Sharekhan

by BNP PARIBAS

Covid-19: India Inc's health report

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The Covid-19 pandemic continues to impact the global economy since its outbreak. As for India, a 21-day lockdown and other prompt measures by the government have placed us in a still relatively better position, as compared to the figures released by some developed countries, but economic activity has been disrupted at varied levels across sectors and businesses. Now, as India heads for another nationwide shutdown until May 3, 2020, the impact on economic activities will be deeper.

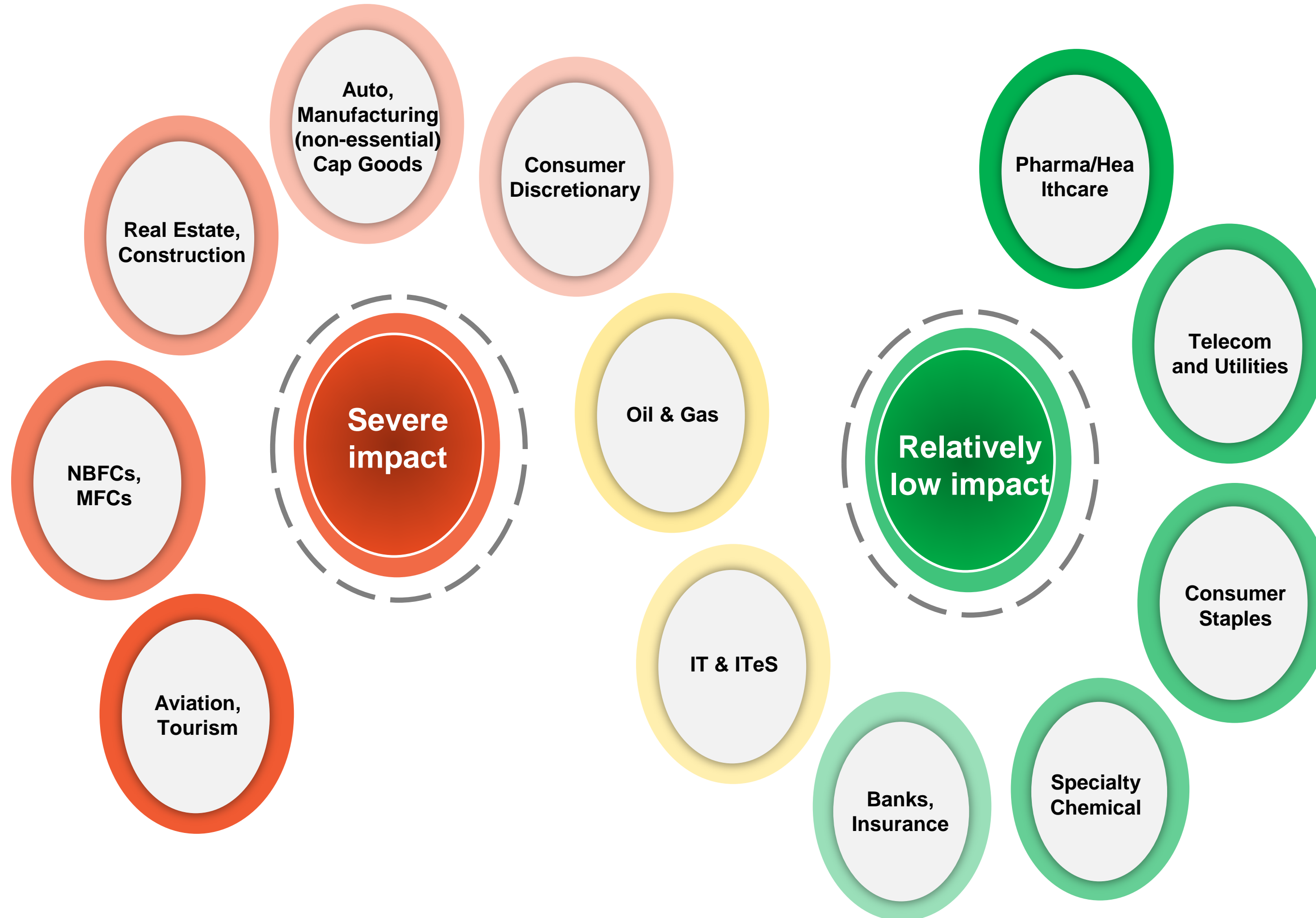
The most-impacted sectors are those that involve discretionary spending, which include multiplexes/theme-parks, automobiles, malls, travel/tourism, real-estate hotels, etc), while essentials such as staples (FMCG), healthcare/pharma, telecom and utilities would be relatively less impacted. Further, owing to low business activity and potential in unsecured books, the financials sector looks highly vulnerable to the Covid-19 crisis.

In this latest Covid-19 edition from Sharekhan, we have tried to broadly outline the sectoral impact and our preferred investment picks in respective sectors. However, we are still in the early days and looking at the severity of the crisis, the impact could be bigger on economy and the recovery would be gradual.

As we are at the start of the Q4FY2020 earnings season, we will get further clarity on the quantum and duration of the impact on companies from the current crisis. We will keep you posted…

Stay Safe for a Stronger tomorrow…

Covid-19 sectoral impact: The beaten and the brave



Sectoral business impact

Sector resilience	Sector	Impact lockdown	Beyond one month lockdown	Business recovery timeline
Low	Aviation/Travel	Very High	Very High	Slower
	NBFCs/MFCs	Very High	Very High	Slower
	Real Estate/Construction	Very High	Very High	Slower
	Auto/Capital Goods	Very High	High	Slower
Medium	Discretionary	High	High	In-line with GDP
	Oil & Gas	High	High	In-line with GDP
	Information Technology	Moderate	High	Slower
	Banking & Insurance	Moderate	High	In-line with GDP
High	Speciality Chemicals	Limited	Moderate	Early
	Consumer Staples	Limited	Moderate	Early
	Pharma	Limited	Moderate	Early
	Utilities	Limited	Moderate	Early

Business impact

Steering away: Recovery depends on multiple drivers

1

Demand-side drivers

- Surge in pent-up demand after the lockdown
- Seasonal demand
- Change in consumer behaviour on account of public health measures and social distancing
- Demand recovery in exports

2

Supply-side drivers

- Return of migrant labour and casual labour
- Access to capital and business loans
- Faster revival of industrial output
- Availability of imported raw materials
- Higher enquiries for sourcing from alternative locations

3

Other drivers

- Return of government spending
- Rolling out of large government stimulus packages
- Duration of Covid-19 outbreak
- Ease of interest rate by central banks
- Monsoon intensity and duration

Sectoral analysis in current environment

Sector	Remarks
Capital Goods	▪ Weak order inflows and lower production
Banks/NBFCs/ MFCs	▪ High credit cost , increasing NPAs and low credit offtake dent profitability
Construction	▪ Weak orders, stretched working capital cycle
Automobiles	▪ Weak automobile demand
Discretionary	▪ Shutdown of stores due to lockdown

Sector	Remarks
Oil & Gas	▪ Global oil demand likely to decline owing to low business activities
IT	▪ Supply disruption, but work-from-home approval from over 95% customers
Specialty Chemical	▪ Part of chain of essential products; moderate revenue pick-up
Consumer Staples	▪ Limited volume impact, margins may surprise positively
Pharma	▪ Demand remains strong, plants operating at 25-50% capacity

The New Normal - Life after Covid-19

01 **Work from Home**

More machines and automation; video conferencing

02 **Spend on Healthcare**

Telemedicine; better hygiene, efficacy of healthcare system

03 **Digital connect**

Spending on digital technologies; digital media consumption

04 **Increase in outsourcing**

Opportunity for higher outsourcing intensity; small captives may shut their operation

05 **India as manufacturing alternative**

Companies are on the lookout for an alternative production hub.

Sector wise-Outlook and Picks

Consumer Goods

Our stance: Neutral

- Consumer staples companies will face a limited impact of the Covid-19 outbreak as compared to companies manufacturing discretionary/non-essential products due to rising demand for personal hygiene products and essential products.
- Supply disruptions due to lockdown in domestic and key international markets would result in another year of muted sales in FY2021. However, benign input prices and judicious advertisement spends would provide some support to operating margins.
- However, long-term growth prospects are intact in view of the low penetration of some key categories in rural market, growth of e-Commerce as a channel of distribution and innovation through new products launches and entry into the category.
- We prefer companies with a strong portfolio of brands largely targeted towards essentials, strong cash flows and good dividend payout.

Preferred picks

1. Asian Paints
2. Britannia Industries
3. Hindustan Unilever
4. Dabur India

Asian Paints

- Asian Paints Limited (APL) is a market leader in the domestic paints industry with 55% market share. Unlike peers, the company has de-risked its business model, deriving more than 80% of revenue from decorative paints. The company has a strong portfolio of brands straddling the pyramid.
- The Coronavirus outbreak would affect sales volumes of decorative paints as consumers defer spends for refurbishing homes. However, recent sharp correction in crude oil prices would help mitigate impact to some extent as 30% of key inputs are crude-linked.
- Rising middle-income group, rapid urbanisation, and shift to organised from unorganised segments would help APL achieve steady volume growth of high-single to low-double digits in the domestic decorative paints business in the long run.
- APL has a sturdy balance sheet with stable working capital management and a low debt to equity ratio. Moreover, company has a strong return profile with RoE and RoCE remaining upwards of 20% at 22.5% and 24.7%, respectively.

Britannia Industries

- Britannia Industries (Britannia) will see a lesser impact of the Coronavirus as 75-80% of product portfolio comprises essentials.
- We expect demand for biscuits and allied essential products to see better demand in the coming quarters. However, production and supply disruptions caused due to a lock-down in the country might affect sales in the near term.
- Sustained innovation, focus on growing adjacencies (dairy & bakery), enhancing reach in the *Hindi*-speaking belt and improving profitability through efficiencies would drive earnings growth in the long run.
- Operating efficiencies, cost-saving initiatives and premiumisation strategy helped Britannia to see its OPM improving to ~16% in FY2020 from a mere 7% in FY2013. The company has strong return profile with RoE and RoCE expected to stand at 30.3% and 38.2%, respectively in FY2020E.

Hindustan Unilever

- Hindustan Unilever (HUL) is India's largest consumer staples companies with market leadership in highly-penetrated categories such as soaps and detergents. The company has strong direct distribution reach of three million outlets.
- About 50-55% of HUL's product portfolio is in essential categories. The company would benefit from strong demand for soaps, hand sanitisers, hand wash and detergents in the near to medium term.
- The company's long-term growth prospects are intact. With the merger of GSK Consumer's *health food drinks* business, the company becomes one of the strong players in the package food segment. We expect more new launches in the foods business in the coming years.
- With negative working capital and strong cash flows, the company is one of the cheery dividend payers (average dividend payout for last 4 years stood at ~99%). It has strong return profile with RoE and RoCE standing at 84.2% and 113.2%, respectively.

Dabur India

- Dabur India's positioning as an *Ayurvedic* products company, with a focus on herbal and natural products in the healthcare and personal care segments and a strong presence in the branded juices segment make it a formidable play in the domestic market.
- Despite a slowdown in the domestic market, Dabur was resilient, clocking revenue growth of ~7% (driven by 5-6% volume growth) in the first nine months of FY2020, with OPM improving by 232 bps to 16.2%. This was mainly on account of steady performance in some key categories where it gains market share.
- FY2021 performance will be affected by supply disruption caused due to spread of coronavirus. However sustained innovation, investment behind brands and consumer connect initiatives are some key growth drivers for Dabur in the long run.
- Dabur India has a well-diversified portfolio of brands (largely rural-centric) in the domestic market. We expect revenue and PAT to grow at a CAGR of ~10% and 12.6% over FY2019-22.

Consumer Discretionary

Our stance: Neutral

- Consumer discretionary companies will see major hit on revenues since the lock down from March 23, 2020, as a result of the initial closure of malls, restaurants and cinemas by most state governments and the country entering a complete lockdown.
- H1FY2021 will see major disruption as shutdown of stores, affects revenue and profitability. If pandemic situation is under control by June-July, we expect demand revival from H2FY2021 (largely driven by pent-up demand/festive season).
- Long-term growth prospects of sector are intact as the company's are focusing on expanding its reach (by targeting tier2/tier-3 towns); banking on e-commerce/online channels to drive the next leg of growth; improving store fundamentals and driving efficiencies to see better margins.
- We prefer companies having a strong brand portfolio and a lean balance sheet with strong growth prospects.

Preferred picks

1. Bata India
2. Titan
3. Trent

Cont'd....

Bata India

- Bata India (Bata) is India's largest retailer and manufacturer of footwear with a retail network of 1,400 stores selling ~ 47 million pairs of footwear every year. Its revenue and PAT clocked a CAGR of 6% and 26%, respectively over FY2016-19.
- Coronavirus-led lockdown will affect footfalls in Q4FY020 and Q1FY2021 due to the closure of retail stores as well as malls. Bata has wedding-related products in its portfolio and the postponement of weddings will also have an impact on sales in the near term.
- However, long-term growth prospects are intact as the company is focusing on re-branding itself from a conventional footwear player to a branded footwear player by slowing store additions and focusing more on growing into different segments.
- Consistent store expansion, innovation, focus on the women's footwear category (growing by 20-25%) and premiumisation strategies (about 50% product portfolio) would help Bata to achieve same-store-sales growth (SSSG) of 6-8% and low-double-digit revenue growth in the long run.

Titan Company

- Titan Company (Titan) is one of the leading the brands in the domestic retail space with strong presence in the branded jewellery and watches segment with close to 1800 stores spread across more than 2.3 million sq. ft of retail space.
- The lockdown in India due to the spread of the Coronavirus will affect jewellery and watches businesses in H1FY2021 as the company has shut down all retail shops coupled with postponement of the wedding season due to curb on social gatherings.
- Long-term growth prospects are, however, intact as a large shift happening from non-branded to branded jewellery players, sustained new innovation in jewellery and watches segment and the thrust on expanding into tier-II and tier-III towns due to improving demographics would help Titan to achieve consistent double-digit revenue growth and gradual improvement in margins in the long run.
- With a strong retail presence and portfolio of established brands, Titan is one of the better companies in the discretionary space. It has strong return profile with RoE and RoCE standing at 27.2% and 37.2%, respectively.

Trent

- Trent is a leading branded retail company that operates Westside, a chain of departmental stores retailing apparel, footwear and other accessories. It also operates value fashion chain *Zudio* and has a associations to operate *Zara* and *Massimo Dutti* stores in India.
- Closure of malls and retail stores due the spread of Coronavirus will impact the performance at the fag end of Q4FY2020 and in Q1FY2021. However, H2FY2021 is expected to be slightly better due to the festive season. Overall, FY2021 is expected to remain soft but strong recovery is expected in FY2022 as Trent will be one of key beneficiary of lower supply constraints as 99% of products sold are in-house.
- However, we expect same-store sales growth (SSSG) trajectory to improve, backed by better store fundamentals in the medium term. Almost 100% share of private labels will help the company improve its supply chain and maintain its OPM expansion momentum in the medium term.
- Trent has a lean balance sheet with working capital cycle standing close to 30 days and a debt:equity ratio of less than 1x.

Oil & Gas

Our stance: Positive

- Oil & gas companies are expected to get impacted by the Coronavirus outbreak as global crude oil demand is estimated to decline in excess of 20 mbpd due to a slowdown in economic activities.
- Lockdown in India has dragged down fuel sales volume by 30-40% at petrol pumps in India. Hence, refinery utilisation to fall below sub 60-70% level while marketing volumes (especially of petrol, diesel and ATF) and CNG are also expected to decline by sharply. Additionally, fall in crude oil price and the Indian rupee's depreciation would result into inventory and forex losses for OMCs.
- Non-revision of auto fuel prices have resulted into higher marketing margin but the same would not be enough to offset fall in volumes.
- Long-term volume and margin outlook for CGD companies remains intact, led by regulatory push and low gas cost. Low crude oil prices benefit OMCs as refining and marketing margins improve. Lower oil prices would impact oil realisations of upstream PSUs.

Preferred picks

1. **Reliance Industries**
2. **Mahanagar Gas**
3. **Gujarat Gas**

Cont'd....

Reliance Industries

- The sharp correction of 25% in Reliance Industries Limited's stock price from recent highs, seems to be factoring in a prolonged weakness in refining & petrochemical margins due to Covid-19, no improvement in telecom business from potential hike in average revenue per user (ARPU) and low valuation for the retail business.
- Likely ARPU hike in telecom business and a weak Indian rupee could mitigate earnings volatility from decline in refining & petrochemical margins to some extent amid weak demand in times of the Coronavirus outbreak.
- Potential induction of strategic partner for telecom and retail businesses could act as a key catalyst for value-unlocking from the consumer business.
- The company's aim to increase the share of EBITDA from the consumer business to 50% (from ~37% in Q3FY2020) seems a step in the right direction to tide over margin volatility in cyclical business.

Mahanagar Gas

- Mahanagar Gas Ltd (MGL) is a dominant CGD player in and around Mumbai with CNG/PNG sales volumes of 2.2 mmscmd/0.8 mmscmd in FY2019.
- CNG sales volumes are expected to get impacted in the near term as most vehicles have gone off-road given Covid-19-led lockdown in Mumbai.
- We expect MGL's volume growth to recovery sharply to 6-7% in H2FY2021E led by a higher adoption of CNG-fitted four-wheelers and increased penetration of PNG. Recent sharp cut in gas prices is positive for sustained high margins of MGL given its ability to retain some portion of lower gas cost.
- MGL's steep valuation discount with peers makes it the cheapest stock in the domestic CGD space despite industry leading EBITDA margin of Rs. 9-9.5/scm and a superior RoE of 23-25%.

Gujarat Gas

- Gujarat Gas (GGAS) is the largest gas distribution player in India with gas sales volume of 9.3 mmscmd in Q3FY2020. Out of the total volume, industrial segment accounts for ~77% and the remaining comes from CNG and domestic PNG.
- Although countrywide lockdown is likely to impact volume during Q4FY20E-H1FY21E but long term volume growth outlook remains intact supported by regulatory push to curb pollution and low LNG prices.
- The sharp decline in crude oil prices is expected to lower price of crude-linked LNG (30-35% of total gas sourcing mix), which would improve margin of Gujarat Gas although with a lag of 3-6 months.
- GGAS is likely to be a key beneficiary of government's aim to increase share of gas to 15% by 2025 in India's overall energy mix from 6% currently. Furthermore, development of six new geographical areas would lead to the next leg of volume growth. We expect PAT CAGR of 12% over FY20E-FY22E with robust RoE of 27-29%.

Capital Goods

Our stance: Positive

- Covid-19 has put pressure on production, order inflows and Greenfield capex may take a back seat in near term. Large private sector capex is out of sight as utilisation remains low.
- Lower utilisation rate will affect industrial players in H1FY21, but we do expect companies with a higher service revenue and product basket to see some pickup in H2FY21.
- For consumer durables companies, extension of lockdown may affect the crucial summer season. Consumer durable companies with strong cash flows and better working capital remain better equipped to wade through the crisis and rebound quickly when the current situation becomes better.
- We prefer industry leaders with a strong diversified order book, execution capabilities and healthy balance sheet for the project based companies. In consumer durable we prefer companies with strong cash flow position and better working capital management.

Preferred picks

1. **L&T**
2. **Dixon Technologies**
3. **V-Guard**

Cont'd....

L&T

- L&T is a best-in-class EPC company, and dominates domestic EPC market along with consistent revenue growth, large room to grow in absolute revenue terms, business diversification & operating profitability.
- Amid current adverse macroeconomics, competition is weakening and large EPC companies like L&T have strong systems & contracting abilities.
- Order inflows in recent years have been diversified across different states and across different infrastructure verticals. Further, a large diversified order book provides strong visibility.
- The turnaround time to normalcy may be quick for L&T, as a large part of the migrant labour force is still at the site and reliance on global supply chain is limited.

Dixon Technologies

- Dixon Technologies (Dixon) has the first-mover advantage as it operates both in OEMs (original equipment manufacturers) and ODM (own development model). The company has a diversified business model with consumer electronics (LED TV sets), lighting products, home appliances (washing machines) and mobile phones being the key segments.
- The company has a strong relationship with clients across segments and focuses on adding new ones across segment on a continuous basis coupled with enhancing its product offerings in the ODM space.
- Dixon has expanded capacities across its key business verticals by setting up a facility at Tirupati to grab opportunities arising out of the enhanced demand requirement of the OEMs.
- The company has a strong balance sheet (is net debt free) with minimal working capital requirement and generates a return ratio of over 20%. Hence, we believe that it will be able to deliver healthy performance in medium to long run despite some hiccups in the near term owing to lockdown as a result of Covid-19.

V-Guard

- Covid-19 led restricted mobility with factory lockdown is expected to impact sales, supply chain working capital and higher fixed costs until normalcy returns.
- The company remains better equipped during the current environment owing to its strong cash position and unutilised working capital limits and is expected to surface stronger as the current situation subsides.
- V-Guard stock price provides favourable risk-reward ratio to investors (P/E of 29.5x/25x its FY2021E/FY2022E earnings), which is at a discount to five-year average one-year forward P/E.
- Company's extended distribution network coupled with thrust on innovation, branding and promotion to tap potential market share in the long run.

Cement/Infrastructure/Building Materials

Our stance (on cement sector): Positive

- The Covid-19 outbreak is expected to hurt cement industry during Q4FY2020 and Q1FY2021 with loss of production days from mid-March 2020. In case shutdown of plants is extended, it would affect the channel network of the industry and slash cement prices, which would affect net earnings negatively.
- The Infrastructure sector is expected to get affected the most, owing to lower execution and contraction in operating margins.
- The infrastructure sector is also likely to be affected on the order tendering front as government prioritizes funds toward social causes. Delay in receiving payments and claims may also drive up working capital requirement.
- Building materials space is expected to be affected by loss of sales from mid-March 2020. Further, continued production and sales halt along with stoppage of work on real estate sector is expected to affect demand environment. The sector may see healthy rebound in demand post normalcy due to pent-up demand.

Preferred picks

1. UltraTech
2. Shree Cement
3. KNR Constructions

Cont'd....

Ultratech

- UltraTech, being the domestic market leader in the cement space, is well-positioned to revive earnings growth trajectory once normalcy returns.
- Cement sector's key parameters like pricing environment and lower input costs still remain favourable, which can aid UltraTech in maintaining healthy profitability post normalcy.
- Covid-19 related disruptions may gradually improve during H1FY2021, post which H2FY2021 may see strong revival on account of low base effect and pent-up demand.
- Ultratech, prior to Covid-19, has prepared itself with both organic and inorganic expansions while it has also lowered its leverage position which should aid faster recovery of earnings post normalcy.

Shree Cement

- Shree Cement had raised Rs. 2400 crore through QIP prior to Covid-19 pandemic to increase cement capacity from 40 mtpa to 60 mtpa. The expansion plans may get delayed due to prevailing situation, however, availability of requisite funds with *nil* increase in leverage should help in maintaining its long term growth trajectory.
- Although the cement industry is expected to be affected by Covid-19 related disruptions, Northern India is better placed in terms of cement price and utilisation levels benefitting cement players like Shree Cement.
- Shree Cement is one of the efficient cement player which should also benefit from lower key input costs like power & fuel and freight costs maintaining healthy OPM amidst weak demand in the near term.
- The company has also been focusing on improving upon its trade sales and premium products which should help in supporting demand while bulk demand remain subdued in the near term.

KNR Constructions

- KNR Constructions' divestment of its hybrid annuity model (HAM) projects along with one build-operate-transfer (BOT) project to Cube Highways is expected to help in lowering leverage and increased focus on EPC execution post normalcy from Covid-19 related disruptions.
- Strong order backlog as of Q3FY2020 end at 2.6x TTM standalone revenue provides comfort on earnings considering muted order tendering expectations in the infrastructure sector at least during H1FY2021.
- The company's experience of over two decades in project execution along with a conservative management profile adds credibility on sailing through the current tough environment in the sector.
- The company can gear up execution at a faster pace post normalcy as it has already received appointed dates for most of its HAM projects.

Specialty chemicals

Our stance: Positive

- The Covid-19 outbreak's impact on specialty chemical companies is expected to be lower as few of the products have been classified as essential products and the government has provided permission to run the manufacturing facilities taking all relevant precautions.
- Global players' (MNCs and innovators) confidence in souring materials from China has been lowered as China-faced several issues one after another such as i) environmental issues, ii) stringent regulatory issue, iii) US-China trade war issues and the latest iv) epicentre of the Coronavirus outbreak.
- The above factors have provided a significant opportunity for Indian players to move up its ranking in the vendors list of global players be it MNCs or innovators.
- The company in this space are well geared to tap the opportunity as they have been scaling up there capacity without relying much on external borrowing.

Preferred picks

1. **Aarti Industries**
2. **PI Industries**
3. **SRF**

Cont'd....

Aarti Industries

- Aarti Industries (Aarti) is a leading speciality chemicals company in benzene-based derivatives with a global footprint having integrated operations and high level of cost optimisation.
- The company has been investing in the right areas for building capabilities and richer client engagements, which would create a long-term moat in a booming industry.
- Multi-year growth levers are getting stronger, as the company has signed third multi-year contracts worth $125 million with global players for 10 years, though small in size but brings in new capabilities for long-term growth.
- The company expects significant growth prospects in sight, led by expansion and diversification plans and concerns over supplies from China. Though there could be some impact in Q4FY20 and Q1FY21, owing to lockdown due to Covid-19, however we believe the company to deliver healthy performance once the lockdown is lifted and things normalise.

PI Industries

- PI Industries focuses on developing complex chemistry solutions in agri-sciences with an integrated approach. The company currently operates a strong infrastructure setup, consisting of three formulation facilities and nine multi-product plants under its three manufacturing facilities.
- A strong custom synthesis manufacturing CSM order book of $1.4 billion at the end of Q3FY2020 provides healthy revenue visibility. Management foresees encouraging outlook for the CSM business as business sentiments improve globally for products, wherein the company operates.
- The company had outlined capex of Rs. 600 crore for FY2020 (Rs. 550 crore incurred till date) and Rs. 250-300 crore for FY2021E.
- As things normalise post the lifting of lockdown, we expect the company to deliver robust performance. With industry-leading return ratios and a healthy balance sheet and strong earnings visibility, we expect the stock to continue to trade at rich valuations.

SRF

- SRF is a chemical-based multi-business entity engaged in the manufacturing of industrial and specialty intermediates. The company's diversified business portfolio covers Technical Textiles, Chemicals (Fluorochemicals and Specialty chemicals) and Packaging Films.
- The management sees significant growth opportunities in agro chemicals and active pharma ingredients (developing two pharma molecules in collaborations with innovators). Considering strong buoyancy in the chemical
- The company generates a healthy operating cash flow and, hence, largely relies on internal accruals to fund its capex programme. Improved utilisation levels at expanded capacities would help in higher assets turnover as well as debt reduction. This augurs well for improved margin profile and higher return ratio.
- Though weakness in technical textiles and fluorochemicals exists currently owing to the slowdown in the automobiles sector, however we believe that the company will be able deliver healthy performance led by the speciality chemicals and packaging films.

Pharmaceuticals

Our stance: Neutral

- The Pharma sector is unlikely to be materially impacted by the Coronavirus pandemic. Major suppliers of bulk drugs (APIs) have resumed production.
- Recognising the potential risk of the supply disruption of drug shortages within the country, the government has quickly addressed all standing issues by ensuring movement of all essentials. If full manufacturing resumes by end of April, companies can recover a large portion of lost sales during the remainder of the year
- Covid-19 has disrupted manufacturing as well as pharma supply chains, creating drug shortages worldwide. As India is a leading manufacturer of generics, Indian Pharmaceutical companies are best positioned to cater the visible unmet need of global pharmaceutical industry, thus pointing towards high growth in exports.
- Given the cost-conscious nature of various of various exports markets, companies with a wider product portfolio and integrated value chain are expected to benefit.

Preferred picks

1. **IPCA**
2. **Divis Laboratories**
3. **Biocon**
4. **Laurus Labs**

IPCA

- IPCA is a fully-integrated Indian pharmaceutical company, manufacturing more than 350 formulations and 80 APIs for various therapeutic segments.
- There are various anti-viral drugs, immunotherapies and vaccines that are being tested and developed to treat COVID-19. However, HCQS (Hydroxychloroquine Sulphate) and chloroquine are among key drugs identified so far to fight COVID -19 and the results have shown efficacy.
- IPCA is one of the largest and vertically integrated manufacturers of HCQS and could potentially benefit from the opportunity. Strong order inflows point at potentially large order inflows.
- IPCA's balance sheet position with a liner debt equity levels. IPCA also has a strong return ratios profile with ROE of around 19%.

Divis Laboratories

- Divis is the leading manufacturer of active pharmaceuticals ingredients (APIs), intermediates and registered starting materials offering high-quality products with the highest level of compliance and integrity
- The recent outbreak of Corona virus leading to supply disruption from China has resulted in a hunt for an alternative sourcing base and global players are looking at India. Being a leading player in the API space with ample headroom to ramp up the production, benefits of backward integration accruing makes Divis a key beneficiary.
- Measures taken by the government of India such as setting up bulk drug manufacturing parks and faster environment clearance channel to boost API production in the country, would benefit players like Divis, though in the long term.
- Divis has a strong financial muscle. Earnings are expected to grow in strong double digits over the next 2 years. The debt:equity is quite low close to zero while the return ratios are also sturdy, with ROCE and ROE at 22.7% and 17,6%, respectively as at FY2020.

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Biocon

- Biocon is a fully integrated API manufacturing facilities, strong capabilities in biologics, innovative drug development and a branded generics business in India. It has built a strong presence in lucrative high-growth segments such as statins, immuno-suppressants and anti-diabetes drugs .
- Biologics business is expected to grow impressively going ahead. Commercialization of *Ogivri* in the US and Europe, USFDA approval for the new *Pegfilgrastim* plant at Bengaluru and expected launch of *insulin glargine* in the US in H2CY2020 would be key growth drivers
- The small molecules segment is also expected to grow by a healthy pace driven by new fillings in the active pharmaceutical ingredient (API) space, and traction in the generic formulations.
- Biocon's earnings are expected to grow impressively by around 30% CAGR over Fy20-FY22, which is on the higher side as compared to other players. A liner Debt equity position and marked improvement in the ROE points towards strong financials.

Laurus Labs

- Laurus is a leading research-driven pharmaceutical company, working with major generic pharmaceutical companies. The company's major focus areas include anti-retroviral, Hepatitis C, and Oncology drugs.
- Laurus is a prominent player in the API space and this augurs well as it could benefit from increased demand globally. Also the company is leveraging its strengths in the API space to forward integrate in to formulations.
- Robust growth in formulations business and a strong order book for CRAMs business, which would unfold over the near to medium term and provides ample growth visibility.
- A significant ramp up in the formulations would aid OPM expansion. A toned down capex, healthy debt equity points at strong balance sheet position. Improving profitability would enhance ROEs to 15% by FY22 from 11% in FY20.

BFSI

Our stance: Neutral

- Notwithstanding the RBI's relief, the pandemic's impact leading to higher credit cost could significantly dent profitability. Loan growth to be in mid-single digits for FY21E on a low base; opex curbs likely across players.
- NBFCs are impacted by decline in collections; faces challenges on asset-liability mismatch, rise in provisions and muted growth in FY21E. Housing Loans are relatively better off, but segments (ex. SME, Unsecured, affordable housing, etc) are likely to be impacted.
- For the insurance business, the renewal premiums growth is expected to be weak due to cashflow issues and an overall weak sentiment. Also, market linked plans incremental sales growth may be impacted.
- We prefer strong institutions, which have comfort of high capitalisation, strong balance sheets and customer segments, which are granular and are relatively to be less impacted by the lockdown.

Preferred picks

1. HDFC Bank
2. Kotak Mahindra Bank
3. HDFC Life

HDFC Bank

- HDFC Bank stands out with its earnings visibility, consistent growth (10-yr CAGR in advances of 23.5%, networth of 26% and a PAT CAGR of 25%) and robust quality of assets (GNPA/NPA% maintained at sub 2% / 0.8% levels respectively consistently) over a long period, which we believe still hold strong.
- The Coronavirus outbreak is expected to impact growth as well as asset quality of banks and NBFCs.
- HDFC Bank derives its strength from its retail loan portfolio (~48 % of total loan book), which despite tepid overall system-wide credit growth, has been growing well. Moreover, since 80% of its SME portfolio has additional collateral to cover the outstanding loans, 80% of wholesale is rated AA+ and above and, 80% of SME portfolio is self-funded that indicates that the bank's book quality is more resilient to the risks of slowdown.
- HDFC Bank currently trades at a reasonable valuation and recent market weakness has dragged down the stock price so much that at present, the stock is available at below its long term average 1-yr forward PBV multiple of 3.7x.

Kotak Mahindra Bank

- We believe that the bank remains an attractive business franchise, with well-rounded products and services. Consistent performance across interest rate and asset cycles is a key differentiator and indicates the management's quality and strength of the franchise. Its subsidiaries are shaping up well, the insurance subsidiary is expected to be a significant value contributor to the bank.
- The recent Coronavirus contagion is expected to impact growth as well as asset quality of banks and NBFCs, resulting in higher delinquencies across sectors.
- We believe that a healthy retail asset base along with industry best margins and well-maintained asset quality provide the bank with a strong and latent margin lever and an opportunity to explore other assets with lower risks.
- Kotak Mahindra Bank has corrected sharply and we believe valuations are now reasonable, and risk-reward in favour of long-term investors. Considering the bank's strong operating metrics as well as quality of its subsidiaries, we opine that at present valuations, the stock is attractive for long-term investment.

HDFC Life

- HDFC Life Insurance stands out among peers with its strong parent, robust brand recall along with sister concern bank which has an attractive retail business which gives it with deep client penetration.
- We believe HDFC Life's sustained product leadership will help it sustain superior VNB margins and operating Return on Embedded Value (RoEV), relative to peers, which provides support to its valuations.
- Insurance companies would be sensitive to bond downgrades, and if market volatility persists, the investment portfolios and investment earnings too may be impacted as well. HDFC Life has a well-diversified product portfolio, which has strong components of protection as well as savings plans, which we believe is should enable the company to see minimal impact due to shift in customer preferences.
- We believe that the Insurance market has significant growth opportunities and HLIC is well placed to capture them. HDFC Life, by virtue of its bancassurance partnerships, digital strength and industry leader status, should be able to deliver 18+% VNB and EVOP CAGR over the next 2-3 years.

Automobiles

Our stance: Neutral

- Lower economic growth due to the Covid-19 outbreak would impact discretionary purchases such as automobiles where demand is likely to be deferred.
- Rural areas would be relatively less impacted by Covid-19 as farming comes under essential services and would be relatively less impacted by the lockdown.
- We expect significant discounting in early phase by automotive companies to bring back customers. Negative operating leverage and higher discount would more than offset benefit of favourable commodity prices, thus impacting margins.
- We expect automotive sector recovery in FY22, as economic growth picks up post normalisation of business activity. We prefer companies which are less impacted by Covid-19 and companies having leadership position in respective segments with strong balance sheet, which would enable to comeback strongly once demand recovers.

Preferred picks

1. **M&M**
2. **Balkrishna Industries**

Cont'd....

M&M

- M&M is the market leader in tractors with market share of 40% and a leading player in utility vehicles and light commercial vehicles with market share of 20% and 40%, respectively.
- M&M would be relatively less impacted by Covid-19 as about 40% of revenues come from tractors (agriculture comes under essential category).
- While automotive demand would be impacted by Covid-19 in FY2021 in; M&M strategy of launching new products (all utility vehicles will have petrol variants) would drive volumes in FY22. Also, cash conservation strategy (recently company held back investment in loss making Ssangyong Motor) would help bounce back strongly when recovery happens.
- M&M's core business valuations at 8x FY22 are below long-term historical average of 14-15x and lower than 10.4x witnessed during global financial crisis. M&M debt: equity at 0.15x indicates a strong balance sheet.

Balkrishna Industries

- Balkrishna Industries would be relatively less impacted by Covid-19 as 67% of the revenues come from the agricultural segment which comes under essential category and will not be impacted by lockdown.
- Introduction of new products and enhancement of distribution network are key long-term drivers. Company plans to double its global market share to 10% over the next few years.
- A steep drop in crude oil prices would benefit Balkrishna Industries as about 35-40% raw material is crude linked and would boost margins
- Balkrishna has a sturdy balance sheet with stable working capital management and a debt to equity ratio of 0.3x (among the lowest debt in the tyres industry). Balkrishna also has strong return profile with a RoE and RoCE in the range of 18-20%.

IT Services

Our stance: Neutral

- The Covid-19 outbreak has caused supply disruptions to some extent and will also likely result in material deterioration in the demand environment in H1FY2021E. However, most IT companies have been able to get approvals to work from home (WFM) from their clients (over 95%), both offshore and onsite.
- We believe IT companies could potentially face delays in deal closures during next six months owing to travel restrictions, whose revenue contributes 3-4% to total revenue of tier-I IT companies.
- We expect a weak year in FY2021E owing to anticipated slowdown in global IT spending, the growth for the sector would bounce back in FY2022E once the situation get normalise.
- We preferred company having strong business model, long runway for growth, good dividend payout and reasonable valuation.

Preferred picks

1. TCS
2. Infosys
3. L&T Infotech

TCS

- TCS is among the pioneers of IT services outsourcing business in India and is the largest ($20,913 million revenue in FY2019) IT services firm in terms of export revenue. TCS is one of the preferred IT vendors for most *Fortune 500*/Global 1,000 companies.
- TCS has very limited direct exposure to the troubled vertical and regions (China, Italy) in the wake of COVID-19 outbreak. However, large banks could also push back discretionary work owing to travel restrictions and lower interest regime, which would impact revenue growth in FY2021E.
- Total consideration value (TCV) of deal wins is expected to be strong in Q4FY2020 despite travel restrictions in many countries, supported by Walgreen Boots deal and Phoenix. The stock trades at 17x FY2022E EPS, implies around 20% discount to valuations prevalent a month ago.
- We continue to like TCS on account of strength in its business model, consistency, solid execution and strong FCF generation profile.

Infosys

- Infosys’ digital revenue has reported strong growth momentum in the past few quarters and now contributes more than 41% to total revenue.
- Infosys had the best deal momentum and deal pipeline before the COVID-19 crisis. While this provides revenue visibility in the near-term, we believe the revenue growth in FY2021E will be impacted significantly owing to material deterioration in demand environment on account of business disruptions in the light of COVID-19 outbreak.
- The investigation resulting from whistleblower complaints has largely cleared by the company as well as the US SEC.
- Infosys is an industry leader with solid execution, available at reasonable valuations (14x FY2022 EPS) and a fairly attractive yield.

L&T Infotech

- Given L&T Infotech’s higher exposure to the BFSI and energy verticals (57% of total revenue), we believe the company could face challenges in the revenue growth in the near-term owing to spending moderation by clients in these verticals.
- However, the company has been biggest growth performer in the last three years and we expect it would outperform its peers in terms revenue growth during these challenging periods.
- We like the company given its consistency in large deal wins, focused execution, prudent account mining and a dynamic leadership team. LTI has won 21 large deals with a combined TCV of $978+ million in the past 14 quarters (1QFY17-3QFY20).
- We believe the recent 25%+ correction provides a good entry point to accumulate an efficiently managed scale player, however the relatively higher exposure to energy and BFSI verticals could weigh on the growth trajectory in FY2021E.

Telecom

Our stance: Neutral

- Covid-19 outbreak has limited impact on telcos' revenue, as their services are considered an essential service during the lockdown.
- With increased use of telecom services during lockdown (due to work-from-home, which is a viable alternative for several companies), telecom companies have benefited from the surge in demand for voice and data.
- Given the complete lockdown in India due to Covid-19, we believe telecom companies may see lower net subscriber additions in the next 2-3 months. With physical recharges being unavailable during the lockdown, there has been a shift to digital recharges to 30-40% currently from 15% in last 1-2 years.
- We believe there could be an industry-wide price action over the next 2-3 quarters as Vodafone attempts to survive amid regulatory/financial burden. This could be through an increase in ARPU, higher data bundle plans and minimum recharge plans.

Preferred picks

1. Bharti Airtel

Bharti Airtel

- Covid-19 outbreak has limited impact on Bharti Airtel's earnings. Bharti Airtel has recently announced that the company has extended free incoming calls until 17th April 2020 with additional Rs. 10 talk-time for its low income subscribers (80 million).

- However, increased voice as well as data consumption due to nationwide lockdowns would benefit the company in terms of higher recharge value .

- Bharti Airtel's financial position is relatively stronger than Vodafone Idea, which would help the company from the weakening of Vodafone Idea in telecom market. Even if Vodafone Idea survives going ahead, its weak 7-8 circles could benefit Airtel significantly over the coming 2-3 quarters in terms subscriber additions.

- Bharti Airtel has successfully retained/migrated its non-4G base to 4G despite intense competition from Reliance JIO. Given higher ARPU, subsiding competitive intensity and potential EBITDA growth over next 2-3 years, we remain positive on Bharti Airtel.

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