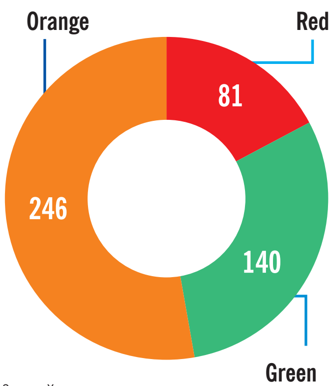
For the long haul

Looking for great businesses? An analysis by Moneyworks4me.com shows where to look

Colour of the season

Almost half of the BSE 500 companies fall in the 'orange' category



Source: Xoxoxox

Go green

The highest number of 'green' companies were noted in the engineering, infotech and pharmaceutical sectors

Rank	Industry name	No. of companies			CAGR growth rates (%)		Avg 6-yr margin (%)
		Green	Orange	Red	Net sales	Net profit	
1	Engg	25	17	3	29	33	10
2	IT	19	22	5	38	38	18
3	Pharma	13	16	2	15	11	15
4	BFSI	13	30	13	20*	17*	14*
5	Infra	9	30	4	35	53	10
6	Auto	8	4	5	16	10	7
7	Steel	8	8	5	22	22	13
8	FMCG	5	8	1	15	12	15
9	Petrochem	4	4	3	32	38	5
10	Transport	4	4	4	25	-51	11

Source: MoneyWorks4me.com; * Includes only banks

Deluged by too much data, investors often end up suckers in the stock markets. Seldom do they realise that to pick the right companies you got to pick the right business first. An analysis of financial data for BSE 500 companies over the past six years by *Moneyworks4me.com* threw up some interesting results. As it turns out, the strongest companies, based on fundamentals, are not from the most glorified sectors in the market today, but from among the old favorites like engineering and information technology.

Of the 500 stocks in the index, 146 companies qualified as "green" companies, 246 were "orange" and 81 "red". The green companies are those that clocked more than 12 per cent growth in net sales, net profit and earnings per share and have consistently clocked over 12 per cent return on capital over the last ten years and have a debt-net profit ratio of less than 3. For banks, additional parameters like net interest income, non-performing assets and capital adequacy ratio were taken into consideration. Red refers to companies with a growth and return ratio less than 8 per cent, while orange refers to those between 8 and 12 per cent.

The highest number of green companies were into engineering (25) and infotech (19), pharmaceuticals (13) and banks and financial services (13). (See graph, *Go green*.) Reinforcing the faith in the fundamentals of these sectors is the fact that the number of red companies in these industries is low.

The engineering industry has been driven by factors like a diverse user industry base, continued upsurge in industrial growth and government emphasis on infrastructure and power. These are expected to help the industry in clocking higher growth rates and better margins in future. Since the industry is capital intensive and requires a high level of technical expertise, the high entry barrier makes it very difficult for other players to eat into the market share of existing players here. Competing with leaders like BHEL, for instance, would be a herculean task.

Ditto for IT. The industry has performed wonders in the last decade. Some critical factors that have played a key role in the success of this industry are the lower labour cost, high scalability and the evolution of India as a preferred destination for outsourcing. The long-term outlook for this business remains bullish, due to the increasing pace of IT application in every field. The market leaders here have the advantage of a long-standing relationship with clients, where most of their revenues come from repeat clientele. This also reduces pricing pressure from clients to some extent, which has enabled some IT companies to report impressive profit margins.

Several players in both the engineering and technology space have positions that seem defendable with a combination of technology and relationships. It's very difficult for companies to change their engineering or technology partners, especially if they have been dependable. It enables these players to hold their margins during tough times, improve them during good times and certainly introduce new offers with relative ease. Considering the robust economic growth expected in India and the inevitability of higher usage of IT worldwide, one can expect strong companies in the two sectors to continue to do well.

Similarly, industries like infrastructure and petrochemicals also look impressive, based on growth parameters. But this may not be true at all times. Infrastructure was led by the boom in the real estate industry, but it has suffered the most in the recession. Petrochemicals are dependent on unstable crude prices, which again is dicey. Pharma will prove to be more stable, as it has been the least affected in recessionary times. ◻