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The Smart Investor
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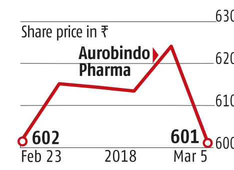
QUICK TAKE: END TO AUROBINDO'S REGULATORY WOES?



Share of Aurobindo Pharma fell 3.7% after the US FDA issued observations on deficiencies in the firm's Pashamailaram plant, which contributes 15% of its US sales. Analysts, however, say the observations are mild and will not have a major impact on its business

COMMODITIES P6
DUTY CUT PUSHES UP EDIBLE OIL PRICES

Trade war fear spooks markets

Benchmark indices slump most in nearly a month; Metal stocks melt

SAMIE MODAK
Mumbai, 5 March

The markets on Monday posted their worst single-day performance in nearly a month on worries of a global trade war after the US planned to impose stiff tariffs on steel and aluminium imports.

Shares of metal companies led the decline. Political uncertainty in Italy also weighed on investors' sentiment after exit polls showed Eurosceptic parties gaining support. The domestic equities posted a fourth straight session of loss despite the positivity following the Bharatiya Janata Party's (BJP's) strong showing in the Northeast state elections.

The benchmark BSE Sensex closed at 33,745, down 300 points, or 0.9 per cent, while the Nifty50 index fell 100 points, or 0.95 per cent, to 10,359. Both the indices fell the most since February 9.

US President Donald Trump plans to levy tariffs on steel and aluminium to boost domestic industry and jobs. He has also threatened to impose a tax on cars. A formal agreement in this regard is expected to be signed this week. Investors fear the move would ignite a global trade war, with China warning that it won't sit idle if its economy is hurt. Most Asian markets also fell close to 1 per cent in Monday's trade.

"The domestic market was hit on fears of a likely hike in the US import tariff on steel and aluminium. The metal sector has taken the biggest hit so far. Indian exporters would look at the dawning possibility of a global trade war, adding to the anxiety of the investors awaiting outcomes of major central banks meetings this week," said Anand James, chief market strategist, Geojit Financial Services.

Both domestic and overseas investors were net sellers on Monday. Foreign institutional investors sold shares worth ₹3.7 billion, while their domestic counterparts pulled out ₹1.5 billion. The overall market breadth was negative as 2,041 stocks ended in the red, while only 701 gained.

According to experts, the equity markets are likely to remain volatile, while gold could see safe-haven buying as a hedge against global uncertainties.

Most sectoral indices, barring technology, ended with losses. The BSE Metal index dropped 3.3 per cent to a two-month low. Shares of Hindalco and JSW Steel fell over 4 per cent each. Among the Sensex pack, Tata Motors and Tata Steel fell the most at 5 per cent and 3 per cent, respectively. Among the top gainers were Sun Pharma and TCS, which rose over 2 per cent each. On a year-to-date basis, the Sensex and the Nifty are down by over 1 per cent each.

BJP win fails to lift mood

The BJP-led coalition's win in Tripura and Nagaland has failed to lift investors' sentiment. This is the first time the BJP was able to make significant headway in the northeastern states. "It builds a strong momentum for the BJP in the upcoming state elections in 2018 and the national polls in 2019," said Ajay Bodke, chief portfolio manager — PMS, Prabhudas Lilladher.

"These election results will be a sentiment booster for the BJP... Upcoming state elections will be important as they will largely be two-way fights between the BJP and the Congress," said Sonal Varma, chief economist, Nomura India.

MOOD TRACKER

SENSEX GAINERS & LOSERS

GAINERS	Mar 5 (₹)	Chg 1-day (%)
TCS	3,104	2.2
M&M	739	0.8
SBI	264	0.5
LOSERS		
Tata Motors	352	-5.0
Tata Steel	655	-3.0
Bajaj Auto	2942	-2.7

TOP 5 BSE SECTORAL LOSERS

GAINERS	Mar 05,'18 (₹)	Chg 1 Day (%)
Metal	14,534	-3.3
Oil & Gas	15,240	-1.8
Auto	24,434	-1.6
FMCG	10,384	-1.2
Capital Goods	18,839	-1.0

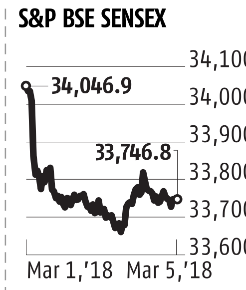
Source: Exchange

WORLD EQUITY INDICES

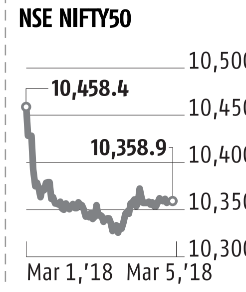
Name	Country	Mar 5, 2018	Change 1-day (%)
AMERICA (MAR 2)			
DOW JONES	US	24,538	-0.29
S&P 500	US	2,691	0.51
NASDAQ COMPOSITE	US	7,258	1.08
EUROPE — 18:36 IST			
CAC 40	France	5,145	0.16
FTSE 100	Britain	7,086	0.23
Euro Stoxx 50	Eurozone	3,334	0.29
ASIA			
HANG SENG	Hong Kong	29,886	-2.28
NIKKEI 225	Japan	21,042	-0.66
SHANGHAI SE COMP	China	3,257	0.07

Source: Bloomberg Compiled by *BS* Research Bureau

S&P BSE SENSEX



NSE NIFTY50



US regulator likely to okay NSE for derivatives

PAVAN BURUGULA
Mumbai, 5 March

The National Stock Exchange (NSE) is close to receiving the US Commodity Futures Trading Commission's (CFTC's) approval that would enable a class of hedge funds to deal on its derivatives platform.

The exchange has already completed the formalities pertaining to the process and is expecting a 'no-action' letter from the CFTC in the next few weeks, sources in the know said.

The development will give a green light to US-based hedge funds, which currently opt for offshore platforms such as the Singapore Exchange (SGX) to deal in Indian derivatives.

According to US laws, funds which pool substantial amount of money from US citizens are allowed to invest only in derivatives that are approved by the CFTC.

The licence — called 'foreign part 30' — allows exchanges and entities situated outside the US to solicit and accept orders from US-based funds.

The NSE had applied for the licence more than three years ago. But, not much progress could be made before 2017 as the Securities and Exchange Board of India (Sebi) did not have any information-sharing agreements with the US regulators. Late last year, Sebi had signed a pact with the US Securities and Exchange Commission (SEC) under the International Organization of Securities Commissions (Iosco) protocol.

"Most of the hurdles were cleared once the information-sharing agreement between Sebi and the SEC came into effect. The licence will help India attract more US-based institutions to participate in Indian derivatives. We had extensive meetings with CFTC officials in the past few months and are expecting the final approval very soon," said a source.

The development couldn't have come at a better time as the Indian market regulator and intermediaries are making efforts to contain the export of Indian trading and also deepen the futures market.

Also, the licence was not typically a top priority for the Indian exchanges until recently. Since the US hedge funds were not allowed to deal directly in Indian futures, they were using offshore destinations such as the SGX for trading. Those investors who wanted an exposure into single-stock futures used participatory notes (p-notes) to have an indirect exposure.

However, both the routes are no longer available for foreign investors. Last month, Indian bourses terminated all data-sharing agreements with the foreign exchanges. In other words, offshore exchanges will no longer be able to offer contracts based on domestic securities once the notice period ends in August. Earlier, Sebi had banned p-notes subscribers from investing in the Indian derivatives markets for any purposes other than hedging.

Also, the BSE is not far behind in the pursuit. Sources said the BSE had applied for the same licence. It is also learnt that the bourses is pursuing an advanced CFTC licence that will also allow it to set up its commercial terminals in the US.

Unlike India, the US market has a dual regulator system, wherein the SEC largely controls equity space, while commodities and derivatives are largely regulated by the CFTC. Until 2002, single-stock futures were banned in the US. Subsequently, the US government allowed US-based funds to invest in single-stock futures, both domestically and internationally, and the segment was brought under the CFTC's purview.

In the aftermath of the Lehman crisis, the US government had constituted the Dodd-Frank committee to prescribe curbs on excessive risks taken by the US banks and hedge funds. In line with the recommendations, the SEC — the US markets regulator — in collaboration with the CFTC, brought in a new framework of restrictions on the investments made by hedge funds in the derivatives markets.

IN THE FINAL LAP

- SENSE is in final stages of receiving CFTC's licence that would allow US hedge funds to deal with Indian derivatives
- The licence will allow several large-ticket US hedge funds who have been using offshore routes such as SGX to directly trade in Indian F&O
- The development will help NSE to attract more big-ticket US investors to India and deepen domestic F&O market
- The licence was stuck for several years as there was no information-sharing agreement between Sebi and US market regulators
- Last year, Sebi signed the agreement with US SEC under Iosco Protocol

Closed-end funds gain traction

Since 2017, 47 such schemes launched; mopped up ₹175 billion

ASHLEY COUTINHO
Mumbai, 5 March

After two consecutive years of lull, the launch of closed-end funds has gained traction in the past year.

In 2017, 47 closed-end schemes were launched, which collectively mopped up ₹175 billion. This is more than the combined amount collected in 2014, 2015, and 2016. This year so far, 11 funds have hit the market.

"In general, the appetite for these funds grows whenever the markets are buoyant," said Kaustubh Belapurkar, director (fund research), Morningstar Investment Advisor India.

The benchmark BSE Sensex returned 28 per cent in 2017. It rose another 5 per cent in January, but since then it has given up the gains and is down 1 per cent year-to-date.

Closed-end schemes had become a cult favourite with the mutual fund sector in the second half of 2013, as the equity market sputtered back to life.

According to sectoral officials, the new norms on scheme categorisation might offer a fillip to the launch of more closed-end equity products.

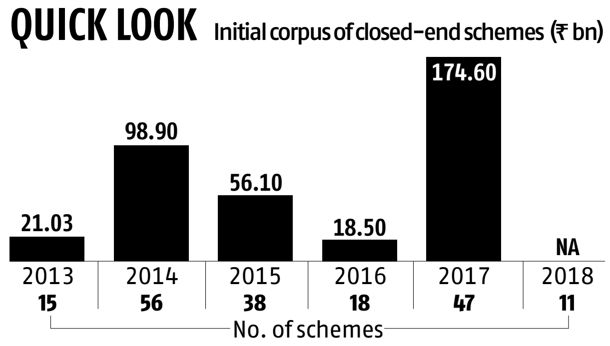
The Securities and Exchange Board of India has broadly classified all schemes under 10 categories of equity funds, 16 categories of debt funds, and six categories of hybrid funds. Fund houses can only launch one scheme under each of these categories. However, closed-end schemes have been kept outside the ambit of this categorisation, which means there is no upper limit on how many such schemes can be launched by each fund house.

Closed-end funds are considered riskier than open-end ones, since their lock-in nature prevents an exit in case the market tanks. However, fund houses in favour of such schemes argue their closed-end nature helps long-term wealth creation and the lack of churning is a relief for fund managers.

"There is nothing that a closed-end fund can do, that an open-end fund can't. Investors should opt for these funds only if they are looking for a special theme to invest in," said Belapurkar.

In the past, inflows into closed-end offerings have been largely driven by the high commissions paid to distributors, with the commission for the entire lock-in period paid upfront, experts said.

QUICK LOOK Initial corpus of closed-end schemes (₹ bn)



Source: Value Research

THE COMPASS

Rural boost for two-wheeler companies

Risk-reward favourable for Hero; rising competition and commodity prices may play spoilsport

RAM PRASAD SAHU

Aided by a recovery in rural markets and a low base, the two-wheeler segment posted a 25 per cent-plus growth for the second month in a row. The growth was led by TVS Motor, which sold 36 per cent more two-wheelers in February over the year-ago period. Sales of Hero MotoCorp, Bajaj Auto and Royal Enfield also grew at 20-25 per cent year-on-year. After an inconsistent period of growth in the second half of 2017, brokerages said the demand for two-wheelers was coming back.

One of the reasons for higher demand in February, which is likely to sustain, is an increase in the minimum support prices (MSPs) for crops and government initiatives in rural housing, infrastructure and roads. Given that half of motorcycle volumes come from rural areas, this segment is expected to do well. Recovery in export sales, too, is a positive and mitigates some of the risks in the domestic segment, especially the weakness in urban cities. Scooter sales are also expected to be robust because of the growing women workforce, improving road conditions in rural areas, and launches in the 125cc and 150cc segments. The scooters segment continues to gain market share, which has now doubled from the FY11-levels of 17.6 per cent.

Analysts at Nomura said capacity constraints for Honda over FY19 and FY20 could hurt it. This will give Hero MotoCorp and TVS Motor an opportunity to gain market share.

But, there could be some bumps as well. Morgan Stanley had highlighted two headwind of higher competition and commodity prices. This is because of a slew of launches by Bajaj Auto, especially Hero MotoCorp, which is pricing its products aggressively to gain market share. While Bajaj Auto has launched the 110cc and 125cc Discover variants, Hero plans to launch the 125cc variants of its two scooter brands, the Duet and the Maestro Edge, to tap the executive segment further. It also plans to launch the 200cc motorcycles, Xtreme and Xpulse, to make inroads into the premium segment.

Despite headwind on the raw material front, given increasing competition, firms may be reluctant to increase prices, thereby hampering profitability, analysts said. If the December quarter performance for the sector is anything to go by, firms could see margin pressures of 200 basis points in FY19. The true impact would depend on companies' ability to achieve higher volumes and cut costs.

For now, most analysts believe Hero MotoCorp would be a key beneficiary of the government's increased focus on rural India. Further, its aggression to gain share in scooters and focus on premium motorcycles should be beneficial. Moreover, the stock is attractively priced.

STEADY VOLUMES, MARGIN HEADWIND

FY19 estimates (₹ bn)	Hero MotoCorp	Bajaj Auto	TVS Motor	Eicher
YTD FY18 volume growth (%)	14.0	4.1	17.6	23.0
Net sales	**352.90**	**286.40**	**171.00**	**102.70**
Ebitda (%)	16.10	19.40	8.50	33.20
Net profit	**39.50**	**47.50**	**8.30**	**23.20**
P/E (x)	17.8	18.3	38.6	27.4

YTD: year-to-date, Eicher numbers are for Royal Enfield Source: Brokerages

Dilip Buildcon: Rising orders point to better outlook

Earnings could get a leg-up from early completion of projects

UJJVAL JAUHARI

Shares of Dilip Buildcon have gained a lot of traction recently, rising over 18 per cent to nearly ₹962 from the closing low of ₹812 in the first fortnight of February, after consolidating since October last year. And, there could be more gains in store.

The optimism comes on account of the company receiving letters of award in the past one week from the National Highways Authority of India (NHAI) for two new hybrid annuity model projects worth ₹44.73 billion in Karnataka and ₹20.13 billion in Andhra Pradesh. Moreover, it has been declared the lowest bidder by the NHAI for three new hybrid annuity model projects valued at ₹53.90 billion in Karnataka and Jharkhand.

The new orders, along with those won earlier in the quarter, suggest that the company will meet its FY18 order guidance. This is in contrast to the muted pace of ordering by the NHAI during the first nine months of FY18, which had led to some concerns over the company's revenue growth, despite its good execution track record.

Analysts at JM Financial had said while the current pace of execution was overwhelming, higher execution also implies pressure on order inflows to maintain growth.

Nomura, too, had said strong execution led to an increase in FY18 sales, and order inflows in Q4 of FY18 would be the next trigger. The brokerage maintained its 'positive' stance on the stock, with a target price of ₹1,265.

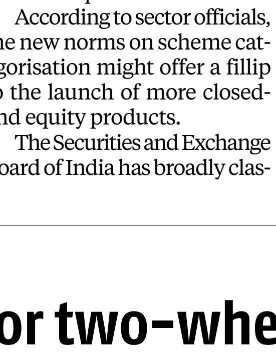
The company, despite slow order flows in the first nine months (about ₹35 billion), had maintained its order guidance of ₹80-100 billion for FY18.

Increased budgetary allocations on infrastructure and the Bharat Mala project, among others, are likely to drive the order flows for the company, thereby driving its earnings.

Divyata Dalal at Sytematix Shares said with order flows having picked up now, the higher-than-expected orders, coupled with timely execution, could lead to an upgrade in revenue and earnings visibility. However, higher order inflows and execution of hybrid annuity model projects can put pressure on its working capital requirements, which needs to be monitored, Dalal said.

Analysts at Kotak Institutional Equities said winning bids by Dilip Buildcon suggest rational pricing by market participants, as the company had won ₹114 billion worth of road construction orders in the 11 months of FY18, more than the ₹110 billion project cost estimated by the NHAI. This means no risks to profitability.

Given its track record of early completion of projects, Dilip Buildcon can also benefit from the associated bonus, said Soumen Chatterjee, head of research at Guiness Securities. Also, those at Nomura said the firm's operating profit margins were to improve on early completion bonus. They expect a 250-basis point sequential improvement in margins in the March 2018 quarter to about 20 per cent.



Compiled by BS Research Bureau