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Choose your stocks wisely, only select midcap stocks likely to outperform; 10 stocks to bet on

NEW DELHI: The relentless selling seen in the markets in the last two months pushed the S&P BSE Sensex in the red, erasing most of its gains made so far in the year 2015, while S&P BSE Midcap index was also down over 1 per cent, as of data collected on 27 April, 2015.
The selling has been broad-based with some of the midcap stocks losing up to 50 per cent in the last one month. After a sharp fall in March, the Sensex has already plunged over 2 per cent in April alone, and the BSE Midcap index has taken a hit of nearly 3 per cent in the same period.

CNX Midcap is now in a correction phase, say experts. "Technically speaking, we have seen three black crows candlestick pattern in CNX Midcap Index, which clearly depicts further downside movement in it," says Vivek Gupta, CMT - Director Research, CapitalVia Global Research Limited.

"From now on, investors should close their long position in it and in intraday traders should look for an opportunity to short sell midcap stocks," he adds.

However, from a longer-term perspective, midcaps looks better placed to give investors a double digit return, say experts. They feel that the rally would continue because the undertone still remains very optimistic as most of the macro factors are in favor of the Indian economy.

Investors should look at building their portfolio of high quality midcap stocks, which can deliver double digit return as the economy bounces back. In the recent days, midcap stocks have been the most favorite of the many market participants, be it the institutional investors or the retail investors.

"Most of the mid cap stocks have performed well in the bourses on the expectation that with the improvement in the economy and on the back of major reforms and measures initiative taken by the Central government, the mid cap companies would spring earning surprises over the next couple of quarters," says D K Aggarwal, CMD, SMC Investments and Advisors Ltd.

"It is expected that the rally would continue because the undertone still remains very optimistic as most of the macro factors are in favour of the Indian economy, be it decline in crude oil price, which is helping India to reduce its import bill, currency stability or political stability," he adds.

What is the right approach?
While building a portfolio, investors should be very careful in picking midcap stocks. Over the last 15 months, stocks in the CNX Midcap Index have outperformed the stocks in the Nifty Index by a big margin, but that doesn't necessarily imply that it will underperform in the immediate future.

"It is evident that the stocks of relatively smaller companies (and hence smaller market capitalization) tend to outperform stocks of bigger companies (which enjoy larger capitalizations) over longer time horizons," says Amit Nigam, Head - Equities, Peerless Fund Management Co. Ltd.

"Investing in a smaller company, which is well run, gives us an opportunity to invest in a good business at relatively lower valuations than its large peer," he adds.

"The target company that you choose should have the ability to grow faster than its larger peers in the industry growth rate (thus gain market share) and is available at cheaper valuations because it may not be a discovered stock (not well researched/ known in the capital markets)," added Nigam.

Analysts think that with the economy yet to pick up its growth momentum in a meaningful way, the smaller companies have a possibility to surprise positively on the growth front.

However, it is unlikely that overall the midcap indices will outperform the large caps, and only a handful of stocks will be able to do that.

"The midcaps are priced at higher valuations and on an overall basis they will not outperform. Midcaps are overvalued compared to large caps on a PE ratio basis," says Vikas Gupta, Executive Vice-President and Fund Manager, Arthveda Fund Management Pvt Ltd.

"In valuation ratios, midcaps might look cheaper, but one should bear in mind that they are leveraged more than the large caps and have higher near-term and longer-term default risk on their debt. Hence these are riskier companies," he adds.

However, there is a section of midcaps, which have low leverage, higher growth profile and the market is yet to realize that in terms of their valuation ratios. Gupta is of the view that these are from sectors which the market might not be paying attention to. That is where the investment opportunity lies, he adds.

We have collated a list of midcap stocks from various experts for a period of 6-12 months:
Hitesh Agrawal - Head Research, Reliance Securities
SRF (Target Price Rs1,150): The company has emerged as a niche chemical player on the back of its R&D strength and vast experience in fluorine chemistry, mainly catering to agrochemical and pharmaceutical companies.

We expect high margin chemical business to sustain high growth trajectory leading to improvement in its revenue contribution from 24% in FY14 to 34% in FY17E. Coupled with this, an expected cyclical recovery in packaging business could add thrust to overall growth and margins.

Atul Auto (Target price set at Rs 683): We are upbeat on Atul Auto's growth profile, gaining confidence from soon-to-be-launched Petrol variant and its potential to explore the vast export market. Atul's market share in goods carrier segment is 18% while in passenger carrier segment its market share is 5%. In terms of dealer network, Atul has a total of 325 touch points with 200 primary dealers and 125 sub-dealers and intends to grow by 25-30 dealers every year.
HSIL's (Target Price Rs495): The company's building product division has grown at a CAGR of 22.6% in the last five years on the back of high demand in sanitaryware products and changing consumers' preference towards premium and lifestyle products. We believe these drivers are intact. Recovery in container glass business will convert into better realizations and in turn improve the blended margins.
Treehouse Education (Target price set at Rs 550): We expect Treehouse Education to register revenue CAGR of 24% over FY14-17E aided by robust addition of pre-schools, increase in capacity utilization of K-12 schools and additional revenue stream from day care services. The company intends to add 100-120 schools annually until FY17E while maintaining the ratio in favor of higher number of owned preschools.
Kansai Nerolac (Target Price Rs253): The company, being the leader in the industrial paints, is expected to milk dual benefits of benign raw material environment as well as anticipated cyclical recovery in industrial business. We believe 300-400 bps YoY improvement in the gross margins will be partially negated by pass-on benefit to the trade. Nonetheless, we believe KNPL is a strategically strong story and are positive on the company.
Vivek Gupta, CMT - Director Research, CapitalVia Global Research Limited
Crompton Greaves Ltd: Target price set at Rs 230

After registering a 52-week high of 231, the stock is in a short-term correction phase and is sustaining below the falling trend line. It is likely to show northward journey again with the crossing of the resistance at the level of 181, where one may initiate the long position in the stock for the targets of 207/230. Immediate support of 155 can be placed as stop loss in it.

IDBI: Target price set at Rs 101
The stock is accumulating at the lower levels in long term charts and is having a crucial resistance at the level of 85. Further the stock is closing in green below this level from the last few trading sessions, and it is likely to show an upmove with the breakout of the mentioned resistance mark, where one may expect the stock to test the level of 101, if it sustains above the support level of 69.

ICICI Securities
PTC India Ltd: Target price set at Rs 115
PTC's business model is most aligned to a sharp revival in the power sector demand through - i) signing more PSAs (lock untied capacity of 4GW), ii) growth in trading business volume and improving long-term volume to aid margins.

PTC has provided Rs267 mn in Q3FY15 for diminution in value of the remaining stake in Teesta Urja project, which is likely to reverse - as the regulated business model over 15% RoE should be achievable given that the project is 91% complete and no more surprise is expected.

Dish TV Ltd: Target price set at Rs 100
Dish TV reported an APRU increase to Rs177 in Q3FY15 compared to Rs163 in Q4FY14 due to the price hikes taken in Aug 2014. The company has increased its mid and economy package prices by 20% and 15% since FY14-end as it bridges the gap with other DTH players, while basic packages price increases were in line with industry averages.

We believe the recent hikes along with differential pricing will help sustain a 6%/7% ARPU increase in FY15/FY16 compared to 4% YoY increase in FY13/FY14.

Further triggers to the stock price are favorable regulatory developments with respect to taxation (GST), license fee reduction and industry sops.

Dewan Housing Finance Ltd: Target price set at Rs 544
Dewan Housing Finance (DHFL) primarily provides housing loans to self-employed members of the low and middle income group in tier 2-3 cities and metro peripheries where large HFCs and private banks have a limited presence.

The recent capital raising exercise of $130mn provided the company with the much needed capital to pursue faster asset growth. The increasing proportion of higher yield loan categories in the asset book will support yields.

Investors would and should continue to pay attention to high operating cost metrics, past media controversies and acquisition track record as potential red flags.

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