Value Investors Meetup

Company Analysis & Themes

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Which Sectors should you consider for Research/Investing?

Attribute	Indicative List of Sectors
Requiring less Financial Capital/Physical Assets (Asset-light businesses)	FMCG, IT
Driven by Brands, Intellectual Capital	FMCG, Pharma, IT
Optimistic Demand Growth scenario	Automobile, Cement, Banking & Financial Services, Consumer Discretionary, Durables
Domestic Consumption-driven	Automobile, Banking & Financial Services, Consumer Discretionary, Durables, FMCG, Food & Beverage, Personal Care, Pharma, Multiplex, QSR
Generating positive Free Cash Flows	FMCG, Pharma, IT
Globally competitive, outsourcing driven	IT, Auto Ancillary, Electronics

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Which Sectors should you avoid?

Sectors which should be **avoided**:

- Cash guzzlers (Airlines in the past, but have turned the corner*)
- Commoditized products
- Too much Government control

Caveats/Exceptions

Some of these sectors can be considered at the bottom of the cycle. However, it may be difficult to spot the end of the cycle.

Not all companies in a bad sector are bad investments, and vice versa.

*** Warren Buffett invested $8bn in 4 US airlines in early 2017**

Which Companies should be avoided?

- Management/CG issues
- Erratic record of revenue growth and margins
- Poor RoE (Return on Equity)
- High leverage (debt) on the balance sheet
- Companies growing primarily through acquisitions
- Most of assets held abroad (mines?)
- Low effective tax payout, low dividends (since taxes and dividends can only be paid out of real profits, not paper profits)

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Which Companies should be avoided?

- Negative press reports, regulatory issues, raids
- **Promoter**s have **pledge**d a large % of their holdings of shares
- Stock consistently has **low ratio of deliverable volumes to total traded volumes** (predominance of speculative activity)
- Proposed QIP (avoid buying after QIP)
- FCCBs coming up for maturity in the near future

Which Companies should be treated with suspicion?

- Promoter running the show alone, with few professional managers
- Family members in key positions, and on the Board
- Poor Corporate Governance
- Large number of transactions with promoter-owned entities
- Promoters paying huge salaries to themselves, regardless of company's profits
- Companies changing accounting year frequently

Which Companies should be treated with suspicion?

- Companies shifting registered office to remote locations, so that not many shareholders are able to attend AGMs/EGMs
- Promoter frequently appearing on TV channels, giving press interviews (ahead of QIP?)
- Investor-shy companies (avoiding investors, analysts completely)
- Sudden exit of key personnel such as CFO / mass exodus
- Bad press, income tax / ED raids, etc.

How to Assess Management Quality?

- **Past financial performance**: Robust revenue growth, margins, cash flows, return ratios, dividend distribution
- **Capital allocation**: Consistent, high RoE, sticking to core competence, avoiding unrelated diversifications or expensive acquisitions
- **Shareholder value creation** (sustained historical stock price performance over a period of time, backed by deliverable vol.)

  - Function of past financial performance
- Absence of Negative Media Reports, Controversies, etc.

Are all MNCs Good Bets?

A number of MNCs have proved to be good bets in the past.

- Support from parent company re. access to products /technology, global best practices, etc.
- High level of corporate governance
- Low debt
- Full tax payments
- High dividend payout (as % of post-tax profit)

However not all MNCs are investor-friendly:

- Royalty payments a contentious issue (recent increase)
- Products routed through unlisted 100% subsidiaries in India (For instance, Procter & Gamble Home Products Ltd.; Suzuki Motor Gujarat)
- Delisting in bad markets (Cadbury, Reckitt & Colman)

Case Studies: Investor-Unfriendly MNCs

- **P&G's 100% subsidiary Procter & Gamble Home Products Pvt. Ltd.**

P&G operates under three entities in India - two listed entities "Procter & Gamble Hygiene and Health Care Limited" and 'Gillette India Limited', as well as one 100% subsidiary of the parent company in the U.S. called 'Procter & Gamble Home Products'.

Distributes products in Fabric Care, Hair Care and Baby Care segments.
Ariel Front-O-Mat, Ariel 2 Fragrances, Tide Detergent, Tide Bar (Fabric Care)
Shampoo brands Pantene, Pro V, Head & Shoulders and Rejoice (Hair Care)

Name of Co.	Ownership	Sales FY16 (RsCr)	% of Group Sales	PAT FY16 (RsCr)	% of Group PAT
P&G HH Ltd.	70.6%	2,484	24.2%	423	59.7%
P&G Home Products P. Ltd.	100.0%	5,711	55.7%	72	10.2%
Gillette India Ltd.	75.0%	2,053	20.0%	213	30.1%
Total Group Sales		**10,248**	**100.0%**	**708**	**100.0%**

While P&G has apparently kept the most profitable businesses with its listed entities, the question why it continues to have a 100% subsidiary, remains.

Investor-Unfriendly MNCs: Impact of 100% Subsidiary

P&G's 100% subsidiary Procter & Gamble Home Products Pvt. Ltd.

Computation of Impact of 100% Subsidiary on Listed Company's EPS

No. of Shares issued by Listed Co. (Cr)	:	3.246
FY16 EPS of Listed Co. (Rs)	:	130.37
Net Profit of 100% Subsidiary in FY16 (RsCr)	:	72
EPS foregone by Listed Co. in FY16 (Rs)	:	22.18
EPS of Listed Co. including that of 100% Subs.	:	152.55
EPS of Listed Co. on TTM basis (Rs)	:	142.25
P/e of Listed Co. on TTM basis	:	51x
Price foregone by Investors, assuming same p/e	:	Rs1131 (51*22.18)

Case Studies: Investor-Unfriendly MNCs

Suzuki has a 100% subsidiary Suzuki Motor Gujarat (SMG)

Suzuki Motor Corporation holds a 56.2% stake in Maruti Suzuki India Ltd.

Suzuki Motor Corporation plans to invest Rs2,600Cr through SMG, to build its second assembly plant in India and an engine and transmission unit.

Maruti Suzuki India Ltd. will produce and sell vehicles to SMG.

Again, **this translates into a clear conflict of interest**, between Suzuki Motor Corporation and the minority investors in Maruti Suzuki India Ltd., as the sales by Maruti Suzuki India Ltd. to SMG are unlikely to be at the same prices, at which Maruti Suzuki India sells its products directly.

A Few Research/Investing Themes

- “High-priced” Stocks
- New Listings resulting from Spin-offs [Information Asymmetry]
- Special Dividends on Sale of Assets
- Differential Voting Rights (DVR) Shares

Research Theme: High-Priced Stocks

High-priced Stocks are those with **face value of Rs10 per share**, and **market price of above Rs1,000**.

Quite often, **liquidity in such stocks remains muted**, due to the high price. Institutions corner some of these stocks even as retail investors stay away.

The key issue for retail investors is **difficulty in rupee cost averaging**, given the high price.

Research Theme: High-Priced Stocks

Comparison of Liquidity in 3 Prominent Stocks

	Eicher Motors	Page Industries	Havells India
Face Value (Rs)	10	10	1
Price (Rs)	29,237	24,455	566
Market Cap (RsCr)	79,591	27,277	35,387
Total Shares (Cr)	2.7	1.1	62.5
Free Float shares (Cr)	1.3	0.6	24.0
Retail Shares (Cr)	0.2	0.1	3.3
Avg Daily trading Volumes (last 3 yrs)	58,171	12,498	1,431,867
Avg Daily Turnover (RsCr)	122	19	53
Volume as % of Free Float	0.4%	0.2%	0.6%
Volume as % of Retail Holdings	2.5%	1.7%	4.3%

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Research Theme: High-Priced Stocks

It has also been observed in the past, that **many such companies which spilt the face value of their stock from Rs10 to say Rs5, Rs2 or Re1 per share, have seen their stock price outperform the markets**, subsequent to the split.

Even today, there are many such high-priced stocks, which can potentially split face value, going ahead.

Eicher Motors, Page Industries, Hawkins Cookers are some examples of companies, which have steadfastly avoided splitting the face value of their stock.

Disclaimer: Not every high-priced stock may split face value in the foreseeable future, nor can the timing of such split be predicted with accuracy.

Case Studies: High-Priced Stocks

Asian Paints Ltd.

Split from Rs10 to Re1 (effective Jul.30, 2013)	Daily Avg Traded Qty	Daily Avg Turnover Rs Cr
6 months before Split	913,130	43.25
6 months after Split	1,22,6149	58.23

Grasim Industries Ltd.

Split from Rs10 to Rs2 (effective Oct. 6, 2016)	Daily Avg Traded Qty	Daily Avg Turnover Rs Cr
Apr 16 - Oct 16 (Pre-Split)	128,984	58.86
Oct 16 - Apr17 (Post-Split)	254,586	123.24

Most of the splits lead to increase in trading volumes, after the split.

Research Theme: New Listings from Spin-offs

High appetite for newly-listed stocks, resulting from **Spin-offs**.

Examples:

Name of Original Co.	Name of Co. spun-off
Omkar Speciality Chem.	Lasa SuperGenerics Ltd.
Sintex Industries Ltd.	Sintex Plastics Technology Ltd.
Crompton Greaves Ltd.	Crompton Greaves Consumer Electricals Ltd.
Max India Ltd.	Max Ventures & Industries Ltd.
Future Retail Ltd.	Future Enterprises Ltd.
Arvind Ltd.	Arvind SmartSpaces Ltd.
Marico Ltd.	Kaya Ltd. (formerly Marico Kaya)

Most of these stocks have given market-beating returns post listing.

Disclaimer: Not every new spun-off stock may perform. Caution advised.

Research Theme: Special Dividends on Sale of Assets

Special Dividends are paid off of one-time events, such as the sale of key assets or property, or entire divisions or businesses.

Sales of (i) Surplus Property or (ii) Key Assets / Divisions / Businesses?

- Whether the company's core operations are being divested
- Prospective performance of continuing divisions after such asset sales
- Re-investing asset sale proceeds in continuing operations, vis-à-vis distributing profits via Special Dividends

When is an Asset Sale a Cause for Concern?

When the divested entity/business accounts for a **large percentage of the divestor company's operations**.

Live Example: Sale of Business

LEEL Electrical (formerly Lloyd Electric) sold its Consumer Durables business to Havells for Rs1550Cr in FY17. Paid special dividend of Rs20/share from sale proceeds.

Particulars	**31.03.2016**	**31.03.2017**
SEGMENT REVENUE		
a) Consumer Durables	1,337.19	1,885.46
b) OEM & Packaged Air-conditioning	879.78	936.01
c) Heat Exchangers & Components	611.01	603.93
Sub-Total (a+b+c)	**2,827.98**	**3,425.40**
SEGMENT RESULTS		
a) Consumer Durables	105.65	120.94
b) OEM & Packaged Air-conditioning	50.15	59.74
c) Heat Exchangers & Components	81.77	66.09
Sub-Total (a+b+c)	**237.57**	**246.77**

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Live Example: Sale of Business

Particulars	FY16	FY17
Revenue mix		
a) Consumer Durables	47.3%	55.0%
b) OEM & Packaged Air-conditioning	31.1%	27.3%
c) Heat Exchangers & Components	21.6%	17.6%
	100.0%	**100.0%**
Segment margin		
a) Consumer Durables	7.9%	6.4%
b) OEM & Packaged Air-conditioning	5.7%	6.4%
c) Heat Exchangers & Components	13.4%	10.9%

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Live Example: Sale of Business - Exceptions

Swelect Energy Systems Ltd. (formerly Numeric Power Systems Ltd.) sold its mainstay UPS business to Legrand, France in May, 2012. Paid special dividend of Rs120 per share in July, 2012.

However, co. seems to have bounced back well in FY17. So, there could be exceptional cases, where companies do well even after the sale of key assets.

Cons Income Stmt (Rs Cr)	**2012**	**2013**	**2014**	**2015**	**2016**
Revenue	599.49	176.46	176.45	221.84	206.34
Continuing operations	53.88	106.60	176.45	221.84	206.34
Discontinued Ops (UPS)	545.61	69.86	0.00	0.00	0.00
Other Income	0.09	44.84	26.85	26.78	35.14
Net Profit	**34.78**	**520.87**	**16.18**	**-0.04**	**13.22**
Exceptional Income	0.00	629.39			

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Research Theme: DVR Shares

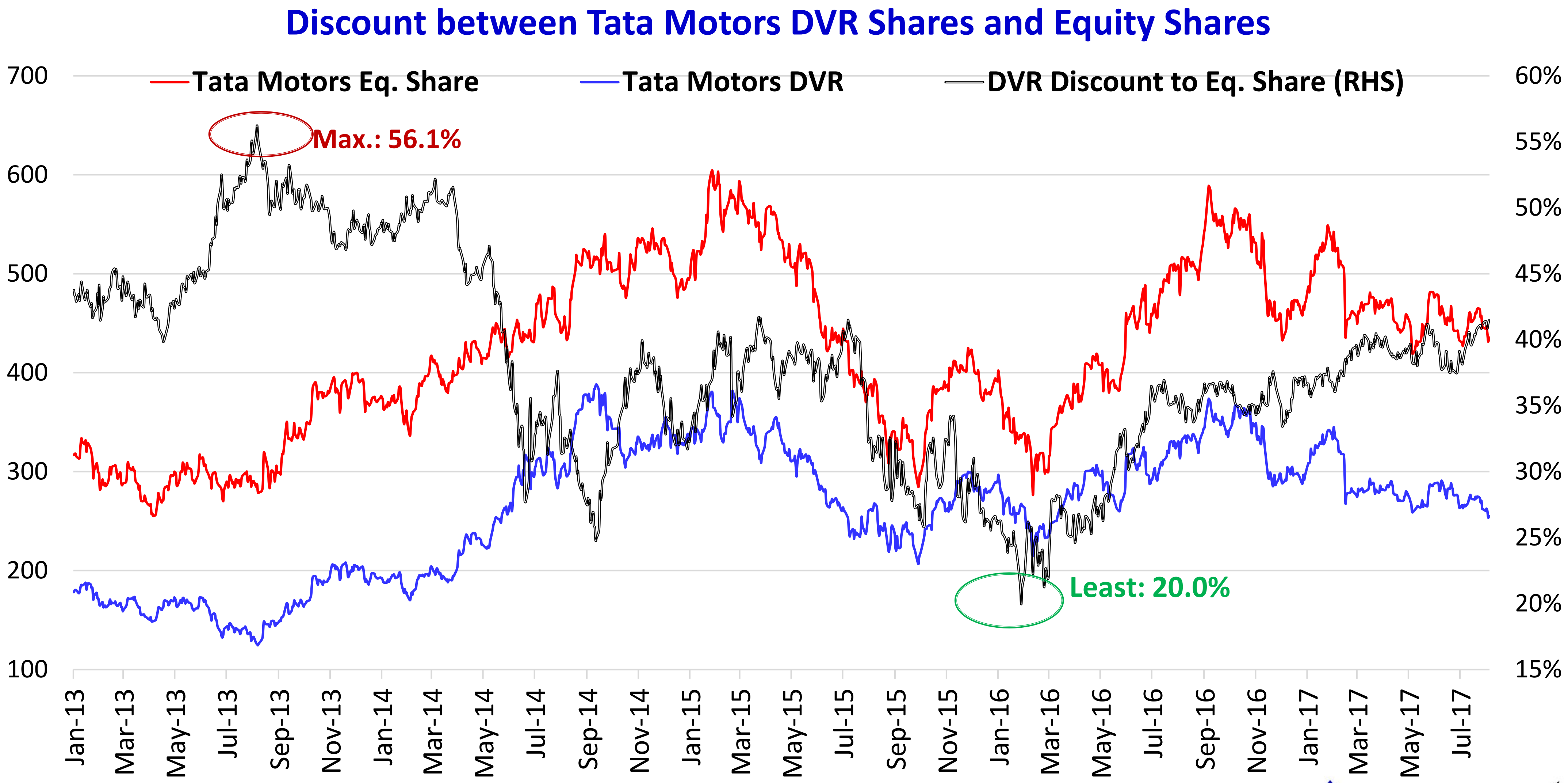
DVR (Differential Voting Rights) shares carry no voting rights. However, usually they trade at a discount to ordinary shares. Also dividend may be higher than on ordinary shares.

Only a few companies like Tata Motors, Future Enterprises, Jain Irrigation, Gujarat NRE Coke have issued DVRs.

DVRs can be considered for investing, depending on the discount at which they trade to the ordinary share at that point in time. Obviously, the higher the discount to the ordinary share, the more the attractiveness of the DVR.

However, it may not be possible to predict if and when the discount could narrow.

Research Theme: DVR Shares



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