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Investment Matters

June 2022

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EQUITY OUTLOOK

Resilient fundamentals, external headwinds

India's corporate earnings stayed resilient through the multiple shocks in early CY22. 4QFY22 earnings were strong with 22% PAT growth for the Nifty, driven by resilient margins despite the external shocks. More importantly, consensus estimates for FY23 and FY24 have stayed stable. We believe that this underpins the upward trajectory of the broader market in the medium term. In the short term, however, rising rates, elevated inflation and domestic consumption trends will rule, and keep the markets volatile.

	May-22	Performance (%) 1M	3M	6M	1Y
Major Indian indices					
Sensex	55,566	-2.6%	-1.2%	-2.6%	7.0%
Nifty	16,585	-3.0%	-1.2%	-2.3%	6.4%
CNX-100	16,768	-4.0%	-1.5%	-2.9%	6.1%
CNX-500	14,120	-4.5%	-1.3%	-3.6%	6.8%
Mid-cap and Small-cap Indices					
BSE Mid-cap	23,144	-5.2%	-0.9%	-6.3%	6.4%
BSE Small-cap	26,371	-7.8%	-1.1%	-5.6%	11.8%
CNX Mid-cap	28,288	-5.3%	0.2%	-4.6%	9.7%
CNX Small-cap	9,209	-10.2%	-6.5%	-13.6%	-0.6%

Source: NSE, BSE

	May-22	Performance (%) 1M	3M	6M	1Y
NSE sector indices					
CNX Bank	35,487	-1.7%	-2.0%	-0.6%	-0.1%
CNX Auto	11,587	4.6%	7.1%	9.3%	10.4%
CNX Realty	412	-7.2%	-5.7%	-15.6%	22.5%
CNX Infrastructure	4,877	-4.9%	1.6%	-1.7%	12.7%
CNX Energy	25,641	-10.3%	5.9%	12.3%	28.8%
CNX FMCG	38,713	1.3%	9.0%	3.5%	9.8%
CNX Pharma	12,604	-6.4%	-2.5%	-7.7%	-10.3%
CNX IT	29,679	-6.1%	-12.3%	-15.3%	9.5%

Source: NSE, BSE

4QFY22 earnings – key thoughts

Non-financials									
4QFY22	Revenue growth		Gross margins			EBITDA margin			PAT	
	y/y	q/q	Reported	y/y chg	q/q chg	Reported	y/y chg	q/q chg	y/y	q/q
Nifty	23.0%	9.0%	53.2%	-4.0%	-1.0%	18.3%	-1.5%	-0.7%	17.4%	3.3%

Financials (NBFCs and Banks) Change in % points										
4QFY22	Revenue growth		Cost-income			Credit costs			PAT	
	y/y	q/q	Reported	y/y chg	q/q chg	Reported	y/y chg	q/q chg	y/y	q/q
Nifty	18.6%	2.6%	44.7%	0.05%	0.48%	0.24%	-19 bps	-2 bps	41.2%	9.0%

All companies							
4QFY22	Revenue growth		EBITDA growth			PAT	
	y/y	q/q	Reported	y/y chg	q/q chg	y/y	q/q
Nifty	22.6%	8.5%	22.8%	13.0%	8.4%	22.1%	5.0%

Source: Spark Capital, Alchemy capital

- The quarter took a couple of lumpy hits – Omicron at the beginning which led to some partial shutdowns and the Ukraine war which caused a spike in commodity prices towards the end.

- **Non-financials:** Topline growth was strong, but margins took a hit due to commodity prices, in the main. Some of the gross margin stress was mitigated in fixed costs leading to lower stress at the EBITDA

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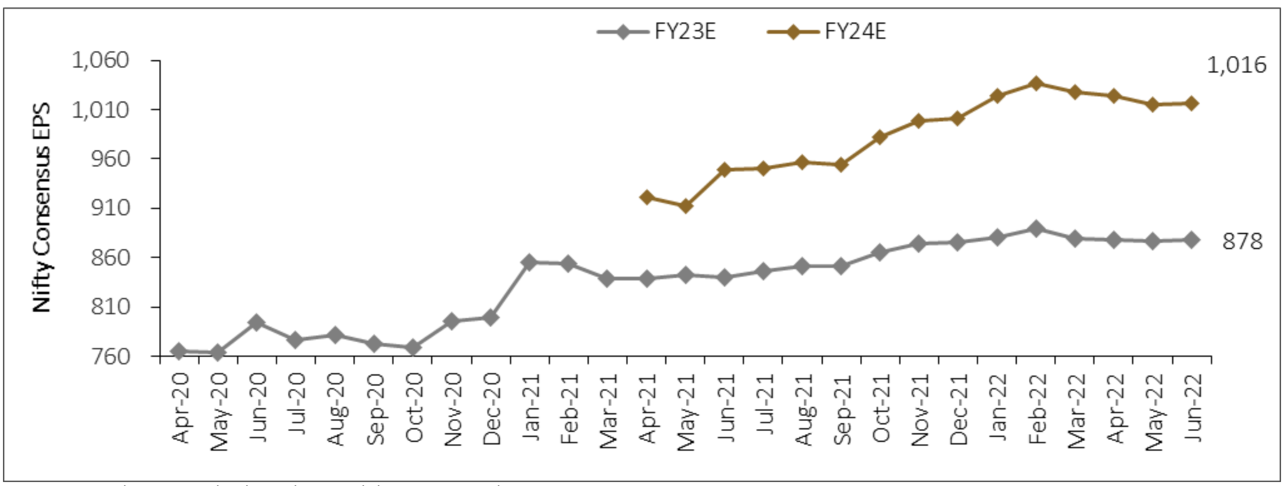
level. PAT growth was at 17%, despite all the pain.

- **Financials:** Revenue growth is recovering as the economy opens up, as is evident from other data like credit card spends. Credit costs were sharply down but could still fall further as Covid-related stress washes out and the benefits of the last three years' risk aversion accrue.
- **Aggregate:** Revenue growth of 23% YOY and PAT growth of 18% YOY is a strong outcome, despite the stresses of the Omicron and Ukraine war. The margin pressures may continue into 1QFY23, but price hikes would take over from there.

Strong earnings outlook

The macro headwinds have not shaken the earnings outlook for the Nifty. Consensus estimates for FY23/ FY24 have stabilised after the first round of cuts in March 2022, following the Ukraine invasion. Our sector-wise earnings analysis gives us confidence that these numbers have limited downside risk. Chart 1 below gives us the sector –wise earnings growth and the contribution to Nifty EPS growth. Apart from IT and Energy, we see little risk to the forecasts for most other sectors.

Chart 1



Source: Ambit Capital, Bloomberg, Alchemy Capital

Financials: BFSI earnings are heading for a golden spell over the next two-three years. Credit costs should remain ultra –soft as banks a) recover from the credit shocks of the asset quality review and Covid and b) harvest the benefit from being risk-off for 4-5 years. In addition, revenue drivers should kick in as loan growth recovers and fee income bounces back as the economy opens up. We see little downside risk to these consensus forecasts through this cycle.

Auto: This is another sector that is coming out of a long winter. Successive regulatory shocks were compounded by the headwinds from covid that finally culminated in the chip shortage. Over the next 2-3 years, we expect demand to recover and margin pressures to ease – moreover, competitive pressures should peak as the strong companies benefit from survivorship bias. There appears to be a little to no vulnerability to these forecasts.

E&C/Infra/Cap Goods benefit from the changing policy environment. There are multiple drivers to the capex cycle in play – government spending, PLIs, recovery in private demand – and should keep earnings growth elevated. Moreover, the sector is more resilient to inflation as it generally operates on a cost pass-through basis.

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Consumer earnings are driven by two factors. We expect demand to recover in FY23 on the back of opening-up and the strong agri sectors. As incomes recover at the bottom of the pyramid, the headwinds from the inflation should ease and consumption demand would start to come back. Moreover, the worst of input price pressures are over, and the companies would continue their calibrated price hikes to bring back margins.

Pharma/Telecom: The growth is driven by turnarounds in Sun Pharma and Bharti, driven by individual company factors and less by macro factors. There is very little risk to these.

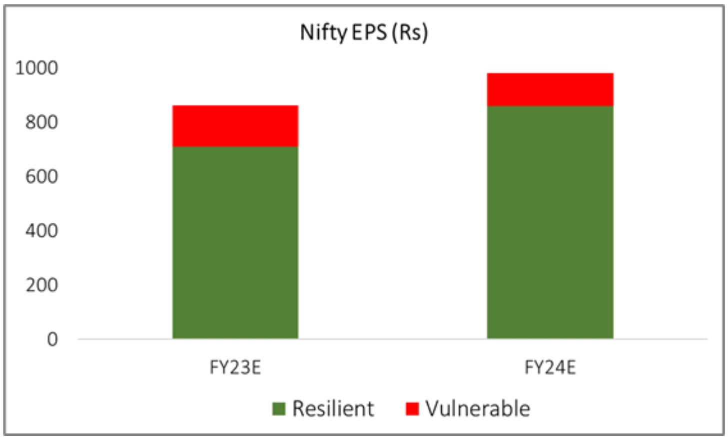
Metals and mining: Consensus estimates have already factored in a sharp decline in realisations over FY23, and stabilisation thereafter. Spot prices are still running ahead of the consensus numbers, so there is a little scope for further downgrades.

Oil and Gas is one of the most vulnerable sectors in this universe. The estimates depends on the stickiness of global oil prices, which could unwind if the Ukraine invasion is peacefully resolved. There would be a second-order positive impact on other sectors that would mitigate some of the demand, but this remains the main point of vulnerability to consensus estimates.

Information technology: This sector could see some volatility in forecasts. As the narrative around a US recession gathers strength, analysts may turn jittery and downgrade forecasts for FY24. We believe that the sector is seeing structural tailwinds and may not necessarily be vulnerable to a US slowdown, but consensus estimates could still be vulnerable in coming quarters.

Sectoral composition of Nifty EPS

Sectors	% contribution to Nifty EPS growth	
	FY23E	FY24E
BFSI	44%	44%
Energy	23%	5%
Auto / Auto Anc	23%	13%
IT	10%	13%
E&C / Infra / Cap. Goods	7%	5%
Consumer	6%	6%
Pharma	6%	3%
Telecom	6%	6%
Metals & Mining	-24%	-2%
Rest	-1%	6%



Source: Ambit Capital, Bloomberg, Alchemy Capital

Green shading represents sectors where we at Alchemy believe risks to consensus earnings are low. Red is where we see some risks to consensus earnings forecasts.

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Short-term factors

The earnings resilience is a source of comfort, but it would play out over a longer period. In the short term, however, the markets would be governed by factors other than quarterly results, and this could lead to continued to volatility.

- **Interest rates** in India and the US will be an important factor. We believe the RBI will continue to tighten through CY22 and take the repo rate back to pre-Covid levels, at least. The Fed, too, is likely to raise rates and tighten liquidity significantly, probably well into CY23. Some of this has already been priced into the markets, but we do not rule out continued volatility for some more quarters.
- **Inflation** remains elevated and the second-order effects (wages, inflationary expectations) are starting to become visible. The good news is that a large part of this is supply-driven and could easily unwind as quickly as it manifested. Until that happens, however, it will remain a source of worry for governments, central bankers, company managements and investors.
- **Consumption recovery** is key to sustaining the earnings momentum across most sectors. We believe that the rebound in unorganised-sector employment and strong wage inflation will help the consumer overcome the headwinds of inflation as we head deeper into FY23. A strong agri economy should also help. The market will track evidence of this as we head towards the festival season in 3-4 months from now and it will determine the short-term outlook for Indian equities.

Slowing deployment, but still minimising cash

We are deploying new cash in a staggered manner to take advantage of the recent volatility. We intend to, however, deploy within a reasonable period and do not plan to meaningfully increase our cash position. For stock-picking, we continue to "follow the earnings", with obvious filters for valuation and quality. We are positive on IT, manufacturing, automotive, chemicals and pharma and high contact sectors like retail and hospitality.

Seshadri Sen
Head of Research
Alchemy Capital Management Pvt. Ltd.

Source: Alchemy Research

MARKET INSIGHTS

Alchemy view on Market trends, analysis, and way forward; with additional inputs from industry experts about the different aspects to superlative asset management.

1. Market Views Market Views - May 2022 - YouTube

2. Interviews :

- Mr. Hiren Ved in an interaction with CNBC TV 18 : Watch the video
- Mr. Hiren Ved in an interaction with Economic Times : Read the article
- Mr. Seshadri Sen in an interaction with Economic Times : Read the article

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Q4 FY22 PERFORMANCE OF PORTFOLIO COMPANIES

The following table summarizes the performance of portfolio companies** in Q4 FY22 :

Scrip	Sales (Rs Mn)			EBITDA (Rs Mn)			PAT (Rs Mn)		
	Q4FY22	Q4FY21	% chg	Q4FY22	Q4FY21	% chg	Q4FY22	Q4FY21	% chg
TATA ELXSI LTD	6,817	5,184	32%	2,212	1,680	32%	1,600	1,151	39%
BAJAJ FINANCE LTD	60,677	46,594	30%	39,671	30,534	30%	24,195	13,466	80%
ICICI BANK LTD #	1,73,420	1,45,425	19%	1,02,930	85,398	21%	70,190	44,028	59%
DIVI'S LABORATORIES LTD	25,184	17,882	41%	11,044	7,163	54%	8,511	4,845	76%
MAX HEALTHCARE INSTITUTE LTD	9,388	8,019	17%	2,103	1,681	25%	1,217	804	51%
DEEPAK NITRITE LTD	18,724	14,632	28%	4,103	4,547	-10%	2,698	2,963	-9%
UNITED SPIRITS LTD	25,357	22,304	14%	4,318	3,963	9%	2,623	2,312	13%
AVENUE SUPERMARTS LTD	87,865	74,117	19%	7,393	6,127	21%	4,268	4,139	3%
TITAN COMPANY LTD	77,960	74,940	4%	7,940	8,170	-3%	5,100	5,640	-10%
RELIANCE INDUSTRIES LTD	20,73,750	14,95,750	39%	3,38,230	2,65,880	27%	2,07,638	1,79,543	16%
SUNDRAM FASTENERS LTD	13,398	12,731	5%	1,915	2,368	-19%	1,065	1,408	-24%
DIXON TECHNOLOGIES (INDIA) LTD	29,528	21,097	40%	1,182	798	48%	720	487	48%
TATA CONSUMER PRODUCTS LTD	31,754	30,372	5%	4,443	3,002	48%	2,298	989	132%
L&T TECHNOLOGY SERVICES LTD	17,561	14,405	22%	3,805	2,931	30%	2,402	1,788	34%
P I INDUSTRIES LTD	13,952	11,971	17%	3,050	2,274	34%	2,040	1,821	12%
VARUN BEVERAGES LTD	28,275	22,409	26%	5,310	3,816	39%	2,999	1,734	73%
PRAJ INDUSTRIES LTD	8,290	5,671	46%	780	749	4%	499	495	1%
ANGEL ONE LTD	5,095	3,016	69%	2,796	1,663	68%	2,048	1,214	69%
LARSEN & TOUBRO INFOTECH LTD	43,016	32,694	32%	8,464	7,155	18%	5,521	4,818	15%
BAJAJ FINSERV LTD	1,88,617	1,53,869	23%	34,622	23,585	47%	13,461	9,785	38%
BLUE DART EXPRESS LTD	11,659	9,683	20%	2,918	2,483	18%	1,490	1,036	44%
GLAND PHARMA LTD	11,030	8,877	24%	3,484	3,277	6%	2,850	2,604	9%
V-MART RETAIL LTD	4,588	3,519	30%	503	336	50%	-26	-15	NA
EICHER MOTORS LTD	31,947	29,224	9%	7,550	6,435	17%	5,534	4,681	18%
SYNGENE INTERNATIONAL LTD	7,581	6,586	15%	2,412	2,107	14%	1,328	1,176	13%
BAJAJ ELECTRICALS LTD	13,224	12,545	5%	592	716	-17%	443	560	-21%
HDFC LIFE INSURANCE COMPANY LTD @	30,490	28,810	6%	8,950	7,820	14%	3,575	3,179	12%
GARWARE TECHNICAL FIBRES LTD	3,563	3,354	6%	734	709	3%	514	507	1%
BAJAJ AUTO LTD	77,281	84,128	-8%	13,656	15,241	-10%	14,690	13,321	10%
VIP INDUSTRIES LTD	3,559	2,430	46%	326	32	918%	124	-38	NA
ABB INDIA LTD	19,749	16,292	21%	1,879	1,323	42%	627	791	-21%
DYNAMATIC TECHNOLOGIES LTD	3,209	3,533	-9%	482	493	-2%	150	-78	NA
FSN E-COMMERCE VENTURES LTD	9,733	7,405	31%	385	448	-14%	76	179	-58%
TRENT LTD	11,853	7,737	53%	1,523	1,366	12%	749	569	32%
TATA CONSULTANCY SERVICES LTD	5,05,910	4,37,050	16%	1,38,450	1,28,010	8%	94,105	86,944	8%
INDIAN HOTELS COMPANY LTD	8,721	6,150	42%	1,590	713	123%	566	-1,103	NA
MPHASIS LTD	32,777	25,243	30%	5,772	4,671	24%	3,781	3,033	25%
MARUTI SUZUKI INDIA LTD	2,67,400	2,40,237	11%	24,268	19,911	22%	18,389	11,661	58%
INDIAMART INTERMESH LTD	2,014	1,797	12%	572	854	-33%	574	557	3%
BARBEQUE-NATION HOSPITALITY LTD	2,510	2,263	11%	445	455	-2%	-1	62	NA
DELTA CORP LTD	2,182	2,113	3%	690	792	-13%	482	571	-16%
JUBILANT FOODWORKS LTD	11,579	10,379	12%	2,897	2,506	16%	1,161	1,053	10%
INFO EDGE (INDIA) LTD	4,729	2,965	59%	1,194	521	129%	1,021	289	254%
3M INDIA LTD	9,256	8,272	12%	1,575	1,024	54%	1,056	654	62%
JB CHEMICALS & PHARMA LTD	6,246	5,285	18%	1,249	1,492	-16%	846	1,013	-17%
GODREJ PROPERTIES LTD	13,306	4,326	208%	2,580	-1,541	NA	1,842	-2,157	NA
BHARAT FORGE CO LTD	35,731	20,828	72%	5,539	4,258	30%	2,357	2,086	13%
EASY TRIP PLANNERS LTD	609	574	6%	294	324	-9%	233	305	-24%

# indicates Net Interest Income + Other income, Pre-Provision Operating Profit and PAT for banks
@ Indicates Annual Premium Equivalent (APE) and Value of New Business (VNB) for life insurance companies
** For Alchemy High Growth, Alchemy High Growth Select Stock

Source: Alchemy Research

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