FIRST LIGHT

26 September 2019

RESEARCH

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Gains from tax cuts – PSUs, gas utilities top bets

Infrastructure

Corporate tax cut an earnings booster; HG Infra to gain the most

Logistics

Tax cut may have limited benefits; demand challenges persist

SUMMARY

Oil & Gas

The tax rate cut announced by the government will be earnings accretive by 6-15% for energy companies in our coverage universe. Most of these, being PSUs (or owned by PSUs), would pass the gains on as dividend payouts. RIL may retain the benefit due to its limited earnings delta. However, fair value changes will not be commensurate with the earnings uptick considering differing valuation methodologies – gas utilities stand to gain the most (DCF-based valuations), followed by upstream players; OMCs and RIL gain the least.

Click here for the full report.

Infrastructure

The corporate tax reduction announced last week will bump up standalone EPS by 2-13% for our infrastructure universe over FY20-FY22, with HGIEL benefiting the most. EPS accretion could be lower should developers choose to cede some of the advantage towards more competitive project bids. The tax cut proves timely for the sector as most companies were heading for a full tax regime by FY21, upon expiry of 80IA exemptions. Also, attendant benefits of enhanced cash flows and lower working capital should pump up IRRs of operational assets by 50-100bps.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	555
GAIL	Buy	200
ONGC	Buy	200
TCS	Add	2,360
HPCL	Sell	200

MID-CAP IDEAS

Company	Rating	Target
Balkrishna Ind	Buy	1,290
Future Supply	Buy	730
Greenply Industries	Buy	195
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.65	(8bps)	11bps	(145bps)
India 10Y yield (%)	6.78	3bps	21bps	(135bps)
USD/INR	71.02	(0.1)	0.9	2.3
Brent Crude (US$/bbl)	63.10	(2.6)	6.3	(22.9)
Dow	26,808	(0.5)	4.6	1.2
Shanghai	2,985	0.3	3.0	7.3
Sensex	39,097	0	6.5	6.7
India FII (US$ mn)	**23 Sep**	**MTD**	**CYTD**	**FYTD**
FII-D	(61.0)	115.4	4,362.6	3,817.9
FII-E	395.4	(375.2)	6,830.9	(14.3)

Source: Bank of Baroda Economics Research

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Logistics

Our industry interactions suggest that while the recent corporate tax sop will aid earnings of select logistics companies within our coverage, the benefits may not be proportional to the cut as large corporate clients likely negotiate for better pricing. Four of our coverage stocks – TCIEXP, MLL, CCRI and FSCSL – could see earnings uptick ranging between 1-10%. Accordingly, we change our TP, but maintain rating across companies. MLL, TCIEXP and FSCSL remain top long-term, fundamental picks, while TRPC is our top value pick.

Click here for the full report.

OIL & GAS

25 September 2019

Gains from tax cuts – PSUs, gas utilities top bets

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The tax rate cut announced by the government will be earnings accretive by 6-15% for energy companies in our coverage universe. Most of these, being PSUs (or owned by PSUs), would pass the gains on as dividend payouts. RIL may retain the benefit due to its limited earnings delta. However, fair value changes will not be commensurate with the earnings uptick considering differing valuation methodologies – gas utilities stand to gain the most (DCF-based valuations), followed by upstream players; OMCs and RIL gain the least.

PSUs to pass on the gains: Earnings for all the energy PSUs are expected to surge by ~15% from FY20, as they were at the full 33% tax rate until FY19. However, from a valuation perspective, upstream companies (ONGC/ Oil India) gain the most, as we have based their fair value calculations on cash earnings multiples. OMC valuations change the least as these are derived from EBITDA multiples (for cyclical businesses). A common thread across PSUs would be an increase in dividend payouts, as none of these companies are likely to retain the earnings gains. Our preferred picks are ONGC, OINL and IOCL, all of which are attractively valued at 6-7x FY21E EPS.

Gas utilities to gain the most: Earnings for gas utilities are expected to surge by an average of ~12%, with GAIL and Indraprastha Gas (IGL) gaining the most (~15%). Our valuations being DCF-based for most companies (SOTP for GAIL includes DCF for pipelines), the fair values across utilities improve closely in line with earnings (implying GAIL and IGL are the most attractive bets on tax cuts). Considering most of these companies have aggressive capex plans due to their improving volume prospects, a bulk of the incremental earnings would be ploughed back into the business (GAIL could be an exception, being a PSU).

Limited gains for RIL: RIL's FY19 tax rate at 28% (consolidated financials) was one of the lowest in our coverage universe, and management guidance over FY20-FY22 has been at ~25%. Hence, earnings change from the tax rate proposal is marginal. Considering the recent uptick in global GRMs, we now raise RIL's GRM estimates to US$ 12/bbl for FY20/FY21 (from US$ 11), leading to a ~5% increase in FY20/21 earnings. Consumer-facing businesses (RJio and Retail) gain the most from tax cuts and could amplify valuation expectations if RIL were to plan an IPO for these businesses (especially Retail). Cyclical business valuations remain unchanged as they are based on EBITDA multiples.

TOP PICKS

Ticker	Price	Target	Rating
RIL IN	1,280	1,500	BUY
GAIL IN	137	200	BUY
PLNG IN	259	380	BUY
ONGC IN	132	200	BUY
IGL IN	349	455	BUY
GUJGA IN	176	270	BUY

Price & Target in Rupees

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INFRASTRUCTURE

25 September 2019

Corporate tax cut an earnings booster; HG Infra to gain the most

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The corporate tax reduction announced last week will bump up standalone EPS by 2-13% for our infrastructure universe over FY20-FY22, with HGIEL benefiting the most. EPS accretion could be lower should developers choose to cede some of the advantage towards more competitive project bids. The tax cut proves timely for the sector as most companies were heading for a full tax regime by FY21, upon expiry of 80IA exemptions. Also, attendant benefits of enhanced cash flows and lower working capital should pump up IRRs of operational assets by 50-100bps.

EPS boost of 2-14% from tax cut: Within our coverage universe, HG Infra (HGIEL) falls under the full tax bracket (35% incl. cess) and hence is expected to see the biggest 13% earnings upside. However, we cut our TP on the stock to Rs 395 vs. Rs 405 on sector headwinds and rollover. For the rest of our coverage, a winding down of orders carrying 80IA benefits would have put most players under the full/higher tax regime by FY21 (barring KNR Constructions which has a Rs 7bn backlog qualifying for 80IA). Now, they will shift instead to the new tax rate of 25.2%, resulting in better cash flows and controlled leverage.

We estimate a 2-13% boost to standalone earnings for our coverage companies over FY20-FY22 and a 50-100bps rise in IRR for their operational assets (BOT) housed in SPVs, thus raising the latter's appeal for financial investors.

Competitive bidding could erode EPS benefit: While existing contracts are unlikely to be renegotiated, the tax cut advantage could be ceded by contractors/developers in order to make bids for future projects more competitive. While we await management commentary on this front, we believe delayed order placement by NHAI will keep competition stiff, resulting in aggressive bidding and some erosion of the anticipated EPS upside.

Targets revised; PNCL remains top pick: Order awarding for NHAI's Rs 600bn bid pipeline could pick up from Oct-Nov'19, per our company checks. Led by near-term headwinds of delayed ordering and tardy award of appointed dates, we cut the one-year forward P/E multiple across our coverage by 1-2x. Baking in the tax cut and rolling over to Sep'21 valuations, we have new targets for Dilip Buildcon (Rs 610 vs. Rs 600), HGIEL (Rs 395 vs. Rs 405), KNRC (Rs 360 vs. Rs 350) and Sadbhav Engg (Rs 175 vs. Rs 180). Our long-term positive stance on the sector holds; reiterate PNC Infra, KNRC, HGIEL, Ashoka Buildcon as top picks.

KEY RECOMMENDATIONS

Ticker	Price*	Target	Rating
ASBL IN	110	185	BUY
DBL IN	438	610	BUY
HGINFRA IN	197	395	BUY
KNRC IN	231	360	BUY
PNCL IN	190	250	BUY
SADE IN	139	175	BUY

Price & Target in Rupees | *CMP as on 24-Sep.
HGINFRA = HGIEL

ORDER BACKLOG as of Jun'19

Ticker	OB (Rs bn)	Book-to-bill (x)	Executable (%)
ASBL IN	90.4	2.4	75.3
DBL IN	190.3	2.1	75.5
HGINFRA IN	57.1	2.7	56.6
KNRC IN	65.2	3.2	71.1
PNCL IN	118.9	3.2	92.1
SADE IN	108.1	3.1	74.2

Source: Company, BOBCAPS Research

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LOGISTICS

25 September 2019

Tax cut may have limited benefits; demand challenges persist

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Our industry interactions suggest that while the recent corporate tax sop will aid earnings of select logistics companies within our coverage, the benefits may not be proportional to the cut as large corporate clients likely negotiate for better pricing. Four of our coverage stocks – TCIEXP, MLL, CCRI and FSCSL – could see earnings uptick ranging between 1-10%. Accordingly, we change our TP, but maintain rating across companies. MLL, TCIEXP and FSCSL remain top long-term, fundamental picks, while TRPC is our top value pick.

Earnings benefit unlikely to be commensurate with tax cut: Our industry checks suggest that logistics service providers with large corporate clientele may face negotiations on pricing, as the latter look to have the tax cut benefit passed on to their customers. Working capital benefits will also vary – FTL/asset-light players with low margins are unlikely to readily benefit till TDS incidence is lowered (~2%/10% for transportation/warehousing currently), while express/LTL players should profit from lower advance tax.

Earnings accretion in varying degrees: From our coverage universe, TCI Express (TCIEXP) and Mahindra Logistics (MLL) fall in the full tax bracket and are hence best placed to benefit. But we expect competitive pressure and client renegotiation to limit the earnings increase to 10%/1% for TCIEXP/MLL. Future Supply Chain (FSCSL) has nil tax liability in FY20, but is likely to benefit from FY21. Given its ~28% tax rate in FY19, the earnings boost for Container Corp is estimated at only 4%. Transport Corp (TRPC) and Allcargo (AGLL) will not see any impact as they are in the 18-22% tax bracket.

Targets increased, ratings maintained: We raise our Jun'20 target prices for TCIEXP, MLL and FSCSL by 7%, 2%, and 2% respectively, building in the tax impact. For CCRI, we move to a TP of Rs 575 from Rs 530, factoring in the earnings upgrade and a slight increase in one-year forward P/E.

Demand climate remains subdued: Some logistics stocks have rallied over the past few days, bolstered by the tax cut and progress on the national draft logistics policy. However, we reiterate our cautious near-term view on the sector where demand remains feeble, as evidenced by weak market indicators (EXIM trade, major port volumes, container rail traffic). We expect most logistics companies to miss Q2FY20 estimates, sparking earnings downgrades.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
AGLL IN	109	125	BUY
CCRI IN	581	575	ADD
FSCSL IN	527	730	BUY
MAHLOG IN	387	525	BUY
TCIEXP IN	700	840	BUY
TRPC IN	290	365	BUY

Price & Target in Rupees | Price as of 24-Sep | MAHLOG = MLL

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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