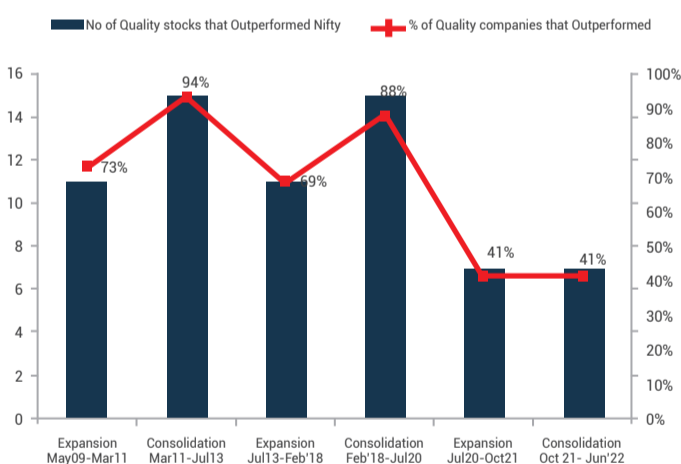


## Investigating Recent Under-Performance of Quality Companies

July 2022

### What does “Quality” denote and why such companies are preferred for Investment?

Companies with high and sustainable competitive advantages that protect their market share and profitability possess high MOAT and are referred to as “Quality” companies. Some names with which Indian stock market associates the notion of Quality are Asian Paints Ltd, Nestle Limited, Britannia Ltd, Hindustan Unilever Ltd, Pidilite Industries, Bajaj Finance, HDFC Bank, Titan etc. Fundamentally these companies have shown consistent Cashflow growth over the last 10-15 years. In terms of stock market performance, these “Quality companies” in times of market expansion have either yielded similar market returns or more and during consolidation these companies have fallen lesser than the market (assuming Nifty returns for illustrating market returns). In the last 10-15 years, the superior performances of these companies have been witnessed multiple times and hence the return matrix of these companies have imprinted on investors’ mind thus making them Investor favorites.



The chart illustrates number of quality stocks in Nifty 50 that outperformed vs all good Quality companies present in Nifty 50 during various phases of the market. In the phase of 2009-11 where Index expanded by ~60%, 11 out of 15 good quality companies rose more than the Index with average return of 271%. Hence, 73% of Quality stocks outperformed the Index and so on. However, In the current phase expansion between Jul 20 to Oct 21, only 7 out of 17 (i.e 41%) quality stocks outperformed the market. Also, in the recent market fall from Oct 21 till Jun 22, unlike previous periods, less than half of the quality stocks outperformed the Index.

### Under Performance by Quality Companies in Recent Times

In the recent times, post Covid lows in Mar 2020, there is a strange change of behavior of these quality companies price movement vis a vis market movement. So, the superior performance of quality companies that seemed as a rule of the market has been overruled by the markets. In the recent rally from Mar 2020 lows to Oct 2021 highs, these companies delivered more or less market returns however, during the decline from Oct 2021 highs to Jun 2022 lows, these companies have fallen “more” than the market unlike what was witnessed in earlier expansion and consolidation phases of the market

## Table of Returns for Quality Nifty Companies during Oct 2021 to Jun 2022

Performance of Nifty Companies between 18<sup>th</sup> Oct 2021 (where Nifty made its peak) to 30<sup>th</sup> Jun 2022

**Nifty (-)15%**

BAJAJFINSV	-41.5	TITAN	-25.0	INFY	-18.4	NESTLEIND	-10.1	RELIANCE	-4.1
WIPRO	-41.4	GRASIM	-24.7	KOTAKBANK	-17.4	DRREDDY	-9.9	EICHERMOT	-1.1
TATASTEEL	-38.6	ULTRACEMCO	-24.2	ADANIPTS	-17.1	BRITANNIA	-9.7	SUNPHARMA	-0.6
HINDALCO	-37.6	HDFC	-22.8	ASIANPAINT	-16.9	SBILIFE	-9.3	COALINDIA	0.2
INDUSINDBK	-34.9	HDFCLIFE	-21.8	TATACONSUM	-16.3	ONGC	-6.5	BHARTIARTL	0.6
BPCL	-33.3	AXISBANK	-21.7	HINDUNILVR	-16.0	SBIN	-6.4	CIPLA	1.5
SHREECEM	-32.6	JSWSTEEL	-21.1	UPL	-15.8	HEROMOTOCO	-6.3	POWERGRID	4.0
TECHM	-32.4	HCLTECH	-20.3	APOLLOHOSP	-14.9	BAJAJ-AUTO	-5.3	ITC	4.2
DIVISLAB	-32.1	HDFCBANK	-19.3	LT	-12.9	ICICIBANK	-5.1	MARUTI	10.6
BAJFINANCE	-31.3	TATAMOTORS	-19.2	TCS	-10.4	NTPC	-4.4	M&M	20.0

## Factors Attributed to Quality Companies Recent Underperformance

Our studies show that this inferior performance has more to do with the investment opportunity becoming more wider than before in Indian context. In times of benign corporate profit growth during the last 10 years, these companies continued exhibiting consistently high cash flow growth which kept shifting their valuation range to higher and higher trajectories. Going forward, a broad based earnings growth is expected from all sectors like Banking, IT, Pharma, Industrials, Energy ,Discretionary etc. This has resulted in Valuation range of the favoured stocks coming down one notch lower to 2016-2020 levels.

## Some Examples of Quality Companies' Valuation Re-basing



Asian Paints	Range 1	Range 2	Range 3	Unjustified Range	Comfort Regime
Period	2006-12	2012-16	2016-20	2020-22	
Mkt cap to Sales	2-4x	4-6x	6-8x	8-13x	6-8x



Titan	Range 1	Range 2	Unjustified Range	Comfort Regime
Period	2006-16	2016-20	2020-22	
Mkt cap to Sales	2.0-3.3x	3.5-5.5x	5.5-8x	3.5-5.5x



Nestleind	Range 1	Range 2	Range 3	Unjustified Range	Comfort Regime
Period	2006-09	2009-15	2015-18	2018-22	
Mkt cap to Sales	3.2-4.2x	4.2-6.2x	6-8x	8-13x	6-8x

## Is Quality Out of Fashion Now?

We believe the valuation range for Quality companies are settling by the process of mean reversion. In many stocks the reset has been already done while in some the process is still continuing. Quality is here to be. There are many opportunities in good quality companies that Investors have waited for years for making an entry. This era has to be utilized for the same. We assume, companies will rebase itself to previous valuation range and then react to earnings and cash flow for the new trajectory for prices. We have seen over a long term period, companies with high cash flow and sustainable high return ratios reward stock market investors. Hence, the faith on quality stocks is maintained and this price correction is assumed to be a part of adjustment to normalcy. In the long term, Investors make money if they are associated to good quality companies and management. So, sometime these companies go out of fashion but for long term investment Quality is forever.

---

Narnolia Investment Advisors Private Ltd. (NARNOLIA) is a SEBI Registered Investment Advisors (Non Individual) having SEBI Registration Number INA300005439 (Permanent) , CIN:- U67120JH2007PTC012791 Corporate Address: 803, Wing A, Kanakia Wall Street, Chakala, Andheri, Mumbai – 400093, PH: 022 6270 1200/ 022 6839 1200, Email Id: iap@narnolia.com. SEBI Regional office address: L&T Chambers, 3rd Floor, 16 Camac Street, Kolkata – 700017 NARNOLIA is 100% subsidiary of Narnolia Capital Advisors Private Ltd. which is NBFC registered with RBI. Narnolia Capital Advisors Private Ltd is owned by Narnolia Securities under the Promotership of Mr. Krishnanand Narnolia. Details of associate entities are available on the website of the Company. Narnolia is not affiliated with any intermediaries for execution or distribution services and no consideration including any commission or referral fees is received directly or indirectly at group level for the said services. Client shall not be under any obligation to avail the execution/distribution or other services offered through any entity as recommended by NARNOLIA and no consideration is received for the same. There is no pending regulatory matter against NARNOLIA as on date. No disciplinary action has been taken against the Company by any regulatory/statutory authority. No complaint has been lodged by any client relating to our Investment Advisory Services.

### Conflict of Interest

Narnolia Financial Services Ltd., a company registered under the Companies Act, 1956, is a SEBI registered intermediary and offers services as Merchant Banker, Portfolio Manager, Research Analyst and also AMFI registered Mutual Fund distributor and is one of the affiliates/Associate Company of NARNOLIA. However, appropriate Chinese walls is maintained as required under SEBI Investment Advisor Regulation.

### Disclaimer

This report has been prepared by Narnolia Financial Services Ltd. (NFSL) and is meant for sole use by the recipient and not for public circulation. The report and information contained herein is strictly confidential and may not be altered in any way, transmitted to, copied or distributed, in part or in whole, to any other person or to the media or reproduced in any form, without prior written consent of NFSL. The report is based on the facts, figures and information that are considered true, correct, reliable and accurate. The intent of this report is not recommendatory in nature. The information is obtained from publicly available media or other sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. The report is prepared solely for informational purpose and does not constitute an offer document or solicitation of offer to buy or sell or subscribe for securities or other financial instruments for the clients. Nothing in this report constitutes investment, legal, accounting and tax advice or a representation that any investment or strategy is suitable or appropriate to your specific circumstances. The securities discussed and opinions expressed in this report may not be suitable for all investors, who must make their own investment decisions, based on their own investment objectives, financial positions and needs of specific recipient. Certain transactions -including those involving futures, options, another derivative products as well as non-investment grade securities - involve substantial risk and are not suitable for all investors. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his/her/its own advisors to determine the merits and risks of such an investment. Neither the Company, not its directors, employees, agents or representatives shall be liable for any damages whether direct or indirect, incidental, special or consequential including lost revenue or lost profits or lost opportunities that may arise from or in connection with the use of the information/report. The person accessing this information specifically agrees to exempt NFSL or any of its affiliates or employees from, any and all responsibility/liability arising from such misuse and agrees not to hold NFSL or any of its affiliates or employees responsible for any such misuse and further agrees to hold NFSL or any of its affiliates or employees free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors and delays. Investment in Securities Market is subject to Market risks, read all the related documents carefully before investing. Past performance may not be indicative of future results and no promise or guarantee can be given for the same. Performance related information is not verified by SEBI. For detailed disclosures & disclaimers please refer to our website at [www.narnolia.com](http://www.narnolia.com) This report is not directed or intended for distribution to or use by any person or entity resident in a state, country or any jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject NFSL& its group companies to registration or licensing requirements within such jurisdictions.