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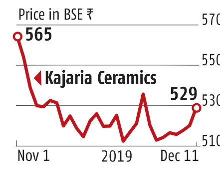
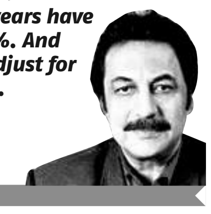
QUICK TAKE: KAJARIA CERAMICS ATTRACTIVE AFTER FALL



Despite a sagging growth environment, Kajaria Ceramics is expected to grow well and gain market share, led by strong distribution and brand equity. This, along with impressive return ratios, its debt-free status, and healthy free-cash flows, offer strong support to the stock

"A remarkable statistic is Indian markets' return has been around 14% INR CAGR since 1980. Returns in last 20 years have plummeted to a mere 11%. And just 6-7% last 5 years. Adjust for volatility (Sharpe ratio)... What's left?"

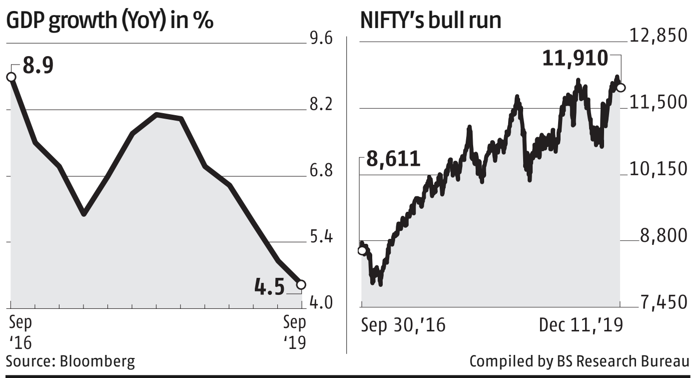
SHANKAR SHARMA,
Co-founder, First Global



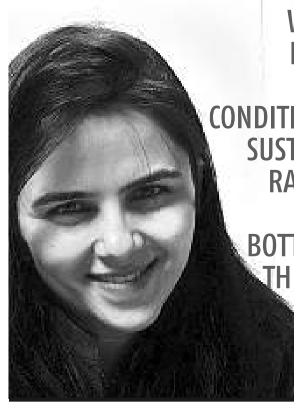
Revival hopes help markets absorb GDP shocker

SAMIE MODAK
Mumbai, 11 December

MARKET DIVERGENCE: STUDY IN CONTRAST



Source: Bloomberg
Compiled by BS Research Bureau



WE EXPECT FY21 TO BE BETTER THAN FY20 AS DOMESTIC FINANCIAL CONDITIONS HAVE IMPROVED SUSTAINABLY FOLLOWING RATE CUTS, AND DUE TO EASING OF SUPPLY BOTTLENECKS FOLLOWING THE SERIES OF REFORMS

PRACHI MISHRA
India chief economist, Goldman Sachs

IF GLOBAL GROWTH STABILISES AND RECOVERS OVER THE COURSE OF 2020, AS WE EXPECT, THE MONETARY EASING SEEN OVER THE COURSE OF 2019 IS LIKELY TO COME TO AN END

RIC DEVERELL
Chief economist, Macquarie

The markets have managed to continue their winning run despite faltering economic growth. For the three-month period ended September, the country's gross domestic product (GDP) grew at 4.5 per cent, its slowest pace since March 2013.

The market, however, has largely been unperturbed by the GDP shocker. Economic conditions are key to market performance as strong GDP growth results in strong corporate earnings — a key driver for share prices. Then what explains the optimism in the market?

Hopes of revival and earnings growth in 2020, surprise tax cuts, and robust foreign flows — thanks to easy global monetary policies — are a few reasons why the markets have managed to digest the low GDP footprint.

While the GDP data is released with a two-month lag, markets always try to factor in future expectations. Most economists and analysts are projecting economic and corporate earnings growth to pick up by next year. "We expect 2020 to be better than 2019 and FY21 to be better than FY20 on account of five reasons," says Prachi Mishra, India chief economist, Goldman Sachs.

"First, the global economy could improve moderately; second, domestic financial conditions have improved sustainably following rate cuts; third, fiscal impulse is expected to be positive; fourth, the easing of supply bottlenecks following series of reforms; and finally, the early signs of economic stabilisation."

The US-based investment bank forecasts GDP growth of 6.6 per cent in FY21, and expects corporate earnings to grow 16 per cent in CY20, slightly below consensus estimates of 20 per cent.

Deteriorating economic conditions domestically this year have led to easing of monetary policy by most central banks.

The US Federal Reserve lowered policy rates by 75 basis points (bps) and moved from balance sheet reduction to mild expansion.

Similarly, the European Central Bank resumed its quantitative easing drive. Most central banks, including the Reserve Bank of India, have cut interest rates. This has boosted liquidity and risk sentiment amid softening of bond yields.

Over $6 billion have flown into India since September, driving up share prices. Further, economists predict the easy monetary stance will continue till growth revives, which could be well into next year.

"If global growth stabilises and recovers over the course of 2020, as we expect, the monetary easing seen over the course of 2019 is likely to come to an end, with most major central banks on hold over 2020," says Ric Deverell, chief economist at Macquarie.

It is not that there has been no impact of the slowing economic growth on the market. In September, both the Sensex and Nifty declined to seven-month lows in flows, on concerns surrounding the slowing growth and financial sector turmoil.

After Finance Minister Nirmala Sitharaman surprised the Street with reduction in the corporation tax rate to 22 per cent (excluding surcharges) from 30 per cent, indices soared close to 8 per cent in the following two sessions.

Arguably, if not for the tax cuts, they could have been 5-10 per cent lower than the current levels. The tax cut led to all-round buying in the market, amid realigning of stock prices with fresh earnings projections. Hopes of further reform measures have kept sentiment buoyant.

It seems that the pain in the broader markets has been masked by the indices touching new highs.

So far this year, the Nifty has hovered around record highs, but the Nifty Midcap 100 and Nifty Smallcap 100 have declined 41 per cent and 25 per cent from their peaks. Several stocks are much below their record levels.

Even in the benchmark indices, nearly half the stocks are back to their 2018 levels. Select bluechips such as Reliance Industries, Bajaj Finance, Asian Paints, and ICICI Bank have gained sharply this year.

On the other hand, YES Bank, Zee Entertainment, and Indiabulls Housing have seen a sharp fall.

Similarly, automobile stocks have corrected sharply amid the drop in sales. Market players say the divergence in market performance is on account of weak economic conditions. In an environment of healthy growth, mid-caps and small-caps tend to perform better than large-caps.

Most of the recent gains in stocks have been on account of valuation re-rating, amid weak earnings growth. This has resulted in valuations of several stocks soaring to record highs. Analysts say investors have already priced in the earnings growth for next year, which could mean muted returns in 2020.

Goldman Sachs, for instance, expects the Nifty to gain only 8 per cent next year. "The performance in 2019 has been pretty good against the backdrop of soft profit growth. So, we've borrowed from the potential performance in 2020," said Timothy Moe, chief Asia-Pacific regional equity strategist at Goldman Sachs.

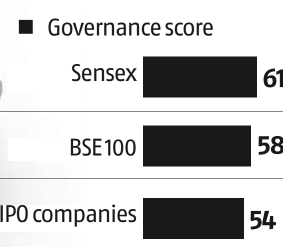
High valuations also mean little room for disappointment. If earnings or GDP growth fails to pick up as estimated, markets could be vulnerable to sharp corrections, say analysts.

New IPOs fail the corporate governance test

Poor track record has been a drag on returns for companies

SACHIN P MAMPATTA
Mumbai, 11 December

CODE OF CONDUCT



Source: Institutional Investor Advisory Services India (IiAS)

Companies that have recently come out with their initial public offerings (IPOs) have worse corporate governance scores than those in key benchmark indices, shows an annual examination of governance standards across companies.

Recently listed companies scored 54, compared to 58 for the BSE100 firms and 61 for entities in the Sensex pack, showed the *Indian Corporate Governance Scorecard* report by governance firm Institutional Investor Advisory Services India (IiAS).

The framework was developed in association with the BSE and the International Finance Corporation (IFC). The initiative had financial support from the government of Japan. The study re-evaluated 50 companies that went for listing between April 2015 and March 2017.

"Institutionalisation of governance practices has led to greater stability of scores for the larger listed companies. IPO companies have not been able to hold ground. The median score for IPO firms declined to 54 from 55 last year, with the lowest company scoring a mere 29. Nonetheless, the study shows that the markets have rewarded the more stable and better-governed companies," it said.

The report noted that issues remain in IPO companies in which there seems to be a need to institutionalise governance practices.

"In IPO companies, severe issues were reported by auditors in some of the companies. As a result, the number of entities in which auditors have raised concerns on the financial statements has increased to 32 per cent from 24 per cent in 2018," it said.

It has reduced for the BSE100 companies, from 35 per cent previously to 25 per cent this year.

The score is developed on the basis of factors including treatment of shareholders, disclosures and transparency. The role of the board and stakeholders is also considered. Interestingly, public sector companies have the lowest scores among different promoter groups in the BSE100 pack.

Such companies scored 52, compared to 60 for private promoter-led companies. Widely held firms fared better with a score of 62.

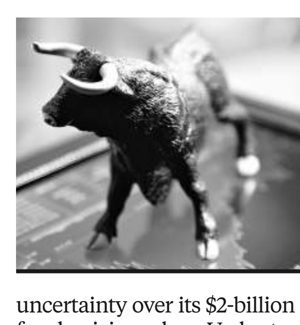
Multinational companies had the highest score at 63. Lack of adequate independent board representation, and lack of transparency on issues, including related party transactions, are among reasons expected to have weighed on the governance score of public sector companies.

There are tangible returns for firms that have better governance practices, noted the report. It stated that those with a governance score of 60 or above, which fall under the well-governed category, have outperformed the rest over periods of two and three years.

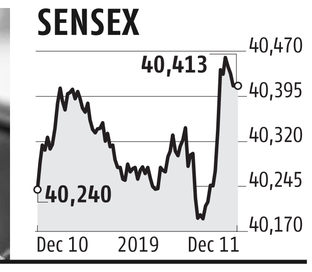
"This analysis is not a back-testing of current scores, but an assessment of companies scored in our earlier studies. Therefore, the assessment has predictive value. Essentially, well-governed companies will deliver better market returns going forward," the report added.

Indices back to winning ways as banking, IT stocks shine

PRESS TRUST OF INDIA
Mumbai, 11 December



SENSEX



The benchmark indices resumed their upward march on Wednesday, propelled by buying in bank, IT and auto stocks during the fag end, amid lacklustre global cues.

Overcoming a bout of volatility in late trade, the Sensex finished 172.69 points or 0.43 per cent higher at 40,412.57. Similarly, the broader Nifty climbed 53.35 points or 0.45 per cent to close at 11,910.15.

NTPC was the top gainer in the Sensex pack, spurting 2.77 per cent, followed by ONGC, Tech Mahindra, Kotak Bank, TCS, Asian Paints, IndusInd Bank and Tata Motors, which gained up to 2.28 per cent.

On the other hand, YES Bank topped the laggards' list for the second straight day, plunging 15.33 per cent amid uncertainty over its $2-billion fund raising plan. Vedanta, Hero MotoCorp, L&T, Bharti Airtel and HUL also tumbled up to 1.63 per cent.

"After a subdued trade during most part of the day, market witnessed a sharp turnaround due to short covering in index heavyweights. Upcoming macro indicators like CPI inflation and IIP data are unlikely to paint a rosy picture which may reduce upside potential in the near term. On the global front, FOMC meeting, UK election and US tariff deadline remain key events," said Vinod Nair, Head (Research) at Geojit Financial Services.

Sectorally, the BSE Utilities was the biggest gainer with 1.52 per cent jump, followed by oil & gas (1.13 per cent), power (1.12 per cent), IT (0.97 per cent), realty (0.90 per cent) and finance (0.58 per cent).

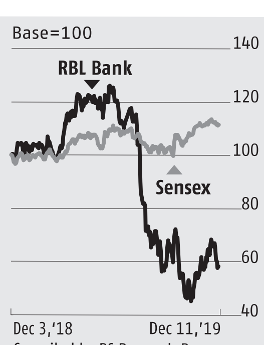
In Asia, Tokyo and Bangkok ended lower, while Hong Kong rose 0.79 per cent and Shanghai added 0.2 per cent. Seoul and Singapore also finished in the green.

THE COMPASS

RBL Bank: Asset quality woes overshadow recent fund-raise

Analysts unsure of provisioning that bank may need to take up

HAMSINI KARTHIK



Compiled by BS Research Bureau

When money comes in at the right time for a bank and in proper measure, it's a huge relief for investors. What's more, if it comes when asset quality clean-up is underway, it sends out a message that investors haven't lost faith in the franchise. However, considering RBL Bank's share price movement — down about 10 per cent in a week — these positives aren't really showing up.

This is despite the bank's common equity tier-1 (CET-1) ratio increasing from 11.3 per cent to 15.3 per cent, after last week's fund raising of ₹2,025 crore.

The reasons are asset quality-related concerns, and the Street not being sure of the extent of provisioning that awaits the bank, its impact on return profile, and more importantly, when the trouble is likely bottom out.

To be fair, RBL Bank, in its September quarter (Q2) results, spelt out its exposure to real estate companies, non-banking financial companies, and certain other business groups, the watch list for which totalled ₹1,800 crore. However, what didn't go down well with the Street was the gross non-performing asset (NPA) ratio touching 2.6 per cent, which breached the full-year NPA guidance earlier provided by the bank at 2.5 per cent.

In this context, analysts at Morgan Stanley have increased their slippage and credit cost estimates for FY20 and FY21 building in ₹2,500 crore of incremental slippages (loans turning bad), compared to the bank's guided watch list.

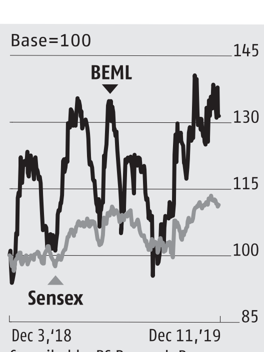
Further, while no new pressure has emerged in the last month, analysts still remain sceptic on the bank's asset quality. Those at Emkay Global Financial Services say that given the rising systemic corporate stress, the bank's corporate stress pool will remain dynamic. They anticipate the bank's return on assets to touch a low of 0.9 per cent in FY20, weakest since listing.

Considering these unsettling issues around asset quality, analysts expect the RBL Bank stock to remain under pressure and advise investors to stay on the sidelines. For now, the good part is that most analysts tracking the stock haven't changed their stance significantly in the last six months. However, a weak December quarter may nudge them to reconsider their stand.

BEML a good play on metro rail, defence orders

With ₹2,560 crore worth orders to be executed, H2 likely to bring more cheer

UJJVAL JAUHARI



Compiled by BS Research Bureau

Public sector major BEML remains in the news on account of the government's decision on strategic disinvestment of its stake in the company, which could mean some value unlocking for investors.

Analysts say that while the divestment theme could be played out, the company's business prospects themselves make BEML a good investment.

This is despite the company — which makes heavy equipment for transportation, mining, construction and other sectors — having seen its stock rebound by about 50 per cent since its August lows of ₹644.

BEML's growing order book stands at close to ₹9,600 crore, and provides revenue visibility for at least three years. The order inflow traction from the metro coach segment remains strong and analysts expect significant increase in the value of new contracts by FY20-end.

While the defence segment too will drive BEML's prospects, mining and construction equipment hold promise as well. In defence, the company is executing a large order of ₹1,400 crore for armoured recovery vehicles (ARVs) and Sarvatra Bridge Systems (₹500 crore), and is expected to garner new deals worth ₹1,000-1,200 crore, say analysts.

In mining and construction equipment, fresh allocation of mines and also pressure on Coal India to improve production can lead to a surge in the segment's order flow.

After a muted first half, the firm's second half performance is expected to be strong given that it has about ₹2,560 crore worth of orders to be executed in this period.

Investors should note, however, that the company's quarterly performance can be lumpy as seen historically, while execution picks up during the second half; a significant portion of its profit is reported in the last two quarters of the year.

Therefore, as compared to a 6.7 per cent revenue growth in H1FY20, analysts estimate FY20 revenue growth at more than 17 per cent, with operating profit growing more than 47 per cent despite an operational loss during the first half.

Meanwhile, revenue from in-house developed products is improving and will boost profitability (up 1,200 bps year-on-year to 68 per cent in FY19), while the working capital cycle improving with better quality of receivables.

Himanshu Kapadia of Elara Capital expects earnings to grow 44 per cent a year over FY19-22 with improved return ratios. He says the stock (trading at ₹983) commands an attractive valuations of close to 22x its FY21 estimated earnings.