# FIRST LIGHT

08 June 2021

## RESEARCH

### [#1 Watch Out] India Strategy | Climate Action

Clean your way up

### InterGlobe Aviation | Target: Rs 2,000 | +12% | ADD

Strong balance sheet, leadership premium – upgrade to ADD

### Power

Stay selective – sustained rally requires reforms

## SUMMARY

### India Strategy: Climate Action

- Climate fears mounting due to global warming, shift in US stance and surge in ESG activism; coal, oil, auto, steel and cement to bear the brunt
- Industries have room to pass on compliance costs to end users; sunset for coal though. Climate concerns to impact investment decisions hereon
- Renewables, energy efficiency, batteries and hydrogen to dominate fresh capex. Companies leveraged to these technologies have long growth runway

**Click here for the full report.**

### InterGlobe Aviation

- IndiGo's Q4FY21 RASK came in at Rs 3.3, EBITDAR at Rs 7.3bn was hit by rising fuel costs and the company suffered a Rs 11.6bn net loss
- IndiGo looks poised for a strong revenue recovery given its leadership, ready capacity, sound balance sheet and firm footing vis-à-vis peers
- We raise FY23 EPS and value the stock at 9x FY23E adj. EV/EBITDAR for a new TP of Rs 2,000 (vs. Rs 1,100) – upgrade from SELL to ADD

**Click here for the full report.**

## TOP PICKS

### Large-cap ideas

| Company | Rating | Target |
|---|---|---|
| TCS | Buy | 3,780 |
| Tech Mahindra | Buy | 1,190 |
| Tata Power | Buy | 131 |

### Mid-cap ideas

| Company | Rating | Target |
|---|---|---|
| Alkem Labs | Buy | 3,620 |
| Ajanta Pharma | Buy | 2,300 |
| Alembic Pharma | Buy | 1,230 |

Source: BOBCAPS Research

### Daily macro indicators

| Indicator | Current | 2D (%) | 1M (%) | 12M (%) |
|---|---|---|---|---|
| US 10Y yield (%) | 1.53 | (4bps) | (4bps) | 71bps |
| India 10Y yield (%) | 6.01 | (2bps) | (1bps) | 23bps |
| USD/INR | 72.90 | (0.1) | 0.8 | 3.6 |
| Brent Crude (US$/bbl) | 72.22 | 1.0 | 5.8 | 75.4 |
| Dow | 34,600 | (0.1) | (0.5) | 26.9 |
| Shanghai | 3,580 | (0.5) | 4.7 | 21.1 |
| Sensex | 52,276 | (0.1) | 6.2 | 53.9 |
| **India FII (US$ mn)** | **7 Jun** | **MTD** | **CYTD** | **FYTD** |
| FII-D | (61.3) | (69.6) | (2,650.2) | (622.9) |
| FII-E | 22.1 | 612.9 | 7,199.0 | (127.4) |

Source: Bank of Baroda Economics Research

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## Power

- Sector rally in June driven by expected recovery in power demand as Covid-19 restrictions ease but this is not sufficient for the rally to sustain
- Recent regulatory proposals seek to reduce discoms' cost of power but addressing pricing, collection and infrastructure is a bigger challenge
- Recommend that investors be selective. We like TPWR due to possible external investments in renewables, deleveraging and restructuring

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CLIMATE ACTION | #1 Watch Out | 09 June 2021

# Clean your way up

**Kumar Manish**
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- **Climate fears mounting due to global warming, shift in US stance and surge in ESG activism; coal, oil, auto, steel and cement to bear the brunt**
- **Industries have room to pass on compliance costs to end users; sunset for coal though. Climate concerns to impact investment decisions hereon**
- **Renewables, energy efficiency, batteries and hydrogen to dominate fresh capex. Companies leveraged to these technologies have long growth runway**

**Climate concerns at our doorstep:** There is now a near universal consensus on the reality and adverse impacts of global warming. The 2015 Paris Agreement that had most major $CO_2$ emitters committing to specific reduction targets was an important milestone. We are also currently seeing a groundswell of global climate activism. In our view, ESG investing – currently a separate vehicle – will become fully integrated with mainstream investing far sooner than earlier anticipated.

**Pressure on emitters:** Coal-based IPP (45% of India's $CO_2$ emissions per our estimates), automobiles (12%), steel (10%) and cement (8%) are among the largest polluters in India. Pressure is intensifying on these sectors the world over. Auto is already seeing exponential growth in electric vehicles, and calls for climate action on other industries will only become more strident as we draw closer to 2030. It will, for instance, become increasingly difficult to sponsor greenfield coal-based power plants. Our analyses show that global carbon emissions in 2030 will likely be lower than 2019 due to these efforts, but could still far exceed the desired 2°C trajectory.

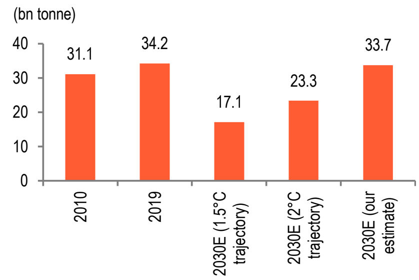
**Implementation of green tech no longer costly:** Contrary to the general perception that the use of clean technology will render several manufacturers unviable, our analyses show that the end consumer price will likely increase by a mere 1-5% across most products if polluting industries such as steel were to shift to greener manufacturing alternatives. Nuclear energy may partly set off the inevitable cutback in coal for base load power supply.

**Winners and losers:** We believe a majority of new capex will be directed towards emission reduction initiatives, which include renewable power generation, electric vehicles, batteries, hydrogen, energy-efficient manufacturing, and carbon capture and storage. Global players leveraged to these technologies include Siemens, ABB, Bosch, 3M, Linde, Honeywell, and Schaeffler. For emitters in India, we expect earnings will remain intact much longer than that of global peers, but valuation multiples will likely start to derate sooner than later due to dwindling interest from large global investors and pension funds.

## Watch Out

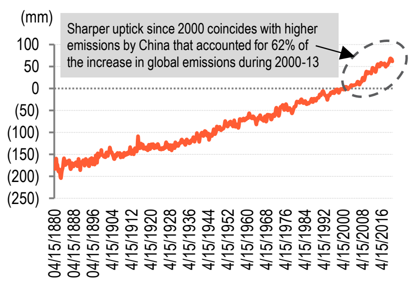
Our new 'Watch Out' series aims to track trends with long-term implications on the Indian economy in general and companies in particular. We focus on environmental concerns in this inaugural edition.

**2030 global emission may be double the desired 1.5°C temperature trajectory**




Source: BOBCAPS Research, BP Statistical Review 2020, IPCC Special Report

**Sea level change vs. 1993-2008 average**




Source: NOAA Climate.gov, USA (sea-level data), BP Statistical Review (carbon emission data), BOBCAPS Research (China's estimated contribution to global emissions)

**ADD**

**TP: Rs 2,000 | ▲ 12%**

## INTERGLOBE AVIATION | Aviation | 09 June 2021

# Strong balance sheet, leadership premium – upgrade to ADD

- **IndiGo's Q4FY21 RASK came in at Rs 3.3, EBITDAR at Rs 7.3bn was hit by rising fuel costs and the company suffered a Rs 11.6bn net loss**
- **IndiGo looks poised for a strong revenue recovery given its leadership, ready capacity, sound balance sheet and firm footing vis-à-vis peers**
- **We raise FY23 EPS and value the stock at 9x FY23E adj. EV/EBITDAR for a new TP of Rs 2,000 (vs. Rs 1,100) – upgrade from SELL to ADD**

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**Disappointing Q4:** IndiGo's Q4 revenue plunged 25% YoY to Rs 62.2bn. RASK was in line with our estimate at Rs 3.3 (excluding other income). Rising fuel costs amidst the ongoing pandemic reduced EBITDAR YoY to Rs 7.3bn, yielding a margin of 11.8% vs. 14.3% reported in Q3FY21. Lower other income, higher interest cost and depreciation induced an adjusted net loss of Rs 11.6bn, translating to negative EPS of Rs 30 for the quarter.

**Strong growth recovery expected:** A benign USDINR, the vulnerability of most of its peers (negative net worth and massive cash burn), and a strong balance sheet are some of the key factors that put IndiGo in a sweet spot for growth in FY23. Though rising crude cost will impact its profitability in the near-to-mid-term, we believe cost headwinds will immensely weaken the competition, thus giving IndiGo a leadership advantage. Our current FY22-FY23 assumptions for crude stand at US$ 65/bbl and for the USDINR stand at Rs 73/USD.

**FY23 earnings to rebound:** We cut our FY22 revenue estimate by 24% owing to the pandemic-linked slowdown but maintain FY23 numbers as normalcy is likely to return by FY22-end. As a result, our EPS for FY22 turns negative at Rs 102 (earlier -Rs 17). IndiGo's decision to maintain its fleet size at 285 but upgrade to more fuel-efficient aircraft will augment earnings in FY23. Accordingly, we revise our FY23 EBITDA estimate upward by 26% and our EPS to 79 (Rs 38 earlier). We are 8% higher than consensus on revenue but 4% lower on EPS for FY23.

**Upgrade to ADD:** We believe demand recovery for the industry will be postponed to FY23, at which time IndiGo is likely to emerge as the biggest beneficiary given its market leadership (~55% share) over peers, ready capacity and sound balance sheet to tide over the pandemic. Given these positives, we now value the stock at 9x FY23E adj. EV/EBITDAR (from 6.5x earlier), revise our Mar'22 TP from Rs 1,100 to Rs 2,000 and upgrade our rating from SELL to ADD.

### Key changes

| Target | Rating |
|---|---|
| ▲ | ▲ |

| | |
|---|---|
| Ticker/Price | INDIGO IN/Rs 1,784 |
| Market cap | US$ 9.4bn |
| Free float | 25% |
| 3M ADV | US$ 21.8mn |
| 52wk high/low | Rs 1,850/Rs 875 |
| Promoter/FPI/DII | 75%/15%/7% |

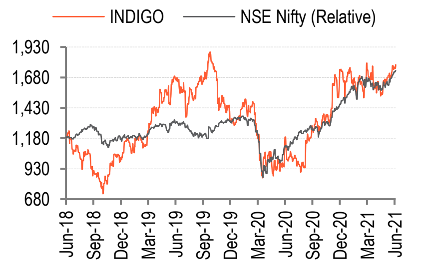
Source: NSE | Price as of 8 Jun 2021

### Key financials

| Y/E 31 Mar | FY21P | FY22E | FY23E |
|---|---|---|---|
| Total revenue (Rs mn) | 146,406 | 253,899 | 437,222 |
| EBITDA (Rs mn) | (5,485) | 19,487 | 81,940 |
| Adj. net profit (Rs mn) | (58,298) | (39,373) | 30,560 |
| Adj. EPS (Rs) | (151.5) | (102.3) | 79.4 |
| Consensus EPS (Rs) | (151.0) | (61.0) | 83.0 |
| Adj. ROAE (%) | (8221.5) | 101.8 | (255.7) |
| Adj. P/E (x) | (11.8) | (17.4) | 22.5 |
| EV/EBITDA (x) | (108.0) | 31.0 | 7.7 |
| Adj. EPS growth (%) | NA | NA | - |

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

### Stock performance




Source: NSE

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## POWER

09 June 2021

# Stay selective – sustained rally requires reforms

- **Sector rally in June driven by expected recovery in power demand as Covid-19 restrictions ease but this is not sufficient for the rally to sustain**
- **Recent regulatory proposals seek to reduce discoms' cost of power but addressing pricing, collection and infrastructure is a bigger challenge**
- **Recommend that investors be selective. We like TPWR due to possible external investments in renewables, deleveraging and restructuring**

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**Power sector rally fuelled by expected demand recovery:** Stocks in our coverage have rallied by 5.2-10.7% in June vs. a 1% gain for the Nifty. An expected rise in power demand after the removal of Covid-related restrictions could have fuelled the rally. A similar run-up after the first wave of the pandemic did not sustain despite a strong revival in power demand (Fig 1).

**Regulatory proposals to reduce discom costs:** The Ministry of Power (MoP) recently proposed the following to reduce discoms' power purchase costs:
**1) Market Based Economic Dispatch (MBED):** Thermal power purchase can be undertaken through a centralised pool of power plants vs. current purchases that are limited to each discom's PPA – this will maximise procurement from cheaper plants and save Rs 120bn or Rs 0.09/unit per MOP's estimates.

**2) Market Based Procurement of Renewables:** Per **The Economic Times**, the government is evaluating a proposal to sell power from new renewable projects on power exchanges. The differential between market-discovered prices and bid prices will be paid by the party that has called the bid (like SECI) every month. Current projects will have an option to shift to this system. Discoms could buy power from the exchange rather than entering into long-term PPAs. Also, SECI's renewable projects awaiting PPAs from discoms can proceed towards construction.

**3) Trading of Renewable Energy Certificates (REC):** MoP proposes to restart REC trading and raise their validity to 15 years for new projects and till the PPA ends for existing projects vs. 3 years earlier. Discoms will be able to meet renewable portfolio obligations (RPO) without signing a PPA with generators by buying RECs.

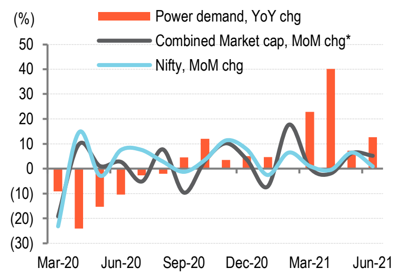
**Discom reforms key for sustainable rally:** While these developments will address the cost side of discom operations to some extent, the pricing, collection and last-mile infrastructure will need remedying to bring about sustainable change and raise investor confidence in the sector. TPWR is our top pick as it is aligning towards renewables and, as the No. 1 private power distributor, it will play a growing role in distribution once the sector opens up. Stock catalysts include new external investments in the renewable business, disinvestment of non-core assets and group restructuring to save costs.

### Recommendation snapshot

| Ticker | Price | Target | Rating |
|---|---|---|---|
| NTPC IN | 116 | 111 | REDUCE |
| PWGR IN | 234 | 261 | ADD |
| TPWR IN | 117 | 131 | BUY |

Price & Target in Rupees | Price as of 8 Jun 2021

### Power stock rallies short-lived




Source: POSOCO, Bloomberg, BOBCAPS Research | *Combined Market Cap of NTPC, PWGR, TPW, TPWR, CESC

# Disclaimer

**Recommendation scale: 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)

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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