BOBCAPS
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FIRST LIGHT

22 October 2020

RESEARCH

L&T Infotech | Target: Rs 3,590 | +16% | BUY

Robust growth and pipeline; margin shines

Oil & Gas

OMCs – Depressed valuations overlook earnings traction

SUMMARY

L&T Infotech

L&T Infotech's (LTI) Q2FY21 revenue beat estimates, with 2.3% QoQ CC growth due to an uptick in the manufacturing and BFS verticals. Operating margins stood at a record high of 19.9% backed by increased offshoring and tight SG&A cost control. We raise FY21/FY22/FY23 EPS by 12%/10%/9% given LTI's strong revenue mix, favourable offshore presence, client mining skills and robust leadership. Rolling valuations over, we move to a new Sep'21 TP of Rs 3,590 (vs. Rs 3,290), set at an unchanged target P/E of 27x. BUY.

Click here for the full report.

Oil & Gas

The earnings outlook for oil marketing companies (OMC) remains buoyant as marketing margins are holding at elevated levels. Recovery in oil product demand, albeit a bit delayed, looks imminent in H2FY21. Benchmark GRMs have begun to revive from October. BPCL's divestment process has raised hopes for sustained and irreversible deregulation in petrol and diesel pricing. Delays in this divestment have led to a sharp share price correction in OMCs (IOCL, HPCL), making risk-reward favourable.

Click here for the full report.

TOP PICKS

LARGE-CAP IDEAS

Company	Rating	Target
Bajaj Finance	Buy	4,000
Cipla	Buy	850
GAIL	Buy	155
Petronet LNG	Buy	310
Tech Mahindra	Buy	910

MID-CAP IDEAS

Company	Rating	Target
Alkem Labs	Buy	3,600
Chola Investment	Buy	280
Laurus Labs	Buy	1,200
Transport Corp	Buy	270
Mahanagar Gas	Sell	750

Source: BOBCAPS Research

DAILY MACRO INDICATORS

Indicator	Current	2D (%)	1M (%)	12M (%)
US 10Y yield (%)	0.79	2bps	9bps	(98bps)
India 10Y yield (%)	5.93	(1bps)	(8bps)	(61bps)
USD/INR	73.47	(0.1)	0	(3.6)
Brent Crude (US$/bbl)	43.20	1.3	0	(27.7)
Dow	28,309	0.4	2.4	5.7
Shanghai	3,328	0.5	(0.3)	12.6
Sensex	40,544	0.3	4.4	4.1
India FII (US$ mn)	**19 Oct**	**MTD**	**CYTD**	**FYTD**
FII-D	(2.8)	238.3	(14,441.4)	(4,681.9)
FII-E	271.1	1,463.5	5,503.5	12,106.5

Source: Bank of Baroda Economics Research

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BUY
TP: Rs 3,590 | ⮝ 16%

L&T INFOTECH | IT Services | 21 October 2020

Robust growth and pipeline; margin shines

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Record high EBIT margin: In line with the V-shaped recovery across the sector, LTI's 2.3% QoQ CC revenue growth (against 1.4% est.) was driven by traction in BFS and manufacturing. The top client continues to grow well. Insurance, retail, CPG, pharma and hi-tech remained weak due to the Covid impact. Two key areas of emerging demand are cloud (partnership with hyperscalers such as AWS and Google Cloud) and data-driven products. EBIT margin stood at an all-time high of 19.9% (17.8% est.), increasing 240bps QoQ amid LTI completing five years of operations.

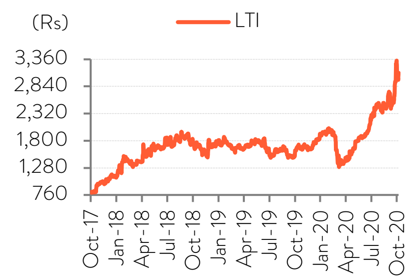
TCV recovery: Q2 TCV stood at US$ 40mn, recovering QoQ but still down 60% YoY. As per management, large deals are taking longer to close post Covid-19. Q2 deal wins came from hi-tech, manufacturing and BFS, including new Fortune-500 clients. A total of 20 new logos were added across verticals.

Increased FY21 visibility: Management outlook remains cautiously positive on the back of a healthy deal pipeline and strong client mining. The Q3FY21 outlook is upbeat as revenue has already crossed Q4FY20 figures QTD. PAT margin guidance for FY21 is in the range of 14-15%, despite salary hikes and hiring starting from Jan'21, as LTI will continue leveraging offshoring of work.

Ticker/Price	LTI IN/Rs 3,100
Market cap	US$ 7.4bn
Shares o/s	176mn
3M ADV	US$ 12.3mn
52wk high/low	Rs 3,513/Rs 1,210
Promoter/FPI/DII	75%/8%/10%

Source: NSE

STOCK PERFORMANCE



Source: NSE

KEY FINANCIALS

Y/E 31 Mar	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (Rs mn)	94,458	108,786	126,041	156,270	180,528
EBITDA (Rs mn)	18,835	20,291	26,757	30,740	35,306
Adj. net profit (Rs mn)	15,157	15,198	18,419	21,656	24,988
Adj. EPS (Rs)	86.5	86.4	105.0	123.4	142.4
Adj. EPS growth (%)	36.1	0.0	21.5	17.6	15.4
Adj. ROAE (%)	34.6	29.5	31.0	30.5	29.6
Adj. P/E (x)	35.9	35.9	29.5	25.1	21.8
EV/EBITDA (x)	28.8	26.7	20.3	17.7	15.2

Source: Company, BOBCAPS Research

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OIL & GAS

21 October 2020

OMCs – Depressed valuations overlook earnings traction

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The earnings outlook for oil marketing companies (OMC) remains buoyant as marketing margins are holding at elevated levels. Recovery in oil product demand, albeit a bit delayed, looks imminent in H2FY21. Benchmark GRMs have begun to revive from October. BPCL's divestment process has raised hopes for sustained and irreversible deregulation in petrol and diesel pricing. Delays in this divestment have led to a sharp share price correction in OMCs (IOCL, HPCL), making risk-reward favourable.

Robust marketing margins to protect earnings: OMCs' stupendously high marketing margins in Q1FY21 made up for the impact of low product sales and negative benchmark GRMs during the quarter. The marketing segment could continue to anchor earnings growth through FY21-FY22, giving OMCs a near-term advantage over global peers that are exposed to the refining segment. GRMs have started to recover from Oct'20, but the outlook remains uncertain as a second wave of the pandemic hits the US and Europe. High marketing margins provide a cushion against cyclical uncertainty in OMC earnings.

Sales volume to normalise in H2FY21: Petroleum product consumption declined ~11% in H1FY21. Diesel consumption, a key barometer of economic activity, remained negative at −15.6% YoY in Sep'20 (vs. −25% in H1). Petrol demand, a barometer of personal mobility, has recovered faster to −5% YoY in Sep'20 (vs. −20% in H1). Trends for October look promising **(see Argus Media's report)**, with diesel offtake improving 9% in the first half of the month. We could see a return to normal product consumption in India during H2FY21.

Valuations at a disconnect with fundamentals: OMCs (IOCL, HPCL) are currently trading at depressed valuations of ~3x FY22E EPS, barring BPCL (8x) due to divestment expectations. At these low valuations, the companies offer excellent dividend yields (>15%), assuming earnings remain buoyant. With completion of the BPCL divestment (in FY21E), ~40% of the fuel retailing market would be privatised. This will make free pricing for petrol/diesel an irreversible reform and hence boost valuation multiples for HPCL and IOCL.

We prefer IOCL, HPCL and BPCL in that order, based on current valuations, outlook on dividend yield, and triggers from better refining margins once oil demand normalises.

KEY RECOMMENDATIONS

Ticker	Price	Target	Rating
IOCL IN	76	195	BUY
BPCL IN	350	480	BUY
HPCL IN	178	440	BUY

Price & Target in Rupees

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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