Investor

MONDAY, JANUARY 27, 2020

EXPERT VIEW

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—Nomura

L&T Q3FY20: Results (₹ million)

LT IN Equity Consolidated	Dec '19	Dec '18	Sep '19	Change y-o-y (%)	Change q-o-q (%)	Vs Nomura Est. (%)
Net Sales	3,62,427	3,42 ,340	3,53,285	6	3	-7
Operating Ebitda	41,177	37,514	40,219	10	2	-4
Ebitda Margin	11.4%	11.0%	11.4%	40 bps	(2)	34
Recurring PAT	21,608	18,980	23,085	14	-6	-13
Recurring EPS (₹)	15.24	13.39	16.29	14	-6	-13

Source: Company data, Nomura estimates

LARSEN & TOUBRO RATING: **BUY**

Execution issues impact numbers

Improvement in core Ebitda margin key positive; project deferrals expected to be resolved soon; 'Buy' maintained

ORDER INFLOWS AT ₹416 bn (+2% y-o-y) in Q3 were much higher than our estimate of ₹280 bn (9MFY20 order inflows of ₹1286 bn were up 11% y-o-y). Domestic ordering remains muted at ₹237 bn (-19% y-o-y). Order inflows were largely led by international order inflows at ₹179 bn (+56% y-o-y). Management maintained its guidance for order inflow growth at 10-12% in FY20. This implies order inflows of ~₹600 bn in Q4FY20, thus meeting the lower end of the guidance. **Buy** retained.

Management highlighted a robust pipeline of projects worth ₹3.0 trn for Q4FY20, including ₹0.5 trn worth of international orders. Thus, in the absence of project deferrals, the 10-12% order inflow growth guidance seems achievable.

Execution headwinds from project deferrals, but with resolution now in sight we expect contribution from such projects Q4 onwards: Q3FY20 revenue at ₹362 bn (+6% y-o-y) was much below our estimate of ₹389 bn and the consensus estimate of ₹393 bn (9MFY20 revenue of ₹1,012 bn is up 10% y-o-y). However, project execution was delayed due to project reviews/deferrals of orders from Maharashtra and Andhra Pradesh, as well as air pollution related work stoppage in Delhi region. According to management, these delays accounted for ~₹25-30 bn of revenue loss in Q3FY20. Management notes that ~5% of the order book was non-moving for 9MFY20. However, now with execution of the coastal road project having resumed (₹75 bn of orders), the level of non-moving orders has now fallen to 2.7% of the current order book of ₹3.06 trn on our estimates. Management has maintained its guidance of 12-15% revenue growth for FY20.

Working capital levels remain elevated but stable, as reflected in strong OCF: Net working capital (NWC) remained at 23.5% of core sales, similar to 23% in both Q1FY20 and Q2FY20. Since NWC levels are stable, there has been strong OCF generation of ~₹25 bn for Q3FY20. Payable levels still remained low due to liquidity stress at vendors, while receivables and inventory were broadly stable.

Core sales declined by ~3% y-o-y in Q3FY20 led by a 5% y-o-y fall in infrastructure revenue. However, core Ebitda margin improved ~20bp y-o-y to 8.9%: This is despite Q3FY19 having ₹5.5 bn of gains in the Others segment, which was not present in Q3FY20. We had noted in an earlier report that due to commodity price declines, we expect a 55-60bp y-o-y improvement in core Ebitda margin in 1HFY21, which we view as a key catalyst for the stock.

NOMURA

KOTAK MAHINDRA BANK
RATING: **NEUTRAL**

Slowdown took a toll on loan growth

FY21/22e EPS down 4/7% given lower loan growth assumptions; 'Neutral' retained with TP of ₹1,625

KMB'S THIRD-QUARTER result mirrored the overall slowdown in the economy, which led to moderation in loan growth and elevated slippage trajectory. Overall operating performance was healthy with PPoP increasing by 23% y-o-y, despite the bank making ₹2 bn provisions toward pension obligations. We cut our EPS estimate for FY21/22 by 4%/7%, primarily as we factor in lower loan growth assumption. Maintain **Neutral**.

Loan growth moderates; higher provisions drag earnings

Standalone PAT increased 24% y-o-y to ~₹16 bn (4% miss v/s our estimate of ₹16.6 bn) due to higher provisions of ₹4.4 bn (our estimate: ₹3.8 bn). NII grew ~17% y-o-y to ₹34.3 bn (2% miss), impacted by moderate loan growth; however, margins improved 8bp q-o-q to 4.7%. Opex increased 21% y-o-y to ₹23.8 bn, led by one-off of ₹2 bn toward pension obligations. Thus, the C/I ratio came in at 49.9% v/s 45.2% in Q2. Loan book grew ~10% y-o-y to ₹2.2 trn, reflecting the slowdown in

the business banking/corporate banking and CV/CE portfolios. Deposits growth moderated to 12% y-o-y to ₹2.4 trn. However, CASA grew at ~19% y-o-y (mix thus improved 10bp q-o-q to 53.7%).

Asset quality deteriorated, with GNPL/NNPL increasing by ~8%/6% q-o-q led by a few corporate chunky accounts, unsecured and CV/CE segments. PCR ratio improved 42bp q-o-q to ~64%. KMB's subsidiaries reported a strong performance, with PAT up 35% y-o-y for Kotak Prime, 29% y-o-y for Kotak Securities and 20% y-o-y for the AMC business.

We continue believing in KMB's capability to deliver in a challenging environment and appreciate the progress in building a strong liability franchise

Highlights from mgmt commentary

Corporate banking slowdown was led by under-utilisation of loan limits by better-rated corporates as they preferred CP markets. Home loan & LAP portfolio is growing well led by lower cost of funds and is getting better risk adjusted returns.

Valuation and view

KMB's loan growth is moderating due to weaker trends in the corporate banking and CV/CE portfolios. We marginally cut our loan growth assumption and estimate KMB to deliver 14%/24% loan book/PAT CAGR over FY19-22, led by stable margins and a further improvement in operating leverage. We cut our PAT estimate by 4%/7% for FY21/22. We continue believing in KMB's capability to deliver in a challenging environment and appreciate the progress it is making in building a strong liability franchise. Maintain **Neutral** with a TP of ₹1,625 (3.8x Sep21e ABV + ₹494 for subs) as we roll forward our estimates to Sep'21.

MOTILAL OSWAL

We cut our FY21/22 estimates by 4%/7%

Change %/bps

	FY20e	FY21e	FY22e
Net Interest Income	-1.2	-3.5	-5.7
Other Income	0.0	0.0	0.0
Total Income	**-0.9**	**-2.6**	**-4.2**
Operating Expenses	1.1	-0.1	-1.0
Operating Profits	**-2.5**	**-4.5**	**-6.6**
Provisions	-2.1	-8.1	-6.4
PBT	**-2.6**	**-4.0**	**-6.6**
Tax	-9.6	-4.0	-6.6
Standalone PAT	**-0.1**	**-4.0**	**-6.6**
Consolidated PAT	**0.3**	**-2.6**	**-4.7**
Loans	-3.9	-6.4	-6.4
Deposits	-3.5	-3.5	-2.6
Margins	2	1	(5)
SA RoA	2	(3)	(10)
Core RoE	(2)	(56)	(91)
EPS	0.3	-2.6	-4.7
BV	0.0	-0.6	-1.5
Consol BV	0.0	-0.3	-1.0

Source: Motilal Oswal estimates

HAVELLS INDIA
RATING: **BUY**

Weak showing by company in third quarter

FY20-22e EPS cut by 3% due to macro scenario; TP revised to ₹850; 'Buy' maintained

HAVL REPORTED A weak Q3 with sales/PAT clocking -10%/+2% y-o-y. Muted demand, liquidity crunch and subdued B2B traction (30% mix) dragged topline. But, cost rationalisation aided op-margin expansion (+130bps q-o-q; +10bps y-o-y). Challenging domestic macros warrant caution, entailing us to trim FY20-22e EPS by ~3%. We continue to view HAVL as a quality, multi-year growth franchise with diversified mix, market leadership, entrenched brand & reach and robust B/S. **BUY.**

Highlights: HAVL's Q3 sales stood at ₹22.7 bn (-10% y-o-y; +2% q-o-q) with op-margin at 11.8% (+10bps y-o-y; +130bps q-o-q); PAT at ₹2.0 bn (+2% y-o-y; +11% q-o-q). Almost 70% of HAVL's biz mix is B2C and the remainder B2B. Weak macros, liquidity challenges and slowdown in infra segment sharply impacted demand for industrial cables and switchgears as well as professional lighting. ECD sales remained flattish y-o-y, despite subdued consumer sentiment, delayed winter (~15% mix is Water Heaters) and dealer de-stocking. On the brighter side, cost rationalisation initiatives are seen playing out, aiding y-o-y & q-o-q expansion in op-margin, despite soft revenue.

Buy: In our opinion, HAVL's diversified product mix (holistic play), market leadership, consistent product launches, strong brand and entrenched distribution should continue to support its premium valuation. Further enhancing comfort are HAVL's nil leverage, robust CFs, sizeable cash pile & good return ratios. Retain **Buy** with revised PT of ₹850 (post roll-over). Key risks: (i) Extended demand slowdown; (ii) subdued traction in Lloyd (iii) higher competition, pricing pressures.

JEFFERIES

HAVL IN – Financial snapshot

Y/E March

	FY20E	FY21E	FY22E
Net sales (₹ mn)	102,083	116,621	132,455
Growth (%)	1.5	14.2	13.6
Adjusted PAT (₹ mn)	8,247	10,811	13,319
Adj. EPS (₹)	13.2	17.3	21.3
RoCE (%)	23.6	28.4	30.8
RONW (%)	18.4	21.6	23.4
PE (x)	45	35	28
EV/Ebitda (x)	31.2	23.9	20.9
EV/Sales (x)	3.5	3.0	2.8

Source: Jefferies estimates, company data

Personal Finance

EMBEDDED VALUE

Rushing to buy insurance now? Don't end up with a wrong policy

Understand the terms and conditions of each life insurance policy before you sign on the dotted line

Kamalji Sahay

ILLUSTRATION: SHYAM KUMAR PRASAD

LIFE INSURANCE COMPANIES earn around 50% of their annual premium income in the fourth quarter of the financial year. This is not just because insurers become more active during the last quarter but the demand for life insurance and health insurance also picks up during January to March every year. The reason is that individuals look for suitable investment options for saving income tax under Section 80C of the Income Tax Act, which provides rebate on amount of premium paid to up to ₹1.5 lakh among other options.

Every year young people find employment and at least 15-20% of those who join the organised sector earn taxable income. Again, a large chunk of population enter the tax bracket by virtue of increase in salary/income and other taxable compensations. Such segments are most vulnerable to miss-selling or uninformed buying of life insurance products.

Rush in buying insurance

Many a youngster would be anxiously looking for a product for investing around ₹1 lakh a year to save taxes. In such a scenario what happens is the irrational selection of life insurance products, sometimes just the opposite of what somebody really needs as a tool of life insurance protection.

There are several instances when they are sold Ulip products promoted as an "excellent investment instrument", without sharing knowledge of the expense ratio, mortality cost and the appropriateness of time for entering the market. Many a time a large chunk of money is spent for buying very little insurance cover whereas the young buyer needed to have a large sum assured term insurance plan for protecting the financial needs of his dependents, a young wife and children or the old parents without income of their own.

Life insurance is a long-term contract. It may appear easy to enter into such contract with an insurance company but traditionally exiting a life insurance contract is very difficult. If someone unilaterally terminates the contract then most of the time he forfeits a large share of the amount deposited as premium or sometimes the entire amount. They file complaints with the Ombudsman or the consumer forum only to learn that as per the terms and conditions of the policy only a small sum or no sum is payable. In their haste and anxiety to save tax under Section 80C which provides for several alternative avenues also, many people take wrong decision or get misled by unscrupulous intermediaries. In the process they lose more than what they gain as 20 to 30% of the premium paid as income tax relief.

Insurance for financial planning

A person who buys a wrong policy in haste cannot just blame an insurer and keep away from life insurance for the rest of his life. He will continue to need life insurance and will once again buy a policy. But the second time he is expected to be wiser. The terms and conditions of each product must be fully understood before signing the proposal form. If need be, more than one plan can be bought and the sum assured, premium and tenure of policy could be so adjusted as to maximise tax savings. For adequate evaluation of life insurance requirement and systematic planning in respect of products the time available for anyone is the entire year. Hence one should avoid getting swept away by the deluge in the last quarter.

The writer is former MD & CEO, Star Union Dai-ichi Life Insurance

Need to bring in tax parity between investments in MFs and Ulips

Long-term capital gains from mutual funds are taxable whereas the maturity proceeds of Ulips are exempt even if partially withdrawn

BUDGET IDEAS 2020

SUNIL GIDWANI

LIFE INSURANCE INDUSTRY is not just about protection of life but perceived by many as an investment product and hence more than 50% of the life insurance industry's business comprise unit-linked insurance policy (Ulips). While the purpose of an insurance product may be completely different, Ulip has all the elements of an investment product.

The insurance business is managing pool of funds and making prudent investments. Hence it would not be out of place to compare mutual funds and insurance products like Ulip. But when it comes to taxation, there is much difference between mutual fund products and insurance products.

Long-term capital gains in MFs

Long-term gains from all categories of mutual funds including equity funds are now taxable whereas the maturity proceeds of Ulips being categories as insurance proceeds are exempt even if partially withdrawn and there are no other adverse consequences if withdrawn after a lock-in.

Again, securities transaction tax is payable on redemption of equity fund and on every trade of ETFs on a stock exchange. ULIP redemption does not attract such tax.

A mutual fund scheme could be categorised as equity, debt, hybrid, etc., and within such there could be schemes based on a specific strategy or theme like large-caps, multi-cap, small-cap. Within each of these schemes, an investor can go for dividend payout or a dividend reinvestment plan. Similarly, one can invest directly in a mutual fund or invest through an agent or distributor thereby invest in a Regular plan. In each of these options, the price the investor pays at the current net asset value or NAV is different. And hence a switch from one plan to another within the same scheme means different units and quantity being issued to the investor. The switch does not result in any cash flow for the investor but is regarded as taxable transfer resulting in liability to pay capital gains tax.

ILLUSTRATION: SHYAM KUMAR PRASAD

No capital gains in Ulip

For Ulip, which is very similar to a hybrid or balanced fund with agreed percentage allocation to debt and equity, the policyholder or 'investor' simply can move from one option to another. In fact, within the broad parameters a policy holder can even increase or decrease allocation even among equity and debt. Such change of asset allocation does not result in any capital gains tax. The reason is that insurance companies do not issue any units to the investor and the calculations in terms of value of a policyholder's investments are all done at the backend.

Products like Ulips already have an added advantage of a tax deduction under Section 80C for payer at the time of investment, the discrimination during the lifetime of the investment also acts as a major deterrent and a cash flow issue due to capital gains tax treatment.

Currently, the law provides for exemption from capital gains tax for mutual fund investors only where there is consolidation or one or more schemes or plans.

One of the measures to increase participation in capital markets that the government should consider is to bring parity in tax treatment of investments in mutual funds and Ulips.

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