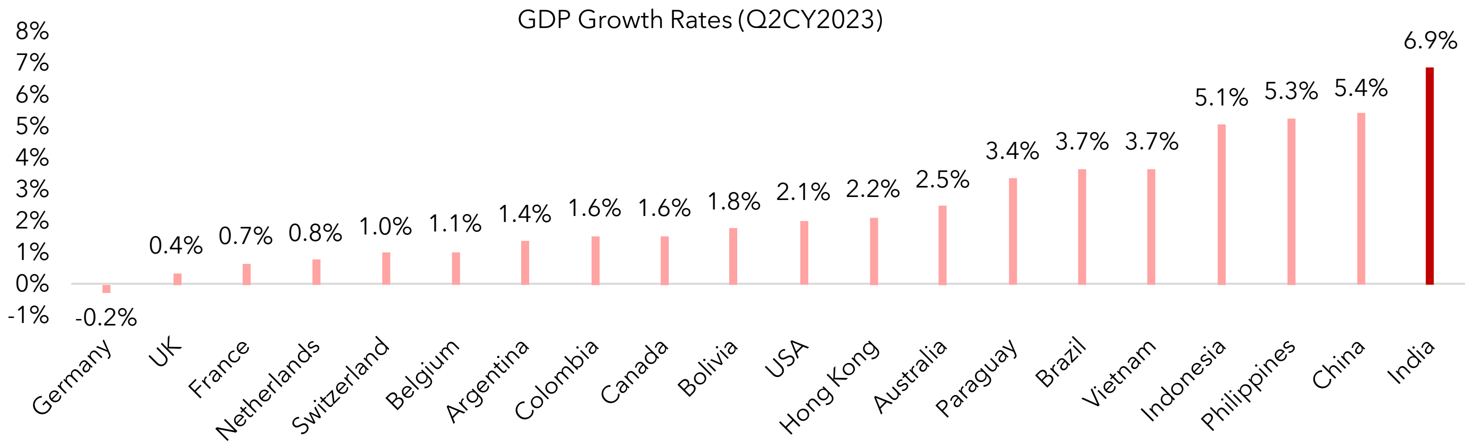
UNIFI INVESTMENT MANAGEMENT

STRATEGY COMMUNIQUE
Q3-CY 2023

The Rhetoric of Slowdown vs. Reality of Expansion

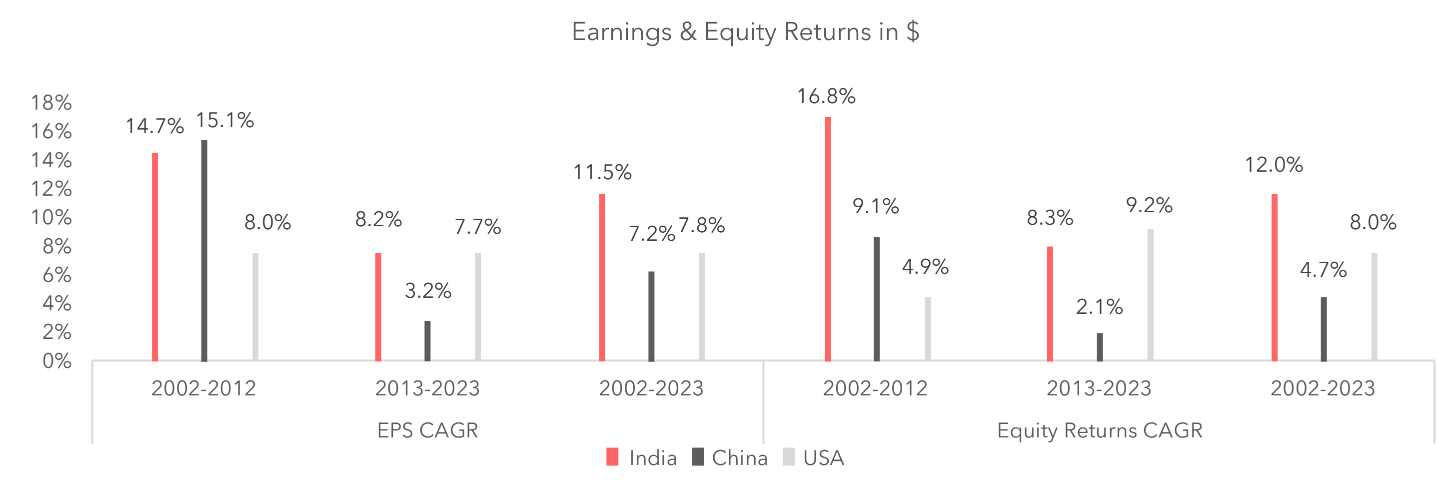
How exactly is the world faring? Headlines have an enduring palette for a certain economic condition. As we ushered in 2023, an imminent global recession/stagflation was a certainty, given the prevalent interest rate calendar, inflation, fiscal tightening, and geo-political sentiments. The reality of the ensuing economic landscape is however different. An unyielding pursuit of economic growth by policymakers, relentless advancement of technology, and progress in productivity have not only reshaped industries but fundamentally altered economic outcomes. At the heart of this pursuit is the acute recognition of the impact of economic growth on societal progress. The data, at scale, is a testament to this fact.

Currently, over 80% of the countries that publish quarterly GDP data [IMF] are reporting expansion of GDP. Contrary to the consensus expectations of a recession in 2023, the growth outlook for most regions during the year has been revised upwards. Among the major economies, [ex-Germany and Russia], all other regions are clocking growth. While GDP contraction is likely in some of the European countries and a slowdown in GDP growth is likely in the US between 2023 and 2024, the forecast by the IMF suggests that the vast majority of the countries would maintain positive growth momentum, in 2023 and 2024. While the delayed impact of aggressive monetary policy tightening can slow down the global economy, this is likely to be compensated by continued accommodative fiscal policies. Moreover, a significant deterioration in growth prospects would also result in a pivot by the major central banks which would help prevent sustained low GDP growth. A cursory glance at real GDP growth (Q2 CY 2023) around the World is as follows.

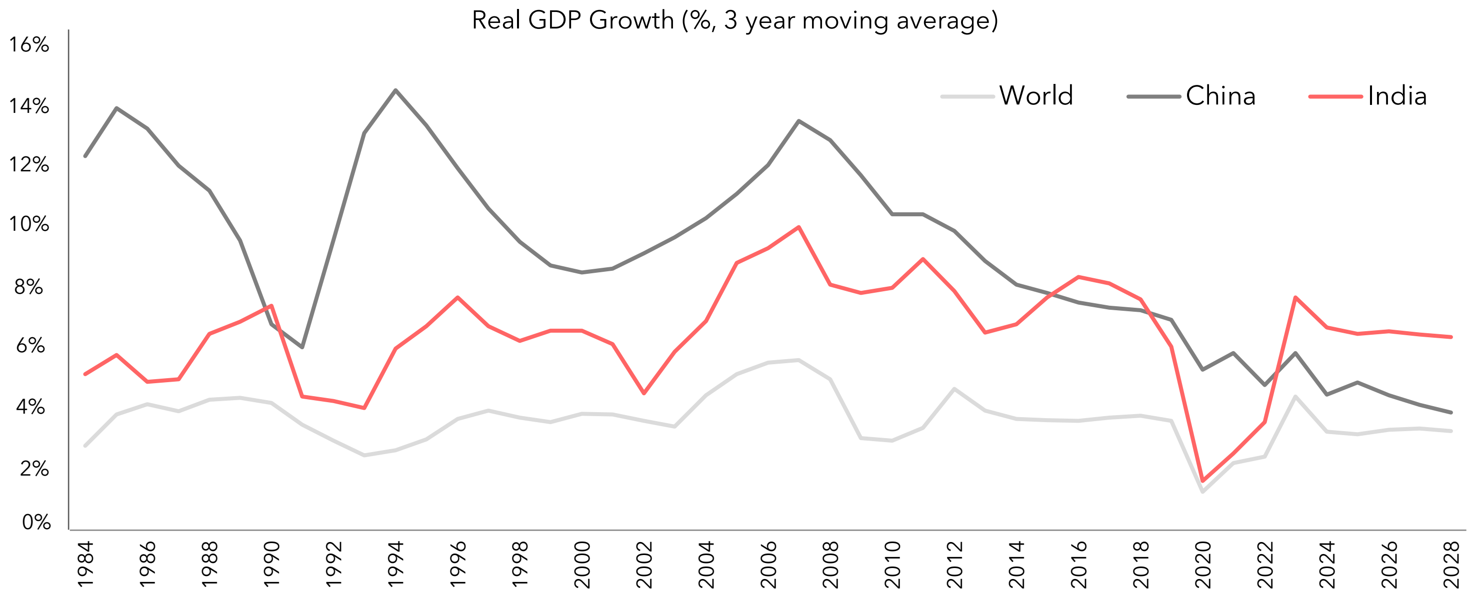


Source: Spark Research

While India is currently maintaining the highest growth rate among the systemically important economies of the world, as per the IMF, India is likely to retain this position in each year between 2023 and 2028. Despite the prevalent macroeconomic stress, India is pivoting to the structurally finest it has been in a decade. It's equity returns are the outcome. From here on, the arithmetic importance of India's contribution to global growth is apparent.



Source: Bloomberg, Motilal Research



Source: IMF, Spark Research

While the makings of high growth rates have been prevalent in India, today, the execution between builders of public policy, and private enterprise is of a genre resulting in outcomes not seen before. The strong resilience of domestic consumer demand, execution of government policies to promote investments, and diversification of the global supply chain into India, is aiding in the maintenance of this momentum in growth. While the outcomes are a function of several intricate factors, we shall evaluate a few moving parts.

Structure behind the numbers

In our previous note to you, we touched upon the various parameters of productivity that are driving India's economic progress. While rising corporate and household incomes are of a nature that is addressing India's generational shift in consumption, the broad contours of India's economic makeup are undergoing a shift. We evaluate a few factors here.

Current Account Deficit

Why a lower CAD pays off in the long term?

Before we get to India's evolving CAD scenario, let us refresh the theory. A persistently high CAD makes any country highly dependent on foreign capital flows. The characteristics of such flows are they disappear exactly when the nation needs it the most. This is particularly true of emerging economies. A high CAD is an indication of a nation's structural reliance on external resources, and unless addressed, restricts the ability of such an economy to increase economic multiplier effects. For instance, one of the key reasons for India to be able to grow at 8-9% during FY04-09 was that India had a current account surplus during FY01-03. Had India's current account been weaker, or negative, it would not have been possible to have maintained such rates of growth; or the after-effects could have been painful. In the same breath, even if a CAD-nation receives sufficient foreign capital flows and increases its forex reserves, it is very different from another country with lower capital flows but a current account surplus. In the former case, the rise in forex reserves is due to the accretion of liabilities, as foreign capital flows are an obligation to be repaid. India is conversing towards a more sustainable CAD regime today, lending credence to the sustainability of the growth to come.

Over the past many years, India has run a Current Account Deficit of -2%. This is expected to neutralise over the next few years and gradually turn positive. The various moving parts of India's CAD are as follows.

As a % of GDP	FY23	FY24E	FY25E	FY26E	FY27E	Comment
Net Imports Goods	-7.7%	-6.8%	-6.4%	-6.0%	-5.7%	
Oil Imports (Brent Crude @$95)	-3.3%	-3.1%	-3.0%	-2.8%	-2.7%	The decline in net oil imports is based on our assumption of mid-single digits in volume growth while prices are stable at $ 95/Barrel
Non-Oil Imports	-4.4%	-3.6%	-3.4%	-3.2%	-3.0%	
Coal	-1.6%	-1.2%	-1.1%	-1.0%	-1.0%	Coal prices have declined by ~25-30% compared to last year. We have not assumed any benefit led by a transition to green energy
Electronics	-2.0%	-2.0%	-1.9%	-1.9%	-1.8%	Assumed gradual moderation in net electronics imports as indigenous manufacturing under PLI scheme & China plus one gains some pace.
Gold	-1.1%	-1.0%	-1.0%	-1.0%	-1.0%	
Textile	0.7%	1.0%	1.0%	1.0%	1.0%	
Net Import Services & others	5.8%	5.4%	5.4%	5.3%	5.3%	
IT Exports	3.4%	3.3%	3.2%	3.2%	3.2%	Assumed gradual moderation from IT exports led by a near-term slowdown in the sector.
Remittances	3.0%	2.6%	2.6%	2.5%	2.4%	Assumed lower remittance on the assumption of Brent crude being stable and gradual transition towards an alternate source of fuel over the next few years
CAD	-2.0%	-1.4%	-0.9%	-0.6%	-0.4%	

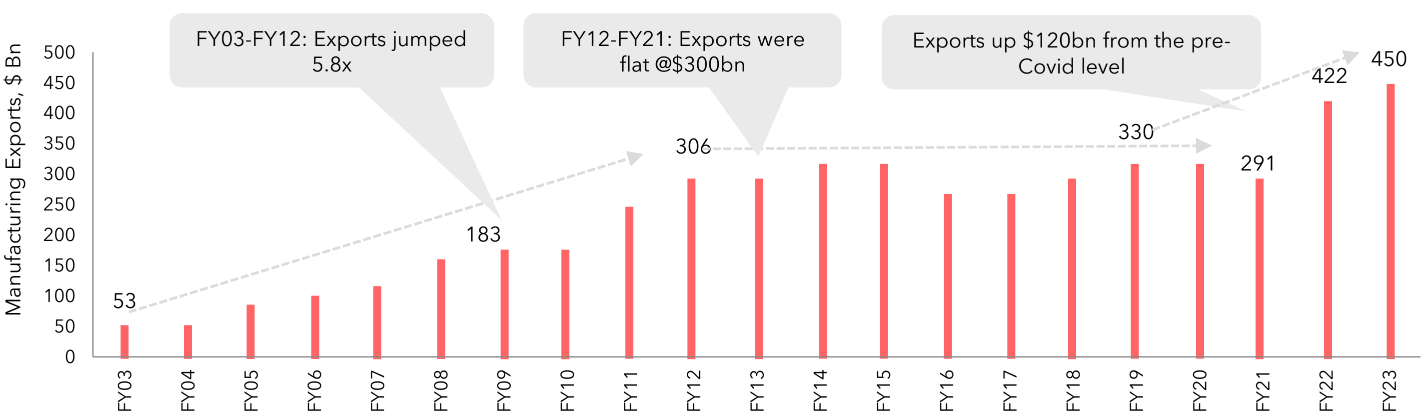
We expect India's CAD to decline gradually over the next few years and eventually turn positive somewhere around FY28-FY29. This is largely based on our assumption that Brent crude is stable at ~$95 / barrel. This shall lead to a ~40% decline in CAD by FY27. The benefit from lower oil & coal imports shall be pared off to some extent by relatively lower IT exports and lower remittances. As a result, India's ability to maintain its existing high rates of growth, and investment outcomes is likely to be more sustainable than ever.

Manufacturing Pivot

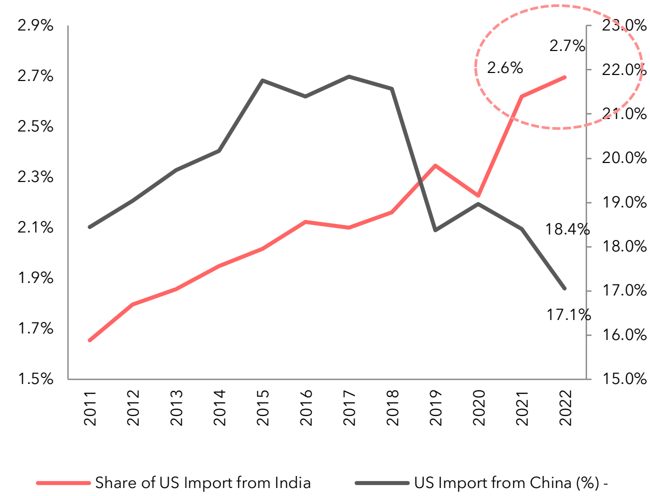
Moment of absolute growth

Much has been said about the resurgence of Manufacturing in India. This is important, as manufacturing as a % of India's GDP has declined from 17% of GVA a decade ago to 15% of GVA in FY23. One of the main reasons why manufacturing-led growth is preferable is because of its ability to generate large employment across the spectrum of the economy. India has historically delivered below par on its employment generation endeavours, due to its limited success with manufacturing. Over the past 3 years, there has been a concerted effort to deliver on this, and the numbers are showing up. Although India's share in global exports is still less than 2%, it must be noted that it is at an all-time high now and increased by 0.2% during the past three years to 1.82%. The shift of the supply chain away from China is abetting this trend and is expected to strengthen from here on.

As the data below indicates, there has been considerable progress in India's manufacturing economy.



Source: MOC, CMIE, Spark Research



Source: Spark Research

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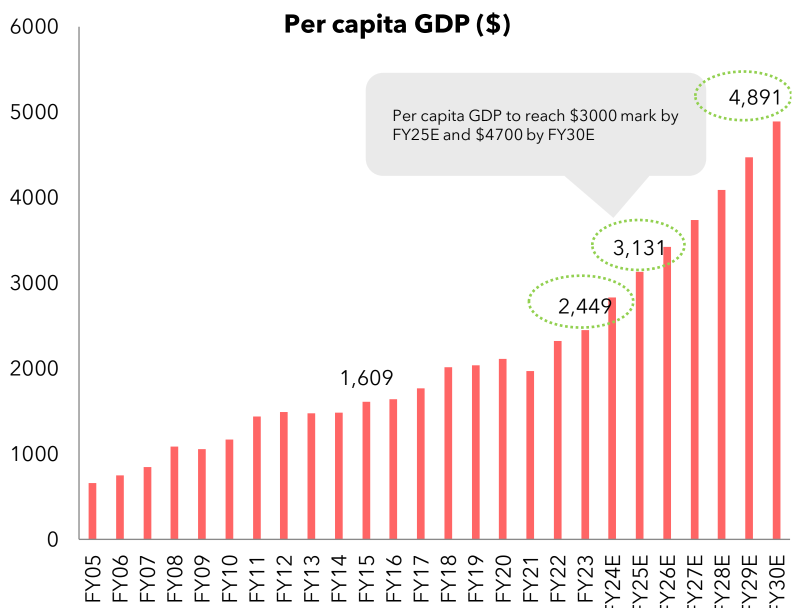
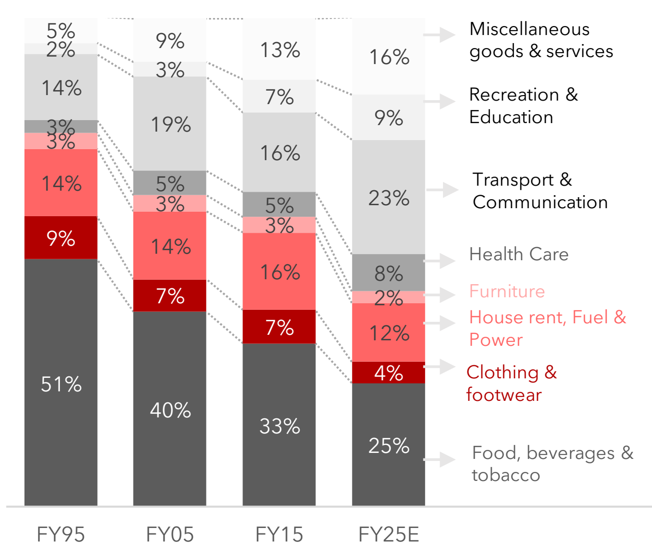
The $2,000 mark

Moment of Pivot in India's consumption

The starting point of conversations around India's potential is its 1.4 billion people and their many needs, and the consequent growth pivots on domestic consumption and investments. India has crossed the $2,000 per capita income mark – which has been an inflection point for the non-linear jump in discretionary spending in other countries. It is at this juncture that discretionary spending rise as increase in income levels drive a shift in household spending away from necessities to premiumization and discretionary spending. As India's real wages grow in mid-single digits from here on, disposable incomes will grow at a much higher rate. Importantly, this is well supported by the stock of India's demography. By 2030, India's working-age population is expected to be 1.04 billion with a dependency ratio to be the lowest in its history at 31.2%, contributing just under a quarter of the incremental global workforce. The working-age population bulge is expected to last till 2055. The "Asian Miracle" was built on harnessing this trend: Japan entered this sweet spot in 1964, South Korea in 1967 and China in 1994. What this can do to India's consumption is exciting.

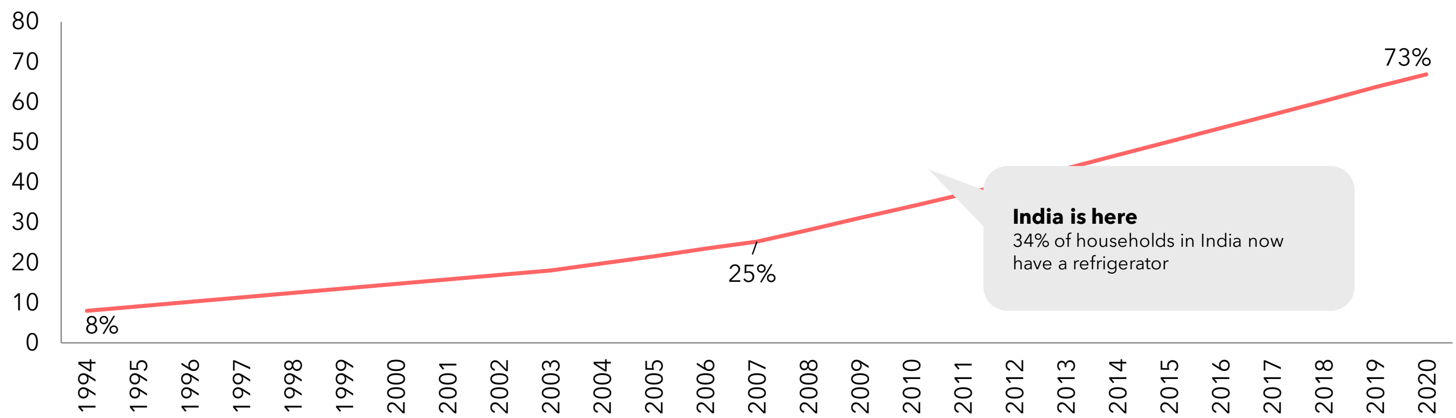




Source: GOI, Spark Research

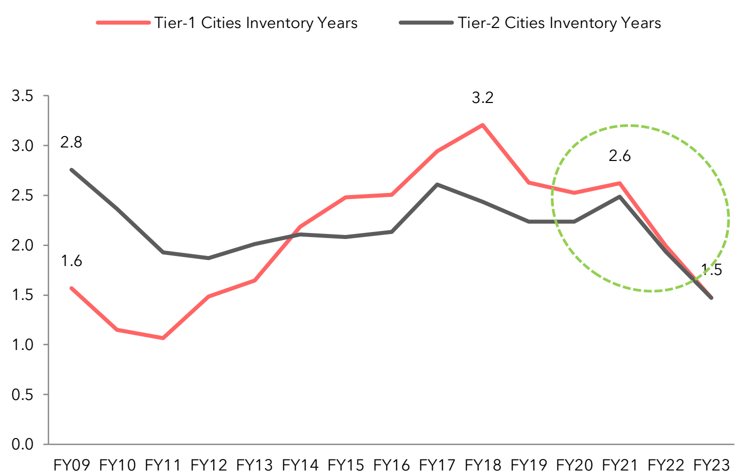
Source: CSO, Spark Research

Indonesia: % of household with a Refrigerator

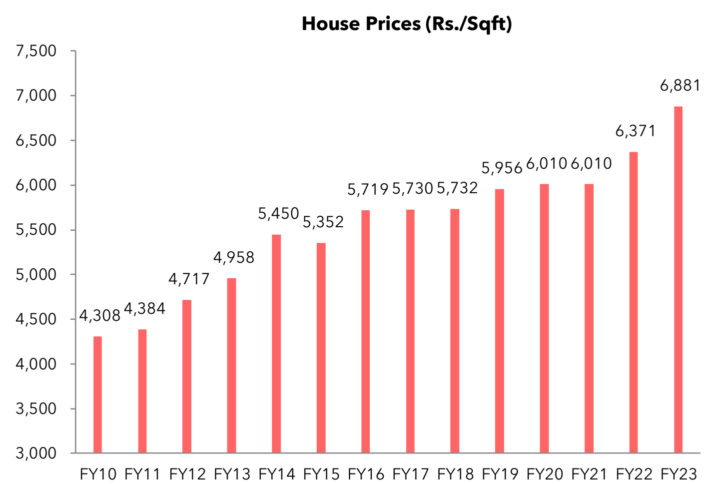


Source: World Bank, Spark Research

We use trends in India's housing sector as a proxy for the strength of India's consumption. Over the last year, India's unsold housing inventory has been declining sharply in both tier 1/tier 2 cities while property prices have increased after remaining stagnant for the last 8 years



Source: Spark Research

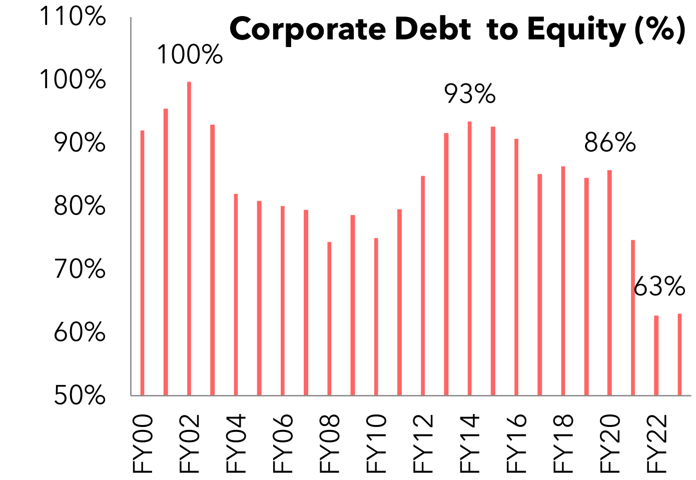


Source: Spark Research

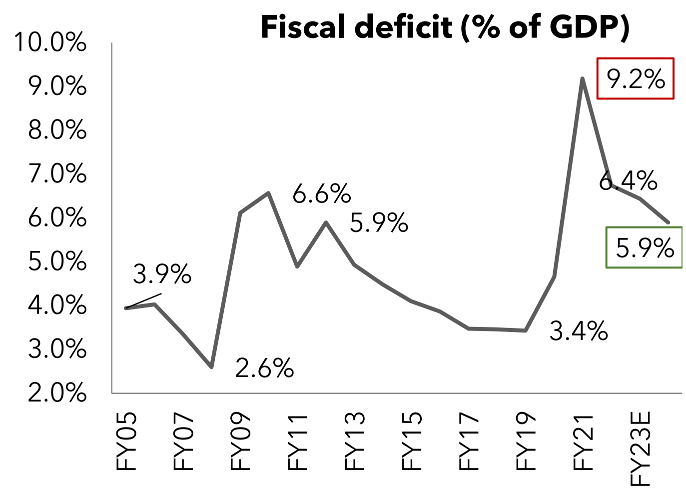
A new Investment cycle

India's Corporates, Government, Households & Banks balance sheets at a position of strength, kickstarting a new economic cycle.

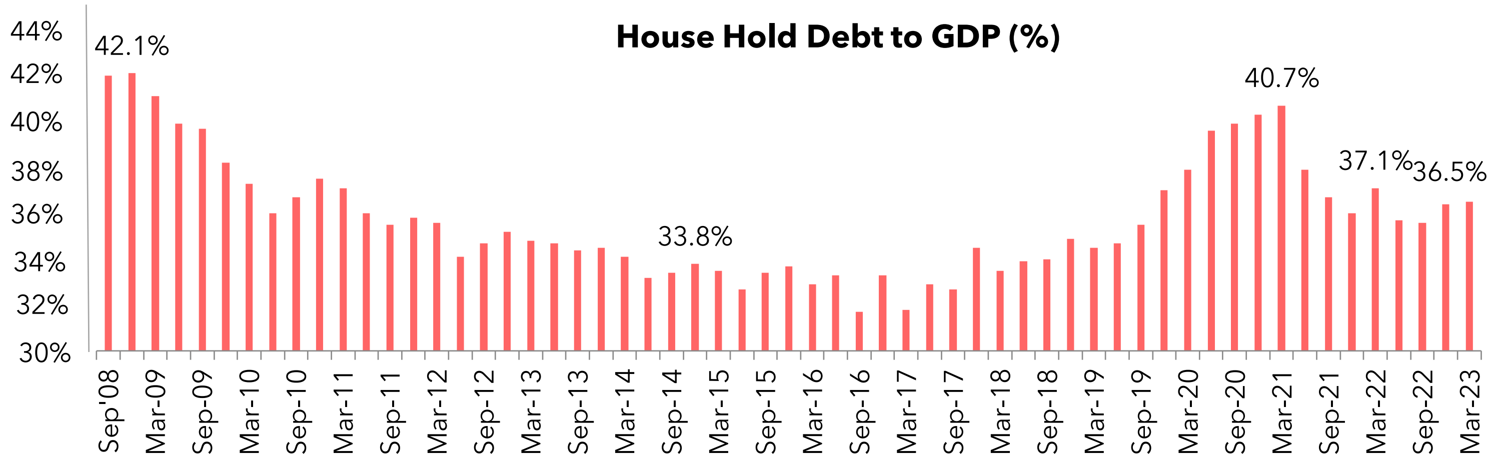
India's Balance Sheet is showing all the characteristics of kickstarting a new economic cycle as Corporates, Government, Households, and Banks balance sheet points to a comfortable position. While corporate debt to equity has fallen from 93% in FY14 to 63% in FY23, Fiscal Deficit as % of GDP ballooned during Covid-19 to 9.2% is expected to moderate to 5.9% in FY24BE. Household Debt to GDP has moderated to 36.4% in Dec'22 from 40.7% from a year ago. In the same breadth, post-COVID, India has witnessed a sharp rebound in credit demand led by strong consumption demand, government-guaranteed loans to MSMEs and higher working capital requirements by corporates, etc. This has led to decadal high loan growth of ~15%-16% in FY23. Credit growth during FY23 was broad-based, led by higher growth from the Retail, Services, and Agriculture segments. Early trends of FY24 are indicating continued demand momentum which shall aid in sustaining higher loan growth in FY24 as well.



Source: CMIE, Spark Research



Source: GOI, Spark Research



Source: Spark Research

Banking Reforms

Asset Quality Review by the Central Bank (2015)

The Insolvency and Bankruptcy Code (2016)

Recapitalization of government owned banks

	FY14	FY16	FY18	FY22	FY23
GNPA (Rs Tn)	2.3	5.6	9.7	7.0	5.4
GNPA %	3.8%	7.5%	11.2%	5.9%	3.9%
Total Banking System Advances (Rs Tn)	60	74	87	119	138
Net NPA%	*2.1%*	*4.4%*	*6.0%*	*1.7%*	*1.0%*
Capital Adequacy Ratio (CAR %)	*13%*	*13%*	*14%*	*17%*	*17%*

Historically, and as seen in the previous decades, these are levels from which the credit sector progresses into a new cycle.

	Phase 1	Phase 2	Phase 3	Phase 4	Phase 5	Phase 6
	Downcycle	**Cycle Bottom / Early Recovery**	**Midcycle**	**Late Cycle**	**Downcycle**	**Cycle Bottom / Early Recovery**
	1998-2002	**2003 - 2005**	**2006 - 2008**	**2009 - 2012**	**2013 - 2020**	**2021 - 2024**
	▪ Lower commodity prices ▪ NPA cycle was bottoming out; Banking system had excess liquidity ▪ Real Estate slowdown; Uncertain global market outlook	▪ Early signs of commodity price increase ▪ Electricity Act- Opening-up of power sector ▪ Higher Govt. Spend	▪ Strong private participation in power, steel and cement ▪ Commodity prices on strong up-move globally, triggering capex ▪ Pickup in residential real estate	▪ Excess capacity starts building up post '08-'09 crisis ▪ Leveraged private players especially in power and steel sector ▪ Demand drops due to global slowdown and domestic policy paralysis	▪ Lower commodity prices ▪ Adverse real estate cycle with massive excess inventories ▪ Excess supply across sectors ▪ Balance sheet repair with gradual consolidation in market share with a few players	▪ Balance sheet strengthens across large companies ▪ Large assets under NCLT resolved ▪ Falling corporate NPA cycle ▪ Residential Realty, Govt spend and favorable global demand ▪ PLI incentives system might pre-empt/fast track potential capacity addition
Govt Capex CAGR (%)	4%	23%	8%	11%	12%	**Start of an upcycle led by:** ▪ Deleverage trend across sectors ▪ Demand-led Inflation should drive utilization and capex ▪ Rising trend of Environmental clearances granted; More brownfield capex to follow
GFCF CAGR (%)	9.0%	12.5%	21.5%	14.4%	8.5%	
Metal prices CAGR (%)	0%	24%	21%	5%	-4%	
WPI Inflation (%)	4.6%	5.5%	5.5%	8.1%	1.6%	
Cost of Debt (%)	10.5%	6.7%	9.3%	9.2%	8.1%	
Leverage (D/E)	Deleverage in 2002	Releveraging	Releveraging	Releveraging	Deleverage in 2021	
Slippages (%)	6.7%	3.6%	1.8%	2.2%	6.0%	
Corporate Credit growth (%)	12%	23%	24%	22%	3%	
Liquidity/Excess SLR (%)	7.8%	16.3%	4.9%	4.7%	7.2%	
Capacity Utilization (%)	~80%	~85%	>90%	~75%	~70%	
Private sector in Public Infra	**Low**	**Low**	**High**	**Very High**	**Low**	
Residential Real Estate	Slowdown ⇩	Strong Growth ⇧	Moderate Growth ⇔	Strong Growth ⇧	Slowdown/Consolidation ⇩	
Global Outlook	Negative	Positive	Very Positive	Negative	Positive since Oct-20	

Note: *Government Capex is the Central & State Government spend CAGR during the specific periods, GFCF – Gross fixed capital formation; Metal price is USD price of Copper and Steel; WPI – Average inflation during that period; Cost of debt is 10 yr AAA corporate bond yield; Capacity Utilization is average utilization of steel, cement and aluminum capacity*

Source: RBI, Ministry of Commerce, Spark Research

In Summary

While India has much to do and execute, structurally, this is the finest India has been and this is showing up in India's resilient corporate earnings. After a strong 23% earnings CAGR over FY20-23, Nifty50 is expected to post 21.5% in earnings growth for FY 2024. This is in part a function of the early days of India's investment cycle, where a combination of strengthening services industry, green shoots in manufacturing, and productivity improvement are driving a recursive cycle of growth. Over time, this will culminate into better growth, and investment outcomes.

As the World's fastest-growing economy of scale, India is home to several high-growth companies. India's unique depth of formalization and consumption means many of the firms that are participating in this period of pivot, will command high growth valuations. The swift integration of digital tools, from payments to tax systems, is shifting India from a sprawling cash-based economy to an efficient modern one. This massive productivity shift is expected to be reflected in the value of India's top firms. This may lead to pockets of excess in valuations. However, we continue to be mindful of the same in constructing or advising any portfolio. It's worth emphasizing that the current economic climate is intricate and ever-changing. As the market responds to ongoing news, we remain vigilant, ensuring we don't overpay for potential and knowing when to exit once our investment goals are met.

An outline of our investment and advisory strategies has been presented in the following sections, with a performance summary for Q1 FY24. Please do not hesitate to contact your investment manager or relationship manager for a detailed review of the portfolio.

Revisiting our strategies

As we imagine portfolio(s) for the year ahead, we briefly revisit what our strategy today stands for and how we are thinking about it.

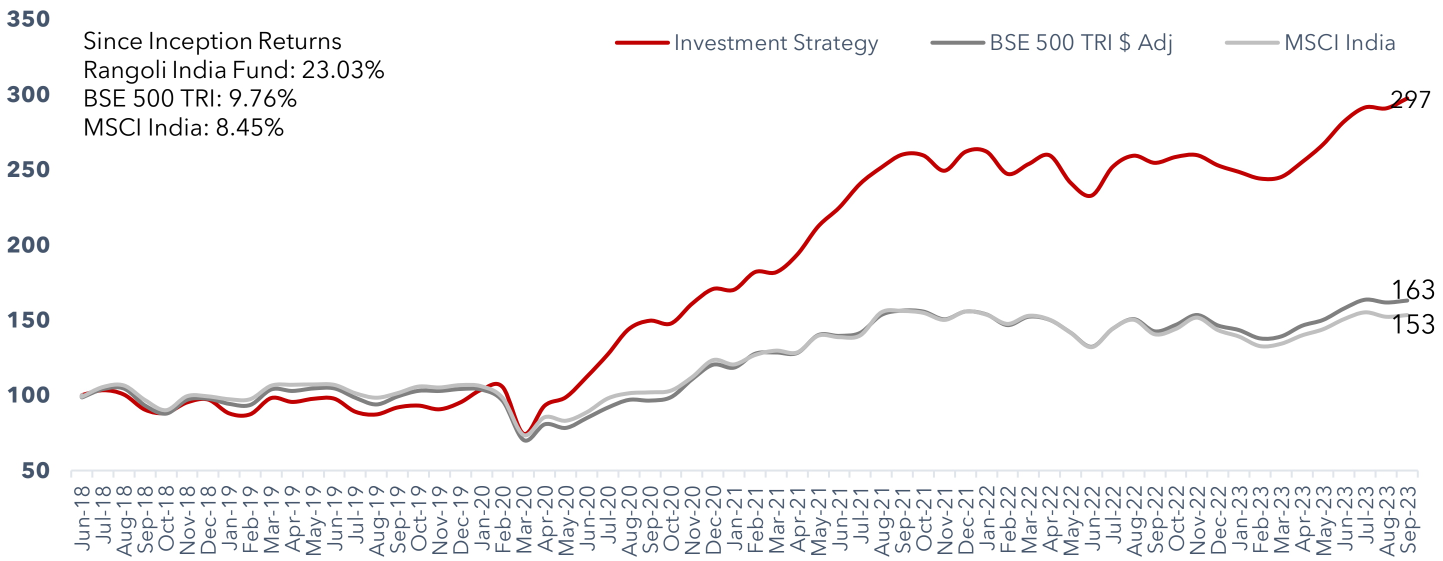
Market cap composition

	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Sep-23
Marketcap Categorisation						
Large Cap (%)	7.32%	12.14%	17.52%	28.40%	17.04%	40.05%
Mid Cap (%)	33.72%	19.67%	19.70%	30.84%	18.55%	33.16%
Small Cap (%)	50.81%	65.67%	61.71%	40.55%	35.86%	19.95%
Cash (%)	8.15%	2.52%	1.07%	0.20%	28.55%	6.84%

Sector composition

Sector Exposure	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Sep-23
Material	23.6%	5.0%	15.9%	28.9%	11.1%	5.7%
Financials	21.6%	28.5%	20.8%	28.7%	29.0%	28.1%
Consumer Discretionary	15.3%	28.0%	7.9%	7.2%	9.3%	11.3%
Energy	13.9%	-	-	-	-	-
Consumer Staples	9.6%	4.2%	11.8%	-	1.8%	-
Information Technology	5.5%	9.1%	14.5%	14.8%	7.4%	26.1%
Industrial	2.2%	-	9.1%	-	5.8%	4.0%
Healthcare	-	22.7%	19.0%	5.4%	5.9%	13.7%
Communication Services	-	-	-	14.7%	1.0%	-
Utilities	-	-	-	-	-	-
Real Estate	-	-	-	-	-	6.4%

Returns



Summary of results from the quarter Q3 - CY 2023

Company	Brief background and Investment rationale
Axis Bank	Axis Bank reported a PAT of Rs 5,797cr vs Rs 6,761cr (excluding goodwill write-offs from Citi Acquisition) and Rs 4,125cr in 1QFY23. Axis Bank reported 1.6% QoQ / 22.4% YoY growth in loan book (YoY growth includes Citi Acquisition). Margins declined by 12bps QoQ to 4.1% led by 28bps QoQ increase in cost of funds. The Management guided that the cost of deposits would continue to rise over the next three quarters but at a slower pace. Cost to Assets increased by ~16bps QoQ to 2.51% Excluding Citi's integration expenses, cost to assets would have been at 2.4%. Higher opex is largely due to Citi acquisition as Citi's business being entirely a retail business is at relatively higher cost. Management indicated that they continue to invest in the business as they are constructive on the environment. Asset quality continues to improve with moderation in GNPAs & NNPAs. The bank now has one of the lowest net NPAs across all major banks. The bank has been reporting normalized gross slippages of ~1.9-2% for the past 5 quarters. However, net slippages continue to be running below normalized levels led by higher recoveries. Credit cost came at merely 49bps vs 15bps in Q4FY23. Axis Bank carries unutilized provisions of ~60bps of loan book. Key risks would include a deterioration in asset quality leading to higher-than-expected credit costs and lower-than-expected loan growth.
State Bank of India	SBI reported PAT of Rs 16,884cr vs Rs 16,695cr in 1QFY24 and Rs 6,068cr in 1QFY23. Credit growth improved sequentially to 1.1% QoQ / 14.9% YoY. Margins declined by 27bps QoQ to 3.33% led by repricing of cost of deposits. Management endeavors to maintain margins at 3.4% + in FY24 vs 3.4% in FY23. Cost to average assets ratio declined by 34bp QoQ to 1.9% led by lower business momentum and absence of one-offs in employee expenses. Gross NPA improved by ~2bp QoQ to 2.76% while Net NPA increased ~4bps QoQ to 0.71%. Gross slippages increased to 1% vs 0.4% for 4QFY23 led by higher agri slippages which contributed ~30% of slippages. Higher gross slippage was led by agri loans which are seasonal in nature and accounted in 1Q and 3Q in a financial year. The bank has been reporting gross slippages of ~0.4-0.5% over the past 3 quarters. Management indicated that ~20% of 1QFY24 slippages has already been recovered till date. Net slippages stood at 0.5% vs -0.1% in 4QFY23. Credit cost declined to 30bps vs 40bps in 4QFY23. Given the strong credit cycle, we expect SBI to deliver 13-15% credit growth for FY24. Key risks would include lower-than-expected loan growth, deterioration of asset quality leading to higher-than-expected credit costs and higher treasury losses.
Narayana Hrudayalaya	Narayana reported revenue growth of 19% YoY to Rs. 1,233cr, driven by both India and Cayman operations. India business reported 14% YoY revenue growth largely led by ARPOB increase. The company's strategy is to drive revenue per patient rather than increasing the number of patients. The growth in ARPOB is predominantly a function of company doing higher end surgeries and has very low-price escalation impact. The Cayman business also had a strong revenue growth of 32% YoY with EBITDA Margin being stable at 40%+. Consolidated EBITDA Margin came in at 21.9% in this quarter vs 18.6% in Q1FY23. Strong revenue growth coupled with margin expansion resulted in PAT of Rs. 184cr in this quarter vs Rs. 111cr in Q1FY23 (growth of 66%). The company has recently commissioned its Oncology block in Cayman, and this is a margin accretive business which will lead to higher revenue and improved profitability for the Cayman operations. The company is also adding a 50-bed hospital in Cayman which would be

	operational by Q1FY25. The domestic business profitability would be improved on the backdrop of better case mix and payor mix. The company is incurring a capex of R.s 1,400cr in FY24 and this would give growth for the mid-term. Key risks include government policies in India and Cayman, margin contraction in the interim period of high capex.
Crompton Consumer	Crompton Greaves Consumer reported flat revenues at Rs.1,877cr, on account of the performance of ECD division, which grew at 6% YoY. This was offset by the weakness in the lighting segment, which de-grew 13% YoY. Consolidated gross margin was down 60bps YoY due to high energy efficiency norms related expenses and price corrections in pumps. EBITDA margins were down 190bps YoY as the company spent more on advertising to gain market share. As a result, EBITDA fell 15% YoY to Rs.186cr. Overall, PAT came at Rs.122cr vs Rs.126cr YoY [down 2%]. The potential recovery in the lighting segment and ramp-up of the appliance's portfolio post the acquisition of Butterfly, provide good visibility for earnings growth going forward. Crompton is amongst India's most profitable players in the consumer durables space with best-in-class margins, and capital efficiency. We continue to like the company given their execution and expect them to benefit from this phase of consolidation and growth in household spending on durables. Key risks to the investment could emanate from a drop in consumer sentiment, and steep inflation in raw material prices.
Infosys	Infosys reported 1%/4.2% QoQ/YoY CC revenue growth in Q1FY24 at US$4.6 Bn after degrowth in Q4 FY23. As per company this was lower than their internal growth expectations due to a higher-than-expected slowdown in discretionary IT spend, delay in closure, and ramp up of certain large/mega deals. The EBIT margin declined QoQ by 24bps to 20.8% due to higher variable pay and promotions (90bps impact) which was partly offset by higher utilization and cost efficiencies (70bps impact). The company reiterated FY24 EBIT margin guidance of 20-22% and is on margin expansion strategy. PAT came to Rs.5,945cr down 3% QoQ and up 11% YoY. Infosys has downgraded its FY24 revenue growth guidance to 1-3.5% YoY CC (from earlier 4-7%) which implies 0.2-1.8% CAGR over the rest of FY24. This seems reasonable and unlikely to disappoint. Infosys signed 16 large deals with TCV of US$2.3 Bn in Q1 and now revival of revenue growth depends much on ramp-up of large deals with increase in IT spending. With overall expectation of recovery in US macros and some uncertainties, Tier-1 IT is a better place to be in. Key risks: Slowdown in the USA and Europe and cuts in discretionary IT spending by enterprise clients.
Redington	Redington reported strong revenue growth at 26% YoY. Revenues for Q1 FY24 were Rs.21,187cr. The growth number is noteworthy, given the context of global slowdown reflecting market share gains and Redington's execution capabilities across geographies. Standalone business in India grew 28% YoY, while the global business grew 25% YoY. There has been a slowdown in consumer spending, while enterprise demand and government spending remain strong. Due to the product mix change, the gross margins were lower at 5.6% vs 5.8% in the previous quarter, primarily led by lower gross margins in the global businesses.

	Higher opex outgo towards developing the services capabilities and higher factoring costs hurt margins. This led to a lower EBITDA Margin at 2% vs 2.5% sequentially. Working capital intensity increased to 40 days vs 28 days YoY and 32 days QoQ. Overall, PAT declined by 22% to 255cr. Additionally, the MD - Rajiv Srivastava stepped down. We expect Redington to moderate expenses towards the service capability building which should result in sequential improvements in EBITDA margins. From a capital allocation standpoint, the company's return ratio is healthy, and the company continues to pay out 40% of PAT as dividends which results in a dividend yield of c.4%. We like Redington given that they are amongst the top 2 ICT distributors across the markets it operates in. The company's dominant positioning and financial muscle give it a significant competitive advantage in a business that has high barriers to entry. Redington has created a strong services business - both in the 3rd party logistics business and the high-margin cloud business. Redington's broad portfolio and relationships with vendors across segments allows for balanced growth and reduces vendor concentration. Redington has demonstrated robust risk management practices over the years that help better manage credit, inventory, and currency risks. A significant shift in consumer and enterprise behavior has led to higher need for higher computing > leading to shorter product life cycles > and acceptance of premiumization. This tailwind benefits Redington. Key risks would continue to be a higher interest rate regime environment, delayed recovery in margins and slowdown/delays in the high margin enterprise business.
Sonata Software	Sonata's IT Services revenue came in at US$77.3Mn, up 17.5%/36% QoQ/YoY (with full quarter Quant revenue) and 4%/15.8% organically. The segment's EBITDA margins (excl. OI & FX) at 21.1%, were up 40 bps QoQ, supported by revenue benefit (+140bps) and a one-time benefit (+260bps) but was partially offset by a wage hike (-60bps), large deal transition (-150bps) and investment in Microsoft Fabric & GEN AI (-160bps). Their India domestic business grew 0.6%/3.6% QoQ/YoY. Domestic business EBITDA came at Rs 56.4cr up 4%/28% QoQ/YoY. Quant acquisition done recently is doing well with strong foothold in BFSI and Healthcare verticals which is now fully integrated. It grew 7.2% QoQ with 32% EBITDA margin in Q1 FY24. Consol PAT came at Rs 120cr up 5.5%/11.4% QoQ/YoY. Sonata crossed US$300 Mn ARR in International business. The endeavor is to reach US$500 Mn by FY 2027. In Q4 FY23 Sonata won a large deal of US$160 Mn value and won 2 additional large deals in Q1'24 with large deal pipeline at 40% of total deal wins. These 3 large deal wins will convert to revenue in a couple of quarters with full ramp up in CY2023. Domestic business reported industry leading RoCE. Overall company aspires to reach revenue of US$1.5 Bn by end of FY 2026 at an EBITDA of early 20's. Key risks: Slowdown in the USA and Europe and cuts in discretionary IT spending by enterprise clients.
ICICI Securities	ICICI Securities' revenue at Rs. 934cr in 1QFY24, higher 18% YoY and 6% QoQ. Cash ADTO volumes were higher by c.20% sequentially and ISec gained retail cash market share to 12.2% vs 11% in the previous quarter. Derivative market and broking allied offerings such as margin trading, prime and other fees remained steady sequentially. To ensure the lending book AUM remains stable, Isec deliberately did not pass on the complete interest rate hike to customers

	and chose to absorb the impact. This is impacting profitability. The total retail and allied income was Rs.515cr, higher by 5% over the previous quarter. Distribution revenue at Rs.159cr for the quarter was up 4% YoY on the back of healthy growth across Mutual Funds and Life Insurance. Isec continues to focus on building the distribution revenues to reduce cyclicality. Corporate finance revenues is dependent upon primary issuances and stood at Rs.40cr for the quarter. This segment is cyclical. Overall, higher interest expenses led to a PAT of 271cr. ISec continues to make investments in technology and branding and expects to gain market share in the derivative segment that has benefited the discount brokers. Profitability for the quarter was slightly impacted as the increase in interest cost has not yet been fully transmitted to customers. The transmission of rate hike to customers is expected to take place in the subsequent quarters. We like the business resilience given the improving share of non-brokerage revenues in sales, technology leadership, continuing consolidation of the user base, high RoE of c.40% and dividend yield of c.4%. Key risks would arise from a downcycle in equity markets leading to lower volume turnover and lower deal flow for corporate finance.
DCM Shriram	DCM Shriram reported a degrowth of 2.5% in revenues at Rs. 2,780cr. EBITDA and PAT recorded a YoY degrowth of 62% and 78% at 166cr and 57cr, respectively. The revenue and profitability decline in the current quarter were primarily driven by the Chloro-alkali segment. The fall in construction activities and recession worries globally continue to impact the PVC demand. The same has been reflected in global PVC price which has witnessed a decline of ~40% on a YoY basis. Also, a significant capacity addition for Caustic soda in the domestic market coupled with low global demand has impacted ECU caustic realizations, which have declined 33% on a YoY basis. Hence, the current unfavorable demand-supply dynamics and elevated energy costs have led to a decline in profitability for the Chloro-alkali segment. The sugar segment registered a 33% expansion in domestic volumes with the rebase of opening inventory and allotment of higher quota driven by new capacity expansion. The distillery business delivered volumes of 3.6cr litres vs 3.5cr litres YoY. As a result, the operating profitability in the sugar segment was strong with ~20bps yield improvement in the current sugar season and record high sugar export prices. The rest of the next season will continue to be better for the sugar segment in terms of volumes and profitability with global sugar prices at record levels, domestic prices inching up, and as the company commercializes new ethanol capacity. Agri-business had performed steadily across verticals. Fenesta's exceptional business performance has continued while the Cement was a drag due to input cost inflation. The company is placed for a sustained growth trajectory with an improved balance sheet and cumulative capex of Rs. 3000cr to be commercialized in the next 6 months. However, the near-term outlook for commodity prices is not yet out of the woods. Key risks: Unexpected regulatory developments in Sugar/Ethanol business and a decline in the strong Caustic Soda cycle in the international market.
HAL	HAL reported revenue growth of 8% YoY to Rs. 3,915cr. The reported EBITDA is up 6% YoY to Rs. 877cr. There's one-off increase in pension contributions of Rs. 193cr pertaining to the retrospective impact of the period between Jan17 to Mar23. Adjusted for one-offs, the EBITDA increased by ~29% YoY to Rs. 1,070cr. Q1 24 Gross margins was at 74% vs 72% YoY due to the change in mix towards ROH. Reported PBT was up 34% while the reported PAT was up 33% YoY to Rs. 810cr due to higher other income YoY because of increased net cash balances. Over the last few quarters, the company's Repair & Overhaul [ROH] business has grown at 20%+ while the manufacturing business execution has been weak. In FY23, ROH business grew by 28% from Rs. 17,077cr to Rs. 21,894cr while manufacturing business declined from Rs. 7,375cr to 4,740cr.

	HAL's primary role today is as an assembler of aircraft to develop a domestic eco-system of defense Aircraft manufacturing vs just import reliance. HAL does this via the transfer of technology (ToT) agreements. Over years of handling various ToT, and with the support of India's own Aeronautical Development Agency, HAL has built good domestic manufacturing capability now. The government's stance to indigenize the manufacturing of defense equipment will lead to HAL's manufacturing business growing at a healthy rate post-FY24. The company has an order book of ~Rs.80,000cr as of June-23 with an inquiry pipeline of ~Rs. 90,000cr worth of orders in the next 18 months. In addition, there has been indication of building an export business as well which has negligible contribution as of now. Key risks to investment could be any policy changes relating to the Defense sector and delay in execution of key platforms.
ICICI Bank Limited	ICICI reported PAT of Rs 9,648crs vs Rs 9,112crs in 1QFY24 and Rs 6,905crs in 1QFY23. ICICI Bank continued to gain loan market share in 1QFY24 as well. The bank reported a loan growth of 3.7% QoQ / 18.1% YoY. During FY23, ICICI's retail book grew by ~21%, higher than any other large private bank. During 1QFY24, margins declined by ~12bps QoQ to 4.8% led by higher cost of deposits. Management indicated that it expects cost of deposits to continue to increase over the next couple of quarters. Cost to assets stood at 2.4% vs 2.3% in 4QFY23 and 2.1% in 1QFY23. Cost ratios has been rising over the past 4-5quarters as the bank is making investment towards technology, people, distribution and building our brand. Management stated that there is good market opportunity and the bank will continue to invest for the future. The bank continued to witness moderation in GNPA & NNPA led by higher recoveries. Gross Slippages increased to 2.1% vs 1.8% in 4QFY23 led by agri slippages. Excluding agri delinquencies, slippages were stable at 1.8% QoQ. ~95% of gross slippages were from Retail & Business banking segment. This is largely similar to trend over the past 4-5 quarters. Net slippages increased to 0.7% vs Nil in 4QFY23. Management indicated that the pace of write backs and recoveries has declined compared to last few quarters. The bank reported credit cost of 50bps similar to credit cost over the past 4-5quarters. However, a large proportion of credit over the past few quarters was led by contingent provisioning. ICICI Bank carries unutilised provisions of ~125bps of loan book which is significantly higher than the expected credit cost for FY24. Key risks would include lower-than-expected loan growth, deterioration of asset quality leading to higher-than-expected credit costs, and higher treasury losses.
Kewal Kiran Clothing Limited	Kewal Kiran delivered revenue growth of 15% YoY to Rs.178cr, aided by strong sales of the bottomwear and accessories categories. The company added 5 new stores in the quarter and is on track to double its store count to 700 stores in the next three years, by adding 80-100 stores per annum. EBITDA margins were stable at 19% YoY. As a result, EBIDTA was up by 16% YoY to Rs.34cr. Overall, PAT was up by 56% YoY to Rs.34cr. We like the business as it stands out in the retail spectrum, with control over manufacturing and branding, enabling them to keep most of the margins at their end. In the last decade, they have followed financial prudence and capital allocation discipline and returned 75% of earnings to shareholders. We believe that the rise in household incomes will keep up the demand for discretionary clothing allowing the branded players to grow higher and gain market share. Key Risks: Competitive Intensity from MNC brands and private labels of large format stores.

Oberoi Realty Limited	Oberoi reported area sales of Rs. 476cr in this quarter i.e. a decline of 37% YoY. The muted sales in this quarter is because of company didn't have any new launches and also there has not been any sales from 360 West. However, the balance of FY24 would see heavy launches with both the Thane projects set to be finally launched. Company has large land parcel in Thane (potential to develop more than 15 Mn sqft) and the projects would be launched in phases from October festive season. The company would also be launching new towers in Goregaon and Borivali in Q3/Q4 of this year. Given the launch momentum and strong industry demand, we expect the company to register higher sales in this year. The success of Thane would provide the company with multi-year growth opportunity as it has huge land parcels. The P&L for real estate company is a lag effect as revenue has to be recognised only after handing over the property to customer. Accordingly, the company reported revenue of Rs. 910cr and PAT of Rs. 322cr for Q1FY24. Key risks: Delayed projects launches, slowdown in the demand.
Polycab India	Polycab delivered revenue growth of 42% YoY to Rs.3,889cr, aided by strong volume growth in cables & wires segment, which grew at 47% YoY. The company was able to drive 50% volume growth on account of distribution expansion and market share gains from unorganised players. The FMEG segment revenue was up only 2% YoY at Rs.315cr, on account of lower offtake in the fans category. Polycab was able to improve EBITDA margin YoY to 14.1%, thanks to better product mix, operating leverage and optimum inventory hedging mechanism. As a result, EBITDA was up by 76% YoY to Rs.549cr. Overall, PAT grew at 81% YoY to Rs.403cr. Polycab is the market leader in Cables & Wires with 24% market share of the organised market. In the last 5 years, the company has built a consumer durable portfolio of reasonable scale to leverage the existing distribution network. We remain positive about the medium-term earnings due to strong traction in B2B cables business, pickup in real estate demand and expanding product categories in the FMEG segment. The company has showcased good pricing discipline in a tough raw material market, enabling them to maintain normalised margins going forward. Key risks include further escalation in metal prices, slowdown of demand.

Market cap composition

As on Sep 28th, 2023	FY 24E
Wt. Avg PE	21.2x
Wt. Avg Earnings Growth	12.1%
Wt. Avg ROE	22%
Wt. Avg Mcap	$ 17,929 mn

Market cap composition

Rangoli India Fund	Market Cap (USD Mn)	PBT (USD Mn)		YoY	PAT (USD Mn)		P / E	RoE (%)
	As on 28th Sep	Q1 FY23	Q1 FY24		FY 23	FY 24E	FY 24E	FY 24E
Atul Limited	2,490	28	17	-41%	64	59	42.3	10%
Axis Bank	38,202	700	935	34%	2,738	2,849	13.4	18%
Coromandel International	3,978	85	79	-6%	250	239	16.7	24%
CG Consumer	2,353	22	19	-15%	59	61	38.3	19%
Cyient Limited	2,253	20	26	30%	68	90	24.9	23%
Dr.Reddys Laboratories	10,893	186	222	20%	559	631	17.3	22%
Eicher Motors	11,325	100	146	45%	322	382	29.6	23%
GMM PFAUDLER	1,009	11	10	-2%	27	29	35.0	26%
HIL Limited	259	13	9	-34%	18	21	12.5	15%
Hindustan Aeronautics Limited	15,193	102	131	28%	553	647	23.5	23%
ICICI Securities	2,412	46	44	-6%	138	166	14.6	333%
Infosys Limited	71,841	954	1,006	5%	2,992	2,951	24.3	32%
Kewal Kiran Clothing	523	3	5	50%	15	17	30.8	24%
KFin Technologies	960	6	7	12%	24	28	34.8	24%
Narayana Hrudayalaya	2,650	17	25	43%	73	86	31.0	29%
Oberoi Realty	4,940	65	51	-22%	236	236	21.0	15%
Power Finance Corporation	7,775	698	890	27%	1,440	1,553	5.0	18%
Redington	1,431	52	42	-19%	173	155	9.3	17%
Sonata Software Limited	1,834	18	19	2%	56	66	27.9	38%
State Bank of India	63,313	1,300	3,031	133%	6,233	6,596	9.6	18%

The positions discussed here constitute the key investments under the strategy. Please do not hesitate to contact your relationship manager or advisor to discuss any of these stocks in further detail and our rationale behind the same.

RISK MANAGEMENT

While the environment is buoyant for India in the longer term, in the shorter to medium term, the aftereffects of unforeseen economic linkages from a recessionary West may be a risk. While India remains a largely domestic consumption-oriented economy, a rapid worsening of the economies in the West may affect their balance of trade with the World [including India] in the immediate to medium term. India's Current Account Deficit and foreign exchange reserves may be under pressure if energy prices remain elevated and rise. The recent softening of energy and commodity prices will assist India's macroeconomic case, but there remains the prospect of second or third-order impact from global macroeconomic and geo-political shocks.

Risk	Level	Mitigants
Concentration Risk	Fund	At the portfolio level, such risks are minimized by limiting the aggregate exposure of the portfolio to such investments to less than 10% of the value at the time of investment.
Foreign Exchange Risk	Fund	Fund has invested in only Indian Listed companies and hence the fund's investments do not face any foreign exchange risk at the Fund level.
Leverage Risk	Investee Company/Fund	Fund has not taken any leverage at the Fund level. Except for financial companies, most of the investee companies in the strategies carry nil to moderate debt on their balance sheets with a track record of having managed leverage well in the past. Their leverage is monitored regularly.
Realization Risk	Investee Company/Fund	High Impact cost, due to thin trading at the time of buying or selling is endemic to small & mid-caps. We plan our investment decisions, the size of the investment and trading strategies to minimize the realization risk.
Strategy Risk	Investee Company	Investments are evaluated from a bottom-up and top-down perspective. The fund investments align with the segments of the economy that are emerging and companies that have characteristics which make them the dominant participants in their industry. The investments are assessed through a detailed financial model that captures historical performance and forward estimates based on publicly disclosed documents. The investment team rigorously undertakes quarterly diligence for any change in the investment thesis.
Reputation Risk	Investee Company	Company selection starts with rigorous fundamental analysis and a historical performance review supported by a detailed financial model constructed internally. We have an internally designed governance framework vetted over many years. This governance framework helps us in evaluating companies that meet our internal guidelines. We evaluate the investee companies both at an absolute and relative level. Periodic maintenance diligence of management/ financials has been done for Investee companies.

Extra Financial Risk	Investee Company/Fund	We avoid investing in companies with a known history of corporate governance issues. If such an issue arises in an existing investment, we stop additional purchases and start optimally exiting the investment. Our governance framework helps us in identifying any lapses in corporate governance. We actively monitor all publicly disclosed documents regarding ESG [Environmental, social, and corporate governance]. Any reported misconduct is evaluated by the investment committee for further action.
Geopolitical risks	Investee Company	Geopolitical tensions globally can disrupt the supply chain in the region. This might have a non-linear impact on business.
Raw material inflation	Investee Company	India continues to be dependent on the supply of feedstock whose pricing is global in nature. Key categories would be crude, metals, minerals, and natural commodities. Sharp movement in their underlying prices will have a short-term financial impact on the companies. The situation in China [political] has the potential to disrupt the supply chain of a few of our investee companies.
Key Man Risk	Investee Company	Small and mid-caps are frequently managed by a key promoter/person on whom the business is completely reliant and without whom the business would be materially inferior. We generally avoid such names and in cases where we make any exceptions, the aggregate exposure of the portfolio to such investments is limited to less than 10% by value.