March 2022

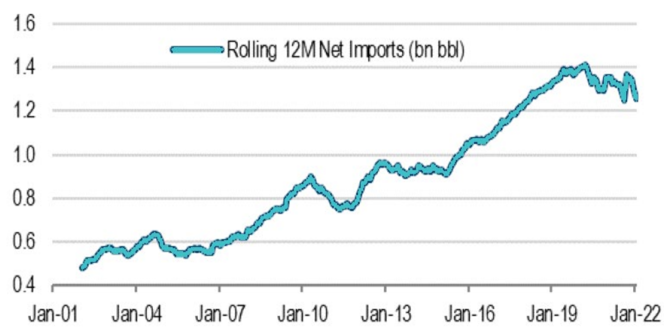
TRIVANTAGE CAPITAL

Dear Investor,

The Russia – Ukraine conflict has changed the economic outlook for India and the rest of the world for this year at the least. Therefore, it is important to balance the commodities-led inflationary headwinds with the steadily improving franchise strengths of our portfolio companies. The Q3 FY22 earnings season that recently concluded highlighted the resilience of leading banks, NBFCs, HFCs in the BFSI universe of listed businesses.

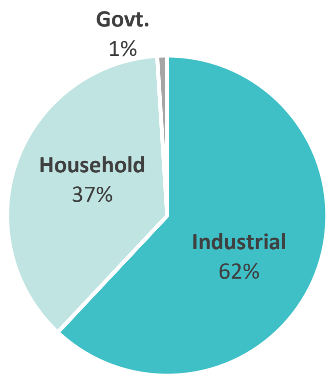
India at present imports 45% of its energy needs which on a rolling 12-month basis was about 1.25 billion barrels (Exhibit 1). At the Brent crude price of USD 120 per bl, the additional import bill would be about USD 60 bn. This steep increase in the price will offset households' consumption of other discretionary spending and would thus lower the GDP growth rates.

Exhibit 1: India's rolling 12M net imports was 1.25bn barrel; 1.4bn pre-Covid



Source: Credit Suisse, March 2022

Exhibit 2: India's oil consumption split by volume



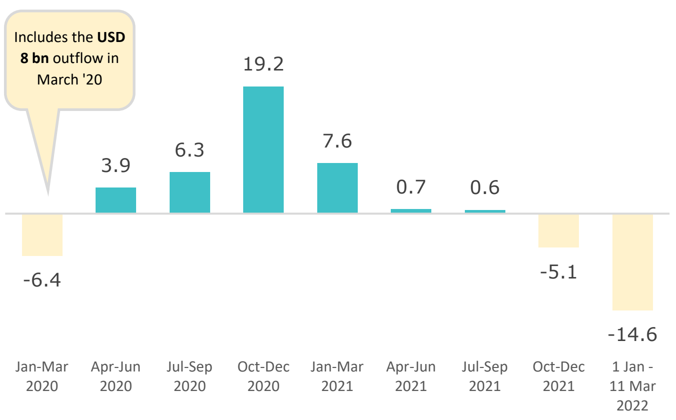
Source: Credit Suisse, March 2022

The households in India at present account for 37% of crude oil consumption by volume (Exhibit 2). There is also an inflationary impact of the conflict on many other commodities such as palm oil, wheat and crude derivatives which would lead to price increases in various essential consumption items. Consequently, all this is going to result in higher inflation.

RBI in their February policy has estimated the real GDP to grow at 7.8% and the CPI to be at 4.5% in FY23.

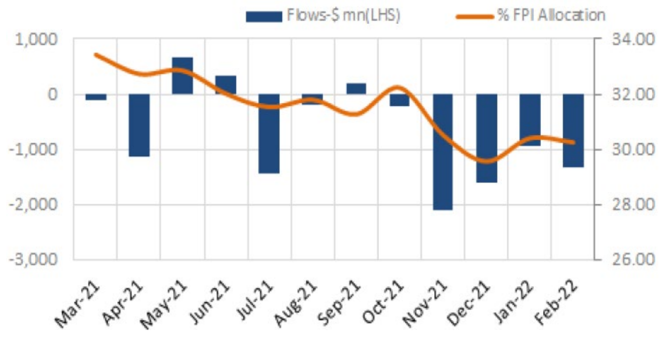
These estimates will need to be revised with a downside bias to GDP and an upside bias to CPI. The nominal GDP growth rates for FY23 are likely to remain over 10% which could peg the credit growth rates for a few leading lenders at around 15% as these lenders are well poised to win market shares due to their superior liability franchise and capital positions. Due to the weak capital market conditions, modest lending franchises will not find it easy to raise equity capital and will have to compromise on growing their lending books.

Exhibit 3: Monthly FII Net Investments (Equities) in USD bn



Source: NSDL

Exhibit 4: FPI sector allocation and flows trend: BFSI Stocks



Source: IIFL Securities, March 2022

The relentless FII selling is exhibited in Exhibit 3 which puts the Q1 CY22 till date figure of USD -14 bn as the highest net outflow in any quarter including Q1 CY20 which was massively impacted due to the outbreak of the Covid pandemic.

Exhibit 4 shows how a big part of these outflows was from the BFSI stocks which have seen the outflows between approx. USD 1 bn to USD 2 bn per month for the past four months.

Q3 FY22 results show the continued growth in credit and deposit market shares for the leading private sector banks. Exhibits 5 & 6 show how the top 4 private sector banks have grown their credit and deposit books between 15 to 20% YoY as compared to the industry average of between 11 to 12%. The industry-leading growth in both these metrics came from AU Small Finance Bank at a staggering 33% and 49% respectively.

Exhibit 5: Trend in loan growth (YoY) - Broad-based improvement witnessed

	3Q FY21	4Q FY21	1Q FY22	2Q FY22	3Q FY22
AU Small Finance Bank	14.0	28.2	29.4	31.6	32.6
Kotak Mahindra Bank	-1.2	1.8	6.6	14.7	18.1
Axis Bank	3.6	7.5	9.5	10.1	16.7
HDFC Bank	15.6	14	14.4	15.5	16.5
ICICI Bank	10.0	13.7	17	17.2	16.4
IndusInd Bank	-0.1	2.8	6.4	9.7	10.4
SBI	7.6	5.3	5.8	6.5	8.9
Bank of Baroda	6.8	2.3	-2.7	3.6	4.8
Total	**8.0**	**7.5**	**8.0**	**9.8**	**11.8**

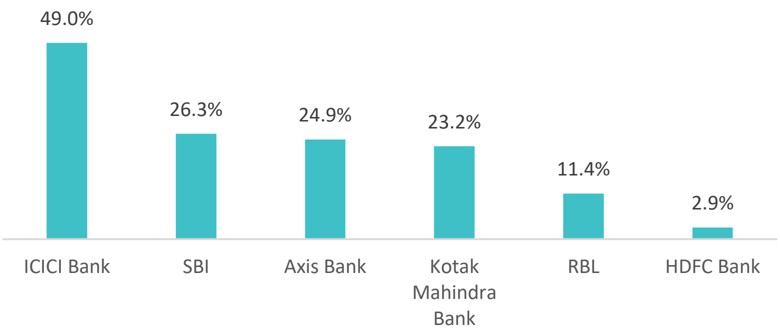
Source: IIFL Securities, March 2022

Exhibit 6: Trend in deposit growth (YoY) – Deposit growth has remained healthy

	3Q FY21	4Q FY21	1Q FY22	2Q FY22	3Q FY22
AU Small Finance Bank	24.5	37.5	38.5	44.7	49.0
Axis Bank	8.4	9.0	13.6	18.1	20.3
IndusInd Bank	10.3	26.7	26.5	20.8	19.0
ICICI Bank	22.1	21.0	15.5	17.3	16.4
Kotak Mahindra Bank	10.8	6.6	9.6	11.5	15.1
HDFC Bank	19.1	16.3	13.2	14.4	13.8
SBI	13.6	13.6	8.8	9.8	8.8
Bank of Baroda	6.5	2.2	-0.3	0.5	2.5
Total	**13.8**	**13.2**	**10.3**	**11.5**	**11.3**

Source: IIFL Securities, March 2022

Exhibit 7: Credit card spend per month - YoY Growth (%) (Jan 2022)



Source: IIFL Securities, March 2022

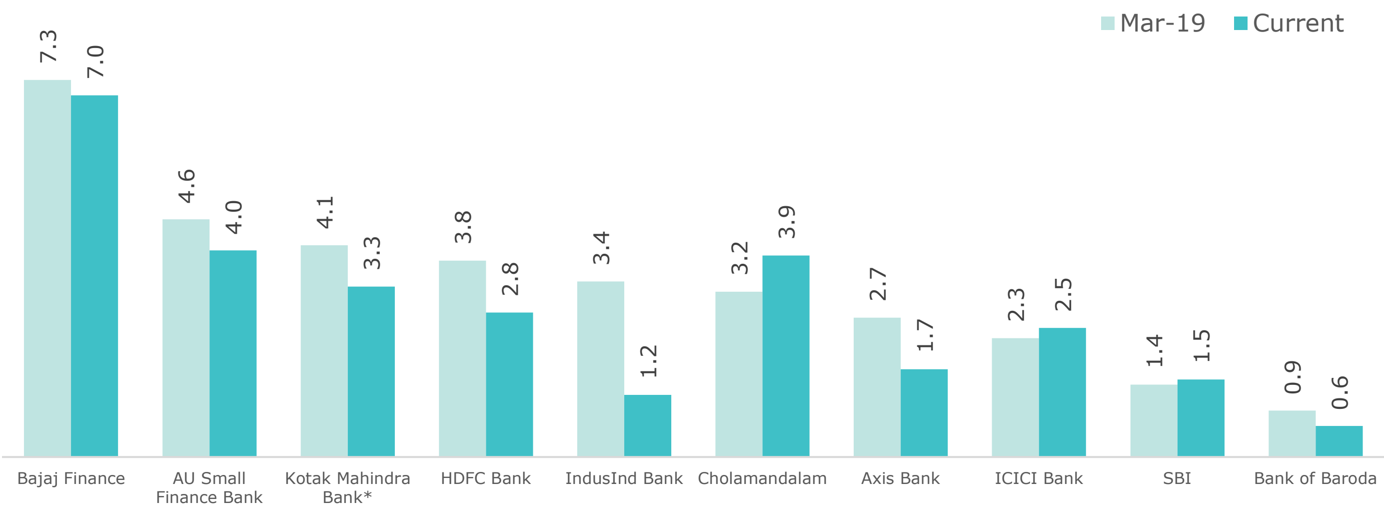
It is encouraging to see the credit growth trends continue in Jan '22.

Exhibit 7 highlights the growth in credit card spends at an industry-leading figure of around 50% p.a. for ICICI Bank (after an impressive 32% p.a. in Q3 FY22) and around 25% each for SBI, Axis and Kotak Mahindra Banks.

Due to certain bank-specific circumstances, HDFC Bank showed flat growth in the month on a YoY basis. This data confirms the continuing market share gains for some of the leading private sector banks and SBI.

Post the Russian – Ukraine conflict, the valuations of many of the BFSI stocks have corrected without much of a perceived impact on their fundamentals. As discussed earlier, the FIIs have been the main sellers in such stocks as these are the ones they owned the most. There is, of course, an argument that the prolonged conflict will lower the GDP growth rate expectations in the world economy and in particular countries such as India that will need to spend much more on oil and other commodity imports and will thus have less to invest in infrastructure growth.

Exhibit 8: Valuations of many BFSI stocks have moderated (12-month forward P/B multiple (X))

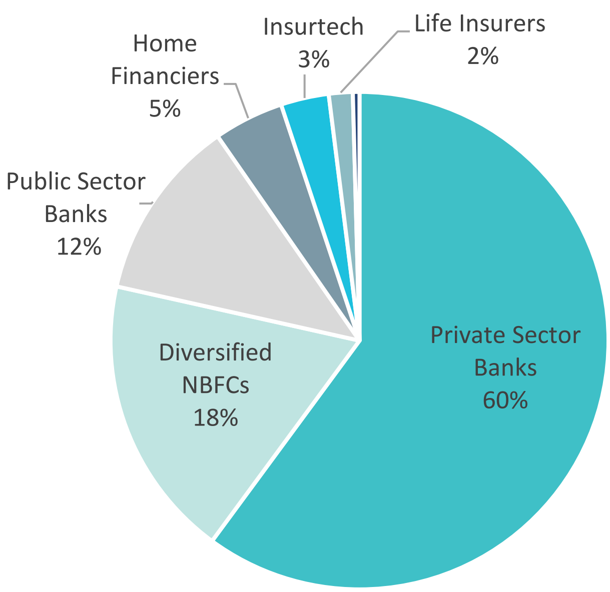


Source: Kotak Institutional Equities estimates, March 2022. *Source: Trivantage Capital Research

A lower GDP growth will impact the credit growth outlook of the banking sector. However, as we have pointed out earlier, certain market-leading lending franchises are well poised to win market shares due to their relative strengths. Even though the macro factors are important it is equally or more important to evaluate the stock-specific factors.

Exhibit 8 shows how for certain lenders the valuations when compared to the pre-pandemic levels of March 2019 have moderated with the exception of Cholamandalam, ICICI Bank and SBI.

Exhibit 9: Trivantage Capital Resurgent Financials Equity Strategy
A Well-Diversified Portfolio



As on 13 March 2022

We have made certain changes in our portfolio in the past quarter to reflect all the factors discussed above.

Exhibit 9 shows the latest portfolio composition. The portfolio is dominated by some of the strongest lenders and within them some private sector banks in particular.

NBFCs and HFCs are represented by stocks that have a good upside/downside tradeoff in our opinion.

We have a representative each from both life insurance and insurtech categories to add to the portfolio diversification.

Overall, given the uncertainty prevailing in the markets, we believe our portfolio will be resilient and yet well poised to take advantage of a sudden surge in the markets due to an optimistic outcome.

We do not expect any significant deterioration in the franchise strength of our portfolio companies and believe that a sharp drop in valuations will make them more attractive from a 3 to 5-year horizon point of view.

We wish you and your families the best of health and happiness.

Yours Sincerely,

Nikhil Johri
Founder & Chief Investment Officer