

# IOP – Set to seize the opportunity

October 2021

**Smallcaps offers a larger opportunity for Alpha generation**

# Smallcaps offer a larger opportunity for Alpha generation

- Wide dispersion of returns in both mid as well as small caps provides scope for bottom-up stock picking
- It is observed that the most Multibaggers were seen in the Midcap and Small cap space rather than Large caps due to dispersion

Returns range of Top 500 Companies by Market Cap (as on 31 <sup>st</sup> March 2020)			
Absolute Returns Range	Top 100	101 - 250	251 - 500
> 10x	1	8	8
5x- 10x	8	17	13
3x- 5x	15	22	21
2x- 3x	18	28	32
2x	11	20	34
Between 0 and 50%	18	16	45
Between 0 and -20%	13	9	19
Between -20% and -50%	11	19	42
Less than -50%	5	11	36

- Small Cap Index space on a whole is extremely dispersed with 108 stocks returns >100% and 36 stocks are <-50% and return distribution is across all the categories
- High dispersed portfolio returns are dominated by particular stock/sector
- Simple being present or absent in a few names - out of the highly dispersed stocks results in significant outperformance/underperformance of the portfolio

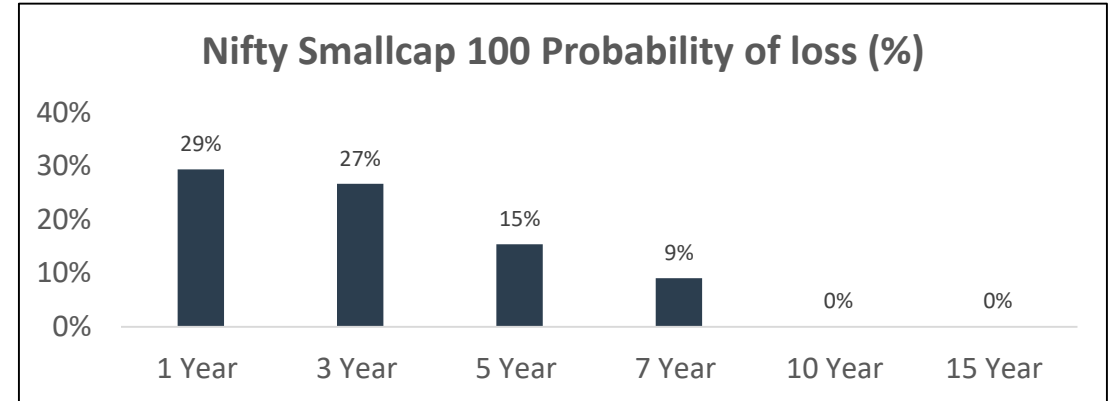
Source : Capitaline. Data as on 31<sup>st</sup> March 2020.

Absolute Returns from 31<sup>st</sup> March 2014 to 31<sup>st</sup> March 2020 considered for top 500 companies by market capitalization (as on 31<sup>st</sup> March 2020)

Disclaimer: Past performance may not be sustained in the future. Historical performance indications and financial market scenarios are not reliable indicators of current or future performance.

# Nifty Small Cap 100 Rolling Historical Returns : Long Term Investing is Beneficial

Year	Close	1 Year	3 Year	5 Year	7 Year	10 Year	15 Year
2003	1000						
2004	1349	35%					
2005	2188	62%					
2006	3098	42%	46%				
2007	5801	87%	63%				
2008	1684	-71%	-8%	11%			
2009	3486	107%	4%	21%			
2010	4101	18%	-11%	13%	22%		
2011	2712	-34%	17%	-3%	10%		
2012	3710	37%	2%	-9%	8%		
2013	3403	-8%	-6%	15%	1%	13%	
2014	5273	55%	25%	9%	-1%	15%	
2015	5653	7%	15%	7%	19%	10%	
2016	5781	2%	19%	16%	7%	6%	
2017	9093	57%	20%	20%	12%	5%	
2018	6449	-29%	4%	14%	13%	14%	13%
2019	5835	-10%	0%	2%	7%	5%	10%
2020	7088	21%	-8%	5%	11%	6%	8%
<b>Probability of loss</b>		5/17	4/15	2/13	1/11	0/8	0/3
<b>Probability of loss (%)</b>		29%	27%	15%	9%	0%	0%
<b>Average Return</b>		22%	12%	9%	10%	9%	11%

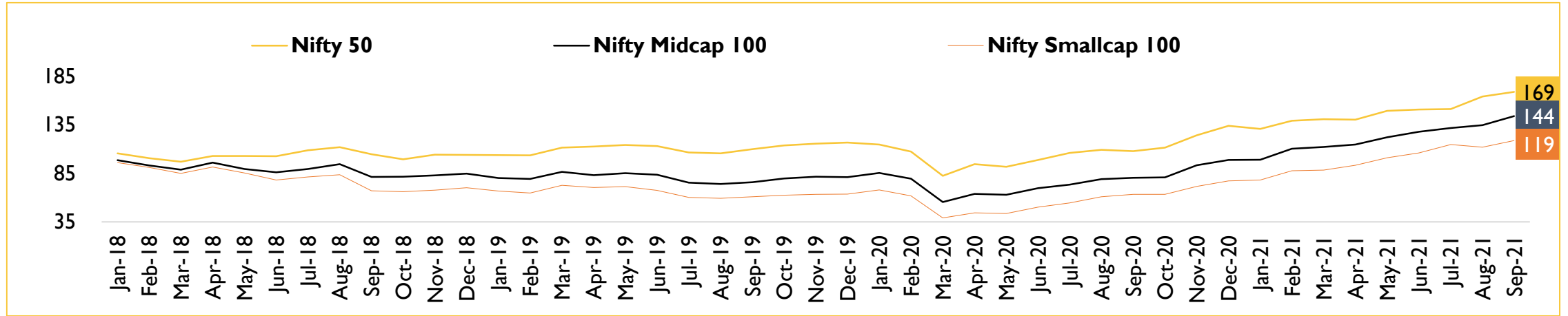


## Observations

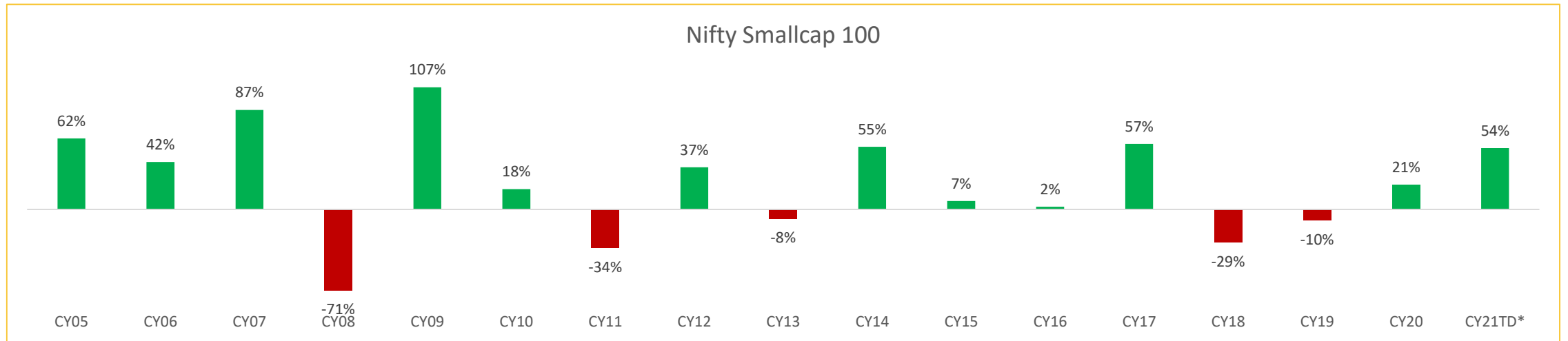
- Similar to the Sensex, this small cap space finds the probability of loss being zero for 10 year time horizon
- But unlike Sensex, short term investment in Small cap space is riskier, thus Probability of loss for 1 year is 29% with min return being (71%)
- Based on the historical data, even this space, is beneficial with long term investing

# Why now? - Expect smallcaps to bounce back with economic recovery

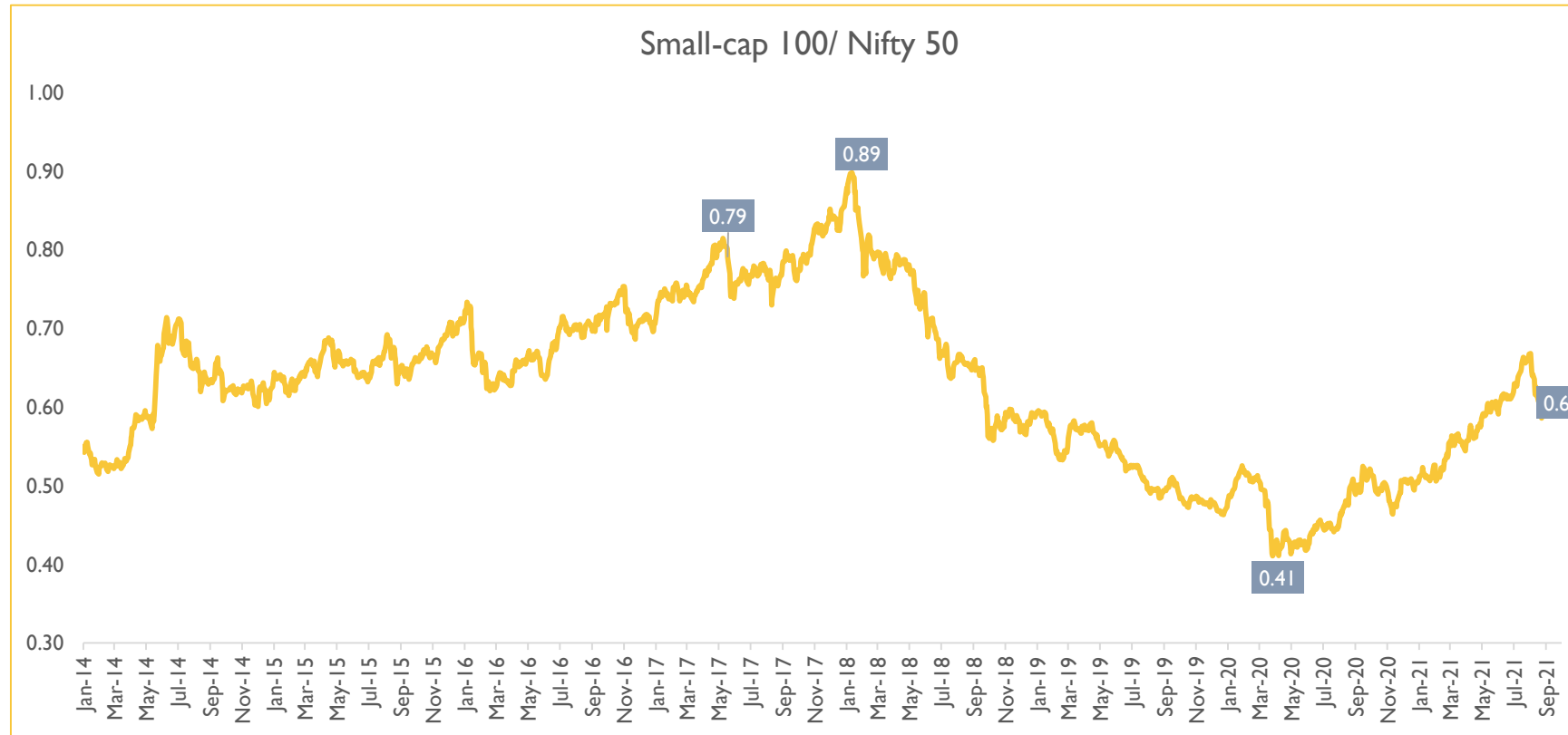
Large caps and mid caps have been outperforming smallcaps for 2 years now ...



Small caps have never seen two consecutive years of negative return before 2018

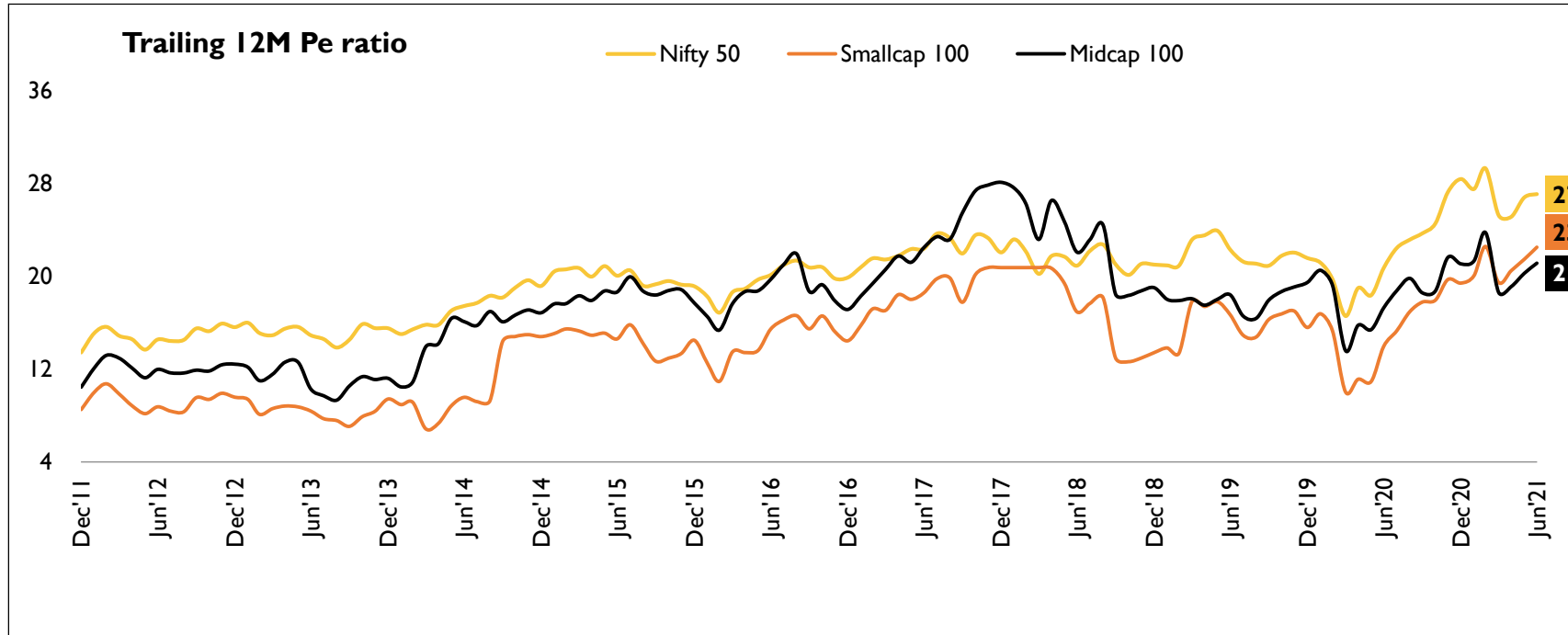


## Why Now? - Ample Room for Growth: Nifty Smallcap 100/Nifty 50 still attractive



- This ratio is a good indicator for investing in smallcaps
- It peaks out at ~0.9. Current level suggests room for growth

# Why now? – Smallcaps still trading at a discount to Nifty 50



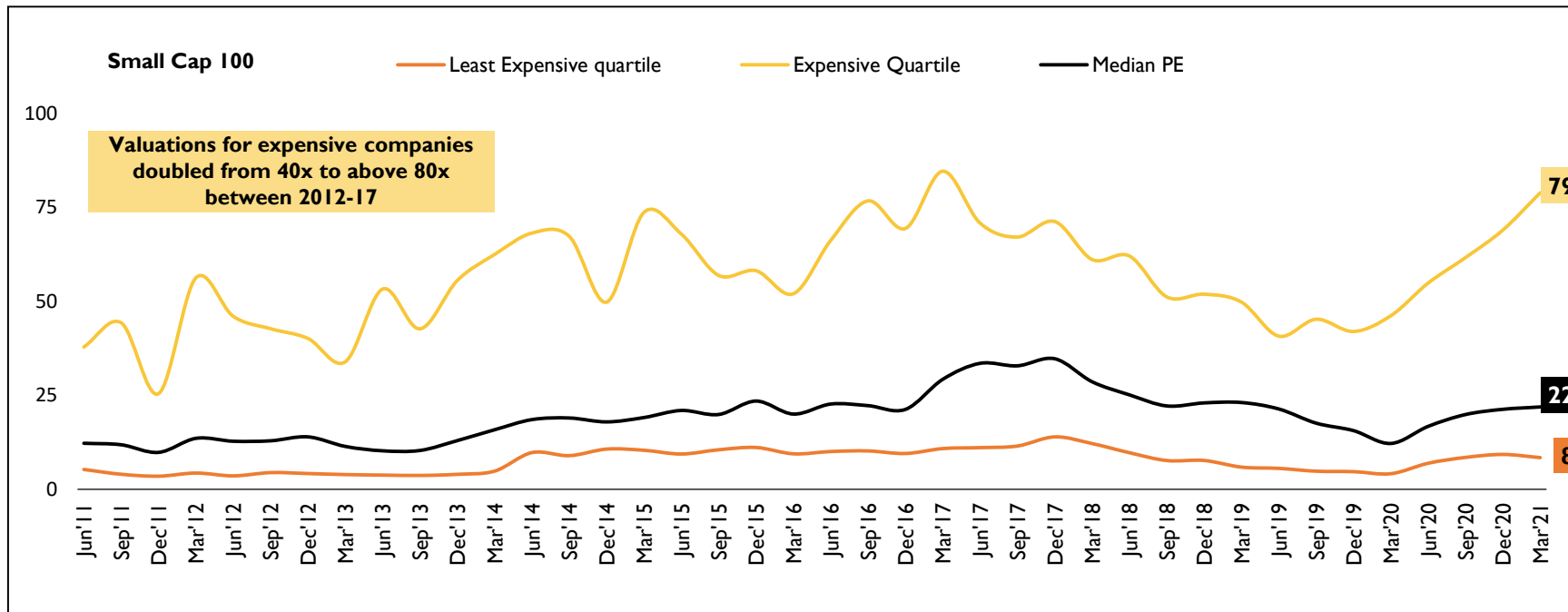
- Removing the loss making companies from both the indices, then Nifty Mid-cap and Nifty Small-Cap indices are trading at trailing P/E of 21x and 23x FY21 earnings, at a marginal discount to Nifty.

Source: MOSL, Data as on 31<sup>st</sup> July 2021

Disclaimer: Past performance may or may not be sustained in future. The above graph is used to explain the concept and is for illustration purpose only and should not be used for development or implementation of an investment strategy.

# Divergence prevalent in Smallcap 100 Universe

- *Valuations are hiding more than what they are revealing. If one looks at the trailing 12M valuations for the Smallcap 100, there is a wide divergence between the top quartile and bottom-quartile companies vs. the median P/E of the index.*



- We have taken the NSE Smallcap 100 universe and broken down the aggregate into four quartiles based on their trailing 12M PEs. Loss making companies have been removed from the aggregates.
- The aggregate quartile P/E of the most expensive stocks trade at 79x, while the least expensive stocks trade at 8.5x.
- Historically (as well as on average), the least expensive aggregate for Smallcap 100 has traded at 7.6x, while the most expensive has traded at 56x.

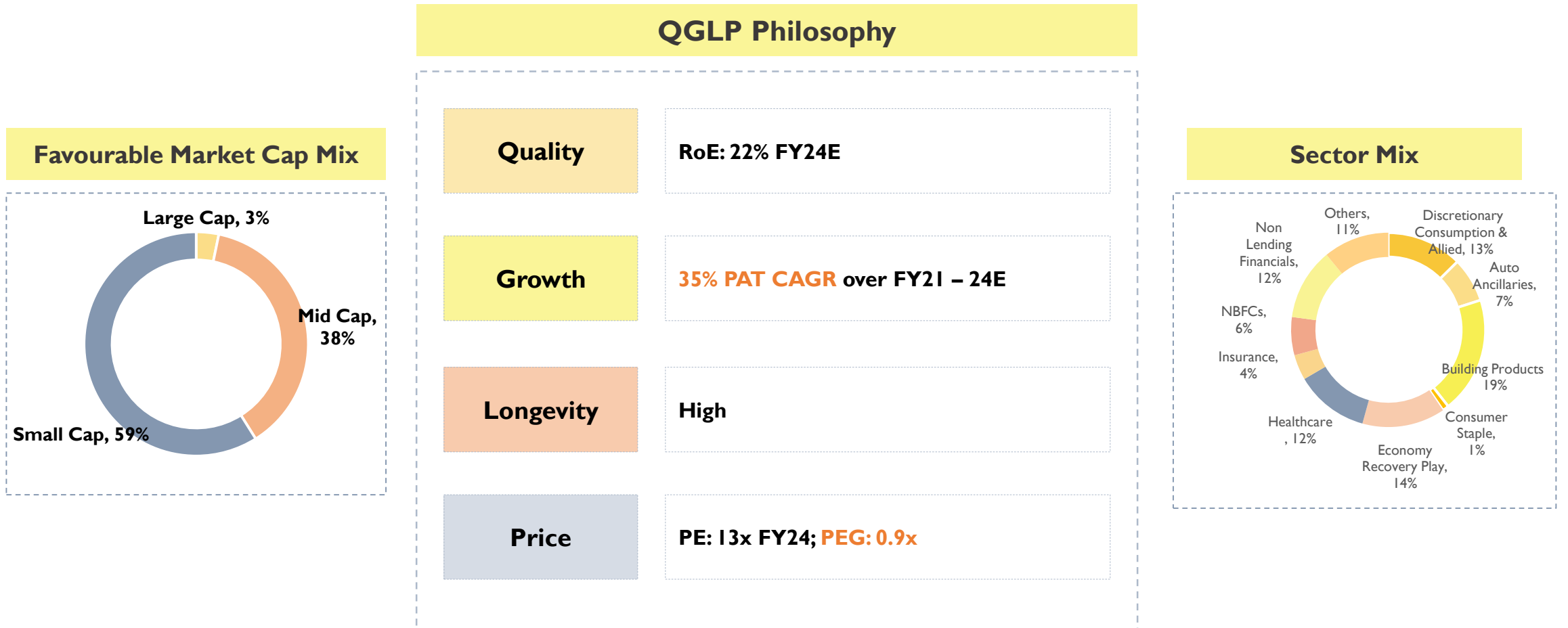
Source: MOSL, Data as on 31<sup>st</sup> July 2021

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**Given such divergence in Small cap Index, IOP portfolio still available at a historically low PEG of 0.9x**

# Historically Low PEG : Earnings Growth and Valuations in a Sweet Spot



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# Low PEG : WCS23 'Valuation Insights' - Evidence Suggests It's the Best Time to Buy

PEG is short for P/E to Growth ratio : TTM P/E divided by 3 yrs forward earnings growth

PEG- What Works & What Doesn't		
PEG	Average 3Yr Alpha	Instances from 1998-2015
0-1	19%	33%
3+	-10%	11%
< 0*	-19%	34%

\* A PEG lesser than zero implies PAT de-growth in the next 3 years

In the 23<sup>rd</sup> Annual Wealth Creation Study, we used the PEG Ratio with 3-years' forward earnings to study return outcomes.

The findings revealed that

- **Buying stocks at PEG less than 1x is supremely profitable**
- **On average, 1 of every 3 stocks is likely to trade at PEG of less than 1x**

## Low PEG : WCS23 ‘Valuation Insights’ - Evidence Suggests It’s the Best Time to Buy

Period 2013-18					
	1 yr	2 yr	3 yr	4 yr	5 yr
Sensex Return	19%	22%	10%	12%	12%
PEG < 1x Return	36%	61%	38%	45%	39%
<b>Alpha</b>	<b>17%</b>	<b>39%</b>	<b>28%</b>	<b>33%</b>	<b>27%</b>

- **Efficacy of PEG ratio is remarkable irrespective of the number of years of growth insight that investors may have.**
- Thus, PEG of less than 1x works for growth forecasts of 1, 2, 3, 4 or 5 years!
- **PEG of 1x delivered handsome alpha in 14 out of 15 observations (barring GFC led fall in 08)**

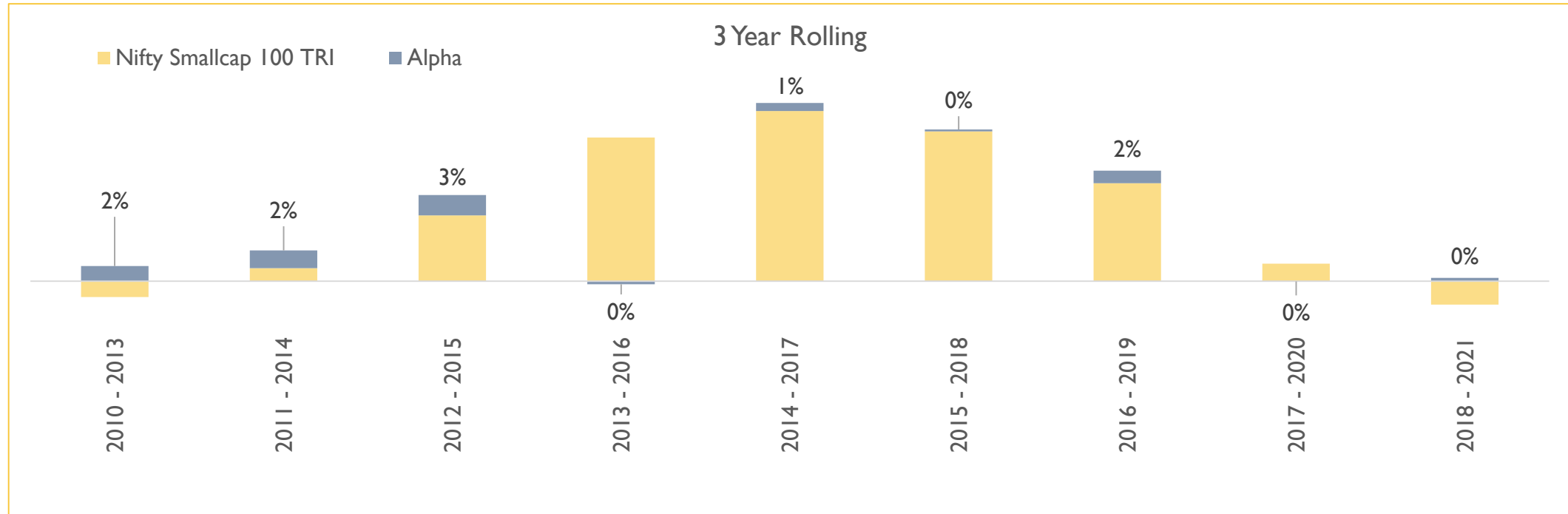
## Strategy has a stellar track record of identifying Multi-baggers

Past Multibaggers	Initial Buy	Portfolio Status	Return	Multiple
Alkem Labs	Dec-15	Part of Portfolio	188%	2.9x
Dr.Lal Path Labs	Aug-16	Exited (Nov-20)	119%	2.2x
Mahanagar Gas	Aug-16	Part of Portfolio	111%	2.1x
TTK Prestige	Jul-16	Part of Portfolio	110%	2.1x
Kajaria Ceramics	Jul-16	Part of Portfolio	92%	1.9x

Potential Multibaggers	First Purchase Month	Average Purchase Price	Return	Multiple
Gland Pharma	Nov-20	2068	78%	1.8x
ICICI Securities	Dec-19	467	78%	1.8x
Max Financial	Nov-20	622	64%	1.6x
CDSL	May-21	855	55%	1.6x

# Unbroken positive 3-yr rolling returns till Mar-19



**Multi-decadal opportunity to buy into small caps**

Source: MOAMC Internal Research

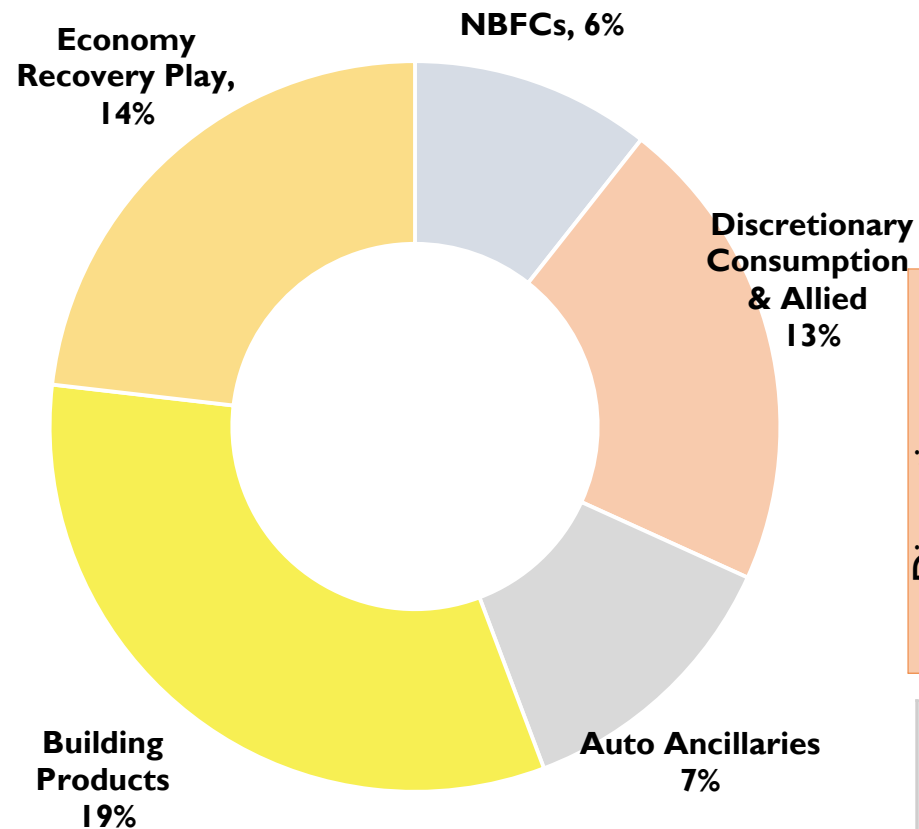
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# Portfolio Positioning and High Conviction Bets

# 60% of the portfolio is allocated towards beneficiaries of economic recovery

Economy Recovery Plays		
Aegis Logistics		4%
Qess Corp		4%
Blue Dart		2%
HEG		1%
Engineers India		1%
ITD Cementation		1%

Building Products		
Kajaria Ceramics		10%
Birla Corp		6%
Century Ply		2%
KEI		2%



NBFCs		
Can Fin Homes		6%

Discretionary Consumption & Allied		
VIP Industries		6%
Blue Star		4%
TTK Prestige		3%

Auto Ancillaries		
Gabriel		4%
Suprajit Industries		2%
Sundaram Fastners		1%

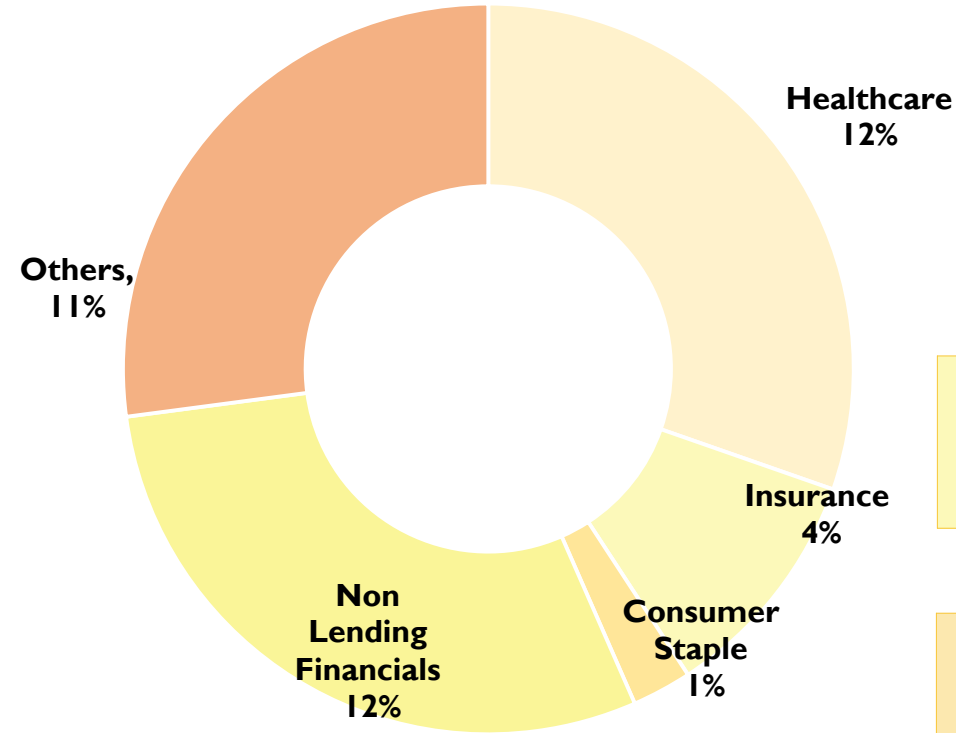


# 42% of the portfolio remains invested in Compounders

Others	Mahanagar Gas	4%
	Dhanuka Agritech	3%
	Bayer Cropscience	2%
	Clean Science & Technology	2%

Healthcare	Alkem Labs	6%
	Ipca Labs	3%
	Gland Pharma	3%

Non Lending Financials	ICICI Securities	8%
	CDSL	4%



Insurance	Max Financial Services Limited	4%
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Consumption	Emami Ltd.	1%
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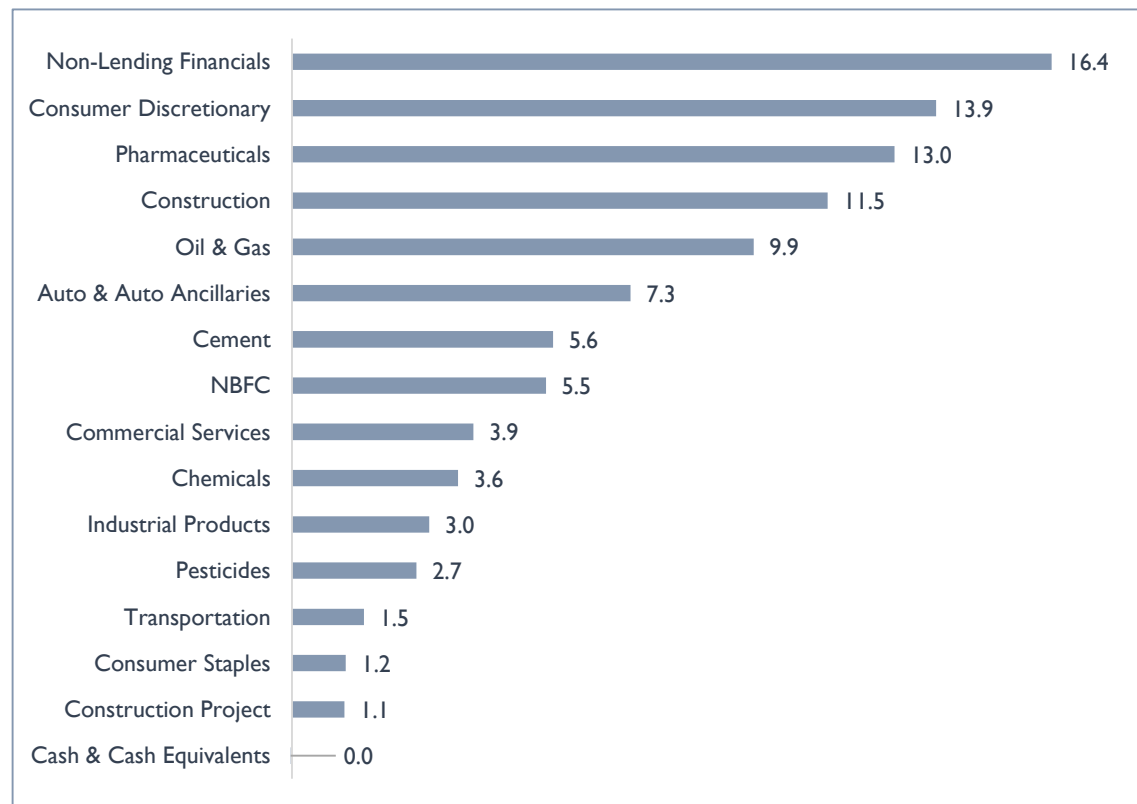
# Portfolio Performance

# Portfolio Allocation

## Top 10 Holdings & Market Capitalization

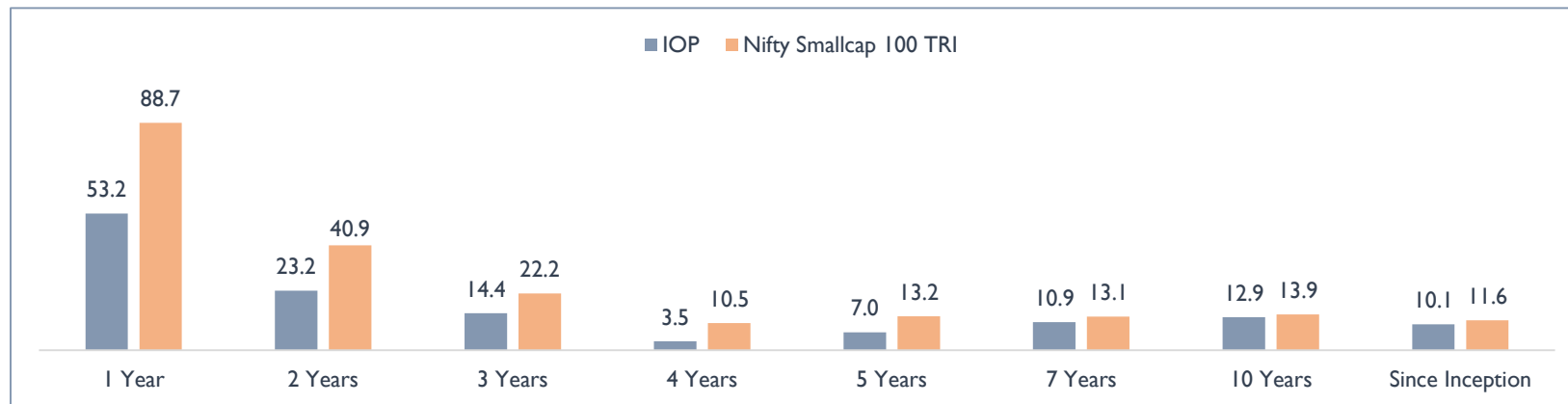
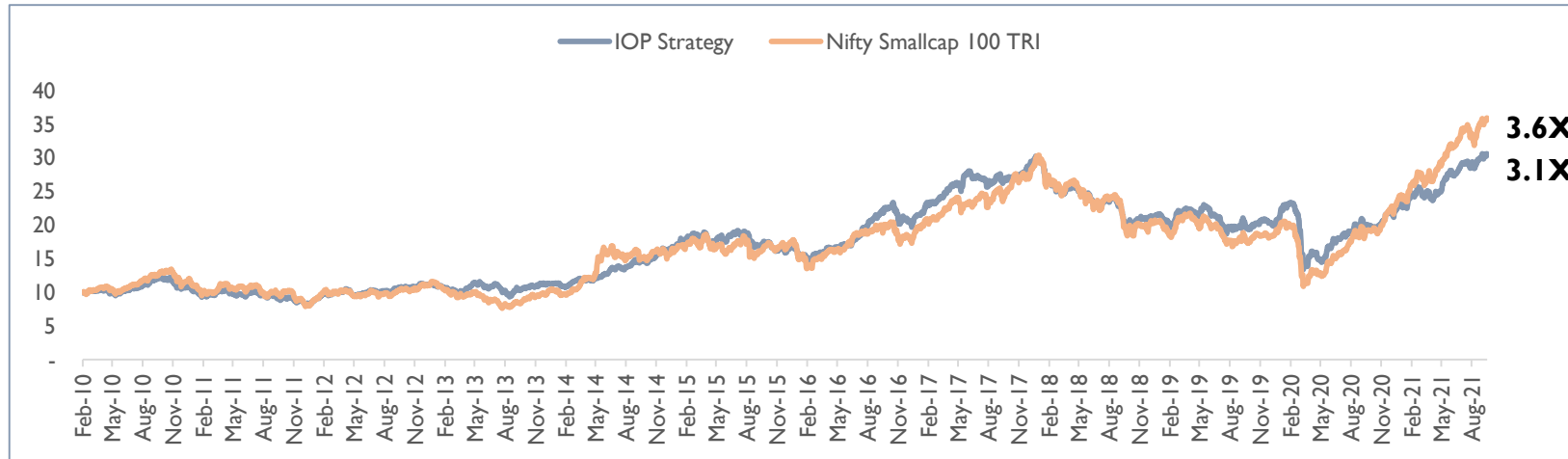
Scrip Name	% Holding
Kajaria Ceramics Limited	9.9
ICICI Securities Limited	7.6
Can Fin Homes Limited	6.3
VIP Industries Limited	6.3
Alkem Laboratories Limited	6.0
Birla Corporation Limited	5.7
Mahanagar Gas Limited	4.5
Central Depository Services (India) Limited	4.3
Max Financial Services Limited	4.2
Aegis Logistics Limited	4.1

## Sectoral Allocation



IOP Strategy Inception Date: 15<sup>th</sup> Feb 2010; Data as on 30<sup>th</sup> September 2021; Data Source: MOAMC Internal Research; RFR: 7.25%; \*Earnings as of Dec 2020 quarter and market price as on 30<sup>th</sup> April 2021; Source: Capitaline and Internal Analysis; Please Note: Returns up to 1 year are absolute & over 1 year are Compounded Annualized. Returns calculated using Time Weighted Rate of Return (TWRR) at an aggregate strategy level. The performance related information is not verified by SEBI. All portfolio related holdings and sector data provided above is for model portfolio. Returns & Portfolio of client may vary vis-à-vis as compared to Investment Approach aggregate level returns due to various factors viz. timing of investment/ additional investment, timing of withdrawals, specific client mandates, variation of expenses charged & dividend income. Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments.

# Portfolio Performance



One lac invested in the strategy on 15th Feb 2010 would have grown to Rs. ~3.1 lacs today against ~3.6 lacs invested in Benchmark

IOP Strategy Inception Date: 15<sup>th</sup> Feb 2010; Data as on 30<sup>th</sup> September 2021; Data Source: MOAMC Internal Research; Please Note: Returns up to 1 year are absolute & over 1 year are Compounded Annualized. Returns calculated using Time Weighted Rate of Return (TWRR) at an aggregate strategy level. The performance related information is not verified by SEBI. All portfolio related holdings and sector data provided above is for model portfolio. Returns & Portfolio of client may vary vis-à-vis as compared to Investment Approach aggregate level returns due to various factors viz. timing of investment/ additional investment, timing of withdrawals, specific client mandates, variation of expenses charged & dividend income. Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments.



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## KAJARIA CERAMICS

Strong brand and distribution, market share gains and Real Estate revival to benefit

### Global Export Opportunity being serviced by Morbi

- Massive global export opportunity in tiles as countries look to restrict sourcing from China.
- A large chunk of supplies from Morbi to get diverted for exports that are growing at 50%yoy.

### Domestic real estate market is at the bottom

- We expect Kajaria to benefit from the boom in real estate cycle which is currently at the bottom of the cycle

### Market Share Gains

- Kajaria is the best ceramics play and is constantly gaining share from other private players
- Net cash balance sheet and superior brand, will help capitalise on market share gain

**RoE:**  
**22% FY24E**

**Q1 EPS  
Growth:**  
**L to P**

**TTM EPS  
Growth:**  
**114% YoY**

**FY24 PEG:**  
**1.8x**

2

**ICICI SECURITIES Ltd.**

Strong growth in demat accounts, non brokerage income bring diversification

**Industry tailwinds**

Strong post-Covid ADTO trend has extended in the 2QFY21 too. Over 3m demat accounts were opened in the past four months.

**Impact of regulations**

No impact on ISEC due to the new margin norms or share pledging norms that came into effect on 1st Sep'20

**MTF and ESOP funding book to grow**

Will grow the MTF and ESOP funding book from current levels of INR15b. Received shareholder approval for up to INR35b on the loan book currently, but this cap could be increased in the future.

**Revenue diversification**

Targeting to grow non-brokerage revenue from 40-42% to 50% of total revenue in a year or so

**RoE:**  
**43% FY24E****Q1 EPS**  
**Growth:**  
**61% YoY****TTM EPS**  
**Growth:**  
**91% YoY****FY24 PEG:**  
**1.7x**

3

**MAX FINANCIALS**

Best in class metrics, Axis Bank as largest shareholder, secular runway & collapse of hold-co structure

**Strong underlying insurance business**

- With best in class metrics (20%+ VNB Margins, 20% RoEVs) and growth track record (20%+ EV compounding).

**Axis Bank overhang on verge of resolution**

- Axis Bank emerging as the single largest shareholder with 18% stake. The firm recently received regulatory approvals.

**Holdco structure to collapse**

- Expect Max Life shares to be listed in the next 12-18 months.

**Attractively valued**

- Max is at 15x EVOP v/s 35x for HDFC Life, despite business metrics and growth being quite similar.

**RoE:**  
**29% FY24E****Q1 EPS**  
**Growth:**  
**-87%****TTM EPS**  
**Growth:**  
**13% YoY****FY24 PEG:**  
**0.4x**



4

**CENTRAL DEPOSITORY SERVICES (INDIA) LIMITED**

Capital markets intermediary in a duopoly play

**Strong Macro variables to support the Growth**

Improving macro variables (demographics, per capita income), push towards financial inclusion, and shift in savings towards financial assets bodes well for capital market intermediaries

**Duopoly market with significant market share**

The asset-light model, duopoly play on the secular increase in stockholder accounts coupled with potential market share gains is a major positive for this thinly covered stock

**Well poised for growth as a proxy play**

As a proxy play on Indian capital markets, CDSL has several new revenue opportunities like (a) dematerialisation of unlisted public companies (d) transaction charges from new pledge/unpledged rules (c) commodity repository (d) Insurance repository business aids CDSL's topline growth

**Company to demand higher multiples**

Empirical studies suggest that limited-entry sectors tend to trade at higher multiples as investors gauge greater confidence in revenue/earnings, and more importantly, multiples tend to expand when new entities are listed

**RoE:**  
**26% FY24E****Q1 EPS**  
**Growth:**  
**38% YoY****TTM EPS**  
**Growth:**  
**75% YoY****FY24 PEG:**  
**2.4x**

5

## GLAND PHARMA

A focused injectable player in a large end market with a strong track record

### Unique Business Model

- 100% focus on injectable across different formats,
- High backward integration,
- No Front end and own pipeline of molecules
- A win win for both partners and suppliers. High Longevity

### Favourable Economics

- Injectables forms 40% share of the global Pharma market of ~USD 1tn,
- Demand is growing at 10% annually in USD terms globally and 13% annually in the US itself
- Supply is unable to match the pace of demand

### Exemplary Financial and Operational Excellence

- Zero US FDA notifications across its facilities over the last 2 decades reflects the culture of the firm and strong focus on quality parameters.
- This positions them to be a preferred supplier for their partners

### Key Triggers

- Sputnik Vaccine orders
- Large Cash pile to be used for possible M&As
- Large Injectibles market in China – yet to be explored

**RoE:**  
**19% FY24E**

**Q1 EPS Growth:**  
**6% YoY**

**TTM EPS Growth:**  
**11% YoY**

**FY24 PEG:**  
**2.0x**

**Small Cap stocks are a volatile and unpredictable lot...**

**...but may provide the greatest opportunities for upside**

**To earn super-normal returns with small cap stocks:**

- **Be patient**
- **Never exit looking at rear-view performance**
- **Double up at extremes if possible**

# Chairman – Investment Committee

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**Raamdeo Agrawal**  
**Chairman, MOFSL**

- Raamdeo Agrawal is the Co-Founder of Motilal Oswal Financial Services Limited (MOFSL).
- As Chairman of Motilal Oswal Asset Management Company, he has been instrumental in evolving the investment management philosophy and framework.
- He is on the National Committee on Capital Markets of the Confederation of Indian Industry (CII), and is the recipient of "Rashtriya Samman Patra" awarded by the Government of India.
- He has also featured on 'Wizards of Dalal Street' on CNBC. Research and stock-picking are his passions which are reflected in the book "Corporate Numbers Game" that he co-authored in 1986 along with Ram K Piparia.
- He has also authored the Art of Wealth Creation, that compiles insights from 21 years of his Annual 'Wealth Creation Studies'.
- Raamdeo Agrawal is an Associate of Institute of Chartered Accountants of India.

# Portfolio Manager

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Fund Manager

## Manish Sonthalia

- Manish has been managing the Strategy since inception and also serves as the Director of the Motilal Oswal India Fund, Mauritius.
- He has over 25 years of experience in equity research and fund management, with over 14 years with Motilal Oswal PMS.
- He has been the guiding pillar in the PMS investment process and has been managing various PMS strategies and AIFs at MOAMC.
- Manish holds various post graduate degrees including an MBA in Finance, FCA, Company Secretaryship (CS) and Cost & Works Accountancy (CWA).

**Thank You!**

**THINK EQUITY**  
**THINK MOTILAL OSWAL**

**MOTILAL OSWAL**  
**ASSET MANAGEMENT**

**BUY RIGHT**  
**SIT TIGHT**

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