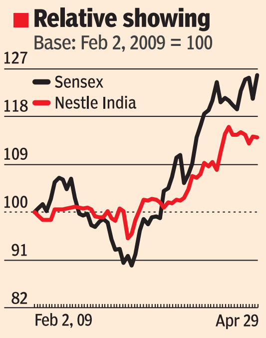
Insight

Margin boost

Nestle India's performance for the quarter ended March was in line with street expectations.

Total revenues rose 16% year on year to Rs 1,265.85 crore. Domestic revenues were 94% of the revenue pie and grew 18.7% on the back of better sales volume and price realisations. The rest came from exports, which fell 15%, mainly because exports to Russia were lower. The decline, however, was somewhat offset by better price realisations on account of the rupee's weakness against the US dollar.

Performance at the operating level was good as margins improved by 185 basis points (100 basis points make one percentage point) to 23.93%. The company attributed this to lower petroleum prices; favourable sales mix and improved net realisations. Also, other operating income more than doubled (up 110%) to Rs 4.93 crore and foreign exposure management was better, which helped operating margins. Other operating income included backlog of export incentives received during the quarter.



Some analysts were expecting a fall in margins on account of higher input costs — mainly wheat and sugar. Sugar prices had grown 33% year on year in March. But the company seems to have benefited from a fall in the prices of coffee and skimmed milk powder. Thus, total expenditure grew 13%, lower than revenue growth, to Rs 966.68 crore and helped operating profit jump 26% to Rs 304.1 crore.

Net profit grew 23.2% to Rs 197.3 crore despite a 35% increase in tax outgo.

At Rs 1,702, the stock trades at 24.2 times its estimated earnings for 2009. It has underperformed in the last one month, appreciating 7% to Rs 1,702 per share compared with a 15% increase in the BSE Sensex. However, analysts like the stock in its space and investors could consider it on declines.

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Ponzi scheme

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Evidently, even though sales were being made to DAL, hardly any sales were actually being paid for by DAL.

In other words, the company was using aggressive accounting to boost its sales as well as profit numbers. As long as these “paper” sales to DAL kept going, the net sales and profit numbers of DLF kept growing quarter on quarter. But profit is not always cash, as any accountant will tell you.

The “business model” was akin to a Ponzi scheme, where an illusion of a successful investment scheme is created by using money being brought in by new investors to pay off the older investors.

In this instance, as long as sales to DAL kept going up, DLF kept showing increasing profits and sales. But at the same time, receivables kept going up as well.

For a Ponzi scheme to keep going, the money new investors get into the scheme should be more than the money being paid to the older investors. Similarly, for DLF revenues and profits to keep growing, the company needed to book more and more sales to DAL, which couldn't have gone on forever.

Sales to DAL fell to Rs 655 crore for the quarter ended December 31, 2008, down from Rs 2,057 crore for the quarter ended December 31, 2007. This dramatic fall led to the total income of DLF falling 59% to Rs 1,503 crore. Profit fell even more dramatically by 68% to Rs 682 crore.

And for the quarter ended March 31, 2009, sales to DAL have fallen even more dramatically to Rs 322 crore, as against Rs 1,845 crore in quarter ended March 31, 2008. This has pulled down sales and profits of DLF big time.

Clearly, accounting gimmickry to boost sales cannot continue forever.

In the March quarter, DAL paid around Rs 800 crore of the nearly Rs 5,400 crore it owed DLF as on December 31, 2008. But even after this, DAL owes around Rs 4,900 crore (Rs 5,400 crore outstanding in the last quarter - Rs 800 crore paid by DAL + Rs 323 crore of sales made to DAL during the quarter) to DLF, which is not a good sign. DLF has suspended further sales to DAL.

The stock has rallied 66.5% since March 9, 2009, despite there being no fundamental improvement in the company's situation. Further complicating the scenario is the fact that for the first six months of this financial year, DLF has outstanding land bank payments of Rs 5,000 crore and debt refinancing needs of Rs 4,500 crore, say analysts.

In order to reduce debt, the company is trying to sell its non-core assets like its wind power business. The non-core businesses — DLF Pramerica Life Insurance, Hotels and Power, etc — posted a loss of Rs 163 crore for the quarter.

The downtrend in real estate prices only makes the situation even more difficult. The company, which like most real estate companies, had been holding on to prices, recently sold its Capital Greens project located at Shivaji Marg, Delhi, at Rs 4,500-5,500 per sq ft, 30-40% lower than prices of existing projects. Even though the booking amount paid by the customers will help the company improve its cash position, it may not be good enough to solve the funding problems of DLF.

Analysts say the company may also see cancellations of bookings made previously, given the state of the economy. Other than this, in the March quarter, the company gave price reset and other benefits to customers, which led to Rs 688 crore of lower revenue and a profit-before-tax impact of Rs 302 crore.

The company's situation sure does not look good.

For those who still have the stock, it might be a good time to sell before the bears come in.

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Prospect theory can help you profit

Concepts like loss aversion and sunk cost fallacy help us understand our own instincts

Mazhar Mohammad

“Only when you combine sound intellect with emotional discipline, you get rational behaviour”— Warren Buffett

Ravi is a smart, intelligent and young techie with MBA (finance) from a reputed business school. He constructed a smart and sizeable portfolio in 2004, which multiplied six times as the market rallied from 4000 to 20000 levels. He felt very happy looking at his paper profits, which never translated into real money. After seeing new highs, which were followed by sharp corrections of 2004 and 2006, my friend assumed the bull market was eternal and the 2008 correction too would follow the same pattern and scale new milestones such as 25000 and 30000. Then, the inevitable happened, as Mr Market, who generously rewarded long-term investors for four years, embarked on a southward journey. My friend's portfolio, which was loaded with small and midcap stocks, melted like wax in no time.

Why did Ravi fail to book profits? Did he fall in love with the bull market? Did he become a victim of his own greed?

Following the footsteps of Baron Rothschild, an 18th century British banker who famously said, “The time to buy is when there is blood in the street,” I advised Ravi to go for staggered buying and build a new portfolio when the Sensex was trading at sub-10000 levels, merely because stocks were available at lower prices.

Ravi has enough risk appetite and stomach to hold on to his scrips for the longer term. But to my surprise, he turned down my advice and worried that the market may come down to 6000 levels.

What prompted Ravi, who was bold enough to consider buying even at 20000 levels, to shy away from the market when he got the opportunity to buy at much lesser prices? Fear?

Yes, Ravi succumbed to his emotions by letting greed and fear influence his decision-making and acted in a manner contrary to his own financial interest.

Is this type of behaviour limited only to Ravi? No, this type of behaviour is common to most investors. Even professional money managers fall in love with bull markets and behave irrationally.

For more insight into investor behaviour and to understand how emotions impact our decision making and force us to act against our own financial interest, let us try to understand what is known as the 'prospect theory'.

Prospect theory

The theory was developed by Daniel Kahneman of the department of psychology at Princeton University and Amos Tversky.

Their seminal work, “Prospect Theory: An Analysis of Decisions Under Risk,” which was published in the journal of Econometrica in 1979, has the distinction of being the second-most cited article during the 1975-2000.

The article states that investors have an irrational tendency to be less willing to gamble with profits than with losses and explains how investors make decisions when confronted with risk. It also shows how fear of losing and greed for gains impact our decision making. It also empirically proved that investors are not risk averse but they are loss averse.

Kahneman was felicitated for his work done in collaboration with Tversky with Nobel Prize in Economics for the year 2002.

Prospect theory identifies two behavioural anomalies, as far as our losses are concerned viz. loss aversion and sunk cost fallacy.

Loss aversion

Loss aversion refers to people's tendency to strongly prefer avoiding losses to acquiring gains.

Kahneman and Tversky empirically proved this.

Say you participated in a television game show. There, you are confronted with the following two situations:

Situation I

You are given Rs 10,000 and two options:

- Guaranteed win of Rs 5,000
- Sealed envelope, which contains either real notes of Rs 10,000 or mere white papers

Which option will you choose?

Situation II

- You are given Rs 10,000 and two options:
- Guaranteed loss of Rs 5,000
- Flip of a coin. If it is heads, you will lose Rs 8,000 and if it is tails, you won't lose anything.

Which option will you choose?

Research suggests that you will choose the first option in Situation I as there is a guaranteed win of Rs 5,000 where as in Situation II you will choose the second option as you don't want to take a guaranteed loss of Rs 5,000. Instead, you prefer to test your luck by going for a flip of a coin. It is this attitude that makes gamblers so popular with casinos.

When we apply the same concept to stock markets, we see similar type of behaviour among investors. For instance, X bought MIC Electronics at Rs 250. The stock tumbled to 75. At this juncture, he has the opportunity to book his losses and invest in a better counter. But he prefers to reduce his cost of purchase by investing in the same scrip with the intention of 'break even'. It happens because investors are reluctant to book losses. Research suggests that the pain of loss is twice the pleasure of gain. It may be the reason investors are so reluctant to get out of the counter, even their investment decision proved wrong and unfruitful. Loss aversion also forces the investors to book profits very quickly at early stages of rally without riding the profits. In fact, the success of investors lies in riding the winners and cutting the losses. But in practice they behave in opposite direction hurting their own financial interest.

Sunk cost fallacy

Sunk cost fallacy is another form of loss aversion. It shows the inability of investors to forget the money incurred and investors tend to base their future decisions based on money already spent.

For instance, X joined the one year executive MBA programme. He found the programme boring and not in line with his career objectives. He has the option of discontinuing the course and do whatever interests him. But he decides to continue in it just because he paid the money. By reluctantly doing so, he is not only wasting additional money on the course but also his valuable time.

In stock markets, averaging the cost price with the intention of breakeven is the best example of sunk cost fallacy. It is like throwing good money after bad.

In case of gains, investors suffer from biases like status quo, i.e. inability to make decisions, and endowment effect, i.e. falling in love with what you own.

It is always said that markets did well, but investors fared poorly. Investors too can do well by identifying their own behavioural anomalies and refraining from repeating the same mistakes.

The writer is technical analyst, Darashaw & Co, Mumbai. Views are personal.

General insurers' premium growth plunged last fiscal

Growth dropped to 9.09% from 12.63% in FY08

Nandini Goswami. Kolkata

The over Rs 30,000 crore general insurance industry, comprising 16-odd players, has registered a drop in premium income growth for the financial year 2008-09.

The industry clocked a 9.09% growth in premium in 2008-09 against 12.63% growth in FY08.

Most private players saw a massive decline in premium growth in the second half of 2008-09. However, four national players held ground in that period and doubled their growth to 7.11% over 2007-08.

Figures with the Insurance Regulatory & Development Authority (Irda), collated and analysed by *DNA Money*, show economic downturn, coupled with fall in premium rates in a complete price de-control regime, caused the low numbers.

Rise in gross premium (in Rs crore)

Company	Premium	Growth in 08-09	Growth in 07-08
Royal Sundaram	806.22	15.73%	15.75%
Tata AIG General	882.93	8.12%	9.69%
Reliance General	1914.81	(-) 1.62%	113.35%
Iffco-Tokio	1515	22.63%	7.43%
ICICI Lombard	3419.84	2.25%	11.36%
Bajaj Allianz General	2640.49	9.82%	33.33%
Cholamandalam	685.44	30.14%	79.17%
HDFC Ergo	339.48	41.63%	13.89%
New India Assurance	5516.62	4.53%	5.12%
National Insurance Co	4276.81	6.73%	5.67%
United India Insurance	4275.44	14.33%	6.86%
Oriental Insurance	3960.57	4%	(-) 1.86%
Total	**30601.20**	**9.09%**	**12.63%**

Source: IRDA

Comparative figures between different players in the general insurance space reveal interesting facts.

Reliance General Insurance, which witnessed the highest premium growth of 113.35% in 2007-08, saw a degrowth of 1.62% in 2008-09.

Leading private sector players ICICI Lombard General and Bajaj Allianz General saw declines in premium growth to 2.25% and 9.82%, respectively against a growth of 11.36% and 33.33% in 2007-08.

While Royal Sundaram and Tata AIG General managed lower declines in FY09, Iffco Tokio reversed the market trend with a substantial growth of 22.63% against a growth of 7.43% in 2007-08. On a lower base, HDFC Ergo also registered a 42% growth in 2008-09 against a growth of 14% the previous year.

Among nationalised players, except for the largest player — New India Assurance — all the other three companies recorded a growth in 2008-09 over 2007-08. New India Assurance's premium grew 4.53% in 2008-09 against a growth of 5.12% the previous year.

United India clocked the biggest jump in premium income with a 14.33% growth in 2008-09 against 6.86% growth the previous year.

Oriental Insurance also registered a 4% growth in premium in 2008-09 against a negative growth of 1.86% the previous year. National Insurance grew 6.73% from 5.67% the previous year.

An insurance analyst said the public sector growth was due to the aggressive pricing strategy and a shift in the customer base from private to public sector as a safer bet in a soft market.

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Banks take a hard look...

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“One can empathetically say that most MFIs haven't had the time to spruce up their controls to match their rapid growth. This is potentially dangerous,” he said.

Fellow banker and head of microfinance and sustainable development for Royal Bank of Scotland in India, Moumita Sen Sarma, said a slowdown in microfinance would be welcome. “If there is a slowdown in growth of MFIs, it will allow them to focus on strengthening their systems and processes.
Out risk appetite will be lower for MFIs that are not following robust systems and processes,” she said.

RBS has recently launched toolkits that help MFIs audit and put MIS systems in place.

Some MFIs remain confident despite the fund crunch.

Titus Mathew, executive of SaDhan, an association of community development finance institutions, said banks choosing to be more cognizant shouldn't be a problem. “The emphasis on asset quality is a good thing for the asset class. Growth is going to be toned down in 2009-10 versus 2008-09 because we are growing into new markets and there has been a liquidity squeeze because the RBI's rate cuts haven't yet transmitted fully,” he said.

Mathew expects growth to be at least a few percentage points lower than the 70%+ growth seen last year.

There are also some lifelines for the MFIs.

Investment bankers like Intellecap and Grameen Capital are helping them get both debt and equity funding to build their books and then approach banks for funds.

Moreover, there have been a few deals in which banks such as IndusInd Bank, Yes Bank and ICICI Bank have provided advances to MFIs such as Bandhan and SKS for agricultural and allied lending. The MFIs have to administer loans and channel the collections to the bank.

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DLF plans to review ties with DLF Assets

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The move would also help DAL's restless investor DE Shaw to make an exit. The earlier plan of DAL listing as a real estate investment trust on the Singapore stock exchange was cancelled due to volatile market conditions.

Sources said DLF might own as much as 40% of DAL.

A DLF spokesperson declined to comment on the plans.

If DLF goes ahead and acquires a significant stake in the firm, it will get DAL's tax-free rental income from special economic zones on its own balance sheet.

With demand for both commercial and residential property falling, DLF reported a 93% year-on-year drop in its profit at Rs 159 crore for the March quarter. Sales were down 69% at Rs 1,351 crore.

DLF is also looking to sell its non-real estate business of wind power to service the mounting debt and for construction of properties.

“Wind Power has met with a good response from strategic partners wherein the due diligence of the assets is currently underway,” the company said.

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Trade gap pierces $100 bn-mark

In fact, the average price for our crude, at $82.72 per barrel, last year was only 3.8% higher than the annual average price of $79.66 during 2007-08. For the year as a whole, the growth rate in oil imports slowed down to 16.9% from 39.5% in 2007-08. Domestic recession was reflected in import rate deceleration to only 13.2% from nearly 34% in respect of non-oil imports, with bullion, electronics and transport equipment bearing the brunt.

In general terms, the showing in exports and imports during 2008-09 was in conformity with expectations. Still, the macro aspects of our foreign trade should engender concern.

The ever-rising scale of the trade deficit indicates the chronic inability of our exports to pay for our imports; rather, the import-purchasing power of exports is diminishing; this ratio was nearly 75% in 2004-05 and it has declined to 58.6% in 2008-09.

The import-cover — that is, the number of months of imports that could be financed by the foreign exchange reserves at our disposal, other than gold and SDRs — has also fallen sharply in the last fiscal to 10.1 months from over 14 months in 2007-08.

The share of exports to the gross domestic product in nominal terms at market prices has risen marginally to 14.1% during 2008-09 from the preceding year's 13.9%, despite the lacklustre export performance.

This improvement is statistical in that, while in rupee terms, exports grew by 16.9% as against 14.7% in 2007-08, the pace of spurt in GDP was only fractionally better at 14.9% compared with 14.4%.

On the other hand, the imports/GDP ratio was on the ascendant, jumping to 24.1% last year from 21.4%. This ratio was as low as 15.9% in 2004-05.

Auto sales record hat-trick of rises

Combined sales of Santro, i10, Getz and i20 were 41,258 units; Accent and Verna together sold 3,073 units whereas the Sonata Transform sold 34 units and the Tuscon sold six units.

Honda Siel Cars sold 3,656 units (3,400 units), a growth of 7.5%. It sold 2,801 units of the City, 625 of the Civic and 230 of the Accord.

In two-wheelers, Hero Honda sold 3,70,575 units (2,86,252 units), a growth of 29.5%. Senior VP (marketing and sales) Anil Dua said new models — including variants and refreshes launched last fiscal — have been driving volumes. TVS Motor saw sales rise by a modest 3% last month to 1,13,119 units (1,09,972 units), with bike sales registering a degrowth. The company's exports were also affected because of the slowdown in some target markets.

India Yamaha Motors sold 15,120 units (10,199 units) in April.

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GHCL indulged in insider trade

“He is no more a director of the company, and that decision is irrevocable. We made a mistake in actually nominating him as a director,” Dalmia said.

According to documents available with *DNA Money*, Jain, through his companies L D Leasing and Credit Private Ltd and Pranidhi Holdings Pvt Ltd bought 925,000 shares of GHCL between April 17 and 24.

A GHCL official told *DNA Money* two other intermediaries of Jain — a person named Deepak Bachhawat and Destiny Securities Ltd — had also purchased 32,510 shares between April 17 and 24.

“Jain bought these shares when he was a director with the company. He hadn't resigned back then, so he should have informed the BSE and Sebi about the purchases. This is a clear case of insider trading and we want the regulators to take appropriate action against him,” Dalmia said.

Responding to the charges, Pramod Jain told *DNA Money*: “I haven't indulged in insider trading at all. I am a trader and I trade in shares everyday. I bought shares of GHCL and sold them, that is my business. Insider trading is based on some (prior) information, which is not the case here.”

Jain said the intermediaries were his 'persons acting in concert'. “So, when they buy or sell shares, it's not my concern,” he said.

GHCL sources said Jain has pledged his entire stake with private money lenders and he has given post-dated cheques to them.

“Jain is backing a small investor group and is asking GHCL to declare an open offer at Rs 125 per share through them,” he said.

The source said Jain is trying this so that he could sell some of his stake to pay off his own dues.

But Dalmia denied any open offer possibility. “We are not going to announce any open offer,” he said.

Jain, on his part completely denied pledging his shares.

“My shares are not pledged at all. Dalmia is just trying to deviate from the real issue by saying all this,” Jain said.

Sebi banned top GHCL officials from trading in the share market on April 20. *DNA Money* had reported the drop in promoter shareholding, from 38% to 18%, on April 15.

Last week, the Securities and Exchange Board of India banned the GHCL promoters from dealing in the securities market for violating securities market laws including insider trading rules.

Meanwhile, the company in consultation with legal advisors said Sebi has wrongly alleged that GHCL has filed incorrect shareholding of promoters over the last four quarters.

“In our detailed objections, we have strongly contested the findings and orders of Sebi, factually and legally,” GHCL said. It also added that it did not plant any false information story to media last year to induce investment.

“We have given our reply to Sebi and expect them to consider our case. A similar case happened with Bharti Airtel also and Sebi, then, had asked them for a reply. Why they haven't done that with us? Why does Sebi have two standards?” Dalmia asked.

Dalmia also said that as and when Sebi lifts its orders against them to trade in shares, they would increase their stake in the company from the existing 18% to “healthier levels” of earlier stake of 38%.

“We might own even more than 40% of GHCL if the situation demands,” Dalmia added.

Jain had, in a letter to Sebi, said he had withdrawn his resignation on March 27.

“During the course of my diligence on the working of the company, I found some serious irregularities” Jain had alleged in the letter.

A GHCL official said this was incorrect. “We purchased all those companies before the economic meltdown. No one expected this recession to be so severe. For GHCL, the biggest growth will come from the retail segment,” Nikhil Sen, head of international business and strategy at GHCL, told *DNA Money*.

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