# FIRST LIGHT

23 April 2020

## RESEARCH

### Automobiles | Q4FY20 Preview

Covid-19 stalls recovery hopes

### Reliance Industries | Target: Rs 1,550 | +14% | BUY

RJio creates India profile for Facebook

### Kotak Mahindra Bank | Target: Rs 1,450 | +26% | BUY

Quality franchise; capital raising adds buffer – reiterate BUY

## SUMMARY

### Automobiles: Q4FY20 Preview

Weak dispatches in Q4FY20 due to BS-IV inventory liquidation and the March lockdown saw aggregate FY20 volumes declining at record rates. We expect a 34% YoY drop in Q4 aggregate EBITDA for our auto coverage. Covid-19 restrictions and the subsequent economic impact will hurt discretionary demand – we cut volume forecasts and reduce FY21/FY22 earnings 35-60% (20-29% ex-TTMT). Valuations post the sharp correction are close to the 10-year mean. Prefer companies with strong balance sheet and FCF prospects. Top picks: MSIL, EIM.

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### Reliance Industries

Reliance Industries' (RIL) deleveraging plans appears back on track with a 9.99% stake sale in RJio to Facebook for US$ 5.8bn (valuing RJio at ~US$ 61bn). Key highlights: (a) the deal values RJio at 8.7x FY22E EBITDA (Rs 780/sh vs. our estimate of US$ 42bn or Rs 562/sh), (b) it entails partnership between WhatsApp, JioMart and Retail for spearheading RIL's new initiative to connect small merchants and 'kirana' stores. We raise RIL's SOTP value to Rs 1,550 (vs. Rs 1,500) on higher value for RJio (partly neutralised by higher debt as Aramco deal could fall through).

**Click here for the full report.**

## TOP PICKS

### LARGE-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Bajaj Finance | Buy | 3,000 |
| Cipla | Buy | 570 |
| Eicher Motors | Buy | 18,100 |
| Petronet LNG | Buy | 330 |
| Reliance Industries | Buy | 1,550 |

### MID-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Alkem Labs | Buy | 2,870 |
| Greenply Industries | Buy | 145 |
| Laurus Labs | Buy | 510 |
| Transport Corp | Buy | 255 |
| Ashok Leyland | Reduce | 43 |

Source: BOBCAPS Research

### DAILY MACRO INDICATORS

| Indicator | Current | 2D (%) | 1M (%) | 12M (%) |
|---|---|---|---|---|
| US 10Y yield (%) | 0.58 | (3bps) | (24bps) | (198bps) |
| India 10Y yield (%) | 6.21 | 0bps | (5bps) | (127bps) |
| USD/INR | 76.83 | (0.4) | (1.8) | (9.9) |
| Brent Crude (US$/bbl) | 21.66 | (15.3) | (5.2) | (65.5) |
| Dow | 23,019 | (2.7) | 23.3 | (10.8) |
| Shanghai | 2,827 | (0.9) | 3.9 | (11.3) |
| Sensex | 30,637 | (3.2) | 5.8 | (18.1) |
| **India FII (US$ mn)** | **20 Apr** | **MTD** | **CYTD** | **FYTD** |
| FII-D | 201.2 | (788.8) | (10,548.3) | (788.8) |
| FII-E | 12.1 | (113.7) | (6,716.7) | (113.7) |

Source: Bank of Baroda Economics Research

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## Kotak Mahindra Bank

Kotak Mahindra Bank (KMB) has received board approval to raise ~Rs 75bn in capital which will bolster CAR by ~300bps, reduce promoter stake to 29% and build buffers against contingencies. KMB's CAR has always been well above the regulatory threshold, which in part explains the lower ROE than HDFCB. Liability franchise continues to improve (56% CASA ratio for Q4) and a reduced savings rate would curb cost of funds. We reiterate BUY but revise our Mar'21 TP to Rs 1,450 (vs. Rs 1,875) as we cut FY21-FY22 EPS 17-25% on slower growth ahead.

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**AUTOMOBILES** | Q4FY20 Preview | 22 April 2020

# Covid-19 stalls recovery hopes

**Weak dispatches in Q4FY20 due to BS-IV inventory liquidation and the March lockdown saw aggregate FY20 volumes declining at record rates. We expect a 34% YoY drop in Q4 aggregate EBITDA for our auto coverage. Covid-19 restrictions and the subsequent economic impact will hurt discretionary demand – we cut volume forecasts and reduce FY21/FY22 earnings 35-60% (20-29% ex-TTMT). Valuations post the sharp correction are close to the 10-year mean. Prefer companies with strong balance sheet and FCF prospects. Top picks: MSIL, EIM.**

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**Yet another weak quarter:** All auto OEMs reported soft dispatch volumes in Q4FY20 due to (1) BS-IV inventory destocking ahead of emission norm change, (2) slow ramp-up of BS-VI vehicle production for some OEMs due to component shortage from Chinese suppliers post Covid-19-led plant closures, and (3) the India lockdown which hit production/sales for 7-10 days. We expect our coverage companies to report a 26% YoY decline in topline for Q4. Negative operating leverage is likely to dent margins and drive a 34% YoY fall in EBITDA.

**FY20 – a year to forget:** Significant price hikes in two-wheelers and passenger vehicles over the last 18 months in a weak macro climate, curtailed dispatches ahead of BS-VI transition, and the lockdown impact in March have prompted a slump in volumes across categories in FY20. MHCVs saw the largest decline at 42% YoY followed by 18% slippage in PV and 2W volumes. Market leaders in each of these segments saw flat to slight improvement in market share in FY20.

**Covid-19 clouds FY21 outlook:** In addition to the production/sales impact during the lockdown period, the economic fallout from the pandemic could hurt discretionary consumption, at least for the next couple of quarters. Assuming the lockdown is lifted in the next two weeks as scheduled, we build in a volume decline in H1FY21 and a rebound from the second half. For FY21, we estimate that volumes will slip 10%/7.5%/7.5% for the MHCV/PV/2W segments.

**Maintain Maruti, Eicher as top picks:** We cut FY21/FY22 earnings estimates across our coverage by 35-60% (20-29% ex-Tata Motors) to reflect weak volumes, and also pare our target P/E by 10% for most companies. Stocks have corrected 25-60% in 2020 YTD, making valuations more palatable in some cases (such as Mahindra & Mahindra: upgrade from ADD to BUY, and Ashok Leyland: up from SELL to REDUCE). We prefer companies with robust net-cash balance sheets and healthy FCF potential (Maruti & Eicher are top picks).

**RECOMMENDATION SNAPSHOT**

| Ticker | Price | Target | Rating |
|---|---|---|---|
| AL IN | 44 | 43 | REDUCE |
| BJAUT IN | 2,325 | 2,630 | ADD |
| EIM IN | 13,490 | 18,100 | BUY |
| HMCL IN | 1,835 | 2,140 | BUY |
| MM IN | 330 | 400 | BUY |
| MSIL IN | 5,009 | 6,100 | BUY |
| TTMT IN | 74 | 82 | ADD |
| TVSL IN | 309 | 310 | REDUCE |

Price & Target in Rupees

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**BUY**
TP: Rs 1,550 | ⮝ 14%

**RELIANCE INDUSTRIES** | Oil & Gas | 22 April 2020

# RJio creates India profile for Facebook

**Reliance Industries' (RIL) deleveraging plans appears back on track with a 9.99% stake sale in RJio to Facebook for US$ 5.8bn (valuing RJio at ~US$ 61bn). Key highlights: (a) the deal values RJio at 8.7x FY22E EBITDA (Rs 780/sh vs. our estimate of US$ 42bn or Rs 562/sh), (b) it entails partnership between WhatsApp, JioMart and Retail for spearheading RIL's new initiative to connect small merchants and 'kirana' stores. We raise RIL's SOTP value to Rs 1,550 (vs. Rs 1,500) on higher value for RJio (partly neutralised by higher debt as Aramco deal could fall through).**

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**Facebook deal carries multiple synergies:** (a) **RJio:** Access to ~400mn Jio subscribers and Jio platforms could enhance the reach of Facebook's various apps; (b) **Retail:** JV between the JioMart platform and WhatsApp for facilitating transactions with small merchants and grocery ('kirana') stores will bolster RIL's retail reach across the unorganised grocery space; (c) **WhatsApp Pay:** Facebook's attempt to launch WhatsApp Pay had faced regulatory hurdles. Its JV with Reliance Retail could provide the much-needed boost for potential transactions and help it grab market share from the likes of PayTM and Google Pay.

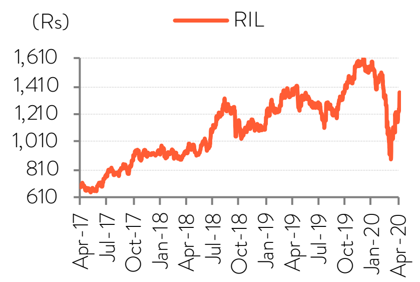
**Enhanced valuation benchmark for RJio:** RJio's rapid subscriber addition over the last 3.5 years has now yielded dividends. Deal valuation at 8.7x FY22E EBITDA optically appears well above our estimates as it clearly factors in strong earnings growth potential from parallel offerings as well (ecommerce, media and content, among others). We raise RJio's valuation to match this transaction.

**Maintain BUY:** RIL's deleveraging plans are back on track. But with the recent crash in oil prices jeopardising the Aramco deal, we lower our debt reduction estimates to US$ 6bn (from US$ 18bn), restricting the rise in our SOTP value.

| | |
|---|---|
| Ticker/Price | RIL IN/Rs 1,364 |
| Market cap | US$ 113.0bn |
| Shares o/s | 6,339mn |
| 3M ADV | US$ 235.2mn |
| 52wk high/low | Rs 1,618/Rs 876 |
| Promoter/FPI/DII | 50%/24%/26% |

Source: NSE

## STOCK PERFORMANCE




Source: NSE

## KEY FINANCIALS

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Total revenue (Rs mn) | 4,082,650 | 5,810,200 | 5,268,941 | 3,996,719 | 4,186,967 |
| EBITDA (Rs mn) | 641,760 | 839,180 | 894,646 | 1,092,380 | 1,358,263 |
| Adj. net profit (Rs mn) | 352,869 | 398,370 | 422,150 | 508,442 | 729,607 |
| Adj. EPS (Rs) | 59.6 | 67.2 | 66.6 | 80.2 | 115.1 |
| Adj. EPS growth (%) | 17.4 | 12.8 | (0.9) | 20.4 | 43.5 |
| Adj. ROAE (%) | 12.7 | 11.7 | 10.4 | 11.3 | 14.3 |
| Adj. P/E (x) | 22.9 | 20.3 | 20.5 | 17.0 | 11.8 |
| EV/EBITDA (x) | 16.4 | 12.6 | 12.1 | 10.5 | 8.2 |

Source: Company, BOBCAPS Research

COMPANY UPDATE

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**BUY**
TP: Rs 1,450 | ⮝ 26%

## KOTAK MAHINDRA BANK

| Banking | 22 April 2020

# Quality franchise; capital raising adds buffer – reiterate BUY

**Kotak Mahindra Bank (KMB) has received board approval to raise ~Rs 75bn in capital which will bolster CAR by ~300bps, reduce promoter stake to 29% and build buffers against contingencies. KMB's CAR has always been well above the regulatory threshold, which in part explains the lower ROE than HDFCB. Liability franchise continues to improve (56% CASA ratio for Q4) and a reduced savings rate would curb cost of funds. We reiterate BUY but revise our Mar'21 TP to Rs 1,450 (vs. Rs 1,875) as we cut FY21-FY22 EPS 17-25% on slower growth ahead.**

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**Diluting 3.4% equity to raise Rs 74.8bn:** KMB has received board approval to raise equity capital by issuing up to 65mn shares, which entails dilution of 3.4%. We believe this capital infusion exercise ticks multiple boxes – (1) it reduces promoter stake to 29% from 30% currently. As per the bank's agreement and approval from RBI, promoter holding has to be pared to 26% by Aug'20; (2) KMB is well capitalised with a 17.7% tier-1 ratio – this capital raise will add ~300bps to the tier-1 ratio and further strengthen the balance sheet in a turbulent period; (3) part of the capital could be used to support subsidiaries.

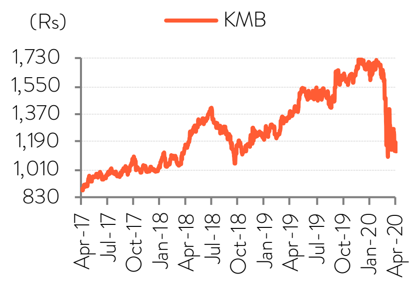
**Top-notch liability franchise:** The bank continues to do exceedingly well on the liability front. Proforma numbers for Q4FY20 indicate that the CASA ratio improved by 250bps QoQ to 56.2%, likely aided in part by the Yes Bank saga. KMB also reduced the interest rate on savings deposits by up to 150bps in Apr'20. This will lead to substantial savings for the bank and drive down its cost of funds, thereby providing a cushion to margins.

**Maintain BUY:** KMB fares well in terms of its capital position and liability franchise. However, we reduce FY21-FY22 EPS by 17-25% to factor in slower loan growth and increased credit costs despite solid underwriting standards, given buildup of economic stress due to Covid-19. Maintain BUY.

| | |
|---|---|
| Ticker/Price | KMB IN/Rs 1,152 |
| Market cap | US$ 28.8bn |
| Shares o/s | 1,910mn |
| 3M ADV | US$ 92.7mn |
| 52wk high/low | Rs 1,740/Rs 1,001 |
| Promoter/FPI/DII | 30%/40%/30% |

Source: NSE

### STOCK PERFORMANCE




Source: NSE

### KEY FINANCIALS

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Net interest income | 95,317 | 112,590 | 133,737 | 149,552 | 170,423 |
| NII growth (%) | 1729.6 | 1812.1 | 1878.3 | 1182.5 | 1395.5 |
| Adj. net profit (Rs mn) | 40,619 | 42,571 | 63,009 | 65,310 | 75,983 |
| EPS (Rs) | 21.8 | 25.5 | 33.0 | 33.6 | 38.5 |
| P/E (x) | 52.8 | 45.2 | 34.9 | 34.2 | 29.9 |
| P/BV (x) | 5.9 | 5.2 | 4.5 | 3.7 | 3.3 |
| ROA (%) | 1.7 | 1.7 | 1.9 | 1.7 | 1.8 |
| ROE (%) | 12.5 | 12.2 | 13.9 | 11.8 | 11.6 |

Source: Company, BOBCAPS Research

### IMPACT OF RS 74.8BN EQUITY INFUSION IN KMB

| Particulars | Pre-issue | Post-issue |
|---|---|---|
| Tier-1 (%) | 17.7 | 19.9 |
| CAR (%) | 18.2 | 20.5 |
| Shares held by promoter (#) | 572 | 572 |
| Promoter holding (%) | 30 | 29 |

Source: Company, BOBCAPS Research | Our capital adequacy calculations are based on net worth

# 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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