Diwali Picks

*Yesterday**

CONTRIBUTING ANALYSTS

FINANCIALS

- *Darpin Shah, darpin.shah@hdfcsec.com,+91-22-6171-7318*
- *Madhukar Ladha, madhukar.ladha@hdfcsec.com, +91-22-6171-7323*
- *Keshav Binani, keshav.binani@hdfcsec.com, +91-22-6171-7325*

IT & NEW AGE BUSINESSES

- *Apurva Prasad, apurva.prasad@hdfcsec.com,+91-22-6171-7327*
- *Amit Chandra, amit.chandra@hdfcsec.com,+91-22-6171-7345*
- *Akshay Ramnani, akshay.ramnani@hdfcsec.com,+91-22-6171-7334*

AUTOMOBILES

- *Abhishek Jain, abhishekkumar.jain@hdfcsec.com,+91-22-6171-7320*

CONSUMER

- *Naveen Trivedi, naveen.trivedi@hdfcsec.com,+91-22-6171-7324*
- *Siddhant Chhabria, siddhant.chhabria@hdfcsec.com, +91-22-6171-7336*
- *Himanshu Shah, himanshu.shah@hdfcsec.com,+91-22-6171-7315*
- *Mansi Lall, mansi.lall@hdfcsec.com, +91-22-3021-2070*

OIL & GAS

- *Nilesh Ghuge, nilesh.ghuge@hdfcsec.com,+91-22-6171-7342*
- *Divya Singhal, divya.singhal@hdfcsec.com, +91-22-6639-3038*

INFRA & CONSTRUCTION

- *Parikshit Kandpal, parikshitd.kandpal@hdfcsec.com,+91-22-6171-7317*
- *Kunal Bhandari, kunal.bhandari@hdfcsec.com,+91-22-6639-3035*

HEALTHCARE

- *Amey Chalke, amey.chalke@hdfcsec.com,+91-22-6171-7321*
- *Eshan Desai, eshan.desai@hdfcsec.com,+91-22-6639-2476*

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*** YESTERDAY – a superhit song by the Beatles**

Yesterday all my troubles seemed so far away.
Now it looks as though they're here to stay.
Oh, I believe in yesterday…

Diwali Picks

Sector	Company	Mkt Cap (Rs bn)	CMP (Rs)	Aspirational Price (Rs)
Financials	Axis Bank	1,570	602	718
	RBL Bank	220	523	618
	Cholamandalam Finance	209	1,334	1,816
	SBI Life Insurance	564	564	850
IT & New Age Businesses	TCS	7,259	1,935	2,520
	L&T Technology Services	179	1,749	2,170
	Zensar Technologies	53	270	345
Automobiles	Ashok Leyland	332	113	172
	Lumax Auto Technologies	11	170	241
Consumer	ITC	3,396	277	382
	Zee Entertainment	441	448	585
	Voltas	176	533	651
	V-Guard Industries	81	191	240
	Gulf Oil Lubricants	44	724	886
Oil & Gas	Petronet LNG	324	215	333
	Indraprastha Gas	176	250	370
Infra & Construction	Oberoi Realty	156	428	552
	PNC Infratech	36	139	270
Healthcare	Dr Reddys's Labs	399	2,460	3,090
	Jubilant Life Sciences	103	670	980

Yesterday*

The Karma cycle has hit Indian equity markets, yet again. The new Samvat is set to begin with Nifty at ~11% off recent peaks. Debt markets have been in a daze post the IL&FS default. FPIs have net sold over Rs 560bn of Indian equities in YTD FY19, worse than they did in FY08. Inflation and fiscal risks loom large with crude persistently above $75 and the INR having slipped ~15%. A sub-par uneven monsoon, upcoming political turmoil and the sticky NPA problem have added fuel to the fire of pessimism.

Our view is that valuations, especially in mid caps, have been hit by a dose of reality. The macro setup has been uninspiring for a while, with crude remaining high, re-adjustment of the real economy post GST rollout and the weak corporate capex cycle. ***The home truth for investors is that India is never as exciting as the global economic experts make it in their PDFs, nor is it in any imminent risk of imploding into a socio-economic-political quagmire as the prophets of doom will have us believe.***

A number of structural levers have been shifted in India over the last four years and hold longer term promise for broad-based GDP growth. These include the move towards increased formalisation in the economy (via demonetisation, GST and a stronger income tax net) and the financialisation of savings. Monthly equity SIP inflows have held up at ~$1 bn despite the crack in Indices. The large government-led hike in infra-creation (especially roads), rising urbanization, digitisation and the steady rise in business-friendliness also bode well.

In our Diwali picks, we have selected durable businesses run by capable managers, that are aligned with India's long term trends. <u>These stocks should stand you in good stead as volatility in macros (and sentiment) increases on the way forward.</u>

History teaches us that a confluence of (perceived) negatives and widespread fear/gloom in markets throws up the best of opportunities for long term investors. This time, it's no different! **For investors, Diwali 2018 may actually be yesterday, once more…**

Dipen Sheth, Head – Institutional Research
dipen.sheth@hdfcsec.com
+91-22-6171-7339

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FINANCIALS

Axis Bank

Change in guard, healthy B/S and a granular book

Aspirational Price : Rs 718 (2.5x Sept-20E ABV of Rs 287)

CMP Rs 602, MCap Rs 1,570bn, 2.25x FY20E ABV of Rs 267

WHY

- Change in guard : A much needed change at the top level has boosted Axis Bank's sagging image. **Amitabh Chowdhary comes in with a solid track record at HDFC Life Insurance. We expect big, bold changes to follow. Re-rating is imminent.**
- Axis Bank has recognised asset quality pain over the last couple of years (industry NPAs ~15%+, GNPAs have recently eased a bit to 6.52%). We expect this to reduce further, in view of the accelerated recognition.
- Granular liabilities + assets make for a stable balance sheet. Retail TD + CASA form ~80% of total deposits, ~48% of assets are retail while retail fees constitute 60% of the fee mix. This has been a conscious evolution, playing out over the past several years at Axis Bank.
- A cleaned up (and well capitalised) B/S : Tier I ~13%, PCR ~69% (despite asset quality pain, GNPA 6.5%). Tier 1 was boosted by a Rs 116bn fund raise from leading investors like Bain Capital, LIC late last year.
- As wholesale funding for NBFCs gets tighter, large banks with deposit franchise (like Axis) will benefit.

WHY NOT

- Near term volatility in asset quality, especially if another cleanup is initiated by the new CEO. We may also see a talent exodus.
- SUUTI sale (~10% stake can come up for sale if the Govt goes aggressively for disinvestment).

RBL Bank

Growth, NIM and asset quality

Aspirational Price : Rs 618 (3.0x Sept-20 ABV of Rs 206)

CMP Rs 523, MCap Rs 220bn, 3.1x FY20E ABV of Rs192

WHY

- RBL is among India's fastest growing banks. We see it as a sustainable and high quality franchise in the making, and expect it to deliver ~33% CAGR over the next two years at least. **Recent concerns around the wholesale funding squeeze should not apply to RBL, in our view.**
- This will happen with rising contribution from the retail book, which helps deliver superior NIMs and increases granularity (reduces risk) of the loan book. Retail growth is driven by a broad portfolio of product offerings that span secured/unsecured segments, individual and SME clients.
- Strong fee traction: Improving fee trends (~3% of loans) driven by card fees (40% of the total fees). RBL is building out a disproportionately strong presence in the cards business.
- Tight leash on asset quality: Despite the healthy business momentum, RBK's asset quality remains best in class. The net stressed book at a mere 81bps, with net NPAs at a very creditable 0.74%. Coverage is running at a creditable 62%.
- While CASA franchise is yet to play out fully, differential pricing and branch expansion should help push it up over the next few years. This will help contain cost of funds and reduce dependence on wholesale borrowing.

WHY NOT

- C/I improvement via operating leverage may get deferred as investments in branch expansion and business acquisition continue. Op cost is running at well over 270 bps in the RoA tree. We cost-income ratio at 51%+ for some time to come.

Cholamandalam Finance

Asset quality plus growth

Aspirational Price : Rs 1,816 (3.75x Sept-20E ABV of Rs 484)

CMP Rs 1334, MCap Rs 209bn, 2.9x FY20E ABV of Rs 433

WHY

- Asset quality: Chola has the best asset quality amongst peers, with GNPAs at ~3% (VF NPAs at ~2.2%). LAP NPAs are also on the mend. We believe Chola is managed by high quality professionals whose strategic initiatives, expertise and execution are demonstrably top class.
- It is the most diversified NBFC in the peerset, with presence across segments (HCV, LCV, Cars, LAP, etc.) and regions (no state contributes >13% of the portfolio).
- Chola's steady and system-beating growth is driven by a healthy B/S, deep presence, CV industry tailwinds and, of late, its edge over smaller up-country NBFCs in the face of liquidity issues in the sector. **We do not foresee any liquidity concerns at Chola in the face of upheaval in the short term debt market.**
- Operating leverage will kick in as new branch productivity increases and recovery expenses reduce (with improving asset quality). Chola has added a whopping 28% of its current branch count in the last two years, which makes us confident that cost-income will fall with growth.

WHY NOT

- The recent CEO exit was a negative surprise. There is uncertainty regarding who will now lead the co. However, we do not see this materially impacting current operations. 2QFY19 has seen the momentum sustaining, confirming our view.
- Liquidity issues and rising CoF can impact Chola. Here, we believe a slight bump up in costs may happen, but that pricing power is intact.

SBI Life Insurance

Financialisation play

Aspirational Price Rs 850 (22x FY20E P/VNB)

CMP Rs 564, MCap Rs 564bn

WHY

- SBI Life, a joint venture of SBI and BNP Paribas Cardif, is the largest private sector life insurance player in the country. Life insurance in India is underpenetrated and offers a lucrative, long-term growth opportunity. It is set to benefit from an inevitable increase in financialisation of domestic savings.
- In the last few years, SBI Life has consistently grown faster than its private peers, resulting in its New Business Premium (NBP) market share improving from 16.6% in FY15 to 20.3% in 1HFY19.
- SBI Life has also revamped its group credit protect product from a 5-yr regular premium product to a single premium product. Lapses were high in the regular pay product; however the single premium product locks in persistency and improves margins.
- The company boasts of the lowest cost structure across its peer set with operating expenses to premium ratio at 6.8% in FY18 (vs. 10-17% for other companies).
- It has an unbeatable distribution advantage, owing to its parent SBI. Additionally, SBI Life continues to tie-up with other banks, including Punjab & Sind Bank and South Indian Bank recently.
- Strong VNB margin improvement is visible. 1HFY19 VNB margin was at 19.2% from 18.4% in FY18 owing to rising protection in the mix. We model a modest increase to 19.7% hereon over FY19-21E.
- Driven by higher unwind rates and strong VNB margin growth, we model RoEVs to improve from 16.9% in FY18 to 19.2% in FY21E.

WHY NOT

- Macro headwinds - higher inflation and interest rates - may eat into the savings potential and lead to lower life insurance premium growth.
- Life insurance is a highly regulated sector and risks persist especially from tighter regulation on surrender value of PAR products, and selling practices in certain credit protect segments.
- Normalisation of income tax rate can reduce profitability and EV. Currently the industry enjoys a 14.5% tax rate.

IT & NEW-AGE BUSINESSES

Tata Consultancy Services

Growth & scale dominance

Aspirational Price Rs 2,520 (24x FY21E EPS)

CMP Rs 1,935, MCap Rs 7,259bn

WHY

- TCS continues its scale (largest) and growth dominance within Tier-1 IT unabated. **This is led by a strong Digital share in the mix (28%), which is growing at >40% YoY. This is the largest and fastest growing digital portfolio within Indian IT.**
- Strong deal wins provide growth visibility with record deal signings (TCV of USD 9.8bn in 1HFY19) and 6 additions in >USD 100mn accounts in last two quarters.
- Growth traction in core verticals (BFSI and Retail & CPG) across geographies and strong execution engine with industry leading margin (26.5% EBIT%) and lowest attrition (10.9%).
- Efficient capital allocation via dividend and buyback over FY18-21 (factored 87% of FCF as payout), strong free cash generation (95% FCF/PAT).
- Currency tailwinds (the INR has depreciated ~14% YTD) have kicked in after a two year hiatus. We see resilient margin even as TCS re-invests some of these benefits for the long term.

WHY NOT

- Slowdown in macros (US economy, currently running at a multi-year high) can impact discretionary spend and client budgets.
- Adverse developments in H-1B visa regulations.

L&T Technology Services

Growth leadership and high visibility

Aspirational Price Rs 2,170 (22x FY21E EPS)

CMP Rs 1,749, MCap Rs 179bn

WHY

- Leading pure-play ER&D service provider with diversified vertical presence, favourable delivery metrics (offshore contributes 52% in the revenue mix), lowest client concentration risk vs. peers (top 10 clients account for <40% vs 50-70% for peers) and a marquee client base that reaffirms our positive view on LTT's business franchise.
- LTT is winning large deal wins, has a strong pipeline and growth visibility is rising within accounts. **The ER&D services space globally is growing at ~12% CAGR, much faster than the 6-7% growth of business IT services. LTT is seen as a fast-growing and highly capable player in its global peerset.**
- Co is seeing broad-based growth across verticals (led by revival in the Process Industry/ Transportation verticals) and recovery in Industrial Product vertical compared to growth skew earlier.
- Improving business-mix (Process industry, Industrial Product, Medical device) is leading to better margin profile as well as tight execution on fixed price contract.
- Large account mining opportunity in top-30 accounts (~65% of rev) and limited competition in most verticals.

WHY NOT

- Slowdown in the US economy.
- Volatility in large accounts.

Zensar Technologies

Digitally transformed

Aspirational Price Rs 345 (16x FY21E EPS)

CMP Rs 270, MCap Rs 53bn

WHY

- Zensar's growth lagged peers over FY16-18 (3.2% revenue CAGR vs ~11% for mid-cap IT) owing mostly to ongoing restructuring, client specific issues and the drag from its non-core business. **Most of these issues have been addressed and the company is back on the growth path**, led by (1) Recovery in Cloud & Infrastructure (CIS) business, (2) Mega deal wins worth USD 600mn TCV (highest ever) over FY18, (3) Revamped US sales engine, (4) Focus on penetrating Digital offerings in Top-30 strategic accounts, and (5) Acquisition of four Digital companies (Foolproof, Keystone, Cynosure & Indigo Slate).
- We believe USD revenue will grow at 13% CAGR (core 16%) over FY18-21E led by ~26% revenue CAGR in Digital. EBITDA margin will expand gradually to 13.8/14.8% in FY19/20E led by higher utilisation, recovery in IMS and currency tailwinds. Core Services (ex- MVS & RoW) margin is at 15% and hiving of the non core business can boost company margins by ~200bps.
- We have a positive view on Zensar based on (1) Focus on Digital POC led sales, (2) Robust deal wins, and (3) Growth visibility in the core business. We build 13/27/26% Revenue/EBITDA/PAT CAGR over FY18-21E. Zensar is set to post the second highest earnings CAGR in our IT coverage universe. We have a BUY rating with an TP of Rs 350 based on 16x FY20E EPS.

WHY NOT

- Execution risks associated with execution of large deal wins.
- Higher than anticipated onsite wage inflation can impact margins.
- Sale of non-core business can take longer than expected.

AUTOMOBILES

Ashok Leyland

Broad-based macro play

Aspirational Price Rs 172 (20x FY21 EPS)

CMP Rs 113, MCap Rs 332bn

WHY

- **Ashok Leyland (the second largest Indian CV manufacturer) has consistently managed to increase market share** in both MHCV (23.4% in FY12 to 34.2% in FY18) and LCV segments (1.7% in FY12 to 8.4% in FY18).
- We believe India's mild economic recovery (M&HCV market is cyclical but on average grows at 1.5x GDP growth) coupled with ALL's strong track record of market share gains and its pricing power augurs well for the company's growth prospects.
- After 19/37% growth in domestic CVs vols in FY18/1HFY19, we expect the momentum to continue in FY20/FY21E, buoyed by government spending on infrastructure, strong traction in E-commerce, logistics and mining segments, pre-purchases for BS-VI in FY20 and a possible vehicle scrappage scheme in FY21.
- We expect revenue mix from relatively less cyclical segments (exports, spares and defense) to increase to +20% by FY22E from 14% in FY18, which augurs well for the company's profitability.
- Strong ROIC (+40%) and FCF profile (net cash & cash equivalents at Rs 36bn).

WHY NOT

- Further increase in fuel prices and the inherent cyclicality of M&HCV business are key concerns

Lumax Auto Technologies

Gearing up

Aspirational Price Rs 241 (18x FY21E EPS)

CMP Rs 170, MCap Rs 11bn

WHY

- Lumax Auto is a highly diversified auto components manufacturer with a debt free balance sheet and decent return ratios (~15% RoCE). **Apart from the core lighting and sheet metal business, it has forayed into several speciality and value-added categories like automatic gear shifters, seat frames and air intake via collaborations/JVs.**
- We expect rising contribution from new categories, as the co steadily increases walletshare with OEMs such as Honda, Volkswagen, MSIL and Ford while ramping up with anchor client Bajaj Auto.
- Bajaj contributes ~35% to LATL's revenues. With 30% volume growth, Bajaj has gained 250 bps YoY in domestic motorcycle market share in 1HFY19. This will support revenue growth at Lumax Auto.
- Co is constantly acquiring new orders. For example, it has won orders for LED Headlamps for (Discover & Avenger) and swing arm (Avenger and Pulsar) from Bajaj Auto, PCB for Tail lamp and Stop lamp from Maruti (Swift), PCB for Tail lamp (Passion Pro) and sheet metal components (CT100, ES model) from Hero Moto.
- We expect ~ 30% earnings CAGR over FY18-20E based on (1) High revenue traction in Lighting, Gear shifters and Sheet metal components, (2) Expansion in the aftermarket business (40 new products to be launched over FY18-20E).

WHY NOT

- High dependence on 2Ws (~48% of revenue).

CONSUMER

ITC

War horse for uncertain times

Aspirational Price Rs 382 (32x P/E Sep-20 EPS)

CMP Rs 277, MCap Rs 3,396bn

WHY

- We believe ITC is a relatively safe stock to accumulate during volatile times such as the present. It is coming off six years of cigarette volume decline and is poised to deliver 11% earnings growth over FY19-21E.
- **The nagging concern on ITC has been punitive tax hikes on cigarettes. Still, ITC has delivered ~10% cigarette revenue CAGR over FY10-18 (FMCG sector delivered 13%), despite continuous the volume cracks over FY12-18. This reflects ITC's pricing power.** Volume growth has come back if 1HFY19 (~ 3.5%) is any indication.
- We believe ITC can outperform hereon, driven by (1) Recovery in rural consumption which accounts for 2/3 of smokers, many of whom are uptrading from beedis, (2) Expectation of a stable tax environment (7-8% annual hikes) as the catch-up with global tax rates is largely done, (3) Favorable base and (4) A clamp down on the illicit trade. In such a scenario, ITC can deliver mid single digit volume growth over FY18-21E. Our 8% revenue CAGR estimate over FY18-21E looks easily achievable vs. 10/9% CAGR in last 10/5 years.
- Non-cigarette businesses are doing well. In its FMCG business (now approaching $ 2bn in revenues), ITC has power brands like Aashirvaad, Sunfeast and Bingo. Other non-cigarette segments (Hotels, Paper and Agri) are also doing well. We expect overall non-cigarette business to deliver 14% revenue CAGR during FY18-21E.
- At 25x FY20E EPS, ITC trades at an unfair discount of ~35% to the sector and provides a good entry point. We value it at 32x (~20% discount to the sector).

WHY NOT

- Tax hikes greater than 10% to reduce affordability will hamper cigarette volume growth.

Zee Entertainment

Best execution, OTT an overhang

Aspirational Price Rs 585 (30x Sep-20E EPS)

CMP Rs 448, MCap Rs 441bn

WHY

- Driven by its diversified content, genre and regional portfolio, Zee has fought its way to the top of the broadcasters' league tables in India (ex Sports) over FY13-18. **Its viewership market share now stands at 20% vs. 18.3% in 2QFY18, ~100-150bps higher than Star. We expect this leadership to persist.**
- **Recent fears of viewership (and revenue) loss to OTT offerings seem exaggerated to us.** Despite its late start, ZEE5 is aligned with Zee's core strengths in Hindi and regional GEC genres. We believe ZEE5 can become at least a relevant player in the digital ecosystem, even as we recognize that eventual outcomes depend on evolution of the OTT space, Zee's execution and the competitive landscape.
- Investments in new regional markets (Malayalam, Punjabi, etc.) and movie channels in established markets will help boost revenues hereon.
- Management remains profit and capital conscious. Its exit from the sports genre, investments into digital and its tight fix on costs and margins in the core business are commendable at a time when part of the competition is engaging in 'burn' strategies.

WHY NOT

- Competition in the OTT space is running high from global and national players (Youtube, Star, Voot, Jio TV, Amazon, Netflix). This may impact Zee structurally, and lead to further derating of valuation multiple.

Voltas

Cooling remains a hot business

Aspirational Price Rs 651 (35/17/20x P/E Sep-20 EPS for UCP/EMPS/EPS)

CMP Rs 533, MCap Rs 176bn

WHY

- **Voltas has consistently gained market share over the last 5 years in the Room AC market (200bps in the last 2 years alone) to cement its persistent leadership status.** India's Room AC penetration is low at ~5%, presenting a multi-year growth opportunity.
- Consumer financing is also driving growth. Revenue seasonality has declined over the years, as consumers now purchase during renovation/construction. Stricter energy efficiency norms are driving up the share of costlier inverter ACs (40% in the mix), resulting in higher affordability in running cost.
- Although the Room AC market is getting competitive, Voltas' key competitive advantage is its distribution network (15,000 touch points, largest in the RAC industry), coupled with a wide product range at attractive price points. Despite a sluggish performance in the summer of 2018, we maintain that the AC industry will sustain its secular long-term growth (i.e. ~10% volume CAGR).
- The JV with Arcelik and the launch of the Voltas-Beko brand in under-penetrated categories (washing machine, refrigerators, microwaves and dishwasher), provides multi-year growth visibility for the company. Voltas works at 45% ROCE and is debt-free.

WHY NOT

- Sharp rise in commodity inflation coupled with further depreciation in rupee will impact margins.
- Higher competitive intensity from MNC players like Daikin and LG will impact market share.

V-Guard Industries

National evolution

Aspirational Price: Rs 240 (35x Sep-20E EPS)

CMP Rs 191, MCap Rs 81bn

WHY

- V-Guard, one of Southern India's oldest electrical appliances players, is a fast-growing brand with a sales footprint rapidly expanding into the rest of India. Its product range includes voltage stabilisers, fans, cables, water heaters, pumps and kitchen appliances. Despite its nascent non-South presence, V-Guard delivers ~25% ROCE and remains debt-free.
- The co has undergone a makeover during FY19 via a one-time brand identity exercise, in-line with its strategy to increase pan-India penetration and diversify into several hi-growth categories. **With this brand-investment, focus on R&D (tech-rich product launches) and recruitment of senior talent, we envisage a DNA change that can take V-guard to the next level.**
- Co has grown at 3-4x GDP in the past. Urbanisation and improving power availability will support appliances demand. Lower category penetration and the GST-led shift (from unbranded to branded products) provide a multi-year growth opportunity. While V-Guard has delivered 25% revenue CAGR over FY08-18, we are building 15% revenue CAGR over FY18-21E.
- Two-thirds of the company's distribution network has already been established in the non-South region (38% revenue mix). This provides significant potential for revenue growth (50% non-South revenue mix target) and operating leverage to expand on existing investments. We expect ~150bps EBITDA margin expansion over FY19-21E as oplev kicks in (non-South EBITDAM is ~700bps lower vs. South).

WHY NOT

- Sharp commodity inflation (especially in copper), coupled with further currency depreciation can impact gross margins.
- Weak room AC sales can impact stabilizer offtake (V-Guard's cash cow).

Gulf Oil Lubricants

Bridging the gap

Aspirational Price Rs 886 (22x Sep-20E EPS)

CMP Rs 724, MCap Rs 44bn

WHY

- Gulf Oil is a fast-growing branded lubes business promoted by the Hinduja group. Over the last two years (FY16-18), Gulf's volume/revenue/EBITDA/PAT have grown by 25/32/51/61% vs. market leader Castrol's 5.4/8.5/8.8/8.4%. This aggressive show has been led by an increase in capacity (75 to 90mn KL p.a. in FY16 and 130mn KL in FY19), expansion in distribution reach by ~15% p.a. (~65k retailers vs. 150k for Castrol), and improving product and customer (B2C) mix. Its market share in B2C segment is ~8% vs. 22% for Castrol.
- We expect Gulf to register 2-3x industry volume growth (currently at low to mid-single digit). As market leader with premium positioning, Castrol enjoyed gross margins of 53-54% over CY6-18 and EBITDA margin of 24-25%. Over the last couple of years, Gulf has significantly bridged this gap. It still enjoys a lower gross margin of 47-48% (EBITDA margin of 17-18%).
- We foresee further room for growth/margin improvement for Gulf. Despite increase in crude oil prices, Gulf has been able to improve its Gross margin from 46 to 48% over FY16-18 (sustainability is key). Volume growth in Castrol has been at the expense of margin, down from 54% to 52%.
- Gulf Oil enjoys high return ratios (RoIC is ~40%), while new capacity does not consume significant capital. **At roughly half of Castrol's volumes, Gulf's market cap is ~25% of Castrol's.** A discount is naturally called for, given the lower margin profile and smaller market share. But we believe it is currently wide enough to present a lucrative bargain.

WHY NOT

- Rupee depreciation and increase in crude oil prices could impact margins especially in the near-term. Industry volume growth is in low-mid single digit. Increase in competitive intensity especially from market leader is a risk. Increase in oil change drain interval due to improved technologies is additional risks.

OIL & GAS

Petronet LNG

Resilient business at attractive valuation

Aspirational Price Rs 333

CMP Rs 215, MCap Rs 324bn (18x FY21 P/E)

WHY

- PLNG's volumes increased 1.6x, EBITDA and PAT jumped up more than 2.3x while stock price soared 3x during FY15-FY18. **The prospect of a mere 4.5% vol CAGR over the next three years has led to the stock correcting 18% from Oct-17 peaks. It is currently trading at 11.2x FY21E EPS.** We think this is a good bargain given the company's de-risked and steady growth profile and earnings visibility.
- With no major capex, PLNG can generate free cash flow of over Rs 74bn over FY19E-21E. It is searching for growth in the overseas markets. After its solid track record at Dahej and its stumble at Kochi, we believe Petronet will allocate capital more prudently in future.
- Rising competition from new LNG terminals and capital allocation are unlikely to have structural impact on pricing or volume growth as Petronet remains the lowest cost regassifier in India. Also, its current volumes at Dahej (est. ~92% of FY21 EBITDA) are protected via firm contracts upto FY28, including the contracted 5% YoY tariff rise.

WHY NOT

- Domestic gas production (~60 mmscmd) is expected to increase by ~50% via production hikes from ONGC (10mmscmd) and RIL-BP (20-25mmscmd) by FY22E. However, we also expect the domestic gas market to expand substantially by that time.

Indraprastha Gas

Another business with strong visibility

Aspirational Price Rs 370 (24x FY21 P/E)

CMP Rs 250, MCap Rs 176bn

WHY

- Capex-heavy businesses of strategic importance (power, fertilizers, gas transmission pipelines) work under regulated equity returns in India. This aims to secure investment and build-out of such assets.
- City Gas Distribution (CGD) is viable even without such regulation owing to a combination of relatively low capex and gas sourcing (pricing) advantages. This helps generate higher than regulated returns (IGL has posted ~<>% RoIC over the trailing decade) which can then be reinvested, obviating the need for budgetary or regulatory support.
- IGL's monopolistic gas supplier status in Delhi/NCR, regulatory support in the form of prioritised gas allocation, ban on petrol/diesel for public transport and ban on FO/LSHS/pet coke in favour of PNG convince us that this is a business to own for the long term.
- **We do not foresee major regulatory adversity in CGD either through a change in gas allocation or capping returns. This is because the superior returns in CGD will be reinvested and help increase the share of gas in India's energy mix from 20% (from 6% currently) by 2025.**
- We expect volume CAGR of 10.4% over FY18-21E for IGL as, (1) State government will add 2,000 new buses over FY19-20, and (2) Expansion of pipeline network in new areas like Karnal, Rewari and part of Gurugram will add volumes from 2HFY19 onwards. Besides, retail CNG prices are at 38/46% discount to diesel/petrol. This provides adequate pricing power.

WHY NOT

- Ministry of Petroleum and Natural Gas (MOPNG) has allocated 100% domestic gas for domestic households (DPNG) and transport sector (CNG), which ensures a low sourcing price for CGD players. Any change here can severely impact viability of the business. We think this is unlikely to change as CGD players are being allowed high profits consciously, to encourage and drive re-investment.

INFRA, CONSTRUCTION & REAL ESTATE

Oberoi Realty

Branding the saviour

Aspirational Price Rs 552 (1.2x FY20E NAV of Rs 460/sh)

CMP Rs 428, MCap Rs 155.7bn

WHY

- ORL has been gaining Residential market share in Mumbai, with RERA driving the shift initially. After the recent NBFC liquidity sqeeze, ORL is in a sweet spot as its funding lines are secured with banks.
- New launches in Goregaon (3mn sqft), Mulund (2mn sqft), Thane (3mn sqft) will drive pre-sales volume. ORL finances construction from internal accruals, and uses bank debt largely for building rental assets.
- Rentals to grow from Rs 3.5bn/annum to Rs 12bn by FY22E. These alone justify ~70% of current market cap. New residential projects and land acquisitions will add more value.
- ORL projects have given higher investment returns at 13% vs. peers at 9% (4yr CAGR). Owing to a strong brand, high construction quality and a gated community ecosystem, ORL enjoys 20-25% pricing premium vs. peers.
- **ORL continues to be a net cash company and hence with the NBFC liquidity squeeze for competition, ORL may be able to acquire new land parcels at reasonable valuations.**
- **Valuation:** We use DCF to value the residential business at Rs 259/sh, hotels at Rs 21/sh, commercial assets at Rs 117/sh, social infrastructure at Rs 9/sh, other assets at Rs 49/sh and net debt at Rs (7)/sh to arrive at SoTP valuation of Rs 460/sh. We ascribe a NAV premium of 20% and maintain BUY stance with TP of Rs 552/sh.

WHY NOT

- High interest rates impact customers' buying power.
- Delays in project approvals may lead to postponement of launches.
- ORL has a high share of premium residential projects with longish sales cycle. Economic slowdown/stock market corrections are negatively correlated to sales. This may impact cashflows.
- ORL has a high unsold inventory in the 360W Worli project with Rs 400mn avg ticket size. This may impact cash flows if sales recovery gets delayed.

PNC Infratech

Ripe for re-rating

Aspirational Price Rs 270 (18x FY20E core EPS + Rs 56/sh BOT assets value)

CMP Rs 139, MCap Rs 35.7bn, 6.4x FY20 EPS (core)

WHY

- After a tepid FY18, PNC Infratech is set to grow at a scorching pace over FY19-20 with a strong order backlog of 8.8x FY18 revenues. PNC's 1QFY19 order backlog stands at Rs 157.5bn, which provides the revenue visibility for our est. 22% EPS CAGR over FY18-20E. Our earnings estimates are ~30% higher than consensus.
- Currently, 42% of the order backlog (Rs 66.1bn) is generating revenue, and the balance Rs 92bn will move into execution from end 3Q/early 4QFY19E.
- **Earnings will bottom out, with 2QFY19E to be the worst quarter for the company as the extended monsoon has impacted execution. PNC's balance sheet is clean, with a standalone net D/E of only 0.12x.**
- PNC has now expanded operations in Maharashtra and Karnataka besides dominating in UP with 70% share. These States have large ordering potential.
- Asset monetization can free up almost Rs 5bn of cash, which can be utilised to meet HAM equity funding requirement of Rs 7bn.
- **Valuation:** We value PNC at 18x FY20E and arrive at an aspirational TP of Rs 270/sh (Standalone EPC Rs 214, Rs 56/sh from BOT's). At CMP, PNC trades at 6.4x FY20E core EPC valuation, which is inexpensive.

WHY NOT

- Ordering is expected to be muted over next 1yr due to election outcome related uncertainty. Execution can be challenged by delays in land acquisition.
- High crude and bitumen prices and rising interest rates impact profitability.
- PNC's HAM projects will need a large aftermarket for monetisation.

HEALTHCARE

Dr Reddy's Labs

Turnaround in play

Aspirational Price Rs 3,090 (20x Sep-20E EPS + Rs 520 for niche products)

CMP Rs 2,460, MCap Rs 399bn

WHY

- After three years of regulatory pain, Dr Reddy's is likely to emerge from the shadows. Since the appointment of the new COO (Erez Israeli), co has been aggressively pursuing cost control measures and divesting non-profitable assets. The effects were clearly visible in the 2Q results (margins improved despite the fall in US revenues).
- Improved launch momentum in the US (launched 8 products till Oct-18 and likely to launch additional 10-12 in the rest of FY19). The company has 100 pending ANDAs in the US market.
- **US FDA inspection at Duvvada is likely to lead to resolution of the warning letter unresolved for three years. This plant is important for DRRD's future launches in oncology.**
- We expect DRRD's lucrative US business to rebound over FY18-21E and grow at ~17% CAGR, led by niche launches like gSuboxone, gCopaxone and gNuvaring.
- The US recovery, impact of one-off launches, currency tailwinds and persistent cost control will drive EBITDA margin almost 700bps to ~24%+ by FY20. We model 29% earnings CAGR and re-iterate BUY with a TP of Rs 3,080 (20x Sep '20E EPS +Rs 520 for niche products).

WHY NOT

- Approvals for complex generic products are typically uncertain. Any delay here will hit revenue growth visibility.
- US FDA compliance is an ever-present risk.

Jubilant Life Science

All cylinders firing

Aspirational Price Rs 980 (10x EV/e for pharma + 4x for LSI on Sep-20 est.)

CMP Rs 670, MCap Rs 103bn

WHY

- Jubilant is a diversified pharma-cum-speciality chemical intermediates manufacturer with a global footprint. **Almost every segment of its business is likely to fire well over FY19-21E.**
- In the pharma business, Jubilant will become the only player in select Venom products in the US, while it will leverage the Triad pharmacy presence to drive radio pharma revenues. It is also adding injectables capacity in the contract manufacturing segment. Meanwhile, a better pricing environment is visible in its generic segment. Overall, we model ~13% rev. CAGR in pharma business.
- The chemicals business is also looking up. A new block will be commissioned for acetic anhydride, govt ethanol contracts are getting repriced while the decline in the Vitamin B3 business is set for a reversal with renewed availability of key RMs.
- With increasing contribution of the pharma segment (high value business), de-leveraging of balance sheet and 20% earnings CAGR, we believe JUBL should command a higher multiple. At present it is trading at 6.2x FY20E and 5.0x FY21E EV/EBITDA, at a 50% discount to peers. Re-iterate BUY with a TP of Rs 980 (Sep-20E EV/EBITDA, 10x for pharma + 4x for LSI).

WHY NOT

- Regulatory clampdown on select facilities.

CONTRIBUTING ANALYSTS

Company	Analyst	Qualification
Axis Bank	Darpin Shah	MBA
RBL Bank	Darpin Shah	MBA
Cholamandalam Finance	Darpin Shah	MBA
SBI Life Insurance	Madhukar Ladha, Keshav Binani	CA, CA
TCS	Apurva Prasad, Amit Chandra, Akshay Ramnani	MBA, MBA, CA
L&T Technology Services	Apurva Prasad, Amit Chandra, Akshay Ramnani	MBA, MBA, CA
Zensar Technologies	Amit Chandra, Apurva Prasad, Akshay Ramnani	MBA, MBA, CA
Ashok Leyland	Abhishek Jain	MBA
Lumax Auto Technologies	Abhishek Jain	MBA
V-Guard Industries	Naveen Trivedi, Siddhant Chhabria	MBA, PGDBM
ITC	Naveen Trivedi, Siddhant Chhabria	MBA, PGDBM
Voltas	Naveen Trivedi, Siddhant Chhabria	MBA, CA
Gulf Oil Lubricants	Himanshu Shah, Mansi Lall	CA, MBA
Zee Entertainment	Himanshu Shah, Mansi Lall	CA, MBA
Petronet LNG	Nilesh Ghuge, Divya Singhal	MMS, CA
Indraprastha Gas	Nilesh Ghuge, Divya Singhal	MMS, CA
PNC Infratech	Parikshit Kandpal, Kunal Bhandari	CFA, ACA
Oberoi Realty	Parikshit Kandpal, Kunal Bhandari	CFA, ACA
Dr Reddy's Labs	Amey Chalke, Eshan Desai	MBA, MBA
Jubilant Life Sciences	Amey Chalke, Eshan Desai	MBA, MBA

Disclosure:

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: compliancеofficer@hdfcsec.com Phone: (022) 3045 3600

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HDFC securities
Institutional Equities
Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,
Senapati Bapat Marg, Lower Parel, Mumbai - 400 013
Board : +91-22-6171 7330   www.hdfcsec.com