Modi 2.0: Stock Pick Ideas

B P WEALTH

Friday 24th May, 2019

Mahindra & Mahindra Financial services

Company Overview

Mahindra and Mahindra Financial Services (MMFS) is a subsidiary of India conglomerate Mahindra & Mahindra (M&M). MMFS was set up two decades ago, with the objective of financing the vehicles sold by parent M&M. Over last decade MMFS has transformed itself from a captive lender to the largest semi-urban and rural focused diversified NBFC. MMFS as a branch network of 1,300+ branches, 2m+ customers and asset under management of INR670b+ as of FY19. MMFS has two subsidiaries viz. Mahindra Rural Housing Finance and Mahindra Insurance Brokers.

Investment Rationale

- Gradual recovery in Auto sector and expected normal monsoon would drive earnings growth
- Strong AUM growth added with recoveries picking up
- Asset Quality improves further

Valuation Outlook

We expect M&M financial services to be a beneficiary of the gradual recovery in the auto sector to be witnessed in the 2nd half of this year, which would translate into better festive sales compared to a tepid performance last year. This would be driven by a normal expected monsoon and completion of election overhang leading to improved sentiment, especially in the rural areas. Implementation of BS 6 norms in April 2020 would also play a role on account of pre-buying .The Government's increased rural spending and infra push would also further accelerate the rural economy. The management has guided for a loan growth of ~15% and the CV segment would continue to show high levels of growth owing to a low base. Increasing focus on the used vehicle business would lead to higher yields going ahead. Better recoveries and operating leverage would result in improving NIMs, making us believe that ROA target of 3% as indicated by the management seems achievable. Therefore, we assign a "BUY" rating looking at its future plans which will enable to drive the growth of the company.

Ratnamani Metals and Tubes Ltd

Company Overview

Ratnamani Metals and Tubes was incorporated in 1983. It is the market leader in manufacturing Tubes & Pipes in Stainless Steel/Exotic and also a significant player in manufacturing Carbon Steel Welded Pipes. The company is multi location and multi product enterprise. It caters to more than 16 industries and has 37 countries export presence. The company is headquartered in Ahmedabad and its manufacturing facilities are at Chhatral, Indrad and Kutch in Gujarat and its business offices are situated in Mumbai, Delhi, Hyderabad and Chennai. The company's product offerings consist of diverse grades with significant quantum of customisation, which is the USP of the company. RMTL's product portfolio distinguishes it from its peers both in stainless steel and carbon steel categories wherein the company's products find application in critical areas and in diverse end-user industries like oil & gas, power, nuclear, refineries, etc. The products are widely accepted by its end user industries across India as well as abroad. On the back of a revival of capex in key end user industries, RMTL has undertaken capex to cater to the potential demand.

Investment Rationale

- Established market dominance largely from customizable and distinguished product portfolio
- Niche player in stainless steel segment
- New capacity commissioning would add more opportunity to addressable market
- Revival in capex cycle to drive higher operating leverage

Valuation Outlook

The industry is all abuzz with news of high visibility investment in Domestic Oil Refineries and exciting opportunities emerging in other segments. The resultant growth momentum is expected to hold sway for the next decade. With new capacities and facilities, Ratnamani Metals and Tubes Ltd. is fully equipped to exploit the upcoming prospects. The company has able to make difference through delivering premium products, offering wide product portfolio and becoming preferred supplier. This helps to maintain market leadership, higher margins and ability to afloat during turbulence times. A decade of expansion and diversification later, company is at a very important juncture of record high order book as well as international orders. Considering its leadership position in the domestic stainless steel pipe segment, we believe Ratnamani is best suited to benefit from the impending revival in the domestic capex cycle in oil refinery, petrochemicals, power and fertilizer sectors. We expect Revenue/EBITDA/PAT to grow at CAGR of 23.3%/33.4%/31.1% respectively from FY18-FY21. Thus, we recommend BUY rating for a target price of INR 1280 (upside 42%) valuing at 18x PE to FY21E EPS

Larsen & Toubro Ltd.

Company Overview

Larsen and Toubro (LT) is India's largest E&C company. Apart from core construction activity, LT has made significant inroads into a diverse range of products and services through its subsidiaries and manufacturing JVs in power BTG, forging and shipbuilding. The company is also involved in various developmental projects in roads, ports, railways and power. Overseas contributes ~18-20% of the business.

Investment Rationale

» Public capex Spend to continue supported by strong government policies
» Rise in short cycle orders in the order mix to drive up execution
» Transition to an asset light business model

Valuation Outlook

L&T has consistently been delivering in terms of bagging orders, strong execution of backlog and at the same time improving the quality of its balance sheet thereby generating reasonable cash flows : L&T maintained its revenue growth and order inflow guidance at 12-15% and 10-12% for FY20. The momentum set on infrastructure building, coupled with incremental tax revenues, the emphasis on investments in areas such as airports, railroads, water supply and distribution, expressway programs, power availability, Oil & Gas production and mass rapid transit system is expected to continue. Further revival of stressed businesses and recovery of NPAs are expected to ease the concerns on liquidity and perk-up the business sentiment. Improved credit growth is also expected to aid an uptick in private capex in areas of transportation infrastructure, green energy, commercial real estate, digital technology & services. Owing to above reasons, we recommend 'BUY' rating and remain optimistic towards the future growth of the company.

Ircon International

Company Overview

Ircon International Ltd. (IIL) are an integrated Indian engineering and construction company, specializing in major infrastructure projects, including, railways, highways, bridges etc. IIL provides EPC services on a fixed-sum turnkey basis as well as on an item-rate basis for various infrastructure projects. IIL executes on build, operate and transfer mode in various projects in order to meet the requirements of its bids. In 2016, IIL was ranked number 248 in the list of the top 250 international contractors by Engineering News Record (ENR) of the United States. IIL are headquartered in Saket, New Delhi and have an overseas office in Malaysia. Additionally, have 26 project offices in India and abroad (including in Sri Lanka, Bangladesh, South Africa and Algeria) and five regional offices to support and manage its business operations. IIL's order book as of a particular date comprises of the anticipated revenues from uncompleted portions of existing contracts (signed contracts for which all pre-conditions to entry have been met, including letters of intent issued by the client).

Investment Rationale

» Our construction business operates in diverse sectors covering many countries
» Excellent execution track record through strong operating systems and controls
» Visible growth through robust order book and steady execution

Valuation Outlook

IRCON is the largest PSU carrying out EPC projects in railways. It faces no competition domestically for all projects it bags from the railway ministry as they are on nomination basis. IRCON is on a strong footing on the back of revival in government capex in railways and roads. IRCON has one of the highest order book to sales ratio across all EPC companies and possesses a healthy balance sheet which can support further growth in order book. By leveraging its strong execution skills in railways, IRCON has successfully created an additional growth engine in the form of roads which now contributes 21% to the company's revenue. Thus we give a 'BUY' rating based on the attractive valuations and the above mentioned factors.

Engineers India Ltd.

Company Overview

Engineers India Limited (EIL), Incorporated in 1965 is a Central Public sector enterprise of Government of India under the control of Ministry of Petroleum and Natural Gas. It provides consultancy services in different range of projects and engineering services such as project conceptualization, planning, design, engineering, construction with maintenance and monitoring the operation of plant in various industries such as Refining, Petrochemicals, Pipelines, Oil & Gas, Terminals & Storages, Mining & Metallurgy and Infrastructure. EIL domestically has four manufacturing units located at Mumbai, Kolkata, Chennai and Vadodara and at overseas locations such as Abu Dhabi, London, Milan and Shanghai.

Investment Rationale

» Niche player in construction and engineering services
» Revival in capex cycle to drive higher operating leverage
» Strong order inflows would usher higher revenue growth going forward

Valuation Outlook

Engineers India is a market leader in the hydrocarbon segment, where it provides consultancy and turnkey solutions. OMCs' strong cash flow position, the necessity to upgrade to BS-VI-complaint facilities, and the need to put up additional capacities (given 100% utilization of existing facilities) augur well for the company. Moreover, OMCs plan to add 74-134mmtpa of capacity with an outlay of INR4.2t. This provides potential business opportunity of INR160b for company in the consultancy segment. Over past few years revenue and earnings growth was subdued due to slag in orders from oil and gas sector which seems to be changing. We expect Revenue/EBITDA/Pat to grow at 21%/17%/8% CAGR for FY1-21E. We value the stock by assigning 16x PE to FY21E EPS and recommend BUY rating for a target of INR 127 for a period of 12-15 months