# FIRST LIGHT

13 January 2020

## RESEARCH

### BOB Economics Research | Monthly Chartbook

Gradual recovery on the cards

### BOB Economics Research | IIP

IIP improves marginally

### Infosys | Target: Rs 840 | +14% | ADD

Commentary lack new growth impetus

### Infrastructure | Q3FY20 Preview

Execution a mix bag

### Logistics | Q3FY20 Preview

Insipid quarter beckons

## SUMMARY

### India Economics: Monthly Chartbook

While manufacturing and services PMIs picked up further in Dec'19, decelerating railway freight and credit growth, lacklustre non-oil-non-gold imports and dip in government spending imply that broader economic activity is muted. Given the pressure on tax revenues and government restricting its fiscal deficit, we do not see government spending picking up. Privatisation will drive private sector capex in the country next year and give room to government to spend on infra sector.

**Click here for the full report.**

### India Economics: IIP

Industrial growth rose to 4-month high of 1.8% in Nov'19 from (-) 4% in Oct'19. The improvement was led by manufacturing at 2.7% and mining at 1.7%. Intermediate and FMCG output rose by 17.1% and 2% respectively. While manufacturing PMI did hit a 7-month high of 52.7 in Dec'19 (51.2 in Nov'19), we believe recovery will be gradual as government spending will remain muted. Private sector and household demand will remain lukewarm given, capacity utilisation is at 69% and consumer confidence is at 5-year low.

**Click here for the full report.**

## TOP PICKS

### LARGE-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Cipla | Buy | 570 |
| ONGC | Buy | 210 |
| Petronet LNG | Buy | 400 |
| Reliance Industries | Buy | 1,860 |
| TCS | Add | 2,230 |

### MID-CAP IDEAS

| Company | Rating | Target |
|---|---|---|
| Alkem Labs | Buy | 2,290 |
| Future Supply | Buy | 680 |
| Greenply Industries | Buy | 210 |
| Laurus Labs | Buy | 480 |
| PNC Infratech | Buy | 245 |

Source: BOBCAPS Research

### DAILY MACRO INDICATORS

| Indicator | Current | 2D (%) | 1M (%) | 12M (%) |
|---|---|---|---|---|
| US 10Y yield (%) | 1.85 | (2bps) | 4bps | (89bps) |
| India 10Y yield (%) | 6.53 | (3bps) | (13bps) | (106bps) |
| USD/INR | 71.21 | 0.7 | (0.2) | (1.1) |
| Brent Crude (US$/bbl) | 65.37 | (0.1) | 1.7 | 6.0 |
| Dow | 28,957 | 0.7 | 3.8 | 20.6 |
| Shanghai | 3,095 | 0.9 | 6.2 | 22.1 |
| Sensex | 41,452 | 1.6 | 2.4 | 14.8 |
| **India FII (US$ mn)** | **8 Jan** | **MTD** | **CYTD** | **FYTD** |
| FII-D | 9.1 | (913.8) | (913.8) | 2,030.3 |
| FII-E | (47.9) | 248.6 | 248.6 | 7,637.8 |

Source: Bank of Baroda Economics Research

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## Infosys

Infosys (INFO)'s Q3FY20 operating performance fell tad short on expectations led by operating margin miss (EBIT margins at 21.9% V/s our est. of 22.4%). Revised guidance was no surprise and imply soft starting grounds for FY21. Management commentary provided no increamental impetus to suggest improvement in growth outlook. We keep FY21/FY22 EPS estimates broadly unchanged and roll forward to a Dec'20 TP of Rs 840 (Rs 860 earlier, reset target P/E to 18x V/s 19x). Retain ADD.

**Click here for the full report.**

## Infrastructure: Q3FY20 Preview

Moderate execution due to prolonged monsoon and lack of order wards in the past year is expected to contain revenue growth at ~9% YoY for our infrastructure universe in Q3FY20. EBITDA margins should hold firm, but earnings are forecast to decline ~12% YoY on higher interest and depreciation. PNCL and HGIEL are likely to buck the trend with stronger earnings. DBL, HGIEL, KNRC and ASBL saw order inflows in Q3 vs. nil for other coverage stocks. We continue to prefer PNCL, HGIEL, KNRC and ASBL.

**Click here for the full report.**

## Logistics: Q3FY20 Preview

Logistics companies in our coverage are expected to report a tepid Q3 as domestic and EXIM trade headwinds continue unabated. TCIEXP is likely to remain the outperformer with double digit rise in revenue and EBITDA (+10% YoY each). CCRI to also post healthy EBITDA growth (+11% YoY), notwithstanding muted topline (+3%). Three companies in our coverage are likely to post EBITDA decline – MLL (-18% YoY), FSCSL (-9%), and VRLL (-7%) – owing to muted demand from key client segments.

**Click here for the full report.**

# Gradual recovery on the cards

**While manufacturing and services PMIs picked up further in Dec'19, decelerating railway freight and credit growth, lacklustre non-oil-non-gold imports and dip in government spending imply that broader economic activity is muted. Given the pressure on tax revenues and government restricting its fiscal deficit, we do not see government spending picking up. Privatisation will drive private sector capex in the country next year and give room to government to spend on infra sector.**

**Consumption remains subdued:** Non-oil-non-gold imports edged lower in Nov'19. Consumer durables output declined to an all time low of (-) 18%. However, there seems to be some improvement in passenger car sales in Dec'19 after a (-) 10.8% decline seen in Nov'19. With RBI's consumer confidence index at a 5-year low, consumption revival will be gradual.

**Government spending cools off:** General government spending is easing. On FYTD basis, expenditure growth softened to 10.2% in Nov'19 from a 11.1% in Sep'19. Centre's revenue spending has eased to 13% (14% in Sep'19). Revenue expenditure of states has fallen to 8.8% (9.4% in Sep'19). Centre's capex has dipped to 11.7% (15.3%in Sep'19) and capex by states remains muted at 1.2% (-1.3% in Sep'19). The cut in spending is on the back of revenue shortfall. States have resorted to higher borrowing to sustain spending. In Apr-Dec'19 states have borrowerd Rs 3.7tn, 30.5% higher than last year.

**Growth outlook is muted:** We expect GDP to be lower at 5% in FY20 and gradually revive to 5.7% in FY21. The gradual recovery will be led by transmission of past rate cuts, expansion of global demand, government's privatisation roadmap, infra pipeline and improvement in credit cycle.

**Inflation and rates:** Inflation is likely to exhibit a sharp upturn in Dec'19 (6.6%) & Q4FY20 (5.9%) before decelerating. Another overhang on interest rates on government securities is the fear of higher fiscal deficit, given muted government revenues. Yields fell by 2bps in Jan'20 after RBI announced 'operation twist'. Given lacklustre revenue collections, states will borrow even higher amount next year and RBI can cut rates only in H2FY21. Thus yields are likely to remain firm for now.

**Higher oil prices to put pressure on INR:** Despite higher oil prices and subdued FII inflows, INR rose by 0.5% in Dec'19 after falling by (-) 1.1% in Nov'19. INR gained in-line with other EM currencies (up by 2.1% in Dec'19) as risk sentiment improved due to ebbing US-China trade tensions. However, flaring up of geo-political tensions in the Middle East and the resulting volatility in oil prices remains a key risk to INR .

IIP

10 January 2020

# IIP improves marginally

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**Industrial growth rose to 4-month high of 1.8% in Nov'19 from (-) 4% in Oct'19. The improvement was led by manufacturing at 2.7% and mining at 1.7%. Intermediate and FMCG output rose by 17.1% and 2% respectively. While manufacturing PMI did hit a 7-month high of 52.7 in Dec'19 (51.2 in Nov'19), we believe recovery will be gradual as government spending will remain muted. Private sector and household demand will remain lukewarm given, capacity utilisation is at 69% and consumer confidence is at 5-year low.**

**IIP growth sees revival:** Industrial output rose by 1.8% in Nov'19 to its highest in 4-months, and up from (-) 4% in Oct'19. Rebound was seen in mining output which expanded by 1.7% from (-) 8% in Oct'19, followed by manufacturing at 2.7% from (-) 2.3% in Oct'19. Within manufacturing the improvement was led by wood & wooden products (23.2%), basic metals (12.9%) and electrical equipment (8.6%). Contraction in electricity output also eased to (-) 5% in Nov'19 from (-) 12.2% in Oct'19. In Q3FY20 so far (Oct-Nov'19), industrial growth remains muted at (-) 1.1% versus (-) 0.3% in Q2. Despite improvement in Nov'19, mining and electricity output is far lower in Q3. Manufacturing output has done a tad bit better at 0.2% versus (-) 0.3% in Q2.

**Intermediate and consumer goods supported the growth:** Intermediate goods output rose by 17.1% in Nov'19 versus 22.9% in Oct'19 within which MS slabs, electric heaters and fragrances/oil essentials were the biggest contributor to growth. FMCG output too rose by 2% in Nov'19 (-1.8% in Oct'19). Infra & Construction goods continued to contract at (-) 3.5% in Nov'19 (-9.7% in Oct'19). Primary goods rebounded, in-line with mining, to (-) 0.3% in Nov'19 vs (-) 6% in Oct'19. Capital goods production declined at a slower pace of (-) 8.6% in Nov'19 from (-) 22% in Oct'19. Consumer durable production also showed some semblance of stability as it dropped by only (-) 1.5% in Nov'19 compared with (-) 18.8% in Oct'19.

**IIP might improve optically in H2FY20:** IIP growth might improve in H2FY20 on the back of base effect and clearance of excess inventory. In H1FY19, IIP growth was 5.2% versus 2.6% in H2FY19. However, recovery is likely to be gradual as domestic and global demand is likely to show gradual improvement. Domestic demand will face headwinds from lower spending by centre and states on the back of muted tax collections.

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**ADD**
TP: Rs 840 | ⮝ 14%

**INFOSYS** | IT Services | 11 January 2020

# Commentary lack new growth impetus

**Infosys (INFO)'s Q3FY20 operating performance fell tad short on expectations led by operating margin miss (EBIT margins at 21.9% V/s our est. of 22.4%). Revised guidance was no surprise and imply soft starting grounds for FY21. Management commentary provided no increamental impetus to suggest improvement in growth outlook. We keep FY21/FY22 EPS estimates broadly unchanged and roll forward to a Dec'20 TP of Rs 840 (Rs 860 earlier, reset target P/E to 18x V/s 19x). Retain ADD.**

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**Clean chit on whistleblower allegations:** Audit committee investigation report dismissed whistblower allegations and concluded no financial impropriety or executive misconduct. This will ease overhang on the stock and render relief to multiple stakeholders.

**Tad operating margin miss:** While INFO's 1% QoQ cc revenue growth was inline, EBIT margins at 21.9% (up 20bps) missed street and our estimates of an QoQ improvement of 40-50bps and 70bps respectively. Operating metrics were a mixed bag, with positives from 1) onsite/offshore mix, 2) attrition, and a weak show from 1) BFSI vertical, 2) performance of top clients.

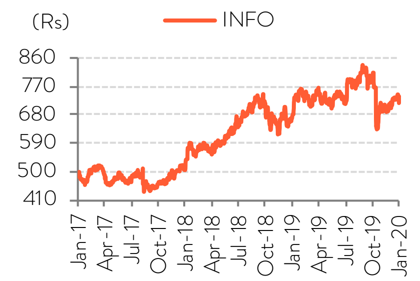
**Revised guidance was no surprise:** INFO now expects FY20 revenue growth of 10-10.5% YoY CC (from 9-10% guided earlier). This imply 0%-1.5% QoQ cc growth in Q4FY20 at lower and top end respectively (which is inline). Operating margin guidance unchanged at 21% to 23%.

**Renewal still dominate deal wins:** Deal win TCV at US$1.8bn marked seasonal moderation (down 36% QoQ) albeit up 15% YoY. Higher share of renewals continued for 3rd consecutive quarter leading to 9mFY19 renewal deal proportion to 75% V/s 53% in 9mFY19.

| | |
|---|---|
| Ticker/Price | INFO IN/Rs 738 |
| Market cap | US$ 45.3bn |
| Shares o/s | 4,349mn |
| 3M ADV | US$ 121.1mn |
| 52wk high/low | Rs 847/Rs 615 |
| Promoter/FPI/DII | 13%/35%/52% |

Source: NSE

## STOCK PERFORMANCE




Source: NSE

## KEY FINANCIALS

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Total revenue (Rs mn) | 7,05,220 | 8,26,760 | 9,04,520 | 9,83,395 | 10,88,229 |
| EBITDA (Rs mn) | 1,90,100 | 2,08,890 | 2,24,386 | 2,53,371 | 2,80,381 |
| Adj. net profit (Rs mn) | 1,60,280 | 1,54,100 | 1,65,074 | 1,81,291 | 2,04,353 |
| Adj. EPS (Rs) | 36.9 | 35.4 | 38.9 | 42.7 | 48.1 |
| Adj. EPS growth (%) | 17.3 | (4.0) | 9.9 | 9.8 | 12.7 |
| Adj. ROAE (%) | 23.9 | 24.5 | 25.8 | 25.6 | 26.0 |
| Adj. P/E (x) | 20.0 | 20.9 | 19.0 | 17.3 | 15.3 |
| EV/EBITDA (x) | 15.4 | 14.4 | 13.5 | 11.9 | 10.5 |

Source: Company, BOBCAPS Research

# Execution a mix bag

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**Moderate execution due to prolonged monsoon and lack of order wards in the past year is expected to contain revenue growth at ~9% YoY for our infrastructure universe in Q3FY20. EBITDA margins should hold firm, but earnings are forecast to decline ~12% YoY on higher interest and depreciation. PNCL and HGIEL are likely to buck the trend with stronger earnings. DBL, HGIEL, KNRC and ASBL saw order inflows in Q3 vs. nil for other coverage stocks. We continue to prefer PNCL, HGIEL, KNRC and ASBL.**

**Execution to remain moderate:** We expect revenue growth of ~9% YoY for our coverage stocks in Q3 mainly due to the extended monsoon season hampering the pace of project execution. PNCL is likely to clock robust revenue growth of ~78% YoY led by a high executable order backlog and low base. EBITDA margins for our coverage look to be stable in the range of 12-19%, while adjusted PAT margins are expected to decline by ~150bps YoY to 6.4% due to higher interest and depreciation.

**Moderate order inflows:** Order inflows failed to revive after elections (Centre as-well-as states) as expected, due to land acquisition issues and delayed disbursals amid a change of guard at various state governments. We believe NHAI awarding could pick up from end Jan'20. The book-to-bill ratio for road developers remains strong at 2.2-2.9x as on Dec'19 despite subdued ordering.

**Award of appointed dates a key positive:** As at end-Dec'19, ADs for only 7 of the 45 HAM projects won by our coverage universe (excluding 2 won in Q3) were pending from NHAI (vs. 12 as at end-Sep'19), leading to a better executable backlog for most companies. Our management interactions suggest the balance dates could be awarded in Q4 (5 projects)/FY21 (2 projects).

**Quarterly monitorable:** The key quarterly monitorable to watch for would be the leverage position, working capital cycle, outlook on the award of ADs for the remaining projects, perspective on order inflows, progress on asset monetisation plans and segmental diversification plans to support growth.

**Stay selective:** Execution visibility on the existing order backlog remains intact, albeit with some lag due to delayed ADs, even as India's road sector holds immense opportunities. We believe players with lean balance sheets will benefit the most when ordering activity revives. We stay selective and prefer PNCL, HGIEL, KNRC and ASBL.

## RECOMMENDATION SNAPSHOT

| Ticker | Price | Target | Rating |
|---|---|---|---|
| ASBL IN | 102 | 190 | BUY |
| DBL IN | 405 | 560 | BUY |
| HGINFRA IN | 263 | 390 | BUY |
| KNRC IN | 255 | 340 | BUY |
| PNCL IN | 194 | 245 | BUY |
| SADE IN | 123 | 160 | BUY |

Price & Target in Rupees | Price as of 9 Jan 2020

## ORDER BACKLOG as on Dec'19E*

| Ticker | Backlog (Rs bn) | Book-to-bill (x) | Executable (%) |
|---|---|---|---|
| ASBL IN | 93.9 | 2.4 | 80.8 |
| DBL IN | 209.8 | 2.3 | 88.7 |
| HGINFRA IN | 61.3 | 2.8 | 53.2 |
| KNRC IN | 65.6 | 2.9 | 70.4 |
| PNCL IN | 105.8 | 2.2 | 81.1 |
| SADE IN | 80.2 | 2.5 | 100.0 |

Source: Company, BOBCAPS Research | *Includes L1 projects

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LOGISTICS | Q3FY20 Preview | 10 January 2020

# Insipid quarter beckons

**Logistics companies in our coverage are expected to report a tepid Q3 as domestic and EXIM trade headwinds continue unabated. TCIEXP is likely to remain the outperformer with double digit rise in revenue and EBITDA (+10% YoY each). CCRI to also post healthy EBITDA growth (+11% YoY), notwithstanding muted topline (+3%). Three companies in our coverage are likely to post EBITDA decline – MLL (-18% YoY), FSCSL (-9%), and VRLL (-7%) – owing to muted demand from key client segments.**

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**Weak trade to impact topline growth:** Both EXIM and domestic trade remained tepid in Q3FY20. Core EXIM trade (non-oil, non-gold) fell -5% YoY in Oct-Nov'19. Indian Railway's container traffic grew +3% YoY in Q3 (-0.2% in Q2), but NTKM growth was flat (+0.2%) due to lower leads (-2.7%). Container volume at major ports was also down (-2.2% YoY). This is expected to weigh on the topline growth of logistics companies – we forecast median revenue growth of +8% YoY for our coverage universe (+5%/+14% in H1/FY19).

**TCIEXP to be the outperformer:** TCI Express (TCIEXP) is likely to be the only company to post double digit growth in both revenue and EBITDA (+10% YoY) in our coverage. Despite muted volume from existing customers, addition to SME clients to aid the company's topline. Though CCRI has reported volumes dip (-1.7% YoY) in Q3, EBITDA growth is likely to be decent (+11% YoY) led by higher realisation, lower empty running charges, and controlled costs.

**3PL companies to remain in doldrums:** Battered by plunging auto sales, Mahindra Logistics' (MLL) revenue/EBITDA is forecast to fall -2%/-18% YoY in Q3. Future Supply Chain Solutions' (FSCSL) revenue growth is likely to be decent at +12% YoY, but steeper increases in fixed costs, depreciation, and interest stemming from commissioning of new warehouses is likely to mar profitability – its EBITDA/PBT is estimated to decline by -9%/-47% YoY.

**TRPC, AGLL to post steady performance:** Strong growth in the seaways division (+25% YoY), led by the addition of a new ship in Oct'19, is likely to drive +8% uptick in topline. AGLL's revenue is also forecast to rise by +8% YoY, led by the MTO segment (+9%) while the CFS segment languishes (-5%). VRL Logistics (VRLL) is estimated to print sedate revenue increase of +2% YoY due to moderate growth in both GT (+4%) and PT (-6%) segments. Despite stable fuel costs, higher employee expenses can dent EBITDA growth (-7% YoY).

## RECOMMENDATION SNAPSHOT

| Ticker | Price | Target | Rating |
|---|---|---|---|
| AGLL IN | 99 | 120 | BUY |
| CCRI IN | 561 | 655 | ADD |
| FSCSL IN | 464 | 680 | BUY |
| MAHLOG IN | 409 | 460 | BUY |
| TCIEXP IN | 727 | 855 | ADD |
| TPRC IN | 269 | 365 | BUY |
| VRLL IN | 270 | 330 | BUY |

Price & Target in Rupees I 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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