

## A Study on Wealth Creation 1996 - 2001

### The Fastest . . .

MOST INQUIRE RANK	THE FASTEST	CAGR % OF ADJUSTED MKT. CAP ('96 TO '01)	APPRECIATION (NO. OF TIMES)
1	Infosys Technologies	131.1	66.0
2	Wipro	114.6	45.5
3	Satyam Computer	112.1	42.9
4	Moser Baer	82.3	20.1
5	SSI	82.2	20.1
6	Aurobindo Pharma	66.6	12.8
7	Zee Telefilms	56.9	9.5
8	Panacea Biotech	54.5	8.8
9	Cipla	49.6	7.5
10	HDFC Bank	47.9	7.1

### The Biggest . . .

RANK BASED ON SIZE	THE BIGGEST	WEALTH CREATED IN RS CR ('96 TO '01)	APPRECIATION (NO. OF TIMES)
1	Hindustan Lever	37,738	3.1
2	Reliance Industries	30,905	3.8
3	Wipro	29,737	45.5
4	Infosys Technologies	26,365	66.0
5	Reliance Petroleum	15,795	3.6
6	ITC	14,415	3.6
7	Satyam Computer	7,154	42.9
8	Cipla	5,230	7.5
9	HDFC Bank	4,738	7.1
10	Ranbaxy Laboratories	3,484	1.7

- *High RoE (well above cost of capital) is the foundation of Wealth Creation*
- *Return on incremental capital employed in the long run should be higher than the expected rate of return*
- *Growth in the same business franchise is likely to be more rewarding in the future than from a totally new line of business*
- *To generate superior returns, purchase stocks with a high Margin of Safety which is reflected in a 'Payback Ratio' of less than two*

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## Objective, Concept & Methodology

### Objective

The foundation of Wealth Creation is in buying businesses at a price substantially lower than their intrinsic value. Lower the market value than the intrinsic value, higher is the margin of safety. In this year's study, we continue our endeavour to know the characteristics of businesses, which create value for their shareholders.

As Phil Fisher says, *"It seems logical that even before thinking of buying any common stocks, the first step is to see how money has been most successfully made in the past."* Wealth Creation studies are attempts to study the past as a guide to the future and gain insights into the valuation of such successful opportunities.

### Concept

Wealth Creation is the process by which a company enhances the market value of capital entrusted to it by its shareholders. It is a basic measure of success for any commercial venture. Wealth Creation is achieved by rational actions of a company in a sustained manner.

### Methodology

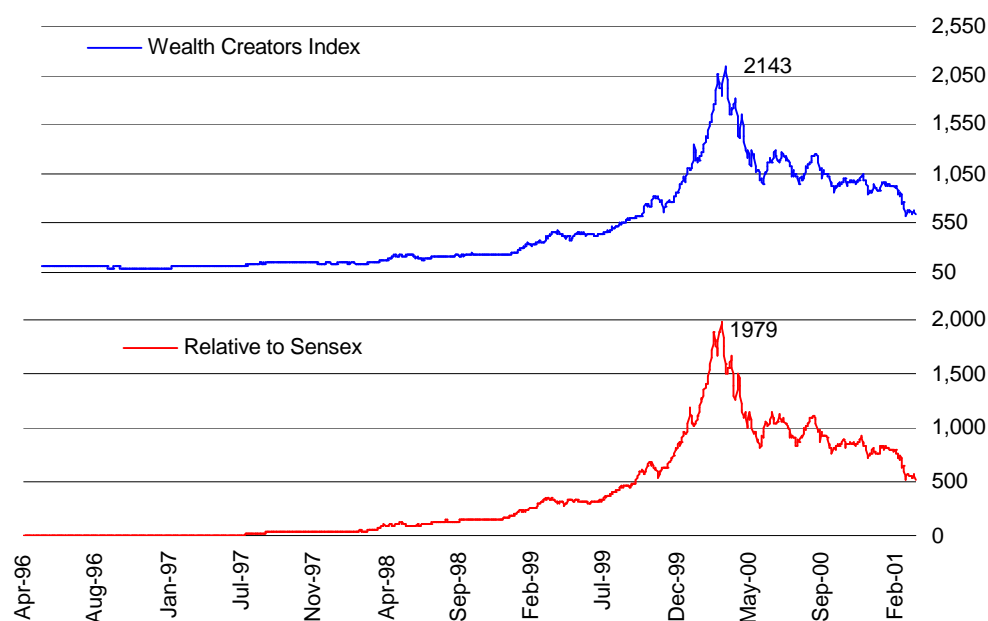
For the purpose of our study\*, we have identified companies which have the distinction of having added at least Rs 100 cr to their market capitalisation after adjusting for dilution during 1996-2001. Our findings are that only 71 companies fulfill this criteria. This is the second lowest tally in all the Wealth Creation Studies conducted so far. We have termed the group of Wealth Creators as the 'MOST-Inquire 71 Wealth Creators'. The Wealth Creators have been listed in Appendix I & II. The ranks have been accorded on the basis of Speed of Wealth Creation, that is, compounded growth in Wealth Created during the period under study.

\* *The database used for this study is that of Capitaline Data and Trends.*

## The Wealth Creator Group Vs BSE Sensex

This study pertains to the period from April 1996 to March 2001. During this period, the BSE Sensex rose at a modest CAGR of 1.4% while, the Wealth Creators' Index appreciated at a CAGR of 44.3%. The chart below depicts the relative performance of the 'MO St-Inquire 71' Vs the BSE Sensex during the period under review. Despite having fallen by 71% from the peak of 2143 in March 2000, the Wealth Creators' Index managed to outperform the Sensex by 427% during the study period.

WEALTH CREATOR GROUP VS BSE SENSEX (31.3.96 TO 31.3.01)



	MAR-96	MAR-97	MAR-98	MAR-99	MAR-00	MAR-01
BSE Sensex	3,366.6	3,360.9	3,892.8	3,740.0	5,001.3	3,604.4
y-o-y Performance (%)	-	(0.2)	15.8	(3.9)	33.7	(27.9)
Wealth Creators Index	101.2	104.1	174.0	467.7	1642.6	632.6
y-o-y Performance (%)	-	2.8	67.2	168.9	251.2	(61.5)
5Year CAGR (%) Sensex						1.4
5Year CAGR (%) Wealth Creators						44.3

Market capitalisation of the MO St-Inquire 71 Wealth Creators increased by Rs2.17 lakh crore in the study period implying a CAGR of 44.3% while the rest of the market was in a destructive mode with Rs2.03 lakh crore getting eroded in the study period. The net wealth created was a meagre Rs13, 926 crore. A closer look at India Inc. (5,779 non-finance companies) reveals that its financials were deteriorating in the study period.

## India Inc. ~ Financials

(IN RS 'OO CR)							
YEAR	1996	1997	1998	1999	2000	2001	CAGR 96-01
<b>Sales</b>	<b>4,745</b>	<b>5,622</b>	<b>6,107</b>	<b>6,994</b>	<b>8,489</b>	<b>10,248</b>	<b>16.7</b>
<b>EBITDA</b>	<b>604</b>	<b>683</b>	<b>719</b>	<b>782</b>	<b>890</b>	<b>1,009</b>	<b>10.8</b>
Interest	231	305	345	423	462	530	<b>18.1</b>
Depreciation	144	193	231	278	348	389	<b>22.0</b>
Other Income	167	196	228	256	311	386	<b>18.3</b>
<b>PBT</b>	<b>396</b>	<b>381</b>	<b>371</b>	<b>338</b>	<b>391</b>	<b>476</b>	<b>3.8</b>
Tax	78	88	90	100	120	148	<b>13.7</b>
<b>PAT</b>	<b>318</b>	<b>293</b>	<b>282</b>	<b>238</b>	<b>271</b>	<b>328</b>	<b>0.7</b>
Networth	2,258	2,723	2,999	3,345	3,912	4,649	<b>15.5</b>
Debt	2,246	2,887	3,373	3,991	4,390	4,846	<b>16.6</b>
Interest / Sales (%)	4.9	5.4	5.6	6.0	5.4	5.2	
Interest on Debt (%)	10.3	10.6	10.2	10.6	10.5	10.9	
EBITDA/ Sales (%)	12.7	12.2	11.8	11.2	10.5	9.8	
Tax Rate (%)	19.7	23.1	24.1	29.7	30.8	31.0	
NPM (%)	6.7	5.2	4.6	3.4	3.2	3.2	
RoCE (%)	13.9	12.2	11.2	10.4	10.3	10.6	
RoE (%)	14.1	10.8	9.4	7.1	6.9	7.1	

## The Wealth Creator Group ~ Financials

(IN RS 'OO CR)							
YEAR	1996	1997	1998	1999	2000	2001	CAGR 96-01
<b>Sales</b>	<b>500</b>	<b>615</b>	<b>745</b>	<b>948</b>	<b>1,217</b>	<b>1,535</b>	<b>25.2</b>
<b>EBITDA</b>	<b>58</b>	<b>75</b>	<b>99</b>	<b>116</b>	<b>149</b>	<b>178</b>	<b>25.3</b>
Interest	11	15	18	22	24	27	19.8
Depreciation	12	15	21	26	36	44	30.2
Other Income	20	20	23	31	39	48	18.8
<b>PBT</b>	<b>55</b>	<b>65</b>	<b>84</b>	<b>99</b>	<b>128</b>	<b>156</b>	<b>22.9</b>
Tax	13	16	18	21	24	27	16.5
<b>PAT</b>	<b>43</b>	<b>49</b>	<b>65</b>	<b>78</b>	<b>104</b>	<b>128</b>	<b>24.6</b>
Networth	218	249	293	345	464	579	21.6
Debt	125	172	189	217	232	254	15.3
Interest/Sales (%)	2.2	2.5	2.4	2.3	2.0	1.8	
Interest/Debt (%)	8.8	8.9	9.4	10.0	10.5	10.8	
EBITDA/Sales (%)	11.6	12.2	13.3	12.2	12.2	11.6	
Tax Rate (%)	23.0	25.0	21.8	21.6	19.1	17.6	
NPM (%)	8.5	7.9	8.8	8.2	8.5	8.3	
RoCE (%)	12.4	11.6	13.6	13.8	14.9	15.4	
RoE (%)	19.6	19.6	22.3	22.5	22.4	22.2	

- The Wealth Creator Group had profitable growth whereas India Inc. grew but, with a simultaneous decline in profitability.

## Wealth Creators ~ Business Analysis

### Nature of Business

The trio IT, FMCG and Pharma continue to dominate the list of Wealth Creators. These sectors combined together have contributed 70% to the Wealth Created in 1996-2001 study compared to 80% in the 1995-2000 study. Share of Petrochem sector in Wealth Created has increased from 8% in our previous study to 22% in the current study.

(RS CR)

INDUSTRY CLASSIFICATION	NET WEALTH CREATED	NO OF COS.	CONTR. TO WEALTH CREATED (%)	ROCE 2001 (%)	ROCE 1996 (%)	5 YEAR CAGR % (1996-01)	
						NP	SALES
IT	69,187	13	31.9	32	38	68	34
FMCG	63,350	15	29.2	39	42	32	17
Petrochem	48,068	3	22.1	18	14	24	46
Pharmaceuticals	19,656	15	9.1	23	36	16	19
Banking and Finance	7,395	2	3.4	4	3	26	27
Automobiles	3,162	3	1.5	47	44	40	30
Media	1,264	1	0.6	4	33	43	34
Metals	862	3	0.4	24	14	34	16
Chemicals	744	2	0.3	27	44	8	31
Engineering	477	1	0.2	7	45	-2	6
Power Generation	277	1	0.1	13	14	13	9
Consumer Durables	256	1	0.1	14	34	3	11
Others	2,485	11	1.1	18	28	24	25
<b>Total</b>	<b>217,180</b>	<b>71</b>	<b>100.0</b>	<b>18</b>	<b>22</b>	<b>25</b>	<b>25</b>

### Management—MNC Vs Indian

In the first four Wealth Creation Studies, the contribution of MNCs to the total wealth created ranged between 35% and 50%. It is only in the last two studies including the current one, MNC contribution to the total wealth created has fallen below 30%. The home grown IT and Pharma companies have displaced the MNCs as a major Wealth Creating class. Now, with the recent wave of delisting by several MNC subsidiaries operating in India, the question is will MNC stocks attract investor fancy?

WEALTH CREATION STUDY	NO OF COMPANIES			% WEALTH CREATED	
	MNCS	TOTAL	MNCS % OF TOTAL	MNCS	OTHERS
1996-01	19	71	26.8	29.7	70.3
1995-00	21	100	21.0	14.8	85.2
1994-99	43	100	43.0	50.2	49.8
1993-98	50	100	50.0	47.3	52.7
1992-97	19	45	42.2	38.4	61.6
1991-96	38	100	38.0	35.7	64.3

## Wealth Creators ~ Business Analysis

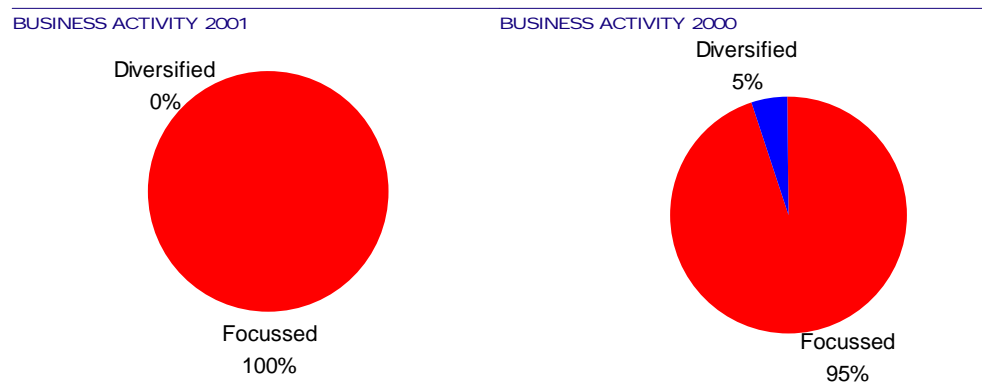
### Speed Vs Size

The speed of Wealth Creation is directly correlated to the size of market capitalisation. Thus, if one wants speed in Wealth Creation, then it is imperative for investors to buy companies with relatively small market capitalisations and whose businesses have the potential to create value for shareholders on a consistent basis.

(RS CR)		
MARKET CAPITALISATION	MEAN SIZE	MEAN SPEED (%)
>= 1000	4,187	13.1
>= 500 < 1000	681	29.9
>= 250 < 500	342	33.9
< 250	97	34.2

### Business Activity

A common feature across all the Wealth Creation Studies, including the current one, is that companies, which have consistently created wealth for their shareholders, have adopted an extremely focussed business policy. The current study too states that all the 71 Wealth Creators have a focussed business policy compared to 95% in the 1995-2000 study.



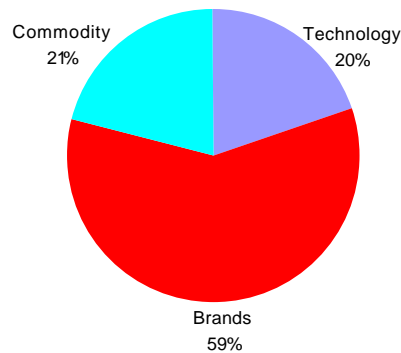
## Wealth Creators ~ Business Analysis

### Product Attributes

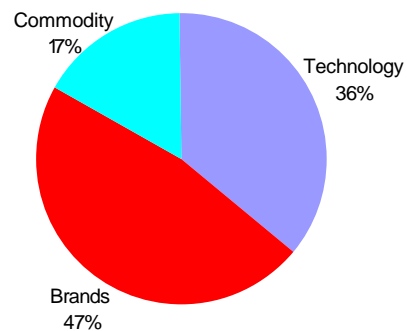
All the current and past successful Wealth Creators have erected high entry barriers through superior technology or strong brand building. In the current study period, 79% of the Wealth Creating companies have one of these attributes as the differentiating factor.

We also observed that the share of commodity companies has been increasing from 14% in the 1994-1999 study, 17% in the 1995-2000 study to 21% in the current 1996-2001 study.

PRODUCT ATTRIBUTES 2001



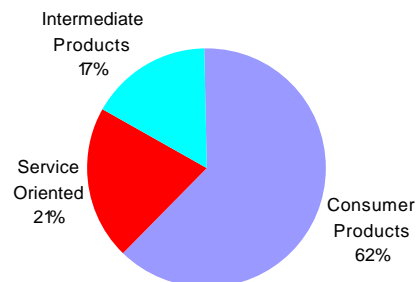
PRODUCT ATTRIBUTES 2000



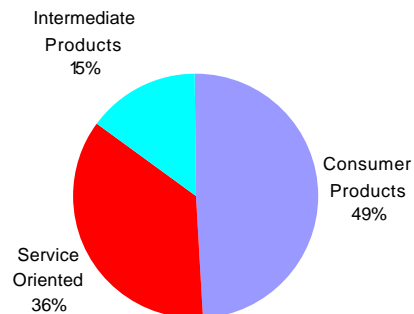
### Consumer Profile

A strong consumer or service franchise is critical to Wealth Creation. Consumer products and service-oriented businesses continue to dominate our universe of Wealth Creators—83% of the wealth creating companies fall under this category.

CONSUMER PROFILE 2001



CONSUMER PROFILE 2000





## Wealth Creators ~ New Economy Vs Old Economy

We have classified the technology, media and telecom sector companies as New economy companies and the rest as Old economy companies.

	OLD	NEW
Number of Companies in <i>Inquire-MOST</i> 71	57	14
Earnings CAGR (%) (1996-2001)	19.9	66.0
Market Cap CAGR (%)	27.8	94.5
PE 1996	15.2	11.9
PE 2001	18.4	26.2

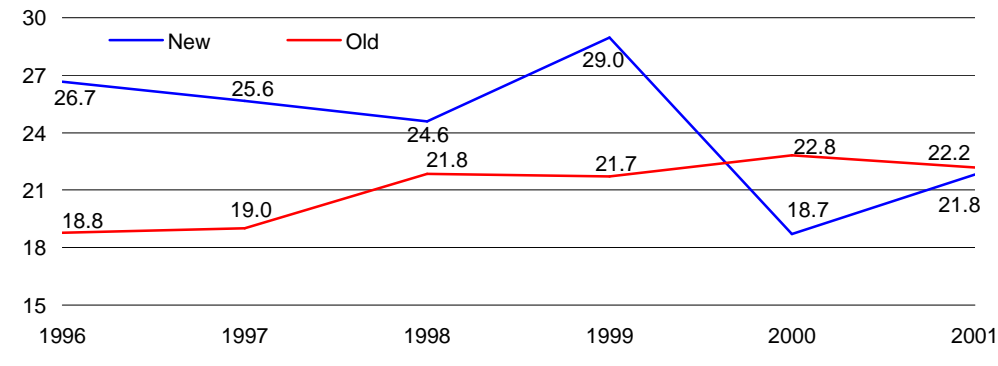
- Earnings of new economy companies have grown at a CAGR of 66% as compared to 20% of old economy companies.
- The PE multiple of new economy stocks has expanded from 12x in 1995 to 26x in 2000 while that of old economy companies has expanded from 15x to 18x over the same period.
- The CAGR in market capitalisation for new economy companies has been 95% compared to 28% for old economy companies during the study period
- The differential in their valuation seems to be narrowing down, as the new economy companies are showing signs of slowing down in the earnings growth rate. In the 1995-2000 study, the PE multiple for new economy companies was 122x compared to 26x in the current study.

## Wealth Creators ~ New Economy Vs Old Economy

### Return on Equity

The new economy companies have displayed volatility in their ROEs. As against that, old economy companies have registered a steady improvement in their ROEs. For both the groups, the ROEs are now almost equal.

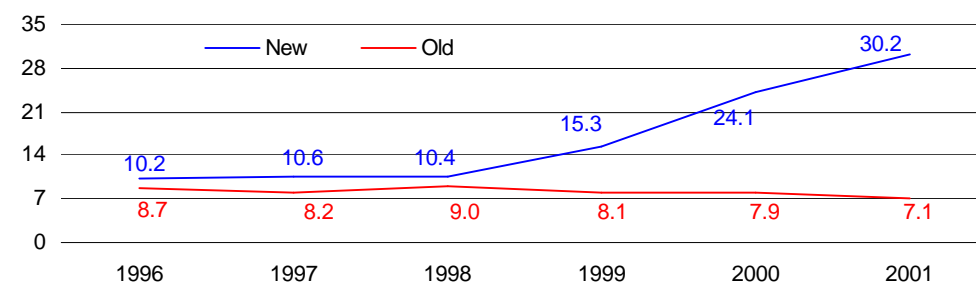
WEALTH CREATORS - ROE



### Net Profit/Sales

The new economy companies recorded significant improvements in their NPM levels during the study period. These companies saw their NPM levels rise from 10% in 1996 to 30% in 2000. In the old economy, the companies witnessed a marginal decline in NPM levels. **Is the margin expansion of new economy companies sustainable?**

NPM/SALES (%)

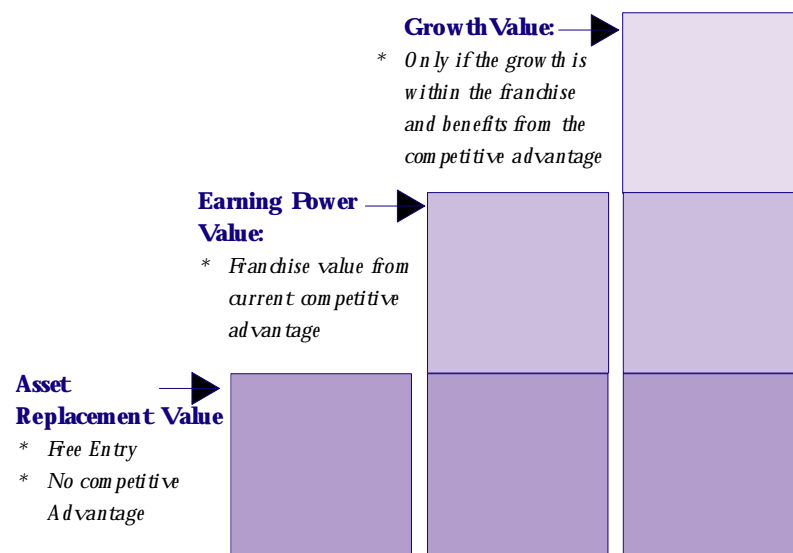


## Three Components of Value

Value investing starts with having a better understanding of the intrinsic value of the company than rest of the market. A company's intrinsic value can be divided into three parts:

- I Asset Replacement Value
- II Earning Power Value
- III Growth Value

These components of value exist in companies in differing proportions.



### Asset Replacement Value

- Basic value of a business with no competitive advantage is the replacement cost of assets. Any new entrant can get these assets by paying the current price.
- Typically found in industries like cement, steel, aluminium, refining and petrochemicals
- Companies like Gujarat Ambuja, Reliance and Hindalco, where this component is high, trade at a low P/BV.

## Three Components of Value

### Earning Power Value

- Competition keeps eroding profitability till it falls below the cost of capital.
- Competitive advantage or some kind of entry barrier allows companies to earn higher returns than the cost of capital.
- Higher the entry barriers and the longer they last, higher and larger will be the profits above the cost of capital.
- **Solidity of the barrier or competitive advantage is the starting point of Wealth Creation. If it is missing, any amount of growth will be meaningless in the long run.**
- HLL, Infosys and Hero Honda have a high component of value due to their competitive advantage over and above asset value.

### Growth Value

- Growth is the most difficult to estimate. Especially, to project growth for a long period into the future is not an easy task.
- All growth is not rewarding. Growth has to be in the same franchise of business.
- Free competition allows all the firms to enter new businesses.
- New lines of business without competitive advantage are unlikely to earn attractive returns ( $>$  cost of capital) on additional capital for a meaningful period.
- **Hence, only 'valuable growth' is the growth in businesses where the firm enjoys a competitive advantage.**

COMPANY	YEAR ENDED	BV (RS)	CMP (RS) 24/12/01	ROE 2001	P/BV
Gujarat Ambuja Cements	Jun-01	104	192	12.2	1.8
Hindalco	Mar-01	588	643	15.5	1.1
Nestle	Dec-00	27	500	46.0	18.7
Hindustan Lever	Dec-00	11	216	52.7	19.7
Infosys Technologies	Mar-01	210	4,040	45.2	19.2
Hero Honda Motors	Mar-01	32	235	39.2	7.4

## Wealth Creation Process of Growing Companies

A consistent finding of the Wealth Creation Studies including the current one is that, most of the wealth has been created by companies who have witnessed their earnings grow faster than 25% annually.

EARNINGS GROWTH	NO OF COMPANIES	WEALTH CREATED	% OF WEALTH CREATED
>25	38	147,435	68
20-25	10	7,383	3
15-20	10	39,257	18
<15	13	23,106	11
<b>Total</b>	<b>71</b>	<b>217,180</b>	<b>100</b>

But again, companies which fulfill the earnings growth criteria, need not always be successful in creating wealth in the markets. Earnings growth is a necessary condition for Wealth Creating companies but not a sufficient one.

### Not All Growth Creates Value

We quested further to probe the process of Wealth Creation of Growing companies.

Value of a share is the Present Value of all future free cash flows. The formula:

$$\text{Present Value of Future Cash Flows} = C \times (RoC - G)/(R - G)$$

C: Capital Employed

RoC: Return on Incremental Capital Employed / Equity

G: Growth in Capital Employed

R: Cost of Capital

### Value created by growth depends on

- Profitability of incremental capital employed. Greater the amount by which incremental returns (RoC) exceed the cost of capital (R), greater will be the value created.
- Amount of capital that can be deployed in the business. In the long run, growth (G) has to be a fraction of cost of capital.

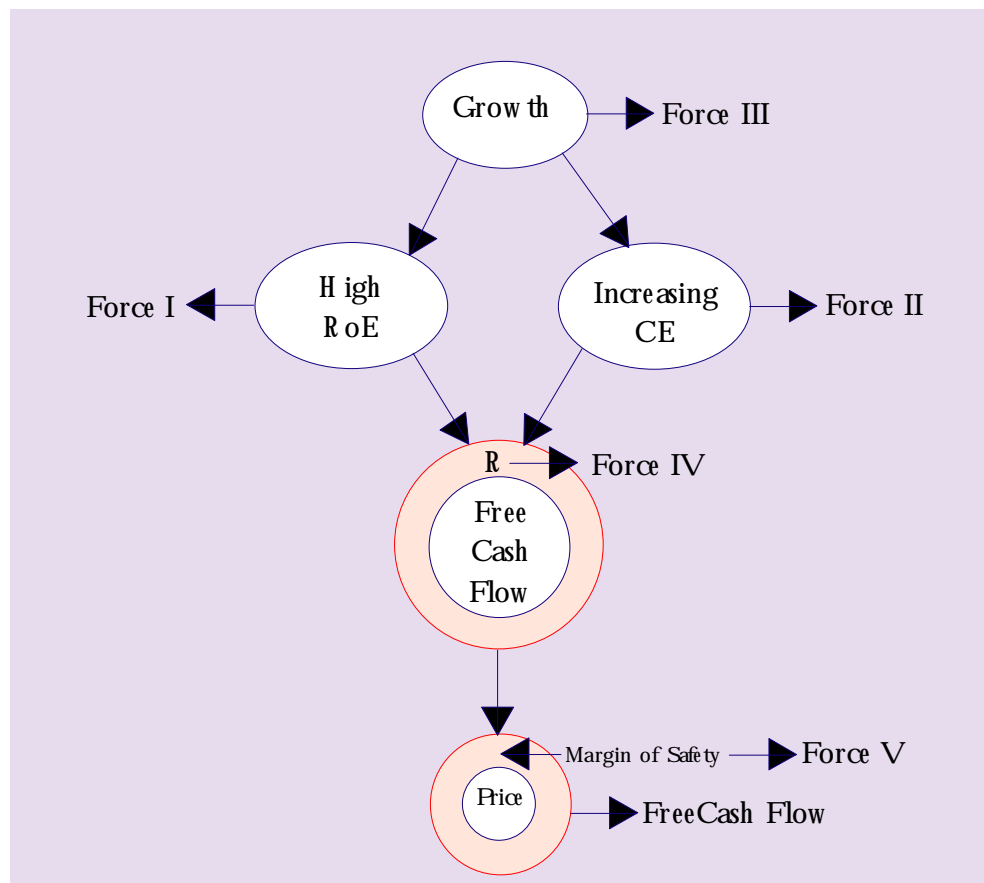
An investor should substitute cost of capital with the return that he/she expects on the investment to decide on the extent of Margin of Safety.

**We have termed the above four variables, along with the principle of Margin of Safety, the Five Forces of Wealth Creation.**

*"It is actually the interaction of capital employed, the returns on that capital and the future capital generated versus the purchase price today"*

—Warren Buffett, 1995

## Five Forces of Wealth Creations



*RoE = Return on Equity*

*CE = Capital Employed*

*R = Cost of Capital*

### Force I: High RoE

RoE substantially higher than the cost of capital signifies that the company possesses some edge over its competitors. Continuation of this competitive advantage in parts longevity to the Wealth Creation Process.

ROE (%) IN 2001	NO OF COS	% OF TOTAL COS	WEALTH CREATED	
			(RS CR)	(%)
<15	17	24	10,142	5
>15<25	27	38	66,392	31
>25<35	15	21	31,165	14
>35	12	17	109,481	50
<b>Total</b>	<b>71</b>	<b>100</b>	<b>217,180</b>	<b>100</b>

### Force II: High RoE coupled with Increasing Capital Employed

Whenever the RoE is high, there will be wealth creation. But, size of the wealth created is dependent on the amount of capital employed. High capital employed is a function of the size of the opportunity. Businesses which can consume substantial

## Five Forces of Wealth Creation

amounts of capital at high incremental returns only can create Big Wealth because profitable growth through increasing R oE is generally difficult and limited.

Our findings:

- Increasing R oE coupled with increasing capital employed is a lethal combination.
- For all but three of the ten fastest Wealth Creators, the CAGR in R oE in the study period ranged from 5% to 20%. For the three companies, which witnessed a decline in R oE, large equity dilutions were to be blamed.
- For the Top-Ten Fastest Wealth Creators, the CAGR in capital employed during 1996-2001 ranged from 20% for Cipla to 135% for SSI.
- Growth adds value to the business if the growth is in the same franchise. **All the Wealth Creators have had growth happening in the same line of business.**

COMPANY	ROE (%)			CE (RS CR)		CAGR (%)	
	2001	1996	CAGR	2001	1996	CE	MCAP
Infosys Technologies	45	26	11	1,219	80	73	131
Wipro	36	24	8	1,841	469	31	115
Satyam Computer	60	25	19	900	77	64	112
Moser Baer	21	30	(35)	885	41	85	82
SSI	7	52	(34)	842	12	135	82
Aurobindo Pharma	25	19	5	491	52	57	67
Zee Telefilms	4	31	(7)	4,306	83	120	57
Panacea Biotech	30	18	11	132	32	32	54
Cipla	25	14	12	735	300	20	50
HDFC Bank	23	9	20	980	241	32	48

### Force III: Growth

High R oE starts the wealth creation process. Large capital deployment gives it size. But, most investors are interested in SPEED. This comes from growth in free cash flow, that is,  $Cx(RoC - G)$ .

Growth in free cash flows can come by an increasing R oE or increasing the capital employed. Generally, under normal circumstances one of the factors is increasing. But, when a company finds itself in a situation when both the RoC as well as capital is growing, the combination is exponential. This is what has happened in recent years in the Indian technology stocks. This happens when

- Size of the opportunity is huge
- Competitive advantage is wide and long
- Managements are capable of seizing the opportunity

An investor has to then foresee the growth/degrowth in R oE ahead of the crowd.

## Five Forces of Wealth Creation

### Force IV: Cost of Capital

*“Investing is nothing but laying money today for more to be received in the future.”*

The level of interest rates prevailing in the economy will determine the discount rate (cost of capital) by which future free cash flows of the companies will be discounted to arrive at the present value. The table below illustrates the present value of Rs100 receivable after 5 years.

Cost of Capital (%)	20.0	15.0	10.0
Present Value of Rs100 Receivable After 5 years	40.2	49.7	62.1

Higher the discount rate, lower will be the present value of future cash flows. Thus, the cost of capital will be a key determinant of valuation of businesses.

### US Stock Market experience with the level of interest rates

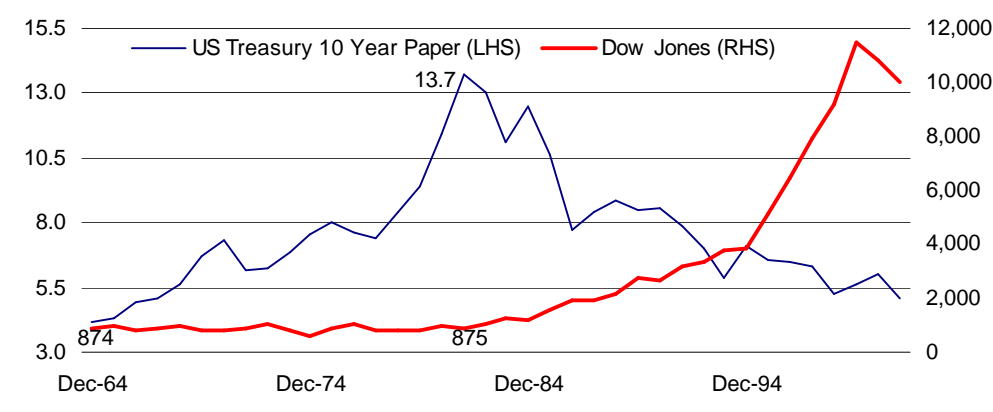
Interest rates have played a role in US stock market valuations.

	31-Dec-64	31-Dec-81	31-Dec-94
DJIA	874	875	9,181
Change in GNP (%)	-	373	177
Interest Rates (%)	4.2	13.7	5.0

During the 17-year period of 1964-1981 though the US GNP increased by 373%, the Dow Jones index remained almost at the same level. In the following 17-year period, the US GNP less than tripled but the Dow Jones index rose more than tenfolds. Divergence in stock market behaviour in the two 17-year periods can be explained by having a closer look at how the interest rates behaved in the same period.

In the first period, interest rates rose from 4.2% to 13.7% while in the second period they declined to 5%. High interest rates shrank the business values in the first period. The reverse happened in the second period with the business valuations improving as the interest rates were trundling downhill.

US TREASURY 10-YEAR PAPER VS DOW JONES



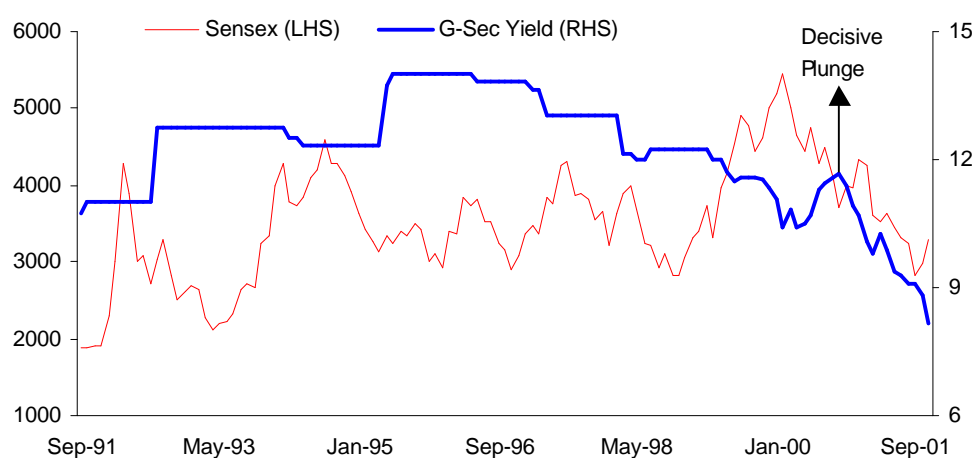


## Five Forces of Wealth Creation

### Will the US experience be repeated in India?

In India, we have been witnessing a declining interest rate scenario since FY97. The lower interest rate regime at this stage—which may continue for a reasonably long period of time—will dramatically alter valuations of all the businesses in the stock markets. As is apparent from the financials of India Inc. (see page 5), a drop in interest rates by 2% will increase India Inc's bottom line by around 20%. A higher level of profitability combined with a lower discounting rate will prop up stock market valuations in India.

INTEREST RATE (%) VS SENSEX



### Force V: Margin of Safety

Intrinsic value of a company is determined by the interplay of sum of free cash flows and cost of capital. But, an investor will make money only if he buys at an attractive price. Eventually, purchase price will determine the rate of return.

*"Never count on making a good sale. Have the purchase price be so attractive, that even a mediocre sale gives an attractive return"*

— Warren Buffett

An investor has to understand what the price implied is in terms of free cash flow, growth and longevity.

To adjudge market expectations and a company's inherent capability to deliver free cash flows in future, we have used our time tested "Payback ratio" barometer.

## Five Forces of Wealth Creation

### Payback Ratio

Generally, it has been observed that market price is often based on the assumption that earnings will grow at their current rate for another five or more years and then remain constant (Manitou Investment Management research). We have defined payback ratio as the result of market capitalisation of the company divided by the sum of profits of the company for the next five years. With the benefit of hindsight, we have calculated the payback ratio for all the 71 Wealth Creators. Following are our findings:

	PAY BACK RATIO					TOTAL
	<=1	1>=2	2>=3	3>=4	>4	
RoE <15 (no of cos.)	8	5	2	1	1	17
% Wealth Created	1.4	1.0	0.2	0.4	1.6	4.7
Mean Rate of Return	34.6	19.4	18.3	13.9	11.8	25.7
RoE >15<25 (no of cos.)	9	6	5	3	4	27
% Wealth Created	9.5	17.3	2.3	0.6	1.0	30.6
Mean Rate of Return	31.3	24.1	12.9	26.2	17.0	23.6
RoE >25<35 (no of cos.)	5	4	4	2	0	15
% Wealth Created	0.8	10.7	2.6	0.2	0.0	14.3
Mean Rate of Return	30.9	40.2	28.5	3.3	na	29.1
RoE >35 (no of cos.)	6	2	1	2	1	12
% Wealth Created	31.2	0.8	0.1	17.5	0.8	50.4
Mean Rate of Return	74.2	34.6	29.4	16.0	18.7	49.6
Total Companies	28	17	12	8	6	71
Total Wealth Created	42.9	29.8	5.2	18.8	3.4	100.0
All Companies Mean Rate	41.4	27.8	20.4	16.4	16.4	29.6

- The three companies - Infosys, Wipro and Satyam - had a payback ratio of less than one and an RoE of above 35% in the study period.
- Companies with high RoE (> 35%) numbering only 12 have created 50% of the wealth. They are few, but necessary in the portfolio.
- Higher the RoE, longer can be the payback.

### Thoughts for the Future

Based on findings of the six Wealth Creation Studies including the current study, we make an attempt to identify the future Wealth Creators.

### Criteria and Assumptions

- RoE greater than 25% in 2001 and sustainable
- Companies with focussed business approach
- Growth in the same franchise
- Earnings to grow by a CAGR of at least 20% during the next five years

## Five Forces of Wealth Creation

Based on these criteria, we have arrived at 24 companies which have the potential of creating wealth for its shareholders. The list is only indicative. We have calculated the payback ratio for the companies assuming that their earnings will grow by a CAGR of at least 20% during the next five years.

Payback Ratio	<=1	1>=2	2>=3	3>=4	>4
No of Cos	2	7	6	3	6
Company	BPCL Concor	Asian Paints CMC Hughes Software ITC Polaris Software SBCH Satyam Computer	Britannia Ind Hero Honda HCL Tech Novartis Sun Pharma Wockhardt	Digital HDFC Bank Pfizer	Aventis Pharma Cipla HLL Infosys Tech Nestle Wipro

### Conclusion

- High RoE (well above cost of capital) is the foundation of Wealth Creation.
- Return on incremental capital employed in the long run should be higher than the expected rate of return.
- Growth in the same business franchise is likely to be more rewarding in the future than from a totally new line of business
- To generate superior returns, purchase stocks with a high Margin of Safety which is reflected in a 'Payback Ratio' of less than two.

# 'MOST-Inquire 71' ~ Wealth Creators

# Appendix I

SR. NO.	COMPANY NAME	ROE (%)		CE (RS CR)		PAYBACK RATIO (X)	WEALTHCREATED		MCAP CAGR
		2001	1996	2001	1996		NET	%	
1	Adani Exports	24.8	37.9	1,038	214	0.6	251	0.12	13.2
2	Amtek Auto	14.7	17.0	100	23	0.7	216	0.10	39.3
3	Apollo Hospitals	11.5	19.7	384	90	0.6	270	0.12	28.7
4	Asian Paints	25.9	26.1	634	322	3.4	206	0.09	4.3
5	Astrazeneca	21.4	30.3	65	31	1.3	123	0.06	21.4
6	Aurobindo	24.7	19.3	491	52	0.2	543	0.25	66.6
7	Aventis Pharma	18.1	18.8	231	159	5.2	461	0.21	12.3
8	Berger Paints (India)	20.2	25.5	226	69	0.6	172	0.08	28.6
9	Bharat Heavy Electricals	8.2	22.6	4,795	2,504	1.1	477	0.22	3.0
10	Bharat Petroleum	20.1	22.3	7,655	1,981	1.4	1,368	0.63	5.7
11	Birla 3M	19.3	7.8	100	32	6.3	314	0.14	22.4
12	Britannia Industries	29.4	17.3	415	154	1.8	1,547	0.71	38.4
13	BSES	12.8	12.1	3,086	2,205	1.4	277	0.13	2.4
14	Cadbury India	21.5	22.0	229	101	3.3	899	0.41	27.8
15	Castrol India	34.1	41.1	408	274	3.3	307	0.14	2.3
16	Cipla	25.1	14.5	735	300	1.3	5,230	2.41	49.6
17	Dabur India	21.4	21.4	544	344	2.4	1,023	0.47	19.5
18	Digital Globalsoft	37.4	28.3	140	84	1.6	1,061	0.49	35.2
19	Dr Reddy's Laboratories	26.1	17.1	894	313	2.9	3,203	1.47	36.8
20	E Merck (India)	29.2	26.8	135	88	2.7	466	0.21	19.7
21	Electrosteel Castings	21.1	20.7	534	123	0.2	113	0.05	5.3
22	e-Serve International	24.6	12.4	44	37	3.5	134	0.06	44.9
23	Essel Propack	17.3	13.6	390	223	2.7	226	0.10	11.5
24	FCL Technologies & Products	19.9	12.1	194	42	4.1	137	0.06	19.9
25	German Remedies	23.4	21.1	142	63	0.8	335	0.15	33.8
26	Gillette India	11.1	10.5	385	48	3.8	945	0.44	13.9
27	Glaxo (India)	17.9	79.6	445	275	4.2	1,204	0.55	13.6
28	Godfrey Phillips India	21.8	24.3	259	228	0.8	237	0.11	20.8
29	GTL	34.2	30.8	1,344	133	0.3	212	0.10	10.1
30	Gujarat Gas Company	37.4	41.0	123	33	1.3	572	0.26	34.0
31	HDFC Bank	23.0	9.2	980	241	1.3	4,738	2.18	47.9
32	Hero Honda Motors	39.2	27.4	815	105	0.8	2,224	1.02	37.1
33	Hindustan Inks & Resins	14.7	46.1	314	182	1.0	314	0.14	33.8
34	Hindustan Lever	52.7	29.3	2,364	1,070	3.8	37,738	17.38	25.2
35	Hindustan Zinc	14.6	5.0	1,108	791	0.8	532	0.25	19.9
36	Hitech Drilling Services India	12.2	12.4	15,588	5,110	0.5	127	0.06	10.7
37	HDFC	20.0	13.5	2,813	1,767	2.2	2,657	1.22	11.0
38	IBP	14.7	10.2	356	233	1.4	437	0.20	19.4
39	Information Technologies	6.3	31.1	1,036	49	1.2	723	0.33	38.5
40	Infosys Technologies	45.2	26.3	1,219	80	0.4	26,365	12.14	131.1

# 'MOST-Inquire 71' ~ Wealth Creators

# Appendix I

SR. NO.	COMPANY NAME	ROE (%)		CE (RS CR)		PAYBACK RATIO (X)	WEALTHCREATED		MCAP CAGR
		2001	1996	2001	1996		NET	%	
41	ITC	29.0	24.9	4,184	1,740	1.7	14,415	6.64	29.1
42	Jagatjit Industries	13.5	20.6	216	99	0.9	107	0.05	2.9
43	MIRC Electronics	14.3	22.4	411	169	0.5	256	0.12	36.6
44	Morepen Laboratories	16.9	31.8	856	95	2.9	541	0.25	21.2
45	Moser Baer (India)	52.9	30.1	885	41	0.1	606	0.28	82.3
46	Motherson Sumi Systems	18.6	18.0	129	60	1.4	142	0.07	20.0
47	MPhasis BFL Limited	2.5	48.7	809	29	2.1	271	0.12	13.5
48	Nestle India	46.0	23.0	338	467	4.8	1,801	0.83	18.7
49	Nicholas Piramal India	16.2	13.6	500	324	2.5	480	0.22	1.5
50	NIT	36.2	36.7	616	113	0.9	2,217	1.02	38.1
51	Nirma	19.1	25.9	2,362	183	0.8	2,523	1.16	1.3
52	Panacea Biotec	30.2	17.9	132	32	0.4	240	0.11	54.5
53	Pfizer	27.8	16.8	132	98	2.1	1,087	0.50	42.0
54	Pidilite Industries	22.1	20.8	257	160	1.2	315	0.15	19.5
55	Procter & Gamble	45.0	19.7	175	122	3.0	353	0.16	6.8
56	Punjab Tractors	25.9	31.4	439	130	1.0	796	0.37	19.1
57	Ranbaxy Laboratories	11.5	17.2	1,799	1,047	4.5	3,484	1.60	11.8
58	Reliance Industries	22.1	15.9	21,618	8,438	1.1	30,905	14.23	30.3
59	Reliance Petroleum	17.7	n.a.	14,716	559	0.4	15,795	7.27	29.2
60	Rolta India	32.2	13.8	405	139	0.3	359	0.17	35.4
61	Roofit Industries	30.7	29.6	411	40	0.3	130	0.06	35.5
62	Satyam Computer Services	59.8	25.4	900	77	0.2	7,154	3.29	112.1
63	SB Consumer Healthcare	29.9	36.9	255	99	2.1	861	0.40	15.5
64	SB Pharma	17.0	19.0	179	85	3.3	156	0.07	5.9
65	SSI	38.5	52.4	842	12	0.3	190	0.09	82.2
66	Sun Pharma	28.8	22.9	351	109	1.4	2,103	0.97	43.7
67	Tata Elxsi	36.3	6.4	57	40	2.3	158	0.07	29.4
68	United Breweries	1.7	11.4	501	267	2.2	242	0.11	23.1
69	Vikas Wsp	43.1	37.9	215	21	0.8	109	0.05	12.3
70	Wipro	35.6	24.3	1,841	469	0.6	29,737	13.69	114.6
71	Zee Telefilms	27.6	30.9	4,306	83	1.0	1,264	0.58	56.9

Note: Payback Ratio = Market Capitalisation of 1996 divided by sum of five years profit from 1997-2001.

CE = Capital Employed

# 'MOST-Inquire 71' ~ Wealth Creators (Rankings)

## Appendix II

COMPANY		CAGR	WEALTH CREATED	
RANK	NAME	(%)	(RS CR)	%
1	Infosys Technologies	131.1	26,365	12.1
2	Wipro	114.6	29,737	13.7
3	Satyam Computer Services	112.1	7,154	3.3
4	Moser Baer (India)	82.3	606	0.3
5	SSI	82.2	190	0.1
6	Aurobindo Pharma	66.6	543	0.2
7	Zee Telefilms	56.9	1,264	0.6
8	Panacea Biotec	54.5	240	0.1
9	Cipla	49.6	5,230	2.4
10	HDFC Bank	47.9	4,738	2.2
11	e-Serve International	44.9	134	0.1
12	Sun Pharmaceuticals Industries	43.7	2,103	1.0
13	Pfizer	42.0	1,087	0.5
14	Amtek Auto	39.3	216	0.1
15	Information Technologies	38.5	723	0.3
16	Britannia Industries	38.4	1,547	0.7
17	NIIT	38.1	2,217	1.0
18	Hero Honda Motors	37.1	2,224	1.0
19	Dr Reddy's Laboratories	36.8	3,203	1.5
20	MIRC Electronics	36.6	256	0.1
21	Roofit Industries	35.5	130	0.1
22	Rolta India	35.4	359	0.2
23	Digital Globalsoft	35.2	1,061	0.5
24	Gujarat Gas Company	34.0	572	0.3
25	Hindustan Inks & Resins	33.8	314	0.1
26	German Remedies	33.8	335	0.2
27	Reliance Industries	30.3	30,905	14.2
28	Tata Elxsi	29.4	158	0.1
29	Reliance Petroleum	29.2	15,795	7.3
30	ITC	29.1	14,415	6.6
31	Apollo Hospitals Enterprise	28.7	270	0.1
32	Berger Paints (India)	28.6	172	0.1
33	Cadbury India	27.8	899	0.4
34	Hindustan Lever	25.2	37,738	17.4
35	United Breweries	23.1	242	0.1
36	Birla 3M	22.4	314	0.1

COMPANY		CAGR	WEALTH CREATED	
RANK	NAME	(%)	(RS CR)	%
37	Astrazeneca Pharma India	21.4	123	0.1
38	Morepen Laboratories	21.2	541	0.2
39	Godfrey Phillips India	20.8	237	0.1
40	Motherson Sumi Systems	20.0	142	0.1
41	Hindustan Zinc	19.9	532	0.2
42	FCL Technologies & Products	19.9	137	0.1
43	E Merck (India)	19.7	466	0.2
44	Dabur India	19.5	1,023	0.5
45	Pidilite Industries	19.5	315	0.1
46	IBP	19.4	437	0.2
47	Punjab Tractors	19.1	796	0.4
48	Nestle India	18.7	1,801	0.8
49	Smithkline Beecham Cons.	15.5	861	0.4
50	Gillette India	13.9	945	0.4
51	Glaxo (India)	13.6	1,204	0.6
52	MPhasis BFL Limited	13.5	271	0.1
53	Adani Exports	13.2	251	0.1
54	Aventis Pharma	12.3	461	0.2
55	Vikas Wsp	12.3	109	0.1
56	Ranbaxy Laboratories	11.8	3,484	1.6
57	Essel Propack	11.5	226	0.1
58	HDFC	11.0	2,657	1.2
59	Hitech Drilling Services India	10.7	127	0.1
60	GTL	10.1	212	0.1
61	Procter & Gamble	6.8	353	0.2
62	Smithkline Beecham Pharma.	5.9	156	0.1
63	Bharat Petroleum Corporation	5.7	1,368	0.6
64	Electrosteel Castings	5.3	113	0.1
65	Asian Paints (India)	4.3	206	0.1
66	Bharat Heavy Electricals	3.0	477	0.2
67	Jagatjit Industries	2.9	107	0.0
68	BSES	2.4	277	0.1
69	Castrol India	2.3	307	0.1
70	Nirma	1.5	2,523	1.2
71	Nicholas Piramal India	1.3	480	0.2
Total			217,180	100.0

# Summation of Earnings (Cumulative earnings in x years for y% growth in profits) Appendix III

% r	Years											
	1	2	3	4	5	6	7	8	9	10	15	20
0.10	1.1	2.3	3.6	5.1	6.7	8.5	10.4	12.6	14.9	17.5	34.9	63.0
0.11	1.1	2.3	3.7	5.2	6.9	8.8	10.9	13.2	15.7	18.6	38.2	71.3
0.12	1.1	2.4	3.8	5.4	7.1	9.1	11.3	13.8	16.5	19.7	41.8	80.7
0.13	1.1	2.4	3.8	5.5	7.3	9.4	11.8	14.4	17.4	20.8	45.7	91.5
0.14	1.1	2.4	3.9	5.6	7.5	9.7	12.2	15.1	18.3	22.0	50.0	103.8
0.15	1.2	2.5	4.0	5.7	7.8	10.1	12.7	15.8	19.3	23.3	54.7	117.8
0.16	1.2	2.5	4.1	5.9	8.0	10.4	13.2	16.5	20.3	24.7	59.9	133.8
0.17	1.2	2.5	4.1	6.0	8.2	10.8	13.8	17.3	21.4	26.2	65.6	152.1
0.18	1.2	2.6	4.2	6.2	8.4	11.1	14.3	18.1	22.5	27.8	71.9	173.0
0.19	1.2	2.6	4.3	6.3	8.7	11.5	14.9	18.9	23.7	29.4	78.9	196.8
0.20	1.2	2.6	4.4	6.4	8.9	11.9	15.5	19.8	25.0	31.2	86.4	224.0
0.21	1.2	2.7	4.4	6.6	9.2	12.3	16.1	20.7	26.3	33.0	94.8	255.0
0.22	1.2	2.7	4.5	6.7	9.4	12.7	16.8	21.7	27.7	35.0	103.9	290.3
0.23	1.2	2.7	4.6	6.9	9.7	13.2	17.4	22.7	29.1	37.0	114.0	330.6
0.24	1.2	2.8	4.7	7.0	10.0	13.6	18.1	23.7	30.6	39.2	125.0	376.5
0.25	1.3	2.8	4.8	7.2	10.3	14.1	18.8	24.8	32.3	41.6	137.1	428.7
0.26	1.3	2.8	4.8	7.4	10.5	14.5	19.6	25.9	33.9	44.0	150.4	488.1
0.27	1.3	2.9	4.9	7.5	10.8	15.0	20.4	27.1	35.7	46.6	164.9	555.7
0.28	1.3	2.9	5.0	7.7	11.1	15.5	21.2	28.4	37.6	49.4	180.9	632.6
0.29	1.3	3.0	5.1	7.9	11.4	16.1	22.0	29.7	39.6	52.3	198.3	720.0
0.30	1.3	3.0	5.2	8.0	11.8	16.6	22.9	31.0	41.6	55.4	217.5	819.2
0.35	1.4	3.2	5.6	9.0	13.4	19.5	27.7	38.7	53.6	73.7	343.9	1555.5
0.40	1.4	3.4	6.1	9.9	15.3	22.9	33.4	48.2	68.8	97.7	541.0	2924.9
0.45	1.5	3.6	6.6	11.0	17.4	26.7	40.2	59.7	88.1	129.2	845.3	5435.7
0.50	1.5	3.8	7.1	12.2	19.8	31.2	48.3	73.9	112.3	170.0	1310.7	9972.8
0.55	1.6	4.0	7.7	13.4	22.4	36.3	57.8	91.1	142.7	222.8	2015.3	18052.4
0.60	1.6	4.2	8.3	14.8	25.3	42.1	68.9	111.9	180.6	290.5	3071.8	32235.4
0.65	1.7	4.4	8.9	16.3	28.5	48.7	82.0	136.9	227.6	377.1	4640.8	56784.5
0.70	1.7	4.6	9.5	17.9	32.1	56.2	97.2	167.0	285.6	487.2	6949.2	98700.3
0.75	1.8	4.8	10.2	19.6	36.0	64.7	115.0	202.9	356.9	626.2	10314.5	169329.2
0.80	1.8	5.0	10.9	21.4	40.3	74.3	135.5	245.7	444.1	801.1	15177.7	286833.1
0.85	1.9	5.3	11.6	23.3	45.0	85.1	159.2	296.4	550.3	1019.9	22145.5	479938.3
0.90	1.9	5.5	12.4	25.4	50.2	97.2	186.6	356.4	679.1	1292.2	32046.9	793564.0
0.95	2.0	5.8	13.2	27.6	55.8	110.8	218.0	427.1	834.7	1629.7	46005.6	1297186.9
1.00	2.0	6.0	14.0	30.0	62.0	126.0	254.0	510.0	1022.0	2046.0	65534.0	2097150.0

Note: % r = rate of earning growth

## N O T E S

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