

RESEARCH

BOB Economics Research | Weekly Wrap

US Fed turns dovish

Sun Pharma | Target: Rs 615 | +35% | BUY

Concerns overblown – reiterate BUY

IT Services

Valuation headwinds from new H-1B visa curbs

Automobiles

Nov'18 auto sales remain muted

SUMMARY

India Economics: Weekly Wrap

Global yields fell as crude prices edged below US\$ 60/bbl and US Fed turned dovish. Anticipated positive outcome of the US-China trade talks further supported the markets. Global equity markets went up, but Europe and China under-performed. Notably, Chinese economy slowed down further in the month. Even India's growth moderated to 7.1% in Q2FY19 (8.2% in Q1FY19) as consumers cut down on spending. Manufacturing growth also decelerated. With energy prices falling, growth is likely to remain at Q2FY19 levels in H2. RBI to remain on hold.

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TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Axis Bank	Buy	750
Cipla	Buy	615
GAIL	Buy	525
Reliance Industries	Buy	1,340
TCS	Buy	2,360

MID-CAP IDEAS

Company	Rating	Target
Greenply Industries	Buy	250
L&T Infotech	Buy	2,070
Laurus Labs	Buy	495
Mayur Uniquoters	Buy	565
Mphasis	Buy	1,360

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	2.99	(4bps)	(16bps)	58bps
India 10Y yield (%)	7.61	0bps	(25bps)	55bps
USD/INR	69.58	0.4	5.9	(8.0)
Brent Crude (US\$/bbl)	58.71	(1.3)	(22.2)	(7.6)
Dow	25,538	0.8	1.7	5.2
Shanghai	2,588	0.8	(0.6)	(22.0)
Sensex	36,194	0.1	5.1	9.2
India FII (US\$ mn)	29 Nov	MTD	CYTD	FYTD
FII-D	(75.6)	868.0	(7,593.3)	(7,839.3)
FII-E	171.0	891.1	(4,867.1)	(6,992.6)

Source: Bank of Baroda Economics Research

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Sun Pharma

Sun Pharma's (SUNP) valuation multiple has de-rated ~15% in the last six trading sessions amidst various allegations, including the arrangement with Aditya Medisales, a spike in non-current loans & advances, and recent whistleblower claims of insider trading linked to the Ranbaxy buyout. Management allayed most of these concerns in its conference call today, addressing the media-led allegations in detail and stressing its focus on strong corporate governance. While we await further action from SEBI, we do not see any major adverse implications on SUNP's business and hence on earnings. Reiterate BUY with an unchanged Mar'20 target price of Rs 615 (16x FY21E EV/EBITDA).

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IT Services

The Trump administration on Friday proposed key changes to H-1B visa rules wherein: (1) companies will require to electronically register their petitions in advance, and (2) the order of selection under the H-1B and advanced degree caps will be reversed to ensure more approvals for highly skilled resources. Post localisation and reskilling measures over the past three years, we believe Indian IT vendors are better placed to tackle visa constraints but expect valuation pressure due to market apprehensions over the potential earnings impact.

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Automobiles

Weak consumer sentiment, moderate festive season sales and a systemic liquidity crunch dampened auto sales across most segments in November. Maruti Suzuki (MSIL) reported a 0.7% YoY dip in volumes whereas Hero MotoCorp (HMCL) reported meagre 0.8% growth. CV sales also remained sluggish as MHCV sales fell 18-24% YoY, partly offset by LCVs which remain the best performing segment. Tractor sales were healthy, rising 13% YoY for M&M (MM) whereas Escorts posted a strong 56% YoY growth.

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WEEKLY WRAP

03 December 2018

US Fed turns dovish

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Markets

- **Bonds:** Global yields fell for the second consecutive week, supported by lower crude oil prices and Fed chairman's dovish statement that US rates are close to 'neutral'. Weaker than estimated US consumer confidence and home sales also drove yields lower. Indian 10Y yield dipped by 10bps (7.61%) driven by RBI's announcement of OMO purchases of Rs 400bn in Dec'18. Liquidity deficit in the system decreased to Rs 960bn as on 30 Nov 2018 versus Rs 1.1tn in the previous week.
- **Currency:** Despite US 10Y tipping below 3%, DXY index went up by 0.5% in the week as concerns over outcome of trade talks between US and China drove most currencies lower. EUR and GBP were also impacted by uncertainty around Brexit and Italy. AUD and INR appreciated. INR strengthened by 1.6% to close below at 69.58/\$ as oil prices continued to remain below US\$ 60/bbl. Equity FII inflows of US\$ 609mn in the week also lent support.
- **Equity:** Led by dovish stance of US Fed Chairman and hopes of positive outcome from the G20 summit on US-China trade front, global equity indices closed higher. Dow went up by 5.2%, followed by Sensex (3.5%) and Nikkei (3.3%). European and Chinese markets underperformed. Former because of Brexit and Italy, latter because of poor data.
- **Upcoming key events:** This is a data heavy week with release of manufacturing and services PMIs across the world besides US payroll data and German and US factory orders. On the domestic front, India's manufacturing and services PMI and RBI's monetary policy decision are awaited this week.



BUY

TP: Rs 615 | ▲ 35%

SUN PHARMA

Pharmaceuticals

03 December 2018

Concerns overblown – reiterate BUY

Whistleblower allegations cast shadow on valuations: Sun Pharma's (SUNP) valuation multiple has de-rated ~15% in the last six trading sessions amidst various allegations, including the arrangement with Aditya Medisales, a spike in non-current loans & advances, and recent whistleblower claims of insider trading linked to the Ranbaxy buyout. Management allayed most of these concerns in its conference call today, addressing the media-led allegations in detail and stressing its focus on strong corporate governance.

Key conference call takeaways: Management highlighted that –

- 1) the **allegations** raised have been sourced from the media – some date back over 15 years and some are factually incorrect,
- 2) the arrangement with **Aditya Medisales** is geared towards an efficient tax structure and is in the interest of stakeholders, though the company is open to change should investors flag issues,
- 3) **loans & advances** in FY18 (Rs 22.4bn from Rs 0.7bn in FY17) are pharma-related structured business loans pertaining to non-related parties. SUNP has an option to unwind these transactions to allay investor concerns though management is comfortable about the security of the investments,
- 4) **Sudhir Valia's** involvement in the company is limited to tax planning,
- 5) the **audit** of a few subsidiaries by Valia & Timbadia was in accordance with the law – these subsidiaries are non-material and hence did not merit the engagement of external audit firms,
- 6) SUNP has not stood guarantee for any of **Suraksha Realtors** liabilities,
- 7) the company was never involved in **insider trading** for the Ranbaxy deal (case already settled with SEBI),
- 8) SEBI has provided no communication on the **whistleblower** or on reopening of the insider trading case.

Maintain positive view: While we await further action from SEBI, we do not see any major adverse implications on SUNP's business and hence on earnings. Post today's correction, the stock is trading at 13x FY20E EV/EBITDA which is 5% lower than large-cap peers and in line with Dr Reddy's. This despite SUNP deriving 70% of its EBITDA from India and other emerging markets, which merits a higher multiple. Outperformance in coming quarters or Ilumya scale-up could be strong near-term catalysts. Reiterate BUY with an unchanged Mar'20 target price of Rs 615 (16x FY21E EV/EBITDA).

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Ticker/Price	SUNP IN/Rs 455
Market cap	US\$ 15.5bn
Shares o/s	2,399mn
3M ADV	US\$ 63.0mn
52wk high/low	Rs 679/Rs 435
Promoter/FPI/DII	54%/17%/16%

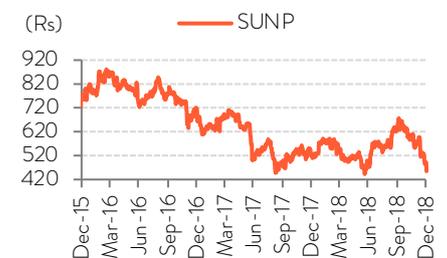
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19E	FY20E	FY21E
Adj. net profit (Rs mn)	37,789	48,601	56,465
Adj. EPS (Rs)	15.8	20.3	23.5
Adj. EPS growth (%)	12.2	28.6	16.2
Adj. ROAE (%)	7.9	9.1	9.5
Adj. P/E (x)	28.9	22.5	19.3
EV/EBITDA (x)	15.5	12.8	10.7

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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IT SERVICES

03 December 2018

Valuation headwinds from new H-1B visa curbs

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Tougher visa caps ratcheting up pressure on India IT players: Following a slew of tighter controls on work visas in the US, we have seen a marked increase in the rate of visa denials (at ~24% in Q4FY17 vs. ~18% in Q1FY17) and scrutiny for Indian petitions (72% rate of request for evidence in Q4FY17 vs. 18% in Q1FY17). During the Sep'18 quarter, several Indian IT companies (Hexaware, Persistent) and US-based players (DXC, Virtusa) commented on their inability to execute some onsite projects due to the talent crunch induced by H-1B visa caps and scarcity of local resources (US tech unemployment rate at 2.1%).

Immigration priority on US Congress's Fall 2018 agenda; close monitoring warranted: While the Trump administration's immigration stance is not new, it warrants close monitoring as both the potential long-term solutions (localisation) and short-term remedies (subcontracting) will have operating cost ramifications for Indian IT service providers.

Localisation inevitable; potential cost impact puts valuations at risk: In our view, localisation is an inevitable but long-term solution. Over the last three years, Indian IT companies have emphasised on localisation, reskilling and onsite training centres to reduce dependence on H-1B visas (new visa approvals for the top 5 Indian IT players dropped 41% in FY17 vs. FY15 (Sep year-end). Buoyant deal activity underscores an improvement in IT spends despite the adverse regulatory changes. That said, market apprehensions over the likely business, margin and earnings impact of the visa caps may put pressure on valuations.

Top picks: Amongst large-caps, we continue to prefer Infosys followed by TCS. Hexaware, L&T Infotech and Mphasis are our preferred names amongst mid-cap players.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
TCS IN	1,982	2,360	BUY
INFO IN	621	820	BUY
WPRO IN	318	290	SELL
HCLT IN	1,018	1,160	ADD
TECHM IN	695	790	ADD
LTI IN	1,573	2,070	BUY
MPHL IN	998	1,360	BUY
MTCL IN	893	1,120	ADD
HEXW IN	327	530	ADD
PSYS IN	604	740	REDUCE
NITEC IN	1,103	1,390	ADD
ECLX IN	1,016	1,080	REDUCE

Price & Target in Rupees



AUTOMOBILES

03 December 2018

Nov'18 Auto Sales remains muted

Weak consumer sentiment, moderate festive season sales and a systemic liquidity crunch dampened auto sales across most segments in November. Maruti Suzuki (MSIL) reported a 0.7% YoY dip in volumes whereas Hero MotoCorp (HMCL) reported meagre 0.8% growth. CV sales also remained sluggish as MHCV sales fell 18-24% YoY, partly offset by LCVs which remain the best performing segment. Tractor sales were healthy, rising 13% YoY for M&M (MM) whereas Escorts posted a strong 56% YoY growth.

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PV sales sluggish: PV sales remained tepid across companies as weak start to festive season sales led to inventory buildup across dealers. Higher insurance cost and weak consumer sentiment also eroded demand this festive season. On a company-wise basis: (1) MSIL posted a 0.7% YoY dip in volumes as domestic sales grew just 0.5% whereas exports dropped 19%. The Mini segment was the worst hit, plunging 22% YoY. (2) MM's PV sales increased a mere 1% YoY as UVs, which contribute ~90% volume share, grew at 1%. (3) Tata Motors' (TTMT) domestic PV segment dropped 1% YoY to 16,982 units.

Two-wheelers show mixed trend: TVS Motor (TVSL) and Bajaj Auto (BJAUT) reported healthy volume growth of 27% and 25% YoY respectively, albeit on a lower base (Nov'17 saw moderate sales as it followed the festive season). 2W sales for TVSL/BJAUT grew by 26%/31% YoY. Hero Motors' (HMCL) volumes were up only 1% to 610,252 units and Royal Enfield (RE) sales dipped 6% YoY to 65,744 units. Dealers believe that the recent shocks from increased insurance costs and higher fuel prices are behind and are seeing early signs of normalising demand.

MHCVs hit by liquidity squeeze: MHCV sales were affected the most by the recent liquidity crunch in the market as majority of sales are done on financing terms. However, continued strong momentum in LCV demand arrested the plunge in overall CV sales. Company-wise: (1) Ashok Leyland's (AL) volumes dipped 9% YoY due to an 18% dip in MHCVs. (2) MM's CV sales increased 26% YoY led by LCVs (+29%) while MHCVs declined (-20%). (3) TTMT's domestic CV sales slipped 5% YoY.

Tractor sales spike: MM reported tractor sales of 25,949 units (+13% YoY) while Escorts grew much faster at 56% YoY, selling 8,005 units.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
AL IN	107	125	ADD
BJAUT IN	2,736	2,830	ADD
HMCL IN	3,039	3,550	BUY
MM IN	761	880	ADD
MSIL IN	7,779	8,830	BUY
TTMT IN	175	270	BUY
TVSL IN	551	580	ADD

Price & Target in Rupees

SALES SNAPSHOT

Ticker	Volume	YoY (%)	MoM (%)
AL IN	13,121	(9.2)	(13.4)
BJAUT IN	406,930	24.7	(19.7)
EIM IN*	70,464	(6.1)	(7.8)
HMCL IN	610,252	0.8	(16.9)
MM IN	71,050	15.4	(32.8)
MSIL IN	153,539	(0.7)	4.6
TVSL IN	319,965	27.0	(19.7)
TTMT IN	55,074	(4.0)	(11.5)

Source: Company | *RE & VECV combined



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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