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FIRST LIGHT

15 March 2019

RESEARCH

Logistics

Transformation underway – prefer MLL, FSCSL, TCIEXP, TRPC

BOB Economics Research | Wholesale Inflation

Food inflation drives WPI higher

eClerx Services | Target: Rs 1,020 | –11% | REDUCE

Announces Rs 2.6bn buyback – a transient trigger

Pharmaceuticals

Lonza call takeaways: China's API dominance receding

SUMMARY

Logistics

India's US$ 160bn logistics industry is amidst a much-needed transformation led by (1) structural reforms (GST, e-way bill) and the government's infrastructure thrust (DFC, Sagarmala), (2) the emergence of new-age, service-oriented businesses versus asset-heavy models, and (3) growing formalisation of the sector, propelling organised players to the fore. We prefer the emerging 3PL and express segments for long-term value creation. Among stocks, MLL, FSCSL, and TCIEXP are our top fundamental picks, while TRPC offers compelling valuations.

Click here for the full report.

India Economics: Wholesale Inflation

WPI increased to 2.9% in Feb'19 from 2.8% in Jan'19 led by food inflation at 3.3% in Feb'19 (1.8% in Jan'19). Fuel and power inflation too rose by 40bps MoM to 2.2% in Feb'19. However, manufactured inflation softened to 2.3% in Feb'19 (2.6% in Jan'19). Weak global growth outlook will support lower commodity prices in coming months. However, food inflation may inch up from a low of 0.3% seen in FYTD19. Even so, inflation, in particular CPI, will be lower than RBI's target of 4% thus opening up room for easing in Apr'19.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Axis Bank	Buy	750
Cipla	Buy	620
GAIL	Buy	515
Reliance Industries	Buy	1,300
TCS	Buy	2,390

MID-CAP IDEAS

Company	Rating	Target
Greenply Industries	Buy	230
L&T Infotech	Buy	2,080
Laurus Labs	Buy	495
Mayur Uniquoters	Buy	540
Mphasis	Buy	1,150

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	2.62	2bps	(3bps)	(20bps)
India 10Y yield (%)	7.55	4bps	2bps	(14bps)
USD/INR	69.54	0.2	2.3	(7.3)
Brent Crude (US$/bbl)	67.55	1.3	9.8	4.1
Dow	25,703	0.6	2.6	3.8
Shanghai	3,027	(1.1)	14.1	(8.0)
Sensex	37,752	0.6	3.7	11.6
India FII (US$ mn)	**12 Mar**	**MTD**	**CYTD**	**FYTD**
FII-D	47.0	848.6	(819.5)	(7,810.2)
FII-E	511.1	1,838.1	3,915.5	(2,767.4)

Source: Bank of Baroda Economics Research

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eClerx Services

eClerx (ECLX) has announced a buyback worth Rs 2.6bn through the tender offer route at a maximum price of Rs 1,600/sh (39.6% premium over today's closing price of Rs 1,146), translating into 1.63mn shares or 4.23% of paid up equity shares. As per our calculations, this is likely to be EPS-dilutive by 0.6-0.9% but could translate into ~90bps ROE improvement. We view the buyback as a transient trigger in the absence of operational performance improvement (9MFY19 EBIT down 21.6% YoY).

Click here for the full report.

Pharmaceuticals

We hosted the Lonza Group on an investor conference call to gain greater insights into the API shortages stemming from China environmental, social and corporate governance (ESG) issues. Lonza is a Swiss-based company with revenues of US$ 5.5bn and a world leader in the manufacture of active ingredients for pharmaceutical and biotech companies.

Click here for the full report.

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LOGISTICS

14 March 2019

Transformation underway

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India's US$ 160bn logistics industry is amidst a much-needed transformation led by (1) structural reforms (GST, e-way bill) and the government's infrastructure thrust (DFC, Sagarmala), (2) the emergence of new-age, service-oriented businesses versus asset-heavy models, and (3) growing formalisation of the sector, propelling organised players to the fore. We prefer the emerging 3PL and express segments for long-term value creation. Among stocks, MLL, FSCSL, and TCIEXP are our top fundamental picks, while TRPC offers compelling valuations.

Easing impediments: Major bottlenecks – a suboptimal modal mix, inadequate infrastructure and a lack of formalisation – have traditionally plagued the logistics industry. However, we see these impediments easing led by the implementation of structural reforms (GST, e-way bill, infrastructure status to logistics) and progress on marquee infrastructure projects such as the dedicated freight corridor (DFC). These structural drivers are expected to fuel a 9-10% CAGR in the industry over the next 3-4 years, giving rise to a US$ 200bn+ opportunity.

Emergence of new business models: Evolving supply chain needs are fostering businesses that offer integrated, value-added services and leverage technology for efficiency gains. These models are in stark contrast to the traditional asset-intensive ones that focused solely on transportation and/or warehousing of cargo. The emerging third-party (3PL) logistics and express segments are prime examples.

Prefer 3PL and express: We like the 3PL and express distribution segments as they offer the rare trinity of structural, above-industry growth potential, sustainable moats (high customer lock-in, scalability) and sturdy return ratios (ROE of 25-30%+). Realignment of supply chains post GST rollout in 2017 and increasing logistics outsourcing trends are expected to catalyse growth in these industries – we forecast an ~18%/15% CAGR for 3PL/express over FY19-FY21.

Top picks – MLL, FSCSL, TCIEXP, TRPC: Our stock preferences are aligned with our industry theme of 3PL/express growing faster. Mahindra Logistics (MLL), Future Supply (FSCSL), and TCI Express (TCIEXP) are our top fundamental picks for their strong earnings (28%/27%/25% CAGR) and ROIC (43%/23%/ 44% on average) profiles over FY19-FY21. Transport Corp (TRPC) is our value pick as it is trading at an attractive 11x one-year forward P/E. We also initiate coverage on Allcargo Logistics (AGLL, BUY) and Concor (CCRI, REDUCE).

KEY RECOMMENDATIONS

Ticker	Price*	Target	Rating
MAHLOG IN	499	625	BUY
FSCSL IN	633	780	BUY
TCIEXP IN	744	880	BUY
TRPC IN	291	365	BUY
AGLL IN	112	130	BUY
CCRI IN	523	530	REDUCE

Price & Target in Rupees | MAHLOG = MLL
*All closing prices as of 13 Mar 2019

Bank of Baroda
India's International Bank

WHOLESALE INFLATION

14 March 2019

Food inflation drives WPI higher

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WPI increased to 2.9% in Feb'19 from 2.8% in Jan'19 led by food inflation at 3.3% in Feb'19 (1.8% in Jan'19). Fuel and power inflation too rose by 40bps MoM to 2.2% in Feb'19. However, manufactured inflation softened to 2.3% in Feb'19 (2.6% in Jan'19). Weak global growth outlook will support lower commodity prices in coming months. However, food inflation may inch up from a low of 0.3% seen in FYTD19. Even so, inflation, in particular CPI, will be lower than RBI's target of 4% thus opening up room for easing in Apr'19.

Food inflation rises: WPI food inflation rose to 3.3% in Feb'19 from 1.8% in Jan'19 on a YoY basis. The increase was broad based. Amongst food grains, inflation in pulses saw the sharpest jump, rising to a 26-month high of 10.9% in Feb'19 compared with 7.6% in Jan'19. Wheat prices accelerated by 12.3% in Feb'19 led by 25% YoY increase in international prices. Prices of vegetables increased by 6.8% in Feb'19 compared with decline of (-) 4.2% in Jan'19. In addition, most of the protein based items continued to see an uptick with prices of eggs rising by 3.8% in Feb'19 from 0.9% in Jan'19. However, milk prices eased to 1.6% in Feb'19.

Fuel & power inflation ticks up: Despite international oil prices falling by (-) 2% in Feb'19 on a YoY basis, fuel and power inflation inched up marginally, from 1.8% in Jan'19 to 2.2% in Feb'19. This was led by mineral oils (1.7% vs 0.1% in Jan'19). Coal and electricity prices continued to slip for the second consecutive month in Feb'19. A plausible explanation for the rise in fuel & power inflation is weakening rupee. Rupee fell by (-) 9.5% in Feb'19 on a YoY basis vs 4% appreciation seen in Feb'18. In Mar'19, with crude hovering around US$ 66/bbl (MTD basis), we expect fuel inflation to remain muted.

Core inflation cooling: Both core and manufactured product inflation eased further in Feb'19 to 2.4% and 2.3% from 2.9% and 2.6% respectively in Jan'19. The decline was broad-based, led by basic metals, other manufacturing items, wearing apparel, leather, furniture and paper products. This was in-line with softening international commodity prices (-7% in Feb'19 vs -6.9% in Jan'19) on a YoY basis. Pharma, machinery/electrical equipment and motor vehicles saw increase in prices.

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REDUCE
TP: Rs 1,020 | ⮟ 11%

ECLERX SERVICES | IT Services | 14 March 2019

Announces Rs 2.6bn buyback – a transient trigger

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Event: eClerx (ECLX) has announced a buyback worth Rs 2.6bn through the tender offer route at a maximum price of Rs 1,600/sh (39.6% premium over today's closing price of Rs 1,146), translating into 1.63mn shares or 4.23% of paid up equity shares.

Financial implications: As per our calculations, this is likely to be EPS-dilutive by 0.6-0.9% but could translate into ~90bps ROE improvement.

Payout ratio: The buyback coupled with interim dividend of Re 1/sh announced in Aug'18 implies a payout ratio of ~124% (based on our estimated FY19 net profit of Rs 2.15bn) and marks an improvement over the FY18/FY17 payout ratios of ~89%/67%.

A temporary trigger: We view this development as a positive step towards efficient capital allocation. We had highlighted the possibility of a buyback as a near-term catalyst in our report 'Not out of the woods yet' dated 31 Jan 2019, and the stock has already inched up ~11% in the past week in the run-up to the announcement. Nonetheless, we see this as a transient trigger in the absence of operational performance improvement (9MFY19 EBIT down 21.6% YoY).

Maintain REDUCE: We believe continued investments toward onsite delivery expansion (which has a 3-6-month lag in revenues vs. costs) and offshore revenue leakage due to roll-offs (though relatively lower than last year) will limit margin expansion, at least till H1FY20. A structural downward reset to operating margins led by a changing business mix in favour of onsite revenues precludes a constructive outlook. Reiterate REDUCE. We value the stock at an unchanged target P/E multiple of 13.5x, a 20% discount to its five-year average 12-month forward P/E due to a weaker margin and growth profile.

FIG 1 – BUYBACKS OVER FY17-FY19

Particulars	FY17	FY18	FY19
Buyback size (Rs mn)	2,340	2,580	2,620
No of equity shares (in mn)	1.17	1.29	1.63
% of equity	2.78	3.23	4.23
Buyback price (Rs per sh)	2,000	2,000	1,600
Premium over last price (%)	40.2	33.3	39.6
Date of announcement (Board meeting)	14-Oct-16	22-Dec-17	14-Mar-19

Source: Company, BOBCAPS Research

Ticker/Price	ECLX IN/Rs 1,146
Market cap	US$ 640.3mn
Shares o/s	39mn
3M ADV	US$ 0.3mn
52wk high/low	Rs 1,368/Rs 976
Promoter/FPI/DII	50%/25%/25%

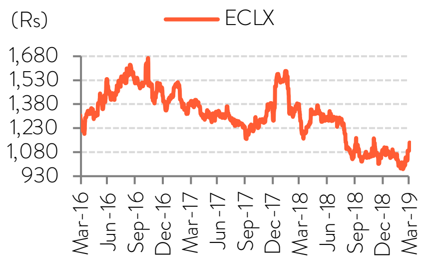
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	2,156	2,478	2,964
Adj. EPS (Rs)	56.7	65.2	78.0
Adj. EPS growth (%)	(23.8)	14.9	19.6
Adj. ROAE (%)	16.9	18.1	20.1
Adj. P/E (x)	20.2	17.6	14.7
EV/EBITDA (x)	13.8	11.2	9.4

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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PHARMACEUTICALS

14 March 2019

Lonza call takeaways: China's API dominance receding

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We hosted the Lonza Group on an investor conference call to gain greater insights into the API shortages stemming from China environmental, social and corporate governance (ESG) issues. Lonza is a Swiss-based company with revenues of US$ 5.5bn and a world leader in the manufacture of active ingredients for pharmaceutical and biotech companies. We provide key call highlights below.

Multi-year opportunity: China's blue-sky policy has created an abrupt shortage of API supplies globally. Lonza believes the resolution of quality issues in China could be a protracted affair. Over the last 15 months, regulator checks on quality of material from China have also become more stringent. Local regulators are stepping up certification requirements, especially from ESG investors.

Sourcing from China coming off: Over the last two years, Lonza's dependency on sourcing APIs from China has reduced materially due to quality and environmental concerns. The company has switched over to alternate suppliers and brought manufacturing of many critical raw materials inhouse. Its key focus is on security of supplies and it prefers to avoid the spot market entirely.

Cost arbitrage has narrowed vs. western world: Compliance and other costs in China are shooting up and hence the cost arbitrage derived from sourcing supplies from China is narrowing, except for some commodity APIs where the country has a scale advantage.

API price inflation to normalise: API prices are not expected to increase much besides normal price inflation given that most of contracts are for five years or more and have fixed pricing with some inflation variable. Key materials that have seen sharp price increases in recent months include Acetone and Acetonitrile.

Sartan prices largely stable: Impurity profiles are a key concern for biotech companies as the cost of testing them inhouse could be very high. Overall, sartans have not seen substantial prices hikes so far.

Our view: We believe the impact of the API shortage is already in the base for select companies such as Divi's Labs and Dr Reddy's. While volume gains could sustain, API prices have now started to normalise. We remain selective in our picks and prefer Cipla, Aurobindo Pharma and Laurus. Upsides in Divi's could be capped following the recent rally.

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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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