ALCHEMY
CAPITAL MANAGEMENT
CELEBRATING 20 YEARS

Investment Matters

February 2023

EQUITY OUTLOOK

Growth Budget – Positive for Equities

The strong Union Budget for FY24 is positive for the equity markets in the medium term. The fiscal prudence, combined with improved quality of expenditure, paves the way for a multi-year macro sweet spot-high GDP growth with stable financial conditions. In this context, we believe that growth stocks and quality will make a comeback in CY23, and the value rally is likely to fizzle out. The caveat is that valuations continue to matter and high PE stocks without support from earnings and cash flows may underperform. Also, we think the market will re-focus on quality metrics like strong balance sheets, return ratios and management strength.

Equity Markets in January 2023

		Performance (%)			
	Jan -23	1M	3M	6M	1Y
Major Indian Indices					
Sensex	59,550	-2.1%	-2.0%	3.4%	2.6%
Nifty	17,662	-2.4%	-1.9%	2.9%	1.9%
CNX-100	17,601	-3.6%	-3.5%	1.2%	0.3%
CNX-500	14,936	-3.3%	-3.2%	1.8%	0.1%
Mid-cap and Small-cap Indices					
BSE Mid-cap	24,643	-2.7%	-2.8%	2.5%	0.1%
BSE Small-cap	28,206	-2.5%	-2.1%	4.2%	-3.5%
CNX Mid-cap	30,676	-2.6%	-2.4%	3.5%	1.3%
CNX Small-cap	9,502	-2.4%	-1.9%	3.6%	-14.5%

Source: NSE, BSE

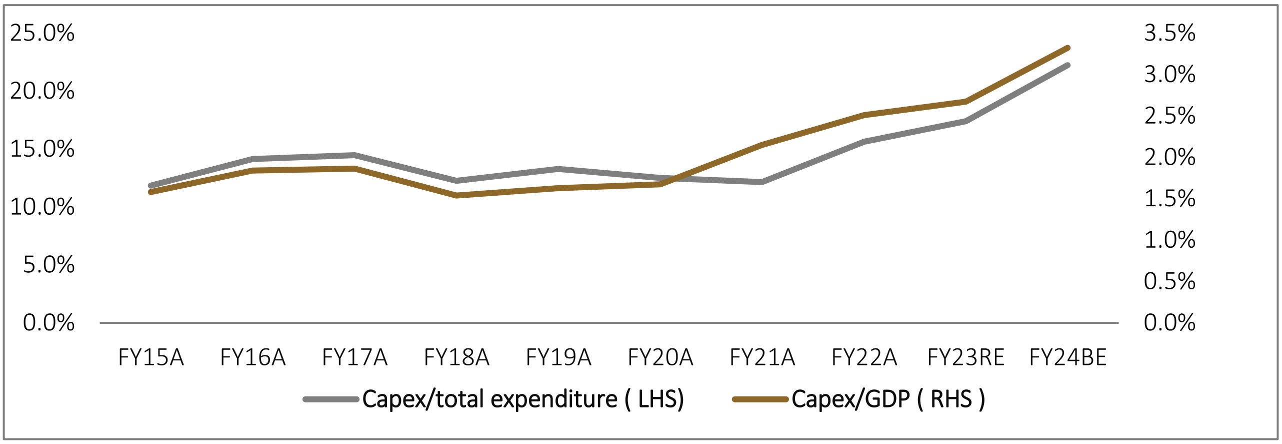
		Performance (%)			
	Jan-23	1M	3M	6M	1Y
NSE sector Indices					
CNX Bank	40,655	-5.4%	-1.6%	8.4%	7.1%
CNX Auto	13,324	5.6%	-0.4%	6.2%	13.8%
CNX Realty	412	-4.7%	-6.2%	-8.7%	-14.3%
CNX Infrastructure	5,061	-3.6%	-3.3%	3.5%	0.1%
CNX Energy	23,714	-8.3%	-11.1%	-8.9%	-5.1%
CNX FMCG	44,457	0.6%	0.4%	4.6%	21.9%
CNX Pharma	12,360	-1.9%	-6.4%	-3.3%	-6.2%
CNX IT	29,740	3.9%	3.5%	2.0%	-14.6%

Source: NSE, BSE

Union Budget FY24

Capital Expenditure

The standout feature was the surge in capital expenditure – raised by 37% to Rs 10tn. This was driven by increased allocation to railways, road construction and the green initiatives of the petroleum ministries. All these categories have significant multiplier effects on the economy and should help improve India's long-term growth potential. This breaks the multi-year trend of India's public spending shifting towards revenue expenditure (including subsidies).



Source: Ambit Capital Research, Alchemy Capital
Note: BE: Budget Estimate, RE: Revised Estimate, A: Actual Data

Key Capex categories	2022-23E (INR Crores)	2023-24E (INR Crores)	YoY Growth	Comments
Ministry of railways	137000	240000	75%	Focus on rolling stock and new lines - strong multiplier and productivity impact
Ministry of road transport and highways	187744	258606	38%	Has strong linkages to core sectors like steel, cement, commercial vehicles
Capital outlay on defence services	152370	162600	7%	Moderating growth
Ministry of petroleum & natural gas	600	35509	58x	Financing the green initiative; imperative for meeting climate goals
Total	**477714**	**696715**		

Source: Alchemy Capital

EQUITY OUTLOOK

Taxation

The other positive came from the direct tax proposals. Market fears of increased capital gains tax on equities proved unfounded – they were left untouched. In addition, there were marginal cuts in income tax rates across all income groups. In our view the tax cuts are not material enough for a significant consumption boost, but we see them as a positive signal of the government's approach to taxation.

Income Tax

There were marginal cuts in income tax rates across all income groups. The threshold for tax brackets was raised and the peak rate was cut to below 40%, which is a strong positive signal. The other important subtext is the strengthening of the new tax regime – we see clear signals that the government intends to fully transition to an exemption-free code over time.

Capital Gains Tax (CGT)

There were worries about a rationalisation of capital gains tax and a higher resultant incidence on equities. That was left untouched and, to that extent, a positive for the markets. We do not see the case for equating CGT across asset classes. The taxation of the underlying debt and equity are different, and the CGT rates should reflect that difference, in our view.

Life Insurance

The new tax proposals are negative for life insurers in the medium term. At the bottom end, the transition to the new regime will reduce buyer incentives for the savings products, which are a large part of life insurers' portfolios. At the top end, the capping of premiums at Rs 500k means that HNIs are now excluded from the market – as is the lifetime value of clients as upselling is capped beyond a point. This, we believe, would lead to a moderation of insurers' rich valuations over time. We have been very selective about investing in this sector and will be even more cautious after this budget.

Fiscal Deficit

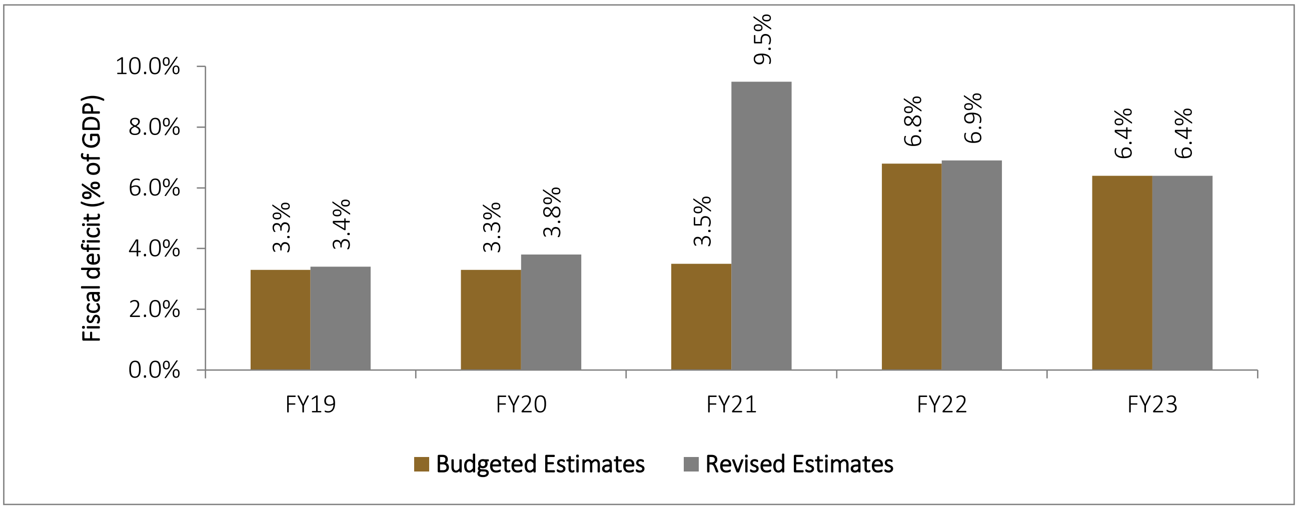
Sticking to the Consolidation Path

Despite these expansionary measures, the fiscal deficit contracted. A 50bps contraction to 5.9% in FY24 reaffirms the government's commitment to bring the fisc below 4.5% by FY26. India had taken up the fiscal deficit targets in the wake of Covid and this is a good time to start to consolidate. A reduction in the fiscal deficit does constrain growth – but we think that the changing composition of spending towards capex cushions the impact. The flipside is that the conservative fiscal policy should help the overall financial stability and keep long bond yields in check.

Reasonable Assumptions

This has been achieved with moderate assumptions on tax collections. GDP growth assumptions are at a moderate 10.5% and tax collections are largely in line with that at 11.5%. These are reasonable buoyancy assumptions, and we see very little risk of a shortfall. Interestingly, the tax collections for FY23 overshot the budget estimates – a rare occurrence in India's history.

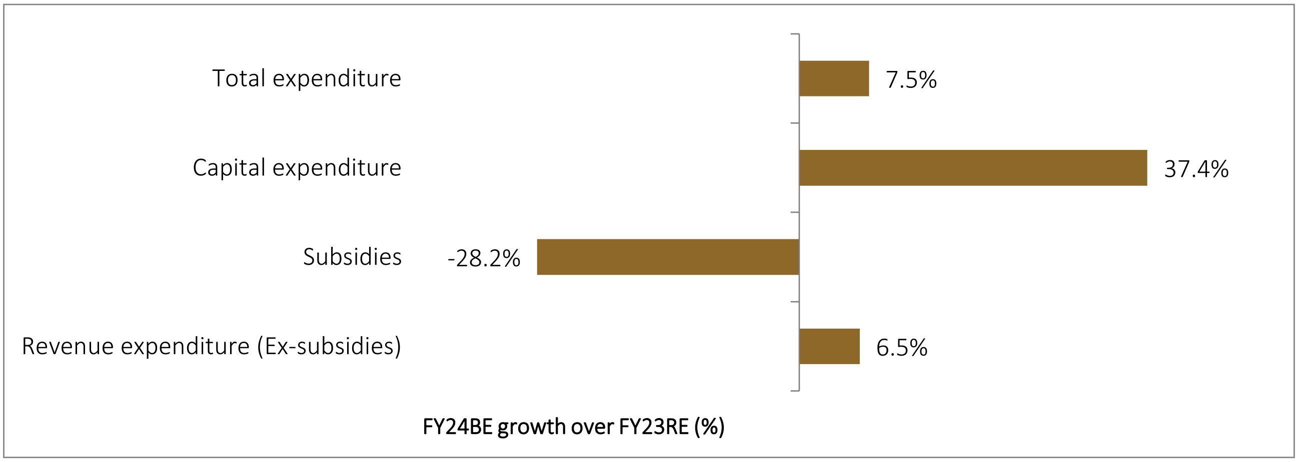
EQUITY OUTLOOK



Source: Ambit Capital Research, Alchemy Capital.

Key Risk: Global Macro

Global macro is an imponderable here. The fiscal maths has been built on a sharp cut in food and fuel subsidies. This is reasonable – there was a one-off spike in FY23 due to global oil and commodity price inflation. If this assumption goes awry, however, the government may have less room to manoeuvre and may need to cut back on the planned capital expenditure to keep the fiscal in check. We shall be monitoring this trend closely.



Source: Ambit Capital Research, Bloomberg, Alchemy Capital

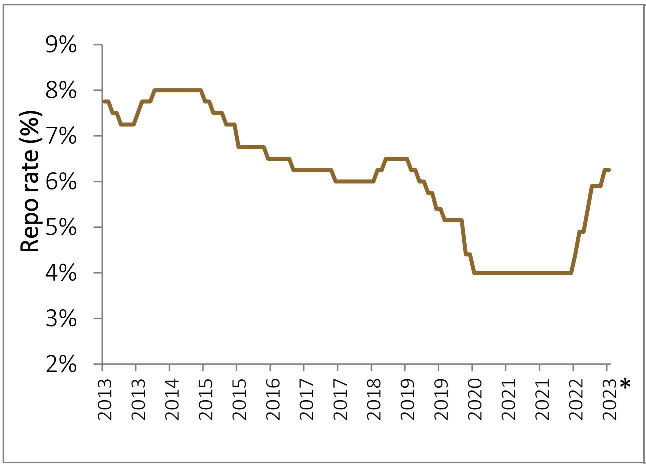
EQUITY OUTLOOK

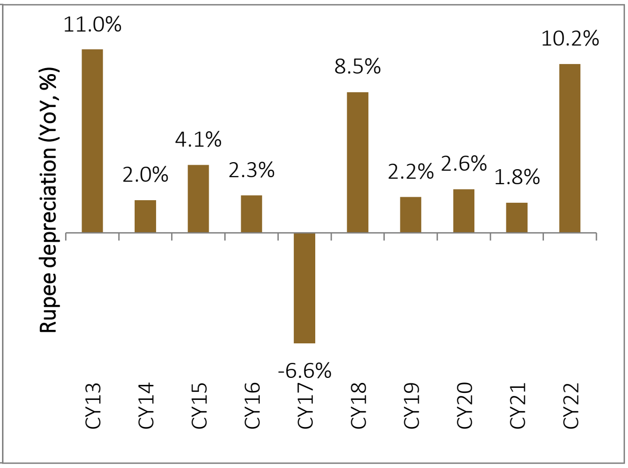
Markets – Stick to Quality

Supportive Macro

Our constructive view on the markets is underpinned by an expectation of a robust macro. Sure, there are near-term growth challenges from a high base effect, slowing global growth, and the withdrawal of excess liquidity. Over the medium term, however, we believe multiple tailwinds will propel growth to a sustained, multi-year, 6%+ range.

- Consumption should recover as incomes continue to rise and inflation moderates from the post-pandemic supply shock.
- The capex cycle should recover, helped by both public and private spending. We have already seen anecdotal evidence of this in the order books of capital goods manufacturers and the budget outlay adds further momentum to that trend.
- We see an extended period of financial stability with interest rates topping out at levels that are in the mid-range of the historic range. Moreover, the currency weakness seems to be orderly and is unlikely to cause a major shock. This is helped, of course, by both corporate and consumer balance sheets being largely healthy following the deleveraging of the last 3-4 years.





*Source: Ambit Capital Research, Alchemy Capital. | *Data as on 31 Jan 2023*

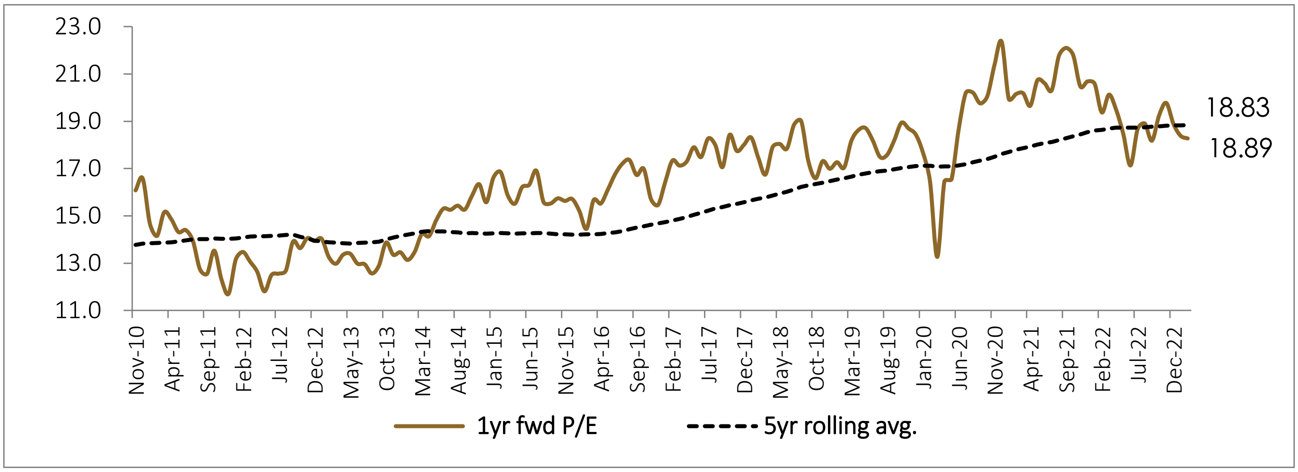
Key Mantra: Growth

We continue to focus on high-growth companies as our core investment thesis. The value rally of 2022 may not sustain into 2023, in our view – the re-rating seems to be over, and it is difficult to find pockets of egregious undervaluation at this stage. On the other hand, the strong economic cycle is throwing up a broader set of high-growth companies to choose from, with strong balance sheets and high profitability ratios.

Tread Carefully on Valuations

The extended valuations on the broader market, however, make stock-picking more difficult. 2022 was brutal for companies with rich valuations, and many winners from the 2011-2020 decade have been consistent underperformers in the recent past. We continue to use valuation as a filter for high-growth companies and are careful of overpaying. We are not, however, averse to buying high P/E companies as long as growth and cash flows support these valuations.

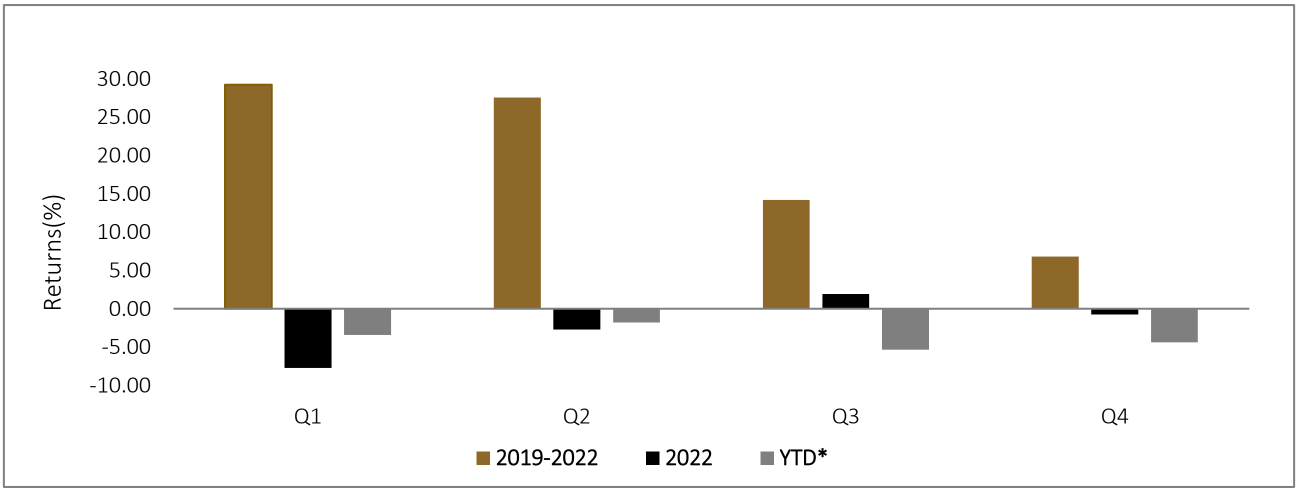
EQUITY OUTLOOK



Source: Ambit Capital Research, Alchemy Capital.
Note: The data is for Nifty 50 Index

Stick to Quality

High-quality companies were laggards in the value rally of 2022. Filters like strong balance sheets, quality management/business models, and robust return ratios did not seem to work last year. We see the tide already turning in 2023 and see quality making a comeback in CY23. We are sharpening our quality filters for our stock-picking and have exited exposures where we see challenges on the business or management front.



Source: Bloomberg, Alchemy Capital.
*Note: We divided the BSE 500 into four quartiles, based on FY22 ROE. The returns mentioned here are the median returns for each quartile for the relevant period. Q1 refers to the top quartile, and so on. | *Data as on 31 Jan 2023.*

EQUITY OUTLOOK

Adani Impact

Final word: We do not see the sell-off in the Adani group stocks triggering a broader contagion in the market. We had stayed away from this group due to our filters on leverage. We also, at this stage, do not see this triggering any sort of crisis in the financial system, as bank exposures are limited to ~1% of net advances, going by the disclosures made so far.

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

Source: Alchemy Capital

MARKET INSIGHTS

Alchemy Capital's 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 - Jan 2023 - YouTube

2. Interviews:

- Mr. Alok Agarwal in an interaction with Moneycontrol: Read the article
- Mr. Hiren Ved in an interaction with Mint: Read the article
- Mr. Seshadri Sen in an interaction with Moneycontrol: Read the article
- Mr. Alok Agarwal in an interaction with The Economic Times: Read the article
- Mr. Seshadri Sen in an interaction with MintGenie: Read the article
- Mr. Hiren Ved in an interaction with CNBC-TV18: Watch the video
- Mr. Seshadri Sen in an interaction with ET Now: Watch the video
- Mr. Hiren Ved in an interaction with ET Now: Watch the video

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ALCHEMY
CAPITAL MANAGEMENT

Q3 FY23 PERFORMANCE OF PORTFOLIO COMPANIES

The following table summarizes the performance of portfolio companies** which have published their results so far in Q3 FY23 :

SCRIP	Sales (Rs Mn)			EBITDA (Rs Mn)			PAT (Rs Mn)		
	Q3FY23	Q3FY22	% chg	Q3FY23	Q3FY22	% chg	Q3FY23	Q3FY22	% chg
HDFC BANK LTD @	3,14,877	2,66,270	18%	1,90,241	1,67,760	13%	1,22,595	1,03,422	19%
PRAJ INDUSTRIES LTD	9,100	5,856	55%	860	510	69%	623	371	68%
MARUTI SUZUKI INDIA LTD	2,78,492	2,21,876	26%	28,331	15,590	82%	23,513	10,113	133%
FEDERAL BANK LTD @	24,905	20,231	23%	12,742	9,143	39%	8,036	5,217	54%
APOLLO TYRES LTD	64,228	57,075	13%	9,134	7,599	20%	2,921	2,235	31%
ASHOK LEYLAND LTD	89,850	55,036	63%	7,773	2,239	247%	3,613	58	6173%
GREAT EASTERN SHIPPING CO LTD	14,210	9,386	51%	7,964	4,103	94%	6,272	2,053	206%
MPHASIS LTD	35,062	31,237	12%	6,175	5,531	12%	4,123	3,577	15%
LTIMINDTREE LTD	86,200	41,376	108%	13,748	8,944	54%	10,007	6,120	64%
TATA ELXSI LTD	8,177	6,354	29%	2,469	2,108	17%	1,947	1,510	29%
ICICI BANK LTD @	2,14,886	1,72,231	25%	1,32,712	1,01,483	31%	83,119	61,938	34%
RELIANCE INDUSTRIES LTD	21,71,640	18,50,270	17%	3,83,940	3,37,530	14%	1,57,920	1,85,490	-15%
SUNDARAM FASTENERS LTD	14,030	12,075	16%	1,963	1,910	3%	1,181	1,100	7%
PERSISTENT SYSTEMS LTD	21,694	14,917	45%	4,016	2,511	60%	2,676	1,764	52%
MAX HEALTHCARE INSTITUTE LTD	14,638	12,899	13%	4,050	3,355	21%	2,688	2,524	6%
DIXON TECHNOLOGIES (INDIA) LTD	24,047	29,528	-19%	1,112	1,182	-6%	519	632	-18%
BAJAJ FINSERV LTD #	74,347	60,005	24%	48,529	39,192	24%	29,730	21,253	40%
TVS MOTOR COMPANY LTD	65,454	57,064	15%	6,589	5,683	16%	3,528	2,883	22%
BLUE DART EXPRESS LTD	13,371	12,548	7%	2,281	2,737	-17%	887	1,234	-28%
SYNGENE INTERNATIONAL LTD	7,859	6,414	23%	2,466	1,835	34%	1,097	1,040	5%
KPIT TECHNOLOGIES LTD	9,171	6,224	47%	1,699	1,150	48%	1,005	700	44%
BAJAJ ELECTRICALS LTD	14,629	13,198	11%	1,017	921	10%	611	482	27%
AXIS BANK LTD @	1,61,248	1,24,929	29%	92,775	61,615	51%	58,531	36,142	62%
AVENUE SUPERMARTS LTD	1,15,691	92,178	26%	9,653	8,665	11%	5,897	5,526	7%
LARSEN & TOUBRO LTD	4,63,897	3,95,629	17%	66,535	59,823	11%	25,529	20,547	24%
BARBEQUE-NATION HOSPITALITY LTD	3,282	2,867	14%	620	657	-6%	73	148	-51%
GREENPANEL INDUSTRIES LTD	4,202	4,244	-1%	920	1,111	-17%	375	631	-41%
UNITED SPIRITS LTD	27,787	29,474	-6%	3,718	5,187	-28%	2,142	2,996	-29%
VARUN BEVERAGES LTD *	22,142	17,343	28%	3,075	2,076	48%	815	326	150%
TATA CONSUMER PRODUCTS LTD	34,746	32,084	8%	4,537	4,617	-2%	3,644	2,901	26%
INDIAN HOTELS COMPANY LTD	16,858	11,112	52%	5,972	3,218	86%	3,827	760	404%
C E INFO SYSTEMS LTD	677	433	56%	279	156	79%	296	185	60%

Bajaj Finserv Ltd. is a conglomerate of diverse businesses (NBFC/insurance) which we value on sum of parts. The results here are of Bajaj Finance, which is the largest subsidiary by value.
@ Sales = NII + Non-interest income + treasury income

Source: Alchemy Capital

** For Alchemy High Growth, Alchemy High Growth Select Stock

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