31 March 2021

MORNING INDIA

ASIAMONEY Brokers Poll 2020 (India)

Market snapshot

Equities - India	Close	Chg .%	CYTD.%
Sensex	50,137	2.3	5.0
Nifty-50	14,845	2.3	6.2
Nifty-M 100	23,609	1.7	13.3
Equities-Global	**Close**	**Chg .%**	**CYTD.%**
S&P 500	3,959	-0.3	5.4
Nasdaq	13,045	-0.1	1.2
FTSE 100	6,772	0.5	4.8
DAX	15,009	1.3	9.4
Hang Seng	11,021	0.7	2.6
Nikkei 225	29,433	0.2	7.2
Commodities	**Close**	**Chg .%**	**CYTD.%**
Brent (US$/Bbl)	63	-0.5	23.9
Gold ($/OZ)	1,685	-2.7	-11.2
Cu (US$/MT)	8,770	-2.2	13.2
Almn (US$/MT)	2,206	-3.1	11.8
Currency	**Close**	**Chg .%**	**CYTD.%**
USD/INR	73.4	1.2	0.4
USD/EUR	1.2	-0.7	-4.1
USD/JPY	110.4	0.7	6.9
YIELD (%)	**Close**	**1MChg**	**CYTD chg**
10 Yrs G-Sec	6.1	0.02	0.3
10 Yrs AAA Corp	7.1	-0.01	0.6
Flows (USD b)	**30-Mar**	**MTD**	**CY21**
FIIs	0.10	2.73	7.62
DIIs	0.30	0.43	-3.75
Volumes (INRb)	**30-Mar**	**MTD***	**YTD***
Cash	727	722	795
F&O	27,975	44,834	41,267

Note: *Average

Today's top research idea

Maruti Suzuki: Demand momentum remains strong; Product life cycle to improve

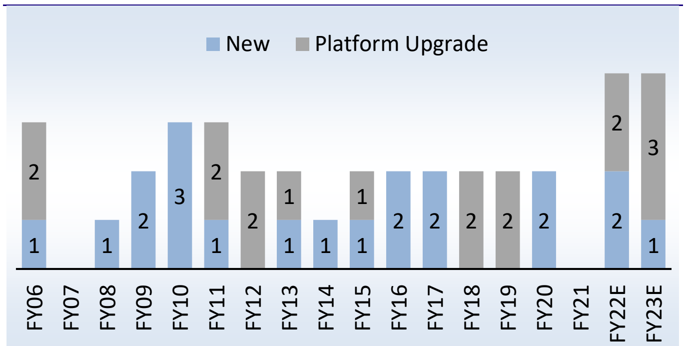
- The MSIL stock has underperformed in the last six months, impacted by market share loss and pressure on margin, despite a strong volume recovery. We see both these concerns abating as: a) product life cycle improves, and b) price increase/discount moderation drives a recovery in profitability.
- PV demand momentum has sustained driven by preference towards personal mobility. Domestic volumes for the industry have been higher than FY19 levels (previous peak) since Sep'20 onwards.
- FY22 looks far more promising for MSIL, with several launches lined up for the next two years, with a mixture of full upgrades of existing models as well as new model launches in the SUV segment.
- We expect further cost inflation (of 200-250bp) in 1HCY21. We see several levers to margin from the base of 3QFY21 via price increases (~300bp), discount moderation (~100bp), operating leverage (50bp), product mix improvement (not factored into our estimate), etc. We estimate EBIT margin to improve by 220bp (over 3QFY21 levels) to 8.5% in FY23E v/s 9.8% in FY19 and a peak of 12% in FY18.
- We expect ~30% volume growth in FY22E and positive evolution of margin. We see 27% upside at our TP of INR8,700/share. MSIL is our top Auto pick.

Research covered

Cos/Sector	Key Highlights
Maruti Suzuki	Demand momentum remains strong
4th Ideation Conference (Day 3)	Key insights from the virtual conference.
Retail	Slow recovery, increase in RM costs cast shadow on retailers

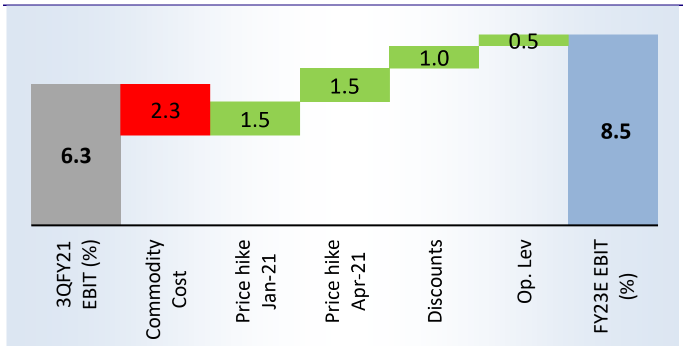
Chart of the Day: Maruti Suzuki (Demand momentum remains strong)

Expect MSIL's product pipeline to catch-up with several new models and upgrades of key models



Source: Company, MOFSL

Price hikes, lower discounts, and operating leverage to dilute commodity cost inflation and drive EBIT margin



Source: Company, MOFSL

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In the news today

Kindly click on textbox for the detailed news link

1

DGCA approves 18,843 flights per week for summer schedule

Aviation regulator DGCA on Tuesday said it has approved 18,843 flights per week from 108 airports for the summer schedule, which begins on the last Sunday of March and ends on the last Sunday of October. The number of flights for this year's summer schedule has been approved keeping in mind that airlines …

2

What triggered Rupee's second steepest decline in FY21?

The Indian currency lost about 1% Tuesday against the dollar, its second-steepest decline in FY21, as a global strength in the US unit and the surging year-end demand for dollars that are needed to meet payment obligations for imports weighed on the rupee. The local unit may extend losses over the next few days on expectations of higher US spending on expenditure likely boosting the dollar even further.

3

Centre releases Rs 30,000 crore as GST compensation for FY21

The central government has released Rs 30,000 crore as goods and service tax (GST) compensation to states for FY21, the finance ministry said Tuesday. Finance Minister Nirmala Sitharaman had said last week in Rajya Sabha during her reply in Budget session that states will get Rs 30,000 crore as GST compensation within March, …

4

GIC to buy 1.1 million sq ft Phoenix Group's IT SEZ in Hyderabad for Rs 1,050 crore

Singapore sovereign wealth fund GIC has entered into an agreement to buy an Information Technology-Special Economic Zone (IT-SEZ) spread over 1.1 million sq ft in Hyderabad’s Gachibowli locality from the Phoenix Group for Rs 1,050 crore, persons with direct knowledge of the development said….

5

First harvest of tea in Assam, West Bengal hit by dry spell in March

The first harvest of tea in Assam and West Bengal, the country’s largest black tea producing states, has been hit by the dry spell in March. The first flush tea harvest loss could be between 5% and 10%, industry executives said. Tea producers in the region are worried whether the weather will improve in April for the tea bushes to produce quality teas….

6

Govt proposes concession on road tax on submitting scrapping certificate

The Ministry of Road Transport and Highways on Tuesday issued draft rules regarding concession in motor vehicle tax against scrapped vehicles. If the vehicle is registered against submission of "certificate of scrapping", the concession in motor vehicle tax will be upto 25 per cent in …

7

Tata Power bags orders to develop 60 MW solar project in Gujarat

Tata Power on Tuesday said it has bagged an order to develop 60 MW (mega watt) solar project for Gujarat Urja Vikas Nigam. The company has received a letter of award from Gujarat Urja Vikas Nigam Limited (GUVNL) on March 26, 2021, to develop a 60 MW solar project in the state …

30 March 2021

Update | Sector: Automobiles

Maruti Suzuki

BSE SENSEX	S&P CNX
50,137	14,845

Stock Info

Bloomberg	MSIL IN
Equity Shares (m)	302
M.Cap.(INRb)/(USDb)	2070 / 28.2
52-Week Range (INR)	8400 / 4002
1, 6, 12 Rel. Per (%)	-2/-30/-18
12M Avg Val (INR M)	8996
Free float (%)	43.6

Financials Snapshot (INR b)

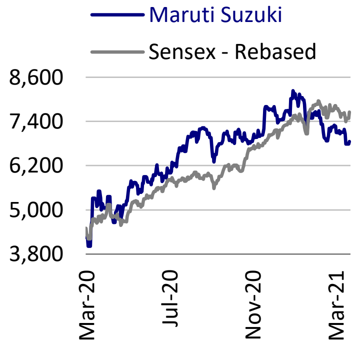
Y/E MARCH	2020	2021E	2022E
Sales	756.1	702.1	923.6
EBITDA	73.0	56.0	97.1
Adj. PAT	56.5	48.2	79.5
Cons. Adj. EPS - INR	188.0	160.8	266.9
EPS Gr. (%)	-25.8	-14.4	65.9
BV/Sh. (INR)	1,603	1,691	1,894
Ratios			
RoE (%)	11.7	9.4	13.9
RoCE (%)	14.6	11.8	17.7
Payout (%)	38.5	37.3	37.5
Valuations			
P/E (x)	36.5	42.6	25.7
P/BV (x)	4.3	4.1	3.6
EV/EBITDA (x)	23.4	29.6	16.3
Div. Yield (%)	0.9	0.9	1.5

Shareholding pattern (%)

As On	Dec-20	Sep-20	Dec-19
Promoter	56.4	56.4	56.2
DII	15.7	16.8	15.6
FII	23.1	21.9	23.2
Others	4.9	5.0	5.0

FII Includes depository receipts

Stock Performance (1-year)



CMP: INR6,853 TP: NR8,700 (+27%) Buy

Demand momentum remains strong

Product life cycle to improve |Levers for margin recovery in place

The MSIL stock has underperformed (27% v/s Nifty and 23% v/s NSE Auto Index) in the last six months, impacted by market share loss and pressure on margin, despite a strong volume recovery. We see both these concerns abating as: a) product life cycle improves, and b) price increase/discount moderation drives a recovery in profitability. We expect ~30% volume growth in FY22E and positive evolution of margin. We see 27% upside at our TP of INR8,700/share. MSIL is our top Auto pick.

Demand momentum remains strong

Demand for Passenger Vehicles was stronger than expected once COVID-related lockdown restrictions were lifted due to shift in preference towards personal mobility. This was reflected in strong demand with first-time buyer (FTB) share increasing to 50% in FY21 YTD (from 45% in FY20) of domestic volumes. Domestic volumes for the industry have been higher than FY19 levels (previous peak) since Sep'20 onwards. Recovery in the PV demand would have been better, but for a sharp rise in fuel prices (~30% increase in the last eight months). This, resulted in an increase in sales of CNG vehicles.

MSIL has several drivers to grow stronger

Significant fuel price inflation resulted in customers preferring CNG vehicles due to significantly lower running costs (INR1.5/km v/s INR4.5/km for WagonR CNG v/s petrol). MSIL enjoys a substantial advantage in CNG as it offers factory fitted CNG in eight models. MSIL's CNG vehicle sales are expected to grow by 47%/59% in FY21E/FY22E. MSIL gained the most due to increase in demand from first-time buyers, driven by its stronghold in the Mini segment (where its market share increased by ~5pp in FY21 YTD to ~84). While we expect FTB share to normalize over the next 6-9 months, new launches would offset any impact of this.

MSIL's product pipeline turning favorable

One of the reasons for market share loss for MSIL (48.1% in FY21 YTD v/s 51.2% in FY19) has been the lack of new product launches, especially in the fast-growing Compact UV segment. Its last new product launch came in Sep'19 (S-Presso), which was preceded by XL6 (Apr'19). FY22 looks far more promising for MSIL, with several launches lined up for the next two years, with a mixture of full upgrades of existing models (Alto, Celerio, Brezza, Ciaz, and Baleno) as well as new model launches (Jimny, Grand Vitara, and mid-sized MUVs). These launches are focused on SUVs (all new models and Brezza), but would also address its key entry-level model Alto after a gap of 10 years.

Margin near trough, recovery would be gradual from 2HFY22E

MSIL has already seen a 300bp impact of a sharp commodity price inflation in 3QFY21. Based on spot prices of key commodities, we expect further cost inflation (of 200-250bp) in 1HCY21. We see several levers to margin from the base of 3QFY21 via price increases (~300bp), discount moderation (~100bp), operating leverage (50bp), product mix improvement (not factored into our estimate), etc. We estimate EBIT margin to improve by 220bp (over 3QFY21 levels) to 8.5% in FY23E v/s 9.8% in FY19 and a peak of 12% in FY18.

Valuation and view

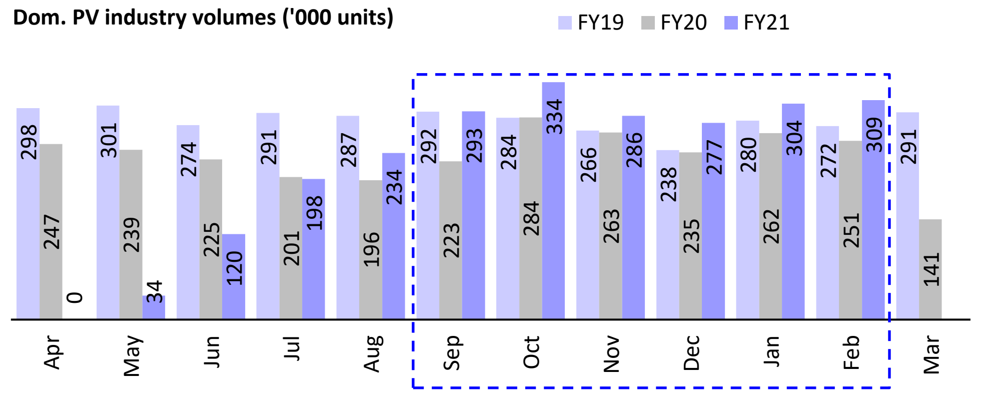
After a gap of almost 20 months, we expect new product launches to resume with a mixture of complete product upgrades (five in 2-3 years) and new model launches (three in two years). This should drive volumes and market share growth. Profitability is near the trough and margin improvement should be seen from the lows of 3QFY21. We see further improvement in dividend payouts and a resultant re-rating. The stock trades at 25.7x/21.2x FY22E/FY23E consolidated EPS. Maintain **Buy** with a TP of INR8,700 per share (27x Mar'23E consolidated EPS). Near term supply-side disruptions and further increase in key commodity prices are key risk.

Demand momentum remains strong

"Demand for used Cars has risen substantially. This is reflected in inquiry levels, which are up 15-18% YoY in a market (for new Cars) that has declined 18% so far this fiscal. The problem in the used Cars space is not of demand but of supply," said Shashank Srivastava, Executive Director, Maruti Suzuki

- Demand for Passenger Vehicles was stronger than expected once COVID-related lockdown restrictions were lifted due to shift in preference towards personal mobility. This was reflected in strong demand with FTB share increasing to 50% in FY21 YTD (from 45% in FY20) of domestic volumes.
- Demand momentum has remained strong after the initial benefit of pent-up demand. Domestic volumes for the industry have been higher than FY19 levels (previous peak) since Sep'20 onwards.
- COVID-related lockdown restrictions and work from home (WFH) have led to higher savings due to lower discretionary spending. Lower interest rates (MCLR declined by ~100bp during Feb'20 to Aug'20) and normalization in unemployment reverting to pre-COVID levels further boosted PV sales.
- Improvement in consumer sentiment since Sep'20 as reflected in Future Expectations Index being higher than pre-COVID levels.
- Limited supply of pre-owned Cars have benefitted demand for new Cars as replacement of Cars got deferred during FY21.
- Recovery in the PV demand would have been better, but for a sharp rise in fuel prices (~30% increase in the last eight months). This, resulted in an increase in sales of CNG vehicles.

Domestic PV industry volumes trend higher than FY19 levels since Sep'20



Source: Company, MOFSL

The Indian economy has successfully navigated the **"Survive to Revive"** phase over the past few quarters. Robust corporate earnings, after the pandemic-led disruption, and improving macroeconomic data indicate positive near-term prospects and have led the broader indices to new heights. Furthermore, with economic growth being the focal point, the government has rightly focused on infrastructure development.

Thus, inspired by the success of our traditional conferences, we rolled out the **'Motilal Oswal 4th Ideation Conference' – Our Emerging Companies Platform from 23rd–25th March, 2021**.

The full-day virtual conference, with matching schedules across time zones, from Asia to the US, consists of interactive sessions with 60+ corporates – as they dwell on future challenges and opportunities in store in this disruptive world.

Our guests shed light on how their respective industries are coping with the dual challenge of the pandemic and slowdown, and the way forward hereafter.

We bring you key insights from the virtual conference.

Capital Goods

Surya Roshni | (SYR IN, Mkt Cap USD0.3b, CMP INR371)

A. **Lighting:** The Consumer Lighting segment has been growing at a healthy pace, while Professional Lighting has begun to see an uptick. SYR is the second largest lighting manufacturer in India (after Phillips). It has increased its manufacturing market share recently; Professional Lighting is now expected to grow in the double digits. LED price hikes have been taken, and the management believes prices would either stabilize or rise hereafter.

B. **Consumer Durables:** SYR is one of the players to achieve the fastest INR1b sales in Fans. With huge competition in the economy segment of Fans, the management has now decided to gradually scale up the value chain. Categories chosen in this segment (Fans, Water Heaters, Mixer Grinders) are significant in size and offer huge growth potential.

C. **Debt and working capital:** The management aims to further reduce debt by INR1–1.1b in FY22 – for 9MFY21, debt was down by INR2.8b. The introduction of channel financing has aided a reduction in working capital days to 65 (from 91 days). The count of debtors in the Steel segment is moderately higher on account of exposure to the Oil & Gas segment.

Financials – Banks

City Union Bank | (CUBK IN, Mkt Cap USD1.7b, CMP INR164)

A. Most of the business segments have reached activity levels of ~90% of pre-COVID levels. Overall, CUBK remains conservative on loan growth and expects low double-digit growth for FY22.

B. On the asset quality front, the bank continues to hold its stated guidance, with the slippage ratio expected to remain at 3.0–3.5% for FY21E. On the other hand, restructuring would remain between 5–6% of loans. Furthermore, some of the sectors – such as Hotels, Passenger Transportation, and Education – are still below pre-COVID levels.

C. It prefers to be the sole lender to its borrowers; it saw a higher recovery rate on NPAs in the previous cycle and therefore expects controlled credit cost on stressed loans.

D. Outside of the southern states, it is opening up branches in Maharashtra, Rajasthan, and Gujarat.

E. It expects a marginal increase in the C/I ratio for FY22 on the expectation of lower treasury profits v/s FY21.

F. The Gold Loan portfolio comprises largely agri gold loans. It expects gold loan growth to moderate against that observed over the last few quarters – due to lending constraints in other business segments.

G. The management expects ROA to reach 1.5% by 1HFY23.

Healthcare

Granules India | (GRAN IN, Mkt Cap USD1.1b, CMP INR318)

A. **Paracetamol price update:** There has been a sharp rise in PAP (key raw material for Paracetamol) prices due to the plant shutdown in China on account of environmental issues. While the rise in raw material cost has been passed on with an increase in Paracetamol prices, the overall offtake of Paracetamol has been reduced due to constraints on raw material availability. RM supply is expected to come on line from Jun'21.

B. **Guidance**: The management is confident of achieving 20-25%/22-25% YoY growth in sales/PAT in FY22. R&D spend next year will be 2.2-2.5x from last year and the focus will be on controlled substances/niche molecules (modified/extended release). Its endeavor is to retain GMs at current levels of 52-53%.

C. **Capex:** Capacity utilization for the API plant is over 90% (except for the Visakhapatnam facility) and for the Formulations plant it is 85-90%. GRAN intends to spend on capital expenditure related to the Formulation facility. While the API facilities are optimally utilized, it plans to increase outsourcing of APIs instead of expanding its in-house facility. Overall, the management would be spending INR4b over the next two years. A considerable portion would be spent towards the construction of intermediates and a finished dosage facility (~10b capacity) in Genome valley. It has allocated spends of INR4b over the next three years in Genome valley. The investment in setting up an Onco-API plant is on track and would be operational from 3QFY22. The target asset turnover for incremental capex will be ~2x.

D. **Other highlights**: The company currently has 34 ANDA approvals. It will launch 3-4 products in the next couple of quarters. GRAN currently has 7-8 products developed using multi-unit pellet system (MUPS) technology and has received approval for two products. An additional 2-3 filings are expected in the next 12 months. The MUPS block, with a capacity of 2.5-5b FDs, would be operational from 3QFY22. Metformin contract expiry —GRAN had a contract to supply metformin with Heritage, but moved away from this contract since Dec'20. It is stocking up inventories and most sales will be visible from 1QFY21 onwards.

Infrastructure

Dilip Buildcon | (DBL IN, Mkt Cap USD1.1b, CMP INR577)

A. **Diversification:** The contribution of Roads in the total order book has declined from 90% in FY16 to ~50% currently. Diversification has also been done while factoring in the parallel use of machinery. For example, an INR45b Dam project in Gujarat required just INR0.8b worth of new machinery. Recently won mining projects are expected to contribute INR20b in revenue per year for the next 25 years.

B. **Asset monetization:** Over the next two years, DBL expects INR20b in proceeds from the monetization of its HAM projects (INR9b in FY22 and INR11b in FY23). DBL is the only company to have completed two cycles of asset monetization (24 assets were monetized in the first cycle and 12 assets in the second cycle).

C. **Debt reduction:** Proceeds from the HAM project monetization would partly be used to pare down debt at the standalone level. The management aims to be debt-free at the standalone level. Any debt taken on for growth would be at the consolidated level.

Metals

HEG | (HEG IN, Mkt Cap USD0.8b, CMP INR1546)

A. **Demand outlook:** With steel production improving across the globe, demand for graphite electrodes remains robust. The management has guided for capacity utilization of 80% in FY22 v/s ~65% in 9MFY21.

B. **Margin outlook:** With an improving demand scenario and record-high steel prices, the management is confident of a 15–20% hike in graphite electrode prices in 1QFY22. As a result, margins are likely to improve from current levels.

C. **Capacity expansion**: The company is in the midst of expanding its capacity from 80ktpa to 100ktpa. The expansion would be completed by Dec'22 and entail capex of INR12b – of which INR4.5b has already been spent and INR6.5b would be spent in FY22.

D. **Balance sheet:** The company does not have long-term debt and has a treasury of INR14.5b, yielding 6.5% p.a.

E. **Demand outlook:** With steel production improving across the globe, demand for graphite electrodes remains robust. The management has guided for capacity utilization of 80% in FY22 v/s ~65% in 9MFY21.

Others

Advanced Enzyme Technologies | (ADVENZY IN, Mkt Cap USD0.5b, CMP INR343)

A. **Human Nutrition** (75% of revenues): ADV provides proprietary enzyme products and customized enzyme solutions to various pharmaceutical and nutraceutical companies that use the ingredient as an API in their formulations. Within Human Nutrition, ADV's revenue from probiotics is expected to double in FY21 (16% of topline for 9MFY21) – it aims to expand considerably in this segment. Nutraceuticals is another key focus area; the company has a strong B2C model in the US and is trying to replicate this in India as well.

B. **Animal Nutrition** (12% of revenues): A major proportion of the revenue in this segment comes from the Indian market. ADV provides feed additives for animal nutrition, primarily catering to poultry and swine. Additives improve digestibility, thereby maximizing the nutrients animals absorb from the feed and thus reducing the overall feed cost.
Animal Nutrition has a global market size opportunity of USD7.5b, with a USD40m addressable market for ADV over the next five years. The company is targeting expansion in other Asian geographies in this segment, which has been impacted by the COVID situation – due to travel restrictions, logistic issues, higher container costs, and shipment delays.

C. **Bio Processing**: This segment contributes 13% (9% from food and 4% from non-food) to the company's revenues. The major focus areas are baking, leather, and textile processing. ADV is working on innovative solutions using effervescent tablet technology. ADV acquired this from the recent acquisition of Scitech. It is also focusing on improving Scitech's profitability, which is currently lower than that of ADV.

D. **Growth drivers:** Currently, Indian and the US together contribute almost 85–86% to revenues; 6% comes from Asia (ex-India), 7% from Europe, and around 2% from other markets. i) New launches, ii) the addition of new customers, and iii) increased traction from existing customers in the key markets of the US, EU, and India are factors expected to drive growth in revenue as well as earnings for ADV over the next 2–3 years

E. **Capex and R&D:** Routine capex is expected to be around INR100–120m per annum, with additional capex of INR300–350m over the next 2–3 years for the construction of a research facility. R&D expenses are estimated to remain at 5% of revenues.

F. **Client concentration:** The Top 10 clients contribute nearly 47% to the company's revenues. Despite losing one of its major clients in the US in 4QFY20, the company's FY21 US revenues are on par with FY20 revenues.

Antony Waste Handling Cell | (AWHCL IN, Mkt Cap USD0.1b, CMP INR264)

A. The company operates in: i) municipal solid Waste (MSW) Collection and Transportation projects, which involve door-to-door collection of MSW from households, slums, commercial establishments, and other bulk-waste generators from a designated area through primary collection vehicles like compactors, dumper placers, and tippers, and transportation of these materials to the processing facility, transfer station, or a landfill disposal site; ii) MSW processing projects, which involve sorting and segregating the waste received from MSW C&T, followed by composting, recycling, shredding, and compressing, as required; and iii) Mechanized sweeping projects, which involve deploying of power sweeping machines, manpower, and comprehensive maintenance.

B. **New contract and renewal of existing contracts:** The company is in talks with eight municipal corporations for new contracts. Of this, it is confident of at least converting two contracts. In the contracts, which are expiring, it is confident of getting them to renew as municipal corporations are quite comfortable with the existing player.

C. **Working capital:** Net working capital cycle for the company is not very high (at 45 days). Some receivables are under stress due to legacy contract work, which was entered earlier (for which arbitration is still going on). Current receivables (since CY15) have not been under stress.

D. **Guidance:** In 3-5 years, the management intends to double revenue. It expects annual CFO of INR800-900m.

Brigade Enterprises | (BRGD IN, Mkt Cap USD0.7b, CMP INR251)

A. The management expects sales of ~1-1.2m sq ft in 4QFY21 (on the highest ever sales of 1.5m sq ft in 3QFY21). For some projects, it has taken 3-5% price hikes across its Residential portfolio. This has offset the increase in material cost primarily of steel and cement.

B. The Retail segment is improving QoQ as footfalls revive back to 70-80% of pre-COVID levels. Office lease rentals are received on a regular basis – ~99% of pre-COVID leasing amount has been collected. The second wave of COVID-19 has delayed the signing up of additional Commercial leasing (may take 2-3 quarters). Decent occupancies across Hotels – operational breakeven likely to be achieved during 4QFY21. Recovery to pre-COVID levels will depend upon resumption of travel on the back of the vaccination drive.

C. During the next three years, the company will have a portfolio of 10m sq feet on the leasing side. This will generate additional revenue of INR9-10b. Land bank snapshot: Current land bank stands ~50m sq ft – majority of which is in Bengaluru and in the Residential segment. It has been scouting for additional land parcels. It plans to incur INR5-5.5b on capex over the next 2-3 years.

D. Debt profile and financials | Leasing debt: ~INR3.2b (INR1.7b of debt is moved to LRDC), Residential debt: ~INR6.08b, Hospitality debt: ~INR5.8b. Until the company completes the twin towers (in Bengaluru), it may add some more loans. Debt-to-equity ratio currently stands at 1.27x (the management would be comfortable till ~1.5x).

Blue Dart Express | (BDE IN, Mkt Cap USD1.6b, CMP INR4962)

A. **Air logistics:** This remains the dominant business for Blue Dart, with 50% market share. However, the business has challenges as it is a costly service, and during economic downturn, customers do not prefer air shipping as it is a premium service.

B. **E-commerce**: Volumes are rising as online shopping continues to grow; e-commerce shipments form 19–20% of the total revenue, which has increased to 20%+ during the lockdown.

C. **Ground logistics**: The company is the fourth largest player w.r.t. on-ground deliveries (with 16–17% market share). The management is focusing heavily on this segment, supported by increased road connectivity on account of favorable government policies. The company looks to expand in 500+ cities, industrial areas, and parks – which have immense potential.

D. **Minimum wage law**: The minimum wage law would result in increased employee costs. The company's minimum wage stands at INR12–15k/month, and the law may revise the minimum wage to INR16–18k/month; hence, this would have a low impact on the company.

E. **Crude oil impact:** The oil price impact remains neutral due to additional surcharge levied by the company. The additional surcharge is dependent on oil prices and is passed onto consumers (revised on monthly basis depending on oil prices). Thus, logistic costs remain hedged from oil prices.

F. **Outlook**: Revenue is expected to expand at a 13–15% CAGR over the next 3–5 years. Operating profit margins should reach 10–11% on a sustainable basis – this would increase as volumes rise, and leverage would help increase the profitability of the business. We expect aircraft logistics to expand in the high single digits over the next 4–5 years, while ground logistics would increase in the mid-double digits.

Pricol | (PRICOL IN, Mkt Cap USD0.1b, CMP INR66)

A. **Driver information systems and sensors – potential growth driver**: The 'digital and connected' cluster is expected to be a growth driver for the company going forward. It is a market leader in this segment, and around 65% of revenue is generated from this segment. The shift from the mechanical to electronic cluster in vehicles has led to an increase in content (3–4x).

B. **Pumps and allied products**: Due to the transition from BS4 to BS6, some products have turned mandatory for vehicles (such as the purge valve and fuel pump module in 2Ws). The company supplies pump modules to major domestic and international 2W OEMs. The revenue contribution from this segment stands at around 35%. Redundancy is low in this product category (5–7 years). To de-risk itself from EVs, the company has started supplying large pumps for recreational vehicles, generators, and tractors.

C. **Revenue contribution:** 2W OEMs contribute around 65% to revenues (BJAUT, HMCL, and TVSL – top 3 customers); it is fully ready to face the EV disruption with the connected instrument cluster. PVs account for 10% of revenues and CVs ~15%.

D. **New products:** Contribution to overall revenues for 9MFY21 was ~40% (v/s 10–15% normally), driven by BS6 as well as the electronic cluster. The company has a strong order book for the next 2–3 years, driven by new products such as the electronic cluster for 2Ws/CVs/PVs, larger pumps, and exports. The company is set to grow ~20% over the next couple of years and targets an EBITDA margin of 10–13% at minimum (v/s ~15% in 3QFY21).

E. **Surging price of electronic components:** This is hurting the company, but it is mitigating the supply risks by paying a higher price. This price cannot be directly passed on to the customer – it passes on price hikes with a six-month lag. This would put pressure on margins in the foreseeable future.

F. **Prudent capital allocation:** The company is being judicious with allocating capital as it has completely divested from its loss-making overseas operations in Mexico and Brazil (Feb'20) and the Czech Republic (Aug'20). Moreover, after the last 3–4 years of heightened capex to prepare for the BS6 transition, it expects the capex intensity to be substantially lower over the next three years (<INR0.5b p.a). From the current capacity, it can grow revenues to ~INR20b p.a. and would need to debottleneck even more to achieve further growth.

G. **Exports:** The business is expected to grow, driven by new orders from global suppliers such as Caterpillar, HD, Ducati, BMW, KTM, Deutz, Polar, Renault/Nissan, and PSA.

Vidhi Specialty Food Ingredients | (VSFI IN, Mkt Cap USD0.1b, CMP INR189)

A. **Capacity expansion:** The company is undergoing aggressive expansion plans, with two new facilities, one in Dahej (greenfield), with a capacity of 360MT per month, and another at its existing unit in Roha (brownfield), with a capacity of 350MT per month. The first phase of Roha facility involves installation of 200MT facility. Post completion, the second phase involves 150MT capacity. VFSI expects to receive EC in the next 30-45 days. Commercial production of Phase I is expected to commence in the next 6-8 months.

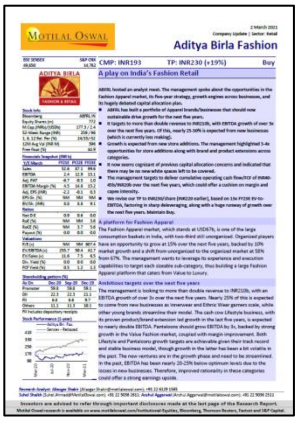
B. **Margin:** VSFI managed to improve margin from historical levels of 13-14%. This is due to increase in the ratio of manufacturing turnover to trading turnover. Earlier, it imported RM higher than its requirement, which was used for trading purpose (after meeting its manufacturing requirement). With an increase in demand and throughput, material imported for trading was used for manufacturing, leading to an improvement in margin.

C. Phase I unit will be utilized for manufacturing of new products. Post commencement of operations, the same is expected to improve overall margin. The Phase II unit will be utilized for manufacturing of its existing product portfolio to meet increasing demand.

D. Out of global consumption of food colors, ~20% share is occupied by natural colors, while the rest is dominated by synthetic colors. The size of the global synthetic color market is 50,000MTPA, of which 3,600MTPA is managed by VSFI. Going forward, the company aims to increase its capacity by 3x over the next 2-3 years.

Retail

Our earlier retail update

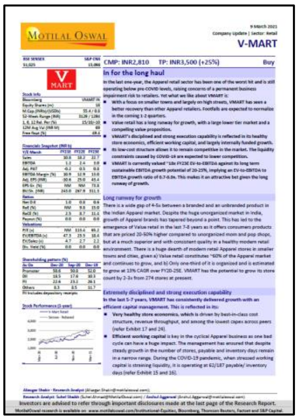

2 March 2021

Company Update | Sector: Retail

Aditya Birla Fashion

CMP: INR193 TP: INR230 (+19%) Buy

A play on India's Fashion Retail


9 March 2021

Company Update | Sector: Retail

V-MART

CMP: INR2,810 TP: INR3,500 (+25%) Buy

In for the long haul

Slow recovery, increase in RM costs cast shadow on retailers

After steady recovery in sales in the festive season (in 3QFY21), the Retail industry is witnessing positive trends such as the resumption of store adds and improving WC and leverage positions. However, factors such as softness in recovery trends (given the rise in COVID cases) and the risk of increasing RM costs remain deterrents. The recent correction does offer a better entry point in these stocks – especially given their better competitive positions and balance sheets, and the potential growth in retail stocks. Nevertheless, we believe the market exuberance may cool down until we see revival in revenues over the next six months. Here are the key takeaways from our channel checks.

Revenue recovery slow and gradual

Over Jan–Feb'21, retailers across categories, barring QSR and Consumer Durables, continued to deliver revenue below the last year's base pre-COVID. Apparel companies, particularly, reported the highest revenue declines (v/s last year) at 15–20% (Exhibit 3). The impact of the second wave of COVID in some regions, followed by government restrictions, has been lower on store operations. However, footfall has been slow and, in turn, derailed the MoM sales recovery trend seen up to Dec'20. We continue to see a better trend in high-street stores and tier 2/3 city stores than large-format stores and metro / tier 1 stores. Yet, the favorable base in March – due to 10- to 15-day store closures in the corresponding quarter, coupled with festive shopping expectations – could see March at around 100–110% of last year's sales. Subsequently, we expect ABFRL/Trent/V-Mart to post 3%/12%/8% YoY revenue growth in 4QFY21. Grocery retailers such as DMart have recovered with 100–105% of LTL sales over Jan–Feb'21; in 4QFY21, it is expected to report over 20% growth, benefiting from a favorable base due to last year's lockdown impact. Sales trends in Trent are likely to benefit from fewer Westside stores in malls. Zudio's strong performance is attributable to customer downtrading and 35 store additions (44% YoY) in YTDFY21. In ABFRL, the Retail business in Lifestyle continues to perform better. However, Pantaloons – which has large-format stores and a high proportion of stores in malls – may see slower sales recovery. V-Mart should benefit from its higher share of stores in tier 2/3 cities.

Store adds resume steadily

Weak throughput is rendering the Real Estate market conducive for retailers. A lower competitive intensity has curbed irrational rental deals at prime locations. Subsequently, retailers with better liquidity positions have commenced store additions at a steady pace. We expect Westside to add 6, Zudio to add 14, and V-Mart to add 7 stores in 4QFY21. Furthermore, the managements of retailers have indicated that retailers would resume a steady rate of 15–20% store additions from FY22E (as in the pre-COVID era).

Escalating RM costs a red flag

At this time when apparel demand is still sluggish, the surge in raw material prices remains a big dampener. Cotton yarn and crude-based fabric prices have rallied nearly 30% in the last six months. Typically, fabric costs contribute 25–35% to the total raw material cost – depending on the category of the apparel player. Hence, this could result in an 8–10% increase in overall raw material costs. Old inventory may have cushioned the impact up to Feb'21; however, the impact of rising RM cost should start reflecting from Mar'21. Based on our discussion, retailers may gradually endeavor to pass on the cost increase from 1QFY22. However, given the weak demand scenario, it may take a couple of quarters to fully pass on the increase in cost, thus potentially impacting gross margins by 150–400bps.

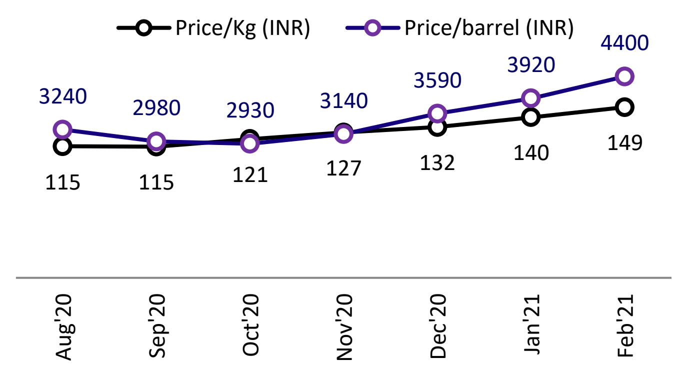
Sales recovery alleviating working capital stress, improving balance sheet

The high inventory position has largely relaxed over the last six months and payables have normalized. We observe large retailers have taken advantage of the COVID disruption to now operate with a leaner inventory and payable days. This has given them multiple advantages in the form of better commercial terms, product availability, and quicker design turnaround. This would further enable larger retailers to improve their competitive positions and gain market share. Also, curtailed cash burn, along with the easing of liquidity, should improve the leverage positions of retailers across the board.

Valuation

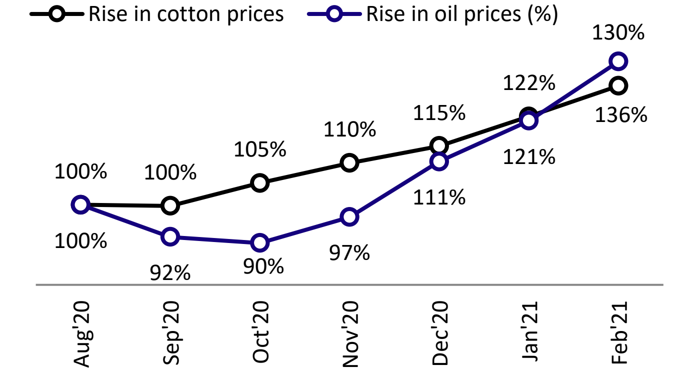
The Retail industry still faces the risk of increasing commodity costs and is yet to come out of the woods completely. Hence, in terms of pre-COVID scale, the rich valuation certainly raises concerns – DMart is trading at FY23E EV/EBITDA of 47x and apparel retailers Trent, ABFRL, and V-Mart are trading at FY23E EV/EBITDA of 32x, 13x, and 18x, respectively. Over the last month, retail stocks have corrected 10–20%, offering a better entry point – especially given their better competitive positions, balance sheets, and growth expectations, which could provide strong tailwinds once the market has revived. Nevertheless, we feel the market exuberance may cool down and upsides may be capped until we see revival in revenues over the next six months.

Cotton/Oil prices on continuous uptrend



Source: MOFSL, Company

Cotton/Oil prices up by 30%/36% in the past six months (rebased to 100 in Aug'20)



Source: MOFSL, Company

JSW Energy: Looking to raise $750 mn for our hydro operating assets; Prashant Jain, Jt MD & CEO

- Looking to raise $750 m for our hydro operating assets
- Expect to hit the market over the next couple of months
- Will know about the pricing of bonds once we hit the market
- Part of the proceeds will be used to retire some debt
- Company is generating cash profit of Rs. 2000 crore which will be used in capex
- Our net debt will move up because of projects on ground
- Have planned capex over the next 24 months as more of our projects come into play
- March demand growth is 24% YoY
- Average merchant tariff is now at Rs. 4.5 per unit; merchant power tariffs peaked at nearly Rs. 9 per unit
- We are at an 8-quarter low when it comes to receivables
- 60% of our portfolio will soon be from receivables segment

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Minda Industries: Running at more than full capacity levels, need expansion to meet demand; Sunil Bohra, ED & Group CFO

- Wil expand capacity to 180 wheels from 120 wheels a month in Haryana
- Lightening plant will be a greenfield plant in Gujarat
- Expansion will come on stream in FY22
- Both plants should start production in FY22
- Need surplus capacity in alloy wheels
- Company running at more than full capacity levels
- Need expansion to meet increasing demand
- See increased demand in aftermarket sales
- Expanding capacity to meet the order inflow we have already received

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Mahindra Lifespace: Potential sales value for Kalyan Project is seen at Rs. 600 crore; Arvind Subramanian, MD & CEO

- Current project acquired is close to the project acquired in 2019
- Kalyan project will have 7 lakh sq ft carpet area and will be launched next year
- Potential sales value for Kalyan project is seen at Rs. 600 crore
- Will spend Rs. 400 crore on land and construction cost for Kalyan project
- If launched in CY2021, will be able to deliver Kalyan Project 4 years after that
- Prices in Kalyan have gone up by 8-12%
- Strong resurgence in demand for residential real estate sector is seen now
- Definite steps taken by customers to get new flats

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Blue Star and Daikin India: Blue Star expects 25% growth in Q4; sales improving for Daikin as well; B Thiagarajan, MD (Blue Star) and Kanwaljeet Jawa, MD & CEO (Daikin India)

- Witnessed 17% growth in Q3, expecting 25% growth in Q4 (Blue Star)
- Aiming to pump in more in Tier-II, III and IV towns (Blue Star)
- Not possible for us to absorb the commodity price rise (Blue Star)
- Hike prices by around 5-8% from January 1; will further hike price by 3-5% from April 1 (Blue Star)
- Seeing good demand both in urban and rural areas (Daikin India)
- Think AC industry can drive Rs. 1 lakh crore of revenue going ahead (Daikin India)
- Market may inch up to 12-13 m units in FY22 from 7 m units in FY19 (Daikin India)

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FASTER INFLATION IS COMING. HOW BAD WILL IT BE?

- An economic debate that has been heating up for a few weeks in markets and the academic world made a notable appearance in Congress last week when lawmakers questioned Federal Reserve Chair Jerome Powell and Treasury Secretary Janet Yellen about inflation. This is understandable given that the answers about the scale, scope and duration of a possible surge in inflation have implications that go well beyond economic well-being and the country's borders.
- Economists are mostly split into three camps when it comes to higher inflation, which has not been on the radar screen in any meaningful sense for more than a decade. The first camp, which seems to include both Powell and Yellen, considers any surge in inflation as primarily transitory with few if any consequential spillovers. The second thinks it could be a longer-lasting phenomenon whose potentially wider and more risky consequences would, nevertheless, be temporary and reversible. The third one fears that higher inflation could prove to be a more durable and consequential problem with multifaceted domestic and international effects.
- All three camps agree that, statistically, the US will experience a notable pickup in the measured inflation rate. This is due to "base effects"— comparison with an abnormally low number in a previous period; in this case specifically, the readings that followed the Covid-related lockdown a year ago were particularly stunted.
- Should they remain essentially statistical anomalies, the higher inflation rates should have minimal consequences in the short term and none over the longer one. This is where the first camp loses interest in the inflation debate; it doesn't see it posing any challenges either to the Biden administration's fiscal plans or the Fed's continued pursuit of ultra-expansionary policies.
- The two other camps think that the base effects will be amplified soon by what, in the old inflation literature, was known as demand-pull inflation. Here, a boom in both private and public demand outpaces the ability of the supply side to respond, putting upward pressure on prices. Already, there are initial signs of supply bottlenecks and higher transportation costs, most of which appeared before last week's blockage in the Suez Canal, which is now disturbing supply chains more meaningfully and, once again, highlighting their lack of resilience.
- The combination of base effects and demand-pull would likely keep the inflation rate above the Federal Reserve's 2% target for a few months after years of undershoots. The third camp thinks that either the prospect or emergence of such an outcome would, in turn, alter inflationary expectations and related behaviors, adding a "cost-push" element to the inflationary dynamic. This would be supported by structural changes in the production and labor landscapes, including intensified corporate concentration, deglobalization, disrupted movement of people and more skill mismatches.
- Seeking to protect their profits from higher input costs and emboldened by lower internal and external competition, companies would opt for preemptive price increases. Meanwhile, wage earners would also seek to protect themselves, reminiscent of the "real wage resistance" of a few decades ago.

- The third camp's scenario, with its possibility of a self-feeding dynamic that would keep inflation high and rising, would pose bigger risks for the country's longer-term economic and social well-being. The Biden administration's drive to reshape the economy, a main driver in the transition of fiscal intervention from relief to recovery, would risk being delayed if not derailed. This would add to inflation's regressive influence on American society which, by imposing a disproportionate burden on the less fortunate segments, would worsen an already concerning inequality trifecta of income, wealth and opportunity. And all this would be taking place in the run-up to the 2022 midterm elections.
- Meanwhile, the Fed would find itself fighting criticism of a discredited policy framework revision that naively shifted its emphasis too far away from preemptive measures based on inflation forecasts to reactive ones based on outcomes. In this scenario, the Fed would probably feel compelled to hit the brakes hard, risking what would still be a less than full and sufficiently inclusive recovery. All of that would be bad not just for the U.S. but also for the global economy and markets.
- The third scenario is not the only one posing risks. Even the second, more benign one does because of possible market reaction. While economists and the Fed would view a spike in inflation through a longer lens, markets might well end up living more in what Bloomberg's Jonathan Ferro labels "the moment" — that is, reacting in the short term by rapidly taking bond yields higher and risking to destabilize stocks and other risk assets that have benefited enormously from the widespread market confidence in continuing ample and predictable liquidity injections. Coming at a time of excessive and, in some cases, irresponsible risk-taking, this could have adverse economic spillovers.
- Such effects would be felt well beyond the U.S. Already, European Central Bank officials have complained about the "undue tightening" of euro-zone financial conditions because of higher U.S. bond yields. This has also contributed to a slowly widening cycle of interest rate increases by central banks in emerging economies.
- In assessing all this, I end up with rather high conviction that the US will experience rising inflation in the next few months because of base effects and demand-pull. While, on balance, a subsequent phase of significant cost-push effects is not strictly in my baseline, it is enough of a meaningful threat to require close and frequent monitoring. With that comes the risk of higher market volatility and, on the political front, the prospects of more heated congressional deliberations on economic and social well-being that could make subsequent fiscal packages harder to pass quickly notwithstanding their importance for a lasting U.S. recovery.

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