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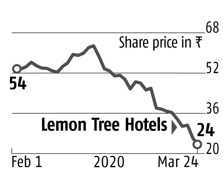
The Smart Investor

QUICK TAKE: LEMON TREE IN A TIGHT SPOT



Shares of Lemon Tree Hotels have crashed 62% in the past one month on concerns over the hotel chain operator debt position. Analysts say the company will face challenges in raising fresh funds or meeting existing obligations if the business disruption continues

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India VIX breaches 2008 peaks

JASH KRIPLANI
Mumbai, 24 March

India VIX, which is also called the fear index, touched 86.63 on Tuesday, higher than its historic closing peak of 85.13 it reached during the 2008 global financial crisis.

According to brokerages, unless volatility reduces, the markets are unlikely to see the current sell-off bottoming out. "We think volatility needs to stabilise before the broader markets can heal. There is a precedent for this. In 2008, 2011, 2015 and 2018, equity volatility peaked well ahead of the ultimate low," Morgan Stanley said in a note.

Market participants say such high levels of implied volatility indicate the markets are firmly in a bear grip.

"Current implied volatility is not far from the record levels seen in 2008 financial crisis. On Tuesday, volatility levels continued to rise even as the markets saw some recovery from lower levels, indicating a bear grip over the markets. Unless implied volatility cools, 500- to 600-point swings in the index cannot be ruled out," said Chandan Taparia, head of derivatives and technical research, Motilal Oswal Financial Services.

On Tuesday, India VIX spiked by 20 per cent before closing 13.8 per cent higher at 81.9. The all-time high for India VIX in intra-day trading is 92.53, which was touched in November 2008. "If implied volatility moves to the 100 zone, it would theoretically mean the index can double or become zero," said an analyst.

However, the peaking of volatility can also drive the markets towards their bottom. "After a shock, the markets first become comfortable with the level of uncertainty (volatility), then with the level of price. We think that risk/reward for the markets is improving. This remains a key unticked box on our checklist," the note added.

Source: Exchange
Compiled by BS Research Bureau

The spike in volatility, combined with sharp daily swings, has forced futures and options traders to avoid risky strategies and look at hedging their bets.

"We are advising participants to stay calm and light at this historic, decade-high volatility. For options traders, we are suggesting a bear-put strategy to be with downtrends. Simply buying options is not advisable because option premiums are much higher and can quickly melt down with market swings in an unfavourable scenario," Taparia said.

According to analysts, writing or selling options is also a high-risk strategy that can trap traders in current conditions.

HIGHS AND LOWS

616%
Year-to-date jump in volatility index

15.7
Average India VIX for five years

92.53
All-time high on VIX on intra-day basis

Market participants say the volatility seen in recent days amid the coronavirus scare has been abnormal. Year-to-date, the Nifty is down 35 per cent, while the Sensex is down 37 per cent. In the same period, India VIX has seen a jump of over 600 per cent. Over the last five years, India VIX has been traded at average levels of 15.

However, there is a case for volatility to see some moderation.

"We see case for volatility to moderate, and position for a peak in implied volatility at these levels. First, markets now imply levels of volatility that have rarely, if ever, been realised over a 1- or three-month horizon, even in the global financial crisis," the Morgan Stanley note said.

Markets witness mild recovery

SAMIE MODAK
Mumbai, 24 March

The Indian markets on Tuesday rose 2.5 per cent, underperforming global peers, most of which rose over 5 per cent after the US Federal Reserve announced an open-ended bond-buying programme to fight the COVID-19 pandemic.

In intra-day trade, the Sensex had jumped nearly 6 per cent, mirroring gains in the Asian and European markets. It, however, gave up half the gains in the last hour of trade as the relief measures announced by FM Nirmala Sitharaman left investors disappointed.

Experts said investors were pinning hopes on a big-bang stimulus package from the FM, who addressed the media at 2 pm.

"The market came off highs as no significant announcements were made by the finance minister and the fact that the economic package was still in development," said Vinod Nair, head of research at Geojit Financial Services.

The Sensex after climbing to 27,463 settled at 26,674, up 693 points, or 2.7 per cent. The Nifty rose 2.5 per cent, or 191 points, to end at 7,801.

Meanwhile, some Asian and European markets rose as much as 7 per cent, boosted by the Fed's move and also as the number of new coronavirus cases in Italy slowed for a second day.

Many investors expressed disappointment as the Indian markets underperformed its global peers, both on the way down on Monday and also on the way up on Tuesday. "The Indian markets gained the least among the Asian and European markets continuing its underperformance," said Deepak Jasani, head retail research, HDFC Securities.

Vikas Khemani, founder, Carnelian Capital Advisors, said: "The government should work with supersonic speed and announce a stimulus plan. Businesses will have no money to fund their fixed costs in the absence of revenues. There will be serious liquidity constraints in the economy. Its second and third order impact can be scary and can push economy into depression."

Rebuilding confidence, asset quality: Kathpalia's task at IndusInd Bank

HAMSINI KARTHIK & ABHIJIT LELE
Mumbai, 24 March

VOLATILE DAY OF TRADE
Figures price in ₹

336.6 (Mar 23) — 312.4 (Mar 24); Change -7.2; 2020; axis 200–400

Compiled by BS Research Bureau
Source: Exchange

SCORECARD
Asset quality and capital burn

(%)	Slippages	CAR
Q3 FY18	1.6	15.3
Q4 FY18	3.0	14.6
Q1 FY19	1.6	14.3
Q2 FY19	1.4	13.9
Q3 FY19	2.5	13.8
Q4 FY19	10.2	13.7
Q1 FY20	1.9	14.5
Q2 FY20	2.7	14.3
Q3 FY20	4.5	13.5

CAR: Capital adequacy ratio
Source: Brokerage reports

The transition from a cabin to corner office for Sumant Kathpalia, the newly appointed managing director & chief executive officer of IndusInd Bank, comes at a time when few things are working in favour of the lender, especially asset quality and its share price, which hit the lower circuit thrice during the Tuesday's opening trade. Though there was some recovery, the stock closed with a loss of over 7 per cent.

Kathpalia may have hoped for a better welcome by the bourses on his first day as IndusInd Bank's new boss. However, Tuesday's stock reaction was also an indicator of the challenges ahead of him — probably the toughest faced by the bank in the past decade.

SUMANT KATHPALIA MAY HAVE HOPED TO BE WELCOMED BETTER BY THE BOURSES ON HIS FIRST DAY AS INDUSIND BANK'S NEW BOSS. BUT, TUESDAY'S STOCK REACTION WAS ALSO AN INDICATOR OF THE CHALLENGES AHEAD OF HIM

At ₹312.35 apiece, IndusInd Bank (IndusInd) trades at an eight-year low and at these levels, it also indicates that investors' risk-aversion may be the highest for the stock. From that standpoint, Kathpalia has two critical and urgent tasks cut out — revive investors' confidence and stabilise asset quality.

Outgoing MD & CEO Romesh Sobti, who was at the helm for over 12 years, had tried to assuage these concerns. "But with each passing day and lockouts gripping the country, one isn't sure how much to accept these words from the management as positive guidance," said an analyst from a domestic brokerage. Even last week, Sobti reassured investors that the bank's net non-performing assets (NPA) ratio would fall to less 1 per cent from 1.05 per cent seen in the December quarter (Q3).

In the current circumstances, analysts say, the bank needs to post good numbers both on growth and asset quality, for at least three consecutive quarters under Kathpalia's leadership

However, in the current circumstances, analysts say, for at least three consecutive quarters under Kathpalia's leadership, the bank needs to post good numbers both on growth and asset quality. This becomes imperative if his aim to repair the bank's image. "Restoring confidence is critical and the new management will have to rebuild trust with investors," says Kajal Gandhi of ICICI Securities.

The Street had turned cautious on IndusInd when for two successive quarters, its gross NPA ratio stayed unabated in the 2.18-2.19 per cent range. "Unless we see good numbers, it's tough to think that net NPA ratio could fall to less than 1 per cent," said another analyst.

What compounds the problem is the sustainability of loan growth. At 20 per cent growth, Q3 was a forgettable quarter for the bank. "He (Kathpalia) is moving into the driver's seat when the economic slowdown will entrench further," says a senior executive of another private bank. "It will bite every sector of the economy and put severe pressure on income and asset quality."

The silver lining is that Kathpalia isn't an outsider to the bank and hence, the ritual that most incumbent CEOs do — clean up the books, churn top-level management — may not be the case with him. "So the probability of kitchen sink cleaning appears low," says Gandhi. Therefore, she says what has already been identified as stress could only come under the hammer and no fresh worms could come out.

While IndusInd's exposure to three stressed accounts (Zee, Anil Ambani Group, and DHFL) declined to 0.47 per cent in Q3 from 1.1 per cent Q2, JPMorgan observes that the bank's telecom and real estate sector exposure (9.2 per cent of loan book) remains a concern and potentially an overhang. New stress may also emerge from the microfinance and SME book, amid the events taking shape in the economy.

The other favourable aspect is his leadership in the consumer banking business (over half of the bank's retail loans). Under Sobti, the bank has realigned its book to equally account for retail and wholesale loans. Kathpalia's task is to take this "retailisation" story forward, which given his background appears a reasonable ask.

A similar rebalancing in liabilities, especially deposits, also works to the bank's advantage. Unlike peers, IndusInd has been able to retain a sizeable chunk of low-cost current account-savings account (CASA) deposits in the last two years and at 42.4 per cent in the December quarter, it is placed in a sweet spot to tackle a moderate increase in the cost of funds. "Increasing share of retail deposits is also going to test Kathpalia's leadership," says a banker. Whether IndusInd has strived to retain its retail depositors' confidence amid the YES Bank fiasco will soon be known.

With 5.73 per cent blended cost of capital and net interest margin at an all-time high of 4.15 per cent in Q3, thanks to its high-yielding retail (including microfinance) book, Kathpalia may find a helping hand in these tough times. The new boss' ability to deliver on these fronts will be the critical piece to regain the Street's confidence.

Brokers face hurdles as states in lockdown

People working in the broking industry complained about difficulties in reaching offices because of the curfews imposed by various state governments. This prompted industry body Association of National Exchanges of Members of India (Anmi) to write the authorities. "Anmi requests government, Finance Ministry and Sebi for closure of share markets unless all state governments declare share broking and depository services as essential services exempted from lockdown and curfew," said Vijay Bhushan, president, Anmi. Industry players say while Mumbai, Gujarat, Rajasthan have declared capital markets as essential services on the ground they were facing difficulties convincing the authorities. Naresh Pachisia, MD, SKP Securities on Tuesday tweeted that "Mumbai Police is simply not letting colleagues commute to office." BS REPORTER

Centre, Sebi may remove tax on buybacks, LTCG to lift sentiment

SHRIMI CHOUDHARY
New Delhi, 24 March

In a bid to lift sentiment, the Centre and capital markets regulator Sebi are weighing the possibility of reducing the tax burden on investors. They are considering temporary removal of tax on share buybacks and on long-term capital gains (LTCG).

These measures could be part of an ongoing exercise to provide relief and exemptions to India Inc and investors, amid the turmoil caused by the stock market meltdown, due to a halt in economic activity.

People in the know said these measures are under serious consideration and could be announced after further deliberations between various stakeholders.

Investors have already swamped the government and Sebi with such demands as stocks of several companies have taken a beating.

Market participants believe the removal of buyback tax will prompt more firms to announce buybacks, which could help provide a floor to share prices.

In addition, the removal of LTCG tax will be a good sentiment booster given shares of most firms have dropped below the January 31, 2018 grandfathering date.

At present, investors have to pay 10 per cent LTCG on gains from equities over and above ₹1 lakh in a financial year.

The people said the government has asked the regulator to examine the changes in the tax structure and prepare a feasibility report.

The government is also looking at the revenue it may have to forgo if the buyback tax is removed.

Finance Minister Nirmala Sitharaman on Tuesday said Sebi and the finance ministry were monitoring the markets thrice a day.

In July 2019, there was a tax levied on buybacks by listed companies, in the Union Budget, meant to bridge the arbitrage between buybacks and dividend payouts.

Market participants believe the removal of buyback tax will prompt more firms to announce buybacks, which could help provide a floor to share prices

"Any change in the structure of buyback tax would allow cash-rich corporates to buy more shares from investors and would certainly help them create value for remaining shareholders," said a market expert.

Sun Pharmaceutical, Dalmia Bharat, Motilal Oswal Financial Services, and Ramkrishna Forgings are some firms to have announced share buybacks in recent weeks. Earlier, Thomas Cook India and Granules India had announced buyback schemes.

Besides, many promoters have bought shares from the open market to restore investor confidence and to raise their holdings at a time when share prices have fallen to multi-year lows.

Meanwhile, the regulator is said to have directed market intermediaries, including mutual funds, to go completely digital in dealing with Know Your Customer, subscription trading, and redemptions. At present, 30 per cent of the work requires physical documentation, especially in KYC and redemption procedures.

The regulator has taken a slew of measures to control volatility in markets. Last week, it had tightened norms for short-selling and had said that short positions in the derivatives market could not exceed the value of the holdings of the underlying stocks, or the collateral provided by them.

Further, it had imposed an additional position limit of ₹500 crore for the futures and options (F&O) segment.

THE COMPASS

Impact on infra capex may be worse than '08

As lockdowns affect projects, government spending on relief measures may limit future infra spends

UJJVAL JAUHARI

The COVID-19-led slowdown is likely to hurt the prospects of infrastructure players severely. Companies, which were already feeling the heat on project execution and project closures, may face more uncertainties related to project completion, new project financing, and future order flows.

The recent channel checks by HDFC Securities show that the call for janata curfew has resulted in project sites staring at closure. Players in the engineering, procurement and construction (EPC), transmission and distribution (T&D), road construction and building segments are all seeing their projects' progress getting impacted with the Central and state governments' directives for lockdowns and curfews.

Companies' focus on employee and labour safety amidst coronavirus pandemic is another reason for project commencements taking a back seat. Sandeep Upadhyay, managing director and chief executive, Centrum Infrastructure Advisory says that EPC players may still take the cover of force majeure clause as per contractual provisions (an extraordinary event and circumstances beyond their control), and let operators (toll roads, etc) also have some coverage under insurance. However, there will be challenges for players who have bid for projects earlier and are awaiting financial closures. Bids with a longer-term view (10-15 years), lower revenues or lower traffic may hurt their near-term financials.

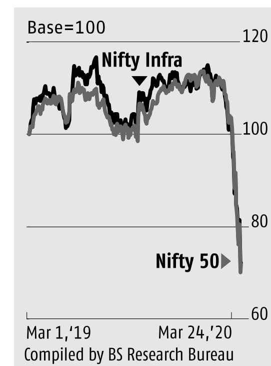
The government is already under financial stress and is now allocating funds for relief measures, which in turn, may limit its ability to fund future infrastructure projects. "The government's ability to spend on the infrastructure in next 1-2 years will get impacted," says an analyst at a domestic brokerage.

Lower input costs with a decline in commodity prices may be among the few relief measures for players.

In this backdrop, analysts say the impact of COVID-19 stress on infrastructure capex may be worse than that seen during 2008. During the financial crisis in 2008 and onwards, the heat was felt by players on export income, while domestic revenues largely remained intact and government spending was good. Only private capex took a hit and players like ABB, Siemens, and Thermax had seen some pressure. However, with the pressure on government capex, the current slowdown is likely to get worse for the infra sector.

Thus, analysts at Emkay Global say that even after the recent correction, investors should wait before dabbling in the sector, given the continued uncertainty on infra capex growth, which is further worsened by the COVID-19 impact.

Analysts prefer companies with a strong balance sheet. While Emkay prefers KNR Constructions, Cummins India, and PNC Infratech, HDFC Securities feels KEC International, Kalpataru Power Transmission with global operations are less impacted on the execution front.



Compiled by BS Research Bureau

Street betting on HUL to scale up VWash

Strong distribution network, firm's cost efficiency will help increase sales of acquired portfolio

SHREEPAD S AUTE

The stock of Hindustan Unilever (HUL) surged 7.6 per cent to ₹2,011 on Tuesday, outperforming the 3.2 per cent rise in the Nifty FMCG index. Besides the broader market recovery (Nifty50 was up 2.5 per cent) and the economic package indicated by the finance minister, the acquisition of VWash brand and portfolio announced on Monday, after market hours, supported the stock.

What made the Street positive about the deal — despite the minuscule size of the category where VWash is a market leader — were expectations of expansion of the market and brand size under HUL.

VWash is a feminine intimate hygiene brand launched by Glenmark Pharmaceuticals in 2013. It includes liquid wash, wipes, depilatory cream, and sanitary towels.

According to analysts at PhillipCapital, "HUL is positioned well to acquire brands that have hit a wall, despite being present in categories that are fast growing, although under-penetrated and niche."

The urban penetration of this category is sub-8 per cent. Analysts at Edelweiss Securities also echo similar views. "We have no doubts about HUL's ability to undertake market development," they said in a note.

The strong distribution network of HUL (9 million outlets), clear focus, and the company's cost efficiency are likely to help the high-margin VWash brand scale higher (and deliver high growth) in the medium to long term, as observed in case of Indulekha — a premium hair oil brand.

After acquiring it in 2016, Indulekha's turnover jumped 4x to ₹400 crore in less than five years; its earnings before interest, tax, depreciation and amortisation margin, too, expanded sharply to over 50 per cent in 2018-19, from 30 per cent, according to PhillipCapital.

The financial details of the deal weren't disclosed, but HUL's management expects double-digit growth of the VWash brand to continue. It also believes that the launch of low-unit or small packages will help increase the overall reach of the brand. The overall hygiene habits in the country, too, are expected to improve, in light of the current contagion.

The VWash deal — expected to fructify in a few months, along with GlaxoSmithKline Consumer Healthcare (GSK Consumer) — will strengthen HUL's presence in the chemist channel.

This will support the company's existing portfolio as well. HUL recently got all the approvals for its GSK Consumer acquisition; this is expected to be earnings accretive.

How the new category shapes up with HUL's overall efficiency and reach will be keenly watched. The stock is currently trading at 50x its 2020-21 estimated earnings.

Compiled by BS Research Bureau