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Dear Investor,

Just when everything was starting to look better – US-China trade wars coming to an end, Indian Banking NPA problems receding, corporate earnings beginning to look up etc, the world was hit by a pandemic –Covid19. The scale and the speed at which the virus has spread have surprised everyone. What started in one province of China has today spread to almost every country of the World with varying intensity. Europe and now US, appears to have suffered maximum from the contagion, both in terms of economic damage as well as fatalities.

The Indian government fortunately has taken many steps proactively like announcing a lockdown when the transmission was very early in the cycle. This has helped to keep the infected cases under control. While the number of cases has increased significantly over the last few days, it should be noted that 60% of total states in India have less than 100 cases. However, the sheer size and the density of our population pose a major risk of community transmission and will be a key risk to watch out for going forward.

As economic growth slows down globally with negative growth expected for the next two quarters, equities (being a growth asset) have seen major drawdown/redemptions. FIIs in India have sold equities worth INR620 bn in the month of March 2020. The aggressive nature of current selling can be gauged from the fact that even in 2008 global financial crises FII selling was INR530 bn for the full calendar year.

As can be seen from China and South Korea, it takes approximately 3-4 months for the curve to flatten, therefore India should start to see flattening of the curve from mid to late April onwards. With this as our base assumption, we will believe growth will start to recover from Q2FY21 onwards and a full blown recovery will be seen by Q4FY21.

The silver lining for India amidst this uncertain environment has been the 40% fall in crude oil prices and healthy forex reserves of USD 470 bn. This gives us significant headroom for fiscal and monetary expansion. Already we have seen RBI cut interest rates by 75 bps and infuse sizeable liquidity (INR1400 bn) in the banking system. Government of India is also expected to announce measures to support sectors which have been hit severely by this pandemic like hotels, aviation, tourism etc.

As always markets and stocks have discounted the expected fall in corporate earnings much in advance. Broader indices have fallen 28% in March 2020. This correction has made long term valuations cheap.

While we agree that these are unchartered territories, most previous market corrections have been succeeded by equally strong recoveries. For example, after a 60% fall in 2008, Sensex recovered 100% in 2009-10.

Keeping in mind our base assumption of curve flattening from mid to late April onwards, we have shortlisted some stocks. The key guiding factor while selecting these stocks has been: balance sheet strength, corporate governance standards and long-term growth potential of the companies.

As markets continue to remain volatile the idea of this note is to highlight investment opportunities from a long-term perspective and companies which we believe will do well going forward. Therefore, no target prices have been mentioned but it will be fair to assume that these companies will emerge as winners as and when the markets stabilize.

PSU stocks have also fallen significantly. While these stocks may not qualify as long-term structural stories or “compounders”, some of the stocks have become good dividend yield plays. Therefore, these stocks also offer good trading opportunities.

An equal weight of all the stocks mentioned in the report would be recommended.

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Finally, as we pass through these uncertain times, the best investment strategy to deploy funds would be "**Accumulation**" over next few weeks rather than one-time lumpsum investment.

Stay Safe and Happy Investing.

Hindustan Unilever Ltd. CMP: Rs. 2153

The Company has grown at **CAGR of 9%** for the past decade till FY19 in terms of revenues and 16% in EBITDA with highest ever annual margins of 23% in FY19. Company reported revenues worth Rs. 393.10bn in FY19 in which the main segments, namely **Home Care, Beauty & Personal Care, and Food & Refreshments contributed 34%, 46% and 19% respectively**.

HUVR is a prominent name in the FMCG industry famed for its penetration strategy in Rural India and is backed by one of the largest FMCG companies globally, namely Unilever PLC who holds 61.9% (reduced from 67.2% after merger of GSK india). India is the 3rd largest market for the global giant with HUVR contributing ~9% to their revenues. Company has 61 total brands under its belt with 5 brands that have crossed the Rs. 20bn mark, 7 brands that are between Rs. 10bn-20bn and 8 brands that are in Rs. 5bn-10bn range as per FY19 annual report. Company added another prominent brand under its arsenal, 'Horlicks' which has increased number of brands under Rs. 20bn+ to 6.

COVID-19 Impact: company has several brands that sell products that are under the "Essentials List" such as Lifebuoy, Dove, Pears, Lux, Clinic Plus, Vim, Sunsilk, Ponds, Indulekha, Lever Ayush Rin, Vaseline, Closeup, Pepsodent, Brooke Bond, Surf Excel, Knorr, Kissan , Axe Boost and recently acquired Horlicks. There has been a surge in demand for these products whereas the premium portfolio such as Magnum will see a drop in demand. A nationwide lockdown has disrupted manufacturing as necessary approvals has to be taken to keep plants on even though they manufacture essential goods, barring these, manufacturing for all other goods have halted completely. Revenues will be impacted due to this but not a greater extent compared to peers as greater part of the portfolio is in the essentials list.

Conclusion: HUVR is one of the safest bets in the current market scenario where other players are finding difficulties in generating any revenues. An MNC backed by a strong parent with India as the 3rd largest market for them and the MD of HUVR, Mr Sanjiv Mehta also having a position in Unilever PLC as President, South Asia brings greater comfort for an investment decision. We believe in such a scenario; the stock will continue to command premium valuations. As per Bloomberg estimates, on P/E basis, at CMP of Rs. 2153, the stock is currently trading at 54.3x and 46.6x FY21e and FY22e EPS of Rs. 39.7 and Rs. 46.2 respectively.

Nestle India Ltd. CMP: Rs. 15150

Company for the past decade till CY19 has grown at a CAGR of 7% and EBITDA CAGR of 10%. Company commands superior return ratios with ROE and ROCE at 47% and 71% as of CY19 respectively.

COVID-19 Impact: Domestically sold products which also contribute major part to the company's revenues such as Maggi, Nescafe, Baby food products, Milk and its variants form part of the essentials list and are thus allowed for manufacturing. Manufacturing is although impacted due to lower staff to avoid spread of the virus. There is also a clear shortage of the more famous products such as Maggi due to hoarding and goods that are manufactured but are stuck in transit due to non or low availability of drivers for logistics. Revenue disruptions will occur albeit to a much smaller scale comparatively.

Conclusion: Nestle India is another strong company with superior return ratios and back by a strong globally present parent. Company has no debt on its books and majority of products fall under the essentials list. This company will continue to command its premium and makes for a good safe investment.

Bata India Ltd. CMP: Rs. 1192

Bata has ~13% market share in the organised footwear space in India. Organised footwear space is ~50% of overall footwear market which is around Rs. 58000crs. The per capita footwear consumption in India stands at 1.7 pairs v/s global average of 3.

Bata has grown at a CAGR of 10% CAGR over the past decade (upto FY19) in revenues and 14% in EBIDTA on account of margin improvement. For 9MFY20 the margins too have improved by 80bps to 17.8%.

Covid-19 impact: in a bear case we believe they would lose out on 15 days sales for March-20 and 1 month sales in FY21. However it would be more of a deferment of demand and some-bit would come back in the later period, however we have assumed a flat growth for FY21 period.

Conclusion: Bata's efforts in making its brands more premium and relevant to the customers has bode well for the company but the full extent of benefits has yet to accrue. This coupled with efforts taken for image re-transformation ("the new cool youth brand") through newer and better designed products at faster pace, introduction of international brands in India and store renovations for better in store experience, opening exclusive brand stores (Red, Power and Bubblegummers) will enhance the Bata brand and in culmination become the new BATA. Bata has a very strong balance sheet with 48% networth in cash and cash equivalents as of FY19 thus we believe that it is one of the safest bet in the retail space. At CMP of RS 1192 the stock trades at 48x its FY21e EPS of RS 25 and 33x its FY22e EPS of Rs 33.

Titan Ltd. CMP: Rs. 862

Predominantly a watch company in the early part of this century, Titan has transformed into a jewelry company with jewelry contributing 80% of the sales. Organized jewelry business stands at only 31% in India. Tanishq aspires to grow its jewelry business by 2.5X in next 5 years by doubling its market share to 10%, focusing on the wedding segment.

Covid Impact: In case of Titan wedding is an important part of their business and with lock-down this will definitely impact their Jewellery business and Jewellery purchase has a last priority in-terms of discretionary spends hence expect FY21 would be a mid-single digit growth for the Jewellery business which has been growing at 20% plus over last few years.

Conclusion: Titan is one of the few qualitative companies that has the potential to grow at a CAGR of 20% over 3-5year period. Recent issues with larger jewellers have opened up the opportunity (in-terms of gaining more market share) for players like Titan wherein customers demand in terms of "Trust" + "Design" + "Safety" is easily met. In terms of Balance Sheet strength Titan is Net Debt free company and enjoys ROE and ROCE above 20%. Thus it would continue to enjoy premium valuation and is in somewhat a monopolistic position in the Jewellery space. At CMP of Rs 862 the stock trades at 53x its FY21e EPS of Rs 16.3 and 37x its FY22e EPS of Rs 23.6

Trent Ltd. CMP: Rs. 451

Trent straddles across value, smart fashion and premium apparel segments through Zudio Westside and Zara formats. It also has a presence in the grocery segment through its joint venture with Tesco. Trent has come a long way from being a small 4 store company with Rs.60/- per share cash in the balance sheet in the year 2000 with a less than Rs.50 crore turnover (when the stock price was Rs.70!) to Rs.2532 crore turnover company with 150 Westside and 56 Zudio stores in FY19 YTD FY20 these have increased to ~175 Westside stores and ~75 Zudio stores.

Covid-19 Impact: complete closure of stores since last week of March would obviously impact business, however again in case of Trent we expect deferment of demand that would come in the later period. Since the pick-up would be slow we believe that the store opening and SSS growth to be slightly lower for FY21.

Star Bazaar i.e. Tesco JV being a departmental store would not be impacted so much as it sells essentials and grocery.

Conclusion: Over last 15 years, Trent has got its business model right and is likely to add around 80-100 stores every year in the next few years, growing in size by about 20-24% YoY. It has delivered a decent SSG over last 4-5 years and this gives us confidence that it can compound its sales at 20- 25% in the coming 8-10 years. This could result in at least equal if not higher bottom-line growth. The grocery business which is a joint venture with Tesco could breakeven in next 2-3 years and has a great growth potential as well. Zara business will continue to deliver a decent cash flow YOY. The promoters have recently infused Rs 9.5bn in the company at Rs410 per share thus the company has enough cash-on-books to take care of the current situation as well as expansion plans. Looking at all the above, we do believe that Trent will be a great compounder over the long term. On consolidated basis at CMP of Rs 451 the stock trades at 72x its FY21e EPS of Rs 6.3 and 44.2x Its FY22e EPS of Rs 10.2.

ITC Ltd. CMP: Rs. 178

ITC is a leading name across all its segments which is aided by several brands that are known nationwide. Some example include Bingo!,Sunfeast, BNatural, Aashirvaad, ITC Hotels, Candyman, Yippee!, Fiama, Savlon, Dermafique, Vivel, and Classmate among many others. These brands are very large in their own segments and the company through most of these bands reach a total 124 million households in India. Company has delivered a Revenue, EBITDA and PAT CAGR (FY14-19) of 6.5%, 7.24% and 7.21% respectively.

Covid-19 Impact: Currently only essential items are allowed to be manufactured, supplied and sold in the markets. Packaged products which include biscuits, juices, candies, pulses among other things contribute 25% to company's revenues as of FY19 and 9MFY20. Due to panic and more attention to health and safety, company has witnessed higher demand for these products. One major revenue contributor i.e. Tobacco and Cigarettes (contributes 41% to revenues as of FY19 and 9MFY20) are not part of the essentials list and thus new manufacturing to replenish the stock for the product will not happen and this will impact revenues negatively.

Conclusion: ITC is a strong player in the FMCG space and the cheapest in the whole lot of companies having strong brands under their belt. the company is putting all efforts to diversify and reach a target of Rs 1000bn by 2030 into FMCG business wherein it achieved a turnover of Rs 125bn in FY19. Company has also recently announced a change in its dividend pay-out policy and raised it to 80-85% of profits (earlier it was 55-57%) which indicates that a large part of capex has been done and also a consistent dividend in the range of Rs 10-12. The stock at CMP of Rs 178 is trading at 14x its FY21e EPS of RS 13 and 12.3x its FY22e EPS of Rs 14.5.

Bharti Airtel Ltd. CMP: Rs. 424

Bharti Airtel is one of the largest mobile network operator in India with approximately 300 million subscribers (~35% Market Share)(The total number of telephone subscribers in India reached 1172.44 million as on 31 December 2019). Bharti's Average revenue per user (Arpu) for mobile services increased to Rs 135 in Q3FY20 from Rs 128 in Q2FY20, Mobile data traffic increased to 5,166 petabyte in Q3FY20 as compared to 2,996 petabyte in Q2FY20 and Mobile 4G data customers increased 60.6% QoQ to 123.8 mn from 77.1 mn. The above data highlights the growth potential and the growth trajectory in which Bharti Airtel is well placed. Currently, the stock is down ~25% from its peak due to the Coronavirus (COVID-19) outbreak and the consequent complete lockdown in India.

Impact on account of COVID 19 Break-out-

In the current situation of complete lockdown in India due to COVID-19, would impact physical recharges and the net subscriber additions on a broader picture, however, data subscribers with higher ARPUs and longer-term recharges of 60/90 days would remain unaffected to Bharti's revenue. Against this, increased data consumption amongst the 4G/Volte customers (30% of Bharti's subscribers) would mitigate some impact on the revenue and profitability.

Conclusion – Since a long time now, talks of two private player market in the telecom Industry is being spoken about i.e. Reliance Jio and Bharti Airtel owing to Vodafone's Idea Ltd. poor financial position and reducing subscriber base (month-on-month). Further in terms of AGR dues, Bharti Airtel paid its full and final AGR-linked dues of INR 18,000 crore to the Department of Telecommunications (DoT) after its self-assessment exercise. However, we believe that BHARTI remains in a win-win situation, irrespective of the SC's outcome as, in the worst-case scenario of no government support on AGR dues, BHARTI's financial position is strong enough to withstand the storm, and in fact, could lead to significant market share gains for the company at the cost of Vodafone Idea. On the other hand, if the government supports the telecom industry, Vodafone would survive, but it would require a sharp ARPU increase along with a moratorium of payments to service its regulatory and debt obligations, which could also benefit BHARTI. Hence, in either of the cases Bharti Airtel would be the beneficiary.

Cipla Ltd. CMP: Rs. 450

Cipla is a Rs 160 bn pharmaceuticals company, with sales across India (40% of sales), US (22% of sales), South Africa (18%), Europe(5%) ROW markets(10%) and APIs. Cipla is India's second largest pharmaceuticals company, with focus on chronic therapies namely respiratory, cardiology, urology as well as acute (anti infectives). Cipla's overall chronic and key therapies (respiratory, cardiovascular) have been growing more than the industry. In Q1FY20, Cipla has restructured its trade generics business (20% of India sales), widened reach to Tier 3 & 4 cities and brought the business back to growth.

Cipla has also strategically built up its US business with limited competition launches. Cipla's US sales have grown at 15% CAGR to Rs34.2 bn in FY19 and Rs 30 bn in 9MFY20. The company has completed its Phase III trials for gADVAIR and expects ANDA filing soon. Cipla has 65 ANDAs pending USFDA approval, and 22 tentative approvals.

Covid-19 Impact: The countrywide lockdown in India will marginally impact Cipla, as 60% of India business is chronic and would entail stocking medicines in advance. The acute business will be impacted due to lower footfalls at chemist shops for 21 days during Q4FY20- Q1FY21. With the increase in COVID19 cases globally, there is an increased demand for respiratory, anti retrovirals and anti infectives, as the line of treatment. We expect CIPLA to benefit across markets, asIndia's largest affordable player in respiratory and anti retrovirals (ARVs) and the third largest player in anti infectives. The company may witness delays in supply chain locally as well as in exports.

Conclusion: Cipla will grow across key therapies and geographies namely India, US and South Africa. With stable EBITDA margins of 19-20% and lower taxes from FY21, we believe Cipla is well positioned as a growth stock for long term.

HDFC Bank Ltd. CMP: Rs. 814

Over the years, HDFC Bank (HDFCB) has reported consistent performance in terms of business growth, profitability and efficiency, with focus on maintaining portfolio quality. With $5 billion in cash and nearly 80% of its loans given to high-rated companies, HDFC Bank is in better position to withstand any short-term economic storm. The bank is sitting on excess liquidity led by strong deposit growth, a stance that the bank has adopted since 2018 (which was then criticized) as it believes that systemic liquidity risks still remain high. Bank's SME loans comprises of borrowers which have a self-funding component of 60-65% & have additional collateral against their loan. Bank has limited exposure to restaurants and hospitality business. On the retail side, around 75% of the personal loan portfolio is to salaried borrowers, working for top companies, and therefore, it will take a while before job losses are seen at their end.

Covid-19 impact: If the covid-19 outbreak and the subsequent lockdown to contain its spread continue for more than two-three months, it will no doubt hit every sector of the economy. Depending on the duration, Bank's earnings will negatively impact owing to a) a moderation in loan growth, b) lower margins, c) slower growth in fee income, and d) higher NPLs. The increase in delinquencies does not appear to be alarming as of now but we continue to be watchful. While large part of the bank's retail exposure is towards salaried segments, loans to self-employed & SME are at a higher risk given the lockdown. We expect slippages to inch up and bank is likely to increase provisioning buffers driving up credit costs.

Conclusion: Uncertainty about duration of the lockdown will keep the stock volatile in the near term, but we see attractive risk reward given a robust balance sheet, better liability franchise long-term growth potential. At CMP, the stock has seen a ~38% correction from its December peak and its valuations are attractive at 2.4x its FY21E ABV and 2.1x its FY22E ABV.

<u>Kotak Mahindra Bank Ltd.</u> <u>CMP: Rs. 1140</u>

Kotak Mahindra Bank is a powerful banking franchise with a strong liability profile and stable asset quality. Bank has decided to maintain a conservative stance in lending in the past few quarters which will put them in good stead during these times when other leading banks can report much higher than expected slippages. During Q3FY20, GNPA and NNPA stood at 2.46% and 0.89% respectively and could inch up because of defaults in unsecured personal loans segment like credit cards and consumer durables.

Covid-19 impact: in a bear case if lockdown extends up to a three-month period, recoveries will be hit and there can be a surge of NPA's across the banking system. Bank is focussing on its asset side and improving its recovery mechanism. The extended moratorium can affect the willingness to pay, but the bank is focussed on reaching out to the customers one way or the other and collect the instalments. Growth in advances will also be minimal but can rebound strongly once the lockdown is lifted.

Conclusion: Kotak Mahindra Bank offers a safe harbour with a strong capital adequacy of 18.21% and will be well placed to tide over this crisis. The liability side is also strong and there can be an uptick in deposits with other riskier private sector banks losing deposits due to Covid-19 as well as Yes Bank fiasco. One of the major overhangs was also eliminated when RBI allowed Mr Uday Kotak to bring down his shareholding to 26% of the paid-up voting equity share capital from the 15% they had demanded earlier.

<u>ICICI Bank Ltd.</u> <u>CMP: Rs. 287</u>

ICICI bank's business profile has strengthened significantly over last few years, with moderation in NPA (Rs 434.54 Bn in Q3FY20 vs 515.91 Bn in Q3FY19), de-risking the balance sheet (BB & Below rated pool declined from 9.4% in Q4FY18 to 1.4% in Q3FY19), steady pick-up in retail credit offtake (clocking ~19% growth) and a sharp improvement in provision coverage ratio (up from 48% in Q4FY18 to 76% in Q3FY19). We believe ICICI bank have the most favourable risk-reward at this stage of the NPL cycle and could gain market shares in a changing competitive landscape due to its strong digital footprint. Bank's liability franchise is relatively better than most of its peers, with CASA ratio stood at 47% in Q3FY20. Because of which, bank has managed to keep their cost of deposits low (one of the lowest in financial space), which help the bank in a current tight liquidity environment.

Covid-19 impact: Depending on the duration of the lockdown, Bank's earnings will negatively impact owing to a) a moderation in loan growth, b) slower growth in fee income, and c) higher NPLs. With a higher share of floating rate loans and increasing share of loans linked to external benchmarks, asset yields are likely to fall faster than funding cost, which will result in NIM compression. Besides, a slowdown in the consumer space remains an area of risk on growth and provisions in the near term.

With a strong growth profile, robust liability franchise and focus on risk adjusted return-oriented business, ICICI Bank is in better position to withstand upcoming economic storm.

Conclusion: We remain positive on ICICI Bank's fundamentals given its superior liability profile, less risky loan portfolio (housing), lower aggression in lending with greater emphasis in establishing strong underwriting practices and was gradually coming out of the previous corporate credit cycle .At CMP the stock trades at 1.6x its FY21E ABV and 1.4x its FY22E ABV.

HDFC Life Insurance Ltd. CMP: Rs. 422

We believe the Indian insurance market has substantial growth opportunities; and HDFC Life Insurance (HLI), with its strong brand image and widespread bank assurance network is well placed to capture these opportunities. HLI has been at the forefront of product innovation, and what is really impressive is its ability to continuously rebalance its product mix based on risk, market dynamics, & customer appetite. Currently, it has the highest share of pure protection products in revenue among listed life insurers, which leads to a high overall margin. During 9MFY20, the company's new business margin improved 260 bps to 26.6%, with the value of new business growing 44.9% YoY to Rs 1,407 cr. Operating return on EV stood at 19% while the Indian Embedded Value (IEV) improved 19.8% YoY to Rs. 20,841 cr. Savings business grew 32% in 9MFY20. Similarly, the protection business also rose by 32%.

Covid-19 impact: In the near term, the company's performance will remain under pressure due to higher exposure to equity. The share of equity in total AUM for HLI is close to 37%, which makes underlying funds vulnerable to under-performance during stock-market downturns and increases the probability, ceteris paribus, of clients surrendering policies citing disappointment with performance. Around 10% of market correction will have a -0.3% impact on VNB Margin and -1.3% in EV.

Conclusion: We believe medium to long term prospects for the company remain intact, given its solid product portfolio (with lower ULIP mix & higher protection business), diversified distribution network and favorable macro traits in the domestic life insurance industry. Furthermore, the recent fiasco might have a sentimental positive impact on the overall insurance industry as people could understand the importance of insurance. Given the relatively lower mortality rate and geographic concentration of the infection, the mortality impact on life insurers appears to be low at this stage.

Dividend yield plays:

Investors looking for good dividend pay-outs can look at some PSU companies. As mentioned earlier, PSU companies do not have a great track record in terms of long term wealth creation as compared to some other privately managed companies. However, given the price damage in the last one month, some companies are offering good dividend yields and can see a significant trading bounce as and when the market stabilizes. We would like to highlight Power Finance Corporation and Rural Electrification Corporation as two good dividend yield plays. Both the companies have a dividend pay-out policy of 5% of net worth or 30% of profits whichever is higher. At current market prices, the dividend yield for PFC and REC works out to approximately 10%. While these companies do run the risk of earnings being subject to government policies, we believe reasonable valuations and good dividend pay-outs do offer a downside protection and a good trading opportunity as and when the markets stabilize.

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Contact	Email ID	Contact No.	Sector
Mr. Kunal Bhatia	kunal.bhatia@dalal-broacha.com	022 67141442	Auto, Auto Ancillary, FMCG
Mrs.CharulataGaidhani	charulata.gaidhani@dalal-broacha.com	022 67141446	Pharma /Healthcare
Mrs.AbhilashaSatale	Abhilasha.satale@dalal-broacha.com	022 67141438	Mid- cap senior analyst
Mr. Mayank Babla	mayank.babladalal-broacha.com	022 67141412	I.T/Telecom/Media
Mr. AvinashTanawade	avinash.tanawade@dalal-broacha.com	022 67141449	BFSI
Mr. Suraj Nandu	suraj.nandu@dalal-broacha.com	022 67141438	Associate
Ms. Nidhi Babaria	nidhi.babaria@dalal-broacha.com	022 67141450	Associate
Mr. Tanush Mehta	tanush.mehta@dalal-broacha.com	022 67141441	Associate

Address: - 508, Maker Chambers V, 221 Nariman Point, Mumbai 400 021
Tel: 91-22- 2282 2992, 2287 6173, Fax: 91-22-2287 0092
E-mail: research@dalalbroachaindia.com, equity.research@dalal-broacha.com