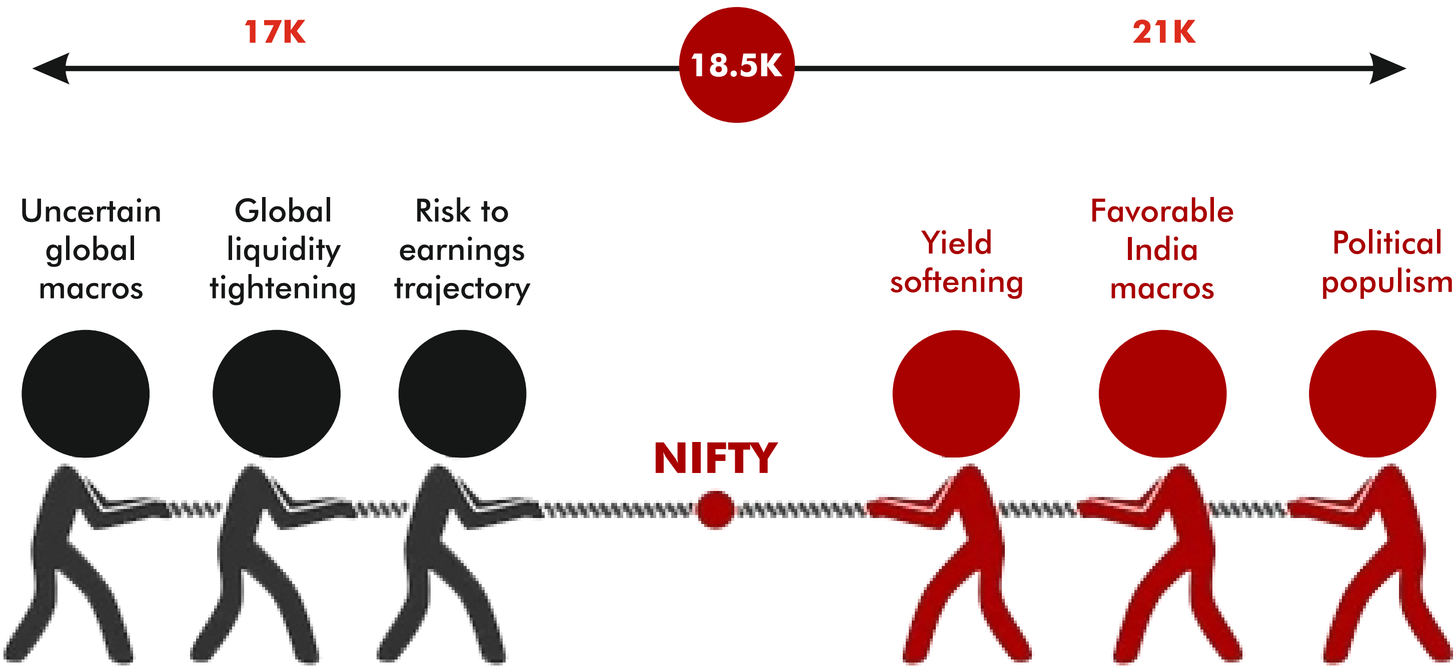
STRATEGY

May 2023



G&C 18.2: Riders on the storm

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G&C 18.2: Riders on the storm

Mar-24 EYBY-based Nifty fair valuation rises to 20.9K using 7.1% G-Sec yield & Mar-24 EPS of ₹940 (vs consensus' ₹991). We reduce our 10-year yield assumption from 7.3% as OIS curve, real rate & repo G-sec spread indicate yields will stay benign. But we see risk to earnings as growth engine of Nifty "BFSI" will slow down in FY24 with contribution to incremental EPS growth tapering (43%) & risks to earnings of IT, O&G (Reliance) & Metals remain. We expect banking NIMs to reduce & any decline in policy rates in 2H can put more pressure. The OIS curve is highlighting the possibility of rate cuts over next few months. Also, Fed & ECB will be contracting BS, which will impact liquidity, though India stands out w.r.t peers on macros & can outperform peers. Preference remains in favour of large-caps over SMID. Reducing "IT" weight. Still marginally OW on "Banks"; Replaced "Bank Nifty" with "SBI Cards". Highlight UW in Auto/FMCG & OW in OMCs/Metals.

We estimate a Nifty fair value of 20900 by Mar-24

With Mar-24 EPS estimate at INR940, 10-year yield at 7.1% & market trading at -2.6 EYBY Gap (LTA), implied Nifty sustainable level is 20889. Upside to our target is possible if yields sustain at lower levels or Mar-24 earnings are higher than expectations, & the latter appears unlikely. Key risk is lack of global liquidity & earnings estimate sustenance. Over next few months, Fed & ECB will be contracting BS. As liquidity dries up, short rates go up & opportunity cost of investing in equities goes up! This can impact FII flows, though India macro stands out w.r.t. peers.

Where is the 10-year yield heading?

We have changed our assumption of 10-year yield from 7.3% to 7.1% (Mar-24). Swaps are a leading indicator of bond rates & 5-year OIS rates have come off significantly since Feb-23, indicating possibility of rate cuts in 2HFY24. We observe that in 6 months leading to general elections (2004-19), yields remain benign. Demand for G-Sec from Life Insurance firms remains robust, while banks' demand is expected to increase as LCR has come off. Lastly, (repo - yield) spread at end of rate hike cycle is usually smaller than 10-year avg/median (99/111bps). Putting it all together, it's highly likely that yields can stay benign with a downward bias.

Earnings estimate trajectory to change?

EPS estimates in FY21-23 were resilient but trend continuation in FY24 looks difficult. Earnings trajectory will likely change from FY24, with BFSI contribution to incr. EPS growth tapering to 43%. Our house view suggests IT, Metals & O&G (Reliance) contribute ~20% of incr. EPS growth & are at risk. While banks' EPS trajectory remains robust, risks to "Tech earnings" remain with expectation of revenue growth normalization to pre-Covid period. Delay in China recovery can hit Reliance & Metal earnings. Our analysis suggests, even in FY21-22 year when agg. headline earnings were met, "earnings delivery" breadth remained poor. It's global cyclicals earnings upgrades which delivered earnings in FY21/22. We don't see material upgrades, additionally yield softening can put even bank NIMs at risk.

G&C Portfolio Positioning - concentrated in large-caps (83%)

Mid//small-cap allocations are 12%/5% and cash allocation 5.2%. While we retain OW on banks, we recommend reducing weight as valuations aren't as cheap as in May-22 and book yield bond yield differential model suggests muted 1-year returns. We reduce weight in IT and add to Healthcare. Other key OWs: Metals and OMCs. Key UWs: FMCG, Auto and Capital Goods. Since Sep-22, G&C portfolio has outperformed NSE500 by 3.2%. We make 5 changes.

What's in: SBICARD, INDIGO, AFFLE, MAXHEALTH, and INDIAMART

What's out: LICHF, GCPL, and BANK NIFTY

Exhibit A: G&C 18.2 composition

Company	Mcap ($mn)
Large-Caps	
TCS	145,024
HDFC Bank	111,977
ICICI Bank	80,444
ITC	64,094
Bharti Airtel	55,332
Bajaj Finance	49,967
HCL Technologies	36,005
Axis Bank	34,364
Tata Motors	22,714
Tata Steel	15,968
SBI Life Insurance	14,398
Tech Mahindra	12,529
Hindalco Industries	11,275
InterGlobe Aviation	10,698
SBI Cards	10,099
BPCL	9,561
Info Edge India	6,181
SRF	9,169
Dr Reddy's Laboratories	9,146
Mid-Caps	
Max Healthcare	5,998
HPCL	4,507
PB Fintech	3,436
Federal Bank	3,269
Small-Caps	
IndiaMart InterMesh	2,179
Affle India	1,474
GE Shipping	1,230
Amber Enterprises	771

Source: Company, Ambit Capital research

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Tug of War: Yield Softening vs Normalized Earnings Trajectory

In our note "A tough catch up to fair value" dated 9-Jan-23, we highlighted that EYBY Gap implied Nifty fair value is 19.5k (Dec-23) at 7.3% yield, Dec-23 EPS (INR920) and markets trading at LTA (-2.6) of EYBY Gap. But, some assumptions have changed as compared to Dec-23. Our assumption of 10-year yield was 7.3% (Dec-23), and we move it to 7.1% (Mar-24) as the OIS curve, real rate, repo G-sec spread, price action, etc. converge in unison. From FY24, the earnings trajectory will likely change with BFSI's contribution to incremental earnings growth will taper. In addition to BFSI, IT (7%), Auto (13%), O&G (14%), FMCG (4%) and Metals (5%) contributions will be significant to incremental growth. The estimate sustenance will be key and we see earnings risk in IT, Metals, and O&G (Reliance). While Nifty FY24 consensus EPS is ~INR991, our FY24 EPS estimate stands at INR940. We have kept FY24 Nifty EPS growth(12%) in line with nominal GDP growth(10.5%).

We roll forward our target to Mar-24. EYBY Gap implied Nifty fair value is 20.9k (Mar-24) at 7.1% yield, Mar-24 EPS (INR940) and markets are trading at LTA (-2.6). Upside surprise is possible if yields sustain at lower levels (<7.1%), Mar-24 earnings are higher than expectations (>940), or Nifty trades at a lower EYBY Gap than LTA (<-2.6).

EYBY Framework: At 7.1% yield, 940 Mar'24 EPS

Revisiting the EYBY Gap Framework: EYBY gap measures the attractiveness of equities w.r.t bonds by comparing earnings yield (1/PE) with bond yield. Higher the earnings yield as compared to the bond yield (higher gap), the better the subsequent returns and vice-versa. In Jan'23, we highlighted the emergence of fault line but India's robust earnings (thanks to banks) as the only saving grace pegging a Nifty fair value of 19.5k for Dec'23.

We re-visit our view and roll-forward our targets to Mar-24.

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: EYBY Gap, yield, and earnings estimate (Mar-24).

Assumptions: 7.1% yield, INR940 EPS for March-24, and Nifty trade at LTA EYBY Gap (-2.6).

How our assumptions fared? What's the change?

- **FY24 earnings estimate:** Nifty earnings estimates have been relatively resilient, with FY23 expected growth at 14.3%. The estimate was cut by 5%, but is still better than the decadal average of 8%. This has happened amid global uncertainty and robust earnings surprise by BFSI, a key contributor to FY23 earnings growth (+195%), which contributed to India's outperformance. While consensus earnings estimates for FY24 have remained unchanged since Jan-23 (INR991), there are risks to Nifty FY24 EPS growth and earnings would be lower than consensus estimated growth (18.1%). We cover this in the Earnings section but the key takeaway is banks' contribution to FY24 earnings growth is coming off and earnings estimate sustenance is seen only in banks and auto. We roll forward our targets to Mar-24, assuming cuts to the consensus earnings estimate (FY24) of INR991. Our earnings assumption stands at INR940 though we rolled one quarter from Dec-23 to Mar-24.
- **Earnings yield bond gap**: Markets can trade at expensive valuations if earnings remain robust but selecting a long-term average (-2.6) looks like an appropriate assumption. We take LTA (-2.6) as the valuation at which markets would trade.

- **Yield:** Our assumption of yield for the next 1 year has been 7.3% from Sep-22. In G&C 18.1 (5th Sep'22), we highlighted that at the end of rate hike cycle, this spread between the repo rate and G-sec is usually significantly less than 10-year average/median of 99bps/111bps. And we expected yield to stay at 7.3% with intermittent volatility. We are reaching the end of the rate hike cycle and we expect yields to stay at 7.1%. The OIS curve (swaps) leads the bond market and signals the possibility of rate cuts. For details, please refer to our section" Where the 10-year yield is heading"?

FY24 would be a tug-of-war between earnings trajectory normalization vs. benign yield. And, this is what the note touches on in detail.

Putting it together

With bond yield at 7.1%, Mar-24 EPS INR940,and EYBY Gap (-2.6), the Nifty implied sustainable price level is 20900 (March-24).

Exhibit 1: Sensitivity analysis - Implied Nifty levels (Mar-24) for different EPS scenarios (consensus EPS stands at ~INR991) at 7.1% yield

Mar'24 EPS(INR)	Implied Nifty Level
910	20,222
920	20,444
930	20,667
940	**20,889**
950	21,111
960	21,333

Source: Bloomberg, Ambit Capital research

In the above scenario, we have considered yield as 7.1% and varied Mar'24 earnings. In the second case, we do a sensitivity analysis for Nifty levels under varying conditions of earnings and yields. For instance, under conditions of Mar-24 EPS of INR910 and the 10-year yield at 7.1%, Nifty's fair valuation is ~20.2k.

Exhibit 2: Implied Nifty levels(Mar-24) for different yields and earnings levels

10-year yield	Mar-24 EPS(INR)					
	910	**920**	**930**	**940**	**950**	**960**
6.9%	21,163	21,395	21,628	21,860	22,093	22,326
7.0%	20,682	20,909	21,136	21,364	21,591	21,818
7.1%	20,222	20,444	20,667	**20,889**	21,111	21,333
7.2%	19,783	20,000	20,217	20,435	20,652	20,870
7.3%	19,362	19,574	19,787	20,000	20,213	20,426
7.4%	18,958	19,167	19,375	19,583	19,792	20,000
7.5%	18,571	18,776	18,980	19,184	19,388	19,592

Source: Bloomberg, Ambit Capital research

At EYBY Gap of -2.4% and Mar-24 EPS of 920, the implied Nifty level turns out to be 19,574.

Exhibit 3: Implied Nifty levels (Mar-24) for different EYBY Gap and earnings levels at 7.1% yield

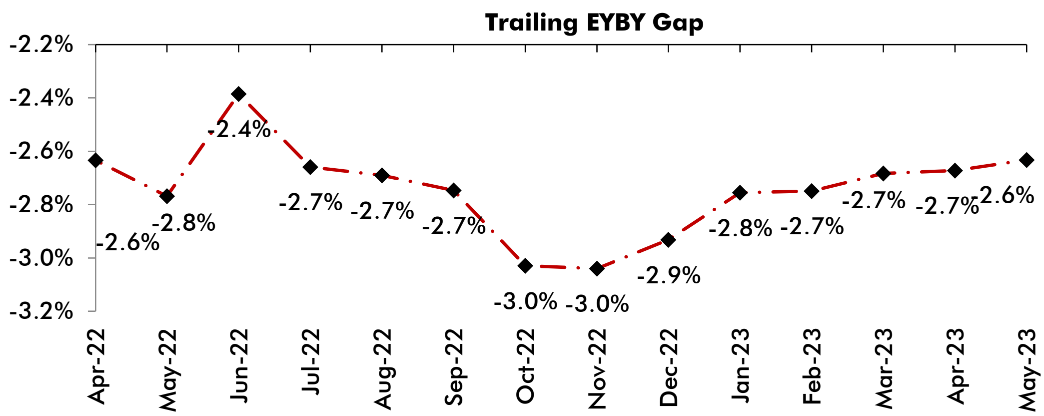
EYBY Gap	Mar-24 EPS(INR)					
	910	920	930	940	950	960
-2.4%	19,362	19,574	19,787	20,000	20,213	20,426
-2.5%	19,783	20,000	20,217	20,435	20,652	20,870
-2.6%	20,222	20,444	20,667	**20,889**	21,111	21,333
-2.7%	20,682	20,909	21,136	21,364	21,591	21,818
-2.8%	21,163	21,395	21,628	21,860	22,093	22,326
-2.9%	21,667	21,905	22,143	22,381	22,619	22,857

Source: Bloomberg, Ambit Capital research

Our take: Markets are not expensive

The markets are not expensive, with EYBY Gap at (-2.6%) in line with LTA (-2.6%). There can be some volatility as institutional flows can be lower due to global liquidity, which can worsen as we move into the year and the opportunity cost of investing will increase with rising deposit rates. A greater than 10% upside from the Nifty fair value indicates an interesting opportunity! The polarization continues, a theme that we have highlighted in G&C 18.1, and stock selection would hold the key.

Exhibit 4: EYBY Gap stands at LTA(-2.6) in line with the long-term average



Source: Bloomberg, Ambit Capital research Note: Latest available data as of 12th May'23

Where is the 10-year yield heading?

Our analysis suggests that 10-year yields will stay benign. Swaps are the leading indicator of bond rates and 5-year OIS (long) rates have come off significantly since Feb-23, highlighting possibility of rate cuts. We observe that in the 6 months leading to general elections (2004-19), the G-sec has softened in 3 out of 4 instances. Why this year can be different? Real rates have turned positive and look adequate even if inflation remains sticky. The spread between the policy rate and 10-year yield has been mostly lower than the 10-year average/median spread (99/111bps) in most instances. The price action also confirms the breakdown of 10-year rates. Even from a supply-demand perspective, bond demand can remain strong from life insurance companies and banks will increase their ownership as well (LCR has reduced to 124). On the other hand, the FY24 borrowing program though steep was lower than bond market participants' expectations. Putting it all together, we see yields at 7.1% with a possibility of softening.

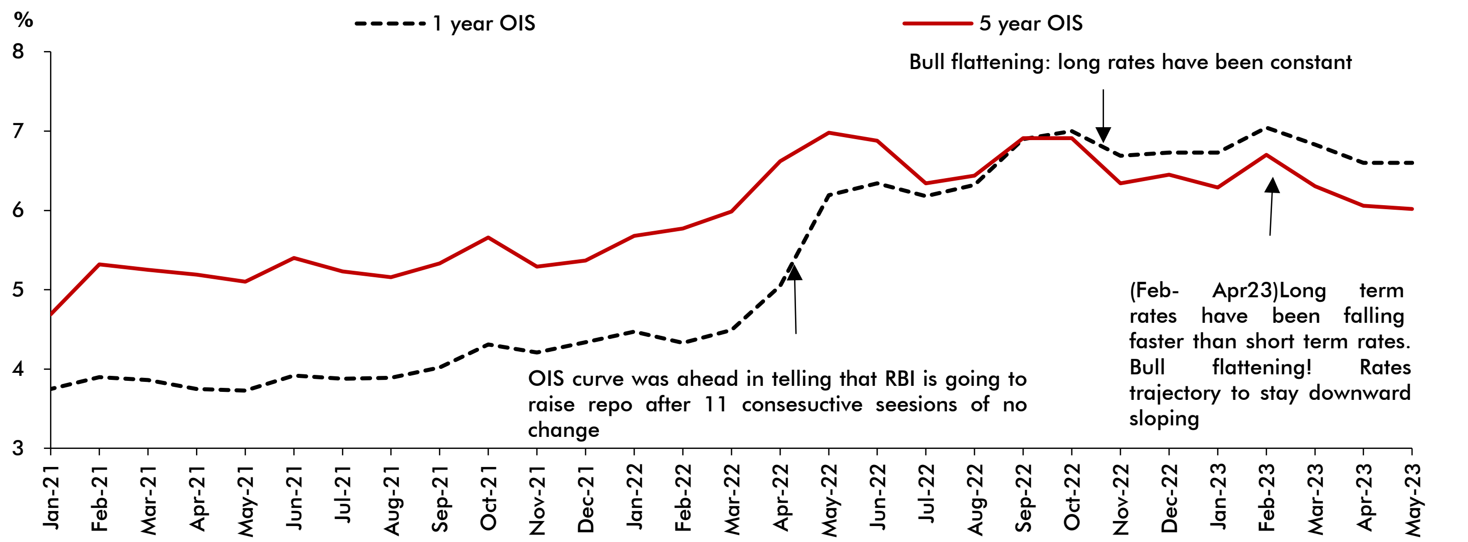
Swaps, an early indicator of the bond rate

Bull Flattening of the OIS Curve: The overnight indexed swap* (OIS) has been a lead predictor of interest rate trajectory. The bull flattening of the OIS curve is supportive of higher stock prices. A bull flattener is an environment in which long-term rates are falling faster than short-term rates. Some interesting observations from the last 1 year:

- Notice the fall in the 5-year OIS rate vs the 1-year OIS rate post May-22, indicating faster rate cuts ahead once RBI is done with the rate hike cycle. Perhaps they were also indicating that inflation has peaked! We highlighted this in "G&C18.0: Changing our lens and direction" on Sep-22. And since then, the 10-year rates moved nowhere and inflation has peaked.
- Notice the rise of the 1-year OIS curve since the CY22 beginning – the OIS curve was indicating front loading of repo hikes. And, the same happened.

What's happening currently? The 5-year OIS rates have come off by 68bps since Feb-23, whereas the 1-year OIS rate has come down by 45bps. A bull flattening! We expect the rates to come down gradually from here.

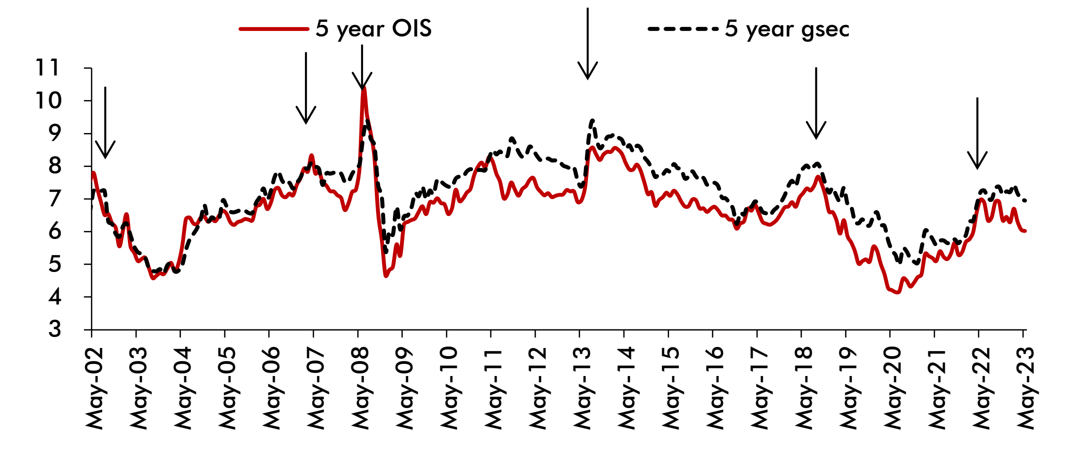
Exhibit 5: Bull flattening of the OIS curve



ource: Bloomberg, Ambit Capital research, Note: Latest data as of 12th May'23

In most of the instances, the peaks of the 5-year OIS curve have signalled long-term yield softening as indicated in the below chart and seems to be happening right now.

Exhibit 6: Historically, 5-year OIS curve peaks have signalled long term yield softening

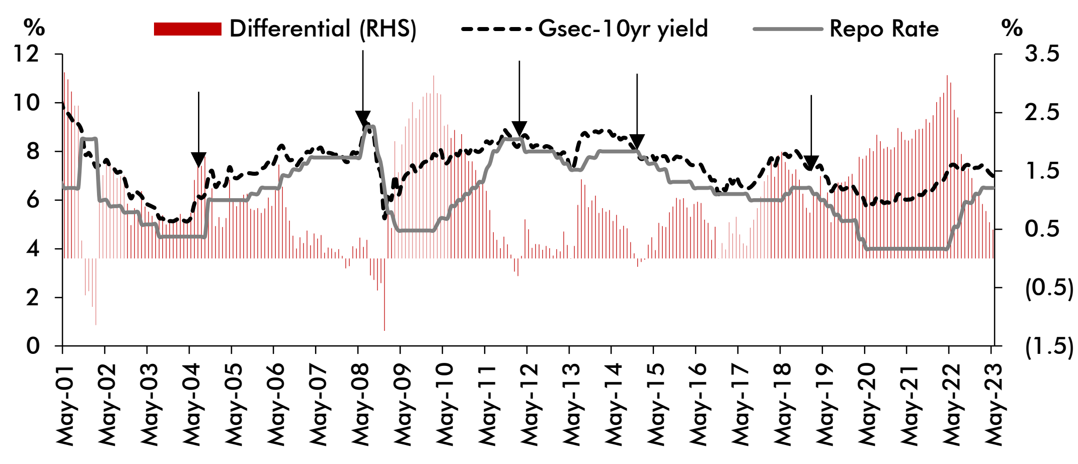


Source: Bloomberg, Ambit Capital research, Note: latest data as of 12th May'23

Reaching the end of the hike cycle: What is the gap between policy and market rate telling us?

The 10-year average/median spread between the 10-year yield (market rate) and repo rate, a measure of the inflation expectations is 99/111bps. The spread at the end of the rate hike cycle has been lower or at most equal to a 10-year average/median of 99/111bps. With a terminal rate of 6.5%, the yield looks capped at 7.5% (recent highs). What's worth highlighting is that assumption of spread being at a 10-year average/median at the end of this rate hike cycle is very conservative!

Exhibit 7: Spread at the end of the rate hike cycle has been lower or at most equal to 10-year average/median of 99/111bps



Source: Bloomberg, Ambit Capital research, latest data as of 12th May'23

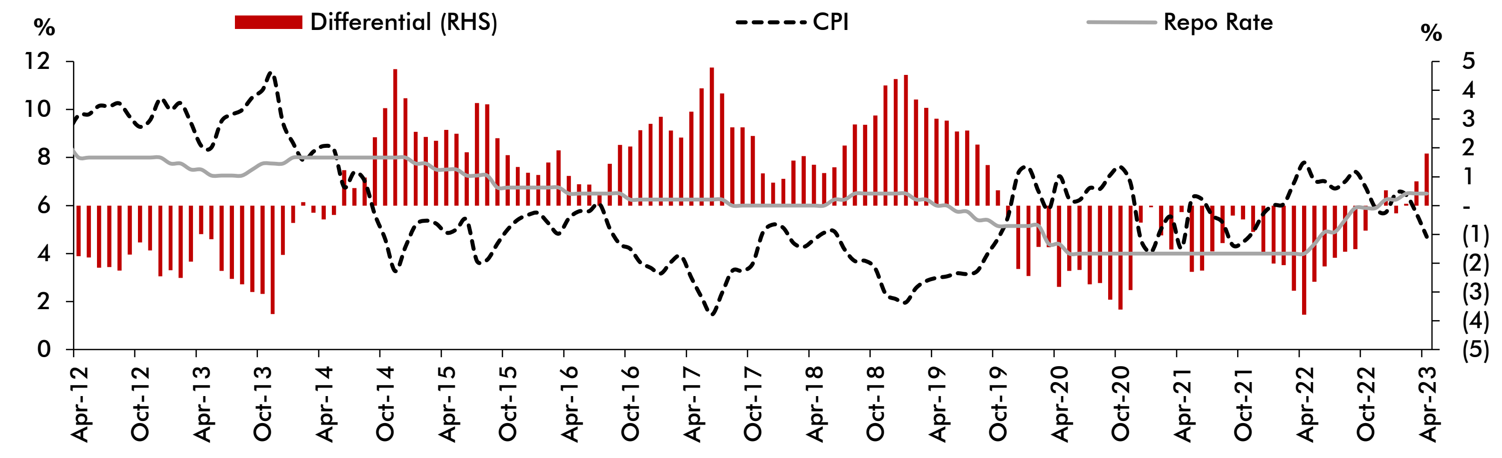
In previous episodes, at the end of rate hike cycles, the spread has been mostly lower than 10-year average/median in most instances. The spread is highest at the beginning of the rate hike cycle and reduces significantly as market expectations of rate hikes manifest and make the low post-end of the rate hike cycle. A more realistic assessment can be 7.1%-7.3%, with a bias towards the lower bound!

The "real policy rate" is at the highest level since Aug-19

RBI has raised the repo rate by 250bps since May'22 and has taken the policy rate to 6.5% to curb inflationary pressures. While the effect of cumulative cuts will be observed over the next few months, retail inflation came at 4.7% in Apr-23 (5.66% on Mar-23), falling below the repo rate for the 3rd time since Sep-19. The trajectory of the real policy rate seems to have altered. The inflation-adjusted real rate is at 1.8% right now, highest since Aug-19.

We have an official CPI estimate for 1QFY24 from the RBI (5.1%) and FY24 (5.2%); a 6.5% terminal repo rate would yield a (>100bps) real positive policy rate, which looks adequate. This suggests that even if inflation remains sticky, RBI need not keep raising policy rates.

Exhibit 8: Real interest rates>100bps as inflations eases below 5% in Apr'23



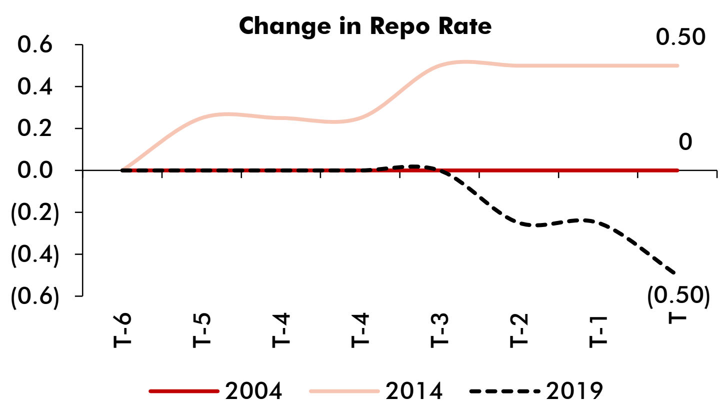
Source: Bloomberg, Ambit Capital research, Note: Latest data as of 30th April'23

Rate trajectory: What happens before general elections?

An analysis of general elections (Lok Sabha) held over the last two decades suggests that yields stay benign leading up to elections, except for the 2014 elections when macros were in far worse shape. We observe that in the 6 months leading to the general elections, 10-year yields have declined in 3 out of 4 instances. Additionally, the rate trajectory has also stayed benign throughout. Elections are still 11 months away and with inflation tapering off and rising real yields, we don't expect the trajectory to be materially different. It's worth highlighting that only in 2014, the yield at the general election time was higher than the yield a year ago. Macroeconomic environment plays an important role in policy rates decision and with inflation coming down, OIS curves indicating a possibility of rates cuts, we don't see any reason why yields behavior could be different this time.

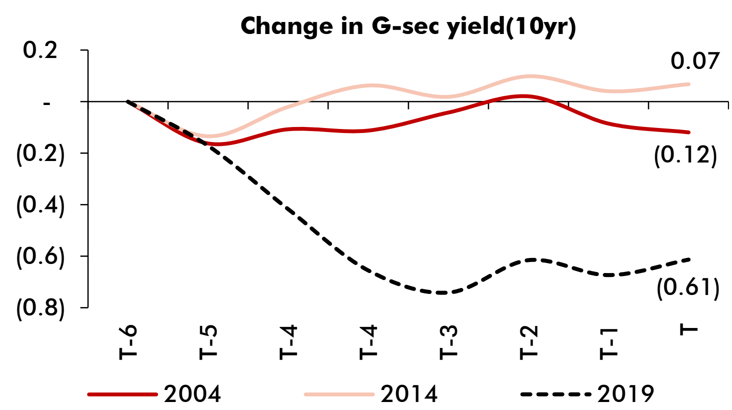
In 2009, we witnessed massive cuts in repo and G-secs post-GFC crisis. And, hence it was excluded from the below charts.

Exhibit 9: Evolution of policy rate before general elections



Source: Bloomberg, Ambit Capital research Note: T pertains to April of the election year

Exhibit 10: Evolution of 10-year yield before general elections



Source: Bloomberg, Ambit Capital research Note: T pertains to April of the election year

Behavior of the crowd: What is price action telling us?

The 10-year G-sec yield has been consolidating at 7.3-7.5% over the last 9 months and has a breakdown. The yield trades below 200dma and has failed to cross the resistance line. Expect yields to stay below 7.3% and trade with a bias towards 6.9%.

Exhibit 11: Notice the recent breakdown in 10yr yield; expect yields to stay below 7.3%

Source: Bloomberg, Ambit Capital research Note: Latest data as of 15th May'23

Demand from life insurance companies remains robust

Statutory requirements require financial institutions such as banks and insurance companies to hold government securities. While SLR for banks is ~18% of the NTDL, insurance companies have to invest at least 25% of their funds in Central government securities.

Exhibit 12: Insurance companies have statutory requirements to hold F-secs

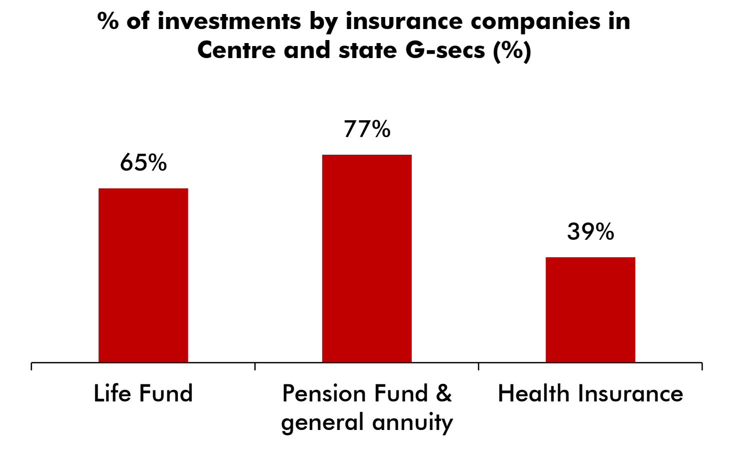
Percentage of funds as per IRDAI regulations	Life Insurance Companies	Pension and annuity funds	General Insurance Companies
Central Government Securities	Not less than 25%	Not less than 20%	Not less than 20%
Central Government Securities, state government, and other approved government securities	Not less than 50% (including above)	Not less than 40% (including above)	Not less than 30% (including above)
Housing and Infrastructure	Not less than 15%		Not less than 15%
Other Approved Investments	Not exceed 50%	Not exceed 60%	Not exceed 70%

Source: Bloomberg, Ambit Capital research

With insurance penetration having increased from 3.4% to 4.2% between CY16 and CY22, the share of Central government G-secs held by insurance companies increased by 389bps during the period. The increase in demand for G-Secs in the last 3 years has been a function of the emergence of non-participating products as a category. These are fixed benefit products that result in life insurance purchasing G-secs. This is unlike CY00-18 when private life insurance was dominated by ULIP. ULIPs have a higher equity mix, unlike non-participating products which are purely backed by G-secs/ fixed benefit products. Non-par products also enjoyed tax benefits such as exemption on both, premium payments and returns, but the latter's exemption has been removed in the latest budget.

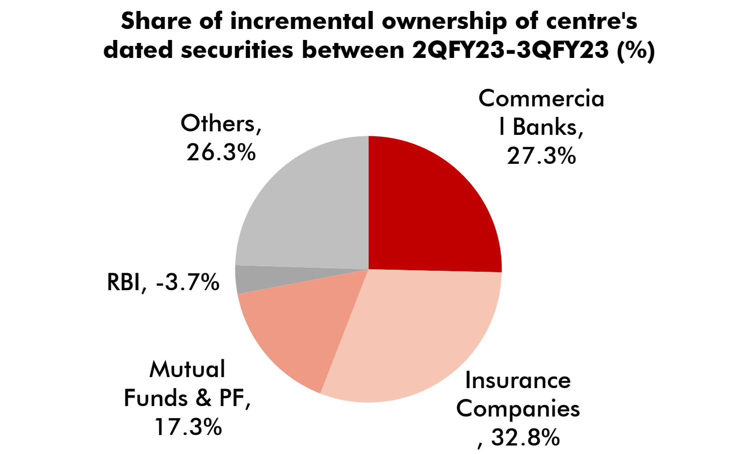
The impact of tax changes announced in the 2023 budget on "non-par" products is likely to be clear only at the end of 1QFY24 given Apr-23 had agents going on extended leaves and some companies also benefitted from premiums being delayed from Mar'23 to Apr-23. Apr'23 premium data however was pleasing for HDFC Life, noting the company's annualized premium equivalent (APE) increased by +13% despite it having one of the highest exposures to the non-par segment (11% of APE). It's worth highlighting that even with tax changes impact, life insurance companies would continue to be meaningful player as "industry growth" would counteract the impact of "tax changes".

Exhibit 13: Insurance companies invest a significant % of their AUMs in G-sec



Source: IRDAI, Ambit Capital research. Note – Data as of the end of FY22.

Exhibit 14: Insurance companies overtook banks in 3QFY23 in subscribing to dated securities

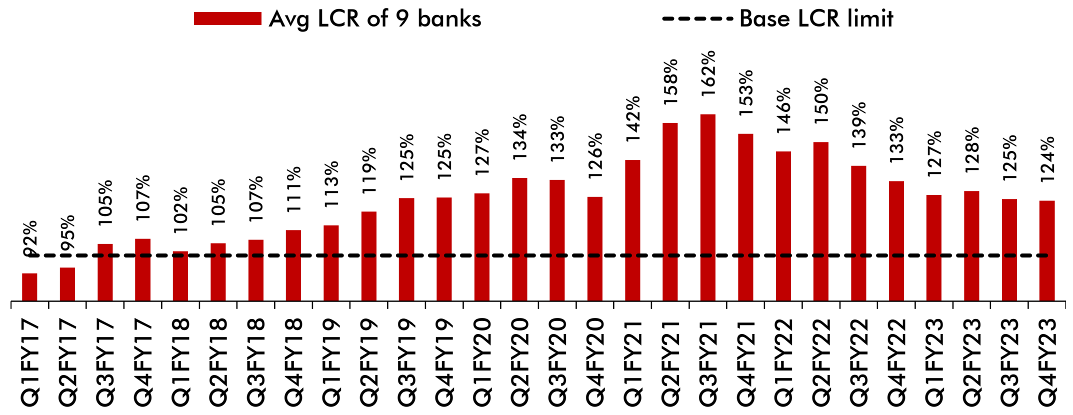


Source: Bloomberg, Ambit Capital research

Can Banks increase ownership of government bonds?

The average liquidity coverage ratio (LCR) which represents the bank's liquid holdings in the form of cash and SLR securities (mostly G-secs) rose to 162% in Dec'20. Gradually, banks trimmed the levels down to 125% against the minimum requirement of 100%, indicating limited room for additional trimming. This implies as the banks build up their balance sheet (deposits + borrowings) in FY24, there should be proportionate increase in liquid securities (mostly G-secs) to maintain LCR. Our banking team expects NDTL/Balance sheet to grow by 13-14% over the next year. This means that banks' ownership of G-sec which has been declining over the last few quarters can move up from here. This indicates that current "G-sec" holding of banks – 35.6 lakhs crore – can increase by 4.6 lakh crores or conservatively 3.5-4 lakh crores over the next 1 year as the total increase can get spread across state/central govt. bonds.

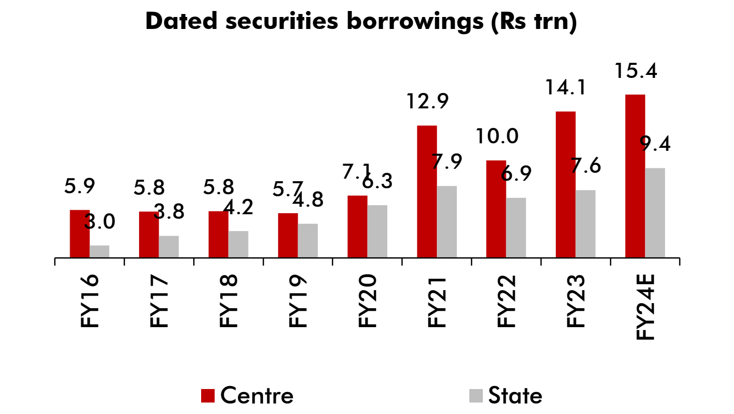
Exhibit 15: Banking Universe LCR has come down from 162% in 3QFY21 to 124%



Source: Company, Ambit Capital research Note: IIB, KMB, RBL, Yes Bank, Federal Bank, Axis, ICICI, HDFC Bank and SBI constitute the peer set

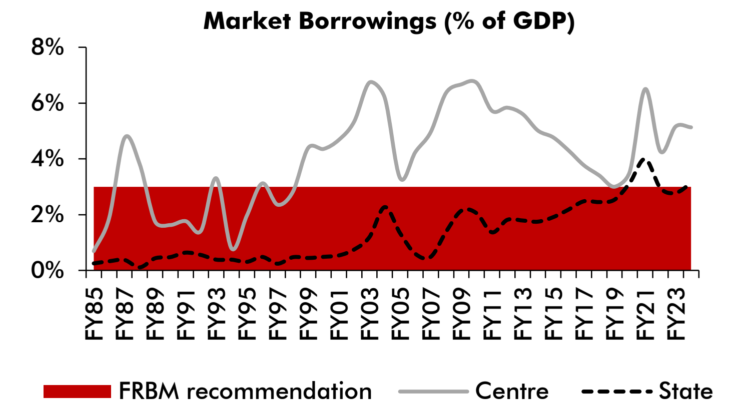
Borrowing program: Since the pandemic, Centre's borrowing has been elevated and almost 200bps higher than the Fiscal Responsibility and Budget Management Act (FRBM Act) has recommended. While states were prudent with their spending in last 2 years, we believe pre-election spending would lead to higher borrowings. On the other hand, the FY24 borrowing program though steep was lower than bond market participants' expectations. Putting it all together, we see yields at 7.1% with a possibility of softening.

Exhibit 16: General government borrowing would be ₹25trn in FY24…



Source: RBI, Ambit Capital research. Note- State government borrowing has been extrapolated on the basis of the budgets of 17 major states covering ~80% of the GDP

Exhibit 17: … which is above the recommended limit for states and Centre



Source: RBI, CEIC, Ambit Capital research. Note- State government borrowing has been extrapolated on the basis of the budgets of 17 major states covering ~80% of the GDP

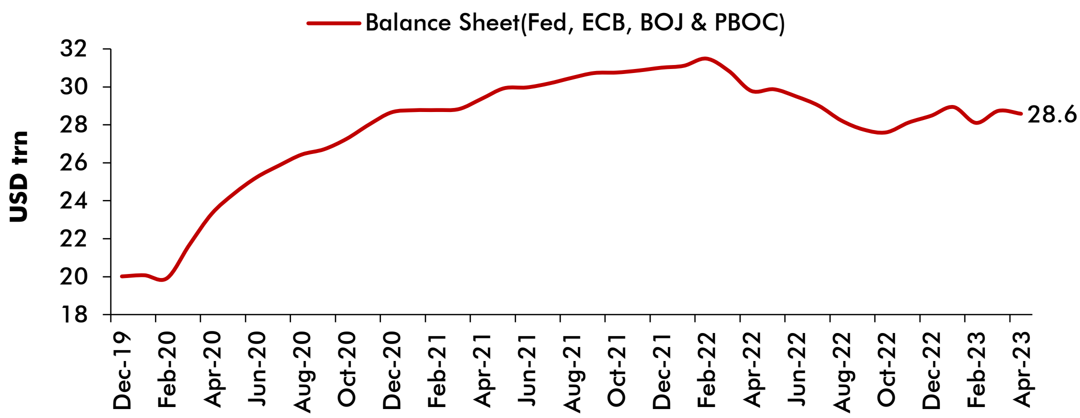
Liquidity has yet not receded

While the aggregate BS (in USD terms) may give an illusion of contraction, it is driven by depreciation of Euro, Yen, and Yuan vs USD and not the actual balance sheet contraction with the exception of ECB. Over next few months, out of the 4 major Central Banks, US and ECB will be contracting BS while PBOC and BOJ will continue with BS expansion. This will impact liquidity. As liquidity dries up, short rates go up and the opportunity cost of investing in Indian Equities goes up! This can impact FII flows which are a driver of market returns. With the rising deposit rates, opportunity cost of investing in equities has increased, which can weigh negatively on the DMF flows.

The global liquidity has not yet altered meaningfully. The aggregate balance sheet of US, ECB, China, and Japan currently stands at USD28.6trn, 9% down from an ATH (USD31.5trn). Putting things into perspective, the aggregate BS stood at USD19.9trn at Feb-20 and current BS is still 44% higher than pre-pandemic period. But even this small contraction in balance sheet is illusory. The following fact put things in perspective:

"While the aggregate BS (in USD terms) may give an illusion of contraction, it is driven by depreciation of Euro, Yen, and Yuan vs USD and not the actual balance sheet contraction with the exception of ECB."

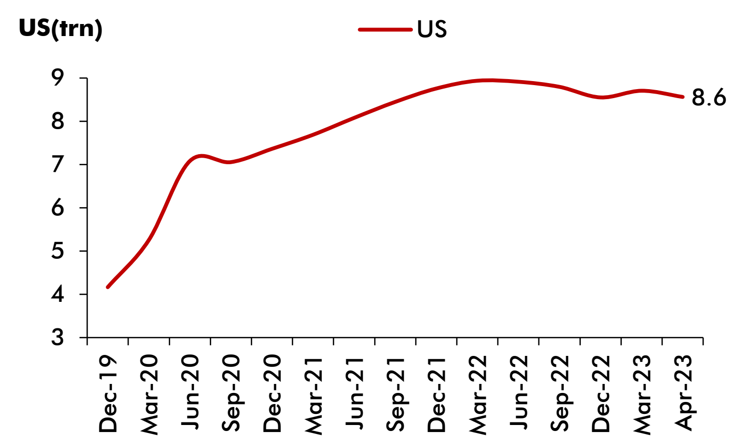
Exhibit 18: Total assets of major central banks were down 9% from ATH of USD31.5trn in Feb'22



Source: Bloomberg, Ambit Capital research ,Note: latest data as of 30th April'23

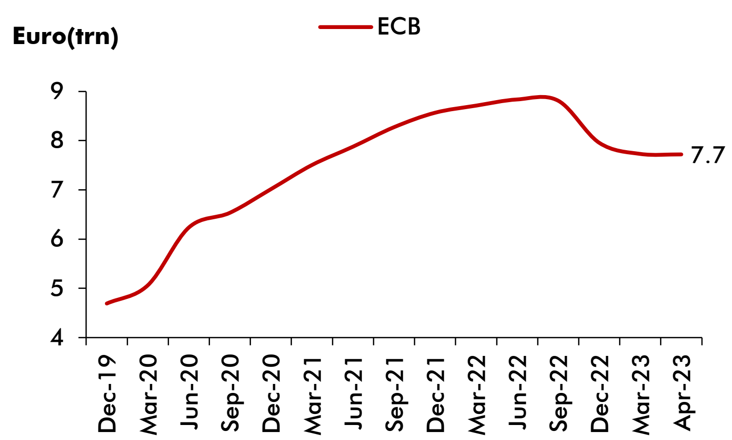
The following exhibits puts things in perspective.

Exhibit 19: US Balance Sheet is down only ~4% from ATH…



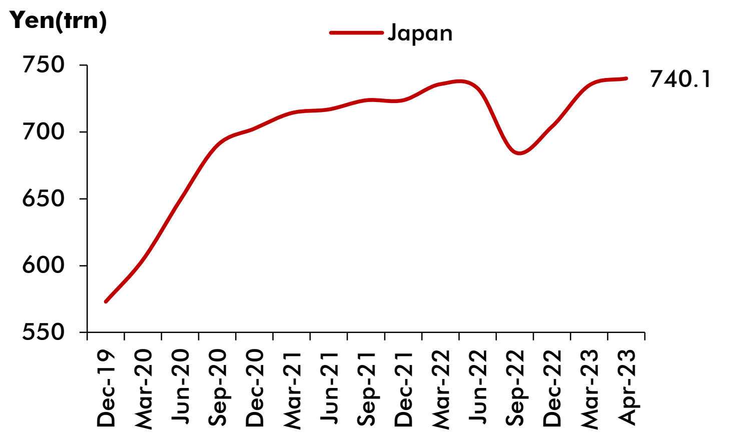
Source: Bloomberg, Ambit Capital research, Note: latest data as of 30th April'23

Exhibit 20: …ECB's Balance sheet is down 13% from ATH…



Source: Bloomberg, Ambit Capital research, Note: latest data as of 30th April'23

Exhibit 21: Whereas BOJ's Balance sheet is at ATH…



Source: Bloomberg, Ambit Capital research, Note: latest data as of 30th April'23

Exhibit 22: …and so is PBOC's balance sheet

Source: Bloomberg, Ambit Capital research, Note: latest data as of 30th April'23

What are the key central banks speaking on Balance sheet contraction?

ECB: In the recent speech, "Back to normal? Balance sheet size and interest rate control", ECB Officials have quoted:

"Further TLTRO repayments and a gradual run-down of our monetary policy bond portfolio imply that our balance sheet is expected to decline meaningfully over the coming years, thereby reducing excess liquidity. However, the size of our balance sheet will not return to the levels seen before the global financial crisis "

Putting numbers into perspective, current BS size: Eur7.7trn; BS size before/after GFC crisis: Eur2trn. Hence there is the scope of huge contraction.

FED: In FOMC's report – 'Open Market operation during 2022', the US fed mentions – *"The portfolio declines through mid-2025 as maturing principal payments are allowed to run off, subject to caps. The pace of decline is more rapid early in the projection period, with monthly declines averaging close to $80 billion through mid-2024, after which the pace slows as the caps are reduced"*

Putting the numbers into perspective, current (domestic) BS size: USD7.7trn; based on US Fed's projections, security holdings by end of year will fall by 6% vs current levels.

PBOC: Commentary from 1QCY23- *"The PBOC will make good use of policy-backed and development-oriented financial instruments, with the priorities on supporting infrastructure construction and promoting government investment to drive private investment."*

Policy makers continue to see signs of weakness in the foundations of current economic recovery. The above commentary suggests China would continue with its quantitative easing policy as they would like to bring overall financing costs of business further down. Currently, PBOC's balance sheet stands at USD6.1trn, which is 5% higher than previous year.

Bank of Japan: While addressing the parliament, Bank of Japan's governor mentioned that *'central bank will end its yield curve control policy and then start shrinking its balance sheet, once prospects heighten for inflation to sustainably hit its 2% target'*

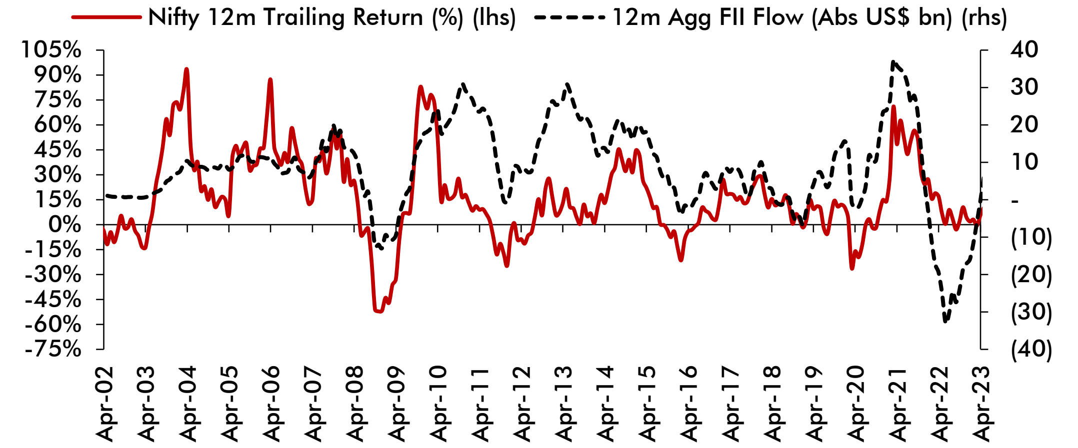
Bank of Japan has been very clear on its quantitative easing policy outlook- Tightening will only begin when inflation comes down to target rate of 2% on a sustainable manner. Until then it will continue to purchase Government bonds, CPs, ETFs and J-REITS. Currently, BoJ's balance sheet stands at USD5.4trn.

In nutshell, out of the 4 major Central Banks, US and ECB will be contracting balance sheets while PBOC and BOJ will continue with BS expansion.

But, why is this important? As liquidity dries up from here, short rates go up and the opportunity cost of investing in Indian Equities goes up! This can impact FII flows which are the driver of market returns. The below exhibit puts things in perspective.

Nifty trailing 12M returns and 12M aggregate FII flows are positively correlated (51%). This is reflected in Indian equities' performance. As the aggregate FII flows plummet, so does the market returns. In "State of Market", we pointed out that FIIs still control market direction! Notice the divergence in FII flows in 2HCY22 vs 1HCY22, and the market returns. As the FII flows returned, the market delivered returns.

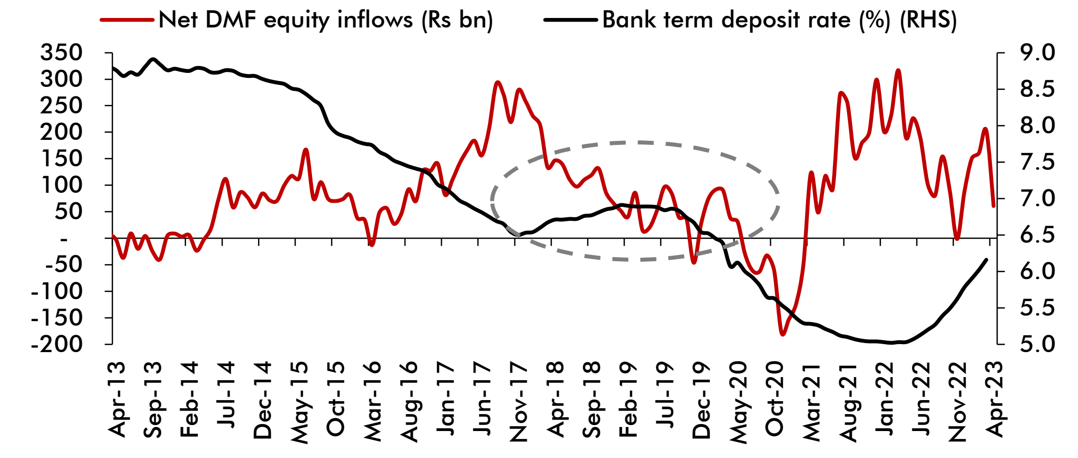
Exhibit 23: FII slows and market return trajectory are closely related…



Source: Bloomberg, Ambit Capital research,

From a domestic flows perspective, the opportunity cost of investing in equity has increased with deposit rates increasing from 5.03% to 6.16% over March (latest available data), which can weigh negatively on DMF equity inflows.

Exhibit 24: Rising deposit rates increase opportunity cost and impact DMF equity inflows



Source: Bloomberg, Ambit Capital research, Note: latest data as of 30th April'23.

Economic Monitor

India stands out among peers

India enters FY24 during a time of global uncertainty. Despite the external headwinds, India is better positioned than most of its emerging market peers. India's external account would be the silver lining in FY24, with the combined effect of narrowing current account deficit and strong capital inflows that could lead to rupee appreciating by 2.4%. However, the risk of fiscal profligacy remains high in an election year.

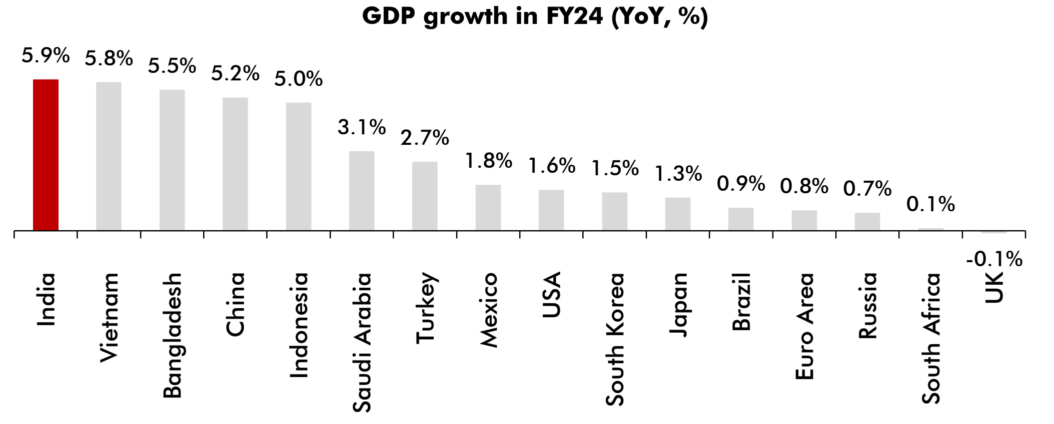
How is India placed compared to other EMs?

After nearly 3 years of the pandemic and its fallouts such as high inflation, India has entered the financial year in a better macro environment. India will face several headwinds including a weak external environment, moderation of pent-up demand, and uninspiring private capex. Despite the headwinds, India seems to be better placed than its peers.

India is expected to witness the highest growth among its peers

The RBI has projected a growth of 6.5% YoY for India in FY24 (Ambit estimates it at 5.5-6% YoY). While multilateral organizations like IMF do not agree with RBI's growth projections, their estimates still place India above its peers. In Apr'23, IMF upgraded India's GDP estimations by 20bps (see exhibit below).

Exhibit 25: India will have the highest GDP growth among all its peers in FY24

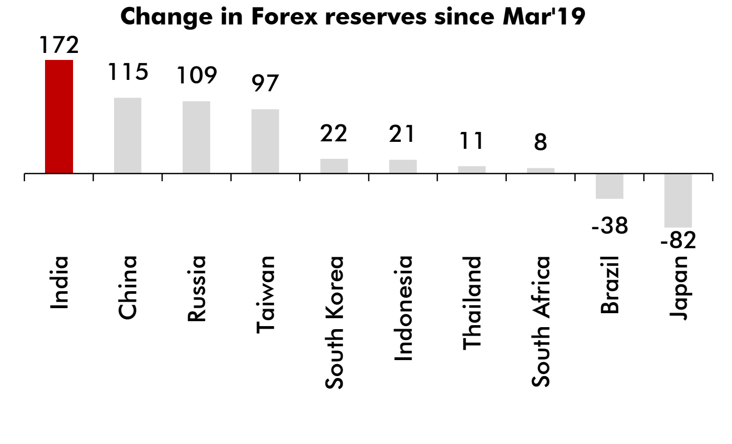


Source: IMF, Ambit Capital research

India's forex war chest helps maintain strong import cover

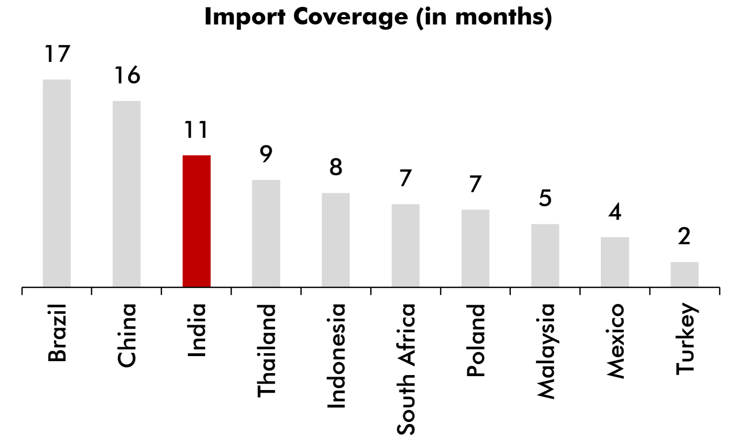
India currently has USD 584bn as forex reserves. Among EM peers, only China (USD3.2trn) and Russia (USD599bn) hold more forex reserves than India. Such a huge war chest protects India during times of foreign exchange volatility (see exhibit below). Imports in 2HFY23 contracted by 5% YoY, while India increased its forex reserves by USD46bn (net). This led to India's import coverage expanding by ~2 months, from 9 months to 10.9 months in Apr'23. This too contributes to India's external sector resilience as many of India's peers have import coverage of less than 10 months (see exhibit below)

Exhibit 26: India was the highest net purchaser of dollars in the last 4 years



Source: Bloomberg, Ambit Capital research

Exhibit 27: India's import cover is greater than most of its peers

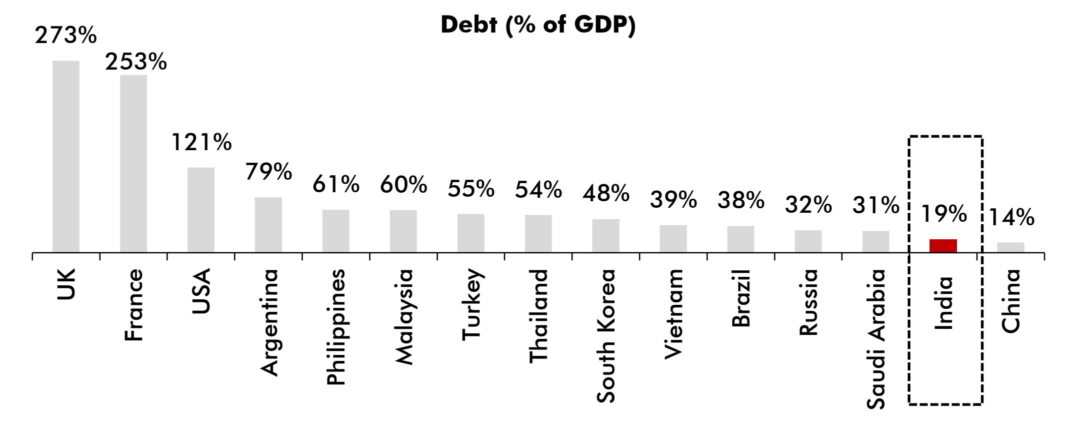


Source: Bloomberg, Ambit Capital research, Note- Data as on Apr'23

India's external debt obligation is very low

India historically has been uncomfortable about higher share of external debt, hence has stringent capital controls. While India loses out on billions of dollars due to not being included in global bond indices, it faces less foreign currency risk on its debts (see exhibit below).

Exhibit 28: India's external debt to GDP is one of the lowest among large economies

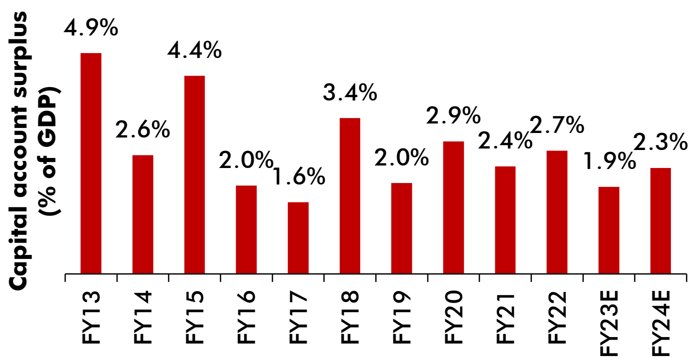


Source: CEIC, World Bank, Ambit Capital research. Note – Data as last reported by the countries

INR can appreciate by 2.4% in FY24

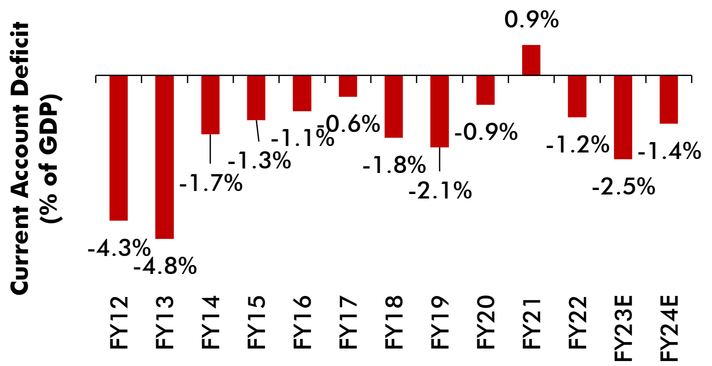
Strong global headwinds and cracks in domestic demand would deteriorate India's exports and imports. Our model suggests that India's Current Account Deficit (CAD) would fall to 1.9% of GDP in FY24 as against 2.5% expected in FY23. Similarly, India's stronger macro position compared to its emerging market peers can help India draw higher capital flows in FY24. Data suggests that a falling balance of payment (BoP) helps strengthen the rupee.

Exhibit 29: India's external account position…



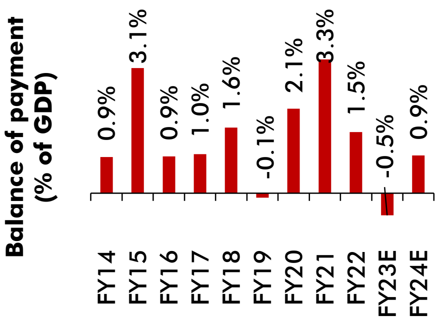
Source: CEIC, Ambit Capital research

Exhibit 30: … is expected to strengthen in FY24



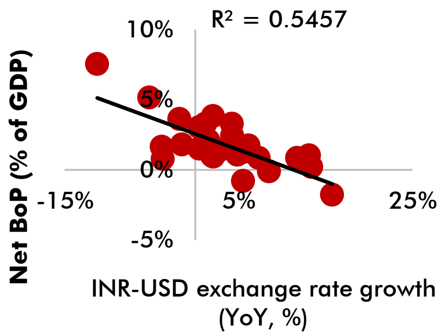
Source: CEIC, Ambit Capital research

Exhibit 31: BoP will turn positive in FY24



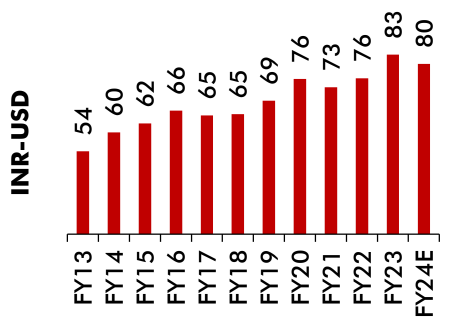
Source: CEIC, Ambit Capital research

Exhibit 32: Stronger BoP leads to appreciation of the rupee



Source: CEIC, Ambit Capital research

Exhibit 33: This would lead to the rupee settling at 80 vs USD



Source: Bloomberg, Ambit Capital research

Though the risk of fiscal profligacy remains high in an election year

Past "General Elections" have seen incumbent parties at the Centre roll out welfare schemes to attract votes. These schemes tend to be large in terms of fiscal allocation (see table below). This year too the chances are high that the Government might come up with schemes that entail a high fiscal cost. This could upset the Government's budget math and could also lead to higher than budgeted borrowings.

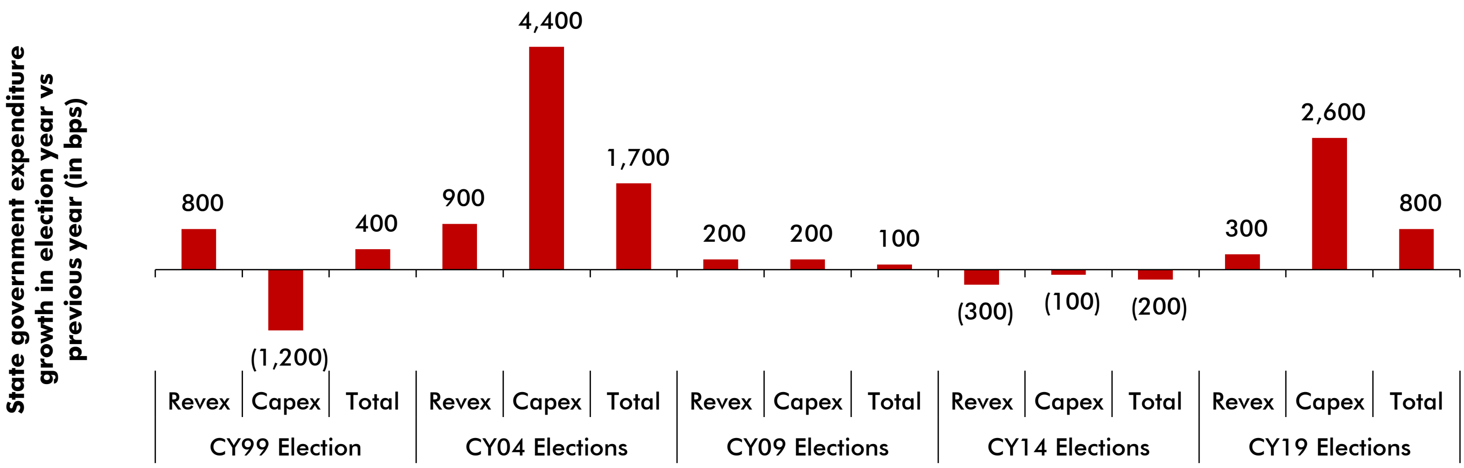
Exhibit 34: Central Govt. tends to roll out large welfare schemes in an election year

Election year	Pre- Election scheme	Description
CY19	PM-KISAN	Announced in the interim budget, PM Kisan was a scheme wherein more than 120 million farmers receive a cash transfer of ₹6,000 each per year. In CY19, the first tranche was given to more than 10mn farmers just before the elections. The scheme although introduced in the FY20 budget, ₹125bn was disbursed right before the election in 2019.
CY14	National Food Security Act, 2013	Passed in CY13, this act aimed to provide subsidised food grains to 75% of India's rural population and 50% of its urban population. 75% of the population was covered under the scheme. Eligible persons could buy food grains like rice/wheat at subsidised prices as low as ₹2/3 per kg every month.
CY08	Debt Waiver	Agricultural Debt Waiver was announced in Feb'08 wherein debts of 30mn farmers were waived off. The move cost the exchequer ₹600bn (1.2% of the GDP)

Source: Bloomberg, Ambit Capital research

Like the Centre, even states announce populist schemes before elections. States tend to take their spending a notch higher during the election year. They consistently have higher capex and revex growth rates during an election year than the year before. With states having been prudent with their spending in the last 2 years, it is reasonable to expect states to loosen their purse string in FY24.

Exhibit 35: State governments tend to increase their spending growth during elections



Source: CMIE, Ambit Capital research. Note- data refers to the delta in growth rate in the election year vs growth rate in the previous year

Although fiscal profligacy is a key risk to yields, a stable rupee can help keep the yields in control, as a stronger rupee signifies a more resilient macro environment.

Evaluating sectoral attractiveness

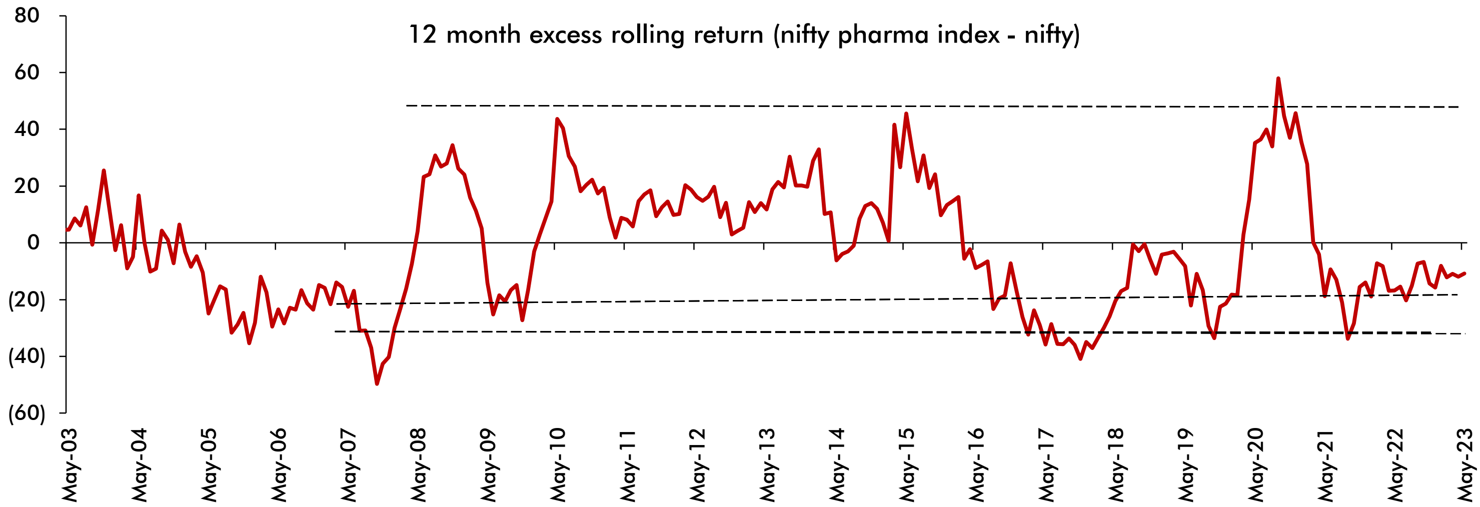
Our "sectoral attractiveness" framework comprises four parameters – 1. Excess returns. 2. Relative valuation. 3. Earnings estimate sustenance. 4. Ownership of the sector. In addition to this, we also look at sector specific intermarket relationships. We suggest taking off some weight from Banks and adding some weight in Healthcare. We also keep Auto, FMCG and Capital Goods as key UWs. On other hand, Metals appear attractive and we keep significant OW in OMC's.

"Sectoral attractiveness" determination is a key attribute for determining portfolio allocation. We evaluate sectoral attractiveness on four key parameters:

- **"Mean reversion" determined by excess returns**

We define excess returns of the sector as the 12-month rolling return differential of a sector w.r.t. market. The idea behind tracking these excess returns is that there is an anchoring bias in play and investors look at how much the sector has outperformed/underperformed Nifty over the last 1 year. "Extreme outperformance can breed reversion to mean and so does extreme underperformance". In May (slides 30-33), we highlighted banks' underperformance w.r.t market is close to historical troughs and historically – this in itself serves as a great signaling tool. The key is to look at sectors that are at the turning points.

Exhibit 36: The excess returns of Pharma w.r.t market bottomed out in Sep-21, but reversion is taking time!

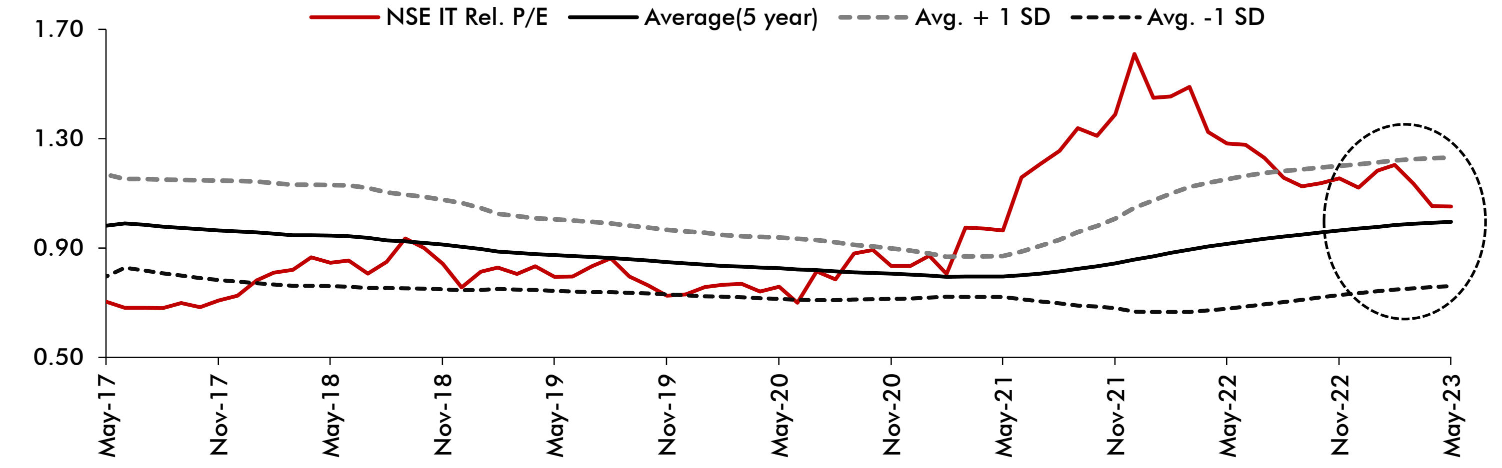


Source: Bloomberg, Ambit Capital research, Note: Latest data as of 12th May 2023.

- **"Relative valuation"**

The relative valuation of the sector w.r.t. market is the second variable for evaluating sector attractiveness. The crux is "Entry multiples matter!". As highlighted in the Availability Factor(AF) note, AF of Indian equities is contracting as demand for Indian Equities (23% CAGR) is outstripping supply of equities (13% CAGR over the past 5 years), which has manifested in higher "trough multiples".

Exhibit 37: With regional banks crisis in the US, Nifty IT valuations moderated to 5-year average



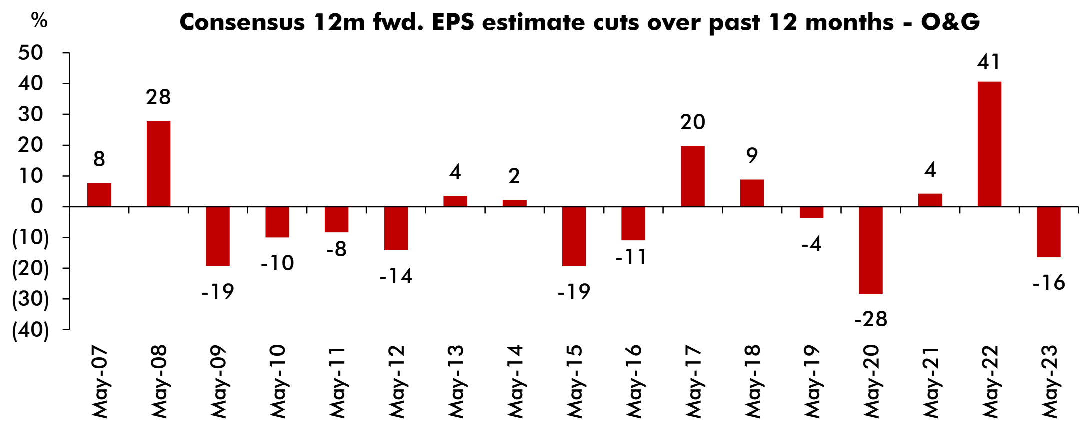
Source: Bloomberg, Ambit Capital research, Note: Latest data as of 12th May 2023.

To account for this, it makes sense to look at relative valuations. How the extreme relative valuation of IT/Banks manifested in abysmal/good returns. Both the first and second variables are based on the principle of "mean reversion". The drawback with this analysis is that sometimes mean reversion can be slower, as it happened with mid-caps in 2018-19!

- **Earnings estimate sustenance**

  We look at earning estimate sustenance across sectors and compare it with the historical trend over the last decade. This gives us an idea of whether earnings cuts are reaching business cycle lows or they are already showing reversion like in the case of O&G. This is the third variable of our sectoral positioning framework.

Exhibit 38: O&G earnings trajectory is one of the worst as compared to the last 15 years



Source: Bloomberg, Ambit Capital research., Note: latest available data as of 11th May,2012

- **Ownership**

  The ownership of the sector by DMF is the last variable of our sectoral evaluation. If the sector is under-owned and the mean reversion begins to manifest on price and valuation, this can add legs to the rally! We look at ownership of the sectors by comparing domestic MFs' allocation with index weights. The perfect way would be to compare the entire institutional investor ownership with the index weights, but since FII data comes with a lag, we have considered DMF as the representative.

  This is how the sector looks like on our framework right now.

Exhibit 39: How sectors look on our framework

Sectors	Recent Excess Returns	Relative Valuation to Nifty	Earnings estimates sustenance	Ownership w.r.t NSE500 Sector weights	G&C Positioning
Auto	Unattractive	Unattractive	Robust	Significantly Overweight	UW
Banks	Neutral	Neutral	Robust	Overweight	OW
IT	Very attractive	Unattractive	Risk	Neutral	OW
Pharma	Attractive	Attractive	One of worst**	Significantly Overweight	OW
FMCG	Unattractive	Unattractive	Robust	Significantly Underweight	UW
Metals	Attractive	Neutral	One of worst**	Significantly Underweight	OW
O&G	Attractive	Neutral	One of worst**	Significantly Underweight	UW*
Capital Goods	Neutral	Very Unattractive	Neutral	Overweight	UW

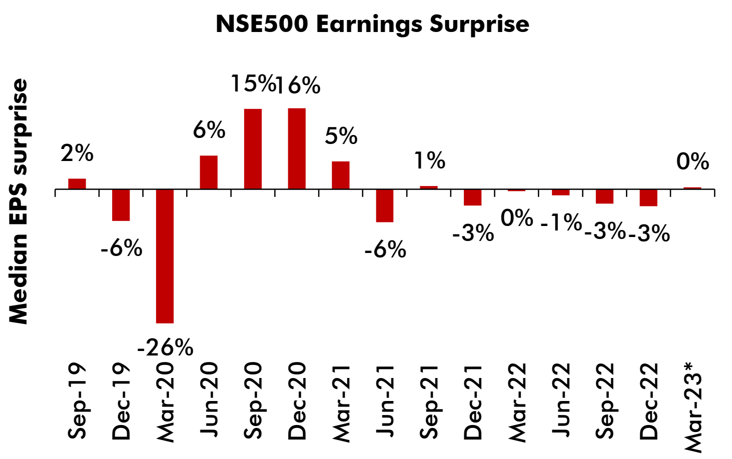
Source: Ambit Capital research, Bloomberg Note: Scores are assigned for excess returns, relative valuation and classified into 5 quintiles,, 0-0.20 scores as very unattractive, 0.20- 0.40 as unattractive, 0.40-0.60 as Neutral,0.60-0.80 as attractive, and 0.80 to 1 as Very attractive. Ownership is calculated as difference between Equity holdings of DMF's and NSE500 sector weights. +/- 5% are defined as neutral, 5-15% as underweight/overweight, >15% are classified as significant OW/UW.Earnings estimate sustenance has been calculated based on comparison of how earnings estimates evolution for current FY and next FY. We have disproportionate OW in OMC's but don't own Reliance, ** Possibility of sustenance here on, with trajectory touching cyclical lows*

Earnings estimate trajectory to change?

While headline Nifty earnings estimates in FY21-23 have stayed resilient, continuation in FY24 will be difficult. Additionally, "earnings delivery" breadth has remained poor even if headline numbers were met. From FY24, the earnings trajectory will likely change with BFSI's contribution to incremental earnings growth tapering. From FY24, the earnings trajectory will likely change with BFSI's contribution to incremental earnings growth tapering to 43%. Our house view suggests that IT, Metals, and O&G (Reliance) contribute 21% of incremental earnings growth and can be at risk. While the banks' earnings estimate remain robust, NIMs can be at risk if policy rates are cut. The risks to "Tech earnings" remain with the expectation of revenue growth normalization to the pre-Covid period and developed economies' GDP growth estimates tapering down. Reliance earnings are geared to Petchem margin and are at risk, hinging on China's recovery. Owing to same reason, metals' earnings are also at risk.

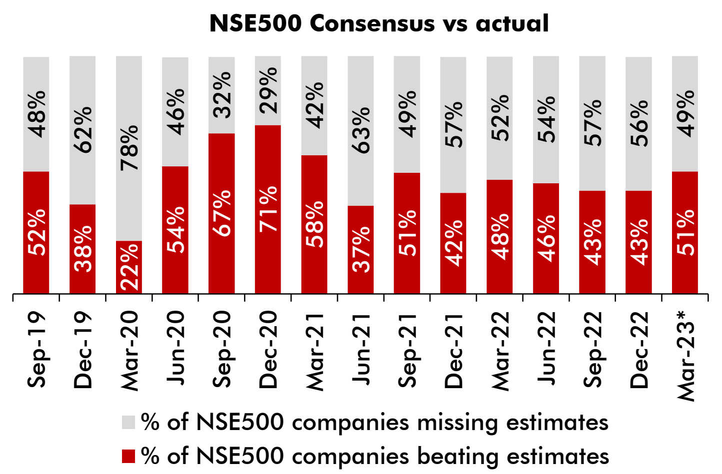
4QFY23 reporting season has been strong, with the number of companies delivering positive earnings surprise exceeding the companies delivering negative earnings surprise for the first time since Sep-21.

Exhibit 40: Earnings surprise has been significantly better as compared to last few quarters



Source: Bloomberg, Ambit Capital research Note: Mar-23 quarter results pertain to results declared so far*

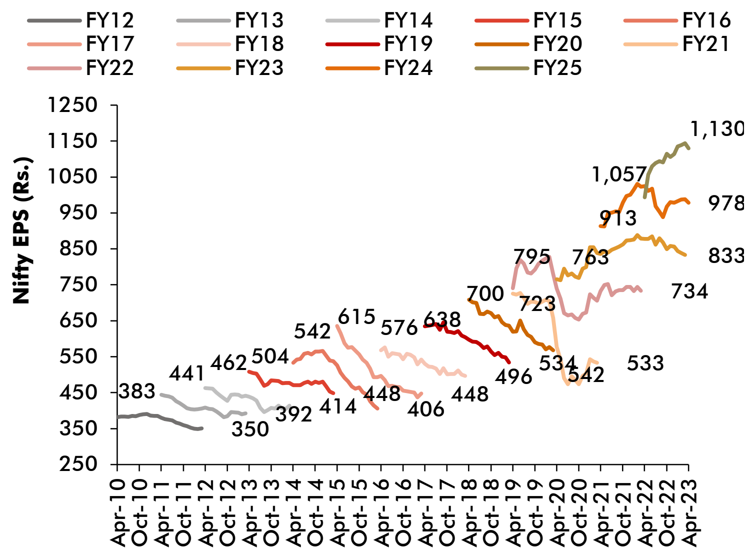
Exhibit 41: Companies delivering positive earnings surprise - a majority in 4QFY23*, the first time since Sep-21



Source: Bloomberg, Ambit Capital research Note: Mar-23 quarter results pertain to results declared so far*

How do EPS trajectories evolve? Despite FY24/25 estimates trending upwards, we think that this is probably overoptimism. Since FY12, Nifty earnings estimates have been revised downwards as we move in to the year. Our analysis indicates that in any financial year, EPS estimates have, on average, been revised downwards by 16% over the last 2 years (t-24 to t), and by 8% on average over the last one year.

Exhibit 42: Optimism in the market with FY24/FY25 estimates trending upwards…



Source: Bloomberg, Ambit Capital research

Exhibit 43: …while there could be more cuts in the trajectory of Nifty FY24 and FY25 earnings

Sector	Free float Weight	Contribution to Earnings Growth (%)		
		FY23E	FY24E	FY25E
BFSI	38%	195%	42%	43%
IT	13%	20%	7%	10%
Oil & Gas	12%	-42%	14%	8%
Consumer	11%	0%	4%	5%
Auto / Auto Anc	6%	58%	13%	8%
E&C / Infra / Cap. Goods	5%	14%	5%	6%
Metals and Mining	3%	-174%	5%	8%
Utilities	2%	-4%	2%	2%
Pharma	3%	22%	2%	3%
Cement	2%	-8%	1%	1%
Telecom	2%	12%	3%	5%
Retail	1%	4%	0%	1%
Healthcare	1%	-1%	0%	0%
Chemicals	0%	4%	1%	1%

Source: Bloomberg, Ambit Capital research

Additionally, earnings delivery breadth has been poor, even if Nifty aggregate earnings are delivered. For instance, in FY22, Nifty earnings estimates were sustained, but the breadth of earnings delivery remained poor. Over the last decade, only ~23 % (median over FY12-22) of the Nifty constituents have been able to deliver earnings estimates at the start of the financial year (t-12), suggesting that earnings estimates sustenance is a rarity. Additionally, only ~4% of Nifty constituents (median over FY12-22) have beaten earnings estimates at the start of financial year by 25%.

Exhibit 44: Breadth of earnings delivery remain poor

Deviation	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23*
Below -50%	16%	12%	12%	20%	29%	19%	18%	14%	24%	10%	4%	6%
-25% to -50%	10%	14%	20%	24%	19%	17%	10%	14%	16%	18%	10%	9%
0 to -25%	43%	34%	34%	37%	44%	40%	42%	47%	41%	37%	41%	56%
0% to 10%	24%	24%	16%	14%	2%	8%	12%	14%	10%	12%	20%	18%
10% to 25%	4%	12%	10%	2%	4%w	4%	4%	10%	2%	12%	6%	6%
25% to 50%	2%	2%	4%	0%	2%	8%	12%	0%	2%	0%	8%	3%
50% and above	0%	2%	4%	2%	0%	4%	2%	0%	4%	10%	10%	3%

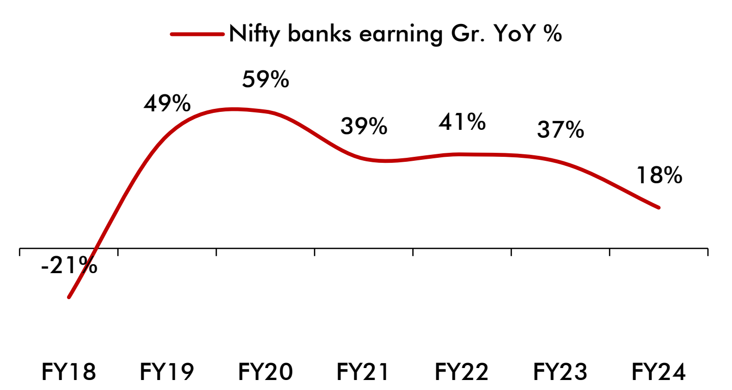
*Source: Bloomberg, Ambit Capital research, *out of 34 companies which have reported earning so far, Note: deviation is measured between earnings estimate at the start of FY and actual EPS.*

"Growth Engine" slow down can drive normalization of earnings trajectory!

The growth engine of Nifty earnings-BFSI will taper from FY24. Amongst Nifty, Banks earnings will grow at 18% in FY24 as compared to 37% in FY23. While BFSI drove bulk of FY23earnings growth (+195%), they will contribute only 42% of FY24 earnings growth; other contributors are Auto (13%), IT (7%), O&G (14%) and Metals (5%).In O&G, Nifty heavyweight "RIL" earnings can be at risk which hinges on "petchem margin" and hence, China's recovery. Likewise for Metals. We expect limited growth surprises and some softening of FY24 growth expectations in IT. Slowdown risks in entry-level vehicles and weaker rural sentiment pose muted growth outlook in Auto. Thus, Nifty FY24 EPS growth would be lower than 18% (current estimate), especially when earnings estimate sustenance is seen only in banks and autos.

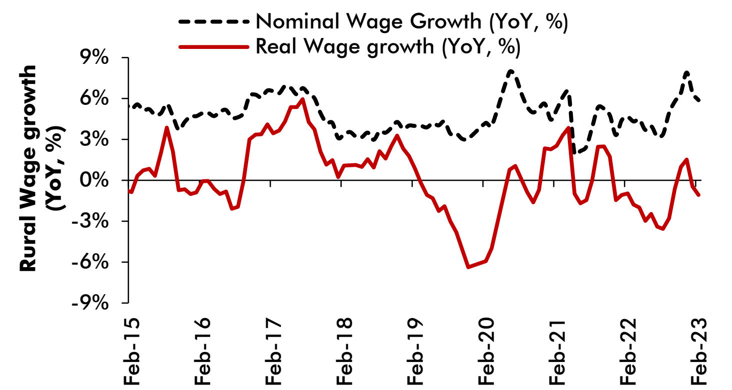
The Narrative in Charts

Exhibit 45: Banks earnings estimates are robust but growth will slow down from here



Source: Company, Ambit Capital research

Exhibit 46: Gradual improvement in real wage growth, expect FMCG volumes to improve albeit at slow pace



Source: Company, Ambit Capital research

Exhibit 47: Delay in Petchem margin recovery can be extremely detrimental for Reliance earnings

Sensitivity analysis of RIL's EPS

Petchem Margins (FY24E) (US$/T)	Consolidated EPS (FY24E) (INR)	% Change YoY (FY24E vs. FY23)
350	99	0%
400	106	8%
450	113	15%
500	120	22%
550	127	29%
600	134	36%
650	141	43%

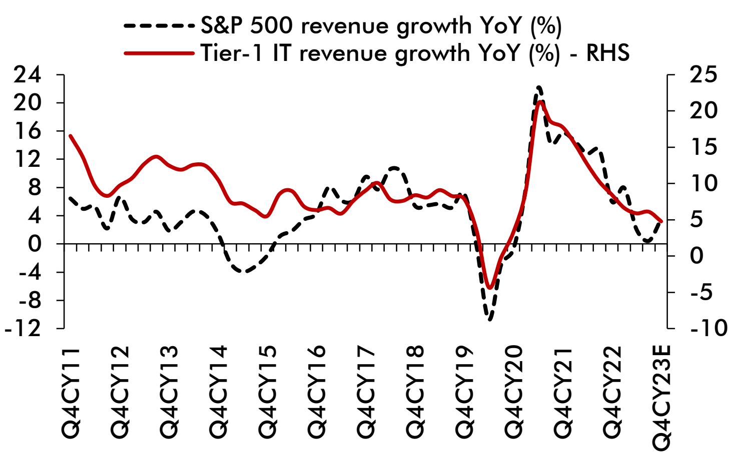
Source: Company, Ambit Capital research

Exhibit 48: Pre-poll surge in award/tendering typically leads to hangover as evident in L&T's operating metrics from 2019

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Order inflow	43%	94%	-18%	21%	-16%	-30%	-2%
Revenue	18%	36%	43%	13%	27%	13%	-4%
NWC/Sales	21%	20%	20%	18%	23%	23%	24%
OCF	(13.4)	24.1	18.6	61.8	(38.2)	13.9	24.9

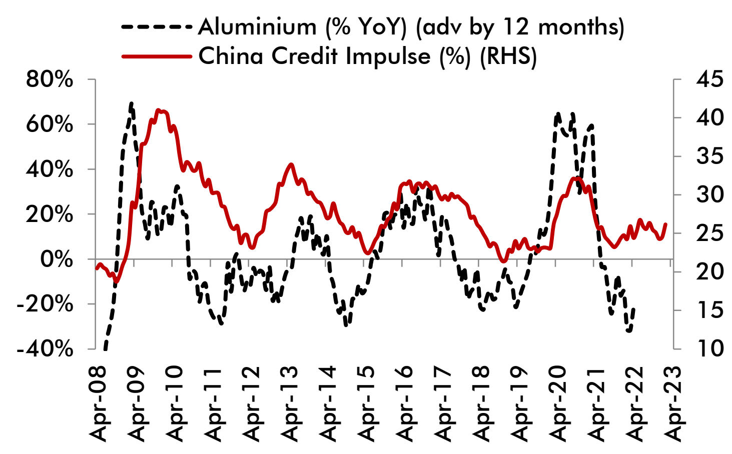
Source: Company, Ambit Capital research

Exhibit 49: Tier-1 IT revenue growth in line with S&P 500 revenue growth, which could moderate to ~4% in CY23E



Source: Company, Ambit Capital research

Exhibit 50: Chinese credit impulse flattish – no clear impetus to base metals as well in the near term



Source: Company, Ambit Capital research

Banks

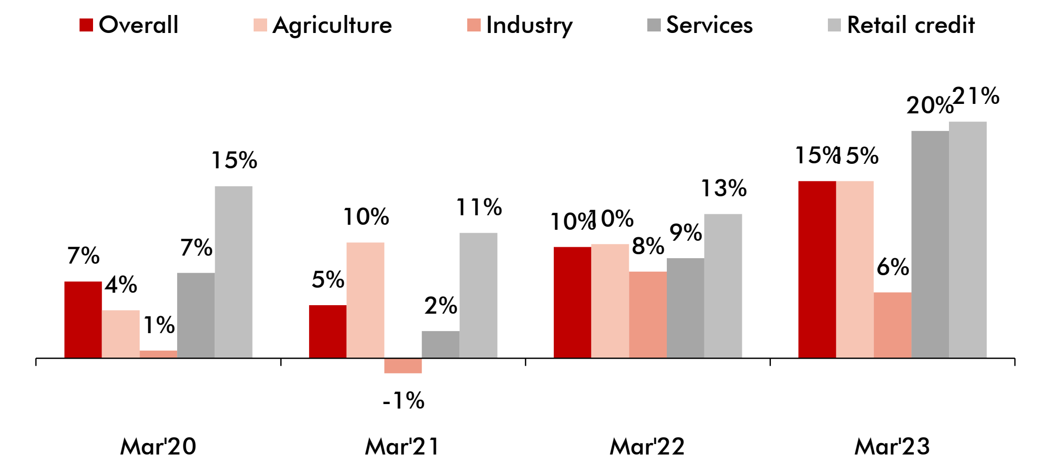
Steady earnings despite multiple headwinds

We expect loan growth to moderate to 12-14% in FY24 from 15-16% in FY23 as credit growth in corporate stays muted and deposit growth stays anchored at ~10%. We also expect NIMs to compress in FY24 as cost of funds gets repriced while levers for asset repricing are limited. Asset quality stays solid with low net slippage. Banks have high coverage on NPLs/stress loans and thus credit costs will undershoot long-term average in FY24. This will partially compensate for loan growth/margin pressures, leading to banks delivering earnings growth of 13% in FY24 vs 48% in FY23. We recommend banks which have structurally improved their core PPP trajectory and are trading at reasonable valuations. Prefer Axis>SBI>ICICI Bank>HDFC Bank>Kotak in large-caps. Prefer Federal in mid-caps.

Loan growth to moderate

System loan growth was strong 15-16% YoY in FY23, though down from peak of 18% in the month of October. Growth was driven by strong traction in retail loans, growing 20%+ YoY, NBFCs growing 30% YoY. Corporate growth gradually recovered to 8% YoY in FY22 but the pace has slowed to 6% in FY23 as demand stays selective amidst uncertain macros.

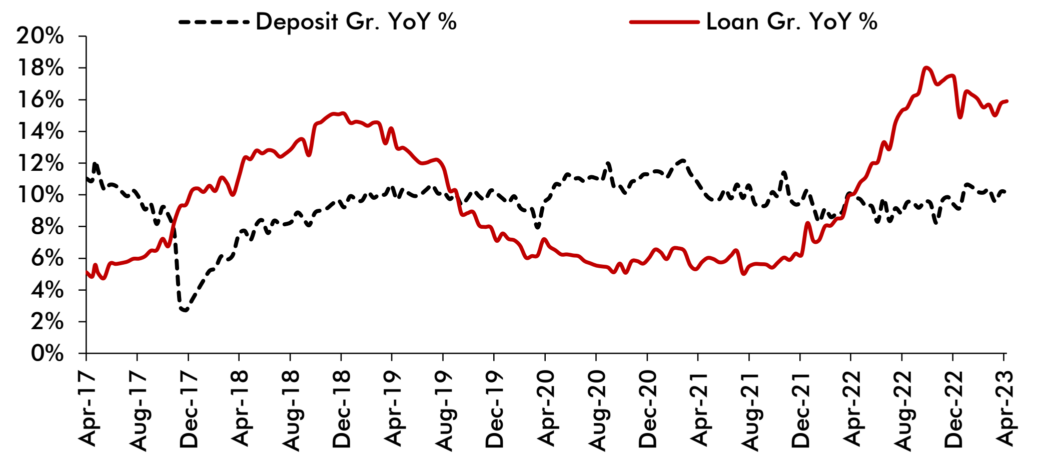
Exhibit 51: Loan growth was led by retail/services



Source: RBI, Ambit Capital research

Moreover, deposit growth stays around 10% YoY, and is likely to limit loan growth as credit-deposit ratio across most banks is near peak levels.

Exhibit 52: As in previous cycles, loan growth and deposit growth stay near each other and with deposit growth not picking up, loan growth will eventually be dragged lower



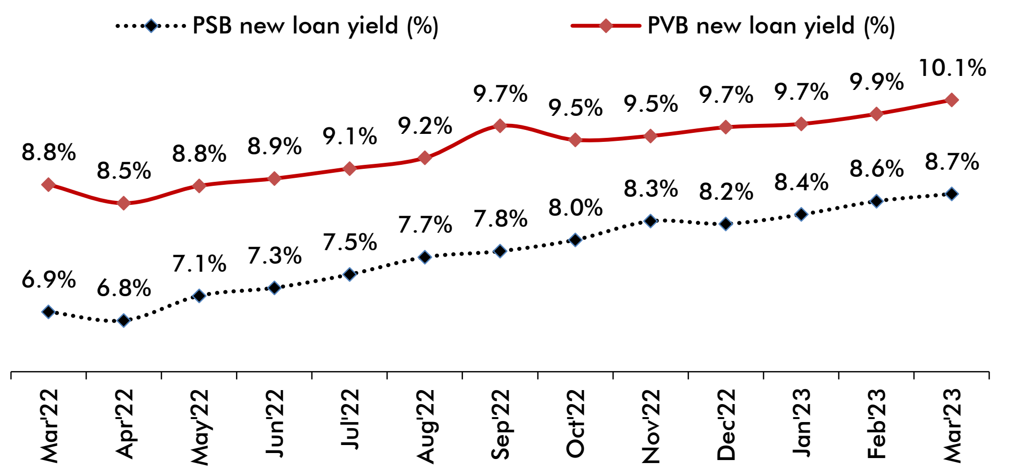
Source: RBI, Ambit Capital research

We expect loan growth to range between 12-14% in FY24 vs. 15-16% in FY23.

Margins – levers for asset repricing limited, liability repricing to continue

Banks benefitted by transmission of repo hike (250bps in FY23) into loan segments (especially floating rate retail loans and SME loans). Yields on new loans expanded ~120bps across the private and ~177bps public banks over Mar'22 and Mar'23.

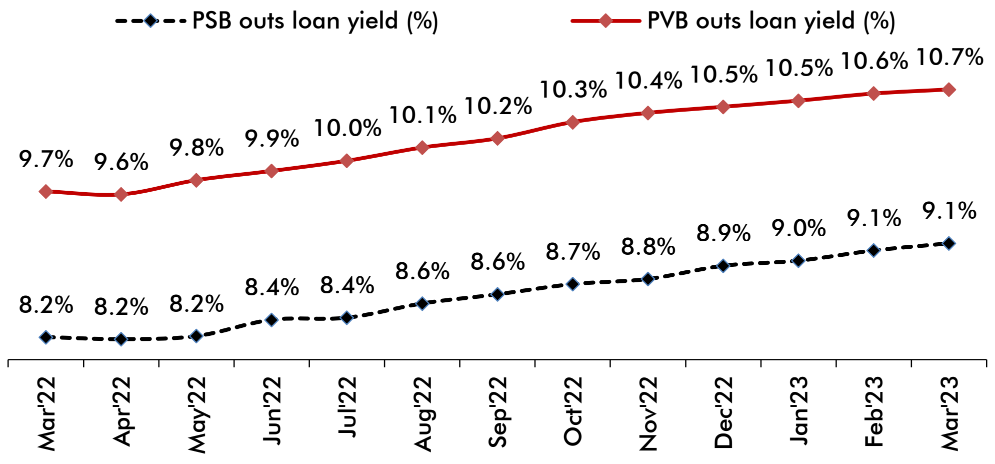
Exhibit 53: Disbursement yields sharply improved following repo hike



Source: RBI, Ambit Capital research

Gradually, yields have improved with every passing month. And with banks have floating book linked to repo rate and other external benchmarks, existing book got repriced quickly lead to outstanding loan yields expand ~100bps for both PSB and PVB.

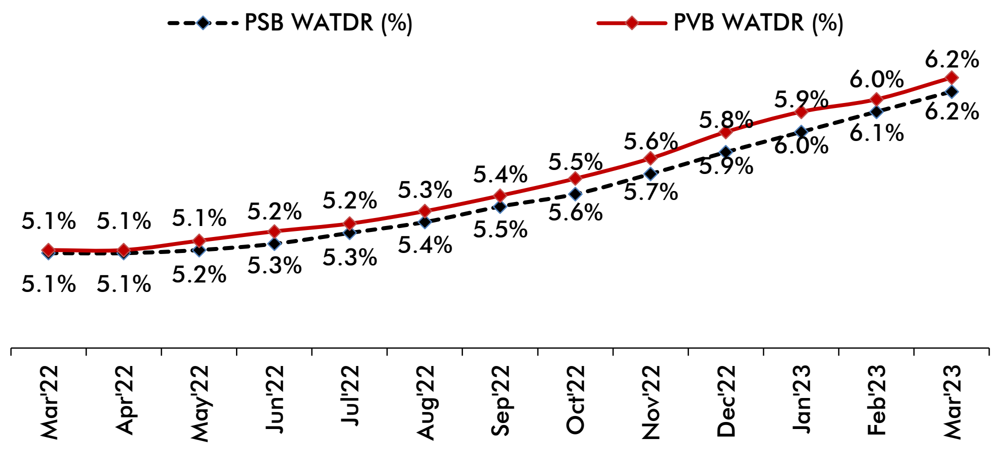
Exhibit 54: Outstanding loan yields sharply expanded by ~100bps



Source: RBI, Ambit Capital research

However, on the deposits side, while term deposits have got repriced following pace of loans, large banks kept savings rate unchanged leading to lower blended repricing on cost of funds.

Exhibit 55: Strong loan demand forced banks to offer ~110bps better TD rates in one year



Source: RBI, Ambit Capital research

Consequently, banks reported best ever NIMs for the year.

Exhibit 56: NIMs expanded ~30bps across our coverage universe

NIM %	FY19	FY20	FY21	FY22	FY23E	FY23E over FY22
ICICI Bank	3.2%	3.5%	3.6%	3.8%	4.4%	0.56%
Axis Bank	3.2%	3.2%	3.4%	3.3%	3.7%	0.36%
Kotak Mahindra Bank	4.1%	4.2%	4.3%	4.3%	4.9%	0.56%
State Bank of India*	2.7%	2.8%	2.9%	2.8%	2.9%	0.19%
Federal Bank	2.9%	2.9%	3.1%	3.0%	3.2%	0.21%
City Union Bank*	3.9%	3.7%	3.7%	3.5%	3.6%	0.08%
Bandhan Bank*	9.1%	8.7%	7.4%	7.1%	6.6%	-0.53%
RBL Bank	3.7%	4.5%	4.2%	4.1%	4.3%	0.16%
AU Small Finance Bank	5.4%	5.2%	5.2%	5.5%	5.7%	0.20%
Weighted average	**3.0%**	**3.2%**	**3.2%**	**3.2%**	**3.5%**	**0.29%**

*Source: Company, Ambit Capital research, * 4QFY23 results pending*

However, going ahead, three components of the loan book will behave accordingly:

- Repo and other external benchmark linked loans (formed 42% and 47% of PSB and PVB loans) – got repriced in line with repo hikes and will behave as fixed book in case of no repo hikes.
- MCLR (formed 44% and 17% of PSB and PVB loans) – got repriced in line with rise in cost of funds and will continue to reprice in FY24.
- Fixed book (formed 14% and 37% of PSB and PVB loans) – no rate transmission on account of rise in repo rate.

Thus, banks have only one portion of the loan book, i.e. MCLR, which will get repricing benefits. Moreover, with CASA to continue under pressure due to high rate differential with term deposits and money market instruments and repricing of cost of funds, we expect margins to contract in FY24.

We expect coverage banks to see following margin contraction in FY24.

Exhibit 57: We expect ~10bps contraction ex-Bandhan

NIM %	FY23E	FY24E	Change (%)
ICICI Bank	4.4%	4.2%	-0.18%
Axis Bank	3.7%	3.6%	-0.12%
Kotak Mahindra Bank	4.9%	4.6%	-0.25%
State Bank of India*	2.9%	2.9%	-0.01%
Federal Bank	3.2%	3.1%	-0.11%
City Union Bank*	3.6%	3.5%	-0.07%
Bandhan Bank*	6.6%	6.7%	0.16%
RBL Bank	4.3%	4.1%	-0.16%
AU Small Finance Bank	5.7%	5.3%	-0.43%
Weighted average	**3.5%**	**3.4%**	**-0.06%**

*Source: Company, Ambit Capital research, *4QFY23 results pending*

Asset quality to hold ground – credit cost to continue undershooting LTA

Collection efficiency continues to stay strong across segments. Corporate asset quality stays healthy. Retail secured is stable and retail high yielding such as MFI/CV has gradually come back. As a result banks have reported low net slippages in FY23 and restructured book is also down.

Exhibit 58: Net slippages stay very low

Net slippages %	FY18	FY19	FY20	FY21	FY22	FY23E	FY23E over FY22
ICICI Bank	4.2%	0.8%	1.0%	1.5%	0.4%	0.2%	-0.1%
Axis Bank	6.6%	1.0%	2.1%	1.6%	0.9%	0.6%	-0.4%
Kotak Mahindra Bank	0.5%	0.5%	0.7%	1.4%	0.1%	0.2%	0.1%
State Bank of India*	4.6%	0.4%	1.3%	0.5%	0.2%	0.2%	0.0%
Federal Bank	2.1%	0.9%	0.9%	1.2%	0.5%	0.3%	-0.2%
City Union Bank*	1.5%	1.4%	2.5%	2.6%	1.9%	1.4%	-0.5%
Bandhan Bank*	2.0%	2.4%	2.1%	10.2%	4.7%	8.6%	3.8%
RBL Bank	1.3%	1.3%	4.9%	3.7%	4.1%	2.4%	-1.7%
AU Small Finance Bank	2.3%	1.7%	0.2%	4.3%	-1.1%	0.3%	1.5%
Weighted average	**4.5%**	**0.6%**	**1.4%**	**1.1%**	**0.5%**	**0.5%**	**0.0%**

*Source: Company, Ambit Capital research, *4QFY23 results pending*

As a result, credit cost stays low and gradually coverage on NPLs has improved for most banks.

While we expect net slippage trend to gradually mean revert, current trends indicate credit cost will continue to undershoot long term average even in FY24 and will to some extend compensate for margin/loan growth pressures.

Exhibit 59: We expect credit cost to stay low in FY24 too

Credit cost %	FY19	FY20	FY21	FY22	FY23E	FY24E
ICICI Bank	3.6%	2.3%	2.4%	1.1%	0.7%	0.4%
Axis Bank	2.6%	3.5%	2.4%	1.1%	0.3%	0.5%
Kotak Mahindra Bank	0.5%	1.0%	1.1%	0.3%	0.2%	0.8%
State Bank of India*	2.6%	1.9%	1.8%	0.9%	0.6%	0.8%
Federal Bank	0.8%	1.0%	1.3%	0.9%	0.5%	0.7%
City Union Bank*	1.0%	2.3%	2.2%	1.6%	1.5%	1.1%
Bandhan Bank*	2.1%	2.6%	5.2%	9.0%	4.3%	3.3%
RBL Bank	1.4%	3.6%	3.8%	4.8%	1.6%	2.0%
AU Small Finance Bank	0.8%	1.1%	2.3%	0.9%	0.3%	0.7%
Weighted average	**2.5%**	**2.1%**	**2.0%**	**1.2%**	**0.6%**	**0.7%**

*Source: Company, Ambit Capital research,*4QFY23 results pending*

So, we expect overall earnings traction to stay healthy at 15% across the banks.

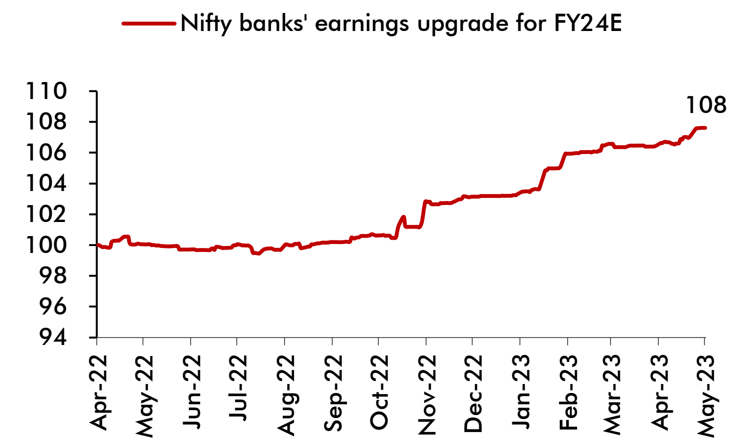
Exhibit 60: We see earnings growth at 15% over FY23-25E despite high base of FY23

PAT gr.	FY23E	FY24E	FY25E	CAGR FY23-25
ICICI Bank	36.7%	14.7%	16.0%	15.3%
Axis Bank#	68.4%	6.3%	21.7%	13.7%
Kotak Mahindra Bank	27.6%	-6.4%	13.4%	3.0%
State Bank of India*	44.6%	19.5%	15.5%	17.5%
Federal Bank	59.3%	7.2%	23.0%	14.8%
City Union Bank*	24.2%	18.6%	6.8%	12.6%
Bandhan Bank*	1507.5%	51.3%	18.7%	34.0%
RBL Bank	NA	-49.5%	13.6%	-24.3%
AU Small Finance Bank	26.4%	5.3%	21.5%	13.1%
Weighted average	**47.7%**	**12.9%**	**16.8%**	**14.8%**

*Source: Company, Ambit Capital research, *4QFY23 results pending, #excluding Citi impact*

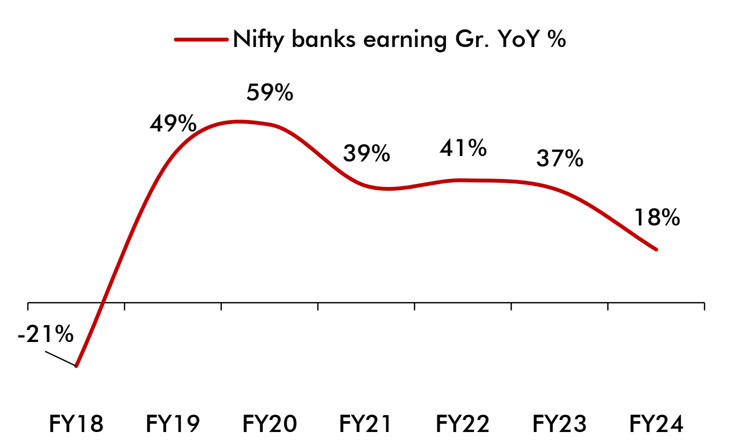
For banks in the Nifty index, street has upgraded earnings by ~8% for FY24 in the last one year and expects earnings growth closer to loan growth expectation of 18%.

Exhibit 61: Street has upgraded earnings by 8% and...



Source: Bloomberg, Ambit Capital research

Exhibit 62: ...expect earnings growth closer to loan growth



Source: Bloomberg, Ambit Capital research

FMCG

GM expansion certain; low risk of earnings downgrade

Volume growth for FMCG sector has remained tepid over the last 12 months (negative volume growth at industry level over the last 3m/6m/12m). As inflation recedes and FMCG companies take price cuts coupled with improving macros (positive real rural wage growth, lowering of MNREGA job seekers, etc.), we expect volume growth to gradually recover – higher for Food and Beverages (F&B) followed by Home and personal care (HPC) companies. Risk to the thesis emerges from El Nino and thus potential delayed recovery of rural markets. With a broader softening of RM prices (between 5-50% YoY), a CPI-WPI gap of >300bps, sequential GM improvement which has begun from 4QFY23 is likely to accelerate in FY24. Thus, we expect FY24E earnings to be led by margin recovery and FY25E earnings to be driven by volume growth and moderate EBITDAM expansion. Our/consensus estimates are largely building this trajectory and hence expect a low risk of downgrades. We remain selective and prefer BRIT (scale-up of adjacencies) and GCPL (turnaround on business execution) amongst BUYs and NEST amongst SELLs.

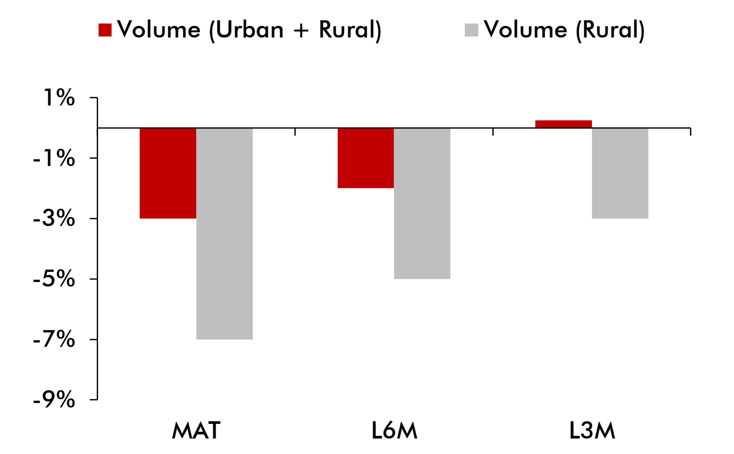
Volume recovery to be gradual...

Basis empirical evidence, demand growth recovery after any slowdown phase is always gradual. Our interaction with experts suggests that rural consumers prioritise spending in the following order once they see improving income/savings levels.

- To repay loans/ de-leverage themselves;
- Towards income generating assets such as 2W, tractor, rickshaw, cycle etc.;
- To upgrade themselves in their food requirements;
- Towards other staples and shift from unbranded to branded; and then
- Towards semi-discretionary to discretionary spends.

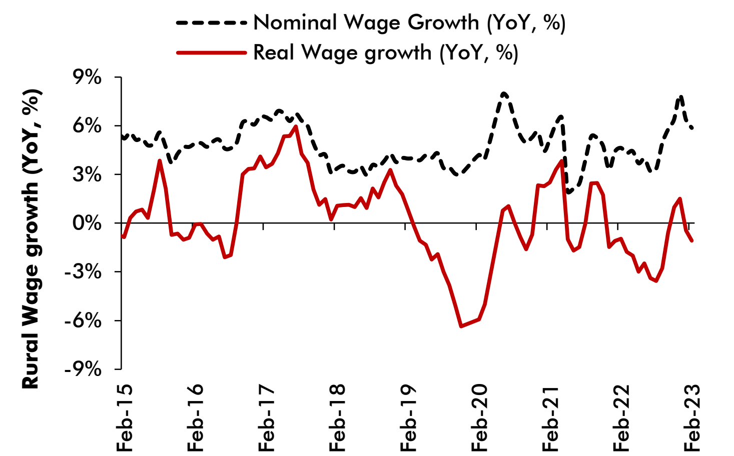
Should that trend repeat, it would take some time for FMCG companies to revert to normalized volume growth of mid to high single digits. Within consumer categories, we believe F&B companies should be able to see growth ahead of HPC categories – a trend that is already playing out and which will sustain going ahead too.

Exhibit 63: Negative sectoral volume growth largely owing to stress in rural India...



Source: Company, Ambit Capital research; Note – Approximate values basis HUVR's 4QFY23 ppt; MAT is basis last 12 month data

Exhibit 64: ...with gradual improvement in real wage growth, expect consumption to improve albeit at a slow pace



Source: Company, CMIE, Ambit Capital research

Margin expansion is where comfort lies the most…

Over the past 18 months (before 4QFY23), gross margin pressure has been a consistent narrative for most FMCG companies since RM prices across crude, palm oil, PFAD, and packaging material shot up by at least 50% YoY. With sequential moderation in most commodities, except for Alcobev companies, we reiterate that FMCG companies would benefit from sequential GM expansion which has already begun from 3QFY23 to only accelerate into FY24E.

Exhibit 65: GM is almost at the lowest level over the last 7-8 quarters; expect GM to gradually inch back to levels pre-inflation, viz. 3QFY21

Company Name	3QFY21	3QFY23	3QFY23 vs 3QFY21
BRIT	43.1%	43.7%	0.6%
DABUR	49.7%	45.5%	-4.2%
HUVR	54.0%	47.5%	-6.5%
GCPL	55.1%	51.1%	-3.9%
MRCO	46.9%	44.9%	-2.0%
NEST	59.1%	54.9%	-4.2%
TATACONS	37.8%	41.5%	3.7%
APNT	45.1%	38.6%	-6.5%
BRGR	44.2%	34.7%	-9.5%
UNSP	44.6%	40.6%	-4.0%
UBBL	54.1%	42.0%	-12.0%

Source: Company, Ambit Capital research

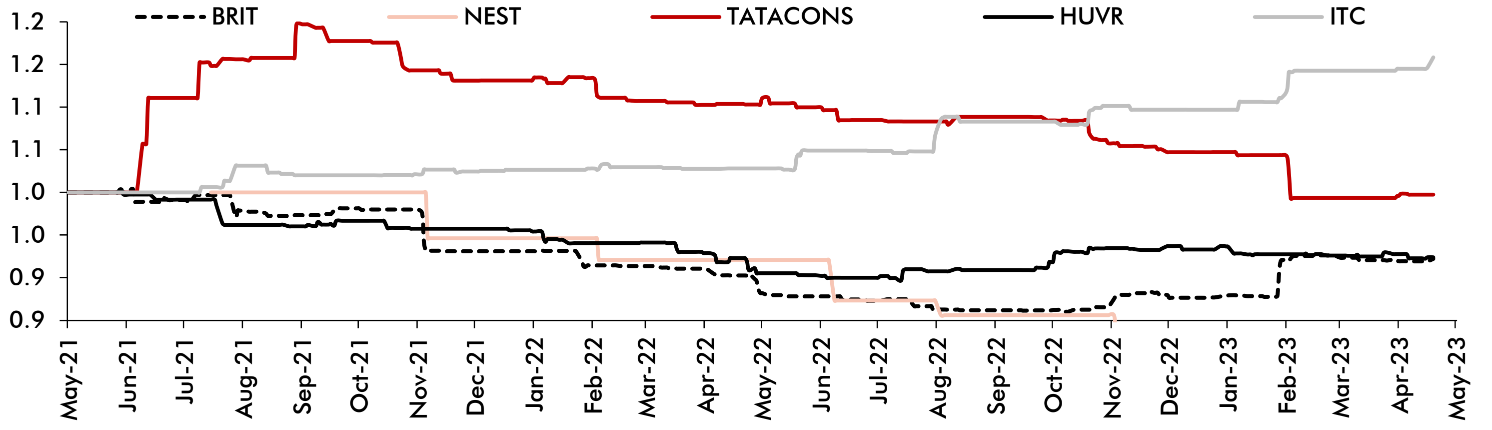
Exhibit 66: GM across key HPC commodities are flat to down on a YoY basis; inflation persists in F&B though

Commodity	Category impacted	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23
Sugar	Food items	7%	5%	7%	1%	0%	1%
Crude Oil	Packaging and logistic	76%	69%	69%	33%	21%	-11%
Wheat	Food items	10%	12%	11%	16%	18%	20%
Palm Oil	Food items	47%	58%	53%	-15%	-21%	-33%
Milk	Milk and derivatives	2%	3%	6%	5%	7%	9%
PFAD	Soaps	59%	68%	41%	-27%	-31%	-46%
Tea	Beverages	-22%	-17%	-12%	8%	11%	10%
Coffee	Beverages	19%	44%	52%	38%	24%	11%
Alkyl Benzene (LAB)	Detergents	32%	20%	20%	15%	10%	3%

Source: Bloomberg, Ambit Capital research

We believe another signal to spot that a sector has bottomed out emerges from potential cuts to consensus earnings. As seen in the below exhibit, the extent of cuts to FY24 EPS has ebbed/reduced and, in some instances, we have also started to see upgrades (e.g. BRIT and GCPL). Thus, we believe consensus estimates for FY24E are realistic and the likelihood of an earnings cut seems low.

Exhibit 67: We believe we are at the end of earnings downgrade cycle; over the last two quarters, there was already upgrade in ITC and BRIT amongst Nifty FMCG companies



Source: Bloomberg, Ambit Capital research, latest available data as of 6th May 2023.

Oil & Gas: Earnings rebound on the horizon

Due to the improved economic outlook and increase in natural gas domestic production, we expect oil/gas consumption to rise by 5%/9% YoY in FY24E. Also, we expect margin upgradation due to normalization in the global energy market and supportive regulations. Thus, we expect FY24E earnings to be led by both volumes and margin recoveries. Our and consensus numbers are largely building this, and hence expect a low probability of changes. However, RIL's earnings are highly dependent on Petchem's margin rebound which puts it at high risk. OMCs' profitability would revive due to positive marketing margins for all major products, and above-average refining cracks. CGDs would see twin recovery in volumes and margins. RIL's consumer businesses are bearing the brunt of a consumer slowdown, and 60% of FY23-24E EPS is driven by standalone business. We continue to remain selective, and our pecking order is OMCs (prefer BPCL/HPCL over IOCL)>ONGC>IGL. We are SELLers on RIL, GAIL, PLNG, GGas, and MGL.

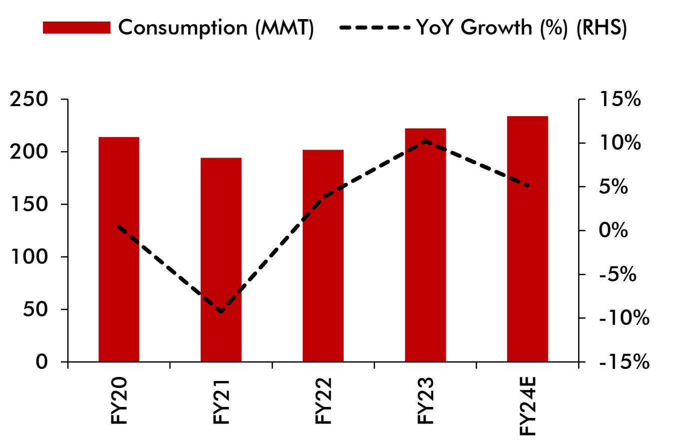
Both oil and natural gas consumption to be higher…

India's petroleum products consumption hit a new record in FY23 and reached 222.3 MMT. This was 10.2% higher YoY, and broke a record of 214.1 MMT reached in FY20. Demand took a hit in FY21 due to the pandemic and posted a modest recovery in FY22. As per PPAC's projections released in Feb-23, India's petroleum products consumption will touch a new high of 233.8 MMT in FY24E.

- Diesel consumption is expected to be 90.6 MMT in FY24E vs. 85.9 MMT in FY23, while petrol consumption to touch 37.8 MMT in FY23 vs. 35.0 MMT.
- LPG consumption is expected to rise to 29.1 MMT vs. 28.5 MMT.

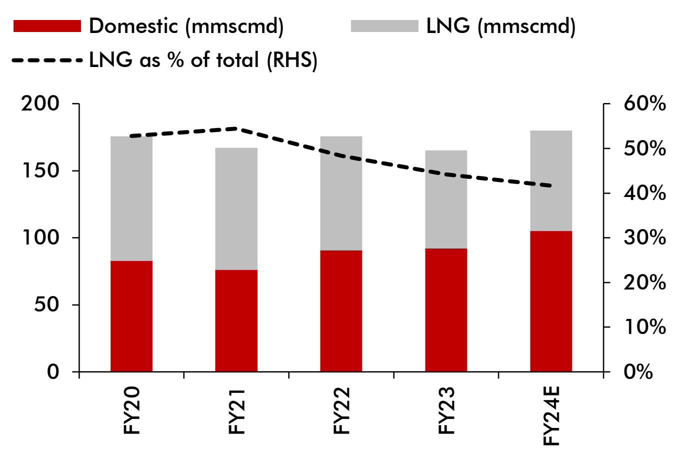
In the case of natural gas, consumption grew by 2.8% CAGR in FY17-22 but took a back seat in FY23 due to the unprecedented situation created by the Russia-Ukraine war. Consumption of 165 mmscmd in FY23 was lower than 176 mmscmd in FY20. Now, overall consumption is expected to reach 180 mmscmd in FY24E due to an increase in domestic production, while LNG volumes continue to be under pressure.

Exhibit 68: Oil consumption is expected to be on the ascent for FY24E; we expect 5% YoY growth



Source: PPAC, Ambit Capital research

Exhibit 69: Increase in domestic production of natural gas to boost consumption in FY24E; we expect 9% YoY growth



Source: PPAC, Ambit Capital research; Note: LNG represents imported natural gas

...margins will also see uplift due to normalization in global energy market...

We expect improvement in margins for the Indian Oil & Gas sector due to normalization in the global energy market.

- Brent was under pressure due to prolonged Covid-19 restrictions in China, recessionary fear in OECD countries, and continuation of Russian oil supply. Despite all this, we are constructive on oil prices due to OPEC+ commitment to defend US$80-90/bbl level for Brent, underinvestment by publicly listed companies, end of Strategic Petroleum Reserves (SPR) releases, slow production growth from non-OPEC+ producers, and rising demand (China reopening and aviation recovery, gas to oil switching). Our Brent estimate for FY24E is US$88 per barrel but see marginal downside risks to the same.
- We expect Singapore GRMs to average US$9/bbl in FY24E vs. US$4/US$19 per barrel in FY18-22/FY23. This is due to a reduction in premium associated with geopolitical issues and increase in refining capacities.
- OMCs' overall gross marketing margin is expected to be ₹3.9/L in FY24E driven by lower crude and refining cracks; positive contribution from both petrol and diesel. Margins were negative ₹2.3/L in FY23.
- RIL's overall petchem margins are expected to average US$500 per tonnes in FY24E vs. US$350 per tonnes in FY23. Most of the improvement would be due to Polypropylene, Paraxylene, and PTA.

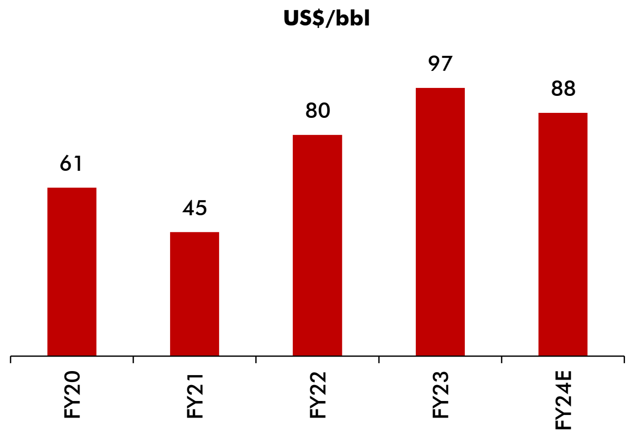
While decrease in GRMs is negative for the refining segment, OMCs marketing profits increases with the net impact being positive for OMCs as they have more marketing volumes vs refining volumes. In the case of Reliance, recovery of petchem margins would offset refining weakness. Implementation of Kirit Parikh Committee (KPC) recommendations and softness in global natural gas market would be beneficial for gas companies.

Exhibit 70: EBITDA margins to improve for most of companies in FY24E vs. FY23

Company	FY20	FY21	FY22	FY23E	FY24E
RIL	14%	16%	15%	16%	17%
BPCL*	2%	7%	4%	2%	4%
IOCL	4%	10%	7%	3%	6%
HPCL	2%	7%	3%	-2%	3%
ONGC*	42%	39%	49%	51%	45%
GAIL*	12%	11%	15%	5%	7%
PLNG	11%	18%	12%	8%	9%
IGL	23%	30%	24%	14%	18%
MGL	35%	43%	26%	19%	25%
GGAS	16%	21%	13%	14%	18%

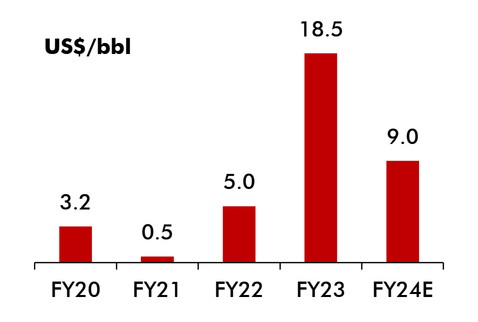
*Source: Company, Ambit Capital research,*4QFY23 results pending*

Exhibit 71: Brent is expected to average US$88/bbl in FY24E, a decrease of 10% YoY



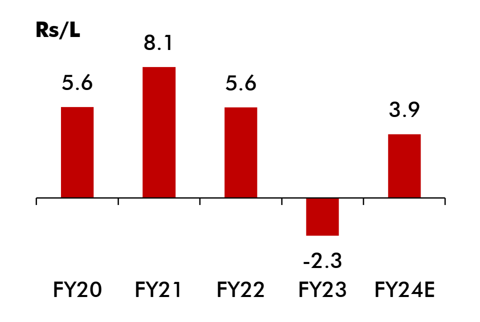
Source: Bloomberg, Ambit Capital research

Exhibit 72: Singapore refining margins to normalize in FY24E



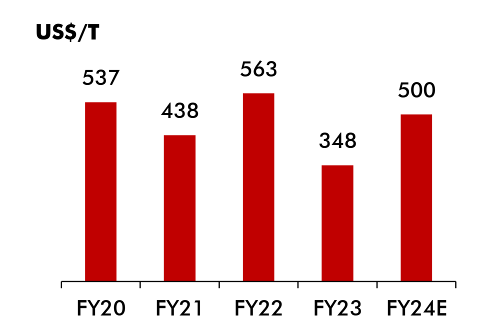
Source: Bloomberg, Ambit Capital research

Exhibit 73: OMCs' GMM to turn positive in FY24E



Source: Company, Ambit Capital research; Note: GMM stands for gross marketing margin

Exhibit 74: Recovery of Chinese demand would lead to Petchem recovery for RIL



Source: Company, Bloomberg, Ambit Capital research

...but there are downside risks for margins especially for RIL

- We are building in Petchem margin recovery due to a rebound in activities in U.S., EU, and China. However, a delay in this, especially in China, would be extremely detrimental for Reliance's earnings, altering the Nifty earnings trajectory.

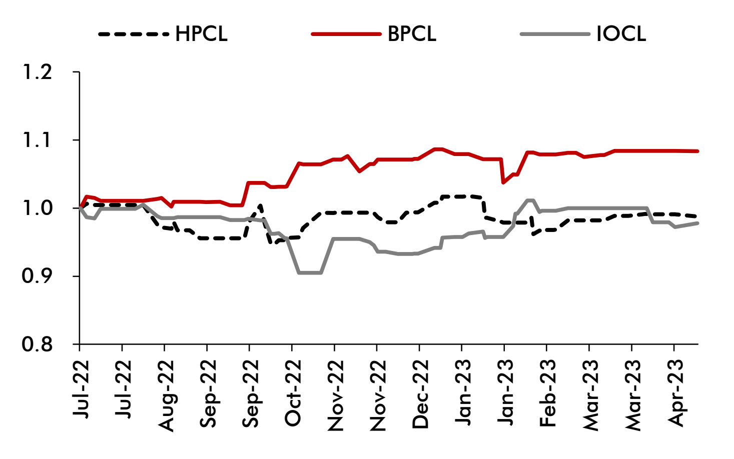
Exhibit 75: Sensitivity analysis of RIL's EPS at different Petchem assumptions; our base case is US$500/T

Petchem Margins (FY24E) (US$/T)	Consolidated EPS (FY24E) (₹)	% Change YoY (FY24E vs. FY23)
350	99	0%
400	106	8%
450	113	15%
500	120	22%
550	127	29%
600	134	36%
650	141	43%

Source: Company, Ambit Capital research

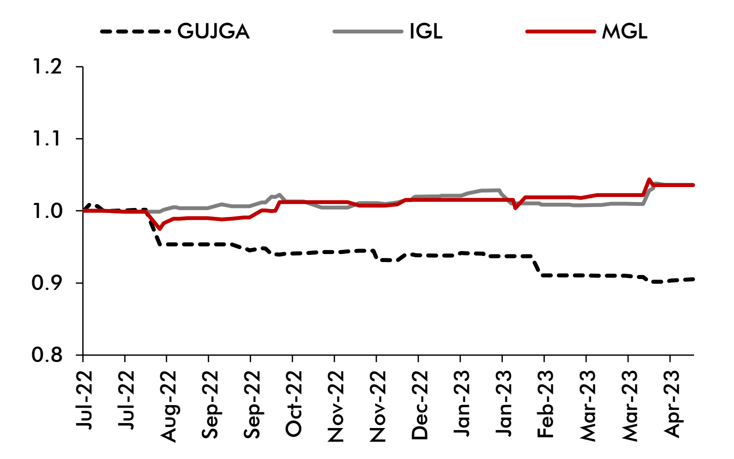
- We see limited pressure on OMCs and CGDs to reduce retail fuel prices due to low profitability in FY23 and uncertainties about their costs. However, assembly elections in some major states (Rajasthan, Chhattisgarh, Madhya Pradesh, Karnataka, and Telangana) in 2023, and Lok Sabha election in May-24 may act as a spanner in the works.

Exhibit 76: Consistent consensus upgrades for OMCs; we see little scope for same now (FY24 EBITDA indexed to 1)



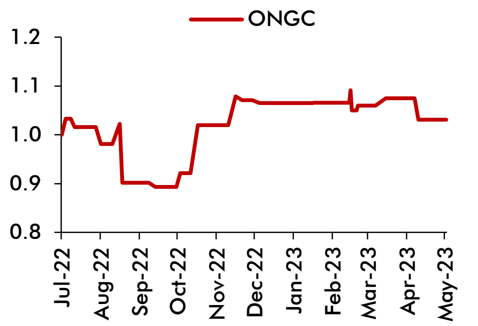
Source: Bloomberg, Ambit Capital research

Exhibit 77: We have same expectations for CGDs; don't see much upgrade from current level (FY24 EBITDA indexed to 1)



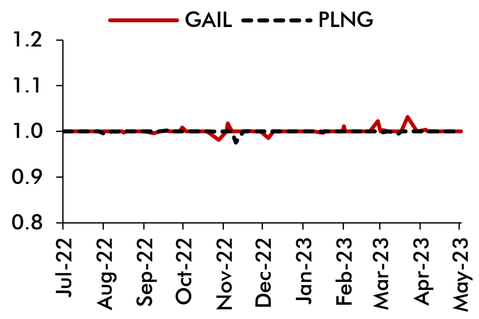
Source: Bloomberg, Ambit Capital research

Exhibit 78: Marginal upgrades expected due to start of KG-D5 (FY24 EBITDA indexed to 1)



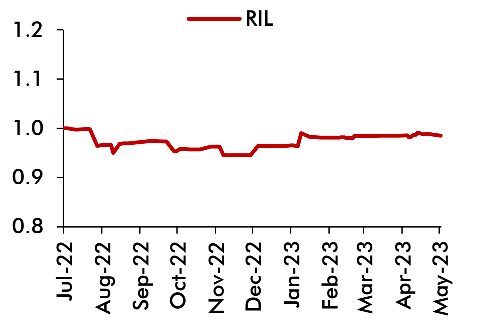
Source: Bloomberg, Ambit Capital research

Exhibit 79: Not much change is expected for gas utilities (FY24 EBITDA indexed to 1)



Source: Bloomberg, Ambit Capital research

Exhibit 80: RIL's earnings are highly dependent on petchem recovery (FY24 EBITDA indexed to 1)



Source: Bloomberg, Ambit Capital research

E&C/Cap Goods

Near-term strength driven by cyclicality and elections

We expect order activity to remain strong in FY24 led by pre-election spending on infrastructure across railways, water supply, and T&D projects. However, a pre-election surge is typically followed by a collapse post elections, leading to a long slowdown. We expect post FY24 both order inflow outlook and working capital cycle to worsen in line with past election cycle trends. Gross margins too have benefitted in 2HFY23 as commodity price fall benefited manufacturers. L&T should see the benefit reflected in its earnings with a lag in FY24. Over a period, these margin benefits will get passed on to customers though FY24 may see continued benefits on account of the lag effect. Current valuations build in never before seen growth (16-18%) and FCF/sales (6-10%) for the industrials sector for the next 20-25 years. We have a SELL on the sector with pecking order of KKC>LT>ABB>HWA>SIEM.

Tender/award activity has been strong of late led by railways/water…

FY23 tenders rose 56% to ₹14.2tn, 55% higher than the pre-pandemic peak. FY23 awards, however, were up 18%, with L&T following closely at 17%. Activity level in sub-segments like power distribution, railways, water, and irrigation is up sharply on a YoY basis, while road sector orders are down 19% YoY. The value of tenders issued by the Centre is up 29% YoY, while states' tender activity is up 76% YoY.

…in the run-up to general elections and will benefit FY24 earnings; but past trends suggest this does not end well

Pre-election trends from the past (May 2019) suggest that L&T's domestic infra segment order inflow will remain strong until 1HFY24 as general elections approach in May'24. Both Centre and State governments tend to complete project awards before the election code of conduct sets in. Revenue growth and working capital cycle also peak in the run-up to elections before collapsing after that. While execution slowdown can set in with a gap of 2-3 quarters, ordering slowdown and NWC cycle worsening can be immediate, and takes 2-3 years to normalise until a fresh election cycle resumes. With private sector order inflow still below 15% of the total for L&T, dependence on government inflows remains high. Nevertheless, L&T's FY24 earnings may benefit due to the pre-election spending.

Exhibit 81: Railways, power, water, and irrigation driving pre-election surge in award/tender activity

₹ bn	Orders			Tenders		
	FY22	FY23	% YoY	FY22	FY23	% YoY
Roadways	1,646	1,330	-19%	3,016	4,385	45%
Power	694	985	42%	216	1,381	541%
Railways	572	838	46%	692	1,084	57%
Water	373	727	95%	1,408	2,974	111%
Irrigation	169	159	-5%	554	1,254	126%
Others	1,006	1,248	24%	3,244	3,157	-3%
Orders ex-L&T	**4,458**	**5,287**	**19%**			
Add: L&T orders*	1,371	1,600	17%			
Total	**5,829**	**6,887**	**18%**	**9,130**	**14,234**	**56%**
Total ex-roads	**4,183**	**5,557**	**33%**	**6,114**	**9,850**	**61%**

Source: Projects Today, Ambit Capital research

Exhibit 82: However, pre-election surge typically leads to a hangover as evident in L&T's operating metrics from 2019

	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Order inflow	43%	94%	-18%	21%	-16%	-30%	-2%
Revenue	18%	36%	43%	13%	27%	13%	-4%
NWC/Sales	21%	20%	20%	18%	23%	23%	24%
OCF	(13.4)	24.1	18.6	61.8	(38.2)	13.9	24.9

Source: Company, Ambit Capital research

Margin benefit from falling commodity price is not sustainable

Gross margins for the cap goods sector have benefitted in 2HFY23 as commodity prices and freight rates fell from the 2022 peak, while these companies are yet to pass on the relief to their customers. With most of the contracts with B2B clients, eventually the commodity price fall will be passed on leading to margin normalization, though L&T should see the benefit emerging with a lag in FY24

Exhibit 83: Gross margins for the cap goods sector have been on a high in 2HFY23 as commodity prices fell

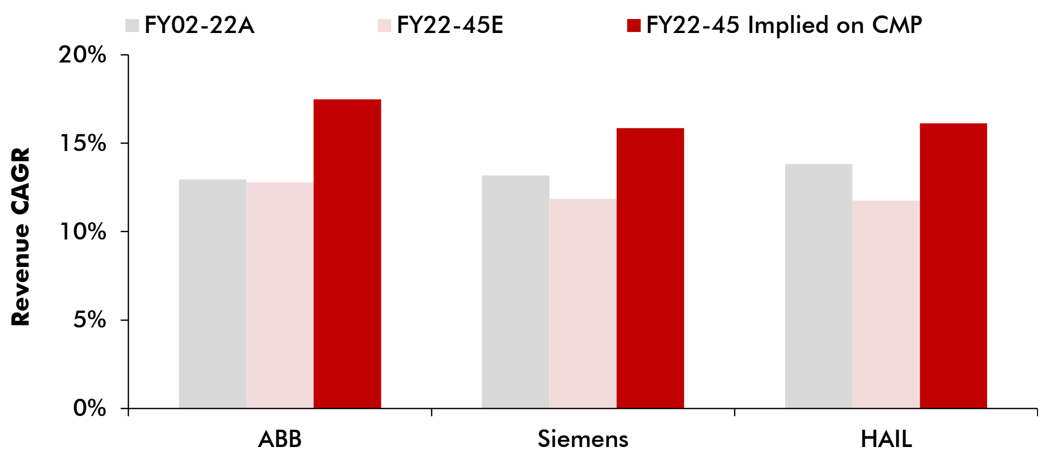
Company	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
ABB	32.0%	34.0%	36.2%	34.8%	36.1%
SIEM	31.4%	31.8%	32.0%	32.7%	32.8%
HWA	43.0%	49.4%	48.8%	49.1%	40.6%
KKC	33.3%	32.0%	31.1%	31.8%	33.8%
TRIV	44.8%	44.5%	43.1%	46.7%	48.6%
CGPOWER	30.6%	28.1%	28.6%	31.8%	31.6%
TMX	43.9%	37.8%	41.3%	40.6%	44.1%
CU	63.3%	65.9%	63.5%	64.5%	62.9%
GWN	54.7%	57.4%	53.8%	53.5%	54.9%
AIAE	62.2%	56.1%	56.5%	55.4%	63.3%

Source: Company, Ambit Capital research

Current valuations reflect consumer-like multiples building in growth that has never been delivered even on a low base

Reverse DCF of the listed Indian automation names like ABB, Siemens, and Honeywell Automation suggests that ceteris paribus revenue growth needs to sustain at 16-18% p.a. for the next 20-25 years. This is even higher than the 13-14% CAGR witnessed over the last 20 years when the base was extremely favorable both for the Indian economy as well as these industrial companies. While there are tailwinds in the form of manufacturing capex pick-up and supply chain disruptions leading to benefit for Indian economy, we believe expectations of such high growth, that too for a longer timeframe, are misplaced. Moreover, this also comes along with the expectation of lower cost of funding reflecting as lower discount rate, which is fundamentally flawed – higher growth has to be accompanied by higher cost of funds to compensate for higher inflationary effects as well as higher associated risks.

Exhibit 84: Reverse DCF implies CMP builds in 16-18% revenue CAGR until FY45E vs 13-14% delivered over FY02-22

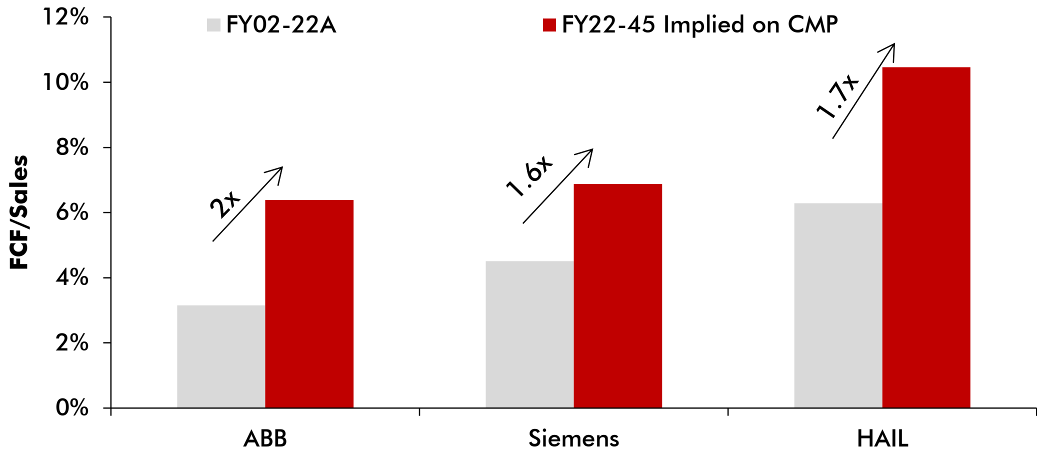


Source: Company, Ambit Capital research

...and ignoring cyclicality for what is essentially a cyclical sector, leading to doubling of FCF as % of sales compared to historical levels

There are two other anomalies with the current valuations as depicted by our reverse DCF: 1) even as capex cycle comes in a burst and fades in a crash, current valuations reflect that peak margin levels estimated for FY25 will sustain forever and 2) because of the lack of cyclicality assumed, FCF/sales through the next 20-25 years appear very high at 6.5-10.5% levels, which is almost double of what has been delivered over the past 20 years.

Exhibit 85: ...and 6.5-10.5% FCF/sales vs 3-6.5% delivered



Source: Company, Ambit Capital research

Technology

Not yet the time to get constructive

We believe revenue growth will normalize to, at or below pre-Covid levels on 1) weak growth in 4Q and outlook for 1Q, 2) sluggish growth in large segments (BFSI/Hitech/Telecom/US), and 3) tepid LTM deal flow growth and a pullback in discretionary/short cycle deal flow and 4) Weaker macro with developed market CY23E GDP cuts of 70-130bps over last 8 months and weaker client financials. Tier-1 IT growth has fallen to 9.5% CC YoY (versus 17.8% last year) and Tier-2 fell to 10.1% CC YoY (versus 30.1% last year). We expect growth at or below pre-Covid at 5.1%/7% in FY24/25, flat margins in FY24 with fall in FY25, and cash conversion below pre-Covid. Valuations at 22.1/26.6x 1-year forward PE for tier-1/tier-2 (24%/61% premium to pre-Covid average) are tough to sustain. Not yet the time to get constructive.

Broad-based slowing, tepid large deal wins, and discretionary pullbacks

Tier-1/Tier-2 growth slowed to 9.5/10.1% CC YoY (versus 17.8/30.1% in 4QFY22), with large segments – BFSI/Telecom/Hitech/US – slowing sharply. BFSI/Telecom is now at 6%/4% CC YoY. LTM large deal win growth has been soft (ex-Coforge/Wipro) and shorter cycle deal flow pullback has been seen. These deals were strong growth drivers earlier. Outlook turned more uniformly cautious across BFSI/Retail/Hitech (60% of tier-1 revenue) versus more scattered commentary earlier.

Weaker macro, slowing cloud providers, and bank troubles keep us cautious

With the macro picture turning incrementally cautious, CY23E GDP expectations have been trimmed by 70-130bps at US/Europe/UK over the past 8 months, with growth expected to be negative for the UK and materially below pre-Covid in both US/Europe. Even CY24E estimates are lower by 60-70bps across geographies. Historically, S&P500 revenue and profitability have had a high correlation with tier-1 IT. Bloomberg consensus expects 4% revenue growth in CY23E at S&P500 (versus 16% in CY21), which might also have implications on tech-spend growth. In addition, banking troubles in US/Europe will have a direct/indirect impact, and cloud provider slowdown will hurt with a lag.

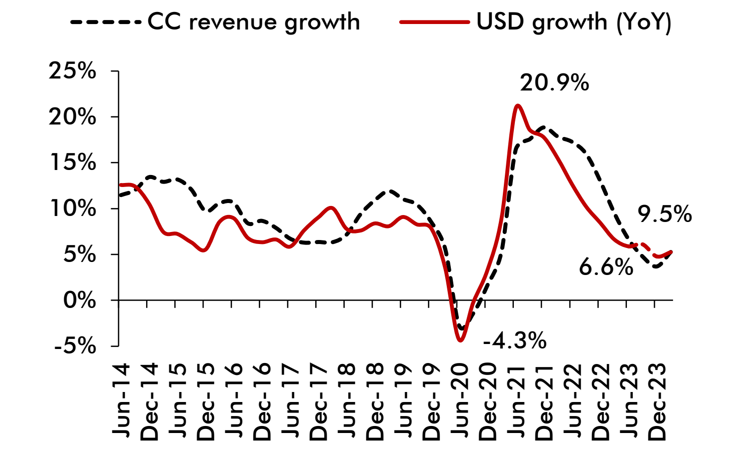
Margins to stay below pre-Covid; Stay flat in FY24 and fall in FY25

Ex Coforge/LTIM, EBIT margins are now lower than pre-Covid across companies despite utilizing material operational scope across sub-con costs, flat to down hiring, utilization/offshoring increases, and currency benefits. Contrary to street hopes of margin increases over both FY24/25E, we see flattish margins in FY24E with declines in FY25E. This is given: 1) attrition could stay above pre-Covid as GIC hiring continues and back-fill is still costly, 2) pyramid might not be an incremental lever (especially at Infosys/TCS), 3) pricing, people/asset takeovers/deal transition costs pressure margins and 4) SGA/travel cost increases will happen and operating scope will largely get used up by FY24E itself. Expect top-4 IT EBIT margin to decline 170bps to 20.6% over FY22-25E. We are 6-13% lower vs consensus on FY25E EPS in our coverage companies, with higher pessimism on Tier-2 IT.

Valuations not cheap for sector to be defensive; build structural growth uplift

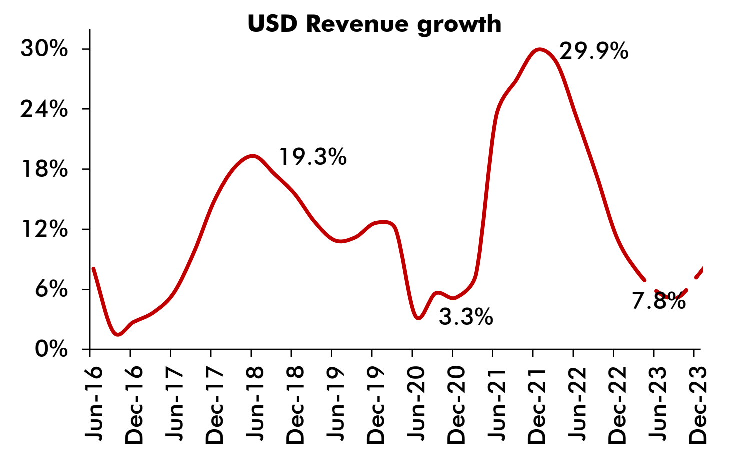
We believe with incrementally weaker macro, growth will normalize to, at or below pre-Covid, margins could stay materially below pre-Covid and cash generation is weaker than pre-Covid. In such a scenario, valuations at 22.1/26.6x 1-year forward PE for tier-1/tier-2 IT (24/61% premium to pre-Covid 3-year average) are difficult to sustain. Current valuations imply USD revenue CAGR of 7.5-10.0/14.8-16.3% for tier-1/tier-2 IT excluding our BUYs – HCLT, TECHM, Mphasis – where ask rates are more reasonable. We believe IT has been defensive when it is cheaper. Currently, Nifty IT trades at a 13% premium to Nifty (versus a historical average of 9%) and traded at a discount to Nifty over FY16-20, when similar as projected 7% USD revenue/PAT CAGR was seen. **Pecking order: Tier-1:** HCLT > TECHM (BUYs) > Infosys > Cognizant > Wipro > TCS (SELLs)**; Tier-2:** Mphasis (BUY) > Coforge > LTIMindtree (SELLs)

Exhibit 86: Top-4 IT growth at 9.5% CC YoY (versus 17.8% in 4QFY22); weaker outlook and 4Q performance drive lower CC growth of 5.1/7% (versus 6.3/7% earlier) in FY24/25E



Source: Company, Ambit Capital research

Exhibit 87: Tier-2 IT growth has moderated sharply from 3QFY22 peak; expect growth to normalize from 14.5% in FY23 to 7%/12% in FY24/25E



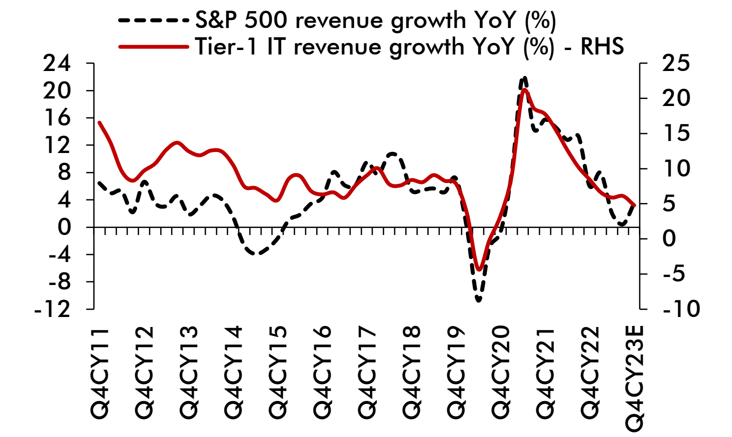
Source: Company, Ambit Capital research

Exhibit 88: As expected BFSI/Retail/Hitech and Communication commentary turned uniformly cautious versus more scattered caution earlier. Discretionary and smaller deal pullback, especially in US, was cited across players

	BFSI (overall)	Mortgage	P&C Insurance	Capital markets	Retail	Hi-Tech	Telecom	ENU	US
TCS	✓	✓	✓		✓	✓			✓
Infosys	✓	✓		✓	✓	✓	✓		✓
HCL Tech							✓		
Wipro	✓			✓		✓			
TechM						✓			
LTIM	✓			✓	✓				
Mphasis	✓	✓			✓	✓			
Coforge	✓	✓		✓					

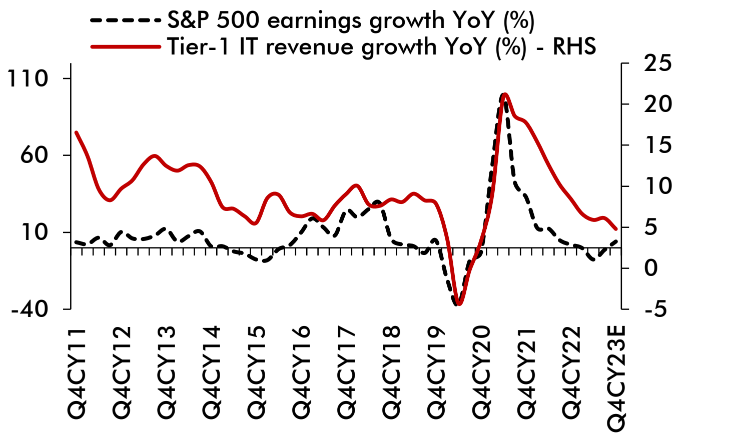
Source: Company, Ambit Capital research

Exhibit 89: Tier-1 IT revenue growth has been in line with S&P 500 revenue growth, which could moderate to ~4% in CY23E



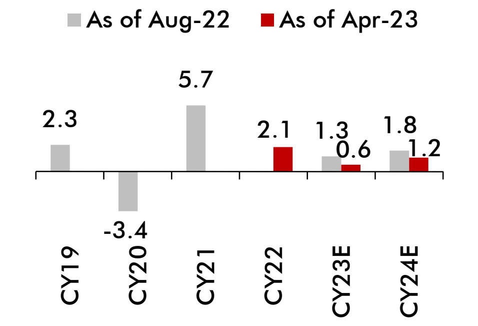
Source: Bloomberg, Ambit Capital research

Exhibit 90: Sharp moderation in earnings doesn't support IT spend increase; rather supports spend reallocation stance



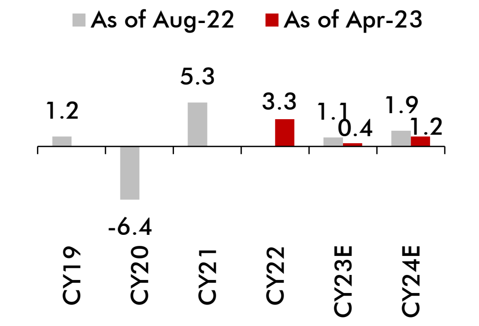
Source: Bloomberg, Ambit Capital research

Exhibit 91: US – CY23E GDP growth estimate cut 70bps over past 8 months



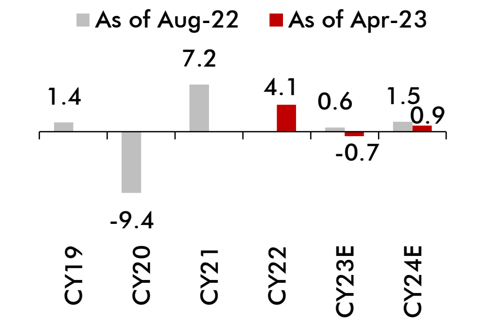
Source: Bloomberg, Ambit Capital research

Exhibit 92: Euro area – Similar cut in GDP expectations in CY23E/CY24E



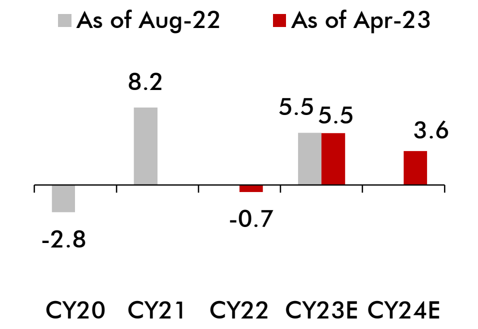
Source: Bloomberg, Ambit Capital research

Exhibit 93: UK – Sees worst GDP cuts for CY23E – 130bps over 8 months



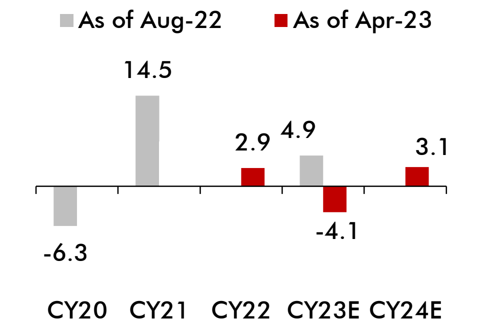
Source: Bloomberg, Ambit Capital research

Exhibit 94: BFSI – CY23E revenue might show recovery post-fall in CY22 with ~6% positive delta over CY22-23



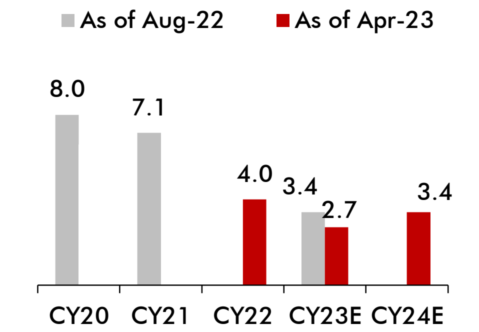
Source: Bloomberg, Ambit Capital research

Exhibit 95: Manufacturing (Hi-Tech + Auto) – Hi-tech could see sharper moderation with Auto more defensive



Source: Bloomberg, Ambit Capital research

Exhibit 96: Retail/CPG – Moderation expected as inflation and consumer pain impact retailers



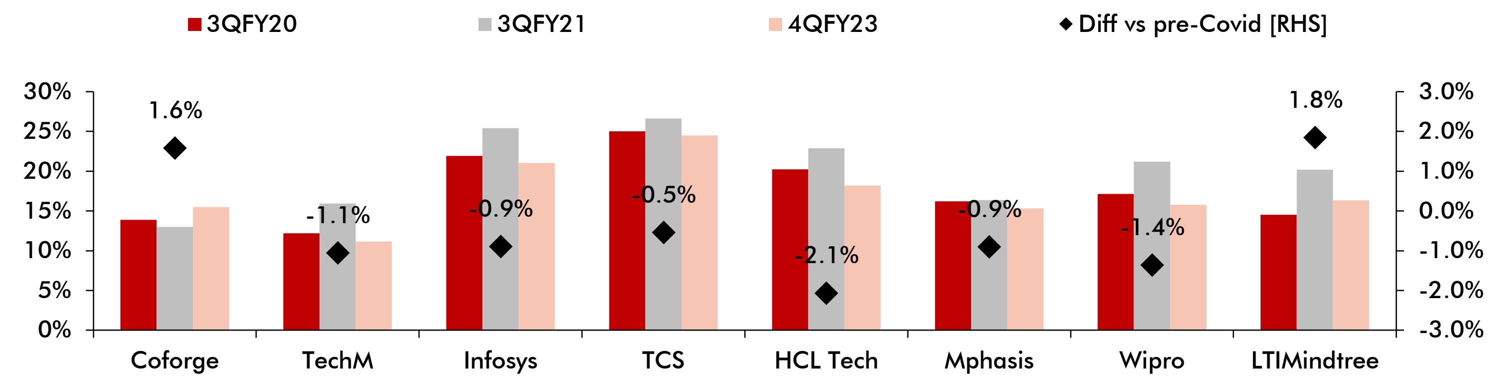
Source: Bloomberg, Ambit Capital research

Exhibit 97: Our coverage companies have disappointed on consensus margin expectations in 4 of 5 quarters, including 4Q

	Actual					Delta vs cons				
	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23
TCS	25.0%	23.1%	24.0%	24.5%	24.5%	0bps	-40bps	20bps	-30bps	-50bps
Infosys	21.6%	20.1%	21.5%	21.5%	21.0%	-170bps	-80bps	100bps	-40bps	-60bps
Wipro	16.3%	14.3%	14.0%	15.6%	15.8%	-50bps	-180bps	-10bps	80bps	10bps
HCLT	18.0%	17.0%	17.9%	19.6%	18.2%	-190bps	-60bps	60bps	80bps	-30bps
TechM	13.2%	11.0%	11.4%	12.0%	11.2%	-110bps	-40bps	10bps	20bps	-80bps
LTIM	18.0%	17.3%	17.5%	13.9%	16.4%					20bps
Coforge	15.5%	12.5%	14.4%	14.5%	15.5%	-110bps	-90bps	10bps	-70bps	-70bps
Mphasis	15.2%	15.3%	15.3%	15.3%	15.3%	10bps	30bps	-10bps	-10bps	0bps

Source: Company, Bloomberg, Ambit Capital research

Exhibit 98: Margins peaked in 3QFY21 and are 1-2% below pre-Covid levels across companies (ex Coforge/LTIM); In 4Q, EBIT margins were flat to declining in 6 of 8 coverage companies



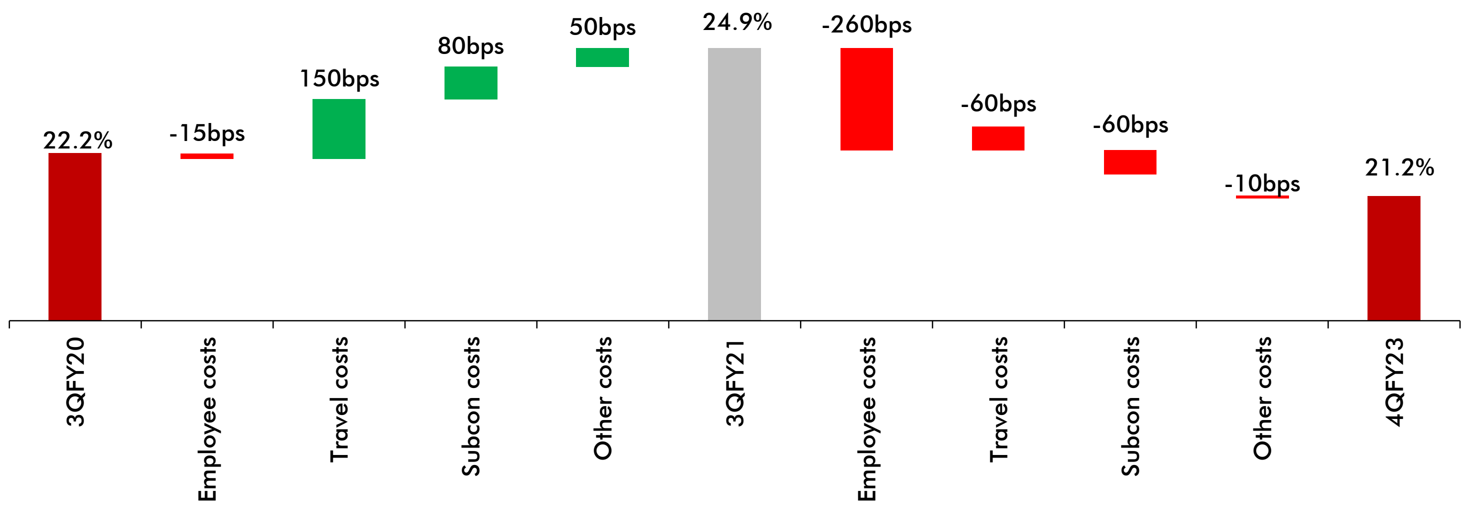
Source: Company, Ambit Capital research

Exhibit 99: YoY margin drivers: Despite sub-con reduction, higher offshoring, currency benefits YoY margins moderated across companies (ex HCLT/Mphasis). Ex INR depreciation (10%) impacts margins would have been at least 200-450bps down

Company	Utilisation	Offshoring	Sub-con	Currency benefit	SG&A	Employee cost	Change in EBIT
TCS			+	+	-	-	-0.5%
Infosys	-	-	+	+	-	-	-0.5%
Wipro	-	+	+	+	-	-	-0.5%
HCLT			-	+	-	-	0.2%
TechM	+		+	+	-	-	-2.1%
LTIM	-	+	-	+	+	-	-1.6%
Coforge	+	+		+	-	+	-0.1%
Mphasis	+	+		+	+	-	0.2%
Count (+)	**3 / 6**	**4 / 5**	**4 / 6**	**8 / 8**	**2 / 8**	**1 / 8**	

Source: Company, Ambit Capital research. Note: + symbol indicates positive impact on margins and – symbol indicates negative impact on margins

Exhibit 100: Tier-1 IT margin walk – Tier-1 IT EBIT margins are now 100bps below pre-Covid falling 370bps from peak in 4Q , despite only half of the travel and sub-con savings reversing with rest made-up by employee costs



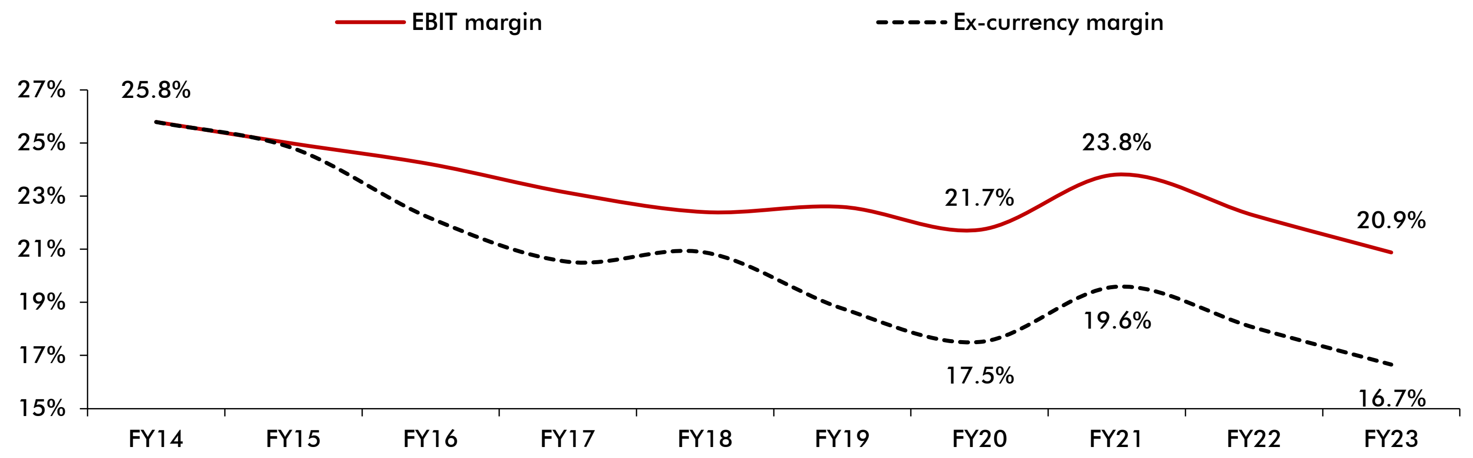
Source: Company, Ambit Capital research

Exhibit 101: Consensus FY24/25E margin expectations build increase in both FY24/25E. We remain materially below consensus on margins and see falls in margins in FY25E. Suggesting return to trend seen over FY14-20....

	FY21	FY22	FY23	Consensus		Ambit	
				FY24E	FY25E	FY24E	FY25E
TCS	25.9%	25.3%	24.1%	24.8%	25.1%	24.1%	23.5%
Infosys	24.5%	23.0%	21.1%	21.8%	22.1%	21.2%	20.9%
HCL Tech	21.4%	18.9%	18.2%	18.6%	19.0%	18.2%	18.2%
Wipro	19.4%	16.9%	14.9%	15.9%	16.2%	15.5%	15.3%
Tech Mahindra	14.2%	14.6%	11.4%	12.3%	12.9%	12.4%	13.2%
Mphasis	16.1%	15.3%	15.3%	15.8%	16.1%	15.8%	15.9%
LTIMindtree	18.6%	17.8%	16.2%	16.8%	17.5%	16.5%	16.2%
Coforge	12.9%	13.8%	14.3%	14.7%	15.1%	14.0%	13.8%

Source: Company, Bloomberg, Ambit Capital research

Exhibit 102: ...when margins dropped 410bps over FY14-20 despite 17% currency depreciation; should have contributed 425bps benefit at 25bp sensitivity to 1% INR depreciation



Source: Company, Ambit Capital research

Exhibit 103: Cash generation is deteriorating with CFO/FCF growth lagging revenue/EBITDA growth on a 2-year basis. While LTIM/Wipro/TECHM/HCLT/Infosys are weaker; this is a sector-wide issue with even Accenture not immune

	LTM (YoY) growth				2yr CAGR LTM growth			
	USD Revenue	EBITDA	CFO	FCF	USD Revenue	EBITDA	CFO	FCF
TCS	9%	12%	6%	6%	12%	13%	4%	5%
Infosys	12%	12%	-8%	-10%	16%	12%	-2%	-4%
Wipro	7%	2%	18%	28%	17%	7%	-6%	-5%
HCLT	10%	12%	9%	10%	11%	6%	-3%	-3%
TechM	10%	0%	5%	5%	14%	8%	-17%	-22%
Mphasis	15%	15%	-15%	-1%	19%	16%	0%	9%
LTIMindtree	27%	16%	2%	0%	28%	18%	-13%	-11%
Coforge	25%	26%	24%	30%	31%	34%	12%	8%

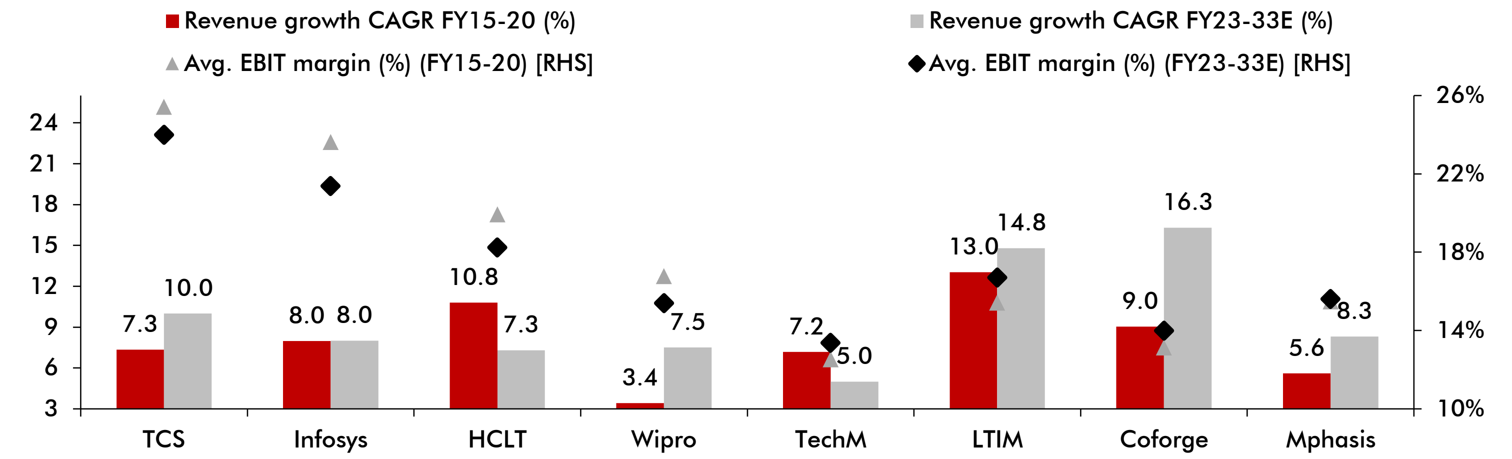
Source Company, Ambit Capital research

Exhibit 104: Tier-1/Tier-2 IT valuations at ~16%/47% premium to pre-Covid 3-yr average, while MNC/Challenger valuations are at or below pre-Covid levels; even at 1SD above pre-Covid average 10%/15% downsides are possible in Tier-1/Tier-2 IT

	1 Yr forward PE (x)	Current 3 Yr average PE (x)	Pre-Covid 3 Yr average PE (x)	Pre-Covid 3 Yr average +1SD PE (x)	1 Yr forward premium to 3 Yr avg (Pre-Covid)	Down-side to current valuations vs Pre-Covid	Down-side to current valuations vs +1SD Pre-Covid
Tier-1 IT	20.2	20.7	17.4	18.6	16%	-14%	-8%
- Top-4 IT	21.3	22.3	17.9	19.4	19%	-16%	-9%
Tier-2 IT	24.2	26.4	16.5	20.4	47%	-32%	-16%
Global Peers							
MNC	21.1	21.9	20.6	22.1	2%	-2%	5%
Challengers	20.8	25.4	26.1	30.6	-20%	25%	47%

Source: Bloomberg, Ambit Capital research. Note: Tier-1 IT includes TCS, Infosys, HCL Tech, Wipro and Cognizant; Top-4 IT includes TCS, Infosys, HCL Tech and Wipro; Tier-2 IT includes LTIM, MPHL, COFORGE; MNC peers include Accenture and Capgemini; Challengers include EPAM, Globant, Endava.

Exhibit 105: Ask rates are more reasonable at our BUYs – HCLT, TechM and Mphasis; for others ask rates are still steep and build a structural uplift in growth versus pre-Covid



Source: Company, Ambit Capital research

Automobiles

Volume growth and margin expansion to moderate

After a year of strong volume rebound and margin expansion, we expect both volume growth and margin expansion to taper. This will be driven by: 1) elevated base post 25-35% jump in volumes across categories in FY23, leading to a moderation in growth outlook and 2) stabilization in input commodity costs post sharp fall in FY23, resulting in capping of further GM gains. We believe, this along with muted scale benefits, resumption of ad spends and discounts would limit EBITDAM expansion. Thus, while FY24E earnings are likely to be better vs FY23, growth is likely to moderate. We see our/consensus numbers largely building this, and hence expect low probability of upgrades. In a moderating earnings growth environment, we believe it is important to remain selective. Our pecking order is Tata Motors>EIM>AL. We are SELLers on MSIL and M&M.

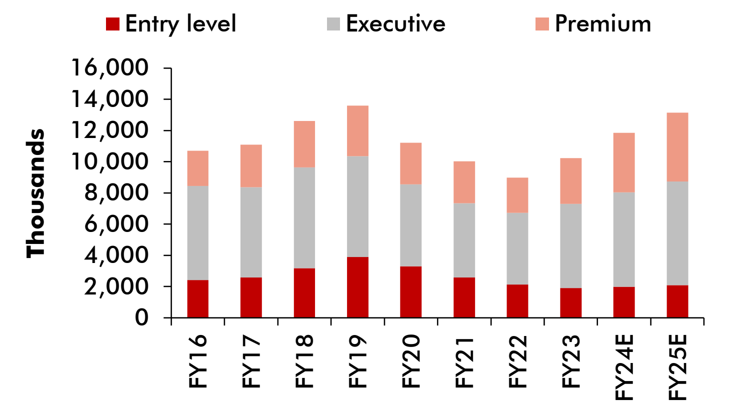
Volume growth to moderate post sharp jump in FY23…

Domestic automobile volumes are likely to taper off across the board in FY24E vs a sharp jump in FY23. In FY23, domestic PV/2W/M&HCV/tractor industries saw volumes grow by 27%/18%/38%/10%.

For PVs, growth was led by a combination of easing supply constraints and healthy order backlogs, resulting in record-high wholesales in FY23. Other personal mobility segments like 2Ws also saw improved demand in FY23 led by stability in TCO and a revival in consumer incomes in urban areas post ~36% cumulative decline in volumes in FY19-22. We note that rural demand (non-agri) for 2Ws continues to struggle and hence scooters/premium motorcycles should outperform entry/executive motorcycles. Goods M&HCVs continued to witness an upcycle post a sharp ~56% decline in FY19-22 and the upcycle is expected to continue till FY25E. Tractors also saw strong growth supported by an increase in MSP, above-normal rainfalls, and healthy water reservoirs.

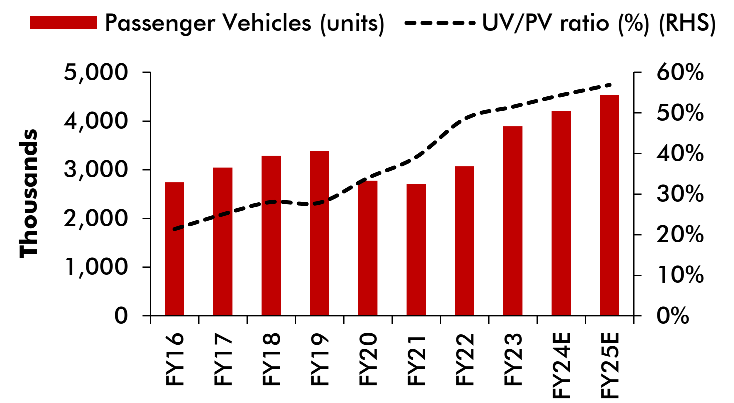
However, we believe growth in FY24E will start to taper owing to: 1) elevated base for a few segments like PVs and M&HCVs, 2) continued weakness in rural demand, which will weigh on 2W demand segments like entry/executive motorcycles, 3) reversal in tractor cycle after years of upcycle since FY20, 4) introduction of stringent safety regulations like seatbelt reminders, airbags, etc. As a result, against superior growth witnessed in FY23, we expect PV/2W/M&HCV/tractor industries to post volume CAGR of 8%/12%/11%/5% in FY23-25E.

Exhibit 106: Domestic 2W demand saw a sharp rebound in FY23; expect premium MCs to grow ahead of entry



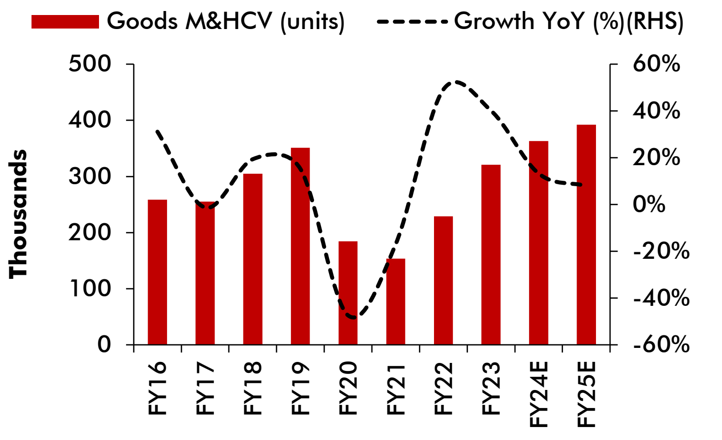
Source: PPAC, Ambit Capital research

Exhibit 107: PV industry grew 27% YoY to a record high of 3.8mn units in FY23, expect growth to moderate



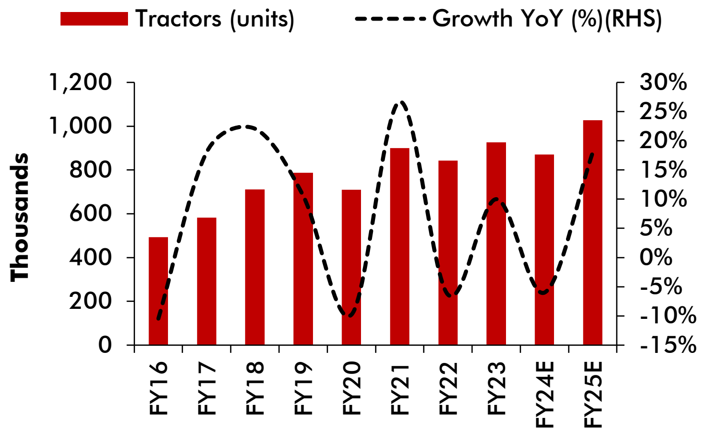
Source: PPAC, Ambit Capital research

Exhibit 108: Goods M&HCV industry growth also set to taper in FY24/25E post 45% volume CAGR in FY21-23



Source: PPAC, Ambit Capital research

Exhibit 109: Tractors have seen an upcycle from FY20; expect muted growth in FY24E as El Nino likely to play out



Source: PPAC, Ambit Capital research

...margins likely to expand but only marginally from here...

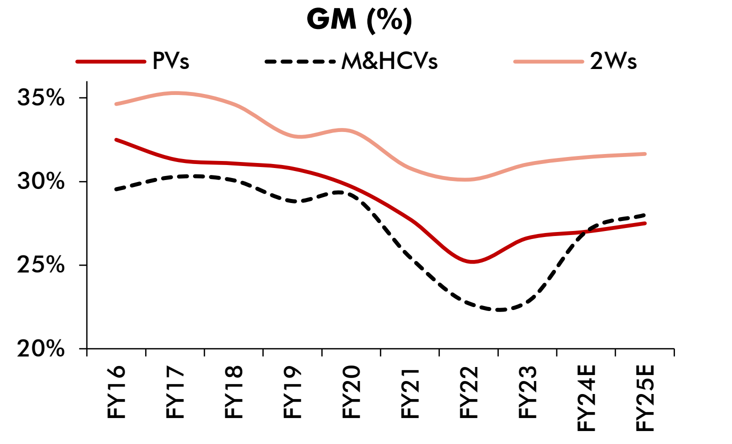
We expect continued improvement in GM of auto manufacturers in FY24E owing to easing/stabilization of input commodity costs and graded price hikes. However, we believe that bulk of the margin expansion benefits are now behind and see some margin pressures ahead in the form of 1) tapering of growth rates as discussed earlier, which is likely to drive weak operating leverage benefits; 2) discounts for many OEMs are at multi-year lows owing to supply chain challenges; easing of supply chain challenges would result in a rise in discounts; 3) many OEMs had postponed new model launches owing to the Covid outbreak and supply chain challenges. New model launches would lead to increased ad spends, which are likely to put further pressure on margin.

Exhibit 110: Input commodities have corrected sharply over last few quarters – but we see some margin pressure ahead given increase in input costs in 4Q

RM	FY22				FY23			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
CRC India (₹/ton)	75,205	77,414	74,552	73,946	77,049	64,206	61,449	64,200
Aluminium (USD/MT)	2,412	2,651	2,757	3,247	2,903	2,357	2,355	2,440
LEAD (USD/MT)	2,136	2,291	2,301	2,328	2,206	1,975	2,089	2,134
Copper (USD/MT)	9,702	9,390	9,712	9,985	9,529	7,761	8,020	8,941
RSS4KO (NR) (₹/kg)	169	173	177	166	173	163	147	143
Palladium (USD/oz)	2,801	2,475	1,954	2,353	2,113	2,092	1,955	1,577
Europe Natural gas ($/mmbtu)	8	14	29	28	31	60	37	18
Europe Freight Index*	141	146	151	162	177	168	152	157
Crude (USD/bbl)	69	73	80	97	112	98	89	82

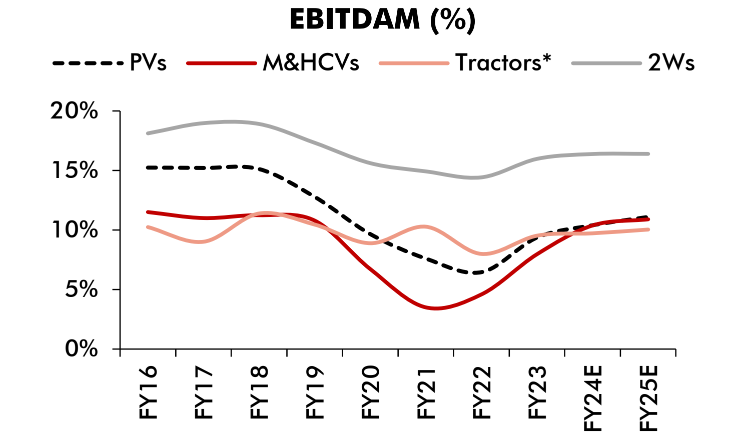
*Source: Bloomberg, Ambit Capital research*indexed to 100*

Exhibit 111: GM declined post FY21, but started reviving in the last few quarters; expect muted expansion ahead as input costs stabilize



Source: Company, Ambit Capital research

Exhibit 112: Weak operating leverage benefits, muted GM expansion and resumption of ad spends and discounts to drive muted EBITDAM expansion

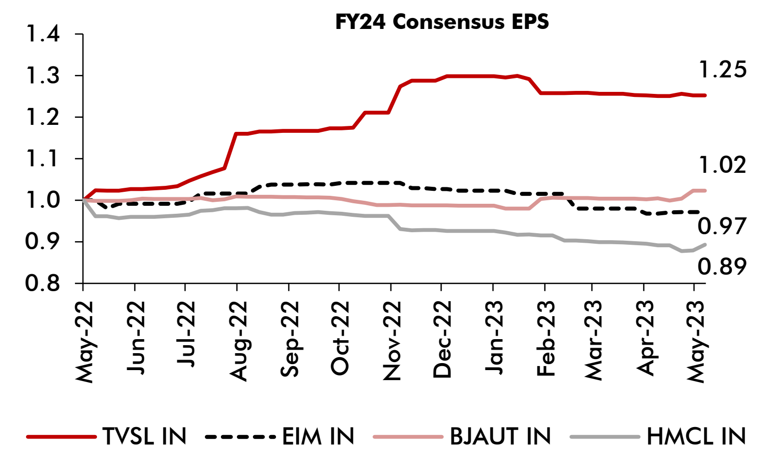


Source: Bloomberg, Ambit Capital research * EBITM

Growth to moderate in FY24...

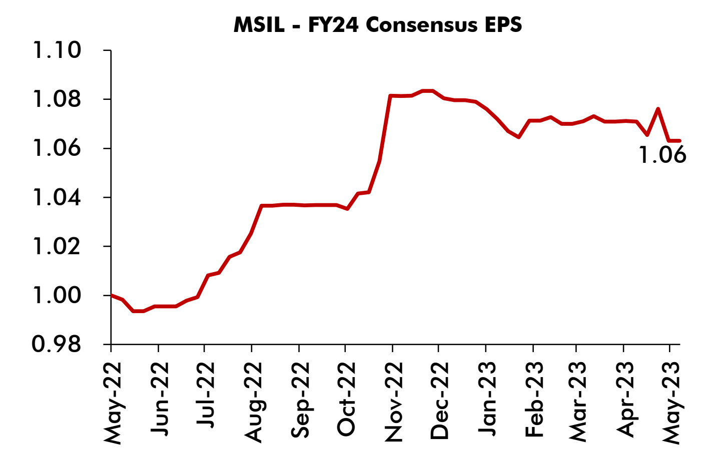
Given the moderation in volume growth and margin expansion, we expect earnings growth to start moderating for the sector in FY24E. We believe, within the personal mobility segments like PV/2Ws, OEMs having higher exposure to premium vehicles like UVs in PVs (TTMT) and premium motorcycles in 2Ws (EIM) would grow ahead of others in the auto OEM pack. In CV OEMs, easing discounts and a higher mix of higher tonnage vehicles would support earnings but the period of strong earnings growth witnessed in the earlier part of the CV upcycle is now behind. In terms of earnings estimates for FY24E, we see our/consensus numbers largely building higher earnings vs FY23 and hence expect a low probability of upgrades.

Exhibit 113: Consistent consensus upgrades for 2W OEMs; we see little scope for further upgrades now (EPS indexed to 1)



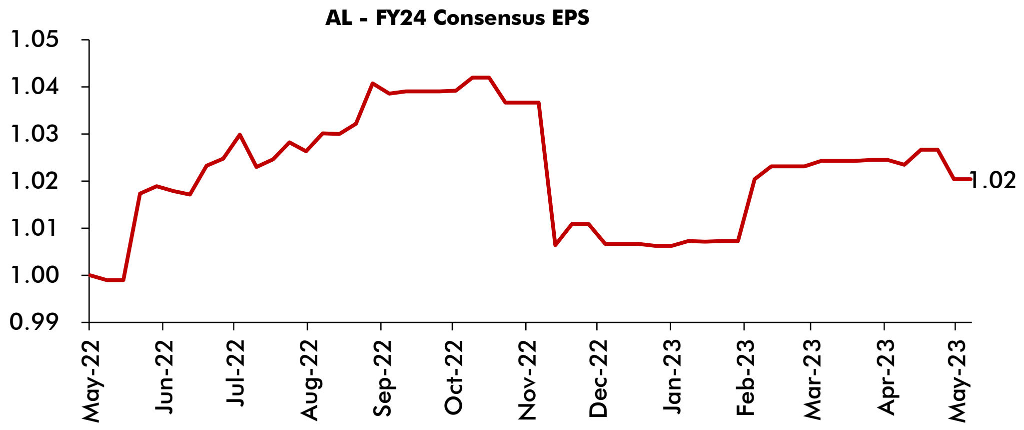
Source: Bloomberg, Ambit Capital research

Exhibit 114: PV OEMs EPS upgrades have topped off; we see limited scope for further upgrades now



Source: Bloomberg, Ambit Capital research

Exhibit 115: CV OEMs EPS largely steady, but CV upcycle is now set to slow down, limiting further EPS upgrades hereon



Source: Bloomberg, Ambit Capital research

Metals

Risk to FY24 estimates from near-term headwinds

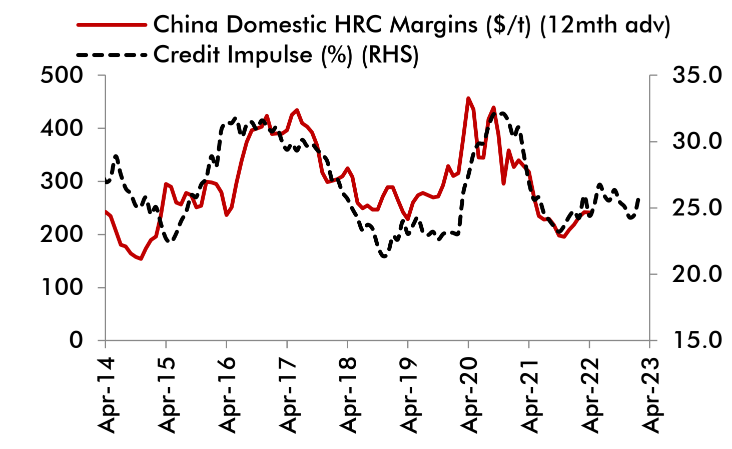
Metals cycle has reverted from the peak in Sep'21 to near trough levels in the past few months driven by lagged impact of the global credit tightening cycle. Chinese credit impulse bottomed in Oct'21 but is now likely to stay flattish through CY23. US financial conditions tightening cycle appears to be peaking out, though any substantial easing may materialize only in CY24. In the near term, global steel prices have corrected but Indian steel prices are now trading above import parity, which could be a risk for FY24 estimates. For Novelis, can de-stocking could last another quarter or two. Metals valuations bottomed in July'22 this cycle at 0.8-0.9 P/B. The cycle should ultimately revert from trough to peak, (with an increase in book value/share and P/B to >1.5x) though that recovery path might be slightly elongated. RoE should improve to >=15% in FY25 once higher incremental ROCE/shorter cycle brownfield projects commission. Our pecking order in our BUYs is TSL>JSW>HNDL>NMDC.

Tough demand environment: The demand environment is expected to remain somewhat tough in FY24. Chinese NPC targets imply a flattish Chinese credit impulse through CY24 – which suggests there may neither be upward nor downward momentum in demand. US financial conditions are unlikely to turn incrementally negative from here, but lagged impact of the tightness seen so far suggests limited possibility of positive surprise on demand. So, overall, demand environment has been tough for the past several months – it's unlikely to change either way over the next couple of quarters

Expect slight margin recovery: We see a slight recovery in margins given: 1) destocking is coming to an end and inventory levels are already very low. For the past few months, we were seeing a double whammy of a) low real demand and b) destocking. At least the destocking-related headwind should come closer to the end, as is also reflected in generally low inventories across the demand. 2) Even if Chinese GDP growth is supported to a larger extent by services, and less from investment, there will be positive net real-interest differential, which should be reflected in a stronger yuan – which is positive for metal spreads. Given the benefit of operating and financial leverage, the slight improvement in EBITDA should get somewhat magnified when it comes to EPS.

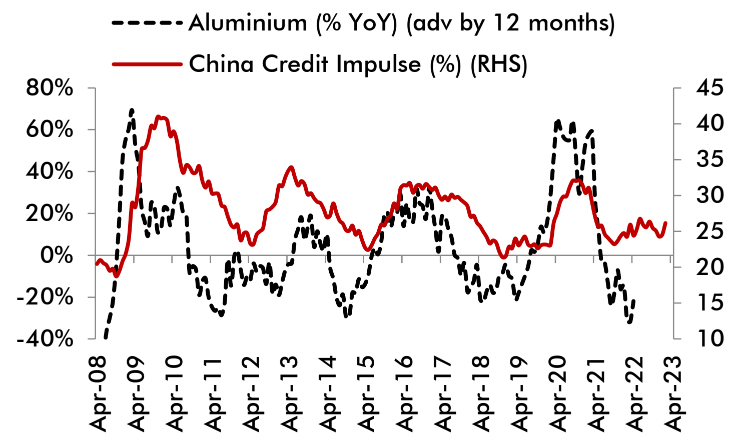
Marginal recovery built into valuations: The market is building in some recovery in margins for FY24, implying >₹15,000/t for Tata Steel India business for FY24 vs ₹13,000/t for 4QFY23E. Consensus estimates appear largely in line with our expectation for most metals companies barring JSW where we are above and NMDC where we are below the street. So, there is a marginal recovery built into valuations. HNDL should benefit from the reversal of metal price lag in 4QFY23, which should help almost double its EPS from ₹6/share in 3Q to ₹12/share in 4Q. Over the longer term (2HFY25-FY26), Novelis should start getting the benefit of higher-priced can sheet/auto contracts even if all the new volumes are not absorbed (despite take or pay contracts).

Exhibit 116: Chinese credit impulse flattish – no clear impetus to demand



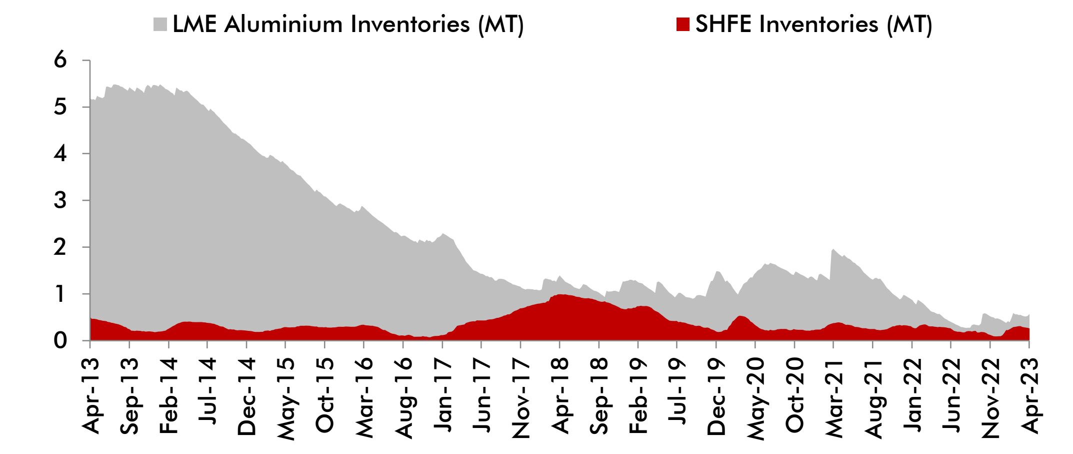
Source: Bloomberg, Ambit Capital research

Exhibit 117: Chinese credit impulse flattish – no clear impetus to base metals as well in the near term



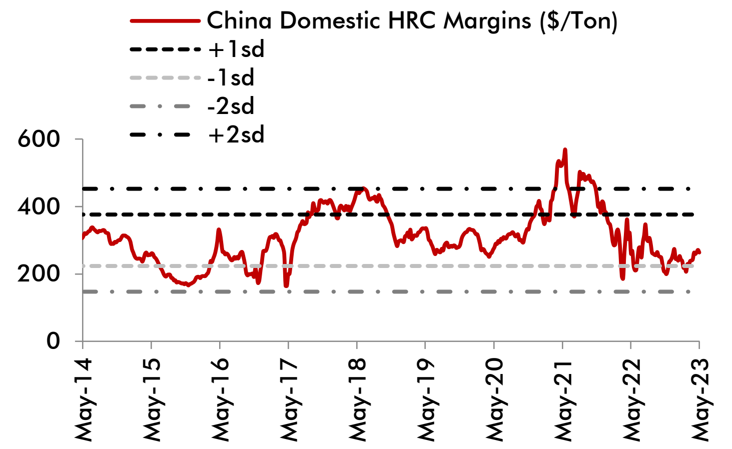
Source: Bloomberg, Ambit Capital research

Exhibit 118: On-exchange aluminium inventories are low vs historical standards



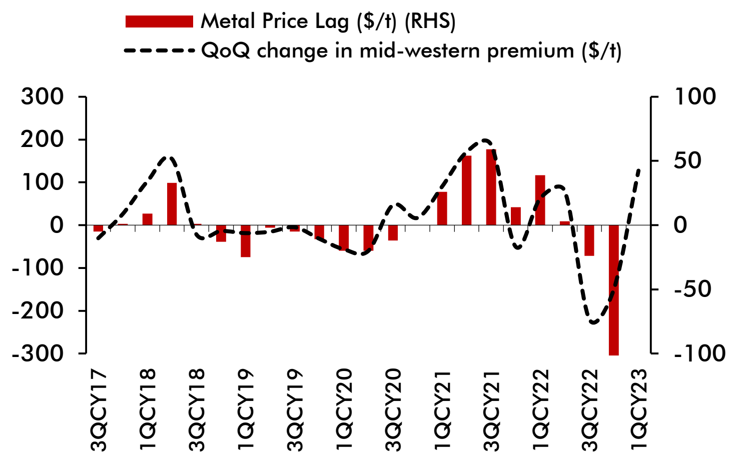
Source: Bloomberg, Ambit Capital research

Exhibit 119: Chinese margins have been trending close to historical trough levels



Source: Bloomberg, Ambit Capital research

Exhibit 120: Metal price lag to aid HNDL's EPS expansion in 4QFY23



Source: Bloomberg, Ambit Capital research

Reviewing our G&C 18.1 portfolio

We revisit our G&C 18.1 portfolio launched in Jan'23. We did a minor tweak to our portfolio on 2nd Mar'23. Our G&C 18.1 portfolio has underperformed NSE500 index by ~20bps dragged by IT over the last 2 months. It's worth highlighting that between 9thJan-12th May23, G&C 18.1 outperformed benchmark by 210bps and the cumulative outperformance is 320bps since Sep-22. Our OW call on OMCs worked well over the last 2 months, with HPCL/BPCL standing out. Our U/W call on Auto didn't work, but our only Auto stock Tata Motors delivered 21% over the last 2 months. Our O/W call on IT didn't work out over the last 2 months, after initial outperformance. We reduce some weight in IT considering risks to earnings estimates. Banks outperformed the market and alpha generation was driven by ICICI Bank and Axis Bank. GE Shipping, Tata Motors, and HPCL were the biggest outperformers while Amber, Federal Bank and Tech Mahindra were the biggest laggards. Our preference order remains large-caps>mid-caps>small-caps. Our stance of small-caps has played out (underperformance over Nifty at ~12% since our call) while mid-cap has remained resilient.

The historical trend is in favour..

The softening of yields and favorable domestic macros coincide with the market's resilient performance in the 2nd half of the calendar year. It delivers the best performance in 4Q with median returns of 5.9 % followed by 3Q (median returns-4.7% since 2000).

Exhibit 121: Historically, Nifty has been stronger in 2HCY as compared to 1HCY

Years	Q1(CY)	Q2(CY)	Q3(CY)	Q4(CY)
2000	3.2	-3.7	-13.6	-0.6
2001	-9.1	-3.5	-17.5	15.9
2002	6.7	-6.4	-8.9	13.5
2003	-10.5	15.9	24.9	32.6
2004	-5.7	-15	15.9	19.2
2005	-2.2	9.1	17.1	9
2006	20	-8.1	14.7	10.5
2007	-3.7	13	16.3	22.2
2008	-22.9	-14.7	-3	-24.5
2009	2.1	42	18.5	2.3
2010	0.9	1.2	13.5	1.7
2011	-4.9	-3.2	-12.5	-6.5
2012	14.5	-0.3	8	3.5
2013	-3.8	2.8	-1.8	9.9
2014	6.3	13.5	4.6	4
2015	2.5	-1.4	-5	0
2016	-2.6	7.1	3.9	-4.9
2017	12.1	3.8	2.8	7.6
2018	-4	5.9	2	-0.6
2019	7	1.4	-2.7	6
2020	-29.3	19.8	9.2	24.3
2021	5.1	7	12.1	-1.5
2022	0.6	-9.6	8.3	5.9
2023	-9.6			
Summary				
Average	-0.8	3.3	4.7	6.5
Median	0.6	1.4	4.6	5.9
Proportion of Positive return	52%	57%	65%	70%

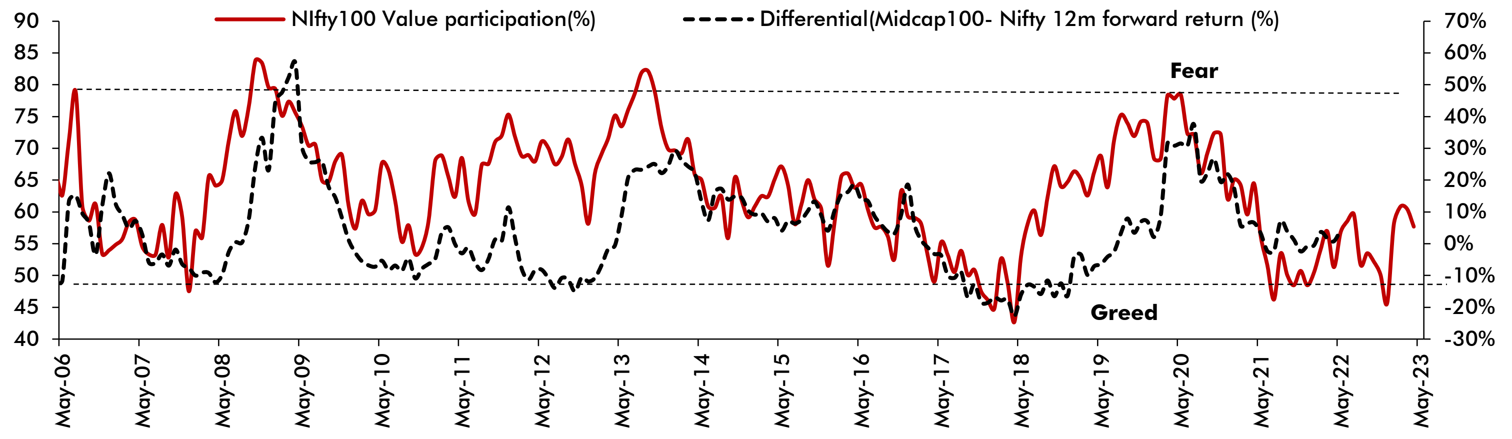
Source: Bloomberg, Ambit Capital research

Remain cautious on small-caps and mid-caps

Our portfolio remains tilted towards large-caps and we remain cautious on small-caps and mid-caps. Our earlier note "A bounce in the building weakness" captures the essence – earnings estimate trajectory is worse in SMID as compared to large-caps, valuations are still expensive and lastly, one of our best size positioning indicators, "Nifty100 Value participation", continues to signal small and mid-cap underperformance. "Nifty 100 value participation" has increased from 46.1 in Dec-22 to 57.7 but remains tilted towards greed, indicating the likelihood of SMID underperformance.

If Nifty 100 value participation is high, it indicates fear is dominating the market and activity is higher in large-caps and vice-versa. When fear becomes excessive, markets rally over the next 1 year, and small-caps and mid-caps outperform Nifty and vice-versa. Since 16th Mar'22, our size positioning has been in favour of large-caps over mid-caps and small-caps. While Nifty has delivered 8% since then, outperforming small-caps (-3%), mid-caps have been the best-performing equity cohort, delivering 14% returns.

Exhibit 122: Portfolios tilted toward large-caps are likely to outperform

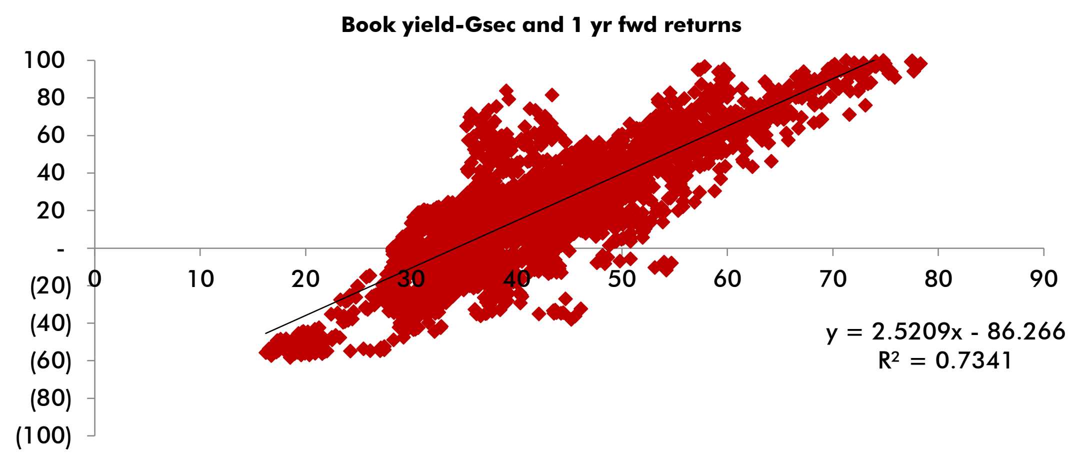


Source: Bloomberg, Ambit Capital research, Note: Analysis is based on market value by participation. Latest data as of 12th May2023 Note: Nifty100 value participation refers to the monthly turnover of the top 100 companies on NSE as a % of total monthly turnover (by value).

Expectations of "muted returns" from banks

We have recommended taking some weight off from banks, as our bond yield book yield differential predicts limited returns for Bank Nifty (7.4%) over next 1 year. Our book yield bond yield differential model for banks, adapted from our earnings yield bond yield (EYBY) model for market, uses book yield (1/PB) in place of earnings yield as earnings are often volatile for banks. It explains 73% of the 1-year forward returns. Our model predicts banks are not attractive either from returns generation perspective.

Exhibit 123: Our model predicts muted returns for banks over the next 1 year



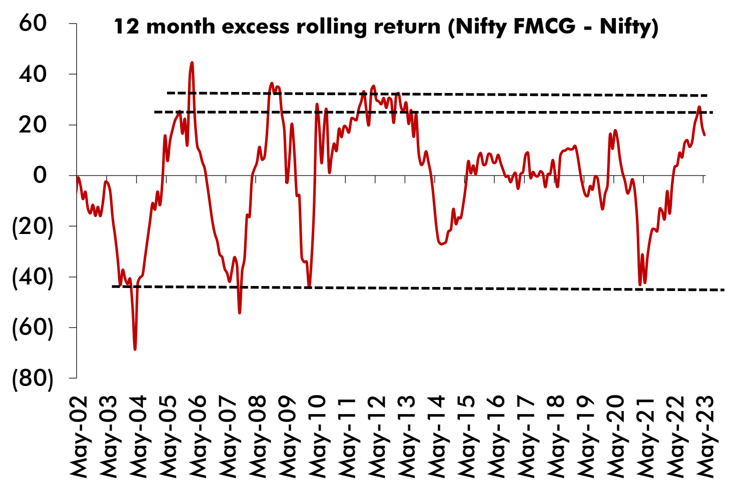
Source: Bloomberg, Ambit Capital research, Note: latest data as of 16th May,2023

What will be on our radar?

FMCG's outperformance w.r.t Nifty on 12M return differential seems to have peaked out in Feb'23 and we remain underweight in FMCG as expensive valuations already factors in margin upgrade. While we have reduced our banks weights, we are still OW on Financials. We do not hold any PSU banks in our portfolio as the private bank underperformance w.r.t PSUs on 12M return differential has peaked out and we believe private banks are likely to outperform PSU banks over next 1 year. We only hold private banks in our portfolio. In G&C 18.1 note, we highlighted NBFC's underperformance w.r.t banks is close to troughs and will be on radar. NBFC underperformance has peaked out and in fact it was earlier than expectation.

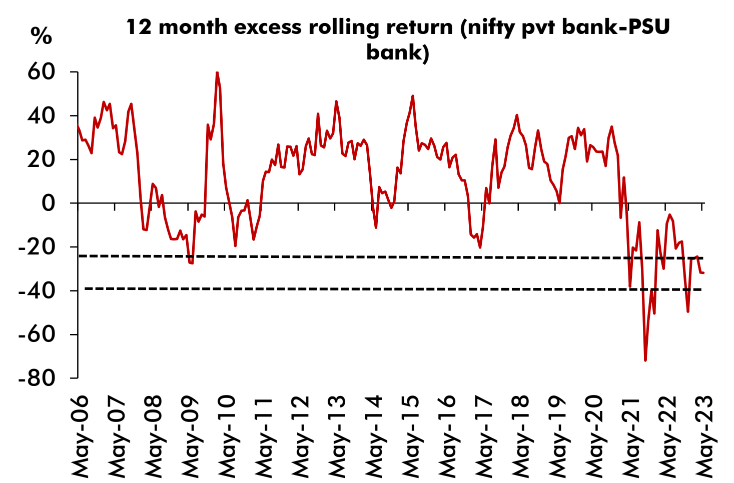
Let me leave you with this – Media's underperformance w.r.t Nifty has peaked out; however business update (merger) of Zee, the biggest contributor of the Media index, remains a key monitorable.

Exhibit 124: Mean reversion in FMCG has begun after peak outperformance in Feb'23



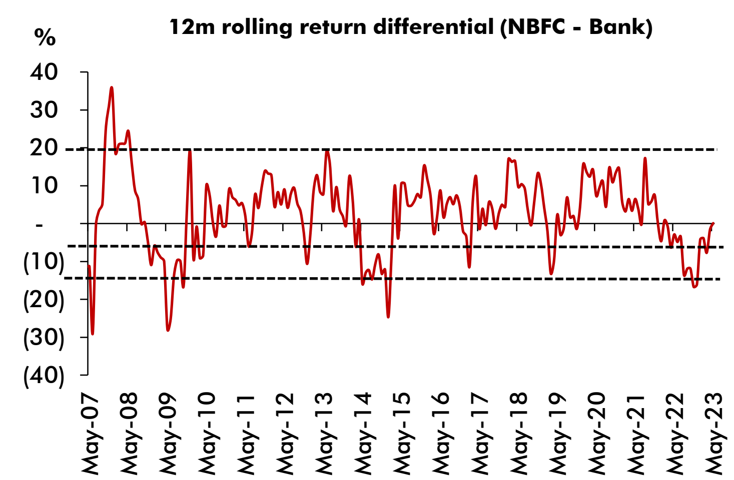
Source: Bloommberg, Ambit Capital research, Note: Latest data as of 12th May'23

Exhibit 125: Private banks likely to outperform PSU banks over the next 1 year



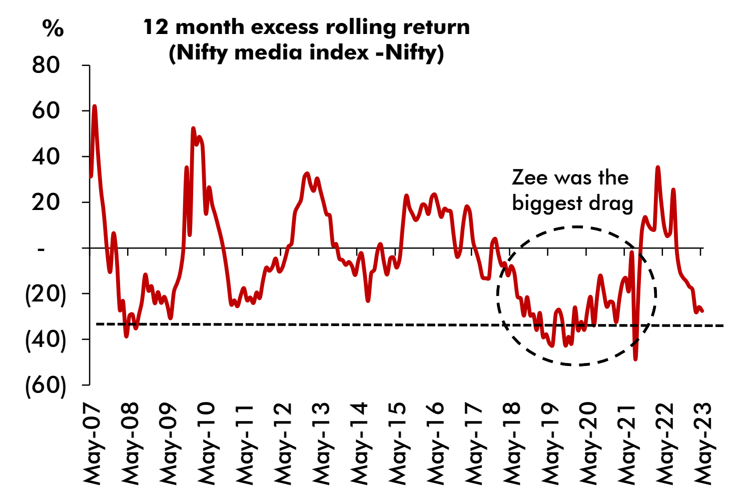
Source: Bloommberg, Ambit Capital research, Note: Latest data as of 12th May'23

Exhibit 126: NBFC underperformance has peaked out; still the right time to turn constructive



Source: Bloommberg,, Ambit Capital research, Note: Latest data as of 12th May'23

Exhibit 127: And so has Media's underperformance; however business update of Zee is a key monitorable

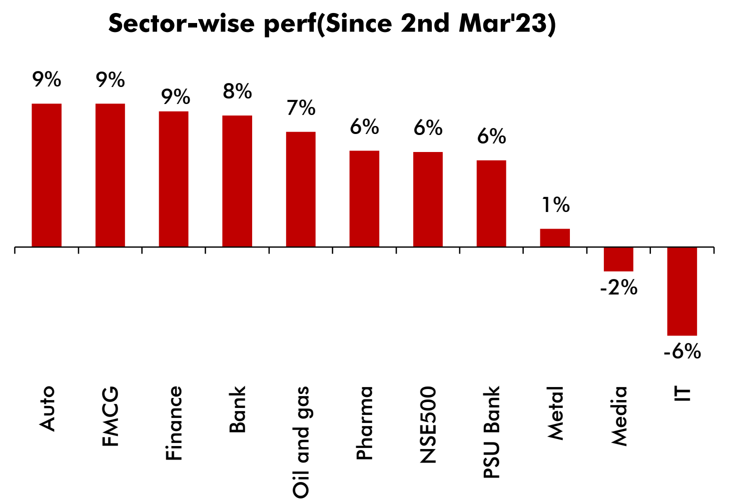


Source: Bloommberg,, Ambit Capital research, Note: Latest data as of 12th May'23

Audit of our portfolio returns

- Since 2nd Mar'23, Auto was the biggest outperformer followed by FMCG. IT and Media were the biggest laggards. We had one Auto stock in our portfolio, Tata Motors, which was our biggest outperformer (20.5%). Nifty 500 delivered 4.8%, while the G&C portfolio (including cash) delivered (4.6%), marginally underperforming the index.
- In G&C 18.1 dated 9th Jan'22, we changed our stance on IT from UW to neutral and were the biggest contributors to alpha generation between Jan-Feb 23. However, since March-23, IT has been the biggest underperformer in the aftermath of the US regional banks crisis and dragged overall performance. This has been cushioned by our disproportionate OW in OMCs - HPCL and BPCL. Metals, was the other key laggard, underperforming the broader market by 5%.
- Amongst financial stocks, we changed our stock selections and tilted towards banks (vs. BFSI earlier). While we remained OW, we also recommended taking some weight off of banks. While ICICI, Axis, Bajaj Finance and Bank Nifty outperformed the market, HDFC Bank, LIC housing finance, SBI life insurance and Federal Bank underperformed. Federal Bank was the key laggard in our portfolio.
- Healthcare marginally outperformed the market by ~0.1%, but our portfolio stock Dr. Reddy's underperformed the broader market.
- GE Shipping (20.9%), SRF (12.4%), and Info Edge (10.4%) outperformed the market significantly.

Exhibit 128: Auto and FMCG were biggest outperformers; Realty and Media were the biggest drags (NSE500).



Source: Bloomberg, Ambit Capital research, Notes: Returns have been calculated over 2nd Mar'23 to 12th May'22.

Exhibit 129: G&C 18.1 – Sector-wise performance and attribution

Sector	Weight in G&C	Contribution to return
Financials	34.9	1.8%
Oil & Gas	6.7	1.0%
FMCG	9.2	0.8%
Auto and Auto Anc.	3.8	0.8%
Chemicals	3.7	0.5%
Media	3.5	0.4%
Miscellaneous	1.6	0.3%
Telecom	4.1	0.1%
New-age tech	3.5	0.0%
Healthcare	4.4	0.0%
Metals and Mining	7.5	-0.1%
Consumer Durable	1.3	-0.1%
IT	15.7	-0.4%
TOTAL	**100**	**5.20%**

Source: Bloomberg, Ambit Capital research, Notes: Returns have been calculated over 2nd Mar'23 to 12th May'22.

Exhibit 130: Performance of our G&C 18.1 portfolio

Company name	Caps	Sector	Absolute Price Performance	Contribution to G&C 18.1 performance
Tata Motors	Large Cap	Auto and Auto Anc.	20.5%	0.8%
HPCL	Mid Cap	Oil & Gas	19.1%	0.5%
ICICI Bank	Large Cap	Financials	8.7%	0.5%
BPCL	Large Cap	Oil & Gas	12.6%	0.5%
Axis Bank	Large Cap	Financials	6.8%	0.5%
SRF	Large Cap	Chemicals	12.4%	0.5%
ITC	Large Cap	FMCG	9.2%	0.4%
Bajaj Finance	Large Cap	Financials	10.1%	0.4%
Info Edge	Large Cap	Media	10.4%	0.4%
GCPL	Large Cap	FMCG	7.9%	0.3%
GE Shipping	Small Cap	Miscellaneous	20.9%	0.3%
HDFC Bank	Large Cap	Financials	3.2%	0.2%
SBI Life Insurance	Large Cap	Financials	5.1%	0.2%
Bharti Airtel	Large Cap	Telecom	3.6%	0.1%
Nifty Bank	Large Cap	Financials	6.2%	0.1%
LIC Housing Finance	Mid Cap	Financials	4.5%	0.1%
PB Fintech	Mid Cap	New-age tech	1.4%	0.0%
Dr Reddy's Labs	Large Cap	Healthcare	0.6%	0.0%
Tata Steel	Large Cap	Metals and Mining	-0.2%	0.0%
TCS	Large Cap	IT	-2.0%	-0.1%
Hindalco Industries	Large Cap	Metals and Mining	-2.9%	-0.1%
Amber Enterprises	Small Cap	Consumer Durable	-9.3%	-0.1%
HCL Tech	Large Cap	IT	-2.1%	-0.1%
Tech Mahindra	Large Cap	IT	-3.6%	-0.2%
Federal Bank	Mid Cap	Financials	-6.2%	-0.2%
G&C 18.1 performance				**5.2%**
G&C 18.1 returns(incl. Cash)				**4.6%**
Alpha v/s NSE500				**-0.1%**

Source: Bloomberg, Ambit Capital research Note: Performance from 2nd Mar-12th May 23

What goes out and what comes in?

What goes out? We exclude three stocks – LIC housing finance, GCPL and Bank Nifty from our G&C 18.1 portfolio.

What comes in? There are **five new additions** to our portfolio – SBI cards, Indigo, Affle (India), Max Healthcare and IndiaMart Intermesh. These along with 22 existing stocks from G&C 18.1 comprise our latest G&C18.2 portfolio.

Weight reductions: We reduced weights of HCL Tech from 7% to 4.5%.

Size Allocation: Concentrated towards large-caps (83%). Mid-cap/small-cap allocations stand at 12%/5%. Cash allocation stands at 5.2%.

Since mid-caps and small-caps are included in the portfolio, NSE500 is our benchmark.

Exhibit 131: G&C Portfolio vs NSE500: Implicit sector weights

Sector	Weights		Deviation
	G&C 18.2	NSE500	vs.NSE500
Media	6.3	0.6	5.7
Metals and Mining	6.8	3.1	3.6
Financials	34.7	31.9	2.8
New-age tech	3.2	0.8	2.5
Telecom	3.9	1.9	2.0
Healthcare	6.8	5.0	1.8
IT	11.7	10.2	1.5
Chemicals	3.8	2.5	1.3
Consumer Durable	1.1	0.8	0.3
Oil & Gas	7.1	9.1	(2.0)
Auto and Auto Anc.	4.2	6.5	(2.2)
FMCG	4.8	11.3	(6.5)
Miscellaneous*	5.5	16.3	N/A

Source: Bloomberg, Ambit Capital research, cannot be compared with NSE500*

Exhibit 132: Dissection of our G&C Portfolio – OW/UW w.r.t Nifty500

Sector	UW/OW	Portfolio Companies
Overweight		
Media	5.7	Affle India, IndiaMart InterMesh, Info Edge
Metals and Mining	3.6	Hindalco Industries, Tata Steel
Financials	2.8	Axis Bank, Bajaj Finance, Federal Bank, HDFC Bank, ICICI Bank, SBI Cards, SBI Life Insurance
New-age tech	2.5	PB Fintech
Telecom	2.0	Bharti Airtel
Healthcare	1.8	Dr Reddy's Labs, Max Healthcare
IT	1.5	HCL Tech, TCS, Tech Mahindra
Chemicals	1.3	SRF
Consumer Durable	0.3	Amber Enterprises India
Underweight		
Oil & Gas	(2.0)	BPCL, HPCL
Auto and Auto Anc.	(2.2)	Tata Motors
FMCG	(6.5)	ITC
Miscellaneous	N/A	GE Shipping, Indigo

Source: Bloomberg, Ambit Capital research

Why we have included these stocks in the portfolio?

Indiamart: After its struggles with new paid client acquisition during Covid, revenue has returned to 17-18% CAGR from pre-Covid levels while EBITDA margins have normalised. INMART has successfully shrugged off Covid blip and competition from verticalised e-B2B players as well as traditional rivals like JDMart. We remain convinced of INMART's strong network effects and execution that will enable it to monetise B2B SMBs and accelerate revenue growth. 47x FY25E target P/E is for 20%+ revenue CAGR and operating leverage that we believe will drive 38% FY23-25E EPS CAGR. INMART also appears to be a 'Make In India' beneficiary given its exposure to B2B SMBs engaged in manufacturing, mostly for the domestic market.

Affle: Global mobile/programmatic advertising is set to outpace total ad-spends, with similar trends likely to replicate in underpenetrated markets like India, SEA, LATAM and MEA, from where Affle derives +80% of revenues. These macro-led tailwinds in mobile advertising are key enablers for Affle's growth story. Its full-service offering which enables conversions by tracking a user across range of form factors is its under-appreciated strength. Its differentiated outcome-based pricing aligns well with advertiser RoI, marquee clientele and cross-channel inventory access, and should drive 24% revenue CAGR over FY23-25E (8x over FY23-33E). EBITDA margin could expand 230bps over FY23-25E to 22.4% (26% by FY33E) on acquisition turnarounds and non-linearity of employee/other expenses. Our TP of ₹ 1,250 implies 41x FY25 P/E.

SBI Cards: We expect momentum in card addition and card spends to continue given the state of the economy and lower penetration of credit cards in India. Thus, we believe credit card is a high-growth and high-RoE industry for a long period. SBI Cards should grow at least in line with industry due to low penetration in SBI's customer base, SBI's strong distribution in non-metros and strong branding recall. Decline in revolver loans is cyclical in nature and we don't expect any meaningful cut in MDR by the regulator. We expect EPS CAGR/average RoE of ~30%/27% over FY23-25E. Our TP of ₹1,155 implies 28x FY25E EPS.

Interglobe Aviation (Indigo): Indigo enjoys leadership in the Indian market (market share: ~55% in CY22 vs sub-20% in CY10) on the back of successful low-cost carrier model, cost leadership and strong brand recall. Increasing air travel demand, improvement in yields and reduction in CASK amid moderation in ATF prices helped Indigo report highest ever quarterly revenue and net profit in 3QFY23. Indigo remains a key beneficiary of consolidation in the sector (exit of Kingfisher/Jet/GoAir) and favourable demand-supply dynamics in the long run given low air travel penetration in India. Despite increasing competitive intensity, we prefer Indigo given established leadership, strong balance sheet, efficient fleet and cost structure. Longer term, we continue to believe Indigo's strategy to focus away from metro routes and expand into Tier-2/Tier-3 domestic routes and international routes would ultimately bear fruit (higher yielding compared to metro routes). Consensus expects 13%/40% rev/EBITDA CAGR over FY23-25E. Indigo (NOT RATED) is currently trading at 8x EV/EBITDA.

Max Healthcare: Max Healthcare is a leading hospital chain in North India, particularly in the Delhi/NCR region, and the second largest hospital chain in India in terms of revenue. Its concentrated, cluster-based approach has allowed it to build a well-regarded brand in its target market cities. It has achieved industry-high margins and RoCE led by a maturing network and efficiency initiatives brought in after takeover by Radiant Lifecare in 2018. FY24-27 bed-expansion (~83% of bed capacity) is most aggressive among peers. But lower bed density in home markets (Delhi, Mumbai) and high brownfield share (~82% of bed-addition) should translate into growth with limited impact on margins and return ratios. Consensus expects 16%/16% revenue/EBITDA CAGR over FY23-25E. Max Healthcare (NOT RATED) is currently trading at 24x FY25 EV/EBITDA.

Exhibit 133: G&C 18.2 composition and valuation

Company	Sector	Mcap ($ mn)	MDV-3m ($ mn)	Accounting Decile	Greatness Score	Ambit stance	P/E		P/B		ROCE/ROA
							FY24E	FY25E	FY24E	FY25E	FY23*
Tata Motors	Auto	22,476	49	D9	0%	BUY	9.4	7.5	3	2.1	5.9
SRF	Chemicals	9,207	14	D4	92%	NR	30.9	25.9	6.1	5.1	17.2
Amber Enterprises	Consumer Durable	745	1	D3	67%	BUY	24	17.8	2.8	2.4	10.6
HDFC Bank	Financials	113,307	281	N/A	N/A	NR	18.6	15.7	2.9	2.5	2
ICICI Bank	Financials	80,257	190	N/A	N/A	BUY	18	15.5	2.9	2.5	2.1
Bajaj Finance	Financials	49,463	69	N/A	N/A	SELL	30.5	26.5	6.2	5.2	4.6
Axis Bank	Financials	34,105	126	N/A	N/A	BUY	11.9	10.2	1.8	1.6	1.6
SBI Life Insurance	Financials	14,457	13	N/A	N/A	BUY	20.2	17.7	2.1	1.8	N/A
SBI Cards	Financials	9,979	8	N/A	N/A	BUY	29	21.3	6.8	5.4	5.6
Federal Bank	Financials	3,243	14	N/A	N/A	BUY	8.4	6.7	1.1	1	1.1
ITC	FMCG	63,581	47	D3	42%	NR	25.1	22.6	7.6	7.2	N/A
Dr Reddy's Lab	Healthcare	9,050	17	D1	75%	BUY	15.7	14.2	2.8	2.4	18.1
Max Healthcare	Healthcare	5,906	10	D10	67%	NR	38.5	33	5.4	4.6	N/A
TCS	IT	145,780	70	D4	50%	SELL	26.2	24.9	11	9.4	53.3
HCL Tech	IT	36,173	29	D3	33%	BUY	18.7	17.5	4.4	4.3	26.7
Tech Mahindra	IT	12,403	30	D7	58%	BUY	17.9	15.8	3.3	3.1	17.7
Info Edge India	Media	6,103	9	D5	58%	BUY	59.9	46.1	3.4	3.3	3.9
IndiaMart InterMesh	Media	2,201	5	D1	75%	BUY	55.6	41	7.7	6.6	12.8
Affle India	Media	1,492	2	D4	58%	BUY	40.4	30.1	7.8	7.2	15.6
Tata Steel	Metals and Mining	15,875	47	D5	75%	BUY	9.8	6.7	1.1	1	12.4
Hindalco Industries	Metals and Mining	11,067	28	D5	83%	BUY	7.9	7	0.9	0.8	12.2
InterGlobe Aviation	Aviation	10,483	11	D4	42%	NR	23.3	17.5	N/A	88.8	N/A
GE Shipping Co	Shipping	1,176	2	D2	67%	BUY	5.5	8.1	1	0.9	22
PB Fintech	New-age tech	3,321	11	D5	33%	BUY	N/A	149.9	4.8	4.5	-13.8
BPCL	Oil & Gas	9,552	12	D9	17%	BUY	7.6	6.5	1.4	1.2	2.6
HPCL	Oil & Gas	4,501	9	D5	17%	BUY	5	5.2	1.1	1	-15.8
Bharti Airtel	Telecom	55,654	36	D2	50%	BUY	30.6	19.4	6.6	5.6	7.5

Source: Company, Ambit Capital research, Note: NR indicates 'Not Rated', For SBI Life, P/E indicates Price to Value of New Business per share (P/VNB); Ambit estimates have been used coverage cos else Consensus estimates are used; Data as of 12th May,23

Exhibit 134: Top large-cap BUY ideas

Company Name	Ambit Sector	Mcap	FF Mcap	MDVT - 3m	Acctg. Decile	Revenue Growth (YoY) (%)		2Y Revenue CAGR	EPS Growth (YoY) (%)		2Y EPS CAGR	P/E (x)		P/B (x)		RoE (%)	
		(US$ mn)	(US$ mn)	(US$ mn)	FY22	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Bharti Airtel	Telecom	55,654	24,977	36	D2	13	16	14	83	58	70	31	19	7	6	19	26
HCL Tech	IT	36,173	14,209	29	D3	9	8	8	7	7	7	19	18	4	4	24	25
Axis Bank	Financials	34,105	31,312	126	N/A	10	15	12	14	16	15	12	10	2	2	16	16
Tata Motors	Auto and Auto Anc	22,476	12,049	49	D9	25	11	18	1,411	26	336	9	7	3	2	30	27
SBI Cards	Financials	9,979	3,089	8	N/A	25	43	34	25	36	30	29	21	7	5	26	28
Dr Reddy's Labs	Healthcare	9,050	6,633	17	D1	9	8	8	15	10	13	16	14	3	2	19	18

Source: Company, Ambit Capital research, Latest data as of 12th May,23, For BFSI cos, Revenue indicates Net interest income. FY23 Ambit estimates are considered for companies haven't reported FY23 actuals as of 8th May'23.

Exhibit 135: Top mid-cap BUY ideas

Company Name	Ambit Sector	Mcap	FF Mcap	MDVT - 3m	Acctg. Decile	Revenue Growth (YoY) (%)		2Y Revenue CAGR	EPS Growth (YoY) (%)		2Y EPS CAGR	P/E (x)		P/B (x)		RoE (%)	
		(US$ mn)	(US$ mn)	(US$ mn)	FY22	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
TVS Motor Co	Auto and Auto Anc	7,153	3,557	13	D9	10	14	12	22	22	22	32	27	8	6	27	26
Indian Hotels Co	Hotels	6,180	3,820	12	D6	9	10	9	15	20	17	44	37	5	5	0	0
Federal Bank	Financials	3,243	3,243	14	N/A	12	17	14	16	25	20	8	7	1	1	14	15
Prestige Estates Projects	Real-Estate	2,368	817	3	D9	12	19	16	31	34	32	27	20	2	2	8	10
Zee Ent.	Media	2,176	2,089	16	D5	18	18	18	99	21	55	11	9	1	1	10	11

Source: Company, Ambit Capital research, Latest data as of 12th May,23, For BFSI cos, Revenue indicates Net interest income. FY23 Ambit estimates are considered for companies haven't reported FY23 actuals as of 8th May'23.

Exhibit 136: Top small-cap BUY ideas

Company Name	Ambit Sector	Mcap	FF Mcap	MDVT - 3m	Acctg. Decile	Revenue Growth (YoY) (%)		2Y Revenue CAGR	EPS Growth (YoY) (%)		2Y EPS CAGR	P/E (x)		P/B (x)		RoE (%)	
		(US$ mn)	(US$ mn)	(US$ mn)	FY22	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
PB Fintech	New-age tech	3,321	3,321	11	D5	25	27	26	89	418	N/A	N/A	150	5	4	(1)	3
Bajaj Electricals	Consumer Durable	1,641	609	1	D8	(1)	12	5	58	35	46	38	28	6	5	15	17
City Union Bank	Financials	1,245	1,245	6	N/A	4	8	6	20	12	16	9	8	1	1	15	15
Amber Enterprises	Consumer Durable	745	444	1	D3	22	18	20	88	35	59	24	18	3	2	13	15
Safari Industries	Consumer Durable	712	376	1	D3	22	21	21	34	25	29	38	31	11	8	28	26
AMI Organics	Healthcare	470	285	1	D7	21	21	21	26	24	25	36	29	6	5	17	18

Source: Company, Ambit Capital research, Latest data as of 12th May,23, For BFSI cos, Revenue indicates Net interest income. FY23 Ambit estimates are considered for companies haven't reported FY23 actuals as of 8th May'23.,

Exhibit 137: Top SELL ideas

Company Name	Ambit Sector	Mcap	FF Mcap	MDVT - 3m	Acctg. Decile	Revenue Growth (YoY) (%)		2Y Revenue CAGR	EPS Growth (YoY) (%)		EPS CARG	P/E (x)		P/B (x)		RoE (%)	
		(US$ mn)	(US$ mn)	(US$ mn)	FY22	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	(FY23-25E)*	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Reliance Industries	Oil & Gas	204,528	101,262	165	D5	2	6	4	22	(1)	9	21	21	2.3	2.1	10	10
Kotak Mahindra Bank	Financials	47,391	35,093	78	N/A	9	14	11	(6)	13	3	38	34	4.4	3.9	12	12
LTIMindtree	IT	16,872	5,283	21	D1	10	13	11	9	10	10	29	26	7.5	6.4	28	27
Bandhan Bank	Financials	4,638	2,784	18	N/A	18	21	20	24	18	21	12	10	1.7	1.4	15	16
Dalmia Bharat	Cement	4,745	2,095	7	D4	6	9	12	7	(11)	(6)	35	39	2.4	2.3	9	8
Godrej Properties	Real Estate	4,527	1,880	7	D10	16	24	21	13	15	28	58	50	3.8	3.5	7	7
M&M Financial	Financials	4,236	2,027	10	N/A	14	18	14	(4)	26	34	18	15	1.9	1.7	11	12
APL Apollo Tubes	Building Materials	3,981	2,741	5	D5	16	11	17	34	21	19	38	31	8.8	7.1	28	29

Source: Company, Ambit Capital research Latest data as of 12th May,23, For BFSI cos, Revenue indicates Net interest income. FY23 Ambit estimates are considered for companies haven't reported FY23 actuals as of 8th May'23.

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 notes. We take an active call for size orientation of the portfolio. Currently, portfolio preference is in favour of large caps. Our sector allocation framework based on excess returns, relative valuation, earning estimate sustenance and ownership plays a key role in sectoral allocation. 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: At any point in time, cash held in our portfolio would be between 2-15%.

Weights of the stocks: For large-cap stocks, we have kept two weight categories – 6% and 4.1%. For mid-cap 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 138: Valuation of G&C portfolio 18.2 vs. Nifty500

Portfolio	Mcap (Median)	6MDVT	P/E - Median (x)		P/B - Median (x)		RoE - Median (%)		EPS growth		Beta - Median (x)
	US$ mn	US$ mn	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	
G&C 18.2	10,483	16.0	21.0	17.5	3.6	3.4	16.7	16.9	37%	17%	1.07
NSE500	2,049	2.9	24.5	20.0	3.7	3.3	17.0	17.7	24%	15%	0.98

Source: Company, Ambit Capital research, latest data as of 15th May'23

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Explanation of Investment Rating - Our target prices are with a 12-month perspective. Returns stated are our internal benchmark

Investment Rating	Expected return (over 12-month)
BUY	We expect this stock to deliver more than 10% returns over the next12 month
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.
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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