Strategy Communique

Q4

CY 2023

UNIFI INVESTMENT MANAGEMENT

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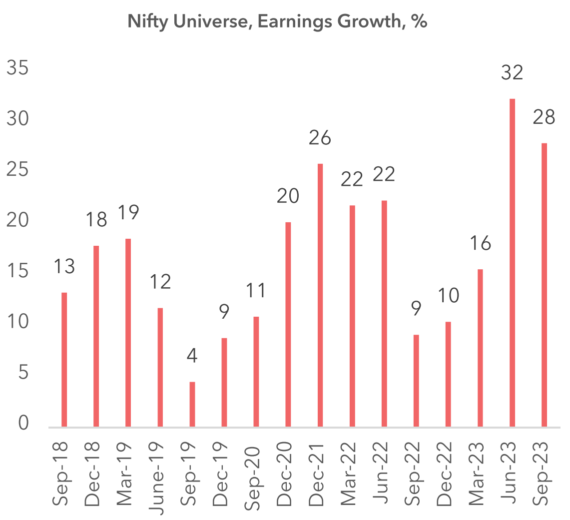
Distilling from the Noise

The modern economic environment is characterized by an abundance of data. While more information is available, the ability to distill meaningful insights is increasingly challenging. Concentrating on a few variables more reflective of India's economic reality helps construct a more coherent view of the country from an investment point of view.

Breakout in Earnings

Amidst the noise of a slowdown and general recessionary conditions, India's aggregate earnings, as indicated by the benchmark Nifty 50, have grown faster than expected. The September quarter of FY 2024 saw India Inc.'s earnings increase by 28% YoY. This is the fastest pace of growth recorded over a 5-year period and stands out all the more because of the absolute quantum of growth. For the first half of FY 2024, Nifty-50 grew earnings by 30% YoY, while excluding the oil marketing companies, grew 20% YoY.

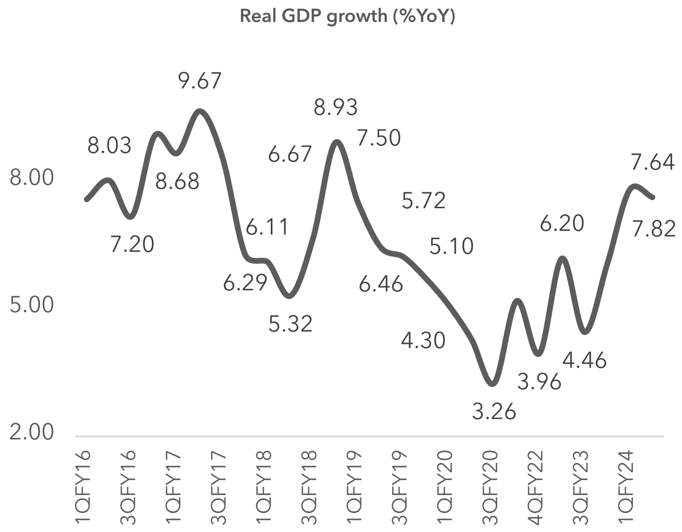


Adjusted for the Covid disrupted periods

What is driving earnings growth? India's earnings resilience is broad-based, underpinned by a combination of robust domestic demand, rising public infrastructure investment, and a strengthening financial sector, which was reflected in India's GDP growth for Q2 FY2024, providing the macro backdrop for driving earnings growth. We delve into a few of them.

India, GDP, driver of Earnings

India's real GDP grew 7.6% YoY in Q2 of FY24 (vs. 6.2% of Q2 FY23), significantly ahead of expectations of around 6.8%. While the absolute direction of growth is strong, the structure of growth is all the more encouraging. While the following is data-dense, it will lead to a finer appreciation of India's economic landscape and the sustainability of the same. GDP growth was significantly driven by investments (9.9% in Q2 FY24, highest in five quarters vs. 6.5% in Q2 FY23) and fiscal spending (+12.4% in Q2 FY24 vs. -4.1% in Q2 FY23). India's investment rate rose to 32.9% of GDP vs 32.1% YoY, while corporate investments grew 3.3% YoY last quarter after declining for two quarters. Further, with better real growth, nominal GDP growth came in at 9.1% vs. 8% sequentially, while India's industrial sector, which has consistently lagged growth, rose significantly at 13.2% YoY (vs. -0.5% in Q2 Y23 and +5.5% in 1QFY24). Acceleration in industrial sector growth was broad-based, led by lower input costs and better corporate performance. Overall, India's GDP growth is robust, led by domestic variables, and this structure will likely stay similar for the foreseeable periods.



Adjusted for the Covid disrupted periods

India's GDP growth is all the more positive in the context of several headwinds: fiscal consolidation at a central level, discipline with financial leverage, and prevalent high interest rates. In the pre-Covid decade, India's trend growth rate declined from 8% in 2007-12 to 6-6.5%. This was an outcome of slow capital formation (real estate and corporate capex). With the change in the pace of capital formation today, the trend towards a 7% plus scenario looks more realistic and ably supported by other structural drivers across labour growth, infrastructure, services exports, and formalization of the economy.

The structure behind the numbers

In our previous notes, we touched upon a few macros that are driving India's economic progress. We evaluate a few additional factors here. 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.

Inflation | Favorable trends make capital formation easier

Systemically weak inflation is never a desirable situation. A certain level of inflation is an indication of the strength of demand salience and rising incomes. The most desirable level of inflation, i.e., change in price over a period is always positive but at a sustainable level, and what is sustainable is a function of GDP and income growth in an economy. The RBI has a medium-term target inflation of 4%, ranging from 2-6%. Over the past few months, just as India's real GDP growth has been better than expected, the headline consumer price inflation [CPI] has also been lower than forecasts. In nine of the past 12 months, the headline inflation has been in the RBI's desired range of 2-6%, with an average of 5.2% during the past three months (SepNov'23). More importantly, core inflation (excluding volatile items such as food and fuel) was at a 44-month low of 4.1% YoY in Nov '23, with inflation expectations three months ahead at the lowest since the pandemic began. Overall, India's inflation dynamics are favorable, giving policymakers [RBI, Budget for FY-25] the flexibility to focus on growth without the burden of excessive oversight on interest rates and constrained fiscal flexibility.

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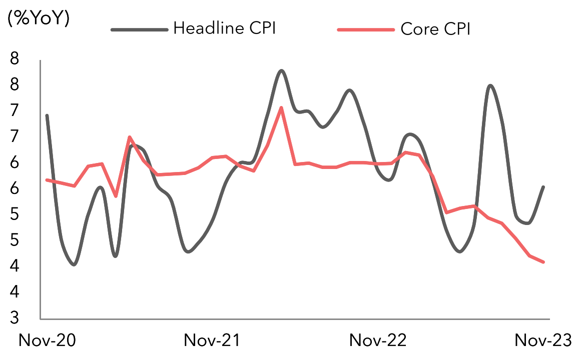
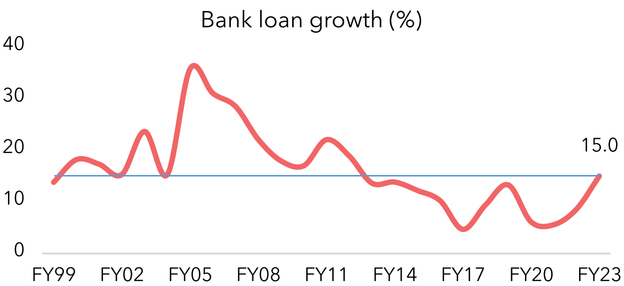


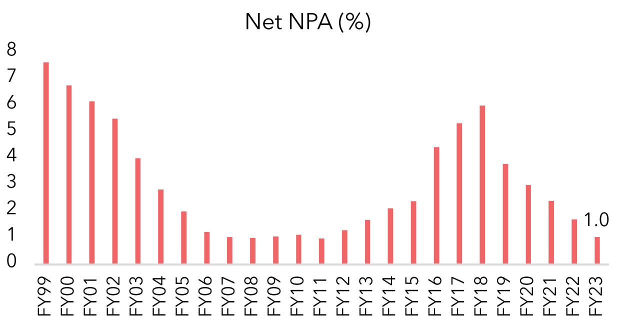
As we advance, the RBI expects headline inflation to ease towards its medium-term target of 4% by 2QFY25, which, if achieved, will be the first 4% quarterly headline inflation in five years. This will allow the RBI to manage rates better and support India's growth ambitions of close to 7.0%, plus sustainable GDP growth.

India's Banking Sector

At its cyclical best

A critical prerequisite for the revival and sustainability of an investment cycle in the economy is a comfortably positioned banking/financial sector. India's financial sector has not only seen an improvement in its financial position over the past decade but has possibly been in the best health since 1991. The structural ability to support India's vast need for building infrastructure, expand manufacturing capacities, support retail consumption, and support sustainable GDP growth of 7% plus cannot be overstated. For most of the pre-COVID decade, the financial health of India's banking sector was mediocre, with poor underwriting, rising non-performing assets, and an inability to meet the capital requirements of the industry. During the past three years, NPAs have fallen continuously to the lowest in almost three decades, underwriting standards have improved, and loan growth has picked up strongly. What has continued from the pre-COVID period is that the lenders have been growing their non-corporate loans much faster. The industrial sector accounts for only about a quarter of bank loan books now, compared to its share of 40% a decade ago and its peak of 49% in FY99.



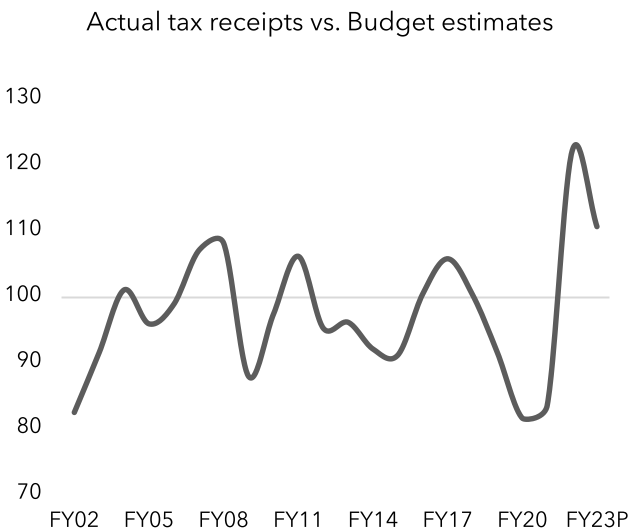


A weak financial sector constrained any economy's ability to grow and was partly responsible for slowing India down. With the change in health, the sector's ability to support the revival in the investment cycle is vital. Thus we continue to advise investments in the financial sector.

Fiscal deficit consolidation

Creates space for the private sector's growth

While a fiscal deficit enables the Government to increase spending on public services, infrastructure, and other vital areas that will stimulate economic growth, a consistently high deficit will lead to an increase in debt burden, currency devaluation, higher inflation, and structurally weaken the economy. India has always had a fiscal deficit since independence; however, it rose to the highest in almost four decades due to COVID. Since then, the Government has been consolidated the deficit well. From 7-8% of GDP, India's combined fiscal deficit widened to more than 13% of GDP in FY21, which has come down to 9.1% of GDP in FY23 and is budgeted to fall further to 6% of GDP in FY24, and trend lower from there on.



One of the critical reasons India has achieved this challenging combination of lower deficit and better growth is better-than-expected tax receipts for the Government. In FY22 and FY23, gross tax receipts were 10-20% higher than the budgeted amount – totaling INR5t and INR3t, respectively, indicating buoyancy of economic health. As a result, the Government has met its deficit targets without compromising on its intended spending, especially social welfare, which is critical for India. In the current year (FY24), total receipts will likely exceed the targets by more than a trillion rupees. In the coming years, either the deficit will trend lower significantly, or the Government will consider growing its spending faster than expected, and both outcomes will benefit the economy. In a nutshell, this is a critical enabler of India's domestic investment and enterprise consumption, bearing positively on earnings growth for the times to come.

Summary and Portfolio Construction

After years of groundwork, several macroeconomic trends are converging from across the spectrum. While rising incomes reflect a good quality of household consumption, the supply side is investing in a mix of import substitution, China+1 supply chain, and a supportive government policy lending to investments in broad-ranging infrastructure. Encouragingly, these translate into the most relevant lead indicators, such as GDP growth and healthy earnings growth for firms able to be a part of this. Over time, this will culminate in better growth and investment outcomes.

Over the past quarters, our advice was to increase the allocation to the firms with larger market capitalizations. This is not a reflection of an expansion in our set of beliefs, but a continuation of alignment to practicing growth investing at a reasonable price [GARP]. Despite market conditions, our approach to participation in India's heterogeneous opportunities is to buy growth firms at a reasonable price, adjusted for capital efficiency and the runway of consolidation in industry leadership that is on offer. Today, the opportunities that reflect our growth philosophy are found in firms with larger capitalizations. It is an outcome of the same principle we have practised across cycles.

From a portfolio perspective, we remain constructive on India's financial sector. As explained in the earlier sections, India is in a new cycle of economic expansion, coinciding with the end of a higher provisioning cycle, which continues to result in higher credit growth for the banks. As a result, banks are a significant constituent in portfolios advised by us. Banks have posted a good quarter in Q2-24 with improvement across Net Interest Margins, asset quality, and healthy credit growth.

After a few years of consolidation, we believe technology spending will rebound amidst improved macroeconomic conditions in the U.S. No surprise that we have advised to increase the exposure to I.T. significantly over the past few months. We continue to align with the sector, but unlike the previous cycle, our exposure now also consists of larger firms that are in a position to participate in the broader spectrum of technology spending. We continue to prospect for opportunities within I.T. and believe that firms that cut back on technology spending will risk long-term competitiveness.

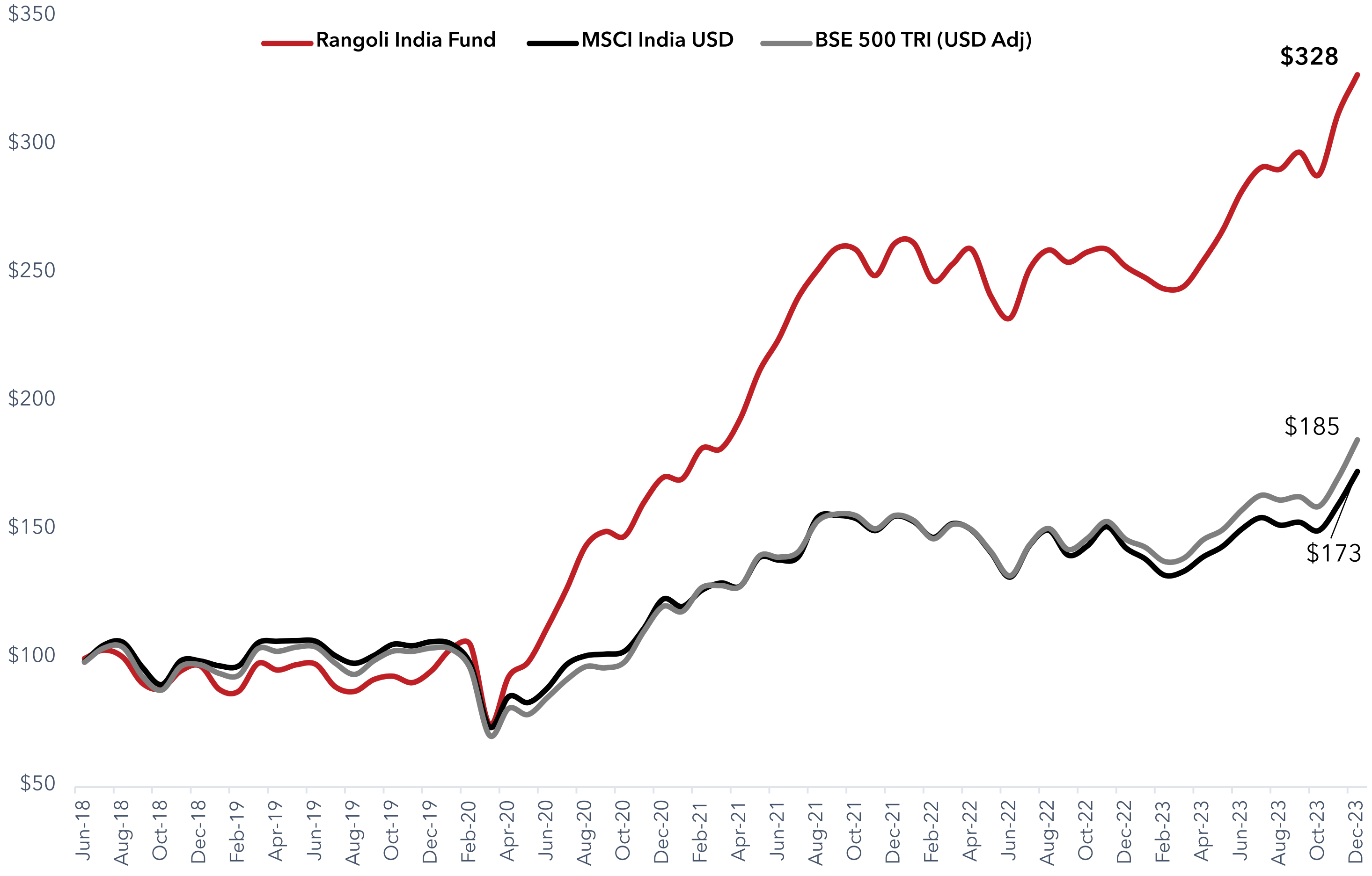
Within healthcare, we continue to like a network chain hospital that focuses on the midmarket and is a cost leader in healthcare, focusing on shifting to higher-margin specialities and improving their case mix. We have also advised allocation to one of India's leading generic manufacturers catering to developed economies. After years of pricing-led disruptions, the industry is entering a price consolidation phase with a better outlook on volumes and margins.

Consumption trends in the real estate industry indicate the health of the sentiment in Indian households. Housing inventory in the country suggests healthy demand traction, benefiting developers and the entire value chain of building products. As interest rates peak and the Government continues to focus on building infrastructure, the industry will continue to benefit from the trends. India is historically resilient to a certain pace of inflation and interest rates; thus, the headline movement in each variable has had little or no impact on real estate consumption. In 2022, India's top seven cities delivered the highest sale of units in over a decade [c.215,000]. The supply side is supportive of this buoyancy, with new launches reflecting a decadal high. This has a significant flywheel effect on several players in the building value chain, from cables & wires, electrical durables, sanitary ware, and other building materials.

Other businesses we like and advise are from across industries drawn from the bottom up and experiencing fundamental strength in their performance. Where necessary, we have right-sized our positions based on the changes in their risk and reward over the past few quarters. We have taken the gains where our thesis has played out and reallocated them to positions where we believe the risk/reward is more favourable. It's worth emphasizing that the current economic climate is intricate and everchanging. As the market responds to ongoing news, we remain vigilant, ensuring we are conscious of our investment goals amid the general sense of euphoria.

An outline of companies advised by us has been presented in the following sections, with a performance summary for Q4 CY 23.

Returns



Returns as of 31st December 2023

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Summary of results from the quarter Q2 – FY 2024

Company	Brief background and Investment rationale
State Bank of India	SBI reported PAT of Rs 14,330cr vs Rs 16,884cr in Q2FY24 and Rs 13,265cr in Q2FY23. SBI reported 3.4% QoQ / 13.3% YoY growth in loan book. Management reiterated its guidance of ~12-14% loan growth led by sustained higher growth in Retail & MSME and double-digit growth in corporate book. Management mentioned that it can grow above 14% in FY24. Margins declined by 1bps QoQ to 3.32%. Majority of term-deposit (TDs) have been repriced and the rest of TDs will be repriced in Q3FY24. Management guided that margins shall moderate by ~3-5bps over the next couple of quarters. Cost to avg assets ratio increased by ~32bps Q-o-Q to 2.2% led by one-offs in in employee expenses. Employee expenses include one-time expense of Rs3,417cr on account of revision of wages for IBA employees. SBI is accounting for 14% wage revision vs 10% earlier. Gross NPA improved by ~21bp QoQ to 2.55% while Net NPA improved by ~7bps QoQ to 0.64%. Gross slippages improved to 0.5% vs 1% in Q1FY24. Slippages are seasonally higher in 1Q due to higher agri slippages. Agri slippages contributed 30% of total slippages in 1Q. Net slippages stood at Nil vs 0.5% in Q1FY24. The bank has been reporting gross slippages of ~0.4-0.5% over the past 4 quarters. Credit cost was Nil vs 30bps in Q1FY24. Key risks would include lower-than-expected loan growth, deterioration of asset quality leading to higher-than-expected credit costs and higher treasury losses.
Infosys	Infosys reported 2.3%/2.5% QoQ/YoY CC revenue growth in Q2 at $ 4.7 bn which was broadly within expectation of 1-2% after a moderate Q1'24. As per company this was in line with their internal growth expectations due to higher-than-expected slowdown in discretionary IT spend, delay in closure, and ramp up of certain large/mega deals. The EBIT margins improved Q-o-Q by 40bps to 21.2% led by cost optimisation benefits. The company reiterated FY24E EBIT margin guidance of 20-22% and is on margin expansion strategy. PAT came at Rs 6,215cr up 4.5% Q-o-Q and up 3% YoY. With that Infosys has downgraded its FY24 revenue growth guidance to 1-2.5% YoY CC (from earlier 4-7%) which implies 1% sequential growth for the rest of FY24. This seems reasonable and unlikely to disappoint. Infosys reported a record high TCV of 7.7bn USD 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.
Narayana Hrudayalaya	Narayana reported strong revenue growth of 14% YoY to Rs. 1,233cr, driven by both India and Cayman operations. India Business ARPOB continued to see an upward trend (9% YoY growth in Q2FY24 ARPOB) due to changes in the case mix, bed mix and improved productivity. The 3 new hospitals in India made a cumulative EBITDA Margin of 7% and the margin trend here is expected to further improve in the next few quarters. Cayman business also had strong revenue growth of 13% YoY with EBITDA Margin being stable at 40%+. Consolidated EBITDA Margin came in at 23.6% in this quarter vs 21.3% in Q2 FY24. Strong revenue growth coupled with margin expansion resulted in an adjusted PAT of Rs. 227cr in this quarter vs Rs. 156cr in Q2 FY24 (growth of 45%). The company has recently commissioned its Oncology block in Cayman, and this is the first full-fledged oncology department in Cayman. This will lead to higher revenue and improved profitability for the Cayman business. The company is also adding a 50-bed hospital in Cayman which would be operational by Q1FY25. On the domestic front, it is adding a green field hospital in Kolkata and debottlenecking Bangalore Hospital. For Cayman and India, it would be incurring Rs. 1,100cr capex in FY24 and this would give the growth for the midterm. Key risks include government policies in India and Cayman, and margin contraction in the interim period of high capex.
Eicher Motors	Eicher's Q2FY24 results came slightly ahead of our expectation driven by lower RM costs and the impact of price hikes taken in Q1FY24. This led to a sequential improvement in Gross Margins by 350bps sequentially. While the revenues were up just 0.75% sequentially EBIDTA increased by 8.35% sequentially. Margins came in at very strong 27.9% as against 26% in Q1FY24. Since FY20 margins have been in the 24% range (as against 30% previously). So, the trend seems to be reversing despite increased competition. Overall, PAT came in at Rs938.4cr, an increase of 53% yoy and 3% QoQ. In the international market the weak macro environment has been impacting sales but they are also careful enough to not push down the inventory. The company has maintained its market share of 8-9% in the middle weight category in the geographies that it operates. New Launches - The newly launched Himalayan 450 has got good reviews and should help drive growth including in the international market. They have also launched the Meteor 650 in North America which should aid growth in that geography. Overall, it seems quite a few interesting launches, including one in March'24, are in the pipeline that are (sub)category creators. And all these products are ready as per the management. It is just a question of appropriate timing. Key Risks - potential slowdown in the 2-W sector, increased slowdown in export markets, delay in new launches and strong traction of competitors' launches in the 250cc and above category.

Dr Reddy’s

Dr Reddy’s Laboratories is India’s second-largest pharmaceutical company in terms of revenue. The company started its business as a bulk-drugs player, the company rapidly moved up the value chain to become a major generic formulation company with global operations. Currently, the company generates 45% of its Revenue from the US market, 20% from the Domestic market and the balance from the RoW market. Currently, the US Generics market is witnessing a few significant changes due to supply disruptions after a 7-to-8-year downcycle. In the last 1 year, multiple participants in this market, specifically those based outside India, have exited the US generics market, leading to supply disruption and drug shortages. These exits have come in three forms a) bankruptcy filing, b) selling to a peer, and c) selling to strategic investors/spinoffs. All these disruptions, whether structural or shortterm, are leading to drug shortages in the US market. This should benefit India-based U.S. Generic players, who suffered significant price erosion in the last few years.

The company reported a 9% YoY growth in revenue to Rs. 6,880cr in Q2 FY24. North American business reported growth of 9% cc YoY to USD 383Mn driven by market share expansion in the core portfolio and integration of the Mayne acquisition, while the overall business declined 1.5% cc QoQ. Europe business reported growth of 26% YoY and 4% QoQ. Growth was driven by leveraging the existing portfolio, contribution from new products and favourable forex. India's business growth was in the mid-single digit after excluding the impact of NLEM and discontinued products. The reported growth was 3% YoY. Russia and CIS business did not grow due to currency devaluation and in cc terms, the growth stood at 4% YoY and 9% QoQ. EBITDA increased by 5% YoY due to the higher expenses on account of investment in sales, marketing, digitalization, and R&D spending. PAT was up 33% YoY due to higher other income. Private and Confidential. Circulation to Unit Holders Only Umbrella AIF Blend Fund 2– Q2 FY24 | 5 The net cash on books as of Q2 24 is Rs. 5900cr. The company is open for small as well as large deals and the key criteria will be to buy an asset with the products/ capabilities which Dr Reddy’s does not have.

Key risks: In case the price erosion improvement cycle is not sustainable in the medium term, the margins and growth in US business will be at risk. Product contraction towards Revlimid. Any earnings dilutive or non-core acquisition.

Redington

Redington reported revenue growth of 17% YoY. Revenues for Q2FY24 were Rs.22,220cr. The growth number is noteworthy, given the context of the global slowdown reflecting market share gains and Redington's execution capabilities across geographies. Standalone business in India grew 16% YoY, while the global business grew 17% YoY. There has been a slowdown in consumer spending, while enterprise demand and government spending remain strong. There is a sequential improvement in numbers. Gross and EBITDA margins improved by 20bps sequentially to 5.8% and 2.2%. The EBITDA improvement came in despite higher opex outgo which captures the factoring cost in Turkey. Factoring cost for the quarter was 87cr, higher by 27cr over the previous quarter number of 60cr. Redington under the previous CEO [Rajiv Srivastava] had seen a higher than ramp up in costs which had led to margin reduction. He subsequently resigned and the CFO took over in the interim. The numbers for the quarter reflect the course correction adopted. Working capital intensity decreased to 35 days from 40 days. We expect the company to deliver better balance between profitability and growth going forward.

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 into a dividend yield of c.4%. We like Redington given that they are amongst the top 2 ICT distributors across markets it operates in. The company’s dominant positioning and financial muscle give it significant competitive advantage in a business that has high barriers to entry. Redington has created a strong services business - both on 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 practises over cycles that help better manage credit, inventory, and currency risks. A significant shift in consumer and enterprise behaviour has led to higher need for higher computing > leading to shorter product life cycles > and acceptance of premiumization. This tailwind benefits Redington.

Key risks are higher interest rate regime environment, delayed recovery in margins and slowdown/delays in the high margin enterprise business.

Axis Bank

Axis Bank reported PAT of Rs 5,864cr vs Rs 5,797cr in Q1FY24 and Rs 5,330cr in Q2FY23. Axis Bank reported 4.5% QoQ / 22.8% YoY growth in loan book (YoY growth includes Citi Acquisition). Margins improved by 1bps QoQ to 4.11% led by the deployment of excess liquidity. Yields on Funds improved by 14bps QoQ offsetting ~14bps increase in the cost of funds of 14bps. Management guided that the marginal cost of funds has stabilized and the pace of increase in deposit cost will be moderate in H2FY24. Cost to Assets increased by ~13bps QoQ to 2.64%. Management indicated that higher margins and lower credit cost trajectory are giving them the opportunity to invest in the business. They have guided earlier that they can pull back the cost if need be. Management remains committed to achieve a cost-to-asset ratio of around 2.1% in the medium-term including CITI bank integration costs.

Asset quality continues to improve led by moderation in GNPAs & NNPAs. The bank has now one of the lowest net-NPAs across all major banks. Gross slippages further improved to ~1.5% vs ~1.9-2% for the past 5 quarters. Net slippages stood at 0.4% vs 0.5% in Q1FY23 led by higher recoveries. Credit cost came at merely 37bps vs 49bps in Q1FY24. Axis Bank carries unutilised provisions of ~56bps 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.

Crompton Greaves Consumer	Crompton Greaves Consumer reported 11% revenue growth at Rs.1,476cr, on account of strong performance of ECD division, which grew at 17% YoY. This was offset by the weakness in the lighting segment, which de-grew 12% YoY. Consolidated Gross margins was down 110bps YoY due to high BEE related expenses and price corrections in pumps. EBITDA margins were down 115bps YoY as the company spent more on advertising to gain market share. As a result, EBITDA fell 10% YoY to Rs.175cr. Overall, PAT came at Rs.97cr vs Rs.126cr YoY [down 23%]. 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 materials.
Oberoi Realty	The residential real estate market is divided into 3 segments: a) Affordable Housing (Real estate players make 10-15% EBITDA Margin); Mid segment (20-25% margin); Premium (>40% margin). Oberoi is present only in the premium segment and makes a 40-50% EBITDA Margin (highest in the industry). Till now the company is present only in the MMR region and has key projects in Goregaon, Mulund, Borivali and Worli. Oberoi reported area sales of Rs. 965cr in this quarter i.e. a decline of 17% YoY and 100%+ QoQ. The company didn't have any new launches in H2FY23 and H1 FY24 and this has impacted the sales numbers. The strong sequential uptick is primarily due to company selling 4 units in the Three Sixty West project with a cumulative sale value of Rs. 317cr. The collections remained strong at 1,100cr in this quarter resulting in a net debt to equity of 0.18x. The Kholset project is launched in November and there will be 5 towers. The company will be launching a few towers in the first phase and all these houses would be 3BHK. Pokhran project will be launched in Q4. Given these launches, H2 will be much better than H1 for Oberoi. The reported revenue was up 77% YoY at Rs. 1,217cr in Q2 FY24 with EBITDA margins of 52% vs 45% YoY. PAT was up Rs. 457cr vs 318cr YoY, up 44%. The way Oberoi operates is it identifies micro markets in MMR and buys huge parcels (given their balance sheet strength). The company would be releasing inventory into the market gradually by launching a few towers in each phase. Oberoi has 2 land parcels in Thane. At Rs. 25,000/sqft realisation, both these projects can contribute to sales of Rs. 42,000cr over the next 15 years for Oberoi. Key risks: Delayed projects launches, slowdown in the demand.
Kewal Kiran Clothing	Kewal Kiran delivered revenue growth of 16% YoY to Rs.262cr, aided by strong sales of the bottom wear category and early offtake of winter wear sales. The company added 16 new stores in the quarter and is on track to double its store count to 700 stores in the next three years, by adding 60-80 stores per annum. EBITDA margins were up from 22% to 23.5% YoY on the back of operating leverage. As a result, EBIDTA was up by 23% YoY to Rs.62cr. Overall, PAT was up by 27% YoY to Rs.50cr. 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.
KFin Technologies	KFin is a registrar and transfer agent (RTA); a service provider to the asset management industry (MFs & AIFs). KFin services 25 of the 46 AMCs with C.Rs.14.8 trillion AUM. KFin's overall average AUM market share is at c.34%. KFin has a c.47-48% market share in the issuer solutions market where it caters to 5,600+ corporate clients. KFin also offers transfer agency and fund accounting solutions for the AIF, PMS players and other international clients. KFin got listed on 29 Dec 2022. For 2QFY24, revenues/EBITDA/PAT grew 17%/32%/28% YoY at Rs.209 cr, 94 cr and 61 cr respectively. EBITDA margins are at 45% vs 40% YoY. Growth in AUM with stable yields and similar costs leading to operating leverage - EBITDA margins improved to 44.8% vs 38.8% QoQ. Domestic MF revenues yields were broadly stable at 0.038%. The revenue growth in issuer solution was 13% YoY as new folios were added. The total folios managed are c.11.4cr. International business growth was 48% YoY and 30% QoQ. This was led by client additions and clients going live. Yield in the international business is 5bps+ as there is a floor / minimum fees from each client irrespective of the AUM vs the domestic business where yields are c.3.8-4bps. Growth in the international business is expected to continue in 2HFY24. Historically 44-45% PAT is in the 1H while the rest is in 2H. We like the business given the favorable industry structure of a duopoly, low asset intensity and capital efficiency. The overall average AUM in domestic mutual funds continued to grow faster than the industry, aided by contributions from new clients & faster growth in existing clients' portfolios. KFin' presence in international geographies offers a meaningful opportunity given the first mover advantage. Key risks would include delay in international AUM, event risks from a merger of any mutual funds leading to consolidation and change in the regulatory landscape that may result in pressure on yields.

Sonata Software

Sonata's IT Services came in at US$80.9Mn, up 4.7%/40% QoQ/YoY, lead by both M&A and organic growth. The segment's EBITDA margins at 24.6% were up 9.6%/38% QoQ/YoY. Their domestic business came in flat QoQ after several years, which may reverse in Q3. The deal pipeline remained strong as it is up by 25% QoQ. Domestic business EBITDA came in at 56cr up 20% YoY. PAT growth was limited due to a combination of cash and non-cash charges related to M&A.

Sonata's focused on the newer areas of tech spends : AI & Data, which has reduced their exposure to "traditional" IT Services. They have taken market share in the BFSI, which is led by data privacy & consumer facing applications. Tailwinds are synergies from Quant M&A and large deal pipelines.

Key Risks - Slowdown in the USA and Europe and cuts in discretionary IT spending by enterprise clients.

Cyient Limited

Cyient DET business grew 1% CC QoQ and 17% CC YoY at USD 178 mn, which was broadly in line with expectations. Within the segments,Transportation/Connectivity/Sustainability/New Growth Areas grew 2.7%/-8.1%/4.9%/5.7% CC QoQ. Growth was lower due to the softness in connectivity(communication) industry. EBIT margin came higher at 16.5% with a margin expansion of +47 bps QoQ. This margin expansion came on full benefit of SG&A optimisation activities carried by company over last many quarters and rate hikes. DLM reported revenue of Rs 292 cr, grew 70% YoY, EBITDA of Rs 23.5 cr(margin of 8.1%), and PAT at Rs 14.6 cr. On a consolidated basis revenue came at $ 215 mn, and grew 4.7%/23% QoQ/ YoY. Adj PAT at Rs 183 cr, up 4% QoQ.

Company earlier guided for FY24 revenue growth in mid-range of 15-20%. Now it lowered revenue guidance to the lower end of this band at 15%-16% as clients are lowering spending. Given overall order intake and momentum in Aerospace/ Defence/Automotive industries revenue growth should remain in double-digits. Company has maintained its margin expansion guidance of 150-250 bps in FY24 over FY23 base of 13.7%.

Key Risks - Slowdown in the USA and Europe and cuts in discretionary ER&D spending by enterprise clients.

Summary of portfolio valuation

Wt. Avg PE	**FY 24E**
Wt. Avg PB	25.2
Wt. Avg ROE	4.5
Wt. Avg Mcap $ mn	24.5%
Capital Goods	23,595

*Only on the direct eq allocation excluding cash & cash equivalents and ETF, if any

Rangoli India Fund	**Market Cap (USD Mn)**	**PBT (USD Mn)**		**YoY%**	**PAT (USD Mn)**		**P / E**	**RoE (%)**
	As on 29th Dec	**Q2 FY24**	**Q2 FY23**		**FY 23**	**FY 24E**	**FY 24E**	**FY 24E**
Axis Bank	41,064	866	940	9%	2,738	2,851	14.4	18%
Coromandel International	4,451	119	120	1%	250	239	18.6	24%
Cyient Ltd	3,069	16	30	89%	68	90	34.2	20%
Dr.Reddys Laboratories	11,682	195	231	18%	467	644	18.1	21%
Eicher Motors	13,703	106	157	48%	322	428	32.0	25%
GMM PFAUDLER	875	12	12	-4%	27	29	30.3	26%
HCL Technologies	48,058	554	617	11%	1,842	2,100	22.9	26%
HIL Limited	256	1	2	137%	18	21	12.3	15%
ICICI Securities	2,803	49	68	40%	138	166	16.9	44%
Indian Energy Exchange Ltd	1,810	11	14	21%	38	40	45.3	37%
Infosys	77,353	1,014	1,055	4%	2,992	2,952	26.2	32%
ITC	69,637	754	801	6%	2,372	2,559	27.2	30%
Karur Vysya Bank	1,630	42	62	48%	137	181	9.0	16%
Kewal Kiran Clothing	570	6	8	26%	15	18	32.3	25%

KFin Technologies	995	7	10	39%	24	28	36.0	24%
Narayana Hrudayalaya	2,967	24	30	26%	73	97	30.7	32%
Newgen Software	1,322	4	6	60%	22	26	50.4	19%
NIIT Learning Systems	715	5	8	55%	24	26	27.4	27%
Oberoi Realty	6,339	47	72	54%	236	236	26.9	15%
Redington	1,669	57	49	-14%	173	150	11.1	16%
Sonata Software	2,516	18	20	12%	56	66	38.2	38%
State Bank of India	69,215	2,184	2,322	6%	6,233	6,809	10.2	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 Manegmemt

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/Fund	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.