# Strategy

May 19, 2024

## What does 100X P/E mean?

**The benevolence and/or complacency of market participants have resulted in a large number of stocks trading at astronomically high levels. Investors may want to get a handle on the market size implied by such high multiples. A 100X P/E essentially implies earnings growing at the rate of cost of equity over 100 years or at much higher growth rates over a shorter period of time.**

### Astronomical valuations being ascribed to higher number of stocks

The Indian equity market appears to be fairly benevolent or complacent with basic issues such as market size and profitability being sidelined, given its obsession with narratives. Valuation methodologies have low or no linkage to fundamentals, which makes high multiples palatable, no matter how outrageous the implied math for underlying parameters becomes at higher multiples. The current benign mood has resulted in much higher number of high P/E companies currently compared with history. Exhibit 1 shows the number of Indian stocks that have been trading above 50X and 100X each year in the past decade on a one-year forward basis. Even ignoring 'young' companies in 'young' industries, the number is very high. It is interesting to see that several such high P/E companies are in 'traditional' sectors, which face massive disruption risks.

### 100X P/E = 83,000X earnings in the 100$^{th}$ year

A simple but stark way to appreciate a P/E multiple is that the P/E multiple is the number of years a company will have to grow its earnings at the current cost of equity (ignoring terminal value). Thus, a stock trading at 100X P/E would theoretically need to compound its earnings (FCFE) at the rate of cost of equity over 100 years. Thus, such a company will need to deliver 10,000X-83,000X current earnings in the 100$^{th}$ year, depending on the cost of equity (see Exhibit 2). *Ceteris paribus*, the sector will need to expand by a similar quantum.

### 100X P/E requires higher earnings CAGR for shorter growth phases

Companies will require sharper and higher growth rates over a shorter period to justify very high P/Es. A 100X P/E company, which may be in the growth phase over the next 40 years, will need to report an earnings CAGR of 20% over the next 20 years and 9% CAGR over the subsequent 20, according to our simplistic DCF model (see Exhibit 3). If the industry's growth phase were to be shortened by 20 years, required growth rates will be even higher (see Exhibit 4). Even if we assume (1) stable market structure and (2) stable profitability, the particular sector will then require becoming 200X in the first scenario and 30X in the second one. Only a few sunrise sectors may pass this small test!

### Current profitability is already elevated, even as competition is ramping up

We note that many sectors and stocks enjoy very high profitability and returns, which are unlikely to last beyond the next 5-10 years, as forces of disruption have strengthened across sectors (see Exhibits 5-6). The implied market size would need to be even higher in case profitability were to decline from current elevated levels. The latter is extremely likely, the former is unlikely.

**Key estimates summary**

| | 2024E | 2025E | 2026E |
|---|---|---|---|
| **Nifty estimates** | | | |
| Earnings growth (%) | 21.0 | 9.1 | 13.5 |
| Nifty EPS (Rs) | 995 | 1,093 | 1,245 |
| Nifty P/E (X) | 22.5 | 20.5 | 18.0 |
| **Macro data** | | | |
| Real GDP (%) | 7.6 | 6.6 | 6.5 |
| Avg CPI inflation (%) | 5.4 | 4.4 | 4.2 |

Source: Company data, Kotak Institutional Equities estimates

**Quick Numbers**

104 companies trading at above 50X P/E (one-year forward consensus) in the Indian market

A 100X P/E company should have 83,000X earnings in the 100$^{th}$ year to justify its current multiple, if earnings were to compound at cost of equity of 12%

A 100X P/E should grow its earnings at 20% over 20 years and lower growth rate after that to justify its multiple in a hypothetical higher-growth scenario

Full sector coverage on KINSITE



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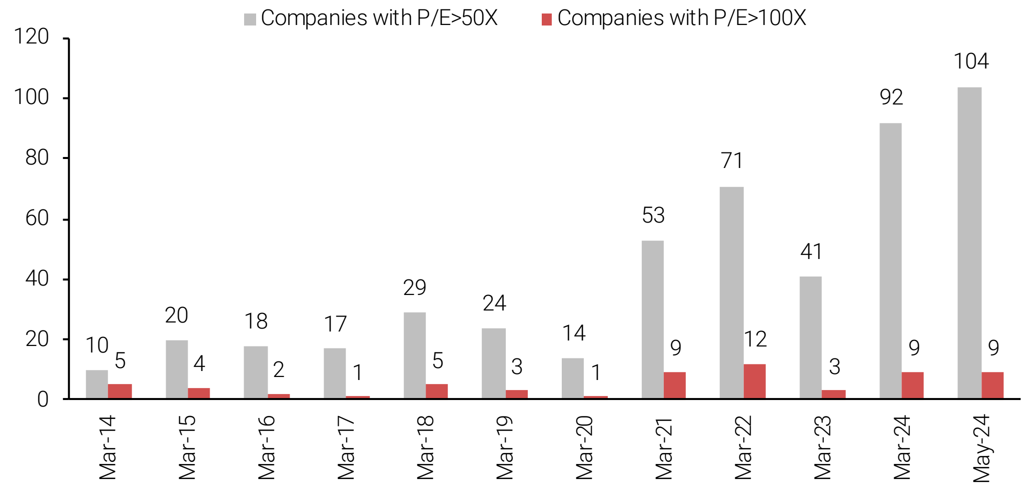
**Number of companies trading at more than 50X P/E multiple has increased 10X over the past 10 years**

Exhibit 1: Number of companies trading at more than 50X 12-m forward P/E multiple (X)




Source: Bloomberg, Kotak Institutional Equities

**A company will need to deliver 10,000-80,000X current earnings in the 100th year to justify a 100X P/E multiple**

Exhibit 2: Required earnings growth to justify 100X P/E

| Year | 0 | 10 | 20 | 30 | 40 | 50 | 60 | 70 | 80 | 90 | 100 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Cost of equity (%) | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 |
| Future earnings | 1 | 3 | 10 | 30 | 93 | 289 | 898 | 2,788 | 8,658 | 26,892 | 83,522 |
| Cost of equity (%) | 12.0 | 11.5 | 11.0 | 10.5 | 10.0 | 9.5 | 9.0 | 8.5 | 8.0 | 7.5 | 7.0 |
| Future earnings | 1 | 3 | 9 | 26 | 70 | 180 | 445 | 1,048 | 2,358 | 5,068 | 10,397 |

Source: Kotak Institutional Equities estimates

**A company will need to deliver 20% earnings CAGR over the next 20 years, 9% CAGR over the subsequent 20 years to justify a 100X P/E multiple**

Exhibit 3: Required growth rate to justify 100X P/E for sectors reaching terminal growth in 40 years

| Assumptions | 2024-43 | 2044-64 | Terminal |
|---|---|---|---|
| Growth (%) | 20 | 9 | 5 |
| Discount rate (%) | 12.0 | 11.0 | 10.0 |

| | 2024 | 2025 | 2026 | 2027 | 2038 | 2039 | 2040 | 2041 | 2042 | 2043 | 2044 | 2045 | 2056 | 2057 | 2058 | 2059 | 2060 | 2061 | 2062 | 2063 | 2064 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| PAT | 100 | 120 | 144 | 173 | 1,284 | 1,541 | 1,849 | 2,219 | 2,662 | 3,195 | 3,486 | 3,803 | 9,912 | 10,814 | 11,798 | 12,872 | 14,043 | 15,321 | 16,715 | 18,236 | 19,896 |
| FCF/PAT (X) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| FCF | 100 | 120 | 144 | 173 | 1,284 | 1,541 | 1,849 | 2,219 | 2,662 | 3,195 | 3,486 | 3,803 | 9,912 | 10,814 | 11,798 | 12,872 | 14,043 | 15,321 | 16,715 | 18,236 | 19,896 |
| FCF discounted | 100 | 107 | 115 | 123 | 263 | 281 | 302 | 323 | 346 | 371 | 432 | 425 | 351 | 345 | 339 | 334 | 328 | 322 | 317 | 311 | 306 |
| NPV of cash flows | 11,845 | | | | | | | | | | | | | | | | | | | | |
| Terminal value | 6,428 | | | | | | | | | | | | | | | | | | | | |
| NPV of terminal value | 142 | | | | | | | | | | | | | | | | | | | | |
| EV | 11,987 | | | | | | | | | | | | | | | | | | | | |
| **P/E (X)** | **100** | | | | | | | | | | | | | | | | | | | | |

Source: Kotak Institutional Equities estimates

**A company will need to deliver 23% earnings CAGR over the next 10 years, 15% CAGR over the subsequent 10 years to justify a 100X P/E multiple**

Exhibit 4: Required growth rate to justify 100X P/E for sectors reaching terminal growth in 20 years

| Assumptions | 2024-33 | 2034-44 | Terminal |
|---|---|---|---|
| Growth (%) | 23 | 15 | 5 |
| Discount rate (%) | 12.0 | 11.5 | 10.5 |

| | 2024 | 2025 | 2026 | 2027 | 2038 | 2039 | 2040 | 2041 | 2042 | 2043 | 2044 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| PAT | 100 | 123 | 151 | 186 | 1,287 | 1,480 | 1,702 | 1,957 | 2,250 | 2,588 | 2,976 |
| FCF/PAT (X) | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| FCF | 100 | 123 | 151 | 186 | 1,287 | 1,480 | 1,702 | 1,957 | 2,250 | 2,588 | 2,976 |
| FCF discounted | 100 | 110 | 120 | 132 | 263 | 270 | 278 | 285 | 293 | 300 | 337 |
| NPV of cash flows | 4,586 | | | | | | | | | | |
| Terminal value | 56,816 | | | | | | | | | | |
| NPV of terminal value | 7,713 | | | | | | | | | | |
| EV | 12,299 | | | | | | | | | | |
| **P/E (X)** | **100** | | | | | | | | | | |

Source: Kotak Institutional Equities estimates

**The threat of disruption has accelerated across sectors in the past few years**

Exhibit 5: Key disruption themes for Indian consumer sectors

| Disruption | | | |
|---|---|---|---|
| **Environment** | **Formalization** | **Standardization** | **Technological disruption** |
| Clean air and higher share of renewables in India's energy mix | Shift from unorganized to organized will gather pace | Products will be more generic/standardized | Technological advancement will lead to disruption of business models along with increasing productivity |
| Key beneficiaries: Automobiles (EV), clean energy companies,, pollution control equipment suppliers | Key beneficiaries: Consumer companies in sectors with high share of unorganized sector, private banks, large real-estate developers and organized retailers | | Key beneficiaries: Adaptive businesses, automobiles (EV), private banks, clean energy companies |
| Key losers: Automobiles (ICEV), coal, oil (E&P and R&M) | Key losers: Building component companies | Key losers: Semi-branded commodities such as building components and consumer appliances | Key losers: Automobiles (ICEV), coal, oil, semi-branded businesses |

Source: Kotak Institutional Equities estimates

**Most consumer sectors face modest-to-high threats from disruptive forces**

Exhibit 6: Assessment of threats to 'moats' of various consumer sectors

| | New competition | Eroding distribution | Standardization |
|---|---|---|---|
| Alcobev | Low | Low | Modest |
| Automobiles-2W | High | Low | High |
| Automobiles-4W | High | Low | Modest |
| Cables and wires | Modest | High | High |
| Cement | Modest | High | High |
| Consumer durables | High | Moderate | High |
| Home care | High | Modest | Modest |
| Paints | High | Low | High |
| Personal care | Modest | Modest | Low |
| QSR | Moderate | Modest | High |
| Tobacco | Low | Low | High |

Source: Kotak Institutional Equities estimates

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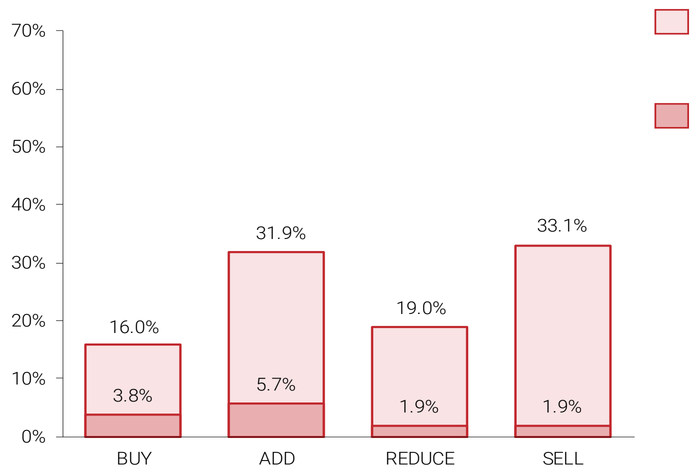


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Source: Kotak Institutional Equities

As of March 31, 2024

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