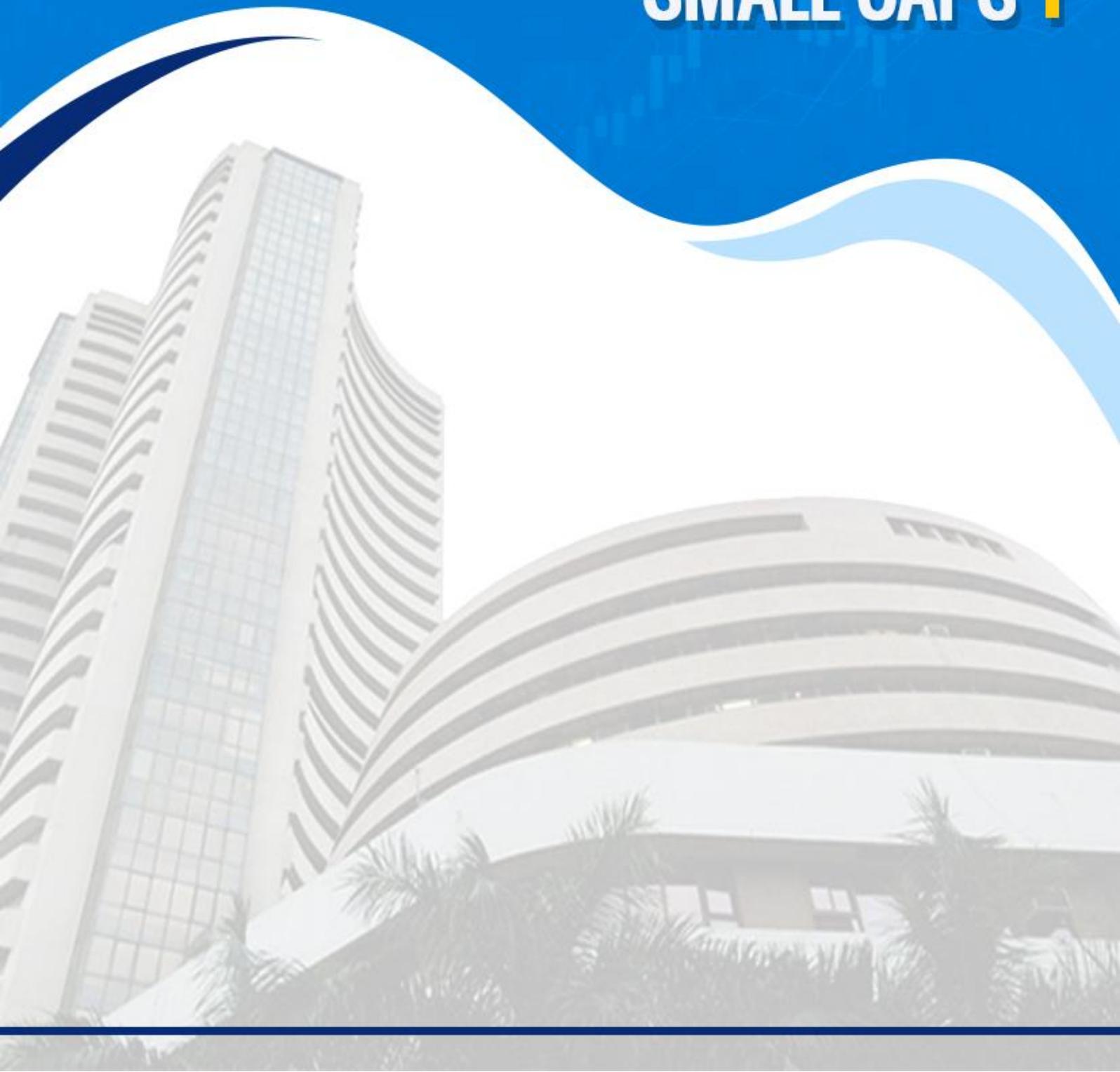


IMPACT OF CHANGES IN MF REGULATIONS ON SMALL CAPS



Top Picks

Company	CMP (₹)	TP (₹)
Auto		
Endurance Technologies	1,080	1,297
Swaraj Engines	1,615	1,891
Banking/NBFC		
Cholamandalam Inv.	225	280
IDFC First Bank	31	36
IT		
Persistent Systems	1,011	1,276
Zensar Technologies	174	204
Pharma & Healthcare		
Metropolis Healthcare	1,751	2,156
Telecom/ Others		
Chalet Hotels	152	200
Hawkins cooker	4,838	5,682
Hindustan Aero.	852	1,125
Inox Leisure	289	350
JK Lakshmi cement	256	328
Reliance Industries	2,319	2,543
VIP Industries	283	348

Source: Company, Angel Research

Note: Closing price as on 11th Sept., 2020

SEBI circular on Mutual Funds could broaden market rally

SEBI has surprised all market participants with its latest circulars wherein multi-cap mutual funds will be required to increase their exposure to mid and small caps stocks to 25% of their AUM by January 2021. Based on our calculations Multi-cap funds may need to decrease their exposure to large caps by ₹40,650 crore and increase their exposure to mid and small cap stocks by ₹12,960 crore and ₹27,690 crore by January 2021. While the allocation shift should not cause too much of an issue for large and mid cap stocks given better liquidity it can lead to a rerating for the small cap space given limited availability of quality stocks. We believe that flows would go the most liquid names in the small cap space where there are reasonable MF holdings rather than in smaller name with low liquidity and fund holdings. As per our analysis the top 100 small caps stocks with relatively large market caps and MF holdings have a free float market cap of ~₹2,36,000 crore and could attract the majority of the flows (10-12% of free float on higher side) to small caps if any. In our top picks portfolio we have six stocks which are from the above list viz. Chalet Hotels, Hawkins Cooler, Inox Leisure, JK Lakshmi Cement, Persistent Systems and VIP Industries. Metropolis Healthcare though not part of the above list is part of the Nifty Smallcap 100 index and could also attract MF flows while Zensar Technologies and Swaraj Engines are other high conviction small cap stocks in the portfolio.

SEBI Circular could cause disruptions to existing multicap schemes

SEBI issued a circular on the 11th of September 2020 with a view to diversify the investments of underlying investments of multi-cap funds across mid and small caps. Under the new guidelines SEBI has proposed raising the minimum investment in equities for Multi Cap Funds to 75% of assets from the earlier 65% along with other proposed changes listed below:

- Minimum investment of 25% of total assets in large cap companies.
- Minimum investment of 25% of total assets in mid cap companies.
- Minimum investment of 25% of total assets in small cap companies.

Some shift in AUM to Mid and small caps likely over next few months

As per our calculations multi-cap funds have a total AUM of ₹1,46,500 crore with almost 74% of AUM being allocated to large caps while allocation to mid and small caps are 16.5% and 6.2% respectively. If the SEBI recommendations are implemented then there could be shift of ₹40,650 crore from large caps to mid and small caps on the higher side. However the situation is still fluid and the actual shift could be lower as MF houses are most likely to ask SEBI to reconsider the proposal. However even if SEBI does not reconsider the proposal then fund houses have the option of either merging it with existing large cap schemes or changing the fund categorization to minimize the impact.

Exhibit 1: Summary of likely shift in aggregate AUM for multi-cap schemes

	Scheme Profile Amt (₹ Cr)				Possibility of churn +/- (₹ Cr)			
	AUM	Large Cap	Mid Cap	Small Cap	Cash & Equivalent	Large Cap	Mid Cap	Small Cap
Total	146,501	108,140	24,224	9,040	5,093	(40,650)	12,960	27,690

Source: Company, Angel Research

Exhibit 2: List of top100 smallcap stocks based on market cap and MF holdings

Sr. No	Company Name	Free Float Market Cap (₹ Cr)	Market Cap (₹ Cr)	Mutual Funds Holdings (%)
1	Multi Comm. Exc.	7928	7928	21.8
2	Indian Energy Ex	5699	5699	14.8
3	PVR	5623	6924	16.9
4	Persistent Sys	5296	7727	24.7
5	Tata Chemicals	4883	7464	17.4
6	Redington India	4334	4334	11.5
7	Strides Pharma	4321	6147	15.6
8	CESC	4149	8285	19.7
9	K E C Intl.	4033	8344	22.8
10	Chola Financial	3979	7770	24.8
11	Kajaria Ceramics	3946	7528	16.5
12	Apollo Tyres	3880	6650	17.2
13	C D S L	3727	4659	13.3
14	APL Apollo Tubes	3718	6036	10.2
15	Can Fin Homes	3646	5208	11.4
16	SKF India	3623	7641	24.0
17	VST Industries	3591	5294	13.9
18	Blue Star	3563	5818	21.3
19	JM Financial	3559	7882	7.7
20	Cyient	3199	4168	21.4
21	EIH	3149	4864	10.7
22	Natl. Aluminium	3144	6483	7.7
23	Radico Khaitan	3141	5262	13.3
24	Amber Enterp.	3112	5559	6.5
25	Finolex Inds.	2981	6271	12.9
26	ERIS Lifescience	2948	6633	10.7
27	Karur Vysya Bank	2875	2937	16.9
28	Rallis India	2868	5747	16.3
29	Carborundum Uni.	2775	4789	23.7
30	Finolex Cables	2734	4263	19.7
31	Birlasoft Ltd	2725	4601	6.6
32	J B Chem & Pharm	2724	6177	12.2
33	GE Shipping Co	2713	3828	20.2
34	V-Guard Industri	2685	7205	11.0
35	Timken India	2624	8148	10.2
36	Orient Electric	2535	4124	16.5
37	Quess Corp	2464	5511	13.1
38	Elgi Equipments	2439	3582	9.6
39	Westlife Develop	2425	5931	12.4
40	Grindwell Norton	2399	5755	15.9

Source: Company, Angel Research, Capitaline

Exhibit 3: List of top100 smallcap stocks based on market cap and MF holdings Contd.

Sr. No	Company Name	Free Float Market Cap (₹ Cr)	Market Cap (₹ Cr)	Mutual Funds Holdings (%)
41	TTK Prestige	2398	8105	11.2
42	Chambal Fert.	2390	5962	13.7
43	Vaibhav Global	2372	5716	9.0
44	Narayana Hrudaya	2364	6540	14.6
45	Sonata Software	2353	3276	12.2
46	Affle India	2344	7413	9.0
47	DCB Bank	2261	2656	27.8
48	Team Lease Serv.	2234	3725	9.9
49	Guj Pipavav Port	2198	3926	25.0
50	Ratnamani Metals	2108	5292	13.4
51	Firstsour.Solu.	2057	4461	7.8
52	Engineers India	1963	4047	17.3
53	Jyothy Labs	1954	5266	13.9
54	Bajaj Electrical	1930	5241	11.4
55	CEAT	1930	3620	6.6
56	KEI Industries	1920	3227	21.0
57	Delta Corp	1917	2862	6.6
58	Century Textiles	1879	3774	8.9
59	V I P Inds.	1861	3998	9.7
60	Galaxy Surfact.	1839	6325	12.8
61	Balrampur Chini	1817	3091	8.2
62	IRB Infra.Devl.	1785	4224	6.8
63	PNC Infratech	1774	4038	22.8
64	CCL Products	1770	3272	10.3
65	Brigade Enterpr.	1767	3322	17.9
66	Kalpataru Power	1763	3865	21.9
67	Sheela Foam	1709	6838	19.7
69	Birla Corpn.	1707	4602	10.9
70	V-Mart Retail	1676	3431	17.2
71	Vardhman Textile	1632	4318	20.3
72	JK Lakshmi Cem.	1622	3015	16.8
73	KNR Construct.	1581	3515	32.0
74	NLC India	1532	7363	8.4
75	Johnson Con. Hit	1510	5865	13.6
76	Linde India	1509	6036	10.6
77	Symphony	1459	5838	10.1
78	Cera Sanitary.	1453	3192	10.1
79	Inox Leisure	1429	2971	19.7
80	Thyrocare Tech.	1403	4132	7.9
81	ICRA	1281	2661	15.0

Source: Company, Angel Research, Capitaline

Exhibit 4: List of top100 smallcap stocks based on market cap and MF holdings Contd.

Sr. No	Company Name	Free Float Market Cap (₹ Cr)	Market Cap (₹ Cr)	Mutual Funds Holdings (%)
82	Dilip Buildcon	1258	5033	6.7
83	SpiceJet	1234	3078	9.5
84	Star Cement	1204	3623	7.5
85	BEML Ltd	1186	2579	19.8
86	eClerx Services	1180	2555	17.9
87	Cochin Shipyard	1169	4308	6.9
88	MAS FINANC SER	1166	4417	8.8
89	Hawkins Cookers	1125	2559	14.1
90	Advanced Enzyme	1078	2569	8.6
91	TCI Express	1028	3108	8.1
92	K P R Mill Ltd	986	3977	16.5
93	Mishra Dhatu Nig	979	3766	14.1
94	GE Power	970	3086	13.4
95	Century Plyboard	965	3581	6.7
96	Chalet Hotels	894	3126	18.2
97	Dhanuka Agritech	879	3516	12.8
98	Sundaram Clayton	832	3330	12.2
99	Prism Johnson	672	2675	7.9
100	GE T&D India	636	2545	12.5

Source: Company, Angel Research, Capitaline

Note: In order to arrive at stocks which are most likely to attract investments by multi-cap funds we have initially considered stocks ranked between 250-450 in terms of market cap as of the 11th of September. Within the top 200 small cap stocks by market cap we have considered 100 stocks with the largest percentage of MF holdings.

Exhibit 5: Rationale - Top Picks Stocks

Company	CMP (₹)	TP (₹)	Rationale
Auto			
Endurance Technologies	1,080	1,297	Pent up demand and consumer preference for personal transportation is positive for domestic 2W companies, which would benefit Endurance.
Swaraj Engines	1,615	1,891	Strong recovery in the tractor industry (due to robust Rabi crop, hike in MSP & a normal monsoon) will benefit players like Swaraj Engines.
BFSI			
Cholamandalam Inv.	225	280	Diversified product mix will help capture growth in LCV, tractor and 2W segment. Adequate capital adequacy (20%+) and declined trend in Cost of fund and strong parentage provide comfort.
IDFC First Bank	31	36	We believe efforts to built retail liability franchise, fresh capital infusion and provision taken on the wholesale book will help to tide over this difficult time.
IT			
Persistent Systems	1,011	1,276	Company has won deals worth USD 150mn in Q1Y21 and management has highlighted strong deal pipeline which will drive growth in H2FY21.
Zensar Technologies	174	204	We expect strong sequential growth in Q2FY21 driven by ramp up of existing projects and limited exposure to sectors like retail and Oil & gas.
Pharma & Healthcare			
Metropolis Healthcare	1,751	2,156	We are positive on the company given expected long term growth rates of ~15% CAGR, stable margins profile and moderating competitive intensity.
Telecom/ Others			
Chalet Hotels	154	200	Company has posted strong sequential revpar growth in July and future improvement is expected over next few months led by increased occupancy.
Hawkins cooker	4,838	5,682	Gaining market share with peer, strong demand post Covid-19 and increase in penetration of cooking gas to drive higher growth.
Hindustan Aeronautics	852	1,125	Strong order book of Rs. 52,000 crore with likely order flow of Rs. 39,000 crore in FY2021 to drive growth over best few years
Inox Leisure	289	350	Share prices have corrected more than 40% as all theatres are closed down due to covid-19 issue. Although, long term fundamentals are intact. Covid-19 can lead to further consolidation in the industry.
JK Lakshmi Cement	256	328	It is trading at a significant discount compared to other north based cement company such as JK Cement as well as historical valuation.
Reliance Industries	2,319	2,543	Digital and retail business to be key growth driver for the company. Spin off and investment by strategic investor in O2C business is key monetizable.
VIP Industries	283	348	Market leader (~50%+ share) with strong brand and wide distribution network. Recent correction provides investment opportunity in high quality stock from long term perspective

Source: Company, Angel Research

Exhibit 6: Top Picks Valuation Table

	Market Cap (₹ cr)	CMP (₹)	Sales (₹)		PAT (₹)		ROE (%)		P/E (x)	
			FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22
Auto										
Endurance Technologies	15,186	1,080	5,884	7,465	281	608	8.7	16.2	54.0	25.0
Swaraj Engines	1,959	1,615	711	899	64	86	16.2	17.1	30.6	22.8
IT										
Persistent Systems	7,727	1,011	4,159	4,756	415	488	15.4	15.9	18.6	15.8
Zensar Technologies	3,917	174	4,059	4,558	319	384	12.5	14.3	12.3	10.2
Pharma & Healthcare										
Metropolis Healthcare	8,918	1,751	920	1,156	144	217	23.0	27.4	62.0	41.1
Telecom/Others										
Chalet Hotels	3,126	152	484	995	(73)	83	(4.6)	4.9	NA	37.8
Hawkins cooker	2,558	4,838	575	728	51	77	32.5	42.4	50.2	33.2
Hindustan Aeronautics	28,503	852	21,293	25,552	2,961	3,791	23.3	24.0	9.6	7.5
Inox Leisure	2,971	289	628	2,153	(146)	162	NA	14.5	NA	18.3
JK Lakshmi cement	3,015	256	3,793	4,306	223	278	14.5	12.3	13.5	10.8
Reliance	15,680	2,319	3,342	4,241	264	420	5.7	8.7	59.5	37.3
VIP Industries	3,998	283	808	1,650	(136)	108	NA	19.6	NA	37.0

Source: Company, Angel Research * RIL standalone numbers (market cap, revenues & PAT in '00' crore)

Exhibit 7: Top Picks Valuation Table – Banking/NBFC

Particular	Market Cap (₹ Cr)	CMP (₹)	NII (₹ Cr)		PAT (₹ Cr)		EPS (₹)		ROE (%)		P/BV (x)	
			FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22	FY21	FY22
IDFC First Bank	17,613	31	6,939	8,121	90	1530	0.2	2.7	0.5	8.0	1.1	1.0
Cholamand. Inv. & Fin	18,400	225	3,783	3,962	987	1346	12.0	17.0	11.5	14.1	2.0	1.8

Source: Company, Angel Research

Note: CMP is Closing price as of 11th Sep, 2020

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Buy (> 15%)

*Accumulate (5% to 15%)
Reduce (-5% to -15%)*

*Neutral (-5 to 5%)
Sell (< -15)*

