Market this Week

1 May 2022

AMN CAPITAL

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Performance - Major Market Indices - week ended 29 April 2022

INDEX	29-Apr-22	Return (%) 1 week	1 month	1 year
Broad Market Indices				
NIFTY 50	17,102.55	-0.4%	-2.3%	14.8%
NIFTY 500	14,783.35	-0.7%	-0.8%	18.0%
NIFTY MIDCAP 100	29,880.35	-1.4%	1.0%	23.0%
NIFTY SMALLCAP 100	10,256.95	-2.7%	-1.0%	19.3%
Volatility Index				
INDIA VIX	19.42	5.8%	-5.8%	-16.7%
Sectoral Indices				
NIFTY BANK	36,088.15	0.1%	-0.7%	7.0%
NIFTY AUTO	11,078.10	0.5%	5.1%	13.3%
NIFTY FINANCIAL SERVICES	16,636.55	-0.2%	-3.1%	3.7%
NIFTY FMCG	38,204.15	1.1%	6.5%	12.3%
NIFTY IT	31,622.40	-2.5%	-13.3%	22.2%
NIFTY MEDIA	2,149.70	-6.2%	-8.9%	38.4%
NIFTY METAL	6,327.30	-1.8%	-1.6%	30.3%
NIFTY PHARMA	13,462.85	-0.8%	-2.1%	1.2%
NIFTY REALTY	443.75	-1.0%	-4.0%	42.1%
NIFTY ENERGY	28,594.15	-1.0%	10.6%	58.3%

Market gave negative returns this week with the declines in midcaps and smallcaps being steeper than that of largecaps. The volatility index is up 5.8 percent and is inching closer to the 20-mark indicating the increasing risk level in the markets. Among the sectoral indices, the media, IT, and metal indices declined, while the IT index remained resilient by posting a gain of 1.1 percent for the week. The steepest decline among sectoral indices was posted by the media sector which declined 6.2 percent for the week.

For the month of April 2022, Auto, FMCG, and Energy indices outperformed with gains of 5.1 percent, 6.5 percent, and 10.6 percent respectively. The under-performing sectors were IT, media, and realty which declined by 13.3 percent, 8.9 percent, and 4.0 percent respectively.

Nifty IT Index

The Nifty IT index declined by 13.3 percent in the month of April 2022 and is the largest loser among sectoral indices. The Nifty IT index is designed to capture the performance of listed Indian IT companies and is constituted of 10 companies. TCS and Infosys, together, has a weightage of 55 percent in the index.

Infosys

The share price of Infosys declined by 17.8 percent in April 2022. The company announced its results for the quarter and year ended 31 March 2022 on 13 April 2022 and the results were disappointing leading to selloff in the stock. For the quarter ended 31 March 2022, revenue increased by 22.7 percent year-on-year, operating profit increased by 8 percent year-on-year, and net-profit increased by 12 percent year-on-year. Operating margins declined by 3 percentage points from 24.5 percent in March 2021 quarter to 21.5 percent in March 2022 quarter.

The last two years has been good for Infosys both in terms of stock performance and financial performance. Between fiscal 2020 and fiscal 2022, revenue increased by 34 percent and operating profit increased by 41.42 percent. The stock which was trading at ₹650 per share in April 2020 gained by 141 percent over the next two years and is currently trading at ₹1,570. This is a superior return particularly from the stock of a company of Infosys's size. When the stock was trading at ₹650 per share in April 2020, it had a price-earnings ratio of 17. The current price-earnings ratio is 30.

TCS too declared its results for the quarter and year ended 31 March 2022 last month. The revenue increased by 22.17 percent, operating profit is up 7.6 percent, and net-profit is up 7.35 percent for the quarter. The stock price of TCS declined by 5.17 percent in April 2022.

TCS

The stock and financial performance of TCS over the last two years is like that of Infosys but not as large in scale as Infosys. For TCS, in the last two years, revenue and operating profit are up 22.17 percent and 26 percent respectively. The stock price is up 86 percent in the last two years, from ₹1,900 per share in April 2020 to ₹3,546 per share in April 2022. The price-earnings ratio in April 2020 was 22.04. The stock currently trades at a price-earnings ratio of 34.

The Twin Catalysts

It is essential to identify quality stocks to invest to achieve superior investment returns. But that along will not guarantee superior returns. I have found from my experience in investing that there are two catalysts necessary for a stock to give superior returns, even for stocks of high-quality companies. These two catalysts are – low valuations and high growth.

The cases of Infosys and TCS over the last two years which is discussed above illustrates this point nicely. In April 2020, Infosys was trading at a lower price-earnings ratio that TCS. For Infosys, it was 17 while for TCS it was 22.04. Moreover, the growth in revenue and profit over the next two years for Infosys was greater than TCS. Infosys grew its revenue and profit by 34 percent and 41.42 percent, respectively, while the corresponding figures for TCS was 22.17 percent and 26 percent, respectively.

The effects of the different levels of valuation and growth for these stocks are evident in their stock price performance. Between April 2020 and April 2022, the stock price of Infosys gained by 141 percent, far superior to the 86 percent return provided by the stock of TCS.

Buyback - Sarda Energy & Minerals

Sarda Energy – a manufacturer of Steel and Ferro Alloys – announced on 23 April 2022 to buyback a maximum of 8,11,108 equity shares of face value ₹10/- through the tender offer route. The buyback price for the offer is ₹1,500/- per equity share. The record date for the issue is 6 May 2022.

The promoters and promoter group have informed their intention to participate in the buyback offer up to a maximum of 5,88,023 equity shares and the public holds 99,14,875 equity shares, which means about 1,05,02,898 equity shares are eligible to participate in the offer.

The buyback offer represents 7.72 percent of the total shares eligible to participate. This means if all the eligible shares are tendered in the offer, then for every 100 shares tendered only 7 – 8 equity shares will be accepted, and the rest returned to the investor. This is a very low acceptance ratio.

The buyback price of ₹1,500 per equity share is at a premium of 24.68 percent to the current market price of ₹1,203 per equity share. That is a reasonable return.

Below, we discuss two cases of how the buyback can play out. In the first case, we assume that all the eligible shares are tendered, so we have an acceptance ratio of 7.72 percent. In the second case, we assume that only half of the eligible shares are tendered, and the acceptance ratio is 15.44 percent. Also, the unaccepted shares which will be returned have to be sold in the secondary market at the prevailing market price. We hypothesize three levels of price at the end of buyback process and expected returns for all three levels are calculated.

Case 1: all eligible shares tendered (acceptance ratio 7.72%)

Hypothesis	current market price	Shares Bought	Cost of purchase	Acceptance Ratio	Shares Accepted	Buyback price	Shares returned	Total cash received	Return (%)
price declines by 5%	1,203.00	100.00	1,20,300.00	7.72%	8	1,500.00	92	1,17,042.20	-2.7%
price remains unchanged	1,203.00	100.00	1,20,300.00	7.72%	8	1,500.00	92	1,22,592.84	1.9%
price increases by 5%	1,203.00	100.00	1,20,300.00	7.72%	8	1,500.00	92	1,28,143.48	6.5%

Case 2: only half of eligible shares tendered (acceptance ratio 15.44%)

Hypothesis	current market price	Shares Bought	Cost of purchase	Acceptance Ratio	Shares Accepted	Buyback price	Shares returned	Total cash received	Return (%)
price declines by 5%	1,203.00	100.00	1,20,300.00	15.44%	15	1,500.00	85	1,19,799.40	-0.4%
price remains unchanged	1,203.00	100.00	1,20,300.00	15.44%	15	1,500.00	85	1,24,885.68	3.8%
price increases by 5%	1,203.00	100.00	1,20,300.00	15.44%	15	1,500.00	85	1,29,971.96	8.0%

In both the cases, if the price declines by at least 5 percent, the investor makes a loss. The returns are mediocre when the price at the end of buyback process remains unchanged from the price of now. If the price increases by 5 percent during the buyback process, then case 1 provides an expected return of 6.5 percent and case 2 provides an expected return of 8 percent.

A buyback offer through the tender offer route typically takes three months to complete. In that case, the annualized expected return for case 1 is 28 percent and for case 2 is 36 percent, which are not commensurate with the risk and effort involved in the process.

Moreover, for this to happen the stock price should appreciate during the buyback process, which is hard to assess from the present.

There is no incentive in buying shares of 'Sarda Energy' to tender in the buyback offer from an investment return perspective.

Thanks for Reading

Arun M Narayanan

Managing Partner, AMN Capital