



EPS Growth of Sensex 30 Companies

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Abstract

Company Valuation methods are broadly classified into Relative Valuation Methods and Absolute Valuation Methods. Relative valuation methods compare the variables of the company with other similar companies. Absolute valuation methods used company own variables, dividends and cash flow to identify the true value of the company. Current market price of any stock is the multiplication of price earnings ratio and earnings per share. Changes in EPS and PE Ratio increases and decreases the market price of any stock. But there are other factors also affect the performance of the company such as business cycle, interest rates, inflation, growth rate, ROIIC, tax rates, equity risk premium, cyclical fluctuations and bull and bear trends in the national and international economies. In this research paper two variables, EPS Growth Rate and PE Growth has been taken from 2019 to 2024. Sensex 30 companies have been taken as a sample to establish the relationship between the variables. Correlation between Earnings Growth and PE Growth has been tested through Pearson's Correlation.

Keywords: Valuation, eps growth, pe ratio

Introduction

Sensex is the large cap well diversified index of 30 companies listed on Bombay Stock Exchange. Sensex gave around 13% to 15 % return (including dividends) over 30-year period. Investment in large cap companies is less risky as compare to small cap companies. When an investor invests in such indexes their risk is diversified. DHFL and Yes Bank are latest examples where investors burn their hard-earned money. Fund managers investment styles vary from person to person. There are number of strategies adopted by the fund managers to identify the intrinsic value of the company and get margin of safety in buying decisions. Some are value investors whereas others are growth investors. Some fund managers play momentum strategy while others play turnaround strategy. Growth at reasonable price strategy is also used by some of the fund managers. Fund managers use Moat, BCG Matrix and Competitive advantage theory in making investment decisions.

Company Valuation methods are broadly classified into Relative Valuation Methods and Absolute Valuation Methods. Relative valuation methods compare the variables of the company with other similar company. Relative valuation methods take PE Ratio, Price to Book Value Ratio, Sales Growth, Net Profit Growth, EV to EBITDA, ROCE, ROE, Price to Earnings Ratio, Price to Cash Flows, Dividend Yield Ratio etc. to compare the parameters of the company with other similar company. Absolute valuation methods used company own variables, dividends and cash flow to identify the true value of the company. Absolute valuation methods include – Discounted Cash Flow Method, Pay Back Period, Economic Value-Added Method, Dividend Discount Model, Residual Income Model, Walter Model, Traditional Model and Modigliani Miller Model. In this research paper author uses EPS growth and PE ratio to identify the companies within Sensex which can generate healthy returns for the investors.

Objectives of the Study

1. To identify the EPS Growth of Sensex 30 Companies of India.

2. To identify the PE Growth of Sensex 30 Companies.
3. To identify the Correlation between EPS Growth and PE Growth of Sensex 30 companies.

Review of Literature

Current market price of any stock is the multiplication of price earnings ratio and earnings per share. Earnings per share are calculated by dividing the company net profits from the total number of outstanding shares of the company. Price earnings ratio is calculated by dividing the current market price of the company from the earnings per share of the company. Earnings per share are the net results of sales, gross profits, operating profits of the company. Price earnings ratio defines the number of times investor willing to pay for purchasing the shares of the company. Christopher Mayer in his book 100 Bagger defines PE and EPS as twin engines of growth. Stock price increases when either PE ratio increases or the Earnings of the company increases. So, investor should make investments in such companies when there is scope of earnings growth as well as PE expansion (Mayer, 2015) ^[4]. Price earnings ratio of the company is affected by the multiple of factors. A company whose growth rate is high get high PE ratio in the market. PE ratio is affected by the several factors such as interest rates, inflation expectations, growth rate, ROIIC, tax rates, equity risk premium, cyclical fluctuations and bull and bear trends in the economy (Mauboussin, 2014) ^[3]. So, one has to invest at right PE to get their money grow in future. While investing in any stock PE ratio can be taken as industry average or the company specific average PE. The other way to find the PE of the company is to find out maintenance capital expenditure or reinvestment rate of the company taking into consideration the profit growth of the company and return on invested capital. Profit growth is equal to retention ratio multiplied by return on incremental invested capital.

Profit Growth = Retention Ratio x Return on Incremental Invested Capital.

The balance left after retention is available to be disturbed among the equity shareholders.

Payout Ratio (i.e. Earnings Available to Equity Shareholder) = 1 - Retention Ratio.

Estimated Price Earnings Ratio will be Earnings/ Required Rate of Return - Growth Rate

$$\text{Expected PE Ratio} = \frac{\text{Earnings}}{r - g}$$

Thus, profit left after maintenance capital expenditure or reinvestment rate is the real profit available to be distributed to the equity share holders of the company. This profit should be used to calculate the PE of the company (Steven, 2019).

As per rule of 72 at 7% interest rate of fixed deposits money is doubled in 10 years. Compounded growth rate of 24% is required if investor want to double its wealth in every 3 years. Companies differ in their nature, size and composition. Some are consistent performer or secular companies whereas other are cyclical companies. Some companies require high amount of capital expenditure for growth and expansion whereas other's can use retained earnings for their growth. Some companies pay dividends whereas other pays no dividends. Companies are divided on the basis of their capital into large cap companies, mid cap companies and small cap companies. Investment managers around the world use multiple strategies to find intrinsic value and margin of safety in valuing these companies. Company valuation methods have been broadly classified into Relative Valuation Methods and Absolute Valuation Methods. Relative valuation methods compare the performance of company with other similar companies whereas absolute valuation methods use cash flows or dividends to determine the intrinsic value of the company.

The two important determinants for valuing stocks are high Return on Capital Employed and high Earnings Growth. When we saw companies like HUL, Nestle and Britannia their return on capital employed is very high but their earnings growth has been low. When we look at companies like State Bank of India, Bharti Airtel, ICICI Bank and Bajaj Finance their return on capital employed is low but their earnings growth is high. The companies whose earnings growth is high should focus on increasing the return on capital employed and the companies whose return on capital employed is high should focus on increasing in earning growth. A company whose return on capital employed is high and earnings growth is also very high getting higher PE valuation in the market (Agrawal, 2014) ^[1].

Style of investment of fund manager differs from manager to manager. We cannot say one investment style is perfect and other investment style is not perfect. Some fund managers look into companies who are at their turnaround stage whereas other fund managers want to invest in steady growth companies. Some fund managers play momentum strategies where other fund managers want to invest in consistent compounders. Some investors are value investors whereas others are growth investor. Some fund managers find cyclical companies are best bet as they are available at cheap valuations. Fund manager Ramdeo Agrawal prefer to invest in private sector companies (such as Titan and Asian Paints). Fund manager Ramesh Damani find Bharat Electronics limited as best bet for investment.

Some fund managers use BCG Matrix, Competitive Advantage Model and Moat to find the intrinsic value of the

companies. BCG Matrix was given by Boston Consulting Group in the year 1970 also known as Growth Share Matrix. BCG Matrix model distribute companies into Stars, Cash Cows, Question mark and Dogs. Stars are those companies whose market share is high as well as growth rate is also high (such as Bajaj Finance). BCG matrix helps the fund managers to identify companies whose market share is high as well as growth rate is also high. When fund manages identifies such companies, the next question is for how much time this competitive advantage will be enjoyed by the companies.

Competitive Advantage theory was propounded by Michael E. Porter in the year 1985. It describes how and why firms achieve superior performance compared to its competitors. Porter categorizes three types of competitive advantages in his theory. They are Cost Leadership (lowest cost producer), Differentiation (unique product) and Focus or Niche Strategy (Such as Royal Enfield). Competitive Advantage theory has been used by the fund managers to identify companies for investments.

Moat refers to company's competitive advantage that protects company from its competitors. It refers to how long company can enjoy super profits and do not allow other companies to enter into their industry and snatch the market share. There are various types of moats enjoyed by the companies. They are Monopoly Business, Switching Cost, Network Effect, Scalability, Low Cost Producer, Niche Market Segment, Intangible Assets, Patents, Trademarks, Copy Right, Entry Barrier, Distribution Moat and Software Adoption etc. These moats did not allow competitors to steal the super profits and market share enjoyed by the company. By applying all these strategies small investors can also find companies which can generate tons and tons of wealth and generate above average return from the market.

One valuation method cannot be applied to all the companies for valuation. Dividend Discount Model cannot be applied to companies which are not paying dividends. Discounted Cash Flow Method cannot be applied to companies, when companies generating negative operating cash flow for a very long period of time. Most of the valuations are relative valuation as they are easy to use and less time consuming (Fernandez, 2007) ^[2]. In this research paper, author is using EPS Growth and PE Ratio to find companies which are consistently performing and on available at reasonable valuation parameters.

Research Methodology

EPS Growth of the Sensex 30 companies has been taken for five-year period from 2019 to 2024. Compounded average growth rate has been calculated by using CAGR formula. In the same way PE ratio of Sensex 30 companies has been calculated for five-year period from 2019 to 2024. PE Expansion and PE Contraction of Sensex 30 companies have been calculated using CAGR calculator during this period.

Correlation between Earnings Growth and PE Growth has been tested through Pearson's Correlation using Excel software. Earnings Growth has been taken as independent variable and PE Growth has been taken as dependent variable.

Analysis & Interpretation

Table 1 shows the growth of Sensex 30 companies from 2019 to 2024. During this period EPS grow by 2.36 times from 897.07 (2019) to 2124.29 (2024). This indicates us our

money has been more than doubled in Sensex 30 companies from 2019 to 2024. Average EPS growth of Sensex 30 companies during this period is 20.73 percent.

Pearson's correlation has been applied for data analysis. EPS Growth has been taken as independent variable and PE Growth has been taken as dependent variable. Out of Sensex 30 companies 26 companies has been taken for analysis whose PE is positive during 2019 to 2024. Zomato limited is excluded from the analysis due to recent listing.

When we saw the relationship between EPS Growth and PE Growth we found low positive relationship between the variables. Correlation between

EPS Growth and PE Growth is 0.16. PE of the company reduces when there is less expectation of growth in the future. If we saw Table 2, PE ratio of all the banking companies has been reducing year after year due to lack of interest of investors in making fixed deposits and move towards share market investments. PE of the company also reduces when there is growth in earnings. Thus, just looking at the numbers, one cannot say reduction of PE is due to lack of interest of investors in the company or there is growth in earnings due to which PE has been taper down. It can only be found when we put EPS and PE on the same chart,

Table 1: EPS Growth of Sensex 30 Companies of India

S. No.	Company Name	EPS 2019	EPS 2020	EPS 2021	EPS 2022	EPS 2023	EPS 2024	EPS Gr.
1	Reliance	29.28	29.10	38.75	44.87	49.29	51.45	11.93
2	HDFC Bank	20.50	24.85	28.87	34.31	41.22	42.16	15.51
3	Bharti Airtel	0.74	-55.06	-25.63	7.23	14.97	13.20	77.94
4	TCS	83.87	86.19	87.67	104.75	115.19	126.88	8.63
5	ICICI Bank	6.60	14.78	26.58	36.14	48.74	63.02	57.03
6	SBI	2.58	22.15	25.11	39.64	62.35	75.17	96.28
7	Bajaj Finance	6.91	8.75	7.33	11.61	19.01	23.35	27.57
8	Infosys	35.26	38.96	45.42	52.56	58.08	63.20	12.38
9	Hindustan Uniliver	27.97	31.17	34.03	37.79	43.07	43.74	9.35
10	ITC	10.27	12.45	10.69	12.37	15.44	16.39	9.80
11	L&T	63.48	68.02	82.47	61.70	74.50	95.00	8.40
12	Maruti Suzuki	253.2	187.9	145.3	128.43	273.56	429.01	11.12
13	M&M	42.76	1.02	14.58	52.91	82.68	90.62	16.21
14	Kotak Mah. Bank	37.74	44.92	50.41	60.91	75.13	91.62	19.41
15	Sun Pharma	11.11	15.69	12.1	13.64	35.32	39.91	29.14
16	HCL Tech	37.31	40.75	41.07	49.74	54.73	57.86	9.17
17	Axis Bank	19.59	6.57	23.49	45.99	35.16	85.49	34.27
18	Ultratech Cement	87.51	199.4	189.26	254.42	175.41	242.65	22.63
19	NTPC	13.88	11.72	15.09	17.2	17.44	21.46	9.11
20	Bajaj Finserve	20.23	21.17	28.09	28.63	40.29	51.07	20.35
21	Adani Ports	19.27	18.52	24.58	23.13	24.58	37.55	14.27
22	Titan	15.82	16.91	10.96	24.48	36.61	39.38	20.01
23	Nestle India	10.21	10.8	10.99	12.4	15.55	20.4	14.85
24	Tata Motors	-99.84	-39.08	-40.51	-34.46	7.27	94.47	194.31
25	Power Grid	10.79	11.89	12.94	18.09	16.58	16.74	9.18
26	Asian Paints	22.48	28.2	32.73	31.59	42.81	56.92	20.42
27	Tata Steel	9.07	1.38	6.26	32.88	7.17	-3.55	-182.89
28	Indusind Bank	54.77	63.7	36.68	59.52	95.24	114.99	15.99
29	Tech Mahindra	43.7	41.76	45.73	57.27	49.6	24.14	-11.19
	Total EPS	897.07	964.58	1021.04	1319.74	1626.99	2124.29	601.18
	Avg. EPS Growth							20.73

0	EPS Gr.	PE Growth
EPS Gr.	1	0.162160626
PE Growth	0.162160626	1

PE expansion and PE contraction depend upon the buyer and seller interest in any particular company and also the

performance and results posted by the company. Three companies Bharti Airtel, SBI and Tata Motors are turnaround companies and have negative PE during these years from 2019 to 2024 but they are generating high positive EPS during this period.

Table 2: Price Earnings (PE) Ratio of Sensex 30 Companies of India

S. No.	Company Name	PE 2019	PE 2020	PE 2021	PE 2022	PE 2023	PE 2024	Average PE	PE Growth
1	Reliance	21.70	15.10	29.30	28.60	22.90	28.80	25.25	5.82
2	HDFC Bank	32.50	16.90	26.60	23.10	20.40	16.20	24.35	-13.00
3	Bharti Airtel	345.30	-8.20	-8.70	143.10	58.80	86.50	215.90	-24.18
4	TCS	25.10	20.00	37.00	36.90	28.80	31.00	28.05	4.31
5	ICICI Bank	33.40	19.50	26.60	22.90	19.10	18.00	25.70	-11.63
6	SBI	-44.10	14.00	16.00	12.20	9.90	9.70	-17.20	-173.87
7	Bajaj Finance	49.00	24.20	68.60	61.20	29.10	51.60	50.30	1.04
8	Infosys	21.90	15.40	31.70	37.50	24.70	26.00	23.95	3.49
9	Hindustan Uniliver	70.70	73.10	77.90	55.00	61.20	51.60	61.15	-6.10

10	ITC	30.00	14.10	20.30	20.90	26.20	26.10	28.05	-2.75
11	L&T	22.40	21.80	30.40	29.70	30.50	41.00	31.70	12.85
12	Maruti Suzuki	30.80	20.90	46.40	70.40	33.80	32.50	31.65	1.08
13	M&M	12.80	14.40	-116.70	15.20	13.00	19.20	16.00	8.45
14	Kotak Mah. Bank	36.70	28.40	37.60	32.40	24.20	20.40	28.55	-11.08
15	Sun Pharma	33.89	20.51	56.36	34.24	56.15	43.64	38.77	5.19
16	HCL Tech	15.00	10.60	20.40	27.80	19.60	26.40	20.70	11.97
17	Axis Bank	47.43	22.40	71.40	18.50	12.80	24.10	35.77	-12.66
18	Ultratech Cement	59.40	25.50	29.60	29.30	37.50	43.80	51.60	-5.91
19	NTPC	10.58	5.80	8.90	8.20	9.90	16.70	13.64	9.56
20	Bajaj Finserve	36.00	18.20	41.70	64.80	33.70	33.90	34.95	-1.19
21	Adani Ports	21.60	10.80	35.30	32.80	26.80	37.70	29.65	11.78
22	Titan	74.00	54.90	183.30	101.10	73.70	97.80	85.90	5.74
23	Nestle India	57.70	75.80	73.90	77.40	63.90	84.20	70.95	7.85
24	Tata Motors	-2.17	-2.16	-7.59	-12.59	66.72	12.12	4.98	-241.06
25	Power Grid	10.20	7.53	12.50	8.99	10.21	16.73	13.47	10.40
26	Asian Paints	66.28	59.06	77.50	97.44	64.88	50.41	58.35	-5.33
27	Tata Steel	31.76	5.46	23.84	15.07	11.12	13.35	22.56	-15.91
28	Indusind Bank	31.76	5.46	23.84	15.07	11.12	12.35	22.06	-17.21
29	Tech Mahindra	17.30	11.20	23.10	28.00	20.50	43.20	30.25	20.08
	Total PE	1198.93	620.66	997.05	1135.22	921.20	1015.00	1106.97	
	Avg. PE Ratio	41.34	21.40	34.38	39.15	31.77	35.00	38.17	

S. No.	Company Name	EPS Growth	PE Growth
1	Bharti Airtel	77.94	-24.18
2	SBI	96.28	-173.87
3	Tata Motors	194.31	-241.06

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Conclusion

Our test result indicates low positive correlation 0.16 between EPS growth and PE growth. This indicates us that there are other factors also which affect the up and down movement of PE ratio. Three companies namely SBI, Airtel, and Tata Motors PE growth has been negative during 2019 to 2024. But these companies showing higher growth rate in earnings during this period. Sensex multiply 2.36 times and double the money during 2019 to 2024. Average PE ratio of Sensex companies during this period is around 38.17. Changes in PE ratio depend upon number of factors. These factors are changes in interest rates, inflation, growth rate of company, buyer and seller interest in any particular company, upward and downward cycles in the company, upward and downward cycles in national and international economies, company competitive advantage, monopoly status enjoyed by the company and company moat etc. Investor have to read PE changes, EPS growth and Market Price of any shares simultaneously before making any buying and selling decision in the company.

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