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# FIRST LIGHT

21 January 2021

## RESEARCH

### BOB Economics Research | FY22 Budget Preview
Reviving growth with fiscal consolidation

### L&T Infotech | Target: Rs 4,740 | +16% | BUY
Large deals accelerate; margins shine

### Federal Bank | Target: Rs 85 | +10% | ADD
Operating performance remains strong

### CEAT | Target: Rs 780 | −40% | SELL
Healthy Q3 but long-term woes remain; maintain SELL

## SUMMARY

### India Economics: FY22 Budget Preview

A counter cyclical fiscal response to contraction in GDP growth implies India's fiscal deficit will rise to 7.2% of GDP in FY21. The underlying rebound in GDP growth to 10.5% in FY22 will give room to government to reduce fiscal deficit to 5.3% of GDP in FY22 resulting in net and gross borrowing of Rs 8.5tn and Rs 11.2tn respectively. The focus of the Budget should be to revive India's private sector capex cycle. Crowding in investments through higher infrastructure spending financed by asset monetisation will be key.

Click here **for the full report.**

### L&T Infotech

L&T Infotech's (LTI) Q3FY21 dollar revenue growth was strong at 5.8% QoQ due to an uptick in the manufacturing and BFS verticals. Operating margins stood at a record high of 20.6% backed by increased offshoring and tight SG&A cost control. We raise FY21-FY23 EPS estimates by 4-6% and roll over to a new Dec'21 TP of Rs 4,740 (vs. Rs 3,860), set at a higher target P/E of 30x (vs. 27x) given LTI's strong revenue mix, favourable offshore presence, client mining skills and robust leadership. Retain BUY.

Click here **for the full report.**

## TOP PICKS

### LARGE-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Cipla | Buy | 900 |
| GAIL | Buy | 155 |
| Petronet LNG | Buy | 330 |
| TCS | Buy | 3,710 |
| Tech Mahindra | Buy | 1,040 |

### MID-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Alkem Labs | Buy | 3,600 |
| Greenply Industries | Buy | 150 |
| Laurus Labs | Buy | 410 |
| Transport Corp | Buy | 300 |
| Mahanagar Gas | Sell | 750 |

Source: BOBCAPS Research

### DAILY MACRO INDICATORS

| Indicator | Current | 2D (%) | 1M (%) | 12M (%) |
|---|---|---|---|---|
| US 10Y yield (%) | 1.09 | 1bps | 14bps | (69bps) |
| India 10Y yield (%) | 5.91 | (1bps) | 0bps | (73bps) |
| USD/INR | 73.17 | 0.2 | 0.5 | (2.8) |
| Brent Crude (US$/bbl) | 55.90 | 2.1 | 7.0 | (13.5) |
| Dow | 30,931 | 0.4 | 2.5 | 5.9 |
| Shanghai | 3,566 | (0.8) | 5.1 | 16.8 |
| Sensex | 49,398 | 1.7 | 5.2 | 19.5 |
| **India FII (US$ mn)** | **18 Jan** | **MTD** | **CYTD** | **FYTD** |
| FII-D | (176.9) | (660.4) | (660.4) | (4,754.0) |
| FII-E | 266.5 | 2,562.7 | 2,562.7 | 32,538.4 |

Source: Bank of Baroda Economics Research

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## Federal Bank

Federal Bank (FB) reported above-estimated PAT of ~Rs 4bn (–8% YoY) on lower provisioning than forecast. Proforma GNPA ratio spiked to 3.4% driven by Rs 11bn in slippages. Covid-specific restructuring so far is ~Rs 11bn and guided at Rs 15bn- 16bn for FY21 (1.3% of loans). Retail loan growth held strong at 16% YoY with a robust uptick in gold loans. NIM was up 9bps QoQ to 3.2%. FB may raise capital in H2CY21. We raise our TP to Rs 85 (vs. Rs 55) as we hike FY22-FY23 EPS 13-18%, roll to Mar'23 valuations and assign the stock a 1x P/BV multiple.

**Click here for the full report.**

## CEAT

CEAT surprised positively on both revenue and earnings in Q3FY21, led by strong replacement demand and above-expected gross margins which could be a function of low-cost inventory. Revenue was up 30% YoY and operating margin expanded 410bps YoY. We continue to believe that capex (~Rs 35bn) will far exceed estimated operating cash flow (~Rs 25bn) over FY21-FY23, necessitating external funding and adding pressure on both balance sheet and earnings. We retain our TP of Rs 780 (14x Mar'23E EPS) and maintain SELL.

**Click here for the full report.**

FY22 BUDGET PREVIEW

20 January 2021

# Reviving growth with fiscal consolidation

**A counter cyclical fiscal response to contraction in GDP growth implies India's fiscal deficit will rise to 7.2% of GDP in FY21. The underlying rebound in GDP growth to 10.5% in FY22 will give room to government to reduce fiscal deficit to 5.3% of GDP in FY22 resulting in net and gross borrowing of Rs 8.5tn and Rs 11.2tn respectively. The focus of the Budget should be to revive India's private sector capex cycle. Crowding in investments through higher infrastructure spending financed by asset monetisation will be key.**

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**FY21 fiscal deficit at 7.2%:** With a 4.2% decline in nominal GDP, Centre's net revenues are estimated to fall by 6.7% to Rs 15.7tn (8.1% of GDP) instead of BE of Rs 20.2tn (9% of GDP). On the other hand, spending is likely to increase by 13.3% in FY21 to Rs 30.4tn (15.6% of GDP). The widened gap between revenue and spending will be met by an increase in fiscal deficit to 7.2% of GDP from BE of 3.5%. Most of the fiscal deficit will be financed through bonds (77% of FD).

**Reviving investment cycle, a priority:** India's investment (GFCF) to GDP ratio peaked at more than 35% in FY08. It now stands at less than 25%. While government capex (% of GDP) has been stable, both corporate and household investment have been on a relative decline. Lower corporate taxes and PLI scheme to incentivise investments will create conditions for higher investments. But higher government spending is also one-way to crowd-in private investments. The same can be financed by a well-crafted asset monetisation plan wherein existing assets can be monetised. In addition, higher infra investments require a dedicated fund/ institution to fund the projects.

**FY22 fiscal deficit at 5.3% of GDP:** A push towards investments can go hand in hand with fiscal consolidation. India's nominal GDP growth is estimated to increase by 14% in FY22. Both direct as well as indirect taxes are likely to see a revival and are estimated to increase by 16% in FY22. Disinvestment receipts, higher dividends and 5G auctions will add to inflows. Thus the government can let the private sector take the lead and reduce fiscal deficit to 5.3% of GDP in FY22. This will amount to overall gross and net borrowing of Rs 11.2tn and Rs 8.5tn respectively. States will borrow another Rs 9tn. A fiscal consolidation glide path will go a long way in ensuring enough resources are available for private capex cycle to revive in the medium-term.

## KEY HIGHLIGHTS

- Reviving private capex, infrastructure spending, and asset monetisation to be key focus areas of FY22 Budget.
- Fiscal deficit for FY21/FY22 estimated at 7.2%/5.3% of GDP.
- Gross/net borrowings in FY22 estimated at Rs 11.2tn/Rs 8.5tn.

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**BUY**
TP: Rs 4,740 | ▲ 16%

**L&T INFOTECH** | IT Services | 20 January 2021

## Large deals accelerate; margins shine

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**L&T Infotech's (LTI) Q3FY21 dollar revenue growth was strong at 5.8% QoQ due to an uptick in the manufacturing and BFS verticals. Operating margins stood at a record high of 20.6% backed by increased offshoring and tight SG&A cost control. We raise FY21-FY23 EPS estimates by 4-6% and roll over to a new Dec'21 TP of Rs 4,740 (vs. Rs 3,860), set at a higher target P/E of 30x (vs. 27x) given LTI's strong revenue mix, favourable offshore presence, client mining skills and robust leadership. Retain BUY.**

**BFS and manufacturing lead growth:** LTI's QoQ growth of 5.8% USD/5.3% CC was strong, albeit below our estimate of 7.5% USD/7.2% CC. Growth was driven by momentum in BFS/manufacturing which were up 8.2%/9.7% QoQ, USD. The insurance and energy-utilities verticals remained weak with low-single-digit contraction. Retail-CPG managed to recover with 4.8% growth. EBIT margin was up 80bps QoQ to 20.6%, bettering our estimate of 19%, owing to lower employee cost, increased offshoring and higher utilisation (81%, +60bps).

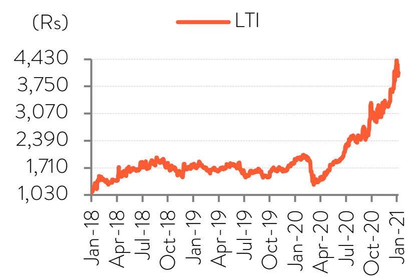
**Two large deal wins:** LTI won two large deals: (1) a six-year US$ 204mn deal wherein it will take over Injazat's ERP and infrastructure services, besides assisting in digital, cloud and ERP transformation projects. Injazat deal revenue will flow through from next quarter; and (2) a five-year energy deal with a Fortune-500 company for net new TCV of US$ 74mn. Total TCV in Q3 was the highest ever at US$ 278mn, up from a mere US$ 40mn in Q2.

**High-single-digit growth in FY21:** With a healthy pipeline, we expect strong growth in the fourth quarter. LTI has already bagged a few large deals in Q4 so far. Management expects to deliver high-single-digit growth in FY21 and leader-quadrant worthy growth in FY22. LTI's in-house cloud capabilities and high-level partnerships with hyperscalers will help maintain the momentum.

| | |
|---|---|
| Ticker/Price | LTI IN/Rs 4,091 |
| Market cap | US$ 9.9bn |
| Shares o/s | 176mn |
| 3M ADV | US$ 22.5mn |
| 52wk high/low | Rs 4,483/Rs 1,210 |
| Promoter/FPI/DII | 75%/8%/10% |

Source: NSE

### STOCK PERFORMANCE




Source: NSE

### KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Total revenue (Rs mn) | 94,458 | 108,786 | 124,790 | 155,299 | 188,200 |
| EBITDA (Rs mn) | 18,835 | 20,291 | 27,429 | 33,152 | 40,115 |
| Adj. net profit (Rs mn) | 15,157 | 15,198 | 19,052 | 23,883 | 28,339 |
| Adj. EPS (Rs) | 86.5 | 86.4 | 108.6 | 136.1 | 161.5 |
| Adj. EPS growth (%) | 36.1 | 0.0 | 25.6 | 25.4 | 18.7 |
| Adj. ROAE (%) | 34.6 | 29.5 | 32.0 | 33.2 | 32.5 |
| Adj. P/E (x) | 47.3 | 47.3 | 37.7 | 30.1 | 25.3 |
| EV/EBITDA (x) | 38.0 | 35.3 | 26.2 | 21.7 | 17.7 |

Source: Company, BOBCAPS Research

RESULT REVIEW

**ADD**
TP: Rs 85 | ▲ 10%

**FEDERAL BANK** | Banking | 20 January 2021

# Operating performance remains strong

**Federal Bank (FB) reported above-estimated PAT of ~Rs 4bn (–8% YoY) on lower provisioning than forecast. Proforma GNPA ratio spiked to 3.4% driven by Rs 11bn in slippages. Covid-specific restructuring so far is ~Rs 11bn and guided at Rs 15bn- 16bn for FY21 (1.3% of loans). Retail loan growth held strong at 16% YoY with a robust uptick in gold loans. NIM was up 9bps QoQ to 3.2%. FB may raise capital in H2CY21. We raise our TP to Rs 85 (vs. Rs 55) as we hike FY22-FY23 EPS 13-18%, roll to Mar'23 valuations and assign the stock a 1x P/BV multiple.**

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**Asset quality deteriorates ex-standstill:** FB's reported GNPA ratio declined 13bps QoQ to 2.7% but increased to 3.4% on excluding the asset classification standstill, given proforma slippages worth Rs 10.7bn. The bank has a Covid-specific restructuring book of ~Rs 11bn and expects to add Rs 4bn-5bn in Q4, taking the overall restructured portfolio to <1.5% of loans (vs. 2-3% anticipated earlier), carrying a >90% overlap with the moratorium book. A large part of the restructuring was driven by retail, especially the mortgage portfolio. The SMA-1 & 2 book currently stands 60-70bps higher than pre-Covid levels of 1.8%.

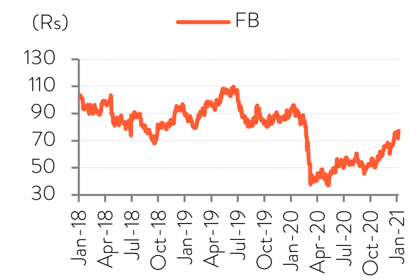
**Loan growth remains weak but expected to pick up:** Overall loan growth was muted at 5% YoY given the conscious rundown in the corporate portfolio. However, retail loans grew 16% YoY with a 67% YoY increase in gold loans. The bank is witnessing strong traction across product verticals and based on the existing pipeline of sanctions, management expects that FY21 loan growth could be ~10%. Traction in the liability franchise is tracking well.

**Maintain ADD:** We raise our FY22-FY23 EPS by 13-18% to factor in higher other income and lower operating expenses. Valuing the stock at 1x P/BV (vs. 0.7x earlier), we roll over to a new Mar'22 TP of Rs 85.

| | |
|---|---|
| Ticker/Price | FB IN/Rs 77 |
| Market cap | US$ 2.1bn |
| Shares o/s | 1,993mn |
| 3M ADV | US$ 32.9mn |
| 52wk high/low | Rs 97/Rs 36 |
| Promoter/FPI/DII | 0%/31%/69% |

Source: NSE

## STOCK PERFORMANCE




Source: NSE

## KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Net interest income | 41,763 | 46,489 | 55,628 | 62,451 | 72,746 |
| NII growth (%) | 16.6 | 11.3 | 19.7 | 12.3 | 16.5 |
| Adj. net profit (Rs mn) | 12,439 | 15,428 | 14,775 | 17,126 | 20,055 |
| EPS (Rs) | 6.3 | 7.8 | 7.4 | 8.6 | 10.1 |
| P/E (x) | 12.3 | 10.0 | 10.4 | 9.0 | 7.7 |
| P/BV (x) | 1.2 | 1.1 | 1.0 | 0.9 | 0.8 |
| ROA (%) | 0.8 | 0.9 | 0.8 | 0.8 | 0.8 |
| ROE (%) | 9.8 | 11.1 | 9.7 | 10.4 | 11.2 |

Source: Company, BOBCAPS Research

RESULT REVIEW

**SELL**
TP: Rs 780 | ⋎ 40%

**CEAT** | Auto Components | 20 January 2021

# Healthy Q3 but long-term woes remain; maintain SELL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**CEAT surprised positively on both revenue and earnings in Q3FY21, led by strong replacement demand and above-expected gross margins which could be a function of low-cost inventory. Revenue was up 30% YoY and operating margin expanded 410bps YoY. We continue to believe that capex (~Rs 35bn) will far exceed estimated operating cash flow (~Rs 25bn) over FY21-FY23, necessitating external funding and adding pressure on both balance sheet and earnings. We retain our TP of Rs 780 (14x Mar'23E EPS) and maintain SELL.**


**Strong Q3:** At Rs 22.1bn (+30% YoY), revenue was 10% ahead of our estimate backed by strong replacement demand which was up ~35% YoY. Gross margin declined 100bps sequentially against an estimated ~400bps contraction. Further, higher operating efficiencies supported EBITDA growth of 80% YoY to Rs 3.3bn. EBITDA margin thus stood at 14.7% and adj. PAT grew 2.2x YoY to Rs 1.4bn.

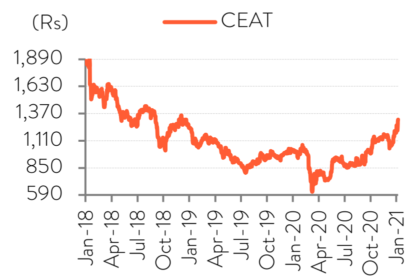
**Surge in commodity prices to erode earnings:** With the >30% rise in both rubber and brent crude prices from Q2FY21 levels, we anticipate gross margin deterioration for tyre companies (see our recent report **Spiking RM costs to puncture earnings**). To mitigate this impact, players will have to effect price hikes of over 15% which looks difficult. We bake in a decline of ~150bps YoY in CEAT's FY22 gross margin, resulting in a drop in operating margin and earnings.

**Maintain SELL:** External borrowings to fund capex will not only undermine the balance sheet but also depress profits due to higher interest. Management believes rising input costs could pressure margins. We model for EBITDA margin shrinkage to 10.5% in FY23 and project a revenue/EBITDA /adj. PAT CAGR of +13%/–4%/–20% over FY21-FY23. Our Mar'22 TP remains at Rs 780, set at an unchanged 14x FY23E EPS. SELL.

| | |
|---|---|
| Ticker/Price | CEAT IN/Rs 1,310 |
| Market cap | US$ 726.1mn |
| Shares o/s | 40mn |
| 3M ADV | US$ 5.3mn |
| 52wk high/low | Rs 1,353/Rs 600 |
| Promoter/FPI/DII | 47%/28%/9% |

Source: NSE

## STOCK PERFORMANCE




Source: NSE

## KEY FINANCIALS

| Y/E 31 Mar | FY19A | FY20A | FY21E | FY22E | FY23E |
|---|---|---|---|---|---|
| Total revenue (Rs mn) | 68,313 | 65,811 | 73,158 | 84,906 | 93,560 |
| EBITDA (Rs mn) | 5,965 | 7,053 | 9,213 | 8,497 | 9,867 |
| Adj. net profit (Rs mn) | 2,889 | 3,005 | 3,721 | 1,964 | 2,263 |
| Adj. EPS (Rs) | 71.4 | 74.3 | 92.0 | 48.6 | 55.9 |
| Adj. EPS growth (%) | 3.7 | 4.0 | 23.8 | (47.2) | 15.2 |
| Adj. ROAE (%) | 10.5 | 10.3 | 11.4 | 5.7 | 6.1 |
| Adj. P/E (x) | 18.3 | 17.6 | 14.2 | 27.0 | 23.4 |
| EV/EBITDA (x) | 10.0 | 8.8 | 7.2 | 8.4 | 7.8 |

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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