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AMBIT 365

THE SINE CURVE: CHOPPY WATERS

NEWSLETTER • FEBRUARY '24

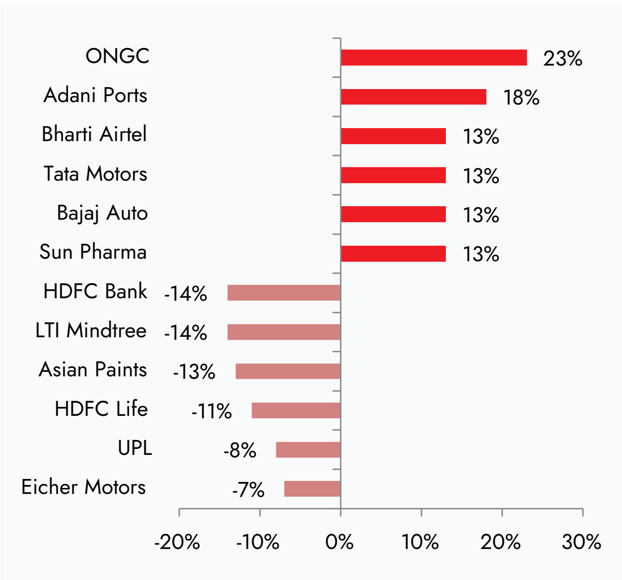
CHOPPY WATERS!

The market turned choppy in January, following a very strong Santa rally in December. Nifty did 3 sharp downs and 3 sharp ups during the month and finally closed flat. Performance dispersion between frontline stocks was stark. In Nifty, the top 10 names were up 10-23%, and the bottom 10 names were down 5-10%. **It was a satisfying month for Ambit365, as we navigated this volatility well to close the month 2.5% up; both long and short books contributed to nearly half of this gain.** Ambit365 participated in about half of the top-gainers and top-losers. This, we must admit was an unusually high hit rate.

3 trends continued this month – i) Weakening consumption demand. While the rural demand weakness has been visible for a while, cracks in the urban demand are also showing; ii) PSUs continue to be on a strong wicket. ONGC is the top gainer +23% and iii) Private banks continue to underperform.

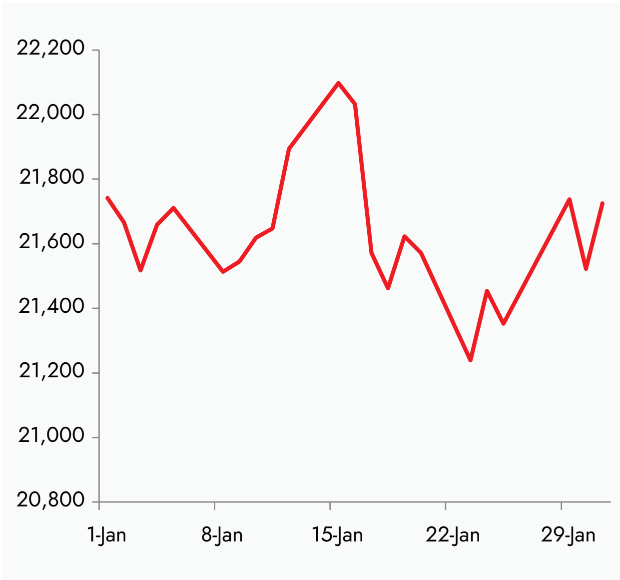
Ambit 365 has been positioned well to capture these trends. Our top contributors to this month's performance in the long book were diversified - Tata Power (51bps), Tata Motors (32bps), Reliance Industries (25bps) while in the short book the major contributors were from consumers and private banks - ICICI Prudential Life (45bps), HUL (31bps), HDFC Bank (27bps) in the short book. FPIs, who have generally shunned PSUs all of the last decade have been big buyers in PSU names and sellers in private banks.

Chart 1: Nifty50 Divergence trend for Jan'24



Source: Bloomberg

Chart 2: Nifty choppiness...



Source: Bloomberg

THE 3 CS – CONSUMPTION (WEAK), CAPEX (STRONG), CD RATIOS (PSU BANKS > PRIVATE BANKS)

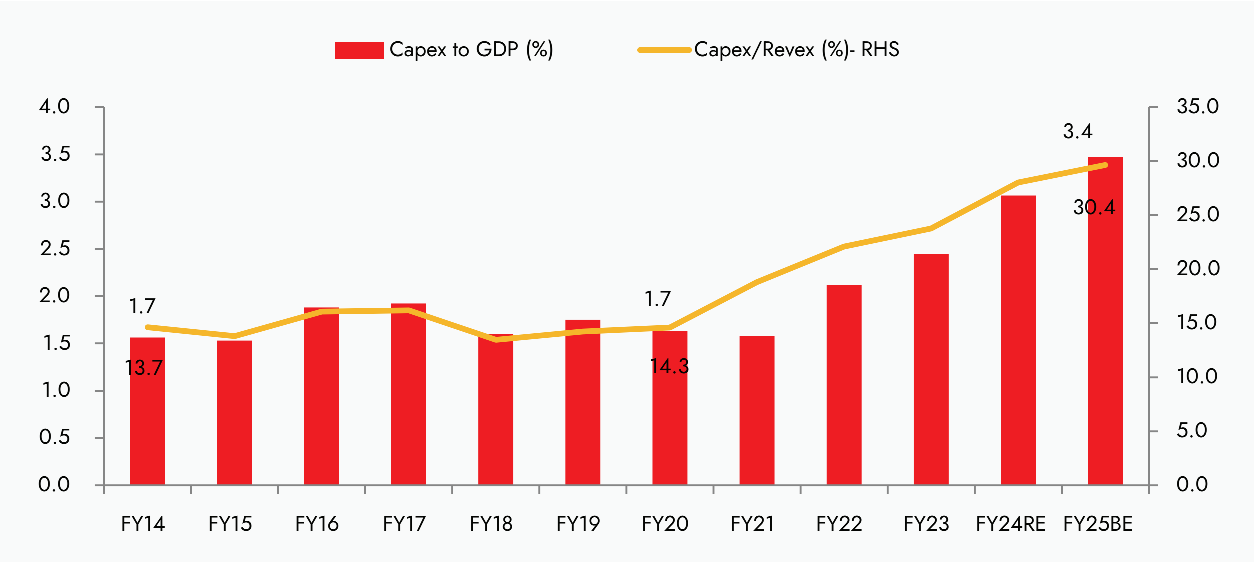
Consumption demand weakens further: While companies and analysts have expressed concerns about subdued rural demand with hopes of revival & optimism regarding urban demand, the January results suggest a cause for alarm regarding weaker urban demand as well. As per Nielson, the overall FMCG sector growth continues to wane, with price growth turning negligible and volume CAGR for 5yrs at 2.8%. While we appreciate the risks in extrapolating one quarter's data, the worry is that weakness is seen across many sectors. For now, we are just tabulating notable bytes from consumer companies' results and channel checks. We maintain short positions on few of names mentioned below.

Companies	Commentary
HUL	The operating environment remains challenging with weather vagaries (uneven monsoon/delayed winter); subdued festive season (weak consumer sentiment) and uneven economic recovery (urban>rural / premium>mass), resulting in flat revenue growth - **Rohit Java (CEO & MD)**
ITC	Cigarette volume declined by 1-2% on a high base during Q3, management witnessed premium portfolio doing well. Within FMCG - sales growth decelerated to 7.6% YoY in Q3FY24 vs. 18% in Q3FY23
Marico	Revenue declined by 3% YoY despite volume growth at 2%, given the price drops in core brands & channel liquidity issues in the domestic business.
Jubilant Foodworks	LFL growth (sales growth in non-split restaurants opened before the financial year) at -2.9%YoY vs. 0.3% YoY, despite a seasonally strong quarter. Delivery channels grew by 6% YoY whereas the Dine-in channels declined by 6% YoY.
Havells	The consumer demand has been sluggish over the last few quarters. The B2C segment saw a little slowish demand, whereas B2B is doing well. We are seeing some revival in the private capex - **Anil Rai Gupta (CMD)**
Asian Paints	Sales growth at 5% YoY vs. Domestic Volume growth at 12% in Q3FY24. The gap between value & volume growth will continue in the near term. Post festival season, muted demand has led to downtrading, Asian Paints has started reducing prices - 1.3% in Q3 & 2% in Jan'24,
United Spirits	Perfect K -shaped demand pattern where P&A segment sales grew by 10% YoY whereas, Popular segment sales declined 12.4% YoY. The company has mentioned it has not witnessed any downgrading, rather the consumers are reducing the number of occasions for purchase.
Page Industries	**Based on our channel checks** - Double-digit volume decline on account of a broader market slowdown, and internal changes on channel and inventory management. There has been a steeper decline in growth in Women's wear due of higher competitive intensity.

Source: Company's results, management interviews, commentary, channel checks etc.

Capex continues to be on driving seat: In the Interim budget presented on 1st February, the Finance Minister announced a 16.9% growth in government capex (accounting for 3.4% of GDP) for FY25. This is despite budgeting a 30bps reduction in fiscal deficit target to 5.1%. With private sector capex showing signs of a pick-up, the economy in FY25 will also be capex-driven. In the recent Interim budget 2024-25, the FM chose to place long-term development over short-term populism.

Chart 3: Capex/Revex ratio & Capex to GDP ratio improving resulting into 17% capex CAGR over FY14-FY25BE

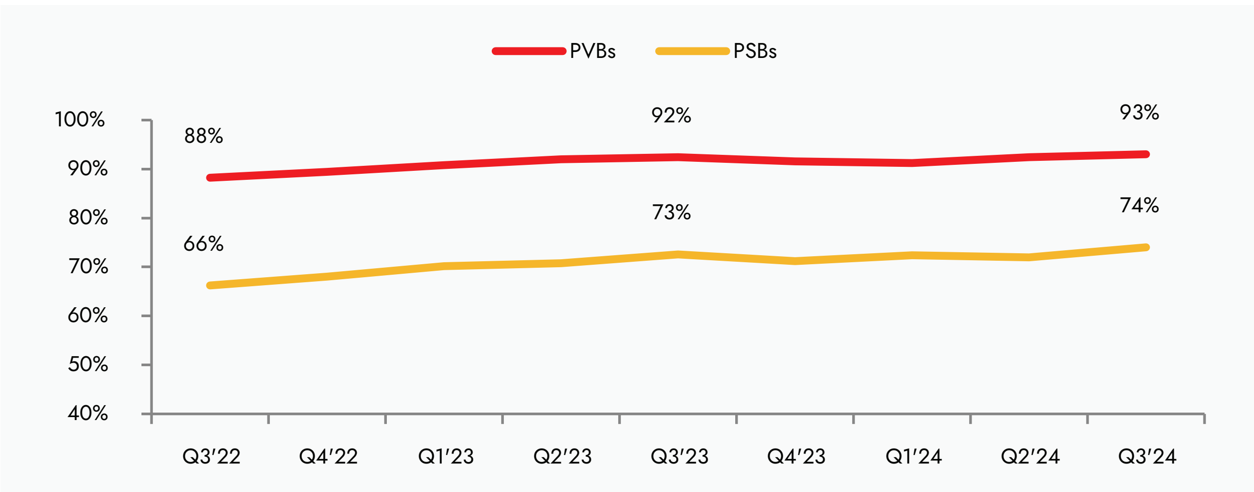


Source: MoF

The FM emphasised the concept of **GDP – Growth, Development & Progress** during the interim budget 2024-25 speech, setting the tone for **'Viksit Bharat' by 2047.**

CD Ratio - lower the better: In banking, the clear driver is the CD (Credit-Deposit) ratio. A higher CD ratio caps headroom for growth and puts pressure on deposit mobilization and margins. We see PSU banks to be better placed in this aspect vs. private players.

Chart 4: BFSI: CD ratio divergence for PSBs vs. PVBs



Source: Companies Financials for CD ratio - PVBs (HDFCB, ICICIB, AXSB, KMB, IIB) and PSBs (SBI, BOB, Canara, PNB, Union)

OUTLOOK

Markets will be non-linear in 2024

Going into print, we feel the need to make a few tactical adjustments to our book, while maintaining our core structural views intact. BSE PSU Index is up >50% since the Oct 2023 correction (incidentally beating the much-hyped Magnificent 7 by more than 50%, over the same period!). While we maintain our structural positive stance- we are booking some gains. We have been fence-sitters on IT services. We have held the view that of the 2 market expectations: - (a) a resilient US economy, and (b) sharp and deep rate cuts by the Fed, one will go wrong. After the strong non-farm payroll print on 2 Feb (353k compared to consensus estimate of 185k), we are inclined to believe that the US economy is showing amazing resilience. This increases the probability of better visibility for Indian IT companies. We have started to build some long positions in TCS. Also, if the rates fail to decline as expected by the market, this could have a negative impact on the premium valuations of consumer stocks. Analysts are yet to adjust their Cost of Equity assumptions upwards. We continue to maintain short positions in that space.

Far too much money is riding on one side of the boat this year- with the assumptions of very sharp rate cuts. Disappointment here is bound to create sharp volatility. **January volatility was perhaps a teaser of what is in store for the full year. In a non-linear market, stock level dispersions are very high, an ideal environment for Ambit 365.**

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