Dimensional Securities Pvt Ltd.

Diwali Picks 2019, Samvat 2076

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Stock	**CMP**	**Target**	**Upside**
ITC Ltd.	251	315	25.5%
HDFC Ltd.	2100	2400	14.3%
VRL Logistics	268	338	26.1%
Zydus Wellness	1689	2008	18.9%
Nocil	114	145	27.2%
S. H. Kelkar	132	156	18.2%

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ITC Ltd

ITC is the monopoly business in cigarette in India contributing more than 85% of the legal cigarette consumption along with significantly high tax consumption on tobacco in the country. Cigarette remain addictive consumption and demographic distribution of India will remain important factor for increasing cigarette consumption in the country. Number of cigarette consumption per capita in India is far lower compared to its immediate peers, this is due to differential tax treatment on other products. Hence, the affordability is lower on high cost cigarette. Affordability is improving as the disposable income for the middle class is increasing.

Other FMCG business of the company has achieved over Rs 12,500cr revenue in FY19. Among listed players, this is only lower to HUL ltd and far higher than other major peers like Dabur, Marico, Godrej. Since ITC focus has been on achieving scale ahead of profitability, we see subdued EBIT margin in other FMCG business. We expect EBIT margin to gradually improve as the company gets economies of scale with increasing revenue.

Significant portion of Agri and paper business should be seen as support businesses to the cigarette due to large intersegment sales. Hotel and Paper segment is supported by limited supply in the industry.

Valuations: We Value ITC on a SoTP method, with each segment valued as per its competitive intensity and ITC bargaining power in the segment. Cigarette being a monopoly is valued at 16x EV/EBIT, is significantly lower than last 5yr average. Other FMCG business is valued at 5x EV/Sales as margin is currently on upmove and yet to stabilize. We value ITC at 315/share, 25% upside from the current price

Symbol	CMP	M. Cap	TTM P/E	2W Vol.
ITC	251.0	305872.0	22.0	16215.2

	ITC Ltd.		
Description	FY17	FY18	FY19
Net Sales	42776.6	43448.9	48352.7
EBITDA (Ex OI)	15460.6	16503.2	18425.4
Profit After Tax	10471.3	11485.1	12824.2
Adjusted EPS	8.5	9.2	10.3
ROE (%)	24.3	24.1	23.8
ROCE (%)	36.0	35.4	34.4
Debt/Equity(x)	0.0	0.0	0.0
Adjusted PE (x)	33.1	27.7	28.9
EV/EBITDA(x)	19.6	16.9	17.5

HDFC Ltd.

HDFC is India's largest provider of housing finance, primarily focusing on retail housing. HDFC’s distribution network spans 392 outlets, which include 113 offices of HDFC’s distribution company. In addition, HDFC covers additional locations through its outreach programmes, which has helped the corporation disburse housing loans in more than 2,400 towns and cities in India. It has also supplemented the distribution channel through the appointment of direct selling agents (DSA). Currently, 72.2% of the shares are held by foreign institutional investors/foreign direct investments and 10.0% by individuals.

With the current challenges in HFC and PSU banks, we believe business will gravitate towards franchise which has stronger balance sheet and distribution reach. HDFC, being the largest players in the fray will be leading beneficial in this transition.

Besides the core business of mortgages, HDFC has evolved into a financial conglomerate, diversifying into other businesses through its subsidiaries viz., HDFC Standard Life Insurance (51.6%), HDFC Asset Management Company (52.8%), HDFC Bank (21.4%), HDFC General Insurance Company (58.4%) and 10% in Bandhan Bank.

We value HDFC on a SoTP basis to arrive at target price of Rs 2,400, 14% upside to the current share price.

Symbol	CMP	M. Cap	TTM P/E	2W Vol.
HDFC	2100.0	363105.0	22.8	3380.3

	HDFC Ltd.		
Description	FY17	FY18	FY19
Interest Income	61034.0	79474.0	95694.0
Interest Expenses	21992.0	24764.0	29584.0
Operating Expenses	23791.0	37046.0	45067.0
PAT (inc share of Assoc)	11051.0	11980.0	16232.0
EPS	69.6	71.5	94.3
P/B	4.0	3.4	3.1
PE	21.6	25.5	20.9

Zydus Wellness Ltd. –

Zydus Wellness, the FMCG arm of the Cadila group, has created a niche for itself with a range of wellness and innovative products. Some of the main brands of the company include:

* Sugar Free: It is a low calorie sweetner with over 80% market share in the category.
* Nutralite: It is a zero cholesterol substitute for butter.
* Everyuth: Market leader in peel off and scrub.

With increase in lifestyle diseases and more people searching for healthy alternatives, Zydus could be looking at a multi-year growth opportunity. The company continuously comes out with innovate offerings like new Sugarlite which has similar taste to sugar but has 50% lower calorie, Sugarfree Veda made from natural extracts of Elachi, Tulsi, and lemon and flavoured Nutralite Mayonnaise.

In Oct 2018, Zydus further strengthened its brand portfolio by acquiring Complan, Glucon-D and Nycil Powder from Heinz at an enterprise value of Rs. 4,600 cr, which was at a multiple of 20X EV/EBITDA. These brands were not key focus areas for Heinz, which led to loss of market share continuously. However, for Zydus, these brands form key part of its core business. It will cross-utilize its own and Heinz's existing distribution network, and would be aggressively adding more dealers as a part of its brand extension. This will aid the top line growth for the company, and given management's track record of efficiency, there is also a scope for margin expansion for these brands.

The company is also exploring international opportunity in geographies like Africa, South East Asia & SAARC. These markets can provide incremental growth to the company. Zydus is currently trading at a 1 Yr fwd P/E of 41X, which is at 25-30% discount to other FMCG players. Given the strong track record of the management, niche portfolio of brands and opportunities, we believe Zydus to be good portfolio buy.

Symbol	CMP	M. Cap	TTM P/E	2W Vol.
ZYDUS	1670.0	9629.0	44.2	13.5

	Zydus Wellness Ltd.		
Description	FY17	FY18	FY19
Net Sales	430.6	512.6	842.8
EBITDA (Ex OI)	99.1	125.3	174.4
Profit After Tax	111.3	136.5	171.2
Adjusted EPS	27.9	34.3	29.3
ROE (%)	21.5	21.9	8.4
ROCE (%)	23.5	23.3	7.1
Debt/Equity(x)	0.0	0.0	0.5
Adjusted PE (x)	31.2	34.2	44.3
EV/EBITDA(x)	22.6	26.2	41.7

VRL Logistics Ltd.

VRL Logistics Ltd. (VRL) is a well-established surface transportation brand in the country when and the industry leader in Less-than-Truck-Load space. VRL operates with a fleet size of 4,400 trucks with over 697 branches, 195 agencies and 46 trans-shipment hubs, giving it a huge scale and wide network to work with.

VRL has fair amount of dealings with SME & MSME sector which is going through a rough phase, owing to which company is seeing some stagnation in its volume. Adding to that are the woes of other manufacturing industries like automobiles, auto ancillaries, textiles, etc. company has not been able to grow its volume over last two years. However, given VRL's dominant position in the LTL industry, we believe that it'll see a strong uptick in its volume once the recovery sets in.

Over the last few years, due to strings of policy decisions like demonetization, GST and e-way bill, the balance in the logistics industry has shifted in the favour of organized players like VRL, who has been able to sustain their business despite overall slowdown, while many SFOs have gone out of the business.

The trucking industry is largely dominated by Full-Truck-Load (FTL) segment which forms nearly 88% of the road industry. However, VRL has carved out huge market sare in the LTL segment which forms 10% of the industry but is expected to grow at a faster rate. The upcoming DFCC, which will be a huge negative for FTL players, will be beneficial to LTL players like VRL as demand for short distance last mile delivery will go up.

Currently, company's business is at the bottom of the business cycle and we expect recovery to set is with the base also being favourable. We are valuing VRL at 20X FY21's normalized EPS of Rs. 16.9 to arrive at our target price of Rs. 338 for the stock, which presents a potential upside of 23% from the CMP of Rs. 273.

Symbol	CMP	M. Cap	TTM P/E	2W Vol.
VRLLOG	268.0	2375.0	24.9	36.9

	VRL Logistics Ltd.		
Description	FY17	FY18	FY19
Net Sales	1803.1	1922.3	2109.5
EBITDA (Ex OI)	215.9	234.8	244.5
Profit After Tax	70.5	92.6	91.9
Adjusted EPS	7.7	10.2	10.2
ROE (%)	13.4	16.3	14.8
ROCE (%)	17.3	21.6	20.8
Debt/Equity(x)	0.3	0.1	0.2
Adjusted PE (x)	40.3	37.5	27.7
EV/EBITDA(x)	13.4	14.2	10.6

NOCIL Ltd.

An Arvind Mafatlal Group enterprise, Nocil is India's largest rubber chemicals manufacturer, having manufacturing facilities at Navi Mumbai and Dahej. In FY18 Nocil had capacity of 55,000 MTPA for rubber chemicals (including capacity for intermediates) operating at 95% utilization levels. NOCIL doubled it's capacity taking the total capacity to 1,10,000 MTPA expected to be operational by H2FY20.

Automobile industry consumes ~80% of the total rubber manufactured. Tyre specifically consumes ~65% of the total rubber. Growth in automobile sector will lead to growth in rubber consumption thereby increase demand for rubber chemicals. The key advantage for NOCIL is that EV disruption in automobile sector will remain unaffected for the company

On back of improved manufacturing process at Dahej and technological advancement, NOCIL has been able to expand its gross profit margin by 1990 bps over last 5 years. Also, the company has focused on production of high margin premium products which make the higher margin sustainable going forward.

We are valuing NOCIL at 12X FY22's normalized EPS of Rs 12 to arrive at our target price of Rs. 144 for the stock, which presents a potential upside of 31% from the CMP of Rs 110. Accordingly, we recommend a BUY on the stock.

Symbol	CMP	M. Cap	TTM P/E	2W Vol.
NOCIL	114.0	1826.0	11.1	749.1

	Nocil Ltd.		
Description	FY17	FY18	FY19
Net Sales	742.2	967.6	1042.9
EBITDA (Ex OI)	159.2	265.4	292.7
Profit After Tax	97.1	169.9	184.9
Adjusted EPS	5.9	10.3	11.2
ROE (%)	14.1	17.4	16.8
ROCE (%)	20.8	25.9	25.1
Debt/Equity(x)	0.0	0.0	0.0
Adjusted PE (x)	15.8	18.5	13.2
EV/EBITDA(x)	8.5	11.1	7.9

S H Kelkar

S H Kelkar (SHK) is Flavors & Fragrances (F&F) manufacturing company. Globally top 10 F&F companies command ~78% market share. F&F has various applications such as packaged foods, detergents, soaps, cents etc. However, cost of F&F ingredient in final product is typically in range of 0.5%-2%. Since the value terms contribution in final product is so small, undercutting from here will not be possible.

SHK owns ~13% market share in domestic F&F market, mainly contributed by unorganized segment. The company has 40-50% capacity utilization in Fragrance segment thereby having sufficient headroom to cater to additional demand. SHK spending 2.5-3% of revenue towards R&D while the global spends stands at 6-7% of sales annually. Moreover, SHK has 12 molecules patented.

90% of revenue contribution is from Fragrances segment, SHK holds 23% market share. The segment is expected to grow at 10%. 10% of revenue contribution is from Flavors segment, SHK holds 2% market share and the same is expected to grow at 20-25% due to lower base. Due to number of factors disrupting raw materials supply, the prices escalated and inventory got piled up with SHK. Going forward the inventory levels are expected to come down. EBITDA margin post normalization is expected to be stable in range of 16-18% compared to 12% EBITDA margin in FY19.

We recommend a buy on S H Kelkar with a target price of Rs. 156

Symbol	CMP	M. Cap	TTM P/E	2W Vol.
SHK	132.0	1962.0	22.3	116.5

	SH Kelkar & Co Ltd.		
Description	FY17	FY18	FY19
Net Sales	980.5	1021.0	1043.6
EBITDA (Ex OI)	166.9	159.4	133.7
Profit After Tax	104.8	92.6	87.8
Adjusted EPS	7.2	6.5	6.1
ROE (%)	13.7	11.1	10.2
ROCE (%)	18.8	15.5	11.7
Debt/Equity(x)	0.1	0.2	0.4
Adjusted PE (x)	41.1	39.8	25.1
EV/EBITDA(x)	24.2	21.0	15.6

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