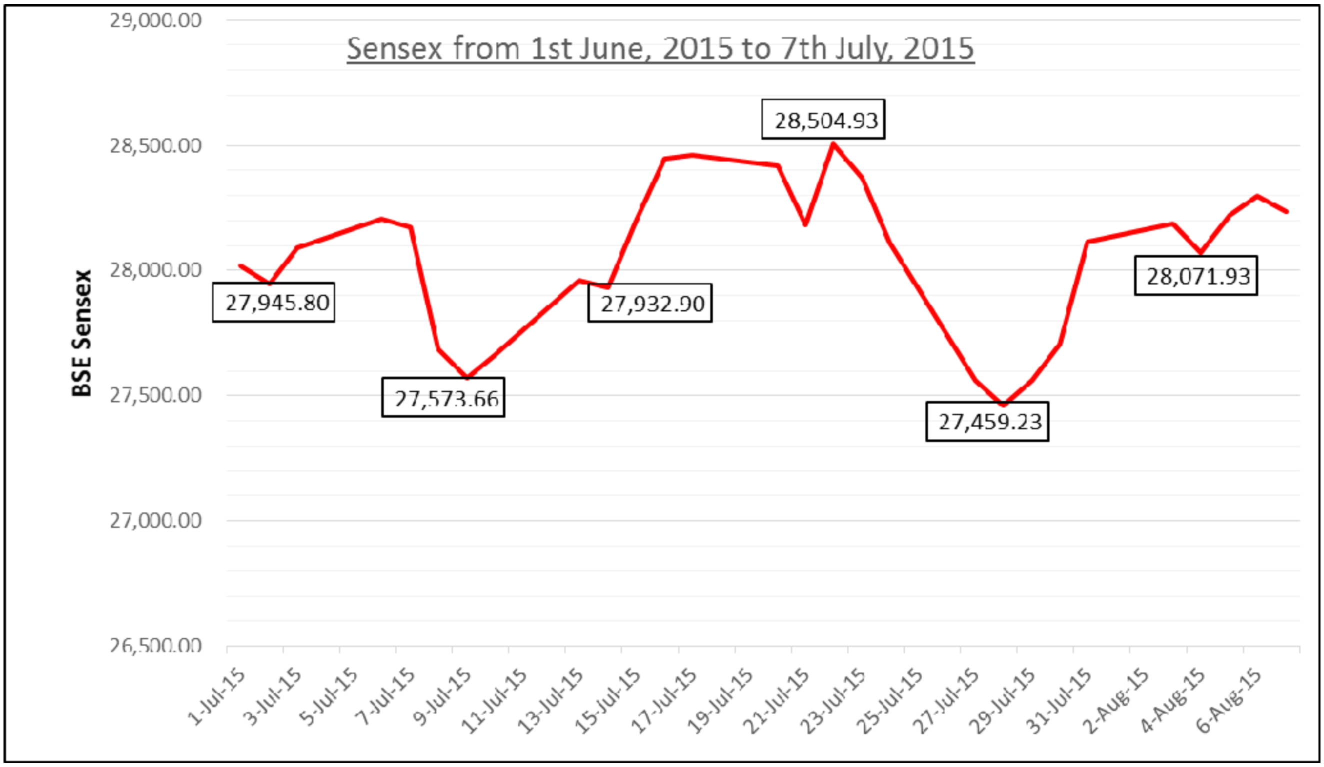
AXIS Equities Pvt. Ltd.
58, Mittal Chambers, 228, Nariman Point, Mumbai - 400 021
Tel. : 6115 1919 Fax : 6115 1999 Email : dipanmehta@vsnl.com

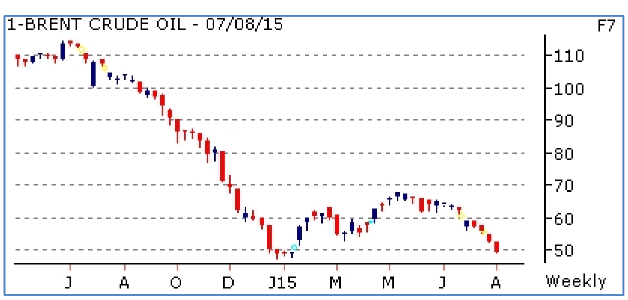
Range Bound Sensex in July



Range bound Sensex, midcap rally gathers momentum

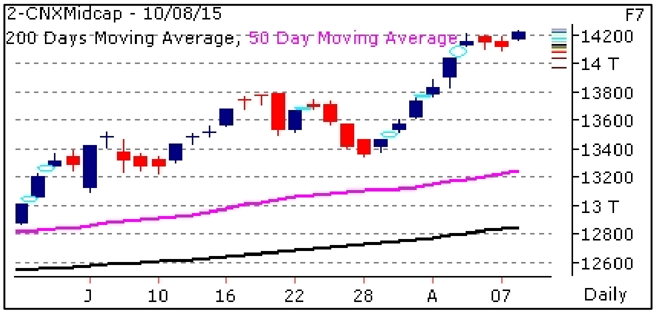
The Sensex held on to its gains in July and traded in a narrow 1,000 point range between 27,500 and 28,500. Institutional flows were strong as both FIIs and domestic investors were net buyers to the tune of Rs. 5,589.25 crores and Rs. 737.36 crores respectively. The month was marked by heavy news flow on the corporate front with the June quarter earnings releases in full swing. The key takeaway so far from this results season is that revenue growth was muted but profits expanded due to fall in input costs. The decline in commodity prices and negative wholesale price inflation is clearly translating into healthier bottom-line for the commodity consumers.

Brent crude declines, re-tests earlier bottom



Another noteworthy trend was the slide in crude oil prices (Brent), which again touched multi-month lows of $ 49.24 per barrel (07-08-2015) after rallying to $67.91 per barrel earlier in the year (06-05-2015). The fundamentals for this commodity remain stressed and although this correction is positive for India; there are negative implications for global growth.

Midcaps in a bull market



That apart, the highlight of the month was the rally in Midcap stocks. The CNX Midcap Index touched an all-time high of 14,215.6 on 4th August, and was up by 5.52 % for July. While many market commentators and media in particular, have expressed awe, concern and fears about the spike in midcap stocks, we view it as an integral part of any bull market. In every bull market, the midcaps out shine the large caps by a huge margin and this one is no different. Keeping this in mind, the centerpiece of this newsletter is on this subject and is appropriately titled " *Midcap Mania*".

Midcap Mania

Midcaps deliver multibagger returns

An important facet of every bull market is the price movement of small and midcap stocks. The street has seen several mid cap stocks deliver multibagger returns since the beginning of this bull market (August 2013). Investors have been surprised by the price and volume action in these stocks, which continue to fly and soar to even higher levels. The top 20 multibaggers of this bull market with present market cap in excess of Rs. 5000 crores are listed below.

Scrip	**Market Cap**	**Price as on 01-08-2013**	**Price as on 31-07-2015**	**Gains (times)**
Welspun India	9,004.85	50.50	896.25	17.75
BEML Ltd	6,305.34	141.90	1,514.25	10.67
SRF	7,997.74	130.70	1,392.85	10.66
NBCC	12,340.80	106.15	1,028.40	9.69
Tata Elxsi	5,310.30	180.40	1,705.30	9.45
Aurobindo Pharma	44,293.71	81.65	758.50	9.29
TVS Motor Co.	11,305.00	30.65	237.95	7.76
Dalmia Bharat	5,776.16	101.00	711.35	7.04
Ashok Leyland	24,047.66	12.74	84.50	6.63
Ajanta Pharma	13,757.24	243.69	1,563.30	6.42
Symphony	6,030.47	281.95	1,724.05	6.11
Bharat Forge	26,676.55	195.95	1,145.90	5.85
PC Jewellers	8,169.65	78.20	456.15	5.83
Eicher Motors	51,760.66	3,457.30	19,070.05	5.52
Monsanto India	5,625.93	620.50	3,259.00	5.25
P I Inds.	8,948.47	125.10	655.20	5.24
Rajesh Exports	15,342.31	101.30	519.55	5.13
SKS Microfinance	7,365.30	114.90	582.25	5.07
Guj Pipavav Port	11,394.68	47.60	235.70	4.95
Bajaj Fin.	29,480.33	1,133.75	5,496.70	4.85

Midcap index vs Nifty

Apart from these, many midcaps have done well and for the record, during the period August 2013 to July 2015, the CNX Midcap index has appreciated by 108.27 % against a rise of 49.53% by the CNX Nifty. These stocks have created wealth for investors and rewarded them for the risk they have taken by investing in them.

Risks of investing in Midcaps

Investors have risked by investing in midcap stocks. There are many instances of these destroying wealth as well. This destruction generally happens in a bear market and the 40 worst performers of the last bear market which lasted from December 2007 to February 2009 are listed below.

The question which then arises is that is it sensible to invest in this sub-asset class?

The cycle of bull and bear market will continue and if gains by midcap counters are eventually lost in a bear market then what is the point of investing in them at all.

The answer is provided by the long term returns delivered by midcap stocks as compared to large cap stocks.

Scrip	Value Destroyed	Scrip	Value Destroyed
Unitech	-94.22%	Indbull Real Estate	-87.71%
Aban Offshore	-93.61%	Shasun Pharma.	-87.51%
Cholamandalam	-93.58%	Kalpataru Power	-87.34%
Jai Corp	-93.49%	Anant Raj	-87.21%
Vaibhav Global	-93.00%	IIFL Holdings	-87.15%
Omaxe	-92.34%	Bajaj Fin.	-86.98%
Kolte Patil Dev.	-91.73%	OCL India	-86.96%
Puravankarara	-91.58%	Godrej Industries	-86.76%
Sobha Devel.	-91.29%	Lak. Mach. Works	-86.66%
H D I L	-91.21%	Siti Cable	-86.59%
Bajaj Holdings	-90.82%	Welspun Corp	-86.44%
Vakrangee	-90.04%	Reliance Capital	-86.41%
Videocon Inds.	-89.54%	Netwrk.18 Media	-86.37%
Suzlon Energy	-89.53%	Welspun India	-86.20%
Inox Leisure	-89.50%	G M D C	-86.16%
Mahindra Life.	-88.71%	Ruchi Soya Inds.	-85.94%
Phoenix Mills	-88.40%	DLF	-85.87%
SREI Infra. Fin.	-88.22%	Jet Airways	-85.81%
DCB Bank	-88.11%	JSW Steel	-85.74%
NCC	-87.74%	Bombay Burmah	-85.58%

The CNX Midcap Index, which is a widely followed midcap index, was launched in 2003 with a base of 1000 on 1st January 2003. The CNX Nifty on that day was 1100.15. Over the past 12 years or so, the CNX Midcap has multiplied by 14.11 times to 14,114.95(07/08/2015) whereas the CNX Nifty has appreciated by 7.78 times to 8564.60 (07/08/2015). The extent of outperformance of the midcap index over the large cap index (CNX Nifty) is alluring enough to invest in midcap stocks.

This brings us to the reasons why midcaps outperform and the strategy which investors should follow to identify the right stocks. There is no denying that investors have to be very selective when it comes to dealing with midcaps. For one the universe is large and secondly, history has shown that these businesses are more risky than large well established corporations.

Advantages of midcaps

Midcaps have certain advantages over large caps, which is why their growth rates are faster.

1. Their small size and lower base effect makes it easier for managements to grow the business. Even small incremental order, customer wins or product launches can sustain decent growth rates.
2. These companies are generally driven by entrepreneurs who are ambitious, hands on and have the gusto and energy to drive revenues and profits.

3. More often than not, they are present in sunrise or high growth sectors and that in itself is an advantage because there are many opportunities within their marketplace which can be exploited.
4. Their small size and flat organization structure makes them more nimble and they are therefore able to move faster than their large cap counterparts.

Disadvantages of midcaps

There are disadvantages as well:

1. These companies may have very high client / product concentration and failure on part of a single large customer / product can lead to de-growth and losses.
2. These companies require capital to grow the business and build capacity. High debt and associated interest burden can lead to severe losses and even bankruptcy; if the cash flows are not steady and sizable in relation to the debt on books.
3. Churn in top level management can impact performance. As compared to large organizations, these companies do not have management depth and exit of one or more key manager could affect execution.
4. Lastly, corporate governance standards are generally weaker than larger companies. Maximum corporate frauds and operational mishaps have been noticed in midcap companies. From minority shareholders point of view, this is a very important risk factor.

Midcap Checklist

In light of these advantages and disadvantages, what are the key elements which investors should look out for when investing in midcap companies? Based on our experience and what history has taught us, we have prepared a basic checklist which investors may follow.

1. Since midcaps have a higher risk profile and almost the entire value of the company can be wiped out in a matter of months, investors have to be very careful of the corporate governance standards and the business model.
2. Irrespective of the past growth rates and the opportunities within the sector, if the management of a midcap company is not transparent, or has a poor reputation or suspect corporate governance standards, then such companies must be avoided at all costs.
3. The quality of the balance sheet is more important than the revenues and profits as per the profit and loss statement. If there is far too much debt then that is a major red flag. Frequent dilution of equity is also detrimental to minority shareholders. Investors must seek out businesses which are asset light and will therefore have a higher return on capital employed. The companies which have created maximum shareholder value are the ones which have high return ratios.
4. The more diversified the revenue mix, the better it is, as that will reduce earnings volatility. Overdependence on raw material source or supplier must also be monitored. Regulatory environment is also important as a single change in government policy can bring about ruin.
5. The size of the opportunity must also be a factor in selection. There is no point in investing in a slow growth midcap company as the risks will remain but the scope to earn higher returns evaporates. Investors would then be better off in a similar large cap company. At least the risk will be lower; even if the performance is average.

There are many more aspects which investors should consider, but following the above with a disciplined approach will lead to fabulous outcomes. One common mistake which must be avoided is to be too focused on the prevailing price to earnings (PE) multiple. Many quality midcaps trade at rich valuations and that can deter investors. Just because a stock is trading at a high PE multiple does not mean it is not a good investment. These companies invariably deliver fantastic performance year after year and long term investors can benefit from the power of compounding.

Our views on stocks, midcaps in particular

We are of the opinion that this rally in midcaps will sustain and although our view for the Sensex and Nifty is flat to range bound, midcaps will do well. This earnings season has thrown up a few positive surprises in the

- Banking and financial services sector
- Software services sector
- Pharmaceuticals
- Consumer oriented industries
- Niche exporters

Our advise would be to selectively increase exposure to midcaps within these industries.

The monsoons and current logjam in parliament remain key risks but the fall in commodity prices does raise hopes of a further interest rate cut. The last RBI policy (5th August) was positive with the Governor showing a marginal inclination to cut interest rates; if the monsoon effect on agro product prices was not damaging. He said and we quote:

> *"We held the policy rate at 7.25 per cent while we await data on whether recent increases in inflation, including in non-food items, are temporary, and whether the monsoon will continue to be near-normal. We note the recent fall in oil prices, which will be very beneficial for India. As we await greater transmission of our frontloaded past actions, we will monitor developments for emerging room for more accommodation."*

The key words here were ***"..room for more accommodation",*** which in simple terms means scope to ease the monetary policy i.e. reduce interest rates. A cut in interest rates could trigger the Sensex to break out of its present range.

As has been the practice, we are disclosing the average returns of our portfolio management division.

Returns of the Portfolio Management Division upto 31st July, 2015

	1MONTH	3 MONTH	6 MONTHS	1 YEAR	3 YEAR	5 YEAR
Axis Equities PMD Performance	7.15%	9.84%	8.24%	40.94%	36.73%	18.15%
SENSEX	1.21%	4.10%	-4.36%	7.66%	16.80%	7.72%
NIFTY	1.97%	4.37%	-3.69%	9.47%	16.84%	7.97%
Out Performance	5.18%	5.47%	11.93%	31.47%	19.89%	10.18%
(higher of Sensex and Nifty)						

Our focus on investing in quality midcaps has paid off and resulted in a decent outperformance over the broad market indices.

Dipan Mehta