'Unlock rally' in hotel, multiplex, and retail stocks may fizzle out

Currently, the Street is ignoring shrinkage of balance sheets and delay in return to normalcy

SHREEPAD S AUTE
Mumbai, 26 August

The gradual relaxation of lockdown restrictions has improved sentiment towards stocks in categories, such as hotel, retail, and multiplex, which have been hit the hardest by the Covid-19 pandemic. Many stocks from these segments have gained 30-100 per cent in the past three months, outperforming the 26.5-per cent rise on the BSE Sensex.

There is little doubt that things now aren't as bad as they were three-four months back and the market is now looking beyond the 2020-21 financials. However, the key issue is whether the rally will sustain.

According to G Chokkalingam, founder of Equinomics Research and Advisory, "We believe the rally in the stocks of categories, such as retail, hotel, and multiplex, is unlikely to sustain. The market is ignoring two key aspects — the balance sheet shrinkage because of losses during the pandemic period and the expected delay in return to normalcy."

Dhananjay Sinha, director and head of institutional research at Systematix Group, shared a similar view. "Things may be looking better now. But, we believe categories like hotel, retail, and multiplex will continue to remain under pressure and underperform the overall market," said Sinha, adding, "We prefer other stocks, such as those from the banking or automobile ancillary space, where earnings visibility and value addition are relatively good."

What is still keeping the recovery outlook of these categories gloomy is the consumer buying behaviour amid income uncertainty. Some experts said even if restrictions are removed, a recovery in the economic status of households will not happen immediately. Besides, limited social events and people avoiding crowded/public places cannot be ruled out. These will have direct implications on business growth in these categories, taking a toll on operating leverage and, thus, the overall earnings.

While in the case of hotels, even though the lockdown is fully lifted, occupancy improvement will take time. Archana Gude, an analyst at IDBI Capital, said: "Earnings visibility is very feeble for hotels, though the September quarter should see sequential improvement. Unless there is earnings sustainability, hotel stocks are unlikely to get back their valuation multiples."

For retailers, geographical mix and the nature of the product portfolio are key deciding factors. For instance, stocks such as V-Mart will be in better shape, given their higher exposure to semi-urban and rural areas, while companies like Trent and Aditya Birla Fashion and Retail, which have a major presence in tier-1/urban areas, will continue to feel the pain, said Akhil Parekh, analyst at Elara Capital. Essential consumer goods retailers, such as Avenue Supermarts, should witness less impact than those selling apparel and luxury goods.

In the case of multiplexes, though some analysts have a positive stance, footfall should be impacted by the rising preference for over-the-top platforms. Further, a likely delay in content releases and lower demand in the food and beverage segment (over 20 per cent of revenue) are the other key challenges.

Some analysts believe smaller/single-screen players, which have large a market share and are struggling with liquidity issues in this period, will pave the way for players like PVR and Inox Leisure, with relatively fast recovery. The jury, however, is out on this.

Also, many companies in sectors, such as multiplex and retail, have undertaken stringent cost-control measures and favourably re-negotiated rental cost.

SHARP GAINS

Price in ₹

	August 26	Change (%)
Lemon Tree Hotels	30.8	84.7
PVR	1,322.7	58.2
Indian Hotels	104.9	54.8
EIH	89.5	54.6
Shoppers Stop	194.2	46.2
Inox Leisure	292.3	41.9
Trent	649.7	41.4
Aditya Birla Fashion	149.0	39.5
V-Mart Retail	2,073.7	31.6
Avenue Supermarts	2,408.5	5.2
BSE SENSEX	**39,073.9**	**27.7**

Change in % is over the past three months. Source: Exchange, *Bloomberg*

Experts warn against chasing momentum

Retail investors may get fingers burnt by aggresively buying small-, mid-caps stocks

SANJAY KUMAR SINGH

Mid- and small-cap stocks have outperformed large caps in the ongoing market rally. Since the market's low on March 23, the Sensex is up 49.5 per cent, the S&P BSE MidCap Index is up 55.4 per cent, and the S&P BSE SmallCap Index is up 67.6 per cent.

After this run-up, experts say they are seeing signs of momentum-chasing in some mid- and small-cap counters, which could result in retail investors getting their fingers burnt.

The mid- and small-cap universe underperformed in 2018 and 2019. It also got battered during the March downturn. "After the March lows, the mid- and small-cap indices were at extremely attractive valuations, which led to the recent run-up," says Pranav Gokhale, fund manager, Invesco Mutual Fund.

The rally has been broad-based so far. "In future, it is likely to become more selective. Only stock prices of those companies will continue to rise that show strong earnings growth," says Jatin Khemani, founder and chief executive officer, Stalwart Advisors, a Securities and Exchange Board of India-registered independent equity research firm.

The economy at large will have to turn around for more mid- and small-cap stocks to show improved earnings performance. "For that to happen, the rural recovery must continue, private capital expenditure must revive, and the government's Make-In-India initiative must fructify," says Madanagopal Ramu, fund manager, Sundaram Alternate Assets.

Valuations are no longer as attractive as they were in March. "Mid-cap valuations are above their 10-year mean, but small-cap valuations are still below their 10-year mean on the basis of positive, adjusted price-to-earnings ratio. Valuations are at the higher end, but they are not extremely stretched," says Gokhale.

Valuations have turned frothy in some stocks. "Current prices discount a few years of earnings growth in some cases and some of these stocks are running based purely on momentum," says Ramu. Things could end badly for retail investors in such stocks.

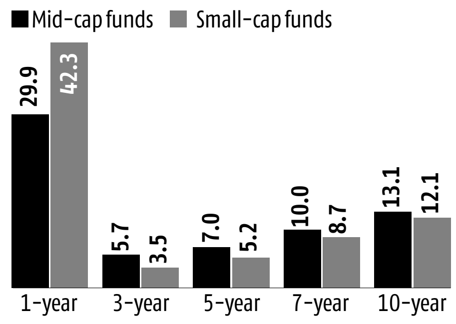
Many new entrants have chosen to invest directly. "These investors may have made money in the past few months. But now they need to reorient their portfolios towards stocks that will be able to grow their earnings. If they do not have the time or the ability to identify such stocks, they should hand over their money to fund managers who are better equipped to do so," says Ramu. In stocks where valuations have become overheated, investors should book profits.

When investing in mid- and small-cap stocks, Gokhale emphasises the need to identify strong, scalable businesses with superior return ratios, which generate sufficient cash flows that give them the ability to withstand downturns.

According to Khemani, investors should stick to stocks where the debt-to-equity ratio is not high, so that the company's survival itself does not become an issue if the Covid-19 pandemic continues. Investors also need to go with companies whose business models are likely to stay relevant for the next 10 years or more. Finally, they must enter mid- and small-cap stocks with at least a three- to five-year horizon.

IF YOU CAN'T TRACK STOCKS, TAKE THE MUTUAL FUND ROUTE

Category average SIP returns (%)



Source: *mutualfundindia.com*

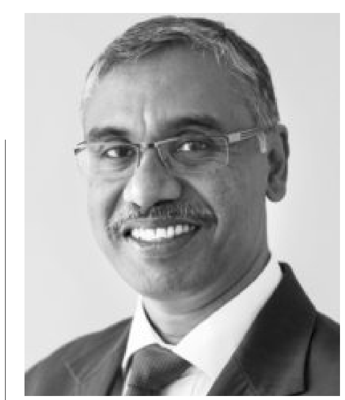
YOUR MONEY

'Stock-picking now has become harder'

There is limited upside for Indian equities unless there is slowdown in the spread of the virus, says **VIDHU SHEKHAR**, country head–India, CFA Institute. In conversation with **Ashley Coutinho**, he says stock-picking has become harder, but the potential reward for stock-picking skills has increased. Excerpts:

Q&A

VIDHU SHEKHAR
Country head–India, CFA Institute



Retail volumes in the market have shot up lately.

This seems to be a global trend, with people at home turning their attention towards trading. Modern trading platforms use a variety of behavioural nudges to encourage trading. Irrespective of what happens to the markets, long-term outcomes for uninformed investors and traders are seldom positive.

The market seems to have run ahead of fundamentals on hopes of an early rebound in the economy. How difficult has stock-picking become in this environment?

Over the past few years, it has become increasingly hard for fund managers to beat the index. My guess is that while stock-picking has got harder with the pandemic, the potential reward for stock-picking skills has increased. Companies differ in terms of the resilience of their balance sheets, their ability to hold on to business in a shrinking market, and their agility to reinvent themselves.

Is a correction imminent, given the significant run-up from March lows?

Market correction depends on the earnings recovery in the next few quarters. Liquidity should remain adequate, but financial sector stress and availability of credit will drive both consumption and investment.

Fund managers, particularly those of large-cap funds, have struggled to beat the benchmarks. Do we see an acceleration in the shift towards passive funds in India?

The difficulty in beating the index is a sign of maturity of Indian markets and the Indian asset management industry. This will continue to put pressure on asset managers; to what extent this will translate into a shift from active to passive depends on the wealth management industry.

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