Equity Research

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Strategy

Outlook 2021: Bull market environment driven by 'discount rate', mean reversion of 'PAT/GDP' and long term outlook; Drivers of near term aggregate demand still weak!

- **Indian equities have entered a bull market environment** as evidenced by the one year rolled forward P/E at 22x rising beyond the peak of FY08 at ~20x on an 'ex-ante basis' and significant broadening of the market rally by market cap size and various investment styles (Dividend yield, PSUs, High Beta, Small caps etc). CAPE although expensive at 26x (+1 s.d.) is still lower as compared to its peak of 34x in FY08. Valuation on P/B at 3x is close to the LTA and does not indicate overvaluation, although it does reflect low ROEs. On a cross asset basis, Gold outperformed the most, followed by mid/small caps in CY20.
- **Bull market environment prevailing in CY21** could take Nifty50 to 14,900 levels. However, if market bullishness reverts to average sentiment, the base case fundamental value is ~13,500, which indicates flat returns for CY21. If a risk-off environment materialises, we expect NIFTY50 to touch 11,600 on the downside.
- **Top picks: Large caps -** SBI Life, ICICI Lombard, Axis Bank, HDFC Bank, NTPC, Cipla, Bharti Airtel, Ultratech, Infosys, Dabur, Bajaj Auto; **Midcaps –** GGL, Balkrishna, Alkem, Astral Polytechnik, Akzo Nobel; **Small Caps -** Greenpanel, Heritage foods, Bajaj Consumer
- **Discount rate and long term outlook driving P/ E expansion:** The current P/E multiple expansion is driven by **rising risk appetite (lower equity risk premium as evidenced by falling CDS spreads)** due to record QE program of global central banks and prospects of Covid vaccine, which along with **lower interest rates (risk-free rates)**, is driving down the overall 'discount rate' for equities.
- **Long term growth value improving**: Policy reforms by the government towards making India attractive as a global manufacturing hub (Lower taxes, Labour reforms, ease of doing business, digitalisation) are improving the long-term demand outlook which is reflecting in the expansion of the 'market implied long term growth value' of the NIFTY50 to ~57% despite a fall in discount rate as explained above.
- **Mean reversion of 'PAT/GDP' ratio, which hit a two-decade low of less than 3%, is helping augment earnings/cashflow outlook**. We expect NIFTY50 earnings to grow at a CAGR of ~19% over FY20-23.
  - Earnings growth expectation over FY20-23 is largely driven by normalising of depressed earnings by corporate banks, telecom, auto, commodities and pharma.
  - Margin expansion story to slow down as input costs rise and volume growth will be the key earnings driver in CY21, which will have its underpinnings on aggregate demand revival. Top line growth expectations, which reflect aggregate demand, are low to moderate.
- **Economic outlook: Near-term growth impulses are currently still weak** with households preferring savings over consumption, government spending constrained by weak financial resources, and corporate sector deferring capex and cutting opex. Some of these challenges will reverse in CY21 due to aggregate demand normalising, pent-up demand, and improving resource mobilisation by the government. We expect economic activity levels to normalise to FY20 levels in FY22 (GDP growth: FY21 -7.5%; FY22 +8.5%) and the INR to be fairly stable within the 73-75 range. Exports are expected to grow 13% in CY21 after dropping 11% in CY20. Price levels (CPI) are also expected to be stable within the 4-6% range in CY21. As per early ENSO forecasts there is little probability of El-Nino condition in CY21 which should augur well for monsoons.

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Sector analyses and top picks

Consumer staples and discretionary	Manoj Menon (+91 22 6637 7209) manoj.menon@icicisecurities.com Vismaya Agarwal (+91 22 6637 7632) vismaya.agarwal@icicisecurities.com Karan Bhuwania (+91 226637 7351) karan.bhuwania@icicisecurities.com
Outlook 2021	**CY2021: Potentially a year of consumption recovery (on low base for some).** **Staples:** We see moderate inflation and return of rural wage growth to be the key drivers. We expect the industry formalisation thesis to sustain – strategic focus on growth even at the cost of (gross) margins. There are risks too – consumers reverting to pre-CY20 behaviour (lower health and hygiene focus, lower in-home consumption of packaged food). **Discretionary:** Growth drivers are (1) sharp demand recovery (mostly priced in), (2) store expansion (locking in lower rentals) and (some) cost efficiencies driving operating leverage benefits. **Paints:** We remain structural bulls as companies continue to focus on creating multiple growth drivers, mostly DCF-accretive (home décor, ancillary products – waterproofing, adhesives, primer, putty). **Valuation:** As per I-Sec Consumer Momentum Indicator (CMI), we find better margin of safety in Staples (4% undervaluation) over Discretionary (28% overvaluation). **Top picks:** Akzo, Bajaj Cons., Dabur, Godrej Cons., HUL, ITC, Jyothy Lab **Businesses with industry tailwinds:** Jubilant Foodworks, Titan, Sheela Foam, Westlife, Zydus Wellness **Executing better:** Asian Paints, Emami, Marico, Nestle, Tata Cons., United Spirits **Special situation:** Bajaj Consumer **Preferred turnaround picks:** Akzo Nobel, Page **Top-10 trends for 2021:** #1 Staples growth recovery could be delayed – lags GDP growth by 4-6 quarters #2 Inflationary environment key to revenue growth performance #3 Rural wage growth necessary for real rural recovery #4 Optical recovery in rural and premiumisation trend #5 Consumers reverting back to pre-COVID behaviour could be a big risk to growth #6 Channel dynamics – opportunities & otherwise #7 Retailers look for store network expansion in CY2021 (after a pause in CY2020) #8 Volume growth focus over gross margins #9 Cost savings and efficiencies to likely support operating margins #10 M&As could accelerate – bolt-ons **Valuation and risks:** We value stocks on DCF (WACC and TG ranging from 10-13%, 3-6% respectively) except Godrej Cons. and Tata Cons. which we value on SoTP basis. Key upside risk is better-than-expected gross margins due to correction in input prices. Key downside risk is unexpected irrational competition due to deceleration in general consumption demand. Please refer table 8 for revised target prices and ratings.
Stock Picks	**Top picks:** Akzo, Bajaj Cons., Dabur, Godrej Cons., HUL, ITC, Jyothy Lab **Businesses with industry tailwinds:** Jubilant Foodworks, Titan, Sheela Foam, Westlife, Zydus Wellness **Executing better:** Asian Paints, Emami, Marico, Nestle, Tata Cons., United Spirits **Special situation:** Bajaj Consumer **Preferred turnaround picks:** Akzo Nobel, Page

Autos	Nishant Vass (+91 22 6637 7260) nishant.vass@icicisecurities.com Pratit Vajani (+91 22 6637 7161) pratit.vajani@icicisecurities.com
Outlook 2021	It is fair to assume CY20 did not go as per plan (thanks to Covid) for most and the auto sector too was impacted as mobility needs got constrained in H1 due to lockdowns. However, H2 was a story of pent-up demand release and growing industry optimism. As we move into CY21, we find ourselves forecasting strong double-digit industry growth (aided by base effect: H1CY20) while assuming a continuation of more of the same trend (rural outperforming urban). A better winter crop harvest under the rising commodity price environment is likely to benefit rural cashflows. Rebound in infrastructure activities (e.g. construction) in rural markets could also lend a fillip to ancillary income streams for households, hence the relative preference for more rural-facing auto segments, viz. tractors and 2Ws vs PVs. We expect urban PV demand to remain more skewed towards the ‘uptrading existing vehicle’ theme with SUVs continuing to grow in terms of volume/revenue contribution. Commercial segment demand (CVs / 3Ws) is likely to undergo the sharpest rise as economic activity normalisation would increase the need for freight carrying capacity. Key risk: Sustenance of current elevated input costs could dent margins if OEMs defer proportional price hikes. **Top ideas:** Bajaj Auto, TVS Motors, Balkrishna Industries, Motherson Sumi **Value buys:** M&M, Tata Motors, Mahindra CIE On the consumer side, we believe Covid has prompted rapid digital adoption, which is unlikely to reverse easily. Thus brand interactions with customers, whether virtual product launches or virtual vehicle selling, has become a quintessential requirement. This is likely to act as a pivot towards leaner and more customer service oriented dealership franchises with reduced need for excessive physical presence. Rise in finance penetration and a well incentivised scrappage policy could be potential levers to keep prices of 2Ws and the demand-challenged CVs under control. **Top-8 focus trends for CY21:**

	1. ‘Premiumisation’ continues to be in play; ‘scooterisation’ expected to revive in CY21 2. Rural again continues to drive aggregate demand 3. Scrappage policy, freight demand increase could act as triggers for M&HCV industry 4. North and East regions continue to do well as mobility normalisation happens 5. Consumer sentiment remains modest amidst continued unemployment worries 6. Competitive intensity likely to remain elevated (discounts and new launches) even as rising input costs potentially dent margins 7. Rising finance penetration with lower interest rates to smoothen monthly wallet impact 8. Tractor sales growth trends to remain positive, but expectations also remain high **Valuation and risks:** Auto is a cyclical sector; hence we use throughcycle (10-15 years) valuations to analyse the position of the cycle. Sector valuations currently remain relatively expensive on a forward basis even as consensus expectations factor-in FY18/FY19 peak industry dynamics to reflect back in FY23. **Key upside risk:** Better than expected volume recovery. **Key downside risk:** Margin decline amidst rising input costs.
Stock Picks	• **Top ideas:** Bajaj Auto, TVS Motors, Balkrishna Industries, Motherson Sumi • **Value buys:** M&M, Tata Motors, Mahindra CIE

Insurance	Ansuman Deb (+91 22 6637 7312) Ravin Kurwa (+91 22 2277 7653)	ansuman.deb@icicisecurities.com ravin.kurwa@icicisecurities.com
Outlook 2021	We believe CY21 will continue to have tailwinds for Indian life as well as non-life insurance sectors. Health premiums and motor recovery along with price hikes should be the main levers for non-life insurance. Life insurance will have growth from positive outlook on protection and from new distribution tie-ups. **Protection can bounce back with improvement in medical tests and credit disbursal:** Growth in sum assured (ex-LIC), has moderated from 25% / 12% / 38% in Apr’20 / May’20 / Jun’20 to 9% / (-)17% in Oct’20 / Nov’20 for individual sum assured while growth in group sum assured (ex-LIC) has improved from (-)41% in May’20 to (-)6% in Nov’20. Improvement in credit disbursements can further increase credit life while individual protection should benefit from better possibility of medical testing. Savings segment should see sustained relative attractiveness over bank deposits amidst low interest rates. Higher government borrowing program to aid cash flow management to insurers. (charts 2,3 and table 2) Premium growth can be aided by increasing bancassurance partnerships. Non-life should continue to outperform on the back of: (1) strong growth in health premiums (chart 4). We have seen similar trends in China (table 3 and chart 5); (2) high but decelerating trend in Covid-related claims (charts 6&7); (3) gradually improving auto registrations (table 4); (4) declining market share of PSU insurers (chart 8).	
Stock Picks	• **Top-picks: SBI Life, ICICI Lombard**	

Capital Goods	Renjith Sivaram (+91 22 6637 7340) Vipin Goel (+91 22 6637 7397)	renjith.sivaram@icicisecurities.com vipin.goel@icicisecurities.com
Outlook 2021	• Given the likely recovery in capex from public sector, multilateral funded projects and certain process industries, we believe, companies like L&T, KEC will be key beneficiaries. In mid and small cap spaces, we prefer AIA Engineering, Engineers India and ISGEC. Having survived the worst of the Covid-19 pandemic and lockdown-related slowdown, the macro outlook is limping back to normalcy. Public sector may continue to do the heavy lifting in terms of investments in near to medium term. However, certain segments like pharma, chemicals, electronics, emission-norm solutions, cement, energy optimisation solutions, automation, digitalisation etc. are currently in investment mode. With government’s focus on renewable energy, we believe, orders related to green energy corridors will witness finalisations and healthy executions. Thermal power capex weakness will continue, with focus shifting to renewables. • **Top-picks:** Larsen & Toubro, KEC, AIA Engineering • **Valuation Re-rating pick:** Cummins India • **Small-cap valuation pick:** ISGEC • **Domestic oil and gas valuation play:** Engineers India • **Cranking up of economy to favour cyclicals:** We believe the traction in public sector spending to crank up the economy will be a key trend in 2021, given the sharp fall in GDP due to the lockdown. Given the strain in borrowing, there may be urgency to push multi-lateral funded projects and capex from other budgetary sources. Hence, we believe this can boost growth prospects of cyclical companies, who execute projects and supply products catering to infrastructure segment. • **Automation and digitalisation demand to remain sanguine:** To enable export competitiveness and improve efficiency, we believe, demand for automation and digitalisation will continue. Solutions towards emission control and energy optimisation may also see healthy growth traction. • **Stable growth expected from process industries:** Though there is a lull in the overall investment outlook from large core industries, thermal power etc, we believe, there will be healthy demand from process industries like food & beverages, pharma, chemicals etc. Capex programmes of oil and gas may also continue in near to medium term. • **PLI scheme and electronics capacity addition to propel demand:** Government has recently announced PLI scheme focusing towards localisation of consumer durables, auto and electronics. This is likely to support demand for automation, motors and other products. We believe this will drive private sector capex in the near to medium term.	
Stock Picks	• **Top-picks: Larsen & Toubro, KEC, AIA Engineering**	

Cement	Krupal Maniar, CFA (+91 22 6637 7254) krupal.maniar@icicisecurities.com Dharmesh Shah (+91 22 6637 7480) shah.dharmesh@icicisecurities.com
Outlook 2021	• We continue to maintain our positive stance for CY21 as we expect consensus earnings upgrade to continue. Industry average EBITDA/te grew 25% YoY in FY20, which further rose 20% YoY to >Rs1,250/te in H1FY21. With improving volumes / prices, investors are likely to get more convinced about the sustainability of these profitability. Consensus FY21E / FY22E EBITDA has been upgraded by 25% / 15% during H2CY20; our estimates are ~10% ahead of consensus (refer table 2). SRCM and UTCEM remain our top picks. We also like ACEM, JKCE and TRCL. **Key trends for CY21** • **Demand recovery likely to be robust** with 13-14% YoY growth for FY22E on a low base (2-3% YoY decline in both FY20 and FY21E), **resulting in 6% CAGR over FY20-22E**. Rural and semi-urban housing coupled with government-led infrastructure will be the key demand drivers. East, Central and South are likely to lead demand growth, also aided by elections in West Bengal, Uttar Pradesh and Tamil Nadu. • **Capacity additions to grow at 4% CAGR over FY20-23E:** 60% of 33mnte clinker and 70mnte cement capacities (including ~10mnte likely to be announced soon) are planned to be added in high-growth markets of East and Central regions over FY20-FY23E and 50% of these capacities are expected towards the end of FY23E. Huge divergence in regional growth during FY20-21E has resulted in North, Central and East operating at 85% utilisation in FY21E from 80% in FY19; while utilisation of South and West has likely declined from 70% in FY19 to current ~60%. • **Industry consolidation to increase further** with share of top six companies in the respective regions ex-South likely to increase from 67-80% in FY19 to 77-85% by FY23E. A few more M&As (including that of JPA) may result in further consolidation. • **Prices may further increase in North and Central in FY22E** led by increasing utilisation and higher consolidation. However, prices in East may remain under pressure owing to fight for market share. Prices in South rose sharply by >10% in FY21E till date, hence are expected to remain volatile. Cost escalations are likely to be passed on and companies may report >15% YoY EBITDA growth in FY22E over ~15% YoY growth in FY21E. Consensus earnings upgrade may continue in CY21. • **Decade of stock price outperformance backed by strong earnings / growth visibility:** Sector has outperformed broad indices over the past decade and delivered robust returns, and we expect this trend to continue. UTCEM, SRCM, TRCL and JKCE delivered 17%, 29%, 24% and 30% CAGR returns respectively over past 10 years, and 13%, 18%, 19% and 26% over past five years; they have also outperformed broad indices over past one / two years.
Stock Picks	• **Top picks: SRCM, UTCEM**

Pharmaceuticals	Sriraam Rathi (+91 22 6637 7574) sriraam.rathi@icicisecurities.com Vinay Bafna (+91 22 6637 7339) vinay.bafna@icicisecurities.com
Outlook 2021	• We remain positive on the pharma sector for next year as we expect growth in India formulations to revive to 10-11%, cost control measures undertaken during the pandemic to aid profitability, and positive growth in US sales on a corrected base coupled with normalised price erosion. Pharma companies under our coverage witnessed an average 58% growth in stock prices over the past one year largely due to improved profitability and valuation rerating given growth visibility. USFDA inspections have been restricted in CY20 due to the pandemic and would resume once the COVID-19 situation normalises. We recommend BUY on companies with strong India business and pipeline of complex generics in the US. Cipla, Alkem and Abbott India are our top picks. • **Outlook for CY21:** We are positive on the sector and expect revenue growth to improve in the coming year. We believe India business would see healthy recovery in growth on the low base of CY20, which has been impacted by COVID-19 led lockdown. We believe ~10% growth is sustainable over the medium term while CY21 may witness higher growth. In the US, companies with clean FDA record and complex generics pipeline are poised to grow with steady improvement in profitability. USFDA inspections were restricted in CY20 owing to travel restrictions caused by the pandemic. We expect these inspections to resume as the situation normalises with an option of implementing desktop audit for quick resumption of the process. Progress on specialty business in the US would be closely monitored as this segment has lagged expectations. API and CRAMS businesses would continue to grow at a healthy pace with India becoming a preferred manufacturing destination. • **Key sector trends in CY20:** Key notable trends in pharma were: 1) lack of USFDA inspections at Indian plants as travel restrictions were imposed since Mar-Apr'20 due to the pandemic; 2) weak growth in India formulations, especially in the acute segment as new prescriptions dwindled with low doctor-patient interaction due to the lockdown; 3) strong traction in API business; and 4) cost rationalisation. The sector outperformed the broader market led by growth visibility, profitability improvement led by cost savings, stable pricing in US market, and no major regulatory hurdles. Indian plants received four warning letters in CY20-TD vs 15 in CY19 as the number of inspections was limited this year. • **Key expectations in CY21:** - Growth recovery in Indian branded pharma market to be >10% vs ~3% in CY20. - High number of USFDA inspections once situation normalises since several plants are due for re-inspection. - Positive growth in US generic business as price erosion has normalised. - Improved profitability and cost-savings undertaken during lockdown would partially sustain. - Focus on execution to improve growth and moderation in capex & R&D spend. • **Our view:** We continue to prefer companies with higher India sales, complex generic pipeline in the US, and clean FDA status. **Top picks:** Cipla, Alkem Labs, and Abbott India. Rationale: higher India sales, and improving margins

	and return ratios. Considering the recent run-up in stock price, we downgrade Aurobindo to ADD from Buy, Cadila to HOLD from Buy, Glenmark to ADD from Buy, JB Chemicals to ADD from Buy, Natco to HOLD from Add, Pfizer to REDUCE from Hold, Shilpa Medicare to HOLD from Add and Strides to ADD from Buy. Post the recent stock price correction we upgrade Sanofi to ADD from Hold. • **Key risks:** High number of USFDA inspections, currency volatility, and inclusion of more products under NLEM in India.
Stock Picks	• **Top picks: Cipla, Alkem Labs, and Abbott India**

Branded Apparels	Krupal Maniar, CFA (+91 22 6637 7254) krupal.maniar@icicisecurities.com Dharmesh Shah (+91 22 6637 7480) shah.dharmesh@icicisecurities.com
Outlook 2021	Apparel retail companies are likely to see gradual demand recovery in CY21 with concerns around Covid may recede by mid-CY21. After sharp >40% YoY decline in CY20, revenues may inch towards CY19-levels in CY21. Companies have partially resumed purchases for SS'21 collections, given demand optimism seen during recent festive sales. Most companies strengthened their balance sheet in CY20 via equity raise and are likely to resume aggressive expansion in CY21 as the market is still hugely unpenetrated. Online / e-commerce sales seem poised to continue the growth momentum seen in CY20. We remain cautiously optimistic on apparel retail for the coming year. Top picks: Trent, V-Mart, ABFRL. **Top key trends for CY21:** • **Acceleration in distribution network:** After a halt in CY20, companies are likely to accelerate store additions in CY21 as the market is still hugely unpenetrated. ABFRL may add 300-400 EBOs and 30-40 Pantaloons stores. Trent may add 25-30 Westside stores and 70-80 Zudio stores while V-Mart may add 40-50 stores in CY21. • **Footfalls to increase** as concerns around Covid may recede by mid-CY21. • **Greater adaptability and acceptability of e-commerce as a channel:** Online / e-commerce sales seem poised to continue the growth momentum seen in CY20, with its share increasing from low-single digit to low-double digit. Accordingly, companies may invest further to strengthen their online capabilities. • **Value-fashion retail may gain momentum** as price-conscious consumers from the unorganised sector get first experience of organised retail. • **Lifestyle brands seek to make WFH fashionable:** Companies have introduced WFH wear as a new category, which provides all-day clothing for remote working, conference calls /virtual meetings. This may help reduce huge unsold inventories. • **Women wear, kids wear, casualwear, athleisure, sportswear are expected to grow faster** than the relatively matured formal menswear market. • **Few cost savings** (e.g. winding-up of unprofitable stores, rationalisation of travel, repairs, warehousing and discretionary spends, re-negotiated rents etc) **may be structural** and companies are likely to return to pre-Covid profitability in CY21. • **Companies may see working capital release** with sales improving from H2FY21. • **Industry consolidation:** Companies with stronger balance sheet may seek opportunity to gain market share.
Stock Picks	• **Top picks: Trent, V-Mart, ABFRL.**

Building Materials	Nehal Shah (+91 22 6637 7235) nehal.shah@icicisecurities.com Jigar Shah (+91 22 6637 7416) jigar.shah@@icicisecurities.com
Outlook 2021	The organised building material sector is likely to be on a strong comeback trail with branded companies expected to report healthy volume growth/earnings in CY21 driven by: 1) low base of last year, 2) strong pent-up demand in renovation / refurbishment segment, and 3) impressive pick-up in secondary sales in real estate sector post Covid. In the branded categories space, we expect growth recovery in CY21 to be led by: 1) the plumbing pipe segment (expectations of accelerated consolidation in PVC/CPVC pipes post Covid), 2) tile segment (driven by impressive market share gains from Morbi players who are incrementally focusing on exports post Covid) and MDF (on the back of higher demand for modular furniture (MF) vs organised carpentry, and 3) expected increase in MF shipments with India likely becoming a manufacturing hub replacing China). **Outlook CY21: Branded plumbing pipe, tile and MDF categories are likely themes to outperform in CY21.** Branded categories like plumbing pipes, MDF and ceramic tiles seem poised to outpace the other building material categories in terms of volume growth recovery. We also expect other categories to report healthy growth led by lower base of last year. Recovery in adhesives / construction chemicals, plywood and laminates (more dependent on growth in secondary real estate market or refurbishment/renovation demand) is likely to be more visible than in the sanitaryware segment, which derives a high percentage of growth from new construction activities. • **Ceramic tiles:** While the ceramic tile category also derives high percentage of growth from new construction activities (which may take time to recover), the branded ceramic tile players are likely to witness impressive volume recovery driven by market share gains from the Morbi players who are focusing incrementally on exports, which has seen exponential surge post Covid. • **Plumbing pipes:** Accelerated consolidation in the PVC/CPVC pipe segment post Covid, sustained replacement demand and opening up of opportunities in the underground drainage system and water storage tanks space in India, are likely major catalysts for branded plumbing pipe players in CY21. • **Wood panels:** Gradual liquidation of high inventories in real estate sector resulting in higher rate of occupation of

premises, and pent-up demand in renovation, would aid recovery in the plywood/laminates segment. MDF category on the other hand is expected to report robust growth in CY21 led by: 1) increasing demand in India and opening up of export opportunities post Covid, 2) increasing replacement to cheaper plywood, and 3) import substitution on expected anti-dumping duty on thin MDF and likely countervailing duty on all MDF imports.

- **Adhesive/construction chemicals:** Increasing awareness and acceptance, and firm pent-up demand in maintenance and DIY categories in particular would drive decent growth in CY21.
- **Sanitaryware:** The sanitaryware category, which derives a high percentage growth from new construction activities in the real estate sector, may witness relatively slower recovery than the other building material categories.

Stock Picks

- **Value picks**: Greenply Industries (MTLM)
- **Growth + Value picks (in order of priority)**: Greenpanel Industries (GNPL), Prince Pipes (PPF), Century Plyboards (CPBI)
- **Stocks having considerable rerating or turnaround potential in the near term (in order of priority)**: Greenpanel Industries (GNPL), Somany Ceramics (SOMC), Greenply Industries (MTLM)
- **Resilient and compounding themes (in order of priority)**: Astral Poly Technik (ASTRA), Supreme Industries (SI), Pidilite Industries (PIDI), Kajaria Ceramics (KJC)

Dairy

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Outlook 2021

Due to reduction in milk procurement prices, the dairy companies under our coverage reported life-high margins in CY20. While there was some impact on revenues due to lower sales to HoReCa and institutions, the B2C sales were not impacted in CY20. Milk procurement prices declined due to (1) reduction in demand from HoReCa and B2B consumers and (2) normal monsoon as well as flush season. Global SMP prices declined c.10% which also impacted milk prices in India. In H1CY21, we model the dairy companies to continue to report life-high margins. However, we expect milk procurement prices to increase in H2CY21 and expect reduction in EBITDA margins in H2CY21. We model the Dairy companies under our coverage to report revenue and PAT growth of 12% and 28%, respectively in CY21, YoY. Stock calls: Retain BUY on Heritage, HOLD on Hatsun and Parag.

- **What happened in CY20:** Stock prices of dairy companies (Heritage & Parag) declined 12-15% whereas Hatsun's share price increased c.40% due to better earnings. The revenue growth of dairy companies was in the range of min-single digits in CY20, YoY whereas PAT growth was 60-100%, YoY. EBITDA margins expanded due to reduction in milk procurement prices.
- **Lower milk procurement prices:** Milk procurement prices declined 12% in Dec'20 from Dec'19 levels. Key reasons for higher milk procurement prices were (1) lower demand for milk from B2B customers, (2) lower demand for value added products such as ice-cream, (3) normal monsoon in CY20 and (4) normal flush season in CY20.
- **Lower global SMP prices:** Due to lower demand for milk globally, SMP prices declined to US$2,799 in Dec'20 from US$3,036 in Jan'20.
- **Deflation in animal feed prices:** The animal feed prices also declined during CY20 and key reasons were (1) Lower demand from farmers due to lower milk prices, (2) Higher production of food-grains and (3) availability of green fodder due to normal monsoon. Godrej Agrovet's animal feed prices deflated 3% in Q3CY20.
- **What to expect in CY21:** We expect milk procurement prices to remain lower in H1CY21 but increase in H2CY20 due to rising food inflation which will push animal feed prices upwards. We also model dairy companies to raise prices in H2CY21. We model the dairy companies under our coverage to report revenue and PAT growth of 12% and 28%, respectively in CY21 over CY20.
- **Stock Calls:** We maintain Heritage as our top pick in Dairy sector with BUY rating. While we remain structurally positive on Hatsun, we need more comfort on valuations to turn bullish. Hence, we rate Hatsun HOLD. We also maintain HOLD rating on Parag as the company is unlikely to retain benefits of lower milk procurement prices. It generates c.35% revenues from B2B consumers.

Stock Picks

- **Top picks: Heritage Foods**

Metals

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Outlook 2021

Our outlook for metal stocks under coverage remains cautious to negative for CY21. We rate all metal stocks at either HOLD / REDUCE / SELL. We downgrade Tata Steel and Hindalco to HOLD from ADD and JSPL to REDUCE from ADD. The current margins, valuations clearly tell a story of caution. Chinese demand stimuli, artificial RM shortages through restrictions on scrap imports (helping all the commodities -- iron ore and aluminium in particular) sustain the rally for now. Deleveraging, as a theme, is important but overhyped given such cyclically high margins, valuations.

What happened in CY20?

- **Covid induced correction, followed by a sharp recovery.** The extent of correction and the V-shaped recovery can be gauged from the fact that while Q1FY21 witnessed ~Rs6,000/te EBITDA for Tata Steel, it can very well be ~Rs18,000-19,000/te for Q4FY21.
- **Chinese demand outlook improved.** Chinese steel demand continues to surprise all through the year (even in November). Despite 12-13% production growth, there has hardly been any increase in exports. Consensus demand estimates for CY21 stands at 4-5% YoY, which is impressive given the base of CY20.
- **Valuations are rich.** We looked at asset valuations. Stock prices have doubled after touching 0.5x P/B or below. At current P/B, RoEs are already stretching and testing the upcycle RoE. The margin of safety is gone.
- **Steel/Aluminium margin curves are testing cyclical highs.** The same is true for Indian counterparts (Chart 1-3).

Chinese BoF spreads are at levels where firms are making decent profits even while costs are challenged artificially – through restrictions of scrap and of late coking coal imports from Australia. Latest Chinese aluminium smelter profits (average) ~US$500-600/te.

- **Strength in iron ore continues.** Continuous restrictions of scrap imports in China have increased costs for Chinese EAF-led players, thereby, allowing relative BoF profitability at higher iron ore prices. Brazilian export recovery has been much slower than expected. Nov' 20 exports fell ~6% MoM, Vale has reduced production guidance for CY20. 400mnte Brazilian ore production has been pushed back to CY23. Indian iron ore mining witnessed disruption as expected, the same could hardly translate into returns for NMDC, given the additional incidence of premium to renew Karnataka mines. Yet supply stays constrained and is leading to elevated pellet prices (~ Rs 11000/te now) and margins for players like NMDC (Q3/Q4FY21 margins can be ~Rs2,600-2,700/te).

CY21 Outlook (India steel/iron ore/aluminium)

- **We rate all metal stocks at either HOLD / REDUCE / SELL. We downgrade Tata Steel and Hindalco to HOLD from ADD and JSPL to REDUCE from ADD.**
- With spreads at cyclical high, CY21 comes with a high probability of correction in spreads – across steel, aluminium. As spreads correct, so will valuations.
- Given that aluminium is a start-stop sector, increase in aluminium profitability is leading to a delayed response to increase in aluminium production. Hence, pricing response in alumina is a bit delayed.
- **There is hardly any EV theme in conventional commodities (steel/aluminium/zinc)** that we see. There is no copper miner in India barring Hindustan Copper, where there was newsflow of a possible merger with Coal India/NMDC.
- There are **artificial supports to global spreads** driven by Chinese restrictions on imports of scrap, and on restrictions of coking coal. It's not a matter of if, but when restrictions ease.
- **Past cycle learnings.** The trigger for directional change in margins cannot be anticipated. The downturn will be equally sharp. Avoid commodities is the call for CY21.

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Outlook 2021

Vaccine-driven demand recovery is likely to boost GRMs, oil and spot LNG, but hit Henry Hub prices and marketing margins. This augurs well for GAIL's H2FY21E-FY22E gas marketing and earnings outlook vs its poor showing in H1FY21. IOC's FY21E EPS would surge driven by marketing margins and inventory gains. Its reported FY22E EPS is estimated to fall (no inventory gains), but core EPS to rise YoY. FY21E-FY22E EPS of only GGL, GSPL and PLNG, whose volumes are back to pre-lockdown levels, are estimated to be up YoY. GGL is our top pick in CGD given its strong EPS and volume growth and as it is likely to be the least hit by competition. IGL and MGL are more vulnerable to competition though its impact may not be as severe as earlier thought and be visible only after some time.

- **GGL and GSPL top picks:** Notification of regulations allowing competition, OMCs demanding 90-100% rise in commission on CNG sold from their sites, and likely rise in domestic gas prices (committee is expected to propose a formula revision) do not augur well for IGL and MGL with high CNG in their sales mix. Regulations appear to have made it difficult for OMCs to hurt incumbents in retail CNG, but they may be hit if OMCs target BEST and DTC (10-43% of MGL-IGL's volumes). Despite likely strong H2FY21E EPS driven by lofty margins and no impact of competition in the near term, we reiterate SELL on IGL and REDUCE on MGL. Among CGD players, we prefer GGL. We estimate GGL's FY20-FY22E EPS CAGR at 22% (FY21E driven by margins and FY22E by volumes) and volume CAGR at 11% driven by ceramics, chemicals and pharmaceuticals and NGT order to implement ban on polluting fuels. We reiterate BUY on GGL and its parent GSPL (GGL is the main driver of GSPL's earnings). We retain HOLD on PLNG, despite its 21% 2-year EPS CAGR, given risk of domestic gas output rise and regas terminal overcapacity in Gujarat by FY23E.
- **GAIL to gain from high oil prices:** Hopes that Covid vaccines would boost demand has led to surge in oil prices, which however may be capped due to: 1) lockdowns in US and Europe hitting demand, and 2) rising Libya, OPEC+ and US output. US sanctions on Iran exports, if lifted, may lead to oil price fall. High oil prices have boosted US rig count, oil and associated gas output, which in turn has led to fall in Henry Hub (HH) gas prices. Current spike in spot LNG prices due to liquefaction capacity outages is likely to be shortlived, but modest capacity additions will keep spot LNG prices high (FY22-FY23 futures at US$6.2-6.0/mmbtu). High oil, spot LNG and low HH prices would mean GAIL's gas marketing EBITDA at Rs9.2bn in H2FY21E (minus Rs8.9bn in H1) and Rs8.2bn in FY22E. We estimate GAIL's FY21 EPS to be down 37% YoY, but FY22E PS to be up 17% YoY. Retain HOLD.
- **GRM recovery key to IOC's stock performance:** IOC's share price is down 24% in CY20-TD despite H1FY21 EPS being up 117% YoY (driven by marketing margins and inventory gains) and trading at 0.85x FY21E P/BV and dividend yield of 7.3%. GRM recovery may be the key to IOC's share price rising. We estimate rise in global refinery utilisation to 77.6% in CY21E from 72.4% (38-year low) in CY20E, on vaccines boosting global demand and refinery closures, driving rise in IOC's GRM and its core EPS (excluding inventory gain) by 31% YoY. Retain ADD.

Stock Picks

- **Top-Picks: GSPL, GGL**

Real Estate	Adhidev Chattopadhyay (+91 22 6637 7451) adhidev.chattopadhyay@icicisecurities.com
Outlook 2021	While Covid-19 concerns may linger in CY21E, we expect the broader theme of consolidation in favour of large, organized developers to accelerate in CY21 as a number of unlisted developers continue to remain in financial trouble and grapple with stalled projects. Q2FY21 residential sales bookings for our coverage universe stood at 70-100% of Q2FY20 sales, which points to continued consolidation and market share gains. For CY21, all listed developers have a number of planned launches and continue to focus on monetisation of ready inventory. For office leasing, while CY20E may see a 50% YoY decline in demand, we expect leasing momentum to bounce back in CY21. With two REITs already listed in India (Embassy REIT and Mindspace REIT), this opens the door for more potential REIT listings by other large annuity asset developers. We reiterate our BUY rating on DLF, Brigade Enterprises, Phoenix Mills and the Embassy and Mindspace REITs. • **Consolidation in residential space to accelerate in favour of listed players:** Based on our channel checks and management commentary from listed developers in our coverage universe, the momentum seen in Q2FY21 residential sales bookings has carried forward into the festive season in Oct-Nov 2020 as low mortgage rates, price discounts and stamp duty cuts continue to attract home buyers. We expect these players' H2FY21 sales bookings to be either flat YoY or marginally higher YoY with continued focus on monetising ready inventory with a few launches thrown in depending on project approvals coming through. With all listed developers having a strong pipeline of launches heading into FY22E, we believe a combination of waning Covid-19 impact and further industry consolidation may enable our coverage universe to achieve a double-digit residential volume growth in FY22E. • **Office leasing to pick up in CY21:** While CY19 was a record year with 42msf of net absorption and another 40msf of net absorption was expected in CY20E prior to Covid, we have built in net absorption of 22msf in CY20E which is a 40-50% reduction in demand. While net absorption (incremental physical office space occupied) has taken a beating in Q2-Q3CY20 owing to lockdowns across India's Tier I cities, a number of pre-leasing deals being signed augurs well for a pick-up in occupancy levels from CY21. We expect office leasing to see a pick up from Q2CY21 (April 2021 onwards) and expect 28msf of net absorption in CY21E. • **REITs have emerged as a potent asset monetisation tool:** With two REIT listings in India by Embassy Office Parks and Mindspace Business Parks, the door has opened for more potential REIT listings from CY21 onwards. With India having 479msf of occupied Grade A office stock as of September 2020 and global institutional investors continuing to invest in annuity assets, we expect more REIT listings over the next 2-3 years. Developers in our coverage universe such as DLF, Phoenix Mills and Oberoi Realty have already highlighted their medium-term plans to consider a REIT listing. Further, large annuity portfolio buyouts in CY20 such as Blackstone buying out Prestige Estates' office and mall assets and Brookfield's acquisition of RMZ's office portfolio points to consolidation in favour of institutional landlords for annuity assets. • **Mall consumption showing green shoots in festive season:** While rental waivers may result in mall owners incurring an average 50% rental loss at the industry level in FY21E, consumption levels in Q3FY21 during the festive season range between 70-90% of pre-Covid levels. With increase in mall operating hours, resumption of Food and Beverage (F&B) and multiplexes, mall rentals may revert back to 90% minimum guarantee from Q1FY22 as consumption stabilises to pre-Covid levels in FY22E.
Stock Picks	• **Top-picks: DLF, Brigade Enterprises, Phoenix Mills and the Embassy and Mindspace REITs**

Technology	Sudheer Guntupalli (+91 22 6637 7573) sudheer,guntupalli@icicisecurities.com Hardik Sangani (+91 22 6637 7504) hardik.sangani@@icicisecurities.com
Outlook 2021	2021 should present an acid test for the lofty expectations around Covid-led acceleration in cloud / digital adoption and cost savings. Re-rating in Indian IT (~up to ~41%, v/s pre-Covid) hints at much taller expectations vs even global tech (MSFT, Amazon, Alphabet, ~3-17%). More surprisingly, the consensus optimism on Indian IT seems to be 'relatively' pushed out into longer term. These disproportionate / asymmetric expectations should correct in 2021. (1) Weakness in incremental sales / backlog of hyper-scalers (link), (2) stagnancy in cloud deals (link) and (3) Gartner's CY21 outlook (link) underpin our assessment. As inoculation and businesses progress to reestablish human connect, clients should recalibrate IT spends, which appear partly pulled forward (e.g. BFSI). So, rather than pent up, IT spends may turn out to be lower. Resumption in travel / marketing events and weaker US$ can be the key cost headwinds. In this backdrop, after 3 years of maintaining OW stance, we see high likelihood of NIFTY IT under performance in 2021. Prefer stocks with scope for idiosyncratic surprises & valuation comfort. • **Multiple positives (many one time) led to strong outperformance in CY20.** Relatively better business resilience / continuity (vs domestic sectors), strong beat on subdued estimates, great cost / cash management, lofty expectations around accelerated digital / cloud adoption and rub-off impact of the NASDAQ momentum largely led IT sector's stellar outperformance in CY20 (34% YTD, vs Nifty). Many of these surprises / factors are one time in nature and will cease to be relevant in CY21. • **Surprisingly, taller expectations for Indian IT vs even global tech.** The strong rally within NASDAQ 100 was largely fueled by stocks like Tesla, Apple, Netflix and Amazon etc – which have different business model and technology constructs (v/s Indian IT). It is interesting to note that global companies which are 'relatively' closer (e.g. Microsoft, Alphabet) have seen their stocks largely underperform Indian IT, as the pandemic unfolded. Multiple re-rating in Indian IT (~up to 41%, v/s pre-Covid) hints at much taller expectations vs global tech (~3-17%). Adjusted for the COE reset (-150 bps), stocks like Microsoft, Amazon and Alphabet, supposedly the biggest beneficiaries of a potential accelerated digitalisation, sharply de-rated (~3%-17%) over Feb – Dec'20. This indicates that unlike their Indian counterparts, US markets are not sharing a proportionate euphoria about the prospects of a material growth acceleration. More surprisingly, the consensus optimism on Indian IT seems to be relatively pushed out into longer term (v/s global tech) as reflected in FY22/CY21 EPS revisions over the course of the pandemic.

	• **CY21 will likely see correction in these 'disproportionate' expectations.** Indisputably, adoption of digital / cloud has been an evolving theme for a few years now benefitting IT firms. Going forward into medium term too, we expect this to be more of an evolution, rather than a revolution. We are skeptical on the street's hyper-optimism around Covid-led acceleration in digital / cloud adoption. (1) Weakness in incremental sales / backlog of hyper-scalars (link), (2) recent moderation in their commentary, (3) stagnancy in As-A-Service deals reported by advisories like ISG (link) and (4) Gartner's CY21 IT spending outlook (link) underpin our assessment. • **Rather than pent up, IT spends may turn out to be lower than usual.** While Indian IT reported marginal revenue decline / lower-than-usual growth in CY20, same thing cannot be said about the IT spends of some key verticals (e.g. BFSI). IT spends either remained resilient or even increased through the pandemic despite a decline in revenue run-rate across firms. This was understandable given many businesses upped their IT spends to ensure their business continuity / resilience. For instance, our analysis suggests increase in IT spends of Top-5 US / Top-8 global banks accelerated over 9MCY20 (vs 9MCY19, Refer charts 13-14). Some of these incremental spends may be one-time in nature (e.g. WFH enablement). Even adjusted for this, we understand many firms incurred higher-than-normal spends in strengthening their systems to cater to peak time digital traffic under lockdowns. We reckon this could have translated into partial pull forward of IT spends from future years. Now we notice that physical activity across most economies and industries is already reverting to pre-Covid baseline levels. Progress on inoculation over 2021 should further accelerate the reversion of traffic from digital to physical channels. As businesses focus on re-establishing human connect after a long gap, we expect re-calibration in IT spends, which appear partly pulled forward into CY20. Contrary to expectations, rather than a pent up, IT spends could turn out to be lower than usual in 2021. • **Travel, marketing events and weaker US$ – Potential cost headwinds.** Besides deferrals of wage hikes, absence of travel costs and marketing events were the biggest margin tailwinds for IT companies over 9MCY20. In our base case, we do not expect travel, marketing events to meaningfully resume before Sep-21. However, our recent conversations with industry stakeholders hint at potentially faster-than-expected resumption in travel. In addition, restarting of marketing events and potentially weaker US$ are key margin headwinds to look out for. • **We see high likelihood of NIFTY IT UNDER PERFORMANCE over 2021.** We have been maintaining Over Weight (OW) stance on the sector for the previous three years post Tax Cuts and Jobs Act (TCJA) came into effect in US in Dec-17. As disproportionate and asymmetric expectations of the street around Covid led (1) acceleration in cloud / digital adoption and (2) cost savings come more in-line with reality, we see a high likelihood of NIFTY IT under performance over 2021. Recent Infosys' commentary around reaching 'just' pre-Covid growth in FY22 (~8-10% YoY, vs expectations of strong acceleration) is a good starting point for the expectation reset. Some of the one-time (elaborated in Section I) and technical (erstwhile DII under-ownership) factors which partly aided the sector's massive re-rating / outperformance (vs both global tech and Nifty) over 2020 will cease to be relevant in 2021. Potentially, the last leg of surprise related to Covid 'comeback' should come in Dec-20 earnings. Current relative valuations of Indian IT (vs global tech) will present a more compelling investment case in the latter, especially for FIIs. In that context, we stay cautious and selective on IT sector preferring stocks with scope for idiosyncratic surprises & valuation comfort (INFO, HCLT, MPHL & MTCL). Over the previous few years (even pre-Covid), IT emerged as a relative trade to investors looking to hedge the weakness in the Indian economy / INR. Continued weakness in domestic macro can pose key risk to our thesis.
Stock Picks	**Large-caps: Infosys and HCLT ; Mid-caps: Mphasis, Mindtree**
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Outlook 2021	CY21 could be a year of significant industry repair with another round of large tariff hikes, which may drive higher revenue growth than previously (as major SIM consolidation is done) and with higher incremental EBITDA margin. Also, lower capex intensity means strong FCFE generation, particularly for Bharti Airtel (Bharti). For Vodafone Idea (VIL), it could be decisive year with big events such as fund raising, translation of tariff hikes, and reducing cash losses. We expect Bharti to continue growing its revenue market share contrary to consensus estimates. Spectrum auction may not be critical for incumbents due to their already strong holdings. Clarity on contingent liabilities would be closely watched on AGR payment terms and outcome of the one-time spectrum charges case. • **Tariff hikes should come anytime.** Telcos took tariff hikes of 25-40% in the prepaid category during Dec'19. Another round of hikes was expected in CY20, but has been pushed to CY21 due to: 1) Covid shock; 2) pending clarity on floor prices; and 3) VIL completing network integration and new branding. TRAI has floated a consultation paper evaluating floor prices on telecom services, and operators have asked for 5-9x increase in data prices. Outcome of the consultation is awaited. VIL has said it would be the first to take tariff hikes and is probably waiting for clarity on floor prices. Regardless of floor prices, tariff hikes to come latest by Mar'21 and peers to follow. We estimate tariff hikes to drive ~20% rise in Bharti / VIL's ARPU for FY22E • **4G subs addition should continue.** 4G penetration has increased to 57%, up 425bps in 6MCY20 despite the Covid shock. 4G subs base has grown by 7% to 646mn (43mn net add). This was partially enabled by Jiophone sales, which grew to 100mn in Mar'20. CY21 should see continued growth in 4G subs addition and may also accelerate from operators (subsidising) driven the low-end smartphone launch. This should help increase ARPU organically from change in subscriber mix. Unlikely earlier, Bharti has seen strong growth in its 4G subs in CY20 and, considering it has been expanding its 4G network deeper into the market, it should continue to grow fast. VIL's 4G net add has been subdued.

- **Revenue (comparable) growth to be higher.** Industry AGR (incl NLD) revenues have grown 27% over Q2FY20 to Q2FY21 aided by tariff hikes; however, industry revenues are still 8% lower than in Q1FY17. Further, operators' investment has significantly risen due to investments in 4G, AGR liability and higher debt. The industry therefore needs significantly higher revenues compared to pre-RJio launch to earn respectable return ratios. Our working shows, VIL needs >50% tariff hikes to cash breakeven in FY23E and remain a going concern. We are factoring-in mobile revenue growth (adjusted for IUC impact) of 26% and 20% for Bharti India mobile and VIL respectively in FY22E.
- **Bharti's incremental revenue market share to remain higher.** Bharti's incremental AGR (incl NLD) has grown sharply narrowing its gap with the market leader, thereby driving higher market share. Bharti's AGR (incl NLD) market share improved by 100bps YoY to 32.2% during Q2FY21 despite negative impact of Bharti becoming a net IUC payer from receiver. This should correct with IUC becoming nil from 1st Jan'21. This compares to RJio grabbing 315bps market share to 39%, which benefited from becoming a net IUC receiver unlike payer earlier. Bharti's incremental AGR (incl NLD) YoY has grown from just Rs3bn in Q2FY20 to Rs31bn in Q2FY21 and it has narrowed its gap with RJio to Rs13bn from Rs30bn earlier, thus earning higher incremental market share. This gives us confidence that Bharti's market share would continue to grow in FY22E too
  Further, Bharti was able to pass-on tariff hikes efficiently with least leakage into ARPU among telcos. Company may again be a net beneficiary of SIM consolidation (though lower magnitude) from upcoming tariff hikes, which is not factored in our estimates
- **Capex to moderate, FCF generation to rise.** On normalised basis, telcos should earn 65-70% incremental EBITDA margin and Bharti should get most of it. VIL may see higher EBITDA from cost optimisation and targeted saving of Rs40bn. We expect capex to moderate for Bharti in FY22E on completion of significant 4G expansion and investment into fiber. Though VIL has under-invested in network, we see a cashflow mismatch which would cap its ability to incur capex. Bharti has already been generating FCF and a rise in it EBITDA would only add to cashflow. We see Bharti generating Rs150bn in FCFE while VIL would see huge cash burn of Rs80bn. The cashflow is positive because it was positively impacted by moratorium on deferred spectrum liability
- **Spectrum auction limited to renewal spectrum.** DoT is planning for a spectrum auction in Q4FY21 (Jan-Mar'21) for spectrum coming up for renewal, and unsold 4G spectrum. It is unlikely to auction the 3300-3600MHz spectrum, which is the popular 5G band. Bharti and VIL have very limited spectrum coming up for renewal and RJio has 850MHz (originally owned by Reliance Communications). 1) Bharti has Rs129bn of spectrum coming for renewal at TRAI's recommended spectrum reserve prices if it renews entire spectrum. However, the company has already bought spectrum from Tata Tele, Telenor and Videocon in these circles, and thus does not need to renew its entire spectrum. In our base case, we estimate Bharti to buy spectrum worth only Rs58bn in the upcoming auctions. 2) VIL has Rs100bn worth of spectrum coming up for renewal; however, the Vodafone and Idea merger has added significant spectrum in VIL, and it may require to buy spectrum worth only Rs19bn in the upcoming auctions.
- **Liabilities to watch. 1)** AGR order says telcos have to pay 10% of total AGR dues by end-Mar'21. Operators believe they have already paid more than 10% towards AGR dues and don't see more payment in Mar'21. DoT is consulting with the Solicitor General on AGR order interpretation; and **2)** the Supreme Court is hearing the one-time spectrum charges case. Bharti has already provisioned Rs56bn and VIL Rs39bn in Q4FY20. In case telcos lose the case, it could be the worst case impact in our view.

Stock Picks	**Top Pick: Bharti Airtel**

Logistics

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Outlook 2021

We believe road-to-rail intermodal shift, given renewed Indian Railways' (IR) thrust to capture road traffic, will drive CY21 discourse. Given so much investment (per annum spend has been augmented from Rs450bn to Rs1,600bn) in freight intensive corridors for IR definitely warrants a look at rail-based players like Concor (upgrade to BUY from HOLD: 19.2% upside) and Gateway Distriparks (maintain BUY: 74.0% upside). Road consolidation theme didn't play out as expected in CY20. Yet the pressure on road will intensify once DFC commissions (expected on June 22). We maintain BUY on TCI Express (efficient express player) and VRL Logistics (normalisation of earnings and consequentially value).

What happened in CY20

- **Rail gained share from road in CY20.** Covid-19 pandemic has allowed Indian Railways to be significantly active in creating an intermodal (road to rail) shift. Rail freight has been showing substantial YoY growth in revenue and loading (YTD rail freight volumes down only 3.6%YoY). While rail was already gaining market share in autos, the same has been witnessed in FMCG and ecommerce with the start of parcel trains. There are trends of road traffic having shifted with the start of RoRo operations (e.g from Karnataka to Maharashtra).
- **Continued thrust on road capex was the counterbalancing factor for road to rail intermodal shift.** Even in the year of the pandemic, MoRTH YTD capex has increased by 5% YoY, while IR capital spend is actually down 3% YoY. Continued thrust on road construction continues to support road freight.
- **Organised road transport gains limited as moratorium extension limits stress on unorganised leveraged road operators.** As the stress of intermodal shift (road to rail) intensified (e-way bill generation for road transporters ~ 10-15% below pre pandemic), allowing market economics could have led to consolidation in the market and higher pricing power for debt free organised sector players. Yet, we see supply returning and increased pricing pressure starting to impact road operators as diesel prices increase.
- **Institutionalisation of warehousing segment continues to accelerate.** There has been a 44% CAGR increase in annual warehousing transaction from FY17-20. Mumbai (69%), Bengaluru (50%), NCR (45%) and Ahmedabad (43%) lead in terms of warehousing transactions. 3PL contributed ~35%, ecommerce ~23% and manufacturing ~23%. FMCG still contributed ~3% of the total transactions during this period and has just started to gather steam.

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- **Increase in global air freight and container shipping freight rates.** Global container (shipping) freight rates spiked, driven by years of capacity rationalisation (ships), reduction in belly cargo as passenger aircraft were grounded. The increase in air freight rate was witnessed in India, though since then commercial carriers have introduced significant domestic freight capacity. Also, the imbalance in EXIM trade have led to a reduction in inflow of containers, causing a shortage and an increase in container rental rates.

Expectations from CY21

- **The trend of intermodal shift (road to rail) will only intensify.** This trend is will only intensify with the commissioning of DFC, now expected in June 22. The three Gujarat-based ports will be connected to DFC first. This may lead to permanent shift in container cargo away from JNPT to Mundra and will perhaps help in NCR utilisation of ICDs a bit better than expected. One thing is certain, the intermodal shift, given so much investment in freight intensive corridors for Indian Railways definitely warrants a look at rail-based players like Concor (upgrade to BUY from HOLD) and Gateway Distriparks (maintain BUY). Express players will do well by collaborating with Indian Railways to increase i) business sustainability/ESG score and ii) thwart competition.
- **Distribution of Covid-19 vaccine -- what kind of opportunity is it?** Snowman Logistics (associate of Gateway Distriparks) highlighted the uncertainty in our Fireside Chat series (link) on sustained demand and profitability of vaccine distribution as well as cold chain. Investments are being undertaken in a cautious manner. While players like Mahindra Logistics (MLL), TCI Express (TCIE) and Blue Dart Express (BDE) are equipped to capture any business uptick possibility on account of vaccine distribution – initial interactions suggest limited excitement.
- **Warehousing consolidation to continue; 3PL players will be key beneficiaries.** NH development continues to define new warehousing clusters as more outsourcing is observed from FMCG and FMCD (still very nascent) spaces – both having contributed only 3% to last three years' warehousing transactions. MLL will be a key beneficiary of the same.

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<tr><td>Stock Picks</td><td>• Top picks: TCI Express and Mahindra Logistics</td></tr>
<tr><td>Healthcare</td><td>Sriraam Rathi (+91 22 6637 7574) sriraam.rathi@icicisecurities.com
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<tr><td>Outlook 2021</td><td>

We remain positive on healthcare space and expect strong growth recovery in non-COVID business along with potential margin improvement from cost-control initiatives undertaken in the past few months. Sector companies under our coverage witnessed average appreciation of 37% in stock prices over the last year largely driven by diagnostic companies. Key notable points for CY21: 1) Recovery in occupancy level including medical tourists for hospitals, 2) likely improvement in volume growth for diagnostic companies with shift from unorganised market to organised players, 3) incremental business from COVID-19 patients and 4) upward reset of EBITDA margin with partial continuation of cost-control initiatives undertaken during the lockdown. However, the meaningful stock price appreciation over the past few months has limited the upside potential.

- **Outlook for CY21**
  - **Hospitals:** We expect occupancy levels to move back to pre-COVID levels in H1CY21 as lockdown restrictions have largely been eased and elective surgeries are reverting to normal levels. However, medical tourism will take longer to normalise (10-15% of hospital revenue for companies) as international travel remains limited and apprehensions may remain until successful preventive vaccination. We expect revenue growth to be strong ~25% in FY22E on a low base that has been impacted due to the lockdown and return of normal double-digit growth. The companies focused on various cost-control measures during the lockdown, which may be partially sustainable and can also help in improving RoCE.
  - **Diagnostics:** We believe diagnostic companies will observe growth in base (ex-COVID) business in Q4CY20 and expect strong mid-teens growth in CY21. Low base of H1CY20 will help in registering very strong growth in H1CY21. Further, COVID-19 related tests will provide upside contingent on its continuity. We also expect faster shift from unorganised to organised players in the current environment as larger brands are associated with safety & hygiene and have efficient home collection, which has seen increased traction as well as likely consolidation in the industry.
- **Key sector trends in CY20:** Key notable trends across hospital and diagnostic sectors: 1) Business was impacted during lockdown as elective surgeries/tests were postponed and gradual recovery started in Q3CY20, and 2) diagnostic companies have seen faster recovery in base business volumes and most reached pre-COVID level volumes in Sep'20. We believe the cost-control measures announced during the lockdown by the companies will be partially sustainable over longer term. The impact on profitability was much lower than expectation despite loss of revenue resulting in earnings upgrades.
- **Our view:** We are positive on healthcare sector given high visibility on sustainable growth, increasing reach and likely margin expansion. However, stocks have seen meaningful re-rating in valuation in past few months which has limited the upside potential, hence we downgrade Apollo, Fortis and HCG to ADD from Buy. Top picks: Dr Lal Pathlabs and Aster DM.
- **Key risks:** Regulatory hurdles such as price ceiling on hospital treatments and diagnostic tests, and increase in competitive pressures.

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<tr><td>Stock Picks</td><td>• Top picks: Dr Lal Pathlabs and Aster DM</td></tr>
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Power	Rahul Modi (+91 22 6637 7373) Anshuman Ashit (+91 22 6637 7419)	rahul.modi@icicisecurities.com anshuman.ashit@icicisecurities.com

Outlook 2021

CY20 was an eventful year for power sector, which made a better-than-expected comeback in the second half after the difficulties faced during Q1FY21 due to the outbreak of Covid-19 pandemic. But we expect CY21 to be an operationally and financially stronger year for the entire sector, with many pending/on-going concerns likely to be addressed soon. CY21 is also expected to be a highly eventful year, particularly on the generation and distribution front, while transmission space may spring a surprise with few large-sized opportunities. Renewables are set to take a leap on several fronts – capacity, generation, manufacturing, rooftop, pumps among several others – but conventional will continue to hold strong. Expect innovative tendering, policies and financing to become a norm rather than an exception.

Top picks: NTPC (TP: Rs165/sh), Coal India (TP: Rs240/sh), CESC (TP: Rs851/sh)

- **NTPC –** Strong operational performance; capacity addition on track; 16% expected earnings growth over FY20-22E with 6-7% dividend yield; valuations attractive
- **Coal India –** Higher volumes; cost-control measures underway; receivables to decline; FY22E dividend yield at 14.8%.
- **CESC –** One of the most undervalued midcap power stocks; can rerate on any positive commentary/actions on better capital allocation; good operational recovery

Key things to watch in CY21:

- **Capacity addition –** RE, particularly solar, will gather a significant pace. Wind capacity addition will restart. Thermal addition is also expected to continue led by NTPC.
- Large RE parks (**UMREPP**) may be the new route to achieve capacity targets of 175GW RE by CY22-end and 300GW solar by CY30. **Solar tariffs** are expected in the range of Rs2-2.5/unit.
- **Demand recovery** looks strong and demand growth sustainable. Expect power demand to maintain its positive trajectory and end FY21 with 5-6% growth YoY.
- Domestic **coal production** will increase, helped by higher coal PLFs and e-auctions, which will consequently reduce dependency on imports.
- **Transmission** may witness a fillip with opportunities related to upcoming RE capacities, ISTS tenders and strategically important projects
- **Merchant power prices** may average higher at Rs2.5-3/unit as demand improves
- **Solar module manufacturing** will be promoted and further incentivised through policies and schemes. Around Rs45bn PLI scheme will help.
- **Stressed asset resolution** to restart.
- **Electricity (amendment) Act** and **National Tariff Policy** is expected to come up
- More discoms will be up for **privatisation**. Three discoms in Odisha have already been privatised and many other states and UTs are in the pipeline including MP, Jharkhand, Rajasthan, UP, Chandigarh, Puducherry.
- **Smart metering** to gain significant momentum
- Ambitious **KUSUM scheme** will start delivering and have a big impact. Scheme targets more than 30GW solar installation for agricultural sector through three components. Ultimate aim is to solarise agricultural feeders. No financial burden on farmers and opportunity to increase farmer income, reduce losses, reduce state subsidies and cross subsidies among other benefits.
- **SECI** to get more innovative with tendering including flexi RE contracts with focus on 24x7 RE supply, pure storage capacity tenders, revival of wind power and solarising agricultural grids.
- Further liquidity infusion through **PFC/REC scheme** will help ease systemic stress. Nearly Rs1.14trn has already been sanctioned; expect disbursements to the tune of Rs200bn in next one month
- Focus on improving on **ESG** front will continue for all companies in the sector

Stock Picks	Top picks: NTPC, Coal India, CESC

Media	Sanjesh Jain (+91 22 6637 7153) Sameer Pardikar (+91 22 2277 7637)	sanjesh.jain@icicisecurities.com sameer.pardikar@icicisecurities.com

Outlook 2021

Ad revenues were weak in FY21 due to Covid and lack of fresh programming for more than a quarter though digital media gained traction during the same period. We expect TV ad revenues to rebound in FY22E, but it could still be lower than in FY20. Further, Zee Entertainment (ZEEL) and Sun TV have lost viewership share, which would put pressure on realisation. Subscription revenues would face risk from NTO 2.0 implementation. ZEEL is aggressively investing in OTT and may continue with it while Sun TV is yet to start investing. Relatively, we like ZEEL as it may see much higher rebound in ad revenues and gain from traction in OTT, but key to watch would be continued balance sheet discipline.

- **GEC viewership at pre-Covid levels, OTT gaining huge ground.** Hindi GEC primetime viewership dipped in FY20 and has been low in FY21-TD due to fewer fresh programmes due to lockdown. In Q3FY21-TD, viewership has reached pre-Covid levels. However, we don't see much rise in viewership (impressions) from current levels due to strong penetration of OTT and pay-TV reaching maturity, particularly in urban markets.

  Though Zee TV has reached its pre-Covid (Q3FY20) viewership share, &TV saw erosion under this parameter, which was already low. Star has been aggressively investing in content and gained significant viewership share. Zee TV's new shows failed to lift its viewership share, and its top-2 shows are showing signs of weakness (Kumkum Bhagya and Kundali Bhagya). Until Zee TV refreshes some of its underperforming shows, we don't see it gaining viewership share in FY22.

  ZEEL's performance in South GEC market has been good with gains in viewership share in Tamil and Telugu with stable share in Kannada. However, it has lost significant viewership share in non-South regions – Marathi and Bangla – to Star and would need to significantly refresh shows to rebound to dominant position.

  Sun TV has lost considerable viewership share in Tamil GEC all-day segment. In FY21-TD its share was 47.7%, which has further declined to 40.6% in Q3FY21-TD. Sun TV's path to recovery could be difficult and may hurt margins.

  BARC viewership is currency and lower viewership share spells lower realisation. BARC viewership share is a good proxy to the broadcaster's market share in TV ad revenues. Sun TV's share in the ad revenue pie may shrink in FY22 if it fails to recoup its lost viewership share soon.

- **Can TV ad revenues cross FY20 levels?** Per FICCI-KPMG report, total ad revenues in FY21 are likely to dip 19.6% to Rs575bn and the only medium to see increase is digital at 12%. TV ad revenues are expected to decline 17% to Rs217bn in FY21E, but rise 19% in FY22E to Rs258bn, which would still be lower than FY20 levels. We see risk to TV ad revenues if OTT adoption rises significantly. Disney+ Hotstar has shared guidance of 70-100mn users by FY24. ZEE5 has been aggressively pushing adoption and we expect it to evolve as competitive digital platform over the coming years.

  We are factoring-in ZEEL ad revenues to dip by 20% in FY21E, but to rebound 31% in FY22E due to low base of past two years. We don't see it reaching FY19 levels of Rs50bn even in FY22E (Rs49bn). Sun TV may see a steeper ad revenue fall of 24% in FY21E due to: 1) higher dependence on local ads (40%), which would see gradual recovery; and 2) weak viewership share. We are factoring-in Sun TV's ad revenue bounce-back in FY22 but to be relatively lower at 28%.

- **Subscription revenues face risk of NTO 2.0 implementation.** NTO 1.0 boosted TV subscription revenues from higher consumer payouts and lower leakage. Further, rising adoption of OTT also has helped drive higher subscription revenues. FY21 was a difficult year and we understand broadcasters have not taken any price rise for channels or reduced discounts. NTO 2.0 implementation has been stalled due to ongoing case in Bombay High Court. The hearing is complete and the Court has reserved the verdict. If NTO 2.0 is implemented as proposed, we see headwinds to FY22 subscription revenues. We have factored-in ~7% subscription revenue growth for ZEEL / Sun TV in FY22E.

- **OTT: ZEEL aggressively investing, Sun TV promised investment in FY22.** FICCI-KPMG report estimates 22mn subscribers and subscriptions each in FY20, and we expect this to jump to 40mn subscribers and 41mn subscriptions in FY21, with the corresponding figures for FY22E being 57mn and 62mn respectively. We estimate subscription revenues to rise from Rs19bn in FY20 to Rs46bn in FY22E. These estimates look conservative as Disney+ Hotstar has shared guidance of 70-100mn paid users in FY24.

- ZEEL has been aggressively pushing ZEE5 to grab the rising OTT opportunity with its 'freemium' model. It has also been aggressive investing in original shows and movies, and has released 43 properties in H1FY21. ZEE5 revenues were Rs1.9bn in H1FY21 and we expect this to rise much faster over next five years. ZEE5 costs stood at Rs5.2bn, which includes content, marketing and technology costs. Though the company does not share data on paid subscribers, its monthly active users were 55mn in Q2FY21.

- Sun TV has been monetising TV content and movies through its OTT platform SunNXT, but it has not invested in originals. It plans to invest in originals from Q4FY21 and has announced corresponding spend of Rs2bn. Sun TV has been lagging in investment in content, marketing and technology, which is disappointing considering its very strong balance sheet.

- Sun TV is planning to release eight movies in next 12-18 months, which should help drive theatrical revenues, and their premiere on TV / OTT may help boost rating and subscriber base. It remains to be tested if only a strong movie library can drive loyal OTT subscriptions.

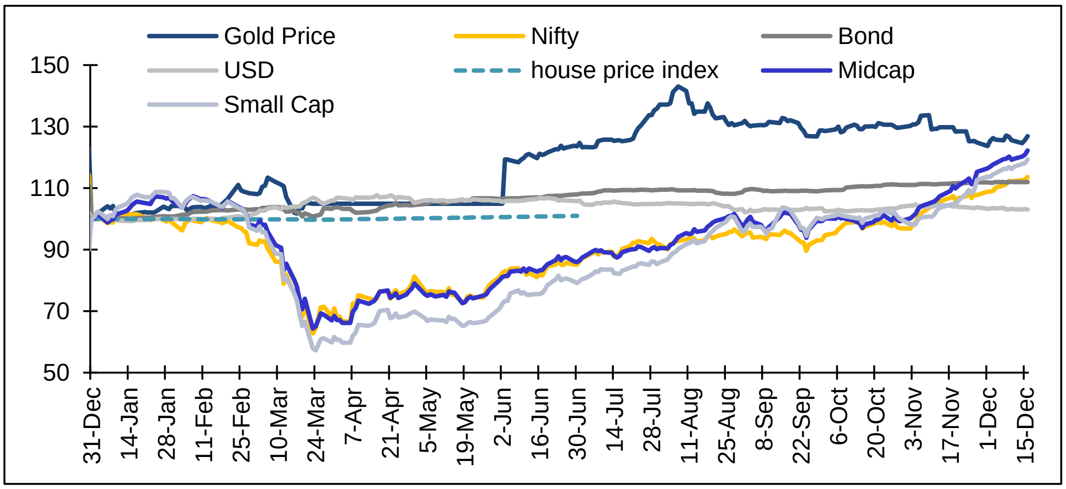
Aviation	Ansuman Deb (+91 22 6637 7312) Ravin Kurwa (+91 22 2277 7653)	ansuman.deb@icicisecurities.com ravin.kurwa@icicisecurities.com
Outlook 2021	The Covid impact on airlines was dominated by regulatory clampdown on flying in first half of FY21 while gradual opening up led to positive demand recovery from Sep'20. However, going into CY21, there is possibility of oversupply as capacity limits are gradually eased and aircraft lessors continue to work with all airlines to restructure lease tenures and payments. Crude rally can pose additional pressure on profitability as well as volumes. • **Expect complete recovery in domestic traffic in FY22 (back to FY20 levels) provided average fares remain flat.** There is doubt on complete recovery of corporate traffic (~40% of erstwhile mix) as work from home remains rampant with virtual platforms becoming the new meeting norm. However, on the basis of pent-up demand, partial recovery of corporate traffic and overall traffic recovery seen in countries like China, we expect domestic traffic in FY22 to restore back to FY20 levels (141mn). However, this will happen only if average fare remains broadly at levels of ~Rs4,000. • **Vaccine transport remains a huge, but uncertain, opportunity for airlines.** Transportation of Covid vaccines remains a humungous opportunity for airlines, but very challenging too. The low-temperature transportation requirement will have many stipulations and infrastructure requirements for first mile, last mile as well airport hubs. There is speculation that countries with local manufacturing capacities may use road transportation, but the country's preparedness on road infrastructure and required containers will have to be assessed. Countries with no local vaccine manufacturing will have to depend more on airfreight. It also remains to be seen if Government can use defence transport airlines for this purpose. Profitability of the entire operation remains a separate topic altogether (refer tables 1&2 for vaccine details and country categorisation on basis of local manufacturing). • **International travel recovery to take time and will depend upon vaccine efficacy.** Restoration of international travel will depend upon the timeline for vaccine distribution. International capacity (ASK) share of airlines like IndiGo and SpiceJet will likely be deployed partially in the domestic segment. • **Capacity cycle could worsen** due to transfer of fleet from international to domestic routes, no fleet reduction by any airline and excess spare aircraft with Boeing / Airbus / lessors. o There has been no news of any major capacity cuts by any airline in India. Lessors have clearly shown they are ready to work with Indian airlines. Global demand recovery is unlikely to be more than India such that aircraft moves away from the country. o International capacity of IndiGo, SpiceJet, Air India Express can partly make its way to Indian domestic market. o If 50% / 100% of the international capacity of Indigo, SpiceJet and Air India express moves to domestic segment in FY22, then the total domestic capacity can grow 22% / 44% over FY20.	
Economy	Anagha Deodhar (+91 22 2277 7622)	anagha.deodhar@icicisecurities.com
Outlook 2021	• We expect the Indian economy to contract 7.5% in FY21 and grow 8.5% in FY22. We expect the economy to post positive growth in all quarters of CY21, starting with a modest growth of ~0.8% YoY in Q4FY21 (Q1CY21) and increasing sharply to ~20% in Q1FY22 (Q2CY21) due to low base effect and sequential momentum. • We expect inflation to remain elevated in early CY21 due to supply-side constraints. As per our forecasts, CPI inflation is likely to average 6% in Q4FY21 (Q1CY21) and 5.6% in Q1FY22 (Q2CY21). However, we expect inflation to ease and decline to ~4.3% towards the end of CY21. • Given the expected inflation trajectory, we expect the MPC to hold rates till Q2FY22 (Q3CY21). The RBI may continue to take other measures to keep financial conditions easy to support recovery. • The IMF expects global growth at -4.4% in CY20 and 5.2% in CY21. In line with contraction in global growth, global trade is expected to contract 10% in CY20 and grow 8% in CY21. Given the weak global trade backdrop, we expect India's exports to decline 11% YoY in FY21 and increase 13% in FY22. Imports, on the other hand, are expected to decline by as much as 25% in FY21 due to weak domestic economy and low commodity prices. In FY22, we expect imports to grow 22% due to low base effect, recovery in domestic economy and uptick in commodity prices. In CY21, we expect the INR to trade in a range of 73-75/USD with an appreciation bias.	

Source: I-Sec research

Indian equities have entered a bull market environment

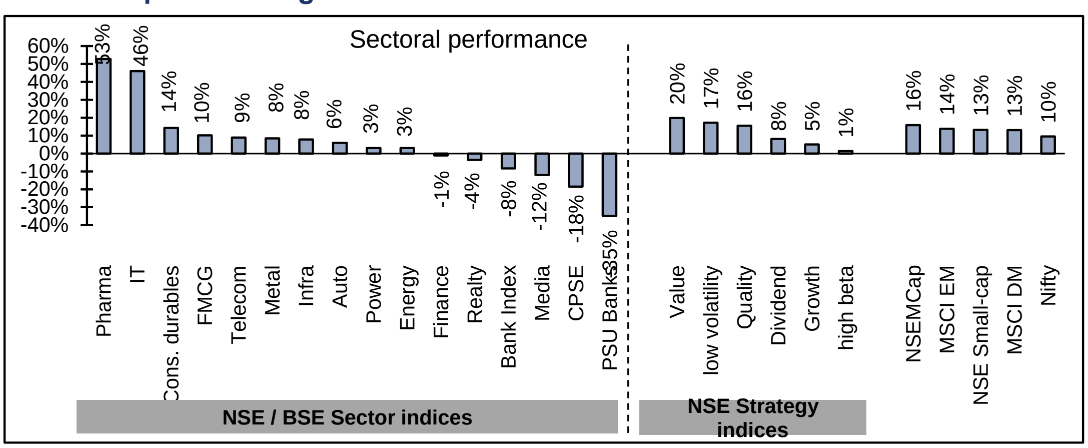
Indian equities have entered a bull market environment as evidenced by the one year rolled forward P/E at 22x rising beyond the peak of FY08 at ~20x on an 'ex-ante basis' and significant broadening of the market rally by market cap size and various investment styles (Dividend yield, PSUs, High Beta, Small caps etc). CAPE although expensive at 26x (+1 s.d.) is still lower as compared to its peak of 34x in FY08. Valuation on P/B at 3x is close to the LTA and does not indicate overvaluation, although it does reflect low ROEs. On a cross asset basis, Gold outperformed the most, followed by mid/small caps in CY20.

Chart 1: Gold, mid and smallcaps outperform



Note: Interesting to note that Equities have outperformed bonds in a period where yields have dropped across the yield curve (60bps at the long end, and sharper at the shorter end).
Note: Gold price refers to the MCXGOLD Index, Bonds refer to the CRISIL Composite Bond Fund Index, House Price Index is published by the RBI on a quarterly basis
Source: Bloomberg, RBI, I-Sec Research

Chart 2: CYTD sector performance hides the volatility in between; and 'value' stocks outperformed 'growth' stocks!



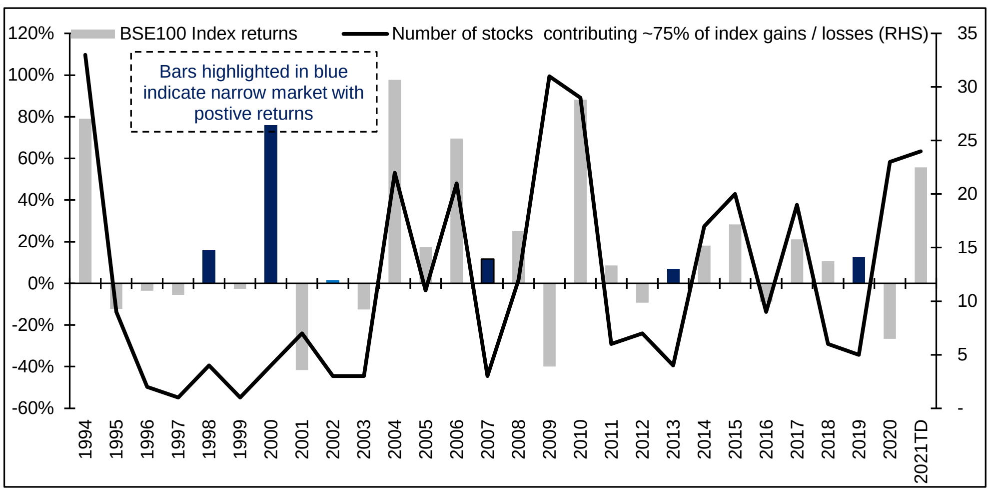
Source: Bloomberg, I-Sec Research

Table 1: Market breadth improving

	Phase I	Phase II	Phase III	Phase IV
Dates	23rd Mar- 30th Apr	30th Apr - 28th Aug	28th Aug - 14th Oct	14th Oct till now
NIFTY50	+30%	+18%	+3%	+11%
Top Outperforming themes	Pharma + 45% Energy (Largely RIL) + 34% Infra + 31%	Small Cap + 44% High beta + 43% Media + 44% Auto +37% Metal +36% IT +28% Pharma + 25% Realty PSU Banks & Energy + 21%	IT + 23%	Metal + 35%, Realty + 34% PSU Banks +26%, CPSE 25%, High Beta and Power + 24% Banking and Finance + 23% Telecom +19%, Midcaps +17% Infra, Dividend, and smallcaps +13%,
Top Underperforming themes	PSU Banks + 4% Realty + 8% Media + 14%	FMCG +9% Telecom +10% Finance +11%	PSU Banks -19% Telecom -18% Metal -11% Media -10% Real estate -8% Energy -8%	IT +2% Pharma +5% Media +6% Auto, Low volatility +9%
Average themes	Low Volatility & Quality + 26% Dividend Yield + 24% Beta + 21% Small Caps & Mid Caps + 21%	Infra + 18% Power + 16%	Consumer Durables + 3% Pharma 2%	Energy, FMCG + 11% Value and Quality: +11%

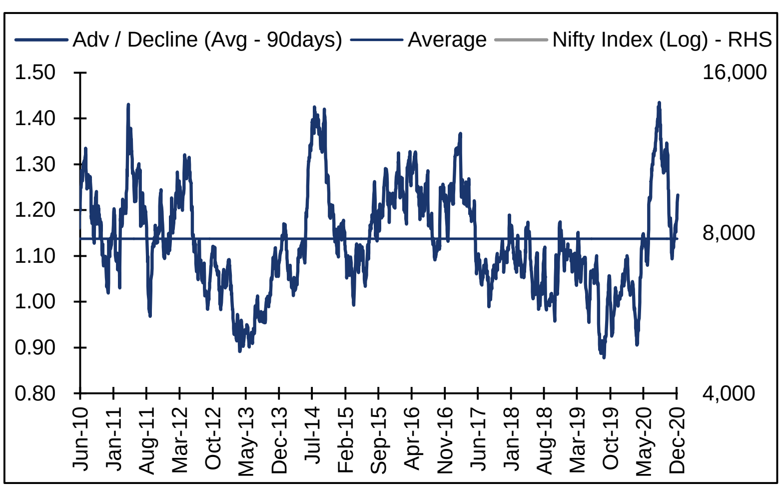
Source: Bloomberg, I-Sec Research

Chart 3: Historical BSE100 index returns and number of stocks contributing >75% to index returns



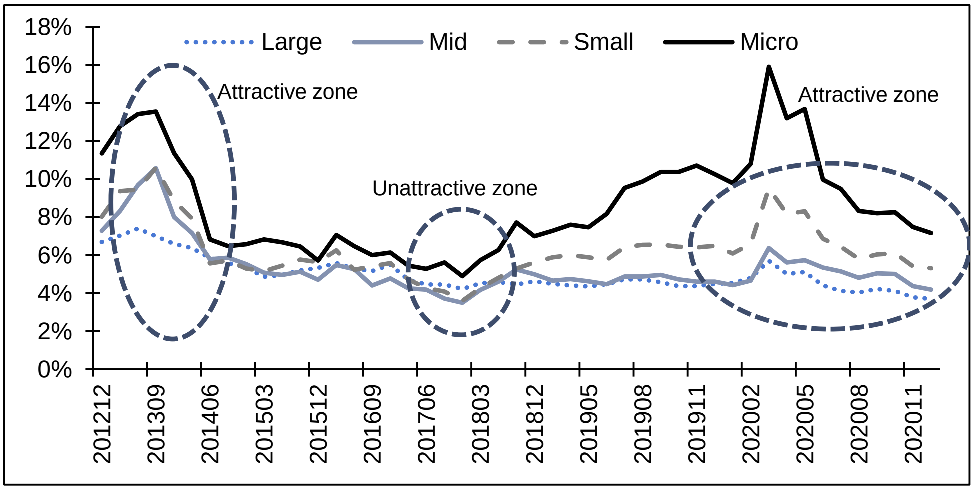
Source: Capital line, Bloomberg, I-Sec Research

Chart 4: Advance – decline ratio also breaks the downward trend since FY17



Source: Capital line, Bloomberg, I-Sec Research

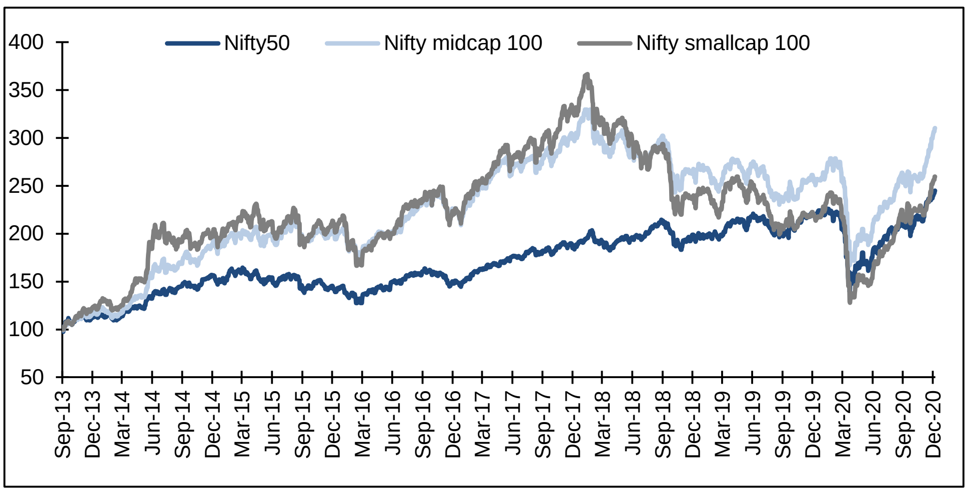
Chart 5: Broader market turned attractive on trailing earnings yields since start of CY20…



Source: Capital line, Bloomberg, I-Sec Research

(For more details, refer our [report dated 28th Nov 2019])

Chart 6: …and have outperformed Nifty50 since then

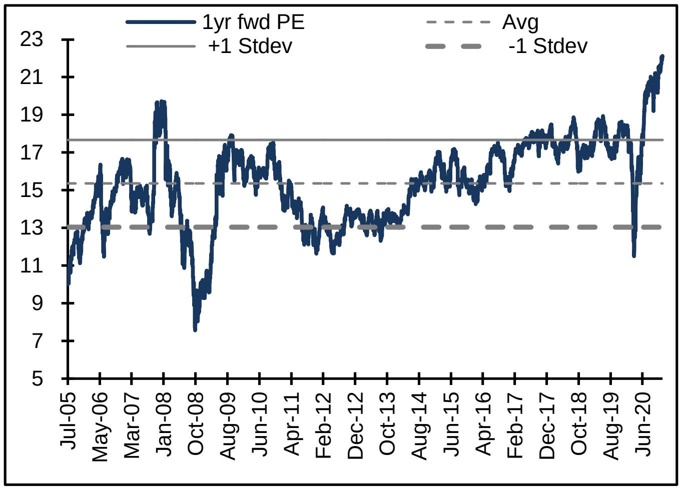


Source: Capital line, Bloomberg, I-Sec Research

Forward P/E ratio higher than FY08 bull market although lower on CAPE and P/B basis

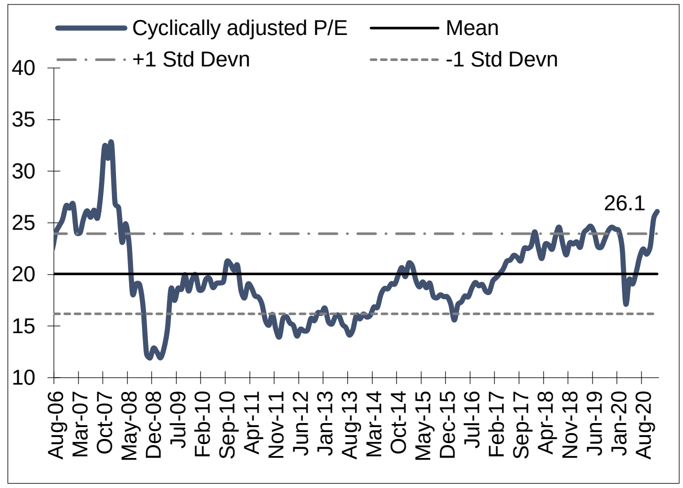
One year rolled forward P/E at 22x is now the highest since the peak of FY08 at ~20x on an 'ex-ante basis'. CAPE although expensive at +1 s.d. / 26x is still lower as compared to its peak of 34x in FY08. Valuation on P/B at 3x is close to the LTA and does not indicate overvaluation, although it does reflect low ROEs.

Chart 7: One year rolled forward PE at 22x exceeds FY08 bull market peak on 'ex-ante' basis



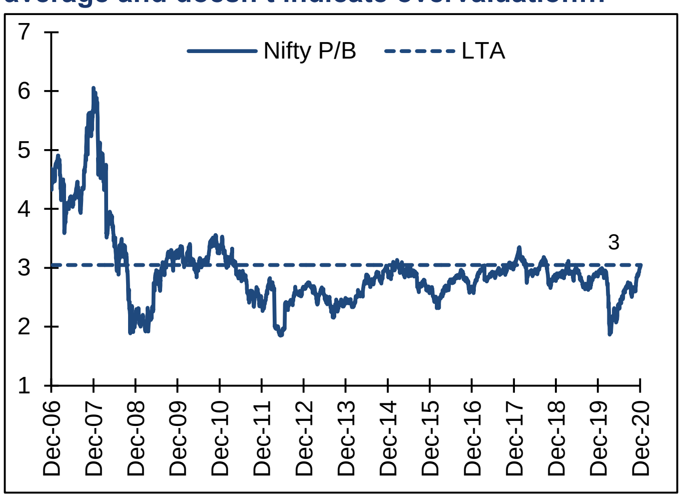
Source: Bloomberg, I-sec research

Chart 8: Cyclically adjusted PE ratio (CAPE) expensive, at +1s.d., but lower than FY08 peak



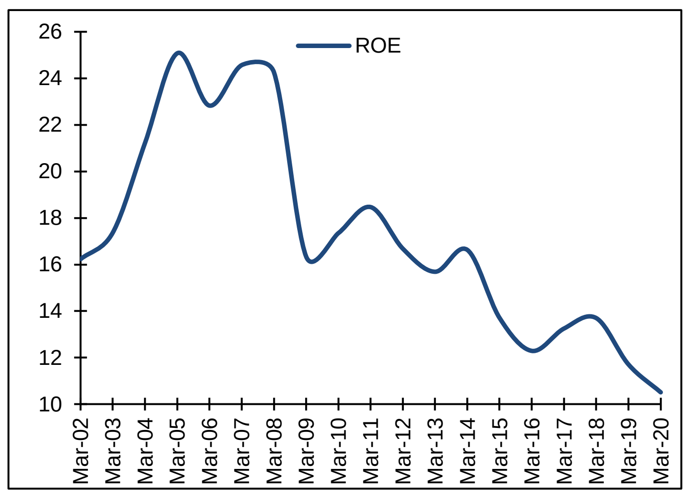
Source: Bloomberg, CEIC, I-sec research

Chart 9: Valuation on PB is close to Long term average and doesn't indicate overvaluation…



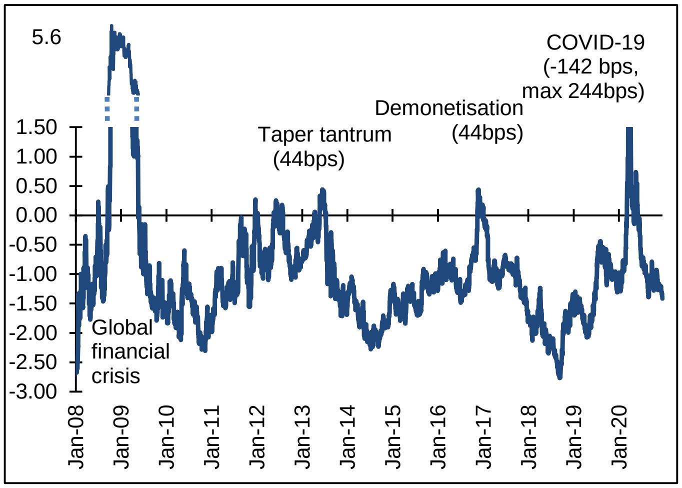
Source: Bloomberg, CEIC, I-sec research

Chart 10: …but does reflect low ROEs



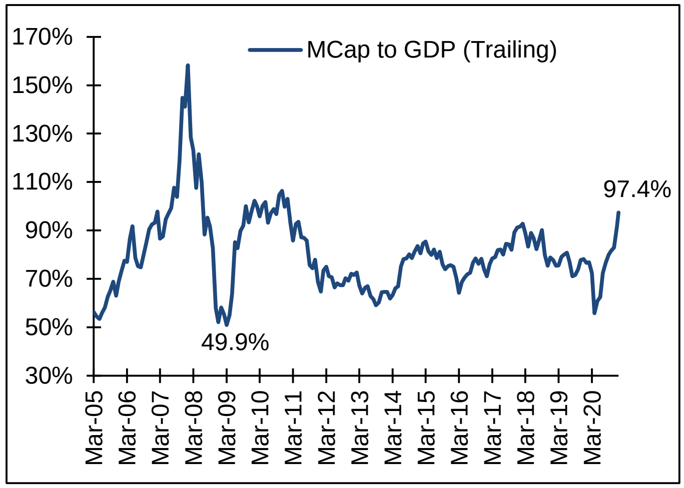
Note: ROE represents Nifty50 ROE
Source: Bloomberg, I-sec research

Chart 11: Bond-earnings yield spread is firmly below pre-pandemic levels



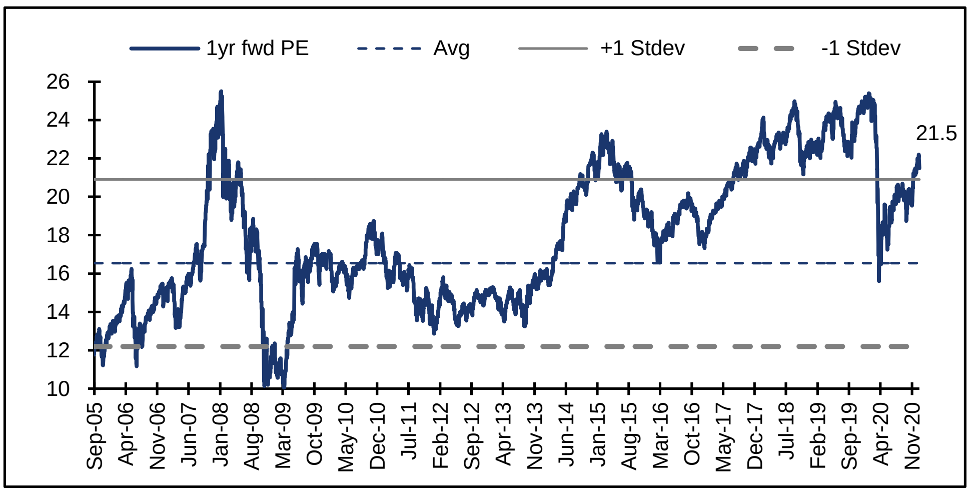
Source: Bloomberg, I-sec research

Chart 12: Market cap to GDP elevated due to broad market outperformance and falling trailing GDP



Source: Bloomberg, I-sec research

Chart 13: Forward PE on ex-post basis is also exceeding +1S.d.

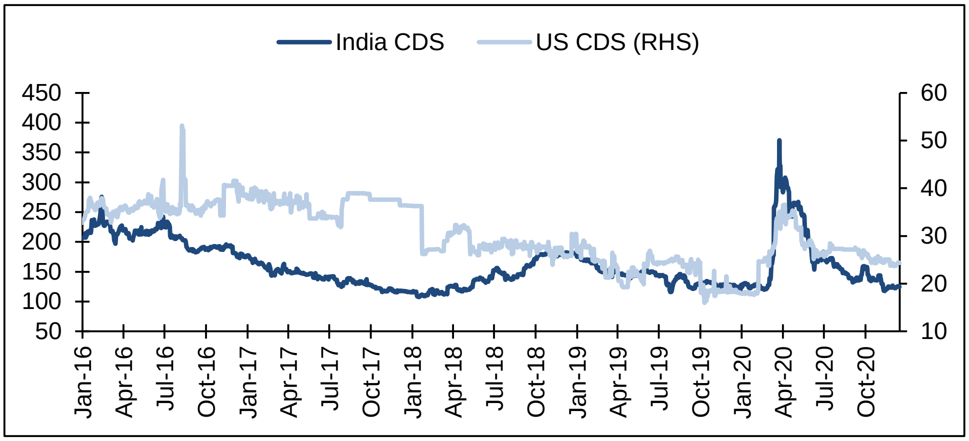


Source: Bloomberg, I-Sec Research

Discount rate, long term outlook driving P/ E expansion

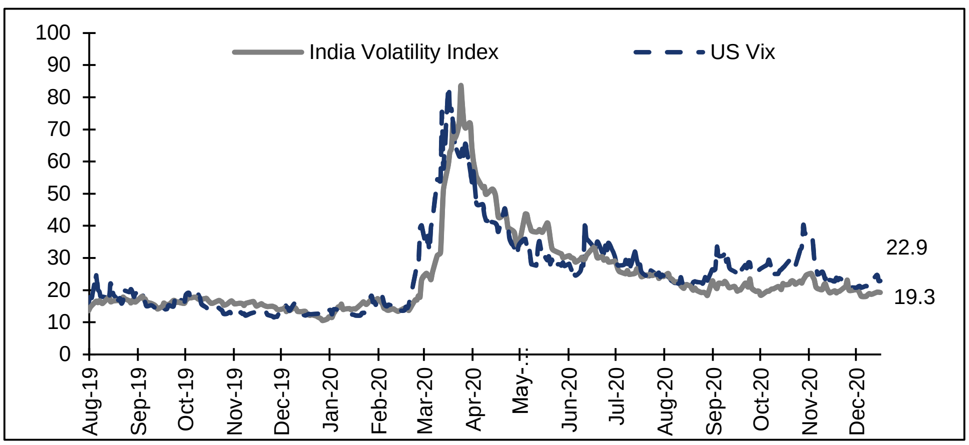
The current P/E multiple expansion is driven by **rising risk appetite (lower equity risk premium as evidenced by falling CDS spreads)** due to record QE program of global central banks and prospects of Covid vaccine, which along with **lower interest rates (risk-free rates)**, is driving down the overall 'discount rate' for equities.

Chart 14: Rising risk appetite reflecting in declining CDS spreads



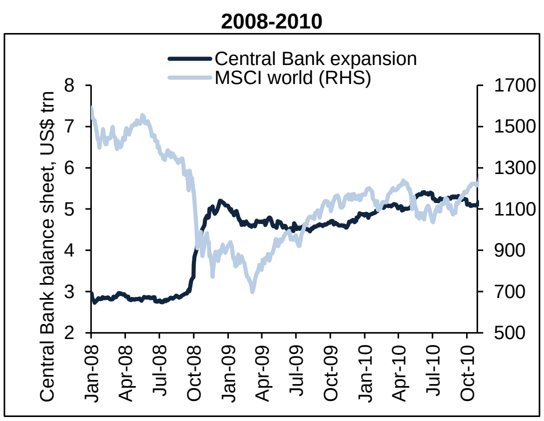
Source: Bloomberg, I-Sec Research

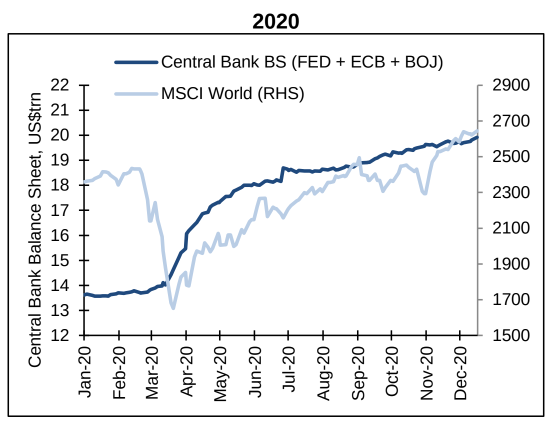
Chart 15: ...and VIX being much lower than their peaks



Source: Capital line, Bloomberg, I-Sec Research

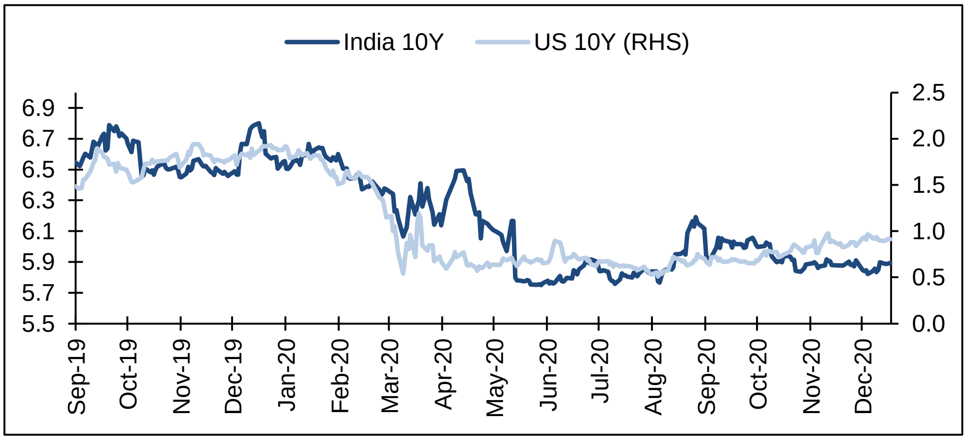
Chart 16: Record QE program in 2020 – Combined central bank expansion versus equity performance





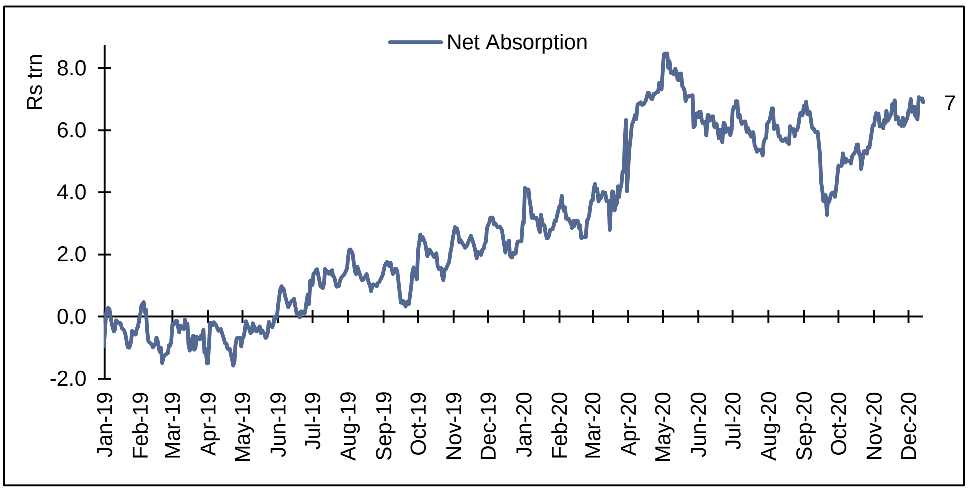
Source: CEIC, Bloomberg, I-Sec Research

Chart 17: Sharp drop in 10Y yields



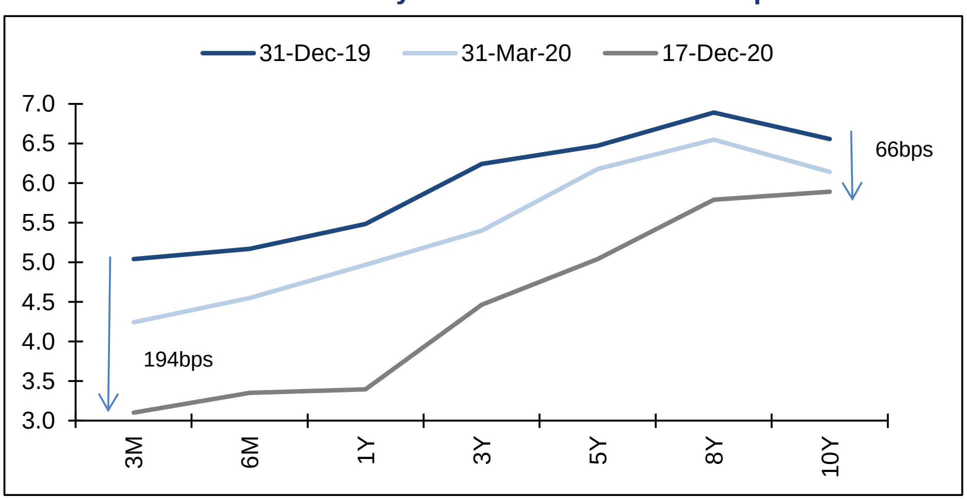
Source: Bloomberg, I-Sec Research

Chart 18: With very high domestic liquidity…



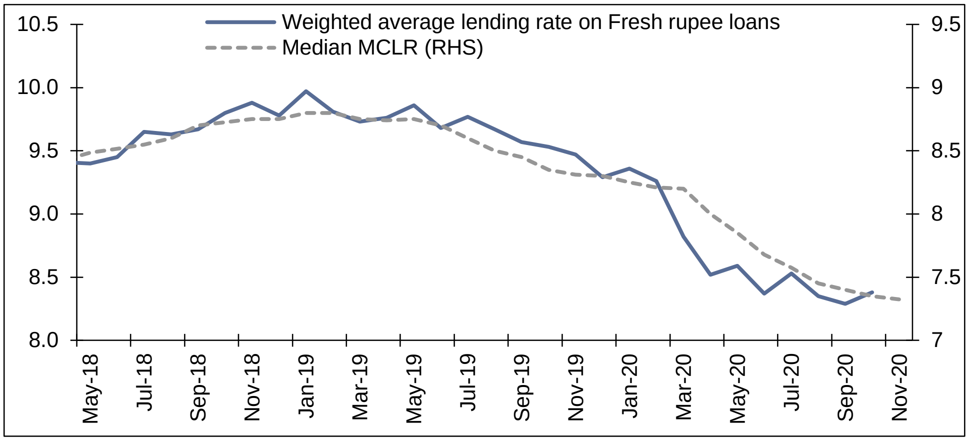
Source: CEIC, RBI, I-Sec Research

Chart 19: …Fall in short term yields has been much sharper



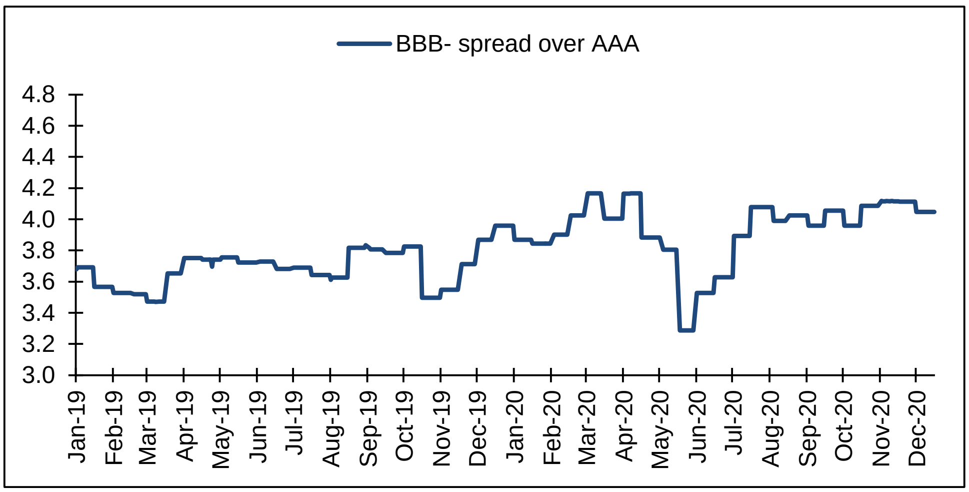
Source: Bloomberg, I-Sec Research

Chart 20: Lending rates continue to fall



Source: RBI, CEIC, I-Sec Research

Chart 21: Risk aversion still elevated in credit markets

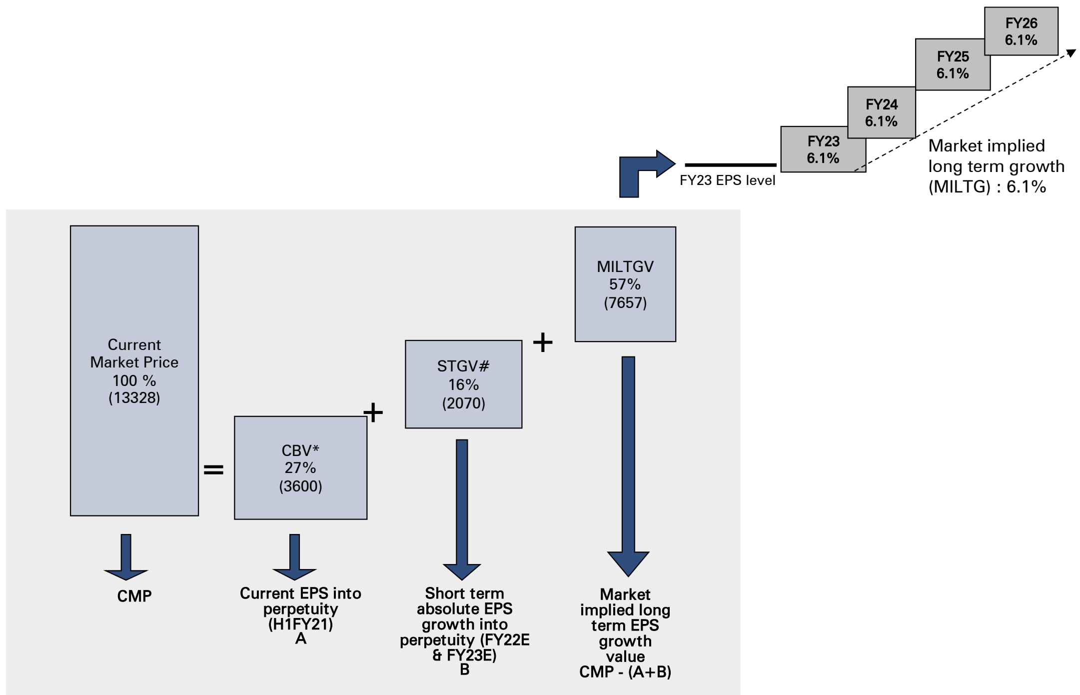


Source: Bloomberg, FIMMDA, I-Sec Research

Long term growth value improving

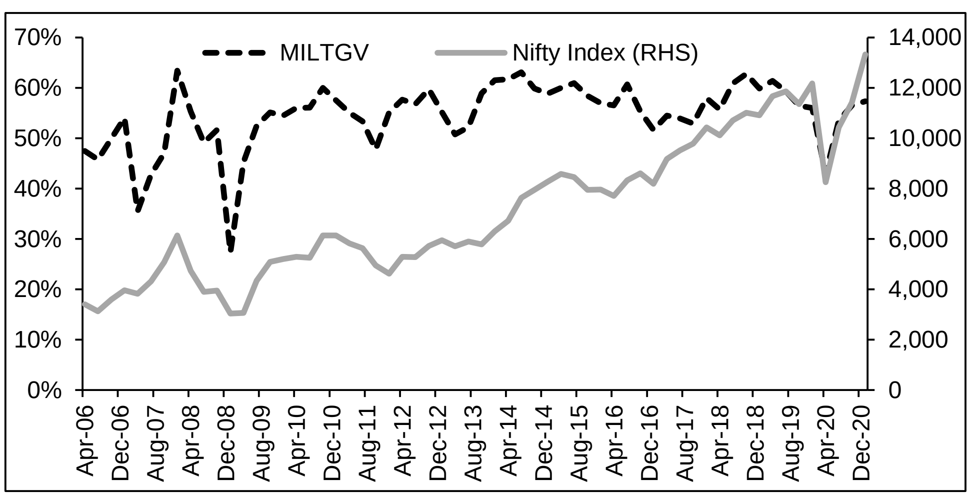
Policy reforms by the government towards making India attractive as a global manufacturing hub (Lower taxes, Labour reforms, ease of doing business, digitalisation) are improving the long-term demand outlook which is reflecting in the expansion of the 'market implied long term growth value' of the NIFTY50 to ~57% despite a fall in discount rate as explained above

Chart 22: Nifty market implied value break-up



Note: *CBV=Current business value; #STGV = Short term growth value
Source: Bloomberg, I-sec research

Chart 23: Long term growth value ascribed to the Nifty touching FY08 levels of 57%



Source: Bloomberg, I-sec research

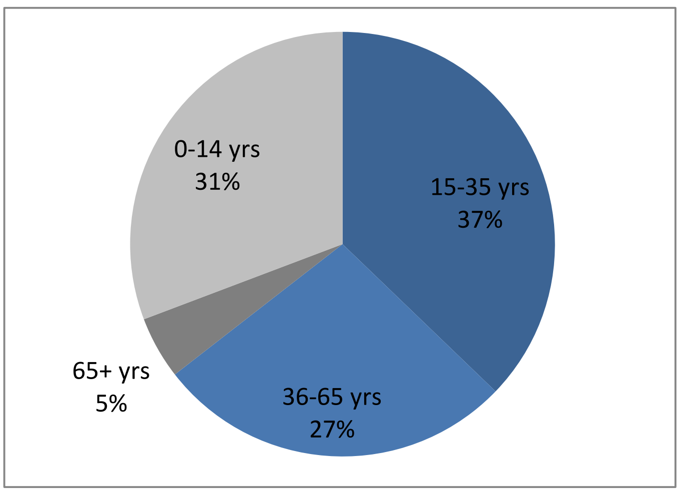
For more details on the MILTGV methodology, refer our note [Quality businesses with low 'Market implied long-term growth value' dated 9 Apr'20]

Table 2: Key policy reforms by the government

India Reforms	Description
Unified Tax on Goods and Services	The Goods and Services Tax went into effect nationwide on July 1 2017, creating India's first-ever national market and replacing most state and federal taxes.
Insolvency and Bankruptcy code	Makes it quicker and easier for companies to go through the process of bankruptcy
Corporate tax rate reduction	Corporate tax reduced from 30% to 25% for all firms while for new manufacturing firms it has been reduced further to 17%
Labour Laws rationalised to 4 from 29	The four labour codes are more coherent flexible. Employers with less than 300 workers have the right to terminate workers (up from 100) and states have been given freedom to raise this threshold.
Agriculture reforms	Reforms related to marketing of agricultural produce, contract farming and controls on transportation, storage, prices and distribution under Essential Commodities Act (ECA) of 1955
Liberalise FDI investments	Sectors such as Defence, Coal mining, Civil aviation, Railway and e-commerce
PLI scheme	Attract investments into manufacturing of Electronics, chemicals, Auto etc
Derugulation of Diesel pricing	Lowers government susbidy
Other reforms	Digital India, Swatch Bharat, rural electrification, rural roads etc

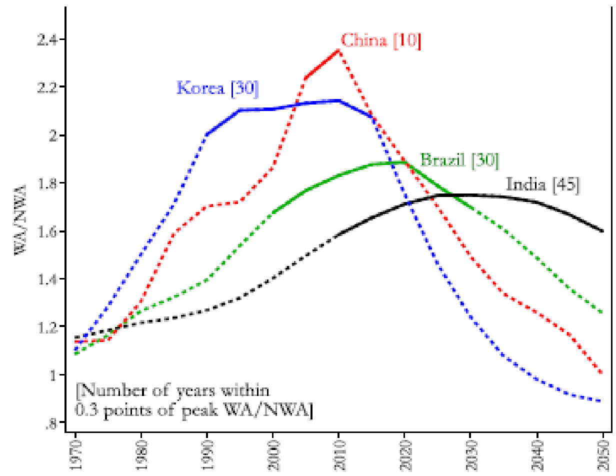
Source: I-Sec Research

Chart 24: Large working age population



Source: Census 2011, I-Sec research

Chart 25: that's expected to age slower than peer economies



WA/NWA: Working Age population / Non-working age population
Source: Economic Survey of India, Vol.1, I-Sec research

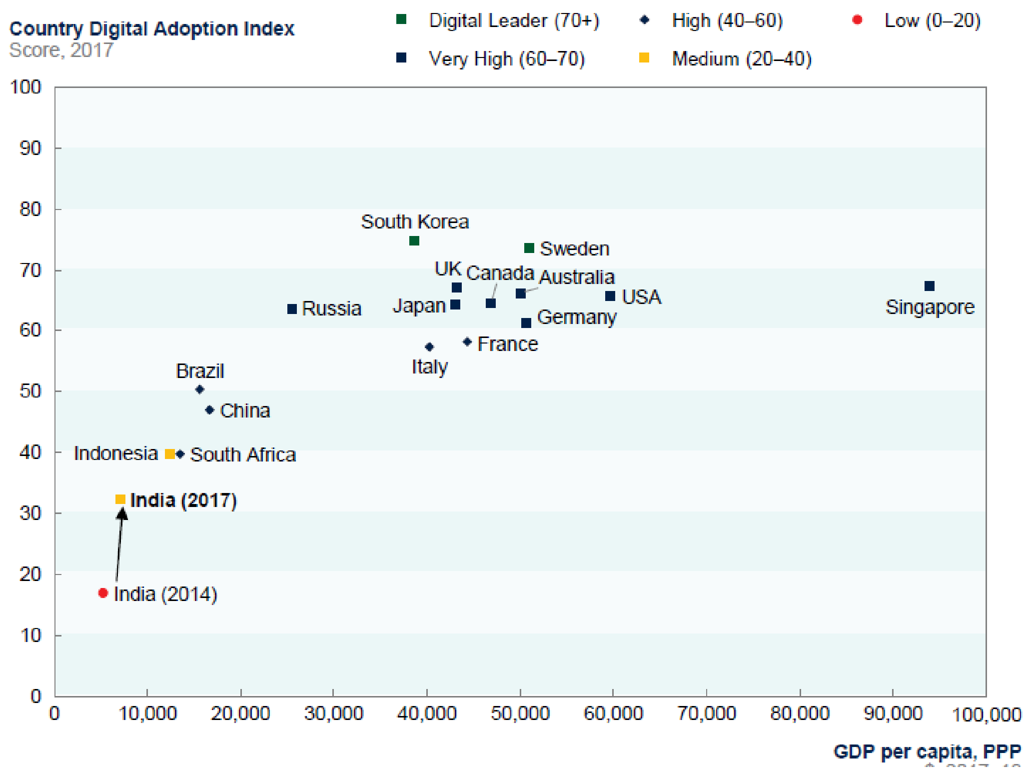
Chart 26: Demographic dividend intact

Decade	Additional PCI growth due to demographic dividend	Working age/Total pop
2001-10	1.44	57.1
2011-20	2.62	60.5
2021-30	1.81	64.4
2031-40	1.92	63.2
2041-50	1.37	63.3

Source: Economic Survey of India, 2018; I-Sec Research

Chart 27: Fastest growing digital economy in the world

India's score on the Country Digital Adoption Index has risen faster than the trend based on GDP per capita in the last four years



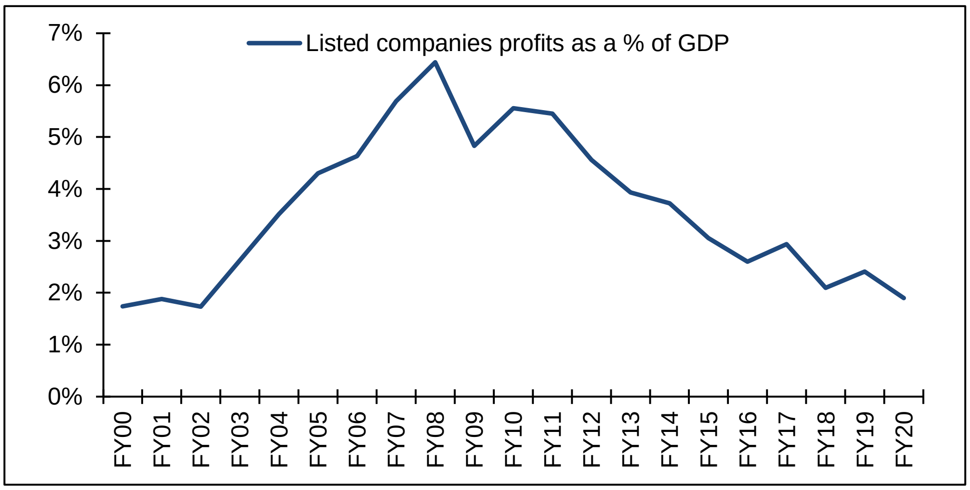
Source: MEITY, I-Sec Research

Mean reversion of ‘PAT/GDP’ ratio, which hit a two-decade low of less than 3%, is helping augment earnings/cashflow outlook.

We expect NIFTY50 earnings to grow at a CAGR of ~19% over FY20-23.

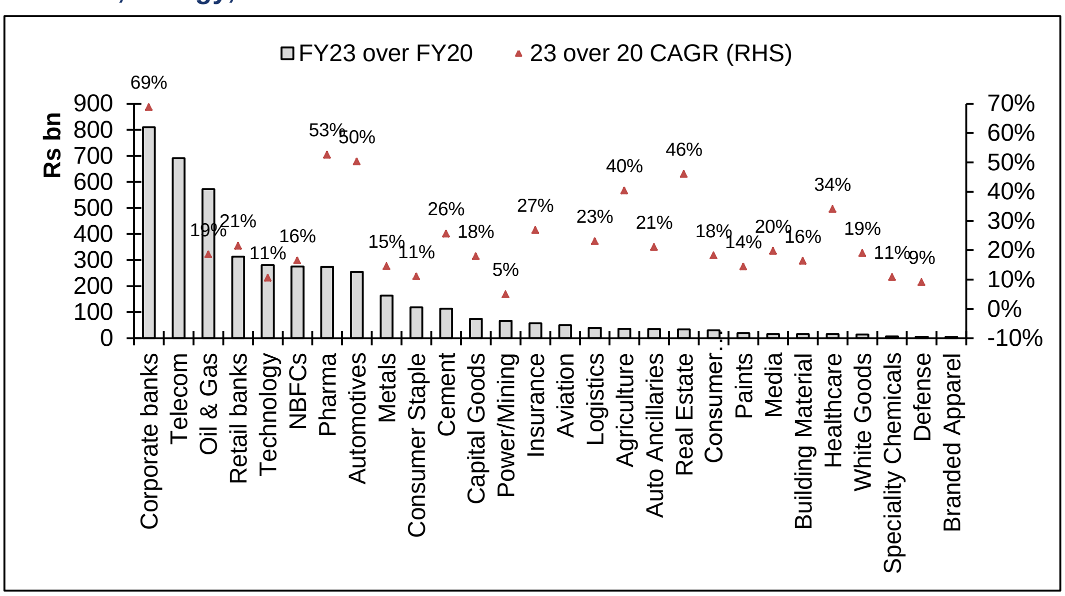
- Earnings growth expectation over FY20-23 is largely driven by normalising of depressed earnings by corporate banks, telecom, auto, commodities and pharma.
- Margin expansion story to slow down as input costs rise and volume growth will be the key earnings driver in CY21, which will have its underpinnings on aggregate demand revival. Top line growth expectations, which reflect aggregate demand, are low to moderate.

Chart 28: Listed PAT to GDP is at low range last seen in FY00-02



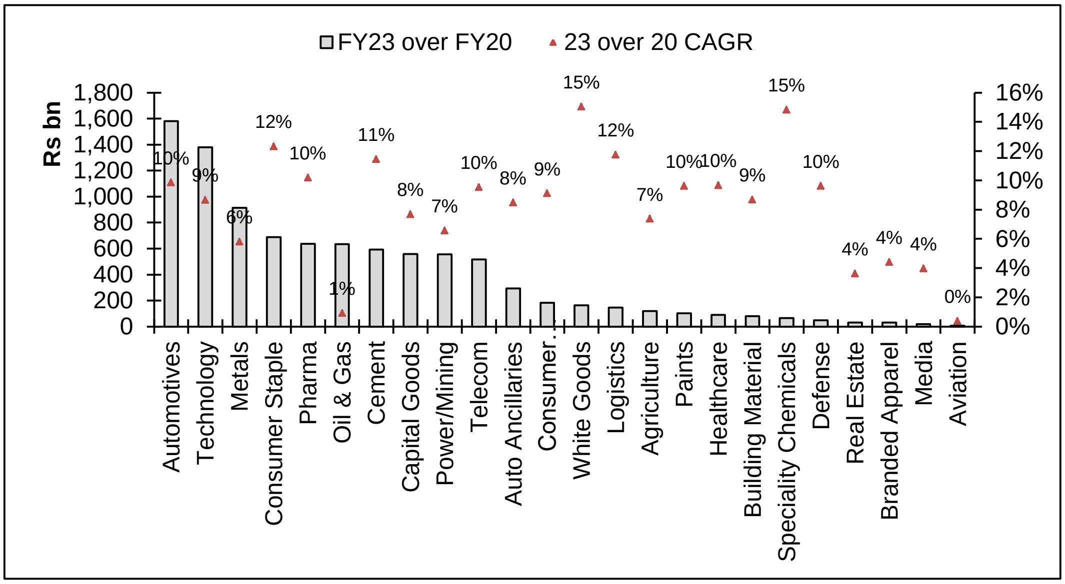
Source: Capitaline, Bloomberg, I-Sec Research

Chart 29: PAT to GDP mean reversion over FY20 -23 driven by corporate banks, Telecom, Energy, Auto and Pharma



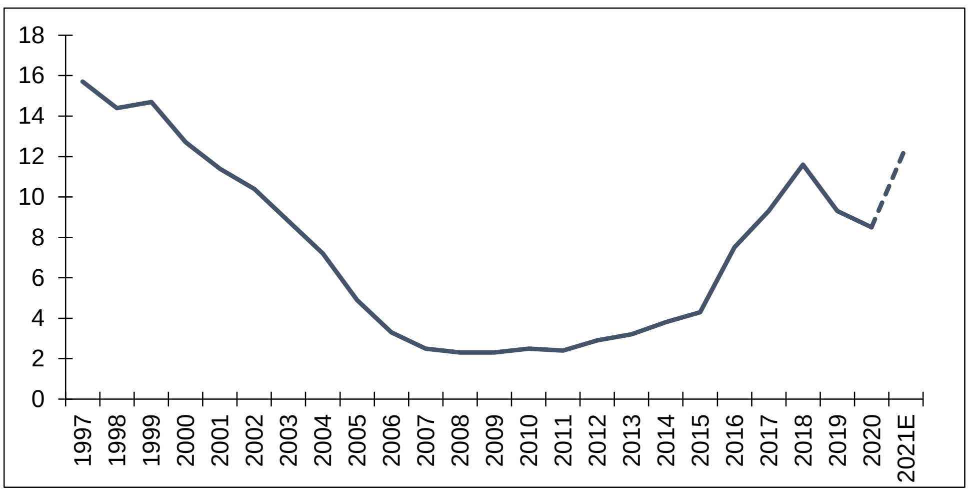
Note: Universe of top 250 companies with consensus estimates
Source: Capitaline, Bloomberg, I-Sec Research

Chart 30: Top line growth expectations are low to moderate



Source: Capitaline, Bloomberg, I-Sec Research

Chart 31: Key risk to earnings – rise in GNPAs – RBI estimates put baseline FY21 GNPA at 12.5%

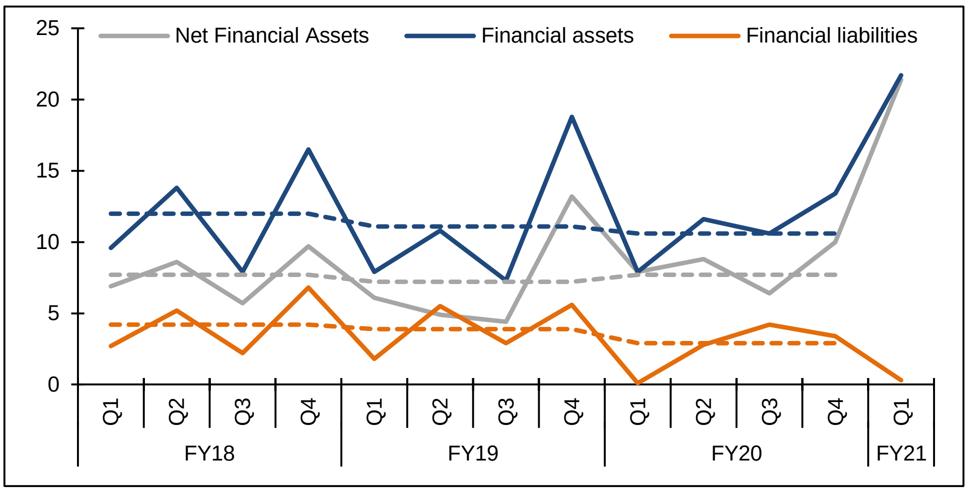


Source: RBI, I-sec research

Economic outlook: Near-term growth impulses are currently still weak

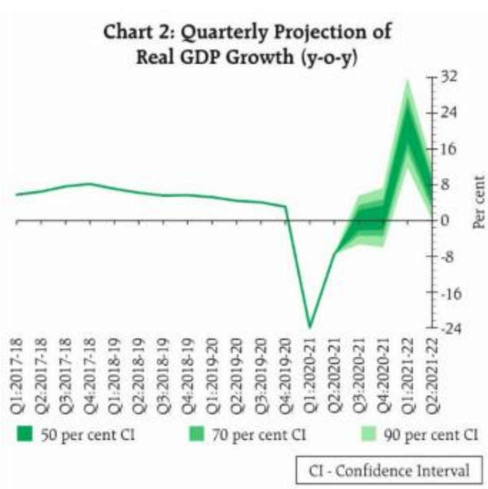
Near-term growth impulses are currently still weak with households preferring savings over consumption, government spending constrained by weak financial resources, and corporate sector deferring capex and cutting opex. Some of these challenges will reverse in CY21 due to aggregate demand normalising, pent-up demand, and improving resource mobilisation by the government. We expect economic activity levels to normalise to FY20 levels in FY22 (GDP growth: FY21 - 7.5%; FY22 +8.5%) and the INR to be fairly stable within the 73-75 range. Exports are expected to grow 13% in CY21 after dropping 11% in CY20. Price levels (CPI) are also expected to be stable within the 4-6% range in CY21. As per early ENSO forecasts there is little probability of El-Nino condition in CY21 which should augur well for monsoons

Chart 32: Households preferred savings over consumption



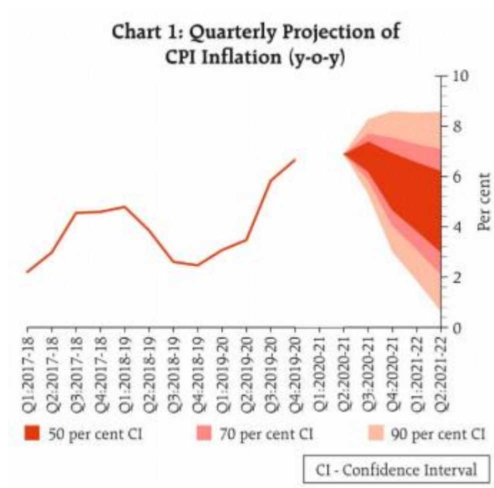
Source: RBI, I-Sec Research

Chart 33: RBI GDP forecast



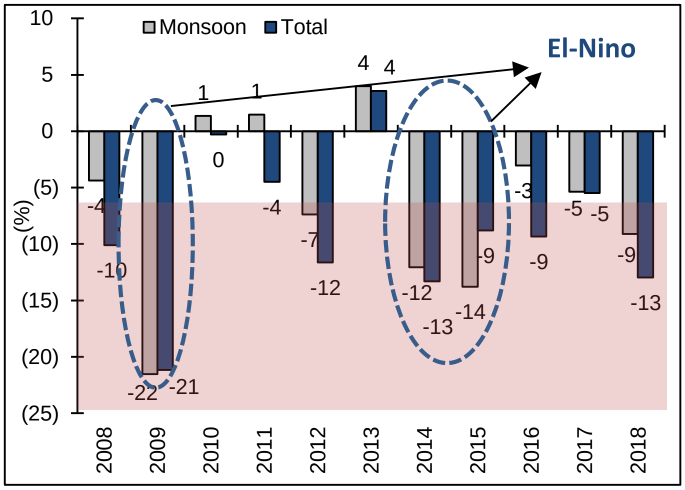
Source: RBI, I-Sec Research

Chart 34: RBI CPI forecast



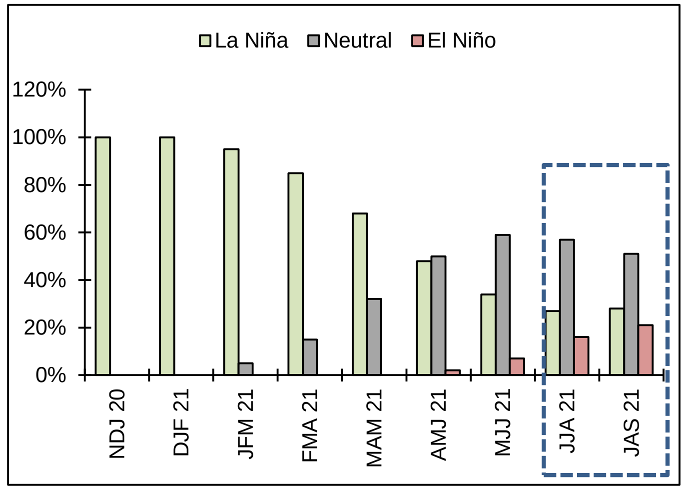
Source: RBI MPC, I-Sec Research

Chart 35: Monsoon has been low in El Nino years



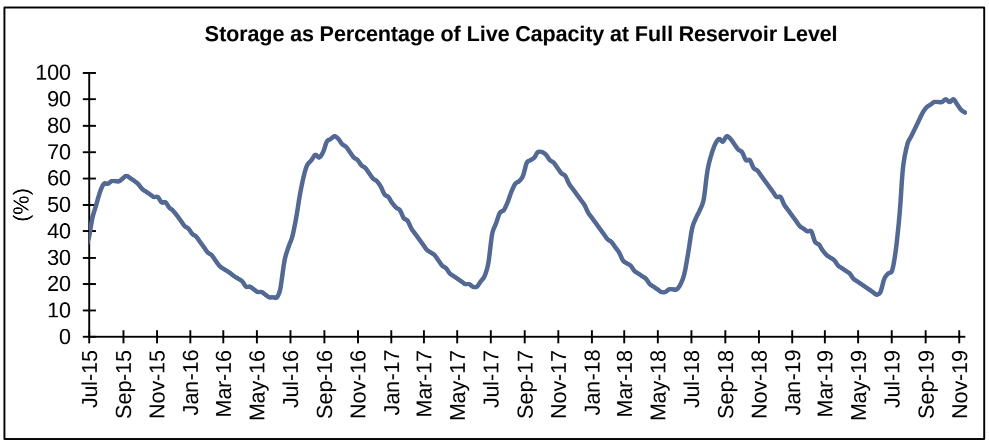
Source: Central Water Commission, CEIC, I-Sec Research

Chart 36: Probability of El-Nino effect in monsoon months for CY21 is much lower than CY20 – around 19%



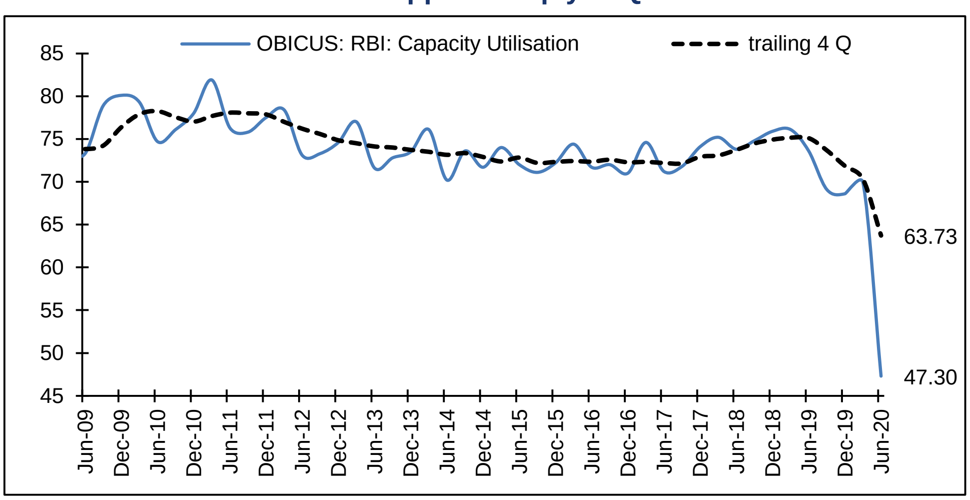
Source: International Research Institute - Columbia University, I-Sec Research

Chart 37: Water reservoir levels higher currently



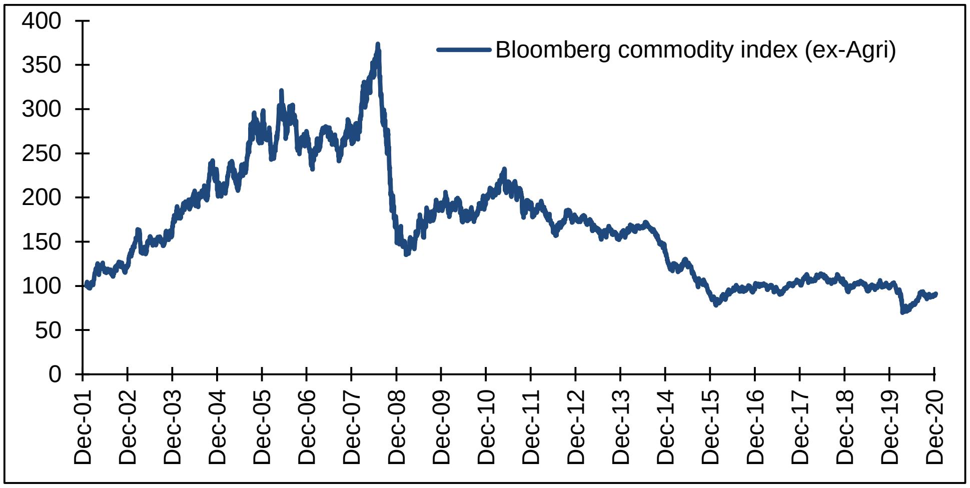
Source: CEIC, I-Sec Research

Chart 38: Utilisation levels dropped sharply in Q2FY21



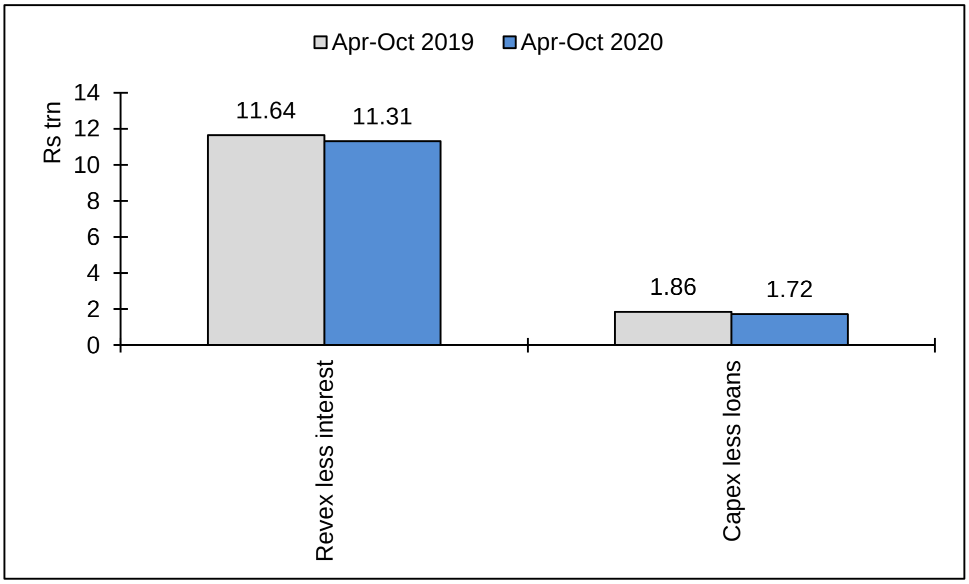
Source: CEIC, I-Sec Research

Chart 39: Global commodity prices don't seem to show strong uptrend



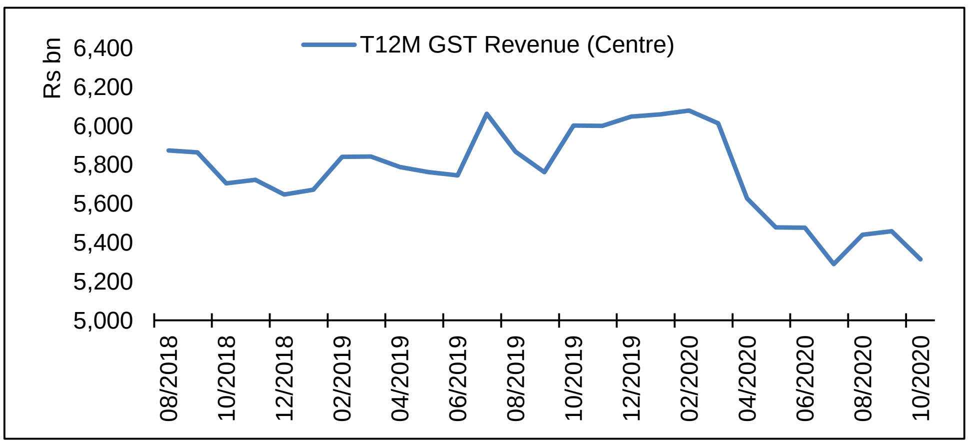
Source: Bloomberg, I-Sec research

Chart 40: Government expenditures have been flat YoY



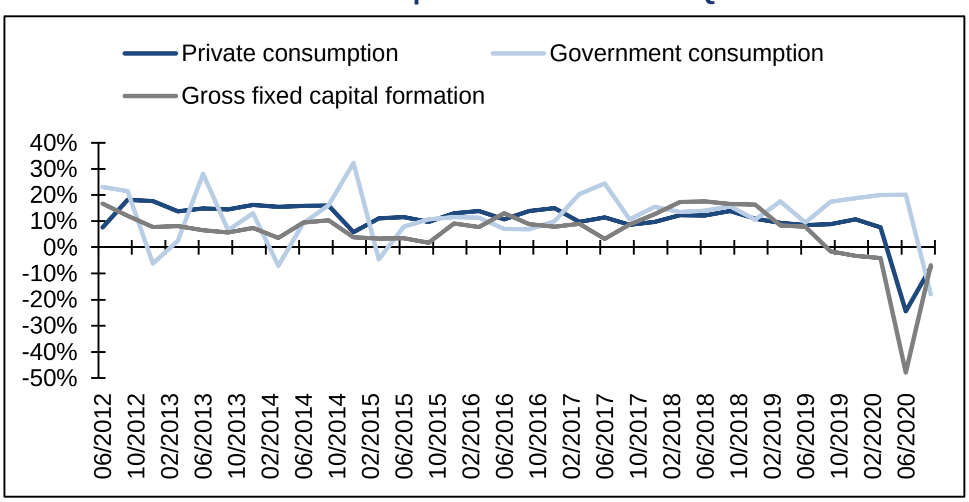
Source: CEIC, CGA, I-Sec Research

Chart 41: As fiscal revenues take a deep hit



Source: CEIC, CGA, I-Sec Research

Chart 42: Government consumption also fell YoY in Q2FY21



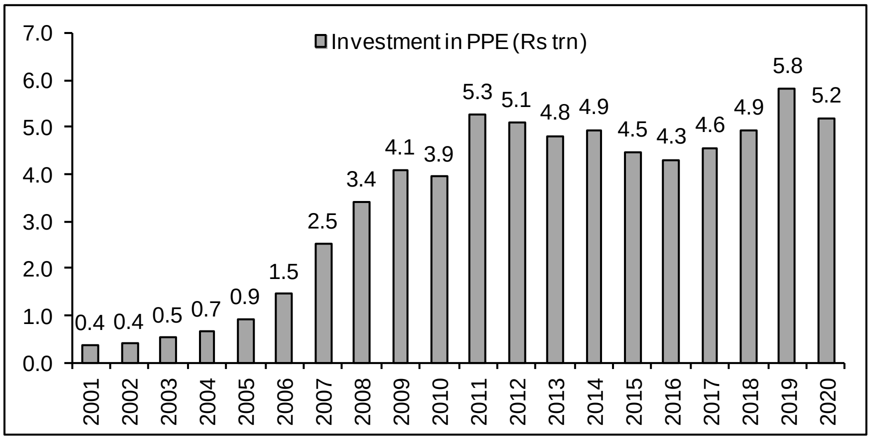
Source: CEIC, CGA, I-Sec Research

Annexures

Corporate capex and balance sheet

Corporate sector has postponed capex and embarked on major cost-cutting initiatives although some of it will start reversing in CY21

Chart 43: Private capex is stagnating



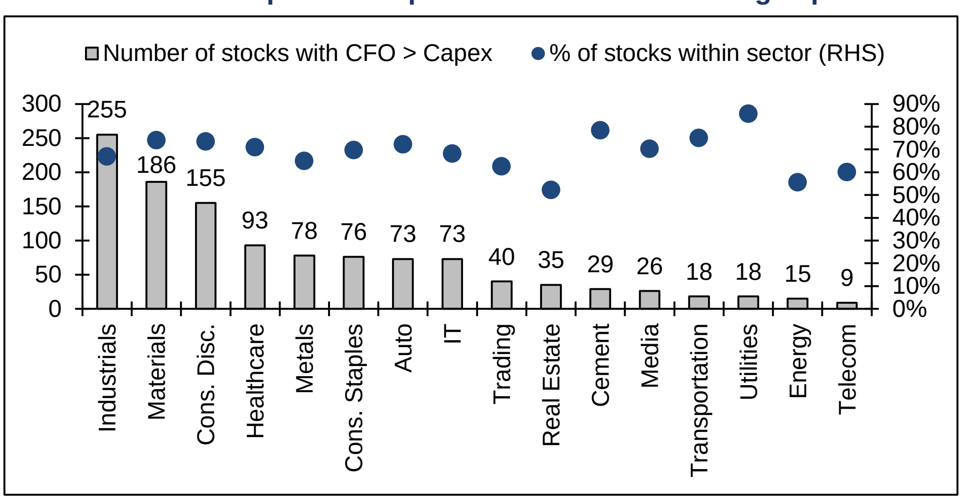
Note: For more details on capex, please refer to our note dated 30-Sep'20
Source: Capitaline, I-Sec Research

Table 3: Large amount of 'excess' cash generation in India Inc.

Particulars	Amount in Rs bn
Capex via cash spent in FY20	
Net cash spent towards asset purchases	5,383
GFA (FY19)	60.030
As a % of Gross Fixed Assets (FY19)	9.0%
Free cash flow generation in FY20	
Cash flow from operations (after adjusting for working capital changes)	8,844
Less: net cash spend towards capex in FY20	5,383
Free cash flow	3,461
Less: Interest payments	2,267
Excess cash generation	1.195

Source: Capitaline, I-Sec Research

Chart 44: Sectoral split of companies with CFO exceeding capex is healthy



Source: Capitaline, I-Sec Research

High frequency indicators

Table 4: High frequency consumption indicators

Consumption Indicator	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20
Personal Loan growth	15%	12%	11%	10%	11%	11%	9%	9%	NA
4W growth	-51.0%	NA	-85.2%	-49.6%	-3.9%	14.2%	26.5%	14.2%	4.6%
2W growth	-39.8%	NA	-83.8%	-38.6%	-15.2%	3.0%	11.6%	16.9%	13.4%
IIP - Primary Goods.	-4.0%	-26.6%	-19.6%	-14.5%	-10.8%	-10.8%	-1.5%	-3.3%	NA
IIP Consumer Goods Durables	-36.8%	-95.7%	-70.3%	-34.8%	-23.7%	-9.6%	3.4%	17.6%	NA
IIP Consumer Goods Non Durables	-22.3%	-48.1%	-9.7%	6.9%	1.8%	-2.3%	2.4%	7.5%	NA
Petrol Consumption	-16.4%	-60.4%	-35.3%	-13.5%	-10.4%	-7.5%	3.3%	4.5%	5.1%
Nikkei India Services PMI	49.30	5.40	12.60	33.70	34.20	41.80	49.80	54.10	53.70
CPI	5.84%	7.22%	6.27%	6.23%	6.73%	6.69%	7.27%	7.61%	6.93%
Passenger - all airports	-37.8%	-99.8%	-97.5%	-85.3%	-84.1%	-78.6%	-69.5%	-62.2%	NA
Foreign tourist arrivals	-66.4%	NA	NA	NA	NA	NA	NA	NA	NA
Consumer confidence index	85.60	NA	63.70	NA	53.80	NA	49.90	NA	52.30
	Sep-18	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**	**Mar-20**	**Jun-20**	**Sep-20**
Private final consumption exp real	8.79%	7.04%	6.19%	5.50%	6.39%	6.64%	2.72%	-26.68%	-11.32%

Source: CEIC, Bloomberg, I-Sec Research

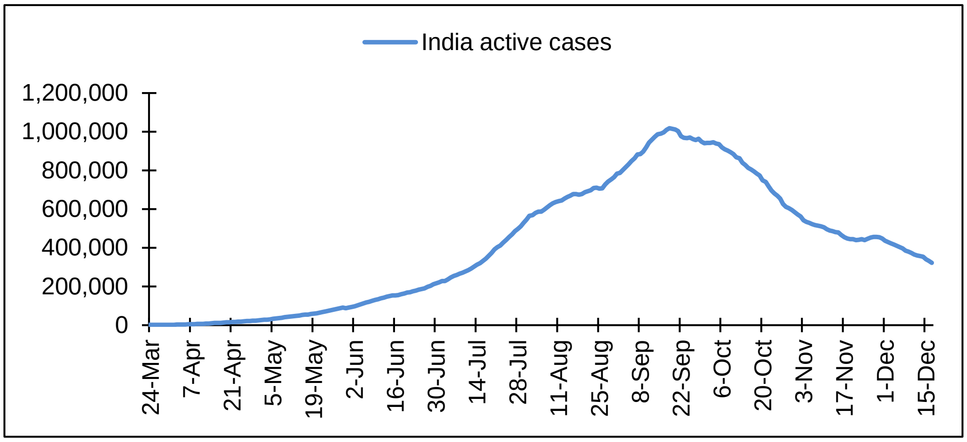
Table 5: High frequency industrial indicators

Industrial Indicator	Mar-20	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20
Overall credit growth (fortnightly)	6.1%	6.8%	6.2%	6.2%	5.8%	5.5%	5.1%	5.1%	5.8%
Industry loan growth	0.67%	1.73%	1.69%	2.25%	0.82%	0.49%	0.00%	-1.68%	NA
CV growth	-88.1%	NA	NA	NA	NA	NA	NA	NA	NA
Thermal plant Load factor	60.27	42.17	48.00	49.88	53.09	49.13	55.45	55.54	53.03
IIP growth	-18.7%	-57.3%	-33.4%	-16.6%	-10.5%	-7.4%	0.5%	3.6%	NA
Core sector growth (%)	-8.56	-37.86	-21.42	-12.44	-7.60	-7.35	-0.15	-2.54	NA
Diesel Consumption	-24.16%	-55.52%	-29.40%	-15.45%	-19.45%	-20.79%	-5.95%	7.47%	-6.98%
Power demand	-8.4%	-22.5%	-14.9%	-11.0%	-4.2%	-2.4%	3.8%	11.1%	3.7%
IIP Capital Goods	-38.8%	-92.7%	-65.9%	-37.4%	-22.8%	-14.8%	-1.3%	3.3%	NA
Nikkei India manufacturing PMI	51.8	27.4	30.8	47.2	46.0	52.0	56.8	58.9	56.3
WPI Commodity price index	0.42%	-1.57%	-3.37%	-1.81%	-0.25%	0.41%	1.32%	1.48%	1.55%
Cargo - Air	-32.02%	-82.85%	-67.68%	-40.56%	-34.59%	-29.44%	-16.23%	-13.86%	NA
Cargo - all ports	-5.1%	-21.1%	-23.3%	-14.5%	-13.2%	-10.4%	-1.9%	-1.2%	2.8%
Freight traffic - railways	-18.94%	-40.15%	-28.13%	-11.60%	-7.68%	1.35%	17.86%	11.05%	8.41%
Import Growth (%)	-27.97%	-59.70%	-51.04%	-48.04%	-29.56%	-26.04%	-19.60%	-11.53%	-13.32%
Export growth (%)	-34.33%	-60.98%	-35.70%	-12.21%	-9.54%	-12.23%	5.98%	-5.12%	-8.73%
Trade Deficit (USD bn)	-9.98	-6.92	-3.66	0.65	-4.75	-6.66	-2.74	-8.71	-9.87
Industrial Indicator	**Sep-18**	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**	**Mar-20**	**Jun-20**	**Sep-20**
Capacity utilisation	74.80	75.90	76.10	73.60	69.10	68.60	69.90	47.30	NA
GFCF	11.45%	11.43%	4.40%	4.57%	-3.92%	-5.16%	-6.48%	-47.08%	-7.35%

Source: CEIC, Bloomberg, I-Sec Research

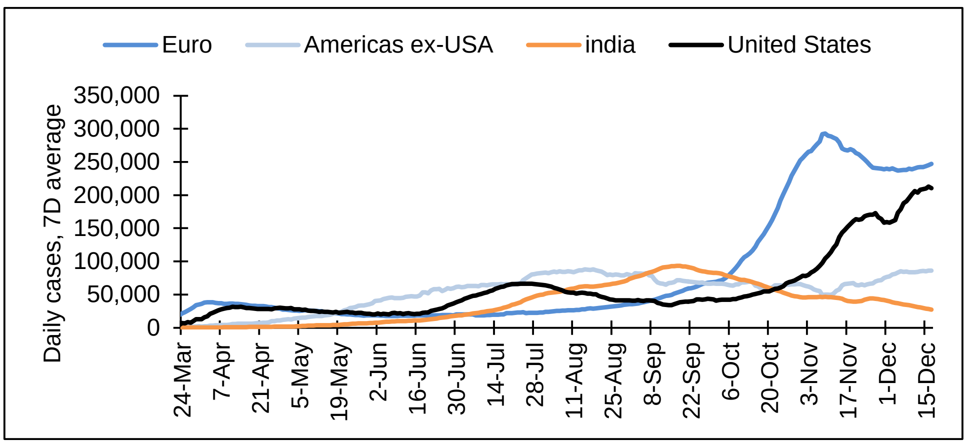
Covid update: Second wave of COVID-19 poses near term challenges even as hopes of vaccine turn into reality

Chart 45: India Active cases continue to see a downtrend



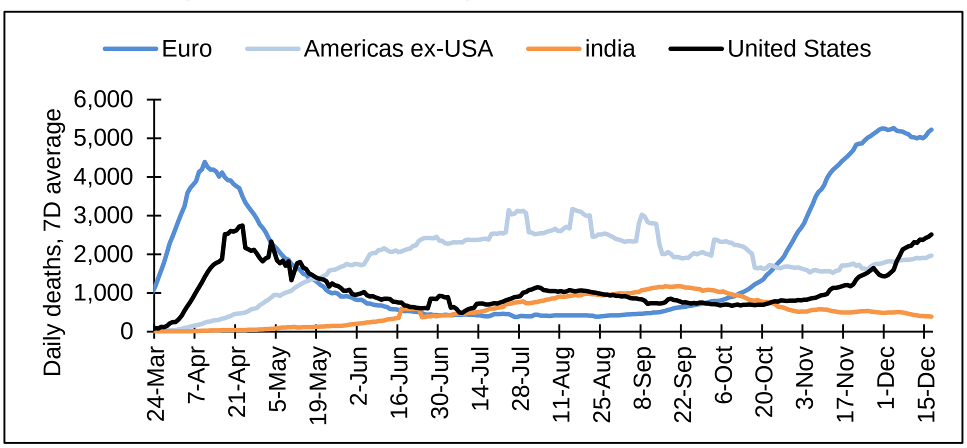
Source: CEIC, MOHFW, I-Sec Research

Chart 46: Daily new cases



Source: CEIC, WHO, I-Sec Research

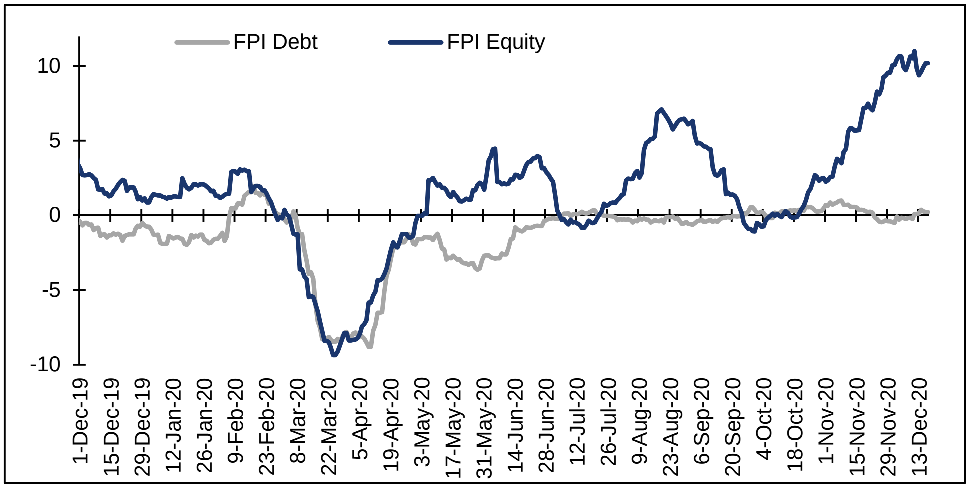
Chart 47: Daily deaths for India stays low



Source: CEIC, WHO, I-Sec Research

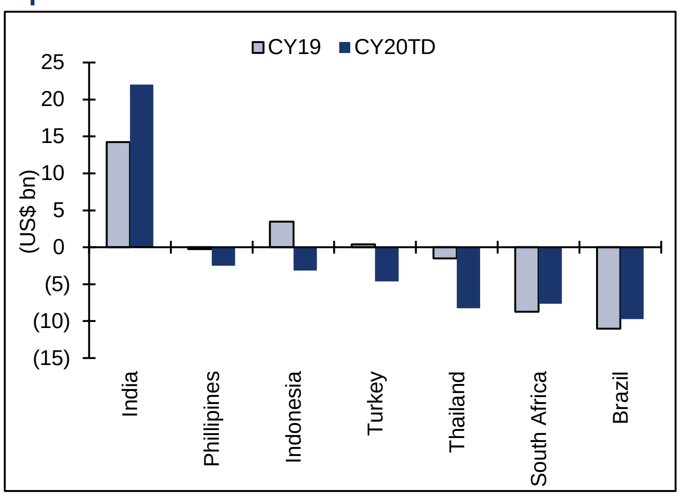
Foreign flows

Chart 48: While India saw heavy FPI outflows during the March lows, equity flows since then have been very strong, with Nov'20 recording the highest monthly FPI inflows by a wide margin*



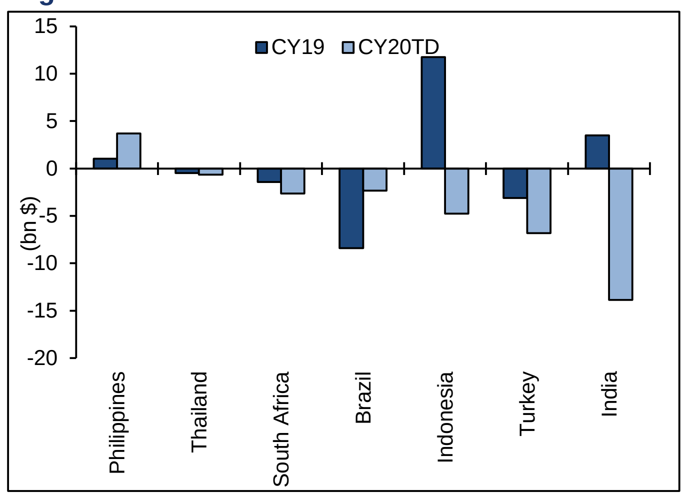
*Data available since CY99
Source: NSDL, I-Sec Research

Chart 49: Among EMs, India saw higher flows in equities in CY20



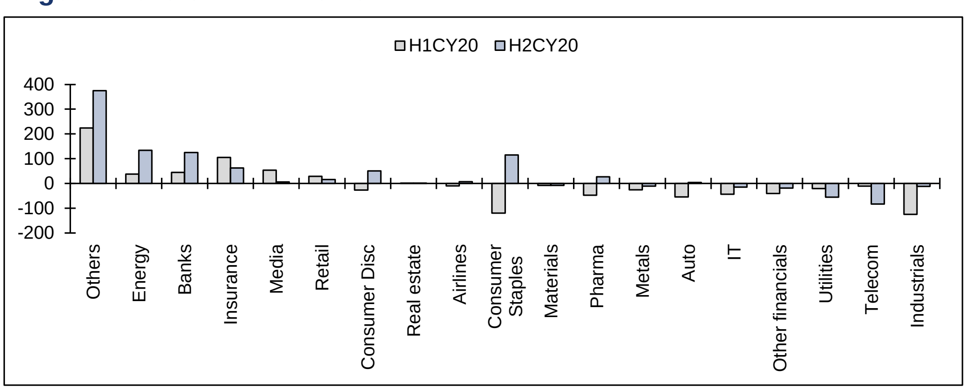
Source: Bloomberg, I-Sec Research

Chart 50: …but higher outflows in the Debt segment



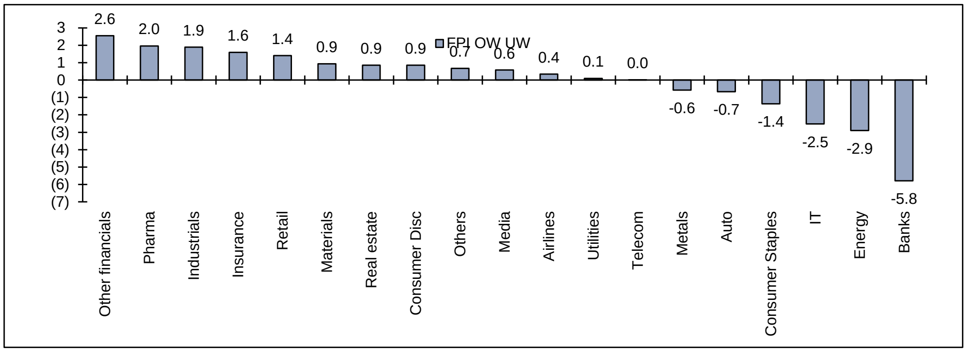
Source: Bloomberg, I-Sec Research

Chart 51: Sectoral FPI Flows in CY20 – Energy and Financials absorbed the largest share of FPI inflows



Source: NSDL, I-Sec Research

Chart 52: FPI sectoral stance in Indian equities vs Nifty50



Source: NSDL, NSE, I-Sec Research

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