Fundamental Muhurat Picks

Samvat - 2077

November 2020

Wishing everyone Happy Diwali and a Prosperous Samvat 2077

Samvat 2076 belonged to mid & small caps even though most economy driven sectors and benchmark indices failed to deliver. In Samvat 2076 till date (i.e. 27 Oct'19 to 3rd Nov'20) the Sensex & Nifty-50 have risen by 2.6% & 1.6%, respectively. During the same period the Nifty Mid Cap 100 Index & BSE Small Cap Index have returned 6% & 11%, respectively. Two defensive sectors namely BSE Healthcare (up 49%) and BSE IT (up 41%) gave exceptional returns in Samvat 2076. Equity markets worldwide have gone through a roller coaster ride in this calendar year. For example the Nifty-50 fell 40% between January & March and then rose by 60% from the lows of March. The Nifty Mid Cap 100 Index was trading at a discount to Nifty-50 in terms of valuations at the start of Samvat 2076 but has now gone into premium. If Samvat 2076 belonged to defensive sectors and mid & small caps, will Samvat 2077 belong to the economy driven sectors and large caps?

The pandemic has accelerated the shift towards a digital economy. In Samvat 2076 the leadership shifted from banking to the technology sector. The Nasdaq Composite Index went up 33% while the Dow Jones Index has remained flat. When other economies went for massive fiscal stimulus India went slow which has impacted our GDP in June quarter. Now, when most European nations are going in for fresh lockdowns, Indian economy is recovering very fast and returning to normalcy. India has a chance to come out stronger and report healthy growth in CY21/Samvat 2077, provided we don't see a big second wave of Covid cases.

US markets rallied post elections even though it is a close contest. In the likelihood of a divided Congress the focus will turn towards the Federal Reserve to stir the economy. The ECB could also swing into action to protect the Euro zone from going into a double dip. Availability of a proper vaccine could be two quarters away. In between if the number of Covid cases go up during winter then we can expect further fiscal and monetary support coming from governments and central banks. Not sure whether the efficacy of the same medicine being repeated (i.e. stimulus and liquidity injunction) will have the same/desired results. At the start of Samvat 2076 the Nifty-50 was trading at 18x on 1 Yr Fw PE which has now gone to 22x on Fw PE as we are about to start Samvat 2077. The risk-reward balance is less attractive after the recent recovery in stock prices. The earnings yield of Nifty-50 works to 4.5% which is way below the 10 Yr. G-Sec yield of 5.9%. However, the very low global bond yields is supporting flows into risky assets like equities that is keeping valuations at elevated levels.

As we advance towards getting the vaccine (by middle of next year) and economy gets back to normalcy, we can expect the economy driven sectors to outperform the defensives in Samvat 2077. Banks, NBFCs, automobiles, oil & gas, telecom, utilities, capital goods, cement and metals could come into focus in Samvat 2077. The potential upside in most of these sectors based on our one year price targets ranges between 20 & 39% (Vs single digit potential upside in Nifty-50). Since most of the economy driven sectors are prone to market correction one should have an accumulation strategy in them rather than investing at one go.
Happy Investing, Happy Samvat 2077.

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Top 10 Muhurat Picks

Company	Rating	Price (Rs) 04-Nov-20	Fair Value (Rs)	Upside (%)	Mkt cap. (Rs bn)	EPS (Rs) FY22E	EPS (Rs) FY23E	EPS growth (%) FY22E	EPS growth (%) FY23E	P/E (X) FY22E	P/E (X) FY23E	P/B (X) FY22E	P/B (X) FY23E	RoE (%) FY22E	RoE (%) FY23E
Axis Bank	BUY	525	600	14.3	1,607	42.8	53.7	24.5	25.4	12.3	9.8	1.5	1.4	12.3	13.9
Bajaj Auto	BUY	2,927	3,900	33.2	847	184.5	216.1	19.7	17.1	15.9	13.5	3.6	3.2	23.4	24.9
L&T	BUY	940	1,300	38.3	1,320	62.9	76.1	86.9	21.0	14.9	12.3	1.8	1.6	12.5	13.9
Ambuja Cements	BUY	264	300	13.5	525	14.4	17.4	18.0	20.5	18.3	15.2	2.1	1.9	11.8	12.9
ITC	BUY	170	260	53.1	2,089	12.5	13.8	17.9	9.8	13.5	12.3	3.1	3.0	22.3	24.1
Bajaj Finserv	BUY	5,812	8,000	37.6	925	425.3	528.0	57.5	24.1	13.7	11.0	2.5	2.2	19.9	21.2
SBI Life Insurance	BUY	791	1,100	39.1	791	20.8	23.6	16.9	13.1	38.0	33.6	7.1	6.0	20.1	19.3
Infosys	BUY	1,094	1,400	28.0	4,660	48.9	55.4	12.0	13.2	22.4	19.7	5.7	5.2	27.0	27.6
Hindustan Zinc	BUY	214	295	37.9	904	20.3	22.7	14.7	11.8	10.6	9.4	2.8	2.8	26.9	30.1
Bharti Airtel	BUY	453	710	56.7	2,472	10.2	21.4	NM	NM	44.6	21.2	4.2	3.7	9.5	18.4

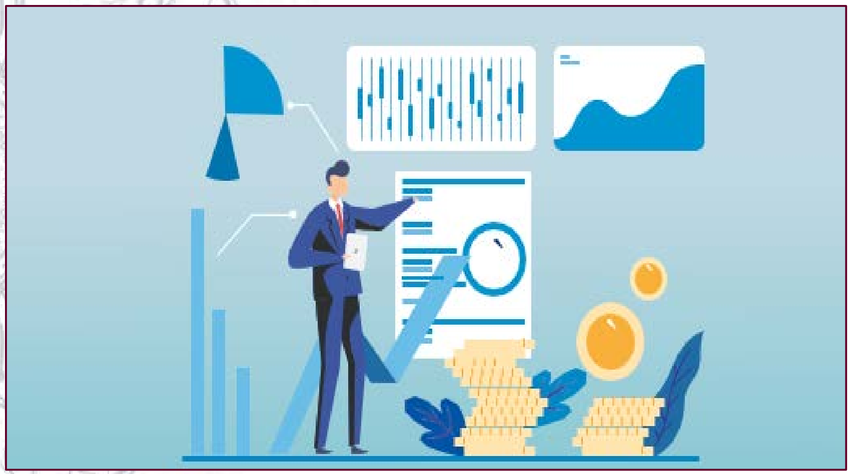
Source: Companies, Kotak Institutional Equities estimates

The above valuation summary is taken from Kotak Institutional Equities (KIE) India Daily report which is available on our website at: https://mtrade.kotaksecurities.com/research_report/recommendation/indiadaily.html.

Detailed company reports are available on our website at: https://www.kotaksecurities.com/ksweb/ResearchCall/Fundamental.

Axis Bank (AXSB) – BUY

CMP: Rs.525	Target: Rs.600
Time: 12 Months	Upside: 14.3%



Investment Argument:

- Axis Bank's 2QFY21 core operating profit growth was ~20% yoy driven by 11% yoy revenue growth on the back of 20% yoy Net interest income (NII) growth.
- In 2QFY21, loan growth was 11% yoy. Net interest margin (NIM) improved to 3.6% largely on lower cost of funds down which was down to 4.6%. Cost-to-income ratio trended down to 38% in 2QFY21 (vs 42% in FY20)
- Asset quality was stable in 2QFY21 but stressed book has increased due to Covid. Gross Non-performing loans (NPLs) went down to 4.2% & Net NPL to 1% in 2QFY21. We expect Gross NPLs to decline in the medium term.
- Retail loans as percentage of overall loans has gone up from 45% in FY17 to 53% as on 2QFY21. CASA ratio of 44% is in line with peers. We expect overall NIMs to remain at ~3.5-3.6% in FY22-23E.
- We like the bank for its superior franchise at inexpensive valuation and believe it would come out of this crisis relatively stronger
- We expect earnings growth of 24.5% in FY22E and 25.4% in FY23E. Axis Bank trades at 1.5x FY22E book value. We are valuing the bank at 1.9x book and ~15x on September 2022E Earnings per share for RoEs (Return on equities) of ~12% in FY22E and ~14% in FY23E

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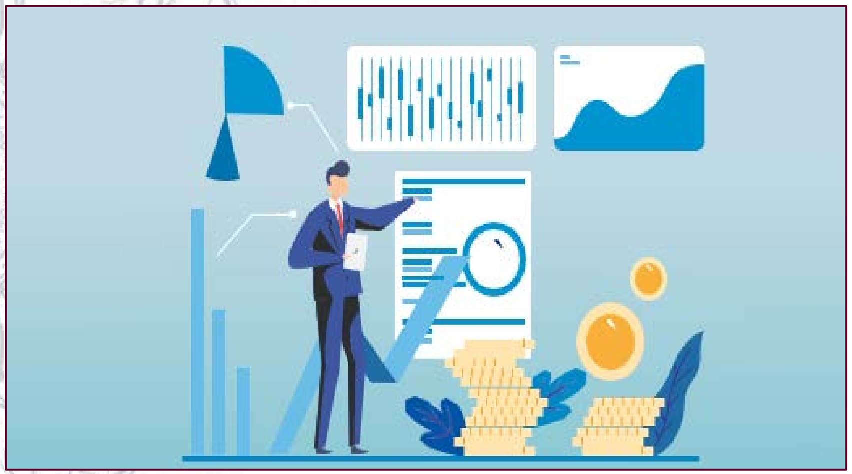
Bajaj Auto (BJAUT) – BUY

CMP: Rs.2927	Target: Rs.3900
Time: 12 Months	Upside: 33.2%



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Investment Argument:

- Domestic motorcycle retail demand has reached 90% of the last year levels and export motorcycle retail demand has reached 90-95% of the last year levels for the company, which is encouraging.
- The company will be following a three-fold strategy to gain market share in the domestic two wheeler market – aggressive product launches in 125 cc segment, retaining dominant position in sports motorcycle segment and providing innovative offerings in top-end of entry motorcycle segment.
- Strong long-term growth potential in export geographies where the company has already established itself as a formidable player. We expect export volume mix to improve to 52% in FY23E from 47% in FY20.
- Company is able to maintain operating margins in current challenging times. In 2QFY21, company reported operating margin of 17.7% (+110 bps yoy and +440 bps qoq).
- We expect company's sales volume to grow by 20.5% in FY22E and 14.6% in FY23E. We expect gross profit per vehicle to improve to Rs21,154 in FY2023E from Rs19,307 in FY2020 led by richer mix in the domestic two wheeler segment and improvement in export mix.
- Our Sum of Total Parts (SoTP) based fair value stands at Rs3,900. We value standalone business at Rs3,788 per share based on Discounted Cash Flow (DCF) methodology and add Rs112 for company's stake in KTM.

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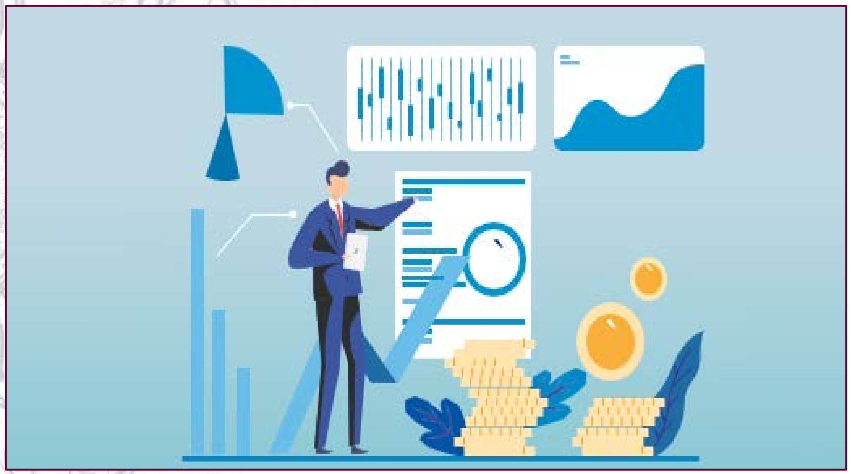
L&T (LT) – BUY

CMP: Rs.940	Target: Rs.1300
Time: 12 Months	Upside: 38.3%



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Investment Argument:

- Sharp improvement in Engineering & Construction revenues on qoq basis was led by improving manpower availability and easing of supply chain issues. Performance is still down yoy but is expected to improve sharply during 2HFY21.
- L&T indicated a strong prospect pipeline of Rs6.1 lakh cr spread across domestic (Rs4.8 lakh cr) and international (Rs1.3 lakh cr), which should start materializing in coming quarters with bunching up of a few orders.
- We envisage a meaningful recovery in 2HFY21 based on (1) a strong order inflow pipeline and (2) favorable gross margin trends sustaining.
- Existing order backlog can drive a 25% yoy growth in execution in absence of supply-chain issues.
- While domestic market contributes majority of order inflow and backlog, L&T is achieving diversification in regions beyond Middle East.
- Net working capital as percentage of sales has remained flat qoq during the quarter on improved collections from government which resulted in improving operational cash flows during the quarter.
- We expect profits to grow by 86.9% and 21.0% in FY22E/FY23E, respectively.
- The stock trades at sub-12x/sub-10x FY2020/22 core E&C earnings.

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Ambuja Cements (ACEM) – BUY

CMP: Rs.264	Target: Rs.300
Time: 12 Months	Upside: 13.5%

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Investment Argument:

- Expansion plans and cost-saving projects provide a strong growth visibility. Company is increasing capacity in North India, the most profitable region in the country.
- Company's 3QCY20 standalone earnings were significantly above our and consensus estimates on higher volumes and lower costs. We believe the renewed focus on the MSA with ACC, after various management changes in the last one year, is reaping benefits.
- We expect standalone business volume growth of 15% in CY21E and 13% in CY22E and capacity utilization increase from 76% in CY20E to 93% in CY22E.
- We estimate earnings per share (EPS) to grow at a compounded annual growth rate (CAGR) of 19% over CY20-22E led by capacity expansion which will drive volume CAGR of 14% in the same period.
- Company has a net cash equivalent to ~17% of market cap and 4-7% free cash flow (FCF) yield in CY20-22E.
- Strong growth visibility, a robust balance sheet and attractive va luations. Stock is trading at a steep discount to its 10-year mean of 13x EV/EBITDA (Enterprise Value / Earnings Before Interest, Taxes, Depreciation & Amortization) and peers. Our Fair Value of Rs300/share is based on 8.5x EV/EBITDA December 2022E financials.

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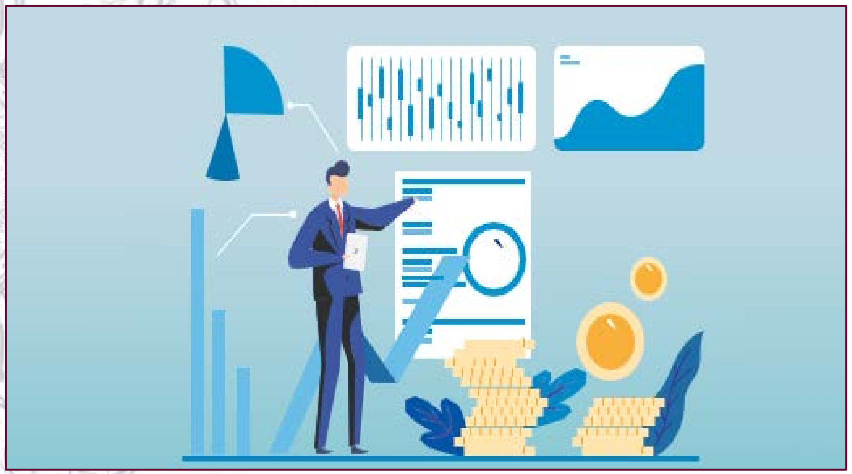
ITC (ITC) – BUY

CMP: Rs.170	Target: Rs.260
Time: 12 Months	Upside: 53.1%



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Investment Argument:

- Cigarette volume dipped a bit in July and Aug (after normative levels in June) due to local lockdowns but have picked up again in September.
- FMCG core portfolio (75% of FMCG ex-stationery) is tracking well except for slight moderation in biscuits. ITC has been able to develop strong brands in select categories. New Product launches have picked up momentum in the past few years.
- Discretionary/out of home (OOH) portfolio is witnessing some recovery (lower salience of juices/deo's in Q2 would also help optically).
- Stationery sales continue to be depressed as schools are shut and weakness in topline continues for hotels but losses likely to moderate as compared to Q1 levels.
- We believe concerns around cigarette taxation in view of stretched government finances and rising focus on ESG-compliant investment are more-than-adequately priced in.
- The stock offers a good combination of (1) inexpensive valuations (13X Sep 22E PE), (2) healthy dividend yield (6%) and (3) promise of solid LT growth in FMCG. We do not see any structural negative emerge for ITC from the ongoing pandemic.
- Recommend buy with a sum of the parts (SOTP) based fair value of Rs 260.

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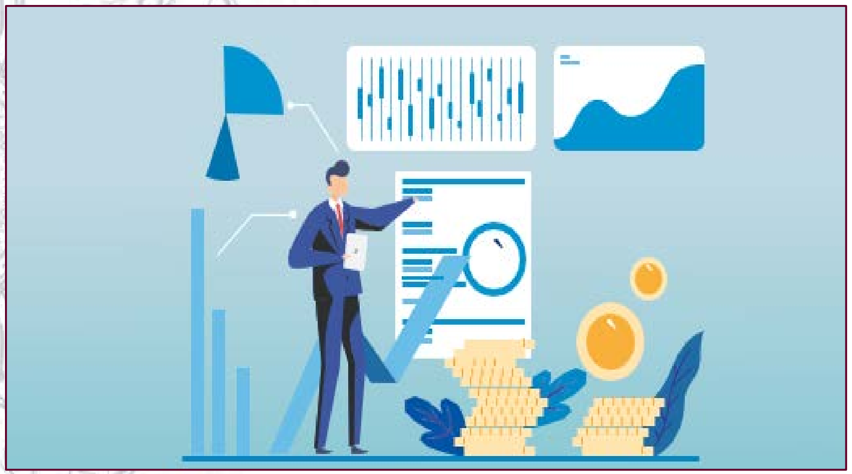
Bajaj Finserv (BJFIN) – BUY

CMP: Rs.5812	Target: Rs.8000
Time: 12 Months	Upside: 37.6%



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Investment Argument:

- In 2QFY21, Bajaj Life Individual annual premium equivalent (APE) was up 19% yoy. Strong growth in high-margin non-par business (1.5x yoy) led to ~1.1x yoy growth in gross value of new business (VNB) in 1HFY21.
- Expect Bajaj Life to deliver pre-overrun VNB margins of ~23% in next two years.
- In 2QFY21, Bajaj General reported combined ratio of 97.4% (Down 5.3% yoy). Profit after tax growth was 13% yoy. Claims ratio improved 0.9% yoy to 70.8% with most reduction in motor (Down 3% to 65%). Lower expense ratio also boosted earnings.
- We expect ~26% yoy increase in VNB (pre cost overrun) in FY21E on the back of 5% yoy increase in APE and 380 bps yoy margin expansion in Bajaj Life. In Bajaj General, we expect combined ratio to decline 3.8% yoy to 97% in FY21E.
- Performance of the both subsidiaries were encouraging & Bajaj Finance adds 67% of total value to Bajaj Finserv. Holding company discount for Bajaj Finance remains high at >50%. Bajaj Finserv remains our preferred vehicle to play Bajaj Finance.
- We are rolling over our fair value to Rs8,000 (September 2022E) from Rs7,600 earlier. We value the Bajaj General business at 4X book (lower than valuation of 4.7X book for ICICI Lombard) and Bajaj Life at 1.4X embedded value (EV), lower than our fair value multiples of ~2-3.8X EV for mature listed peers.

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SBI Life Insurance (SBILIFE) – BUY

CMP: Rs.791	Target: Rs.1100
Time: 12 Months	Upside: 39.1%

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Investment Argument:

- In 2QFY21, SBI Life reported 0.5% yoy/0.2% qoq expansion in value of new business (VNB) margin to 18.9% on the back of sharp growth in the protection business at 70% yoy; individual protection was up 58% yoy.
- SBI Life's solvency ratio increased to 245% in 2QFY21 as compared to 195% in 2QFY20, higher-than-regulatory requirement of 150% and internal threshold of 180%.
- We expect SBI Life's VNB margins to expand 0.3% yoy to 19% in FY21E and further increase to 21% by FY23E led by (1) increasing share of protection mix, (2) pick-up in growth of high-margin non-par savings post slowing down in 2Q & (3) margin expansion in protection and non-par businesses.
- Embedded value was up 21% yoy in 2QFY21. VNB margin expansion should support operating Return on Embedded Value (RoEV) at 16-17% in FY21-23E. Expect Return on Equity (RoE) to be healthy at 20% in FY22E and 19.3% in FY23E.
- We expect improving business momentum in 2nd half. Strong persistency trends will cushion operating variance. Revival in APE growth from 2HFY21E (up ~25% yoy led by 5% yoy increase in 3Q and 10% qoq increase in 4Q; ~15-16% over FY22-23E).
- SBI Life trades at 2.1X & 1.8X Price/EV (Embedded value) on FY22E & FY23E, respectively. We value the business at 2.8X EV on September 2022E

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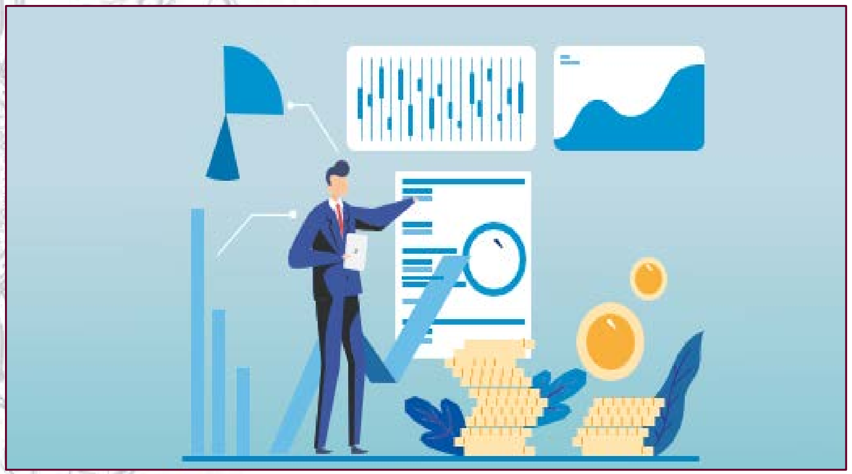
Infosys (INFO) – BUY

CMP: Rs.1094	Target: Rs.1400
Time: 12 Months	Upside: 28.0%



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Investment Argument:

- Infosys impressed with excellent results and a significant beat on revenues, EBIT (Earning before interest and tax) and net profit in Q2FY21.
- Infosys delivered strong sequential revenue growth of 4% in constant currency in 2QFY21. Company has raised revenue growth and margin guidance for FY21E.
- Infosys' new deal wins hit a new high of US$270 cr. Net new deals at US$270 cr was 2.2x of the previous high achieved in Sep-18. Infosys won 16 large deals, highest ever.
- Large deal pipeline remains strong as clients look to accelerate digital transformation programs and focus on automation and cost efficiency.
- FY21 EBIT margin guidance band is raised to 23-24% from 21-23% earlier. We have raised FY21-23 EPS estimate by 8-9% after 2QFY21 results.
- We expect earnings to grow by 12.2% in FY21E, 12.0% in FY22E and 13.2% in FY23E.
- We expect Return on Equity of 26.8% in FY21E, 27% in FY22E, & 27.6% in FY23E.
- Infosys to lead the industry on growth with success in strategic priorities viz: scaling digital, large deal success, sales and marketing augmentation driving better account mining and stability in management ranks.
- We value the stock at 25x December 2022E EPS.

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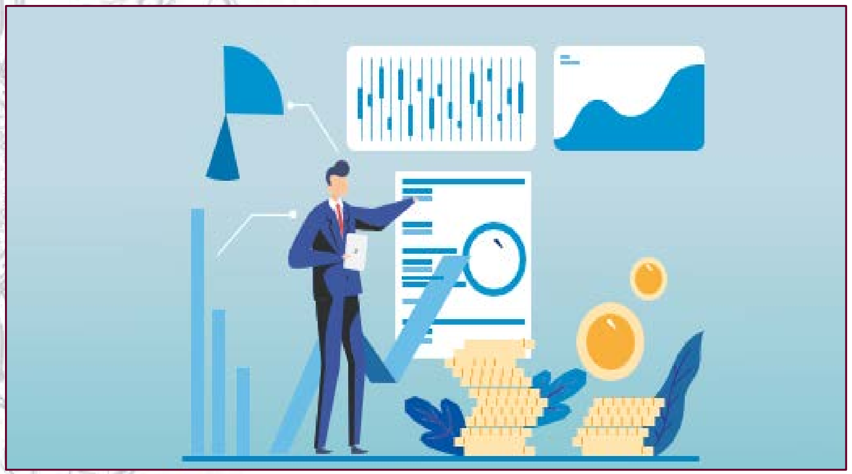
Hindustan Zinc (HZ) – BUY

CMP: Rs.214	Target: Rs.295
Time: 12 Months	Upside: 37.9%



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Investment Argument:

- Hindustan Zinc's (HZ) 2QFY21 revenues increased by 25% to Rs.5,660 cr led by higher metal volumes & silver prices. Volumes increased by 8%/30%/51% yoy for zinc/lead/silver.
- Stronger than expected demand recovery in China, mine supply disruptions, buoyant sentiments and higher liquidity supported 30% increase in zinc prices from March lows.
- HZ 2QFY21 operating profit (i.e. EBITDA) of Rs.2,952 cr increased 43% yoy mainly led by 43% yoy higher silver prices and lower zinc cost of production. Zinc cost of production (CoP) fell sequentially to US$ 919/ton in 2QFY21 (-12% yoy & -10% qoq).
- HZ mined metal capacity would increase from 1 mtpa to 1.2 mtpa in FY21E. We expect volume growth of 8% in FY21 and 14% in FY22.
- The Board has approved an interim dividend of Rs21.3/share. We expect dividend yield of 10% and 9.5% in FY21 and FY22, respectively.
- HZ's strong growth visibility, high payout, Free cash flow yield and inexpensive valuation suggest attractive risk-reward. Our Fair Value works to Rs.295 at an unchanged 8x EV/EBITDA on Mar'22E. EV stands for Enterprise Value & EBITDA stands for Earnings Before Interest, Tax, Depreciation & Amortization.

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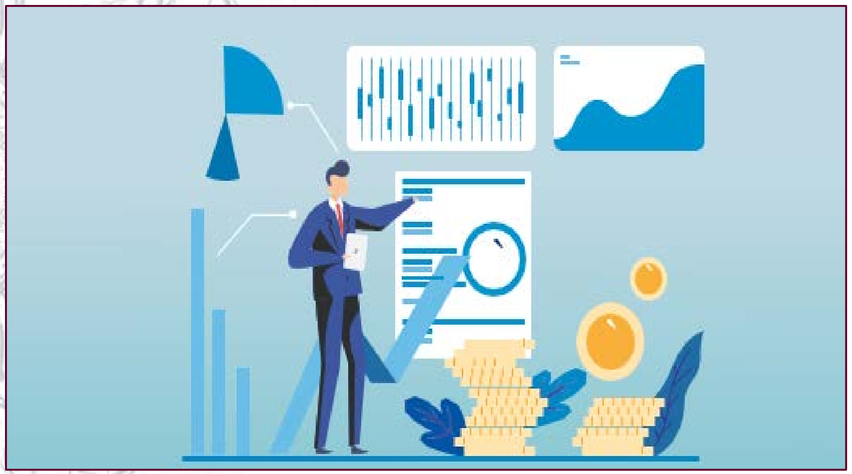
Bharti Airtel (BHARTI) – BUY

CMP: Rs.453	Target: Rs.710
Time: 12 Months	Upside: 56.7%



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Investment Argument:

- We believe Bharti remains a solid medium-term bet on (1) improvement in sector fundamentals (regardless of whether the end game is a 2-player structure or a 3-player one) and (2) sustained solid execution.
- Management said that the current tariffs are still at low levels. They have guided for Average Revenue Per User (ARPU) to move to Rs200 in the short term and Rs300 in the medium term.
- We expect Bharti to report free cash flow of Rs17,227 cr during FY21-23E period. Bharti has sufficient cash on books with no liquidity issues. Bharti can look at asset opportunities but the decision for the same will not be based on pressure to reduce net debt.
- Bharti is looking to develop new streams of revenues and drive efficiencies through its digital platform. Besides this, the company is also seeing good growth in the enterprise solutions and has recently launched Airtel IQ, a cloud-based omni-channel communications platform.
- 2QFY21 was a stellar quarter for Bharti's India wireless business on all counts. It added overall 1.39 cr net customers. In 2QFY21, Bharti reported revenue of Rs25,785 cr, EBITDA of Rs11,642 cr (margin of 45.2%) and PBT of Rs609 cr.
- We value the stock on Sum of the parts (SOTP) & arrive at a fair value of Rs710.

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Rating Scale (Private Client Group)

Definitions of ratings

BUY	–	We expect the stock to deliver more than 15% returns over the next 12 months
ADD	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
REDUCE	–	We expect the stock to deliver -5% - +5% returns over the next 12 months
SELL	–	We expect the stock to deliver < -5% returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	–	We advise investor to subscribe to the IPO.
RS	–	**Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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