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# Correction may not be very deep, positive corporate earnings surprise provides fillip to equity markets

Even though the equity market rally in the last one and half years is driven by strong liquidity and expansion in valuation multiples, earnings growth have also contributed to the rally.

SAMPATH REDDY | OCTOBER 09, 2021 / 08:11 AM IST



It was quite a positive surprise that corporate earnings registered a healthy growth amidst the COVID-19 pandemic in FY21 when the Indian economy witnessed one of its most severe post-Independence recessions. Nifty EPS growth came in at a healthy 18 percent in FY21, despite a record GDP contraction of 7.3 percent contrary to many expectations of a decline in earnings of upto about 10 percent.

Even though FY21 earnings growth was supported by a weaker base of FY20 due to the COVID-19 impact in the last quarter, the extent of rebound was spectacular and has aided strong stock market performance. This surprise in earnings was driven by stringent cost controls across sectors. Despite the second wave, the earnings for FY22 and FY23 have not seen any significant downgrades and are anticipated to grow by around 25 percent and around 20 percent respectively.

## Sectors driving earnings growth

It is counter-intuitive to have seen earnings grow at such a strong pace during the pandemic phase. However, deeper analysis reveals that some of the key sectors having large contributions to the aggregate earnings have demonstrated resilience. Banking and Financial Services which accounts for over 25 percent of the earnings have recovered from the corporate loan stress and are were further supported by moratorium and liquidity measures like TLRTRO (Targeted Long-Term Repo Operations), ECLGS (Emergency Credit Line Guarantee Scheme) etc. during the pandemic phase, thus helping the sector post good earnings growth. With this, the largest corporate sector (banking) in terms of earnings is adding to the stable growth in current and next year.

## Fiscal Year-Wise Nifty Sectoral Profit & Growth Trend (in percent)

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Sector	Profit After Tax (PAT) - Rs in Billion				Growth YoY (%)			
	FY20	FY21	FY22E	FY23E	FY20	FY21	FY22E	FY23E
Agro Chemicals	27	35	45	53	8	30	31	16
Automobiles	103	178	229	421	-53	74	28	84
Banking	896	1,116	1,500	1,898	48	25	34	27
Capital Goods	89	69	91	113	11	-22	32	24
Cement	116	123	163	192	45	6	33	18
Consumer	289	292	326	394	20	1	11	21
Healthcare	90	128	159	185	10	42	24	17
Infrastructure	37	50	66	81	-7	35	32	23
Metals	71	216	720	549	-70	205	233	-24
Oil & Gas	743	994	1,096	1,302	-26	34	10	19
Retail	15	10	16	27	9	-35	61	68
Technology	741	792	925	1,106	4	7	17	20
Telecom	-41	-7	28	53	Loss	Loss	LP	91
Utilities	411	404	445	486	6	-2	10	9
Nifty index	3,586	4,400	5,809	6,858	-3	23	32	18

Source: Motil Oswal

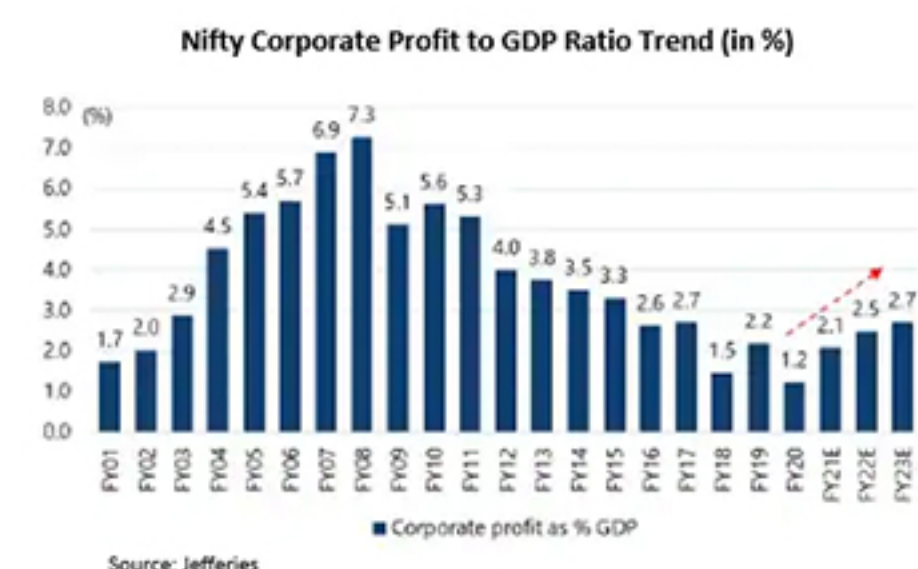
Software services sector has seen a sharp improvement in earnings growth, buoyed by an uptick in digital spends and cost cutting due to employees working-from-home. The increased spending on technology is resulting in strong deal wins for the Software companies and is expected to contribute to good earnings growth for current and next year as well.

Commodity producers such as Steel, Aluminium, Cement and Chemicals have also seen a sharp recovery in earnings growth due to higher commodity prices driven by supply shocks in many cases. The strong cash flows of the aluminium and steel companies is helping them de-leverage their balance sheets.

## Corporate profitability cycle on an uptrend in India

With the second wave significantly moderating in India over the past few months, lockdown restrictions have been relaxed and various economic trackers show that economic/business activity have now gone back to pre-pandemic levels. Also, the pace of vaccinations has progressed very well due to which we believe that COVID-19-driven economic shocks are firmly behind us. RBI is estimating the GDP growth to recover to 9.5 percent in FY22. Hence, we believe corporate earnings growth will sustain.

As shown by the corporate profits to GDP ratio in the below chart, corporate earnings growth has not been in commensurate with the GDP growth in the last many years. This was driven by stress in few sectors like corporate banks--which were struggling with asset quality issues and are now back on a profitable growth trajectory. Metals, which were also struggling in terms of profitability have seen sharp recovery in their earnings. The consolidation in the metal sector driven by NCLT resolutions is now bearing fruits. Pharmaceutical sector was impacted by US FDA actions and pricing pressure in export markets in the past few years which now seems to have bottomed out. Therefore, the corporate profitability cycle (corporate profit as the percent of GDP) is now once again on an uptrend in India after moderating for more than a decade.



Even though the equity market rally in the last one and half years is driven by strong liquidity and expansion in valuation multiples, earnings growth have also contributed to the rally. We believe that the earnings growth outlook continues to be healthy and hence any correction may not be very deep despite seemingly higher valuations.

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