

# India Strategy

## Indian market: Overweight cyclicals

### Be selective in stock picking

- While Nifty has corrected by c.9% from its Jun'19 peak, the decline in small and mid-cap indices has been sharper. However, relative valuations indicate that mid & small-cap underperformance is unlikely to continue.
- From a strategy perspective, we recommend going overweight on our small and mid-cap and universe, as well as on sectors like BFSI, pharmaceuticals and metals. We have an equal-weight stance on auto, consumer durables, IT, FMCG, cement and utilities, and an underweight one on capital goods.
- We like SBI (NOT RATED), ICICI Bank(LONG,) Mannapuram Finance (NOT RATED), Cipla (ADD), Baja Auto (LONG), VIP (LONG), Voltas (LONG), Sriram Transport (ADD), TCS(LONG) and Tata Steel (NOT RATED).

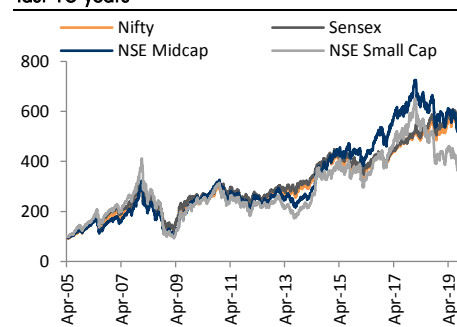
### It's time to buy, but only selectively

- **Same cycle playing out again:** It's the fourth time in last 10 years when, as per financial markets, the world is nearing its end. The only difference vis-à-vis the last cycle is the flow of domestic money which has helped hold up the frontline index (Nifty down only c.9% from peak) even as mid and small-cap indices have nosedived (down c30-35% from top). Relative valuation of midcap/ small-cap indices vis-à-vis Nifty indicates that their underperformance is unlikely to continue. Consequently, we give higher weightage to small and mid-cap stocks.
- **Gold remains asset class of the year:** Policies of the Donald Trump administration have exposed USD to risk. Also, global USD reserves are declining, the Euro is replacing USD in global trade, and the Yen is coming back in flavor. The unabated China-US trade war can bring inflation to the US. Trump policies can jeopardize the Petro-dollar, which was an important sink for USD. All these can bring the Trump dream of a weaker USD to reality, much faster than he would have anticipated. Hence, real assets will do well. We like gold, and steel is our favorite among metals. Equities which benefit from higher gold prices should also do well.
- **Prefer BFSI, consumer durables, chemicals, pharmaceuticals:** Our observations: (a) NBFCs have been beaten out of shape and Govt. intervention is critical and inevitable; however, we do concede that the timing and form of such an intervention is uncertain. (b) Private sector capex may not start soon enough. Government push on infrastructure creation would continue and aid EPC companies. (c) China's pollution-related crackdown has helped Indian chemical companies. (d) The pharmaceutical index is trading near its 10-year low valuation, and the bad news flow seems to be slowing down. (e) Given a slew of welfare schemes, consumer durables continue to do well.
- **Metals — our contrarian equal weight:** No one has timed steel better than metal players themselves, and they have raised money at cycle peaks (in 2 of the last 3 peaks). However, as of now, valuations are extremely cheap (and as always is the case, the future appears bleak). We like Tata Steel among metal players. Despite the near-term pain, there is plenty of money on the table (as in the last three cycles).

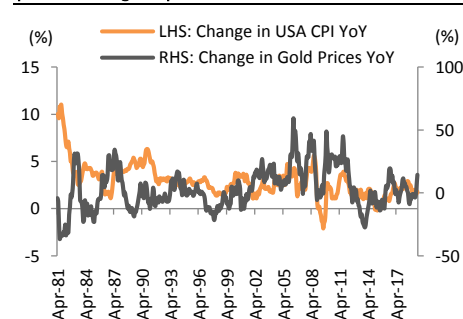
### Company Snapshot

Company	Reco.	CMP	MCap Rs. Mn.	Price Target	Target Date
Bajaj Auto Ltd	Long	2737	792	3063	Sept 20
ICICI Bank Ltd	Long	412	2657	550	Sept 20
Sriram Transport Finance Co Ltd	Add	1020	21	1150	Mar 20

### Underperformance of small-cap index starkest in last 15 years



### Changes in US trade policies inflationary — a big positive for gold prices

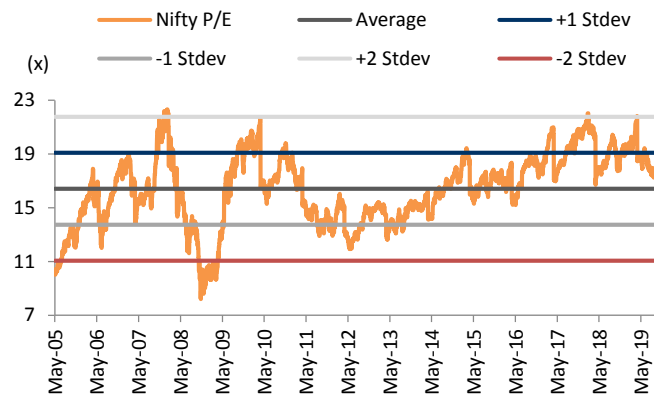


## Indian markets: Overweight cyclicals

The Indian market correction has been led by multiple factors: (1) Expectation of a reformist budget, (2) fatigue because of tepid earnings growth, and (3) continued NPA problems and failure of IBC in quick process resolution. Having said that, valuations of the broader market have corrected, most stocks have tanked, and it's ambiguous whether the biggest buying opportunities will emerge. We are positive on markets but recommend a stock and sector-specific strategy. Banking, pharmaceuticals, oil marketing companies, and select automobile companies are our biggest buys. After the steep correction, metals are also looking attractive; however, as always, metal stocks will test investor patience.

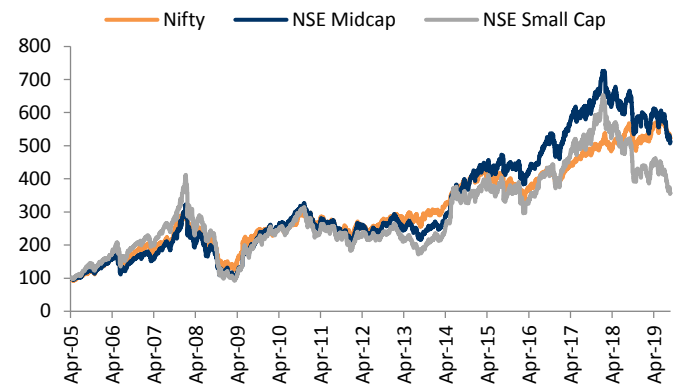
*Indian market valuations in BUY zone; small-cap underperformance hasn't been as stark over last 15 years*

**Exhibit 1: Nifty trading near its long-term average PE**



Source: Bloomberg, Equirus Securities

**Exhibit 2: Underperformance of small-cap index starkest in last 15 years**



Source: Bloomberg, Equirus Securities

### Structural issues exist but market reaction overdone

Small and mid-cap players are facing headwinds in terms of (1) stretched WC cycles, (2) a visible slowdown in the auto industry, (3) liquidity crisis, and (4) wealth erosion effect which is hurting promoters as well. We however believe the market, as always, is overreacting with the small-cap index underperformance sharpest in last 15 years. While the small-cap index is currently at Jul'16 levels, Nifty is up c.35%, Sensex c.40% and midcap index c.17.5% vis-à-vis Jul'16. The relative valuation of Nifty and small-cap indices is touching post-Lehman and 2013 lows. The downtrend from here on can be only in line with Nifty.

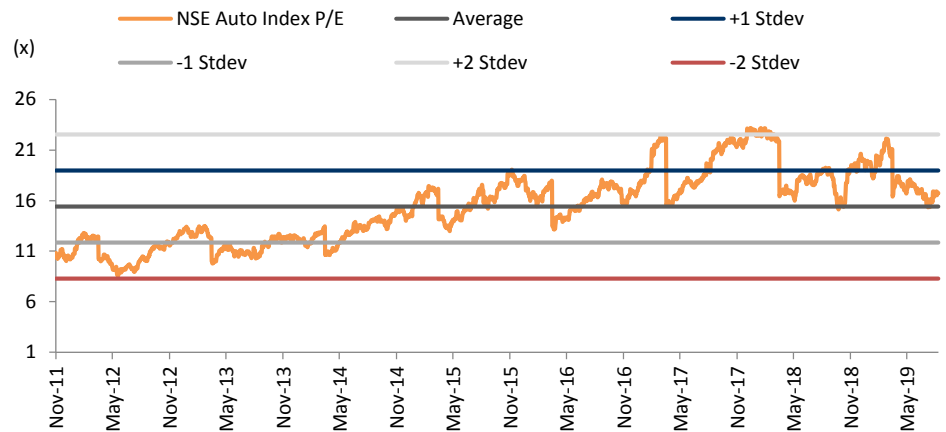
## Auto sector

### Appears to have de-rated significantly

Slowing demand, liquidity crisis, high channel inventory and protracted WC cycles are leading to a sales slowdown for Indian auto companies. Consequently, valuations have also corrected.

*NSE auto index appears to be pricing in most of the near-term pain*

**Exhibit 3: NSE auto index trends**

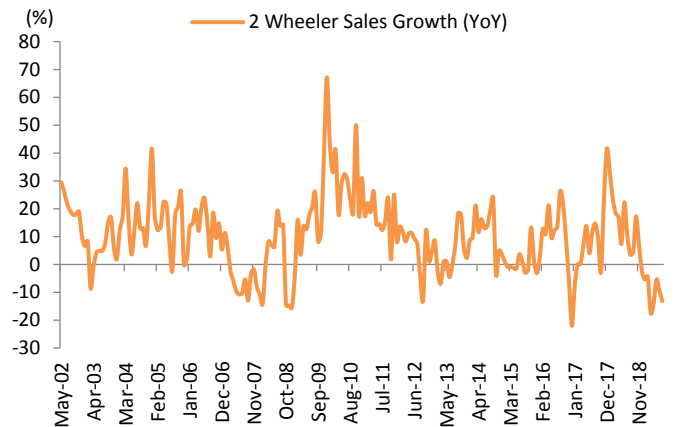


Source: Bloomberg, Equirus Securities

### Automobile sales growth has always been volatile...

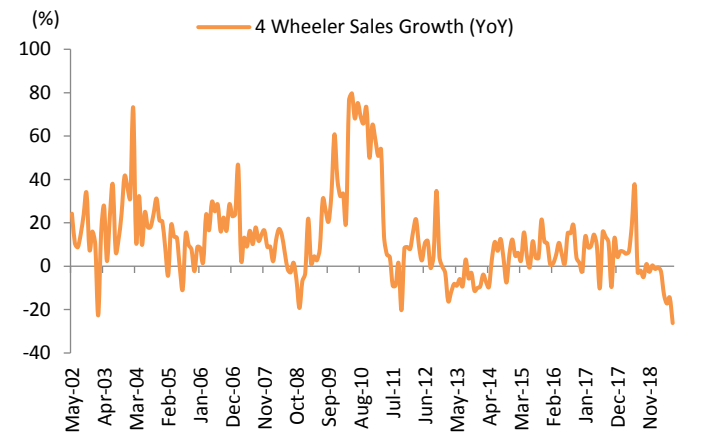
Indian auto sales have always been volatile. The standard deviation (SD) of 4W and 2W growth numbers are a whopping 19% and 13% respectively. This data alone means that a host of external factors are at play, including the monsoon, govt. stimulus, an impact of rise in minimum support prices and wealth effect of land and property prices.

**Exhibit 4: 2W sales growth has always been volatile; nothing structural in current slowdown**



Source: SIAM, Equirus Securities

**Exhibit 5: 4W sales growth trajectory relatively stable, but such declines seen many times in past**



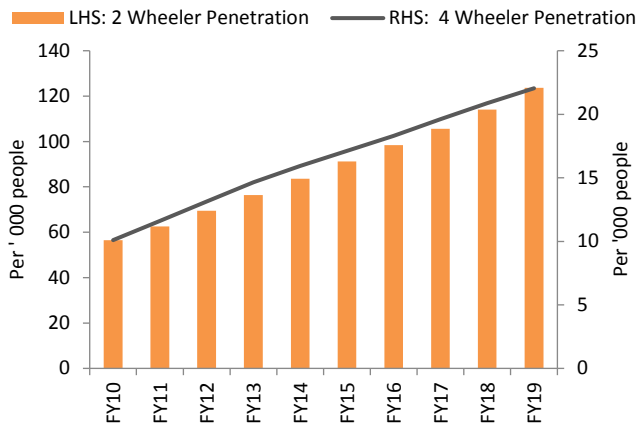
Source: SIAM, Equirus Securities

### ...hence not advisable to read too much into current sales slowdown

Given that the average 19-year monthly yoy sales growth has been 13% for 4Ws and SD of growth has been 19%, it is equally likely that statistically, growth can be 32% or -6% in a month. Therefore, we should not read much into these bouts of slowdown in auto sales. Stock valuations are obviously a different question.

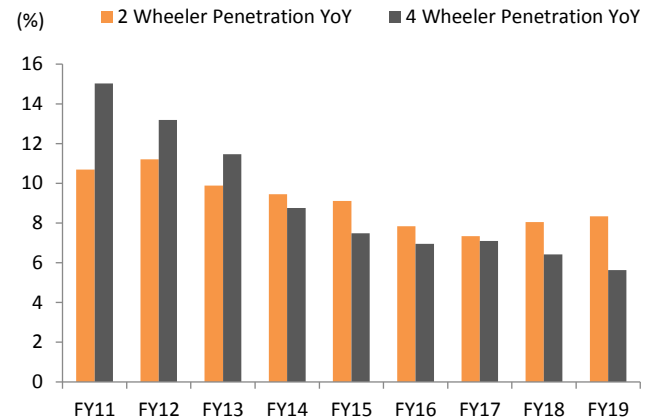
### India's 2W and 4W penetration is far from saturation

**Exhibit 6: India's 2W penetration doubles, 4Ws rises 1.2X in last decade...**



Source: SIAM, Equirus Securities

**Exhibit 7: ...leading to a drop in growth rates (%)**



Source: SIAM, Equirus Securities

### It's the right time to nibble into automobile stocks

We like a number of auto and auto ancillary stocks. Given the valuations, we would recommend going LONG on Amara Raja Batteries, Bajaj Auto, Minda Industries, and Lumax Industries. Bajaj Auto is one of our top picks in the space.

**Exhibit 8: Long-rated stocks in our auto and auto ancillary universe**

Company	EPS			ROE			P/ BV			Div Yield
	2019A	2020E	2021E	2019	2020E	2021E	2019	2020E	2021E	2020E
Amara Raja Batteries Ltd	29.6	36.4	42.1	16%	17%	17%	3.2	2.7	2.3	1%
Apollo Tyres Ltd	15.5	18.3	19.2	6%	10%	10%	0.9	0.9	0.8	2%
Atul Auto Ltd	24.8	27.6	27.8	24%	22%	20%	1.9	1.7	1.5	3%
Bajaj Auto Ltd	158.5	172.0	191.1	21%	20%	20%	3.4	3.1	2.7	2%
Exide Industries Ltd	8.7	11.2	12.4	13%	15%	15%	2.5	2.3	2.0	1%
FIEM Industries Ltd	41.6	57.2	66.9	12%	15%	15%	1.0	0.9	0.8	3%
Hero MotoCorp Ltd	174.9	183.1	193.0	29%	27%	26%	4.1	3.7	3.4	4%
Lumax Industries Ltd	94.7	120.8	129.0	22%	24%	23%	5.6	4.7	4.2	2%
Minda Industries Ltd	11.4	14.9	18.7	20%	24%	26%	5.5	4.9	4.3	1%
Subros Ltd	13.3	18.4	21.1	16%	16%	16%	2.2	1.9	1.7	1%

Source: Company, Equirus Securities

*We like Amara Raja Batteries, Bajaj Auto, Minda Industries, & Lumax Industries. Bajaj Auto is among our top auto picks*

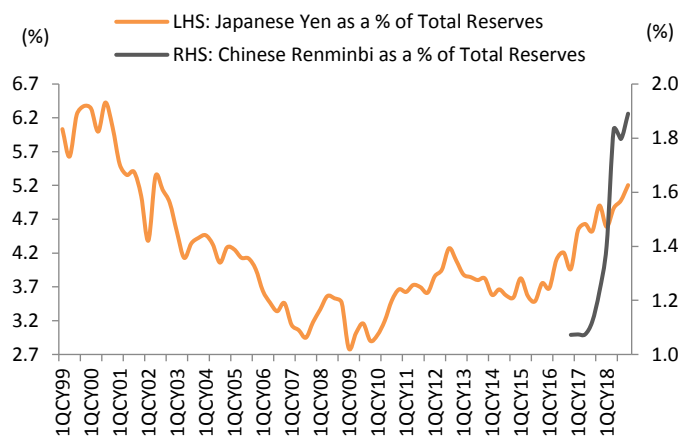
## Oil, USD, Gold: Gold to price in flash crash risk of USD, negative yields

Given India's import dependence, rising oil is always a trouble for the country. Risk off and sudden strength of the dollar, which can put all EM currencies into a tailspin, is another macro risk for India. Having said that, the macro situation appears benign for India. Significant USD reserves provide us further comfort on the macro front.

### World is slowly but surely moving away from USD as reserve currency

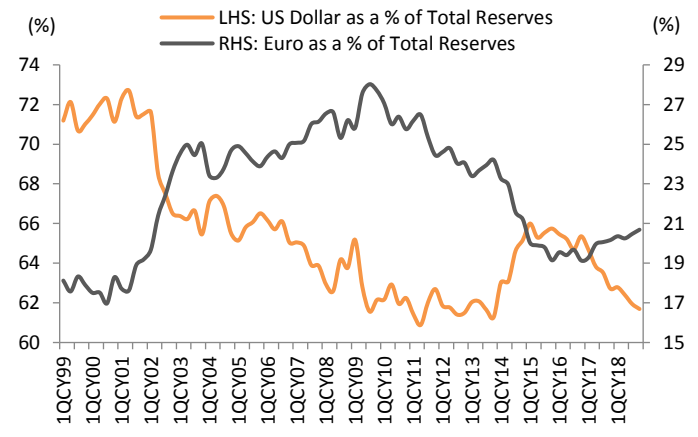
With advent of the Euro, there had been a structural decline in global reserves in USD terms; however, the Eurozone crisis at CY12/13-beginning prompted investors to start shifting to USD. Yuan and Yen are becoming preferred currencies in the new world order. Euro is also making a comeback and as a global reserve currency (as a percentage of USD) is only marginally above its historical bottom of CY11.

**Exhibit 9: Yen back in favor; CNY increasingly preferred as global reserve currency**



Source: IMF, Equirus Securities

**Exhibit 10: USD (% of global reserves) nearing its 2011 lows; Euro making a fresh comeback**



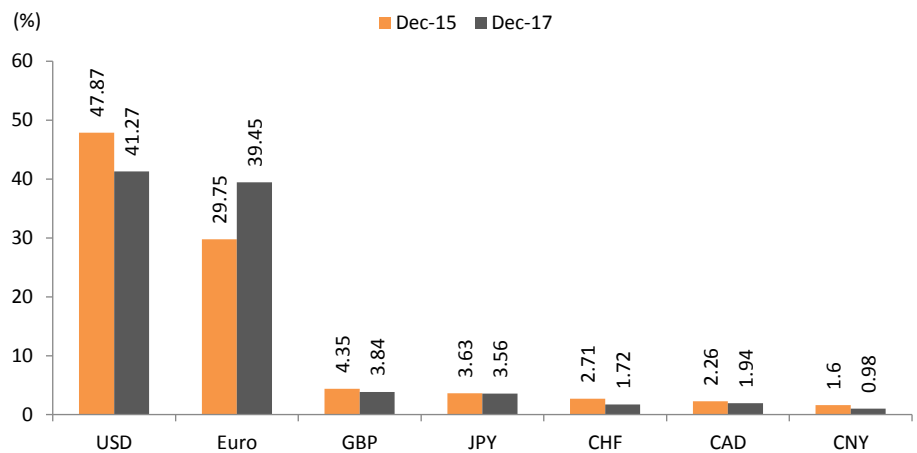
Source: IMF, Equirus Securities

### Global trade also slowly moving away from USD

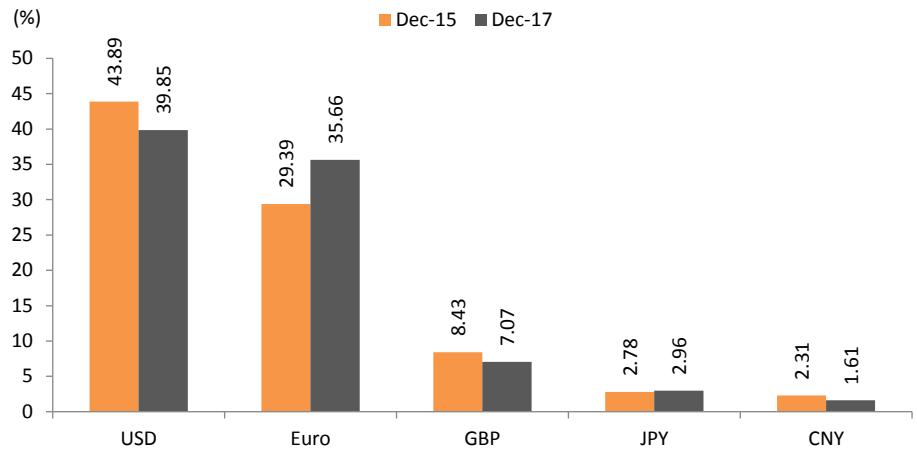
Yen, Yuan, GBP and Euro are gaining market share in global trade at the expense of USD. The process is slow but steady and USD is losing its dominance.

**Exhibit 11: USD slowly losing dominance as preferred global remittance currency**

Yen, Yuan, GBP and Euro gaining market share in global trade at the expense of USD



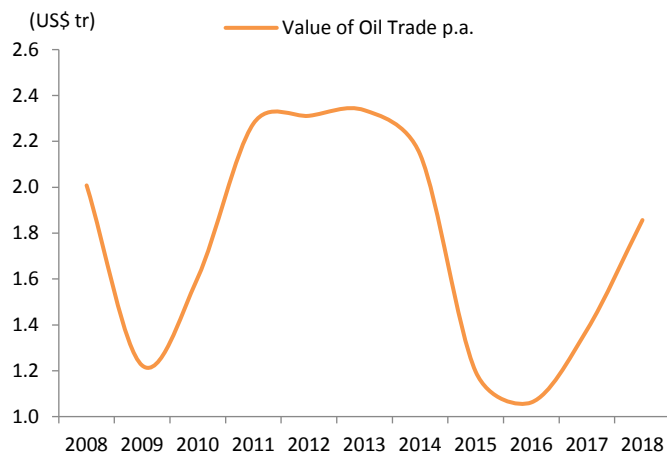
Source: SWIFT data, Equirus Securities

**Exhibit 12: Euro is slowly increasing its share in cross border trade as well**

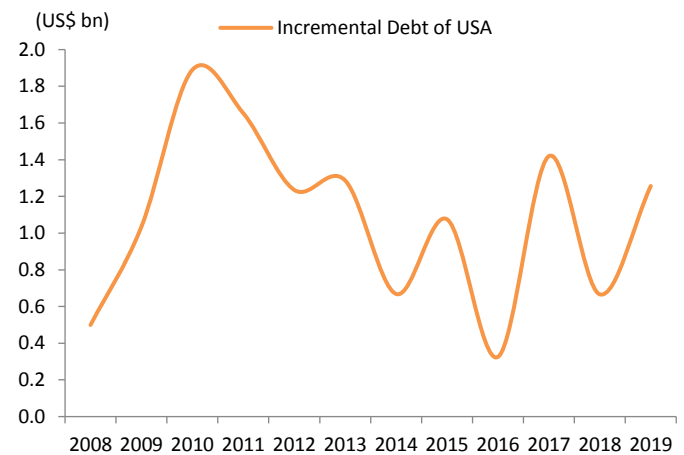
Source: SWIFT data, Equirus Securities

**Oil trade dominated by USD; provides ~USD 1trn of deficit financing opportunity**

Over 71 mn oil barrels are traded per day worldwide, mostly in USD. This is the biggest demand source of USD which keeps the great money printing machine of America running. Approximately c.60% of global trade is denominated in USD; hence on a conservative basis, c. USD 1trn demand is generated per annum.

**Exhibit 13: Overall oil trade at US\$1.9tr per annum; ~60% traded in US\$**

Source: Bloomberg, Equirus Securities

**Exhibit 14: Oil trade at a significant sink of US\$; hence, despite huge incremental debt, USD remains steady**

Source: Bloomberg, Equirus Securities

USD used in oil trade is also called Petro dollar. Till the time Petro-dollar is in vogue, the US can enjoy an unprecedented budget deficit while (a) having 'AAA' ratings and low inflation, (b) surviving bursting of asset bubbles and (c) sustaining extremely prosperous lifestyles of its citizens. All of this will be funded by the world and the US military might. It is indeed ironical that the US uses military power to keep Petro-dollar floating and the same is provided by the very people against whom it uses its military might.

### Things changing, and the world is realizing its bargaining power...

The Solomon bond trader and then the treasury secretary's 'William Simon' gift to USA and Saudi largesse to USA were coming to an agreement on the Saudi's fixing oil prices in USD and parking surplus in US treasuries. So for decades now, US consumers and government adventures have been financed by their imports (yes! their import of oil). However, things are changing now as:

- 1) China is trying to develop an alternate Petro-currency by opening a crude oil trading exchange in Shanghai.
- 2) Iran keeps threatening to trade in Euro.
- 3) Saudi Arabia is threatening to stop trading oil in USD ([Link](#))
- 4) Russia is attempting to fix oil prices in currencies other than USD ([Link](#))
- 5) Venezuela is also trying to get away from USD ([Link](#))

### ...which is only being reinforced by Trump's big policy flip-flops

Big shifts in policies by the Trump administration is no good for USD. Unless America starts producing cheaper goods and replaces them from the world map, it is better for the US to remain a consumer of Chinese goods. Imposing tariff and restricting trade cannot solve President Trump's perceived problem. It's a long haul for the US to become competitive vis-à-vis China. Moreover, trade deficit with China is a source of cheap financing of US national debt. A trade embargo will hurt China, but hurt USA even more.

### All of above adding to perceived risk to USD, gold on a structural rise

All the aforementioned reasons are adding to the perceived risks to USD. While the world may not start dumping dollars immediately, it will seek an alternative refuge and gold fits the bill. Gold is on a structural rise.

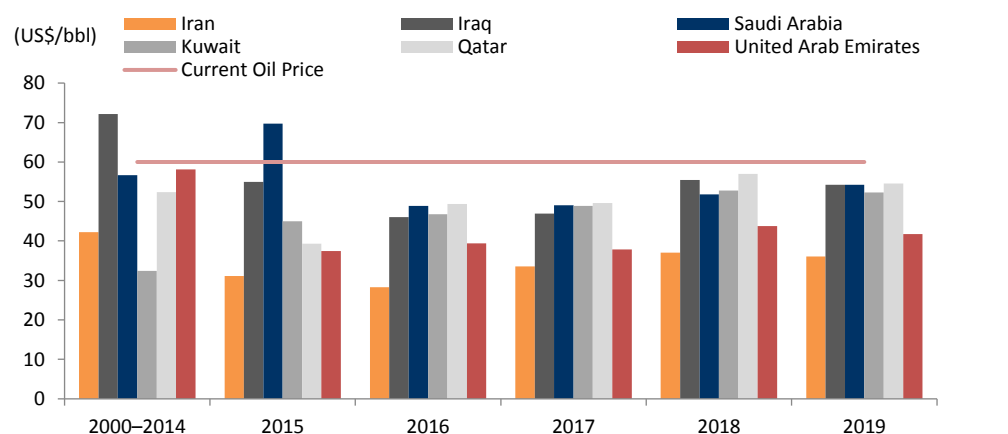
### What USD risks mean for EMs; positive but highly volatile

A weakening dollar or a rise in its risk perception will rejuvenate emerging markets as an asset class. However, the ride is unlikely to be smooth, and rather highly volatile. Carry trade is already coming back but we recommend investing in India or EMs only if one has enough firepower to withstand high volatility.

### Current oil prices well above external breakeven prices for major producers; Oil prices may not push much higher – positive for India

The IMF has recently started reporting external breakeven oil prices for all oil-producing nations (external breakeven oil prices = the price at which current account balance is zero). This means while oil-producing nations may have to issue debt to fund the fiscal deficit, currency stability is not a threat.

Exhibit 15: Current oil prices for big ME oil producers



Source: Bloomberg, Equirus Securities

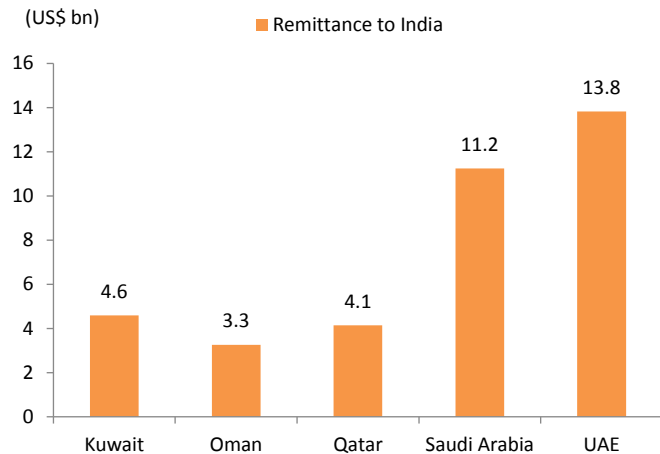
Perceived risk to USD; Trump's policy flip-flops adding to woes

Current oil prices above CAD-neutral levels for most big ME oil producers

### External breakeven prices for most oil-producing countries can come down further if they plug dollar repatriation to India

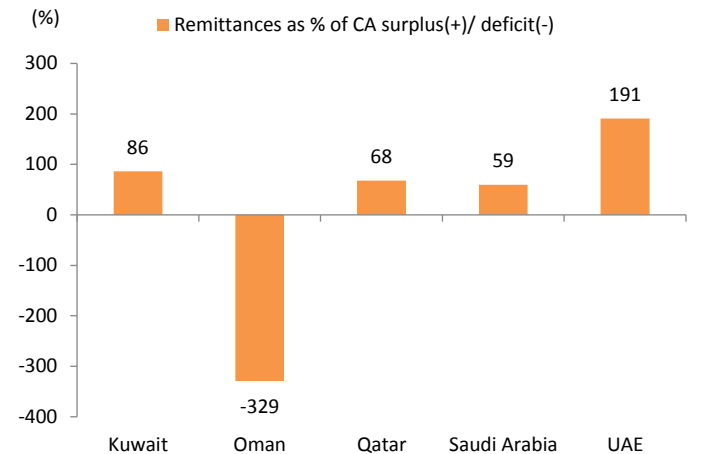
Most Middle East countries have big USD repatriation to countries like India. If they enter into a currency swap agreement, their external breakeven prices of dollar will further come down. Ideal for all these nations would be to start trading in respective currencies; however, we recognize that may not happen soon. But at the same time, they have started various risk mitigation measures which will help them in bringing down dollar dependence.

**Exhibit 16: Most Middle East countries have high USD remittances to India**



Source: IMF, Equirus Securities

**Exhibit 17: Remittances as a percentage of current account (CA) surplus/ deficit is quite high**



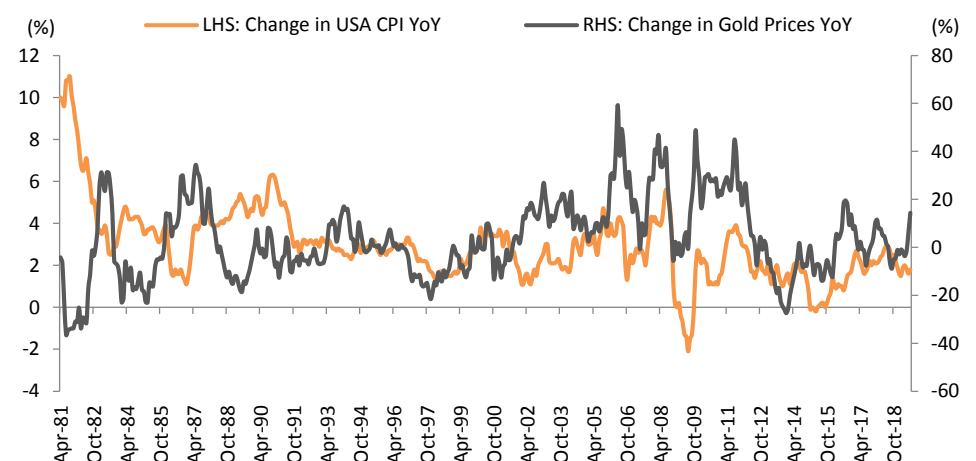
Source: IMF, Equirus Securities

1. UAE and India have signed a currency swap agreement ([Link](#)). This will reduce foreign outflows of USD by USD 0.5bn, which will increase its CA surplus by 2%. Importantly, it will provide a big cushion against the fall in Brent which jeopardises the currency (UAE dirham pegged against US\$).
2. India is in active talks with oil exporting nations to sign currency swaps; this would help India as well as other nations.

### Trump policies inflationary — another positive for gold

As depicted in Exhibit 18, the inflation trajectory in USD is a prime determinant of gold prices over the long term. There has been volatility during risk-off periods; however, over the long term, USD inflation has been the prime driver of gold prices (in USD). Now policies of 'trade war' and imposing tariffs on imports is at best inflationary, and worst far more damaging including flash crash of the dollar. In this scenario, gold will price in a changing inflation trajectory as well as possibility of flash crash in USD. Gold, being a store of value, will rise in such conditions.

**Exhibit 18: Change in US trade policies inflationary, a big positive for gold prices**



Source: Bloomberg, Equirus Securities

*USD inflation a prime driver of gold prices (in USD)*



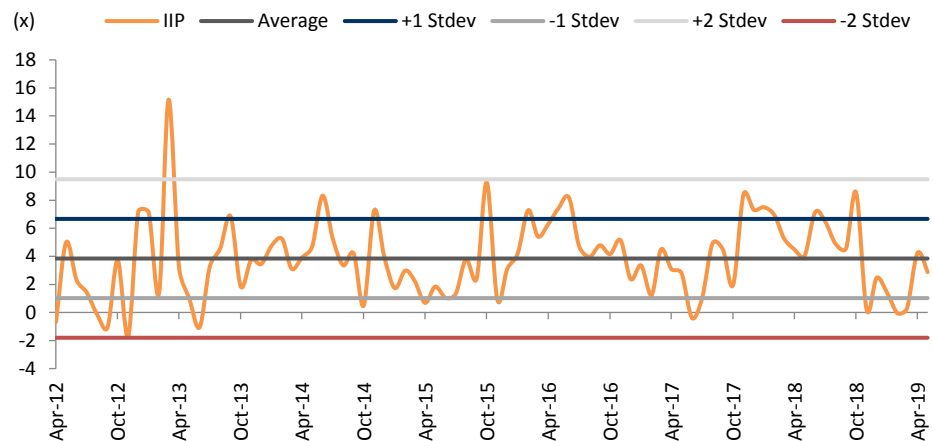
## Indian economy: Cyclical slowdown

The Indian economy is seeing a slowdown, with the impact more pronounced for the auto sector. The perception of what appears to be a cyclical slowdown has been exacerbated by the stock market correction led by a change in govt. taxation policies.

### India IIP averages 3.84% in last 8 years, so single-digit IIP not a new problem...

Indian IIP growth has been anaemic for the last 8 years; a better part of the street is still in ages of the synchronised global growth period of 2005-08 when IIP was well above 10% for 3-4 straight years. While nothing is impossible, it looks unlikely that we will touch the hey days of 2005-08.

Exhibit 19: Indian IIP growth trends

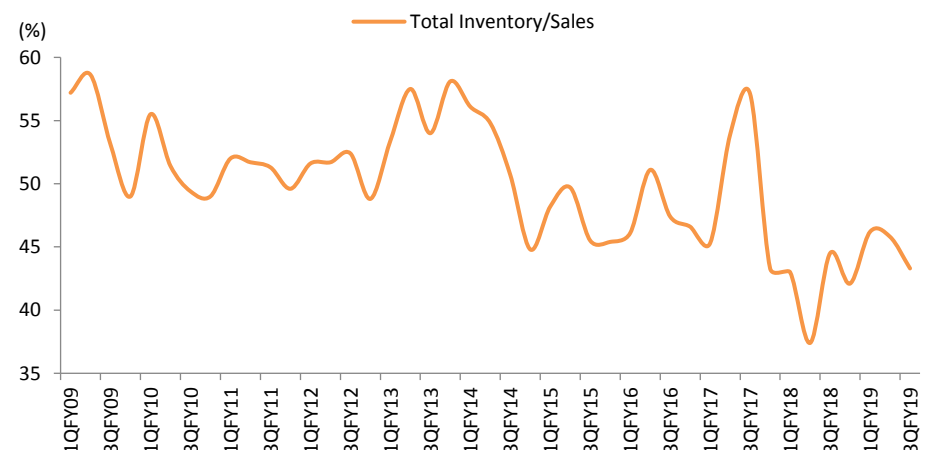


Source: Bloomberg, Equirus Securities

### ...but pessimism a problem; declining inventory-to-sales also points to pessimism

The Indian economy saw its first inventory rundown around GST implementation, which was on expected lines. However, post that, we have not seen inventory build-up. Uncertainty over election results might be one reason for the same but, as always, it's the perception of a slowdown which creates a slowdown. The stock market correction is doing no good to Indian corporate sentiments.

Exhibit 20: Trends in inventory-to sales ratio



Source: RBI, Equirus Securities

### Stretched working capital cycles add to woes

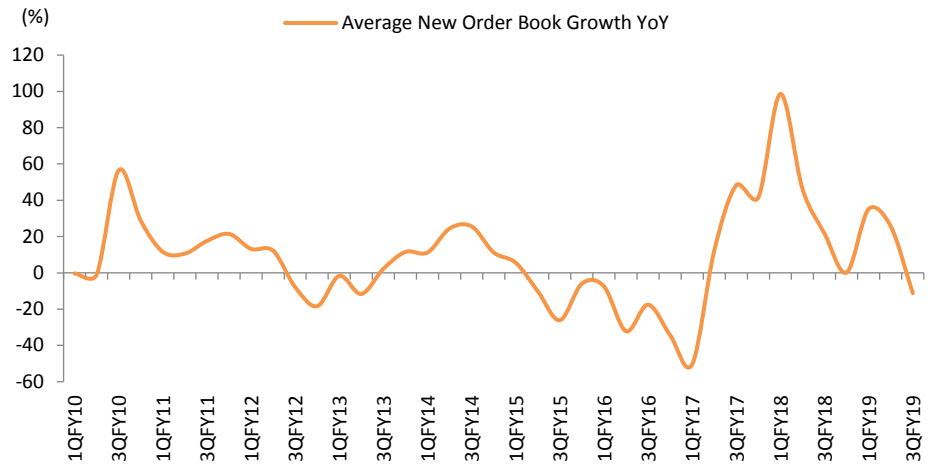
While the RBI is pumping enough liquidity into the system, lack of trust owing to the NBFC crisis is curtailing credit flow into the system; this in turn is stretching working capital cycles. Government delays to pay GST credit is not helping. Our interaction with many small businessmen indicates that, in many cases, they have been depositing GST from their savings as stretched WC cycles means money is not reaching them on time.

Indian IIP growth has been tepid at best in the past 8 years

Economy going through a cycle of pessimism, denoted in low inventory-to-sales ratio

*New orders declining and manifesting in a slowdown*

**Exhibit 21: New order book growth is also tepid**

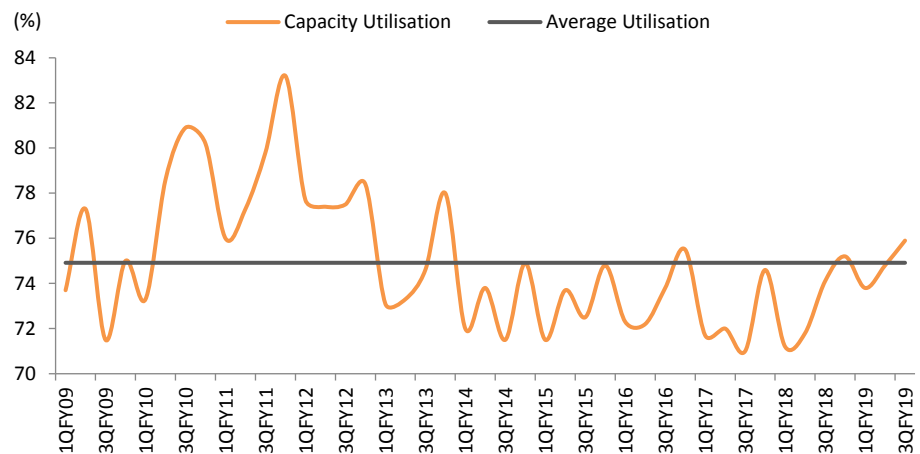


Source: RBI, Equirus Securities

### Capacity utilization increasing, but may not lead to increased capex

While RBI data shows increased capacity utilization, which is higher than 8-year average, fresh capex might not start soon given the shaky confidence level in the credit system.

**Exhibit 22: Capacity utilization in the system**



Source: RBI, Equirus Securities

### Low inventory, rising utilization may bring temporary inflation back in system

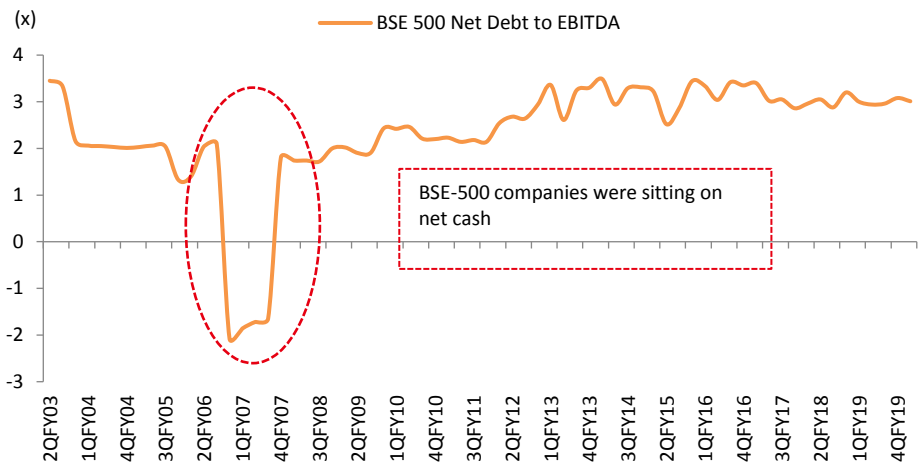
Low systemic inventory and increasing capacity utilization can bring the inflation scare back if demand revives. However, the same can be only temporary.

### Slowdown in capex a result of overleveraged balance sheets

The cyclical slowdown in capex has been led by an attempt to deleverage balance sheets; however, we don't see great development in the same. BSE 500 companies went into a big capex drive in 2005-06 when, on an aggregate basis, they were sitting on cash. Hence, bank lending became easy and companies went into a capex overdrive. We don't see that happening yet.

*System utilization rising but still not high enough to indicate a big demand squeeze-led inflation*

Exhibit 23: Net debt/EBITDA trends for BSE500 players



Source: Bloomberg, Equirus Securities

**Private sector capex may not start in near-to-mid-term**

Past leverage and capex trends indicate that Indian corporates are unlikely to restart capex in the near-to-mid-term. More so, when banking credit is difficult to get and a slowdown in end demand is not aiding profitability.

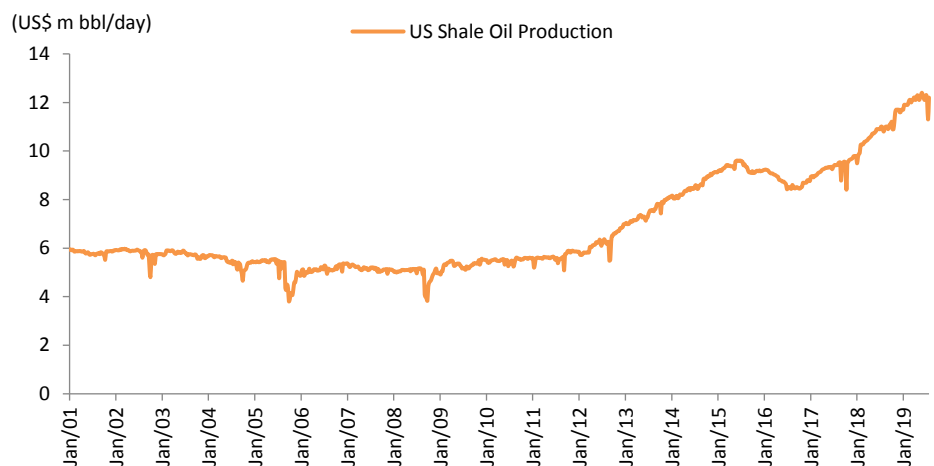
**Lending inability of PSBs — another impediment to capex**

Most PSU banks are struggling to meet the statutory capital requirements, which is impairing their lending abilities. On the other hand, big private sector banks like Yes Bank are also struggling. Before they start lending, NBFCs and banks need to stabilize their balance sheets.

**Crude spike unlikely; India's currency/CAD not at big risk**

The world is slowing down, and trade wars would not do any good to crude demand; this is not good news for crude prices. While a sudden terror act can push up prices, a continuous rise of US shale oil production and lower cost would act as a counter- balancing factor to crude prices.

Exhibit 24: US shale oil production at a multi-year high



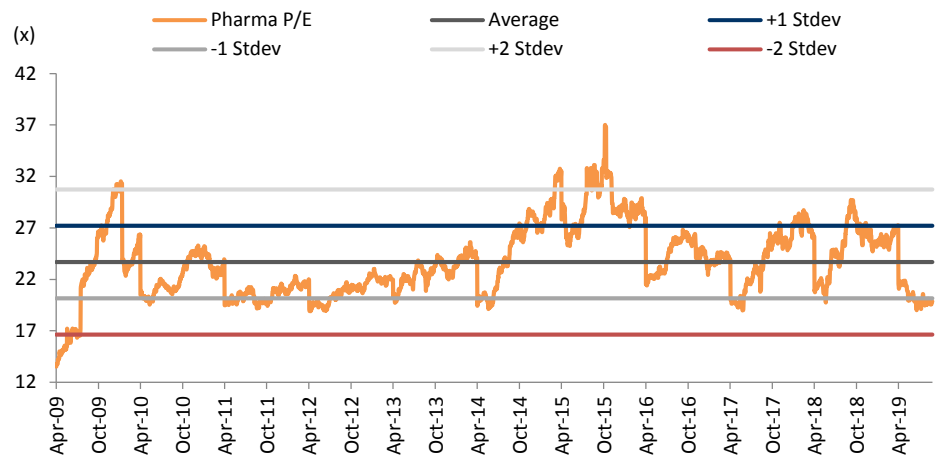
Source: Bloomberg, Equirus Securities

Analysis of BSE500 players indicates current net debt/EBITDA levels won't lead to a spike in capex

High US shale gas production de-risks world from a Middle East conflict-driven oil shock

## Pharmaceuticals: BUY amid concerns

Exhibit 25: Pharmaceutical index trading near worst valuation of last 10 years



Source: Bloomberg, Equirus Securities

### However, industry fundamentals on an improving trend

- 1) While we are nowhere near the steady growth witnessed by the industry, it appears the base has been formed.
- 2) The rate of generic price erosion is stabilizing in the US.
- 3) With entry of Amazon, the monopoly of PBMs has been challenged.
- 4) Big generic players like Teva have exited part of the US generic market as they cannot take any more price cuts.
- 5) While a large number of ANDA filing remains an industry overhang, quick disposal of ANDAs is an opportunity for pharmaceutical players.

Exhibit 26: Long-rated stocks in pharmaceutical space

Company	EPS			ROE			P/ BV			Div Yield
	2019A	2020E	2021E	2019	2020E	2021E	2019	2020E	2021E	2020E
Ajanta Pharma Ltd	42.1	50.3	58.5	17%	19%	19%	2.2	2.0	1.7	1%
Aurobindo Pharma Ltd	41.9	47.7	54.1	19%	18%	18%	4.2	3.6	3.2	0%
Cadila Healthcare Ltd	18.4	17.5	21.1	20%	17%	17%	2.3	2.0	1.7	2%
Dr Lal PathLabs Ltd	24.6	31.1	38.0	24%	25%	25%	10.4	8.7	7.2	0%
Ipca Laboratories Ltd	36.0	42.8	59.1	16%	16%	19%	3.9	3.4	2.9	0%
Jubilant Life Sciences Ltd	57.5	66.5	66.3	20%	19%	17%	1.3	1.1	1.0	1%
Natco Pharma Ltd	36.5	21.5	31.7	20%	11%	14%	2.8	2.6	2.3	1%
Sun Pharmaceutical Industries Ltd	14.7	21.7	23.3	9%	12%	12%	2.4	2.2	2.0	0%
Thyrocare Technologies Ltd	17.9	23.7	28.3	22%	28%	31%	5.9	5.3	4.8	2%
Torrent Pharmaceuticals Ltd	51.1	66.7	72.5	18%	20%	21%	5.5	4.7	4.6	1%

Source: Company, Equirus Securities

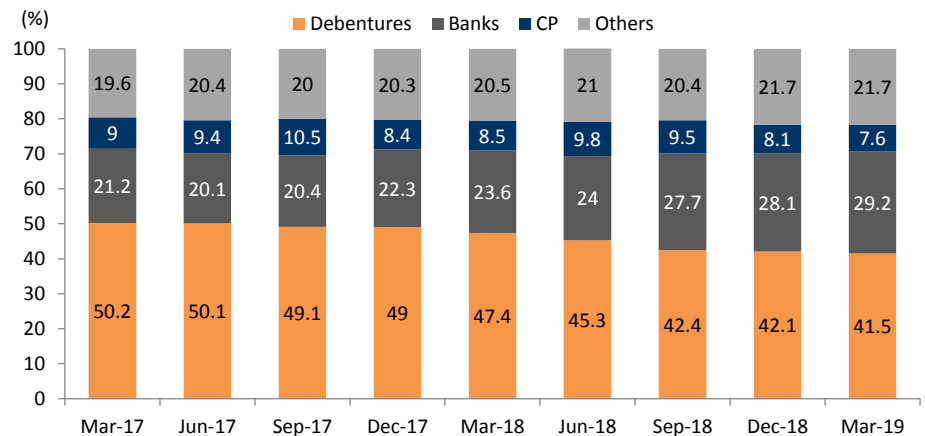
While pharma sector problems are well known and appreciated, valuations are near a 10-year low and price in most concerns

We also like the diagnostic space, with Dr Lal Path Labs and Thyocare as our top picks

## Indian Banking, NBFC: Crisis aggravating slowdown, radical solution needed

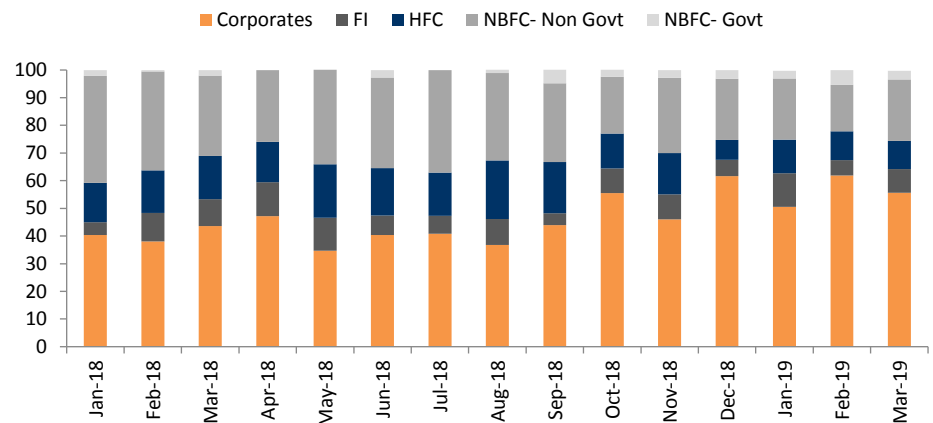
The NBFC crisis is intensifying as (a) banks are becoming reluctant and (b) the CP market is drying up for NBFCs as some have defaulted on payments. Overall, the CP market is shrinking, while banks are filling in and even corporates are subscribing to the same. At the same time, a delay in coupon payments is creating havoc for fresh issuance.

**Exhibit 27: NBFC crisis is led by inability to roll over CPs and also to raise debentures; Relying on risk averse banks is accentuating the crisis**



Source: RBI, Equirus Securities

**Exhibit 28: Mostly CPs subscribed by corporates; recent events lead to risk aversion**



Source: RBI, Equirus Securities

### A decline in CP issuance and debentures is leading to higher reliance of NBFCs on the banking sector, which is a negative for NBFCs and for economy as such

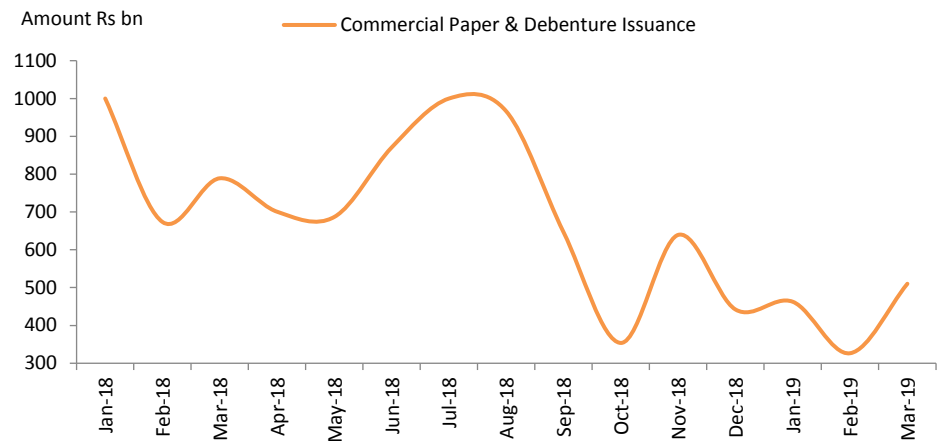
Decline in CP and debenture issuance is forcing Indian NBFCs to rely on bank funding as well as outside sources. This in turn is leading to non-rolling of CPs and, in extreme cases, default as well. NBFCs are a source of funding for many small corporates and builders, which is leading to the protracted working capital cycles and at the same time protracted GST refund cycles exacerbating the problems. Recent announcement on GSR+T refund within 30 days for MSME's is a positive step.

Over last two years, the debenture market has sharply reduced for NBFCs who are relying more on banks

CPs mainly subscribed by corporates; delayed payment not helping fresh issuance

**Exhibit 29: Commercial paper and debenture issuance trends**

*CP and debenture issuance had picked up in Q4FY19 but would have likely declined again in Q1FY20 (data unavailable)*



Source: RBI, Equirus Securities

**Indian banking sector: IBC a great idea, but situations are not resolving fast enough**

IBC was launched with great fanfare in India, and it was assumed that cases will resolve fast. However, it is facing multiple roadblocks

- 1) The brief presented by the resolution professional (RP) is at best an abridged one
- 2) In many cases, total liability is unknown. Bidders have been asked to bid in the dark.
- 3) In many cases, the statutory liability is also unknown, and no guarantee is given that bidder will get an unencumbered company
- 4) CoC (committee of creditors) has been given very high powers and Resolution Professional (RP) can act only on their recommendation
- 5) Sometimes decision on every step is challenged in the court of law, which drags the total process
- 6) CoC hasn't been able to weed out non-serious bidders. Many a times, people with no Net Worth also get hearings in CoC and delay the process.
- 7) Sometimes CoC introduces the BG (bank guarantee) criterion in between the process to weed out one or two non-serious players; in this manner, it renders the total resolution process vulnerable to legal challenges.

**However, Indian banking system needs capital urgently as on a systemic basis, it doesn't have capital to fund growth**

As per the RBI, the net worth of the Indian banking system is ~Rs 12trn vs. loans of ~Rs 90trn. This means that there is room for growth as the system level.

However net worth distribution/ loans are skewed towards private sector banks

**What's the solution? India needs its own version of TARP**

India needs its own version of TARP (Troubled Asset Relief Program). Asia is not new to these kind of emergency measures; we have seen this scenario pan out in Malaysia, after the great Asian crisis. What we need is a bad bank to manage all bad assets, and work as a distress asset fund. There are numerous examples of such 'bad banks' in the world.

*As per the RBI, the net worth of the Indian banking system is ~Rs 23trn vs. loans of ~Rs 100trn*

## Indian market positioning: Long — Banks, OMCs, pharmaceuticals Equal weight — Metals, consumers

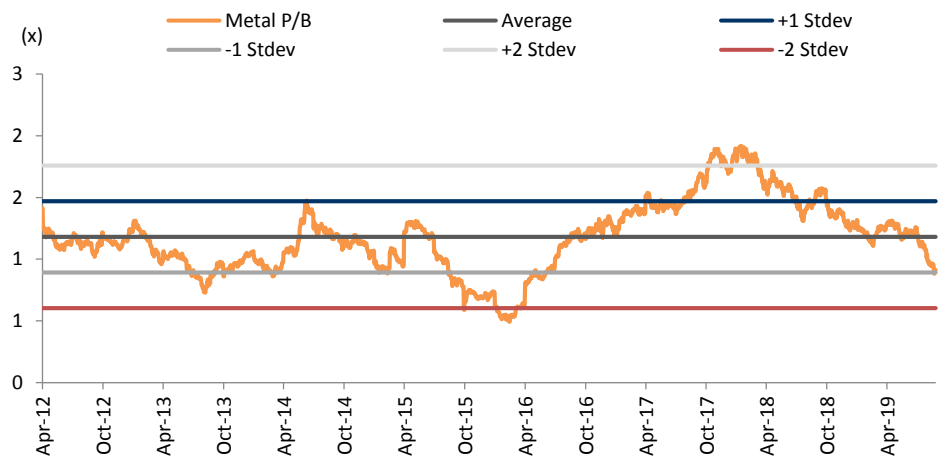
It's time for contrition buy on banks, gold-based financing companies, select metal names, OMCs and even pharmaceuticals. We are underweight consumer, and equal weight on the Indian chemicals space and overweight utilities.

### Metal index: Equal weight

As usual, metals are showing a sharp sell-off amid a tough environment. With cheap valuations in this scenario, we think it's a good time to buy metal stocks.

*Metal index trading at -1 SD of 8 years average as non-ferrous stocks are still holding well*

Exhibit 30: Metal index



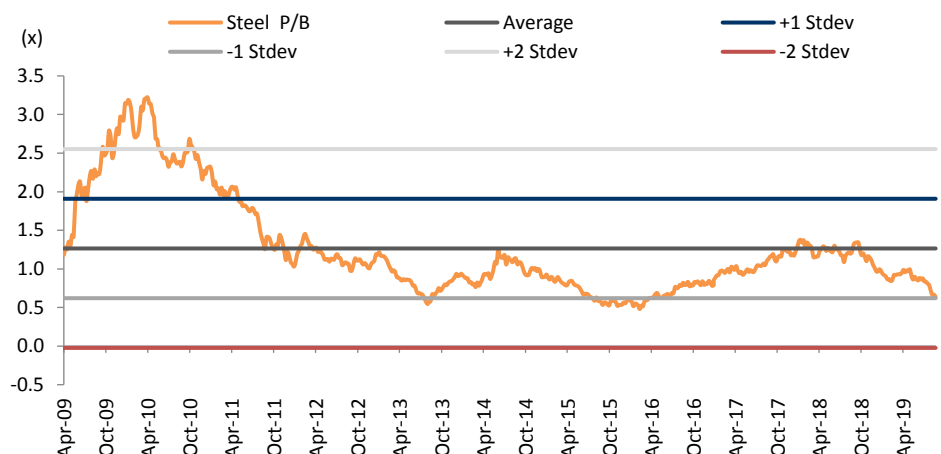
Source: Bloomberg, Equirus Securities

### Steel: time to be overweight among metals

Among metals, steel is showing signs of big bottom formation. In the past on each of the three instances, steel stocks have shown a sharp bounce back. While the current scenario is gloomy, we think this is an opportune time to buy commodities rather than when things look upbeat.

*Steel stocks trading near worst valuation in last 10 years; but this time, they have downside protection in terms of MIP*

Exhibit 31: Steel index



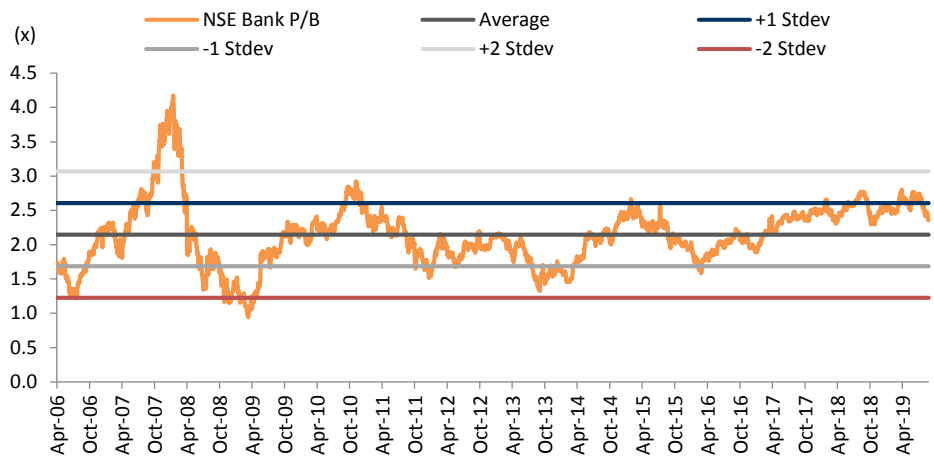
Source: Bloomberg, Equirus Securities

Note: We have used Tata Steel, JSW Steel, JSPL and SAIL to calculate sector P/B for steel index

## BFSI: Go long, BUY selective NBFCs

It's time for bottom fishing in this space. The gloom out there is manifesting in sector valuations. While the overall banking index valuation is far from being distressed, the stress becomes more apparent with one looks at PSB valuations closely.

Exhibit 32: Bank index

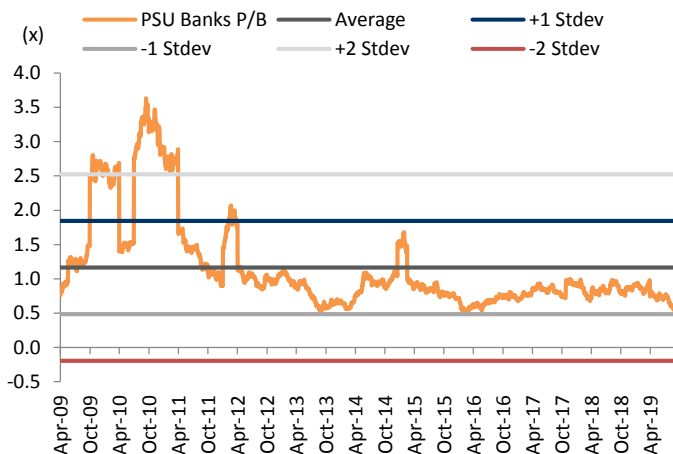


Source: Bloomberg, Equirus Securities

## BUY selective PSBs; SBI Bank our top pick

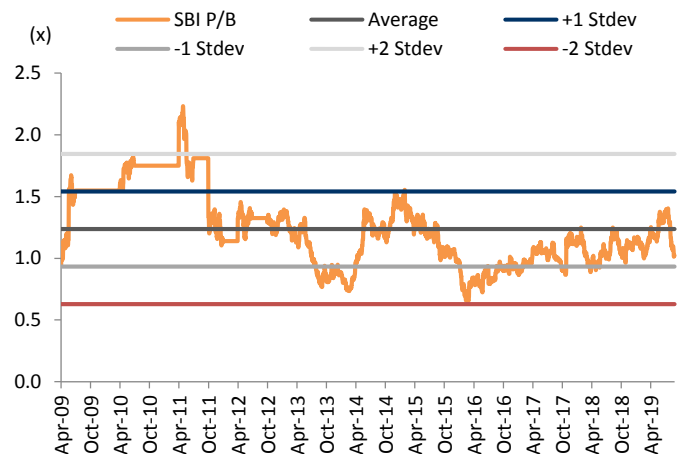
In the banking space, PSBs look most interesting to us. We like the biggest public sector lender, SBI Bank (NOT RATED). While the PSU banking index is not trading at all-time lows, note that PSBs have taken big losses and hence much of the NPA pain is over. Compared to Dec'15, books of PSBs are much cleaner and investors won't get nasty surprises.

Exhibit 33: PSBs trading near 0.5X P/B. With recent govt. capital infusion, the space has become more attractive



Source: Bloomberg, Equirus Securities

Exhibit 34: Among PSBs, we like SBI the most. We don't cover SBI now; it's a strategy pick



Source: Bloomberg, Equirus Securities

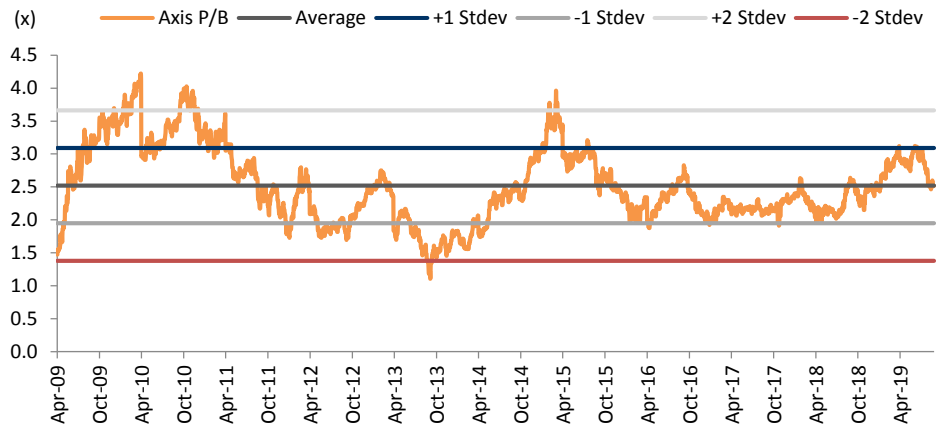
## We like AXIS Bank among private sector banks

From a strategy perspective, AXIS Bank's (NOT RATED) asset quality will likely improve further from FY20 onwards as a large part of the stress is already recognized. The high provisioning coverage ratio (PCR) of +65% offers comfort. Operating profit could bounce back in FY20-FY21E. The bank's strong retail franchise as well as robust CASA accruals are likely to continue. Valuations offer additional comfort.



### Exhibit 35: Within the private sector banking space, we prefer Axis Bank over others

Axis Bank's asset quality to improve further, with large part of stress already recognized

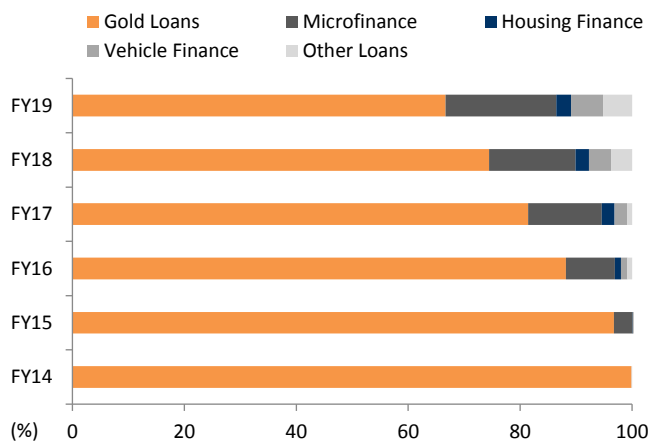


Source: Bloomberg, Equirus Securities

### We prefer gold lending companies (Mannapuram) among NBFCs

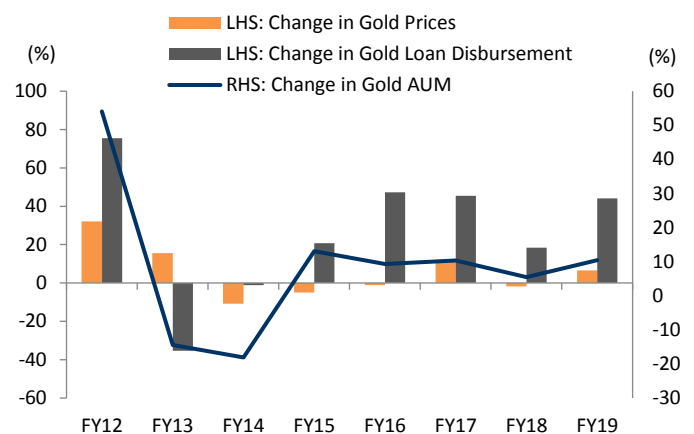
Mannapuram lends with gold as collateral, with a typical LTV ratio of 67-68%. Given an increase in gold prices, there are two re-rating steps: (a) there is more demand for gold loans, and (b) LTV declines provide higher ability to lend. The company has also diversified and 67% of its current book is related to gold loans.

### Exhibit 36: Gold loans form 67% of Mannapuram's book



Source: Ace Equity, Bloomberg, Company, Equirus Securities

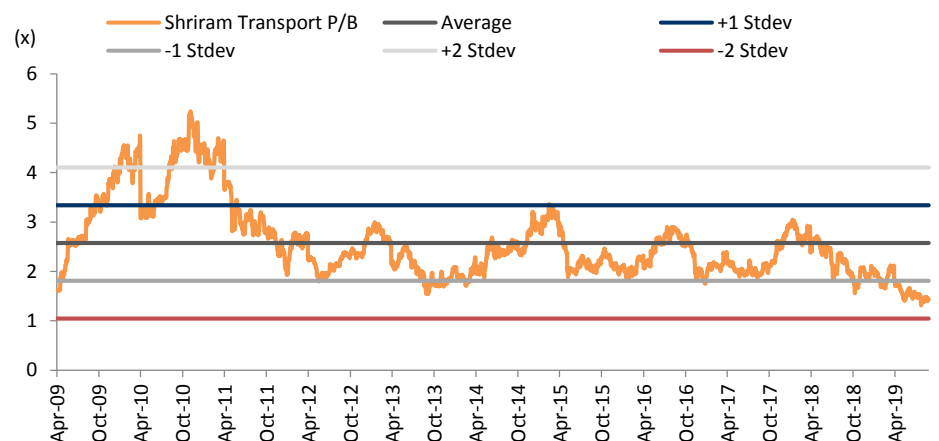
### Exhibit 37: Historically, with an increase in gold prices, gold AUM has grown; trend to continue ahead



Source: Ace Equity, Bloomberg, Company, Equirus Securities

### At these levels, one cannot be negative on NBFCs; we like Sriram Transport

### Exhibit 38: Sriram Transport : P/B trends



Source: Bloomberg, Equirus Securities

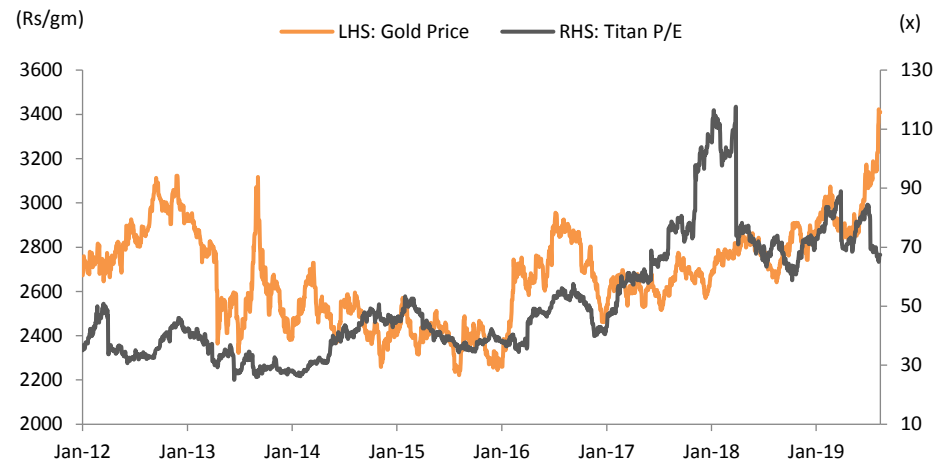
While CVs are going through a downturn, the decade-worst valuation of Shriram is factoring this in; there is significant money to be made even if there is a hint of cyclical upturn

### Consumption: Titan (NOT RATED), VIP Industries our top picks

Titan will benefit from a rise in gold prices. In the consumption space, VIP is another pick.

#### Exhibit 39: Rising gold prices leads to a re-rating in Titan

*We are positive on gold hence Titan is one of our strategy picks*



Source: Bloomberg, Equirus Securities

### Infrastructure: to benefit from Govt. expenditure; we like PNC Infra and HG Infra

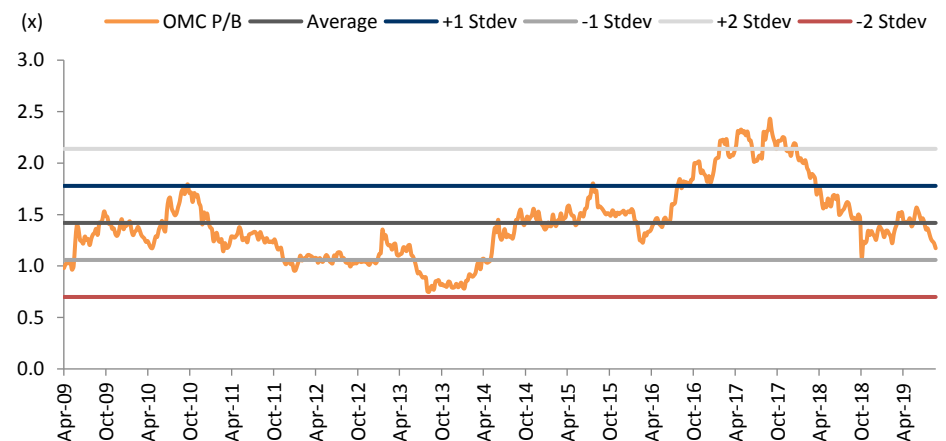
While we are not that bullish on private sector capex, govt. infra expenditure would continue. In this space, we like PNC Infra (LONG, Rs 230) and HG Infra (LONG, Rs 384)

### Oil & gas: prefer OMCs

A stable-to-declining crude is positive for Indian OMCs. There is fear of the government interfering in the pricing of fuel and via a roll-back of reforms initiated in 2014. There has been one instance as well when GOI did the same, which however was in stable to declining crude oil scenario. We don't cover the sector yet but it looks attractive.

#### Exhibit 40: P/B trends for OMCs

*With stable-to-declining crude oil and 3-year low valuations, OMCs present a decent upside*



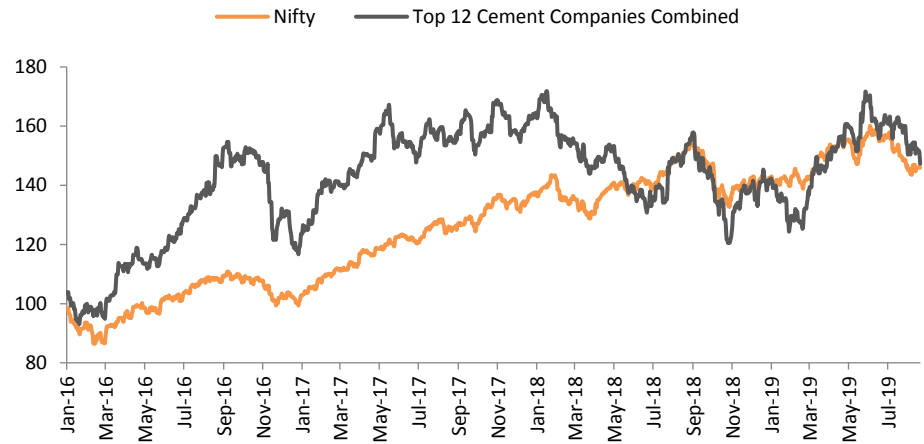
Source: Bloomberg, Equirus Securities

Note: We have used BPCL, HPCL and IOC to calculate sector P/B for OMC index

### Cement: Performs in line with markets over last 3 years, trend to continue

While the sector has been a market performer over last three years, high valuations still don't leave any room for negative surprises. We maintain an equal-weight stance on the sector with Ultratech (UTCEM, NOT RATED) as our preferred pick.

**Exhibit 41: Cement index relative to Nifty**



Source: Bloomberg, Equirus Securities

*Cement has been a market performer in last 3 years; we expect the trend to continue. UTCEM (not rated) is our top pick*