FIRST LIGHT

23 November 2020

RESEARCH

Market Strategy | Deep Value Picks

PSU – depressed valuations an opportunity or value trap?

BOB Economics Research | GDP Update

India on recovery path

SUMMARY

Market Strategy: Deep Value Picks

PSU stocks have had a most forgettable year in 2020 with the Nifty PSE index declining ~30% since Jan'20. Average P/E for some Navratna PSUs has shrunk to <7x on FY22E despite a robust earnings outlook. The rationale for buybacks emerges from the deep discount on valuations. While the HPCL buyback sets the right tone for reviving PSUs valuations, BPCL's divestment could lend an impetus to the rerating momentum. We believe PSUs in the cyclical business – especially oil – offer attractive risk-reward.

Click here for the full report.

India Economics: GDP Update

High frequency indicators show an underlying revival in economic activity led by private sector. Corporate results, freight movement, indirect tax collections, imports, electricity demand and E-Way bills are pointing to a steady upturn in the economy. Thus we are revising our GDP growth to (-) 8.2% in FY21, with an upside risk, from our earlier projection of (-) 8.8%. Growth will revive further to 8.8% in FY22. Key risk to our growth projections are below normal monsoon, higher oil prices and delay in Covid-19 vaccine.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	900
GAIL	Buy	155
Petronet LNG	Buy	330
TCS	Buy	3,180
Tech Mahindra	Buy	980

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 (%)	0.83	(4bps)	6bps	(94bps)
India 10Y yield (%)	5.88	0bps	(6bps)	(63bps)
USD/INR	74.27	(0.1)	(1.2)	(3.5)
Brent Crude (US$/bbl)	44.20	(0.3)	3.7	(30.9)
Dow	29,483	0.2	4.6	6.2
Shanghai	3,363	0.5	1.5	15.8
Sensex	43,600	(1.3)	7.8	7.5
India FII (US$ mn)	**18 Nov**	**MTD**	**CYTD**	**FYTD**
FII-D	(14.1)	149.5	(14,080.2)	(4,320.7)
FII-E	726.7	5,868.9	12,415.4	19,018.3

Source: Bank of Baroda Economics Research

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DEEP VALUE PICKS

20 November 2020

PSU – depressed valuations an opportunity or value trap?

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PSU stocks have had a most forgettable year in 2020 with the Nifty PSE index declining ~30% since Jan'20. Average P/E for some Navratna PSUs has shrunk to <7x on FY22E despite a robust earnings outlook. The rationale for buybacks emerges from the deep discount on valuations. While the HPCL buyback sets the right tone for reviving PSUs valuations, BPCL's divestment could lend an impetus to the rerating momentum. We believe PSUs in the cyclical business – especially oil – offer attractive risk-reward.

Valuation gap with Nifty widens: The Nifty PSE index has underperformed the Nifty by a staggering 105% since Jun'14 despite many cash-rich PSUs maintaining healthy dividend payouts. The PSE index was lagging the broader market by 28% until Jan'18, but the underperformance worsened sharply from Q4FY18 triggered by the open offer exemption granted to ONGC on its deal with HPCL.

Government needs valuation trend to reverse...: The government's steep divestment target of Rs 2tn for FY21 would need most PSUs to trend much higher than current value, whether it explores strategic divestment (BPCL, Concor, Air India) or fund raising through secondary markets (ETFs, IPOs). There's some hope that the government may be able to lock in proceeds from the BPCL divestment in FY21 (quantum not yet ascertained), going by the recently concluded first stage of this process (EOI).

...while PSUs well placed to opt for buyback: For companies that have ROE/ ROCE of >10% and are trading at <1x FY20 P/BV (deep value PSUs), a buyback is clearly a preferred move to enhance shareholder value. Various large PSUs fit into this bracket and carry the flexibility to offer attractive buybacks. We note that the one announced by HPCL in Nov'20, where the promoters will not be participating, has resulted in a 25% stock rally.

Cyclicals to lead the rerating pack: We expect cyclicals to helm the rerating among PSUs. Oil entities lead the deep value pack following the attractive buyback plan by stepdown PSU HPCL (owned by ONGC). BPCL's divestment is expected to have direct implications on industry dynamics for IOCL – the latter could lead the rerating pack. SAIL and NMDC are other deep value bets among cyclicals considering positive indicators of an industry turnaround.

GDP UPDATE

20 November 2020

India on recovery path

High frequency indicators show an underlying revival in economic activity led by private sector. Corporate results, freight movement, indirect tax collections, imports, electricity demand and E-Way bills are pointing to a steady upturn in the economy. Thus we are revising our GDP growth to (-) 8.2% in FY21, with an upside risk, from our earlier projection of (-) 8.8%. Growth will revive further to 8.8% in FY22. Key risk to our growth projections are below normal monsoon, higher oil prices and delay in Covid-19 vaccine.

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KEY HIGHLIGHTS

- GDP to contract by 8.2% in FY21
- High frequency macro indicators showing rebound in activity
- FY22 growth to revive to 8.8% on the back of normalisation of activity.

GDP to contract at a slower pace: After contracting by 23.9% in Q1, economic activity has shown resilience. It is also related to increase in doubling of Covid-19 infection rate to 71 days in Nov'20 from 20 days at the peak. Corporate results have surprised positively with consumer goods, metals and automobile firms reporting better results. The bigger impact is on the informal sector.

What high frequency indicators say?: High frequency indicators show improvement seen in Q2 continuing into Q3 with manufacturing PMI at a 13-year high and services PMI too above 50 (expanding). Rail freight movement (13.6% in Nov'20, 4.6% in Q2, -21.4% in Q1), electricity demand (4.9% in Nov'20, -1.6% in Q2, -15.3% in Q1), E-way bills generated (155mn in Q2 versus 78mn in Q1), and GST collections (up 10.2% in Oct'20) point to a continued economic recovery.

Upside to government spending: Owing to revival in economic activity indirect tax collections were higher by 11.7% in Q2 compared with a decline of 34.1% in Q1. Higher excise duty on petroleum products is also a factor. A revival in corporate profitability also bodes well for tax collections. Thus government may kickstart its spending in H2 to support growth, as spending by centre and states each was down by 0.6% as of Sep'20 (FYTD basis) led by lower capex. Capital spending was lower by 11.6% for centre and 23.2% for states.

Where we see growth?: The above backdrop makes us believe that India's FY21 growth prospects are now different from our earlier assessment when we had projected growth of (-) 8.8%. Our new assessment is that GDP will contract by 8.2%, with an upside risk. The upward revision to our estimates is led by industry from supply side and both consumption and investment from demand side. However, given the lockdowns in Europe and US, exports may be muted.

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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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