FIRST LIGHT

15 June 2020

RESEARCH

Eicher Motors | Target: Rs 18,100 | +7% | ADD

Downtrading fears could dent volumes – cut to ADD

BOB Economics Research | Inflation and IIP

Food inflation falls, industrial output contracts sharply

Oil & Gas

Petroleum consumption surges 47% in May

Agriculture

India's sugar demand improves post lockdown

SUMMARY

Eicher Motors

Eicher Motors (EIM) reported in-line Q4FY20 revenue but disappointing operating margins at 20.8%, the lowest in the last eight quarters. Due to the economic slowdown, we believe Royal Enfield sales could slow significantly as customers either postpone purchases or downtrade to cheaper models. We tweak FY20-FY22 estimates and now expect EIM to post a 4%/5%/4% CAGR in revenue/EBITDA/PAT. We maintain our Mar'21 TP at Rs 18,100 but downgrade the stock from BUY to ADD as upsides look capped post the recent rally.

Click here **for the full report.**

India Economics: Inflation and IIP

India's industrial production contracted by 55.5% in Apr'20 on the back of a nationwide lockdown led by 95.7% and 92% reduction in consumer durables and capital goods respectively. As supply side restrictions eased in May'20, food inflation fell to 9.3% from 10.5% in Apr'20. However, core inflation data was not available apart from housing and health. Notably, health inflation did inch up. We do believe sharp contraction in growth warrants another rate cut by RBI to mitigate the impact on the economy.

Click here **for the full report.**

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	3,000
Cipla	Buy	690
GAIL	Buy	140
Petronet LNG	Buy	330
Eicher Motors	Add	18,100

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,950
Chola Investment	Buy	200
Laurus Labs	Buy	630
Transport Corp	Buy	240
Mahanagar Gas	Sell	710

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.67	(6bps)	(4bps)	(143bps)
India 10Y yield (%)	5.99	1bps	(18bps)	(102bps)
USD/INR	75.79	(0.3)	(0.1)	(9.0)
Brent Crude (US$/bbl)	38.55	(7.6)	30.1	(37.1)
Dow	25,128	(6.9)	3.7	(3.7)
Shanghai	2,921	(0.8)	0.9	0.3
Sensex	33,538	(2.1)	6.3	(15.6)
India FII (US$ mn)	**10 Jun**	**MTD**	**CYTD**	**FYTD**
FII-D	(10.1)	(306.6)	(14,361.9)	(4,602.4)
FII-E	(49.1)	2,751.4	(2,163.2)	4,439.8

Source: Bank of Baroda Economics Research

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Oil & Gas

India's petroleum product consumption surged 47% MoM (–21% YoY) to 14.6mmt in May'20 as fuels across segments exhibited resurgent growth in tandem with the Indian economy's emergence from the world's strictest lockdown. A YoY comparison still shows weak demand trends for all petroleum products, except LPG (+13% YoY).

Click here for the full report.

Agriculture

We recently hosted a call with Abhinash Verma, Director General of Indian Sugar Mills Association (ISMA). Key takeaways: (1) Sugar production in India is expected to decline to ~27.1mn tonnes (mt) for sugar season 2019-20 from ~33mt in SS18-19, mainly due to lower output in Maharashtra and Karnataka. (2) Due to Covid -19, the domestic sugar industry lost sales of ~1mt in SS19-20; consumption is expected to be 25-25.2mt. (3) Prices have been range bound for the last few months at ~Rs 31/kg due to the lockdown but have started to move up in June and are currently at ~Rs 32/kg.

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ADD
TP: Rs 18,100 | ⮝ 7%

EICHER MOTORS | Auto Components | 13 June 2020

Downtrading fears could dent volumes – cut to ADD

Eicher Motors (EIM) reported in-line Q4FY20 revenue but disappointing operating margins at 20.8%, the lowest in the last eight quarters. Due to the economic slowdown, we believe Royal Enfield sales could slow significantly as customers either postpone purchases or downtrade to cheaper models. We tweak FY20-FY22 estimates and now expect EIM to post a 4%/5%/4% CAGR in revenue/EBITDA/PAT. We maintain our Mar'21 TP at Rs 18,100 but downgrade the stock from BUY to ADD as upsides look capped post the recent rally.

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Disappointing Q4: EIM's standalone topline declined 13% YoY as a 17% drop in volumes was only partly offset by a 5% rise in ASP. EBITDA at Rs 4.5bn (–35% YoY) came in much lower than estimates. The company reported weak quarterly operating margins of 20.8% (vs. 24.9% estimated) owing to an increase of ~Rs 5,000 per bike in input costs and lower operating efficiencies. Reported PAT declined 28% YoY to Rs 3.5bn.

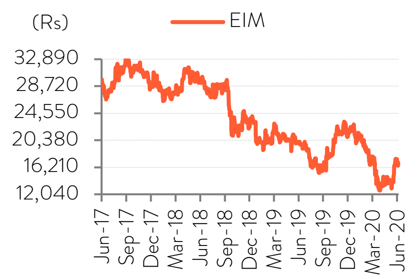
Covid-19 downtrading fears: Due to the significant dent in personal incomes of most salaried as well as self-employed people owing to the pandemic, we believe Royal Enfield (RE) could be one of the hardest hit companies. RE sales have dropped steadily over the last few quarters amid slower economic activity. We believe the company could witness a ~15% YoY volume decline in its FY21 annual sales.

Cut to ADD: We expect EIM to clock a revenue/ EBITDA/PAT CAGR of 4%/5%/4%. We forecast a ~400bps drop in ROCE and ROE by end-FY22 to ~20% each. Our SOTP-based TP of Rs 18,100 remains unchanged and is based on Rs 16,700 for RE (22x FY22E EPS) and Rs 1,400 for VECV. We, however, downgrade our rating to ADD given the ~22% rally in stock price since May which limits upside potential.

Ticker/Price	EIM IN/Rs 16,857
Market cap	US$ 6.0bn
Shares o/s	27mn
3M ADV	US$ 49.5mn
52wk high/low	Rs 23,450/Rs 12,450
Promoter/FPI/DII	49%/32%/7%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20P	FY21E	FY22E
Total revenue (Rs mn)	89,575	97,945	90,775	81,900	97,431
EBITDA (Rs mn)	28,532	29,269	22,038	19,354	24,119
Adj. net profit (Rs mn)	20,249	20,544	21,234	16,560	23,401
Adj. EPS (Rs)	628.4	758.3	697.9	518.5	760.4
Adj. EPS growth (%)	9.6	20.7	(8.0)	(25.7)	46.7
Adj. ROAE (%)	37.7	28.8	24.5	16.8	20.2
Adj. P/E (x)	26.8	22.2	24.2	32.5	22.2
EV/EBITDA (x)	15.9	15.1	19.0	22.2	18.5

Source: Company, BOBCAPS Research

INFLATION AND IIP

12 June 2020

Food inflation falls, industrial output contracts sharply

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India's industrial production contracted by 55.5% in Apr'20 on the back of a nationwide lockdown led by 95.7% and 92% reduction in consumer durables and capital goods respectively. As supply side restrictions eased in May'20, food inflation fell to 9.3% from 10.5% in Apr'20. However, core inflation data was not available apart from housing and health. Notably, health inflation did inch up. We do believe sharp contraction in growth warrants another rate cut by RBI to mitigate the impact on the economy.

KEY HIGHLIGHTS

- Food inflation eases to 9.3% in May'20 from 10.5% in Apr'20.
- Health inflation rises, housing moderates.
- IIP growth plummets by 55.5% in Apr'20, led by manufacturing.

IIP growth plummets: Industrial output declined by 55.5% in Apr'20 from a decline of 18.3% in Mar'20 on the back of nationwide lockdown. The decline was led by manufacturing sector which contracted by 64.3% compared with a decline of 22.4% in Mar'20. Within manufacturing, consumer durables contracted by 95.7% in Apr'20, capital goods declined by 92% and infrastructure goods fell by 83.9%. Mining and electricity output also contracted by 27.4% and 22.6% respectively. Industrial activity will see improvement in coming months as unlocking of the economy has begun though there are supply side challenges in the form of labour availability.

Food inflation falls: Consumer food inflation moderated by 120bps to 9.3% in May'20 from 10.5% in Apr'20. This was led by sharp fall in vegetable inflation to 5.3% against 23.6% in Apr'20. It was expected as lockdown restrictions have been eased. Apart oils and fats and non-alcoholic beverages, deceleration was seen across the food group. Food inflation is likely to ease further as supply side bottlenecks have been further removed. Even international food prices are moderating which bode well for domestic food prices. In addition, a normal monsoon will ensure ample production and thus lower food inflation.

Within core, only housing and health indices were reported. Housing inflation moderated to 3.7% from 3.9% in Apr'20. However, health index rose sharply by 150bps to 4.3% against 2.8% in Apr'20. Lower demand should drive core inflation lower, though labour availability is a challenge.

Policy space remains: The sharp decline in industrial production shows growth challenges will require fiscal and monetary policy intervention. While RBI has reduced policy rate by 115bps, we believe there is room for another 25bps rate cut as moderating food inflation shows inflation will be below RBI's target in H2FY21.

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OIL & GAS

12 June 2020

Petroleum consumption surges 47% in May

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- India's petroleum product consumption surged 47% MoM (–21% YoY) to 14.6mmt in May'20 as fuels across segments exhibited resurgent growth in tandem with the Indian economy's emergence from the world's strictest lockdown.
- A YoY comparison still shows weak demand trends for all petroleum products, except LPG (+13% YoY). The latter is possibly due to the oil minister's announcement of free LPG cylinder distribution to the poor.
- Petrol and diesel consumption stood at 1.8mmt (+82% MoM, –35% YoY) and 5.5 mmt (+69% MoM, –29% YoY) respectively in May. ATF consumption was at 0.1mmt (+98% MoM, –84% YoY) – this remains the worst hit fuel with demand only at ~18% of normal levels.
- Demand for fuel oil (+61% MoM, –3% YoY), bitumen (+192% MoM, –14% YoY) and pet coke (+34% MoM, +4% YoY) showed marked MoM improvement as refinery operations gathered pace.
- India's power and energy demand, which had nosedived, are also returning to pre-lockdown levels faster than expected – electricity consumption is currently at 100 Billion Units (BU) vs. the five-year average of 107bu and refineries are operating at >80% capacity.
- Based on **IOCL's recent Covid-19 update**, the earnings outlook for OMCs' marketing business remains stable as they have begun taking daily price revisions. We prefer IOCL, HPCL and BPCL, in that order, considering both valuations and benefits from a staggered easing of the lockdown across states.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
IOCL IN	88	200	BUY
BPCL IN	373	470	BUY
HPCL IN	211	340	BUY

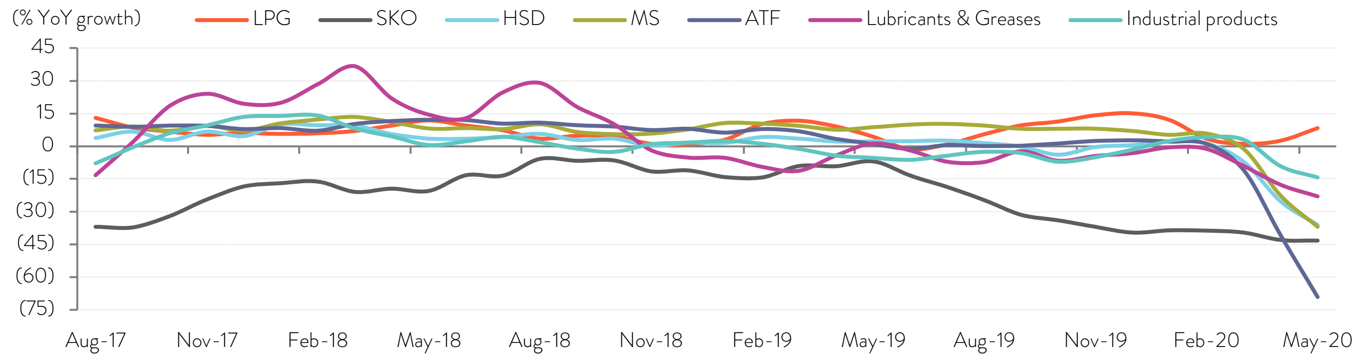
Price & Target in Rupees

PETRO PRODUCT CONSUMPTION

('000 mt)	May'20	YoY (%)	FY20	YoY (%)
LPG	2,317	12.6	26,366	5.9
SKO	181	(32.4)	2,397	(30.7)
HSD	5,495	(29.4)	82,579	(1.0)
MS	1,769	(35.3)	29,976	6.0
Naphtha	1,084	(0.1)	14,436	0.7
ATF	111	(84.1)	8,000	(3.8)
LDO	69	40.4	596	5.3
Lubes & Greases	255	(17.2)	3,959	(8.1)
FO & LSHS	479	(3.4)	6,512	(6.4)
Bitumen	571	(13.5)	6,747	(5.5)
Petcoke	1,523	3.7	22,086	(1.9)
Others	792	(21.2)	10,189	13.2
Total	**14,646**	**(21.3)**	**212,788**	**0.4**

Source: PPAC

FIG 1 – QUARTERLY ROLLING CONSUMPTION GROWTH FOR PETROLEUM PRODUCTS



Source: PPAC, BOBCAPS Research

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AGRICULTURE

12 June 2020

India's sugar demand improves post lockdown

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We recently hosted a call with Abhinash Verma, Director General of Indian Sugar Mills Association (ISMA). Following are the key takeaways:

Sugar

- Sugar production in India is expected to decline to ~27.1mn tonnes (mt) for sugar season 2019-20 from ~33mt in SS18-19, mainly due to lower output in Maharashtra and Karnataka.
- Production in SS19-20 was earlier estimated at a lower ~26.5mt but jaggery and unrefined sugar ('khandsari') players shut operations due to the lockdown and hence cane was diverted to sugar production, resulting in additional output of 0.5-0.6mt.
- Due to Covid -19, the domestic sugar industry lost sales of ~1mt in SS19-20; consumption is expected to be 25-25.2mt.
- Exports from India are projected at ~5mt in SS19-20, aided by newer markets such as Indonesia. ISMA's believes that if the government provides an export subsidy for 7mt in the upcoming season as has been demanded by the industry, exports from India could rise to ~6mt.
- Sugar closing stock in SS19-20 is expected to reduce by ~3mt to ~11.5mt.
- For SS20-21, production in the country is likely to improve primarily due to higher output in states such as Maharashtra.
- Prices have been range bound for the last few months at ~Rs 31/kg due to the lockdown but have started to move up in June and are currently at ~Rs 32/kg.
- The industry has asked the government to continue with 4mt of buffer sugar inventory, to raise sugar MSP (minimum support price) to Rs 35-36/kg from Rs 31, provide export incentives, and keep cane FRP (fair price) unchanged.

Ethanol

- Ethanol demand from OMCs remains strong with stable prices (Rs 43.75/ltr for C-heavy molasses, Rs 54.27/ltr for B-heavy molasses). Crude price has no linkage to ethanol and does not affect the government pricing formula.
- B-heavy molasses-based ethanol resulted in sugarcane diversion of 0.7-0.8mt in SS19-20. About 1.5-2mt is expected to be diverted in SS20-21.

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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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