ROHA ASSET MANAGERS
GROWTH THAT BUILDS TRUST

EQUITY INVESTMENT STRATEGY

"Volatile market environment should be treated as an opportunity for investors."

Equity market volatility over the last few months has got exaggerated by weak global noise such as inflation scare, much rumoured US recession, Europe energy crisis and extreme volatility in currency markets. The turmoil in Europe will continue, driven primarily by uncertainty on energy issues while the US may not outperform the way it did in the past decade. Chinese economy is expected to grow at just over 3% this year as per recent IMF forecasts, due to its zero covid policy and crack-down on excessive real estate lending.

However, when we look at India, we continue to believe that domestic growth should withstand global concerns and markets will brace this volatility or weak sentiments and eventually climb wall of worries despite currency depreciation. And there are plenty of reasons to briefly highlight as under-

- **Broad-based earnings recovery.** This will be led by private banks or financials, industrials & capital goods and autos. Real Estate cycle also remains robust with reducing unsold inventory levels, which is reflected in strong pre-sales and better cash flows. There is no material impact of rate hike on demand for home loans. Even in the first five months of current fiscal, home loan outstanding of banks has registered double digit growth rate, despite the RBI raising interest rates.

- **Consumption demand has exceeded even pre-covid levels and one of the best in many years.** Segments like Travel, hotels, restaurants are witnessing brisk business activity. Consumption demand in branded apparel, appliances or white goods, footwear, jewellery sales are all witnessing massive recovery at the retail level. E-commerce firms alone have estimated to garner sales worth $12 bn during the 9 day Navratri festive season that just got concluded. Autos - whether electric 2 wheeler, cars, commercial vehicles or tractors sales are all showing strong momentum.
Barring cement and consumer staples where margins can hit a bottom in 2Q or the metals sector, most other sectors should report good earnings growth.

• **Inflation appears to be peaking out with broad softening of commodity prices,** though Europe led crisis is still creating some near term shortage on energy-intensive commodity chemicals. Average prices of metals like Aluminium, copper, steel, pvc and rubber prices have declined by anywhere 11% to 25% though oil & gas and coal have sustained rising trend due to geopolitical issue.

• **Gross collection of direct taxes** for FY23 so far in the current fiscal (till about 1st week of October) grew by almost 24% to about Rs 9 lac cr, which is 52% of the budget estimates for the full year of tax collection target. **Also, GST collection shows no major let up in demand and consumption.**

• **Banks are reflecting an uptick in loans and advances with lower NPA's.** There is increased momentum of new credit disbursements from both banks and NBFCs.

• **Corporate capex** outlook is looking up after many years driven by with increased localisation trends. Earnings of capital goods companies are at cyclical lows and can improve significantly as there are all indications of higher order backlogs. Capex cycle is picking up driven by renewables, automation and PLI schemes. Even Govt's capex is accelerating **in large infra projects including defence and railway sectors with thrust** towards indigenisation of procurement and modernisation efforts.

›› *2Q results preview*

We expect net income of automobiles (led by improvement in chip availability), banks (should see strong loan growth, NIM expansion and a sharp decline in loan-loss provisions) and diversified financials accelerating loan growth to increase sharply. Weak earnings are expected from cement (high fuel and power costs), metals & mining (lower commodity prices, weak realization) and oil, gas & consumable fuels (from weak refining margins and large inventory/marketing losses in case of downstream oil Companies). IT services is likely to have modest constant currency revenue growth besides margin headwinds.

›› *Our Portfolio strategy*

We remain positive on Indian manufacturing companies with cost competence and driven by import substitution, shift from unorganised to organised or green energy led growth. Additionally, we like engineering & **capital goods** (capex recovery), **banks/financial services** (worst of asset quality issues behind) and real estate plays (legacy land monetisation/building products). **Cement and select mid cap technology,** despite near term cost pressures look attractive post correction given longer run-way to growth. **Select consumer companies in retail, travel & hospitality** will benefit from post covid opening of economy. Besides, we continue to like **specialty chemicals** due to china + 1 shift and sustainable growth outlook including certain energy intensive **commodity chemicals** that will benefit from Europe-led energy crisis. Some of these segments are witnessing stronger product prices that should get reflected in earnings.

›› Brief view on sectors we have invested are as under -

• **Capital Goods -** will be driven by capex cycle recovery. There is **healthy enquiry pipeline and broad-based capex recovery across the sectors** such as Railways, metros, cement, power (waste heat recovery and waste to energy), mining, sugar and ethanol, water treatment, chemicals, including EVs and data centers etc. We expect the execution of all EPC and capital goods companies to improve on a strong order book. We expect margin to start getting the benefit from the recent moderation in commodity prices while the full impact will be visible from 2HFY23. Defence PSUs are doing extremely well and there is long run way to growth due to reducing import content with restricted list by Indian govt and more localisation efforts.

• **Infrastructure -** Within EPC players, we are selective and prefer those who have better cash flows, lower WC cycles and execution capability.

• **Banks and Financials -** worst of asset quality issues are behind. Banks are reflecting an uptick in loans and advances with lower NPA's. There is increased momentum of new credit disbursements from both banks and NBFCs in auto, home, sme or micro finance. Higher lending rates are seen as providing a cushion for bank margins with higher interest rates passed on almost immediately. This may help revive economic and business growth. 2q earnings of banking sector can grow by close to 23 to 30% with improvement in asset quality, which is a healthy performance. As a choice, we are quite positive on **housing finance companies** on the back of **strong real estate demand, low interest rates and better asset quality.** We expect NBFCs to report strong performance, reflected by accelerating loan. Overall valuations in the sector are in favour.

• **Building products** as real estate cycle is coming back after multi year lows, largely contributed by lucrative interest rates of close to 7-7.5%. When real estate sector revives, it creates multiplier effect on the economy - be it **cement, steel, pipes and other building products** including employment. We are positive on residential demand while commercial space is also gradually coming back. Importantly, this is one sector where we are witnessing the biggest shift in demand from un-organised local builders to A grade developers.

• **Specialty chemicals** is another area we have invested given continued business shift from China due to pollution control norms or expected China+1 strategy to have India as an alternate supply source. Huge amount of capex is happening in this space which is an indicator of growth prospects in this segment. Importantly, new projects appear to favor either backward integration or import substitution or new molecules with export opportunities.

Certain commodity chemicals too are witnessing abnormal margins due to energy crisis in Europe. However, specialty chemicals in niche products and applications in pharma / agro including niche applications are the ones we prefer given their better character of being less volatile with sustainable growth. **In case of agro-chemicals, exports/international sales are likely to continue to grow faster, befitting from elevated crop prices and increased outsourcing.**

• **Consumption -** Segments like travel, hotels, restaurants, branded apparel, appliances or white goods, autos, footwear, jewellery sales are all witnessing massive recovery at the retail level. We have taken selective exposure in a few companies that will benefit from such a strong business revival.

• **Cement -** there are cost pressures on power & fuel and **margins in 2Q are likely to hit a bottom** for cement sector in general. July & August are normally the weakest months. Volume & price has declined & fuel cost is higher than in Q1. However, in the 2nd half, we expect there should be up-cycle in cement demand on improving volume and pricing, driven **by rural housing and govt. infra projects.** There is expected acceleration of construction of affordable housing across grameen and urban areas.

• **Technology -** IT sector currently faces are of attrition and higher salary costs. Besides deal wins are likely to be muted in 2Q given global backdrop. We are looking at few mid cap companies post correction as valuations have turned attractive.

• **Textile** will be impacted by high cotton prices and weak exports demand in 2Q. In the entire value chain, apparels and garments players are better placed due to pricing power or ability to pass on higher costs.

›› What we are avoiding to invest?

Metals - we are cautious on metals cycle now. Commodity prices have corrected for ferros and non ferros metals. Global stimulus, weaker dollar including China's import of industrial commodities supported metals prices in the past. These factors of support are now reversing. Overall risk reward may not be favourable. In 2Q results, there will be an average decline in steel realization of Rs12,000-13,000/ton qoq, led by price cuts in the domestic markets and export duty; EBITDA/ton for large steel companies will decline by 30-40% to Rs5,500/ton on average. NBase metal companies in 2QFY23 should be severely impacted by weak commodity prices. Zinc / Aluminum / Alumina prices corrected by anywhere 10% to 18% qoq in 2QFY23 in US$ terms. So profitability can be severely impacted.

Oil & Gas - Profitability for upstream companies will be impacted due to lower crude realization and windfall tax of nearly US$28/bbl imposed on upstream companies from July 1, 2022. Volumes will remain muted. Downstream PSU Oil companies will also suffer due to continued losses on auto fuel and LPG, sharply reduced refining margins and large inventory losses in both refining and marketing businesses. There will be marginal gains of export tax during the quarter. However, we are avoiding the sector being largely regulated.

Pharmaceuticals - we are cautious on investing in pharma companies given raw material cost pressures coupled with rising freight costs. There is still US generic price erosion and some negative impact will be felt on account of EU/EM currency depreciation. In the US, there have not been any meaningful new launches in 2QFY23 for companies.

New age digital companies - while they are disruptive companies, many are still in cash burn stage and valuations despite correction are ahead of time and offer little margin of safety. It is possible that some of disruptive businesses can themselves get disrupted and only a few will survive or make it big. This along with higher valuations will continue to lead to capital losses and hence our cautious stance.

High macro and global concerns only act as a distraction to own individual companies on their respective business merit. One need not succumb to such a fearful noisy environment and focus on long term investing. It is good that we are currently passing though weak sentiments, largely driven by global issues, which means that prospective returns in Indian markets are going to be much better. Strategy is to stay invested in good Indian businesses and ride the global storm.

HAPPY INVESTING,

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