PhillipCapital

Coronavirus Impact

Manageable in the near term | Prolonged - detrimental

INDIA | STRATEGY

12 February 2020

We looked at macro and micro data to gauge India's trade exposure to China. India has a total trade (X+M) exposure of 20%; imports at 14% of India's total imports. Current understanding of Coronavirus indicates that its impact is expected to last for Q4FY20 and improve thereafter. There will be a two-level impact – importers will be impacted due to supply-chain risks; exporters will suffer because of China lockdown. Our channel checks show that the Indian industry has inventory/stocks to sail for 30-45 days, but certain segments will be dented. In case the disease persists for a prolonged period, its impact will be fairly harmful on the supply chain. While this will be an overhang on the stock markets, its subsiding scale will be taken as a positive. Sectors that depend on China for imports include metals, automobiles, consumer durables, consumer electricals, pharmaceuticals, and chemicals. Others such as staples, consumer discretionary, retail, infrastructure, cement, capital goods, and financials are less exposed.

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China is India's largest importing partner

India imported goods worth US$ 70bn in FY19 (13.7% of total imports); FYTD20 at US$ 52bn (14.3%). Exports stood at US$ 17bn (5.1% of total exports); FYTD20 at US$ 13bn (5.5%). Our share of exports to China has increased from 3% in FY17 to 5.4% currently.

What we import from China (% of total imports from China): Electronic components (10%), telecom instruments (9%), computer hardware (7%), machinery for dairy (6%), organic chemicals (5%), electric machinery (4%), residual chemical (4%), bulk drugs (3%), electronic instruments (3%), consumer electronics (3%), fertilizers (3%), AC/refrigeration machinery (2%), iron & steel (2%), auto components (2%).

What we export to China (% of total exports to China): Petroleum products (13%), organic chemicals (12%), marine products (9%), plastic raw materials (5%), spices (5%), cotton yarn (3%), granite (3%), iron & steel (3%), electronic instruments (3%), residual chemical (2%), dyes (2%), bulk drugs (1%).

Growth impact – marginal for now; substantial if it persists

Our channel checks suggest that supply chain seems manageable for 30-45 days (inventory available). Thus, production impact will be marginal in the near-term, but substantial if it persists. Smaller players will suffer more than the larger ones from the inventory-management point of view. However, exporters will face payment delays followed by lower demand for their produce; MSMEs are at greater risk.

Price impact – mixed

Partial settlement of the US-China trade deal had brought optimism of global economic progress in 2020, which was dented by the coronavirus outbreak. While it is early days, China is certainly expected to see lower demand/growth, which is positive for globally traded commodities in the near-medium term. However, disruption in supply chain could result in higher prices. Additionally, exporters may have to dump their produce in India/other countries, thus lowering prices.

Sectoral impact:

- **Metals:** Overall negative; near-term respite for few specific segments. Negative for Hindalco, Vedanta, Nalco, NMDC.
- **Pharma:** Divis, Ipca Labs, and Biocon will gain from coronavirus; negative impact on others.
- **Specialty Chemicals:** Could trigger a manufacturing shift to India; Aarti is best placed.
- **Agrochemicals:** PI and UPL have very limited exposure (10-20%) to raw materials. Higher input dependency for – Dhanuka (not rated), Rallis (not rated), Insecticides India (not rated), Sharda Cropchem (not rated).
- **Automobiles/Consumer durables/Electricals:** Negative due to broad based input dependency.

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Imports from China

Commodity/Country	FY19 US$ Mn	FY19 % of total	FYTD'20 Nov US$ Mn	FYTD'20 Nov % of total	FYTD'20 Dec US$ Mn	FYTD'20 Dec % of total
Telecom Instruments	7417	10.5%	4144	8.8%	4573	8.8%
Electronics Components	5811	8.3%	4582	9.5%	4953	9.8%
Computer Hardware, Peripherals	4002	5.7%	3148	6.7%	3495	6.7%
Industrial Machinery For Dairy Etc	3831	5.4%	2812	6.1%	3170	6.0%
Organic Chemicals	3590	5.1%	2315	4.9%	2553	4.9%
Electric Machinery And Equipment	2640	3.8%	1768	3.8%	1972	3.8%
Residual Chemical And Allied Prod	2521	3.6%	1700	3.6%	1887	3.6%
Bulk Drugs, Drug Intermediates	2405	3.4%	1591	3.4%	1790	3.4%
Electronics Instruments	2371	3.4%	1635	3.5%	1831	3.5%
Consumer Electronics	2094	3.0%	1622	3.4%	1768	3.5%
Fertilizers Manufactured	2045	2.9%	1533	3.1%	1626	3.3%
Products Of Iron And Steel	1731	2.5%	1132	2.5%	1274	2.4%
AC, Refrigeration Machinery Etc	1663	2.4%	994	2.1%	1113	2.1%
Iron And Steel	1422	2.0%	849	1.8%	937	1.8%
Plastic Raw Materials	1345	1.9%	911	1.9%	989	1.9%
Auto Components/Parts	1238	1.8%	769	1.6%	847	1.6%
Aluminium, Products Of Aluminium	1212	1.7%	708	1.5%	786	1.5%
Other Commodities	1104	1.6%	651	1.4%	730	1.4%
Other Misc. Engineering Items	1036	1.5%	711	1.6%	806	1.5%
Manmade Yarn, Fabrics, Madeups	1026	1.5%	766	1.7%	861	1.6%
Accumulators And Batteries	1019	1.4%	686	1.4%	742	1.5%
Machine Tools	833	1.2%	503	1.1%	564	1.1%
Plastic Sheet, Film, Etc	736	1.0%	547	1.2%	615	1.2%
Inorganic Chemicals	726	1.0%	445	0.9%	487	0.9%
Other Construction Machinery	723	1.0%	361	0.8%	415	0.8%
Glass And Glassware	705	1.0%	496	1.1%	548	1.1%
Coal, Coke and Briquittes Etc	699	1.0%	152	0.3%	154	0.3%
Cranes, Lifts And Winches	690	1.0%	463	1.0%	513	1.0%
Project Goods	553	0.8%	315	0.6%	332	0.7%
Paper, Paper Board And Product	523	0.7%	391	0.8%	426	0.8%
Medical And Scientific Instrument	518	0.7%	397	0.9%	457	0.8%
Paint, Varnish and Allied Product	389	0.6%	295	0.6%	326	0.6%
Processed Minerals	382	0.5%	132	0.3%	146	0.3%
Total	**70,320**	**100%**	**46,901**	**100%**	**51,912**	**100%**

Source: Ministry of Commerce, PhillipCapital India Research

Percentage share of total imports FY19 vs. YTD FY20 (as of Dec):

- Overall, the share of total imports remained stable.
- **Declining share:** Telecom instruments.
- **Increasing share:** Electronic components.

Exports to China

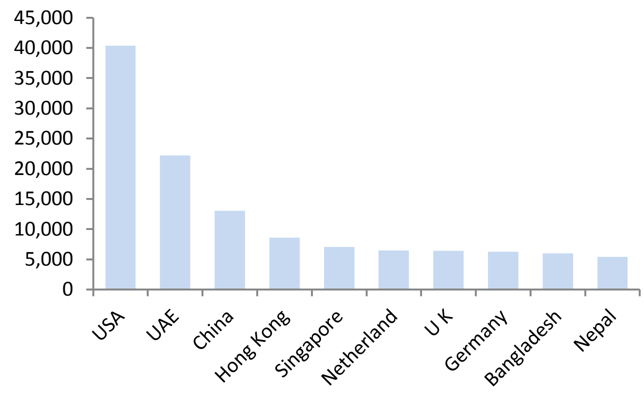
US$ Mn	FY19		FYTD'20 Nov		FYTD'20 Dec	
Commodity/Country	US$ Mn	% of total	US$ Mn	% of total	US$ Mn	% of total
Petroleum Products	2854	17.0%	1568	13.5%	1739	13.3%
Organic Chemicals	2519	15.0%	1458	12.6%	1580	12.1%
Cotton Yarn	1273	7.6%	398	3.4%	447	3.4%
Plastic Raw Materials	1043	6.2%	581	5.0%	651	5.0%
Marine Products	724	4.3%	1025	8.9%	1178	9.0%
Cotton Raw Incld. Waste	505	3.0%	23	0.2%	38	0.3%
Spices	447	2.7%	549	4.7%	589	4.5%
Granite, Natural Stone And Product	443	2.6%	294	2.5%	328	2.5%
Iron And Steel	319	1.9%	390	3.4%	452	3.5%
Electronics Instruments	304	1.8%	375	3.2%	439	3.4%
Electric Machinery And Equipment	298	1.8%	168	1.5%	183	1.4%
Residual Chemical And Allied Prod.	269	1.6%	199	1.7%	221	1.7%
Pearl, Precious, Semiprecious Stones	230	1.4%	51	0.4%	56	0.4%
Dyes	201	1.2%	202	1.7%	225	1.7%
Bulk Drugs, Drug Intermediates	173	1.0%	157	1.4%	178	1.4%
IC Engines And Parts	167	1.0%	120	1.0%	131	1.0%
Indl. Machinery For Dairy Etc	163	1.0%	122	1.1%	136	1.0%
Telecom Instruments	137	0.8%	86	0.7%	118	0.9%
Paper, Paper Board And Product	118	0.7%	55	0.5%	66	0.5%
Electronics Components	117	0.7%	72	0.6%	82	0.6%
Atm, Injecting Molding Machinery	89	0.5%	75	0.7%	85	0.7%
Total	**16,753**	**100%**	**11,570**	**100%**	**13,059**	**100%**

Source: Ministry of Commerce, PhillipCapital India Research

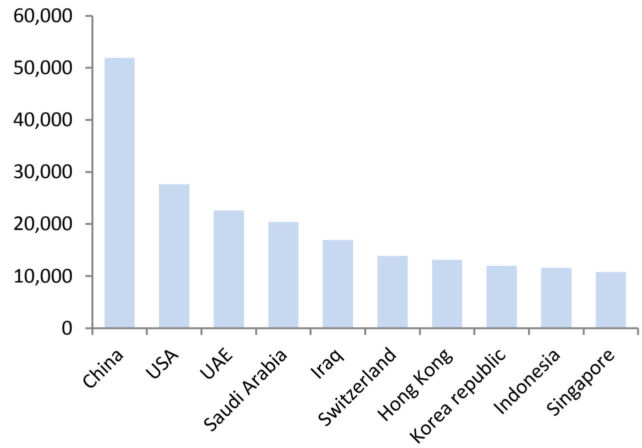
Percentage share of total exports FY19 vs. YTD FY20 (as of Dec):

- **Declining share:** Petroleum product and organic chemical (% of total) exports declined marginally in December FYTD'20. Exports of cotton yarn also reduced drastically.
- **Increasing share:** Marine product exports surged this financial year.

India's top-10 export countries (YTD FY20, USD mn)

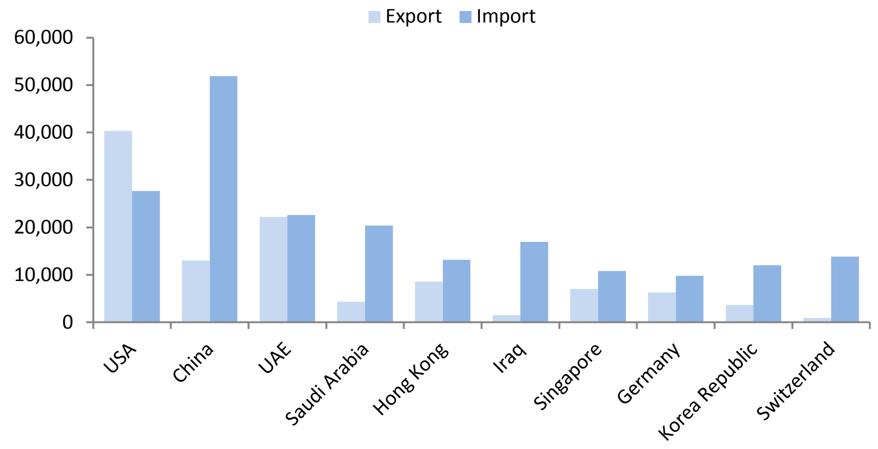


India's top-10 import countries (YTD FY20, USD mn)



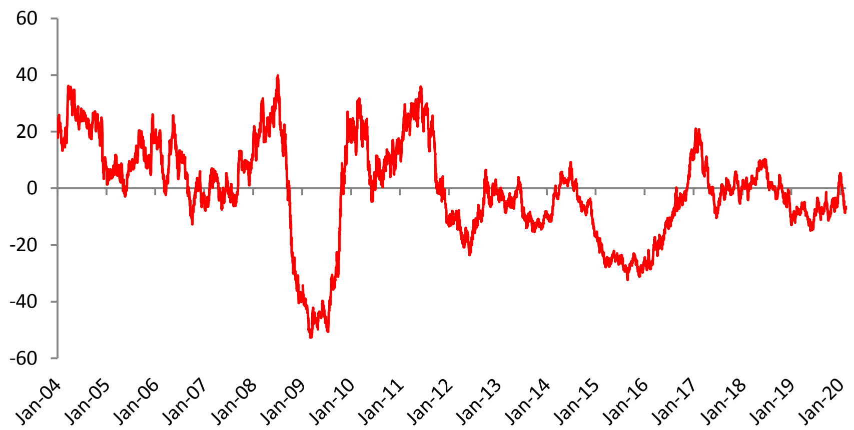
Source: Ministry of Commerce, PhillipCapital India Research

India's top-10 trading partners (YTD FY20, USD mn)



Source: Ministry of Commerce, PhillipCapital India Research

Bloomberg commodity index (yoy growth, %)



Source: Bloomberg, PhillipCapital India Research

Sectoral Impact

Agriculture Inputs
Fertilisers: Neutral
Agrochemicals: Neutral to Negative

Fertiliser: Neutral
- India is import-dependent for fertiliser raw materials and finished products.
- It only imports finished products urea (10-15%) and DAP (40-45%) from China.
- We expect coronavirus to not have any major impact on India's sourcing as the rabi season is done.
- Fresh requirement will start for kharif only by April/May.
- There is enough supply available from other countries such as Saudi Arabia, USA, Oman, Morocco, Qatar, Jordan and Russia to cover any shortfall from China.
- However, short supply from China is likely to raise international prices of DAP if the disruption lasts beyond March, as China is one of the major suppliers to other countries. This is likely to force Indian importers to raise MRPs of DAP.

Agrochemicals: Neutral to negative
- Indian agrochemicals companies have varied dependency for raw materials from China.
- **In our coverage universe, PI and UPL has very limited exposure (10-20%) to China's raw materials**. Both have diversified raw materials sourcing by replacing China with South Asian countries and became integrated players. Also, many companies have sourced materials (for 30-90 days) in advance due to the Chinese New Year. Therefore, coronavirus will not have any major impact in the short term.
- However, if the outbreak extends beyond March, it is likely to hurt companies such as Dhanuka Agritech, Insecticides India, and Rallis – who are exposed to the tune of 20-30%. We expect Sharda Cropchem to be impacted the most due to its exposure of over 90% in sourcing raw materials.

Negative impact: Sharda Cropchem (not rated), Dhanuka (not rated), Rallis (not rated), Insecticides India (not rated).

Automobiles
There is reasonable exposure to China in terms of imports of parts/components for all segments. Currently, companies have stated that they have an inventory of 6-8 weeks – manageable. However, in case the outbreak persists for long, the blow will be fairly strong.

Consumer durables/electricals
- Rapid increase of Coronavirus has impacted manufacturing facilities in China. The Indian consumer durables industry is highly dependent on China. Products that are imported from China include AC components, compressor, and appliances. In ACs, c. 50% of the 'bill of materials' for most companies is imported; out of this, compressors is the main component.
- Most compressor/appliances manufacturing units were shut due to Chinese New year. The rapid outbreak of coronavirus extended the shutdown. However, situation in China seems to be easing off, as some of the AC component manufacturing facilities have started operations from 10th Feb. 2020, but not at full utilization. China's supply chain is highly disrupted and upsetting both in-bound and out-bound supply.
- Logistics lag: It takes 30-35 days to receive products from China to India and Indian vendors take 10-15 days to manufacture/assemble and dispatch to channel partners. Total lag is 30 + 15 days.

- Currently, the Indian consumer durable industry has an inventory of c.45 days (Q4FY20) from seasonal products such as ACs, as RAC companies are pre-building inventory from November 2019 for the upcoming summer season. If the situation worsens, it may hurt the industry, which will look at alternate countries such as Korea, Vietnam, and Thailand for supply even as these come at a higher cost than China.
- The next most important thing to watch is shipments, which we believe will start from the end of February. Once these start, the situation may normalize or will have a lag of 15-20 days. In the near term, companies could hike prices by 3-5% and will work on inventory management.

Metals

- China consumes c.50% of global metals and mining resources. Though it is a bit early for the actual impact assessment, the overall sense is that any prolonged disruption from the corona virus outbreak will have a significant bearing on the global metals markets due to its potential impact on commodity demand. China has already extended the shutdowns in factories for another week. However, steel BF mills and aluminium smelters continue to operate. Delays in re-starting downstream facilities may lead to inventory build-up, ultimately impacting prices.
- <u>While any prolonged impact of outbreak is negative there could be some near term respite for few specific segments</u>. Wuhan Iron and Steel Co. has an annual production of c.30mn tonnes representing 3% of China's production and is situated in Wuhan City. Strict travel restriction from the city will impact supply. Also, in case of further restrictions from China, steel and aluminium supplies may be impacted, creating a short-term vacuum in the international market and supporting price. On the other hand, copper concentrate, iron ore, and bauxite players will see downside (as China is the largest importer of these materials) which ultimately cascades on to the finished product.

<u>Stocks to be impacted</u>
Negative: Hindalco, Vedanta, Nalco, NMDC.
Other steel players would be moderately impacted in the short term.

Pharma

Neutral to negative; DIVIS, IPCA, BION are better placed

- The lockdown of industrial activity in China after the outbreak of the corona virus has certainly raised concerns in terms of sourcing of input materials for the global pharma industry, as China is the largest source of intermediates and APIs. In fact, China is the world's leading producer (over 2,000 APIs) and exporter of APIs by volume, accounting for 20% of total global API output; 65% of India's requirement for API/intermediates comes from the red giant.
- A large chunk of China's pharma manufacturing takes place in Hubei province - the epicentre of the coronavirus outbreak. Although most of the Chinese provinces have been allowed to start industrial operations from 10th February, industrial activity is likely to remain at a low over next few weeks as the return of the working population could take time caused by health concerns.
- Although most drug manufacturers in India maintain a 1-3-month raw-material inventory, China's production cuts could reduce supplies in the near term, which would spike RM prices, which in turn could dent Indian operations operationally as well as financially.
- **<u>Divi's Laboratories</u>**, one of the leading manufacturers of intermediates/APIs in the world could potentially be the top beneficiary of Chinese supply disruption, supported by its already expanded capacity and backward integration. A similar disruption in China in FY19 had helped DIVI report robust earnings growth in Q2 and Q3. Similarly, **<u>IPCA Laboratories,</u>** with relatively better-integrated API operations

compared with other formulators, should benefit from a temporary price appreciation. **Biocon** is almost immune to China because of zero RM dependency, making it a safe investment.

Specialty Chemicals

The outbreak could trigger a manufacturing shift to India; ARTO is best placed

- The Indian specialty chemicals industry has already positioned itself as the best alternate manufacturing hub after China. India is positioned as a partner of choice for global biggies based on its relative cost advantage over China, lower taxes, policy certainty, and visible procurement risk from China for MNCs. So any supply disruption in China due to the outbreak can benefit the Indian industry in value and volume terms. However, this industry is dependent on China for 20-30% of its input and intermediates requirements. So while supply disruption could be a big earnings opportunity for Indian peers, led by a price spike and volume opportunity in the near term, it will also spike input material costs.
  - **ARTO** is the top beneficiary led by global reach, cost effective manufacturing, expanded capacities and limited import dependency on China.
  - **SRF** could benefit from a manufacturing shift in the medium term, but may not benefit from a price spike due to the nature of its fluoro specialty business in the near term.
  - **VO** has lowest China dependency but could see adverse impact of languishing crude prices on its leading product sales (ATBS).
  - **ATLP** has relatively larger China input dependency, but price opportunity could be positive. China may not have any major adverse impact despite having vanillin manufacturing operation in China as the said operation is still loss making.

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Large cap stocks

Rating	Criteria	Definition
BUY	>= +10%	Target price is equal to or more than 10% of current market price
NEUTRAL	-10% > to < +10%	Target price is less than +10% but more than -10%
SELL	<= -10%	Target price is less than or equal to -10%.

Mid cap and Small cap stocks

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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