Business Standard

The Smart Investor

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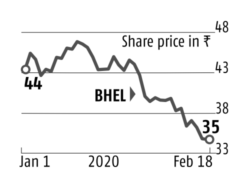
QUICK TAKE: INVESTORS SHUN BHEL



BHEL has lost a fourth of its value in the past one month. Weak order inflows, execution issues, margin erosion, and negative operating cash flow are key issues plaguing the state-owned power equipment maker. Analysts say the stock could slide even further

"Customer insight is more than walking in the customer's shoes. First, you have to take off your own"

MOTILAL OSWAL, MD and CEO, Motilal Oswal Group

Trailing payouts catch Sebi attention

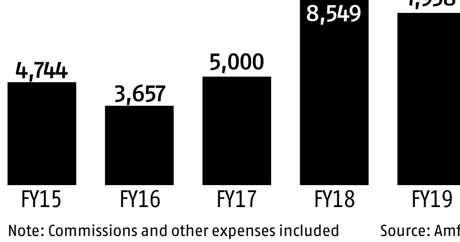
Regulator examining divergence between first-year and subsequent years' commission rates

JASH KRIPLANI
Mumbai, 18 February

SHRINKING PIE

After the scrapping of upfront commission, overall payouts have taken a hit

Gross amount paid to MF distributors (₹ cr)



Note: Commissions and other expenses included Source: Amfi

The Securities and Exchange Board of India (Sebi) could take a re-look at the trail commission structure of mutual funds (MFs).

This is part of its examining instances of divergence between first-year and subsequent commission payouts in some MF schemes, according to people aware of the matter.

Sources suggested the divergence in first and subsequent trail payouts had been 45-50 basis points.

According to industry participants, divergences in such schemes happened after fund houses were debarred from offering upfront commission, and some of them are using the grey area to incentivise distributors through higher trail in the first year. "In the absence of upfront commission, some fund houses have adjusted their first-year trail," said a senior executive of a fund house.

Experts say such a move could dent the purpose of debarring upfront commissions.

"Upfront commission was scrapped with the aim of curbing a portfolio churn. Large distributors in particular nudged their clients to shift schemes to gain from upfront commission," said a fund manager.

Upfront commissions were offered as one-time payment to distributors for selling an MF product. "While the trail model is still better than upfront — which was a clear incentive to churn investor portfolios — there is a need to iron out any further grey areas in commission payouts," said a member of Sebi's 19-member Mutual Fund Advisory Committee.

On the differences in trail commissions, Madhabi Puri Buch, whole-time member of Sebi, said: "This has recently come to our notice as to how trail commission is being structured. We will look into it."

She was speaking on the sidelines of Sebi's board meeting on Monday.

The MF industry has seen a slew of changes in the past couple of years to protect investors' interests and reduce the cost of investing.

The regulator has pulled up fund houses for "unfairly" slapping higher fees upon investors coming through direct plans, where there are no intermediaries and hence there is no need to charge them for commission payouts. To ensure there is no scope for one set of investors bearing the cost for those coming through a different investment mode, the regulator also made it mandatory that fund houses book scheme-related expenses in the same schemes.

In 2018-19, MFs' payouts to distributors through commissions and other distribution-related expenses dropped 7 per cent to ₹7,938 crore, following the scrapping of upfront commission by the regulator.

Private banks that offer distribution services saw a sharp reduction in distribution income because their business models were largely oriented towards upfront commission. Such banks saw 7-20 per cent dip in their commission.

Apart from scrapping upfront commission, Sebi has capped maximum commission payouts to bring down the overall cost of investing.

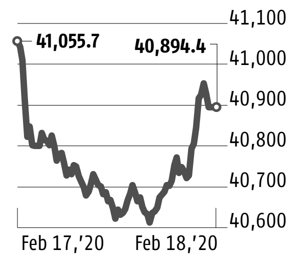
The expense ratios — charges borne by investors — have also been linked to scheme size to pass on benefits of scale to the end investor.

Indices fall for 4th day on global cues

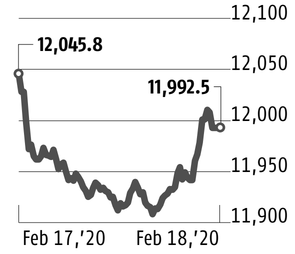
SUNDAR SETHURAMAN
Mumbai, 18 February

FALLING SENTIMENT

Sensex



Nifty 50



The benchmark indices posted their fourth straight session of losses amid weakness in global markets, as investors fretted over the economic impact of coronavirus. Concerns were exacerbated after Apple warned that the outbreak was a threat to global businesses.

Coronavirus has now resulted in the death of 1,800 people, while the total number of confirmed cases has jumped to 72,436. It has crippled economic activity in China.

The Sensex fell as much as 445 points before closing at 40,895 — a decline of 161 points or 0.4 per cent. The Nifty dropped 53 points or 0.4 per cent, to close at 11,993.

Buying was witnessed in the last hour of the trade, with technology companies and select public sector undertakings (PSUs) gaining due to ETF-related buying.

In the past four sessions, the Sensex has declined 672 points, or 1.6 per cent. The index on Tuesday closed at its lowest level in two weeks.

The market trend has been weak because of tepid corporate earnings.

Quarterly profits of more than half of Nifty firms missed estimates in the latest reporting season, *Bloomberg* data showed.

"The global economy will slow down as the virus brings the second-largest economy to a standstill. The economic consequence of the SARS epidemic of 2003, which continued for close to 8 months, impacted the Chinese GDP by 1 per cent. China used to account for about 4.3 per cent of the world economy compared to 16.3 per cent in 2019," said Geojit in a note.

Market players said the markets may remain range-bound with a negative bias due to lack of triggers domestically and rising global uncertainties.

"The indices will track global markets and witness huge volatility tracking the developments around coronavirus and its impact," said Siddhartha Khemka, head (retail research), Motilal Oswal Financial Services.

Among Sensex components, Bharti Airtel dropped the most at 3.05 per cent. IndusInd Bank and Maruti were the other worst-performing stocks, declining 2.4 and 1.9 per cent, respectively. Barring 10, all Sensex stocks fell. Vodafone Idea fell 11 per cent on Tuesday after the ratings downgrade, due to a worsening risk profile.

Nifty: YES Bank to make way for Shree Cement

SAMIE MODAK
Mumbai, 18 February

TAKING STOCK

ENTRIES

NIFTY: Shree Cement

NIFTY NEXT 50: Adani Transmission, IDBI Bank, Info Edge, L&T Infotech, Torrent Pharma

EXITS

NIFTY: YES Bank

NIFTY NEXT 50: Ashok Leyland, Indiabulls Housing, L&T Finance, Shree Cement, Vodafone Idea

Note: Changes to be effective from March 27 Source: NSE Indices

Shree Cement will replace YES Bank in the benchmark Nifty, the NSE has said in a release. The changes will be effective from March 27.

Shree Cement will join UltraTech Cement in the bluechip company index. The Kolkata-based firm has pipped Dabur and Godrej Consumer Products, who were among the front-runners for index inclusion.

Among the three, Shree Cement has the highest free-float market capitalisation, thanks to a ₹3,000-crore fund raise in November. The bourse has also announced five changes to the Nifty Next 50, with Vodafone Idea and Indiabulls Housing Finance moving out, and Torrent Pharmaceuticals and Adani Transmission getting added.

It has also announced major changes to other indices such as the Nifty500, Nifty100 and Nifty MidCap 150 indices.

It has tweaked the inclusion criteria for theme-based indices. Earlier, firms from top 800 in terms of market value were eligible. Under the new criteria, the bourse will select firms from the Nifty500 that comprise the top 500 firms.

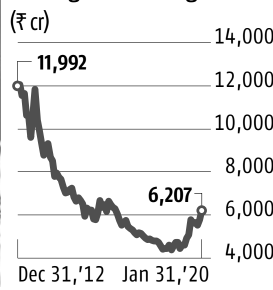
AUM for Gold ETFs up 30% in a year

SAMIE MODAK & DILIP JHA
Mumbai, 18 February

REGAINING SHEEN

Gold ETFs are finding favour among investors again

(₹ cr)



Domestic investors are rekindling their interest in gold exchange-traded funds (ETFs), amid a sharp rally in prices of the yellow metal.

In January, gold ETFs offered by mutual funds (MFs) saw net inflows of ₹202 crore, the most since December 2012. In the previous 12 months, the average flows into these investment vehicle was a paltry ₹16 crore, shows data provided by Value Research.

Further, the assets under management (AUM) of gold ETFs has soared to ₹6,207 crore, the most since September 2016. In the past one year, assets have soared by over 30 per cent. This surge has been underpinned by an over 20 per cent plus in gold prices.Experts say many investors are opting for gold ETFs going by past returns.

"Investors always look at past returns for taking their position in gold or any other asset class. Gold has yielded 22 per cent and 33 per cent returns in the last one year and two years, respectively," said Kishore Narne, associate director at Motilal Oswal Financial Services.

Hopes of further gains in the price of the previous metal could sustain inflows into gold ETFs. "With the dwindling global economy awaiting monetary easing, gold prices may rise at least 10 per cent from their current level over a six-month period. In a falling interest rate regime, investors find safe havens better than risky assets," says Narne.

Industry players say some investors are taking money of equity and debt products and reinvesting them into gold.

"The coronavirus outbreak has triggered some rotation into safe-haven assets. As the virus uncertainty remains high, investors' demand for gold remains unabatedly strong, with ETF holdings reaching fresh all-time highs of 83.4 million ounces," said Jitendra Gohil, head (India equity research), Credit Suisse Wealth Management.

Tarun Birani, CEO of TBNG Capital Advisors, said volatility in both the debt and equity markets coupled, with the rise in gold prices, has helped in AUM growth.

Interestingly, the traction in the ETF market has risen despite demand for physical gold remaining soft.

"Physical demand appears weak, considering a 48 per cent year-on-year decline in imports in January 2020," adds Gohil.

Credit Suisse expects investors' appetite for gold to stay intact "given the ongoing uncertainty and accommodative major central banks".

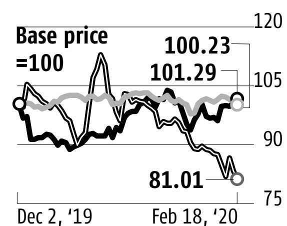
It has 12-month forecasts of $1,600 per ounce. Prices are hovering around $1,587 per ounce.

The current AUM for gold ETFs is half the peak AUM of ₹12,000 crore hit in 2013. Between 2013 and 2018, gold ETFs had lost nearly two-thirds of their asset.

Keep aviation stocks grounded: Analysts

NIKITA VASHISHT
New Delhi, 18 February

TURBULENT RIDE



The contagion effect of the coronavirus (Covid-19) could soon bite the Indian aviation sector, which is already dealing with modest air traffic growth due to the economic slowdown.

While the sector has seen limited impact so far, failure to contain the spread till April could dent sentiment, experts have warned.

Kapil Kaul, chief executive officer of CAPA's South Asia unit, says the demand to East Asia and Southeast Asia could be affected, and outbound travel from April will have to be watched, depending on the severity in the next few weeks.

So far, Indian carriers have either cancelled or temporarily suspended flights to China/Hong Kong. Air India and IndiGo have terminated flights to China, while SpiceJet is running a few routes to Hong Kong.

"There are two scenarios in which the sector could be affected. First, a massive outbreak of the virus in the West could hamper freight movement. Second, the spread of the virus in Indonesia, Thailand, Vietnam, and Singapore — especially till March or April — which are peak tourist seasons could affect the outlook," said Jagannarayan Padmanabhan, director (transport and logistics), CRISIL Infrastructure Advisory.

According to CRISIL estimates, there were 6 million passengers that travelled to East Asia in 2019.

Further, market leader InterGlobe Aviation-run IndiGo has 9 per cent of its entire international capacity allocated towards East Asia, of which China accounts for about 3 per cent.

Air India operates the maximum number of flights to the region.

Given these developments, analysts remain cautious on both SpiceJet and IndiGo, on account of weak fundamentals, and have advised investors to avoid the stock. The coronavirus outbreak, they say, adds to the concerns.

"Each flight cancelled could cause an Indian carrier to miss out on gross revenue of approximately ₹55-72 lakh per flight, according to CARE Rating's estimates, which would eventually impact the profitability of these players that are already reeling under intense pressure. Both IndiGo and SpiceJet will remain highly volatile, until the epidemic stabilises. It is best for investors to avoid both these stocks for now," says Nirali Shah, a senior research analyst, at Samco Securities.

Fundamentally, she says, Airbus has shut down its final assembly line producing A320 planes in Tianjin due to Coronavirus, which will slow down aircraft delivery to IndiGo. SpiceJet, too, recently inducted two A320 aircraft to its fleet.

At the stock exchanges, both SpiceJet and IndiGo have underperformed the benchmark Sensex in the past three months.

While SpiceJet and IndiGo have declined 19 per cent and 0.6 per cent, respectively, the Sensex has added 2 per cent during the period.

Gagan Dixit, an analyst tracking the sector at Elara Capital, further says that while IndiGo has been unable to resolve its A320neo-based engine issues, growth prospects for SpiceJet remain dependent on the return of Boeing 737 Max, which could negatively affect their expansion plans.

THE COMPASS

Consolidation a blockbuster move for RIL shareholders

In addition to synergy gains, strategic partner could add to digital offerings

RAM PRASAD SAHU

GOOD SHOW

Price in ₹

	Feb 18, 2020	1-day % Chng
Hathway Cable & Datacom	23.10	20.00
TV18 Broadcast	28.85	14.71
DEN Networks	59.50	9.98
Network18 Media Investment	30.05	4.89

Source: Exchange Compiled by *BS* Research Bureau

The merger of the media and distribution arms of Reliance Industries under the Network18 umbrella is a positive for shareholders of all four entities.

Analysts believe that despite a common ownership, it was difficult to value the separately listed entities. With consolidation of cable distributors DEN Networks and Hathway Cable and Datacom, broadcaster TV18 under the holding company Network18 Media and Investments, the 'sum of parts' valuation is expected to be higher. The merged entity will rank among the top three Indian media companies.

The head of research at a domestic brokerage believes the move will improve decision-making and avoid overlaps across business functions. This should help generate synergies and improve operating efficiency of the combined entity, he added.

In addition to fine-tuning content deals within the group, the merger could lead to rationalisation of the 27,000 local cable operators with a base of 15 million households and 1 million broadband subscribers.

Edelweiss Research says there would be better cash flow management with funding requirement of the cable business met by the free cash flow of the entertainment segment. The cash will come handy as the group plans to expand and strengthen its reach in the northern and western regions of the domestic cable market.

While a single entity should help, there are multiple challenges ahead. Implementation of the new tariff order from March 1 could lead to lower subscription revenues.

Further, heavy competition in the digital space is expected to result in higher costs. Monetisation could be an issue, given the lack of traction for a majority of new content.

Higher competition from Netflix, Amazon, Disney Star, and HBO Max, and the proliferation of niche and regional content will add to pressure. In this context, bringing in a strategic partner could help both on the content front as well as improve its market share across mediums. Given the swap ratio and discount at which they were trading, shareholders of TV18 and Hathway, which ended 15-20 per cent up, gained the most.

Asset quality remains Achilles' heel for IndusInd Bank

Stock price needle hasn't moved despite lender's clarification on telecom exposure

HAMSINI KARTHIK

ON THE BOURSE

BSE price in ₹

	Feb 18, 2020	YTD Chng (%)
IndusInd Bank	1,144.15	-24.26
HDFC Bank	1,213.55	-4.58
Axis Bank	733.40	-2.73
Kotak Mahindra Bank	1,691.05	0.39
ICICI Bank	541.30	0.47

Source: Exchange Compiled by BS Research Bureau

IndusInd Bank's stock hit a three-year low on Tuesday, when it tanked over 2 per cent to end the day at ₹1,140.

Even if over 70 per cent of analysts polled by *Bloomberg* are positive (with an average target price of ₹1,676), the Street's actions don't echo this stance. IndusInd has seen the biggest fall of over 24 per cent in calendar year 2020 so far among top private banks.

Marred by concerns, especially uncertainties over its telecom exposure, the compulsion to remain positive seems to be drying up fast. This probably explains why it didn't move the needle much, despite the bank clarifying its telecom exposure.

Also, while the telecom sector's exposure is restricted to 1.2 per cent of its total book, and fund-based exposure to Vodafone Idea is ₹995 crore (non-fund based ₹2,409 crore), the worry is whether IndusInd can afford another round of asset quality pressure.

With the Infrastructure Leasing & Financial Services (IL&FS) fiasco and housing finance companies-related bad loan pressure hitting the bank, its gross non-performing assets (GNPA) ratio touched a multi-quarter high of 2.2 per cent in the December quarter (Q3).

According to estimates of Suresh Ganapathy of Macquarie Capital, the total exposure to the three main stress sectors — real estate (including lease rentals), telecom, and possibly gems and jewellery — stands at close to 13 per cent of the loan book.

"In addition, there are worries cropping up over microfinance (10 per cent of the loan book) and commercial vehicles (16 per cent) book," adds Ganapathy.

Even if one were to regard the stress in commercial vehicle loans as cyclical, how other sectors play out will be closely monitored.

The larger worry is also a likely deferral in its asset quality improvement.

The management, in its Q3 results meet, hinted at normalisation of asset quality in 2020-21 (FY21). However, Morgan Stanley estimates GNPA as a ratio of total loans to touch 3.7 per cent in 2021-22 (FY22), from Q3's 2.2 per cent.

The brokerage had earlier estimated FY22 GNPA ratio at 2.4 per cent.

"We had built in elevated provisions, but see increased risk in some sectors. This drives an increase in our provisioning estimates from 145-155 basis points (bps) earlier for FY22 to 165-250 bps now, and cuts in earnings estimates of 29 per cent for FY21 and 11 per cent for FY22," the brokerage adds.

The Street is also apprehensive about the bank's silence in revealing the successor to Romesh Sobti, who is expected to step down as its managing director and chief executive officer on March 23.

With uncertainties looming large, investors need more comfort than just valuations at 2x its FY21 estimated book.