Prudent Broking

Money through wisdom

SAMVAT 2075

TIME TO BUILD YOUR PORTFOLIO

SAMVAT 2074 : A ROLLER COASTER RIDE

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Samvat 2074 has been a roller coaster ride for Indian equities. While Nifty, as on 26 October 2018, was just about 1% lower compared to last Diwali's close of 10146, the swings in between were enormous. From 10146 on last Diwali, Nifty went all the way to 11171 in January 2018, plunged to 9951 in March, then surged to make a fresh record high of 11760 in August, from where it fell again to current level of near 10000.

Performance of World equity indices since last Diwali

Name	% Change
Bovespa - Br	12
Nasdaq Compo	9
DJ Industria	7
Merval - Arg	4
S&P 500	4
Jakarta Comp	2
Kuala Lumpur	0
NIFTY	**-1**
Nikkei 225	-1
Mexico IPC	-3
Paris CAC 40	-7
FTSE 100	-8
Straits Time	-11
Taiwan Weigh	-12
Hang Seng	-12
Frankfurt Da	-14
Seoul Compos	-18
Shanghai Com	-23

Performance of Sectoal indices since last Diwali

Name	% Change
NIFTY	-1
SENSEX	3
Nifty Financial Services	3
Bank Nifty	2
Nifty India Consumption	-3
NIfty Energy	-3
Nifty 200	-4
Nifty Pharma	-5
NIfty 500	-6
Nifty MNC	-7
Nifty Metal	-14
Nifty Infra	-17
Nifty Commodities	-17
Nifty Media	-20
Nifty PSE	-21
Nifty Auto	-23
Nifty Realty	-28

Let's have a look at the key global and local factors which have impacted performance of equities in the year gone by and what are the key factors to eye in next Samvat.

OIL

From being close to $57 a barrel last Diwali, and $70 in mid-August 2018, Brent crude shot up to a four year high of $86 in early October. The commodity since then has corrected and is currently around $72 a barrel. India imports more than 80% of the oil consumed and hence a relentless rise in oil directly impacts trade deficit, foreign exchange, input costs of manufactures, transport bill etc. and sparks fuel inflation fears.

US sanctions on Iran restricting sales of oil and petrochemical products from Iran, comes into effect from November 4th and has been the main reason of rise in oil. On the other hand, trade war concerns and assurance from Saudi Arabia of adequate supply have been the key reason of recent fall.

Taking cues from the charts, $70 is the important immediate support for Brent crude, below which 66-62 zone would be the next target area. On the way up, a crossover of recent top of $86 can take the commodity to around $94.

US TREASURY YIELD

US 10-year treasury yield, which were around 2.3% last Diwali, have shot up to about 3.25% in early October this year and is currently trading around 3%. This rapid rise has been on the back continuous tightening by the US Fed, which has already raised rates by 75 bps in calendar 2018 and is expected to hike one more time in the remainder of the calendar 2018. The rise in US bond yields make emerging market equities less attractive and hence has been a headwind. In past 12 months, FIIs have been net sellers to the tune of nearly Rs. 18000 cr.

Going forward, this will be the key variable to eye. A sustainable upmove in US bond yield will exert a pressure on emerging market equities as a risk-off scenario might play out.

TRADE WAR

US president Trump has been at loggerheads with many countries on account of the trade deficit US runs with these countries. While the differences with Canada, Mexico have been sorted via a new deal and those with EU have quietened, US-China relation continues to be tense. Both the parties have imposed tariffs on billions of dollars worth products being imported from the opposite country. If these trade retaliations continue, world growth is likely to take a hit. A resolution will obviously be positive.

IL&FS CRISIS

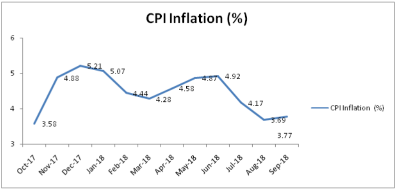
The biggest factor at home was the liquidity crisis that hit NBFCs after the trouble at IL&FS. NBFCs, which have seen a very high growth phase over past couple of years owing to easy liquidity and trouble at PSU Banks, have been facing liquidity crunch coupled with higher borrowing costs over past couple of months, which is sure to affect their growth in coming quarters. However, more important thing to watch out would be that this liquidity crisis does not results into solvency crisis and from that perspective, market will keenly watch out rollover of these NBFCs' short term debt when it comes for maturity over next couple of weeks.

ASSEMBLEY AND GENERAL ELECTION

Assembly elections in Rajasthan, Madhya Pradesh, Chhatisgarh, Telangana and Mizoram will be held in November and December and would be the last set of assembly elections before the 2019 general election. Markets would keenly watch out the results of these elections to guage the probability of BJP coming back to power in 2019 with a clear majority. A set back in these election might dampen the mood in the short term.

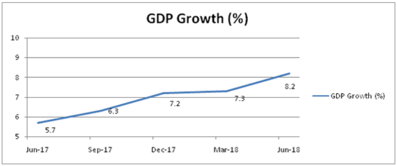
2019 general election would be the bigger event to eye. In the past, unexpected results of general election has resulted in wild swings in stock market and the same could repeat this time around. Markets usually dislike hung Parliament and in that sense, a clear mandate would be welcomed and vice versa.

How have Macro Indicators Performed since Last Samvat?



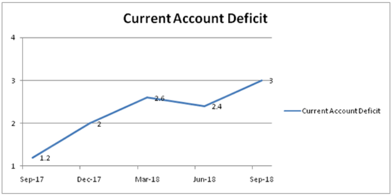
The consumer price index (CPI) inflation has been broadly in the range as provided by RBI of 4% (+/-2%). The inflation had spiked in January 2018 to 5.07%. However, since then it has softened and in September 2018, the same stood at 3.77%. The inflation has softened on account of benign food prices.

However, the rising crude prices, depreciating rupee and increase in minimum support prices (MSP) could pose an upside risk to the inflation going ahead.



The gross domestic product has improved from 5.7% in 2QFY18 to 8.2% in 2QFY19. The economy has recovered from the transitional changes on account of demonetization and goods and service tax (GST) and is back on the growth track. However, the growth could be hampered by the liquidity crunch at the non-banking finance companies. These NBFCs have huge amount of exposure to small and medium enterprise (SME). With growth slowing at NBFCs on account of liquiidty crunch, there could be a simulatenous slowdown in growth of SMEs which could impact the growth in the economy.

Further, monsoon was weak during this year which could impact incomes of households in the rural area. During the festive season, the passenger vehicle sales and two-wheeler sales remained weak-which indicated a subdued sentiment in rural geography. This could impact consumption and in-turn the economic growth.



We have significantly deteriorated on this parameter. The current account deficit was 1.2% in September 2017 quarter and as per ICRA it is expected to increase to 3% in September 2018. This is mainly on account of rising crude prices and falling rupee. Further, weakening exports have also added to the woes. The government will have to incentivize and bring in structural changes in order to boost export. Further, government will have to make the business environment conductive to encourage foreign inflows into the country.

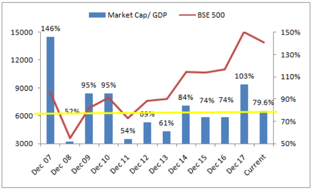
In November 2017, Moody's Investors Service ("Moody's") had upgraded the Government of India's . local and foreign currency issuer ratings to Baa2 from Baa3 and changed the outlook on the rating to stable from positive. A fall in the fiscal deficit numbers then the budgeted one's could lead to a downgrade of our sovereign rating which in-turn could impact our foreign flows.

Is the Market Correction Enough to go Diwali Shopping in Share Markets?

Warren Buffet, the world's third richest man who is considered one of the most successful investors in the world, looks at this indicator to gauge whether valuations in the share markets are expensive or not. This indicator is market capitalization to gross domestic product ratio. And this ratio has always indicated whether the markets are overheated or not. And every time this ratio has shot up above the long term average, there has been a correction in the markets as seen in the chart below.

If you observe in December 2007, when the blue bar shot up to 146%, which is way above the long term average of 80% (indicated by yellow line), there has been a correction in the broader indices (represented by the red line). Similar is the case for December 2010 and December 2017, wherein the blue bar shot above the long term average, which led to the correction in the red line.

The Market Cap/ GDP Ratio of Listed BSE Companies since December 2007

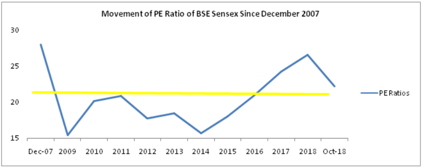


Source: Bloomberg Quint, Prudent Broking Service

In December 2017, the marketcap/gdp ratio stood at 103%-way above the yellow line indicating that the markets were overheated and a correction was due. Since then, there has been a healthy correction in the indices. Year to date, indices such as BSE Midcap and BSE Smallcap have corrected by 18% and 26% respectively. Whereas, BSE Sensex is up marginally by 1%.

At the current juncture, we are a tad below the long term average indicating that the correction has been sharp since January 2018. And the good part is that we are nowhere near the marketcap/gdp ratio of 146% as seen in December 2008.

Let's talk about one more valuation matrix i.e price/earnings (PE) ratio. Looking at the price/earnings ratio of BSE Sensex index, the Price/ Earnings (PE) ratio of BSE Sensex was hovering around 26 times when the markets started correcting in January 2018. Currently, the benchmark index is trading at a PE valuation of 22.1 times, a tad higher than the ten year median PE of BSE Sensex of around 20.5 times. But the valuations are nowhere near the 2007 levels when the Sensex PE was at 28 times.



Source: Prudent Broking Service

All these indicators states that share markets are not expensive post the hefty correction, but they aren't very cheap as well. However, we believe certain stocks have corrected handsomely and you can definitely go shop them. So, here we go.

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CDSL

Target Price	Absolute Upside	CAGR Growth
Rs 426	74 %	14.9% (from an FY23 Perspective)

Central Depository Services Ltd (CDSL) is our top pick to play the financialization trend. CDSL has grown its consolidated core income and profit after tax at a CAGR of 16.1% and 15.6% respectively for a period of five years. If this is not enviable, CDSL return ratios such as RoE and RoIC stands at 16% and 36% respectively over a period of five years.

Not only this, the company boasts of very strong operating leverage. A large part of their expenses are fixed. Hence, in a scenario wherein the revenues spike up, there won't be a simultaneous spike in the expenses, which will help CDSL to earn higher operating margins. This is the prime reason behind the company earning average operating margins and PAT margins over a period of preceding eight years to the tune of 80% and 57% respectively. These are excellent numbers!

Further, CDSL has a very strong balance sheet. With zero debt, liquid investments (investments + cash) accounts for around 78% of the balance sheet size. The cash per share stands at Rs 53. Hence, if you are buying the stock at Rs 244, you are essentially getting cash of Rs 53 for free. Hence, effectively you are buying this stock at (Rs 244 – Rs 53) =Rs 191.

If you consider the effective buying price of Rs 191, the price/earnings ratio for CDSL stands at 19x. An 19x p/e seems to be reasonable for a company which is growing its RoIC at 34% on a consistent basis.

With just one competitor NSDL and globally being just the second depository to get listed, CDSL will continue to deserve a scarcity premium. We value CDSL at a target multiple of 25x and derive at the target price of Rs 426. This essentially leaves investors with an absolute upside of 74% from an FY23 perspective. Also, the target price implies a CAGR of 14.9% (including dividend yield) from an FY23 perspective.

Mahanagar Gas

Target Price	Absolute Upside	CAGR Growth
Rs 1150	37 %	16.3% (from an FY21 Perspective)

Mahanagar Gas is our top pick to play the megatrend shift which is being witnessed to cleaner fuels. Mahanagar Gas is the **sole distributor** of Compressed Natural Gas (CNG) and Piped Natural Gas (PNG) in the city of Mumbai and adjoining areas such as Thane/Kalyan/Dombivali and the Raigad district.

Now, talking about Mumbai's and adjoining areas population-it is almost equivalent to the population size of Australia! Imagine the size of opportunity it offers to Mahanagar Gas in fuelling automobiles with CNG and providing gas to every household in Mumbai and adjoining areas!

The competition in absolutely **ZERO** in the geographies in which it is present as it enjoys infrastructure exclusivity in Mumbai till 2020, Thane/Kalyan/Dombivli/Bhiwani etc till 2030 and Raigad District till 2040. The company is confident that it will be able to extent the infrastructure exclusivity for ten more years in Mumbai post 2020 too.

Not only this, Mahanagar secures 80% of its gas requirements (i.e its input cost) under Administered Price Mechanism (APM). The government has incentivized companies in City Gas Distribution (CGD) and CNG business to acquire gas at lower costs. Beneath APM, Mahanagar secures gas at around USD 3 as compared to the spot rate of USD 10-11. This has enabled Mahanagar to enjoy average operating margins over a period of ten years to the tune of 33%.

With negligible debt, the company generates huge free cash flows. This has enabled the bank to dole out hefty dividends and at the current market price, the dividend yield stands at 2.32%.

As compared to its peer Indraprastha Gas which is trading at a price/earnings multiple of 25.7x, Mahanagar is trading at a considerable discount of around 16.8x. Since getting listed in July 2016, Mahangar has traded at a median price earnings of 21.4x and the recent correction in the stock offers a great entry point for the investors.

Given the strong return ratios, healthy margins, government's impetus on using cleaner fuel and negligible competition in the areas in which it operatres, we have valued the company at a target multiple of 19x from an FY21 perspective and have derived at a target price of Rs 1150. This leaves investors with absolute returns of 37% and a compounded annual growth rate (CAGR) of 16.3% from an FY21 perspective including a dividend yield of 2.3%.

Karur Vysya Bank

Target Price	Absolute Upside	CAGR Growth
Rs 114	45%	30% (from an FY20 Perspective)

The bank we are recommending is Karur Vysya Bank... The panic in the market has led to the valuation of this stock falling below its book value.

The bank is currently trading at a price/book of 0.9 times. Compare this, with a 10 year average price/ book value for the bank of 1.4 times. It is a steal at this price!

Despite a great financial performance over a long period of ten years, the company is trading at a significant discount as compared to its peers as seen in the table below:

Peer Comparison of Key Financials

Particulars	NIMs *	Return on Asset *	Cagr of Loan Book Growth **	Price/Book
Karur Vysya Bank	**3.3%**	**1.1%**	**16.9%**	**0.94**
City Union Bank	3.0%	1.5 %	19.9%	3.04
Federal Bank	3.1%	1.1%	17.1%	1.15

*NIMs and RoA are taken as an average of preceding ten years.

**CaGR of loan book growth is taken of the preceding ten years.

The stock has corrected a whopping 40% from its 52 week high. The fall has largely been triggered by the ongoing correction in the midcap space. Further, deterioration in asset quality has also partially contributed to the fall.

Having said that, all the concerns pertaining to asset quality are largely addressed in the books. With multiple trigger ahead and the worst over for the bank, it is set to deliver robust results going ahead. Given its long-term track record and dominance in the geographies it operates, we value the company at a conservative price/book value of 1.2 times from a FY20 perspective and derive at the target price of Rs 114.

This leaves investors with a point to point return of 45% and a compounded annual growth rate (CaGR) of 30% from an FY20 perspective. We recommend a Buy view on the stock from a long term perspective.

PSP Projects

Target Price	Absolute Upside	CAGR Growth
Rs 613	61%	40% (from an FY20 Perspective)

Provided you live in Gujarat or not, thing about the most prestigious real estate architecture you have seen or heard about in Gujarat?

I am sure you would have thought of **Sabarmati Riverfront!** Yes, this is the very same place where our Prime Minister Mr Narendra Modi took President Xi Jinping during his visit to India. Such is the significance of this project. And guess who has played a significant role in building it! PSP Projects. Now, it is very important to note that PSP Projects is just a construction company. It is NOT a real estate company engaged in selling of residential or commercial properties.

Now that you have got a fair idea about the business lets discuss why this stock should make it to your investment portfolio!

Strong Execution Capabilities

One key factor behind this strong performance is the execution skills of PSP. There has hardly been any instance, wherein PSP has delivered the project after its deadline. Adoption of SAP system to mobilize its resources and supervision of projects by the promoter himself, has led to PSP delivering on-time projects.

Since their incorporation in Fiscal 2009, the company has executed 14 projects for Cadila Healthcare Limited and its affiliates, six projects for Torrent Pharmaceuticals Limited and its affiliates and four projects for Nirma Limited and its affiliates. And if this does not impress you...this data will- It has build six of the eight private building projects in the first smart city of India ‘Gift City’.

This execution skills, has enabled the company to grow its revenues and profits exponentially over the past years. And the most interesting part...**the company has achieved this super growth with almost zero debt on its books.**

Little did the company know that these execution skills will help them to secure a project for the world's largest diamond bourse at Dream City in Surat in October 2017. This one single order is worth a humongous Rs 1,575 crore. Compare this to their revenues of Rs 414 crore in FY17. This single order is worth 3.8 times its revenues for FY17. Such is the size of the order.

Efficient Working Capital Management

Imagine a company engaged in the real estate sector having a negative working capital. There will be just a few of them... And one of them is PSP Projects. Negative working capital essentially means that the company's operating profits are not getting blocked in working capital and the cash flow is available at disposal to the management to be either re-invested in the business or be declared as dividends. The negative or minimal working capital requirements have helped the company to maintain debt at almost negligible levels. Further, this has enabled them to declare decent dividends in the preceding years. The last dividend of Rs 5 per share in FY18, implies a current dividend yield of 1.04% for the stock.

Strong Order Book

The company has a strong order book which is 3.3 times its FY18 revenues. This provides strong revenue visibility in the coming years. The order book is expected to be materialized as revenues in the next two years.

Further, the management has guided for incremental orders worth Rs 1,000 crore in the current fiscal. Of the guided amount, the company has already secured orders worth Rs 419 crore as of 5 September 2018. We have derived our projections for revenue in FY19 and FY20 on the basis of the current order book in hand (i.e Rs 2402 crore).

Valuations

The company is trading at a price/ earnings of 20x currently. **We have given the company an exit multiple of 20x and have derived at our target price of Rs 613 from an FY20 perspective.**

This leaves investor with absolute gains of 61% and a compounded annual growth rate (CaGR) of 40% from an FY20 perspective.

With a strong order book and return ratios almost touching 40%, the company is a great proxy play on the revival in private capex and infrastructure boom in India.

Symphony

Target Price	Absolute Upside	CAGR Growth
Rs 1350	33.5%	12.8% (from an FY21 Perspective)

What Lead to the Hefty Correction in Stock Price of Symphony since January 2018?

As seen in the chart above, there has been a healthy correction in Symphony's stock price. Since closing at an all time high of Rs 2144 in January 2018, the stock is down by a mind boggling 54%. More than half of the market cap has eroded.

The Reason...

There is only one...Weak summers. In the preceding two years (i.e. summer of 2017 & 2018), the temperatures have not soared to crazy levels. Unlike air-conditioner, air-cooler is not a planned purchase. The price of a basic cooler of Symphony lies in the range of Rs 4000-10,000. As the price is way lower as compared to air-conditioners, the purchase of air cooler is very impulsive. As soon as the temperature hit levels above 40-42 degrees, the sales of air-coolers picks up. However, this has not been the case in the preceding two years thus impacting its financial performance for FY18 and the first half of FY19.

Having said that, global warming is a real phenomenon. Globally temperatures are rising. Though we can't predict whether the next summer will be intense or not, what we do know is temperature are going to soar in the long run. And this will immensely benefit Symphony.

Under-Penetration of Air-Coolers in Indian Markets to Aid Volume Growth

Currently only 14% of the Indian households own air-coolers. Hence, the market is highly under-penetrated. Given that Symphony is almost a generic name for air-coolers and according to a market study, eight of ten consumers said 'Symphony chaahiye' when they went to buy an air-cooler, Symphony will be the prime beneficiary of this growing under-penetrated industry. Not to forget, the benefit of goods and service tax. 73% of the air-cooler market is un-organized. This opportunity is up for grabs for Symphony! Given GST will rationalize tax structure between organized and un-organized players, the shift to organized players will benefit Symphony.

Acquisition of Australian Business will De-Risk the Business Model by Reducing Seasonality

In-order to reduce the seasonality factor of the Indian business, they have de-risked their business model by making an acquisition in Australia in first quarter of FY19. Australian summers are our winters and Australian winters are our summers.

And the acquisition is going to borne fruits right from day one! The acquired company has a 30% and 25% market share of the domestic Australian air cooler and ducted gas heaters market respectively. With this acquisition, exports will contribute to 42% of the overall revenues from 22% as present currently.

This acquisition will also open up export opportunity for Symphony to Australia. As the Australian business garners a good market share as stated above, it will open up the opportunity to sell Symphony's products in this geography.

Turnaround of Subsidiaries in Mexico and China

Two of its international acquisitions- one in Mexico and the other in China which were in losses have now turn-around. Hence, these two firing engines which were silent till now are now making noises. The loss from these two subsidiaries was to the extent of Rs 6.9 crore in CY17. However, they have turnaround and posted a profit of Rs 7 crore in CY18. The management is positive on both these subsidiaries posting good sets of results going ahead.

With a robust domestic opportunity coupled with the Australian acquisition and turnaround in Mexico and China subsidiaries, we expect Symphony to deliver better sets of results moving ahead.

An Impeccably Strong Balance Sheet

With an asset light model and almost negligible debt, the company has delivered excellent return ratios. The company has negligible debt as its sales policy with dealers is on a 100% advance basis. Symphony does not give any credit period to its dealers unlike its peers. On account of this, the working capital day for Symphony stands at 38 days- far superior as compared to its peers.

Further, the business is a cash generating machine. Cash coupled with liquid investments accounts for 54% of the balance sheet size. Further, the company has been able to generate fantastic free cash flows. Over a period from FY08 to FY17, for every Rs 100 of cash flow from operation it has converted free cash flows to the tune of Rs 77. Minimal capital expenditure (capex) requirements on account of asset light model, has enabled the company to generate such healthy free cash flows.

These free cash flows in-turn could either be used to be dispersed as dividends or be retained in the organization to expand its business. The average dividend pay-out ratio from FY12 to FY16 stood at 93.1%. And when the going got tough in FY17 and FY18, Symphony retained the cash in the business to acquire the Australian business.

All these factors have led to average RoE, RoCE and Core RoCE (adjusted for cash and liquid investments) in the preceding ten years of 40%, 51% and 132% respectively. These are excellent numbers!

as Stated by the Management in its Result Discussion

A Buy Back of a Significant Sum to be Declared soon as Stated by the Management in its Result Discussion

The dividend payout ratio which stood at an average of 93% from FY12 to FY16, reduced to an average of 17.6% between FY17 to FY18. This was partially on account of taxation changes on payment of dividend. The company in its recent call has hinted of a buyback of a significant amount which can drive the stock price upwards in the near term.

Valuations

Currently, the stock is trading at trailing twelve month price/earnings of 35.5 times. Now, the P/E might look expensive at this juncture as the earnings of the preceding twelve months have been hammered on account of weak summer. If we take normalized earnings, the p/e ratio will trend downwards.

Further, with the acquisition of Climate Technologies and turnaround in its subsidiaries in Mexico and China coupled with the robust opportunity for the Indian business, there are multiple triggers for the business to grow going ahead.

With return ratio's and RoIC north of 40% and 100% respectively, we give the company an exit multiple of 33 times and derive at a target price of Rs 1350 from an FY21 perspective. This leaves investors with an absolute return of 33.5% and 12.8% compounded annual growth rate (CaGR) from an FY21 perspective.

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WHAT ARE THE CHARTS SAYING...

- As shown in the monthly chart of Nifty above, while Nifty made a higher top of 11760 in August, the RSI, a technical indicator, made a lower top, which is called negative divergence in technical parlance and suggests that there is less strength in the latest upmove and there is possibility of peaking out/correction.
- This is what happened in subsequent months as Nifty could not sustain higher levels and plunged sharply in September and October.
- After this steep correction, Nifty is at a crucial juncture. 9951, the bottom made in March, is a crucial support, a decisive breach of which will break the higher-top higher-bottom formation on the monthly chart. If that happens, next meaningful support to eye would be 34-month moving average, which is placed around 9500 at present. This level also coincides with the trendline adjoining bottoms made in August 2013 and February 2016, and hence is a crucial support to eye.
- However, in the event of 9500 not holding, 9119-8970 would be the next support zone where 9119 is the top made in March 2015 while 8970 is the top made in September 2016.
- On the way up, 11760, the top made in August, is obviously the major target/hurdle to eye for next Samvat. If that is taken out decisively, the upmove can extend to 12600 kind of level, where the upward sloping trendline adjoining tops made in November 2010 and March 2015, is placed.
- To sum up, while overall trend continues to be bullish, one has to be prepared for further correction and keep accumulating, keeping above support levels in mind, for longer term gains.