Money Today
MAKES YOU RICHER
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Building wealth in 2015

Despite the sharp rise, the valuation of the Indian stock market is still attractive.

(Photo: Reuters)

The Indian stock market turned out to be among the world's best performers in 2014 with the Bombay Stock Exchange (BSE) Sensex rising 29% from 21,140 on January 1 to 27,312 on December 19. Most market players believe this stellar run will continue in 2015 on the back of reforms, strong foreign fund inflows, revival of manufacturing, improvement in the macro-economic situation and rise in corporate earnings growth.

Attractive Valuations

Despite the sharp rise, the valuation of the Indian stock market is still attractive. On December 12, the Sensex was trading at a price-to-earnings (PE) ratio of 18.5, marginally lower than the five-year average of 18.77. Yogesh Nagaonkar, vice-president, Institutional Equities, Bonanza Portfolio, says Indian stocks are an attractive investment if the person's horizon is three-five years. One reason is that the return on equity of BSE

200 companies is bottoming out. "Revival of growth of Indian companies, which were facing tough times for the past five years, is still at a nascent stage. Nifty 50 companies can see 16-17% earnings growth in the next one year. This may rise to 19-20% two years from now," he says.
"Indian companies have done massive restructuring over the last five years. Almost every business has become leaner and focused on efficiency. Because we don't expect further deterioration, we see operating and financial leveraging show its maximum impact in 2017-18," says Ravi Gopalakrishnan, head of equities, Canara Robeco Mutual Fund. If we look at the numbers, India's stock markets have risen quite a bit of late, but even then they are not very expensive. At present, they are trading at 17 times forward earnings for 2015-16. Though this is slightly above the long-term average of 15 times, it is not very high. Gopalakrishnan explains why. "Earnings pick-up in 2017-18 will trigger expansion of PE multiples," he says.

New Themes

In every bull market, a new set of stocks performs well and comes on top. For example, around 2000, information technology (IT) stocks were everyone's favourite. Between 1 February 1999 and 13 December 2000, the IT index rose 94% on a yearly basis, as against 15% returns given by the Sensex. This period was followed by the era of infrastructure stocks in 2004-08. To see how much liking markets took to these shares, look at returns from DSPBR TIGER fund, an infrastructure fund from the DSPBR stable. Between 11 June 2004 and 9 January 2008, the fund returned 65%; the stock market returned 50% during the period. While in 2007-08 FMCG stocks did worse than the market, they were the darling of investors for the next five years (See The Best And The Worst). "The main constituents of the present rally will be different from what we have been seeing," says Vaibhav Sanghvi, managing director, Ambit Investment Advisors. He says Europe and Japan are not doing well and China is slowing. The US, he says, is the only big economy which is growing. In this backdrop, domestic industrial, material, consumer discretionary and financial companies are likely to do well, he says.

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STOCK RECOMENDATIONS 2015

TCS
RECOMMENDED BY:
PRABHUDAS LILLADHER

WHY BUY: Experts don't expect downward revision in earnings estimates for 2014-15 and 2015-16 despite growth challenges.

Karur Vysya Bank
RECOMMENDED BY:
INDIA NIVESH SECURTIES

WHY BUY: The strategy of moving the loan book from high-risk assets to less riskier SME/ retail assets has worked well. SME/retail segments continue to do well.

Crompton Greaves
RECOMMENDED BY:
ANGEL BROKING

WHY BUY: The company has announced the demerger of its consumer business into a wholly-owned subsidiary. This will unlock shareholder value. Crompton Consumer Products will get a valuation multiple of as high as 25 times.

City Union Bank
RECOMMENDED BY:
HBJ CAPITAL

WHY BUY: Good play on economic recovery. It is a well-managed franchise with high return on equity (20%+) and margins (3%+) and less than 2% gross NPAs.

CEAT
RECOMMENDED BY:
ANGEL BROKING

WHY BUY: High demand in the passenger vehicle segment and ramp-up of production will enable Ceat to clock double-digit growth over the next two years.

NBCC
RECOMMENDED BY:
NOMURA

WHY BUY: NBCC enjoys the benefits of negative working capital and cash-rich balance sheet. It passes on the risk to sub-vendors on back-to-back contracts, thus remaining asset-light. The land/housing redevelopment opportunity will drive earnings growth for years to come.

KPIT Technologies
RECOMMENDED BY:
HBJ CAPITAL

WHY BUY: The company has a good track record of inorganic growth through acquisitions. A pick-up in the SAP business along with inherent built-in operational leverage will improve margins.

Britannia
RECOMMENDED BY:
BONANZA PORTFOLIO

WHY BUY: The company has a good management, has been increasing market share in biscuits and is available at a discount to larger peers like HUL, ITC and Nestle.

Gokul Raj, executive director and head of investments at HBJ Capital, is bullish on quality businesses in sub-sectors that are sensitive to macroeconomic changes. "These businesses will capitalise on cyclical factors to deliver good returns over the medium term." Raj says

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improvement in industrial production should benefit makers of fast moving industrial goods such as bearings, besides forging and welding companies.

EXPECTED REFORMS & INVESTING OPPORTUNITIES

BANKING SECTOR

There is a huge concern about non-performing assets (NPAs) of banks. "I believe that the NPAs will peak between now and March 2015. After that, once economic activity picks up, cash flows of companies will improve and they will be able to service debt better," says PVK Mohan, Head of Equity, Principal AMC

REAL ESTATE

The government plans to get the real estate regulation Bill cleared by Parliament. The Bill seeks to ensure that builders operate in a transparent manner and don't take buyers for a ride. Also, the proposed Real Estate Investment Trusts will help the sector attract funds and ensure more participation by retail investors

POWER SECTOR

The government will soon schedule auction of coal blocks. Lalit Thakkar, managing director, Institution, Angel Broking believes a number of power companies will take part in the auction. If the auction is successful, it will remove one of the biggest constraints for coal-based power plants in the near term.

INFRASTRUCTURE SECTOR

The value of stalled projects is Rs 2,43,043 crore. Existing norms dictate that banks can convert loans of a defaulting infrastructure company into equity only at a price higher than the market price of the company's shares. Hence, no bank converts loans into equity in the restructuring process. Thakkar says the government plans to reverse the policy.

Ajit Deshmukh, director, Equirus Capital, says, "In the wake of the government's 'Make in India' push, infrastructure and manufacturing/industrial sectors are most likely to get investor interest in 2015. In my opinion, there will be some themes that will offer investors good opportunities to make money; however, focusing on quality companies and avoiding attempts to make a quick buck are recommended. In the coming year, investors should watch out for inflation and interest rates." Both these are likely to fall next year, helping industry as a whole. Banks, too, may see pick-up in demand for loans if this happens. But not everyone believes that there will be one sector that will make a lot of money for investors in 2015. "We expect 2015-17 to be a wealth creation period just like 2003-08. In 2003-08, the Sensex went up by five times, and most

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sector indices went up by 300-1,500%. I expect the market rally to be broad-based," says Rajesh Kothari, managing director, AlfAccurate Advisors.

STOCK RECOMMENDATIONS 2015

Finolex Industries

RECOMMENDED BY: **HBJ CAPITAL**

WHY BUY: Finolex is undergoing a transformation that will improve its performance sharply over the next three years. It is shifting from a commoditised B2B model to a brand-oriented B2C business by using its distribution strength.

Axis Bank

RECOMMENDED BY: **ANGEL BROKING**

WHY BUY: The bank has a good current account savings account base and impressive Tier-1 capital adequacy ratio. The stock trades at a discount of 38% to HDFC Bank.

Bajaj Finance

RECOMMENDED BY: **BONANZA PORTFOLIO**

WHY BUY: It's a play on the consumer sector, which is expected to witness another boom. Bajaj continues to reap the benefits of healthy consumer demand and is among the few companies doing well in this space.

JSW Steel

RECOMMENDED BY: **HDFC SECURITIES**

WHY BUY: Continued improvement in the product mix and backward integration will help the company avoid erosion of margins.

Kirloskar Ferrous Ind.

RECOMMENDED BY: **HEM SECURITIES**

WHY BUY: Kirloskar has a long-standing relationship with original equipment makers. It will also gain from improving operational efficiency and strong fundamentals.

Dr Reddy's Laboratories

RECOMMENDED BY: **NOMURA**

WHY BUY: Positive surprises from the US generic pipeline and increasing visibility on proprietary and biologic R&D programmes over the next 12 months bode well for the stock.

Lumax Auto Technologies

RECOMMENDED BY: **INDIA NIVESH SECURITIES**

WHY BUY: Lumax is a supplier of key components to two-wheeler and passenger car industries. Growth of key customers such as Bajaj Auto, Piaggio, Honda Motorcycles and Scooters, Maruti Suzuki, Toyota and Tata Motors bodes well for the stock.

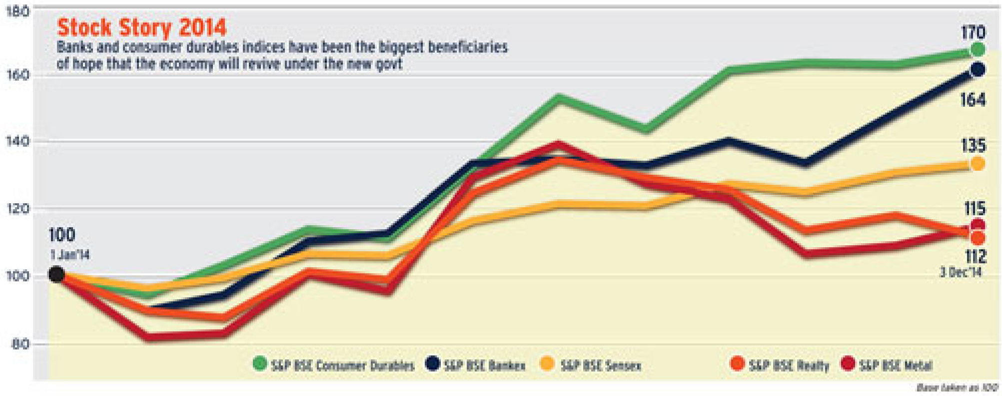
FIIs' Love Affair

India is firmly on the map of foreign institutional investors or FIIs. Since 2000, they have been net buyers of Indian equities every year except 2008 and 2011. From the start of the year till December 10, FII net inflows into India were Rs 1.05 lakh crore (See FIIs Come to Town).
Kothari says, "India is in a sweet spot. Global liquidity inflows will continue to remain strong as investors prefer growth. With China and most commodity-driven economies slowing, India will be a preferred choice for global investors. I think India will attract a lot of FDI (foreign direct investment) and FII money over the next two-three years."
In 2014, till December 12, the Sensex was the second-best performer globally, the best being Shanghai Index with returns of 35.58%. PVK Mohan, head of equities, Principal AMC, says it's not without reason that India is FIIs' favourite emerging market. He says first we have a performing government whose intentions are clear. Second, we had massive current account and fiscal deficits in 2013, both of which are under control now. This means the country's macros are falling in place. Third, India is a diversified and huge market which is well-regulated and well-run, he says.
"FIIs consider a country for investment when it has at least three things. First, consistency of rules; second, a predictable currency; and third, ease of doing business. There is hope the government and the Reserve Bank of India will improve India's performance on these parameters," says Gopalakrishnan of Canara Robeco.

Eye on Reforms

With the new government claiming that it will do everything possible for high economic growth, there is expectation that it will carry out wide-ranging economic reforms. "If we look at the first six months of this government, the reforms that have been carried out may appear small if you look at them individually, but cumulatively they will have a far-reaching impact," says Gopalakrishnan.
Kothari of AlfAccurate Advisors believes 2015 may see Parliament clear a few important bills. Besides, there is expectation of reforms in power, coal, road, health care and education sectors. "But it will be simplification of processes in major sectors that can improve India's rank in the ease of doing business," says Kothari. The market is keenly watching progress on

Goods and Services Tax, FDI in insurance, labour reforms and land acquisition laws.



Some initial moves by the government have already had a positive impact on sectors and stocks. Lalit Thakkar, managing director, Institution, Angel Broking, says, "Raising of the FDI cap in defence from 26% to 49% will benefit defence equipment manufacturing companies." He says the gainers will be L&T, Tata Motors, Mahindra & Mahindra, Bharat Forge and Ashok Leyland. The stock of Ashok Leyland has risen 51% to Rs 34.65 (on November 28) since the announcement of the FDI cap increase on August 6. Also, 100% FDI in railway in signalling, electrification, public-private partnership projects, suburban corridors, etc, should benefit companies like ABB, L&T and Siemens.

Arun Thukral, MD & CEO, Axis Securities, says, "Overall the government has taken a lot of small actions to enhance the ease of doing business in India. We anticipate implementation of these decisions. This will bring a slew of opportunities across sectors. In such a scenario, equities can provide investors good returns." He adds that given the softening commodity and crude oil prices, India looks more promising to FIIs than Brazil or Russia.

Although optimism is good, the ground reality can be different and the pace of change could be slow considering that India is a democratic country. The 49% FDI cap in insurance was proposed a decade ago but has not able to see the light of day yet. Nagaonkar of Bonanza says, "The reforms can be delayed if there is stiff opposition. In the upper house, it will take another two years for the BJP to get majority. If that happens, it will be easier for the government to pass major bills."

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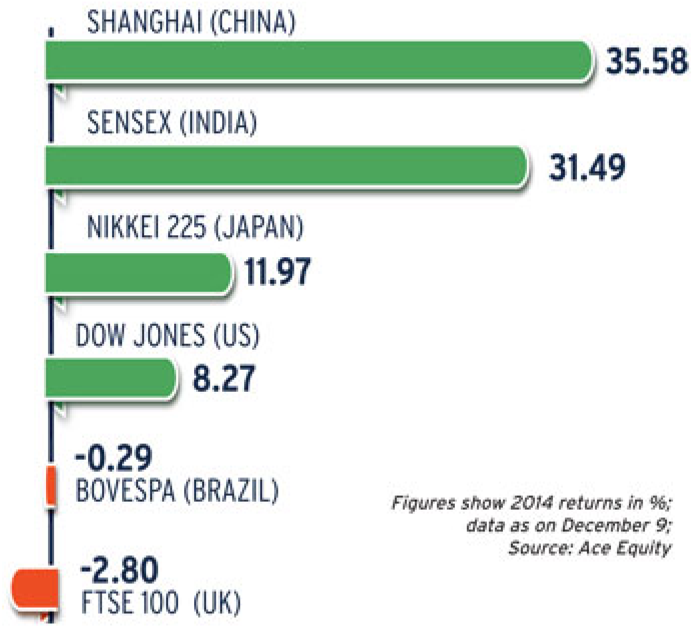
Global Star Cast

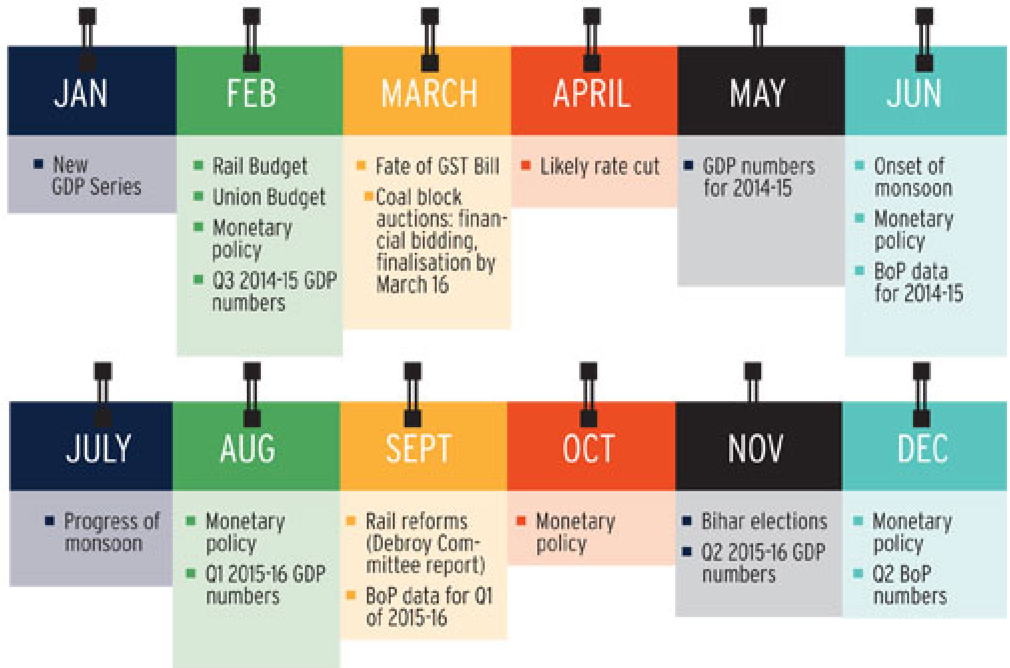


Beware of Risks

Equity markets can be spooked anytime. As they soar, they may face strong global headwinds. Credit Suisse, in its report, 'India Market Strategy 2015', highlights that India's markets are much more linked to the world than the economy: a high 56% of Nifty revenues are not in Indian rupees, and of the rest, a large proportion comes from banks that lend to these export sectors. According to the report, pharmaceuticals and IT should be relatively unscathed, but others, in particular materials, are likely to be impacted.

In 2015, Watch Out For...

Events that will decide market direction in new year



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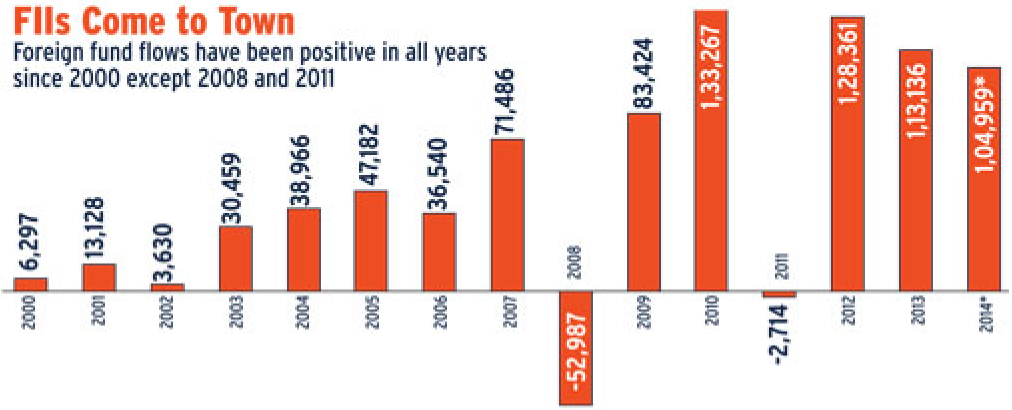
"Domestic risks come from heightened expectation as reality is that there has not been great improvement on the ground," says Mohan of Principal Mutual Fund. He adds that stock markets have already risen 30% in 2014, which means a lot of good news has been discounted. The direction of the market is upward but perhaps it has gone up too fast and so there may be a short-term correction or a period of movement within a band.

The Best And The Worst

	S&P BSE Sensex	S&P BSE Teck	S&P BSE Realty	S&P BSE Power	S&P BSE Oil & Gas	S&P BSE Metal	S&P BSE IT	S&P BSE Healthcare	S&P BSE FMCG	S&P Bse Capital Goods	S&P BSE Bankex	S&P BSE Auto	S&P BSE Consumer Durables
2010	17.43	23.49	-25.92	-6.27	1.25	1.13	31.59	34.19	31.97	9.20	33.39	37.65	67.93
2011	-24.64	-16.47	-51.84	-39.91	-28.98	-47.19	-15.72	-12.83	9.53	-47.66	-31.59	-20.44	-16.87
2012	25.70	1.41	53.44	10.86	13.14	19.13	-1.18	38.53	46.61	34.71	56.72	40.31	46.08
2013	8.98	47.36	-32.09	-14.57	3.71	-9.99	59.78	22.55	11.00	-5.56	-9.36	7.29	-24.59
2014*	31.46	14.63	16.11	21.23	16.83	8.24	15.21	49.24	23.99	52.04	62.73	54.29	69.14

*Figures show returns in %; *Data as on December 10; source: Ace Equity*

There are some structural risks as well. Over the last few years growth has been coming from the rural economy, which can slow down. "Between 2007 and 2014, the capital employed for BSE 500 companies, which represents 90% market capitalisation of listed companies, went up from Rs 5 lakh crore to Rs 30 lakh crore. This is an increase of six times. It's a huge increase. Therefore, we should be a little careful when we say there will be more capex because there is a huge capex which has been incurred which is yet to be fully utilised," says Rajesh Iyer, EVP, Head - Investment Advisory Services & Family Office.



*Figures show net FII inflows in equities in Rs crore; *data as on December 10; source: Ace Equity*

He says in the next 12-18 months it will be critical to monitor where demand is coming from and if consumption is increasing. There is also the risk of slowdown in rural consumption, he says. But not everyone agrees that demand from rural areas will fall. Vikas Gupta, EVP, Arthveda Fund Management, says the government has taken several decisions that can spur the rural economy. "The emphasis on toilets, for example, will bring money from companies' corporate social responsibility budgets along with government spending. There is also an emphasis on building schools. These will touch lives in rural areas," he says.