Strategy

'Through-the-cycle' 100-baggers – old school manufacturing companies dominate

Over the past 20 years, India's 'investment rate', real estate and corporate profits have been through the niches and recesses of economic cycles – one full upcycle (2003–2010), followed by a full down cycle (2011–2020) and the emergence of the most recent upcycle post-FY21. In this context, the journey through economic cycles throws up medium-term tailwinds/headwinds for stocks. Consequently, the **longevity of a business model and the growth durability are put to test when a company weathers a full economic cycle.** Given the backdrop, it is an opportune time to evaluate stocks that have been **able to persevere and preserve value while battling economic downturns and being able to reap the full benefits of economic upcycles.** We reckon, traditional manufacturing and a few service companies form the bulk of the 100-baggers, sporting >25% CAGR stock price appreciation (ex-dividends) for the 20-year period.

The real McCoy: 'Through-the-cycle' outperformers

Business models that flourish during economic upcycles and preserve value during downturns can be labelled as **'through-the-cycle' (TTC)** compounders. Minimum 25% compounding over the past 20 years makes up our list of TTC 100-baggers. Most of the stocks that constitute this list hail from traditional manufacturing – **commodities (chemicals, cement, etc.), building materials, home appliances, capital goods, engineering, discretionary consumption, staples, pharma, etc. A few TTC 100-baggers emanate from the services sector such as financials and rating agency.**

Economic cycles and investor behaviour provide massive tailwinds or headwinds for stocks in the medium term; investors may get carried away

- **Cycle-1 belonged to capital-intensive and cyclical stocks**: Investors reaped the benefits of a booming investment and real estate cycle between 2003–2010. This resulted in a rapid expansion in gross fixed capital formation (GFCF), which in turn also boosted the credit cycle. During this phase, capital intensive and cyclical stocks were propelled by prodigious tailwinds and turned out to be massive multi-baggers. Given the balance-sheet-driven nature of these stocks, their P/B found a significant upwards slant – from sub-2x levels, to reach >4x by the time the cycle ended.
- **Cycle-2 belonged to low earnings volatility and quality stocks**: However, post-2010, capex, credit and real estate cycles started their respective journeys to decadal lows. In contrast, the NPA cycle had only begun rising, thereby, denting the performance of companies that formed part of such sectors. In parallel, 'private final consumption expenditure' (PFCE) was relatively resilient. This prompted the 'flight-to-safety' behaviour among investors, fuelling **'richer valuations' for low-earnings-volatility stocks, or high RoE consumption-related stocks over 2011-2021**.

  The benefitting stocks in this set saw their P/Es swell from sub-30x level to reach >70x by 2021. That said, they are currently observing a reversal of the trajectory, as the next cycle is being driven by the 'investment rate'.
- **Cycle 3 is again being driven by capital-intensive and cyclical stocks as investment cycle again starts to pick up after a decade.** Also, going by the past empirical evidence, it is likely that the 'richening of valuations' for low earnings volatility stocks a.k.a. quality stocks seen in cycle 2 may mostly reverse going ahead, resulting in a dip in their P/E ratio. This process has already started with most quality stocks showing a dip in their lofty P/E ratios since FY21.

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i-Lens screener

i-Lens is our screening framework for critical factors related to economy / sectors / stocks

Exclusions: We exclude stocks –

- That have shown <25% CAGR in both cycles (1 and 2) while the bulk of the returns have been generated during the current cycle, i.e. cycle-3.
- Exhibiting negative price-CAGR in either cycle 1 or 2.
- With a current market cap of less than INR 200bn, except for a few 'BUY' rated stocks under our coverage.

Learnings from observing 'through-the-cycle' 100 baggers include –

- **Having a focussed business model:** None of the stocks had a diversified business approach while there was a sharp focus on core business. This factor also speaks volumes about the quality of the management and the sharp focus they bring to the business strategy.
- **Focus on value creating growth:** Earnings growth and RoE > 'cost of equity'. This is again a virtue of the management quality and indicates prudent capital allocation decisions while the tailwinds of economic cycles propelled earnings growth.
- **Business throws out more cash than it consumes:** Cumulative 'operating cash flow' (OCF) exceeded cumulative capex over the past two decades for most of the stocks (excluding one-off acquisitions) and speaks about the quality of the business.
- **Avoid –**
  - **High financial leverage and reduction in financial leverage over time.**
  - **Regulated sectors:** Almost all the stocks were from unregulated sectors except for liquor.
- **Competition is overstated:** Competition is a key risk while evaluating a company, but obsessing over it may not be beneficial for an investor. Almost all the stocks belonged to sectors where there were multiple competitors.
- **Fancy growth stories seldom materialise:** The new age sectors during the '2000 dot-com bubble' aligned under Telecom, Media and Technology (TMT) – comprising stocks with high growth expectations. Our two-decade analysis starts in 2003 and is well past 2000's dot-com bubble burst. While TMT stocks did correct significantly, yet not a single one made it to the list.
- **Cheap valuations, to start with, is an important criterion:** Median earnings CAGR for the TTC 100-baggers was ~19% while the price CAGR was ~28%. Median-trailing-P/E of the stocks was around 11x at the beginning of the 20-year period, while it currently stands at ~55x.

Exhibit 1: TTC 100-baggers dominated by traditional manufacturing companies

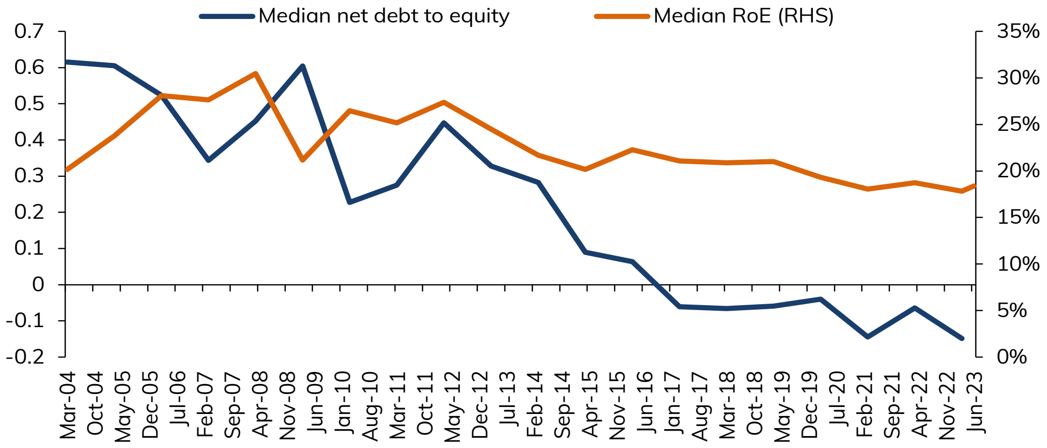
Company name	Sector	Isec rating	Price 20 year CAGR	No of times	CAGR			Earnings 20 year CAGR (FY03-FY23)	ROE (FY04-FY23)			PB (FY04-FY23) Median	PE (FY04-FY23) Median
					Cycle 1 (Sep'03 - Dec'10)	Cycle 2 (Dec'10 - Jan'20)	Cycle 3 (Jan'20 - Sep'23)		High	Low	Median		
P I Industries	Materials	NR*	55%	6485	85%	46%	26%	48%	49%	7%	23%	5.47	20.6
KEI Industries	Industrials	NR*	50%	3315	66%	38%	52%	38%	92%	-9%	21%	2.07	13.2
Bajaj Finance	Financial Services	NR*	43%	1336	41%	58%	16%	35%	30%	2%	22%	2.33	29.2
Titan Company	Cons discretionary	ADD	40%	859	70%	23%	32%	30%	71%	15%	35%	11.56	39.3
Relaxo Footwear	Cons discretionary	NR*	38%	584	41%	50%	5%	21%	51%	7%	23%	6.39	26.9
Havells India	Cons discretionary	BUY	37%	568	61%	25%	27%	27%	73%	1%	28%	7.76	37.5
Deepak Nitrite	Materials	NR*	36%	501	22%	39%	62%	23%	57%	4%	14%	1.67	12.2
Balkrishna Inds	Auto	ADD	35%	435	39%	36%	27%	22%	54%	15%	26%	2.76	12.8
Navin Fluorine	Materials	REDUCE	35%	433	27%	39%	46%	13%	68%	-0.3%	18%	1.57	17.3
Hatsun Agro	Consumer Staples	HOLD	34%	366	35%	36%	28%	23%	63%	4%	27%	9.24	63.5
UPL	Materials	ADD	34%	324	75%	18%	5%	18%	34%	11%	19%	2.38	15.4
Kajaria Ceramics	Materials	ADD	33%	321	35%	35%	26%	19%	37%	6%	20%	4.44	23.4
Shree Cement	Cement	REDUCE	33%	291	53%	31%	4%	20%	93%	7%	19%	4.99	34.2
Supreme Inds.	Industrials	HOLD	31%	233	34%	28%	34%	24%	54%	8%	25%	4.88	23.4
Ajanta Pharma	Healthcare	BUY	31%	220	19%	57%	13%	32%	56%	3%	21%	4.02	15.9
Eicher Motors	Auto	BUY	31%	214	33%	36%	15%	25%	46%	8%	23%	3.94	22.1
Berger Paints	Cons discretionary	REDUCE	31%	214	39%	35%	7%	18%	35%	22%	27%	7.20	31.9
Phoenix Mills	Real Estate	ADD	31%	207	56%	16%	23%	27%	NM	1%	8%	2.69	30.5
Pidilite Inds.	Materials	ADD	29%	167	38%	29%	14%	17%	40%	18%	28%	8.19	34.6
Atul	Industrials	NR*	29%	163	22%	43%	12%	13%	33%	3%	17%	1.59	15.4
United Breweries	Cons discretionary	NR*	29%	159	71%	11%	7%	18%	26%	NM	13%	11.07	88.4
Linde India	Materials	NR*	29%	153	35%	9%	76%	22%	20%	0%	8%	2.36	62.1
Honeywell Auto	Industrials	HOLD	28%	149	35%	31%	10%	17%	45%	13%	21%	7.75	41.5
Coromandel Inter	Materials	NR*	28%	148	67%	8%	17%	24%	58%	16%	25%	3.16	14.6
Cholaman Investment	Financial Services	ADD	28%	146	23%	27%	43%	26%	24%	-2%	19%	2.00	19.1
Kotak Bank	Private banks	HOLD	28%	133	47%	25%	2%	30%	50%	11%	16%	3.60	24.4
Shriram Finance	Financial Services	NR*	27%	127	72%	3%	20%	32%	70%	12%	24%	2.05	11.5
Carborundum.	Industrials	HOLD	27%	120	42%	11%	42%	14%	36%	9%	17%	3.09	24.8
Marico	Consumer Staples	ADD	27%	119	41%	20%	18%	17%	84%	24%	39%	13.12	36.6
Emami	Consumer Staples	ADD	27%	116	59%	9%	18%	19%	73%	15%	38%	8.79	25.0
United Spirits	Cons discretionary	ADD	27%	114	61%	9%	15%	22%	31%	-16%	19%	9.17	54.3
Trent	Cons discretionary	BUY	26%	107	25%	22%	41%	18%	21%	-6%	7%	3.45	51.6
Asian Paints	Cons discretionary	REDUCE	26%	105	36%	22%	17%	19%	69%	24%	35%	12.78	42.9
Voltas	Industrials	HOLD	26%	96	54%	14%	7%	12%	47%	6%	18%	4.44	25.1
CRISIL	Financial Services	NR*	25%	93	45%	12%	25%	19%	55%	22%	37%	11.36	31.7
Grindwell Norton	Industrials	HOLD	25%	91	26%	20%	38%	16%	29%	16%	20%	4.30	21.0
Sundaram Finance	Financial Services	HOLD	25%	88	35%	22%	15%	19%	24%	12%	15%	2.02	16.6
Godrej Consumer	Consumer Staples	ADD	25%	88	40%	20%	11%	19%	243%	15%	31%	8.22	34.3
Divi's Lab.	Healthcare	HOLD	25%	86	31%	22%	20%	18%	65%	13%	29%	6.13	23.6
Siemens	Industrials	ADD	25%	85	49%	7%	29%	15%	52%	5%	16%	7.65	47.6
Bata India	Cons discretionary	HOLD	25%	84	35%	29%	-2%	LTP	43%	-24%	20%	7.02	37.0
Britannia Inds.	Consumer Staples	ADD	25%	82	20%	35%	10%	17%	84%	18%	42%	14.69	39.2
Timken India	Auto	NR*	25%	82	23%	21%	37%	16%	38%	9%	20%	4.06	27.9
Larsen & Toubro	Industrials	BUY	25%	81	55%	5%	23%	17%	31%	11%	16%	3.13	25.4
Manappuram	Financial Services	BUY	25%	81	134%	11%	-7%	44%	85%	9%	30%	1.30	7.4
Kalpataru Project	Industrials	BUY	25%	81	65%	11%	11%	20%	96%	7%	13%	1.52	16.4
Zydus Wellness	Consumer Staples	BUY	25%	81	104%	11%	2%	32%	110%	3%	26%	4.52	30.9
Genus Power	Utilities	BUY	25%	81	66%	2%	86%	14%	69%	3%	12%	1.37	9.9
Somany Ceramics	Cons discretionary	BUY	25%	81	42%	16%	38%	LTP	32%	-3%	14%	1.49	18.9
Greenply Inds	Cons discretionary	BUY	25%	81	57%	17%	1%	13%	40%	10%	22%	2.65	14.0

Source: Capitaline, I-Sec research

Note: NR* represents company not under I-sec coverage. Price CAGR excludes dividend returns.

Fundamentals and valuations trend of TTC 100-baggers

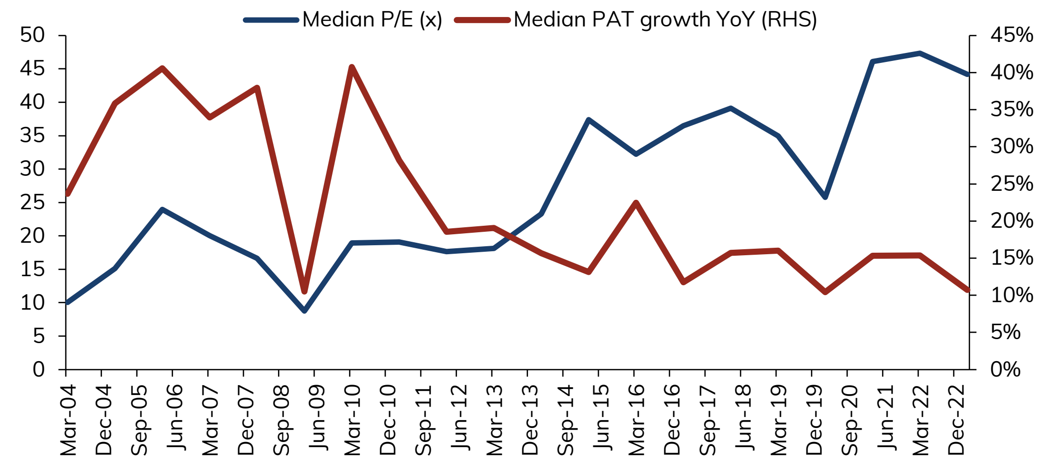
Exhibit 2: Median ROE sustaining above value creating zone while risks associated with financial leverage disappears



Source: Capitaline, I-Sec research

Note: Median has been taken of 50 companies selected in Exhibit 1

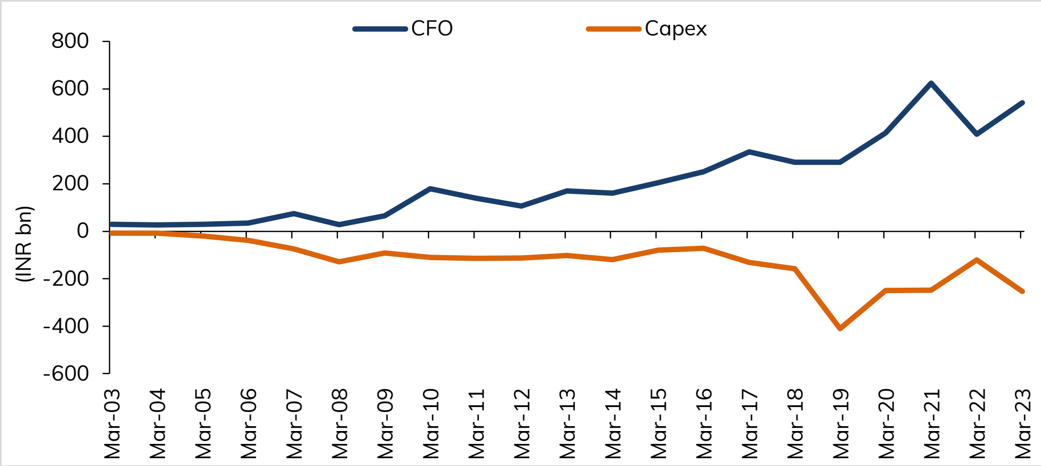
Exhibit 3: 100-bagger is an interplay of earnings growth and P/E expansion



Source: Capitaline, I-Sec research

Note: Median has been taken of 50 companies selected in Exhibit 1

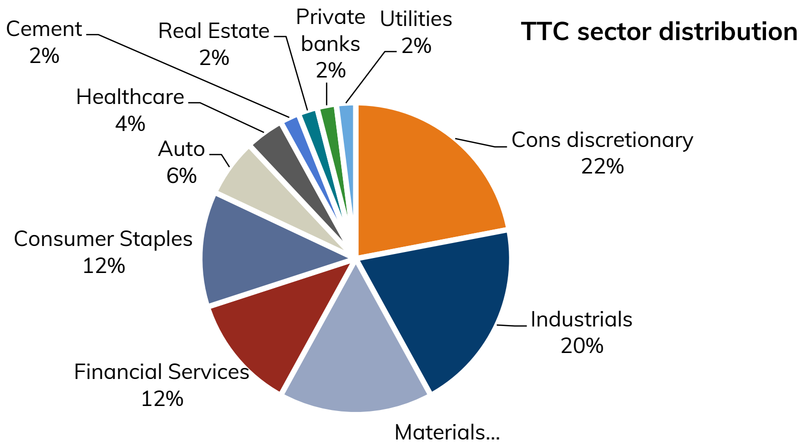
Exhibit 4: Cumulative OCF exceeds cumulative capex over the past two decades for most of the stocks (excluding one-off acquisitions)



Source: Capitaline, I-Sec research

Note: We have taken total CFO and Capex of 43 companies (ex-financials) selected in Exhibit 1

Exhibit 5: Discretionary, Industrials and Materials sectors dominate TTC 100-baggers

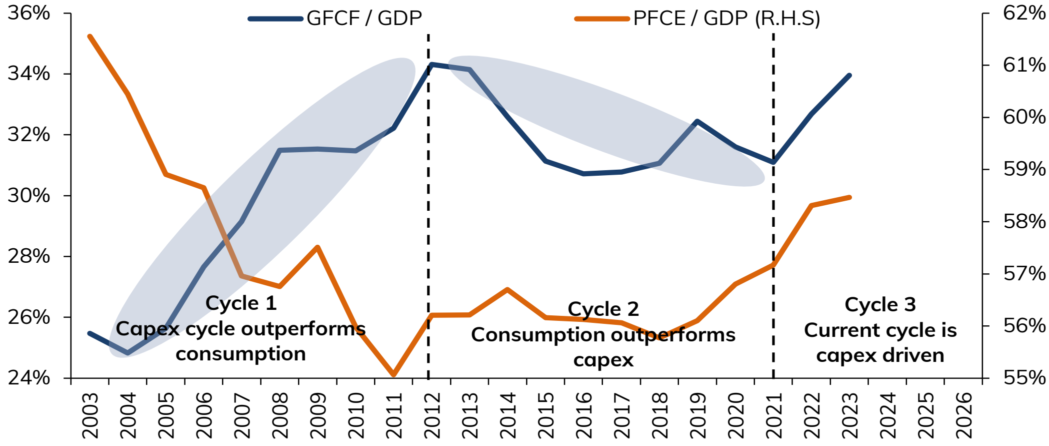


Source: Capitaline, I-Sec research

Note: We have considered 50 companies selected in Exhibit 1

Various economic cycles over the past two decades

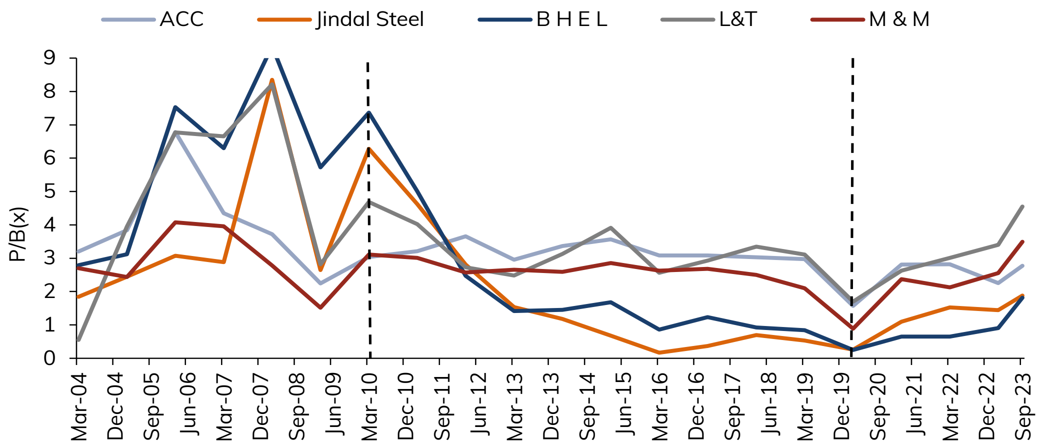
Exhibit 6: Cycle-1 capex driven; consumption supported cycle-2; capex remerges as current cycle's pillar



Source: I-Sec research

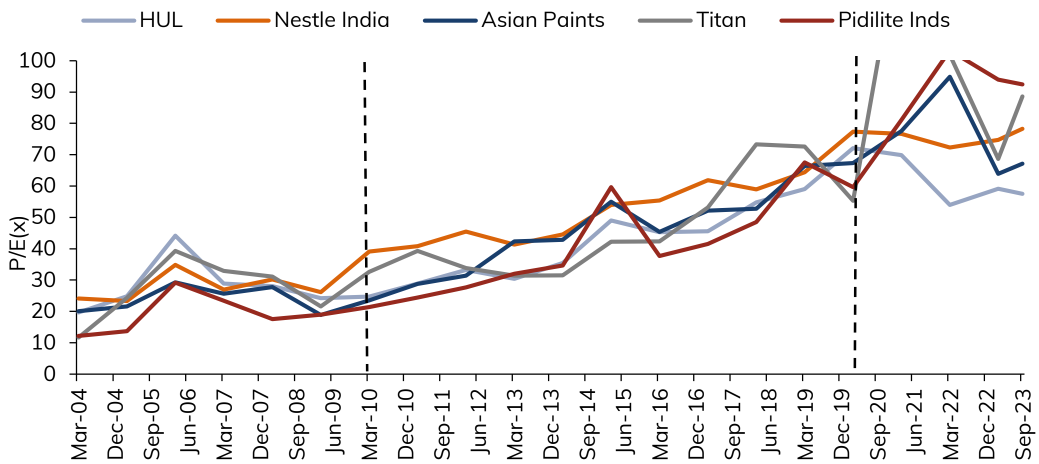
Note – GFCF stands for Gross fixed capital formation and GFCF / GDP ratio indicates the 'investment rate'. PFCE stands for private final consumption expenditure and FCE / GDP indicates overall consumption as a percentage of GDP

Exhibit 7: Capital-intensive and cyclical stocks saw massive re-rating in P/B during cycle-1; got de-rated in cycle-2



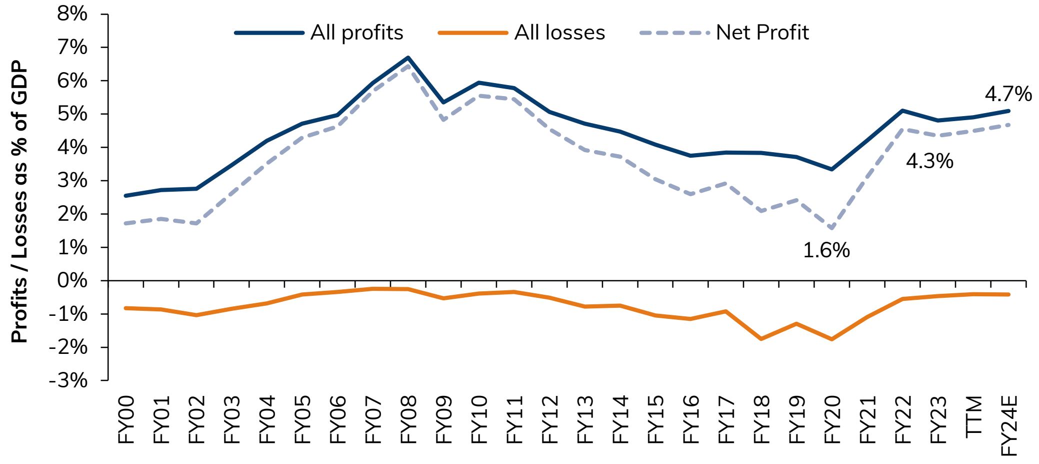
Source: Capitaline, I-Sec research

Exhibit 8: Low earnings volatility and quality stocks saw notable P/E expansion in cycle 2



Source: Capitaline, I-Sec research

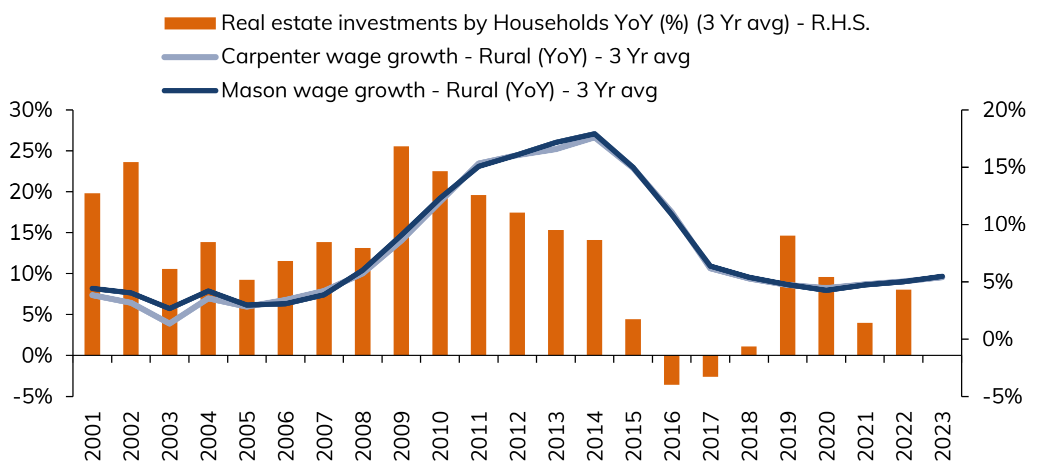
Exhibit 9: Profit cycle (listed space) is in-sync with investment cycle



Source: Bloomberg, Capitaline, I-sec research

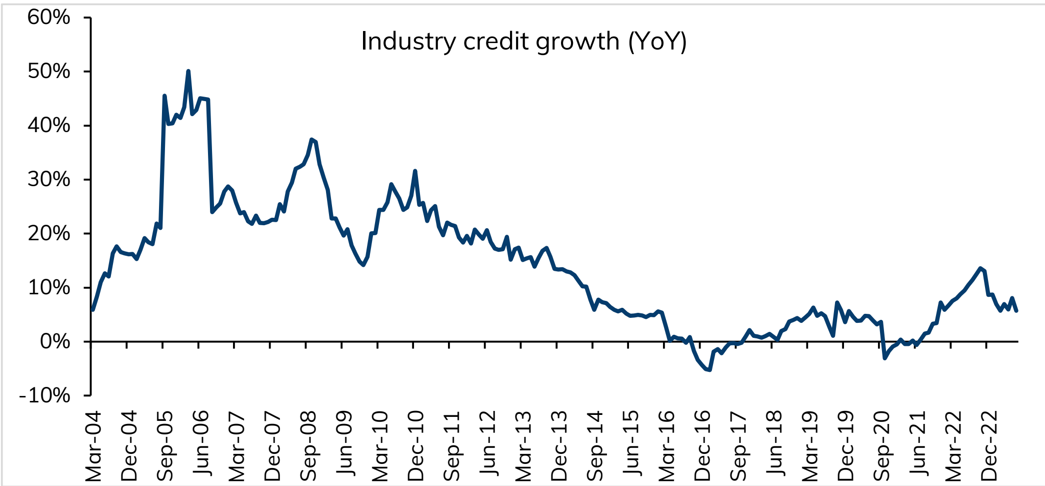
Note: TTM represents Q1FY24 TTM numbers.

Exhibit 10: Real estate investment cycle is in-sync with overall investment cycle



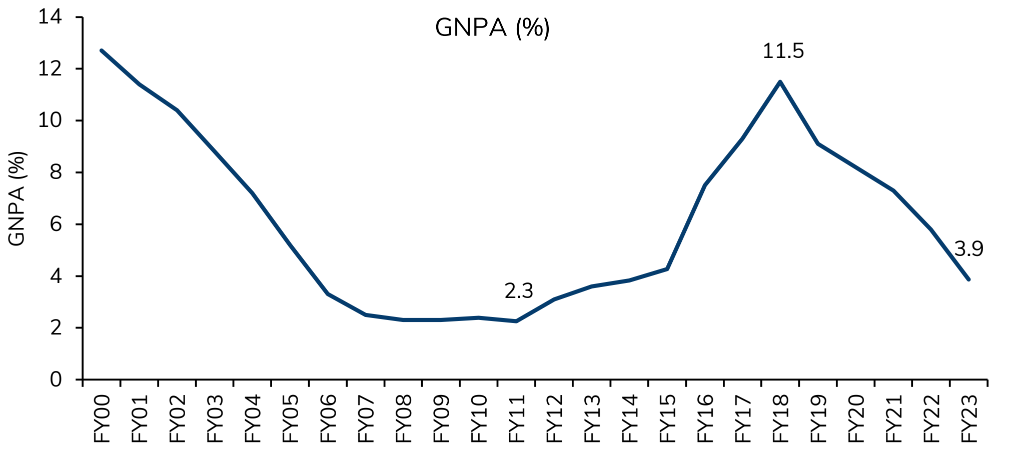
Source: CEIC, I-sec research

Exhibit 11: Industry credit cycle is in-sync with investment cycle...



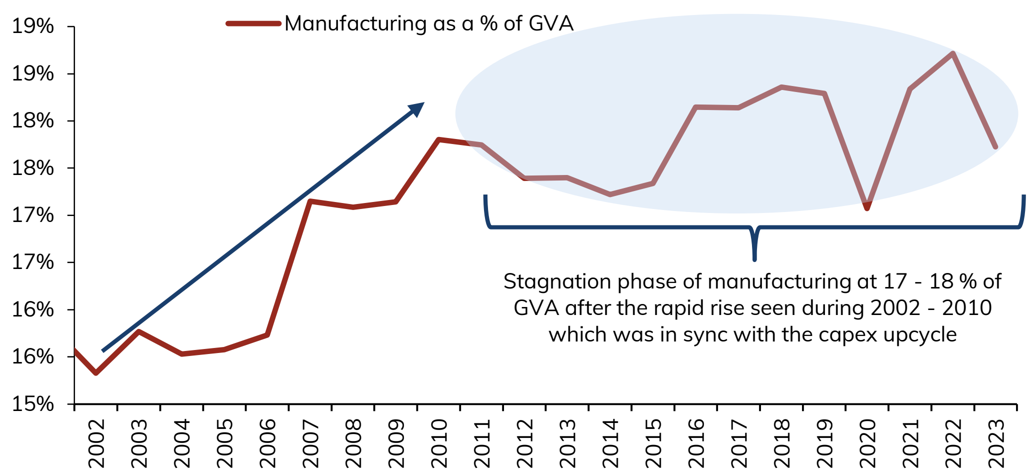
Source: CEIC, I-sec research

Exhibit 12: ...and so is NPA cycle



Source: RBI, I-sec research

Exhibit 13: Manufacturing cycle correlated with investment cycle; slack in 2023 is due to consumer goods while capital goods grew robustly



Source: CEIC, I-sec research

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