Diwali Picks

*Climate change hits India!**

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**An age-old school lesson seems to be lost on the majority of Indian analysts, economists, businessmen and, of course, politicians. It is the simple (yet profound) fact that weather and climate refer to two completely different conditions in the environment.*

The folks at NASA say: 'The difference between weather and climate is a measure of time. Weather is what conditions of the atmosphere are over a short period of time, and climate is how the atmosphere behaves over relatively long periods of time.'

https://www.nasa.gov/mission_pages/noaa-n/climate/climate_weather.html

Diwali Picks

Sector	Company	Mkt Cap (Rs bn)	CMP (Rs)	Aspirational Price
Financials	City Union Bank	106	160	230
	Kotak Mahindra Bank	2,061	1,082	1,277
	SBI Life Insurance	690	690	850
	DHFL	169	538	700
IT & New Age Businesses	Tata Elxsi	54	862	1,220
	MCX	58	1,134	1,500
	Teamlease	28	1,628	2,125
Automobiles	Mahindra & Mahindra	823	1,325	1,773
	Jamna Auto	23	59	82
	Force Motors	48	3,700	6,540
Consumer	V-Guard Industries	81	191	250
	ITC	3,239	266	357
	Dish TV	76	72	125
Cement	Birla Corp	78	1,009	1,450
Metals & Mining	GMDC	47	149	225
Oil & Gas	Indian Oil Corporation	2,013	415	526
	Petronet LNG	376	251	304
Infra & Construction	PNC Infratech	38	149	205
Healthcare	Lupin	480	1,062	2,045
	Granules India	35	136	240
Capital Goods	Cummins India	251	907	1,100

Climate change!

India is changing rapidly (arguably for the better) in crucial aspects such as governance, economic and fiscal policy mix, subsidy management, business friendliness, taxation policy, physical/digital infrastructure and the general rule of law. These are huge changes which will not happen uniformly or instantly.

For example, we are still not constructive on the Modi government's cumulative efforts to resolve NPAs in the banking system or to free labour markets from vicious government control. However, we firmly believe that the stormy weather in today's policy mix is but a precursor to the climate change that is setting in. Sadly, many Indians are still fretting about the weather, instead of adapting to the climate change.

Consider the following examples:

- **Demonetisation** and its follow-through processes are pulling more people into the income tax net *(less than 3% Indians pay ANY income tax)*. This bodes well for government finances in future. Banks are already flush with deposits, interest rates have fallen (no doubt helped by other factors, too), after India made a decisive first move last November towards becoming a less-cash economy (9% of GDP vs 12% earlier). Savings are undergoing a (hopefully) permanent shift, away from traditional and relatively unproductive sinks such as gold and real estate, towards financialisation.
- *Meanwhile, Indians are agonising over the (entirely understandable) disruption that demonetisation caused. They are busy painting doomsday scenarios for businesses, consumers and the government. They believe earnings growth is not going to revive, the private sector capex cycle is dead and that consumer demand is going to fall off a cliff.*
- **GST** enables a seamless pass-through of input tax credit for businesses across the manufacturing and services spectrum. It makes life difficult for informal businesses above a threshold size. GST also opens up trade flows across the country and eliminates tax arbitrage across states. It is a tax reform that states across the political spectrum have collaborated on. Adoption hiccups are currently in motion. *Meanwhile, Indians across the business (and intellectual) spectrum think GST will lead to inflation, fiscal pain, business destruction, unmanageable compliance effort and red tape.*
- **The push for digitisation**, especially of the financial system, is the third pillar of the government's efforts to formalise the Indian economy. This, when ~90% of the working population is engaged in sub-sized, informal enterprises and an estimated 20-30% of GDP is also neither tracked nor taxed. Aadhar (an idea seeded by the previous government) is the key that will track identities across personal, financial and government-facing transactions. This will enable taxes (and subsidies) to be accurately applied via a rule-based, auditable and efficient manner. Aadhar also enables the creation of reliable credit histories at zero incremental effort, opening up millions of marginal borrowers to the (much cheaper, more efficient and arguably merit-based) formal credit system.
- *Meanwhile, large swathes of media and liberati agonise over the possible 'loss of privacy' and other potential misuses of Aadhar, a fair but exaggerated fear that draws attention away from the obvious benefits of a technology-led tracking system in the financial domain.*

For decades, Indians have had to put up with *inefficient, inappropriate, slothful, corrupt and apathetic governance*. The economy trundled along mostly on sub-optimal and informal linkages. Not to mention that uniquely Indian innovation (or shall we say the poor man's compromise?) called 'jugaad'.

No wonder, India mostly lagged the world in virtually every aspect of human and economic development. Whatever little happened was achieved *in spite of the government and the law*. Whenever Indians did well, they had to dodge the system. Or because they got a favour from someone. Or, easier still, they did it out of their own country, mostly in places where merit mattered.

We think a change has been set in motion. The festering tumour in the economy has been treated with the strong chemotherapy of structural reforms like demonetisation, GST and Aadhar. There's more to come, surely.

The weather has turned stormy. Many of us don't realise the climate change that is actually upon us. So let's stop agonising over the weather and learn a new game to play. Difficult, but possible. And entirely desirable.

For investors, this game will centre around which businesses are best placed to capitalise on the climate change that is in play. Here is our list of Diwali picks. Some of these are already in some kind of play or the other, whether it is the visible pull back in the business from demonetisation, the competitive advantages that accrue to them with respect to the GST rollout, or the specific drivers in their business evolution that are apparent to us. *We have set aspirational target prices for all these stocks with a two-year view.*

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FINANCIALS

Kotak Mahindra Bank

Diversified + capable + capitalised

Aspirational Price Rs 1,277 (4.5x FY20E core ABV +215 sub value)

CMP Rs 1,082, MCap Rs 2,061bn

WHY

- High promoter holding of ~30.1% provides skin in the game
- On track for 20%+ loan CAGR, with merger-related issues behind and a well-capitalised B/S (Tier at 18%+)
- Superior and sustainable NIMs; reduction in SA rate provides a further cushion
- One of the lowest stress exposures; net impaired assets at a mere 1.3%
- Diversified presence across financial services (Insurance, Securities and Asset Management). ~32% of PAT is contributed by non-banking services

WHY NOT

- High valuations (unlikely to change!)

SBI Life Insurance

Financialisation play

Aspirational Price Rs 850 (3x FY20E EV)

CMP Rs 690, MCap Rs 690bn

WHY

- SBI Life is the largest private sector life insurance player in the country
- Life insurance in India is highly underpenetrated, and offers long-term growth opportunities. Also, it offers a play on financialisation of domestic savings
- In the last few years, SBI Life has consistently grown faster than pvt peers, resulting in its market share improving from 15.9% in FY15 to 20% in FY17
- Lowest cost structure across peerset with opex-to-premium ratio at 7.8% in FY17 vs. 10-17% for other players
- Unbeatable distribution advantage, owing to its parent SBI. Bancassurance contributed 63.5% in FY17 to its new business premium
- It has consistently improved its persistency ratio, resulting in superior EVOP return at 23%. Its 61st month persistency at 68.1% is ahead of the pvt pack

WHY NOT

- Highly regulated sector
- Normalisation of income tax rate to reduce profitability and EV

City Union Bank

Conservative + regional lending franchise

Aspirational Price Rs 230 (2.75x FY20E ABV of Rs 84)

CMP Rs 160, MCap Rs 106bn

WHY

- Despite headwinds in the home terrain (TN), stress remains under control (net impaired assets at 2.3% vs. 3-4% for the best regional peers)
- Motivated employees, loyal customers and sticky SME-lending franchise (pricing power)
- Superior NIMs (~4%+ over trailing six years), with a relatively high exposure to MSME (34%) and trader (17%) segments
- Superior return ratios (RoAA 1.5%+) across cycles
- Strong operating leverage to play out on expanded costs, as growth (19% CAGR over FY17-20E) kicks in

WHY NOT

- Regional skew (TN)
- Low CASA at <23%

DHFL

Re-rating on the horizon

Aspirational Price Rs 700 (2.2x FY20E P/ABV)

CMP Rs 538, MCap Rs 169bn

WHY

- DHFL is the third-largest HFC, with an AUM of Rs 850bn. It has delivered loan book growth of 20% CAGR over the last five years. In 1QFY18, its disbursement growth rate at 33% beat most peers
- The mortgage loan segment at 9% of GDP is still highly under-penetrated in India, and offers a long-term structural play
- The company is a key beneficiary of the PMAY subsidy and the government's push towards affordable housing, owing to its strong presence in Tier II and Tier III cities, along with a focus on the middle and low-income categories
- A management revamp is driving higher operational efficiency and improving productivity, which will help in bettering C/I and return ratios

WHY NOT

- Monetisation of a building in Kalina is delayed. Of DHFL's net worth of Rs 80bn, Rs 5.8bn is stuck here
- Intense competition in the mortgage segment, leading to compression in spreads

IT & NEW-AGE BUSINESSES

Tata Elxsi

Designed for growth

Aspirational Price Rs 1,220 (22x FY21E)

CMP Rs 862, MCap Rs 54bn

WHY

- Opportunity from rising global ER&D spend, high growth in the EPD segment (82% of rev) and strong offshore delivery model
- Strong competencies in the niche automotive vertical (50% of revenue), supported by scalability and non-linearity from the 'Autonomai' platform (driverless car software)
- Strategic vendor to group co JLR (top client and 22% of rev), with an increasing share
- Growth prospects in its marquee client base, including JLR, Mercedes, BMW, Ford, Nissan, Isuzu and Subaru in the automotive segment

WHY NOT

- High client concentration risk
- Valuations at a premium to the sector

MCX

Non-linear opp, regulatory tailwinds

Aspirational Price Rs 1,500 (35x FY20 EPS)

CMP Rs 1,134, MCap Rs 58bn

WHY

- Well placed in the large under-penetrated Indian commodities market (~90% market share). Great business model with embedded non-linearity, negative working capital and low incremental capital needs for fuelling growth
- We see value based on (1) Embedded non-linearity, (2) Favourable regulatory environment (SEBI has allowed Category III AIFs to participate in commodities derivatives, and is also considering the entry of institutions into commodity derivatives trading), and (3) Super-normal growth prospects with the start of options trading and new product launches (Indices)
- Options trading (starting Oct-17), can boost ADTV significantly, slated to grow from Rs 226bn in FY17 to Rs 530bn in FY20E (~33% CAGR). Institutional participation is close to fructifying (likely in 6-12 months), and can further boost ADTV
- MCX's AP of Rs 1,500 is based on 35x FY20E (20% EPS CAGR over FY17-20E)

WHY NOT

- NSE and BSE can the commodities market (universal exchange)
- Regulatory delays

TeamLease

Huge addressable opp, shift to organised sector

Aspirational Price Rs 2,125 (35x FY20 EPS) (excluding 80JJAA benefit), and adding back the NPV of the tax benefit availed over next three years.

CMP Rs 1,628, MCap Rs 28bn

WHY

- TeamLease is a market leader in organised flexi-staffing, with ~6% market share. The flexi-staffing market is growing at 4x GDP, and holds great opportunities for players like TeamLease
- Macro tailwinds, such as (1) GST and labour reforms, (2) Expansion of organised businesses to Tier 2/3 cities, (3) Rising preference for organised staffing providers, and (4) Government-driven skill development initiatives will drive 20-30% CAGR in organised flexi-staffing over the next 4 to 5 years
- We like the low-risk business model, owing to a focus on non SLA-based contracts and the collect-and-pay model. Margins will improve 78bps over FY17-20E to 2.2%, led by a rising mark-up (currently at Rs 729/associate/month, +7% YoY), and an increasing contribution from the higher-margin IT staffing business
- TeamLease's revenue/EBITDA/PAT are expected to grow at 21/40/26% CAGR respectively over FY17-20E.

WHY NOT

- Increased competition from unorganised players
- Macro slowdown leading to lower appetite_for flexi-staffing

AUTOMOBILES

M&M

A value buy, aligned with India

Aspirational Price Rs 1,773 (14x FY20E Core+Rs 499 subs value+other investments at BV)

CMP Rs 1,325, MCap Rs 823bn

WHY

- Volume growth on an uptrend, led by a strong demand in tractors and a cyclical recovery in LCVs
- A pick-up in the rural economy, led by good monsoon and lower interest rates, augurs well for the profitable farm eqpt segment where M&M has a market share of 48%
- Focus on the UV segment with new launches, changes and fresh positioning of old products will support growth
- Operating leverage and higher share of tractors to offset headwinds in margins
- Bottoming out of Tech Mahindra's weak performance and strong performance of MMFSL will result in upgrades for M&M

WHY NOT

- UV business to faces pressure, with rising competitive intensity and shorter product refresh cycles
- Ssangyong's profitability has not improved materially, as no model has been able to achieve scale
- Losses in the two-wheeler business

Jamna Auto

Quality play on the MHCV upcycle and GST

Aspirational Price Rs 82 (17x FY20E EPS)

CMP Rs 59, MCap Rs 23bn

WHY

- Debt-free auto ancillary with high return ratios – a bit of a rarity!
- High, sustainable market-share of 70% in OEM supplies, ergo a direct beneficiary of MHCV upcycle; We think MHCVs will grow at 8-10% over the next 2 years, led by a pick-up in infra and construction
- Shift to higher tonnage vehicles to push greater sales of parabolic springs, where realisations are higher by 15% vs conventional
- GST implementation to bring price parity between unorganised and organised players. After market revenues are at higher realisations.
- With a recovery in OEM demand and healthy growth in other non-cyclical segments, we estimate 22% CAGR in Jamna's revenues over FY17-20E

WHY NOT

- High client concentration on Tata Motors and Ashok Leyland (65% of revenue)
- Cyclical nature of CV industry may result in volatility in margins and earnings trajectory

Force Motors

Lux car rider + interesting p-LCV play

Aspirational Price Rs 6,540 (22x FY20E EPS)

CMP Rs 3,700, MCap Rs 48bn

WHY

- Low penetration of luxury cars in India at a meagre 1.3% of PV market vols vs. 2.7% in Brazil, 7% in China and 13% in USA offers a huge opportunity for FML, as it is the sole supplier of power train components for Mercedes and BMW
- Indian luxury car market to grow exponentially over the next five years, driven by (1) Strong growth in PV sales (12% CAGR over FY17-21E), and (2) Increasing number of Ultra HNIs, (3) Increasing disposable income and (4) Local investment by foreign car manufacturers
- Its passenger LCV business has a niche and growing product (Traveller)

WHY NOT

- Not investor friendly; management does not meet, except at AGMs!
- R&D expenditure continues to be high, owing to entry into the electric mobility space and technology upgradation; planned capex of Rs 10bn over the next three years promises further upsides but plans are unclear

CONSUMER

V-Guard Industries

Multi-year growth, margin expansion

Aspirational Price Rs 250 (35x FY20E)

CMP Rs 191, MCap Rs 81bn

WHY

- V-Guard is a strong appliances player in South India, and is set to grow in non-South, which contributes only ~35% to the overall business. Leadership in stabilisers and a well-diversified portfolio spanning fans, electrical wires and pumps have resulted in robust 25% revenue CAGR over the last 10 years. We conservatively expect V-Guard to deliver 15% revenue CAGR over FY17-20E.
- V-Guard has displayed 3-4x growth multiplier to GDP rate in the past. We expect ~200bps EBITDA margin expansion over the next 2-3 years. Co works at 30% ROCE and is debt-free. Urbanisation and improving power availability will support appliances demand. Lower category penetration and the GST-led shift from unbranded to branded offer growth opportunities
- Dealer expansion in non-South markets has been >4x during FY11-17, as compared to ~2x in the South market. 66% of total dealers are in the non-South markets, while the contribution to business is only 35% (21% in FY12). This will rise, driving margins

WHY NOT

- Sharp fluctuations in copper prices can impact gross margins
- Competitive forces can drive up ad/promo spends or pricing, which can impact the EBITDA margin

ITC

Smoke that does not fade away

Aspirational Price Rs 357 (30x FY20E)

CMP Rs 266, MCap Rs 3,239bn

WHY

- Despite punitive taxes, ITC has been able to register ~10% and ~9% revenue CAGR in the last 10 and 5 years. The recent cigarette price hike would be absorbed gradually, and pressure on volumes will subside over 2-3 quarters. Our 7% cigarette revenue CAGR over FY17-20E is conservative
- ITC's market leadership in cigarettes (~70% market share) provides it with strong pricing power. Despite punitive tax increases, cigarette EBIT grew by 15% and 13% CAGR during the last 10 and 5 years. We expect cigarette EBIT CAGR of 10% over FY17-20E
- Non-cigarette businesses, led by FMCG are now set to be significantly value accretive. We expect ~13% sales CAGR over FY17-20E.
- With an EBITDA margin of 36% and core RoCE of ~40%, the stock is trading at a sharp discount to FMCG players. The overhang of a further rise in taxes and government intent to restrict cigarette consumption have resulted in a 20% dip over the last three months. Our aspirational price is Rs 357, based on 30x P/E on FY20 EPS

WHY NOT

- Sharp increase in taxes on cigarettes

Dish TV

Gearing up

Aspirational Price Rs 125 (10x FY20E EV/EBITDA)

CMP Rs 72, MCap Rs 76bn

WHY

- Dish TV (DITV), a pioneer in India's DTH (direct-to-home) space, is set to recover from a phase of under-performance.
- DITV's weak FY17 performance (EBITDA fell 5%) was in stark contrast with Videocon D2H and Airtel DTH (which posted EBITDA growth in the 20s). Persistently inferior subscriber stability and ARPU have undermined DITV's performance

  The upcoming merger with Videocon D2H holds significant cost rationalisation potential (Rs 4.7bn by FY20E, ~23.7% of FY17 EBITDA). VD2H's content cost is 39% of revenue, whereas DITV's content cost is 31% of revenue (35% for the combined entity). DITV should be able to lower content costs by at least 200-250bps because of the scale of the combined entity (18-19% of India's TV C&S population). Other synergies like employee costs and SGA expenses can contribute another ~100bps of synergies
- Our positive view on DITV is derived from its inexpensive valuations (6.5/5.7x FY19/20E EV/EBITDA), synergies from the merger, DAS IV digitisation and GST. Additional benefits can accrue from a reduction in licence fees and TRAI's tariff order. Our aspirational price is Rs 125 (10x FY20E EV/EBITDA).

WHY NOT

- Given the company's mediocre past in terms of accounting practices (thus corporate governance) and execution, it is fair to highlight some of the risks for our call below
- Post a weak 2HFY17 owing to demonetisation, DITV finally registered a recovery in ARPU / subscription revenue. Sustenance of subscription revenue growth and RMS are key for re-rating
- Inability to lower content costs, especially from the Star network (given their monopoly in sports content), could negatively impact our synergy calculations

CEMENT, METALS & MINING

Birla Corp

Aspirational Price Rs 1,450 (11x FY20 EV/EBITDA)

CMP Rs 1,009, MCap Rs 78bn

WHY

- Birla Corp is now a ~15 mTPA entity, with a footprint across North, Central and East India. Its scale and spread now rivals Ramco, albeit with a different geographical focus. We expect BCorp to generate Rs 11.6/12.2bn in EBITDA in FY19/20, broadly in line with what Ramco could deliver in the same period. However, BCorp trades at ~9.3/8.4x FY19/20 EV/EBITDA, vs Ramco, which trades at 12.1/11.8x.
- It is one of the most attractive cement stocks on cash flow yields in our coverage universe (10.1/7.9x OCF/FCF yields vs 4.9/2.7x for top 5).
- We expect it to generate 23.6/29.9% in EBITDA/PAT CAGR during FY17-20, driven mainly by strong delivery at the acquired Reliance ops. The Reliance acquisition has also given Birla Corp access to limestone leases in Maharashtra (4 mTPA at Rs 24bn already in the works), HP, Rajasthan, Karnataka and AP. These will help BCorp’s future growth, without having to participate in limestone auctions

WHY NOT

- Sustained high leverage, driven by aggressive capacity build-up. Sustained low prices in the Central region (>50% of dispatches), driven by UltraTech's JPA acquisition

GMDC

Aspirational Price Rs 225 (7x FY20 EV/EBITDA)

CMP Rs 149, MCap Rs 47bn

WHY

- GMDC's lignite got a competitive boost when taxation reduced to 5% (from 37% effective) under GST. The result is evident from ~55% growth in lignite volumes, also helped by costlier imported coal and petcoke.
- We see several structural positives for GMDC. These include cement leases being granted in Kutch, with a potential of ~25 mTPA additional cement capacity, grant of 250 mT lignite reserve to GMDC (mostly incremental to existing operations), and GMDC's lignite is likely to remain the lowest-priced fuel available in Gujarat by a wide margin
- We also foresee some possibility of GMDC taking price hikes (despite anti-profiteering clauses in GST), given the run-up in pet-coke and Indonesian fuel. Further, GMDC could also witness higher investor payouts, as the state government may raise dividends to offset the loss of VAT from lignite
- GMDC trades at 5.2/4.3x EV/EBITDA, and continued delivery will help further re-rate the stock

WHY NOT

- Capital misallocation

OIL & GAS

Indian Oil Corporation

Aspirational Price Rs 526 (6.5x FY20 EV/EBITDA)

CMP Rs 415, MCap Rs 2,013bn

Paradip rampup

WHY

- **Paradip to aid refinery earnings:** The Paradip refinery's capacity utilisation stood at 55% in FY17. We expect this to hit 90% (management guided 95%) in FY18 and 110% in FY20. IOC's numbers will visibly improve at 80% utilisation and higher. Given the Nelson refinery complexity of 12.2, Paradip can process heavier and sour (cheap) crude, and still generate 81% distillate yield. This will push up blended GRMs
- **Least sensitive to marketing margin: IOCL is the mo**st defensive play amongst the three OMCs, with the least sensitivity to changes in marketing margins of the OMCs. The company has a diversified revenue stream, with 19% EBITDA contribution from the marketing business, while petchem and refining contribute ~58%. This earning diversity and scale of operations give an edge to IOCL

WHY NOT

- Petrol and diesel prices were deregulated which resulted in lower under recoveries. However, LPG and Kerosene are still regulated. Currently OMCs are compensated fully but there is no clarity on subsidy sharing should crude rise

Petronet LNG

Aspirational Price Rs 304 (9.5x FY20 EV/EBITDA)

CMP Rs 251, MCap Rs 376bn

Gaining earnings traction

WHY

- **Moving away from marketing to tolling:** PLNG has moved away from the marketing model to pure tolling, resulting in better earnings quality. Further, customers have funded its capex, resulting in payback <1 year, and also adding to the stickiness of the customer. The contribution of the trading profits has reduced from 40% of PBT in FY13 to < 6% in FY17
- **Kochi terminal to break-even:** The Kochi terminal, which was commissioned in 2014 and accounts for 35% of the balance sheet, is making losses owing to lack of pipeline infra. With GAIL's pipeline coming onstream by Dec-18, we expect Kochi utilisation to go up from ~12% in 1QFY18 to 40% by FY19E
- **Dahej expansion:** 2.5 mmt of Dahej expansion would be commissioned by FY19-end, which should drive volumes beyond FY19. EPC contracts for expansion are already awarded
- **Cost advantage over new entrants:** PLNG has a significant cost advantage over new capacity. For example, PLNG's new capacity charge would not cover the cost of capital.

WHY NOT

- Rising crude prices can push up Ras gas price which may result in offtake issues (however Petronet does have back to back arrangement with offtakers)

INFRA & CONSTRUCTION

PNC Infratech

Gaining earnings traction

Aspirational Price Rs 205 (18x FY20E, Rs48/sh BOT Road assets value)

CMP Rs 149, MCap Rs 38bn

WHY

- Strong order backlog: PNC's order backlog of Rs 105bn (5x FY18E revenue) lends visibility to growth. The entire order backlog to commence execution by 4QFY18E
- Currently, 30% of the order backlog (Rs 30bn) is generating revenues, and the balance Rs 70.5bn is at various stages of financial closure and land acquisition
- Earnings to bottom out, with 2QFY18E as the worst quarter for the company
- Balance sheet is comfortable, with a net standalone D/E of 0.09x.
- Large ordering potential (Rs 1tn) in UP, Bihar, MP, Rajasthan etc augurs well for future growth
- Valuation: We value PNC at 18x FY20E and arrive at Aspirational TP of Rs 205/sh (including Rs 48/sh from BOT's)

WHY NOT

- High exposure to Uttar Pradesh
- Extension of the sand mining ban
- Delay in land acquisition

HEALTHCARE

Lupin

Good business at even better valuations

Aspirational Price Rs 2,045 (20x FY21E EPS)

CMP Rs 1,062, MCap Rs 480bn

WHY

- Fourth-largest player in the US generic market as per yearly prescriptions
- Large number of approvals for the US market will come from niche categories (OCs, ophthal, derma, controlled substances and respiratory)
- Robust pipeline of 150+ ANDAs to fructify over the next 2-3 years. Multiple FTF launches expected in FY19.
- Launched 140+ products in India (~25% of sales) over the last three years, 50-60% in chronic categories. Will continue to outperform market growth
- At 15.4x FY19E, with 14% EPS CAGR over FY17-20E, it is the most undervalued stock in the pharma large-cap space

WHY NOT

- Considering the number of facilities, US FDA compliance risk is always present, although Lupin has a strong track record
- Regulatory changes in the domestic market

Granules India

Moving up the value chain

Aspirational Price Rs 240 (15x FY21E EPS)

CMP Rs 136, MCap Rs 35bn

WHY

- The US Rx business will scale-up in a big way from 2HFY18, after key ANDA approvals begin to flow in. Granules also plans to file 20-22 ANDAs over the next 2 years.
- Ramp-up in the Omnichem JV post EIR from the US FDA for the new plant. Granules expects to generate Rs 4.5-5bn in sales at JV level by FY20.
- Expanding core capacities for Paracetamol and Metformin to kick-in from 2HFY18.
- Foresee 16% top-line CAGR over FY17-20E.
- At 12.2x FY19E, with 23% EPS CAGR, represents strong growth at comfortable valuations.

WHY NOT

- Untested R&D expertise for the US market.
- Heavy capex in the near-term to impact FCF generation and return ratios.

CAPITAL GOODS

Cummins India Ltd (CIL)

Exports growth can surprise

Aspirational Price Rs 1,100 (28x FY21E EPS of Rs 39.3)

CMP Rs 907, MCap Rs 251bn

WHY

- CIL's exports grew a stellar 43% in FY15. With softness in the lead indicators, exports fell 3/2/3% in FY15/16/1QFY17 respectively.
- Lead indicators for exports: China's GDP growth, oil prices, steel and copper prices. With China's GDP growth at 6.9% in 2QCY17 and Brent crude firmly above USD50, we expect a revision of exports' growth guidance in the coming quarters, which currently stands at -5% to 0%.
- The same may lead to double-digit growth in sales, as it did in FY15 (11/6/8% YoY sales growth in FY15/FY16/FY17 respectively)
- Operating leverage to kick in with better capacity utilisation. Also, the effective tax rate will be lower if the sales mix tilts more towards exports (exports from the Phaltan SEZ).
- PAT growth stood at 14.9/6.7/-2.1% in FY15/FY16/ FY17 respectively.
- Superior distribution and spares franchise, strong balance sheet and best-in-class return ratios.

WHY NOT

- Low capacity utilisation (our thesis : this will change)
- Protectionist measures by the countries to which CIL exports

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