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STRATEGY INSIGHT | **September 05, 2022**

Changing our lens and direction

We relaunch G&C portfolio after a hiatus of three years. Since 28 Feb-22, our outlook was negative with Nifty fair valuation of 14.6-15.1K by Sep-22. Market has rebounded after reaching closer and now with the worst of macro behind we no more foresee massive downside! Our greed & fear indicator shows moderation in fear. We shift focus to next year; our EYBY model predicts Sep-23 Nifty of 18700, an upside albeit nominal. The market structure appears favourable and massive FII outflows in all likelihood are behind. Supply-side disruptions are receding and perhaps margins have bottomed out. In our G&C portfolio, we play real yield expansion through banks. We are OW on Auto focusing on upturn in CV cycle and UW on O&G (SELLers on Reliance) and FMCG. Other OW are Media, Healthcare and Metals given favorable business-valuation combination; still underweight on IT & Cement. Our preference remains large-caps (75% allocation). There's high likelihood of market oscillations given risks of acceleration in earnings downgrade cycle, liquidity contraction and uncertain demand.

We estimate a Nifty fair value 18700 by Sep-23

With Sep-23 earnings estimate at INR880, 10-year yield at 7.3% and market trading at -2.6 EYBY Gap (LTA), the implied Nifty sustainable level is 18700. Upside to our target is possible if yields sustain at lower levels, Sep-23 earnings are higher than expectations, and Nifty trades at a higher EYBY Gap than LTA.

Psychological factors: FII flows & market structure appear favorable

Our analysis of FII flows over the last 2 decades, showing FII outflows occur before the start of the rate hike cycle anticipating hikes and FII inflows 6M/12M into the cycle, have been positive in each instance. We also note that after the worst 20 episodes of FII monthly outflows over the last 2 decades, the selling abates and market has closed higher 18/20 times over the next 1 year. All these findings suggest the likelihood of this nascent trend of FII inflows would persist. Our analysis of market structure based on RSI/BB/200dma/AD of the Nifty index over the last 2 decades suggests that "prices are likely to be higher over the next 12 months" with a target of 18500-19000.

Things to watch out for

Supply-side disruptions have eased and margins have likely bottomed out. But, we should watch for acceleration in the earnings downgrade cycle, especially in BFSI, which is a key contributor to FY23 EPS growth. The demand situation on the rural side remains a key monitorable, whereas liquidity contraction can also weigh on market returns.

G&C portfolio positioning

We are OW on BFSI that appears immune to the earnings downgrade cycle, and banks are likely to do well as real yield increases. PVGO framework, how much growth contributes towards the enterprise value, plays an important role in stock selection along with forensic score and greatness score in line with previous G&C portfolios. We are OW on Auto, Healthcare, Media and Metals, and UW on Cement, IT, O&G and FMCG. Our equity allocation towards large-caps/midcaps/small-caps is 75%/22%/3%. Cash allocation stands at 8%.

Exhibit A: G&C 18.0

Company	Mcap (US$ mn)
Attractive valuations*	
Bharti Airtel	52,888
Godrej Consumer	11,722
Indraprastha Gas	3,665
Info Edge	6,866
ITC	50,132
Oil India	2,589
TVS Motors	6,101
Tata Motors	20,661
Moderate/Rich valuations	
Amber Enterprises	950
Ashok Leyland	6,014
Axis Bank	28,846
Bajaj Finance	54,495
Dr Reddy's	8,730
Federal Bank	3,151
HCL Tech	31,404
HDFC Life Insurance	15,207
ICICI Bank	76,042
ICICI Lombard	7,740
Laurus Labs	3,828
LIC Housing Finance	2,879
PB Fintech	2,719
SBI Cards	11,012
SRF	9,660
Tata Steel	16,130
Tech Mahindra	12,866
VIP Industries	1,047

Source: Ambit Capital research, Bloomberg
*Attractive valuations as per "present value of growth opportunity" valuation framework

Research Analysts

Bharat Arora
+91 22 6623 3278
bharat.arora@ambit.co

Nitin Bhasin
+91 22 6623 3241
nitin.bhasin@ambit.co

Viraj Dhandhukiya
+91 22 6623 3149
viraj.dhandhukiya@ambit.co

Ambit Research team
ambitresearch@ambit.co

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Nifty: Become positive, 18700 by Sep-23

Surprise to upside probable

We have been sellers on Nifty with target of 14600-15100 from Feb-22, and Nifty touched 15182. We change our stance as we see crisis factors coming off and we move our targets one-year forward. Our Greed & Fear Indicator shows a strong moderation in fear. Our EYBY Gap model with 7.3% rate (bull flattening of OIS curve) for Sep-23 and Nifty EPS of INR880 (consensus EPS stands at INR915) predicts 18700 levels for Nifty. The psychological factor also appears supportive with FII outflows possibly coming to end, a factor which controls the Nifty direction. Over 2000-22, FII outflows have always occurred in anticipation of rate hikes but have been positive over the next 12 months in rate hike cycles. Lastly, over the last 2 decades, the worst 20 monthly episodes of FII outflows have often signaled an end of "FII selling" and the market has closed up 18/20 times higher. Nifty constituents RSI, BB, advance-decline ratio, and %200 DMA indicate the market hit an oversold zone and empirical evidence over the last 2 decades indicates "markets are likely to trend higher". The global supply chain pressure index has moderated and margin seems to have bottomed out. The FY23 earnings cut trajectory also appears reasonable as compared to the decade.

EYBY Framework: At 7.3% yield, 880 Sep-23 EPS

EYBY gap measures the attractiveness of equities w.r.t bonds by comparing the earnings yield with the bond yield. The higher the earnings yield as compared to the bond yield (higher gap), the better the subsequent returns and vice-versa. In our note dated 28th Feb-22 "EYBY: The Gap that maps returns" and "EYBY: Addressing your pertinent queries", we asserted that:

- EYBY Gap is a better predictor of returns as compared to price multiples (P/E, P/B, and P/S).
- If the G-sec yield crosses 7.5%, the Nifty can touch 14600-15100 in CY22. Nifty touched 15182.

Our thinking is that the worst of macro is behind us, the economy has been resilient amidst the rate hike cycle, the crisis has been averted and it's time to shift from the near-term targets to the EYBY model-based Sep-23 fair value, especially when OIS curve signal potential rate cuts ahead once RBI is done with the rate hike cycle.

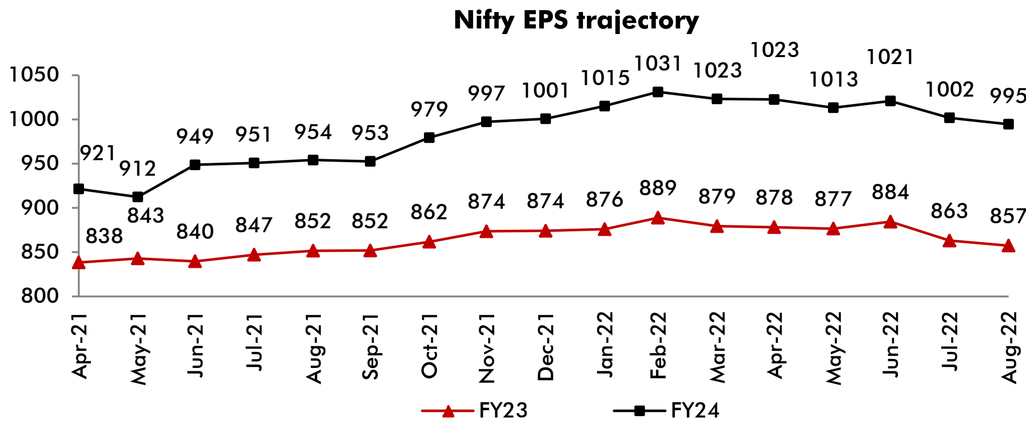
Mathematically, the earnings yield bond yield gap can be shown as:

EYBY Gap = (Earnings/Price)- Bond yield

To work out the EYBY Gap implied fair value, three inputs are required:

- **Earnings yield bond gap**: We take the long-term average (-2.6) as the input. The premise is that as earnings growth normalizes in FY23 from a deflated FY16-21 period (6.9% EPS CAGR), the inflated multiples can normalize and hence choosing LTA looks reasonable.
- **Earnings**: The consensus earnings for Nifty FY23 and FY24 currently stand at INR857/994. For Sep-23, the consensus earnings estimate approximates to INR915. We take the base case scenario of INR880 accounting for potential cuts over the next 12 months. BFSI is the biggest contributor to EPS growth and any hiccups there can alter the EPS trajectory materially. The Nifty EPS trajectory has finally begun to taper and we expect some more moderation. But with improving sentiment, inflation expectations and cooling of commodity costs, we expect it to remain one of the best in the decade.

Exhibit 1: Nifty EPS trajectory has begun to taper, but remains one of the best in the decade

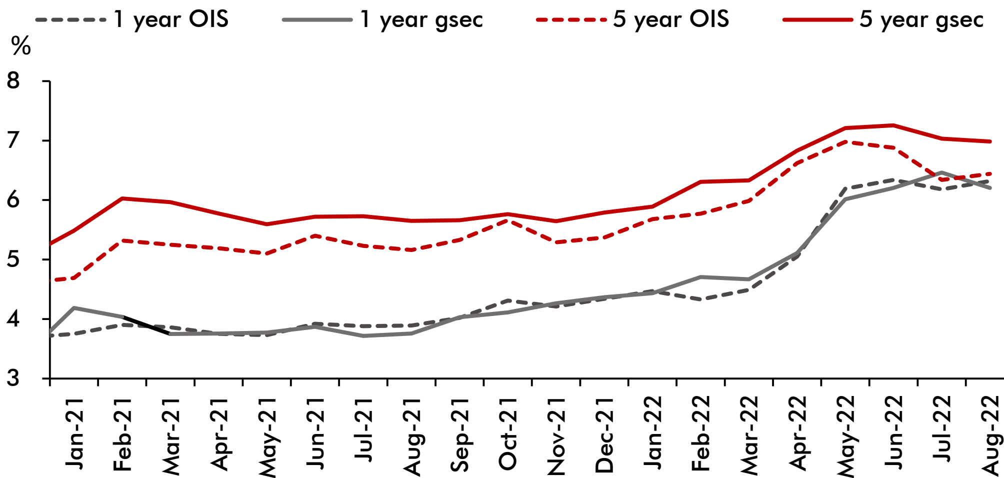


Source: Ambit Capital Research, Bloomberg

- **Bond yield**: The bull flattening of the OIS curve is supportive of higher stock prices. Also, with normalization of the spread between repo and 10-year yield over the next 12 months we believe bond yields can stay put at 7.3%.

The bull flattening of the OIS curve since mid-June suggests that the market is betting that RBI would cut rates faster once it is done with the rate hike cycle. This might look surprising, but notice the rise of the OIS curve since CY22 beginning – the OIS curve was indicating* front loading of repo hikes. Likewise, notice the fall in the 5-year OIS rate vs the 1-year OIS rate, indicating faster rate cuts ahead once RBI is done with the rate hike cycle! Perhaps they are also indicating that inflation has peaked!

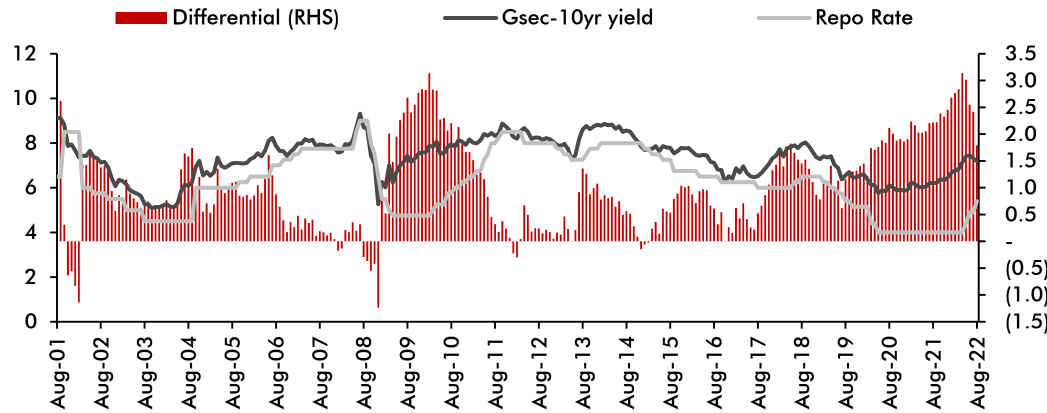
Exhibit 2: Bull flattening of the OIS curve



Source: Ambit Capital research, Bloomberg; Note: A bull flattener is an environment in which long-term rates are decreasing more quickly than short-term rates.

The *OIS curve remained elevated in June after a 40bps rate hike in May. Since June-end, while 1-year OIS rates have declined by 2bps, the 5-year OIS rates have declined by 44bps. A bull flattener! The spread between repo rate and 10-year yield has come off significantly from the highest levels, which suggests that inflation expectations have peaked and there is moderation in yield expectations too. The spread has come off from a decadal high of 314bps to 179bps currently.

Exhibit 3: The spread has eased from the highs



Source: Ambit Capital Research, Bloomberg

Our economist Sumit Shekhar's exit repo rate assumption for FY23/FY24 is 5.5%/6.5%, and for Sep-23 we assume 6%. Assuming a normalized spread of 130bps, which is significantly higher than median/average 10-year spread of 99/111bps, rates can stay close to 7.3% by Sept-end. With these inputs – bond yield as 7.3% (unchanged over next 12 months), Sept-23 earnings INR880 and EYBY Gap -2.6 – the Nifty implied price level is 18,723.

Exhibit 4: Sensitivity analysis: Implied Nifty levels for different earnings scenarios

Sep-23 TTM EPS	Implied Nifty Level
880	18723
890	18936
900	19149
910	19362
920	19574
930	19787

Source: Ambit Capital Research, Bloomberg

In the above scenario, we have considered yield as constant varying Sept-23 earnings. In the second case, we do a sensitivity analysis for Nifty levels under varying conditions of earnings and g-sec yields. For instance, under conditions of Sept-23 EPS at INR900 and 10-year g-sec yield at 7.5%, Nifty fair valuation is approximately 18367.

Exhibit 5: Scenario Analysis for different yield levels and earnings

10-year yield	Sep-23 EPS				
	880	**890**	**900**	**910**	**920**
7.1	19556	19778	20000	20222	20444
7.2	19130	19348	19565	19783	20000
7.3	**18723**	**18936**	**19149**	**19362**	**19574**
7.4	18333	18542	18750	18958	19167
7.5	17959	18163	18367	18571	18776
7.6	17600	17800	18000	18200	18400

Source: Ambit Capital Research, Bloomberg

What is more probable: downside risk or overshoot targets?

It all comes down to whether the market valuations over LTA are sustainable. During FY16-21, EPS growth was 7% CAGR, and the average market multiple was 24.6x TTM. If FY23 delivered EPS growth turns out to be 10-12%, can markets can trade at 24.5x or a lower EYBY Gap (<-2.6)? As earnings growth normalizes in FY23 from a deflated FY16-21 period (6.9% EPS CAGR), the inflated multiples can normalize and, hence, choosing LTA for Nifty level calculations looks reasonable. But, at the same time, SIP flows remain robust, and FII flows have turned positive, which can impact market multiples. India is the fastest growing economy in the world, and as investors

search for growth, it is a possibility. Yes, quantitative tightening (withdrawal of liquidity) is a risk but if last year's FII outflows and market performance are any indicator, the downside is protected especially when sentiment is improving, inflation expectations are improving and DII flows remain robust. With the EYBY model, we do a sensitivity analysis with different Sept-23 EPS and EYBY Gap at 7.3% yield. For an EYBY Gap of -2.8% and Sept-23 EPS of 880, the implied Nifty level turns out to be 19556.

Exhibit 6: Scenario analysis: Implied Nifty levels for different EYBY Gap & earnings

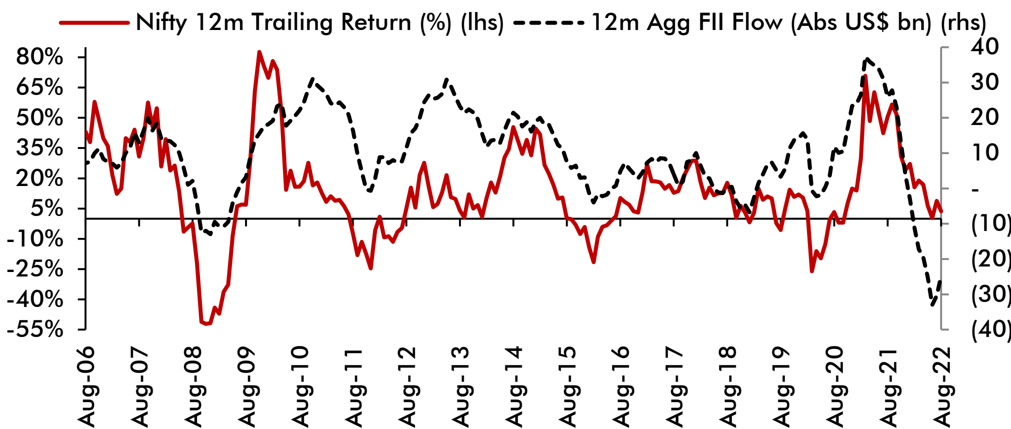
EYBY Gap	Sep-23 EPS(INR)				
	880	890	900	910	920
-2.5	18333	18542	18750	18958	19167
-2.6	18723	18936	19149	19362	19574
-2.7	19130	19348	19565	19783	20000
-2.8	**19556**	**19778**	**20000**	**20222**	**20444**
-2.9	20000	20227	20455	20682	20909

Source: Ambit Capital Research, Bloomberg

FII flows: Historical and empirical evidence suggests the end of outflows

FII outflows are another key variable that deserves attention! In "State of Market", we pointed out that FIIs still control market direction! FIIs have turned net buyers after 9 months in July'22 with inflows of US$0.84bn in equities, and Nifty returned 8.9% in July. DIIs pumped in US$16.6bn in equities in 1QFY23, but the market still corrected 10% driven by FII outflows.

Exhibit 7: FII flows and market returns trajectory are closely linked



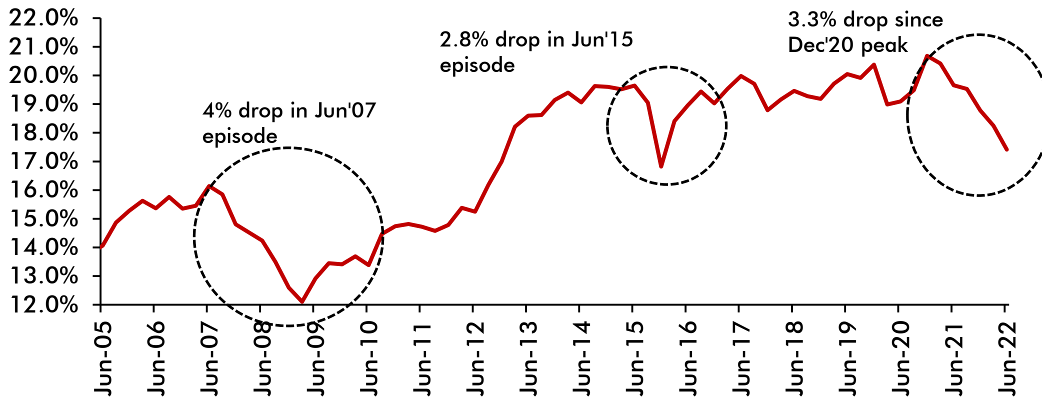
Source: Ambit Capital Research, Bloomberg

Hence, dissecting the trajectory of FII flows going ahead is an important variable for determining market direction going ahead! We try to make sense of this by keeping

- The FII ownership pattern,
- "FII flows behavior" with Fed rate hikes,
- And lastly, analyze the worst episodes of FII monthly outflows.

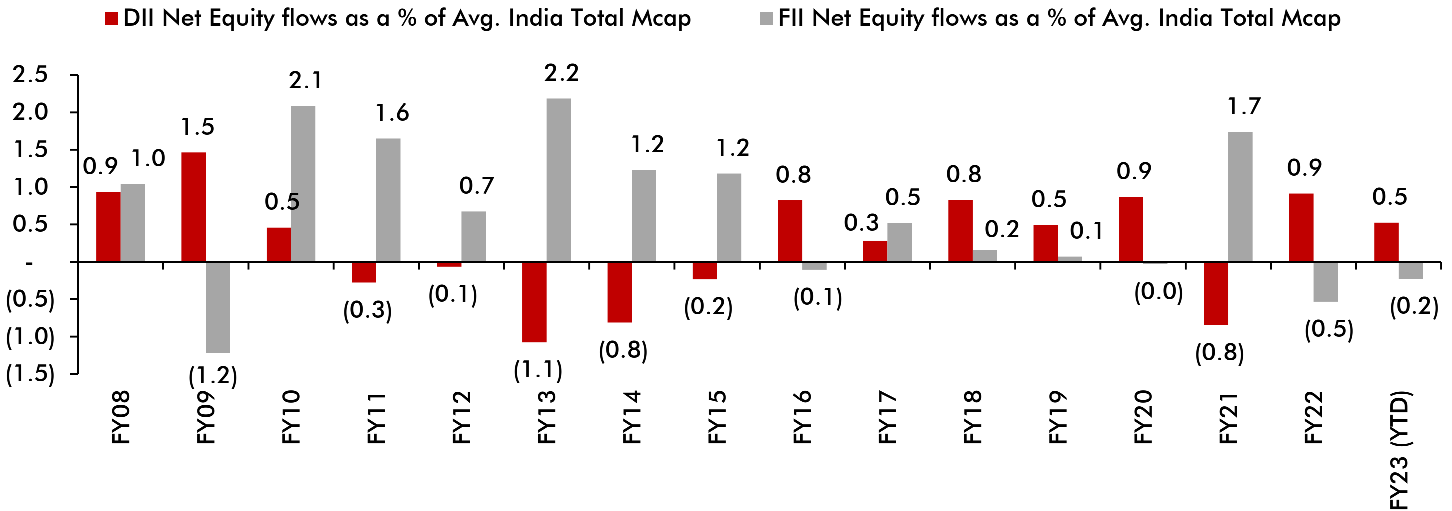
The FII ownership of Indian equities is the fourth lowest in the decade currently at 17.4% (lowest at 15.2% on Jun 12) and during the worst episodes they come off by 280-400bps from the top. This has to be viewed in conjunction with the fact cumulative outflows in FY22 and FY23 were close to the worst episode of FY09 at June-end. Can the anchoring bias set in? Our analysis suggests the odds are in favour and FII inflows in July and August are telling the same.

Exhibit 8: FII ownership of Indian equities is second lowest in the decade



Source: Ambit Capital Research, Bloomberg

Exhibit 9: Cumulative FII outflows as a % of total mcap in FY22 & 23 (YTD) touched FY09 levels in June, post which FIIs turned buyers



Source: Ambit Capital Research, Bloomberg

<u>FII flows & Fed rate hike</u>: Historically, the rise in US interest rates has not been negative for FII equity flows. Over the last 3 rate hike cycles, during the first 6m/12 months of the hike cycle, FII equity inflows have actually been positive <u>as the bulk of the selling always happens before the first rate hike itself.</u>

Exhibit 10: FIIs turn buyers in Indian equities & debt(except one instance) once the rate hike cycle beguns

Rate change cycle	FII's Debt flows($bn)						FII's Equity flows($bn)					
	Last12m	Last6m	Last3m	Next3m	Next6m	Next12m	Last12m	Last6m	Last3m	Next3m	Next6m	Next12m
30-Jun-06	0.1	(0.1)	(0.4)	(0.1)	0.8	0.6	9.0	3.7	1.2	1.4	5.1	9.8
17-Dec-15	8.0	1.4	1.7	(1.5)	(1.5)	(6.9)	2.1	(3.7)	(1.2)	(0.4)	3.4	4.7
15-Dec-16	(7.0)	(5.3)	(5.9)	0.6	13.4	22.8	4.6	1.2	(2.2)	2.6	7.2	7.1
17-Mar-22	0.6	(1.0)	(1.5)	(1.5)			(18.1)	(19.2)	(15.0)	(12.5)		

Source: Bloomberg, Ambit Capital research

<u>FII outflows in June were the second highest ever. What's next?</u>

In Jun-22, FIIs sold USD6.34bn, the highest since Mar-20; as a % of FF Mcap this was the sixth worst instance (seond worst in absolute terms). In a comparison of the worst 20 episodes of FII outflows over the last 2 decades, the evidence is that outflows moderate over the next 6 months; only in one instance has the market corrected significantly, market has closed higher in 18 out of these 20 episodes.

Exhibit 11: Top 20 months of FII outflows (ordered): Market has closed higher 18/20 times over the next 12 months

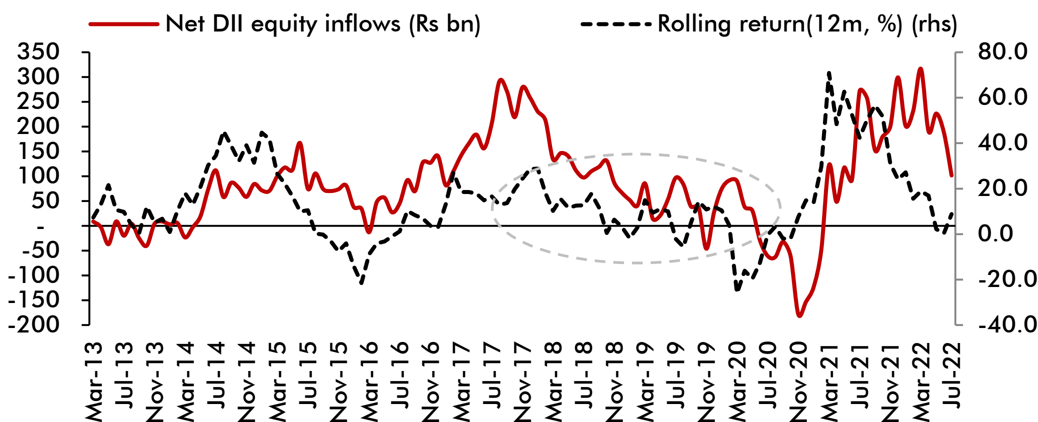
Date	FII flows as % of FF Mcap	FII flows (next 6 m agg.)/% of FF mcap	12m fwd returns	Nifty P/E
Oct-08	-1.2%	-0.1%	63%	10.5
Mar-20	-1.2%	1.2%	71%	19.5
Jan-08	-0.8%	-0.6%	-44%	19.3
May-04	-0.7%	3.4%	41%	11.8
May-06	-0.7%	2.5%	40%	17.1
Jun-08	-0.7%	-2.0%	6%	14.2
Sep-08	-0.5%	-2.1%	30%	14.1
Jun-22	-0.5%	N/A	N/A	20.4
Oct-05	-0.4%	2.9%	58%	14.1
Aug-07	-0.4%	1.1%	-2%	17.4
Oct-18	-0.4%	1.1%	14%	21.3
Aug-15	-0.4%	-0.6%	10%	20.6
Aug-11	-0.4%	1.4%	5%	14.6
May-10	-0.4%	4.1%	9%	20.1
Jan-09	-0.4%	2.7%	70%	11.2
Jun-13	-0.4%	1.4%	30%	16.3
Nov-16	-0.4%	0.8%	24%	21.0
May-22	-0.3%	N/A	N/A	21.5
Feb-22	-0.3%	N/A	N/A	22.5
Nov-08	-0.3%	1.8%	83%	10.0
Average	-0.5%	1.1%	30%	16.9
Median	-0.4%	1.2%	30%	17.3

Source: Bloomberg, Ambit Capital research

This along with the fourth lowest ownership in a decade, 330bps reduction in ownership in this cycle (close to previous cycles), and historical evidence of moderation in outflows post first rate hike strongly indicate that FII outflows in equities can moderate. Over the last 2 months, in our weekly flipbooks, we have been highlighting this trend change in FII flows. FIIs invested US$6bn, the highest monthly flow since Dec-20, and we expect this nascent trend to persist.

A key risk for the market can be moderation in DII flows which have counteracted FII outflows till Jun-22. Over the next few months, DIIs face a double whammy of rising bank deposit rates and slowing Nifty 1-year returns. The base of 12M rolling return has shifted to 17200 zone, and 12M rolling returns have already contracted to ~4%. Historically, this has coincided with a reduction in DII net equity inflows. This bucked the trend in the last few months before they become sellers in Aug-22! But, with FIIs turning buyers, the market should sustain!

Exhibit 12: DII equity inflows likely to contract as 12M rolling Nifty returns plummet



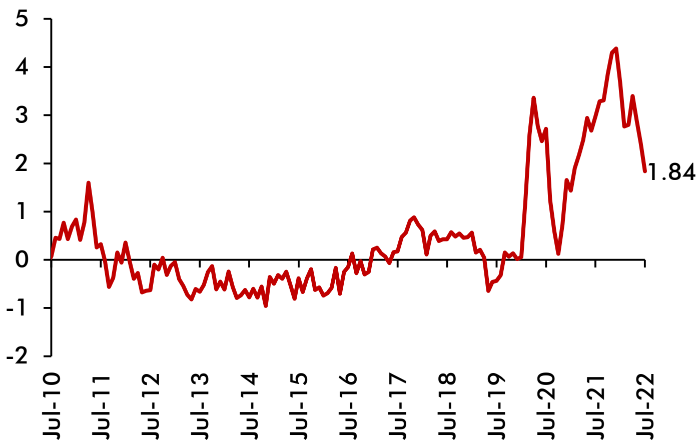
Source: Ambit Capital Research, Bloomberg

Additionally, supply-chain bottlenecks are easing, which augurs well from an inflation perspective.

Supply chain bottlenecks are easing

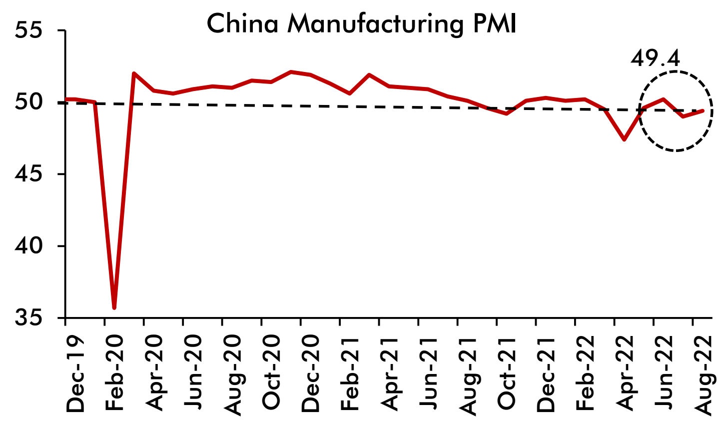
Supply-chain bottlenecks have begun to ease, inflation has peaked (at least in India), commodity prices are cooling, and with China's manufacturing activity/exports normalizing, inflation is likely to head lower, bolstering margins. Supply-side pressures are easing with the global supply chain pressure index (GSCPI) coming off. While the index remains elevated relative to the history, it was noticeably down in Jun'22 from December's peak. Expanding Chinese manufacturing PMI as the economy reopens should help ease inflationary pressures. While PMI again contracted in July and August, macroeconomic data is indicating that the adverse impact of Covid is fading. The PMI data for August was better than market forecasts!

Exhibit 13: The Global Supply Chain Pressure index has significantly eased from peaks



Source: Ambit Capital research, Federal Reserve Bank of New York. GSCPI mashes together various global shipping and transportation costs plus other supply chain indicators including delivery times, backlogs, and inventory levels.

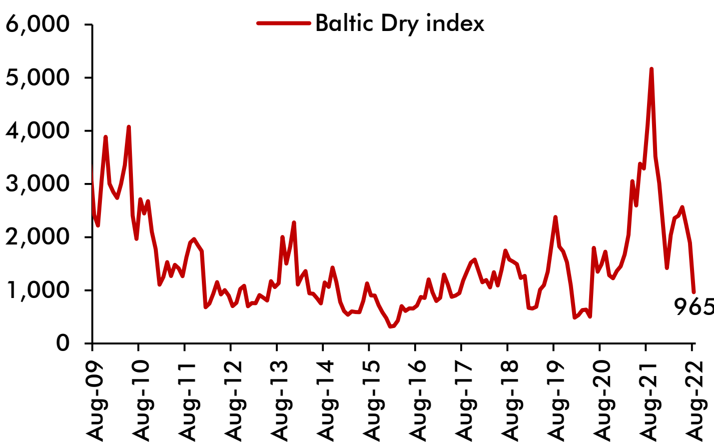
Exhibit 14: China's manufacturing PMI is bouncing back from April lows



Source: Ambit Capital Research, Bloomberg

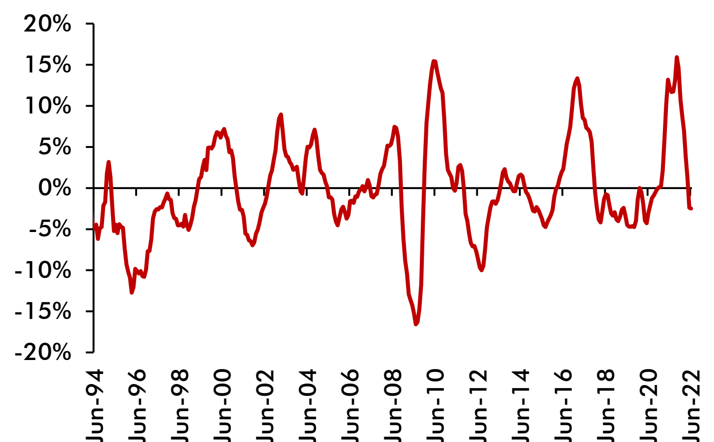
The Baltic Dry Index, which measures transportation costs for bulk goods, is down ~81% from its Sept-Oct'21 high. This also indicates that transportation networks have improved and new orders could pick up once costs come down. The cost to ship goods is at the same level as post 2007-09 recession, and it wasn't prohibitive then.

Exhibit 15: Baltic Dry Index (BDI) is down ~81% from its Sept-Oct'21 high



Source: Ambit Capital Research, Bloomberg

Exhibit 16: Cooling of China PPI will alleviate some manufacturing inflation

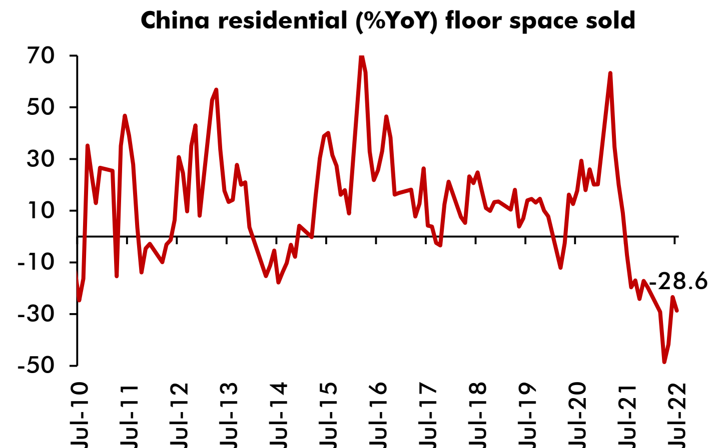


Source: Ambit Capital Research, Bloomberg

Exhibit 17: Exports rose 14% YoY in the first half of CY22

Source: Ambit Capital Research, Bloomberg

Exhibit 18: Slowing property sales should keep a lid on commodity prices

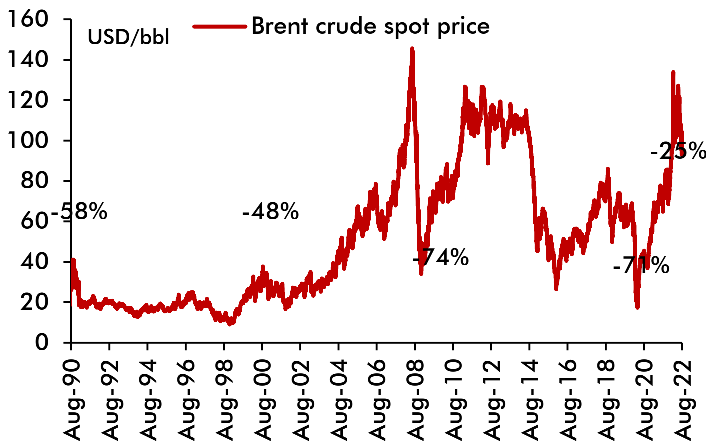


Source: Ambit Capital Research, Bloomberg

Key Question: Is the correction over in commodities?

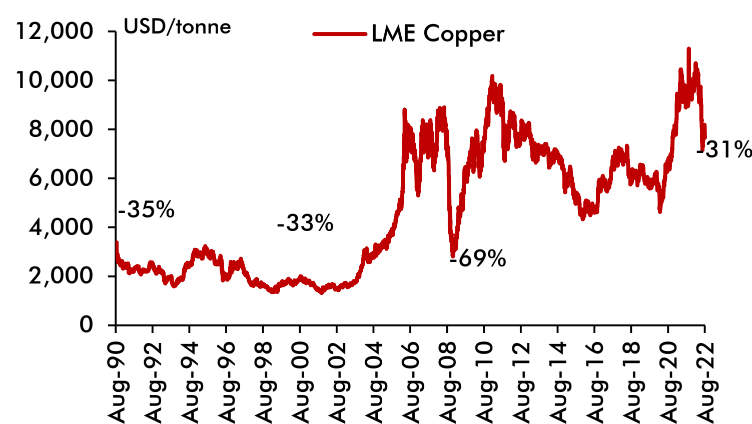
The commodity price correction in a recession is usually deeper than it has declined in this cycle. Currently, crude has only fallen 25% from its Mar'22 high with the Russia-Ukraine war-led oil shortage making forecasting difficult. Copper has corrected 31% from its Oct'21 peak. While the copper price correction is in line with a typical recession, oil falls by more than 60%. So, there is possibility of more correction! This will augment gross margins, though the IT sector (our key sectoral underweight) and exports will suffer if the world slips into recession. The Indian economy is still domestic demand-driven (60%), so growth can slow down but will still be reasonable.

Exhibit 19: On average, crude prices drop by ~60% in a typical recession



Source: Ambit Capital Research, Bloomberg

Exhibit 20: Copper prices have dropped ~31% since Oct'21 peak, in line with past recessions

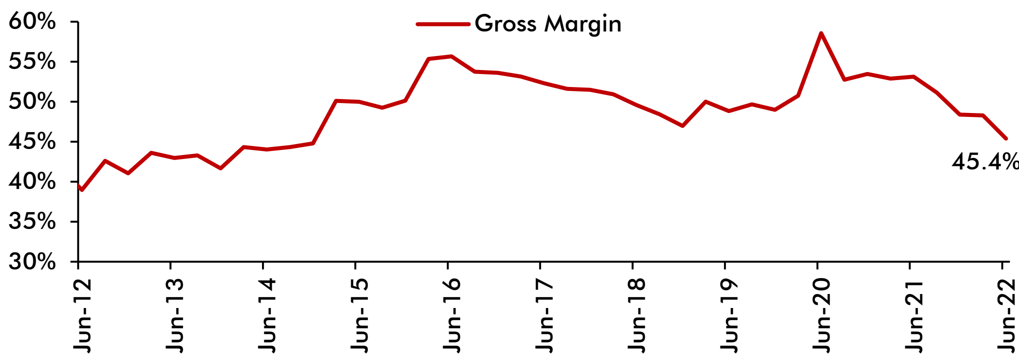


Source: Ambit Capital Research, Bloomberg

Margin pressure is likely to alleviate

Over the past three quarters, operating expense savings have arrested a significant fall in net profit margin (NPM), while gross margin compressed. Please refer to "Story of the reporting season" for details. In Jun'22, GM touched ~45.4% (lowest since Dec-14), declining from 59% in Jun-20 and falling below pre-pandemic levels (49% in Dec-19) as input inflation remained high. Pressure on gross margins is likely to alleviate as industrial metal/commodity prices have eased and inflation has peaked. Easing of the supply chain pressure will further help GM expand as transportation costs taper.

Exhibit 21: Gross margin seems to have bottomed out, as commodity prices have softened and inflation has begun to moderate



Source: Bloomberg, Ace Equity, Ambit Capital research; Note: Quarter data has been used for NSE-500 ex-BFSI

"Market structure" signal: Prices to trend higher

We analyze market structure through the advance decline ratio, RSI, Bollinger Bands, and %200-DMA stocks of Nifty to incorporate the psychological aspect of investing in our analysis. The conclusion is uniform - "markets are likely to be higher over the next 12 months, barring intermittent volatility".

Investing is the intersection of economics and psychology- Seth Klarman

Exhibit 22: Markets are likely to be higher over the next 12 months, barring intermittent volatility

Indicator	Median 12M forward returns (%)
% 200 DMA stocks of Nifty ≤20%	20%
Advance decline ≤ 0.02	39%
% Nifty stocks with RSI greater than 70 ≤ 2%	10%
% Nifty stocks trading above upper Bollinger Band ≤ 2%	19%

Source: Company, Ambit Capital Research Note: These returns are from their respective bottoms mentioned in sections

Proportion of Nifty stocks above 200-DMA: In our flipbook dated 27th June'22, "What is market structure telling us?", we analyzed market structure based on "% of Nifty stocks trading above 200 DMA". We highlighted that the % of stocks above 200-DMA has fallen close to the Mar-20 zones (20%). Historically, Nifty 12M fwd. returns from the day's share of stocks trading above the 200-DMA slipped below 20% and have been a reasonable 30%/20% on average/median basis. Nifty has delivered 11% returns since then. The shore of Nifty stocks above 200-DMA currently stands at 72%.

Exhibit 23: "Only 20% of Nifty stocks trade above 200 DMA" - A signal of reversal

Date	Nifty returns (%)			TTM P/E ratio
	3 months	6 months	12 months	
30-Oct-02	10%	0%	62%	11.6
11-Nov-02	10%	-2%	68%	11.8
13-Jun-06	30%	41%	54%	14.8
24-Jun-08	-1%	-30%	2%	15.2
23-Mar-09	44%	69%	78%	11.4
10-Feb-11	6%	-1%	3%	17.0
23-May-11	-8%	-13%	-10%	16.6
05-Aug-11	1%	2%	0%	15.2
23-Nov-11	17%	3%	20%	14.1
21-Aug-13	13%	16%	49%	14.3
01-Sep-15	2%	-7%	13%	20.1
15-Jan-16	6%	15%	13%	19.4
09-Mar-20	-4%	8%	44%	22.0
Average	**10%**	**8%**	**30%**	**15.7**
Median	**6%**	**2%**	**20%**	**15.2**

Source: Ambit Capital Research, Bloomberg

Advance/Decline Ratio (Weekly): In our flipbook dated 11th July, "Another look at the market structure" we highlighted daily advance/decline ratio has hit a trough, an oversold condition, and the possibility of a bounce back, which has materialized. We analyze the weekly advance/decline ratio here, a rare signal! The **Advance/Decline ratio** for an index measures how many stocks closed higher/lower over the reference interval. Nifty weekly **advance/decline** ratio hit trough .02 in June, a rare event over the last 2 decades. A weekly advance/decline ratio of .02 implies only 1 constituent closed higher whereas 49 closed higher than the previous week. In every instance when weekly A/D <=.02, market returns have been positive and 12m fwd. average/median Nifty returns have been 50%/39%. The valuation in this episode is not significantly different from other episodes! Nifty is up 14% since then!

Exhibit 24: Nifty weekly advance/decline ratio suggests a strong move over the next 1 year

Date	Nifty advance/ decline ratio	Nifty fwd price perf (%)		PE ratio
		6m	12m	
22-May-06	0.00	28%	39%	17.2
29-Dec-08	0.02	50%	78%	10.6
02-Mar-20	0.00	4%	34%	23.4
20-Jun-22	0.02			19.9
Average		**27%**	**50%**	**17.1**
Median		**28%**	**39%**	**17.2**

Source: Bloomberg, Ambit Capital research

Relative strength indicator (RSI): RSI measures the magnitude of recent price changes to evaluate the overbought or oversold condition in the price of the stock. We did the RSI distribution analysis for Nifty stocks over the last 2 decades with monthly RSI. The number of Nifty stocks above (>70) RSI bottomed out in May, indicating that excess at the Nifty constituent level has moderated. Historically, when % Nifty constituents with RSI>70 has fallen (≤ 2%), Nifty has delivered 10% average/median 12M fwd. returns, with only one instance delivering negative returns. In the current episode, Nifty has delivered 6% returns so far! Currently, among Nifty constituents, only two stocks (ITC and M&M) trade above>70 RSI.

Stocks in the RSI zone >70 are considered to be overbought and stocks in the RSI zone <30 are considered to be oversold.

Exhibit 25: The % of Nifty members with (>70 RSI) <=2%. Nifty delivers 10% returns on 12M fwd. average/median basis

Dates	Count (>70)	Nifty fwd. returns			P/E
		6m	12m	24m	
Mar-08	1	-17%	-36%	11%	17.2
Jun-08	1	-27%	6%	31%	14.2
Feb-11	1	-6%	1%	7%	17.3
Aug-11	1	8%	5%	9%	14.6
Nov-11	1	2%	22%	28%	14.5
Jan-16	0	14%	13%	46%	19.7
Dec-16	1	16%	29%	33%	20.9
Oct-18	1	13%	14%	12%	21.3
Jul-19	1	8%	0%	42%	23.7
Aug-20	1	28%	50%	41%	29.0
May-22	1				
Average		4%	10%	26%	19.2
Median		8%	10%	30%	18.5

Source: Ambit Capital Research, Bloomberg

Bollinger bands: The monthly **Bollinger bands (BB)** are envelopes around the stock prices based on 20 months' average and 2 standard deviations. We analyzed Nifty constituent's BB distribution over the last 2 decades to indicate oversold conditions. On average, 5 stocks (currently 5) trade above the upper monthly BB where the trend is strong. It hit its recent trough (1) on Feb-22. Historically, screening for troughs (<=2% constituents above upper BB) has been an accurate signal for a reversal! Again, this is a very rare signal. A case in point: the number of stocks trading above Upper BB in Mar-20 was not zero, but 2! *Adding valuation to the equation*: In the current episode in Feb-22, TTM P/E was lower than the 5-year average! The 12M fwd. returns have never been negative for such episodes! Across the troughs, Nifty 12M fwd. returns have been 15%/19% on an average/median basis. Nifty has delivered 4.4% returns since then!

Exhibit 26: Historically, when (≤1) Nifty stock trades above upper BB, Nifty 12M fwd returns have been 15%/19% on average/median basis

Date	No. of Nifty stocks (BB>2)	Nifty fwd. returns		TTM P/E	5 year avg P/E
		6m	12m		
Jan-03	1	14%	74%	12.1	15.4
Apr-04	1	-1%	6%	14.5	14.7
Mar-05	1	28%	67%	12.7	14.3
Oct-05	1	50%	58%	14.1	14.0
May-06	1	29%	40%	17.1	14.1
Jan-08	1	-16%	-44%	19.3	15.5
Aug-09	2	6%	16%	21.1	16.3
Jan-10	0	10%	13%	22.1	17.1
Oct-10	1	-4%	-11%	20.7	18.3
Nov-11	1	2%	22%	14.5	18.1
May-12	1	19%	22%	14.1	17.9
Apr-15	0	-1%	-4%	21.6	17.3
Dec-16	0	16%	29%	20.9	18.1
Mar-18	1	8%	15%	21.9	19.9
Nov-18	0	10%	11%	22.3	20.8
Jul-19	0	8%	0%	23.7	21.8
Dec-21	1	-9%		23.2	25.1
Feb-22	1			22.5	25.1
Average		8%	15%	20.8	18.0
Median		10%	19%	18.6	17.6

Source: Ambit Capital Research, Bloomberg

Summarizing our flipbook and these indicators, a part of the market movement has played out, and the market touching 18500-19000 looks very likely. The weekly advance/decline ratio signals a much higher Nifty target. The EYBY framework is also pointing in a similar direction!

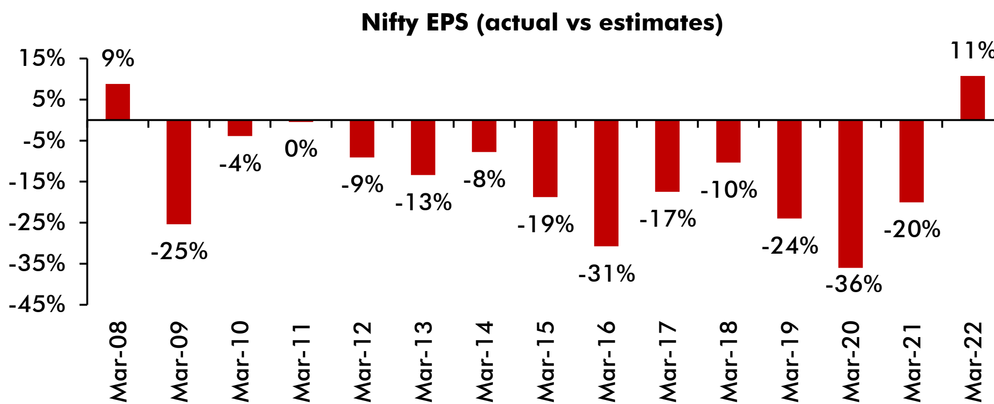
Things to watch out for

The earnings estimate trajectory is one of the best in the decade measured by estimates cut 5 months into the financial year. Banks are likely to contribute 40% of FY23 earnings growth and have bucked the trend of earnings downgrades in FY23. Acceleration in earnings downgrades, particularly in banks, can put FY23 earnings at risk. Whilst FY23 bank earnings are less at risk given mid-teen credit growth and low NPAs, it's FY24 we are more worried about as that would require credit growth to maintain momentum, which needs more than retail credit growth that is currently driving growth. As central banks contract the balance sheet and RBI continues to focus on inflation, liquidity is expected to decline, which can weigh on market returns. Forward returns and Mcap/M2 are strongly correlated with an R^2 of 73%. Lastly, on the demand side, while urban demand has revived, rural demand remains weak. As money contraction continues to tame inflation, our FY23 GDP growth estimate of 6.5% can be at risk.

Acceleration in earnings downgrades

What's at play? In our recent analyst note "Dissecting the trajectory of FY23 earnings estimates", we highlighted how recency bias can trickle into 1-year fwd. EPS expectations with TTM earnings growth shaping earnings expectation for the future. But **delivering "earnings estimates" is a rare event!** Historically, analysts' expectations of Nifty EPS growth have been revised downwards every single year since FY09. FY22 was an aberration in the last decade, in which earnings estimates held up.

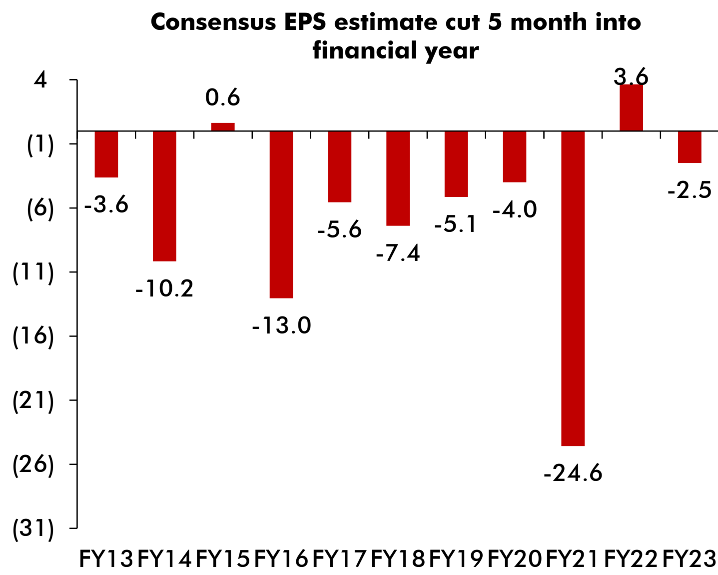
Exhibit 27: FY22 is an exception with earnings expectations being met!



Source: Ambit Capital research, Bloomberg Note: The deviation has been calculated across Nifty earnings estimates at the start of the financial year and actual Nifty EPS delivered

The Nifty FY23 EPS growth estimate of 15% seems optimistic! But Nifty FY23 EPS cut has been one of the best in the decade and earnings growth of 10-12% would be significantly higher than the FY16-21 EPS CAGR of 6.9%. BFSI is likely to contribute the bulk of the earning growth and this sector would determine the trajectory of the earnings growth.

Exhibit 28: FY23EPS trajectory is still better than most of the last decade



Source: Ambit Capital research, Bloomberg

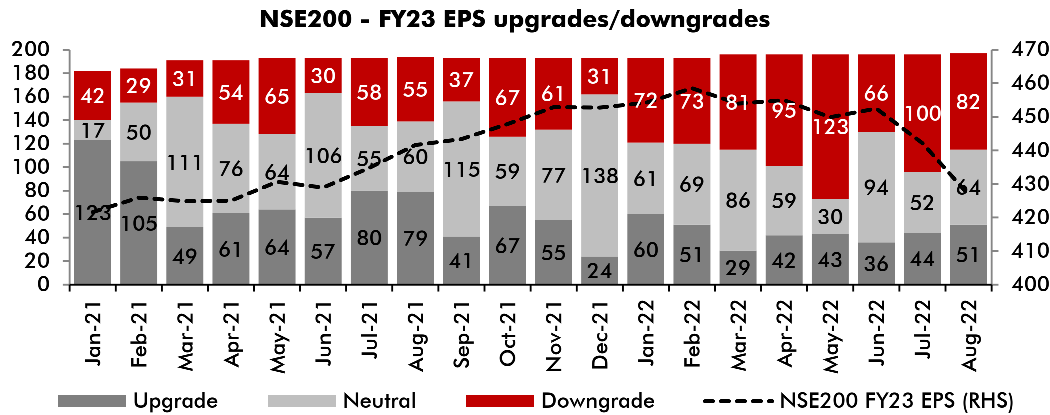
Exhibit 29: BFSI to drive FY23/FY24E earnings growth

Sector	Sector-wise contribution to EPS growth(Consensus)		
	FY22E	FY23E	FY24E
BFSI	30%	55%	43%
IT	6%	8%	12%
Oil & Gas	12%	20%	11%
Consumer	-2%	7%	5%
Auto / Auto Anc	5%	27%	14%
E&C / Infra / Cap. Goods	-4%	7%	4%
Metals & Mining	35%	-35%	-4%
Utilities	4%	-3%	2%
Pharma	1%	7%	3%
Cement	2%	-2%	2%
Telecom	9%	6%	5%
Retail	1%	1%	1%
Healthcare	1%	0%	1%
Chemicals	1%	2%	1%

Source: Ambit Capital research, Bloomberg

Nifty FY23 earnings estimate trajectory has come off from INR881 to INR857 in the last 2 months. While the upgrade/downgrade ratio has worsened in CY22 from 0.77 in Dec-21 to 0.62 in Aug, it has improved substantially over the last month (0.44 in July). 80/114 companies' earnings estimates are higher/lower than Dec-21 levels. The key to generating alpha will hinge on portfolio positioning in the sectors/stocks which have stayed immune to the earnings downgrades cycle.

Exhibit 30: Earnings upgrade/downgrade ratio improved in Aug-22



Source: Ambit Capital Research, Bloomberg

Are there sectors bucking the trend of earnings downgrades?

Earnings downgrades (FY23) have been more pronounced across the universe with Financials, Consumer Discretionary and Utilities being exceptions. Auto and Capital Goods have witnessed the 5th quarter of sequential downgrades. In FY23, Healthcare, Auto, Metals, Consumer Durables and Cement/Building Materials have witnessed double-digit downgrades whereas O&G earnings downgrades have begun (13% downgrade in this quarter after 4 quarters of earnings upgrades). If this is viewed in conjunction with attractive valuations, Financials are in a sweet spot! Chemical is another sector that has stayed immune to the downgrades cycle. FMCG bucked the trend of downgrades in this quarter but valuations have expanded! The earnings downgrades in Financials will determine the trajectory of FY23 earnings growth as they are expected to contribute at least half of earnings growth.

And, the earnings estimate trajectory of heavyweight banks is a key variable going ahead! Whilst FY23 bank earnings are less at risk given mid-teen credit growth and low NPAs, it's FY24 we are more worried about as that would require credit growth to maintain momentum, which needs more than just retail credit growth which is currently driving growth.

Exhibit 31: FY23 earnings revision history for NSE200 universe

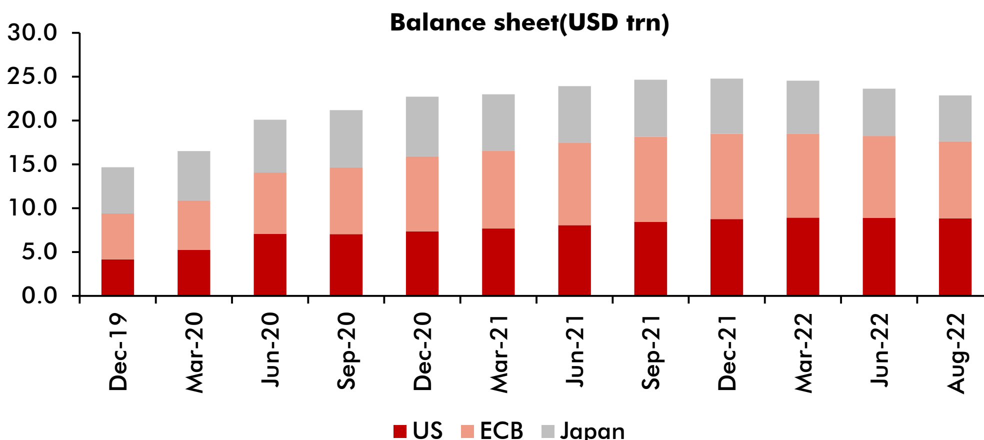
Sector	Wt.	FY23 EPS growth (QoQ) - Sector-wise							Since Mar'21	Since Mar'22
		Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Latest		
Financials	31%	7%	2%	-1%	-2%	1%	-2%	0%	-2%	-2%
IT	14%	5%	0%	1%	-1%	2%	-5%	-4%	-7%	-9%
Oil & Gas	11%	4%	-1%	3%	4%	12%	6%	-13%	9%	-8%
FMCG	10%	1%	-3%	-1%	-3%	1%	-3%	1%	-9%	-2%
Healthcare	6%	3%	1%	1%	-4%	-2%	-6%	-6%	-16%	-12%
Auto	5%	16%	0%	-3%	-4%	-7%	-11%	-2%	-24%	-13%
Capital Goods	4%	11%	3%	-1%	-2%	-1%	-3%	-2%	-6%	-5%
Metals	4%	17%	33%	7%	8%	2%	-9%	-9%	31%	-17%
Cement & Building Materials	4%	6%	2%	5%	-2%	-7%	-15%	-4%	-21%	-19%
Utilities	3%	3%	1%	1%	-4%	2%	0%	1%	1%	1%
Telecom	2%	-19%	-16%	-7%	-30%	51%	-21%	-47%	-66%	-58%
Chemicals	1%	5%	4%	3%	-3%	4%	1%	4%	13%	5%
Misc.	1%	9%	-5%	-1%	11%	-4%	-29%	-13%	-39%	-39%
Consumer Durable	1%	14%	-2%	0%	-2%	-4%	-7%	-8%	-22%	-15%
Media	1%	1%	-4%	-5%	-2%	-2%	-10%	-9%	-28%	-18%
Real Estate	1%	17%	8%	0%	2%	2%	-3%	1%	10%	-2%
Consumer Discretionary	0%	2%	-5%	1%	2%	5%	-2%	4%	5%	2%

Source: Ambit Capital Research, Bloomberg

"Liquidity contraction" can weigh on market returns

As central banks implemented expansionary monetary policies to prevent the global economy from slipping into a recession, global money supply increased from US$71trn in Dec'19 to US$91trn in Mar'22 and currently stands at US$88trn. The aggregate central bank balance sheet increased more than 50% since Dec.19.

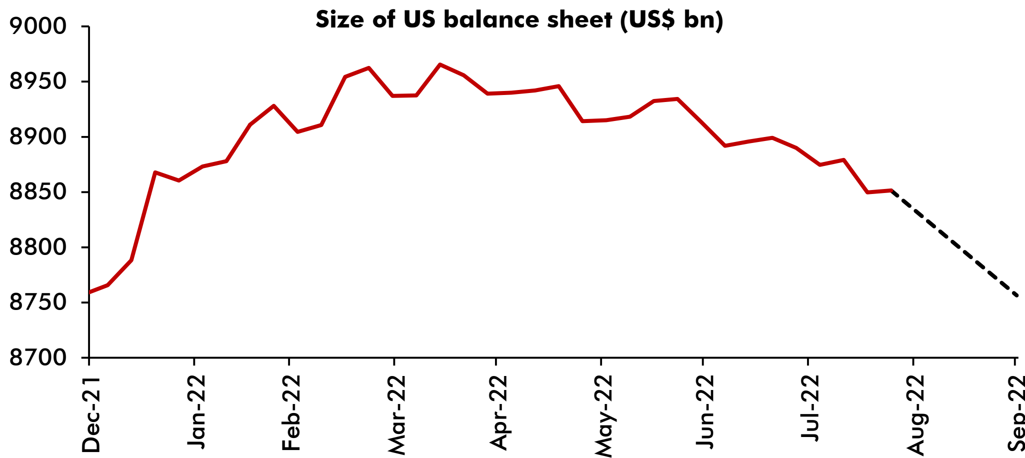
Exhibit 32: Global central banks' balance sheets expanded significantly in the Covid aftermath and has begun to contract



Source: Ambit Capital Research, Bloomberg

The path ahead? The contraction in balance sheets will continue. The Fed has begun to reduce its ~$8.9trn balance sheet beginning June 1 by no longer reinvesting proceeds of up to $30bn in maturing Treasury securities and up to $17.5bn in maturing agency mortgage-backed securities per month. Beginning September 1, these caps will rise to $60bn and $35bn respectively. This acceleration in liquidity contraction can weigh on markets.

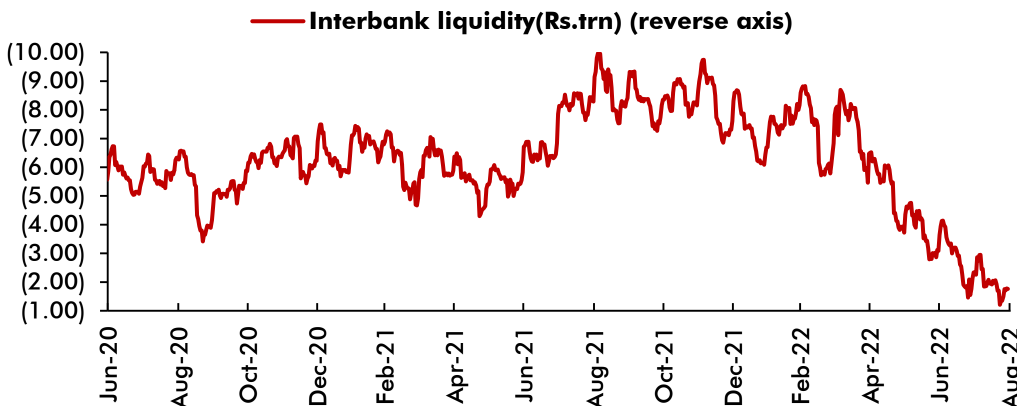
Exhibit 33: Fed's B/S reduction plans to maximize predictability and minimize market disruption in addition to policy rate hardening



Source: Ambit Capital research, Bloomberg; Red dotted line shows projections based on Fed announcement on 4 May 2022.

This can weigh on the liquidity with RBI also draining liquidity. India Banking Liquidity index has fallen since Apr'22 as RBI instituted the Standing Deposit Facility (SDF) at 3.75%, 40 bps above the fixed rate reverse repo (FRRR) as the floor of the LAF corridor. Since Sep.21, the liquidity contraction was fuelled by variable rate reverse repo (VRRR).

Exhibit 34: Interbank liquidity has been declining since Apr'22

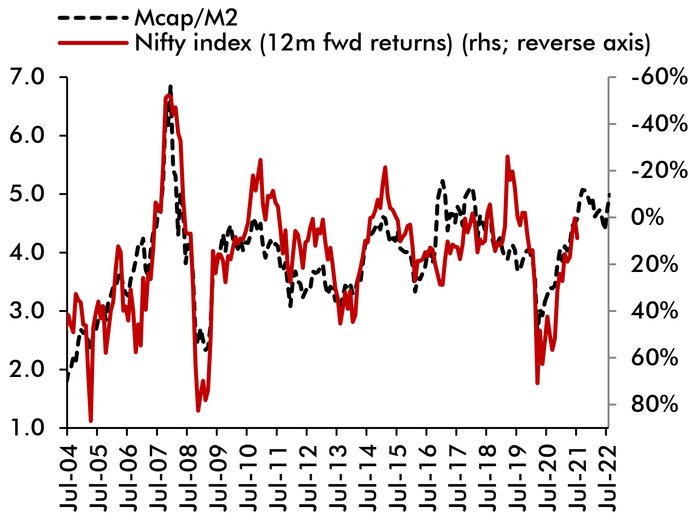


*Source: Ambit Capital research, Bloomberg Note: India Banking Liquidity Index tracks the daily outstanding banking system net borrowing from the Reserve Bank of India adjusted for banks' excess cash reserves held with the RBI. **A positive borrowing amount implies a liquidity deficit with banks, while a negative amount implies a liquidity surplus.***

Liquidity/money supply & market capitalization - The relationship

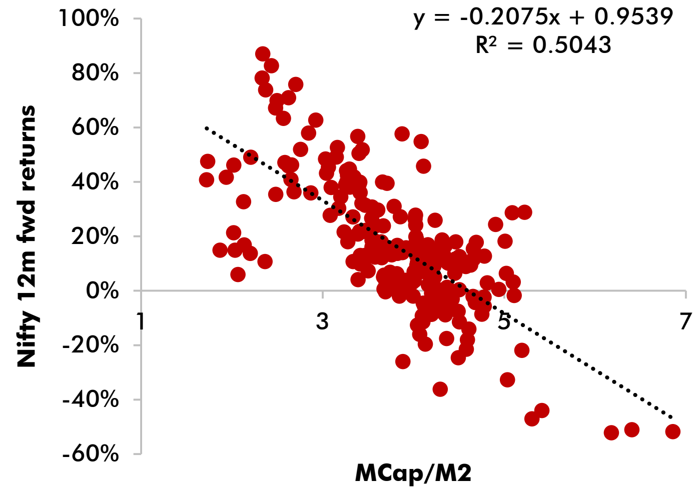
Money supply has to be viewed in conjunction with equity market capitalization. With RBI's focus on inflation and consequent synchronized monetary tightening, money supply (M2) is going to contract, leading to expansion in the broad money-chasing markets (MCap/M2) ratio. Historically, there has been a strong negative correlation between (MCap/M2) and Nifty 12M forward returns (-71%), suggesting that market returns would contract as money supply recedes. Empirical evidence shows that as Mcap/M2 exceeds 5, the market corrects. The same has manifested this time. Currently, it stands at 4.7.

Exhibit 35: Historically, there has been a strong negative correlation between (MCap/M2) and Nifty 12M forward returns (-71%)



Source: Ambit Capital research, Bloomberg; Latest data as of 31 July 2022

Exhibit 36: The predictive power of Mcap/M2 for explaining 12-month forward returns stands at a robust 50%

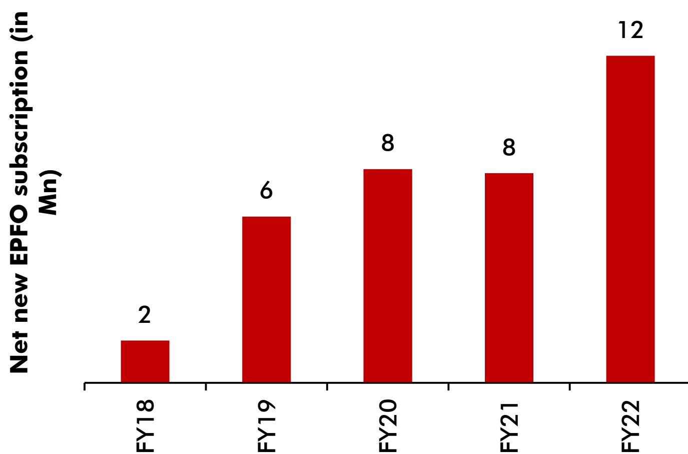


Source: Ambit Capital research, Bloomberg; Latest data as of 31 July 2022

Demand-side constraints

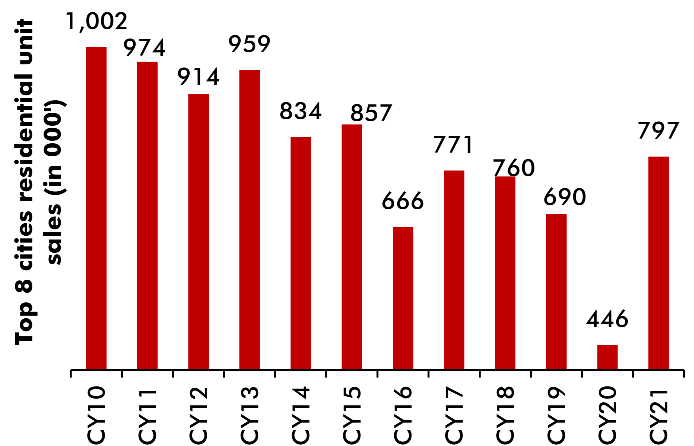
On the demand side, while consumption in urban India seems to have revived on the back of increased hiring (led by the IT sector), rural (which represents 40% of consumption) remains in distress. In FY22, rural wages grew marginally, at 4% on a nominal and 0.2% on a real basis. The unemployment rate, though down from the May-21 high, remains above the historical average while rural inflation remains elevated, leading to a deep contraction in real rural wage growth. In line with declining/marginal growth in real wages, rural LFPR has been trending downwards since FY16. This coupled with weak wage growth has led to suppressed rural demand as indicated by 2W sales hitting the lowest levels in FY22 since FY13. As monetary contraction continues in an attempt to tame inflation, a possible increase in unemployment will trickle down to weak GDP growth (our FY23 estimate of 6.5% can be at risk).

Exhibit 37: Hiring in urban India, especially formal sector, has grown significantly (led by IT hiring)



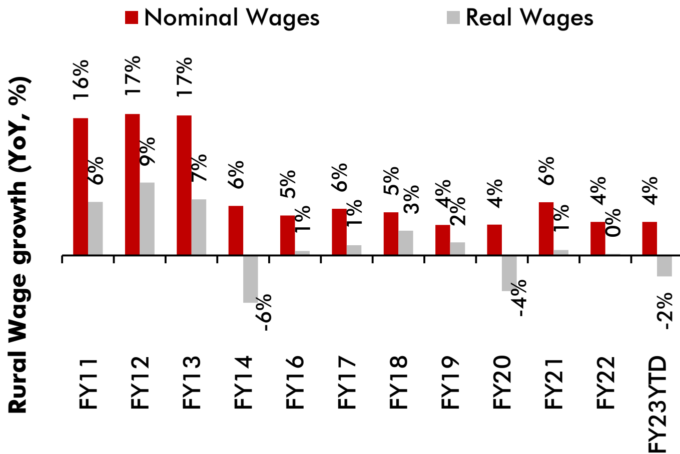
Source: Ambit Capital research, MoSPI. Note- 1) EPFO- Employee's Provident Fund Organization. 2) Net New EPFO subscriptions= (New Subscriptions + Re-joined subscriptions) - Ceased Subscriptions. 3) FY22 data up to Feb'22

Exhibit 38: FY22 was one of the best years for RE sales



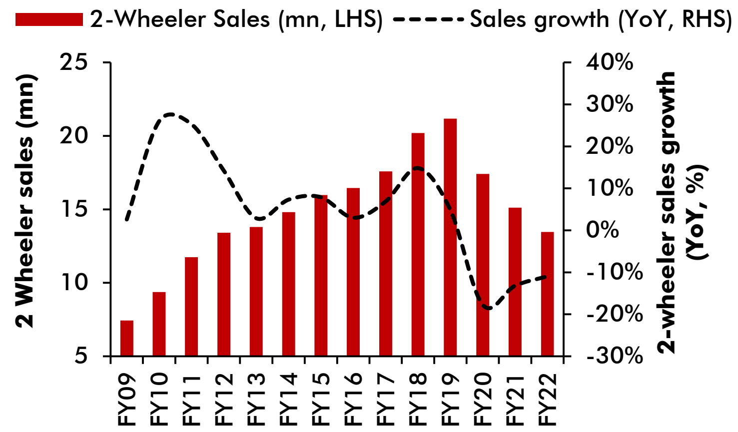
Source: Ambit Capital research, Knight Frank

Exhibit 39: Rural real & nominal wages have grown marginally in the last 5 years



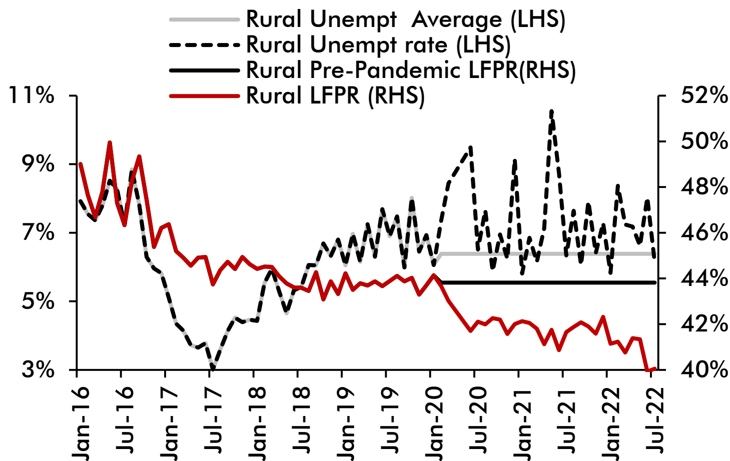
Source: Ambit Capital research, RBI, CMIE. Real Wage growth has been calculated by normalizing Nominal wage growth with CPI-AL.

Exhibit 40: 2W sales fell to the lowest in FY22 since FY13



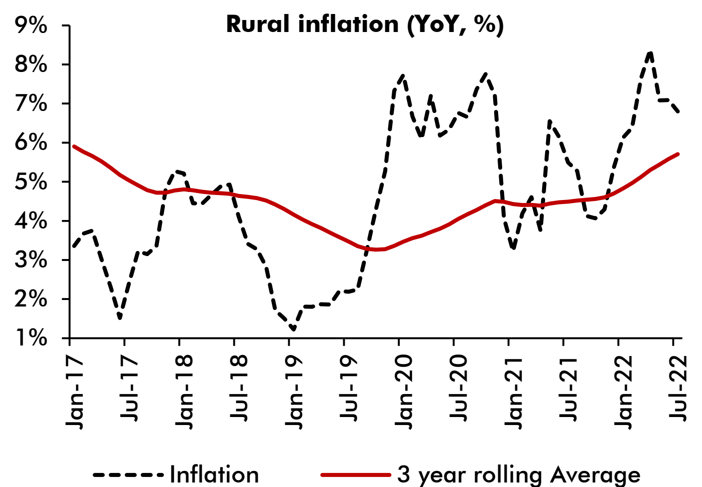
Source: Ambit Capital research, CEIC

Exhibit 41: Rural labour market is facing mass exodus and high unemployment



Source: Ambit Capital research, CMIE. Note- 1)LFPR- Labour force participation rate, Unempt- Unemployment 2) Pre-pandemic average is the monthly average between Feb'17 and Feb'20. 3) Apr'20 and may'20 data has been omitted to avoid skewness.

Exhibit 42: Rural inflation is much higher than average and trending higher than urban inflation for the last 2 months



Source: Ambit Capital research

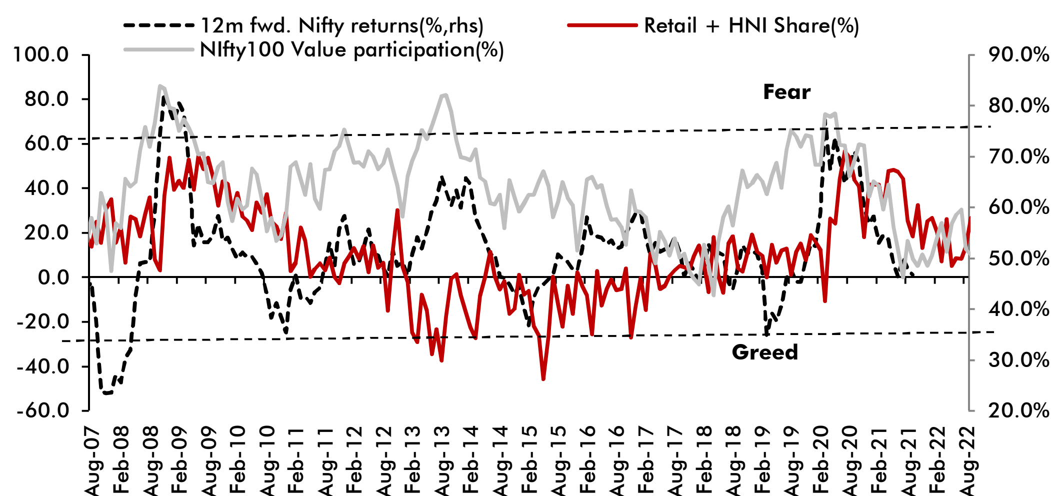
G&C 18.0 portfolio

The G&C portfolio is guided by one or more of these attributes – large-cap preference, high on greatness/forensic scores, ranks high on the Present Value of Growth Opportunity (PVGO) framework, and our house view. The G&C 18.0 portfolio is geared towards large-caps, at 75% of the portfolio weight, while midcaps/small-caps constitute 22%/3%. The Greed & Fear indicator has shown strong moderation in fear and we change our stance on midcaps, though the preference order remains large-caps > midcaps > small-caps. Cash allocation stands at 8%. We continue with banks as our key sectoral OW and IT as the key sectoral UW. Banks do well in a rising real yield scenario and we have gone OW on BFSI. And, we have added eight (BFSI) and only two IT stocks in our G&C portfolio. We introduce the "Present value of growth opportunity" framework to select stocks along with greatness, forensics, and house view. We are overweight on Auto, Healthcare, Metals, Media, and BFSI and underweight on O&G/FMCG/IT/Cement.

Greed vs fear indicator: Turns away from fear in Aug-22

The crisis has been averted and it is also reflected in market behavior. The greed vs fear direction has shown a strong moderation in fear (in August) measured by Nifty 100 value participation, which has been on an upward since Feb-22. Midcaps and small-caps underperformed and people flocked to safety with Nifty100 value participation at the highest levels (in Jul-22). Our relative preference remains large-cap> midcap> small-cap. But we become buyers on midcaps while we remain sellers on small-caps. We expect midcaps to do well along with the market, and selecting quality midcaps can be the differentiator.

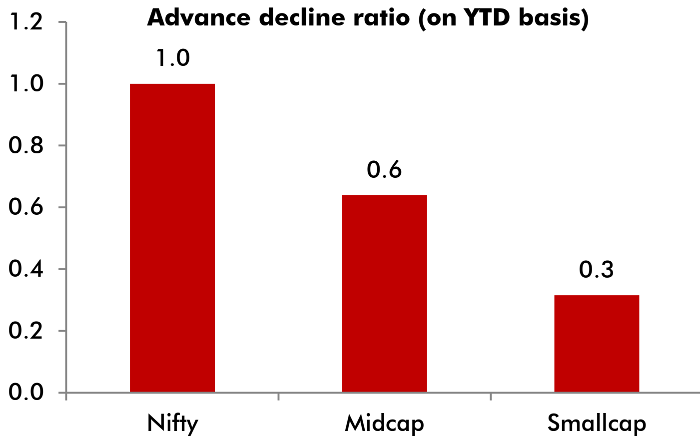
Exhibit 43: Greed vs fear indicator shows moderation in fear



Source: Ambit Capital research, Bloomberg; Note: analysis is based on market value by participation. Latest data as of 26th Aug 2022.

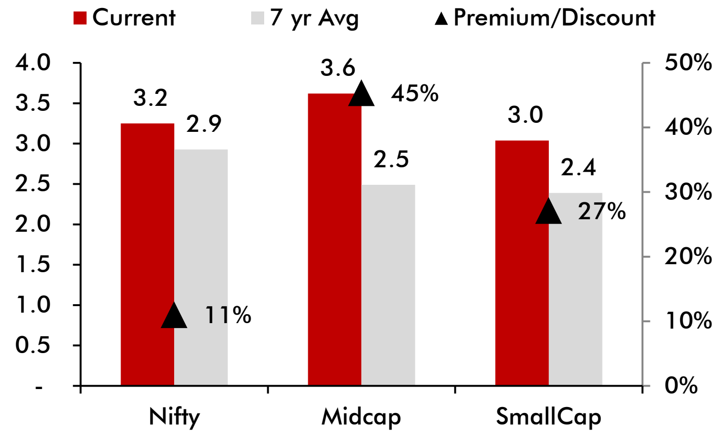
In CY22, while the differential between Nifty and midcap returns was not substantial as compared to small-caps which underperformed massively, the breadth of stocks delivering positive returns in CY22 was significantly better for Nifty as compared to mid-caps and small-caps. We believe this trend can continue. Also, the market cap contribution of large-caps has reached trough levels and is set for a rebound. The aggregate PAT of NSE100 as a proportion of NSE500 has declined significantly. As the recovery continues, we expect this to normalize led by banks and so does the NSE100 market cap contribution! And lastly, the RoE differential of the midcap index with Nifty has converged significantly, which explains the sustenance of the premium. We screen through our universe to select quality midcaps in our portfolio.

Exhibit 44: The breadth is in favour of large-caps over small-caps and midcaps



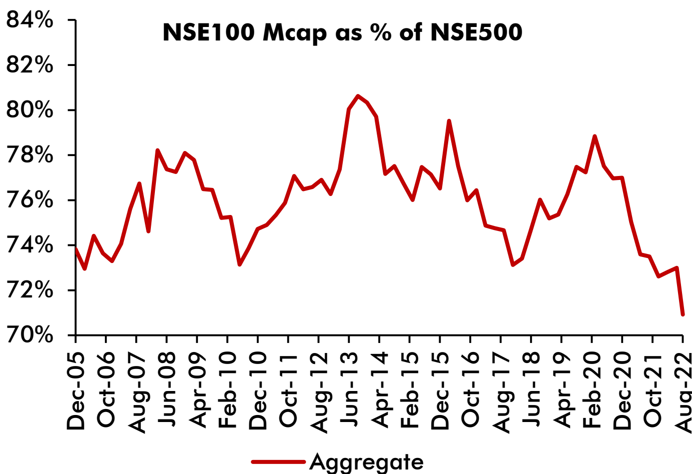
Source: Bloomberg, Ambit Capital research; Note: For mid-cap and small-cap performance we have used Nifty Midcap 150 Index and Nifty Small cap 250 Index

Exhibit 45: Nifty valuation appears reasonable



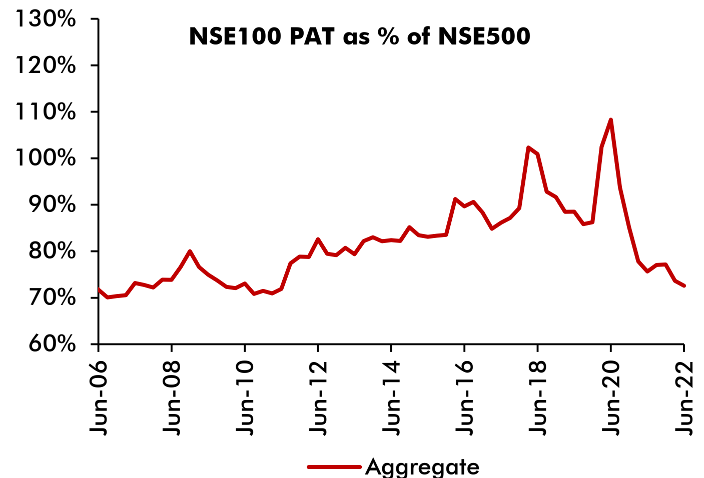
Source: Bloomberg, Ambit Capital research; Note: For mid-cap and small-cap performance we have used Nifty Midcap 150 Index and Nifty Small cap 250 Index

Exhibit 46: The proportion of NSE100 in NSE500 aggregate has significantly reduced post Covid



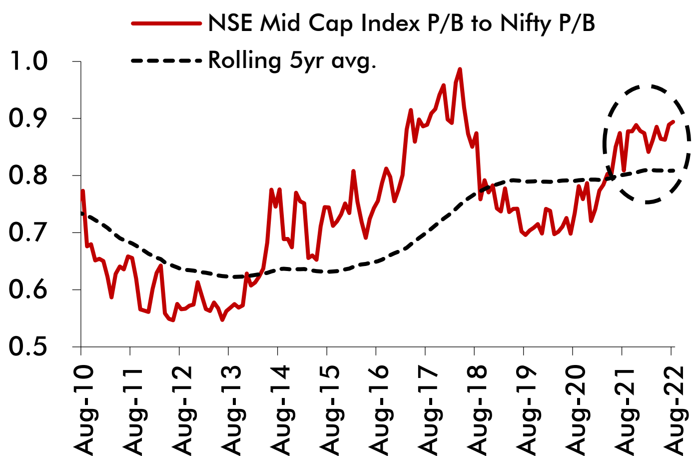
Source: Ambit Capital Research, Bloomberg

Exhibit 47: NSE100's contribution to NSE500 PAT has come off significantly



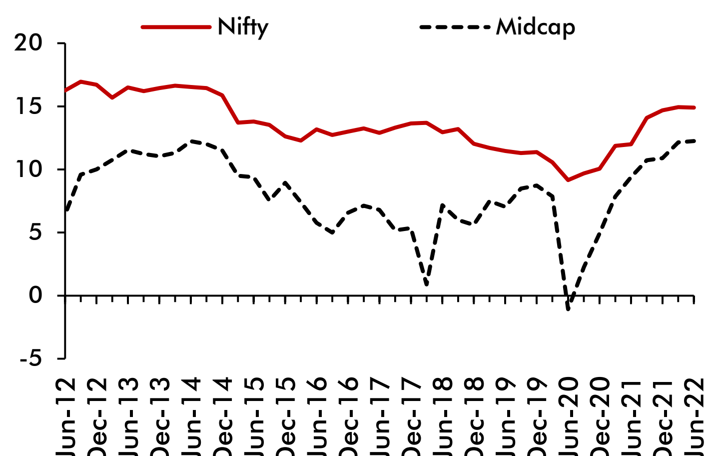
Source: Ambit Capital Research, Bloomberg

Exhibit 48: The premium of midcap to Nifty...



Source: Ambit Capital research, Bloomberg

Exhibit 49: ...can be explained by convergence in RoE



Source: Ambit Capital research, Bloomberg

Relaunching G&C portfolio

Revisiting our G&C portfolio methodology

We construct our model G&C portfolio with the following premises:

Stock selection criteria: In line with earlier iterations, stocks that can be considered for inclusion in our G&C portfolio need to clear our "forensic" and "greatness" filters. For more details on these frameworks, please refer to this note. We have introduced the present value of growth opportunity (PVGO) framework in taking sectoral allocation calls and selecting "value" ideas whenever possible. IT/FMCG for instance are UWs as per our framework. We take an active call for size orientation of the portfolio. Currently, portfolio preference is in favour of large-caps. Lastly, our analysts' preferred picks in our OW/UW sectors also find a place.

Size of the portfolio: We construct our portfolio assuming a dummy allocation of US$1bn. Consequently, any stock that does not meet our minimum liquidity threshold does not get included in our portfolio.

Number of stocks: At any point in time, the maximum number of stocks in our portfolio is restricted to 25-30.

Cash holding: Finally, at any point in time, cash held in our portfolio would be between 2-15%.

Weights of the stocks: For large-cap stocks, we suggest based on conviction two weight allocation categories – ~6% and ~4%. Likewise, for midcap stocks, we have kept two weight categories – ~3% and ~2%. For small-cap stocks, we have kept the weight at 1.5%. AMFI classification has been used for stock categorization.

Exhibit 50: Valuation of G&C portfolio 18.0 vs. Nifty 50 and Nifty100

Portfolio	Median M-CAP	Median 6M ADV	Median FY22	Median FY22	Median FY22	Expected Earnings growth		Beta
	(US $mn)	(US $mn)	P/E(x)	P/B(x)	ROE(%)	FY23E	FY24E	
G&C 18	9,195	20.8	24.5	4.4	12.1	24%	35%	0.9
Nifty	20,784	43.3	26.3	4.0	11.6	15%	16%	1.0
Nifty100	11,693	23.6	29.7	4.4	11.6	10%	17%	1.0

Source: Bloomberg, Ambit Capital research,Note:G&C18 EPS is calculated after adjusting Exceptioal items for FY22.

Composition of G&C 18.0

Our portfolio remains conservative and 8/26 stocks trade at attractive valuations: We are OW on Banking and Financial stocks, a space we like given the earnings trajectory and a play on real yield expansion. We remain underweight on IT stocks due to expensive valuations amid rising US recession risks. This has been explained in detail in the next section. Our weight allocation of large-caps stands at 75%, with Banking and Financials contributing 37%. We don't restrict our investing universe to Nifty and seek quality liquid ideas from NSE200, except illiquid ones. The reference index is Nifty 100 for sector allocations.

Exhibit 51: Implicit sector weights

Sector	G&C 18	Nifty	Nifty 100*	Deviation	
				vs.Nifty	vs.Nifty100
Financial Services	36.3	37.3	34.2	(1.0)	2.1
IT	10.1	14.1	12.4	(4.0)	(2.3)
Oil & Gas	6	12.4	11.1	(6.4)	(5.1)
FMCG	8.2	10.2	11.4	(2.1)	(3.2)
Auto & Auto Anc	9.1	6.0	5.3	3.1	3.8
Media	4.1	0	0.4	4.1	3.7
New age tech	3	0	0.3	3.0	2.7
Miscellaneous	0	0.8	1.2	(0.8)	(1.2)
Capital Goods	0	3.8	4.6	(3.8)	(4.6)
Healthcare	6.1	3.8	3.9	2.3	2.2
Cement & Building Materials	0	3.4	4.1	(3.4)	(4.1)
Utilities	0	2.0	4.2	(2.0)	(4.2)
Metals & Mining	6	3.4	3.3	2.6	2.7
Chemicals	4.1	0.5	1.2	3.6	2.9
Telecom	4.1	2.3	2.2	1.8	1.9
Consumer durable	3.0	0	0.4	3.0	2.6

Source: Bloomberg, Ambit Capital research

Exhibit 52: Dissection of our OW/UW call w.r.t Nifty100

Sectors	OW/UW (%)	Portfolio Companies
Overweight		
Financials	2.1	Axis, Federal, Bajaj Finance, ICICI Bank, HDFC life, ICICI Lombard,SBI Cards, LIC Housing Finance
Auto & Auto Anc	3.8	Tata Motors, TVS motors, Ashok Leyland
Media	3.7	Info Edge
Healthcare	2.2	Dr. Reddy, Laurus Labs
Metals & Mining	2.7	Tata Steel
Chemicals	2.9	SRF
Telecom	1.9	Bharti Airtel
Consumer Durable	2.6	Amber Enterprises, VIP Industries
Underweight		
IT	-2.3	HCL Tech, Tech Mahindra
Oil & Gas	-5.1	IGL, Oil India
FMCG	-3.2	Godrej Consumers, ITC

Source: Company, Ambit Capital research

Exhibit 53: G&C 18.0 - Composition and valuations

Company	Sector	Mcap US$mn	MDV-6m (Median) $mn	Accounting Decile	Greatness Score	Ambit stance	P/E		P/B		ROCE*/ROA
							FY23E	FY24E	FY23E	FY24E	FY22
Tata Motors	Auto & Auto Anc	20,661	98	D10	0%	BUY	24.1	9.2	3.4	2.5	2.1
TVS Motor	Auto & Auto Anc	6,101	15	D10	42%	BUY	30.2	24.5	7.9	6.3	76.0
Ashok Leyland	Auto & Auto Anc	6,014	24	D3	17%	BUY	45.2	17.9	6.2	5.0	2.9
SRF	Chemicals	9,660	20	D1	92%	NR	33.6	29.2	7.3	6.0	17.7
Amber Enterprises	Consumer Durable	950	3	D4	58%	BUY	37.0	27.5	3.9	3.4	6.8
VIP Industries	Consumer Durable	1,047	3	D10	17%	BUY	42.5	36.9	12.0	9.8	12.1
Axis Bank	Financials	28,846	80	N/A	N/A	BUY	12.3	10.3	1.8	1.5	12.0
Bajaj Finance	Financials	54,495	98	N/A	N/A	NR	40.3	31.8	8.2	6.6	3.7
ICICI Bank	Financials	76,042	124	N/A	N/A	BUY	20.1	17.5	3.2	2.8	14.7
HDFC Life Ins	Financials	15,207	28	N/A	N/A	NR	68.3	56.5	7.4	6.8	0.6
ICICI Lombard	Financials	7,740	9	N/A	N/A	NR	35.7	28.3	5.9	5.1	2.8
SBI Cards	Financials	11,012	15	N/A	N/A	BUY	32.2	24.5	8.9	6.9	23.0
Federal Bank	Financials	3,151	15	N/A	N/A	BUY	10.1	8.5	1.2	1.1	10.8
LIC Housing	Financials	2,879	12	N/A	N/A	BUY	5.8	5.1	0.8	0.7	10.1
Godrej Consumer	FMCG	11,722	13	D1	42%	BUY	49.2	38.6	7.3	6.5	18.1
ITC	FMCG	50,132	61	D4	58%	NR	22.8	20.5	6.2	5.9	24.9
Dr Reddy's	Healthcare	8,730	22	D1	50%	BUY	21.5	16.1	3.2	2.8	11.8
Laurus	Healthcare	3,828	9	D5	83%	BUY	25.2	19.8	6.9	5.3	24.0
HCL Technologies	IT	31,404	44	D4	42%	BUY	18.3	16.4	4.1	4.0	23.7
Tech Mahindra	IT	12,866	45	D7	67%	BUY	18.6	15.8	3.3	3.1	19.9
Info Edge	Media	6,866	22	D4	42%	BUY	86.7	71.3	3.8	3.7	3.9
Tata Steel	Metals & Mining	16,130	108	D4	67%	BUY	6.4	5.8	1.0	0.9	29.7
PB Fintech	New-age tech	2,719	5	D6	75%	BUY	N/A	N/A	4.0	3.9	-25.4
Oil India	Oil & Gas	2,589	6	D9	58%	NR	3.0	3.6	0.6	0.5	15.7
IGL	Oil & Gas	3,665	11	D5	100%	BUY	22.2	16.8	3.9	3.5	15.7
Bharti Airtel	Telecom	52,888	58	D6	0%	BUY	34.6	23.2	6.0	5.3	7.9

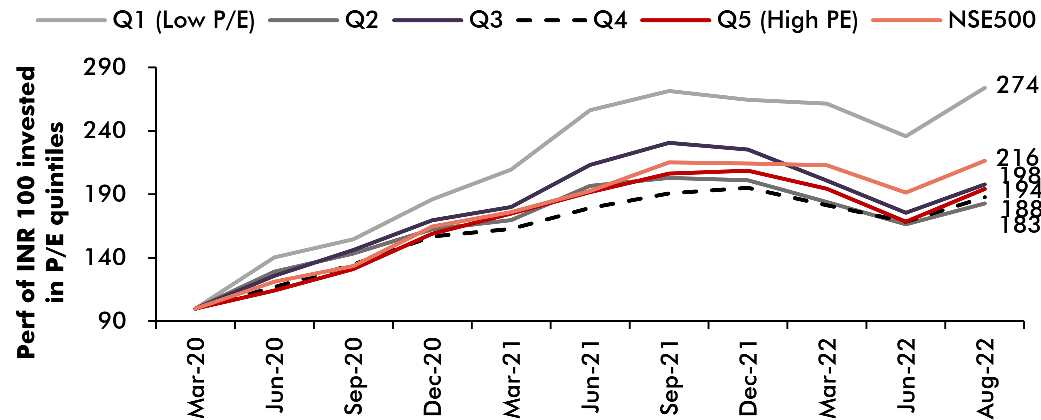
Source: Bloomberg, Ambit Capital research, Note: ROCE- pre-tax have been considered, ROA considered for financials, For Not rated companies-consensus estimates are considered.

We also introduce our PVGO framework, which plays a key role in stock selection and sector allocation along with house views!

PVGO framework for stock selection

In CY22, rising interest rates supported value outperformance as growth stocks have significantly higher duration than value stocks. In our recent note, [Strategy: Hide in "Intersection of good quality and value" for outperformance!], we showed that value outperformance (low P/E) is working on a broader universe like NSE500 ex-BFSI, delivering excess returns w.r.t. growth (high P/E) to the extent of 3% on a YTD basis. Since Mar-20, Q1 (lowest P/E quintile) outperformed NSE500 by ~58% on absolute basis and the outperformance has continued in CY22.

Exhibit 54: Since Mar-20, Q1 (lowest P/E quintile) has outperformed NSE500 by ~58%



Source: Ambit Capital research, Bloomberg

For capturing the "value part", we introduce a stock selection framework answering the question "**What portion of enterprise value is attributed to growth?**"

Introducing PVGO framework to screen for "value"

The Present value of growth opportunity (PVGO) can be mathematically defined as:

PVGO= FGV/EV i.e. future growth value as a % of enterprise value

Where,

FGV= future growth value= EV-COV, and

COV= current operating value= post-tax EBIT/WACC

EV= Market Capitalization + Net Debt

Note:

- The tax rate is computed as the total tax expense/PBT. We adjust outliers by substituting with the universe median tax rate.
- For WACC, the cost of debt is defined as the total interest expense/average total debt while the cost of equity is computed using CAPM.
- Market Return is calculated using the internal rate of return (from the Dividend Discount Model) weighted by the market-cap of each index member. This is a forward-looking (rather than historical) estimate of market returns. The risk-free rate is the yield on a 10-year government bond.

We look at FMCG and IT on this framework.

A look at the IT sector (our key sectoral underweight) through the PVGO lens

The application of the methodology to the IT sector highlights that, though the IT index has underperformed NSE200 by ~30% in CY22, the share of FGV as a percentage of EV trends suggests stocks are still way off from Covid troughs and are significantly higher than 7-year average/median PVGO for all of them. This implies that while prices have corrected, on the valuation front they are still expensive. Valuation still do not adequately factor in risks to demand from weakening macro/client financials.

HCL Tech, Wipro, and Tech Mahindra PVGO are the lowest amongst IT stocks. We are BUYers on Tech Mahindra with expectations of margin improvement driven by better growth (~9.5% CAGR, FY22-25E) on 5G transition and strong deal wins. We are BUYers on HCLTECH on favorable segmental skew and growth convergence with peers over FY22-25E aided by new deal wins. But, we are sellers on Wipro due to weaker positioning in developed markets leading to growth lag versus peers and higher margin dilution.

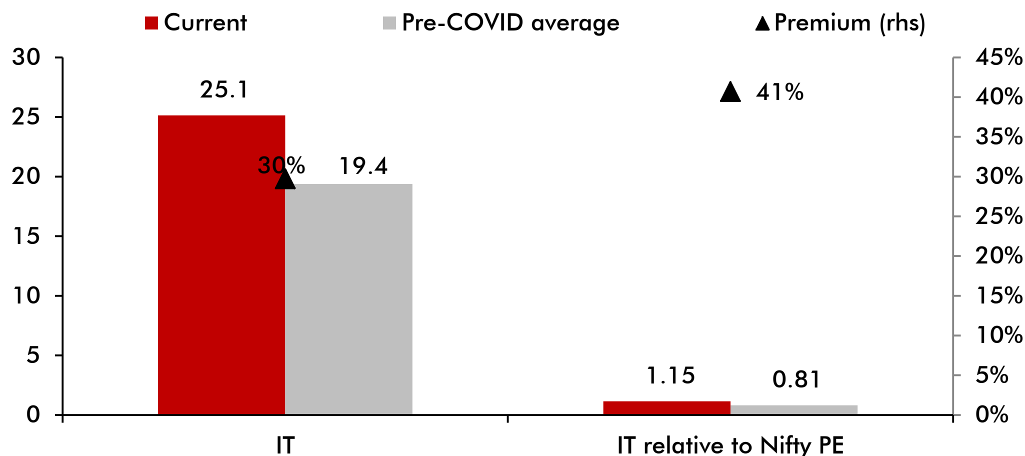
Exhibit 55: All IT stocks above their LTA average/median PVGO contribution

Company	Stance	Current	Min	7-year average	7-year median	Max
HCL Tech	BUY	55%	-99%	38%	37%	73%
Mphasis	BUY	73%	-36%	43%	43%	77%
Tech Mahindra	BUY	55%	-251%	43%	42%	93%
Coforge	SELL	72%	-607%	42%	54%	84%
Infosys	SELL	70%	-3%	50%	50%	78%
L&T Infotech	SELL	77%	8%	54%	60%	84%
Mindtree	SELL	73%	-26%	59%	59%	82%
TCS	SELL	73%	-17%	61%	61%	84%
Wipro	SELL	56%	-46%	35%	34%	85%

Source: Ambit Capital research, Bloomberg

This reflects in IT index valuation of 25.1 x, which is still at a 30% premium to the pre-Covid 3-year average, implying significant downside if valuations revert to pre-Covid average. 1QFY23 reporting season has highlighted the inability to push price hikes, weakening macro, absence of large deals, and rising subcontracting costs. Focus will be on outlook, for which large deal wins (sluggish lately), BFSI/Retail demand (50% of revenue), and any impact of short cycle deal flow momentum should be watched. We maintain IT as the key sectoral underweight as highlighted in SOM.

Exhibit 56: IT valuations at 25.1x are still at a 30% premium to pre-Covid 3-year average



Source: Ambit Capital research, Bloomberg

FMCG appears expensive on PVGO framework

FMCG has outperformed NSE200 by ~14% in CY22. The share of FGV as a percentage of EV is close to the 7-year average/median for all FMCG stocks barring Tata consumer where it is materially higher.Zydus Wellness, Britannia, GCPL and ITC trade below the 7-yr median. The PVGO trajectory for the covered FMCG universe has been upward sloping over the last decade, with ~13% average increase in PVGO over the last 5 years. Nonetheless, valuations are expensive and we are underweight on the sector.

Exhibit 57: Britannia, GCPL, ITC, Zydus wellness trades below 7-yr median PVGO

Company	Stance	Current	Min	7-year average	7-year median	Max
Britannia	BUY	77%	-50%	79%	79%	87%
Dabur India	BUY	82%	-13%	78%	79%	86%
GCPL	BUY	74%	-4%	76%	75%	85%
Marico	BUY	81%	-21%	78%	80%	86%
United Breweries	BUY	91%	33%	88%	88%	96%
Zydus Wellness	BUY	72%	-13%	74%	75%	88%
ITC	NOT RATED	60%	2%	58%	66%	78%
HUL	SELL	86%	32%	83%	84%	88%
Nestle India	SELL	92%	46%	90%	91%	94%
Tata Consumer	SELL	85%	-52%	69%	69%	87%
United Spirits	SELL	89%	-54%	85%	84%	154%

Source: Ambit Capital research, Bloomberg

This PVGO framework has been used in stock selection. We are screening for stocks whose firm values are factoring in growth contribution below their historical 7-year median currently and meet liquidity criterion. The following stocks meet the criterion.

Exhibit 58: PVGO stock selection – Names that are trading cheap w.r.t. 7-year median

Company	Stance	Current	Min	7-year average	7-year median	Max
Bharti Airtel	BUY	59%	1%	76%	66%	155%
Godrej Consumer	BUY	74%	-4%	76%	75%	85%
IGL	BUY	55%	-31%	61%	63%	80%
Info Edge	BUY	-2%	-58%	65%	78%	95%
Tata Motors	BUY	98%	-88%	96%	98%	359%
TVS Motor	BUY	47%	-62%	54%	52%	110%
ITC	NOT RATED	60%	2%	58%	66%	78%
Oil India	NOT RATED	-148%	-184%	-34%	-8%	37%

Source: Bloomberg, Ambit Capital research;

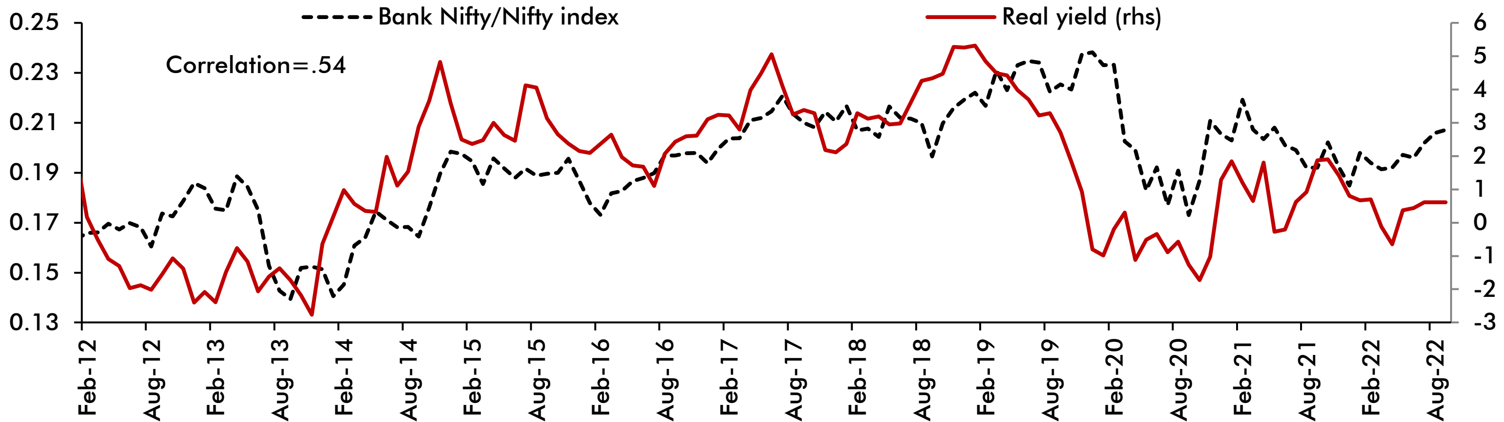
In addition to this, we take our house views on sectors/stocks playing an important role in stock selection. Our view on key sectors, including why we are overweight/underweight, what are the key monitorables and our fundamental reasoning behind G&C portfolio stocks, have been explained in the next section.

Banks

Playing the 'rising real yield' scenario

In addition to the PVGO framework for stock selection, banks are our key sectoral overweight and are expected to outperform over the next 12 months (details). In our latest SOM May'22, we underlined that in the rising yield scenario, historically, banks have outperformed Nifty by 18%. Improving credit growth, NIM expansion on the back of rising credit, and ameliorating asset quality support our call on banks as the key sectoral overweight.

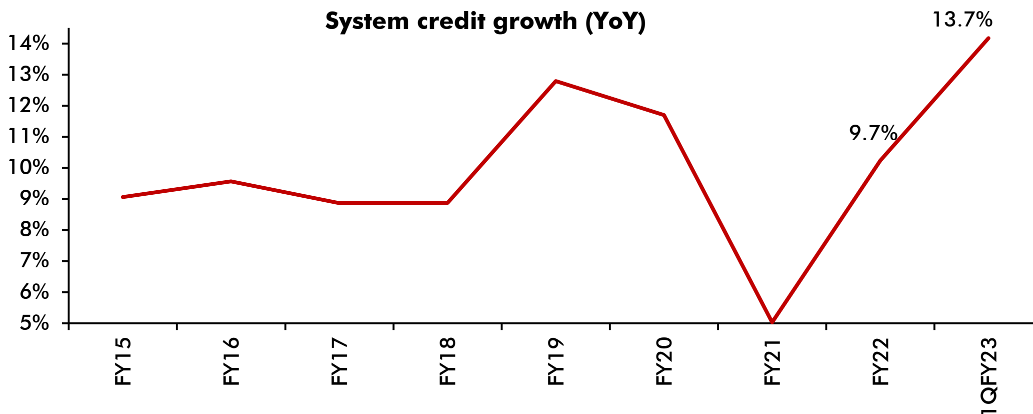
Exhibit 59: Increasing yield and moderation in inflation to improve real yield and drive banks' outperformance over Nifty



Source: Ambit Capital Research, Bloomberg; Note: Latest data is as of 31 August 2022.

We build on this further, with our BFSI analyst Pankaj Agarwal adding a few details. Improving credit growth and ameliorating asset quality support our call of banks as the key sectoral overweight. Credit growth is accelerating for banks with credit growth jumping to 13.7% YoY at 1QFY23, highest in the last 7 years.

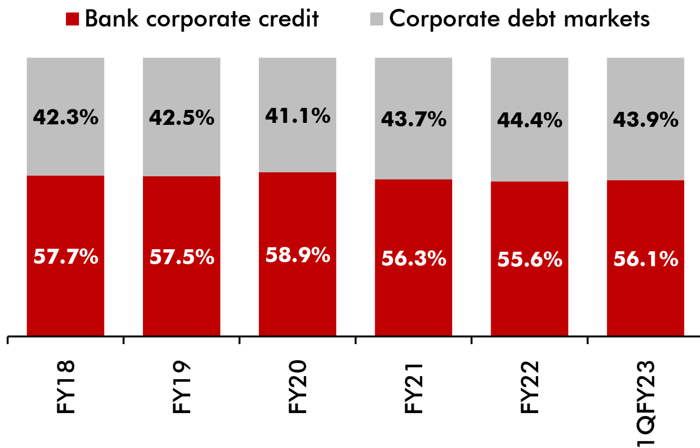
Exhibit 60: Credit growth has increased to ~14%



Source: RBI, Ambit Capital research

Credit demand has improved across the board. While retail credit growth has returned to pre-pandemic levels, corporate credit growth is showing signs of improvement from 3QFY22. As yields have hardened, CPs/corporate bonds no longer remained attractive. This supported improvement in banks' corporate credit.

Exhibit 61: Banks have reclaimed some market share from the bond market



Source: RBI, SEBI, Ambit Capital research

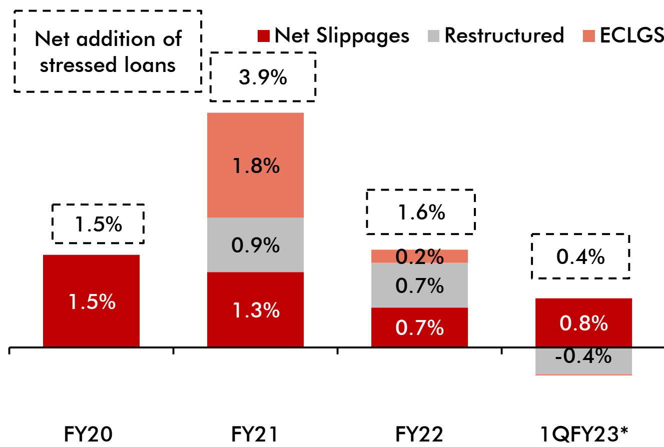
Exhibit 62: Pick-up in credit growth across segments

Break-up of non-food gross bank credit	Mix	YoY Growth				
	Jul'22	FY19	FY20	FY21	FY22	Jul'22
Overall credit	**100.00%**	**12.30%**	**6.70%**	**4.90%**	**9.70%**	**15.10%**
Agriculture	**13.30%**	**7.90%**	**4.20%**	**12.30%**	**9.90%**	**13.18%**
Industry	**27.70%**	**6.90%**	**0.70%**	**0.40%**	**7.50%**	**10.46%**
SME/MSME	**6.80%**	1.10%	1.10%	6.70%	30.70%	**30.58%**
Large Enterprises	**21.00%**	8.20%	0.60%	-0.80%	1.90%	**5.23%**
Personal Loans	**31.30%**	**16.40%**	**15.00%**	**10.20%**	**12.60%**	**18.84%**
Housing*	**15.40%**	19.00%	15.30%	9.10%	12.90%	**16.19%**
Credit Cards	**1.40%**	28.60%	22.50%	7.80%	12.60%	**28.28%**
Vehicle Loans	**3.80%**	6.50%	9.10%	21.20%	9.30%	**19.21%**
Other PL	**9.10%**	16.10%	19.80%	13.70%	14.50%	**21.52%**
Services	**27.60%**	**17.80%**	**7.40%**	**1.40%**	**8.70%**	**16.48%**
Transport	**1.40%**	5.80%	7.40%	5.40%	8.60%	**9.56%**
Trade	**6.30%**	13.10%	4.60%	11.80%	10.80%	**14.19%**
Real Estate	**2.60%**	8.90%	13.60%	2.50%	0.50%	**3.60%**
NBFCs	**10.10%**	41.20%	29.00%	4.50%	11.20%	**27.36%**
Other Services	**6.30%**	9.50%	-13.30%	-4.70%	6.60%	**11.92%**

Source: RBI, Ambit Capital research

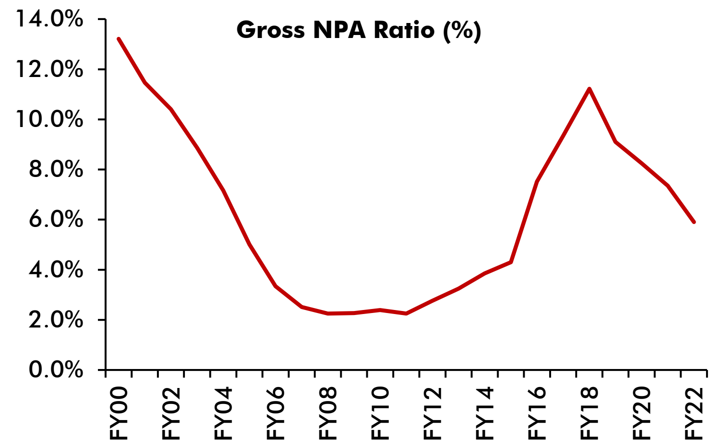
Asset quality has also been improving for the sector with a fall in both outstanding gross NPA ratio and fresh slippages.

Exhibit 63: Factoring in restructuring/ECLGS loans, FY22 stress was almost similar to FY20 levels



*Source: Company, Ambit Capital research, Note: Aggregate data of 13 banks, ECLGS data provided till dates by banks- DCB/BOB ECLGS as on 1QFY23; ICICIBC/CUBK ECLGS as on 4QFY22, SBIN ECLGS as on 3QFY22, AXSB/HDFCB/IIB/RBL/Bandhan, ECLGS as on 1QFY22 and FB/KMB/AU ECLGS as on 2QFY22. *1QFY23 data is annualized*

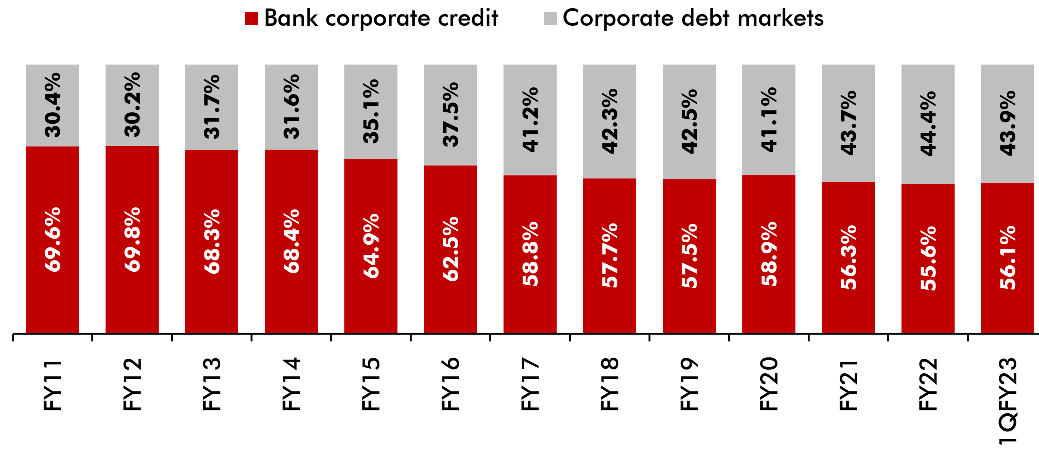
Exhibit 64: Asset quality is improving



Source: RBI, Ambit Capital research.

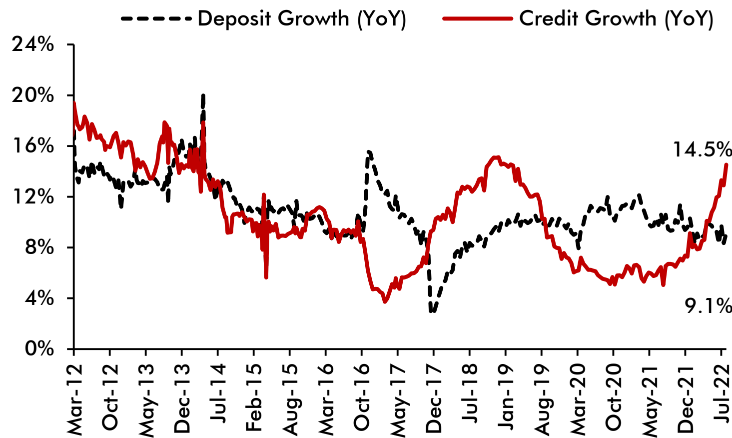
As yields have hardened, CPs no longer remains attractive. This has favored improvement in banks' corporate credit. Our pecking order in banks – Axis Bank > Federal Bank >ICICI Bank, while we remain sellers on Bandhan Bank and Kotak Mahindra Bank.

Exhibit 65: Banks have reclaimed some market share from the bond market



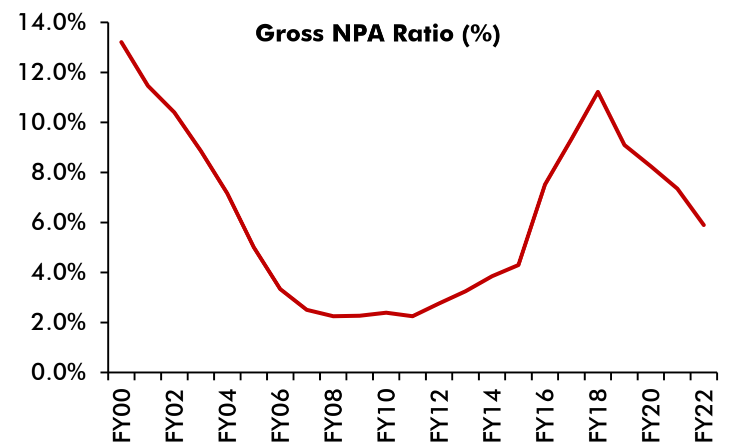
Source: Ambit Capital research, Bloomberg

Exhibit 66: Loan growth has started to outpace deposit growth



Source: RBI, Company, Ambit Capital research

Exhibit 67: Asset quality improving



Source: Source: Company, Ambit Capital research.

The key aspects to watch out for Deposit Growth and Stress in MSME Sector.

Exhibit 68: Key aspects to monitor

Variable	Comments
Deposit growth	Deposit growth of ~8% YoY lags loan growth of ~15%. Banks would either have to raise deposits and take some hit on NIMs or settle for lower loan growth.
Stress in MSME Sector	Most restructured loans are in the MSME sector, which is most vulnerable in case Indian/global economy weakens. Hence, spike in NPAs in this segment cannot be ruled out.

Source: Company, Ambit Capital research

Auto & Auto Ancillaries

Easing headwinds to drive earnings

Post significant earnings contraction in FY19-22 owing to multiple headwinds like safety/emission regulations, Covid outbreak, chip shortages etc., we believe the domestic auto sector is now poised for a major revival. Easing chip shortages along with robust order backlogs provide visibility for superior volume growth on a benign base of FY22. We expect domestic PV/2W/M&HCV industry to deliver 12%/13%/25% volume CAGR in FY22-24E. Also, apart from rising scale, falling input commodity costs imply improving profitability outlook for auto OEMs in FY23-24E post witnessing major input cost inflation in FY21-22. Our spot metal cost index for 2Ws/PVs is down 300-400bps vs. peaks, which is set to reflect with a lag on auto OEM profitability. A combination of high volume growth visibility and improving profitability trends will drive ~35% EBITDA CAGR in FY22-24E for stocks in our coverage. Key risks: Rise of China-Taiwan tensions and reversal of falling input costs.

We are most bullish on domestic CV plays given superior earnings growth outlook vs. personal mobility OEMs like 2Ws/PVs. This is driven by steady fleet operator profitability; favourable truck supply-demand dynamics post severe downturn in FY20-21, and strong replacement demand. Also, valuations for CV plays are near mid-cycle band levels vs near upper end of valuation band for 2Ws/PVs plays. Meanwhile, we expect mean reversion in the tractor cycle in FY24E, with decline of 6% in domestic tractor industry volumes post upcycle over FY20-23E.

Pecking order: Tata Motors > Bharat Forge > Ashok Leyland > Maruti Suzuki (BUYs) > Bajaj Auto > Hero MotoCorp > MRF > Sona Comstar (SELLs). Prefer auto OEMs over auto ancillary plays given higher scope for earnings surprise in former vs latter.

Exhibit 69: Key aspects to monitor

Variable	Comments	Companies
Volume trends	Most auto OEMs have order backlogs to the tune of 20%+ of FY22 volumes. This provides visibility of revenue growth on a benign FY22 base. However, easing chip supplies implies order backlogs of OEMs would get tested.	Tata Motors (incl. JLR) followed by MSIL and Eicher Motors have significant order backlogs
Input costs trends	Post witnessing significant input cost inflation in FY20-21, commodity costs have begun to soften. We expect commodity contract prices to converge with current spot input commodity prices. Any reversal in falling commodity price trends would dilute to an extent our margin improvement thesis	Auto OEMs would be bigger beneficiaries of metal deflation vs ancillaries as there is no history of price cuts for auto OEMs. Ancillaries typically have to pass on benefit to OEMs.
Global macro trends	Significant slowdown in US/Europe would adversely impact outlook for global ancillary companies and export-oriented companies. Also, any incremental lockdowns in China or rise in China-Taiwan tensions would drive supply-side pressures for the industry.	OEMs like Tata Motors (through JLR), would be impacted. Auto ancillary plays like SAMIL, Bharat Forge, Sundram Fasteners and Sona would be impacted.

Source: Company, Ambit Capital research

Technology

Still not time to turn

We expect growth moderation in FY23E and return to pre-Covid growth rates by FY24E as (i) digital shift is funded through pressure on legacy and (ii) digital growth itself moderates in percentage terms on base effect and project based-nature. Market share gains have not been visible across stronger MNCs, tier-2 IT, challengers (EPAM/GLOB) or captives, deal flows have weakened and macro has deteriorated, which further add weight to our view. Margins across companies (ex Mindtree) have fallen to below pre-Covid levels and recovery could be gradual given supply pressures, leveraged operating parameters and reversal of travel/facility cost saves. In addition to growth and margin moderation, cash generation has also weakened and, with liquidity pullbacks, should reflect in moderation of valuations. We await company commentary deterioration and elevated consensus margin expectation reset before we turn constructive.

We look for 13.7% YoY growth in CC terms in FY23E and trend growth of 8.3/7.8% YoY in FY24/25E. We saw peak EBIT margin in FY21 at 23.8%, but moderation to 20.7/21.2/21% by FY23/24/25E as temporary cuts (travel, sub-contractor, SGA) reversed and supply-side pressures hurt. We expect USD revenue/PAT CAGR of 8.3%/8.0% over FY22-25E for Tier-1 IT. Tier-1/Tier-2 IT valuations at 24.6/27.5x 1-year forward are still at 40%/63% above pre-Covid averages, limiting optimism.

Pecking order: HCL Tech > TECHM > Mphasis (BUYs) > Infosys > Cognizant > Wipro > TCS > Coforge > Mindtree > LTI (SELLs). Prefer Tier-1 IT over Tier-2 IT.

Exhibit 70: Key factors to monitor

Variable	Comments	Companies
Softness in BFSI/Retail (~45% of Tier-1 revenue) clientele	F500 client financials indicate weakening in both verticals but SIs still expect tech spends resilience with digital transformation initiatives continuing at key clients. However, with 6 of 8 global banks indicating CY22E tech spends to be similar or lower than CY21 levels, it might start reflecting in growth from 2H.	TCS/Wipro have highest exposure to BFSI within Tier-1 IT followed by Infosys while HCLT/TechM have relatively lower exposure
Macro weakness in Europe	Despite captive takeover deals in the geography, growth has remained largely similar to US. However, now with anniversary of these deals and softening of macro in UK/Europe, with indications of deeper recession demand too might weaken.	Within Tier-1 IT, TCS and Within Tier-2, Coforge has the highest exposure to Europe and are more vulnerable.
Supply-side pressures	Companies where cost aggression is higher or discretionary cost saves (travel/facility) are higher are more vulnerable. Prefer companies where either bad news on margins is already out or there are drivers which help margin defensibility.	Mindtree (14% per person employee cost reduction since pre-Covid) is risky. HCLT/TechM/Mphasis have either bad news in or factors driving margin stability or improvement.

Source: Company, Ambit Capital research

Oil & Gas

On the cliff edge

High price volatility has been the mantra for the oil market since Mar'22 due to geopolitical concerns in Eastern Europe. However, increasing oil supplies and recessionary concerns have knocked off approximately US$30/bbl from peak crude oil prices in Jun-22. The plunge has been even steeper for refining cracks due to an increase in refinery runs along with lackluster driving demand during the Northern Hemisphere summer season. There are more upside risks than downside in the next 6-12 months and hence we expect oil prices and refining cracks especially Gasoil/ATF to remain elevated as compared to FY22. In the case of natural gas, the market is expected to be even tighter due to the tussle for LNG, logistical issues in transportation, and high demand during winter.

RIL: Benefits of refining upcycle are likely to be offset by choppy petchem margins. Besides, we see RIL (SELL) materially stepping up uncertain consumer investments as it looks to list RRVL and JPL.

OMCs: Negative marketing margin on diesel and petrol have reduced due to softness in crude oil and refining cracks. Currently, there is no under-recovery in petrol. However, we believe that marketing margin would normalize in FY24 only as margin on diesel is expected to be under pressure due to low middle distillate inventories globally. Beyond FY23, we expect demand moderation and supply response. Thus the energy markets will be lukewarm. In this environment, BPCL/HPCL are expected to outperform IOCL. We prefer BPCL>HPCL>IOCL.

CGDs: High domestic & imported gas costs and under allocation of domestic gas may put downward pressure on margins in near to medium term. Also, the attractiveness of CNG vs. diesel/petrol is around 15/30% currently vs. 50/80% a year ago, which makes price hikes more challenging now. We remain BUYers on IGL only due to its strong volume growth trajectory to partially offset margin pressure. Among the other two where we are SELLers, we prefer GGas over MGL.

Gas Utilities: Gas volumes are expected to be under pressure in the near to medium term due to high spot LNG prices and force majeure by Gazprom Germania. Also, the spread between HHUB vs. LNG continues to be favourable while HHUB vs. Brent spread may come under pressure. We prefer GAIL (BUY) over PLNG (SELL) due to high volume growth and strong support from trading business.

Exhibit 71: Short-term prospects for the oil & gas market

Variable	Comments	Companies
APM Price Revision (Oct-22/Apr-23)	As per our estimates, APM price is expected to be US$9.5/US$12.0 per MMBTU in 2HFY23/FY24. In our view, CGDs can manage upcoming price revision but not the next one and government support will be needed.	IGL, MGL, and GGas
Oil Price	**Upside Risks:** EU ban on Russian oil, limited OPEC spare capacity, stoppage of oil withdrawal from SPR, and high demand due to lifting of Covid-19 restrictions in China, gas-to-oil switching, and continuous recovery in global economy **Downside Risks:** Possibility of increase in Iranian oil supply and demand destruction due to prolonged Covid-19 restrictions in China and recession. Back in 2008, around 2.5 mb/d of demand destruction was enough to bring crude to US$30/bbl from US$110/bbl; however, we haven't yet seen any sign of weakness in oil market.	RIL, IOCL, BPCL, and HPCL
Refining cracks	We expect refining cracks especially gasoil to remain elevated as compared to FY22 due to EU ban on Russian oil products by 5-Feb, 2023, continuous increase in demand, and low inventories level (gasoil inventories are 26% below 5-yr average in U.S.). However, additional refining capacity and increase in refinery run can provide some support.	RIL, IOCL, BPCL, and HPCL

Source: Bloomberg, Ambit Capital research

FMCG

GM improvement in 2H, watch for volume recovery

The growth drivers for FMCG are increase in penetration, premiumisation, rising share of organized brands and distribution expansion. Within FMCG, F&B players are poised to clock faster revenue growth (as seen in FY16-20) led by superior volume growth than HPC companies. HPC companies on the other hand are striving to seize premiumisation of categories, which however is taking time owing to macro headwinds. In the near term, the sector has been plagued with lower than pre-Covid volume growth. Also, sharp RM inflation across multiple categories led to a dent on gross margins for most of the FMCG companies. With cool-off in prices of some RMs, we expect sequential improvement in gross margins from 2HFY23. However, for volume recovery to come back to pre-Covid levels (industry), it would need a better macro push. In this context, we remain selective and prefer GCPL (turnaround on business execution) and BRIT (likelihood of scale up of adjacencies).

Exhibit 72: Variables to monitor FMCG over the next 3 quarters

Variable	Comments	Companies
Volume growth	Consensus is building moderate (low to mid-single digit) volume growth for FY23. Any turnaround in volume trajectory in 2HFY23 may lead to some upgrades.	NA
Gross margin	With clear signs of moderation in RM prices, conviction on building GM expansion is high.	Companies benefitted: HUVR, GCPL and BRIT
Ad spends	Management is guiding for multiple new launches and foray into adjacent categories which will require higher brand-building investments.	HUVR, NEST and MRCO reduced their ad spends the most over FY20-22. Expect these companies to increase ad-spends.

Source: Bloomberg, Ambit Capital research

Investment thesis for the stocks

Amber Enterprises

(AMBER IN, TP Rs3287, upside 46%)

Credible EMS import substitution play

Amber is the largest AC manufacturer in India. Opportunities around the ban on gas-charged RACs and PLI scheme for components will aid growth prospects. We believe Amber will scale up in components across RAC and non-RAC businesses. Components should post 32% revenue CAGR, driving 28%/38% consolidated revenue/EBITDA CAGR over FY22-25E. Over the next 2 years, we expect Amber's components business to scale up to 58% of overall revenue. The components business will post 32% revenue/EBITDA CAGR over FY22-25E. This is on the back of scale-up in new client business and growth in motors & electronics business over FY22-24E as reliability cycles for new products are close to completion. We expect RoCE to improve by 7ppt to 14% over FY22-24E. This RoCE expansion will be driven by scale-up in component/subsidiary businesses which are structurally higher-RoCE segments. Investment phase for Amber is close to being over with cumulative capex/investment of ~Rs11bn incurred over FY20-23E. The key catalysts to monitor over the next six to twelve months: (a) scale-up of RAC components business on the back of GOI's import ban and PLI scheme, (b) recovery in standalone margins as commodity prices ease and (c) improvement in RoCE for FY24 as capex cycle ends by FY23 for Amber. Our 2-year DCF-based TP of Rs3287/share implies 30x 1-year fwd EPS, which is at a 30% discount to leading brands like Voltas.

BUY

Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	AMBER

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenues	42	58	70
EBITDA	3	4	6
Diluted EPS(Rs)	33	61	82

Source: Company, Ambit Capital research

Ashok Leyland

(AL IN,TP Rs168, upside 8%)

Prime beneficiary of domestic CV upcycle

Post ~60% decline in FY19-21, we expect AL's goods M&HCV volumes to clock ~27% CAGR in FY22-25E. This will result in FY19 volumes getting exceeded by FY25E. Moreover, AL has been successful in recovering domestic M&HCV market share from lows of 22% to 30%+ in 1QFY23 owing to launch of CNG ICVs and continued network distribution expansion in North/East. On account of superior volume growth outlook, falling discounts and shift towards higher tonnage vehicles during CV upcycles, we expect AL's revenue to clock ~36% CAGR in FY22-24E. Sharp jump in scale and improving mix would also lead to EBITDAM expanding ~620bps in FY22-24E, driving EBITDA jump of ~4x in FY22-24E. Additionally, we don't foresee AL's capex spends exceeding ~3% of sales in FY22-24E given present capacity utilization of ~60%. Hence, we expect AL to generate cumulative FCF of ~Rs34bn in FY23-24E, resulting in AL turning net debt free by FY25E. Thus, RoE would move up to upcycle levels of ~30%+ by FY24E, driving re-rating. The key catalysts to monitor over the next six to twelve months: (a) monthly goods M&HCV wholesale print, (b) rising fleet utilization of truckers with new additions to fleet and (c) trajectory of discounts and mix of higher tonnage vehicles in industry volumes. Reversal in falling input commodity trend and any weakness in goods M&HCV growth momentum are key risks to our call. Our DCF-based TP of Rs178 implies 12x FY24E EV/EBITDA.

BUY

Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	GREEN

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenues	217	323	403
EBITDA	10	22	44
EPS(Rs)	0	4	9

Source: Company, Ambit Capital research

Axis Bank

(AXSB IN,TP Rs1003, upside 34%)

Moving in the right direction

Axis Bank is improving structurally on asset quality as well as at the operating level. Separation of underwriting function from business, focus on higher-rated corporates and focus on in-house customers for retail loans have resulted in asset quality performance of Axis Bank being best amongst private sector banks during the pandemic. PCR of 77% and additional provisioning buffer of ~1.7% of loans should lead to decade-low credit cost of ~60bps in FY23/24E (vs 280bps in FY17-22). Rising share of retail/rural loans and rising market share in credit cards would result in better yields and lower PSL drag, driving a minimum ~10bps NIM improvement in FY22-24E. Also, acquisition of Citi's India retail business should strengthen Axis' retail business as Axis gets a foothold in the affluent segment. Key catalysts: Credit cost should average ~60bps in FY23/24E vs (vs 280bps in FY17-22). NIM improvement of ~10bps in FY22-24E driven by: 1) rising share of SME/high-yielding retail loans in the loan mix, 2) rising share of loans in interest-earning assets, 3) rising market share in credit cards, and 4) lower dependence on low-yield RIDF bonds. We expect 25% EPS CAGR over FY22-25 with 15.7% RoE in FY24/FY25 vs ~5% in FY17-22. Stock is trading at 1.3x/10.2x FY24 BVPS/EPS and is at ~50% discount to large private sector banks peers.

BUY

Ambit Estimates

	FY22	FY23E	FY24E
EPS (Rs)	42.4	60.9	72.8
Adj. BVPS (Rs)	366.9	421.2	486.7
ROE (%)	12.0%	15.1%	15.7%
P/ABV (x)	1.78	1.55	1.34

Source: Company, Ambit Capital research

Bharti Airtel

(BHARTI IN, TP Rs900, upside 22%)

Biggest telecom tariff hike beneficiary

The telecom sector faced a decade of hyper-competition, adversarial government stance and predatory pricing. There are now only three private telcos vs. 10 in 2016. Given high consumer surplus due to smartphone applications telcos are powering, they were able to raise prices 1.6-3x in 2019-22. Government's accommodative stance is evident from reduced spectrum prices vs. prior auctions, royalty concessions and ample 5G spectrum availability. Airtel's 2022 auction purchases are NPV positive. It has a strong balance sheet (3x FY23E net debt/EBITDA) and consistently outperformed Jio since tariff hikes given its focussed approach. We expect 12% mobile tariff CAGR over FY22-25E vs. 16% in FY19-22. Airtel is also able capitalising on Covid induced digitisation opportunities as it dominates B2B and home entertainment markets; telco adjacencies that we expect to drive 20% incremental revenues that are likely to be catalysed by 5G rollouts over FY22-26E. RIL's imperative to IPO Jio by 2024 entails new uncertain investments. We believe that this will make Jio accommodative towards tariff hikes over FY22-26. Even VIL is precariously placed and has opted to give the government 30% shareholding in lieu of deferred dues; so the government too will be in tune with industry for tariff hikes. We expect a 12% price hike for 4G users in 2022-end as the impact of the 2021 tariff hikes has already percolated into the sector's user base and 5G services are likely to be launched.

BUY

Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	GREEN

Source: Company, Ambit Capital research

Ambit Estimates (Rs bn)

Particulars	FY22	FY23E	FY24E
Revenue	1,363	1,558	1,831
EBITDA	695	798	945
Diluted EPS(Rs)	7	16	29

Source: Company, Ambit Capital research

Dr. Reddy's Laboratories

(DRRD IN, TP Rs5700, upside 36%)

Multiple strings to its bow

A more diversified business mix, rising complexity in product pipeline, renewed focus/growth in India, and improving margin/RoCE trajectory underpin our positive stance. Key factors behind recent underperformance viz. elevated US price erosion and Russia-Ukraine conflict are fading. US price erosion should revert to mean levels (7-8%) vs. double-digit range currently as post Covid catch-up eases. Russia has held up well in terms of underlying growth (+21% YoY in rouble terms over 3QFY22-1QFY23) as well as currency. Meanwhile, rising share of non-US businesses (65% vs. 55% in FY17), leaner cost structure and efforts on complex generics (25-30% of pending ANDA pipeline) should help sustain 10%+ sales growth and 20%+ RoCE over FY22-25. Our DCF-based TP of Rs5,700 implies valuation of 22x FY24E EPS, which is attractive given forecast 18% FY22-25E EPS CAGR and relative to 3-year average of 23x. The key catalysts to monitor over the next six to 12 months: (a) launch and scale-up of key pipeline assets (gRevlimid, gLexiscan among others) and step-up in new launches (~25 p.a. over FY23-24) in the US, (b) easing US price erosion, (c) organic and inorganic initiatives to accelerate growth in India and (d) any signs of easing of the Russia/Ukraine conflict. Besides the above factors not playing out as per expectations, key risks to monitor include: (a) continued rise in cost of inputs, power and freight that have impacted margins over the last two quarters and (b) adverse compliance-related events at any of its plants given pick-up in pace of US FDA inspections in India.

BUY

Flags

Accounting:	GREEN
Predictability:	GREEN
Earnings Momentum:	GREEN

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenues	214	238	267
EBITDA	46	59	66
EPS(Rs)	175	195	261

Source: Company, Ambit Capital research

Federal Bank

(FB IN, TP Rs143, upside 19%)

Strengthening its core

Federal Bank has one of the best liability franchises with highest share of sticky retail deposits in the banking system, higher share of branches in deposit-rich Kerala (3rd highest after SBI/Canara) and increasing share in NRI deposits. Market share in CA/SA/NRE deposits improved 15bps/5bps/50bps over FY20-22 and increasing share of retail deposits as FB continued to invest in new products and forge new partnerships. Share of retail/high-yield loans increased to ~54%/21% as FB continued to expand its product portfolio. Also, increasing market share in payments/credit cards, tie-ups with fintechs/third-parties and focus on RM-led corporate banking model should help to expand fee income. FB delivered one of the best asset quality performances during the entire COVID period. Key catalysts: Low exposure to stressed sectors to keep average credit cost ~65bps in FY23/24E (vs 105bps in FY20-22). NIM improvement of ~20bps in FY22-24E would be driven by diversification into high-yield segments. Hence, we expect the bank to improve RoE to a sustainable ~14.5% from FY25E vs average ~10% in the last decade. The stock is trading at 1.0x/8.0x FY24 BVPS/EPS

BUY

Ambit Estimates

	FY22	FY23E	FY24E
EPS (Rs)	9.0	12.3	14.3
BVPS (Rs)	89.4	99.3	110.7
ROE (%)	10.8%	13.0%	13.7%
P/BV (x)	1.27	1.15	1.03

Source: Company, Ambit Capital research

Godrej Consumer

(GCPL IN, TP Rs874, upside 0%)

Building blocks in place, execution to follow

Appointment of Sudhir Sitapati as MD & CEO and Dharnesh as GAUM cluster head reflects new management's hunger to work on the missing pieces – category development, innovation and recalibrating GTM. The task is arduous but most concerns seem internal, hence fixable. Strategy to – (i) increase ad spends and improve brand equity for HI products, (ii) democratize pack sizes in air care and hair care to increase weighted distribution, (iii) approach GAUM's dry hair business as fashion business vs FMCG business, (iv) re-positioning of baby wipes and rewire GTM in Indonesia, and (v) appoint global category teams to look at overall innovation and R&D will leverage cross-selling opportunities – is appropriate since it clearly addresses the missing gaps of the past strategies. We will monitor (i) potential re-launch/re-branding of Good Knight/HIT HI brands in India, (ii) gross margin improvement getting ploughed into higher ad spends, (iii) innovation and introduction of SKUs at competitive price points in hair care and air care, (iii) positive constant-currency growth in Indonesia and (iv) rising saliency of FMCG in GAUM leading to sustaining of double-digit growth. As management walks this path, conviction on GCPL's ability to clock double-digit growth will increase. As that happens, the stock which is trading at 38x FY24 P/E, i.e. ~20% discount to peers, should get narrow. We are building in 11%/16%/16% revenue/EBITDA/PAT CAGR over FY22-25E.

BUY

Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	AMBER

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenues	123	136	150
EBITDA	24	26	33
EPS(Rs)	18	19	24

Source: Company, Ambit Capital research

HCL Technologies

(HCLT IN, TP Rs1165, upside 26%)

Growth equalisation, trough margins and attractive valuations

HCLT's higher business skew towards IMS (~40% revenue), which benefits from traction in cloud, cybersecurity and workplace transformation coupled with improved capabilities in app modernization would aid in improving deal participation (USD8.7bn net-new deal wins over LTM, up 12% YoY). It is the 3rd largest player in ER&D globally and would benefit from uptick in manufacturing, driven by growth in digital engineering, Industrial IoT & smart manufacturing with ER&D segment likely to outperform overall company growth and be accretive to margins. Products & Platforms business will likely cushion pressure on services margins and aid in robust FCF generation (~30% FCF contribution). We expect USD revenue/EPS CAGR of 8.7/7.1% over FY22-25E with improvement in EBIT margins from 17% in 1Q to 18.3% by FY25E. Valuations at 16.7x FY24E PE are at discount of ~29-36% discount to Infosys/TCS with ~5% dividend yield, despite likely better or similar growth.

Key monitorables:

- **Continuation of strength in ER&D business:** ER&D business grew at 23% CC YoY in 1Q, better than larger pure-play Indian ER&D players (ex Tata Elxsi). Expected to stay strong on manufacturing resilience and demand tailwinds.
- **IT services margin improvement:** IT services (~73% revenue mix) business margin at 15.7% in 1Q has been a drag on overall business. Uptick here is needed for overall margin profile improvement
- **Indications of stability in Products business and margins:** Within the Products & Platforms' revenue mix, the company had indicated that 56% of business growth was at high-single to very strong double digits while the rest of the business declined in FY22. Sustenance of growth in in new-gen products and moderation of revenue decline in core products would be key to watch.

BUY

Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	AMBER

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenue	857	981	1,073
EBIT	162	173	199
EPS (Rs)	50	50	56

Source: Company, Ambit Capital research

ICICI Bank

(ICICIBC IN, TP Rs 983, upside 13%)

Future ready juggernaut

ICICI Bank is focusing on risk adjusted returns at the bank level rather than at the department level. This visible in its performance as core PPOP/RWA increased to 4.2% in 1QFY23 vs 3.1% in FY19. This is because incentives of top management are linked to overall PPOP/ROE. The liability side is well-positioned with retail deposits/CASA at 60%/47% of deposits. Net slippages/restructured loan trends in FY21-FY23YTD of ICICI Bank are one of the best in the industry and reflect better credit underwriting post the FY14-18 corporate credit cycle. With higher provisioning coverage and moderating restructuring loans of ~0.8%, we believe average credit cost should be ~70bps over FY23-24E. Focus on high-yield retail/SME loans and unwinding of low-yield overseas loan book will continue to have a positive impact on NIM. Key catalysts: Credit cost should average ~70bps in FY23/24E vs (vs 190bps in FY20-22). NIM improvement of ~12bps in FY22-24E driven by increasing share of high yield retail/SME loans. This should lead to ~18% core operating profit CAGR over FY22-25 and average RoE of ~16% over FY23-25 vs ~9% in FY17-22. The stock is trading at 2.1x/17.6x FY24E BVPS/EPS.

BUY

Ambit Estimates

	FY22	FY23E	FY24E
EPS (Rs)	33.7	43.0	49.6
Adj. BVPS (Rs)	235.6	272.7	314.9
ROE (%)	14.7%	16.3%	16.3%
P/ABV (x)	2.84	2.45	2.12

Source: Company, Ambit Capital research

Indraprastha Gas

(IGL IN, TP Rs560, upside 34%)

Best-placed among CGDs

IGL is well-placed to benefit from rising gas consumption in the country and thus we expect volume CAGR of 14% during FY22-25E (vs. 5%/10% for MGL/GGas). This is due to enlarging opportunities in NCR because of pollution concerns and increasing penetration in contiguous virgin GAs which will also provide opportunities like inter-state transportation. The company has already started sale of CNG in all GAs won during the 9th and 10th PNGRB bidding rounds. High domestic and imported gas costs may put downward pressure on margins in the near to medium term. Also, the attractiveness of CNG vs. diesel/petrol is 15%/30% currently vs. 50%/80% a year ago, which makes price hikes more challenging now. However, we expect 14% volume CAGR in FY22-25E vs. 11% in FY15-20, to partially offset margin pressure, resulting in 12% FY22-25E EPS CAGR. Continuity of volume growth as the current penetration of CNG in NCR, despite being the highest in the nation, has a lot of headroom. Also we expect limited threat from EVs in the near to medium due to better economics of CNG vehicles. Further hike in domestic gas prices in Oct-22 and Apr-23, elevated spot LNG prices, lower domestic gas allocation, and likely faster implementation of EV policy in Delhi would remain an overhang. However, start of RIL's MJ field from 3QFY22 will increase domestic gas allocation and ease pricing pressure too as the CGD industry has made a representation to the government on rising gas prices and the company remains hopeful of a near-term solution.

BUY

Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	AMBER

Source: Company, Ambit Capital research

Ambit Estimates (Rs bn)

Particulars	FY22	FY23E	FY24E
Revenue	77	124	105
EBITDA	19	19	25
Diluted EPS (Rs.)	19	19	25

Source: Company, Ambit Capital research

Info Edge (India)

(INFOE IN, TP Rs5216, upside 23%)

A low-risk compounder

Since 2020, Info Edge's share price swung wildly as Zomato/PB Fintech listed and their perception varied. But these are now only 13% of our SoTP and we don't build stake sales soon. Secular GCC hiring and domestic revival would cushion adverse US recession impact; we expect recruitment revenues to post 29% FY22-24E CAGR (11% in FY20-22). Realty/matchmaking businesses remain stunted. Hence Info Edge is committing capital to investees operating in adjacencies (e.g. 4B, Aisle Networks). These strategic initiatives will start contributing meaningfully to revenue in 3-5 years. We like Info Edge for recruitment's resilience, iterative approach to realty/matchmaking and reduced investee risks. Growing recruitment cash flows allow for more strategic and financial investments. Investment via AIFs (SEBI regulated, 12-year life) will force Info Edge to be financially disciplined and plan exits in FY25-30E, enabling recycling of capital. Expect progressive increase in cash distribution to shareholders. Billing growth is the key lead indicator for Info Edge as it runs prepaid subscription businesses across four online classified verticals: jobs (most critical), realty, matchmaking and education. We expect recruitment billing growth of 18% in FY23E, akin to 19% FY19-22 CAGR, defying IT services slowdown fears. The efficacy of Info Edge's strategic investments would be borne out by continued growth outperformance of recruitment investees (IIMJobs, Zwayam and DoSelect) vs. core business. Info Edge has already managed to scale up these companies to collectively reach ~7% of FY22 recruitment revenue scale vs. <2% when it invested in them (2019-21). We build in 25% YoY growth for these businesses collectively in FY23 vs. recruitment's 18%, validating the company's strategic investment stance.

BUY

Flags

Accounting:	GREEN
Predictability:	GREEN
Earnings Momentum:	GREEN

Source: Company, Ambit Capital research

Ambit Estimates (Rs.bn)

Particulars	FY22	FY23E	FY24E
Revenue	15	21	25
EBITDA	5	7	9
Diluted EPS (Rs.)	692	49	60

Source: Company, Ambit Capital research; Note: FY22 metrics are distorted by MTM gains on Zomato/PB listing

ITC

(ITC IN, Not Rated)

New beginnings?

The largest business of ITC, cigarettes (46% of FY20 revenues), has solid moats around innovation which lead to regular new launches and thus ~75% market share and high margin and FCF profile. Its second-largest business, FMCG (28% of revenues), is where the scale-up has been slower than initial expectations but amongst sub-categories, foods is clearly gaining market share and growing. ITC has made consistent investments in brand-building, helping it create brands across the packed food categories be it in staples/biscuits/snacks etc (>Rs60bn/40bn/25bn sizes in terms of consumer spends). Other concern of decline in RoCE owing to asset-heavy hotels business has also been addressed by management shifting to an asset-light model and inching up dividend payout to 80-85%. This allays the investor concerns except for on ESG. FMCG's EBITDA margin which was hovering in mid-single digits pre-Covid is at a striking distance from double digits now (~9% as at FY22). As its foods business scales up and share of atta (flour; inherently low-margin business) goes down, brand incubation needs will reduce. Further, as leverage kicks in, consensus is expecting EBITDA margin for FMCG business to expand to early teens by FY25E. Consensus estimates for ITC are 12%/13%/12% revenue/EBITDA/PAT growth over FY22-25E (largely in line with peers) but the stock is trading at 20x FY24 P/E, i.e. ~50% discount to FMCG peers. The key catalysts to monitor over the next 6-12 months include: (a) sustenance of double-digit revenue growth in FMCG business bundled with EBITDAM margin expansion, (b) room inventory addition in hotel business and improving occupancy, and (c) any corporate restructuring. Key risks include: a) elevated RM inflation leading to lower volume growth and delay in margin recovery and b) tax hikes in cigarette.

NOT RATED

Reported numbers (Rs bn)

	FY20	FY21	FY22
Revenues	456	455	563
EBITDA	179	155	189
EPS(Rs)	12	11	12

Source: Bloomberg, Ambit Capital research

Laurus Labs

(LAURUS IN, TP Rs525, upside 21%)

Improving business mix, capex step-up

Cyclical recovery in ARVs and structurally improving business mix in favour of higher margins and more predictable non-ARV businesses (45%/55% in FY22/25) are the key factors behind our positive thesis. In particular, the rising share of the Synthesis business in revenues (~19% in FY22, to go up to ~32% by FY25), on the back of new contract wins and projects scaling up, augurs well for margins and RoCE. Step-up in capex guidance for FY23-24 (Rs20-25bn vs Rs15bn over FY22-23) is encouraging given capex is usually a good lead indicator of growth in most of its businesses. We expect improving mix to drive ~190bps GM expansion, which along with operating leverage (~25% of gross block not generating revenues) will translate into 31% EPS CAGR over FY22-25. Improving earnings predictability due to lower dependence on institutional tenders should support higher multiples too. The key catalysts to monitor over the next six to twelve months: (a) execution on Synthesis growth and capex (~40% of incremental allocation over FY23-24) along with any new contract win announcements, (b) recovery in ARV APIs and formulation revenues as channel inventory normalizes and tendering activity picks up in 2HFY23 and (c) the company's ability to manage elevated input, power and freight costs. Slower-than-expected recovery in ARVs and slackening of growth momentum in Synthesis are key risks to our call. Our DCF-based TP of Rs690 implies an exit FY24E P/E of 24x, which is achievable given improving business mix in favour of more predictable businesses.

BUY

Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	GREEN

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenues	49	67	78
EBITDA	14	21	25
EPS	15	23	29

Company, Ambit Capital research

LIC Housing Finance

(LICHF IN, TP Rs574, upside 37%)

Cyclical recovery at play

RoA/RoE dropped to a decade low of 1%/10% in FY22 due to compression in NIMs and increase in credit cost. We expect 15% RoE in FY23/24E and 40% EPS CAGR in FY22-24E led by: (i) pick-up in AUM growth (13% CAGR in FY22-24E driven by some acceleration in housing loan and normalization in LAP/developer book, (ii) ~30bps NIM expansion in FY22-24E due to assets re-pricing faster than liabilities and growth pick-up in high-yield LAP/developer book, and (iii) average credit cost of <40bps in FY23/24E vs 72bps in FY21/22 driven by moderating stressed pool and lower historical LGD of only 20%. Current valuation of 0.8x one-year forward P/B is at ~8% discount to 3-year rolling average and lower for ~15% RoE business. Key catalysts: Credit cost should decrease to average ~37bps over FY23-24 (vs ~70bps over FY21-22) given decreasing stressed loans and historical LGD <20%. NIM improvement of ~30bps in FY22-24E given loans are repricing faster than liabilities.

BUY

Ambit Estimates

	FY22	FY23E	FY24E
EPS (Rs)	41.6	71.9	81.5
BVPS (Rs)	448.5	501.6	570.8
ROE (%)	10.1%	15.3%	15.2%
P/BV (x)	0.9	0.8	0.7

Company, Ambit Capital research

Oil India

NOT RATED

(OINL IN, Not Rated)

Double support of macros and operations

Oil/Gas production has increased by 2%/15% in FY22 YoY. The company has target's Oil/Gas production of 4MMT/5BCM by FY25E from 3MMT/3BCM in FY22. Also, it has target to reach 15MMTOE by FY30E which implies a 6-7% volume CAGR. The management remains confident of NRL expansion 9MMT to be completed by FY25 (3x increase). In our view, OIL is well placed to get double benefits of increasing volumes and strong hydrocarbon prices. Also, a high % of middle distillate production along with an unprecedented level of refining cracks especially gasoil will provide further support. OIL's current R/P ratio is 10 years for crude oil and 25 years for natural gas, and RRR is more than 100% during the last 6 years; all of this proves operational sustainability and excellence. Continuity of sturdy hydrocarbon prices and refining cracks due to geopolitical issues and limited additional refining capacity to result in strong earnings. Also, 30%/70% increase in Oil/Gas production by FY25E post completion of major projects in Assam will provide additional support. Windfall tax on gas, issues with Russian investments, and lower-than-expected production (delayed ramp-up from new fields) could impact earnings outlook and valuation. Any unwarranted Capex for overseas/domestic acquisition could raise capital allocation concerns.

Reported numbers (Rs bn)

	FY20	FY21	FY22
Revenues	203	223	300
EBITDA	57	58	105
EPS(Rs)	49	39	52

Source: Bloomberg, Ambit Capital research

PB Fintech

BUY

(POLICYBZ IN, TP 1020, upside 111%)

Cracking the tough nut

PB Fintech's online insurance/credit marketplace has a dominant position with 90%+/53%+ share in a business that is not so easy to crack given its 'push' nature. Rising online insurance/lending penetration, POSP scale-up and an end-to-end full service offering should help drive 22% revenue CAGR over FY22-41E (37% CAGR over FY22-25E). Understanding insurance idiosyncrasies and a full service offering from prospecting – policy issuance – post sales support – claim support and new products leveraging rich data are key moats for the business. Profitability is a matter of choice and would improve as share of insurance renewals (90%+ contribution margin) increases. Insurance renewals could touch 60% of premium and 47% of revenues in the next 2 decades (versus 29% in 1Q). We like the Build vs Buy focus of the company that has helped scale up POSP business to largest in the industry in 3 quarters. Expect steady state EBITDA/contribution margins of ~35%/45% as scale rises. DCF based TP of Rs1020.

Key monitorables:

- **Any regulatory actions impacting take rates:** Any adverse interventions by IRDAI capping commissions to insurance brokers.
- **Growth and increasing share of renewals:** Continued market share gains driving higher-than-industry growth in protection and rising share of insurance renewals, which have ~85% PBT margin is key for improving profitability.
- **Meeting profitability guidance:** Core (Paisabazaar+Policybazaar) has already turned profitable at the adj. EBITDA level. With investments in POSP business capped at Rs2bn in FY23E, overall entity should become profitable on adj. EBITDA by FY24E.

Flags

Accounting:	GREEN
Predictability:	GREEN
Earnings Momentum:	AMBER

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenue	14	23	30
Adj EBITDA	(3)	(1)	0
EPS (Rs)	(20)	(12)	(4)

Source: Company, Ambit Capital research

SBI Cards

BUY

(SBICARD IN, TP 1338, upside 43%)

Spends to drive profitability

Low credit card penetration in India and increasing digitalisation should drive 20% CAGR in the credit card industry over the next decade. SBI Cards should grow faster than industry due to low penetration in SBI's customer base, SBI's strong distribution in non-metros and strong brand recall. Credit card spends/loans have bounced back and grew 87%/31% YoY in 1QFY23 on a low base. Historically, average monthly card spends in the second half of the fiscal are 10-15% higher than in the first half. Hence, we expect QoQ acceleration in card spends to continue in the rest of FY23 with ~40% YoY growth in FY23 and 25% growth in FY24. Share of high-yield revolver loans has bottomed out and is increasing in the loan mix. The latest discussion paper of the RBI implies that a meaningful cut in MDR has low probability. Key catalysts: Credit cost should average ~6.5% in FY23/24E, which is below the long-term average due to lower share of revolver compared to historical average. Spends growth of 28% over FY22-25 should be in line with industry growth. Improving share of revolvers in loan mix should aid NIM expansion of ~220bps between FY22-25. We expect EPS CAGR and average RoE of ~43% and ~32% respectively over FY22-25E.

Ambit Estimates

	FY22	FY23E	FY24E
EPS (Rs)	17.1	29.0	38.1
BVPS (Rs)	82.2	105.4	135.9
ROE (%)	23.0%	30.9%	31.6%
P/BV (x)	11.05	8.62	6.68

SRF

NOT RATED

(SRF IN, Not Rated)

Consistent compounder

SRF leveraged its fluorination expertise to foray into high-growth specialty chemicals – revenue contribution from this segment has improved to 42% from 18% in FY11 (22% CAGR). Superior execution capability, scalable capacity and leadership position in fluorochemicals in India are key strengths. Capital allocation has largely been in this segment too (~55% of annual capex) and likely to remain in this range going forward, keeping RoCE in the 20%+ range. Investments in pharma (~Rs2bn at Dahej) and fluoropolymer segments (~Rs4bn) over the last 12-24 months expands its addressable market and leaves it well-placed to achieve targeted 30% revenue share from the pharma segment over the next 2-3 years. The key catalysts to monitor over the next six to twelve months: (a) execution on specialty chemicals capex (~55% of incremental allocation) along with initiatives to diversify into pharma; (b) value-add portfolio cushioning packaging margin as global capacities increase and (c) favourable pricing in new refrigerant supply contracts. Key risks: a) slowdown in agrochemicals (>80% of specialty) demand and b) sustained volatility in raw material and input prices.

Reported numbers (Rs bn)

	FY20	FY21	FY22
Revenues	72	84	124
EBITDA	15	21	31
EPS(Rs.)	32	41	64

Source: Bloomberg, Ambit Capital research

Tata Motors

BUY

(TTMT IN, TP Rs550, upside 19%)

Poised for significant deleveraging

We expect Tata Motors (TTMT) to see significant deleveraging in FY23-24E driven by 1) improving FCF generation outlook at JLR 2) continued market share gains and margin revival for domestic PV business, and 3) upcycle for domestic CV business post severe downturn in FY20-21. In FY23, we expect JLR to witness higher scale driven by continued easing of chip shortages amid record higher order backlog of 200k units and launch of RR/RR Sport refresh. We believe this, coupled with cost and capex control would add Rs191bn of FCF in FY23-24E. Meanwhile, we see continued profitability improvement for PV business led by rising scale and easing input costs. CV business will also add to cash flows on continued upcycle, better mix, easing RM costs and falling discounts. Led by the confluence of these factors, we see net auto debt at Rs110bn in FY24E vs Rs607bn at end-1QFY23. The key catalysts to monitor over the next six to twelve months include: (a) JLR order backlog execution and FCF generation; (b) monthly wholesales for domestic PV and CV business (c) input commodity cost contracts converging towards spot rates which are ~20% lower vs contract prices. Meanwhile, inability to ramp up JLR wholesales owing to chip shortages, moderation in domestic CV upcycle momentum and market share loss for domestic PV business are key risks. Our SOTP-based TP of Rs550, which is achievable given improving business mix in favour of more predictable businesses.

Flags

Accounting:	RED
Predictability:	AMBER
Earnings Momentum:	AMBER

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenues	2,785	3,335	3,906
EBITDA	248	332	466
EPS(Rs)	(27)	19	50

Source: Bloomberg, Ambit Capital research

Tata Steel

BUY

(TATA IN, TP Rs1700, upside 60%)

Remains a strong deleveraging story

Historically, TSL exhibited the highest beta to metals cycles, which is a function of high operating and financial leverage. While TSL still has high operating leverage, steady deleveraging has reduced its financial leverage over the past 2 years. TSL is not just a trade on iron ore prices anymore, it remains one of the strongest deleveraging stories in global metals. Various cost improvement programmes have also helped curtail conversion loss in India, which is one of the reasons why TSL should report higher EBITDA/t in India in FY23 vs previous downcycles. TSL should witness a book value increase in FY23, even in a recession, something not seen in previous downcycles. The stock is trading at 1.1x FY23 BPVS while we expect trough RoE of >12% vs <0% in previous down cycles. Our TP of Rs1,700 implies 1.4x FY24 BVPS. Key catalysts: (1) deleveraging likely to continue - TSL has set 40MT capacity target for India by 2030. This expansion will entail much lower capital cost relative to $1,000/t greenfield cost. Mid-cycle EBITDA of Rs15,000/t for India and $50-$75/t for Europe should provide TSL sufficient arsenal to continue deleveraging; (2) lower conversion loss= higher margins - TSL has improved productivity of BSL operations, and overall conversion/yield loss for its steel operations is now is at the lowest levels in past two decades. Higher operating efficiency should itself support higher EBITDA/t this downcycle and (3) China supply response/export duty; we believe the current production pace is not sustainable. Chinese demand could get more support from stimulus measures + recovery from lockdowns.

Flags

Accounting:	GREEN
Predictability:	GREEN
Earnings Momentum:	GREEN

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenue	2,440	2,290	2,148
EBITDA	634	400	400
EPS (Rs)	33	17	18

Source: Company, Ambit Capital research

Tech Mahindra

(TECHM IN, TP Rs1230, upside 17%)

Tactical play on 5G shift & margin recovery

Traction in 5G-related spends would drive growth in Communications segment, while improved momentum in enterprise segment would aid overall growth. We derive comfort from deal wins at USD0.7-1.0bn range over past 6 quarters as compared to USD0.4-0.5bn range pre-Covid. BPO might continue to augment IT services growth with companies accelerating customer experience and front office transformation. EBIT margin recovery to ~14% range by 1QFY24 aided by improvement in offshoring, pyramiding, utilization and lower sub-contractor costs should offset wage hike impacts. The stock currently trades at 16.0x FY24E EPS (discount of 12-40% to Wipro/TCS) implying 6.1% USD revenue CAGR over FY22-32E at 14% average EBIT margin.

Key monitorables:

- **Sustained deal win momentum:** TechM has reoriented its GTM organization with new leadership in place in 4 sub-verticals, improved capabilities and geographical expansion aided by ~USD1bn acquisition spend since FY21. Quarterly deal wins have remained elevated at USD0.7-1.0bn range over past 6 quarter, better than pre-Covid levels.
- **Benefits from 5G-related spend upcycle:** With 5G-related spend upcycle, TechM is expected to benefit given ~40% revenue exposure to Telecom vertical. Historically, too, TechM benefitted from technology transition in the vertical during FY13-15 (4G rollout).
- **Margin stability in the 13-14% range:** While 1Q margins were impacted due to cost pressures and deal ramp-ups, they are expected to improve to ~14% over next 4 quarters and might sustain at 13-14% over FY24/25E given possible aggression on cost savings.

BUY

Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	AMBER

Ambit Estimates

	FY22	FY23E	FY24E
Revenue (USDmn)	5,998	6,726	7,256
EBIT margin (%)	14.6	12.1	13.4
EPS (Rs)	62.9	56.9	66.8

Source: *Company, Ambit Capital research*

VIP Industries

(VIP IN, TP Rs650, upside 24%)

Gearing for a smooth take-off

FY22 revenue recovered (though behind peers) to 75% of FY20 levels led by luggage (88%). But backpacks (42%) continue to underperform. Hard luggage continues to gain traction given increased preference and inventory shortage (soft). Bangladesh continues to drive structural cost advantage with India+Bangladesh expected to account for 75-80% of quantity sold in FY23 (vs 66% in FY22). With business recovery visible, focus on brandex/expansion (120-150 EBOs) and innovation (Tech series, Anti-viral) prevails though exports remain stagnant at ~3% of revenue. Whilst 1QFY22 revenue recovered to 105% of pre-Covid (1QFY20) levels on 8% volume uptick. But cost was at ~120% of pre-Covid levels, which impacting profitability. Recent hirings across procurements, sales and supply chain functions include people with experience in Havmor and Britannia; their stints overlap with Anindya Dutta, MD, VIP (ex-Havmor, Britannia). Recommend monitoring (i) potential revenue uptick in mass premium (VIP) and premium (Carlton) categories, (ii) Bangladesh-led GM improvement and (iii) EBO store expansion to ~500 by end-FY23E (vs 376 in FY22). As profitability improved on better mix (sales, manufacturing), the stock, now trading at 37x FY24 P/E, should rerate to 45x FY24 P/E - similar to that of discretionary peers. We build in 25%/45%/60% revenue/EBITDA/PAT CAGR over FY22-25E.

BUY

Flags

Accounting:	GREEN
Predictability:	AMBER
Earnings Momentum:	AMBER

Ambit Estimates (Rs bn)

	FY22	FY23E	FY24E
Revenues	13	19	22
EBITDA	1.5	2.9	3.9
EPS(Rs)	4.7	10.7	16.0

Source: Bloomberg, Ambit Capital research,
Note: EPS is adjusted for EO items.

Institutional Equities Team

Research Analysts

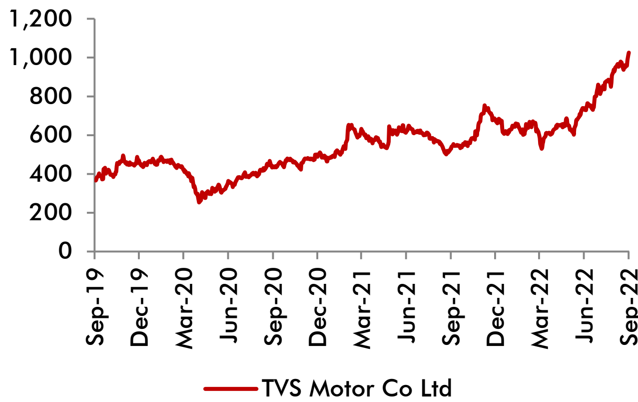
Name	Industry Sectors	Desk-Phone	E-mail
Nitin Bhasin - Head of Research	Strategy / Accounting / Home Building / Consumer Durables	(022) 66233241	nitin.bhasin@ambit.co
Alok Shah, CFA	Consumer Staples	(022) 66233259	alok.shah@ambit.co
Amandeep Singh Grover	Mid/Small-Caps / Hotels / Real Estate / Aviation	(022) 66233082	amandeep.grover@ambit.co
Amar Kedia	Capital Goods / Infrastructure	(022) 66233212	amar.kedia@ambit.co
Ashish Kanodia, CFA	Consumer Discretionary	(022) 66233264	ashish.kanodia@ambit.co
Ashwin Mehta, CFA	Technology	(022) 66233295	ashwin.mehta@ambit.co
Bharat Arora, CFA	Strategy	(022) 66233278	bharat.arora@ambit.co
Dhruv Jain	Mid-Caps / Home Building / Consumer Durables	(022) 66233177	dhruv.jain@ambit.co
Eashaan Nair	Economy / Strategy	(022) 66233033	eashaan.nair@ambit.co
Gaurav Jhunjhunuwala	Media / Telecom / Oil & Gas	(022) 66233227	gaurav.jhunjhunuwala@ambit.co
Jaiveer Shekhawat	Mid/Small-Caps	(022) 66233021	jaiveer.shekhawat@ambit.co
Jashandeep Chadha, CFA	Metals & Mining / Cement	(022) 66233246	jashandeep.chadha@ambit.co
Karan Khanna, CFA	Mid/Small-Caps / Hotels / Real Estate / Aviation	(022) 66233251	karan.khanna@ambit.co
Karan Kokane, CFA	Automobiles / Auto Ancillaries	(022) 66233028	karan.kokane@ambit.co
Kumar Saumya	Chemicals	(022) 66233242	kumar.saumya@ambit.co
Namant Satiya, CFA	Consumer Staples	(022) 66233259	namant.satiya@ambit.co
Pankaj Agarwal, CFA	Banking / Financial Services	(022) 66233206	pankaj.agarwal@ambit.co
Parth Dalia	Healthcare	(022) 66233041	parth.dalia@ambit.co
Parth Majithia	Strategy / Forensic Accounting	(022) 66233149	parth.majithia@ambit.co
Pratik Matkar	Banking / Financial Services	(022) 66233252	pratik.matkar@ambit.co
Prashant Nair, CFA	Healthcare	(022) 66233041	prashant.nair@ambit.co
Satyadeep Jain, CFA	Metals & Mining / Cement	(022) 66233246	satyadeep.jain@ambit.co
Sumit Shekhar	Economy / Strategy	(022) 66233229	sumit.shekhar@ambit.co
Vamshi Krishna Utterker	Technology	(022) 66233047	vamshikrishna.utterker@ambit.co
Videesha Sheth	Consumer Discretionary	(022) 66233264	videesha.sheth@ambit.co
Vinit Powle	Strategy / Forensic Accounting	(022) 66233149	vinit.powle@ambit.co
Viraj Dhandhukiya	Strategy	(022) 66233278	viraj.dhandhukiya@ambit.co
Vivekanand Subbaraman, CFA	Media / Telecom / Oil & Gas	(022) 66233261	vivekanand.s@ambit.co
Yash Joglekar	Technology	(022) 66233027	yash.joglekar@ambit.co

Sales

Name	Regions	Desk-Phone	E-mail
Dhiraj Agarwal - MD & Head of Sales	India	(022) 66233253	dhiraj.agarwal@ambit.co
Bhavin Shah	India	(022) 66233186	bhavin.shah@ambit.co
Dharmen Shah	India / Asia	(022) 66233289	dharmen.shah@ambit.co
Abhishek Raichura	UK & Europe	(022) 66233287	abhishek.raichura@ambit.co
Pranav Verma	Asia	(022) 66233214	pranav.verma@ambit.co
Shiva Kartik	India	(022) 66233299	shiva.kartik@ambit.co
Soumya Agarwal	India	(022) 66233062	soumya.agarwal@ambit.co
USA / Canada			
Hitakshi Mehra	Americas	+1(646) 793 6751	hitakshi.mehra@ambitamerica.co
Sean Rodrigues	Americas	(022) 66233211	sean.rodrigues@ambit.co
Singapore			
Sundeep Parate	Singapore	+65 6536 1918	sundeep.parate@ambit.co
Pooja Narayanan	Singapore	+65 6536 1918	pooja.narayanan@ambit.co
Production			
Sajid Merchant	Production	(022) 66233247	sajid.merchant@ambit.co
Sharoz G Hussain	Production	(022) 66233183	sharoz.hussain@ambit.co
Jestin George	Editor	(022) 66233272	jestin.george@ambit.co
Richard Mugutmal	Editor	(022) 66233273	richard.mugutmal@ambit.co
Nikhil Pillai	Database	(022) 66233265	nikhil.pillai@ambit.co

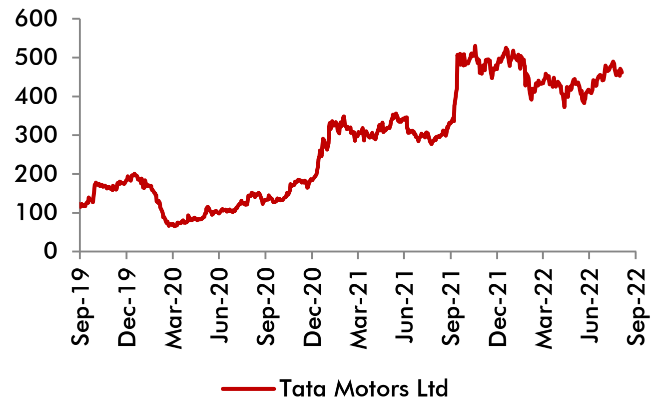
Stock price performance - Strategy

TVS Motor (TVSL IN, BUY)



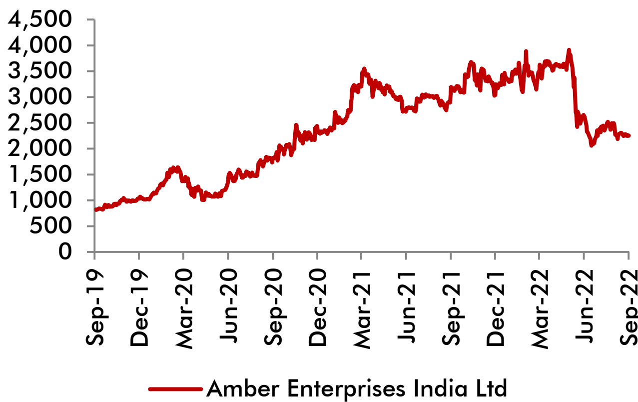
Source: Bloomberg, Ambit Capital research

Tata Motors (TTMT IN, BUY)



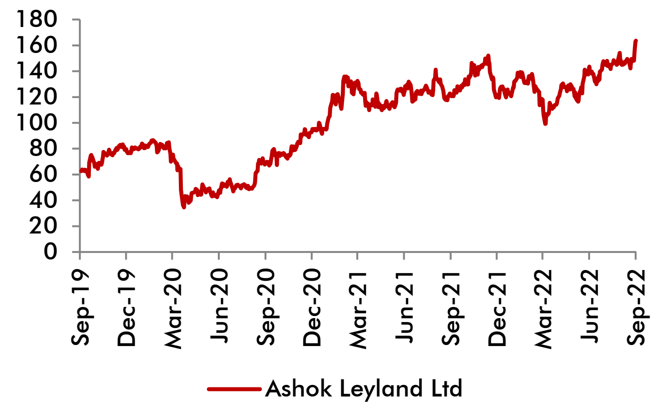
Source: Bloomberg, Ambit Capital research

Amber Enterprises India Ltd (AMBER IN, BUY)



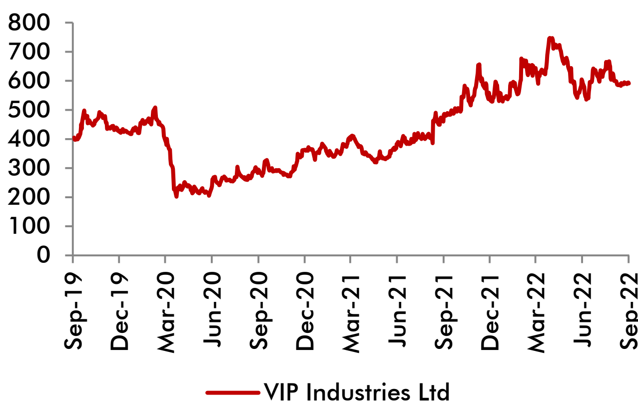
Source: Bloomberg, Ambit Capital research

Ashok Leyland Ltd (AL IN, BUY)



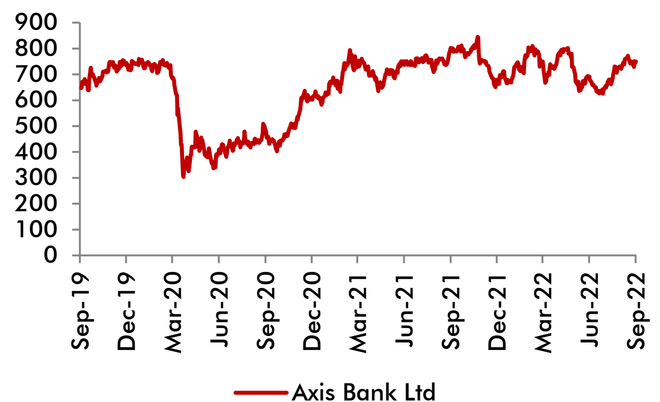
Source: Bloomberg, Ambit Capital research

VIP Industries Ltd Ltd (VIP IN, BUY)



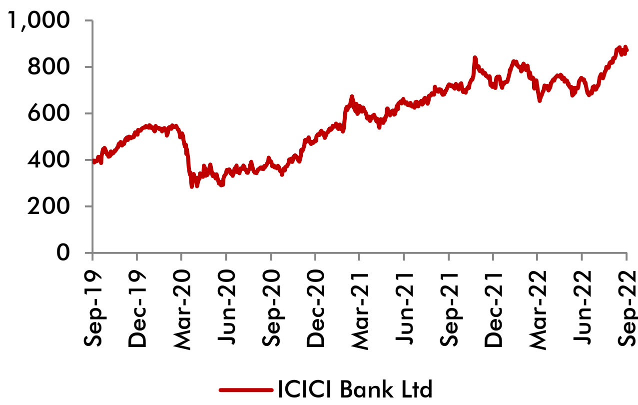
Source: Bloomberg, Ambit Capital research

Axis Bank Ltd (AXSB IN, BUY)



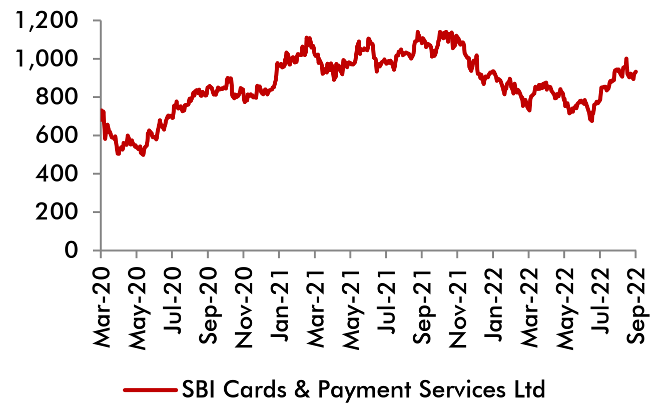
Source: Bloomberg, Ambit Capital research

ICICI Bank Ltd (ICICI IN, BUY)



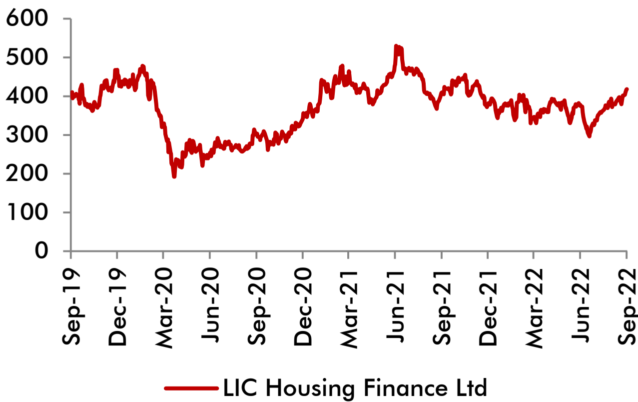
Source: Bloomberg, Ambit Capital research

SBI Cards & Payment Services (SBICARD IN, BUY)



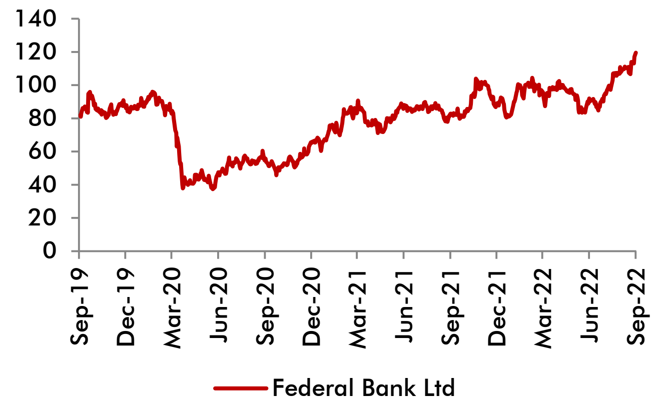
Source: Bloomberg, Ambit Capital research

LIC Housing Finance Ltd (LICHF IN, BUY)



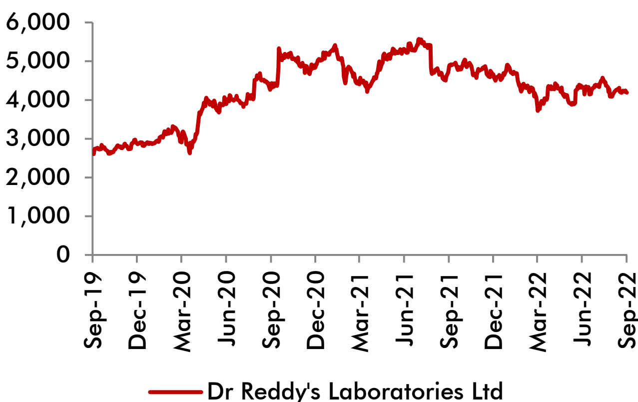
Source: Bloomberg, Ambit Capital research

Federal Bank Ltd (FB IN, BUY)



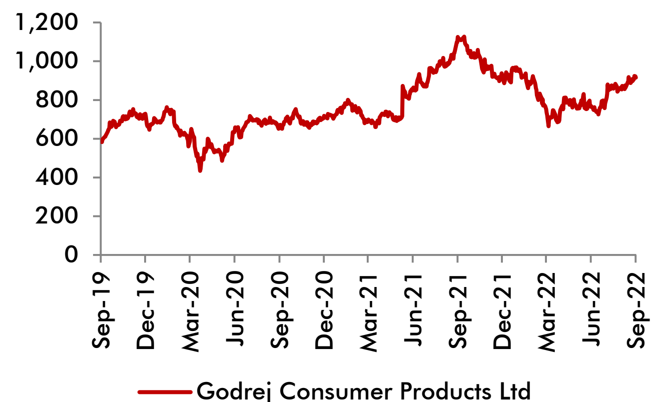
Source: Bloomberg, Ambit Capital research

Dr. Reddy's Laboratories (DRRD IN, BUY)



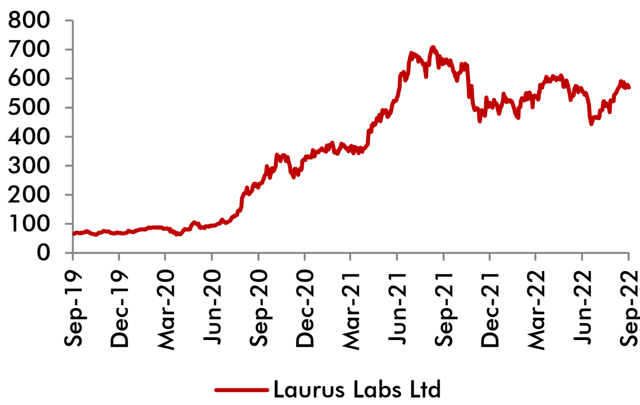
Source: Bloomberg, Ambit Capital research

Godrej Consumer Products Ltd (GCPL IN, BUY)



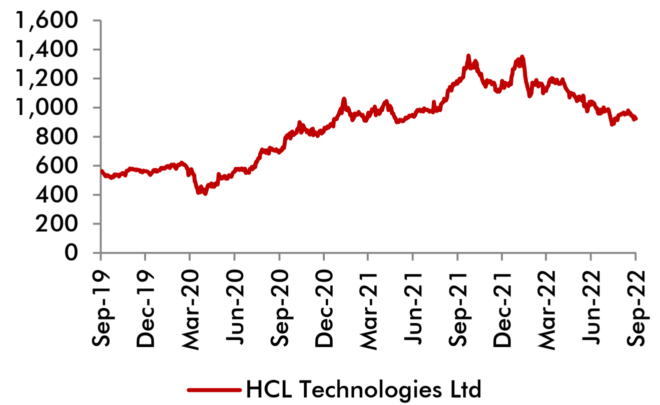
Source: Bloomberg, Ambit Capital research

Laurus Labs Limited (LAURUS IN, BUY)



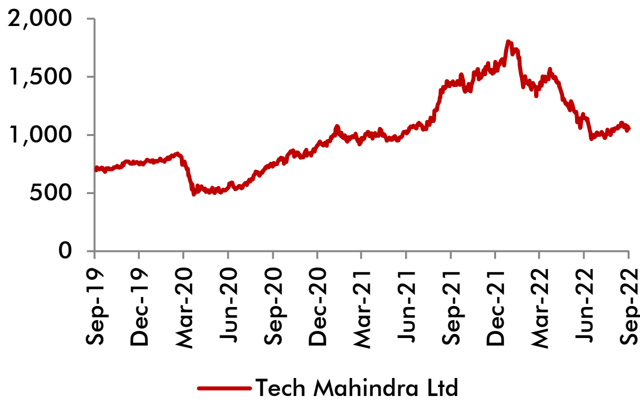
Source: Bloomberg, Ambit Capital research

HCL Technologies Ltd (HCLT IN, BUY)



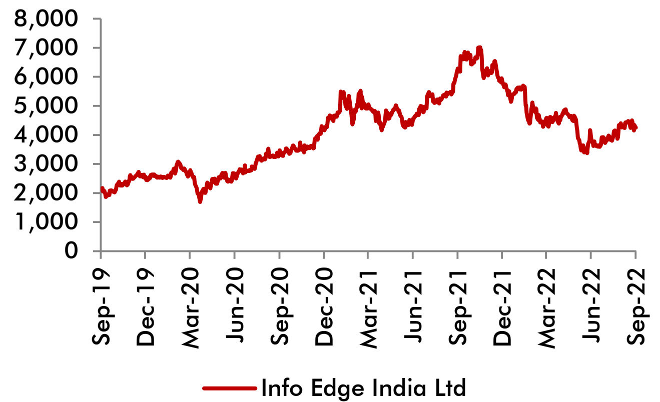
Source: Bloomberg, Ambit Capital research

Tech Mahindra Ltd (TECHM IN, BUY)



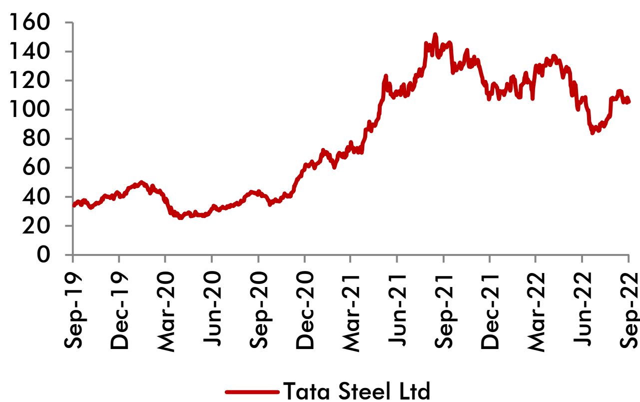
Source: Bloomberg, Ambit Capital research

Info Edge India Ltd (INFOE IN, BUY)



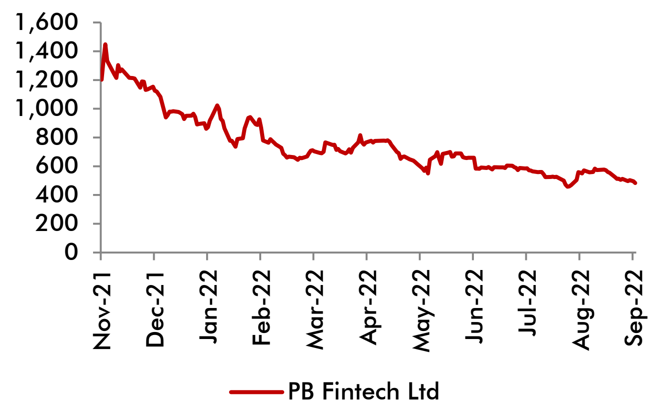
Source: Bloomberg, Ambit Capital research

Tata Steel Ltd (TATA IN, BUY)



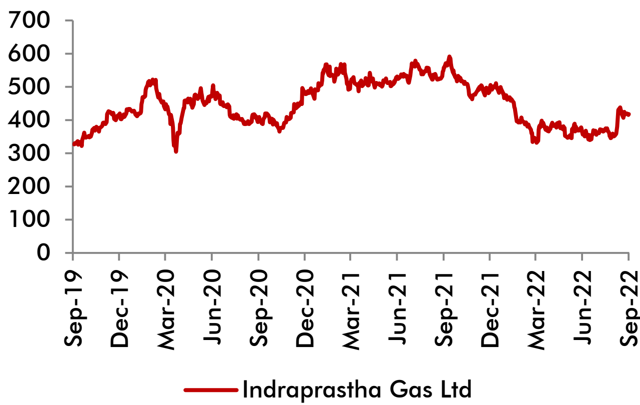
Source: Bloomberg, Ambit Capital research

PB Fintech Ltd. (India) (POLICYBZ IN, BUY)



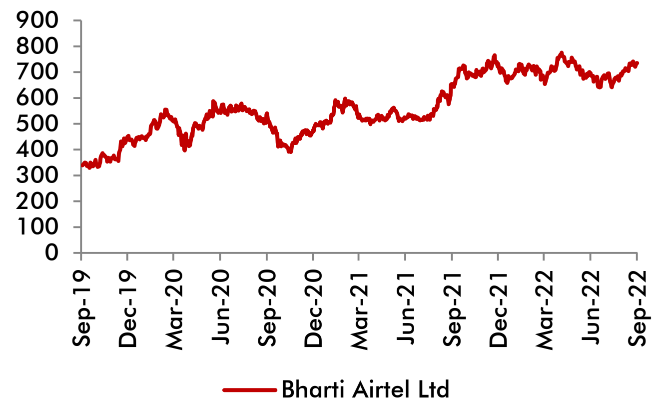
Source: Bloomberg, Ambit Capital research

Indraprastha Gas Ltd (IGL IN, BUY)



Source: Bloomberg, Ambit Capital research

Bharti Airtel Ltd (BHARTI IN, BUY)

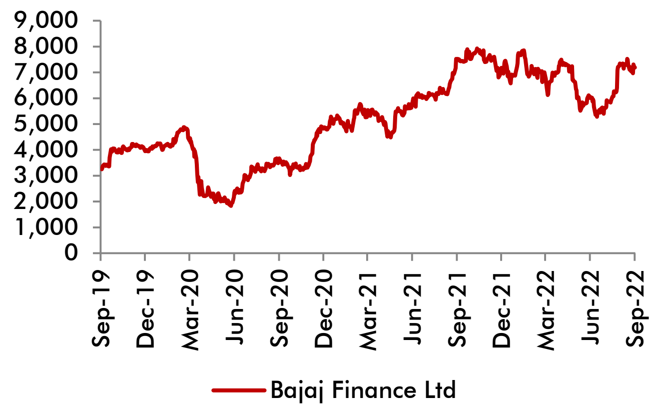


Source: Bloomberg, Ambit Capital research

SRF Limited (SRF IN, NOT RATED)

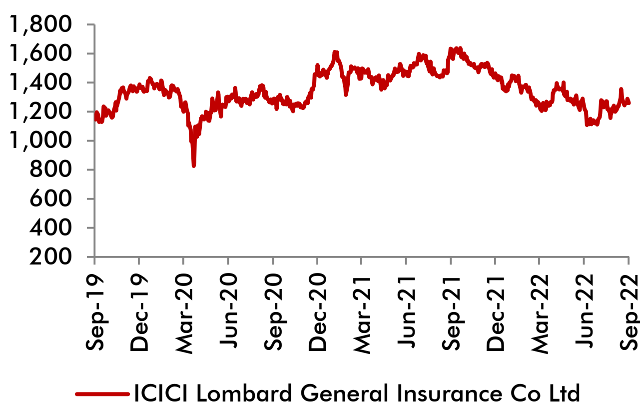
Source: Bloomberg, Ambit Capital research

Bajaj Finance Ltd (BAF IN Equity, NOT RATED)



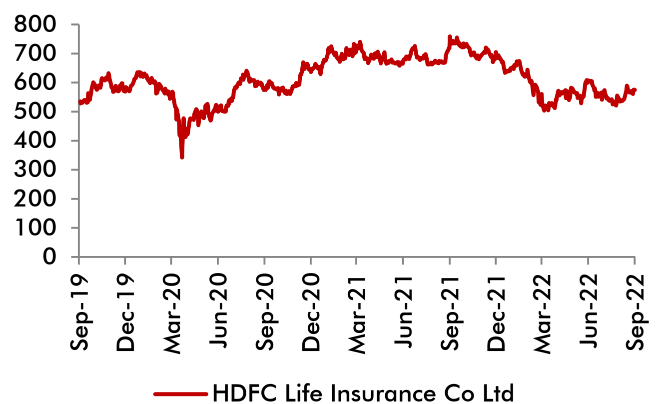
Source: Bloomberg, Ambit Capital research

ICICI Lombard General Insurance (ICICIGI IN, NOT RATED)



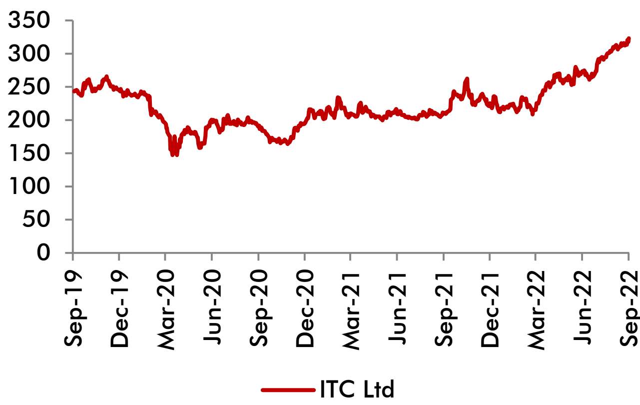
Source: Bloomberg, Ambit Capital research

HDFC Life Insurance Co Ltd (HDFCLIFE IN, NOT RATED)



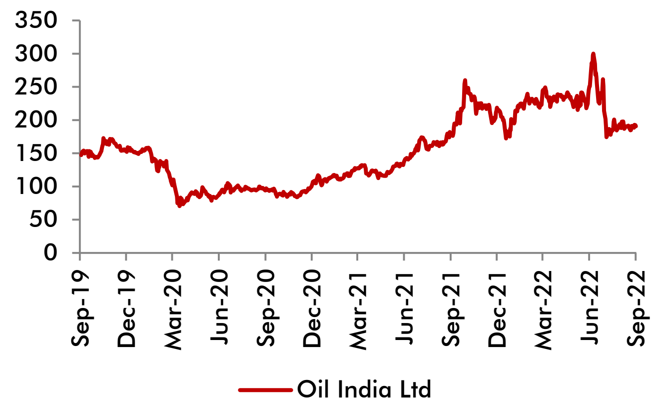
Source: Bloomberg, Ambit Capital research

ITC Ltd (ITC IN, NOT RATED)



Source: Bloomberg, Ambit Capital research

Oil India Ltd (OINL IN, NOT RATED)



Source: Bloomberg, Ambit Capital research

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Investment Rating	Expected return (over 12-month)
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SELL	We expect this stock to deliver less than or equal to 10 % returns over the next 12 months
UNDER REVIEW	We have coverage on the stock but we have suspended our estimates, TP and recommendation for the time being NOT
NOT RATED	We do not have any forward-looking estimates, valuation, or recommendation for the stock.
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NEGATIVE	We have a negative view on the sector and most of stocks under our coverage in the sector are SELLs
NO STANCE	We have forward looking estimates for the stock but we refrain from assigning valuation and recommendation

Note: At certain times the Rating may not be in sync with the description above as the stock prices can be volatile and analysts can take time to react to development.

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