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What are the typical characteristics of a multi-bagger stock?

Stocks can turn multi-baggers for plethora of reasons. First and foremost are those companies which are fundamentally strong and have intrinsic value much above their price which leads them to turn multi-baggers over a period of time. These companies typically tend to have high return ratios, low leverage, positive free cash flows, steady growth, capital efficient business model, good corporate governance, etc. Apart from these steady compounders cum multi-baggers, certain other companies turn multi-baggers like turnaround or cyclical or asset-heavy companies which are available at distressed valuations. These companies tend to come out of a vicious downcycle in their industry or business model or any company specific issues.

Can you please share with us your experience of picking a multi-bagger stock and how where you able to identify it earlier than others?

We identified and invested in a leading biscuit maker company couple of years back which has turned almost a four-bagger now. The company is a market leader in its category and among the country's top three biscuit makers. Consumer companies in general tend to have steady growth, high return ratios, low debt and positive free cash flows. Specifically our invested company was a story of margin expansion from mid single digits to teens which played out in the last few years. Increasing market share, strong brand and distribution, operating leverage and change in top management all contributed to robust earnings growth as well as stock price performance.

What exactly does an investor need to look at while studying the quality of promoters and management?

Quality of promoters and management or corporate governance practices is of prime importance. We have an internal DEFT model (Discipline, Environment, Fairness and Transparency) which has many parameters to track corporate governance practices of various companies. For example we check whether the promoters stick to the core business, history of merger, acquisitions, restructurings, whether promoters understand cost of equity, undue benefits if any to promoters or management, related party transactions, placements and insider trading, disclosure of market sensitive information and whether stock prices anticipate results or such information, etc. These above parameters are not exhaustive and have to be looked in a holistic manner.

Can large-cap stocks turn out to be multi-baggers as well?

Large-cap can indeed turn out to be multi-baggers over a period of time. Typically large-cap companies are market leaders and have strong fundamentals and business models to weather adverse cycles. They inhibit a greater extent of compounding led gains which makes them multi-baggers over a period of time.

How to accommodate potential multi-baggers in a portfolio framework?

Weightage of a perceived multi-bagger depends upon the mandate of the portfolio and consequent portfolio construction which balances risk, reward and volatility. Apart from company fundamentals and valuation, quality, size and liquidity of the stocks are other relevant factors to determine the extent of their holdings. Since every portfolio will have a different mandate, no thumb rule can be applied.

rate higher than 25 per cent on an annualised basis. Our data mining suggests that there are only five companies viz., MRF, Wipro, Berger Paints Ltd, Asian Paints Ltd and Balkrishna Industries Ltd.

Top 10 stocks by historical returns for 25 years period

Stocks	CAGR %	Absolute Returns %
MRF	33.20	1,29,534
Wipro	31.26	89,628
Berger Paints India	27.30	41,656
Asian Paints	26.41	34,929
Balkrishna Industries	25.22	27,536
Bilites QVS Pharma	24.66	24,634
Indian Hume Pipe Co.	23.6	19,663
Nesco	23.23	18,422
TVS Srichakra	22.91	17,225
Bosch	22.03	14,408

However, the list magnifies as the tenure is reduced. There are almost 644 companies that we could identify have generated more than 25 per cent annualised returns (as on October 3, 2016) if we consider a period of five years. As many as 271 companies have delivered returns higher than 25 per cent on annualised basis over a 15-year period.

No of Stocks delivered returns > 25% Historical period

No of Stocks delivered returns > 25%	Historical period
5	25
81	20
271	15
217	10
644	5

This data suggests huge opportunity for including multi-bagger stocks in one's portfolio. One just has to be smart enough to hold on to a dozen of such multi-bagger stocks for several years together. We find that investors often do well in identifying multi-bagger stocks, but at times are extremely careless when it comes to holding on the multi-bagger stocks for a long term.

WHERE TO FOCUS WHILE SELECTING MULTIBAGGER STOCKS?

Investors can focus on those companies that are not being discussed too much either in media or in public. Often the