

## Exploring ‘buy’ opportunities across the sentiment spectrum of Mr Market

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## Strategy

### Exploring 'buy' opportunities across the sentiment spectrum of Mr Market

**Measuring the implied value assigned to long-term growth in earnings by Mr. Market:** Long-term growth prospects as 'perceived' by the collective wisdom of investors (allegorised as Mr. Market) are embedded in stock prices which leads to major fluctuations in stock prices whenever those perceptions change. Change in perception regarding long-term prospects due to short term events provides maximum opportunities in investing (examples – March'20 market wide sell off; Titan in 2015-16; currently the second wave of Covid).

**Segmenting the NSE200 universe based on market expectations and top picks:** Using our proprietary MILTGV framework (**Market Implied Long Term Growth Value on the NSE200 universe stocks**), we classify fundamentally sound investible stocks with upsides (BUY rating by our analysts) into segments based on Mr Market's various degrees of pessimism / optimism. Given the focus on long term growth which depends on sustainability of growth, we have **preferred stocks with relatively lower ESG risk** or the riskier ones showing improvement in their score.

- ▶ **Extreme pessimism - Negative MILTGV:** Market is assigning negative value to long-term growth in earnings beyond FY23 for 18 stocks, which implies expectation of negative or near zero growth beyond FY23 consensus earnings into perpetuity.
  - Stocks are largely PSUs engaged in economic activities of **utilities, oil & gas and financials** with a higher proportion **scoring low on ESG**.
  - Consensus Median RoE of this bucket is 14.2% in FY23E while earnings growth over FY20-23 is 9%.
  - **BUY – NTPC and GAIL:** Market's assumption of negative growth into perpetuity appears too pessimistic for some of the stocks with **prospects to grow and add value (RoE>ke) while improving ESG scores**.
- ▶ **Low expectations - 0 < MILTGV <30%:** Market is assigning less than 30% of the current market value to long-term growth in earnings beyond FY23.
  - 18 stocks from financials, metals and energy sector constitute the second bucket with a larger proportion of **low ESG scores**.
  - Consensus median earnings growth of this group is expected to be 11% over FY20-23 and Median RoE in FY22 is expected to be 15.2%.
  - **BUY – SBI, Federal bank and BPCL:** Opportunity to pick improving earnings growth and minimum value creating profile stocks with long term business track record and improving or low risk ESG score.
- ▶ **Low to moderate expectations – 30% < MILTGV <50%:** Market is assigning between 30% to 50% of the current market value to long-term growth in earnings beyond FY23.
  - 32 stocks majorly from auto, financials, healthcare, IT and a mix of other sectors constitute the low to moderate expectations with lower incidence of high risk ESG scores.
  - Median earnings growth of this group is expected to be 13% over FY20-23 and Median RoE in FY23 is expected to be 16.5%.
  - **BUY - Axis bank, Bandhan Bank, Bajaj Auto, Tata Motors:** Opportunity to buy quality stocks with growth at reasonable valuations

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- ▶ **Moderate to high expectations – 50% < MILTGV <70%:** Market is assigning between 50% to 70% of the current market value to earnings growth beyond FY23.
  - 55 stocks majorly from cement, industrials, IT, auto, pharma, financials.
  - Median earnings growth of this group is expected to be 18% over FY20-23 and Median RoE in FY23 is expected to be 17.7%.
  - **BUY - HDFC Bank, Bharti Airtel, HDFC, L&T, Infosys, Balkrishna Inds, Sun Pharma:** Opportunity to buy quality leadership stocks with consistent earnings growth or improving growth profile albeit at a reasonable premium.
- ▶ **Highest expectations - MILTGV >70%:** Market expects bulk of the value (>70%) from such stocks to be derived from long-term earnings growth rather than the earnings trajectory till FY23. Hence, the most important factor for such stocks is the potential earnings growth over the long term, along with the adequate balance sheet strength and capital allocation decisions to achieve such high long term growth.
  - 68 stocks majorly from consumer, auto, financials, pharma, industrials and new age sectors such as retail, digital, green energy etc.
  - Median earnings growth of this group is expected to be 19% over FY20-23 and Median RoE in FY23 is expected to be 20%.
  - **BUY – Tata consumer products, Divi’s Lab, SBI Life:** Buying should be restricted to high quality growth stocks (earnings CAGR > 15-20%) involved in economic activities which have high long term growth visibility. Also, such stocks should be consistently beating or meeting estimates as valuation re-rating is unlikely.
- ▶ **Pessimism/Optimism about long term growth prospects of a stock by Mr Market could both be overstated or understated and does not guarantee investment success.** For example, Mr Market could be understating the pessimism for a low single digit P/E stock which is witnessing permanent erosion in earnings power due to massive competition or for a 100 P/E stock may be understating the multi-decade high growth ‘competitive advantage period’ ahead. Investible stocks based on sound long-term fundamentals along with ‘margin of safety’ in terms of ‘lesser optimism’ about ‘long term growth prospects’ by Mr. Market provide better ‘risk-reward’ ratio. However, it is not unusual to find exceptional growth stocks whose earnings trajectory continue to surpass the ‘high optimism’ of the market in the long run.
- ▶ **Why is MILTGV superior to a P/E ranking for measuring Mr. Market’s optimism/pessimism?** P/E ratio as a relative valuation tool does not indicate the underlying riskiness of a business. Our MILTGV framework discounts the earnings base by the  $K_e$  of individual stocks (based on the CAPM model) thereby, appropriately discounting risky earnings.

Currently, the concept working in favour of the above strategy is the trend of low estimation error in forecasted earnings which improves the readings from our framework.

## Segmenting the NSE200 universe based on market expectations and top picks

Using our proprietary MILTGV framework (Market Implied Long Term Growth Value) on the NSE200 universe stocks, we classify fundamentally sound investible stocks with upsides (BUY rating by our analysts) into segments based on Mr Market's various degrees of pessimism / optimism. Given the focus on long term growth which depends on sustainability of growth, we have preferred stocks with relatively lower ESG risk or the riskier ones showing improvement in their score.

**Table 1: Buying opportunities within Mr. Market's sentiment spectrum ranging from 'high expectations' to 'extreme pessimism'**

Name	Broad sector	Market cap Rs bn	Earnings CAGR		Forward PE FY23	MILTGV Latest	Net Debt / Equity FY20	ESG Rating		Improvement in Low ESG scores
			FY18-23	FY23				MSCI	Sustainalytics	
<a href="#">Tata Consumer</a>	Consumption	626	29%	8.7	46.0	82%	3%	A	na	
<a href="#">SBI Life Insuran</a>	Financials	898	20%	14.8	38.2	78%	0%	BB	26.5	
<a href="#">Divi's Lab</a>	Export	1,004	34%	24.5	35.1	75%	-2%	B	18.5	
<a href="#">Bharti Airtel</a>	Consumption	2,912	82%	16.3	24.2	70%	165%	BBB	25.7	
<a href="#">Balkrishna Inds</a>	Consumption	327	18%	19.4	22.7	68%	13%	BB	na	
<a href="#">Infosys</a>	Export	5,755	12%	30.1	22.5	60%	7%	A	15.2	
<a href="#">Sun Pharma Inds</a>	Export	1,548	35%	12.4	22.3	58%	2%	CCC	36.8	Improving
<a href="#">HDFC Bank</a>	Financials	7,667	25%	17.6	16.8	55%	0%	na	28	
<a href="#">H D F C</a>	Financials	4,356	25%	13.0	14.9	52%	0%	A	19	
<a href="#">Larsen &amp; Toubro</a>	industrials	1,870	14%	14.2	15.2	50%	196%	BB	33.4	Improving
<a href="#">Bajaj Auto</a>	Consumption	1,042	11%	23.7	16.1	48%	-2%	BBB	14.9	
<a href="#">Axis Bank</a>	Financials	1,996	133%	12.9	14.7	47%	0%	A	29.3	
<a href="#">Tata Motors</a>	Consumption	1,057	6%	15.8	9.4	45%	183%	B	29.2	Improving
<a href="#">Bandhan Bank</a>	Financials	498	42%	23.5	9.1	36%	0%	A	28.5	
<a href="#">St Bk of India</a>	Financials	2,942	nm	13.5	6.8	19%	0%	A	30	
<a href="#">B P C L</a>	Commodity	885	2%	20.3	9.0	12%	111%	BBB	36.2	Improving
<a href="#">Federal Bank</a>	Financials	144	24%	11.9	6.5	1%	0%	na	na	
<a href="#">GAIL (India)</a>	Commodity	597	12%	13.4	7.8	-6%	0%	B	28.9	Improving
<a href="#">NTPC</a>	industrials	959	15%	13.7	5.2	-52%	144%	CCC	40.8	Improving



Note: Above forward estimates used are consensus estimates. Please see ESG rating scales below.

Latest analyst reports for companies are available at links on the company name

Source: Capitaline, Bloomberg, I-sec research

### MSCI Letter ratings classification

Letter Rating	Leader/Laggard
AAA	Leader
AA	Leader
A	Average
BBB	Average
BB	Average
B	Laggard
CCC	Laggard

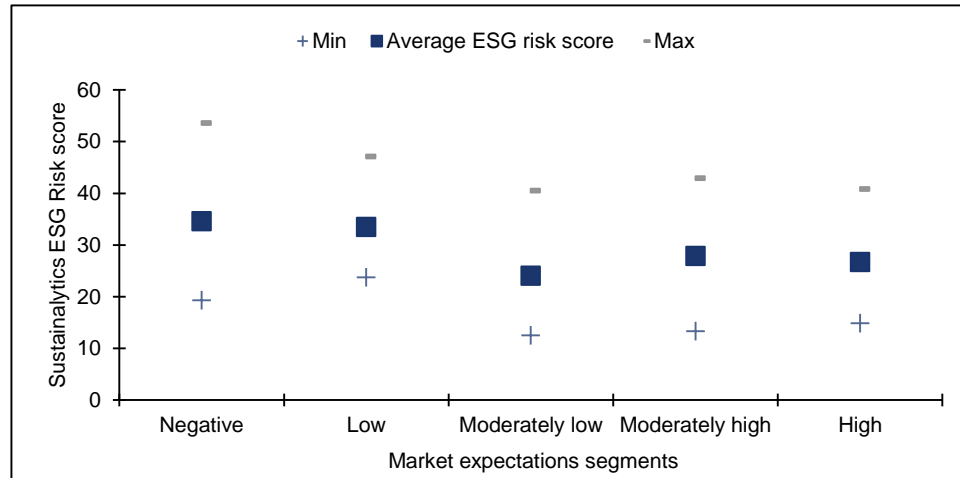
Source: MSCI

### Sustainalytics categorization based on ESG Risk score

Score	Category
0-10	Negligible
10-20	Low
20-30	Medium
30-40	High
40+	Severe

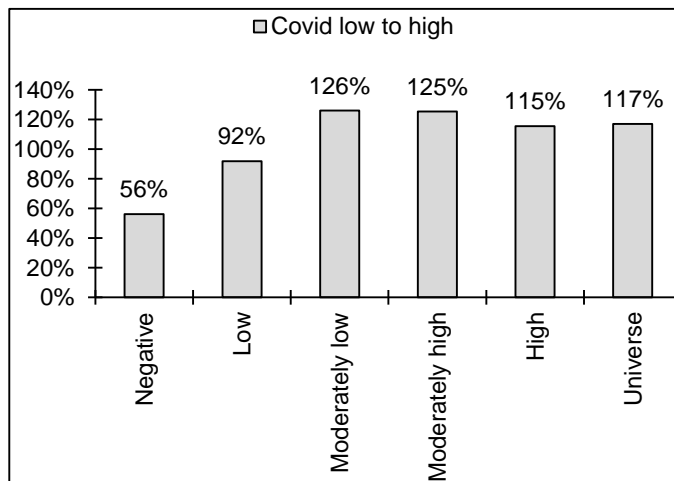
Source: Sustainalytics

**Chart 1: Sustainalytics ESG score profile across MILTGV segments**



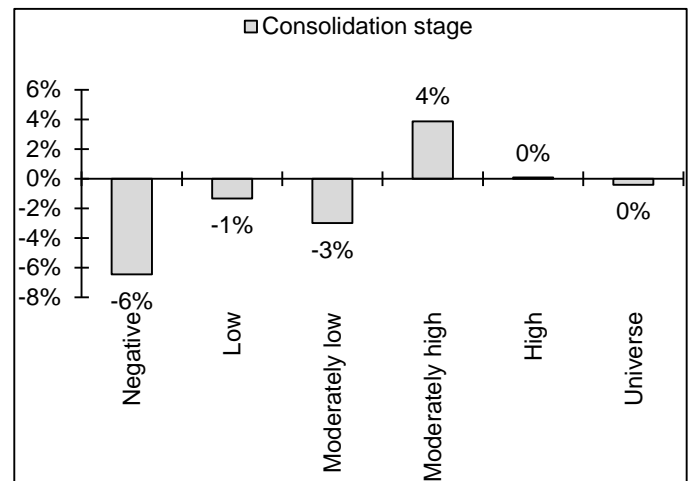
Source: [Sustainalytics](#), I-Sec Research

**Chart 2: Performance of MILTGV buckets from Mar'20 low to Feb'21 high**



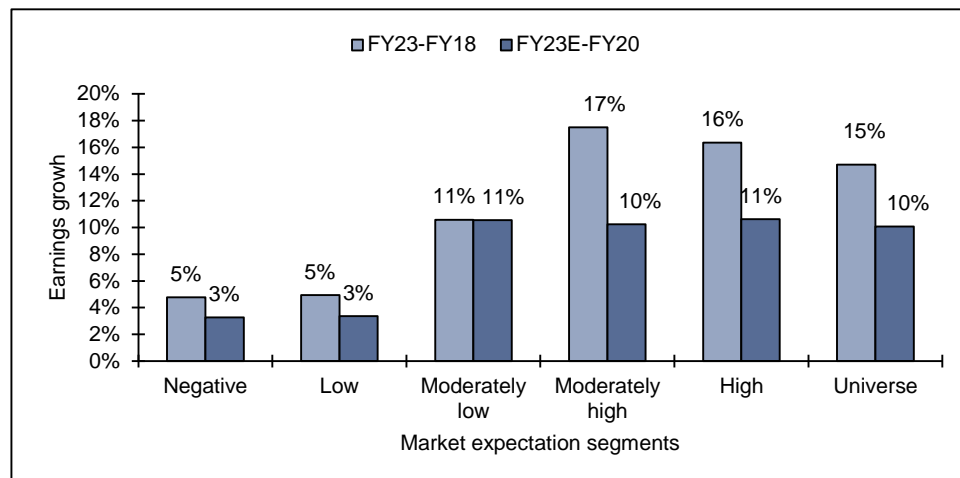
Source: Bloomberg, I-Sec Research

**Chart 3: Performance of MILTGV buckets from Feb'21 high to current prices**



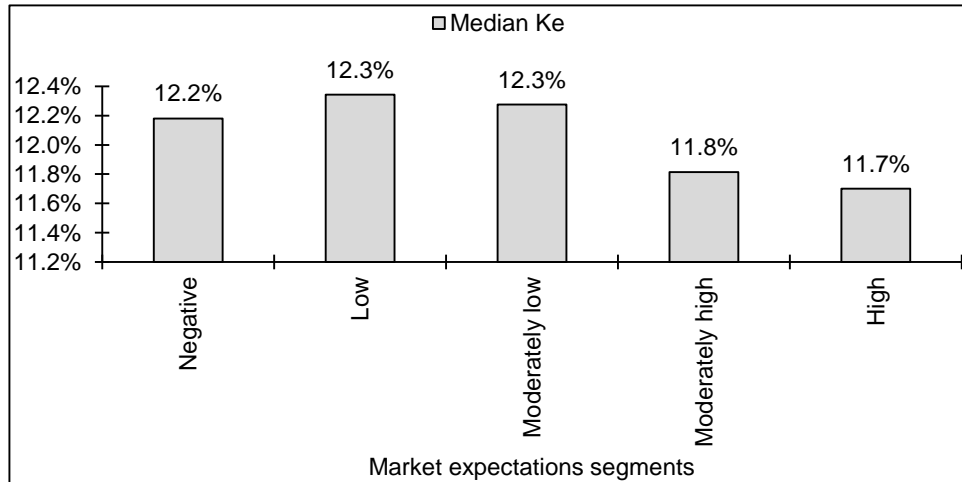
Source: Bloomberg, I-Sec Research

**Chart 4: Near term earnings growth expectations for each of the 'market implied long term growth value' (MILTGV) buckets**



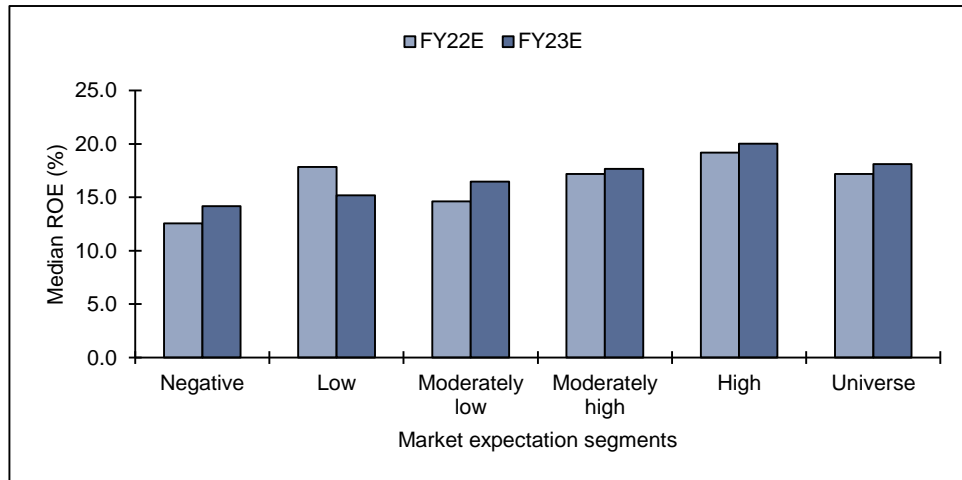
Source: Bloomberg, Capitaline, I-Sec research

**Chart 5: Ke lower for stocks with higher market expectations**



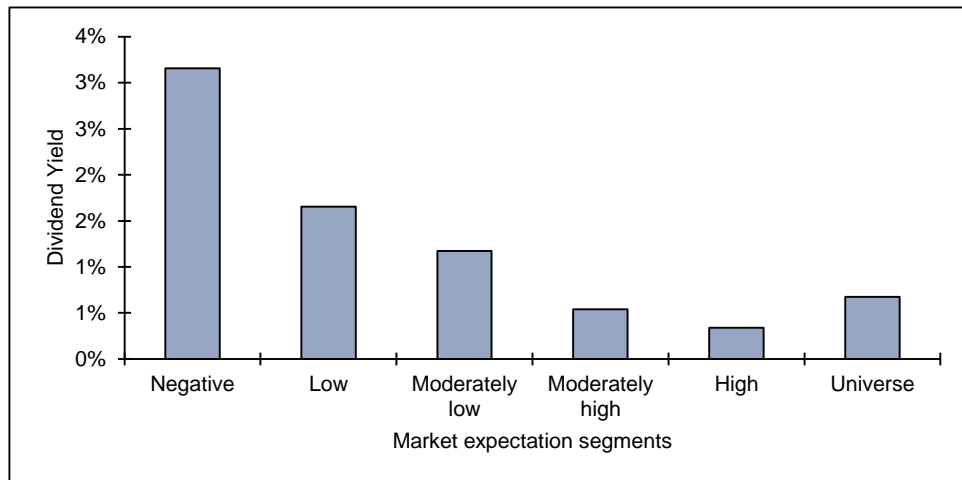
Source: Capitaline, Bloomberg, I-Sec Research

**Chart 6: Near term RoE expectations for each of the 'market implied long term growth value' buckets**



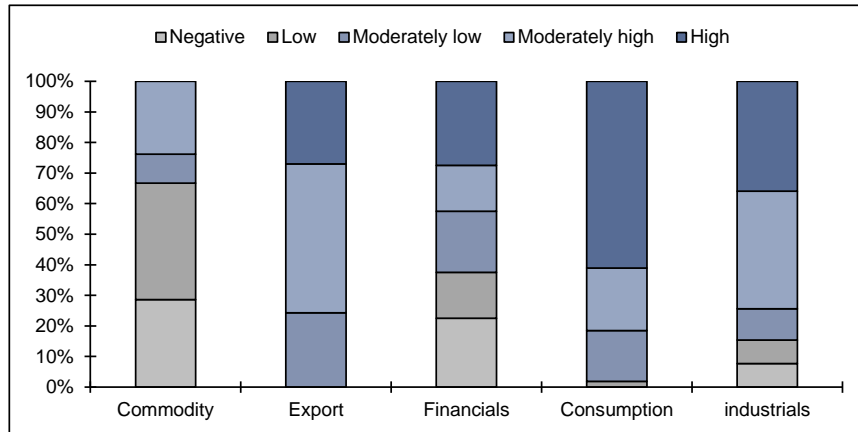
Source: Capitaline, Bloomberg, I-Sec Research

**Chart 7: Dividend yield for each of the 'market implied long term growth value' buckets**



Source: Capitaline, Bloomberg, I-Sec Research

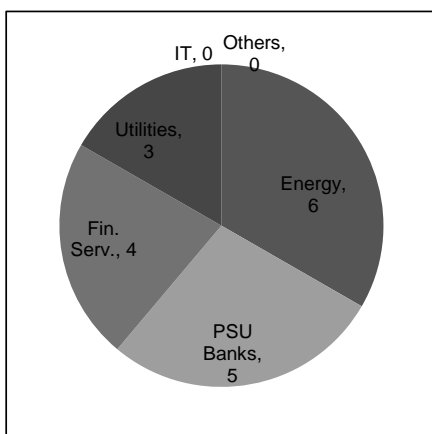
**Chart 8: Broad sectoral overlap with each of the MILTGV buckets**



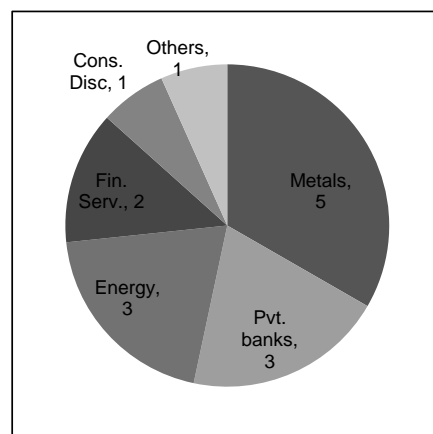
Source: Capitaline, Bloomberg, I-Sec Research

**Sectoral breakup of MILTGV buckets**

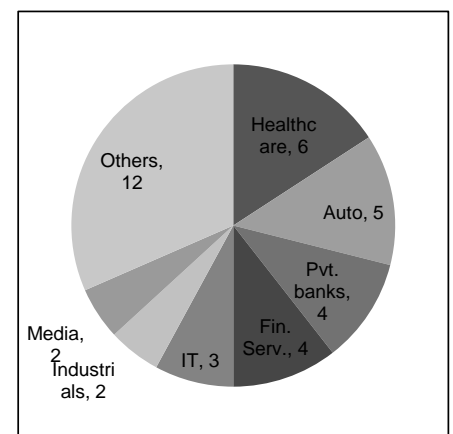
**Chart 9: Negative MILTGV**



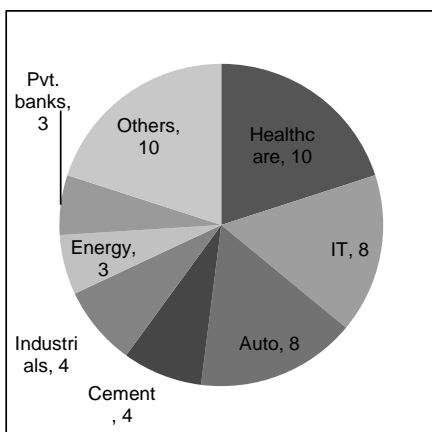
**Chart 10: Low expectations – MILTGV less than 30%**



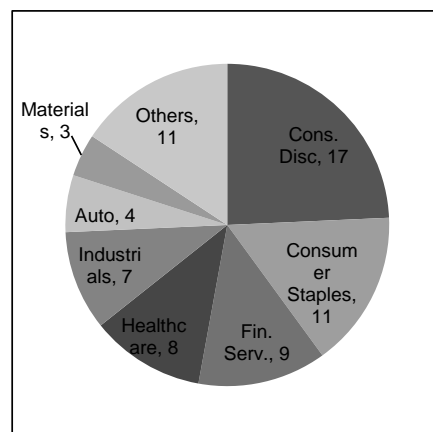
**Chart 11: Moderately low expectations – MILTGV between 30% and 50%**



**Chart 12: Moderately high expectation – MILTGV between 50% and 70%**

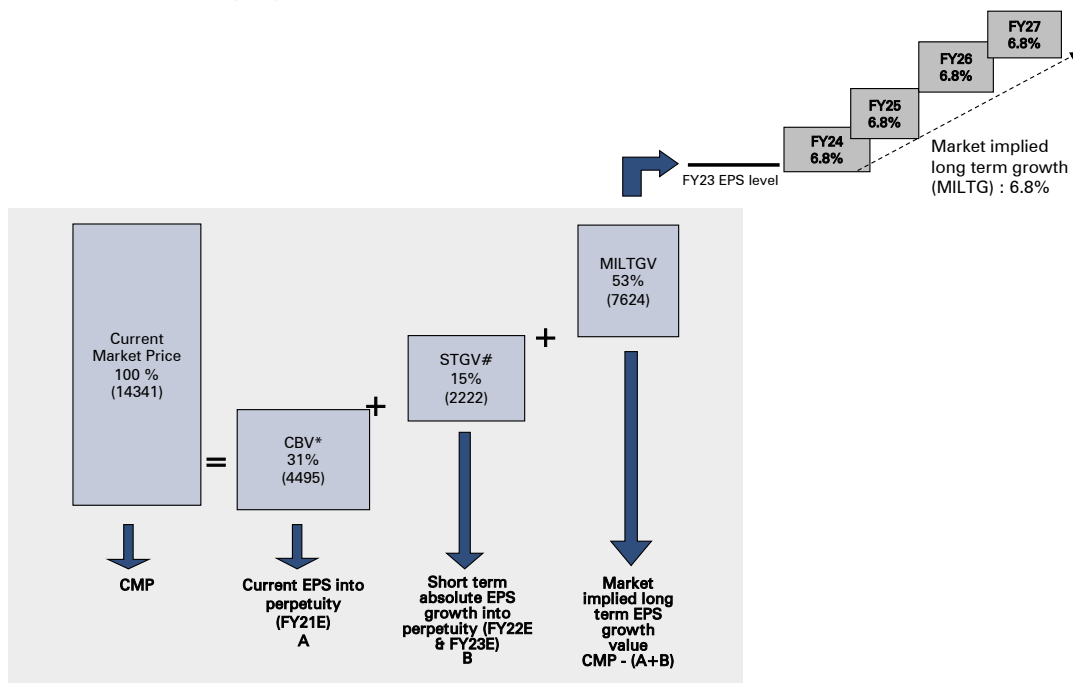


**Chart 13: High expectations – MILTGV greater than 70%**



Source: Bloomberg, I-Sec Research

**Chart 14: Explaining MILTGV – market attributing 53% of the current price of Nifty50 to earnings growth beyond FY23**



Note: \*CBV=Current business value; #STGV = Short term growth value  
 Source: Bloomberg, Capitaline, I-Sec Research



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