FIRST LIGHT

27 September 2019

RESEARCH

Top picks

- **Mid-cap ideas** – Balkrishna Industries replaced by **Alkem Labs** (see **Corporate tax cut – bonanza for healthcare services**)

Banking

Tax cut to bolster earnings

Midcaps

Tax cut benefits capped by demand headwinds

Mahindra Logistics | Target: Rs 525 | +41% | BUY

Meeting takeaways: Reiterates growth plan; technology to the fore

Banking | Credit Tracker

Business momentum remains sluggish

SUMMARY

Banking

The corporate tax cut provides much needed cheer for banks under our coverage – we raise FY21-FY22 earnings by 2-14% and ROE estimates by 30-220bps, but believe the near-term impact is already in the price. Also, the sustainability of higher ROE is debatable as banks may concede some of the gains to spur loan growth. Corporate banks such as AXSB and ICICIBC could also witness a one-time hit on EPS upon DTA reversal. We retain ICICIBC as our top pick and upgrade HDFCB to BUY.

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
Alkem Labs	Buy	2,230
Future Supply	Buy	730
Greenply Industries	Buy	200
Laurus Labs	Buy	480
PNC Infratech	Buy	250

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	1.74	9bps	20bps	(131bps)
India 10Y yield (%)	6.76	(2bps)	28bps	(131bps)
USD/INR	71.04	0	1.4	2.2
Brent Crude (US$/bbl)	62.39	(1.1)	6.3	(23.3)
Dow	26,971	0.6	4.1	2.2
Shanghai	2,955	(1.0)	3.2	5.3
Sensex	38,594	(1.3)	2.9	5.6
India FII (US$ mn)	**24 Sep**	**MTD**	**CYTD**	**FYTD**
FII-D	(26.7)	88.7	4,335.9	3,791.3
FII-E	(105.4)	(480.7)	6,725.4	(119.8)

Source: Bank of Baroda Economics Research

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Midcaps

We upgrade FY20 earnings by 2-11% for midcap companies under our coverage post the recent corporate tax cut. Top gainers include SI (11%), FNXP (10%), VMART (10%) and PIDI (9%). Our estimates are adjusted for pass-along of partial benefits to customers as companies look to perk up stagnating demand and deliver on growth targets, especially in the high-competition tile, plywood, PVC pipe and retail segments. GIL and CRS remain our preferred picks in the midcap space.

Click here for the full report.

Mahindra Logistics

We interacted with Mahindra Logistics' (MLL) CEO designate Rampraveen Swaminathan who will assume the role of CEO from Oct 1. Key highlights: (1) growth strategy unchanged, (2) technology push underway, and (3) thrust on building sustainable revenue streams.

Click here for the full report.

Banking: Credit Tracker

RBI data shows that credit and deposit growth for the fortnight ended 13 September were both weak at 10% YoY. Credit growth has been moderating over the past few quarters due to anaemic corporate demand, sluggish lending to NBFCs and a slowdown in unsecured retail credit. Investment growth was bleak at ~3% YoY while SLR held at ~26%. Loan growth is expected to remain elusive in FY20 despite the shift in pricing power to banks from NBFCs.

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BANKING

26 September 2019

Tax cut to bolster earnings

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The corporate tax cut provides much needed cheer for banks under our coverage – we raise FY21-FY22 earnings by 2-14% and ROE estimates by 30-220bps, but believe the near-term impact is already in the price. Also, the sustainability of higher ROE is debatable as banks may concede some of the gains to spur loan growth. Corporate banks such as AXSB and ICICIBC could also witness a one-time hit on EPS upon DTA reversal. We retain ICICIBC as our top pick and upgrade HDFCB to BUY.

Near-term impact of tax cut priced in: The government has reduced the marginal/effective tax rate to 22%/25.6% vs. 30%/34.9% earlier. We see banks that operated near the marginal tax rate, especially retail players such as HDFC Bank (HDFCB) and IndusInd Bank (IIB), benefiting the most from this reduction. However, the rally in financial stocks after the tax announcement last week appears to have priced in most of the near-term benefits.

Premature to gauge sustainable ROE uplift: We do see a positive impact on financials of banks under our coverage as the tax cut drives a 2-14% increase in EPS and a 30-220bps spike in our ROE estimates for FY21-FY22. But the odds of long-term sustainable improvement in ROE are debatable. In our view, the tax cut may lead to pickup in economic activity, but this will only come with a lag given that most capex-heavy sectors are either facing financial stress or deficient demand. Further, banks may pass on some of the tax benefit to spur loan growth, which could claw back much of the ROE improvement over the long run.

DTA reversal to hurt FY20 earnings: Banks, especially corporate players such as Axis (AXSB) and ICICI Bank (ICICIBC), that faced NPA woes over the past few years have large outstanding deferred tax assets (DTA) on their balance sheets. DTA was created due to the write-off policy on bad loans, assuming a marginal tax rate of ~34%. Rebasing to the new level of ~26% may result in a one-time hit for banks as the markdown impact will pass through the P&L in FY20.

Upgrade HDFCB to BUY; retain ICICIBC as top pick: HDFCB, IIB and AXSB have the biggest ROE upsides of banks under our coverage. We roll our target prices over to Sep'20 and upgrade HDFCB from ADD to BUY. However, we retain ICICIBC as our top pick given receding asset quality pangs, normalising credit costs and reviving loan growth.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
AXSB IN	700	950	BUY
HDFCB IN	1,246	1,440	BUY
ICICIBC IN	452	525	BUY
IIB IN	1,548	1,850	BUY
SBIN IN	282	360	BUY
YES IN	51	50	SELL

Price & Target in Rupees

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MIDCAPS

26 September 2019

Tax cut benefits capped by demand headwinds

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We upgrade FY20 earnings by 2-11% for midcap companies under our coverage post the recent corporate tax cut. Top gainers include SI (11%), FNXP (10%), VMART (10%) and PIDI (9%). Our estimates are adjusted for pass-along of partial benefits to customers as companies look to perk up stagnating demand and deliver on growth targets, especially in the high-competition tile, plywood, PVC pipe and retail segments. GIL and CRS remain our preferred picks in the midcap space.

Earnings upgrade of 2-11%: Following the government announcement slashing corporate tax rates from 34.9% to 25.6% (incl. surcharge), we upgrade earnings estimates for midcap companies under our coverage by 2-11% from FY20. Supreme Infra (SI, 11%), Finolex Industries (FNXP, 10%), V-Mart (V-MART, 10%) and Pidilite Industries (PIDI, 9%) will see the biggest upsides. Century Ply sees no change as it was already at a low tax rate.

Upgrades not commensurate with rate cuts: We do not expect the entire tax benefit to percolate to earnings, as our coverage companies likely pass along a portion of the benefit to the distribution chain/consumers and also plough some into added promotion or branding activity to revive demand. Per our industry interactions, this trend is likely to be more pronounced in segments facing high competition such as tiles, plywood, PVC pipes and retail, as also in companies with higher B2B sales.

Target price changes across the board, ratings maintained: We raise target prices across our midcap universe to bake in the tax impact, but leave ratings unchanged. We also cut our target multiple on Somany Ceramics to 15x (~25% discount to five-year average fwd P/E) due to recent lapses in systems and processes accompanied by continued demand headwinds, but retain BUY on cheap valuations.

Greenply and Cera top picks: Greenply Industries (GIL, TP: Rs 200, BUY) and Cera Sanitaryware (CRS, TP: Rs 3,135, BUY) are our preferred picks in the midcap space despite the tepid near-term demand environment, due to their strong balance sheets and reasonable valuations.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
KJC IN	569	650	BUY
SOMC IN	195	340	BUY
MTLM IN	162	200	BUY
CPBI IN	155	200	BUY
CRS IN	2,697	3,135	BUY
ASTRA IN	1,182	1,005	REDUCE
FNXP IN	576	610	ADD
SI IN	1,194	1,210	ADD
PIDI IN	1,439	1,240	SELL
MUNI IN	216	335	BUY
VMART IN	2,149	2,030	SELL

Price & Target in Rupees | MTLM = GIL

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BUY
TP: Rs 525 | ⮝ 41%

MAHINDRA LOGISTICS | Logistics | 26 September 2019

Meeting takeaways: Reiterates growth plan; technology to the fore

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We interacted with Mahindra Logistics' (MLL) CEO designate Rampraveen Swaminathan who will assume the role of CEO from Oct 1. Key highlights: (1) growth strategy unchanged, (2) technology push underway, and (3) thrust on building sustainable revenue streams.

- Swaminathan has over two decades of experience in B2B businesses across auto, capital goods and paper, spanning large corporate names and both domestic and international operations.
- MLL's growth strategy will remain focused on growing non-Mahindra business, warehousing- and distribution logistics-led growth, and maintaining an asset-light business model.
- Management believes existing businesses – 3PL, shared mobility and freight forwarding – have healthy growth potential. Consolidating its position in these businesses remains a key short-term priority.
- Technology will play a key role in helping the company deliver more efficient and newer services to customers. Leveraging technology, MLL aims to (1) augment network optimisation in transportation; (2) integrate warehousing systems and secondary distribution; and (3) drive fleet, network and roster optimisation in the shared mobility/PTS segment.
- In the non-Mahindra auto segment, inbound and in-factory logistics offer vast potential. At present, MLL has only three clients that avail of in-factory logistics services, which indicates headroom for growth. Management expects to add auto component clients, a focus area, once demand improves.
- Consumer and pharma companies are gradually transitioning to 3PL, led by MNCs. Wallet share gain and client addition has led to 20%+ YoY growth in this vertical for the company in Q1FY20. In e-commerce vertical, MLL is striving to raise share in customer's logistics spend. It recently added Asian Paints to its client roster.
- Management is optimistic about festive season demand and a growth uptrend in H2FY20.
- **Our view:** Near-term growth obstacles notwithstanding, we remain positive on MLL's long-term prospects. Reiterate BUY with a Jun'20 TP of Rs 525.

Ticker/Price	MAHLOG IN/Rs 372
Market cap	US$ 375.0mn
Shares o/s	71mn
3M ADV	US$ 0.4mn
52wk high/low	Rs 578/Rs 324
Promoter/FPI/DII	59%/10%/13%

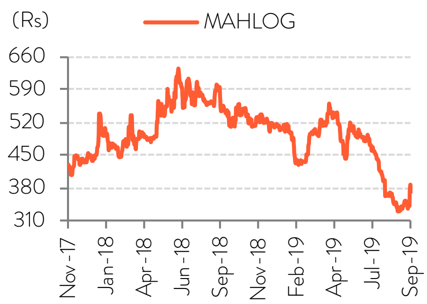
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY20E	FY21E	FY22E
Total revenue (Rs mn)	38,957	44,392	51,380
EBITDA (Rs mn)	1,436	1,928	2,404
Adj. net profit (Rs mn)	969	1,304	1,628
Adj. EPS (Rs)	13.6	18.2	22.8
Adj. EPS growth (%)	13.1	34.5	24.9
Adj. ROAE (%)	18.1	21.0	22.9
Adj. P/E (x)	27.5	20.4	16.3
EV/EBITDA (x)	17.8	12.8	10.2

Source: Company, BOBCAPS Research

STOCK PERFORMANCE



Source: NSE

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BANKING | Credit Tracker | 26 September 2019

Business momentum remains sluggish

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RBI data shows that credit and deposit growth for the fortnight ended 13 September were both weak at 10% YoY. Credit growth has been moderating over the past few quarters due to anaemic corporate demand, sluggish lending to NBFCs and a slowdown in unsecured retail credit. Investment growth was bleak at ~3% YoY while SLR held at ~26%. Loan growth is expected to remain elusive in FY20 despite the shift in pricing power to banks from NBFCs.

Deposit growth remains at 10%: Deposit growth for the fortnight ended 13 September held at 10% YoY, in keeping with the trend seen over the past couple of quarters. Deposit growth continues to lag credit growth which we believe has lent banks an opportunity to marginally lower their term deposit rates over the last few months. In absolute terms, deposits declined by Rs 0.6tn FoF to Rs 127tn.

Credit growth remains subdued: As per RBI data, credit growth for the fortnight ended 13 September grew 10% YoY. In absolute terms, credit offtake grew by Rs 0.2tn FoF to Rs 97tn. RBI data on sectoral deployment of credit for Jul'19 suggests that while corporate loan growth was low at 6.1% YoY, it is showing gradual signs of revival. Retail loan growth at 17% YoY for Jul'19 has reduced by ~200bps from its recent peak in Apr'18 given slower growth in unsecured retail credit products such as credit cards.

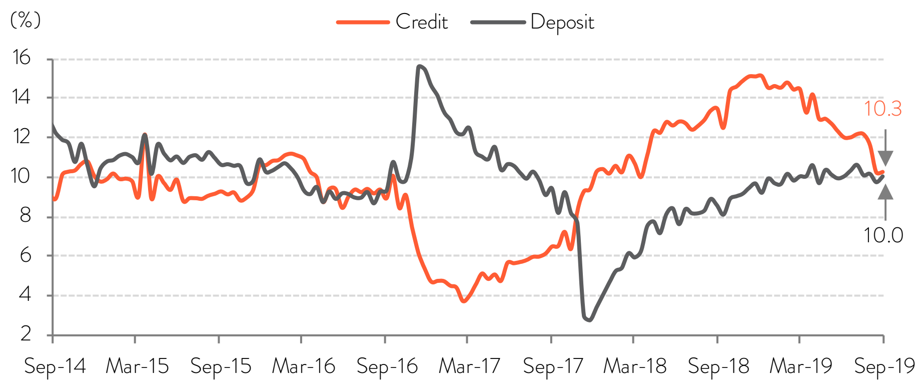
Expect sub-15% loan growth in FY20: We do not expect any material improvement in credit growth for FY20. However, market share gains by private banks are likely to continue.

KEY DATA

Particulars	14-Sep-18	13-Sep-19
Deposits (Rs trn)	115.6	127.2
YoY growth (%)	8.5	10.0
YTD growth (%)	1.2	1.2
Loans (Rs trn)	88.0	97.0
YoY growth (%)	13.5	10.3
YTD growth (%)	2.0	(0.7)
CD ratio (%)	76.1	76.2
SLR ratio (%)	27.9	26.3

Source: RBI, BOBCAPS Research

FIG 1 – CREDIT AND DEPOSIT GROWTH IN BANKING SYSTEM



Source: RBI, 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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