STRATEGY COMMUNIQUE:
Q2: CY 2024

Conscious and Disciplined Approach

In a rapidly changing economic landscape, there is sometimes a temptation to seek simplistic explanations for the environment we navigate. While straightforward narratives are comforting, they are rarely adequate in capturing the moving parts that will determine investment outcomes. India's capital markets today are a prime example of this. The phenomenon of specific segments of the markets experiencing significant gains and rising performance can lead to misleading perceptions about risks.

This drives us to stay true to our investment philosophy of "Growth at a Reasonable Price" [GARP]. Our investment decisions and advice focus on the sustainability and practicality of expectations, balancing capital preservation and growth duality. As a result, we are patient and deliberate in our decision-making. This is crucial in building a resilient portfolio that will perform well across various market environments.

Portfolio, actions

In emerging markets, where high economic and industry-specific growth rates depend on policy, the probability of change in national leadership is a pivotal moment [Mexico, France, India]. As active managers, it is our mandate to assign probabilities to such events and prepare for conceivable outcomes.

Accordingly, over the last couple of months, and getting into a Government-related event, we advised to built exposure in policy-agnostic businesses through IT Services, pharmaceuticals, staples, and discretionary consumption. This provided us with stability to the portfolio and mitigated possible policy risks. We had ~50% of our portfolios in larger capitalization firms available at fair valuations at the end of Q1CY24, which provided us with attractive upsides and the added benefit of lower downside and liquidity.

> If risk did not materialize, it does not mean it did not exist.

Post-elections, with the assurance of policy continuity towards infrastructure in general, we advised to build exposure in select firms participating in infrastructure development. Domestic-oriented businesses that consume discretionary and non-discretionary continue to find incremental exposure in portfolio. This includes diversified opportunities across agrochem, industrial, healthcare services, and savings financialization. Similarly, we have had a significant allocation to the credit cycle over the past few years. We advised to reallocate capital significantly within the banking sector from the relatively more expensive private banks to more reasonably valued public sector and smaller private banks.

As of date, our investment drivers can broadly be classified into the following.

Driver 1: Capex-oriented businesses that continue to derive benefits from public and private capex (15-20%)

- Infrastructure Development
- Metal and Mining

Driver 3: India Credit Cycle - Sustained growth in the banking sector through select banks that offer deep value (20-30%)

- Strong credit quality and steady credit growth at a reasonable valuation

Driver 2: Domestic-oriented businesses that benefit from the recovery in discretionary consumption and premiumisation (25-35%)

- Consumer Discretionary
- Financialization of Savings
- Healthcare

Driver 4: Globally competitive product and services where India has a deep and sustainable competitive advantage (15-25%)

- IT/ITes Services
- Pharmaceuticals
- Chemicals

Over the past few quarters, we have meticulously adjusted our portfolio advice in response to evolving opportunities. Where our investment thesis has proven successful, we have realized gains and suggested reallocating these funds to opportunities where we perceive attractive outcomes. This vigilance allows us to navigate market fluctuations effectively.

Key Sectors	Dec'18	Dec'19	Dec'20	Dec'21	Dec'22	Dec'23	May'24	July'24
Financials	22%	28%	21%	29%	29%	27%	18%	28%
Materials	2%	0%	9%	6%	7%	5%	8%	18%
IT	0%	23%	19%	5%	6%	12%	25%	17%
Healthcare	6%	9%	15%	15%	7%	23%	24%	15%
Industrials	15%	28%	8%	7%	9%	10%	5%	9%
Consumer	30%	5%	16%	29%	11%	4%	7%	7%

**Data as of quarter end for KIOF – Rangoli India Fund.*
Jul'24 data is as of 25-07-2024
Sectors as per the GICS classification.

Earnings Review

Despite expectations of a lower growth rate, the Indian economy delivered better-than-expected numbers, growing 8.2% YoY in Q4. This was primarily driven by an uptick in private and government consumption. A more significant change was seen in exports, up 8.1%, along with easing imports, which supported external balances. As a result, growth for the entire year was 8.2%, above estimates of 7.8%.

Private consumption remained steady in the quarter, with 4% growth, similar to the previous quarter. Private consumption is expected to revive after slowing down to 4% in FY24 vs. 6.8% in FY23. Recent data indicate that rural consumption growth was faster than that of urban. With likely normal monsoon and modest inflation, consumption revival is expected to continue, boding well for consumption-driven sectors.

The macro strength continues to be reflected in India's aggregate earnings. For Q4-2024, across the spectrum of benchmarks, Nifty 50, Nifty 100, and Nifty Midcap grew earnings by 18%, 16%, and 6%, respectively. The sectoral breakup of the broader Nifty 100 is as follows. The earnings growth of the broader sectors spanning banks, NBFCs, automobiles, healthcare, and real estate are in the range of comfortable double digits and run between 1.5x and 2.0x of nominal GDP.

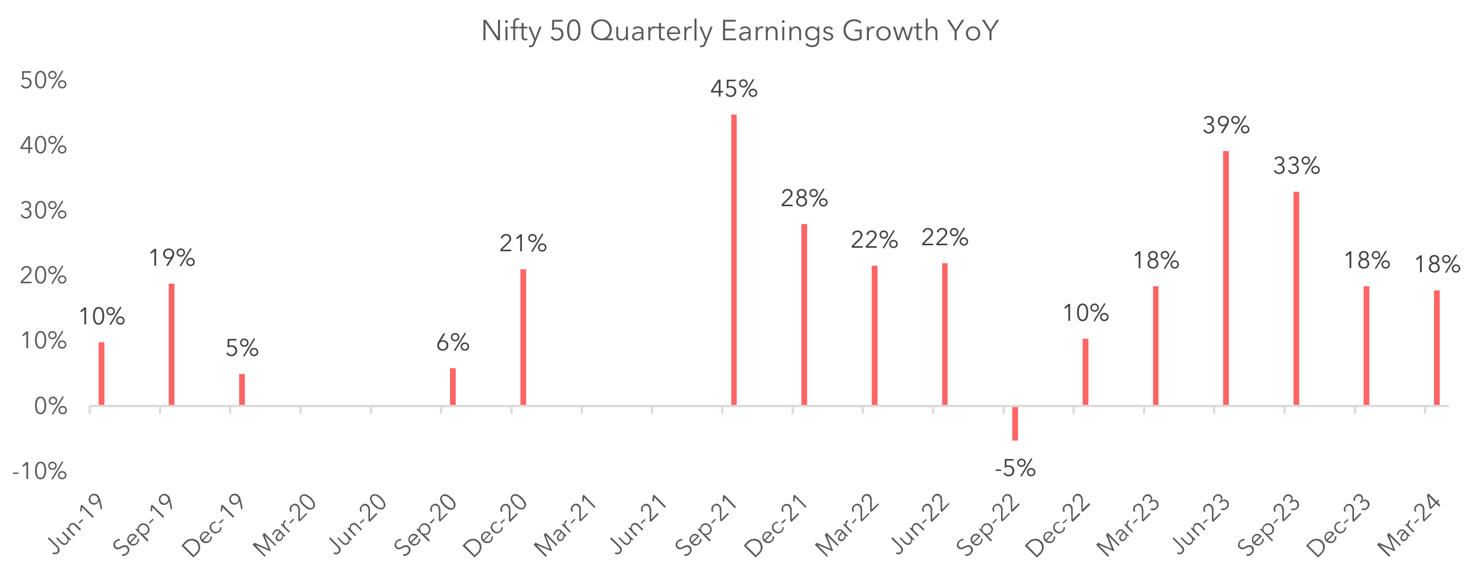
Sector-wise Q4 earnings growth of Nity-top 100 firms

Nifty 100	Adj PAT In Cr		PAT Growth
Sector	March '23	March '24	YoY %
Automobiles	15,176	30,529	101%
Banks-Private	33,967	44,579	31%
Banks-PSU	28,550	33,811	18%
Capital Goods	8,917	11,694	31%
Cement	4,316	5,606	30%
Chemicals & Fertilizers	562	422	-25%
Consumer	12,886	13,589	5%
Consumer Durables	358	447	25%

Healthcare	5,152	7,420	44%
Infrastructure	2,297	2,361	3%
Insurance	15,002	15,697	5%
Metals	10,830	7,653	-29%
Misc*	1,768	3,147	78%
NBFC	18,067	24,127	34%
Oil & Gas	48,476	43,018	-11%
Real Estate	570	921	62%
Retail	1,246	1,592	28%
Technology	26,809	28,985	8%
Telecom	3,006	3,900	30%
Utilities	23,053	23,179	1%
Total	261,007	302,675	16%

[*Zomato, IRCTC, Info Edge, etc]

For Q4 FY 2024, Nifty-100 and Nifty-50 grew reported earnings by c.20%.



Adjusted for the Covid disrupted periods

As we have communicated earlier, index earnings often oversimplify the market, reducing its diverse components to a single investment target. This obscures company-specific risks and investment potential. As absolute return-oriented managers, we evaluate risk and reward at the individual firm level. This approach ensures detailed, firm-specific metrics drive stock selection and investment management.

The structure behind the numbers

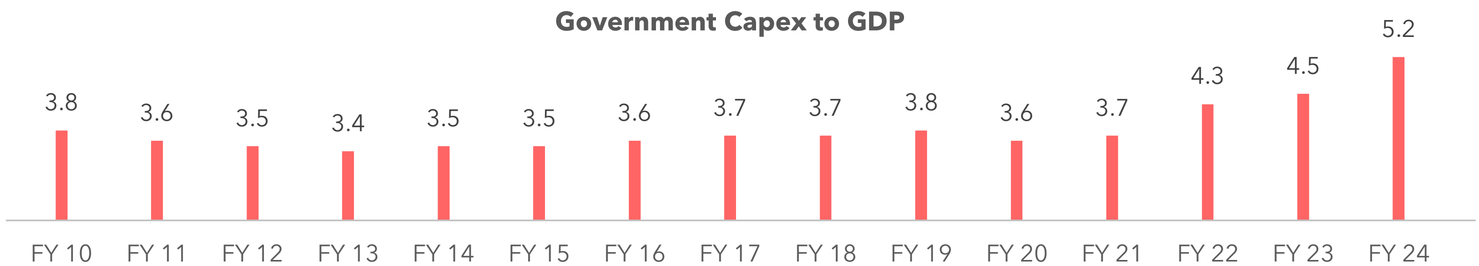
While rising corporate and household incomes address India's generational shift in consumption, the broad contours of India's economic makeup are shifting. As our exposure to firms building India's infrastructure has risen, we evaluate a few of the macros related to this.

Achieving lower fiscal deficit with strong capex growth

The quantum of India's persistent fiscal deficit has historically constrained the ability to deliver significant infrastructure development. However, the past few years, especially post-pandemic, have been very different. Not only has the fiscal deficit come down, but the government's expenditure on capital projects has been the best in history. India's structural infrastructure deficit is now addressed through better execution on the ground and support at the policy level.

India's combined fiscal deficit [Central] rose to its all-time high of 9.2% of GDP in FY21, compared to 4.6% of GDP in FY20 (and 3.4% of GDP in FY19). This narrowed to 6.7% of GDP in FY22, with the promise of bringing it down to 4.5% by FY26. This is budgeted to fall further to 5.1% of GDP in FY25, meeting its target of 4.5% next year.

This discipline in fiscal management has coincided with rising capex, increasing to an all-time high of 5.2% of GDP in FY24, compared to 3.7% in the pre-pandemic years. This was possible as government receipts increased sharply to an all-time high of 17.7% of GDP in FY22, which rose further to 18.3% in FY24.



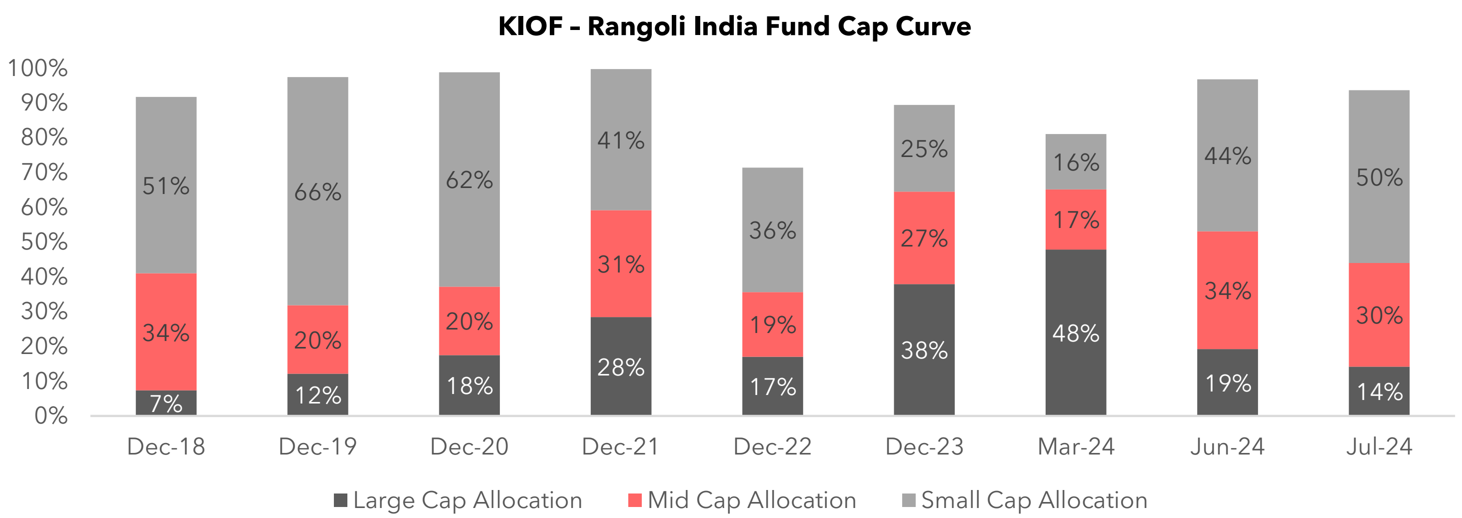
Source: RBI

This has percolated to widespread capital expenditure, driving our interest in the sector. More structurally, total factor productivity (TFP) has significantly contributed to GVA growth. To top this, the softening of inflation provided tailwinds to growth. The next leg of growth prospects will be influenced by (1) the pace of private consumption and capex recovery and (2) global growth and rates cycle.

Portfolio Summary

The current portfolio advised by us demonstrates an agile approach to market capitalization, backing opportunities rather than a pre-determined preference for small, mid, or large-cap stocks. This approach is a continuation of our commitment to growth at a Reasonable Price (GARP). A fundamental tenet of GARP ensures that our investment strategy remains flexible and responsive to market conditions.

This is a representation of how the cap curve in the portfolios has changed over the past few years:



Source: Kotak