

India Equity Strategy

Small and mid-caps: wind in their sails

SEBI's circular mandating multi-cap funds to allocate at least 25% of their AUMs in mid and small-caps each by early Feb 2021 has come as a surprise, given the large AUMs currently under the multi-cap category. We believe some of the large multi-cap fund schemes might opt to reclassify into (or merge with the existing) "large and mid-caps" category, given the difficulty of managing sizeable AUMs with a high proportion of relatively less liquid Indian mid and small-caps. However, this mandate would still lead to forced inflows into mid and small-caps over the next four months, especially small-caps, given the sizeable gap between existing and proposed holdings across most schemes. As per current holdings and no scheme reclassification, this shift would lead to an outflow of ~Rs. 350bn from large caps (top 100 stocks by market capitalisation) and inflows of ~Rs. 130bn into mid-caps (next 150 stocks), and ~Rs. 280bn into small-caps (beyond the top 250 stocks). As per our analysis, these inflows would amount to ~1.2% of total free-float of mid-caps and a whopping ~7% for small-caps.

We believe quality small caps that were impacted in the past two years by investor apathy and flight to safety might continue their strong show, which has been visible in FY21 YTD. Investors should remain disciplined and stick to fundamentals while selecting small-caps, given the fact that economic headwinds might persist for a while, and valuations for quality mid and small-caps are not mouthwatering after the run-up. We continue to see selective bottom-up investible ideas with favourable risk-rewards across all market caps. Consumer, IT, Pharma, Chemicals, Cement, and Agri/rural might remain the preferred sector choice for investors in the near term. However, we also see this as a potential catalyst for rerating of ignored stocks in the economy-facing sectors such as Infra/Industrials, Hotels, Auto Ancillaries, Financials and Real Estate, if there is a confluence of strong balance sheets and attractive valuations.

Interestingly, in some of the above sectors, the themes of "big becoming bigger" and "winner takes it all" do not hold true, given the fragmented nature of business and niche opportunities, which makes a multi-year investment case for strong small-cap business models within these sectors. High divergence of valuations between large caps and mid/small caps emerged over the past two years in sectors such as Consumer, IT, Cement, and Financials, which might normalise to an extent, helped by this catalyst and high retail investor interest.

Our top mid-cap research picks are Mphasis, ACC, Crompton Consumer, IGL, Gujarat Gas, Max Financial, JK Cement, Endurance Technologies, Persistent, and Aarti Industries.

Our top small-cap research picks are CDSL, KNR Construction, Alkyl Amines, Galaxy Surfactants, Radico Khaitan, PNC Infratech, Brigade Enterprises, Sonata Software, Mastek, and Ahluwalia Contracts.

Our model portfolio already has a good blend of mid and small caps with a weightage of around 15%. We further add Persistent Systems, Aarti Industries, Endurance Technologies, and Radico Khaitan to our model portfolio and reduce our weightage in ICICI Prudential and Bajaj Finance.

HSIE Midcap Coverage Top Picks

Company Name	Rating	TP
Indraprastha Gas	ADD	444
ACC	BUY	1,610
Mphasis	BUY	1,450
Gujarat Gas	ADD	326
Aarti Industries	BUY	1,320
Max Financial Services	ADD	645
Crompton Greaves Consumer Electricals	ADD	275
Endurance Technologies	BUY	1,085
JK Cement	BUY	1,635
Persistent Systems	ADD	1,105

Source: HSIE Research

HSIE Small Cap Coverage Top Picks

Company Name	Rating	TP
Alkyl Amines Chemicals	BUY	4,010
Radico Khaitan	ADD	426
Galaxy Surfactants	BUY	2,070
Central Depository Services	BUY	412
PNC Infratech	BUY	234
KNR Construction	BUY	300
Brigade Enterprises	BUY	213
Sonata Software	BUY	370
Mastek	BUY	815
Ahluwalia Contracts	BUY	286

Source: HSIE Research

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HSIE Mid Cap Coverage (Top Picks Highlighted)

Company Name	Price	Mkt Cap (INR Bn)	Rating	TP	PE		ROE
					FY21	FY22	
Indraprastha Gas Ltd.	403	282	ADD	444	26.1	19.5	22.6
ACC Ltd.	1,322	248	BUY	1610	17.7	16.4	12.4
Trent Ltd.	695	247	ADD	460	-ve	110.9	6.8
SRF Ltd.	4,206	242	BUY	5120	28.4	22.1	22.5
General Insurance Corporation of India Ltd.	135	236	BUY	165	6.3	7.4	10.2
Container Corporation Of India Ltd.	384	234	ADD	400	27.4	19.5	3.6
Voltas Ltd.	656	217	ADD	653	47.6	32.0	14.1
Mphasis Ltd.	1,154	215	BUY	1450	18.1	15.8	21.6
AU Small Finance Bank Ltd.	673	206	ADD	724	34.7	23.8	50.0
Gujarat Gas Ltd.	296	204	ADD	326	25.2	17.8	43.4
Ashok Leyland Ltd.	68	200	REDUCE	57	-ve	35.9	5.5
Mindtree Ltd.	1,184	195	ADD	1240	24.0	20.5	19.6
ABB India Ltd.	898	190	SELL	827	51.8	38.9	5.5
Cholamandalam Investment & Finance Company Ltd.	224	184	BUY	249	20.7	11.6	14.7
The New India Assurance Co. Ltd.	109	180	SELL	100	13.4	10.4	3.8
Aarti Industries Ltd.	1,022	178	BUY	1320	32.8	24.4	19.5
Emami Ltd.	384	170	REDUCE	232	34.0	29.9	15.8
The Ramco Cements Ltd.	703	166	ADD	713	30.7	25.5	12.7
Shriram Transport Finance Company Ltd.	644	163	ADD	793	7.2	5.2	14.7
Mahindra & Mahindra Financial Services Ltd.	131	162	BUY	228	18.9	9.1	9.0
Escorts Ltd.	1,199	162	ADD	1200	22.1	17.6	16.3
Max Financial Services Ltd.	598	161	ADD	645	41.0	37.8	21.6
Crompton Greaves Consumer Electricals Ltd.	254	160	ADD	275	41.2	31.6	43.1
L&T Technology Services Ltd.	1,524	159	REDUCE	1395	24.5	19.5	31.8
ICICI Securities Ltd.	474	153	REDUCE	540	23.1	20.7	49.5
Endurance Technologies Ltd.	1,081	152	BUY	1085	36.9	24.7	20.3
LIC Housing Finance Ltd.	297	150	REDUCE	296	7.2	6.2	13.9
Oberoi Realty Ltd.	379	138	BUY	500	19.6	16.0	8.2
Dalmia Bharat Ltd.	713	134	BUY	1005	47.4	25.6	4.9
Amara Raja Batteries Ltd.	747	128	ADD	780	25.9	19.2	18.9
Hexaware Technologies Ltd.	417	125	REDUCE	385	17.6	15.7	25.8
Aditya Birla Fashion and Retail Ltd.	132	114	ADD	120	-ve	-ve	-13.6
Gujarat State Petronet Ltd.	198	112	BUY	252	8.8	7.1	55.9
JK Cement Ltd.	1,436	111	BUY	1635	28.1	18.7	16.9
Phoenix Mills Ltd.	612	105	BUY	828	71.3	25.0	10.0
The Federal Bank Ltd.	52	103	BUY	64	8.2	6.8	11.0
Oil India Ltd.	94	102	REDUCE	99	7.8	5.2	8.6
Prestige Estate Projects Ltd.	243	97	BUY	280	31.9	24.0	9.2
Navin Fluorine International Ltd.	1,957	97	ADD	2210	43.8	35.6	32.4
Motilal Oswal Financial Services Ltd.	651	96	ADD	715	16.2	15.4	7.1
RBL Bank Ltd.	183	93	REDUCE	148	19.2	9.2	5.5
KEC International Ltd.	325	83	BUY	334	15.1	12.1	21.6
TTK Prestige Ltd.	5,835	81	ADD	6000	48.1	36.4	15.0
Multi Commodity Exchange Of India Ltd.	1,555	79	ADD	1600	34.5	29.2	14.1
Persistent Systems Ltd.	1,011	77	ADD	1105	20.6	17.6	14.5
V-Guard Industries Ltd.	168	72	REDUCE	157	45.5	32.1	20.6

Source: Bloomberg, HSIE Research

HSIE Small Cap Coverage (Top Picks Highlighted)

Company Name	Price	Mkt Cap (INR Bn)	Rating	TP	PE		ROE
					FY21	FY22	
Alkyl Amines Chemicals Ltd.	3,185	65	BUY	4010	29.7	26.2	43.2
Galaxy Surfactants Ltd.	1,782	63	BUY	2070	28.3	23.4	23.7
Symphony Ltd.	835	58	REDUCE	810	41.7	30.0	27.9
Radico Khaitan Ltd.	394	53	ADD	426	22.3	17.4	15.8
Dilip Buildcon Ltd.	368	50	BUY	466	7.7	6.6	21.4
Central Depository Services (India) Ltd.	446	47	BUY	412	35.8	32.8	15.3
IRB Infrastructure Developers Ltd.	120	42	BUY	142	17.5	13.5	11.3
Cyient Ltd.	378	42	ADD	410	13.2	11.0	13.5
PNC Infratech Ltd.	158	40	BUY	234	12.4	9.5	18.9
Zensar Technologies Ltd.	173	39	ADD	200	15.6	12.4	13.7
Kalpataru Power Transmission Ltd.	250	39	BUY	357	10.5	7.8	12.8
TeamLease Services Ltd.	2,181	37	BUY	2120	40.9	30.7	6.8
Star Cement Ltd.	88	36	BUY	120	16.0	11.2	16.1
KNR Construction Ltd.	250	35	BUY	300	15.6	10.8	17.1
Brigade Enterprises Ltd.	162	33	BUY	213	117.6	14.6	5.0
Sonata Software Ltd.	312	33	BUY	370	14.4	12.3	38.7
Indostar Capital Finance Ltd.	261	32	REDUCE	267	23.0	15.1	-11.7
Spicejet Ltd.	51	31	ADD	95	10.9	2.8	0.0
JK Lakshmi Cement Ltd.	258	30	BUY	385	14.8	10.3	16.0
Balaji Amines Ltd.	840	27	BUY	980	21.7	17.4	15.8
BSE Ltd.	530	24	ADD	565	21.0	17.4	3.0
Majesco Ltd.	771	23	BUY	1050	31.4	25.8	12.9
Sobha Ltd.	238	23	BUY	348	11.2	7.2	12.1
Mastek Ltd.	799	20	BUY	815	15.7	13.7	16.4
Ashoka Buildcon Ltd.	69	19	BUY	141	-ve	-ve	42.4
NCC Ltd.	32	19	BUY	48	13.4	15.7	6.9
Ahluwalia Contracts (India) Ltd.	248	17	BUY	286	29.6	11.5	17.3
Shoppers Stop Ltd.	174	15	REDUCE	190	-ve	-ve	-29.0
Subros Ltd.	232	15	ADD	220	82.9	21.9	11.9
PSP Projects Ltd.	417	15	REDUCE	370	11.8	9.4	26.6
HG Infra Engineering Ltd.	192	13	BUY	337	8.7	6.2	20.7
Kolte Patil Developers Ltd.	163	12	BUY	240	17.0	10.9	10.9
Repco Home Finance Ltd.	180	11	ADD	207	4.9	4.7	16.3
Gateway Distriparks Ltd.	89	11	ADD	104	21.6	15.6	0.0
Sadbhav Engineering Ltd.	54	9	BUY	62	13.3	7.5	-6.3
JMC Projects (India) Ltd.	52	9	BUY	69	28.1	7.7	4.4
ITD Cementation India Ltd.	50	9	ADD	54	31.2	8.6	1.5
Capacite Infraprojects Ltd.	125	8	BUY	147	236.0	8.1	10.3
J Kumar Infraproject Ltd.	109	8	BUY	138	16.7	4.3	7.9

Source: Bloomberg, HSIE Research

Model Portfolio

Model Portfolio	Price	Rating	TP	M Cap US\$ bn	Model port on 120920			P/E	
					Wt	Port Wt	Rel wt	FY21E	FY22E
Nifty	11,464			1,651.7	100.0%	100.0%	0.0%		
Autos					6.5%	3.0%	-354 bps		
Maruti Suzuki India Ltd	7,194	BUY	6,980	29.5	2.2%		-215 bps	47.3	30.5
Bajaj Auto Ltd	2,916	ADD	3,145	11.5	0.8%		-81 bps	21.1	16.1
Mahindra & Mahindra Ltd	614	ADD	610	10.4	1.3%		-129 bps	16.5	13.0
Hero MotoCorp Ltd	2,992	BUY	3,100	8.1	1.1%	2.0%	90 bps	21.1	17.4
Eicher Motors Ltd	2,160	REDUCE	1,803	8.0	0.6%		-62 bps	41.7	26.4
Tata Motors Ltd	144	ADD	118	6.5	0.6%		-57 bps	-ve	21.4
Endurance	1,081	BUY	1,085	2.1		1.0%	100 bps	36.9	24.7
Banks and NBFCs					31.0%	30.5%	150 bps		
HDFC Bank Ltd	1,079			80.7	9.7%	9.7%	0 bps	21.9	17.8
Housing Development Finance Corp Ltd	1,768			43.1	6.3%	6.3%	0 bps	19.7	16.4
Kotak Mahindra Bank Ltd	1,330	ADD	1,331	35.8	3.8%		-384 bps	33.9	26.8
ICICI Bank	371	BUY	456	34.7	4.8%	8.0%	319 bps	16.8	13.9
Bajaj Finance Ltd	3,544	ADD	3,643	29.0	1.8%	0.0%	-180 bps	47.8	28.4
State Bank of India	203	BUY	286	24.6	1.3%	2.5%	122 bps	10.0	6.4
Axis Bank Ltd	447	BUY	565	18.6	2.6%	4.0%	141 bps	15.0	9.1
IndusInd Bank Ltd	610	ADD	584	5.8	0.7%		-71 bps	9.4	6.8
Insurance					0.8%	3.5%	268 bps		
Bajaj Finserv Ltd	6,128			13.3	0.8%		-82 bps	27.2	18.5
SBI Life	864	BUY	975	11.8		2.5%	250 bps	53.9	48.5
Max Financial	598	ADD	645	2.2		1.0%	100 bps	41.0	37.8
Consumer- Staples					8.7%	7.0%	-168 bps		
Hindustan Unilever Ltd	2,159	REDUCE	2,016	69.0	4.1%		-406 bps	60.5	51.0
ITC Ltd	184	BUY	236	30.8	3.0%	4.5%	154 bps	16.5	14.0
Nestle India Ltd	16,325	REDUCE	14,103	21.4	1.3%		-129 bps	70.8	62.0
Britannia Industries Ltd	3,772	REDUCE	3,479	12.3	0.4%		-31 bps	48.4	45.4
United Spirits	547	ADD	569	5.4		1.5%	150 bps	72.4	39.8
Radico Khaitan	394	ADD	426	0.7		1.0%	100 bps	22.3	17.4
Consumer Discretionary (ex-Autos)					4.0%	1.0%	-302 bps		
Asian Paints Ltd	2,036	REDUCE	1,800	26.6	3.0%		-303 bps	75.7	57.9
Titan Co Ltd	1,168	REDUCE	950	14.1	1.0%		-99 bps	118.7	55.5
Crompton Consumer	254	ADD	275	2.2		1.0%	100 bps	41.2	31.6
Industrials (Infra+ Cap Goods)					2.4%	4.0%	158 bps		
Larsen & Toubro Ltd	917	BUY	1,260	17.5	1.9%	3.0%	111 bps	18.3	13.0
Adani Ports & Special Economic Zone Ltd	343			9.5	0.5%		-53 bps	17.0	13.8
KNR Constructions	250	BUY	300	0.5		1.0%	100 bps	15.6	10.8
IT and Exchanges					15.7%	15.5%	-22 bps		
Tata Consultancy Services Ltd	2,374	ADD	2,325	121.1	4.9%	2.0%	-290 bps	28.5	25.0
Infosys Ltd	946	BUY	1,075	54.8	7.1%	7.0%	-6 bps	23.0	20.4
HCL Technologies Ltd	722	BUY	770	26.6	1.7%	1.0%	-72 bps	16.9	15.3
Wipro Ltd	293	ADD	295	22.8	1.0%		-101 bps	17.7	16.6
Tech Mahindra Ltd	765	BUY	820	10.1	1.0%	2.0%	97 bps	17.6	14.9
L&T Infotech	2,499	ADD	2,750	5.9		0.5%	50 bps	26.0	22.4
Mphasis	1,154	BUY	1,450	2.9		1.0%	100 bps	18.1	15.8
Persistent	1,011	ADD	1,105	1.1		1.0%	100 bps	20.6	17.6
CDSL Ltd	446	BUY	412	0.6		1.0%	100 bps	35.8	32.8

Model Portfolio	Price	Rating	TP	M Cap US\$ bn	Model port on 120920			P/E	
					Wt	Port Wt	Rel wt	FY21E	FY22E
Energy (Oil & Gas)					15.7%	13.0%	-468 bps		
Reliance Industries Ltd	2,320	ADD	1,992	208.1	14.0%	10.0%	-398 bps	35.7	23.5
Bharat Petroleum Corp Ltd	429	ADD	445	12.6	0.7%		-68 bps	13.8	10.3
Oil & Natural Gas Corp Ltd	73	REDUCE	78	12.5	0.4%		-42 bps	10.5	5.5
Indian Oil Corp Ltd	83	ADD	96	10.6	0.4%		-36 bps	7.4	5.3
GAIL India Ltd	91	ADD	128	5.6	0.2%		-21 bps	8.2	6.5
Indraprastha Gas	403	ADD	444	3.8		1.5%	150 bps	26.1	19.5
Gujarat Gas	296	ADD	326	2.8		1.5%	150 bps	25.2	17.8
Metals & Mining					2.7%	1.0%	-173 bps		
Coal India Ltd	125			10.5	0.6%	1.0%	39 bps	6.4	5.2
JSW Steel Ltd	288			9.5	0.6%		-60 bps	33.1	12.7
Vedanta Ltd	132			6.7	0.4%		-45 bps	18.6	8.8
Tata Steel Ltd	408			6.3	0.6%		-56 bps	NM	8.2
Hindalco Industries Ltd	179			5.5	0.5%		-51 bps	13.1	7.6
Cement					2.8%	2.5%	-31 bps		
UltraTech Cement Ltd	3,904	BUY	4,915	15.3	1.0%	1.5%	52 bps	33.5	24.3
Shree Cement	19,503	REDUCE	20,900	9.6	1.2%		-123 bps	43.5	31.9
Grasim Industries Ltd	721			6.5	0.6%		-60 bps	28.6	18.7
JK Cement	1,436	BUY	1,635	1.5		1.0%	100 bps	28.1	18.7
Chemicals					0.7%	3.0%	129 bps		
UPL Ltd	499			5.2	0.7%		-53 bps	13.1	10.8
Aarti Industries	1,024	BUY	1,320	2.4		1.0%	100 bps	32.8	24.4
Galaxy Surfactants	1,782	BUY	2,070	0.9		1.0%	100 bps	29.0	23.4
Alkyl Amines	3,185	BUY	4,010	0.9		1.0%	100 bps	29.7	26.2
Media					0.4%	0.0%	-36 bps		
Zee Entertainment Enterprises Ltd	218			2.8	0.4%		-36 bps	19.5	13.5
Pharma					2.9%	3.0%	109 bps		
Sun Pharmaceutical Industries Ltd	506	ADD	535	16.5	1.1%		-109 bps	25.0	21.4
Dr Reddy's Laboratories Ltd	4,402	REDUCE	3,940	10.0	1.1%		-113 bps	27.9	23.3
Cipla Ltd/India	726	BUY	805	8.0	0.7%	1.5%	80 bps	27.1	23.4
Torrent Pharma	2,837	ADD	2,620	6.5		0.5%	50 bps	42.1	33.4
Aurobindo Pharma	803	BUY	980	6.4		1.0%	100 bps	14.5	13.1
Telecom					2.8%	4.0%	116 bps		
Bharti Airtel Ltd	492			36.5	2.6%	4.0%	145 bps	-ve	34.6
Bharti Infratel Ltd	202			5.1	0.3%		-29 bps	12.1	11.6
Utilities					1.6%	4.0%	240 bps		
Power Grid Corp of India Ltd	175			12.5	0.9%	2.0%	116 bps	7.8	7.2
NTPC Ltd	90			12.1	0.8%	2.0%	124 bps	6.9	6.0
Cash					0	5%	500 bps		

Source: Bloomberg, HSIE Research

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