FIRST LIGHT

30 July 2019

RESEARCH

Dr Reddy's Labs | Target: Rs 2,900 | +9% | ADD

Adj. EBITDA in line; upgrade to ADD on reasonable valuations

Reliance Industries | Target: Rs 1,335 | +10% | ADD

Diversification now bearing fruit

BOB Economics Research | Weekly Wrap

Awaiting US Fed stance

Supreme Industries | Target: Rs 1,135 | +6% | ADD

Good volume growth but margins underperform

SUMMARY

Dr Reddy's Labs

Q1 reported 18% EBITDA miss impacted by one-offs in gross margins (PSAI & inventory write-offs in US totaling US$20mn, in my view), while adj. EBITDA was in line. Management expects PSAI weakness to reverse in coming quarters. Gross margins in the global generics rose 170bps QoQ (from lows of 55.9%), led by a better US and India mix. We roll over to a Sep'20 TP of Rs 2,900 (from Rs 2,800) and upgrade to ADD (from REDUCE) on reasonable valuations. DRRD continues to expect >30 launches in the US & cost savings in FY20.

Click here for the full report.

Reliance Industries

Reliance Industries' (RIL) FY19 Annual Report spells out its vision across its diversified businesses, viz.: (a) enhance oil-to-chemicals conversion ratio to >70% to hedge against potential EV-led oil demand transition; (b) to consequently enhance petrochemicals output; (c) maintain revenue growth traction in retail to augment market share (US$ 67bn organised retail market); and (d) RJio to target replicating wireless penetration in wireline (FTTH), enhancing ARPUs. We maintain ADD on near-term macro challenges.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Cipla	Buy	630
GAIL*	Buy	245
ONGC	Buy	230
TCS	Add	2,360
HPCL	Sell	210

*GAIL target price is adjusted for the 1:1 bonus issue

MID-CAP IDEAS

Company	Rating	Target
Balkrishna Ind	Buy	1,290
Future Supply	Buy	780
Greenply Industries	Buy	245
Laurus Labs	Buy	495
PNC Infratech	Buy	235

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	2.07	(1bps)	2bps	(88bps)
India 10Y yield (%)	6.52	1bps	(41bps)	(126bps)
USD/INR	68.90	0.2	0.4	(0.4)
Brent Crude (US$/bbl)	63.46	0.1	(4.6)	(14.6)
Dow	27,192	0.2	2.5	6.8
Shanghai	2,945	0.2	(1.1)	2.5
Sensex	37,883	0.1	(4.3)	1.5
India FII (US$ mn)	**25 Jul**	**MTD**	**CYTD**	**FYTD**
FII-D	4.8	1,274.5	2,702.8	2,158.2
FII-E	77.6	(2,005.2)	9,333.7	2,488.5

Source: Bank of Baroda Economics Research

BOBCAPS Research
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India Economics: Weekly Wrap

ECB held policy rates steady but emphasised that low inflation will call for more accommodation even though recession fear is low. US' Q2 GDP was a tad bit lower at 2.1% vs 3.1% in Q1 led by exports and investment. Consumption held up and US yields went up. On the domestic front, uncertainty over RBI rate cut, sovereign bond issue and rise in oil prices led to 10Y bond yield rising by 16bps. However, yields fell today as FM commented on room for rate cuts and continuation of sovereign bond issue. US Fed will drive markets this week.

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Supreme Industries

Supreme Industries (SI) reported below-expected Q1FY20 revenue growth of 6.8% YoY despite a healthy 13.5% rise in volumes. EBITDA margins contracted 215bps YoY to 11.6% due to higher raw material cost (+125bps) and other expenditure (+80bps), which led to EBITDA/adj. PAT declines of 10%/16.5% YoY. Management has guided for revenue growth of 12-15% with operating margins of 13.5-14.5% in FY20. We pare FY20/FY21 earnings estimates by ~3% each and roll over to a revised Jun'20 TP of Rs 1,135 (earlier Rs 1,120).

Click here for the full report.

ADD
TP: Rs 2,900 | ⮝ 9%

DR REDDY'S LABS | Pharmaceuticals | 29 July 2019

Adj. EBITDA in line; upgrade to ADD on reasonable valuations

Q1 reported 18% EBITDA miss impacted by one-offs in gross margins (PSAI & inventory write-offs in US totaling US$20mn, in my view), while adj. EBITDA was in line. Management expects PSAI weakness to reverse in coming quarters. Gross margins in the global generics rose 170bps QoQ (from lows of 55.9%), led by a better US and India mix. We roll over to a Sep'20 TP of Rs 2,900 (from Rs 2,800) and upgrade to ADD (from REDUCE) on reasonable valuations. DRRD continues to expect >30 launches in the US & cost savings in FY20.

Vivek Kumar
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Upgrade to ADD: The stock has performed in line with our expectations since we initiated coverage in Nov'18 (REDUCE, TP Rs 2710). We now upgrade our rating based on stabilising US base business, nearing monetisation of key assets (gNuvaring: Q4FY20 / Copaxone: Q1FY21), and cost control in SGA. This together fuels a ~5% increase in FY21 EPS while we cut our FY20 estimate by 2% due to the risk of inventory write-off in the US. We roll over to a Sep'20 TP of Rs 2,900 and see reasonable upside in the stock. Early Srikakulam API resolution and gRevlimid & gVimovo launches are upside risks to our estimates.

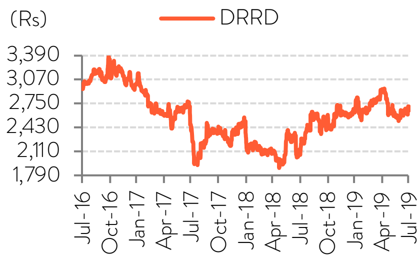
Good scale-up in US sales; India grew 14% YoY: DRRD clocked US$ 234mn in US sales, up 10% QoQ, led by Daptomycin injectable, Isotretinoin relaunch and Suboxone. The company's FY20 launch target of >30 ANDAs is on track with ramp-up likely in H2 led by gNuvaring. We expect gross margins to head up from Q2 with normalising PSAI sales and lower inventory write-offs vs. Q1.

Key earnings call takeaways: (1) R&D spend to stay within US$ 250mn-300mn range. (2) gNuvaring – goal date due in coming weeks; expect additional queries from USFDA. (3) Srikakulam/CTO-6 reinspection expected soon. (4) Other income includes Revlimid settlement income of Rs 3.5bn. (5) DRRD has 10% market share in gSuboxone.

Ticker/Price	DRRD IN/Rs 2,654
Market cap	US$ 6.4bn
Shares o/s	166mn
3M ADV	US$ 25.9mn
52wk high/low	Rs 2,964/Rs 1,873
Promoter/FPI/DII	27%/27%/18%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	9,404	17,895	21,010	25,171	27,249
Adj. EPS (Rs)	56.7	107.8	126.6	151.6	164.2
Adj. EPS growth (%)	(20.1)	90.3	17.4	19.8	8.3
Adj. ROAE (%)	7.7	13.8	14.3	15.0	14.4
Adj. P/E (x)	46.8	24.6	21.0	17.5	16.2
EV/EBITDA (x)	20.6	15.0	12.0	10.5	9.5

Source: Company, BOBCAPS Research

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ADD
TP: Rs 1,335 | ⮝ 10%

RELIANCE INDUSTRIES | Oil & Gas | 29 July 2019

Diversification now bearing fruit

Reliance Industries' (RIL) FY19 Annual Report spells out its vision across its diversified businesses, viz.: (a) enhance oil-to-chemicals conversion ratio to >70% to hedge against potential EV-led oil demand transition; (b) to consequently enhance petrochemicals output; (c) maintain revenue growth traction in retail to augment market share (US$ 67bn organised retail market); and (d) RJio to target replicating wireless penetration in wireline (FTTH), enhancing ARPUs. We maintain ADD on near-term macro challenges.

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Refining – enhancing oil to chemicals: The complexity index of RIL's Jamnagar integrated refinery has been enhanced to 21.1 (from 12.7) after the commissioning of integrated projects such as ROGC, PX expansion and petcoke gasifiers. Over the long term, RIL intends to enhance oil to chemicals conversion at its refinery to over 70%, eventually nullifying the output of all road transportation fuels (gasoline, diesel) and converting them to petrochemicals.

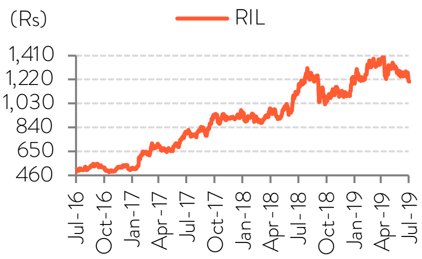
Petrochemicals – near-term headwinds, long-term capex driver: Record production in FY19 (37.7mmtpa) could be difficult to repeat in FY20 considering emerging macro headwinds. New capacities (ROGC/PX), ethane imports and a crash in LNG prices were primary margin drivers in FY19 (EBITDA at US$ 141/MT, +8% YoY). However, this segment seems to be the most insulated from the threat of EVs, considering polymers/polyesters are part of diverse building blocks of economic activity.

Our view: In our view, RIL's strategy to enhance the oil-to-chemicals ratio would entail setting up 40-45mmtpa of petchem capacities over 10 years (capex of ~US$ 30bn), forming the next large capex wave for the company after RJio. Assuming RIL's management continues with its asset-light strategy, we won't be surprised if it dilutes stakes in cyclical businesses (Saudi Aramco was at the centre of media speculation recently) to fund this outlay.

Ticker/Price	RIL IN/Rs 1,211
Market cap	US$ 104.3bn
Shares o/s	5,927mn
3M ADV	US$ 158.3mn
52wk high/low	Rs 1,418/Rs 1,016
Promoter/FPI/DII	47%/24%/28%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	352,869	398,370	455,232	586,847	758,312
Adj. EPS (Rs)	59.6	67.2	76.8	99.0	128.0
Adj. EPS growth (%)	17.4	12.8	14.3	28.9	29.2
Adj. ROAE (%)	12.7	11.7	11.2	12.9	14.7
Adj. P/E (x)	20.3	18.0	15.8	12.2	9.5
EV/EBITDA (x)	14.3	10.7	10.4	7.8	6.5

Source: Company, BOBCAPS Research

WEEKLY WRAP

29 July 2019

Awaiting US Fed stance

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ECB held policy rates steady but emphasised that low inflation will call for more accommodation even though recession fear is low. US' Q2 GDP was a tad bit lower at 2.1% vs 3.1% in Q1 led by exports and investment. Consumption held up and US yields went up. On the domestic front, uncertainty over RBI rate cut, sovereign bond issue and rise in oil prices led to 10Y bond yield rising by 16bps. However, yields fell today as FM commented on room for rate cuts and continuation of sovereign bond issue. US Fed will drive markets this week.

Markets

- **Bonds:** Global yields closed mixed. US 10Y yield rose by 2bps (2.07%) amidst better than expected GDP, durable goods orders and buoyant labour market conditions. Crude prices rose by 1.6% (US$ 63/bbl) driven by tensions in Middle East. India's 10Y yield rose by 16bps (6.52%) as uncertainty emerged over sovereign bond issue but started the week on a lower note as FM reaffirmed continuation of the issue and called for rate cut by RBI. System liquidity was in surplus of Rs 1.3tn as on 26 Jul 2019, at the same level as in the previous week.

- **Currency:** Except CNY, other global currencies closed lower this week. DXY rose for the second straight week (+0.9%) as US macro data (GDP, durable goods orders and jobless claims) surprised positively. EUR depreciated by (-) 0.9% as flash PMIs signalled a further slowdown in the region. GBP was weighed down by Brexit concerns. INR depreciated by (-) 0.1% in the week led by higher oil prices and FII outflows of US$ 733mn.

- **Equity:** Barring Sensex, other global indices closed the week higher. This was on the back of ECB's dovish stance and the same being expected by US Fed. Dow rose by 0.1% supported by strong corporate earnings. European indices too ended in green. However, Sensex ended the week in red (-1.2%) led by muted corporate earnings and persistent selling by FII.

- **Upcoming key events:** In the current week, markets await policy decisions by US Fed, BoE and BoJ. Apart from that, markets will also carefully read global manufacturing PMIs, Euro Area GDP print, US non-farm payroll data, unemployment rate and factory orders. On the domestic front, eight core index and fiscal deficit data are scheduled for release.

RESULT REVIEW

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ADD
TP: Rs 1,135 | ⮝ 6%

SUPREME INDUSTRIES | Plastic Products | 29 July 2019

Good volume growth but margins underperform

Supreme Industries (SI) reported below-expected Q1FY20 revenue growth of 6.8% YoY despite a healthy 13.5% rise in volumes. EBITDA margins contracted 215bps YoY to 11.6% due to higher raw material cost (+125bps) and other expenditure (+80bps), which led to EBITDA/adj. PAT declines of 10%/16.5% YoY. Management has guided for revenue growth of 12-15% with operating margins of 13.5-14.5% in FY20. We pare FY20/FY21 earnings estimates by ~3% each and roll over to a revised Jun'20 TP of Rs 1,135 (earlier Rs 1,120).

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Volume-led revenue growth: SI's revenue grew 6.8% YoY to Rs 14.4bn in Q1 with plastic piping revenues up 20%, whereas industrials/packing products declined 17%/6% YoY. Volume growth came from piping (+22.4%) and packaging (+0.8% YoY), while the industrials and consumer segments fell 16.1%/3.3% YoY, leading to blended growth of 13.5% YoY. The company saw high demand in the agri pipes category. Management has maintained its overall guidance of 8-10% volume growth and 12-15% value growth for FY20.

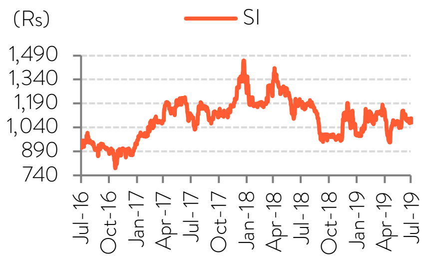
Operating margins slip: SI's operating margins contracted 215bps YoY to 11.6% primarily due to higher raw material cost (+125bps) and other expenditure (+80bps). Gross margins shrank on account of inventory losses in raw material (as prices fell) and also due to higher sales of agri pipes which have lower margins. EBITDA/adj. PAT for the quarter thus decreased 10%/16.5% YoY. Management has lowered its operating margin range to 13.5-14.5% (earlier 13.5-15%) for FY20.

Maintain ADD: We pare FY20/FY21 earnings estimates by ~3% each post the soft Q1 results and move to a revised Jun'20 TP of Rs 1,135. Maintain ADD as we continue to like SI for its strong brand, comprehensive portfolio, wide distribution reach and sound balance sheet.

Ticker/Price	SI IN/Rs 1,075
Market cap	US$ 2.0bn
Shares o/s	127mn
3M ADV	US$ 1.2mn
52wk high/low	Rs 1,275/Rs 938
Promoter/FPI/DII	50%/8%/42%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	4,242	3,683	4,321	5,089	6,011
Adj. EPS (Rs)	33.4	29.0	34.0	40.1	47.3
Adj. EPS growth (%)	0.1	(13.2)	17.3	17.8	18.1
Adj. ROAE (%)	23.6	18.2	19.1	20.3	21.5
Adj. P/E (x)	32.2	37.1	31.6	26.8	22.7
EV/EBITDA (x)	17.2	17.2	15.9	13.9	12.1

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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