MONTHLY NEWSLETTER

September 2022

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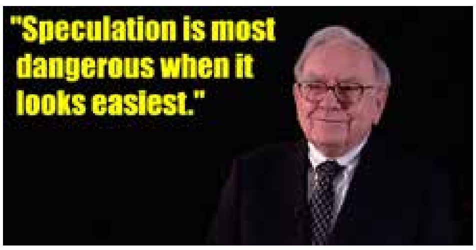
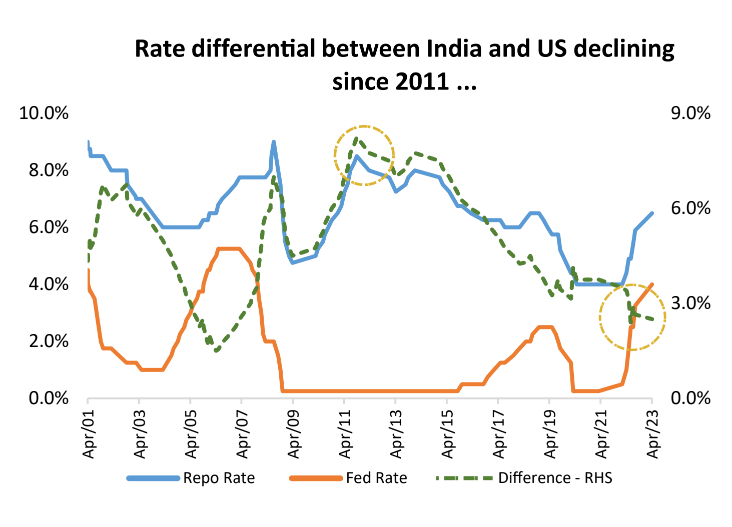


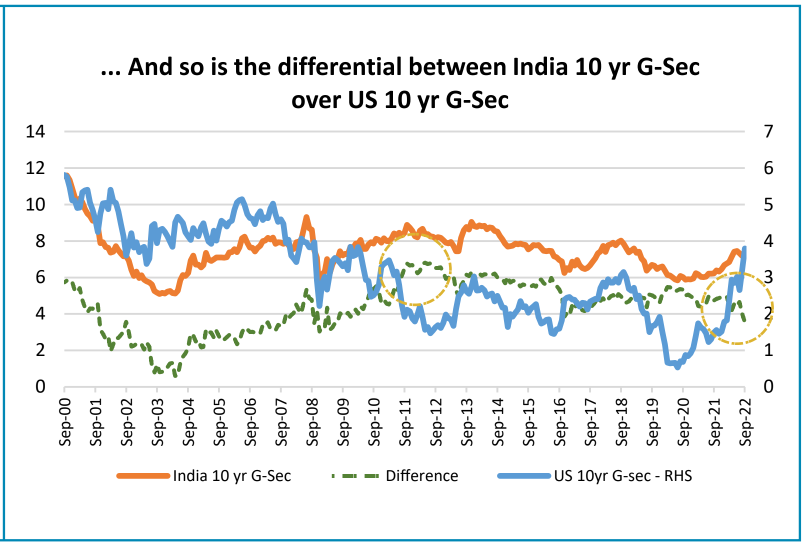
WHAT'S INSIDE

FIGHT AGAINST INFLATION & INTEREST RATES – INDIA V/S U.S.

A lot has been spoken of the rising interest rates this year and where it is headed. In this article, we will compare India v/s US and see how these two countries differ in terms of trajectory, levels and most importantly, the current position that these countries are in. We also take a look at the most important driving force in today's interest rate rise, INFLATION. How are the two countries stacked up in terms of inflation and who is better equipped to handle it? Let's dive in!

US interest rates in an upward trend

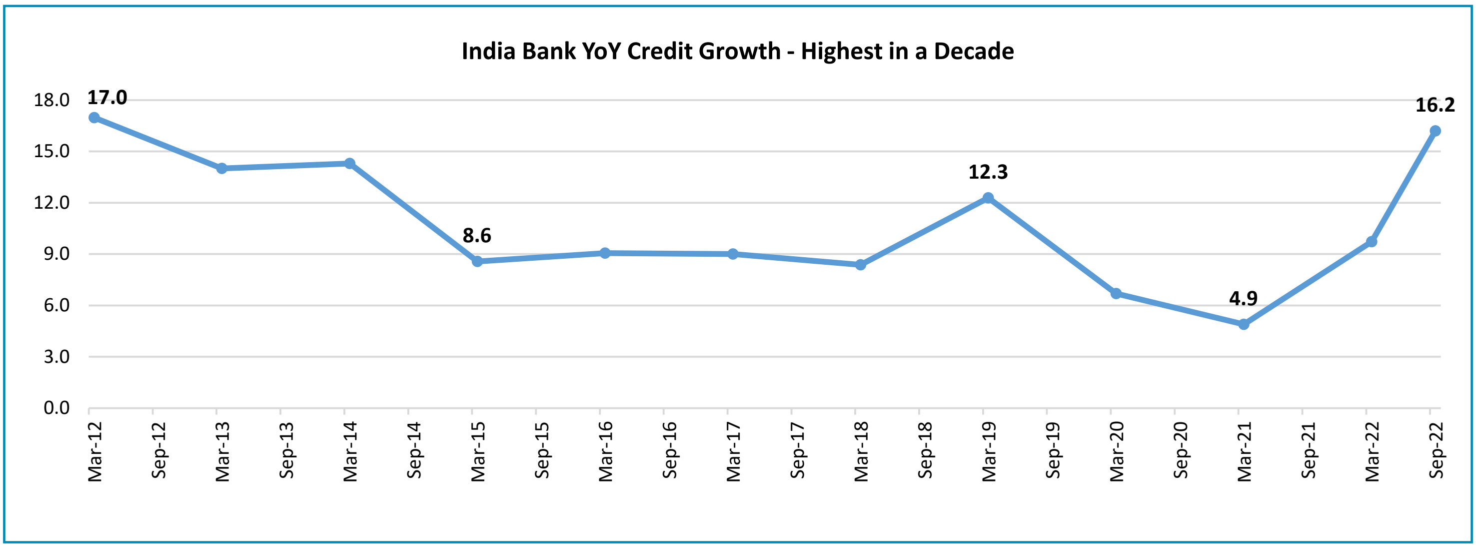




US interest rates have been hiked 300bps cumulatively post pandemic and are now above its previous peak (5yr basis). Fed remains committed to achieving its 2% CPI inflation target (8.2% in Sep '22). Rates are expected to reach 4% and stay there in 2023 before moving down again in 2024 as inflation eases. The US 10yr G-Sec is already pricing in the expectation of future rate hikes.

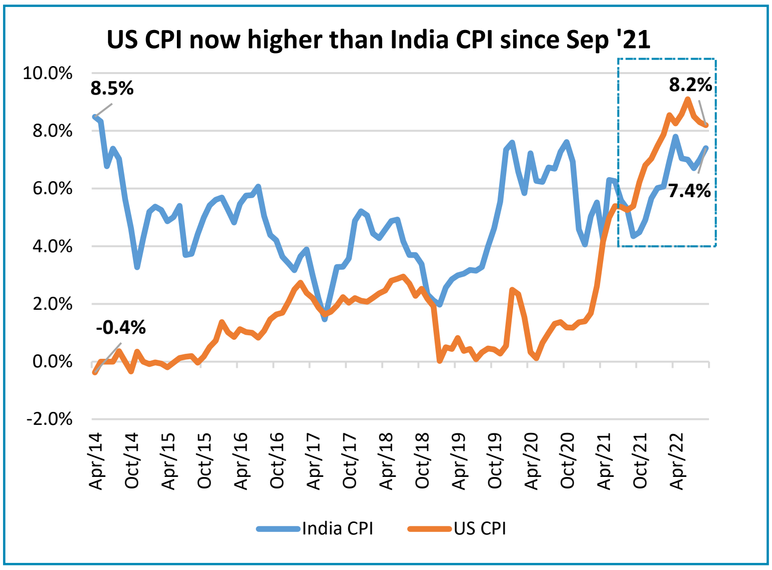
India much better placed

India has hiked repo rate by a cumulative 190bps since the pandemic lows, lower than US' 300bps cumulative hike. India's interest rate is still below its previous peak (5yr basis) at this juncture compared to the US. India has been able to manage its inflation much better led by active Government policy action. India's inflation rate (7.4% in Sep '22) is lower than US (8.2% in Sep '22), contrary to historical trends. Despite the rate hikes, credit growth continues to pick up, clocking 16.2% YoY growth in Sep '22 (a decadal high!)



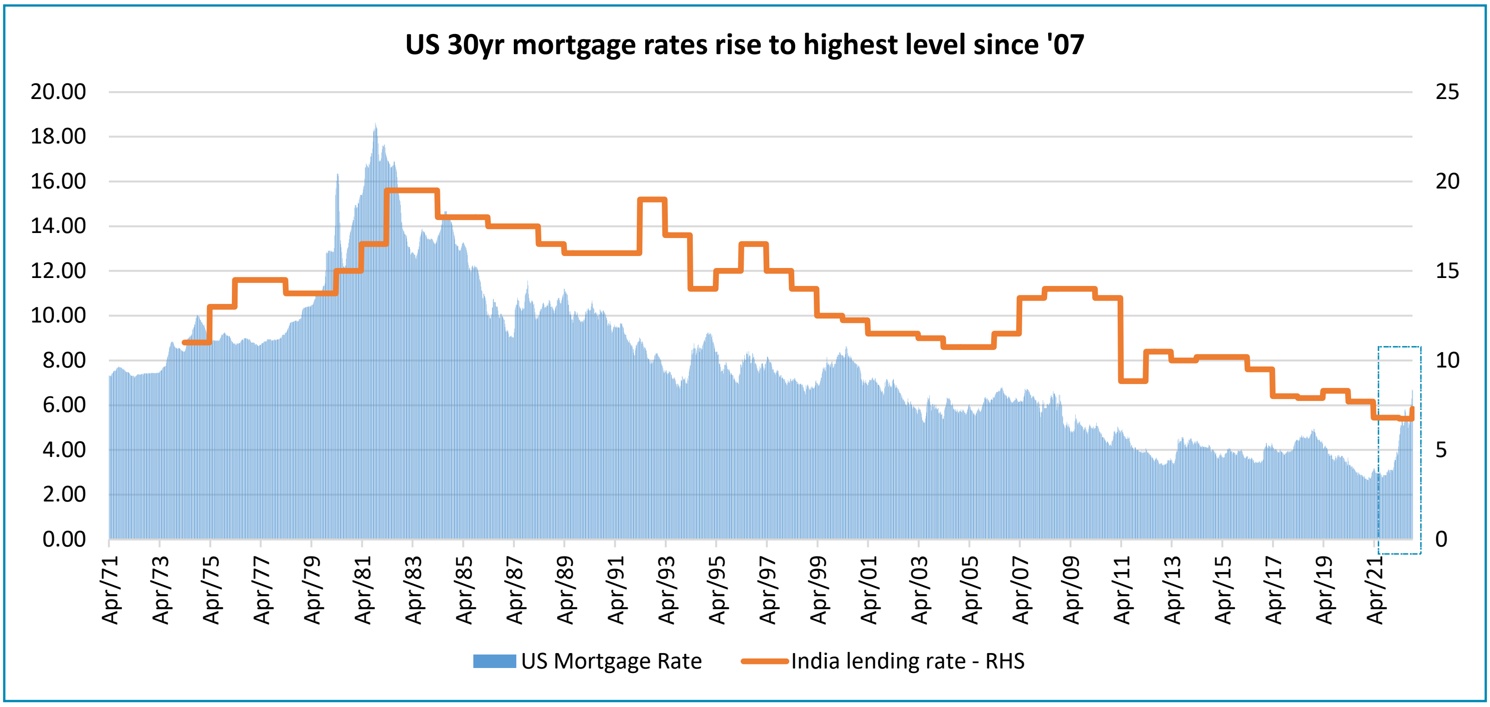
India CPI in relation to US CPI – now v/s 6 year average of FY14-20 – trends have reversed

The US has seen its CPI inflation skyrocket to 8%+ in each of the last 7 months from just 0.1% somewhere at the start of the pandemic (May '20). US CPI over the past 6 years prior to the pandemic (FY14-20) was also pretty low and manageable, averaging 1.1%. The current 8%+ levels are also much higher than the Fed's inflation target of 2%. This gives us a sense of the gravity of the situation and the need for the Fed's action in terms of the swift rate hikes. India on the other hand, has managed its inflation quite well. The lowest point of India's CPI inflation in the pandemic era stood at 4% (Jan '21), which is currently hovering at ~7%. The gap between India's current inflation (7%) and the 6 year average (4.5%) is also not very high, compared to that of the US. Additionally, the RBI's inflation target on the upper end is 6%, making it not such a daunting task to bring down the inflation within the targeted range. In fact, RBI estimates India's inflation to lower to 5.8% by Q4FY23.



Lending rates, fast rising in the US

Another comparison we make is the lending rates between India and US. We stack up the 30yr fixed mortgage rates in the US with the lending rates in India. While both have seen a structural decline since the early 80's, US 30yr mortgage rates have almost doubled since the start of CY22, and are at the highest level since 2007. In comparison, our lending rates are not at alarming levels.



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India is the bright spot on the dark global horizon: IMF MD Kristalina Georgieva

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Synopsis
"India deserves to be called a bright spot on this otherwise dark horizon because it has been a fast-growing economy, even during these difficult times, but most importantly, this growth is underpinned by structural reforms," Georgieva said.

In its latest report released in Oct '22, IMF has also highlighted India as a standout economy amongst the gloom and doom surrounding the global economy. India's growth is underpinned by its structural reforms, the IMF said.

Conclusion

India's interest rate trajectory has seen a more measured rise when compared to the US. Even when compared on a 5yr basis, India is yet to breach the interest rate peak whereas US is already past its 5yr peak. India's underlying economy is exhibiting immense strength and ready for take-off, reflective in the bank credit growth at a decadal high, undeterred by the rising interest rates. The IMF in its latest report also hails India as being a bright spot in the global doom. India has also managed its inflation way better than the US and is well equipped to contain it within RBI's set limits. US on the other hand has a long way to go before it tames inflation. The lending rate comparison also puts India ahead of the US. The US have seen its US 30yr mortgage rates doubling and reaching highest levels since '07, whereas India's lending rates are not at alarming levels.

Q2 FY23 TREND SO FAR

HDFC BANK	• **Deposits grew 19% yoy** in Q2FY23 and **Loans and advances grew 23.5% yoy. CASA ratio was at 45% vs 46.8% yoy.**
TITAN COMPANY	• **Sales grew 18% yoy (3-year CAGR: 24%) in Q2FY23.** Jewellery business grew 18% yoy (3-year CAGR: 27%). Watches & wearables and EyeCare division grew 20% and 7% yoy respectively. **Outlook for festive season (from Navratri in end Sep'22) continues to be optimistic.**
APL APOLLO	• **APL Apollo Tubes reported highest ever quarterly volumes in Q2FY23 i.e. ~0.6 mn tons.** Volumes were up ~41% yoy and ~42% qoq.
Dabur	• **Revenue to grow at mid-single digit. Operating margin expected to be lower by ~150-200 bps yoy** due to input cost pressure but will see qoq improvement.
DMart	• **Revenue grew 36% yoy and at a 3-year CAGR of 20% in Q2FY23.** It added 8 stores taking the total to 302 stores.
BAJAJ FINANCE LIMITED	• **Consolidated AUM grew by a strong 31% yoy, 7% qoq.** Customer franchise addition was up 19%.
AU SMALL FINANCE BANK	• **Advances grew by robust 42.5% yoy, however 6% qoq growth weak.** Deposits grew robust 49% yoy with **CASA ratio improved to 42% vs 39% qoq and 30% yoy. Collection efficiency impressive** with monthly collection efficiency for Aug- Oct between 105-110%.
LODHA	• **Reported best ever Q2 sales.** It added 4 new projects with ~2.2 msf saleable area with GDV of ~Rs.3,100 crs.
TATA STEEL	• **Domestic volumes in Q2FY23 recovered well on sequential basis (higher 21% qoq)** mainly driven by strong revival in auto segment. Europe volumes were down 12% qoq due to seasonal factors.
IndusInd Bank	• **Healthy growth in advances (+18% yoy and 5% qoq) and deposits (+15% yoy and 4% qoq) with stable CASA Ratio.**
FEDERAL BANK	• **Advances growth picked up well to 19% yoy** (ahead of industry growth of 16%), **deposit growth was weak at** 10% yoy. **CASA ratio dropped 40bps qoq to 36.4%** after rising for multiple quarters.
IDFC FIRST Bank	• **Strong yoy growth of 25% in advances and 36% in deposits. CASA Ratio healthy at 51.3%.**

AUTO H1 FY23 TRENDS

Particulars (In Units)	Sep-22	Sep-21	YoY (%)	H1FY23	H1FY22	YoY (%)
Two-Wheeler	**1,015,702**	**931,654**	**9%**	**6,695,468**	**5,236,360**	**28%**
Hero Moto Corp	250,246	278,630	**-10%**	2,855,244	2,463,112	**16%**
Bajaj Auto	105,914	118,918	**-11%**	1,892,324	1,929,220	**-2%**
Three-Wheeler	**63,915**	**37,172**	**72%**	**393,000**	**353,000**	**11%**
Bajaj Auto 3W	19,474	13,849	**41%**	217,660	221,201	**-2%**
M&M	5,008	2,981	**68%**	24,814	10,785	**130%**
Passenger Vehicle	**260,556**	**237,502**	**10%**	**1,573,391**	**1,228,175**	**28%**
Maruti India	176,014	86,380	**104%**	985,000	733,135	**34%**
Tata Motors	36,435	23,866	**53%**	190,353	74,490	**156%**
Tractors	**52,595**	**53,392**	**-1%**	**514,000**	**451,000**	**14%**
Escorts	12,232	8,816	**39%**	50,500	47,008	**7%**
M&M (Tractors)	48,713	40,331	**21%**	212,049	188,849	**12%**
Commercial Vehicle	**71,233**	**59,927**	**19%**	**503,000**	**311,000**	**62%**
Tata Motors	28,615	24,822	**15%**	202,562	137,032	**48%**
Ashok Leyland	11,284	8,476	**33%**	82,797	45,530	**82%**
Volvo Eicher	4,638	3,808	**22%**	34,092	20,940	**63%**

Source: Company Data, Vahaan, FADA and Equentis Research

Key takeaways

- In H1FY23, it was a strong show across segments, wherein personal mobility showcased steady growth and CVs prospered.
- India's mobility data continues to lead both on transit mobility and workplace mobility with offices, schools reaching normalcy.
- In FY22 the auto industry went through multiple headwinds such as chip shortage issues, rising RM costs and weak demand in rural areas of India hence the H1FY22 numbers remained impacted.
- In H1FY23 3W Industry witnessed a tactical shift from ICE to EV; around ~45% 3W market is driven by EVs.
- PV's continues to see high demand and long waiting period (Avg waiting period ~6-10 months), But as on September-22 the semi-conductor chip issues has seen some softening, volumes have improved on Month on Month (MoM) basis and the same momentum is expected to continue in the near term.
- CV's continue to grow in high double digit due to strong demand in passenger and cargo segments.

OEM Wise Market share trends: According to the FADA's September'22 press release, 1) In PV segment, market share losses for Maruti Suzuki continued(268bps YoY to ~39.88%), while M&M (up 115bps YoY to ~8.58%) and Tata Motors (up 237bps YoY to ~13.98%) were the beneficiaries led by their new product successes. 2) In 2W space, Hero Motocorp continues to lose market share for the third consecutive time to a decadal low of 31.8% in overall domestic 2Ws, while Bajaj Auto lost 188bps to reach sub-10% market share. 3) In EVs, Tata Motors' share stood at 85% in PVs with MG Motors at ~9% share; Okinawa/Ola Electric led the 2W EV space at 8.3k/9.6k, respectively, at 35% combined share, taking market share from Hero Electric at ~16%; 4) tractor segment witnessed TAFE gaining share (up 64bps YoY to ~12.67%) at the expense of John Deere (down 37bps YoY to ~8.11%) with M&M still maintaining its ~40% share YoY.

Festive season trend (Navratri Auto retail numbers): For the first time, FADA has released Navratri Auto Retail figures. Overall retails increased by a massive 57% compared to Navratri'21. All categories also showed extremely high growth with 2W, 3W, CV, PV and Tractors increasing by 52%, 115%, 48%, 70% and 58% respectively. The overall numbers were higher than ~Navratri-19 numbers which clearly shows that Auto sector is seeing decent recovery and the volumes were higher by ~16% of pre-covid levels.

New launches in H1FY23: As the domestic Automobile industry witnessed strong recovery, OEMS are back in the market with the new launches. In H1FY23 we saw multiple new launches from the OEMs in order to capture the market share and meet the consumer demands. We would like to highlight some of the new launches by the OEMs.

PVs

Mahindra Scorpio N

MSIL Grand Vitara

Tata Tiago EV

2Ws

Ather Energy Gen-3

Hero Vida V1

Conclusion

Domestic Automobile sector is witnessing steady recovery, with re-opening of educational institutions, offices and strong on-going festive season and the demand for 2Ws expected to improve in the near term. Apart from this, huge pending order book with PV OEMs and easing of semi-conductor chip shortage will provide strong volume numbers for upcoming quarters. The EV space is gaining a lot of popularity and has also become quite attractive for commercial businesses engaged in last-mile delivery and ride sharing. Elevated fuel costs and rising ownership cost of ICE vehicles will lead to push Electric vehicles going forward. We continue to remain positive on Auto Industry and believe industry could show cyclical upturn.

FOOD FOR THOUGHT

HOW TO AVOID VALUE TRAPS

Excited about discovering a share with low PE or book value multiples? Then beware, it could be a value trap. Value investing is popular, but it can also lead to value traps. Low price is different from excellent value stocks. Investors who pursue only stock prices irrespective of the underlying factors will likely fall into a value trap.

What Is a Value Trap?

A value trap is a stock or asset that seems to be cheaper as it has been trading at low P/E (low price to earnings), P/CF (price to cash flow) or P/B (price to book value) for a long time. They are companies that seem to be undervalued, but their stock prices aren't likely to increase. Many times, these companies are in declining industries or have poor fundamentals. Value traps can be challenging to spot, but due diligence can help to avoid them. If one takes the time to understand a company and its business, one can protect themselves from these risky investments.

Here are 5 indicators to avoid value traps

Management rarely keeps its promises

Every company's management declares its short-and-long-term goals. However, they often fail to live up to their promises. Over-promising and under-delivering are key indicators that the investment is a value trap. So, how does one avoid it? One can review annual reports and promoter interviews and look for business goals and achievements. If they are lagging, then there is a problem. Look for businesses that under-promise and over-deliver. For instance, the management of Suzlon kept promising a better future for its shareholders, who had been losing money for more than a decade when the stock's CAGR returns were negative 7-10% over 5-10 years. In the recent period, the stock price has improved as the company has emerged from a debt restructuring exercise two years back. Jaiprakash Associates is another example which failed to deliver on its promises, and the stock has performed poorly i.e. negative CAGR of 15-20% in the last 5-10 years.

Cash flows aren't keeping pace with earnings or earnings growth is sub-optimal

A value trap could also be a company whose cash flow isn't in line with its earnings or is suffering from sub-optimal earnings growth. It can mean the company is not generating enough cash to fund its operations and growth. As a result, it may eventually resort to selling-off assets, taking on debt to stay afloat, or consistently raising capital through equity offerings.

For example, in the case of Bosch Ltd, the growth in OCF/FCF during the last 10 years is far lower than the PAT growth, which in itself is just 1% resulting in a stock price CAGR of just 6% . Incidentally, the CAGR over last 5 years has been -5%. Other examples include NTPC and Glaxosmithkline Pharmaceuticals, where the CAGR stock returns range between 2-4% in the past 10 years. In comparison, Nifty 50 has delivered a CAGR growth of approximately 12% over the past 5 and 10 years.

Inefficient capital allocation

Another crucial indicator of a value trap is inefficient capital allocation. It means that the company is not using its capital in a way that will generate shareholder value. For example, a company may allocate funds towards unrelated diversification or non-core businesses. This is unhealthy for Return On Capital Employed (ROCE). During the last couple of decades, multiple instances were observed where businesses experimented with unrelated diversification and struggled. Unitech (a real estate firm) forayed into telecom. Over time, it was saddled with debt and had to sell its entire stake to Telenor. LIC Housing Finance had lent as high as 7% of its overall loans to the project loan segment, wherein other better-managed HFCs have kept this at sub 1%. The resulting impact has seen GNPA in the project loan segment swell to an extremely high level of 35%, leading to low profitability and, consequently 5 years stock price CAGR of -8% and 10-year CAGR of just 5%. A few other examples include Vedanta Ltd and Tata Motors, where the CAGR returns delivered were in the range of -3% to +5% in last 5-10-years period.

Over-dependence on a specific product or market cycles

Over-dependence on a particular product or market cycle is one of the most significant signs of a value trap. If a company relies too heavily on one product or market to stay afloat, it may run into trouble in the future if the demand for that product begins stagnating or falling. As a result, it can lead to financial problems and even bankruptcy. Castrol for example heavily relied on a single product which resulted in the negative stock returns in the past 10 years (-9% CAGR).

Over-dependence on market cycles can also mean a decline in a company's business as the cycles are constantly changing. Coal India is a good example, which hasn't performed over the long term yielding negative 5% CAGR returns to its investors. An industry that was once booming could eventually become stagnant. Interestingly, P/E ratio of cyclical stocks may be low at the peak of their cycle thanks to their historical growth rate and hence seem undervalued. Therefore, an investor may also have to check for the PEG ratio.

Falling market share

Falling market share is one of the chief indicators of a value trap. If a company loses market share to its competitors, it may be in trouble as its consumers could be moving away. Falling market share and declining sales margins can also signify that a company is losing its competitive edge. For instance, Symphony has been consistently experiencing a decline in its market share which has also adversely impacted its share price performance in the last five years (-8%) even though the 10 year CAGR still looks reasonable at 15%. Hero MotoCorp, is an example of a low industry growth rate coupled with the emergence of new brands giving a dent to market share resulting in only 4% CAGR in 10 years and -7% CAGR in last 5 years.

Conclusion

There are a few ways to avoid value traps. First, research the company thoroughly before investing. Understand the industry it is in and its competitive landscape. Next, look at the financials and make sure they are strong. The historical performance of a seemingly value opportunity or its industry peers or other names displaying similar attributes in the past but turning out to be duds should give enough confidence of which way this one could turn out to be. Also, pay attention to what the key management personnel are doing. If they are selling their shares without any apparent reason, it may be a sign that the company is not as healthy as it appears.

Disclaimer: Stocks mentioned here are just for educational purposes and should not be construed as recommendations

WHAT CAUGHT OUR ATTENTION THIS MONTH !

India's corporate credit quality continues to be strong: CRISIL

As per CRISIL Ratings, corporate credit ratio (upgrades vs downgrades) continues to be high - at 5.52 times in the first half of this fiscal (H1-FY23) - underscoring ongoing broad-based improvement in India Inc's credit quality.

The credit ratio was 5.04 times in the second half of last fiscal (H2-FY22).

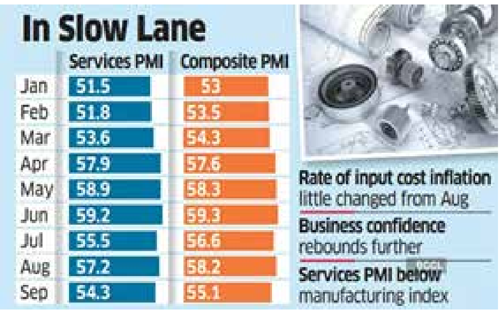
The rating agency highlighted the three reasons that stand out which are strengthening domestic demand, with the economy expected to grow 7.3% this fiscal, higher realisations leading to better cash flows, and continuation of debt-light balance sheets as capex remains low.

Consumer spending in India expected to be high this festive season

Consumers have expressed a strong desire to buy more discretionary products during the festive season, according to Deloitte's Global State of Consumer Tracker

The survey findings clearly indicate that consumers plan to increase their discretionary spend by 30% (on items such as recreation and entertainment, restaurants, and leisure travel) in August 2022, compared with April 2022

Despite concerns over inflation, the planned spending over the next four weeks will see spike across age groups in all categories.



Services sector growth hit 6-month low in September

The S&P Global India services Purchasing Managers' Index fell to 54.3 in September from August's 57.2.

The upturn was reportedly restricted by price pressures, an increasingly competitive environment and unfavourable public policies

The Indian service sector has overcome many adversities in recent months, with the latest PMI data continuing to show a strong performance despite some loss of growth momentum in September.

India's current account deficit widens to 2.8% of GDP in Q1FY23: RBI

India's CAD, an indicator of the balance of payment position, in the first quarter of the fiscal widened to 2.8%of GDP at USD 23.9 bn, mainly on account of a higher trade deficit.

The CAD stood at $13.4 bn, or 1.5% of GDP, in the preceding January-March quarter, while there had been a surplus of $6.6 bn, or 0.9% of GDP, in Q1FY22.

Underlying the CAD in Q1:2022-23 was the widening of the merchandise trade deficit to USD 68.6 bn from USD 54.5 bn in Q4:2021-22 and an increase in net outgo of investment income payments.

RBI hikes repo rate by 50 bps to 5.9%; pegs GDP growth at 7%

The RBI raised benchmark lending rates for the 4th straight time in a row, in a bid to tame the soaring inflation.

Owing to slowing economic growth, debt mounting and sharp currency depreciation, GDP growth forecast for the current financial year (FY23) was slashed to 7% from 7.2%.

India: 'Make in India' completes 8 years, FY23 FDI to cross $100 billion, says govt

The government said that the 'Make in India' initiate to boost manufacturing in the country completes eight years on September 25 with annual foreign direct investment (FDI) doubling to $83 billion

Also, on the back of economic reforms and ease of doing Business in recent years, India is on track to attract $100 billion FDI in the current fiscal.

"Make In India" has substantial accomplishments across 27 sectors, these include strategic sectors of manufacturing and services as well.

Direct tax collection grows 24 per cent to Rs 8.98 lakh crore till Oct 8

The gross collection of taxes on corporate earnings rose 16.74% during April 1 to October 8, while personal income tax collection jumped 32.30%.

After adjusting refunds, direct tax collection stood at Rs 7.45 lakh crore, 16.3% higher than the net collection for the corresponding period a year ago.

This collection is 52.46% of the total Budget Estimates of Direct Taxes for FY 2022-23.

World Bank slashes India's economic growth forecast to 6.5% for FY23

The World Bank slashed India's real GDP growth forecast for 2022-23 to 6.5% from 7.5% it had projected in June and cautioned that spillovers from Russia's invasion of Ukraine and global monetary tightening will weigh on its economic outlook.

In its report on South Asia, private investment growth is likely to be dampened by heightened uncertainty and higher financing costs, while slowing global demand will impact India's exports.

It, however, said India is recovering stronger than the rest of the world.

India's bonds will have to wait longer for global index inclusion

India will have to wait to access $40 billion that would potentially have come into its bond market as the much-awaited inclusion in global bond indices was pushed back, after JPMorgan retained the country's bonds on its watch list.

Indian government bonds return more than 6% annually, which tops that of most advanced economies and beats even some emerging market peers.

That doesn't seem to have cut much ice with JPMorgan index managers as issues regarding taxation and settlements remain unresolved.

IMF Cuts Global Growth, Says "For Many, 2023 Will Feel Like a Recession"

IMF predicts global growth will slow to 2.7% next year, 0.2 percentage point lower than its July forecast, and anticipates 2023 will feel like a recession for millions around the world.

Aside from the global financial crisis and the peak of the Covid-19 pandemic, this is "the weakest growth profile since 2001"

More than a third of the global economy will see two consecutive quarters of negative growth, while the three largest economies - the United States, the European Union and China - will continue to slow, as per report.

China's Chip Industry Set For "Deep Pain" From U.S. Export Controls

US has introduced a sweeping set of export controls that will make it much more difficult for Chinese companies to develop cutting-edge technologies, especially semiconductors

As per the new rules, US companies will be barred from exporting critical chip-manufacturing tools to China and also forbid US citizens and companies from providing direct or indirect support to Chinese companies involved in advanced chip-making.

The new rules are toughest action taken by the Biden administration and can be seen as a watershed of sorts since the goal of the effort is not just to stay ahead of China, but also to degrade Chinese efforts to catch up with US.

German inflation hits highest level in more than 70 years

Germany's annual rate of inflation accelerated again in September, beating forecasts and posting the highest reading since December 1951, according to preliminary data released by German statistics office Destatis.

The consumer price index rose 10.0% in the year to September.

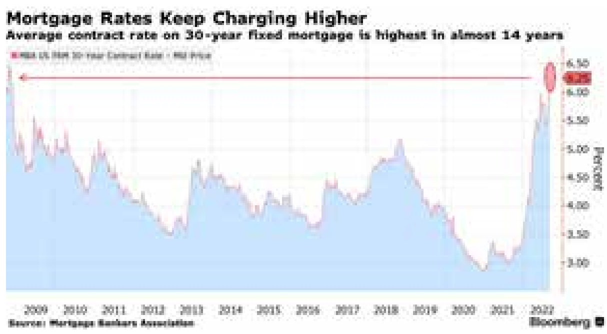
Since Russia's invasion of Ukraine, energy prices have markedly increased and have had a considerable impact on the high rate of inflation, also higher supply-chain problems and significant price increases as the economic recovery got underway are other factors pushing inflation higher.

US mortgage interest rates hit 6.25 % mark, highest since 2008

The highly interest-rate-sensitive housing sector in the US has been hugely impacted by the rising mortgage rates as the Fed made an aggressive move to bring down the high inflation by lifting borrowing costs.

The National Association of Realtors reported that U.S. existing home sales have been dropping for seven months.

U.S. has experienced a significant imbalance in the housing market, which was once "red hot." A better realignment is needed between supply and demand, for which the housing market would have to go through a correction to get back.



THANK YOU

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