

BEYOND EUPHORIA: THE QUINTESSENCE OF QUALITY!



Dear Patrons,

CYTD23, thus far, has been extremely positive for the broader markets with 33%/47% returns for Midcap (Nifty Midcap 100)/Microcap (Nifty Microcap 250) index in contrast to 10% for the Nifty 50. This outperformance has been much stark since the regional bank crisis in the US with Large/Mid/Small cap indices returning 14%/35%/44% since then in the ensuing 5 months. This comes on the back of a challenging CY22 which saw -11%/-17%/-21% drawdown in the Large/Mid/Small cap indices in the first 6 months which saw many large debutants (IPOs) correcting between 30-50%.

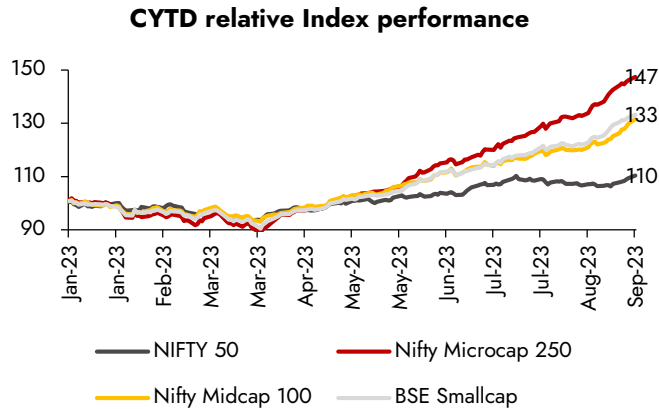
Exhibit 1: By CY22 end, we saw a median -30% decline of leading IPOs of 2021

Issuer Company	Issue Size (Rs Cr.)	Issue Price	Listing Day Close	Listing Day Gain	Price as on 30/12/2022	Change from listing day
One 97 Communications	18,300	2,150.0	1,564.2	-27.3%	531.0	-66%
Zomato	9,375	76.0	125.9	65.6%	59.3	-53%
Star Health	7,249	900.0	906.9	0.8%	566.3	-38%
PB Fintech	5,625	980.0	1,202.9	22.7%	448.3	-63%
Sona BLW Precision Forgings	5,550	291.0	362.9	24.7%	419.5	16%
FSN E-Commerce Ventures	5,352	187.5	367.8	96.2%	154.9	-58%
Nuvoco Vistas Corporation	5,000	570.0	531.3	-6.8%	365.1	-31%
IRFC	4,633	26.0	24.9	-4.4%	32.6	31%
Chemplast Sanmar	3,850	541.0	534.9	-1.1%	459.7	-14%
CarTrade Tech	2,999	1,618.0	1,500.1	-7.3%	468.7	-69%
Aptus Value Housing Finance	2,780	353.0	346.5	-1.8%	303.8	-12%
Aditya Birla Sun Life AMC	2,768	712.0	699.7	-1.7%	455.0	-35%
Macrotech Developers	2,500	486.0	463.2	-4.7%	545.5	18%
KIMS	2,144	825.0	995.9	20.7%	1,547.3	55%
Sapphire Foods India	2,073	1,180.0	1,216.1	3.1%	1,337.3	10%

Source: Ambit Asset Management, chittorgarh.com

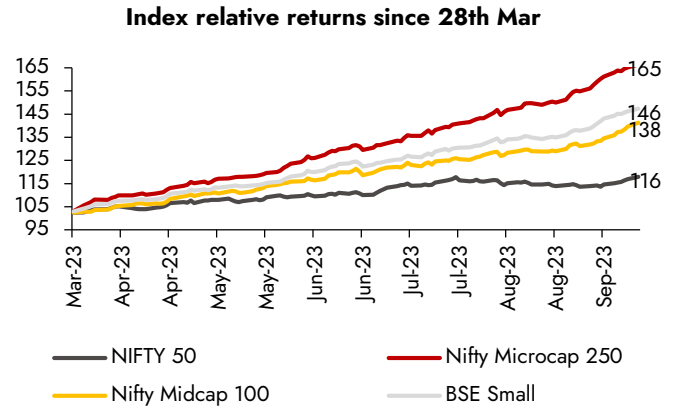
While this recent rally might be backed by underlying fundamentals of the economy improving significantly and in the hope of stabilizing global macros, the extent and quantum of it, however, in addition to 2-3 other important factors – which we highlight in this report – warrant attention and perhaps caution. In this note, we take a look at these factors, compare them to earlier cycles, and try to understand where we are headed.

Exhibit 2: Broader markets have outperformed NIFTY in CY23...



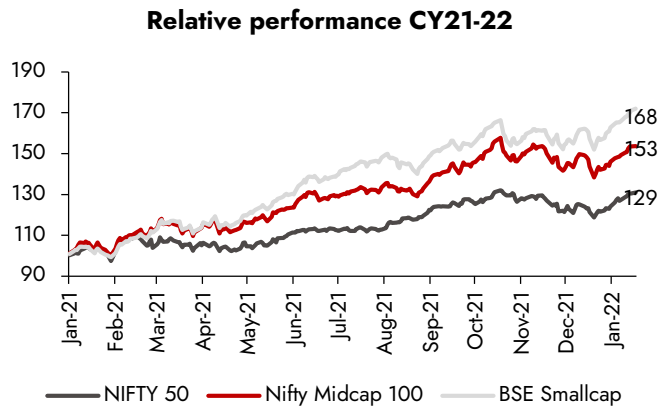
Source: Ambit Asset Management, ACE Equity, Till 11th Sep 2023

Exhibit 3: ...Especially post the Regional Bank crisis in the US



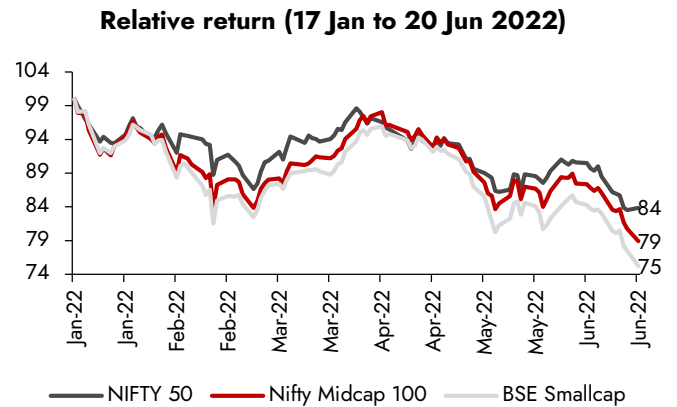
Source: Ambit Asset Management, ACE Equity, Till 11th Sep 2023

Exhibit 4: A similar trend was seen in CY21...



Source: Ambit Asset Management, ACE Equity

Exhibit 5: ...which followed a sharp correction as the narrative weakened

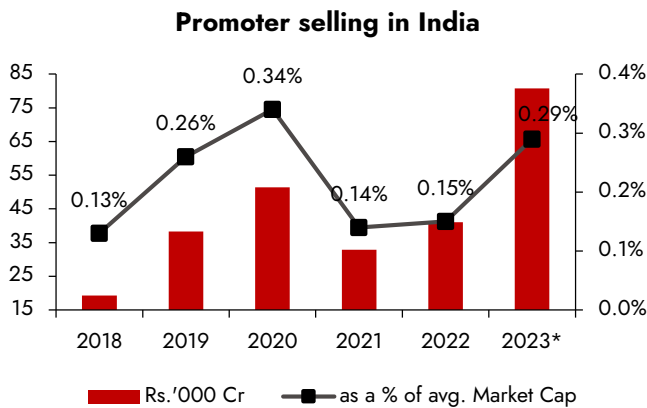


Source: Ambit Asset Management, ACE Equity

Beyond Euphoria!

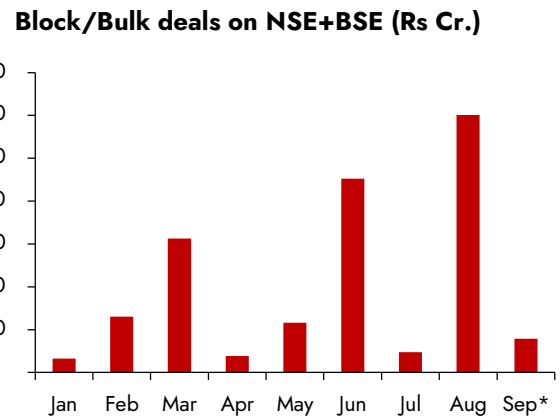
1. Bunch of selling by insiders (Promoters / strategic investors) – CY23 for markets also stands out from the perspective of promoters and strategic investors (Private Equity) stake sale. These are the people who know the underlying business the best. Promoter selling in CYTD23 stood at Rs807bn which is ~2x from CY22 and ~50% higher from the earlier peak in CY20 (**Refer Exhibit: 6**). Many of the companies where promoters or strategic investors were looking for an exit (as per media articles) have taken place in quick succession over the last few months (**Refer Exhibit: 7, 8**). The bunching-in of these transactions over such a short duration may indicate fair market liquidity and valuations, at least over the near term.

Exhibit 6: Selling by insiders in India Inc. has already surpassed the earlier peak



Source: Ambit Asset Management, [CNBC TV18](#), *Till 18th Aug-2023

Exhibit 7: Slew of bulk deals have taken place, especially over the last month



Source: Ambit Asset Management, NSE, BSE Note: Data includes only SELL transactions to avoid duplications. Only large deals are considered hence list is not exhaustive. * - Data till 6th Sept 2023

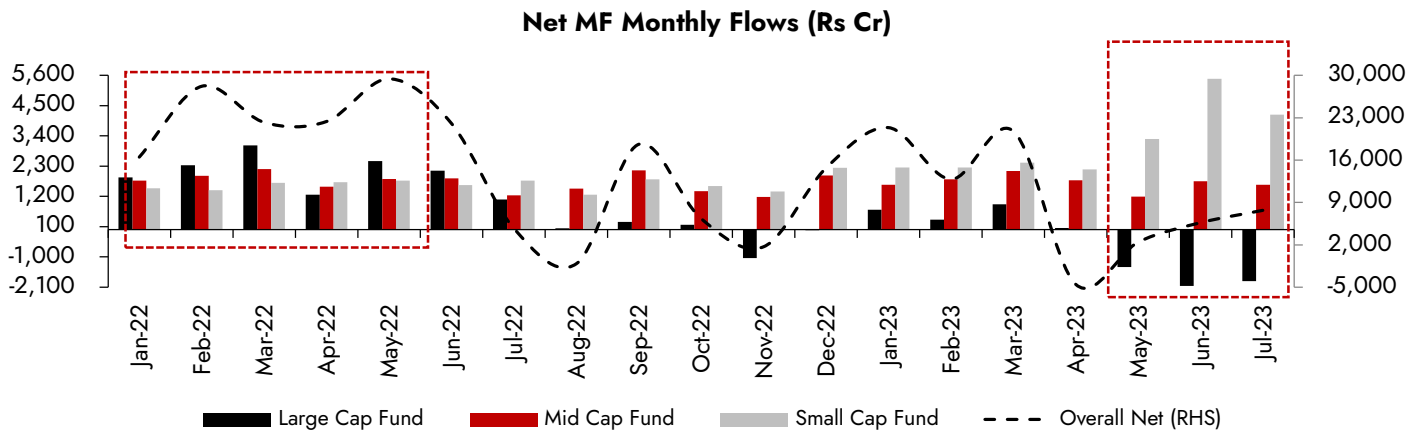
Exhibit 8: A lot of large stake sale/divestments by promoters/large investors over the last few months

Company	Date	Investor	Type	Stake (%)	Value (Rs Cr)
Coforge	24-Aug	Barings	Promoter	26.6%	7,684
Kotak Mahindra	09-Jun	Canada Pension Plan Inv.	Financial Investor	1.7%	6,124
Interglobe Aviation	16-Feb, 16-Aug	Shobha Gangwal	Promoter	7.0%	5,746
Sona BLW	13-Mar	Singapore Vii Topco Iii Pte	Promoter	20.5%	4,917
Shriram Finance	21-Jun	Piramal Enterprises	Strategic Investor	8.3%	4,824
HDFC AMC	20-Jun	Aberdeen	Promoter	10.2%	4,079
Vedanta	03-Aug	Twin Star Holdings	Promoter	4.1%	3,983
IDFC First Bank	01-Sep	Warbug (Cloverdell Inv)	Financial Investor	4.2%	2,480
Timken	20-Jun	Timken Singapore Pte	Promoter	10.1%	2,362
Syngene	01-Feb	Biocon	Promoter	10.0%	2,240
One 97 Comm.	25-Aug	Ant Financial	Financial Investor	3.6%	2,037
CMS Info Systems	9-Jun, 10-Aug	Sion Investment Holdings	Promoter	32.8%	1,709
Amara Raja	18-Jul	Clarios Arbl Holding Lp	Financial Investor	14.0%	1,562
Star Health	28-Aug	Multiple Investors	Financial Investor	3.4%	1,221
Credit Access	30-Jun	Creditaccess India B.V.	Promoter	5.8%	1,121
Kalyan Jewelers	28-Mar, 16-Jun	Warbug (Highdell Inv Ltd)	Financial Investor	8.5%	982
Zomato	30-Aug	Softbank (Svf Growth)	Financial Investor	1.2%	947
GMM Pfudler	18-Aug	Pfudler Inc.	Promoter	13.5%	824
CIE Automotive	13-Mar	M&M Ltd	Promoter	6.1%	821
Eris Lifesciences	Jun-Jul	Rakesh Shah	Financial Investor	6.2%	601
SJS Enterprises	22-Aug	Evergraph Holdings Pte Ltd	Promoter	30.1%	550

Source: Ambit Asset Management, NSE, BSE, As of 6th Sep 2023

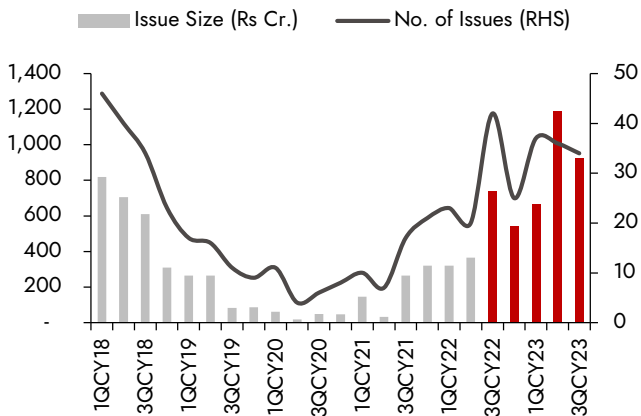
2. Increased Retail fund flow toward riskier categories – In addition to the above, retail investors’ fund flow is increasingly gravitating toward riskier segments. Mainboard IPOs are being heavily over-subscribed, the number of SME IPOs has seen a sharp jump over the last few years (**Refer Exhibit: 10**), and Mutual Funds are seeing increased flow in Small/Mid Caps in place of large-caps (**Refer Exhibit: 9**). While this may very well be an indication of increased market participation and financialization of savings, the quantum of it when studied in retrospect with past market cycles warrants attention.

Exhibit 9: Sharp uptick in Small/Mid cap fund flows in contrast to Large Cap funds Net Monthly MF Inflow is still below H1CY22 peak



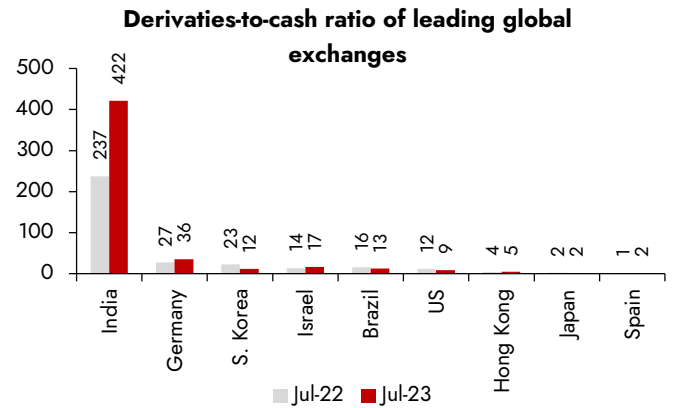
Source: Ambit Asset Management, AMFI Data

Exhibit 10: SME IPOs are crossing earlier peak in terms of no. and size of issues



Source: Ambit Asset Management, chittorgarh.com, Note: NSE and BSE SME IPOs

Exhibit 11: Increased F&O participation + new contract addition = increased speculation ratio on



Source: Ambit Asset Management, I-Sec Research, WFE, Note: Data o exchange(s) across these countries

3. PSUs, Cap goods and Manufacturing industries have seen the sharpest run-up – absolute and relative – Among the top performers in BSE-500 index constituents, the majority have been in the Cap Goods, Manufacturing, or PSU / Defense theme which has caught on to the investor frenzy. Defense, Make-in-India, and pre-election spending by the government have led to buoyant order flows in the construction/engineering space.

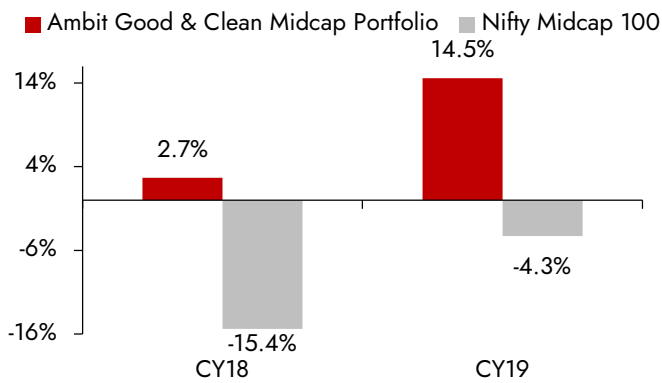
Exhibit 12: BSE-500 top performers from the lows of 28th March – Infra/Construction/Manufacturing stands out

Company	Industry	Mcap (Rs mn)	% Change* from 28th Mar Low
Mazagon Dock Shipbuilders	Ship Building	458,068	259%
Suzlon Energy	Electric Equipment	327,385	241%
IRFC	Finance Term Lending (PSU)	1,107,556	232%
Ircon International	Engineering - Construction	150,577	202%
Cochin Shipyard	Ship Building	158,046	188%
Rail Vikas Nigam	Engineering - Construction	395,111	186%
SJVN	Power Generation/Distribution	301,808	149%
Mishra Dhatu Nigam	Steel & Iron Products	81,165	148%
MMTC	Trading	97,335	144%
JBM Auto	Auto Ancillary	177,690	139%
REC	Finance Term Lending (PSU)	711,234	137%
Kalyan Jewellers India	Diamond & Jewellery	254,732	131%
Adani Power	Power Generation/Distribution	1,536,990	129%
Engineers India	Engineering	90,742	127%
Apar Industries	Electric Equipment	192,283	120%
Cholamandalam Financial Holdings	Finance - Investment	206,330	111%
PFC	Finance Term Lending	808,393	109%
Welspun Corp	Steel & Iron Products	101,377	107%
Zensar Technologies	IT - Software	124,535	106%
Macrotech Developers	Construction - Real Estate	769,244	102%

Source: Ambit Asset Management, ACE Equity, Till 11th Sep 2023

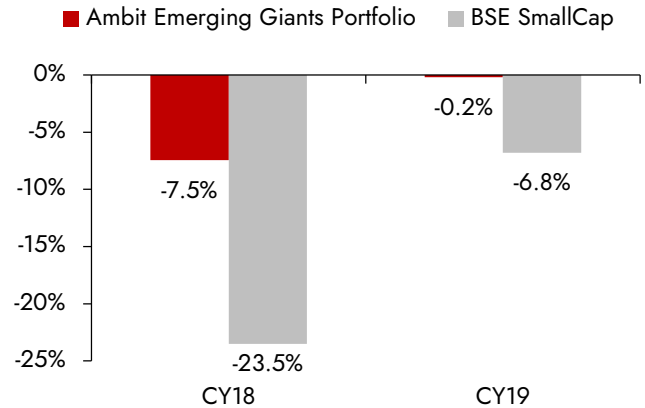
4. Quality is paramount! – What should we as investors do in such a scenario? This is a question we often get asked. We would like to emphasize the importance of sticking with companies with strong ‘Earnings’ potential (**Refer Exhibit: 15**) AND ‘Quality’ (Corporate governance, Capital allocation, low Debt). This is the core to our ‘Good & Clean’ approach to portfolio construction, especially for Mid / Small Caps. While such a strategy might underperform periodically during times of extreme optimism (Euphoria), it has consistently helped protect downside during tough periods (**Refer Exhibit: 13, 14**). Thus, over a longer term, the point-to-point returns out-perform the index by a fair margin.

Exhibit 13: Our Midcap portfolio performed well during sharp market correction...



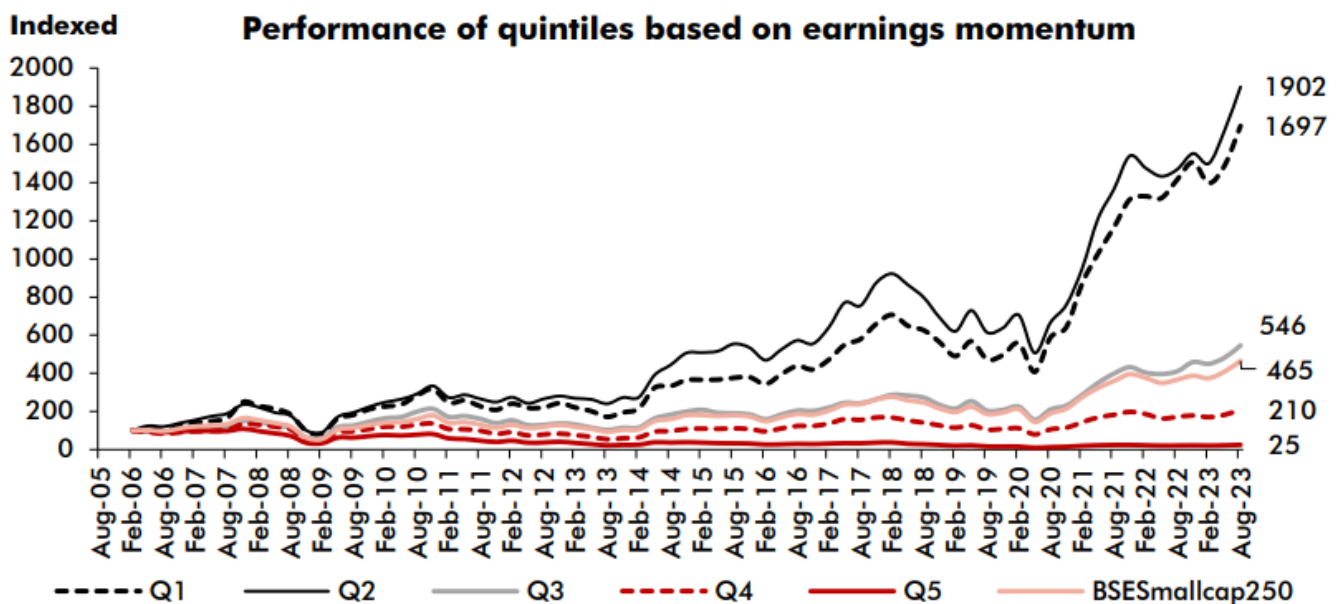
Source: Ambit Asset Management, Note: *BSE 500 TRI is the selected benchmark for the Ambit Good & Clean Midcap. The same is reported to SEBI. Nifty Midcap100 was the benchmark in CY18 and CY19

Exhibit 14: ... similar to our Small-Cap Portfolio



Source: Ambit Asset Management, Note: *BSE 500 TRI is the selected benchmark for Ambit Emerging Giants. The same is reported to SEBI. Nifty BSE Small Cap Index was the benchmark in CY18 and CY19

Exhibit 15: It is ‘Earnings’ which is the eventual ‘fuel’ to stock price movement, as can be seen over the longer duration in SmallCap Index, companies with the strongest earnings momentum have outperformed the most



Source: Bloomberg, Ambit Capital research

Conclusion

While the recent market rally may have come as a huge relief for the investors after an 18-month-long sideways movement, there are enough reasons to believe that caution is warranted and that it may well be foolhardy to believe that the current rally will not witness a pullback. Insiders such as promoters or strategic investors are the ones who know the most about a specific business. We see them buy when prices are depressed and sell when the overvaluation kicks in to realize some gains. The bunch-up of these in the past few months in addition to the increased small/micro-cap run-up warrants attention. We remain confident about the India story in the medium to long term and believe we are on track to touch the \$10tn mark over the next decade. We continue to emphasize our philosophy of 'Good & Clean' especially in Small/Mid-Caps with focus on 'Earnings' growth and 'Quality' management. We feel that short-term volatility may persist as we head into elections. Over the long run, however, we expect the markets to be fundamentally driven.

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