September 1, 2022

INDIA REWIND

DSP INVESTMENT MANAGERS

India Rewind is a monthly update from DSP's Investment desk. It separates the alpha from the noise and aims to deliver key insights to readers, packed within a 2 minute reading time.

2022 could very well become a *tale of two halves*. While in HY22 MSCI India USD was down ~-15.7%, a sharp rebound of ~13.5% came from the end of June-Aug 2022. For YTD/Aug'22, MSCI India USD Index returned ~-4.3%/3.9%, MSCI India Smallcap Index returned ~-9.8%/5.1% sharply outperforming MSCI EM ~-19.3%/0.03% and MSCI DM ~-18.7%/-4.3%. As highlighted last month, the trend reversal continues in FII flows with an inflow of ~USD 7bn since the end of last quarter (best since Dec'20). Financials and Utilities emerged as the preferred sectors for the FIIs. After the recent inflows, FII outflows YTD is now ~USD 21bn while domestic inflows have remained extremely strong at ~USD 30bn. The monthly systematic flows have remained on an average ~USD 1.5bn which depicts a change in behavior of retail investors, continuing investing despite the market volatility. MSCI India now trades at 21.6x, 1SD above its long-term average with a premium of ~2-3 SD above World and EM. While India commands a premium, it remains the fastest growing large economy despite the dark clouds of global recession and slowdown. India's GDP is expected to grow by ~7.1% in FY23 compared to World GDP at ~2.5% and average EM peers at ~3.5%.

How did Indian companies perform in the 1QFY23 (June 2022 quarter)?
MSCI India's net profit grew 12% YoY (vs. 21% YoY in the previous quarter). 45% of the MSCI India companies missed street expectations, 16% reported in line while 38% beat expectations. Financials contributed the most to profit growth (12pp) while commodity-related sectors (energy, metals, and mining) posted a drag on the profits. Margins pressure was witnessed across sectors (MSCI India's ex-financials overall margin contracted by ~300bps QOQ), making this the sixth consecutive quarterly decline in EBITDA margins *(please see chart of the month)*
Post the recent ~2% downgrades, MSCI India's earnings are expected to grow ~15% in FY23 and ~14% in FY24 (vs. 17%/13% earlier expectations). There was a wide sector and stock disparity observed in MSCI India index, while telecom, utilities saw the largest positive earnings surprise, energy and industrials saw the largest negative surprise. On the other hand, cement and utilities have the largest proportion of stocks beating estimates and pharma witnessed the largest number of misses.

Based on the earnings transcripts and our analysis of key stocks and sectors, a few common themes emerge related to demand and margins. Here is a quick snapshot of our analysis:

- **Margins pressure continues but expect relief as commodity prices cooled off in recent months:** Despite the calibrated price hikes, most companies across sectors continue to face margin pressure amid rising input costs and rupee depreciation. Managements remain hopeful of sequential margin improvement as commodity prices eased since late May. Auto companies now expect chip supply to improve further from 2QFY23 onwards.
- **Urban consumption remains strong while the rural economy still facing the heat:** Consumer companies saw improvement in revenues partly driven by pricing with urban demand continuing to outpace rural. Managements remain hopeful of a recovery in rural demand in the near term given normal monsoon good harvest and MSP increases.
- **Consumer services/re-opening pockets seeing strong demand trends:** With the covid-related headwinds largely behind us, companies in the entertainment (mainly movies), travel and hotel industries saw strong pent-up demand. Banks also noted a strong pickup in consumer discretionary spending (via cards) driven by seasonal/summer travel and a pickup in personal loans due to increased consumption demand. Automakers witnessed a revival in passenger car demand led by new launches across the car manufacturers.

Fed shifts focus back on Inflation: The hawkish comments of the US Fed chair at the Jackson Hole Symposium may correct the market's perception of US Fed easing in rate hikes in near future. The focus shifts back to bringing down inflation even if that can hurt economic growth in the near term. **How does this impact India?** The RBI may further go for a rate hike which may have near term impact on the capex spending in India (as credit cost inches up), overall liquidity in the system may face a challenge and slowdown in the global economy which also hurts India's export (currently India is ~2.5% of world export). The domestic economy (business top line, demand and earnings, overall tax collection) in India has remained resilient so far which provides comfort for India's GDP growth in FY23.

Chart of the Month: MSCI India 1QFY23 Profits up 12%YoY, Sales up 32% YoY, Ex-Financials profits were flat.

MSCI India	Reported Cos.		Earnings growth		Sales growth		EBITDA margin	
(1QFY23 earnings)	Sector weight (%)	# of Cos.	YoY (%)	QoQ (%)	YoY (%)	QoQ (%)	1QFY23 (%)	QoQ (bps)
Financials	24%	21	49%	(8%)	(6%)	(22%)	-	-
InfoTech	17%	9	1%	(7%)	21%	7%	22%	-153
Energy	13%	7	(31%)	(74%)	49%	(5%)	7%	-384
Staples	9%	11	21%	(3%)	24%	7%	21%	-79
Consumer Disc.	9%	15	(8%)	(76%)	32%	8%	8%	-302
Utilities	6%	9	15%	(12%)	60%	28%	26%	-693
Cement/Other Mat.	6%	11	22%	(13%)	37%	(7%)	20%	-30
Industrials	5%	9	139%	(14%)	67%	(9%)	13%	-254
Healthcare	5%	9	4%	34%	3%	(1%)	22%	+514
Telcos	3%	3	60%	(22%)	20%	4%	48%	-320
Metals & Mining	3%	5	(17%)	(26%)	25%	(9%)	21%	-132
MSCI India	100%	109	12%	(24%)	32%	(3%)	-	-
MSCI India- (ex financials)	76%	88	0%	(30%)	38%	(1%)	14%	-284

Chart Source: Goldman Sachs, Sources: Internal, Bloomberg, UBS Research FII - Foreign Institutional Investor, DII- Domestic Institutional Investor, FY - Financial Year, CY – Calendar Year; YoY is Year over Year, YTD- Year to date, QoQ – Quarter on quarter EM- Emerging Markets, DM- Developed Markets, EBITDA – Earnings before interest, tax, depreciation and amortization., Cos - Constituents

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For past Issues, please see below:
India Rewind August 2022
India Rewind July 2022
India Rewind June 2022
Older Issues

We hope you found this note interesting and welcome your feedback on InvestmentStrategists@dspim.com

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India at a Glance

	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Economic Activity and Employment								
GDP, USD bn	2295	2651	2701	2871	2668	3174	3446	3770
GDP per capita, USD	1767	2018	2036	2141	1969	2318	2439	2701
Real GDP growth, %	8.3	6.8	6.5	4.0	-6.6	8.7	7.0	6.0
Prices, interest rates and money								
CPI inflation, % y/y (average)	4.5	3.6	3.4	4.8	6.2	5.5	6.7	5.0
Repo rate, % (year-end)	6.25	6.0	6.25	4.4	4.0	4.0	6.0	6.0
10 year bond yield, % (year-end)	6.7	7.4	7.4	6.1	6.2	6.8	7.7	7.5
USDINR (year-end)	64.8	65.0	69.2	75.4	73.5	75.8	80.0	82.0
Fiscal accounts								
General government budget balance, % GDP	-7.0	-5.9	-5.9	-7.8	-13.9	-10.7	-10.2	-9.5
Balance of payments								
Trade balance, USD bn	-112	-160	-180	-158	-102	-192	-254	-247
Exports, USD bn	280	309	337	320	296	422	453	430
Imports, USD bn	393	469	518	478	398	615	707	677
Current account balance, USD bn	-14	-49	-57	-25	24	-50	-102	-96
Foreign direct investment (net), USD bn	35.6	30.3	30.7	43.0	44.0	39.9	35.6	38.1
Total FX reserves, USD bn	370	425	413	478	577	607	540	520
Total external debt, % GDP	20.5	20.0	20.1	19.5	21.4	20.8	20.5	20.4
Credit ratings								
Moody's	Baa3	Baa2	Baa2	Baa2	Baa3	Baa3	Baa3	Baa3
S&P	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-
Fitch	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-	BBB-

Source: CEIC, Haver, UBS estimates; Note: Data is for FY ending March, E - Estimates