FIRST LIGHT

24 November 2023

RESEARCH

BOB ECONOMICS RESEARCH | TURNOVER TO ASSET RATIO

Has capacity utilization for India Inc. improved in H1?

CONSUMER STAPLES | Q2FY24 REVIEW

Lacklustre volume growth but margins improve

Daily macro indicators

Indicator	21-Nov	22-Nov	Chg (%)
US 10Y yield (%)	4.39	4.40	1bps
India 10Y yield (%)	7.27	7.25	(3bps)
USD/INR	83.35	83.32	0.0
Brent Crude (US$/bbl)	82.5	82.0	(0.6)
Dow	35,088	35,273	0.5
Hang Seng	17,734	17,735	0.0
Sensex	65,931	66,023	0.1
India FII (US$ mn)	**20-Nov**	**21-Nov**	**Chg ($ mn)**
FII-D	(4.1)	81.4	85.5
FII-E	(71.9)	(18.3)	53.6

Source: Bank of Baroda Economics Research

SUMMARY

INDIA ECONOMICS: TURNOVER TO ASSET RATIO

Depressed sales in H1-FY24 has impacted the turnover to fixed asset ratio of India Inc. This ratio is a closely used proxy for capacity utilization rate of the non-financial sector, in particular. Fixed asset creation has still picked up in H1, with auto companies among others hinting at expanding its total production capacity. Even crude oil and infrastructure companies have spoken of balanced capex and growth mix, with former hinting at production augmentation plans. However, what has been a concern is the muted growth in sales in comparison to the existing stock of fixed assets. This held for industries such as chemicals and consumer durables where some momentum was visible in H1FY23, but is now losing steam due to depressed sales. Some core capital goods sectors such as infrastructure and iron and steel have held up well.

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CONSUMER STAPLES: Q2FY24 REVIEW

- Our FMCG coverage saw muted volume growth in Q2 due to heightened regional competition and delayed rural recovery
- Margin expansion continued for consumer companies despite a steep increase in A&P spends
- Management commentaries point to potential volume recovery in H2FY24; we retain NEST, ITC and TCPL as top picks

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TURNOVER TO ASSET RATIO

23 November 2023

Has capacity utilization for India Inc. improved in H1?

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Depressed sales in H1-FY24 has impacted the turnover to fixed asset ratio of India Inc. This ratio is a closely used proxy for capacity utilization rate of the non-financial sector, in particular. Fixed asset creation has still picked up in H1, with auto companies among others hinting at expanding its total production capacity. Even crude oil and infrastructure companies have spoken of balanced capex and growth mix, with former hinting at production augmentation plans. However, what has been a concern is the muted growth in sales in comparison to the existing stock of fixed assets. This held for industries such as chemicals and consumer durables where some momentum was visible in H1FY23, but is now losing steam due to depressed sales. Some core capital goods sectors such as infrastructure and iron and steel have held up well.

- Turnover to Fixed assets ratio of companies, which can be used as a proxy for capacity utilization of the economy, has witnessed moderation in H1FY24 compared to H1FY23. However, it was higher than that in 2019, 2020 and 2021.
- Excluding Banking and financial services (BFSI) the ratio has also come off, albeit higher than the pre pandemic level.
- Depressed level of sales compared to pace of asset creation has resulted in the same.
- Sectoral data shows infrastructure, consumer durables and ship building were at the top end of the spectrum. Major infra related sectors such as capital goods, auto and ancillaries and chemicals were in the median range.

What H1 numbers reflect?

- A way of looking at capacity utilization in the economy is through the lens of ratio of turnover to fixed assets ratio of India Inc. especially for the non-financial sector. Here we analyzed balance sheets and P/L data of 1,982 companies for H1FY24. Excluding BFSI companies, the count comes to 1,752 companies. For turnover, we have used the half yearly net sales data and for fixed assets we have used the sum of fixed assets and Capital work in progress.
- The H-1 data for the aggregate sample has moderated to 1.25 from 1.29, seen in the corresponding period of previous year. Excluding BFSI sector, the turnover to fixed asset ratio has come off to 1.04 from 1.14 in H1FY23, albeit remaining above the pre pandemic level of 0.80, seen during H1FY19. Interestingly RBI data for Q1FY24 showed capacity utilization rate of the economy moved down to 73.6% from 76.3% in Mar'23. The main reason behind this is the softening of sales numbers which is visible since the beginning of this financial year and the trend is continuing this quarter as well. Notably, if we exclude the outlier industries (trading, diamond and jewellery and IT) which have an inflated turnover to fixed assets ratio, due to their inherent way of functioning, the ratio is below 1 at 0.98.

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CONSUMER STAPLES | Q2FY24 Review | 23 November 2023

Lacklustre volume growth but margins improve

- **Our FMCG coverage saw muted volume growth in Q2 due to heightened regional competition and delayed rural recovery**
- **Margin expansion continued for consumer companies despite a steep increase in A&P spends**
- **Management commentaries point to potential volume recovery in H2FY24; we retain NEST, ITC and TCPL as top picks**

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Volume growth remains subdued: Q2FY24 demand trends broadly mirrored those of the preceding quarter. Although the second quarter began with positive demand signals in both rural and urban markets, it ended on a weak note as a patchy monsoon and higher food inflation dampened buyer sentiment. Companies did cut prices to pass on the benefits of lower input costs, but this failed to invigorate volumes due to heightened competition from regional players and the challenging demand environment. Nevertheless, our coverage continued to post robust EBITDA margin expansion, even as A&P spends moved up.

Competition from regional players dents growth: For the second consecutive quarter, FMCG companies encountered intense competition in select categories from regional players due to price moderation in key commodities. Commentaries from key players concurred on the resurgence of small and regional players, which would explain the muted volume growth and market share loss in certain categories. In the wake of competitive headwinds, companies under coverage reduced prices to protect market share and now anticipate gradual volume recovery in H2FY24.

Rural recovery falters: Rural markets saw subdued demand recovery during Q2FY24 owing to uneven distribution of the monsoon and higher food inflation. Companies are hopeful of a recovery in rural markets amid easing inflation, rising rural wages and higher government capex.

Top picks: We expect the demand climate to improve in H2FY24, enabling consumer players to sustain their growth trajectory. However, regional competition remains a key monitorable along with revival in rural markets. Consumer staples players have taken price cuts which should encourage volume growth, albeit with a lag of a couple of quarters. We expect companies with a strong product slate, large rural presence, robust launch pipeline and localised marketing to continue to grow and gain market share in their respective categories. Post earnings, we believe NEST (BUY, TP Rs 28,260), ITC (BUY, TP Rs 523) and TCPL (BUY, TP Rs 1,038) are best placed.

Recommendation snapshot

Ticker	Price	Target	Rating
BRIT IN	4,694	5,844	BUY
DABUR IN	541	669	BUY
GCPL IN	1,009	1,159	BUY
HUVR IN	2,522	3,069	BUY
ITC IN	440	523	BUY
MRCO IN	533	646	BUY
NEST IN	24,351	28,260	BUY
TATACONS IN	928	1,038	BUY
ZYWL IN	1,553	1,556	HOLD

Price & Target in Rupees | Price as of 22 Nov 2023 | TATACONS = TCPL

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Note: Recommendation structure changed with effect from 21 June 2021

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