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INDIA

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Strategy

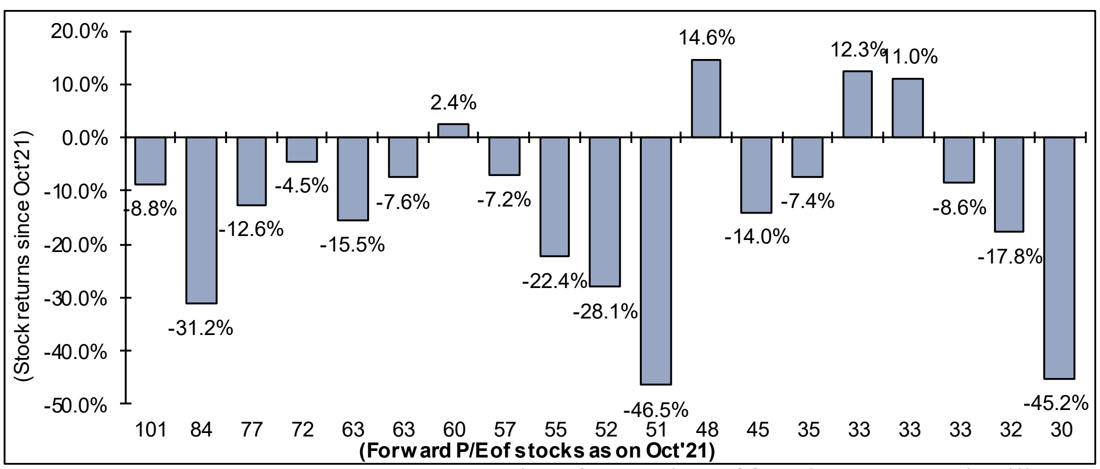
More evidence of growth emanating from capex and credit cycle; valuation pressure on expensive stocks to continue till QT cycle ends

Evidence of capex and credit cycle driving demand in the economy: On the growth aspect, incremental evidence is pointing towards investments driving demand in the economy.

- **Q3FY23 GDP growth of 4.4% was largely supported by GFCF** (gross fixed capital formation) growth of 8.3% while consumption (PFCE – private final consumption expenditure) lagged at 2.1%.
- **Central government capex spends picked pace in Jan'23** and stands at Rs7.2trn on a trailing 12-month (TTM) basis (43% YoY growth) although state capex growth is lagging at Rs5.5trn on TTM basis (10% YoY growth). Corporate capex of listed space is showing signs of improvement with TTM aggregate capex rising above Rs7trn level.
- **Non-food credit growth for Feb'23 was robust at 16.5%.** Other high-frequency indicators supporting the 'investment cycle' include robust core sector growth, electricity demand, thermal PLF and diesel consumption (*table-1*).
- **Household investment in real estate**, which is a significant portion of GFCF (25% share of GFCF in FY21), is showing signs of a cyclical upswing.

- **QT cycle triggered contraction in equity valuation for the NIFTY50 from ~23x in Oct'21 to sub-19x currently.** Bulk of the correction in stock prices emerged from the low-volatility and expensive segment of the NIFTY50 (>30x forward P/E) concentrated around quality financials (insurance, NBFCs, private banks), consumption and IT. The average forward P/E of the said stocks has dipped from ~54x in Oct'21 to ~39x currently.

Chart 1: Expensive (>30 P/E) and low volatility stocks have given maximum negative returns since QT fear began in Oct'21 with a few exceptions



Note: Amongst the low-volatility and expensive stocks (>30x forward P/E as of Oct'21), only Britannia (+14%), Maruti (+12%) and Eicher (+11%) have eked out double-digit positive returns since Oct'21 within the NIFTY50

- **Outlook:** Excluding the expensive pack mentioned above, the average market valuation has dipped from 17.8x in Oct'21 to 14.9x currently. Incidentally, the reasonably valued part of the market makes up most of the capital-intensive stocks (including banks) wherein demand from the economy remains robust. We continue to be overweight on capital-intensive and cyclical stocks with value attributes linked to the domestic economy.
- **Top picks from our coverage universe:** SBI, Axis Bank, Fusion, L&T, BHEL, Siemens, NTPC, NHPC, ONGC, IOCL, IGL, Coal India, UltraTech, Astral, Greenpanel Industries, EPL, Chemplast Sanmar, JSPL, Jindal Stainless, Ashok Leyland, Bharti Airtel, Phoenix Mills, Brigade Enterprises, Indian Hotels, TVS Motors, ITC, Jubilant Foodworks, Metro Brands.

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Chart 2: Market map for Feb’23

(1) **[1-Feb-23]** Policymakers lifted the Fed’s target for its benchmark rate by 0.25% to a range of 4.5% to 4.75%.

(2) **[1-Feb-23]** Union Budget FY24 was pro-growth and provided focus on capex.

(3) **[1-Feb-23]** Manufacturing PMI at 55.4 in January.

(4) **[2-Feb-23]** The ECB increased interest rates by 0.5%.

(5) **[2-Feb-23]** BOE increased interest rate to 4% saying more hikes may be needed.

(6) **[2-Feb-23]** The Labor Department said that there were more than 11 million job openings in December.

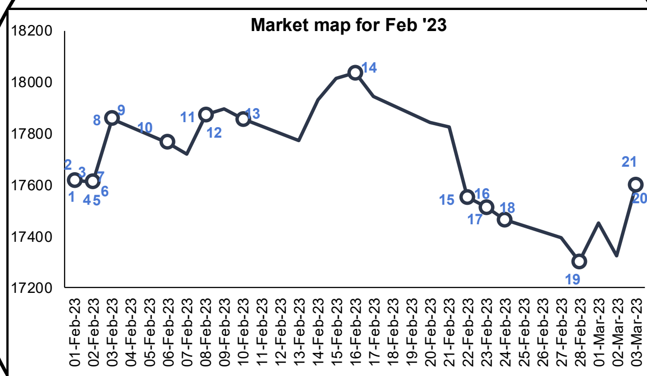
(7) **[2-Feb-23]** US Employers announced more than 100,000 job cuts in January. The technology sector made up 41% of the planned reductions, Thursday’s report showed.

(8) **[3-Feb-23]** According to NielsenIQ The rural markets declined 2.8% registering the sixth consecutive quarter with negative volume growth, while the urban market maintained stable positive growth of 1.6%.

(9) **[3-Feb-23]** Services PMI at 57.2 in January.

(10) **[4-Feb-23]** Top policy makers at BOE signaled that the most aggressive tightening cycle in three decades may be nearing an end.

(11) **[8-Feb-23]** Aggregate level capacity utilisation for the manufacturing sector improved to 74% in the second quarter of FY23 from 72.4% in the previous quarter.



(21) **[3-Mar-23]** Services PMI Business Activity Index rose to 59.4 in February from 57.2 in January.

(20) **[3-Mar-23]** GST Collections In February Dip Below Rs 1.5 Lakh Crore GST revenue collected in February stood at Rs 1,49,577 crore.

(19) **[28-Feb-23]** India's GDP growth moderates to 4.4 per cent in Q3.

(18) **[24-Feb-23]** Heat waves and El Nino pose threat to India's agriculture according to Skymet.

(17) **[23-Feb-23]** MPC minutes indicate fivergence between members on rate hikes.

(16) **[22-Feb-23]** Fed minutes shows that the it is inclined towards more rate hikes.

(15) **[22-Feb-23]** The value of the US housing market shrunk by the most (US$ 2.3 tn) since the 2008 as the pandemic boom fizzled out.

(14) **[16-Feb-23]** U.S. producer price index for final demand jumped 0.7% last month, the most since June and bolstered by higher energy costs.

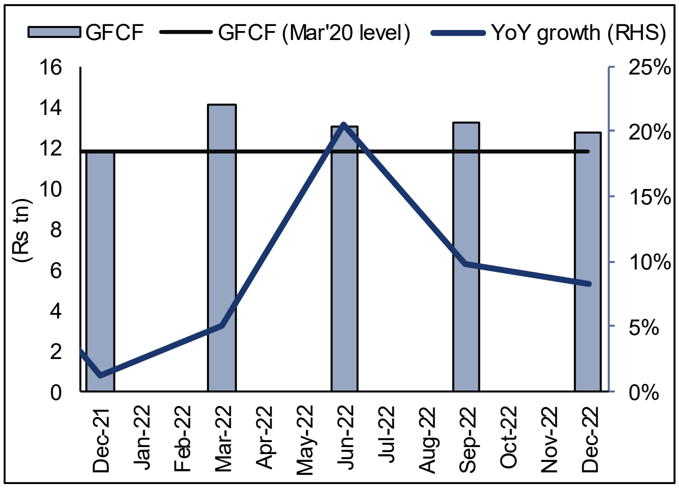
(13) **[10-Feb-23]** Arcelor Mittal SA expects steel demand to rebound this year, driven by an economic recovery and a rebuild of inventories in the firm’s key markets.

(12) **[8-Feb-23]** Domestic air passenger traffic touched 1.25 crore in January this year, an increase of 96% compared to the year-ago period.

Source: Bloomberg, I-Sec research

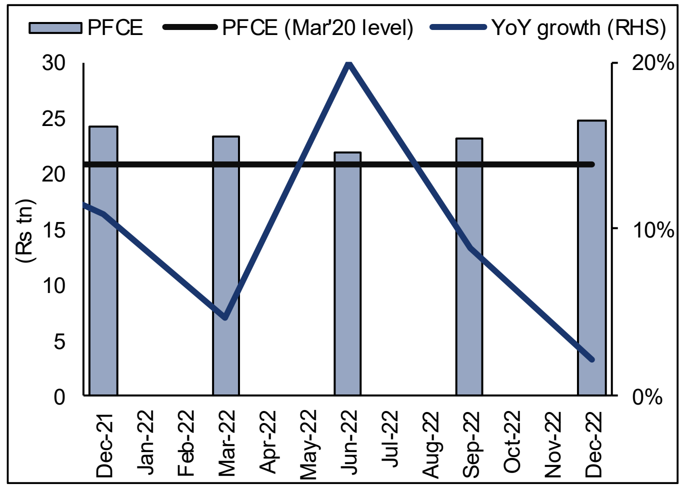
Story in charts

Chart 3: GFCF (gross fixed capital formation) growth sustains …



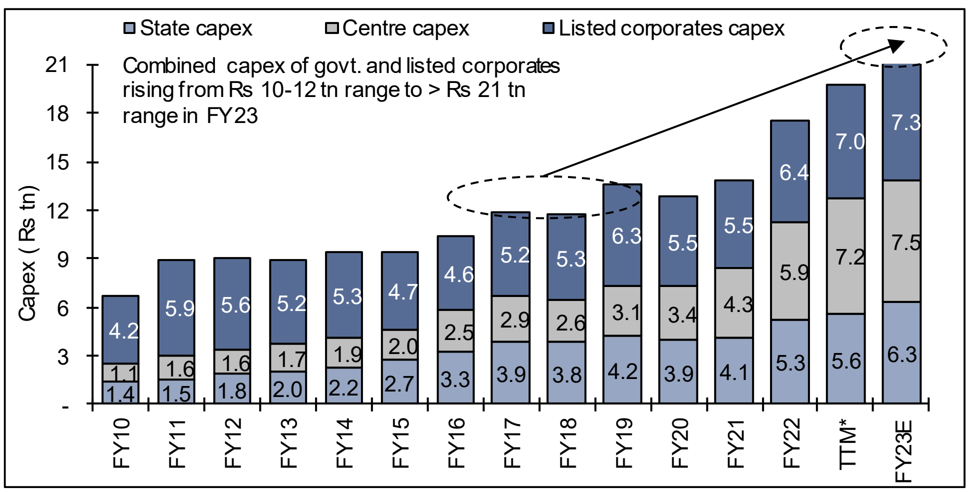
Source: Bloomberg, I-Sec research

Chart 4: …while PFCE (private final consumption expenditure) growth lags



Source: Bloomberg, I-Sec research

Chart 5: GFCF expansion likely driven by robust Central government capex and real estate cycle; corporate and state capex grow at a relatively slower pace



Source: CEIC, Capitaline, I-Sec research
Note: Centre and state capex TTM data is considered till Jan'23 and listed corporate capex data is available till Sep'22.

Table 1: High-frequency data continues to be robust

Consumption Indicator	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
Personal Loan growth	18.1%	18.7%	19.4%	19.4%	20.1%	19.6%	20.0%	20.4%	NA
4W growth	19.1%	11.1%	21.1%	92.0%	28.6%	28.1%	7.2%	17.2%	NA
2W growth	24.0%	10.2%	17.0%	13.5%	2.3%	17.7%	3.9%	5.0%	NA
IIP - Primary Goods.	13.8%	2.5%	1.7%	9.5%	2.0%	4.8%	8.3%	NA	NA
IIP Consumer Goods Durables	25.2%	2.3%	-4.4%	-5.5%	-17.8%	5.3%	-10.4%	NA	NA
IIP Consumer Goods Non-Durables	2.9%	-2.9%	-9.0%	-5.7%	-13.4%	9.1%	7.2%	NA	NA
Petrol Consumption	23.2%	6.8%	11.6%	8.8%	9.0%	8.2%	5.9%	14.2%	NA
S&P India Services PMI	59.20	55.50	57.20	54.30	55.10	56.40	58.50	57.20	59.40
CPI	7.01%	6.71%	7.00%	7.41%	6.77%	5.88%	5.72%	6.52%	NA
Passenger - all airports	288.1%	127.4%	73.1%	61.6%	40.0%	21.8%	23.1%	101.0%	NA
GST Collections (Rs bn)	1,446	1,490	1,436	1,477	1,517	1,459	1,495	1,559	1,496
Consumer confidence index	NA	77.30	NA	80.60	NA	83.50	NA	84.80	NA

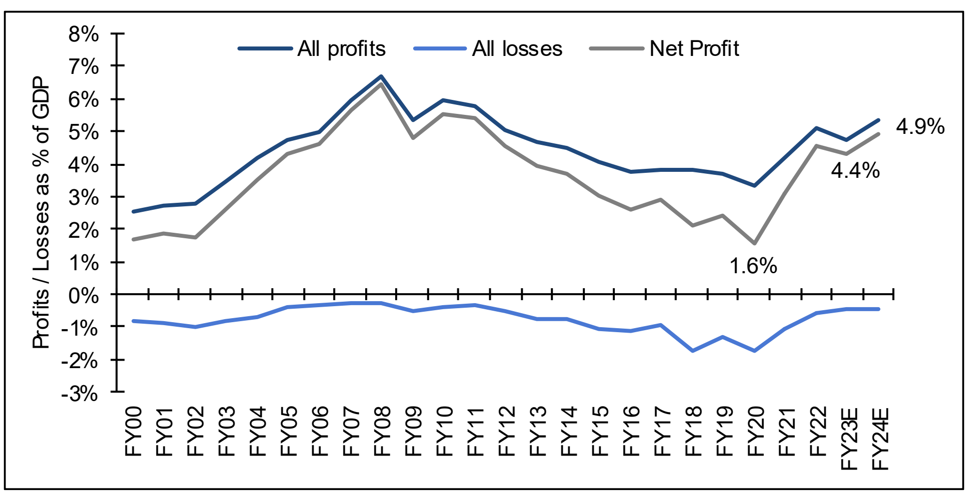
	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Private final consumption exp real	1.57%	6.77%	17.64%	14.23%	10.84%	4.68%	20.04%	8.83%	2.10%

Industrial Indicator	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
Non-food credit growth (fortnightly)	12.6%	15.1%	16.0%	16.9%	18.3%	17.6%	15.3%	16.7%	16.5%
Industry loan growth	9.47%	10.46%	11.40%	12.56%	13.57%	13.07%	8.64%	8.75%	NA
Thermal plant Load factor	68.24	59.34	58.63	60.57	55.80	61.37	65.11	66.85	68.91
IIP growth	12.6%	2.2%	-0.7%	3.3%	-4.2%	7.3%	4.3%	NA	NA
Core sector growth (%)	13.13	4.77	4.21	8.30	0.73	5.72	7.00	7.80	NA
Diesel Consumption	23.75%	8.20%	13.04%	13.43%	5.50%	19.18%	6.48%	12.67%	NA
Power demand	16.7%	3.6%	1.8%	12.7%	0.04%	11.0%	11.6%	12.3%	NA
IIP Capital Goods	28.6%	5.1%	4.3%	11.4%	-1.7%	21.6%	7.6%	NA	NA
S&P Global India manufacturing PMI	53.9	56.4	56.2	55.1	55.3	55.7	57.8	55.4	55.3
WPI Commodity price index	16.23%	14.07%	12.48%	10.55%	8.67%	6.12%	4.95%	4.73%	NA
Cargo - Air	13.95%	6.12%	-1.19%	-0.48%	-14.53%	-2.26%	-5.90%	-3.67%	NA
Cargo - all ports	13.5%	15.1%	8.0%	14.9%	3.6%	2.0%	10.4%	12.2%	NA
Freight traffic - railways	19.32%	17.51%	15.66%	10.32%	0.76%	4.26%	5.96%	6.43%	NA
Import Growth (%)	53.22%	38.65%	37.62%	14.88%	10.01%	9.80%	-0.24%	-3.63%	NA
Export growth (%)	30.16%	8.06%	10.93%	4.66%	-11.55%	9.74%	-3.13%	-6.58%	NA
Trade Deficit (US$ bn)	-22.21	-25.61	-25.03	-29.27	-27.40	-23.33	-22.15	-17.74	NA

Industrial Indicator	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Capacity utilisation	66.60	69.40	60.00	68.30	72.40	75.30	72.40	74.00	NA
GFCF	3.01%	13.99%	61.03%	12.42%	1.24%	4.95%	20.56%	9.75%	8.28%

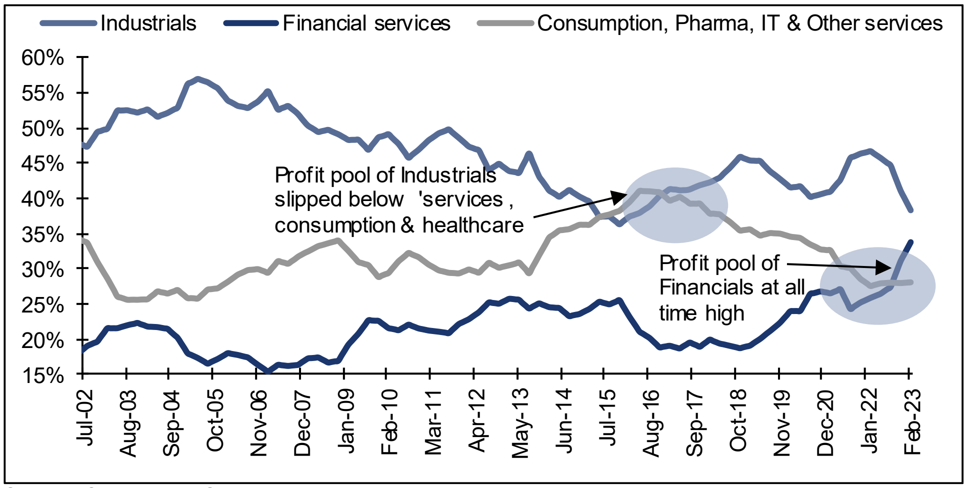
Source: CEIC, Bloomberg, I-Sec research

Chart 6: Profit cycle – 'PAT to GDP' likely to dip marginally in FY23E to 4.4%



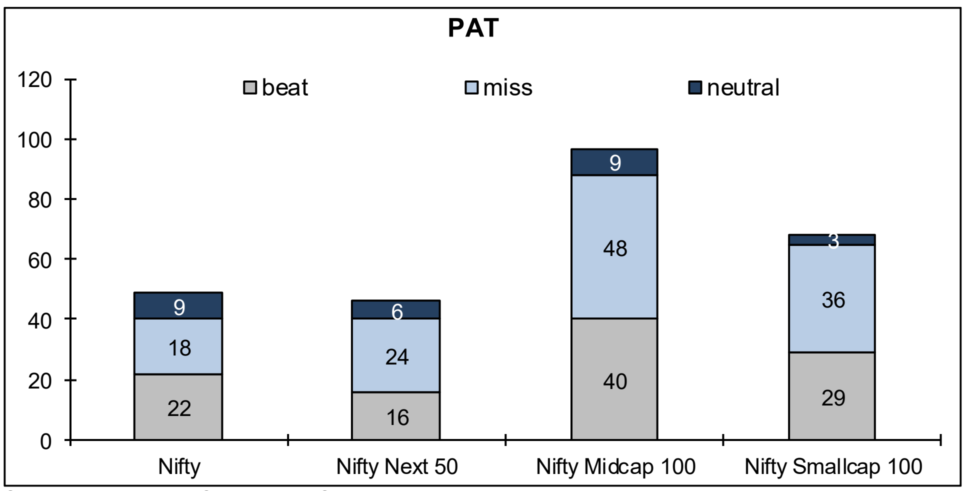
Source: Capitaline, Bloomberg, I-Sec research

Chart 7: Share of financials in aggregate corporate profit pool is at an all-time high while commodities drag down the share of overall industrial space



Source: Capitaline, I-Sec research
Note: We have considered top 1,000 companies by market cap (only profitable ones) at respective periods.

Chart 8: Beats outpace misses in the NIFTY 50, and vice versa in NIFTY Next 50 during Q3FY23



Source: Bloomberg, Capitaline, I-Sec research
Note – Within +/- 3% of consensus PAT is neutral while >+3% is beat and <-3% is miss.

Table 2: Q3FY23 earnings

	Sales			EBITDA			PAT			PAT (incl. financials)		
Free float, Rs bn	**Q3FY23**	**YoY**	**QoQ**	**Q3FY23**	**YoY**	**QoQ**	**Q3FY23**	**YoY**	**QoQ**	**Q3FY23**	**YoY**	**QoQ**
Nifty	5,930	16%	1%	1,028	4%	14%	509	-5%	13%	897	9%	10%
Next50	1,558	21%	2%	132	-29%	42%	65	-44%	236%	97	-32%	77%
Midcap100	1,542	15%	2%	172	2%	51%	56	-27%	166%	140	-3%	44%
Nifty 200	**9,031**	**16%**	**1%**	**1,331**	**-1%**	**20%**	**629**	**-13%**	**28%**	**1,134**	**2%**	**17%**

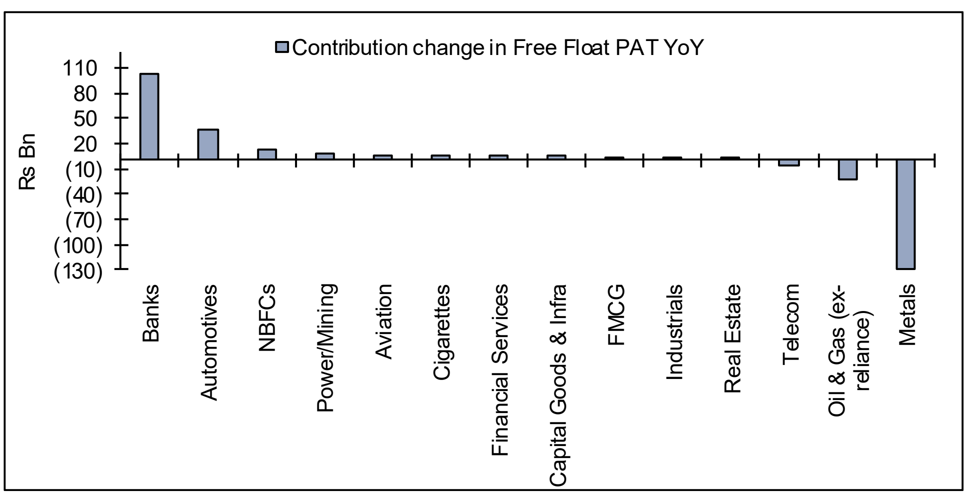
Source: Capitaline, I-Sec research

Table 3: Sectoral distribution of earnings

Free float, Rs bn	NSE 200 Index	Sales			EBITDA			PAT			Actual *vs* consensus expectations		
Sector	**Weights**	**Q3FY23**	**YoY**	**QoQ**	**Q3FY23**	**YoY**	**QoQ**	**Q3FY23**	**YoY**	**QoQ**	**Beat**	**Neutral**	**Miss**
Agriculture	0.66%	107	20.9%	7%	24	17.5%	6.5%	13	13.8%	9.9%	2	0	0
Auto Ancillaries	0.88%	131	27.5%	3%	12	15.4%	1.7%	6	23.2%	-4.3%	1	0	5
Automotives	4.55%	933	25.0%	4%	115	52.9%	29.6%	59	158.5%	45.9%	5	2	2
Aviation	0.24%	50	60.7%	19%	10	74.8%	NM	7	NM	LtoP	1	0	0
Building Material	0.59%	16	8.3%	2%	3	-8.4%	7.1%	2	-18.0%	-0.4%	0	0	2
Capital Goods & Infra	3.02%	446	16.6%	8%	49	15.9%	9.5%	25	24.2%	12.3%	3	0	2
Cement	2.56%	181	14.9%	7%	24	-10.1%	25.6%	11	-18.3%	7.0%	3	0	4
Cigarettes	2.71%	115	2.3%	1%	44	22.0%	6.1%	36	21.0%	12.6%	1	0	0
Defence	0.63%	43	5.0%	6%	8	-10.4%	-16.5%	8	14.6%	-0.6%	2	0	1
Discretionary	3.85%	210	9.4%	6%	28	-2.3%	8.7%	17	-1.5%	17.4%	5	4	9
FMCG	5.72%	222	13.0%	0%	39	9.3%	4.6%	27	10.5%	6.4%	7	1	5
Industrials	0.98%	64	41.9%	-30%	4	111.1%	-12.8%	2	LtoP	77.9%	1	0	0
Internet	0.22%	9	50.5%	16%	-1	loss maker	loss maker	-1	loss maker	loss maker	1	0	2
Logistics	0.80%	29	9.4%	-4%	11	-0.4%	-7.4%	6	-14.6%	-17.3%	0	0	3
Media	0.25%	22	-1.7%	4%	5	-27.2%	12.3%	1	-70.8%	-41.9%	0	1	1
Metals	3.58%	1,192	-0.1%	-5%	118	-55.7%	-8.5%	11	-91.9%	-63.5%	1	3	7
Oil & Gas	2.52%	2,221	20.4%	5%	154	-9.5%	NM	84	-20.6%	LtoP	5	1	5
Reliance Industries	8.14%	1,108	17.4%	-6%	180	18.6%	12.9%	91	0.6%	14.8%	1	0	0
Paints	1.45%	49	2.0%	2%	9	2.4%	25.7%	6	2.5%	31.2%	0	0	2
Pharma	4.62%	323	12.9%	3%	70	9.8%	1.6%	41	-6.7%	-4.0%	4	1	14
Power/Mining	3.25%	386	31.3%	1%	140	25.3%	22.2%	49	20.5%	11.6%	3	0	4
Real Estate	0.54%	19	40.4%	58%	6	59.0%	92.6%	4	91.6%	65.3%	2	0	2
Speciality Chemicals	0.76%	82	33.8%	-9%	14	24.1%	-5.5%	8	21.9%	-17.0%	4	0	1
Technology	12.00%	848	20.0%	5%	165	9.9%	5.7%	133	-2.7%	7.5%	5	5	3
Telecom	2.29%	227	14.6%	1%	100	8.5%	-2.3%	-15	loss maker	loss maker	1	0	3
NBFCs	7.21%	146	NM	NM	116	NM	NM	73	23.7%	-4.0%	3	2	3
Financial Services	3.66%	361	NM	NM	68	NM	NM	49	13.4%	-10.1%	5	2	7
Banking	22.32%	898	NM	NM	675	NM	NM	383	37.1%	11.4%	12	2	3
Total	**100.0%**	**9,033**	**16.5%**	**1%**	**1,332**	**-0.7%**	**20%**	**1,135**	**2.5%**	**17.4%**	**78**	**24**	**90**
Ex-financials	66.8%	9,033	16.5%	1%	1,332	-0.7%	20%	629	-13.3%	27.9%	58	18	77
Ex-Commodity	93.9%	5,620	19.1%	1%	1,060	17.1%	12%	1,040	20.6%	8.8%	72	20	78
Ex-Financials & Ex-commodity	**60.7%**	**5,620**	**19.1%**	**1%**	**1,060**	**17.1%**	**12%**	**534**	**11.3%**	**11.2%**	**52**	**14**	**65**

Source: Capitaline, Bloomberg, I Sec research

Chart 9: Q3FY23 sectoral contribution to YoY change in 'aggregate profit pool' within NSE-200 universe



Source: Capitaline, Bloomberg, I-Sec research

Chart 10: Recent correction improves prospects of achieving expected returns of ~12 % over the next one year (long-term returns of ~12% expected from NIFTY50 based on rolling 10-year returns)

Source: Bloomberg, I-Sec research

Market valuations snapshot

Chart 11: Nifty50 forward P/E at 18.7x (ex-post basis)

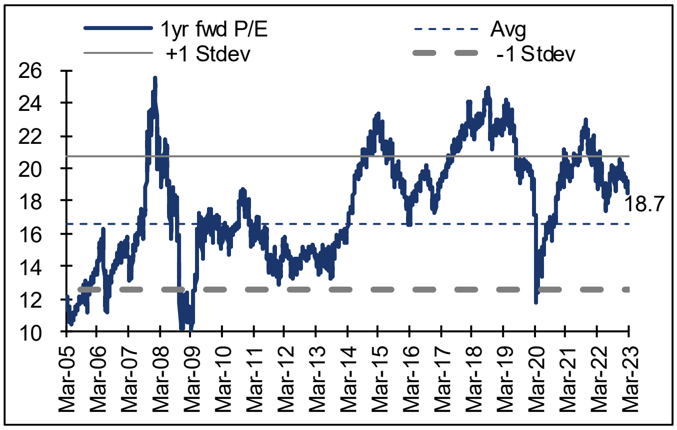


Chart 12: CAPE at 27.66x

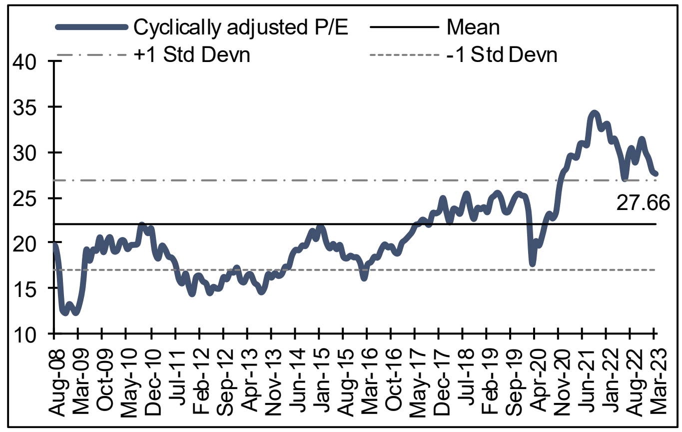


Chart 13: Nifty P/B below long-term average level

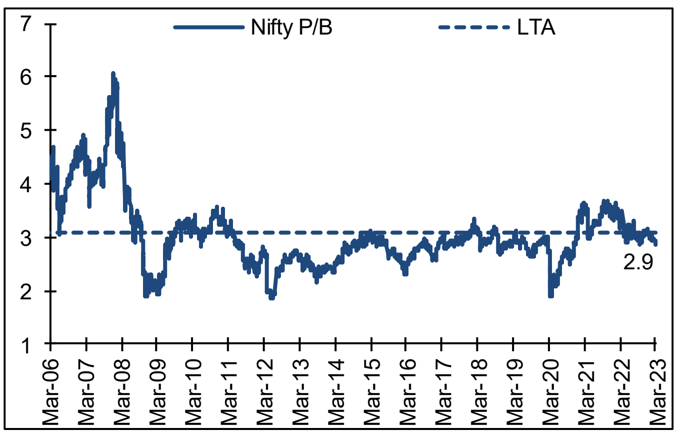


Chart 14: 'Market cap to GDP' at 96.5%

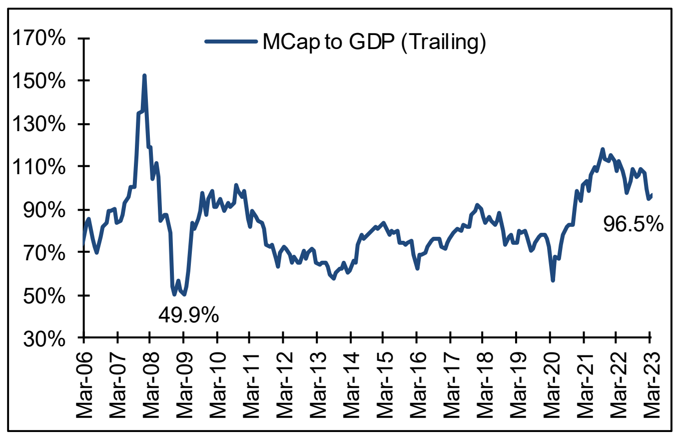
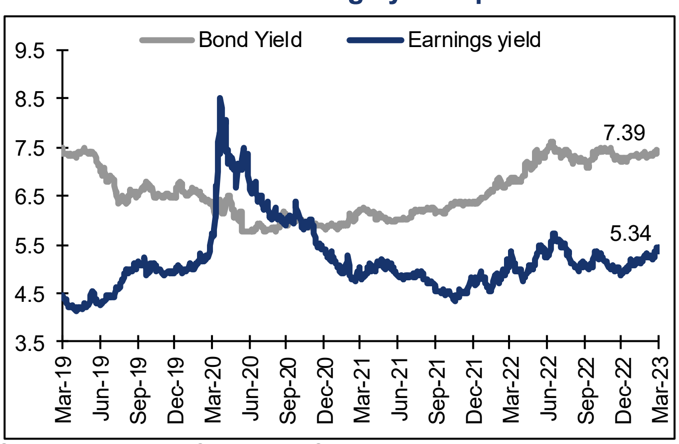
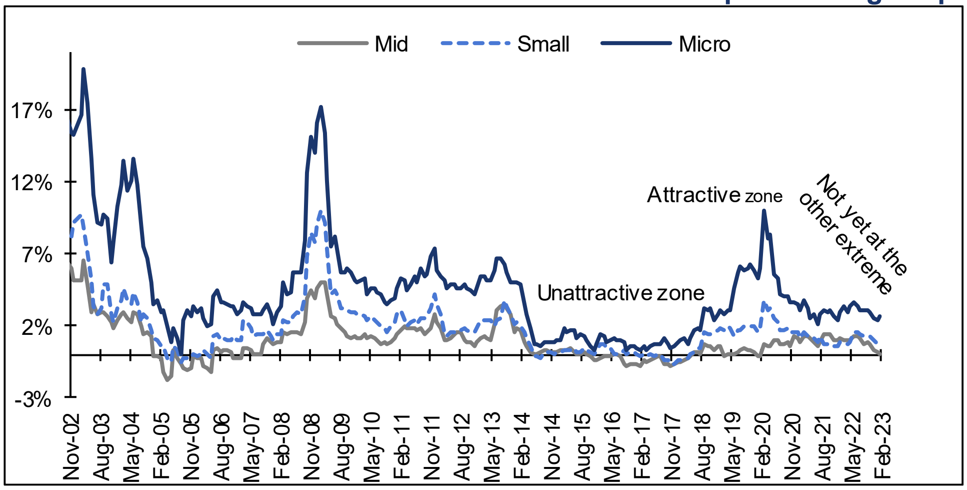


Chart 15: Bond and earnings yield spread



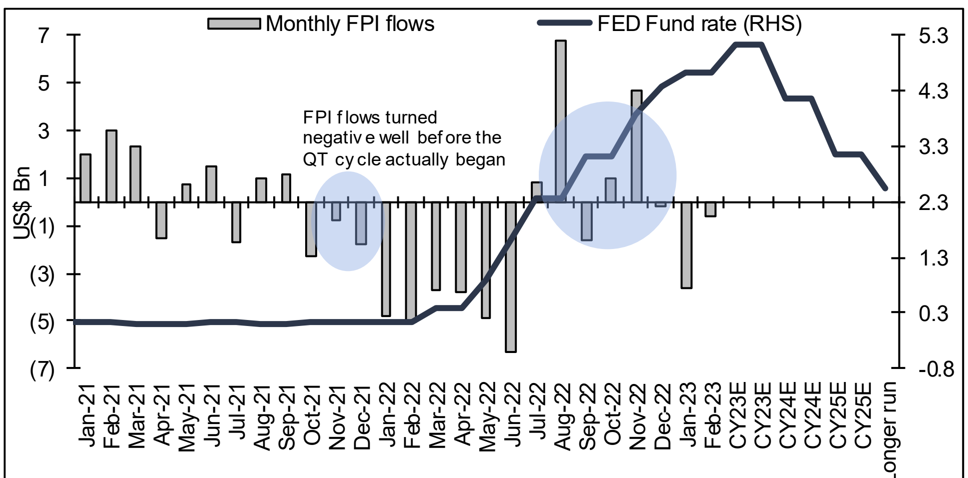
Source: Bloomberg, Capitaline, I-Sec research

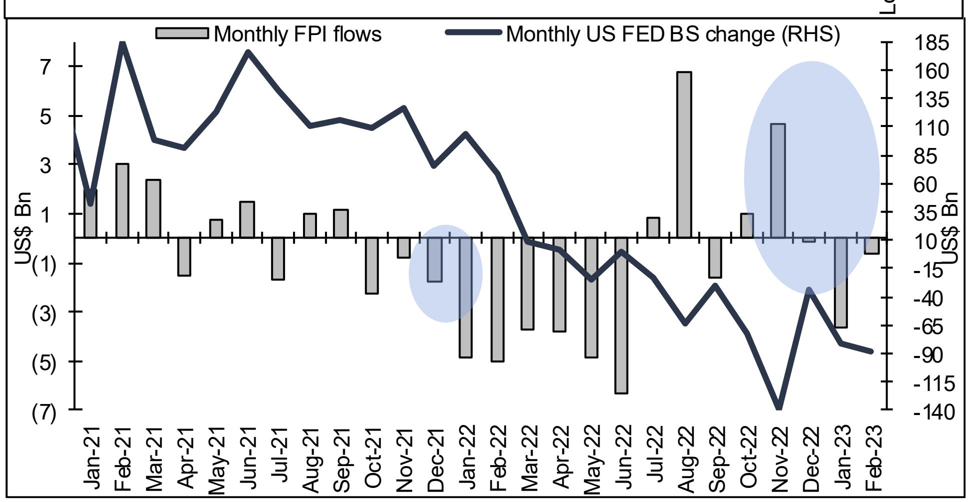
Chart 16: TTM valuation discount of mid- and small-caps over large caps



Note: Large-cap – top 100 companies by market-cap rank, mid-caps – next 150 companies (101-250th rank), small-cap companies – next 250 companies (251 to 500th rank), and micro-caps – next 500 companies. Above chart refers to trailing earnings yield spreads of mid-, small- and micro-caps over large-caps at each point in time. Only profitable companies are considered in the calculations.
Source: Bloomberg, Capitaline, I-Sec research

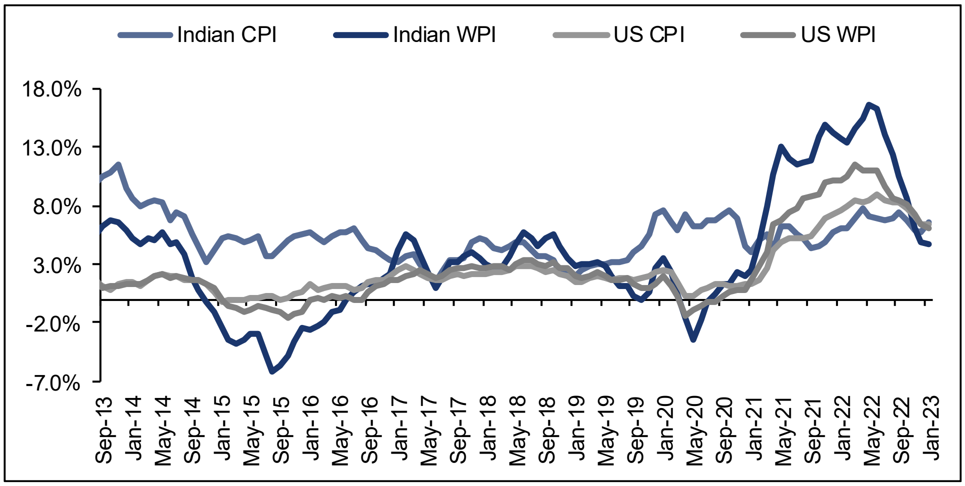
Chart 17: US Fed downshifts in terms of rate hikes during Jan'23 policy – prospects of policy pivot hinges on inflation trajectory





Source: Bloomberg, Latest projections of Federal Reserve Board members and Federal Reserve Bank presidents, I-Sec research

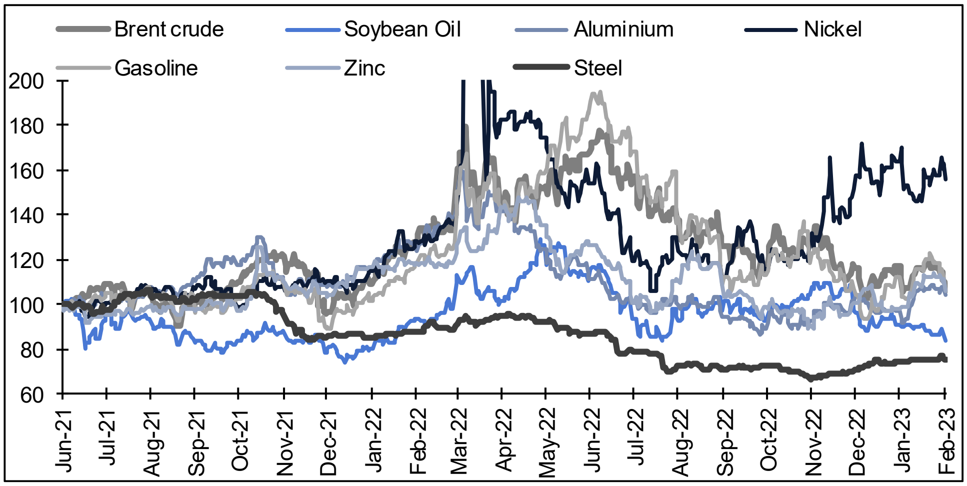
Chart 18: Wholesale and retail inflation trajectory slowing down for India and US



Source: Bloomberg, CEIC, I-Sec research

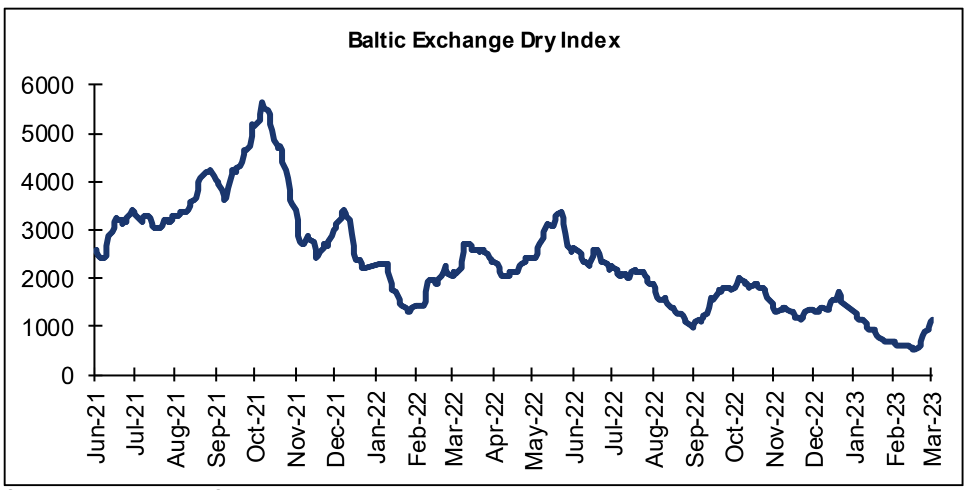
Drivers of inflation mean-reverting post the spike seen last year

Chart 19: Commodity prices continue to cool after a sharp rise in Mar'22, thereby helping pare inflation expectations



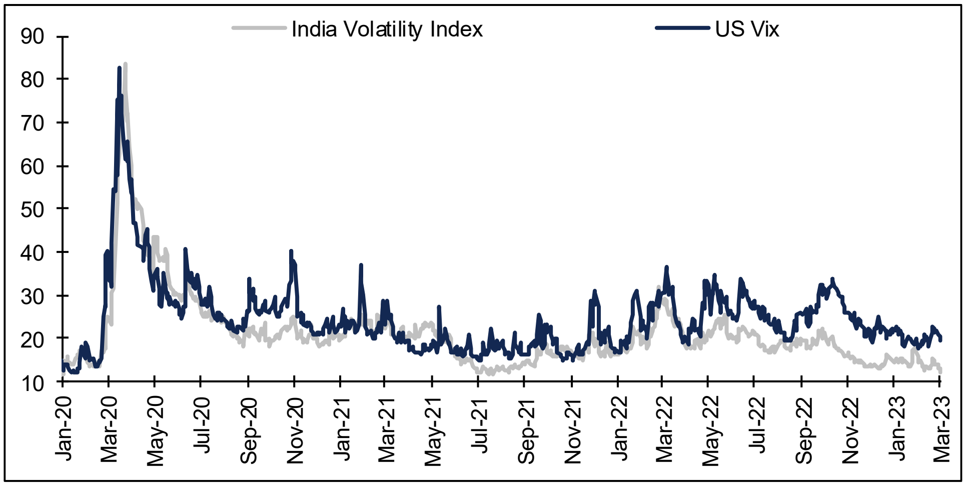
Source: Bloomberg, I-Sec research
Note: Commodity prices have been reset to 100 at beginning of Jun'22

Chart 20: Shipping cost index has fallen significantly from peak of Oct'21



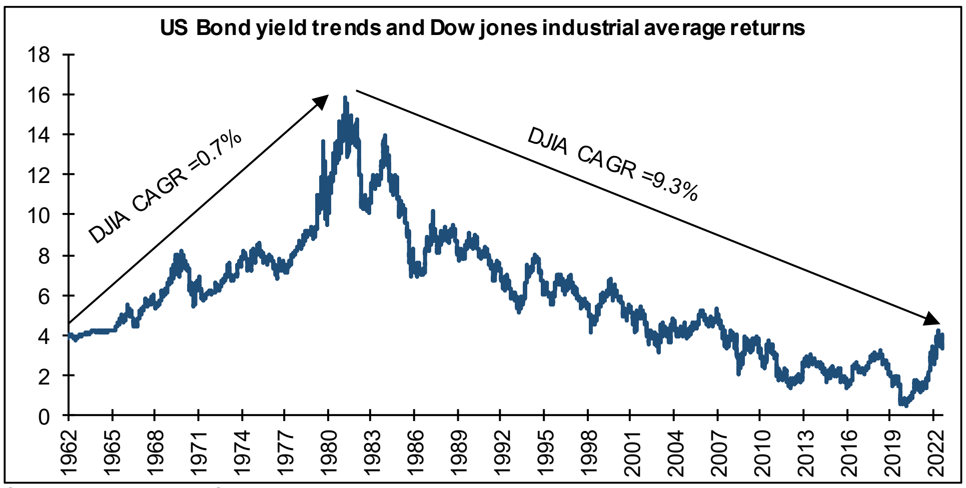
Source: Bloomberg, I-Sec research

Chart 21: Fear has receded from higher levels



Source: Bloomberg, I-Sec research

Chart 22: Structural rise in US bond yields similar to that in 1960s-80s is unlikely given the current inflation trajectories



Source: Bloomberg, I-Sec research

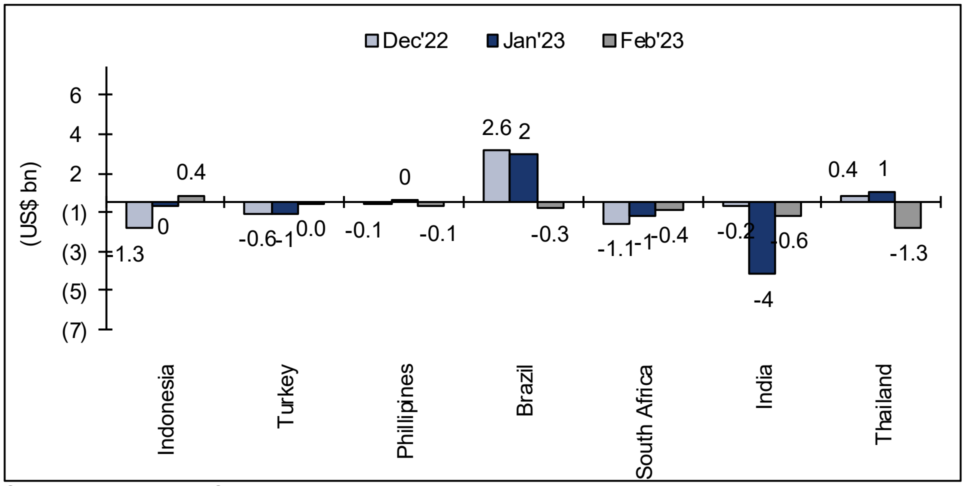
Table 4: FPI sectoral flows since Q3FY22

(Rs bn)

Sector	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23 till Feb'23	AUM as on Feb'23
Industrials, Construction, capital goods and chemicals	26	(43)	(18)	130	112	36	3,208
Metals & Mining	(42)	92	(50)	(37)	43	17	1,188
Healthcare	(24)	(24)	37	105	35	12	2,197
Other services	(13)	(32)	30	19	(4)	7	682
Const. Material	(57)	(60)	(31)	7	9	(2)	779
Realty	31	(22)	(13)	(12)	22	(4)	510
IT & Hardware	(148)	(282)	(284)	(135)	12	(11)	5,114
FMCG	(93)	(27)	(3)	105	73	(12)	3,231
Telecom	9	11	(25)	91	(9)	(26)	1,136
Power	(5)	11	9	21	(10)	(33)	1,237
Disc Cons	210	(216)	(103)	153	83	(50)	5,473
Energy	(35)	(40)	(39)	(84)	(14)	(126)	4,508
Financials	(243)	(469)	(330)	121	121	(151)	14,946
Total	**(385)**	**(1,100)**	**(821)**	**486**	**474**	**(341)**	**44,211**

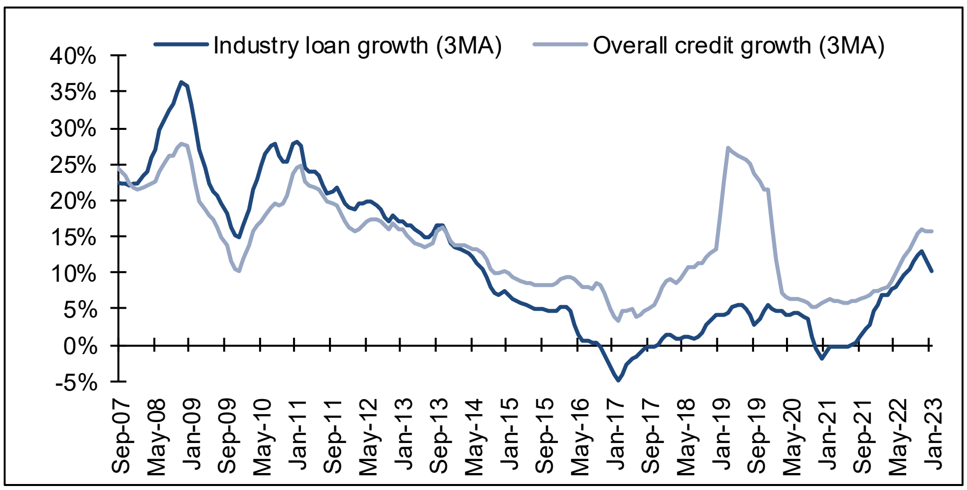
Sources: NSDL, I-Sec research
Note: NSDL has changed sector classification from Apr'22. We have broadly attempted to map old sectors with the new sectors.

Chart 23: Emerging market outflows moderate



Source: Bloomberg, I-Sec research

Chart 24: Financial leverage and industry credit at an early stage of recovery



Source: CEIC, I-Sec research

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