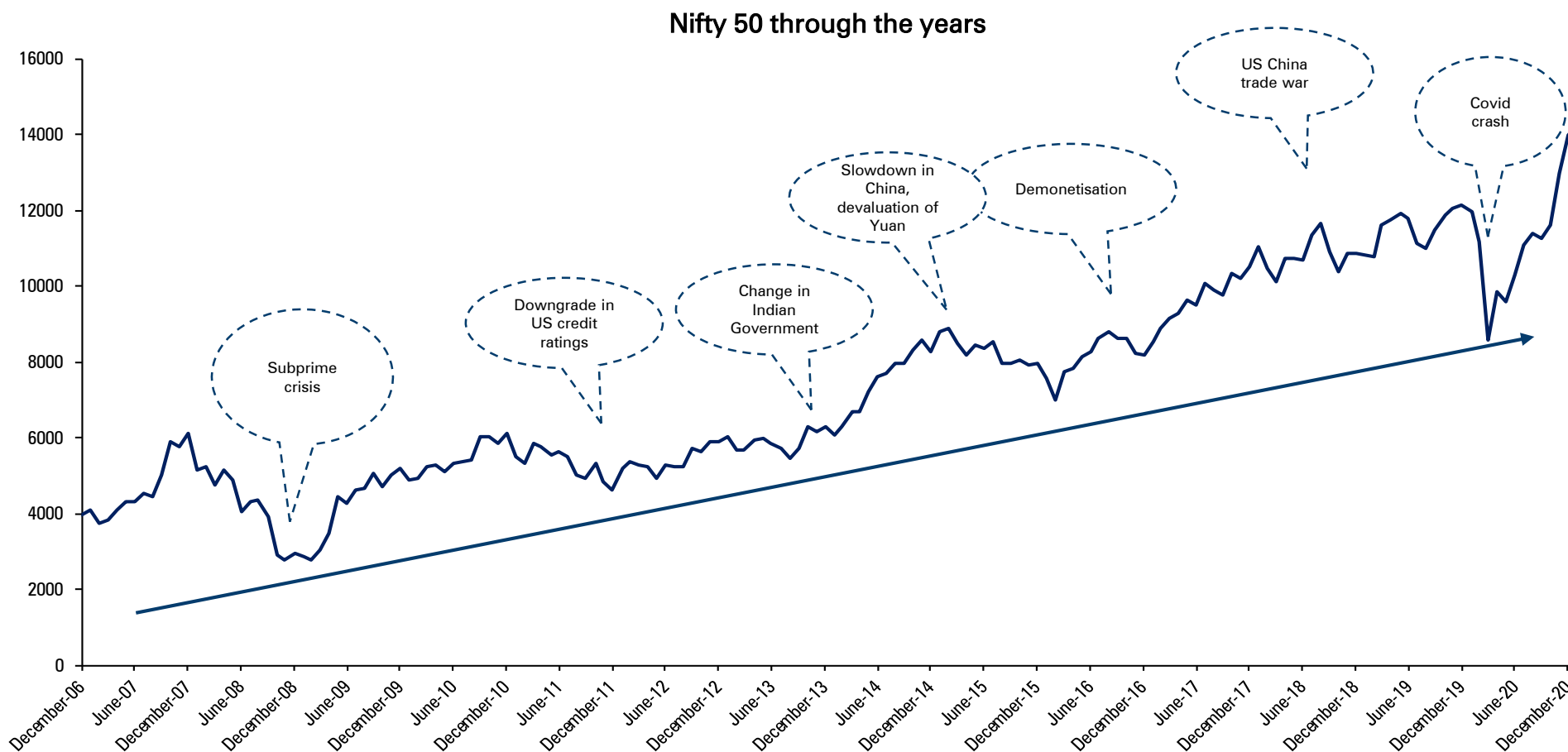


# Leaders of Tomorrow



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



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				

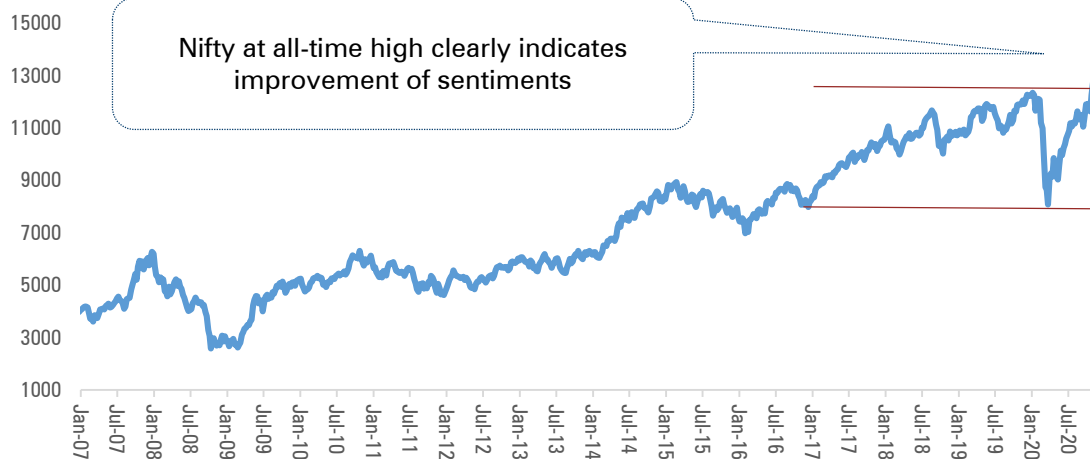
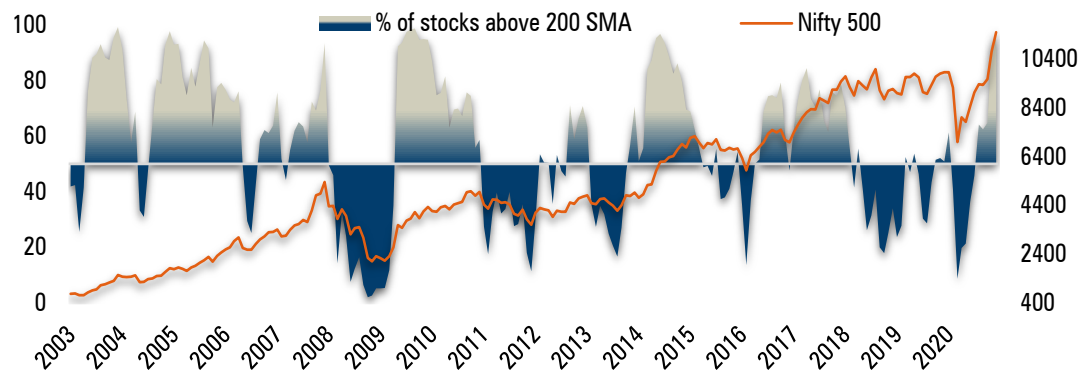
# FII inflows at historical high, market sentiments bouyant...

## 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

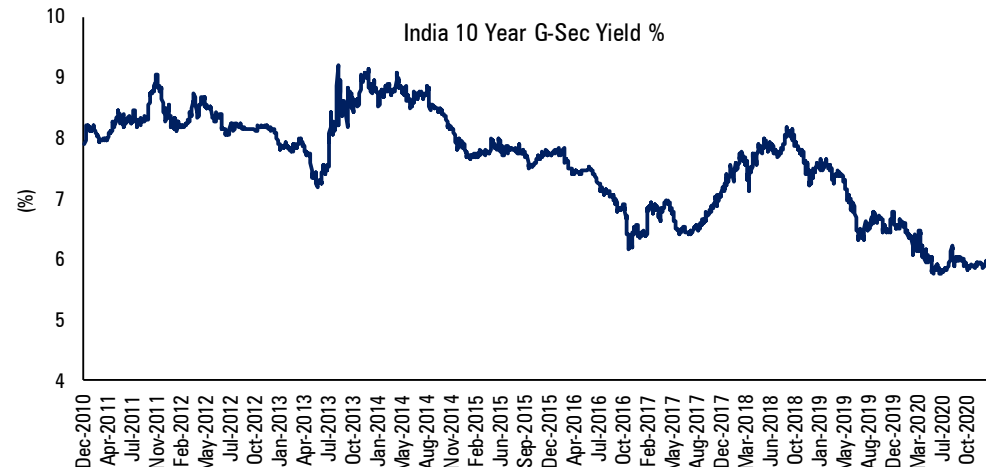


Greater than 90% of the NSE500 stocks are trading above their 200 SMA. This has never happened in previous bull runs. This highlights broad based participation and strong market sentiments.

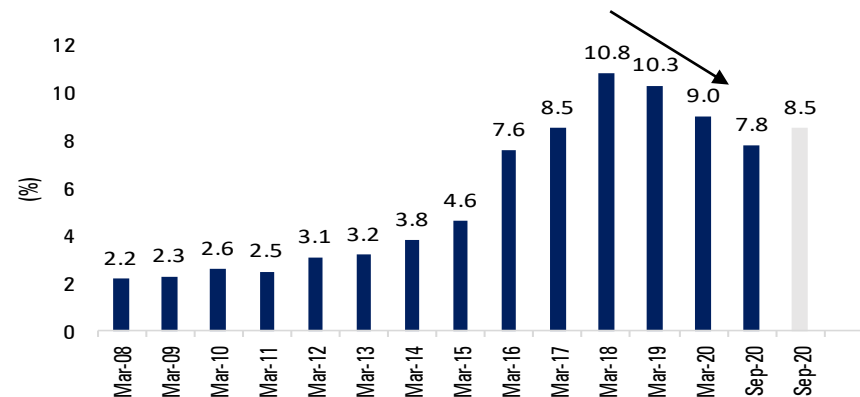
# Positive conditions for a broad based market rally...

## Interest rates at all time low

India 10 Year G-Sec Yield %

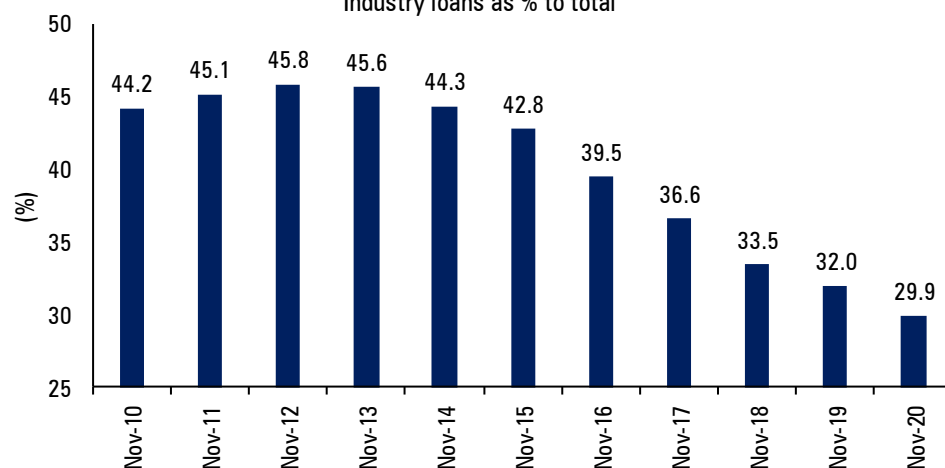


## Asset quality concerns peaked out

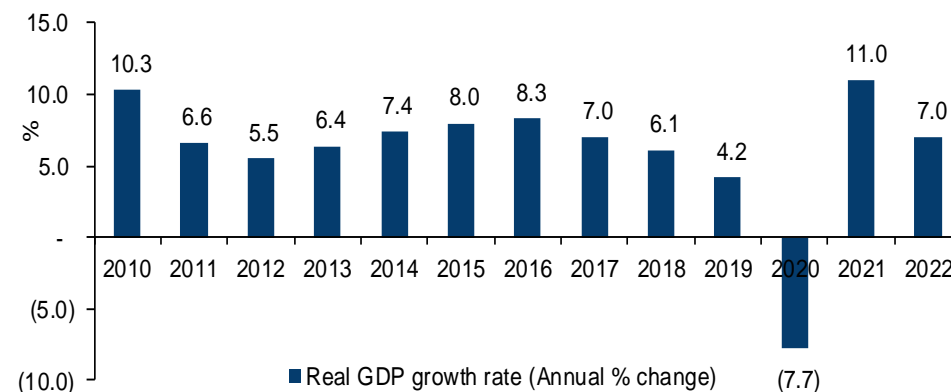


## Corporate debt at lowest levels

Industry loans as % to total



## Historical GDP growth rate of India

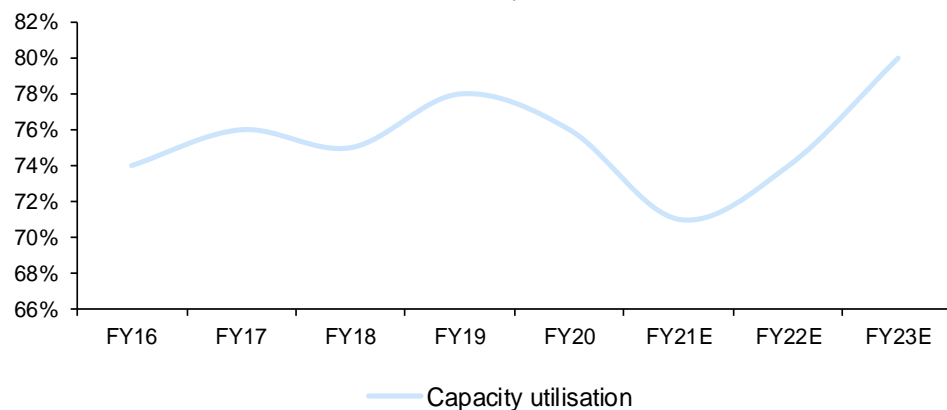


Source: NSE, RBI, IMF, WorldBank, ICICI Direct Research

# Capacity utilisation trend for core sectors

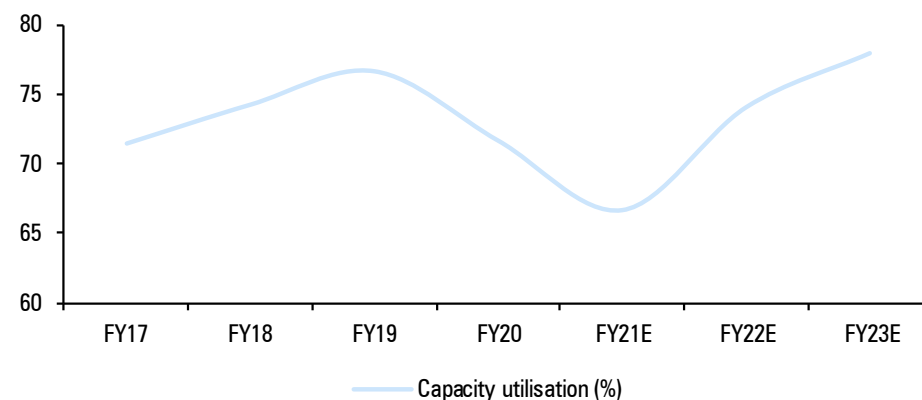
Steady demand from core industries should improve capacity utilisation in steel sector

Steel Capacity utilisation



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

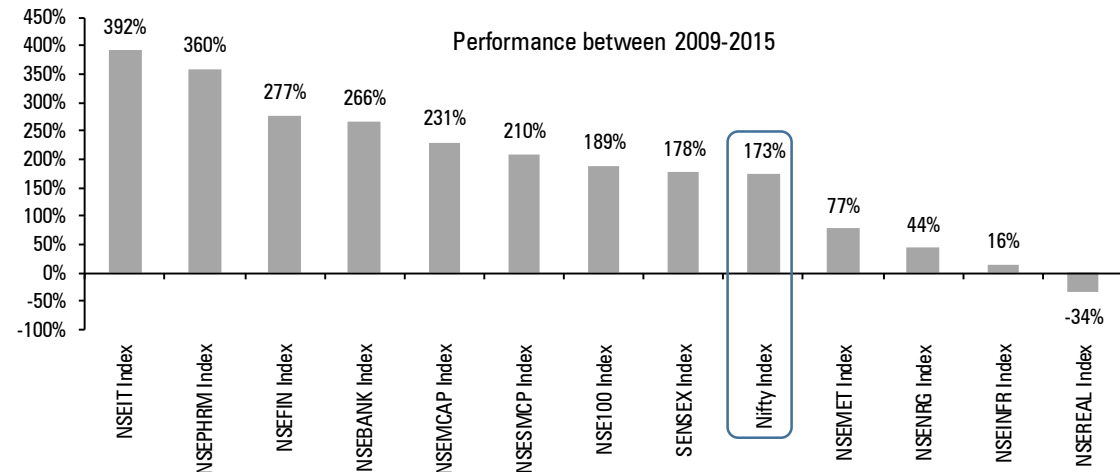
Capacity utilisation (%)



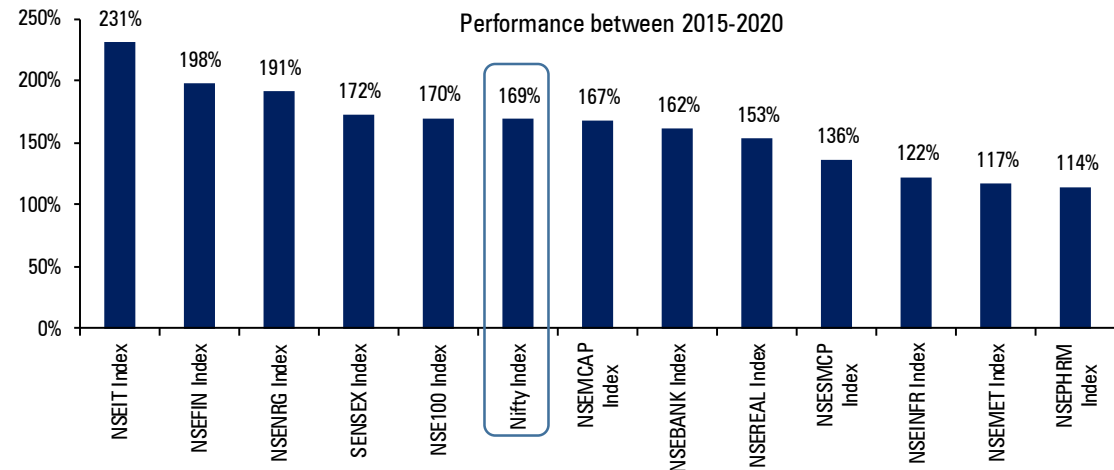
Source: Company, ICICI Direct Research

# 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%



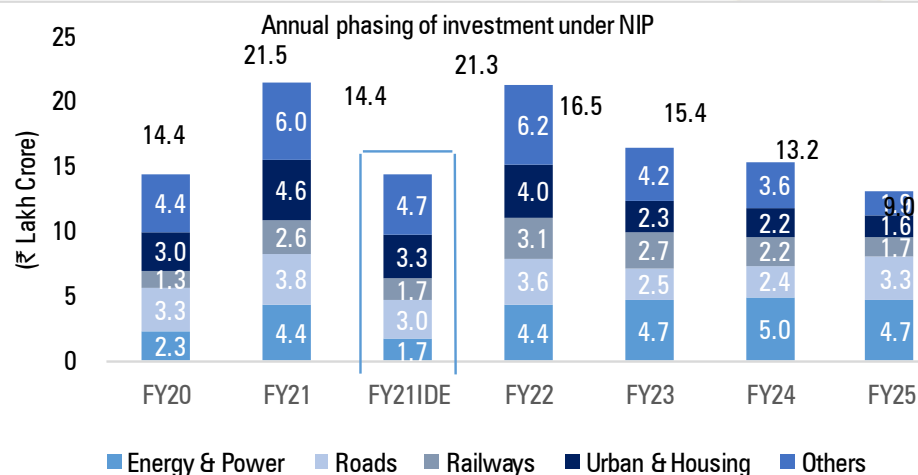
Sectoral Indices	1 year	3 year	5 year	10 year
Nifty Realty	-4.3%	-10.2%	103.4%	6.5%
Nifty Bank	-0.5%	11.3%	99.9%	187.7%
Nifty Metal	20.6%	-23.0%	91.6%	-25.6%
Nifty Financial Services	4.2%	31.2%	131.3%	254.6%
Nifty Energy	7.9%	15.3%	95.7%	88.6%
Nifty Infra	13.5%	3.2%	53.8%	23.7%
Nifty IT	57.4%	95.2%	128.7%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



Source: Bloomberg, ICICI Direct Research



Capex plan under National Infrastructure plan



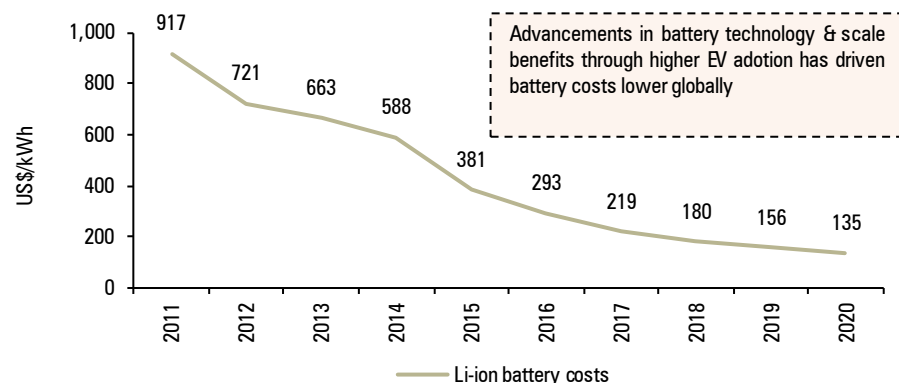
PLI scheme boost for favorable domestic manufacturing

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

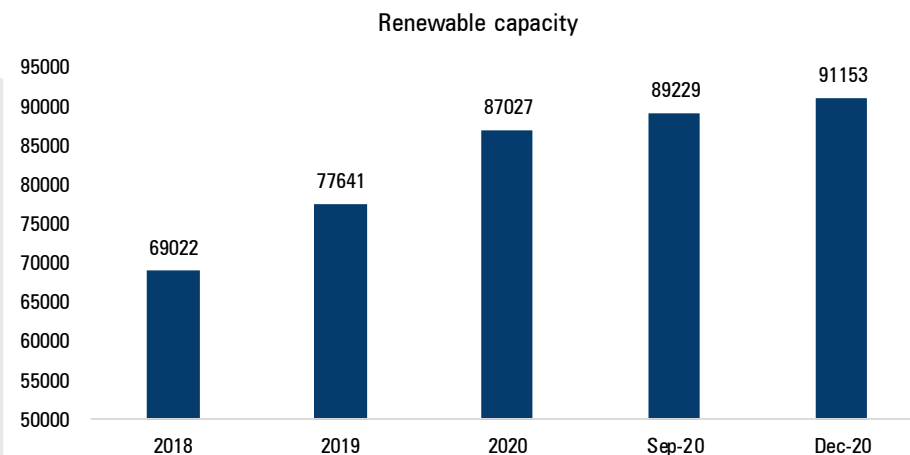


# What we will not touch: stocks and sectors impacted by disruption

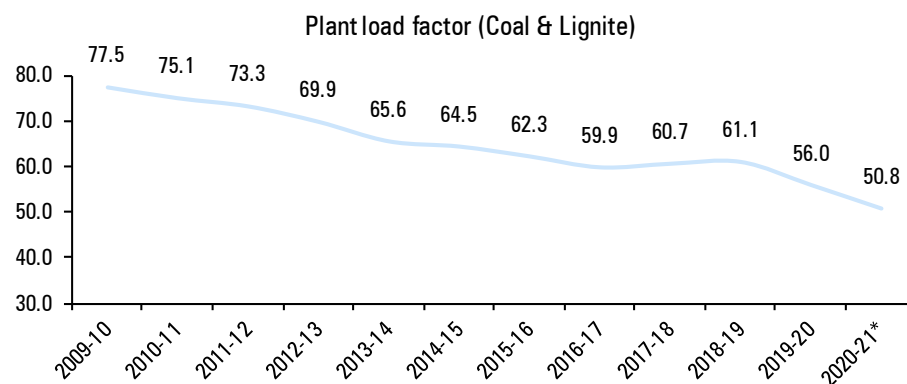
## Declining trend in Li-ion battery costs



## Renewable capacity & solar tariff in India



## Countrywide PLFs for thermal power plants



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

# What are small-caps?

Small-caps are essentially the companies which rank 251 and beyond in the pegging order of listed companies on market capitalization basis.

## Large Caps – Top 100 companies by market cap

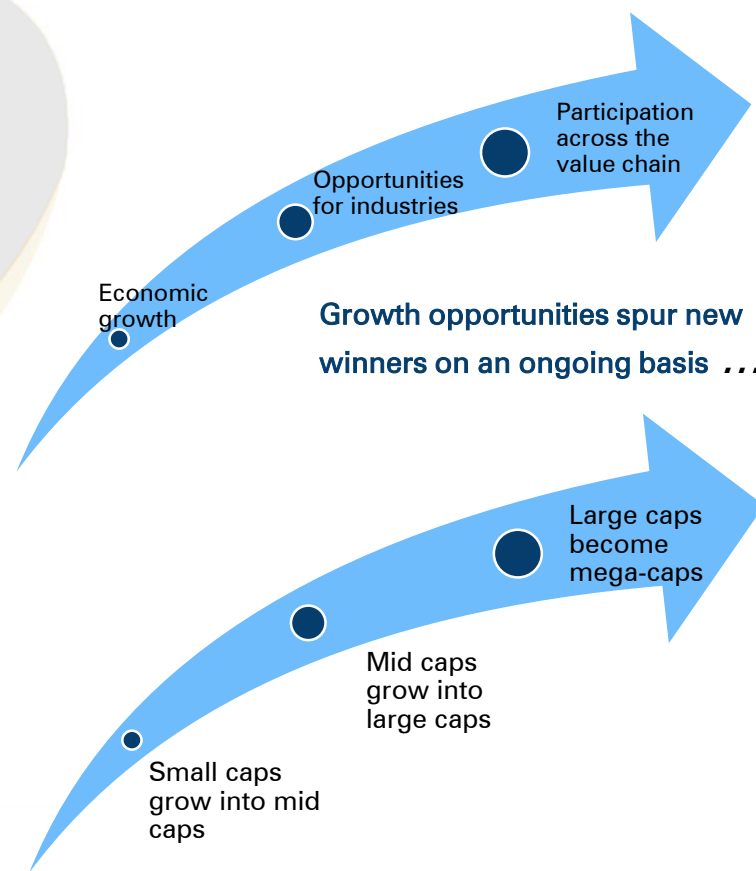
(As of Dec 2020: MCap  $\sim > = ₹ 29,000$  crore)

## Mid Caps – 101<sup>st</sup> – 250<sup>th</sup> companies by market cap

(As of Dec 2020: MCap between ₹ 29,000 crore and  $\sim ₹ 8,400$  crore)

## Small Caps – 251<sup>st</sup> and beyond companies by market cap

(As of Dec 2020: MCap  $\sim < = ₹ 8,400$  crore)



Source:: SEBI, ICICI Direct Research

## Midcap Opportunity in Tractor Space



Industry growing at 10% CAGR → 1.6x present size in next 5 years

Leader with 43% market share grows to 50% market share in next 5 years → 1.9x today's size

Implied profit multiplication = >2x

Smaller player with 11% market share grows to 15% market share in 5 years → 2.2x today's size

Implied profit multiplication = >2.5x

## Small-Cap Opportunity in Power tiller Space



Industry growing at 15% CAGR → 2x present size in next 5 years

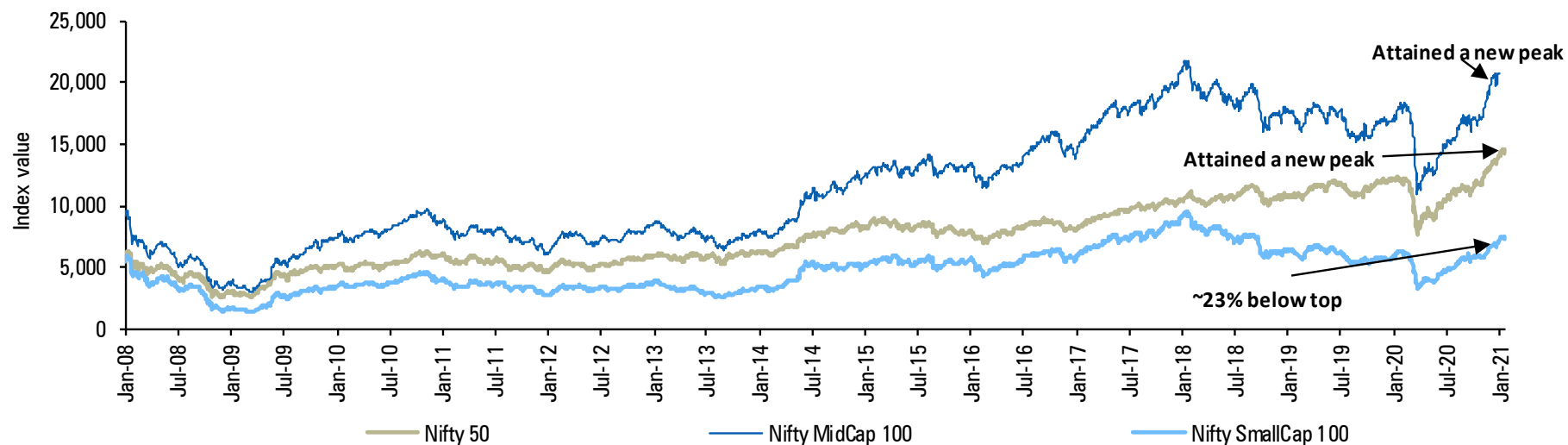
Leader with 50% market share grows to 70% market share in 5 years due to import restrictions → 2.8x today's size

Implied profit multiplication = >3.5x

Source:: ICICI Direct Research

# Small-cap – at the cusp of mean reversion

While large cap index and mid cap index have rescaled previous peak (as of January 2021), small cap index remains well below its life high (~23% from top) signalling that previous peak is still some distance away ...



Source: NSE, ICICI Direct Research

# Historical data suggest reasonable headroom for small-cap outperformance

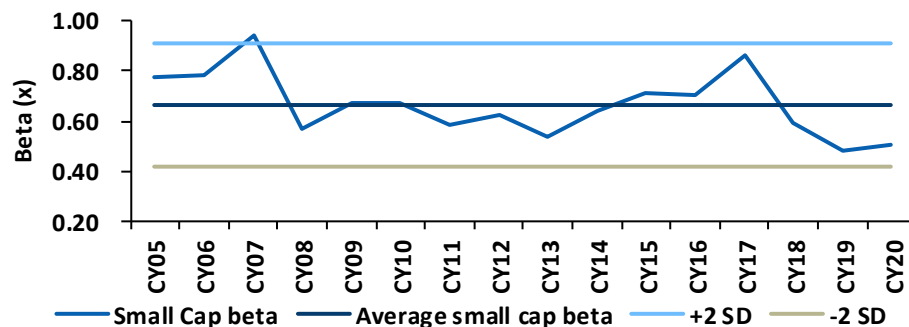
CY	Nifty 50		Nifty Midcap 100		Nifty Small Cap 100		Small Cap Alpha (%)	
	Year end index value	YoY Returns (%)	Year end index value	YoY Returns (%)	Year end index value	YoY Returns (%)	Over Nifty	Over Nifty Midcap
2020	13,982	15	20,842	22	7,088	21	7	(0)
2019	12,168	12	17,103	(4)	5,835	(10)	(22)	(5)
2018	10,863	3	17,876	(15)	6,449	(29)	(32)	(14)
2017	10,531	29	21,134	47	9,093	57	29	10
2016	8,186	3	14,351	7	5,781	2	(1)	(5)
2015	7,946	(4)	13,397	6	5,653	7	11	1
2014	8,283	31	12,584	56	5,273	55	24	(1)
2013	6,304	7	8,071	(5)	3,403	(8)	(15)	(3)
2012	5,905	28	8,505	39	3,710	37	9	(2)
2011	4,624	(25)	6,112	(31)	2,712	(34)	(9)	(3)
2010	6,135	18	8,857	19	4,101	18	(0)	(2)
2009	5,201	76	7,433	99	3,486	107	31	8
2008	2,959	(52)	3,736	(59)	1,684	(71)	(19)	(12)
2007	6,139	55	9,200	77	5,801	87	33	10

- Historically, small caps have bounced back strongly from every year of negative/low returns.
- In recent times, CY20 performance (up 21%) came on the back of two years of double-digit decline i.e. -29% in CY18 and -10% in CY19.
- There remains significant headroom for continued recovery in the small cap space
- Interestingly small cap's are yet to generate meaningful alpha over their larger counterparts namely Nifty 50 and Nifty Midcap

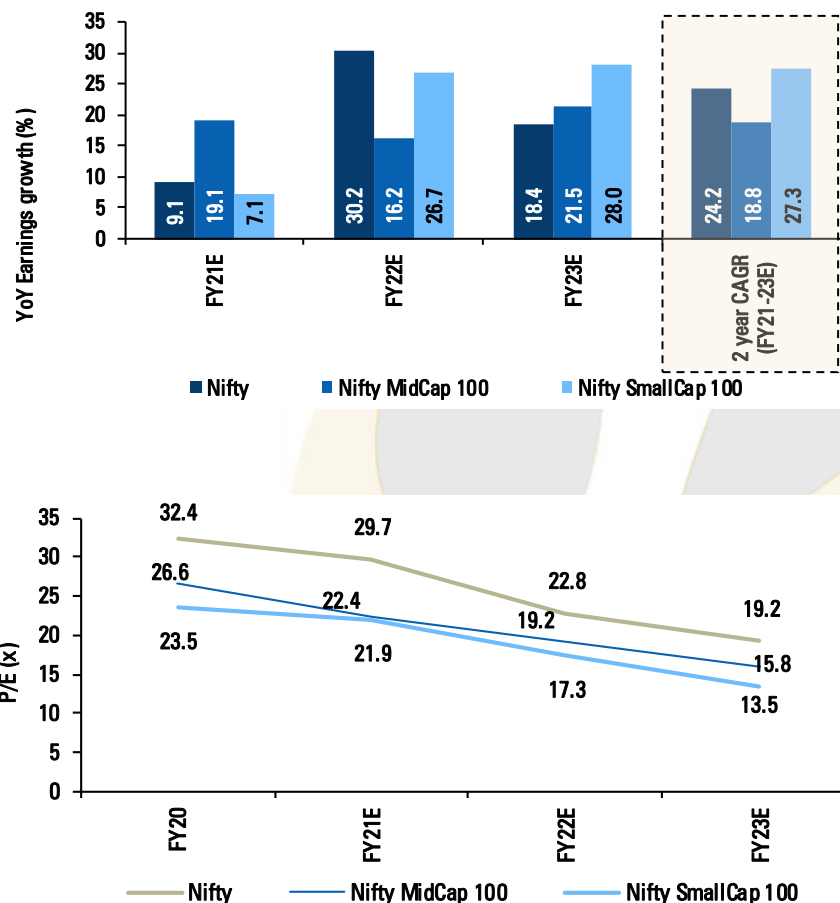
As against an average long period beta of ~0.7x of Nifty Small Cap 100 vs. Nifty 50, the present small cap index beta stands at ~0.5x i.e. near to average-2 std dev; near to its bottom range. The same is indicative of potential outperformance of Small caps vis-à-vis bellwether index

(Small Cap beta = small cap index value/Nifty index value)

Source:: NSE, ICICI Direct Research



# Small-caps provide strong earnings visibility at reasonable valuations



Low interest rate scenario is a key tailwind to overall equities (TINA factor). Within equities, small caps offer superior earnings potential, with FY21E-23E CAGR seen at ~27%. This compares to ~24% CAGR seen at large caps and ~19% CAGR seen at mid caps

Consequent to relative price underperformance recently and higher expected earnings up ahead, valuations for small caps vis-a-vis narrower indices are at attractive levels (~14x P/E on FY23E EPS). This provides margin of safety on small caps.

Source:: NSE, ICICI Direct Research

# Our past history of well researched stocks turning multi-baggers



## Phillips Carbon Black Limited

**A leader in supplying carbon black, an essential compound for manufacturing tyres**

Details	Initiation	Peak
Date	11-Jul-16	12-Jan-18
Price	175	1455
Mcap	600 crore	5,000 crore
RoCE	6%	17%

**Nano Nivesh**

July 11, 2016

**Phillips Carbon Black (PHICAR)**

Phillips Carbon Black (PCBL) is the manufacturer of carbon black, which is primarily used as a reinforcement material in tyres and other industrial rubber goods. PCBL is the largest manufacturer of carbon black in India with a market share of 31%. With the robust auto sector outlook, a steep correction in crude price (raw material a crude derivative) and operational efficiencies, PCBL is on a strong footing with robust prospects, going forward. With a turnaround in sight, we expect the PAT to quadruple from current levels by FY18E.

**Highlights**

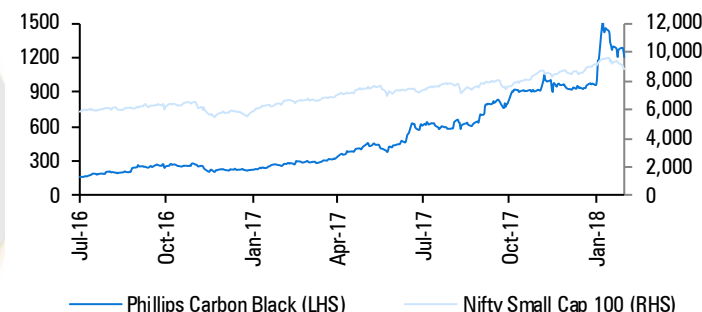
- Carbon black - capacity utilisation inching upwards:** PCBL has an effective installed capacity of 411 kilo tonne (KT) for carbon black (name plate capacity at 472 KT). In FY16, PCBL operated at 81% capacity utilisation levels with carbon black sales at 335 KT. Going forward, on the back of a pick-up in tyre demand domestically & imposition of anti-dumping duty, PCBL is witnessing robust demand. Capacity utilisation is expected to augment to 93% in FY18E with corresponding carbon black sales at 380 KT in FY18E, implying sales volume CAGR of 6.5% in FY16-18E. PCBL also sells high margin specialty grade carbon black, which finds application in plastics, inks, etc. Its volume in FY16 was at 5 KT (2.5 KT in FY15). Going forward, the specialty grade sales volume is expected at 10 KT in FY17E & 18 KT in FY18E, which will further drive profitability.
- Decline in crude price; operating leverage to enhance profitability:** PCBL uses carbon black feed stock (CBFS) as its key raw material for manufacturing carbon black. CBFS is a crude derivative and,

**Price**  
₹ 175

**Recommendation**  
**Buy**

**Fair value**  
₹ 225-240

Phillips Carbon Black turned ~8x vs. small cap index return of ~50% during last small cap run (2016-2018)



**Affle is a technology platform that enables advertisers to do targeted advertising**

Details	Initiation	Peak
Date	18-May-20	16-Dec-20
Price	1275	4007
Mcap	3,250 crore	10,200 crore
RoCE	32%	32%

**Affle India (AFFIND)**

CMP: ₹ 1275 Target: ₹ 1530 (20%) Target Period: 12 months May 18, 2020

**BUY**

**Unique play on digital ad tech...**

Incorporated in 2006, Affle is a technology platform that enables advertisers to do targeted advertising. It helps advertiser to measure the effectiveness of advertisement as it charges only when a user downloads an app or completes a transaction. In FY19, consolidated revenues rose 49.1% YoY while PAT increased 75.4% YoY. Despite this robust growth, revenues are just a fraction of the overall mobile advertisement market, representing tremendous scope for growth. Going forward, we expect revenues and PAT to increase at a CAGR of 32% and 31%, respectively, over FY19-22E.

**Shift to mobile advertisement imminent**

Mobile advertisement has seen tremendous growth at 41% CAGR in 2016-19 led by rising smartphone penetration, low data tariffs and young demographics. Going forward, mobile advertising is expected to increase at a CAGR of ~35% in 2019-25. Further, in a post Covid world, we expect a significant shift among consumers to adopt digital technology across the world especially in India & other emerging markets. Further, within verticals, we expect e-commerce to witness robust growth. It will be a key segment driving digital ad spend in future. Affle generates ~75% of its revenues from India & Emerging markets. Within verticals, it generates more than ~50% of revenues from e-commerce making it a key beneficiary of changing digital trends in future.

**Unique business model makes Affle preferred ad tech partner**

Affle, through its various platforms like data management platform, fraud detection platform and real time inventory buying ad inventory helps

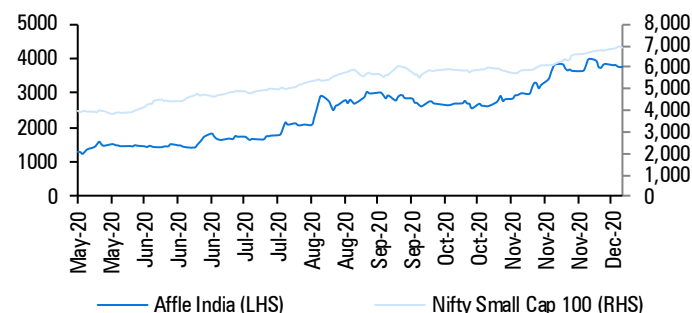
**Particulars**

Particulars	Amount
Market Capitalization (₹ Crore)	3,250.8
Total Debt	8.9
Cash and Investments (₹ Crore)	30.5
EV (₹ Crore)	3,229.3
32-week H1	2296/751
Equity capital	25.5
Face value	10.0

**Price Performance**

May 18-19 Aug 2019

Affle India turned ~3x vs. small cap index return of 75% during current small cap run (mid May 2020 onwards)





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.
- **Dominant market share position**
- **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) Multi-bagger approach
  - b) Universe of 15-20 companies
  - c) No sector will be more than 25% of the portfolio
  - d) Individual stocks should not be more than 10% and less than 3% of portfolio while investing

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