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FIRST LIGHT

11 August 2020

RESEARCH

Container Corp of India | Target: Rs 345 | –11% | SELL

Increased land licence fee a massive blow; downgrade to SELL

Finolex Industries | Target: Rs 560 | +24% | BUY

Tough quarter but outlook healthy; raise to BUY on low valuations

BOB Economics Research | Weekly Wrap

Global recovery continues

Mahanagar Gas | Target: Rs 750 | –23% | SELL

Muted volume outlook

Persistent Systems | Target: Rs 740 | –26% | SELL

CEO resigns after short stint; reiterate SELL

SUMMARY

Container Corp of India

Container Corp's (CCRI) Q1FY21 revenue/EBITDA dropped 27%/61% YoY, in line with estimates. The Q1 print was eclipsed by a sharp rise in LLF claim by the Railways at Rs 7.8bn for two terminals vs. CCRI's total estimate of Rs 4.8bn. If implemented, this new LLF policy will erode CCRI's earnings and mar the stake sale process. We have not accounted for the disputed amount in our estimates, but lower our target P/E to 15x (vs. 19x) to factor in the risk. On rollover, we cut our TP to Rs 345 (vs. Rs 415). Downgrade to SELL from REDUCE.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	850
GAIL	Buy	150
Petronet LNG	Buy	305
Tech Mahindra	Buy	780

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	240
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.56	3bps	(10bps)	(115bps)
India 10Y yield (%)	5.89	3bps	11bps	(51bps)
USD/INR	74.94	0	0.1	(6.0)
Brent Crude (US$/bbl)	44.40	(1.5)	2.6	(22.6)
Dow	27,433	0.2	5.2	4.0
Shanghai	3,354	(1.0)	(1.5)	20.0
Sensex	38,041	0	4.7	1.9
India FII (US$ mn)	**6 Aug**	**MTD**	**CYTD**	**FYTD**
FII-D	(61.0)	(115.7)	(14,643.3)	(4,883.8)
FII-E	76.9	1,167.8	(120.3)	6,482.6

Source: Bank of Baroda Economics Research

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Finolex Industries

Finolex Industries' (FNXP) Q1 revenue declined 40% YoY, with volumes sliding 42% in both PVC pipe and resin segments amid the lockdown. EBITDA margins expanded 260bps YoY to 15.7% on higher gross margins and lower other expense. EBITDA/PAT contracted 29%/39% YoY. Management indicated strong demand for agri pipes in Q1 and a gradual pick-up in the non-agri segment too. We raise FY21 earnings by 4% (FY22 unchanged) and roll over to a new Sep'21 TP of Rs 560 (vs. Rs 545). Upgrade from ADD to BUY on reasonable valuations.

Click here for the full report.

India Economics: Weekly Wrap

Global yields rose with macro data surprising positively. Rising exports from China and Germany and expanding global PMIs point to sustained recovery. However, India's recovery has plateaued for now. Global equity markets went up. So was the case for India as FII equity inflows continued. RBI did keep rates on hold with inflation remaining above its tolerance band of 6%. This month too inflation is estimated at 6.2%. Given limited room for easing, RBI did allow dispensation to borrowers to restructure loans.

Click here for the full report.

Mahanagar Gas

Mahanagar Gas's (MAHGL) Q1FY21 PAT underperformed at Rs 0.45bn (–73% YoY). EBITDA margins declined to Rs 7.9/scm (–23% YoY) on a crash in CNG volumes (–78% YoY) and overall volumes disappointed at 101mmscm (–63% YoY). An extended lockdown in the Mumbai region could keep CNG volumes sluggish till Q3FY21. Volume growth revival beyond FY21 also looks challenging given saturation in existing areas of operations. Our TP changes to Rs 750 (from Rs 710) as we roll over to Sep'21. Maintain SELL.

Click here for the full report.

Persistent Systems

In a surprising development, Persistent System's (PSYS) CEO Christopher O'Connor has resigned after a short stint of 1.5 years. The new leadership team had taken over full operations of the company only a year ago in Q1FY20. O'Connor was one of the first non-Indian-origin CEOs of an Indian IT company. He had led IoT business units at IBM previously. Promoter and MD Anand Deshpande is expected to take charge till a new CEO is appointed to ensure stability of operations.

Click here for the full report.

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SELL
TP: Rs 345 | ∀ 11%

CONTAINER CORP OF INDIA | Logistics | 10 August 2020

Increased land licence fee a massive blow; downgrade to SELL

Container Corp's (CCRI) Q1FY21 revenue/EBITDA dropped 27%/61% YoY, in line with estimates. The Q1 print was eclipsed by a sharp rise in LLF claim by the Railways at Rs 7.8bn for two terminals vs. CCRI's total estimate of Rs 4.8bn. If implemented, this new LLF policy will erode CCRI's earnings and mar the stake sale process. We have not accounted for the disputed amount in our estimates, but lower our target P/E to 15x (vs. 19x) to factor in the risk. On rollover, we cut our TP to Rs 345 (vs. Rs 415). Downgrade to SELL from REDUCE.

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In-line quarter: The sharp revenue plunge in Q1 was catalysed by volume/ realisation declines of 21%/8% YoY. Higher land licensing fee (LLF) and operating leverage dragged EBITDA margin down 11ppt YoY to 13.4%. PAT fell 73% YoY to Rs 617mn. CCRI sees headwinds continuing in Q2/Q3, with recovery from Q4FY21, and maintains its guidance of a 20% volume decline in FY21.

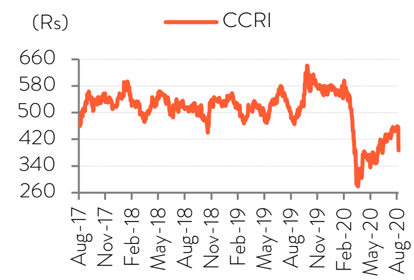
Land licence fee jolt: CCRI received an LLF claim of Rs 7.8bn from the Indian Railways (IR) for its Okhla and Tughlakabad terminals, much higher than its estimate of Rs 4.8bn for all 26 terminals. IR seems to have valued land at ~2x the circle rate, resulting in the steep divergence. CCRI is discussing the matter with the IR and will continue to make LLF provisions as per its own estimations, recognising the claim as a contingent liability till clarity emerges.

Earnings profile could be structurally altered: Though a final decision on LLF is pending, if implemented, this policy will not only erode CCRI's earnings (~30%/ 20% impact on our FY21/FY22 EPS), but also make the long-term earnings trajectory volatile by adding operating leverage in a cyclical company. Further, the strategic stake sale may not fetch expected gains as CCRI's appeal as a highly profitable, strategic asset wanes. Akin to CCRI, we have not baked the LLF claim into our forecast, but cut our target multiple to factor in the risk.

Ticker/Price	CCRI IN/Rs 386
Market cap	US$ 3.1bn
Shares o/s	609mn
3M ADV	US$ 12.1mn
52wk high/low	Rs 666/Rs 263
Promoter/FPI/DII	55%/27%/14%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	65,427	64,738	58,802	75,695	87,863
EBITDA (Rs mn)	14,408	16,749	13,335	19,460	22,988
Adj. net profit (Rs mn)	12,154	12,574	8,146	12,904	15,267
Adj. EPS (Rs)	19.9	20.6	13.4	21.2	25.1
Adj. EPS growth (%)	14.5	3.5	(35.2)	58.4	18.3
Adj. ROAE (%)	12.3	12.3	7.9	11.7	12.8
Adj. P/E (x)	19.4	18.7	28.9	18.2	15.4
EV/EBITDA (x)	15.1	13.6	17.0	10.8	9.0

Source: Company, BOBCAPS Research

RESULT REVIEW

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BUY
TP: Rs 560 | ⮝ 24%

FINOLEX INDUSTRIES | Plastic Products | 10 August 2020

Tough quarter but outlook healthy; raise to BUY on low valuations

Finolex Industries' (FNXP) Q1 revenue declined 40% YoY, with volumes sliding 42% in both PVC pipe and resin segments amid the lockdown. EBITDA margins expanded 260bps YoY to 15.7% on higher gross margins and lower other expense. EBITDA/PAT contracted 29%/39% YoY. Management indicated strong demand for agri pipes in Q1 and a gradual pick-up in the non-agri segment too. We raise FY21 earnings by 4% (FY22 unchanged) and roll over to a new Sep'21 TP of Rs 560 (vs. Rs 545). Upgrade from ADD to BUY on reasonable valuations.

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Lockdown hurts volumes: FNXP's Q1FY21 standalone revenue dropped 42% YoY to Rs 5.6bn. The PVC resin segment declined 45% YoY with volumes/ realisations slipping 42%/5%. PVC pipes & fittings revenue also fell 40% YoY, with volumes down 42% whereas realisations increased 3%. Management stated that agricultural pipe volumes could have been better but for logistical/ production issues due to the lockdown. June saw 85% of year-ago volumes and July 96%. FNXP expects agri pipe segment (~70% of total volumes in FY20) to be flat YoY in FY21.

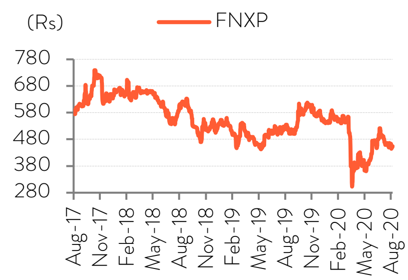
Margins increase: Operating margins increased by 260bps YoY on higher gross margins (+260bps) and lower other expense (–243bps), partly offset by higher employee cost (+243bps). EBITDA/PBT declined 28%/33% YoY. Gross margins expanded due to better realisations whereas other expenses declined on the back of cost control initiatives. Management stated that PVC prices have increased nearer to pre-Covid levels and hence should not be a drag on margins.

Valuations reasonable – upgrade to BUY: We increase PAT estimates for FY21 by 4% (FY22 unchanged) and roll forward to a revised Sep'21 TP of Rs 560 (earlier Rs 545), based on an unchanged 20x one-year forward P/E. Upgrade to BUY as current valuations look reasonable at 16.8x FY22E.

Ticker/Price	FNXP IN/Rs 453
Market cap	US$ 751.0mn
Shares o/s	124mn
3M ADV	US$ 0.3mn
52wk high/low	Rs 627/Rs 290
Promoter/FPI/DII	52%/2%/45%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	30,913	29,860	28,490	30,992	33,397
EBITDA (Rs mn)	6,043	4,481	4,630	4,755	5,046
Adj. net profit (Rs mn)	3,857	3,327	3,207	3,349	3,611
Adj. EPS (Rs)	31.1	26.8	25.8	27.0	29.1
Adj. EPS growth (%)	28.9	(13.8)	(3.6)	4.4	7.8
Adj. ROAE (%)	14.4	14.6	15.5	14.9	14.8
Adj. P/E (x)	14.6	16.9	17.5	16.8	15.6
EV/EBITDA (x)	9.4	12.4	12.0	11.7	10.6

Source: Company, BOBCAPS Research

WEEKLY WRAP

10 August 2020

Global recovery continues

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Global yields rose with macro data surprising positively. Rising exports from China and Germany and expanding global PMIs point to sustained recovery. However, India's recovery has plateaued for now. Global equity markets went up. So was the case for India as FII equity inflows continued. RBI did keep rates on hold with inflation remaining above its tolerance band of 6%. This month too inflation is estimated at 6.2%. Given limited room for easing, RBI did allow dispensation to borrowers to restructure loans.

Markets

- **Bonds:** Global long end yields closed higher. US 10Y yield increased by 4bps (0.56%) supported by an improving economy with higher job additions and better manufacturing and services data. UK 10Y yield also rose by 4bps as BoE estimates showed that GDP is expected to contract at a less sharp pace (9% in CY20, 14% projected earlier). Oil prices also rose by 2.5% (US$ 44/bbl). India's 10Y yield rose the most by 5bps (5.89%) as RBI's concern of future inflation trajectory left little room for rate cut in the near term. System liquidity surplus was at Rs 3.8tn as on 7 Aug 2020; same as previous week.

- **Currency:** Global currencies closed mixed in the week on the back of escalation in US-China trade tensions. DXY rose by 0.1% in the week after falling to a 2-year low as US non-farm payrolls rose more than expected in Jun'20. GBP depreciated by 0.3% amidst Brexit uncertainty and expectations of negative rates. INR depreciated by 0.2% as oil prices increased. FII inflows were US$ 1.1bn in the week.

- **Equity:** Global equity indices went up with encouraging economic data. Dow surged by 3.8%, its biggest gain since Jun'20, followed by both Dax and Nikkei climbing by 2.9% each. Sensex (1.2%) too ended in green as RBI announced regulatory dispensation for restructuring loans while keeping rates on hold. Metal and auto stocks advanced the most.

- **Upcoming key events:** In the current week, markets await key data prints from the US (CPI, industrial production retail sales), China (industrial production FAI, retail sales) and UK (Q2 GDP). On the domestic front, India's CPI, WPI, industrial production and trade data are due.

RESULT REVIEW

SELL
TP: Rs 750 | ∨ 23%

MAHANAGAR GAS | Oil & Gas | 10 August 2020

Muted volume outlook

Mahanagar Gas's (MAHGL) Q1FY21 PAT underperformed at Rs 0.45bn (–73% YoY). EBITDA margins declined to Rs 7.9/scm (–23% YoY) on a crash in CNG volumes (–78% YoY) and overall volumes disappointed at 101mmscm (–63% YoY). An extended lockdown in the Mumbai region could keep CNG volumes sluggish till Q3FY21. Volume growth revival beyond FY21 also looks challenging given saturation in existing areas of operations. Our TP changes to Rs 750 (from Rs 710) as we roll over to Sep'21. Maintain SELL.

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Volumes crash during lockdown: CNG volumes fell the most, declining 78% YoY to 44mmscm, against an overall volume decline of 63% to 101mmscm. Sluggishness in CNG volumes could continue through H2FY21 considering the extended lockdown in Mumbai. Over the long term, rising infrastructure constraints for CNG retail outlet expansion and improving alternate travel options (metro) in Mumbai suggest CNG volume growth may remain weak.

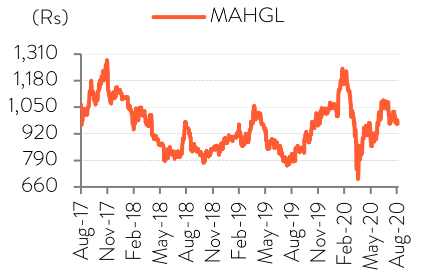
Margins decline on sluggish volumes: Q1 EBITDA was muted at Rs 0.8bn (–71% YoY) as margins contracted to Rs 7.9/scm (–23% YoY). Although gas prices declined, margins were under pressure due to the steep drop in volumes, especially for the high-margin CNG segment. As volumes take longer to revive, MAHGL may not be able to cash in on lower gas costs.

Maintain SELL: Muted FY20-FY23 earnings trends accompanied by recurring concerns over CNG volume growth are likely to add fuel to the sustained derating in multiples seen over the last quarter. Expansion into new areas could also be delayed due to the pandemic impact. Additionally, PNGRB regulations on marketing exclusivity raise concerns over potential competition emerging for MAHGL in Mumbai, especially in the high-margin CNG segment.

Ticker/Price	MAHGL IN/Rs 968
Market cap	US$ 1.3bn
Shares o/s	99mn
3M ADV	US$ 13.2mn
52wk high/low	Rs 1,246/Rs 664
Promoter/FPI/DII	33%/30%/38%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20P	FY21E	FY22E	FY23E
Total revenue (Rs mn)	27,911	29,721	27,877	32,819	34,866
EBITDA (Rs mn)	8,855	10,528	10,626	12,112	12,382
Adj. net profit (Rs mn)	5,467	7,935	7,437	8,381	8,408
Adj. EPS (Rs)	55.3	80.3	75.3	84.8	85.1
Adj. EPS growth (%)	14.4	45.1	(6.3)	12.7	0.3
Adj. ROAE (%)	24.2	29.5	23.9	24.4	22.2
Adj. P/E (x)	17.5	12.1	12.9	11.4	11.4
EV/EBITDA (x)	10.7	8.9	8.8	7.6	7.3

Source: Company, BOBCAPS Research

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SELL
TP: Rs 740 | ∀ 26%

PERSISTENT SYSTEMS | IT Services | 10 August 2020

CEO resigns after short stint; reiterate SELL

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In a surprising development, Persistent System's (PSYS) CEO Christopher O'Connor has resigned after a short stint of 1.5 years. The new leadership team had taken over full operations of the company only a year ago in Q1FY20. O'Connor was one of the first non-Indian-origin CEOs of an Indian IT company. He had led IoT business units at IBM previously. Promoter and MD Anand Deshpande is expected to take charge till a new CEO is appointed to ensure stability of operations.

Business strategy could suffer: O'Connor's strategy for PSYS was oriented towards incremental changes rather than disruptive ones. Key pillars of his strategy were: (1) improve branding & marketing, (2) bolster reseller revenues, (3) focus on building salesforce capability with acquisition of 'Youperience', and (4) deepen account mining with IBM by leveraging his experience of working there.

Most recently, PSYS had announced the IBM Cloud Pak deployment practice to help organisations migrate and modernise IBM workloads across cloud environments. IBM's CEO in Q2CY20 named PSYS as one of the key partners helping to expand the reach of its hybrid cloud platform. All of these initiatives could get derailed post the CEO's exit.

Frequent changes in top management: In his short stint, O'Connor inducted new members into the senior management (Sandeep Kalra–Technology Services) and dismissed some old hands (in the Technology Services and Accelerite unit). His resignation adds to company's history of senior leadership churn and could pose additional challenges in current tough economic climate.

Bumpy transition to professional leadership: With O'Connor's appointment as CEO, PSYS began the transition from a promoter-run organisation to professional leadership. This transition has, however, been marked by the active engagement of promoter and MD Anand Deshpande. With the CEO's departure, PSYS remains an outlier amongst mid-cap peers who have successfully ensured or effected the transition to professional leadership.

Reiterate SELL: PSYS remains a growth laggard among mid-caps due to its delayed pivot to the enterprise business. It has also failed to move away from its patchy project-based revenues towards an annuity-based revenue model. CEO resignation adds to the volatility. Frequent changes in top management will affect client relationships. We reiterate SELL with a Jun'21 TP of Rs 740.

Ticker/Price	PSYS IN/Rs 1,000
Market cap	US$ 1.1bn
Shares o/s	80mn
3M ADV	US$ 1.8mn
52wk high/low	Rs 1,007/Rs 420
Promoter/FPI/DII	30%/26%/44%

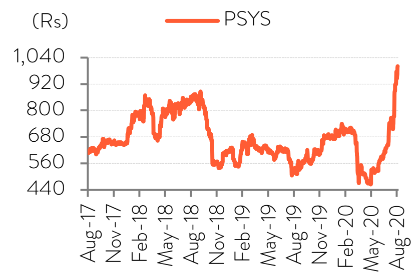
Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY21E	FY22E	FY23E
Total revenue (Rs mn)	41,190	46,708	51,767
EBITDA (Rs mn)	6,513	7,809	8,901
Adj. net profit (Rs mn)	3,715	4,486	5,237
Adj. EPS (Rs)	46.6	56.2	65.7
Adj. EPS growth (%)	9.2	20.8	16.7
Adj. ROAE (%)	14.3	15.7	16.5
Adj. P/E (x)	21.5	17.8	15.2
EV/EBITDA (x)	12.0	10.0	8.5

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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