

Draft Copy

## A Study on Wealth Creation

(Rs. in Cr)

Inquire Rank	FASTEST	CAGR % of adjusted mcap (91 to 96)	Rank based on size	BIGGEST	Amount of Wealth Created 1991-96
1	Dr Reddy's Labs	98.0	1	Hind Lever	9102.2
2	Vysya Bank	95.3	2	SBI	7829.4
3	TVS Suzuki	89.7	3	Telco	7074.0
4	United Phosphorus	89.0	4	ITC	5736.2
5	Oriental Hotels	85.7	5	Bajaj Auto	4923.0
6	Himatsingka Seide	79.9	6	Hindalco	4005.3
7	Indian Hotels	79.8	7	Indian Hotels	3144.4
8	H D F C	76.9	8	Tata Chemicals	3112.4
9	Trafalgar House	75.6	9	Ranbaxy Labs	2755.2
10	Essel Packaging	75.6	10	Castrol	2394.5

### Conclusions

- Wealth Creating companies have a substantially high ROE and ROCE.
- A high correlation is seen between ROE and PE for the Wealth Creators group - Inquire 100.
- Mid cap stocks have a propensity to create wealth faster as compared to the heavyweight blue chips.
- Companies focused on their core businesses form 87% of the group.
- Dilution of capital per se does not detract from Wealth Creations.

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## Concept

The ability of a company to enhance the market value of the capital entrusted to it by its shareholders is the creation of shareholder wealth. This is the basic measure of success for a commercial venture. A Wealth Creator is a Company which enhances its market value by rational actions in a sustained manner.

The study is targeted towards determining which enterprises are most likely to achieve this, and the purpose of this study is an attempt to capture the characteristics of Wealth Creators.

For an investor, the wealth created by the company is the difference between his investment cost (adjusted for dilutions) and the market value of his holdings. An equity investor needs to be adequately compensated for the risk he bears and thus the wealth generated, through equity investment must be greater than that from other relatively low risk assets.

At the time of an investment decision we are familiar with the financial statistics of the company, its management, products, etc. yet do we stop to ask ourselves, "Does this Company have the ability to create great wealth for us on a sustained basis?". We hope this study brings us closer to the answer.

## Methodology

For the purpose of our study we have identified the 100 top Wealth Creators over the last five years (1991-96) in the Indian Stock Market. These companies have the distinction of having atleast quadrupled their market capitalisation over this period (adjusted for dilutions) which gives a CARG of 32% p.a. or higher.

A bench mark of Rs.100 crores in Wealth Creation has been a qualification criterion for this group which we have termed the **"Inquire 100"**.

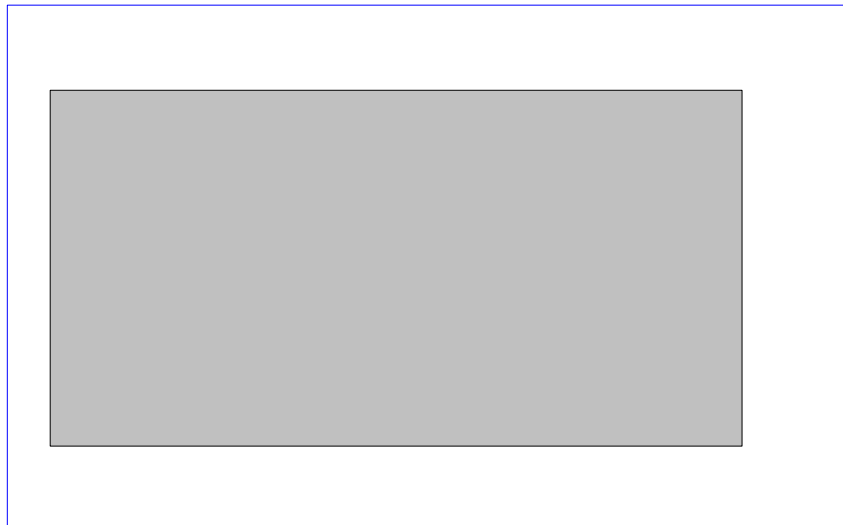
The ranks have been accorded on the basis of the speed of wealth creations i.e. compounded growth in wealth over the period of study.

The database used for this study is that of Capitaline Ole and Trends.

## Wealth Creators - Management

Tatas	10
Birla	3
TVS	3
Ajay Piramal	2
Anji Reddy	2
Jindal	2
L M Thapar	2
Rane	2
Sterlite	2
FERA	32
Others	40

The bulk of the Inquire 100 belong to well established groups known for their managerial acumen.



MNC's form a disproportionately large percentage of the Inquire 100, given that they account for less than 5% of the total population of listed companies.

The group of **First Generation entrepreneurs** is strikingly large at 23%.

The presence of the **Joint Sector** is very low.

## Wealth Creators - Industry Analysis

Pharmaceuticals	13
Automobile	6
Automobile Accessories	6
Cement	6
Hotels	5
Electrical Equipment	5
Pesticides	5
Packaging	4
Speciality Chemicals	3
Aluminium	2
Banks	2
Cable	2
Cigarettes	2
Compressors / Drilling Equipments	2
Machine Tools	2
Paint	2
Personal Products	2
Power Generation	2
Tyres	2
Others*	27

\* Airconditioning, Ceramics, Cigarettes, Computers, Dye-stuff, Diamond, Fertiliser, Mining, Lubricants, NBFC, Shipping, Printing, Telecom, Tractor, Tyres, Glass, Welding, Fasteners

<b>Product Attribute</b>	<b>%</b>
Technology	51
Brands	21
Commodity	28
<b>Business Activity</b>	<b>%</b>
Focussed	87
Diversified	13

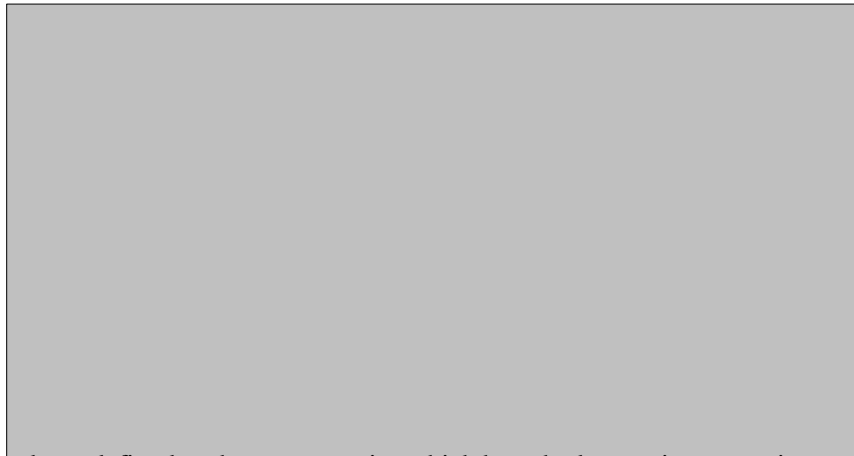
Commodity businesses form a minor percentage of the group.

Companies that are focussed on their core businesses form 87% of the group: few diversified companies have made the grade as wealth creators.

Competitive sectors of the economy have also produced successful wealth creators - Of the Inquire 100, 33 companies enjoyed a predominant market share in their respective industries.

Businesses with high entry barriers arising out of proprietary knowledge in technology and marketing such as in pharmaceuticals, enjoy a strong representation.

## Wealth Creators - Categorised



**Blue Chips** have been defined as those companies which have had a consistent earnings record. As can be seen above Blue Chips have done exceedingly well. The environment of deregulation, competition, mergers & acquisitions is likely to see established blue chips consolidate their position further.

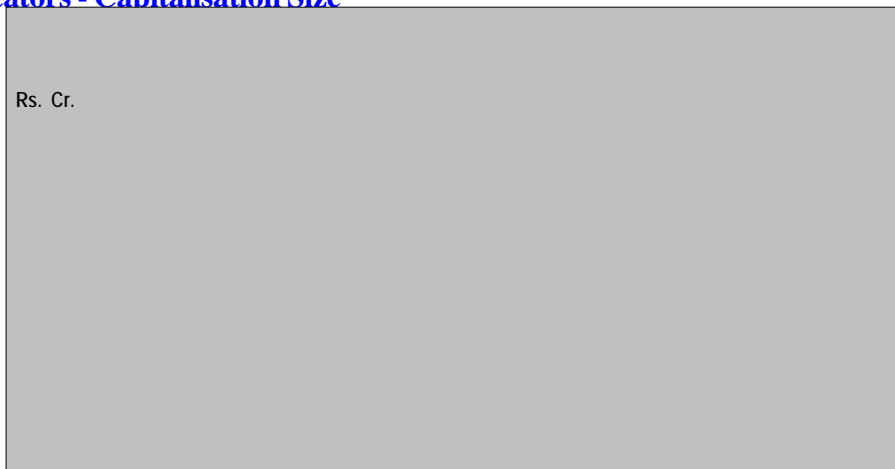
**Fast growers** have grown their turnover at greater than 30% p.a. over the period of the study. We believe this group of companies will maintain a strong presence in the category of wealth creators of the future.

We expect the demands of a competitive environment to push a larger number of companies towards **restructuring** and this could be a fertile ground to locate wealth creators. Identifying **turnarounds** at an early stage can be highly rewarding though somewhat risky.

Very few **new entrants** have been able to create meaningful wealth at an early stage of their existence.

The rate of wealth creation has been much faster in case of turnaround and new entrants compared to blue chips and fast growers.

## Wealth Creators - Capitalisation Size



Of the Inquire 100, 80 companies had a market capitalisation of Rs.150 crores or less in 1991. The median market cap was Rs.92 crores for the Inquire 100.

Of the top 25 market cap companies of 1991, 6 have found representation in the Inquire 100. However, they do not find a place in the first 25 wealth creators in the Inquire 100. Thus the speed of wealth creation comes from the mid & small cap companies.

However, the surety of wealth creation is greater for large cap stocks given their strike rate of 25% amongst the top 25 large cap companies in 1991.

## Wealth Creators - Sales Growth (CAGR)

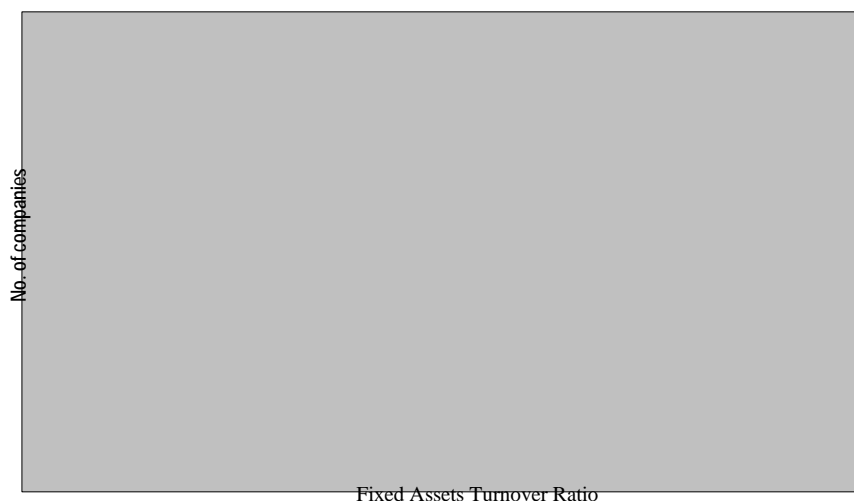


A very high rate of sales growth does not necessarily translate into wealth creation. Of the Inquire 100, 68 constituents grew sales during the period of study between 10% to 30% CAGR. The median rate of growth was 23%.

This moderate rate of sales growth was sufficient to generate shareholder return of 32% p.a., implying that these companies

- were able to adequately leverage fixed costs
- were able to control operating costs
- did not over stretch themselves financially
- were able to increase margins, and
- were able to increase the overall asset utilisation

## Wealth Creators - Capital Intensity



The majority of companies in the Inquire 100 enjoy a relatively high Fixed Asset Turnover ratio implying low capital intensity.

Given the predominance of technology and marketing based companies in the Inquire 100 this is not surprising. With intellectual capital becoming increasingly recognised and playing a more important role in the current business environment, this trend is likely to be maintained.

## Wealth Creators - Debt Growth (CAGR)

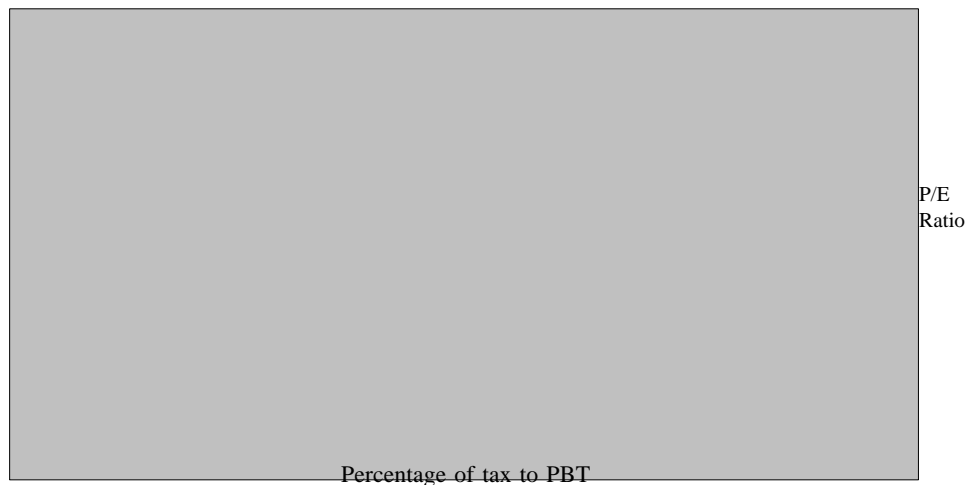


As many as 68 of the Inquire 100 have either reduced debt or grown it conservatively.

This implies that wealth creators progressively improve their financial position using internal generation to bring down their overall cost of capital (see pg 9 on Payout Policy).

Wealth Creation does not appear compatible with strategy of aggressive financial leveraging.

## Wealth Creators - P/E - Tax Ratio correlation



Wealth Creators don't disappoint the exchequer. Paying tax not only benefits the government - it's good for shareholders too because of the perception of a superior quality of earnings which is rewarded by a higher P/E ratio.

Of the Inquire 100, only 10 companies were zero tax payers for the period under study. More than half of the constituents paid an average tax rate of 20% or more.

This shows that a high rate of tax is not an impediment to wealth creation - as the market accords a higher P/E ratio to a high tax paying company.

The higher P/E multiple is a reflection of the sentiment of investors for the quality and sustainability of earnings of tax paying companies.



### Wealth Creators - Rights/Bonus

R I G H T S	BONUS		
		Yes	No
	Yes	25	31
	No	24	20
	Total	49	51

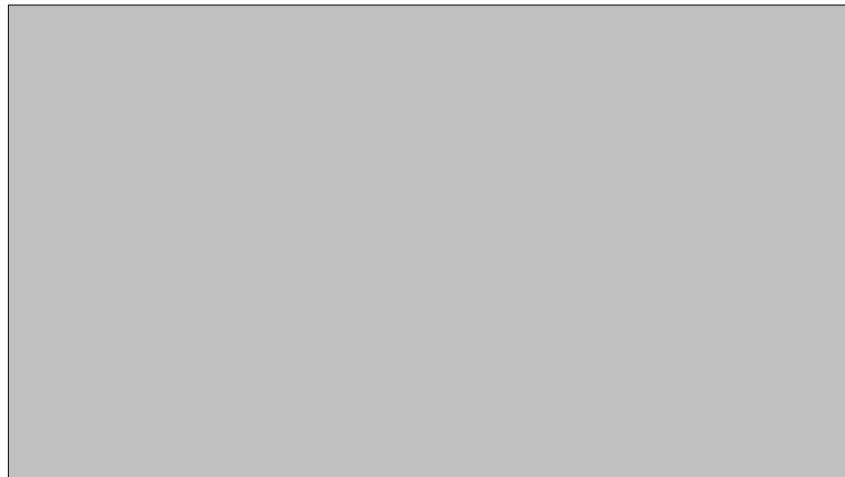
### CAGR Returns (%)

R I G H T S	BONUS	
		No
	Yes	38.9
	No	44.3

Of the Inquire 100 as many as 56 companies issued rights in the period of study and 49 issued a bonus.

This implies that issuance or non-issuance of rights or bonus does not have an impact on satisfying the criterion for entry into the wealth creators list - Inquire 100, as long as the capital deployed by the company yields an adequate return.

### Wealth Creators - Dividend Payout



Dividend Payout Ratio (%)

Average dividend distributed as a percentage of net profits is 25.86%.

The majority of the Inquire 100 appear to follow a conservative dividend payout policy.

This allows for a high ploughback into the business facilitating

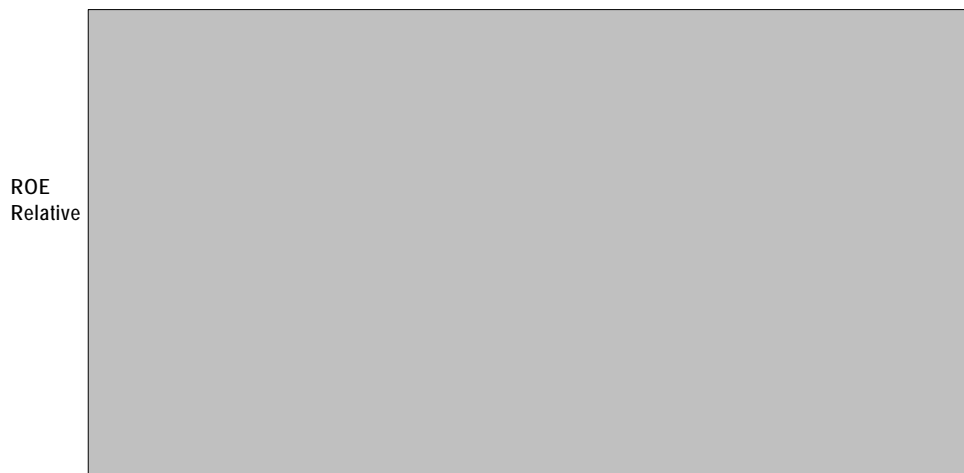
- Repayment of costly debt
- Redeploying funds at a high rate of return on capital employed in the business thus bringing into play the effect of compounding whereas in case of distribution of dividend, shareholders are taxed a second time on the dividend received, thus reducing their post-tax return further.

## Wealth Creators - Return on Equity (ROE)



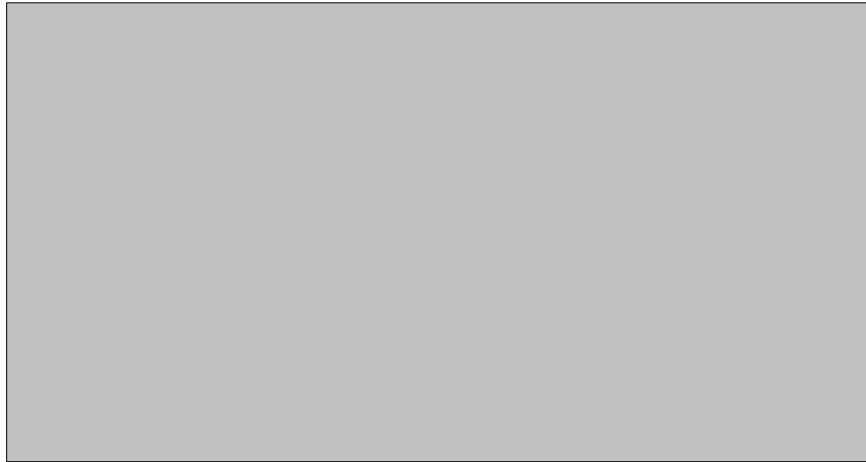
Shareholder's wealth in the company is not just the equity capital but reserves as well. EPS indicates return on equity capital whereas ROE shows the earnings on total shareholder funds retained in the business. ROE sets the pace at which a company is creating wealth. It is observed that high ROE companies are given high P/E which in turn leads to higher wealth for shareholders in terms of higher market capitalisation.

## Wealth Creators vs Sensex Companies - ROE Relative



The wealth creating companies typically beat the market because they have higher ROE than the sensex scrips. The pace at which network increases is higher in these companies and with the benefit of compounding, not only do the rich become richer but at a faster pace as well.

## Wealth Creators - ROCE & ROE



The ROCE and ROE of the Inquire 100 show a secular rise over the period of study. This shows a sustained improvement by these companies in the productivity of assets which is an integral part of the process of wealth creation.

The relatively high ROCE & ROE implies the ability of these companies to earn a return higher than their cost of capital.

## **An Observation on Valuation**

Wealth Creation occurs when a **great management** runs a **great business**. But, for an outsider to buy into such great businesses through the stock market, he must enter at the right price to earn substantial appreciation .

This led us to ask what constitutes the right price?

The price of a stock comprises both qualitative and quantitative factors. The EPS is a statistical derivation and forms the quantitative factor. The qualitative factors get built into the PE ratio. This makes us ask what should be the PE ratio accorded to a stock?

Study reveals that in 1991, as many as 63 of the Inquire 100 were trading at a substantially lower PE ratio to their respective ROEs. We also found that by 1996, in most of these cases the PE ratios had caught up with the level of the sustainable ROE. This drew us to the conclusion that the PE ratio accorded should be closer to the sustainable ROE of the company.

Consequently, there is an inherent margin of safety in buying a stock at a P/E ratio substantially lower than its sustainable ROE. This is where the opportunity lies.

## **The conclusion**

The search for wealth creators is an eternal endeavour. The study does reveal that wealth creating companies have substantial correlation with a high ROE. Buying them at a P/E lower to ROE could result in substantial capital appreciation. However, right judgement of long term sustainability, prosperity of business and responsible management play a crucial role in identifying wealth creators.

Inquire Rank	Rank based on size	Company Name	CAGR of adjusted Mcap. (%)	Amount of Wealth Created (Rs. Cr.)	CAGR of Sales (%)	CAGR Net Profit (%)	Wt. Avg. ROE (%)	Abs. Chg. in ROCE 1991-96 (%)
1	37	Dr Reddy's Labs	98.0	539.7	50.1	64.2	39.6	-14.0
2	42	Vysya Bank	95.3	456.2	37.9	44.5	40.1	0.3
3	35	TVS Suzuki	89.7	598.3	23.5	52.2	43.8	34.5
4	38	United Phosphorus	89.0	501.4	49.8	70.3	29.5	-23.3
5	39	Oriental Hotels	85.7	466.6	23.2	30.6	15.9	-12.7
6	64	Himatsingka Seide	79.9	219.1	47.2	54.7	38.4	13.6
7	7	Indian Hotels	79.8	3144.4	22.1	32.3	27.1	9.9
8	11	H D F C	76.9	2201.8	32.0	32.6	19.1	1.8
9	75	Trafalgar House	75.6	168.5	48.2	45.5	23.0	37.4
10	58	Essel Packaging	75.6	256.2	24.8	41.1	30.9	-2.1
11	9	Ranbaxy Labs	74.1	2755.2	28.1	54.4	24.9	1.2
12	56	Thomas Cook	70.7	276.1	31.7	41.9	29.7	9.2
13	17	Madras Cements	70.2	1284.6	24.0	29.5	33.3	0.3
14	14	E I Hotel	69.9	1853.4	23.8	25.8	20.0	12.0
15	15	Asea Brown Boveri	67.6	1749.2	25.5	38.2	22.7	10.8
16	10	Castrol	67.1	2394.5	29.0	52.1	35.4	14.4
17	34	Sund Fastners	67.1	599.1	21.0	24.2	26.6	14.2
18	28	CIPLA	66.8	692.0	26.5	29.4	26.6	-1.4
19	48	Carrier Aircon	66.1	371.0	30.2	73.4	14.4	39.1
20	78	Advani Oerlikon	65.7	153.8	13.0	28.5	22.1	25.3
21	97	Monsanto Chemicals	63.3	106.0	54.0	74.0	36.8	94.5
22	81	Shriram Honda	62.9	148.4	27.6	27.5	31.6	23.3
23	46	Hotel Leela Venture	62.5	376.3	39.5	50.3	25.3	10.7
24	91	Tata Press	62.2	122.7	14.4	32.8	12.2	7.8
25	31	Saw Pipes	61.2	607.0	68.9	69.9	41.8	2.8
26	89	Chicago Penumat	56.0	126.6	19.6	24.4	11.4	9.5
27	2	SBI	55.9	7829.4	7.4	11.6	11.1	-0.2
28	12	MICO	55.4	2149.8	22.5	27.4	18.7	21.7
29	72	Raasi Cement	55.2	179.9	31.6	46.7	21.2	17.7
30	100	Asahi India Safe	54.1	101.5	29.2	18.0	35.8	3.9
31	4	ITC	53.7	5736.2	20.3	33.7	37.9	-3.0
32	88	Nippondenso	53.6	133.2	34.7	37.3	70.4	30.9
33	25	MRF	52.8	932.8	17.7	13.5	16.1	-6.8
34	61	Sundaram Clayton	51.6	248.9	14.6	20.3	9.1	12.9
35	52	Sandvik Asia	51.2	308.1	13.9	26.8	28.3	14.0
36	33	Wipro	50.9	599.7	34.8	42.4	17.4	-2.7
37	51	Nicholas Piramal	50.7	317.4	40.1	57.7	16.8	-5.0
38	84	Kajaria Ceramics	50.1	143.3	36.9	42.4	26.9	4.6
39	1	Hind Lever	49.7	9102.2	22.1	23.8	31.6	6.1
40	13	M & M	49.1	2023.9	18.0	25.9	13.2	7.5
41	96	Siltap Chemicals	48.4	106.1	39.6	36.1	54.8	29.3
42	16	Guj Ambuja Cement	47.7	1592.7	29.6	37.6	23.8	-17.1
43	40	Punjab Tractors	47.6	464.7	20.0	27.0	23.5	8.6
44	41	Knoll Pharma	47.0	463.7	23.3	1.3	22.5	32.6
45	79	Piramal Healthcare	47.0	151.8	20.3	43.2	29.0	24.5
46	63	Widia India	46.7	222.8	13.0	15.7	21.7	-8.1
47	99	Gabriel	46.4	102.5	23.7	28.0	23.0	7.6
48	68	Finolex Cables	45.5	200.8	27.3	41.3	22.3	-5.1
49	44	Zuari Agro	45.5	421.2	24.6	32.7	21.2	15.5
50	76	Himachal Futuristic	44.7	163.1	132.0	150.9	20.3	-1.3

# Inquire 100 Wealth Creators (contd.)

(Period : 1991-96)

Inquire Rank	Rank based on size	Company Name	CAGR of adjusted Mcap. (%)	Amount of Wealth Created (Rs. Cr.)	CAGR of Sales (%)	CAGR Net Profit (%)	Wt. Avg. ROE (%)	Abs. Chg. in ROCE 1991-96 (%)
51	92	Zandu Pharma	44.7	118.9	20.1	13.8	19.3	-0.7
52	65	K E C Intl	44.4	208.5	29.8	41.7	12.9	4.2
53	62	Goodlass Nerolac	43.6	231.5	18.5	26.9	22.9	12.5
54	87	ITW Signode	43.6	135.1	33.6	31.4	18.8	-32.7
55	90	APR	42.8	126.2	19.5	10.5	22.9	-19.2
56	21	Ponds	42.5	1127.0	19.3	40.1	35.1	24.1
57	8	Tata Chemicals	42.3	3112.4	23.7	27.8	22.1	2.5
58	73	Rhone-Poulenc(I)	42.2	178.9	9.6	1.8	8.1	-6.9
59	55	Garware Polyester	42.2	285.3	15.8	65.2	22.2	-0.3
60	36	ICI	42.1	568.1	2.7	11.0	14.6	19.4
61	98	Engine Valves	42.0	103.2	18.5	12.0	17.6	11.8
62	29	Sesa Goa	41.9	633.2	28.8	22.2	24.1	-21.7
63	43	Hero Honda	41.7	432.1	25.9	29.9	30.6	1.7
64	18	Siemens	41.7	1208.6	25.3	25.0	14.6	-7.2
65	5	Bajaj Auto	41.5	4923.0	16.2	23.4	23.2	13.8
66	23	Glaxo India	41.4	954.6	19.3	17.7	34.3	17.8
67	54	Colour Chem	41.4	287.6	18.5	26.8	19.3	-3.0
68	80	Flex Inds	41.3	150.9	54.4	56.5	23.1	-8.0
69	27	Great Eastern	40.3	724.4	29.7	27.7	21.7	0.1
70	69	Cyanamid India	40.0	192.3	15.1	22.0	24.9	14.5
71	74	Eternit Everest	39.1	170.6	9.7	35.7	30.4	9.2
72	66	Tata Invest Corp	38.2	206.0	32.3	33.2	10.4	16.9
73	20	Kirloskar Cummins	38.1	1141.7	19.2	25.6	23.7	9.9
74	6	Hindalco	37.7	4005.3	13.2	33.8	20.0	-4.4
75	30	India Cement	37.6	611.2	33.5	55.7	15.8	4.7
76	70	Wartsila Diesel	37.4	190.0	26.1	31.7	22.8	11.6
77	45	Apollo Tyres	37.3	381.3	33.2	22.8	14.8	-3.0
78	93	Atlas Copco	37.0	117.8	11.2	36.5	19.6	19.1
79	22	Asian Paints	36.9	1111.2	17.8	21.4	21.3	7.8
80	71	Dalmia Cement	36.4	187.0	15.7	20.6	18.9	-1.2
81	19	Indian Rayon	35.8	1161.4	21.6	28.9	15.0	5.8
82	82	Madras Aluminium	35.7	145.6	-66.7	-66.7	0.0	-8.4
83	59	Sandoz	35.5	251.4	12.9	13.8	19.5	14.2
84	94	Rane (Madras)	35.1	117.6	15.0	12.4	16.4	1.8
85	85	Cheminor Drugs	35.0	140.5	30.2	43.8	25.8	-12.5
86	83	Nalco Chemicals	34.6	145.0	36.9	68.3	27.5	25.8
87	77	Max India	34.5	163.0	22.8	32.8	19.1	-5.7
88	53	Smithkline Bee Pharma	34.3	290.1	21.8	15.1	19.0	-1.6
89	26	Tata Power	34.3	771.7	20.4	27.7	13.4	-1.8
90	95	Jindal Iron	33.9	110.8	98.9	134.2	27.8	-22.6
91	47	Asian Hotels	33.8	374.7	21.1	20.5	30.7	27.3
92	67	E Merck (India)	33.5	204.7	16.0	27.5	18.3	23.0
93	24	BSES	33.0	945.2	27.3	61.6	18.7	-8.9
94	3	Telco	33.0	7074.0	24.1	21.8	15.6	-5.1
95	49	Crompton Greaves	32.7	367.8	19.1	21.8	13.8	-3.7
96	50	Andhra Valley	32.1	362.2	20.0	25.9	12.7	-3.8
97	57	Rallis	32.0	274.3	13.5	19.3	18.9	8.4
98	32	Sterlite Inds	32.0	604.0	53.6	65.5	26.8	-0.1
99	60	BASF	32.0	250.5	19.6	17.7	21.2	6.6
100	86	Godfrey Phillips	32.0	136.5	10.1	34.1	35.0	-25.8

Inquire Rank	Company Name	Rank based on size	Inquire Rank	Company Name	Rank based on size
20	Advani Oerlikon	78	52	K E C Intl	65
96	Andhra Valley	50	38	Kajaria Ceramics	84
77	Apollo Tyres	45	73	Kirloskar Cummins	20
55	APR	90	44	Knoll Pharma	41
30	Asahi India Safe	100	82	Madras Aluminium	82
15	Asea Brown Boveri	15	13	Madras Cements	17
91	Asian Hotels	47	40	M & M	13
79	Asian Paints	22	87	Max India	77
78	Atlas Copco	93	28	MICO	12
65	Bajaj Auto	5	21	Monsanto Chemicals	97
99	BASF	60	33	MRF	25
93	BSES	24	86	Nalco Chemicals	83
19	Carrier Aircon	48	37	Nicholas Piramal	51
16	Castrol	10	32	Nippondenso	88
85	Cheminar Drugs	85	5	Oriental Hotels	39
26	Chicago Penumatic	89	45	Piramal Healthcare	79
18	CIPLA	28	56	Ponds	21
67	Colour Chemicals	54	43	Punjab Tractors	40
95	Crompton Greaves	49	29	Raasi Cement	72
70	Cyanamid India	69	97	Rallis	57
80	Dalmia Cement	71	11	Ranbaxy Labs	9
1	Dr Reddy's Labs	37	84	Rane (Madras)	94
14	E I Hotel	14	58	Rhone-Poulenc(I)	73
92	E Merck (India)	67	83	Sandoz	59
61	Engine Valves	98	35	Sandvik Asia	52
10	Essel Packaging	58	25	Saw Pipes	31
71	Eternit Everest	74	27	SBI	2
48	Finolex Cables	68	62	Sesa Goa	29
68	Flex Inds	80	22	Shriram Honda	81
47	Gabriel	99	64	Siemens	18
59	Garware Polyester	55	41	Siltap Chemical	96
66	Glaxo India	23	88	Smithkline B Pharma	53
100	Godfrey Phillips	86	98	Sterlite Inds	32
53	Goodlass Nerolac	62	17	Sundaram Fastners	34
69	Great Eastern	27	34	Sundaram Clayton	61
42	Gujarat Ambuja Cement	16	57	Tata Chemicals	8
8	H D F C	11	89	Tata Power	26
63	Hero Honda	43	24	Tata Press	91
50	Himachal Futuristic	76	72	Tata Invest. Corp	66
6	Himatsingka Seide	64	94	Telco	3
39	Hind Lever	1	12	Thomas Cook	56
74	Hindalco	6	9	Trafalgar House	75
23	Hotel Leela Venture	46	3	TVS Suzuki	35
60	ICI	36	4	United Phosphorus	38
75	India Cement	30	2	Vysya Bank	42
7	Indian Hotels	7	76	Wartsila Diesel	70
81	Indian Rayon	19	46	Widia India	63
31	ITC	4	36	Wipro	33
54	ITW Signode	87	51	Zandu Pharma	92
90	Jindal Iron	95	49	Zuari Agro	44

## NOTES

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