

FAITH & PATIENCE

October 31, 2020

For the month ended October 30, 2020, Nifty 50 index was up 3.51% over previous month's close. Mid and small caps underperformed large caps. NSE Midcap 100 Index was up 0.49% and NSE small cap Index was marginally down 0.07%. Within sectors, Information Technology, banking, realty outperformed Nifty 50 index whereas media, pharma, auto, consumer goods underperformed. Foreign funds (FII or FPI) were net buyers at USD2.6bn, whereas domestic funds net sellers at USD2.4bn.

Fig: Flows

(USD mn)	Curr	MTD	CYTD
FII - Cash	(118)	2,696	6,737
DII - Cash	(34)	(2,441)	6,590
FII - Debt	(87)	385	(14,295)

Source: Bloomberg

GST collections in October stood at over INR1.05tr, crossing for the first time INR1tr mark since February this calendar year. The GST revenues for the month are 10% higher than in the same month last year. The growth in GST revenue as compared to that in the months of July, August and September, 2020 of -14%, -8% and 5% respectively clearly show the trajectory of recovery of the economy and, correspondingly, of the revenues.

We are currently in quarter two FY2021 corporate results season. 32 out of the 50 Nifty companies have announced their results as on October 31, 2020. Companies that have reported earnings, thus far, account for - (a) 70% of est. PAT for the Nifty, (b) 63% of India's market capitalization, and (c) 79% of the Nifty 50 index weight. Q2FY2021 has been good earnings season, with big beats on aggregates and improved management commentaries. Profits for the 32 companies that have posted their results have grown 24% YoY (v/s market expectations of a decline). The breadth of earnings beat and consequent earnings upgrades has been one of the best in recent memory.

What is driving the beat? (a) Sharper-than-expected underlying demand recovery in multiple sectors, as the supply situation has been restored to normalcy; (b) better-than-expected pricing power/realization; (c) continued cost optimization initiatives; and (d) lower-than-expected provisioning costs in Banking, Financial Services and Insurance (BFSI). Corporate commentaries have turned better, with Consumer and Consumer Discretionary companies guiding for improved demand in the festive season, IT companies highlighting robust and growing deal pipelines, and BFSI demonstrating improved collection efficiency / disbursement trends and guiding for controlled restructuring ahead.

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Key takeaways at sectoral level: (a) Information Technology: Headline numbers were strong; 9 of the 12 companies reported beats on a profit after tax basis, while 10 out of 12 saw upward earnings revision for FY2022. Enterprises are undertaking cloud adoption at a faster pace and digital transformation at the workplace has accelerated, with the strengthening theme of vendor consolidation benefitting the well-entrenched business models of Tier-I IT. (b) Healthcare: Midcap Pharma names continue to dominate, as companies reported strong sets of results, leading to earnings upgrades for FY2022. (c) Banks: Private banks have beaten expectations handsomely, with higher collection efficiency, uptick in loan growth, and healthy Provision Coverage Ratio. Large private sector banks saw earnings upgrades. Management commentaries indicated stress on asset quality due to the pandemic may not be as bad as initially feared, although banks continue to increase provisions for COVID-related stress. (d) Consumer: Companies have reported demand revival and volume growth in the quarter. Rural continues to outperform urban. Cost optimization has once again aided margins. Government's recent policy to push travel allowance claims against 3x goods & services spend (most likely goods) is also supportive. (e) Automobile: Sector performance has been above expectations and management commentaries are, quite upbeat for the festive season. The 32 Nifty companies (with declared results) have reported Sales/EBITDA/PBT/PAT growth - 9%/14%/14%/24% (v/s market expectations of -7%/3%/-7%/-0.6% YoY). The earnings upgrade/downgrade ratio for 2QFY2021 is skewed in favour of upgrades.

We believe smooth and unencumbered recovery, in economy and markets, cannot be taken for granted while the COVID-19 pandemic is still active. In the last few weeks, many European countries and UK have imposed new national lockdowns. This time, however, around governments are well aware that the economy cannot be fully shut down as mentioned by French Prime Minister Jean Castex noted that "unemployment and poverty can also kill". India is seeing good performance from exports sector (see attached table. One crore means Ten million) and it appears that "Atmanirbhar Bharat" or Self-Reliant India campaign of Government is yielding results. This campaign was launched to attract global supply chains and manufacturing companies, who are looking for alternatives to China, to set up units in India. This campaign is also focused on improving India's share in global exports. Micro Small and Medium Enterprises (MSMEs) make up half of our exports sector and seemed to be pulling through thanks to demand revival and the government guarantee provided on working capital loan top-up. These MSMEs have now deployed working capital on export orders as they see big opportunities.

EXPORT OF MAJOR COMMODITIES		
Commodities	Values (₹ crore)	
	Sep'19	Sep'20
Tea	547.18	550.89
Coffee	369.76	383.91
Rice	2,668.33	5,328.42
Other cereals	91.25	410.93
Tobacco	589.58	674.71
Spices	2,314.23	2,656.65
Cashew	314.02	180.33
Oil meals	474.91	721.73
Oil seeds	361.76	505.61
Fruits & Vegetables	1,388.20	1,409.36
Cereal preparations & misc processed	912.16	1,255.04
Marine products	4,540.45	4,424.36
Meat, dairy & poultry products	2,323.30	2,871.05
Iron ore	1,032.42	2,229.56
Mica, Coal & Other	2,754.02	2,646.75
Leather & leather products	2,645.65	2,633.69
Ceramic products & glassware	1,668.47	2,340.43
Gems & Jewellery	25,588.98	19,855.53
Drugs & Pharmaceuticals	12,853.76	16,468.35
Organic & Inorganic Chemicals	12,754.61	13,518.93
Engineering goods	46,634.45	50,654.15
Electronic goods	6,627.64	6,832.02
Cotton yarn/Fabs./made-ups, Handloom	5,760.75	6,847.63
Man-made yarn/Fabs./made-ups	2,818.23	2,638.34
RMG of all textiles	7,702.57	8,745.34
Jute mfg. including floor covering	212.45	259.62

While India is not immune to lockdowns in Europe but we do believe that Government of India will stand by MSMEs in the hour of crisis which arises out of COVID-19 related challenges in export markets.

We have been consistent with our stated strategy, which we had discussed during our last call in May 2020, that we would be adopting a cautious approach and would scale-up exposure to mid and small caps over a period of time. We are quite encouraged with the earnings season so far, particularly the performance of exports and overall recovery of economy also evidenced by GST collections. Increase in economic activity, continued demand improvement, coupled with cost rationalization, has been the key highlight of 2QFY2021 earnings. Economic recovery continues, with high-frequency data for October coming in quite strong (GST collections, Manufacturing PMI index, rail freight, power demand). More importantly, COVID-19 cases have seen meaningful decline in India active cases to ~0.5mn currently from the peak of 1.02m active cases in mid-September. There is a demand from the industry for another round of fiscal stimulus and if it happens it could elevate sentiment further, in our view.

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Best,

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