Angel Broking

#InvestAndChill

A complete guide to kick start
your investment journey.

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Tools for new investors to begin their investment journey

"*The Only Constant in Life Is Change*". A lot has changed over the past two decades with the advancements in technology and the very best example is in front of your eyes. With businesses transforming into digital enterprises, the entire customer journey has become fluid and efficient. It is safe to say that apart from awareness, technology has helped further develop the markets in India and has attracted more participation for the new generation. One of the reasons may be that the youngsters today are far more cognizant of the need to secure their futures than those of the previous generations. To underscore the point, wealth creation due to power of compounding provided by equities is one of the key reasons one should start investing as early as possible. The benefit of this is that a new investor can enjoys the flexibility of experimentation and are likely to possess a better risk appetite than investors in their 40s or 50s.

The new-gen investors today are equipped with gadgets (devices) and tools like rating metrics, historical data and screening tools among others that help them find stocks with a click of a button. There can be some pitfalls if incorrectly use these tools. Hence, we would like to share some qualitative and quantitative factors to identify stocks for new investors that are investing in equities. It is always recommended to use a portfolio approach with investments across asset classes (e.g., Equity, Debt, Commodities, etc.) in order to diversify risk.

What are some of the qualitative factors?

To start with, criterion like quality of management often gets overlooked by a large section of investor community at the time of making the investment. Although, this qualitative factor in itself does not guarantee success, decisions made by the management can sometimes be a game changer. An example of this would be how the funds of the company, whether generated internally or raised externally are utilized. The term that may ring a bell to you is "Capital Allocation". If the company is able to earn a higher return than the cost of funds or rate of interest on a term deposit and is ploughing the profits it earns back in the business to fund future expansion then, there is a high likelihood that significant value will be created for the shareholders in the long run.

It is also always good to see if the management or the promoter has a skin in the game and are constantly increasing their stake in the company, which clearly indicates the management's confidence in the business. Apart from capital allocation and promoter's interest, past decisions and their resultant impact on the company can also aid in identifying top-level managements. Their ability to adapt to changes like timely diversification to minimize any negative shocks or capitalizing on new growth opportunities also play a crucial role in the long-term success of the business. It is recommended that you pick simple businesses that are easier to understand and are known brand names. A classic example of this would be the likes of Maruti Suzuki or Hindustan Unilever.

Some measurables that can help you identify good stocks

Above point about management quality, when true, is regularly observed in businesses that have track record of superior operating performance. While screening for stocks, quantitative factors like consistent revenue and profit growth over period of 10 years or more, high return ratios (ROE and ROCE), low or manageable debt levels, no pledged shares and history of positive free cash flow generation (FCF) can be used to identify an ideal business for you to invest in.

In continuation to our earlier point of capital allocation, quantitative analysis of retained earnings and the incremental increase in earnings per share can be used to pick potential outperformers.

Some generally used measurables to build a screens are Sales and Earnings CAGR of more than 10% over 10 years, ROE and ROCE of more than 12-15%, consistent FCF growth over 10 years (more years with positive FCF is preferred) and debt/equity ratio of less than 1x.

Buy right, avoid traps and enjoy the ride

Generally, buying a stock at a lower price to earnings (P/E) multiple is advisable as P/E means that the stock is trading “x” times earnings per share (EPS) and a lower P/E stock is perceived to be undervalued. For example, a stock quoting at Rs. 100 per share with an EPS of Rs.20 is said to be trading at P/E of 5x. Although this appears cheap, there might be an underlying reason why the market is not willing to pay higher multiple for each rupee of profit generated by the company. Using the low P/E screen in isolation can result in you getting stuck in a “Value Trap”. Hence, a combination of low P/E, high ROE and revenue & profit growth should be used while screening for your ideal investment candidate. Finally, equities yield the best returns when invested right and held for longer period of times (for a period of seven years or more). Monitoring the stock for developments is a must in order to ensure that the business is on track and to identify if there are potential disruptions that can have long term repercussions on the stock and your returns.

To help you get a head start in the investing game, we are laying down some stock ideas with brief rationale. You will see that these stocks have posted steady growth over the years and fulfill most of the criteria discussed above.

ESCORTS

Escorts
(target ₹1,573)

Escorts is a prominent tractor player domestically with market share in excess of 11%. The company's brand of tractors is particularly strong in the northern as well as the eastern belt of India. Due to record food-grain procurement by government agencies as well as better than expected Rabi crop and prospects of a normal monsoon, we expect the tractor industry will continue to outperform the larger automobile space in FY21 with Escorts a key beneficiary. Escorts in the recent past has also entered into a strategic partnership with Kubota Corporation of Japan (one of the global leaders in farm machinery and implements), which provides further visibility of growth for the company, going forward.

Crompton Greaves

Crompton Greaves Consumer
(Target ₹480)

Crompton Greaves Consumer Electrical (CGCEL) is of India's leading fast moving electrical goods (FMEG) company with a strong presence in the fan and residential pump category. The company is the market leader in the domestic fan and residential water pump business with value market share of 24% and 28%, respectively. The company has over the years been focusing on increasing the contribution from premium products in its portfolio which will lead to better realizations and margins. The premium fan category now accounts for ~20% of the company's fan business up from 14% in FY17 and is expected to improve further. On the lighting front, CGCEL is focusing on high margin street lights, fixtures and battens business. CGCEL is our top picks in the FMEG space as we believe that it is best positioned to benefit from the strong growth in the FMEG space given wide product portfolio and strong brand recall.

Mindtree

Mindtree
(Target ₹ 2,550)

Mindtree is one of the leading mid cap IT service provider and part of the L&T group with revenues of over USD 1bn in FY21. The company has a very strong presence in BFSI, Communications, Media & Technology, Retail, CPG & Manufacturing, and Travel & Hospitality segment. Company has also reported a good set of numbers for Q4FY21 with 5.2% qoq growth in revenues to USD 288.2mn while new deal wins also remained strong at USD 375mn as compared to USD 312mn in Q3FY2021. The company was one of the worst impacted in the sector due to the company's high exposure to the Travel & Hospitality segment. However, with significant improvement in the Covid situation in developed economies we expect strong recovery in the Travel & Hospitality segment which will drive growth for the company in FY2022.

FEDERAL BANK
YOUR PERFECT BANKING PARTNER

Federal Bank
(Target ₹ 110)

Federal bank is one of India's largest old generation private sector banks with deposits of Rs. 1.73 lakh cr. and a loan book of Rs. 1.32 lakh cr. at the end of FY2021. On the asset quality front NPA's have remained steady for the bank over the past few years with GNPA for Q4FY21 at 3.41% while NNPA ratio stood at 1.19% as the impact of the Covid-19 has been limited so far on the asset quality front. The company has posted a decent set of numbers for Q4FY21 as the loan book grew by 7.9% YoY led by strong growth in retail portfolio. NIM's for the quarter was up by 1bps QoQ to 3.23% while NII grew by 17% YoY to Rs. 1,420 crore. Federal Bank is one of our top picks in the mid cap banking space and we expect the bank to post strong NII and PAT growth of 21.4%/19.1% between FY20-FY23.

KALPA-TARU POWER TRANSMISSION LIMITED

CARBORUNDUM

Kalpataru Power (Target ₹480)

Part of Kalpataru group, Kalpataru Power Transmission (KPTL) is one of India's leading EPC companies with diversified presence across Power T&D, Indian Oil & Gas EPC and Railway projects. It holds 67.75% stake in JMC Projects which has presence across B&F, Urban Infra, Water, etc. KPTL is in on course in its deleveraging journey where it is nearing full exit of Power BOT assets and now focussing on exiting of Road BOT assets. The order inflows and execution are strong especially for subsidiaries (JMC and international T&D) and completions/exits from Indore Real Estate Project/Shubham Logistics should enable to company to fully focus on its core business. Merging of JMC Project and guided reduction in promoter pledge can remove the overhang from the stock and start the re-rating process.

Carborundum Universal (target ₹660)

Carborundum Universal (CUMI) is part of the Murugappa group and is a leading manufacturer of abrasives, industrial ceramics, refractories, and electro minerals in India having application across diversified user industries. The company is expected to benefit from improving demand scenarios across its end user industries such as auto, auto components, engineering, basic metals, infrastructure, and power. While demand from the Auto sector has been robust, we expect demand from metal industry pick up given increased economic activity. Apart from operating leverage, improvement in product mix (w/ value addition) and new product introductions can lead to margin expansion and enhance return ratios.

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