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India Market Strategy

Unlevered stocks best picks in tremulous market

March 2020

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Recent market correction, driven by global turmoil, has put Nifty valuations (at 15.5x one-year forward)) at an attractive level. While recent policy measures comprising the corporate tax cut and dividend tax exemption are unlikely to spur private capex in the near term, we see value in cash-rich PSUs (ONGC, IOCL, GAIL) that are likely to deploy tax savings toward higher dividends or buybacks. In the longer run, we expect financials, consumption (including autos), and oil & gas sector to fuel a 20% Nifty EPS CAGR (FY20-FY22), forming the bedrock of our new model portfolio.

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Tax cuts unlikely to impel private capex in near term: Private sector capex has nosedived 40% YoY to Rs 1.3tn in Q3 and 49% YoY in 9MFY20. Our analysis suggests that adoption of the new tax regime (NTR) offers little impetus to capex as only a handful of companies are looking to reinvest the savings amid a dull economic climate. Our case study of the 2017 Trump tax cut further shows only a transient positive impact on capex levels of S&P 500 companies (+18% YoY in 2018), soon disrupted by China trade tensions in 2019 (–13% YoY). That said, buybacks/dividends of these players touched all-time highs in 2018.

Cash-rich companies best bets on NTR…: In the initial phase of NTR adoption, we see value in cash-rich companies (mostly PSUs – some of them already offering >7% yields), as they look to pass on the tax benefits to shareholders via dividends and/or buybacks. Dividend distribution tax (DDT) exemption makes for an even stronger investment proposition. Based on our screen for high dividends, cheap valuations (<10x FY22E EPS) and strong profitability (>15% ROE), we find ONGC, IOCL, GAIL and Coal India attractive among PSUs.

…as also select high P/E stocks: Eicher Motors (EIM) and Bajaj Auto (BJAUT) also stand out despite high multiples (>15x P/E), given their robust return ratios (>25% ROCE), low leverage (<0.5x D/E) and cash flow edge from NTR migration. These themes form the core of our newly launched BOBCAPS Model Portfolio (Fig 20).

Nifty valuations seem to be close to a bottom: We appear to be passing through a protracted sluggish phase in the market (~5% annualised return since Jun'17), with Nifty P/E derating from 21x to 16x one-year forward earnings. Barring a major global crisis such as that seen in 2008, the Nifty has typically bottomed out at ~15x levels (~10,000 levels based on current earnings estimates). We believe earnings momentum from NTR adoption, followed by higher dividends or share buybacks could trigger a rise above 20x P/E by FY22 (>13000 levels).

BOBCAPS MODEL PORTFOLIO KEY PICKS

	Overweight	Underweight
Autos	Eicher Motors	Mahindra & Mahindra
	Maruti Suzuki	
Financials	Bajaj Finance	IndusInd Bank
	ICICI Bank	
	Kotak Mahindra Bank	
Energy	GAIL	Bharat Petroleum
	Indian Oil	NTPC
	Petronet LNG	
Pharma	Cipla	Sun Pharma
	Laurus Labs	Dr. Reddy's
	Alembic Pharma	
IT	HCL Tech	Tech Mahindra
	L&T Infotech	Wipro
Infra	PNC Infrastructure	Larsen & Toubro
	KNR Constructions	

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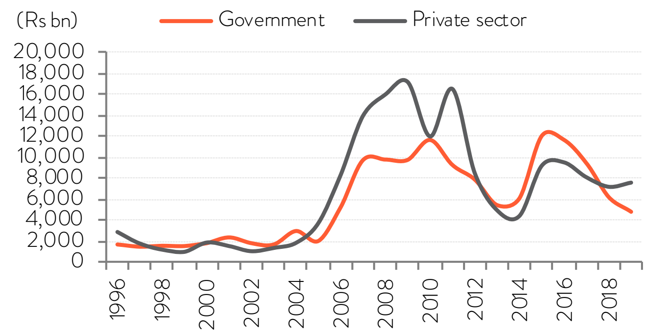
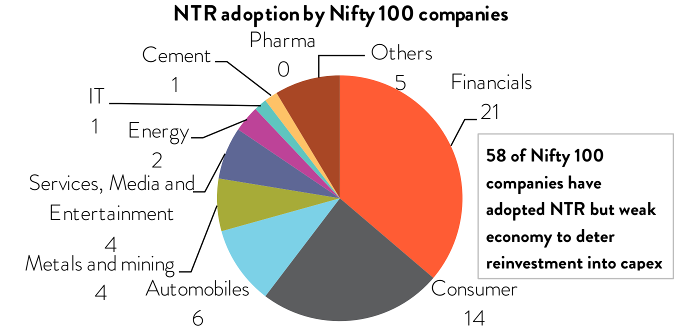
Focus charts

FIG 1 – SLUMP IN CAPEX CYCLE



Source: CMIE, BOBCAPS Research | Refers to New Project capex

FIG 2 – TAX CUTS UNLIKELY TO KICKSTART CAPEX



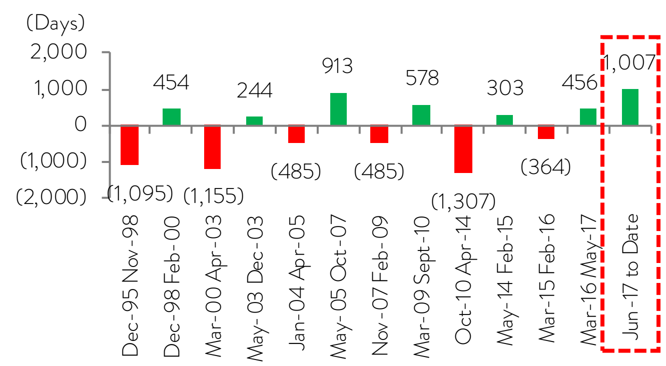
Source: Company, BOBCAPS Research

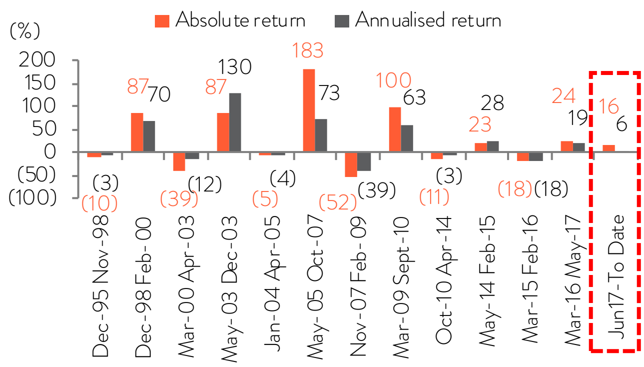
FIG 3 – TAX SAVINGS MORE LIKELY TO RESULT IN HIGHER DIVIDENDS/BUYBACKS: PREFER SELECT CASH-RICH PSUs AND HIGH P/E STOCKS

Company	P/E (x)		P/B (x)		ROE (%)	ROCE (%)	D/E (x)	Dividend yield (%)		
	FY20E	FY21E	FY20E	FY21E				FY19	FY20E	FY21E
Undemanding and unlevered (<15 P/E, <0.5X D/E)										
Coal India	5.3	5.1	2.7	2.3	68.99	68.99	0.00	8.3	10.7	11.6
GAIL (India)	7.0	6.2	0.9	0.8	14.72	14.2	0.02	3.8	4.9	4.9
IOCL	6.4	5.4	0.7	0.7	16.64	9.3	0.94	9.3	5.1	7.5
ONGC	3.6	3.2	0.4	0.35	14.74	13.01	0.12	9.4	9.4	9.7
Expensive, unlevered and high-profit (>15 PE, >20% ROCE, <0.5X D/E)										
Bajaj Auto	13.8	12.4	2.6	2.3	22.6	22.6	-	2.3	2.7	2.9
Eicher Motors	21.2	17.4	4.0	3.4	33.2	32.7	-	0.7	0.7	0.9
HCL Technologies	12.3	11.2	2.6	2.3	28.5	28.1	-	0.9	2.1	3.0
HDFC Asset Mgmt	39.4	34.2	14.0	11.9	35.0	35.0	-	0.4	1.3	1.5
Infosys	16.3	14.9	3.3	4.1	24.6	24.6	-	2.5	3.3	3.8
TCS	20.7	18.9	7.2	6.7	40.5	40.4	-	1.5	3.3	3.2

Source: Bloomberg, BOBCAPS Research

FIG 4 – ANALYSIS OF NIFTY BULL & BEAR RUNS





Source: Company, BOBCAPS Research | ■ : Bull phase; ■ : Bear phase

Near-term capex recovery unlikely

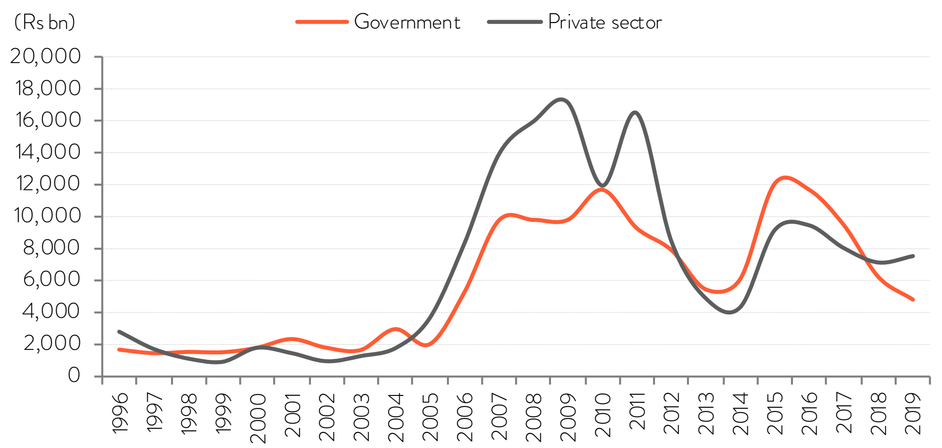
- Industry-wide capex in India has slumped 29% YoY in 9MFY20 as spending from both public and private sectors has come under pressure.
- In a bid to revive private capex, the government cut corporate tax rates from 30% to 25% from Sep'19. But our analysis suggests that most adoptees of the new tax regime are unlikely to plough incremental earnings back into the business.
- A study of corporate behaviour post the 2017 US tax cut shows an immediate surge in dividends/buybacks but only a transient fillip to capex.
- We believe India would need additional incentives to boost consumption, essential to complete the loop of reforms for capex turnaround. But given the current weak fiscal environment, the Centre's only option is to compromise on fiscal deficit targets to revive economic growth.

Persistent slump in capital expenditure

Excluding large aircraft orders, private capex has declined 40% YoY to Rs 1.3tn in Q3FY20 and 49% YoY in 9MFY20. Capital outlay by the government has also plunged 44% for the nine-month period (to ~Rs 2tn). Nonetheless, the government has maintained its capex target of Rs 3.5tn for FY20RE (+13% YoY) and intends to raise spends to Rs 4.1tn in FY21BE (+18% YoY).

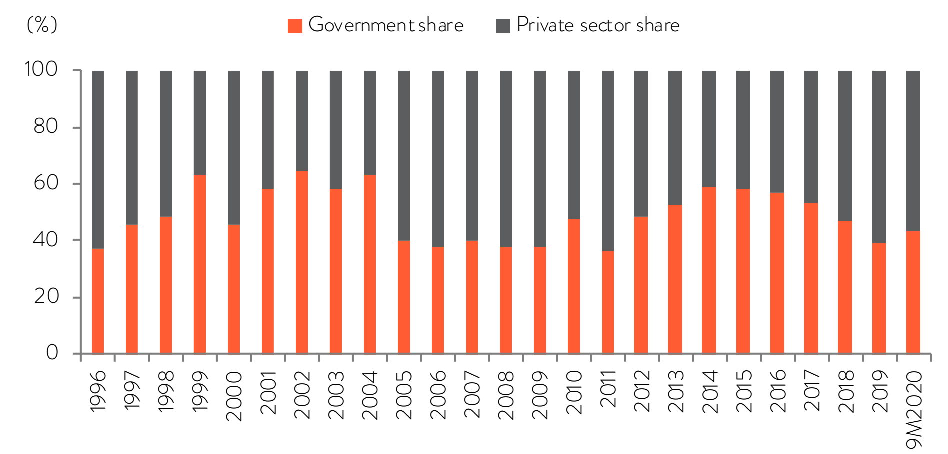
Additional outlay from internal and extra budgetary resources (IEBR) is also projected to rise to Rs 6.7tn, with major allocation towards railways, roads, transport and highways. This could augur well for the investment cycle over the longer term and subsequently for GDP trends over FY21-FY22.

FIG 5 – CAPEX TRENDS (NEW PROJECTS)



Source: CMIE, BOBCAPS Research

FIG 6 – CAPEX COMPOSITION



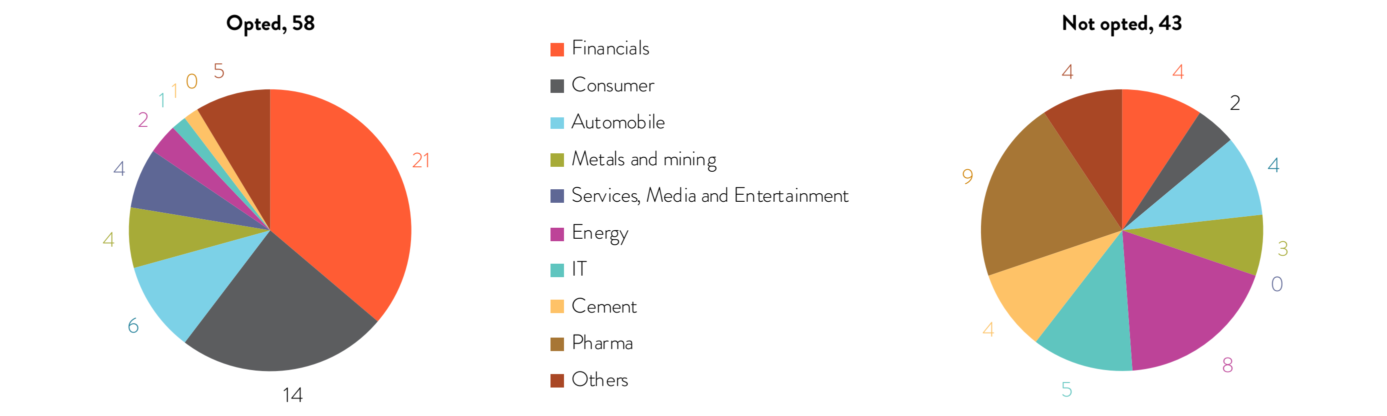
Source: BOBCAPS Research, Company

NTR adoption yet to kickstart capex upcycle

Initial trends indicate that the new corporate tax regime (NTR) introduced in Sep'19 has not yet translated to any near-term capex recovery in the economy, especially from the private sector. While ~58 companies among the Nifty 100 have opted for NTR, the current anaemic demand climate (that has resulted in underutilised capacities) implies it will be awhile before India Inc reinvests the tax savings into their business.

Most public sector enterprises have not migrated to the new regime. Even if they do opt in, the incremental earnings will likely be paid out as dividends in light of the government's dire need for revenue in the face of widening fiscal slippage.

FIG 7 – ADOPTION OF NTR AMONG NIFTY 100 COMPANIES



Source: Company, BOBCAPS Research

FIG 8 – ADOPTION OF NTR ACROSS KEY SECTORS

	Sector-wise NTR adoption (Low/High)	Management commentary on tax savings deployment	Reason for delayed migration to NTR
TECHNOLOGY, INTERNET	Low adoption among tech services	NA	ETR well below 25% given benefits from SEZ schemes that carry MAT credit entitlement
	High adoption for ecommerce players	**Reinvestment** in lateral businesses, expansion	–
CEMENT	Low adoption	NA	Unused MAT credits on earlier investments; potential decision in FY22 subject to FY20-FY22 investment plans ETR >30% for Nifty 100 cement players (ex-Ambuja, ACC, Shree Cement) implies likely migration to NTR
AUTOMOBILES	High adoption for two-wheeler and passenger vehicle OEMs, and for auto ancillaries	**Reinvestment** especially by OEMs towards new hybrid/EV tech; high discounts imply benefits need not be passed on	–
	Low adoption for CV-heavy OEMs – Ashok Leyland, Tata Motors, M&M	NA	Availability of MAT credits and other investment deductions
CONSUMER GOODS	High adoption (ex-Godrej Consumer, Dabur which have MAT credits)	Pass-along of benefits unnecessary because price changes strategically led by product value proposition – per management commentary DDT exemption makes case stronger for MNCs (Nestle, P&G) to pay out higher dividends	–
FINANCIALS	Low adoption for PSUs	NA	Carry-forward losses from NPA provisioning
	High for private banks	**Reinvestment**	–
	High for NBFCs	**Reinvestment**	–
	Low for insurance companies (ex-ICICI Lombard)	NA	ETR < 20%; awaiting clarity from IRDAI on DTA asset adjustments. Most insurance players expected to adopt NTR by FY21
METALS & MINING	Mixed adoption for PSUs		
	▪ NMDC – Yes	**Reinvestment**	–
	▪ Coal India – No	NA	Evaluating unused MAT credits. Likely to adopt NTR later (FY20/FY21) as ETR >34%

	Sector-wise NTR adoption (Low/High)	Management commentary on tax savings deployment	Reason for delayed migration to NTR
	Mixed adoption for private players		
	▪ Tata Steel/Vedanta group – **Yes**	**Deleveraging**	–
	▪ Hindalco, JSW Steel – **No**	NA	Unused MAT credit
PHARMACEUTICALS	**Low** adoption	NA	Unused MAT credit. Expected to migrate to NTR by FY22
SERVICES, MEDIA & ENTERTAINMENT	**High** adoption	**Dividend payout** for Concor and Siemens (latter for cash transfer to German parent) **Reinvestment** for consumer-facing companies IndiGo, Page Industries, Zee Ent	–
OIL & GAS	**Low** adoption for PSUs and RIL	NA	Unused MAT credit. RIL's ETR among the lowest at ~25%. Likely adoption by FY21/ FY22 due to ETR >30%
	State PSUs (Gujarat Gas, Gujarat State Petronet) have opted in	**Reinvestment** into the business	–

Source: BOBCAPS Research | ETR – Effective Tax Rate, MAT – Minimum Alternate Tax, NTR – New Tax Regime

Case study: US tax cuts yielded capex boost, albeit briefly

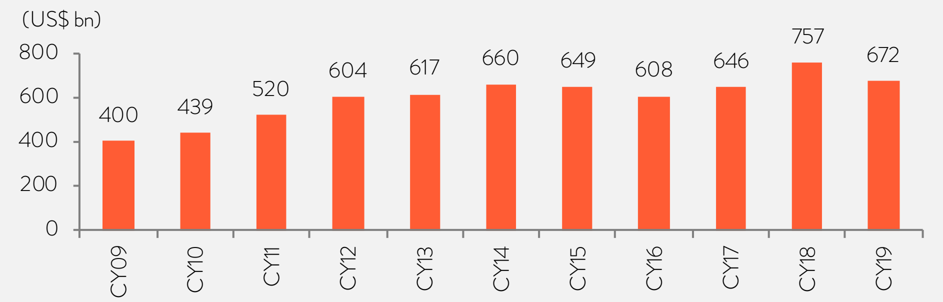
Corporate tax cut proposal – from global to territorial tax system

- In 2017, the corporate tax rate in the US was lowered from 35% to 21%, while some related business deductions and credits were reduced or withdrawn. The corporate alternative minimum tax was also eliminated.
- The US further moved from a global to a territorial tax system with respect to corporate income tax. Instead of a corporation paying the US tax rate for income earned in any country (less a credit for taxes paid to that country), each subsidiary pays the tax rate of the country in which it is legally established.
- In other words, under a territorial tax system, the corporation saves the difference between the generally higher US tax rate and the lower rate of the country in which the subsidiary is legally established.

Buybacks/dividends surged post-cut; capex followed

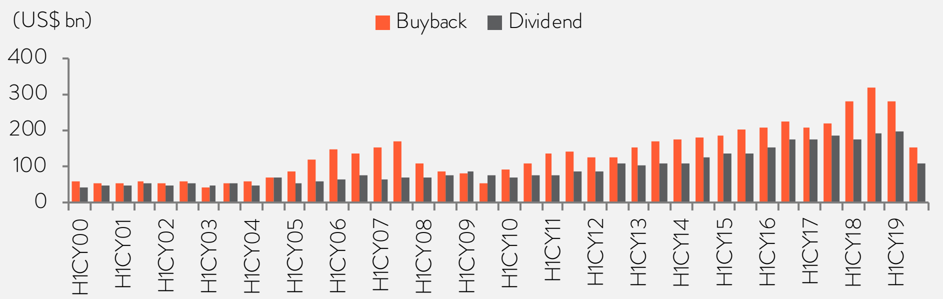
- Immediately after the Sep'17 tax cut announcement, S&P 500 companies deployed historical high levels of cash totalling US$ 965bn (+22% YoY) towards buybacks (US$ 600bn) and dividends (US$ 364bn) in 2018. This, however, tapered down to US$ 735bn (–24% YoY) in 2019.
- Capex levels among S&P 500 companies also picked up with a slight lag, to US$ 756bn (+17% YoY) in 2018 – again a historical high. But this momentum was abruptly halted by escalation of the US-China trade dispute, leading to a reversal in capex trend to ~US$ 672bn (–13% YoY) in 2019.

FIG 9 – S&P 500 CAPEX TREND



Source: Bloomberg

FIG 10 – S&P 500 DIVIDENDS + BUYBACKS



Source: Company, BOBCAPS Research

Limited fiscal headspace to prop up consumption

Government-led incentives to boost consumption (demand) are crucial to complete the loop for capex revival. However, our analysis of the fiscal math indicates the Centre has limited headroom to bolster demand.

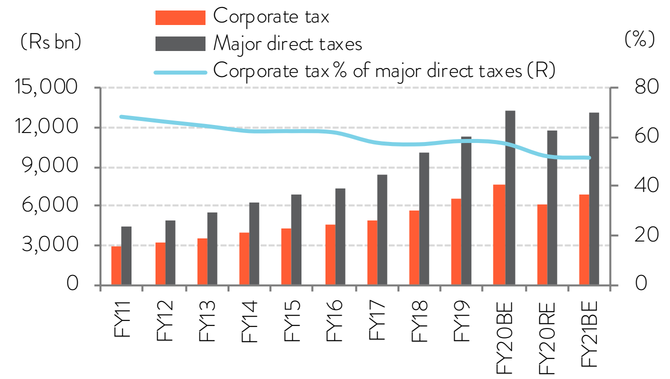
- The government has guided for **fiscal deficit** at 3.8%/3.5% in FY20/FY21, overshooting fiscal glide targets of 3.5%/3.0%.
- **GST collection** guidance for FY20 has been slashed by ~Rs 2tn as the monthly inflow is well below initial estimates. The Centre expects a 16% increase to Rs 14.8tn in FY21BE which appears challenging given the ongoing economic slowdown – we estimate a shortfall of ~Rs 1tn for FY21.
- The **corporate tax collection** target has also been revised down by 8% for FY20RE to Rs 6.1tn (–8% YoY), after factoring in the impact of NTR. Surprisingly, a ~12% improvement to Rs 6.8tn is baked in for FY21BE though ~43% of Nifty 100 companies (including many cash-rich PSUs) are yet to adopt NTR – implying likely underperformance on this front as well.
- **Income tax collection** for FY20RE is pegged at Rs 5.6tn, up 18% YoY, with slower 14% YoY growth to Rs 6.4tn in FY21BE – attributed to the cut in personal tax rates. We believe the economic downturn will amplify the adverse impact.
- The **divestment** target of Rs 2.1tn (FY21RE) also looks difficult to achieve given that only ~Rs 360bn has been mopped up in FY20 YTD vs. Rs 650bn targeted. Apart from BPCL, Air India and Concor, the government now plans to raise ~Rs 900bn by listing LIC. With rollover of the ~Rs 500bn BPCL stake sale into FY21, dependence on divestment to meet the fiscal deficit target has surged to 26%. Further delays (most likely Air India and LIC IPO) could drive a major fiscal slippage and dent government capex plans.

FIG 11 – REVISED GST COLLECTIONS

(Rs mn)	FY20BE	FY20RE	Chg (%)	FY21BE	YoY Chg (%)
State GST	8,091,330	6,560,461	(18.9)	7,841,809	19.5
Central GST	6,633,430	6,123,270	(7.7)	6,905,000	12.8
Total GST	**14,724,760**	**12,683,731**	**(13.9)**	**14,746,809**	**16.3**

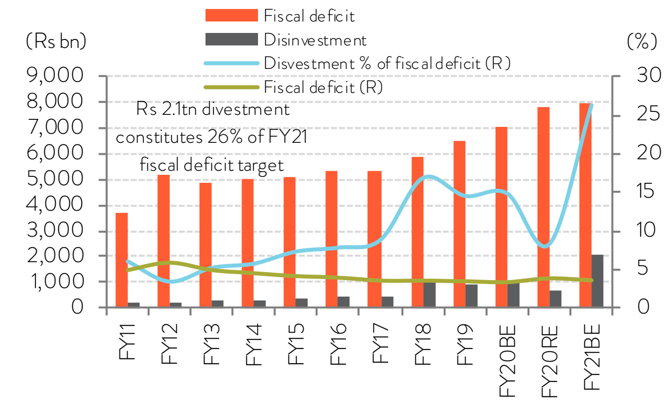
Source: Company, BOBCAPS Research

FIG 12 – DIRECT TAX COMPOSITION



Source: Company, BOBCAPS Research

FIG 13 – DISINVESTMENT VS. FISCAL DEFICIT



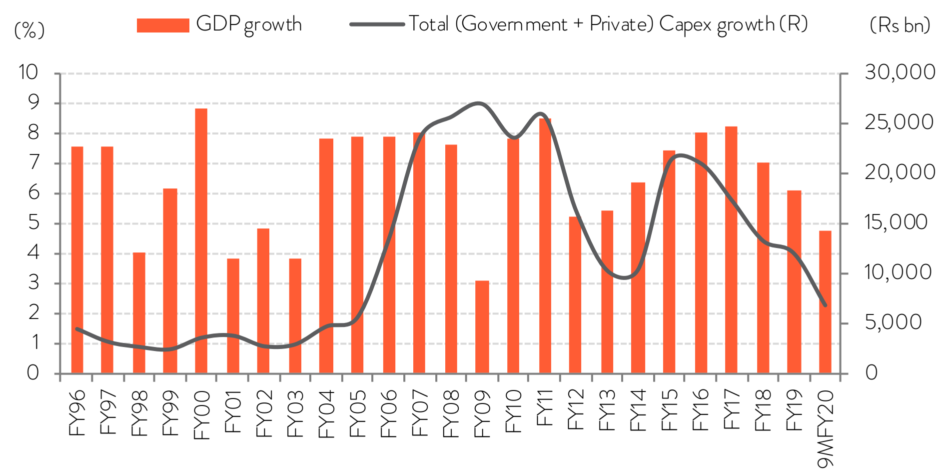
Source: Company, BOBCAPS Research

GDP vs. capex

Historically, the relationship between capex and GDP growth has been largely inconclusive. However, from FY10 onwards, both metrics have exhibited a closer correlation (Fig 10). GDP projections by Sameer Narang, our Chief Economist at Bank of Baroda, indicate a reversal in India's economic slump from FY21 (see **India's Road to Recovery**). Primary drive of a GDP revival is expected to be government spending.

Stronger GDP growth in FY21, estimated at 5.5% vs. 5.0% for FY20, would be led by (1) higher government spending backed by strategic divestments, (2) better credit availability in the economy, in particular with NBFCs and, (3) stronger consumption – rural (terms of trade) and tax cuts.

FIG 14 – GDP GROWTH VS. CAPEX



Source: Company, BOBCAPS Research

Unlevered companies ideal bets in current climate

- As argued earlier, savings from NTR (as also DDT) are unlikely to be reinvested until the economic revival is in sight. Instead, cash-rich players (mostly PSUs) are most likely to pass on the tax benefits to shareholders via dividends and/or buybacks – thus, such companies make for the best investments at this juncture.
- When we combine higher dividends with undemanding valuations (<15x FY22E EPS) and strong profitability (above 10% ROE), the investment proposition becomes even more appealing. ONGC, IOCL, GAIL and Coal India look compelling based on these parameters.
- A few companies trading at higher multiples (>15x P/E) also look attractive when we screen for robust return ratios (>20% ROCE), low leverage (<0.5x D/E) and cash flow advantage from NTR adoption. Eicher Motors and Bajaj Auto stand out in this context.
- We would avoid highly levered players (>1x D/E) despite their migration to NTR, as tax benefits could be diluted toward reducing leverage. Debt levels may also rise further if the economic climate worsens.

Select cash-rich PSUs offer value...

PSUs (<0.5x leverage) such as ONGC, IOCL, GAIL and Coal India stand out among the Nifty 100 as fundamentally strong picks, considering their attractive P/E (<8x on FY22E), healthy profitability (>10% RoCE) and high dividend yields (>7%). Apart from NTR-led higher potential dividends, the case for owning cash-rich PSUs has become even stronger following the announcement of DDT exemption.

Though the transfer of DDT liability to investors (at marginal tax rate) reduces the attractiveness of dividend yields, PSUs and MNCs may explore the option of grossing up payouts to the extent of DDT savings.

FIG 15 – CASH RICH WITH UNDEMANDING VALUATIONS (<15X P/E, <0.5X D/E)

Company	P/E (x)		P/B (x)		ROE (%)	ROCE (%)	D/E (x)	Dividend yield (%)		
	FY20E	FY21E	FY20E	FY21E				FY19	FY20E	FY21E
Aurobindo Pharma	8.6	8.1	1.4	1.2	14.35	10.35	0.40	0.5	0.6	0.7
BPCL	9.9	9.4	1.8	1.6	19.74	11.34	0.79	4.5	3.1	3.9
Cadila Healthcare	16.2	14.6	2.1	1.9	19.33	14.22	0.35	1.4	1.2	1.3
Coal India	**5.3**	**5.1**	**2.7**	**2.3**	**68.99**	**68.99**	**0.00**	**8.3**	**10.7**	**11.6**
G A I L (India)	**7.0**	**6.2**	**0.9**	**0.8**	**14.72**	**14.2**	**0.02**	**3.8**	**4.9**	**4.9**
Grasim Industries	13.4	11.2	0.6	0.6	6.83	6.36	0.08	1.1	1.0	1.1
Hero Motocorp	11.3	10.1	2.6	2.4	27.54	27.54	0.00	4.4	4.7	4.8
Hindalco Industries	6.6	5.9	0.5	0.5	2.13	1.47	0.44	0.8	1.0	1.0
Hindustan Zinc	8.3	7.6	1.8	1.7	22.73	21.93	0.08	12.6	7.5	8.0
IOCL	**6.4**	**5.4**	**0.7**	**0.7**	**16.64**	**9.3**	**0.94**	**9.3**	**5.1**	**7.5**
L & T Finance	7.3	6.2	1.1	0.9	3.39	2.74	0.28	1.1	1.2	1.6
M&M	10.6	9.3	1.1	1.0	13.97	12.87	0.08	1.8	1.9	2.0
NHPC	6.5	5.9	0.6	0.5	7.33	4.42	0.66	3.5	8.0	8.5
NMDC	4.6	4.5	0.8	0.7	18.45	18.14	0.01	6.6	7.4	7.5
ONGC	**3.6**	**3.2**	**0.4**	**0.35**	**14.74**	**13.01**	**0.12**	**9.4**	**9.4**	**9.7**
Petronet LNG	9.7	9.2	2.5	2.2	21.79	19.63	0.07	2.0	4.6	4.9
Tata Steel	5.7	5.1	0.5	0.4	15.45	10.85	0.41	4.0	3.4	3.3
Vedanta	5.4	4.7	0.6	0.5	6.15	4.02	0.54	19.9	12.2	15.0
Zee Entertainment	9.8	8.7	1.6	1.4	25.59	21.23	0.16	1.8	2.0	2.2

Source: Bloomberg, BOBCAPS Research

Many of the cash-rich public sector companies have been trading at historical-low single-digit P/E ratios due to worries over cash utilisation (as cash is usually diverted to fund government divestment plans). Investor concerns have been exacerbated in the current climate of high fiscal slippage risk and heavy budgetary reliance on divestment. That said, the only way for the government to achieve its divestment targets is to ensure optimum fundamentals for PSUs (by avoiding unnecessary M&A and supporting high dividend payouts), which could normalise their beaten down valuations.

We prefer **GAIL** and **IOCL** among the PSU pack from an earnings and valuation standpoint. GAIL could offer upsides from value unlocking through the proposed demerger and pipeline asset monetisation. Recent crash in oil prices augurs well for OMCs, however IOCL stands out as per metrics mentioned earlier.

We remain Neutral on **Coal India** and **ONGC**, as per views generated by our fundamental research team, and considering their high dividend potential. In our view, the worst is over for ONGC (equal weight) in terms of cash utilisation headwinds post the HPCL acquisition.

...along with some high P/E stocks

A few companies trading at higher multiples (>15x P/E) look attractive when we screen the Nifty 100 for high return ratios (>20% ROCE) and low leverage (<0.5x D/E). Consumer-facing (auto, FMCG) and IT services companies are the obvious choices on these parameters (Fig 17).

Auto companies offer value as industry fundamentals are expected to improve from H2FY20 due to the base effect. Our top picks within this space are **Eicher Motors** and **Bajaj Auto,** given their added cash flow advantage from NTR adoption. We also prefer **TCS, HCL Tech** and **Infosys** in the IT space and **HDFC AMC** among financials.

FIG 16 – EXPENSIVE, UNLEVERED, HIGH-PROFIT (>15 PE, >20% ROCE, <0.5X D/E)

Company	P/E (x)		P/B (x)		ROE (%)	ROCE (%)	Dividend yield (%)		
	FY20E	FY21E	FY20E	FY21E			FY19	FY20E	FY21E
Asian Paints	53.6	45.8	14.3	12.5	25.7	25.7	0.6	0.7	0.9
Bajaj Auto	**13.8**	**12.4**	**2.6**	**2.3**	**22.6**	**22.6**	**2.3**	**2.7**	**2.9**
Britannia Industries	44.8	39.2	12.7	10.6	30.8	30.7	0.5	0.7	0.8
Dabur India	45.2	40	11.4	9.9	30.8	28.7	0.6	0.8	0.9
Divi'S Laboratories	34.5	27.8	6.4	5.4	20.6	20.3	0.7	0.6	0.7
Eicher Motors	**21.2**	**17.4**	**4.0**	**3.4**	**33.2**	**32.7**	**0.7**	**0.7**	**0.9**
Godrej Consumer Products	34.7	30.4	7.2	6.5	36.7	36.7	1.6	1.4	1.6
HCL Technologies	**12.3**	**11.2**	**2.6**	**2.3**	**28.5**	**28.1**	**0.9**	**2.1**	**3.0**
HDFC Asset Mgmt	**39.4**	**34.2**	**14.0**	**11.9**	**35.0**	**35.0**	**0.4**	**1.3**	**1.5**
Hindustan Unilever	52.8	45.3	24.9	22.1	83.4	83.4	1.0	1.2	1.5
ITC	13.3	12	3.1	2.9	23.1	23.1	3.2	4.1	4.7
Infosys	**16.3**	**14.9**	**3.3**	**4.1**	**24.6**	**24.6**	**2.5**	**3.3**	**3.8**
Marico	29.2	26.5	9.6	8.8	28.7	27.6	1.8	2.0	2.3
Oracle Financial Services	11.8	11.1	3.8	4.2	32.2	32.2	5.4	6.0	6.9
Page Industries	50.0	42.3	22.3	18.7	49.4	45.1	1.4	0.9	1.1
Pidilite Industries	57.8	50.1	14.6	12.3	22.2	22.2	0.4	0.5	0.6
Tata Consultancy Services	**20.7**	**18.9**	**7.2**	**6.7**	**40.5**	**40.4**	**1.5**	**3.3**	**3.2**
Tech Mahindra	12.8	11.4	2.5	2.3	21.7	21.6	2.0	2.5	2.9

Source: Bloomberg, BOBCAPS Research

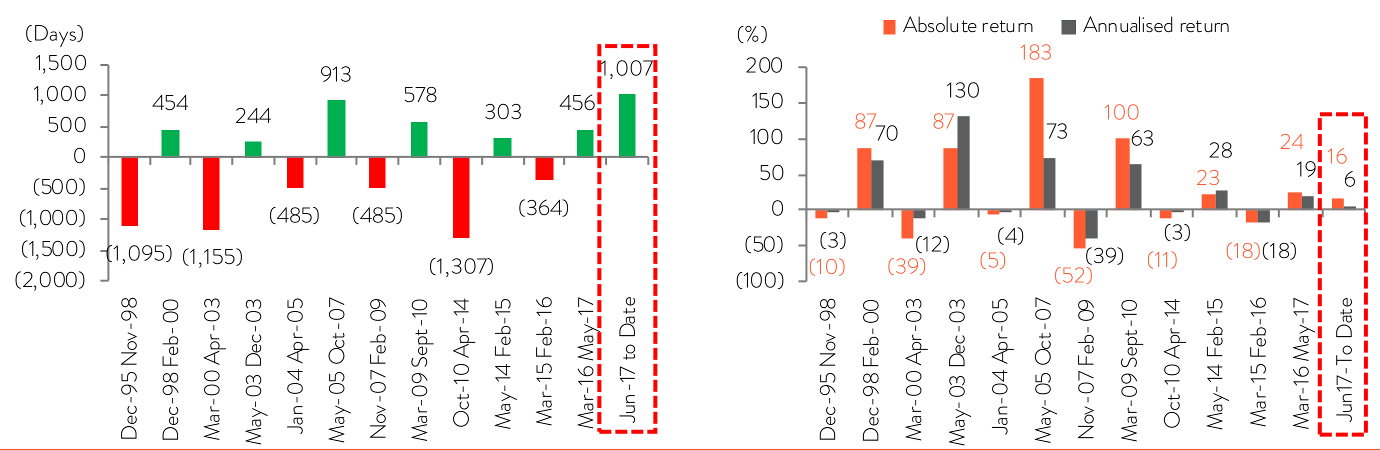
Nifty valuations seem to be close to a bottom

- Our analysis shows that Nifty P/E has swung through sharp expansions and reversals during every bull and bear phase respectively – usually peaking at 22-24x and bottoming at 15-17x.
- At current levels of 15x one-year forward earnings, Nifty valuations appeared to have bottomed given above range.
- Earnings momentum on the back of NTR adoption, higher dividends and/or buybacks (amplified by DDT exemption) could trigger a rise in Nifty P/E above 20x by FY22 (>13000 levels).

Bear phases longer but bull phases stronger

An interesting analysis emerges when we categorise historical Nifty 50 movement into bull and bear cycles. Bear phases usually last longer, roughly twice that of bull phases. However, absolute movement in the Nifty during bull runs outweighs bear phases by a similar ratio of ~2:1, realigning markets into net positive return territory at the end of every bull run.

FIG 17 – NIFTY BULL & BEAR RUNS

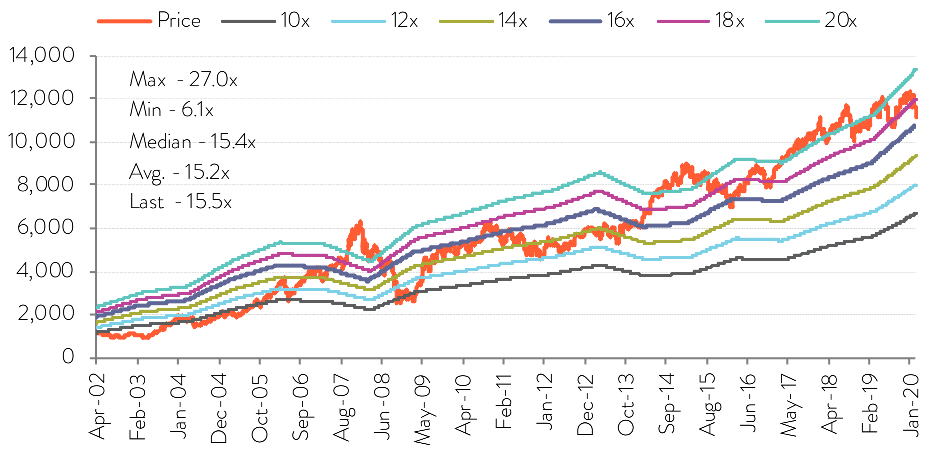


Source: Company, BOBCAPS Research | ■ : Bull phase; ■ : Bear phase

Striking P/E shifts in each phase

Sharp changes in Nifty P/E are a key feature of every bull and bear run – these are usually driven by changes in (1) earnings expectations, (2) economic fundamentals, and/or (3) liquidity conditions. Similar to absolute returns, P/E expansion in bull phases is much steeper than the contraction in bear phases. On average, the market has bottomed out at 15-17x one-year forward P/E over the last decade (6x being the historical low) and peaked out at 21-23x (27x being the historical peak).

FIG 18 – NIFTY 50 P/E BAND



Source: Bloomberg, BOBCAPS Research

Expect >20x Nifty P/E in FY22

We appear to be passing through a protracted sluggish phase in the market (~5% annualised return since Jun'17), with Nifty P/E derating from 21x to 16x one-year forward earnings. Barring a major global crisis such as that seen in 2008, the Nifty has typically bottomed out at ~15x levels (~10,000 levels).

We expect Nifty valuations to rerate to >20x by FY22, translating to 13,500-14,000 levels. We further estimate a ~23% earnings CAGR over FY20-FY22 assuming (1) economic recovery from H2FY21, and (2) consequent earnings pick-up as high-frequency macro indicators start to improve (auto sales, oil/gas consumption). In the near term, the recent crash in oil prices could shore up India's fiscal balance and help restrict the downside in Indian markets.

We believe auto, oil PSU and consumer companies will be the biggest earnings drivers – consequently, they form the core of our newly introduced BOBCAPS Model Portfolio.

BOBCAPS model portfolio

- We build our model portfolio by assigning a higher preference for low-levered companies that offer value either through undemanding valuations or high profitability that could potentially expand multiples.
- The portfolio is benchmarked to the Nifty 50 and its constituents determined based on stocks identified by our BOBCAPS Research team.

Top picks

- In our view, select cash-rich PSUs offer deep value and provide multiple levers for returns, the most critical being (1) high dividend yields (>7%) and (2) the normalisation of P/Es as investor concerns recede (20-50% potential returns).
- Among private companies, our key picks among **large-caps** are Reliance Industries, Bajaj Finance, ICICI Bank, Eicher Motors, Maruti Suzuki, HCL Tech and Cipla (heavy overweight ideas vs. Nifty 50).

  Key **mid-cap** picks in our model portfolio are Petronet LNG, Laurus Labs, L&T Infotech, PNC Infrastructure and KNR Constructions.

FIG 19 – KEY SECTORAL PICKS | ■ : SECTOR/STOCK OVERWEIGHT; ■ : SECTOR/STOCK UNDERWEIGHT

Autos	Financials	Energy	Pharma	IT	Infrastructure
▪ Eicher Motors ▪ Maruti Suzuki	▪ Bajaj Finance ▪ ICICI Bank ▪ Kotak Mahindra Bank	▪ GAIL (India) ▪ Indian Oil ▪ Petronet LNG	▪ Cipla ▪ Laurus Labs ▪ Alembic Pharma	▪ HCL Tech ▪ L&T Infotech	▪ PNC Infrastructure ▪ KNR Constructions
▪ Mahindra & Mahindra	▪ IndusInd Bank	▪ Bharat Petroleum ▪ NTPC	▪ Sun Pharma ▪ Dr. Reddy's	▪ Tech Mahindra ▪ Wipro	▪ Larsen & Toubro

Source: BOBCAPS Research

Model portfolio

FIG 20 – BOBCAPS MODEL PORTFOLIO (BMP)

Company	Nifty weight (%)	BMP weight (%)	Earnings CAGR (FY20-FY22E)	ROE (%)	ROCE (%)	P/E (x)	
						FY21E	FY22E
Bajaj Auto	0.8	0.8	9.5	22.6	22.6	13.8	12.44
Eicher Motors	0.5	2.0	14.6	27.6	27.1	21.2	17.4
Hero MotoCorp	0.6	0.0	12.5	27.5	27.0	11.3	10.0
Mahindra & Mahindra	1.0	0.0	4.2	13.8	9.8	10.6	9.3
Maruti Suzuki India	1.8	2.5	3.0	17.1	17.1	25.2	20.3
Tata Motors	0.6	0.7	210.0	(37.0)	(14.5)	6.6	4.7
Automobiles	**5.3**	**6.0**					
Grasim Industries	0.6	0.6	13.3	3.1	3.7	13.4	11.2
UltraTech Cement	1.0	0.9	23.2	8.9	7.2	24.1	20.1
Shree Cement	0.6	0.0	20.5	10.8	9.6	37.6	32.7
Cement	**2.2**	**1.5**					
Larsen & Toubro	3.2	0.0	16.8	15.2	6.3	13.4	11.4
PNC Infra	0.0	1.5	37.4	11.9	12.6	NA	NA
KNR Constructions	0.0	1.0	(5.3)	19.2	19.9	12.5	11.5
Infrastructure & Construction	**3.2**	**2.5**					
Asian Paints	1.6	1.6	16.4	24.1	22.7	53.7	45.8
Britannia Industries	0.7	0.7	14.9	30.3	28.8	44.9	39.1
Hindustan Unilever	2.7	2.7	22.0	79.9	79.4	52.8	45.4
ITC	4.1	4.1	8.6	22.6	22.9	13.5	12.0
Nestle India	1.15	1.1	16.4	70.3	72.3	57.6	51.7
Titan	1.0	1.0	25.3	25.2	18.7	52.3	42.5
Consumer	**11.2**	**11.2**					
Bharat Petroleum Corporation	0.8	0.0	15.4	20.7	11.8	10.7	9.3
GAIL (India)	0.5	1.3	13.0	14.9	14.3	7.1	7.5
Indian Oil Corporation	0.6	1.0	24.3	15.4	9.9	6.1	6.0
NTPC	1.1	0.0	14.3	11.8	6.4	9.6	7.6
Oil & Natural Gas Corporation	0.9	0.9	7.8	14.4	11.0	3.5	4.1
Power Grid Corporation of India	0.9	0.9	9.9	17.7	8.6	10.5	8.3
Petronet LNG	0.0	1.5	(4.3)	22.3	22.0	15.0	10.4
Reliance Industries	9.8	9.9	24.6	11.6	8.5	19.8	12.8
Oil & Gas	**14.5**	**15.5**					
UPL	0.6	1.0	27.1	12.2	7.1	17.1	11.6
Agrochemicals	**0.6**	**1.0**					
Axis Bank	3.4	3.4	37.7	7.6	2.1	13.7	10.6
Bajaj Finance	2.2	3.2	34.2	22.5	4.4	29.0	22.2
Bajaj Finserv	1.1	1.5	21.4	14.5	5.1	21.5	16.6
HDFC Bank	11.0	9.5	15.8	17.0	7.3	18.8	15.6
HDFC	8.3	8.0	14.1	15.9	4.8	21.0	16.0
ICICI Bank	6.9	7.0	46.4	3.8	1.5	15.1	15.9
IndusInd Bank	1.8	1.5	29.3	13.1	4.8	16.7	8.9
Kotak Mahindra Bank	4.5	5.0	19.4	14.1	6.8	42.3	28.4
State Bank of India	2.6	2.6	40.6	5.9	2.4	40.0	8.1

Company	Nifty weight (%)	BMP weight (%)	Earnings CAGR (FY20-FY22E)	ROE (%)	ROCE (%)	P/E (x)	
						FY21E	FY22E
BFSI	**42.0**	**41.6**					
HCL Technologies	1.2	2.0	10.4	24.8	24.9	12.3	11.2
Infosys	5.3	5.0	10.1	23.7	23.7	16.3	14.9
Tata Consultancy Services	4.5	4.5	9.5	35.2	32.3	20.7	18.9
Tech Mahindra	0.9	0.0	21.19	22.0	19.7	12.8	11.4
L&T Infotech	0.0	1.0	14.2	28.1	37.5	18.4	16.2
Wipro	0.7	0.0	5.1	17.2	14.6	12.0	11.3
IT Services	**12.8**	**12.5**					
Zee Entertainment Enterprises	0.4	0.0	11.2	19.0	17.2	9.9	8.7
Media & Entertainment	**0.4**	**0.0**					
Coal India	0.8	0.8	4.0	74.9	68.3	5.3	5.1
Hindalco Industries	0.6	0.6	6.5	9.8	7.4	6.6	6.0
JSW Steel	0.6	0.6	27.1	24.3	16.4	9.6	8.0
Tata Steel	0.7	0.7	29.0	15.7	8.3	5.7	5.1
Vedanta	0.6	0.6	7.3	11.0	9.6	5.4	4.7
Mining & Steel	**3.3**	**3.3**					
Cipla	0.5	0.8	14.4	10.4	8.4	17.7	15.4
Dr Reddy's Laboratories	0.7	0.0	24.2	14.1	11.1	20.4	17.6
Laurus Labs	0.0	1.0	40.7	6.2	6.0	14.7	11.9
Alembic Pharma	0.0	1.0	9.5	23.6	18.2	18.9	17.2
Sun Pharmaceutical Industries	0.9	0.0	17.0	6.7	6.8	18.2	15.9
Pharmaceuticals	**2.1**	**2.8**					
Adani Ports and Special Economic Zone	0.6	0.0	18.1	17.6	11.2	12.2	10.4
Ports	**0.6**	**0.0**					
Bharti Airtel	1.7	1.7	-	0.6	4.0	71.3	33.0
Bharti Infratel	0.4	0.4	6.6	15.8	15.9	12.2	11.7
Telecom	**2.2**	**2.2**					

Source: BOBCAPS Research, Bloomberg

Key risks

Covid-19: Transient impact priced in; risks high if outbreak continues post-Q1

- While key industries in several Chinese provinces have come to a halt amid **spread of the novel coronavirus (Covid-19)**, it is hoped that warmer weather over the next two months would cause the outbreak to subside (by Apr'20) – markets globally seem to be pricing this perception in.
- In the worst case, the epidemic may extend through Q1FY21 – this could have a knock-on effect on the world economy and disrupt global supply chains. China is the world's second largest economy and a major trade partner for many countries, including India.

Concerns

For Indian importers, supply disruptions in key segments are the biggest threat. Exports to China are taking a hit too. Export-import trade between India and China (including Hong Kong) totalled US$ 115bn in 2019. Consumer durables, electronics and solar panels would be the hardest hit as these depend heavily on Chinese imports, with no immediate alternatives available.

Some impact on exporters of products such as cotton yarn, sea food, petrochemicals, gems and jewellery is also inevitable, given that China is among the biggest markets for these products.

Gains

Sectors that are highly import-dependent on China, such as ceramics and plastics, are expected to drive demand for Indian manufacturers, with import volumes reducing. India's steel, paper, leather and textile readymade garment (RMG) segments have a window of opportunity to expand exports, as China's own exports from these sectors account for a sizeable share of global trade.

Sectors such as aluminium, electronics and pharmaceutical bulk drugs in India may not be unable to meet the China-linked supply void in global trade, as they either are running at peak utilisation or face capability issues. Most countries including India do not have the scale or size to take material advantage of the opportunities arising from supply disruptions in these sectors. Significant resources and time would be needed to set up additional capacities, by when China might recommence production.

COVID-19 FATALITIES

Country	Total confirmed	Total recovered	Total deaths
Mainland China	80,735	58,685	3,121
South Korea	7,382	118	53
Italy	7,375	622	366
Iran	6,566	2,134	194
France	1,209	-	19
Germany	1,040	18	-
Spain	673	32	17
US	554	-	22
Japan	502	116	23
Switzerland	337	-	2
UK	273	-	3
Netherlands	265	-	3
Sweden	203	-	-
Belgium	200	-	-
Norway	176	-	-
Singapore	150	78	-
Hong Kong	114	59	3
Austria	104	-	-
Others	2,162	245	14
Total	**110,020**	**62,107**	**3,840**

Source: Company, BOBCAPS Research. Data as of 9th Mar 2020

COVID-19 IMPACT

Gainers	Neutral	Concerns
Ceramics	Auto Components	Consumer Durables
Leather Goods	Aluminium	Electronics
Paper	Agriculture	Jewellery
Downstream Plastics	Pharma	Petrochemicals
Steel	Energy PSUs	Solar
Textile – Apparels		Shipping & Logistics

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

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