New Year Picks

2020 : The haze may lift

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New Year Picks

Sector	Company	Mkt Cap (Rs bn)	CMP (Rs)	Target Price (Rs)
Financials	Axis Bank	2,143	760	958
	State Bank of India	3,010	337	404
	City Union Bank	171	232	261
	Cholamandalam Investment & Finance	238	304	404
	SBI Life	989	989	1.230
	ICICI Lombard (Sell)	641	1,411	1,060
IT & New Age Businesses	Infosys	3,138	737	840
	L&T Technology Services	154	1,479	1,705
	Teamlease	43	2,524	3,415
	Sonata Software	32	305	405
Consumer	Symphony	81	1,162	1,888
	Jubilant Foodworks	215	1,627	2,184
	Britannia	732	3,042	3,638
	Dabur	813	460	512
	Avenue Supermarts (Sell)	1,207	1,926	1,250
	V-Mart	30	1,639	2,150
Cement	UltraTech	1,171	4,056	5,350
	JK Cement	90	1,160	1,523
Oil & Gas, Chemicals	Gujarat Gas	156	226	270
	Alkyl Amines	22	1,069	1,840
Automobiles	Bajaj Auto	938	3,242	3,530
Logistics	Container Corporation	349	573	640
Pharmaceuticals	Alkem Laboratories (Not Rated)*	241	2,017	2,400
	Torrent Pharma	318	1,870	2,100
Industrials & Infra	Larsen & Toubro	1,824	1,300	1,703
	KNR Constructions	33	234	378

*Fair Value

2020 : The haze may lift

At the cusp of 2020, Indian stock markets look more polarised than its fractious politics! It seems that incremental inflows are mostly chasing less than a dozen stocks. The reasons for this 'passive flight to safety' are not difficult to identify. Macro growth has slipped, alarmingly some say, and is not just on a cyclical downtick. High frequency data and core indicators are mostly struggling. Policy reform has been directionally encouraging (GST, RERA, IBC, tax cuts, the push for formalisation and financialisation) but messy and inadequate. Government's efforts to spur capex are sputtering. Modi 2.0 looks like a tougher grind than Modi 1.0, say the detractors.

So why should the haze lift? An under-estimated factor is the slowly healing global economy, post some concrete steps by the two largest economies in the world (US and China) to end their looming trade stalemate. Government policy action, as we well know from history, has been boldest when it is cornered. Our intuition is that the upcoming budget may well see the government springing a surprise on its naysayers.

Our top picks for 2020 are hardly different from the compilation we made a few months ago at the turn of the Samvat and derive from underlying quality and a measure of sanity in valuations.

- **FINANCIALS:** The healing cycle is set to play out further at stressed lenders, despite a slowing economy. Our picks here include the rapidly healing Axis Bank and SBI. We also like steady compounders such as Cholamandalam Inv & Finance and CUB. In the non-lending pack, SBI Life is set for sustainable growth. ICICI Lombard is a great business, but looks overpriced in view of the de-tariffing risk in TP.

- **CONSUMER** cos are sitting on very high valuations, even as sentiment (as seen in volume growth) has struggled considerably of late. New age businesses like QSR face long growth runways and (justifiably) command high valuations. Durables/appliances players with niche strengths are similar. The category expansion play at Britannia is not fully priced in, even after the run up over the last few years. Dabur's focus and rising distribution penetration drive our optimism, while Jubilant's multi-year growth story is yet to play out. Among retailers, we see structural risks playing out for the stratospherically valued D-Mart while V-Mart offers an interesting growth proposition, driven by strategic focus on value retailing.

- **TECHNOLOGY cos,** with all their enticing talent, FCFs and payout yields, are going for under 15x FY22E EPS (top 5 avg). Value is emerging at Infosys. Staffing leader Teamlease is relatively affordable now, while the growth/valuation bargains at L&T Tech and Sonata seem sensible at CMP.

- **CEMENT** may not enjoy the twin benefits of higher pricing and softer coal prices for another year. Our preferred stocks here include market leader Ultratech and the fast growing and (now) reasonably profitable JK Cement.

- **AUTOMOBILES** are battling a severe cyclical downturn and face longer term challenges, as the threat of EVs looms large. Sales vols are down 19/38/14% for PVs/MHCVs/2Ws in 1HFY20. Here, we like Bajaj Auto's global sales footprint, while Concor can capture freight from truckers in the congested Delhi-Mumbai route as the Dedicated Freight Corridor takes off.

- **OIL** cos will find it a hard ask to recover from a value destructive regulatory environment. The unfettered-by-regulation city gas distributors thus make sense. Gujarat Gas will (as its product mix tilts towards CNG) tread the path of Indraprastha Gas. Meanwhile, the exceptionally talented and prudent Alkyl Amines is our speciality chemicals pick.

- **INDUSTRIALS** never really recovered from the slowdown in corporate capex after the fairy-tale pre-GFC years. Barring L&T, infra stocks have gone through a ride to heaven and back. KNR Constructions is the other consistent performer in this space.

- **PHARMA** may well emerge in 2020, from its multi-year slump. But we are betting here on the more domestic-focussed Alkem and torrent, that also have interesting USs pipeline and look set to improve capital efficiency and cash flows in the foreseeable future.

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FINANCIALS

Axis Bank

Well set

Target Price Rs 958 (2.75x Sep-21E ABV of Rs 339 + Rs 27 for subs)

CMP Rs 760, Mcap Rs 2,143bn

WHY

- **Strategic Re-orientation:** We like the well-articulated (and executed) strategic revamp so far, post the top management change last year. Combined with strong liability franchise and product suite, reducing stress and capital raise this makes Axis Bank one of our top picks for 2020.
- **Reducing Stress and Improving Returns:** We expect a significant improvement in return ratios over FY21-22E, driven by a reduction in credit costs. Sustained reduction in reported (GNPAs ~5%, -100bps YoY) and anticipated stress pools (BB and below exposure at ~2%) and decent coverage (~62% calc. and ~9% contingent provisions) provide comfort.
- **Well-Capitalised:** While the recent Rs 125bn fund raise had us puzzled, we recognize that it will only add to ammunition, as competition grapples with uncertain times.

WHY NOT

- A reversal of the ongoing trend of asset quality improvement, with higher slippages and slower recoveries would be a prime risk factor. This holds more than academic importance, given the sluggish economy.
- While the change in top management is welcome and will naturally lead to some (desirable) attrition below, we are wary of rising churn in middle management which can have an impact on near term business stability.

State Bank of India

The healing cycle has begun

Target Price Rs 404 (1.3x Sept-21E ABV of 232 + Rs 102 for subs)

CMP Rs 337, MCap Rs 3,010bn

WHY

- **Eventual Healing:** Despite the possibility of lumpy near term stress (DHFL is likely to be recognized as an NPA in 3QFY20), we believe the worst in terms of asset quality is long behind SBIN and that eventual healing is highly likely. Faster resolutions could result in positive surprises on this front.
- **B/S Fortification:** SBIN has increased coverage dramatically in the past year (+~900bps) and coverage on exposure to historically vulnerable sectors, too, is high. Consequently, we expect credit costs to trend downwards and RoAAs to expand, although not to 1% levels.
- **Value unlocking potential**: Value unlocking from SBI's unlisted subs/strategic holdings (across cards, AMC, GI) over next few years will likely boost its SoTP value. Also, for its listed subsidiary (SBI Life), we believe growth surprises will persist, coupled with better product mix. SBI Life's raised TP adds another 4% to SBIN’s SoTP.
- **Valuations Underpin Our Stance:** At ~1x FY22E (net of subs), valuation seems to factor in pretty adverse asset quality outcomes vs. expectations. Any uptick in recoveries and/or moderation in slippages could trigger a re-rating.

WHY NOT

- Continued delay in the resolution of large assets could delay expected asset quality improvement.
- SBIN’s current chairman is set to retire in Oct-20. The impact on strategic changes and financial performance is uncertain.
- Standard exposure to stressed names/sectors and broader macros could adversely impact SBIN’s asset quality.

City Union Bank

Consistent compounder

Target Price Rs 261 (3x Sep-21E ABV of Rs 87)

CMP Rs 232, Mcap Rs 171bn

WHY

- **Lending Franchise:** CUBK's strong customer connect in its pet MSME segment is a strong plus, particularly in its home state, TN. This makes CUBK the preferred banker for its customers and gives it pricing power.
- **Superior Margins:** Higher yields resulting from pricing power, translate into superior NIMs, despite a milder CASA franchise (~25%) vs. peers. While margins (~4%), have come under pressure recently, due to a dip in the CD ratio, they remain best-in-class by a wide margin.
- **Consistent and Conservative:** CUBK has consistently delivered RoE in excess of ~15% for the last 13 years. This is attributable to superior margins, steady cost control and no major asset quality shocks. Deteriorating macros may impact growth and asset quality in the near term. However, the tax rate cut should cushion RoE.

WHY NOT

- Deteriorating macros, especially in CUBK's home state may negatively impact asset quality and growth.
- Recent growth trends have not been inspiring. The bank is treading consciously, we reckon, as it grapples with rising stress.

Cholamandalam Investment & Finance

Quality, across cycles

Target Price Rs 404 (3.5x Sep-21E ABV of Rs 115)

CMP Rs 304, Mcap Rs 238bn

WHY

- **Diversification And Availability Of Funds Drive Growth:** Asset financiers were hit by a double whammy (slowing auto sales and a funding crunch) in the past year. Diversification across products (HCVs, MCVs, LCVs, CE, Used CVs, HE etc.) and geographies (no state forms >15% of AUMs), and a considerable upcountry presence have insulated CIFC from the slowdown in auto sales (~24% AUM growth in 1HFY20).
- **Funding Not A Worry:** CIFC emerged largely unscathed even as funding dried up for the sector, in the aftermath of the IL&FS episode in late CY18. It has, in fact, gained marketshare from the continuing polarisation in the space. CIFC has raised ~Rs 90bn (net) from banks since Sept-18 and has adequate liquidity buffers.
- **Superior Asset Quality:** GNPAs of ~2.3% in the Vehicle Finance segment are among the lowest in the peerset. Over the years, CIFC has seen a considerable improvement in Home Equity (LAP) asset quality (~5.8% GNPAs).

WHY NOT

- Like other asset financiers, CIFC's growth and asset quality prospects remain vulnerable (albeit to a lesser extent, as seen earlier) to deterioration in macros.
- Yet another systemic shock could temporarily affect the availability of funds (from banks and debt markets) for the sector (incl. CIFC).

NON-LENDING FINANCIALS

SBI Life

Compounding at play

Target Price Rs 1,230 (Dec-20E EV + 25.4x FY22E VNB)

CMP Rs 989, MCap Rs 989bn

WHY

- **Growth continues at strong pace:** As per IRDAI data for FY20TD (Nov-19), SBILIFE's NBP/APE have increased to Rs 107.2/61.8bn, +39/22% YoY. We have built an FY19-22E APE CAGR of 18.0%.
- **SBI channel out-performing, sustainably:** Even now, only 61% of SBI's branches are activated (business > Rs 0.6mn p.a.) and SBI contributed ~Rs 3.8mn/branch in FY19, which SBILIFE expects to increase to Rs 4.5mn in FY20E. Also, SBI has increased its commission targets from SBILIFE to Rs 12.5bn (+25% YoY, in FY20E) without increase in payout rates. We believe branch activations will increase and the SBI channel will easily grow at 15-20% p.a. over next 3-5 years.
- **Newer tie-ups performing better than expectation:** Management stated that relatively newer tie-ups such as ALBK, Syndicate, Repco, P&S Bank continue to do better than expectations. It expects contribution from these banks to touch 10% in new business sales as early as FY22E. Management also indicated that it is looking to add new partners shortly.
- **Margin expansion to continue:** 1HFY20 VNBM improved 100bps vs 1HFY19 owing to better product mix (higher protection and NPAR savings, +400bps), negated by lower interest rates (-300bps). We foresee share of protection and NPAR to improve further while cost ratios are expected to remain under check. We build in FY19-22E VNB CAGR of 23.3%.

WHY NOT

- Lower than expected growth, lower protection share and lower margins remain key risks to our call.
- Rising competition (esp. via digital disruptors) poses pricing risk. Life insurance is a serious, long term contract. So this is a relatively milder risk for SBILIFE.

ICICI Lombard (Sell)

Strong franchise, but lofty valuations

Target Price : Rs 1,060 (26x Sept-21E EPS of Rs 40.8)

CMP Rs 1,411, MCap Rs 641bn

WHY

- **Too costly!** At CMP of Rs 1,407 India's largest pvt non-life insurer trades at FY20/21E P/E of 45.7/36.7x and P/ABV of 9.7/8.0x for RoEs of 22.5/23.9%. Valuations are factoring in 14-year (FY19-33E) APAT CAGR of 19.8%, as per our reverse DCF! We do see a high growth phase currently, but ICICIGI is likely to post lower-than-implied growth by FY23E and, more seriously, faces regulatory disruption that threatens to eat into current (super normal) profits in the Third Party (TP) sub-segment within motor insurance.
- **Steady deterioration likely in motor OD (own damage):** Driven by government diktat, high pricing in TP egment currently subsidises the OD business. This will vanish soon we believe. Also, to write longer term business, ICICIGI continues to offer high discounts to customers. Channel checks indicate that most GI cos also pay high commissions to dealers.
- **TP pricing to come under pressure**: Post the implementation of the Motor Vehicles Act (2019), we expect claims to fall in the TP business. This will drive an initial surge in profits. Govt is likely to react by capping TP prices or de-tariffing, both of which should arrest the surge in TP profitability. Over half of ICICI Lombard's current profits are attributable to the TP business.
- **High competitive intensity in health:** Health comprises ~19.3% of ex. crop FY19 NEP. Standalone Health Insurers are seeing much faster growth (FY11-19 CAGR of 28.1%) and now own a lion's share (40.8% in FY18) in the profitable retail health segment (+1,710bps over FY14-18)

WHY NOT

- Any delay in TP pricing pressure (after detariffing) can result in abnormally high profits over the medium term. This can drive up the stock price.
- PSU shrinkage accelerates : PSUs have lost ~1,100bps market share in favor of pvt. insurers over the last five years. This still represents a large addressable growth opportunity (40% PSU share in FY19) for ICICIGI.

IT & NEW-AGE BUSINESSES

Infosys

Catching up

Target Price Rs 840 (18x Sep-21E EPS)

CMP Rs 737, MCap Rs 3,138bn

WHY

- **Valuation catch-up imminent:** At CMP, INFY trades at 16.5x FY21E at a ~30% discount (peak discount vs. ~14% median discount) to TCS' valuations. Growth outperformance vs. TCS (1.2x on rev/EPS over FY19-22E), full clearance from the whistleblower allegations and increase in revenue guidance (currently at 9-10% CC for FY20) likely to trigger a re-rating/catch-up. Our TP implies 18x Sep-21E EPS.
- **Strong growth trajectory, at a bargain:** We expect USD rev/EPS at 10/9% CAGR over FY19-22E, driven by (1) Focus on large deals (77% YoY in 1H TCV & broad-based wins), (2) Recovery in T25 and large account mining (uptick in >USD 100mn), (3) Increased engagement with deal advisory and hiring of large-deal directors, (4) Acceleration in large public sector deals, (5) Partnerships (Temasek, Hitachi) creating opportunities in APAC region, and (6) Senior management involvement (from deal inception stage) on large deals and S&M building industry themes (to drive non-RFP based wins).
- **Stable margins, accelerated investment phase behind:** Completion of accelerated investment phase in increasing localisation (delivery centers) and S&M investments is expected to be followed by stable margins, supported by better resource mobilisation, pricing in digital, automation, steady sub-contracting expenses and onshore utilisation levers. We've factored EBIT% at 21.7/22.2/22.2% for FY20/21/22E (current guided band at 21-23%).

WHY NOT

- (1) Global macros turning adverse and impacting enterprise client budgets esp. in BFSI & Retail & CPG, (2) Appreciation in INR, leading to margin challenges, (3) Key management exits, (4) Resource mobilisation challenges resulting in higher sub-contracting.

L&T Technology Services

Buy the dip!

Target Price Rs 1,705 (18x Sep-21E EPS)

CMP Rs 1,479, MCap Rs 154bn

WHY

- **Solid business model:** L&T Technology Services (LTTS) is a leading ER&D pureplay service provider with diversified presence across Transportation, Process Industry, Telecom & Hi-tech, Medical devices and Industrial products verticals and a marquee client base, including 51 of top-100 global R&D spenders.
- **Huge addressable opp:** LTTS has large addressable opportunity across verticals with just 0.5% penetration within its T30 accounts and high tenure with large accounts (T30 average duration at >6yrs). LTTS has low client concentration vs. peers (T10 at 36% of rev) and leading delivery-mix (56% offshore rev mix).
- **Current slack will recede:** While growth has slowed on client specific challenges (largely in Hi-tech segment), the business is resilient and expected to rebound to stronger growth in FY21E supported by strong capabilities, deal wins/pipeline and negligible competition in Process Industry, Industrial Products (growth expected to be led by Process industry/Medical devices in near term). LTTS' IP strategy is also expected to fructify soon especially around i-BEMS and EnP platforms.
- **Decent bargain:** We build USD rev/EPS CAGR of 11.5/14.5% over FY19-22E, factoring USD rev growth at 10.2/11.5/12.7% and EBIT% at 17.0/17.3/17.6% for FY20/21/22E, respectively and value LTTS at 18x Sep-21E EPS.

WHY NOT

- Macros turning adverse, such as escalation in US-China trade war
- INR appreciation can impact margins

Teamlease

Multi-year growth story

Target Price Rs 3,415 (40x Sep-21E EPS)

CMP Rs 2,524, MCap Rs 43bn

WHY

- **New age star:** Teamlease is multi-year growth story on rising urbanisation and India becoming increasingly 'organised' in its manpower hiring and tax compliance. India's flexi staffing workforce has risen at 16.3% CAGR over FY15-18 and constitutes 0.2% of the total population (4.4% of the formal workforce), offering a multi-year growth runway of 15-20% CAGR.
- **Diversified leader, clear India play:** Client and Vertical diversification shields the company from cyclical down turns. Co has grown at 24% (mostly organic) over FY14-19 and is India-focused unlike peers.
- **New LoBs:** Teamlease has diversified in to specialised staffing (8% of rev) like IT and Telecom staffing through acquisitions. These are high margin business and will aid margin expansion. EBIT margins have expanded from 0.6% in FY16 to 1.9% in FY19, led by productivity gains (core business), higher mark-up and acquisition of higher margin IT staffing business.
- **Expanding margins, low risk, high profitability:** We like company's minimal capital requirements, low risk business model (non-outcome based), focus on scaling Core+NETAP associates and diversified client base. There is scope for further margin expansion through productivity benefits and better business mix.
- **Deserves a premium:** Teamlease's ability to grow ~15-20% organically, focus on driving productivity through automation, lower funding exposure, domestic exposure and high management pedigree demand premium valuations. We expect revenue/EBIT/PAT to grow at 19/28/33% CAGR over FY20-22E. The stock trades at a P/E of 33.9/26.0x FY21/22E earnings.

WHY NOT

- Continued soft macros in India will cap temp staffing at several key sectors like telecom, retail, real estate, logistics and financial services.
- Pricing power for Teamlease may suffer with rising organised competition.

Sonata Software

Focussed and consistent

Target Price Rs 405 (12x Dec-21 EPS)

CMP Rs 305, MCap Rs 32bn

WHY

- **Not your average IT midcap:** Sonata's platformation strategy to provide IT services around IPs, its strategic relationship with Microsoft (top client, Sonata generates licence revenue of ~USD 220mn p.a. for Microsoft) and focus on IP-led revenue (higher margin) is driving consistent growth in revenue and profitability.
- **Steady growth:** Total revenue/EBITDA/PAT has grown at a healthy CAGR of 14/28/26% over FY14-19. International IT Services (IITS, 38% of rev) and Domestic Product Services (DPS, 62% of rev) have delivered 18/11% revenue CAGR over this period.
- **Unique strengths:** We like the company's strategic alignment with Microsoft. Within IITS, Microsoft Platform Engg (25% of rev) + Microsoft D365 services + Microsoft IP-Led revenue is ~60% of IITS revenue (organic growth at ~10-11%). Growth in IP-led revenues (8-qtr CQGR of 9%) is impressive and has led to margin expansion in IITS business. Sonata's IT services margins at ~22-23% top the mid-cap IT pack. We think Sonata is well placed to grow and has made the right investments to mine Top-5 strategic accounts. We like its IP-focussed business model, high RoE (~35%) and dividend yield of ~4%.
- **Bargain valuation:** We expect revenue/EBIT/APAT CAGR of 11/15/14% over FY20-22E. The stock trades at attractive valuation of 9.9x FY21E EPS.

WHY NOT

- High client concentration (Top-5 is 59% of revenue). Slowdown in Top-account (Microsoft) can be a risk. Rise in receivable in the DPS business due to domestic slowdown is a risk. However, bad debt in the DPS business over the past 25 years is less than 0.5% of revenue.
- Slow down in US macros and Brexit uncertainty (Europe is 30% of rev).

CONSUMER

Symphony

The cooler dude

Target Price Rs 1,888 (45x Dec-21E EPS)

CMP Rs 1,162, MCap Rs 81bn

WHY

- **Category king:** Symphony's constant focus on product innovation and superior franchise with distributors makes the company competitive. A flurry of new launches has received a positive response. This provides good visibility on the likely performance in the non-seasonal quarters. We are confident on strong revenue growth in 2HFY20.
- **Miles to go for the leader:** Summer 2019 confirms our thesis that Symphony can deliver strong growth in a hot summer. The organised air cooler market (27/35% volume/value mix) can deliver 15% CAGR despite rising preference for RACs.
- **High RoIC and clean cash flows = dividend visibility:** The co has stated that it does not require a treasury larger than Rs 3-4bn for its operations. Hence, dividend payouts to the extent of 50% of PAT will begin from FY20. Co will maintain healthy payouts.
- **New markets, new opps:** The Climate Tech acquisition has given Symphony access to the Australian and US markets. A dominant market share and established distribution network in Australia, and tie-ups with top retailers in the US can provide substantial growth in these markets. These provide upside risks to our estimates.

WHY NOT

- In the event of a weak (or short) summer, Symphony's revenues could take a substantial hit as the air cooler market relies on the weather to drive volumes.

Jubilant FoodWorks

Beyond pizza leadership

Target Price Rs 2,184 (46x Dec-21E EPS)

CMP Rs 1,627, MCap Rs 215bn

WHY

- **Right time, right place:** Jubilant FoodWorks is India's largest QSR with >1,250 outlets in 276 cities. It is the master franchisee of the Domino's Pizza brand in India and neighbouring countries of South Asia. Consumer behavior is rapidly evolving, driven by aggressive discounting by food aggregators. Eating out in India is still at low levels at 3-4x per month, significantly lower vs. Far East Asian neighbours. The no. of families that can afford (and wants) to eat out is also rising every year, especially in urban areas. This provides a large opportunity for JFL to tap beyond pizzas.
- **Transformation in progress:** JFL is cognizant of this opportunity and is working on (1) A stronger Domino's Menu (pizza variants, in-house beverages, more sides etc), (2) Fixing the Dunkin' business model, (3) Developing home-grown new cuisine brands (Chinese, North Indian, etc), (4) Aggregators have already penetrated 500 cities vs. Domino's at 276. In response, JFL is aspiring to grow non-linearly driven by its investments in technology, core team and creating more brands under the JFL umbrella.
- JFL's investments in tech will allow the co to (1) Launch a custom made loyalty program (proven winning strategy for Domino's US), (2) Localized marketing (like HUL's WIMI – Winning in Many Indias), (3) Manpower optimization (converting fixed to part-time employees), and (4) Quality control and operational efficiency driven by artificial intelligence tools.
- **Fresh bakes coming up:** We believe JFL's earnings upgrade cycle will begin from 3QFY20 onwards which will help re-rate the stock. JFL remains our top pick in the consumer space. We value JFL at 45x Dec-21E EPS.

WHY NOT

- Deep discounting aggregators dents growth and pricing for JFL. Commodity inflation (milk, chicken, wheat etc.) can also hit margins.
- Failure of home-grown brands (Hong's Kitchen)

Britannia

Category expansion on the cards

Target Price Rs 3,638 (45x Dec-21E EPS)

CMP Rs 3,042, MCap Rs 732bn

WHY

- **Leader, and premiumising:** Britannia is India's leading biscuit brand by value market share. Over the last five years, BRIT has premiumised its portfolio, strengthened its distribution in the Hindi belt and kept a tight lid on costs. As a result, revenue/EBITDA grew at 11/28% CAGR over FY14-19.
- **Category expansion:** Britannia is now looking to leverage its brand name into other snacking categories (cake, rusks, beverages, salty snacks, croissant, etc.) in order to become a 'total snacks company'. Eventually, BRIT will focus on becoming a 'total foods company'. Hence, the addressable opportunity is large. All product launches are GM accretive to BRIT. Co remains committed to its cost savings program. Corp tax cuts (1,000bps) add more funds to its reinvestment kitty.
- **Tough news priced in, can only improve hereon:** The recent slowdown has impacted biscuit category growth (particularly in rural markets) resulting in a subdued 1HFY20 show. We expect growth rates to recover after a normal monsoon, acceleration in PM Kisan Yojana fund transfers and a favorable base.
- **Costly, but deserves a premium:** We expect 12/17% revenue/EBITDA CAGR over FY19-22E. We value Britannia at 45x Dec-21E EPS.

WHY NOT

- Rural slowdown sustains over the next 12 months.
- Commodity inflation (milk, sugar, wheat etc.) intensifies.

Dabur

Focus + depth = faster growth

Target Price Rs 512 (40x Dec-21E EPS)

CMP Rs 460, MCap Rs 813bn

WHY

- **Rural king:** Dabur's rural growth has consistently outpaced urban growth owing to distribution expansion (direct reach at 51k villages vs. 49k in 1QFY20). This is in contrast to the sector. HUL and Marico reported weaker rural growth vs. urban. The co also intends to expand its presence upto 60k villages by the end of FY21. To combat liquidity stress, Dabur provided additional credit to select distributors.
- **Energetic, innovative leader:** Mohit Malhotra's (new CEO) strategies and execution are visible in Dabur's 1HFY20 performance, wherein co has outperformed its peerset. Malhotra is focusing on (a) Scaling power brands (8 brands with 65% revenue mix) which have a large addressable opportunity and (b) Deeper rural penetration led by higher direct reach. While beverage market share is at all time high, growth recovery here is critical for Dabur to outperform.
- **Rural recovery on the cards:** We expect rural growth to recover from 1QFY21 led by Rabi crop harvest, acceleration in transfers of PM Kisan Yojana, other govt. led initiatives and a favorable base.
- **Premium valuations to sustain:** Dabur has gained healthy market share across categories like Oral Care, Shampoo, Hair Oils and Juices in 1HFY20. It gives us visibility on healthy performance once consumption dynamics improve. We value Dabur at 40x Dec-21E EPS.

WHY NOT

- Any further delay in recovery (particularly in rural) and high inflation will hamper our earnings estimate for Dabur.
- Real Juice (20% of domestic revenue) has been under pressure for the last 3-4 quarters led by category specific issues. Any further impact on the category can impact earnings growth for Dabur

Avenue Supermarts (SELL)

Rising competition to hit margins, valuations

Target Price Rs 1,250 (25x Sep-21E EPS)

CMP Rs 1,926, MCap Rs 1,207bn

WHY

- **Select e-grocers closing in on D-MART's key proposition – Pricing:** While D-MART continues to remain cost/price leader in F&G, E-grocers have been closing in. Interestingly, this doesn't come at the expense of deteriorating economics (trading margins for the latter have improved).

  ...Online biggies getting battle-ready too: Amazon/Flipkart have bumped up their authorized capital significantly in FY19 to Rs.35/18.5bn. We reckon most of these investments will find their way in supply chain and pricing as both aggressively acquire customers. D-MART will have to defend turf. We are building in flat EBITDA margins over FY19-22E despite rising scale.

- **Expansion target seems on track, there is a need to rev up run-rate:** D-MART is on track to add 27 stores in FY19. However, more needs to be done on this front as key peers have stepped up expansion. Our analysis on 460+ districts suggests that achieving/maintaining sales velocity in new stores may be a challenge.

- **Stock supply to weigh on performance:** Per SEBI regulations, the promoter group needs to reduce stake to 75% by end FY20 (currently ~80%). With a QIP on the cards, supply will challenge already punchy valuations.

- **Valued to the moon and back:** At 39x Sept-21 EV/EBITDA, there is just too much implied growth and its longevity, especially as competitive intensity rises in F&G. We build in revenue/EBITDA/APAT CAGR of 25/28/28% CAGR over FY19-22E. We assign a DCF-based TP of Rs. 1,250/sh (implying 25x Sep-21 EV/EBITDA)

WHY NOT

- Big peers such as Amazon/Walmart (via Flipkart) may struggle with assortment selection, trading margins and cost structures in the medium to long term.

- With low float, the stock can command high valuation premium.

V-Mart

Sharp shooter on expansion drive

Target Price Rs 2,150 (20x Sep-21E EPS)

CMP Rs 1,639, MCap Rs 30bn

WHY

- **Low Avg. Order Value (AoV), cost of retailing = Safety net:** Low AoVs in mass value fashion (~Rs. 750-800), coupled with low cost of retailing vs e-tail formats insulates this category from online predators.

- **Value fashion (VF) tail is out of gas; V-MART to gain**: Our analysis of the VF tail indicates credit cycles as high as 6 months (on COGS). Sales velocity too, has come off. VMART will benefit from any supply disruptions at peers.

- **Stepping up expansion:** While the VF tail struggles to get store economics right, V-MART is expanding furiously to capture market share. We bake 24% area CAGR and 55-85 store additions p.a. over FY19-22E. Our SSSG CAGR of ~5% over FY19-22E is mostly led by footprint expansion.

- **Correction, a good entry point:** SSSG has moderated to 3% and inventory piled up in 1HFY20, working capital can normalize hereon. The stock seems over-punished (>50% correction in valuation over a year) (15x Sep-21 EV/EBITDA). Our revenue/EBITDA/LTL PAT (pre-corporate tax cut) CAGR of 22/16/16% respectively over FY19-22E and assign a DCF-based TP of Rs. 2,150/sh.

WHY NOT

- National VF retailers succeed in penetrating V-MART's bread-and-butter territories faster than expected and profitably so, 2. The VF mass tail stages a turnaround (unlikely as funding seems to have dried up).

CEMENT

UltraTech

The galloping elephant

Target Price Rs 5,350 15x Sep-21E EBITDA (implies $ 210/t)

CMP Rs 4,056, MCap Rs 1,171bn

WHY

- **Strong pan India distribution:** With a total capacity of 112mn MT in India (post consolidation of Century Textiles and Binani Cements), UltraTech accounts for 25% of India's cement capacity. With a pan India footprint, it has leadership in both trade and non-trade segments and commands premium pricing. Even in the white cement/putty segment, UltraTech is a leader brand in India.
- **Multiple cost levers to bolster margin:** Owing to its distribution strength and improving cost efficiencies, the co has consistently generated above average margins. With its increased size, the co's bargaining power on input materials and freight-service purchase will also accelerate. Further, the co is expanding WHRS generation capability to 20% by FY21-end vs. 9% currently. With increased no. of plants, even lead distance will reduce. With production ramp-up, this should bolster its operating margin.
- **Stable leverage profile:** Despite the mega acquisitions of Century and Binani, its leverage remains under control. Net D/E is merely 0.6x and net debt/EBITDA is 2.1x. Despite factoring in growth capex, we estimate Ultratech to deliver free cash flow yields of 5%+ over the next two years.
- The stock currently trades at 12.4/11.1x FY21/22E consol. EBITDA. We recommend BUY with a TP of Rs 5,350 (15x Sep-21E EBITDA).

WHY NOT

- Continuation of subdued demand (as in 1H) in 2HFY20 will impact utilization as well as pricing power, leading to pull down in profitability.
- Possible reversal in fuel costs which have remained soft in the past 12 months. Thermal coal is ~ $ 80/t today, from a peak of $ 120/t in Sep-18.

JK Cement

Shining bright

Target Price Rs 1,523, 10x Sep-21 EBITDA (implies $115/t)

CMP Rs 1,160, MCap Rs 90bn

WHY

- **While cement booster:** JK Cement is present across two businesses – Grey cement and White Cement/Putty. In the grey cement business, it has 15mn MT capacity (FY20, post the recent expansion) spread across north and south regions and sells in all regions except in east. In the white/putty business, it has 1.7mn MT capacity spread across India and UAE.
- **Better placed on pricing:** Post its 40% grey cement expansion, the lucrative-north/central markets will rise in JK's sales mix from the current 70%. As clinker utilisation is highest (80%+) in these markets, JK Cement shall benefit from its strong pricing and from better volume growth visibility.
- **Efficiency to rise:** JK Cement's weak grey cement margins (~Rs400/MT during FY14-19) owe to old and inefficient kilns in north (~12% of clinker capacity). As JKCE is increasing its clinker capacity by 37% during FY20-21E to 10.4mn MT, blended opex/t will fall. This should help push up total EBITDA by ~13% CAGR over FY20-22E after the sharp 40%+ hike in FY20E.
- **Leadership in white/putty segment:** JK Cement, along with UltraTech, controls ~80% of the white cement segment in India. Even in white-cement based putty, both cos have pan-India presence and ~45% market share. In such a high demand segment, having a strong brand recall helps JK Cement command premium domestic margins of 30%.
- Robust margin in the white/putty segment, and expected rebound in grey margins should support JK Cement's expansion in central markets, keeping its leverage ratio in check.

WHY NOT

- Continuation of subdued demand will delay ramp-up of its new plants
- Spike up in fuel costs.

OIL & GAS

Gujarat Gas

Favorable macros will drive growth

Target Price Rs 270 (20x Dec-21E EPS)

CMP Rs 226, MCap Rs 156bn

WHY

- **Well placed gas distributor in India's largest gas market:** Industrial and commercial customers that constitute ~80% of GGL's volumes are fed by a blend of Long Term and spot LNG. Supply glut in the global LNG market will ensure benign spot LNG prices. As sourcing mix tilts towards spot LNG, blended purchase price will fall. This benefit will be part-retained, driving up margins and spur demand as well.
- **CNG to rise in the mix:** GGL's well connected CNG network will enrich sales mix steadily (<20% today). GGL operates 352 CNG stations in Gujarat as on Sep-19. It plans to expand aggressively in FY20 and add 70+ stations. The company intends to tilt revenue mix towards higher margin CNG but the mammoth industrial volume hides this steady evolution. However, GGL's presence in tier 2 and 3 cities enables CGD expansion at a faster pace than peers.
- CGD entities deserve higher valuation multiples than utilities considering they are (1) Unregulated, (2) Relatively less capex-intensive, and (3) Competing as viable alternatives (in industrial/commercial markets). We believe their pricing freedom has been granted tacitly by regulators, since superior returns in CGD can be reinvested to help increase the share of gas in India's energy mix to 20% (from 6% currently) by 2025. This valuation premium will expand as profits outpace volumes (already visible in IGL). We value GGL at 20x FY21E EPS (vs. 25x for IGL and 19x for MGL).

WHY NOT

- Morbi (Rajkot) is a tile manufacturing hub. GGL supplies 60% of total volumes to tile manufacturers. Hence, slowdown in domestic real estate market or imposition of anti-dumping duty in key export destinations can indirectly impact volumes of GGL significantly.

CHEMICALS

Alkyl Amines

Exponential growth opportunity ahead

Target Price Rs 1,840 (22x Dec-21E EPS)

CMP Rs 1,069, MCap Rs 22bn

WHY

- **Sweet spot:** AACL has an edge in the industry as its peers are running at close to full capacity for Methyl Amines. Alkyl (1) Has 20-25% idle capacity at Dahej and, (2) Will debottleneck another 15kTPA by FY21. This will enable market share gains as demand continues to grow unabated in pharma (~50% of sales mix). Volume growth should be ~10-15% YoY in FY20 led by both pharmaceuticals and agrochemicals (~20% of sales mix).
- **Compounding visibility:** The company will spend Rs 0.8-1bn on capex annually in FY20/FY21/FY22 on (1) Debottlenecking at Dahej by 1QFY21 and (2) Capacity expansion of Methyl Amines (and its derivatives) and Acetonitrile at Kurukumbh. This will generate revenue potential of ~Rs 3.75bn (44% of FY19 net revenue).
- Tight supply of Acetonitrile in the global market, a declining trend in raw material prices and a conscious drive towards a richer product mix will expand EBITDA margins in FY20/21 (~21.5% vs 19.4/18.9% in FY19/18).
- **Valuation and view:** High intrinsic profitability (RoIC 25%+), market share gains in Methyl Amines, and a prudent management make AACL an attractive bet at 14.0/12.1x FY21/22E EPS.

WHY NOT

- Margins may fall if the current downtrend in raw material prices (particularly methanol) reverses. We think this is unlikely given the large methanol capacities coming up in the region.

AUTOMOBILES & LOGISTICS

Bajaj Auto

Well positioned for BSVI transition

Target Price Rs 3,530, 18x Sep-21E EPS

CMP Rs 3,242, MCap Rs 938bn

WHY

- **Well equipped for BS-VI:** With its KTM association, Bajaj Auto is relatively less impacted by the emission standards rollover. It is geographically well diversified, with exports accounting for over 40% of volumes, spanning 2W/3W. Both transition impact and market risks on the co are lower than peer Hero Motocorp.
- **Recovered marketshare:** Bajaj clawed back to 26% market share in the motorbike segment in FY19 (vs. 22% in FY18), mostly owing to a changing product mix (phased out Discover from the executive segment and cut prices in entry level bikes). This brought its share of pain (EBITDA margin fell 390bps over FY17-19) but pulled Bajaj back into dealer favour. 2QFY20 has seen better margins as product mix and pricing power have returned.
- **Corporate tax cut to help:** The tax cut has come as a relief to Bajaj Auto ahead of the BS-VI rollover. The lowering of tax rates will partially offset revenue/margin pressures, particularly with the impending BS-VI transition. Some pass through is visible via discounts.
- **Cyclical tailwinds:** Over the near term, co will benefit from the strong monsoon (110% of long period average). Lower fuel prices and easing of commodity inputs will also support demand/margins.
- **EV prowess:** The recent display of the electric vehicle (Chetak) reflects well on Bajaj's R&D capabilities. We suspect the OEM is well prepared for any technological shifts in the future, though technical details were not shared.

WHY NOT

- Higher than expected cost hike due to BSVI related transition
- Sharp slowdown in exports

Container Corporation

Beneficiary of the DFC

Target Price Rs 640, 24x Sep-21E EPS

CMP Rs 573, MCap Rs 349bn

WHY

- **Market leader in core segment:** Concor is the dominant Container Train Operator (CTO) owing to its huge network of ICDs/CFSs.
- **DFC augurs well:** We expect Concor's volumes to grow in the mid-teens, in tandem with the phased commencement of the Dedicated Freight Corridor (DFC). DFCCIL's MD expects 990 kms (~30% of the project) to be commissioned by Mar-Apr 2020. Eventually the DFC will enable full-fledged double stacking of container trains in the Mumbai-Delhi route, which holds the promise of substantially lower transit time and freight cost vs. truckers. The DFC will connect landlocked (but economically significant) northern states like Haryana, NCR to ports in Gujarat (Mundra and Pipavav) in Phase-I, by mid CY20. CONCOR will benefit as over 45% of its EXIM traffic moves through these ports. As rail-based volumes rise, we expect rail coefficient at major Western ports to rise to ~30%.
- **Efficiencies to rise with double stacking:** CONCOR's adj. EBITDA margin has risen by 280bps over FY17-19, due to efficiency improvements and operating leverage arising out of double stacking. Empty running charges have declined 10% YoY in FY19 with the ramp up of double stacking services at the Khatuwas terminal. As the DFC gets operational, double stacking will drive better utilisation of its network.
- **Divestment kicker:** Govt initiatives on divestment will address capital allocation concerns and will lead to a re-rating of valuation multiples in our view.

WHY NOT

- Weak global macros impacting EXIM volumes negatively.
- Any delay in privatization or slower than expected commissioning of DFC.

PHARMACEUTICALS

Alkem Laboratories (Not rated)

Preferred 'India' play

Fair Value Rs 2,400 (20x FY22E EPS)

CMP Rs 1,995, MCap Rs 240bn

WHY

- **Solid domestic franchise:** Despite being acute focussed, Alkem's India business (~70% of revenues, 90%+ profits) has grown at 15% CAGR over FY14-19, outperforming the India Pharma Market (IPM) by ~500bps. It ranks 6^{th} with 3.4% market share in IPM. We expect this segment to grow ahead of peers driven by strong performance in both acute (#1 in anti-infective) and chronic (high-growth) segments.
- **US revenues to grow stably:** Despite being a late entrant, Alkem has demonstrated good execution in the US (fair market share in the products launched). New product launches (10-12 p.a, ~70 pending ANDAs) will offset base business erosion (mid-single digit) and drive 10% revenue CAGR over the next three years.
- **Levers for margin expansion in place:** Higher profit contribution from chronic portfolio, improving MR productivity and operating leverage in US will drive margin expansion of ~300bps over FY19-22e. This, coupled with moderating capex, will drive ROIC higher from 15% in FY19 to 19% in FY22E. Importantly, FCF generation should cross Rs 20bn over this period.
- **Smooth sailing:** Alkem has outperformed the sector by 10% over the trailing year. Strong earnings growth (22% CAGR) and rising return ratios (+400bps) over FY19-22e, should make the stock command 20x FY22E EPS (10% premium to large cap peers)

WHY NOT

- India - Expansion of NLEM (national list of essential medicines) coverage, capping of trade margins, slowdown in IPM can adversely impact growth
- US - Regulatory risk at plants, higher price erosion, delay in product approvals and launches in US can dampen growth expectation.

Torrent Pharma

India business on firm footing

Fair Value Rs 2,100 (26x FY22E EPS)

CMP Rs 1,870, MCap Rs 318bn

WHY

- **India franchise (chronic led) to outperform peerset:** Post the successful turnaround of the Unichem acquired business, we expect Torrent to focus on revenue synergies (scaling smaller brands of Unichem) and consolidate its position in chronic therapies. India biz should grow at 12% CAGR over FY19-22E ahead of the IPM.
- **Subdued growth in US, resolution of 483s remains key**: US biz (18% of revenues) is expected to grow at 5% CAGR in FY19-22e led by delay in approvals (Dahej – OAI and Indrad – WL), shutdown at Levittown facility (WL) and slower ramp up of Losartan. Successful resolution of Dahej (majority of pending ANDAs) & Indrad (50%+ revenues) will remove the key overhang on the stock.
- **Improving FCF to reduce leverage**: Torrent's EBITDA margin (27% in 1HFY20, best among peers) will further improve by 60bps over the next two years led by improvement in FF productivity. We expect FCF generation of over Rs 47bn over next three years which will lead to reduction in net debt/EBITDA from 2x in FY19 to 0.3x in FY22e.
- **Strong core:** With robust earnings growth (23% CAGR over FY19-22e), reducing leverage and superior return ratios (ROCE of 22% in FY22e), the stock should trade at 26x FY22e in our view (20% premium to its 5-year historical average to factor higher exposure to India post Unichem).

WHY NOT

- US – Delay in resolution of OAI status at Dahej and WL at Indrad will impact product approvals (largely factored in).
- India – Widening of price control net, slowdown in IPM can adversely impact growth.

CAPITAL GOODS & CONSTRUCTION

Larsen & Toubro

Awaiting ordering tailwinds

Target Price Rs 1,703 (22x FY21E core EPS + Rs 334/sh subsidiaries value)

CMP Rs 1,300, MCap Rs 1,824bn

WHY

- **Anchor stock:** LT continues to be a preferred proxy for Indian infra and capex cycles with contribution spanning decades across cycles. Though domestic orders account for ~78% of the outstanding order book of Rs 3.03tn, it has achieved successful geographical diversification across Middle East, Europe, USA and Africa, with many marquee government orders.
- **Encouraging order inflow:** Co successfully secured orders worth Rs 870bn during 1HFY20 despite overhang from elections and continued weak economic outlook. During 3QFY20, the company has secured new orders worth ~Rs 300bn already.
- **Stalled projects not a worry:** The Mumbai-Ahmedabad Bullet Train project is on hold. While this was baked in the 10-12% YoY inflow guidance, other Central Govt projects will counter the near term bleak ordering environment. Though Maharashtra comprises 11% of the order book, on-ground execution and payments on Infra projects are reassuring. With the AP government also commencing projects in the Amaravati capital region, LT can expect clarity on its stalled projects (2-3% of order book) soon.
- **Favoured borrower:** L&T's credit rating and execution track record make it virtually immune to liquidity issues. Co continues to secure funds from Banks/Financial Institutions on relatively favorable terms.
- **Valuation:** We value L&T at 22x FY21E EPS for our TP of Rs 1,703/sh (Standalone EPC Rs 1,369, Rs 334/sh for Subsidiaries). At CMP, L&T trades at 14.9x FY21E core EPC valuation, providing significant upside potential.

WHY NOT

- With private capex yet to pick pace, government ordering would continue to drive the new order inflow for the company during 2HFY20. Lack of ordering may lead to heightened competitive intensity with a resultant impact on the margins.

KNR Constructions

Marching ahead

Target Price Rs 378 (18x FY21E core EPS + Rs 59/sh BOT assets value)

CMP Rs 234, MCap Rs 33bn

WHY

- **Unique capital consciousness:** KNR Constructions is the only listed EPC player with near-zero long term debt, since its listing. Of the Rs 3.1bn in gross debt, Rs 2.1bn is from promoters. Net D/E (including this debt) is 0.2x only.
- **Strong visibility:** Order book of Rs 67bn (2.6x FY20E revenue) lends strong growth visibility. We expect 20/19% FY19-21E Rev/APAT CAGR. KNR has secured orders worth Rs 18bn during 1HFY20E. With Rs 10-15bn of NHAI project wins expected across EPC and HAM, it is on course to achieve order inflow guidance for FY20 (Rs 30bn).
- **Top class execution:** KNR's credit rating and track record has ensured funding lines from financial institutions despite the recent reluctance of financial institutions to lend to infra cos.
- With a strong balance sheet vs. mid-size peers, KNR enjoys a credit rating of AA-. The company is disposing its shareholding in 3 HAM projects at a blended multiple of ~1.8x to Cube Highways (an infra asset investor funded by I-squared Capital and ADIA). This transaction bodes well from a balance sheet perspective as it reduces the equity commitment towards the three projects, enabling the KNR to bid for new HAM projects. NWC for the company is lowest at 42 days vs. the peerset average of 85 (Sep-19).
- **Valuation:** We value KNR at 18x FY21E EPS and arrive at a TP of Rs 378/sh (standalone EPC at Rs 319/sh, Rs 59/sh from BOT assets). At CMP, KNR trades at 9.9x FY21E core EPC valuation, providing significant upside potential.

WHY NOT

- NHAI ordering, which is expected to contribute significantly to new order inflows during 2HFY20, is yet to gather pace. Further delays may impact execution till FY21E.
- KNR is awaiting Appointed Dates for two HAM projects (~23% of order book). Any further delays may impact our FY21E revenue estimates.
- KNR's order book continues to be concentrated in the Roads and Irrigation segment. Further diversification and building credentials in other segments is required to sustain valuations.

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Disclosure:

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Mutual Funds Investments are subject to market risk. Please read the offer and scheme related documents carefully before investing.

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