LIGHTHOUSE CANTON

India Macros and Markets

Prepared by LC Capital India

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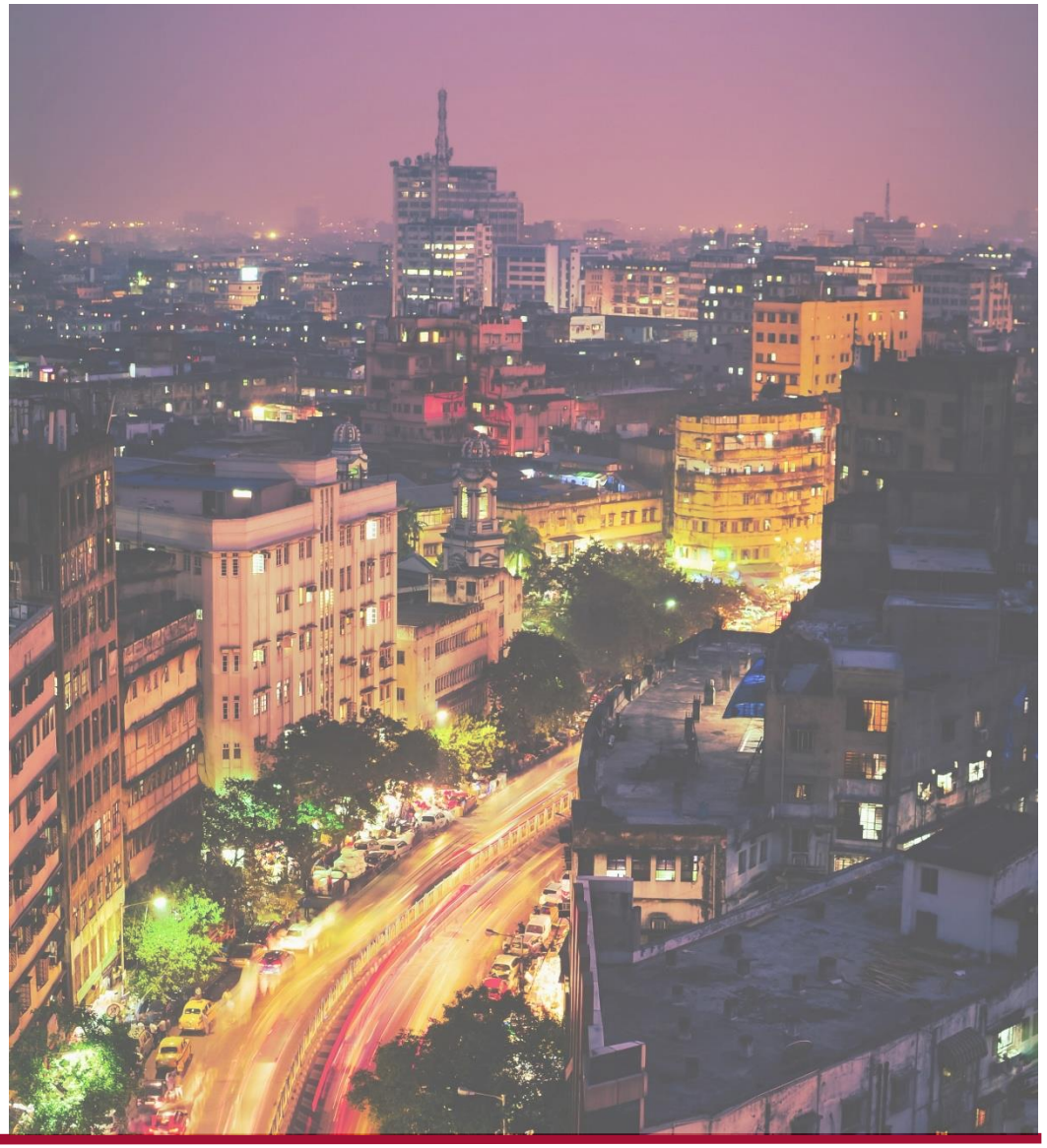
Executive Summary

- Since June 2020, India's economy has seen an ***ongoing transition between reflationary and disinflationary*** regime.
- Most of the high frequency indicators currently point ***towards a recovery*** after a brief slowdown due to 2nd wave of pandemic.
- ***Growth in consumption*** would depend upon the ***employment and spending***. Currently the ***outlook*** on both fronts look ***weak***.
- ***Lower private capex*** is attributed to ***lower capacity utilization.***
- Increase in ***demand***, ***improvement*** in ***corporate balance sheet***, ***revival in bank lending*** could lead to a ***transition*** towards higher capex.
- Recent ***revival*** in ***government and states spending*** would help to ***kick start demand***.
- India's ***exports*** would ***benefit from revival in global growth***. As more economies have recently opened up, we have seen a jump in India's exports (March and May 2021 have seen 5% and 15% rise respectively on quarterly basis).
- Although ***valuations*** may ***not be supportive*** but from ***historical relative price*** basis mid and small cap stocks still looks attractive.
- As per the latest research published by MOSL, ***Q1FY22 earnings for Nifty*** 50 ***companies*** have been strong – ***Sales and PAT on YoY have grown by*** 50% ***and*** 101% ***respectively***.
- ***Expectation of revival in government spending and private capex*** would help to ***incentivize economic growth, drive sales and profitability of companies*** which may support higher valuation.
- We expect ***cyclical sectors*** like Real estate, Capital goods, Banks, Metals, Oil & Gas, Industrials to be the big beneficiaries of sustained recovery in India's economy. Top ***sector bets of FIIs and DIIs*** also gives us the comfort level.

Contents

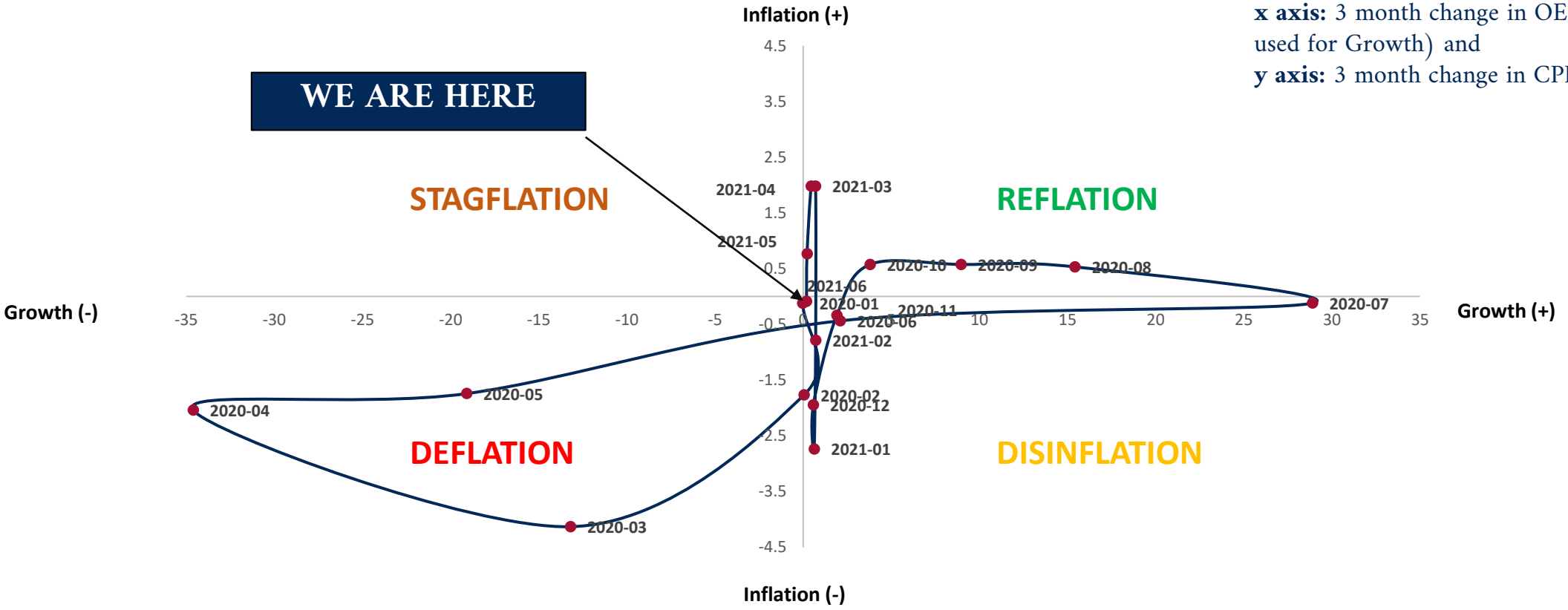
- State of India's economy?
- Big Picture – What are the high frequency indicators stating about the health of the economy?
- Focus on various components of GDP – consumption, private capex, government spending and net exports
- Focus on earnings, valuation and positioning in equity markets and outline factors which could impact interest rates
- Key Risk – Decline in pace of vaccines administered



India – Reflation or Disinflation, Whither?

With exception to Mar, Apr and May 2020, Indian economy has spent most of the time in reflationary or disinflationary cycle.

x axis: 3 month change in OECD CLI (indicator used for Growth) and
y axis: 3 month change in CPI



Source –OECD, LC Capital India | Data as on June 2021

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Big Picture View on India's Macros

Charts on High Frequency Indicators: Are green shoots visible?

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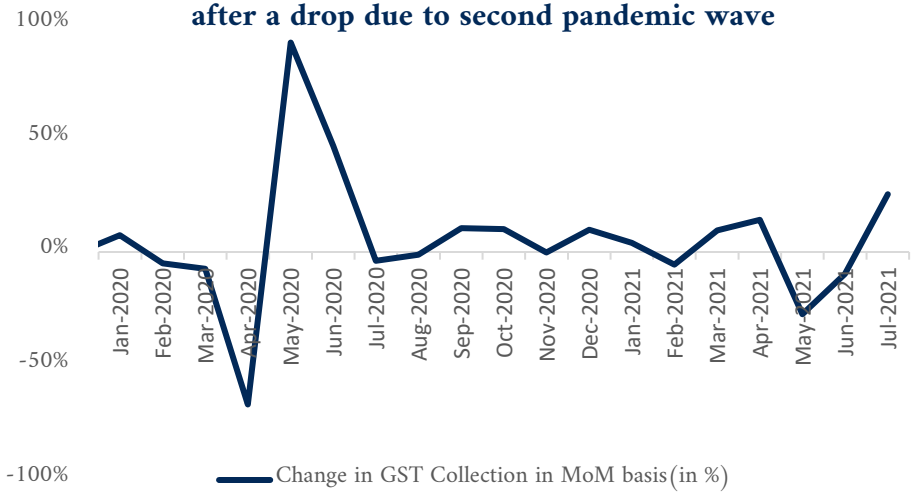
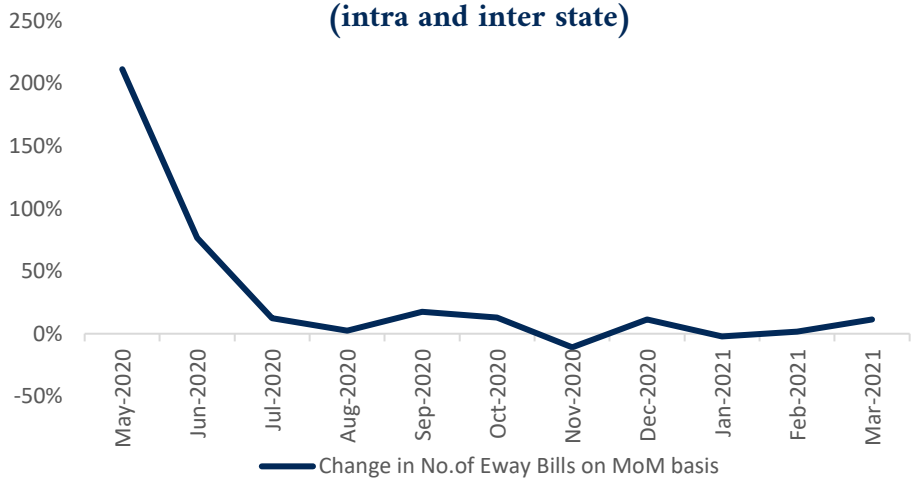
India's economy has recovered post the slowdown due to first and second wave

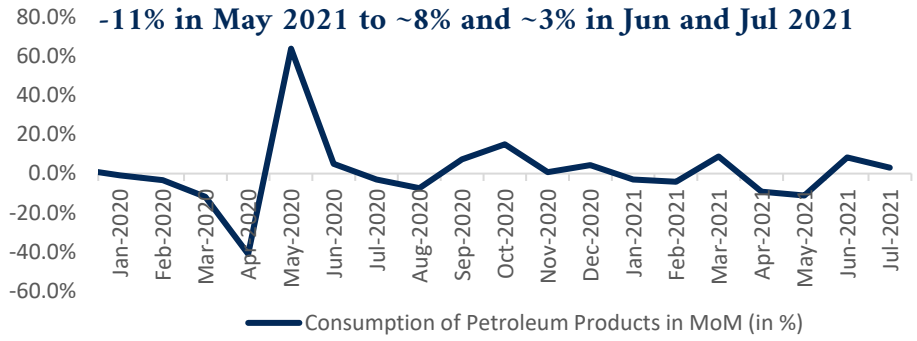
GST Collections have recovered in Jun and Jul 2021 after a drop due to second pandemic wave



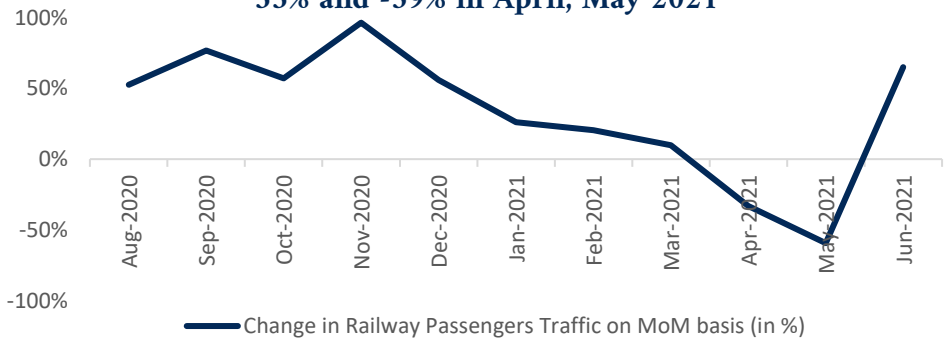
....The recovery is also witnessed in no. of e-way bills (intra and inter state)



Petroleum products have also recovered from -11% in May 2021 to ~8% and ~3% in Jun and Jul 2021



Railway traffic has moved up by 65% in June 2021 vs -33% and -59% in April, May 2021



Source –Bloomberg, CEIC, GST, LC Capital India

Charts on High Frequency Indicators: Recovery in autos?

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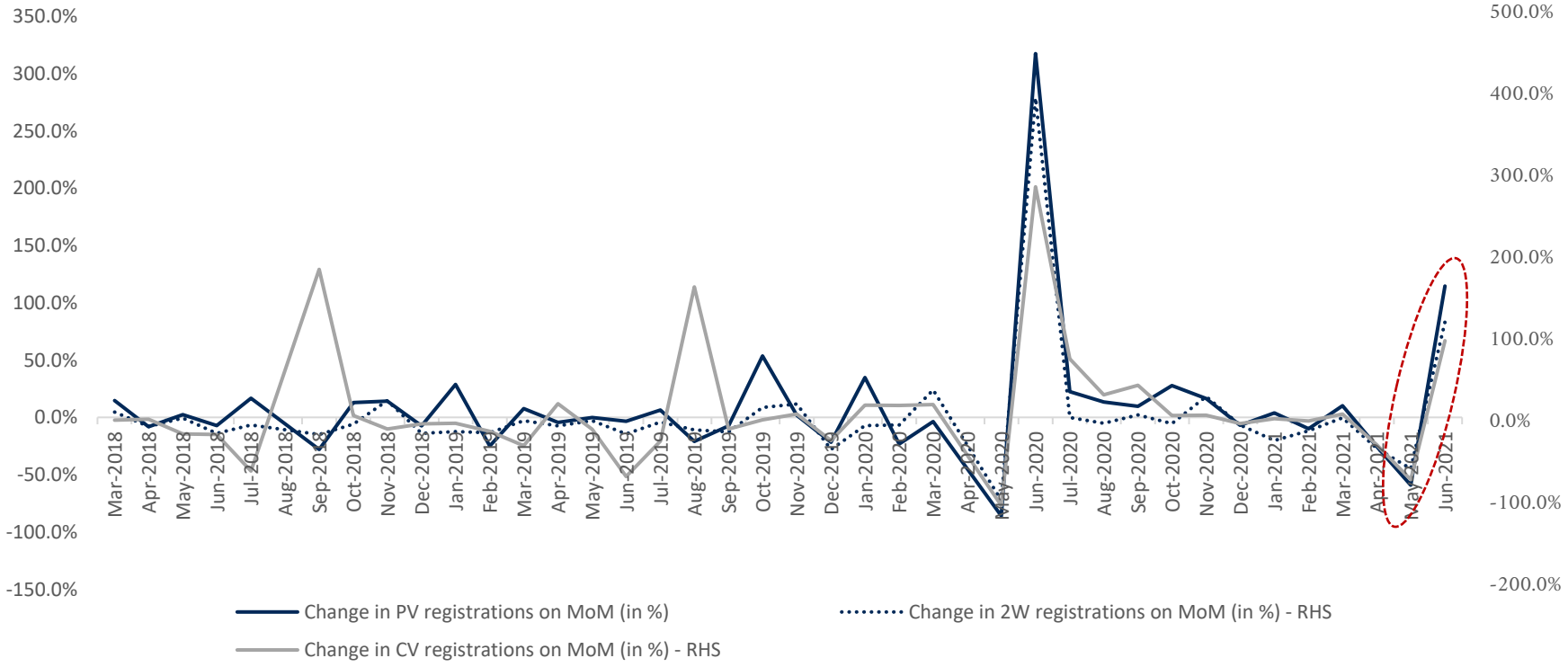
Strong recovery in auto sales witnessed in June 2021

Sales of Passenger Vehicle, 2-Wheeler and Commercial Vehicles have jumped up by more than 100% in Jun 2021 primarily because of the pandemic impact in Apr-May 2021



Source –Bloomberg, CEIC, GST, LC Capital India

Charts on High Frequency Indicators: Recovery in retail transactions?

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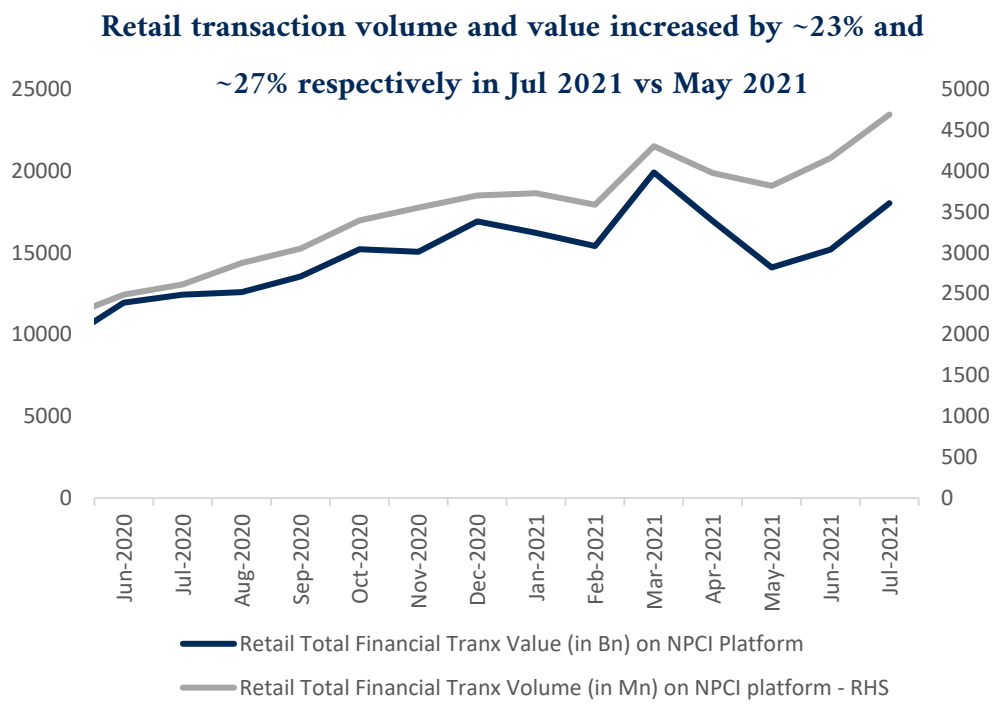
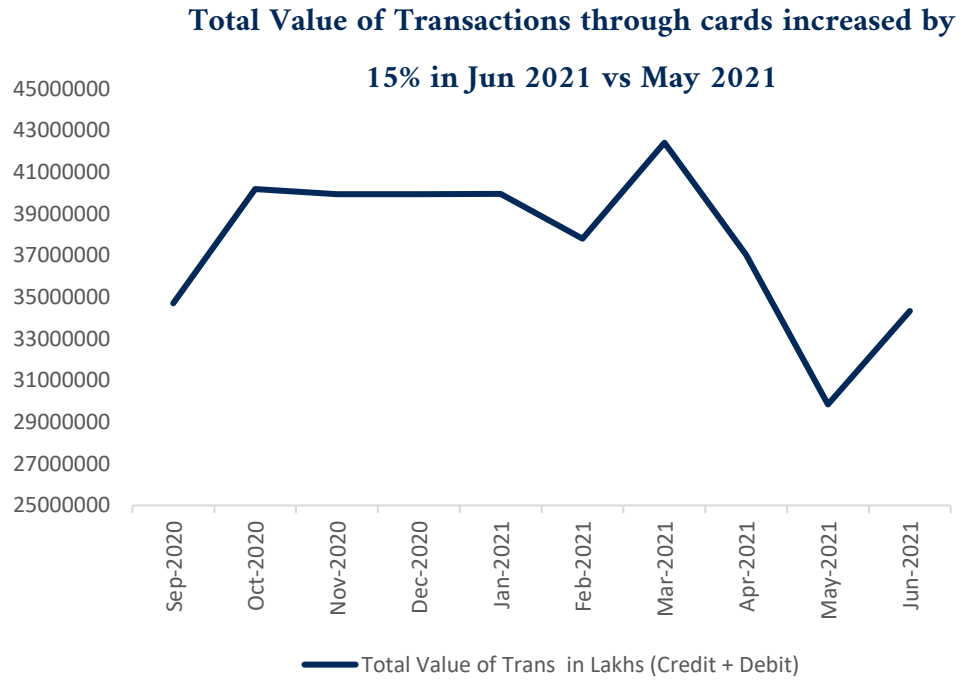
Increased transactions through cards and on NPCI platform reflects stronger organized activity



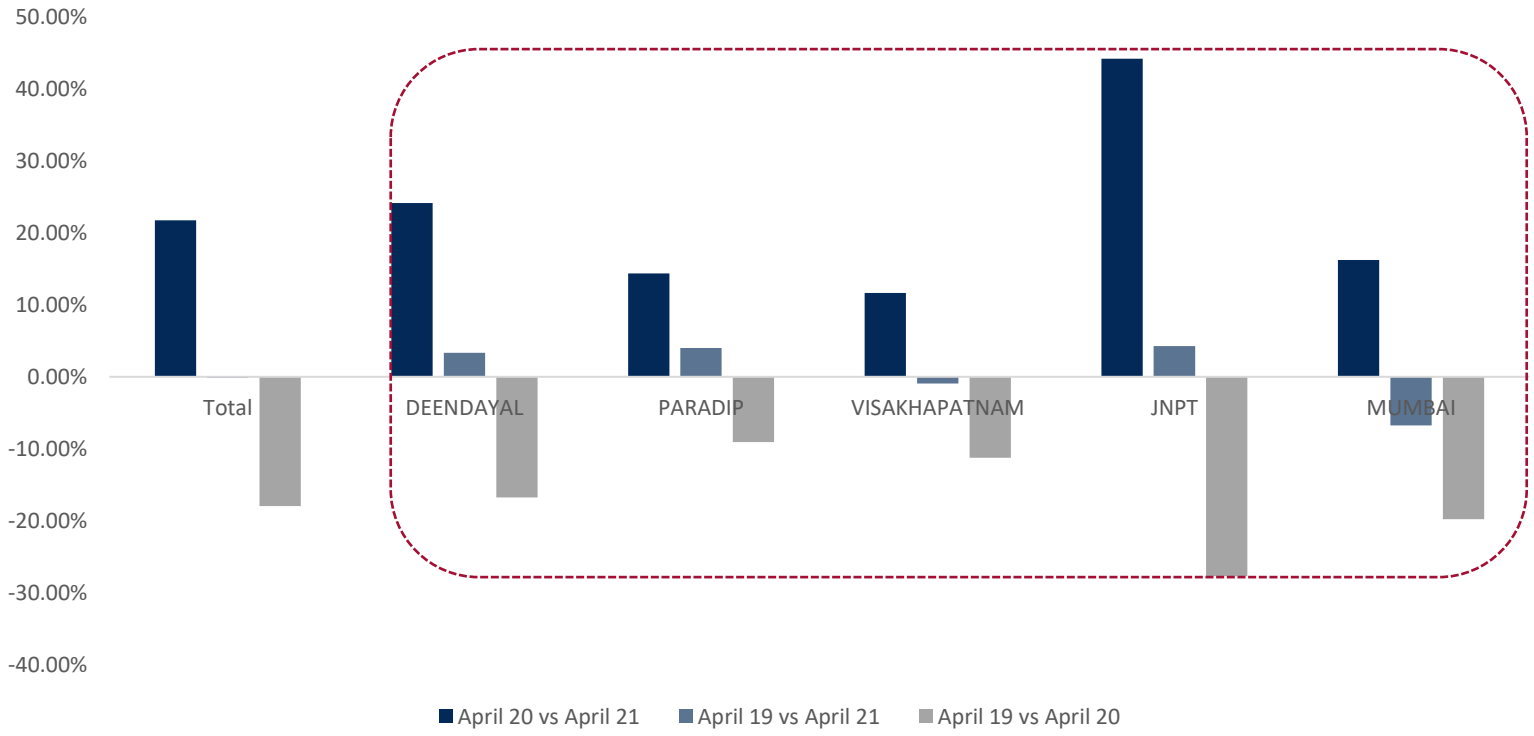


Source –NPCI, RBI, LC Capital India

View on Port Traffic: Is growth visible?

Though the port traffic has increased on YoY basis in April 2021, but the total traffic is still below levels of Apr 2019

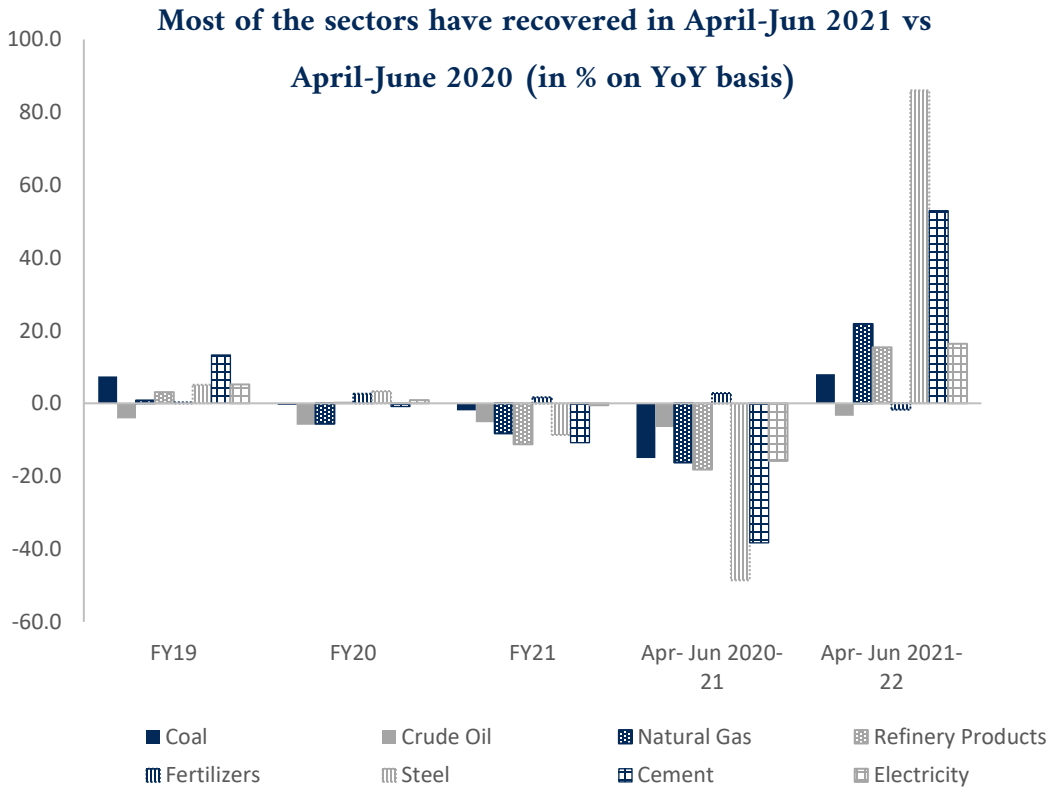
Total port traffic has increased by ~22% in April 2021 vs April 2020

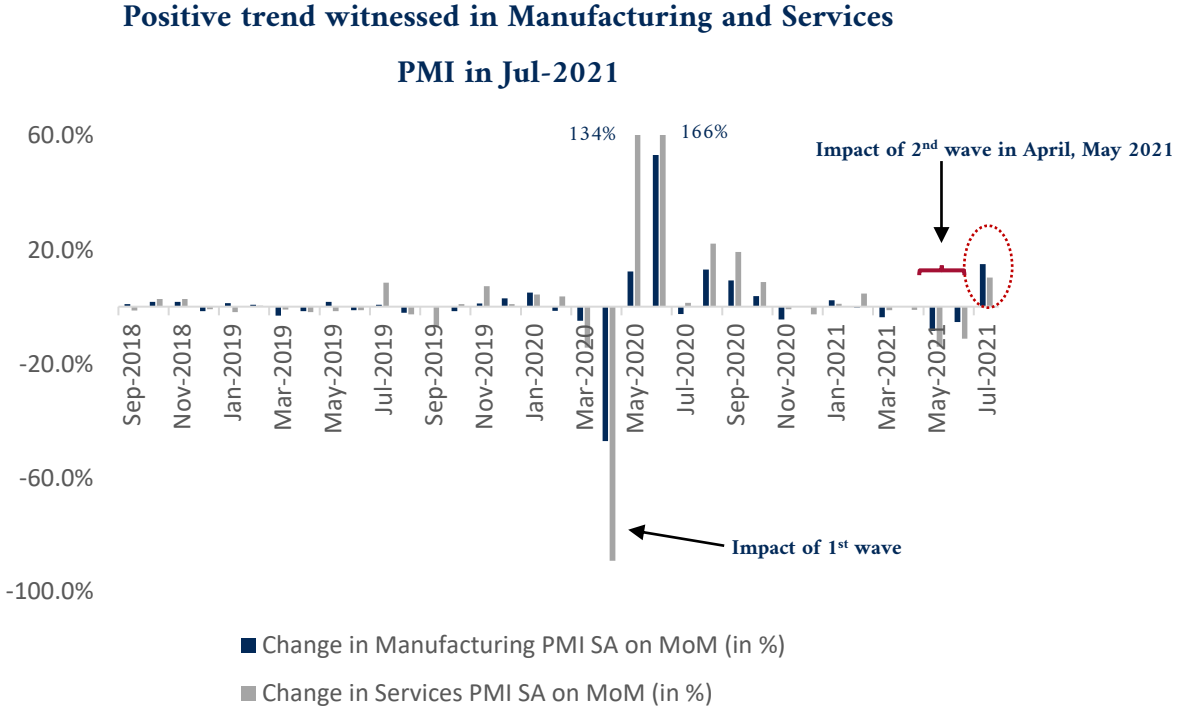


Source –IPA, LC Capital India

View on Sectors and Industry: Is growth visible?

Broad based recovery seen across different sectors and industry





Source –Bloomberg, EaIndustry, LC Capital India

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Focus on various components of GDP

Consumption, Private Capex, Government Spending and Net exports

Consumption: Outlook on Employment

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Faded Outlook may derail improvement in consumption

Annual Income	Outlook	Jun-15	Jun-16	Jun-17	Sep-17	Jun-18	Sep-18	Jul-19	Sep-19	Jul-20	Sep-20	Jan-21	Mar-21	May-21	Change Jan 21 vs Mar 21	Change Mar 21 vs May 21
Rs. 1 lakh or less	Remain the same	29%	30%	33%	22%	26%	17%	18%	15%	13%	13%	15%	18%	16%	↑	↓
	Will improve	49%	50%	44%	50%	49%	52%	55%	51%	47%	52%	54%	43%	36%	↓	↓
	Will worsen	22%	20%	24%	28%	25%	31%	28%	35%	40%	35%	31%	39%	48%	↑	↑
Rs. 1 to less than 3 lakh	Remain the same	25%	30%	27%	24%	26%	17%	17%	16%	13%	14%	16%	17%	16%	↑	↓
	Will improve	59%	50%	54%	54%	54%	55%	58%	52%	49%	55%	55%	48%	34%	↓	↓
	Will worsen	16%	20%	20%	22%	21%	27%	25%	32%	38%	31%	29%	35%	50%	↑	↑
Rs. 3 lakh to 5 lakh	Remain the same	24%	27%	26%	21%	25%	17%	19%	14%	14%	18%	19%	18%	16%	↓	↓
	Will improve	57%	59%	60%	54%	52%	56%	57%	52%	50%	57%	61%	51%	37%	↓	↓
	Will worsen	19%	14%	14%	25%	23%	26%	25%	34%	36%	25%	20%	31%	46%	↑	↑
Rs. 5 lakh or more	Remain the same	24%	26%	21%	17%	27%	17%	21%	18%	12%	18%	18%	15%	19%	↓	↑
	Will improve	56%	54%	60%	55%	41%	52%	58%	46%	56%	53%	62%	58%	42%	↓	↓
	Will worsen	20%	20%	19%	28%	32%	31%	21%	36%	32%	28%	20%	27%	40%	↑	↑

KEY HIGHLIGHTS

Though we had seen steady improvement in employment levels from Sept 2020 to Jan 2021 (in some cases the improvement in employment numbers were much better than pre-Covid levels), but the employment outlook has declined across all income groups in Mar 2021 and May 2021.

Worsening outlook on employment could affect the consumption which thereby would have an impact on overall economic growth.

Source –RBI Consumer Confidence Survey, LC Capital India | As data for July survey was not uploaded on RBI site at the time of analysis, hence we have not included the same.

Consumption: Outlook on Spending (Essential/Non-essential)

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Gloom and doom for essentials; Negative bias continues for non-essentials

ESSENTIAL SPENDING

Annual Income	Outlook	Jun-15	Jun-16	Jun-17	Sep-17	Jun-18	Sep-18	Jul-19	Sep-19	Jul-20	Sep-20	Jan-21	Mar-21	May-21	Change Jan 21 vs Mar 21	Change Mar 21 vs May 21
Rs. 1 lakh or less	Remain the same	9%	7%	14%	11%	9%	14%	15%	14%	25%	21%	20%	19%	24%	↓	↑
	Will decrease	5%	10%	5%	3%	2%	3%	3%	5%	9%	6%	6%	6%	9%	↑	↑
	Will increase	86%	82%	81%	86%	88%	83%	82%	81%	66%	73%	74%	74%	67%	↓	↓
Rs. 1 to less than 3 lakh	Remain the same	8%	13%	13%	10%	10%	13%	14%	13%	21%	24%	23%	21%	24%	↓	↑
	Will decrease	4%	8%	4%	3%	3%	2%	3%	3%	7%	5%	5%	5%	6%	↑	↑
	Will increase	88%	79%	83%	86%	87%	85%	84%	84%	71%	71%	73%	75%	69%	↑	↓
Rs. 3 lakh to 5 lakh	Remain the same	8%	6%	11%	12%	10%	9%	15%	15%	24%	22%	22%	20%	26%	↓	↑
	Will decrease	2%	5%	4%	3%	3%	3%	2%	1%	7%	4%	3%	3%	6%	↓	↑
	Will increase	89%	89%	86%	85%	87%	88%	82%	84%	69%	74%	75%	77%	68%	↑	↓
Rs. 5 lakh or more	Remain the same	6%	8%	13%	18%	17%	15%	18%	16%	21%	24%	24%	18%	25%	↓	↑
	Will decrease	6%	4%	7%	5%	3%	3%	3%	1%	7%	4%	1%	5%	7%	↑	↑
	Will increase	88%	88%	80%	77%	80%	82%	79%	84%	72%	72%	75%	77%	68%	↑	↓

KEY HIGHLIGHTS

Across income groups, there was an improving outlook towards essential spending in Mar 2021 vs Jan 2021 (exception being income group of Rs 1 lakh or less).

The recovery has faded in May 2021 where all income groups have shown a decline.

NON-ESSENTIAL SPENDING

Annual Income	Outlook	Jun-15	Jun-16	Jun-17	Sep-17	Jun-18	Sep-18	Jul-19	Sep-19	Jul-20	Sep-20	Jan-21	Mar-21	May-21	Change Jan 21 vs Mar 21	Change Mar 21 vs May 21
Rs. 1 lakh or less	Remain the same	22%	34%	33%	28%	24%	29%	39%	31%	38%	35%	34%	37%	41%	↑	↑
	Will decrease	27%	19%	12%	9%	11%	23%	26%	28%	41%	35%	39%	42%	40%	↑	↓
	Will increase	51%	47%	55%	63%	65%	48%	36%	41%	21%	30%	27%	21%	19%	↓	↓
Rs. 1 to less than 3 lakh	Remain the same	28%	29%	33%	31%	32%	37%	45%	44%	39%	38%	37%	38%	41%	↑	↑
	Will decrease	20%	20%	10%	9%	8%	13%	19%	25%	39%	31%	36%	35%	36%	↓	↑
	Will increase	52%	51%	57%	60%	61%	49%	36%	31%	22%	31%	27%	27%	23%	↓	↓
Rs. 3 lakh to 5 lakh	Remain the same	21%	25%	32%	30%	30%	33%	41%	44%	37%	38%	44%	44%	37%	↑	↓
	Will decrease	15%	14%	10%	7%	9%	14%	19%	27%	38%	25%	27%	30%	37%	↑	↑
	Will increase	64%	61%	58%	63%	61%	53%	41%	29%	25%	37%	29%	26%	26%	↓	↓
Rs. 5 lakh or more	Remain the same	24%	28%	24%	36%	36%	28%	47%	49%	30%	43%	40%	40%	44%	↓	↑
	Will decrease	15%	12%	15%	8%	15%	19%	14%	18%	40%	19%	21%	22%	25%	↑	↑
	Will increase	61%	60%	61%	56%	49%	53%	38%	33%	30%	38%	38%	38%	31%	↑	↓

KEY HIGHLIGHTS

After reaching the lows in July 2020, the outlook for non-essential spending had improved in Sept 2020 across income groups. But the trend has not sustained since Sept 2020. This is in line with employment outlook which has also declined especially in Mar and May 2021.

Decline in spending does not bode well for services side of economy.

Source –RBI Consumer Confidence Survey, LC Capital India | As data for July survey was not uploaded on RBI site at the time of analysis, hence we have not included the same.

Private Capex: Capacity Utilization vs Bank Credit Growth

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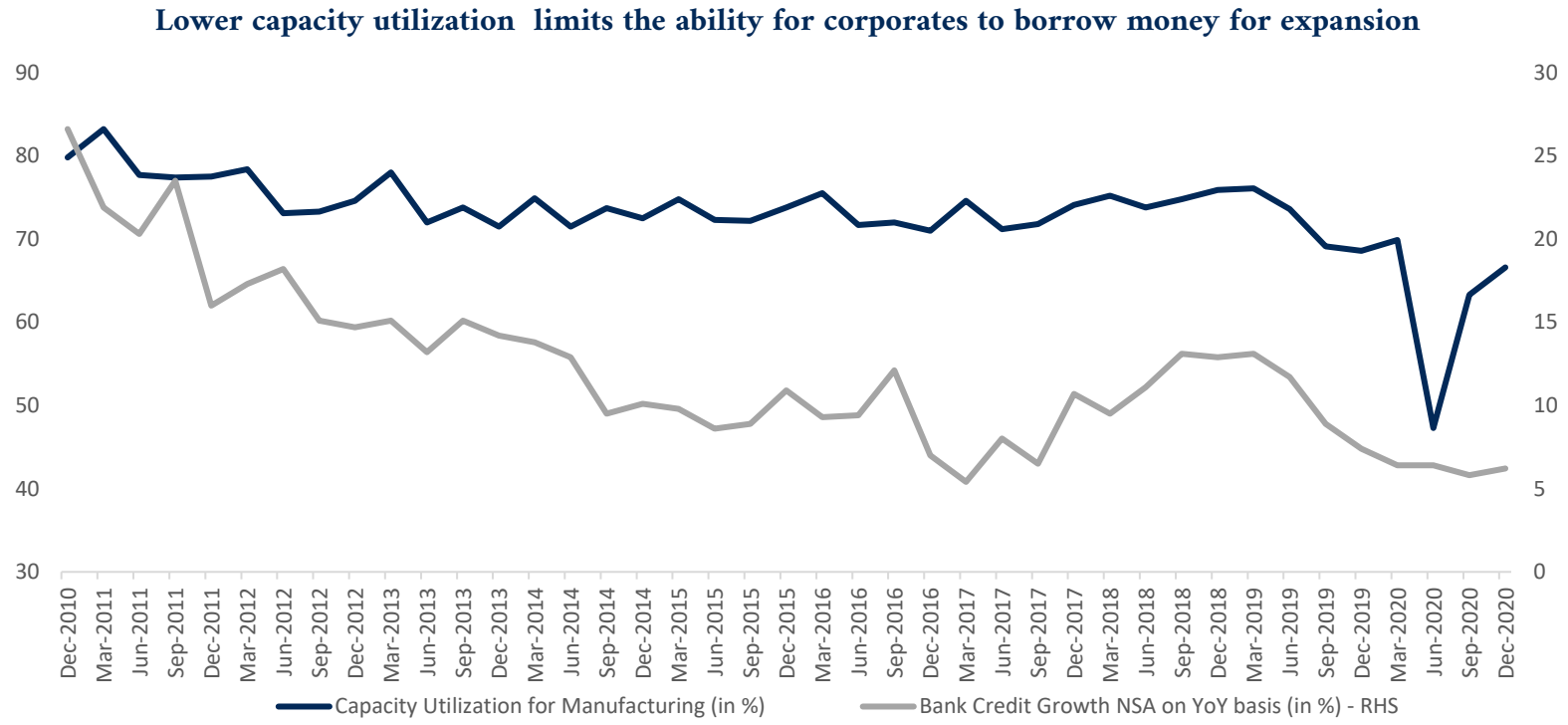
Higher Demand -> Higher utilization -> Increase in borrowing (plans for capex)

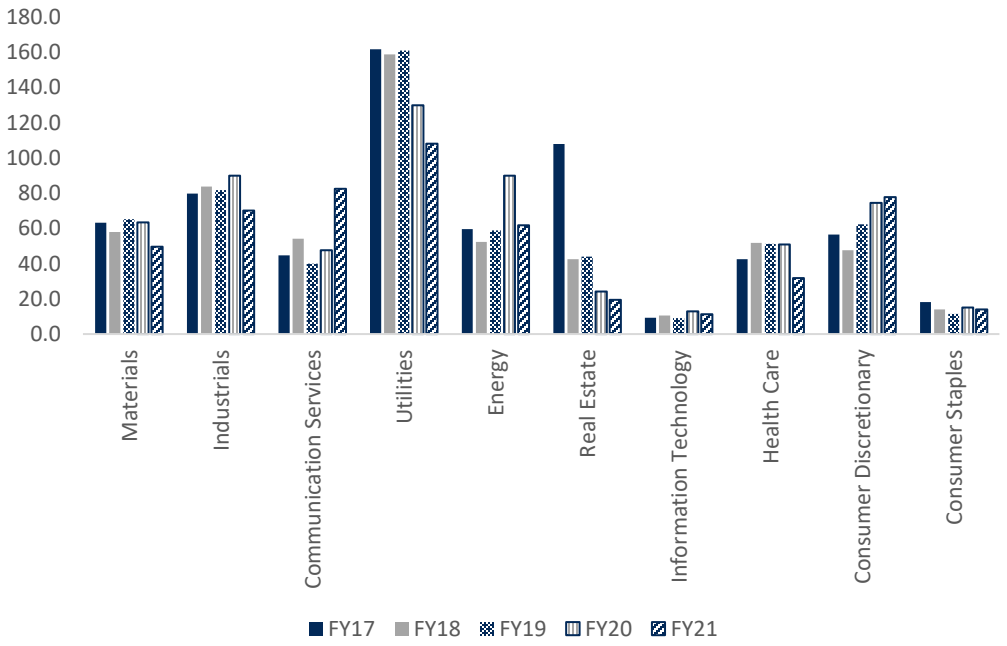


Source –Bloomberg, LC Capital India

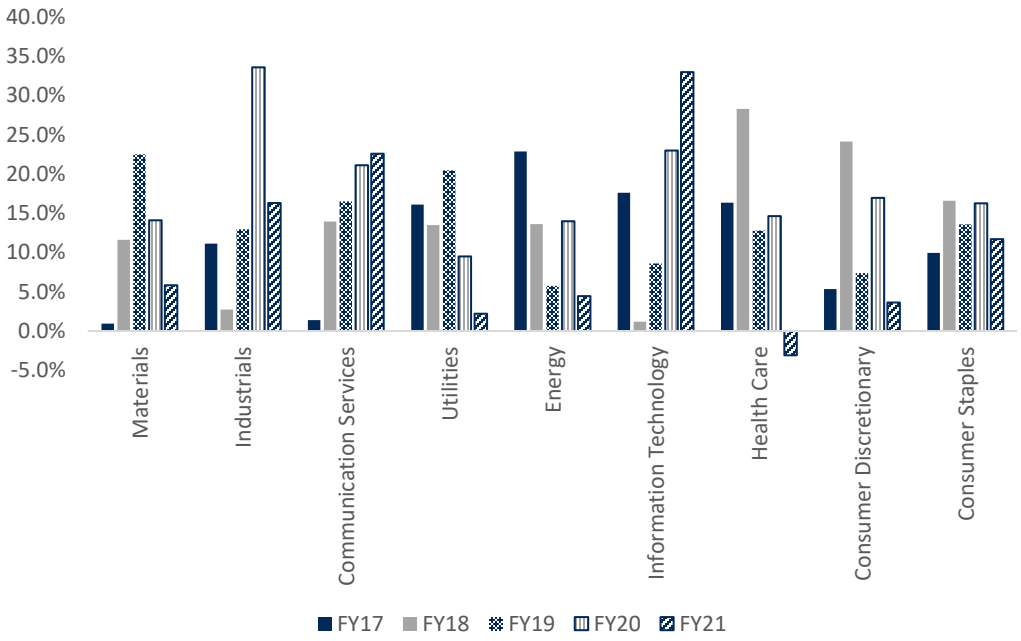
Private Capex: Corporate India (BSE 100 companies) has deleveraged their B/S??

Improved quality of balance sheet would help corporate India to take advantage of next phase of growth

In last 5 years most sectors have reduced the debt to equity* (in %)



....this is evident from reduction in gross block (yoy basis)**



Source –Bloomberg, LC Capital India. Sector classification is GICS Sectors. The analysis does not include Financials | * Data is ex Adani Green and Indigo | ** Data does not include Real estate because of negative outliers

Private Capex: Can banks fuel growth??

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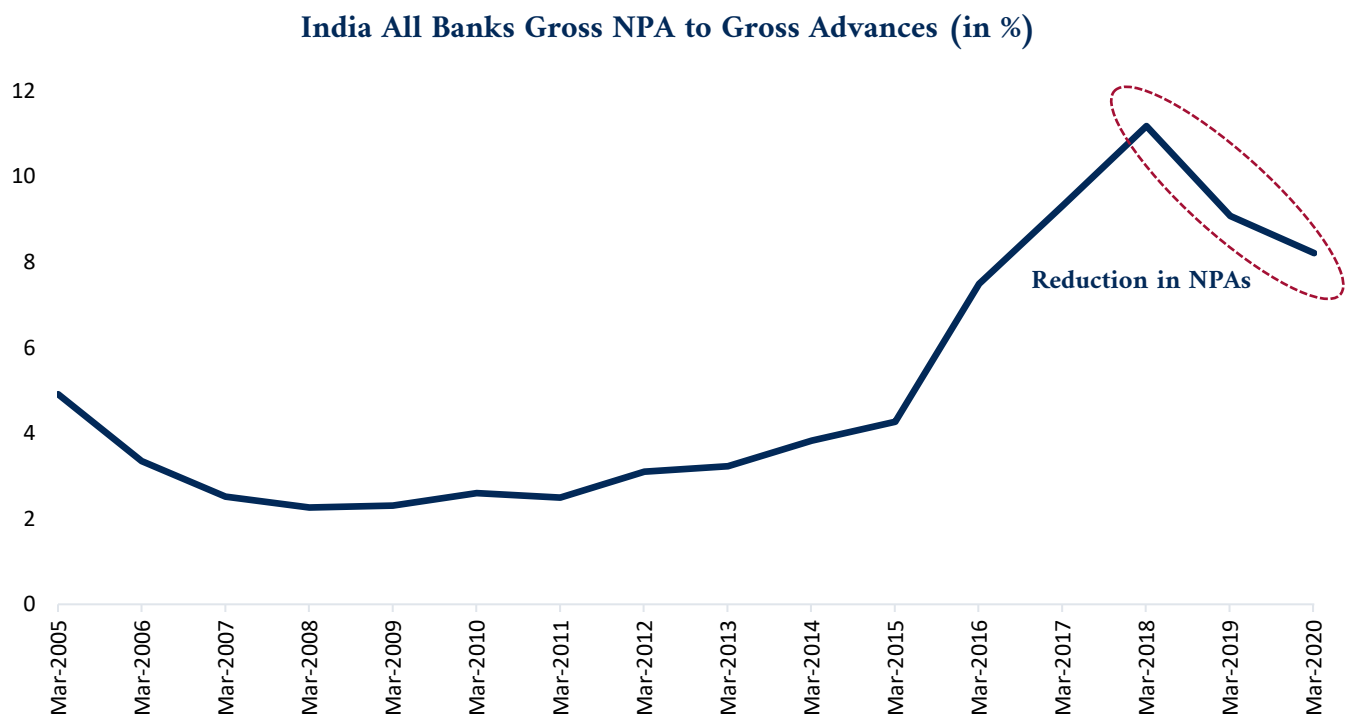
Significant improvement in Bank NPAs would help to kick start credit cycle

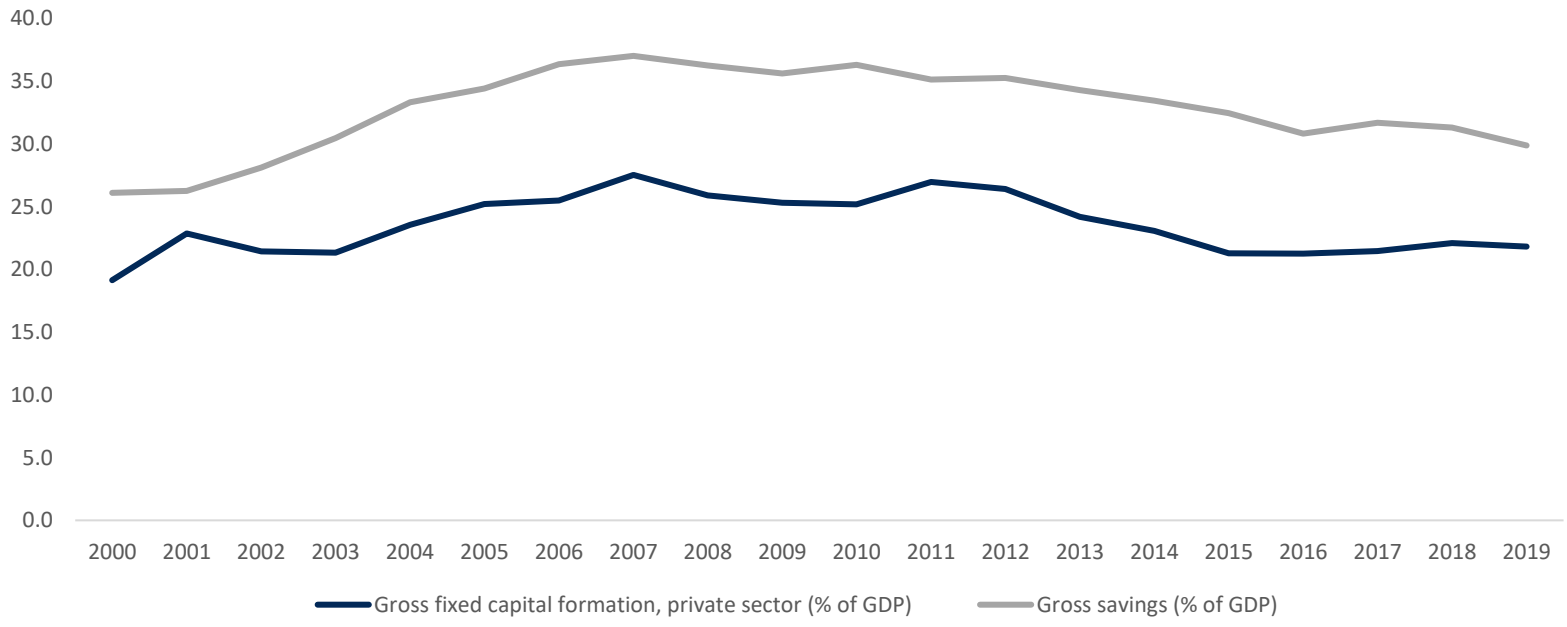


Source –Bloomberg, LC Capital India

Private Capex: Historical linkage between savings and investment

Higher gross savings -> Increase in spending -> Drive capacity utilization -> Increase in capex

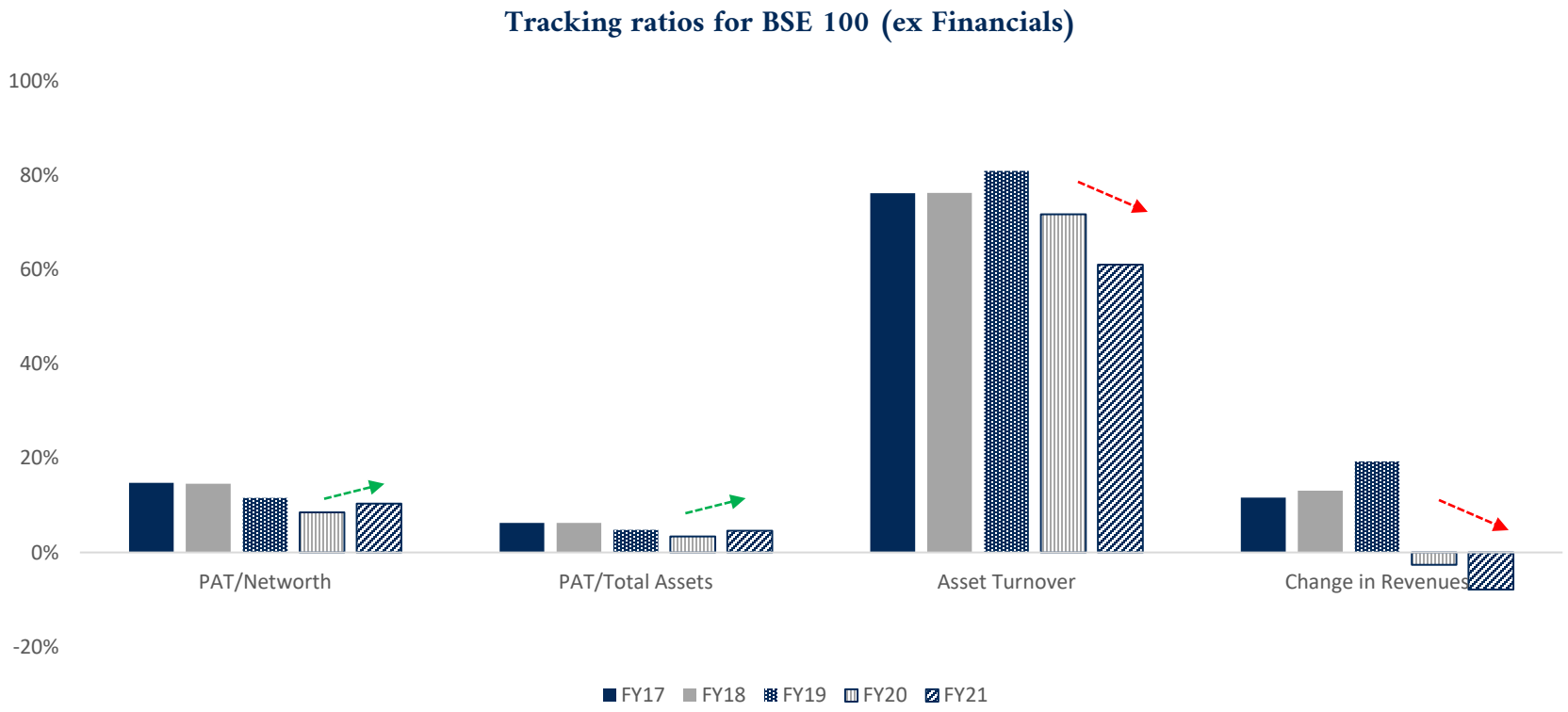
Gross Fixed capital from private sector is highly correlated with Gross Savings: – 0.84



Source –World Bank, LC Capital India

Private Capex: Next inflection point??

Sustainable improvement in key ratios would indicate the start of new capex cycle



Source –Bloomberg, LC Capital India

Government Spending: Revival in Government and States Spending?

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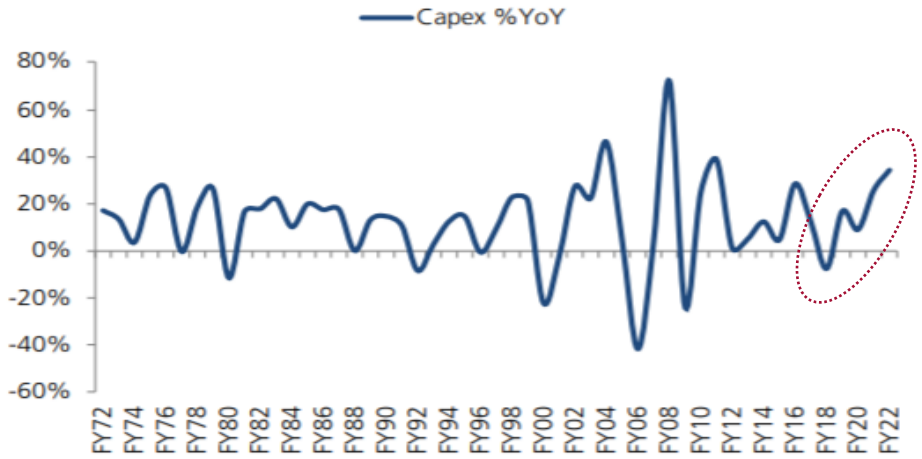
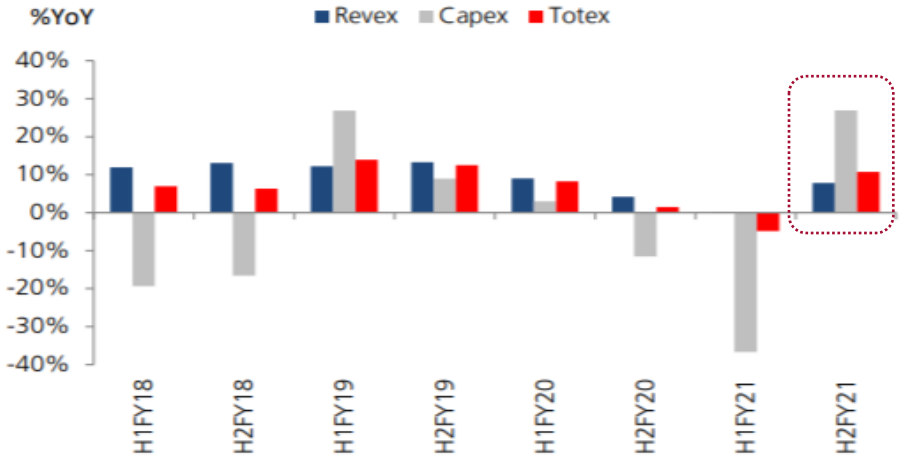
Strong revival in Government and State expenditures would help to drive overall demand

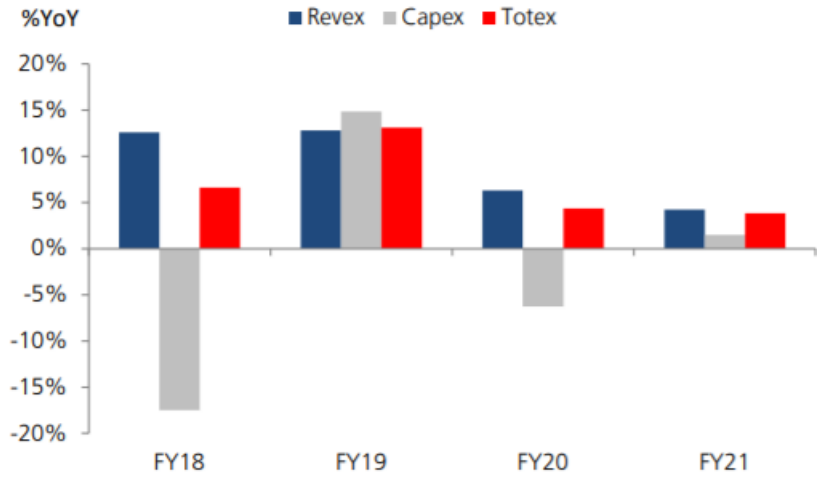
Strong trend for Government Capital Expenditure*



.....although picking up in 2nd half of FY21**



State Capex has been slow in FY20 and FY21.....**



Source – JM Financial, * FY21 are realized estimates and FY22 are budgeted estimates, **14 states ex – BH,JH,WB

Net Exports: Can India benefit from rise in global trade?

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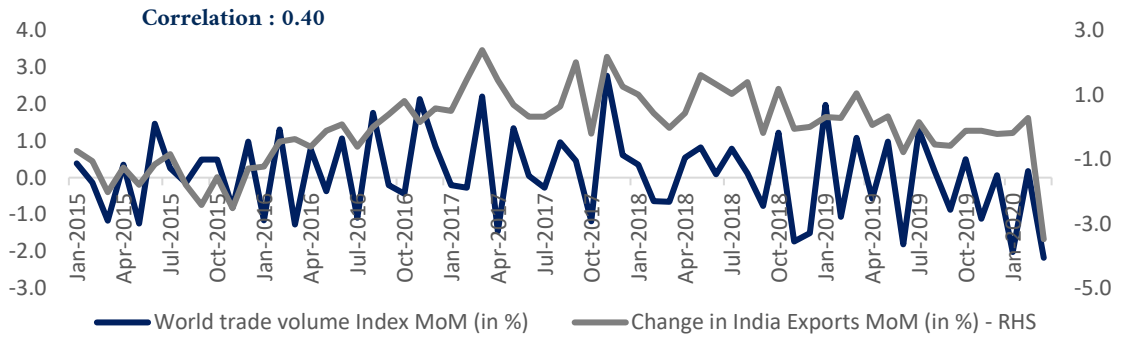
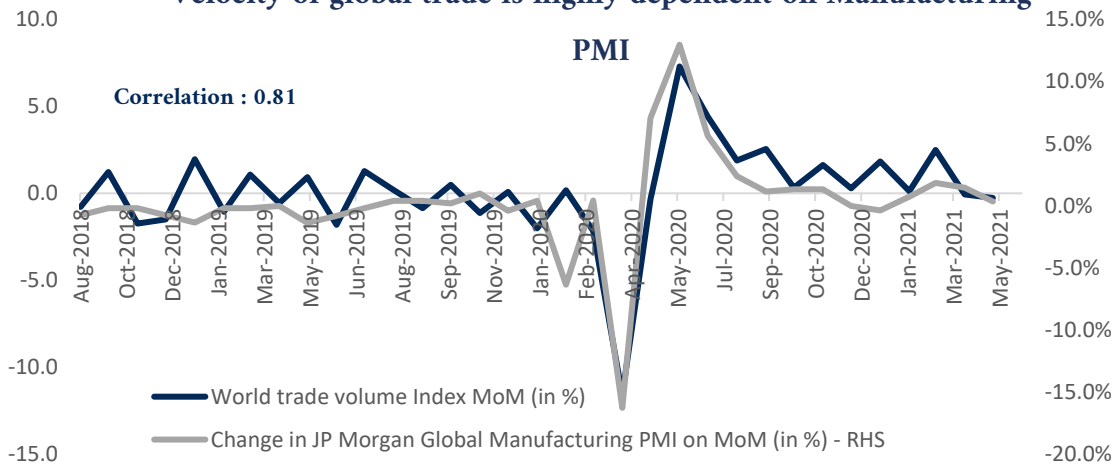
Higher Money Supply -> Drive Manufacturing PMI -> Higher Velocity of global Trade = Good for exports in India

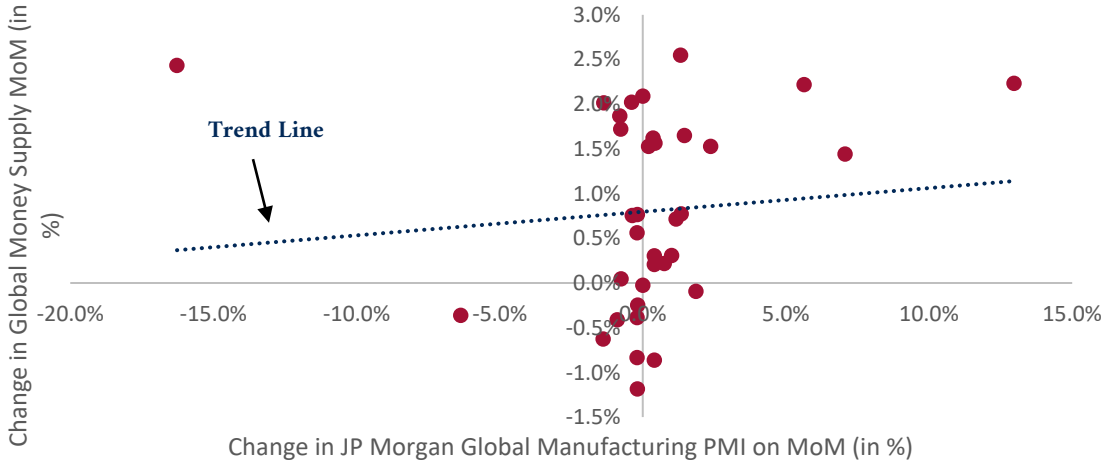
Increase in velocity of global trades helps India's export growth*



Velocity of global trade is highly dependent on Manufacturing PMI



Money supply helps to drive manufacturing PMI**



Source –Bloomberg, LC Capital India | * Data until 31st March 2020 | ** Data from Sept 2018 to July 2021

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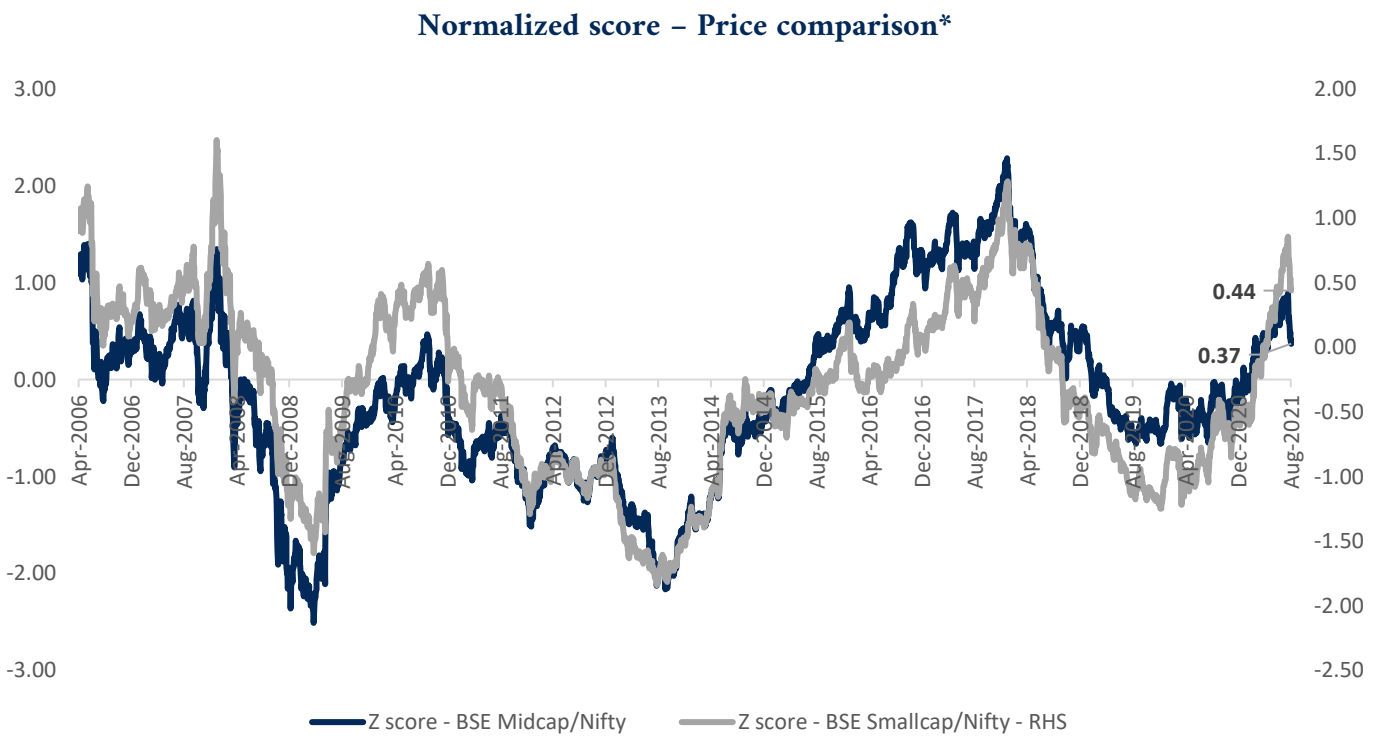
Markets…

Focus on valuations, positioning and earnings

Valuations: Are small and mid cap stocks looking expensive vs large cap??

Although valuations (in terms of trailing 12m P/B) may not be supportive, but from historical relative price basis, mid and small cap stocks still looks attractive

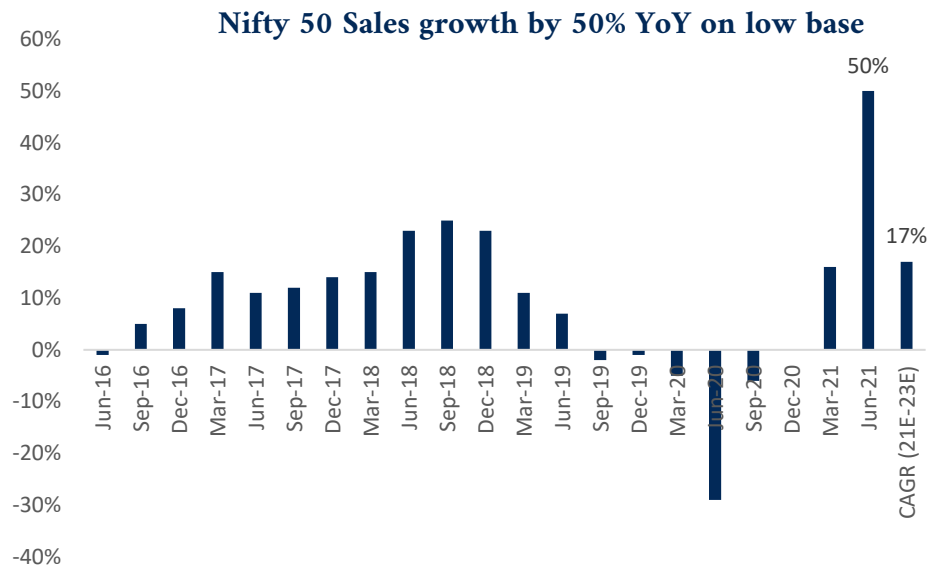


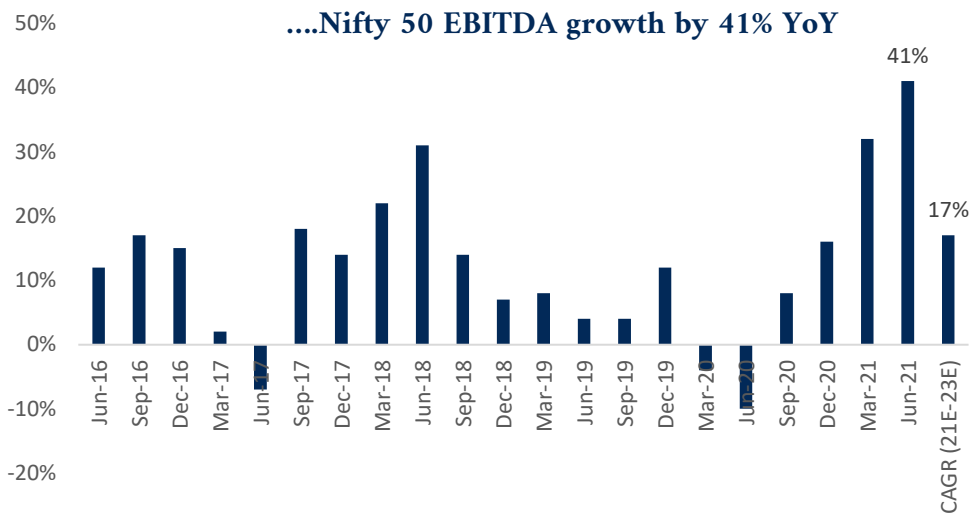
Percentile scores for Valuations (20th April 2015 – 16th August 2021) -

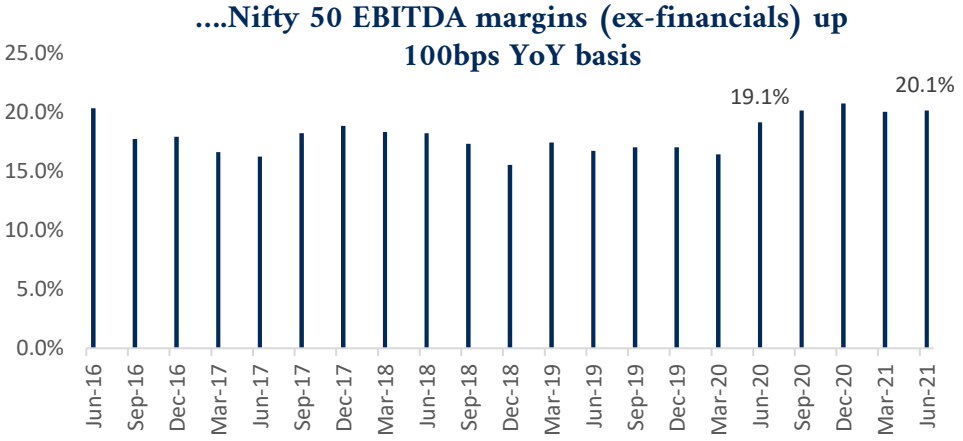
Price to Book –** BSE Small Cap(99%), BSE Mid Cap (99%), Nifty 50 (97%)

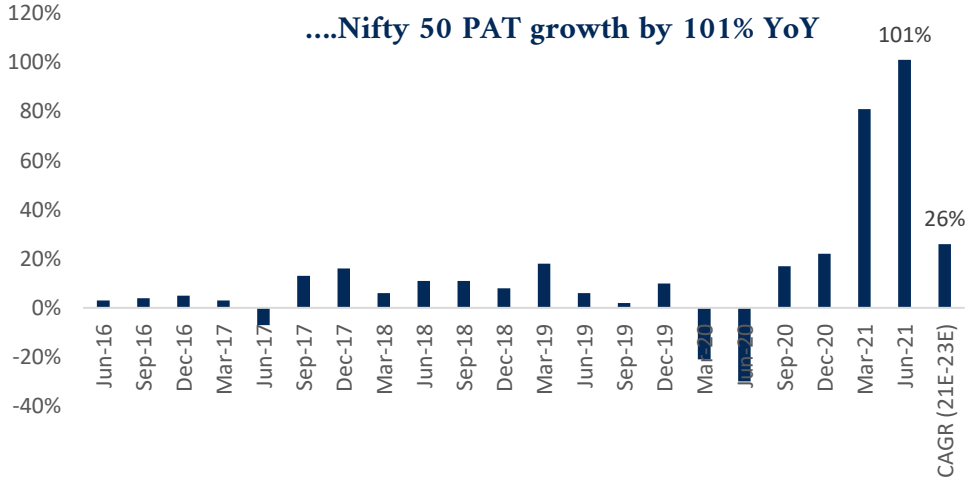
Source – Bloomberg, LC Capital India | * Data from April 2003 to 16th August 2021

Earnings: Track Q1FY22 earnings for Nifty 50 - Strong top-line and bottom-line growth for companies







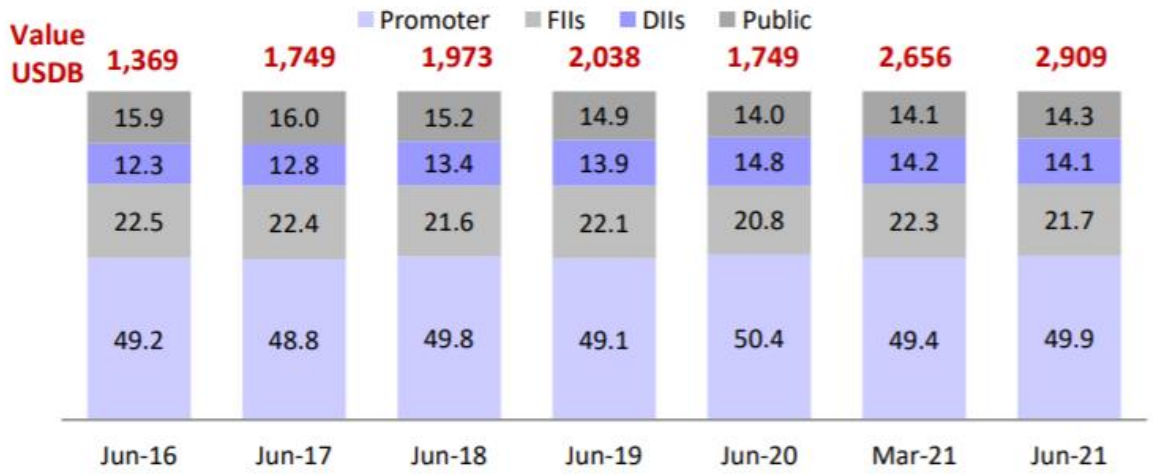


Source –MOSL Research India Strategy Report

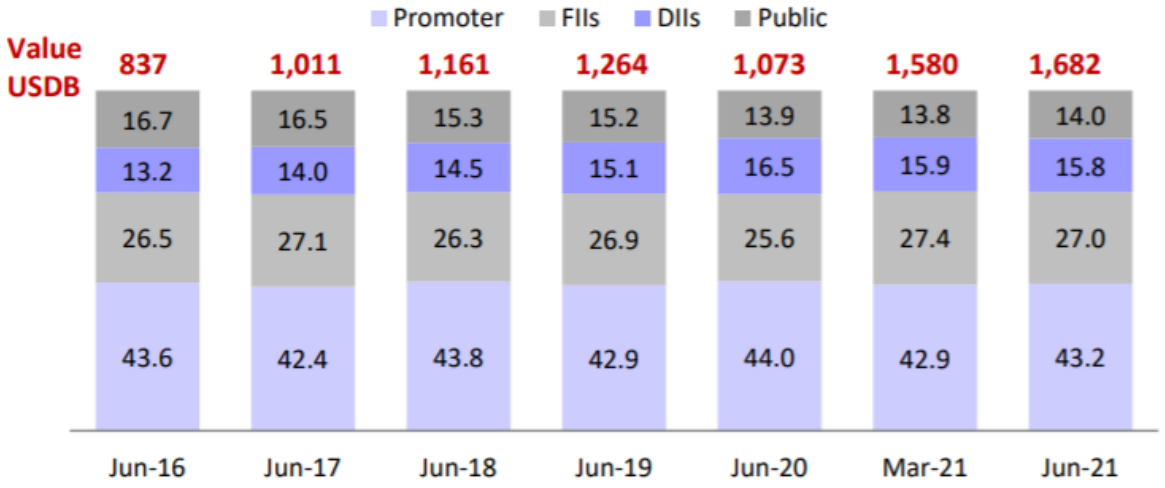
Flows: Ownership analysis for FIIs and DIIs…

The recent market moves have led to FIIs reducing stake in Nifty 50 and Nifty 500 companies.

In Nifty 500 on QoQ basis (June 2021 vs March 2021), FII's stake has reduced by 60 bps and DII's stake remains stable….



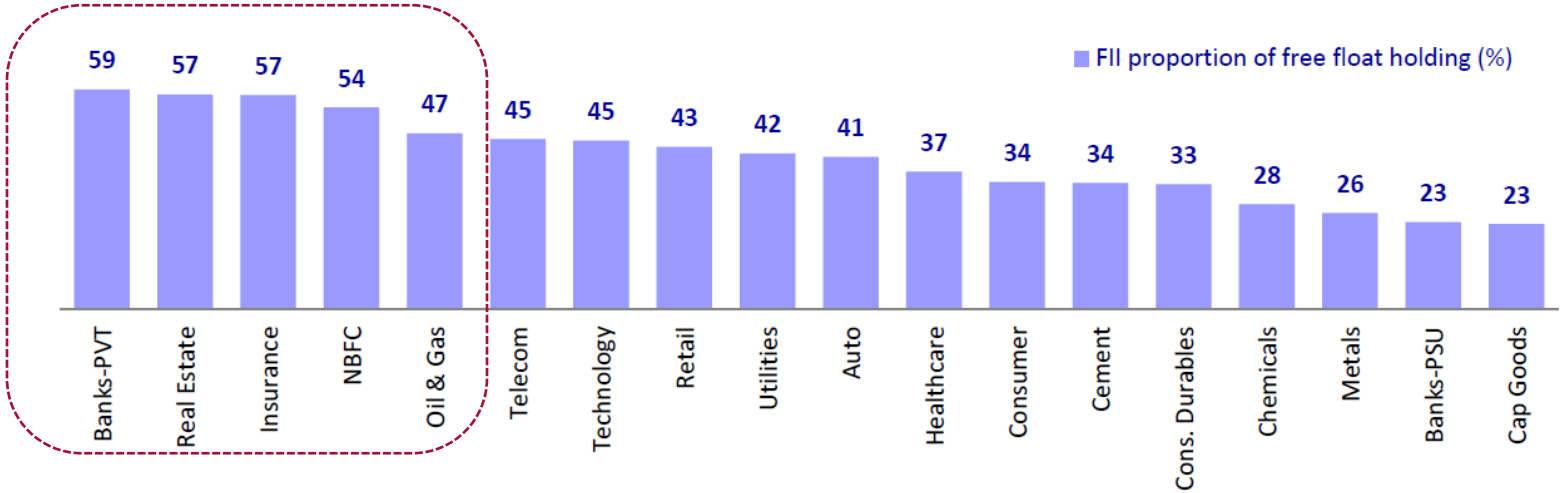
….In Nifty 50 on QoQ basis (June 2021 vs March 2021), FII's stake has reduced by 40 bps and DII's stake remains stable

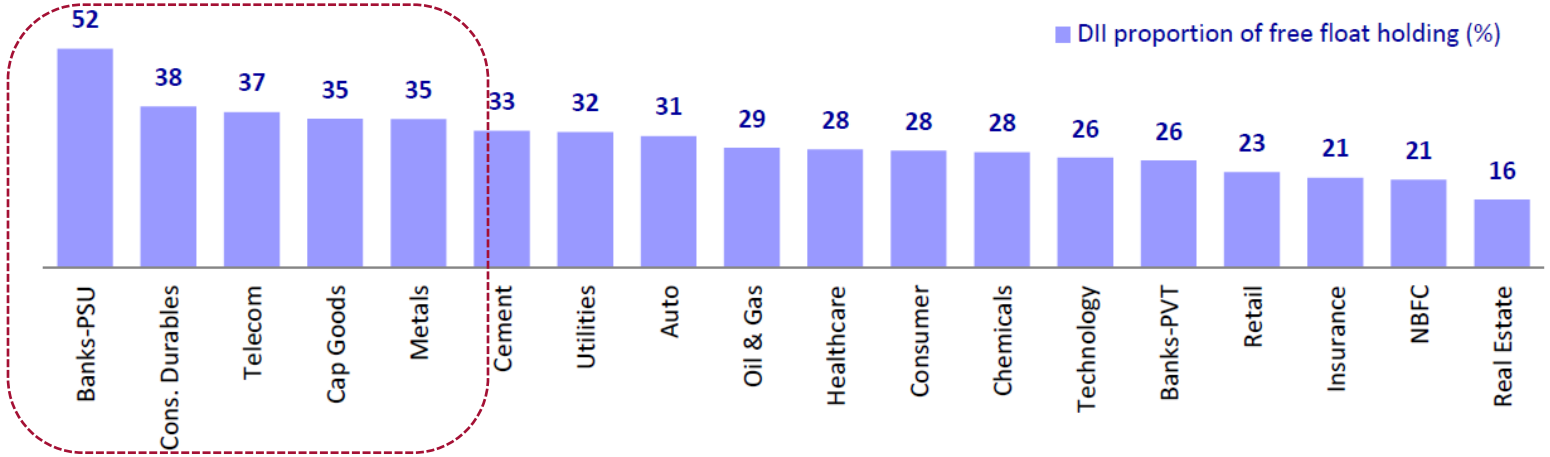


Source –MOSL Research India Strategy Report

Flows: Sectoral Holdings - Top bets are in cyclical sectors

Institutional participation higher in cyclical sectors which should benefit from recovery in economic activity





Source –MOSL Research India Strategy Report

Fixed Income: Can yields rise?

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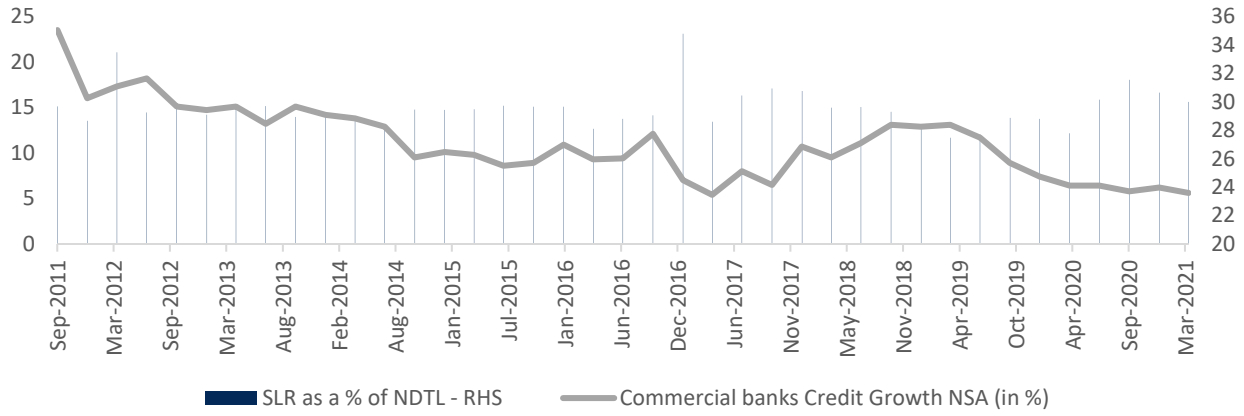
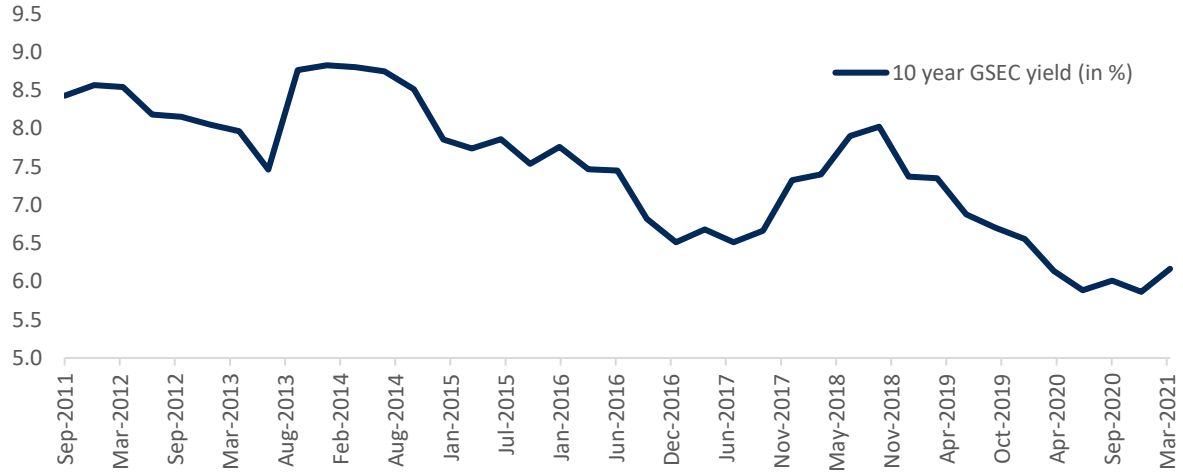
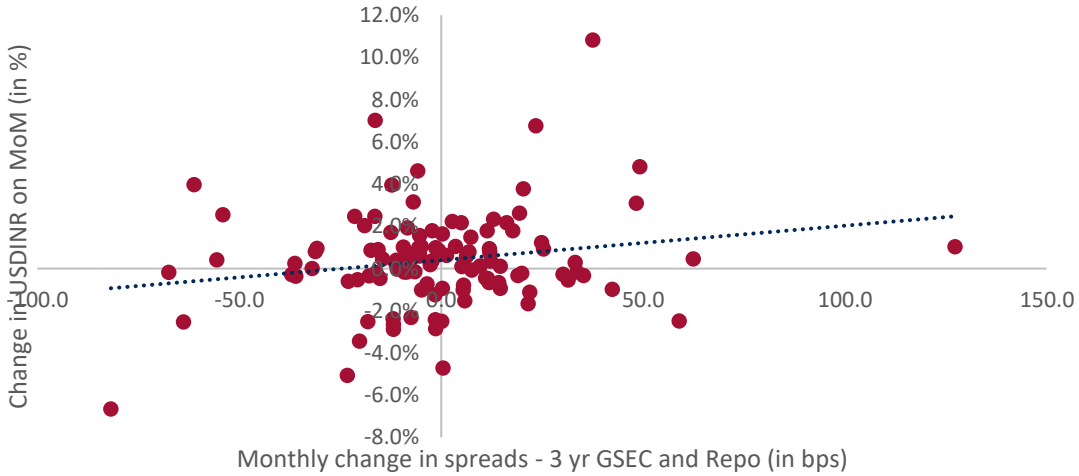
Higher credit growth or high USD appreciation may affect rates in India

Low Credit Growth has led to further investments in Gov sec by banks - > key driver for 10 year yield





Positive correlation between spreads and currency*



Source –Bloomberg, Investing.com, Yahoo Finance, LC Capital India | *Data from Feb 2012 to June 2021

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Vaccination rates…

will determine the pace of recovery

Key risk: Important to track the vaccine administered

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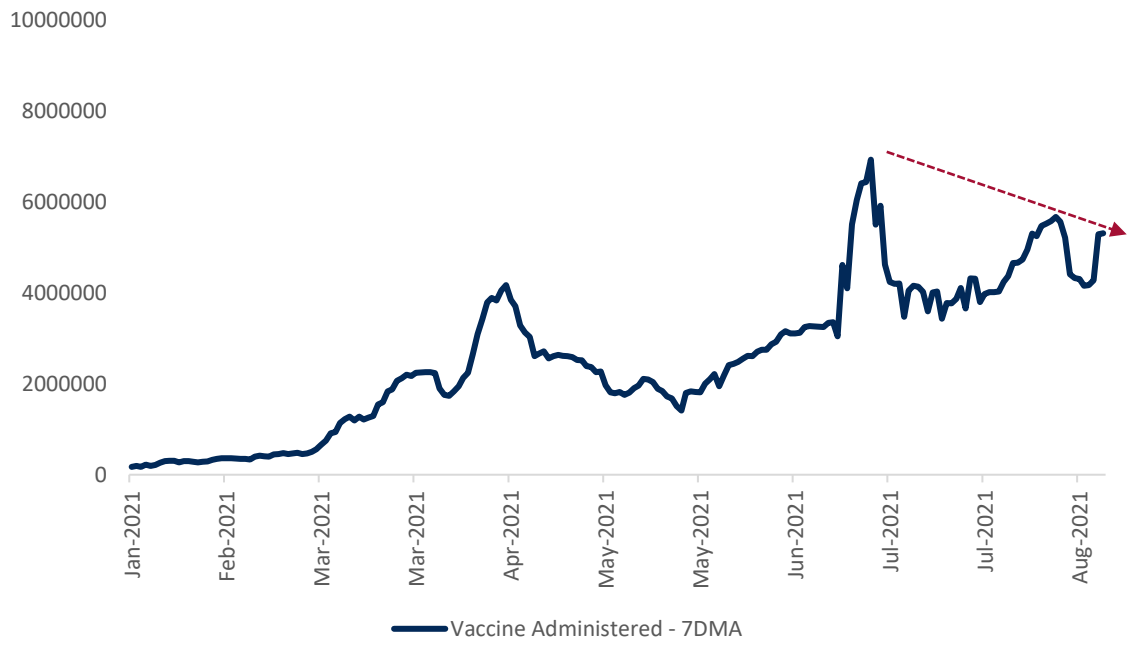
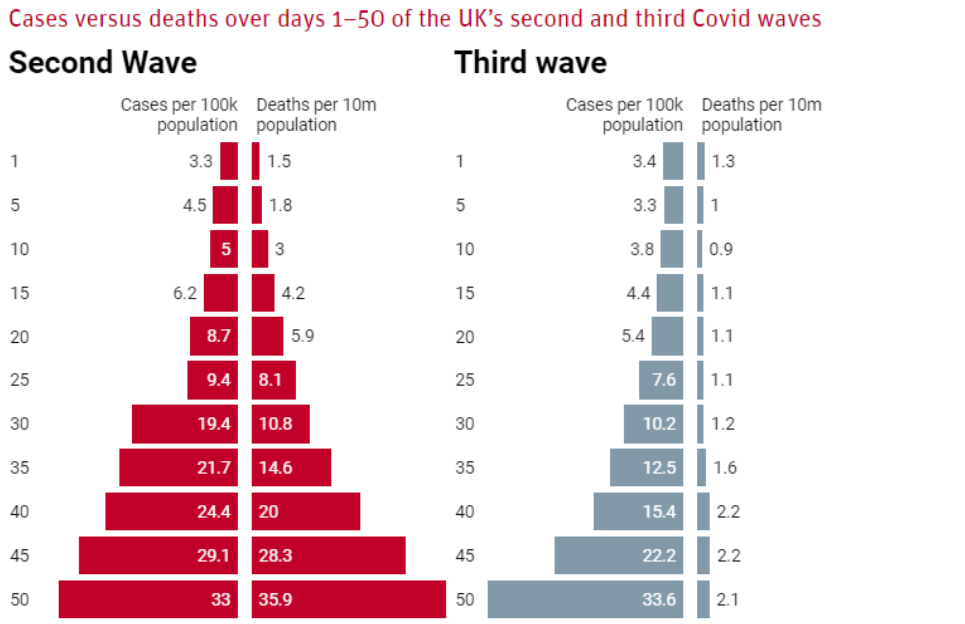
We would keep a close eye on the pace of vaccination in order to alter our views on growth and inflation

7DMA in India has declined from 6.9mn in June 2021 to 5.3mn in August 2021



Efficient vaccination drive may help to reduce mortality risk and drive recovery



Calculations based on a seven-day rolling average of daily recorded cases and deaths. Second wave is recorded from 8/9/20, third wave is recorded from 14/5/21.

Source: UK Government, ONS

Source – Bloomberg | Data from Jan 2021 to 16th August 2021

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