

Mutual Fund Insight

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**Personal Finance
Insight 24**
Save your gains from tax

Fund Radar 30
Will small caps
go up in smoke?

Interview 42
'Promoters with fire build
the next large caps'



‘Promoters with fire build the next large caps’

Aditya Khemani on spotting hunger that drives big growth

In a market where mid- and small-cap valuations still look stretched, many investors are asking: Will earnings growth keep pace? For Aditya Khemani, Fund Manager at Invesco Mutual Fund, the answer depends on how you look at time. Earnings risk, he says, never goes away. But over a three-, five- or 10-year horizon, it matters far less.

With over 19 years in the market and ₹25,000 crore spread across five funds under his watch, Khemani prefers to look beyond quarterly noise. His lens: quality businesses, cash-flow strength and promoters with the drive to scale. In this conversation, he explains why patience matters, how balance has helped his funds recover and what

investors should watch in today’s crowded mid- and small-cap space.

Mid and small-cap valuations still look elevated despite the recent run-up. Do you think earnings growth can keep pace, or are we staring at the risk of disappointment?

When we talk about equities, earnings risk will always be there. There’s no way to run away from it. In good markets or bad, in strong economies or weak ones, earnings risk is something investors must take in their stride.

The key point is the investment horizon. Whether you’re looking at six months, a year, or five years makes a big difference. For

instance, if you entered the market five or 10 years ago, it wouldn’t have mattered which quarter earnings risk showed up; it wouldn’t have significantly affected your long-term returns. But if you entered just two or three quarters ago, then an earnings disappointment would have mattered more.

So yes, earnings risk is always present, even now. But the moment you start thinking in terms of the next three, five, or 10 years, things become much clearer from that perspective.

If we look at the mid-cap and small-cap segments, do you think earnings growth in this space can justify current

valuations, or are we in a zone of excess optimism?

Valuation is always a very subjective matter. Most people look at it simplistically, say the FY26 or FY27 P/E ratio and conclude that a stock is expensive. But that approach can be misleading. India is viewed as a growth market by both foreign and domestic investors, and in growth stocks, 60–70 per cent (or even more) of the value comes from the terminal value, earnings that accrue beyond the next 10 years. So, just looking at the next one or two years' P/E multiples is too narrow an exercise.

On an aggregate basis, I would say the market might be 20–25 per cent expensive. But if you're backing a company that can grow earnings at 20 per cent or more over a long period, that premium doesn't really distort returns much. For example, if earnings grow at 20 per cent CAGR over the next decade and you buy the stock 20–25 per cent expensive, your compounding could still be 17–18 per cent CAGR, quite close to the earnings growth.

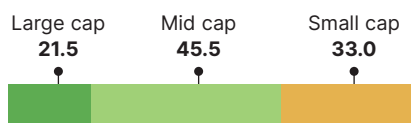
Of course, if a stock is trading 40–50 per cent above fair value, that's a clear no-go for us. As long as growth continues and valuations are within a reasonable premium, we're comfortable holding. However, it's not just growth; we also consider multiple factors. Our framework is built on high quality and high growth, but equally important is strong cash flow conversion. And, of course, valuations must make sense. You can't buy any company at any price. We all saw what happened in the bubble of 2000. Many IT companies delivered strong earnings growth, but their stock prices didn't create wealth over the next 10–15 years because entry valuations were excessive.

So, a 15–20 per cent premium is fine. But paying 50–100 per cent above intrinsic value is dangerous. The reality is that, right now, many investors (i.e., a lot of money) are chasing quality companies, which makes it harder to find bargains. As an investor, you must decide whether to stick with high-quality, high-growth names at a reasonable premium or move down the quality and growth curve to find cheaper opportunities. It's ultimately a trade-off each investor has to make, depending on their philosophy.

Net assets (pure equity)

₹23,389 cr

Market cap mix (in %)



Portfolio related data as of July 31, 2025

You often emphasise bottom-up stock picking. What's the framework you use to identify high-quality businesses and, more importantly, to hold on to them across market cycles?

You're right. We are essentially a bottom-up stock-picking house. At the core, we focus on high-growth and high-quality businesses. However, within that, our philosophy can be broken down into two parts: a quantitative framework and a qualitative framework.

On the quantitative side, the checklist is fairly standard and not significantly different from what most quality investors look for, such as strong earnings growth, a high return

on capital, healthy cash flow conversion and limited leverage on the balance sheet. These factors are important, but they can typically be estimated only for the next two or three years.

The real differentiation comes on the qualitative side, because stock prices derive 70–80 per cent of their value from terminal value—earnings that lie well beyond the next decade. That's where softer factors matter most, and a significant portion of our effort is devoted to assessing them.

For me, understanding the "jockey"—the promoter or management team—is extremely important. When you place money in a company, the person leading it becomes crucial. If the promoter has the right hunger and vision, the company moves in the right direction. Many mid-cap companies today are not small by any means, as they generate annual profits of ₹400–600 crore. At that stage, complacency can easily set in. So, I try to gauge whether the promoter still has the fire in the belly to scale the company into a large cap over time.

But the promoter alone cannot take a company from one stage to the next. To move from zero to one requires a founder's drive, but to move from one to 10 requires a strong second line of leadership and professionalisation. We assess whether the promoter is willing to attract high-quality professionals, compensate them well, and foster a strong culture. Factors such as attrition levels, organisational depth and openness to professional management matter a great deal.

The industry itself is equally important. No matter how strong the promoter is, if the industry is structurally slow-growing, the company's growth will eventually be

INTERVIEW

capped. Therefore, we prefer businesses in industries that have long-term growth tailwinds. Take hospitals, for example. There's significant scope for value migration from smaller hospitals to larger, better-managed chains as consolidation and formalisation accelerate. That creates an opportunity for the right promoters to scale meaningfully.

Ultimately, the biggest wealth creation happens when a high-quality promoter meets a high-growth business. That's what we try to identify and hold on to through the market cycles.

Invesco India Large & Mid Cap Fund also runs a relatively higher mid-cap exposure compared to its peers. Even though large-cap stocks look attractively valued, what is driving this positioning?

If you look at the Invesco India Large & Mid Cap Fund today, the allocation is roughly 40 per cent in large caps and about 60 per cent in mid and small caps. The benchmark, by comparison, is closer to 50:50. So yes, we are overweight in mid and small caps.

Now, many people argue that large caps look cheaper. But there's a difference between optical cheapness and real earnings growth. A lot of large-cap companies have become very big—they're in mature segments like IT services, with revenues of \$20–30 billion. It's unrealistic to expect them to grow much faster than India's GDP. So yes, they may look optically cheap at 18–20x earnings, but beyond a point, they lack strong growth drivers.

In contrast, mid and small caps still offer higher earnings growth potential. Since we position our funds as high-quality, high-growth,

Performance report In % pa

Invesco India Large & Mid Cap

Managing since November 9, 2023

Fund	29.7
Category avg.	17.8
BSE Large Mid Cap TRI	16.5

Invesco India Mid Cap

Managing since November 9, 2023

Fund	31.7
Category avg.	20.4
BSE 150 MidCap TRI	20.1

Invesco India Smallcap

Managing since November 9, 2023

Fund	23.1
Category avg.	17.3
BSE 250 SmallCap TRI	16.5

Return data for direct plans, as of Aug 31, 2025

we want earnings growth closer to 20 per cent. That can only be achieved by leaning more towards mid and small caps.

That doesn't automatically mean higher risk. For example, healthcare is a significant sector across our funds, accounting for approximately 18–19 per cent in Large & Mid Cap and over 20 per cent in both small-cap and mid-cap strategies. Healthcare is a defensive sector, and many of our holdings there are mid- and small-cap names. So while the fund may look tilted towards mid and small caps, the underlying businesses are resilient and defensive.

It's important to separate "size" from "risk". Risk comes from the

business model, not whether a company is large, mid or small. A large-cap metal company can be riskier than a small-cap hospital chain.

Also, let's put 'mid caps' in context. By SEBI's definition, mid caps are companies ranked 101 to 250 by market capitalisation. These are not small businesses.

For example, the largest mid-cap company earns ₹2,500–2,600 crore in profit and has ₹8,000–9,000 crore cash on its balance sheet. Calling such a company "risky" simply because it's a mid cap doesn't make sense. I see mid caps as smaller large caps and small caps as more like mid caps.

Even within small caps, we're selective. Small caps go up to around ₹30,000 crore market cap. But companies below ₹10,000 crore are where risk is higher. In our small-cap fund, exposure to this sub-segment is just about 5–6 per cent.

So yes, we may appear overweight in mid and small caps, but what matters far more is which sectors and what part of the market cap spectrum we are invested in. That's how we balance high growth with sensible risk management.

Invesco India Mid Cap Fund had a tough phase in 2022 and 2023, but staged a sharp turnaround in 2024. What changes helped drive this recovery?

I took over the fund in November 2023—so yes, that was one change. But leaving that aside, when I came in, the markets had just gone through three to four years of strong, broad-based growth. Everything was doing well, which made it harder to separate the strong business models from the weaker ones.

We decided to focus on six to eight

themes that looked attractive from a long-term perspective—businesses that could continue growing even if the macro slowed. These included areas driven by disruption, companies gaining market share, or sectors with structural growth tailwinds. That was the top-down approach. On the bottom-up side, we sharpened our stock selection within those themes.

We also reduced the number of holdings. Earlier, the fund had around 80 names; today, it has 48. A sharper portfolio helps you position meaningfully while still being diversified. To manage risk, we capped individual positions. No stock accounts for more than about 5 per cent of the fund. That way, even with fewer holdings, we don't run excessive concentration risk.

Another change was in sector positioning. About 18–24 months ago, sectors like industrials and defence had rallied sharply. Valuations in some cases looked ahead of reality; companies were trading at 7–8x sales and 40–50x earnings, despite being cyclical in nature. Having seen this play out in 2007–08, we reduced our exposure there. We don't chase momentum. Our focus is whether a stock or sector will help us over the next one to three years, not the next three months. For example, while autos saw momentum recently, we were comfortable trimming exposure.

At the portfolio level, these changes created a high-quality construct, over 20 per cent ROE and more than 20 per cent earnings growth. At the same time, I believe balance is essential. You cannot run a portfolio that is entirely high-growth, high-P/E stocks. When growth investing does well, such a portfolio will soar, but when sentiment turns, it gets hit disproportionately.



Our focus is on sticking to our process. We are long-term investors, backing strong businesses in the small- and mid-cap space for three to five years.



That's why our portfolio always maintains a balance, roughly 60 per cent growth-oriented names and 30–40 per cent value-style. This ensures consistency. Last year, when growth investing outperformed, our fund did very well. This year, even as growth has been under pressure, our performance remains strong because of that balance.

So, the key changes were sharpening the portfolio, reducing holdings, managing concentration risk, cutting exposure to overheated sectors and maintaining a growth–value balance. Together, these helped drive the turnaround.

In 2024, the Invesco India Smallcap Fund stood out with nearly 13 per cent outperformance compared to the BSE 250 Smallcap TRI. You've spoken about what drove this performance, but can investors expect such a gap to sustain going forward?

If you had asked me or my team a year ago whether we would deliver the kind of outperformance we achieved, I don't think anyone could have predicted it. The reality is you cannot control outcomes; you can only control the process and the ingredients that go into it.

Our focus is on sticking to our

process. We are long-term investors and our approach is to back strong businesses in the small- and mid-cap space where we can remain invested for three to five years. We don't believe in constantly getting in and out of companies.

That said, the level of outperformance we delivered in 2024 was unusually high, and it would not be realistic for investors to expect such large gaps every year. What we can promise is that we will continue to follow our disciplined framework to give investors the best possible outcomes over the long term.

Recently, the small-cap fund has increased its allocation to relatively larger small caps compared to earlier, when it was tilted more towards smaller names. Is this a conscious shift towards stability, or more of a byproduct of the opportunities available in the market?

This is a conscious shift. Our fund size is growing, and with that comes a responsibility to manage risk more carefully. Small caps, by definition, go up to about ₹30,000–32,000 crore in market cap. But below ₹8,000–9,000 crore, companies tend to be far more volatile. That segment is now only about 5–6 per cent of our portfolio.

We have deliberately positioned the portfolio towards the larger end of small caps—companies with a market cap of ₹8,000–30,000 crore. This is intentional and by design. It comes from experience that when things go wrong in very small companies, liquidity becomes a serious challenge, and exits are difficult. So, we'd rather stay disciplined and avoid that part of the market. 