DOES EQUITY RESEARCH GUIDELINES WORK FOR SMALL INVESTORS??

A Presentation for Apex Investment Limited

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SOME GENERAL POINTS

- A listed company publishes its audited/unaudited accounts periodically which contain
- Balance Sheet which describes how the assets of the company is financed by equity and debt
- Profit and Loss Statement which describes the revenue and profit of the company
- Cash Flow Statement which describes the general changes in cash position of the company due to various financial transactions carried out by the company over the reporting period
- Notes to Accounts describes in further depth the above with details of all numbers
- Corporate Governance Guidelines and Compliance
- Management Discussion by Chairman and Managing Director of Company
- Review of media reports
- General Investor is an equity holder of company. Bondholder, Long and short term financier, preference share holder all are paid first before a company distributes its profits to common investors.
- Assets= Capital + Liabilities
- EPS = Earning per Share, NAV : Net Asset Value per share
- Cash Dividend Payout Ratio = (Cash dividend paid per share/ Earning per share) %

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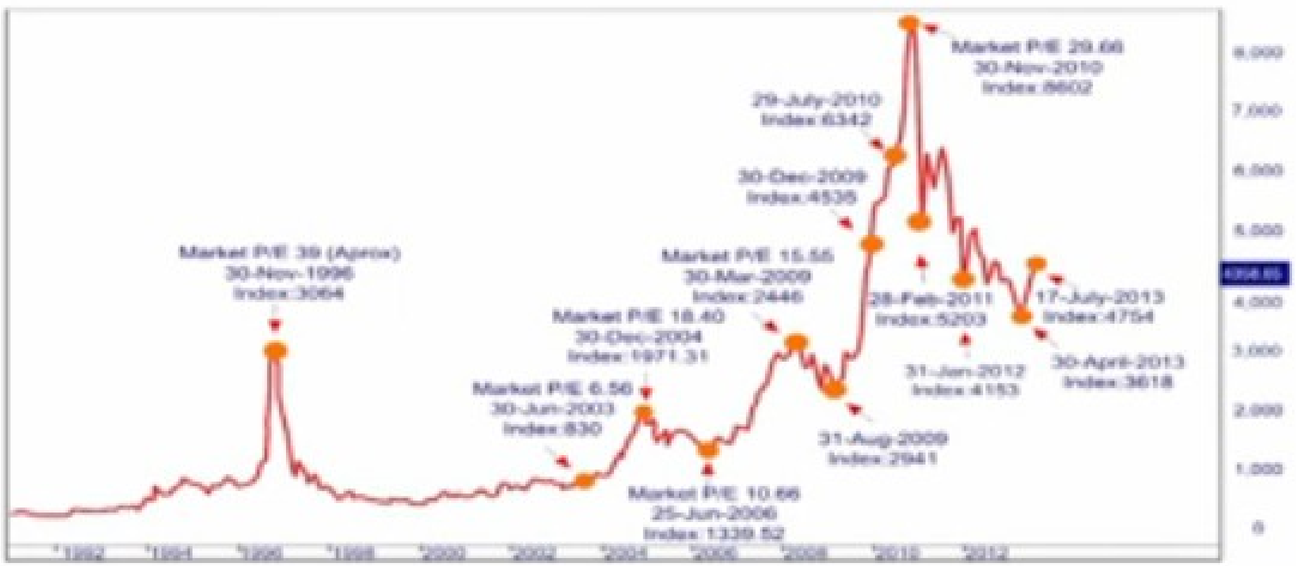
Common Concept – True or False??



DSE General Index - Monthly

- **It is a common conception that equity research or asystematic study of the financials of a listed company is not a rewarding experience. Commonly people say that Fundamental analysis does not work in a nascent market like Bangladesh. Is it true?**
- **Stock market is a casino**
- **Stock market is controlled by market makers, manipulators**

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OUR EXPERIENCE AT EMPIRE CAPITAL IS DIFFERENT

- **On April 12, 2013 we published a report titled "Power Sector Analysis : A Comparative Analysis of Five Energy Generating Companies." The report was a broad fundamental analysis on the listed power generation companies in Bangladesh. Our conclusions in the report were,**
- **"From the investors point of view KPCL and SPPCL would be rewarding for investment. Thereby, these two shares have higher chance to have a large rally in price as money flows into stocks.**
- **It may be concluded that the more than satisfactory performance of these companies may attract further institutional demand, local and foreign for the shares of these companies. Retail investors can also take advantage of the situation as the persistent lagging performance of banks & NBFI (Forward market P/E of Banks of 10.52) may concentrate institutional fund flow to this sector and preserve equity and perhaps produce capital gains once DSE & CSE market conditions improve."**
- To test our above conclusions we did an evaluation of the findings of our research. Say an investor A had followed our research and invested equal amounts of money in SPPCL and KPCL. We also considered an investor B who invested in the power sector equal amounts of money in all five companies covered in our research. Say an investor C who did not follow the research and invested generally in DSEX, although readers are aware index trading is not possible in Bangladesh at the moment.

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Investment returns benchmarking

Name of Company	MP18.04.13	MP 21.06.15	Return
KPCL	33.4	72.5	117.0659
SPL	27.65	41.4	49.72875
GBB	17.79	18.9	6.23946
Baraka	21.5	32.5	51.16279
SPPCL	45.73	53.4	16.77236
DSEX	3571.27	4511	26.31361
Investor Category			
Investor A	39.555	62.95	59.10527
Investor B	29.214	43.74	49.72274
Investor C	3571.27	4511	26.31361

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INVESTMENT RETURN BENCHMARKING

- **It can be seen that over this time period of approximately 26 months, Investor A who strictly followed Empire Capital recommendation would have returned 59% cumulatively. Investor B who read our research report and concluded that power generation companies are worth investing would generate a return of 49.7% cumulatively. Investor C who would just invest in DSEX (currently no index trading is available) would generate return of only 26.3% . Over this holding period, Investor A outperformed Investor B by 10% and Investor C (a general investor) by 33%.** In the long run such differences in rates of return can make vast differences in total amount of equity and returns say over a 10 year period. An average investor who starts out early has an investing horizon of 40-60 years in his life time. **So superior returns can take the savvy investor who indulges in quality equity research much further then a general trend follower.**

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A Peer comparison of Listed Power Generation companies

	SUMIT POWER 2012	SPPCL 2012	KPCL Q3 2012	GBBPOWER Q3 2012	BEDL Q2 2012
Current Profit for the year Cr. BDT	248.665	47.067	120.758	7.832	10.123
Growth of Profit	-19.05%	19.08%	81.38%	3.74%	-8.83%
Annual NPAT Cr. BDT	248.67	47.07	161.01	10.44	20.25
Forward/Trailing EPS	3.8	6.17	5.11	1.39	1.62
Forward/Trailing P/E	12.03	9.01	9.47	19.50	17.10
Market Price	45.7	55.6	48.4	27.1	27.7
Price Earnings Growth – PEG	2.87	0.28	0.32	0.41	-4.34
Net Profit Margin	42.20%	38.165	13.96%	20.41%	31.05%
	64.57%	34.52%	7.40%	17.11%	26.73%
Debt to Equity Ratio	0.28	0.23	0.77	0	0.1
	0.51	0.66	0.4	1	0.13
Quick Assets Ratio	1.78	2.85	0.79	7.08	4.15
	1.02	0.37	0.31	3.43	4.39
Energy sold MWH	1,805,636	470,924	1,220,341	172,423	316,327
Capacity MW	316	66	265	22.8	51

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RATIO ANALYSIS

	Formula	KPCL	SUMITPOWER	GBBPOWER	BEDL	SPPCL	
RATIO ANALYSIS		2011	2011	2011	2011	2011	Industry Average
Current Ratio	Current asset/Current Liability	0.45	1.32	3.92	4.78	0.51	2.20
Quick Ratio	Cash/Current Liability	0.31	1.02	3.43	4.39	0.37	1.90
Inventory Turnover	COGS/ inventory	9.13	2.96	6.75	4.38	5.33	5.71
Average Collection Period	Account receivable/(Sales/360)	57.00	74.13	124.48	71.94	57.07	76.92
Fixed Asset Turnover	Sales/ Fixed Asset	1.19	0.28	0.34	0.30	0.39	0.50
Total Asset Turnover	Sales/ Asset	0.88	0.24	0.29	0.22	0.34	0.39
Debt Ratio	Total Liability/ Total Asset	0.70	0.41	0.52	0.16	0.53	0.47
Debt-to-Equity	Long. term Liability/ Equity	0.40	0.51	1.00	0.13	0.66	0.54
Times Interest Earned	Interest exp./ NBIT	2.70	8.08	1.75	3.48	3.21	3.84
Gross Profit Margin	Gross Profit/ Sales	13.90%	59.44%	49.46%	53.35%	53.15%	45.86%
Operating Profit Margin	Operating Profit/ Sales	12.73%	69.27%	43.60%	43.88%	48.16%	43.53%
Net Profit Margin	NPAT/ Sales	7.40%	64.57%	17.11%	26.73%	34.52%	30.07%
Earnings Per Share	NPAT/No. of share	2.83	6.37	2.57	1.90	5.18	3.77
Price/Earnings Ratio	Price/ EPS	17.73	8.37	19.56	29.95	13.82	17.89
Return on Total Assets (ROA)	Sales/ Fixed Asset	6.48%	15.34%	4.89%	5.78%	11.90%	8.88%
Return on Equity (ROE)	Sales/ Equity	21.65%	26.02%	10.24%	6.91%	25.42%	18.05%
Equity Multiplier	Total Asset/ Equity	3.34	1.70	2.10	1.20	2.14	2.09

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Ratio Analysis

- **Liquidity position of power sector:**
- **The five selected companies had enough liquid assets in hand in 2011 as indicated by the average industry average of current asset ratio and quick asset ratio of 2.20 and 1.90 respectively.** As per the acid test/ quick asset ratio the power industry possessed almost two times higher cash in circulation or cash tied up to the operation of total short term liability. This implies that in 2011 on an average this industry had twice the capacity to pay off current liability.
- **An in-depth examination of liquidity position of individual companies would give better understanding. It reveals that only GBBPOWER and BEDL were having liquidity margin above the industry average**.

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Ratio Analysis

- **Turnover of assets: Though individually none of the company had shown inefficiency in inventory management, SUMIPOWER generated lowest turnover to asset in 2011.**
- Taking a closer look at the asset turnover ratio, one important point is noticeable that on an average asset turnover of peer companies of KPCL was below 50% of total asset these companies held. Only KPCL alone achieved sales so high, 1.91 times of its fixed asset value. This can be attributed to its advantage over its peer companies to receive higher tariff on selling of electricity being a retail power plant which signed up PPA with BPDB in 1997. Notably, KPCL's contribution to total sales of group was 61% in 2011.

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RATIO ANALYSIS

- **Leverage ratio:**
- Debt ratio reveals that BEDL was the best in terms of leveraging its operation with external liability. It financed only 16% of its asset with debt. SUMITPOWER had been also operating along with debt leverage of below industry average of 47% of total asset. However, SUMITPOWER had been bearing the highest debt obligation in 2011, 44.2% of total debt of group, but managed to keep the debt ratio below industry average as it has the largest capacity installment in production and consolidated asset including four subsidiaries of BDT 20.031 billion which is almost 49% of industry's total asset.
- KPCL's 44% of total asset was financed by external debt. 56% of total loan comprised of bank term loan which implies that the company has financed its working capital and assert heavily by external debt. Its capital structure is 40:60 (Debt: Equity). After getting IPO proceeds of its subsidiary KJACL this company would be able to liquidate its liability, thus we expect its debt ratio will improve in following year.
- The total revenue of this group was about BDT 1835.39 crore in 2011, while KPCL alone shared 61.3% of this group sales revenue. Both the plants of KPCL are considered to be the most efficient power generation plant in Bangladesh and hold the distinction of being first IPP of the country. Thereafter, SUMITPOWER generated second largest sales amongst the group of around 25%. On accounts of holding of majority of the capacity among the group, these two companies tapped biggest part of the market demand.
- Though revenue of SUMITPOWER was only 42% of that KPCL earned in 2011, a closer look at the profitability ratios of the group shows that net profit margin of SUMITPOWER of 64.57% was the highest and way above the industry margin of 30%. This company had successfully generated large amount of profit over its peer companies in 2011 due to lower cost requirement in producing electricity. This company owns 11 plants and all these are natural gas based plants except the Madanganj Power Plant which is HFO based plant. Gross profit margin for SUMITPOWER was 59% while KPCL generated gross profit of only 13% of its sales on account of enduring high cost of purchasing HFO oil for all three plants it owns. On the contrary, profitability ratios for BEDL, SPPCL and GBBPOWER are showing better ability to cling on an average 40% to 50% of their revenue as respective operational profit compare to that of KPCL. Altogether three of these companies have the capacity of 139 MWh which is only 21% of total capacity of group and half of that of KPCL, thus the amount of profit brought in by these companies are insignificant to what KPCL earned in 2011.

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RATIO ANALYSIS

RATIO ANALYSIS	KPCL 2012 Q3	SUMITPOWER 2012 Q4	GBBPOWER 2012 Q3	BEDL 2012 Q3	SPPCL 2012 Q4	Industry Average 2012Q3
Current Ratio	0.95	2.17	7.73	4.85	3.04	3.75
Quick Ratio	0.79	1.78	7.08	4.15	2.85	3.33
Inventory Turnover	8.30	2.51	5.22	0.93	5.60	4.51
Average Collection Period	134.35	64.73	192.65	148.01	63.24	120.60
Fixed Asset Turnover	0.94	0.36	0.25	0.13	0.43	0.42
Total Asset Turnover	0.61	0.28	0.20	0.09	0.27	0.29
Debt Ratio	0.64	0.30	0.03	0.15	0.29	0.28
Debt-to-Equity	0.77	0.28	0.00	0.10	0.23	0.28
Times Interest Earned	3.24	4.87	1.89	4.19	4.12	3.66
Gross Profit Margin	21.30%	61.50%	49.11%	58.92%	54.00%	48.97%
Operating Profit Margin	20.05%	53.10%	48.58%	47.63%	48.64%	43.60%
Net Profit Margin	13.96%	42.20%	20.41%	31.05%	38.16%	29.16%
Earnings Per Share	3.83	3.80	1.04	0.81	6.17	3.13
Price/Earnings Ratio	9.63	12.29	17.86	17.47	9.38	13.33
Return on Total Assets (ROA)	8.53%	11.71%	4.01%	2.92%	10.42%	7.52%
Return on Equity (ROE)	23.87%	16.83%	4.13%	3.42%	14.58%	12.57%
Equity Multiplier	2.80	1.44	1.03	1.17	1.40	1.57
PEG	0.40		0.54	-5.40		-0.89
Forward EPS	5.11		1.39	1.62	6.17	2.86
Forward PE	9.63		20.21	17.45	9.38	

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RATIO ANALYSIS

- **Liquidity test for all the inspected companies reveals that over all liquidity of asset has improved in first nine months of 2012. Industry average as on September 2012 shows 75% markup in liquidity over full accounting period of 2011.**
- Significant improvement can be observed for KPCL, SUMITPOWER and GBBPOWER. GBBPOWR gained liquidity rapidity mostly in form of cash in hand and bank deposit. This change can be attributed to the upsurge in consolidated revenue of BDT 325.642 mn for the period on nine months in 2012 as against consolidated revenue of BDT 104.277 mn for the same period of 2011.

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RATIO ANALYSIS

	KPCL 2011	SUMITPOWER 2012	GBBPOWER 2011	BEDL 2012	SPPCL 2012
Dividend Payout	88.25%	52.63%	97.35%	110.77%	48.62%

The low Price Earnings valuations, lucrative price earnings growth and payout suggest the stocks may also be potentially attractive for taking dividends. As KPCL, SPPCL and GBBPOWER had healthy growth in net profit and also price earnings growth (PEG) are less than one, we can expect high dividend payout from these shares. Even if they payout low dividend for next years, high earnings growth of all of these companies suggest that the retained amount of profit would be invested for capital expansion which will also improve the earnings per share. Thus, in both ways investors will be better off with these shares.

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CONCLUSION – "THERE IS METHOD TO MADNESS"

- All the companies in power industry of Bangladesh is producing public utility which is protected from global price hike of energy resources by fuel price tariff mechanism of BERC. **BPDB has taken a massive capacity expansion plan to add about 12000MW Generation capacity in next 5 years and about 25000 MW by 2021 with the aim to provide quality and reliable electricity to all the people of Country for desired economic and social development.** This expansion policy has piled up financial cost for some companies. However, all the examined companies have successfully protected their operating profit hoarding sufficient earnings either by increasing sales or cutting cost. The entire power industry as a whole is secured for investment as it is protected by sufficient amount of liquid asset. **From the investors point of view KPCL and SPPCL would be rewarding for investment.** Robust growth in sales revenue of KPCL and cost efficiency in operation has put the financial performance of KPCL behind all the business risks. SPPCL is showing steady growth in operation and announced the highest earnings per share of Tk. 6.17(Undiluted), 4.42 (DilutedPost IPO) as for year ending December 2012. In addition to that, only two shares lying below the sectoral P/E of 10.13 as of March 27, 2013 are SPPCL and KPCL. Thereby, these two shares have higher chance to have a large rally in price as money flows into stocks.
- It may be concluded that the more than satisfactory performance of these companies may attract further institutional demand, local and foreign for the shares of these companies. Retail investors can also take advantage of the situation as the persistent lagging performance of banks & NBFI (Forward market P/E of Banks of 10.52) may concentrate institutional fund flow to this sector and preserve equity and perhaps produce capital gains once DSE & CSE market conditions improve.

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Present Research efforts of Empire Capital

- Daily Market Synopsis
- Weekly Market Synopsis
- Individual Stock Analysis
- Industry Analysis
- Capital Market Exposure of Listed Banks, NBFI, Non life insurance companies
- PEG Ratio updates of listed companies for Identifying growth stocks in the Bangladesh Capital Market
- Capital Market Yearly Review
- Maintenance of Database on listed companies and DSE Turnover
- Impact Analysis
- Technical Analysis

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- Dynamic Investment Planning
- Risk Management of Margin, Equity, Risk Profiling of Clients
- Customer Satisfaction Surveys, Customer Relationship Management
- Increase Market Share of Apex Investment Limited through innovative business expansion campaigns
- Business Planning and Data Mining

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Investments cannot always bring us happiness, but there is no happiness without investments.

"বিনিয়োগ সব সময় আমাদের জীবনে আশীর্বাদ বয়ে আনবে না, তবে বিনিয়োগ ব্যতিত সুখ অর্জন অসম্ভব।"

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