Ten stock picks under 10x P/E

April 2020

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It is a ***Déjà vu*** (*a feeling of having already experienced the present situation*) all over again as markets have a tendency, once in a decade, of creating declines of high magnitude and velocity in a very short span of time. This always leaves the investors in a iffy kind of a situation as to whether the world is coming to an end. However, on the contrary, if one thinks rationally, markets also implicitly offer a lot of dislocated opportunities if one seizes them with patience and holds with conviction. Thus, they can generate alpha over a period of time.

Hence, to capture one such *Déjà vu* feeling, we are recommending stocks across large caps, midcaps and small caps space, which have currently undergone a massive correction on account of the current uncertain environment.

The underlying thesis of these stocks is:

- **Established business models that have survived such panic situations** many a time with a credible management at the helm. All the stocks in our recommended universe are trading at or around 10x P/E on FY22E basis
- The companies have a **steady balance sheet with no leverage and a credible history of generating positive cash flows across business cycles.** The RoCE of such companies (>15%) is sufficient to cover their cost of capital and create incremental economic value added or EVA
- The companies are **consistent dividend distributors.** The dividends earned in rough times like these, to some extent, will help to cover the opportunity cost of holding such stocks. Even the earnings yield of these stocks is equal to or greater than the 10-year G-Sec yields at this point

This clearly does not indicate a bottom but certainly indicates good entry points. Hence, investors can choose to stagger or invest lumpsum depending upon one risk appetite and time horizon.

To encapsulate, near term volatility in stock prices can be high but at the same time *"Nobody rings the bell at the bottom".*

Out top picks under 10x P/E are **Hero MotoCorp, Wipro, Tech Mahindra, Mahanagar Gas, KSB, BEL, Gujarat Pipavav, Kewal Kiran Clothing , TV Today and Heidelberg Cement.**

Hero MotoCorp (HERHON)

Hero MotoCorp is an industry leader in the domestic 2-W segment with a market share of ~35% with its core motorcycle segment market share at ~50%. However, the company is likely to witness near-term headwinds in terms of rebound in volumes amidst Covid-19 outbreak and more than anticipated price increase on account of BS-VI transition (>10%). From a broader perspective, however, it possesses capital efficient business model realising > 25% RoCE on consistent basis and offers an attractive dividend yield of ~5%. At the CMP, it is trading at lucrative valuations of <10x P/E on FY22E numbers, which is at a steep discount to its long period averages.

Heidelberg Cement (HEICEM)

Heidelberg Cement India (HCIL) is one of the few companies in the cement space, which despite having a regional presence, possesses a strong balance sheet and retail presence. The company's grinding capacity has recently been enhanced by ~15% to 6.2 MT and operates mainly in Central India where the pricing environment is the most stable among all five regional markets of India. HCIL, like most other cement companies, would be facing volume disruption in the near term. However, they would be able to withstand the same comfortably owing to cost leadership, strong promoter backup and low D/E of 0.3x. Post the sharp correction in the stock price, HCIL is now available at attractive valuations of 5.0x FY22E EV/EBITDA and at a FY22E P/E multiple of 9.0x as against its five year average PE multiple of 16-17x.

Wipro (WIPRO)

Wipro provides IT services to banking and financial services (31%), consumer (17%), health (13%), manufacturing (12%), technology (8%) and energy segment (13%). In the near term, the company may face revenue pressure due to exposure to affected verticals like energy vertical, lockdown, pricing pressure and slowdown in discretionary spend. However, post H2FY22E we expect IT spending to improve and grow at a healthy pace in FY22E. In addition, digital acceleration, gain in market share led by automation and pick-up in execution could drive large deal wins. The recent correction in the stock price factors in most of the near term negatives and is trading at an attractive valuation of 9x PE on FY22E EPS.

Tech Mahindra (TECMAH)

Tech Mahindra provides IT services to telecom (42% of revenues), manufacturing (17%), technology, media & entertainment (8%), banking & insurance (13%) and other sectors. In H1FY21E, the company may face revenue and margin pressure led by Covid-19 lockdown, pricing pressure, delay in deal ramp ups and slowdown in discretionary spend. However, we expect IT service spending to improve post H2FY21E and a revival in FY22E. Further, the company's leadership in telecom vertical will make it a key beneficiary of vendor consolidation in the segment and 5G opportunities. Enterprise business segment will also benefit from improved competencies, sharper market positioning and success in large deals. The recent correction in stock price factors in most of the near term negatives while the stock is attractively valued at 9.5x PE on FY22E EPS.

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Bharat Electronic (BHAELE)

Strong execution, significant order wins including Akash, Coastal surveillance Systems augur well for BEL. FY20E order inflows have come in healthy at ₹ 13000 crore. Focus on diversification into non-defence segments, which is expected to contribute ~20% to the revenue albeit with lower margins over the next three to five years and contributes ~ 8-10% of the order book, will keep margins between 16% and 18% in the long run. Covid-19 will have an impact as some projects may get delayed but the anticipated medical devices order from government amid Covid-19 outbreak and likely operational relaxation by respective state governments to aerospace and defence firms from India Lockdown may lead to some cushion in FY21E. Overall strong order book of ₹ 51300 crore (which is 4x book to bill ratio) continues to provide strong revenue visibility. We expect BEL to report revenue, EBITDA CAGR of 4.7%, 5.2%, respectively, in FY20-22E (due to high base on a YoY basis). BEL currently exhibits attractive valuations, has always paid consistent dividends, commands a debt free balance sheet and generates strong CFO yield.

KSB Ltd (KSBPUM)

KSB's pump segment revenue is majorly divided into two vertical viz. (i) standard pumps (ii) industrial pumps. Standard pumps constitute ~40% to the pump revenue while rest comes from industrial segment. The company caters to various industries such as Chemical, Agrochemical, Paper Pulp, Fertiliser, Residential, Power, Agriculture, Oil & Gas To Name a few. Hence, it provides immunity to any adverse scenario in any particular industries during turbulent times. The order backlog of the company remains at ₹ 1500 crore excluding nuclear order. Of ₹ 1500 crore, around 40% came from standard pumps. We do not expect this to get much impacted due to postponement of orders owing to Covid-19. For the industrial segment, we believe the company's order backlog varies across different industries. Hence, it can provide some respite to overall execution, going ahead. However, one can expect a dent in the execution cycle for CY20, which should get offset by better executions in the following year. Further, service business recorded revenue of ₹ 80-90 crore in CY19. We expect this to become sizeable in the overall performance, going ahead, resulting into an improvement in the blended OPM. Historically, the company maintained DPS to tune of ₹ 5-6/share, which provides dividend yield of 1.5%. Further, the company is making FCF/share to the tune of ₹ 12-15 proving FCF yield of around 3-3.5%. Moreover, the company has been generating other income to the tune of ₹ 40 crore on cash of ₹ 207 crore. Based on our CY22 estimates, earnings yield of the company is well over the 10 year G Sec yields. Historically, positive spread of equity over bond yield provides better investment opportunity. Hence, we expect downside in KSB from present levels to be limited.

Gujarat Pipavav (GUJPPL)

Gujarat Pipavav was expected to see major disruptions during March and April, as most of the services on the GPPL port are meant for the Far East (China in particular), which saw disruption due to the annual Chinese new year and then the Covid-19 crisis. However, faster than expected ramp up in the Chinese container ports (workers allowed to return to the port, factories restarting), would lead to clear back log of cargoes and de-bottlenecking of the global EXIM cargo movement (re-positioning of containers stranded at the Chinese ports). The increased container movement between Far East and India, would lead to a higher capacity utilisation for GPPL (with a favourable product mix of EXIM cargo compared to coastal cargo movement). The current FCF yield on the stock looks extremely attractive (11% on trailing FY19 basis), it is a debt free company and owned by worlds largest port and terminal operator (APM terminals). The stock currently trades at attractive multiple of 7x FY22E multiple considering a revenue growth of 6.5% and 9.6% in FY21E and FY22E respectively.

Kewal Kiran Clothing (KEWKIR)

Kewal Kiran Clothing (KKCL) is one of India's major branded apparel manufacturers with presence across casual, formal, semi-formal and western wear for men & women. It has a portfolio of four major brands (Killer, Easies, LawmanPg3 and Integriti) capturing various consumer price points. The company has a asset light distribution model as more than 90% of its Exclusive Brand Outlets (330+) are owned and operated by franchisees. The company has also enhanced focus on distribution through National Chain Stores (NCS) and e-commerce. NCS and e-commerce has been one of the fastest growing channels with share of contribution increasing from 13% in Q3FY16 to 28.4% in Q3FY20 and 3% to 8.9%, respectively. EBITDA margins for YTDFY20 have dipped to 18.3% (vs. average run rate of 20%+). Though the near term revenue growth would be impacted owing to impact of COVID19 (closure of stores due to national lockdown), however over the longer term the management is looking to achieve a double digit revenue growth and has alluded at a possibility of dilution in margin profile to a range of 18-19%. Despite the same, KKCL remains one of the most profitable branded apparel players having a robust balance sheet with cash & investments worth ~₹ 270 crore. We expect the working capital days to inch up in the near term owing to liquidity stress faced by the Multi Brand Outlets (MBO) channel. However, with the company having robust cash & investments, we do not foresee a significant increase in working capital debt. The debt/equity ratio is comfortably placed at 0.2x. The stock currently trades at 9x FY22E earnings.

Mahanagar Gas (MAHGAS)

Mahanagar Gas is currently the sole authorised distributor of CNG and PNG in Mumbai & its adjoining areas. MGL's planned capex in Pen, Uran and Karjat areas along with steady growth in Mumbai region provides visibility for volume growth in medium to long term. In the CNG segment, MGL had a network of 248 CNG stations in February 2020 and plans to add 25 CNG stations per year for the next three years. Although the company's sales volumes are expected to decline in range of ~30% in near term due to lockdown amid Covid-19 outbreak, we expect the steady volume growth once normalcy is restored. Going ahead, we estimate total volume at 3.4 mmscmd for FY22E with volume growth at 7.3% CAGR for next two years. Low gas prices and strong pricing power will help MGL to report healthy margins of ₹ 14.6/scm in FY22E. On account of attractive valuations, strong return ratios and favourable government policies, we expect MGL to be a beneficiary of India's growing CGD sector. The stock is currently trading at 9.5x FY22E EPS.

TV Today (TVTNET)

TV Today has maintained its leadership in Hindi news segment with *Aaj Tak* and *India Today* has seen increase in market share, over the past five quarters. The monetisation across digital platform continued to remain robust as digital segment has continued to display strong growth. We believe news heavy events will help the company to maintain growth momentum in broadcasting revenues in the medium term. Another attractive feature is dividend yield. With no major capex, we expect the company to continue paying high dividends (already paid ₹ 20/share in FY20). The company is available at attractive P/E of ~6x FY22 earnings.

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