Twitter Thread by Kirtan A Shah

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Market PE at 40 and yet the market is not falling, why? Getting asked this question multiple times. Here's a thread covering ‘very basic’ premier on valuation for my retail investor friends.

Do hit the ‘re-tweet’ and help us educate more investors (1/n)

Year	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec
Year 1999	12.44	12.65	14.20	15.26	17.25	17.79	19.60	20.38	21.37	22.35	21.28	23.16
Year 2000	26.16	27.12	25.69	22.81	20.33	23.68	22.33	20.53	20.84	18.22	18.77	19.59
Year 2001	20.75	21.32	18.20	16.08	15.74	15.37	15.32	15.23	13.65	13.76	14.86	15.59
Year 2002	16.42	18.32	18.59	18.02	17.44	16.28	15.39	14.54	14.69	14.25	14.55	14.57
Year 2003	14.56	14.32	13.85	13.20	11.15	12.20	12.50	13.89	15.09	16.60	17.42	19.19
Year 2004	21.02	20.32	20.78	19.91	14.86	12.18	13.08	13.50	14.14	15.00	15.67	16.04
Year 2005	14.41	14.40	14.98	14.16	13.77	14.01	14.31	14.61	15.58	15.26	15.47	16.72
Year 2006	17.27	17.97	19.25	20.59	19.53	16.65	17.95	18.55	20.09	20.92	20.72	20.95
Year 2007	21.24	19.64	17.95	19.28	19.74	20.08	21.30	19.47	21.05	24.59	25.15	26.55
Year 2008	25.33	22.19	20.58	21.26	21.46	19.04	17.56	18.63	17.98	13.77	12.42	12.69
Year 2009	12.73	13.38	13.30	15.89	18.67	20.16	19.83	20.50	21.86	22.34	21.91	22.70
Year 2010	22.84	20.72	22.03	22.76	21.20	21.73	22.42	22.95	24.51	25.23	24.39	23.82
Year 2011	22.84	20.67	21.16	22.02	20.37	20.20	20.49	18.29	18.11	18.15	18.11	17.32
Year 2012	17.71	19.09	18.74	18.46	16.97	16.89	17.22	17.67	18.42	18.95	18.14	18.63
Year 2013	18.87	18.26	17.89	17.40	18.13	17.49	17.88	16.12	16.83	17.72	17.80	18.56
Year 2014	18.29	17.37	18.33	18.99	19.62	20.57	20.66	20.42	21.20	20.65	21.50	21.23
Year 2015	21.73	23.09	23.21	22.88	22.40	22.70	23.49	22.99	21.69	22.48	21.36	21.10
Year 2016	20.34	19.34	20.39	21.29	21.51	22.52	23.33	23.65	24.08	23.35	21.99	21.49
Year 2017	22.44	23.23	23.47	23.37	24.25	24.31	25.11	25.37	25.99	26.26	26.35	26.42
Year 2018	27.24	25.61	24.97	26.00	26.58	26.77	27.19	28.22	27.46	25.05	25.59	26.07
Year 2019	26.08	26.66	27.76	29.12	28.88	29.25	28.28	27.12	26.93	26.51	27.67	28.18
Year 2020	27.96	26.92	21.38	20.38	21.24	24.70	28.60	31.59	32.55	33.99	34.34	37.26
Year 2021	38.71											

For us to be able to comprehend the situation, we need to understand 4 very basic valuation matrixes
(1) Trailing EPS
(2) Forward EPS
(3) Trailing PE
(4) Forward PE

Formula

EPS = Profit After Tax / Number of outstanding Shares
PE = Market Price / EPS (2/n)

So what's a trailing EPS?

So in March 2020, RIL generated a Profit after tax (PAT) of 39,354 cr. The number of outstanding shares of RIL is some

676.21 cr. which means the 39,354 cr of PAT belongs to the 676.21 cr. shareholders, right? (3/n)

That also means that per share, RIL earned Rs. 58.20 (39,354/676.21). This 58.20 is called the trailing (TTM) EPS. Trailing means past, already done. (4/n)



Profit & Loss

Consolidated Figures in Rs. Crores / View Standalone

PRODUCT SEGM

	Mar 2009	Mar 2010	Mar 2011	Mar 2012	Mar 2013	Mar 2014	Mar 2015	Mar 2016	Mar 2017	Mar 2018	Mar 2019	Mar 2020
Sales +	151,101	203,174	265,050	357,677	395,957	433,521	374,372	272,583	303,954	390,823	568,337	595,887
Expenses +	127,894	172,271	226,427	323,169	362,912	398,722	337,008	230,845	257,647	326,508	484,087	507,413
Operating Profit	**23,206**	**30,902**	**38,623**	**34,508**	**33,045**	**34,799**	**37,364**	**41,738**	**46,307**	**64,315**	**84,250**	**88,474**
OPM %	15%	15%	15%	10%	8%	8%	10%	15%	15%	16%	15%	15%
Other Income	2,130	10,783	1,964	6,194	7,867	9,001	8,613	12,255	9,222	9,869	8,406	9,362
Interest	1,816	2,060	2,411	2,893	3,463	3,836	3,316	3,691	3,849	8,052	16,495	22,027
Depreciation	5,651	10,946	14,121	12,401	11,232	11,201	11,547	11,565	11,646	16,706	20,934	22,203
Profit before tax	**17,869**	**28,680**	**24,055**	**25,408**	**26,217**	**28,763**	**31,114**	**36,737**	**40,034**	**49,426**	**55,227**	**53,606**
Tax %	16%	15%	20%	22%	20%	22%	24%	23%	25%	27%	28%	26%
Net Profit	**14,969**	**24,503**	**19,294**	**19,724**	**20,879**	**22,493**	**23,566**	**29,745**	**29,901**	**36,075**	**39,588**	**39,354**
EPS in Rs	22.29	35.12	27.63	28.27	30.31	32.62	34.14	43.03	43.11	53.39	58.55	58.20
Dividend Payout %	12%	9%	12%	13%	13%	12%	12%	10%	11%	10%	10%	10%

So RIL earns 58.20 rupees per share but you pay 58.20 * 33.16 = 1930, 33.16 times more to buy 1 share from the market, that 33.16 is called the Price/Earnings (PE) ratio. This is again trailing as 58.20 EPS is trailing. (5/n)

33.16 PE may be looked at as taking 33.16 years to receive your investment back assuming the company keeps earning 58.20 each year (58.20 * 33.16 = 1930). But what if the company earns more than 58.20? (6/n)

So let's say, next year the company is expected to earn 20% more say 70 rupees (58.20 + 20%) per share as earning (EPS), then automatically, you start thinking that from next year's perspective the PE is cheaper. How? (7/n)

How? If next year's EPS (expected) is 70 per share and you are paying 1930 to buy the share, next year if 70 is actually the EPS (because earnings grew at 20%), the PE will become 1930/70 = 27.58 from the 33.16 you feel today. (8/n)

Which means in a company, which is expected to increase the earnings (EPS), will automatically have a lower PE the next year. This 70 projected EPS is called forward EPS and 27.58 is called forward PE. Generally good companies, increase their earnings year on year (9/n)



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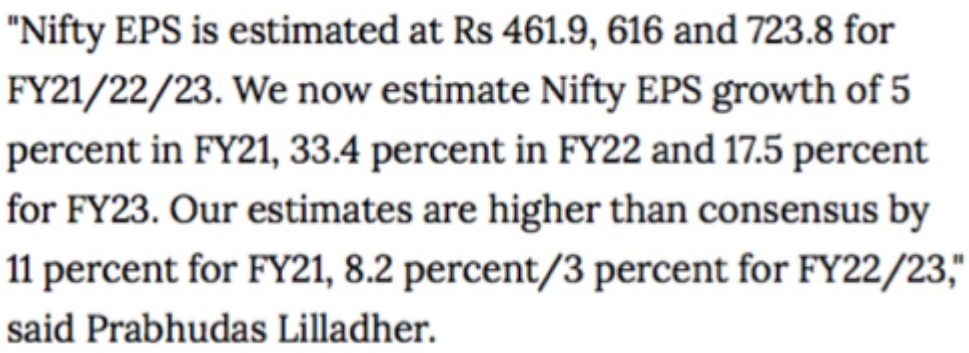
So you are buying RIL at 33.16 PE today, assuming the EPS will move from 58 to 70 and hence from the next year perspective, the PE (forward PE) you are paying is only 27.58. (10/n)

Now, like a stock has a PE and EPS (trailing & forward) Index also has it. Nifty trailing PE is 40 and trailing EPS is 365 (14600/40) (11/n)

How is Nifty's PE & EPS calculated?

Nifty's PE & EPS (trailing or forward) will be the weighted average PE & EPS of the 50 stocks the index is made up of. So if one stocks PE exponentially increases it has an increased impact on the nifty PE and vice versa (even for EPS) (12/n)

Nifty's forward EPS is expected to be 461.9 for FY 21 and hence next year's PE is expected to be 31.61 (14600/461.9) vs the current 40 we see today. This is said as "Nifty is currently trading at 31.61 times 1-year forward EPS" (13/n)


"Nifty EPS is estimated at Rs 461.9, 616 and 723.8 for FY21/22/23. We now estimate Nifty EPS growth of 5 percent in FY21, 33.4 percent in FY22 and 17.5 percent for FY23. Our estimates are higher than consensus by 11 percent for FY21, 8.2 percent/3 percent for FY22/23," said Prabhudas Lilladher.

Nifty's FY22 expected EPS is 616 and hence FY22 PE is expected to be 23.70 (14600/616) and Nifty's FY23 expected EPS is 723.8 and hence FY23 PE is expected to be 20.17 (14600/723.8) (14/n)

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10 years average PE of Nifty is 19.9 and hence when FY23 PE is expected to be 20.17, analysts say Nifty is discounting FY23 earnings. Important here to also note is that Nifty is trading at 59% premium to FY21 EPS (31.61-19.9/19.9) (15/n)

The current PE is high at 40 because the earnings (EPS) has fallen drastically in the last 2 quarters due to COVID but prices have not and can look cheaper tomorrow ONLY if earnings pick up, like I have explained above (16/n)

But imagine if the forward expected EPS (earnings) does not come through? Today RILs PE is 33.16 because of 58.20 as EPS, you were expecting 70 as EPS and hence forward PE as 27.58 and hence buying it but the EPS next year comes at 60? (17/n)

Which means PE then would be 32.2 (1930/60) vs your expectations of 27.58 and hence it will suddenly start looking expensive again and might see selling pressure. (18/n)

Which is y it is said that stocks adjust back 2 the earnings. Today stocks r going ■■ bcoz of lower $ fuelling liquidity, lower % globally but @ some point earnings will have 2 support the valuations, if it does nt, PE will start looking expensive & that can trigger ■ in stock

So, keep an eye on the earning season over the next 2-3 quarters as it's the single most important factor to monitor which can move stock prices once the easily liquidity slows down. (20/21)

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> Here\u2019s a compilation of Personal Finance threads I have written so far. Thank you for motivating me to do it.
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>
> — Kirtan A Shah (@kirtan0810) December 13, 2020