

ET Investor's Guide

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Saluting the small heroes

Small companies have big dreams. And a portfolio with exposure to such 'potential' companies is likely to outperform the market benchmark. ETIG lists the fastest-growing small companies in India

IT'S EVERY investor's dream to ride on well-managed and fast-growing companies. If a company fulfils both these criteria and is a small untraded company, that's even better. Some of today's chartbusters were small companies a few years ago. A portfolio with exposure to such 'potential' companies has a high probability of outperforming the market benchmark.

ET Investor's Guide has identified such companies. But here's a caveat — past performance is no guarantee for future performance. Also, smaller companies often do not have an established track record. So, before making any investment decision, a thorough background check is desirable. As last count, there were close to 4,900 companies listed on the Bombay Stock Exchange (BSE), of which, more than half are actively traded.

It is also important to arrive at the right definition for a fast-growing and well-managed company. This is easier said than done. Reported financial data has dozens of parameters, some of which appear attractive, while others may disappoint investors. Another issue is to balance growth and operational efficiency. A fast growth in net sales and profit can't be sustained for a long time if the company does not generate satisfactory financial returns from the capital it utilises.

RETURN ON CAPITAL EMPLOYED (RoCE): A good way to judge the operational efficiency of a company is to look at its RoCE. This ratio (expressed as a percentage) represents the efficiency with which capital is utilised to generate revenue. RoCE should always be higher than the rate at which a company borrows money, else the company may be unable to meet its financial obligations.

RoCE should also be significantly higher than the risk-free return (such as bank deposits) in the economy, else it's better to park money in bank deposits — where returns are certain — rather than take the risk of investing in a company's stock. At the current rate of interest, bank deposits give a return of around 10% per annum, while companies can borrow funds at an interest rate of 10-12% p.a. To make the cut, a company must generate an average RoCE of at least 15% over the past three years.



TOP FASTEST-GROWING SMALL COMPANIES

THREE-YEAR AVERAGE GROWTH					THREE-YEAR AVERAGE GROWTH						
RANK	COMPANY	NET SALES	PAT	ROCE	P/E	RANK	COMPANY	NET SALES	PAT	ROCE	P/E
1	Jaybhari Textiles	245	232	123.7	78.7	11	Prajay Engineers	128	365	23.8	7.3
2	ICSA (India)	277	338	58.1	11.3	12	Venus Remedies	81	181	49.0	12.9
3	Neeco	88	84	161.5	45.5	13	Karuturi Networks	110	106	36.1	21.5
4	Tania Solutions	140	166	73.2	35.1	14	KBI Industries	85	256	42.0	12.7
5	Core Projects & Tech	135	134	75.1	82.0	15	Automobile Corp	43	31	86.2	15.0
6	Praj Industries	79	120	80.7	48.8	16	Webel SL Energy	87	71	80.2	26.5
7	Teledata Informatics	172	207	36.5	3.6	17	Ushdev Int'l	192	108	17.0	4.2
8	Patel Integ. Logistics	27	121	222.1	21.1	18	ANG Auto	115	390	23.0	15.0
9	Northgate Tech	113	219	33.4	33.1	19	Staalcast	50	153	81.2	8.7
10	Electrotherm (India)	134	287	30.2	10.4	20	Kallindee Rail Nirman	73	86	40.0	17.9

HIGH NET SALES & PROFIT GROWTH: What's the use of an efficient business operation if the company can't scale it up and grow faster than its peers? Though no growth figure can satisfy everyone, we have to agree on a minimum figure. A company's growth can shoot up or tank in a year, but we believe that a minimum 20% year-on-year (YoY) growth in net sales for three years is good. Also, sales growth is meaningless if it does not generate equally fast growth in net profit. Given the recent decline in profit growth of companies, we believe that at least a 15% YoY growth in net profits for three years represents a good performance.

THE FINAL WORD: So, what is a good high-growth company? According to our

definition, a well-managed, high-growth company must meet three criteria — an average RoCE of 15% or more for the past three years, average net sales growth of 20% or more for three years, and net profit growth of at least 15% for three years. The largest company in our list is HCL Infosystems, which reported net sales of Rs 9,195 crore during its last four quarters. The smallest company in our list is Selan Exploration Technology, which clocked revenues of Rs 26 crore during the year ended March '07. Most of the companies have net sales of Rs 100-500 crore, while a median-sized company had revenues of around Rs 300 crore.

As regards market value, a typical company in our list has a market capitalisation (m-cap) of around Rs 500 crore. The

most valuable company in our list is TVRCL Infrastructures, for which, the last 30-days average m-cap is Rs 4,412 crore, while the smallest company is Bihar Tubes, which is currently valued at Rs 52 crore.

All kinds of companies have made it to our list — rising construction stars, fast-growing auto ancillaries, small software firms, engineering majors and real estate companies. Some of the hottest companies to make it to our list include IVRCL Infrastructures, Praj Industries, Webel SL Energy, SKF India and Havell's India, among others. The common characteristic among all these companies is the ability to make the most of a business opportunity. Consider ICSA (India) and Electrotherm — the duo used technology to build a new market. While the former launched power

management software and tools to capitalise on rising investment in power sector, the latter launched electric-powered scooters and is now India's fastest-growing two-wheeler maker. Companies like ANG Auto and Automobile Corporation of Goa have made it to the list, thanks to a faster growth in their core markets. The toppers include a clutch of small, but rapidly growing software and IT services companies such as Tania Solutions, Core Projects and Northgate Technologies. These companies have grown by exploiting niches such as telecom, education, government and online advertising. A boom in the real estate sector has ensured a decent representation from that sector too — Jaybhari Textiles and Industries has topped the list from this sector.

NUTS & BOLTS: We believe the market is quick to reward high-performing large companies and is cautious about smaller companies. Since we intended to pick small heroes, we excluded companies with average m-cap of Rs 5,000 crore or more in the past 30 days. We also excluded banks, which operate under a different regulatory environment than companies in other sectors.

It's equally important to weed out very small companies and those not actively traded on the stock exchanges. Size can be defined by two criteria — net sales and m-cap. Typically, both grow in tandem, but not necessarily. Here, we have considered only those companies with net sales of at least Rs 20 crore during the year ended March '07 or December '06. We have also excluded those with m-cap of less than Rs 50 crore.

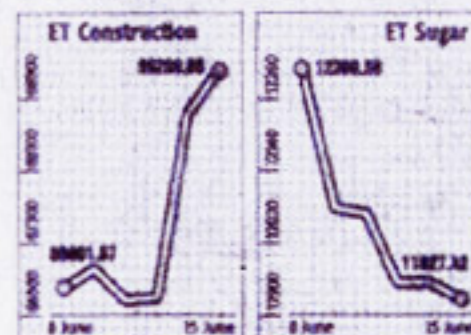
Our list includes only those companies whose average daily trading volume on the BSE is at least 500 shares in the past month. The composite ranking is based on 0.5 times RoCE plus 0.25 times growth in net sales and net profit in the past three years. For the companies for which three years' data is not available, the ranking is based on two years' data.

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(For the complete list of top 100 fastest-growing small companies, log on to: www.etinvestor.com)

MARKET PULSE

TOTALLY SHAKEN AND STIRRED

The market appears to be weak. A huge build-up in short positions in Nifty futures may be a cause for concern



Nothing Can Beat It

Infosys has seen a fall in its valuations. The stock offers investors an attractive entry point, given its better cost management and greater profitability. **PAGE 2**

Pop The Growth Pill

Ipca Labs is poised to gain from its strategic tie-up with Ranbaxy Labs. The stock is likely to outperform the broader benchmark index during the next 12 months. **PAGE 3**

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