AJCON GLOBAL
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Top picks and view on Indian equities before assembly elections.. **Dec. 03, 2018**

Markets completed their best month in four in November, on signs that foreign buying is increasing amid strengthening of the rupee and slipping of crude oil prices into bear territory. The benchmark Sensex rose 5.1 per cent in November — its steepest monthly gain since July. It climbed 0.1 per cent to 36,194.30 on Friday. The Nifty rose 4.7 per cent in the month. Overseas investors bought net Indian shares worth $720 million through November 28 after three months of selling, according to data compiled by Bloomberg. Domestic stocks and the rupee were already surging higher following a sharp decline in global crude oil prices, India's biggest import item. Brent crude prices have come off by over 30 per cent in the past two months, helping India save billions of dollars in oil bills.

India's gross domestic product (GDP) grew 7.1 percent in July-September, down from 8.2 percent in the previous quarter as high fuel prices, a sliding rupee and relatively weaker rural demand seem to have applied the brakes on the economy.

We believe Q2FY19 earnings season has been mixed bag. Nikkei India Manufacturing PMI for November has risen to 54, up from 53.1 that was recorded in October. The latest figure signalled the strongest improvement in the health of the sector in almost one year. Encouraged by falling crude oil prices and a sharp appreciation in rupee, overseas investors have pumped Rs 12,260 crore in the Indian capital markets in November, making it the highest inflow in 10 months.

Going ahead, the OPEC meeting is very crucial as it is estimated that a $10 per barrel increase in crude oil prices will increase the current account deficit of India by $15 billion, or around 0.50 percent of GDP. Rising crude oil prices have has a significant impact on inflation and fiscal deficit.

Going ahead, we believe RBI meeting on Dec., OPEC meeting, outcome from (both exit polls and actual result) of assembly elections in five states will determine the market trend. Political stability or instability could well impact markets in more than one way. Four states went for polls in the month of November 2018 — Madhya Pradesh, Chhattisgarh, Mizoram and Telangana — ahead of general elections 2019. Rajasthan assemble polls are due on Dec. 07, 2018. Opinion polls suggest very tough fight in Rajasthan, MP and Chhattisgarh for the current government. Telangana also does not seem to be a cakewalk for TRS post congress, TDP alliance. But, the outcome of Madhya Pradesh elections will be important for benchmark indices. Investors can start looking for good companies which have a sustainable business model with good ethical management having clearcut strategy for the future at cheap valuation. Importers should be cautious as the rupee may not sustain at these lower levels.

Top picks for the moment

Automotive Axles Ltd.

Established in 1981, Automotive Axles Limited (AAL) is a joint venture of Kalyani Group and Meritor Inc., USA (Meritor Inc, USA – 35.5%, Kalyani Group – 35.5%). With manufacturing facilities located at Mysore (Karnataka) and Jamshedpur (Jharkhand), the company manufactures drive axles, non-drive axles, front steer axles, specialty & defence axles and drum & disc brakes. It provides these products to the major domestic and global manufacturers of trucks & buses pertaining to segments such as light, medium & heavy commercial vehicles, military & off-highway vehicles, aftermarket and exports. As a continuous process, the company believes in introducing new products regularly to meet the emerging needs of the commercial vehicle market.

Products manufactured at AAL are based on technology provided by Arvin Meritor Inc., USA, through Meritor HVS(India)Ltd, India. With manufacturing facilities located at Mysore, Jamshedpur and Pantnagar, the company is currently one of the largest independent manufacturer of Rear Drive Axle Assemblies in the country and with more than 20 years of axle - producing experience and advanced gearing technology from Meritor HVS(India)Ltd, has been manufacturing reliable, long-life heavy duty drive axles. This capability allows the company to meet the steer, drive and trailer axle requirements of customers in the addressed markets.

We are very bullish on this Company owing to its strong promoter group and goodwill it enjoys in the auto ancillary space. The Company would be a major beneficiary from the revival of Commercial vehicles market. A series of reforms, including demonetisation, implementation of Bharat Stage-IV (BS-IV) emission norms, implementation of the GST, and enforcement of overloading norms, have resulted in significant volatility in the purchase considerations of fleet operators, influencing the demand for Commercial Vehicles (CVs). Nevertheless, in FY 2017-18, the domestic CV sales have grown by 20% in volume terms over FY 2016-17. Medium and Heavy Commercial Vehicles (M&HCV) Trucks and Light Commercial Vehicles (LCV) Trucks grew by 19.4% and 28%, respectively, in unit terms in the same period.

The Company has all the ingredients to ride on the upturn of CV cycle. The Company has robust technological capabilities to cater the requirements of heavy duty and multi-axle vehicles. The Company has strong relationship with its marquee clients like Volvo, Eicher, Tata Motors, Ashok Leyland, Essar, Daimler Chrysler, Arvin Meritor, Mahindra & Mahindra, Bajaj Tempo, VFJ (Army), Swaraj Mazda, BEML etc.

The Company upgraded its state-of-the-art manufacturing facilities with modern equipment and technologies such as Face-Hob Gear Cutting and Robotic Gear Quenching for enhanced productivity and energy conservation.

FY 18 was a strong operational year for Automotive Axles Limited (AAL). The Company's constant focus on new product development, forward integration with the customers, adherence to stringent quality standards including Builtin Quality (BIQ), improved input-output mix and strict adherence and continuous focus to meet the customers' delivery performance were the key drivers for our continuous growth. AAL reported a 29% revenue growth from sale of products (net of excise duty) of Rs. 14,788 million in FY 2017-18, compared to Rs. 11,453 million in FY 2016-17. Simultaneously, its EBIDTA increased 48% to Rs. 1,716 million in FY 2017-18 against Rs. 1,156 million in FY 2016-17. The Company's net profit grew by 70% to `839 million inFY 2017-18 against Rs. 494 million in the previous year and (EPS) stood at Rs. 55.54 in FY 2017- 18, compared to Rs. 32.70 in FY17, a growth of 70%.

The Company enjoys strong cash conversion cycle of 50 days which has improved from 100 days in FY14. The return ratios of the Company are also quite upbeat with ROE and ROCE of 19.5 percent and 31 percent respectively with minuscule debt in the books.

At CMP of Rs. 1,374 (FV: Rs. 10), the stock is valued at a P/E of 19x on trailing twelve months EPS. We recommend a Buy with a target price of Rs. 1,786 (19x on estimated FY20 EPS of Rs. 94) implying an upside of 30 percent.

SBI

We believe the bank is well on track to return to its past glories. In Q2FY19, the bank returned to profit at PAT level. SBI posted a net profit of Rs 944.87 crore in Q2FY19, which was against net losses of Rs 4,875.85 crore in Q1FY19. However, the Q2FY19 net profit was down by 40.26% as against profit of Rs 1,581.55 crore recorded in the corresponding period of previous year. Strategy on controlling credit cost and focus on credit quality has enabled Bank to deliver profits despite Mark to Market Provision of Rs. 1,749 crores.

The Bank enjoyed decent domestic credit growth of 11.11 percent in Q2FY19 across retail and high rated corporate. The Bank is expected to leverage credit growth momentum; CD ratio stood at 66 percent in Q2FY19.

NII stood Rs 20,906 crores in Q2FY19, which was up by 12.48% compared to Rs 18,585.90 crore a year ago same period. On the other hand, NII in Q2FY19 was below 4.09% as against NII of Rs 21,798.36 crore recorded in Q1FY19. The bank has tight control on overheads, down 3.19 percent YoY and 1.72 percent QoQ. Higher credit growth and lower slippages lead to improvement in NIMs. NIMs stood at 2.76 percent in Q2FY19.

In Q2FY19, Gross NPAs declined from Rs 2,12,840 crores as on June 18 to Rs 2,05,864 crores as on Sep. 2018, whereas Net NPAs declined from Rs 99,236 Cr to Rs 94,810 Cr during the same period. Gross NPA Ratio at 9.95% declined sequentially by 74 bps. Net NPA Ratio at 4.84% declined sequentially by 45 bps. Provision Coverage Ratio improved by 655 bps YoY from 47.40% as on September 17 to 53.95% as on September 18 and improved by 57 bps sequentially. The benefit of RBI dispensation with regard to amortization of MTM loss has not been availed. NPA ratios have improved aided by lower slippages and higher recoveries while PCR is progressively higher. PCR stood at

SBI has put up for sale three of its non-performing loan accounts to recover dues of Rs 2,110.71 crore. An e-auction will take place on December 13 for the sale of these three accounts — Sona Alloys Pvt Ltd, MCL Global Steel Pvt Ltd and Jayaswal Neco Industries. Earlier on November 22, SBI held e-auction of 11 NPA accounts that had outstanding dues of Rs 1,019 crore towards the bank.

We like the bank as the slippages have come down for SBI and the resolution of NCLT cases is well on track. We expect good writebacks in the coming years although there may be higher provisioning in H2FY19. Our conviction on this PSU bank stems from the positive management commentary in its analyst meet. The Bank management has high visibility of resultions in H2FY19 and expects GNPA at below 8 percent by Q4FY19 and Net NPA at below 4 percent. SBI has a given a guidance of loan CAGR of 12 percent, NIM target of 3 percent, slippages & credit cost of less than 2 percent, ROA of 0.9-1 percent, cost/income of 46 percent by end of FY20. The management of the bank is confient that it is progressing well to meet Slippage ratio and credit cost guidance for FY19E and FY20E.

To unlock value from its subsidiaries, SBI General Insurance and SBI Funds and Cards management are expected to be listed next year. We believe that the bank has accounted for its NPAs and stressed assets and the worst case scenario is now behind us. Prospects of recovery are likely to increase and we expect good write-backs as well.

The present NBFC funds crisis led by ILFS fiasco has also opened a window of opportunity for SBI to pump atleast Rs. 50,000 crores in the NBFC market at attractive interest rates.

HIFY19 RoA and RoE stood at 0.22 percent and 4.23 percent respectively which is expected to improve in H2FY19. At current market price of Rs 285, the bank trades at P/BV of 1.16x (H1FY 18 Book Value stands at Rs. 244) and at adjusted Book Value (after deducting Net NPAs), the stock trades at P/BV of 2.06x. We do not have immediate target in mind but expect handsome returns in the medium term.

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