FIRST LIGHT

04 November 2019

RESEARCH

Yes Bank | Target: Rs 40 | –40% | SELL

No respite from asset quality woes

Future Supply Chain Solutions | Target: Rs 680 | +33% | BUY

Dull Q2 as demand slowdown deepens

Dr Reddy's Labs | Target: Rs 2,960 | +7% | ADD

Multiple one-offs – US to recover from Q3

Laurus Labs | Target: Rs 480 | +30% | BUY

All-round beat – formulations turn EBITDA positive; BUY

SUMMARY

Yes Bank

Yes Bank (YES) reported a Rs 6bn loss due to a one-time DTA impact of Rs 7.1bn. Operating metrics were also weak as NII growth fell 10% YoY and pre-provision profit plunged 38%. Asset quality worsened, with a rise in the 'BB & below' book to Rs 314bn, while FY20 credit cost guidance was doubled to 225-250bps from 125bps. Slippages stayed high at Rs 59.5bn (Rs 62.3bn in Q1), including Rs 20bn from the 'non-BB & below' book. We cut estimates materially on growth and asset quality travails; SELL with a revised Sep'20 TP of Rs 40 (from Rs 50).

Click here for the full report.

Future Supply Chain Solutions

Future Supply Chain's (FSCSL) Q2FY20 standalone earnings nosedived 64% YoY (ex. Ind-AS 116), dented by lower EBITDA (–13% YoY) and higher depreciation (+61%) & interest costs (+332%). The consumption slowdown and consequent deferral of warehouse space addition plans will continue to weigh on earnings in H2. Gradual transition of anchor customer operations to FSCSL's distribution centres and robust client addition are growth triggers beyond FY20. We slash FY20-FY22 EPS by 11-45% and roll to a Mar'21 TP of Rs 680 (vs. Rs 730).

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	555
GAIL	Buy	200
HPCL	Buy	400
ONGC	Buy	200
TCS	Add	2,230

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,230
Future Supply	Buy	680
Greenply Industries	Buy	200
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.69	(8bps)	3bps	(144bps)
India 10Y yield (%)*	6.65	(2bps)	(5bps)	(117bps)
USD/INR	70.93	0	(0.1)	3.4
Brent Crude (US$/bbl)	60.23	(0.6)	(0.9)	(17.4)
Dow	27,046	(0.5)	0.5	6.6
Shanghai	2,929	(0.3)	0.8	12.4
Sensex	40,129	0.2	3.8	16.5
India FII (US$ mn)	**30 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	67.4	564.2	4,537.6	3,993.0
FII-E	1,069.8	1,781.0	9,941.8	3,096.6

Source: Bank of Baroda Economics Research | *7.26% GS 2029

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Dr Reddy's Labs

Q2 headline EBITDA of Rs 14bn (Rs 8.5bn est.) had multiple one-time impacts: (1) licensing income of Rs 6.84bn net of cost, (2) sales hit in the US ($10mn-15mn in our view) from Ranitidine recall & logistic issues, and (3) Rs 1bn in SG&A. Adj. EBITDA was a 3% miss. The 13% QoQ drop in US sales is transitionary and should reverse from Q3. India growth at 9.4% YoY was lower than expected and ROW in line. Impairment charge of Rs 3.5bn and tax benefit of Rs 5.2bn were other one-offs driving PAT. Retain TP of Rs 2,960 on reasonable valuations.

Click here for the full report.

Laurus Labs

Laurus Labs reported its best-ever EBITDA in Q2FY20 with a good topline beat, led by strong operating leverage in the formulation business and gross margin expansion. Weakness in ARVs was a key negative. EBITDA stood at Rs 1.4bn with 19% margins. Profit were Rs 567mn due to low tax. Laurus expects to sustain momentum in H2 even though oncology and other APIs could see mild sales moderation. We retain our TP of Rs 480 and raise FY21/FY22 EBITDA by 5%. Improving returns ratios and positive FCF are focus areas for FY21.

Click here for the full report.

RESULT REVIEW

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

SELL
TP: Rs 40 | ⮟ 40%

YES BANK | Banking | 01 November 2019

No respite from asset quality woes

Yes Bank (YES) reported a Rs 6bn loss due to a one-time DTA impact of Rs 7.1bn. Operating metrics were also weak as NII growth fell 10% YoY and pre-provision profit plunged 38%. Asset quality worsened, with a rise in the 'BB & below' book to Rs 314bn, while FY20 credit cost guidance was doubled to 225-250bps from 125bps. Slippages stayed high at Rs 59.5bn (Rs 62.3bn in Q1), including Rs 20bn from the 'non-BB & below' book. We cut estimates materially on growth and asset quality travails; SELL with a revised Sep'20 TP of Rs 40 (from Rs 50).

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Increase in stressed book a big negative: The BB & below book surged to Rs 314bn (vs. Rs 295bn) due to additions of Rs 52bn from accounts such as Cox & Kings, CG Power, CCD and Altico. Credit cost guidance was increased to a steep 225-250bps for FY20. YES used Rs 21bn of contingent provisions in H1FY20 and has none left to cover advances (67%), but has MTM provisions worth Rs 15bn towards investments (28%) in the BB & below book. Telecom exposure stood at 3% while CRE exposure stood at 7%, with 33% being part of the BB & below book (including NPA) and ~50% rated as BBB.

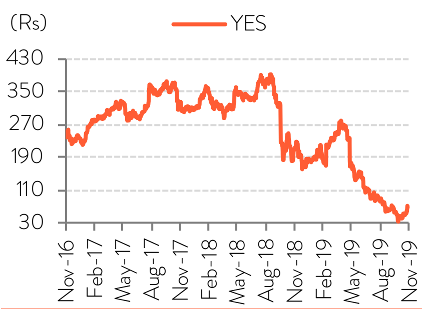
Capital raise around the corner: YES consulted SEBI before announcing the binding US$ 1.2bn offer received from a global investor, valid till 30 Nov – deal pricing will be as per the SEBI formula (two-week average price) or a mutually agreed figure. Apart from this, the bank has received several other non-binding bids from domestic and global institutional investors and family offices.

Retain SELL: We slash FY20-FY22 earnings estimates on slower loan growth, higher slippages and a rise in credit costs. Our Sep'20 TP thus stands revised to Rs 40; we remain sellers as we await clarity on stabilisation of the 'BB & below' rated pool, adherence to credit cost guidance and capital raising.

Ticker/Price	YES IN/Rs 67
Market cap	US$ 2.2bn
Shares o/s	2,318mn
3M ADV	US$ 216.2mn
52wk high/low	Rs 286/Rs 29
Promoter/FPI/DII	20%/40%/41%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	77,370	98,090	89,461	93,551	103,889
NII growth (%)	33.5	26.8	(8.8)	4.6	11.1
Adj. net profit (Rs mn)	42,245	17,203	(5,248)	9,166	18,935
EPS (Rs)	18.4	7.5	(1.6)	2.0	3.7
P/E (x)	3.6	8.9	(41.6)	33.3	18.1
P/BV (x)	0.6	0.6	0.8	0.9	0.9
ROA (%)	1.6	0.5	(0.1)	0.2	0.4
ROE (%)	17.7	6.5	(1.6)	2.5	4.9

Source: Company, BOBCAPS Research

RESULT REVIEW

BUY
TP: Rs 680 | ⮝ 33%

FUTURE SUPPLY CHAIN SOLUTIONS | Logistics | 03 November 2019

Dull Q2 as demand slowdown deepens

Future Supply Chain's (FSCSL) Q2FY20 standalone earnings nosedived 64% YoY (ex. Ind-AS 116), dented by lower EBITDA (–13% YoY) and higher depreciation (+61%) & interest costs (+332%). The consumption slowdown and consequent deferral of warehouse space addition plans will continue to weigh on earnings in H2. Gradual transition of anchor customer operations to FSCSL's distribution centres and robust client addition are growth triggers beyond FY20. We slash FY20-FY22 EPS by 11-45% and roll to a Mar'21 TP of Rs 680 (vs. Rs 730).

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Revenue growth weakens: Revenue growth slowed to 12% YoY as contract logistics moderated to 15% (despite ~30% YoY space addition). Warehouse utilisation was hit by (1) the consumption slowdown which led to lower customer throughput in some discretionary categories (e.g. fashion), and (2) anchor customer's delays in moving existing operations to FSCSL's distribution centres (DC). Express volumes fell 6% YoY, but better yields (+4.5%) capped the revenue decline at 1.5%.

Margin pressure continues: A lower gross margin (–375bps YoY) pulled down the EBITDA margin by 290bps YoY to 10.5% (ex. Ind-AS 116), negating lower employee (–70bps YoY) and other expenses (–13bps) as a percentage of sales.

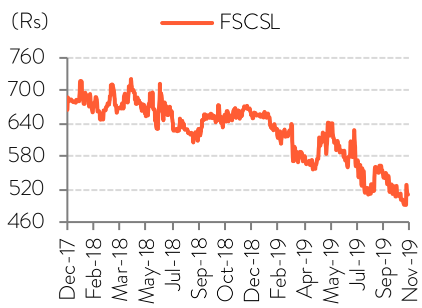
Material growth uptick unlikely in H2: Amid the slowdown, FSCSL has deferred its space addition plans (only 0.7mn sq ft added in H1 vs. 2.5mn planned in FY20). Festive season demand has been subpar and the tough demand climate is likely to weigh on H2 growth. Management expects space absorption in DCs by the anchor customer to pick up in Q3, lending some respite.

TP reduced: We cut FY20E/FY21E/FY22E earnings by 45%/26%/11% and move to a revised Mar'21 TP of Rs 680 set at 22x P/E (vs. 24x). Maintain BUY.

Ticker/Price	FSCSL IN/Rs 510
Market cap	US$ 287.8mn
Shares o/s	40mn
3M ADV	US$ 0.1mn
52wk high/low	Rs 711/Rs 490
Promoter/FPI/DII	52%/5%/19%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	8,319	11,128	13,135	16,343	20,171
EBITDA (Rs mn)	1,332	1,485	1,395	2,127	2,754
Adj. net profit (Rs mn)	903	964	515	838	1,237
Adj. EPS (Rs)	22.5	24.0	12.9	20.9	30.8
Adj. EPS growth (%)	92.8	6.7	(46.6)	62.6	47.5
Adj. ROAE (%)	21.8	17.0	8.2	12.1	15.7
Adj. P/E (x)	22.6	21.2	39.6	24.4	16.5
EV/EBITDA (x)	15.6	13.4	15.3	10.4	8.4

Source: Company, BOBCAPS Research

RESULT REVIEW

ADD

TP: Rs 2,960 | ⮝ 7%

DR REDDY'S LABS | Pharmaceuticals | 01 November 2019

Multiple one-offs – US to recover from Q3

Q2 headline EBITDA of Rs 14bn (Rs 8.5bn est.) had multiple one-time impacts: (1) licensing income of Rs 6.84bn net of cost, (2) sales hit in the US ($10mn-15mn in our view) from Ranitidine recall & logistic issues, and (3) Rs 1bn in SG&A. Adj. EBITDA was a 3% miss. The 13% QoQ drop in US sales is transitionary and should reverse from Q3. India growth at 9.4% YoY was lower than expected and ROW in line. Impairment charge of Rs 3.5bn and tax benefit of Rs 5.2bn were other one-offs driving PAT. Retain TP of Rs 2,960 on reasonable valuations.

Vivek Kumar
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US weak; expect recovery in Q3: US sales fell 13% QoQ to US$ 204mn. Ranitidine and base price erosion had a lower impact than disruption from logistic issues, and hence is transitionary. Excluding this, US business was a tad lower than the Q1 base. Contribution in H2 should be higher (vs. H1 US$ 437mn) given Dr Reddy's (DRRD) has planned +16 launches and benefits from gVigabatrin, Carboprost and Pregabalin should reflect (launched in late Jul'19).

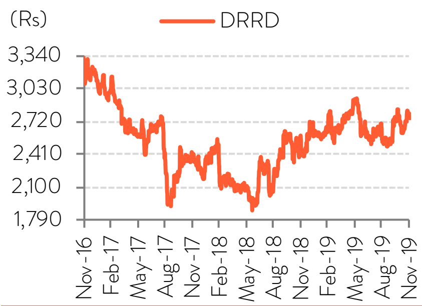
Cost control continues: Core EBITDA margin was stable QoQ at 19% as the tight leash on expenses continues. Opex (staff, R&D, SG&A) was flat YoY and down 2% for H1. DRRD has guided for lower R&D in the US$ 200mn-240mn range for FY20 (vs. US$ 250mn+). We expect 22% margins in H2 as US launches deliver and PSAI margins hold steady. Core EPS for Q2/H1 is Rs 24/ Rs 46. We retain FY21/FY22 EPS factoring NuvaRing and Copaxone launches. Srikakulam API resolution, gRevlimid & gVimovo launches are upside risks.

Earnings call takeaways: (1) Rs 3.5bn impairment charge relates to intangibles on 3 products: Ramelteon, Tobramycin, Imiquimod. (2) gNuvaring/Copaxone expect to submit response on CRL in the near term. (3) Srikakulam/CTO-6 reinspection expected soon. (4) Logistics disruption fixed; products already shipped in Oct'19.

Ticker/Price	DRRD IN/Rs 2,757
Market cap	US$ 6.5bn
Shares o/s	166mn
3M ADV	US$ 23.5mn
52wk high/low	Rs 2,964/Rs 1,873
Promoter/FPI/DII	27%/27%/18%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	142,028	153,852	176,350	192,842	204,855
EBITDA (Rs mn)	22,869	31,333	40,740	42,437	44,388
Adj. net profit (Rs mn)	9,404	17,895	23,531	25,326	27,277
Adj. EPS (Rs)	56.7	107.8	141.8	152.6	164.3
Adj. EPS growth (%)	(20.1)	90.3	31.5	7.6	7.7
Adj. ROAE (%)	7.7	13.8	15.6	14.5	13.8
Adj. P/E (x)	48.7	25.6	19.4	18.1	16.8
EV/EBITDA (x)	21.4	15.5	11.6	10.8	9.9

Source: Company, BOBCAPS Research

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TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 480 | ⮝ 30%

LAURUS LABS | Pharmaceuticals | 01 November 2019

All-round beat – formulations turn EBITDA positive; BUY

Laurus Labs reported its best-ever EBITDA in Q2FY20 with a good topline beat, led by strong operating leverage in the formulation business and gross margin expansion. Weakness in ARVs was a key negative. EBITDA stood at Rs 1.4bn with 19% margins. Profit were Rs 567mn due to low tax. Laurus expects to sustain momentum in H2 even though oncology and other APIs could see mild sales moderation. We retain our TP of Rs 480 and raise FY21/FY22 EBITDA by 5%. Improving returns ratios and positive FCF are focus areas for FY21.

Vivek Kumar
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Q2 margin surprise could sustain: Operating leverage in formulations is clearly visible in the Q2 EBITDA margins of 19% (up 6.5ppt YoY & 4.2ppt QoQ), despite flat gross margins QoQ (up 300bps YoY on softer RM prices from China) and other expense rising 25% QoQ. The step-up in share of high-margin businesses (ex-ARVs) is tracking well and has continued to improve even in Q2, to 51% of sales (from 46% in Q1 and 31% in FY19). Synthesis should see robust growth in H2 led by CDMO supplies.

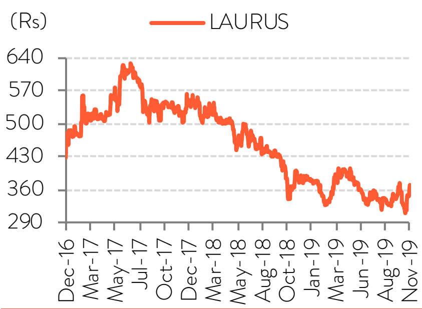
Solid execution on formulations to drive early breakeven: Formulation sales in Q2 remained strong at US$ 22.5mn (US$ 37.5mn in H1), led by LMIC markets. Management has raised the FY20 sales target to US$ 70mn (vs. US$ 40mn); this should advance breakeven from FY21 to FY20 as we estimate Rs 400mn in EBITDA. We upgrade our FY21 estimates and now expect +20% sales growth with >15% margins. The next major capex drive should largely be in FY22.

Earnings call highlights: (1) Laurus expects balance sheet inventory to moderate (up by Rs 2.2bn over Mar-Sep'19). (2) Annualised formulations opex is Rs 1.8bn-1.9bn. (3) Delay in supplementary tender results is causing weak ARV sales; could normalise in Q4. (4) TLE 400 FDA approval expected in four months.

Ticker/Price	LAURUS IN/Rs 370
Market cap	US$ 554.5mn
Shares o/s	106mn
3M ADV	US$ 0.2mn
52wk high/low	Rs 412/Rs 303
Promoter/FPI/DII	33%/9%/39%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	20,562	22,919	25,942	29,423	32,693
EBITDA (Rs mn)	4,134	3,560	4,620	6,220	7,389
Adj. net profit (Rs mn)	1,483	937	1,323	2,451	3,122
Adj. EPS (Rs)	13.9	8.8	12.4	23.0	29.3
Adj. EPS growth (%)	(10.8)	(36.8)	41.1	85.3	27.4
Adj. ROAE (%)	10.5	6.2	8.2	13.7	15.3
Adj. P/E (x)	26.5	42.0	29.8	16.1	12.6
EV/EBITDA (x)	11.7	14.0	10.9	8.1	6.7

Source: Company, BOBCAPS Research

Disclaimer

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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