FIRST LIGHT

01 April 2020

RESEARCH

[Sector Report] Banking

Large private banks offer safe havens

Logistics

Channel check takeaways – lockdown wreaking havoc

Hero MotoCorp | Target: Rs 2,190 | +37% | BUY

Valuations attractive – upgrade to BUY

BOB Economics Research | Interest Rate Outlook

Government sticks to borrowing calendar

IndusInd Bank | Target: Rs 590 | +43% | BUY

Concerns priced in

SUMMARY

Banking

India's banking sector is battling lashing headwinds ranging from anaemic credit demand to elevated bad debt and Covid-19 fears. Against this backdrop, large private banks (ICICIBC, AXSB, HDFCB) offer a higher margin of safety backed by sturdy liability franchises, adequate growth capital and fortified balance sheets. Valuations also look attractive post the recent correction. Given growing Covid-19 tremors, we cut target multiples across banks but retain our preference for ICICIBC, AXSB & HDFCB. We initiate with BUY on FB; ADD on RBK, DCBB, IDFCFB.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	5,200
Cipla	Buy	570
Eicher Motors	Buy	25,000
Petronet LNG	Buy	330
Reliance Industries	Buy	1,500

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	2,870
Greenply Industries	Buy	205
Laurus Labs	Buy	510
Transport Corp	Buy	355
Ashok Leyland	Sell	64

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.73	5bps	(42bps)	(177bps)
India 10Y yield (%)	6.21	7bps	(16bps)	(114bps)
USD/INR	75.42	(0.7)	(4.5)	(9.1)
Brent Crude (US$/bbl)	22.76	(8.7)	(54.9)	(67.0)
Dow	22,327	3.2	(12.1)	(15.0)
Shanghai	2,747	(0.9)	(4.6)	(13.3)
Sensex	28,440	(4.6)	(25.7)	(26.8)
India FII (US$ mn)	**27 Mar**	**MTD**	**CYTD**	**FYTD**
FII-D	(210.1)	(7,578.8)	(9,145.9)	(6,201.8)
FII-E	137.5	(7,404.5)	(5,617.6)	1,771.6

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

Logistics

We recently interacted with a number of logistics companies – listed and unlisted – as well as industry experts. Key takeaways: (1) severe disruption in operations – barring essential commodities, all transportation and warehousing activities have come to a standstill across India since the national lockdown began on 25 March; (2) acute manpower shortage hints at prolonged disruptions; (3) industry consolidation likely; (4) global container trade to contract; (5) asset-light, unlevered companies better insulated – **TCI Express** is our top pick in the sector.

Click here for the full report.

Hero MotoCorp

At Hero MotoCorp's (HMCL) investor call today, senior management stated that proactive steps have been taken to ensure business continuity. With comfortable liquidity, positive feedback from BS-VI models and the likelihood of pent-up demand, HMCL hopes to bounce back as market conditions normalise. Following a steep 22% correction in the past month, the stock is at cheap valuations of 13x FY21E on our bear case earnings – upgrade from REDUCE to BUY. We have a revised Mar'21 TP of Rs 2,190 (vs Rs 2,360) as we lower FY20-FY22 EPS 5-14%.

Click here for the full report.

India Economics: Interest Rate Outlook

Centre's H1FY21 gross borrowing is pegged at Rs 4.88tn in H1FY21 compared with Rs 4.25tn in H1FY20. States will borrow Rs 1.27tn in Q1FY21 (Rs 1.1tn last year). Maturity pattern is skewed towards 30 year at 32% compared with 24% last year. Notably, 5, 10 and 30 year issuances from 1 April are eligible for FPI investment without cap. Despite this yields are unlikely to decline much as there is considerable uncertainty on fiscal deficit and borrowing on account of sharp downward revision in growth and thus revenue collections for FY21.

Click here for the full report.

IndusInd Bank

IndusInd Bank (IIB) hosted an analyst call to address the implications of Covid-19 on its portfolio. The bank plans to recognise some weak accounts as NPA in Q4FY20 which would raise its PCR/credit costs for the quarter to +60%/2.1%. Deposits have declined 10-11% in Q4 due to outflow of government accounts. We trim estimates to build in higher credit cost and softer near-term earnings, but believe current valuations at 0.7x FY22E P/BV price in the concerns. Our Mar'21 TP reduces to Rs 590 (vs. Rs 1,700). Maintain BUY.

Click here for the full report.

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BANKING

31 March 2020

Large private banks offer safe havens

India's banking sector is battling lashing headwinds ranging from anaemic credit demand to elevated bad debt and Covid-19 fears. Against this backdrop, large private banks (ICICIBC, AXSB, HDFCB) offer a higher margin of safety backed by sturdy liability franchises, adequate growth capital and fortified balance sheets. Valuations also look attractive post the recent correction. Given growing Covid-19 tremors, we cut target multiples across banks but retain our preference for ICICIBC, AXSB & HDFCB. We initiate with BUY on FB; ADD on RBK, DCBB, IDFCFB.

Vikesh Mehta
research@bobcaps.in

In the eye of the storm: The Indian banking sector is currently grappling with multiple headwinds. A slowdown in aggregate demand coupled with risk aversion has driven credit growth to a multi-year low. Lending yields are expected to soften as the system is flush with liquidity. Stress formation has moderated from its peak but remains elevated. Initial signs of stress are emerging from the retail segment while SME asset quality continues to worsen. Covid-19 is a new and emerging risk.

Select large banks offer safe ground: In our view, large private banks are best placed to weather the storm, anchored as they are by a lower cost of funds, strong liability franchise, adequate capital and structurally fortified balance sheets. ICICI Bank (ICICIBC), Axis Bank (AXSB) and HDFC Bank (HDFCB) are preferred picks from our banking coverage. At current respective valuations of 1.1x, 0.7x and 1.7x on core FY22E P/BV, these stocks offer robust risk-reward post the recent correction (down 40% on average in one month).

Small banks face risk aversion: We believe market share gains for large private banks will outpace those of small/mid-sized banks in light of the current risk aversion in the sector. On the other hand, public sector banks will continue to bleed market share given a lack of growth capital and mega-merger preoccupations. Initial signs of stress are emerging from the SME space which could further hurt smaller banks with material exposure to the sector.

Sector multiples pared; BUY ICICIBC, ASXB, HDFCB: A prolonged shutdown due to Covid-19 can exacerbate loan growth and credit cost pressures as loans sour and repayments slow, especially in unsecured retail and MSME. We model for lower credit growth (6-16%) and deterioration in asset quality for our existing coverage of large banks over FY20-FY22, leading to EPS cuts of 3-20% across banks. Our target prices for top picks ICICIBC (Rs 465), AXSB (Rs 520) and HDFCB (Rs 1,200) thus reduce 26%, 42% and 19% respectively.

RECOMMENDATION SNAPSHOT

Ticker	Price*	Target	Rating
ICICIBC IN	313	465	BUY
HDFCB IN	832	1,200	BUY
AXSB IN	368	520	BUY
SBIN IN	187	250	BUY
FB IN	41	50	BUY
RBK IN	150	170	ADD
DCBB IN	95	105	ADD
IDFCFB IN	21	23	ADD

Price & Target in Rupees | *As of 30 Mar 2020

LOGISTICS

31 March 2020

Channel check takeaways – lockdown wreaking havoc

Sayan Das Sharma
research@bobcaps.in

We recently interacted with a number of logistics companies – listed and unlisted – as well as industry experts. Key takeaways below.

Severe disruption in operations: Barring essential commodities (food, groceries, healthcare, FMCG), all transportation and warehousing activities have come to a standstill across India since the national lockdown began on 25 March. As per companies we spoke to, law enforcement authorities have been obstructing even transport of essential goods due to a lack of clarity. Hindrances have eased in recent days as the government implemented a system of movement passes for essential goods. But in the absence of return loads and adequate volumes, most players are at 20-30% capacity. Our checks suggest rail freight is relatively less affected.

Acute manpower shortage hints at prolonged disruptions: After the lockdown, a large number of drivers and porters have left for their hometowns, leading to acute labour constraints for the logistics industry. Industry experts believe that even once the lockdown is lifted, operations will take at least a few weeks to recover as labour issues are gradually resolved.

Industry consolidation likely: Small freight operators (SFOs owing 1-5 trucks) form 80-85% of the industry. Already reeling from the consumption slowdown over the past few quarters, they are the hardest hit by the shutdown. Some of these SFOs may default on their vehicle loans owing to acute volume/ realisation pressures, as per our checks. This may usher in an era of consolidation, with larger players acquiring some of these companies or their assets.

Global container trade to contract: Global container trade is likely to contract over 5% in CY20 amid a coronavirus-fuelled recession, as per a large global shipping association. Container demand may see a short-lived recovery as Chinese manufacturing has resumed in March, but lockdowns in the US and Europe are likely to weigh on volumes in the medium term. Among our coverage, Container Corp and Allcargo Logistics have the highest dependence on container trade from India and globally.

Asset-light, unlevered companies better insulated: Though the impact of Covid-19 is difficult to ascertain at present, we expect all logistics companies to witness sluggish earnings for 1-2 quarters, even in an optimistic scenario. We believe asset-light companies with strong balance sheets can tide over the difficult phase and emerge stronger. **TCI Express** is our top pick in the sector.

GROUND CONNECT
Valuable insights from differentiated primary research

RECOMMENDATION SNAPSHOT

Ticker	Rating
AGLL IN	ADD
CCRI IN	ADD
FSCSL IN	REDUCE
MAHLOG IN	BUY
TCIEXP IN	BUY
TRPC IN	BUY
VRLL IN	BUY

Price & Target in Rupees

COMPANY UPDATE

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

BUY
TP: Rs 2,190 | ⮝ 37%

HERO MOTOCORP | Automobiles | 31 March 2020

Valuations attractive – upgrade to BUY

Navin Matta | Nishant Chowhan, CFA
research@bobcaps.in

At Hero MotoCorp's (HMCL) investor call today, senior management stated that proactive steps have been taken to ensure business continuity. With comfortable liquidity, positive feedback from BS-VI models and the likelihood of pent-up demand, HMCL hopes to bounce back as market conditions normalise. Following a steep 22% correction in the past month, the stock is at cheap valuations of 13x FY21E on our bear case earnings – upgrade from REDUCE to BUY. We have a revised Mar'21 TP of Rs 2,190 (vs Rs 2,360) as we lower FY20-FY22 EPS 5-14%.

Demand outlook hazy; inventory under control: HMCL refrained from giving out any guidance on the demand outlook given that the duration of the lockdown and economic fallout from Covid-19 are unknown. BS-IV inventory prior to 25 March totalled 150k units and the company has extended discounts of Rs 10k-15k across models to liquidate this inventory through online sales. Current BS-VI inventory stands at ~35 days of sales.

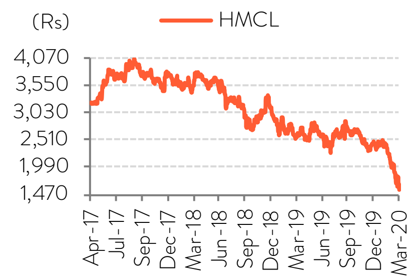
Other key takeaways: (1) Recurring monthly opex is ~Rs 2bn. (2) HMCL currently has ~Rs 40bn in net cash, which should ensure business continuity. (3) Product development projects will progress as planned. (4) Management expects tailwinds from lower crude oil prices and other commodities.
(5) HMCL is unlikely to undertake a buyback as the company looks to conserve resources in these uncertain times.

Upgrade to BUY: While we acknowledge BS-VI-led demand challenges and competitive risks in the two-wheeler space, especially for HMCL, we think the recent sharp fall in stock price adequately prices in these concerns. HMCL is trading at 13x FY21E EPS under our bear case earnings scenario (refer Fig 1), which is a ~30% discount to the 10Y average multiple. We upgrade our rating to BUY with a revised TP of Rs 2,190 based on 13x FY22E EPS.

Ticker/Price	HMCL IN/Rs 1,596
Market cap	US$ 4.2bn
Shares o/s	200mn
3M ADV	US$ 27.6mn
52wk high/low	Rs 3,023/Rs 1,475
Promoter/FPI/DII	35%/36%/18%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	322,305	336,505	289,315	306,513	344,781
EBITDA (Rs mn)	52,802	49,301	42,005	38,211	45,883
Adj. net profit (Rs mn)	36,974	33,848	30,559	28,107	33,669
Adj. EPS (Rs)	185.1	169.5	153.0	140.7	168.6
Adj. EPS growth (%)	9.5	(8.5)	(9.7)	(8.0)	19.8
Adj. ROAE (%)	31.4	26.3	20.7	17.9	19.8
Adj. P/E (x)	8.6	9.4	10.4	11.3	9.5
EV/EBITDA (x)	5.2	5.3	6.3	7.0	5.8

Source: Company, BOBCAPS Research

INTEREST RATE OUTLOOK

31 March 2020

Government sticks to borrowing calendar

Centre's H1FY21 gross borrowing is pegged at Rs 4.88tn in H1FY21 compared with Rs 4.25tn in H1FY20. States will borrow Rs 1.27tn in Q1FY21 (Rs 1.1tn last year). Maturity pattern is skewed towards 30 year at 32% compared with 24% last year. Notably, 5, 10 and 30 year issuances from 1 April are eligible for FPI investment without cap. Despite this yields are unlikely to decline much as there is considerable uncertainty on fiscal deficit and borrowing on account of sharp downward revision in growth and thus revenue collections for FY21.

Sameer Narang
Dipanwita Mazumdar | Sonal Badhan
chief.economist@bankofbaroda.com

H1FY21 gross borrowing at Rs 4.8tn: Gross borrowing in H1FY21 is pegged at Rs 4.8tn (62.6% of total issuances) compared with Rs 4.25tn (59.9%) in H1FY20. Net issuances in H1FY21 are Rs 3.5tn as against Rs 3.3tn last year after accounting for repayment of Rs 1.4tn in H1FY21. WMA limit for government has been increased to Rs 1.2tn as against Rs 750bn as government revenues may remain a bit soft in the near-term on account of lockdown. State borrowing for Q1FY21 is pegged at Rs 1.27tn as against Rs 1.1tn last year.

Maturity pattern skewed towards long-end: Issuance pattern is skewed towards 20 year and above bucket at 32% in H1FY21 vs 24% in H1FY21. Issuances in other buckets as % of total have come-off. Notably, RBI notified 5, 10 and 30 year securities under Fully Automatic Route for foreign investment which should pave the way for inclusion of India in global bond indices. The specified securities constitute 4.7% of outstanding securities. FRB issuances are pegged at Rs 240bn. In addition to this, debt ETF will also be rolled out in H2FY21. Overall switches for the year are pegged at Rs 2.7tn.

Higher fiscal deficit worries: While the government has stuck to its borrowing calendar for FY21, there is considerable uncertainty vis-à-vis FY21 fiscal deficit. Receipts on account of direct and indirect taxes will be lower than Budget estimates on account of substantial downward revision in growth estimates since the Budget was presented. We have revised our GDP growth estimate lower to 4% from 5.5% earlier with risks tilted to the downside. As a result, despite 75bps reduction in repo rate, Indian 10Y yield has remained flat since the announcement of RBI policy. However, we do see deposit rates heading lower with government announcing sharp reduction in small saving deposit rates by 70-140bps across maturities.

KEY HIGHLIGHTS

- Gross borrowing in H1FY21 higher at Rs 4.88tn.
- H2 borrowing expected to be lower at Rs 2.92tn.
- Yields are unlikely to fall as fiscal uncertainty remains.

BUY
TP: Rs 590 | ⮝ 43%

INDUSIND BANK | Banking | 31 March 2020

Concerns priced in

Vikesh Mehta
research@bobcaps.in

IndusInd Bank (IIB) hosted an analyst call to address the implications of Covid-19 on its portfolio. The bank plans to recognise some weak accounts as NPA in Q4FY20 which would raise its PCR/credit costs for the quarter to +60%/2.1%. Deposits have declined 10-11% in Q4 due to outflow of government accounts. We trim estimates to build in higher credit cost and softer near-term earnings, but believe current valuations at 0.7x FY22E P/BV price in the concerns. Our Mar'21 TP reduces to Rs 590 (vs. Rs 1,700). Maintain BUY.

Asset quality manageable: Management believes asset quality will be manageable if Covid-19 disruptions recede within the next three months and that the RBI's moratorium on loan repayment will lend support. IIB has not run a stress-test for a scenario where disruptions extend into Q2FY21, but management believes its loan portfolio is diversified with adequate cover and has a demonstrated ability to weather external shocks. A few weak accounts will be recognised as NPA in Q4 which should increase PCR to +60% (52% in Q3) and credit cost to 2.1%.

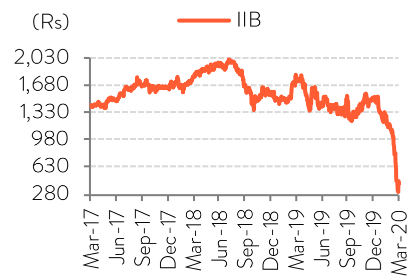
Loan growth to moderate; focus on liabilities: As per management's IndusInd 2.0 strategy, IIB aims to (a) revitalise deposits and make liabilities more granular – deposits declined by 10-11% in Q4 largely due to outflow of government funds; (b) reduce risk concentration by doing away with chunky exposure; (c) ensure a high capital threshold by maintaining 15% CAR; (d) gradually increase PCR to 70%; (e) moderate asset growth and let liabilities lead growth over assets – IIB expects 8-12% YoY loan growth in H1FY21.

Valuations undemanding: We cut our FY20-FY22 EPS by 11-60% and also reset our target P/BV multiple from 2.1x to 1x to reflect loan growth and credit cost headwinds. At current valuations of 0.7x FY22E P/BV, we believe concerns surrounding the stock are priced in. BUY with a revised Mar'21 TP of Rs 590.

Ticker/Price	IIB IN/Rs 413
Market cap	US$ 3.4bn
Shares o/s	628mn
3M ADV	US$ 129.4mn
52wk high/low	Rs 1,824/Rs 236
Promoter/FPI/DII	17%/52%/31%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Net interest income	74,974	88,462	117,866	125,426	148,370
NII growth (%)	23.7	18.0	33.2	6.4	18.3
Adj. net profit (Rs mn)	36,060	33,011	48,034	26,996	54,097
EPS (Rs)	60.2	54.9	73.3	38.1	76.4
P/E (x)	6.9	7.5	5.6	10.8	5.4
P/BV (x)	1.1	0.9	0.8	0.7	0.7
ROA (%)	1.8	1.3	1.5	0.7	1.3
ROE (%)	16.2	13.1	15.4	7.1	12.8

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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