

Weekly Memo

Note: Q4FY21 results have been declared by >94% of the Nifty200 by index weight. Rest (30 companies) are expected to release their results by 30th June, the extended deadline.

Strategy

Fourth consecutive quarter of higher earnings beat improves profit cycle outlook; environment for capex cycle continues to improve

Q4FY21 is turning out to be the fourth consecutive quarter of earnings beat exceeding misses (led by cyclicals), which has resulted in PAT/GDP rising further to 2.8% despite upward revision to FY21 GDP base. 'Look through earnings' of NIFTY200 portfolio has risen sharply by 120% driven by cyclicals in Q4FY21. Latest GDP print indicates economic recovery is led by investments as the real investment rate rose to a 2-year high of 34.3% driven by robust construction and manufacturing sector along with higher government spending. It is also corroborated by robust quarterly results of sectors such as metals, cement, building material, capital goods, auto as well as the resilience shown by merchandise exports. We believe the environment for capex cycle is turning conducive at a macro level. Pick up in contact-intensive consumption will be with a lag and depends on consumer confidence. Rising demand driven moderate inflation and improving pricing power of manufacturers reflected in rising WPI is positive for corporate earnings and stocks in general. Risk emanates from inflation going out of hand and demand outlook falling which looks unlikely currently.

Rolling forward earnings by one quarter, our one-year ahead (June'22) NIFTY50 target stands at 17,250. Our Top picks: SBI, Axis Bank, HDFC Bank, NTPC, PTC India, L&T, Ultratech, Bharti Airtel, Tata communications, GAIL, Tata Motors, TVS Motors, Motherson Sumi, and Jyothy Labs

Markets and Flows: INR has remained resilient at 73 vs US\$ as external environment remains comfortable (record high forex reserves of around US\$600bn, trade deficit under control and FPI+FDI inflows continuing). FPI outflows were limited to just April, while May-June have seen net positive flows. DII inflows have also started picking up along with improving retail participation. The past one month has seen India outperform most global equity markets including EMs and DMs.

P/E expansion unlikely: Normalising of interest rate in US and eventual FED tapering will cap and potentially reverse the record high P/E expansion seen in segments of the market.

Latest data points which indicate further improvement in profit and capex cycle:

- ▶ **Fourth consecutive quarter of beats exceeding misses leading to upgrades:** Beats in Q4FY21 surge overtaking misses, largely driven by cyclicals, as earnings season enters its last stage of reporting in June'21. 'Look through earnings' of NIFTY200 portfolio has risen sharply by 120% driven by cyclicals in Q4FY21.
- ▶ **PAT to GDP ratio improves further to 2.8% driven by cyclicals in FY21** despite upward revision of nominal GDP by 0.8% to Rs197trn. Currently, PAT to GDP ratio is rising from a two-decade low level of 1.6%.
- ▶ **Investment, construction and manufacturing led economic recovery:** Investment rate continued to rise in Q4FY21 and is at a 2-year high of 34.3% in real terms and 7-year high of 31.2% in nominal terms. Construction (14.5% YoY), manufacturing (6.9% YoY) and electricity (9.1% YoY) growth were robust in Q4FY21 as evidenced by GDP print, corporate results and robust merchandise exports. Also, MoM expansion of PMI-manufacturing (>50 reading) in Q1FY22 so far is a positive surprise as April-May'21 may be the worst affected period in the second Covid wave with June expected to witness the reopening of the economy from the partial lockdown. GST collections also remained relatively robust at Rs1.1trn.

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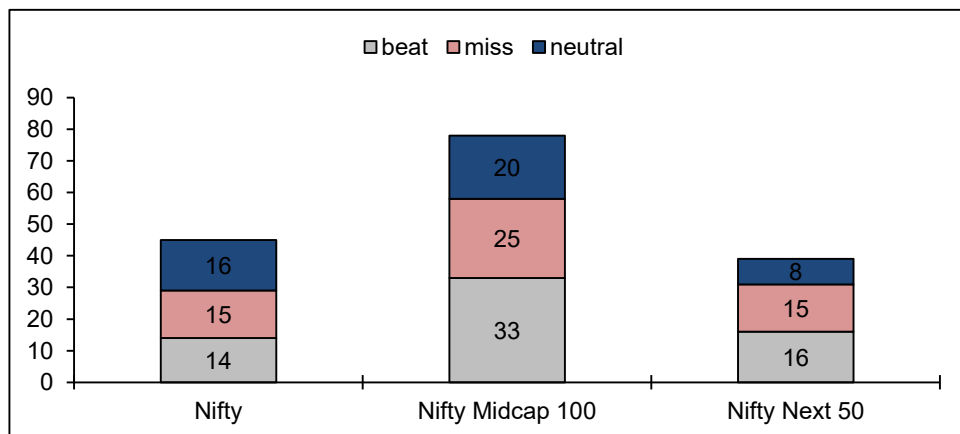
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- ▶ **Factors conducive to the capex cycle / investment rate include:**
 - **Declining real interest rates** both for fresh rupee loans as well as outstanding rupee loans to 8.1% and 9.2%, respectively.
 - **Ample availability of financial resources for corporates for boosting investments as demand revives;** both internal (improvement in profitability and cashflow generation especially for cyclicals) and external (excess banking system liquidity, strong appetite for QIPs & IPOs along with VC funding for new-age sectors)
 - **Countercyclical fiscal policy of the government** to crowd-in private investments.
 - **Conducive policy for boosting manufacturing** through PLI schemes.
 - **Robust global demand via exports feeding through investments** into manufacturing for exports.
 - **Buoyant commodity cycle** is resulting in capex announcements in sectors such as steel & cement.
 - **US infrastructure plan**, if passed, could further augment the global capex cycle
 - **Strong investment demand in the digital economy** (data centres, telecom infra, Industry 4.0, B2B, logistics, digital devices etc.) **and green initiatives** (electric vehicles, net zero carbon emissions, renewable energy etc.)

Story in charts

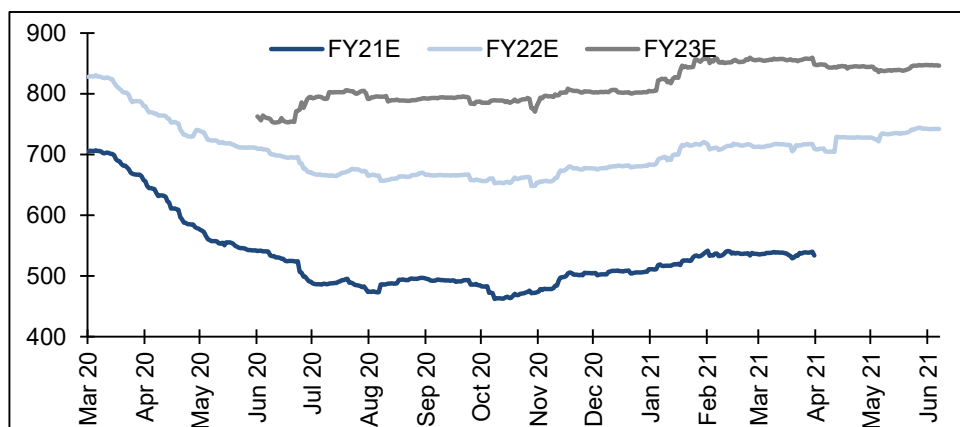
Q4FY21 is turning out to be the fourth consecutive quarter of earnings beat exceeding misses (led by cyclicals), which has resulted in PAT/GDP rising further to 2.8% despite upward revision to FY21 GDP base. 'Look through earnings' of NIFTY200 portfolio has risen sharply by 120% driven by cyclicals in Q4FY21. Latest GDP print indicates real investment rate rose to a 2-year high of 34.3% driven by robust construction and manufacturing sector along with higher government spending. It is also corroborated by robust quarterly results of sectors such as metals, cement, building material, capital goods, auto as well as the resilience shown by merchandise exports. We believe the environment for capex cycle is turning conducive at a macro level. Pick up in contact-intensive consumption will be with a lag and depend on consumer confidence. Rising demand driven moderate inflation and improving pricing power of manufacturers reflected in rising WPI is positive for corporate earnings and stocks in general. Risk emanates from inflation going out of hand and demand outlook falling which looks unlikely currently.

Chart 1: Beats exceed misses at the Nifty200 level for the fourth consecutive quarter



Source: Capitaline, Bloomberg, I-Sec research

Chart 2: Despite the severe health impact of second wave of COVID-19, NIFTY50 FY22 EPS outlook has seen upgrades in the current earnings season, at ~740 so far



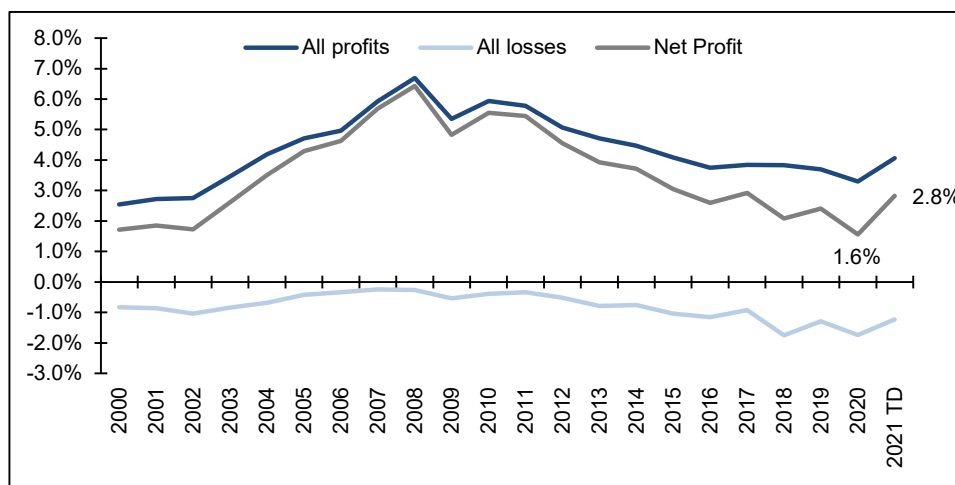
Source: Bloomberg, I-Sec research

Table 1: Earnings beat largely led by cyclicals

(Free float, Rs bn)

Sector	Sales			EBITDA			PAT			Earnings vs consensus		
	Q4FY20	Q4FY21	YoY	Q4FY20	Q4FY21	YoY	Q4FY20	Q4FY21	YoY	beat	neutral	Miss
Agriculture	99	113	13.5%	18	23	23.4%	10	13	24.9%	2	1	1
Auto Ancillaries	130	165	27.1%	16	24	44.6%	8	11	33.7%	6	0	1
Automotives	582	816	40.2%	45	114	155.6%	-15	60	NM	4	2	3
Building Material	5	7	44.7%	1	1	53.1%	1	1	62.6%	0	1	0
Capital Goods	392	428	9.1%	45	57	26.6%	27	31	13.6%	1	2	0
Cement	133	168	26.1%	27	41	54.4%	13	23	81.0%	5	0	1
Cigarettes	77	94	22.6%	30	32	7.4%	27	27	-1.3%	0	1	0
Discretionary	159	202	27.2%	19	27	37.5%	8	14	70.8%	7	6	5
FMCG	116	143	23.9%	20	27	37.4%	15	19	28.1%	3	3	3
Logistics	18	22	23.6%	6	11	80.2%	3	5	97.4%	0	0	2
Media	19	19	0.8%	-3	5	NM	-7	3	NM	0	0	1
Metals	663	953	43.7%	31	249	709.7%	37	140	277.7%	4	4	0
Oil & Gas	1,897	2,147	13.2%	115	236	105.1%	74	144	94.6%	6	0	3
Paints	25	36	44.3%	5	7	54.2%	2	5	88.6%	1	1	0
Pharma	249	264	6.1%	50	67	34.3%	16	30	90.3%	8	6	8
Power/Mining	56	75	33.4%	19	19	-1.8%	3	5	96.7%	3	1	0
Real Estate	13	11	-12.5%	3	2	-33.1%	2	5	200.3%	2	0	1
Speciality Chemicals	31	38	20.8%	3	5	58.4%	5	3	-39.6%	2	0	2
Technology	532	580	9.0%	124	145	17.0%	91	101	11.3%	2	7	3
Telecom	124	133	7.3%	54	64	20.1%	-20	7	NM	2	0	0
NBFCs	63	72	14.0%	60	69	16.1%	25	40	58.6%	1	1	3
Financial Services	190	219	15.5%	48	54	14.4%	22	40	85.6%	1	4	8
Banking	519	595	14.7%	402	494	22.8%	58	170	195.5%	5	4	9
Ex-financials	5,341	6,430	20.4%	627	1,157	84.5%	299	644	115.4%	58	35	35
Total	6,112	7,316	19.7%	1,136	1,775	56.1%	403	894	121.8%	65	44	55

Source: Capitaline, Bloomberg, I-Sec Research

Chart 3: Listed PAT to GDP

Source: Capitaline, Bloomberg, I-Sec research

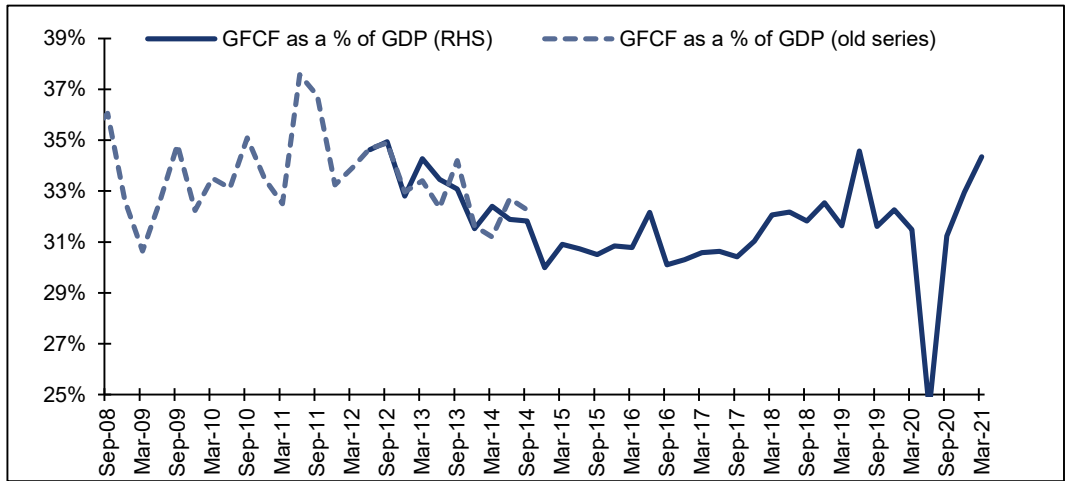
Table 2: 'Look through earnings' of NSE 200 index portfolio increased by 122% in Q4FY21 so far

(Free float, Rs bn)

	Sales			EBITDA			PAT			PAT (incl. financials)		
	Q4FY20	Q4FY21	YoY	Q4FY20	Q4FY21	YoY	Q4FY20	Q4FY21	YoY	Q4FY20	Q4FY21	YoY
Nifty	3,917	4,753	21%	520	840	62%	213	467	119%	326	690	111%
Next50	907	1,018	12%	17	172	894%	60	96	59%	49	88	81%
Midcap100	510	650	27%	87	144	64%	24	81	231%	27	115	333%
Nifty 200	5,333	6,421	20%	625	1,156	85%	298	644	116%	402	893	122%

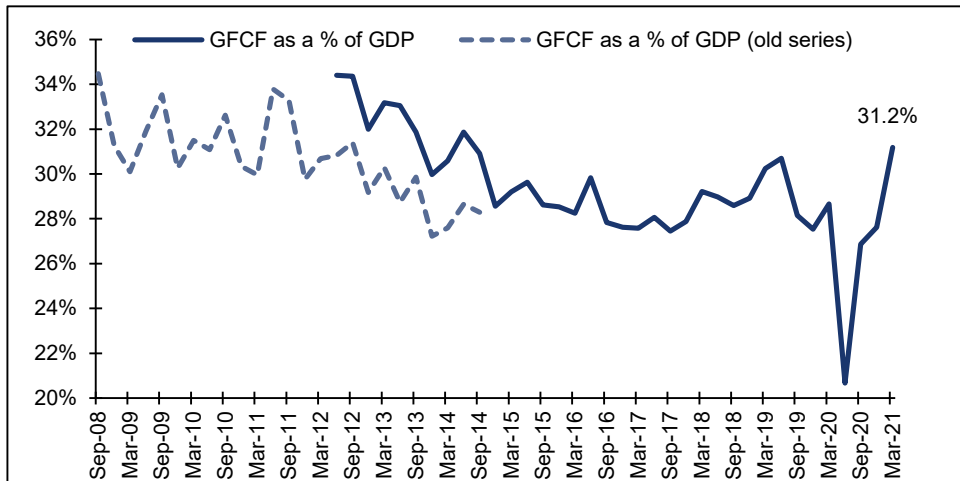
Source: Capitaline, I-Sec Research

Chart 4: GFCF share in real GDP at 34.3% shows uptrend continues after FY16 trough



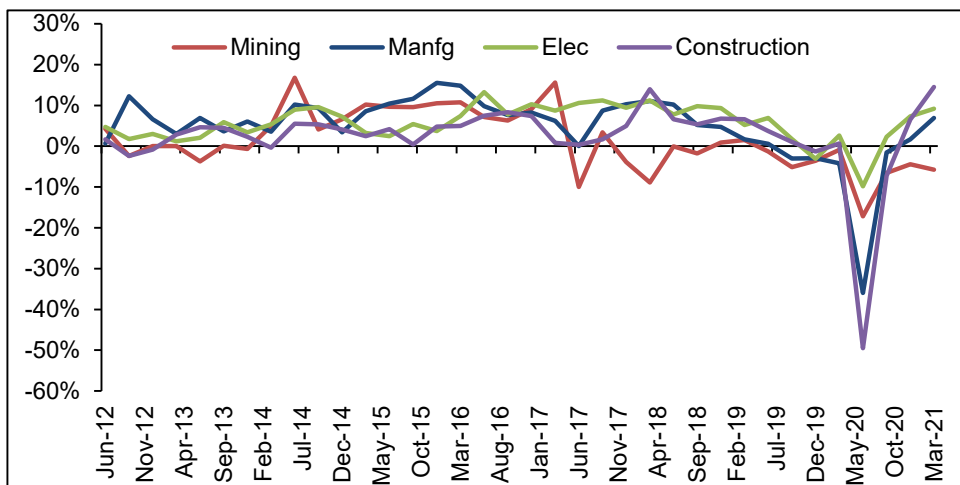
Source: CEIC, I-Sec research

Chart 5: In nominal terms, GFCF share is at 27 quarter high of 31.2%



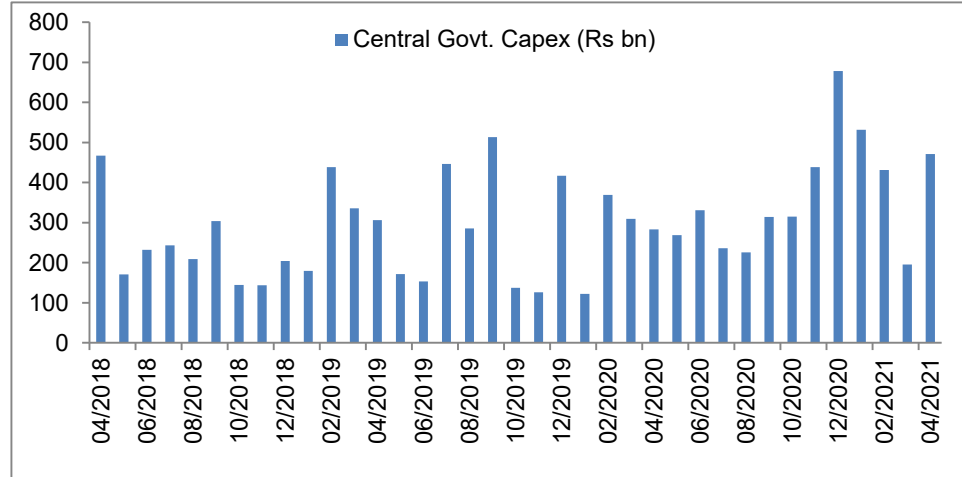
Source: CEIC, I-Sec research

Chart 6: Growth of industrial sectors within the GDP



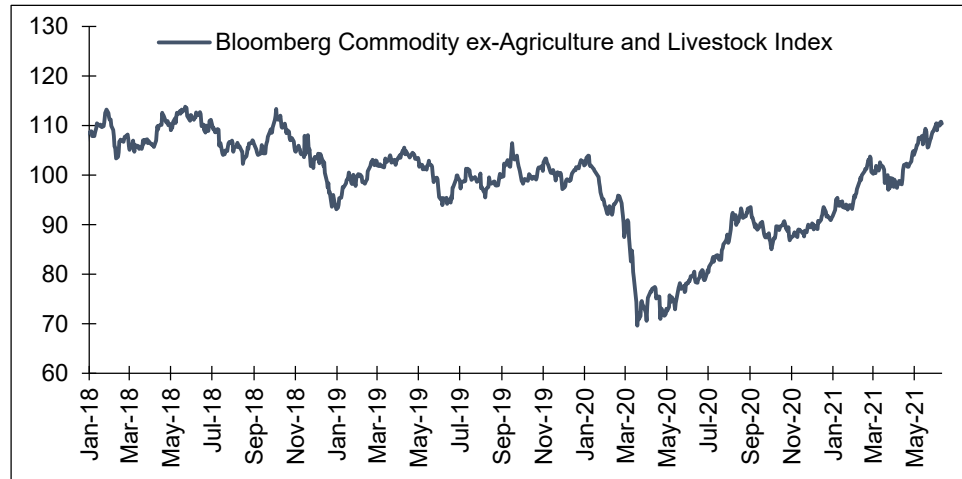
Source: CEIC, I-Sec research

Chart 7: Capex spends by the central government are trending up



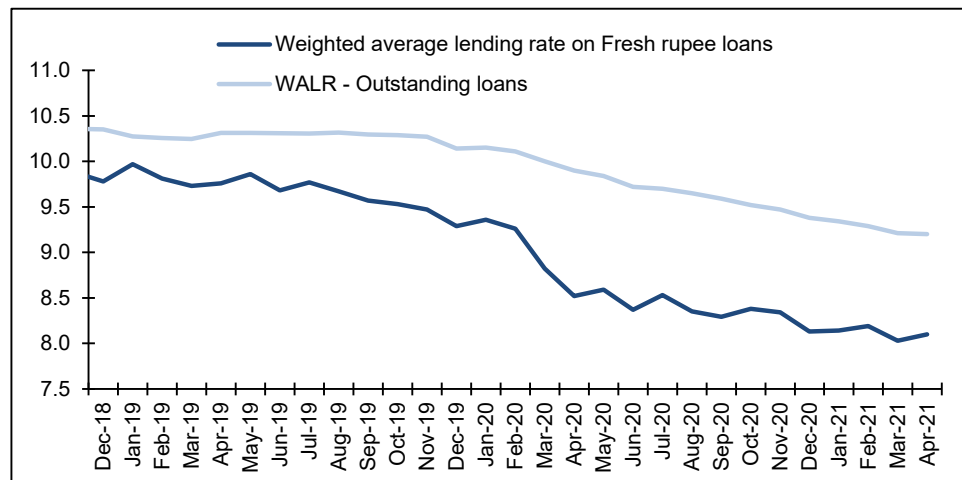
Source: CEIC, I-Sec research

Chart 8: Commodities have been firming up since May'20, improving commodities led capex demand



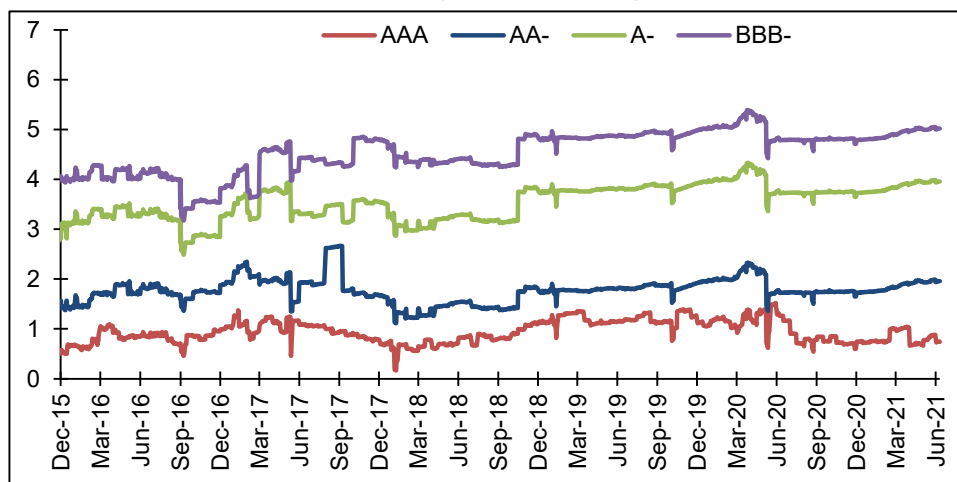
Source: Bloomberg, I-sec research

Chart 9: Lending rates for fresh and outstanding rupee loans continue to drop



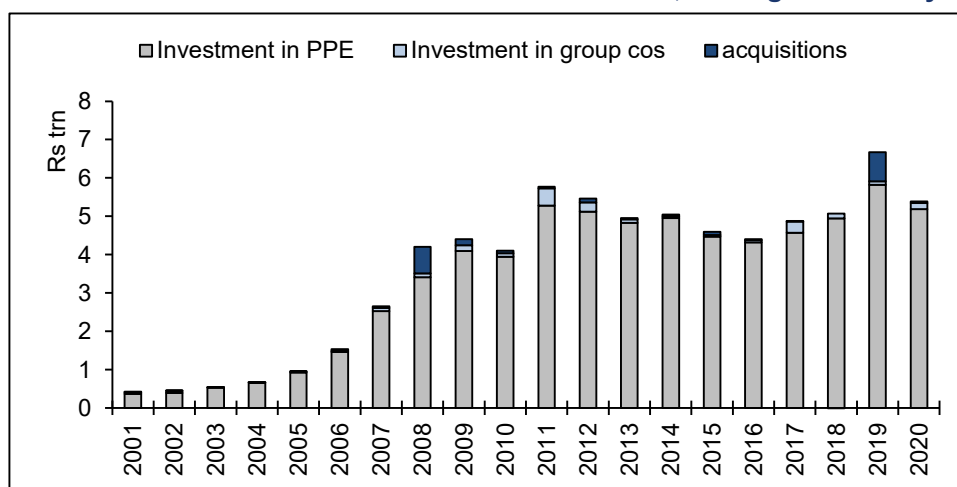
Source: RBI, Bloomberg, I-Sec research

Chart 10: Yield spreads have stayed within range



Source: FIMMDA, Bloomberg, I-Sec research

Chart 11: Investment in PPE lower than FY19 level, but higher than 5 year median



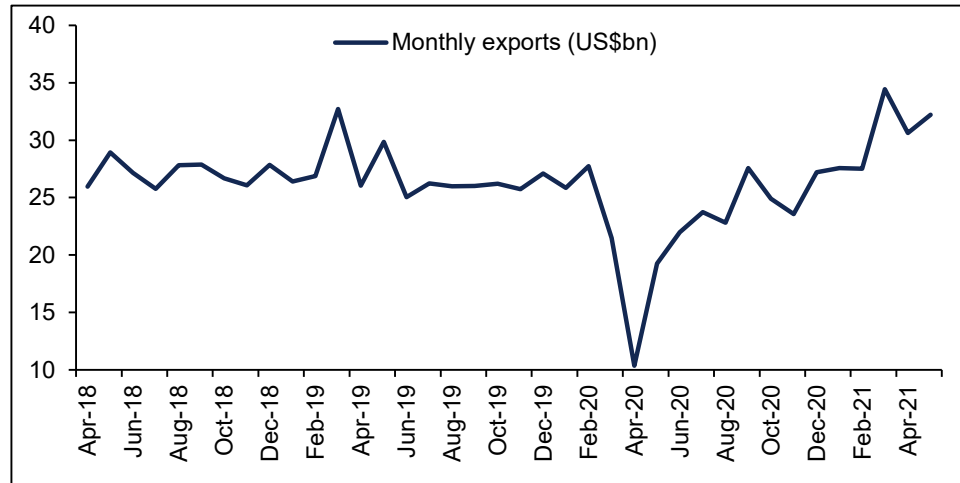
Source: Capitaline, I-Sec Research

Table 3: Key numbers

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

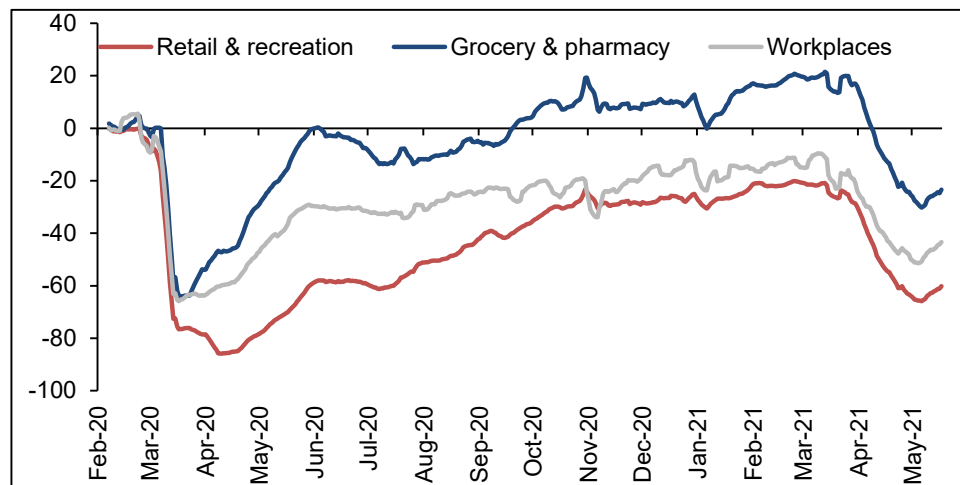
Source: Capitaline, I-Sec Research

Chart 12: Merchandise exports have been resilient through the pandemic, barring the initial months



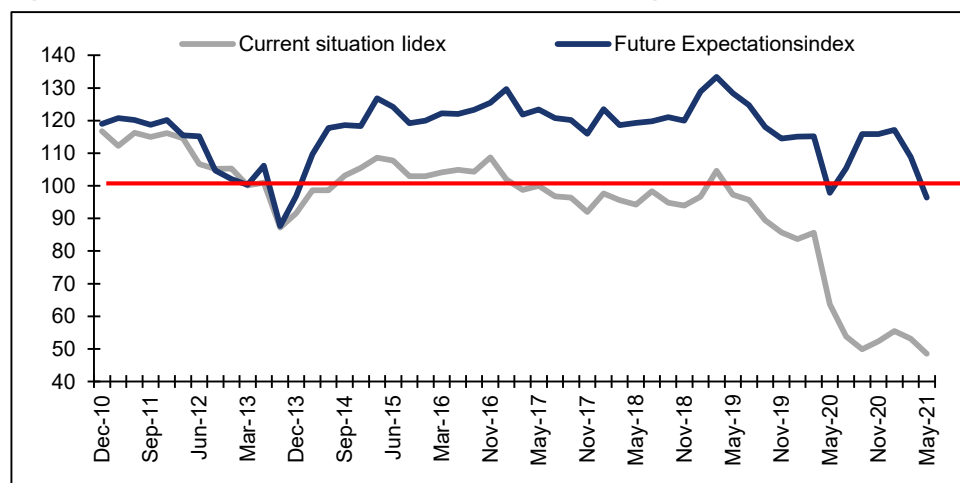
Source: CEIC, I-Sec research

Chart 13: Contact intensive sectors will pick up with a lag - Retail and recreation have seen the biggest impact on mobility



Source: Google, I-Sec research

Chart 14: Consumer confidence for future expectations has dipped below 100 again post the second wave – earlier seen during taper tantrum and first wave



Source: RBI, CEIC, I-Sec research

Rising demand driven moderate inflation and improving pricing power of manufacturers reflected in rising WPI is positive for corporate earnings and stocks in general. Risk emanates from inflation going out of hand and demand outlook falling which looks unlikely currently.

Below exhibits compare Sales growth and EBITDA margins for sectors with WPI and GVA growth.

Industrials

Chart 15: Sales growth

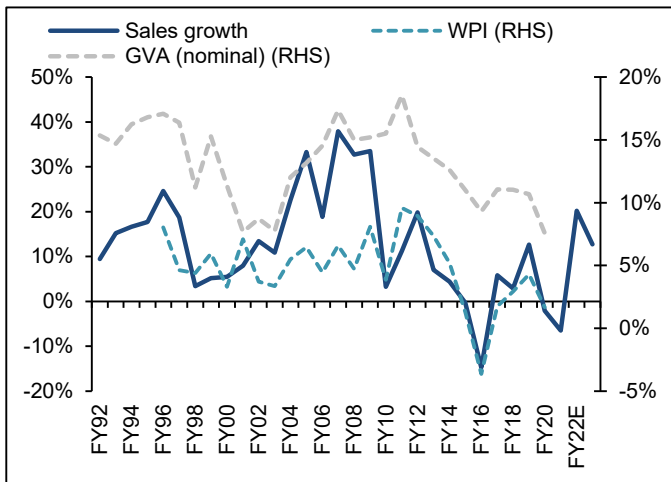
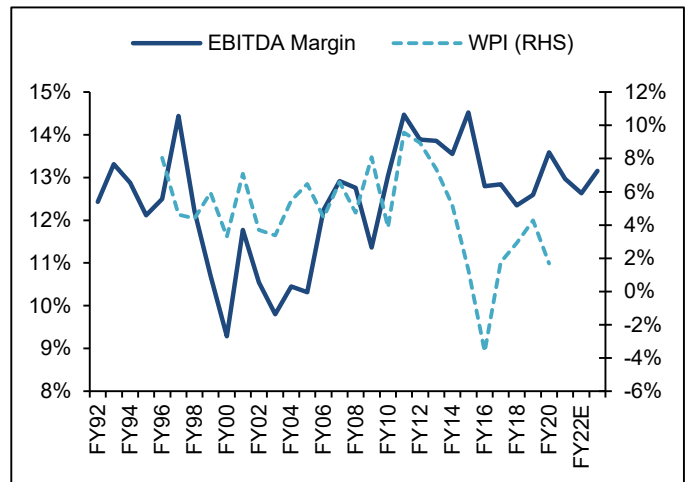


Chart 16: EBITDA margins



Cement

Chart 17: Sales growth

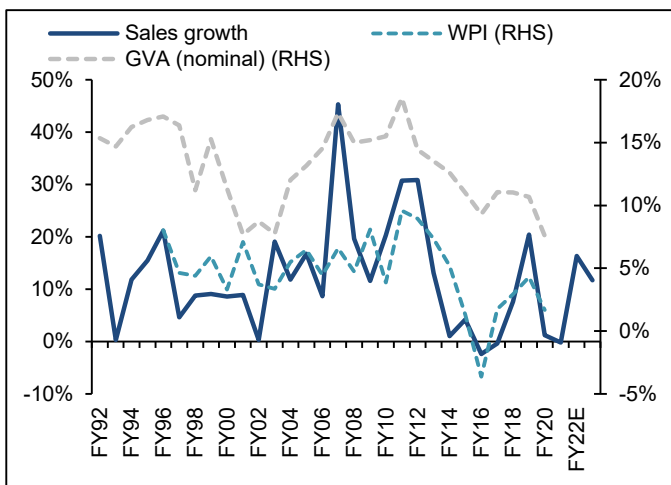
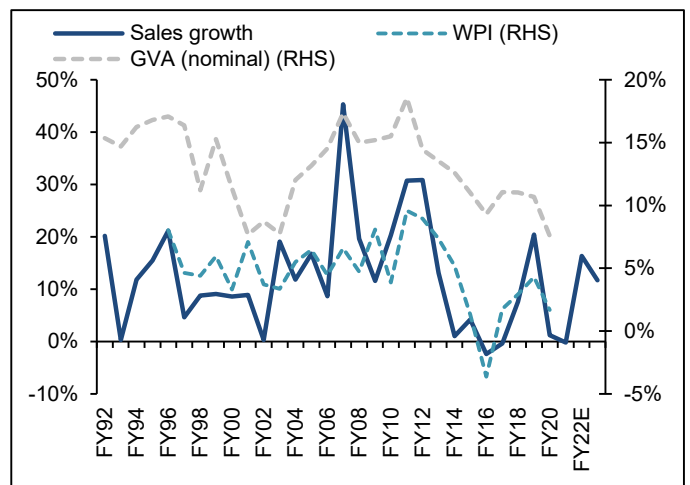


Chart 18: EBITDA margins



Materials

Chart 19: Sales growth

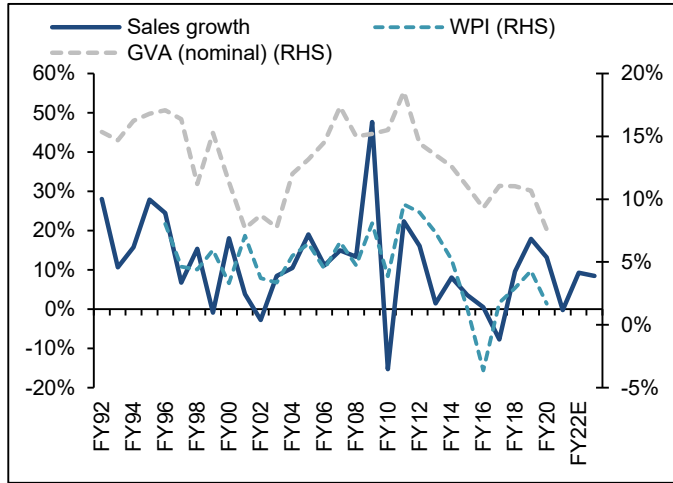
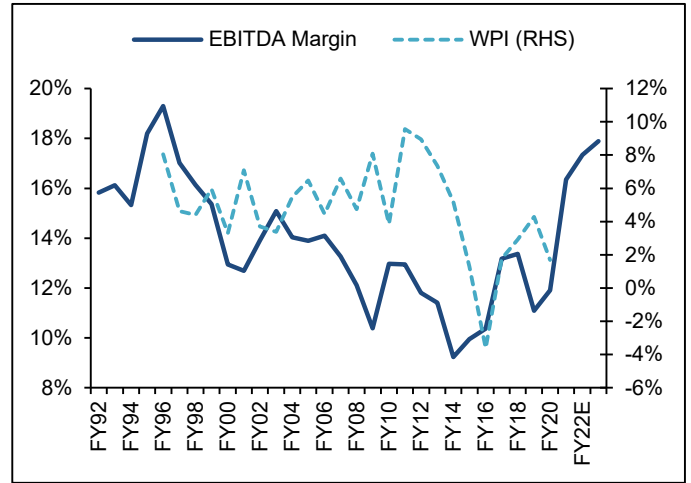


Chart 20: EBITDA margins



Utilities

Chart 21: Sales growth

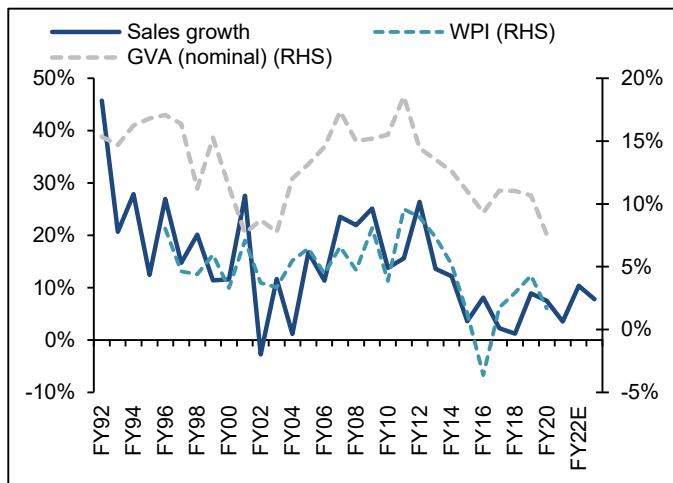
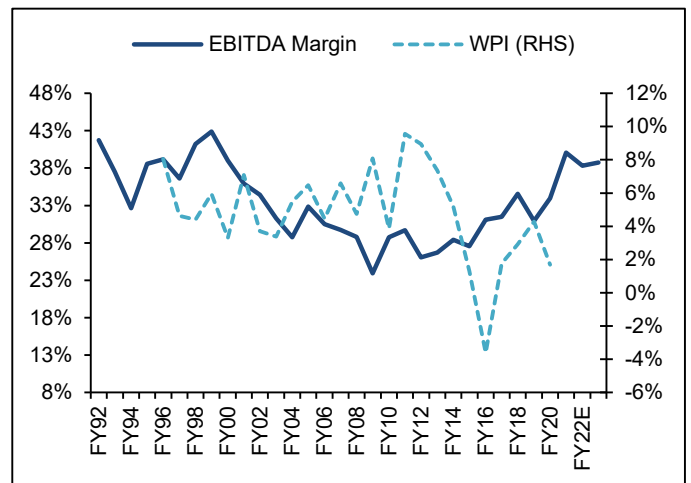


Chart 22: EBITDA margins



Metals

Chart 23: Sales growth

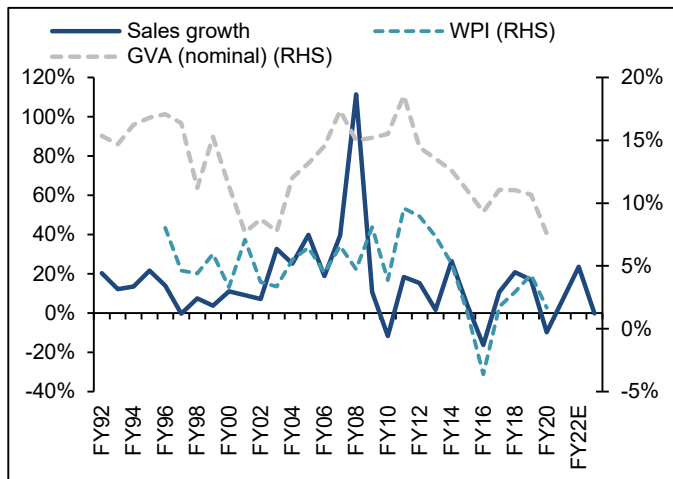
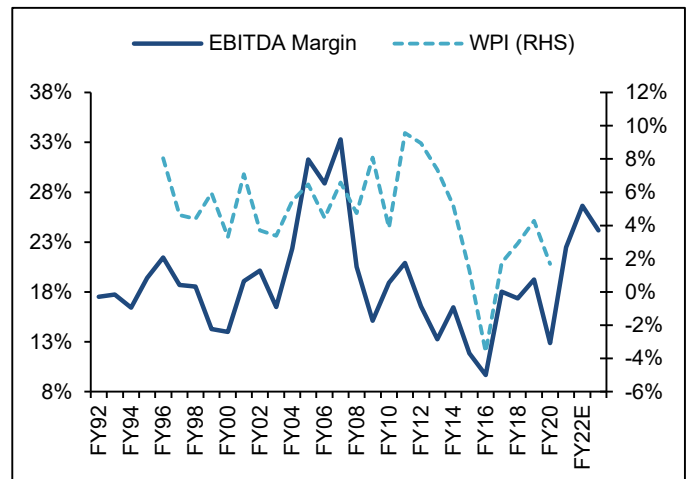


Chart 24: EBITDA margins

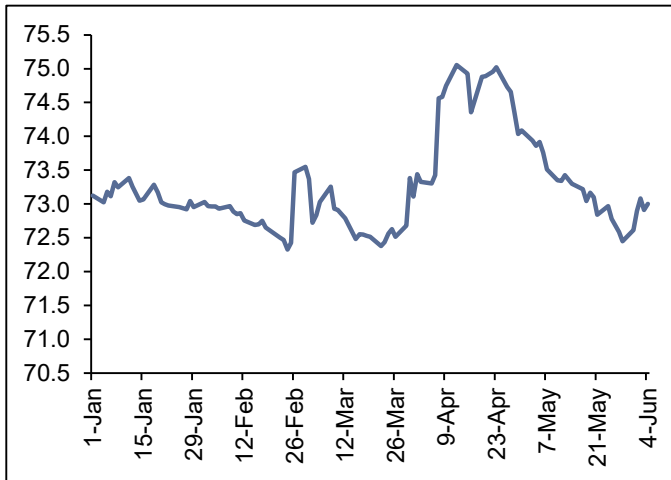


Source: Capitaline, CEIC, I-Sec Research

Markets and Flows

INR has remained resilient at 73 vs US\$ as external environment remains comfortable (record high forex reserves of around US\$600bn, trade deficit under control and FPI+FDI inflows continuing). FPI outflows were limited to just April, while May-June have seen net positive flows. DII inflows have also started picking up along with improving retail participation. The past one month has seen India outperform most global equity markets including EMs and DMs

Chart 25: INR stable at INR73/US\$



Source: Bloomberg, CEIC, I-Sec Research

Chart 26: High forex reserves

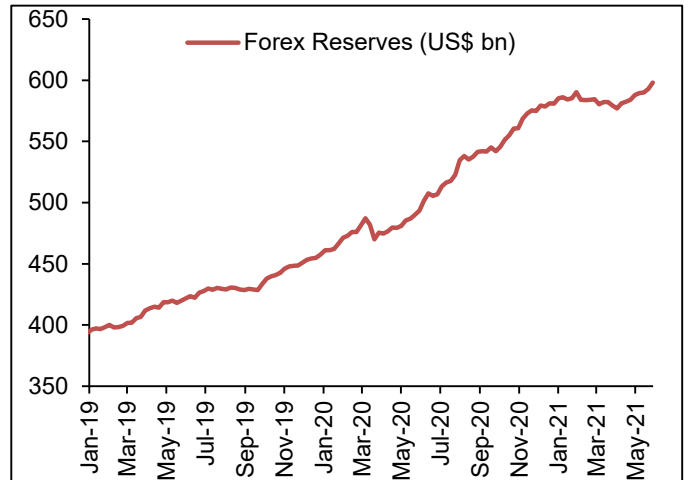


Chart 27: Trade deficit under control

(Merchandise trade deficit)

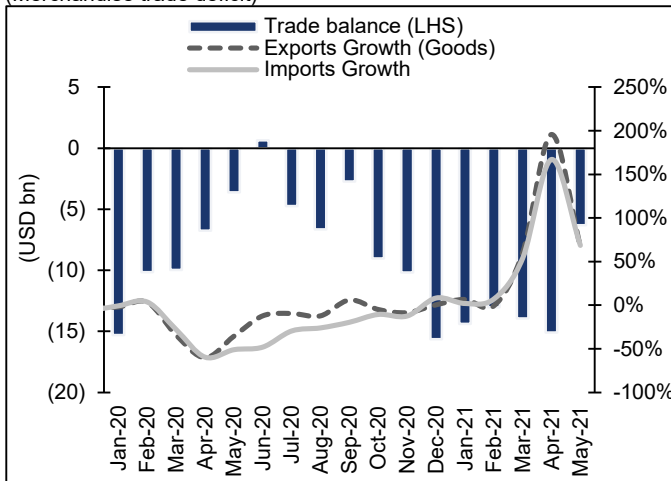
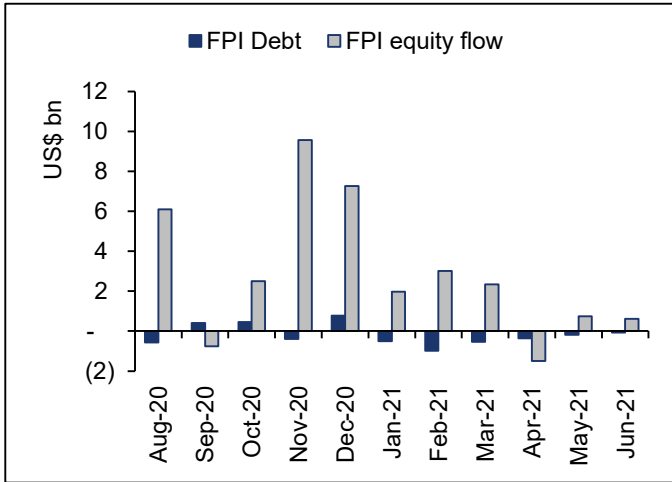


Chart 28: FPI outflows were limited to Apr'21



Source: Bloomberg, I-Sec research

Chart 29: DII flows picking up

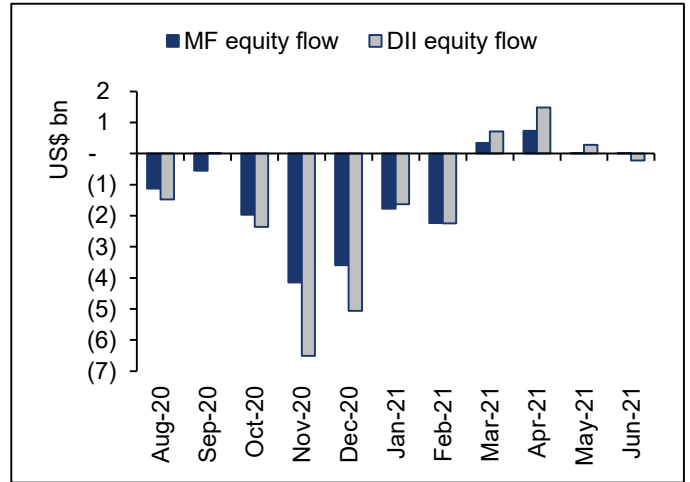
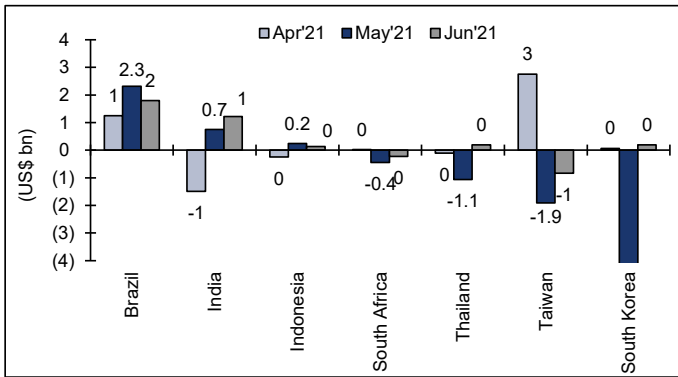


Chart 30: EM Equity flows



Source: Bloomberg, I-Sec research

Chart 31: EM Debt flows

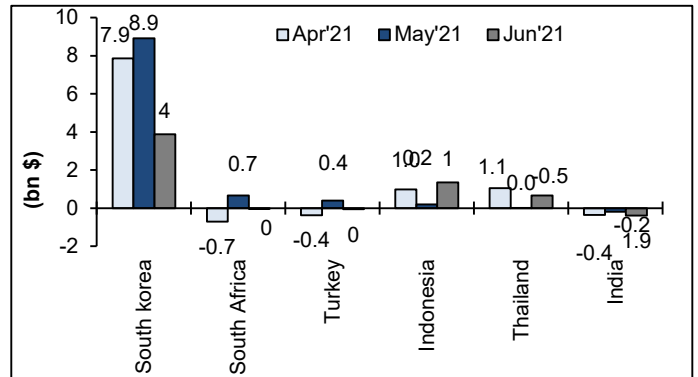


Table 4: India has outperformed most global equities in the past month

Country	Current 10yr bond yield	CYTD	Since recent top (16-Feb)	Monthly	Spot rate	CYTD	Since recent top (16-Feb)	Monthly	Current index	CYTD	Since recent top (16-Feb)	Monthly
Developed Market												
France	0.12	45.8	23.6	(10.2)	1.2	-0.2%	0.7%	0.4%	6,550	18.0%	13.2%	4.5%
Italy	0.79	35.2	32.4	(12.4)	1.2	-0.2%	0.7%	0.4%	25,785	16.0%	10.0%	5.7%
Taiwan	0.45	13.5	11.0	5.4	27.8	1.2%	0.9%	0.6%	16,966	15.2%	7.4%	2.3%
Canada	1.45	77.4	32.8	(8.9)	1.2	5.3%	5.0%	0.2%	20,066	15.1%	8.5%	4.1%
Spain	0.40	35.1	10.4	(12.3)	1.2	-0.2%	0.7%	0.4%	9,167	13.5%	12.4%	2.0%
Germany	(0.24)	32.5	10.4	(8.3)	1.2	-0.2%	0.7%	0.4%	15,571	13.5%	10.7%	3.0%
USA	1.51	59.4	19.4	(11.4)	90.0	0.1%	-0.6%	-0.2%	4,227	12.5%	7.5%	1.8%
Singapore	1.07	22.4	-	-	1.3	-0.1%	0.3%	0.2%	3,153	10.9%	7.4%	0.3%
Australia	1.57	60.2	25.1	(15.0)	0.8	-0.7%	0.2%	1.2%	7,270	10.4%	5.1%	2.4%
United Kingdom	0.76	55.9	13.5	(7.7)	1.4	3.6%	1.9%	0.3%	7,054	9.2%	4.5%	1.5%
Japan	0.07	4.8	(1.6)	(0.9)	109.5	-5.7%	-3.1%	-0.8%	28,861	5.2%	-5.3%	0.9%
Median		35.2	13.5	(8.9)		-0.2%	0.7%	0.4%		13.5%	7.5%	2.3%
Emerging Market												
Russia	2.39	-	-	-	72.2	2.6%	2.0%	2.7%				
Mexico	6.51	96.4	79.4	(37.8)	19.6	1.5%	2.8%	1.8%	50,865	15.4%	13.8%	2.4%
India	6.02	15.1	(0.4)	0.8	73.0	0.1%	-0.4%	0.5%	15,635	11.8%	2.1%	5.3%
Brazil	8.96	205.2	111.4	(32.6)	5.0	3.2%	6.8%	3.7%	129,787	9.0%	8.7%	5.5%
Thailand	1.83	50.8	38.7	7.4	31.2	-3.9%	-3.9%	-0.2%	982	7.9%	3.4%	2.6%
China	3.14	(0.6)	(10.3)	0.7	6.4	2.2%	1.1%	0.7%	5,282	1.4%	-9.0%	5.2%
Malaysia	3.30	65.1	34.4	19.3	4.1	-2.3%	-2.2%	0.0%	11,206	-2.6%	-2.1%	-0.1%
Indonesia	6.39	50.6	10.7	(3.9)	14,255.0	-1.4%	-2.3%	-0.4%	909	-2.7%	-5.3%	3.0%
Median		50.7	22.6	0.4		0.8%	0.4%	0.6%		8%	2%	3.0%

Source: Bloomberg, I-Sec Research

High frequency indicators showing impact on demand; some of which could lead to pent-up demand later in the year

Impact of the second covid wave is showing up on high frequency indicators such as mobility, E-way bills and Auto sales. On the flip side, positive surprise includes robust PMI for both services and manufacturing, strong exports data and high GST collections.

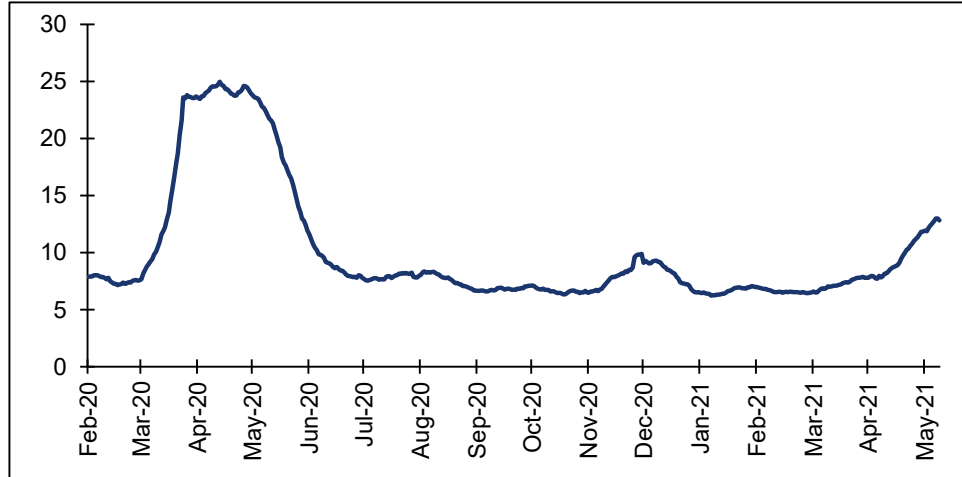
High frequency indicators in April'21 were mixed with Exports sector, PMI-manufacturing and GST collections being robust, but weak mobility data and auto sales

Table 5: India high frequency data robust for Mar-Apr'21

Consumption Indicator	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21
Personal Loan growth	9%	10%	9%	9%	10%	10%	13%	NA
4W growth	14.2%	4.6%	13.6%	11.1%	17.9%	115.2%	NM	NA
2W growth	16.9%	13.4%	7.4%	6.6%	10.2%	72.7%	NM	NA
IIP - Primary Goods	-3.1%	-1.8%	0.4%	0.7%	-4.7%	7.7%	NA	NA
IIP Consumer Goods Durables	18.1%	-3.2%	6.5%	-0.2%	6.6%	54.9%	NA	NA
IIP Consumer Goods Non Durables	7.3%	-0.7%	1.9%	-5.4%	-4.5%	27.5%	NA	NA
Petrol Consumption	4.5%	5.1%	9.4%	6.3%	-1.9%	27.1%	145.2%	NA
Nikkei India Services PMI	54.10	53.70	52.30	52.80	55.30	54.60	54.00	46.40
CPI	7.61%	6.93%	4.59%	4.06%	5.03%	5.52%	4.29%	NA
Passenger - all airports	-62.2%	-56.5%	-50.4%	-46.6%	-42.9%	-3.4%	20042.1%	NA
Foreign tourist arrivals	NA	NA	NA	NA	NA	NA	NA	NA
GST Collections (Rs bn)	1,052	1,050	1,152	1,198	1,131	1,239	1,414	NA
Consumer confidence index	NA	52.30	NA	55.50	NA	53.10	NA	NA
	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Private final consumption exp real	7.55%	6.50%	6.42%	1.98%	-26.18%	-11.19%	-2.80%	2.66%
Industrial Indicator	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21
Overall credit growth (fortnightly)	5.1%	5.8%	6.0%	7.0%	6.6%	5.6%	5.7%	6.0%
Industry loan growth	-1.68%	-0.68%	-1.22%	-1.28%	-0.24%	0.44%	0.40%	NA
CV growth	NA	NA	NA	NA	NA	NA	NA	NA
Thermal plant Load factor	55.54	52.93	57.02	61.10	63.32	66.64	66.56	NA
IIP growth	4.5%	-1.6%	2.2%	-0.9%	-3.4%	22.4%	NA	NA
Core sector growth (%)	-0.52	-1.13	0.42	1.29	-3.85	11.38	56.08	NA
Diesel Consumption	7.47%	-6.94%	-2.70%	-1.88%	-8.38%	27.82%	105.33%	NA
Power demand	11.1%	3.2%	4.5%	4.5%	-0.4%	22.0%	39.3%	NA
IIP Capital Goods	3.2%	-7.5%	2.2%	-9.0%	-3.8%	41.9%	NA	NA
Nikkei India manufacturing PMI	58.9	56.3	56.4	57.7	57.5	55.4	55.5	50.8
WPI Commodity price index	1.31%	2.29%	1.95%	2.51%	4.83%	7.39%	10.49%	NA
Cargo - Air	-13.86%	-12.92%	-8.92%	-11.00%	-8.55%	34.20%	445.34%	NA
Cargo - all ports	-1.2%	2.8%	4.4%	4.0%	1.9%	16.4%	29.5%	33.0%
Freight traffic - railways	11.05%	8.41%	13.51%	11.09%	7.77%	33.04%	86.88%	55.73%
Import Growth (%)	-10.62%	-12.41%	8.19%	1.95%	6.96%	53.74%	167.06%	68.55%
Export growth (%)	-4.96%	-8.52%	0.39%	6.59%	-0.81%	60.29%	195.66%	67.41%
Trade Deficit (USD bn)	-9.04	-10.19	-15.64	-14.39	-13.03	-13.93	-15.10	-6.32
Industrial Indicator	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Capacity utilisation	73.60	69.10	68.60	69.90	47.30	63.30	66.60	NA
GFCF	13.26%	3.90%	2.43%	2.54%	-46.60%	-8.55%	2.59%	10.85%

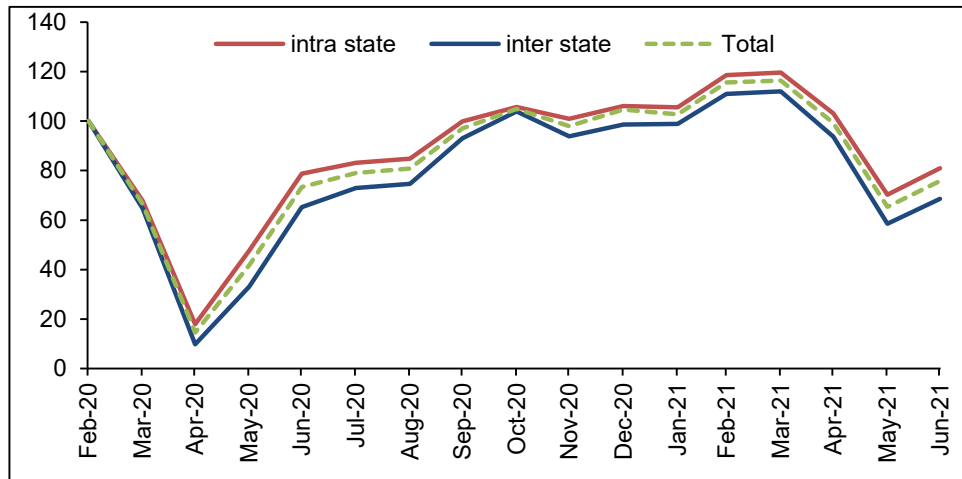
Source: CEIC, Bloomberg, I-sec Research

Chart 32: Unemployment numbers continue to inch up



Source: CMIE

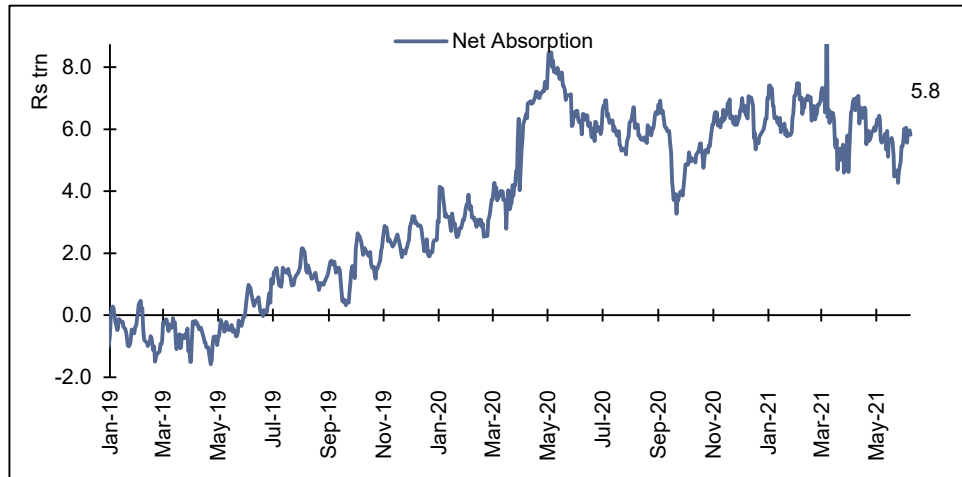
Chart 33: First week of Jun'21 has shown pick up in generation of GST E-way bills



Note: Data for May available till 6th June. Above numbers are indexed to Feb'20 daily average.

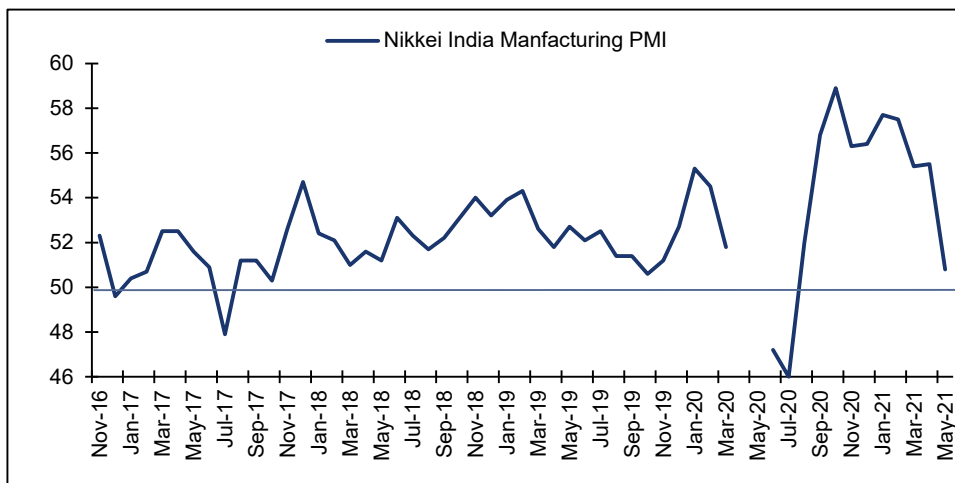
Source: GSTN, I-sec research

Chart 34: Banking system liquidity remains high



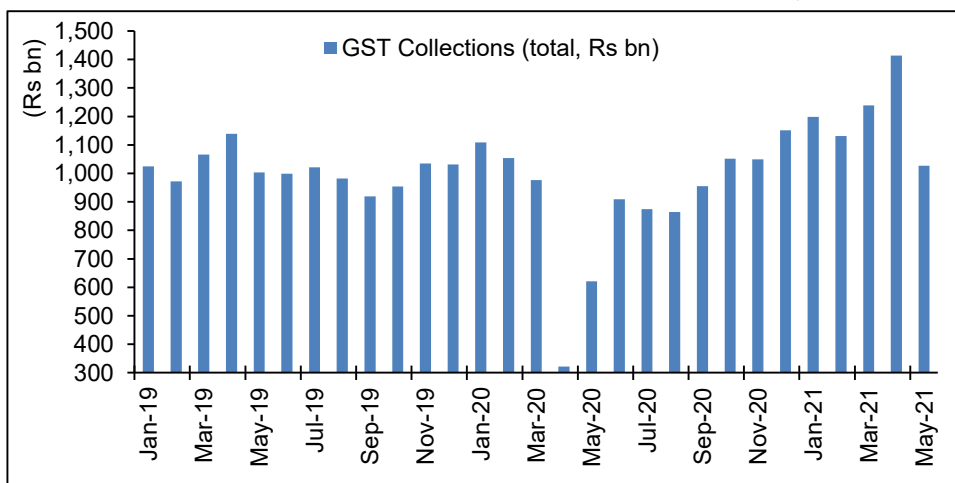
Source: RBI, CEIC, I-sec research

Chart 35: Despite the onset of restrictions due to the second wave, Manufacturing activity expanded for both April and May 2021



Source: Bloomberg, I-Sec research

Chart 36: GST collections remained above the Rs1trn in May'21



Source: Bloomberg, I-Sec research

PE expansion unlikely

Credibility of rolled forward earnings has improved significantly over the past one year given the consistent beats / in-line results. P/B closer to LTA.

Chart 37: Nifty below +1SD on forward PE

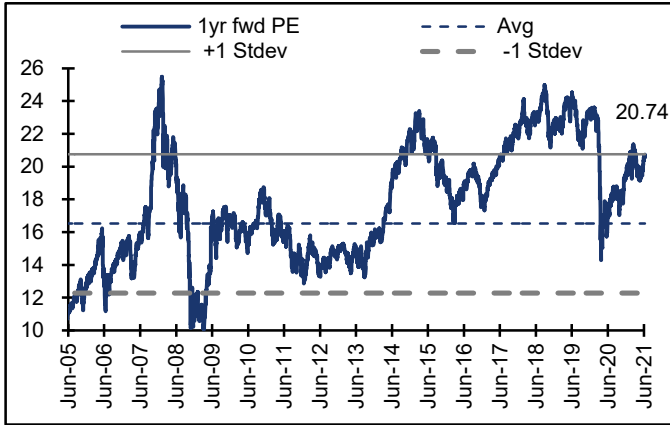


Chart 38: CAPE remains above +2SD

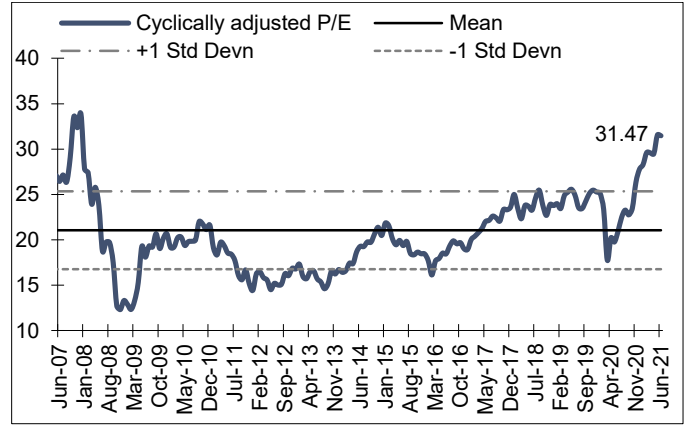


Chart 39: Nifty forward PE (ex-ante)

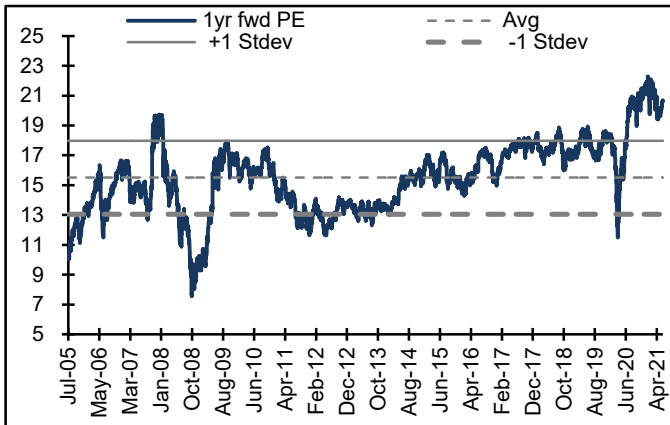


Chart 40: Nifty PB marginally above LTA

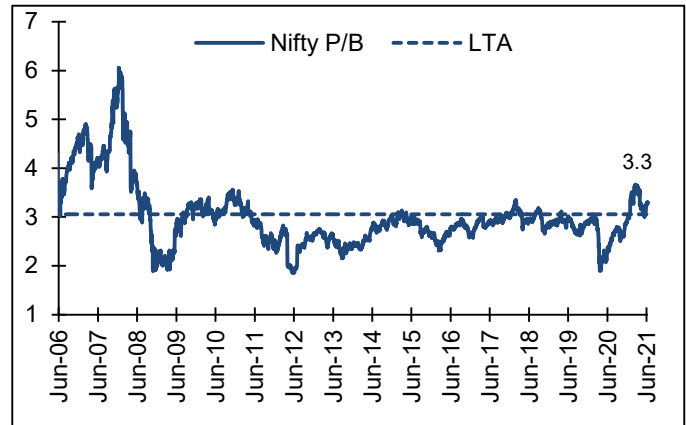


Chart 41: Market cap to GDP above LTA, reflects low trailing GDP

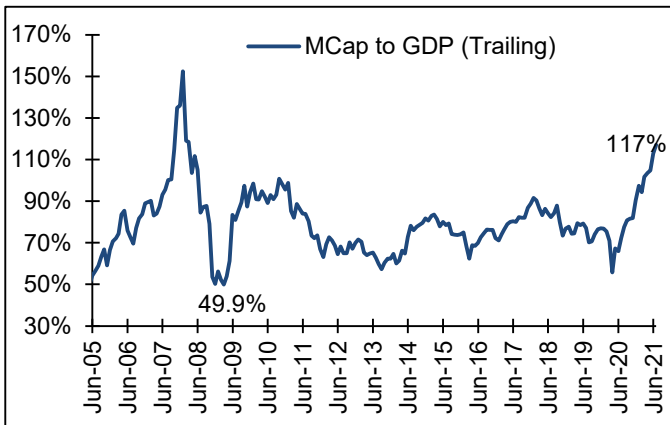
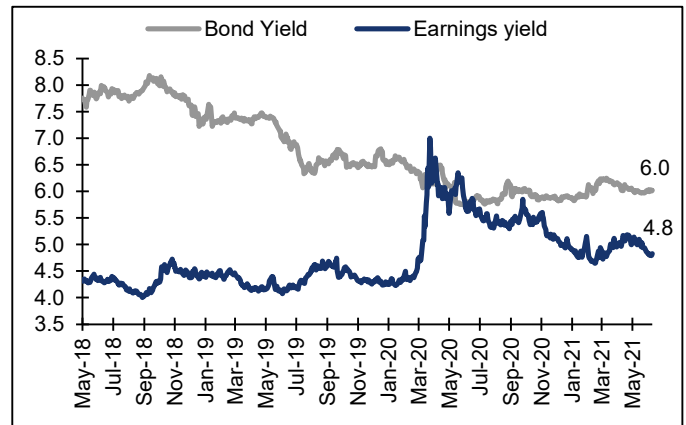


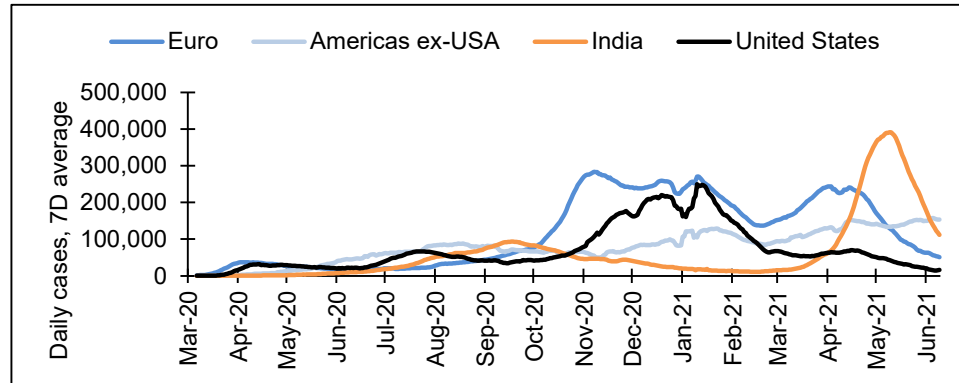
Chart 42: Bond and earnings yield both drop; spread at 120bps



Source: Bloomberg, Capitaline, I-Sec research

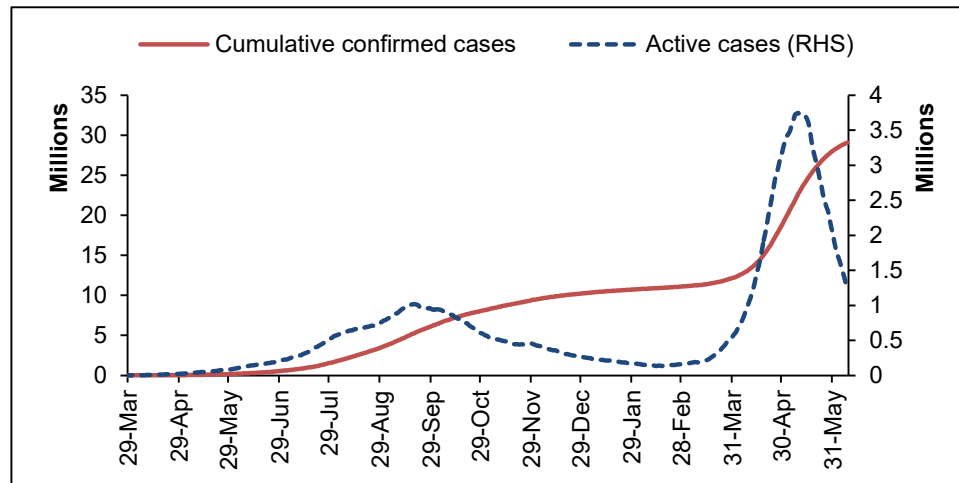
COVID immunity – natural via infections and vaccination

Chart 43: Meaningful dip seen in daily new cases



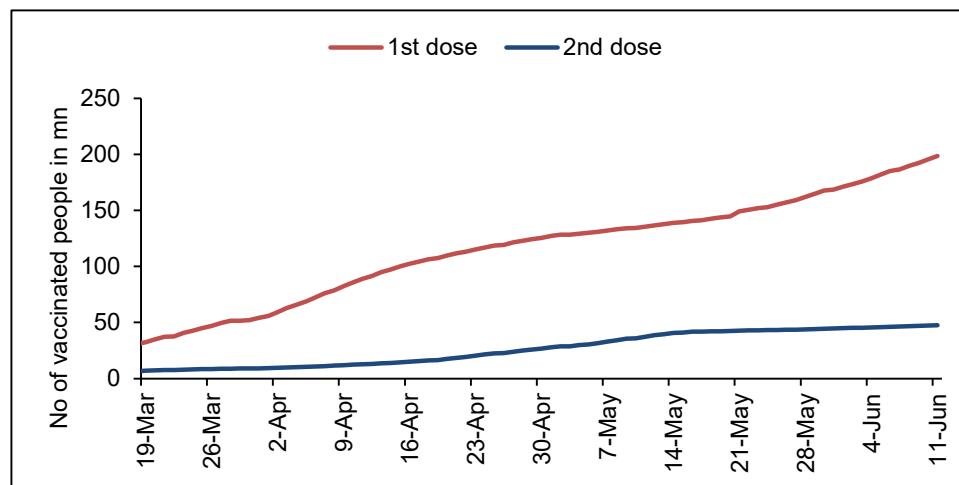
Source: WHO, CEIC, I-Sec research

Chart 44: Total confirmed cases for India stand at 29mn, while active cases continue to dip sharply, currently at 1.2mn



Source: MoHFW, CEIC, I-Sec research

Chart 45: 199mn Indians have received their first dose of the vaccine



Source: Our World in data, I-Sec research

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