With Attractive Valuations, IT & Pharma Midcaps Worth a Look

Investors can book partial profit in frontline stocks and bet on midcaps, says **Prashant Mahesh**

Investors in technology and pharma sectors should partially book profits in their large-cap holdings and start investing their money in mid-cap stocks to exploit current attractive valuations, say experts.

Technology and pharma stocks have been among the best performing sectors in 2013, with the BSE IT index rising 55% and the BSE Healthcare index gaining 25% last year. Large-cap stocks have run up sharply. While TCS gained 72%, Infosys jumped 50%. In the pharma space, Lupin rose 48%, while Sun Pharma moved up to ₹588 from ₹372.

While the outlook for both the sectors is bright, given the sharp run-up in frontline stocks, many experts feel it is time to bet on mid-cap stocks. "After a sharp run-up in stock prices, it makes sense to book half of your profits in large-cap stocks and allocate that money to mid-cap stocks," says Vikas Gupta, fund manager, Arthaveda Fund Management.

Why mid-caps appeal?

After the sharp run-up in stock prices, valuations of frontline stocks within pharma and IT sectors have turned expensive. For example, TCS trades at a P/E of 29, while Infosys is at a P/E of 22. In comparison, mid-cap stocks within the sector are available at lower valuations. For example, Hexaware trades at a P/E of 13.44, Mindtree at a P/E of 15 and NIIT Technologies has a P/E of 9.85. Similarly, in the pharma space, Lupin's P/E stands at 22, while Dishman Pharma from the mid-cap space trades at a P/E of 15. "Mid-cap stocks within the sector are quoting at far lower valuations than large caps. They could catch up in the coming year," says K Subramanyam, AVP (institutional sales), Asit C Mehta Investment Intermediaries. He recommends Mindtree and CMC within the mid-cap space.

With fundamentals for the both industries are intact, valuation differential makes experts believe there is scope for higher appreciation in the mid-cap space. "Though the momentum in IT and pharma sectors is likely to continue in 2014 as the rupee is likely to remain weak and growth firms up in the US, we feel some mid-cap stocks within these two sectors could outperform the large caps," says Arun Gopalan, VP (investments and research), Systematix Shares.

For 2014, Nasscom expects the domestic IT sector to grow by 12-14%, while IT exports are likely to reach $86 billion. In addition, recently-announced results from Accenture have raised optimism for the IT sector. Accenture raised its EPS guidance by two US cents for FY14 and held its revenue forecast intact. This favourable environment could translate into higher business potential for the mid-cap companies.

According to Nasscom, major technology changes are expected to open new opportunities for service providers — that is, smart computing, social technologies, mobility and analytics. "These new opportunities could mean higher business potential for many mid-cap companies," says K Subramanyam. "With the US market doing well, IT companies could likely increase their spending on value-added products," says Vikas Gupta. Some mid-cap companies could benefit from this and he recommends Mindtree, Hexaware and NIIT Technologies.

Pharma Firms Score

Pharma cos with a higher share of export earnings may benefit more in coming days. "IPCA will benefit due to its Indore SEZ getting approval," says Kunj Bansal, chief investment officer, Centrum India. Post-FDA approval of Indore SEZ, IPCA is likely to get higher export business from the US and Canada, as operations scale up in these markets. This will add to IPCAs bottom line. Experts also believe pharma cos will benefit from the huge global generic opportunity along with drugs going off patent in the next couple of years. "Favourable currency, along with the huge generic opportunity, will benefit companies in the pharma space," says K Subramanyam. He recommends Dishman Pharma in the mid-cap space, as the generic API business will be the future growth driver.

prashant.mahesh@timesgroup.com