mint

Tue, 17 Jan-17; Mint - Delhi; Size : 425 sq.cm.; Page : 12

CPSE ETF has potential to beat Nifty over the next 1-3 years: Reliance MF

INTERVIEW

BY PRASHANT NAIR & EKTA BATRA
CNBC-TV18

The government plans to raise Rs6,000 crore from the follow-on Central Public Sector Enterprises Exchange Traded Fund (CPSE ETF) offer, which will open for subscription on 17 January. Sunil Singhania, CIO-equity investments, Reliance Mutual Fund, said the price-to-earnings (P/E) of this basket is almost half that of Nifty right now, the price to book value is one–third that of Nifty, while return on equity (ROE)—a reflection of the efficiency of a company—is almost 30% higher than that of the Nifty companies. In an interview, Singhania said that with underlying stocks comprising large, stable companies, the CPSE ETF, with a good dividend yield and a 5% upfront discount, is an attractive investment option.

Edited excerpts:

How would you answer the question an investor might ask—why should I invest in this fund?

The underlying stocks of which this exchange-traded fund (ETF) comprises are very large, stable companies, they are market leaders in their respective fields. What we have also seen over the last three-four years, maybe in the last two years in particular, is that a lot of these public sector enterprises have transformed themselves into better corporate governance, better profitability, more visible, stable and forecastable earnings. I think the huge dividend yield and also the 5% upfront discount, which every investor is entitled to, turns out to be one of the better products.

Reliance Mutual Fund CIO (equity investments) Sunil Singhania. MINT

This CPSE ETF CAGR (compound annual growth rate) has been quite strong—17% plus versus the Nifty which is at around 8% plus, and this is since the inception. Your sense in terms of what the return rate could possibly be if you are assuming one, two and may be three years?

I don't know what is going to happen in the future but what I can give is some data points. The price-to-earnings (P/E) of this basket is almost half that of the Nifty right now. It is trading at an 11.5 times P/E versus almost the 21 times P/E for the Nifty on a trailing basis. The price to book value is one-third that of Nifty and at the same time the return on equity (ROE), which is a reflection of the efficiency of a company is almost 30% higher than that of the Nifty companies.

So, the companies are highly profitable, they are generating higher return on capital and they are trading at almost 50% discount to the Nifty in terms of their P/E ratio.

Also their dividend yield is almost 4% for this basket, so there is a probability of maybe the discount to Nifty as far as the P/E ratio is concerned coming down. We are very optimistic that with a very low expense ratio, this product has a potential of beating the Nifty over the next one to three years.

This essentially is taking a bet on the government, which is essentially the promoter of these firms. Would you agree with that assessment?

We have to look at the history and then we can basically make some assumption as far as the future is concerned. Yes, the principal shareholder is the government of India. However, over the last two to three years, we have seen the government having an hands-off approach towards managing its public sector enterprises. The other thing we have to also see is that whether it is the oil marketing companies who have got absolute freedom in terms of their pricing with almost zero subsidy burden or the energy companies and the coal companies, which have started to get pricing power and the engineering companies, which are getting benefit of the huge CAPEX, which most of these government companies are getting into. Also as I mentioned earlier, the return on equity (ROEs) has been consistently rising, the profitability has been consistently rising.

So, there is no hesitation in us to believe that these companies are now starting to move in the trajectory of better managed and to some extent even following the trajectory of some of the private sector companies. Also, as I mentioned earlier, because of the risk which we mentioned, already the companies are trading at 50% discount to Nifty, which is slightly negative.

In our active portfolios also we have decent exposure to government companies and the theme for us is a same. As efficiency is coming into the country, as we are seeing a scenario where inefficiencies in governance, inefficiencies in the way you are working as far as the public sector is concerned is coming down even these companies will be benefited out of that. We might see a better capital allocation, a much more focus on efficiency, which is measured in financial terms by the RoE, higher dividend payout, which has already been announced by quite a few companies and also very investor-friendly steps like giving bonuses and stock splits. All these are signs that we are moving to a scenario where the historical discounts, which we have been giving to these companies, are set to contract and with the underlying scenario both from an oil perspective as well as commodity perspective, also improving, I think the profitability of some of these companies can surprise positively on the upside.