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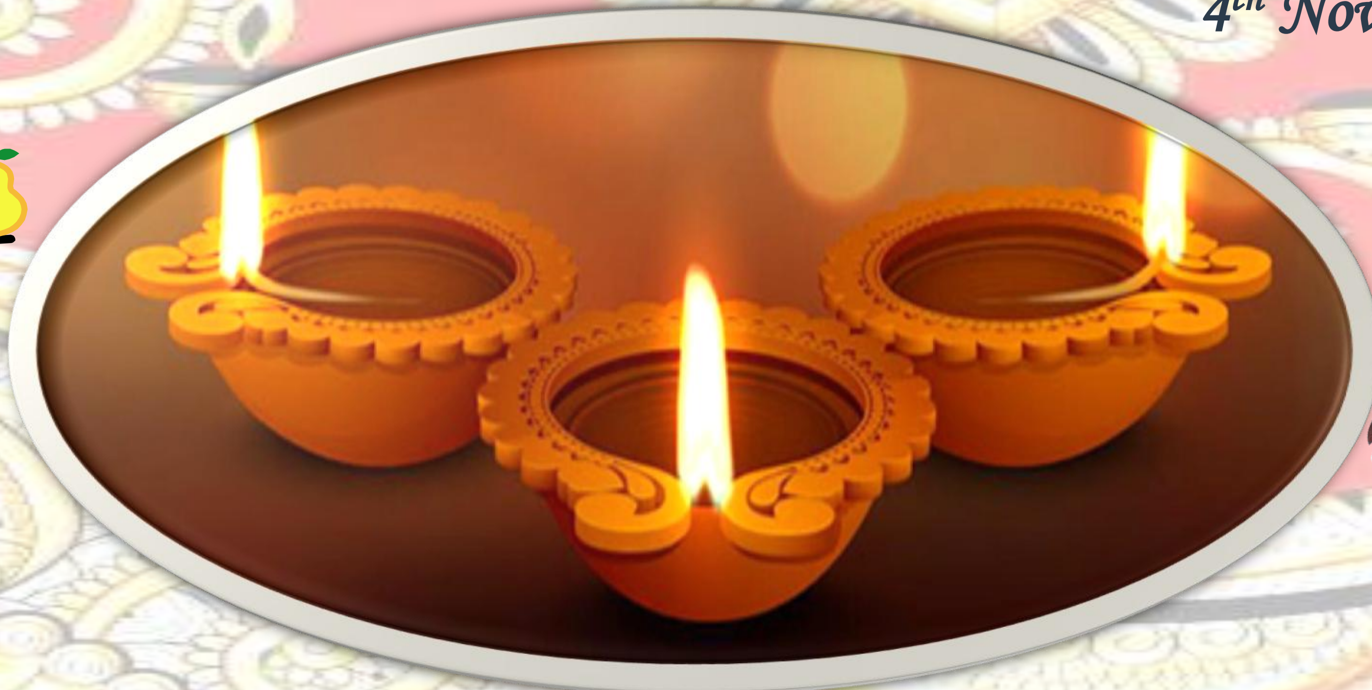
# Happy Diwali

*Diwali Picks*

*4th November 2021*



# Theme going ahead – Value vs. Momentum and froth

**The journey of Indian equity markets from Jan 20121 till now has not had any decent correction.**

We have moved from Nifty levels of around 14000 to 18000+ and India's market cap has risen from USD 2.52 trillion on 31st December 2020 to USD 3.4119 trillion October 2021. Currently, our market cap to GDP stands at 120% vis-à-vis US Equities Market Cap to GDP at 194%. Although this is no indication or a like comparison, the idea is to highlight that although there has been a one-way upside journey, it does not necessarily indicate a high degree of overvaluation, but not akin to a bubble.

Currently, in Indian equity markets, there are pockets and sectors which are highly overvalued and rectification of this overvaluation has already begun in the last fortnight of October. Similarly, there have been a lot many pockets that have been undervalued and the process of markets recognizing this undervaluation has already begun in the last fortnight of October.

We believe that going ahead with this process of correction in overvalued stocks and accumulation/ buying in undervalued stocks will continue. Hence we have based our Diwali Picks on the theme of Value vs. Momentum. To recap most of the market performance in the last 9 months has been driven by technology stocks where although there is a lot of earnings visibility but valuations have reached phenomenally high levels to offer any significant upside to investors. Similarly, a lot many white goods manufacturers and outsourcers who were very richly valued at their peak have corrected in the last few sessions. On the other hand, there is deep value in most of the PSU stocks be it PSU Banks or other PSU names whether in defence or infrastructure. We also believe that there is a good potential and unlock trade in some of the auto names and chances are discretionary consumption may bounce back strongly. Further, the government is likely to become more aggressive on Infrastructure spending. Hence components of infrastructure like steel and cement and other players will continue to do well.

To conclude, Indices may not offer much of an upside going ahead and could also pose some downside risk due to accelerated correction in overvalued stocks and sectors, investors can still make wealth going ahead by investing in undervalued stocks and sectors. Based on this thesis we herewith share our Diwali Picks during this year. We hope investors and our valued clients benefit from our ideas.

## Adani Ports & SEZ Ltd. CMP: INR 693

**Adani Ports & SEZ Limited (APSEZ)'s business is classified into three segments consisting of Ports, Logistics and Special Economic Zone. The company has India-wide presence in ten locations (nine are operational) with the flagship Mundra port in the Gulf of Kutch. It has a large land bank of 8,481 hectares of contiguous land at Mundra with requisite approvals and clearances in place. It continues to grow both organically and inorganically with several acquisitions like Dhamra and recently the Krishnapatnam Port. It has expanded its presence in logistics organically as well inorganically, acquiring Adani Agri Logistics and B2B logistics in the recent past..**

**Key Investment Rationales**

**Multiple growth triggers :** Sustainable market share gains at Mundra (containers particularly), expansion of LPG, LNG terminals at Mundra and Dhamra and the upcoming Vizhingham port are likely to keep volume growth ticking in double digits for the next 3-4 years. Post acquisition of Krishnapatnam Port, the company revised upwards its cargo volume target for FY25 from 400MT to 500MT, a staggering 18% CAGR over FY20. Leveraging its relationships with shipping liners and its ability to offer end-to-end solutions can make business sizable. Management aims to achieve this with an asset-light model and roadmap including Railway transportation, Private freight terminals, trucking and Warehousing.

**Valuation & Outlook**

As shipping lines deploy larger vessels and consolidate routes, the focus will move to ports with O&D demand over transhipment. Thus this consolidation will be a boost for APSEZ given its scale, pan India presence and existing strong relationships with container liner companies. Leveraging its relationships with shipping liners and its ability to offer end-to-end solutions can make business sizable.

| Y/E March (INR mn) | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Net Sales | 113229.6 | 109254.4 | 118730.7 | 125496 |
| Growth | | -3.5% | 8.7% | 5.7% |
| EBITDA | 70621.2 | 65915.6 | 59390.1 | 86986.9 |
| EBITDAM | 62.4% | 60.3% | 50.0% | 69.3% |
| Adj. PAT | 36899.5 | 40448.1 | 37889.2 | 50630.1 |
| Growth | | 9.6% | -6.3% | 33.6% |
| Adj. EPS (INR) | 17.8 | 19.5 | 18.6 | 24.9 |
| P/E (x) | 38.9 | 35.5 | 37.2 | 27.8 |

## RVNL CMP: INR 35

**RVNL is in the field of implementing the railway infrastructure and execute about 30-35% of the Indian Railway infrastructure capex every year. Company has commissioned 102 projects so far. At present, RVNL is executing two kinds of project; a) Direct nomination by the Ministry of Railways, b) SPV route. In FY21 company did not get any assignment from MoR but in terms of SPVs there are some projects in the pipeline while some are in advanced stage. RVNL has got 4 special purpose vehicles (SPVs) which are in operation and 1 SPV to get commissioned in FY23. Company also got few proposals which are at different stages of consideration for making new SPVs.**

**Key Investment Rationales**

**Leading player executing nearly 1/3rd of railway infrastructure CAPEX every year**

RVNL in the field of implementing the railway infrastructure and execute about 30-35% of the Indian Railway infrastructure capex every year. It has been growing at a CAGR of 30%+ for the last 10 years (till FY20). FY21 Order book at Rs750bn provides revenue visibility for the next 4 years. Ministry of Railway has moved to competitive bidding for awarding contract versus nomination base award. And to address this company has set up HSRC infra services Limited and is targeting to bid MoR projects.

**Valuation & Outlook**

Company expects to execute Rs200bn in about 4 years increasing its execution pace. For the first time, RVNL has set up a business development unit and expects business for infra services within 1-3 months. In FY21, core ROE (excluding cash) is higher than reported ROE - by 180 bps at 19%. Reported ROE at 17% is suppressed by losses at associate company and higher other income. RVNL has grown 3x times (in revenue) with respect to the FY15-FY21. Cash balance with RVNL is at Rs14bn.

| Y/E March (INR mn) | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Net Sales | 75973.6 | 100686.8 | 145305.8 | 154037.6 |
| Growth | | 32.5% | 44.3% | 6.0% |
| EBITDA | 3824.3 | 5309.14 | 7864.8 | 8798.6 |
| EBITDAM | 5.0% | 5.3% | 5.4% | 5.7% |
| Adj. PAT | 4697.1 | 5891.24 | 7698.8 | 9228.5 |
| Growth | | 25.4% | 30.7% | 19.9% |
| Adj. EPS (INR) | 2.3 | 2.8 | 3.7 | 4.4 |
| P/E (x) | 15.7 | 12.5 | 9.6 | 8.0 |

## Poonawalla Fincorp — CMP: INR 166

**Poonawala Fincorp (erstwhile Magma Fincorp) has announced a series of leadership changes following the Poonawalla controlled Rising Sun Holdings acquiring controlling stake (~60%) through an equity infusion of Rs34.6bn in May' 21. The board has appointed Mr. Adar Poonawalla as Chairman, Mr. Abhay Bhutada as MD (effective June, 1, 2021) and Mr. Vijay Deshwal as CEO.**

### Key Investment Rationales

**Change in Promoters**

With the change in promoters, It is changing the product strategy and is focusing more on select customers and small/medium business segments with opportunity to cross-sell. It is discontinuing products such as Used CV/CE, tractors and auto lease, and is introducing products to address defined customer need in a large, underserved niche segment. Now, the company can provide loans at competitive rates, benefiting from a large equity base and reduced cost of funds.

The company is going to add a new set of leadership team with the appointment of highly qualified and experienced professionals from reputed financial institutions for various senior management positions. Along with this, rebranding of the company as a Poonawalla Group firm is underway. It is setting the foundation for a strong, stable organization of the future with a well-defined corporate governance framework.

### Valuation & Outlook

Magma, after fund infusion, is well-placed on adequacy, promoter back-up and liquidity. Probable rating upgrades, lower cost of funds and ability to inject equity by the promoter (without fear of forced dilution) are the key positives. The company will rely more on digital distribution and work on enhancing efficiency and asset quality to reduce credit costs and improve profitability, which should result in enhanced growth, higher IRR and risk-adjusted return on capital.

| Y/E March (INR mn) | FY20 | FY21 |
|---|---|---|
| Net Interest Income | 12196 | 12184 |
| Growth | | -0.1% |
| NIM | 7.4% | 8.0% |
| Adj. Book Value | 85.7 | 77.4 |
| Growth | | -9.7% |
| Price/Adj. BV(x) | 1.9 | 2.1 |

## Garden Reach Shipbuilders & Engineers (GRSE) — CMP: INR 219

**GRSE is a shipbuilding company, established under the Ministry of Defence, based out of Kolkata. GRSE caters to shipbuilding requirements of the Indian Navy and the Indian Coast Guard. GRSE is the first Shipyard in the country to export warships and deliver 107 warships to the Indian Navy and Indian Coast Guard, highest among shipyards. With INR257bn of order backlog, GRSE works at 3 different facilities engaged in shipbuilding, besides engineering and diesel engine division.**

### Key Investment Rationales

**INR4.5trn opportunity in Naval expenditure Till 2027 for GRSE**

To achieve fleet of 200 ships, GoI has embarked on a program that can open up INR4.5trn in overall opportunity. This includes INR2.2trn in submarine programs, INR900bn in destroyers and frigates, INR450bn in aircraft carriers, corvettes, and landing platform. Further, GoI has approved INR320bn for coast guards. Annually, Indian naval expenditure is over INR330bn, which, with borrowings, is expected to shore up and support the targeted expenditure.

### Valuation & Outlook

With strong order backlog of INR 257bn and various project deliveries lined up over next 4-5 years, we foresee an exponential rise in financials of GRSE. This will be stemming from multiple project overlapping. Additionally, margins will also gain momentum in line with the revenue rise and cost savings. Balance sheet contains enough cash to make up for any payment delays from GOI and the company may not require any debt to be raised in the medium term.

| Y/E March (INR mn) | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Net Sales | 13496.6 | 13864.2 | 14332.95 | 11408.35 |
| Growth | | 2.7% | 3.4% | -20.4% |
| EBITDA | -148.38 | 421.2 | 404 | 720.6 |
| EBITDAM | -1.1% | 3.0% | 2.8% | 6.3% |
| Adj. PAT | 924.0 | 1099.4 | 1634.8 | 1534.7 |
| Growth | | 19.0% | 48.7% | -6.1% |
| Adj. EPS (INR) | 8.1 | 9.6 | 14.3 | 13.4 |
| P/E (x) | 27.2 | 22.8 | 15.4 | 16.4 |

## Angel One Ltd. CMP: INR 1244

**Angel One Ltd. (AOL) has successfully transformed into a digital broking platform operating in a flat-fee business model resulting in strong growth in revenues (up 98% in FY21) and active clients (up 171% in FY21) with cost efficiency (EBITDA margin of 48% in FY21 vs 29% in FY20). The successful transformation of the business model underlines execution capability of the franchise in retail broking space.**

### Key Investment Rationales

**Full-scale digital platform and discount brokerage model has transformed the business:** Between FY19 and FY21, total broking turnover increased from Rs2.6bn to Rs5.4bn, active clients rose from 0.4mn to 1.6bn, and NSE-active client market share grew from 5% to 8.3%. This transformation is credited to the digital discount broking business model started by the company in late 2019. Sub-broker driven revenues have increased from Rs988mn in FY20 to Rs1.6bn in FY21 whereas direct flat-fee revenues rose from Rs703mn in FY20 (operational only for a quarter) to Rs3.3bn in FY21.

**MTF lending is a high-margin business:** Net interest revenues from the margin trading facility (MTF) stood at ~Rs1.6bn for AOL in FY21. This is a steadier business stream, but with high margin (NIM at ~9%). The granular nature of the book collateralized by underlying stock portfolio keeps credit costs in check.

### Valuation & Outlook

Capital market participation is extremely low in India. Angel Broking is a well-established player and is on the path to become a leading Intech company. Although the company will continue to face competition, it's used technology in an impressive way to achieve scale. Company hiring sought after talent in both mid and senior management is in line with their ambition to become a world class fintech company.

| Y/E March (INR mn) | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Net Sales | 7,648 | 7,626 | 7,246 | 12,637 |
| *Growth* | *77.50%* | *-0.29%* | *-4.98%* | *74.39%* |
| EBIDTA | 2,679 | 2,142 | 1,857 | 4,708 |
| *EBIDTAM* | *35.03%* | *28.08%* | *25.63%* | *37.26%* |
| Adj. PAT | 1,079 | 798 | 823 | 2,969 |
| *Growth* | *248.00%* | *-26.03%* | *3.15%* | *260.50%* |
| Adj. EPS (INR) | 14.99 | 11.09 | 11.44 | 36.28 |
| P/E (x) | 82.96 | 112.13 | 108.70 | 34.28 |

## SAIL CMP: INR 115

**Steel Authority of India Ltd (SAIL) is the leading steel-making company in India. The company is a fully integrated iron and steel maker producing both basic and special steels for domestic construction engineering power railway automotive and defence industries and for sale in export markets. They are also among the seven Maharatnas of the country's Central Public Sector Enterprises.**

### Key Investment Rationales

**Significant debt reduction potential:** In absence of any significant near-term capex, SAIL has potential to reduce its debt dramatically. Key points: i) On the Q1FY22 earnings call, management guided for end-FY22 debt at INR200bn. ii) EBITDA/t expected to be healthy factoring in higher employee cost and steel price moderation. iii) FY22E sales volume expected at 16-16.5mt (management's guidance) implying significant scope for upward revision in Street's estimates.

**Street overawed by seemingly ensuing capex woes:** management announced brownfield capacity expansion of 10-15mtpa. Street is unimpressed though, and cautious, as brownfield-cum modernization plan of FY12 had significant cost overruns and delays. Low commodity prices over FY15–17 further stressed the balance sheet. That said, we believe it is still too early to be overcautious.

### Valuation & Outlook

Despite its highest cost structure among peers and high capex intensity over the medium term, we remain bullish on SAIL as we see: i) substantial scope for debt reduction both due to cash accretion and working capital unlocking; and ii) structural improvement in steel operating environment would maintain EBITDA/t elevated through FY24E—highest in its history.

| Y/E March (INR mn) | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Net Sales | 575,600 | 669,736 | 616,642 | 691,136 |
| *Growth* | *18%* | *16.35%* | *-7.93%* | *12.08%* |
| EBIDTA | 46,356 | 97,615 | 102,157 | 127,387 |
| *EBIDTAM* | *8.05%* | *14.58%* | *16.57%* | *18.43%* |
| Adj. PAT | -5,663 | 21,258 | 19,264 | 36,804 |
| *Growth* | *-118.21%* | *-475.42%* | *-9.38%* | *91.05%* |
| Adj. EPS (INR) | -0.68 | 5.69 | 5.13 | 10.04 |
| P/E (x) | -169.26 | 20.23 | 22.44 | 11.46 |

## Indian Hotels Ltd. CMP: INR 197

**The Indian Hotels Company Limited (IHCL) and its subsidiaries bring together a group of brands and businesses that offer a fusion of warm Indian hospitality and world-class service. These include Taj – the hallmark of iconic hospitality, SeleQtions, a named collection of hotels, Vivanta, sophisticated upscale hotels and Ginger which is revolutionizing the lean luxe segment. Incorporated by the founder of the Tata Group, Jamsetji Tata, the Company opened its first hotel - The Taj Mahal Palace, in Bombay in 1903. IHCL has a portfolio of 196 hotels including 40 under development globally across 4 continents, 12 countries and in over 80 locations.**

### Key Investment Rationales

**Focus on increasing rooms through management contract:** Management contract Hotels has increased from 32% in FY18 to now 46% of the overall portfolio (including Hotels in the pipeline). Currently, ~78% of pipeline Hotels are under management contracts. IHIN targets to take it to 50% going forward. EBITDA flow through management contract income is 70-80% and that too without deploying capital, thus the said initiative is RoCE accretive.

**Cost savings are here to stay:** USL has relaunched two of its largest Prestige brands McDowells No1 and Royal Challenge in the past few months. The initial feedback has been positive.

### Valuation & Outlook

Faster demand revival in the Leisure Travel segment has aided IHIN's performance in FY21. We expect a gradual/sharp recovery in FY22E/FY23E on: a) a low base, b) improvement in ARR once things normalize, c) improved occupancies, d) positivity in cost rationalization efforts in FY21, e) an increase in F&B income as banqueting/conferences resume, and f) higher income from management contracts. New revenue generating avenues have a higher EBITDA margin, and this is being done without deploying capital or with very minimal capital, which bodes well for RoCE.

| Y/E March (INR mn) | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Net Sales | 41,036 | 45,120 | 44,631 | 15,752 |
| *Growth* | *0.69%* | *9.95%* | *-1.08%* | *-64.71%* |
| EBIDTA | 7,416 | 9,167 | 11,000 | -1,957 |
| *EBIDTAM* | *18.07%* | *20.32%* | *24.65%* | *-12.42%* |
| Adj. PAT | 632 | 2,446 | 3,508 | -6,942 |
| *Growth* | *-388.85%* | *286.83%* | *43.41%* | *-297.91%* |
| Adj. EPS (INR) | 0.85 | 2.41 | 2.98 | -6.05 |
| P/E (x) | 231.35 | 81.60 | 65.99 | -32.50 |

## NALCO CMP: INR 97

**National Aluminium Company Limited (NALCO) is a Navratna Central Public Sector Enterprise (CPSE) under Ministry of Mines Government of India. The Company is a group `A' CPSE having integrated and diversified operations in mining metal and power. Presently Government of India holds 51.50% stake in NALCO. The company is one of the largest integrated Bauxite-Alumina-Aluminium- Power Complex in the Country. The Company has a 68.25 lakh TPA Bauxite Mine & 21.00 lakh TPA (normative capacity) Alumina Refinery and 4.60 lakh TPA Aluminium Smelter & 1200MW Captive Power Plant.**

### Key Investment Rationales

**High margin of safety with attractive dividend yield and high cash levels:** Cash and cash equivalents at FY21-end are estimated at INR20bn translating into ~14% of its current market capitalization. The company has declared a dividend of INR2.5 per share in FY21 translating into a current dividend yield of ~3% and we expect the dividend yield to remain at these levels in FY22/23. Nalco recently completed a buyback of ~7% of equity at a price of INR57.5 per share at an outlay of INR7.5bn.

**Captive coal mining to usher in new era:** Nalco has recently been granted mining lease for Utkal D block in Odisha, a coal block allocated to it way back in 2016. The governments new policy initiatives in the mining sector paves the way forward for another mining lease for Utkal E block (also allocated in 2016), together this will lead to 55% of the companies captive requirement of coal for its captive power plant.

### Valuation & Outlook

We remain positive on Nalco given its integrated business model with captive bauxite mines,

coal linkages and firm aluminium prices. Alumina prices have stabilized aided by support from the cost curve and the recovery in aluminum prices. Aluminum prices have firmed up over the past three months with steady Chinese demand and stable inventories. Commissioning of Utkal D coal block would aid power and fuel costs.

| Y/E March (INR mn) | FY18 | FY19 | FY20 | FY21 |
|---|---|---|---|---|
| Net Sales | 95,095 | 114,993 | 84,718 | 89,558 |
| *Growth* | *12.43%* | *-2.60%* | *8.70%* | *-0.20%* |
| EBIDTA | 13,945 | 28,869 | 4,879 | 15,191 |
| *EBIDTAM* | *14.66%* | *25.10%* | *5.76%* | *16.96%* |
| Adj. PAT | 13,424 | 17,324 | 1,382 | 12,995 |
| *Growth* | *98.35%* | *29.05%* | *-92.02%* | *840.12%* |
| Adj. EPS (INR) | 6.94 | 9.29 | 0.73 | 7.07 |
| P/E (x) | 13.96 | 10.43 | 132.74 | 13.71 |

## The India Cements Ltd. — CMP: INR 206

**The India Cements Limited is a South based cement company. The Company's brands include Sankar Super Power, Coromandel King and Raasi Gold. These brands are also available under sub brands, such as Shankar Shakti and Coromandel Super Power. The Company's plants are located in various locations in India, including Malkapur, Vishnupuram, Chilamkur, Yerraguntla, Vallur, Sankari, Dalavoi, Sankarnagar, Banswara and Parli. The Company, based on customer requirement, also supplies its brands in High-density polyethylene (HDPE), Paper and Laminated packing. It produces both the variants viz Blended Cement, as well as Ordinary Portland Cement under different grades.**

### Key Investment Rationales

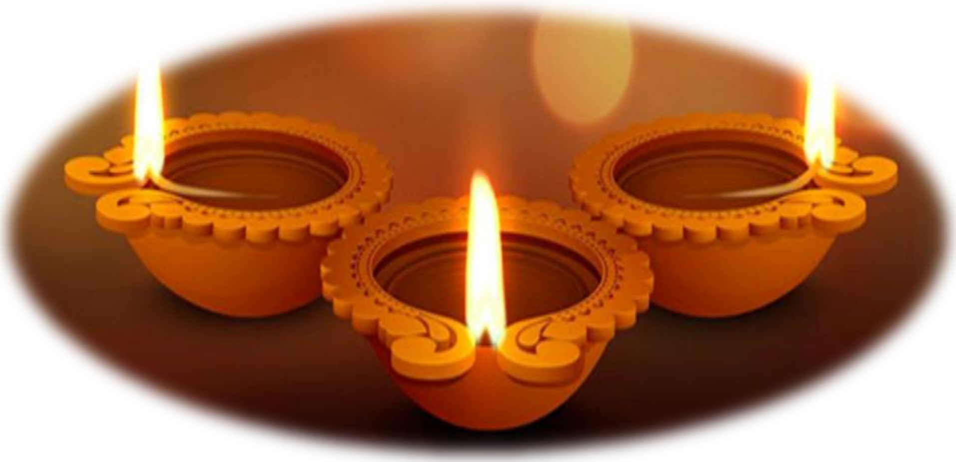
**Best play on demand recovery in South:** Stalled projects in Andhra Pradesh and Telangana, deferred spending on infrastructure in the two states, an extended monsoon and excess capacity had eroded pricing power in the south. Cement sector is expected to perform well in the long-term as government is giving big thrust in the infrastructure sector. The RBI is also supporting the Government of India (GoI) borrowing programme for quality real estate developers, who are doing well and whose quarterly results are on the expected lines. So, growth projection of the cement sector looks positive. Since, India Cement is one of the leading players in cement sector; these triggers will have a positive impact on its stocks.

### Valuation & Outlook

Cement companies have announced a price hike of ₹15 to 25 per bag in the South and ₹10 to 15 per bag MoM (Month-on-Month) in other regions in September 2021. We expect the price hike to be absorbed in H2 with a demand recovery and rising utilization levels. Input cost inflation and seasonal correction in cement prices should keep margins under pressure in the near term; however, margins are likely to bounce back with demand/price recovery in H2FY22.

| Y/E March (INR mn) | FY17 | FY18 | FY19 | FY20 |
|---|---|---|---|---|
| Net Sales | 52,671 | 57,704 | 51,864 | 45,106 |
| *Growth* | *2.03%* | *9.56%* | *-10.12%* | *-13.03%* |
| EBIDTA | 7,335 | 6,649 | 6,365 | 8,283 |
| *EBIDTAM* | *13.93%* | *11.52%* | *12.27%* | *18.36%* |
| Adj. PAT | 705 | 252.6 | 534.63 | 2,084 |
| *Growth* | *-55.25%* | *-64.17%* | *111.65%* | *289.89%* |
| Adj. EPS (INR) | 2.16 | 0.62 | 1.62 | 6.67 |
| P/E (x) | 95.4 | 332.3 | 127.2 | 30.9 |

*Happy Diwali*



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