

A Study on Wealth Creation (1998-2003)

The Eighth Annual Study

Top-10 Wealth Creators (1998-2003)

The fastest

RANK	COMPANY	ADJUSTED MKT. CAP. CAGR (%)	APPRE- CIATION (X)
1	e-Serve International	119	50
2	Matrix Laboratories	96	29
3	Amtek Auto	76	17
4	Mastek	68	13
5	Moser Baer (India)	67	13
6	Sterling Biotech	63	11
7	Hinduja TMT	61	11
8	Infosys Technologies	55	9
9	Aurobindo Pharma	54	9
10	Wipro	52	8

The biggest

RANK	COMPANY	WEALTH CREATED (RS B)	APPRE- CIATION (X)
1	Wipro	244.71	8
2	Infosys Technologies	235.36	9
3	Oil & Natural Gas Corpn	110.51	1
4	Reliance Industries	103.77	2
5	Ranbaxy Laboratories	78.40	3
6	ICICI Bank	62.44	3
7	Dr Reddy's Laboratories	59.33	4
8	HDFC	42.02	2
9	Satyam Computer Services	41.60	7
10	HDFC Bank	41.52	3

Highlights

- ✍ High corporate earnings growth, low interest rates, and depressed valuations in general, set the perfect backdrop for the creation of several *multibaggers*.
- ✍ *Multibaggers* could be of two types: *transitory* and *enduring*. *Transitory multibaggers* are created by the combination of cyclical nature of business and questionable quality of management.
- ✍ Only good quality managements can deliver *enduring multibaggers*.
- ✍ Market folly contributes enormously to the creation of mega *multibaggers*.
- ✍ A wide 'margin of safety' at the time of purchase is non-negotiable for the creation of *multibaggers*.

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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. The lower the market value than the intrinsic value, the higher is the margin of safety. In this year's study, we continue our endeavor to cull out 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 stock, the first step is to see how money has been most successfully made in the past."* Our Wealth Creation studies are attempts to study the past as a guide to the future and gain insights into How to Value a Business.

Concept

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

Methodology

For the purposes of our study*, we have identified companies that have the distinction of having added at least Rs1b to their market capitalization after adjusting for dilution during 1998-2003. Only 83 companies fulfill this criterion. We have termed the group of Wealth Creators as the 'MOST-Inquire 83'. The Wealth Creators have been listed in Appendix I and II. Ranks have been accorded on the basis of Speed of Wealth Creation, that is, the compounded growth in Wealth Created during the period under study.

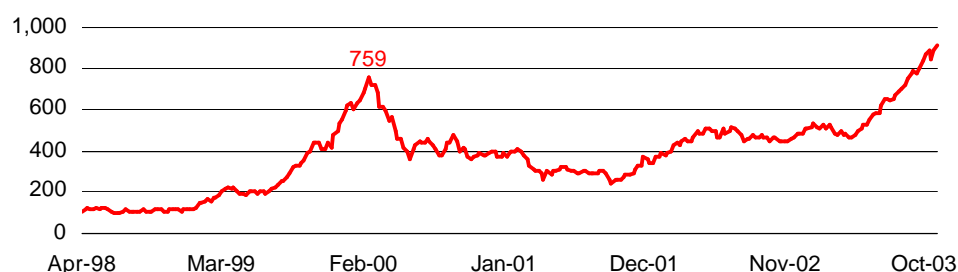
* *Capitaline Olé and Trends databases have been used for this study*

The Wealth Creator Group vs BSE Sensex

This study pertains to the period from April 1998 to March 2003. During this period, the BSE Sensex contracted at a CAGR of 4.8% while the Wealth Creators' Index appreciated at a CAGR of 35.5%. The chart below depicts the relative performance of the 'MOST-Inquire 83' vs. the BSE Sensex during the period under review. Despite having fallen by 37% from the peak in March 2000, the Wealth Creators' Index outperformed the Sensex by 380% during the period of study.

WEALTH CREATORS' INDEX (31.3.98 TO 31.3.03)

Performance in absolute terms



Performance relative to Sensex



GROWTH: SENSEX vs WEALTH CREATORS

	MAR-98	MAR-99	MAR-00	MAR-01	MAR-02	MAR-03
BSE Sensex	3,892.75	3,739.96	5,001.28	3,604.38	3,469.35	3,048.72
YoY Growth (%)	-	-3.9	33.7	-27.9	-3.7	-12.1
Wealth Creators' Index	103.94	216.0	594.5	298.44	442.7	474.7
YoY Growth (%)	-	107.8	175.3	-49.8	48.3	7.2
5-Year CAGR (%) Sensex						-4.8
5-Year CAGR (%) Wealth Creators						35.5

The market capitalization of 'MOST-Inquire 83' increased by Rs1.3t during the period of study while the market capitalization for the rest of the market eroded by Rs1.1t. The net wealth created during the period was Rs300b.

The Wealth Creators' Index had plummeted by 49.8% YoY in March 2001, which is roughly double the Sensex degrowth of 27.9%, mainly because of the Rs950b wealth erosion in Wipro.

Wealth Creators ~ Business Analysis

Nature of business

The trio - IT, Pharma and Banks - dominate the list of Wealth Creators. Combined, these sectors have contributed 70% to the Wealth Created in the 1998-2003 study, as compared to 73% in the 1997-2002 study. The share of the Oil & Gas sector to the total Wealth Created has increased from 5.9% in last year's study to 9.2% in the current study. The fastest Wealth Creator has been the IT sector, comprising of 12 companies, creating Wealth at 53% CAGR during the period of study.

WEALTH CREATORS: CLASSIFICATION BY INDUSTRY (RS B)

INDUSTRY	NET WEALTH CREATED	SPEED CAGR (%) 1998-03	NO OF COS.	CONTR. TO WEALTH CREATED (%)	ROCE 1998 (%)	ROCE 2003 (%)	CAGR (%) 1998-03	
							NP	SALES
IT	571.13	53.2	12	42.5	21.0	25.3	62.7	35.1
Pharma	206.14	29.7	11	15.4	20.7	29.9	30.4	25.1
Banks	158.68	30.2	7	11.8	*17.2	*18.4	33.8	36.3
Oil & Gas	123.75	4.9	4	9.2	24.7	75.2	29.6	25.5
Petrochemicals	112.2	17.5	4	8.4	13.6	14.2	18.3	31.7
Engineering	29.85	16.3	8	2.2	11.5	24.6	77.9	9.6
Auto	29.57	17.5	3	2.2	12.5	44.6	49.5	20.8
FMCG	24.69	6.1	4	1.8	23.2	42.2	19.7	9.7
Metals	22.3	6.3	4	1.7	14.1	22.9	2.2	7
Auto Ancillaries	18.92	23.2	7	1.4	17.4	24.9	21.1	10.2
Cement	12.39	4.9	4	0.9	11.4	12	12.7	7.6
Chemicals	11.77	10.5	5	0.9	20.0	14.6	-3.2	10.1
Others	4.73	20.2	4	0.4	3.5	5.4	-4.2	2.1
Utilities	4.07	1.4	1	0.3	13.0	25.7	33.5	12.7
Textiles	3.84	9.1	1	0.3	3.7	20.3	-207.4	6.9
Consumer Durables	3.33	29	2	0.2	15.5	29.6	20.6	10.1
Shipping	2.99	4.8	1	0.2	13.5	16.6	-0.4	2.9
Healthcare	1.93	53.6	1	0.1	17.0	17.2	26.3	40.3
Total	1,342.27	17.9	83	100.0	17.2	30.1	26.9	21.8

* RoE instead of RoCE

SECTORAL REPRESENTATION: USA VS INDIA (RS B)

SECTOR	USA		INDIA		△
	MKT CAP	%	MKT CAP	%	
Financials	21,292.87	21	1,431.61	12	8.54
Information Technology	18,724.14	18	1,354.59	11	6.71
Healthcare	13,821.97	13	819.75	7	6.46
Consumer Staple	11,228.25	11	636.35	5	5.49
Industrials	11,306.05	11	837.00	7	3.89
Utilities	2,918.83	3	166.71	1	1.42
Telecom Services	3,674.12	4	355.62	3	0.56
Consumer Discretionary	11,614.99	11	1,576.21	13	-2.00
Materials	3,162.18	3	1,640.05	14	-10.67
Energy	6,063.99	6	3,136.25	26	-20.39
Grand Total	103,807.38	100.0	11,954.14	100.0	

Under-represented in India
 Over-represented in India (as at end-December 2003)

Conclusions

- ✍ The Oil & Gas sector has the highest representation in the Indian markets. The monopolistic hold of the government is probably the key to sustained high profitability.
- ✍ The Financial sector is still the most under-represented in the Indian stock markets despite its strong performance in FY03.
- ✍ Healthcare, Industrials and Utilities have room to grow in India.
- ✍ The share of Telecom appears low in the US as well as in India.

Management: MNC vs Indian

The number of MNCs figuring as Wealth Creators has declined from a high of 50% in the 1993-1998 study to a low of 12% in the current study. The homegrown IT and Pharma companies have displaced the MNCs as a major Wealth Creating class. With the recent wave of delisting by several MNC subsidiaries operating in India, the question is, "Will MNC stocks attract investor fancy again?"

WEALTH CREATORS: MNCs vs INDIAN COMPANIES

WEALTH CREATION STUDY	NO OF COMPANIES			% WEALTH CREATED	
	MNCs	TOTAL	MNCs % OF TOTAL	MNCs	OTHERS
1998-03	10	83	12.0	3.1	96.9
1997-02	16	85	18.8	22.8	77.2
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

Speed vs size

The speed of Wealth Creation is correlated to the size of market capitalization. Thus, if one wants speed in Wealth Creation, then it is imperative to buy companies with modest market capitalization and whose businesses have the potential to create value for shareholders on a consistent basis. The mean size of the Wealth Creators in FY98 and the pace at which Wealth has been Created are Rs14.3b and 25% CAGR, respectively. Wipro, the biggest Wealth Creator, had Rs34.4b as its market capitalization. Bigger size requires bigger incremental investment opportunities, which are few and difficult to harness.

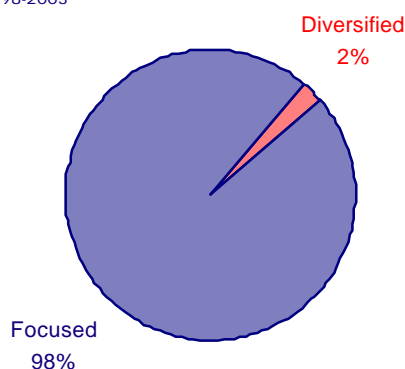
WEALTH CREATORS: CLASSIFICATION BY MARKET CAPITALIZATION			(RS B)
MARKET CAPITALIZATION	MEAN SIZE	NO. OF COS	MEAN SPEED (%)
>= 10	48.33	22	22
5 < 10	7.12	6	6
2.5 < 5	3.66	8	8
< 2.5	1.05	47	47
All Companies	14.27	83	25

Business activity

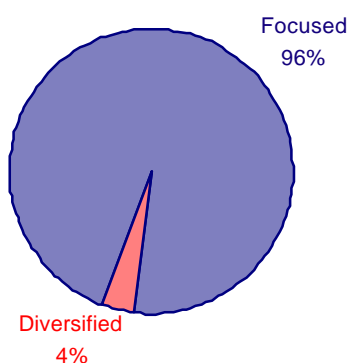
A common feature across all the Wealth Creation Studies, including the current one, is that companies, which have consistently created Wealth for their shareholders, have adopted an extremely focused business policy. The current study also displays a similar trend, as 98% of the Wealth Created was by companies that adopted a focused business approach as compared to 96% in last year's study. Thus, while focus may not be a sufficient condition, it is a necessary condition.

WEALTH CREATORS: CLASSIFICATION BY BUSINESS ACTIVITY

1998-2003



1997-2002



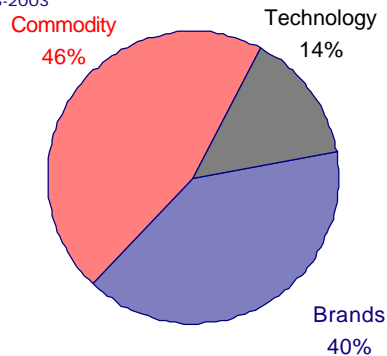
Product attribute

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, 54% of the Wealth Creating companies have one of these attributes as the differentiating factor.

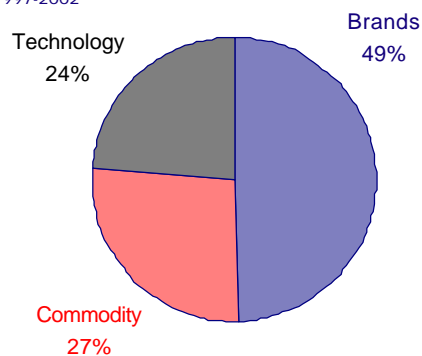
We also observe that the share of commodity companies has been increasing from 14% in the 1994-1999 study, to 17% in the 1995-2000 study, to 21% in the 1996-2001 study, to 27% in the 1997-2002 study and to 46% in the current study. The share of commodity companies in the current study has been the highest of all studies.

WEALTH CREATORS: CLASSIFICATION BY PRODUCT ATTRIBUTE

1998-2003



1997-2002



WEALTH CREATION STUDY	BRANDS (%)	COMMODITY (%)	TECHNOLOGY (%)
1998-03	40	46	14
1997-02	49	26	24
1996-01	57	22	21
1995-00	47	17	36
1994-99	27	14	59
1993-98	26	24	50
1992-97	43	4	53
1991-96	27	20	53

1998-03	WEALTH CREATED (RS B)	WEALTH CREATED (%)
Brands	433.43	32.3
Commodity	337.72	25.2
Technology	571.13	42.6
Total	1,342.27	100.0

Capital allocation

The change in the value of a company is strongly influenced by the superior rate at which capital has been deployed.

The large capital input in Reliance Industries stands out. The future productivity of capital would decide the value of the company.

The remarkable change in ONGC's RoCE has not led to a corresponding change in the market price, probably because the market is unwilling to discount the dramatic change in financials in the recent past.

WEALTH CREATORS: CLASSIFICATION BY CAPITAL ALLOCATION (RS B)

	△ CE	ROCE (%)		MARKET CAP.		△ M.CAP/	
		2003	1998	MAR-98	MAR-03	△ M.CAP	△ CE
Ranbaxy Laboratories	0.92	39	17	38.04	115.81	77.77	84.12
Wipro	27.71	28	23	34.44	285.65	251.21	9.07
Infosys Technologies	26.88	42	40	29.28	267.63	238.35	8.87
Dr Reddys Laboratories	14.34	25	16	10.81	70.15	59.33	4.14
HDFC Bank	19.60	17	22	14.29	65.93	51.64	2.64
Satyam Computer Services	19.30	17	18	6.40	55.66	49.26	2.55
Oil & Natural Gas Corpn	49.01	95	26	396.84	507.35	110.51	2.25
ICICI Bank	66.67	17	19	7.56	82.12	74.56	1.12
Reliance Industries	301.26	14	15	165.18	386.03	220.85	0.73
HDFC	163.70	23	17	37.87	81.07	43.21	0.26

WEALTH CREATION STUDY	2003 ROCE > 1998 ROCE NO. OF COMPANIES	% WEALTH CREATED
1998-2003	58/83	77
1997-2002	55/85	84
1996-2001	41/71	91
1995-2000	50/100	65
1994-1999	65/100	56

In all our Wealth Creation Studies, we have observed that better capital allocation has been consistently rewarded.

Wealth Creation Process of Growing Companies

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

WEALTH CREATORS: CLASSIFICATION BY EARNINGS GROWTH (RS B)

EARNINGS GROWTH	NO OF COMPANIES	CONSTITUENT (%)	WEALTH CREATED	% OF WEALTH CREATED
>25	48	58	1,051.16	78
20-25	7	8	19.72	1
15-20	10	12	215.64	16
<15	18	22	55.75	4
Total	83		1,342.27	100

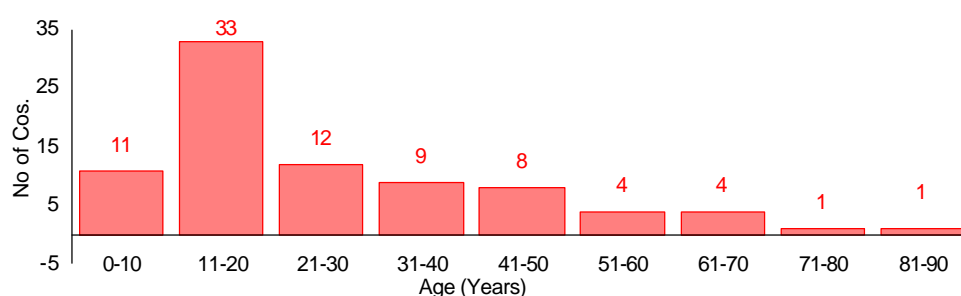
But again, companies that fulfill the earnings growth criteria, need not always be successful in Creating Wealth. Earnings growth is a necessary condition for Wealth Creating companies, but not a sufficient one.

Age analysis of wealth creators

Wipro, belonging to the 51-60 age group, and Infosys, belonging to the 21-30 group, have contributed 15% each, to the total Wealth Created. Barring these two exceptions, we observe that most of the Wealth (59%) has been Created by companies that are less than 30 years old. The maximum Wealth (35%) has been created by companies in the 11-20 years age group. The maximum number of companies also exists in the 11-20 years group. We can infer from this that most of the Wealth has been Created by relatively young companies.

WEALTH CREATORS: CLASSIFICATION BY AGE-GROUP (RS B)

NO. OF YEARS	NO. OF COS.	WEALTH CREATED	% WEALTH CREATED
0-10	11	283.33	21.1
11-20	33	472.67	35.2
21-30	12	37.68	2.8
31-40	9	210.42	15.7
41-50	8	37.36	2.8
51-60	4	257.54	19.2
61-70	4	37.15	2.8
71-80	1	4.25	0.3
81-90	1	1.87	0.1
Total	83	1,342.27	100.0



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.

WEALTH CREATORS: NEW ECONOMY vs OLD ECONOMY

	1998-2003		1995-2000	
	OLD	NEW	OLD	NEW
Number of Wealth Creators	71	12	62	38
5-year Earnings CAGR (%)	25	64	22	39
5-year Market Cap CAGR (%)	13	53	28	99
P/E (x) at the beginning of study period	13	35	18	20
P/E (x) at the end of study period	7	25	23	122

- ✍ Earnings of New Economy companies have grown at a CAGR of 64% as compared to 25% for Old Economy companies.
- ✍ The P/E multiple of both New and Old Economy stocks has contracted during the study period. It declined from 13x in 1998 to 7x in 2003 for Old Economy stocks and from 35x in 1998 to 25x in 2003 for New Economy stocks.
- ✍ The CAGR in market capitalization for New Economy companies has been 53% compared to 13% for Old Economy companies during the study period.
- ✍ Old Economy companies have generated 57% of the total wealth as against 43% generated by New Economy companies.

Importance of Multibaggers in the Portfolio

“ To achieve satisfactory investment results is easier than most people realize; to achieve superior results is harder than it looks.”

- Benjamin Graham

Why chase multibaggers?

Multibaggers are super stocks that multiply in value over a period of time. Investment in such companies can change the overall performance of the portfolio, which can, thus, generate superior returns as compared to the average returns from the market.

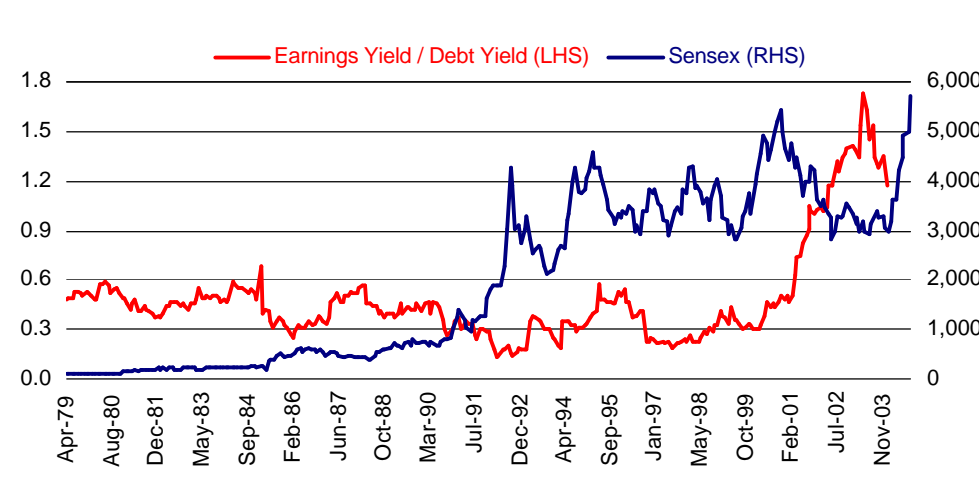
Conditions ideal for the sprouting of multibaggers

Every period is not conducive for a multi-fold increase in stock prices. Unless there are 25-30 *multibaggers* of reasonable size spread across various sectors, it is quite likely that the common investor would miss an opportunity to participate in them. We have looked at the bi-annual data of all companies since 1990 and have compiled a list of triplers with at least Rs1b of net wealth created in two years. Our findings are as under:

YEARS	NO. OF COS.	EARNINGS YIELD (%)	G-SEC YIELD (%)	EARNINGS/ G-SEC YIELD (X)
90-92	118	4.80	12.00	0.40
91-93	20	3.81	12.00	0.32
92-94	3	1.44	11.00	0.13
93-95	67	4.52	12.75	0.35
94-96	7	4.40	12.50	0.35
95-97	2	5.10	12.35	0.41
96-98	13	6.60	14.00	0.47
97-99	38	3.06	13.65	0.22
98-00	115	2.86	12.15	0.24
99-01	17	4.14	12.25	0.34
00-02	10	3.49	10.85	0.32
01-03	20	6.11	9.80	0.62
02-04 *	428	7.72	7.40	1.04
03-05 #	734	9.41	6.15	1.53

* April 2002 - December 2003; # April 2003 - December 2003

EARNINGS YIELD/DEBT YIELD VS SENSEX



There is a clear indication that something is different in 2002-04 as compared to 1998-2000 and 1990-92. The difference, in our view, is as under:

1. Drop in interest rates from 12% to 6%

The value of any financial asset is determined relative to the risk-free rate of return, which has fallen consistently during the study period. The gap between the earnings yield and debt yield has increased significantly. It was at a historical high in March 2003, when earnings yield to debt yield stood at 1.53. The earnings yield to debt yield was at its worst at 0.13, when the Sensex P/E was 70x in 1992. The market rally in 1998-2000 was sector specific and non-technology stocks did not participate. Technology stocks had limited weightage in the Sensex, and the rally could not sustain at an earnings yield to debt yield of 0.32.

2. Acceleration in corporate earnings

Drop in the interest cost has led to an increase in corporate profits. In FY03, corporate profits went up by 44% even though sales growth was just 11%, because of significantly lower interest cost.

3. Severe market depreciation in FY03

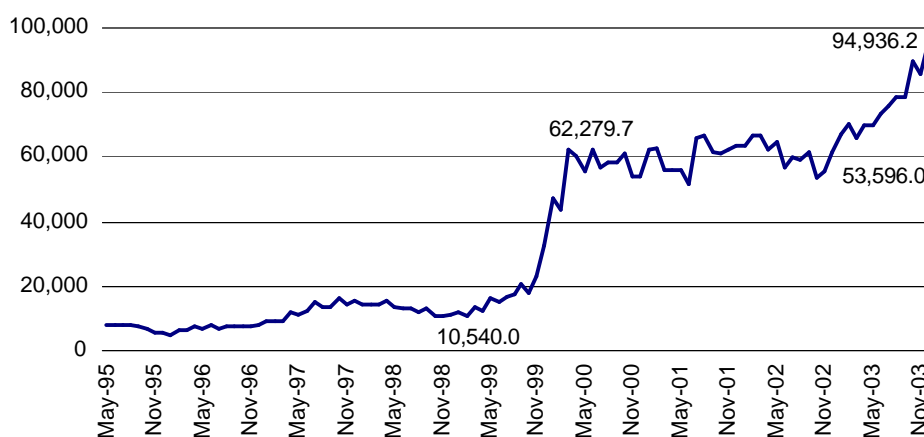
Though the relative attractiveness (read value) of equities improved in FY03, investors stayed away from the stock market. They decided to put their money in bonds because bond prices were going up whereas stock prices were falling. Now that the bond rally is arguably over, investors will flock back to stocks.

Types of multibaggers

Enduring multibaggers

Enduring multibaggers are those companies, whose wealth creation is long lasting. In such stocks, the correction from the peak valuation is limited. In fact, they continue to exist as *multibaggers* even after the correction. *Enduring multibaggers* like Infosys, Wipro, HDFC Bank, Dr Reddy's, Hero Honda and Cipla are typically few and difficult to spot. They appear to be expensive at the time of buying because of the lack of faith in the longevity and magnitude of growth.

HDFC BANK: AN ENDURING MULTIBAGGER (RS M)

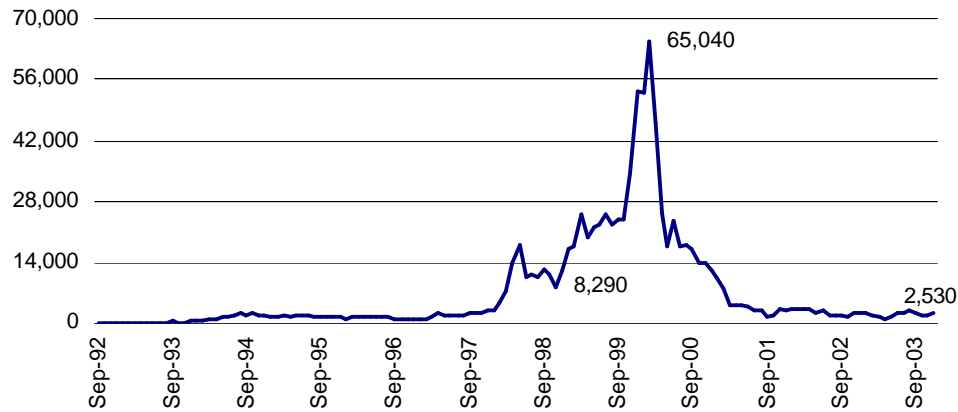


Transitory multibaggers

These are easier to spot, and they attract a lot of crowd and media attention, but they always give nasty end-results. Although there is much hype around such companies, their financials do not support their value or worth at the peak. They succumb to sudden collapse in their earnings and are associated with fluctuating and low RoE and RoCE.

They have unimpressive track records and the correction, post the multiplication in such stocks, is typically almost 100%. Cyclical and fad companies broadly fit into this category. The tragedy with this class of companies is that if you cannot sell in time, you are left with no gains, and most often, with a permanent capital loss.

PENTAMEDIA: A TRANSITORY MULTIBAGGER (RS M)



We took a close look at the 115 stocks that had more than trebled during the period 1998-2000. We assumed that the purchase was made on 1 April 1998 and the sale on 31 December 2003. The results were hardly surprising; most of these stocks turned out to be *transitory multibaggers*. They ended up destroying as much wealth in their journey downwards as they had created during their journey upwards.

TOP 10 TRANSITORY MULTIBAGGERS

COMPANY	NET WEALTH CREATED (RS M)
Pentamedia Graphics	-12,383.5
NIIT	-10,507.8
Silverline Technologies	-10,089.9
Pentasoft Technologies	-9,112.4
Trigyn Technologies	-7,636.8
SSI	-4,932.1
DSQ Software	-3,793.8
Himachal Futuristic Communications	-3,180.5
Morepen Laboratories	-2,539.1
Vikas Wsp	-1,706.9

TOP 10 ENDURING MULTIBAGGERS

COMPANY	NET WEALTH CREATED (RS M)
Wipro	363,224.9
Infosys Technologies	337,387.4
ICICI Bank	162,213.7
Satyam Computer Services	101,967.8
HDFC Bank	79,684.3
Cipla	66,072.0
Sun Pharmaceuticals Industries	52,086.6
Moser Baer (India)	28,016.0
Zee Telefilms	23,872.5
Nirma	22,267.5

What is the winning strategy?

Mr Warren Buffet says:

"Stocks are simple. All you do is buy shares in a great business for less than the business is intrinsically worth, with managers of the highest integrity and ability. Then you own those shares forever."

With this idea in mind, we decided to look at the following three parameters:

- (1) Business
- (2) Management
- (3) Price/Value

(1) Business

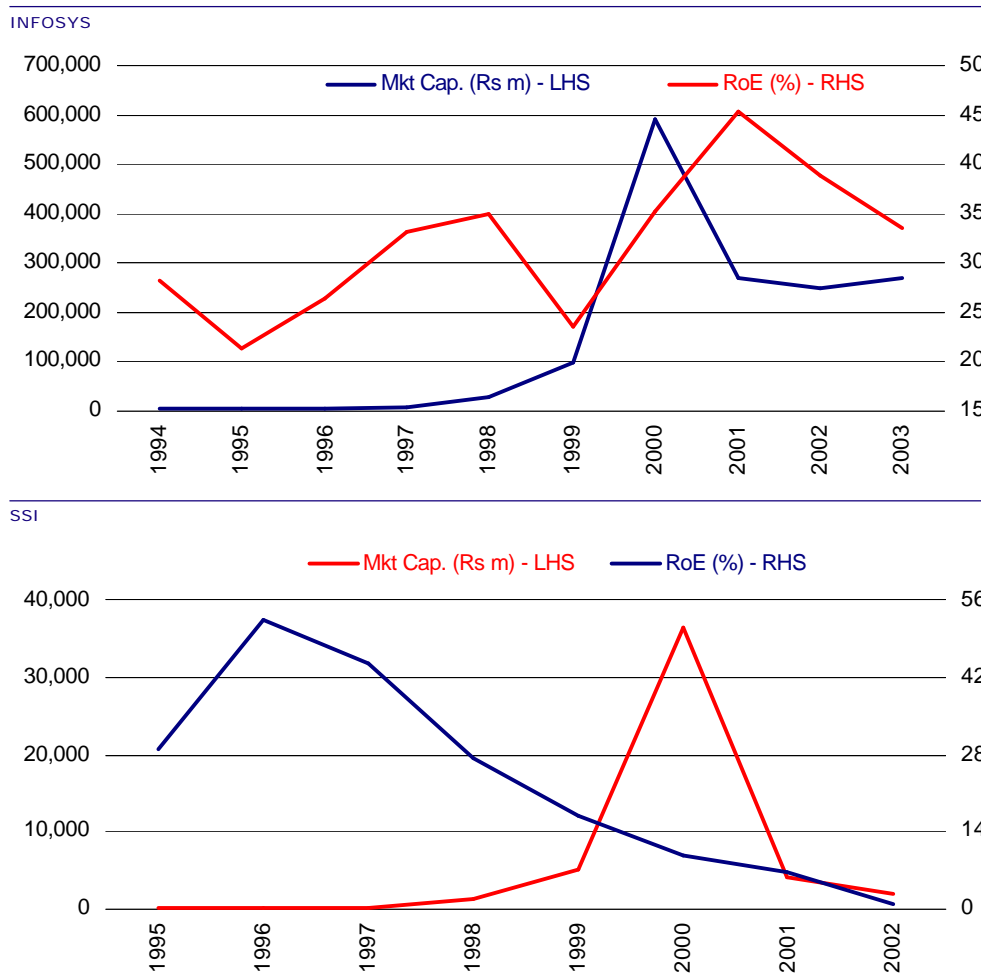
Improvement in business conditions leads to a change in the earnings trend. That is typically the starting point of the dismantling of pessimism on a stock. We find that positive change in business conditions is a must for the creation of a multibagger. The improvement in business conditions can be temporary or permanent. For instance, the opportunity for private sector Banks is long lasting and permanent in nature. The opportunities in Pharma, IT Services, Auto Ancillary and Consumer Non-Durables also appear to be long lasting. However, the change in the fortunes of cyclicals due to the uptrend in prices of steel, cement, shipping freight rates, etc. is transitory in nature.

(2) Management

Management plays a major role in the creation of enduring multibaggers. As CSFB's Michael Mauboussin says, management can be adjudged on the following three characteristics:

- (i) Leadership
- (ii) Driving Factor
- (iii) Allocation of Capital

Since the first two characteristics are more qualitative in nature, we have examined below how Infosys and SSI have done on the capital allocation front.



The above charts show that while SSI could not manage capital well, Infosys' superior and sustained capital productivity allowed it to make a come back.

In our study, we have observed that in businesses like Banking and Pharma, the importance of management is clearly visible. As can be observed in the table below, during the period 1998-2003, the difference in management quality has stood out clearly in case of private sector banks.

ROLE OF MANAGEMENT QUALITY: PRIVATE SECTOR BANKS

COMPANY	NET WORTH GROWTH	MCAP GROWTH
HDFC Bank	687%	361%
Global Trust Bank	-99%	-73%
Bank of Punjab	59%	-2%

In cyclical businesses, management efficiency is even more critical. Every business cycle brings different challenges. Allocating capital during a downturn requires a lot of conviction because it is against popular opinion. Similarly, only managements with deep insight are able to resist huge build-up of capacity at the peak of the cycle. Hence, the contribution of good management cannot be undermined in cyclical businesses, too.

ROLE OF MANAGEMENT QUALITY: CYCLICALS

COMPANY	NET WORTH GROWTH	MCAP GROWTH
Tata Iron & Steel Co.	-22%	-10%
Steel Authority of India	-70%	-12%

While a weak management would at most lead to transitory gains during an upturn, a strong management can shine only if business performance helps. Mr Warren Buffet says, "With a few exceptions, when management with a reputation for brilliance tackles a business with a reputation for poor fundamentals, it is the reputation of the business that remains intact."

For the creation of enduring multibaggers, the combination of a good business and a good management is necessary. In cyclical, despite the fact that poor business conditions are temporary in nature, the best results over a long period of time are achieved when the best management leads the company. Therefore, in our quest for enduring multibaggers, we must look for improvement in business environment combined with good management. When a weak management makes way for a strong management in a good business, it could lead to the emergence of a potential enduring multibagger.

(3) Price/Value

"Have the purchase price be so attractive that even a mediocre sale gives attractive returns."

- Warren Buffet

"When the gap between perception and reality is the maximum, price is the best."

One factor, which is absolutely non-negotiable in the creation of a *multibagger*, is gross under-valuation or a 'huge margin of safety' at the time of purchase. To understand under-valuation, a clear understanding of how to value a business is of paramount importance. While Price/Sales, Price/Book, and Price/Earnings are important guides to approximate values, Mr Benjamin Graham suggests, *"Value of the enterprise to a private buyer because investing is most intelligent when it's business like."*

We refer to a study conducted by Tweedy Brown and Co., entitled, "What has worked in investing". Some of the pointers to undervalued stocks are one or more of the following:

1. Low price in relation to asset value
2. Low price in relation to earnings and cash flows
3. Sustained purchase by insiders
4. A significant decline in stock prices
5. Small market capitalization with growth

We have examined how this measures up in the Indian context and note that the findings are just as relevant in India.

STOCKS WITH LOW P/B & P/E YIELD SUPERIOR RETURNS

QUARTILE	P/B (X)	CAGR (%)	VALUE OF RE.1 INVESTED ON 01/04/93 AT 31/03/03	SENSEX CAGR (%)	VALUE OF RE.1 INVESTED IN SENSEX
1	0.17	0.14	1.01	-4.80	0.78
2	0.35	-4.81	0.78	-4.80	0.78
3	0.61	-4.88	0.78	-4.80	0.78
4	2.68	-6.73	0.71	-4.80	0.78

QUARTILE	P/E (X)	CAGR (%)	VALUE OF RE.1 INVESTED ON 01/04/98 AT 31/03/03	SENSEX CAGR (%)	VALUE OF RE.1 INVESTED IN SENSEX
1	1.80	0.79	1.04	-4.80	0.78
2	3.68	-5.38	0.76	-4.80	0.78
3	7.08	-4.16	0.81	-4.80	0.78
4	43.93	-7.90	0.66	-4.80	0.78

Why low Price/Book and Price/Earnings works

Superior returns are generated because:

1. The reinvested earnings are substantial in relation to the price paid.
2. The bull market is typically very generous to low-priced issues and raises the typical bargain issue to at least a reasonable level.
3. There could be chances of smaller companies being taken over by larger ones.

When to get high margin of safety

We realize that the best time you could get a huge 'margin of safety' is when:

- ✍ Business conditions are unfavorable
- ✍ The near term prospects look poor
- ✍ Low price of the stock in particular and the stock markets in general, reflect the current pessimism

One good opportunity to buy is when a large company's performance has been hit since the pessimism is fully reflected in the price. These companies tend to improve over a period of time.

TO SUM UP...						
	BUSINESS		MANAGEMENT		PRICE	
	GOOD	BAD	GOOD	BAD	OVER	UNDER
Enduring	+	-	+	-	-	+
Transitory	+	-	+	+	-	+

1. A bad business will never create an *enduring multibagger*. It could at most create *transitory multibaggers* during short phases of goodness.
2. The combination of a bad management with a good business could create *transitory multibaggers*.
3. Overpriced stocks have no chance of becoming *multibaggers*.
4. Great businesses run by good managements purchased at huge 'margin of safety' will create *enduring multibaggers*.

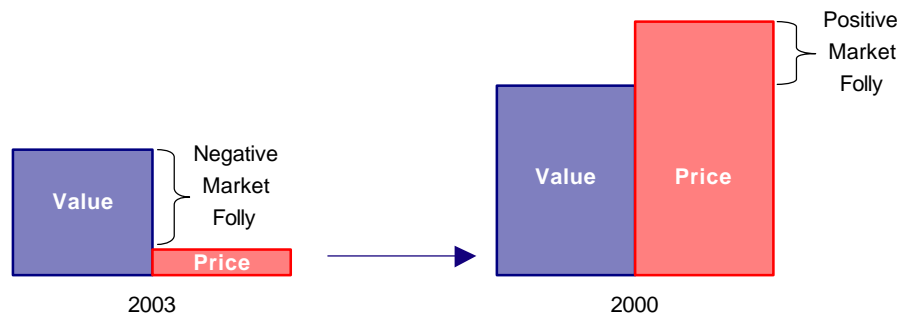
Role of Market Folly in Enhancing Returns

"Whether you achieve outstanding results will depend on the effort and intellect you apply to your investments, as well as on the amplitudes of the stock market folly that prevail during your investment career."

-Warren Buffet

Market folly is helpful on both the ends of the investing activity, viz. while buying as well as selling. The boom of 2000 and the bust of 2003 demonstrate the amplitude of market folly.

MARKET FOLLY: THE TWO EXTREMES



SENSEX P/E



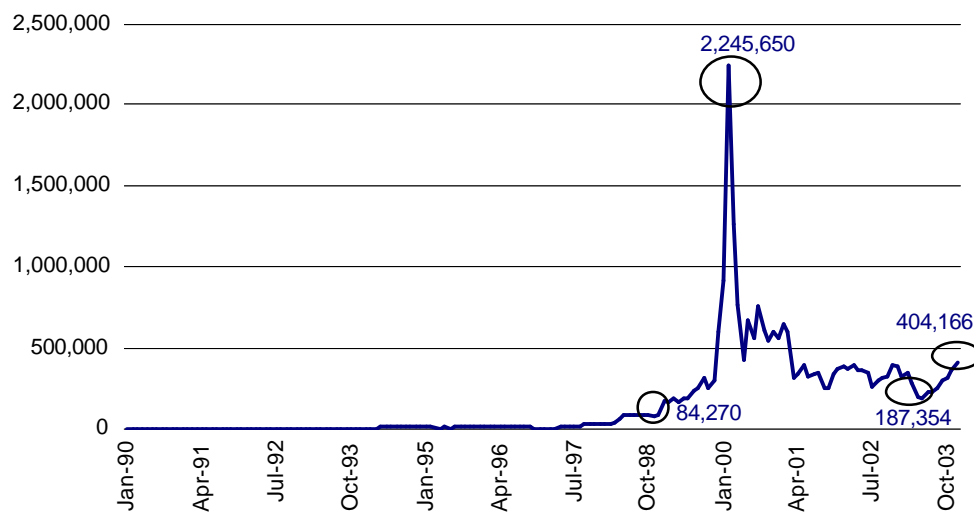
Sensex - 5,229 as on 08/12/03

At the level of 4,500 in 1992, the Sensex P/E was 70x. In March 2003, the Sensex P/E was below 10x despite the risk-free return having fallen to 6% from 12% in 1998.

THE EXTENT OF MARKET FOLLY

YEAR	P/E (X)	INTEREST RATE (%)
1992	69.53	11.00
1998	35.00	12.15
2000	28.67	10.85
2003	10.63	6.15

WIPRO: MARKET FOLLY DROVE MARKET CAP TO CRAZY HEIGHTS (RS M)



Till 1997, Wipro's market capitalization was well below Rs10b and in February 2000, it touched over Rs2t. Currently, it stands at Rs400b. While this illustrates how market folly can enhance returns disproportionately, getting out at the peak is no mean feat.

"Market folly contributes enormously to the creation of mega multibaggers."

'MOST-Inquire 83' ~ Wealth Creators

Appendix I

SR. NO.	COMPANY NAME	ROE (%)		MARKET CAP (RS B)		Δ CE	Δ MCAP/ Δ CE	WEALTH CREATED	
		1998	2003	1998	2003			RS B	%
1	Alfa-Laval (India)	3	13	2.0	4.3	28	8.0	2.3	0.2
2	Amtek Auto	16	3	0.1	3.0	206	1.4	2.2	0.2
3	Apollo Hospitals Enterprise	13	11	0.4	3.7	270	1.2	1.9	0.1
4	Apollo Tyres	15	7	2.4	4.5	141	1.4	1.4	0.1
5	Asahi India Glass	13	5	1.4	2.6	312	0.4	1.2	0.1
6	Ashok Leyland	2	7	4.9	11.6	-669	-1.0	8.3	0.6
7	Asian Paints (India)	26	14	12.5	21.2	127	6.8	8.7	0.6
8	Associated Cement Companies	1	7	19.9	23.7	97	3.9	2.0	0.1
9	Atlas Copco (India)	15	9	1.6	3.1	70	2.2	1.4	0.1
10	Aurobindo Pharma	34	3	0.5	4.9	918	0.5	3.6	0.3
11	Bharat Electronics	13	10	2.2	14.4	435	2.8	12.2	0.9
12	Bharat Forge	9	8	2.9	9.1	-308	-2.0	8.4	0.6
13	Bharat Petroleum Corporation	21	4	57.2	66.6	4,045	0.2	9.4	0.7
14	Blue Dart Express	-8	16	0.2	1.3	29	3.8	1.0	0.1
15	Blue Star	16	19	0.6	1.5	-33	-2.8	1.0	0.1
16	Britannia Industries	24	5	8.7	13.0	326	1.3	4.3	0.3
17	Cipla	29	7	13.3	42.8	783	3.8	29.9	2.2
18	CMC	17	15	1.5	7.5	91	6.6	6.0	0.4
19	Dabur India	20	5	7.1	10.3	22	14.2	3.1	0.2
20	Digital Globalsoft	24	17	4.7	19.9	205	7.4	15.1	1.1
21	Dr Reddys Laboratories	14	3	10.8	70.1	1,434	4.1	59.3	4.4
22	Dredging Corporation of India	17	4	2.4	6.9	399	1.1	4.4	0.3
23	Eicher Motors	8	22	0.3	1.4	45	2.5	1.1	0.1
24	Electrosteel Castings	31	3	1.1	3.5	408	0.6	2.4	0.2
25	Engineers India	16	9	10.6	13.8	290	1.1	3.2	0.2
26	e-Serve International	-10	59	0.1	5.6	42	13.2	5.5	0.4
27	FDC	16	7	0.8	2.6	81	2.2	1.9	0.1
28	Finolex Industries	-3	25	1.3	4.3	-36	-8.3	3.6	0.3
29	Grasim Industries	10	2	22.7	30.3	605	1.3	5.6	0.4
30	Gujarat Ambuja Cements	13	5	20.1	24.8	1,321	0.4	3.7	0.3
31	Gujarat Gas Company	24	5	2.7	4.9	94	2.3	2.2	0.2
32	HDFC Bank	22	17	14.3	65.9	1,960	2.6	41.5	3.1
33	Hero Honda Motors	37	5	17.4	37.6	700	2.9	20.2	1.5
34	Hinduja TMT	5	11	0.3	5.5	239	2.2	5.1	0.4
35	Hindustan Inks & Resins	22	2	0.4	3.3	547	0.5	2.1	0.2
36	HDFC	17	1	37.9	81.1	16,370	0.3	42.0	3.1
37	IBP	11	5	2.6	4.3	-279	-0.6	1.7	0.1
38	ICICI Bank	19	4	7.6	82.1	6,667	1.1	62.4	4.7
39	Indian Petrochemicals Corporation	8	4	17.4	21.0	-1,753	-0.2	3.6	0.3
40	Indo Rama Synthetics (India)	-18	12	2.4	3.6	-493	-0.3	3.8	0.3
41	Infosys Technologies	35	2	29.3	267.6	2,688	8.9	235.4	17.5
42	ING Vysya Bank	16	4	2.4	5.4	107	2.8	2.2	0.2

'MOST-Inquire 83' ~ Wealth Creators

Appendix I

SR. NO.	COMPANY NAME	ROE (%)		MARKET CAP (RS B)		Δ CE	Δ MCAP/ Δ CE	WEALTH CREATED	
		1998	2003	1998	2003			RS B	%
43	J B Chemicals & Pharamaceuticals	26	8	1.1	2.4	100	1.4	1.4	0.1
44	Jaiprakash Industries	2	8	1.6	4.9	284	1.1	2.8	0.2
45	Jindal Iron & Steel Company	6	3	1.8	3.2	-17	-8.2	1.4	0.1
46	Jindal Strips	11	1	1.9	2.7	-1,578	-0.1	2.0	0.1
47	Jubilant Organosys	28	2	0.9	2.2	215	0.6	1.2	0.1
48	Kalyani Brakes	14	11	0.6	2.2	32	4.9	1.6	0.1
49	Karur Vysya Bank	27	1	0.9	2.9	397	0.5	1.9	0.1
50	Kotak Mahindra Bank	7	5	1.0	9.4	-528	-1.6	7.1	0.5
51	LIC Housing Finance	21	1	3.4	4.9	4,878	0.0	1.6	0.1
52	Lupin	18	4	0.7	5.0	829	0.5	3.9	0.3
53	Maharashtra Seamless	12	17	0.5	4.0	145	2.4	3.4	0.3
54	Mastek	10	8	0.5	7.2	93	7.2	6.7	0.5
55	Matrix Laboratories	1	22	0.0	1.9	208	0.9	1.5	0.1
56	MIRC Electronics	16	2	0.5	2.5	59	3.3	2.3	0.2
57	Moser Baer (India)	27	3	0.3	11.2	2,207	0.5	6.0	0.4
58	Motherson Sumi Systems	21	9	0.4	1.8	88	1.5	1.4	0.1
59	MPhasis BFL	-392	2	1.0	11.3	956	1.1	2.2	0.2
60	National Aluminium Company	16	16	36.7	45.7	659	1.4	15.5	1.2
61	National Fertilizer	14	35	13.2	14.7	-387	-0.4	1.5	0.1
62	Navneet Publications (India)	22	19	0.7	2.0	137	0.9	1.3	0.1
63	Nestle India	29	31	42.9	51.6	-222	-3.9	8.7	0.6
64	Neyveli Lignite Corporation	7	36	41.3	44.2	2,785	0.1	4.1	0.3
65	Oil & Natural Gas Corpn	12	4	396.8	507.3	4,901	2.3	110.5	8.2
66	Pfizer	18	16	6.4	8.9	206	1.2	2.6	0.2
67	Pidilite Industries	26	9	2.3	5.5	156	2.0	3.3	0.2
68	Ranbaxy Laboratories	15	7	38.0	115.8	92	84.1	78.4	5.8
69	Rashtriya Chemicals & Fertilizers	15	45	4.3	7.1	263	1.1	2.8	0.2
70	Reliance Industries	18	2	165.2	386.0	30,126	0.7	103.8	7.7
71	Rolta India	20	14	1.4	3.3	477	0.4	1.8	0.1
72	Satyam Computer Services	19	3	6.4	55.7	1,930	2.6	41.6	3.1
73	Shipping Corporation of India	15	10	11.3	14.3	-129	-2.3	3.0	0.2
74	Shree Cement	4	7	0.6	1.6	90	1.1	1.1	0.1
75	Siemens	-119	12	6.6	9.4	-104	-2.7	2.1	0.2
76	State Trading Corporation of India	1	7	0.8	2.0	-580	-0.2	1.2	0.1
77	Sterling Biotech	10	4	0.3	2.9	402	0.7	2.1	0.2
78	Sun Pharmaceuticals Industries	25	10	3.7	25.2	417	5.2	22.1	1.6
79	Sundaram Clayton	9	13	2.0	3.5	41	3.7	1.5	0.1
80	Tata Elxsi	7	244	1.0	2.0	3	34.9	1.0	0.1
81	Tata Honeywell	14	7	0.6	2.1	68	2.2	1.5	0.1
82	Torrent Pharmaceuticals	22	9	1.8	3.3	-186	-0.8	1.5	0.1
83	Wipro	27	2	34.4	285.7	6,171	4.1	244.7	18.2

'MOST-Inquire 83' ~ Wealth Creators (Rankings)

Appendix II

RANK NO.	COMPANY NAME	P/E (X)		PAYBACK RATIO (X)	WEALTH CREATED		MCAP CAGR (%)
		1998	2003		RS B	%	
1	e-Serve International	-6.4	18.6	0.2	5.5	0.41	118.7
2	Matrix Laboratories	19.7	2.5	0.0	1.5	0.11	96.4
3	Amtek Auto	1.8	6.8	0.1	2.2	0.16	76.4
4	Mastek	18.6	18.9	0.4	6.7	0.50	68.1
5	Moser Baer (India)	2.1	4.7	0.0	6.0	0.44	66.5
6	Sterling Biotech	2.1	13.5	0.2	2.1	0.15	62.6
7	Hinduja TMT	3.1	8.9	0.1	5.1	0.38	60.7
8	Infosys Technologies	48.5	27.9	1.0	235.4	17.53	54.6
9	Aurobindo Pharma	2.0	4.8	0.1	3.6	0.27	53.6
10	Wipro	40.2	17.6	1.0	244.7	18.23	52.2
11	Satyam Computer Services	33.3	18.1	0.4	41.6	3.10	48.4
12	Sun Pharmaceuticals Industries	6.5	10.9	0.5	22.1	1.65	46.4
13	Maharashtra Seamless	6.7	6.5	0.3	3.4	0.26	45.9
14	Bharat Electronics	4.2	5.5	0.3	12.2	0.91	45.1
15	Lupin	6.0	6.9	0.3	3.9	0.29	44.9
16	Eicher Motors	6.7	3.7	0.2	1.1	0.08	40.1
17	CMC	21.6	20.2	1.2	6.0	0.45	37.9
18	MIRC Electronics	2.6	4.1	0.2	2.3	0.17	36.1
19	Blue Dart Express	-4.8	6.2	0.3	1.0	0.08	35.9
20	Dr Reddys Laboratories	22.1	17.9	0.9	59.3	4.42	35.0
21	Digital Globalsoft	17.0	18.7	1.3	15.1	1.13	33.4
22	Motherson Sumi Systems	4.8	6.2	0.4	1.4	0.11	33.0
23	MPhasis BFL	-7.1	16.6	0.6	2.2	0.17	32.6
24	Kotak Mahindra Bank	4.5	20.8	0.4	7.1	0.53	31.1
25	Finolex Industries	-11.8	5.3	0.5	3.6	0.27	31.0
26	Hindustan Inks & Resins	3.7	7.6	0.2	2.1	0.16	30.6
27	FDC	6.9	6.5	0.5	1.9	0.14	28.6
28	Kalyani Brakes	9.5	13.8	1.2	1.6	0.12	28.5
29	Apollo Hospitals Enterprise	5.0	13.3	0.3	1.9	0.14	28.0
30	Tata Honeywell	11.6	12.6	0.7	1.5	0.11	27.7
31	HDFC Bank	22.6	17.0	1.2	41.5	3.09	26.8
32	Cipla	13.1	17.3	1.3	29.9	2.23	26.3
33	Bharat Forge	8.1	11.2	1.1	8.4	0.62	25.2
34	Electrosteel Castings	3.0	3.6	0.3	2.4	0.18	25.1
35	ICICI Bank	15.0	6.8	0.4	62.4	4.65	23.9
36	Dredging Corporation of India	5.6	4.2	0.5	4.4	0.33	23.2
37	Ranbaxy Laboratories	20.4	18.6	2.4	78.4	5.84	23.1
38	Shree Cement	6.7	23.7	0.9	1.1	0.08	22.5
39	Navneet Publications (India)	5.7	5.4	0.5	1.3	0.10	22.2
40	Jaiprakash Industries	9.9	4.3	0.4	2.8	0.21	21.9
41	National Aluminium Company	6.7	8.8	1.3	15.5	1.15	20.0
42	State Trading Corporation of India	32.0	-2.4	-1.0	1.2	0.09	19.6

'MOST-Inquire 83' ~ Wealth Creators (Rankings)

Appendix II

RANK NO.	COMPANY NAME	P/E (X)		PAYBACK RATIO (X)	WEALTH CREATED		MCAP CAGR (%)
		1998	2003		RS B	%	
43	Jindal Strips	2.6	100.7	0.7	2.0	0.15	19.1
44	Ashok Leyland	26.7	9.6	1.2	8.3	0.62	18.7
45	Pidilite Industries	8.5	9.3	0.9	3.3	0.24	18.1
46	Hero Honda Motors	22.8	6.5	1.0	20.2	1.50	16.6
47	Alfa-Laval (India)	62.5	9.5	1.3	2.3	0.17	16.3
48	HDFC	12.9	11.7	1.4	42.0	3.13	15.8
49	Rolta India	4.8	2.9	0.3	1.8	0.14	15.8
50	J B Chemicals & Pharamaceuticals	3.9	5.0	0.6	1.4	0.11	15.6
51	Tata Elxsi	50.0	17.5	1.9	1.0	0.08	14.6
52	Blue Star	3.7	4.8	0.4	1.0	0.08	14.2
53	Jubilant Organosys	3.0	4.6	0.6	1.2	0.09	13.5
54	Asahi India Glass	52.4	7.0	1.9	1.2	0.09	13.2
55	Torrent Pharmaceuticals	4.5	6.4	0.7	1.5	0.11	13.1
56	Indo Rama Synthetics (India)	-2.7	2.9	-3.4	3.8	0.29	12.5
57	Jindal Iron & Steel Company	5.6	2.6	26.4	1.4	0.10	12.4
58	Gujarat Gas Company	16.1	9.1	1.2	2.2	0.16	12.4
59	Sundaram Clayton	20.4	9.7	1.6	1.5	0.11	12.0
60	ING Vysya Bank	3.2	6.2	0.7	2.2	0.16	11.8
61	Asian Paints (India)	18.5	14.8	2.1	8.7	0.65	11.1
62	Rashtriya Chemicals & Fertilizers	2.3	-14.8	1.2	2.8	0.21	10.6
63	BP	8.4	4.9	0.6	1.7	0.13	10.4
64	Britannia Industries	30.1	13.1	1.8	4.3	0.32	9.8
65	Reliance Industries	10.0	9.4	1.0	103.8	7.73	9.3
66	Apollo Tyres	6.0	3.7	0.7	1.4	0.11	8.6
67	LIC Housing Finance	3.9	2.7	0.5	1.6	0.12	7.9
68	Dabur India	16.0	12.1	1.8	3.1	0.23	7.6
69	Engineers India	14.4	20.1	2.0	3.2	0.24	5.5
70	Oil & Natural Gas Corpn	14.8	4.8	1.3	110.5	8.23	5.0
71	Shipping Corporation of India	4.6	5.2	0.7	3.0	0.22	4.8
72	Siemens	-4.2	10.8	10.5	2.1	0.16	4.7
73	Atlas Copco (India)	26.6	7.8	1.8	1.4	0.11	4.5
74	Indian Petrochemicals Corporation	7.1	10.3	1.7	3.6	0.27	3.8
75	Nestle India	57.7	25.6	5.7	8.7	0.64	3.7
76	Gujarat Ambuja Cements	15.3	11.2	1.5	3.7	0.28	3.2
77	Bharat Petroleum Corporation	10.7	5.3	1.2	9.4	0.70	3.1
78	Neyveli Lignite Corporation	15.2	3.8	1.1	4.1	0.30	2.8
79	Pfizer	46.3	11.8	2.9	2.6	0.19	2.6
80	Karur Vysya Bank	2.0	2.3	0.2	1.9	0.14	2.6
81	National Fertilizer	7.0	5.1	2.1	1.5	0.11	2.2
82	Associated Cement Companies	148.2	22.8	6.8	2.0	0.15	1.7
83	Grasim Industries	9.8	8.2	1.4	5.6	0.42	1.1

Note: Payback Ratio = (Market Capitalization of 1998) / (Sum of Profits for the five years 1999-2003). CE = Capital Employed

N O T E S

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