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Stocks & Securities

Aditya Birla Money Limited

ADITYA BIRLA CAPITAL

Diwali Top Picks - 2020

9 November 2020

PROTECTING INVESTING FINANCING ADVISING

- **Equity markets witnessed a sharp volatility of ~41% from last SAMVAT 2076 to this SAMVAT 2077. The benchmark Index – Nifty corrected ~35% (lows in March 2020), however bounced back sharply closing up ~6% (at an All-time high) over one year basis.** The correction was attributable to COVID pandemic which resulted in nation-wide lockdown, thereby impacting the investors sentiments, businesses & economy. On the other hand, the bounce back was also sharp, thanks to the robust infusion of liquidity (stimulus package announced across the globe accompanied with low interest rate scenario) in the system and gradual opening of the Indian economy. Also, **several-high frequency indicators** namely vehicle sales (both 2W/4W), steel/cement production, GST collection, E-way bill, insurance premium, cargo handling, railway freight, consumption of electricity, aggregate deposit & non-food credit growth, etc **are almost at/above pre-COVID levels**. **Further, these signs of recovery are clearly visible on Corporate earnings with ~70% of the Nifty companies have met or beaten expectations.** Q2 earnings showcased the strong resilience of India's Corporate Inc, atleast in the listed space. We believe **the recovery momentum will continue as consumers & businesses have found ways to deal in the Covid impacted world. Markets are now at an all-time high & are the leading indicators with structural and cyclical factors likely to play out.**

- The investors globally are cheering the outcome of the US elections with Democrat Joe Biden winning the US Presidency, putting an end to months of uncertainty. **We expect the Fed & European policy makers to persist with loose monetary policy stance, continue with the bond buying programme while additional stimulus support will continue to support the global markets.** However, the global markets may remain nervous in the medium term owing to second wave of COVID emerging in Europe & US and the on-going geo-political tensions.

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- Our recommended Diwali Pick of 2019 have largely been in-line with the benchmark – aggregate return of ~6%. Among the last year's recommended stock Dr Lal Path lab has outperformed significantly (up 66%) and was the top performer in our recommended list.
- **For SAMVAT 2077, we have identified the broad theme which is likely to play-out in the post pandemic world**. Our broad understanding is that 1) '**Work from Home'** would be new normal of which IT companies will be major beneficiary; 2) **Diversifying the vendor sourcing and 'China +1' theme** has opened new gates for pharma/Chemicals/MNC players; 3) Strong focus on **Make In India – via 'PLI schemes**' will provide white goods manufacturers a sharp competitive edge; 4) Awareness & importance of **Insurance** has increased; 5) **India consumption story along with shift towards premiumisation** remains intact & is well insulated from global markets. This story **remains 'essential'** even when it comes to stock picking.
- Thus, our Diwali Pick of 2020 is diversified across sector & are the favourable themes in post covid world while we continue to apply our fundamental filters of strong player, moat, healthy balance sheet & good growth opportunity. At present, Nifty is trading at ~20x its FY22E, which is slightly above its mean valuation. However, we believe **the premium valuation will be supported by robust liquidity & TINA factor as other asset classes like bonds offer low interest rate. Emerging markets like India remains the preferred market among the global investors. We remain positive on Indian economy which is likely to benefit from lower crude prices, lower interest rates, above normal monsoon and governments support (reforms + stimulus).** The economic recovery is to get more durable as covid vaccine becomes more likely next year.
- **The second wave of COVID still remains a near to medium term risk for the economy, esp with festive season underway. However, we believe now it is more of 'known-known' and hence we are in a better position to deal with the same.** Each crisis teaches us the importance of strong & durable business franchises which sustains the crisis, emerges stronger & grows for multi-years. Sticking to quality is of prime importance. We believe **India is yet to see several Golden years for equities as we remain 'finger crossed' that SAMVAT 2077 could be one of them. We wish our stakeholders a very 'Happy Diwali' and prosperous 'SAMVAT 2077'.**

Diwali Top Picks - 2020

Following stocks are our Top-picks for SAMVAT 2077 -

Company	Reco Price	Market Cap (Rs cr)	FY22 RoE	Target	Upside
Alembic pharma	974	19,143	18.1%	1250	28.3%
Amber Enterprises	2190	7,379	14.8%	2650	21.0%
Bajaj Finance	3874	2,33,448	19.8%	4600	18.7%
Divis Laboratories	3412	90,579	23.9%	4000	17.2%
Honeywell Automation	30600	27,055	19.9%	36000	17.6%
Infosys	1136	4,83,954	27.9%	1300	14.4%
ICICI Lombard	1271	57,780	22.1%	1600	25.9%
Minda Industries	327	8,892	13.6%	400	22.3%
Nestle India	17332	1,67,108	98.9%	19500	12.5%

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Alembic Pharma (APL) CMP `974 Market Cap: `19,143 cr

Key Investment Argument: Alembic Pharma has a business split between domestic branded formulations (31%), US (43%), ROW (11%) and APIs (15%). The co. has aggressively started investing in the international generics market with successful ANDA and DMF filings. On the domestic front, it has an extensive range of branded and generic formulations. Alembic’s profitability is superior with its revenue per Rx figures in the US at ~2-3x of peers. Its strong margin profile is an outcome of its strategy to be very selective in what it chooses to launch from its approved ANDA portfolio. It has an approved portfolio of 107 ANDAs, of which only 76 have been launched. In addition to the 43 ANDAs pending launch (but approved), another 64 are pending approval.

Outlook: All the three new facilities (oncology, injectables, ophthalmic and oral solids) are on track for commercialization where the total capex of Rs.15bn has been earmarked. Capex should moderate from FY21 onwards (Rs.3-3.5bn annually) mainly for debottlenecking existing capex and maintenance. It is also investing heavily in R&D (13-14% of sales) to diversify its product pipeline from oral-solids to complex areas (mainly injectables). With its astute product selection, continuous investment in the newer capacities and focused R&D, the Company shall be able to drive strong growth for next 2-3 years.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
Net Sales	45.9	55.2	60.9
EBITDA	13.1	15.8	14.9
Net Profit	8.9	11.1	9.7
P/E (x)	21.4	17.0	19.5
RoE (%)	27.9	19.3	18.1

Source: Bloomberg Consensus, ABML Research

Amber Enterprises (Amber) CMP `2190 Market Cap: `7,379 cr

Key Investment Argument: i) Industry Tailwind: RAC penetration in India is among the lowest at <10%, leaving a huge room for penetration led sustainable growth. Increasing outsourcing practice in the industry: Outsourcing in the RAC has gone up from 17% in FY12 to 40% in FY20 and is poised to rise further.

ii) Govt Focus on reducing RAC imports: Through the anticipated PLI or PMP will further support the domestic RAC manufacturers. De-risking Business model: Amber has over the years, widened its components portfolio which today comprises 33% of the total revenue and it endeavors to take it to 50% over the long term.

iii) Mobility Air Conditioning, a new segment: With the acquisition of Sidwal, which primarily caters to Railways and Metros, it has entered into a new segment of mobility ACs.

Outlook: We believe Amber should be one of the biggest beneficiaries of the global demand for RAC given its scale of operations and cost efficiencies. It is trading at a PE of 32x on FY22E basis which we believe is reasonable given its positioning in the industry.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
Net Sales	39.6	33.9	48.7
EBITDA	3.1	2.4	4.1
Net Profit	1.6	0.8	2.1
P/E (x)	43.5	80.9	32.3
RoE (%)	14.9	6.5	14.8

Source: Bloomberg Consensus, ABML Research

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Bajaj Finance (BAJAF) CMP `3874 Market Cap: `2,33,448 cr

Key Investment Argument: i) Bajaf is a direct play on recovery of India consumption story. With auto, white goods, housing loans & several segments of economy showcasing recovery, Bajaf will scale back to healthy growth trajectory sooner rather than later.

ii) Asset quality has been far superior vs peers. As on Q2FY21, customers having 1 & 2 installments overdue are ~8% of AUM vs 2.3% in Q2FY20. The co has been making hefty provision with ~4% of the book already provided. From hereon, provision should steadily trend lower & support profitability. Besides, technology usage & operational efficiencies to also keep costs under check.

Outlook: We believe worst is behind for Bajaf both on the growth & asset quality front. With low interest rate scenario, cost of funds is also trending south which will support NIM, NII & profitability. Valuations to stay rich owing to strong normalised RoA of 4%, Tier 1 capital of 23%, Superior NIM, efficient technology usage, retail & SME exposure.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
NII	169.1	181.0	221.5
PPP	112.5	129.6	157.8
Net Profit	52.6	53.1	80.6
P/ABV (x)	7.3	6.4	5.4
RoA (%)	3.6	3.1	4.0

Source: Bloomberg Consensus, ABML Research

Divis Lab (DIVIS) CMP `3412 Market Cap: `90,579 cr

Key Investment Argument: i) Divi's operates in three segments namely 1) Generic API (51%), 2) Custom Synthesis (41%) and 3) Nutraceuticals (8%).
ii) The company expects to complete ongoing brownfield expansions at Unit 1 & 2 by 2HFY21. It is also working on debottlenecking and backward integration programs at Unit 1 & 2 at a cost of Rs.3bn and upgrading EOU at a cost of Rs.1.9bn. It expects to complete the rest of the projects by end-2HFY21.
iii) We expect supplies and plant utilization to gradually pick-up from the added capacities from 2HFY22, which should help it to maintain high teens revenues growth for the next 3-4 years. Capex underway from FY20-22 is greater since inception which speaks about the management confidence on the strong demand going ahead.

Outlook: Given its strong execution history, low-cost manufacturing base, long-standing relationships with clients, superior product selection and fungibility of manufacturing facilities, Divi's is well positioned to capture a growing share in the US$100bn contract manufacturing services (CRAMS) market and US$74bn generic API market.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
Net Sales	52.9	67.2	80.5
EBITDA	18.3	26.2	31.7
Net Profit	13.3	18.4	22.6
P/E (x)	66.0	49.3	40.1
RoE (%)	19.3	23.1	23.9

Source: Bloomberg Consensus, ABML Research

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Honeywell Automation (HAL) CMP `30,600 Market Cap: `27,055 cr

Key Investment Argument: HAL is a capital goods company providing integrated automation & control systems. It is backed by its MNC parent which holds 75% stake in the company & has presence across continents reaching >70 countries.

Its exports registered robust CAGR of ~20% over 2005-2020, thereby increasing its share from ~19% in 2005 to ~44% in FY20, mainly due to sales to its other affiliates. HAL would continue to receive higher projects primarily due to low cost advantage going forward. We also believe HAL would benefit from China + 1 theme, as China accounts for ~8% of parents revenue while India accounts ~2% of parents revenue and any shift in sourcing could result into sizeable opportunity for HAL going forward.

Outlook: HAL is well placed to benefit from the revival in capex which is likely to restart from H2FY21. Over FY16-20, its revenue/PAT has registered CAGR of 11%/37% resp. Further its EBITDA margins almost doubled to >19% in 4 years. It has healthy balance sheet – net cash, negative WC, positive FCF & strong return ratio. It is trading at PE of 47x its FY22E and we remain positive on the stock.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
Net Sales	32.9	32.3	35.9
EBITDA	6.4	6.2	6.9
Net Profit	4.9	5.0	5.7
P/E (x)	55.0	54.6	47.4
RoE (%)	25.0	20.6	19.9

Source: Bloomberg Consensus, ABML Research

ICICI Lombard (ICICIGI) CMP `1271 Market Cap: `57,780 cr

Key Investment Argument: i) ICICIGI is all set to grab market share as it has made significant investment for growth while PSU peers are struggling with sub-optimal combined ratio and solvency ratio. The co has significant presence in Motor segment (~60% of NEP) which has started witnessing strong growth - esp the 2W space wherein ICICIGI is the market leader. Demand and awareness of Health insurance has also increased owing to covid.

ii) Claim ratio has been structurally trending south from its usual run-rate of ~74% to ~67% now. Covid claims have risen but Motor TP & non-covid health claims have fallen significantly. As of 30th Sept, industry had 3.24 lakh cases of which ICICIGI had claims from 17k customers, amounting to ₹ 115 cr. Covid claims have reduced in Oct while 2nd wave to be closely watched, esp. with festival season underway.

Outlook: After a period of consolidation, the company is again entering growth phase for which major investments on manpower & technology has been made. Merger with Bharti Axa to provide significant synergies & will be value accretive for shareholders. Technology usage to reduce cost & provide better services to customers. Expect steady PAT growth trajectory to continue alongwith healthy return ratios.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
NEP	94.0	98.6	117.3
PBT	17.0	20.6	24.0
Net Profit	11.9	15.4	18.0
P/E (x)	48.4	39.7	33.4
RoE (%)	20.9	23.0	22.1

Source: Bloomberg Consensus, ABML Research

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Infosys (INFY) CMP `1136 Market Cap: `4,83,954 cr

Key Investment Argument: While Covid-19 has impacted the revenue growth trajectory in the short term across the IT sector, Infosys has outperformed its industry peers. The pandemic has led to increased client spend on digital investments & cloud transformations, the spend is expected to remain buoyant as clients continue to invest in order to ensure resilience in technology infrastructure during uncertain times.

We expect this trend to help drive improvement in the Infosys' revenue growth prospects over FY21-23. A higher proportion of offshore delivery, & SG&A saving along with the possibility of reducing sub-contracting expenses as WFA picks up will support margin expansion going head.

Outlook: Infosys has been delivering robust operational performance in the last few years with a strong balance sheet, we remain confident of the company's prospects going head. Infosys trades at a reasonable valuation of FY22 P/E of ~23x.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
Net Sales	907.9	981.4	1,063.1
EBITDA	223.2	267.3	278.0
Net Profit	166.1	189.7	203.1
P/E (x)	27.0	25.9	23.2
RoE (%)	25.5	27.7	27.9

Source: Bloomberg Consensus, ABML Research

Minda Industries (MIL) CMP `327 Market Cap: `8,892 cr

Key Investment Argument: MIL is one of the fastest growing auto ancillary company in India & has distinctly edge over its peers. The company has strong relationship with most of the leading OEMs & consistently provides new/updated products/services. MIL expects MoM improvement in demand and are currently largely in line or higher than pre-COVID levels on YoY basis. Further it is consumer-driven demand & not filling up of channel inventory which is positive. The company is well diversified, in terms of revenue mix, geography wise – India/International stands at 83/17; Channel wise – OEM/replacement at 84/16; Segment wise –2W/4-W at 47/53 respectively.

Outlook: MIL is an early bird in identifying new products opportunity emerging from regulatory, safety, premiumization & technological change in industry, leading to ample growth prospects. Its traditional business is expected to report stable growth while the new businesses will have a robust growth going forward. MIL over the years has established association with many global technology leaders for various auto components which has further helped the company to grow at a non-linear pace. MIL trading at PE of 30x its FY22E and we remain positive on the stock.

Financial Snapshot

(In ` bn)	FY20	FY21E	FY22E
Net Sales	54.7	51.3	67.1
EBITDA	6.2	5.2	8.1
Net Profit	1.5	0.8	2.9
P/E (x)	59.4	115.9	29.9
RoE (%)	8.8	4.3	13.6

Source: Bloomberg Consensus, ABML Research

Nestle India (NESTLE) CMP `17,332 Market Cap: `167,108 cr

Key Investment Argument: i) Leadership in most of the product offerings: Nestle with its strong parentage has built a strong brand with high brand recall and quality assurance. It enjoys leadership position in ~85% of its products with milk products and nutrition.

ii) Growing with animal spirit after the Maggie incident: Since the Maggi incident, it has completely changed its approach from profitability driven growth to volume based growth approach where it has launched many products in short intervals and is aggressively increasing its reach.

iii) Potential for many innovation based products launch: Given its strong parentage, Nestle globally has many product categories as well as many variants of the existing products which it is yet to launch in India.

Outlook: Nestle has shown signs of aggressive growth in its existing categories as well as new categories. It is on path to lead with volume led growth, innovation based launches and increase in penetration. All these factors make us confident of sustainable growth story of Nestle and makes it most preferred bet in the FMCG space.

Financial Snapshot

(In ` bn)	CY19	CY20E	CY21E
Net Sales	123.7	134.2	150.3
EBITDA	28.6	32.7	37.5
Net Profit	19.7	21.9	25.6
P/E (x)	84.9	76.4	64.6
RoE (%)	70.3	100.9	98.9

Source: Bloomberg Consensus, ABML Research

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Performance of our last year's Diwali picks -

Company	Reco Price	CMP	Returns
Bharti Airtel	385	472	23%
Dalmia Bharat	811	905	12%
Dr Lal Pathlabs	1,374	2,274	66%
HDFC Bank	1,221	1,341	10%
HDFC Life	611	593	-3%
ICICI Lombard	1,207	1,271	5%
L&T	1,424	966	-32%
Marico	381	381	0%
The Phoenix Mills	696	562	-19%
Titan Company	1,275	1,285	1%
Average Return			**6%**

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