VANTAGEPOINT

Our Focus Makes All The Difference

Dear Investor,

Q1 FY24 earnings for our portfolio companies was largely in line with our expectations. Lenders in all formats such as Banks, NBFCs, HFCs and MFIs reported robust credit growth. On an aggregate basis, the system loan growth for banks was 16% YoY and 4% QoQ. As expected, the Net Interest Margins (NIMs) were flat to down on the back of an increase in funding costs. Term Deposits witnessed sharp growth this quarter.

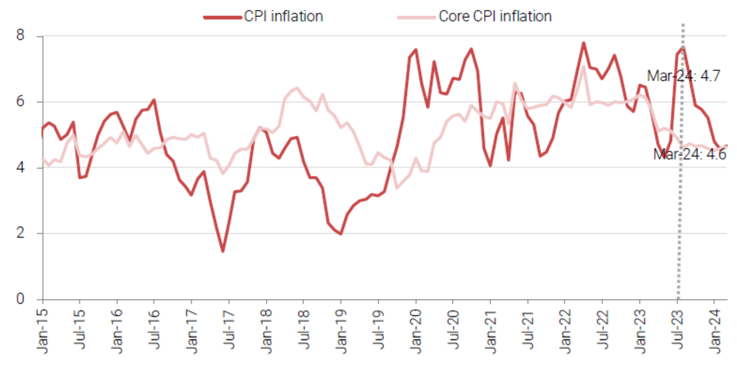
Asset quality metrics remained in the comfort zone though a marginal increase in delinquency was seen in small-ticket unsecured loans.

The recent inflation prints are showing stickiness in food inflation and therefore, headline CPI inflation. Thankfully, the core CPI inflation numbers have moderated.

Exhibit 1 highlights the divergence between these two data points.

The sticky inflation is likely to keep the funding costs elevated for banks and non-banks for a few more quarters. But, as the headline inflation starts moderating, we will see a reduction in both bond yields and the cost of deposits.

Exhibit 1: Headline and core CPI inflation (%)

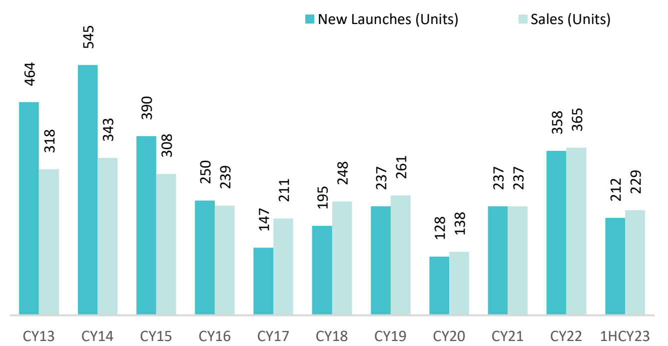


Source: Kotak Institutional Equities, August 2023

In this note, we will highlight certain interesting themes that we have noticed recently.

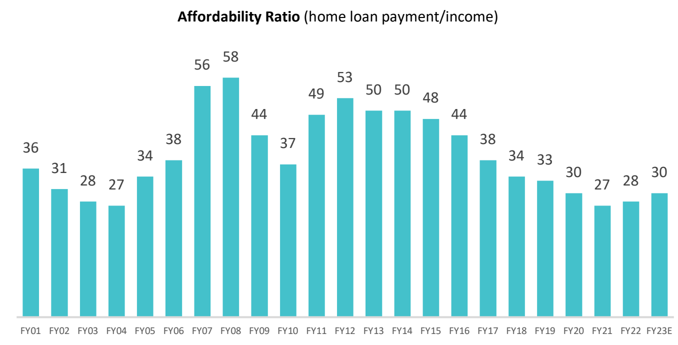
1. Exhibits 2 and 3 show that 2023 is likely to witness the highest-ever sales of residential units of over 400,000 units. This is because the "affordability ratio" continues to be quite attractive due to the rise in incomes despite increases in property prices and interest rates.

Exhibit 2: Residential sales is likely to surpass all-time record of over 400,000 units in CY23



Source: ANAROCK, August 2023

Exhibit 3: The affordability ratio is still the best ever in about last two decades despite increases in prices and interest rates



Source: ANAROCK, August 2023

This augurs well for sustaining the credit growth of lending businesses since housing-related loans form a significant part of loan disbursements.

2. Exhibit 4 shows the segment-wise credit growth for ICICI Bank over the years. <u>This pattern of loan growth can be seen in many banks</u>. The data shows that banks are focussed on much faster growth in retail loans, and within retail, on the unsecured segments of personal loans and credit cards. SME & MSME loans are also growing at a fast pace.

Exhibit 4: Break-up of loan portfolio for ICICI Bank, March fiscal year-ends, 2008-23 (%)

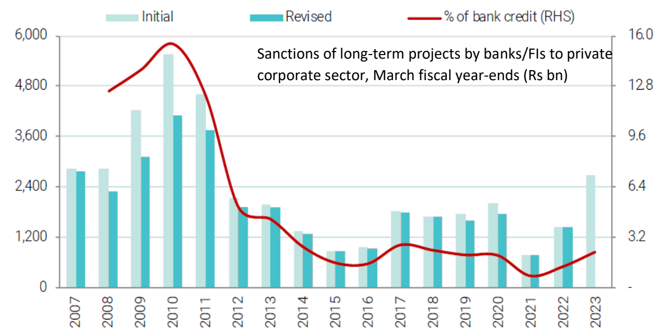
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Domestic	**(8)**	**(17)**	**19**	**14**	**18**	**15**	**18**	**16**	**14**	**16**	**18**	**13**	**16**	**17**	**21**
Retail	(18)	(25)	7	9	11	24	23	4	14	19	24	14	16	20	23
Home Loans	(12)	(18)	14	(10)	18	23	26	23	17	17	19	13	21	20	18
Personal Loans	(25)	(47)	(29)	(27)	8	48	52	43	41	47	49	46	8	27	40
Automobile Loans	(24)	(36)	1	10	22	34	22	18	14	15	8	2	15	11	24
Commercial Business	(19)	(17)	12	18	(16)	(17)	(13)	18	16	15	31	11	5	(1)	5
Credit Cards	(6)	(34)	(18)	(5)	(21)	(1)	15	33	37	28	32	29	6	45	51
Others	(61)	1	48	563	26	58	27	(72)	(61)	11	150	(34)	(20)	6	40
Rural									18	20	15	14	24	6	14
Farmer Finance									0	0	0	0	0	2	3
Jewel Loan									0	0	0	0	0	(13)	11
Rural Business Credit									0	0	0	0	0	34	26
Others									0	0	0	0	0	21	19
Business Banking	0	0	0	0	0	90	17	18	11	38	35	28	24	43	35
SME	0	0	0	0	0	0	0	0	0	0	20	(25)	33	34	19
Corporate	16	(1)	37	13	28	3	12	7	13	(9)	6	14	10	9	14
Overseas	**14**	**(17)**	**22**	**26**	**6**	**22**	**5**	**(0)**	**(20)**	**(14)**	**(2)**	**(14)**	**(30)**	**10**	**(17)**
TOTAL	**(3)**	**(17)**	**19**	**17**	**14**	**17**	**14**	**12**	**7**	**11**	**15**	**10**	**12**	**17**	**19**

Source: Kotak Institutional Equities, August 2023

We believe that this trend can continue given the modest delinquencies in retail/SME/MSME loans and the high demand for credit in this segment.

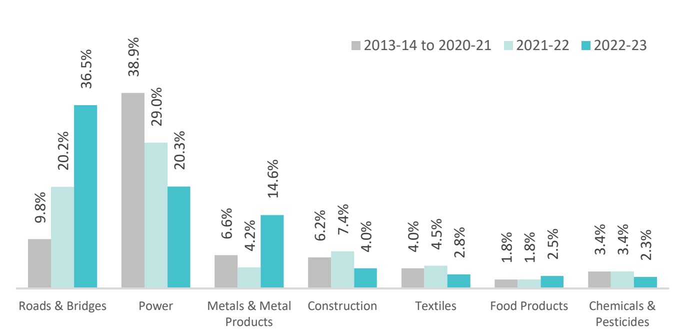
3. Exhibit 5 highlights the % of bank credit to the private corporate sector.

Exhibit 5: Fresh sanctions in FY2023 have improved to a decadal high, but still well below the peak



Source: Kotak Institutional Equities, August 2023

Exhibit 6: Share of Major Industries in Aggregate Cost of Projects Sanctioned by Banks/FIs



Source: RBI Bulletin, August 2023

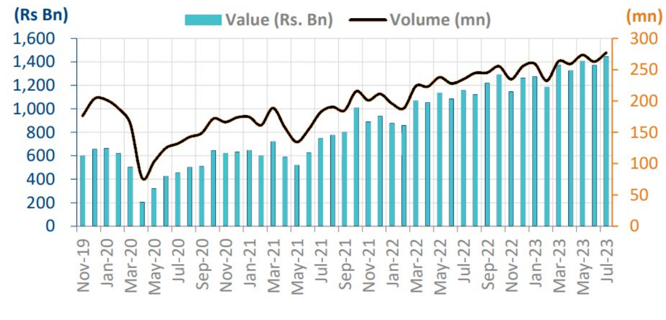
RBI's recent report on project loans by banks and financial institutions shows that fresh sanctions to the private sector rose from 1.3% of loans in FY22 to 2.2% of loans in FY23. Even though this number is at a decadal high, it is still much lower than the previous peak in 2010.

The increase in project funding was in the infrastructure areas of Roads & Bridges followed by Power and Metals & Metal Products as can be observed in Exhibit 6.

Both the Centra and the State Governments have been very focused on reviving the investment cycle and providing a conducive environment for private capex to pick up. We are confident that with improved capacity utilisation, growth in credit demand and improved business expectations, there will be a spurt in private capex.

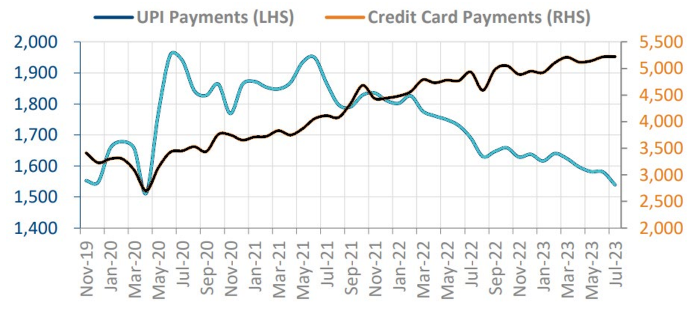
4. Exhibits 7 & 8 highlight how credit card payments have gained momentum over the recent months and how the average transaction size for credit cards has been on the rise. This augurs well for the lenders that focus on this segment.

Exhibit 7: Credit card payments too have gained momentum recently



Source: IIFL Securities, August 2023

Exhibit 8: Average transaction size for UPI payments has fallen, while for credit cards has been on the rise



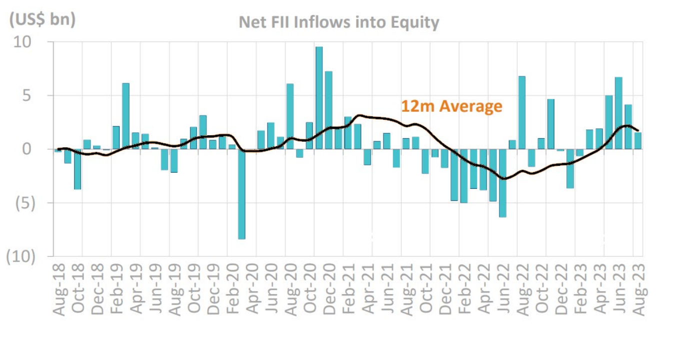
Source: IIFL Securities, August 2023

5. Exhibit 9 shows the strength of FII inflows in CY2023.

   FIIs have brought in a net of over USD 16 bn in this calendar year with a bulk of these inflows from May to July.

   India is standing out amongst the universe of emerging markets in terms of best growth potential, albeit at somewhat stretched valuations.

Exhibit 9: CY23 has already seen FII inflows so far of about $17bn; CY22 saw outflows of the same amount



Source: IIFL Securities, August 2023

Portfolio Commentary & Outlook

We remain quite constructive on the prospects of our portfolio companies. Over the past quarter, we have increased the weightage of small and mid-cap stocks in our portfolios.

Indian markets are well poised to benefit from a significant pool of domestic savings combined with continued interest from global investors. The potential for growth in domestic retail savings into equities can be evidenced by the way SIP (Systematic Investment Plan) inflows have risen from Rs.3,000 crores per month in 2016 to over Rs. 15,000 crores per month at present.

In conclusion, even though India is experiencing tailwinds, we believe that as portfolio managers, we need to remain vigilant for any signs of overheating or irrational exuberance in the case of any of our portfolio holdings.

I look forward to sharing my views on the markets soon.

Yours Sincerely,

Nikhil Johri
Founder & Chief Investment Officer