FIRST LIGHT

26 November 2018

RESEARCH

Top picks

- **Large-cap ideas** – Petronet LNG replaced by **Axis Bank** (see **Multiple rerating triggers – initiate with BUY, 22Nov18**)

Axis Bank | Target: Rs 750 | +20% | BUY

Multiple rerating triggers – initiate with BUY

Energy Tracker

Surprise reversal in macro trends

Tech Mahindra | Target: Rs 790 | +14% | ADD

Targeting broad-based growth

Century Plyboards | Target: Rs 270 | +65% | BUY

MDF prices stabilising

Somany Ceramics | Target: Rs 510 | +75% | BUY

H2FY19 to show better traction

SUMMARY

Axis Bank

We initiate coverage on Axis Bank (AXSB) with BUY and a Mar'20 SOTP-based target price of Rs 750, valuing the core book at 2.1x FY21E P/BV. The stock is ripe for a rerating as key triggers for an earnings resurgence fall into place – (a) new leadership with a formidable track record, (b) shrinking stressed assets and slippages amid a tighter recovery climate, (c) credit cost normalising to <1% over FY20E/FY21E, and (d) loan growth reviving to an 18% CAGR as AXSB benefits from a turning corporate cycle.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Axis Bank	Buy	750
GAIL	Buy	525
Reliance Industries	Buy	1,340
Tata Motors	Buy	270
TCS	Buy	2,360

MID-CAP IDEAS

Company	Rating	Target
Greenply Industries	Buy	250
L&T Infotech	Buy	2,070
Mayur Uniquoters	Buy	565
Mphasis	Buy	1,360
Supreme Industries	Add	1,370

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	3.06	0bps	(14bps)	71bps
India 10Y yield (%)	7.79	0bps	(14bps)	90bps
USD/INR	71.46	0.3	2.9	(10.1)
Brent Crude (US$/bbl)	63.48	1.5	(20.5)	1.5
Dow	24,465	0.0	(3.4)	3.7
Shanghai	2,652	0.2	(0.1)	(22.3)
Sensex	35,200	(0.8)	3.1	5.1
India FII (US$ mn)	**19 Nov**	**MTD**	**CYTD**	**FYTD**
FII-D	(9.1)	880.4	(7,580.9)	(7,826.8)
FII-E	146.7	723.4	(5,034.8)	(7,160.3)

Source: Bank of Baroda Economics Research

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Energy Tracker

Sharp reversals in oil price trends (currently below US$ 65/bbl from highs of ~US$ 87 on 4 Oct) and the USDINR (down to Rs 71 from highs of ~Rs 74.5 on 11 Oct) have turned all macro predictions made in Sep'18 on their head, rendering the government's attempt to cap OMC retail margins rather premature. OMCs may not be fully out of the woods yet as election season looms. We await further clarity on macro trends post some key global events, but see good fundamental value in ONGC, RIL, IOCL, GAIL and IGL.

Click here **for the full report.**

Tech Mahindra

We attended Tech Mahindra's (TECHM) recent analyst meet where the company highlighted its focus on executing the 3-4-3 strategy laid out last year, with a thrust on new technologies. TECHM is further targeting broad-based growth across verticals by exploring innovation opportunities arising from 5G adoption. The digital business remains a focus area and management sees strong growth here backed by a disruptive partner ecosystem and robust product slate. Deal win momentum also looks upbeat. Maintain ADD.

Click here **for the full report.**

Century Plyboards

We recently met the management of Century Plyboards (CPBI). Key takeaways: (1) Plywood demand was largely from the mid-market during H1FY19, which supported double-digit volume growth for CPBI. Management expects high double-digit volume growth to continue. (2) Following the decline in MDF prices in H1FY19, CPBI has not initiated any price cuts in Q3FY19 to date. As per management, MDF prices are unlikely to decline further as profitability is already low. (3) Laminate margins should gradually increase in Q3 & Q4FY19 due to the price hikes (~3%) taken by the company from Nov'18.

Click here **for the full report.**

Somany Ceramics

We met the management of Somany Ceramics (SOMC) and the following are our key takeaways: (1) Demand conditions in the builder segment remain subdued. However, demand from the commercial real estate and government sectors is intact, growing in high single digits. (2) The tighter credit cycle adopted by SOMC to control debtor days led to significant revenue losses in H1FY19 – management indicated that this tightening is now largely complete. (3) SOMC expects gas prices to decline from December as benefits from the recent fall in crude and appreciating currency reflect in Q4FY19.

Click here for the full report.

BUY
TP: Rs 750 | ⮝ 20%

AXIS BANK | Banking | 22 November 2018

Multiple rerating triggers – initiate with BUY

We initiate coverage on Axis Bank (AXSB) with BUY and a Mar'20 SOTP-based target price of Rs 750, valuing the core book at 2.1x FY21E P/BV. The stock is ripe for a rerating as key triggers for an earnings resurgence fall into place – (a) new leadership with a formidable track record, (b) shrinking stressed assets and slippages amid a tighter recovery climate, (c) credit cost normalising to <1% over FY20E/FY21E, and (d) loan growth reviving to an 18% CAGR as AXSB benefits from a turning corporate cycle.

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New leadership a welcome change: Amitabh Chaudhry, who had an impeccable track record helming HDFC Standard Life, joins AXSB as MD & CEO for three years beginning Jan'19. His proven leadership and strategic skills will do much to restore investor confidence and repair the bank's bruised brand image.

Asset quality stress has largely run its course: AXSB has a stressed pool of ~Rs 500bn (~11% of loans), with 60% already booked as NPAs. The residual non-NPA stressed pool of 2.6% is only likely to decline from hereon.

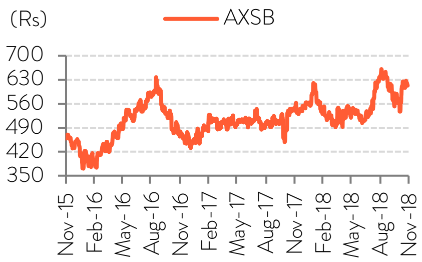
Business franchise fortified: AXSB has engineered a structural shift in underwriting norms for new loans, resulting in a better rating profile for its corporate portfolio (79% high-rated loans in Q2FY19 vs. 62% in FY16) and a shift away from retail home loans. We expect loan growth to return to ~20% from FY21 with ample scope for margin gains (+30bps to 3.7% NIM by FY21E).

Stage set for profitable growth: Asset quality woes hit return ratios in FY17/FY18. Ebbing slippages and credit costs now leave the new management free to focus on profitable growth. We expect earnings to pick up, with ROE/ROA of 16.5%/1.3% by FY21. Our two-stage Gordon growth model values the core business at 2.1x FY21E P/BV (Rs 700) with subsidiaries forming 7% of our target price. BUY.

Ticker/Price	AXSB IN/Rs 627
Market cap	US$ 22.6bn
Shares o/s	2,569mn
3M ADV	US$ 103.7mn
52wk high/low	Rs 678/Rs 481
Promoter/FPI/DII	26%/50%/24%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	36,793	2,757	41,272	1,01,476	1,32,709
EPS (Rs)	15.4	1.1	16.1	39.5	51.7
P/E (x)	40.7	564.1	39.0	15.9	12.1
P/BV (x)	2.7	2.5	2.4	2.2	1.9
ROA (%)	0.7	0.0	0.6	1.2	1.3
ROE (%)	6.8	0.5	6.4	14.4	16.5

Source: Company, BOBCAPS Research

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OIL & GAS | Energy Tracker | 22 November 2018

Surprise reversal in macro trends

Sharp reversals in oil price trends (currently below US$ 65/bbl from highs of ~US$ 87 on 4 Oct) and the USDINR (down to Rs 71 from highs of ~Rs 74.5 on 11 Oct) have turned all macro predictions made in Sep'18 on their head, rendering the government's attempt to cap OMC retail margins rather premature. OMCs may not be fully out of the woods yet as election season looms. We await further clarity on macro trends post some key global events, but see good fundamental value in ONGC, RIL, IOCL, GAIL and IGL.

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Concerns over under-recoveries recede for FY19: If oil prices were to average around US$ 75/bbl in FY19 (US$ 69 so far in H1FY19) and the USDINR Rs 72 (Rs 67 in H1FY19), under-recoveries in FYF19 are unlikely to overshoot budgetary provisions of Rs 250bn by a significant margin (as suspected earlier). Hence, it seems highly improbable that upstream oil companies would have to bear any subsidy burden. Instead, the government could reverse the Rs 2.5/ltr excise duty cuts on petrol/diesel implemented in October. Two key events would lend clarity on price trends over 2019-20: the OPEC meeting on 6 Dec and the review of IRAN sanction exemptions to eight countries due in May'19.

Gas utilities could gain the most, but with a lag: While domestic gas prices would react to the climbdown in oil with a lag (due for revisions in Apr'19 and Oct'19), LNG prices which are based on 3M average rolling Brent prices could drop sharply by Q4FY19. Immediate gainers would be Petronet LNG, GAIL (gas pipeline business), Gujarat State Petronet (GUJS) and CGD businesses with an industrial-heavy customer base (Gujarat Gas – GUJGA). Indraprastha Gas (IGL) looks best positioned among CGD companies for the long term, with multiple volume and margin levers that are least dependent on oil movement.

Cyclicals could gain from a softer oil price environment: Singapore complex GRMs (US$ 5/bbl QTD) have come under pressure, but could revive if oil prices sustain below US$ 70/bbl. The long-term outlook for refineries remains buoyant as IMO regulations are expected to boost GRMs from H2FY20. Petrochemicals earnings outlook remains more structurally buoyant (insulated from threat of EVs), but OMCs remain in a delicate situation as multiple state and general elections (May'19) could prevent a rollback in retail marketing margin pressure from the government. RIL and IOCL remain our preferred picks among cyclicals due to their well-diversified earnings base.

RECOMMENDATIONS

Ticker	Rating
RIL IN	BUY
IOCL IN	BUY
BPCL IN	REDUCE
HPCL IN	SELL
ONGC IN	BUY
OINL IN	BUY
GAIL IN	BUY
PLNG IN	BUY
IGL IN	BUY
GUJGA IN	BUY
GUJS IN	BUY
MAHGL IN	ADD

Price & Target in Rupees

ADD
TP: Rs 790 | ⮝ 14%

TECH MAHINDRA | IT Services | 22 November 2018

Targeting broad-based growth

We attended Tech Mahindra's (TECHM) recent analyst meet where the company highlighted its focus on executing the 3-4-3 strategy laid out last year, with a thrust on new technologies. TECHM is further targeting broad-based growth across verticals by exploring innovation opportunities arising from 5G adoption. The digital business remains a focus area and management sees strong growth here backed by a disruptive partner ecosystem and robust product slate. Deal win momentum also looks upbeat. Maintain ADD.

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Strategy execution in focus: Management is focused on executing the 3-4-3 strategy laid out last year, wherein the company had identified 3 mega trends, 4 key bets and 3 objectives to accelerate growth. Primary thrust areas are new technologies and margin levers.

Communication vertical to act as platform for innovation: 5G presents an opportunity for a system overhaul and TECHM believes it will act as a platform for innovation across industry segments, leading to broad-based growth spanning manufacturing, healthcare and media & entertainment. The company is also spotlighting the media & entertainment business where management sees significant opportunities as telecom players expand across the value chain.

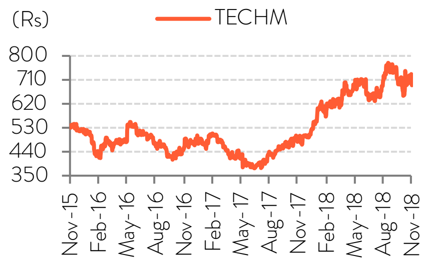
Digital thrust continues: TECHM is continuing with its digital strategy of collaborative disruption by partnering with industry leaders and new-age players. The company also remains focused on investing in platforms and augmenting its product portfolio. After clocking US$ 550mn in net-new deals in the Sep'18 quarter, management expects the strong momentum to continue.

Outlook: Management has guided for 8-10% YoY growth in the enterprise business and mid single-digit growth in the communications vertical in FY19.

Ticker/Price	TECHM IN/Rs 691
Market cap	US$ 8.6bn
Shares o/s	891mn
3M ADV	US$ 37.0mn
52wk high/low	Rs 781/Rs 463
Promoter/FPI/DII	36%/39%/25%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY17A	FY18A	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	28,410	38,001	41,208	43,688	48,509
Adj. EPS (Rs)	31.9	42.7	46.2	49.0	54.4
Adj. EPS growth (%)	(7.6)	33.6	8.3	6.0	11.0
Adj. ROAE (%)	18.1	21.0	20.1	19.0	18.9
Adj. P/E (x)	21.6	16.2	15.0	14.1	12.7
EV/EBITDA (x)	14.0	12.9	9.6	8.8	7.8

Source: Company, BOBCAPS Research

BUY
TP: Rs 270 | ⮝ 65%

CENTURY PLYBOARDS | Construction Materials | 22 November 2018

MDF prices stabilising

We recently met the management of Century Plyboards (CPBI). Below are the key takeaways:

Plywood

- Demand in the plywood segment was largely from the mid-market during H1FY19, which supported double-digit volume growth for CPBI. Management believes this segment will continue to grow, sustaining high double-digit volume growth ahead.
- Plywood operating margins are currently at ~16% and management believes these are sustainable.
- The company is increasingly using PQ and OKUME-grade face veneer instead of the Gurjan variety which is facing availability issues. Face veneer is being procured from the Solomon Islands and Gabon.

MDF

- Following the decline in MDF prices in H1FY19, CPBI has not initiated any price cuts in Q3FY19 to date. As per management, MDF prices are unlikely to decline further as profitability is already very low.
- Management believes excess MDF capacities that became operational in the sector during CY18 will be absorbed over the next 3-4 quarters, easing pressure on margins.
- The MDF market continues to grow at 15-20% and imports are still no threat to India's northern markets, where the company operates.
- Q3 has begun on a positive note – MDF plant utilisation is at ~90% (vs. ~65% in H1FY19) and, at these levels of utilisation, it has ~15% operating margins. CPBI aims to achieve 70-75% utilisation for FY19.
- The company sells ~90% of its MDF to OEMs.

Laminates

- Laminate margins should gradually increase in Q3 & Q4FY19 due to the price hikes (~3%) taken by the company from Nov'18.
- CPBI hopes to install the sixth laminate line with a capacity of 1.5mn sheets over the next few months and achieve full utilisation in FY20.

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Ticker/Price	CPBI IN/Rs 164
Market cap	US$ 512.2mn
Shares o/s	223mn
3M ADV	US$ 0.8mn
52wk high/low	Rs 364/Rs 150
Promoter/FPI/DII	72%/10%/18%

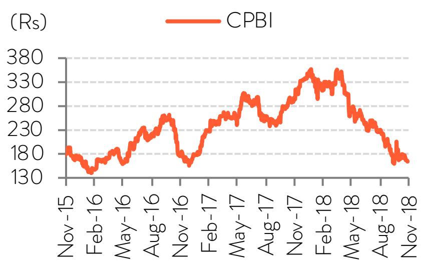
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	1,925	2,368	2,770
Adj. EPS (Rs)	8.7	10.7	12.5
Adj. EPS growth (%)	20.4	23.0	17.0
Adj. ROAE (%)	20.6	21.2	20.7
Adj. P/E (x)	18.9	15.4	13.2
EV/EBITDA (x)	11.7	9.9	8.4

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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BUY
TP: Rs 510 | ⮝ 75%

SOMANY CERAMICS | Construction Materials | 22 November 2018

H2FY19 to show better traction

We met the management of Somany Ceramics (SOMC) and the following are our key takeaways:

- Demand conditions in the builder segment remain subdued. However, demand from the commercial real estate and government sectors is intact, growing in high single digits.
- The tighter credit cycle adopted by SOMC to control debtor days led to significant revenue losses in H1FY19 – management indicated that this tightening is now largely complete. Debtor days have been reined in from ~105 in Mar'18 to ~80 days by Oct'18 and the company has a target of ~70 days going ahead.
- Gas prices have risen to ~Rs 41.5/scm in Q3FY19 (vs. Rs 39/scm in Q2) due to the lag impact of higher crude prices and currency depreciation in earlier months. SOMC expects gas prices to decline from December as benefits from the recent fall in crude and appreciating currency reflect in Q4FY19.
- The company has taken a 2-3% price increase in Sep-Oct'18 which will aid margins.
- Competitors based in Morbi, Gujarat, have also taken some price hikes in Q3 due to the rising cost of production.
- SOMC has installed a chain stove for its spray dryer machine at the Kassar plant which shall enable savings of Rs 4mn-5mn/month due to lower gas consumption.
- Management expects the tile industry to grow at 3-4% and SOMC to deliver high single-digit volume growth in FY19 (with double-digit growth in FY20).
- As per management, operating margins will improve due to better volume growth (and hence operating leverage) along with recent price hikes.
- The bathware segment (sanitaryware and faucets) is expected to maintain its ~30% growth rate due to a low base. Management has maintained its revenue guidance from this segment at Rs 2bn for FY19.

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Ticker/Price	SOMC IN/Rs 291
Market cap	US$ 173.1mn
Shares o/s	42mn
3M ADV	US$ 0.3mn
52wk high/low	Rs 978/Rs 290
Promoter/FPI/DII	52%/5%/44%

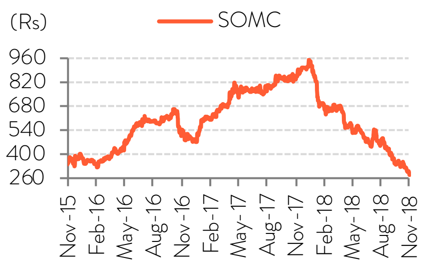
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	480	796	1,069
Adj. EPS (Rs)	11.3	18.8	25.2
Adj. EPS growth (%)	(34.2)	65.9	34.4
Adj. ROAE (%)	7.9	11.9	14.1
Adj. P/E (x)	25.7	15.5	11.5
EV/EBITDA (x)	10.4	8.1	6.4

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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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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