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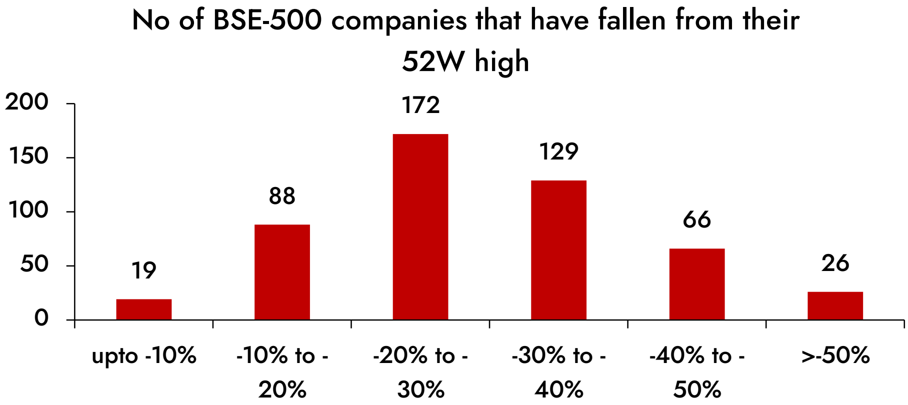
INVESTOR COMPASS

RETURN OF THE MARCH BLACK SWAN

Return of the March Black-Swan!

In a globalized world such as the one we live in, it is very difficult for a nation to insulate itself completely from geopolitical and exogenous events. This was witnessed during COVID – when nations were struggling to source essential medicine supplies – and post-COVID – when supply chain bottlenecks impacted raw material prices for importers. The current Russia-Ukraine war is the third such instance in the last two years. There will hardly be an economy which will not be facing any negative impact – directly or indirectly. The intensity and duration will be the only variables. **In this note we try to assess the impact on the Indian economy and on y(our) portfolio companies, and how we see this as - another opportunity for long-term investors.**

Exhibit 1: ~78% of BSE500 companies are down >20% from their 52W High while 60% are down between 20-40%

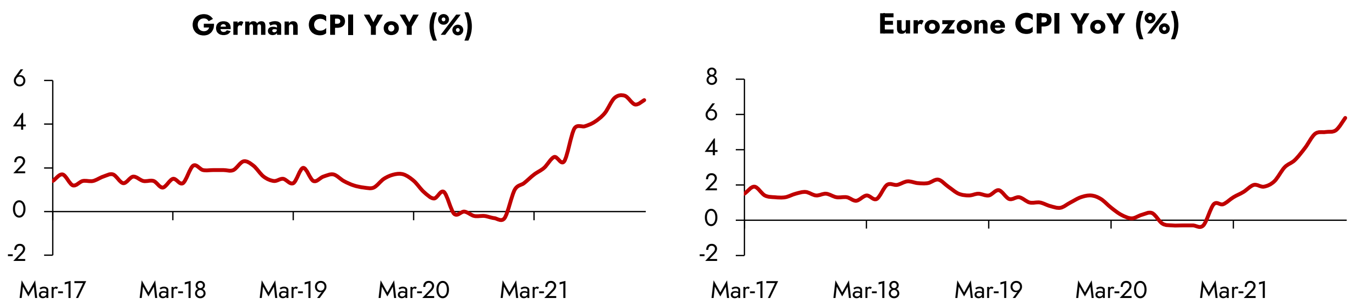


Source: Bloomberg, Ambit Asset management, Last Price as of 7th Mar '22

Impact may vary across Countries and Companies

1. **European nations will be much more impacted** – due to their trade ties and proximity with Russia. Some prominent European countries rely heavily on Russia to meet their energy and commodity needs. Europe accounts for ~53%/43%/85% of Russian Oil/LNG/Pipeline. This will further add to already rising high inflationary environment **(Refer to Exhibit: 2)**. Moreover, the conflict area is nuclear active and [any mishap may pose an imminent risk](), further spiking volatility.

Exhibit 2: EU inflation had been spiking even prior to Russia-Ukraine tussle

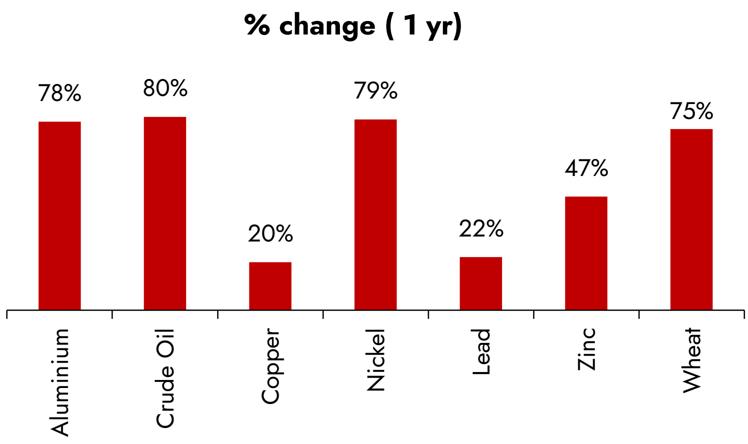


Source: Bloomberg, Ambit Asset management

2. **Countries not involved directly –** will have an impact which will be limited to commodity inflation especially those in which Russia has a high export share **(Refer to Exhibit: 3)**. This will add to inflation and interest rate concerns as central banks will have to increase interest rates to combat an already spiking inflation

Exhibit 3: Russia is a major exporter of commodities (US$370bn in CY20) which has weighed heavily on these commodity price

Commodities	Russian Output	Share of Global Supply	Exports (%)
Aluminium (kt)	4,200	6%	80%
Copper (kt)	1,000	4%	75%
Nickel (kt)	225	8%	90%
Iron Ore (mt)	100	2%	25%
Met Coke (mt)	74	9%	39%
Thermal Coal (mt)	363	17%	48%
Crude Oil (mmbpd)	10	10%	45%



Source: World Steel Association, ILZSG, Bloomberg, Ambit Asset management

3. **Indian Corporates are well insulated… in the longer run –**
    a. Indian Companies having high revenue exposure to Russia and Eastern European countries are expected to face prolonged stress.
    b. Those dependant on global trade (ex-Russia) are expected to witness near term margin compression due to high shipping and input cost.
    c. Domestic focused and service oriented companies will be the least impacted with demand remaining intact.

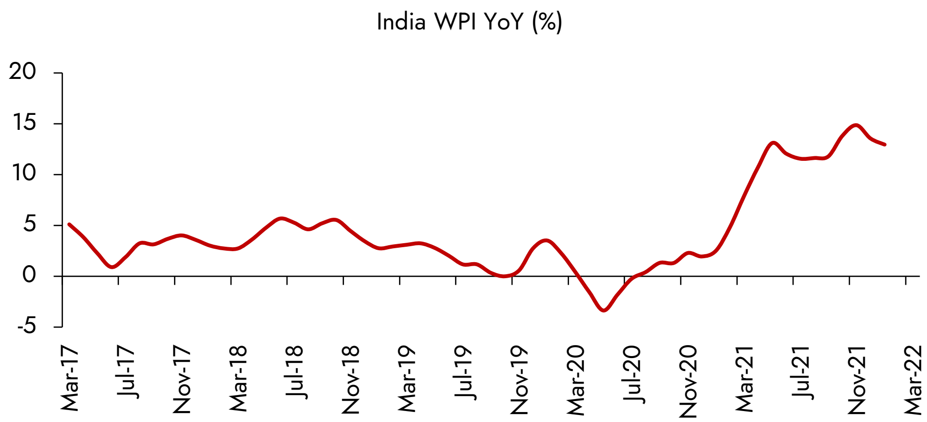
Our coverage companies are relatively well insulated. Most of the companies that have any Russian revenue exposure is limited to 1% of overall revenue – barring one coffee major – which has ~20% revenue exposure

Macro Impact on the Indian Economy

1. **Trade Deficit may inch up –** India – the 3rd largest importer of Crude Oil – imports >80% of its total oil requirements. In FYTD22 (Apr'21-Jan'22), oil imports have risen to $125.5bn (FY21: $82.7bn) driven in part by economic recovery as well as higher oil prices. It is expected that India's trade deficit will inch up to $165bn. As per estimates, every 10% increase in oil prices increases India's Oil imports by $15bn or 0.4% of GDP. This will get reflected in higher current account deficit. On the positive side, India also exports some refinery products & is likely to benefit from higher oil prices.

2. **Already rising inflation may take more time to cool off –** Crude oil related products carry a weight of 7.3% in the WPI basket. Hence, the direct impact of a 10% increase in oil prices is estimated to be ~0.7% on WPI. Adding the indirect impact, the overall impact can be around 1% increase in WPI Inflation. The impact on CPI inflation will be both direct & indirect. Petrol & related products have a weight of 2.4% in the CPI basket. The direct impact of 10% increase in oil prices is only 0.15%. Higher oil prices will also feed into supply chains & push prices of other commodities & services upwards. The indirect impact of this pass-through is likely to be ~0.25-0.35%.

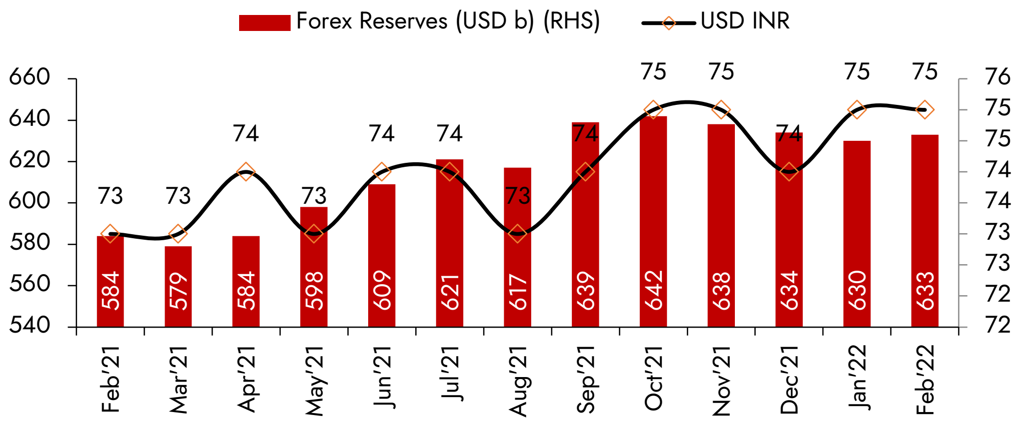
Exhibit 4: India's WPI Inflation has inched up sharply post COVID crossing the 10% threshold



Source: Bloomberg, Ambit Asset management

3. **Narrow Room for navigating fiscal roadmap –** The government has assumed oil prices at $75/bbl in the FY23 budget. Notably, the government lowered its subsidy bill for FY22 & FY23 significantly. Further, it must be noted that the government had cut excise duty on petrol & diesel by Rs5/ltr & Rs10/ltr respectively in Nov '21. With the government walking on the narrow road of fiscal consolidation & already elevated borrowing programme, the fiscal space for increase in subsidies or excise duty is limited.

Exhibit 5: India has been able to cushion the impact of Macro volatility on the currency



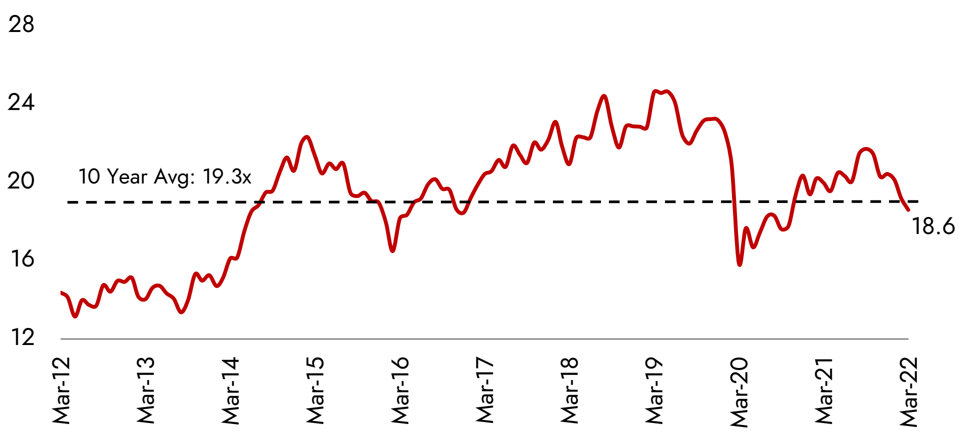
Source: Bloomberg, RBI, Ambit Asset Management

4. **Postponement of LIC IPO –** to FY23 may result in government missing their divestment target for FY22. This may lead to increased Fiscal Deficit, which was earlier estimated at 6.3%. This can however be negated by increased tax collection and lower Capex spend.

Why we believe that this is the right time to invest... for LONG TERM investors

1. **India fastest growing economy in the world –** Despite these macro headwinds, India remains on track to be the fastest growing economy. Moreover, corporate earnings remain resilient, (>45% earnings growth for Nifty50 constituents in 9MFY22). This was despite headwinds of COVID wave 2/3 and the ensuing lockdowns, sharp input cost inflation and supply chain bottlenecks – which may in fact continue in the near term because of the on- going war.

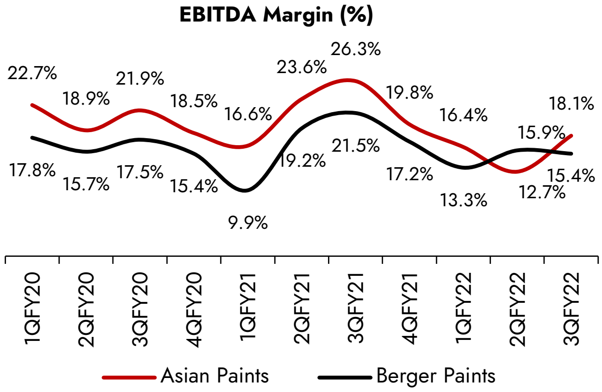
Exhibit 6: After the recent correction, NIFTY is trading below its 10Yr avg 1Y Fwd PE valuations

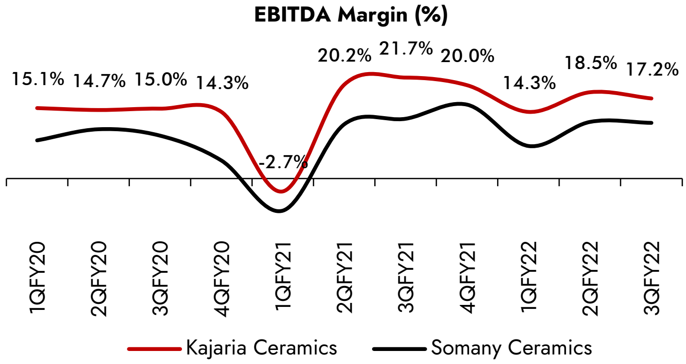


Source: Bloomberg, Ambit Asset Management

2. **K-Shaped recovery will further play –** As we had highlighted in our [FMD note in Sep-2020](), we have seen the ***K-Shaped*** recovery play out in 9MFY22 where leaders were able to absorb cost headwinds far better than unorganized / fragmented players. This was visible in their quarterly results which showcased superior margins and growth profile.
   Companies such as Asian Paints and Kajaria Ceramics, have been able to maintain margins and growth despite severe input cost inflation, will be the eventual beneficiaries once the dust settles. While cost inflation will dent margins of most of these leaders as well, we believe they will be far better placed to tackle the current challenges.

Exhibit 7: Asian Paints – the leader – has outperformed Berger Paints in Margins, even during these turbulent times. Same as Kajaria Cermaics which has continuously maintained its superior margin profile over Somany

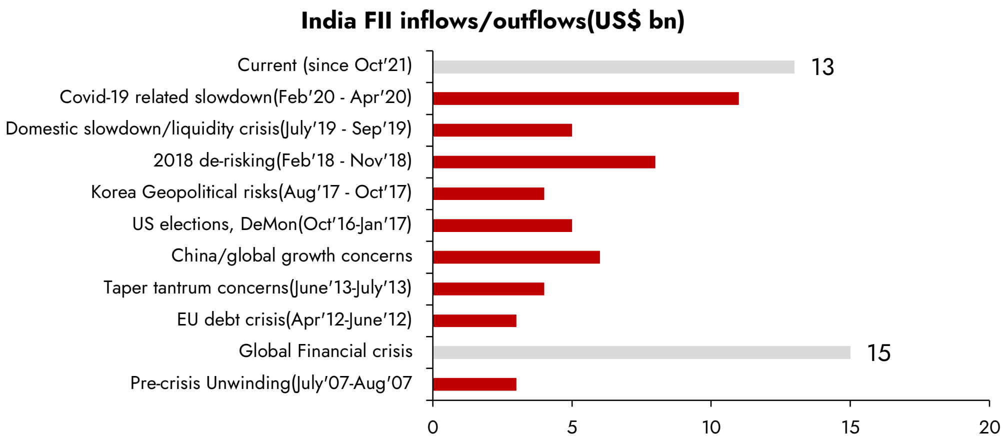




Source: Company, Ambit Asset Management

3. **FII Selling / Increased Volatility –** We have witnessed unprecedented FII selling in FY22TD due to global macro-economic factors – especially Fed rate hike – resulting in money flowing out of Emerging markets. This even led to100% domestic focused or services oriented businesses to correct sharply. Moreover, the increased volatility is adding to those fears and this may continue going forward as the war plays out. As a result, we see this as a good buying opportunity for fundamentally strong business for LONG TERM investors, as no growth (earnings or M Cap) is linear.

Exhibit 8: The current FII selling has been the sharpest since GFC in 2008-09



Source: FactSet, Bloomberg, MSCI Ambit Asset management

Conclusion

Indian corporates will witness near term cost inflation which should normalize going ahead. All but one of our portfolio companies have limited (<1%) to no revenue exposure to Russia. Markets have seen significantly higher volatility since the conflict began in February 2022, and are likely to be this way as the events pertaining to the conflict play out. Moreover, the recent FII selling – which was the heaviest since GFC **(Refer to Exhibit: 9)** – has weighed on the markets. But India remains one of the fastest growing and most attractive EM, more so post Russia's exclusion from MSCI. **A combination of the likely Interest Rate hike (Fed and other Central Banks), State Assembly Election results and Russia-Ukraine conflict might result in increased near term volatility providing a great buying opportunity for long-term investors**.

Exhibit 9: Past 4 market corrections due to war indicate average market correction of -12% which lasted 20 days. Average market performance from trough in 1M/3M/6M is 18%/31%/33% respectively

Return (%)	No. of days of correction	Max correction due to geo-political tension	+1m	+3m	+6m
Iran-Iraq War	49	-10.1	10.6	15.7	47.0
Gulf War	3	-8.1	24.3	39.8	2.0
Kargil War	10	-9.2	22.4	42.5	48.3
9/11 attack	17	-19.5	16	24.4	36.0
Average	***20***	***-11.7***	***18.3***	***30.6***	***33.3***

Source: Exchange Data, Ambit Asset Management

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The performance data for coffee can product between 6th march 2017 - 19th June 2017 represents model portfolio returns. First client was onboarded on 20th June 2017. The performance data for G&C product between 1st June 2016 to 1st April 2018 also includes returns for funds managed for an advisory offshore client. Returns are calculated using TWRR method as prescribed under revised SEBI (Portfolio Managers) Regulations, 2020