TRIVANTAGE CAPITAL

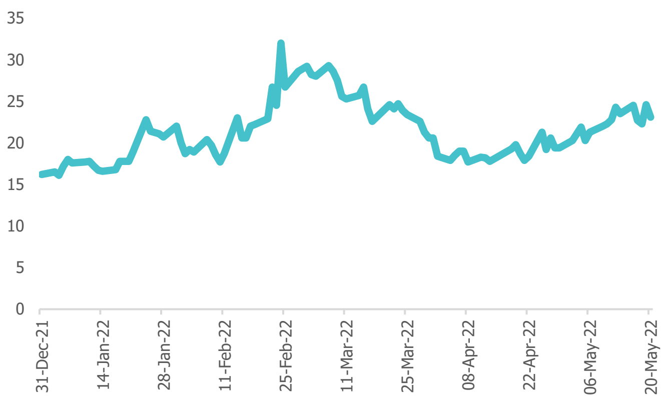
# VANTAGEPOINT

Our Focus Makes All The Difference

**Dear Investor,**

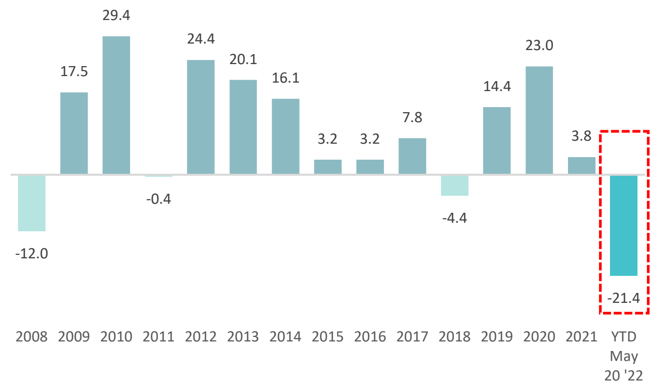
The calendar year 2022 has begun with huge bouts of volatility as shown by the VIX index in Exhibit 1. The volatility index has moved up from 16.1 at the start of the year to 23.1 on May 20th, 2022. One of the main reasons for this has been a massive selling by foreign institutional investors who have, on a net basis, sold USD 21 billion of Indian equities - the highest net outflow in any calendar year since 2008 (Exhibit 2).

**Exhibit 1: India Vix – CYTD May 20, 2022**




Source: NSE

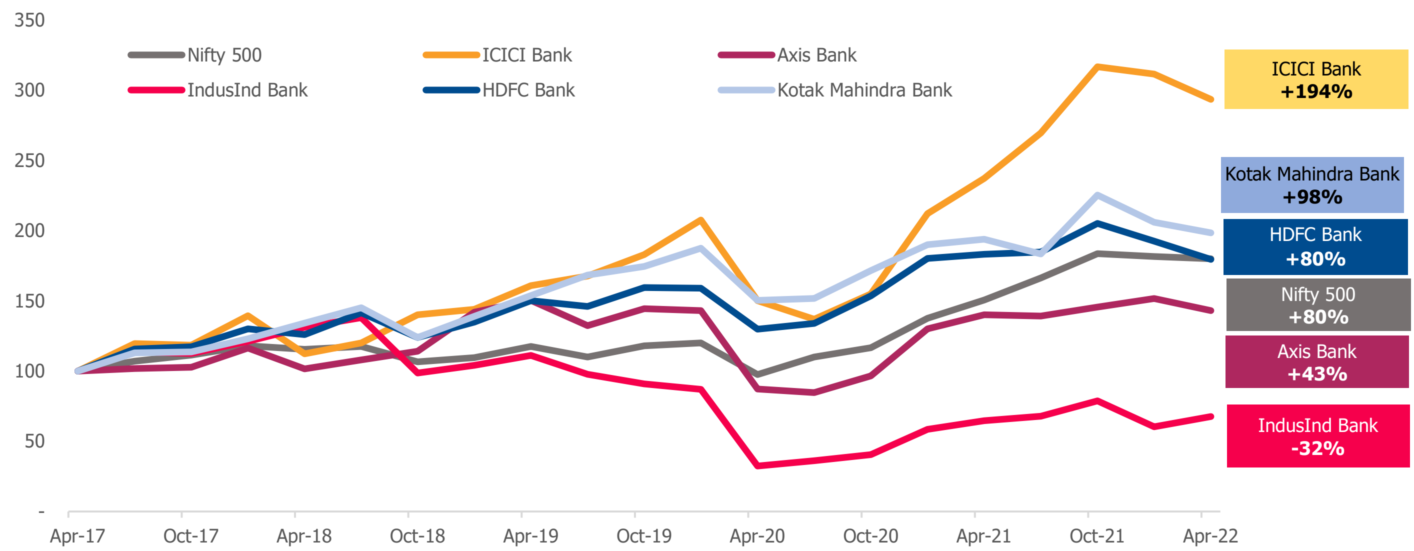
**Exhibit 2: Net FII Inflows in Indian Equities (USD bn)**




Source: NSDL

The past five years have been quite challenging for the financial services sector in terms of stock performance. Since a select few private sector banks lead our investment portfolios, we have evaluated their stock performance and compared that with the key business metrics.

**Exhibit 3: Stock Performance - Key Private Sector Banks Vs Nifty 500 since April 30, 2017 (5-years absolute %)**




As of 30 April 2022. Source: NSE. Stock prices have been rebased for illustrative purposes. Closing market prices for the last business days for calendar months at an interval of 3 months

Nifty 500, a proxy for the Indian stock market, has delivered an absolute return of 80% in 5 years ending April 30, 2022. This return at an approximate 12% CAGR is similar to longer periods such as 10 or 15 years.

Now, if we were to look at how these banks have performed on 7 key performance metrics over the period, then we come to a few conclusions.

**Exhibit 4: Performance of leading private sector banks on key metrics**

| Bank Name | FY2017 - FY2022 | | | | | | |
|---|---|---|---|---|---|---|---|
| | CAGR (%) | | Growth (% Absolute) | | | | |
| | Net Interest Income (NII) | Profit After Tax (PAT) | Advances Market Share | Deposits Market Share | Net Interest Margin | Return on Assets (RoA) | Return on Average Equity |
| ICICI Bank | 17% | 19% | 22% | 42% | 27% | 37% | 42% |
| HDFC Bank | 17% | 20% | 62% | 58% | -10% | 5% | -7% |
| Kotak Bank | 16% | 20% | 31% | 31% | 3% | 25% | -5% |
| Axis Bank | 13% | 29% | 25% | 30% | -3% | 84% | 78% |
| IndusInd Bank | 20% | 11% | 39% | 51% | 3% | -30% | -30% |

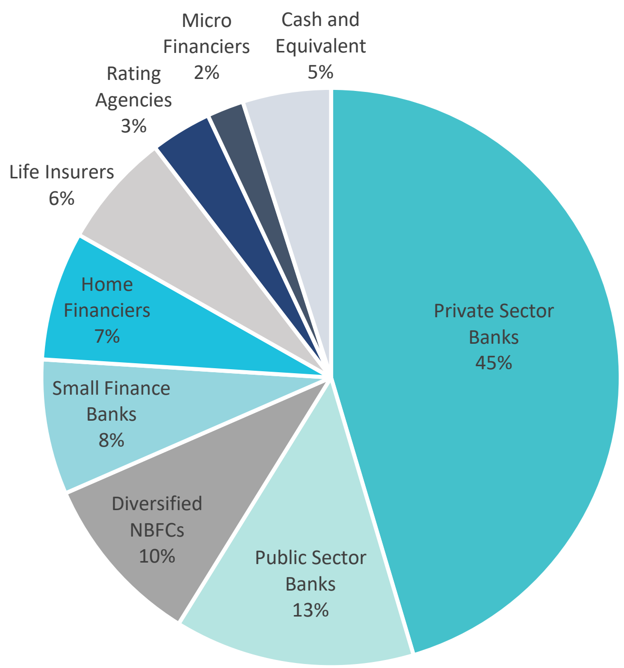
Source: Company presentations, Trivantage Capital Research.

1. It is interesting to note that only ICICI Bank has delivered an improvement across all 7 metrics with the highest improvement in the Net Interest Margins which have gone up by 27% in the 5-year period. The bank has also shown consistent growth in the market shares of deposits and advances, profitability metrics and return ratios. No wonder then that the ICICI Bank stock has delivered the best returns in the 5-year period of 194%, almost 2.5x of the market.
2. On the other hand, the erstwhile bellwether banking stock, HDFC Bank, has shown a reduction in NIMs and ROEs over this period whilst maintaining the best-in-class growth in the market shares of deposits and advances. However, combined with a very significant change in the bank's leadership, the stock delivered in line with returns of the market of 80%. The bank continues to deliver on strong credit growth and with the proposed merger with HDFC, the combined entity will be a force to reckon with in the domain of financial services.
3. Kotak Mahindra Bank stock delivered slightly better than market returns of 98% with decent growth in all metrics other than RoE. The bank showed a 31% improvement in the market shares of both deposits and advances. In addition, the bank also turned out to be a play on financial services as a whole since it owns 100% of rapidly growing businesses in the domains of asset and wealth management, capital markets, insurance etc.
4. In our opinion, the three above-mentioned bank stocks delivered performance in line with the change in fundamentals. What is surprising however is the case of Axis Bank stock which showed an improvement in all the metrics except for NIMs which remained flat over the 5-year period. The stock delivered just a 43% return at almost half of the market and more surprisingly at less than a quarter of ICICI Bank stock. The market has been quite harsh to this stock and with the recent Q4 FY22 results it appears that like in the case of ICICI Bank the asset quality concerns of the previous credit cycle have been largely addressed. We don't know what the trigger would be, but the stock appears set for a re-rating over the course of FY23.
5. The only bank stock in this group to have delivered a negative return over the 5-year period has been IndusInd. The bank showed a significant improvement in market shares of deposits and advances but the overhang on the stock was the much higher credit costs that caused their return ratios to deteriorate quite substantially. In the recent past, however, the process of normalization in the profitability metrics has been evident and if this continues the stock is bound to reflect that over the course of the year.

We believe that the market has been quite right in pricing four of the five bank stocks discussed above over the past 5-year period with the exception of Axis Bank. It appears that the market wholeheartedly rewarded ICICI Bank in the erstwhile Corporate Banks category and overlooked the progress made by its nearest competitor Axis Bank.

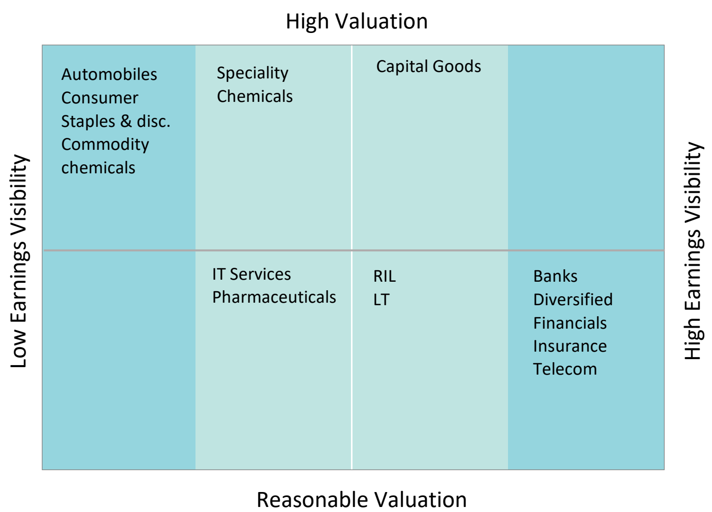
## Portfolio & Outlook

**Exhibit 5:** Trivantage Capital Resurgent Financials Equity Strategy
A Well-Diversified Portfolio




As on 20 May 2022

**Exhibit 6:** Broad classification of major sectors with **strong business models** across major investment criteria of business model, valuations & near-term earnings visibility




Source: Kotak Institutional Equities, May 2022

The earnings season concluded recently was quite reassuring for most of our portfolio companies. Our leading positions showed improvement in market shares, growth rates and return ratios.

As the impact of Omicron subsided after January 2022, February and March showed a strong uptick in business performance across the market spectrum which has continued in April as well.

Despite strong business performance, the stock prices have seen a big correction due to the global geo-political factors which presented unprecedented supply-side challenges leading to a sharp uptick in commodity inflation.

Our latest portfolio composition is depicted in Exhibit 5. It is well-diversified within the broad BFSI universe of listed stocks.

Leading universal banks from private & public sector comprise around 60% of the portfolio.

However, we have consciously avoided almost all second-tier banks that are part of the Nifty Bank index since we believe that the "risk-reward" trade-off is best present in those few banks that are gaining market shares in both deposits and advances, are well-capitalized and quite attractive in terms of their valuation.

The next category in terms of portfolio weights is that of select market-leading diversified NBFCs followed by one of the fastest-growing small finance banks.

The portfolio also comprises of two HFCs, a credit rating agency, two life insurers and an NBFC-MFI. Overall, the portfolio comprises of high-quality businesses that are well-placed to take advantage of the impending credit cycle and the resulting GDP growth.

Very few sectors in the market present an attractive combination of modest valuations, strong business models and high earnings visibility. Kotak Institutional Equities recently issued a strategy note in which they have positioned **BFSI to be one such investment opportunity**, as depicted in Chart 6.

Exhibit 7 lists the valuations of individual stocks both in March 2019 and at present. This table shows how the valuations of most stocks have become so much more attractive after the recent market meltdown led by FII selling.

**Exhibit 7:** Many 'growth' stocks in the banking and diversified financials sectors are trading at attractive valuations

| Company Name | Sector | 12-m forward P/B multiple (X) | |
|---|---|---|---|
| | | Mar-19 | Current |
| AU Small Finance Bank | Banks | 4.6 | 4.7 |
| Axis Bank | Banks | 2.7 | 1.6 |
| Bandhan Bank | Banks | 4.9 | 2.4 |
| Bank of Baroda | Banks | 0.9 | 0.6 |
| Canara Bank | Banks | 1.3 | 0.7 |
| Federal Bank | Banks | 1.4 | 0.9 |
| HDFC Bank | Banks | 3.8 | 2.6 |
| ICICI Bank | Banks | 2.3 | 2.6 |
| Kotak Mahindra Bank* | Banks | 4.0 | 3.2 |
| IndusInd Bank | Banks | 3.4 | 1.3 |
| RBL Bank | Banks | 3.3 | 0.5 |
| State Bank of India | Banks | 1.4 | 1.4 |
| Bajaj Finance | Diversified Financials | 7.3 | 6.3 |
| Cholamandalam | Diversified Financials | 3.2 | 3.9 |
| HDFC | Diversified Financials | 4.6 | 3.0 |
| L&T Finance Holdings | Diversified Financials | 2.0 | 0.8 |
| LIC Housing Finance | Diversified Financials | 1.6 | 0.9 |
| Mahindra & Mahindra Financial | Diversified Financials | 2.3 | 1.3 |
| Muthoot Finance | Diversified Financials | 2.4 | 2.0 |
| Shriram City Union Finance | Diversified Financials | 1.8 | 1.1 |
| Shriram Transport | Diversified Financials | 1.7 | 1.0 |

* Source: Trivantage Capital Research. For all others, Kotak Institutional Equities, May 2022

Persistent inflation will lead to a few more policy repo rate hikes in India which will reprice the funding costs in the economy. Our portfolio companies in the lending space are well-positioned to protect their Net Interest Margins in the higher interest rate environment. As some of the FIIs start reallocating to India when the credit growth momentum picks up, the beaten-down valuations will see a spurt.

Investors who are willing to ride the near-term market volatility due to the continuing Russia-Ukraine conflict, impending Fed rate hikes, and slowing down western economies should benefit when the tide turns suddenly. It is almost impossible to know when the market bottoms and therefore it is important to stay invested in businesses that have strong business models and are valued appropriately for the combination of growth and returns, they offer.

We wish you the very best.

Yours Sincerely,

Nikhil Johri
Founder & Chief Investment Officer

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