

## In Pursuit of Profitability

*“In the business world, the rear-view mirror is always clearer than the windshield.” - Warren Buffett*

As an equity investor, getting hold of new ideas for investment in stocks is not just easy. Investing is slow and long process that individual investor needs to develop himself keeping in view his risk profile and expectations of return. What suits one investor may not suit another. There is no one way to pick one stocks; there are numerous. Finding what you are comfortable with is essential. Investing is an art that can be learnt through patience, discipline and reading what other successful investors have done to get superior returns.

What we have done is to look out for companies with sustainable and durable businesses run by able managers who can grow the top as well the bottom line with superior ROE and ROCE that are not driven by higher total debt in the books.

**Sustainable and durable business:** This is ensured by some kind of distinct advantage, or moat, that the company may have, for instance, proprietary knowledge, access to critical raw material, network effects, entry barrier etc.

**Able manager:** The managers running the business should have high levels of integrity, friendly approach to minority investors, adequate financial disclosures, a spotless track record and a history of showing superior capital allocation skills. They should be ambitious and motivated and able to identify high-return projects and deploy capital incrementally to back their ideas.

**Profitability:** Investment Gurus like Warren Buffet and Philip Fisher have emphasized on the finding the companies with high profit margins. The operating profit margin is an important metric to consider before investing in the shares of a business. For a business to survive in the long run, it has to generate profits. Higher profit margin growing above a threshold signifies a company’s ability to tap new opportunities.

**Superior ROE and ROCEs:** The business should yield higher return on equity, preferably above 15%, which is more than the cost of capital to the company. Further, the higher ROE should not be driven by higher Debt in the books.

Keeping these above principles in mind, we, at Satco Capital, applied following filters on the BSE 500 companies:

- (i) ROCE and ROE higher than 15% CAGR in the last 5 years
- (ii) Net Sales & PAT growth higher than 10% in the last 5 years and,
- (iii) Total Debt to Equity ratio of less than 1.

After applying the filters, we got a short list of following companies that meet the above criteria.

Company Name	FY19		FY18		FY17		FY16		FY15		5 Year	
	ROE (%)	ROCE (%)	Net Sales CAGR	PAT CAGR								
<b>Avenue Supermarts Ltd.</b>	17.71	25.78	18.56	24.18	18.34	21.91	23.56	24.21	19.65	21.39	33.68	41.10
<b>Dr. Lal Pathlabs Ltd.</b>	23.76	34.78	25.32	37.90	28.45	43.07	32.45	47.43	37.14	48.87	16.62	20.09
<b>Endurance Technologies Ltd.</b>	20.90	24.16	20.03	22.29	20.78	21.12	23.19	22.34	23.95	22.77	12.26	19.26
<b>HDFC Bank Ltd.</b>	17.05	16.27	18.43	16.70	18.41	16.35	18.65	16.25	19.94	18.36	19.83	20.69
<b>Larsen &amp; Toubro Infotech Ltd.</b>	35.20	46.57	32.82	41.61	38.00	46.55	40.71	47.05	43.08	48.36	13.93	16.83
<b>Sheela Foam Ltd.</b>	20.15	28.32	25.21	34.61	31.31	38.68	35.89	38.75	19.33	19.02	11.00	36.87
<b>Solar Industries (India) Ltd.</b>	23.84	26.24	23.21	24.57	22.46	22.67	22.46	24.24	21.82	19.28	16.79	16.41

Data Source: ACE Equity

**CMP: Rs. 1569.60**

**Avenue Supermarts Ltd.**

The company has kicked off FY20 on an optimistic note by registering sturdy double digit growth in its operating metrics led by store addition and improvement in gross margin. It has opened eight new stores in Q1, aggregating to 184 stores as of now. It's the highest compared to any other Q1 historically and is expected to add 25-28 stores in FY20; though a large part of additional stores was a spill-over from the previous quarter. **Strong track record of outpacing its peers and benefit of economies of scale would strengthen its market share in organized food and grocery retails in India in near to medium term.**

The sales moved up 26.78% to Rs. 57805.30 million for the June 2019 quarter as compared to Rs. 45594.20 million during the year-ago period. Net Profit growth of 33.80% reported above the corresponding previous quarter figure of Rs. 2506.10 million to Rs. 3353.10

millions. Operating profit for the quarter ended June 2019 rose to Rs. 6078.80 million as compared to Rs. 4369.30 million of corresponding quarter ended June 2018.

The stock is trading at high PE of over 90x based on TTM EPS but offers scope to provide appreciation of over 20% over the next 12 months.

**CMP: Rs. 1246.50**

**Dr. Lal PathLabs Ltd.**

Dr. Lal Pathlab's B2C business has continued to grow its pan- India presence with over 200 patient services centers added in FY17, taking the total number to 1759 centers. The company which bring in ~60% of its top line essentiality caters to walk-in & home collection requests with more than 90% of these center functioning on a revenue sharing franchisee model.

The company witnessed a 14.70% growth in the revenue at Rs. 3245.00 million for the quarter ended June 2019 as compared to Rs. 2829.00 million during the year-ago period. A rise of 14.83% was recorded in the Net profit for the quarter ended June 2019 to Rs. 573.00 million from Rs. 499.00 millions. Operating profit surged to Rs. 1060.00 million from the corresponding previous quarter of Rs. 836.00 millions.

The stock is trading at PE of 51x based on TTM EPS of Rs. 24.33 but offers scope of appreciation of over 20% in next 12 months.

**CMP: Rs. 1625.90**

**Larsen & Toubro InfoTech Ltd.**

Larsen & Toubro Infotech Limited offers end-to-end software solutions and services. It offers various services, such as package implementation and support, application development and maintenance, enterprise application integration, data warehousing and business intelligence, managed services, strategy consulting, engineering services, and embedding intelligence services.

The revenue for the June 2019 quarter is pegged at Rs. 23185.00 million, about 14.03% up against Rs. 20333.00 million recorded during the year-ago period. The Company has registered profit of Rs. 3818.00 million for the quarter ended June 2019, a growth of 9.93% over Rs. 3473.00 million achieved in the corresponding quarter of last year. Operating Profit saw a handsome growth to 5601.00 million from 4896.00 million in the quarter ended June 2019.

The stock is trading below its 52 week high of Rs. 1990 at PE of 18.7x based on TTM EPS of Rs. 86.99 and can be considered for investment for better returns.

**CMP: Rs. 928.15**

**Endurance Technologies Ltd.**

Endurance Technologies (Endurance) is one of the biggest suppliers of components to 2-wheelers and 3-wheelers in India, having core-competence in aluminium casting, transmission and suspension products. The company is likely to benefit from new customer wins, stricter safety norms in India and increasing demand for aluminium content in passenger vehicles across India and Europe.

The quarter ended June 2019 witnessed marginal change in the total revenue at Rs. 13611.60 millions. A growth of 43.29% was recorded in net profit for the quarter ended June 2019 to Rs. 1290.55 million from Rs. 900.67 millions. Operating profit surged to Rs. 2488.47 million from the corresponding previous quarter of Rs. 1807.77 million.

The stock is trading at discount of 38% to its 52 week high of Rs. 1560 and can scale back to its high price over the next one year.

**CMP: Rs. 2228.90**

**HDFC Bank Ltd.**

HDFC Bank (HDFCBK) has consistently grown its market share in loans and deposits across credit cycles, and has emerged as the best-managed bank in India with robust profitability/growth metrics. Increasing granularity of the balance sheet, a focus on fee income growth, an improvement in operating leverage aided by digital initiatives, and controlled credit costs backed by strong underwriting have enabled the bank to outperform most peers.

The revenue zoomed by 21.48% to Rs. 273915.90 million for the quarter ended June 2019 as compared to Rs. 225489.80 million during the corresponding quarter last year. Net profit stood at Rs. 55681.60 million compared to Rs. 46014.40 millions in the corresponding quarter last year, high by 21.01%. **The company has consistently reported growth of over 20% in PAT for every quarter over the several years. The bank is splitting its shares to 2:1 on Sept 19, 2019.** Also, the investors can get chance to get shares of its NBFC subsidiary which is likely to make public issue in the coming year.

The stock is trading at Price to Book value of 4.07x and offers scope for continued steady appreciation in the coming years.

**CMP: Rs. 1223.60**

**Sheela Foam Ltd.**

The company is amongst the top 3 players in the industry and expected to be big beneficiary of the shift in taste following urbanization and changing lifestyle. We observe that shift from unorganized to organized segment is captured largely by economy level matters, which the company has introduced new economy level mattress brands which is leading the volume growth at present.

With no major difference for the quarter ended June 2019, the total revenue stood at Rs. 4356.70 millions. Net profit for the quarter ended June 2019 increased to Rs. 346.30 million

from Rs. 334.50 millions in the corresponding quarter last year. The company reported a good operating profit of Rs. 631.20 million compared to Rs. 556.50 million of corresponding previous quarter.

The stock is trading at a discount of 36% to its 52 week high of Rs. 1817.95 and can be considered for investment.

**CMP: Rs. 1120.05**

**Solar Industries (India) Ltd.**

The company is one of the largest manufacturers and suppliers of Explosive and Explosive Accessories in India covering the entire range of products such as Bulk and Cartridge Explosive, Detonators, Detonating cords and Cast Boosters.

The quarter ended June 2019 witnessed marginal change in the total revenue at Rs. 4032.80 million. A meek growth of 2.48% in net profit was reported for the quarter ended June 2019 to Rs. 499.50 million from Rs. 487.40 millions. The Operating profit of the company witnessed a marginal growth to Rs. 861.70 million from Rs. 842.20 millions in the same quarter last year.

The above stocks have met the selected criteria in these difficult times and can offer reasonably good scope for further appreciation over the next 12 months or so. The investors are, however, advised to check other fundamentals of these companies before taking any investment decisions.

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