What do the Institutions Say: Compilation of recent market research reports as on 6th September 2018

Dear All,

Please find below some of the recent informative research reports / articles on the market / economy as on 6th September 2018. Hope you find the same useful.

1. **Cost of Rupee Depreciation - SBI Ecowrap**
2. **Consumer Sector Outlook - The Other side of greed is Fear - CLSA**
3. **Boiling A Turkey - Lance Roberts (Long/short equity, investment advisor, portfolio strategy, macro)**
4. **Strategy: The curious case of the Indian aviation industry - Kotak Institutional Equities**

Cost of Rupee Depreciation - SBI Ecowrap

In the hindsight, the rupee depreciation of 13% in 2018 and around 7% since Jun'18 when the RBI started hiking rates is largely in consonance will $ strengthening against all currencies. The rupee could not have been immune to such and hence the current depreciation was long overdue and trends in NDF market (rupee at 75 and implied 1 year yield at 7.7%) suggest the pain might not be just over yet!

However, talking down the rupee as was done recently when the markets were volatile might have been counterproductive and thus the pace of depreciation picked up frantic pace in the last week or so. In this context, the statement by FM is most welcome and timely one as it has provided an immediate succor to battered market sentiments.
The RBI could also chip in with a message that could be most comforting under the current circumstances.

There are two perceived benefits of rupee depreciation in the form of increased exports and automatic adjustment of trade deficit in policy circles. However, we believe the traditional view that weak exchange rates could dramatically boost exports growth is not entirely correct over the long term as India's export basket has changed significantly from traditional products to more mechanized engineering goods over the years, thus making them more income elastic rather than price elastic.

We believe, policy makers should be equally mindful of the costs of rupee depreciation. There are many. **First**, India's short term debt obligations at $218 bn due on Dec'18 if rolled over could add a significant cost on the Government. **Second,** oil import bill could go up manifold. **Third,** With yields increasing, this could add up government fiscal costs too. On all these counts the costs could add up to 0.7% of GDP. It may be noted that the yields are already under pressure as unlike earlier years, the government borrowing programme has been evenly distributed between 2 halves in current fiscal. Fourth, as per RBI estimates, assuming a 10% depreciation, this could add upto 50 bps on inflation number. In fact, continued rupee depreciation could result in rate action by RBI in October policy, even as headline CPI will decline meaningfully to 3.6-3.7% in September. This could be thus the biggest predicament waiting to unravel!

Finally, an interesting anecdote. Our empirical analysis reveals an asymmetric behavior on the part of portfolio investors in times of depreciation and appreciation. Thus, it is likely that once the rupee settles at a lower level, portfolio investors now conspicuous by their absence will return in hordes and the rupee will appreciate. This is what history of Indian foreign exchange market says and sometimes the time period of appreciating rupee following a depreciating rupee could be even higher! On a lighter note, this could make both camps happy!

Summary of Rupee Depreciation (Rs Billion)	
Short-term external debt repayment rollover	679
Increased Oil import	353
Fiscal Burden	60
Perceived Cost	**1092**
Perceived Benefit: Increase in exports over trend growth	**150**
Memo:	
Consumption decline	**500**
Source: SBI Research	

Consumer Sector Outlook - The Other side of greed is Fear - CLSA

Reverse DCF and peer comparison to see extent of euphoria in staples

While consumer staples in India have always been a structural story and hence, stocks always command a premium, the extent of PE expansion recently has probably surprised the most bullish of investors. Our reverse DCF analysis suggests that the 10-year implied growth rate in most cases is at a much higher pace than the past decade, and on a higher base. Also, on the most probable 10- year growth rates, terminal growth is 1-3ppts higher than our comfort level. Comparing valuations with other Indian plays, the Nifty, regional & global names suggests Indian consumer staples are among the most highly valued in the world, and in some cases, even higher than next-gen technology companies like Amazon and Alibaba.

PE re-ratings contributed significantly to past five-year stock returns

- Consumer sector PE multiples are near all-time highs in most cases as our coverage (ex-ITC) today trades at a 55x PE compared with 34x 5-years back & 24x 10-years ago
- Interestingly, we would note that of the total stock returns, re-ratings have contributed as much half of overall returns in a few cases, while earnings growth has contributed the rest.
- There are of course exceptions, like ITC and GSK, where their PEs are more palatable, consequent to concern over growth potential, but in most other cases, PE has expanded to highest-ever levels.

Comparison to the Nifty and peers

- The FMCG PE premium to Nifty is close to an all-time high at c.160%. Note the average over the past 10 years is c.110%, while the lowest premium was 20%.

- The PE premium is also close to a high for other India plays like Maruti Suzuki (automobile), Zee (media), L&T (infrastructure), and Titan (discretionary consumption).
- The PE premium is also close to all-time highs for Indian subsidiaries (HUL, Nestle & Colgate) vs parents, and Indian market cap to parent market cap is also at its best.
- Interestingly, Indian staples today are trading at a decent premium to next-gen technology stocks like Amazon, Alibaba and Tencent.

The rationale for this valuation

Our investor interactions highlight rising concern regarding sector multiples. However, there are reasons why stocks are trading at these levels, in our understanding.

- No.1: With rising global uncertainty (trade wars), India is relatively better placed and hence, investor interest in India remains high and the consumer sector is a beneficiary.
- No.2: Indian staples are also a play on an uncertainty of the election outcome—it also becomes a direct play as a rural beneficiary.
- No.3: There is acute investor focus on high corporate governance, healthy cash generation, strong balance sheets and the domestic nature of business.
- No.4: There is improvement in the growth profiles of companies after a few quarters of pain due to issues like demonetisation, rural stress the GST roll-out.
- The price performance of stocks, however, reflects that wherever there is higher visibility for earnings or the recent trend has been strong, the valuation premium has expanded compared to cases where the growth trajectory has been weak.

Boiling A Turkey - Lance Roberts (Long/short equity, investment advisor, portfolio strategy, macro)

There is an age-old fable describing a frog being slowly boiled alive. The premise is that if a frog is put suddenly into boiling water, it will try and save itself. However, if the frog is put in tepid water which is then brought to a boil slowly, it will not perceive the danger and will be cooked to death. The metaphor is often ascribed to the inability, or unwillingness, of people to react to or be aware of threats which arise gradually rather than suddenly.

This metaphor was brought to mind as I was writing last weekend's newsletter discussing the issue of Turkey and the potential threat posed to the global economy. Specifically, I was intrigued by the following points from Daniel Lacalle:

"The collapse of Turkey was an accident waiting to happen and is fully self-inflicted."

It is yet another evidence of the train wreck that monetarists cause in economies. Those that say that 'a country with monetary sovereignty can issue all the currency it wants without risk of default' are wrong yet again. Like in Argentina, Brazil, Iran, Venezuela, monetary sovereignty means nothing without strong fundamentals to back the currency. Turkey took all the actions that MMT lovers applaud. The Erdogan government seized control of the central bank, and decided to print and keep extremely low rates to 'boost the economy' without any measure or control.

Turkey's Money Supply tripled in seven years, and rates were brought down massively to 4,5%.However, the lira depreciation was something that was not just accepted by the government but encouraged. Handouts in fresh-printed liras were given to pensioners in order to increase votes for the current government, subsidies in rapidly devaluing lira soared by more than 20% (agriculture, fuel, tourism industry) as the government tried to compensate the loss of tourism revenues due to security concerns with subsidies and grants.

Loss of foreign currency reserves ensued, but the government soldiered on promoting excessive debt and borrowing. Fiscal deficits soared, and the rapidly devaluing lira led to a rising amount of loans in US dollars.

This is the typical flaw of monetarists, they believe monetary sovereignty shields the country from external shocks and loans in foreign currencies soar because no one wants to lend in a constantly-debased currency at affordable rates. Then the central bank raises rates but the monetary hole keeps rising as the money supply continues to grow to pay for handouts in local currency.

Strategy: The curious case of the Indian aviation industry - Kotak Institutional Equities

We wonder about the role of financiers in exacerbating the current difficult financial condition of the Indian aviation industry given the continued strange inability or reluctance of the companies to raise prices despite large industry losses. The long history of airline bankruptcies should alert them to similar risks in the Indian aviation sector and hopefully induce them to nudge the industry participants towards a more rational pricing behavior.

Does the aircraft leasing model work against industry profitability?
We wonder if the easy availability of aircraft through leasing (direct or sale-and-leaseback) results in poor industry structure through easy entry and exit of operators (limited upfront capital commitment) and irrational pricing behavior (need to fill in the ASK (available seat kilometers) at any price). Airlines seem happy to place huge orders for new aircraft with the aircraft manufacturers in order to avail of large discounts from them, sell the acquired aircraft to aircraft leasing companies at market prices and lease them back, which result in upfront cash and staggered book profits for the airline companies.

Too much of a good thing
The easy availability of leased aircraft through direct leases or sale-and-leaseback deals may force airline companies to adopt aggressive pricing to fill in seats (additional ASK) to meet the future lease rental obligations. It seems to us that the industry is quite desperate to book any revenue and is offering large discounts to fill the available capacity and have some confidence about future revenues. However, an industry with all the major players operating at effectively negative spreads (RASK-CASK) is clearly unsustainable for debt and equity holders both.

JETIN's advance lease incentives and Air India's equity infusion are unlikely to solve the problem
JETIN has received an additional US$300 mn of advance lease incentives and debt recently and Air India will reportedly receive `9.8 bn of equity from the Indian government. We doubt this will address the industry's dire financial condition (see Exhibit 1 for the quarterly results of the listed players from 1QFY19). In fact, JETIN's `20-21 bn of additional inflows are equal to about 1.5 quarters of losses (based on 1QFY19 reported net loss of `13.2 bn). As for the reported `9.8 bn of fresh equity infusion into Air India, we doubt it will achieve anything beyond AI servicing its immediate loan repayments to avoid defaulting on all or part of its `514 bn debt (as of March 31, 2017).

Still not sure why the industry cannot simply raise prices and solve its problems

We have been quite puzzled by the industry's inability to raise ticket prices (RASK) given (1) the steep increase in input (fuel prices) and (2) continued strong growth in passenger volumes (see Exhibit 2; 21% yoy monthly average growth rate for the past 43 months). Yields of the listed airline companies have come off over the past 12 months on a yoy basis (see Exhibits 3-5) despite reasonably high PLF of the major airline companies (see Exhibit 6). The industry will likely make even larger losses in 2QFY19 given a seasonally weak quarter and higher qoq input costs (weaker INR). We can only hope that some sanity dawns on the industry, forced or incentivized by the authorities, financiers, industry players and/or shareholders.

Exhibit 1: Quarterly profits of airlines have declined sharply 4QFY18 onwards
Key quarterly financials of aviation stocks, March fiscal year-ends, 2016-19 (Rs mn)

	1QFY15	2QFY15	3QFY15	4QFY15	1QFY16	2QFY16	3QFY16	4QFY16	1QFY17	2QFY17	3QFY17	4QFY17	1QFY18	2QFY18	3QFY18	4QFY18	1QFY19
Interglobe Aviation (Indigo)																	
Revenues			38,574	38,233	42,115	35,400	42,978	40,907	45,789	41,669	49,865	48,482	57,529	52,910	61,779	57,991	65,120
EBITDAR			12,733	14,030	15,742	8,721	16,699	15,085	15,279	9,677	14,408	13,322	19,507	15,574	19,357	10,821	10,313
EBITDA			7,808	8,554	10,045	2,702	10,136	8,296	8,152	1,956	6,245	5,080	10,970	7,381	9,915	890	(111)
PBT			7,506	8,751	9,229	1,607	9,223	8,177	7,467	1,765	6,021	6,189	11,243	7,645	10,716	1,662	313
PAT			5,296	5,747	6,389	1,132	6,503	5,838	5,918	1,398	4,873	4,403	8,111	5,515	7,620	1,176	278
RASK-CASK (Rs)			0.75	0.79	0.80	0.06	0.75	0.56	0.46	0.01	0.30	0.23	0.61	0.36	0.49	(0.08)	(0.15)
Jet Airways																	
Revenues	46,856	47,723	50,510	50,645	52,201	52,580	54,440	52,856	51,389	54,532	55,111	54,491	56,489	56,266	60,862	59,249	60,105
EBITDAR	5,298	3,967	7,202	1,962	8,697	8,815	12,274	14,009	8,378	12,041	8,402	7,076	7,155	8,367	8,648	(1,784)	(3,816)
EBITDA	688	(730)	2,289	(3,406)	3,508	3,547	6,929	8,562	2,893	6,448	2,605	1,170	1,446	2,615	2,811	(7,649)	(10,185)
PBT	(2,177)	698	631	(17,290)	2,217	876	4,671	3,972	259	1,031	3,052	6,024	535	496	1,653	(10,360)	(13,230)
PAT	(2,177)	698	631	(17,290)	2,217	876	4,671	3,972	259	1,031	3,052	6,024	535	496	1,653	(10,360)	(13,191)
RASK-CASK (Rs)	(0.30)	(0.53)	(0.21)	(0.87)	(0.07)	(0.06)	0.29	0.23	(0.10)	0.22	(0.12)	(0.20)	(0.17)	(0.07)	(0.08)	(0.92)	(0.90)
SpiceJet																	
Revenues	16,786	14,499	13,112	7,863	11,063	10,401	14,600	14,750	15,215	14,004	16,424	16,257	18,695	18,143	20,820	20,293	22,358
EBITDAR	2,022	(77)	88	428	2,608	1,888	5,267	3,398	4,519	3,180	4,177	3,152	4,593	3,975	5,685	3,676	3,634
EBITDA	(721)	(2,674)	(2,063)	(726)	1,000	180	2,973	906	1,924	1,116	1,748	634	2,284	1,558	3,022	695	838
PBT	(1,241)	(3,104)	(2,750)	225	718	290	240	1,079	1,490	589	1,811	416	1,752	1,053	2,400	462	(381)
PAT	(1,241)	(3,104)	(2,750)	225	718	290	240	1,079	1,490	589	1,811	416	1,752	1,053	2,400	462	(381)
RASK-CASK (Rs)	(0.36)	(0.78)	(0.81)	(0.53)	0.16	(0.18)	0.66	0.00	0.33	0.11	0.26	(0.01)	0.34	0.17	0.43	(0.03)	(0.02)

Source: Companies, Kotak Institutional Equities

Happy Reading!!!