



The Rally of 2021

Is it irrationally exuberant?

22nd June 2021



For Internal Circulation Only

Background

- All the indices started a healthy run as a precursor to the General elections of 2014
- This rally suffered a two month set back in the days following the announcement of Demonetization on 8th Nov 2016
- Some weakness had already started building from the early part of 2016 due to lackluster EPS growth for the Nifty cos
- All the 3 Indices – Sensex/Nifty, Midcap and Smallcap reached their peak in Jan 2018 and started correcting
- Sensex/Nifty reclaimed their previous peaks in Mar 2020 before we were hit with the first Covid wave
- The Midcap Index was able to recover to its previous peak of 2018 after a lapse of 3 years in Mar 2021
- The Smallcap Index was the last to recover with the BSE Smallcap Index reclaiming its peak on Feb'21 and the NSE Smallcap much later in Jun'21

What got us alarmed?

- The nascent recovery in the economy after the first wave was battered once again by the 2nd wave in Apr 2021
- Yet the stock market in general and midcap and small cap stocks in particular accelerated their pace of rally in the last 3 months.
- A large number of stocks started hitting their All Time High (ATH) levels
- This was happening when the Covid wave was raging and medical emergency was causing panic in almost every state and metropolitan town. Most regions of the country declared a Lockdown. Hence the rally was even more inexplicable

What did we go looking for?

- We tried to trace the stock price performance in relation to earnings trajectories of the companies that were hitting ATHs
- How had the earnings of the companies fared for stocks trading at levels higher than the peak they had touched in 2017 -2018?
- Our hypothesis:
 - If stock price was higher than its previous peak without any improvement in earnings than this rally was irrational
 - Conversely if the stock prices were higher and so were the earnings than this rally was supported by earnings momentum
 - We also went ahead and checked what was the earnings forecast for these companies in FY22 and FY23

Methodology

- Stocks were split into 3 Groups:
 - Those which had reached their peak prices between 2014 to 2016
 - Those that reached their peak prices between 2017 and 2018
 - Those that reached their peak prices between 2020 and 2021
- Their trailing 12 months (TTM) and 3rd or 4th Quarter Annualized earnings were compared:
 - Why did we look at both TTM and 3 / 4 Q Annualized?
 - It is quite possible that in many companies the TTM earnings may have been suppressed due to Lockdown in Q1FY21
 - While in most cases 4th Quarter (Mar '21) results were already declared, in a few cases we relied on the 3rd Qtr. (Dec '20) results.
 - For the sake of objectivity both the sets (TTM and Annualized) were reviewed separately
- Banking & Financial sector was excluded from this study

Summary of our Analysis

(Details in the following slides)

Period in which the Stock touched ATH	FY17 to FY19	FY14 to FY16	FY20 till date
No of Companies which have higher EPS* currently	167	24	283
TTM EPS	66	20	231
Quarterly Annualized EPS	159	22	260
Loss Making	49	14	13
EPS Lower	119	24	64
Total	335	62	360
Higher EPS %	50%	39%	79%

Source: Ace Equity

*EPS: Max(TTM, Q Annualized)



For Internal Circulation Only

Detailed findings – FY17 to FY19

- Out of 335 companies whose share price made its peak between FY17 & FY19 period, 167 companies (~50%) have seen increase in their TTM EPS or Quarterly annualized EPS ***but share price is yet to claim new peak.***
 - 66 companies have their TTM EPS higher
 - 159 companies have their Quarterly annualized EPS higher
- Out of remaining 168 companies, 49 are loss making & 119 companies have their EPS lower than the maximum EPS seen between FY17 & FY19 period.
- It is quite possible that some more companies may see their ATHs soon. Maybe once the conviction on earnings grows firmer.

Detailed findings – FY14 to FY16

- Out of 62 companies whose share price made its peak between FY14 & FY16 period, 24 companies (~39%) have seen increase in their TTM EPS or Quarterly annualized EPS but share price is yet to claim new peak.
 - 20 companies have their TTM EPS higher
 - 22 companies have their Quarterly annualized EPS higher
- Out of remaining 38 companies, 14 are loss making & 24 companies have their EPS lower than the maximum EPS seen between FY14 & FY16 period.

Detailed findings – FY20 to till date

- Out of 360 companies whose share price made its new peak after FY19, 283 companies (~79%) have also seen increase in their TTM EPS or Quarterly annualized EPS, which may be one of the reason of the recent surge its share price.
 - 231 companies have their TTM EPS higher
 - 260 companies have their Quarterly annualized EPS higher
- Out of remaining 77 companies, 13 are loss making & 64 companies have their EPS lower than the maximum EPS seen between FY17 & FY19 period.

How do the earnings forecast look like?

	FY22 vs FY20	FY22 vs FY21
Growing EPS	336	332
>20%	273	223
<20%	63	109
Loss to Profit	28	32
De-growing EPS	42	42
Profit to Loss	4	0
Loss to Loss	8	12
Total	418	418

For the sake of objectivity we looked at FY 20 (normal year) as well as FY21 (earnings hit by Lockdowns) for the sake of comparison

Source: Bloomberg

Detailed findings – Forward estimates

- Out of 418 companies, 336 companies are forecast to increase their EPS in FY 22 compared to FY20. Another 28 companies are expected to turn profitable. 42 companies are expected to show EPS de-growth and only 12 companies are expected to show losses.
 - Out of 336 growing companies, 273 companies are expected to show more than 20% EPS growth from FY20 to FY22 period.
- Out of 418 companies, 332 companies are forecasted to increase their EPS in FY 22 compared to FY21. Another 32 companies are expected to turn profitable. 42 companies are expected to show EPS de-growth and only 12 companies are expected to show losses.
 - Out of 332 growing companies, 223 companies are expected to show more than 20% EPS growth from FY21 to FY22 period.

Conclusion

- The earnings of majority of the companies which are currently trading at ATH have moved up substantially compared to their earnings at the previous peak.
- In a few cases loss making companies have now become profitable
- Impressively, a large number of companies trading at ATH have demonstrated high TTM EPS, despite more than one quarter of earnings washed out due to Covid related Lockdown
- There are hardly any cases of companies that are trading at ATH now which are loss making now compared to profits earlier
- The true test of the market will be in the ability of the companies trading at ATH to deliver higher earnings in FY22 and beyond (which seems to be case if you go by the consensus estimates)

Bell Curves ■ R Prasad



DISCLAIMER

This presentation is intended for internal use and may contain confidential information that belongs to the sender and/or legally privileged information that is protected by the attorney-client privilege. If you are not the intended recipient of this communication, you must not disseminate copy or take any reliance on it. If you have received this message in error please notify the sender immediately, to arrange the return of the document. This document is not for public distribution and has been furnished to you solely for your information and may not be reproduced or redistributed to any other person. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries, including the United States. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions. This material is for the personal information of the authorized recipient, and we are not soliciting any action based upon it. This report is not to be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. No person associated with Citrus Advisors is obligated to call or initiate contact with you for the purposes of elaborating or following up on the information contained in this document. The material is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon. Neither Citrus Advisors., nor any person connected with it, accepts any liability arising from the use of this document. The recipient of this material should rely on their own investigations and take their own professional advice. Opinions expressed are our current opinions as of the date appearing on this material only. While we endeavor to update on a reasonable basis the information discussed in this material, there may be regulatory, compliance, or other reasons that prevent us from doing so. Prospective investors and others are cautioned that any forward-looking statements are not predictions and may be subject to change without notice. We and our affiliates, officers, directors, and employees world wide, including persons involved in the preparation or issuance of this material may; (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company (ies) discussed herein or may perform or seek to perform investment banking services for such company(ies) or act as advisor or lender / borrower to such company(ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. The same persons may have acted upon the information contained here. No part of this material may be duplicated in any form and/or redistributed without Citrus Advisors' prior written consent. No part of this document may be distributed in India or abroad. In so far as this report includes current or historical information, it is believed to be reliable, although its accuracy and completeness cannot be guaranteed.



For Internal Circulation Only

Thank you



For Internal Circulation Only