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BSE Sensex rallies 100x in 30 years; here’s how you can spot multibagger stocks

NEW DELHI: Stock picking could be a difficult task especially when you have a universe of over 5,000 listed companies on the Bombay Stock Exchange to choose from. The prospect of finding multibagger companies or 100x type of stocks may sound like finding a needle in a haystack.

The precise number of '100' is not as important as the fact that 100x opens the mind to the concept of long-term power of compounding in equity investing, Motilal Oswal said in its annual wealth creation study released earlier this month.

'100x' refers to stock price rising 100-fold over time i.e. '100-baggers' in stock market jargon. Both the short words here are important - '100-fold' and 'over time'.

The BSE Sensex has a base of 100 for the year 1979. The Sensex first touched 10,000 in February 2006, i.e. 100x in 27 years (almost 19% CAGR). As of March 2014, the Sensex stood at 22,400 levels. It was at 224-levels in 1984, i.e. 100x in 30 years (CAGR of 17%), quoted the report.

Given such strong performance of the benchmark indices itself, smart investors should target to beat the benchmark and achieve 100x in 20 years at most, i.e. CAGR of 26%.

Well, data suggests that 100x stocks take on average 12 years to rise 100-fold. And, in a given time-frame, 100x investment opportunities are more than 100x investment ideas.

The S&P BSE Sensex rallied 30 per cent in the calendar year 2014 and many supported by strong foreign flows, domestic institutions and increased participation of retail investors.

After a blockbuster year, 2015 too looks good for equities and analysts across brokerage firms recommend retail investors or first time investors to pick quality stocks for their portfolio but for a period of 3-5 years.

So how should retail investors make their choice in picking right stocks or multibaggers which could give them multifold returns in the years to come?

Dr. Vikas V Gupta, Executive Vice President, Traded Markets and Investment Research, ArthVeda Fund Management Pvt Ltd, is of the view that retail investors should scout for value stocks to construct their portfolio. "To scout for value stocks we must first understand what 'value' stands for," he says.

A 'value stock' is a stock which has either a low price-to-book ratio or low price-to-earnings ratio or low price multiples of other fundamentals, such as sales, cash flow, EBIT etc, explains Gupta.

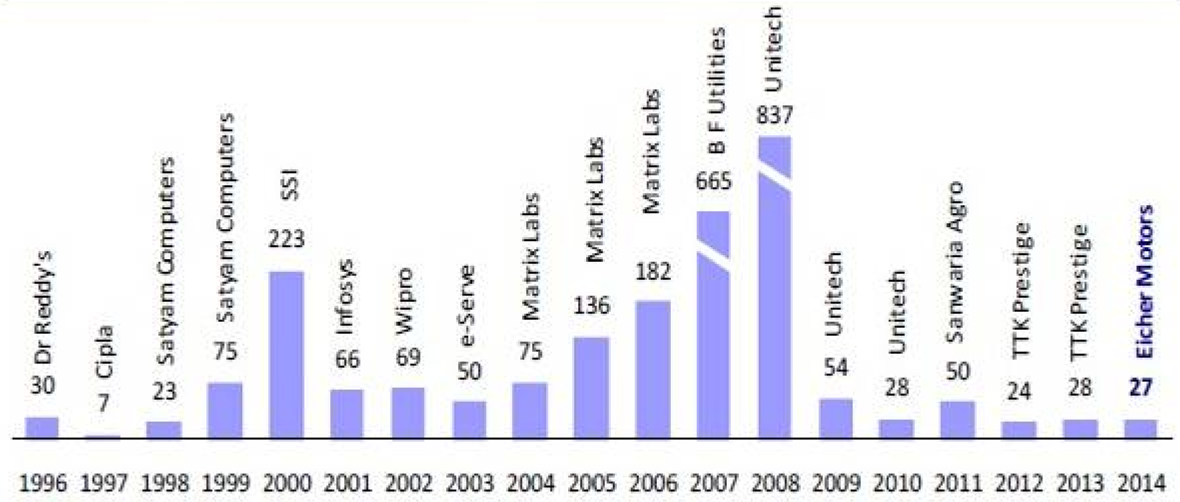
"The Graham-and-Buffettsville definition of a 'value stock' is a stock which is available at a 'significant discount' to 'intrinsic value'. Intrinsic value of a stock is the value of the equity of that company based on a discounted cash flow analysis," says Gupta.

Transitory multi-baggers attract a lot of crowd and media attention, but they always give nasty end-results, say experts. Deep cyclicals 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.

Enduring multi-baggers are those companies, whose wealth creation is long-lasting. Great businesses run by good managements purchased at huge 'margin of safety' will create enduring multi-baggers, says the Motilal Oswal report.

History of Fastest Wealth Creators (5-year Price multiplier, x)



Source: Motilal Oswal

The single-most important time determinant of stock market return is 'GROWTH' in all its dimensions - sales, margin and valuation. And once having gained insightful understanding of growth, especially long-term growth, 100x is arguably its best application, highlights the report.

The task of finding 100x stocks is indeed difficult but not impossible. Once sensitized to such a possibility and armed with the right framework, investors may find the challenge of unearthing the next 100-baggers more joyous than arduous.

Motilal Oswal's analysis of the 100x stocks suggests that their essence lies in the alchemy of 5 elements forming the acronym SQGLP - Size (of company), Quality (of business and management), Growth (in earnings), Longevity (of both quality & growth) and Price (favorable valuation).

Element	100x Feature	Checklist criteria
S – Size	Company should be small and relatively unknown	• Small size, ideally both in terms of sales & market cap • Low analyst coverage & institutional holding • Low traded volumes
Q – Quality	Quality of business	• Large existing or potential profit pool • Favorable competitive landscape • Potential for above cost-of-capital returns
	Quality of management	• Unquestionable integrity • Demonstrable competence • Growth mindset
G – Growth	Growth in earnings	• Multiplicative interplay of growth in (1) Sales volume and/or (2) Selling Price and/or (3) Margin.
L – Longevity	Longevity of quality & growth	• Assess the company's CAP (competitive advantage period) • Check whether growth is reverting to mean or not
P – Price	Favorable valuation	• Ideally, enough room for valuation re-rating

Source: Motilal Oswal

Dr. Vikas V Gupta, Executive Vice President, Traded Markets and Investment Research, ArthVeda

Fund Management Pvt. Ltd, lists out screening process by which investors can create a pool of better companies:
Step 1: Filter out all companies with sales less than INR 250 crore. Companies with sales lower than this are very small companies and might not have the business stability and access to finance that is required for a safe investment. So we will select companies with sales equal to or greater than INR 250 crore.

Step 2: Filter out all companies with debt to equity greater than 30%. Companies with low leverage are safer.

Step 3: Filter out all companies with interest coverage ratio of less than 4. Companies with high interest coverage ratio are good.

Step 4: Filter out all companies with ROE less than 15% since they are earning less than their cost of capital.

Step 5: Filter out all companies with PE ratio greater than 25 since they are too expensive even for a high-quality company.