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FIRST LIGHT

11 May 2022

RESEARCH

BOB Economics Research | Monthly Chartbook

More rate hikes in the offing

Reliance Industries | Target: Rs 2,700 | +9% | HOLD

Margin uptick in cyclicals; consumer business to drive growth

Ajanta Pharma | Target: Rs 2,050 | +24% | BUY

Margin stress continues

Daily macro indicators

Indicator	06-May	09-May	Chg (%)
US 10Y yield (%)	3.13	3.03	(9bps)
India 10Y yield (%)	7.45	7.47	2bps
USD/INR	76.93	77.46	(0.7)
Brent Crude (US$/bbl)	112.4	105.9	(5.7)
Dow	32,899	32,246	(2.0)
Hang Seng	20,793	20,002	(3.8)
Sensex	54,836	54,471	(0.7)
India FII (US$ mn)	**05-May**	**06-May**	**Chg ($ mn)**
FII-D	15.7	(215.8)	(231.5)
FII-E	(205.1)	(601.7)	(396.7)

Source: Bank of Baroda Economics Research

SUMMARY

India Economics: Monthly Chartbook

Globally central banks are faced with the dilemma of high inflation and low growth. Fed kept in focus the overheating inflation print and raised policy rate by 50bps. RBI went for an abrupt rate hike before Fed's decision and raised repo rate by 40bps. Withdrawal of accommodation, hiking of CRR by 50bps and underlining upside risks to inflation; all signalled towards a hawkish policy tilt. Yields went up by 35bps post RBI policy. Even OIS 1Yr rate inched up sharply, all indicative of more rate hikes in the future. We expect 50-75bps rate hike in FY23. Our CPI forecast has a clear upward bias towards 6% and 10Y yield is expected to remain elevated between 7.5-7.75%. Further, elevated growth and inflation concerns as well as persistent FPI outflows drove INR to its record low level.

Click here **for the full report.**

Reliance Industries

- Q4 results in line with consensus – O2C and digital services performed well; we raise FY23/FY24 EBITDA by 8%/4%
- Expect consumer business to deliver 28% EBITDA CAGR over FY22-FY25; transformation of O2C business the next trigger
- TP revised to Rs 2,700 (from Rs 2,520); maintain HOLD given 9% upside potential

Click here **for the full report.**

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Ajanta Pharma

- Q4 revenue 6% ahead of our estimate but margins disappointed with gross/EBITDA margin contraction of 530bps/1050bps YoY to ~72%/24%
- RM inflation and US price erosion continued to take a toll on margins; FY23 gross/EBITDA margins guided at 75%/28%
- We cut FY23-FY24 EBITDA 9-11% and pare our EV/EBITDA multiple to 15x (vs. 17x), yielding a new TP of Rs 2,050 (vs. Rs 2,655); retain BUY

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More rate hikes in the offing

Globally central banks are faced with the dilemma of high inflation and low growth. Fed kept in focus the overheating inflation print and raised policy rate by 50bps. RBI went for an abrupt rate hike before Fed's decision and raised repo rate by 40bps. Withdrawal of accommodation, hiking of CRR by 50bps and underlining upside risks to inflation; all signalled towards a hawkish policy tilt. Yields went up by 35bps post RBI policy. Even OIS 1Yr rate inched up sharply, all indicative of more rate hikes in the future. We expect 50-75bps rate hike in FY23. Our CPI forecast has a clear upward bias towards 6% and 10Y yield is expected to remain elevated between 7.5-7.75%. Further, elevated growth and inflation concerns as well as persistent FPI outflows drove INR to its record low level.

Consumption showing patchy recovery: The economy is slowly and steadily gaining traction as Covid-19 cases drop across the country and mobility indices inch up. Demand for electricity picked up amidst severe heat wave conditions. Digital transactions and fertilizer sales continued an upward momentum. However, PV sales and electronic imports dipped. Furthermore, moderation in two-wheeler and tractor sales signal incipent stress in rural economy. Risks of global spillovers are likely with the ongoing Russia-Ukraine war, tighter global monetary policy and surge in inflation. The annoucement of normal monsoon bodes well for rural consumption. Global food prices retreated in Apr'22 from an all time-high in Mar'22.

Macro indicators of growth remained mixed: Indicators such as services PMI (5-month high in Apr'22), port cargo volume, railway freight, mobility index, showed revival. However, toll collections, E-way bill generation and property sales showed moderation. Hence recovery is not of a durable nature. Further we expect, growth to come down by another 25bps in the range of 7.4-7.5% in FY23, as higher borrowing cost is expected to curtail demand. If the supply side bottlenecks continue to keep inflation elevated there will be a second round impact on growth as well.

Yields under pressure: Between Apr-May'22, India's 10Y yield rose by 63bps. This was on account of 1) RBI's sudden hawkish policy and shifting its gear to inflationary concerns, thus surprisingly raising policy rate by 40bps 2) Elevated domestic inflation print in Mar'22 (7% against consensus of 6.4%), 3) Fed raising rates successively by 25bps and 50bps and 4) global central banks reiterating concerns about overheated inflation print. India's 1Y OIS Swap rates as well as the entire yield curve rose significantly; all indicative of more policy rate hikes from RBI. We expect another 50-75bps rate hike during the year with another increase in the Jun'22 policy. We expect RBI's CPI projection to go for another round of upward revision. Our CPI forecast is at 5.5-6% with a clear upward bias towards 6%. We expect 10Y yield to be between 7.5-7.75% in FY23. However, firm demand at auction, RBI's OMO announcement if any and conduct of switch by the government will lend support.

INR falls to a record-low: INR depreciated for the fourth-straight month in Apr'22. In May'22, INR depreciated further to a record-low of 77.46/$. Broad based-dollar strength (DXY at 20-year high), concerns over inflation, elevated oil prices, Fed's aggressive rate hike cycle and persistent FPI outflows are weighing on the rupee. RBI has intervened in the forex market to support the rupee and is likely to lent further support to INR through direct intervention or swap auctions. INR is likely to remain volatile in the near-term.

Note: The source for all exhibits is 'CEIC and Bank of Baroda' unless otherwise specified

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HOLD

TP: Rs 2,700 | ⮝ 9%

RELIANCE INDUSTRIES | Oil & Gas | 10 May 2022

Margin uptick in cyclicals; consumer business to drive growth

- **Q4 results in line with consensus – O2C and digital services performed well; we raise FY23/FY24 EBITDA by 8%/4%**
- **Expect consumer business to deliver 28% EBITDA CAGR over FY22-FY25; transformation of O2C business the next trigger**
- **TP revised to Rs 2,700 (from Rs 2,520); maintain HOLD given 9% upside potential**

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Q4 results broadly in line: RIL's Q4FY22 EBITDA excluding other income stood at Rs 313.7bn, in line with Bloomberg consensus, while net income was 3.7% short of expectations at Rs 162bn. At the EBITDA level, whereas digital services outperformed consensus, the retail and oil & gas businesses underperformed. Sequentially, the rise in O2C and digital services EBITDA offset the decline in oil & gas and retail.

Raise FY23/FY24 EBITDA forecasts: We raise our FY23/FY24 EBITDA forecasts by 8.3%/3.8% factoring in stronger refining margins, ARPU and gas price realisations. We now forecast 35% YoY growth in FY23 EBITDA backed by both cyclical and consumer engines. Cyclical business will benefit from a surge in refining margin (we conservatively assume +US$ 4/bbl YoY), higher gas realisation (+117% YoY to US$ 10.7/MMbtu) and ramp-up in natural gas production (+22% YoY). We expect the consumer business to benefit from a projected 19% YoY rise in telecom ARPU to Rs 179 and 38% YoY growth in retail revenue in FY23.

Consumer business driving medium-term growth: RIL has successfully transitioned into a consumer conglomerate, achieving leadership in both digital and retail ventures. We expect EBITDA from its consumer business to grow at a 28% CAGR over FY22-FY25. While RIL has unlocked value in these businesses by involving strategic investors, their upcoming listing provides an upside trigger.

Derisking of O2C business the next catalyst: RIL has embarked on a transformation journey for its O2C business to address climate risks. This will involve conversion of carbon feedstocks into chemicals and clean energy. The company aims to tie up with strategic partners and investors to derisk the use of new technologies. The approach also helps unlock value at an early stage.

Maintain HOLD: We have a revised TP of Rs 2,700 for RIL (up from Rs 2,520) with an SOTP valuation for the refining (7.5x FY24E EV/EBITDA), petrochemicals (8.5x), telecom (Jio Infocomm: 10x) and retail (32x) businesses. Our TP includes Rs 110 for the value of its venture into digital services and Rs 47 for the new energy division. We maintain HOLD given 9% upside potential from the current market price.

Key changes

Target	Rating
▲	◀ ▶

Ticker/Price	RIL IN/Rs 2,475
Market cap	US$ 216.5bn
Free float	49%
3M ADV	US$ 227.5mn
52wk high/low	Rs 2,856/Rs 1,906
Promoter/FPI/DII	51%/24%/14%

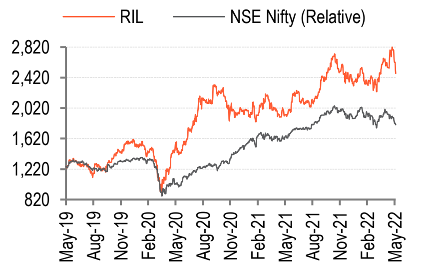
Source: NSE | Price as of 10 May 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	69,99,620	91,94,527	97,16,071
EBITDA (Rs mn)	11,04,600	14,89,932	16,30,621
Adj. net profit (Rs mn)	5,84,201	8,12,135	9,26,915
Adj. EPS (Rs)	86.4	120.0	137.0
Consensus EPS (Rs)	92.7	119.5	135.0
Adj. ROAE (%)	7.9	10.0	10.4
Adj. P/E (x)	28.7	20.6	18.1
EV/EBITDA (x)	17.6	13.0	11.6
Adj. EPS growth (%)	33.8	39.0	14.1

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

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BUY
TP: Rs 2,050 | ⮝ 24%

AJANTA PHARMA | Pharmaceuticals | 11 May 2022

Margin stress continues

- **Q4 revenue 6% ahead of our estimate but margins disappointed with gross/EBITDA margin contraction of 530bps/1050bps YoY to ~72%/24%**
- **RM inflation and US price erosion continued to take a toll on margins; FY23 gross/EBITDA margins guided at 75%/28%**
- **We cut FY23-FY24 EBITDA 9-11% and pare our EV/EBITDA multiple to 15x (vs. 17x), yielding a new TP of Rs 2,050 (vs. Rs 2,655); retain BUY**

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Asia and India led the growth: AJP's Q4FY22 revenue of Rs 8.7bn was 6% ahead of our estimate led by a strong focus on branded sales in Asia (+50% YoY) and India formulations (+12% YoY). US sales remained lacklustre. With price hikes taken in India from April, management expects the domestic market to continue to perform well for the company.

US launches delayed due to pending inspections: US generics revenue grew only 1.2% QoQ in Q4 as strong headwinds in core portfolio pricing largely negated the growth in volumes. AJP's earlier launch guidance has been delayed due to pending approvals as the USFDA has not yet fully resumed plant inspections.

Margins pressure continues: AJP reported Q4 gross/EBITDA margin declines of 530bps/1,050bps YoY to 72.5%/23.7%. Gross margin contracted due to higher raw material cost, price erosion in the US (~150bps impact) and a one-time hit from the of two products (150bps). US price erosion has risen to ~18% for the company in Q4 vs. the normal average of 10%. Per management, pricing is now stabilising and should have a reduced impact as the company launches more products from the pending pipeline. For FY22, AJP's EBITDA margin contracted 670bps.

FY23 revenue guided to grow in mid-teens; margin to remain flat: Management has guided for mid-teens growth in the FY23 topline. However, it expects margins to remain at FY22 levels of ~28% as the industry continues to see higher input costs as well as a return of other costs to pre-Covid levels.

Maintain BUY, TP revised to Rs 2,050: We reduce our FY23-FY24 EBITDA estimates by 9-11% in light of margin pressure arising from raw material cost inflation, US price erosion and expenses retracing to normal levels. Given these headwinds, we also lower our target FY24E EV/EBITDA multiple to 15x (vs. 17x), translating to a reduced TP of Rs 2,050 (vs. Rs 2,655). Maintain BUY as we find branded EM franchise robust and valuation attractive at 14x/12x FY23E/24E EV/EBITDA vs 5-year average of 20x.

Key changes

Target	Rating
▼	◀ ▶

Ticker/Price	AJP IN/Rs 1,658
Market cap	US$ 1.8bn
Free float	31%
3M ADV	US$ 1.9mn
52wk high/low	Rs 2,435/Rs 1,631
Promoter/FPI/DII	70%/9%/12%

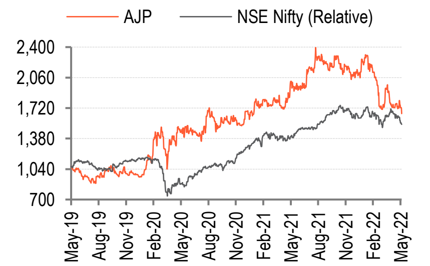
Source: NSE | Price as of 10 May 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	33,410	37,073	40,328
EBITDA (Rs mn)	9,293	10,393	11,508
Adj. net profit (Rs mn)	7,127	7,223	8,106
Adj. EPS (Rs)	81.3	82.4	92.4
Consensus EPS (Rs)	83.2	99.5	111.9
Adj. ROAE (%)	22.5	20.1	19.2
Adj. P/E (x)	20.4	20.1	17.9
EV/EBITDA (x)	15.1	13.5	12.1
Adj. EPS growth (%)	5.8	1.3	12.2

Source: Company, Bloomberg, BOBCAPS Research | P – Provisional

Stock performance



Source: NSE

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

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