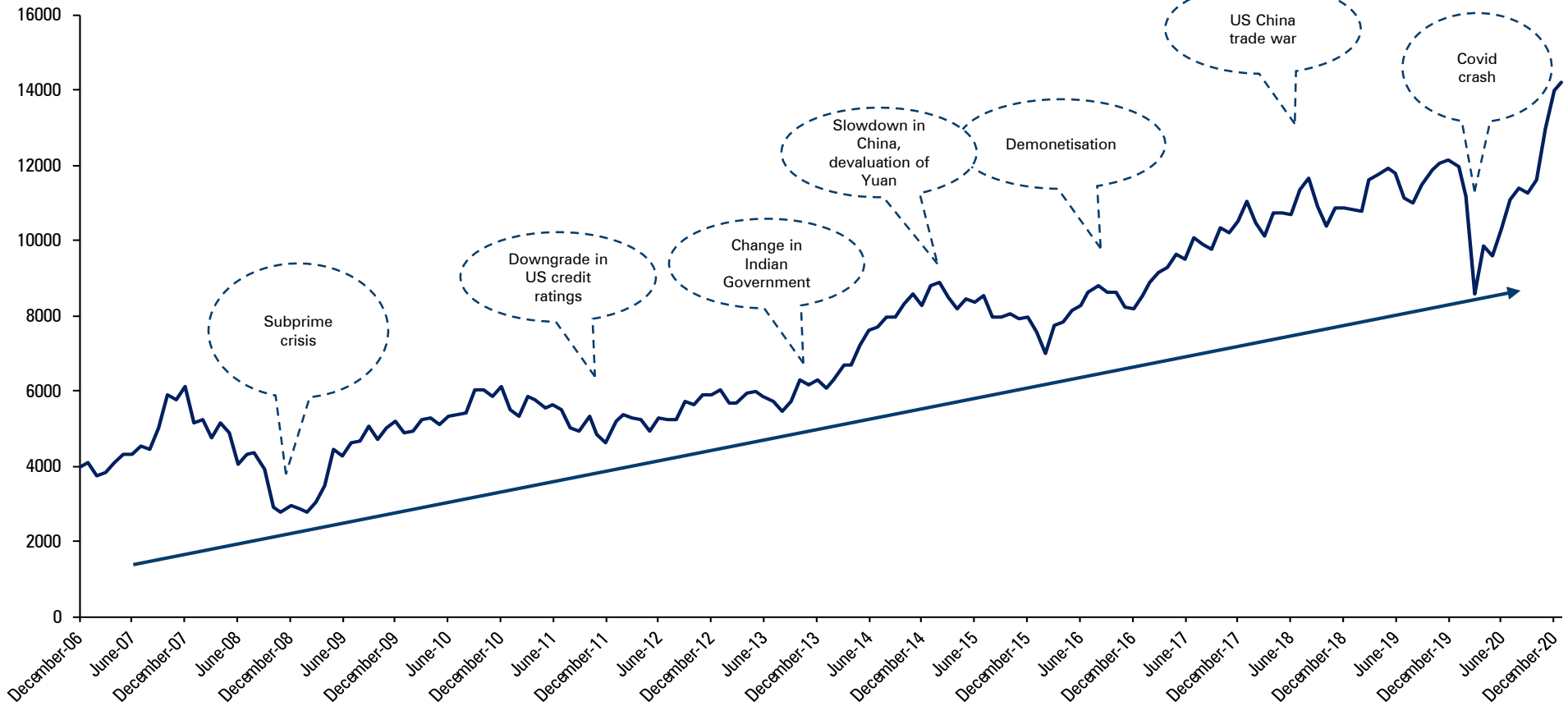


Capital Compounders

Biggest risk in today's market is not being there in the market

Nifty 50 through the years



Source: NSE, Company, ICICI Direct Research

Nifty shifting orbits ...

Nifty currently trades at a PE of ~32x (based on FY20 EPS) and at a PE of ~38x on Trailing Twelve Months (TTM) basis, thereby helping build the public opinion that the broader markets are highly euphoric and running ahead of fundamentals. We however dispel this notion, as we logically derive that present absolute PE multiples make little sense especially when we had a blip in corporate earnings in the recent past due to the Covid pandemic and are staging an impressive earnings CAGR (24%+ over FY21-23E) ahead of us.

Our key focal points:

- (i) Nifty constituents have undergone major change in past decade. The weights of capital efficient sectors such as FMCG, Financials (private banks), IT and Pharma have increased from 29% in March 2009 to 70% in December 2020.
- (ii) These sectors command higher PE multiples as markets prefer Earnings visibility and consistency
- (iii) Better performing business segments within existing companies is not captured by current PE. Companies like L&T, SBI etc. have multiple business lines and hence SoTP (Sum of the parts) based valuations of these names are not captured by the PE ratio alone.

Trend in Sectoral Weightages in Nifty

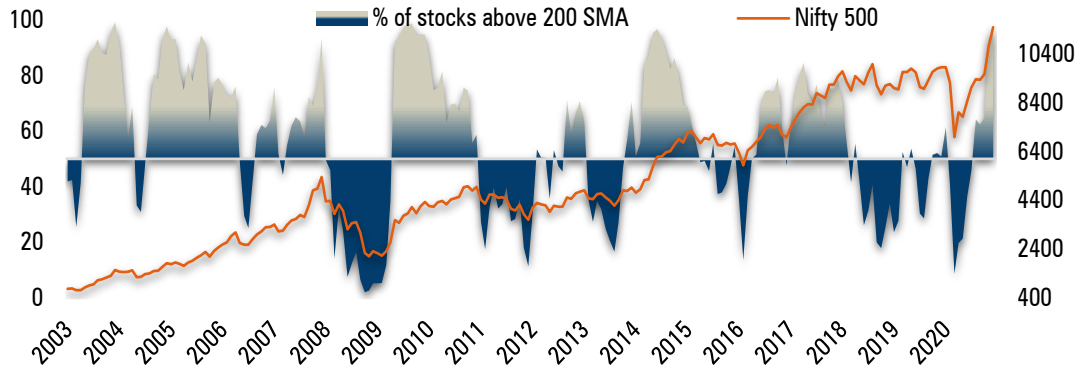
Sectors/Year	Mar-09	Mar-14	Mar-19	Dec-20
Financial Services	11.8	27.5	38.9	38.8
IT	9.1	16.3	13.7	16.3
Oil & Gas	40.7	14.3	15.3	12.5
FMCG	6.4	12.6	11.3	11.5
Automobile	3.3	8.8	6.1	5.4
Pharmaceuticals	2.5	5.2	2.4	3.6
Metals	5.4	4.8	3.7	2.5
Telecom	9.8	1.7	1.5	2.0

Target PE of few individual constituents based on FY23EPS

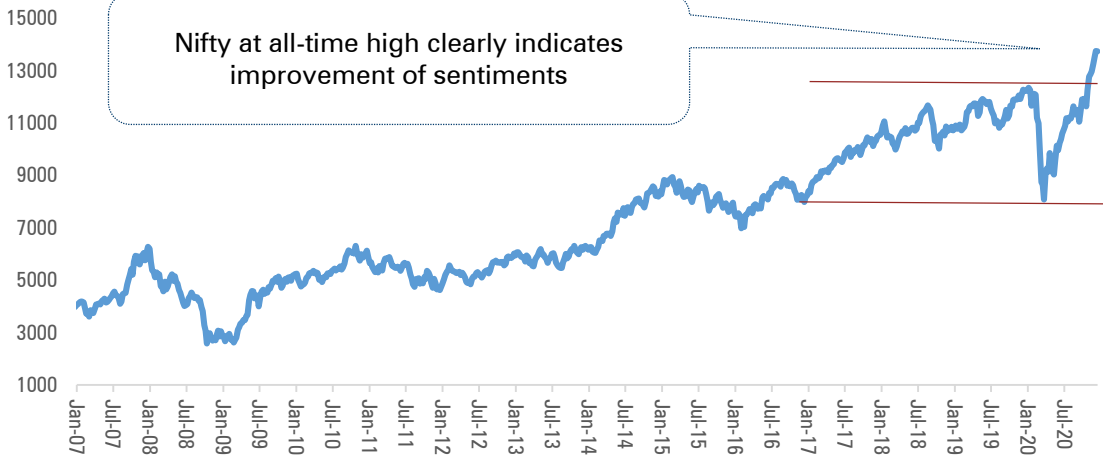
Nifty Stocks	Target PE (x)	Nifty Stocks	Target PE (x)	Nifty Stocks	Target PE (x)
Adani Ports	16.0	SBI Life	45.3	HDFC Bank Ltd	19.3
Asian Paints Ltd	58.2	Titan Co.	58.0	Reliance Industries	17.7
Bajaj Auto Ltd	18.9	Tata Steel	9.2	TCS	29.4
Bajaj Finance Ltd	46.5	Sun Pharma	21.9	Divis Lab	40.0
Bharti Airtel Ltd	32.3	NTPC Ltd	5.4	Axis Bank Ltd	17.5
Dr Reddy's	26.0	Maruti	28.0	Shree Cement	39.8
Nestle India Ltd	63.3	Indusind	37.2	ITC Ltd	17.0
Infosys Ltd	25.4	Britannia	44.5	Grasim Industries	34.7
Overall Nifty PE	26.2				

FII inflows at historical high, market sentiments bouyant...

FII Inflows/Outflows (2020)	
January	12123
February	1820
March	-61973
April	-6884
May	14569
June	21832
July	7563
August	47080
September	-7783
October	19541
November	60358
December	62016
January (till 26th Jan 2021)	23630



FII Inflows/Outflows	
2020	170262
2019	101122
2018	-33014
2017	51252
2016	20568
2015	17808
2014	97054
2013	113136
2012	128360
2011	-2714
2010	133266
2009	83424
2008	-52987
2007	71487
2006	36540
2005	47181
2004	38965
2003	30459
2002	3630



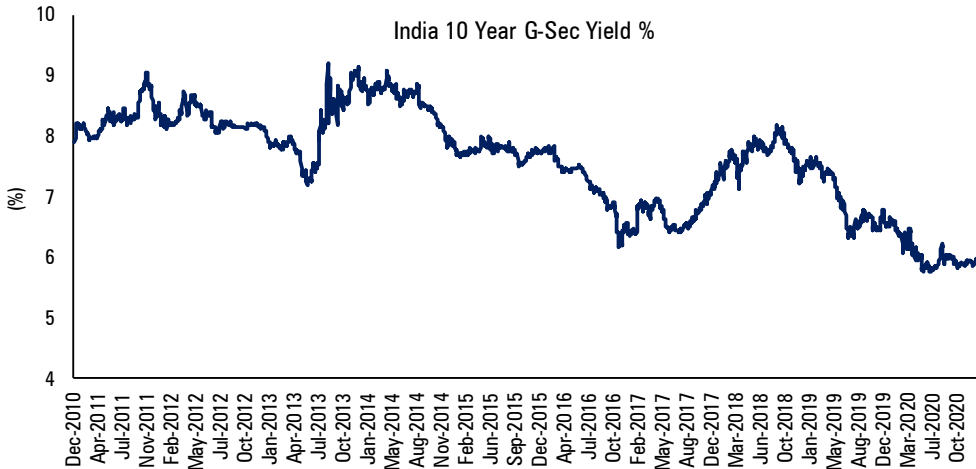
Greater than 90% of the NSE500 stocks are trading above their 200 SMA. This has never happened in previous bull runs. This highlights broad based participation and strong market sentiments.

Source: NSE, NSDL, ICICI Direct Research

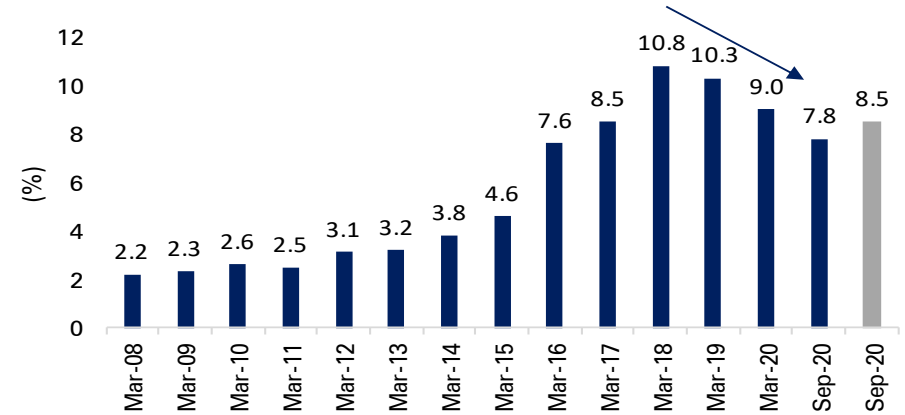
Positive conditions for a broad based market rally...

Interest rates at all time low

India 10 Year G-Sec Yield %

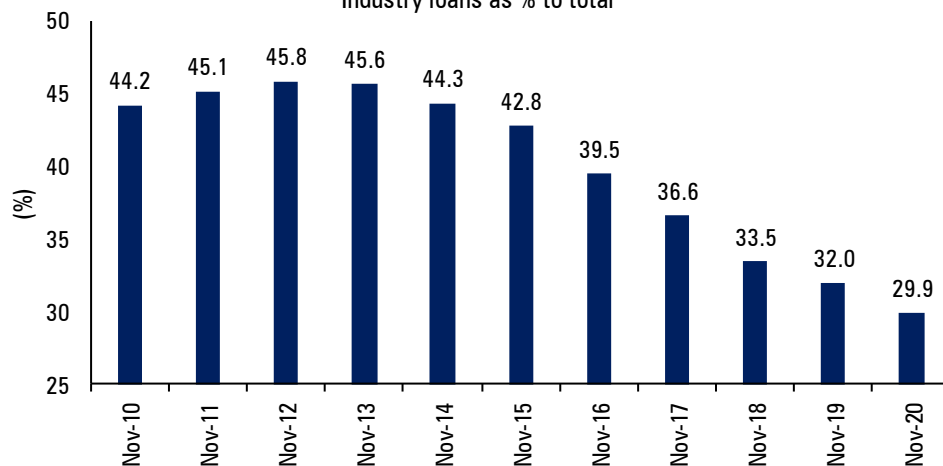


Asset quality concerns peaked out

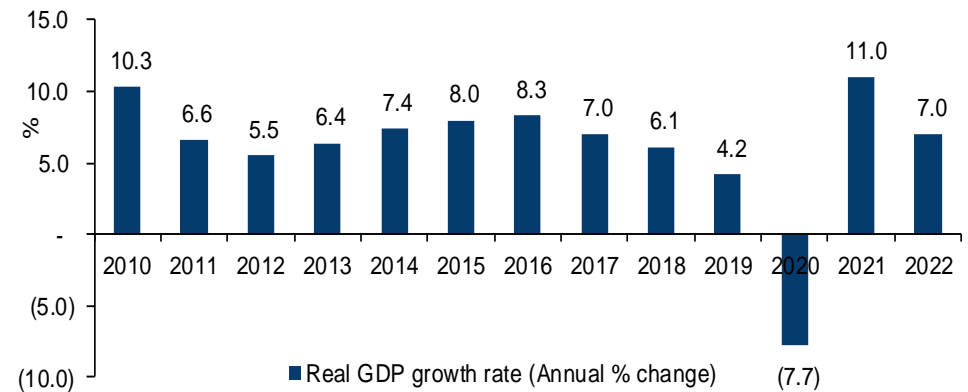


Corporate debt at lowest levels

Industry loans as % to total



Historical GDP growth rate of India

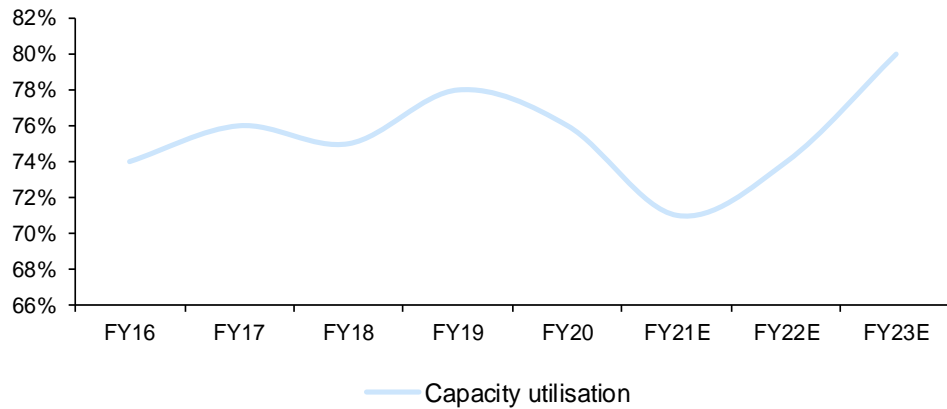


Source: NSE, RBI, IMF, WorldBank, ICICI Direct Research

Capacity utilisation trend for core sectors

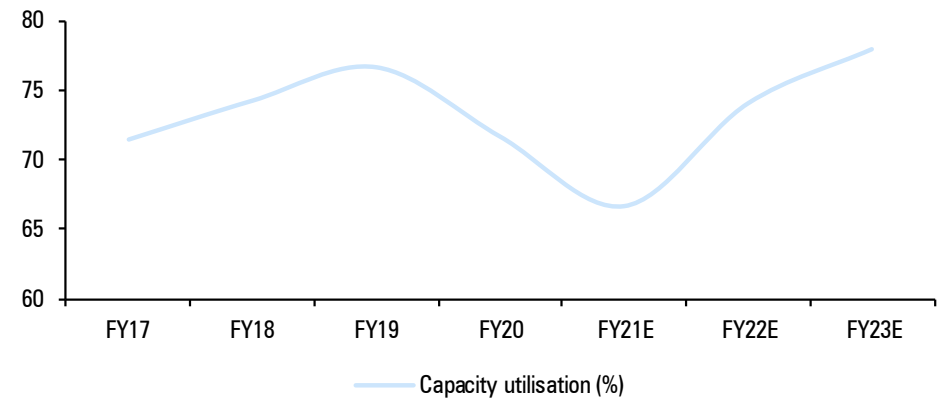
Steady demand from core industries should improve capacity utilisation in steel sector

Steel Capacity utilisation



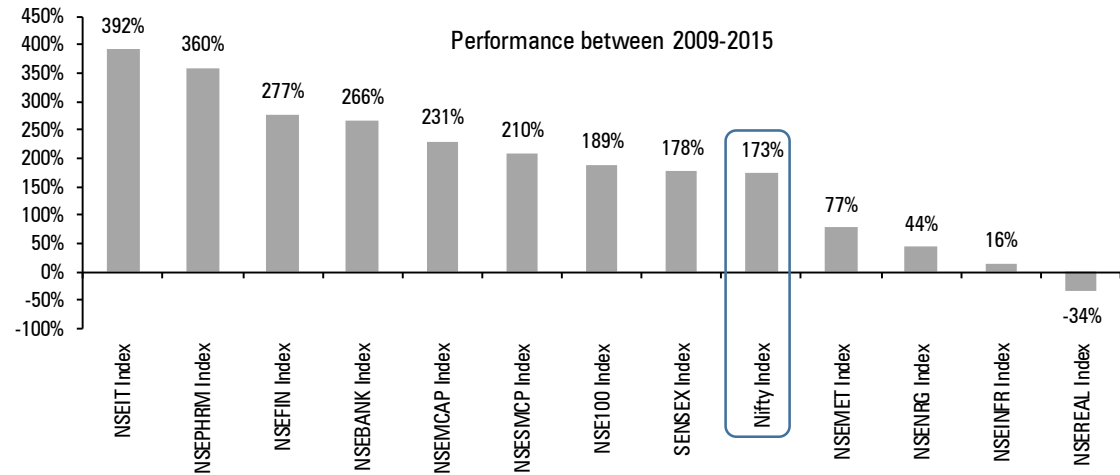
Focus on infrastructure to provide headroom for cap utilisation levels in cement sector

Capacity utilisation (%)

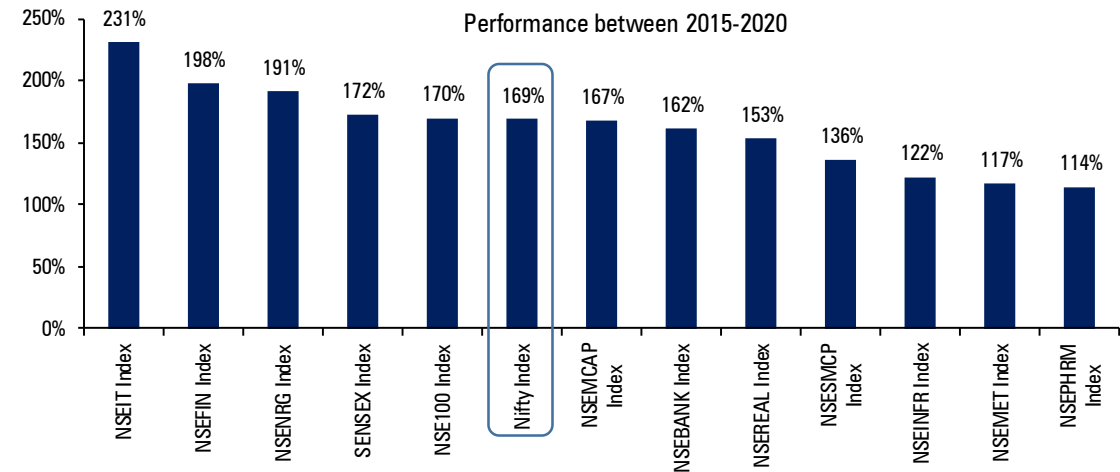


In long term, all market cap types & sectors have performed...

Broader Indices	1 year	3 year	5 year	10 year
Nifty 50	16.6%	26.3%	86.0%	155.3%
Nifty 100	16.1%	23.2%	85.1%	161.9%
Nifty midcap 100	16.4%	-0.2%	69.5%	168.0%
Nifty smallcap 100	14.8%	-19.9%	44.1%	101.8%

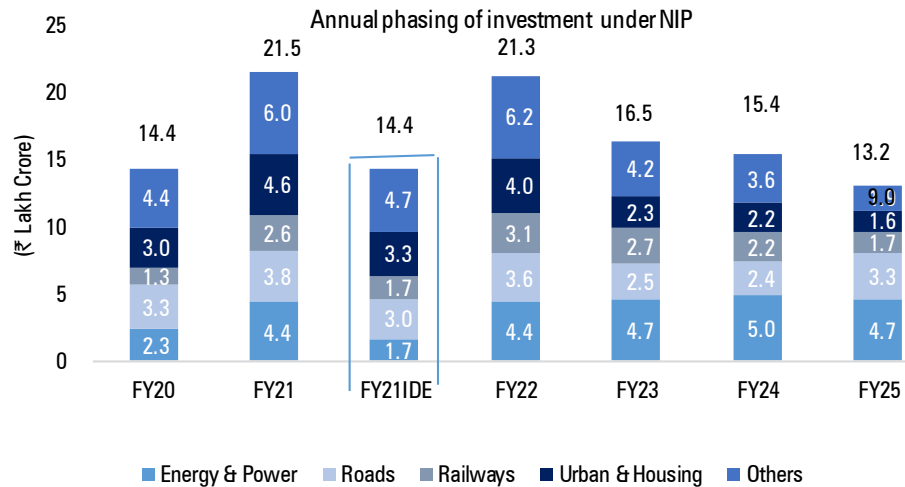


Sectoral Indices	1 year	3 year	5 year	10 year
Nifty Realty	-4.3%	-10.2%	103.4%	6.5%
Nifty Bank	-0.5%	11.3%	99.9%	187.7%
Nifty Metal	20.6%	-23.0%	91.6%	-25.6%
Nifty Financial Services	4.2%	31.2%	131.3%	254.6%
Nifty Energy	7.9%	15.3%	95.7%	88.6%
Nifty Infra	13.5%	3.2%	53.8%	23.7%
Nifty IT	57.4%	95.2%	128.7%	270.8%
Nifty Pharma	49.0%	30.4%	6.9%	167.6%



Source: Bloomberg, ICICI Direct Research

Capex plan under National Infrastructure plan

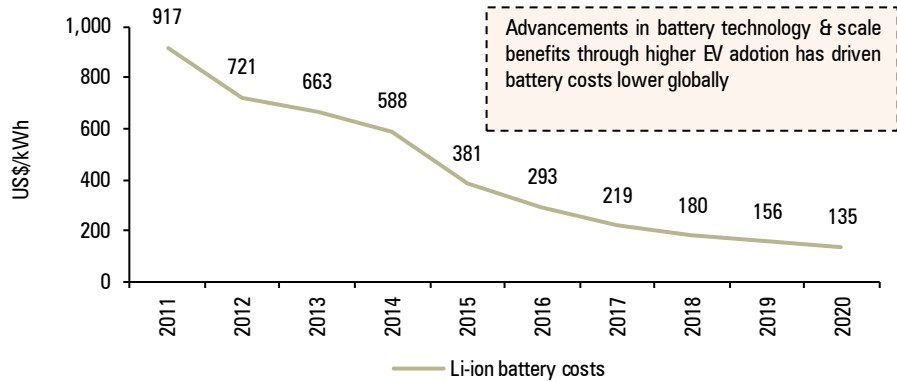


PLI scheme boost for favorable domestic manufacturing

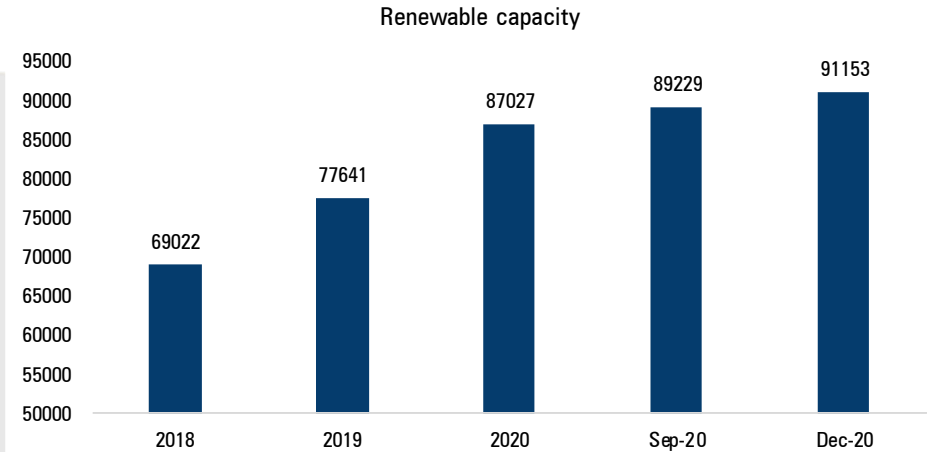
Sectors	Estimated Exp (₹ crore)
Mobile phone manufacturing	47240
API & others	6940
Manufacturing of Medical devices	3420
Advanced Cell Chemistry Battery	18100
Electronic/Technology products	5000
Automobiles & Auto Components	57042
Pharmaceutical Drugs	15000
Telecom & Networking products	12195
Textile products	10683
Food products	10900
High Efficiency Solar PV Modules	4500
White Goods (Acs & LED)	6238
Specialty Steel	6322
Total	203580

What we will not touch: stocks and sectors impacted by disruption

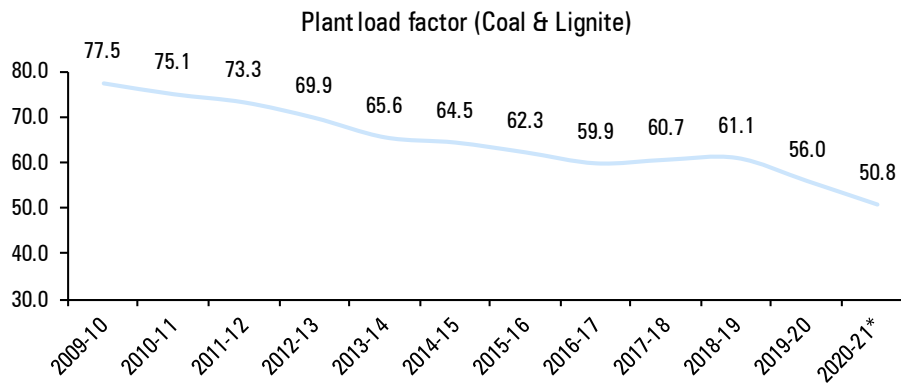
Declining trend in Li-ion battery costs



Renewable capacity in India



Countrywide PLFs for thermal power plants



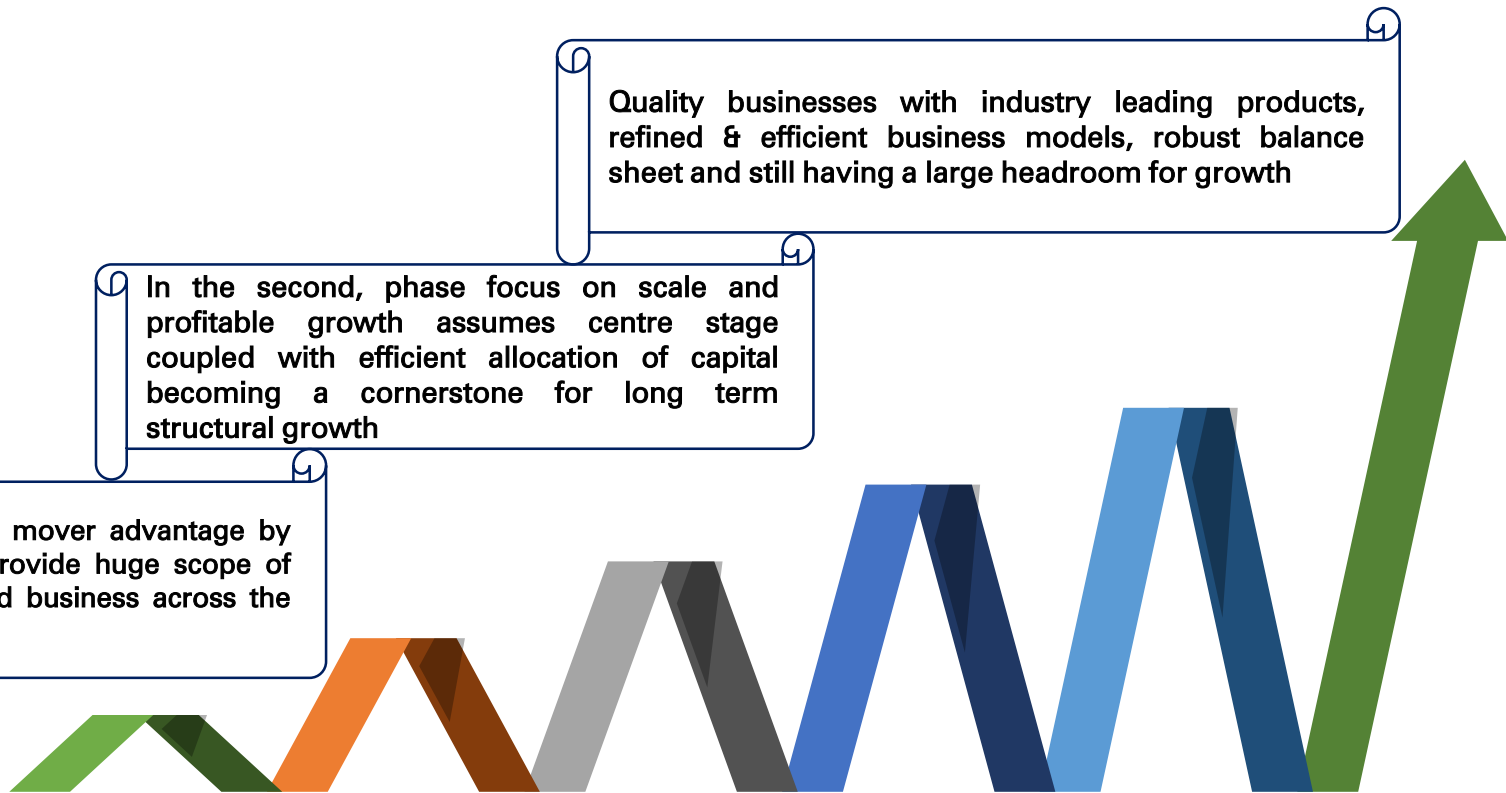
Source: BNEF.com Statista, CEA, ICICI Direct Research

Quality businesses with proven track record of consistent performance and top notch management pedigree is one of the key parameters that sets the base for our portfolio. Headroom for growth and capital efficiency are other key aspects that we give significant importance to.

Quality businesses with industry leading products, refined & efficient business models, robust balance sheet and still having a large headroom for growth

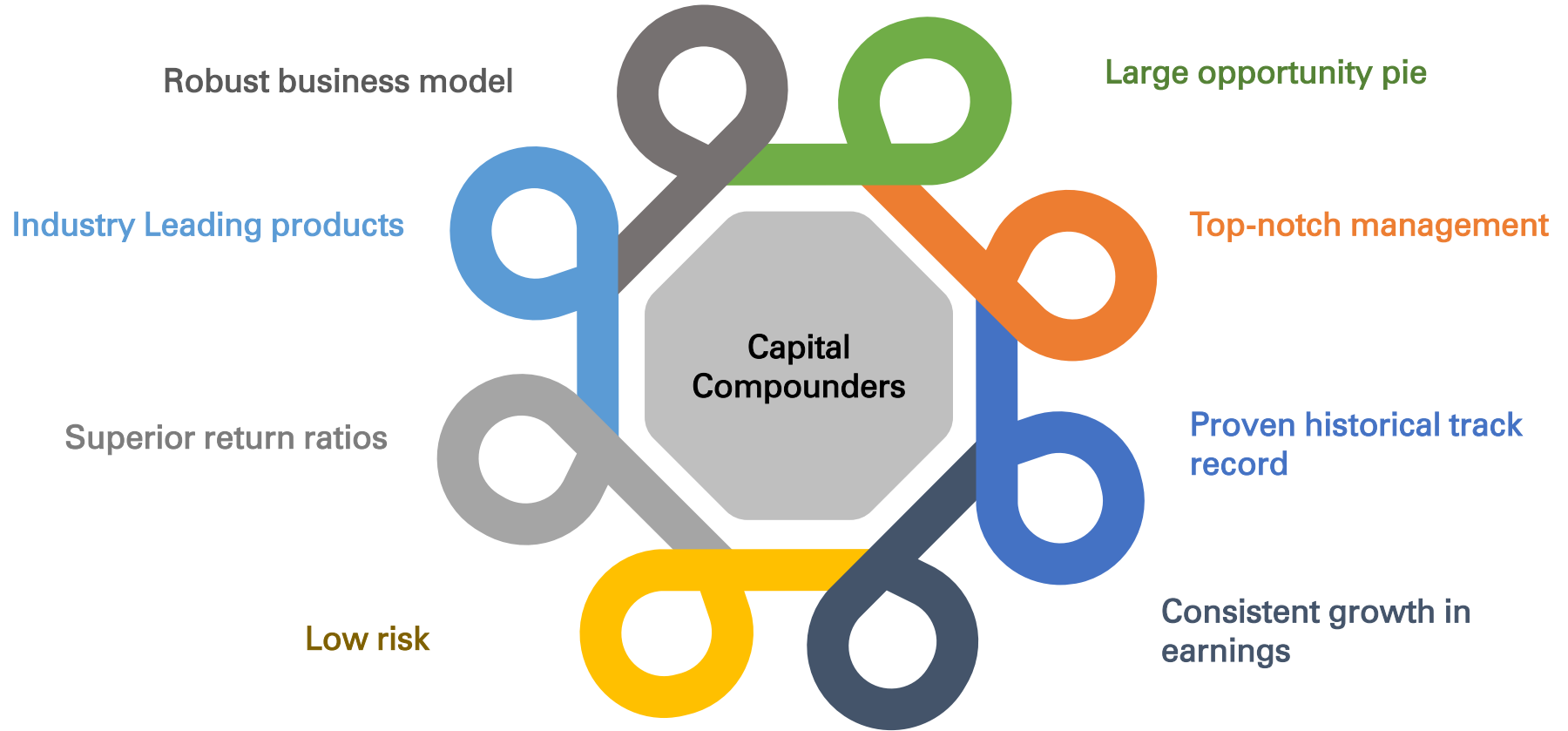
In the second, phase focus on scale and profitable growth assumes centre stage coupled with efficient allocation of capital becoming a cornerstone for long term structural growth

Capitalising on the first mover advantage by identifying areas that provide huge scope of growth and built around business across the same



Key attributes which are common across Capital Compounders

Apart from capital efficiency and consistency of earnings growth, below are some other attributes of Capital Compounders



Investment Strategy

The investment objective of the Capital Compounders portfolio is to achieve long term stable capital appreciation from a portfolio that is predominantly invested in large cap companies. The recommended companies in the portfolio have an established business model, a strong balance sheet, quality management and have delivered superior capital efficiency ratios over a period of time, with the aim of minimising risks in the portfolio.

Some Examples of companies in our portfolio



Over the last ten years company has consistently grown revenue, PAT at a CAGR of 11%, 14% respectively, overcoming several economic challenges such as Demon, GST etc. The company has increased its manufacturing capacity by ~50% in the last three years without taking any debt. As a result, company's return ratios - RoE, RoCE has remained strong at 27% and 30%.



HDFC Bank, largest bank in India by market capitalization, has delivered consistent performance across parameters since more than a decade. Adopting focussed lending approach, advances growth consistently remained ahead of industry at 20-22% CAGR in last decade. Continued branch addition and investment in digital banking kept liabilities franchise to be superior with CASA ratio ahead of 40%.



Trent's Westside division has delivered a healthy performance with consistent SSSG (8-10% over the last seven years) and higher share of private label portfolio (99%) yielding superior gross margins. Trent's value fashion brand Zudio, has grown multi-fold from ₹ 144 crore in FY18 to ₹ 507 crore as on FY20, translating into robust CAGR of 88%.

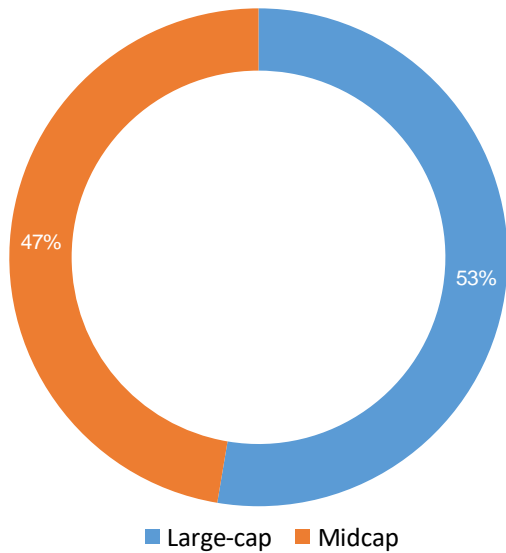
Constructed applying **bottom up style of investing methodology.**

Its key parameters include:

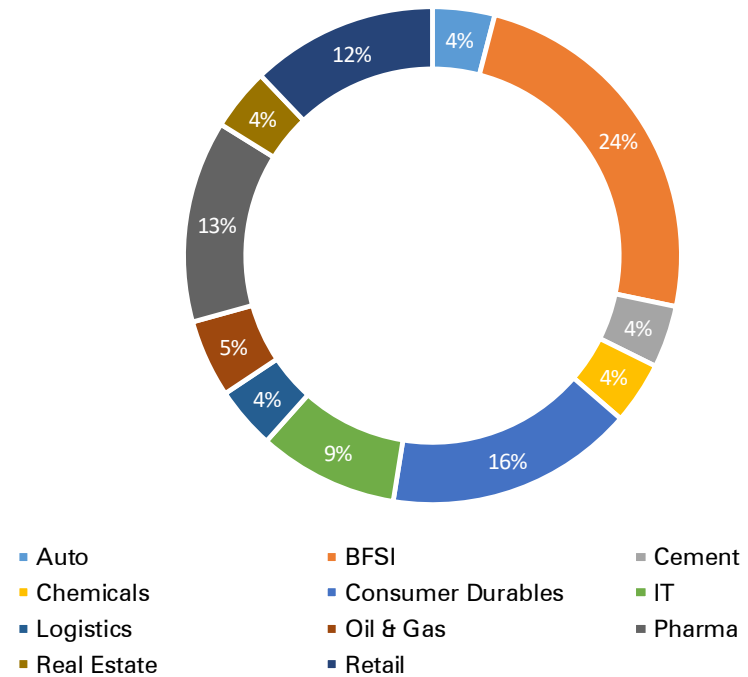
- **Capital efficient businesses** (subjective) with well defined path of higher return ratios in future. Expansion of sustainable ROCE.
- **Robust growth prospects**
- **Low on debt & leverage**
- **Sound Financials;** healthy B/S, positive cash generating businesses
- Run exhaustive check in terms of **management pedigree** and other **corporate governance parameters**
- **Time horizon** – We believe stocks show reasonable performance over 3-5 years
- **Valuation** - We do not follow necessarily a contrarian approach, so we do not aim to buy cheapest stock and sell expensive stocks. Stocks are cheap and expensive for a reason
- **Robust balance sheet**, here the income growth should be faster than the balance sheet growth
- **Other Criteria**
 - a) **Universe of 15-20 companies**
 - b) **No sector will be more than 35% of the portfolio**
 - c) **Individual stocks should not be more than 10% and less than 3% of portfolio while investing**

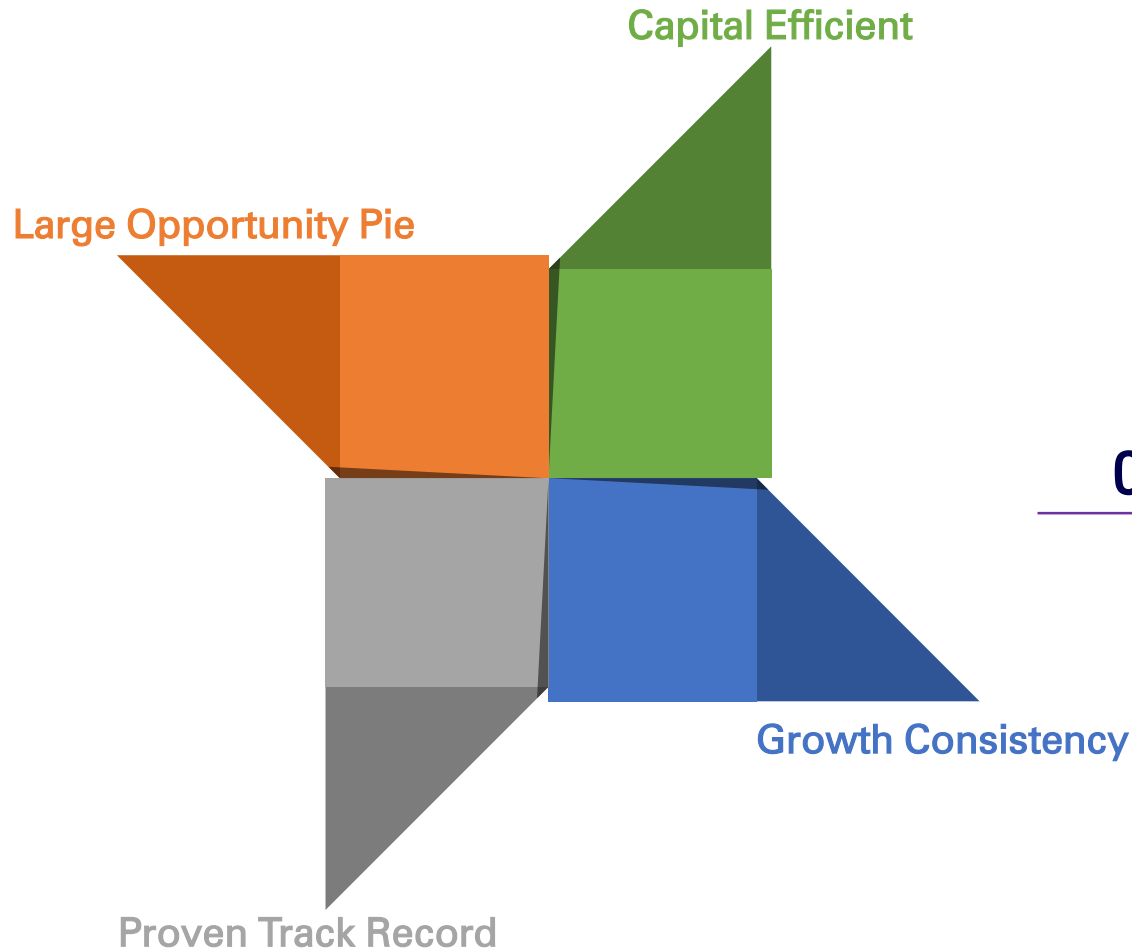
Capital Compounders portfolio focuses on well-established businesses from diversified sectors

Portfolio composition



Portfolio Sectoral Mix





Capital Compounders (October 2021)

Market Outlook & Portfolio Highlights

- Indian markets have been one of the best performing markets this calendar year and are up 25% YTD CY21. This was due to a confluence of fundamental factors.
- Equity as an asset class is being widely recognised as an asset generating inflation beating returns or real returns over a long period of time and is indeed very much liquid in nature; the TINA (there is no alternative) factor is at play.
- Secondly, with the increase in pace of digitisation, a set of efficiencies have crept into organisations as well as the economy, indicating better corporate earnings/GDP growth.
- Corporate earnings have been nearly stagnant in the recent past with FY19-21 Nifty earnings CAGR at ~5%. Currently, we are on the cusp of high double digit growth trajectory with earnings CAGR over FY21-23E at ~ 26%, the key driver for markets to inch higher.

Sensex & Nifty Target

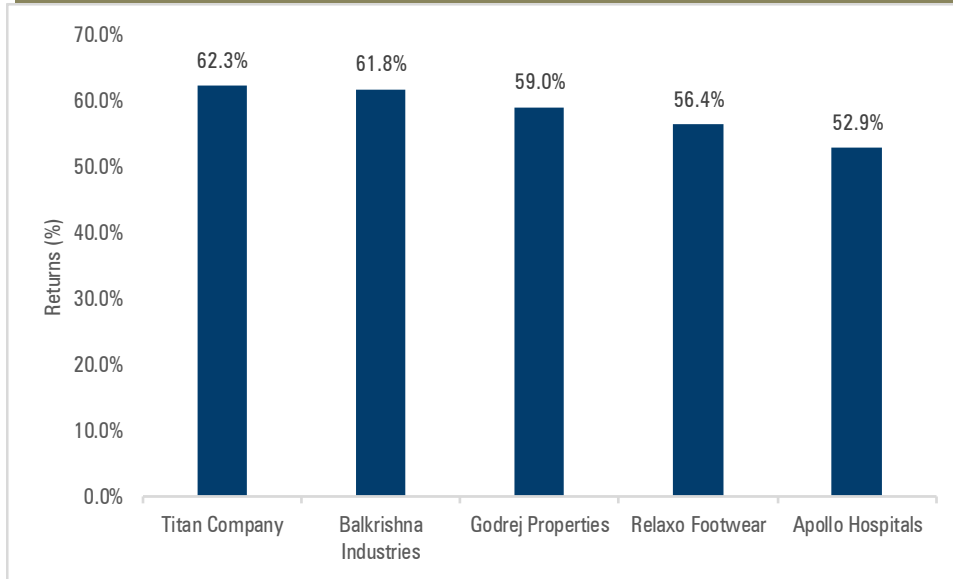
Earnings Estimates	FY19	FY20	FY21	FY22E	FY23E
Nifty EPS (₹/share)	470	440	515	685	815
Growth (%)	3.2%	-6.2%	17.1%	32.9%	19.0%
Earnings CAGR over FY21-23E					25.7%
Target Multiple					24.5x
Nifty Target (at 24.5x FY23E EPS)					20,000
Corresponding Sensex Target					66,600
Potential Upside (@Nifty 17,525)					14%

Portfolio Highlights

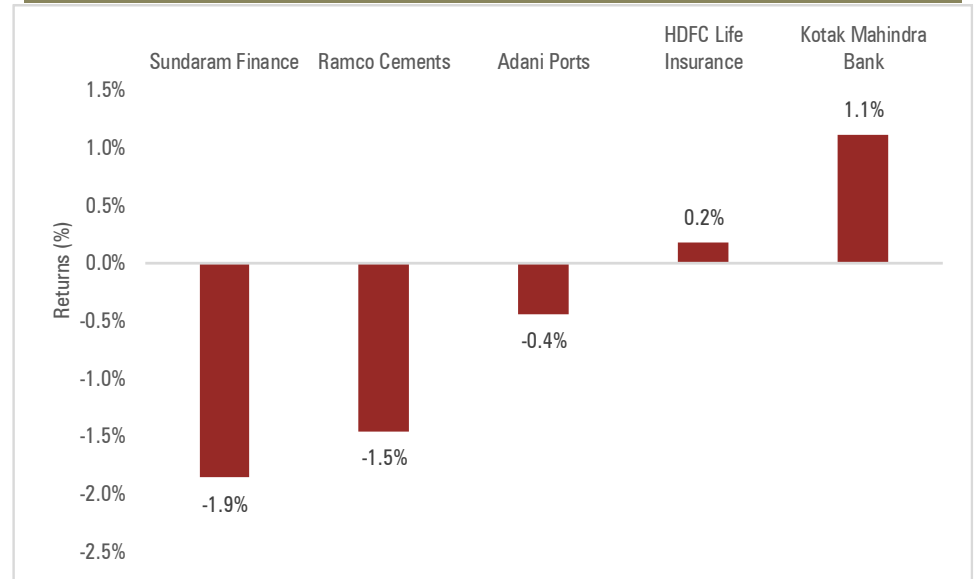
- Inception Date 8th March
- Initial Investment Amount ₹ 549107
- Current Value ₹ 735476
- Return since inception 33.9%
- Benchmark NSE 500
- Benchmark Return 22.3%
- Outperformance 11.6%

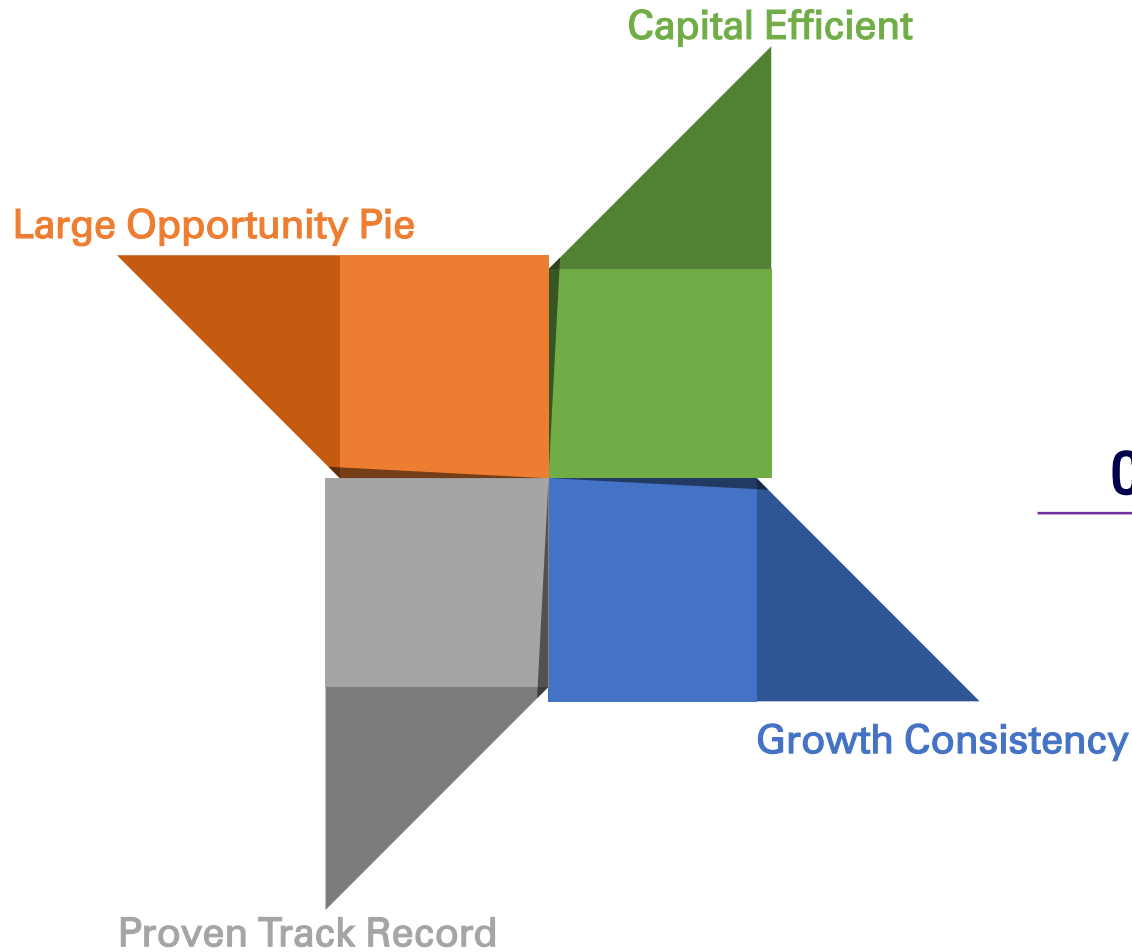
Gainers & Losers

Gainers



Losers





Capital Compounders (January 2022)

Market Outlook & Portfolio Highlights

- CY21 has seen a strong economic recovery from the unlocked lows. The recovery in growth mainly stemmed from the government led initiatives by focusing on “Atmanirbhar” schemes panning across a gamut of sectors, which, in turn, will act as a multiplier catalyst across layers of GDP growth and get the economy back on fast track to achieve the \$5 trillion aspiration.
- On an absolute basis, as on date, the Midcap index is up ~43% with small cap index gaining ~22% amid Nifty gains pegged at ~64%. This implies that over a longer time frame, midcaps & small caps have actually underperformed the Nifty and though absolute returns look optically high in CY21, this shall still continue in CY22E driven by inherit business moats.
- Superior earning potential and reasonable valuations (trades at <20x PE on FY23E, ~0.5x PEG) make us believe that more upsides are in store for investors in the midcap & small cap space. FY21-23E Earnings CAGR; Nifty at 25.8%, Nifty MidCap100: 38.5% and Nifty small cap 100: 28.0%
- We value the Nifty at 20,000 i.e. 24.5x P/E on FY23E EPS of ₹ 815 with corresponding Sensex target at 66600.

Sensex & Nifty Target

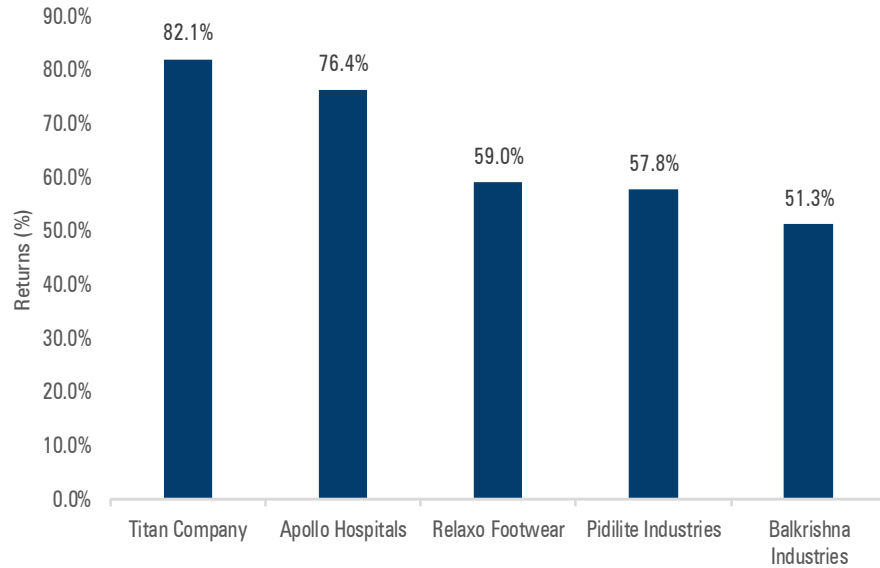
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Nifty EPS (₹/share)	470	440	515	685	815
Growth (%)	3.2%	-6.2%	17.1%	32.9%	19.0%
Earnings CAGR over FY21-23E					25.7%
Target P/E Multiple					24.5x
Nifty Target (using FY23E EPS)					20,000
Corresponding Sensex Target					66,600

Portfolio Highlights

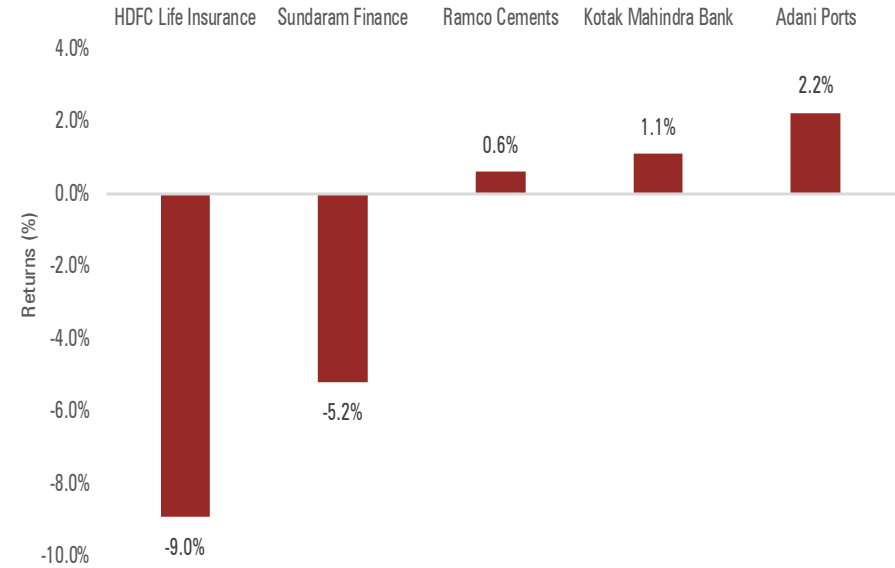
- Inception Date 8th March 2021
- Initial Investment Amount ₹ 549107
- Current Value ₹ 730907
- Return since inception 33.1%
- Benchmark NSE 500
- Benchmark Return 23.7%
- Outperformance 9.4%

Gainers & Losers

Gainers



Losers/Laggards



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