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## **Top picks and view on Indian equities after NDA defeating no-confidence motion.. July 21, 2018**

The NDA government comfortably defeated the Opposition's no-confidence motion. The Lok Sabha on Friday took up a no-confidence motion against the government for debate and voting, two days after the start of the monsoon session. The motion was defeated with 325 members voting against it in the government's favour and 126 for it (backing the Opposition).

The S&P BSE Sensex ended on Friday at 36,496, up 145 points while the broader Nifty50 index settled at 11,010, up 53 points. IT and pharma stocks gained as the rupee hit an all-time low. The Nifty IT index was trading up by 1.5 per cent with Infosys, Tech Mahindra and HCL Tech up between 1.6 per cent to 2.6 per cent. Meanwhile, in the pharma sector, Sun Pharma and Cipla gained over 2.5 per cent each.

Among individual stocks, Bajaj Finserv hit a record high, after the Bajaj Group-owned asset & wealth management firm posted a 41 per cent surge in its first-quarter profit on Thursday.

The rupee is already under pressure amid rising crude oil and higher inflation, while sustained capital outflows by foreign institutional investors (FIIs) from local equities and bond market also pressured the sentiment. Trade wars, volatility in oil prices and higher US interest rate pose a risk to Indian economy. Imposition of high import duty by the US has triggered a trade war like situation with other countries like China, Europe, India too resorting to higher tariffs. Brent crude oil prices hit a four-year high of \$80 per barrel recently, stoked by fears of an escalation in trade war between US and China, proposed US sanctions on Iran and Opec's decision to extend oil quotas till 2018-end. However, prices have cooled off since then as some of these concerns eased. Even then, Brent crude oil prices are around 47 per cent higher at around \$72 a barrel level currently compared to the year ago period.

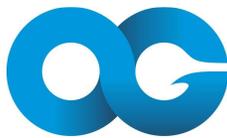
After maintaining record low-interest rates for six years for reviving economic growth since the 2008 financial crisis, the US Fed began raising rates since December 2015. The rates have been hiked five times since January 2017. The nervousness around domestic metal stocks has aggravated recently, with an escalating global trade war. We believe non-ferrous metal prices will see higher volatility, led by a strengthening dollar and a sluggish economic scenario in China and Europe, while the ferrous (steel) sector is better placed. For India's steel sector, prospects remain better, led by domestic demand, an import duty cushion and consolidation. Prices in the domestic market, which had continued to rise since November, might soften a bit due to onset of the monsoon, when construction activities facing slowdown in monsoon. Going ahead, we believe markets will take cue from Q1FY19 results, management commentary post Q1FY19 results, movement in rupee and crude oil prices, key developments from ongoing trade wars between US and China. We advise investors to remain stock specific and consider companies with earnings visibility.

### **Top picks**

#### **Cera Sanitaryware**

**CMP: Rs. 2,674, Target price: Rs. 3,500, Upside: 31%**

The Company enjoys market leadership position in the industry. The Company is transforming itself from a traditional sanitaryware player to a complete bathroom solutions provider. The government's emphasis on affordable housing is a boon for the Company's growth in the coming years. Implementation of GST also helps the Company indirectly as it minimises unhealthy price competition.



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The Company is upgrading its technological edge by inducting new technologies into production processes. The use of 3D printing, robotic glazing, trap glazing, etc. are just few improvements which are helping in quality and productivity in the Sanitaryware plant. In the faucet plant too, robotic grinding and polishing, low pressure and high pressure die casting machines, automatic chrome plating units, etc. have helped in quality.

Constant brand promotion - CERA continued its advertising in several prominent national and regional general entertainment television channels. It helped CERA maintain top of mind recall of its brand name among its target audience - architects, designers, developers, consultants, trade partners and consumers. A recent market research conducted showed that CERA enjoyed top of mind recall amongst influencers.

Launch of new brands: CERA launched two brands to cater to all price segments-JEET for mass segment and SENATOR by CERA for premium segment. Along with CERA and ISVEA, the Company now effectively covers the entire spectrum.

Adding new designs: CERA launched new designs in faucets, tiles, Sanitaryware, wellness, kitchen sinks and mirrors, thereby keeping up and even ahead of the market trend. This is helping the Company gain the leadership in the market place.

Wide distribution: CERA continues its efforts to reach out to under-penetrated towns with full force. Substantial increase in sale has been achieved through this effect and the Company will continue its efforts to reach every nook of the country through its retail network.

More companies entering sanitaryware may pose a threat to the Company's prospects. However, the Company's strong brand recall, distribution strength and product quality are helping it ward off any such threat.

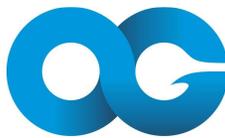
The significant correction in the stock price was owing to fall in topline with the introduction of GST. The current depressed valuations as compared to last 3 years median PE gives an opportunity to investors to grab this consumption story and reap the benefits of wealth creation in the longer term. The management expects 15-18 percent revenue growth in FY19 led by double-digit growth in the faucets and tiles segments. Sanitaryware is expected grow at high single-digits. The management has guided to a 100-150 bps margin improvement for FY19 on account of product premiumisation and price hikes. At CMP of Rs. 2,674 (Face value: Rs. 5), the stock trades at a P/E of 35x on FY18 EPS. We recommend a "Buy" with a target price of Rs. 3,500 (35x on FY19 EPS of Rs.100) implying an upside of 30 percent.

### **L&T Finance Holdings Ltd. (LTFH)**

**CMP: Rs. 155, Target price: Rs. 180, Upside: 16%**

The Company had made a strategic decision to improve its ROE and exit low RoE business. After the appointment of Mr. Dubhashi as MD & CEO in July 2016, LTFH redefined its business strategy to achieve top quartile return on equity (RoE) by FY20 or earlier. Accordingly, the Company has restructured its lending business and exited from number of segments that were a drag on overall profitability. The substantial progress of the restructuring process is reflected in the improved return ratios with RoE increasing from 9.78% in Q1FY17 to 18.45% in Q1FY18. Improvement in earnings is achieved despite accelerated provisions in FY18, especially on impaired wholesale loans. The Company is well on track to deliver on its stated objective and see further RoE improvement driven by loan book growth and decline in the cost-income ratio.

Having reached steady state RoE, the Company's focus will be on:



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- Responsible growth
- Maintaining steady state RoE
- Minimising sigma through tightly managing all families of risk

Cost to Income ratio improved to 23.4 percent in Q1FY19 as compared to 24.07 percent in Q1FY18. The Company's costs were under control despite considerable investments in Digital and data analytics, branch infrastructure and manpower. In Q1FY19, the overall loan book of the company has seen a rise of 24 percent on yoy basis to Rs. 86,571 crores in Q1FY19. The break-up of loan book for Q1FY19 is as follows: Rural - 22%, Housing - 24%, IDF - 8%, Wholesale Excl.IDF - 45% and Rundown - 1%. The Company remains wholesale heavy with ~56% exposure to infrastructure, corporate and supply chain lending. Renewable power and road projects are the key loan segments. RoE is relatively low in wholesale finance mainly due to higher provisions. Management envisages reducing exposure to 50% of the loan book by 2020. LTFH used sell-down of wholesale loans as a strategic lever in guiding its portfolio composition to higher "Retailisation". At the end of Q1FY19, Rural and Housing businesses together constituted 46% of total portfolio as against 35% at the end of Q1FY18.

The Company witnessed Strong growth in fee income as a result of its strategy of concentrating on "NIMs + Fees" for measuring transaction profitability. NIMs + Fees stands at 6.58% (Q1FY19) vs 5.77% (Q1FY18). Despite rising interest rates, NIMs were managed well due to

- a) Change in Product Mix
- b) Better ALM strategy
- c) Competitive position in many of its products

Fee Income is getting more broad based across all businesses.

L&T Finance Holdings (LTFH) has reported a yoy growth of 71 percent in Net Profit to Rs. 538 crore in the first quarter of fiscal 2018-19.

The Company has prepared financial statement for Q1 according to the new accounting rules Indian Accounting Standards, which came into effect from April 1, 2018. In line with the new accounting norms, LTFH's legacy Infrastructure stressed asset portfolio now carries provisions of Rs 30 billion, against total portfolio of Rs 50 billion. Of the Rs 30 billion, the finance company was already carrying nearly Rs 12 billion of provisions as of March 31, 2018, under the old accounting rules. The remaining Rs 18 billion has been made in the first quarter of the current financial year.

Asset Quality performance Q1 FY19 vs. Q1 FY18

Gross Stage 3 levels have gone down to 7.93% from 11.70%, Net Stage 3 levels have gone down to 3.17% from 6.13%, Provision coverage increased to 61.99% from 50.74%

At CMP of Rs. 155, the stock trades at P/BV of 2.59x of Q1FY19 Book Value. We recommend a Buy with a target price of Rs. 180 (2.59 x of FY19 estimated Book Value of Rs. 69.4) by FY19 end implying an upside of 16 percent.

## **RBL Bank**

**CMP: Rs. 576, Target price: 635, Upside: 10%**

In Q1FY19, the net advances grew by 36 percent year-on-year to Rs 42,198.09 crore. "The growth in the corporate & institutional segment and commercial banking (wholesale portfolio) was pegged at 31 percent,



while that of other segments (retail assets and development banking & financial inclusion – non-wholesale portfolio) was 43 percent."

Deposits in Q1 surged 27 percent to Rs 44,949.59 crore YoY with current accounts & savings accounts (CASA) ratio improving to 24.42 percent as at June 2018 from 22.09 percent as at June 2017.

Net interest margin expanded to 4.04 percent for the June quarter, up from 3.54 percent in same period last year and also from 3.8 percent as of FY18.

CASA ratio has improved to 24.42% as on June 30, 2018 from 22.09% as on June 30, 2017.

Capital Adequacy Ratio as per BASEL III Capital regulations as on June 30, 2018 was 14.23%.

In Q1FY19, Provisions for bad loans for the quarter stood at Rs 140.35 crore, which were higher by 24.4 percent compared to March quarter 2018 and increased by a whopping 48.6 percent compared to June quarter last fiscal, but provision coverage ratio improved.

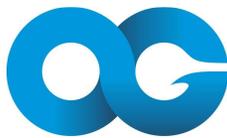
Provision coverage ratio at the end of June quarter stood at 60.41 percent, which has improved from 57.99 percent in June 2017 and 57.57 percent in FY18.

Asset quality remained stable in Q1 with gross non-performing assets as a percentage of gross advances were unchanged at 1.4 percent on sequential basis while net NPAs were lower at 0.75 percent against 0.78 percent in previous year.

Net profit during the quarter stood at Rs 190.04 crore, increased from Rs 141.02 crore in corresponding period last fiscal. The growth was backed by net interest income, other income and operating income.

RoA stood at 1.26% for Q1 FY19, RoE at 11.16% for Q1 FY19. For FY18 (RoA stood at 1.21 percent and ROE of 10.95 percent)

At CMP of Rs. 576 (Face value: Rs. 10), the stock trades at a P/BV of 3.5x at FY18 Book Value of Rs. 164. We recommend a Buy with a target Rs. 635 (3.5x of FY19 estimated Book Value of Rs. 181).



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### **For research related queries contact:**

Mr. Akash Jain – Vice President (Research) at, 022-67160431 (D)

CIN: L74140MH1986PLC041941

SEBI registration Number: INH000001170 as per SEBI (Research Analysts) Regulations, 2014.

**Website:** [www.ajcononline.com](http://www.ajcononline.com)

### **Corporate and Broking Division**

408 - (4<sup>th</sup> Floor), Express Zone, "A" Wing, Cello – Sonal Realty, Near Oberoi Mall and Patel's, Western Express Highway, Goregaon (East), Mumbai – 400063. Tel: 91-22-67160400, Fax: 022-28722062

### **Registered Office:**

101, Samarth, Off. Hinduja Hospital, 151 Lt. P.N. Kotnis Road, Mahim (West), Mumbai – 400016. Tel: 022-24460335/36/40