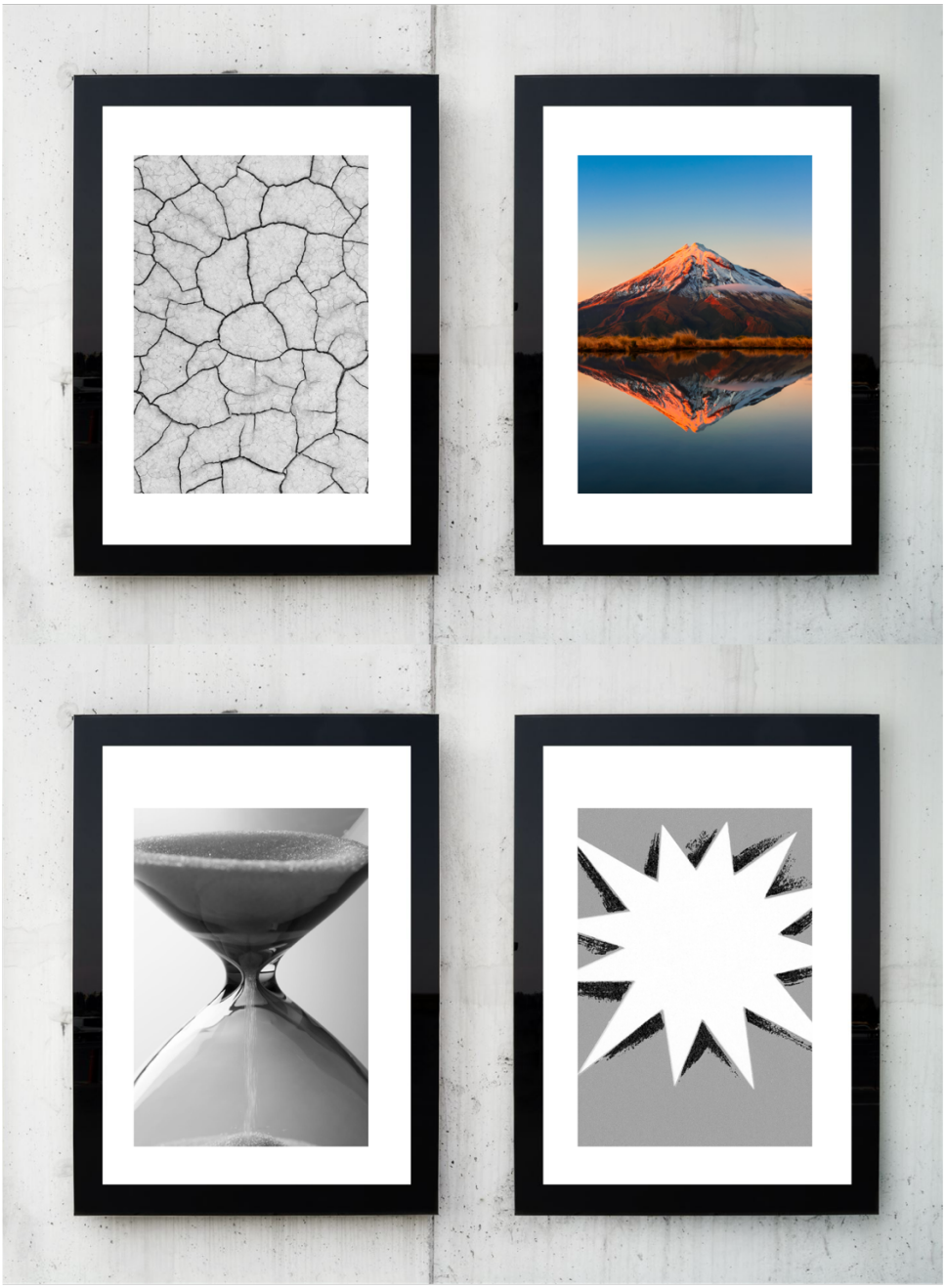
OMNISCIENCE CAPITAL
SCIENCE OF ALPHA FROM SAFETY

FOUR FOLIOS 2025



Omni Four Folios: Study Of Indian Equity Markets

A Scientific Investing Framework for the Scientific Investor

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Introduction: Why we did this study?

The Indian equity markets have more than 5,000 listed companies. In this era of excessive information, where the average retail investor is often **exposed to conflicting information regarding the markets, or is led by prevalent trends or "herd mentality" to decide which companies to invest in**, it is always prudent to have a **structured, rules-based framework** which can quickly sift through these ~5,000 companies to find investment-worthy options which can reward investors in the medium-to-long term.

Currently the general view is that markets are overvalued, and many investors or fund managers are sitting on substantial cash saying they cannot find opportunities to generate alpha. However, as of the date of the study (data as of Dec 25, 2024), the Trailing Twelve Months (TTM) PE of major Indian indices are as follows:

Index	TTM-PE Ratio
Nifty 50	23.3
BSE Midcap	29.9
BSE Smallcap	32.6
Nifty 500	26.7

While this is being considered high, the last 10-year average PE for Nifty 50 is 23 and the 5-year average is 25. So, it looks like Nifty is around its average PE. While Midcaps and Smallcaps seem overvalued, keep in mind that the Midcap universe is larger than Largecaps, and Smallcaps is more than 10 times larger than the Largecap universe. In a large universe it is often easier to find alpha-generating opportunities.

In addition to building substantial cash position in your equity portfolio, the other general advice today is either to look for balanced/hybrid portfolio allocation so that one can reduce the equity allocation or have significantly lower return expectation in the future. While we have an outsized focus on the safety of capital, timing the market with tactical allocation is not the strategy we ascribe to be safe and build long term wealth.

One way to understand our approach to safety and long-term wealth creation is to start with Charlie Munger's mental model of the Power of Inversion. While the quest is to identify an alpha generating portfolio from the full market, one can invert the question and begin with identifying and avoiding the segments that can potentially destroy wealth. The Four Folios study exactly aims to do so – identify the sectors, industries and capitalizations that one should avoid and also identify the segments that one needs to focus on.

Another observation is that when investing in stock markets most people do not focus on what is a good investment but what can help them multiply their wealth and do that quickly. In fact, many investors are not even looking for a good investment but are focused on the next "100-bagger". However, in this search for the next "100-bagger" stock they end up putting a large proportion of their equity investments into stories which don't work out. A priori many times more stocks look like the next "100-bagger" compared to how many eventually turn out to be "100-baggers". And most of these stocks are, typically, extremely overvalued at the time they are

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presented as "100-baggers". This ends up destroying a lot of investor capital when the thesis doesn't work out.

A better approach is to be able to identify "bad investments" a priori and then to eliminate them from the investment universe. This reduces the chances of misallocating capital to investments that are likely to either destroy significant percentage of invested capital or significantly underperform the markets.

The **Scientific Investing Framework** is designed to **"enhance safety"** in terms of statistically identifying the group of companies which are likely to be "bad investments" and eliminating them from the remaining investment process. Based on our extensive research over the past decade, this is a crucial step to generate alpha. Another aspect of safety enhancement is - "**enhance quality"** where the focus should be on businesses with higher competitive advantage which gives these companies the capability to survive and thrive even under unfavorable conditions. "**Enhance growth"** is the next source of alpha where the focus is on identifying 'growth vectors' which are essentially the long-term high growth opportunities. Further alpha generation comes through **"Enhance Returns"** by focusing on the mispriced opportunities which can provide significant rerating potential.

How We did this Study?

A very large number of companies within the ~5,000 companies listed on Indian exchanges are what can be termed microcaps or nanocaps. Many of these companies share the bare essential data as per the regulatory mandates. Also, their businesses might not be very stable on a fundamental level. Hence, **we focus on relatively larger companies which are at a market cap of INR 1000 crores or above.**

Depending on the overall market levels, there are around 1,350-1,400 companies above INR 1,000 crores. The top 100 by market capitalization are considered large caps, the next 150 are considered Midcaps and the remaining 1100+ are considered Smallcaps.

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FOUR FOLIOS: How does one search for alpha-generating opportunities from ~1,400 stocks?

In this high information availability age, it is likely that approximately 5%-10% of stocks are mispriced enough to generate significant alpha. The reason even these opportunities are available is due to behavioral errors by investors.

To sift through this large universe and find those 100-150 stocks which might be alpha generating is a challenging task. Given that most fund managers believe that the market doesn't have any opportunities and are thus sitting on cash, it makes it even more challenging currently. To help investors in this search for alpha, we conducted this study. We trust our proprietary **Scientific Investing Framework** for this task.

The Scientific Investing Framework classifies the investment universe into four groups, termed four folios. These are **Capital Destroyers, Capital Eroders, Capital Imploders and Capital Multipliers**. Statistically speaking, **Capital Destroyers** folio would have most of the companies that should be avoided. These companies are likely to have weak balance sheets and the ones likely to go bankrupt in the near to mid-term are mostly in this folio. These are also companies which, typically, are consistently loss making.

Capital Eroders folio would have most of the companies which, while avoiding the weaknesses of Capital Destroyers, do not have strong competitive advantages. These companies make profits, but the profits are not sufficient to compensate equity investors adequately.

Capital Imploders folio would have companies which enjoy strong balance sheets, persistent competitive advantages, are growing fast, but are extremely overvalued. It is likely that these are what can be called the **darlings of the markets** with most investors and fund managers chasing these stocks. This itself makes them risky stocks to own and these are likely to generate negative alpha over the long term. However, many of these are in momentum and momentum investors pretending to be fundamental investors get trapped in these while chasing short-term performance.

Capital Multipliers folio is what is the ideal investment universe in our opinion. This has companies with strong balance sheets, persistent competitive advantages and are likely to be undervalued.

Digging further within this Capital Multipliers universe we have created a subset, a fifth folio, the **Super Folio**. The Super Folio has companies with persistent competitive advantages or moats, high growth rates & large growth opportunities, strong balance sheet resources and internal accruals to finance this growth and are significantly undervalued. This is where most investors are likely to find high alpha-generating opportunities.

The above statements are statistical, meaning not every stock in the Capital Destroyers is bad, there could be exceptions. Similarly, not every stock in Super folio is good, there could be exceptions.

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While we will not be giving the names of stocks in each folio, we are sharing the sectors and industries that dominate each folio. We also share the prevalence of Large, Mid and Smallcaps in each folio. This should be sufficient for most investors who are willing to dig deeper to know where to look for alpha in the Indian markets for 2025. Of course, the alpha delivery happens over 3-5 years. If one is lucky, sometimes, it happens within 6 months to 2 years. However, most investors should have the patience to hold companies for 3-5 years to allow sufficient time for alpha delivery.

Also, we hold a strong opinion that one should not allocate more than 5% to any single stock; ideally, 2%-5%. This means a portfolio with 20-50 stocks. More than 50 might be overdiversification and less than 20 is too concentrated.

In the following section we present the application of the Scientific Investing Framework and its observations in much greater detail. We also present the Four Folios with the prevalence of various sectors and industries in each. The relevant fundamental and valuation ratios of each folio are also shared, which helps in determining whether this folio has fundamentally risky or fundamentally strong companies, as well as to determine the degree of relative overvaluation or undervaluation relative to the markets.

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FOUR FOLIO Breakdown:

The Four Folio study is a screening process utilizing the Scientific Investing Framework (SIF) to break down any investible universe of companies into the following quadrants:

1. **Capital Destroyers:** These are companies which have high leverage and credit risk, while at the same time having competitive disadvantages (consequently, lower performance and low RoEs) in their respective industries, and hence have the capacity to destroy capital.

2. **Capital Eroders:** Capital Eroders, while having lower credit risk and valuation risk profiles, still lack the competitive advantages necessary to provide sustained cash flows to investors in the long run. These companies, hence, tend to erode investor capital over time.

3. **Capital Imploders:** Capital Imploders refer to companies which do not fall under the previous 2 categories, but are still overvalued by the market, and investor capital in these companies is likely to fall in a Quality-trap or a Growth-trap. Such companies, by nature, can "implode" capital.

4. **Capital Multipliers:** Companies that do not fulfil either of the above 3 criteria (Destroyers/Eroders/Imploders) finally fall under the most favored category – Capital Multipliers. This portfolio – which is arrived at after applying the Scientific Investing Framework – is a pool of companies which have the necessary competitive advantage in their industry, mitigated leverage and interest rate risk and attractive valuations which make Capital Multipliers the best portfolio for the Scientific Investor within the total investible universe.

For the purposes of this study, the total investible universe is chosen as all companies having Market Cap of 1,000 crores or above. As of 25th December 2024, this number stood at 1,377 companies.

Once the total investible universe is selected, we apply our proprietary Scientific Investing Framework to the universe, dividing the market into the above categories (Capital Destroyers/Eroders/Imploders/Multipliers) and analyze each category below.

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Analyzing the "FOUR FOLIOS"

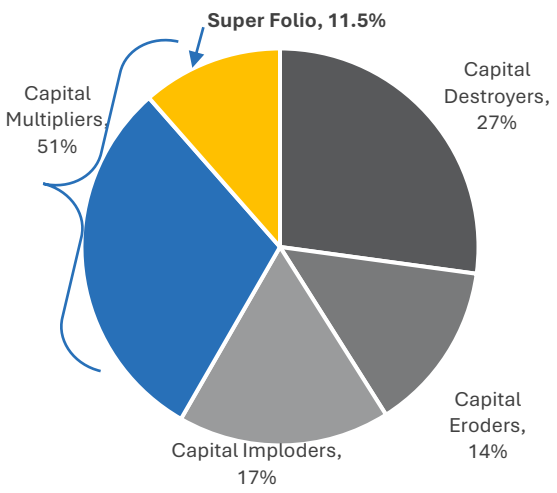
Applying the Scientific Investing Framework to our universe, we break down the total universe into the aforementioned "Four Folios". We further carve out from the Capital Multiplier portfolio a Super Folio with even better fundamental metrics.

In the current universe, the Four Folios are distributed fairly well across the market. In terms of market cap weights, Capital Multipliers occupy ~51% of the total universe, with Super Folio accounting for 23% of the current universe market cap. Based on the total market cap of INR 430 lakh crores, Capital Multipliers account for over INR 220 lakh crores.

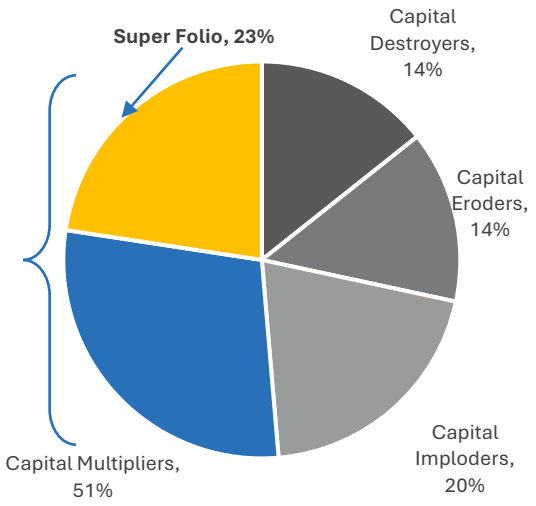
While in terms of # of companies, Capital Multipliers occupy 42% of the total universe, which is 574 companies. Of this, 11%, or 158 companies, are in the Super Folio.

Folios	No. of Companies	Weightage (#companies)	MCap (INR lakh crore)	Weightage (Mcap)
Capital Destroyers	374	27%	61.5	14%
Capital Eroders	191	14%	60.4	14%
Capital Imploders	238	17%	87.1	20%
Capital Multipliers	574	42%	221	51%
Total	1,377	100%	429.6	100%
Super Folio	158	11%	97.1	23%

Four Folios Distribution (Total Universe: 1,377 companies; Mkt Cap INR 430 lakh-crores)



Four Folios Distribution by # companies



Four Folios Distribution by MCap

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"FOUR FOLIOS" – The Scientific Insights

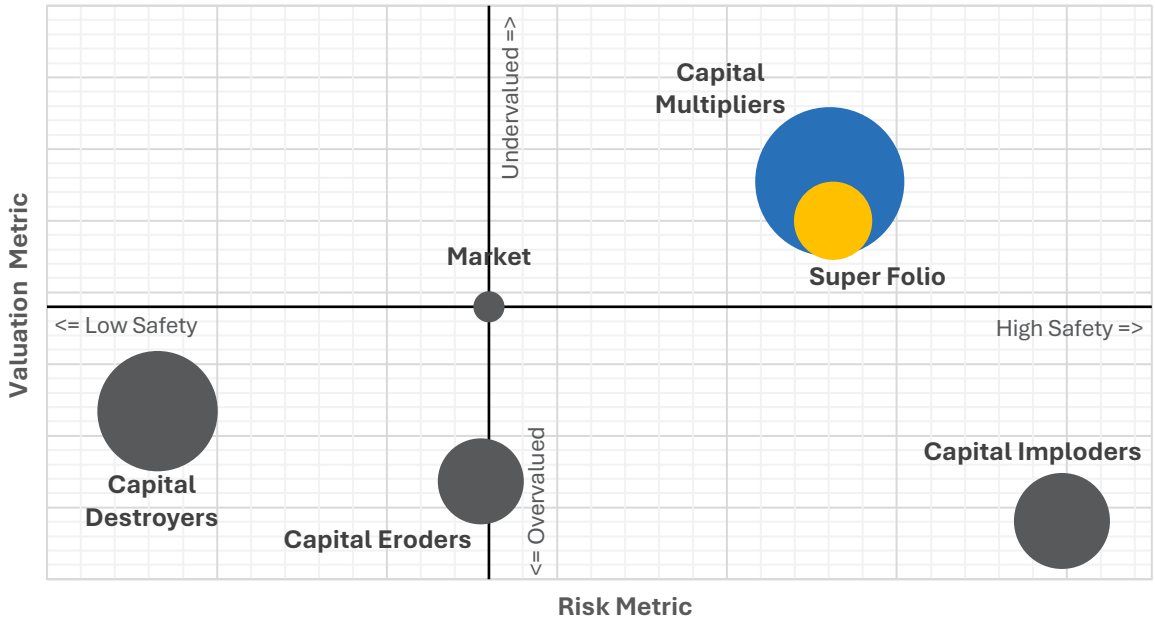
This section presents the core evaluation of four folios on the most important fundamental and valuation parameters which are derived from the Scientific Investing Framework. It may be useful to reiterate here the core process of alpha generation through SIF:

"Enhance Safety, Enhance Quality, Enhance Growth and Enhance Returns"

In this section we do a relative comparison of the four folios at the aggregate level on metrics such as Safety, Quality, Growth and Expected Returns, each plotted against valuation metric. The size of the bubble in the charts below represent the relative size of each folio in terms of number of stocks.

Enhance Safety: Risk vs. Valuation

The first chart below has valuation metric on the y-axis and risk metric on the x-axis. The two axes meet at the respective risk and valuation numbers for the broader market. The first quadrant (top-right) is the most optimal quadrant with high safety and more undervaluation and that is where we see the Capital Multipliers and the Super Folio, a subset of Capital Multipliers. As expected, the capital destroyers folio falls at the bottom-left with lowest safety and overvaluation. Also, the Capital Imploders folio which consists of fundamentally strong companies and hence, safer companies lie at the right most end but is also overvalued.



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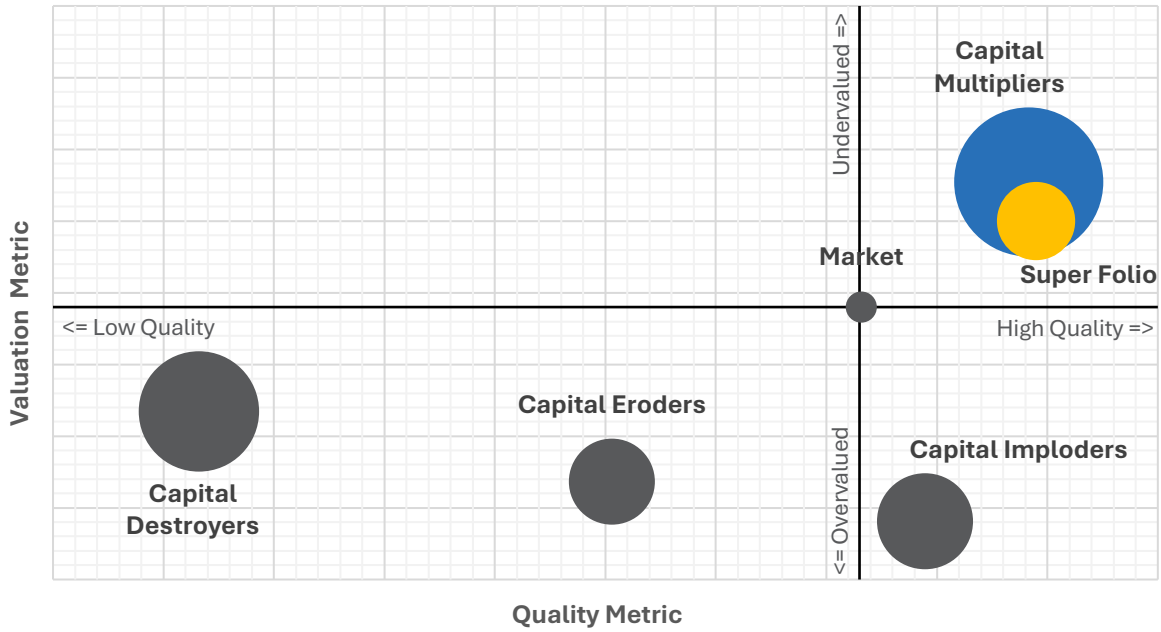
Enhance Quality: Quality vs. Valuation

The second chart below compares the Quality and Valuation matrices. It has valuation metric on the y-axis and quality metric on the x-axis. The two axes meet at the respective quality and valuation numbers for the broader market. Capital multipliers and the Super Folio fall in the first quadrant (top-right) which is the most optimal quadrant with best quality and yet undervalued. Interestingly, the Capital Imploders quality is higher than the broader market but lower than Capital Multipliers. Capital Eroders and Capital Destroyers Folios are expectedly lower quality metrics and are also overvalued.



Enhance Growth: Growth vs. Valuation

The next chart below plots four folios and the Super Folio on growth and valuations metric with valuation metric on the y-axis and growth metric on the x-axis. The two axes meet at the expected growth for the market and the market valuation number. While the Super Folio falls in the first quadrant (top-right), Capital Multipliers fall in second quadrant (top-left) with an expected growth rate lower than the expected growth rate for the broader market. It is important to notice the contrast between the growth rate expectation from Capital Imploders – the fundamentally strong, loved by Mr. Market and overvalued pool and the Capital Multipliers – fundamentally strong, ignored by Mr. Market and undervalued. The over optimism on growth in case of capital imploders typically end in steep de-rating of these companies as the growth normalizes and analysts estimates become more realistic. Similarly, in the case of Capital Multipliers the growth outlook improves as the companies start reporting normalized growth numbers and this leads to significant rerating for the stocks.

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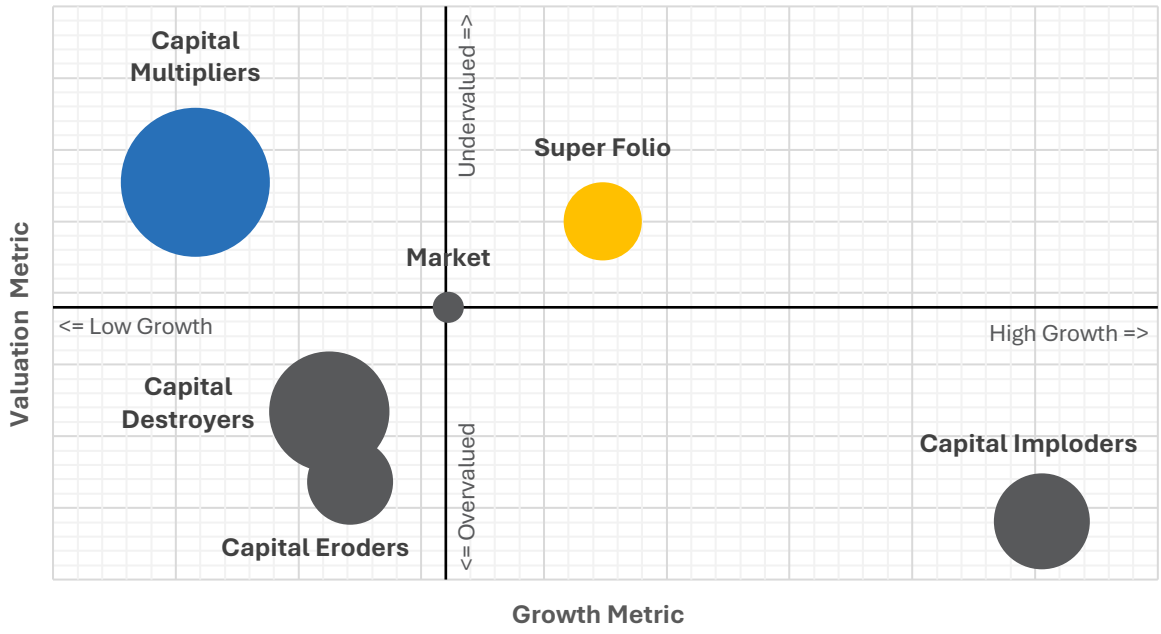
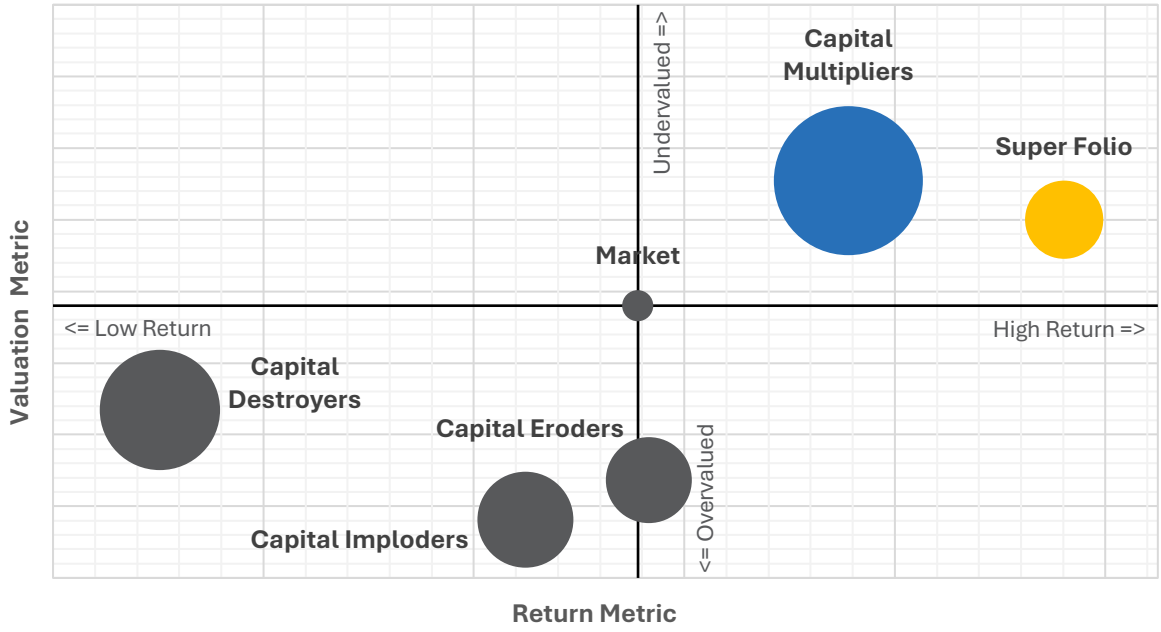


Enhance Returns: Return vs. Valuation

The following chart in this segment has valuation metric on the y-axis and expected return metric on the x-axis. The two axes meet at the expected return and valuation numbers for the broader market. It may be noted that the expected return metric takes into account the normalized expected growth rate, capital efficiency and the starting and the ending valuation multiples. The return metric indicates that Capital Multipliers is the only clear pool where the expected return is higher than the broader market return. Super Folio, being fundamentally strong and most undervalued pool, has the highest expected returns.



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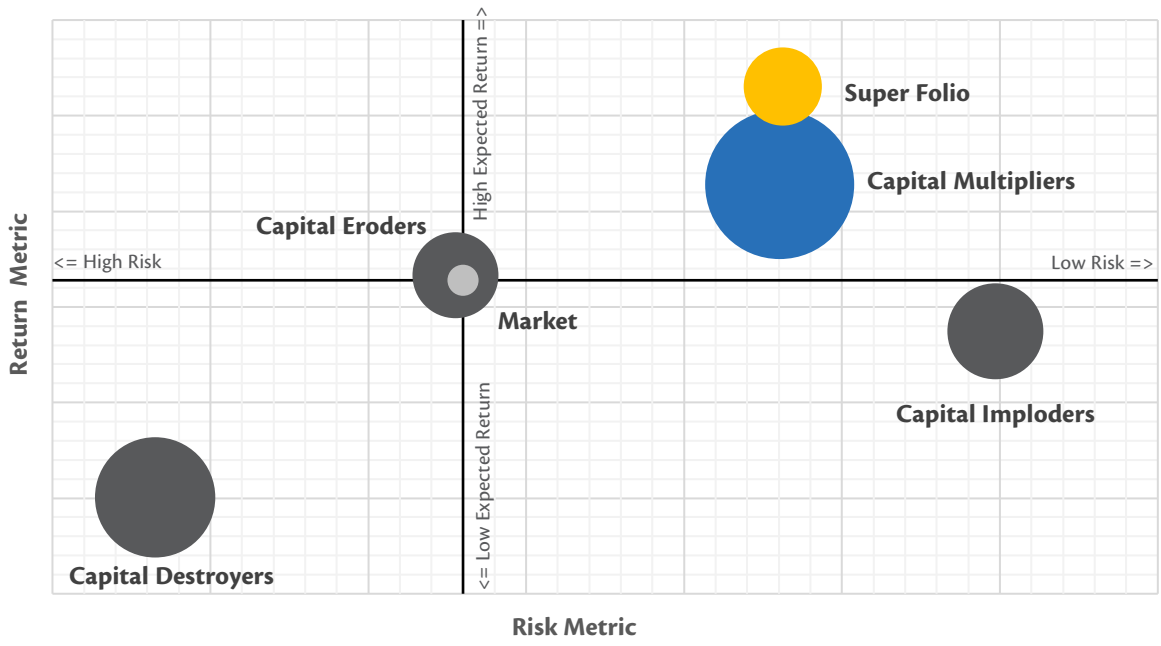
Enhance Returns: Risk vs. Returns



The final chart above compares two of the most popular metrics when it comes to academic financial theory, i.e., Risk vs. Returns. Our fundamental view here, which could sound contrary to the popular belief of "High Risk-High Return", is that, in a risky asset class such as equities, the focus should be on finding the "Low Risk-High Returns" opportunities. Another key difference is in the understanding and definition of the Risk metric. We focus on the fundamental risk of loss of capital vs. the popular statistical metric of price fluctuation which we believe is not the cause but the effect of risk. However, the price fluctuation could be because of many other market anomalies and hence is not the best metric to understand risk.

The above chart has Expected Return metric on the y-axis and Risk metric on the x-axis. Capital Multipliers and the Super Folio pools show that while these two pools have the highest expected returns, they also have the lowest risk metric, implying – Low Risk-High Returns. The Capital Imploders pool has low fundamental risk as most of these companies are high quality companies. However, as this pool is significantly overvalued, the expected return is much lower.

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"FOUR FOLIOS" – Valuation & Fundamentals Matrix

Once the selection process is complete, each portfolio of the Four Folios is compared based on leverage, valuation, competitive advantages, margins, and growth. The following table lists all the relevant ratios of the Four Folio portfolios and the multicap benchmark. These ratios/metrics are discussed for each Four Folio category in subsequent sections.

Four Folios vs. Benchmark (Fundamental & Valuation Ratios)

Ratio	Nifty 500	Capital Destroyers	Capital Eroders	Capital Imploders	Capital Multipliers	Super Folio
VALUATION						
P/E	26.7	521.4	25.9	71.6	18.4	17.7
P/E 1 Yr FWD	23.4	82.2	19.0	59.6	17.7	18.0
P/E 2 Yr FWD	20.0	47.7	16.0	47.5	15.7	15.6
P/CF	20.2	26.3	15.9	62.9	17.2	19.3
P/BV	3.9	3.3	2.6	11.3	3.3	3.1
EV/EBITDA	15.6	21.2	14.1	40.8	12.6	13.1
EV/EBIT	19.2	39.1	19.3	49.3	14.2	13.7
FCF Yield	1.7%	0.6%	0.1%	0.7%	2.7%	2.4%
FCF Yield 1 Yr FWD	2.3%	1.8%	1.0%	1.0%	3.3%	2.9%
FCF Yield 2 Yr FWD	2.9%	2.2%	1.7%	1.4%	3.8%	3.5%
Div. Yield	1.2%	0.4%	0.8%	0.6%	1.6%	1.1%
COMPETITIVE ADVANTAGE						
ROE	14.6%	2.6%	10.1%	15.8%	17.7%	17.8%
ROA	2.5%	0.2%	3.2%	5.3%	2.6%	1.8%
ROCE	15.3%	5.6%	10.4%	18.7%	19.2%	20.7%
5 Yr Average ROCE	13.6%	5.4%	8.7%	20.1%	17.5%	19.3%
Gross Margin	30.9%	32.6%	26.2%	39.0%	31.0%	37.6%
EBITDA Margin	18.7%	15.4%	14.9%	14.1%	21.6%	22.3%
EBIT Margin	15.2%	8.3%	10.9%	11.6%	19.1%	21.4%
Net Margin	10.0%	0.5%	6.6%	8.0%	13.8%	16.0%
LEVERAGE						
Gross Debt to Equity	61.3%	86.3%	58.9%	27.3%	47.9%	52.9%
Net Debt to Equity	45.2%	76.2%	50.9%	3.8%	27.1%	23.1%
Interest Coverage	5.20	1.30	5.10	11.94	9.21	9.25
GROWTH						
Growth Est. 2 Yr FWD	13.2%	12.3%	12.4%	18.1%	11.2%	14.5%

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Four Folios: Actionable Insights

Some quick, actionable insights from the Four Folio analysis are summarized below:

WHAT TO AVOID?

- The companies in the Capital Destroyers folio are likely to cause the largest damage statistically speaking and as seen in the previous section. While we are not naming those companies, we are trying to guide the investors to sectors and industries which are more likely to be present in the folio. For example, in the Capital Destroyers folio, Smallcaps dominate. 341 of the 374 companies are Smallcaps. Of course, this is not surprising given that majority of the companies in the Indian markets are Smallcaps. However, in our universe, while overall 82% of companies are Smallcaps, in the Capital Destroyers universe 91% of the companies are Smallcaps. So Smallcaps are over-represented in the Capital Destroyers folio.

  If one is investing in Smallcaps, then one should be very careful in terms of studying balance sheets. Do these companies have too much debt? Are these companies making losses consistently?

  Chemicals, Real Estate Operations, Textiles & Apparel, Construction & Engineering, Telecommunications Services, Metals & Mining, and Automobile & Auto Parts are some of the industries which are represented significantly in this folio. If one is allocated in these industries, one should do a rigorous due diligence of these companies.

- The Capital Eroders portfolio is dominated by industries such as Automobiles & Auto Parts, Chemicals, Oil & Gas and Machinery/Components. Many of these industries also constitute a significant proportion of the Capital Destroyers portfolio, suggesting that some of these industries are avoidable due to the underperformance and/or weak competitive advantage of the industry as a whole (Having said that, any industry can and probably would have at least some companies within the Capital Multipliers portfolio, dependent on having superior growth and better competitive advantages over their competitors).

- Within Capital Imploders, the companies have strong balance sheets, consistent profitability and high growth rates. However, these companies are extremely overvalued and thus need to be avoided. For example, one could avoid the Personal & Household Products & Services companies since most of them are overvalued. The Capital Imploders portfolio also has presence of Chemicals, Software & IT Services, Pharmaceuticals, Textiles & Apparels, and Food & Tobacco companies. Many of these companies have high growth rates but are extremely overvalued even accounting for those high growth rates. If one is buying these companies at such overvalued prices, holding them for a decade and assuming all the growth assumptions come true, the expected return for the portfolio is likely to be similar to the discount rate being used, meaning something akin to Nifty. However, if the growth assumptions turn out to be overoptimistic during the holding period, the stock price is likely to implode since valuations are quite sensitive to growth assumptions (Of course, in the near term they could be in momentum and thus favorites of short-term traders).

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WHERE TO LOOK FOR POTENTIAL ALPHA?

- Capital Multipliers are the favorite hunting grounds for alpha-generating opportunities. Even better is the Super Folio which is a subset of Capital Multipliers folio. This folio has companies with strong balance sheets, persistent competitive advantages, high growth rates and are, typically, available at significant discounts to their intrinsic values.

  For example, Banking Services is more than 50% by weight and large caps are more than 80% by weight. This means that one could look at large cap banks as a potential investment. Besides, some specialized infrastructure NBFCs, and housing finance companies could hold a higher likelihood of undervaluation.

  Besides, the banks, Construction & Engineering, Chemicals, Automobiles & Auto Parts, and Metals & Mining are some of the other industries in this folio. One should analyze the companies from these industries carefully to see which qualify for Super Folio and which for the avoidable folios.

  Analyzing the rest of the Capital Multipliers Folio, the dominance of large caps continues similar to Super Folio. This reinforces the presence of opportunities in large caps. Besides Banking, this folio shows a strong presence of Software & IT services. Many of the large cap IT companies are present here. Selected companies from Automobile & Auto Parts, Construction & Engineering, Software & IT services, Professional & Commercial Services, etc. also fall under Capital Multipliers and are likely to be market/growth leaders in their respective industries.

A NOTE ON STATISTICAL OPPORTUNITIES FOR INVESTORS

One should note that the Four Folio study is a statistical categorization of the companies into four broad buckets. The Scientific Investing Framework categorizes the companies based on historical, current, and forecasted, fundamental and valuation data which is available. As such, one should understand the limitations of the study. Having said that, the Scientific Investor can keep the following considerations in mind:

- The Capital Destroyers would have a higher presence of fundamentally risky companies. These companies have a higher likelihood of incurring losses and going out of business compared to the rest of the companies. This doesn't mean that there might be no investment opportunities in this folio. For someone who is interested in digging deep and has a highly sophisticated analytical toolkit, sometimes there could be some opportunities here which could be quite rewarding. However, for most investors, these companies are avoidable.

- The Capital Eroders would have a higher presence of companies with weak competitive advantages. In general, companies in this folio are not investment worthy. However, there could be exceptions where the historical data is indicating a weak company, but the company is on its turnaround journey and is becoming stronger. However, to identify such opportunities requires a high level of analytical skills. Most investors would be better off not getting attracted to companies in this folio.

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- The Capital Imploders is the folio which has most of the darlings of the markets. These companies, typically, have high growth, strong competitive advantages but are overvalued. Being strong businesses these companies are quite popular with investors and the media. However, one needs to be aware that at the extreme overvaluations, the chances of getting poor returns over the long term are quite high. We would caution against investing in these companies. ***Remember, Great companies are not necessarily Great investments, unless available at a Great price.***

- The Capital Multipliers, Super Folio would have a higher presence of potentially rewarding companies. The likelihood of these companies going out of business is quite low. However, any investor should still follow full due diligence and analysis before investing in any company present in this folio. However, it is likely that companies in this folio could generate higher alpha over the long-term compared to the rest of the market.

The rest of the Capital Multipliers folio, after excluding Super Folio, is also potentially rewarding, but the rewards could be slightly lower compared to Super Folio. Investing in this folio, however, would be still within a safe and competitively advantaged universe of companies.

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"FOUR FOLIOS" – Industry and Market Cap Breakdown

In this section we analyze each of the Four Folios in detail, including portfolio composition, sector and industry profile, and the expected and resultant variations in fundamental and valuation ratios between all Four Folios and the multicap benchmark.

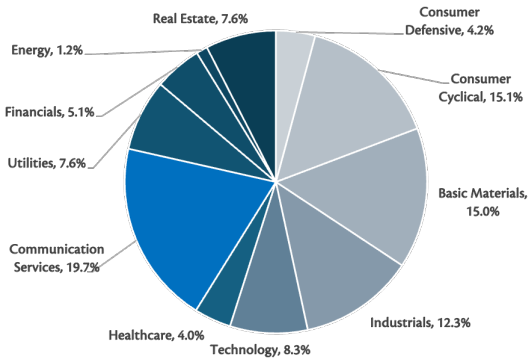
Capital Destroyers:

Capital destroyers – as the name suggests – are companies where investors are likely to lose capital given their history of poor profitability, lacking a competitive advantage in the market, as well as high leverage and credit risk.

From a total of 1,377 companies in the investment universe, 374 companies fall under this category of "Capital Destroyers" comprising 14% of the universe by market cap and 27% of the universe in terms of number of companies.

Within this folio, based on market-cap weightage, over 51% of Capital Destroyers are Large Cap companies, followed by 17% Mid Cap and 32% Small Caps. On an industry level, Telecommunication Services forms the biggest contributor to the Capital Destroyers portfolio, with a weightage of ~16%. The other industries contributing to this folio are Metals & Mining, Automobiles & Auto Parts and Real Estate Operations.

Portfolio Distribution (by Mkt. Cap Weights)



By Sector

Industry	Weightage (%)
Telecommunications Services	18.6%
Metals & Mining	9.0%
Automobiles & Auto Parts	7.9%
Real Estate Operations	7.7%
Electrical Utilities & IPPs	7.6%
Others	49.2%

By Industry

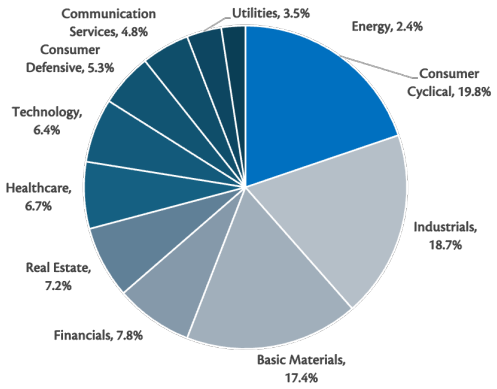
Market Cap Category	Market Cap (INR tn)	Weightage (%)
Large Cap	31.5	51.2%
Mid Cap	10.3	16.7%
Small Cap	19.7	32.0%

By Market Cap Category

**Any references to companies/securities are for Illustrative Purposes Only and Not Recommendatory*

In terms of number of companies, only 13 companies out of 374 (3%) are Largecaps, while 20 companies (5%) are Midcaps and 341 (91%) are Smallcaps. The top industries contributing the largest number of companies are Chemicals, Real Estate Operations, and Textiles & Apparel.

Portfolio Distribution (by # of Companies [Total 374])



By Sector

Industry	Weightage (%)
Chemicals	8.3%
Real Estate Operations	7.5%
Textiles & Apparel	6.7%
Construction & Engg	5.9%
Metal & Mining	5.6%
Others	66.0%

By Industry

Market Cap Category	# of Companies	Weightage (%)
Large Cap	13	3.5%
Mid Cap	20	5.3%
Small Cap	341	91.2%

By Market Cap Category

The dominance of Smallcaps in the Capital Destroyers folio should clearly act as a warning sign to investors with Smallcap allocations. The apparent dominance of Largecaps in terms of the market-cap weightage is due to a handful of telecom companies in this folio.

From a valuation standpoint, the Capital Destroyers portfolio is understandably highly overvalued, with a PE of 521, as 98 companies are loss making and most other companies within the portfolio have a track record of sub-par earnings/profitability.

The leverage risk of the portfolio is also significantly high with a gross debt-to-equity of 86%, and an interest coverage of just 1.3, compared to 61% and 5.2 for the benchmark respectively.

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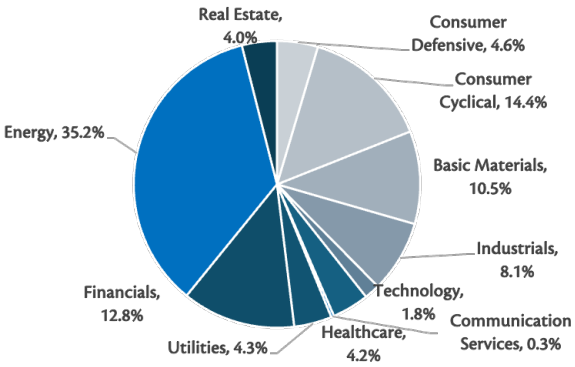
FUNDAMENTALS & VALUATION COMPARISON		
	Nifty 500	Capital Destroyers
P/E	26.7	521.4
P/BV	3.9	3.3
EV/EBITDA	15.6	21.2
Div. Yield	1.2%	0.4%
ROE	14.6%	2.6%
ROA	2.5%	0.2%
ROCE	15.3%	5.6%
EBITDA Margin	18.7%	15.4%
Growth 2 Yr FWD	13.2%	12.3%
Gross Debt to Equity	61.3%	86.3%
Net Debt to Equity	45.2%	76.2%
Interest Coverage	5.20	1.30

Capital Eroders:

Capital Eroders – while displaying better profitability and less leverage risk than Capital Destroyers – are companies which still lack the necessary competitive advantages in their respective industries, as evidenced by lower-than-par returns on their capital and equity as compared to their peers.

We have identified 191 Capital Eroders from the investment universe of 1,377 companies, with Oil & Gas forming the largest segment within this portfolio with a market-cap weightage of 31%. The market cap distribution profile is roughly in line with Capital Destroyers, with around 60% of Capital Eroders comprising of large cap companies, 24% Midcaps and 16% Smallcaps.

Portfolio Distribution (by Mkt. Cap Weights)



By Sector

Industry	Weightage (%)
Oil & Gas	30.6%
Automobiles & Auto Parts	9.1%
Banking Services	8.7%
Machinery, Equipment & Components	6.5%
Construction Materials	6.3%
Others	38.8%

By Industry

Any references to companies/securities are for Illustrative Purposes Only and Not Recommendatory

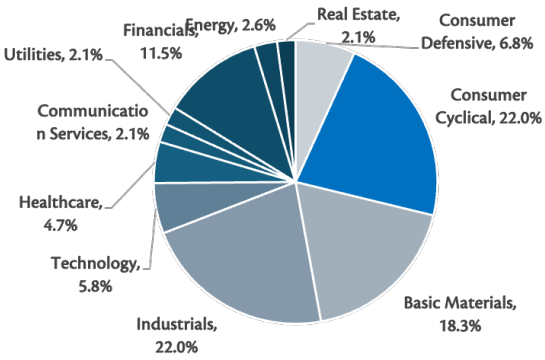
Market Cap Category	Market Cap (INR tn)	Weightage (%)
Large Cap	35.9	59.5%
Mid Cap	14.5	24.0%
Small Cap	10.0	16.5%

By Market Cap Category

However, again, the market-cap weights do not reveal the full truth. For example, just 3 Oil & Gas companies are contributing more than 30% weightage by market cap.

In terms of the weightage by # of companies, only 6% are Largecaps, 13% Midcaps and 81% are Smallcaps. There are 12 Largecaps, 25 Midcaps, and 154 Smallcaps in this universe.
The top industries by # of companies are Automobiles & Auto Parts, Chemicals, and Machinery, Equipment & Components.

Portfolio Distribution (by # of Companies [Total 191])



By Sector

Industry	Weightage (%)
Automobiles & Auto Parts	10.5%
Chemicals	10.5%
Machinery, Equipment & Components	6.7%
Banking Services	9.9%
Metal & Mining	6.3%
Others	57.1%

By Industry

Market Cap Category	# of Companies	Weightage (%)
Large Cap	12	6.3%
Mid Cap	25	13.1%
Small Cap	154	80.6%

By Market Cap Category

On a competitive advantage basis, Capital Eroders are weaker than the market, with RoE levels at ~10% compared to ~15% for the market. Similarly, the EBIT margins too are just 10.9% compared to 15.2% for the benchmark, thus indicating weak or no pricing power. The leverage and credit risk are at par with the benchmark, with both debt-to-equity and interest coverage ratios being quite similar for Capital Eroders and the Indian markets. This similarity extends to valuation comparisons as well, with similar PE ratios to the market (refer to "Four Folios – Valuation & Fundamentals Comparison" section).

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FUNDAMENTALS & VALUATION COMPARISON		
	Nifty 500	Capital Eroders
P/E	26.7	25.9
P/BV	3.9	2.6
EV/EBITDA	15.6	14.1
Div. Yield	1.2%	0.8%
ROE	14.6%	10.1%
ROA	2.5%	3.2%
ROCE	15.3%	10.4%
EBITDA Margin	18.7%	14.9%
Growth 2 Yr FWD	13.2%	12.4%
Gross Debt to Equity	61.3%	58.9%
Net Debt to Equity	45.2%	50.9%
Interest Coverage	5.20	5.10

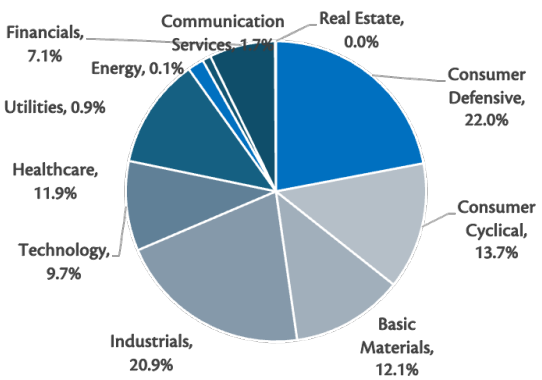
It is apparent that the typical investor in the markets is not able to distinguish between the average company in the markets and Capital Eroders. Otherwise, the valuations of these companies should have been much lower compared to the benchmarks.

Capital Imploders:

Capital Imploders comprise of companies which may have low leverage risk and retain their competitive advantages in the market but are priced at a much higher premium by the market vis-a-vis their growth and performance. This portfolio thus is overvalued and has a higher probability, in the long-term, to undergo a negative re-rating in the market, thereby leading to an "implosion" of capital.

The Capital Imploders folio comprises of 238 companies out of the 1377 in the investment universe. Large caps comprise of nearly 49% of the Capital Imploders portfolio by market cap, with Midcaps comprising 31% and Smallcaps 20%. The largest industries in terms of market caps are, Machinery, Equipment & Components, Personal & Household Products & Services, Chemicals, and Software & IT services.

Portfolio Distribution (by Mkt. Cap Weights)



By Sector

Industry	Weightage (%)
Machinery, Equipment & Components	13.4%
Personal & Household Products & Services	11.3%
Chemicals	7.3%
Software & IT Services	7.1%
Pharmaceuticals	7.1%
Others	53.8%

By Industry

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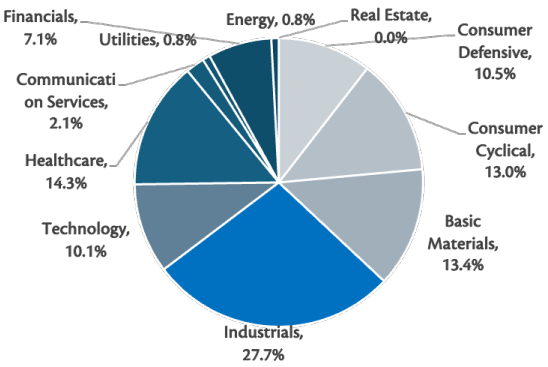
Market Cap Category	Market Cap (INR tn)	Weightage (%)
Large Cap	42.6	48.9%
Mid Cap	26.9	30.9%
Small Cap	17.6	20.2%

By Market Cap Category

In terms of the # of companies, only 10% are Largecaps, 20% Midcaps and 70% are Smallcaps. The largest industries in terms of # of companies are Machinery, Equipment & Components, Chemicals, Pharmaceuticals and Software & IT services.

Portfolio Distribution (by # of Companies [Total 238])



By Sector

Industry	Weightage (%)
Machinery, Equipment & Components	17.2%
Chemicals	9.7%
Pharmaceuticals	8.4%
Software & IT Services	6.7%
Food & Tobacco	5.0%
Others	52.9%

By Industry

Market Cap Category	# of Companies	Weightage (%)
Large Cap	24	10.1%
Mid Cap	47	19.7%
Small Cap	167	70.2%

By Market Cap Category

From a sector perspective, industrials and Consumer Defensive sectors contribute nearly 45% of the total Capital Imploders portfolio, with Machinery, Equipment and Components and FMCGs being the largest industries in the portfolio.

Even if they have reduced leverage risk and long-term competitive advantages, Capital Imploders are understandably much more expensive than the market, with PE ratio of ~72 compared to ~27 for the market, presenting the highest valuation risk amongst the Four Folios after Capital Destroyers.

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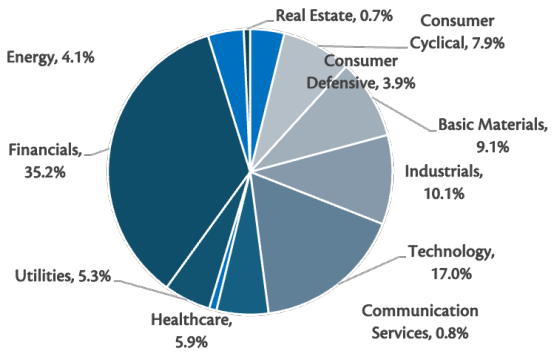
FUNDAMENTALS & VALUATION COMPARISON		
	Nifty 500	Capital Imploders
P/E	26.7	71.6
P/BV	3.9	11.3
EV/EBITDA	15.6	40.8
Div. Yield	1.2%	0.6%
ROE	14.6%	15.8%
ROA	2.5%	5.3%
ROCE	15.3%	18.7%
EBITDA Margin	18.7%	14.1%
Growth 2 Yr FWD	13.2%	18.1%
Gross Debt to Equity	61.3%	27.3%
Net Debt to Equity	45.2%	3.8%
Interest Coverage	5.20	11.94

Capital Multipliers:

Once we have identified and removed the Capital Destroyers/Eroders/Imploders from the investment universe, the remaining companies in the universe form the Capital Multipliers portfolio, consisting of companies which display competitive advantages, while still minimizing leverage and valuation risk, hence forming the most favorably investible portfolio within the investment universe.

We have identified 574 out 1,377 companies which fulfil the conditions of being Capital Multipliers. Compared to previous portfolios, Capital Multipliers have the highest weightage of Large Cap companies at 71%, dominated by the Banking and Software/IT industries which occupy nearly half of the Capital Multipliers portfolio.

Portfolio Distribution (by Mkt. Cap Weights)



By Sector

Industry	Weightage (%)
Banking Services	28.1%
Software & IT Services	16.6%
Automobiles & Auto Parts	7.5%
Pharmaceuticals	5.5%
Metals & Mining	4.9%
Others	37.5%

By Industry

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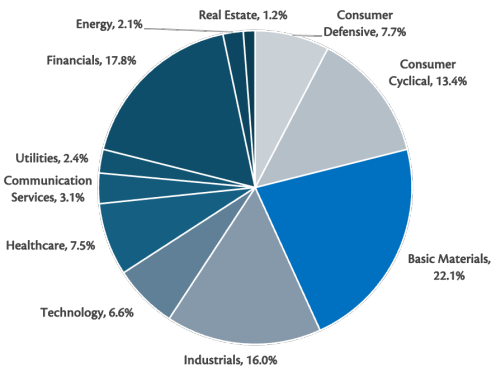
Market Cap Category	Market Cap (INR tn)	Weightage (%)
Large Cap	157.1	71.2%
Mid Cap	31.2	14.2%
Small Cap	32.3	14.6%

By Market Cap Category

In terms of the # of companies, 9% are Largecaps, 10% are Midcaps and 81% are Smallcaps. While someone may have earlier assumed that Smallcaps are mostly falling in the avoidable category (Destroyers/Eroders/Imploders), the Scientific Investing Framework is still able to sift through the large Smallcap universe to include a sizeable number of high-performing Smallcap companies in the Capital Multiplier universe.

Portfolio Distribution (by # of Companies [Total 574])



By Sector

Industry	Weightage (%)
Banking Services	12.0%
Chemicals	11.3%
Automobiles & Auto Parts	7.0%
Metals & Mining	6.8%
Machinery, Equipment & Components	6.6%
Others	56.3%

By Industry

Market Cap Category	# of Companies	Weightage (%)
Large Cap	52	9.1%
Mid Cap	58	10.1%
Small Cap	464	80.8%

By Market Cap Category

From a valuation, leverage and competitive advantages profile, we can already observe that the Capital Multipliers portfolio is most robust on all aspects compared to the market, with a much lower PE ratio at 18 (compared to ~27 for the market), higher RoE levels (17.7% vs. 14.6%) and lower leverage risk with interest coverage of ~9.2 compared to ~5.2 for the market.

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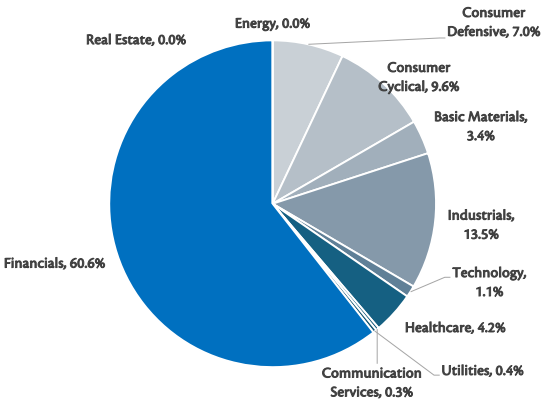
FUNDAMENTALS & VALUATION COMPARISON		
	Nifty 500	Capital Multipliers
P/E	26.7	18.4
P/BV	3.9	3.3
EV/EBITDA	15.6	12.6
Div. Yield	1.2%	1.6%
ROE	14.6%	17.7%
ROA	2.5%	2.6%
ROCE	15.3%	19.2%
EBITDA Margin	18.7%	21.6%
Growth 2 Yr FWD	13.2%	11.2%
Gross Debt to Equity	61.3%	47.9%
Net Debt to Equity	45.2%	27.1%
Interest Coverage	5.20	9.21

Super Folio:

The Super Folio comprises of companies already in the Capital Multipliers portfolio, but with further stringent conditions for reducing both valuation risk and ensuring that companies are market leaders in their respective industries with significant competitive advantages – be it scale, profitability, product superiority – as well as sustained growth.

The Super Folio comprises of 158 companies (over 11% of the total investible universe), with the financial sector comprising the majority of the portfolio with a market cap weightage of 61%. The Super Folio also has a much higher contribution from Large Caps compared to any other previous portfolios in the universe, with Large Caps comprising 81% of the portfolio.

Portfolio Distribution (by Mkt. Cap Weights)



By Sector

Industry	Weightage (%)
Banking Services	51.0%
Automobiles & Auto Parts	9.2%
Insurance	8.8%
Food & Tobacco	6.9%
Construction & Engg	6.1%
Others	18.1%

By Industry

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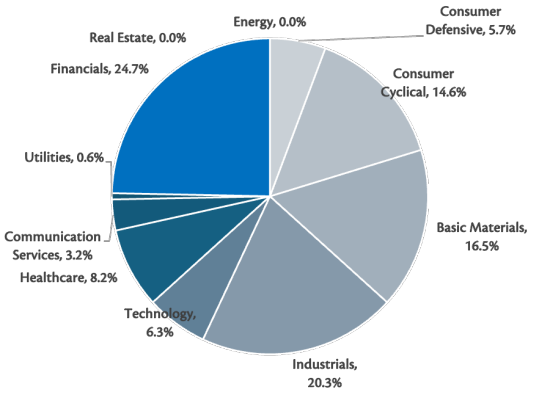
Market Cap Category	Market Cap (INR tn)	Weightage (%)
Large Cap	78.3	80.6%
Mid Cap	7.4	7.6%
Small Cap	11.4	11.7%

By Market Cap Category

In terms of # of companies, this folio has 14% Largecaps, 9% Midcaps and 77% Smallcaps. The top industries by # of companies are: Banking Services, Chemicals, Automobiles & Auto Parts, and Construction & Engineering.

Portfolio Distribution (by # of Companies [Total 158])



By Sector

Industry	Weightage (%)
Banking Services	20.3%
Chemicals	8.2%
Automobiles & Auto Parts	7.6%
Construction & Engg	7.0%
Metals & Mining	6.3%
Others	50.6%

By Industry

Market Cap Category	# of Companies	Weightage (%)
Large Cap	22	13.9%
Mid Cap	14	8.9%
Small Cap	122	77.2%

By Market Cap Category

The Super Folio has stronger valuation metrics than Capital Multipliers, with a slightly lower PE at ~17.7 compared to ~18.4 for Capital Multipliers, as well as better EBIT margins and Net Margins, suggesting that companies in the Super Folio have higher competitive advantages compared to entire Capital Multipliers portfolio. While the ROE looks similar, one should note that the lower Net Debt to Equity of the Super Folio indicates significant amount of cash on the books. This means that after removing the excess cash, the actual operating ROE of the Super Folio is higher. The Net Debt to Equity of this folio 23% is much lower compared to the benchmark at 45%, thus showing the strength of the balance sheet. The interest cover at 9.25 is significantly higher compared to the benchmark's 5.2. In terms of growth rates, this folio has higher growth at 14.5% compared to the benchmark's 13.2% and lower than the 18.1% growth rate of the Capital Imploders. But when one compares that the PE ratio of this folio is 17.7 compared to the

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benchmark's 27 and Capital Imploders 72, one can see that one is getting a much better risk-reward ratio for this folio compared to the other two.

FUNDAMENTALS & VALUATION COMPARISON

	Nifty 500	Super Folio
P/E	26.7	17.7
P/BV	3.9	3.1
EV/EBITDA	15.6	13.1
Div. Yield	1.2%	1.1%
ROE	14.6%	17.8%
ROA	2.5%	1.8%
ROCE	15.3%	20.7%
EBITDA Margin	18.7%	22.3%
Growth 2 Yr FWD	13.2%	14.5%
Gross Debt to Equity	61.3%	52.9%
Net Debt to Equity	45.2%	23.1%
Interest Coverage	5.20	9.25

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Company/Market Capitalization Distribution of Four Folios:

It is also insightful to view the distribution of the Four Folios across the different market cap categories i.e. Large Cap, Mid Cap, and Small Cap. The following table and pie chart indicate the number of Capital Destroyers/Eroders/Imploders/Multipliers and the Super Folio companies within each market cap category, as well as the weightage of each Four Folio within each market cap category.

Four Folio Portfolio Distribution across Market Cap Categories:

Distribution by number of companies:

Folios	Large Cap	Weight (Lcap)	Mid Cap	Weight (Mcap)	Small Cap	Weight (Scap)	Total	Weigh (total)
Capital Destroyers	13	13%	20	13%	341	30%	374	27%
Capital Eroders	12	12%	25	17%	154	14%	191	14%
Capital Imploders	24	24%	47	31%	167	15%	238	17%
Capital Multipliers	52	51%	58	39%	464	41%	574	42%
TOTAL	101		150		1126		1377	
Super Folio	22	22%	14	9%	122	11%	158	11%

Distribution by Market Capitalization:

Folios	Large Cap	Weight (Lcap)	Mid Cap	Weight (Mcap)	Small Cap	Weight (Scap)	Total	Weigh (total)
Capital Destroyers	31.5	12%	10.3	12%	19.7	25%	61.5	14%
Capital Eroders	35.9	13%	14.5	17%	10.0	13%	60.4	14%
Capital Imploders	42.6	16%	26.9	32%	17.6	22%	87.1	20%
Capital Multipliers	157.1	59%	31.2	38%	32.3	41%	220.6	51%
TOTAL	267.1		83.0		79.6		429.6	
Super Folio	78.3	29%	7.4	9%	11.4	14%	97.1	23%

We observe a clear demarcation between Large, Mid, and Small Cap categories in the market today. 52 of the 101, or ~51% of all Large Cap companies are Capital Multipliers (22 in Super Folio), as compared to only ~39% and ~41% of Mid Cap and Small Cap companies respectively being Capital Multipliers.

In contrast, Capital Destroyers form the majority of Small Cap companies with nearly a third of the 1,126 Smallcap companies falling under this category which should be avoided. Midcaps are likely to be the most overvalued part of the market, with 30% of the Midcap universe being in the Capital Imploders category. These observations extend to both number of companies in each category, as well as the market cap contribution of these companies.

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How To Use This Study To Create Your Own Portfolio

Once an industry is identified as promising using the Four Folio analysis, one could use some screeners to search for companies in that industry which have similar or better portfolio characteristics compared to other companies in the same industry (e.g. one could screen all Indian banks listed on the exchange, and pick the ones which have higher-than-average return-on-equity (RoE) while still retaining a lower PE/PB ratio). One can also look for Capital Multipliers within Largecaps, Midcaps and Smallcaps separately. This helps to search for investment-worthy companies (i.e. Capital Multipliers) in a more focused manner.

Our view at OmniScience Capital, as a Scientific Investor, is to always invest in at least 20 companies. Typically, our recommended portfolio would have 20-50 companies. We would suggest the same to investors that when selecting companies for your portfolio, never allocate more than 5% in a single company. Further, attempt to diversify across sectors and industries. Ideally, one would allocate to 4-6 different industries.

Review the portfolio on a quarterly basis for both fundamentals and valuation. As long as the fundamentals are intact and the company is undervalued, one can keep it in the portfolio. The reason to sell a company would be if the fundamentals are permanently impaired due to some reason, or the market has recognized the company, and it is now no longer at a discount to its intrinsic value, or one has an even better opportunity available.

SUMMARY

Based on the Four Folio analysis on the Indian markets today, our view at Omniscience Capital is that **Capital Multipliers i.e. the investment worthy, undervalued, high-growth, high-performing section of the market is currently being dominated by Largecap companies with a sectoral bent towards Banks**, though Capital Multiplier opportunities exist across multiple sectors and industries.

While overvaluation certainly exists in the Midcap and Smallcap universes, the PE levels of Nifty 50 suggest that average PE ratios are similar to the 5/10-year averages, reinforcing the claim that Largecaps are forming the bulk of the undervalued portion of the market. For the Scientific Investor hunting for Alpha, it is imperative to apply the Scientific Investing Framework to remove all avoidable sections of the universe (Capital Destroyers/Eroders/Imploders) and then further perform one's own due diligence in selecting a diverse set of undervalued, high-performing companies from this preferred universe.

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