August 2021

TRIVANTAGE CAPITAL

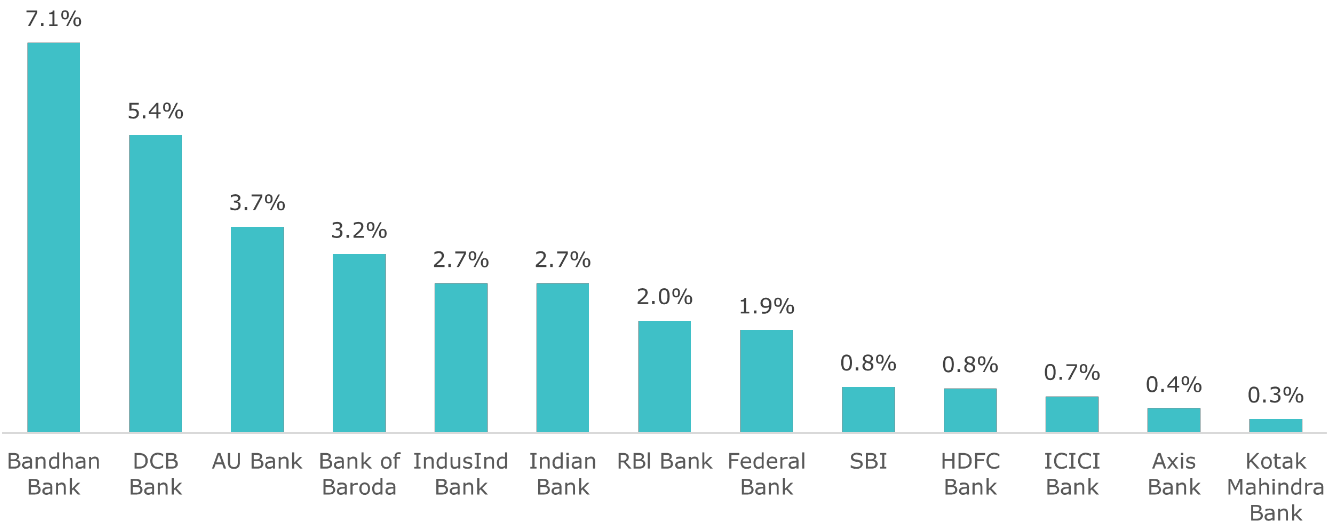
Dear Investor,

Greetings from Trivantage Capital!

The earnings season of our portfolio companies for Q1 FY22 concluded a few days ago. Some of the themes that emerged from the season are as under:

1. **Asset Quality of Lenders:**
The impact of the second wave of the pandemic was not uniform for all lenders. By and large, the small finance banks / Micro Finance Companies / smaller universal banks and most NBFCs were much more adversely impacted than large private sector banks and SBI.

Exhibit 1: The four largest private sector banks & SBI have smaller proportions of restructuring



Note: The above %s are restructured assets as a % of assets. Source: Motilal Oswal Securities, Aug '21.

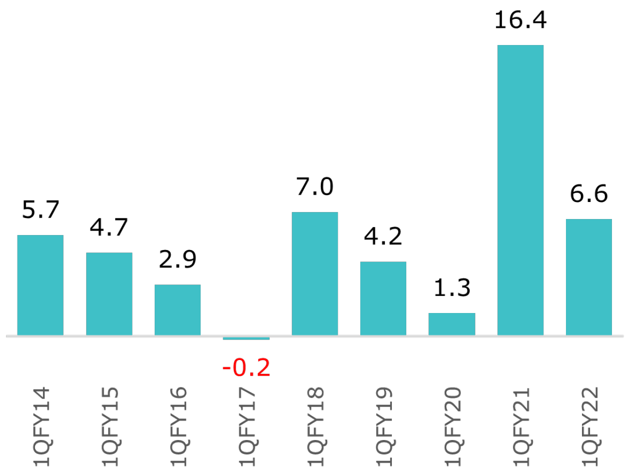
Exhibit 1 lists the proportion of Restructuring done by various lenders. Bandhan Bank which focuses on micro finance showed the highest proportion of restructuring, followed by DCB a much smaller universal bank, whereas the proportions were rather small for the four largest private sector banks and SBI.

The provision coverage levels have also been quite comfortable for large private sector banks with ICICI Bank leading the pack at 78%. The segmental analysis showed that unlike the past the corporate slippages were very manageable however the retail slippages were higher. Many managements during the analyst calls indicated that the collection efficiencies improved quite significantly in July which is quite positive for the sector.

2. Rural v/s Urban Consumption:

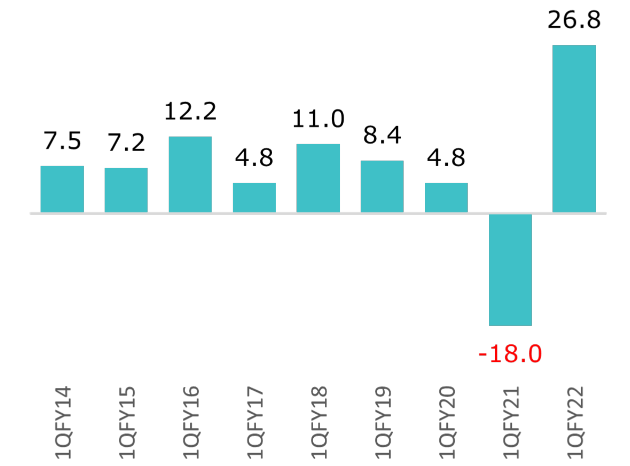
The consumption pattern depicted in Exhibits 2 & 3 show that while both rural and consumption growth rates were positive in the quarter, the second wave impacted the rural consumption significantly unlike the first wave which had primarily impacted the urban consumption. We must, however, note that the base for urban consumption in Q1 FY21 was very low.

Exhibit 2: Rural consumption moderated in 1QFY22, but was still strong v/s pre-COVID years…



Source: Motilal Oswal Securities, Aug '21. Compiled using nine indicators – 1) Real Agri wages, 2) Real non-agri wages, 3) Farmer terms of trade, 4) Agriculture exports 5) Fertilizer sales, 6) Agriculture credit, 7) IIP food products, 8) Reservoir levels and 9) Fiscal rural spending

Exhibit 3: …and urban consumption surged during the second wave due to the very low base of the first wave



Source: Motilal Oswal Securities, Aug '21. Compiled using seven indicators – 1) Employee cost of BSE500 companies, 2) CPI non-food inflation, 3) Personal credit, 4) IIP Consumer durable goods, 5) Petrol consumption and 6) Real House Prices and 7) Non-farm consumer imports

3. Impact on Insurers:

The pandemic related claims affected both the life insurers and the health insurance segment of the general insurers much more than expected by the market. The ULIP policies showed an impressive increase due to the buoyant capital markets. The insurers have become quite conscious of pricing the risk before issuing the protection policies and many of them have built additional reserves for any future recurrences of the pandemic.

4. Liquidity and Cost of Funds:

The liquidity conditions remained quite comfortable and most NBFCs and HFCs maintained high levels in order to be well prepared for any third wave and also to keep the buffers for strong onward lending growth in case the threat of disruptions is abated. RBI has helped maintain the interest rates at reasonably low levels considering the spurt in inflation. This has helped most NBFCs / HFCs to lower their incremental funding costs and a few smarter borrowers that typically lend for long term are borrowing long tenor money instead of issuing CPs and short maturity bonds. The attractive borrowing costs have helped improve the margins.

5. Demand for Funds:

The demand during the quarter was quite modest and as such most lenders showed weak disbursements. This was seen across the segments of Mortgages / Micro Finance, Vehicle Finance, Gold Finance etc. The disbursements were also impacted by risk aversion from lenders and also due to local lockdowns. Various managements have however pointed out to a pick-up in disbursements from July.

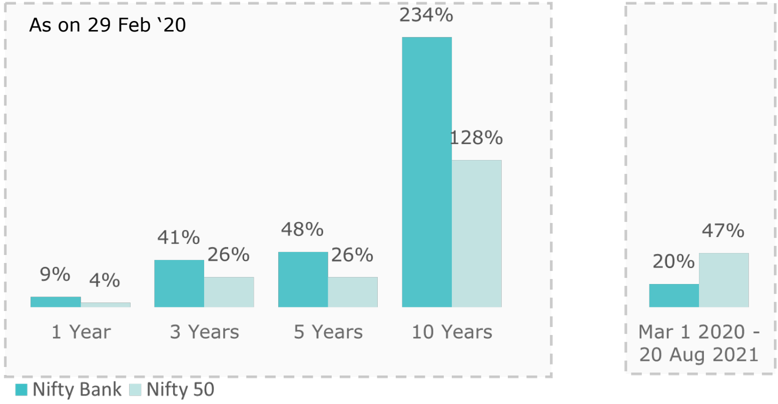
Portfolio and Market Outlook

We have compared the performance of Nifty Bank and Nifty 50 as of end February 2020 before the start of the pandemic in March 2020.

As can be seen from the chart in Exhibit 4, Nifty Bank had outperformed Nifty 50 quite significantly for 1,3, 5 and 10-year periods. However, for the post pandemic period till 20 August 2021, this trend has reversed materially.

We believe that as the threat from the pandemic wanes and the process of normalisation of economic growth begins, the pre-pandemic trends will re-emerge leading to Nifty Bank's outperformance over Nifty 50 yet again.

Exhibit 4: Performance - Nifty Bank vs. Nifty 50



Source: NSE. Trivantage Capital Research. Performances are in absolute %s.

An overwhelming proportion of the listed stocks in the BFSI sector in India have been impacted severely in terms of their valuations.

With the exception of a few leading stocks such as the Bajaj twins, ICICI Bank, AU Bank and HDFC Bank which are close to their life-time high prices (not valuations), most stocks are well below their life-time highs as can be seen from the table in Exhibit 5.

As compared to various other sectors therefore the BFSI sector seems quite well placed in terms of expected potential upside as the GDP growth starts normalising.

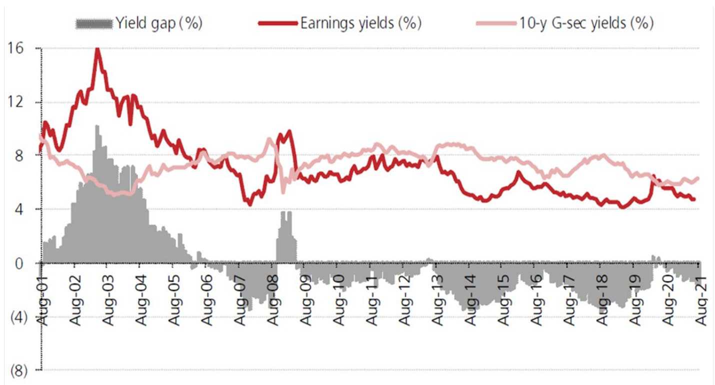
At the overall market level, as highlighted in Exhibit 6, the positive difference between the bond yield and earnings yield (inverse of market P/E) is not very significant anymore indicating that though the market is overvalued at the aggregate level, but not hugely.

Exhibit 5: Except for a select few, most stocks are well below their lifetime high prices

	Lifetime High (Rs.)	CMP (Rs.) (20 Aug '20)	% Diff.
Bajaj Finance	6,733	6,661	-1%
Bajaj Finserv	15,238	14,979	-2%
ICICI Bank	717	681	-5%
AU SFB	1,380	1,301	-6%
HDFC Bank	1,641	1,515	-8%
Max Financial	1,148	1,036	-10%
HDFC Life	746	668	-10%
Axis Bank	828	740	-11%
Muthoot Finance	1,639	1,458	-11%
SBI	467	407	-13%
CAMS	3,741	3,181	-15%
Kotak Bank	2,049	1,704	-17%
Chola Invst & Fin	601	485	-19%
Aavas Financiers	3,074	2,382	-23%
IndusInd Bank	2,038	979	-52%
Bandhan Bank	742	278	-63%
RBL Bank	716	163	-77%

Source: NSE. Trivantage Capital Research. CMP = Closing market price.

Exhibit 6: Gap between earnings yield & bond yield is not very significant (gap between earnings yield of Nifty 50 Index, 10-yr G-Sec in India, March fiscal year-ends 2002-22 (%))



Source: Kotak Institutional Equities

We expect that as the process of economic normalisation intensifies the market will start rebalancing the portfolios away from the overvalued pockets to the reasonably valued ones. We have seen this rebalancing happen in the markets time and again.

Exhibit 7 indicates how in both the large cap and the mid cap segments the FIIs are so much more dominant than the DIIs (MFs & Non-MFs).

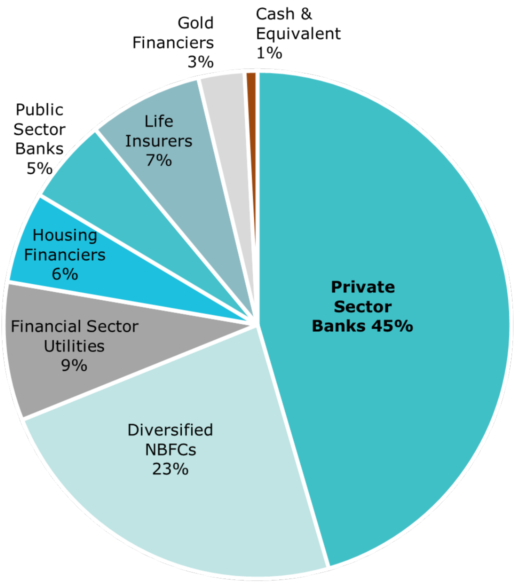
Exhibit 7: FIIs continue to be dominant in the large-cap and mid-cap segments

NSE 100 Index - Shareholding (%)	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Promoters	48.3	48.7	48.5	48.2	48.1	48.3	48.1	48.3	47.9	47.8	48.1
FIIs	22.9	22.7	22.4	22.8	23.1	22.8	22.9	22.3	22.4	22.7	23.6
MFs	6.3	6.5	7.0	7.1	7.2	7.7	7.7	8.1	8.2	8.0	7.6
Non-MFs	6.3	6.3	6.2	6.1	6.1	6.3	6.2	6.5	6.7	6.5	6.3
Individuals	7.8	7.8	7.8	7.7	7.7	7.7	7.7	7.8	7.9	8.1	8.0
Others	8.4	8.0	8.0	8.0	7.8	7.2	7.3	7.0	6.9	6.9	6.6
NSE Midcap Index - Shareholding (%)	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**	**Mar-20**	**Jun-20**	**Sep-20**	**Dec-20**
Promoters	49.7	49.9	53.6	53.1	53.5	55.2	55.9	55.9	55.9	55.5	54.8
FIIs	14.8	14.7	15.3	15.7	15.8	14.9	15.3	14.8	14.2	14.5	15.1
MFs	7.7	8.0	8.3	8.5	8.8	8.8	9.1	9.3	9.2	9.2	8.8
Non-MFs	4.9	4.9	4.8	4.7	4.6	4.9	4.9	4.9	5.1	5.1	5.4
Individuals	8.2	8.2	8.5	8.5	8.5	8.6	8.7	8.8	9.3	9.7	9.7
Others	14.6	14.3	9.5	9.5	8.8	7.6	6.0	6.2	6.5	6.1	6.2

Source: IIFL Securities, August 2021

The BFSI sector is mainly a large cap dominated sector with some attractive mid cap opportunities and therefore the stance of global investors continues to be an important factor. Also, from the point of view of large cap indices such as Sensex and Nifty 50, the weightage of the BFSI stocks is nearly 40%. We believe that the FIIs are waiting to see if India experiences a third wave of the pandemic and if yes, then how severe it is going to be. Till that clarity emerges, the global investors may remain a bit cautious.

Exhibit 8: Our Resurgent Financials strategy offers a well-diversified play on India's financial sector



As on 20 August 2021

Our portfolio remains well-diversified within the BFSI context. The leading private sector banks continue to be the dominant component of the portfolio, followed by the leading non-Banking businesses of Bajaj Finance and Bajaj Finserv followed by CAMS.

ICICI Bank continues to be the top position in the portfolio. The re-emergence of ICICI Bank has surprised many in the market. Exhibit 9 highlights how this stock has outperformed both HDFC Bank and Kotak Bank stocks in 1, 3 and 5-year periods.

Exhibit 9: ICICI Bank's stock performance has surprised many

	1 Year	3 Yrs	5 Yrs	10 Yrs
ICICI Bank	85%	26%	24%	16%
HDFC Bank	43%	13%	19%	21%
Kotak Mahindra Bank	27%	10%	17%	23%

Source: NSE. As on 20 August 2021. Performances are annualised for periods > 1 yr

However, the under-performance remains in the 10-year period and that is an opportunity for the leadership team of ICICI Bank to continue to target making consistent strides in Core Operating Profits of the bank by pursuing the ongoing digital transformation and maintaining asset quality discipline amongst many other key metrics.

Exhibit 10 highlights how leading financial sector businesses have shown prudence in raising equity capital from mainly foreign investors taking advantage of the abundant liquidity in the global financial markets.

Bajaj Finance tops the chart in terms of percentage increase since March 31, 2019.

Aavas' reduction should be seen in the context of an extreme over-capitalisation.

Hence, even a higher reduction will be welcome in their case to improve the Return on Equity numbers.

It is so clear from this data that the leading private sector lenders are well placed to take advantage of the rebound in growth conditions when that happens.

Exhibit 10: Leading financial sector businesses are well-placed with adequate capital to take advantage of a rebound

	Capital Adequacy		
	Mar-19	**Mar-21**	**Diff (%)**
Bajaj Finance	16%	25%	54%
Axis Bank	11%	15%	37%
Au SFB	16%	22%	35%
IndusInd Bank	12%	16%	29%
Kotak Mahindra Bank	17%	21%	27%
ICICI Bank	14%	17%	23%
Cholamandalam	12%	15%	22%
HDFC Bank	15%	17%	13%
Bank of Baroda	10%	11%	5%
State Bank of India	10%	10%	4%
Aavas Financiers	64%	53%	-17%

* Capital Adequacy is considered as CET 1 (Common Equity Tier 1) for banks and Tier 1 for non-banks. Source: Trivantage Capital Research

Given our market outlook, our portfolio is well-balanced to navigate the evolving market conditions over the next few months and well-positioned to capitalise on the rebound in India's economic growth.

We wish you the very best of health and happiness in the months to come.

Yours Sincerely,

Nikhil Johri
Founder & Chief Investment Officer