# Great companies, but...

A study of the intrinsic value of Profit 100 companies shows stocks offer little margin of safety

India's most financially stable and capital efficient companies – that is what we brought to you in our Profit 100 listing (Issue dated November 13, 2009). Apropos our listing, a study conducted by investment portal, *MoneyWorks4me.com*, reveals that more than half of the stocks qualify as "green" companies, but only a handful of them are quoting at attractive discount to their intrinsic value.

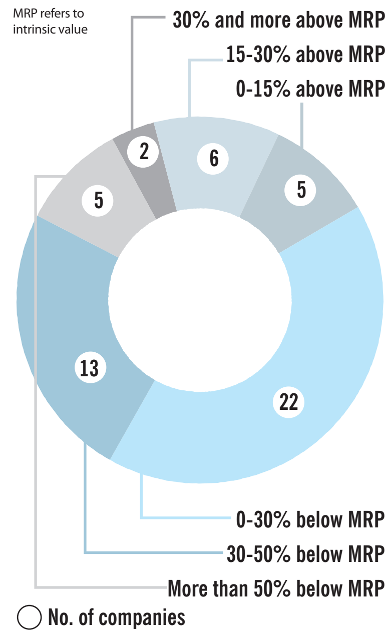
Green companies are those which have clocked more than 12 per cent growth in sales, net profits and earnings per share, and earned a 12 per cent return on capital over the past 10 years. That is not surprising because the listing was also based on similar criteria, albeit for a shorter period of six years. More importantly, while 40 of the companies in the august list are quoting at less than their intrinsic value, only five of them are quoting at a good enough margin of safety to qualify as strong investment candidates by investors. The five stocks -- Bharat Bijlee; Praj Industries; Shanti Gears; Oil Country Tubular and Geodesic -- are quoting at a 50 per cent discount to their intrinsic value or you can call it the MRP (maximum retail price). "Intrinsic value is actually the equivalent of MRP for the stuff we buy because that is really the maximum you an pay for the stock," says Raymond Moses of the Pune-based firm. The concept of intrinsic value and margin of safety was eternalised by investment guru, Benjamin Graham, whose philosophy was to buy stocks substantially below their intrinsic value and profit by selling them closer to that intrinsic price. To arrive at the intrinsic value of a stock, *MoneyWorks4me.com* has considered both dividend income and future selling price. The dividend income is calculated considering the current dividend per share and expected dividend growth rate, while future stock prices are a function of future earnings and the multiple it gets on those earnings. Future earnings are estimated based on the historic trends in earnings and average return on equity earned by a company and the future multiple is also based on historic trends. The two sources of income are then discounted with an expected rate of return of 15 per cent.

A sectoral classification of stocks quoting at more than 30 per cent discount (18 stocks) to intrinsic value shows that software services and pharmaceuticals are currently going cheap. One criticism to calculating intrinsic value based on past trends is that the future could sometimes turn out to be vastly different. A key reason technology stocks today appear to be going cheap is because they are believed to have passed their prime. An appreciating rupee and tough business conditions in the US, for example, are making their future profitability uncertain. But then, that is the reason experts recommend buying stocks at substantial discount to their true value.

So our takeaway, while we do not have dearth of great companies, stocks are not quoting particularly cheap for investors to make pots of money. ☐

## What's cheap

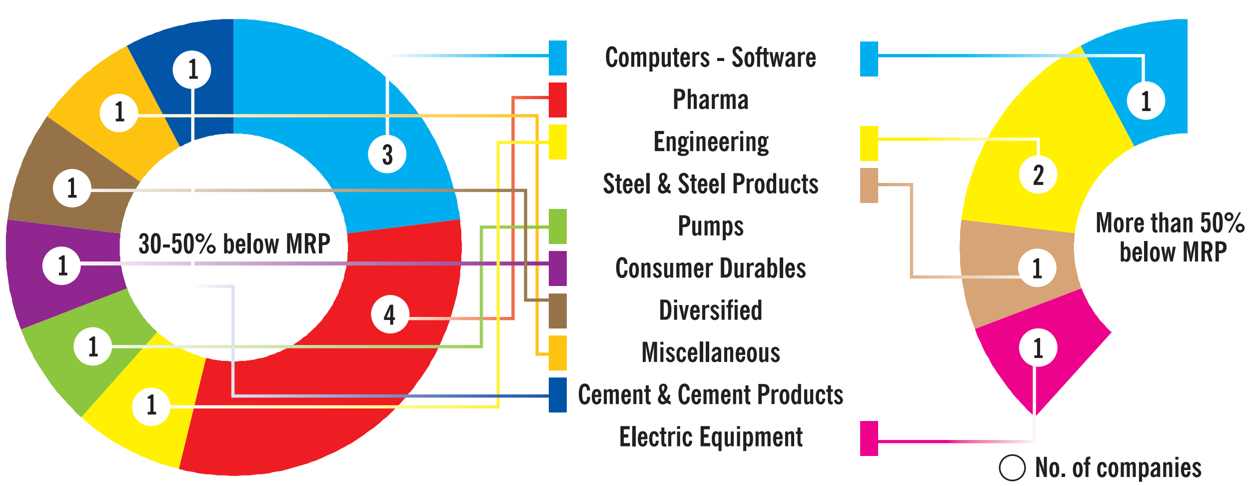
**Only five companies are quoting at a substantial discount to thier intrinsic value**




Source: MoneyWorks4me.com

## Sector speak

**Pharma and IT stocks are the cheapest**




Source: MoneyWorks4me.com