Coming out of debt! Top 10 stocks that returned upto 85% in 2014

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NEW DELHI: Most analysts would advise retail investors to stay out of highly-levered companies and remain invested with quality names, but there are certain companies which are slowly cutting their debt and could possibly be multibaggers in the coming future, say experts.

Investors should look at highly-levered companies only when they have most of their core equity investments in high-quality ultra-large caps .

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Although benchmark indices have rallied a little over 20 per cent so far in the year 2014, the real action was seen in some of the high beta names or companies which have managed to rally up to 85 per cent in the same period. These companies have high exposure to debt, but are on recovery path.

Investors should look at highly-levered companies only when they have most of their core equity investments in high-quality ultra-large caps and are looking to boost up their returns further by taking more risk with leveraged companies.

"These companies, if they come out of the debt trap, will be able to transfer all the value from the debt holders to the equity holders. Since nearly all of them have debt to equity ratios of 1 to 2, it is likely that the shareholder values could double if the debt is paid off," said Dr. Vikas Gupta, Eexecutive Vice President, Arthveda Fund Management Pvt Ltd.

"In some cases, the company might continue the debt in perpetuity since that is the business model. However, the revenues of the company increasing and the interest costs going down should provide a huge boost to the company valuations," he added.

Investors should take exposure in levered names with strict stop losses only when they have diversified portfolio of stocks and sectors. This approach will help them limit losses in case the strategy fails.

A stable government with a pragmatic approach can also help Indian corporates tap global equity markets at reasonable risk premium.

"We would not know if any of the corporates is looking to raise equity. But we find a lot of queries in the sector from investors now looking to buy into names which could be beneficiaries of either deleveraging or equity issuance by companies where financial leverage is very high," Deutsche Bank said in a report.

"A reduction in interest costs from the currently elevated levels is likely to be particularly positive for the leveraged infrastructure names. If interest rates fall by 50 bps, the earnings could move up by as much as 2-36% for the various players (and 4%-71% in case of a 100 bps fall)," added the report.

We have collated a list of ten stocks, recommended by analysts, which are slowly coming out of the 'debt trap'. However, this should be the starting point for the investors to do their own due diligence.

Company Name	YTD Return	P/E
Motherson Sumi	61%	50.86
Apollo Tyres	85%	19.60
IL&FS Transport Networks	50%	20.29
Idea Cellular	-16.24%	28.47
CEAT	40%	6.62
Greenply Industries	58%	12.5
Firstsource Solutions	46%	16.23
Tamil Nadu Newsprint & Papers	16%	6.23
Jaiprakash Associates	50%	46.84
Jindal Steel & Power	30%	23.55

Note: Table compiled from inputs from ET.com, BSEIndia and other website.

Analyst: Tushar Pendharkar, Equity Strategist, Right Horizons Financial Services.

Motherson Sumi Systems Ltd: Target price set at Rs 380-400 in the next 12 months

Motherson Sumi is in the auto ancillary business. The company levered its balance sheet to acquire units outside India to expand its reach in the global market. Despite slowdown in the automobile segment, the company managed to report double digit revenue growth in the past several quarters and is consistently reducing its debt.

My target for Motherson Sumi would be around Rs 380-400 for the next 12 months.

Apollo Tyres Ltd: Target price set at Rs 250-280 in the next 12 months

Around 6 quarters back, Apollo Tyres had debt to equity of over 1.0 and that was the main concern for investors when the management decided to buy Cooper Tires with additional debt of over USD2.5 billion. However, that deal didn't happen and the company avoided the extra debt burden of USD2.5 billion.

During the past 12 months, the company has significantly reduced its debt burden and improved its debt to equity from 1.00 to 0.22 in the past 18 months. The company has not only outperformed the industry average in terms of revenue growth, but it has also improved its margins better than any other equivalent player.

The stock price has almost doubled in the past 12 months. However, it is still trading at a discounted valuation against MRF, which has equivalent fundamentals. The target for Apollo Tyres is around INR250-280 for the next 12 months.

ILFS Transportation Networks Ltd: Target price set at Rs 280-300 in the next 12 months

ILFS Transportation is in infrastructure and road construction business. Past 18 months were pathetic for the industry due to macroeconomic headwinds. The balance sheet of IL&FS Transportation is highly levered and the company has witnessed pressure over its fundamentals on the back of tight liquidity by RBI and unexecuted orders due pending approvals from the government.

The new government has plans to execute pending projects of over 25,000 kms of roads, and I believe that ILFS Transportation is well poised to get the maximum out of its due to its professional team of management, leading position in the industry and pan India operations. My target for the company would be around INR280-300 for the next 12 months.

Idea Cellular: Target price set at Rs 250 for next 18 months

Idea Cellular is in the telecommunication space and the recent spectrum auction has raised debt to equity of most of the players of the industry. The current debt to equity on Idea's balance sheet is 1.18. However, I believe that the company has capability to generate sufficient cash flow to address the current debt burden.

Idea is the fastest-growing company in the Indian telecom space and its data usage has been reported significant YoY growth and outpaced the industry average in the past 6 quarters. The target for the stock would be around INR250 for the next 18 months.

Analyst: Dr. Vikas Gupta, Executive Vice President, Arthveda Fund Management Pvt Ltd.

CEAT:

This company is a major OEM and replacement market tyre supplier. It has developed a strong brand and hence the replacement market is its major segment. The macroeconomic conditions are expected to improve after several years of stagnancy, especially as far as the automobile sector is concerned.

Being the leading player in tyre, the topline growth is a given. Further, its interest coverage is increasing steadily. With an improvement in the economy it is well set to capture the surge in pent-up demand from the passenger vehicle segment and also the demand from commercial vehicles.

The interest coverage ratio is quite safe with nearly 3.5 times. The total debt can be comfortably managed by the company. The valuations are cheap, with EV to EBITDA of 3.6, PE ratio of 5.6 and PBV of 1.5. The company is quite competitive in its peer segment.

Greenply Industries:

A leading player in the interior infrastructure segment (plywood, laminates and MDF). The competitive advantages of being a leader in the segment are visible in the financials and capital efficiency. The company has a very high growth rate, which seems less prone to macro-economic woes. It is a consumption-driven story. It is reducing debt while improving its net worth. Interest coverage is at a comfortable 3.5 or so. EV to EBITDA is at 6.8, price to BV is 2.6 and PE is at 10.2

Consumption and construction activities will continue to drive the sector. It has grown at 20%+ when the economy was growing at 5%. When the economy grows faster, it is likely to do even better.

Firstsource Solutions Ltd:

It is the leading BPO Company of India. Reducing debt, increasing interest coverage and margins. EV to EBITDA of 7.8, PBV of 1 and PE of 10.9. The company will benefit from recovery in the developed economies, i.e. the US and the UK.

In the next one year, the margins might see some pressure due to appreciation of the rupee, but in the longer run it will benefit from the secular depreciation of the rupee vis-a-vis the dollar. This provides a non-Indian economy dependency and diversification.

Tamil Nadu Newsprint

It is a leading paper manufacturer. With an EV to EBITDA of 4.4 , PBV of 0.9, and PE of 7.5, it is available at good valuations. Interest coverage is 2.5 to 3 times, which is comfortable given its cash flow stability.

Deutsche Bank:

Jaiprakash Associates Ltd: Target price set at Rs 77

The management has sold assets worth INR150bn in FY14 to reduce its leverage. While the first few assets were at their set-up cost, the last transaction, to sell the Bokaro Cement plant, was at a substantial premium (over 3x Price/Book).

The company has one of the biggest operating leverages with both its core cement and power business operations running at less than 60% utilizations currently. Given its elevated leverage levels (net debt/EBITDA of over 10x at consolidated level),
any fall in interest rates augurs well.

Jindal Steel & Power Ltd:

Deutsche Banks have ahold recommendation on the stocks. But, on the positive side, the stock underperformance over the last 12 months has taken the stock down to 12xFY15E P/E - one of the lowest levels in its historical trading bands.

The company has virtually come to the end of its large capex phase and this could result in the debt starting to taper off from the currently elevated levels (Net Debt/EBITDA at 5.3x). The global investment bank also adds that early resolution of the ongoing regulatory investigation problem: in the event that the problem is resolved favourably, the stock could once again start trading on a par with the peers.
(Views and recommendations expressed in this section are the analysts' own and do not represent those of EconomicTimes.com. Please consult your financial advisor before taking any position in the stocks mentioned.)

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