2023 Outlook: Year of RRR

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India Macro and Strategy

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'RRR': Reset, Recession and Recovery

- **We see 2023 as a year of three parts. The first part will continue to see a 'Reset' between the normal of the pre-pandemic era and the new normal of the post-pandemic era.**
- **The 'Reset' in our view, like most transformations, will carry its share of pain in the form of a 'Recession'. However, the 'Recession' may be shallow and short-lived, paving the way for a 'Recovery' going into CY24.**
- **We are penciling in GDP growth of 6% in FY24 for India based on the premise of a shallow US recession in CY23 (0-1% decline in US GDP). In an environment of slowing global growth, we expect commodity prices to remain relatively benign, easing the pressure on India's macro fundamentals.**
- **While our base case has been the end of monetary tightening by the US Federal Reserve and the RBI by the end of CY22, we now see increasing possibility of rate hikes in early CY23 as well on the back of continued strength in macro indicators. However, with inflation slowing and global growth moderating, we expect an extended pause through most of CY23, with rate cuts most likely by the end of CY23.**
- **We peg CPI inflation at 4.5% and WPI inflation at 2.6% in FY24 and believe that margin headwinds will now turn into margin tailwinds as input prices ease while selling prices are cut to a lesser extent.**
- **We are penciling in a Current Account Deficit (CAD) of 2% of GDP in FY24 vs. 2.8% in FY23. We expect USD/INR to average 82 in FY24, which is a modest depreciation from our FY23 estimate of 80 (revised from 79.5 earlier).**
- **On the fiscal front, we see only a gradual consolidation as expenditure may remain elevated ahead of general elections in CY24. We peg the fiscal deficit for FY24 at 6.2% of GDP vs. 6.4% of GDP for FY23E.**
- **In the context of our macro outlook, we prefer Large Caps in the 'Reset' to 'Recession' phase as markets are likely to remain volatile and some correction is likely. We believe that Mid-Caps and Small Caps will see traction once interest rates begin to ease.**
- **We believe that FPI flows into Indian equities may see a pick-up as the Fed pauses its rate hike cycle, but Indian markets may remain volatile as a recession looms. India's market valuations remain stretched relative to peers but the same may sustain. The bigger risk, in our view, is earnings downgrades, especially if a recession precipitates a market correction. Overall, we expect Indian equities to deliver positive but low returns in CY23.**
- **In terms of sector positioning, we are positive on domestic demand plays and suggest positioning for rural recovery given expectations of robust farm incomes, moderating inflation and government spending ahead of Lok Sabha (LS) elections in CY24.**

Exhibit 1: Macro outlook

	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24
GDP (% YoY)	8.3	7.0	6.1	3.7	-6.6	8.7	7.5	6.0
GVA (% YoY)	8.0	6.6	6.0	3.8	-4.8	8.1	7.3	5.9
Agriculture (% YoY)	6.8	5.9	2.4	5.5	3.3	3.0	3.8	4.0
Industry ex. construction (% YoY)	8.4	6.8	4.5	-2.2	-1.8	9.8	1.9	5.4
Services inc. construction (% YoY)	8.1	6.7	7.5	5.7	-7.8	8.8	10.2	6.6
CPI (average)	4.5	3.6	3.4	4.7	6.2	5.5	6.4	4.5
WPI (average)	1.8	3.0	4.3	1.7	1.3	12.9	10.0	2.6
Interest rates-Repo (Fiscal year end)	6.25	6	6.25	4.40	4.00	4.00	6.25	5.75
Fiscal deficit (% of GDP)	3.5%	3.5%	3.4%	4.6%	9.3%	6.7%	6.4%	6.2%
Current account balance (% of GDP)	-0.9%	-1.9%	-2.1%	-0.9%	0.9%	-1.3%	-2.8%	-2%
INR/USD (Average)	67.1	64.5	69.9	71.0	74.0	75.0	80.0	82.0
10 year yields (average)	7.17	7.04	7.71	6.85	6.06	6.47	7.35	7
Crude oil price (US$ /bbl average)	49.4	58.6	70.3	58.7	45.5	78.1	95.0	75.0

Source: CEIC, Nirmal Bang Institutional Equities Research

Exhibit 2: Sector positioning for 2023

SECTOR	VIEW	RATIONALE	Top ideas
Financial Services	NEUTRAL	Well capitalised banks and low level of NPAs are structurally positive. However, credit growth may see some slowdown in FY24 with slowing growth and inflation. Net Interest Margins (NIMs) are likely to come under pressure given the competition for deposits. We believe that banks will outperform over NBFCs given their superior deposit franchise.	**Buy**: ICICI Bank, SBI
IT	NEGATIVE	We see demand compression in Developed Markets (DM) given our base case of a US recession in CY23. We believe there is downside risk to both earnings in FY24 and to PE multiples.	**Sell**: Infosys
Oil & Gas	NEUTRAL	A decline in crude oil and natural gas prices on the back of slowing global growth will benefit oil & gas marketing companies and support margins. We are constructive on the gas transmission space.	**Buy**: GSPL & GGL
FMCG	POSITIVE	We see rural recovery going ahead on the back of steady farm incomes, moderating input prices & inflation and pre-election spending, which we believe will be a positive for FMCG stocks.	**Buy**: HUL & Britannia
Consumer Discretionary	NEUTRAL	The best of urban discretionary spending may be over. The sharp recovery in contact-intensive services seen in FY23 may face pressure in FY24 in the event of a global recession. A global recession may also weigh on the Travel and Hospitality sector.	**Buy**: Westlife Foodworld
Automobile & Auto Ancillaries	POSITIVE	We are positive on domestic demand plays in the Auto sector. Two-Wheelers (2W) may see recovery on the back of improvement in rural demand. Tractor sales are expected to remain flat or grow in low single digit on a high base. We expect entry segment PVs and Hatchbacks to remain relatively weak while Premium segment and SUVs will outperform. Sustained infrastructure spending ahead of LS election next year and stabilisation in freight rates will likely support CV demand. Benign commodity prices will provide margin tailwinds. However, pick-up in discounting may soften benefits.	**Buy**: Maruti Suzuki & Apollo Tyres
Pharmaceuticals	NEUTRAL	We are positive on domestic demand plays in the Pharmaceutical sector, supported by easing raw material prices. However, easing price erosion in the US will hold the key for sector re-rating.	**Buy**: Cipla & Eris Lifesciences
Cement	POSITIVE	We believe that sustained infrastructure-related demand ahead of LS election and a rural recovery should support cement volume. Cement companies should also gradually reap benefits from moderation in commodity prices.	**Buy**: UltraTech
Chemicals	POSITIVE	We are structurally positive on the Chemicals sector and believe that the sector is at an inflection point, supported by favourable tailwinds such as China+1, availability of low-cost labour and superior process engineering. Agro-chemicals companies will benefit from strong Rabi sowing trends, rural recovery and lower input costs.	**Buy**: SRF, Vinati Organics, PI Industries & Sumitomo
Capital Goods	NEUTRAL	We believe that Capital Goods players focused on government infrastructure spending will benefit, particularly in the run up to LS elections. We are also positive on private capex recovery, but believe that a global recession could lead to some pushback.	**Buy**: Triveni Turbine & Solar Industries
Consumer Durables	NEUTRAL	We believe that select Consumer Electricals and low-ticket Consumer Durables plays may benefit from recovery in rural demand and moderation in commodity prices.	**Buy**: Stove Kraft & Crompton Greaves

2023: Year of 'RRR'

We see CY23 as a year of three parts; the first part will continue to see a 'Reset' between the normal of the pre-pandemic era and the new normal of the post-pandemic era. The 'Reset' in our view, like most transformations, will carry its share of pain in the form of a 'Recession'. However, the 'Recession' may be shallow and short-lived, paving the way for a 'Recovery' going into CY24.

Reset: The past 12-15 months have witnessed a 'Reset and Rebalance' between the normal of the pre-pandemic era and the new normal of the post-pandemic era.

Some of the Resets currently underway include the following:

(1) Pre-pandemic low inflation era vs. the post pandemic high inflation era
(2) Easy liquidity and low interest rates of pandemic era vs. tighter financial conditions
(3) Pre-pandemic off-shoring vs. post pandemic near shoring/friend shoring
(4) Balance between increases in corporate profitability and wage growth
(5) Balance between renewable energy and fossil fuels

We believe these 'Resets' will continue well into the early part of CY23. While our base case has been the end of monetary tightening by the US Fed and the RBI by the end of CY22, we now see increasing possibility of rate hikes in early CY23 as well on the back of continued strength in macro indicators. These 'Resets', particularly the tightening of financial conditions, will most likely bring in its wake a 'Recession' by the middle of CY23.

Recession: A brief study on the history of US recessions suggests that recessions caused by the US Fed are not uncommon. A saving grace is that recessions caused by Fed tightening are usually shallow and short-lived. **Recessions caused by Fed policy actions have lasted ~1-3 quarters with the average decline in GDP well under 1%**. Nevertheless, while the US economy may be relatively more resilient, other DMs, particularly Europe, faces the prospects of a shaper recession. On the flip side, the opening up of China may provide some tailwinds for global growth.

Exhibit 3: US recessions caused by Fed tightening have been relatively shallow and short-lived

Year	Number of quarters of negative growth	Average decline	Cause of recession/slowdown
1970	**1**	**-0.17**	**Monetary and fiscal tightening post the Vietnam war amid rise in inflation**
1974-75	5	-1.38	OPEC oil embargo. Nixon instituted wage-price controls. Nixon took the US off the 'gold standard' in response to a run on the gold held at Fort Knox, which led to inflation
1980	**3**	**-0.81**	**The Fed caused this recession by raising interest rates to combat inflation. The Iranian oil embargo aggravated economic conditions by reducing US oil supplies, which drove prices up**
1982	4	-1.80	An extension of the 1980 recession caused by the Fed as it resumed hikes after a brief period of rate cuts
1991	**3**	**-0.53**	**1989 savings and loan crisis, higher interest rates and Iraq's invasion of Kuwait**
2008-09	4	-3.24	Subprime mortgage crisis led financial collapse
2020	3	-4.74	Covid-19 health crisis

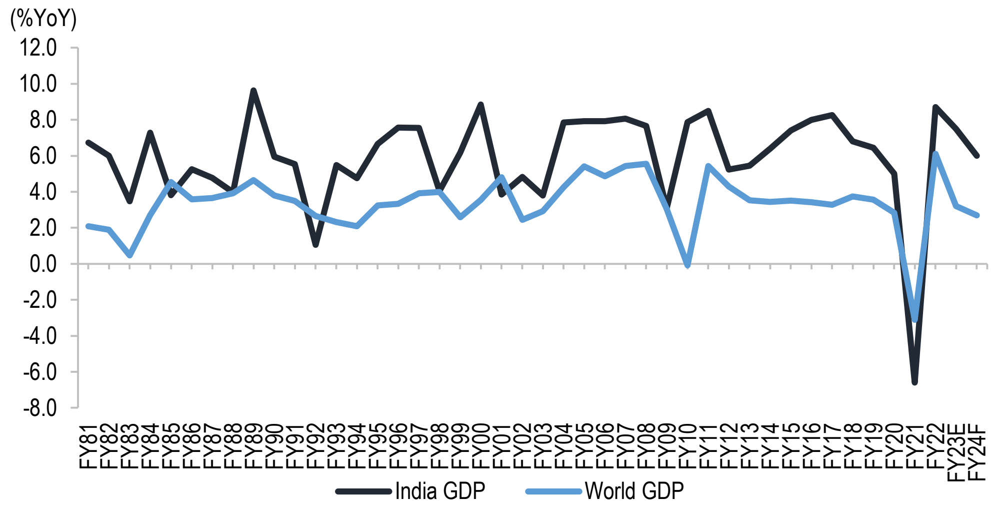
Source: The Balance, Nirmal Bang Institutional Equities Research.

Recovery: We believe that recessionary conditions in the US will be met with policy easing by the Fed by the end of CY23, paving the way for 'Recovery'. However, with a shallow recession, policy easing may be nothing like the Quantitative Easing (QE) implemented during the COVID-19 crisis or the 2008-09 Global Financial Crisis (GFC). Policy easing in our view will largely be restricted to rate cuts by end of CY23 and beyond. Rate cuts in the US may be accompanied by easing from Emerging Market (EM) central banks, including the RBI assuming benign inflation.

India Macro Outlook

Slowing global growth will weigh on India: The IMF expects global growth to slow from 6.0% in CY21 to 3.2% in CY22 and 2.7% in CY23. This is the weakest growth profile since CY01, except for the GFC and the acute phase of the COVID-19 pandemic. As has been the case historically, India's growth tends to move in sync with global growth cycles and therefore slowing global growth is likely to weigh on India.

Exhibit 4: India is not immune to global growth cycles



Source: IMF, NSO, CEIC, Nirmal Bang Institutional Equities Research

We are penciling in 6% GDP growth in FY24: We are factoring in a GDP growth of ~6% in FY24, down from 7.5% in FY23. In our view, stable domestic fundamentals in terms of strong financial sector and non-financial sector balance sheets, and some amount of counter-cyclical fiscal policy ahead of LS elections in FY24 will limit any growth slowdown. We expect Agricultural sector growth to be relatively robust at 4% in FY24, supported by recent Rabi sowing trends. The large part of the slowdown we are factoring in will come from the Services sector (including Construction). The Industry sector may see some recovery in FY24 on a low base as margin pressure on account of elevated raw material (RM) prices have acted as a drag on Manufacturing growth in FY23.

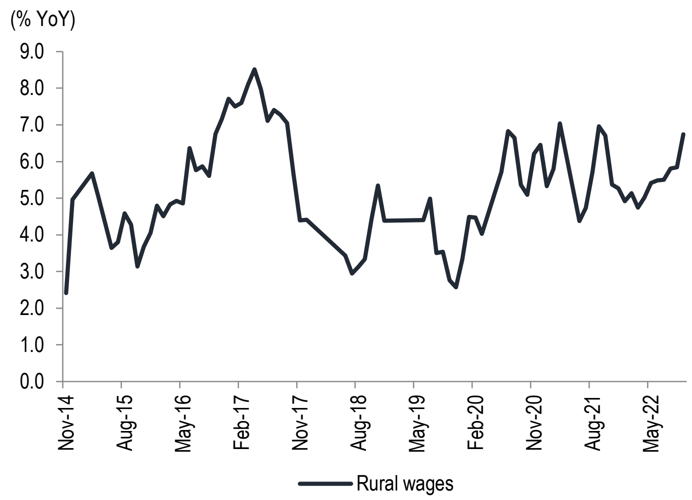
Exhibit 5: Indian economy may grow by 6% in FY24 supported by relatively strong domestic fundamentals

	% of GDP	FY21	FY22	FY23AE	FY23F	FY24F	1QFY23	2QFY23	3QFY23F	4QFY23F	1QFY24F	2QFY24F	3QFY24F	4QFY24F
Agriculture	**13.9**	**3.3**	**3.0**	**3.5**	**3.8**	**4.0**	4.5	4.6	3.0	3.0	4.0	4.0	4.0	4.0
Industry excluding construction	**21.1**	**(1.8)**	**9.8**	**2.4**	**1.9**	**5.4**	**6.0**	**(3.1)**	**1.4**	**1.3**	**5.8**	**9.3**	**6.1**	**5.8**
Mining and Quarrying	2.5	(8.6)	11.6	2.4	1.0	4.8	6.5	(2.8)	0.8	(2.0)	5.7	5.1	2.4	2.4
Manufacturing	16.5	(0.6)	9.9	1.6	1.0	5.4	4.8	(4.3)	0.5	1.2	6.3	9.9	6.1	6.1
Electricity gas and water supply	2.0	(3.6)	7.5	9.0	10.0	5.6	14.7	5.6	10.0	6.9	2.9	8.2	10.1	7.2
Services including construction	**56.6**	**(7.8)**	**8.8**	**9.1**	**10.2**	**6.6**	**17.5**	**9.0**	**6.9**	**6.5**	**7.5**	**5.2**	**5.0**	**5.8**
Construction	7.4	(7.3)	11.5	9.1	9.5	6.3	16.8	6.6	6.7	2.4	12.0	8.9	4.0	4.5
Trade, hotels etc.	17.9	(20.2)	11.1	13.7	14.8	7.0	25.7	14.7	8.9	8.5	15.1	4.7	4.9	4.4
Finance, insurance, real estate etc.	19.8	2.2	4.2	6.4	7.8	5.8	9.2	7.2	7.7	7.2	2.2	5.0	5.6	5.1
Public administration,defence and other services	11.5	(5.5)	12.6	7.9	8.5	7.5	26.3	6.5	3.4	5.3	5.9	4.2	4.7	10.0
GVA at basic price		**(4.8)**	**8.1**	**6.7**	**7.3**	**5.9**	**12.7**	**5.6**	**5.0**	**4.8**	**6.6**	**5.9**	**5.0**	**5.5**
GDP at market price		**(6.6)**	**8.7**	**7.0**	**7.5**	**6.0**	**13.5**	**6.3**	**5.2**	**5.2**	**6.7**	**5.9**	**5.4**	**5.7**

Source: National Statistics Office, CEIC, Nirmal Bang Institutional Equities Research.

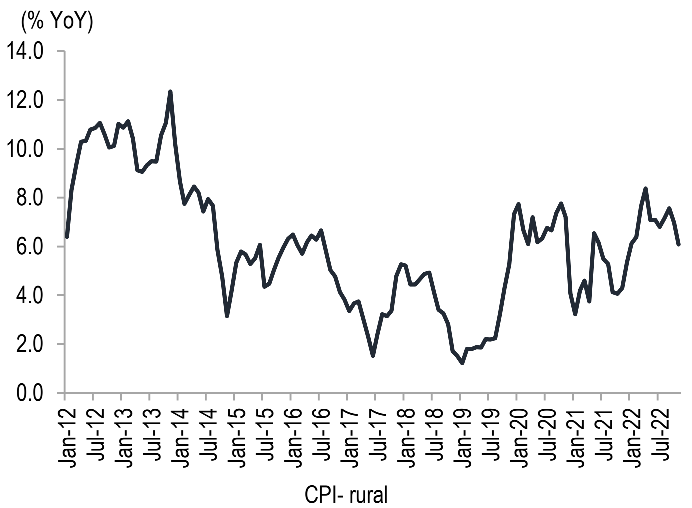
Rural recovery may be on the horizon: On an incremental basis, we expect rural growth to recover going forward, supported by good rabi sowing trends, robust farm incomes and moderating inflation. Moreover, the government's outlay towards rural schemes is expected to remain favorable in the run-up to LS elections in CY24. In a way, the extension of the PM Garib Kalyan Yojana to Dec'23 itself will help alleviate rural distress and support discretionary consumption at the margin. Meanwhile, rural wages are now catching up with inflation. The CPI for Agricultural & Rural Labourers surged by ~17% between Oct'19 and Oct'22 while rural wages are running slightly ahead at ~19.7%.

Exhibit 6: Rural wages are catching up with CPI…



Source: Labour bureau, CEIC, Nirmal Bang Institutional Equities Research

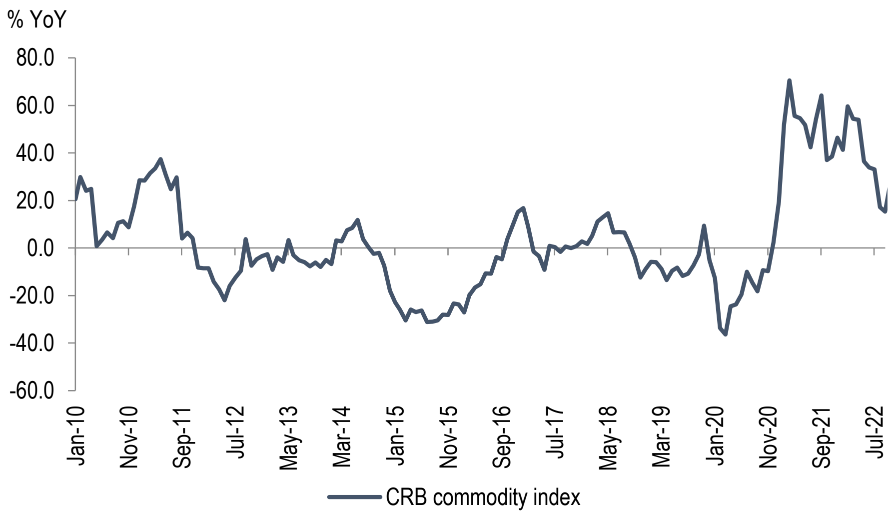
Exhibit 7: …while inflation is moderating



Source: Labour bureau, CEIC, Nirmal Bang Institutional Equities Research

Commodity prices may be relatively benign: In an environment of slowing global growth, we expect commodity prices to be relatively benign, which should support some easing of inflation.

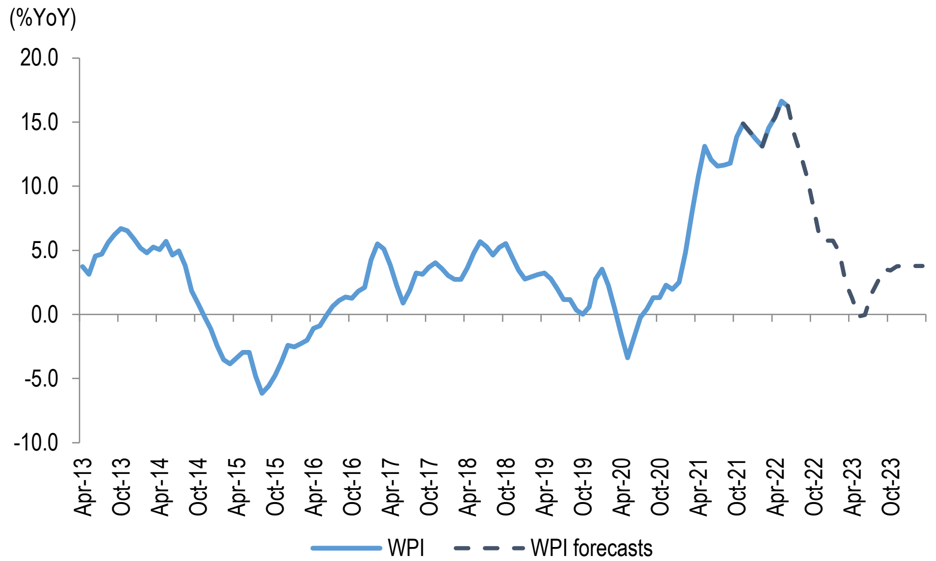
Exhibit 8: Global commodity prices are off from highs



Source: Bloomberg, Nirmal Bang Institutional Equities Research

WPI inflation will likely moderate to ~2.6% in FY24 from 10% in FY23: We expect WPI inflation to moderate to 2.6% in FY24 from ~10% in FY23, supported by easing input prices. This moderation in input costs will be passed on to selling prices, albeit partially supporting some margin expansion for corporates.

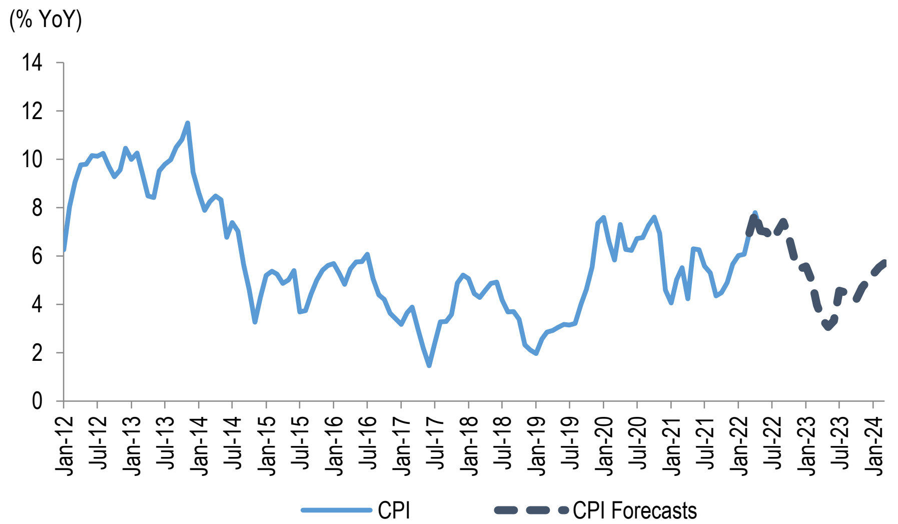
Exhibit 9: WPI inflation likely to average ~2.6% in FY24



Source: Office of the Economic Adviser, CEIC, Nirmal Bang Institutional Equities Research

CPI inflation may average ~4.5% in FY24: We expect CPI inflation to average ~4.5% in FY24, moderating from an estimated 6.4% in FY23. While we expect CPI inflation to moderate, supported by some easing of commodity prices, core CPI inflation will remain ~4.8-5% on account of sticky services inflation and relatively sticky selling prices on goods vis-à-vis easing input prices.

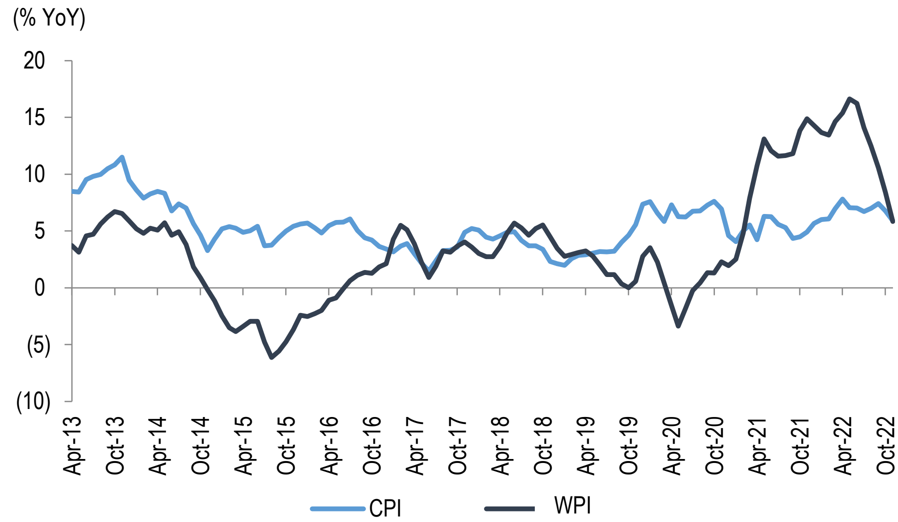
Exhibit 10: CPI inflation likely to average 4.5% in FY24



Source: NSO, CEIC, Nirmal Bang Institutional Equities Research

Margin pressures turning into tailwinds: With easing input prices and moderation in WPI inflation, we believe that the pressure on margins over the past year may turn into margin expansion as the decline in input prices will only partially be passed on to selling prices.

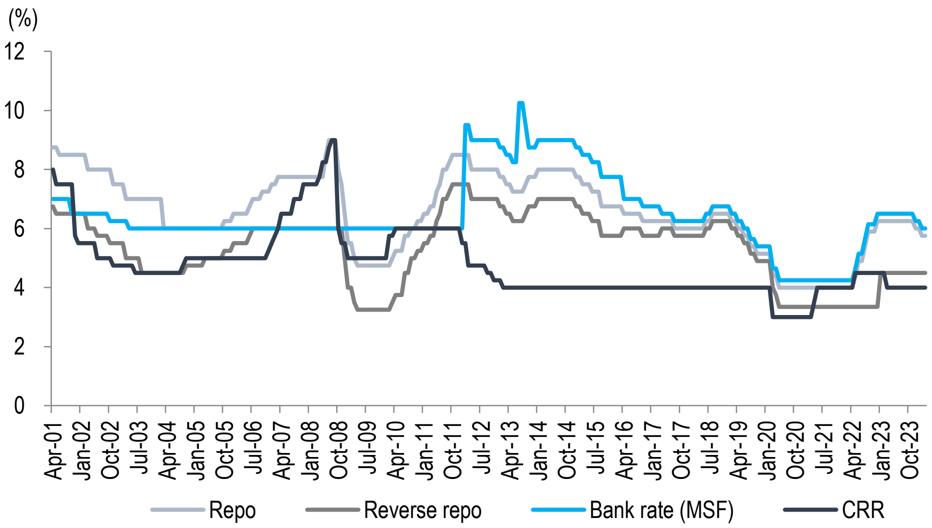
Exhibit 11: Margin pressures turning into tailwinds



Source: Office of the Economic Adviser, NSO, CEIC, Nirmal Bang Institutional Equities Research

We are penciling in an extended pause by RBI in CY23, with rate cuts likely by Dec'23: Our base case does not factor in any further rate hike by the RBI in Feb'23, although we do not rule out that possibility given the strength of recent macro data and relatively hawkish commentary from the central bank. We expect an extended pause by the RBI through CY23, with the possibility of a rate cut by Dec'23 as the Fed begins to ease rates. We are penciling in ~50bps of rate cuts in aggregate towards the end of FY24.

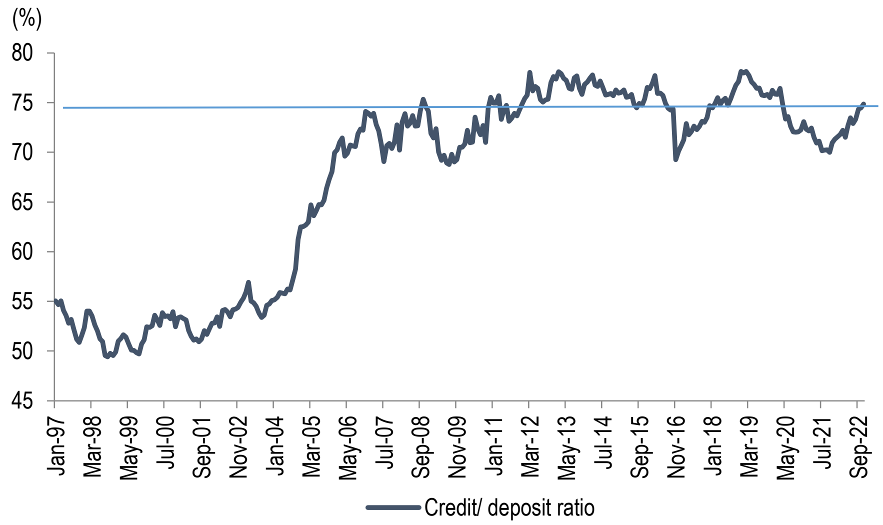
Exhibit 12: We are penciling in an extended pause in CY23 with rate cuts likely in Dec'23 and 1QCY24



Source: RBI, CEIC, Nirmal Bang Institutional Equities Research

Lending rates to rise given the elevated credit-to-deposit ratio: We expect pressure on lending rates given the credit-to-deposit ratio hovering ~75% levels. Meanwhile, with deposit growth at 9.4% YoY lagging credit growth at 17.4% YoY, banks will also continue to raise deposit rates in a bid to garner deposits.

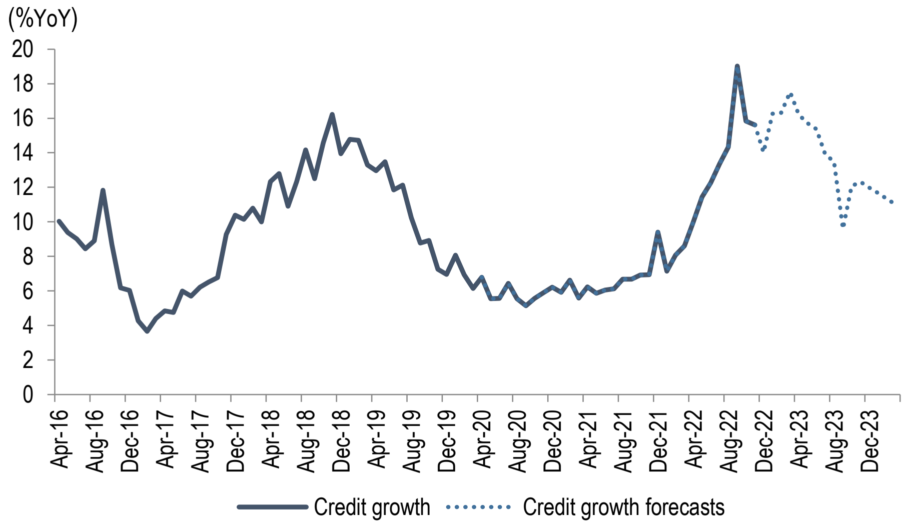
Exhibit 13: Credit-to-deposit ratio at ~75% will pressure lending rates



Source: RBI, CEIC, Nirmal Bang Institutional Equities Research

Credit growth likely to slow to ~11% in FY24: We expect credit growth to slow to ~11% in FY24 from an average of ~15% in FY23. Credit growth in FY24 will largely be in line with our expectation of nominal GDP growth of 10.5%. Moderation in GDP growth, lower inflation and rise in interest rates are among the factors that will contribute to lower credit growth.

Exhibit 14: Credit growth may slow to ~11% in FY24



Source: RBI, CEIC, Nirmal Bang Institutional Equities Research

Fiscal consolidation likely to be gradual ahead of LS elections in FY24: We expect the fiscal deficit target of 6.4% of GDP for FY23 to be met, supported by robust tax collections and higher-than-budgeted nominal GDP growth. We are factoring in only a gradual fiscal consolidation in FY24 and peg the fiscal deficit at 6.2% of GDP. Higher government spending ahead of LS elections in CY24 and the intention to provide some counter-cyclical fiscal support to slowing global growth, in our view, will keep the fiscal deficit elevated. We expect tax collections in FY24 to grow largely in line with nominal GDP growth of 10.5%.

Exhibit 15: Fiscal deficit seen at 6.4% of GDP in FY23 and 6.2% of GDP in FY24

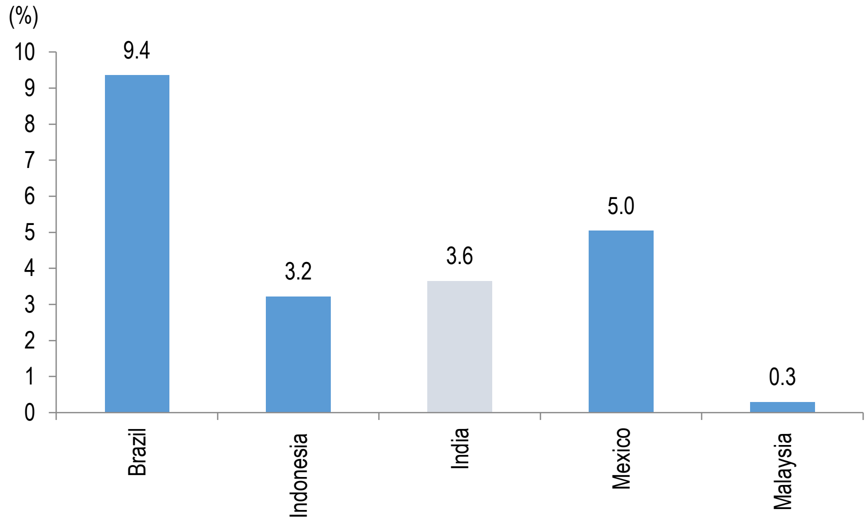
	Item (Rs.bn)	FY18	FY19	FY20	FY21	FY22	FY23BE	FY23E	FY24F
1	**Revenue Receipts (2+3)**	**14,351.2**	**15,631.7**	**16,900.1**	**16,339.2**	**21,684.3**	**22,044.2**	**23,798.9**	**26,338.9**
	% YoY	4.4	8.9	(13.9)	(3.3)	*32.7*	*6.0*	*9.8*	*10.7*
2	*Tax Revenue (net to centre)*	12,426.0	13,169.5	13,445.0	14,262.9	18,203.8	19,347.7	20,752.4	23,138.9
	% YoY	12.8	6.0	(18.5)	6.1	*27.6*	*9.6*	*14.0*	*11.5*
3	*Non-Tax Revenue including spectrum sale*	1,925.2	2,462.2	3,455.1	2,076.3	3,480.4	2,696.5	3,046.5	3,200.0
	% YoY	(29.4)	27.9	10.3	(39.9)	*67.6*	*(14.1)*	*(12.5)*	*5.0*
4	**Non-debt capital receipts (5+6)**	**1,158.2**	**1,028.9**	**666.1**	**576.3**	**392.1**	**792.9**	**792.9**	**850.0**
	% YoY	77.2	(11.2)	(44.4)	(13.5)	*(32.0)*	*(20.7)*	*102.2*	*7.2*
5	*Recoveries of Loans*	156.2	178.4	166.1	197.3	*245.7*	142.91	142.91	200
	% YoY	(11.4)	14.2	12.0	18.8	*24.5*	*(35.0)*	*(41.8)*	*39.9*
6	*Other Receipts includes disinvestment*	1,002.0	850.5	500.0	379.0	*146.4*	650	650	650
	% YoY	109.9	(15.1)	(52.4)	(24.2)	*(61.4)*	*(16.7)*	*344.0*	-
7	**Total Receipts (1+4)**	**15,509.4**	**16,660.6**	**17,566.2**	**16,915.5**	**22,076.3**	**22,837.1**	**24,591.8**	**27,188.9**
	% YoY	7.7	7.4	(15.7)	(3.7)	*30.5*	*4.8*	*11.4*	*10.6*
8	**Total Expenditure (9+10)**	**21,426.7**	**23,114.2**	**26,985.5**	**35,083.4**	**37,941.5**	**39,449.1**	**42,199.1**	**45,926.7**
	% YoY	8.5	7.9	(3.2)	30.0	*8.1*	*4.6*	*11.2*	*8.8*
9	*Revenue Expenditure*	18,789.6	20,084.6	23,496.5	30,835.2	32,013.7	31,946.6	34,696.6	37,298.9
	% YoY	11.1	6.9	(4.0)	31.2	*3.8*	*0.9*	*8.4*	*7.5*
10	*Capital Expenditure*	2,637.0	3,029.6	3,489.1	4,248.2	5,927.8	7,502.5	7,502.5	8,627.8
	% YoY	(7.3)	14.9	3.1	21.8	*39.5*	*24.5*	*26.6*	*15.0*
11	**Fiscal Deficit {7-8}**	**(5,917.3)**	**(6,453.7)**	**(9,419.3)**	**(18,167.9)**	**(15,865.2)**	**(16,612.0)**	**(17,607.3)**	**(18,737.8)**
	% of GDP	(3.5)	(3.4)	(4.6)	(9.3)	(6.7)	(6.4)	(6.4)	(6.2)
12	**Net borrowings including buyback**	4,484.1	4,227.40	4,739.7	10,329.1	8,631.0	11,346.4	11,506.4	12,179.6
	% of GDP	*2.6*	*2.2*	*2.3*	*5.2*	*3.7*	*4.4*	*4.2*	*4.0*

Source: Government of India, Nirmal Bang Institutional Equities Research

Capex push to stay in Budget 2023, but revenue expenditure may also pick up pace: Similar to previous financial years, we expect the on-budget capex push to stay in this year's Union Budget as well. Therefore, we are penciling in a 15% increase in budgeted capex. However, we are also factoring in revenue expenditure growth at ~7.5%. While the growth in revenue expenditure may be lower than the actual increase in FY23, it will be significantly higher than the budgeted numbers for FY23.

Yields to stay range-bound in the near term; may fall to ~7% in 2HFY24: We expect Indian bond yields to remain range-bound in the near term as the compression in yield spreads between India and the US to ~3.5% (below the historical average of ~4.5%) limits the room for a rally. Meanwhile, the government's gross borrowings are also likely to remain elevated at ~Rs16.5tn, driven by an elevated fiscal deficit and high redemptions in FY24. We expect bond yields to moderate to ~7% levels in 2HFY24 in anticipation of easing rates by the Fed and the RBI.

Exhibit 16: India's yield spread with the US comparable to peers (Indonesia) but below long-term average



Source: Bloomberg, Nirmal Bang Institutional Equities Research

CAD to moderate to ~2% of GDP in FY24: We are penciling in a CAD of ~2% of GDP in FY24 vs ~2.8% of GDP in FY23, supported by lower crude oil prices. While slowing global growth will weigh on exports, we also expect import growth to moderate due to lower commodity prices and relatively high import intensity of India's exports. We are factoring in crude oil at US$75/bbl in FY24.

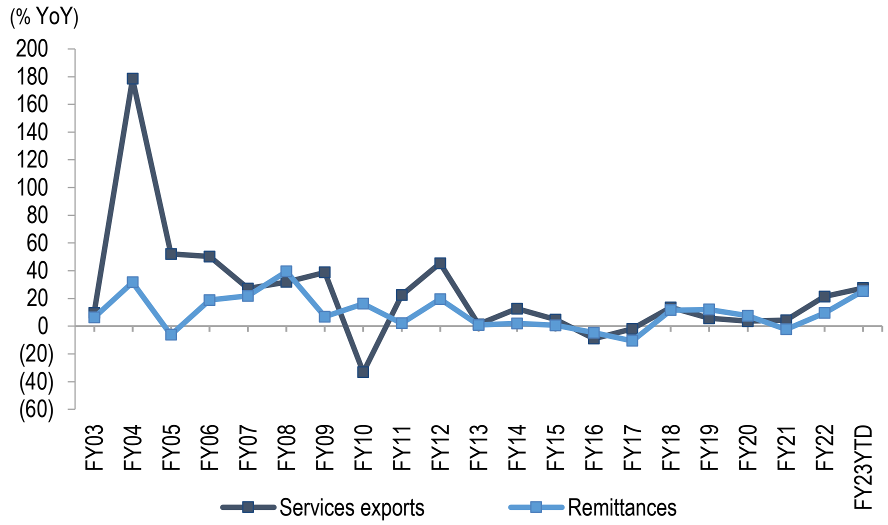
Exhibit 17: CAD seen at 2% of GDP in FY24 vs 2.8% of GDP in FY23

Item/US$bn	1QFY23	2QFY23	1HFY23	FY19	FY20	FY21	FY22	FY23E (US$95/ bbl)	FY24E (US$75/ bbl)
Current account balance	**(18.4)**	**(36.4)**	**(54.6)**	**(57.3)**	**(24.7)**	**23.9**	**(38.8)**	**(94.7)**	**(66.9)**
% of GDP	**(2.2)**	**(4.4)**	**(3.3)**	**(2.1)**	**(0.9)**	**0.9**	**(1.2)**	**(2.8)**	**(2.0)**
Trade balance	**(63.0)**	**(83.5)**	**(146.6)**	**(180.3)**	**(157.5)**	**(102.2)**	**(189.5)**	**(268.7)**	**(244.9)**
Exports	122.8	112.0	234.8	337.2	320.4	296.3	429.2	411.7	416.0
- Oil exports	*25.1*	*24.2*	*49.3*	*48.0*	*42.0*	*25.6*	59.4	*73.7*	*61.1*
Imports	185.8	195.5	381.4	517.5	477.9	398.5	618.6	680.4	660.9
- Oil	*60.04*	*56.34*	*116.38*	*140.8*	*130.0*	*82.6*	160.1	*210.6*	*174.6*
- Gold	*10.55*	*9.80*	*20.35*	*32.0*	*28.2*	*34.6*	49.3	*40.0*	*35.0*
Invisibles	***44.7***	***47.2***	***92.0***	**123.0**	**132.8**	**126.1**	**150.7**	**174.0**	**178.0**
Services (net)	31.1	34.4	65.5	81.94	84.92	88.57	107.52	127.00	120.00
Transfers (net)	22.9	24.8	47.6	69.95	75.21	73.46	80.45	85.00	90.00
Other income (net)	(9.3)	(12.0)	(21.1)	(28.9)	(27.3)	(36.0)	(37.3)	(38.0)	(32.0)
Capital account balance	**22.1**	**6.9**	**29.0**	**54.4**	**83.2**	**63.7**	**85.8**	**50.6**	**75.0**
Net FDI	13.6	6.4	20.0	30.71	43.01	43.96	38.59	38.59	40.00
Net FII	(14.6)	6.5	(8.1)	(0.6)	1.4	36.1	(16.8)	(12.0)	7.0
Loans	3.9	5.5	9.4	15.85	25.69	6.90	33.61	18.00	20.00
-External assistance	1.8	0.5	2.3	3.41	3.75	11.17	5.37	3.00	10.00
-Commercial borrowings	(2.9)	(0.1)	(3.0)	10.4	23.0	(1.3)	8.1	7.0	3.0
- Short term credit	5.1	5.1	10.2	2.02	(1.0)	(4.13)	20.02	10.00	7.00
Banking capital	19.0	(8.4)	10.6	7.4	(5.3)	(21.1)	6.7	5.0	7.0
-NRI deposits	0.3	2.5	2.8	10.4	8.6	7.4	3.2	5.0	7.0
Rupee debt service	(0.1)	(0.0)	(0.1)	(0.0)	(0.1)	(0.1)	(0.1)	-	-
Other capital	0.2	(3.1)	(2.9)	1.1	18.5	(2.1)	23.8	1.0	1.0
Errors and Omissions	0.7	(0.9)	(0.2)	(0.5)	1.0	-	0.5	-	-
Overall balance	**4.4**	(30.4)	(25.8)	**(3.3)**	**59.5**	**87.6**	**47.5**	**(44.2)**	**8.1**
Foreign reserves	589.2	558.8	558.8	412.9	477.8	577.0	607.3	563.2	571.3

Source: RBI, CEIC, Nirmal Bang Institutional Equities Research

Services exports and remittances may see some moderation as global growth slows: Services exports and remittances have provided a strong buffer , offsetting the elevated trade deficit in FY23. Services exports are up by 27.5% YoY FY23YTD while remittances are up by 25.3% YoY. In an environment of slowing global growth and some moderation in commodity prices, it is quite likely that services exports and remittances may see some moderation as well.

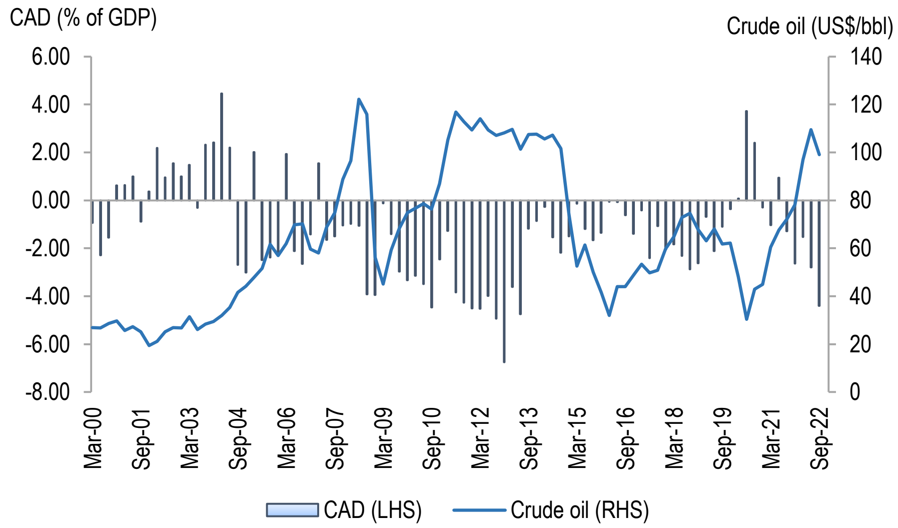
Exhibit 18: Services exports and remittances a strong buffer but may see slowdown



Source: RBI, CEIC, Nirmal Bang Institutional Equities Research

INR to trade with a moderate depreciation bias, but worst likely over: We expect USD/INR to average 82 in FY24, which is a modest depreciation vs our FY23 estimate of 80 (revised from 79.5 earlier). In our view, the worst of the depreciation pressure on INR is likely over with moderation in crude oil prices.

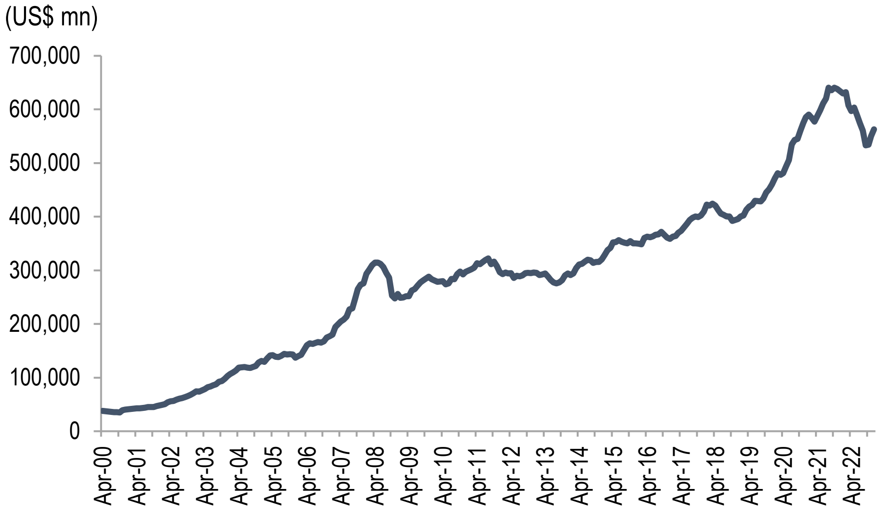
Exhibit 19: Lower crude oil should lead to a lower CAD and less pressure on INR



Source: RBI, Bloomberg, CEIC, Nirmal Bang Institutional Equities Research

India's FX reserves have also rebounded from their lows, partially supported by a lower USD. Moreover, we believe that FPI flows into Indian equities may see a pick-up going forward as the Fed pauses its rate hike cycle, although they may remain volatile as a recession looms.

Exhibit 20: FX reserves are off their lows



Source: RBI, CEIC, Nirmal Bang Institutional Equities Research

Three key risks:

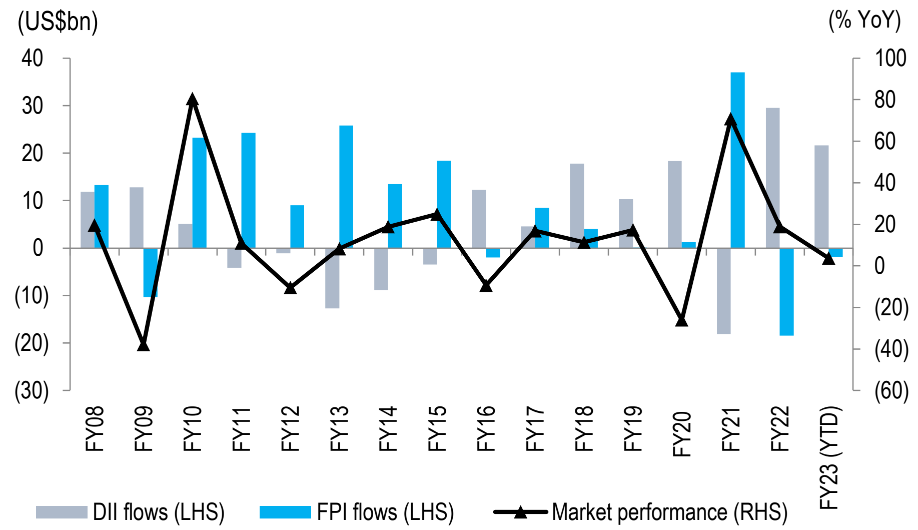
1. **Excessive tightening by global central banks beyond 1QCY23:** Excessive tightening by global central banks (mainly by the US Fed) beyond 1QCY23 may lead to a sharper-than-expected recession. A sharp rise in interest rates can also impair repayment abilities and lead to large mark-to-market losses, posing risks to financial stability.
2. **Flare-up in commodity prices on geopolitical tensions:** Our base case assumes relatively benign commodity prices. Geopolitical tensions and opening up of China's economy (aided by large scale stimulus measures) may push up commodity prices, including that of crude oil. A sharp rise in crude oil prices will once again bring macro stability risks to the fore for India.
3. **Persistence of high inflation may weigh on consumption at the bottom of the pyramid:** Our base case assumes easing of inflationary pressures to some extent, which will aid rural recovery and consumption at the bottom of the pyramid in India. Persistently high inflation along with muted wage increases may derail recovery in domestic private consumption and weigh on growth amid headwinds for external demand.

India Strategy

What will drive Indian markets?

FPI flows may be volatile but positive, but DIIs have become a force to reckon with: Over the past 6-7 years, Domestic Institutional Investors (DIIs) have become a force to reckon with as far as the Indian markets are concerned. Notably, in FY22 and FY23YTD, DIIs have helped with market delivering positive returns - FY22 (+18.9%) and FY23YTD (+3.8%) despite persistent FPI selling. Going into CY23/FY24, we believe that FPI flows will likely remain volatile with the overhang of continued monetary tightening in the early part of CY23 and recessionary fears taking hold sometime later in CY23. But, in our view, FPI flows are likely to return as the Fed pauses its rate hike cycle. However, DII flows are likely to slow with increase in interest rates and the availability of alternate investment options.

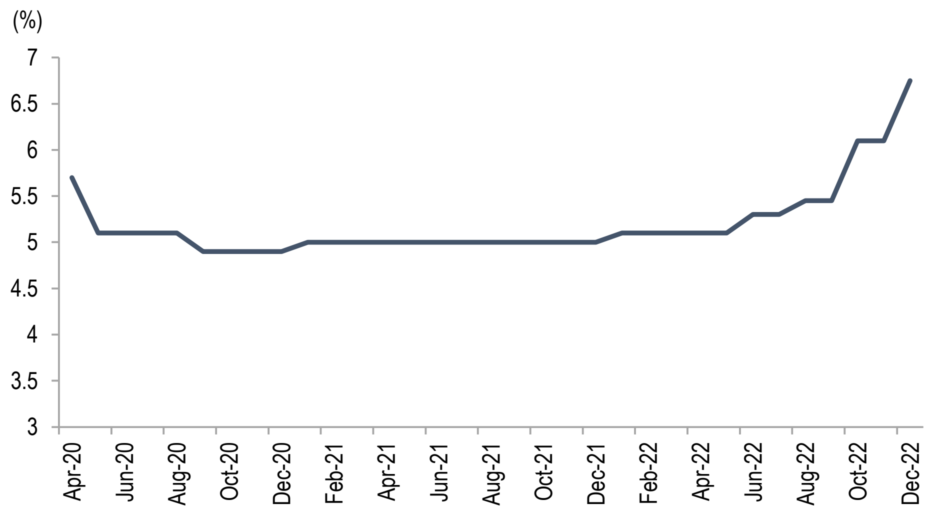
Exhibit 21: DIIs held fort as FPIs turned sellers helping market deliver positive returns



Source: Bloomberg, CEIC, Nirmal Bang Institutional Equities Research

Rising and elevated interest rates may weigh on equities: Interest rates on term deposits have risen over the past year. As a case in point, SBI's 1-year term deposit rates are up by over 175bps. In the case of many large private banks, 1-year term deposit rates are above 7% while in the case of some smaller banks, it is above 8%. In such a scenario, the attractiveness of equities as an asset class declines. Thus, elevated interest rates may weigh on DII flows in CY23.

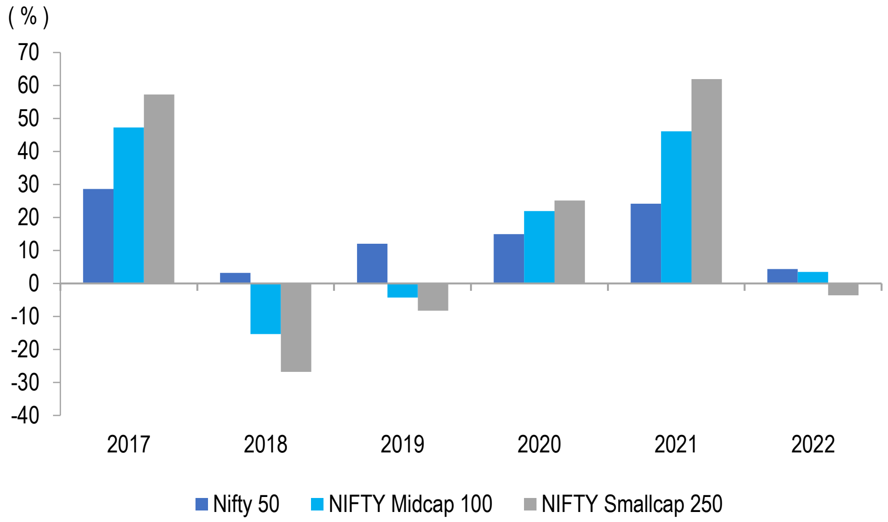
Exhibit 22: SBI's term deposit rates have risen by ~175bps over the past one year



Source: SBI, Nirmal Bang Institutional Equities Research

Large Caps preferred; falling rates may benefit broader markets: In CY22, Large Caps outperformed Mid Caps and Small Caps - unlike in the previous two years when declining interest rates and easy liquidity had fuelled a rally in Mid Caps and Small Caps. In contrast, in CY18, when financial market conditions were relatively tight, and in CY19 when growth was a challenge, Large Caps had outperformed. We expect financial market conditions to remain relatively tight for most of CY23 while growth is also likely to be a challenge. Consequently, we prefer Large Caps in the near term given the overhang of a global recession. We recommend increasing exposure to broader markets gradually as the interest rate cycle begins to turn.

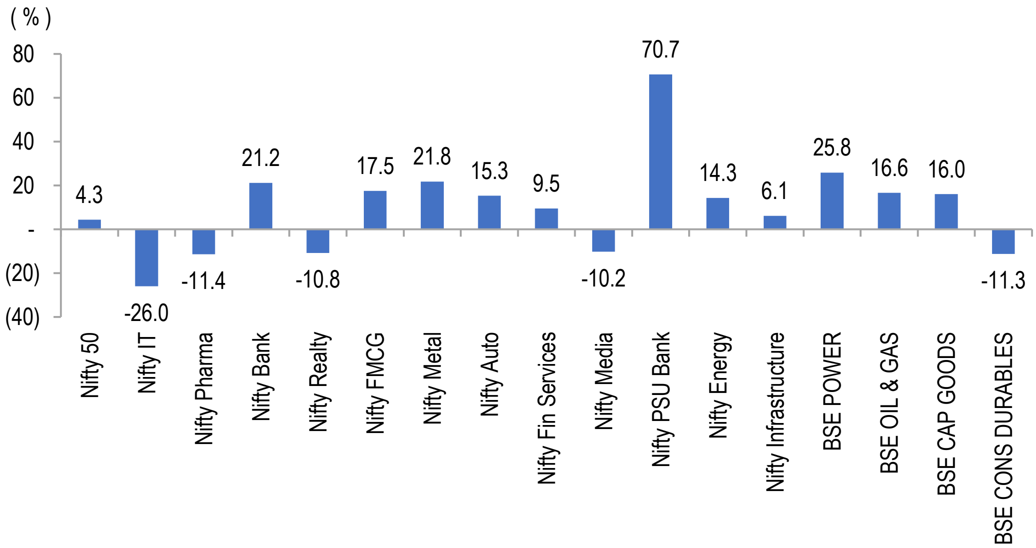
Exhibit 23: Mid Caps and Small Caps outperform in an environment of easy financial conditions



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Domestic focused plays likely to outperform: In CY23, given the overhang of a global recession, we prefer domestic focused plays to external focused plays. With moderation in commodity prices amid global recessionary fears, commodity-linked sectors such as Metals may underperform in CY23. In the Banking sector, we believe that significant outperformance may moderate on account of slower credit growth in FY24 and the possibility of compression in NIMs. On an incremental basis, we recommend positioning for rural recovery based on robust farm incomes, moderating inflation and government spending ahead of LS elections.

Exhibit 24: In CY22, Power, Metals and Banks were lead performers while IT was the worst

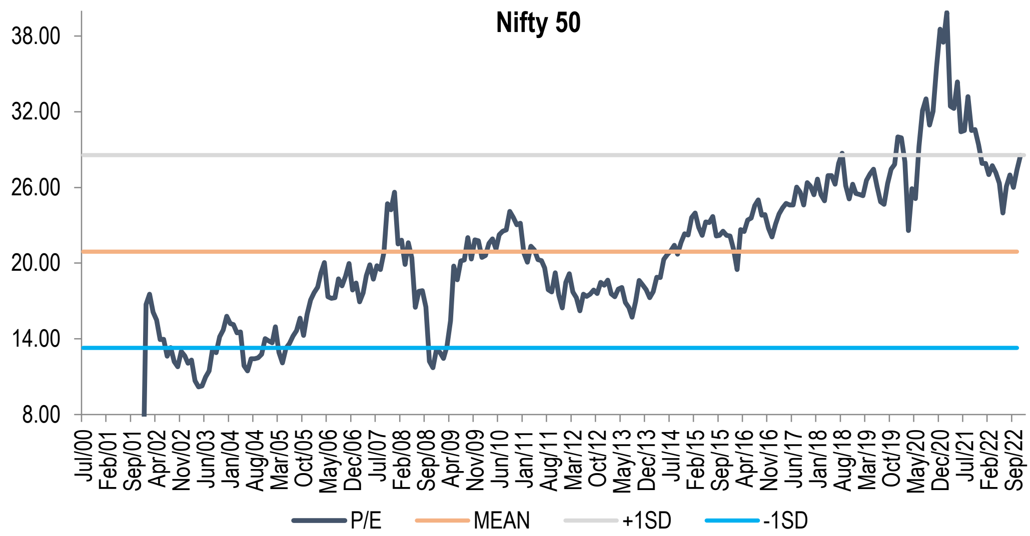


Source: Bloomberg, Nirmal Bang Institutional Equities Research

Can valuations sustain?

Indian equity market valuations are above historical average: Indian equity market valuations remain elevated and are trading above their historical mean. This limits the upside in an environment of elevated interest rates.

Exhibit 25: India equity market valuations are elevated



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Elevated interest rates will keep equity markets volatile: US G-sec yields are significantly above US dividend yields with the spread at the highest level since CY08. Globally, elevated interest rates are likely to keep equity markets volatile and India will be no exception.

Exhibit 26: US bond yields are significantly above dividend yields which will keep equities volatile

Source: Bloomberg, Nirmal Bang Institutional Equities Research

India's valuations remain stretched relative to peers: The valuations of Indian equity markets remain stretched relative to EM peers and other DMs. However, this is to some extent justified by the growth premium it enjoys over peers. Nevertheless, even on a growth-adjusted basis, China and some other South East Asian markets may appear more attractive.

Exhibit 27: Indian equity market valuations remain stretched vs peers but growth is supportive

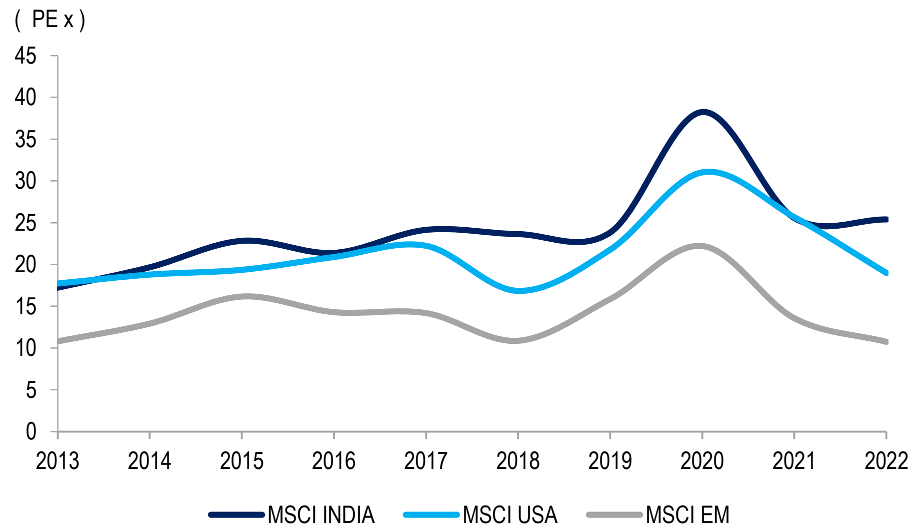
	Growth (2023)	Real rates	Yield spread with US-current	Current PE ratio	Forward PE
India	6	0.95	3.65	21.10	17.84
Developed markets					
US	0.3	0.70	--	16.82	15.35
Japan	1.2	(1.80)	(3.15)	14.01	14.2
Euro area	-0.1	(3.10)	(1.44)	11.87	11.13
Emerging Markets					
China	4.8	2.00	(0.90)	10.23	9.03
Indonesia	4.9	1.65	3.22	13.70	12.5
South Korea	1.7	0.05	(0.18)	11.40	8.89
Malaysia	5.5	1.05	0.29	12.95	12.41
Philippines	6.6	(0.90)	0.79	13.41	11.99
Thailand	3.7	(0.80)	(1.21)	15.72	14.39
Mexico	1.1	4.65	5.04	12.17	10.61
Brazil	0.8	6.60	9.35	6.71	6.72

Bloomberg consensus for 2023 inflation and growth and interest rates, yields are current.

Source: Bloomberg, Nirmal Bang Institutional Equities Research

India has mostly traded at a premium and that may sustain valuations: However, India has traditionally traded at a premium to peers and that is likely to sustain.

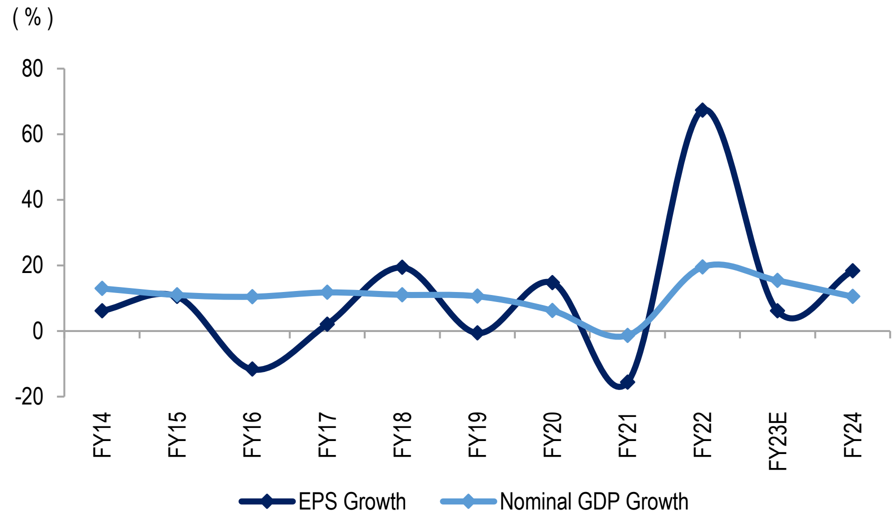
Exhibit 28: India has usually traded at a premium vs peers and that may sustain



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Over-estimation of earnings a bigger risk as earnings track nominal GDP: Earnings growth has largely tracked nominal GDP growth, except during growth spurts. In fact, in FY23, earnings growth is tracking ~6% vs. the government's nominal GDP estimate of 15.4%. However, for FY24, Bloomberg consensus estimate is pegging earnings growth of ~18% vs. estimated nominal GDP growth of 10.5%. Even assuming some benefits of margin expansion for corporates in FY24, given the lagged benefit of inflation, we see higher risk of earnings downgrades than multiple compression. **In our view, earnings downgrades, particularly if recession risks fructify may be the trigger for a market correction.**

Exhibit 29: Earnings downgrade may be a bigger risk than multiple compression in FY24



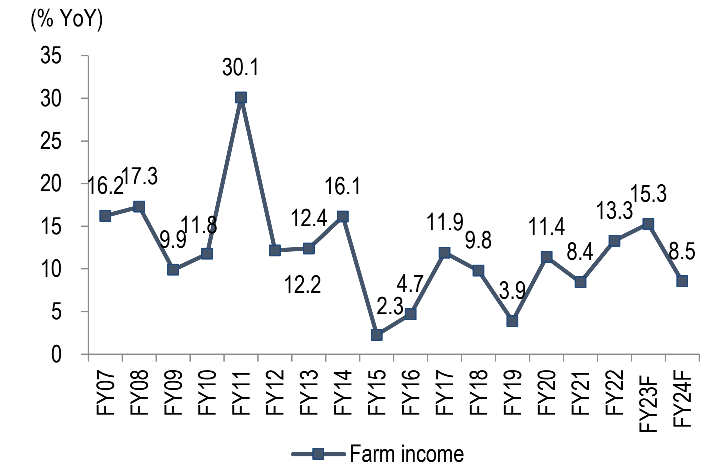
FY23E and FY24E for earnings are based on Bloomberg consensus

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Themes for 2023

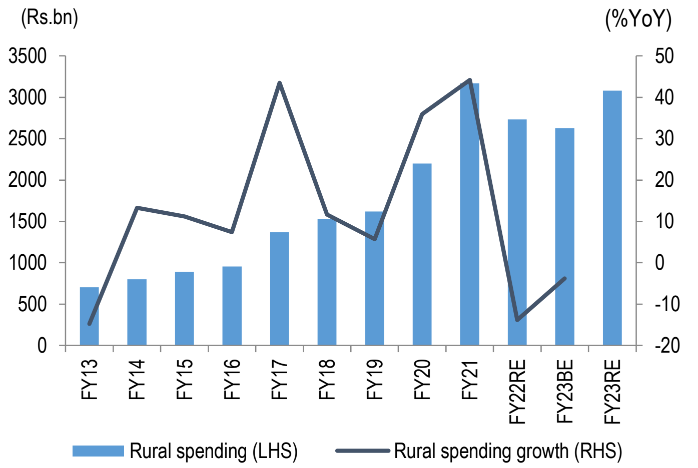
1) **Rural looking up:** Rabi sowing has been progressing well and prices of farm commodities are holding up. Consequently, farm income growth is expected to be relatively healthy in FY24 after double-digit increases in FY22 and FY23E. According to our estimates, topline farm income likely grew by 13-15% in FY22 and FY23E and steady growth of ~8.5-9% may sustain in FY24. Our farm income index accounts for ~60% of total agriculture & allied sector output. Farm incomes have been supported by favourable prices of agricultural commodities ranging from wheat to cotton. At the same time, moderating farm input costs and softening rural inflation should help support recovery in rural consumption beginning in 4QFY23 and beyond. We estimate an increase of ~40% in topline farm income during FY20-FY23E while rural inflation is estimated to rise by 20%.

Exhibit 30: Farm income growth likely to hold up in FY24…



Source: Ministry of Agriculture, CEIC, Nirmal Bang Institutional Equities Research

Exhibit 31: …government rural spending turning around

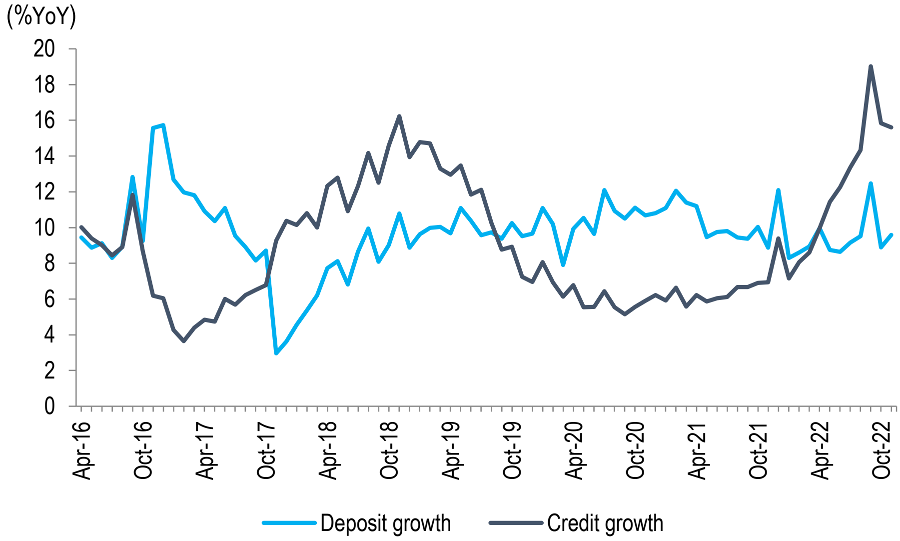


Source: Government of India, Nirmal Bang Institutional Equities Research

Moreover, government's outlay towards rural schemes is expected to remain favorable in the run-up to general elections in CY24. Government spending on rural schemes peaked in FY21 and was expected to decline in FY22 and FY23E, but this is already reversing ahead of general elections in CY24. The government has already increased allocation to the Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS) and other rural asset creation programmes by over Rs450bn in FY23 over the budgeted numbers. **In our view, FMCG, Agrochemicals and low-ticket discretionary consumption expenditure (including 2Ws) will likely be the key beneficiaries of a rural turnaround. Cement will also benefit from government's rural spending on construction activities.**

2) **Banks to gain vs NBFCs but credit growth & NIMs to face pressure:** In our view, the outperformance of the banking sector will moderate going into FY24. The sharp wedge between credit growth and deposit growth will likely put pressure on NIMs going forward as banks compete for deposits. Bank credit growth will likely moderate to ~11% in FY24, led by: (1) Slower GDP growth (2) Moderating inflation (3) End of the Emergency Credit Line Guarantee Scheme (ECLGS) for MSMEs (4) Rising interest rates and (5) Banks' exposure to NBFCs near all-time high.

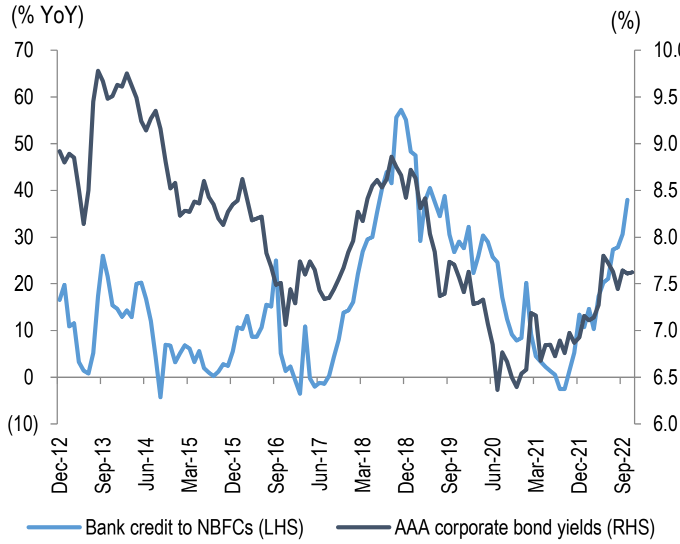
Exhibit 32: NIMs likely to come under pressure given sharp wedge between credit & deposit growth



Source: RBI, CEIC, Nirmal Bang Institutional Equities Research

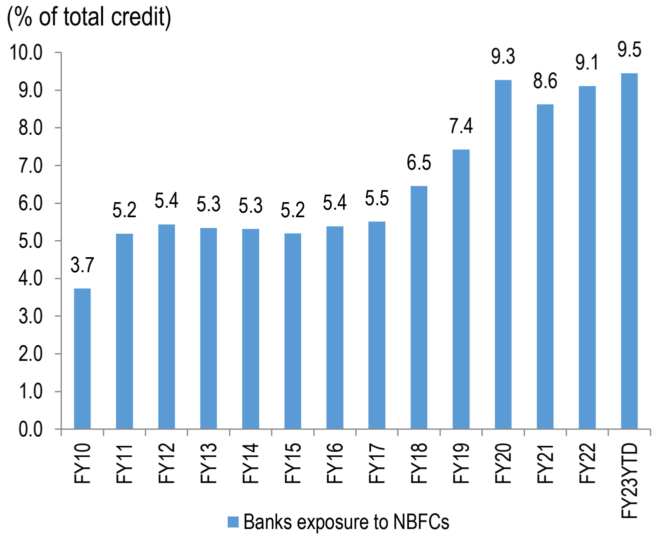
In an environment of rising interest rates, banks typically benefit vs NBFCs given their strong deposit franchise. Meanwhile, NBFCs turn to banks for their funding needs given the rise in market interest rates, which also aids bank credit growth. Moreover, NBFCs are now facing a double whammy with exposure of banks to NBFCs near all-time highs, while on the asset side, banks are entering product lines where NBFCs had a stronghold such as Gold Loans and Consumer Durables Financing.

Exhibit 33: Rise in interest rate benefits bank credit to NBFCs…



Source: RBI, Bloomberg, CEIC, Nirmal Bang Institutional Equities Research

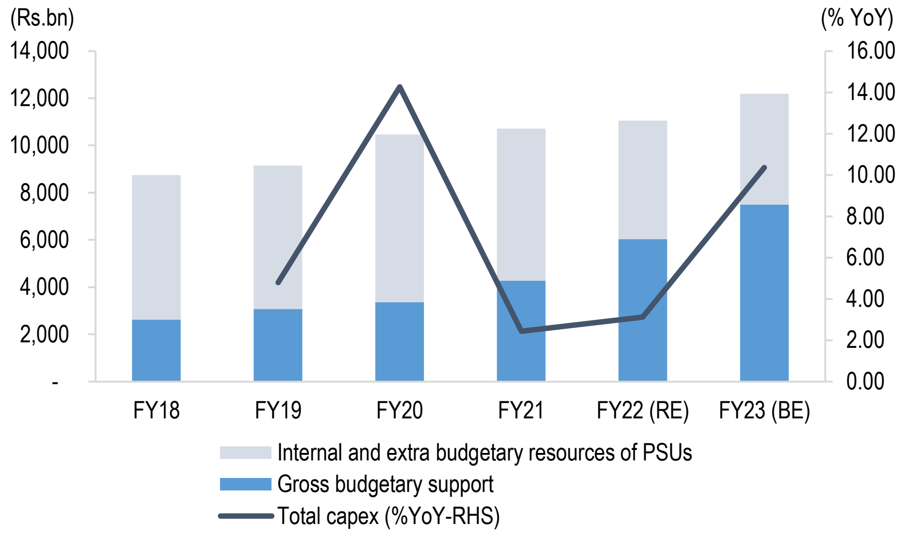
Exhibit 34: … banks' exposure to NBFCs near all-time highs



Source: Government of India, Nirmal Bang Institutional Equities Research

3) **Govt budgetary focus on capex to stay:** Overall, we expect the central government's budgetary focus on capex to stay in this year's budget as well even though a large part of the capex is merely substitution for central government agencies and central public sector enterprises (CPSEs).

Exhibit 35: Government focus on capex to stay



Source: India budget, Nirmal Bang Institutional Equities Research

4) **Private capex recovery under way but may see some stops and starts:** All the drivers for private capex recovery seems to be in place, which include improving capacity utilisation, deleveraged corporate balance sheets and government incentives in terms of both corporate tax cuts and the production linked incentive (PLI) schemes for ~14 sectors. In fact, our analysis suggests that the private capex pipeline is more robust than the government capex pipeline and above pre-pandemic levels. However, our concerns are largely around the fact that the capex pipeline is mainly led by a couple of sectors such as Chemicals and Renewable Energy. More importantly, in the event of a global economic downturn, there is possibility that projects in the pipeline could get delayed. However, projects under the PLI schemes are unlikely to be impacted significantly by a global slowdown given the time-bound incentives.

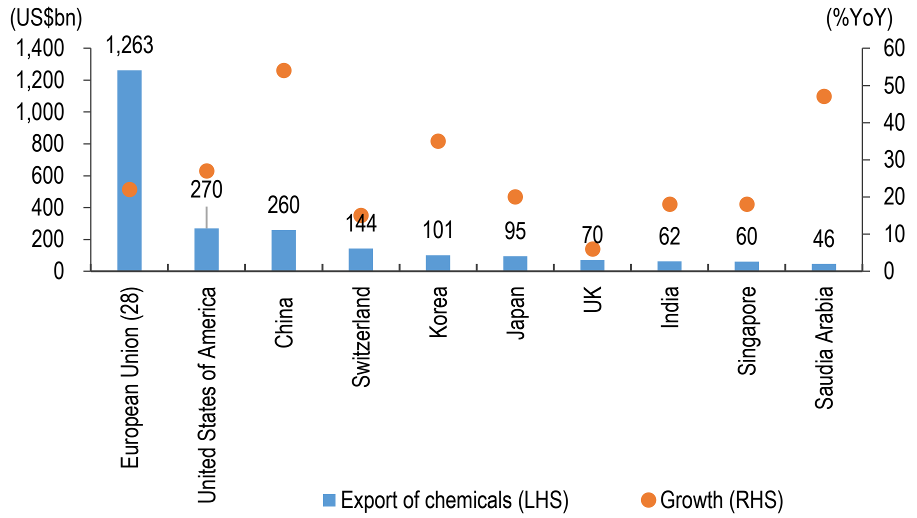
Exhibit 36: Private capex recovery under way with capex announcements above pre-pandemic levels

Capex announcements	Total (Rs.bn)	%YoY	Private sector (Rs.bn)	%YoY	Central government (Rs.bn)	%YoY	State government (Rs.bn)	%YoY
Apr - Nov FY19	12,260.61		5,791.72		3,448.29		3,151.62	
Apr - Nov FY20	10,332.55	-15.73	5,559.93	-4.00	1,915.72	-44.44	3,104.06	-1.51
Apr - Nov FY21	5,533.02	-46.45	2,752.59	-50.49	1,677.71	-12.42	1,102.71	-64.48
Apr - Nov FY22	9,105.70	64.57	6,314.89	129.42	2,286.97	36.31	503.84	-54.31
Apr - Nov FY23	9,369.58	2.90	8,500.43	34.61	547.93	-76.04	326.54	-35.19

Source: India budget, Nirmal Bang Institutional Equities Research

5) **Chemicals may be a structural play for India:** We are structurally positive on the Chemicals sector. In fact, Chemicals is one of the few sectors where India features in the Top 10 exporters list globally with opportunity to further ramp up its place. India's export market share in Chemicals is ~2.2% as of CY21 whereas China's share is at 9.4% (source: *WTO*).

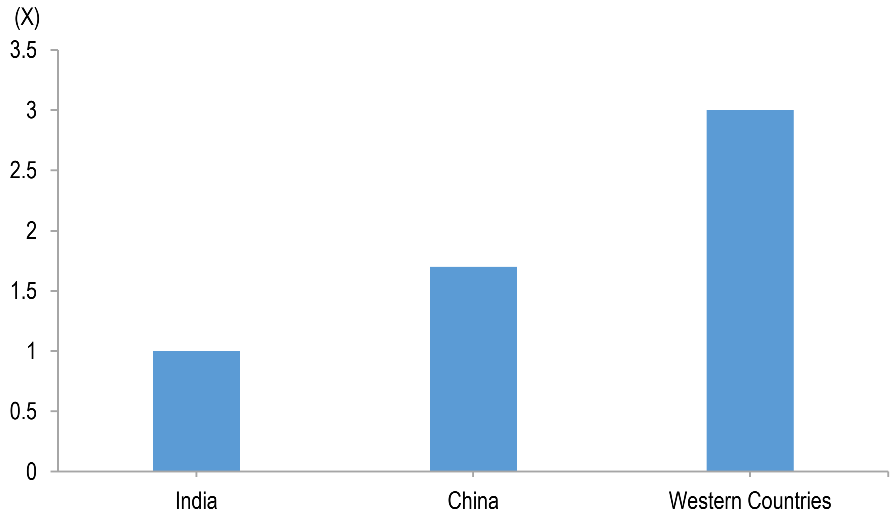
Exhibit 37: India among Top 10 Chemicals exporters globally



Source: WTO.

Moreover, we believe that the Chemicals sector is at an inflection point, supported by favourable tailwinds such as China+1, availability of low-cost labour and superior process engineering.

Exhibit 38: Scientists salaries in India are 1/3rd of western countries



Source: Syngene, Nirmal Bang Institutional Equities Research

Sector views and Top Picks

Banking & Financial Services

Sector view

- Credit growth is likely remain robust, but may slow from FY23 levels on account slowing economic growth and base effect
- NIMs may came under some pressure as deposit rates are inching up amid a race among banks to garner higher deposits
- Well capitalised banks, declining NPAs and lower provisioning requirements bode well for the overall sector

Triggers for the sector

- A sharp growth slowdown and job losses could have a cascading effect on retail NPAs
- Nascent signs of recovery in corporate credit may turn out to be a damp squib and lead to lower credit growth
- Sector may outperform in case credit growth sustains and pressure on margins does not materialise

Top Buy: ICICI Bank

- Overall, the bank's strong performance continues with all-round improvement in: (1) credit growth (2) stability in core profitability (3) lower net delinquency rate and consequently much lower provisions, and higher return ratios.
- In light of changing advances profile on account of corporate asset quality issues, the bank has been able to improve the share of retail portfolio from 57% as of FY18 to 68% in 2QFY23. Part of this success can be attributed to a reputed brand name as well as distribution strength/infrastructure to generate small ticket loans. Of the total retail portfolio, about half is accounted for by housing loans, which are secured in nature.
- With strength in its balance sheet and higher proportion of loans on floating –rates, and particularly on external benchmarks would aid credit yield & margins.
- Non-NPA provision cover stands at 2.1% (of loans). With fresh slippage risks subsiding and the bank holding adequate provisions, credit costs are likely to see a downward trend going forward.

Top Buy: SBI Bank

- Credit growth is picking up, leading to overall gain in the bank's credit market share
- With a superior deposit franchise, the bank may be able to maintain above-system credit growth through competitive rates
- Credit-to-deposit (CD) ratio of ~64% vs. system CD ratio of 75% and higher share of floating rate loans is likely to support margins
- The bank is currently carrying 75% PCR, along with 105bps coverage on standard loans. The current coverage ratios indicate healthy provisioning buffer and is likely to keep overall credit cost lower, aiding return ratios

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IT Services

Sector view

- Expect Tier-1 USD revenue growth in FY24 to be in low to mid-single digits, which we believe is significantly lower than consensus estimates.
- Expect modest price compression, higher travel cost & elevated S&M spending, negative operating leverage and wage increases to lead to flat EBIT margins vis-à-vis FY23 for key Tier-1 companies despite lower supply-side pressures, higher utilization rate and benefits from INR depreciation (on a net basis post cross-currency pressures).
- We not only see earnings compression, but at current high valuations, we think structural returns will be very modest at mid to high single digit at best.
- We believe that one is better off in Tier-1 set than in Tier-2 stocks. In the latter, we see greater earnings and valuation compression risk on a riskier revenue mix in terms of client, vertical and service line concentration.

Triggers for the sector

- Sales and earnings pressure in customer companies
- Slower order inflow in the sector in the quarters ahead
- Disappointing revenue and earnings guidance for FY24 from Infosys and HCL Technologies
- Evidence of pricing pressure

Top Sell: Infosys

- We believe consensus revenue and earnings growth expectations for FY24 and FY25 are high and are vulnerable to downgrades
- We believe that it has a higher discretionary revenue mix, which is vulnerable to spending cuts
- We believe that while optically Infosys has grown faster than TCS, this seems to have been at the expense of margins, relatively speaking
- Technically, it is the most over-owned stock in the IT Services space.

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Oil & Gas

Sector view: Oil Marketing Companies (OMCs)

- Stocks have rallied on expectations of fall in crude oil prices and improving retail spreads. Henceforth, upside looks limited and we suggest buy on declines.

Triggers

- Positives include a sustained decline in oil prices to U$75/bbl
- Healthy GRMs above mid-cycle average also bode well for the sector
- Inventory losses and interim spikes in crude oil prices could revive concerns about retail losses

Sector view: Gas

- Positive on Gas Transmission and LNG import business based on favourable transmission regulations, long-term growth in gas demand (4.5-6% CAGR) and increase in LNG imports
- Neutral on CGD Cos as margin outlook looks subdued, although volume could revive if APM gas prices are cut as per panel report

Triggers

- Increase in capex and gas transportation & gas consumption volume
- APM gas price cut
- LNG price correction
- Revival in Morbi PNG volume

Top Buy: GSPL

- The PNGRB's revised gas pipeline regulations mitigate risk of a tariff cut and incentivises future investments in pipeline expansion and linkage with new gas sources - improves prospects for earnings and returns
- GSPL offers value – 13% CAGR in earnings with potential upside in FY25E as it trades at ~20% discount to FY22 book value, net of market value of GGL stake at 30% holdco discount
- Earnings leveraged to likely steep change in long-term volume - 20-25% upside in volume in FY26E from base case implies EPS CAGR of 15.7% to 17%
- TP of Rs543 based on Sept'24E P/E of 35x

Top Buy: Gujarat Gas

- Long-term potential for revival in outlook for Industrial PNG growth/margins based on the assumption of global spot LNG prices softening from the current elevated levels – ~US$40/mmbtu
- Fuel switching in favour of coal and oil as well as potential demand destruction could eventually cool down LNG prices. Quantum and timing of such a correction, if any, are uncertain
- Robust growth likely in CNG (27.7% share of sales mix) – estimated at 20% per annum - is an added catalyst for earnings growth; this is likely to benefit from expansion in CNG stations
- EPS CAGR of 11.6% over FY23-FY25E and 18% over FY22E-FY25E; DCF based TP of Rs608 using avg. EBITDA/SCM of Rs6.8

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FMCG

Sector view

- We expect volume growth trajectory to improve from 4QFY23 onwards, led by improvement in rural demand
- Sector revenue growth will slightly soften for a quarter or so from previous year's levels, as we expect a larger chunk of price cuts to be executed, which will benefit overall volume growth improvement only with a lag.
- RM inflation has already started to taper off at basket level for FMCG companies from peak. The benefit of this will be witnessed from 3QFY23/4QFY23 on gross margins. But, due to pick-up in overhead spends, especially A&SP, in the very near term, improvement in EBITDA margin will come with a lag. We expect strong margin improvement for the full year, led by correction in commodity prices.
- Valuations for FMCG companies look fair on one-year forward basis.

Triggers for the sector

- Rural growth recovery.
- Sharper correction in RM prices
- Aggressive competition, especially from new players could be a possible negative trigger in some staple categories

Top Buy: Hindustan Unilever (HUL)

- We are currently building in ~15% earnings CAGR over FY22-FY25E, led by: (a) ~10.7% revenue CAGR with ~6% volume CAGR (b) EBITDA margin expansion of ~200bps to 26.5% by FY25E-end, led by sharp gross margin expansion of ~310bps over FY22-FY25E to 54%, largely led by stable input costs beyond the very near term, partial reversal of price hikes taken and mix improvement (led by higher growth from Beauty & Cosmetics on a lower base).
- While the company expects only a modest margin expansion over the longer term, we believe that the above levers should lead to a sharp expansion, at least over FY22-FY25E. We continue to maintain BUY with a TP of Rs3,055, valuing it at ~56.5x on Sept'24 EPS.

Top Buy: Britannia Industries (BRIT)

- On a low margin base of FY22, BRIT should deliver strong ~20% earnings over FY22-FY25E, led by: (1) Long runway for growth in the Indian Packaged Foods industry driving volume as well as value growth through premiumisation; (2) Continues and gradual market share gains in its core category of Biscuits/Cookies, led by (a) Sharper focus on expansion in smaller towns and (b) New Product Developments (NPD's) (3) Normalisation of commodity cost inflation and continued cost optimisation (building in 410bps/270bps expansion in Gross margin/EBITDA margin over FY22-FY25E).
- We value BRIT at ~46x Sept'2024E EPS due to the structural opportunity in the Packaged Foods space, decent return ratios (even while it looks to have come off in FY22), healthy dividend payout and potential addition of new categories going ahead.

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Consumer Discretionary

Sector view

- **Paints –** Over the next one year, we expect revenue growth for the sector to drop as the benefit of steep price hikes normalises along with tapering sharp volume growth momentum. Benefit from low RM prices going forward will be partially offset by higher promotion spends and other overheads along with lower operating leverage benefits. Due to the added concern from new players/capacity in the market, we believe that current sector valuations are fair.
- **Alcoholic Beverages–** The sector witnessed a sharp recovery from the adverse Covid impact and we expect strong growth to continue for the next few quarters. There are near term inflation concerns (glass bottle, ENA, etc.), but operating leverage will take care of margin improvement for the next one year. As we await the outcome of the excise cycle, current valuations seems fair.
- **QSR–** The Indian Food Services industry has seen strong growth in the recent quarters, led by a sharp recovery in on-premise channel. This, along with omni-channel presence and aggressive store expansion will support revenue growth in the near term. We believe that commodity inflation pressure in the very near term will be offset by operating leverage benefits and will thus help deliver better margins for the QSR companies.

Triggers for the sector

- Impact of inflation on overall discretionary consumption for the next few quarters
- In addition, for the Paints companies, there is the lingering impact of import restrictions on commodity inflation. Execution on ground by new Paint players will also be a key monitorable

Top Buy: Westlife Foodworld (WFL)

- We are building in ~9% SSSG CAGR over FY19-FY25E, led by (1) Recent category additions like Fried Chicken (2) Further penetration of McCafé in terms of new stores (~80% store penetration currently) as well as increasing McCafé mix within stores though meal combos & customizations (3) Improved traction in McDelivery (4) Premiumizing the core. This, along with aggressive store expansion (to open 200+ new restaurants in the next 3-4 years, taking the base to 500+ stores with 50-60% store openings in small and emerging towns) should lead to ~13.4% revenue CAGR over FY19-FY25E.
- The margin profile is also improving as AUV has crossed the Rs60mn+ mark, leading to favorable operating leverage. This, along with cost savings and consistent gross margin improvement, led by stable input costs and a better mix, will support EBITDA margin expansion in the medium term (building ~18.8%/19.6% post-IND AS 116 EBITDA margin in FY24/FY25).
- WFL has been our top pick in the Consumer Discretionary space and we continue to have a positive view on WFL over the medium term.

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Auto and Auto Ancillary

Sector view

- We expect the PV segment growth to moderate to ~11-12% in FY24 on the elevated base of FY23 and normalisation of pent-up demand. We expect entry segment PVs and Hatchbacks to remain weak while Premium segment and SUVs are expected to outperform.
- We expect 2W demand to recover slightly and grow by ~9-10% on the lower base of FY23, led by the return of replacement demand, healthy crop yields (supported by normal monsoon)) and government's push to the rural sector ahead of LS elections. However, we still expect FY24 volumes to remain below FY19 peak in FY24.
- The CV segment is expected to continue on its growth trajectory and grow by ~15-16% in FY24, led by higher freight availability (driven by increasing infra & construction activity), overall economic growth and continuing replacement demand.
- Tractor sales are expected to remain flat or grow in lower single digits, supported by favorable rural sentiments on the back of higher MSPs and government incentives ahead of upcoming LS elections amid a higher base.
- EV penetration to pick-up pace on the back of evolving technology leading to refined products, investments in EV charging infrastructure, favorable policy framework, new product launches and capacity & network expansion.
- Benign commodity prices provide margin tailwinds. However, pick-up in discounting will soften the benefits.

Triggers for the sector

- A sharp increase in the cost of vehicle ownership, led by factors like rapidly evolving regulations, rising fuel prices, higher interest rates etc. to hamper growth across segments.
- Exports markets continue to remain under pressure and any further worsening of the global macros will be detrimental for the Indian automobile industry.

Top Buy: Maruti Suzuki

- It is set to recover lost market share on the back of a series of new model launches and plugging of product gaps planned over the next two years
- Margin expansion on the back of operating leverage benefits and commodity tailwinds
- Hybrid and CNG portfolios to help Maruti maneuver the requirements of RDE norms

Top Buy: Apollo Tyres

- Market share gains in TBR & PCR, led by investments in R&D
- Margin expansion on the back of the softening commodity prices to drive earnings growth
- Focus on sweating assets and deleveraging balance sheet with lower capex intensity likely to be funded by internal cash accruals
- EU restructuring helping the margins
- Favourable valuation

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Pharmaceuticals

Sector view

- Strong visibility in the domestic market due to favorable macro-economic trends, steady growth with healthy financials, free cash flow and return ratios
- In the US market, new launches are likely to drive growth. But, concerns about acute price erosion, regulatory concerns and delay/uncertainty in launches remain an overhang
- EM are also expected to grow in double digits, but currency volatility and country-specific risks keep weighing on their performance

Triggers for the sector

- Secular double-digit growth continues in the domestic market, driven by volume growth, price hikes and new launches
- Expected normalisation in the base business' price erosion and new complex launches (including Revlimid) to drive US growth
- Margins are also expected to improve with normalising RM prices and freight charges as well as improvement in the product/revenue mix

Top Buy: Cipla

- It will continue to deliver market-beating growth across Rx, GX and OTC segments in the domestic market
- A robust product pipeline will provide strong visibility in the US market. ~28% of revenue comes from low-competition Respiratory segment
- We are positive about Cipla mainly due to its strong India franchise, robust US pipeline, healthy margins and improving return ratios

Top Buy: Eris Life

- Approximately 90% of its revenue comes from Chronic and Sub-Chronic segment, driven by 6 therapies, including Oral Anti-diabetes (OAD), CVS, VMN, Dermatology, CNS and Women's Health
- The company's foray into Human Insulin (Feb'22) and the Dermatology segment (acquisition of Oaknet in May'22) will help it to enhance its Chronic/Specialty focus
- We like Eris Life due to pure domestic play, specialty focus, strong financials, healthy balance sheet and high return ratios

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Cement

Sector view

- Peripheral construction activities emanating from rural demand coupled with private & public spending on infrastructure are expected to generate strong demand for cement ahead of 2024 general elections.
- We expect continued consolidation, backed by accelerated capacity additions by larger players
- Efforts to reduce costs - increased use of WHRS and continued efforts to explore multiple fuel sources will aid cost optimisation

Triggers for the sector

- Softening of international coal and pet coke prices and availability of RMs may improve margins in the near to medium term
- Delivering cost efficiencies both on logistics and production front through appropriate fuel mix and a well balanced combination of rail & road transportation
- Healthy realisations on the back of strong demand limits margin contraction

Top Buy: UltraTech Cement

- Sheer size and strong presence in core relevant markets makes it our preferred pick
- The company has demonstrated competencies in both organic as well as inorganic expansion and has reduced debt through improved cash conversion
- The company has increased green power mix with further scope for improvement

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Specialty Chemicals

Sector view

- Overall, we are positive on the Indian Specialty Chemicals space. Exposure to innovators in Pharma and Agrochemicals sectors should enable select companies to maintain their high growth trajectory without compromising on margins despite global recession woes
- CDMO model is gaining traction in India and China+1 theme would be a key enabler. Process innovation is a mega trend and India has an edge vs Chinese players, led by R&D and technology expertise as demonstrated by companies like Clean Science & Technology, Aether Industries, SRF etc.
- Energy crisis in Europe should mainly benefit bulk chemicals players as most of the Indian specialty chemicals companies are in fact buyers of those commodities

Triggers for the sector

- Aggressive capacity building exercise with the ability to scale up faster
- Investments in R&D, technology and sustainability initiatives in a meaningful way. All these factors are positively correlated to growth
- Continued order wins from MNCs, mainly long-term contracts
- Demonstration of pass-through ability during crisis situations and instances of customer wallet share gains

Top Buy: SRF | TP:Rs3,100

- We are bullish on the Chemicals business (fluorospecialty business and Refrigerant Gases), which is outperforming consensus estimates quarter by quarter. We expect non-linear growth in Fluorospecialty business to continue, led by rising salience of fluorine, SRF's ability to handle novel complex molecules and strong relationships with innovators.
- Refrigerant Gases growth should continue, led by volume growth and elevated pricing. Entry into HFO post patent expiry should ensure long-term growth for SRF. Fluoropolymers is a new area which could scale up very quickly, in our view.
- Overall, we are impressed with SRF's operational excellence, R&D and technological prowess, capital allocation strategy and aggression in terms of future capex vs peers.
- While margin in the Packaging Films business is under pressure due to pressure in BOPET spreads, we believe that ~75% of the company's fair value is derived from the Chemicals business, which is exceeding expectations every quarter. Overall, we are building in Revenue/EBITDA/APAT CAGR of 20%/23%/19% over FY22-FY25E.

Top Buy: Vinati Organics (VO) | TP: Rs2,300

- While VO continues to be the global leader in its key products wherein growth prospects look strong from a medium term perspective, the company has been successful in diversifying the portfolio by entering Anti-Oxidants, Butyl Phenol and other specialty chemicals products. Almost the entire portfolio is backward integrated and VO is known for its environment friendly cost effective green processes.
- Overall, we are building in Revenue/EBITDA/APAT CAGR of 26%/32%/30% over FY22-FY25E. VO is one of the very few companies from our coverage universe wherein we see potential of ~25% EBITDA CAGR over the next five years, backed by a strong track record, process innovation thrust and sound financials.

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Agrochemicals

Sector view

- Positive on volume growth and earnings, supported by healthy Rabi sowing trends - cumulative area up 4.7% YoY at 57.81mn hectares

Triggers for the sector

- New product launches
- Declining input chemical and freight prices
- China+1 and Europe+1 themes to boost CSM

Top Buy: PI Industries

- The CSM order book increased by ~28.6% QoQ to US$1.8bn in 2QFY23; also, there was healthy 25% YoY volume growth in the CSM business
- The management-maintained PI's total revenue growth guidance for FY23 at 20%+.
- The CPC business has seen good traction in the Rabi season on the back of new products and favorable trends in weather & sowing.
- New product development
  - Commercialization in CSM (1 was commercialized in 1HFY23 and another 6 are planned in 2HFY23)
  - Launches in the domestic CPC business (3/5 done in 1QFY23/1HFY23 and another 2 are planned in 3QFY23 focused on horticulture/wheat/cotton/soyabean)
  - India ranks 2nd in global Fruits & Vegetables - CAGR of 3-3.8% over FY19-FY22 supporting horticulture sector growth
- Earnings CAGR of 24% over FY23E-FY25E; TP of Rs4213 based on Sep24E P/E of 36x core earnings excluding M&A upside

Top buy: Sumitomo Chemicals (SCIL)

- Healthy long-term prospects for margin expansion based on the increase in the share of specialty products which stands at 30% as of 1HFY23
- Japanese parent is sourcing 5 molecules from SCIL for its Japan CPC operations. This offers upside of Rs2.2bn at full scale from FY24E
- Revenue CAGR of 16.9% over FY22-FY25E, aided by new launches in PGR and CPC categories across crops. The company launched seven new products in FY21, six in FY22 and eight in 1HFY23, including three under India's 9(3) registration.
- Earnings CAGR of 24.1% over FY23E-FY25E; TP of Rs543 based on Sep24E P/E of 35x.

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Capital Goods

Sector view

- Growth outlook remains robust on the back of strong ordering outlook and healthy order backlog
- Receding RM costs are likely to aid margins going ahead
- Stretched working capital cycle in an increasing interest rate environment may impact overall profitability

Triggers for the sector

- A sharp slowdown may affect overall ordering outlook
- Normalising inventory levels and improved collection efficiencies may improve overall working capital cycle
- An increasing interest rate environment may lift interest costs, thus impacting overall profitability

Top Buy: Triveni Turbine

- Healthy carry-forward order book with a higher share of export orders (43% of overall order book)
- Strong order inflow outlook, backed by healthy enquiry pipeline (+26% YoY), mainly led by exports (up 58% YoY)
- EBITDA margin likely to remain ~20%+ due to a higher share of exports and increasing share of After-Market Services business.

Top Buy: Solar Industries

- Strong growth outlook over the medium term on the back of higher off-take by CIL and strong demand from miners amid the ongoing Housing & Infra push
- Ramping up of exports and defence operations is likely to be the key growth levers going ahead
- Softening of RM cost headwinds could help in maintaining 21-22% EBITDA margin

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Consumer Durables

Sector view

- Demand outlook remains robust on the back of receding inflationary pressures on consumers' wallet
- Receding RM cost headwinds are likely to aid margins going ahead
- Increased competitive intensity in the Consumer Durables space may impact overall profitability

Triggers for the sector

- A sharp slowdown or persistent inflationary pressure may impact overall demand as consumers may defer purchasing various Consumer Durables
- Margins in the near term may get impacted due to supply chain constraints and rising freight costs on account of lockdown in China amid surging Covid-19 cases
- Scaling up through export opportunities on the back of China+1 theme as foreign brands may look to de-risk and diversify their supply chain

Top Buy: Stove Kraft (SKL)

- SKL is the preferred brand of choice when a consumer is shifting from the unorganised sector to an organised brand, mainly due to attractive "value-for-money" brand positioning
- Expect SKL to outperform industry growth going forward, driven by distribution expansion, new product launches and exports
- Expect margins to improve going forward as SKL has exhausted its high-cost inventory

Top Buy: Crompton Greaves Consumer Electricals (CGEL)

- Market leader in Fans segment with 29% market share
- Expected to outpace industry growth, driven by premiumisation, continuous innovation and deeper distribution reach with investments stepped up in advertising, rural programs, new business development, R&D and sourcing capability
- Acquisition of Butterfly Gandhimathi sets up a platform for a full-fledged kitchen appliances play for CGCEL, with cost and growth synergies to be realised over the medium term

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BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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