VANTAGEPOINT

Our Focus Makes All The Difference

Dear Investor,

The much-awaited reporting of corporate earnings for Q1 FY21 is largely over.

On the whole, the resilience of many banks and other financial services businesses has surprised the market.

This is reflected in the way the stock prices have bounced back from the March 23rd lows.

Table 1, given alongside, lists the gains experienced by a few of our companies in our flagship portfolio.

It is clear from this list that the market has still been quite cautious and discerning towards the prospects of various businesses as many stocks are way below their pre-pandemic highs and therein lies the opportunity for investors, albeit on a very selective basis.

Table 1: Bounceback from post-pandemic bottom (23 Mar – 14 Aug '20)& Drawdown from pre-pandemic high (20 Feb – 14 Aug '20)

Security	Bounceback	Drawdown
Muthoot Finance	139%	33%
ICICI Securities	112%	-6%
HDFC Life Insurance	72%	2%
ICICI Lombard General Insurance	59%	-3%
Bajaj Finance	47%	-32%
Axis Bank	41%	-41%
HDFC Bank	34%	-15%
Aavas Financiers	33%	-29%
ICICI Bank	27%	-34%
AU Small Finance Bank	21%	-40%
Kotak Mahindra Bank	19%	-22%
HDFC Asset Management	11%	-31%

Source: Trivantage Capital Research

Stock selection is more important than ever in the present circumstances.

The impact on various businesses can be categorised as under:

Category 1: Gold Financiers, Brokerages & Insurers

Market is extremely optimistic on:

- **Gold financiers** reflecting the way Gold prices have moved up to a life time high
- **Brokerages** due to an extraordinary rise in trading volumes
- **Insurers**due to the post-pandemic rush towards Life and Health insurance protection covers.

Category 2: Strongly Capitalised Lenders

- Market is moderately optimistic on certain strongly capitalised lenders that have the benefit of a granular deposit franchise and comfortable provision coverage.
- The stock prices, however, reflect the continued concerns on the assessment of "loss given default" after the moratorium period ends on August 31st.

Category 3: Thinly Capitalised Lenders

- Market is pessimistic on thinly capitalised lenders that also do not have the ability to raise equity capital even in an environment that is surplus on liquidity.
- This list includes some of the smaller private sector banks and NBFCs and the State-Owned Banks.

A few interesting highlights of the earnings season are as under:

1. Moratorium outcomes have progressed well from Morat 1.0 to Morat 2.0

Table 2 indicates how the five leading private sector banks in our flagship portfolio have managed to reduce the loans under moratorium quite significantly.

Table 2: Significant reduction in loans under moratorium by leading private banks

	Moratorium 1.0 % of Loans	**Moratorium 2.0** % of Loans	**Provisions** as % of Moratorium Book
ICICI Bank	~30%	18%	8.8%
Kotak Mahindra Bank	~26%	9.7%	6.4%
Axis Bank	25% - 28%	9.7%	12.7%
HDFC Bank	NA	9%	7.8%
AU Small Finance Bank	~25%	11%	9.6%

Source: Motilal Oswal

There are several reasons for this:

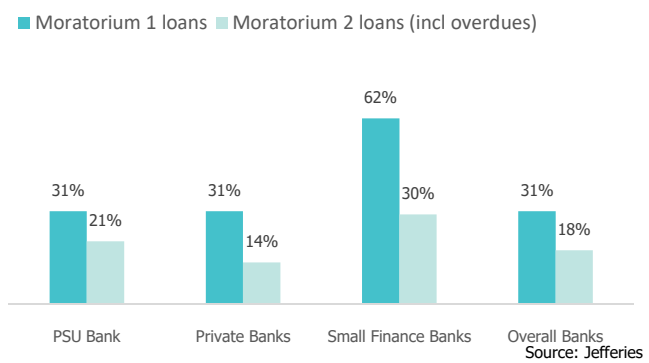
As the economy started opening up, the confidence of many borrowers increased and they decided to let go of the extra cushion that the moratorium provided.

Banks became much tougher in the way they granted Morat 2.0 to mainly such borrowers where availing the facility would enhance the viability of their business activity.

Many Banks that had an "Opt-Out" facility in Morat 1.0 shifted to "Opt-In" to have better control on who should be given the benefit.

Table 3 shows how banks in all formats lowered the Moratorium proportions quite significantly. However, Morat 2.0 levels are the lowest for the private sector universal banks and the highest for small finance banks.

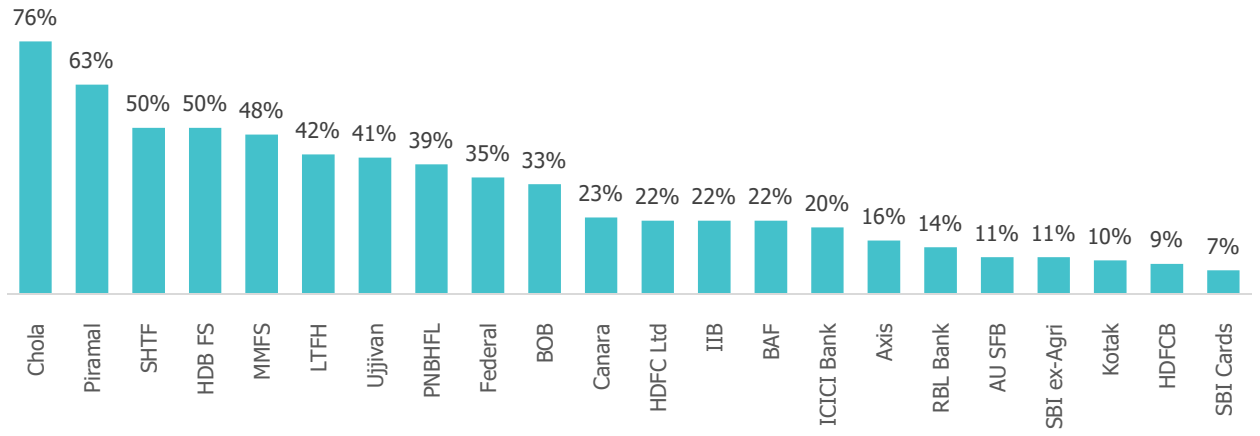
Table 3: Banks in all formats have significantly lowered the Moratorium proportions



Source: Jefferies

Table 4 lists a range of Morat 2.0 levels for various financial sector businesses. Vehicle financiers have understandably got the highest impact as their borrowers have been severely impacted due to a strict lockdown whereas the leading private sector universal banks have been least impacted due to a well-diversified portfolio.

Table 4: Moratorium levels across various financial sector businesses



Source: Jefferies

2. Capital positions have strengthened for our leading companies in our flagship portfolio

Table 5: Equity Capital Raised from FY19 to FY21

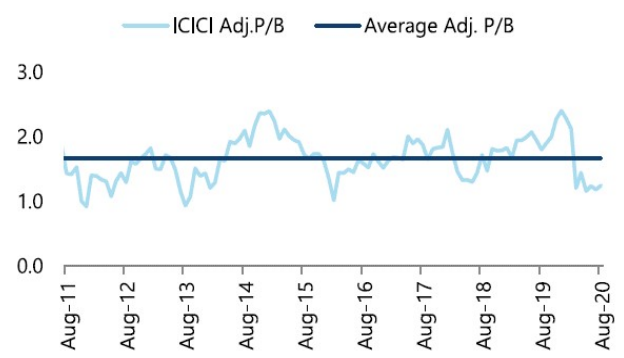
	Minimum CET1 %*	Equity Raised (INR crs)			CET 1% (June 30 '20)	Equity raised Q2 FY21 (INR crs)	CET 1% (post raise in Q2FY21#)
		FY2019	FY2020	Q1 FY21			
Axis Bank	8.0%		2,433		13.5%	10,000	15.1%
ICICI Bank	8.2%				13.3%	15,000	15.0%
Kotak Bank	8.0%			7,443	21.1%		21.1%
HDFC Bank	8.2%	23,716			16.7%		16.7%
Bajaj Finance	10.0%		8,500		22.6%		22.6%

*Required as on March 31, 2021.For Bajaj Finance, figures represent Tier 1% and NOT CET1%. # Based on Trivantage Capital calculations.

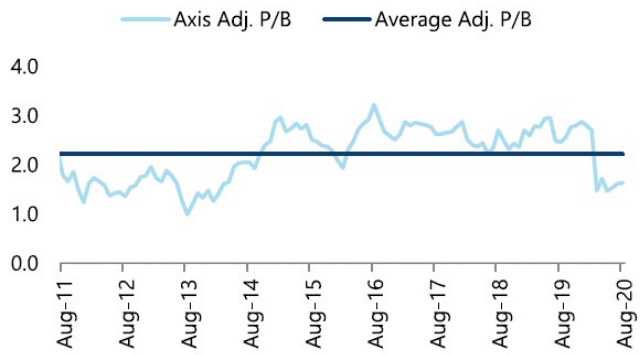
3. Valuations of many stocks are at Multi-year lows

Table 6: Sharp Market Correction has made valuations attractive

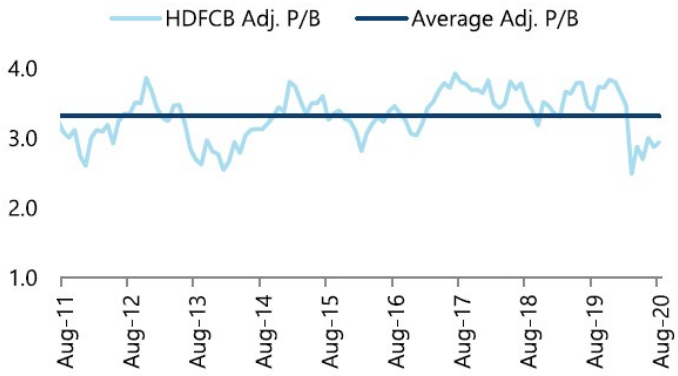
ICICI is trading at +25% discount to its 5-year Price /Adjusted Book Value



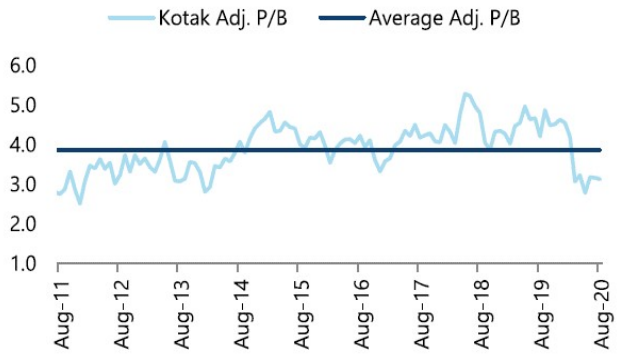
Axis is trading at 35% discount to its 5-year average Price/Adjusted Book Value



HDFCB trades at 14% discount to 5-year average Price /Adjusted Book Value



Kotak Bank trades at 25% discount to 5 year averagePrice /Adjusted Book Value



Source: Jefferies

It is extremely positive that RBI did not extend the moratorium beyond August 31st and allowed for restructuring with upfront provisioning.

Table 7: A Well-Diversified Portfolio

Sector	%
Private Sector Universal Banks	45%
Life Insurers	12%
Consumer Finance	12%
Housing Finance	6%
General Insurers	6%
Asset & Wealth	6%
Small Finance Banks	4%
Microfinance	3%
Gold Finance	3%
Credit Rating Agency	1%
Cash & Equivalent	2%
TOTAL	**100%**

All loans presently under moratorium will be <90 day past due as on September 1 2020. Therefore, for the complete assessment of the delinquencies in this book, we have to roll-forward up to 90 days from September 1, 2020. Hence, the Q3 FY21 results in January will point out to the trajectory of "Normalisation of earnings" to the FY20 levels.We believe that FY22 will surprise the street with a very strong bounce back in economic activity and thus, the earnings profile of lenders. Within these lenders, the ones with strongest capital positions, granular deposit franchise, high provision coverage ratios and strong & stable leadership teams will benefit the most. Kotak Bank and ICICI Bank also present a nice diversification of revenues via their rapidly growing financial services subsidiaries and this is also a factor in these two stocks being our top positions in the flagship portfolio.

We have seen how lenders exposed to the "bottom of the pyramid" have faced the highest levels of moratoriums. However, our choice of lenders in this category make for some interesting exceptions. Aavas is a housing finance business that is quite well placed in this regard as many borrowers live in the house they have borrowed against and have also put in significant capital in the house. History suggests that self-occupied homes is one of the safest categories of loans for lenders. AU is the only small finance bank in our flagship portfolio but unlike others, this bank primarily lends secured loans. Credit Access Grameen's borrowers are mainly in the "essential services" segment in rural India which is far better placed in this pandemic. Muthoot has received no moratorium requests from its borrowers making it one of its kind. Also, rising gold prices have offered enviable protection to the company.

Our flagship portfolio offers the necessary diversification within India's financial sector. Insurers, asset managers, brokerages and rating agencies are not meaningfully correlated with lenders and hence help reduce the portfolio volatility. The "bar-bell" portfolio construction provides a nice balance between the "economy re-opening" beneficiaries such as lenders and "work from home" beneficiaries such as insurers, brokerages etc.

The flagship portfolio has bounced back by nearly 40% from the March 23rdlows and yet, as Table 1 suggests, there continues to be a significant drawdown from the pre-pandemic highs of February 20th. The market environment continues to be positive with extraordinary liquidity, low-interest rates, re-opening of the economy as evidenced by several high-frequency indicators, US Dollar weakening against other currencies (positive for emerging markets) etc. However, the most important milestone would be the approval of a credible vaccine / anti-viral drug by early 2021. A healthcare solution will firmly put the re-rating of the markets in motion. We need to navigate carefully until then.

Best wishes for your safety.

Warm Regards

Nikhil Johri
Founder & Chief Investment Officer