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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.

Indian market's premium (relative) valuation has remained a concern for global investors and rightly so as EMs and China looked relatively more attractive after the large relative underperformance in 2022 (though all markets including India we negative in 2022). MSCI India reached a peak premium of ~150% in Oct-2022 which has now corrected to ~60% in Feb-23. In CYTD 2023, MSCI India underperformed the MSCI EM Index by ~9% which has resulted in the sharp correction of the valuation multiples for India.

Has the Indian market valuation premium normalized?

The MSCI India (USD) Index has typically traded at a premium to EM peers with an average PE premium of ~40% over the past 10-yrs. At present, the strong performance of the MSCI EM index resulted in the underperformance of the MSCI India index. With the recent correction, MSCI India is now trading at a ~60% premium to MSCI EM, indicating a ~20% actual premium over the long-term average.

Since YTD-2023, FII selling has added further pressure to Indian equities. FII's now have sold ~USD 4bn while DII have continued to support the market by ~USD 6.5bn (*trend in line with last year*). Domestic institutions (DIIs) have been a key source of demand for Indian equities in recent years, buying ~US$50bn in the past two years. Domestic mutual funds have contributed ~70% of these flows since 2021, aided by robust systematic monthly inflows. While the relative valuation has come down on the back of India's underperformance recently, India's structural developments have only improved with time.

Based on the earnings transcripts and our analysis of key stocks and sectors, a few common themes emerge related to moderating revenue growth and improving margin trends. Here is a quick snapshot of our analysis:

MSCI India 3QFY23 profits declined ~1% YoY, slightly below the consensus estimate of flat growth. 50% of the MSCI India companies missed consensus expectations, 17% reported in line, and 34% beat estimates. The proportion of stocks missing estimates (c.50%) was the highest in the past 11 quarters. The overall average EPS downgrade was ~-5%, suggesting a soft quarter relative to consensus expectations (*please see chart of the month*).

In terms of sectoral beats and misses, we saw wide inter-sector dispersion. Sector variance was wide with profit growth led by financials and autos but dragged down by commodity cyclical. Ex-financial profits fell ~15% YoY while ex-commodity profits grew ~26% YoY.

Companies remain hopeful of further margin relief in the coming quarters as inflationary pressures ease, consistent with our expectations. On a full-year basis, MSCI India posted ~7% profit growth in CY22. Incorporating earnings trends, MSCI India earnings is expected to grow ~17%/15% in CY 2023/24 driven by upgrades in autos, and industrials.

We analysed earnings transcripts of key stocks to gauge demand and margin guidance from corporates. We highlight a few themes below:

- **High-end/premium demand remains healthy:** Based on the results and forward guidance from consumer companies targeting largely upper-income consumers (jewellery, premium real estate, malls, hotels, premium cars, airlines), we note that high-end demand for premium products remained healthy in the December quarter, and, more importantly, management suggested that growth trends have improved in January.
- **Middle-income consumption slowdown:** Results confirmed a slowdown in middle-income consumption across key categories such as quick service restaurants (QSR), food delivery, paints, and durables reflecting the adverse impact of inflation on disposable incomes. The expected slowdown in middle-income discretionary spending, along with rising competition has been the core reason for our cautious stance on the consumer durables and services sector.
- **Signs of sequential margin improvements as cost pressures ease:** Some select consumer staples and auto companies are seeing sequential improvement in margins given softening in key commodities / raw material costs in the past few quarters. Management remains hopeful of further margin relief as inflationary pressures ease.

Chart of the Month: 3QFY23 Earnings snapshot

MSCI India		Reported Cos.	Earnings growth (3QFY23)		Sales growth (3QFY23)	
3QFY23 earnings		Sector weight (%)	YoY (%)	QoQ (%)	YoY (%)	QoQ (%)
Exporters	InfoTech	15%	12%	10%	21%	6%
	Healthcare	5%	3%	7%	11%	4%
Consumer sensitives	Consumer Disc.	8%	104%	46%	23%	5%
	Staples	9%	19%	3%	11%	(0%)
Financials	Financials	25%	42%	8%	-	-
Investment cyclicals	Industrials	6%	38%	16%	23%	(1%)
	Cement/Other Mat.	6%	(8%)	14%	14%	5%
Commodity cyclicals	Energy	13%	(13%)	55%	18%	(2%)
	Metals & Mining	3%	(100%)	(102%)	(3%)	(4%)
Telcos	Telcos	3%	(32%)	(54%)	17%	1%
Utilities	Utilities	6%	(18%)	(1%)	35%	(1%)
MSCI India		100%	(1%)	13%	-	-

Chart Source: Goldman Research, Sources: Internal, Bloomberg, UBS Research, Goldman Sachs, FII - Foreign Institutional Investor, DII- Domestic Institutional Investor, FY - Financial Year, CY – Calendar Year; YoY is Year over Year, YTD- Year to date, EM- Emerging Markets, DM- Developed Markets, EPS- Earnings per share

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For past Issues, please see below:
India Rewind February 2023
India Rewind January 2023
India Rewind December 2022
Older Issues

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

India at a Glance

	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Economic Activity and Employment								
GDP, USD bn	2295	2651	2701	2871	2668	3176	3391	3659
GDP per capita, USD	1767	2018	2036	2141	1969	2321	2453	2621
Real GDP growth, %	8.3	6.8	6.5	4.0	-6.6	8.7	6.9	5.5
Prices, interest rates and money								
CPI inflation, % y/y (average)	4.5	3.6	3.4	4.8	6.2	5.5	6.5	5.2
Repo rate, % (year-end)	6.25	6.0	6.25	4.4	4.0	4.0	6.50	6.00
10 year bond yield, % (year-end)	6.7	7.4	7.4	6.1	6.2	6.8	7.5	7.0
USDINR (year-end)	64.8	65.0	69.2	75.4	73.5	75.8	83.0	82.0
Fiscal accounts								
General government budget balance, % GDP	-7.0	-5.9	-5.9	-7.8	-13.9	-9.5	-9.4	-9.4
Balance of payments								
Trade balance, USD bn	-112	-160	-180	-158	-102	-189	-290	-278
Exports, USD bn	280	309	337	320	296	429	417	345
Imports, USD bn	393	469	518	478	398	619	707	623
Current account balance, USD bn	-14	-49	-57	-25	24	-39	-104	-83
Foreign direct investment (net), USD bn	35.6	30.3	30.7	43.0	44.0	38.6	39	42
Total FX reserves, USD bn	370	425	413	478	577	607	573	589
Total external debt, % GDP	20.5	20.0	20.1	19.5	21.4	19.1	16.9	16.1
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