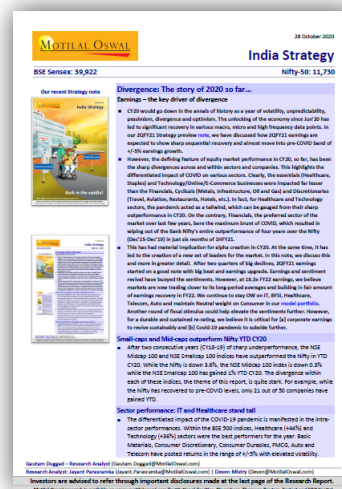


Refer to our Sep'20 Quarter Review



Our recent Strategy notes



Corporate India doubles down on cost control!

Analyzing costs in greater detail; margin expansion to moderate in 2HFY21

- In the recently concluded 2QFY21 results, both Nifty and the MOSL Universe reported broad-based earnings beat, leading to healthy 9-10% earnings upgrades in FY21 estimates for both sets of aggregates. A detailed analysis of 2QFY21 earnings can be found [here](#).
- One of the key and defining features of this performance was the better-than-expected focus on cost mitigation measures, apart from demand recovery and a healthy tailwind from gross margin expansion.
- In this note, we analyze the cost components in slightly greater detail and highlight various elements pertaining to these.

2QFY21 was an optimum combination of gross margin expansion and operating cost reduction

- In 2QFY21, for the MOFSL Coverage Universe, despite 7% YoY decline in revenues, EBITDA posted healthy 9% growth v/s the expectation of a flattish YoY performance. All key sectors, barring Capital Goods and Utilities, reported operating margin expansion. Ex-Financials, Nifty reported 310bps YoY EBITDA margin expansion to 19.8%; MOSL-ex-Financials reported 320bps YoY expansion to 19.4%.
- Thus, operating costs for our Universe declined 11% YoY. Within the operating cost bucket, other expenses declined 8% YoY, pointing toward continued cost control initiatives implemented by companies. Cement (-10%), Automobiles (-11%), Technology (-14%), and Oil & Gas (-21%) YoY have been the key sectors to report double-digit decline in other expenditure. Utilities (+18%), Retail (+4%), and Banks (+4%) YoY have seen an increase in their expenditure over the same period.
- RM tailwind and demand recovery, coupled with better pricing power owing to supply constraints and lower discounts, resulted in sharp gross margin expansion for our Universe. The gross margin for MOSL Universe (129 companies, ex-BFSI, IT, and Telecom) expanded 600bps YoY to 42%. Cyclical and commodities such as Metals and Oil & Gas saw a maximum of 850bps and 490bps gross margin expansion YoY, respectively. The Retail, Consumer, and Automobile sectors have seen 280bps, 100bps, and 50bps contraction, respectively, in gross margins YoY.

Other cost elements of P&L see a marginal rise

- While gross margin expansion and overhead cost reduction clearly propelled operating margin expansion, other elements of P&L costs saw a marginal rise. Staff costs expanded a modest 4% YoY for our MOFSL Universe companies. Sectors that have seen a staff cost increase include Consumer (+9%), Utilities (+9%), Banks (+9%), Healthcare (+8%), Oil and Gas (+8%) and IT (4%). Sectors

that saw YoY contraction in employee costs are Media (-21%), Retail (-20%), Cement (-6%), and Metals (-5%).

- As normalcy returned and new launch/re-launch activity gained momentum, advertising costs for the MOSL Consumer Universe rebounded to 9.3% of sales in 2QFY21 from 7.1% in 1QFY21, but were still down v/s 10.5% in 2QFY20.

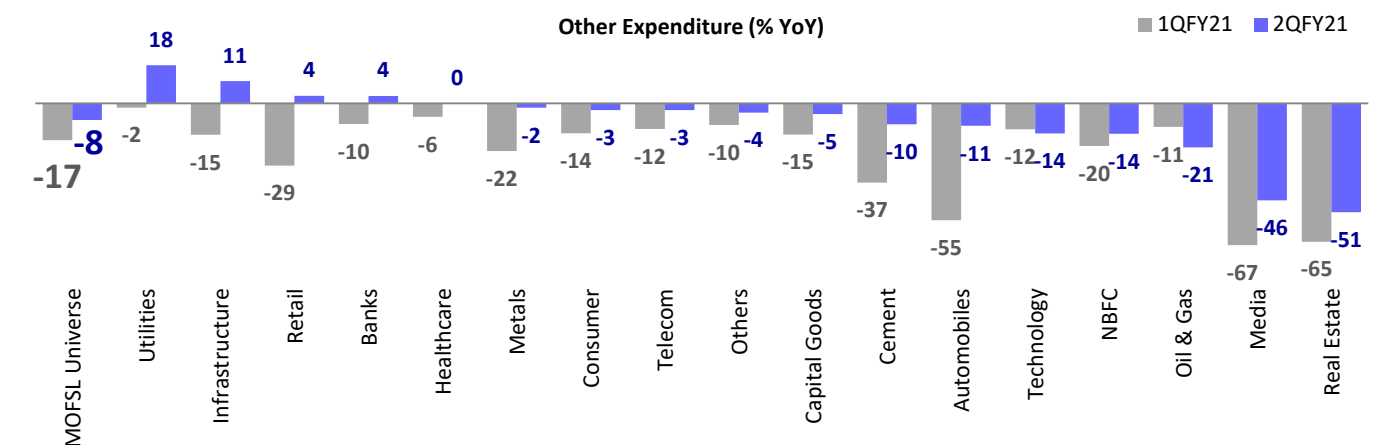
34 Nifty-50 companies have seen EBITDA margin expansion

- 34 out of 50 companies in the Nifty Universe have seen EBITDA margin expansion, while 16 companies have reported EBITDA margin contraction.
- JSW Steel, Divi's Lab, IOC, Ultratech Cement and Sun Pharma have seen expansion of 910bps, 790bps, 690bps, 610bps and 600bps YoY, respectively, in EBITDA margins.
- Coal India, ONGC, Titan, ITC and Eicher Motors, on the other hand, have posted a contraction of 480bps, 440bps, 430bps, 280bps and 240bps YoY, respectively, in EBITDA margins.

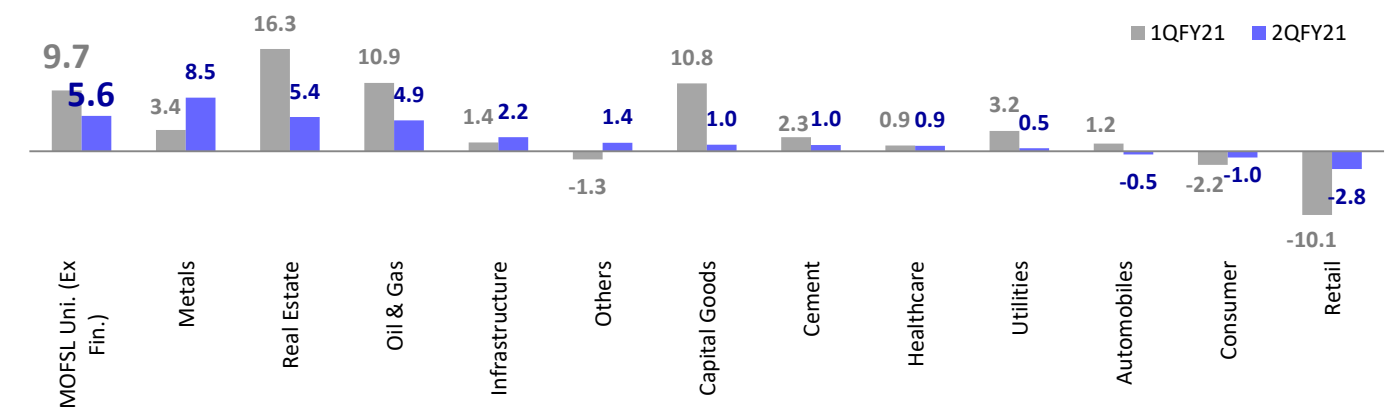
Pace of margin expansion to moderate in 2HFY21

- After the sharp beat on costs and faster-than-expected demand recovery, FY21E earnings for the MOSL Universe and Nifty saw upgrades of 11% and 9%, respectively.
- Going forward, we expect some elements of P&L costs to make a comeback as the economy opens up more and travel cost and other overheads gradually return. Also, RM costs are going up sequentially for several sectors (Consumer, Auto, and Cement).
- Also, cost reduction has been factored in, and consequently, there is limited room for surprise now, in our view. We now build in 140bps and 110bps EBITDA margin expansion to 18.2% and 17.4% for Nifty-ex-Financials for 3QFY21E and 4QFY21E, respectively.
- For the MOSL Universe-ex-Financials, operating margin expansion is expected at 190bps and 220bps to 18.1% and 17.6% for 3QFY21E and 4QFY21E, respectively, v/s 19.4% in 2QFY21.

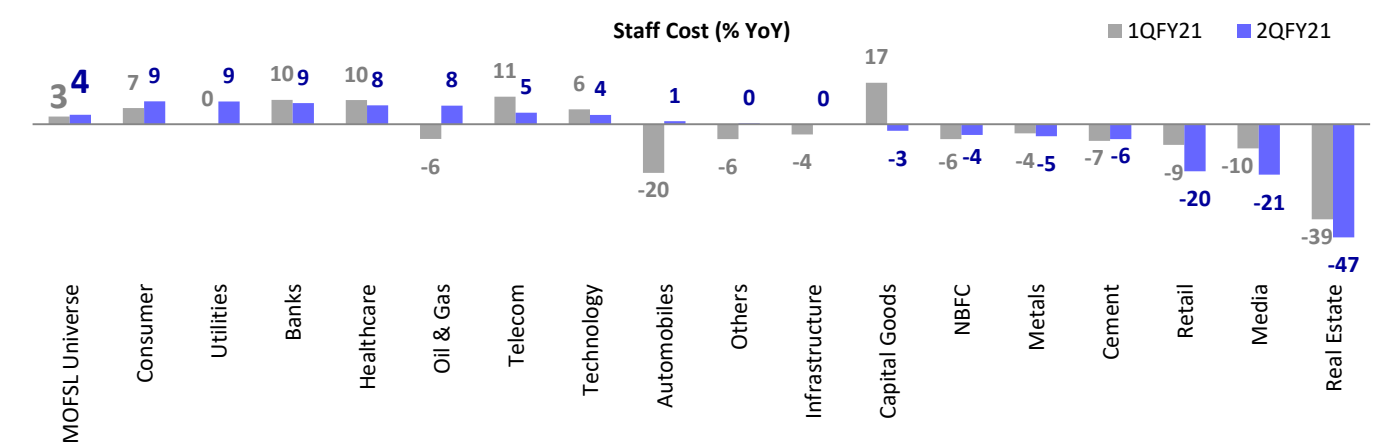
Exhibit 1: Two consecutive quarters of overhead cost reduction across sector in MOSL Universe



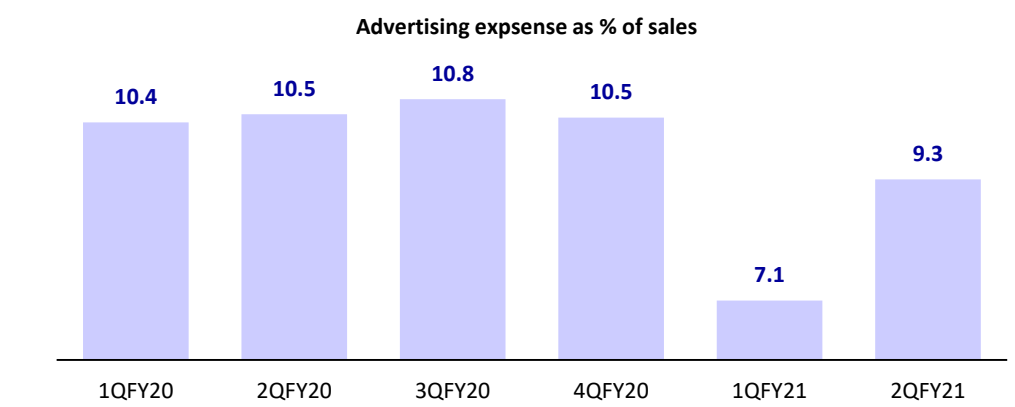
Source: MOFSL, Note: The Universe includes data for 179 companies

Exhibit 2: Gross margins expanded 600bps YoY; Metals and O&G see sharp GM expansion

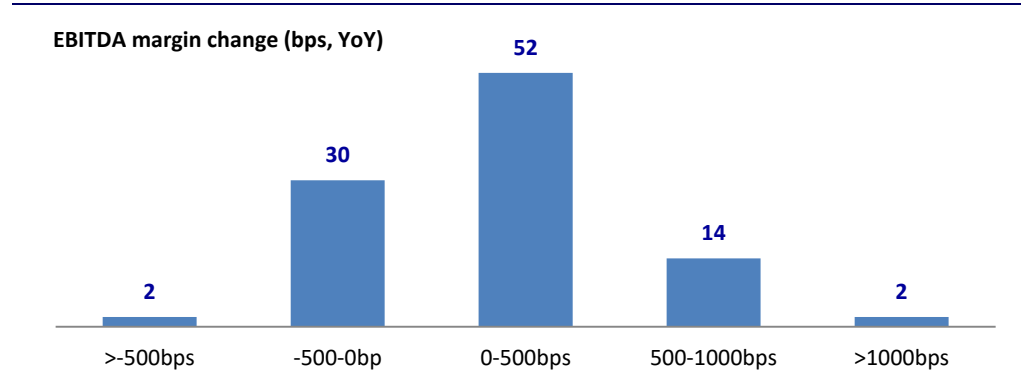
Source: MOFSL, Note: The Universe includes data for 129 companies

Exhibit 3: Staff cost was however up YoY for many sectors

Source: MOFSL, Note: The Universe includes data for 179 companies

Exhibit 4: AD spends rebounded sequentially for Consumer companies but still down YoY

Source: MOFSL, Note: Universe consists of 10 consumer companies

Exhibit 5: 34 out of 50 Nifty companies reported EBITDA margin expansion; 8 reported expansion >=500bps

Source: MOFSL

Exhibit 6: Top 10 Non-BFSI Nifty companies that saw EBITDA margin expansion in 2QFY21

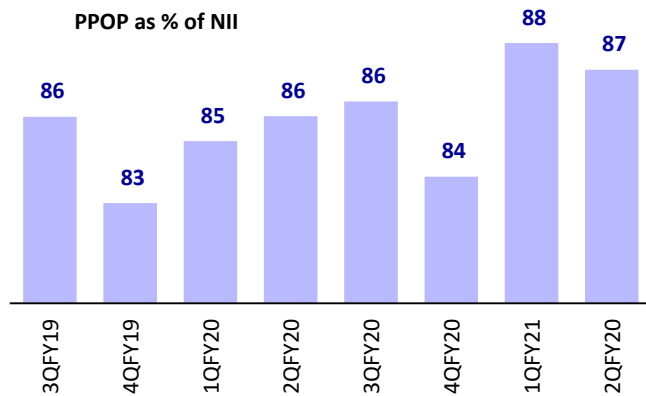
Company	Sector	Sales (INR b)		EBIDTA (INR b)		EBIDTA Margin (%)		
		Sep-19 (actual)	Sep-20 (actual)	Sep-19 (actual)	Sep-20 (actual)	Sep-19 (actual)	Sep-20 (actual)	Chg pp
JSW Steel	Metals	171.1	190.4	22.7	42.5	13.2	22.3	9.1
Divis Labs	Healthcare	14.5	17.5	5.1	7.6	35.3	43.3	7.9
IOC	Oil & Gas	1116.9	856.1	47.1	94.3	4.2	11.0	6.8
Ultratech Cement	Cement	96.2	103.5	19.2	27.0	19.9	26.0	6.1
Sun Pharma	Healthcare	79.5	84.6	16.1	22.2	20.2	26.2	6.0
Tata Steel	Metals	345.8	371.5	38.2	61.1	11.0	16.4	5.4
Asian Paints	Consumer	50.5	53.5	9.5	12.7	18.9	23.6	4.7
Dr Reddy' s Labs	Healthcare	40.8	49.0	8.5	12.2	20.8	24.9	4.2
Infosys	Technology	226.3	245.7	56.4	70.8	24.9	28.8	3.9
Britannia	Consumer	30.5	34.2	4.9	6.8	16.1	19.8	3.6

Source: MOFSL

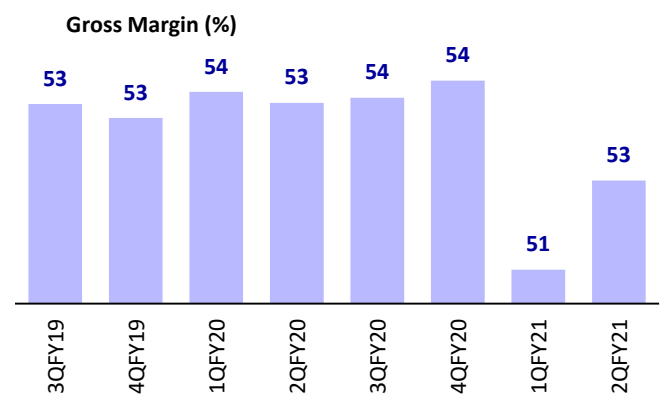
Exhibit 7: Ten Non-BFSI Nifty companies which witnessed maximum EBITDA margin contraction in 2QFY21

Company	Sector	Sales (INR B)		EBIDTA (INR B)		EBIDTA Margin (%)		
		Sep-19 (actual)	Sep-20 (actual)	Sep-19 (actual)	Sep-20 (actual)	Sep-19 (actual)	Sep-20 (actual)	Chg pp
Tata Motors	Automobiles	654.3	535.3	71.6	56.7	10.9	10.6	-0.4
NTPC	Utilities	236.3	250.2	72.1	75.3	30.5	30.1	-0.4
Larsen & Toubro	Capital Goods	353.3	310.3	40.2	33.3	11.4	10.7	-0.6
Hero Motocorp	Automobiles	75.7	93.7	11.0	12.9	14.5	13.7	-0.8
Grasim Industries	Cement	48.0	34.4	6.6	4.0	13.7	11.6	-2.2
Eicher Motors	Automobiles	21.9	21.1	5.4	4.7	24.7	22.3	-2.4
ITC	Consumer	116.6	111.8	45.6	40.6	39.1	36.3	-2.8
Titan Company	Retail	46.6	45.5	5.2	3.1	11.2	6.9	-4.3
ONGC	Oil & Gas	244.9	169.2	132.9	84.4	54.3	49.9	-4.4
Coal India	Utilities	203.8	211.5	42.5	34.0	20.8	16.1	-4.8

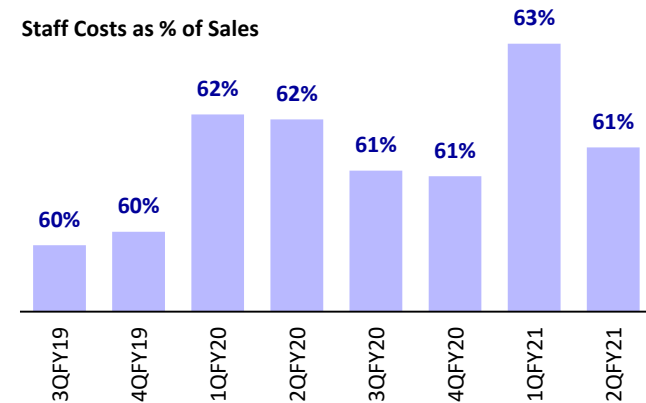
Source: MOFSL

Exhibit 8: For Private Banks, PPOP margins as % of NII remained stable

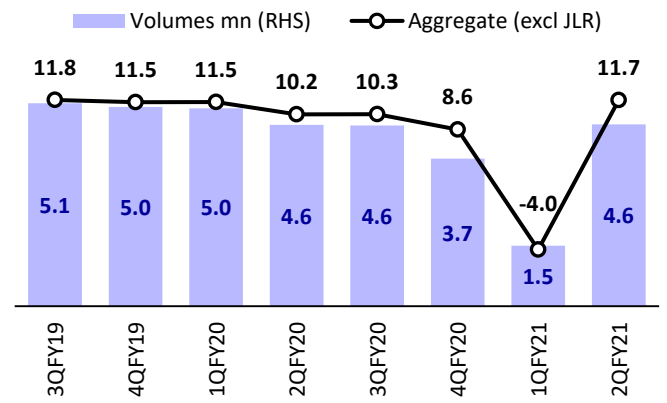
Source: MOFSL. Note: Universe consists of 10 private banks.

Exhibit 9: Gross margins for Consumer companies in MOSL coverage bounce back from the 1QFY21 lows

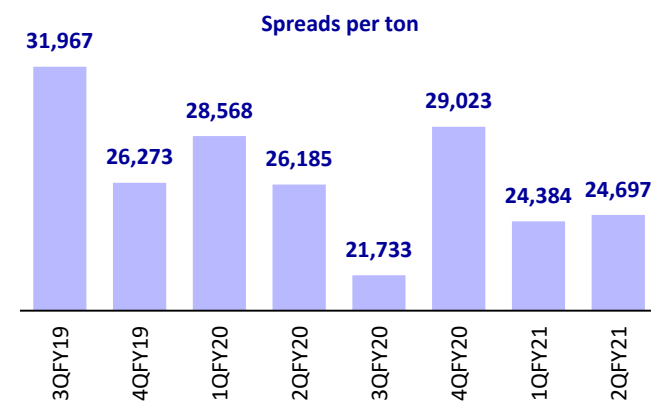
Source: MOFSL. Note: Universe consists of 17 companies.

Exhibit 10: Staff costs decline sequentially and YoY for IT companies

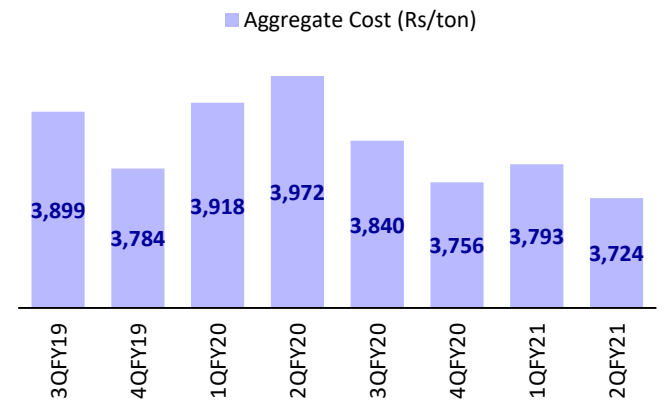
Source: MOFSL. Note: Universe consists of 12 IT companies

Exhibit 11: EBITDA Margins for Autos up YoY after posting operating loss in 1QFY21

Source: MOFSL. MOFSL Auto Universe except JLR

Exhibit 12: Steel spreads per ton stable sequentially in 2QFY21

Source: MOFSL. Universe consists of 4 steel companies.

Exhibit 13: Cement universe posted a 6% YoY decline in operating costs in 2QFY21

Source: MOFSL. Universe consists of 10 cement companies.

NOTES

India Strategy, Thematic and Quant Research Gallery

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BSE Sensex: 39,758
20FY21 India Strategy
S&P CNX: 11,669

20FY21 interim earnings review
Broad-based beat and surprises; Demand recovery and cost optimization key themes; 4% upgrade in 20FY21 EPS

- BE MOPS Universe and 32 Nifty companies have announced their results as of 26th October 2020. Companies that have reported earnings thus far comprise 1st 42% of net P&E for the MOPS Universe, 50.7% of net P&E for the Nifty, 50.5% of India's market capitalization, and 50.7% of the Nifty 50 index weight.
- 20FY21 has been a blockbuster earnings season, with big beats on aggregate and improved management commentary. Nifty profits for the 32 companies that have posted their results have grown 28% YoY (vs exp. of 1% decline). On the other hand, for the BE MOPS companies in the MOPS Universe, profit growth stood at 28% YoY (vs exp. of 1% decline). The breadth of earnings beat and consequent earnings upgrades has been the best in recent memory.
- What is driving the beat? (i) Sharper than expected underlying demand recovery in multiple sectors, even as the supply situation has been relatively to normalcy; (ii) better than expected pricing power/realization; (iii) combined cost optimization initiatives; and (iv) lower than expected provisioning costs in BFSI. Corporate commentary has been mixed, with Consumer and Consumer discretionary companies guiding for improved demand in the festive season, IT companies highlighting robust and growing deal pipeline, and BFSI demonstrating improved collection efficiency / disbursement trends and guiding for continued restructuring ahead.
- KEY SECTORAL INSIGHTS (i) IT: Headline numbers were strong if the 12 companies reported beats as a FY20 base, while 20 out of 32 saw overall earnings revision for FY22. Enterprises are undertaking cloud adoption at a faster pace and digital transformation of the workforce has accelerated, with the strengthening theme of smaller companies benefiting the well-attached business models of Tier-1 IT. (ii) Healthcare: Mphasis Pharma names continue to dominate, as Laurus Labs and Glenmark India reported strong sets of results, leading to double-digit earnings upgrades for FY22. (iii) Banks: Private Banks have beaten expectations handsomely, with higher collection efficiency, uptick in loan growth, and healthy P&L. Large private sector banks such as Kotak, ICICI, and Axis saw double-digit earnings upgrades. Management commentary indicated stress on asset quality due to the pandemic may not be as bad as initially feared, although banks continue to increase provisions for COVID-related stress. (iv) Consumer: Companies have reported demand revival and volume growth in the quarter. Retail continues to outperform others. Cost optimization has once again aided margins. (v) Automobile: Sector performance has been above expectations on account of lower loss in Tata Motors' results. Commentary are, however, quite upbeat for the festive season.

20FY21 result highlights

- The 32 Nifty companies (with declared results) have reported sales/EBITDA/PAT growth: 19%/41%/22% (vs exp. of -7%/7%/7%) QoQ. 17 Nifty companies have beaten our expectations, while seven have not.
- For the MOPS Universe, sales/EBITDA/PAT growth stands at: 19%/16%/22% QoQ. 17 (vs exp. of -7%/7%/7%) QoQ.

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India Strategy
Gautam Duggal
Jayant Parasramka
The Eagle Eye

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Indo-China Conflict: A look at sectoral inter-linkages with China

- Pharmaceuticals, Auto, Consumer Durables, Telecom Equipment most exposed
- The recent border conflict with China in the Galwan valley of Ladakh is unprecedented and has heightened geopolitical tensions. This has caused significant backlash in India.
- Further, the narrative of reducing trade dependence on China is gaining steam.
- In the report, we look at key India-China trade metrics and highlight sectors which are exposed to China on imports, supply chains and raw materials.
- India's trade deficit with China has doubled in the last decade. From sectoral perspective, Pharma, Consumer Durables, Telecom Equipment and Automobiles will be relatively more impacted along with a shift over to stringent trade policy actions/regulations if the India-China conflict escalates further.

Unprecedented geopolitical flare-up in Indo-China relations

The recent (12-14th Jun 2020) flare-up on the Indo-China border in the Galwan valley of Ladakh is unprecedented. It has heightened geopolitical tensions between the two nations leading to reports of potential escalation. The situation is currently fluid with diplomatic and political emphasis on de-escalation and a desired return to normalcy at the earliest. However, these events have caused significant backlash in India, giving rise to a narrative of reducing dependence on China – both on business and commercial fronts. Media reports suggest that the government of India has asked the industry to prepare a list of products imported from China; this would help identify non-essential imports for which local substitutes could then be made available (<https://www.bbc.com/news/health-55444444>). Further, business contracts awarded to Chinese firms have been cancelled by some state governments (Maharashtra and Rajasthan). While we would not like to hypothesize on the possible future steps being contemplated, in this note we look at key macro trade parameters between India and China and the inter-linkages of different sectors with China in terms of sales, supply chains as well as investments. Moreover, we have also highlighted sectors and companies, which would get impacted in case of import curbs or tariffs.

Snapshot of key macro trade metrics between India-China

From a very early deficit in FY00, India ran a trade deficit of USD48.6 bn (1.7% of GDP) with China in FY20. India's imports from China have risen from just 1.4% of total imports in FY00 to an all-time high of 14.4% in FY19 before easing to 14% (USD45.3 bn) in FY20. India's exports to China, as a percent of total exports, have just started picking up pace after touching 1.4% in FY18. In FY20, it stood at USD4.4 bn or 0.3% of total exports from India. Finally, as per official data from the Department of Industrial Policy and Promotion (DIPP), China's FDI inflow over FY00-20 to India stood at a mere USD2.4 bn out of India's total FDI inflow of USD475.1 bn.

Several sectors have material linkages with China

From a sectoral perspective Auto, Consumer Durables, Pharmaceuticals, Telecom, Chemicals and Renewable Power sector (Solar) seem to be the most dependent in terms of sourcing from China. Also, in many cases there appears to be a lack of alternative suppliers at the same scale or costs. While Consumer Durables is dependent on China for components, Pharma is dependent for API sourcing.

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India Strategy
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Tug of War!

Lockdown
Liquidity

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April 2020
India Strategy
Tough battle on!

Tough battle on!

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MOTILAL OSWAL
BULLS & BEARS
INDIA VALUATIONS HANDBOOK

HIGHLIGHTS OF OCT'20 EDITION

- Nifty back in green after declining in Sep'20.
- Private Financials, Cement, Real Estate, Technology and Utilities top outperformers.
- Mid-caps underperform large-caps.
- FII inflows back; DII outflows highest since Mar'16.

BEST PERFORMERS MUM (%)

Company	Return (%)
Kotak Mah. Bk.	22
Zee Bank	18
Tata Steel	15
UltraTech	13
Adani Ports	11
JSW Steel	11
IndusInd Bk.	11
KOHLER	11
HDFC	11
HDFC Bank	10

WORST PERFORMERS MUM (%)

Company	Return (%)
Hero Moto	-11
DRP	-10
Bharat Forge	-8
Balance Ind.	-7
San. Pharm.	-6
ONGC	-5
Dr. Reddy's	-5
Other Motors	-5
DR. Lal. Ind.	-5
Rajshree	-5

Research & Quant Team (Deven@MotilalOswal.com) November 2020

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FUND FOLIO
Indian Mutual Fund Tracker

INR28.2t MF industry AUM rises 5.1% MoM to reach new high.

INR39b Equities see fourth consecutive month of outflows.

INR222b Redemption in equities highest in 31 months.

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November 2020

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NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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