

Playing the scare market

Macro headwinds have resulted in lower risk appetite amongst investors globally, driving falls in equity markets across the world. Whilst India is deemed a “high risk” market, that risk varies enormously across stocks. During times of uncertainty and high volatility companies with high dividend yield and high earnings certainty should represent better investment opportunities. We identify companies based on these characteristics that we think would likely outperform assuming volatile market conditions continue.

Riding the wave of uncertainty

Given the current volatility in markets we’ve run screens to identify companies with high earnings certainty and high dividend yields, given that historically during periods of risk aversion a total return approach has tended to work better, with high dividend yielding stocks outperforming broader markets as investors adapt to lower growth by shifting portfolios towards dividend payouts rather than capital appreciation. Furthermore to reduce the risk of picking stocks that are highly exposed to the economic cycle, as well as investor risk appetite, we exclude companies with a “bear market beta” greater than 1. We have excluded financial stocks from our screen. Figure 3 on p.2 highlights 22 stocks that met our screening criteria for investing in uncertain times.

Screening parameters

Dividend yield: We screen companies with a dividend yield of more than 1.5%. Globally growth is falling and a higher proportion of returns are likely to be through dividends rather than capital appreciation. The shift in portfolios towards high dividend paying stocks is likely even in India, which has historically been known more as a growth rather than yield destination.

Earnings certainty: Economic volatility brings uncertainty in the “E” of the widely followed P/E. We screen for companies that have “high earnings certainty”; this means we select companies which have high earnings quality, low dispersion in analyst forecasts and low historical volatility of EPS growth. Only companies with an earnings certainty score of more than 10 are taken into consideration.

Bear market beta: The screen excludes companies with a “bear market beta” of greater than 1 – based on the beta of the stock with the Sensex during the global financial crisis.

Gearing: The continued hawkish stance of the RBI has led interest rates to reach peak levels and investors shying away from companies with higher leverage; we thereby select companies with Net Debt to Equity of less than 1.

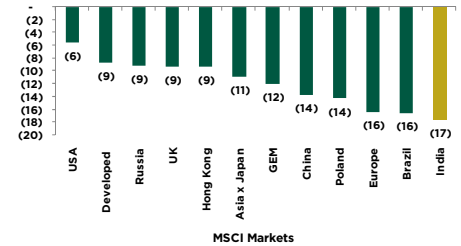
Value: To filter companies with high ROE as well as trading at relatively better multiples we use the factor of ROE/PB and have considered only those companies with ROE/PB ratio greater than 3.

Market capitalization & Liquidity: In uncertain times size and liquidity start to matter more. We therefore only consider companies with a market capitalisation above US\$500m, and average daily turnover above US\$ 1m.

Active coverage: Given the link to liquidity and impact on reliability of earnings expectations, we’ve only considered stocks that have active coverage of more than 5 analysts.

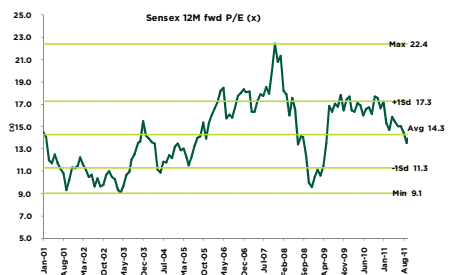
Global exposure: We also flag global exposure of the screened companies. Many investors currently want to avoid India stocks that have material exposure to global economic volatility, given how hard it is to predict what happens in Europe and the US. These stocks are not excluded, but we have highlighted exposure so clients can exclude from the screen if they choose. Do see our recent note on global exposure of India companies (click here).

Fig 1 India tops the chart once again



Source: FactSet, Espirito Santo Securities

Fig 2 Valuation below long term average



Source: FactSet, Espirito Santo Securities

Table 3: Shortlisted companies

Ambuja Cements	Infosys
Ashok Leyland	ITC
Bajaj Auto	Motherson Sumi
Castrol India	NTPC
Colgate-Palmolive	ONGC
Coromandel Int	Opto Circuits
Cummins India	Sun TV Network
GAIL	TCS
HCL Technologies	Thermax
Hero MotoCorp	Wipro
Hindustan Unilever	Zee Entertainment

Source: Espirito Santo Securities

Analysts

Aditya Jhawar
+91 (0) 22 4315 6819
aditya.jhawar@execution-noble.com

Nick Paulson-Ellis
+91 (0) 22 4315 6814
nick.paulson-ellis@execution-noble.com

Nitesh Sharma
+91 (0) 22 4315 6820
nitesh.sharma@execution-noble.com

Sales

Ashish Goenka
+44 203 429 2012
ashish.goenka@execution-noble.com

Poorva Upadhyaya
+1 212 351 6056
pupadhyaya@esinvestment.com

Arijay Prasad
+91 22 4211 0935
arijay.prasad@execution-noble.com

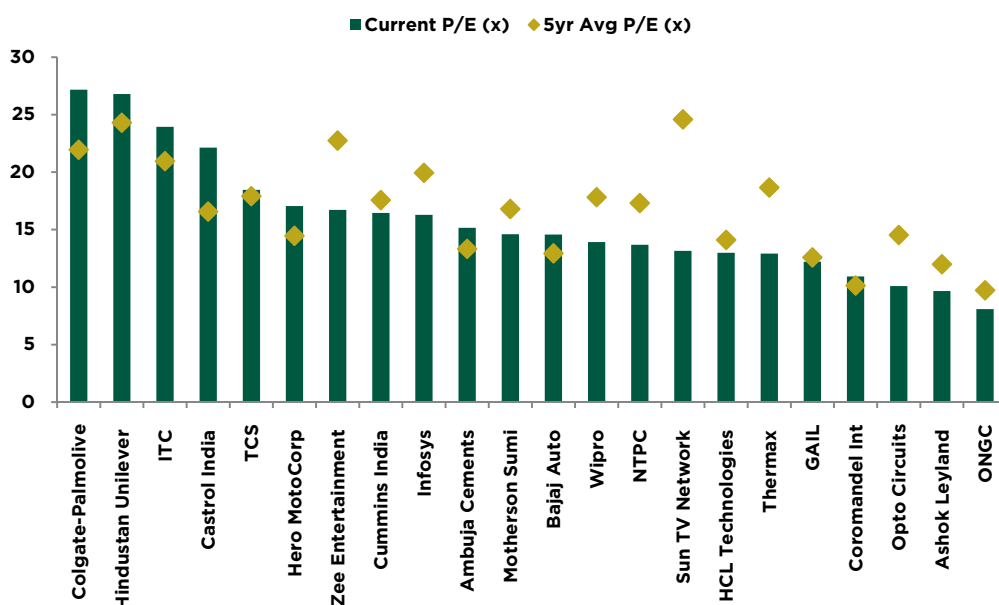
Sunny Shah
+91 22 42110902
sunny.shah@execution-noble.com

Figure 4 Espirito Santo's screen for investing in companies with high yield and high earnings conviction

Company	Sector	Mkt Cap (US\$ m)	Yield (%)	Earnings Certainty	Gearing (%)	Forward ROE/PB	Market Beta	Global Exposure (%)	Earnings growth (%) FY1	ROE (%)	fwd P/E	12M fwd P/B
Ambuja Cements	Materials	4,613	2.0	11.7	(23)	6.7	0.93	2%	2.5	16	15.8	2.5
Ashok Leyland	Industrials	1,489	3.9	11.1	58	9.1	0.95	0%	0.2	17	10.0	1.7
Bajaj Auto	Consumer Discretionary	10,312	2.5	14.7	(5)	11.0	0.99	27%	13.9	51	15.2	6.5
Castrol India	Materials	2,724	3.3	40.8	(112)	5.0	0.60	13%	11.0	81	21.8	16.9
Colgate-Palmolive	Consumer Staples	2,949	2.5	19.7	(103)	3.5	0.37	1%	11.1	106	28.4	26.2
Coromandel International	Materials	1,792	2.6	11.9	14	10.4	0.83	0%	19.2	33	10.3	2.9
Cummins India	Industrials	2,561	2.6	28.8	(5)	5.8	0.72	25%	9.0	33	16.8	5.0
GAIL India	Utilities	11,748	2.1	16.5	20	8.0	0.81	0%	13.6	19	12.6	2.2
HCL Technologies	Information Technology	5,898	1.8	22.6	6	7.5	1.00	98%	26.5	23	12.5	2.7
Hero MotoCorp	Consumer Discretionary	9,387	3.0	24.5	(1)	4.8	0.65	2%	12.4	65	18.0	10.1
Hindustan Unilever	Consumer Staples	14,992	2.4	34.2	(66)	3.4	0.60	8%	13.8	82	26.6	19.9
Infosys	Information Technology	28,683	1.8	31.6	(62)	6.0	0.73	97%	12.7	26	16.0	3.8
ITC	Consumer Staples	34,045	2.0	34.8	(14)	3.6	0.69	7%	21.6	35	24.1	7.8
Motherson Sumi Systems	Consumer Discretionary	1,729	1.7	16.0	56	5.8	0.71	2%	16.4	27	15.8	3.9
NTPC	Utilities	29,076	2.6	16.7	48	7.5	0.75	0%	6.1	14	13.1	1.7
ONGC	Energy	48,418	3.9	13.4	(19)	11.4	0.76	14%	21.1	22	8.0	1.6
Opto Circuits	Health Care	1,041	1.7	11.3	47	9.7	0.93	95%	39.4	29	9.8	2.5
Sun TV Network	Consumer Discretionary	2,570	3.0	17.2	(27)	8.0	0.72	0%	8.6	33	13.1	3.8
Tata Consultancy Services	Information Technology	43,761	1.6	45.2	(30)	5.9	0.73	91%	18.6	36	18.3	5.7
Thermax	Industrials	1,284	1.8	17.0	(46)	7.8	0.97	13%	13.3	29	13.0	3.3
Wipro	Information Technology	17,223	1.8	29.3	(24)	8.1	0.99	91%	5.6	22	13.4	2.7
Zee Entertainment	Consumer Discretionary	2,426	1.7	16.0	(12)	5.9	0.91	36%	7.8	17	16.7	2.8

Source: FactSet, Espirito Santo Securities. * Earnings certainty score is calculated as mean estimates/std deviation in estimates

Figure 5 Screened stocks with 12 months forward multiples



Source: FactSet, Espirito Santo Securities

Pledge to Pledge shares

With the market vulnerable and the recent dramatic falls of stocks like S Kumars, Orchid Chemical, GTL, KS Oils, many clients are concerned about companies where promoters have pledged a substantial portion of their stake to financiers. These stocks are prone to panic and also bear rumours. Below we highlight BSE200 companies whose promoters have pledged a substantial portion of their stake. We are not claiming all companies with pledged shares are bad investments; but in current market conditions there is an inherent systematic risk.

Table 6 BSE200 companies with promoter holdings being pledged

Company Name	% of promoter holding pledged	% of total shares pledged
Pipavav Defence and Offshore Engineering	100%	45%
United Spirits	88%	25%
Gujarat NRE Coke	84%	38%
India Cements	73%	19%
Unitech	68%	33%
Suzlon Energy	65%	36%
Videocon Industries	64%	46%
Jaiprakash Power Ventures	59%	52%
Apollo Hospitals Enterprise	59%	19%
Adani Power	54%	39%
Bombay Rayon Fashions	51%	22%
Shree Renuka Sugars	50%	19%
Max India	40%	14%
Sintex Industries	38%	13%
Tata Power Company	36%	12%
Aban Offshore	34%	18%
Tata Global Beverages	32%	11%
Indiabulls Real Estate	32%	9%
Pantaloon Retail	30%	13%
NCC	29%	6%
IRB Infrastructure Developers	28%	21%
JSW Steel	28%	11%
Asian Paints	27%	14%
Apollo Tyres	27%	12%
Zee Entertainment Enterprises	27%	11%
Lanco Infratech	26%	18%
Bhushan Steel	25%	17%
Motherson Sumi Systems	24%	16%
GMR Infrastructure	23%	17%
Dish T V India	23%	17%
Manappuram Finance	21%	8%
Aurobindo Pharma	20%	11%
Tata Motors	20%	9%
JSW Energy	20%	15%
Sun T V Network	16%	13%
Essar Oil	16%	10%
Hero MotoCorp	14%	7%

Table 6 BSE200 companies with promoter holdings being pledged

Chambal Fertilisers & Chemicals	13%	7%
JSW ISPAT Steel	13%	9%
Jain Irrigation Systems	11%	3%
Tata Consultancy Services	11%	8%
CESC	11%	6%
Mcleod Russel India	10%	4%
United Breweries	9%	7%
Mahindra & Mahindra	8%	2%
GVK Power & Infrastructure	7%	4%
Punj Lloyd	5%	2%
Dr Reddy'S Laboratories	5%	2%
Tata Communications	5%	4%
Crompton Greaves	4%	2%
Yes Bank	4%	1%
United Phosphorus	4%	1%
Tata Steel	3%	1%
Godrej Consumer Products	3%	2%
Torrent Power	3%	2%

Source: Ace Equity, Espirito Santo Securities

Contact details

Nick Paulson-Ellis, Country Head, India

t. +91 22 4315 6814 e: nick.paulson-ellis@execution-noble.com

Sales

Ashish Goenka t: +44 20 3429 2012; e: ashish.goenka@execution-noble.com

Poorva Upadhyaya t: +1 212 351 6056; e: pupadhyaya@esinvestment.com

Arijay Prasad t: +91 22 4315 6841; e: arijay.prasad@execution-noble.com

Sunny Shah t: +91 22 4315 6842; e: sunny.shah@execution-noble.com

Sector leads

Banks and financial institutions:

Saikiran Pulavarthi t +91 22 4315 6824; e saikiran.pulavarthi@execution-noble.com

Santosh Singh t +91 22 4315 6822; e santosh.singh@execution-noble.com

Sri Karthik t +91 22 4315 6826; e sri.karthik@execution-noble.com

Nidhesh Jain t +91 22 4315 6823; e nidhesh.jain@execution-noble.com

Consumer

Nitin Mathur t +91 22 4315 6821; e nitin.mathur@execution-noble.com

Economy

Deepali Bhargava t +91 22 4315 6827; e: deepali.bhardava@execution-noble.com

Healthcare

Chirag Talati t +91 22 4315 6828; e chirag.talati@execution-noble.com

Metals and Mining

Ritesh Shah t: +91 22 4315 6831; e: ritesh.shah@execution-noble.com

Power and Infrastructure

Krishnakant Thakur t: +91 22 4315 6832; e: krishnakant.thakur@execution-noble.com

Pawan Parakh t: +91 22 4315 6833; e: pawan.parakh@execution-noble.com

Strategy

Aditya Jhavar t +91 22 4315 6819; e: aditya.jhavar@execution-noble.com

Nitesh Sharma t +91 22 4315 6820; e nitesh.sharma@execution-noble.com

Technology:

Soumitra Chatterjee t +9122 4315 6829 e soumitra.chatterjee@execution-noble.com

1203 A, Tower 2A,
One Indiabulls Centre,
Elphinstone Road,
Mumbai – 400076
t: +91 22 4315 6800
e: research.india@execution-noble.com

10, Paternoster Square
London EC4M 7AL
U.K
t: + 44 20 7246 0180
t: + 44 20 7246 0190

340 Madison Avenue, 12th Floor
New York NY-10173
U.S.A
t: +1 212 351 6000
t: +1 212 351 6099

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TOTAL	379	100%	40	100%	

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	Count	% of Total	Count	% of IBC	% of Total
Recommendation					
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SHORT TERM NEGATIVE	0	0%	0	0%	0%
TOTAL	0	0%	0	0%	

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Contact Information:

Garreth Hodgson	Senior Managing Director /Head of Sales	(212) 351-6054	ghodgson@esinvestment.com
Eva Gendell	Vice President	(212) 351-6058	egendell@esinvestment.com
Joseph Mcglone	Vice President	(212) 351-6061	jmclglone@esinvestment.com
Joy Bejasa	Vice President	(212) 351-6055	jbejasa@esinvestment.com
Lisa Gottardo	Executive Director	(212) 351-6060	lgottardo@esinvestment.com
Mike Maione	Executive Director	(212) 351-6067	mmaione@esinvestment.com
MikeWilliams	Vice President	(212) 351-6052	mwilliams@esinvestment.com
Pedro Marques	Vice President	(212) 351-6051	pmarques@esinvestment.com
Poorva Upadhyaya	Assistant Vice President	(212) 351-6056	pupadhyaya@esinvestment.com

E.S. Financial Services, Inc.
New York Branch
340 Madison Avenue, 12th Floor
New York, N.Y. 10173

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