# FIRST LIGHT

21 January 2020

## RESEARCH

### [Sector Report] Automobiles
Mixed signals – prefer PVs, two-wheelers

### BOB Economics Research | Weekly Wrap
Union Budget to take centre-stage

### Kotak Mahindra Bank | Target: Rs 1,875 | +16% | BUY
Growth slips while credit cost spikes

## SUMMARY

### Automobiles

The auto industry slump over the past five quarters has seen the Nifty Auto Index plunging ~40% over the 12 months to Sep'19. Subsequent improvement in retail sales and the corporate tax cut have aided a 25% pullback in the auto index. In our view, a low base, good monsoons and gradual macro revival should aid a cyclical recovery in auto volumes from FY21. But looming challenges from new emission norms and continued capacity overhang (in CVs) warrant a selective stock approach – MSIL & EIM are top picks; we are cautious on HMCL, TVSL & AL.

**Click here for the full report.**

### India Economics: Weekly Wrap

US equity markets surged to new highs on the back of signing of US-China trade deal and positive macro data in US (retail sales, housing starts) and China (GDP, industrial production, investments). However, 10Y yields in UK slipped by 14bps after data surprised negatively (industrial production, inflation). On the domestic front, India's CPI and WPI inched up on the back of food inflation. So did bond yields. In the coming days, focus will be on policy measures to revive growth that could be announced in the Union Budget.

**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 | 2,390 |

### 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 (%) | 1.82 | 1bps | (6bps) | (96bps) |
| India 10Y yield (%) | 6.63 | 2bps | (13bps) | (68bps) |
| USD/INR | 64.85 | 0.4 | (1.9) | 3.4 |
| Brent Crude (US$/bbl) | 71.08 | (0.2) | (0.2) | 0.1 |
| Dow | 29,348 | 0.2 | 3.8 | 18.8 |
| Shanghai | 3,075 | 0 | 1.8 | 18.5 |
| Sensex | 41,945 | 0 | 1.4 | 15.3 |
| **India FII (US$ mn)** | **16 Jan** | **MTD** | **CYTD** | **FYTD** |
| FII-D | 30.1 | (1,132.7) | (1,132.7) | 1,811.4 |
| FII-E | 1,372.5 | 1,714.9 | 1,714.9 | 9,104.1 |

Source: Bank of Baroda Economics Research

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## Kotak Mahindra Bank

Kotak Mahindra Bank's (KMB) Q3FY20 PAT at Rs 16bn was below estimates due to weak NII growth and high provisions. Key disappointments were loan growth slipping to a multi-quarter low of 10% YoY and 9MFY20 credit cost spiking to 67bps. Management has toned down its growth guidance from the mid-teens to 10-15% YoY but believes credit cost for FY20 can be held ~60bps. The SMA-2 book declined to Rs 2.7bn (0.1% of loans) given some lumpy corporate slippages. We cut FY20-FY22 EPS by 6-7% and revise our TP to Rs 1,875 (vs. Rs 1,950).

**Click here for the full report.**

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**AUTOMOBILES**

20 January 2020

# Mixed signals – prefer PVs, two-wheelers

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**The auto industry slump over the past five quarters has seen the Nifty Auto Index plunging ~40% over the 12 months to Sep'19. Subsequent improvement in retail sales and the corporate tax cut have aided a 25% pullback in the auto index. In our view, a low base, good monsoons and gradual macro revival should aid a cyclical recovery in auto volumes from FY21. But looming challenges from new emission norms and continued capacity overhang (in CVs) warrant a selective stock approach – MSIL & EIM are top picks; we are cautious on HMCL, TVSL & AL.**

**Expect a cyclical recovery...:** FY20 is likely to close with record low volume sales growth across major automotive segments. That said, the recent pickup in retail growth for passenger vehicles (PV) and two-wheelers (2W) during the Oct'19 festive season points to demand recovering in end-markets. A soft base, above average monsoons this year and gradual economic recovery should spur a cyclical rebound in volume growth from the next fiscal. However, with yet another regulatory-led cost push from new BS-VI emission norms in Apr'20, we do not envisage a V-shaped recovery.

**...but recommend a selective approach:** We prefer the PV segment given low incremental cost pressure from BS-VI changeover (in petrol models), moderate competitive stress and possible unlocking of pent-up demand. In 2Ws, we favour companies with a diversified mix or those with a lesser exposure to mass-market segments. The commercial vehicle (CV) segment warrants a cautious view due to a persistent supply overhang from the sharp rise in system capacity, stiff regulatory-led cost burden, and risk of freight movement shifting to rail upon dedicated freight corridor (DFC) commissioning in FY21.

**Valuations above median, yet sustainable:** In the past five years, auto sector valuations have rerated by ~20% compared to the preceding cycle. At 21x, the current one-year forward P/E multiple is above the median for the sector. In our view, valuations look sustainable as expected earnings recovery will trigger improvement in return ratios (ex-cash) and free cash flows.

**Top picks:** Building in prospects of a cyclical revival as well as structural hindrances, we identify Maruti Suzuki (MSIL) and Eicher Motors (EIM) as top picks. We have ADD ratings on Bajaj Auto (BJAUT), Tata Motors (TTMT) and Mahindra & Mahindra (MM). We are cautious on Hero MotoCorp (HMCL, REDUCE) and TVS Motor (TVSL, REDUCE), but negative on Ashok Leyland (AL, SELL).

**RECOMMENDATION SNAPSHOT**

| Ticker | Price | Target | Rating |
|---|---|---|---|
| AL IN | 84 | 68 | SELL |
| BJAUT IN | 3,118 | 3,470 | ADD |
| EIM IN | 21,292 | 25,000 | BUY |
| HMCL IN | 2,454 | 2,575 | REDUCE |
| MM IN | 569 | 625 | ADD |
| MSIL IN | 7,520 | 8,900 | BUY |
| TTMT IN | 197 | 220 | ADD |
| TVSL IN | 485 | 465 | REDUCE |

Price & Target in Rupees

WEEKLY WRAP

20 January 2020

# Union Budget to take centre-stage

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**US equity markets surged to new highs on the back of signing of US-China trade deal and positive macro data in US (retail sales, housing starts) and China (GDP, industrial production, investments). However, 10Y yields in UK slipped by 14bps after data surprised negatively (industrial production, inflation). On the domestic front, India's CPI and WPI inched up on the back of food inflation. So did bond yields. In the coming days, focus will be on policy measures to revive growth that could be announced in the Union Budget.**

## Markets

- **Bonds:** Global yields closed mixed even after US and China signed Phase 1 trade deal. US 10Y yield closed flat at 1.82%. UK 10Y yield fell by 14bps as economic data disappointed. Oil prices fell by (-) 0.2% due to easing tensions in Middle East. India's 10Y yield rose by 4bps (6.63%) as headline CPI print in Dec'19 rose to a 5-year high of 7.4%. System liquidity surplus was at Rs 3.1tn as on 17 Jan 2020 vs Rs 3.2tn in the previous week.

- **Currency:** Except CNY, other global currencies closed lower this week. DXY rose by 0.3% in the week as US retail sales, jobless claims and housing starts surprised positively. CNY rose by 0.9% to its highest since Jul'19 on the back of signing of US-China trade deal and improved economic data in Dec'19 (exports, retail sales, industrial production and fixed asset investments). INR depreciated by (-) 0.2% in the week even as oil prices eased. FII inflows were US$ 1.2bn.

- **Equity:** Barring Shanghai Comp (-0.5%), global indices ended higher this week. While investors await more clarity on the phase 1 deal signed between US and China, earnings results and positive macro prints (China GDP, Euro Area inflation, US retail sales) kept the sentiments high in US and Europe. Following global cues, Sensex too ended the week 0.8% higher.

- **Upcoming key events:** In the current week, markets will await policy decisions of major central banks (BoJ, ECB). Apart from this, flash manufacturing data of major economies (US, Germany, France and Japan) will give an idea about manufacturing activity in Jan'20. On the domestic front, markets will await cues on Union Budget.

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**BUY**
TP: Rs 1,875 | ⮝ 16%

**KOTAK MAHINDRA BANK** | Banking | 20 January 2020

## Growth slips while credit cost spikes

**Kotak Mahindra Bank's (KMB) Q3FY20 PAT at Rs 16bn was below estimates due to weak NII growth and high provisions. Key disappointments were loan growth slipping to a multi-quarter low of 10% YoY and 9MFY20 credit cost spiking to 67bps. Management has toned down its growth guidance from the mid-teens to 10-15% YoY but believes credit cost for FY20 can be held ~60bps. The SMA-2 book declined to Rs 2.7bn (0.1% of loans) given some lumpy corporate slippages. We cut FY20-FY22 EPS by 6-7% and revise our TP to Rs 1,875 (vs. Rs 1,950).**

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**Slight miss on asset quality:** KMB's GNPA ratio increased 14bps QoQ to 2.46%, driven by a couple of lumpy corporate accounts and slippages in SME, CV/CE and small business loans. The SMA-2 book declined to Rs 2.7bn (0.1% of loans) vs. Rs 4.3bn (0.2%) in Q2 given the corporate slippages. Stress in the unsecured personal loan/credit card portfolio has increased but remains in line with the industry, while NPAs in the agriculture segment were largely stable during the quarter. 9MFY20 credit cost stood at 67bps but guidance for FY20 was maintained near 60bps levels. Telecom exposure to stressed players is low.

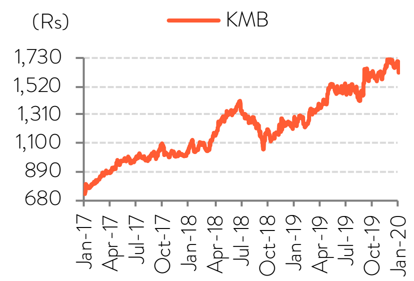
**Loan growth at multi-quarter low:** Loan growth dropped to ~10% YoY in Q3 largely due to sluggish growth in the corporate (3%) and CV/CE (6%) segments. Low working capital utilisation slowed growth in the corporate segment. The retail segment grew 18% YoY as the agri, home loan and small business segments grew in the range of 15-20%. FY20 loan growth guidance stands lowered from the mid-teens to 10-15% YoY. Management highlighted that its '811' digital banking product is driving strong cross-sales across products – growth in balances from these customers is steady with a rise in savings deposits.

**Maintain BUY:** We cut FY20-FY22 EPS estimates by 6-7% to build in slower growth and higher credit costs, yielding a revised Mar'21 TP of Rs 1,875.

| | |
|---|---|
| Ticker/Price | KMB IN/Rs 1,618 |
| Market cap | US$ 43.5bn |
| Shares o/s | 1,910mn |
| 3M ADV | US$ 57.0mn |
| 52wk high/low | Rs 1,735/Rs 1,210 |
| Promoter/FPI/DII | 30%/40%/30% |

Source: NSE

### STOCK PERFORMANCE




Source: NSE

### KEY FINANCIALS

| Y/E 31 Mar | FY18A | FY19A | FY20E | FY21E | FY22E |
|---|---|---|---|---|---|
| Net interest income | 95,317 | 112,590 | 133,258 | 160,501 | 196,487 |
| NII growth (%) | 1729.6 | 1812.1 | 1835.7 | 2044.4 | 2242.1 |
| Adj. net profit (Rs mn) | 40,619 | 41,632 | 61,842 | 77,531 | 97,975 |
| EPS (Rs) | 21.8 | 25.5 | 32.4 | 40.6 | 51.3 |
| P/E (x) | 74.2 | 63.4 | 49.9 | 39.8 | 31.5 |
| P/BV (x) | 8.2 | 7.3 | 6.4 | 5.5 | 4.8 |
| ROA (%) | 1.7 | 1.7 | 1.9 | 2.1 | 2.2 |
| ROE (%) | 12.5 | 12.2 | 13.6 | 14.9 | 16.3 |

Source: Company, BOBCAPS Research

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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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