FIRST LIGHT

24 February 2020

RESEARCH

BOB Economics Research | February MPC Minutes

Policy space to open in Q3FY21

Aurobindo Pharma | Target: Rs 560 | –7% | ADD

USFDA error on Unit IV to erase recent stock gains

Hero MotoCorp | Target: Rs 2,360 | +5% | REDUCE

Visit to HMCL's R&D centre – key takeaways

Greenply Industries | Target: Rs 205 | +49% | BUY

Demand slows but margins resilient

SUMMARY

India Economics: February MPC Minutes

MPC members noted that economic activity has slowed down since the last policy. While reduction in rates is the most optimal response to dip in growth, the elevated inflation levels imply RBI has to wait for inflation to fall below its target and accordingly reduce policy rate to close output gap. Given the uptick in non-vegetable food inflation, this window is likely to open up only in Q3FY21. In the interim, RBI is likely to take measures to improve transmission such as LTRO, CRR exemption, external linking of rates etc.

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	400
Reliance Industries	Buy	1,860

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 (%)	1.57	1bps	(26bps)	(108bps)
India 10Y yield (%)	6.39	0bps	(24bps)	(98bps)
USD/INR	71.56	(0.4)	(0.7)	(0.3)
Brent Crude (US$/bbl)	59.12	2.4	(8.8)	(11.9)
Dow*	29,348	0.4	0	13.1
Shanghai	2,975	(0.3)	(3.3)	7.8
Sensex	41,323	1.0	(1.5)	15.6
India FII (US$ mn)	**17 Feb**	**MTD**	**CYTD**	**FYTD**
FII-D	(16.6)	1,958.4	389.5	3,333.6
FII-E	24.3	1,940.5	3,313.2	10,702.4

Source: Bank of Baroda Economics Research
*Except equity, Indian markets were closed on 19.02.2020

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Aurobindo Pharma

Aurobindo Pharma (ARBP) has received further communication from the USFDA on its Unit IV injectable plant stating that the inspection is still open and under review. The letter issued on 19 February mentions that the establishment inspection report (EIR) with voluntary action indicated (VAI) classification for the facility was erroneously sent to the company and is being retracted. To recap, this plant was last inspected in Nov'19 wherein the FDA had issued 14 observations, some critical in our view. News of the Unit IV EIR retraction will likely erase the positive investor sentiment that saw the stock gain ~20% on 19 February, sparked by hopes of a possible rerating (see our 19 Feb report: **EIR received for Unit IV – a key sentiment booster**). We return to our earlier target multiple of 7x on FY22E EV/EBITDA (from 8x), and hence revert to our TP of Rs 560 (from Rs 640).

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Hero MotoCorp

We visited Hero Moto's (HMCL) R&D centre and attended its investor meet. Alongside BS-VI upgraded models and the new 'Xtreme 160', HMCL also showcased interesting prototypes of 'Quark1' – its shape-changing mobility solution, and 2021 two-wheeler launch 'E-Maestro'. The company plans to invest Rs 100bn over 5-7 years towards new products, network premiumisation and mobility solutions. Given potentially weaker FCF on elevated investments, we cut our target P/E multiple to 13x (vs. 14x) and TP to Rs 2,360 (vs. Rs 2,540).

Click here for the full report.

Greenply Industries

We recently hosted a roadshow with the management of Greenply Industries (GIL). Key takeaways: (1) GIL saw a slowdown in plywood demand during Q3FY20 due to the weak macro climate. Tight liquidity coupled with working capital discipline further dampened sales. Working capital control led the company to forego Rs 150mn-200mn in Q3 revenue. (2) Management is targeting 4-4.5% growth in the India plywood segment in FY20. (3) With no significant pricing pressure on raw material, management believes operating margins in the India business can be maintained at ~11%.

Click here for the full report.

FEBRUARY MPC MINUTES

20 February 2020

Policy space to open in Q3FY21

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MPC members noted that economic activity has slowed down since the last policy. While reduction in rates is the most optimal response to dip in growth, the elevated inflation levels imply RBI has to wait for inflation to fall below its target and accordingly reduce policy rate to close output gap. Given the uptick in non-vegetable food inflation, this window is likely to open up only in Q3FY21. In the interim, RBI is likely to take measures to improve transmission such as LTRO, CRR exemption, external linking of rates etc.

Global slowdown continues: MPC members noted that slowdown persists. RBI Governor pointed out that economic activity has slowed since Dec'19. Some green shoots are visible in the form of rabi sowing and PMI data. Even credit flow to commercial sector is seeing an improvement, though lower than last year. However, capacity utilisation remains low and residential real estate inventory is high. The Budget has given a boost to consumption through tax cuts. External demand is likely to remain weak as impact of coronavirus plays out in the next few months. MPC members reiterated that focus needs to be on structural reforms to boost investments.

Inflation to ease in Q3FY21: The current inflation spike is not only limited to onions (vegetables) but is visible in cereals, pulses, milk, sugar etc. While vegetable prices may come off, the inflation in other non-vegetable food items is likely to taper-off with a lag. Global cereal prices are also inching up and have a high correlation with domestic prices. In addition, transport and communication has seen a surge to 4.8% on the back of increase in telecom tariffs. Despite elevated level of food inflation, muted elements of core (apart from gold) suggests, that CPI inflation is likely to fall below RBI's target of 4% in Q3FY21.

Policy space remains: Given the negative output gap, most MPC members pointed out that policy space for further accommodation remains. Dr Janak Raj pointed out that there is policy space which could be used once inflation outlook becomes clear. Dr Patra emphasised on improving transmission of cumulative 135bps rate reduction into lending rates. Transmission has been partial as of now and RBI's LTRO and CRR exemption to retail and MSME loans will improve transmission. We continue to see 40bps rate cut in Q3FY21 which is in-line with easing cycle seen in Asian Central Banks this year.

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ADD
TP: Rs 560 | ▼ 7%

AUROBINDO PHARMA | Pharmaceuticals | 22 February 2020

USFDA error on Unit IV to erase recent stock gains

USFDA inspection at Unit IV remains open: Aurobindo Pharma (ARBP) has received further communication from the USFDA on its Unit IV injectable plant stating that the inspection is still open and under review. The letter issued on 19 February mentions that the establishment inspection report (EIR) with voluntary action indicated (VAI) classification for the facility was erroneously sent to the company and is being retracted. To recap, this plant was last inspected in Nov'19 wherein the FDA had issued 14 observations, some critical in our view.

Management call takeaways: Our interaction with ARBP's management indicates that the earlier FDA's communication on VAI was intended for an inspection for another facility, possibly Unit VIII – an API plant that was issued four Form 483 observations during the Oct'19 inspection.

Implication: News of the Unit IV EIR retraction will likely erase the positive investor sentiment that saw the stock gain ~20% on 19 February, sparked by hopes of a possible rerating (see our 19 Feb report: **EIR received for Unit IV – a key sentiment booster**). We note that while the exchange notification and our management interactions (on FDA document content received) clearly point to a slipup on the part of the USFDA, this rare misstep by the regulators is unlikely to shake investors' faith in the future EIR communications to companies.

We revert to original 7x multiple and TP of Rs 560: We return to our earlier target multiple of 7x on FY22E EV/EBITDA (from 8x), well below the stock's five-year mean of 9x as downside risks to our FY21/FY22 EPS estimates from unit IV review persist. Global peers such as Teva, Endo and Perrigo are trading at ~7x. Our multiple for ARBP assumes high risk of an official action indicated (OAI) classification for unit IV, which is a key growth driver accounting for 30% of the company's pending ANDA filings. We retain ADD on ARBP and revert to our Mar'21 TP of Rs 560 (from Rs 640).

Near-term events to watch: The USFDA will start inspections at Unit 10 (oral solids) from 24 February and at the Eugia oncology unit sometime in April. Together both house 62 pending ANDAs, accounting for 40% of pending approvals. These units will be key growth drivers over the next 2-3 years. Sandoz regulatory approval is another key monitorable.

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Ticker/Price	ARBP IN/Rs 600
Market cap	US$ 4.9bn
Shares o/s	586mn
3M ADV	US$ 28.6mn
52wk high/low	Rs 838/Rs 389
Promoter/FPI/DII	52%/19%/15%

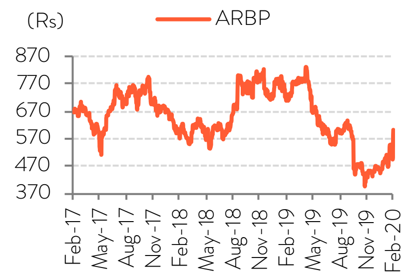
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY20E	FY21E	FY22E
Total revenue (Rs mn)	230,854	285,827	292,957
EBITDA (Rs mn)	47,118	55,500	57,116
Adj. net profit (Rs mn)	27,331	28,939	29,294
Adj. EPS (Rs)	46.6	49.4	50.0
Adj. EPS growth (%)	13.3	5.9	1.2
Adj. ROAE (%)	18.0	16.4	14.4
Adj. P/E (x)	12.9	12.1	12.0
EV/EBITDA (x)	8.4	7.2	7.4

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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COMPANY UPDATE

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REDUCE
TP: Rs 2,360 | ⮝ 5%

HERO MOTOCORP | Automobiles | 20 February 2020

Visit to HMCL's R&D centre – key takeaways

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We visited Hero Moto's (HMCL) R&D centre and attended its investor meet. Alongside BS-VI upgraded models and the new 'Xtreme 160', HMCL also showcased interesting prototypes of 'Quark1' – its shape-changing mobility solution, and 2021 two-wheeler launch 'E-Maestro'. The company plans to invest Rs 100bn over 5-7 years towards new products, network premiumisation and mobility solutions. Given potentially weaker FCF on elevated investments, we cut our target P/E multiple to 13x (vs. 14x) and TP to Rs 2,360 (vs. Rs 2,540).

Visible scale-up in R&D capability: HMCL has made a concerted push towards building solid R&D capabilities with investments of ~US$ 600mn over the past five years. Efforts are visible by way of 150 new projects being generated and notable improvement in build quality/finish of new models. The product development cycle has been cut by ~25% (to three years) with scope for further reduction. In addition to displaying new products in 2W segments, HMCL also showcased an interesting concept model – touted as a shape-changing mobility solution, and highlighted its readiness in EV technology.

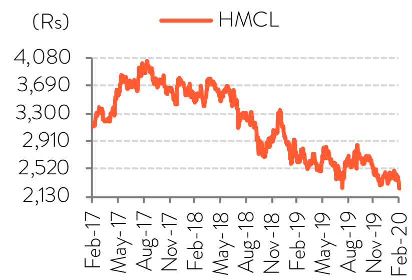
Investing to diversify, build presence in emerging mobility: HMCL's vision entails being the future of mobility. In this regard, it has a Rs 100bn investment pipeline over the next 5-7 years for (1) scaling up its presence in scooters, premium motorcycles and in exports, (2) emerging mobility products/solutions, and (3) network premiumisation.

Maintain REDUCE: While we like HMCL's renewed efforts to expand beyond its core commuter segment and build an emerging mobility vertical, benefits if any will accrue after a long gestation period. High competitive intensity and a potential demand hit from BS-VI transition keep us cautious on the stock.

Ticker/Price	HMCL IN/Rs 2,252
Market cap	US$ 6.3bn
Shares o/s	200mn
3M ADV	US$ 28.0mn
52wk high/low	Rs 3,023/Rs 2,225
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	305,212	345,898	371,622
EBITDA (Rs mn)	52,802	49,301	44,551	43,622	48,972
Adj. net profit (Rs mn)	36,974	33,849	32,352	32,380	36,285
Adj. EPS (Rs)	185.1	169.5	162.0	162.1	181.7
Adj. EPS growth (%)	9.5	(8.5)	(4.4)	0.1	12.1
Adj. ROAE (%)	31.4	26.3	21.8	20.3	21.0
Adj. P/E (x)	12.2	13.3	13.9	13.9	12.4
EV/EBITDA (x)	7.7	7.9	8.8	9.2	8.0

Source: Company, BOBCAPS Research

BUY
TP: Rs 205 | ⮝ 49%

GREENPLY INDUSTRIES | Construction Materials | 20 February 2020

Demand slows but margins resilient

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We recently hosted a roadshow with the management of Greenply Industries (GIL). Following are the key takeaways:

- GIL saw a slowdown in plywood demand during Q3FY20 due to the weak macro climate. Tight liquidity coupled with working capital discipline further dampened sales. Working capital control led the company to forego Rs 150mn-200mn in Q3 revenue.
- During 9MFY20 in India, premium plywood revenue was flat, the Ecotec brand grew at ~4% and decorative veneer at 36% YoY.
- Management is targeting 4-4.5% growth in the India plywood business in FY20. Decorative veneer is expected to clock revenue of Rs 1.15bn-1.2bn vs. Rs 900mn in FY19 due to ramp-up of the Rajkot facility. Peak turnover at this unit is pegged at Rs 1.7bn-1.8bn which GIL hopes to achieve by FY23.
- With no significant pricing pressure on raw material, management believes operating margins in the India business can be maintained at ~11%.
- GIL's biggest market is South India (~35% of revenue) followed by the North (23%) and West (22%), with 20% coming from East India.
- Gabon revenues declined in Q3FY20 due to lower demand in India. To mitigate the slowdown, GIL is raising its focus on Europe and Southeast Asia. Revenues from Europe accounted for 13% of Gabon's turnover in Q3 (vs. 1% YoY) whereas Southeast Asia contributed 27% (vs. 4% YoY).
- Gurjan face veneer prices have declined in recent months, in turn putting pressure on prices of Okume veneer in Indian markets.
- GIL expects Gabon operations to deliver FY20 revenues of Rs 1.45bn-1.5bn (+17% YoY) accompanied by 17.5-18% EBITDA margins.
- GIL plans to lower the standalone working capital cycle by 4-5 days to 84-85 days by end-FY20.
- FY20 capex plans for Gabon operations total Rs 220mn and for India operations Rs 160mn. Going ahead, capex in India would be limited to maintenance outlay of ~Rs 160mn.

Ticker/Price	MTLM IN/Rs 137
Market cap	US$ 235.2mn
Shares o/s	123mn
3M ADV	US$ 0.1mn
52wk high/low	Rs 195/Rs 112
Promoter/FPI/DII	52%/11%/37%

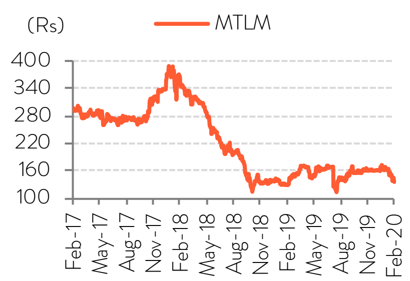
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY20E	FY21E	FY22E
Total revenue (Rs mn)	14,764	16,417	18,080
EBITDA (Rs mn)	1,747	1,987	2,208
Adj. net profit (Rs mn)	996	1,216	1,397
Adj. EPS (Rs)	8.1	9.9	11.4
Adj. EPS growth (%)	16.9	22.2	14.8
Adj. ROAE (%)	26.7	26.6	25.1
Adj. P/E (x)	16.9	13.8	12.0
EV/EBITDA (x)	12.2	9.6	8.6

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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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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