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Sensex P/E multiple hits 21-month low

Analysts say this still doesn't reflect risk from war to growth

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The sell-off in the Indian markets in recent weeks has sparked a sharp decline in equity valuations on Dalal Street. The trailing price-to-earnings (P/E) multiple of the benchmark BSE Sensex hit a 21-month low of 24.2 times (x) on Thursday as the index witnessed another bout of selling.

It declined 366 points or 0.66 per cent on Thursday. With this, the index has fallen 11.5 per cent from its lifetime high of 62,245, touched on October 19.

In comparison, the index was trading at a P/E multiple of 34.4x at the end of March and 31.7x when it hit the all-time high last October. (See adjoining charts)

This is one the sharpest decline in valuations in recent years. Earlier, the index P/E had nearly halved in the Covid-19 sell-off from a pre-pandemic high of 29x in December 2019 to a decade low of 15.7x in March 2020.

Many analysts expect a further downside. "There has been a regime change in the global economy after the Russia-Ukraine conflict. The current valuation still doesn't fully reflect the downside risk to India's economic growth and corporate earnings that lie ahead due to the spike in energy and commodity prices," said Dhananjay Sinha, managing director and chief strategist of JM Finance Institutional Equity.

According to him, there is a strong possibility of a hard landing for the global economy or stagflation in major economies that could push the stock prices much lower from current levels.

Despite the recent decline, the market remains expensive on a historical basis. The Sensex trailing P/E multiple has been 22x on average in the last 10 years, nearly 10 per cent lower than the current earnings multiple.

The Indian equity market also remains relatively expensive on a price-to-book value basis. The index ended Thursday with a P/B ratio of 3.36x, the lowest since last July. The current ratio is nearly 12 per cent higher than the index's 10-year average of around 3x.

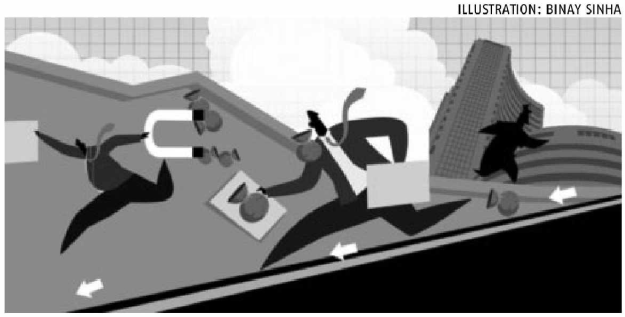
While the P/E multiple is the most common parameter to gauge valuation, many analysts rely on P/B as it's less volatile. In the last two years, the P/B ratio has ranged from a low of 2.3x in May 2020 to a high of 3.8x last September. In comparison, the index P/E multiple has been very volatile with a low of 15.7x in March 2020 and a high of 34.4x in last March.

Others say that most of the decline in valuation has been due to an unprecedented rise in the earnings of commodities producers and banks rather than a big decline in the market. "The Nifty, for example, is down just 13 per cent from its 52-week high, compared to nearly 35 per cent fall in early 2020 after the outbreak of the pandemic and nearly 50 per cent decline in 2008 global financial crisis. We can talk of undervaluation only if the market declines by another 4-5 per cent," said Shailendra Kumar, chief investment officer, Narnolia Securities.

He also expects margin compression for India Inc from higher energy and commodity prices, which may hit earnings in FY23. This could translate into a higher valuation, if the decline in earnings is sharper than the fall in stock prices.

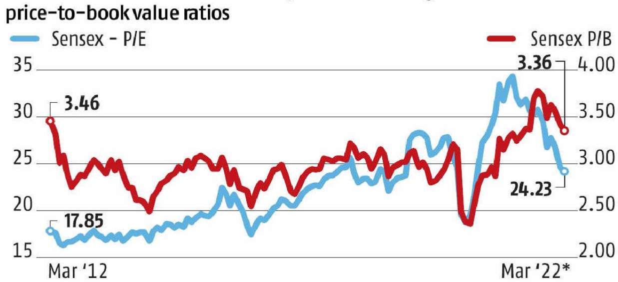
In comparison, the index's underlying earnings per share has risen 58 per cent in the last 12 months, against an 11.3 per cent rise in the index's valuation.

ILLUSTRATION: BINAY SINHA



INDEX VALUATION TAKES A HIT

The historical trend in BSE Sensex price-to-earnings and price-to-book value ratios



Note: *Latest ratio is for March 3, 2022, other numbers at respective month-end
Source: Capitaline, BSE; compiled by BS Research Bureau