ACUMEN

POWER OF INSIGHTS

Series 2 - PETER LYNCH

March 2020

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INSIDE THIS ISSUE

WORDS UNDERLINED IN BLUE REPRESENT CLICKABLE LINKS

"Stand by your stocks as long as the fundamental story of the company hasn't changed."

- Peter Lynch

EDITOR'S NOTE

Dear Readers,

We are delighted to present our second series of Acumen based on **Peter Lynch**, the legendary investor who popularized the PEG ratio and gifted the world an impactful, novel and clear investment framework based on the 6 categories of stocks.

Lynch believed a proper framework of stock classification helps investors set the right goals and expectations from their portfolio in terms of the risk reward profile of the investment. He proposed that by classifying all stocks (under investor investment radar) into six different baskets namely Sluggards (Slow Growers), Stalwarts (Medium Growers), Fast Growers, Cyclicals, Turnarounds and Asset Plays, investors will be able to devise a clear investment strategy which will help them make 3 crucial decision i.e. Entry, Hold & Exit at different stages of the investment.

In this particular issue, we have highlighted the interpretation and application of these 6 categories in the ***Indian Capital Market Context****, broadening our scope of research to present to you examples of Indian Stocks which can be placed in these 6 categories with their risk, reward and performance profiles.*

At the end of this issue our readers would have a robust, simplified and clear methodology while evaluating companies from an investment perspective. Click here for a quick introductory video.

Regards,
Siddharth Vora
CA-CFA-MSc
Investment Research & Products Strategy

INVESTOR OVERVIEW

Peter Lynch

"Invest in What You Know."

Lynch was proud of the fact that many of his great stock ideas were discovered while walking through the grocery store or chatting casually with friends and family.

About

Peter Lynch managed the Fidelity Magellan Fund for 13 years from 1977-1990 achieving an astounding 29.2% annualized return, outperforming its S&P500 benchmark index in 11 out of 13 years, to become one of the most legendary stock investors/fund managers of all time.

Yet in fact, his greatest work remains the books he authored for individual investors such as 'One up on Wall Street' where he illustrates and transforms years of investing wisdom into a lucid and comprehensive investment framework based on sound principles that have stood the test of time.

Nationality

American - Born on January 19, 1944 in Massachusetts, United States.

Company

Fidelity Investments (1966-1990)

Education

Boston College (BA) and The Wharton School of Business at the University of Pennsylvania (MBA).

Books Authored

One up on Wall Street, Learn-to-Earn and Beating the Street.

Famous Investments

Flying Tiger, an air-freight company helped him pay for graduate school. Apple Computer, a multi-bagger stock was bought after he noticed that there was demand for Apple computers in his home and at his office. Dunkin Donuts, Taco Bell and Fannie Mae were also among his multi-bagger investments to name a few.

THE INVESTMENT LYNCHPIN

No matter markets fall or rise, investing legends have sailed through trying times. In fact, in bear markets, learning from legends like Peter Lynch help in filtering and coming up with our own set of investable companies. Peter Lynch's simple yet practical **Bottom Up** approach to investing involved 5 broad steps that common investors could pursue to pick stocks albeit KEEPING A LONG TERM VIEW in such bear markets :-

1) Identify good companies

"Know what you own & know why you own it"

To know what you own, you need to start looking at companies in the industry you work in or have experience in and can understand. You can get valuable fundamental information even from *non-market* related work/outings/meetings, etc - that may not reach the professionals for months or even years. Hence, he advised the common investor to filter good companies based on industry one understands or works in. In fact, most of his successful investments were bought based on his or his friends' firsthand experience/knowledge of products/services offered by the company.

2) Classify the stocks

"By putting your stocks into categories you'll have a better idea of what to expect from them."

Once he identified the companies, Lynch classified them into any of the 6 categories: Fast Growers, Stalwarts, Slow Growers, Turnarounds, Cyclicals and Asset Plays. As a thumb rule he suggested a portfolio of 10 stocks comprising of 4 fast growers, 4 turnarounds and 2 stalwarts mainly to reduce the risk attached to the other 8. However, this should be followed by individuals who have the ability and capacity to take high risk.

3) Value the companies

"What makes a company valuable, and why it will be more valuable tomorrow than it is today. To me, it always comes down to earnings and assets.
There are five basic ways a company can increase earnings: reduce costs; raise prices; expand into new markets; sell more of its product in the old markets; or revitalize, close, or otherwise dispose of a losing operation."*

To get a rough idea for valuation, Peter Lynch used the PEG ratio. He compared a stock's P/E ratio to its earnings growth. A bargain is in store if a fundamentally good company trades at a P/E less than its projected earnings growth rate. He also factored in sustainable dividend yield in the denominator of the PEG ratio considering dividends are reinvested leading to accelerated returns. He also cautioned investors to avoid investing in companies that trade at very high P/E levels and have high (unsustainable) earnings growth rates.

4) Develop a story

"Invest at least as much time and effort in choosing a new stock as you would in choosing a new refrigerator."

The next step is to gather as much information as possible about the company for the growth prospects or any favorable/unfavorable event expected to occur. This is known as the "story." One must not waste time guessing future earnings and rather focus on factors that will drive the earnings growth. As shareholders, we can call the investor relations, listen to con-calls, do on ground research or simply read analyst reports of our full-service brokers. Other than this, if one has an edge in the company / industry they can develop their own investment rationale. Lynch suggested that investors must be able to perform a '2-Minute Drill' to explain their investment decision with significant clarity to have enough conviction to hold the stock through volatile markets.

5) Stick to the story

"People who succeed in the stock market also accept periodic losses, setbacks, and unexpected occurrences. Calamitous drops do not scare them out of the game."
"The real key to making money in stocks is not to get scared out of them."

This is the most underrated point causing most investors to fail by exiting a good story too early and holding on the wrong one for too long. For instance, you might have sold some good stocks at low prices in this market panic. So the approach is, you must keep a regular tab on the story to check for any substantial changes in the fundamental paradigm of the business and stay invested in the company until the original story alters. If you don't have the time to do so, you could always avail the services of your full-service broker or advisor. Most importantly, no matter what, you stick to your company if the fundamentals (you had bet on initially) haven't changed! You could obviously average down in fundamentally good companies. Patience is virtue. This results in extra ordinary rewards.

So now let's directly dive into the process of classifying stocks into 6 baskets. To provide better understanding of classification, we describe each category and have covered a few Indian companies that we think fit into those categories based on earnings trajectory, asset value, etc and the prerequisite characteristics of a category.

These do not qualify as investment recommendations but we intend to provide our readers with examples which will in turn help them in classification of stocks. So say in this market turmoil you have funds to invest, this report could help you in adopting the right approach to think and have your own selected basket of stocks to invest in with proper knowledge of their risk-reward profile. Of course, it's best to consult your advisor if you have no investing experience.

THE SIX CATEGORIES OF COMPANIES

One of Lynch's key contributions to capital markets theory is the categorisation of companies. As mentioned before, one of the most crucial steps is to classify companies into different categories to understand the inherent risk-reward profile.

TYPES OF COMPANIES	***RISK***	***RETURN***
1. *Slow Growers: Large and ageing companies that are growing slightly faster than the economy as a whole and due to limited growth opportunities, they often pay regular dividends. Examples: Dabur, ITC, Castrol India, Wipro, Colgate-Palmolive, Cipla.*	*Low*	*Low*
2. *Stalwarts: Large companies that are clocking annual earnings growth rates of around 10% to 12%. Examples: Asian Paints, Pidilite, Dr Lal Pathlabs, Nestle, HUL, Britannia, TCS.*	*Low*	*Moderate*
3. *Fast Growers: Small, aggressive new companies with annual earnings growth of 20% to 25% a year. Examples: Avenue Supermarts, Relaxo Footwears, Aarti Industries, HDFC AMC, Bajaj Finance, HDFC Life, Vinati Organics, GMM Pfaudler, Abbott India, Muthoot Finance.*	*High*	*High*
4. *Cyclicals: Companies in which sales, profits and stock price tend to rise/fall in a predictable way based on the economic cycle OR even commodity cycle if the company is exposed to a commodity like sugar, paper, chemical, metal stocks, etc. Examples: Ashok Leyland, Tata Steel, Axis Bank, ONGC, L&T, Dhampur Sugar, JK Paper, Eicher Motors, Maruti Suzuki, ICICI Securities, Ultratech Cement, Interglobe Aviation.*	*High/ Low*	*Low/ High*
5. *Turnarounds: Companies that were once battered fundamentally and have pulled themselves out of a serious slump. Examples: Bata India, Symphony, NAM-India, ICICI Bank, Reliance Industries.*	*High*	*High*
6. *Asset plays: Companies where the assets exceed its market capitalization. Examples: Bombay Burmah Trading Corp, HDFC Ltd, SBI, Infoedge, Aditya Birla Capital.*	*Low*	*High*

He also pointed out that the companies change their category with time and expansion. For instance, a company that was initially categorized as a slow grower could now be a medium grower considering the potential triggers in earnings. Secondly, a company could also fall under two categories at the same time.

COMPANIES COVERED

	Company Name	Title	Summary
SLUGGARDS	ITC Ltd	*From Cigarette Addict to Social Smoker*	Due to unfavorable regulatory regime and the illegal cigarette trade practices, ITC's sales growth took a hit. Before this, PAT grew at an average of 22%. Thereafter, PAT grew at an average of 7% and ITC shifted its focus to non-tobacco businesses.
	Dabur India Ltd	*Not so 'Natural' with Nifty*	Although a slow grower, it is a consistent dividend payer that provides stability when the broader market (Nifty) falls. It posted a 25% gain pre-September while Nifty was declining.
STALWARTS	Asian Paints	*Painting the Canvas green*	Once a fast grower (from 2006 to 2011), post 2011 APNT has been a 7 bagger and fits in the medium grower category with the same factors that contributed to its fast earnings growth.
	Pidilite Industries	*Fevicol-ed to Growth*	With creative advertisements, constant product innovation and management focus on waterproofing business, Pidilite is a medium grower with 10Yr PAT CAGR at 13%.
FAST GROWERS	Avenue Supermarts Ltd	*Best Prices Each Day*	Providing customers the lowest possible prices with timely payments to its suppliers and expanding through internal accruals has reflected in DMart's annualized earnings growth rate of ~47% which were attained in the FY12-FY19 period.
	Relaxo Footwear	*Placing the Right Foot Forward*	By penetrating North and East India with affordable footwear, it soon became a leader in the 'Value for Money' footwear segment and now is the 2nd largest footwear company in India after Bata. While 10Yr PAT CAGR was 40%, the share has become a 200-bagger in a decade.
	Aarti Industries Ltd	*The Speciality Chemicals Specialist*	AIL with its timely capacity additions, capitalized the opportunity to grow when the Specialty Chemicals market shifted from China to India which led to an average PAT growth of 27% since 2012. The share has multiplied 30x since 2012 till date.
	HDFC AMC	*Following Parents' Footsteps*	Due to financialization of savings and a highly profitable product mix, it is not only capturing growth in MF business but also is the most profitable AMC in India. The share has returned 80% since its listing in August 2018 and the profit grew at 18% CAGR in the past 5 years.
	Bajaj Finance Ltd	*One stop Stock to play Consumption, Technology and*	Penetrating the vacated small-ticket loans segment and alongside innovating the consumer finance products, BFL saw massive Loan asset growth while maintaining healthy asset quality. It achieved 44%

		Credit Growth Story	CAGR in PAT over FY 15-19.
CYCLICALS	Ashok Leyland	*A Bumpy Truck Ride*	With 70%+ of its sales coming from M&H CV business, Ashok Leyland has a high correlation to Manufacturing IIP growth, making it a cyclical stock. Due to the current slowdown in Indian Auto sector, the share has fallen ~50% since mid-2018.
	Tata Steel	*A Global Meltdown*	An integrated steel player with end user industries like Infra, Auto, Cap goods that are captured in the domestic GDP growth, it also has strong relation to Global Growth, Global GDP and is subject to cyclicality of steel prices. In upward cycles, the stock has become a 2-bagger within 2 years.
TURNAROUNDS	Bata India Ltd	*One Step down, Two Steps Forward*	Bata coming out of its labour union problems and at the same time reviving its image is a turnaround creditable to its management. Post 2004, the PAT grew at 30% CAGR and stock has become a 600 bagger since then.
	Symphony Ltd	*Not so 'cool' a Diversification*	An apt example of 'Diworsification' and thereafter agility of management to divert company's focus back to Air Coolers makes it a turnaround story too. From Rs 0.5 stock in 2004, the stock is now above Rs 1,000.
ASSET PLAYS	Bombay Burmah Trading Corp Ltd (BBTCL)	*Don't Judge a Book by its Cover*	Strong subsidiaries like Britannia made BBTCL an 11-bagger within the last 6 years while BBTCL's standalone profits have actually declined within that period. Add to that, lies a huge potential to unlock value through land assets.
	HDFC Ltd	*Pioneer of sure shot Value Creation in the Indian Financial Landscape*	Stake sale through IPO of strong subsidiaries like HDFC Life and HDFC AMC in 2017 and 2018 respectively unlocked value for the shareholders of an already profitable HDFC Ltd. The shareholders gained ~40% and 16% post HDFC Life and HDFC AMC listing.

(Note: All share price performances are excluding the fall post Coronavirus spread.)

Q. What kind of companies are Slow Growers/Sluggards?

- A slow grower is usually a large and an ageing company growing slightly faster than GDP/GNP growth.

- These are companies that started as fast growers but eventually moved into this category as most of the high growth potential has already been captured by the companies. The runway for growth of such companies has now steadied and assumed a stable plateau.

- These companies pay generous and regular dividends since the growth opportunities have almost dried up. Therefore, such companies should consist a small percentage in your portfolio as dividend payers fare better than non dividend payers when the market declines.

- These are Low Risk, Low Gain and meant for investors who have a low risk appetite. Retirees could invest in such stocks or one could invest in such stocks to lower the risk of the entire portfolio.

There are many bluechips in India that are now growing, albeit at a slow pace including ITC Ltd.

Example 1: ITC Ltd - 'From A Cigarette Addict to A Social Smoker'

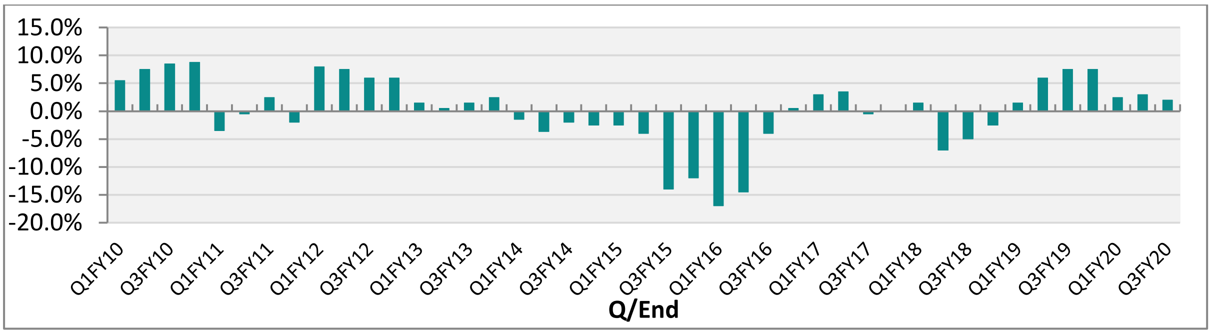
ITC Limited is an Indian multinational conglomerate company headquartered in Kolkata. It is India's largest cigarette maker, leading FMCG marketer, second largest hotel chain, market leader in the Indian paperboard and packaging industry and foremost agri-business player. In fact, the cigarette market in India is dominated by ITC with 78.5% share of sales by volume, followed by Godfrey Phillips (13.5%) and VST Industries Ltd (7%).

Enduring Value

Headwinds in action for cigarette industry

Cigarette business contributed only 46% to topline but almost 85% to total PAT signifying the ITC's dependence on it. That said , punitive and discriminatory taxes on legal cigarettes along with a rise in grey market of cigarettes has impacted ITC's volume growth.

ITC's Cigarette Volume Growth (%)



(Source: Company, PL Research)

Factors affecting Cigarette volume growth

Cause	Fact	Effect
Excessive Taxation	According to Tobacco Institute of India (TII), taxes on cigarettes are ~55 times higher than taxes on other tobacco products on a per kg basis. Tax incidence on cigarettes nearly trebled between 2011-12 and 2017-18 and 2017 was the sixth straight year of tax increase for the cigarette industry. However in Budget 2020, the excise duty was hiked across all tobacco products with tax hike on cigarettes being the biggest of ~9-15%.	Tax factor has made legal, duty-paid cigarettes in India among the costliest in the world in terms of per capita affordability resulting in migration from consumption of duty-paid cigarettes to other lightly taxed or tax-evaded forms of tobacco products including duty-free, bidis, chewing tobacco, gutkha, zarda and snuff. ITC passed on this tax in the form of price hikes which supported margins but triggered a decline in volume. Similarly, to offset impact of falling volumes on topline post Budget 2020 tax hike, ITC increased cigarette prices by 10% to 20%.
Increase in Consumption of Illicitly Traded Cigarettes	In 2014, legal cigarette sales dropped 8.2% YoY to 88.1bn sticks marking a 15-yr low. According to Euromonitor, India was the 4th largest market for illicit trade in cigarettes in volume terms. Illicit trade volumes in cigarettes rose from 19.2% in 2014 to 21.3% in 2015.	This was the biggest reason behind the fall in retail volume of branded cigarettes. During 2015, ITC reported a dip in cigarette volume each quarter.
Stringent Regulatory Policies	The NDA Government made larger pictorial warning mandatory on cigarette packs. The statutorily prescribed pictorial warning occupying 85% of both side of cigarette pack ranked India on 2nd position globally in terms of stringency.	Many anti-tobacco initiatives including cease in sale of loose cigarettes, hiking penalties for smoking in public places and pictorial warning on cigarette packs have led to lower cigarettes business.

(Source: Company,PL Research)

All the aforementioned factors led to a 5 yr PAT CAGR of only 6% for the period 2015-2019 or an average of about 7% post 2014 vis-à-vis an average of 22% pre-2014. The Dividend Payout Ratio has also remained consistent at ~59% on an average.

Due to perennial problems, ITC diversified its focus to non-tobacco businesses. FMCG is now the second largest contributor to ITC's total revenue (13%). However, it contributes just about 2% to Total Profit of the company. Therefore, even though profits from FMCG business grew 120% in FY19, its contribution to drive the overall earnings growth remains small. Likewise, profit from the hotels business rose 17% but contributed only 1% to total profit. Even paper and packaging business, that account for 7% of total profits, grew 24% in FY19. Therefore, the contribution to overall earnings from cigarettes business remained significant but due to fall in cigarette volumes, the earnings growth slowed down.

Despite slowdown in ITC's growth from it's core cigarette business, the other business segments have witnessed encouraging growth traction in recent times. Thus, the thesis of broadening of growth levers for ITC could unfold and make it a medium or fast grower. The volume play leading to operating leverage in the FMCG business and growth outlook in the hotel and paper segment appear positive from a longer term perspective. While incremental market share erosion has been a concern for ITC, the passage of the Bill prohibiting E-Cigarettes which is a rapidly growing market amongst the millenials, came in as a relief. However, this could be driven by the fact that the Central government is a substantial shareholder in the largest domestic manufacturer of conventional cigarettes, ITC. Govt is although planning to pare stake from current ~28% through SUUTI to meet its divestment target by March,2020 end. Further, appointment of Sanjiv Puri, the current MD, as the Chairman after YC Deweshwar took away worries relating to succession planning.

Segmental Performance

Y/e Mar (Rs in Cr)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Segmental Revenue										
FMCG-Cigarettes	18,112	20,721	23,232	27,136	30,418	31,856	34,063	35,878	24,848	22,913
Growth(%)	*15%*	*14%*	*12%*	*17%*	*12%*	*5%*	*7%*	*5%*	*-31%*	*-8%*
FMCG-Others	3,657	4,495	5,556	7,028	8,129	9,044	9,739	10,524	11,339	12,517
Agri	2,304	2,815	3,412	4,922	5,013	5,566	4,257	5,314	4,474	6,075
Paper and Packaging	1,994	2,264	2,525	2,666	3,194	3,558	3,753	3,733	3,695	4,230
Hotels	971	1,139	1,063	1,126	1,186	1,241	1,345	1,400	1,480	1,728
Others	585	644	828	1,042	1,308	1,494	1,534	1,440	1,525	1,884
Segmental PAT										
FMCG-Cigarettes	5,107	6,001	7,191	8,694	10,419	11,637	12,348	13,204	14,128	15,412
Growth(%)	*18%*	*18%*	*20%*	*21%*	*20%*	*12%*	*6%*	*7%*	*7%*	*9%*
FMCG-Others	-380	-332	-215	-89	12	31	57	26	170	326
Agri	436	566	643	731	835	904	934	926	841	793
Paper and Packaging	684	819	937	964	892	921	908	966	1,042	1,239
Hotels	231	283	294	149	146	52	61	117	145	186
Others	99	58	94	136	181	232	166	103	127	172
% of Total Revenue										
FMCG-Cigarettes	66%	65%	63%	62%	62%	60%	62%	62%	52%	46%
FMCG-Others	13%	14%	15%	16%	17%	17%	18%	18%	24%	25%
Agri	8%	9%	9%	11%	10%	11%	8%	9%	9%	12%
Paper and Packaging	7%	7%	7%	6%	6%	7%	7%	6%	8%	9%
Hotels	4%	4%	3%	3%	2%	2%	2%	2%	3%	4%
Others	2%	2%	2%	2%	3%	3%	3%	2%	3%	4%
% of Total PAT										
FMCG-Cigarettes	83%	81%	80%	82%	83%	84%	85%	86%	86%	85%
FMCG-Others	-6%	-4%	-2%	-1%	0%	0%	0%	0%	1%	2%
Agri	7%	8%	7%	7%	7%	7%	6%	6%	5%	4%
Paper and Packaging	11%	11%	10%	9%	7%	7%	6%	6%	6%	7%
Hotels	4%	4%	3%	1%	1%	0%	0%	1%	1%	1%
Others	2%	1%	1%	1%	1%	2%	1%	1%	1%	1%

(Source: ACE Equity, PL Research)

Overall Financial Performance

Y/e Mar (Rs in Cr)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Net Sales	19,136	22,575	26,525	29,901	35,317	38,835	39,192	42,777	43,449	48,353
Growth(%)	*15.6%*	*18.0%*	*17.5%*	*12.7%*	*18.1%*	*10.0%*	*0.9%*	*9.1%*	*1.6%*	*11.3%*
EBIDTA	6,342	7,690	9,231	10,619	13,075	14,143	14,470	15,461	16,503	18,425
Growth(%)	*24.5%*	*21.2%*	*20.1%*	*15.0%*	*23.1%*	*8.2%*	*2.3%*	*6.8%*	*6.7%*	*11.6%*
PAT	4,211	5,069	6,322	7,418	8,991	9,766	9,492	10,471	11,485	12,824
Growth(%)	*25%*	*20%*	*25%*	*17%*	*21%*	*9%*	*-3%*	*10%*	*10%*	*12%*
Div Payout Ratio (%)	94%	69%	57%	56%	54%	52%	73%	57%	56%	57%
Div Yield (%)	3.8%	2.5%	2.0%	1.7%	1.7%	1.9%	2.6%	1.7%	2.0%	1.9%

(Source: ACE Equity, PL Research)

Share Price Performance: ITC Ltd

(Source: Company Data,PL Research)

Pre-coronavirus, ITC's share price had remained more or less rangebound for almost 2 years.

Rising Coronavirus fears have created unexpected demand for bulk food packets which could lead to higher FMCG sales volumes for ITC. Further, it has come out with innovative premium flavoured cigarettes in an attempt to create a new niche in its cigarette business. However, its hospitality business will take a hit due to travel ban in the wake of Coronavirus. Amid the outbreak, ITC is expected to pay higher dividends of ~Rs16/share which means a dividend yield of ~10%. Such high dividend paying stocks are therefore necessary to shield against market declines as per Peter Lynch.

In times when personal care is picking tremendous pace, Dabur has not seen much growth.

EXAMPLE 2 : DABUR INDIA LTD - 'NOT SO NATURAL WITH NIFTY'

Dabur India Ltd is a 135 year old Ayurvedic company promoted by Burman family, operating in key segments including Hair Care, Oral Care, Health Care, Skin Care, Home Care and Foods. It is one of India's largest Ayurvedic medicine and natural products manufacturer with over 250 Herbal/ Ayurvedic products. Its vast FMCG portfolio today includes 5 flagship brands–Dabur, Vatika, Hajmola, Réal and Fem available in over 100 countries, highly popular in the Middle East, SAARC countries, Africa, US, Europe and Russia and overseas revenue today accounts ~27% of Dabur's total turnover. It also has a wide distribution network covering 6.7mn retail outlets in both urban and rural markets.

Financial Performance

Y/e Mar (Rs in Cr)	2012	2013	2014	2015	2016	2017	2018	2019
Net Sales	5,305	6,169	7,075	7,827	7,780	7,614	7,722	8,515
Growth (%)	*29%*	*16%*	*15%*	*11%*	*-1%*	*-2%*	*1%*	*10%*
EBITDA	860	988	1,160	1,316	1,518	1,509	1,617	1,740
Growth (%)	*12%*	*15%*	*17%*	*14%*	*15%*	*-1%*	*7%*	*8%*
PAT	644	766	916	1,068	1,254	1,280	1,358	1,445
Growth (%)	*13%*	*19%*	*20%*	*17%*	*17%*	*2%*	*6%*	*6%*
Div Payout Ratio(%)	35%	34%	33%	33%	32%	31%	98%	34%
Div Yield (%)	1.2%	1.1%	1.0%	0.8%	0.9%	0.8%	2.3%	0.7%

(Source: Ace Equity, PL Research)

Looking at the above numbers, its revenue grew at 7yr CAGR of only 7%. This was caused by slow growing (only 2-3%) rural markets (Dabur has 45% of revenues coming from Rural India), competition from Patanjali coupled with a slowing FMCG space due to unemployment and liquidity crisis.

Dabur is a consistent dividend payer and dividend payers usually are resistant to market declines under normal circumstances. For example if we take the period between 15th May-15th Sept 2019, there were bearish sentiments across markets(Nifty was declining) whereas Dabur posted a 25% gain within the same period. As soon as the FM announced a corporate tax rate cut on Sept 20th 2019, Nifty shot up by ~5.3% whereas Dabur declined ~2.3%. This phenomenon is reflected in the graphs below. This effectively supports Peter Lynch's write up on slow growers as dividend paying stocks provide stability to portfolio during market fall. Although, we cannot rule out that Dabur, given its stronghold in Ayurveda, could benefit from the "Naturals wave" that is picking pace in the country and could spur its revenue growth and get into another category altogether.

Relation of Nifty and Dabur during a market decline under normal circumstances

(1st chart- Nifty, 2nd chart- Dabur)

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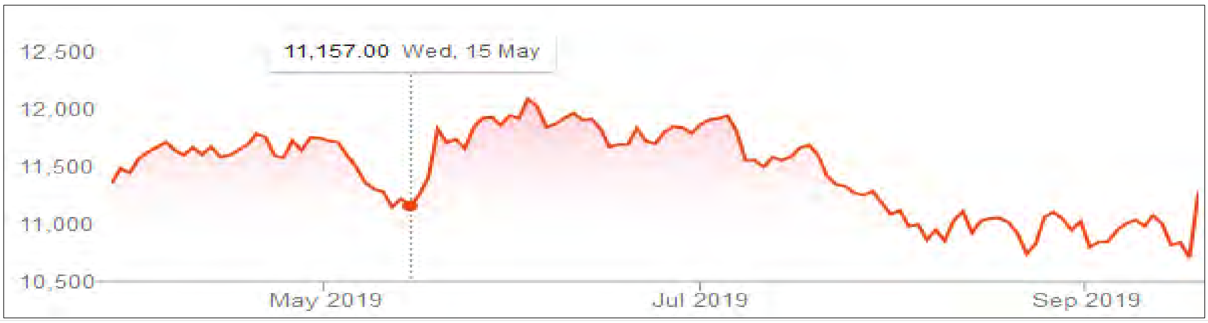


(Source: Google Finance)

(Source: Google Finance)

The inverse relation of Dabur and Nifty did not hold true however when Coronavirus fears exacerbated. However, Dabur could be expected to gain from higher demand for its products considering the increase in demand for essentials by individuals in the fear of a longer lockdown due to Coronavirus.

Few other companies that could fall into Slow Grower category are: ***Castrol India, Wipro, Colgate-Palmolive, Cipla.***

Q. What are Medium Growers/Stalwarts?

- These companies are faster than slow growers and have expected annual earnings growth of 10% to 12%.
- These companies usually sell goods which are a necessity to human life.
- The stalwarts have been good performers, but not the star performers. Most of these are huge companies and it's unusual to get a ten bagger out of these.
- Always keep such stocks in your portfolio because they offer good protection during recessions and hard times.
- Meant for investors with Low Risk appetite since such companies are Low Risk and give Moderate Returns .

Asian Paints is a company that grew at 30-50% rates pre-2011, comfortably sitting in the fast grower category of Peter Lynch. However, post-2011, the company's earnings grew at an average of 12% per year. Thus, it fits in the medium grower category now.

Example 1: Asian Paints Ltd(APNT) - 'Painting the Canvas Green'

Asian Paints is an undisputed leader in the Indian paint industry since past 50 years and commands more than 50% market share in the organized Indian paint industry which is nearly three times its nearest competitor Berger Paints'. The company has operations in 15 countries and has 26 paint manufacturing facilities across the world, servicing consumers in over 65 countries. APNT operates in two segments mainly: Paints (98% of revenues) and Home Improvements (2% of revenues). Its Paints segment is further divided into 2 broad categories: Decorative Paints and Industrial Paints. Its India Decorative business generates around majority of the revenues (83%). The company operates the Industrial Paint business in India through a 50:50 JV with PPG industries of USA.

What fuelled its Growth?

Led by strategic focus on profitable decorative paints segment, APNT was a direct play on the growing economy and India's (underpenetrated) Decorative Paints industry. In an industry where the unorganized sector commands 35% market share, APNT planned on having a wider distribution network and spent on advertising that helped create brand recall among Indian customers.

Introduction of small packets, signature stores, home painting solution services, colour consultancy, Colour World tinting machines (which reduced distributor's inventory cost) were some of the innovative concepts introduced by the company which helped it become a market leader in the Decorative segment and also obtain pricing power. All the above factors accelerated earnings growth for APNT. High double digit earnings growth rates steadied at around 12-15% post 2011. Even now, the aforementioned factors continue to contribute to its earnings growth.

1. Encouraging Macro picture: The Indian paint industry is highly correlated with GDP growth rates. Hence, as economic growth paces, the paints industry will witness growth. In a fast growing country like India, factors like rising frequency of repainting, affordable housing; infrastructure growth and aspirational consumer keen on owning a home would lead to increased paint consumption. The per capita paint consumption is 3.75kgs vs world average of 12-15kgs, highlighting the scope for growth. Another growth driver is the gradual shift in Indian consumers' mindset of considering paint as a necessity as against discretionary item.

2. A leader in paints: APNT is a market leader in the profitable Decorative business that contributes 80%+ to its revenues. The Industrial Paints Business constitutes about 3% of its total sales. It is the 2nd largest player in the Auto OEM segment and a market leader in the Auto Refinish segment. Although the Auto sector has been witnessing a slowdown for a while now, the first one in the paint industry to benefit from a pickup in auto demand would be APNT. The paint industry is highly vulnerable (50% of sales) to crude oil price. Leadership like the one APNT has means the ability to pass on any cost inflation without really affecting volume demand.

3. Widening Distribution Network: APNT has the largest distribution footprint in the paint industry. Essentially, it has a strong dealer network which has increased at a very rapid pace from 23,000 dealers in FY11 to 65,000 dealers currently. Additionally, APNT is fixated at adding around 3,000 dealers every year. Various engagement programs have helped its dealers improve their process, efficiencies and quality creating a win-win situation for both.

4. Consistent Advertising: From the financial performance table below, we can see that APNT spends ~4% of its revenues on advertising every year. This might not always be remunerative, but it has given a tremendous boost to the company's brand recall. When the market is up, everybody makes money. But when the chips are down, only resilient brands stay afloat. This maxim prevails even today. When Nifty lost almost 1200 points between July start and August end of 2019, APNT gained 15%.

5. Moving up the value chain: With a taste for premium picking up among the Indian consumers, APNT's premiumization strategy is playing out. Currently, most of its products sell at 5-10% premium to its competitors'. Pre-2010, the Company had an average PAT margin of about 6% which now stands at an average of 10%. Another important point is that despite sluggish sentiments in the real estate sector, APNT has managed to maintain its margins and growth.

6. Shift from Unorganized to Organized: The paint industry has almost 35% share coming from the unorganized sector. Post the implementation of GST in 2017, the organized paint industry stands to benefit. Furthermore, in 2018, the Government reduced the GST rates from 28% to 18%, thus accelerating growth. In fact, with Indian consumers increasingly becoming brand-conscious, the shift is going to be even more impactful.

7. Continued innovation legacy: The company intends to add 25 Colour Idea stores every year which have the Colour Visualizer, an option for customers to visualize how their favorite colours would look on the walls, prior to painting; an unmatched service. APNT also plans to add 4,000 Colour World outlets which would have tinting machines. These machines require only base colours to be kept and dispense different shades based on the need of the stockist, thereby reducing inventory costs for distributors. They also launched an App for its buyers with a feature to visualize their walls in different colours.

8. New areas of growth: Apart from the paint business, APNT forayed into home improvement business in FY10 with a vision of being a complete decor solution company, leveraging their distribution network and customer base. Currently this segment contributes 2% to topline but could be a key focus area for future growth once real estate demand picks up. Waterproofing and adhesives are also seen as potential areas for growth.

Coupled with all the above mentioned factors, company has a wider product range covering all price segments thereby helping it tap each and every consumer segment. It also has high standards of corporate governance and a promoter holding of ~52% which signifies the confidence of promoters in the company. It is also a consistent dividend paying stock and has very low debt.

In FY19, its revenues grew 15% YoY to Rs 19,350cr. Since 2/3rd of the Industrial Paint demand in India comes from Automotive Industry, the slowdown in Auto Industry especially after October, 2018 has impacted Asian Paints' growth in the auto industrial paint business.

Financial Performance – Asian Paints

Y/e March (Rs in Cr)	2011	2012	2013	2014	2015	2016	2017	2018	2019
Net Sales	7,722	9,632	10,939	12,715	14,183	14,271	15,397	16,887	19,350
Growth (%)	*16%*	*25%*	*14%*	*16%*	*12%*	*1%*	*8%*	*10%*	*15%*
RM Purchases	3,869	4,948	5,372	6,049	6,277	5,904	6,700	7,332	8,919
% of Sales	*50%*	*51%*	*49%*	*48%*	*44%*	*41%*	*44%*	*43%*	*46%*
Advertisement Exps	343	410	515	631	744	561	619	663	796
% of Sales	*4%*	*4%*	*5%*	*5%*	*5%*	*4%*	*4%*	*4%*	*4%*
EBIDTA	1,331	1,511	1,737	2,004	2,243	2,777	3,024	3,207	3,530
EBIDTAM (%)	17%	16%	16%	16%	16%	19%	20%	19%	18%
PAT	881	1,021	1,160	1,263	1,427	1,769	1,967	2,052	2,171
Growth (%)	*0%*	*16%*	*14%*	*9%*	*13%*	*24%*	*11%*	*4%*	*6%*
PATM (%)	10%	9%	9%	9%	9%	10%	10%	10%	10%
D/E (x)	0.11	0.13	0.09	0.06	0.09	0.05	0.07	0.06	0.07
Div Yield (%)	1.3%	1.2%	0.9%	1.0%	0.8%	0.9%	1.0%	0.8%	0.7%
PE (x)	29	31	42	43	56	48	53	53	66

Company Name	Unit	High Growth Phase					Medium Growth Phase				
		Years	Revenue	EBIDTA	PAT	Price	Years	Revenue	EBIDTA	PAT	Price
Asian Paints	CAGR %	2006 - 2011	20.6%	27.78%	33.1%	31.3%	2011 - 2019	12.2%	13.0%	11.9%	24.9%
	Rs.	2006	916	143	86	65	2011	2,657	469	308	253
		2011	2,657	469	308	253	2019	5,361	1,173	804	1,493

(Source: ACE Equity, PL Research)

Share Price Performance: Asian Paints Ltd

(Source: PL Research)

Asian Paints has been a 6 bagger from FY11 till March, 2020 (pre- Coronavirus period). Post 11th March 2020,(post declaration of Coronavirus as pandemic) the share has fallen ~15%. In fact, it has been one of the resilient stocks in Nifty.

Further, as crude oil derivatives are used to make paints, sharp fall in crude oil bodes well for APNT albeit keeping a check on rupee depreciation. However, fear arising from Coronavirus could lead to a fall in demand for real estate and auto, impacting sales of APNT.

EXAMPLE 2: PIDILITE INDUSTRIES LTD- 'FEVICOL-ED TO GROWTH'

Pidilite Industries is India's No.1 adhesives company which owns the iconic brand Fevicol. Its other flagship brands include FeviKwik, M-Seal, Fevicryl and Dr.Fixit to name a few. Pidilite has a portfolio of more than 500 products that are exported to over 80 countries worldwide. Around 84% of its sales come from Consumer & Bazaar (C&B) Segment which can be further divided into Adhesives and Sealants (55%), Paint Chemicals (20%) and, Art, Craft and Stationery (9%). Industrial Products Segment contributes the balance 16% and includes products such as industrial adhesives, synthetic resins, organic pigments and pigment preparations.

Glued to a Steady Growth Path

Pidilite has grown consistently and clocked a 12% 10Yr CAGR in Revenues and 13% 10Yr CAGR in profits and is an appropriate fit in the Medium Grower category of Peter Lynch. There are several factors that have helped it achieve and continue such a steady performance:

1. <u>B2C oriented:</u> Margins in the consumer facing business are much higher than the B2B segments. For Pidilite, the B2C has always contributed much more to the revenues than the B2B segment. As mentioned earlier, Pidilite's C&B Segment contributes almost 84-85% on an average. The PAT margins have also improved from an average of 8% in the pre-2010 period to an average of 12% now. In fact, in the overall economy in general, any company which had B2C exposure has grown at a much faster pace than its peers in B2B in the past 10 years.

2. <u>Creative and Consistent Advertising:</u> Until Pidilite started advertising heavily, adhesive as a product was not something that got advertised also. Pidilite hired the advertising agency, Ogilvy & Mather, which created simple yet creative ads for Pidilite's brands. Yet, the company managed to keep its advertising expenses below 5% of revenues. Further, ad campaigns for Dr Fixit, Fevikwik, M-Seal and Fevistik have also created strong brand recognition in the water proofing, instant glues, sealants and art material categories for PIDI. The consistent advertising is so effective that now Indians use 'Fevicol' instead of the word glue.

3. <u>Product Innovation:</u> Based on customer requirements and feedback, Pidilite launches relevant products for its customers. Over the many years, Pidilite launched many successful products, like Fevicol Wood Grip, Fevicol Marine, Fevistik Super, Fevicol All Fix and M-Seal to name a few, catering to different segments of customers. Some of Pidilite's products have actually created a market themselves. Fevicryl, no-stitch fabric glue, is one such example which was first of its kind in India. The need to have such a product was identified by Pidilite in the Zardozi art segment. It became a huge success among the Zardozi Karigars and now is also exported.

4. First Mover Advantage: Instead of following competition, Pidilite's products are such that develop its own categories and markets. This gave them the first-mover advantage, a massive opportunity to generate huge sales at company-dominated prices and sometimes becoming leaders of that market. Fevicryl is among the many products/segments where Pidilite became a pioneer. Pidilite also launched India's first Craft and Hobby store named Hobby Ideas which received an encouraging response. Essentially, identifying customer needs and launching need-specific products gave Pidilite an edge over others.

5. Strong Management: In 2007-08, Madhukar Parekh, son of late founder Balvant Parekh, initiated the professionalism drive. The owner-family has largely handed over the operations to professionals. This led to a strong legacy of governance and continuity in returns delivery. In April 2015, Bharat Puri became the first non-family CEO and MD of the company, who came with his vast experience at Modelez (Cadbury) and Asian Paints; both these companies have a distribution edge over their peers and are quite similar to Pidilite in many characteristics.

6. Strong Distribution Network: Among the many things, Pidilite is also known for its unparalleled distribution network. This can be attributed to dealers preferring to stock Pidilite's products since they are fast moving. Therefore, dealers stick to stocking only Pidilite's products despite competitor products offering better margins. Considering Bharat Puri's relevant experience, the distribution network is expected to strengthen furthermore.

7. Customer Loyalty: Apart from its thorough advertising, Pidilite has consistently kept engaging with its customers like contractors, carpenters, plumbers and painters through its training and education programs. Further, since adhesives do not form a large part of the furniture making cost (only 2%), the users do not really switch to another brand. This ensured customer 'stickiness'. In fact, it is believed that Fevicol's success can also be attributed to the management identifying carpenters' importance early on in the journey of developing the business thereby creating a loyal customer base with a robust feedback mechanism.

8. Tapping Underpenetrated Industries: Pidilite entered the nascent-stage waterproofing business through its brand Dr Fixit and also launched waterproofing solutions in a market that yet remains underpenetrated such that even Asian Paints' entry into this business in 2017 wasn't really seen as a potential danger by many market experts. As construction quality in India improves and with Indian home buyers taking waterproofing seriously, this business is expected to grow. Even the core adhesives business has room to grow given that affordable housing boost and rising incomes of the middle class come into play. Repeated usage of its existing well-penetrated categories (adhesives at 1x of GDP growth), coupled with rising penetration of the new category (waterproofing at 3x of GDP growth) will drive revenue growth, according to management.

9. Macro Drivers: The waterproofing and adhesives business continue to be driven by growth in construction activities, furniture demand and rising trend of interior decoration with improved standard of living (rising middle class population). The implementation of GST was a blow to the unorganized segment of all industries in India including the 30% unorganized market of Adhesives. This helps market leaders like Pidilite to capture the unorganized segment share.

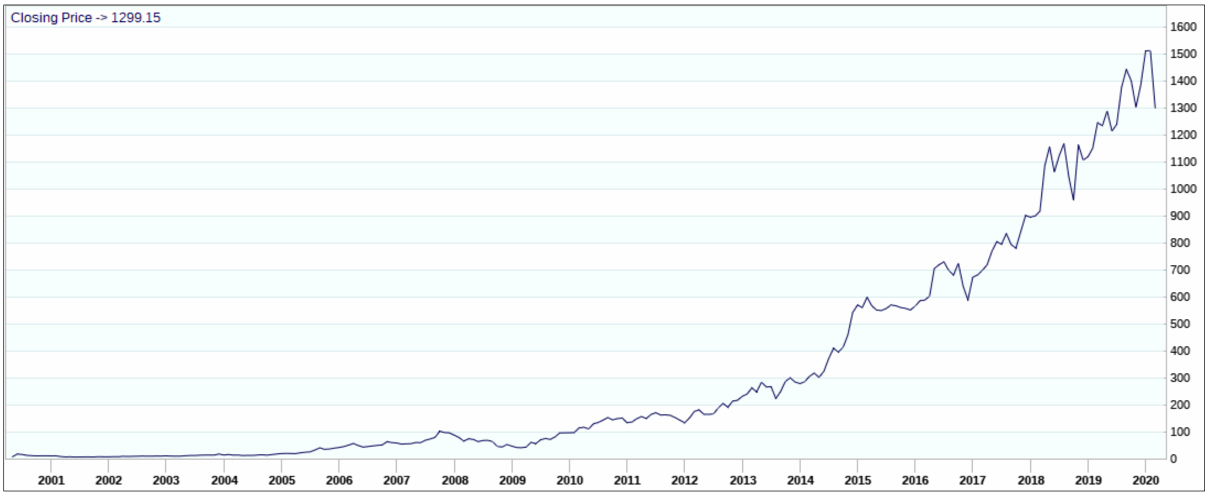
Financial Performance

Y/e March (Rs in Cr)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Net Sales	2,194	2,657	3,127	3,678	4,283	4,844	5,361	5,617	6,078	7,079
Growth (%)	*10%*	*21%*	*18%*	*18%*	*16%*	*13%*	*11%*	*5%*	*8%*	*16%*
Advertisement Exps	72	97	107	148	186	192	193	194	213	230
% of Sales	*3%*	*4%*	*3%*	*4%*	*4%*	*4%*	*4%*	*3%*	*3%*	*3%*
EBITDA	382	469	484	593	671	771	1,173	1,260	1,341	1,368
Growth (%)	*90%*	*23%*	*3%*	*23%*	*13%*	*15%*	*52%*	*7%*	*6%*	*2%*
EBITDAM (%)	17%	18%	15%	16%	16%	16%	22%	22%	22%	19%
PAT	270	308	323	422	447	509	804	858	962	925
Growth (%)	*144%*	*14%*	*5%*	*31%*	*6%*	*14%*	*58%*	*7%*	*12%*	*-4%*
PATM (%)	12%	11%	10%	11%	10%	10%	14%	14%	15%	13%
Div Yield (%)	1.3%	1.2%	1.1%	1.0%	0.9%	0.5%	0.7%	0.7%	0.7%	0.5%

(Source: ACE Equity, PL Research)

Not only has Pidilite delivered constant growth but it has also paid out one-third of its profits as dividends on an average in the past 10 years. As we can see from the table above, the company has steadily generated revenues from Rs 2,194cr in FY10 to Rs 7,079cr in FY19. Likewise, operating profit and margins have also risen.

Share Price Performance: Pidilite Industries Ltd



(Source: PL Research)

The share price of Pidilite has risen more than 12x from Rs140 levels in 2010 to Rs1,699 on 11th March,2020. Post declaration Coronavirus as pandemic, Pidilite has been fallen 23%.

Since crude and crude derivatives form 50-60% of Pidilite's Raw material cost, fall in crude oil is a big positive although rupee depreciation could set off some gains. However, slowdown in end user industries due to Coronavirus could affect sales volume.

Few other companies that could fall into this category are: ***Dr Lal Pathlabs, Nestle, HUL, Britannia, TCS.***

Q. What kind of companies are fast growers?

- These are small, aggressive new enterprises that grow at 20% to 25% a year.
- A fast-growing company doesn't necessarily have to belong to a fast-growing industry. All it needs is the room to expand within a slow-growing industry.
- Expansion into new markets results in the phenomenal acceleration in earnings driving the stock price to giddy heights.
- There's plenty of risk in fast growers, especially in the younger companies that tend to be overzealous and underfinanced.
- If chosen correctly, this category of stocks could be potential 10-to 40-baggers, or even 200-baggers. As long as they can keep it up, fast growers are the big winners in the stock market. The trick is figuring out when they'll stop growing, and how much to pay for the growth.
- High Gain companies are meant for investors with high risk appetite.

We've got an ideal example in the context of the Indian markets to represent this category.

Example 1: Avenue Supermarts Ltd (D-Mart) - 'Best Prices Each Day'

Avenue Supermarts Limited is an Indian supermarket chain which owns and operates stores under the brand D-Mart. D-Mart stores offer customers a range of quality home and personal products under one roof at competitive prices.

Everyday Low Cost – Everyday Low Price (EDLC-EDLP) Strategy

D-Mart has mastered the art of being the lowest cost seller of daily essentials by selling slightly below MRP thereby resulting in customer loyalty and great inventory turnover ratio. This also enables them to make quicker payments to suppliers and vendors and in turn extract higher discounts from their suppliers. Additionally, D-Mart only keeps those brands that fly off the shelf quickly thereby procuring items from either one or very few suppliers at an even better bargain. These discounts from the supplier network are passed on to customers, gaining their loyalty and perpetuating this virtuous cycle.

A unique strategy used by this company is that unlike its brick-and-mortar competitors who use a rental model, D-Mart buys the land along with the entire infrastructure and opens new stores in a cluster. The company taps into reasonably priced real estate opportunities lying in the densely populated residential outskirts of the city . This not only helps it to buy the land at a cheap price but also helps its stores to achieve higher revenue per sqft. In fact, in FY19, D-Mart stores generated $530 revenue per sqft which was higher than $450 of Walmart and nearly thrice the revenue per retail sqft to its rivals like Big Bazaar and Star Bazaar.

Comparison between Avenue Supermarts and Future Retail (TTM basis)

Particulars (Rs Cr) (TTM)	Avenue Supermarts	Future Retail
	Key Financial Metrics	
Sales	23,676	21,302
CFO	1,087	-1,168
PBT	1,719.20	691
PAT	1,221	690
PAT Margin %	5.2%	3.2%
Inventory Turnover Ratio	15.8	4.7
D/E	0.1	1.2
	Key Operating Metrics	
Number of Stores (FY19 end)	176	1,511
Total Mn Sqft (FY19 end)	5.90	16.14
Sales per sqft	40,129	13,198
PBT per sqft	2,914	428
SSSG %	17.8%	6.8%
	Valuation Metrics	
MCap as on 20th March,2020	1,24,120	5,933
P/Sales	5.2	0.3
P/E	101.6	8.6

(Source: PL Research, Company Data)

The key difference from the above table is that D-Mart generates almost the same level of Sales for 1/9th of the stores of its rival Future Retail. Moreover, DMart's inventory turnover ratio is 15.8 vs 4.7 implying a faster churn for D-Mart's goods and highlights the contradictory operating strategies adopted by both.

Financial Performance

Y/e March (Rs in Crs)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Net Sales	2420	3649	5,089	6,975	9,254	12,758	16,505	21,955
% Growth		*51%*	*40%*	*37%*	*33%*	*38%*	*29%*	*33%*
PAT	60	94	161	212	320	492	788	902
% Growth		*56%*	*72%*	*31%*	*51%*	*54%*	*60%*	*15%*
PAT Margin %	2.5%	2.6%	3.2%	3.0%	3.5%	3.9%	4.8%	4.1%
No. of New stores	10	7	13	14	21	21	24	21
Total no. of stores	55	62	75	89	110	131	155	176
% SSSG		*31.6%*	*26.1%*	*22.4%*	*21.5%*	*21.2%*	*14.2%*	*17.8%*

(Source: PL Research, Company Data)

The unique operating strategies opted by its management have played out well for D-Mart as is reflected in its impressive annualized sales growth rate of ~37% and annualized earnings growth rate of ~47% which were attained in the FY12-FY19 period. The SSSG (same-store sales growth) also came in at 17.8% in FY19. Therefore, Avenue Supermarts has checked most of the criterias to fit in the Fast Grower category.

Although the pace of new store additions is slowing down for D-Mart, the management has indicated that if situation demands, it will open new stores using the lease rent model to sustain their current growth rates. Hence, D-Mart's robust model along with its management's flexibility and e-commerce initiatives (D-Mart Ready) could well act as the stimuli for its superlative growth going forward.

Share Price Performance: Avenue Supermarts Ltd

(Source: PL Research)

The company became a 8-bagger within 3 years post its listing in 2017. However, it yet fell 26% post 20th Feb,2020 and 14% from 11th March,2020 (when Coronavirus was declared a pandemic) till 24th March 2020. However, since the company deals in essential items, it has been resilient amid the Coronavirus fear and has recovered since 24th March 2020– share price is now only 2% down from 11th March 2020.

Another example in the fast grower category is Relaxo Footwears Limited.

EXAMPLE 2: RELAXO FOOTWEARS LTD - 'PLACING THE RIGHT FOOT FORWARD'

Relaxo Footwears Limited is one of India's leading footwear manufacturing companies with brands like Hawaii, Flite, Sparx, Bahamas and Schoolmate. In a market that is ~60% dominated by small-scale unorganized players, Relaxo has managed to capture the low end mass segment by offering an impeccable roster of high quality products at low cost thereby becoming a leader in the 'Value' segment. The management's appropriate action plans like penetrating new towns/ channels, brand building and internal operational efficiency made Relaxo's growth story worth telling.

What worked? Right strategies at the right time!

1. Focusing on North and East India: These areas remained quite under penetrated when RFL started catering to these markets which eventually made RFL a market leader in North India.

2. Started Exclusive Brand Outlets (EBOs): Instead of solely relying on multi brand retailers, EBO retail structure helped not only in branding but also in understanding consumer needs, ensuring product availability and in launching relevant products. The continued expansion of EBOs widened their reach too and in 2018 RFL opened their 300th EBO.

3. Penetrating new geographies: Since RFL was already strong in North and Eastern India, they launched a brand called Sparx, a brand for the youth that did very well in the new regions, South and West. Post the success of Sparx, they also increased their regional distribution centers in South India. The management also made a plan to spread Sparx in East India and Bahamas and Flite in West India.

4. Brand Recall: RFL signed top notch celebrities as brand ambassadors that created mass appeal for its brands. At present being Salman Khan, Akshay Kumar and Ranveer Singh.

5. Premiumisation: RFL, which is known for its durable and affordable Blue and White Hawaii rubber chappal also moved up the pyramid, for example, by introducing brands like Sparx which are meant for the young working population. The effect of this can be seen from the realization per pair that increased from Rs 48 in FY08 to Rs 125 in FY19.

6. Diversified Customer Base: The Company sells footwear under its key brands including Hawaii (slippers), Flite (women footwear), Sparx (sports shoes and sandals), Bahamas (trendy slippers) and Schoolmate (school shoes). Each brand has a unique customer base giving the Company a way to tap all kinds of opportunities.

A Brand for each category: Price comparison

Brand	Overview	Target Consumer	Price Range
RELAXO	Popular Brand of Rubber/EVA slippers	All strata of the society	Rs 77-169 for Hawaii
FLITE FASHIONABLE & LITE	Fashionable and light weight footwear	Fashion conscious consumers	Rs 119-549
sparx GO FOR IT	Range of sports , canvas shoes, sandals and slippers	Young Working Population	Rs 199-2,899
Bahamas	Trendy and fashionable flip flops	Contemporary generation	Rs 139-399
SCHOOLMATE A STEP AHEAD	Range of school shoes for boys and girls	School students	Rs 244-499

(Source: Company Data, shopatrelaxo.com)

7. Adapting to the fast changing tastes of customers: With the E-commerce and social media upsurge, the Indian consumers became more fashion conscious than ever before which reduced product life cycles. This implied that a footwear manufacturer must introduce a higher number of designs in a shorter time frame to be competitive. RFL did just that. In fact, RFL restyles ~20% of their portfolio every year.

8. Launched an E-Commerce platform in 2013-14: RFL took advantage of the growing trend of online shopping when there was a sudden rise in the retailing of footwear across the industry by launching their own site and partnering with other E-Commerce players. RFL also created a different strategy and focused only on premium categories for online sales platforms to ensure that there is no cannibalization of sales vis-à-vis traditional channels.

The strategies worked wonders for the company taking the Mcap from Rs 48cr in 2008 to Rs 7,836cr in 2018 (163 times). It also reflected in the financial and operational performance numbers of the company. The Sales and Profit grew every year at an average of ~20% and 40% respectively for the 10 year period from FY08-FY18. The company also clocked an average of 25% ROCE in the last decade. All this achieved with a decreasing Debt/Equity from 1.2x in FY08 to 0.2x in FY18. Currently, the Debt/Equity is 0.1.

However, demonetization fizzled out the Sales and Profit growth for FY17. The introduction of GST in FY18 turned positive for RFL because it created a level playing for all the organized and unorganized footwear players. Apart from the above factors, the four decades of experience in footwear industry and 70% + promoter holding is what makes this company a good investment option.

Penetration is low as per capita consumption of footwear is yet low. With a rise in disposable incomes and premiumization, the Indian footwear Industry is expected to grow tremendously in the coming years.

Additionally, Relaxo along with Bata India is well poised to monetize this opportunity given Relaxo management's strong history of adopting appropriate strategies. This could start another leg of Relaxo's growth considering its wide distribution network, brand recognition, penetration into new geographies and launch of premium footwear.

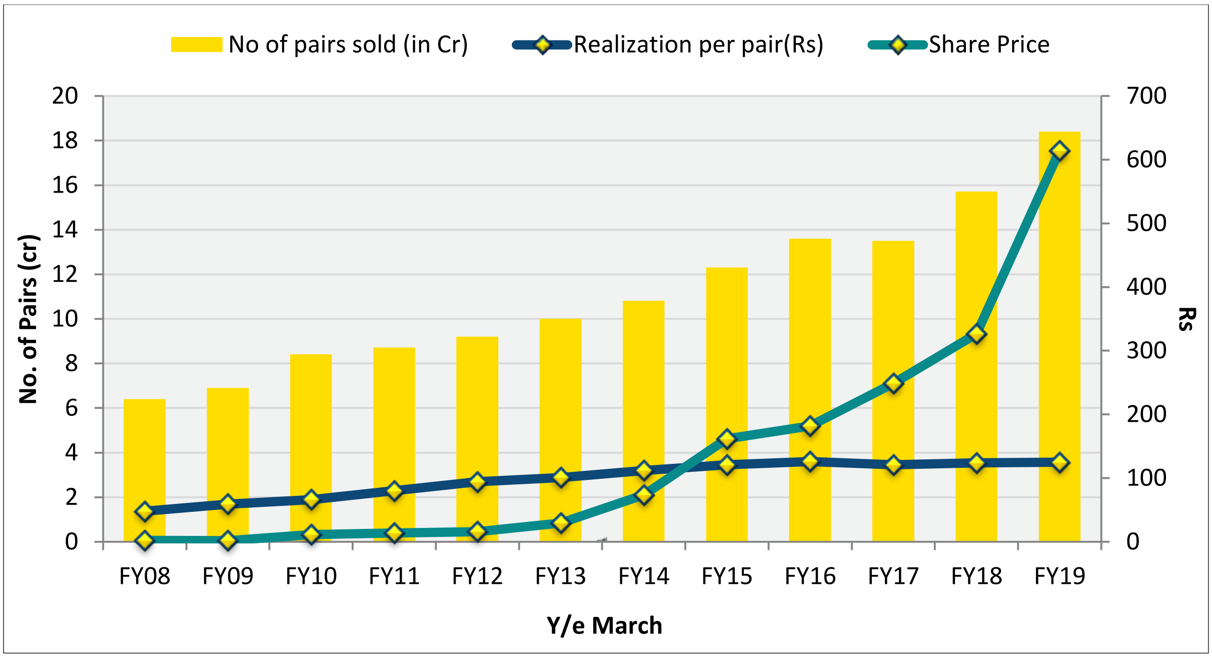
Due to sharp fall in crude oil price to below USD 30, gross margins could improve for both companies to an extent. However, impact of Coronavirus-related slowdown on demand could also be present. On the other hand, there could be a possibility that organized players like Bata and Relaxo could gain some market share given small players find it difficult to tide through demand slowdown and liquidity squeeze due to Coronavirus.

Financial Performance

Y/e March (Rs in Cr)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Net Sales	306	407	554	692	865	1,010	1,212	1,481	1,712	1,631	1,957	2,292
Growth %	*30%*	*33%*	*36%*	*25%*	*25%*	*17%*	*20%*	*22%*	*16%*	*-5%*	*20%*	*17%*
PAT	11	14	38	27	40	45	66	103	120	120	161	175
Growth %	*72%*	*35%*	*165%*	*-29%*	*49%*	*12%*	*46%*	*57%*	*17%*	*0%*	*34%*	*9%*
EBITDAM (%)	10%	10%	14%	10%	11%	11%	12%	14%	14%	14%	15%	14%
PATM (%)	3%	3%	7%	4%	5%	4%	5%	7%	7%	7%	8%	8%
D/E (x)	1.2	1.5	1.3	1.4	1	1	0.7	0.7	0.5	0.3	0.2	0.1
ROCE (%)	20%	22%	30%	18%	22%	22%	26%	30%	30%	26%	30%	26%
Market Cap	48	33	268	335	365	704	1,768	3,876	4,368	5,968	7,836	11,388
No of pairs sold (in Cr)	6.4	6.9	8.4	8.7	9.2	10	10.8	12.3	13.6	13.5	15.7	18.4
Realization per pair (Rs)	48	59	66	80	94	101	112	121	126	121	124	125
No. of EBOs	N/A	N/A	100	127	149	168	179	207	250	270	300	343

(Source: Ace Equity, Company Data, PL Research)

Share Price Performance relation to Pairs sold and Realization per pair: Relaxo Footwear Ltd



(Source: Ace Equity, PL Research)

An investment made in the company in FY08 would have multiplied and become more than 270x (pre-coronavirus). The market cap before 11th March,2020 (Coronavirus was declared a pandemic) was Rs16,720cr with a share price of Rs 673. This fell ~11% to Rs 14,853cr and Rs 597 respectively till date.

Gradual shift of the Specialty Chemical business

Initially, due to stricter norms, the Specialty Chemical (SC) business shifted from Western countries to Asian countries in what is called as Easternization. China due to its low labour cost, liberal regulations and government subsidies took the major chunk of this rapid expansion.

However, starting 2015, Chinese manufacturers also started facing raw material shortage, rising energy costs, higher labour costs, incremental effluent treatment and compliance charges. This resulted in several unorganized chemical manufacturers to shut down in China. The next best alternative to China was India. This led to a gradual shift in the Specialty Chemical business from China to India thus benefitting the Indian SC manufacturers. Therefore, the period from FY14 to FY19 has seen many Specialty Chemical companies booming and becoming fast growers; one of them being Aarti Industries.

EXAMPLE 3 : AARTI INDUSTRIES LTD (AIL) - 'THE SPECIALITY CHEMICALS SPECIALIST'

Aarti Industries Limited is one of the most highly integrated and competitive benzene-based Specialty chemical companies in the world. AIL globally ranks among the top 5 suppliers for 75% of its portfolio. Almost 45% of its revenue comes from exports. It has 16 manufacturing units, mostly located in close proximity to the large ports of western India. The Company operates through 3 segments: Specialty Chemicals (79% of Total Sales), Pharmaceuticals (14% of Total Sales), and Home & Personal Care Chemicals (6% of Total Sales).

AARTI INDUSTRIES LIMITED

The Key Growth Drivers

1. Timely capacity expansion: The growth in revenues has largely been due to AIL's consistent capex to create new capacities for its existing product line and also for higher margin downstream products. In fact, AIL's capex jumped from Rs 69cr in FY11 to Rs 133cr in FY12 and since then has been increasing at an average rate of 35%+. AIL spent ~Rs 3300cr in the 8 yr period from FY12 to FY19.

Key expansion projects

Project	Location	Capacity Details	Commissioning	FY19 Utilization	Objective of Capex
Nitro-Chloro Benzene	Vapi	Expanded from 57 to 75 ktpa and expanding to 108 ktpa	FY16	90%	Diversifying further in Benzene Value chain
Phenylene Diamines	Jhagadia	Expanded from 5 to 12ktpa	FY17	40%	Strengthen presence in high end polymer
Ethylation	Dahej	Set up a 8 to 10ktpa plant	FY17	80%	Increase of Agrochemicals Intermediates
Nitro-Toluene	Jhagadia	Set up a 30ktpa plant	FY18	53%	Foray in Toluene chain

(Source: Company, PL Research)

In addition to the growth in Benzene-based derivatives, AIL also further diversified into toluene chain of products from FY17 onwards. This came at an opportunistic time when the specialty chemical market shifted to India due to stricter norms in China and during this time Aarti also started exporting to China. As seen in the table below, Aarti's contribution of domestic sales also increased from 50% in FY15 to 55% in FY19 due to the rise in domestic demand as a result of import substitution.

2. Country de-risking by MNCs: Post the environmental concerns that were raised in China in 2015 for its chemical industry operations, the Chinese Government increased environmental regulations and decreased subsidies which led to shutdown of many capacities. During the same period the Yuan too had appreciated making the Chinese chemical products costlier. To de-risk from such supply side disruptions, the companies that had large procurement dependency on China, diversified by procuring some of their requirements from India.

3. Diversified portfolio: Currently, AIL has 200 products, 700 domestic customers and 400 export customers spread across the globe with a major presence in USA, Europe and Japan. The Company's product mix is spread across a stream of end user industries catering to small as well as larger MNC conglomerates in each segment. In FY18, the top 10 products and top 10 customers contributed 38% and 22% to the topline respectively. This signifies that AIL has a well-diversified revenue stream reducing its dependency on any one product or geography or customer. Simultaneously, AIL could capitalize on the growth opportunities in other end-user segments.

Revenue Performance

Y/e March (Rs in crs)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Geographical Sales Breakup								
Domestic	989	1,037	1,351	1,459	1,575	1,641	2,115	2,758
% of Total Sales	*59%*	*49%*	*51%*	*50%*	*52%*	*52%*	*56%*	*55%*
Export	684	1,060	1,281	1,449	1,431	1,523	1,691	2,256
% of Total Sales	*41%*	*51%*	*49%*	*50%*	*48%*	*48%*	*44%*	*45%*
Segmental Sales Breakup								
Speciality Chemicals	1,350	1,758	2,217	2,398	2,430	2,569	2,985	3,979
% of Total Sales	*81%*	*84%*	*84%*	*82%*	*81%*	*81%*	*78%*	*79%*
Pharma	165	187	249	303	426	426	556	726
% of Total Sales	*10%*	*9%*	*9%*	*10%*	*14%*	*13%*	*15%*	*14%*
HPC	158	152	167	207	150	168	264	310
% of Total Sales	*9%*	*7%*	*6%*	*7%*	*5%*	*5%*	*7%*	*6%*
Segmental EBIT								
Speciality Chemicals	217	319	333	408	504	566	581	819
Pharma	4	9	30	36	39	48	79	113
HPC	5	5	4	3	-0	1	3	-2
Segmental EBITM (%)								
Speciality Chemicals	16%	18%	15%	17%	21%	22%	19%	21%
Pharma	3%	5%	12%	12%	9%	11%	14%	16%
HPC	3%	3%	2%	2%	0%	0%	1%	-1%

(Source: Company, PL Research)

4. Increased business from Pharma segment: AIL's Pharma segment has the second highest margins of ~15% after its Specialty Chemicals segment with a margin of ~20%. Accordingly, the rise in Pharma's segmental contribution to total sales from 10% in FY12 to 15% in FY19 improved AIL's overall margin growth.

5. Highly integrated operations: One of AIL's USP is its highly integrated operation with process flexibility that enables it to provide one-stop strategic supplies to a large number of leading global downstream customers and also leads to better cost management. This translates into AIL garnering a higher share of revenue from its existing customers.

6. Increasing R&D: The nature of chemicals as a business is one which requires continuous R&D apart from capacity additions to grow. AIL's R&D too increased 5x from Rs 3.8cr in FY12 to Rs 23.3cr in FY19. This enabled AIL to move towards higher value chemical processes and make it best placed to capitalize on any new demand opportunities from existing and new customers. Currently, AIL has identified 15-20 products (currently in R&D phase) for import substitution in Specialty chemicals space and as per management, with improved availability of these intermediates, consumption is likely to increase.

7. Strong client relations and De-risked portfolio: Due to better manufacturing practices, high quality standard norms, timely delivery and compliance to regulations, AIL became the 'Partner of Choice' for several leading clients across different sectors which reduced its earnings volatility and de-risked its portfolio. This also meant that such clients would turn to AIL for any of their new product requirements. Another testament to AIL's long-standing relationships with its customers is that *80% of its top-line is generated from customers who have a business relation in excess of 5 years with the company.* However, AIL doesn't have significant concentration risk since only 22% of the FY18 revenues were contributed by its top 10 customers.

8. Cost plus pricing model: AIL follows a cost plus business model which helps it beat raw material price volatility. *While the company has contracts of varying duration ranging from quarterly to five years, the raw material prices are adjusted quarterly.* For the non-contracted volumes, raw material prices are passed to domestic markets (on a monthly basis). Accordingly, while revenues might swing with higher input prices, the core profitability margins are not impacted.

9. Increase in Value-added products: Revenue share from nitration and chlorination chemistries' products reduced from 50% ten years ago to only 30% in FY19. This shows that share of value added products increased overtime for the company, replacing its low margin base chemistry products. Consequently, the operating margin boosted from ~15% in FY12 to ~21% in FY19.

Therefore, AIL's revenues and EBIDTA grew at an average rate of 15% and 25% in the last 8 years. The operating profit margins also improved considerably led by timely capacity addition, higher share of value added products and closure of Chinese capacities. In fact, Coronavirus in China has further led to prolonged shutdown of many speciality chemical capacities which benefits companies in India that can capitalize on this opportunity.

The D/E also remained constant at 1.1x levels that too with such aggressive capex. This led to the growth in their core segments, i.e., Specialty Chemicals and Pharma which fuelled overall growth of the business.

The Market Cap for the reasons above leaped 28x from Rs 478cr in FY12 to Rs 13,632cr in FY19. *The current Mcap is Rs 13,372cr, down 17% from Rs 16,225cr on 11th March when Coronavirus was declared a pandemic.*

Financial Performance

Y/e March (Rs in crs)	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Net Sales	1,673	2,096	2,632	2,908	3,007	3,163	3,806	5,014
% Growth	*15%*	*25%*	*26%*	*10%*	*3%*	*5%*	*20%*	*32%*
R&D Exps	4	8	9	9	10	11	16	23
EBIDTA	249	361	401	466	572	654	699	971
% Growth	*35%*	*45%*	*11%*	*16%*	*23%*	*14%*	*7%*	*39%*
EBIDTAM (%)	15%	17%	15%	16%	19%	21%	18%	19%
PAT	90	133	152	194	268	328	346	499
% Growth	*35%*	*48%*	*14%*	*27%*	*38%*	*22%*	*6%*	*44%*
PATM (%)	5%	6%	6%	7%	9%	10%	9%	10%
Capex	133	235	291	303	466	530	615	794
Gross Block	730	1,058	1,261	1,442	1,756	2,189	2,518	2,714
D/E (x)	1.1	1.1	1.2	1.2	1.1	1.2	1.3	0.9
Market Cap	478	644	1,086	3,125	4,311	6,288	9,302	13,632

(Source: Ace Equity, PL Research)

Share Price Performance: Aarti Industries Ltd

(Source – PL Research)

Aarti Industries leaped from Rs80 levels in FY14 to Rs 1,000 levels in (Feb) FY20. Supply interruptions arising due to spread of Coronavirus in China leaves room for alternate players like Aarti Industries to gain market share in the global SC supply chain. Further, with a sharp fall in crude oil prices, gross margin could also go up considering Aarti's raw materials are derived from crude oil. However one cannot rule out rupee depreciation decreasing its export competitiveness and also setting off gains from crude oil price fall. Aarti Industries has fallen ~17% since Coronavirus was declared a pandemic on 11th March,2020.

Low mutual fund penetration in India (11% vs world average of 62% MF AUM/GDP ratio), growing popularity of Systematic Investment Plans (SIPs) which have grown at a 3yr CAGR of 38% as well as increasing financialization of household savings and rising disposable incomes are facilitating the MF industry's growth. AMC business in general and HDFC AMC particularly is set to be the clear beneficiary of this long term trend.

EXAMPLE 4 : HDFC AMC LTD- 'FOLLOWING PARENTS' FOOTSTEPS'

HDFC Asset Management Company Limited (HDFC AMC) is the investment manager to India's 2nd largest MF - HDFC Mutual Fund (HDFC MF) with total assets under management (AUM) of Rs 3,57,300r as on FY19. They also enjoy second position in active equity-oriented AUM in the country with a market share of 15.6% as on Dec 2019. Ever since their first full-year of operations in FY02, their profits have grown every year and have clocked a 10yr PAT CAGR of ~22%, making them the most profitable AMC in India since FY13 with ROE & ROCE consistently above 35% and 50% respectively. Their principal shareholders include Housing Development Finance Corporation Limited (HDFC) and Standard Life Investments Limited (SLI). This company is part of HDFC Group, a recognized financial conglomerate, with presence in housing finance, banking, life and non-life insurance, asset management, real estate funds and education finance.

Key beneficiary of the MF industry growth

Industry-leading profitability, strong brand equity, over 2 decades of strong performance track record, larger share of the high quality Equity MF AUM business and robust distribution network are some of the Company's strengths. Given the Company's position in the industry, they are well placed to capitalize on these opportunities.

1. <u>High return generating nature of AMC business</u>
   For an AMC, revenue from operations comprises of investment management fees from the Mutual Fund and portfolio management services and advisory fees. A unique feature of an AMC's revenue is its annuity-like nature. Once an investment is made, it keeps generating the management fee as long as the investor does not redeem it. With the growing popularity of SIPs and digital distribution ecosystem becoming mainstream giving investors easy access to market participation, the long term growth visibility of HDFC AMC has been reassured. Long-lived assets keep making money for the AMC, with very little attendance cost, resulting in high operating leverage as seen by ROCE and ROE numbers. HDFC AMC's latest FY19 ROE and ROCE came in at 52% and 35% alongside an operating margin of 63% and PAT margin of 49% which reflect the above described nature of their business.

2. Financialization of Savings
   The country's Mutual fund industry AUM as a % of GDP rose from 5.6% in FY00 to 12.5% in FY18. However this is still lower than the world average of 62%. Hence, the industry still has tremendous potential for growth, considering India is a large untapped market with favorable demographics of young population. Moreover, the household savings are also shifting to financial assets to what we call as 'Financialization of Savings'. This is mainly due to declining interest rates in Bank FDs and growing awareness of financial knowledge through financial education initiatives.
   The SIP route which is also gaining popularity offers convenience and comes with its own advantages. HDFC AMC's customer transaction preferences support the trend. The AMC's Monthly Systematic transactions (SIP/STP) increased from just Rs 308cr in FY14 to Rs 1,182cr in FY19 registering a 5 yr CAGR of 20%.

3. Reliable Brand and Strong Parentage
   The HDFC group, known for high corporate governance standards, has a firm presence across financial products and services, especially in the retail sector. HDFC AMC benefits from a strong parentage, brand name and its 20 years of experience. The brand recall among customers builds trust as evident from the Company's consistent leadership position in the Indian MF industry. Among the institutional customers, the company also benefits from the brand reputation of the Company's promoters, HDFC and SLI.

4. Capitalizing on bank assets
   HDFC AMC is ultimately a Bank-led AMC that naturally has its own advantages. HDFC Bank would already have customers that trust the bank to keep their money with. This gives HDFC AMC a ready customer base to tap into. Another advantage is of an established infrastructure, i.e., the bank's branches spread across the country that can be leveraged for expanding reach. This kind of reduces the burden of physical infrastructure needed for distribution. Moreover, this burden reduces further with digitization.

5. Wide Distribution network & Reduced Distribution Costs
   In the MF industry, the distribution network forms the backbone of all activities and determines the accessibility of products which could act as a strong moat for an AMC. HDFC AMC enjoys an enduring relationship with their 75,000 distribution partners across India which lends them an edge over peers in this highly competitive industry. The distribution partners consist of HDFC Bank itself, other banks, National Distributors and Independent Financial Advisors (IFAs). Currently, HDFC AMC serves customers in over 200 cities through a network of 210 branches.
   Another important development is the gradual shift from physical transactions to electronic transactions in the MF industry. HDFC AMC also has a dedicated website and an app named HDFC MFOnline which saw ~17% coming from the overall transactions done by its customers as of Q1FY20. The shift is quite noticeable given 67% of the total transactions were done by its customers electronically in FY19 vs 30% in FY15. In fact, as on Dec 2019, 41.7% of AUM was generated directly (excluding HDFC Bank) thereby reducing commission costs for HDFC AMC.

AUM Customer-Wise Breakup

Y/e March (Rs in Cr)	2014	2015	2016	2017	2018	2019
As a % of MAAUM:						
Individual	55%	56%	53%	56%	62%	63%
Institutional	45%	44%	47%	44%	38%	37%

(Source: Company data, PL Research)

6. Enjoys customer stickiness

In the MF industry, individual AUM & retail SIP tend to be stickier, creating the consistent annuity-like income for the AMC. As seen from the table above, as on FY19, HDFC AMC's MAAUM from individual customers accounted for 63% compared to 55% in the Indian MF industry. In fact, as on Dec 2019, HDFC AMC had the highest market share of 15.5% in the total MF industry's individual assets.

Besides, the cap in the total expense ratio (TER) for closed-end equity schemes at 1.25% and non-equity schemes at 1% (in September 2018 by SEBI) did not really affect HDFC AMC's topline much due to the AMC's larger proportion of sticky retail individual assets. Thus, it managed to pass on a large proportion of the TER cuts to distributors thereby getting impacted negligibly by the regulation.

7. Favorable portfolio mix

Equity oriented schemes generally are more profitable vs non-equity oriented schemes considering equity oriented schemes have a higher fee structure due to higher active management. According to AMFI (Association of Mutual Funds in India) data, as of November 2019, 69% of MF industry individual investor assets were held in high yield equity oriented schemes highlighting the strong preference of individuals towards equity oriented schemes vs 76% of MF industry institutions assets that were held in low yield liquid/money market schemes and debt-oriented schemes. Since HDFC AMC has a higher proportion of retail assets and in FY19, active equity schemes contributed almost 48% of its total AUM, HDFC AMC has a superior and profitable product mix vs other MF players.

AUM Geographical Breakup

Y/e March (Rs in Cr)	2014	2015	2016	2017	2018	2019
As a % of MAAUM:						
T30	84%	84%	84%	83%	81%	85%
B15/B30	16%	16%	16%	17%	19%	15%

(Source: Company data, PL Research)

8. Geographical penetration opportunity

In the MF industry, T30 refers to the top 30 geographical locations contributing to the MF AUM in India and B30 refers to the locations beyond the top 30. AMFI data suggests B30 locations tend towards high revenue generating equity assets which is dominated by retail individual investors whereas T30 is dominated by institutional investors. As seen from the table above, out of the total 210 branches, HDFC AMC has 134 branches in B30 locations, which contribute about 15% to their total monthly average AUM in FY19. Hence, the under penetration in the B-30 market creates an opportunity for growth and HDFC AMC being the second largest player in the B-30 segment can tap it well.

The above factors have had an encouraging impact on the AMC's AUM and financials. HDFC AMC's AUM has been growing consistently with FY19 AUM registering a growth of 52% YoY. Besides, the AUM grew at a 5 yr CAGR of 18% from FY15 to FY19. HDFC AMC's current AUM of Rs 3,68,900cr as of Dec, 2019 makes it the largest AMC that commands a market share of 13.9% of the total industry closing AUM. It is also the most profitable AMC in the country. The profits are also growing steadily. The 5 yr PAT CAGR was at 18% from FY15 to FY19.

AUM Performance

Y/e March (Rs in Cr)	2014	2015	2016	2017	2018	2019
Total AUM	1,08,900	1,50,569	1,65,619	2,30,594	2,91,985	3,43,938
Active Equity AUM	N/A	67,481	62,941	95,659	1,44,925	1,64,263
Monthly SIP/STP AUM	308	474	485	677	1,153	1,182

(Source: Company data, PL Research)

In fact, after Sept 2018, SEBI banned upfront commissions and mandated that distributor fees will be paid from scheme account and not from the books of mutual fund houses. Such a regulation's impact was visible from HDFC AMC's Commission Expense as a % of Sales that reduced from Q4FY19's 6.1% to 2.3% in Q1FY20 thus boosting the quarterly PAT margins.

Reduction in Fees and Commissions

Particulars (Rs in Cr)	Q2 FY19	Q3FY19	Q4FY19	Q1FY20	Q2FY20	Q3FY20
Total AUM	*2,92,600*	*3,29,100*	*3,43,900*	*3,56,700*	*3,66,200*	*3,68,900*
% QoQ Growth		*12.5%*	*4.5%*	*3.7%*	*2.7%*	*0.7%*
Revenue from Operations	480	477	487	504	498	525
% of Total AUM (Annualized)	0.66%	0.58%	0.57%	0.57%	0.54%	0.57%
% QoQ Growth		*-0.7%*	*2.0%*	*3.7%*	*-1.3%*	*5.4%*
Other Income	35	56	61	48	51	67
% of Sales	7.3%	11.7%	12.5%	9.6%	10.2%	12.8%
Fees & Commission Exp	74	53	30	11	1	7
% of Sales	*15.3%*	*11.1%*	*6.1%*	*2.3%*	*0.2%*	*1.3%*
PAT	206	243	276	292	368	353
PAT Margin%	*42.9%*	*51.0%*	*56.8%*	*57.8%*	*74.0%*	*67.1%*

(Source: Company data, PL Research)

Financial Performance

Y/e March (Rs in Cr)	2014	2015	2016	2017	2018	2019	TTM
Operating Income	859	1,022	1,443	1,480	1,757	1,915	2,014
Commission Expense	151	173	457	419	327	240	49.2
EBIDTA	486	591	668	704	954	1,206	1,510
EBITDAM (%)	57%	58%	46%	48%	54%	63%	75%
PAT	358	416	478	550	711	931	1,289
PATM (%)	42%	41%	33%	37%	40%	49%	64%
ROE (%)	45%	41%	42%	43%	39%	35%	38%
ROCE (%)	65%	62%	62%	62%	58%	52%	51%

(Source: ACE Equity, PL Research)

The multi-year story for AMCs in India remains intact. The key risk however is the regulatory impact of SEBI that is on a quest to make MF investing cheaper which reduces the margins for AMCs and discourages MF distribution in a way. Hence, all this along with competition from Fintech companies will make the AMC business a pure volume play business, i.e., only large AMCs with huge AUMs and consistent performance would survive in the long run.

Share Price Performance: HDFC AMC Ltd

(Source: PL Research)

HDFC AMC's share has given almost 100% returns since its listing on 10th August, 2018.

Mirroring the reaction of stock market participants especially FII's flight to safety post spread of Coronavirus, HDFC AMC has fallen ~29% post 11th March,2020 and ~39% post 20th Feb,2020.

However, Feb,2020 SIP inflows stood at Rs 8,513cr lower by a mere Rs 19cr MoM but higher by 5% or Rs 418cr YoY. This shows individual investor confidence in Mutual Funds despite market weakness. However, March SIP data and market performance will be key to track redemption activity.

Capitalizing on the opportunities present in the lending space, post the Global Financial Crisis (GFC) in 2008, if there is one company that stood out in terms of growth and quality, then that is Bajaj Finance Ltd. They are amongst the largest personal loan lenders and new loan acquirers, acquiring new loans worth Rs 76.7lakhs in Q3FY20 in India.

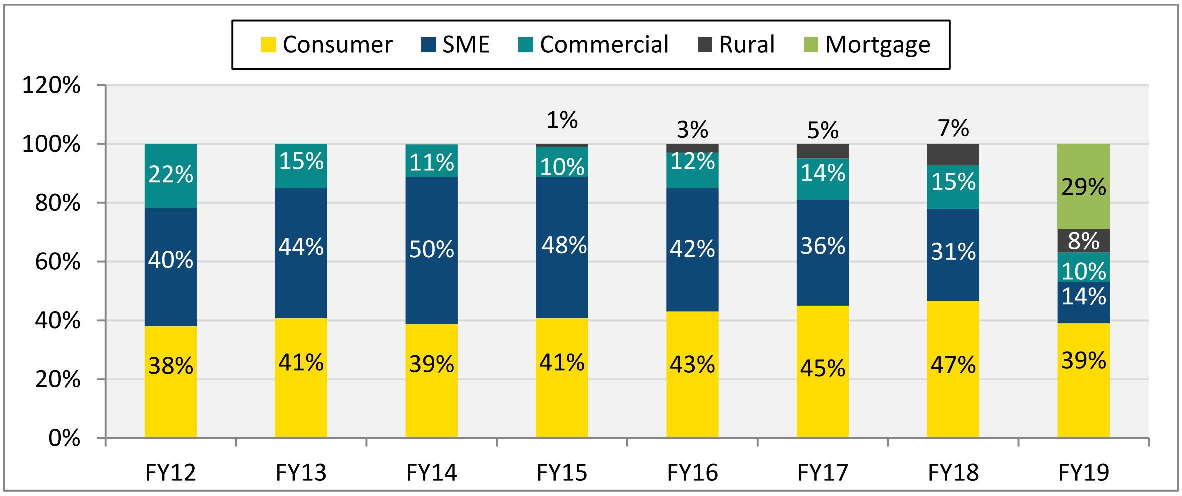
EXAMPLE 5 : BAJAJ FINANCE LTD- 'ONE STOP STOCK TO PLAY CONSUMPTION, TECHNOLOGY AND CREDIT GROWTH STORY'

Bajaj Finance Limited (BFL) is one of the leading non-banking financial companies (NBFC) with strong brand equity and is part of the Bajaj group, one of the oldest & most respected business houses in India. BFL is engaged in lending across retail, SME, and commercial customers and accepts public and corporate deposits. Its management has frequently highlighted that it focuses on the mass affluent segment and the sheer size of India's youth paves the way for its consumer story to be one of the world's most compelling in the next 20 years.

Capturing vacated Small Ticket Loans segment with Innovation

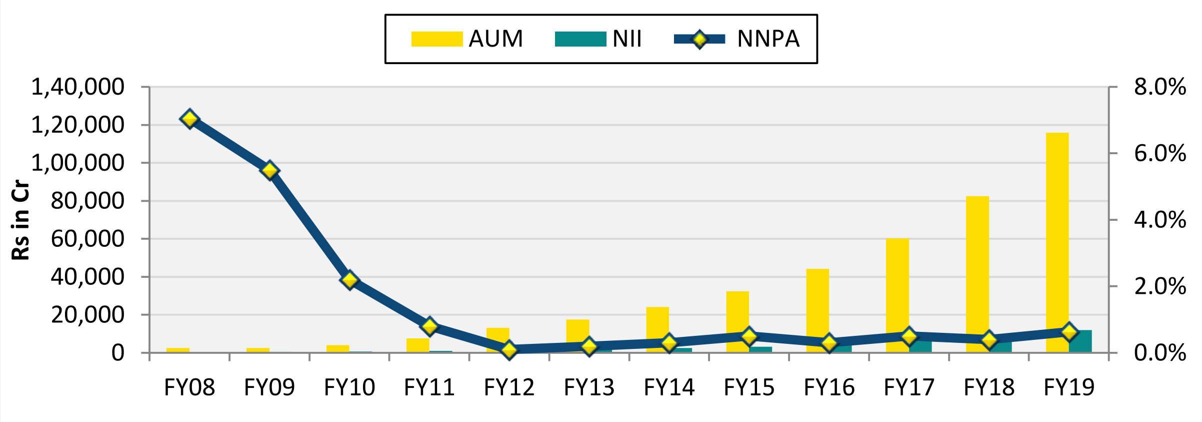
Post GFC, banks were vacating the small ticket consumer financing space which gave BFL an opportunity to capture this space. Over the past decade, Bajaj Finance has established a strong position in the underpenetrated consumer financing segment by strategically adding product lines, targeting affluent customers and underwriting risk via technology platforms. In fact, if we see the loan portfolio mix, we see that BFL is quite diversified, engaged in lending across Consumer (Retail), SMEs, Commercial customers, Rural customers and has recently also added mortgage lending to its loan portfolio.

Loan Portfolio Mix



(Source: Company data, PL Research)

Past 10 year trend in AUM, NII and Net NPAs



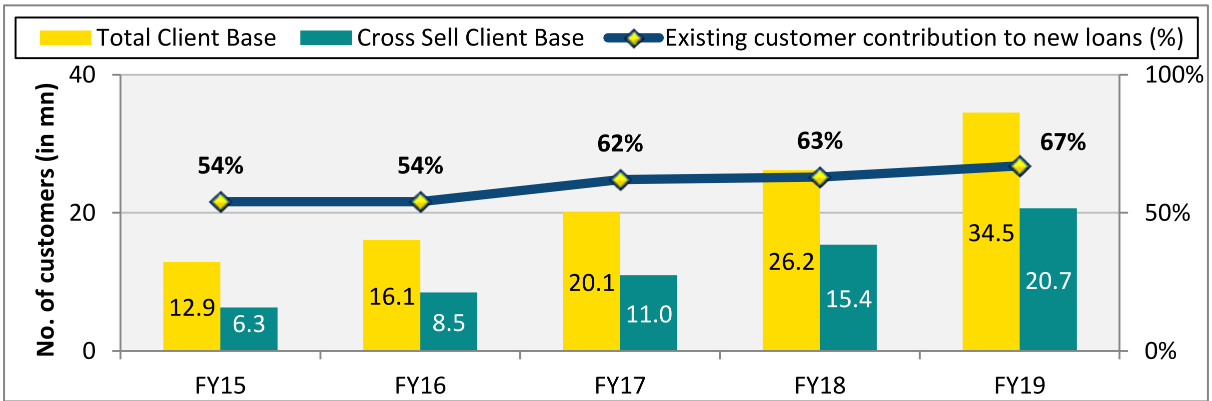
(Source: Company data, PL Research)

By penetrating the consumer finance space post GFC, not only did BFL experience a stellar growth in AUM but it also achieved higher margins through B2C business and reduced concentration risk. In spite of robust growth in AUM in last five years, company has been able to maintain healthy asset quality. In fact, a diversified portfolio enabled BFL to shield itself from the NBFC crisis. Hence, BFL has outperformed all its peers in terms of growth (AUM), return (NII) and risk (NNPA). This is evident from its NII and AUM growth; both grew at a CAGR of 38.4% and 41.8% respectively for the past eleven years led by prudent asset quality (NNPA ranged between 0.3 - 0.6% in the past three years).

With focus on small-ticket loans, other factors that contributed to BFL's growth are:-

1. Focus on Existing Customers through innovative products: BFL has been able to get repeat business due to innovation in plain vanilla loan products. They were the first to introduce a 3-min on the spot approval for Durable Finance offer. Existing member identification (EMI) card is an offering by BFL that carry pre-approved loan facility, offer zero down-payment options and other promotional offers to customers as against a credit cards issued by a bank. Due to this, their customer addition run-rate continues to be on track. Therefore because of their continuous improvements in product features and digital technologies, BFL has less need to worry to acquire new customers. Additionally, the Company aims to have ~75% of new loan originations (67% in FY19) from existing customers, further lowering the risk of acquiring new customers.

Rapid growth in customers

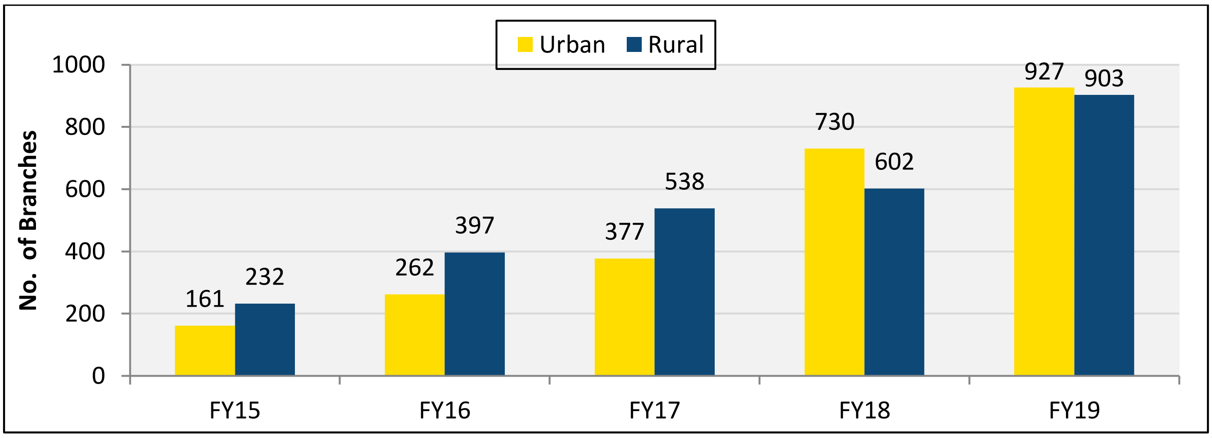


(Source: Company data, PL Research)

2. Tapping Cross-selling Platforms: Cross selling has not only enabled BFL to generate revenues but also create a sticky customer database. We can see from the chart above that clients acquired through cross-selling have been increasing year after year and in FY19 it had a total of 34.5mn customers of which 20.7 is through their cross-selling franchise. BFL has partners such as with RBL Bank, Mobikwik and Future Group. Over FY16-FY19, the company has seen a three-fold rise in cross-sell customer pool to ~21mn, aiding ~5x fee income growth over this period. However, competition in the credit card market from market leaders like HDFC Bank, SBI, ICICI Bank, Axis Bank stays quite prominent.

3. Rural financing to generate higher yields: BFL operates with a unique hub (lending branches) and spoke (franchises) business model to source customers and there is consistent growth in this model with rural lending growing ~8x since FY16 in AUM terms.

No. of Rural and Urban Branches



(Source: Company data, PL Research)

As seen in the chart above, the number of urban branches and rural branches grew ~6x and ~4x respectively between FY15-FY19. Rural lending forms 8% of consolidated AUM in FY19. Currently, with its business is spread over 986 urban and 1,193 rural locations in India, BFL stands fully geared to capture the latent demand arising from the rural consumer market. In fact, it has reduced its geographical concentration risk by diversifying its portfolio over urban and rural locations in India.

4. Focus on Consumer Durables: NBFCs continue to dominate consumer durable disbursements with ~60% market share. Out of this, Bajaj Finance has ~70% market share among NBFCs in this space as of FY20. Such financing largely involves point-of-sale (POS) financing, i.e., loans are normally processed at the retail outlet or showroom (for televisions, kitchen appliances, gadgets, mobile phones etc). Customers prefer the convenience of on-the-spot EMI schemes while making a purchase rather than approaching banks for a loan. This is where BFL created a niche for itself.

5. Growth in Auto Finance: Bajaj Auto had operationally strong Q3FY20. In last 3 years, Bajaj Auto has expanded into 16 new markets for its 3W segment. The share of Bajaj Auto's 2Ws and 3Ws loans financed by Bajaj Finance increased from 52% to 63% in Q3FY20 YoY and 41% to 57% in Q3FY20 YoY respectively.

Financial Performance

Y/e Mar (Rs in Cr)	2015	2016	2017	2018	2019
Net Sales	5,382	7,294	9,967	12,786	18,485
Growth(%)	33.5%	35.5%	36.7%	28.3%	44.6%
EBITDA	3,490	4,940	6,716	8,629	13,029
Growth(%)	33.8%	41.5%	36.0%	28.5%	51.0%
PPOP	1,742	2,507	3,621	4,874	7,681
PAT	898	1,279	1,837	2,496	3,995
Growth(%)	24.9%	42.4%	43.6%	35.9%	60.0%
NIM %	11.1%	11.4%	11.8%	11.4%	12.0%

(Source: Company data, PL Research)

BFL due to all the above factors has clocked 44% CAGR in PAT over FY 15-19. Coupled with all the above mentioned factors, it also has high standards of corporate governance and a promoter holding of ~52.6% signifying promoter confidence. Sustenance of market share particularly in core consumer business and emphasis on higher yielding rural business should ensure higher yields in coming years.

Share Price Performance: Bajaj Finance Ltd

(Source: PL Research)

Bajaj Finance would be a 200-bagger stock if one had invested post GFC or has become a 10-bagger in the last 5 years and such returns are excluding any dividends.

With all fast growers that are richly valued, the investor faces high risk of derating, when growth prospects slow down, as we can see in the case of Bajaj Finance. *With the Coronavirus led global and domestic economic slowdown, Bajaj Finance's business model of unsecured retail lending faces huge challenge in terms of loan growth and asset quality (NPA), thus eroding share price – a fall of 46% from Rs 4,880 on 20th Feb,2020 and 36% from Rs 4,030 (since declaration of Coronavirus as a pandemic) on 11th March,2020 to Rs 2,572 till date.*

Few other companies that could fall into this Fast Grower category are: ***HDFC Life, Vinati Organics, GMM Pfaudler, Abbott India, Muthoot Finance.***

Q. What are Cyclicals?

- Cyclicals are companies whose sales, profits and stock price is affected by the overall health of the economy.
- One must not confuse a cyclical with a seasonal business. Seasonality usually takes place within the year. Cyclical stocks go through a cycle of expansion and contraction which could last 4-5 years.
- Timing is everything in cyclicals, you should be able to detect the early signs that business is falling or picking up. This is because the rise or fall in GDP brings about a faster and bigger change in the the stock price of a cyclical than any other stock.
- Few examples of cyclicals would be auto, capital goods, paper, sugar, real estate, construction materials, steel and chemical companies.
- Even the risk/return profile of such companies is dependent on the phase of the cycle. It could be a High Risk,Low Return stock or a Low Risk, High Return stock depending upon the cycle phase.

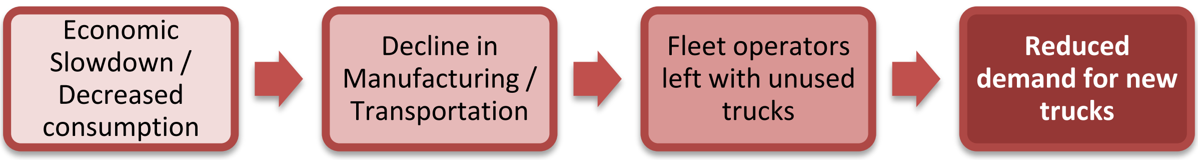
With the Indian economy reeling under slowdown, one sector that has been evidently impacted is the Auto Sector.

Example 1: Ashok Leyland Ltd- 'A Bumpy Truck Ride'

Ashok Leyland, flagship of the Hinduja group, is the 2nd largest manufacturer of commercial vehicles in India, the 3rd largest manufacturer of buses in the world, and the 10th largest manufacturers of trucks. Their commercial vehicle comprises of two segments : Medium and Heavy Commercial Vehicles (M&H CV), and Light Commercial Vehicles (LCV).

Slowdown Woes

Primarily driven by domestic factors like NBFC crisis with a drop in discretionary consumption, India's economic slowdown was reflected in its tepid 6.8% annual GDP growth for FY19 and the quarterly GDP growth (ended Sept, FY19) that touched a six-year low of 4.5%. Since, majority of AL's revenue comes from domestic sales (~94% of total units were sold in domestic market), the slowdown in the Indian economy is mirrored in its stock price that plunged 40% in a year post October,2018. The process below explains how demand for trucks in general is affected by slowdown in economy.



Plant Closures

Many negative developments have taken place in the Auto sector in the past 3-4 years.

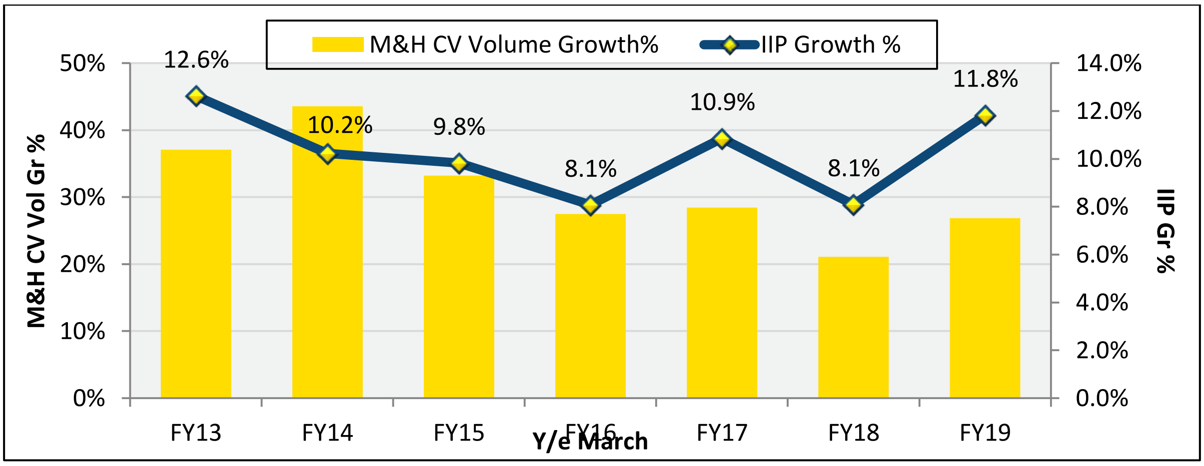
1. Demonetisation in 2016 along with introduction of 28% GST rate in 2017 on Autos gave a severe blow to the sector.
2. The new axle load norms that were introduced in July, 2018 by the Government boosted the load carrying capacity by almost 20-25% for the existing trucks that hurt the demand for new trucks.
3. Tight liquidity conditions post the IL&FS/NBFC crisis in Sept 2018 led to non-availability of finance for fleet operators and their customers alike which resulted in a fall in demand for all autos including trucks.
4. The pressure on Auto manufacturers to comply with the new BS VI emission norms and clearing out the existing vehicle non-compliant stock before April,2020.
5. Freight demand at multi-year lows leading to reduced capacity utilization or increased unused capacity.
6. Cost of ownership of trucks increased significantly due to hike in insurance, road taxes and toll charges. Further, introduction of E-way bill and increased cost of compliance due to GST made the operating environment for fleets unviable.

The above reasons along with a weak macro environment have led the CVs to be among the worst placed in the auto sector slowdown. Due to these low sales volumes, production cuts and temporary plant closures became mandatory. Many factories of Ashok Leyland too underwent shutdown with its Pantnagar plant going for a consecutive 18 day shutdown in September for alignment of production with demand.

The Cyclicality Factor

Cyclical M&H CV business constitutes almost 70% of AL's topline. IIP reflects production in the country and here we have taken manufacturing IIP growth that is closely linked with M&H CV industry sales and hence it has high correlation with AL's M&H CV Volumes too. This can be seen in the chart below.

Relationship between Manufacturing IIP Growth and Ashok Leyland's M&H CV Volume growth



(Source –MOSPI, PL Research)

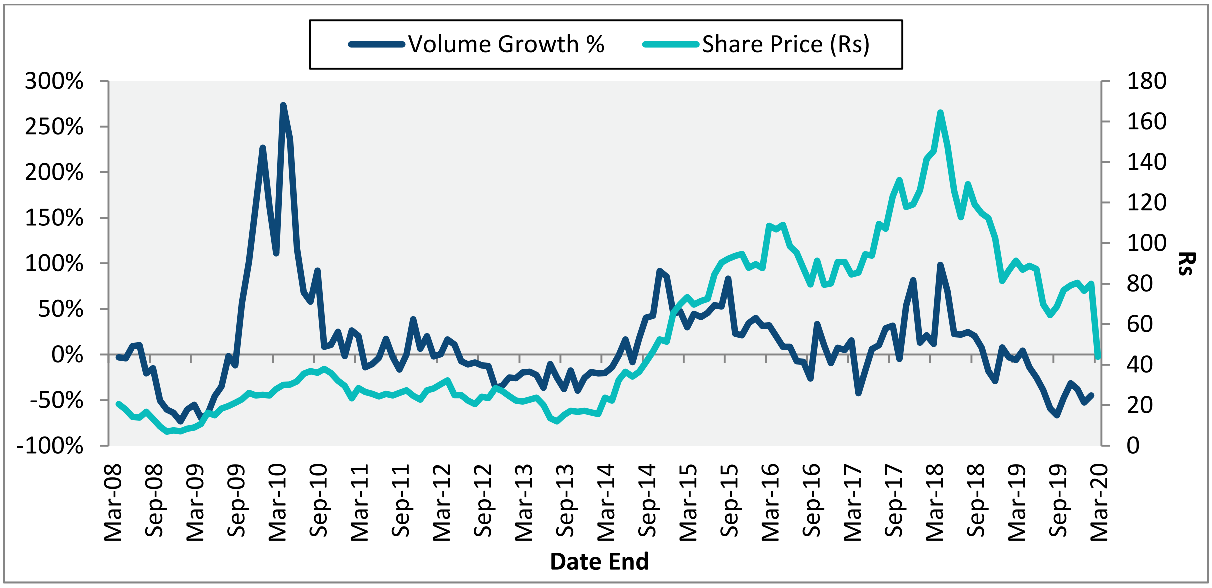
In fact, the most recent data released by Society of Indian Automobile Manufacturers (SIAM) showed that domestic M&H CV industry demand fell by a huge 40% YoY in Feb 2020. The M&H CV industry has been reeling under slowdown and has seen volumes declining on a YoY basis for almost a year now.

Industry M&H CV Domestic Sales Volume by SIAM

2018-19	Month	April	May	June	July	Aug	Sept
	Volumes	28,604	30,169	30,398	28,347	33,994	39,138
	Month	Oct	Nov	Dec	Jan	Feb	March
	Volumes	30,784	25,252	31,217	34,414	34,205	43,397
2019-20	Month	April	May	June	July	Aug	Sept
	Volumes	24,725	24,221	25,424	17,722	15,573	14,855
	YoY Growth(%)	-14%	-20%	-16%	-37%	-54%	-62%
	Month	Oct	Nov	Dec	Jan	Feb	March
	Volumes	15,334	17,039	21,388	22,534	20,425	N/A
	YoY Growth(%)	-50%	-33%	-31%	-35%	-40%	

(Source: PL Research)

Share Price Performance and AL's domestic M&H CV Volumes: Ashok Leyland Ltd



(Source: PL Research)

Above is AL's share price chart further reflecting the cylical nature of the Auto business. If we notice, AL's share price is a function of its M&H CV volume growth. *Post May 2018 peak of Rs 165, the share price halved within a year due to the auto sector slowdown and remained rangebound uptil Feb,2020. Post Feb 2020, spread of Coronavirus in China disrupted the supply chain and fears of India's consumer spending at unusual lows dented the already fragile recovery outlook of the Auto sector. Amidst this, Ashok Leyland ambiguous plan to buy further stake in Hinduja Leyland Finance from promoters was hived off. Additionally, due to the lockdown, AL has shut operations. Thus, the share halved and now stands at Rs 43 from Rs 83 post Coronavirus outbreak in india.*

Until the economy improves, the weak spirits in the overall Auto sector are expected to remain. A silver lining although for the whole sector could be in the form of a GST rate cut from 28% to 18% before April 2020 and a nationwide scrappage policy would also induce purchase of new trucks which would partially offset the impact of BS VI emission norms.

Another sector that is cyclical in nature is steel sector. We have chosen Tata Steel to demonstrate its vulnerabilty to economic cycles.

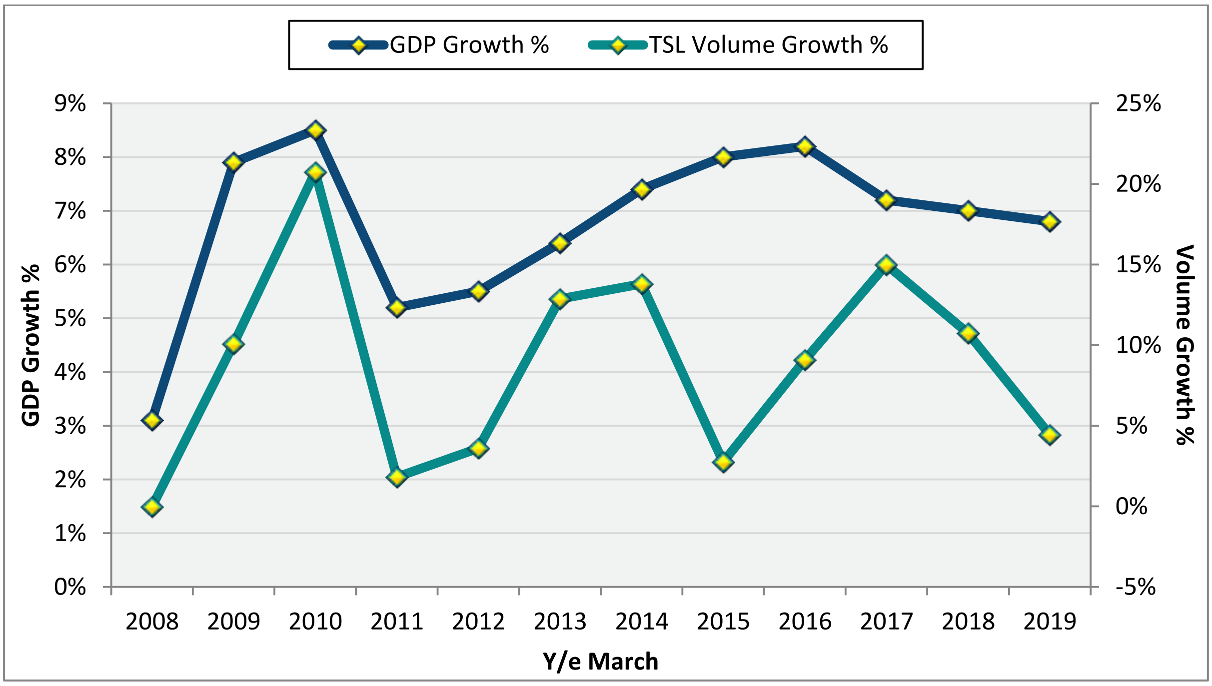
EXAMPLE 2: TATA STEEL LTD- 'A GLOBAL MELTDOWN'

Tata Steel Limited is a leading global steel company and India's largest steel producer with an annual steel production capacity of 33 MnTPA. In India, Tata Steel operates an end-to-end value chain that extends from mining to finished steel goods, catering to an array of market segments such as automotive, construction, general engineering etc.

Since majority of the end-user industries of steel are captured in GDP, we have highlighted the relationship of GDP growth with Tata Steel's sales volume growth. As seen in the chart below, when GDP growth slipped below to 3.1% level in 2008, TSL's sales volume growth remained flat. When the country's economic growth peaked at 8.5% in 2010, Tata Steel's volume growth also peaked to 20.7% . Such relationship can even be seen in 2011.

In India, 90% of the domestic steel production is used for domestic demand. However, after trade tensions, slowdown in global growth especially in UK, Europe and China, steel demand reduced and surplus steel from China was dumped in India. This put pressure on steel prices in India affecting the domestic steel producers. At the same time, even domestic demand in India reduced due to subdued end demand from Infrastructure, Real Estate, Automobiles and Capital Goods. Therefore, post 2011, demand from China and global steel cycle largely affected the volume growth of Tata Steel which has been declining since 2017.

Relationship between GDP Growth and Tata Steel's Volume Growth

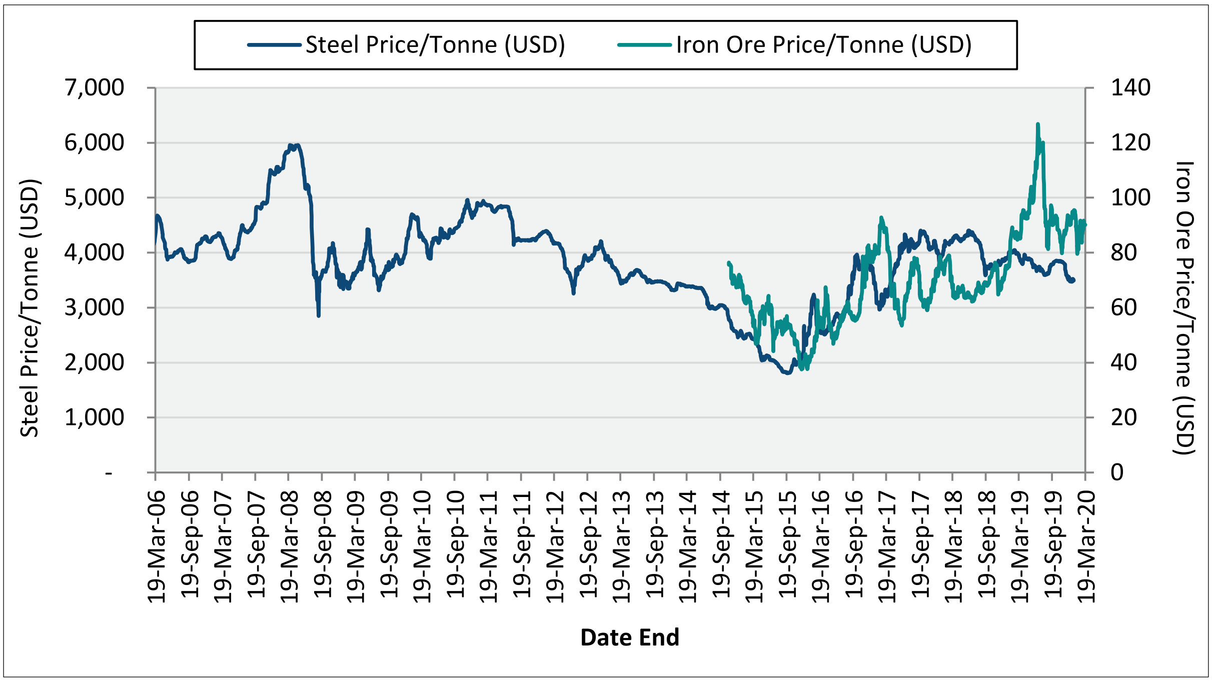


(Source – PL Research)

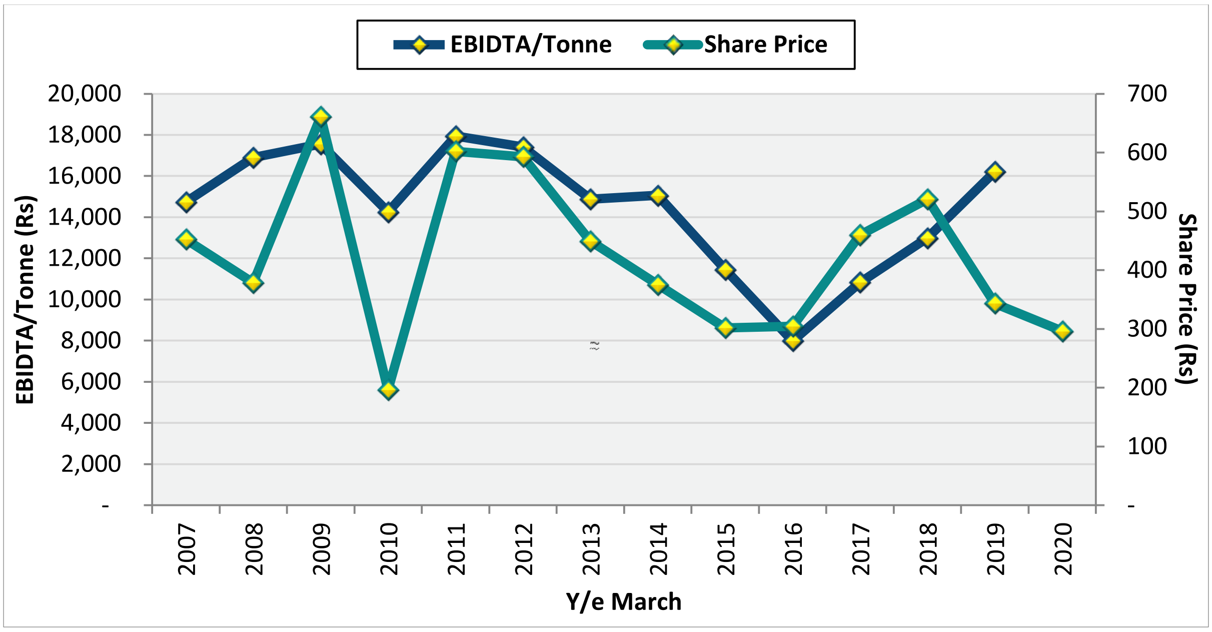
In 2019, the steel demand in India as well as in ROW (Rest of World) remained flat leading to low steel prices in India. Iron ore prices peaked in June due to disruption in the largest mine of the world's largest iron ore producer, Vale situated in Brazil that caters to global production and other major raw material for steel, coking coal price was favorable due to supply adjustments. All this affected un-integrated steel players like JSW steel. However, since Tata Steel is an integrated player, peaking iron price did not affect its EBITDA/tonne.

The cyclicality of an integrated player like Tata steel is dependent on its EBITDA/tonne which is a function of steel prices. So if we see, TSL's share price is largely affected by steel prices and follows the steel commodity cycle.

Relationship between Steel prices, TSL EBITDA/tonne and Share price



(Source: PL Research)



(Source: PL Research)

Share Price Performance: Tata Steel Ltd

(Source: PL Research)

The above price chart looks like a wave with peaks and troughs which is a clear indication of cyclicality in Tata Steel's share price too.

After the Coronavirus outbreak, demand for steel in China reduced, creating inventories for Chinese producers and raising expectations of increased exports from China. Nevertheless, supply additions in China are expected to end in 2020. Additionally, the Chinese government's measures to prop up its epidemic-hit economy is expected to help revive demand for the manufacturing and construction sectors which would absorb the inventory, lowering exports. Lower steel imports from China bode well for Indian steel producers. A critical point here is that Tata steel Europe will be vulnerable to Coronavirus outbreak in Europe and TSL itself will largely be vulnerable to any slowdown in domestic steel end user industries like construction and auto caused due to virus outbreak in India. Additionally, post lockdown in India, TSL has shut some of its plants in India.

Post 20th Feb 2020 and 11th March 2020, the share price has fallen ~38% and ~8% respectively to Rs 277 per share currently.

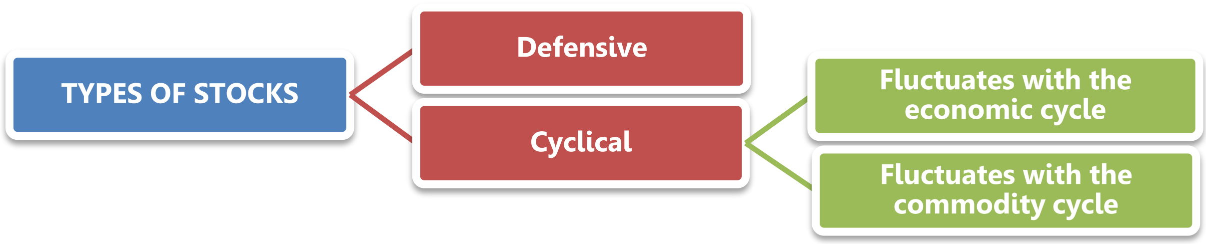
As Peter Lynch has rightly said timing is very important for cyclicals. Hence, an investor should be careful while investing in cyclicals so as to not enter at the peaks of cycles. Stocks in down-cycle currently, include infra, realty, steel and auto stocks.

Inventory and Sales are the key determinants to time any cycle. All financial information come with a lag. Hence, research teams go for channel checks to see the trend in sales volume and inventories. This is where the biggest edge lies in investing in what you know and based on the industry you work in/have business in. The lead indicators of slowdown in industry cycle through inventory built up and slow sales come to you first even before analysts could check and know. Similarly, noticing a pickup in sales and fall in inventory vs last 3 month trend gives you hints of an upcycle. By sticking to investing in cyclical industries that you understand, one reduces the risk of timing the cycle wrongly.

Further, we all know that FMCG, IT, Pharma, Consumer Discretionary companies are all defensive stocks since their performance is unaffected by the economic fluctuations. Whereas, Auto, Realty, Capital Goods, Energy, Consumer Durable companies are cyclical and their performance swings with the economic oscillations.

Within cyclicals we saw a class of stocks and their ancillaries that fluctuate with the economic swings. Apart from these, there are also certain stocks (and their ancillaries) that move with the commodity cycles they are exposed to. These companies have heavy dependence on the prices of the respective commodity either because that commodity is their raw material or finished good. As a result, such companies fluctuate with their respective commodity cycles. Examples include paper, sugar, chemical and metal companies.

To sum it up there are two types of stocks based on cyclicality:-



A cautionary statement as Peter Lynch highlighted in his book is that even bluechip/large cap companies can have cyclical businesses. So one should not think that (s)he can have a recession proof portfolio by investing in bluechip companies. Nevertheless, during a recession, it is preferred to have a large cap cyclical as it would tank lesser vs a small/mid cap. Names like Maruti Suzuki, ACC Ltd, ICICI Bank, BPCL, IOCL, DLF Ltd, Larsen & Toubro Ltd, PGCI, Shriram Transport Finance Ltd, Vedanta Ltd, Ultratech Cement are cyclical stocks and are also a part of NIFTY 200 Index. These are just a few bluechips from the entire list of Index constituents. However, to protect oneself from economic downturns, one can invest in defensive bluechips where the returns may not be alluring but are more or less steady.

Below are the charts of three Bluechip stocks which are also cyclical in nature.

Share Price Performance: Axis Bank Ltd

Share Price Performance: ACC Ltd

Share Price Performance: Maruti Suzuki India Limited

(Source: PL Research)

Q. What are Turnarounds?

- Turnaround companies have been battered and depressed.

- The best thing about investing in successful turnarounds is that of all categories of stocks, their ups and downs are least related to the general market.

- The expansion into new markets results in the phenomenal acceleration in earnings that drive the stock price to giddy heights.

- Turnaround stocks make up lost ground very quickly. Hence, these are High Risk, High Return stocks.

Types of turnarounds:
- Bail-us-out-or-else kind of turnaround where the whole thing is depended on a government loan guarantee.
- Who-would-have-thought-of-it kind of turnaround: Who would ever have believed that you could lose this much money.
- Little-problem-we-didn't-anticipate kind of turnaround: Minor tragedy perceived to be worse than it was, and in minor tragedy there's major opportunity.
- Perfectly-good-company-inside-a-bankrupt-company kind of turnaround.
- Restructuring-to-maximize-shareholder-values kind of turnaround: Restructuring is a company's way of ridding itself of certain unprofitable subsidiaries it should never have acquired in the first place. The earlier buying of these ill-fated subsidiaries, also warmly applauded, is called diworsification.

If there is a company that has successfully turned around and has continued on a growth trajectory, it is Bata India.

Example 1: Bata India Ltd - 'One step down, Two steps forward'

Bata India Ltd is the largest footwear retailer and manufacturer in India with a 70-year old legacy. It is the leader of footwear industry in India. Their products include leather, rubber/canvas footwear and plastic footwear, bags, purses and other accessories.

A management-driven turnaround

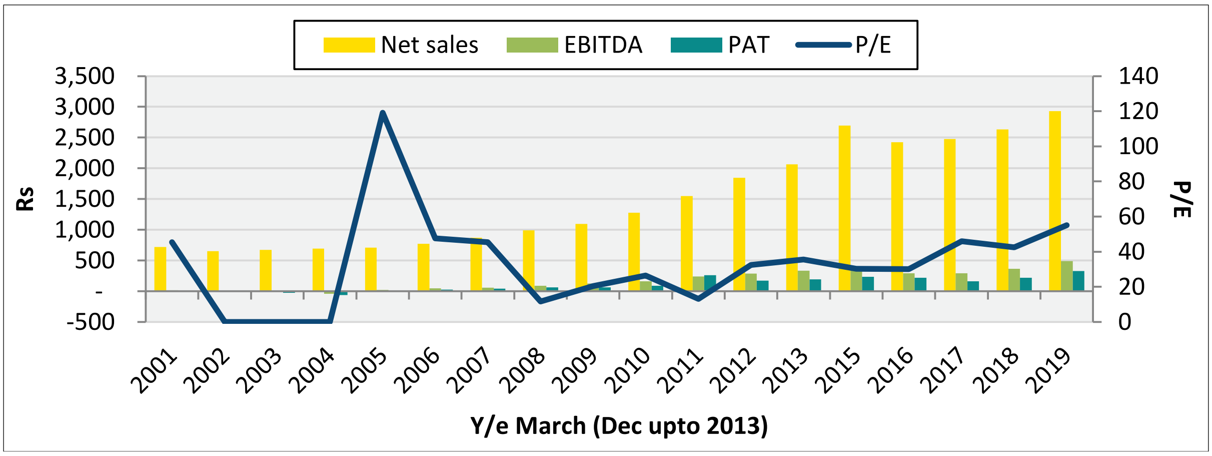
Bata India got listed in 1979 and was considered more of a PSU back then as it was driven by its labour union. Additionally no other shoe company was as big as Bata in India initially. Bata was known for its affordable, durable and comfortable footwear. With hardly any competition of its size, Bata's brands were already famous and hence the management didn't see a need to spend on advertising.

In the 80s, Bata started to face little competition from small/ local players and from global players in the 90s. Bata had troubles with its employee and labour unions. Additionally, Bata footwear got a tag of outdated designs during this time. Consequently, the management revived sub brands through advertising campaigns to lift its image. Hush Puppies' was also launched during this time. However profits kept declining.

In 2004, new management came in and the new CEO PM Sinha and MD Marcelo Villagran took a step against labour problems and outsourced production. They changed the product mix and shut loss making stores thereby improving profitability. However, the next CEO DDB Mudra and MD Rajeev Gopalakrishnan in 2014 wanted to revamp Bata's image into a new vibrant, youth-focused brand. Under them, the company also started selling online, launched new store formats, had more product offerings like handbags, scarves, sunglasses, etc to reinforce its new young image.

With Bata's current trendy yet durable and comfortable offerings, it would be hard to recognize Bata as an old-fashioned company with outdated designs. With the rise of India's brand/ trend conscious youth, branded footwear companies like Bata benefitted and will continue to do so. In fact, its FY19 financial performance on a consolidated basis was phenomenal as topline grew 11% YoY to Rs 2,931cr and profits grew 49% over the previous year to Rs 329cr.

Financial Performance over the past 20 years



(Source: ACE Equity, PL Research)

The graph above clearly depicts the performance turnaround of Bata in terms of Sales, Margins, EBITDA and PAT with the coming of new management in 2004, effectively highlighting the agility and flexibility of the management as the most crucial factor for Bata's revamp.

Share Price Performance – Bata India Ltd

(Source: PL Research)

The share price of Bata has fallen ~32% since 20th Feb, 2020 and 18% since Coronavirus was declared a pandemic on 11th March, 2020 to Rs 1,225. The impact of Coronavirus could be both positive in terms of consolidation in industry and negative due to delayed consumer purchases and therefore virus' impact remains a key monitorable. However, we would say the company stands strong even today if we see its operational metrics.

Key Operational Metrics

Particulars (Y/e March)	2016	2017	2018	2019
Operating Parameters				
Number of stores	1,121	1,293	1,375	1,415
Retail Space (mn sq ft)	2.7	2.6	3.0	3.1
Manufacturing Facilities	5	4	4	4
Total Capacity (mn pairs p.a.)	21	21	21	21
Shoes Sold (mn pairs)	50.0	47.0	47.0	47.3
Avg Realisation per pair (Rs)	485	526	560	620
Number of Employees	7,700	8,034	8,477	10,296
Ratios per Store(Rs mn)				
Revenue per Store	21.6	19.1	19.2	20.7
Gross Profit per Store	11.2	10.2	10.4	11.6
EBIDTA per Store	2.6	2.2	2.6	3.4
PAT per Store	1.9	1.2	1.6	2.3
CFO per Store	1.8	2.0	1.2	2.4
FCFF per Store	1.5	1.6	0.6	1.9
FCFE per Store	1.5	1.6	0.6	1.9
Ratios per Sq Ft (Rs)				
Revenue per Sq Ft	9,142	9,444	8,751	9,548
Gross Profit per Sq Ft	4,754	5,024	4,757	5,355
EBIDTA per Sq Ft	1,094	1,105	1,203	1,589
PAT per Sq Ft	825	607	733	1,072
CFO per Sq Ft	768	979	532	1,124
FCFF per Sq Ft	625	801	285	860
FCFE per Sq Ft	621	797	282	857
Efficiency Ratios				
Capex / Sales (%)	2%	2%	3%	3%
Incremental EBIDTA/ Incremental Sales (%)	23%	-1%	45%	42%
Asset Turnover (x)	8.0	9.3	8.9	9.4

(Source: PL Research)

Diversification is a good strategy a company can adopt to sustain business cycles and thus grow steadily. However if a company diversifies into non-core businesses which is beyond its management's understanding, then such diversification can spell doom for the company.

Peter Lynch in his book, One Up on Wall Street, coined a relevant term for this– **Diworsification**. It is that kind of diversification that can lead to problems for a company. A silver lining though is that such diworsified companies can be future candidates for turnarounds. Hence, an investor could spot such opportunities in the universe of diworsified companies which have gone for restructuring. Successful restructurings/ turnaround companies often reward investors handsomely.

EXAMPLE 2: SYMPHONY LTD - 'NOT SO COOL A DIVERSIFICATION'

Symphony, an Indian MNC with presence in over 60 countries is the world's largest manufacturer of air-coolers. Founded in 1988, in Gujarat, India, Symphony Limited established a new category of evaporative air-cooling in India, taking it to the globe. As a disruptor of a highly unorganized sector, the company has set high benchmarks comprising 108 trademarks, 49 registered designs, 7 copyrights and 8 patents, defining the gold standard of air cooling. It has managed to create leadership in a business which is mainly dominated by the unorganized segment with the organized having only about 30% market share in India. Of this, Symphony commands ~50% share in India's branded air cooler market and has ~12% revenues generated from exports.

Now seen as a world leader in air coolers, only few know that just less than two decades ago it was on the verge of shutting down. Symphony has been listed since 1994 and was a successful company until its management fell to the demands of the investors to capitalize on its distribution and brand image. To counter seasonality that comes with the air cooler business, the management decided to foray into other household electrical appliances like water heaters, purifiers, washing machines, domestic flour mills, room heaters, and exhaust fans. This proved to be a costly step since the management lacked execution capabilities in these business areas.

The company was soon saddled with unserviceable debt that led to its registration with the BIFR (Board for Industrial and Financial Reconstruction) in 2002. The effects of this diversification were seen from 2002. As seen from the table below, the once profitable company, Symphony was caught with constant losses since 2002. In fact, its D/E ratio was negative since its losses had eaten up its reserves and slowly was eating away the paid up capital too.

Standalone Financials post Diworsification

Y/e June(Rs in Cr)	2000	2002	2003	2004	2005	2006	2007	2008	2009
Net sales	30	28	20	25	24	25	42	73	124
EBIDTA	5	-25	0	0	-2	-3	3	17	36
PAT	1	-31	-1	-2	-4	-3	2	15	43
ROCE	11%	-92%	-6%	-16%	-48%	-100%	104%	160%	174%
D/E Ratio	0.8	-2.9	-2.7	-2.4	-1.6	-0.9	-2.5	0.9	0

(Source: ACE Equity, PL Research)

Transition from One Market Many Products to One Product Many Markets

The management took quick steps to restructure and exited all non-core businesses between 2002 and 2004. However, as seen in the table above, the company had to take a hit on its profits for a few years even after the turnaround initiatives began. In its new strategy, the management only focused on Air Coolers, innovating constantly, making the company a pioneer in many air-cooling sub-segments. The company also adopted an asset light model by outsourcing manufacturing while owning the intellectual property rights for design.

As a result, the ROCE turned positive in 2007 and was more than 100%. Additionally, the company due to its leadership and incentives demanded a 100% advance payment from its dealers which helped reduce its receivable days and thus the cash conversion cycle. The company also tapped the overseas markets to align itself with the new strategy of 'One Product Many Markets'. It made 3 acquisitions across Mexico, Australia and China. The most significant of them was IMPCO in 2009 which was followed by Symphony exiting the BIFR the same year.

The turnaround initiatives were extremely successful. The company again started making profits from 2007 onwards. Even the debt was at a negligible 1% of its equity in 2009 and post-2009, Symphony remained an almost debt free company. The Financials have ever since remained extremely healthy. Both the Sales and Profits have grown at a CAGR of 11% in the past decade.

Last 10 Years Standalone Financials

Y/e (Rs in Cr)	June,10	June,11	June,12	June,13	June,14	June,15	Mar,16	Mar,17	Mar,18	Mar,19
Net sales	190	233	250	309	452	463	415	664	687	524
Growth (%)		*23%*	*7%*	*23%*	*46%*	*2%*	*-10%*	*60%*	*3%*	*-24%*
EBIDTA	53	63	64	78	122	135	152	208	219	135
Growth (%)		*19%*	*1%*	*22%*	*57%*	*10%*	*13%*	*36%*	*5%*	*-38%*
PAT	37	45	50	63	99	116	123	175	183	101
Growth (%)		*22%*	*12%*	*25%*	*58%*	*18%*	*6%*	*42%*	*5%*	*-45%*
ROCE (%)	81%	64%	50%	54%	65%	62%	57%	63%	48%	22%
D/E ratio	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0

(Source: ACE Equity, PL Research)

Share Price Performance: Symphony Ltd

(Source: Google Finance, PL Research)

From trading as a penny stock during its restructuring days and then surging to almost Rs2000 in 2018, Symphony is a clear multi-bagger. The turnaround made Symphony's investors extremely rich. Even if an investor would have entered this stock late in 2014 at Rs 300 levels, and then exited in 2018, he would have made 6x returns in 5 years.

The share post 20th Feb,2020 and declaration of Coronavirus as a pandemic on 11th March,2020 fell 41% and 34% respectively to Rs 816 till date.

The companies that we have stated are ones that have already turned around and handsomely rewarded investors.

Q. What kind of companies can be Asset Plays?

- The concept of asset plays was first developed by Peter Lynch. An 'asset play' is a company, sitting on a huge pile of valuable assets like cash, land or natural resources, patents, even tax loss carry forwards or maybe its subsidiary has such hidden assets and the value of this is not captured in the book value or share price.

- One important answer to know is-What will unlock the value of the assets?

- Such a company usually becomes a takeover target and this could double, triple or quadruple the share price.

- The only category where earnings may not be important is this one.

- As long as the company isn't going on a debt binge, thus reducing the value of the assets, you can hold on to such a company.

- Asset plays are Low Risk and High Gain if you're sure of the value of the assets.

- Common examples include companies that own natural resources such as land, timber, oil, or precious metals ; these assets are recorded on their book at a fraction of the true value.

A quick way to find asset plays is filtering fundamentally good companies that have a P/BV below one or the combined market value of the assets of the company is more than its current Market cap. Our example has both these qualities. Another important aspect of buying asset plays is that there should be a way of monetizing those assets so as to unlock the hidden value. Our example has a value unlocking story that might be open to investors.

Example 1: Bombay Burmah Trading Corp Ltd - 'Don't Judge a Book by its Cover'

The Wadia group, one of the oldest conglomerates of India, consists of several companies, four of which are listed on Indian stock exchanges – Bombay Burmah Trading Corp, Britannia Industries, Bombay Dyeing, National Peroxide Ltd.

Bombay Burmah Trading Corporation Limited (BBTCL) being Wadia group's oldest organization, is a multi-product and multi-divisional enterprise with diverse business interests viz. tea and coffee plantations, auto electric components, dental products, real estate, weighing products, horticulture and food - bakery and dairy products. The company's core operation is production and marketing of premium tea and coffees. Today its plantations in the hills of South India produce 8 million kgs of tea annually.

A Value Unlocking story: Trading at a steep discount to its investment value

Back in FY13, Bombay Burmah Trading Corp held a total 50.75% (now 50.66%) stake in Britannia (step down subsidiary) and 14.35% (now 15.28%) in Bombay Dyeing . This was worth a combined total stake value of Rs 3,440cr whereas the MCap of BBTCL was a meagre Rs 788cr which means a discount of ~77% to the investment value. Assuming that Indian conglomerates had an average holding company discount of even 55% to 60%, BBTCL's share price yet was available at 50% discount. Besides, the Price to Book also was less than 1 as shown in the table below.

Arbitrage Opportunity calculation

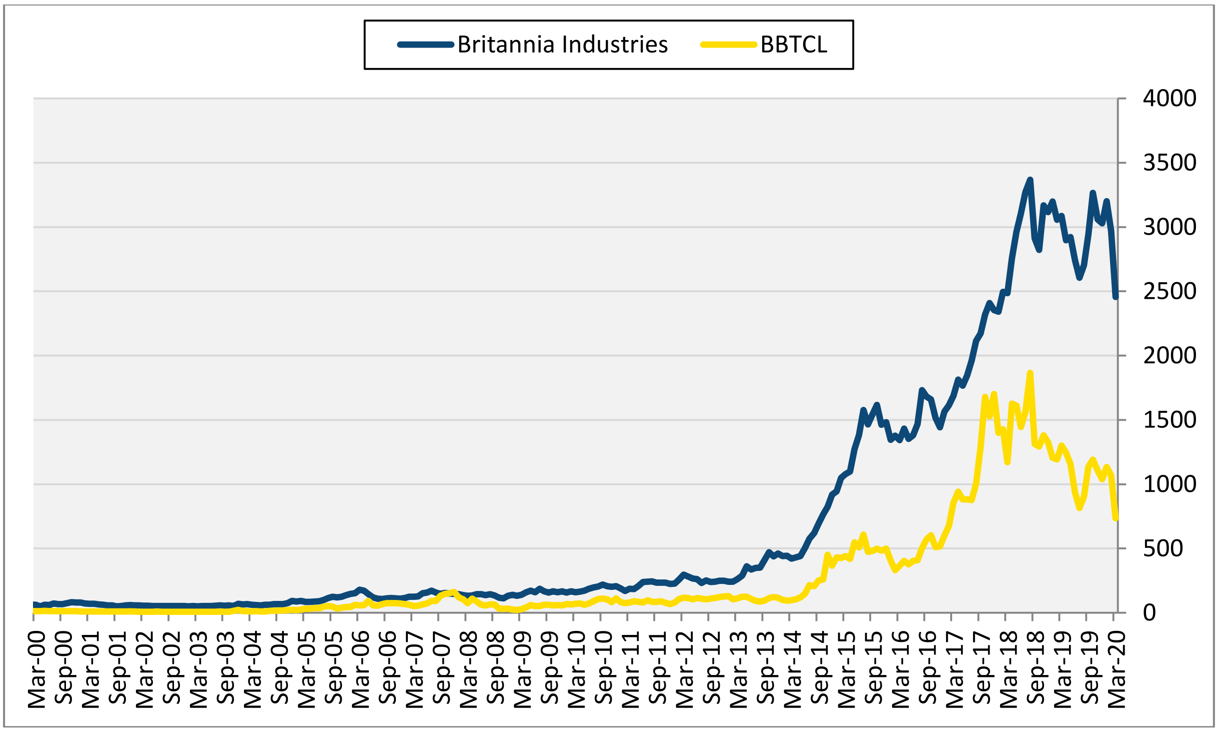
Y/e Mar (Rs in cr)	2013	2014	2015	2016	2017	2018	2019
Mcap of Britannia	6,268	10,116	25,891	32,107	40,595	59,682	74,059
Mcap of Bombay Dyeing	1,807	1,142	1,320	982	1,714	4,944	2,789
Value of BBTCL's Holding after HDC	1,548	2,384	5,998	7,396	9,376	13,936	17,088
Mcap of BBTCL	788	678	3,067	2,567	5,971	8,156	9,087
Discount to Holding Value after HDC	49%	72%	49%	65%	36%	41%	47%
P/BV	0.69	0.53	1.96	1.34	1.62	2.06	1.91
Standalone PAT	19	5	7	-33	-3	-26	-20

(Source: PL Research, Ace Equity)

Another way to look at the difference in Mcap of BBTCL and its investment value is that if an investor ever had interest in playing Britannia's FMCG story but found it too expensive, he could have instead bought BBTCL since it owns half of Britannia. This gave investors a good arbitrage opportunity.

If we look at the table above, we notice on a standalone basis, BBTCL's profits have actually declined whereas BBTCL has become an 11-bagger within the last 6 years. This is only and only because it has strong subsidiaries like Britannia which has also become a 12-bagger within the same period. In the price chart below, we see strong correlation of BBTCL and Britannia stock performance.

Share Price Performance: Britannia Industries Ltd and BBTCL



An investor who invested Rs1 Lakh in FY14 in BBTCL would have become around Rs14.5 Lakhs in FY19 fetching a whopping return of 13.5x in 4 years.

Another unlocking potential: Huge land parcels

As mentioned before, BBTCL owns 15.28% directly of Bombay Dyeing and also another 24.27% through its subsidiaries currently. In our calculation above, we only considered the direct holding of BBTCL in Bombay Dyeing and also did not consider Bombay Dyeing's realty division, Bombay Realty's value of nearly 10,000 acres of land across India acquired in the 1900s at rock bottom prices. This includes 6,973 acres of tea and coffee plantations in South India's prime areas coupled with around 53 acres of clear title land in Central Mumbai.

A snapshot taken from Bombay Dyeing's AR 19 :-

> **Outlook**
>
> Your Company enjoys the benefits of two large contiguous land parcels with clear titles, giving it a significant advantage over other real estate players. The strategic location of two sites, well connected with the commercial hub of Central Mumbai and equidistant from the commercial hubs of South Mumbai and Bandra-Kurla Complex, is expected to add value to the sites. The plan is to develop these sites as

With real estate market prices way above their pre-2000 level, these land parcels gave the company an opportunity to unlock value by developing them. Consequently, the management shifted its focus and constituted Bombay Realty (a 100% subsidiary of Bombay Dyeing) solely for the purpose of developing these land parcels in Mumbai and selling them for massive profits. In fact, Bombay Realty built the Wadia International Centre, spread across 25 acres in Worli, and sold it in 2011.

According to JLL, in FY18, the market value of land at Lower Parel stood at an estimated Rs 30,000/sqft and the same at Naigaon (Dadar) at Rs 10,000-12,000/sq ft. If we assume these rates for the purpose of valuing the 53 acre Mumbai land, the 53 acre land value in itself is around Rs 4,487cr. This is half of BBTCL's Mcap of Rs 8,156cr and the difference between recorded book value and market value as on FY19 considering 3% rise in rela estate prices is Rs 3,748cr which means BBTCL was trading at P/BV of 1.07 without considering any development on the land.

Land Value and Revised P/BV Calculation

Location	Acres	sqft	Rs/sqft	Value
Lower Parel	25	10,89,000	30,000	3,267
Dadar	28	12,19,680	10,000	1,220
Total	**53**			**4,487**

Y/e Mar (Rs in cr)	2018	2019
Freehold Land	139	139
Leasehold Land	124	123
Building	495	612
Total BV	**758**	**874**
Actual Market Value	**4,487**	**4,622**
Discount in Value recorded in books	3,729	3,748
Discount in Value recorded in books	83%	81%
Mcap of BBTCL	8,156	9,087
Revised BV	7,688	8,505
P/BV	2.06	1.91
P/BV (53 acre land at Market value)	1.06	1.07

(Source: PL Research)

A snapshot taken from BBTCL's AR 19 :-

III. Other Information:

(i) Reasons of loss or inadequate profits:

The tea business continued to underperform due to adverse weather conditions, increase in wages and rising input costs and unremunerative price for tea as commodity. Electromags division was under pressure due to resistance by customers, particularly OEMs and price increase of main raw materials as also slowdown in the auto industry. The working of Healthcare Division was impacted due to lower offtake of its alloy products in the wake of health concerns in the dental fraternity regarding the usage of alloys. The unlocking value of land parcels could not be achieved due to sluggish market conditions in the real estate sector and politico-economic conditions. All the adversities of underperformance resulted in losses for the year. However, the overall performance of the Corporation has shown improvement resulting in reduction in losses as compared to previous year.

In fact, a news article dated 7th Jan,2019 reported by Business Line, stated that Wadia group's flagship company, Bombay Dyeing will generate nearly Rs 24,000cr free cash flow over the next few years from its 2 projects spread over 53 acres in the heart of Mumbai.

This means BBTCL and Bombay Dyeing both have significant value that will be unlocked and in the latest development, Bombay Realty has also received part OC for its 'One ICC' residential building. From this, we can foresee the potential BBTCL and Bombay Dyeing has considering that 53 acres in Mumbai is just a small part of the 10,000 acres the group owns!

Coronavirus could impact demand of an already sluggish real estate market. This could delay the monetisation of land assets and hence delay in value unlocking too for BBTCL. The share price of Britannia, Bombay Dyeing and BBTCL have fallen by ~17%, 28% and ~35% respectively from 11th March 2020 till date.

The most evident asset plays are when companies opt for demergers, spin offs, etc. We'd like to highlight some of the advantages of listing a (albeit fundamentally strong) subsidiary/subsidiary stake sale:-

1. Listing a subsidiary gives the much needed opportunity for the market to discover the price of the subsidiary thereby unlocking value.
2. It creates specific management focus on a particular business (for the subsidiary) and market allocates more value to a focused entity than to a diversified entity. The basic principle is that actions like mergers of similar business lines and demergers of different business lines are always valued more by the market.
3. Provide existing investors an opportunity to participate in the fundamentally strong subsidiary by allotting shares of the subsidiary to them. The value of such an opportunity becomes even greater when the subsidiary's business is more valuable than the parent's.
4. The combined valuation of the demerged entities is often greater than the market price of the parent company before the split.
5. Even if the shareholders of the parent do not get a direct allotment of the subsidiary's shares, the intrinsic value of the subsidiary would go up on the balance sheet of the parent after listing its subsidiary.

Our next example is HDFC Ltd is based on this very premise.

Example 2: HDFC Ltd - 'Pioneer of sure-shot Value Creation in the Indian Financial Landsacpe

HDFC is a leading provider of Housing Finance in India. HDFC group of companies are not just fundamentally strong but also enjoy brand recognition.

HDFC Ltd had quite a few gems in the form of strong subsidiaries and had value locked in for a quite a long time before they got listed. 2 companies, HDFC Life and HDFC AMC listed in 2017 and 2018 respectively thereby unlocked value for the shareholders of HDFC Ltd.

Subsequently, the official announcement of HDFC Life's IPO came on 17th July, 2017. HDFC Life, a JV between HDFC Ltd with 61.21% stake and SLI with 34.75% stake. Both were offloading 9.52% and 5.40% respectively through the IPO. HDFC Life listed on 17th Nov,2017 at 7% premium at a price of Rs 311. The existing HDFC shareholders also had a category reserved for 1.56% of the IPO . HDFC Life gained almost 44% within a week of listing. At the same time, HDFC Ltd's share price grew by almost 39% after the announcement uptil the listing date since value unlocking took place simultaneously for the shareholders of HDFC Ltd.

Share Price Performance: HDFC Ltd (during HDFC Life listing process)

(Source: Google Finance, PL Research)

Similarly, HDFC AMC, a JV between HDFC Ltd and SLI with pre-IPO stakes of 57% and 38% offered around 4% and 8% respectively in the HDFC AMC IPO. Around Oct-end of 2017, news about plans to list HDFC AMC came in. HDFC AMC filed for an IPO wherein 9% was reserved for the shareholders of HDFC. HDFC AMC eventually got listed at 58% premium over issue price on 10th Aug, 2018 after its IPO was subscribed 83 times. From the listing news to the actual listing date, HDFC Ltd share price also saw an increase by ~16%. The HDFC Ltd shareholders got an opportunity to make two applications; one in the shareholder category and one in the retail investor category of both the IPOs.

Share Price Performance: HDFC Ltd (during HDFC AMC listing process)

(Source: Google Finance, PL Research)

One might possibly argue that the shareholders didn't really get any direct benefits in the form of entitled shares of HDFC AMC or HDFC Life. Actually the value unlocking did happen for HDFC Ltd as a company; money received could be invested for future growth and then paid back through dividends, buybacks, etc. The one time stake sales increased the net worth of HDFC Ltd making the valuation attractive. The Net worth increased by 84% in 2 years from Rs 60,000cr in FY17 to Rs 1,10,588cr in FY19 and the P/BV reduced in FY18 and FY19 up to some extent (both P/BV were below 10Yr average P/BV of 3.83). At some point, this would attract investor attention and increase the price further. Hence, HDFC Ltd shareholders need to stick to the company for a long term to really realize the value unlocking done by such stake sales.

Valuation Snapshot of HDFC Ltd

Y/e Mar (Rs in Cr)	2015	2016	2017	2018	2019
Net Worth	45,036	50,819	60,008	90,849	1,10,588
P/BV	4.6	3.4	4.0	3.4	3.1

(Source: PL Research, ACE Equity)

HDFC Bank and its subsidiaries!

HDFC Bank Ltd has 3 strong subsidiaries - HDB Financial, HDFC Securities and HDFC Ergo. Also, as per media developments, HDB Financial Services, an NBFC in the retail financing space with presence in 961 cities through 1,350 branches, where HDFC Bank owns almost 95.9% was about to get listed. In fact, a Moneycontrol article in July, 2018 had reflected the value unlocking potential through an IPO of HDB Financial sometime in the future. *However, post the Corona outbreak, fear of rise in NPAs especially in NBFCs remains high. This could potentially further delay the IPO.*

Below, we have listed down a few potential value unlocking opportunities for some of the parent company shareholders if their subsidiaries go for listing.

Parent companies that could see value unlocking through their subsidiaries

Parent	Subsidiary	Stake%	DRHP Filed?
State Bank of India	SBI General Insurance	70%	No
	SBI Caps	100%	No
	SBI AMC	63%	No
	UTI AMC	19%	Yes
Equitas Holdings	Equitas Small Finance Bank	100%	Yes
Kotak Mahindra Bank	Kotak AMC	100%	No
	Kotak securities	100%	No
Punjab National Bank	PNB MetLife	30%	Yes
	UTI AMC	19%	Yes
Reliance	Reliance Retail	94%	No
	Reliance Jio	100%	No
ICICI Bank	ICICI Lombard	56%	Yes
	ICICI AMC	100%	No
Axis Bank	Axis AMC	75%	No
AB Capital	Birla AMC	51%	No
	Birla Life	51%	No
L&T Finance	L&T AMC	64%	No
Info Edge India (Naukri)	Policy Bazaar	16%	No
	Jeevansathi	100%	No
	99acres	100%	No
	Shiksha	100%	No
	Zomato	23%	No
	Ustraa	42%	No
Tata Motors	Tata Technologies	72%	No

(Source: PL Research)

Companies which have been OR are future Asset Plays

Company Name	Value Unlocking Done	Price Performance	Value Unlocking Potential
BBTCL	Despite decreasing PAT, BBTCL's Mcap grew almost 11x mainly due to its 50% stake in Britannia whose Mcap grew ~ 12x.	11x in the 6 year period from FY13 to FY19.	BBTCL along with its subsidiaries owns more than 10K acres of land acquired at rock bottom prices in 1900s. With real estate prices way above their pre-2000 level, these land parcels could unlock value by developing them.
HDFC Ltd & HDFC Bank	Listing of HDFC's subsidiaries - HDFC Life Insurance in which the former holds 72.47% of equity listed in Nov 2017. HDFC AMC listed in Aug 2018 in which HDFC held a total holding of 60%. HDFC Share price surged 11.2% since the filing of HDFC AMC's DRHP.	2x in the 3 year period from FY17 to FY20.	HDB Financial Services- an NBFC promoted by HDFC Bank with almost 95% stake was to be listed. However, Coronavirus has led to fear of increased NPAs which could potentially delay the IPO.
SBI	Listing of SBI's subsidiaries: 4.5% stake sale by SBI in SBI Life Insurance in Oct 2017 to raise Rs 3,465 cr through IPO. SBI sold 4% stake in SBI General Insurance to Axis AMC and Premji Invest for Rs 482cr in H2FY19. SBI share price surged 6% in a week post the news of EOI for its SBI cards IPO BRLM came out on 3rd Sept,2019.	2x in the 3 year period from FY17 to FY20. However, SBI fell ~7% on 16th March,2020 due to SBI Cards listing at 13% discount to issue price and overall bear markets.	SBI General Insurance (70%); SBI AMC (63%); UTI AMC (19%); SBI Caps (100%).
Reliance	In lieu, of Mukesh Ambani's 42nd AGM speech, Reliance announced on Oct 25, 2019 that it would float a new subsidiary to hold its digital businesses including Jio and infuse Rs 1.08 lakh cr to make Jio net debt-free.	1x in the 2 month period since announcement.	RIL considering listing of Reliance Jio and Reliance Retail by FY24 as announced by Chairman Mukesh Ambani in company's 42nd AGM on 12th Aug, 2019. The stock has surged ~1.5x in the 4 month period since the announcement. Extensive store network of Reliance Retail spanning across 24.5mn sqft in the country.
BPCL	Rumours around government divesting ~53% stake came in last week of August when the Government shortlisted names to achieve its divestment target as mentioned in FY19 Budget. BPCL stake got valued at around Rs 60,000 crores ,i.e, a price of ~Rs520/share whereas, the price back then was around Rs330.	The share price touched Rs520, a return of 57% within 2 months in late October,2019.	

(Source: PL Research)

CAN YOU BEAT THE STREET EXPERTS?

"Your investor's edge is not something you get from Wall Street experts. It's something you already have. You can outperform the experts if you use your edge by investing in companies or industries you already understand."

Despite his success as a fund manager and the information asymmetry present between an expert and the normal investor, Lynch strongly believes that the normal investor yet has an edge over the Street expert. He highlighted the disadvantages for a professional investor:-

1) **Constraints imposed by Compliance**: For example, certain fund managers have restrictions with regards to the market capitalization of a stock and hence cannot invest in good companies until they reach a certain market capitalization level. On the other hand, amateurs can enjoy huge gains on good stock picks irrespective of the market capitalization even before it becomes visible to the Street managers.

2) **Opportunity lost in Playing it Safe**: The fund managers have both their job and their reputation at stake. Hence, it is very rare that a fund manager will invest in a stock unknown to the Street despite it being an exciting opportunity to invest in. As Peter Lynch mentions, "Under the current system, a stock isn't truly attractive until a large number of institutions have recognized its suitability and have put it on the recommended list…" Conversely, a retail individual investor has the freedom to be a contrarian in the market without any fear of losing his job.

3) **Capital Uncertainty preventing contrarian bets:** Since the manager invests on behalf of his clients, he has no control over the capital redemptions that is affected by his clients' reactions to the market. It so happens that the manager is left with very little money to invest as the clients pull out money during bear markets and pour in funds during bull markets when stocks have already become expensive. This is exactly the opposite of what one should be doing to generate superior returns - buy during times of fear (bear markets) and sell during times of greed (bull markets).

4) **Time wasted explaining:** A portfolio manager usually has to spend a considerable amount of time and effort in providing explanations to justify his investments. Bigger the client, more the talking a portfolio manager has to do to please his client. Whereas, a common investor is answerable to none but himself and can spend the same time in finding good stocks.

The above points result in what Lynch termed as **the 'Street Lag'**. The normal investor has to face none of these problems and can take advantage of the good opportunities even before the Street experts can act upon them.

The most important point (discussed in cyclicals too) was that the common investor might even know certain information before it gets published/ presented to the market. This kind of edge is only possible if he invests in what he understands by picking up hints from the environment around him.

As Peter Lynch quotes in his book – One Up on Wall Street,

"If you're a surfer, a trucker, a high school dropout, or an eccentric retiree, then you've got an edge already. That's where the ten-baggers come from, beyond the boundaries of accepted Wall Street cogitation."

THE FINAL LYNCHBYTES

*Apart from following a simple fundamental approach to investing, he also analyzed companies on **quantitative points** like:-*

- % contribution of a liked product/ service to overall sales.
- P/E < Earnings growth (PEG<1)
- Lower D/E and favorable debt structure. In addition to that, high cash balance to cover up debt position.
- High cash generated per share relative to the price per share.
- Consistent dividend paying companies signifying shareholder friendly management. Highly indebted companies paying dividends are a red flag.
- Low P/BV. (Try to find actual market value of assets)
- Revenue growth faster than inventory growth.
- Companies with capacity additions may not necessarily translate to earnings growth. A company which achieves earnings growth by increasing prices or reducing costs is preferred.

*Sometimes **perfect stocks/ companies** have the following characteristics:-*

- Simple business that could be ruined by any type of management.
- Spin offs leading to better focus and thus, providing an investment opportunity.
- Low institutional holding with no/less analyst coverage.
- Fake rumors degrading its image.
- Reliable companies in no-growth industries faced with low competition.
- Companies with a niche are usually monopolies.
- Regularly in-demand products.
- Use of technology to be more cost efficient.
- Insiders bought company shares.
- Significant buybacks to restore faith in their own future.

*List of **stock/ companies to avoid**:-*

- Highly publicized but weak fundamentals. (Yes Bank)
- Ones with exciting names raising false sense of security to investors (Indiabulls Housing Finance, Indiabulls Ventures).
- B2C Company with highly concentrated customer base.
- Those diversifying into unrelated businesses (Future Enterprises).
- Whisper stocks with little fundamental track record.

With the many ideas given in a single book and the enriching experience we've had while drafting this report, we would encourage our readers to peruse Peter Lynch's book - 'One Up on Wall Street' to better relate to the investor world.
START INVESTING IN INDUSTRIES YOU UNDERSTAND AND CAN RELATE TO MOST.

Stay tuned for the upcoming issues of Acumen!

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