THE ECONOMIC TIMES

Top five PSU stocks to 'buy' for long term ahead of Budget 2014

By ECONOMICTIMES.COM | 7 Jul, 2014, 03.59PM IST

Post a Comment

By Dr. Vikas Gupta

With a govt who has got a reformist agenda, it is highly likely that economic growth will recover over the next 5 years to levels of 7% plus.

There are a lot of expectations from the new government and the Budget 2014. Investors are trying to get one step ahead of the Budget and are looking to bet on things which could be announced and gain an advantage over other investors. However, we believe that the best way to stay ahead of the Budget is to look at fundamentals.

It is clear that India has been treading a low growth rate for several years now. With a new government who has got a reformist agenda, it is highly likely that economic growth will recover over the next 5 years to its normalized levels of 7% plus.

Under this scenario we look for companies that could be crucial if that growth has to take off. Power and energy fuel the economy and hence these sectors are a must-have. Further, infrastructure is the other part which has to be built and that will require metals and mining.

All the companies in the following are from key sectors of energy, power, metals and mining. They all happen to have very high quality fundamentals, albeit most of them are currently experiencing below normal revenues, earnings and profitability.

However, even these below normal fundamentals are very high quality. Further, they are all trading at very low price multiples, sitting on huge cash balances and available at very high dividend yields. A portfolio investment across several such companies should prove "satisfactory", as Ben Graham would put it, given the margin of safety in these companies.

Oil India

Oil India, a Navratna company, is the second largest hydrocarbon exploration & production (E&P) company in India. It has a high share of oil (62%) in its reserve base. Majority of its assets are located in north-east. It has seen steady growth in production over the last 4-5 years and is expected to continue the trend.

As India aims for more oil security, Oil India will play a major role down the line. Expected easing in pricing norms and government's mission to lower the under recoveries for O&G companies is a key long-term secular trend which will support its growth. Oil India has a net cash balance sheet and has return of capital of about 27%.

Shares of the company are trading at an attractive valuation of nearly 8.0x price to cash earnings, and are trading at a dividend yield of ~ 5 per cent. This could be a great long-term buy for investors.

Coal India

CIL is the largest pure play coal producing company in the world. CIL has the highest coal reserves in India with its annual production of 452MT (in 2013) accounting for nearly 81% of domestic coal production. CIL has a monopoly in the sector with burgeoning power-deficit problem and is extremely important to meet India's growing energy need.

Coal demand is expected to double in this decade. CIL being the largest coal provider would be the biggest beneficiary of this growth. Given that India's growth rate is expected to get back to the 7%+ range in the next few years, it should be kept in mind that growth requires power consumption which is primarily dependent on coal supplied by Coal India.

So CIL is a proxy play on India's future growth. CIL shares are trading at about 16x its trailing earnings and a dividend yield of about 4%.

Engineers India

Engineers India is India's leading consultancy and engineering, procurement & construction company in hydrocarbons & petrochemical space. It has over 50 years of experience and has no real competition in India. As India is keen on securing energy resources to fuel its long-term economic growth, Engineers India will play an important role in making those resources commercially feasible.

The company is also structurally shifting to a revenue mix which has higher percentage (60%-65%) coming from consulting projects. Consulting is a high margin business for the company. Recently the company has been aggressively targeting MENA & the South East Asia region. Given its monopoly, the company is a great long-term opportunity.

NMDC

NMDC, established in 1958, is one the largest producers of iron ore by volume in India. It is also one of the leading low-cost producers of iron ore globally. The lower cost of production results in fat margins for NMDC. With these fat margins, NMDC is in a strong position to absorb any price shocks and maintain its profitability. Further, domestic demand for iron ore remains strong.

India is expected to double its steel production in the next 5-6 years to meets its infrastructure requirement. This should result in sustainable demand for iron-ore in future. Taking into account the above fundamentals and the fact that the stock is trading at about 11.0x trailing earnings with about 3.5% dividend yield and a net cash balance sheet, the stock is a good pick for long term investors.

BHEL

India's largest manufacturer of power generation equipment, BHEL is the only Indian company capable of manufacturing large-size gas-based power plant equipment and one of the few companies worldwide involved in the development of Integrated Gasification Combined Cycle (IGCC) technology.

It holds a preferred supplier position with its domestic customers primarily because the lifecycle cost of BHEL made equipment is lower than its Chinese counterparts. In the long run the power sector should continue to see strong demand because of a huge energy deficit in India.

Its Price to Book is nearly 1.8x, which is markedly lower than its peers. Given its strong order book, high profitability, net cash balance sheet and cheap valuations, the stock is an attractive buy.

(The author is Executive Vice President, Arthveda Fund Management Pvt Ltd. ArthVeda provides fund management services and holds VCF, AIF and PMS licenses regulated by SEBI. The views and recommendations expressed in this section are his own and do not represent those of EconomicTimes.com)