

**BSE Sensex: 52,880**

**S&P CNX: 15,834**

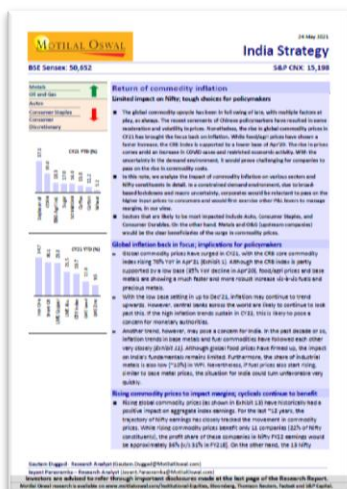
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## Refer our Return of commodity inflation report



## Midcaps hit a home run!

**Several benchmarks being reset; risk-reward metric not lucrative**

- The outperformance of midcap and smallcap indices have gone past their earlier benchmarks on multiple fronts – consecutive months of positive returns, 12-month rolling returns gap v/s the Nifty, relative valuations, and contribution to overall market capitalization.
- There exists a sharp divergence in valuations within these indices, with the gap between the top and bottom quintile expanding.
- While the midcap/smallcap valuations are rich and no longer lucrative on the risk-reward metric, the gradual unlocking of the economy and improved demand backdrop still offer bottom-up opportunities. Consistent earnings delivery v/s expectations is critical for further outperformance in our view.

## Long stretch of monthly positive returns in midcap/smallcap indices

- The recent sharp gains in midcap and smallcap indices have created new benchmarks.
- The NSE Midcap 100/NSE Smallcap 100 indices have generated consecutive positive monthly returns of 102%/67% in the last 13 months/8 months. This is the best such period of consecutive months of positive returns for the NSE Midcap 100. The Nifty Smallcap 100 has bettered this only once in the past.
- The NSE Smallcap 100/NSE Midcap 100 index has outperformed the Nifty in 10/9 out of 12 months.
- Nifty's underperformance v/s the midcap index on a 12-month rolling basis is at the highest levels since the GFC. For the smallcap index, this rolling 12 months underperformance is at the same level as during the GFC.
- Despite these recent sharp gains, the NSE Midcap 100 and NSE Smallcap 100 indices have underperformed the Nifty since their previous peaks of Dec'17. The Nifty has gained 51% since Dec'17, while the NSE Midcap 100/NSE Smallcap 100 have returned 28%/6%.

## M-cap contribution of midcap/smallcap index still away from its peak

- The recent broad-based rally has led to a sharp increase in m-cap contribution from the midcap and smallcap universe.
- The m-cap of the NSE Midcap 100 index now contributes 12.1% to overall m-cap, up from 9.8% in Mar'20. The m-cap for smallcap companies, as a percentage of overall m-cap, has increased to 3.7% at present from 2.7% in Mar'20.
- Peak contribution for the NSE Midcap 100/NSE Smallcap 100 index is 17.4%/4% of total m-cap.
- In terms of absolute m-cap, NSE Midcap 100/NSE Smallcap 100 are at the highest ever levels of INR28t/INR8.5t.

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**Divergence in valuations within midcap and smallcap indices**

- The Nifty Smallcap 100 has been trading at a premium to the Nifty for the first time since Dec'14. It is trading at a premium of 7% v/s an average discount of 21% on a 12-month forward basis.
- Valuations for the Nifty Midcap 100 index is on par with the Nifty on a 12-month forward basis.
- However, if one were to remove loss-making companies from both the indices, then the Nifty Midcap/Nifty Smallcap indices are trading at a trailing P/E of 21x/23x FY21 earnings, at a marginal discount to the Nifty.
- Valuations, however, are hiding more than what they are revealing. If one looks at the trailing 12-month valuations for the NSE Midcap 100 and NSE Smallcap 100 indices, there is a wide divergence within the index.
- We have divided the NSE Midcap 100 and NSE Smallcap 100 universe into four quartiles based on their trailing 12-months P/E. Loss-making companies have been removed from the aggregates. The aggregate quartile P/E of the most expensive stocks in NSE Midcap 100/NSE Smallcap 100 trade at 80x/79x, while the least expensive stocks trade at 9.4x/8.5x. This 12-month trailing P/E is distorted to an extent by the optically low 1QFY20 earnings, due to the stringent COVID-led lockdown. Historically (as well as on average), the least expensive aggregate for the NSE Midcap100/NSE Smallcap100 has traded at 8.8x/7.6x, while the most expensive has traded at 50x/56x. The median P/E for the NSE Midcap 100 index is 29x.

**Valuations rich; earnings delivery critical to sustain the outperformance**

- The sharp outperformance of midcaps, bolstered by healthy earnings, improved sentiments, benign liquidity, and low cost of capital, has more than bridged the valuation gap v/s largecaps. Current valuations, while not prohibitively expensive, are not lucrative from a risk-reward perspective. Meanwhile, balance sheets and cash flows have improved in FY21 as corporates tightened costs and deleveraged. The gradual unlocking of the economy and an improved demand backdrop do offer bottom-up opportunities. Consistent earnings delivery v/s expectations is critical for further outperformance. Any risk-off owing to concerns over potential interest rate hikes may impact midcaps/smallcaps more in our view.

**Exhibit 1: Top midcap ideas**

Company	M-cap (USD b)	EPS (INR)			EPS CAGR FY21-23, %	P/E (x)		P/B (x)		RoE (%)	
		FY21E	FY22E	FY23E		FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Max Financial	4.8	12.2	14.1	18.6	23	73.3	55.5	3.2	2.6	18.6	20.1
Varun Beverages	4.2	7.5	11.0	22.1	72	64.6	32.2	7.9	6.4	12.8	21.9
L&T Technology	4.1	62.8	85.3	106.8	30	34.0	27.1	7.5	6.4	23.9	25.5
Emami	3.4	16.3	16.8	18.8	7	33.4	29.8	11.8	11.7	38.5	39.4
Endurance Tech.	3.1	36.0	48.4	63.9	33	33.6	25.5	5.7	4.9	17.9	20.6
J K Cements	3.0	91.0	110.5	133.5	21	25.7	21.3	5.0	4.2	20.9	21.3
ICICI Securities	3.0	33.1	33.9	35.5	4	20.3	19.4	10.3	9.1	55.0	49.9
Indian Hotels	2.3	-7.1	-3.0	1.8	NM	NM	80.3	5.4	5.2	-10.5	6.6
Aditya Birla Fashion	2.2	-7.1	-4.4	-0.6	NM	NM	NM	10.5	10.9	-20.1	-3.1
Orient Electric	0.9	5.6	6.5	8.2	20	48.8	38.8	12.2	10.0	24.9	25.7

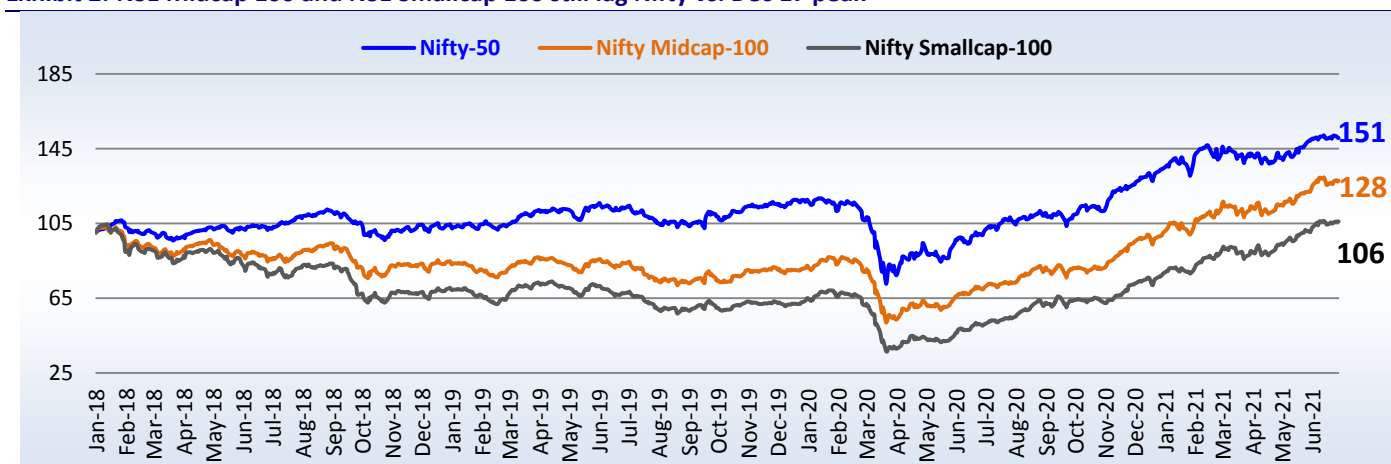
Source: MOFSL

### Long stretch of monthly +ve returns in Mid/Smallcap indices

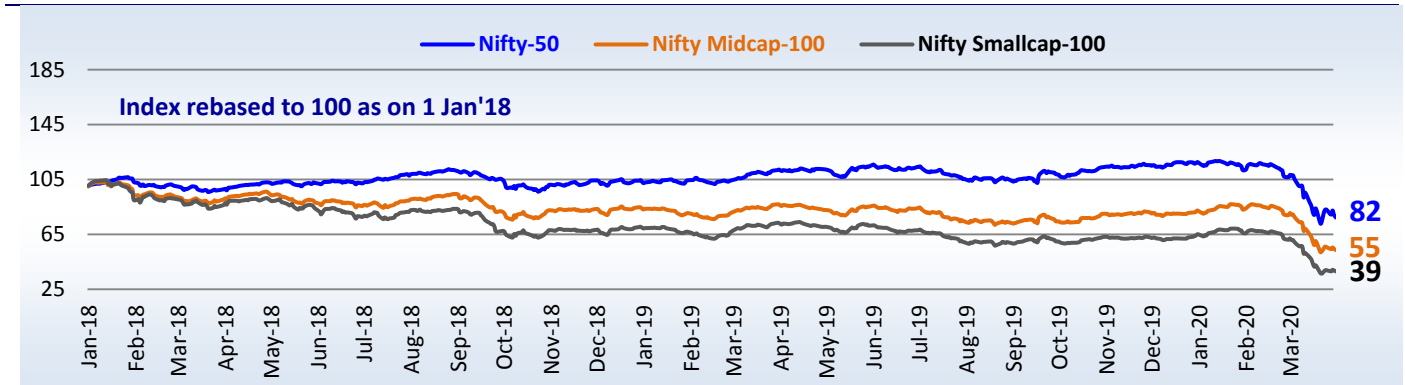
- The Mid-cap and Smallcaps have shown strong buoyancy of-late bolstered by strong underlying sentiments, healthy earnings performance and low cost of capital. We note that the monthly positive returns of these indices vs. Nifty has stretched and has now crossed previous such stretch/near to it.
- The NSE Midcap 100 and NSE Smallcap 100 indices have generated positive monthly returns for the last 13 and 8 months, respectively. NSE Midcap 100 has gained ~102% in the last 13 months, while NSE Smallcap 100 has gained 67% in the last 8 months.
- This is the best such period of consecutive months of positive returns for NSE Midcap 100 index. The second highest consecutive months of positive returns for the Midcap 100 index comprise the 9 months between Apr'03 and Dec'03, wherein it gained by 167%.
- The highest consecutive months of positive returns for the Smallcap100 index comprise the nine months between Jun'04 and Feb'05, wherein it generated cumulative gains of 85%.
- The NSE Smallcap 100 / NSE Midcap 100 index have outperformed the Nifty in 10/9 out of the 12 months. In-fact, in CY21, the Midcap/Smallcap index outperformed the Nifty in every month / in all months except Mar'21.
- Nifty's underperformance v/s Midcap index on 12 months rolling basis is at the highest levels since GFC while for Smallcap index, this rolling 12 months underperformance is at the same level as GFC.
- Interestingly, despite these recent sharp gains, the NSE Midcap 100 and NSE Smallcap 100 indices have underperformed the Nifty since their previous peaks of Dec'17. The Nifty has gained by 51% since Dec'17, while Midcap 100 / Smallcap 100 have returned 27%/6%.

22% of NSE Midcap 100 components and 23% of small cap 100 components have more than doubled since Jan'18 peak. However, 37% of Midcap 100 and 43% of Smallcap 100 components are yet to cross Jan'18 peak

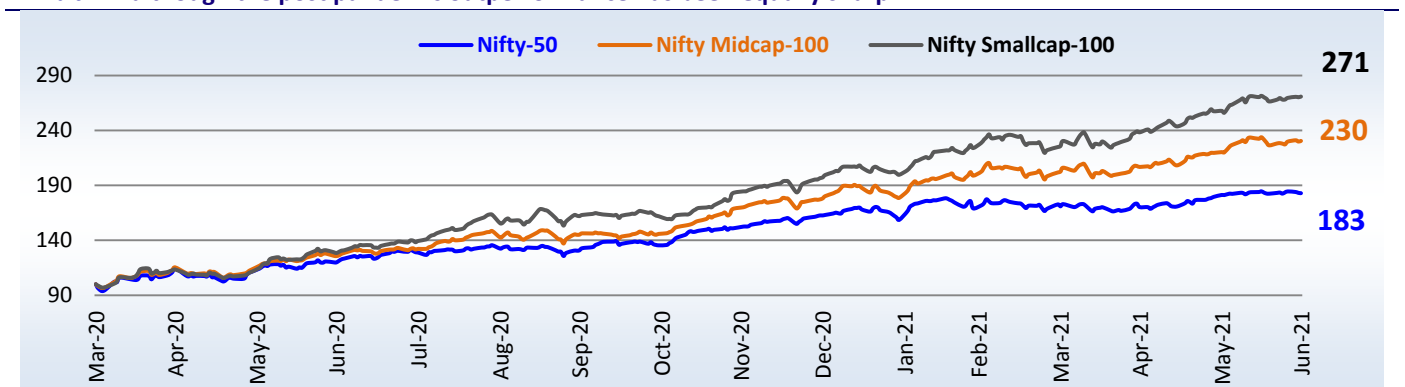
**Exhibit 2: NSE Midcap 100 and NSE Smallcap 100 still lag Nifty vs. Dec'17 peak**



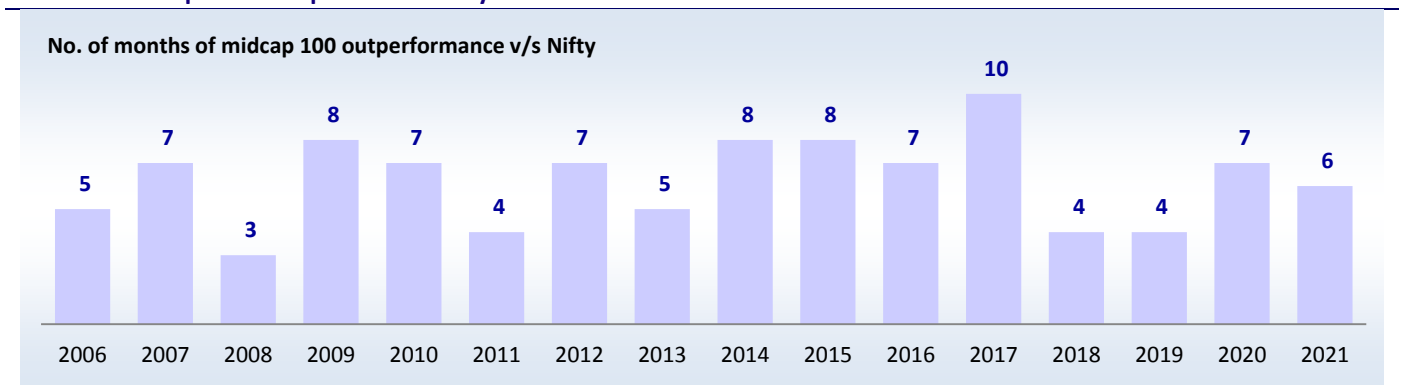
Source: Bloomberg, MOFSL

**Exhibit 3: Midcap100 and Smallcap 100 underperformed Nifty from Jan'18 highs to Mar'20 lows**

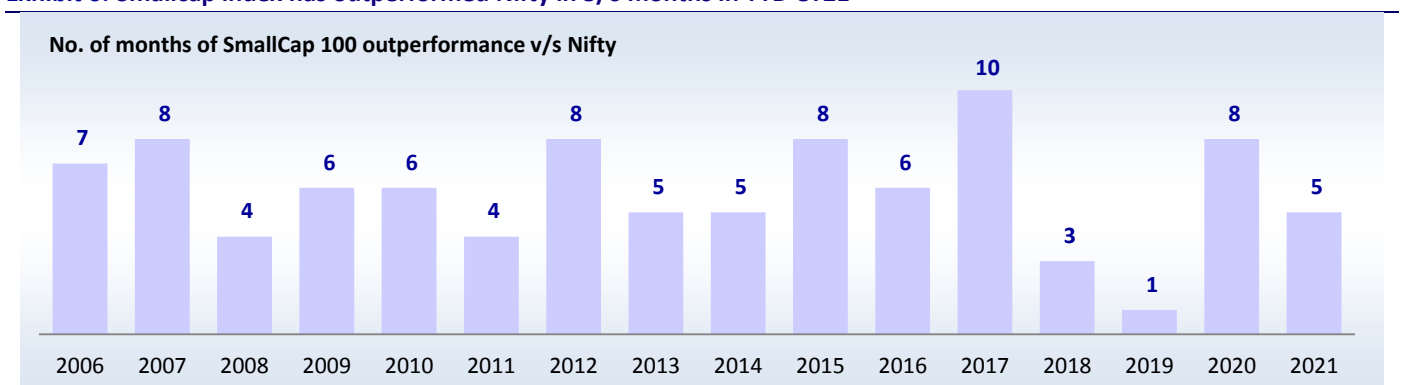
Source: Bloomberg, MOFSL

**Exhibit 4: ..although the post pandemic outperformance has been equally sharp**

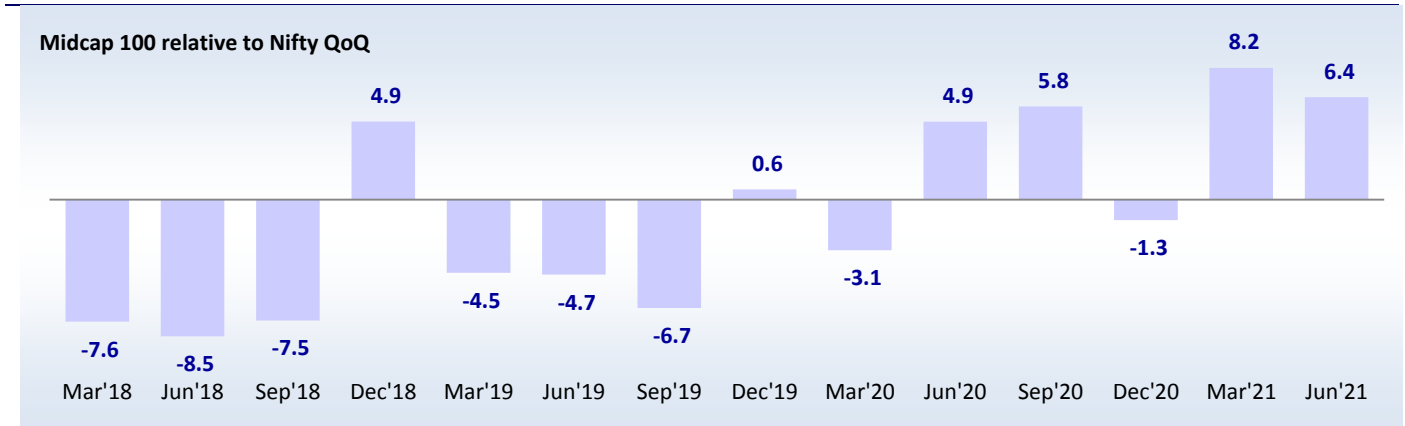
Source: Bloomberg, MOFSL

**Exhibit 5: Midcap index outperformed Nifty in all months in CY21 so far**

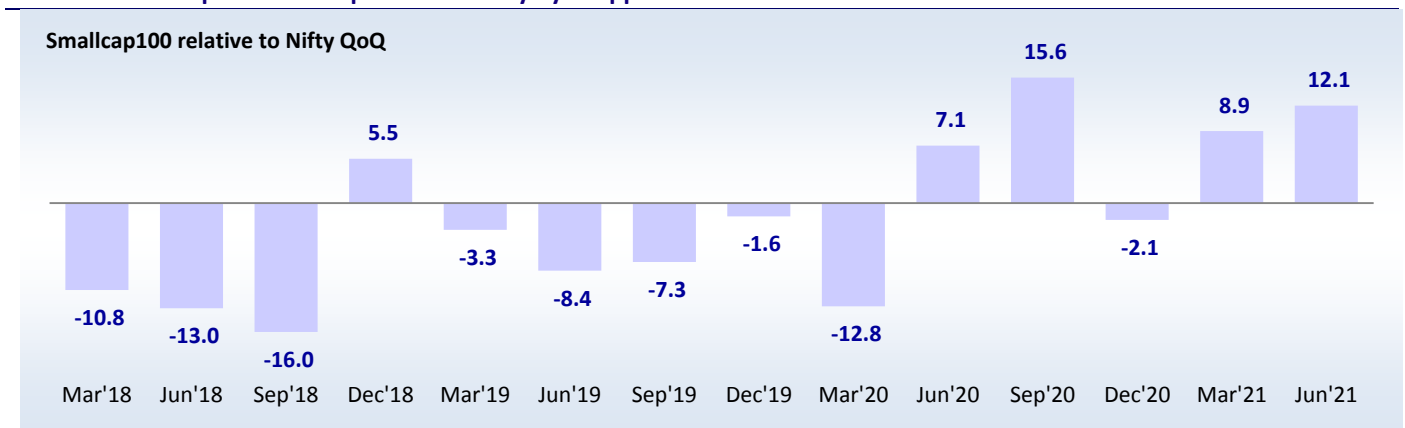
Source: Bloomberg, MOFSL

**Exhibit 6: Smallcap index has outperformed Nifty in 5/6 months in YTD CY21**

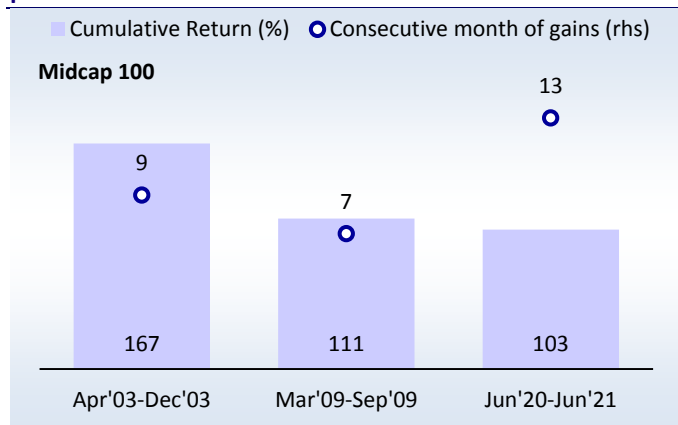
Source: Bloomberg, MOFSL

**Exhibit 7: Midcap 100 has outperformed Nifty by 15pp in CY21**

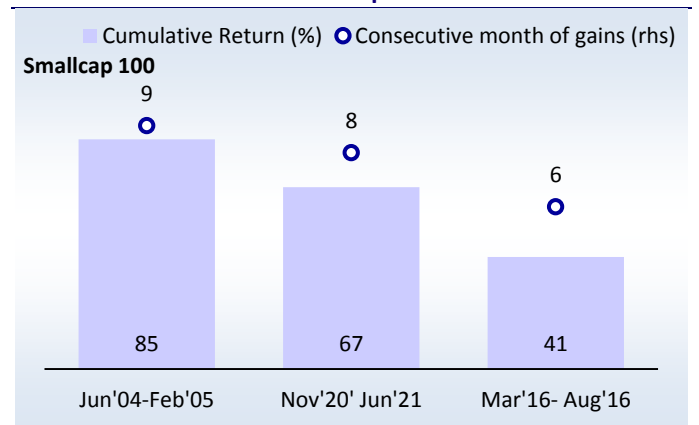
Source: Bloomberg, MOFSL. As on 30 Jun'21

**Exhibit 8: Smallcap 100 has outperformed Nifty by ~22pp in CY21**

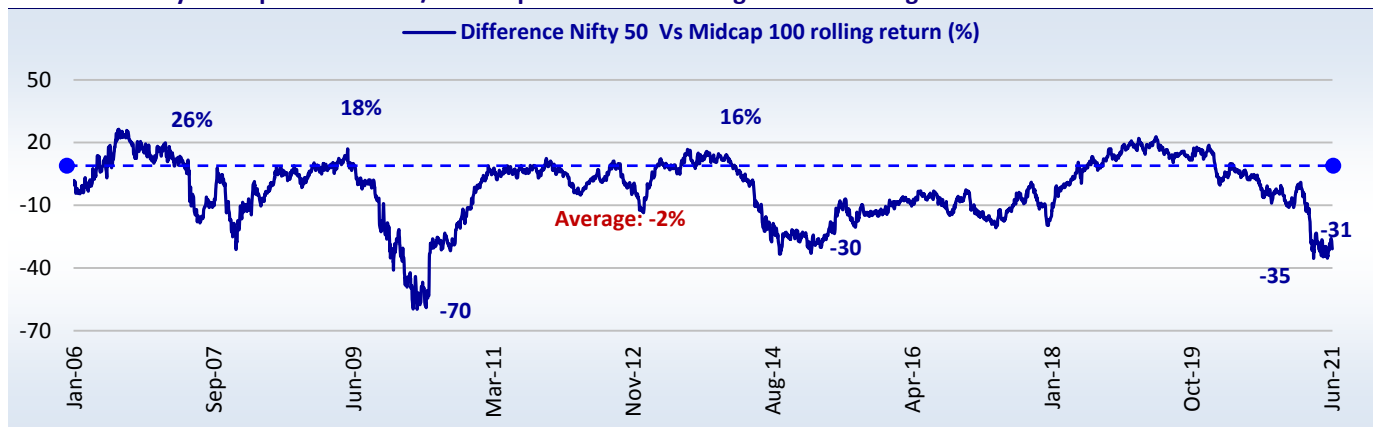
Source: Bloomberg, MOFSL. As on 30 Jun'21

**Exhibit 9: Midcap 100 post highest consecutive months of positive returns**

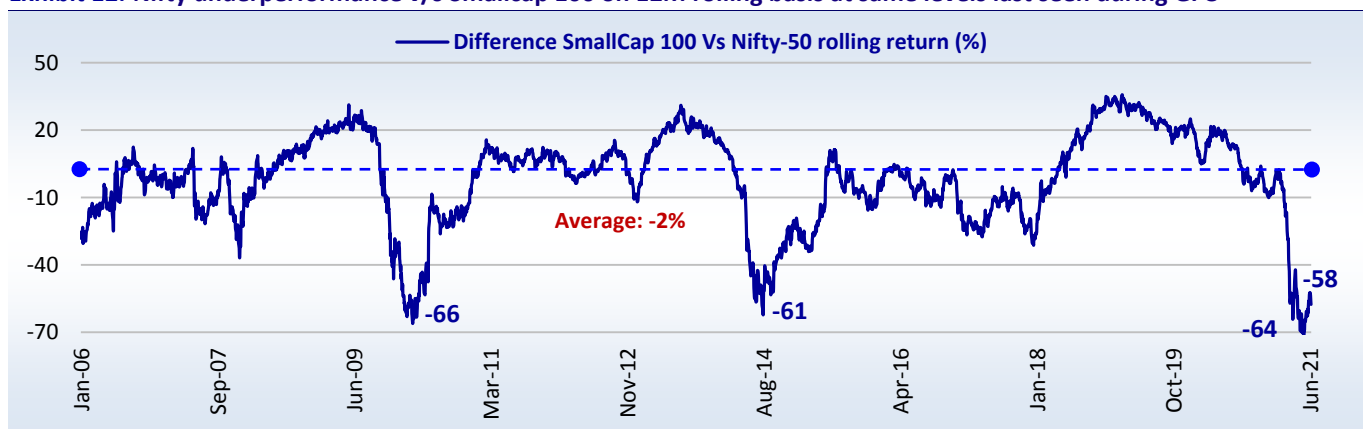
Source: Bloomberg, MOFSL

**Exhibit 10: Smallcap100 has had the second best period in terms of consecutive months of positive returns**

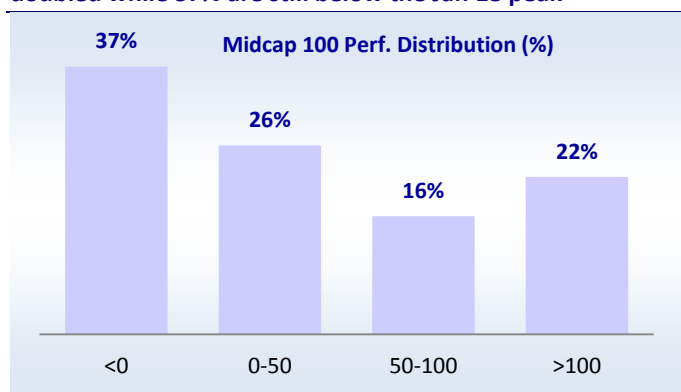
Source: Bloomberg, MOFSL

**Exhibit 11: Nifty underperformance v/s Midcap 100 on 12M rolling basis at the highest levels since GFC**

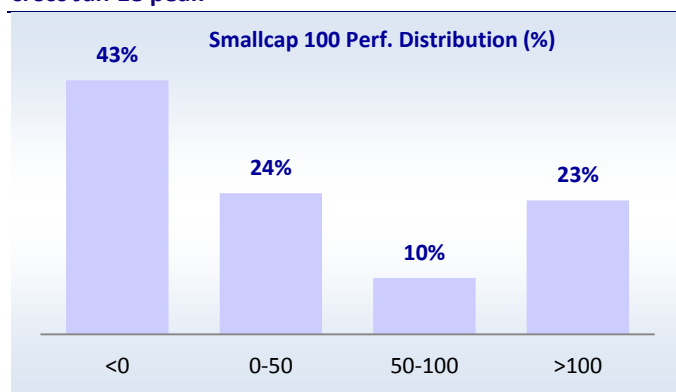
Source: Capitaline, MOFSL

**Exhibit 12: Nifty underperformance v/s Smallcap 100 on 12M rolling basis at same levels last seen during GFC**

Source: Capitaline, MOFSL

**Exhibit 13: 22% of Midcap 100 companies have more than doubled while 37% are still below the Jan'18 peak**

Source: Bloomberg, MOFSL. Based on current constituents

**Exhibit 14: 43% of NSE Smallcap 100 constituents are yet to cross Jan'18 peak**

Source: Bloomberg, MOFSL. Based on current constituents

**Market cap contribution by Midcap and Smallcap rises**

- The recent broad-based rally has led to a sharp increase in market cap contribution from the Midcap and Smallcap index.
- Midcap 100 index market cap now contribute 12.1% to the overall market cap, up from 9.8% in Mar'20.
- Smallcap 100 companies' market cap as a percentage of the overall market cap has increased to 3.7% currently, from 2.7% in Mar'20.

- The peak contribution for the Midcap100/Smallcap100 index is 17.4%/4% of the total market cap.
- In terms of absolute market cap, the Midcap 100 and Smallcap 100 are at the highest ever levels of INR28t/INR8.5t.

**Exhibit 15: NSE Midcap100 market cap contribution still well below the previous peak....**



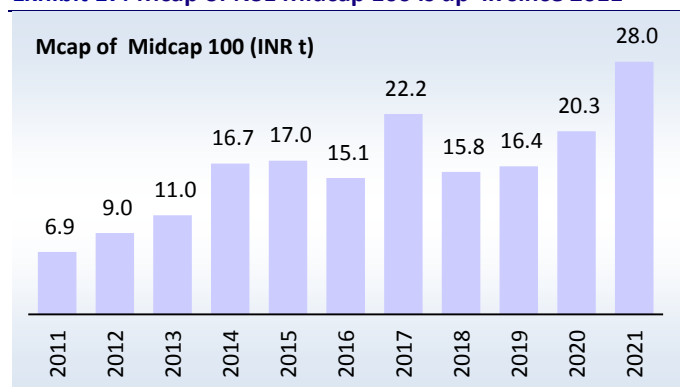
Source: Capitaline, MOFSL

**Exhibit 16: ..however NSE Smallcap 100 market cap contribution near peak of Dec'17**



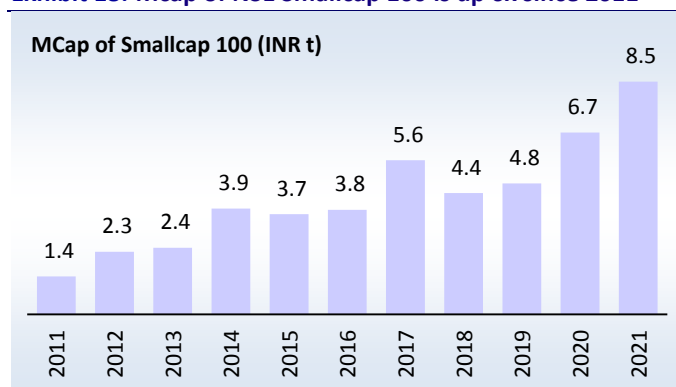
Source: Capitaline, MOFSL

**Exhibit 17: Mcap of NSE Midcap 100 is up 4x since 2011**



Source: Bloomberg, MOFSL. As on 29 Jun'21

**Exhibit 18: Mcap of NSE Smallcap 100 is up 6x since 2011**



Source: Bloomberg, MOFSL. As on 29 Jun'21

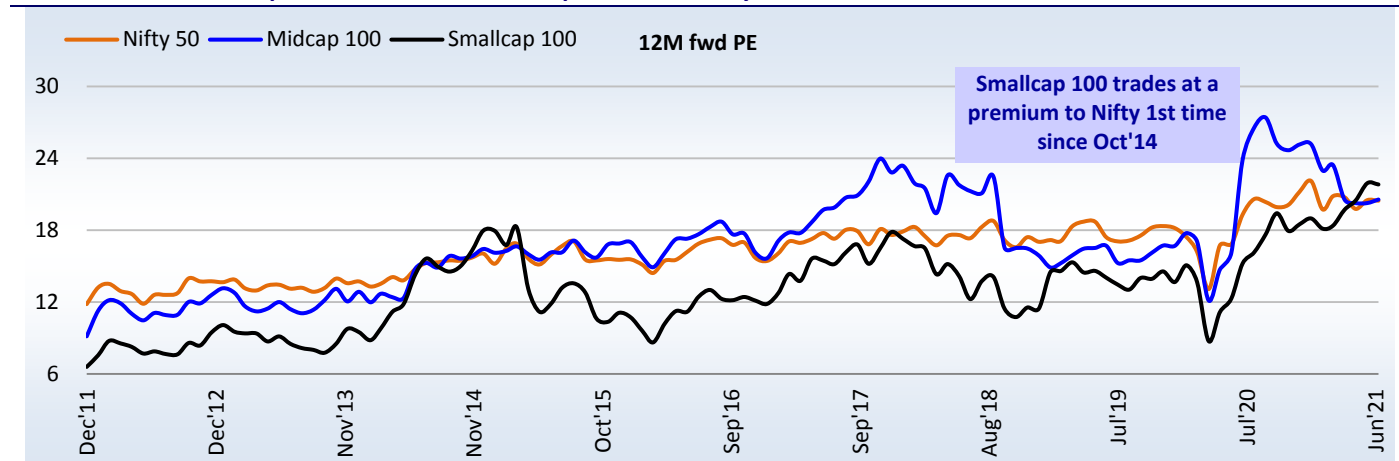
### Divergence in valuations within the Midcap and Smallcap indices

- Nifty Smallcap 100 is now trading at a premium to the Nifty for the first time since Dec'14. It is trading at a premium of 7% v/s an average discount of 21%.
- Nifty Midcap 100 valuations are trading on par with the Nifty 50 and are comparable with the long-term averages.
- However, if one were to remove the loss making companies from both the indices, then Nifty Mid-cap and Nifty Small-Cap indices are trading at trailing P/E of 21x and 23x FY21 earnings, at a marginal discount to Nifty.
- Valuations however are hiding more than what they are revealing. If one looks at the trailing 12M valuations for the Midcap 100 and Smallcap 100 indices, there is a wide divergence between the top quartile and bottom-quartile companies vs. the median P/E of the index.
- We have taken the NSE Midcap 100 and NSE Smallcap 100 universes and broken down the aggregate into four quartiles based on their trailing 12M PEs. Loss making companies have been removed from the aggregates. The aggregate quartile P/E of the most expensive stocks in Midcap 100 / Smallcap 100 trade at 80x/79x, while the least expensive stocks trade at 9.4x/8.5x. This 12-Month



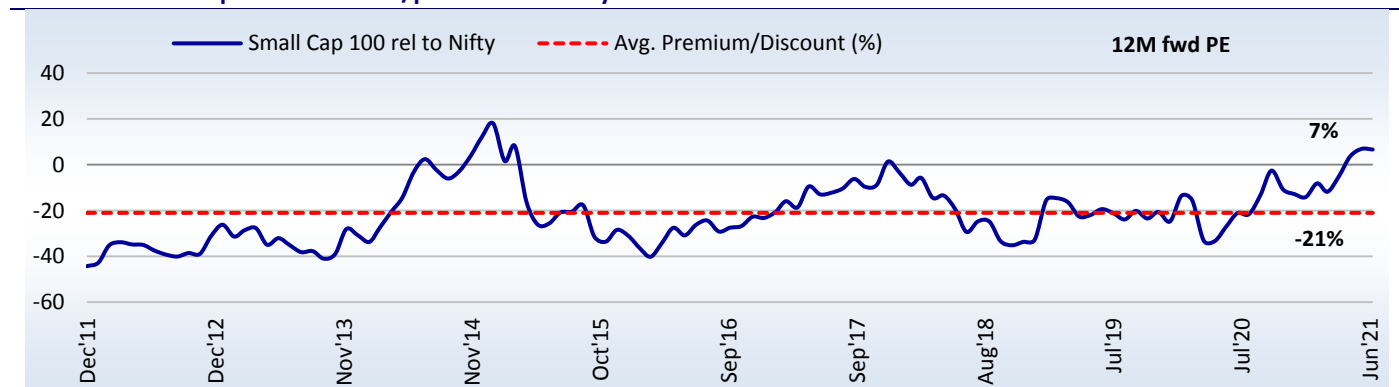
trailing P/E is distorted to an extent by the optically low 1QFY20 earnings due to stringent lockdown. Historically (as well as on average), the least expensive aggregate for Midcap100/Smallcap100 has traded at 8.8x/7.6x, while the most expensive has traded at 50x/56x. The median PE for the Midcap 100 index is 29x.

**Exhibit 19: NSE Smallcap 100 index now trades at premium to Nifty on forward basis...**



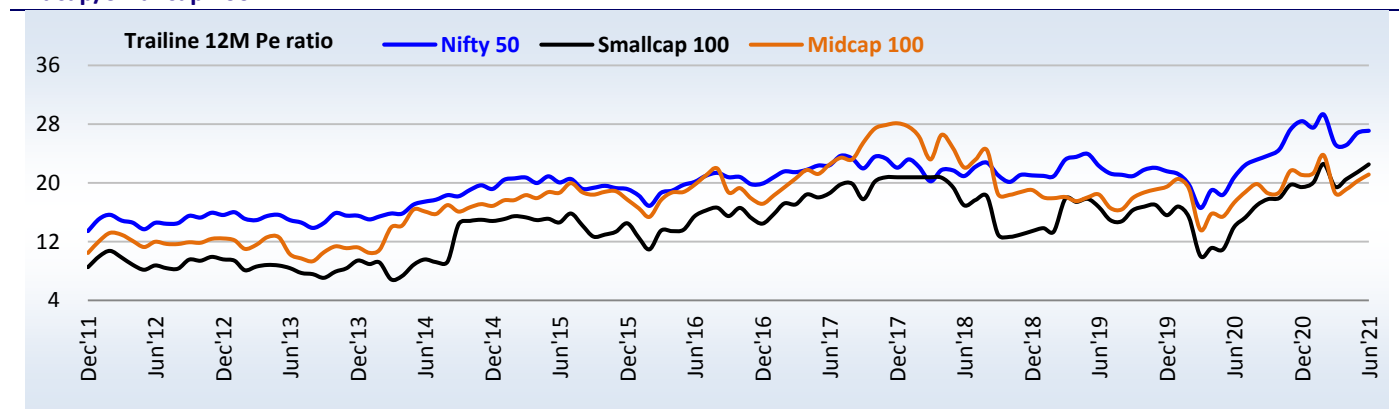
Source: Bloomberg, MOFSL

**Exhibit 20: Smallcap index discount/premium vs. Nifty valuations**



Source: Bloomberg, MOFSL

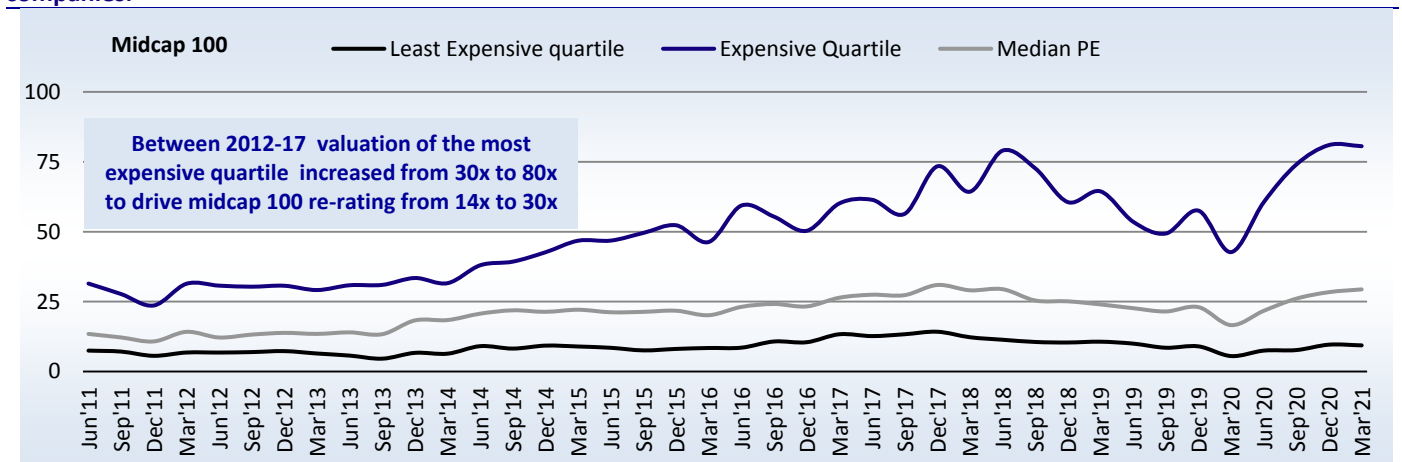
**Exhibit 21: However, on a trailing 12M basis, including only profitable companies, Nifty trades at premium to both Midcap/Smallcap 100**



Source: Bloomberg, MOFSL. Taking only positive earnings companies in index

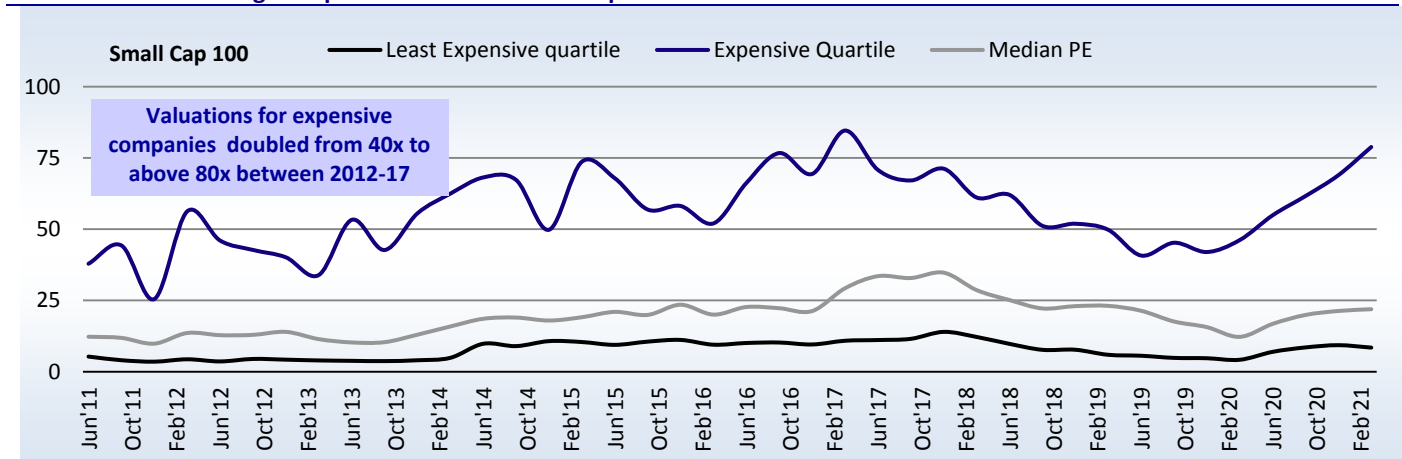


**Exhibit 22: Wide divergence between high PE / low PE stocks within Midcap 100 Universe leading to rise in overall PE for companies.**



Source: Bloomberg, MOFSL. Based on Midcap 100 index. The loss making companies are removed. Index rebalanced every quarter. Trailing 12M PE

**Exhibit 23: ...and divergence prevalent even in Smallcap 100 Universe**

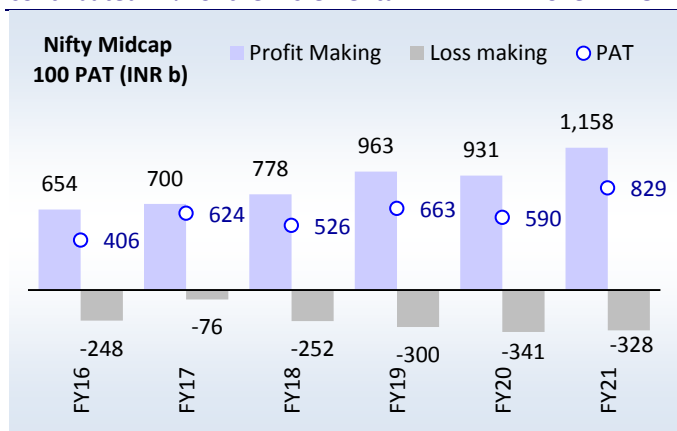


Source: Bloomberg, MOFSL. Based on Smallcap 100. The loss making companies are removed. Index rebalanced every quarter. Trailing 12M PE

**Midcap 100: Profit pools improving since FY18;**

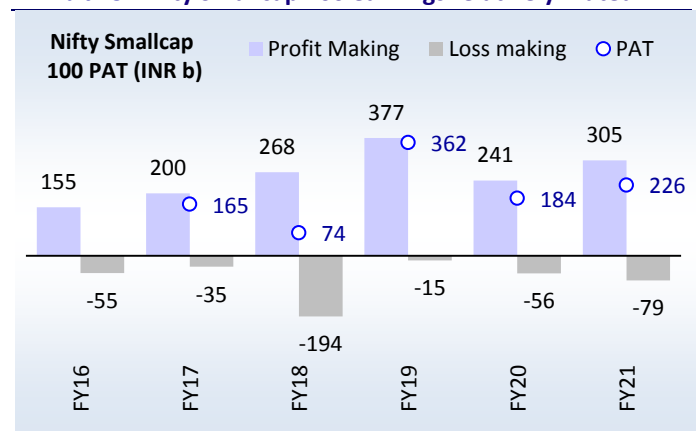
- Midcap 100 profit pool has seen a significant improvement since FY18. Based on a like for like basis for 93 companies which have reported earnings, the profit pool has nearly doubled from INR 542b in FY18 to INR 1.03 tn in FY21.
- The rise is underscored by sharp improvement in profitability of Metals and PSU Banks. PSU banks and Metals have contributed 54% and 20% of the incremental profit for FY21 over FY18. More importantly, the loss pool shrunk for NSE Midcap 100 every year since FY18.
- NSE Small-Cap 100 profit pool however has seen a relatively muted 5% PAT CAGR over FY18-21. For these 81 like for like companies, the loss pool has shrunk in FY21 YoY.

**Exhibit 24: NSE Midcap 100: Metals and PSU bank have contributed 74% of the incremental PAT in FY21 over FY18.**



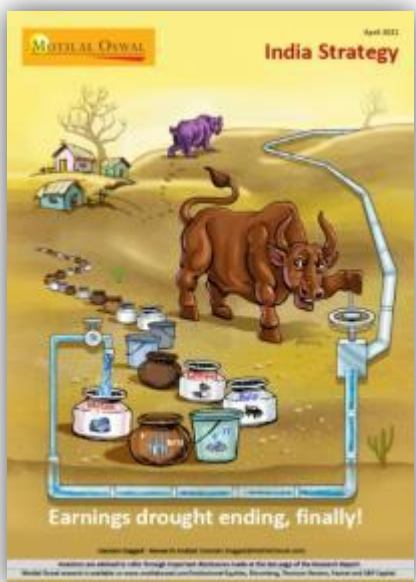
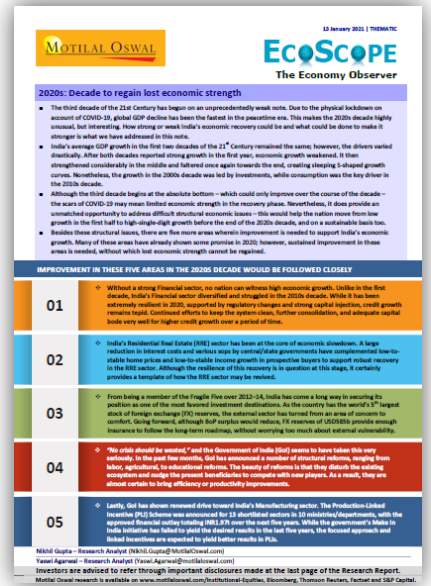
Source: Bloomberg, MOFSL. Based on 93 companies which have declared FY21 results. Using adjusted numbers for Idea

**Exhibit 25: Nifty Smallcap 100 earnings relatively muted**



Source: Bloomberg, MOFSL. Based on 89 companies which have declared FY21 results

# THEMATIC/STRATEGY RESEARCH GALLERY



NOTES



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Analyst ownership of the stock

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