FIRST LIGHT

14 August 2019

RESEARCH

ONGC | Target: Rs 175 | +37% | BUY

Valuations pricing in the worst case

HG Infra Engineering | Target: Rs 405 | +77% | BUY

Revenue miss; expect steady growth momentum ahead

BOB Economics Research | Retail Inflation

CPI moderates, room to cut rates

BOB Economics Research | Weekly Wrap

Global yields fell, India an outlier

Sun Pharma | Target: Rs 455 | +4% | REDUCE

Adj. EBITDA miss, US base to normalise; retain REDUCE

Bharat Petroleum Corp | Target: Rs 280 | –19% | SELL

Macro concerns weigh heavy

Alkem Labs | Target: Rs 2,100 | +19% | BUY

Good Q1, guiding for better margins ahead; retain BUY

Finolex Industries | Target: Rs 560 | +7% | ADD

Profitability drained by lower PVC-EDC delta

SUMMARY

ONGC

ONGC's Q1FY20 earnings outperformed at Rs 59bn (–4% YoY). Key Q1 highlights: (a) production trends lower than estimates – oil/gas at 5.9mmt/ 6.4bcm (–5.6%/+3.6% YoY), (b) operating costs at US$ 7/bbl vs. US$ 8.5/bbl estimated, and (c) oil price realisation above estimates at US$ 66.3/bbl (–7% YoY) on lower discount to Brent. We cut FY20/FY21 earnings by 27%/21% on lower oil price (US$ 65-70/bbl) and production (by ~5%) assumptions. Rolling forward to Sep'21 valuations, we have a revised TP of Rs 175 (from Rs 230).

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	595
GAIL	Buy	175
ONGC	Buy	175
TCS	Add	2,360
HPCL	Sell	200

MID-CAP IDEAS

Company	Rating	Target
Balkrishna Ind	Buy	1,290
Future Supply	Buy	715
Greenply Industries	Buy	245
Laurus Labs	Buy	480
PNC Infratech	Buy	235

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.65	(10bps)	(48bps)	(123bps)
India 10Y yield* (%)	6.50	9bps	(4bps)	(126bps)
USD/INR*	70.79	(0.1)	(3.2)	(2.8)
Brent Crude (US$/bbl)	58.57	0.1	(12.2)	(19.3)
Dow	25,898	(1.5)	(5.2)	2.8
Shanghai	2,815	1.5	(3.9)	1.0
Sensex*	37,582	0.7	(2.5)	(0.8)
India FII (US$ mn)	**8 Aug**	**MTD**	**CYTD**	**FYTD**
FII-D	72.2	152.0	2,805.9	2,261.3
FII-E	(150.4)	(1,380.0)	8,024.6	1,179.4

Source: Bank of Baroda Economics Research
*Indian markets were closed on 12.08.2019 for public holiday

BOBCAPS Research
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HG Infra Engineering

HG Infra's (HGIEL) Q1FY20 revenue grew 17% YoY to Rs 5.3bn but was below estimates due to delayed AD award for the Hapur-Moradabad project. EBITDA margin was healthy at 15.1% (15% est.). Lower interest cost and depreciation aided 27% YoY PAT growth to Rs 344mn (Rs 372 est.), while better recoveries cut gross debt to Rs 3.5bn (Rs 3.8bn as on Mar'19). The order backlog as on Jun'19 stands at Rs 57.1bn (2.7x TTM revenues). In light of the revenue miss, we crop FY20/FY21 EPS by 11%/5%; on rollover, our Jun'20 TP remains at Rs 405.

Click here for the full report.

India Economics: Retail Inflation

Retail inflation slipped to 3.1% in Jul'19 from 3.2% in Jun'19. Sharp decline in fuel and light (LPG) prices was negated by higher food and core inflation. Higher food prices were driven by pulses and spices. Within core, prices rose the most for transport & communication due to higher petrol and diesel excise duties. Education and health moderated. Outlook is benign on the back of decline in oil prices. With headline inflation expected to remain below RBI's trajectory of 4%, we believe there is room to cut rates to support growth.

Click here for the full report.

India Economics: Weekly Wrap

Central Banks of Thailand, Philippines and New Zealand reduced policy rates to support growth which supported equity markets. Global yields fell. EM currencies closed lower after Yuan broke the crucial 7/$ mark. Argentina's surprise election result spooked markets (-30.3% fall in Peso). RBI's unconventional rate cut of 35bps did not led to lower yields as manufacturing sector is looking for fiscal sops. Markets this week will react to developments on US-China trade war, macro data and news on domestic stimulus.

Click here for the full report.

Sun Pharma

Q1 EBITDA was in line despite a gross margin miss which was partly set off by low R&D expense (5% of sales vs. 8% guidance). Normalising for R&D, adj. EBITDA was Rs 16.6bn (6% miss). SUNP expects R&D spends to step up from Q2. Other highlights: Disclosure on global specialty with sales at US$ 94mn and R&D at US$9mn (low due to timing difference), limited concerns on Ilumya formulary coverage from Skyrizi, and a Q3 launch for Cequa. Improving efficiency and cost structure remain focus areas. We roll over to a Sep'20 TP of Rs 455 (vs. Rs 435).

Click here for the full report.

Bharat Petroleum Corp

BPCL's Q1FY20 EBITDA at Rs 21.8bn (–44% YoY) outperformed estimates on higher GRMs (US$ 2.8/bbl after US$ 0.8/bbl inventory loss). Marketing segment EBITDA – inferred after factoring in GRM data – was well above our estimate at Rs 20.5bn (–37% YoY). That said, we maintain our earnings forecast given macro uncertainty, and roll valuations over to Sep'21 for a revised SOTP-based TP of Rs 280 (from Rs 285). Maintain SELL on valuations and sustained risks to marketing margins from political intervention.

Click here for the full report.

Alkem Labs

Alkem Labs reported a good Q1FY20 with an 11% EBITDA beat owing to gross margin expansion and better cost control. India grew 12% YoY and US sales held steady QoQ at US$ 69mn. Alkem's secondary growth trend is tracking strong at 18.7% (vs. 10.4% for IPM), indicative of a better Q2. Management expects volume growth recovery for the industry from Jul/Aug'19, doesn't see any disruption in its trade generic business (15% of sales), and retains 120bps margin expansion guidance for FY20 led by better operating leverage.

Click here for the full report.

Finolex Industries

Finolex Industries (FNXP) reported above-expected Q1FY20 revenue growth of 14% YoY, aided by 15%/18% higher volumes in PVC resin/PVC pipes. But EBITDA margins shrank 1,030bps YoY to 13.1% due to lower PVC resin margins as PVC-EDC delta contracted, dragging EBITDA/PAT down 36%/40% YoY. Management maintained guidance for 12-15% volume growth in PVC pipes with segmental EBIT margins of 8-9% in FY20. We cut FY20/FY21 earnings 5%/1% on tepid Q1 profits and roll over to a Jun'20 TP of Rs 560 (earlier Rs 550).

Click here for the full report.

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 175 | ⮝ 37%

ONGC | Oil & Gas | 14 August 2019

Valuations pricing in the worst case

Rohit Ahuja | Harleen Manglani
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ONGC's Q1FY20 earnings outperformed at Rs 59bn (–4% YoY). Key Q1 highlights: (a) production trends lower than estimates – oil/gas at 5.9mmt/ 6.4bcm (–5.6%/+3.6% YoY), (b) operating costs at US$ 7/bbl vs. US$ 8.5/bbl estimated, and (c) oil price realisation above estimates at US$ 66.3/bbl (–7% YoY) on lower discount to Brent. We cut FY20/FY21 earnings by 27%/21% on lower oil price (US$ 65-70/bbl) and production (by ~5%) assumptions. Rolling forward to Sep'21 valuations, we have a revised TP of Rs 175 (from Rs 230).

Oil production remains a drag; outlook on gas still buoyant: Oil production continues to decline (–5.6% YoY in Q1FY20), leading us to cut production estimates for FY20/FY21 to ~23.2mmt levels. Gas output too trended lower than expectations, falling far behind management's guidance of 4-5mmscmd a year. We reduce estimates for FY20/FY21 to 26.8bcm/28.3bcm (+4.5mmscmd over two years).

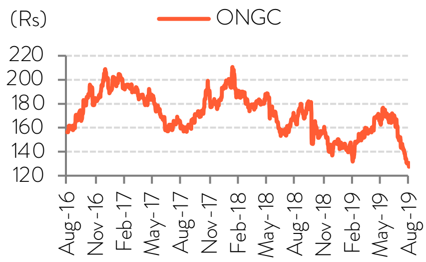
Focus on project execution: PNGRB's recent notification of free pricing for incremental gas production (US$ 7-9/mmbtu as per current trends) augurs well for the financial viability of ONGC's planned ~US$ 10bn capex. Mozambique project FID has been recently finalised as a sales contract for ~12.5mmtpa of the volumes have been signed. Funding for this project would be at the Mozambique SPV level. As per management, break-even gas price is US$ 6-7/mmbtu (down from US$ 9/mmbtu earlier), given reduction in capex and operating cost estimates.

Trading at distressed valuations: At 5.5x FY21E EPS, ONGC's valuations imply ~US$ 45/bbl oil prices, an unjustifiably steep discount to the prevailing Brent oil price (US$ 61/bbl). With ~6% dividend yields, risk-reward appears lucrative. Maintain BUY.

Ticker/Price	ONGC IN/Rs 128
Market cap	US$ 22.6bn
Shares o/s	12,580mn
3M ADV	US$ 23.8mn
52wk high/low	Rs 185/Rs 126
Promoter/FPI/DII	64%/8%/28%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	234,323	348,309	241,255	294,220	337,747
Adj. EPS (Rs)	18.3	27.7	19.2	23.4	26.8
Adj. EPS growth (%)	(3.5)	51.6	(30.7)	22.0	14.8
Adj. ROAE (%)	11.8	16.4	10.6	12.2	13.2
Adj. P/E (x)	7.0	4.6	6.7	5.5	4.8
EV/EBITDA (x)	3.4	3.1	3.9	3.6	3.4

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 405 | ↑ 77%

HG INFRA ENGINEERING

| Infrastructure | 13 August 2019

Revenue miss; expect steady growth momentum ahead

HG Infra's (HGIEL) Q1FY20 revenue grew 17% YoY to Rs 5.3bn but was below estimates due to delayed AD award for the Hapur-Moradabad project. EBITDA margin was healthy at 15.1% (15% est.). Lower interest cost and depreciation aided 27% YoY PAT growth to Rs 344mn (Rs 372 est.), while better recoveries cut gross debt to Rs 3.5bn (Rs 3.8bn as on Mar'19). The order backlog as on Jun'19 stands at Rs 57.1bn (2.7x TTM revenues). In light of the revenue miss, we crop FY20/FY21 EPS by 11%/5%; on rollover, our Jun'20 TP remains at Rs 405.

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Delayed appointed date causes miss on revenue: Q1 revenue grew 16.9% YoY to Rs 5.3bn vs. Rs 6bn estimated as the Hapur-Moradabad road EPC project received the appointed date (AD) later than expected (on 29-May). Better operating leverage saw margin rise 20bps YoY to 15.1% (15% est.), with EBITDA growth of 18.5% YoY. PAT grew 27% YoY to Rs 344mn supported by below-expected interest cost (aided by gross debt reduction) and depreciation (aided by a change in measurement of depreciation on plant & machinery).

HGIEL's order backlog as on Jun'19 was at Rs 57.1bn (2.7x TTM revenue), with the executable share at ~57%. Management expects ADs by Oct'19 for two HAM projects in Haryana, the Delhi-Vadodara (pkg 4) EPC project, and Goa airport project; thus, revenue could pick up pace from H2FY20.

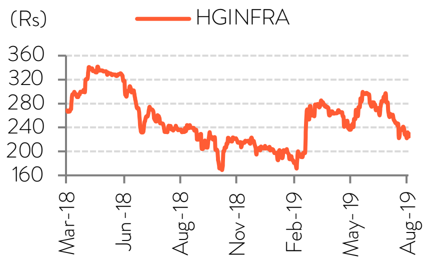
FY20 guidance steady: Management maintained guidance of 25-30% revenue growth and EBITDA margins in the range of 15-16% in FY20. Capex is guided at ~Rs 500mn, gross debt at ~Rs 2.5bn as on Mar'20, receipt of mobilisation advances at Rs 2bn-2.5bn, and order inflows at Rs 40bn-45bn.

Maintain BUY: We trim FY20E/FY21E EPS by 11%/5% mainly due to below-expected revenues in Q1, but maintain our TP at Rs 405 on rolling valuations forward.

Ticker/Price	HGINFRA IN/Rs 228
Market cap	US$ 208.8mn
Shares o/s	65mn
3M ADV	US$ 0.1mn
52wk high/low	Rs 308/Rs 170
Promoter/FPI/DII	74%/2%/16%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS (STANDALONE)

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	843	1,236	1,620	2,006	2,411
Adj. EPS (Rs)	20.3	19.0	24.9	30.8	37.0
Adj. EPS growth (%)	(31.7)	(6.4)	31.1	23.8	20.2
Adj. ROAE (%)	23.5	20.6	21.9	21.9	21.3
Adj. P/E (x)	11.3	12.0	9.2	7.4	6.2
EV/EBITDA (x)	7.9	5.5	4.7	3.9	3.4

Source: Company, BOBCAPS Research

RETAIL INFLATION

13 August 2019

CPI moderates, room to cut rates

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Retail inflation slipped to 3.1% in Jul'19 from 3.2% in Jun'19. Sharp decline in fuel and light (LPG) prices was negated by higher food and core inflation. Higher food prices were driven by pulses and spices. Within core, prices rose the most for transport & communication due to higher petrol and diesel excise duties. Education and health moderated. Outlook is benign on the back of decline in oil prices. With headline inflation expected to remain below RBI's trajectory of 4%, we believe there is room to cut rates to support growth.

Food inflation inches up: Food inflation increased to 2.4% in Jul'19 from 2.2% in Jun'19 led by pulses at 6.8% in Jul'19 (5.7% in Jun'19), spices at 2% (1.6% in Jun'19) and milk products at 1% (0.7% in Jun'19). On the other hand, prices of fruits continue to fall, albeit at a slower pace, at (-) 0.9% in Jul'19 vs (-) 4.2% in Jun'19. Vegetable prices decelerated to 2.8% in Jul'19 from 4.7% in Jun'19. Cereal inflation remained unchanged at 1.3% in Jul'19. Moderation in international prices (Rice at -1.4% in Jul'19 vs 1.8% in Jun'19; Wheat at -7.5% vs 6.6% in Jun'19).

Core inflation rises marginally: Core inflation edged up by 20bps to 4.3% in Jul'19 vs 4.1% in Jun'19. This was led by 90bps jump in transport and communication in Jul'19 (1.6% vs 0.7% in Jun'19). This was due to increase in retail prices of petrol and diesel following increase in excise duties and cess. However, significant moderation in crude prices (-10% decline in Aug'19) implies inflation in this category will be lower. Other core inflation components (except recreation and amusement) noted broad based decline especially health (30 bps decline at 7.9%) and education (40bps decline at 6.4%).

Scope for further rate cuts: While food and core inflation did edge up in Jul'19, the decline in international oil and commodity prices along with lukewarm domestic demand implies core inflation should moderate. Food inflation is likely to increase on the back of low base. However, sufficient food grain stocks in domestic and global markets gives comfort. While recent rainfall activity has led to excess rainfall in certain areas and thus impact prices in the near-term, higher water storage will be beneficial for Rabi season. We expect headline CPI to be at 3.5% and 3.7% in FY20 and 21 respectively. This would give RBI enough headroom for another 40bps cut in FY20 to give growth the desired stimulus.

बैंक ऑफ़ बड़ौदा
Bank of Baroda
India's International Bank

WEEKLY WRAP

13 August 2019

Global yields fell, India an outlier

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Central Banks of Thailand, Philippines and New Zealand reduced policy rates to support growth which supported equity markets. Global yields fell. EM currencies closed lower after Yuan broke the crucial 7/$ mark. Argentina's surprise election result spooked markets (-30.3% fall in Peso). RBI's unconventional rate cut of 35bps did not led to lower yields as manufacturing sector is looking for fiscal sops. Markets this week will react to developments on US-China trade war, macro data and news on domestic stimulus.

Markets

- **Bonds:** Barring India, global yields closed lower led by slowing world economy amidst trade tensions and political turmoil in Hong Kong and Argentina. US 10Y yield fell by 6bps (1.65%). Investors are eying the Fed's Jackson Hole symposium next week. Crude prices fell by 2.1% (US$ 59/bbl). Central banks of Thailand, Philippines and New Zealand reduced rates. India's 10Y yield rose by 15bps of hopes of fiscal sops. System liquidity is in surplus of Rs 1.6tn as on 9 Aug 2019 vs Rs 2tn in the previous week.

- **Currency:** Apart from EUR and JPY, other global currencies closed lower. DXY fell by (-) 0.1% as US-China trade tensions, weaker Yuan and political tensions in Hong Kong and Argentina negatively impacted investor sentiments. GBP too fell (-0.6%) on the back of Brexit paralysis. FII outflows to the tune of US$ 628mn led to weakening of INR in the week.

- **Equity:** Global equity markets closed the week mixed with Dow and Dax gaining 0.7% and 0.2% respectively. Amidst concerns of global growth slowdown, trade and political tensions; policy rate cuts by Asian central banks supported equity markets. Positive surprise from China's trade data too helped. Sensex closed the week 1.2% higher led by Telecom and IT.

- **Upcoming key events:** In the current week, markets will closely observe industrial production and retail sales data of major economies (US and China). Euro area and Hong Kong GDP data will also give some signal about global growth momentum. On the domestic front, CPI, WPI and trade data are scheduled for release this week.

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

REDUCE
TP: Rs 455 | ⮝ 4%

SUN PHARMA | Pharmaceuticals | 13 August 2019

Adj. EBITDA miss, US base to normalise; retain REDUCE

Q1 EBITDA was in line despite a gross margin miss which was partly set off by low R&D expense (5% of sales vs. 8% guidance). Normalising for R&D, adj. EBITDA was Rs 16.6bn (6% miss). SUNP expects R&D spends to step up from Q2. Other highlights: Disclosure on global specialty with sales at US$ 94mn and R&D at US$9mn (low due to timing difference), limited concerns on Ilumya formulary coverage from Skyrizi, and a Q3 launch for Cequa. Improving efficiency and cost structure remain focus areas. We roll over to a Sep'20 TP of Rs 455 (vs. Rs 435).

Vivek Kumar
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US ex-Taro base to normalise heron; Cequa Q3 launch: Ex-Taro, SUNP's US sales stood at US$ 263mn (flat QoQ) – this includes US$ 60mn of short-term supply, which should be discontinued from Q2, and better contribution from Ilumya (as the Rx trend continues to improve at 25% QoQ). Adjusted for these, we believe the US base business has declined sequentially despite five launches in Q1. SUNP highlighted that DTC spends for Ilumya could be lumpy which should pick up in Q2, while Cequa launch spend is in the Q1 base. We estimate US sales of US$ 953mn ex-Taro for FY20 (U$ 230mn over Q2-Q4).

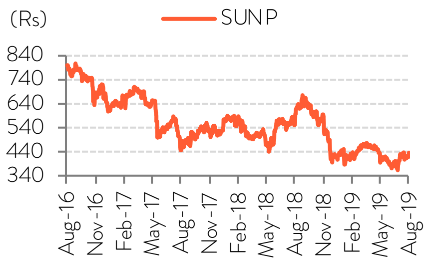
Weak gross margins, in-line India, upbeat ROW: Gross margins fell 365bps QoQ to 70.2% due to provisioning in the India distribution change and a weak product mix across segments. At a secondary level, SUNP's growth was at 12% (vs. 7.5% YoY). ROW growth of 22% YoY was led by Pola Pharma.

Key earnings call takeaways: (1) Management changes: Kal Sundaram moved to head strategic initiatives, Japan & China business; Kirti Ganorkar to head India business; new hire expected for global branded business. (2) No improvement in US generic pricing for broad portfolio. (3) Skyrizi saw no impact to Ilumya formulary coverage. (4) Q1 drop in interest cost led by INR debt repayment. (5) Odomzo market share up from 10% in Q4 to 12%.

Ticker/Price	SUNP IN/Rs 439
Market cap	US$ 14.8bn
Shares o/s	2,399mn
3M ADV	US$ 42.8mn
52wk high/low	Rs 679/Rs 345
Promoter/FPI/DII	54%/17%/16%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	33,666	36,484	47,500	55,534	62,602
Adj. EPS (Rs)	14.0	15.2	19.8	23.1	26.1
Adj. EPS growth (%)	(50.7)	8.4	30.2	16.9	12.7
Adj. ROAE (%)	8.1	8.4	10.1	10.8	11.1
Adj. P/E (x)	31.3	28.9	22.2	19.0	16.8
EV/EBITDA (x)	17.5	16.1	13.7	11.5	10.0

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

SELL
TP: Rs 280 | ⋎ 19%

BHARAT PETROLEUM CORP | Oil & Gas | 13 August 2019

Macro concerns weigh heavy

BPCL's Q1FY20 EBITDA at Rs 21.8bn (–44% YoY) outperformed estimates on higher GRMs (US$ 2.8/bbl after US$ 0.8/bbl inventory loss). Marketing segment EBITDA – inferred after factoring in GRM data – was well above our estimate at Rs 20.5bn (–37% YoY). That said, we maintain our earnings forecast given macro uncertainty, and roll valuations over to Sep'21 for a revised SOTP-based TP of Rs 280 (from Rs 285). Maintain SELL on valuations and sustained risks to marketing margins from political intervention.

Rohit Ahuja | Harleen Manglani
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GRMs beat estimates: BPCL's GRMs came in ahead of expectations but continue to underperform the Singapore benchmark, weakened by low light-heavy crude spreads. Management has pinned hopes for a GRM revival on (a) IMO regulations from H2FY20, and (b) start-up of the acrylic facility at Kochi that could boost margins by US$ 1-2/bbl. A trend reversal in light-heavy spreads could add to the upsides. We therefore maintain our GRM estimates over FY20-FY21 at ~US$ 5.5/bbl.

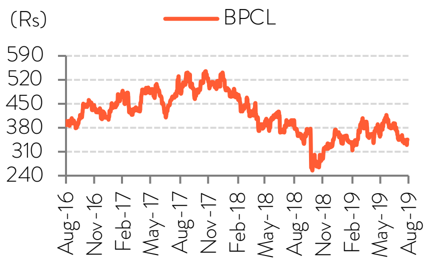
Marketing business earnings outperform: BPCL's Q1 marketing business earnings beat estimates at Rs 20.5bn (~Rs 1,800/mt after Rs 1.3bn inventory loss). The recent decline in oil price offers comfort, but uncertainty remains given the recurring political compulsions (such as state elections). Marketing volumes were in line at 11.1mmt (+1.5% YoY), with market share gains in petrol, diesel and LPG. The company intends to add ~2,000 retail outlets every year until FY22.

Maintain SELL: At 7.2x FY21E EPS BPCL's valuations are at a premium to its OMC peers HPCL and IOCL, while carrying a similar risk as HPCL considering its high reliance on marketing segment earnings. GRM underperformance is another key risk to earnings.

Ticker/Price	BPCL IN/Rs 346
Market cap	US$ 9.6bn
Shares o/s	1,967mn
3M ADV	US$ 28.1mn
52wk high/low	Rs 422/Rs 239
Promoter/FPI/DII	53%/15%/31%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	97,919	85,278	89,184	94,563	101,150
Adj. EPS (Rs)	49.8	43.4	45.3	48.1	51.4
Adj. EPS growth (%)	3.0	(12.9)	4.6	6.0	7.0
Adj. ROAE (%)	29.0	21.8	20.2	19.4	18.8
Adj. P/E (x)	7.0	8.0	7.6	7.2	6.7
EV/EBITDA (x)	6.7	6.9	8.9	7.9	7.8

Source: Company, BOBCAPS Research

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 2,100 | ⮝ 19%

ALKEM LABS | Pharmaceuticals | 13 August 2019

Good Q1, guiding for better margins ahead; retain BUY

Alkem Labs reported a good Q1FY20 with an 11% EBITDA beat owing to gross margin expansion and better cost control. India grew 12% YoY and US sales held steady QoQ at US$ 69mn. Alkem's secondary growth trend is tracking strong at 18.7% (vs. 10.4% for IPM), indicative of a better Q2. Management expects volume growth recovery for the industry from Jul/Aug'19, doesn't see any disruption in its trade generic business (15% of sales), and retains 120bps margin expansion guidance for FY20 led by better operating leverage.

Vivek Kumar
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In-line India growth, gross margin expands: Q1 domestic formulation growth was in line at 12% YoY (volumes up 4%, price 5%, new product 2.7%), with normalised GRx business (15% of sales). We believe better competitiveness in the high-margin acute portfolio, growth in the chronic mix and higher MR productivity along with softening API prices aided the 140bps gross margin expansion. Alkem sees scope for further gross margin gains in coming quarters from API price tailwinds. The company's secondary growth trend is better than IPM (for anti-infective 22%, gastro 17.5%). The chronic portfolio continues to see traction with 27% growth in CVS, 36% in anti-diabetic and 14% in CNS.

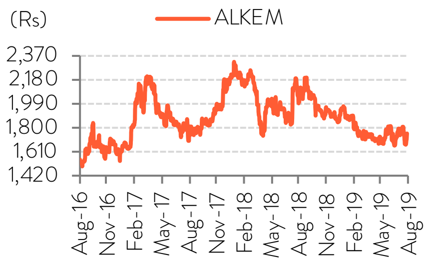
Steady US sales, control cost and 11% EBITDA beat: US sales at US$ 69mn were steady QoQ (+9% YoY). We expect the current quarterly run-rate to improve with scale-up in existing products (gVesicare, Ampyra) and the Sensipar launch. We expect US$ 311mn in FY20 US sales. Part of the EBITDA beat is due to operating leverage/cost control which should continue.

Other key highlights: (1) Alkem expects volume growth recovery to 4.5% for industry from Aug'19 from flattish trend till June. (2) Current MR strength at 10,000 (vs. 9,000 in Mar'19) – no further addition expected in FY20. (3) Tax rate of 13-14% for FY20. (4) Baddi unit EIR (4 observations issued in May'19).

Ticker/Price	ALKEM IN/Rs 1,763
Market cap	US$ 3.0bn
Shares o/s	120mn
3M ADV	US$ 0.7mn
52wk high/low	Rs 1,844/Rs 1,660
Promoter/FPI/DII	66%/2%/5%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	6,309	7,298	8,962	11,133	13,306
Adj. EPS (Rs)	52.8	61.0	75.0	93.1	111.3
Adj. EPS growth (%)	(29.3)	15.7	22.8	24.2	19.5
Adj. ROAE (%)	15.8	16.3	17.7	19.0	19.6
Adj. P/E (x)	33.4	28.9	23.5	18.9	15.8
EV/EBITDA (x)	20.5	19.1	16.2	13.0	10.9

Source: Company, BOBCAPS Research

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TRUST | INNOVATION | EXCELLENCE

ADD
TP: Rs 560 | ⮝ 7%

FINOLEX INDUSTRIES | Plastic Products | 13 August 2019

Profitability drained by lower PVC-EDC delta

Finolex Industries (FNXP) reported above-expected Q1FY20 revenue growth of 14% YoY, aided by 15%/18% higher volumes in PVC resin/PVC pipes. But EBITDA margins shrank 1,030bps YoY to 13.1% due to lower PVC resin margins as PVC-EDC delta contracted, dragging EBITDA/PAT down 36%/40% YoY. Management maintained guidance for 12-15% volume growth in PVC pipes with segmental EBIT margins of 8-9% in FY20. We cut FY20/FY21 earnings 5%/1% on tepid Q1 profits and roll over to a Jun'20 TP of Rs 560 (earlier Rs 550).

Arun Baid
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Volume-led revenue growth: FNXP's Q1 revenue increased 14% YoY to Rs 9.4bn. The PVC resin segment grew 6% YoY aided by a 14.7% uptick in volumes (realisation down 7.5%), while PVC pipes & fittings grew 17.8% YoY backed by 18% higher volumes (realisation flat). The sharp increase in PVC pipe volumes stemmed from both agri and non-agri segment. Management retained guidance of 12-15% volume growth in PVC pipes for FY20.

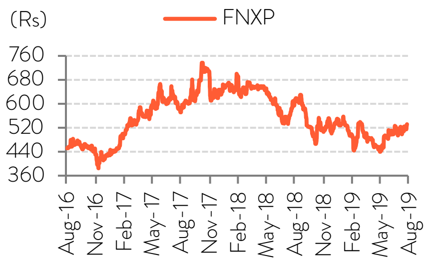
Lower PVC-EDC delta compresses margins: FNXP's operating margins plunged 1,030bps YoY as raw material cost spiralled (+1,000bps YoY). The PVC resin segment saw EBIT margins collapse ~17ppt due to hardening ethylene di-chloride (EDC) prices and sliding PVC prices – this caused the PVC-EDC delta to contract 29% YoY, eroding overall profitability. This delta has improved by ~12% in July and, if sustained, will support better profitability QoQ. Management has maintained guidance of 8-9% EBIT margins for the PVC pipes & fittings segment in FY20.

Maintain ADD: Though we like FNXP for its strong brand name, large distribution reach and well-rounded portfolio post CPVC entry, we expect near-term margin pressure from lower PVC-EDC spreads. We adjust estimates to bake in a weak Q1 and move to a Jun'20 TP of Rs 560.

Ticker/Price	FNXP IN/Rs 526
Market cap	US$ 915.3mn
Shares o/s	124mn
3M ADV	US$ 0.4mn
52wk high/low	Rs 639/Rs 437
Promoter/FPI/DII	52%/2%/45%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19P	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	2,993	3,857	3,166	3,361	3,662
Adj. EPS (Rs)	24.1	31.1	25.5	27.1	29.5
Adj. EPS growth (%)	(15.7)	28.9	(17.9)	6.2	9.0
Adj. ROAE (%)	11.7	14.4	12.0	12.1	12.6
Adj. P/E (x)	21.8	16.9	20.6	19.4	17.8
EV/EBITDA (x)	13.5	10.8	12.3	11.0	10.2

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)

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