“Pent up Demand”: Looking at brighter side of lockdown

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The ***theory of Loss Aversion*** states that "**pain of anticipated loss is quite higher than actual loss itself.**"

If we corroborate the above theory with the present situation in markets, the theory is getting practised to a high degree. The end result is ferocious dislocation of stock prices in relation to its core intrinsic business value. Taking the current panic into account, there is strong uncertainty on how the future will pan out. However, if one looks at the brighter side of the situation, when it ends, will bring strong "pent up demand" across various sectors/business. Hence, there are several dislocated opportunities across the "pent up demand" theme.

Therefore, we list out a few companies that will be direct beneficiaries of the above theme. The universe of stocks that we would like to bet have the following in common:

- **Strong brands and products with established distribution network** coupled with reasonable pricing power
- **Credible management and clean governance record**, who have seen such turbulence in the past and have come out stronger from such a crisis
- From a financial perspective, these companies have **solid balance sheets coupled with ability to generate strong cash flows and comfortable leverage profile.** More importantly, they have a track record of creating shareholder wealth across business cycles

Out top picks under this theme are **Aditya Birla Fashion & Retail, Apollo Hospitals, Exide Industries, Gujarat Gas, Havells India, Kansai Nerolac, Shree Cements, VST Industries, TCI Express** and **United Spirits.**

Aditya Birla Fashion and Retail (ADIFAS)

Aditya Birla Fashion & Retail (ABFRL) combines Madura's portfolio of leading lifestyle brands (Allen Solly, Van Heusen, Louis Philippe and Peter England) with Pantaloons' strength as the largest value fashion retailer. The company has a robust distribution network with 2656 brand stores and a reach across 24000 multi branded outlets (MBOs), along with 343 Pantaloons stores. Over the years, Pantaloons has witnessed a significant upgradation of margin profile, from ~4% in FY15 to 10.1% in Q3FY20 (9.0% in YTD FY20). Owing to the discretionary nature of its product portfolio in both lifestyle brands and Pantaloons, we expect revenue growth to take a hit in the short-term due to the impact of Covid-19. However, we believe that with its strong brand patronage and large distribution reach, it will be able to revive its revenue growth post normalisation of the scenario and improvement in retail footfalls. The stock currently trades at 1.2x FY22E EV/sales.

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Apollo Hospitals (APOHOS)

Apollo Hospitals owns one of the best integrated business models in the healthcare space with a strong management pedigree. Rapid expansion and maturity of older hospitals has kept the overall growth tempo at 12-14% per annum. After an intense capex cycle, especially during FY14-18, the company is focusing on the profitability and return ratios with calculated capex moderation. This is reflected in a marked improvement in both EBITDA margins and RoCE. We expect healthcare sales to grow at a CAGR of ~12% in FY19-22E to ₹ 7160.8 crore mainly due to strong growth at new hospitals and AHLL. The pharmacy business (40% of FY19 revenues) has grown at ~22% CAGR in the last five years on the back of consistent addition of new pharmacies and timely closure of non-performing pharmacies. We expect the pharmacy business to grow at ~17% CAGR in FY19- 22E to ₹ 6153 crore mainly on the back of new addition and improvement in realisation owing to ramp up in private label contribution. The company continues to deliver a healthy set of numbers on the revenue and cost fronts. Despite the likely disturbances in operations due to Covid-19 for a good part of FY21, the overall narrative is panning out on expected lines with sustained margin expansion and improvement in RoCE. The management has reiterated the roadmap for more focus on consolidation of the existing hospitals and making new hospitals profitable.

Exide Industries (EXIIND)

Exide Industries (EIL) is a part of the duopoly in the organised Indian automotive battery space. For EIL, aftermarket i.e. replacement segment forms ~60% of channel mix with OEM sales and exports constituting the rest. Healthy new vehicle sales over FY17-18 and short approximately three year replacement cycles lend strength to the aftermarket channel providing steady state demand in FY20-22E even though the OEM channel would remain largely subdued. EIL is proactive on the lithium ion front, having formed a JV with Swiss player Leclanche for assembly and eventual manufacture of battery cells. EIL clocks decent 13-14% margins with average RoCE at ~15%. It is currently quoting at inexpensive valuations of ~14x P/E on FY22E EPS of ₹ 9.4. Being largely domestic focused and muted base metal prices are a further positive for EIL.

Gujarat Gas (GUJGA)

Gujarat Gas is one of the largest CGD players in India, which operates mainly in Gujarat, Dadra & Nagar Haveli and parts of Thane. In the Tenth CGD bidding round, the company was awarded six new GAs in various parts of the country. In FY20, Gujarat Gas has witnessed robust increase in its sales volume. The company is expected to report 9.1 mmscmd total sales volumes, growth of ~40% YoY as it benefitted from the National Green Tribunal (NGT) order. The company witnessed a strong increase of ~57% YoY in industrial PNG sales in FY20E to ~7.1 mmscmd, aided by higher volumes from ceramic industries in the Morbi area. We expect industrial PNG segment to continue to report strong volumes in future as well on account of stricter implementation of environmental norms. In the CNG segment, the company has a network of more than 375 stations and has CNG sales volume of 1.4 mmscmd. Although we expect sales volumes to drop ~24% in Q1FY21E due to reduced demand, we expect sales to pick up once normalcy is restored. We expect total sales volume to grow at 11% CAGR in the next two years to 11.2 mmscmd in FY22E. The company is also a beneficiary of lower gas prices, which has helped it to maintain healthy gross margins at ₹ 7.2/scm for FY20E. We expect it to continue to report gross margins at ₹ 6.9/scm in FY22E due to relatively good pricing power. Additionally, aggressive expansion in newly acquired GAs gives visibility to stable volume growth. On account of regulatory tailwinds and volume growth outlook, we have positive view on the company.

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Havells India (HAVIND)

Havells' product portfolios includes industrial (wire & cable and switchgears) and consumer segments (home appliances). While the consumer facing business reported good growth in the recent past (~20% CAGR), the industrial category products continued to face challenges due to sluggishness in construction activity. We believe Havells' FY21E performance would be challenging amid lockdown across the country and slowdown in the infrastructure spending. However, Havells is the strong consumer brand with over 8000 dealer network across India. The company is well placed to recoup the lost sales due to lockdown and recovery in the demand of industrial products whenever normalcy returns. We believe Havells will also benefit from its backward integration (strong supply chain) and strong balance sheet position as and when business returns to normalcy. Hence, we believe the stock is available at attractive valuations at the current price.

Kansai Nerolac (KANNER)

Kansai Nerolac (KNPL) is the third largest decorative paint company with ~12% market share in the organised category. Over the last 10 years, KNPL has increased its decorative paint contribution in revenue from 50% to 55%. While its decorative portfolio is likely to face challenges in the near term due to the ongoing lockdown across the country, we believe demand from the automotive industry (where KNPL is the market leader) will remain sluggish in the near to medium term due to shutdown of automotive plants. However, the company is expected to recover its sales loss in the decorative segment as and when normalcy returns while we believe industrial paint category would largely be driven by coil coating and functional powder coatings. We expect Kansai to record revenue, earning CAGR of 11% in FY20-22E with a major recovery being seen in FY22E. On the margin front, we believe the company would benefit from lower raw material prices owing to a sharp reduction in raw material prices. Considering its strong promoter pedigree, lean balance sheet and continuous focus on enhancing dealer reach, Kansai Nerolac is available at attractive valuations at the current price.

Shree Cements (SHRCEM)

Shree Cements' capacity of 43 MT is located mainly in the north and eastern regions, with a presence in the south as well. Shree Cement is the industry leader in terms of margins owing to self-sufficiency in power generation and logistical cost optimisation backed by satellite grinding units. With significant capacity addition in recent years, the company should outperform the industry, going ahead. We expect Shree to clock a volume CAGR of 6.4% in FY20E-22E and revenue CAGR of 5.2% during the same period. Despite lower realisation, the company is expected to post industry leading EBITDA margins of 25% and 27% and blended EBITDA/t of ₹ 1124 and ₹ 1300 per tonne in FY21E and FY22E, respectively. Leverage is not an issue for the company as its D/E is well under control at 0.2x and debt/EBITDA is not expected to cross 1x over the next two years. RoCE is expected to bounce back to double digits in FY22E on the back of an improved performance. While current valuations of 20x FY20E and 18x FY22E EV/EBITDA look expensive, the company is trading at a steep discount to its five year average of 26x. On a P/BV basis as well, the company is trading at ~30% discount to its 5x historical average of 6.8x. Management expertise, industry leadership in profitability and efficient capital allocation would continue to keep Shree Cements as the standout performer in future as well, making it a compelling buy post the recent correction.

VST Industries (VSTIND)

VST Industries' revenues have increased ~15% YoY in 9MFY20 driven by ~10% volume growth and ~5% product mix change. The company has been witnessing superior volume growth in high priced cigarettes as contribution of premium brands Charms, Total and Edition have increased to 60% of volumes in the last few years. With shutting down of manufacturing facilities during the lockdown period of ~40 days, we expect VST to be severely hit at least for two quarters (Q4FY20E and Q1FY21E) due to non-availability of cigarettes and as a result, consumers being unable to consume it. However, the company's fundamentals are robust driven by strong capital structure, steady cash flow and consistent dividend payment of 65% (at the CMP, dividend yield is ~3.2%). Post the sharp correction in the stock price, VST is available at attractive valuations of FY22E P/E multiple of 14x.

TCI Express (TCIEXP)

FY20E remained a tumultuous year for express logistics, marred by slower than usual revenue growth (~5% growth in 9MFY20 for TCI Express). However, in spite of the lowered operating leverage, TCI Express continued to see its margins expand to ~12% levels (50-60 bps blended expansion YoY), reflecting on management focus on picking up profitable sales. Covid-19 continues to impact express logistics. However, players such as start-ups funded by private equity are seeing greater stress in cash flow management, inflated labour cost and other expenses. This can deter them from dealing in unprofitable business sales and lower the competitive intensity in the segment. TCI Express continues to remain a technology led low leverage, asset light model, that would help it in weathering the crisis better than other heavy asset owners and levered players. Risks include heavy reliance on SME players (~50%) which had earlier helped the company to achieve higher growth than its competitors (SMEs could be heavily impacted due to ongoing crisis).

United Spirits (UNISPI)

During 9MFY20, despite general consumption slowdown and rising input prices, USL's judicious management of employee and other overhead costs lowered the impact of gross margin compression on the EBITDA front. The management has also actively de-prioritised few low margin products in certain geographies (that exhibited higher cash collection risks). Prestige & Above (P&A) share in the product mix accounts for 66% in 9MFY20 (increased 100 bps from 65% in Q1FY20). Newer launches have also helped increase the premiumisation trend (McDowell's Platinum, youth centric packaged liquor Hipster, etc). The management expects the premiumisation trend to continue, going forward. They expects prices of key raw materials (ENA, glass) to have peaked out and do not expect further deterioration in gross margins (contracted 421 bps to 44.4% in Q3FY20). Risks include higher taxes by state governments on liquor companies to generate funds for the Covid-19 crisis, continued closure of liquor shops and distilleries in most of the states and negative impact due to the Covid-19 crisis on the premiumisation trend witnessed by the industry in the past few years.

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