AJCON GLOBAL
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Top picks and view on Indian equities **Dec. 17, 2018**

With the state election results and uncertainty at RBI being over, the market would now track global cues. We believe Q2FY19 earnings season has been mixed bag but Q3FY19 could be much better. Event-wise, the upcoming FOMC meeting on December 20 has become the most important meeting in a long while. Domestically, with CPI inflation hitting 17th month low, the new RBI Governor, may take interest in cutting interest rates to boost market sentiments. We do expect volatility as the Central Government may resort to populist measures to gain back popularity amongst the rural community which may be negative for the economy in the long term. With crucial assembly elections (which were considered as semi - finals to Lok Sabha elections in May 2019) results out, the question now comes to our mind as to which party manages to win the General elections. It may be difficult for both major parties BJP and Congress to get majority. Street participants would not prefer a coalition government as decision making and execution becomes difficult in coalition regime for obvious reasons.

The strategy at present should be to invest in phased manner only in companies which are not connected to any political party and have a robust business model backed by quality management especially on the corporate governance front. We would suggest investors to have a look at Pharma MNCs and Private Insurance Companies at the current moment.

Top picks

Security and Intelligence Services Ltd. (SISL)

CMP: Rs. 775, FV: Rs.10, Market Cap: Rs. 5,608 crores, Target price: Rs.995, Upside: 28%

EPS (TTM): Rs. 22.73, P/E: 34x, Equity Capital: Rs. 73.18 crores, Reserves: Rs.533 crores, Long term borrowings: Rs. 98.60 crores, Short term borrowings: 111.07 crores, Cash and cash equivalents: Rs.121.66 crores, ROCE: 26%)

Established in 1974, SISL, a New Delhi-based company, is one of the largest private manpower security solution providers in India and Australia. The company serves a diverse range of renowned clients across all sectors. The Company offers services like Electronic systems surveillance, security consulting and pre-employment verification, facility management, and cash/bullion logistics. The Company has an experience of 30+ years, strong network with presence in 29 states across 630+ districts and 284+ branches.

From humble beginnings over three decades ago, SISL is the largest business services platform of its kind in India and the only one to be listed. Today, it is an Indian multinational with an ever-expanding presence and dominance in both India and Australia.

Today, the Company has a dominant presence across three attractive business services segments - Security, Cash Logistics and Facility Management. SIS caters to clients across B2B, B2G and B2C and the diversity of its client base ensures that SIS is a proxy for the Indian economic growth.

SIS' Security and FM to benefit from Ayushman Bharat (SIS provides services across 300 hospitals and 60,000 beds)

The Company has limited completion and is a major beneficiary of GST regime. India's manpower security sector is largely fragmented with unorganised and small players occupying 70-80 percent of the industry size. Larger tax-compliant security firms like SISL, amongst the top three by revenue in India, are likely to benefit the most.

Marquee institutional clients: The Company's boasts of strong institutional clients like IFFCO, Aditya Birla Group – Grasim, Airtel, Apollo Hospitals, Delhi Metro, DHL, Medanta etc. The Company has long term contracts with the above clients.

Growing strongly through inorganic route:
SISL's wholly-owned subsidiary, is the largest security services provider in Australia in terms of revenues. SIS Australia Group Pty Limited (a subsidiary of SIS) acquired majority stake in Southern Cross Protection (Australia's largest mobile patrol and aviation security entity) in July 2017. With this acquisition, the Company at present provides paramedic and allied health, mobile patrol, and fire rescue services. Chhub Security (CS), another subsidiary of the company, manages security arrangements for various clients in every Australian state. Australia has shown a strong growth of 26% during the year with organic growth of over 12%, the rest coming through the acquisition of the Southern Cross Protection (SXP) business. SISL increased its stake in SXP from 10% to 51%, effective July 1, 2017 and this acquisition enhances our service capabilities by adding the mobile patrol offerings to its solution set. It is now able to offer a more comprehensive bouquet of offerings to its clients and this acquisition makes MSS +SXP the clear No. 1 with a 21% market share in Australia. With its market leadership, SISL has been able to shape and influence the market. Australia continues to play a vital role in the SIS Group and and in FY18 has generated free cash flow of over AUD28 million. SISL has also leveraged a strong balance sheet in Australia to increase its line from NAB to AUD120 million.

The Company is growing organically strongly and is always looking for new attractive opportunities. In Q2FY19 too, SISL completed two acquisitions which are as follows..

a) **SLV security acquisition**

One of the largest security companies in NCR with 70% revenues coming from NCR (11,500 trained security personnel, 16 branches, 1575 sites, Revenue – Rs. 240 crores)

1) Strong Geographical fit

2) NCR is one of the seven largest markets for security services and growing at over 25%

3) Well-diversified, long standing client base

Consolidating its market position in key geographies, SIS – SLV is now a market leader in NCR in terms of monthly billing

b) **Rare Hospitality – Acquisition**

Well-regarded facility Management Company based in Mumbai (4,000 housekeeping personnel, 80 customers, 200+ sites, Revenue: Rs. 82 crores)

1) Strong focus on hospitals – >60% of revenues

2) Long standing client base - retention rates > 95%

3) Client base includes reputed names like ICICI, Reliance, Max Hospital, Asian Heart etc. amongst others

With the acquisition of SLV and Rare, SIS is close to achieving its Vision 2020 plan of becoming No.1 in Security and Facility Management..

Strong pipeline built over the last 12 months coming to fruition. Continued focus on transactions that meet strategic fit and IRR expectations

Robust financial performance in FY18: Consolidated revenue growth has been a stellar 33% and consolidated EBITDA growth at 42%. SISL Return on Capital Employed (ROCE) stood at 26%, which is a very creditable achievement, considering that its capital base significantly increased post its IPO. SISL Operating Cash Flow/ EBITDA is another key financial measure and the Company had an OCF/ EBITDA of 69% and generated operating cash flow of Rs. 2,150 million, which is a new record for the SIS group.

Q2FY19 result highlights

Strong quarterly revenue growth on back of big wins across businesses…

Topline: Rs. 1,690 crores (qoq growth of 4.9 %)

EBITDA: Rs. 78 crores (qoq growth of 5.0%)

PAT: Rs. 44 crores (qoq growth of 10.9%)

Outlook and View: We believe the Company is a proxy for the India consumption story. Security service markets typically growing at 1-1.5x of GDP in developed and at 2x-3x of GDP in developing markets. Low per capita spend on security services in India gives significant headroom for sustainable future growth. India is poised to emerge as one of the leading security services market in the Asia Pacific region. We recommend a Buy with an upside of 30 percent for investors with a horizon of 12 months. At CMP of Rs. 765, at a P/E of 34x on trailing 12 months EPS, the stock may look expensive but it is a structural strong story and we believe it is enjoying scarcity premium. Investors who have patience and ready to hold for 3 to 5 years should gradually accumulate this stock in phased manner on declines.

ICICI Prudential Life Insurance Company

CMP: Rs. 321, FV: Rs. 10, Market Cap: 44,530 crores, Target: Rs. 403, Upside:26%

We believe there is huge opportunity for private life insurers. India is the second-most underinsured country in the world with an insurance gap of $27 billion (approximately Rs 1.98 lakh crore). A survey by specialist insurance and reinsurance market Lloyd's said while India's overall level of insurance penetration (total insurance premiums as a percentage of the gross domestic product) has increased 0.2 percent since 2012, it continues to have one of the highest underinsurance levels globally. Insurance gap refers to the gap between the actual sum assured required versus that taken. For example, if the insurance needed is Rs 100 and an individual has taken Rs 40, the insurance gap is Rs 60.

The Company's performance in HIFY19 was bit subdued. To elaborate, PAT witnessed a fall of 30 percent on yoy basis owing to increase in operating expenses and lower investment income. The main reason for increase in operation expenses is that ICICI Prdential recognize costs incurred (marketing expenses including commissions) to acquire new protection business upfront. This is because accounting rules do not allow amortisation of cost over the life of the policy. However, its operating performance was good. We were encouraged by the fact that there was strong growth of 77 percent on yoy basis in its protection annualised premium equivalent (APE, measure of ascertaining business sales in the life insurance industry). The business mix improved in favor of the high margin protection business. The share of ULIPs in total new business APE stood at 82.2 percent, while that of the protection business improved further to 7.9 percent (4.5 percent in Q1FY18). The new business margin improved significantly by 580 bps to 17.5 percent on yoy basis. There was an improvement in persistency ratio too. The main highlight was the margin expansion due to improving product mix with an increasing share of the protection business.

The value of new business (VNB) witnessed a robust growth of 41.5 percent to Rs. 590 crores in H1FY19 as compared to Rs. 417 crores a year ago. VNB in FY18 stood at Rs.1,286 crores. VNB is the present value of all future profits to shareholders measured at the time of writing of the new business contract. New business premium registered YoY growth of 16 percent to touch Rs. 7,356 crores in FY18.

Persistency or the quality of renewals across all the different brackets saw an improvement. The 13th month persistency stood at 85.2 percent (by premium) as on H1FY19 as compared to 85.7 percent a year ago.

On the other hand, there are negatives like ICICI prudential having higher exposure to ULIP products.

In terms of valuation, the Company is well placed against its peers SBI Life Insurance and HDFC Standard Life as it is trading at a discount in terms of Market Capitalisation/Embedded Value. ICICI Prudential's stock is currently trading at Market Cap/EV of 2.3 times, which is at a significant discount to HDFC Life's (Market Cap/EV of 4.3 times), despite RoEV improving from 16.5 percent in FY17 to 22.7 percent in FY18which is highest in the sector.

Housing Development Finance Corporation (HDFC)

CMP: Rs. 1,904, FV: 2, Market Cap: Rs.3,27,378 crores, Target: Rs. 2,100

HDFC Ltd. is India's leading mortgage lender and a well - established financial conglomerate. It has assisted over 66 Lakh customers in acquiring their own home over the last 4 decades. With a wide network of 514, it caters to over 2,400 towns and cities across India. We believe HDFC is the best play in the Housing Finance space. The Company has garnered around 16 percent market share. The recent mayhem in NBFCs led by IL&FS crisis has pushed back several HFCs but HDFC has been rock solid. We believe the NBFC crisis will augur well for a Company like Housing Development Finance Corporation due to its ability to manage liquidity well.

HDFC Ltd, has become the first financial institution in the country to disburse subsidy to over 51,000 customers amounting to over Rs. 1,100 crore under Credit Linked Subsidy Scheme (CLSS) -the flagship scheme of Government of India's Pradhan Mantri Awas Yojana (PMAY). HDFC has provided loans of over Rs 9,800 crore under PMAY-CLSS, to these customers belonging to EWS (Economically Weaker Section), LIG (Low Income Group) and Middle Income Group (MIG) category. HDFC in line with its vision for providing affordable housing to all has been partnering with the government wholeheartedly to take the scheme, 'Pradhan Mantri Awas Yojana' to the real beneficiaries i.e. EWS, LIG and MIG category. In Q2FY19, HDFC approved 37% of home loans in volume terms and 18% in value terms to customers from the EWS and LIG segment. HDFC Ltd on an average has been approving 8,300 loans on a monthly basis to the EWS and LIG segment, with monthly such average approvals at approximately Rs. 1,354 crore. The average home loan to the EWS and LIG segmentstood at Rs. 10.1 lakh and Rs. 17.6 lakh respectively.

HDFC witnessed 17% growth in the overall loan book on Assets under Management (AUM) basis as on Sep. 2018. HDFC's total advances as on FY18 stood Rs. 3,594 bn with individual loans amounting to Rs. 2,514 bn or ~70% of total advances. Its market share including banks is ~16%, which is second highest after SBI. In Q2FY19 too, credit growth was healthy as against its peers which stood at 16.9% on yoy basis to Rs. 3,79,091 crore. Individual loan portfolio increased 18.3% yoy to Rs. 2,652.33 bn and accounted for 70% of the total. Non individual book grew ~13% on yoy basis.

Total Borrowings stood at Rs. 3,431.72 bn in Q2FY19. The Company has diversified source of funding. Debentures & Securities – 54%, term loans – 18%, Deposits – 28%. We like the Company owing to its strong parentage and optimal Asset Liability Management.

In Q2FY19, NII witnessed a growth of 16 percent on yoy basis to Rs. 2,594 crores. NIM stood at 3.5 percent, Cost/Income ratio – 9 percent, ROE stood at 20.4 percent and RoA stood at 2.4 percent. As per National Housing Bank (NHB) norms, the gross non-performing loans as at September 30, 2018 stood at Rs. 4,278 crore. This is equivalent to 1.13% of the loan portfolio (as against 1.18% as at June 30, 2018). The Company's asset quality improved on qoq basis. GNPA stood at 1.13% (GNPA – Rs. 4278 crore) vs. 1.18% in Q1FY19. NNPA remained nil.The non-performing loans of the individual portfolio stood at 0.66% while that of the non-individual portfolio stood at 2.18%. As per NHB norms, the Corporation is required to carry a total provision of Rs. 2,951 crore. As against this, the balance in the Provisions and Loan Losses Account as at September 30, 2018 stood at Rs. 5,071 crore. This is equivalent to 1.33% of the loan portfolio.

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