FIRST LIGHT

24 May 2022

RESEARCH

Divi's Labs | Target: Rs 4,250 | +9% | HOLD

Strong all-round beat but growth unsustainable – cut to HOLD

BOB Economics Research | Fiscal Update

Government cuts excise etc. What are fiscal implications?

BOB Economics Research | External Borrowings

Taking stock of ECBs

Metals & Mining

Duty changes put near-term pressure on domestic steel margins

SUMMARY

Divi's Labs

- Robust standalone Q4 revenue/EBITDA growth of 45%/57% YoY, ahead of consensus by 11%/17%
- Covid-led growth surge looks unsustainable; inflationary environment, and increased costs likely to sap margins
- We cut FY23-FY24 EBITDA 9-15% and reset to 26x EV/EBITDA (vs. 27x), yielding a new TP of Rs 4,250 (vs. Rs 5,250); downgrade to HOLD

Click here for the full report.

India Economics: Fiscal Update

Centre has recently announced multiple measures to ease inflation. These include, cut in excise duty on fuel products, higher fertilizer subsidy, subsidy on gas cylinders, and cut in custom duty on some items. Earlier too, government had announced relief for PM-GKAY beneficiaries. The fiscal cost of these measures is expected to be Rs ~2.9 lakh crore. While Centre is expected to meet the gap partly via higher indirect tax revenue and nominal GDP, fiscal deficit may slip to 6.6-6.7% in FY23.

Click here for the full report.

Daily macro indicators

Indicator	19-May	20-May	Chg (%)
US 10Y yield (%)	2.84	2.78	(6bps)
India 10Y yield (%)	7.32	7.36	4bps
USD/INR	77.73	77.55	0.2
Brent Crude (US$/bbl)	112	112.6	0.5
Dow	31,253	31,262	0.0
Hang Seng	20,121	20,717	3.0
Sensex	52,792	54,326	2.9
India FII (US$ mn)	**18-May**	**19-May**	**Chg ($ mn)**
FII-D	8.1	21.6	13.5
FII-E	(116.1)	(494.6)	(378.5)

Source: Bank of Baroda Economics Research

BOBCAPS Research
research@bobcaps.in

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda
Important disclosures, including any required research certifications, are provided at the end of this report.

India Economics: External Borrowings

External commercial borrowings (ECBs) have emerged as an important source of financing for corporates including PSUs. Apart from their relative cost advantage (owing to lower global interest rates for an extended period of time), it also supplements the credit demand of the country thus supporting growth. The growing importance of ECBs can be gauged from the fact that ECBs account for a major share of India's external debt. In fact, ECBs accounted for 36.8% of India's external debt as of end of Dec'21. ECB approvals rose to US$ 38.3bn in FY22 from US$ 34.8bn in FY21. However, with global interest rates poised to edge up, the relative attractiveness of ECB inflows may diminish. Further, the recent depreciation seen in INR will also weigh on ECB inflows this year.

Click here for the full report.

Metals & Mining

- Levy or increase of export duty to improve domestic availability of steel products, iron ore and pellets
- This is likely to lower integrated steel margins near-term, limiting capture of any upside from export opportunities
- More importantly, unless these measures are temporary, there would likely be question mark on viability of extant expansion projects

Click here for the full report.

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

HOLD
TP: Rs 4,250 | 9%

DIVI'S LABS | Pharmaceuticals | 23 May 2022

Strong all-round beat but growth unsustainable – cut to HOLD

- **Robust standalone Q4 revenue/EBITDA growth of 45%/57% YoY, ahead of consensus by 11%/17%**
- **Covid-led growth surge looks unsustainable; inflationary environment, and increased costs likely to sap margins**
- **We cut FY23-FY24 EBITDA 9-15% and reset to 26x EV/EBITDA (vs. 27x), yielding a new TP of Rs 4,250 (vs. Rs 5,250); downgrade to HOLD**

Surajit Pal | Saad Shaikh
researchreport@bobcaps.in

Growth to rationalise as Covid-led surge ebbs: DIVI reported a 45%/57% YoY increase in standalone Q4FY22 revenue/EBITDA to Rs 25bn/Rs 11bn, beating consensus estimates by 11%/17%. We believe this abnormal growth was derived from Covid-led drugs (similar to last quarter) and is unsustainable going forward with pandemic subsiding all over the world except China. We thus foresee lower growth on a higher base. On the margin front as well, the inflationary environment coupled with a growth taper would weigh on performance.

Q4 growth led by custom synthesis business; generic volumes intact: During the quarter, the custom synthesis business grew 60% QoQ while generic APIs recorded a decline of 66% QoQ. Management highlighted that there was no reduction in volumes or loss of customers in the generics business and expects generic sales to rebound in the next 6-12 months.

Capacity upgrades helping to reduce geopolitical risk: DIVI's recent investments toward capacity upgrades are yielding fruit in terms of securing the supply of intermediates and curbing geopolitical risk. The company plans to further invest Rs 20bn-30bn over the next 2-3 years for capacity expansion/upgrades in order to tap US$ 20bn worth of molecules that are going off-patent in 3-5 years. Per management, several soon-to-be off-patent molecules are coming from small biopharma companies. DIVI sees large potential in these upcoming molecules and will focus on the ones that offer a long growth runway.

Growth outlook muted; cut to HOLD: Given the current high base, ~85% capacity utilisation, delays at new plants as well as reduced margins and the absence of abnormal growth, we cut our FY23-FY24 EBITDA estimates by 9-15% and lower our target EV/EBITDA multiple from 27x to 26x (implied P/E multiple of 37x) – in line with 5-year average multiple. Our revised TP now stands at Rs 4,250 (Rs 5,250 earlier), offering just 9% upside – downgrade from BUY to HOLD.

Key changes

Target	Rating
▼	▼

Ticker/Price	DIVI IN/Rs 3,898
Market cap	US$ 13.3bn
Free float	48%
3M ADV	US$ 24.5mn
52wk high/low	Rs 5,425/Rs 3,789
Promoter/FPI/DII	52%/21%/16%

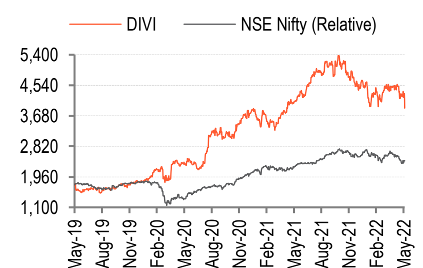
Source: NSE | Price as of 23 May 2022

Key financials

Y/E 31 Mar	FY22P	FY23E	FY24E
Total revenue (Rs mn)	89,598	98,075	1,09,046
EBITDA (Rs mn)	38,819	39,246	42,545
Adj. net profit (Rs mn)	29,604	28,202	30,552
Adj. EPS (Rs)	111.5	106.2	115.1
Consensus EPS (Rs)	111.5	108.0	126.2
Adj. ROAE (%)	28.2	23.2	22.6
Adj. P/E (x)	35.0	36.7	33.9
EV/EBITDA (x)	26.2	25.7	23.5
Adj. EPS growth (%)	49.2	(4.7)	8.3

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

Stock performance



Source: NSE

FISCAL UPDATE

23 May 2022

Government cuts excise etc. What are fiscal implications?

Centre has recently announced multiple measures to ease inflation. These include, cut in excise duty on fuel products, higher fertilizer subsidy, subsidy on gas cylinders, and cut in custom duty on some items. Earlier too, government had announced relief for PM-GKAY beneficiaries. The fiscal cost of these measures is expected to be Rs ~2.9 lakh crore. While Centre is expected to meet the gap partly via higher indirect tax revenue and nominal GDP, fiscal deficit may slip to 6.6-6.7% in FY23.

Sonal Badhan
chief.economist@bankofbaroda.com

Problem at hand: CPI inflation rose to nearly 8 year high (8.3% in May'14) to 7.8% in Apr'22 (est.: 7.5%) from 7% in Mar'22, thus surpassing RBI's mandate for the third consecutive month now. Food inflation rose further by 8.4% in Apr'22 (17-month high) from 7.7% in the previous month. Core inflation rose by 66bps to 7% in Apr'22. Depreciating rupee is also posing concern of imported inflation, apart from recuing RBI's FX reserves to stem sharp fall in INR. Rising inflationary concerns also led to out of cycle repo rate hike (+40bps) by the RBI in mid-May. It is expected that the central bank will have to hike rates by another 50-75 bps to tame inflation. However, higher rates pose risks to growth, at a time when there are fears of imminent global slowdown.

Government measures: In order to help lower the burden on consumers and keep inflation in check, Minister of Finance has announced several measures. **These include:** Rs 8/lt cut in additional excise duty on petrol; Rs 6/lt cut in additional excise duty on diesel; additional; Rs 1.1 lakh crore fertilizer subsidy (over and above Rs 1.05 lakh crore budgeted for FY23); Rs 200 subsidy per gas cylinder (upto 12 cylinders) to ~9 crore beneficiaries of PM Ujjwala Yojna; reduction in customs duty on raw materials and intermediaries for plastics products, and iron and steel. Export duty has been levied on some steel products (up 15%) and iron ore (up to 50% from 30% earlier). Import duty on ferronickel, coking coal, PCI coal has been cut from 2.5% to 0%, while the duty on coke and semi-coke has been cut from 5% to 0%. Import duty on Naphtha has been reduced to 1% from 2.5%, and on PVC to 7.5% from 10%. These measures are expected to reduce the cost of final products.

Fiscal Cost: The Finance Minister has announced that the reduction in additional excise duty on petrol and diesel will solely impact revenues of the Centre, as that duty is not shared with states. Government revenues will suffer a loss of Rs 1 lakh crore due to this. In addition, additional fertilizer subsidy will push the overall subsidy bill up to Rs 4.3 lakh crore from the budgeted Rs 3.2 lakh crore. Fertilizer subsidy will now stand at Rs 2.15 lakh crore. Cost of providing subsidy on gas cylinders will also cost the exchequer Rs 6,100 crore. Previously, on 26 Mar 2022, government had also announced extension of PM-GKAY for another 6 months from Apr-Sep'22, costing the exchequer Rs 80,000 crore.

Fiscal Deficit to rise to 6.6-6.7% of GDP: All things remaining the same, if we take into account the fiscal cost of government measures announced, then the fiscal deficit for FY23 will increase from Rs 16.6 lakh crore to Rs 19.5 lakh crore (7.5% as % of GDP) under *ceteris paribus* conditions. In the Budget nominal GDP was taken at Rs 258 lakh crore. However, some underlying assumptions of FY23 budget have changed.

- Firstly, now with higher inflation, we expect nominal GDP to be higher at 13.5-14% in FY23 compared with 11.1% assumed by the government earlier in Feb'22. This will provide an upward fillip to the denominator which will now be in the range of Rs 268-270 lakh crore.

EXTERNAL BORROWINGS

23 May 2022

Taking stock of ECBs

Aditi Gupta
Economist

External commercial borrowings (ECBs) have emerged as an important source of financing for corporates including PSUs. Apart from their relative cost advantage (owing to lower global interest rates for an extended period), it also supplements the credit demand of the country thus supporting growth. The growing importance of ECBs can be gauged from the fact that ECBs account for a major share of India's external debt. In fact, ECBs accounted for 36.8% of India's external debt as of end of Dec'21. ECB approvals rose to US$ 38.3bn in FY22 from US$ 34.8bn in FY21. However, with global interest rates poised to edge up, the relative attractiveness of ECB inflows may diminish. Recent depreciation in INR will also weigh on ECB inflows this year.

ECB Inflows: Historical trends

From US$ 11.4bn in FY05, ECB approvals surged to US$ 25bn in FY08, before moderating to US$ 17.6bn in FY09 due to the global financial crisis. Thereafter, ECB inflows recovered and touched a high of US$ 34.9bn in FY12. There was a moderation in ECB approvals in the succeeding years, with ECB approvals falling sharply to US$ 17.1bn in FY17. In the period thereafter, RBI introduced several relaxations with respect to ECBs, leading to greater inflows.

In Jan'19, RBI introduced the new ECB framework. Under this, RBI expanded the list of eligible borrowers and lenders to include all entities eligible to receive FDI to tap ECB flows. Further, the minimum average maturity period (MAMP) was kept at 3 years for all ECBs, barring a few exceptions. Additionally, the borrowing limit for all eligible borrowers was raised to US$ 750mn under the automatic route, thus doing away with sector wise limits. This was followed by further easing of restrictions on working capital, general corporate purpose and repayment of rupee loans in Jul'19.

On the other hand, RBI continued to tighten regulations on bank credit and working capital, thereby limiting credit supply to borrowers. Credit growth was also severely curtailed by the NPA crisis. As a result, ECB approvals surged sharply in the next 3-years, to a high of US$ 51bn in FY20. It must be noted that credit growth by SCBs slowed down to just 6.3% in the same period (12.9% in FY19) even as both WALR and repo rate were lower.

In FY21, ECB approvals moderated to US$ 34.8bn due to the Covid-19 pandemic and loss in economic activity. However, in FY22, ECB approvals have jumped to US$ 38.2bn as economic activity picked up, thus spurring demand for credit.

BOBCAPS
TRUST | INNOVATION | EXCELLENCE

METALS & MINING

23 May 2022

Duty changes put near-term pressure on domestic steel margins

- **Levy or increase of export duty to improve domestic availability of steel products, iron ore and pellets**
- **This is likely to lower integrated steel margins near-term, limiting capture of any upside from export opportunities**
- **More importantly, unless these measures are temporary, there would likely be question mark on viability of extant expansion projects**

Kirtan Mehta, CFA
researchreport@bobcaps.in

Indian steel price to follow downward global trend: Improved domestic availability of steel and iron ore with duty adjustment could align domestic spot steel prices below import parity level. Current HRC steel price of around Rs.70k could potentially decline by Rs4k-10k, with US$50/t reduction at the lower end to align with import prices, and upper end impacted by around US$125/t of export penalty,

Raw material duty changes to provide part offset: net 20mt or around 10% extra availability of iron ore and pellets could lower domestic iron ore price by Rs1.5-2.0k. Similarly, reduction of 2.5% import duty could reduce coking coal price by Rs1.0k. Together these could reduce steel production cost by Rs3.0-4.0k.

Near-term pressure on domestic steel margins: These changes could potentially lower domestic steel margins by Rs1-4k for integrated players for a scenario of Rs5k decline in steel prices. Company specific impact is dependent upon proportion of export sale, contractual sale and captive iron ore without index linkage. We believe JSW and JSPL could see lower impact as reduction in iron ore prices could offset fall in domestic steel prices as well as export earnings. Both JSW and TATA could see some insulation from quarterly contract prices for auto segment. SAIL could see higher impact and face higher change in earnings due to lower per unit margin.

Medium-term impact has many moving parts: Medium-term impact could be dependent on several factors. Domestic balance will depend upon impact of measures on Indian demand, level of continuing exports post duty increase, and production level of smaller players, who are at higher risk due to their lower margin. Global prices are also dependent upon timing of rebound and strength of China demand, impact of reduction on global supply from lower Indian export, stability of demand outside China, balance outside China and reduction in coking coal prices.

More importantly, measures need to remain temporary: It is important that industry continue to enjoy flexibility to shift volumes between domestic and international markets, which is essential for supporting current expansion projects under implementation.

Recommendation snapshot

Ticker	Price	Target	Rating
JSP IN	479	555	BUY
JSTL IN	631	810	BUY
SAIL IN	83	150	HOLD
TATA IN	1,171	1,700	BUY

Price & Target in Rupees | Price as of 20 May 2022

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.

Rating distribution

As of 30 April 2022, out of 116 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 66 have BUY ratings, 30 have HOLD ratings, 5 are rated ADD*, 1 is rated REDUCE* and 14 are rated SELL. One company rated ADD has been an investment banking client in the last 12 months. (*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

Analyst certification

Each of the analysts mentioned in this research report certify, with respect to the sections of the report for which they are responsible, that (1) all of the views expressed in this report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

Important disclosures

This product is a compilation of previously published research notes. To view the complete report along with the associated Analyst certifications and Company-specific disclosures, please click on the hyperlink accompanying each excerpt.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed

in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Other disclosures

BOBCAPS does not have any financial interest in the subject company. BOBCAPS does not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS is not engaged in any market making activities for the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.