q2 results as cost adjustments lagged prices; European operations saw a sharper pullback from a stronger Q1
- We cut FY23/FY24 EBITDA by 31%/10% factoring in margin uncertainty in Europe and slower recovery in India operations
- TP lowered to Rs 125 (vs. Rs 140); maintain BUY as we expect TATA to weather the downturn and deliver on earnings-accretive growth

Click here for the full report.

CONSUMER DURABLES

- New Gujarat electronics policy aims to build an ecosystem for electronics manufacturing in India and enable import substitution
- Ceiling for capital support extended to Rs 2bn for investments below Rs 10bn; logistics incentives added with one-time relocation cost
- Policy will support local ESDM players and aid domestic manufacturing of various consumer appliances; prefer DIXON (TP Rs 5,200)

Click here for the full report.

RESULT REVIEW

HOLD

TP: Rs 1,100 | 6%

SUN PHARMA | Pharmaceuticals | 01 November 2022

Strong Q2 but valuations full – cut to HOLD

- **Brisk Q2 revenue growth at 14% YoY to Rs 110bn backed by ramp-up in global specialty business and healthy India/EM sales**
- **EBITDA margin up 375bps QoQ (110bps YoY) on a higher share of specialty products in the mix**
- **Valuations full post ~20% rally in the last 2M; downgrade from BUY to HOLD with TP unchanged at Rs 1,100**

Saad Shaikh
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Global specialty ramp-up remains key driver: SUNP reported strong 14% YoY growth in Q2FY23 revenue to Rs 110bn as the global specialty business clocked a 28% YoY (+5% QoQ) increase to US$ 201mn on the back of Ilumya, Cequa and Winlevi sales. Overall US revenue declined 2% QoQ to US$ 412mn.

India and EM sales healthy; currency volatility hits ROW: Product launches coupled with market share gains in existing products helped India business grow 8.5% YoY (+2% QoQ). SUNP did not record any revenue from Covid products in Q2FY23; adjusting for base-quarter Covid sales, India growth was at 10.9% YoY. Emerging markets grew 15% YoY (+10% QoQ), whereas currency volatility in ROW markets held growth back at a mere 4% YoY (-2% QoQ).

Better mix improves margins; R&D spend to accelerate: Robust growth in the specialty business coupled with likely inflow of production-linked incentives drove EBITDA margin gains of 375bps QoQ (110bps YoY) to 29.2%. Management has guided for acceleration in R&D activity but maintained guidance on spends at 6-8% of sales.

Earnings call highlights: (1) India salesforce expansion completed. (2) Momentum in Ilumya to continue. Psoriatic arthritis market smaller than psoriasis market for new indications. (3) Received PLI benefit in Q2. (4) Absolute increase in staff cost and other expenses on account of India salesforce expansion, Alchemy integration and higher selling & distribution expenses. (5) Total of 92 ANDAs (abbreviated new drug applications) and 13 NDAs (new drug applications) pending. (6) Forex loss in Q2FY23 was Rs. 2.4bn (vs. loss of Rs 764 in Q2FY22).

Downgrade to HOLD: The stock has rallied 20% over the past two months and is currently trading at valuations of 19.2x/17.6x FY23E/FY24E EV/EBITDA, which appear full. We retain our TP of Rs 1,100 based on an unchanged 18.5x FY24E EV/EBITDA multiple – a premium to the stock's 5Y average of 17.5x. This offers just 6% upside potential and hence we downgrade our rating from BUY to HOLD.

Key changes

Target	Rating
◀ ▶	▼

Ticker/Price	SUNP IN/Rs 1,037
Market cap	US$ 30.1bn
Free float	45%
3M ADV	US$ 32.4mn
52wk high/low	Rs 1,049/Rs 734
Promoter/FPI/DII	54%/12%/22%

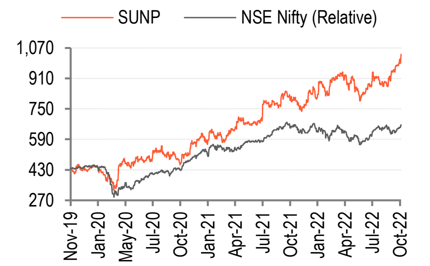
Source: NSE | Price as of 1 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	3,84,265	4,36,221	4,81,978
EBITDA (Rs mn)	1,02,395	1,22,169	1,31,628
Adj. net profit (Rs mn)	76,855	91,531	1,02,652
Adj. EPS (Rs)	32.0	38.2	42.8
Consensus EPS (Rs)	32.0	34.5	40.4
Adj. ROAE (%)	15.3	16.6	16.2
Adj. P/E (x)	32.4	27.2	24.2
EV/EBITDA (x)	23.2	19.2	17.4
Adj. EPS growth (%)	6.6	19.1	12.1

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

CURRENCY OUTLOOK

01 November 2022

Focus on Fed

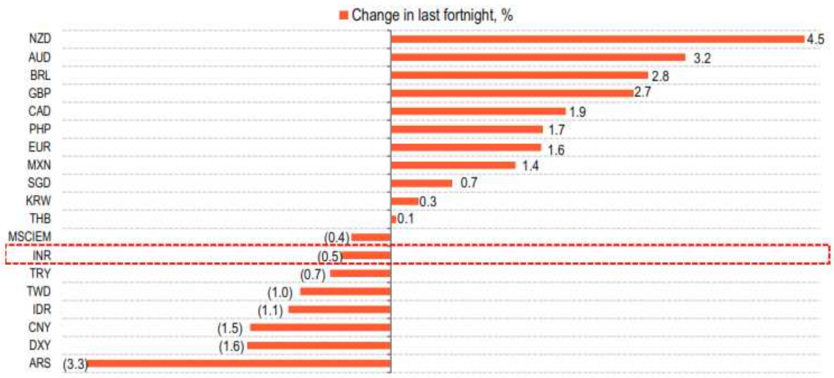
Aditi Gupta
Economist

INR depreciated by 0.5% in the last fortnight even as DXY retreated from a 20-year high. While expectations of a likely slowdown in pace of Fed rate hikes drove DXY lower, slowdown in pace of FPI flows and dwindling macro fundamentals drove INR lower. Fed decision and commentary will determine the trajectory of the dollar, which in turn will determine the movement in INR. In the absence of any shocks, we expect INR to trade in the range of 82.5-82.95/$ in the near-term.

Currency movement in the last fortnight

DXY index retreated in the last fortnight as concerns over growth buoyed expectations that the Fed may pivot from its rate hike path. Stress in the housing segment as well as weakness in consumer spending do not bode well for the economic outlook. As a result, while a 75 bps rate hike is imminent this week, investors have now pared back expectations of future rate hikes, with many analysts now expecting only a 50bps rate hike in Dec'22.

Figure 2: Global currencies depreciated in Sep'22



Source: Bloomberg, Bank of Baroda | Data as of 31 Oct 2022 | Note: Figures in bracket denote depreciation against USD

Despite the weakness in DXY, global currencies were mixed in the fortnight. NZD and AUD rose sharply as CPI inflation inched up further, raising hopes of further rate hikes. Notably, while Reserve Bank of New Zealand has continued with aggressive rate hikes, Reserve Bank of Australia has slowed down the pace of rate hikes in its recent policy meet. Political developments in UK and Brazil drove their respective currencies higher. Further, expectations that the Bank of England may accelerate the pace of its rate hike to 75bps (highest in almost 30 years) this week, as inflation continues to surge, also pushed GBP higher. EUR too gained 1.6% in the fortnight as European Central Bank raised policy rates by another 75 bps. However, concerns over growth capped gains.

BONDS WRAP

01 November 2022

Fortnightly review

Dipanwita Mazumdar
Economist

Global bond market was in a trap trying to untangle growth-inflation dynamics. High frequency indicators in the US and Eurozone reflected slowdown in growth; while inflation worries were aggravated. In the Eurozone inflation again reached a new high. Among the most notable yield movement has been the complete reversal of direction in UK's 10Y yield which fell by 58bps in Oct'22 against 129bps increase seen in Sep'22. This was supported by growing sentiments over fiscal credibility under the newly elected PM. US Fed in its upcoming policy is expected to go for a 75bps hike, yet some slowdown with regard to future pace of rate hike is expected, as impact of frontloading on macro data points are already visible.

On the domestic front, India's 10Y yield traded in the range of 7.36-7.51% in Oct'22, though it exhibited less volatility in trading compared to Sep'22. Some degree of buying was supported by risk off sentiment on account of contagion impact of global growth slowdown. Further, MPC members statement hinting that quite a bit of frontloading has already happened, did not allow yields to increase much. Notable development in the current month has been the correction in short end yield. Cut off for the short tenor papers rose at much slower pace in Oct'22 compared to Sep'22. Liquidity remained in deficit for 14 days in Oct'22. Going forward we expect, either neutrality or deficit in liquidity to be the new normal, considering that credit is at a double digit pace and RBI's forex intervention will continue. We expect India's 10Y yield to trade in the range of 7.35-7.50% in the next 30 days.

Growth inflation dynamics a puzzle:

Few of the notable changes that was noticed in global yield movement in Oct'22 compared to Sep'22 was:

- In UK, sovereign 10Y yields fell sharply by 58bps ion Oct'22 against 129bps increase in the previous month. This was led by growing expectation of fiscal consolidation from newly elected PM. Reports suggested that the Chancellor of the Exchequer is planning to fill a fiscal shortfall of US$ 41bn through spending cuts.
- In Germany as well, 10Y yield rose at a softer pace by 3bps in Oct'22 against 57bps increase in Sep'22. This was on account of ECB's hint at the fact that "substantial progress" has already been made on policy front, suggesting that the pace of rate hikes may slow down.
- In US, 10Y yield also rose at a moderate pace by 22bps in Oct'22 against 64bps in Sep'22. This was on account of elevated growth concerns emanating from new home sales (declining for the 8th straight month) and flash PMI print (2-month low).

CREDIT TRENDS

01 November 2022

Sectoral deployment of credit

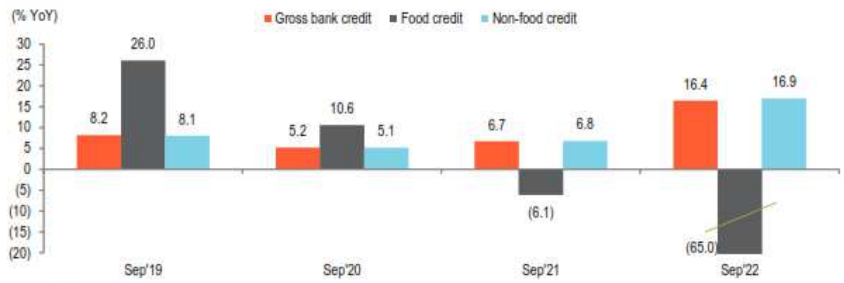
Sonal Badhan
Economist

RBI has recently released its data on sector-wise credit growth till Sep'22. Data indicates that despite increase in lending rates (owing to RBI's rate hikes), credit growth remains robust. In YoY terms, it is higher even than pre-pandemic times (Sep'19), supported by higher non-food credit demand. Within this, credit to industry and services has picked up the most. Going forward, we expect credit demand to remain steady even as RBI continues to hike rates. While personal loan and services sector will be supported by pent-up consumption demand, credit to industry will be buoyed by improvement in investment climate.

Overall trends in credit growth:

Total bank credit rose by 16.4% on YoY basis as of Sep'22, compared with 6.7% growth as of Sep'21 and 8.2% as of Sep'19 (pre-pandemic). Even on FYTD basis, credit demand rose by 6.2% in H1FY23 from 0.1% in H1FY22 and H1FY20. During the financial year, sharp increase was witnessed in the non-food credit demand with growth at 16.9% as of Sep'22 (YoY) versus 6.8% as of Sep'21 and 8.1% as of Sep'19. On the other hand, food credit, given to FCI and state agencies for procurement of food grains, has seen a considerable decline this year.

Figure 1: Total credit demand



Source: RBI, Bank of Baroda Research

Credit to non-food sector:

Industry: Within the non-food sector, credit to industry and services has improved the most. Credit to industry has picked up by 12.6% as of Sep'22, compared with only 1.7% last year and 2.7% as of Sep'19. Apart from base effect, this has been supported largely by the MSME sector, wherein demand by micro and small firms was up by 27.1% versus 13.1% last year and following (-) 0.7% decline in Sep'19. Similar trend was observed for medium sized firms which recorded 36.2% growth in credit demand as of Sep'22, broadly similar to 37.1% as of Sep'21 and significantly up from (-) 0.3% decline during pre-pandemic period (Sep'19). Larger industries have also contributed to increased demand, as credit to this segment has risen by 7.9% from 3.4% as of Sep'19. On FYTD basis, overall credit to industry turned positive in H1FY23 for the first time since H1FY20.

INTEREST RATES

01 November 2022

Pace of deposit and lending rates in H1FY23

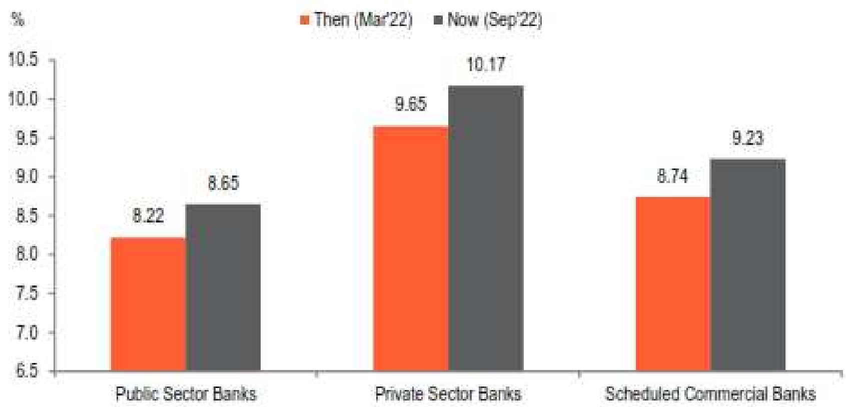
Jahnavi Prabhakar
Economist

In the given landscape, the Central Bank has been on policy tightening spree with liquidity crunched up. The lending rates have risen making the borrowing costlier. Deposit rates though lagging are quickly catching up with higher rates as banks revamp the rates further. The note examines the changes in the deposit and lending rates over the last 6-months.

LENDING RATE

- The weighted average lending rate (WALR) on outstanding rupee loans have become expensive with the increase in rates registered across the board. For public sector banks, the rates have gone up by 43 bps, for Private Banks and SCBs also the rates have edged upwards by 52 bps and 49 bps respectively in Sep'22 compared with Mar'22.

Fig1. WALR for outstanding loans



Source: RBI, Bank of Baroda Research

- WALR on fresh rupee loans have also increased for Public sector (91 bps), Private Banks (88 bps) and SCBS (96 bps) in Sep'22.

- 1-year median marginal cost of fund based lending rate (MCLR) moved higher in Sep'22 compared with the rates back in Mar'22. For SCBs, the MCLR rates have gone up by 50 bps. For Public sector and Private Banks the rates have edged upwards by 45 bps and 40 bps respectively in Sep'22.

BUY
TP: Rs 125 | ⮝ 24%

TATA STEEL | Metals & Mining | 01 November 2022

Integrated Indian operations to weather downturn

- **Weak Q2 results as cost adjustments lagged prices; European operations saw a sharper pullback from a stronger Q1**
- **We cut FY23/FY24 EBITDA by 31%/10% factoring in margin uncertainty in Europe and slower recovery in India operations**
- **TP lowered to Rs 125 (vs. Rs 140); maintain BUY as we expect TATA to weather the downturn and deliver on earnings-accretive growth**

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Weak Q2: TATA's consolidated Q2FY23 EBITDA at Rs 58bn fell 60% QoQ and was 22% below consensus. EBITDA/t declined by 59% QoQ to Rs 8.7k/t in standalone operations and by 67% to US$ 120/t in Europe. Net debt rose 31% HoH to Rs 718bn.

Estimates cut: We cut our FY23/FY24 EBITDA estimates by 31%/10% to reflect our outlook of margin compression in Europe in H2FY23, slower recovery in Indian operations to mid-cycle margin levels by FY24 and higher net debt. While we cut FY23/FY24 EBITDA/t by 37%/29% to US$ 129/US$ 72 for European operations, we broadly maintain our forecasts at Rs 15.4k/Rs 17.3k for India.

Near-term uncertainty…: With Chinese domestic prices declining through October and Indian steel at a 5-7% premium to landed prices, we now look for prices to stabilise over FY24 post the lunar holidays in China. European operations are also exposed to margin uncertainty with the reset of annual contracts ahead of CY23 and energy-related volatility through winter.

…discounted in stock price: We estimate that TATA's stock price is currently discounting EBITDA/t of Rs 13.3-14.3k for standalone operations based on 5Y/10Y multiples. This is well below the mid-cycle margin of Rs 17.3k/t that we expect TATA to deliver from its integrated operations, assuming China gross margins settle at the historical average of US$ 250/t.

Look to medium-term growth: We believe TATA is well positioned to weather this downturn and deliver on its earnings-accretive projects, namely the 6mpta pellet plant, 2mtpa cold rolling mill, 5mtpa TSK expansion and 5mtpa NINL expansion over FY23-FY26.

Maintain BUY: We lower our TP to Rs 125 from Rs 140 as we bake in uncertainty in European operations by scaling back estimates, while maintaining our target FY24E EV/EBITDA multiple at 5.5x which reflects global uncertainty. Given 24% upside potential, we maintain BUY.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	TATA IN/Rs 101
Market cap	US$ 14.8bn
Free float	66%
3M ADV	US$ 72.0mn
52wk high/low	Rs 139/Rs 83
Promoter/FPI/DII	34%/22%/18%

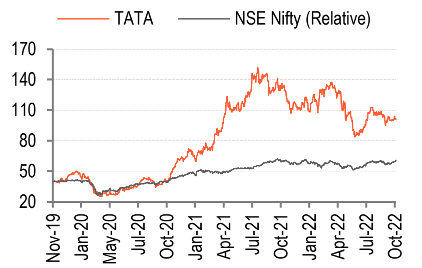
Source: NSE | Price as of 1 Nov 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	2,423	2,160	1,997
EBITDA (Rs mn)	635	358	375
Adj. net profit (Rs mn)	402	173	166
Adj. EPS (Rs)	33.2	14.3	13.7
Consensus EPS (Rs)	33.2	17.7	15.0
Adj. ROAE (%)	42.6	14.2	12.2
Adj. P/E (x)	3.0	7.1	7.4
EV/EBITDA (x)	3.3	5.2	4.7
Adj. EPS growth (%)	436.1	(56.9)	(3.9)

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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CONSUMER DURABLES

01 November 2022

Gujarat electronics policy to boost localisation of appliances

- **New Gujarat electronics policy aims to build an ecosystem for electronics manufacturing in India and enable import substitution**
- **Ceiling for capital support extended to Rs 2bn for investments below Rs 10bn; logistics incentives added with one-time relocation cost**
- **Policy will support local ESDM players and aid domestic manufacturing of various consumer appliances; prefer DIXON (TP Rs 5,200)**

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Gujarat Electronics Policy 2022: The Gujarat government has unveiled a new electronics policy that aims to promote the state as a national hub for electronics system design and manufacturing (ESDM). The host of subsidies and incentives on offer to investors under the policy is expected to attract a slew of additional investments by ESDM companies, boosting growth in the industry and reducing India's dependency on electronic imports.

Thrust on import substitution and export promotion: Domestic production of electronic goods has increased substantially from US$ 37bn in FY16 to US$ 74.7bn in FY21, a CAGR of 17.9%. The objective of the current policy is to bolster local electronics manufacturing and drive annual exports worth US$ 30bn, thereby generating employment opportunities (target of 1mn jobs by 2028)

Major sops on offer: Entities investing <Rs 10bn in ESDM will be eligible for 20% capex assistance up to Rs 2bn. For higher capex, entities will receive added 15% support on investments over Rs 10bn. The capital support will be allocated annually for five years after production begins. In the earlier 2016 policy, incentives to build greenfield capacity were limited to Rs 250mn and a stamp duty waiver. In line with the prior policy, the government will forego 100% stamp duty and registration fee on related land deals. Interest assistance on term loans, electricity subsidy of Re 1/unit, 100% electricity duty reimbursement, and employee provident fund reimbursements will continue.

Logistics support added: Eligible units will receive logistics aid to reduce their operational costs via payment of 25% of total freight charges incurred, with a cap of Rs 500mn p.a. for five years. Also, in case of relocation of plants from other states, one-time support of 50% of the total cost incurred (up to Rs 500mn) will be provided.

Key picks: Supportive government policies should help localise the manufacturing of durables in India in the long term. We continue to prefer DIXON (BUY, TP Rs 5,200) in the electronic manufacturing services (EMS) segment.

Recommendation snapshot

Ticker	Price	Target	Rating
AMBER IN	2,065	2,100	HOLD
BLSTR IN	1,236	1,100	HOLD
CROMPTON IN	362	500	BUY
DIXON IN	4,517	5,200	BUY
HAVL IN	1,216	1,500	BUY
ORIENTEL IN	269	310	HOLD
POLYCAB IN	2,777	3,300	BUY
VGRD IN	256	250	HOLD
VOLT IN	876	1,100	HOLD

Price & Target in Rupees | Price as of 31 Oct 2022

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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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