FIRST LIGHT

16 October 2023

RESEARCH

[SECTOR REPORT] POWER

The bigger the better – BUY NTPC, PWGR

CEMENT | Q2FY24 PREVIEW

Higher demand, lower fuel cost to aid margins

BANKING | Q2FY24 PREVIEW

Growth momentum to continue

HDFC LIFE | TARGET: Rs 700 | +12% | HOLD

Mixed quarter; maintain HOLD

Daily macro indicators

Indicator	11-Oct	12-Oct	Chg (%)
US 10Y yield (%)	4.56	4.70	14bps
India 10Y yield (%)	7.31	7.30	(1bps)
USD/INR	83.19	83.25	(0.1)
Brent Crude (US$/bbl)	85.8	86.0	0.2
Dow	33,805	33,631	(0.5)
Hang Seng	17,893	18,238	1.9
Sensex	66,473	66,408	(0.1)
India FII (US$ mn)	**10-Oct**	**11-Oct**	**Chg ($ mn)**
FII-D	61.6	2.3	(59.2)
FII-E	(108.6)	(21.4)	87.2

Source: Bank of Baroda Economics Research

SUMMARY

[SECTOR REPORT] POWER

- Green energy to dominate capacity creation but thermal power usage to remain sticky as India seeks to plug supply shortages
- Power PSUs have inherent advantages of bigger balance sheets and cheaper funding, which helps them outpace private sector peers
- Our picks: NTPC (TP Rs 290) for the renewable-cum-thermal theme and PWGR (Rs 250) as a play on the green energy corridor; we rate TPW HOLD

Click here **for the full report.**

CEMENT: Q2FY24 PREVIEW

- Cement dispatches robust in Q2, rising 15% YoY on average for our coverage companies
- Drop in fuel cost likely to aid healthy margin gains despite listless realisations
- EBITDA/t reverting to ~Rs 1,000 levels for well-managed players such as UTCEM, JKCE and STRCEM, but valuations lofty

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BANKING: Q2FY24 PREVIEW

- Q2 saw healthy systemic credit growth of 19% YoY led by retail and SME/ MSME segments and supported by recovery in MFI
- Higher deposit cost expected to lower aggregate NIM by 5-10bps QoQ; slight rise in stressed assets to push up credit cost
- PPOP likely to remain steady but QoQ uptick in credit cost could limit PAT; HDFCB, AXSB, SBIN and IIB remain our top picks

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HDFC LIFE

- Q2 slightly short of our estimates; management expects a stronger H2 on new launches, growth in tier-2&3 markets and in bancassurance
- Protection and ULIP share improved in the APE mix in H1FY24 vs. FY23; non-par continues to struggle
- TP maintained at Rs 700 on an unchanged 2.8x FY25E P/EV multiple; retain HOLD

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POWER

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Recommendation snapshot

Ticker	Price	Target	Rating
NTPC IN	242	290	BUY
PWGR IN	202	250	BUY
TPW IN	730	800	HOLD

Price & Target in Rupees | Price as of 13 Oct 2023

Renewables moving from exception to norm: India's target of 500GW of non-fossil fuel-based power capacity by 2030 vs. 178GW now implies renewable energy (RE) additions of ~45GW per year or a 17% CAGR over FY23-FY30. RE addition in the country has accelerated visibly, with auctions of ~43GW of capacity announced in FY24 YTD vs. 12GW in FY23. Over the next five years, we estimate that RE will double to 218GW led by solar additions. Already, renewable supply has progressed from standalone infirm power to hybrid solar–wind power and is now transitioning into round-the-clock or RTC power (solar–wind–storage or solar–storage solutions).

Thermal additions to continue despite greening: Though green energy will be the mainstay of capacity creation in the medium term, we expect India's dependence on thermal power to continue as the country grapples with peak shortages and a warming world. For instance, unusually hot weather this August took peak electricity demand to ~240GW, leading to a peak shortage of ~11GW vs. just 2GW in FY22. As India sets its sights on becoming a US$ 5tn economy, power demand is expected to climb, necessitating the concurrent addition of coal-based capacity.

Power PSUs best positioned: The power sector can be divided into two eras – one of assured returns and one of competitive bidding. Unlike private players, most public sector units (PSU), such as NTPC, PWGR, NHPC and SJVN, have a sizeable base of regulated assets that are expected to continue yielding fixed ROEs as prescribed in the multi-year tariff order. Secondly, competitive bids in the solar space need large and strong balance sheets. Thirdly, as government-backed entities, these companies have better credit ratings, which lowers their cost of funds and makes them more competitive while bidding. We, therefore, prefer power PSUs over private players.

Prefer NTPC and PWGR: We assume coverage on NTPC (TP Rs 290) and PWGR (TP Rs 250) with BUY ratings while keeping TPW (TP Rs 800) at HOLD. In our view, NTPC is the best play on both RE and thermal capex, while PWGR is the next best play on India's planned green energy corridor. TPW will benefit from ongoing distribution reforms given its record of turning operations around in new business areas, but high valuations constrain our rating.

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CEMENT

14 October 2023

Higher demand, lower fuel cost to aid margins

- **Cement dispatches robust in Q2, rising 15% YoY on average for our coverage companies**
- **Drop in fuel cost likely to aid healthy margin gains despite listless realisations**
- **EBITDA/t reverting to ~Rs 1,000 levels for well-managed players such as UTCEM, JKCE and STRCEM, but valuations lofty**

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Healthy volumes to lift revenue: Cement demand momentum has been steady in the July-September quarter, but dispatch momentum was strong, rising ~15% YoY on average for our coverage universe largely due to the incremental capacities of major players. This, in turn, is expected to lend a healthy impetus to revenue, likely supporting average growth of 14% YoY for our coverage.

Demand revival better than expected but supply in excess too: Our management interactions and channel checks indicate a healthy demand revival over August-September. We expect momentum to continue with pickup in the rural sector, an infrastructure push ahead of 2024 general elections and pockets of urban real estate recovery. Price hikes have, however, lagged the uptick in demand and were executed only in September and hence will be reflected fully in Q3. The average pan-India cement price was Rs 356/bag 2QFY24 vs. Rs 350/bag in Q2FY23.

Cost respite to support healthy margin gains: We expect our cement coverage to report an average EBITDA margin of 17.1% in Q2FY24 vs. 11% in the year-ago quarter as fuel cost has dropped. The cost of imported coke and coal is down by 20-30% YoY in Q2FY24 (23% on average and 22% YTD), which is a boon for cement companies as fuel ranges from 25% to 30% of their total cost. Thus, cement price weakness in Q2 should not be a cause for concern as lower fuel expense will likely help players improve operating margins.

Maintenance shutdowns to partly offset cost benefits: Though cheaper fuel may offer some respite, the benefits are likely to be partially offset by higher other expenses due to maintenance shutdowns by cement companies in 2QFY24.

Stock recommendations: We continue to recommend HOLD on UTCEM (TP Rs 9,396), JKCE (Rs 3,474), SRCM (Rs 24,656) and Dalmia Bharat (DALBHARA: TP raised to Rs 2,286 from Rs 1,934). We retain our SELL ratings on JKLC (Rs 551) and TRCL (Rs 585), while moving STRCEM (Rs 159) to HOLD from BUY as valuations look full after the runup in stock price.

Recommendation snapshot

Ticker	Price	Target	Rating
ACC IN	2,010	1,964	HOLD
ACEM IN	440	435	HOLD
DALBHARA IN	2,293	2,286	HOLD
JKCE IN	3,250	3,474	HOLD
JKLC IN	679	551	SELL
ORCMNT IN	188	128	SELL
SRCM IN	26,851	25,731	HOLD
STRCEM IN	163	159	HOLD
TRCL IN	996	585	SELL
UTCEM IN	8,369	9,396	HOLD

Price & Target in Rupees | Price as of 13 Oct 2023

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BANKING | Q2FY24 Preview | 13 October 2023

Growth momentum to continue

- **Q2 saw healthy systemic credit growth of 19% YoY led by retail and SME/ MSME segments and supported by recovery in MFI**
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- **PPOP likely to remain steady but QoQ uptick in credit cost could limit PAT; HDFCB, AXSB, SBIN and IIB remain our top picks**

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Retail and SME/MSME lending boosts credit growth: Per RBI data, system credit grew 19.4% YoY over 1 July to 23 September. The strong loan growth was led by the retail and SME/MSME segments, supported by gradual recovery in MFI and corporate lending. We expect that home loans, vehicle finance, unsecured loans, and small business segments have outperformed in the retail segment. Personal loans and credit cards are also likely to have seen strong momentum. We continue to pencil in system credit growth at 14% for FY24 assuming some moderation in the second half.

Deposit mobilisation to improve: Growth in system deposits accelerated by 90bps QoQ to 12.9% YoY over 1 July to 23 September, according to RBI data. Higher deposit mobilisation was supported by an increase in term deposit rates. Further, banks used their excess liquidity to fund the loan book during Q2, leading to a CD ratio of 78.8% (74.5% in Q2FY23).

Margin pressure from higher deposit costs: Deposit rate realignment, particularly in term deposits, is likely to put margins under pressure. However, banks' core focus on the retail book with a bias towards high-yielding unsecured loans is likely to offset some pressure. We expect a 5-10bps QoQ dip in aggregate NIM vs. 10-15bps in Q1. Our industry checks suggest that the repricing has been largely factored in during Q2 and the cost of funds is unlikely to rise meaningfully for the rest of the year.

Slippages and credit cost to remain in check: We expect a slight increase in stressed loans across our coverage during Q2 with higher slippages from the unsecured book (personal loans and credit cards), while upgrades and recoveries remain flat. The increase in stress may lead to more provisioning and hence higher credit cost. We model for stable GNPA and NNPA with some upward bias during the quarter but expect no major shock from the restructured and SMA books.

Top picks: In our view, Q2 topline growth is likely to remain healthy supported by strong business growth while sticky opex and higher credit cost likely weigh on profitability. Our top picks remain HDFCB (BUY, TP Rs 2,061), AXSB (BUY, TP Rs 1,155), IIB (BUY, TP Rs 1,755) and SBIN (BUY, TP Rs 729).

Recommendation snapshot

Ticker	Price	Target	Rating
AXSB IN	1,018	1,155	BUY
DCBB IN	123	144	BUY
FB IN	149	165	BUY
HDFCB IN	1,550	2,061	BUY
ICICIBC IN	954	1,015	HOLD
IIB IN	1,424	1,755	BUY
KMB IN	1,764	2,122	HOLD
RBK IN	247	233	HOLD
SBIN IN	586	729	BUY

Price & Target in Rupees | Price as of 12 Oct 2023

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HOLD
TP: Rs 700 | 12%

HDFC LIFE | Insurance | 13 October 2023

Mixed quarter; maintain HOLD

- **Q2 slightly short of our estimates; management expects a stronger H2 on new launches, growth in tier-2&3 markets and in bancassurance**
- **Protection and ULIP share improved in the APE mix in H1FY24 vs. FY23; non-par continues to struggle**
- **TP maintained at Rs 700 on an unchanged 2.8x FY25E P/EV multiple; retain HOLD**

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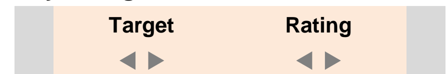
Mixed quarter: HDFC Life's individual and overall APE both grew 9% YoY as at end-H1FY24. Total APE of Rs 30.4bn at end-Q2FY24 missed our estimate of Rs 31.5bn, as did NBP at Rs 71bn. Further, NBP market share slipped from 20.8% in FY23 to 19.1%, though the company retained its #2 rank among private peers. On the positive side, HDFC Life indicated that it rolled out new products, saw strong growth in tier-2/3 cities (mostly <Rs 0.5mn premium paying customers), registered a higher HDFC Bank share (62% at end-H1 vs. 56.5% in Q1), and maintained stable average ticket size despite a decline in large policies. Backed by these factors, management is confident that H2 will outshine H1.

Protection business gains traction; non-par moderates: Non-par APE fell from a high of 38% of total APE at end-FY23 to 24% in H1FY24 (27% in Q1). Non-par products have been repriced twice in the current cycle. The share of protection plans improved from 13% in FY23 to 17% in H1, with two new products launched. ULIPs grew from 16% of APE at end-FY23 to 24% in H1FY24.

H1 VNB margin flat: The company generated VNB of Rs 14.1bn (+10% YoY) with a flat margin of 26.2% at end-H1FY24 and continues to expect the merged entity to be margin-neutral by FY24-end. We retain our VNB margin forecast of 26.5% for both FY24 and FY25 along with a 7% VNB CAGR over FY23-FY25 to Rs 42bn. The company reiterated that VNB growth would come from higher APE and not margin expansion. We continue to model for a 10% APE CAGR over FY23-FY25 to Rs 160bn and a 16% CAGR in EV to Rs 536bn.

Retain HOLD: HDFC Life is trading at 2.5x FY25E P/EV. We continue to value the stock at 2.8x FY25E P/EV– a 30% discount to the long-term mean – for an unchanged TP of Rs 700. Our multiple bakes in positives from higher market share in the HDFC Bank channel, stable ticket size and pickup in demand from tier-2 and tier-3 markets. We also factor in the negatives of a weak VNB margin, market share contraction and high expense ratios, which explains our steep discount to the mean multiple. Considering that our TP offers just 12% upside, we retain HOLD.

Key changes



Ticker/Price	HDFCLIFE IN/Rs 625
Market cap	US$ 16.2bn
Free float	48%
3M ADV	US$ 24.3mn
52wk high/low	Rs 691/Rs 458
Promoter/FPI/DII	52%/26%/8%

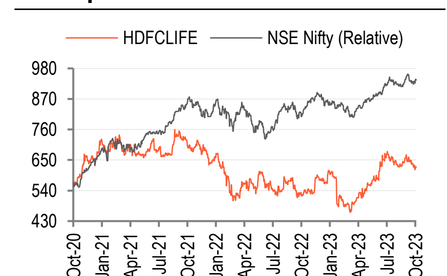
Source: NSE | Price as of 13 Oct 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
NBP (Rs mn)	290,851	338,082	374,392
APE (Rs mn)	133,400	138,132	160,231
VNB (Rs mn)	36,818	36,605	42,461
Embedded Value (Rs mn)	394,988	459,855	535,768
VNB margin (%)	27.6	26.5	26.5
EVPS (Rs)	185.0	215.4	251.0
EPS (Rs)	6.4	7.2	7.8
Consensus EPS (Rs)	6.4	7.7	8.9
P/EV (x)	3.4	2.9	2.5

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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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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