

## Investment Strategy - A study based on Price to Book Value & Dividend Yield

Investing in the Equity markets is an art. And every investor has his or her own style of investing which is usually is a reflection of the return expectations from a particular stock.

Savvy investors use various parameters while zeroing in on their list of preferred stocks. Some long term investors are interested only in growth stocks, while other prefers dividend yield story, low price to earnings ratio, or a low price to book ratio.

There are investors who would also consider the financial performance and ratios, potential of the sector, policy changes and impact of disinvestment on a particular stock.

A popular investment strategy is to identify and invest in undervalued stock with a good dividend yield and the expectation that its fair value will be achieved and in the process Investors will make decent returns. The identification of undervalued stock is done by looking at few important valuation ratios. Usually, Price to Book value and Dividend Yield are two key ratios, on which our study is based, primarily for the reasons explained below.

### Price to Book Value (P/B):

#### What is Price to Book Ratio?

The **price-to-book ratio**, or **P/B ratio**, is a financial ratio used to compare a company's book value to its current market price. Book value is an accounting term denoting the portion of the company owned by the shareholders; in other words, the company's total tangible assets less its total liabilities.

A P/B multiple of less than 1, would imply that the stocks are priced at less than their historical book values in the market. In an inflationary scenario the book values of companies are, in reality, higher than the accounting values. Additionally, in times, when the economy and stock markets are in a boom phase, historically companies have traded above the P/B multiple of 2, indicating of the upside/ potential that stocks below their current book value would carry.

#### Calculation:

The calculation can be performed in two ways, but the result should be the same each way. For instance, the company's market capitalization can be divided by the company's total book value from its balance sheet. The second way, using per-share values, is to divide the company's current share price by the book value per share (i.e. its book value divided by the number of outstanding shares).

## Significance:

As with most ratios, it varies a fair amount by industry. Companies that require more infrastructure capital (for each rupee of profit) will usually trade at P/B ratios much lower than of, for example, consulting firms. A higher P/B ratio implies that investors expect management to create more value from a given set of assets, all else equal (and/or that the market value of the firm's assets is significantly higher than their accounting value). P/B ratios do not, however, directly provide any information on the ability of the firm to generate profits or cash for shareholders. This ratio also gives some idea of whether an investor is paying too much for what would be left if the company went bankrupt immediately.

## Dividend Yield:

### What is Dividend Yield?

The **dividend yield** or the **dividend-price ratio** of a company's stock is the company's annual dividend payments divided by its market cap, or the dividend per share divided by the price per share. It is often expressed as a percentage. Its reciprocal is the Price/Dividend ratio.

### Significance:

Historically, a higher dividend yield is usually considered desirable among investors. A higher dividend yield not only give a decent cash flow to the investor in terms of the annual dividends but also leaves scope for the capital appreciation for the investor unlike a bank fixed deposit or a corporate bond. Additionally, high dividend payments indicate that the company conservatively uses the shareholder's money.

## Parameters:

We initiated a study where we attempted to shortlist companies, from a very broad universe of all the listed companies, which are undervalued in terms of their current and book values and at the same time yield high dividends. The following short listing procedure was adopted:-

- We filtered out all the companies that had market capitalization below Rs. 200 crores
- Secondly, we shortlisted stocks that -
  - Traded at a P/B multiple of less than 1 for the past two consecutive years &
  - Provided a dividend yield of greater than 1.5% the past two consecutive years.

## Results:

We found that 24 companies met the above short listing criteria. Most of these companies primarily belong to Banking, Chemicals and Textiles sector. Please check the detailed list below:

Sr.No.	Particulars Company Name	As on 25 <sup>th</sup> Sep. 2009			First Year			Second Year		
		Market Cap	P/BV (x)	Div Yield (%)	Year End	P/BV(x)	Div Yield (%)	Year End	P/BV(x)	Div Yield (%)
1	Aarti Industries Ltd.	399.36	0.77	3.69	200803	0.80	4.82	200703	0.67	3.39
2	Allahabad Bank Ltd	5315.73	0.65	2.81	200903	0.30	6.44	200803	0.78	3.91
3	Alok Industries Ltd.	1384.02	0.66	5.50	200803	0.73	2.11	200703	0.86	2.45
4	Atul Ltd.	240.41	0.86	4.23	200903	0.37	6.98	200803	0.53	5.29
5	Bongaigaon Refinery & Petrochemicals Ltd.	913.17	0.97	10.94	200803	0.85	10.24	200703	0.84	8.57
6	Carol Info Services Ltd.	229.98	0.48	2.95	200803	0.44	4.28	200703	0.47	4.07
7	Century Enka Ltd.	332.24	0.63	3.37	200903	0.28	7.87	200803	0.49	4.61
8	Cosmo Films Ltd.	212.87	0.75	4.81	200903	0.47	8.03	200803	0.92	5.85
9	Dena Bank Ltd	1910.00	0.79	2.37	200903	0.48	3.72	200803	0.93	1.97
10	Federal Bank Ltd.	4229.97	0.84	2.29	200903	0.55	3.62	200803	0.94	1.85
11	Garden Silk Mills Ltd.	337.15	0.68	1.82	200806	0.46	3.21	200706	0.61	2.63
12	JK Paper Ltd.	316.12	0.58	5.65	200903	0.30	11.19	200803	0.71	4.29
13	JK Tyre & Inds. Ltd.	540.96	0.62	2.93	200903	0.26	7.58	200709	0.74	2.14
14	Kothari Products Ltd.	215.97	0.37	3.04	200803	0.72	1.63	200703	0.68	1.72
15	KPR Mill Ltd.	288.27	0.44	3.32	200903	0.16	9.52	200803	0.72	5.11
16	KRBL Ltd.	349	0.72	1.54	200803	0.78	1.72	200703	0.84	1.86
17	Mahanagar Telephone Nigam Ltd.	5701.50	0.50	4.19	200803	0.52	4.14	200703	0.81	2.73
18	Oriental Bank Of Commerce Ltd	5680.99	0.57	4.21	200903	0.37	6.64	200803	0.77	2.66
19	PNB Gilts Ltd.	388.15	0.58	3.27	200903	0.47	4.30	200803	0.71	5.43
20	Shipping Corpn. Of India Ltd.	5807.67	0.84	6.26	200803	0.66	4.29	200603	0.73	5.02
21	South Indian Bank Ltd.	1376.42	0.98	2.60	200903	0.45	5.85	200803	0.88	2.16
22	SRF Ltd.	1000	0.96	6.79	200903	0.49	13.83	200803	0.75	4.96
23	State Bank Of Bikaner & Jaipur Ltd	2527	0.92	2.96	200903	0.48	6.12	200803	0.15	2.00
24	West Coast Paper Mills Ltd.	402.22	0.67	3.66	200903	0.45	5.41	200803	0.94	4.61

## Conclusion:

In the medium to long term horizon, even if the markets move in range bound pattern, the above listed stocks have a higher probability of moving up the valuation curve with an assurance of limited downside & stable dividend earnings.

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