BOBCAPS
TRUST | INNOVATION | EXCELLENCE

FIRST LIGHT

03 September 2020

RESEARCH

ONGC | Target: Rs 96 | +21% | BUY

Pricing in the worst – upgrade to BUY

Finolex Industries | Target: Rs 560 | +11% | BUY

Demand situation steadily improving

Diversified Financials

AMCs – Product focus and financial advisory taking root

Automobiles

Aug'20 Auto Sales: Recovery led by pre-festive inventory filling

SUMMARY

ONGC

ONGC's Q1FY21 earnings at Rs 5bn (–90% YoY) outperformed estimates on lower operating costs. Q1 highlights: (a) oil/gas production continued to decline (–3.5%/–13.6% YoY), (b) operating costs were lower at US$ 6/bbl (vs. US$ 8/bbl estimated), and (c) oil price realisation was at US$ 28.7/bbl (–57% YoY). We raise FY21/FY22 earnings by 3x/1.6x to factor in higher oil price assumptions (by US$ 5/bbl). Upgrade from ADD to BUY as we roll over to a new Sep'21 TP of Rs 96 (vs. Rs 92). The recent rise in oil prices provides valuation comfort.

Click here for the full report.

Finolex Industries

Key takeaways from our interaction with the management of Finolex Industries (FNXP): (1) Demand for agriculture pipes slowed from June due to early onset of the monsoon this year. Offtake remains weak as this is a seasonally dull demand period due to rainfall across the country. (2) Following easing of the lockdown, FNXP had initially experienced logistical issues due to non-availability of manpower, but this has been steadily improving every month. (3) The company is hopeful of good demand for agriculture pipes from H2FY21 due to the normal monsoons, higher water reservoir levels and a government thrust on the rural economy.

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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 (%)	0.67	(4bps)	14bps	(79bps)
India 10Y yield (%)	5.94	(18bps)	10bps	(58bps)
USD/INR	72.87	1.0	2.6	(0.7)
Brent Crude (US$/bbl)	45.58	0.7	5.3	(21.8)
Dow	28,646	0.8	8.4	9.7
Shanghai	3,411	0.4	3.0	16.4
Sensex	38,901	0.7	3.4	6.4
India FII (US$ mn)	**31 Aug**	**MTD**	**CYTD**	**FYTD**
FII-D	(30.7)	(562.4)	(15,090.0)	(5,330.5)
FII-E	(320.4)	6,095.5	4,807.4	11,410.3

Source: Bank of Baroda Economics Research

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Diversified Financials

We spoke with Mirae AMC CEO Swarup Mohanty recently. Key takeaways: (1) India's AMC industry is increasingly focusing on products rather than distribution as industry assets have not beaten respective benchmarks over long horizons. (2) Most investor portfolios lack prudent asset allocation, offering tailwinds to financial advisory. (3) Yields are likely to shrink further given growing market efficiencies and a rising mix of passive funds. (4) Equity flows could remain muted till Dec'20.

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Automobiles

Auto sales clocked an expectedly healthy recovery across segments in Aug'20, barring MHCVs and 3Ws. We believe filling up of low dealer inventory prior to the festive season and pent-up demand have been key drivers for this recovery. Domestic PV industry sales increased ~20% YoY and 2Ws grew ~8% YoY for HMCL in the month. MHCV volumes continued to be the worst affected, declining 52% YoY for AL. Tractor sales beat our expectations, outperforming other segments and growing at 65%/80% YoY for MM/ESC.

Click here for the full report.

BUY
TP: Rs 96 | ⮝ 21%

ONGC | Oil & Gas | 02 September 2020

Pricing in the worst – upgrade to BUY

ONGC's Q1FY21 earnings at Rs 5bn (–90% YoY) outperformed estimates on lower operating costs. Q1 highlights: (a) oil/gas production continued to decline (–3.5%/–13.6% YoY), (b) operating costs were lower at US$ 6/bbl (vs. US$ 8/bbl estimated), and (c) oil price realisation was at US$ 28.7/bbl (–57% YoY). We raise FY21/FY22 earnings by 3x/1.6x to factor in higher oil price assumptions (by US$ 5/bbl). Upgrade from ADD to BUY as we roll over to a new Sep'21 TP of Rs 96 (vs. Rs 92). The recent rise in oil prices provides valuation comfort.

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Production remains a drag: Q1 oil and gas production fell to 5.7mmt (–3.5% YoY) and 5.5bcm (–13.6%) respectively. Gas production was severely affected by lockdown-led demand disruptions, mostly in the CGD segment. Production could return to normal from Q3FY21, once lockdowns across major cities are lifted. ONGC has revised oil production guidance for FY21 down to 22.7mmt (from 23.3mmt). We according trim our oil and gas production estimates for FY21/FY22 by ~5% each.

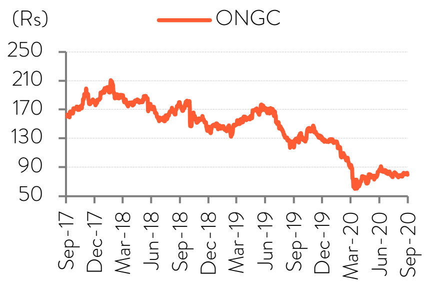
Low operating costs a positive: ONGC surprised with a 40% QoQ decline in operating cost to US$ 6/bbl, as the company strived to reduce contractual rates for assets. Management believes these cost levels are sustainable, providing a necessary cushion against low oil prices.

Upgrade to BUY: The stock's underperformance despite the recent rise in oil prices provides valuation comfort, especially with the decline in operating costs. As oil prices remain robust, we find risk-reward favourable and upgrade earnings estimates. ONGC expects gas pricing across its assets to normalise to a tender-based system (from a pricing formula system). Low prices through the APM pricing formula seem unfair and impact economics for investment in development of new fields.

Ticker/Price	ONGC IN/Rs 79
Market cap	US$ 13.7bn
Shares o/s	12,580mn
3M ADV	US$ 22.8mn
52wk high/low	Rs 150/Rs 50
Promoter/FPI/DII	60%/8%/31%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	4,534,606	4,250,014	2,863,013	3,602,536	4,515,098
EBITDA (Rs mn)	838,648	611,687	381,476	478,782	602,425
Adj. net profit (Rs mn)	348,309	168,256	59,057	126,944	185,456
Adj. EPS (Rs)	27.7	13.4	4.7	10.1	14.7
Adj. EPS growth (%)	51.6	(51.7)	(64.9)	115.0	46.1
Adj. ROAE (%)	16.4	7.9	2.8	5.9	8.2
Adj. P/E (x)	2.9	5.9	16.9	7.9	5.4
EV/EBITDA (x)	2.1	3.2	5.3	4.2	3.4

Source: Company, BOBCAPS Research

BUY
TP: Rs 560 | ⮝ 11%

FINOLEX INDUSTRIES | Plastic Products | 02 September 2020

Demand situation steadily improving

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We recently interacted with the management of Finolex Industries (FNXP). Following are the key takeaways:

- Demand for agriculture pipes slowed from June due to early onset of the monsoon this year. Offtake remains weak as this is a seasonally dull demand period due to rainfall across the country.
- The agriculture segment accounts for ~70% of the company's total turnover and non-agriculture pipes form the balance.
- Following easing of the lockdown, FNXP had initially experienced logistical issues due to non-availability of manpower, but this has been steadily improving every month.
- The company is hopeful of good demand for agriculture pipes from H2FY21 due to the normal monsoons, higher water reservoir levels and a government thrust on the rural economy.
- Sale of non-agriculture pipes (primarily used in housing) picked up in July and showed similar growth trends in August.
- Aggregate pipe volume demand in July was at 90-95% of year-ago sales and could remain at these levels in the near term.
- FNXP is targeting historical 8-9% EBIT margins from the piping segment going ahead as well.
- The PVC-EDC delta is currently at ~US$ 680/mt and will thus nullify the high-cost inventory carried over from FY20. This inventory is expected to be utilised by Q2FY21.
- Business in the agriculture pipe segment continues on the cash-and-carry mode. In the non-agri space, credit is provided to dealers.
- The company remains net-debt free and has no major capex plans for FY21.

Ticker/Price	FNXP IN/Rs 505
Market cap	US$ 858.1mn
Shares o/s	124mn
3M ADV	US$ 0.4mn
52wk high/low	Rs 627/Rs 290
Promoter/FPI/DII	52%/2%/45%

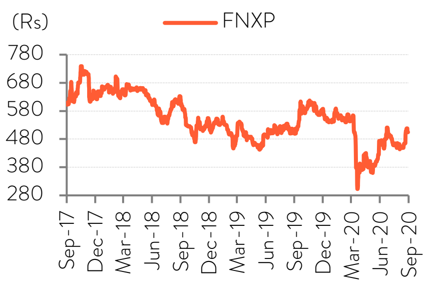
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY21E	FY22E	FY23E
Total revenue (Rs mn)	28,490	30,992	33,397
EBITDA (Rs mn)	4,630	4,755	5,046
Adj. net profit (Rs mn)	3,207	3,349	3,611
Adj. EPS (Rs)	25.8	27.0	29.1
Adj. EPS growth (%)	(3.6)	4.4	7.8
Adj. ROAE (%)	15.5	14.9	14.8
Adj. P/E (x)	19.5	18.7	17.4
EV/EBITDA (x)	13.4	13.0	11.9

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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DIVERSIFIED FINANCIALS

02 September 2020

AMCs – Product focus and financial advisory taking root

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We spoke with Mirae AMC CEO Swarup Mohanty recently. Key takeaways: (1) India's AMC industry is increasingly focusing on products rather than distribution as industry assets have not beaten respective benchmarks over long horizons. (2) Most investor portfolios lack prudent asset allocation, offering tailwinds to financial advisory. (3) Yields are likely to shrink further given growing market efficiencies and a rising mix of passive funds. (4) Equity flows could remain muted till Dec'20.

Focus on products rather than distribution: According to Mr Mohanty, the AMC industry has followed a distribution-led business model, which is slowly making way for a product-based model. This stems from (a) a shift in market dynamics owing to the mid-cap meltdown post-FY17, (b) disruption to traditional distribution channels by online platforms, and (c) inability of industry assets to beat respective benchmarks even over longer horizons. A mix of long-only assets (debt/equity) delivers better returns and so the broadly accepted thesis that only equity makes more money will need to be gradually unlearnt. Investors are now looking at good products over good brands.

Financial advisory taking root: Financial advisory services have become increasingly popular during the Covid-19 lockdown, as investors who have been onboarded since FY15 are mostly first-time entrants to equity products and are nascent to current market volatility. The lack of prudent asset allocation for new and old investors alike offers vast scope for financial advisory.

Yields to shrink but can be offset by opex reduction: Mr Mohanty believes yields are likely to shrink further due to better market efficiencies and an increasing mix of passive funds in AUM. Opex could reduce as digitisation and financial advisory drive changes in the current physical sales model over the medium term while an increased focus on product development will shift manpower needs elsewhere.

Active vs. passive debate has started in India: With many first-time equity investors shying away from volatility, financial advisory taking root and markets becoming efficient, flows into passive funds are likely to increase. We are also likely to see more thematic funds and solutions, where sustainable alpha generation is feasible. First-time investors could enter through the passive route to eliminate the downside risk of beating the benchmark.

RECOMMENDATION SNAPSHOT

Ticker	Price	Target	Rating
HDFCAMC IN	2,421	3,000	BUY
NAM IN	281	210	SELL

Price & Target in Rupees

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AUTOMOBILES

02 September 2020

Aug'20 Auto Sales: Recovery led by pre-festive inventory filling

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Auto sales clocked an expectedly healthy recovery across segments in Aug'20, barring MHCVs and 3Ws. We believe filling up of low dealer inventory prior to the festive season and pent-up demand have been key drivers for this recovery. Domestic PV industry sales increased ~20% YoY and 2Ws grew ~8% YoY for HMCL in the month. MHCV volumes continued to be the worst affected, declining 52% YoY for AL. Tractor sales beat our expectations, outperforming other segments and growing at 65%/80% YoY for MM/ESC.

PV sales up 20%: Domestic sales for Maruti (MSIL) increased 20% YoY to 116.7k units in August while exports fell 15% YoY. The company's Mini segment showed strong growth of 95% YoY. PV sales for M&M (MM) and Hyundai Motors were up 1% and 20% YoY respectively while Tata Motors (TTMT) reported a 153% surge for the month. New entrants KIA/MG Motors reported 74%/41% YoY growth. We believe inventory filling, pent-up demand and gradual recuperation of the supply chain have been key growth drivers.

2Ws post decent show; 3Ws still weak: Hero's (HMCL) volumes increased 8% YoY to 584k in Aug'20, with motorcycle sales growth ahead of scooters. In a press release, HMCL mentioned that it is witnessing strong demand from rural and semi-urban markets and is currently operating at full capacity.

2W sales for Bajaj Auto (BJAUT) dipped 1% YoY to 321k while TVS Motor (TVSL) posted flat sales at 277k units, with mopeds (+23% YoY) outperforming other segments. 3W sales for TVSL (–30%) and BJAUT stayed weak (–46%). Royal Enfield reported 2W volumes of 50k units (–5% YoY), with the exports and >350cc segment posting sharper declines of 38% and 54% respectively.

MHCV sales still soft: Total CV sales for AL plunged 31% YoY to 6.3k units. MHCVs were the worst hit, clocking a 52% YoY drop, while LCVs fell 4% YoY. Total sales for VECV dropped 30% to 2.5k units in August.

Tractor segment outperforms: MM sold 24.5k tractors (+65% YoY) in Aug'20. Competitor Escorts (ESC) sold 7.3k units (+80% YoY). Positive rural sentiment led by timely and widespread monsoons, higher sowing of Kharif crop and adequate availability of retail finance are a few factors that bode well for the agriculture sector. Also, improvement in the supply side compared to previous months and build-up of inventory are supporting sales, according to OEMs.

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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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