FIRST LIGHT

01 September 2022

RESEARCH

India Strategy | Monthly Wrap

Indian market resilient

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India versus global equity markets

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What's in store for INR

SAIL | Target: Rs 90 | +13% | HOLD

Plodding quest for growth

Reliance Industries | Target: Rs 2,700 | +4% | HOLD

AGM takeaways – Growth contours defined

Daily macro indicators

Indicator	26-Aug	29-Aug	Chg (%)
US 10Y yield (%)	3.04	3.1	6bps
India 10Y yield (%)	7.22	7.25	3bps
USD/INR	79.87	79.97	(0.1)
Brent Crude (US$/bbl)	101.0	105.1	4.1
Dow	32,283	32,099	(0.6)
Hang Seng	20,170	20,023	(0.7)
Sensex	58,834	57,973	(1.5)
India FII (US$ mn)	**25-Aug**	**26-Aug**	**Chg ($ mn)**
FII-D	(35.5)	19.9	55.4
FII-E	295.6	(14.2)	(309.8)

Source: Bank of Baroda Economics Research

SUMMARY

India Strategy: Monthly Wrap

- Nifty 50 returned 3.5% in Aug'22, outperforming developed and some emerging market peers
- Nifty valuation has now corrected to its historical mean though the premium over other EMs is close to its upper band
- Domestic factors offer support but the upside looks limited given global headwinds; we continue to prefer retail lenders, FMCG and IT

Click here for the full report.

India Economics: Market Performance

In CY22 so far, we have observed that Indian equity markets (both Sensex and Nifty) have performed relatively better than other major global equity markets. For comparison purpose, we have assumed December 2021 to be the base and have analysed how global markets have performed this year since then.

Click here for the full report.

BOBCAPS Research
research@bobcaps.in

India Economics: Currency Outlook

Volatility returned to the global markets this week driven largely by a more hawkish than expected commentary from the Fed Chair. In a much-anticipated speech at the Annual Jackson Hole symposium, Fed Chair stated that he expects rate to remain high "for some time" while cautioning against "prematurely loosening policy". He also acknowledged that higher rates are likely to impinge on growth and labour market which will bring some "pain to households and businesses". The comments spurred a decline in global currencies against the dollar. INR too has depreciated against the dollar, briefly breaching the 80/$ mark.

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SAIL

- Expect full benefits of Rs 600bn expansion to flow by FY25; doubling of capacity needed to align employee cost with peers
- We conservatively forecast EBITDA/t of Rs 6.8k/Rs 7.7k over FY23/FY24 factoring in our lower steel margin forecasts for the Indian industry
- Maintain HOLD with a TP of Rs 90 (vs. Rs 150), set at a target EV/EBITDA of 4x (vs. 5x) to reflect the global economic downturn

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Reliance Industries

- Positives from the AGM include a clear succession plan, supercharged 5G rollout, restart of O2C investments, and targets in new energy
- No timelines set out for the Jio Digital and Retail listings; new leaders of three arms must prove their mettle to gain investor confidence
- We maintain our HOLD rating with a TP of Rs 2,700

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MONTHLY WRAP | Volume #7 | 30 August 2022

Indian market resilient

- **Nifty 50 returned 3.5% in Aug'22, outperforming developed and some emerging market peers**
- **Nifty valuation has now corrected to its historical mean though the premium over other EMs is close to its upper band**
- **Domestic factors offer support but the upside looks limited given global headwinds; we continue to prefer retail lenders, FMCG and IT**

Kumar Manish | Aseem Madan
research@bobcaps.in

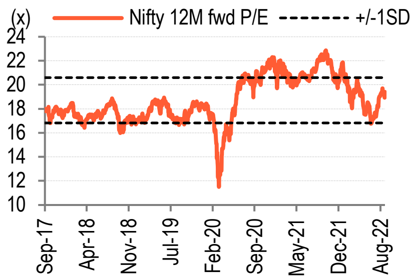
Nifty 50 returned 3.5% in Aug'22: While the Nifty 50 along with other global indices declined immediately after the US Fed's hawkish commentary at Jackson Hole, it recouped all losses the following day and ended the month up 3.5%. The technology sector corrected sharply following the Fed's comments and ended August with -2.6% returns. The INR depreciated slightly (-0.5%) against the USD while bond yields remained flat. Overall, the Nifty ended the month better than other large Asian peers such as China (-2.3%), Taiwan (-0.3%) and Korea (0%).

US Fed Chair comments stalled market rally: Equity markets across the world plummeted after the Fed reiterated its commitment to a long-term inflation goal of 2% even at the cost of "some pain to households and business". Asian currencies (ex-IDR) declined in the range of 0.5% to 2% against the USD in August, though the INR fared somewhat better. As per CME's FedWatch Tool, the probability of a 75bps rate hike in the September FOMC meeting has soared from 28% on 29 July to 68.5% now.

India valuation levels mixed: While India market valuations are now close to five-year historical averages on most parameters, viz. P/E and DY (dividend yield), the valuation premium over EMs has expanded further. That said, India valuations have always been higher relative to EMs. We believe a premium is justified due to the combination of a robust domestic economy, better disclosure norms, falling commodity prices, and slowdown in China. Notably, on unconventional valuation parameters such as market cap-to-GDP ratio and BEER (bond equity earnings yield ratio), India's valuation is at the higher end of the historic range.

Investment view: We maintain that India is better placed than most peers amid the global volatility, though a meaningful capex cycle is still a few quarters away. The Indian market does face headwinds from external factors such as a hawkish US Fed, slowing China growth, and high oil & gas prices, but domestic factors will continue to lend support, in our view. That said, the upside from current levels looks limited near term. We thus believe a conservative approach will serve investors better through CY22. We remain constructive on retail-focused lenders, consumption and IT sectors – the latter due to good earnings visibility and moderate valuations. We are cautious on energy and utilities, and largely neutral on other sectors.

Valuations remains range-bound



Source: Bloomberg, BOBCAPS Research

MARKET PERFORMANCE

30 August 2022

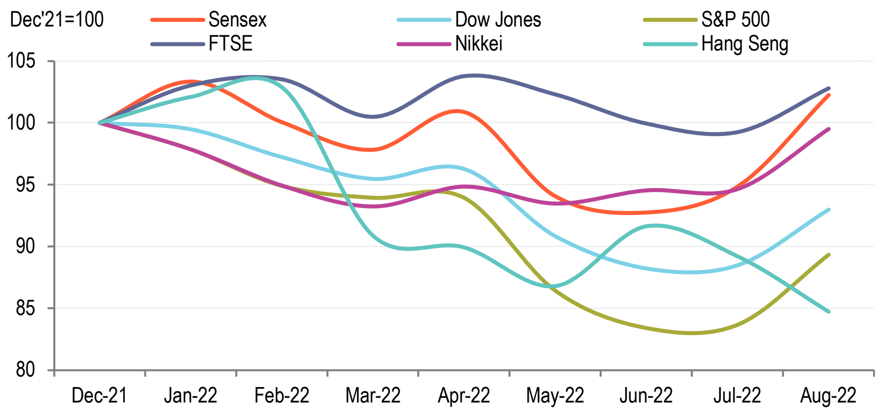
India versus global equity markets

Sonal Badhan
Economist

In CY22 so far, we have observed that Indian equity markets (both Sensex and Nifty) have performed relatively better than other major global equity markets. For comparison purpose, we have assumed December 2021 to be the base and have analysed how global markets have performed this year since then.

The figure below shows that amongst major markets, it is Sensex (Nifty also mirrors the trend) and FTSE which have largely outperformed in CY22 so far. Compared with Dec'21, Sensex and Nifty are up by 2.3% in Aug'22, and FTSE is up by 2.8%. On the other hand, Dow Jones (-7%), S&P500 (-10.7%), Nikkei (-0.5%) and Hang Seng (-15.3%) are all considerably down compared to last year. A key reason for the performance of stock markets in the US remains concerns regarding growth slowdown and Fed's aggressive monetary policy stance. Recently at Jackson Hole too, Fed Chair Powell reasserted that Fed will continue to remain hawkish to tame currently elevated levels of inflation. This is expected to hurt growth in the near-term. Tech-heavy S&P500 has thus been impacted the most in the US.

Figure 1: Sensex and FTSE performed better than others



Source: Bloomberg, Bank of Baroda Research

In case of UK, FTSE is largely dominated by financial, energy and material stocks (contributing to 41% in FTSE versus 16% in S&P). These stocks have been buoyed by increase in rates and global commodity prices. Also there is limited dominance of tech stocks which acted as a drag in other market indices.

CURRENCY OUTLOOK

30 August 2022

What's in store for INR

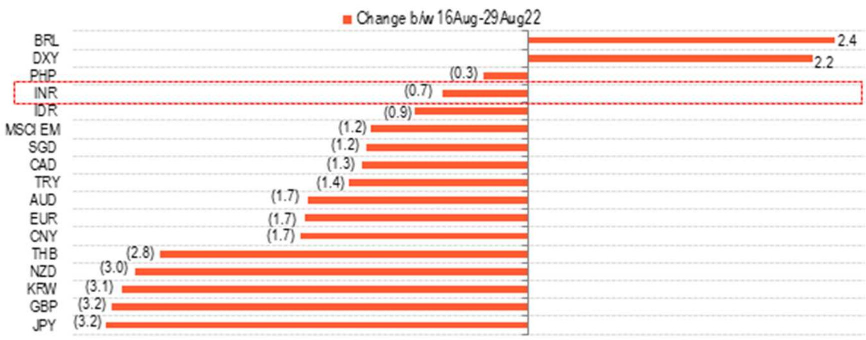
Aditi Gupta
Economist

Volatility returned to the global markets this week driven largely by a more hawkish than expected commentary from the Fed Chair. In a much anticipated speech at the Annual Jackson Hole symposium, Fed Chair stated that he expects rate to remain high "for some time" while cautioning against "prematurely loosening policy". He also acknowledged that higher rates are likely to impinge on growth and labour market which will bring some "pain to households and businesses". The comments spurred a decline in global currencies against the dollar. INR too has depreciated against the dollar, briefly breaching the 80/$ mark.

How have global currencies fared?

Global currencies have declined post the Fed Chair's speech. DXY index, which measures the dollar strength against a basket of currencies has risen by 2.2% in the last fortnight. Unsurprisingly, the Japanese yen (JPY) has seen the maximum decline as the widening policy divergence between the BoJ and other global central banks continues to weigh on the currency. The pound (GBP) has witnessed a sharp decline of 3.2% amidst a worsening cost-of-living crisis which is expected to push the economy into a recession. The euro (EUR) too has been weakening against the dollar. In fact, it is trading below the dollar-parity mark for 7-straight sessions now. A domestic energy crisis due to the Russia-Ukraine war, can be attributed to the weakness in EUR.

Figure 1: Currency movement



Source: Bloomberg, Bank of Baroda | Data as of 29 Aug 2022 | Note: Figures in bracket denote depreciation against USD

CNY too continues to remain under pressure amidst a deteriorating economic outlook, led by the ongoing property crisis. While INR remained largely stable in the last fortnight, it has come under renewed pressure after the Fed Chair's speech on Friday. It continues to flirt around the psychological level of 80/$, with active intervention from RBI preventing a fall below the level.

COMPANY UPDATE

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HOLD

TP: Rs 90 | ⮝ 13%

SAIL | Metals & Mining | 30 August 2022

Plodding quest for growth

- **Expect full benefits of Rs 600bn expansion to flow by FY25; doubling of capacity needed to align employee cost with peers**
- **We conservatively forecast EBITDA/t of Rs 6.8k/Rs 7.7k over FY23/FY24 factoring in our lower steel margin forecasts for the Indian industry**
- **Maintain HOLD with a TP of Rs 90 (vs. Rs 150), set at a target EV/EBITDA of 4x (vs. 5x) to reflect the global economic downturn**

Kirtan Mehta, CFA
research@bobcaps.in

Takeaways from our recent meeting with Amit Agarwal, Head of Investor Relations, SAIL:

Triggers to realise potential: SAIL has completed its Rs 600bn expansion and modernisation plan, but is still some time away from reaping the full benefits even after a decade-long execution drive. In our view, the company has two triggers that can bridge the gap between potential (20.2mt) and targeted production (17-17.5mt of sales guided for FY23): (1) an 0.8-1mt increase in Bhilai plant production after implementation of the Caster-4 unit, and (2) a 1mt rise in output at the IISCO and Durgapur plants via better utilisation of the 1.85mt structure mills (50-55% now) as demand grows in India.

Ramp-up of the Bokaro cold rolled mill could also help bridge the gap in production (6% of product mix in FY22 vs. SAIL's target of 11%). Semi-finished steel output has decreased to 15% of the product mix in FY22 vs. 12% targeted, and further reduction will hinge on ramp-up of the structure mills.

Legacy issues continue to weigh on margins: Improvement in employee cost per tonne remains slow as SAIL's annual manpower reduction by 3,000-4,000 staff is being partly negated by cost inflation and slow production scale-up. As legacy blast furnaces earn US$ 80-90/t lower margins, the average EBITDA margin remains constrained.

Demand pullback behind our estimate cut: We now assume FY23/FY24 EBITDA/t of Rs 6.8k/Rs 7.7k. With legacy blast furnaces still operating, a higher coke rate and weak operating leverage due to a large employee base, we expect the company to earn far lower steel margins than the US$ 200/t possible for the Indian industry, assuming China's gross margin settles at US$ 250/t, a 10Y historical average. SAIL's stock is currently discounting an EBITDA/t of Rs 4.9k/Rs 5.2k based on 5Y/10Y multiples.

Maintain HOLD: We cut FY23/FY24 EBITDA estimates by 39%/29% and lower our target 1Y forward EV/EBITDA multiple to 4x (vs. 5x) to reflect global economic uncertainty. Our TP thus reduces to Rs 90 (vs. Rs 150) – we retain HOLD given the recent stock correction, following which SAIL is trading at 3.7x FY24E EV/EBITDA compared to its 5Y/10Y mean of 5.4x/5.7x.

Key changes

Target	Rating
▼	◄ ►

Ticker/Price	SAIL IN/Rs 80
Market cap	US$
Free float	35%
3M ADV	US$ 27.1mn
52wk high/low	Rs 132/Rs 64
Promoter/FPI/DII	65%/4%/9%

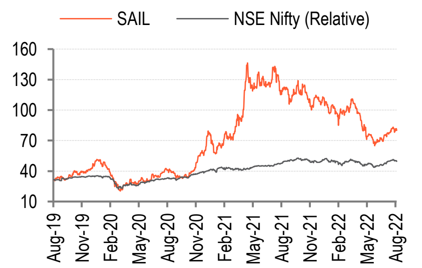
Source: NSE | Price as of 29 Aug 2022

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	1,035	1,024	952
EBITDA (Rs mn)	213	114	135
Adj. net profit (Rs mn)	122	49	67
Adj. EPS (Rs)	29.6	11.9	16.1
Consensus EPS (Rs)	29.6	10.5	10.1
Adj. ROAE (%)	24.6	8.8	11.2
Adj. P/E (x)	2.7	6.7	5.0
EV/EBITDA (x)	3.6	5.1	3.6
Adj. EPS growth (%)	195.0	(59.9)	35.6

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

FLASH NOTE

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HOLD

TP: Rs 2,700 | ⮝ 4%

RELIANCE INDUSTRIES | Oil & Gas | 30 August 2022

AGM takeaways – Growth contours defined

- **Positives from the AGM include a clear succession plan, supercharged 5G rollout, restart of O2C investments, and targets in new energy**
- **No timelines set out for the Jio Digital and Retail listings; new leaders of three arms must prove their mettle to gain investor confidence**
- **We maintain our HOLD rating with a TP of Rs 2,700**

Kirtan Mehta, CFA
research@bobcaps.in

Key takeaways from RIL's annual general meeting of 29 August:

Positive AGM inputs: Announcement of a succession plan by Chairman Mukesh Ambani is a key positive for a family-managed global corporate like RIL. Further, the company has put in motion a ~Rs 4tn (US$ 50bn) investment plan entailing, among others, a proposed fast-track nationwide 5G rollout, restart of growth investments in the oil-to-chemicals (O2C) business, and targets for solar and battery giga factories.

Potential areas of concern: While the family succession plan has been laid out, the new leaders will have to prove their mettle to garner investor confidence. RIL's stock price has been building in the listing of Jio Digital Services and Reliance Retail at healthy valuations, but the much-awaited listing timelines went undisclosed at the AGM.

Successful 5G rollout could spark earning upgrades: RIL plans to launch 5G services in key cities by Diwali (Oct'22) and scale up to nationwide rollout (1,000 cities) by Dec'23. Expansion of broadband to 100mn homes and MSMEs could mean a much faster rise in average revenue per user (ARPU), above our assumption of Rs 205 in FY25 at an 8% FY22-FY25E CAGR.

Targets set for new energy: RIL has set targets of 10GW/20GW by 2024/2026 for its integrated solar PV cell and module factory, and 5GW/50GW by 2024/2027 for its integrated battery facility. It has also announced the transition from gray to green hydrogen from 2025, launch of a power electronics gigafactory and entry into bio-energy.

Restarting investment-led growth in O2C: Investments were announced in three chains, including 3mtpa PTA, 1mtpa PET and 1mtpa polyester facilities by 2026, 1.5mtpa PVC expansion and a 20ktpa carbon-fibre plant.

Maintain HOLD: We retain our TP of Rs 2,700 for RIL based on 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 141 for the upstream business, Rs 110 for the digital services venture and Rs 117 for the new energy division.

Key changes

Target	Rating
◀ ▶	◀ ▶

Ticker/Price	RIL IN/Rs 2,598
Market cap	US$ 224.3bn
Free float	49%
3M ADV	US$ 248.5mn
52wk high/low	Rs 2,856/Rs 2,180
Promoter/FPI/DII	51%/24%/15%

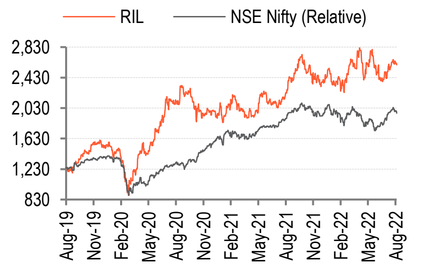
Source: NSE | Price as of 29 Aug 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	6,999,620	9,271,255	9,784,856
EBITDA (Rs mn)	1,104,600	1,511,727	1,614,411
Adj. net profit (Rs mn)	584,201	784,196	889,882
Adj. EPS (Rs)	86.4	115.9	131.5
Consensus EPS (Rs)	86.4	119.5	137.0
Adj. ROAE (%)	7.9	9.6	10.0
Adj. P/E (x)	30.1	22.4	19.7
EV/EBITDA (x)	18.3	13.3	12.2
Adj. EPS growth (%)	33.8	34.2	13.5

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

Stock performance



Source: NSE

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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

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