FIRST LIGHT

11 November 2019

RESEARCH

Top picks

- **Large-cap ideas**
  - GAIL replaced by **Petronet LNG**
    (see **Volumes and margins surge, 30Oct19**)
  - HPCL replaced by **Reliance Industries**
    (see **Cyclicals a mixed bag, RJio and Retail surge ahead, 21Oct19**)

Oil & Gas

OMCs Q2 FY20 – tepid GRMs, marketing earnings sustain

BOB Economics Research | Monthly Chartbook

Government spending to offset weak consumption

GAIL | Target: Rs 160 | +26% | BUY

Trading earnings slump

Oil India | Target: Rs 260 | +57% | BUY

Operationally strong

Gujarat State Petronet | Target: Rs 325 | +52% | BUY

EBITDA above estimates; volume outlook improving

Greenply Industries | Target: Rs 210 | +30% | BUY

Modest quarter, margin expansion continues

SUMMARY

Oil & Gas

All the three OMCs – IOCL, BPCL and HPCL – reported Q2 FY20 earnings well below estimates, impacted by low GRMs (US$3.8-US$3/bbl), under-performing the benchmark Singapore (US$6.5/bbl). Marketing business performance across OMCs remained stable (QoQ), implying depleting concerns on sustainability of earnings as crude prices sustain. we cut GRM estimates for BPCL/HPCL for FY21/22, leading to earnings decline by ~7% to 10%. We downgrade BPCL to REDUCE (from ADD) on high valuations.

Click here **for the full report.**

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	570
ONGC	Buy	200
Petronet LNG	Buy	400
Reliance Industries	Buy	1,670
TCS	Add	2,230

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,230
Future Supply	Buy	680
Greenply Industries	Buy	210
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.92	9bps	36bps	(132bps)
India 10Y yield (%)*	6.72	3bps	4bps	(108bps)
USD/INR	70.97	0	0.1	2.8
Brent Crude (US$/bbl)	62.29	0.9	6.8	(11.8)
Dow	27,675	0.7	4.5	5.7
Shanghai	2,979	0	2.5	13.0
Sensex	40,654	0.5	8.3	16.2
India FII (US$ mn)	**6 Nov**	**MTD**	**CYTD**	**FYTD**
FII-D	387.1	798.9	5,485.7	4,941.0
FII-E	178.0	500.9	10,723.6	3,878.4

Source: Bank of Baroda Economics Research | *7.26% GS 2029

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India Economics: Monthly Chartbook

Consumption demand remained muted even as mild pick-up was seen in the festive season. Services activity has been contracting for two consecutive months now. Elevated growth concerns have prompted Moody's to downgrade India's outlook to negative. However, an above average monsoon and spending by centre and states will ensure some pick-up in demand in H2. States are relying on borrowings to spend as revenue growth slows. With liquidity surplus at Rs 2.8tn, yield curve has steepened. Headline inflation is likely to increase to 4.25% in Oct'19, though it is unsustainable at these levels as growth remains weak. Because of which core inflation will moderate (Philips curve). We expect RBI to cut rates by another 25bps in Dec'19 as growth remains an overwhelming concern.

Click here for the full report.

GAIL

GAIL's Q2FY20 PAT was well below estimates at Rs 10.6bn (–42% YoY). Gross margins underperformed across segments, barring LPG/LHC production. Key Q2 highlights: (a) gas trading EBITDA tanked 75% YoY on lower margins, (b) gas transmission volumes fell short of estimates at 109mmscmd, and (c) LPG EBITDA outperformed. We reduce FY20/FY21/ FY22 earnings by 9.5%/7.6%/13.1% to factor in lower gas trading and transmission profits. This translates to a new Sep'20 TP of Rs 160 (from Rs 200).

Click here for the full report.

Oil India

Oil India's (OINL) Q2 FY20 earnings at Rs 6.2bn (-27% YoY) was below estimates. Key highlights: (a) EBITDA at Rs12.4 bn (-16% YoY) was above estimates on low operating costs (at ~US$6.3/bbl), (b) Oil (0.79 mmt, -4.9% YoY) and Gas (0.66 bcm, +2.5% YoY) sales volumes were in-line. We maintain FY20/FY21 EPS at Rs 37.4/Rs39.9 and production estimates. Our Sept'21 TP remains unchanged at Rs 260. Valuations remain undemanding at 4.4x/4.1x FY21/22E EPS, offering ~8% dividend yields. Maintain BUY.

Click here for the full report.

Gujarat State Petronet

Gujarat State Petronet's (GUJS) Q2FY20 EBITDA outperformed estimates at Rs 4.4bn (–15% YoY), backed by higher margins of Rs 1.2/scm (Rs 1.1/scm estimated). Volumes at 39mmscmd (+13% YoY) were in line, driven by higher offtake from the CGD and power sectors. Management maintained guidance of robust volume trends over FY20-FY22. We broadly maintain our EPS estimates; lower cost of equity assumption translate to a higher Sep'20 DCF-based TP of Rs 325 (from Rs 280).

Click here for the full report.

Greenply Industries

Greenply Industries (GIL) reported consolidated Q2FY20 revenue growth of 5% YoY. Operating margins expanded 200bps YoY as both India and Gabon businesses performed well, driving EBITDA/PAT growth of 27%/64% YoY. Management is now guiding for India revenue growth of ~8% (earlier 8-10%) and margins of ~11% in FY20, with Gabon revenues of Rs 2bn (earlier ~Rs 2.15bn) and margins of ~18%. Maintain BUY, rolling over to a Sep'20 TP of Rs 210 (from Rs 200).

Click here for the full report.

BOBCAPS
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OIL & GAS

11 November 2019

OMCs Q2 FY20– tepid GRMs, marketing earnings sustain

Rohit Ahuja | Harleen Manglani
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All the three OMCs – IOCL, BPCL and HPCL – reported Q2 FY20 earnings well below estimates, impacted by low GRMs (US$3.8-US$3/bbl), under-performing the benchmark Singapore (US$6.5/bbl). Marketing business performance across OMCs remained stable (QoQ), implying depleting concerns on sustainability of earnings as crude prices sustain. we cut GRM estimates for BPCL/HPCL for FY21/22, leading to earnings decline by ~7% to 10%. We downgrade BPCL to REDUCE (from ADD) on high valuations.

Surge in marketing margins: HPCL marketing segment earnings expanded the most (2x YoY) to Rs25 bn, reporting marketing EBITDA at ~Rs2700/MT. BPCL reported flattish marketing margins at ~Rs1900/mt, while IOCL was the lowest at ~1800/MT (**see our Q2 update on IOCL**). In Q2 FY20, all the three OMCs gained market share in petroleum product sales, delivering sales volume growth of 1.5%-2% against industry growth of 0.7%. Interestingly, barring HPCL, they all lost market share in retail fuel sales (Petrol and Diesel), while gained market share in ATF and other industrial product sales.

GRMs remain muted: OMCs continue to under-perform on GRMs, with HPCL reporting the lowest GRMs at US$2.6/bbl for Q2 FY20 (against Singapore complex GRMs at US$6.5/bbl). BPCL (US$3.8/bbl) and IOCL (US$3.6/bbl) too under-performed. Singapore GRMs have declined in Q3 FY20, but diesel spreads have improved while FO spreads have crashed. However, OMC refineries being heavy on diesel output (45-50% of refining output) could benefit from IMO regulations (from Jan CY20).

BPCL privatization – lot of uncertainty around it: BPCL stock price has surged ever since the government has announced its intent to privatise, with valuation bursting above 10x FY21/22E EBITDA. However, recent media reports have created concerns whether the government will be willing to sell its entire stake in one go. Any deal that is different from complete government holding sale can lead to a sharp correction in the stock. However, IOCL (with possible uptick in GRMs leading to IMO) and HPCL (resilient marketing business earnings) offer better value than BPCL. We downgrade BPCL to REDUCE (from ADD), and recommend IOCL/HPCL over it.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
IOCL IN	134	240	BUY
BPCL IN	503	490	Downgrade to REDUCE from ADD
HPCL IN	294	365	BUY

Price & Target in Rupees

Government spending to offset weak consumption

Consumption demand remained muted even as mild pick-up was seen in the festive season. Services activity has been contracting for two consecutive months now. Elevated growth concerns have prompted Moody's to downgrade India's outlook to negative. However, an above average monsoon and spending by centre and states will ensure some pick-up in demand in H2. States are relying on borrowings to spend as revenue growth slows. With liquidity surplus at Rs 2.8tn, yield curve has steepened. Headline inflation is likely to increase to 4.25% in Oct'19, though it is unsustainable at these levels as growth remains weak. Because of which core inflation will moderate (Philips curve). We expect RBI to cut rates by another 25bps in Dec'19 as growth remains an overwhelming concern.

Muted consumption: Led by muted demand for durable goods, two-wheelers and passenger vehicles, consumption demand remained lacklustre in Sep'19. Sales of consumer companies dropped to 5.2% in Sep'19 from 10.5% in Jun'19. Rural demand is likely to improve as a result of firming up of domestic prices (including MSPs) and better rains. Recent uptick in government spending is likely to boost demand in coming months as well.

Government spending revives: Both centre and state governments upped their spending in Sep'19 (3MMA basis), with central government capex taking the lead (65% v 29% in Aug'19). However, on the revenue front, tax revenues of both centre and states remain constrained. Indirect tax collections are growing at 2.8% as of Sep'19 (FYTD basis). Centre has been compensating states for SGST shortfall. Direct tax colletions are also increasing at 5.2% below Budget estimate of 18.6%. To boost spending, states have increased reliance on grants from centre (52% in Sep'19 vs 20% in Aug'19) and market borrowings (Rs 2.8tn in FYTD20 vs Rs 2.1tn in FYTD19). Centre is looking at disinvestments to boost its revenue. Even with centre and states revving up their spending, growth is likely to be below 5% in Q2FY20 due to sharp reduction in private consumption and investment spending.

Inflation at 4%, yields fall in Oct'19: Headline CPI rose to 4% in Oct'19 led by food items such as vegetables and pulses due to unseasonal rains. It is expected to inch up further in Oct'19. However, due to lower crude oil prices, core inflation has moderated to 4%. Even as inflation has inched up and fiscal concerns remain, 10Y yield fell by 5bps in Oct'19 as surplus liquidity in the banking system increased to an average of Rs 2tn in Oct'19.

Lower oil prices to support INR: INR fell marginally by (-) 0.1% in Oct'19 despite robust FII inflows (US$ 2.8bn). During CYTD19, INR has depreciated by (-) 1.6% compared with decline of (-) 8.5% in CY18. This has been possible because of FPI inflows and lower oil prices. With Chinese Yuan appreciating below 7 to US$, we continue to believe that INR is unlikely to depreciate in the near-term.

BUY
TP: Rs 160 | ⮝ 26%

GAIL | Oil & Gas | 09 November 2019

Trading earnings slump

GAIL's Q2FY20 PAT was well below estimates at Rs 10.6bn (–42% YoY). Gross margins underperformed across segments, barring LPG/LHC production. Key Q2 highlights: (a) gas trading EBITDA tanked 75% YoY on lower margins, (b) gas transmission volumes fell short of estimates at 109mmscmd, and (c) LPG EBITDA outperformed. We reduce FY20/FY21/ FY22 earnings by 9.5%/7.6%/13.1% to factor in lower gas trading and transmission profits. This translates to a new Sep'20 TP of Rs 160 (from Rs 200).

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Gas transmission volumes miss estimates but outlook robust: Q2 gas transmission volumes were lower than expected at ~109mmscmd (+2.6% YoY). Tariffs were also lower at Rs 1.41/scm (–9.9% YoY) as revenues carry a one-off expense of Rs 1.9bn. We remain positive on GAIL's volume outlook supported by (a) improving LNG offtake potential from new regasification capacities (Petronet LNG Dahej has added ~5mmscmd from Q2FY20), and (b) incremental domestic gas production (ONGC/RIL: 20-30mmscmd by FY22).

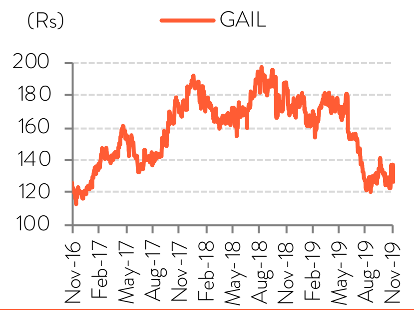
Gas trading disappoints: Q2 gas trading EBITDA at Rs 2.5bn (–75% YoY) declined on lower margins from US LNG, despite management's assurances that hedges/swaps for US volumes would provide a floor to trading margins. These levels of EBITDA may continue over 2-3 quarters until the new fertiliser units that have contracted US LNG (~6mmscmd) come onstream.

Concerns priced in; reiterate BUY: At 9.3x FY22E EPS, GAIL offers attractive risk-reward, pricing in most of the concerns. Management continues to deny the possibility of a split in business segments, but this event appears to be priced in. Our TP of Rs 160 builds in worst-case assumptions across segments.

Ticker/Price	GAIL IN/Rs 127
Market cap	US$ 8.0bn
Shares o/s	4,510mn
3M ADV	US$ 19.1mn
52wk high/low	Rs 190/Rs 120
Promoter/FPI/DII	53%/19%/29%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	574,866	802,795	605,598	701,945	769,572
EBITDA (Rs mn)	76,339	95,556	80,708	96,982	102,802
Adj. net profit (Rs mn)	46,000	63,525	56,278	62,048	61,809
Adj. EPS (Rs)	10.2	14.1	12.5	13.8	13.7
Adj. EPS growth (%)	43.1	38.1	(11.4)	10.3	(0.4)
Adj. ROAE (%)	11.7	15.1	12.6	13.0	12.1
Adj. P/E (x)	12.5	9.0	10.2	9.2	9.3
EV/EBITDA (x)	7.7	5.8	7.1	6.2	6.1

Source: Company, BOBCAPS Research

BUY
TP: Rs 260 | ⮝ 57%

OIL INDIA | Oil & Gas | 10 November 2019

Operationally strong

Oil India's (OINL) Q2 FY20 earnings at Rs 6.2bn (-27% YoY) was below estimates. Key highlights: (a) EBITDA at Rs12.4 bn (-16% YoY) was above estimates on low operating costs (at ~US$6.3/bbl), (b) Oil (0.79 mmt, -4.9% YoY) and Gas (0.66 bcm, +2.5% YoY) sales volumes were in-line. We maintain FY20/FY21 EPS at Rs 37.4/Rs39.9 and production estimates. Our Sept'21 TP remains unchanged at Rs 260. Valuations remain undemanding at 4.4x/4.1x FY21/22E EPS, offering ~8% dividend yields. Maintain BUY.

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Volumes remain a drag: OINL's oil production continues to decline (0.82 mmt, -4.7% YoY), while gas remains robust (0.75 bcm, +1.8% YoY). Oil production continues to trend well below management's earlier guidance of oil production at 3.66mmt. However, gas production remains well in-line with the guidance of 3.02bcm for FY20.Oil price realisation at US$61/bbl (at nil subsidies), while Brent's average price for the quarter was at US$62. Gas production however continues to buck the trend, while realisation too improved to Rs 8.05/scm.

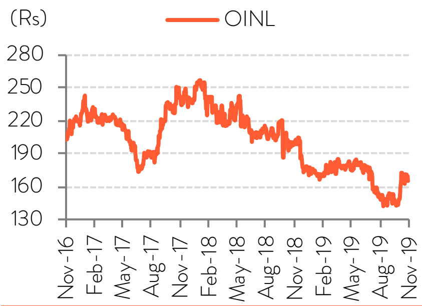
EBITDA beat on low operating costs: OINL's operating costs came in much lower than estimates at US$6.3/bbl in Q2 FY20 (Vs est. US$9/bbl). Costs are trending well below our estimates of US$9/bbl for FY21/22 (US$7/bbl for H1 FY20).

Undemanding valuations, maintain BUY: OINL's current valuations, at 4.1x FY22E, imply Brent at ~US$ 48/bbl levels, offers an unjustifiably steep discount to spot oil prices (US$ 62/bbl). Additionally, dividend yields at ~8.3% for FY20E makes valuations look extremely attractive. OINL seems to be pricing in the worst case.

Ticker/Price	OINL IN/Rs 166
Market cap	US$ 2.5bn
Shares o/s	1,084mn
3M ADV	US$ 2.8mn
52wk high/low	Rs 207/Rs 140
Promoter/FPI/DII	62%/5%/34%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	1,06,565	1,37,350	1,42,263	1,58,444	1,71,003
EBITDA (Rs mn)	41,013	54,838	57,623	65,202	70,706
Adj. net profit (Rs mn)	26,679	32,693	35,282	40,556	43,261
Adj. EPS (Rs)	24.6	30.1	32.5	37.4	39.9
Adj. EPS growth (%)	12.1	22.5	7.9	14.9	6.7
Adj. ROAE (%)	9.4	11.8	12.3	13.3	13.3
Adj. P/E (x)	6.7	5.5	5.1	4.4	4.1
EV/EBITDA (x)	5.0	4.1	3.3	3.6	3.5

Source: Company, BOBCAPS Research

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BUY
TP: Rs 325 | ⮝ 52%

GUJARAT STATE PETRONET

| Oil & Gas | 09 November 2019

EBITDA above estimates; volume outlook improving

Gujarat State Petronet's (GUJS) Q2FY20 EBITDA outperformed estimates at Rs 4.4bn (–15% YoY), backed by higher margins of Rs 1.2/scm (Rs 1.1/scm estimated). Volumes at 39mmscmd (+13% YoY) were in line, driven by higher offtake from the CGD and power sectors. Management maintained guidance of robust volume trends over FY20-FY22. We broadly maintain our EPS estimates; lower cost of equity assumption translate to a higher Sep'20 DCF-based TP of Rs 325 (from Rs 280).

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Volumes stable; CGD/power demand picks up: Q2 volumes at 39mmscmd (+13% YoY) were in line with our estimates. Demand increased from the CGD (10.6mmscmd, +12% YoY) and power (5.9mmsmcd, +29% YoY) segments. Management indicated better potential from the power segment as spot LNG prices remain low (~US$ 5/mmbtu) and demand for power is improving.

RIL continues to offtake ~9mmscmd (stable QoQ), implying its petcoke gasifiers are some time away from commissioning. While GUJS could see volume loss (4-6mmscmd) once RIL's petcoke gasification plant comes online, this could be made up by incremental power/CGD demand in FY20-FY21.

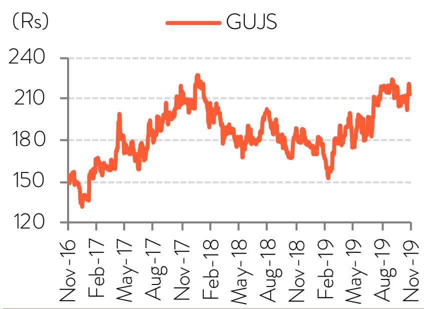
Margins improve: Operating margins improved to Rs 1.2/scm as GUJS was able to pass on higher transmission costs (at Rs 1.4bn, ~3x QoQ) that stemmed from higher tariffs for Reliance Gas Transportation's (RGTIL) east-west pipeline.

Maintain BUY: GUJS has healthy volumes levers in place – (a) planned connectivity to all the five LNG regasification terminals in Gujarat, and (b) an improving demand outlook from CGD and power. At 14x FY22E EPS, valuations look attractive considering stronger volume visibility.

Ticker/Price	GUJS IN/Rs 214
Market cap	US$ 1.7bn
Shares o/s	564mn
3M ADV	US$ 1.9mn
52wk high/low	Rs 230/Rs 149
Promoter/FPI/DII	38%/15%/47%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	13,317	18,773	22,760	22,779	26,241
EBITDA (Rs mn)	11,478	15,426	17,073	16,770	19,090
Adj. net profit (Rs mn)	6,684	7,947	10,395	10,165	11,912
Adj. EPS (Rs)	11.9	14.1	18.4	18.0	21.1
Adj. EPS growth (%)	34.5	18.9	30.8	(2.2)	17.2
Adj. ROAE (%)	14.2	15.2	17.3	14.8	15.5
Adj. P/E (x)	18.0	15.2	11.6	11.9	10.1
EV/EBITDA (x)	10.3	9.7	8.5	8.3	7.1

Source: Company, BOBCAPS Research

BUY
TP: Rs 210 | ⮝ 30%

GREENPLY INDUSTRIES | Construction Materials | 08 November 2019

Modest quarter, margin expansion continues

Greenply Industries (GIL) reported consolidated Q2FY20 revenue growth of 5% YoY. Operating margins expanded 200bps YoY as both India and Gabon businesses performed well, driving EBITDA/PAT growth of 27%/64% YoY. Management is now guiding for India revenue growth of ~8% (earlier 8-10%) and margins of ~11% in FY20, with Gabon revenues of Rs 2bn (earlier ~Rs 2.15bn) and margins of ~18%. Maintain BUY, rolling over to a Sep'20 TP of Rs 210 (from Rs 200).

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Modest revenue growth: GIL reported consolidated revenue growth of 5% YoY to Rs 3.8bn in Q2. India plywood revenues grew just 1.5% YoY to Rs 3.5bn (volume growth at 2.2%) due to tough market conditions, whereas subsidiaries – primarily Gabon face veneer operations – posted a 60% YoY increase to Rs 348mn. Gabon's growth surged due to better utilisation of capacities commissioned in FY19. Consolidated working capital increased by ~18 days due to a 13-day reduction in creditor cycle and 10-day rise in debtor cycle.

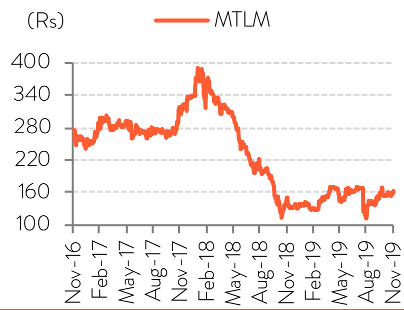
Sustained margin expansion: GIL's consolidated operating margins expanded 200bps YoY to 11.8% aided by higher profitability in both India and Gabon operations. Plywood margins rose 70bps YoY to 11.4% due to a better product mix. Subsidiary margins shot up 13ppt to ~17% as Gabon face veneer operations which largely began in H2FY18 have stabilised. Strong operating margins propelled EBITDA/PAT growth to 27%/64% YoY.

Maintain BUY: We largely maintain our estimates and continue to like GIL for its market leadership in organised plywood, strong brand as well as wide distribution. Rolling valuations forward, we have a revised Sep'20 target price of Rs 210, set at 18x forward P/E.

Ticker/Price	MTLM IN/Rs 161
Market cap	US$ 277.7mn
Shares o/s	123mn
3M ADV	US$ 0.2mn
52wk high/low	Rs 195/Rs 112
Promoter/FPI/DII	52%/11%/37%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	9,123	14,122	15,612	17,804	19,584
EBITDA (Rs mn)	715	1,507	1,772	2,088	2,330
Adj. net profit (Rs mn)	253	852	1,025	1,325	1,526
Adj. EPS (Rs)	2.1	6.9	8.4	10.8	12.4
Adj. EPS growth (%)	NA	236.1	20.3	29.3	15.2
Adj. ROAE (%)	3.1	14.0	27.4	28.6	26.7
Adj. P/E (x)	78.0	23.2	19.3	14.9	13.0
EV/EBITDA (x)	NA	NA	12.5	10.5	9.2

Source: Company, BOBCAPS Research

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)

Rating distribution

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