FIRST LIGHT

15 April 2020

RESEARCH

Building Materials

Lockdown to mar near-term prospects; structural drivers intact

BOB Economics Research | Weekly Wrap

Markets hopeful of a flattening COVID curve

BOB Economics Research | March MPC Minutes

Growth concerns warranted a larger cut

BOB Economics Research | Inflation

Inflation falls, will ease further

Gujarat Gas | Target: Rs 265 | +13% | BUY

Resilient in the face of near-term headwinds

Diversified Financials | Q4FY20 Preview

Robust quarter with limited lockdown impact

SUMMARY

Building Materials

We expect the ongoing lockdown to severely hamper demand for building materials in H1FY21 with some revival only from H2. Longer credit periods and incentives to distributors/dealers in FY21 would erode margins and balance sheet health in the near term, but this should normalise in FY22. We scale back FY22 earnings estimates for our coverage companies by 8-40% and cut target prices, but remain positive given strong balance sheet profiles – SI, KJC (both raised from ADD to BUY), CRS and MTLM are top picks.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	570
Eicher Motors	Buy	25,000
Petronet LNG	Buy	330
Reliance Industries	Buy	1,500

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,870
Greenply Industries	Buy	145
Laurus Labs	Buy	510
Transport Corp	Buy	355
Ashok Leyland	Sell	64

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.72	(5bps)	(8bps)	(185bps)
India 10Y yield (%)	6.49	5bps	43bps	(92bps)
USD/INR	76.27	0	(3.0)	(10.3)
Brent Crude (US$/bbl)	31.48	(4.1)	(15.4)	(56.0)
Dow	23,719	1.2	(5.2)	(10.2)
Shanghai	2,797	(1.0)	(6.7)	(12.3)
Sensex	31,160	4.2	(12.6)	(19.6)
India FII (US$ mn)	**8 Apr**	**MTD**	**CYTD**	**FYTD**
FII-D	(256.5)	(568.7)	(10,328.2)	(568.7)
FII-E	273.6	111.2	(6,491.8)	111.2

Source: Bank of Baroda Economics Research

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India Economics: Weekly Wrap

Globally risk sentiment improved with new projections showing US deaths may be lower than worst case scenario anticipated earlier. Equity markets went up and currencies rebounded. Fed (US$ 2.3tn) and EU (€ 0.5tn) announced further stimulus. Oil fell even as OPEC+ members agreed on a 9.7mn bpd production cut. India's 10Y yield rose by 19bps as FII outflow persisted in the debt segment (US$ 408mn) on fiscal concerns. Markets are hoping of global and domestic flattening of COVID curve.

Click here **for the full report.**

India Economics: March MPC Minutes

MPC members voted unanimously to cut rates and keep an accommodative stance. Dr. Ghate and Dr. Dua voted for 50bps cut. Others 75bps. The larger cut was justified as RBI estimates inflation to fall to 2.6% in H2FY21. While Dr. Dholakia sees room for further rate cuts, the low base implies inflation will be near RBI's mandate in H2FY22. With no growth forecast put out by RBI, we believe further reduction in global and domestic growth impulses may call for a further rate cut. But overwhelming focus will be on financial stability.

Click here **for the full report.**

India Economics: Inflation

CPI moderated to a 4-month low of 5.9% in Mar'20 led by food inflation. Within food, vegetables and protein based items such as milk, eggs and fish noted considerable deceleration. Core was stable at 4.1%. Given the expected dip in discretionary demand, core inflation is likely to remain muted. Food inflation will see some upside risk in near-term due to supply disruptions. While RBI may reduce rates further, focus of monetary policy will be availability of liquidity with real economy and financial stability.

Click here **for the full report.**

Gujarat Gas

Our recent interaction with the Gujarat Gas (GUJGA) management reinforces our core investment thesis: (a) a V-shaped recovery in gas consumption from industrial segments (80% of volumes) post lifting of the economic lockdown, (b) resilient operating margin outlook given benign spot LNG prices, and (c) improved long-term demand outlook for pharma/chemical/ ceramic units in Gujarat vis-à-vis Chinese imports post Covid-19 disruptions. At 12.7x FY22E EPS, GUJGA remains most attractive among CGD peers.

Click here for the full report.

Diversified Financials: Q4FY20 Preview

We expect BAF, MUTH and MGFL to register strong AUM growth in Q4FY20 even as efficient opex and risk management keep profits buoyant. Given that the Covid-19 lockdown began only towards the end of March, it is unlikely to have a meaningful impact on Q4 growth or profits. HDFCAMC is expected to gain market share in liquid funds and maintain profitability. NAM, however, could see run-off in debt, arbitrage and tax-saver funds, and hence lower profits. Management comments on lockdown implications for the year ahead will be a key monitorable.

Click here for the full report.

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BUILDING MATERIALS

13 April 2020

Lockdown to mar near-term prospects; structural drivers intact

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We expect the ongoing lockdown to severely hamper demand for building materials in H1FY21 with some revival only from H2. Longer credit periods and incentives to distributors/dealers in FY21 would erode margins and balance sheet health in the near term, but this should normalise in FY22. We scale back FY22 earnings estimates for our coverage companies by 8-40% and cut target prices, but remain positive given strong balance sheet profiles – SI, KJC (both raised from ADD to BUY), CRS and MTLM are top picks.

Demand revival only in FY22: The Covid-19 lockdown will materially dent earnings for our building material coverage, implying a dull H1FY21. We expect demand recovery only from H2FY21 assuming the coronavirus is under control by Q1FY21. Lack of skilled and unskilled labour who have migrated en masse to their hometowns is an added concern. Though FY22 should be a better year, growth will be slower due to the lingering impact of Covid-19. We cut revenue for coverage stocks by 18-30% for FY21 and 9-21% for FY22 (Fig 2). Given a likely shakeout in the informal sector, organised players should benefit in the long run.

Near-term impact on margins and working capital: With dealers/distributors facing earnings disruptions, we believe large building material companies will support their channel partners by way of added credit and incentives in FY21. Consequently, margins and balance sheets will be stretched while slow sales will lead to negative operating leverage for the year. We thus cut earnings estimates for our coverage companies by 17-69% in FY21 and 8-40% in FY22 (Fig 4). As most coverage stocks have strong balance sheets and cash flows, they will weather the near-term headwinds. We expect a return to near normalcy in FY22.

Target prices cut; ratings broadly maintained: Based on our revised estimates, we cut Mar'21 target prices for our coverage stocks by 8-52%. Despite near-term challenges due to Covid-19, we believe the long-term structural story for the building material sector remains intact. We continue to like companies that have strong brands, wide distribution and sound balance sheets – Supreme Industries (SI), Kajaria Ceramics (KJC), Cera Sanitaryware (CRS) and Greenply Industries (MTLM) are our preferred picks. We upgrade SI and KJC to BUY from ADD given upside potential. Ratings for the rest of our coverage remain unchanged given the recent stock price correction.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
KJC IN	366	425	BUY
SOMC IN	101	165	BUY
CRS IN	2,191	2,550	BUY
PIDI IN	1,349	1,110	SELL
MTLM IN	97	145	BUY
CPBI IN	113	155	BUY
ASTRA IN	970	925	REDUCE
FNXP IN	374	545	BUY
SI IN	894	1,030	BUY
GREENP IN	29	46	BUY

Price & Target in Rupees

WEEKLY WRAP

13 April 2020

Markets hopeful of a flattening COVID curve

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Globally risk sentiment improved with new projections showing US deaths may be lower than worst case scenario anticipated earlier. Equity markets went up and currencies rebounded. Fed (US$ 2.3tn) and EU (€ 0.5tn) announced further stimulus. Oil fell even as OPEC+ members agreed on a 9.7mn bpd production cut. India's 10Y yield rose by 19bps as FII outflow persisted in the debt segment (US$ 408mn) on fiscal concerns. Markets are hoping of global and domestic flattening of COVID curve.

Markets

- **Bonds:** Global yields closed mixed. US 10Y yield rose by 12bps (0.72%) even as FOMC minutes highlighted that downside risks to growth have increased significantly. Fed also unveiled a US$ 2.3tn stimulus package to help main street small enterprises. EU finance ministers agreed on a € 0.5tn support to the economy. Oil prices fell by (-) 7.7% (US$ 31/bbl) despite OPEC+ decision to cut output by 9.7mn bpd. India's 10Y yield rose by 19bps (6.49%) as fiscal worries persisted. System liquidity surplus rose to Rs 4.8tn as on 9 Apr 2020 vs Rs 4.6tn in the previous week.

- **Currency:** Except INR, other global currencies closed higher on improved risk sentiment. DXY fell by (-) 1.1% in the week. AUD rose the most by 5.9% as RBA left policy rate unchanged at 0.25%. EUR and GBP too gained. INR depreciated by (-) 0.1% in the week to hover around its historic lows as FPI outflows receded.

- **Equity:** Global indices ended the week higher led by improved outlook with possible peaking of the COVID-19 cases. Dow surged by 12.7% on the hope that US will do better than worst case scenario. European indices too ended in green. Sensex (12.9%) too rose on the back of likely flattening of COVID-19 curve in India and anticipation of fresh stimulus by government. Auto and banking stocks advanced the most.

- **Upcoming key events:** Markets will track COVID-19 cases which have increased by 504k from 564k last week. Indonesia's policy rate, industrial production of China, Japan, Euro Area along with China's GDP and US housing starts, jobless claims, and advance retail sales will be in focus. On the domestic front, inflation and trade data is awaited.

MARCH MPC MINUTES

13 April 2020

Growth concerns warranted a larger cut

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MPC members voted unanimously to cut rates and keep an accommodative stance. Dr. Ghate and Dr. Dua voted for 50bps cut. Others 75bps. The larger cut was justified as RBI estimates inflation to fall to 2.6% in H2FY21. While Dr. Dholakia sees room for further rate cuts, the low base implies inflation will be near RBI's mandate in H2FY22. With no growth forecast put out by RBI, we believe further reduction in global and domestic growth impulses may call for a further rate cut. But overwhelming focus will be on financial stability.

KEY HIGHLIGHTS

- Inflation expected to remain below RBI's target in FY21.
- Risks to growth remain tilted to the downside.
- Focus will be on financial stability.

Out of turn cut to prioritise growth: MPC members believe a combination of fiscal and monetary measures are required to mitigate the economic impact arising from COVID-19. Dr. Ghate believes monetary policy should aim to minimise fall in aggregate demand. In a demand deficient economy a large rate cut is akin to pushing on a string. Hence, second fiscal stimulus will be helpful. While RBI has not given a growth forecast for FY21, Dr. Raj pointed out that growth is likely to be weak for three reasons: 1) lower discretionary spending, 2) low external demand and 3) delay in revival of investment activity.

Inflation to remain benign: In the MPR, RBI has projected CPI inflation to ease to 2.4% in Q4FY21 from a high of 4.8% in Q1FY21. This is predicated on 1) oil prices at US$ 35/bbl, 2) contraction of global growth in 2020, 3) INR at 75 to US$ and 4) normal monsoon. The decline in inflation is also contingent on pass-through of lower oil international prices. While lower domestic demand implies inflation, in particular, core should see downside pressures some near-term fluctuations due to supply side disruptions are not ruled out. For FY21, RBI's new inflation projection is 3.6% which is 60bps lower than projections by professional forecasters.

Is there space for more: Dr. Dholakia emphasised that there is room for further rate cuts to support growth as inflation is likely to be under control. The current projection of CPI inflation by RBI for H2FY21 is at 2.6% compared with 4.6% in H1FY21. Correspondingly, low base effect implies inflation will rise in H2FY22 closer to RBI's mandate unless global oil prices or aggregate demand falls from current levels. Thus we believe focus of RBI in the next few policies will be 1) financial stability, 2) provision of adequate liquidity, 3) implementation of RBI's forbearance norms, and 4) transmission of earlier rate cuts.

INFLATION

13 April 2020

Inflation falls, will ease further

CPI moderated to a 4-month low of 5.9% in Mar'20 led by food inflation. Within food, vegetables and protein based items such as milk, eggs and fish noted considerable deceleration. Core was stable at 4.1%. Given the expected dip in discretionary demand, core inflation is likely to remain muted. Food inflation will see some upside risk in near-term due to supply disruptions. While RBI may reduce rates further, focus of monetary policy will be availability of liquidity with real economy and financial stability.

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KEY HIGHLIGHTS

- CPI moderates to 5.9% in Mar'20 compared to 6.6% in Feb'20.
- Led by edging down of food inflation especially vegetables.
- CPI to remain within RBI's 4% target in H2FY21, which opens policy space.

Food inflation softens: Headline CPI eased to a 4-month low of 5.9% in Mar'20 from 6.6% in Feb'20 led by drop in food inflation. Food inflation slipped to 5-month low of 8.8% in Mar'20 from 10.8% in Feb'20 led by vegetables. Vegetable prices increased by 18.6% in Mar'20 compared with a jump of 31.6% in Feb'20. In addition, prices of eggs increased by 5.6% compared with an increase of 7.3% in Feb'20. Other categories such as meat and fish, fruits, pulses and sugar also reported a deceleration.

Core remained stable: CPI inflation excluding food and fuel was stable at 4.1% in Mar'20. Within core, personal care and effects segment saw the maximum increase at 8.9% (+190bps) followed by pan, tobacco and intoxicants (+60bps increase to 4.7%) and clothing and footwear (+6bps increase to 2.1%). On the other hand, considerable decline was visible in transport and communication inflation (-90bps to 4.3%), on account of some pass-through of (-) 39% drop in crude prices in Mar'20. Outlook of core inflation is one of moderation as discretionary demand will be impacted due to lockdown and gradual resumption of economic activity.

Inflation outlook and monetary policy: RBI's latest forecast for CPI inflation in FY21 is 3.6% with Q4FY21 inflation at 2.4%. Our estimate for FY21 and FY22 is at 3.8% and 3.7% respectively. Minutes from the latest MPC meeting show Dr Dholakia considering further rate cuts to support growth. With a number of states extending lockdown and gradual resumption of economic activity expected, we believe GDP growth for FY21 may fall as low as 1.5% before recovering to 5.3% in FY22. In the above context unconventional monetary policy measures such as extending liquidity lines to banks in order to on-lend to real economy and restructuring of loans may be more relevant along with policy rate reduction.

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BUY
TP: Rs 265 | ⮝ 13%

GUJARAT GAS | Oil & Gas | 13 April 2020

Resilient in the face of near-term headwinds

Our recent interaction with the Gujarat Gas (GUJGA) management reinforces our core investment thesis: (a) a V-shaped recovery in gas consumption from industrial segments (80% of volumes) post lifting of the economic lockdown, (b) resilient operating margin outlook given benign spot LNG prices, and (c) improved long-term demand outlook for pharma/chemical/ ceramic units in Gujarat vis-à-vis Chinese imports post Covid-19 disruptions. At 12.7x FY22E EPS, GUJGA remains most attractive among CGD peers.

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Improved long-term volume prospects: Ceramic units in Morbi (Gujarat) were absorbing >6mmscmd of GUJGA's volumes until Mar'20. Management expects these units (as also pharma/chemical plants) to benefit from a preference for 'Made in India' products post Covid-19. We expect industrial volumes that are currently down ~50% due to the economic lockdown to show a V-shaped recovery within a month of restrictions being lifted and to potentially retrace to growth of 1mmscmd p.a. from H2FY21. In PNG, domestic demand has made up for the fall in commercial volumes. CNG (down >80%) may take longer to stabilise.

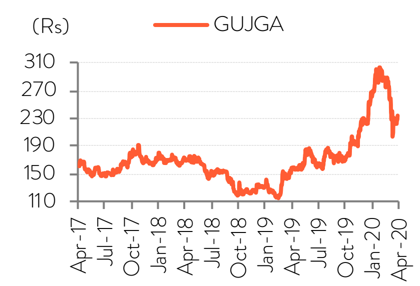
Volume potential from new areas to fructify from FY21: GUJGA's expansion plans are unlikely to be affected by the lockdown as a bulk of its capex usually occurs in H2 each year. The company plans to continue entering newer areas and has maintained capex guidance at Rs 6bn-7bn p.a. The initial strategy is to tap potential from existing networks (Rajasthan to rural Thane near Mumbai). This would help it to simultaneously tap volumes from new areas such as Dahej, Punjab (licenced for six areas) and Rajasthan, that offer 4-5mmscmd potential.

Undemanding valuations: At 12.7x FY22E EPS, GUJGA's valuations remain attractive vs. CGD peers (~15x for IGL/MAHGL). Expected volume and margin stability could narrow this gap. Maintain BUY with a Mar'21 TP of Rs 265.

Ticker/Price	GUJGA IN/Rs 235
Market cap	US$ 2.1bn
Shares o/s	688mn
3M ADV	US$ 4.1mn
52wk high/low	Rs 314/Rs 151
Promoter/FPI/DII	61%/12%/27%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	61,743	77,544	103,191	78,379	91,749
EBITDA (Rs mn)	8,951	9,836	16,670	16,924	20,001
Adj. net profit (Rs mn)	2,914	4,160	12,555	9,993	12,602
Adj. EPS (Rs)	4.2	6.0	18.2	14.5	18.3
Adj. EPS growth (%)	32.7	42.8	201.8	(20.4)	26.1
Adj. ROAE (%)	16.7	20.6	45.8	27.9	32.1
Adj. P/E (x)	55.6	38.9	12.9	16.2	12.8
EV/EBITDA (x)	20.3	18.7	10.9	10.5	8.7

Source: Company, BOBCAPS Research

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DIVERSIFIED FINANCIALS | Q4FY20 Preview | 13 April 2020

Robust quarter with limited lockdown impact

We expect BAF, MUTH and MGFL to register strong AUM growth in Q4FY20 even as efficient opex and risk management keep profits buoyant. Given that the Covid-19 lockdown began only towards the end of March, it is unlikely to have a meaningful impact on Q4 growth or profits. HDFCAMC is expected to gain market share in liquid funds and maintain profitability. NAM, however, could see run-off in debt, arbitrage and tax-saver funds, and hence lower profits. Management comments on lockdown implications for the year ahead will be a key monitorable.

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Key expectations: We expect Bajaj Finance (BAF) to register a strong quarter with declared AUM growth of 27% YoY, though credit cost will be similar to Q3 at 230bps. Gold finance NBFCs, Muthoot Finance (MUTH)/Manappuram Finance (MGFL), are likely to post robust gold loan AUM growth of 17%/29% as 30-50% of disbursals are digital and thus unaffected by the lockdown. We see benign credit costs for both players. Among AMCs, our channel checks suggest HDFC AMC will gain market share in liquid funds, aiding profitability. We forecast a 7% YoY PAT decline for Nippon Life India AMC (NAM) due to fund outflows.

RECOMMENDATION SNAPSHOT

Ticker	Rating
BAF IN	BUY
MUTH IN	BUY
MGFL IN	BUY
HDFCAMC IN	BUY
NAM IN	SELL

FIG 1 – Q4FY20 EXPECTATIONS

NBFCs	Q4FY20E (Rs bn)	YoY (%)	QoQ (%)	Comments
BAF				We expect stable spreads at ~11% levels and a 23% YoY rise in EBITDA. AUM growth was announced at 27% YoY vs. 32% estimated. Credit cost is projected at ~230bps, similar to Q3. Expect a 21% YoY increase in PAT.
AUM	1,476	27.4	1.7	
NII	44	28.5	(3.8)	
PAT	14	21.4	(11.5)	
MUTH				AUM is estimated to rise 17% YoY, maintaining its steady growth streak of the last seven quarters. NII should increase 20% YoY backed by stable spreads. With the cost/income ratio at 29%, we expect EBITDA to grow 32% YoY to Rs 10.8bn. Benign credit cost would aid 57% YoY PAT growth.
AUM	399	16.6	3.7	
NII	15	20.0	(6.0)	
PAT	8	56.9	(0.1)	
MGFL				Gold loan growth is estimated at 29% YoY – a secular growth trend for the last seven quarters. We forecast stable spreads and 11% YoY NII growth. With high expenses (collection efforts and new hires) but benign credit cost, we project a 5% YoY increase in PAT to Rs 2.2bn.
AUM	167	28.6	2.7	
NII	7	10.7	(11.0)	
PAT	2	5.0	(33.0)	
AMCs	**Q4FY20E (Rs bn)**	**YoY (%)**	**QoQ (%)**	**Comments**
HDFCAMC				Revenue growth is estimated at ~10% YoY to Rs 5.4bn, largely driven by stable yields of 53-55bps on AAUM. Strong opex control should translate to EBITDA of Rs 4.1bn and PAT of Rs 3.4bn. Our channel checks suggest that HDFCAMC has gained market share in liquid funds.
Investment Revenue	5	9.7	2.0	
EBITDA	4	15.0	(0.2)	
PAT	3	22.0	(5.0)	
NAM				We expect run-off in debt, arbitrage funds and tax-saver funds due to the lack of alpha generation over the past five years. Revenue is estimated to drop 10% YoY to Rs 3.1bn, though yields should be flattish. EBITDA margins are likely to hold at 48-49%. PAT is forecast to decline 7% YoY to Rs 1.4bn.
Investment Revenue	3	(10.0)	2.0	
EBITDA	2	7.0	3.0	
PAT	1	(6.5)	(5.0)	

Source: BOBCAPS Research | Note: AUM is actual for BAF; AUM for MUTH and MGFL refers to gold AUM

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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