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Kshitij Anand, ECONOMICTIMES.COM Aug 29, 2014, 01.42PM IST

NEW DELHI: Multi-bagger, as the name suggests, is used for stocks which may create multiple bags (multiply money) over the next few years for an investor. This is the term mostly used to describe those stocks which have potential to report explosive growth over the period of time.

"Putting it differently, it is the process of identifying tomorrow's mid or large cap from today's small cap stock," said Kiran Kumar Kavikondala, Director & CEO, WealthRays Securities.

However, one should not go behind multi-baggers based on advice. Rather develop your own tools out of your analytical filters - and the multi-baggers will automatically come out of analysis.

"A 2-bagger is a stock that has doubled in price while a 10-bagger is one which has multiplied your investments 10 fold. So a 10-bagger is amazing since even if a 10-bagger happens over 10 years, it is a return of 26% p.a compounded over 10 years," said Dr. Vikas Gupta, Executive Vice President, Arthveda Fund Management Pvt Ltd.

"So multibaggers are always good to have. However, today everyone is chasing multi-baggers. These are companies which are growing their per share earnings by very large amounts every year," he added.

Gupta is of the view that these are typically what Buffett labels as companies with economic moats. People generally confuse these with companies having a well-known brand. While it is a good indicator, not all companies with a strong brand are necessarily potential multi-baggers, he added.

Here is a checklist of various tools or methodologies which one can adopt in choosing stocks which have the potential to become next multi-baggers:

Debt level is important while looking for a multi-bagger:
What you are chasing after in a multi-bagger is a company that can multiply its worth several times over the next few years. People usually label this is a growth stock. This is then identified with a company which is growing its earnings by large amounts every year.

"However, one should identify if the book value is growing at the same rate. If the EPS is growing at 30% p.a. then one should look at the debt and make sure that that is not growing at more than 30% p.a," said Dr. Vikas Gupta, Executive Vice President, Arthveda Fund Management Pvt Ltd.

"Only if the balance sheet is strong, i.e. debt is less than, say 30% of the equity, then one can say that it is a genuine multi-bagger," he said.

Check the quarterly performance (revenue/EBITDA):
Check the quarterly performance of revenue, EBITDA and net profit. Revenue and EBITDA are the two components which reflect clear picture of the company's operating performance in its segment.

The operating performance of a company should reflect in its multiples; if the multiples are low and the company is outperforming at operating level, then the upside for the stock would be significant.

Look for source of earnings of the company:
It would be better to look for the sources of earnings of the company. If you find that the potential to grow the business is huge in the segment where the company is operating, then it is better to take position now.

"In this case it would be irrelevant to look at the capitalization category (large cap, mid cap, small cap or micro-cap) rather look at the scalability of the operations," said Tushar Pendharkar, Equity Strategist, Right Horizons Financial Services.

"One should only look at the hidden value in the company. It could happen that the investment could take time to reflect profit; however, if the company is sound and you are confident that the business has potential then give time to your investments and be patient," he added.

Earnings per share (EPS) and price multiples:
Give a look at the Basic Earnings Per Share (Basic EPS) and price multiples. Prices of the stocks change on the quarterly performance of basic EPS reported by the company. Investors should calculate the Trailing Twelve Months (TTM) basic EPS and revenue to calculate current Price to EPS (P/E) and Price to Sales (P/S) respectively.

Pendharkar is of the view that these two price multiples provide valuation of a company in the market. If the company has started performing significantly well and its EPS is growing better than its stock price, then one could consider it a better chance for investments.

Look for cues of capex, structural change from Quarterly presentations:
Finally the investors should read and understand the quarterly presentations uploaded by the companies on their websites. Investors would get the recent announcements related to capital expenditure, structural changes in the company, other management decisions, etc.