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FIRST LIGHT

13 October 2020

RESEARCH

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RBI's moves drive Indian yields lower

BOB Economics Research | Inflation and IIP
Inflation remains uncomfortably high, IIP improves

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Early signs of earnings recovery

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Struggling to return to pre-Covid fundamentals

SUMMARY

India Economics: Weekly Wrap

Global yields and equities went up with hopes of fresh US fiscal stimulus gaining ground. Global currencies gained against US$ led by CNY and AUD. India's 10Y yield fell by 6bps after RBI announced accommodative stance well into next financial year, and on tap TLTRO of Rs 1tn, OMOs for SDLs and extension of HTM limits for banks. RBI projected India's growth at (-) 9.5% in FY21 before rebounding to 20.6% in Q1FY22. With inflation projected above 4% in FY22, we see limited room for further rate cuts.

Click here **for the full report.**

India Economics: Inflation and IIP

India's industrial recovery continued with a decline of 8% in Aug'20 as against 10.8%. Most indicators suggest significant improvement in Sep'20. Inflation has increased further to 7.3% in Sep'20 led by food inflation at 10.7%. Within food as many as 6 items reported double digit increase. Core inflation also remains entrenched at 5.7% due to transport (retail fuel) and personal effects (gold). While inflation is expected to moderate, it will remain above RBI's target. RBI will focus on accommodative liquidity to propel.

Click here **for the full report.**

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	850
GAIL	Buy	155
Petronet LNG	Buy	310
Tech Mahindra	Buy	910

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	270
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.77	(1bps)	10bps	(96bps)
India 10Y yield (%)	5.94	(8bps)	(12bps)	(57bps)
USD/INR	73.13	0.2	0.4	(3.0)
Brent Crude (US$/bbl)	42.85	(1.1)	7.0	(29.2)
Dow	28,587	0.6	3.8	6.6
Shanghai	3,272	1.7	1.2	10.0
Sensex	40,509	0.8	4.3	6.2
India FII (US$ mn)	**8 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	(35.2)	(462.6)	(15,142.3)	(5,382.8)
FII-E	167.3	751.2	4,791.3	11,394.3

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

Banking: Q2FY21 Preview

Q2FY21 is yet another quarter where clarity on asset quality will be keenly awaited amid pandemic uncertainty. Fresh slippages are expected to be lower but credit costs will remain elevated as banks shore up provisions to strengthen their balance sheets. The focus will shift from moratorium to the expected quantum of restructuring. Loan growth is likely to remain subdued but NIMs should be largely stable. We expect operating profit to be impacted by muted fee income, lower treasury gains and a pick-up in opex.

Click here for the full report.

Logistics: Q2FY21 Preview

Aggregate revenue of our logistics coverage universe is expected to decline by 5% YoY in Q2FY21, a marked improvement from the 25% drop in Q1, aided by a gradual easing of lockdown restrictions. Apart from VRLL, all other companies in our coverage are likely to post profit, though none are expected to post earnings growth as yet. After the robust trends heralded by high frequency indicators in Sep'20, we are hopeful of a faster-than-anticipated earnings recovery from Q3 on. TCIEXP remains our top pick in the sector.

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Oil & Gas: Q2FY21 Preview

Q2FY21 has been another volatile quarter for the energy sector, with oil and spot LNG prices recovering from multiyear lows but spreads staying muted for cyclicals. The demand environment remains challenging, albeit with some green shoots in natural gas consumption from industrial segments. RIL's earnings are expected to remain under pressure while OMCs could sustain their earnings traction given high marketing margins. Industrial gas utilities are likely to see sharp volume recovery but CGDs would struggle due to pandemic disruptions.

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WEEKLY WRAP

12 October 2020

RBI's moves drive Indian yields lower

Global yields and equities went up with hopes of fresh US fiscal stimulus gaining ground. Global currencies gained against US$ led by CNY and AUD. India's 10Y yield fell by 6bps after RBI announced accommodative stance well into next financial year, and on tap TLTRO of Rs 1tn, OMOs for SDLs and extension of HTM limits for banks. RBI projected India's growth at (-) 9.5% in FY21 before rebounding to 20.6% in Q1FY22. With inflation projected above 4% in FY22, we see limited room for further rate cuts.

Sameer Narang | Aditi Gupta
chief.economist@bankofbaroda.com

Markets

- **Bonds:** US 10Y yield rose by 7bps as investors pinned their hopes on US fiscal stimulus and potential win for Democrats in the upcoming presidential elections. Oil prices shot up by 9.1% (US$ 42.9/bbl) as hurricane Delta in the Gulf of Mexico impacted output. However, India's 10Y yield fell by 6bps (5.94%) following RBI's guidance of an accommodative stance well into next year and additional liquidity support for corporates and state borrowings. System liquidity surplus was at Rs 3.9tn as on 9 Oct 2020 compared with Rs 3.7tn in the previous week.

- **Currency:** Safe-haven JPY (lower by 0.3%) and DXY (down by 0.8%) fell as risk sentiment improved on hopes of US fiscal stimulus. GBP rose by 0.8% to a 1-month high on hopes of Brexit trade deal. CNY also rose sharply to its highest level since Apr'19 as early indicators point towards a win for the Democrats in the upcoming US elections. INR closed flat as higher oil prices (up by 9.1% in the week) were offset by FII inflows (US$ 277mn) and RBI's liquidity infusion measures.

- **Equity:** Global indices ended the week higher on hopes of US stimulus plan and expectations of Democratic win in the US presidential elections. Sensex (4.7%) surged for 7th straight session on the back of reopening of the economy, green shoots and liquidity measures announced by RBI. This was followed by gains in Dow (3.3%) and FTSE (2.9%).

- **Upcoming key events:** In the current week, US (CPI, jobless claims, retail sales, industrial production) and China (Exports, CPI, PPI) data will be in focus. In addition, Indonesia and S. Korea will announce rate decisions. On the domestic front, CPI, WPI and trade data are scheduled for release.

INFLATION AND IIP

12 October 2020

Inflation remains uncomfortably high, IIP improves

India's industrial recovery continued with a decline of 8% in Aug'20 as against 10.8%. Most indicators suggest significant improvement in Sep'20. Inflation has increased further to 7.3% in Sep'20 led by food inflation at 10.7%. Within food as many as 6 items reported double digit increase. Core inflation also remains entrenched at 5.7% due to transport (retail fuel) and personal effects (gold). While inflation is expected to moderate, it will remain above RBI's target. RBI will focus on accommodative liquidity to propel growth.

Sameer Narang
Jahnavi | Aditi Gupta
chief.economist@bankofbaroda.com

IIP in recovery mode: Industrial output contracted at a slightly slower pace of 8% in Aug'20 compared with a decline of 10.8% in Jul'20. Mining and manufacturing output recovered. Electricity output too declined by only 1.8% in Aug'20. Within manufacturing, intermediate (decline of 6.8% in Aug'20 from 11.7% in Jul'20), infrastructure (decline of 2.3% in Aug'20) and consumer durable goods (contracted by 10.3% in Aug'20) saw maximum improvement. Data released for Sep'20 is even more encouraging with positive momentum seen in electricity output, exports, fuel demand and manufacturing PMI.

CPI rises, driven by food: After noting a slight dip in Aug'20, CPI inflation edged up in Sep'20 to 7.3%, an 8-month high. Food inflation rose sharply from 9.1% in Aug'20 to 10.7% in Sep'20 led by vegetables (20.7% in Sep'20 versus 11.5% in Aug'20), eggs (15.5% versus 10.1%) and meat and fish (17.6% versus 16.5% in Aug'20). Prices of 10 out of total 12 items under CFPI increased by more than 4%, with 6 items registering double digit increase. Inflation in protein based items may not moderate so easily. However some moderation was visible in cereal prices at 4.7% versus 5.9% in Aug'20.

Core inflation moderates: Core inflation moderated by 10bps to 5.7% in Sep'20 from 5.8% in Aug'20. This was driven by lower inflation in the personal care items (12.3% in Sep'20 from 14.5% in Jul'20). Notably gold prices fell by 2.4% in Sep'20 on a MoM basis. Housing and recreation reported a decline as well. On the other hand, inflation in transport and communication (11.5% in Sep'20 versus 11% in Aug'20) and education (2.2% in Sep'20 versus 1.7%) edged up. A weak demand side is reflected in moderation in most categories of core inflation apart from transport and personal effects (supply side). We expect inflation at 5.1% and 4.4% in Q3 and Q4FY21 (avg.) thus ruling out any further rate cuts. However, liquidity conditions will remain accommodative to support growth.

KEY HIGHLIGHTS

- CPI inflation rises to 7.3% in Sep'20 from 6.7% in Aug'20 led by food inflation.
- Core inflation edged down by 10bps to 5.7% in Sep'20.
- IIP growth contracted at a slower pace of 8% versus a dip of 10.8% in Jul'20.

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BANKING | Q2FY21 Preview | 12 October 2020

Seeking clarity on asset quality

Q2FY21 is yet another quarter where clarity on asset quality will be keenly awaited amid pandemic uncertainty. Fresh slippages are expected to be lower but credit costs will remain elevated as banks shore up provisions to strengthen their balance sheets. The focus will shift from moratorium to the expected quantum of restructuring. Loan growth is likely to remain subdued but NIMs should be largely stable. We expect operating profit to be impacted by muted fee income, lower treasury gains and a pick-up in opex.

Vikesh Mehta
research@bobcaps.in

Regulatory dispensations to mask true asset quality picture: In our view, fresh slippages are likely to be lower in Q2FY21 given the Supreme Court's stay on NPA recognition until its next hearing and the absence of lumpy corporate delinquencies. This is likely to result in lower headline NPAs even as banks continue to write off loans. We await clarity on key areas such as the expected quantum of restructuring, collection efficiency from the pool that was under moratorium and credit costs for FY21.

Loan growth to remain subdued: Based on recent RBI data, systemic credit growth has slowed down to ~5% YoY in Sep'20 driven by muted corporate growth and deceleration in the retail segment. Pre-result disclosures made by banks under our coverage suggest sluggish loan growth trends for IndusInd Bank (+2% YoY), Federal Bank (+6% YoY) and RBL Bank (–3% YoY). HDFC Bank remains an outlier and continues to grab market share with the disclosure of ~16% YoY growth. We believe credit growth is unlikely to revive quickly as banks retain their focus on protecting balance sheets and asset quality.

High provisions to keep earnings in check: Overall revenue growth is likely to remain weak considering steady deposit inflows and lack of credit deployment. We expect NIM to remain stable as the benefit of recent capital raising coupled with lower deposit costs will offset the impact of higher liquidity. However, muted fee income growth, lower treasury gains and some pick-up in opex could result in sequentially lower operating profit for banks under our coverage.

Despite lower NPA formation, banks are likely to strengthen their balance sheets by shoring up provisions, which will restrain earnings growth. Among our coverage, we expect ICICI Bank, Axis Bank and HDFC Bank to report better profitability.

RECOMMENDATION SNAPSHOT

Ticker	Rating
AXSB IN	BUY
CBK IN	ADD
DCBB IN	SELL
FB IN	ADD
HDFCB IN	BUY
ICICIBC IN	BUY
IDFCFB IN	SELL
IIB IN	BUY
KMB IN	BUY
RBK IN	SELL
SBIN IN	ADD

Source: BOBCAPS Research

LOGISTICS | Q2FY21 Preview | 12 October 2020

Early signs of earnings recovery

Sayan Das Sharma
research@bobcaps.in

Aggregate revenue of our logistics coverage universe is expected to decline by 5% YoY in Q2FY21, a marked improvement from the 25% drop in Q1, aided by a gradual easing of lockdown restrictions. Apart from VRLL, all other companies in our coverage are likely to post profit, though none are expected to post earnings growth as yet. After the robust trends heralded by high frequency indicators in Sep'20, we are hopeful of a faster-than-anticipated earnings recovery from Q3 on. TCIEXP remains our top pick in the sector.

Earnings cycle to start normalising: We forecast an aggregate revenue/ EBITDA decline of 5%/24% YoY for our coverage universe in Q2, considerably slower than the dismal 25%/62% fall in Q1. Most lead industry indicators clocked marked improvement in Sep'20 – e-way bills hit record highs, rail freight volume rose 16%, container rail volume was up 7.5%, and the decline in major port volumes eased to 2% – implying recovery in domestic and EXIM trade. If sustained, this should drive normalisation of the logistics earnings cycle.

Easing supply-side issues to aid road transporters: After an abysmal Q1, easing supply-side challenges should usher in an improved Q2 for road logistics players – TCI Express (TCIEXP), VRL Logistics (VRLL), Transport Corp (TRPC, freight). YoY flattish e-way bill numbers in Q2 (~2x vs. Q1FY21) also signal a demand uptick. We forecast a 15-20% revenue drop for road transporters owing to a sedate July/August (vs. –58% in Q1), but estimate flat EBITDA margins for TCIEXP and TRPC (freight) thanks to their asset-light models. Higher diesel prices (+14% YoY) and operating leverage may affect VRLL's margin (–700bps).

Better show likely from rail transporters…: Container volumes carried by rail dipped 5% YoY in Q2 vs. a 17% YoY drop in Q1, improving steadily through the quarter and culminating in 7.5% growth in Sep'20. Accordingly, Container Corp's (CCRI) provisional volume decline has eased to 9% vs. a 21% fall in Q1. We expect CCRI's revenue/EBITDA to decline 13%/29% YoY (–27%/–61% in Q1).

…and auto-focused 3PL players: An uptick in auto production should aid Mahindra Logistics (MLL) and TRPC's supply chain segment. MLL is forecast to post a 14% YoY revenue decline vs. –54% in Q1 as the auto segment is likely to benefit from sturdy tractor sale volumes (+31% YoY) of its anchor customer, while the non-auto segment would be boosted by e-commerce volumes. TRPC's SCS segment is forecast to post a 25% topline decline (–53% YoY in Q1).

RECOMMENDATION SNAPSHOT

Ticker	Rating
AGLL IN	ADD
CCRI IN	SELL
MAHLOG IN	BUY
TCIEXP IN	BUY
TPRC IN	BUY
VRLL IN	BUY

MAHLOG = MLL

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OIL & GAS | Q2FY21 Preview | 12 October 2020

Struggling to return to pre-Covid fundamentals

Rohit Ahuja | Harleen Manglani
research@bobcaps.in

Q2FY21 has been another volatile quarter for the energy sector, with oil and spot LNG prices recovering from multiyear lows but spreads staying muted for cyclicals. The demand environment remains challenging, albeit with some green shoots in natural gas consumption from industrial segments. RIL's earnings are expected to remain under pressure while OMCs could sustain their earnings traction given high marketing margins. Industrial gas utilities are likely to see sharp volume recovery but CGDs would struggle due to pandemic disruptions.

Margins still muted for cyclicals: Benchmark Singapore GRMs remained muted in Q2FY21 (US$ 0.1/bbl) as an oil demand recovery continued to be elusive. Petrol (gasoline) and naphtha spreads improved QoQ. Singapore GRMs have started improving from Oct'20, averaging ~US$ 2/bbl currently, as oil demand has begun normalising globally. Staggered easing of lockdowns across Asia should revive transportation fuel demand. Petrochemical cracks have also remained subdued in Q2. However, gas-based petrochemical margins may perk up on stronger polymer prices.

Gas consumption stable: Spot LNG prices have surged QoQ in Q2 but remain comfortable, averaging at ~US$ 3.5/mmbtu. **Gas consumption** has stayed stable QoQ at ~150mmscmd. While CNG volumes in metro cities remain depressed due to lockdown extensions, low prices have aided an increase in industrial demand for gas driven by the fertiliser, power and petchem sectors.

With long-term contracted LNG prices declining to <US$ 5/mmbtu in Q2FY21, consumption from industrial units remains robust. This would benefit GAIL, Petronet LNG and Gujarat State Petronet. CGD companies with high exposure to CNG volumes (Indraprastha Gas, Mahanagar Gas) could see volume revival being pushed to Q4FY21.

Earnings volatility to continue: OMCs are expected to report profits in Q2 on the back of robust marketing earnings. Reliance Industries' (RIL) earnings are likely to be under pressure due to a decline in the cyclical and retail segments, though RJio profits remain robust. Midstream gas utilities could report strong earnings on stable volumes and margins. CGD companies could see some profit recovery as lockdowns are eased across metros. Upstream PSU earnings could also improve QoQ due to the oil price surge. The outlook for RIL and midstream gas utilities will be keenly watched.

KEY RECOMMENDATIONS

Ticker	Rating
RIL IN	SELL
IOCL IN	BUY
PLNG IN	BUY
GAIL IN	BUY

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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