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Values that bind

Morning Buzz
INDIA

1 April 2016

Top Research Picks

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- Grasim Industries: VSF plant visit – New expansion driving growth

Other Research

- India IT Services: Q4 Preview: Mixed quarter despite low base
- India Economics: Foreign debt declines further - External vulnerability continues to improve
- India Financials: Credit Tracker: Non-food credit growth stable at 9.9%

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31 March 2016

India Energy

Domestic gas price cut – gains for utilities

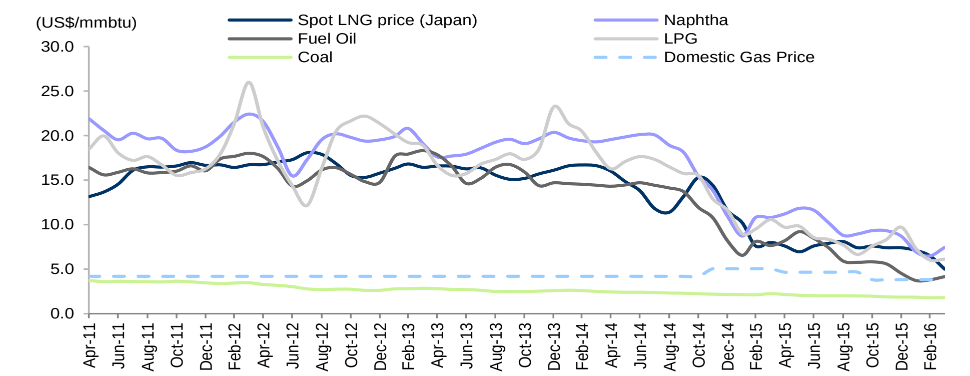
- **Price reduction as expected:** The government has maintained status quo on the gas pricing formula, allowing price to fall 20% to US$ 3.06/mmbtu (GCV, ~US$ 3.25/mmbtu on NCV) for period from Apr'16 to Sep'16. Considering the formula is based on international gas prices for a period of Jan'15 to Dec'15, the declining trend was known and hence shouldn't lead to any significant change in earnings estimates for upstream companies (ONGC, OINL). Price comes close to lifting costs for gas production for ONGC/OIL of ~US$ 3/mmbtu. Investment outlook for domestic gas production becomes bleaker. The gas pricing formula for Deepwater fields (that have higher lifting costs), seems unviable too since it trends at ~US$4.5/mmbtu (assuming current oil prices sustain over the long-term)

- **Positive for demand outlook as blended prices decline further:** Currently, APM gas constitutes 73% of total domestic gas production and ~50% of gas consumption (including LNG) in India. Considering that most of the consumers blend domestic gas with LNG (ratio varies depending on allotment of domestic gas – highest for fertiliser plants), the blended costs for gas prices would decline by ~10% on an average. Power consumers being the most price sensitive would benefit the most from this decline, considering prices are unlikely to return to US$ 4/mmbtu levels for another year or two. We could see an improvement in gas consumption once PLNG commissions its incremental regasification capacity at Dahej.

- **Gains for GAIL:** GAIL consumes ~6mmscmd for its LPG and petrochemicals businesses. Of this, ~3.5mmscmd is domestic gas that is mostly allotted for LPG, while the petrochemicals segment gets a marginal allotment. Margins for the LPG business should expand by ~10% with this price reduction.

- **IGL primary gainer among CGD utilities:** IGL should gain the most from the price cut, considering domestic gas (APM fields) constitutes ~70% of its gas sourcing mix (allotted for CNG and domestic PNG segments). This along with a reduction in LNG prices should lead to ~15% reduction in average gas costs for IGL in FY17. However, its margin expansion would depend on the extent of retail price cuts for CNG and PNG. We believe this could be much lower than the decline in gas prices as IGL's other operating costs have surged over the last few quarters. Gains for Gujarat Gas (GGAS) from this price cut would be relatively lower, as APM gas constitutes only ~20% of its gas sourcing mix.

Fig 1 - Domestic gas price vs alternatives



Source: PPAC, Bloomberg, RCML Research

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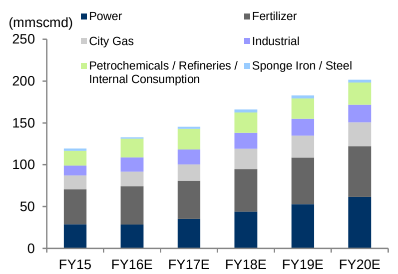
Ticker	CMP (Rs)	TP (Rs)	REC
GAIL IN	359	450	BUY
PLNG IN	244	340	BUY
IGL IN	551	710	BUY
GUJS IN	136	180	BUY
GUJGA IN	534	660	BUY

Domestic gas price

Period	Gas Price	% change
Jan'14 - Nov'14	4.20	NM
Nov'14 - Mar'15	5.05	20.2
Apr'15 - Sep'15	4.66	(7.7)
Oct'15 - Mar'16	3.82	(18.0)
Apr'16 - Sep'16	3.06	(19.9)

Source: PPAC, RCML Research

India gas consumption outlook



Source: Industry, RCML Research

Flash Note
INDIA
CEMENT

31 March 2016

BUY
TP: INR 5,000.00
▲ 30.3%

Grasim Industries

GRASIM IN

VSF plant visit – New expansion driving growth

We visited Grasim's new 120k tpa VSF plant in Vilayat, Gujarat, where high-margin specialty fibre accounts for ~33% of capacity. With this expansion, Grasim's total VSF capacity stands at 498k tpa and its market share at 9% globally. The VSF business has improved markedly in 9MFY16 with volume growth of 19% aided by capacity expansion. With cement likely to do well, any further improvement in the VSF/chemical markets could result in a contraction of the holding company discount. Maintain BUY, TP Rs 5,000.

- **Vilayat plant aiding volume growth:** Grasim's sprawling Vilayat plant is built over 550 acres and has 3 main product plants, 7 auxiliary plants and 96MW of captive power generation. Out of the 120k tpa, ~33% is specialty fibre capacity (modal and micro modal). Management expects the cost of production at this plant to be ~20% lower than its old plants. While VSF prices are controlled by China, specialty fibre "modal" prices are controlled by only one player, Lenzing, who has 19% share in the global VSF market. Specialty fibre VSF command higher margins than normal VSF. Grasim's greenfield capacities at Harihar (Karnataka) and Vilayat (Gujarat) have raised its VSF capacity by 40% in FY16.

- **VSF business on a recovery path:** Grasim's VSF business has improved markedly in the last nine months of FY16, with volumes growing 19% aided by capacity expansion. Realisations have also improved by 12% to Rs 132.7/kg from Rs 118.6/kg in Q4FY15. Management had earlier highlighted that the shutdown of some capacities in China due to environmental regulations had led to the price increase. Realisations would continue to track the global situation, particularly China.

- **Chemical business doing well:** We also visited the company's chemical plant in Vilayat which has a capacity of 182k tpa for caustic soda and 52k tpa for epoxy. The caustic soda plant has already achieved 100% utilisation. With the amalgamation of Aditya Birla Chemicals India (ABCIL) with the chemical segment on 4Jan16 (merger to be effective from Apr'16), Grasim's caustic soda capacity stands increased to 804k tpa from 452k tpa. This merger is likely to result in benefits of scale, better profitability and higher cash flow generation as the capex cycle draws to an end.

- **Valuations reasonable; maintain BUY:** We value Grasim's cement business on UTCEM's TP, assigning a holding company discount of 30% (versus ~50% currently). Grasim's VSF and chemical businesses are valued at an EV/EBITDA of 4x one-year forward. Including the value of liquid investments, we have a TP of Rs 5,000. While the VSF business has been a solid performer in the last two quarters, a consistent showing in future quarters is contingent on the global scenario. With cement likely to do well, any further improvement in the VSF and chemical markets could result in a contraction of the holding company discount. Maintain BUY.

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PRICE CLOSE (30 Mar 16)
INR 3,838.65

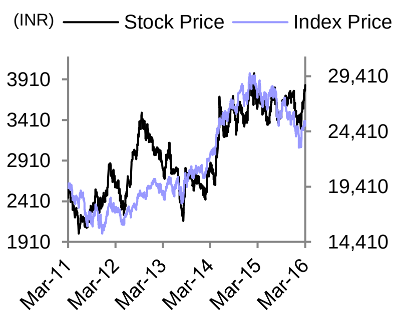
MARKET CAP
INR 358.3 bln
USD 5.4 bln

SHARES O/S
91.7 mln

FREE FLOAT
74.5%

3M AVG DAILY VOLUME/VALUE
0.1 mln / USD 3.9 mln

52 WK HIGH	52 WK LOW
INR 3,858.90	INR 3,233.00



RELIGARE INSTITUTIONAL RESEARCH
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Sector Update
INDIA
INFORMATION TECHNOLOGY

1 April 2016

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India IT Services

Q4 Preview: Mixed quarter despite low base

We expect mixed growth for the RCML IT universe in Q4FY16. Large-caps are likely to report US$ revenue growth of (0.7)-3.2% QoQ with range-bound margins. TECHM is set to post another weak quarter (flat QoQ CC), while INFO/ TCS should lead organic growth among large-caps. We expect a soft quarter for mid-cap IT services with flat QoQ US$ revenue growth. The US$ has appreciated against GBP, and the fx impact should range between -40 to -70 bps; but a weak INR remains a tailwind. Post the strong share price performance in the Indian IT names, we think valuations are beginning to look full. Stay selective.

- **Mixed growth in Q4:** We expect US$ revenue growth of 2.1%/2.3%/3.2%/2.0%/ (0.7)% QoQ for large-caps INFO/TCS/WPRO/HCLT/TECHM in Q4FY16 amid cross-currency headwinds of 40bps-70bps. We thus build in EPS growth of 2.3%/0.4%/ 2.1%/(1.7%)/(9.6%) QoQ for these companies on expectations of flattish margins and lower other income. We foresee weak organic performance from mid-caps.
- **INFO's FY17 revenue guidance the key:** We expect INFO's revenues to come in at the upper end of its FY16 US$ revenue guidance of 8.9-9.3% YoY (RCMLe: 9.2%). The company is likely to guide for US$ revenue growth of 10.5-12.6% in FY17. WPRO is likely to guide for 2.3-5.3% QoQ revenue growth for Q1 led by inorganic revenues (organic growth guidance 1- 3%).
- **Weak performance from mid-caps:** We expect IT mid-caps under our coverage to deliver weak US$ revenue growth, in the range of -1.7 to 1.8% QoQ. MTCL has already issued a profit warning, and we expect NITEC to report lower revenues QoQ. Given the benign competitive environment in the internet real estate space, we expect a better margin performance from INFOE.
- **View:** Overall, we believe Q4FY16 to be a soft quarter sequentially for the RCML IT universe, despite a low Q3 base (due to Chennai floods, weak seasonality). Indian IT stocks have outperformed the Sensex by 3.7% this quarter; however, the INR has retraced from its lows, and valuations for IT large-caps are beginning to look full. We believe that in absence of any big guidance surprise from INFO, the overall earnings upgrade outlook for the sector looks bleak. We thus prefer select stocks with INFO and HCLT as our top picks.

Fig 1 - Q4FY16: IT preview

(Rs mn)	Results date	Sales	QoQ (%)	YoY (%)	EBIT	QoQ (%)	Margins (%)	PAT	QoQ (%)	YoY (%)	EPS (Rs)
TCS	18-Apr-16	284,241	3.9	17.4	75,640	4.0	26.6	61,369	0.4	59.1	31.1
Infosys	15-Apr-16	165,350	4.0	23.4	41,194	4.1	24.9	35,413	2.3	14.5	15.4
Wipro	20-Apr-16	135,240	5.2	11.4	25,572	7.1	18.9	22,802	2.1	3.0	9.3
HCL Tech. (HCLT)	4th week of Apr	107,532	3.9	15.8	21,439	3.3	19.9	18,893	(1.7)	12.2	13.4
Tech Mahindra (TECHM)	24-Apr-16	67,832	1.2	10.9	9,214	(4.2)	13.6	6,861	(9.6)	45.4	8.2

Source: Company, RCML Research

Click here for the full report.

31 March 2016

Foreign debt declines further

External vulnerability continues to improve

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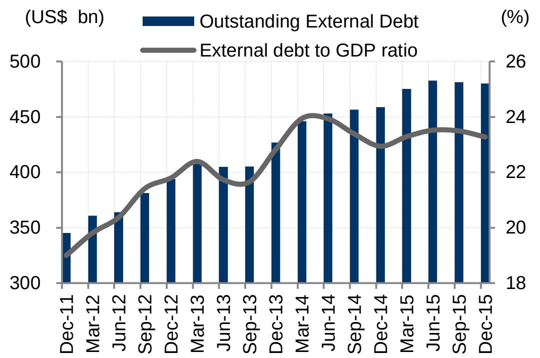
India's external debt fell for the second straight quarter to touch US$ 480.2bn (23.3% of GDP) in Q3FY16 led by a decline in short-term debt. The rise in forex reserves on account of an improvement in BOP position coupled with the continuous fall in short-term debt has led to a sustained improvement in external vulnerability over the last two years, even as mounting ECB stockpile remains a concern. Overall, India's external debt position remains comfortable vis-à-vis other EMs.

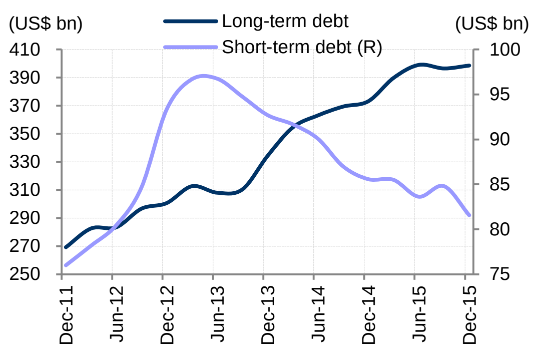
- **External debt at 23.3% of GDP:** India's external debt increased by 4.7% YoY to US$ 480.2bn in Q3FY16. However, on a QoQ basis, it declined for the second straight quarter after touching an all-time high of US$ 482.7bn in end-Jun'15. As a proportion of GDP, external debt remained unchanged at 23.3% by end-Dec'15 versus end-Mar'15.
- **Short-term debt at a 3.5-year low:** India's short-term external debt (by original maturity) slid by 4.6% over last nine months to US$ 81.bn by end-Dec'15. Short-term debt has consistently declined over the last 3.5 years and its share to total external debt touched an eight-year low of 17% during Q3FY16 (Fig. 1). The broader trend of a decline in the sovereign external debt share also continued to play out (Fig. 2).
- **External vulnerability indicators continue to improve…:** Owing to the improvement in India's BOP, forex reserves have risen by ~US$ 75bn in the last two years. This has led to a sustained improvement in external vulnerability; the forex reserves-to-external debt ratio rose to a three-year high of 73% by end-Dec'15. Near-term vulnerability, as measured by the Greenspan-Guidotti rule (short-term/forex reserves) has also improved (Fig. 6). The improvement is more drastic if we consider a stricter version of the rule, which includes the CAD along with short-term debt.
- **…but ECB stockpile continues to mount: External** Commercial borrowings (ECBs), the single largest component of India's external debt (~38% of total), rose 9.4% YoY to US$ 183.6bn by end-Dec'15. The ECB stockpile has risen by a whopping 23.8% p.a. during FY07-FY15 as India Inc. gorged on cheap foreign capital. In fact, ECBs have accounted for nearly three-fifths of the increase in long-term debt over the last decade.
- **India's external debt position comfortable vis-à-vis other EMs:** As per the Quarterly External Debt Statistics (QEDS) data released by the IMF and World Bank, India's external debt-to-GDP (at 23.3%) is quite benign versus other EMs and advanced economies (Fig. 8). Besides, the ratio of India's forex reserves to external debt is amongst the highest in the world (Fig. 9). Thus, in all, India's external debt position remains comfortable.

External debt at 23.3% of GDP by end-Dec'15



Source: CMIE, RCML Research

Long and short-term debt (by original maturity)



Source: CMIE, RCML Research

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31 March 2016

India Financials: Credit Tracker

Non-food credit growth stable at 9.9%

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Non-food credit growth remained stable at 9.9% YoY in Feb'16 vs. 9.8% YoY in Jan'16. While growth in the agri segment was steady at 13.5% YoY (Jan'16: +13.4% YoY), a marginal uptick was seen in the retail segment (+19.2% vs. +18.1% in Jan'16). Services/industry-sector credit growth declined slightly to 5.4%/8.6% YoY (Jan'16: +5.6%/8.9%). On YTD basis, 44% of the incremental credit growth was driven by retail loans. Overall, we do not see credit growth for FY16 improving beyond 12%.

- **Credit to medium enterprises declines by 11%:** Trends in industrial credit remained weak, with growth languishing at 5.4% YoY in Feb'16 vs. 5.7% YoY in Feb'15. Credit to medium enterprises declined by 11% YoY, down for the ninth straight month, restricting growth in industry-sector credit to 3.3% YTD. Growth in credit to large industries (~35% share in non-food credit) remained steady at 7.0% while that to micro and small enterprises grew at a slower pace of 1.7% YoY (Jan'16: 2.4%). A slowdown was observed across sub-sectors such as food processing (-6.2% vs. +12.5%), beverages & tobacco (0.2% vs. 6.8%) and cement & cement products (-4.0% vs. +5.6%). Infrastructure loans grew by 9.1% largely driven by power (+9.6% YoY), telecom (+9.4% YoY) and roads (+7.1% YoY).

- **Retail credit growth improves to 19.2%:** A mild uptick was seen in personal loans which grew by 19.2% YoY (Jan'16: +18.1% YoY), largely driven by a 19% growth in housing loans (Jan'16: +18.4% YoY). Advances against FDs grew sharply at 12.5% YoY while growth in vehicle loans declined to 12.3% YoY. The share of personal loans in non-food credit stayed healthy at 21.2%.

- **Agri loans grow above system average, services segment dips:** Credit to the agri sector grew at 13.5%, above the system average of 9.9%, while its proportion to total credit remained stable at 13.2%. Growth in the services sector declined to 8.6% from 8.9% in Jan'16 due to slower credit growth in sub-segments like shipping, trade and commercial real estate.

Fig 1 - Break-up of non-food credit

Sector / Industry	Feb-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Share of credit (%)	Growth (YoY, %)	Growth (YTD, %)
Non-food Credit	**58,913**	**62,097**	**62,397**	**63,251**	**63,981**	**64,738**	**100.0**	**9.9**	**7.2**
Agriculture	**7,544**	**8,232**	**8,260**	**8,424**	**8,514**	**8,564**	**13.2**	**13.5**	**9.3**
Industry	**26,058**	**26,506**	**26,687**	**26,952**	**27,244**	**27,455**	**42.4**	**5.4**	3.3
Micro & Small	*3,695*	*3,702*	*3,722*	*3,741*	*3,776*	*3,759*	*5.8*	*1.7*	(3.3)
Medium	*1,287*	*1,127*	*1,148*	*1,151*	*1,155*	*1,144*	*1.8*	*(11.1)*	(9.7)
Large	*21,076*	*21,677*	*21,817*	*22,060*	*22,313*	*22,552*	*34.8*	*7.0*	5.2
Services	**13,779**	**14,503**	**14,403**	**14,582**	**14,732**	**14,970**	**23.1**	**8.6**	**5.3**
Trade	*3,521*	*3,586*	*3,605*	*3,629*	*3,662*	*3,730*	*5.8*	*6.0*	*2.9*
Commercial Real Estate	*1,665*	*1,708*	*1,708*	*1,723*	*1,766*	*1,766*	*2.7*	*6.0*	*6.1*
NBFCs	*3,001*	*3,183*	*3,124*	*3,149*	*3,260*	*3,311*	*5.1*	*10.3*	*2.8*
Retail credit	**11,532**	**12,857**	**13,046**	**13,293**	**13,491**	**13,749**	**21.2**	**19.2**	**16.8**
Housing	*6,186*	*6,959*	*7,052*	*7,140*	*7,238*	*7,359*	*11.4*	*19.0*	*14.7*
Vehicle loans	*1,275*	*1,360*	*1,379*	*1,408*	*1,420*	*1,432*	*2.2*	*12.3*	*13.2*

Source: RBI, RCML Research

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Buy	More than 15%
Hold	Between 15% and –5%
Sell	Less than –5%

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