Economic Update

The Indian market underperformed MSCI Emerging Markets Index during the last quarter, driven by the sharp recovery in Chinese markets in last week of September. Mid Cap indices underperformed while the and Small Cap indices outperformed the large-cap indices. Chinese government has announced various market stabilizing measures such as 20bps rate cut, 50 bp RRR cut and talks of establishing a market stabilization fund. Measures were also announced to support the housing market such as rate reduction on mortgage balances & lower housing purchase downpayment etc. This shows that finally policymakers are concerned about the weakness in economy and markets. The Chinese stock markets have reacted very positively but its impact on the much-needed consumption boost is yet to be seen. The trade war rhetoric between China and the USA gets louder, which will continue to impact China's exports.

The FOMC cut rates 50 bps to 4.875% in an 11-1 vote, indicating improved inflation confidence, with Chair Powell noting the labour market was now less tight than before the pandemic, and not a source of inflation pressure. Upside inflation risks were seen to have diminished and downside employment risks were seen higher. He pushed back on early expectations of further 50 bps moves, saying that the Fed was not in a rush, but also said that rates might have been cut in July given that month's payrolls report – agreeing with recent indications that the Fed might see itself as being behind the curve. Powell stressed the cadence of future cuts will be based on incoming data but its widely expected to see two 25 bps cuts each this year. In August meeting The Monetary Policy Committee of RBI maintained the repo rate at 6.5%, with a 4:2 vote, in line with consensus expectations. On the stance, the MPC retained its focus on withdrawal of accommodation such that inflation progressively aligns to the target, while supporting growth. In addition, the RBI remains nimble in the management of liquidity conditions, such that the money market's interest rates evolve in an orderly manner. The monetary policy statement reiterated the vigilance on trend in inflation and food inflation risks which can potentially adversely impact inflation expectations. In the quarter, foreign institutional investors recorded strong net inflows of USD 10.1 billion, while domestic institutions recorded net inflows of USD 12.3 billion. The G-sec yield was continued to go down during quarter but settled at 6.75%. The price of crude oil corrected to around USD 73 per barrel due to weakness in Western and Chinese economy. The INR slightly depreciated during the quarter to close at 83.80 against the USD. India's forex reserved are all time high of USD 692bn so it seems RBI is shoring the reserves into US rate cut cycle instead of letting the INR appreciate.

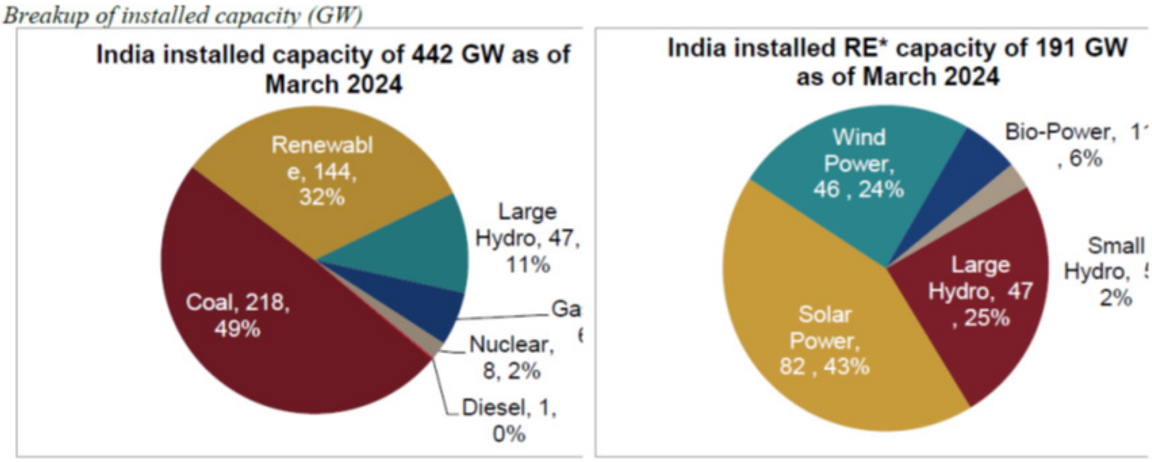
GDP growth at 6.7% for QE June(Vs 7.8% in QE March) was largely in line with expectations, with internals suggesting broad-based growth momentum. The internals of GDP data suggest recovery in private consumption, which rose to a seven-quarter high of 7.4% YoY, while gross fixed capital formation came in at 7.5% YoY, above the previous quarter's level. Government consumption remained weak – spending was restricted in view of general elections. Net exports contributed positively, with growth in exports surpassing imports. Headline CPI inched up to 3.65% YoY in August from 3.5% in July. This was above consensus expectation, led by higher-than-anticipated food prices. However Core CPI (ex food, fuel) remained steady at 3.4% YoY in August, for the second consecutive month.

India current power situation and future of renewable energy

In CY2022, India's per capita electricity consumption of 1.3 MWh was half of that of Brazil while it was around 24% that of China (5.3 MWh) and around 10% of the United Staes (12.7 MWh). Between fiscals 2023 and 2029, India's per capita electricity consumption is expected to grow at ~5-7% CAGR. Power demand is expected to pick up on the back of improvement in access to electricity, in terms of quality and reliability, rising per capital income, increasing EV penetration, railway electrification, on account of intensive rural electrification, resulting in realisation of latent demand from the residential segment, increased penetration of consumer durables.

43% of India's power capacity was renewable but owing to lower capacity utilisation factors, the Renewable Energy(RE) penetration (incl. large hydro) in terms of energy generation was just 21%.

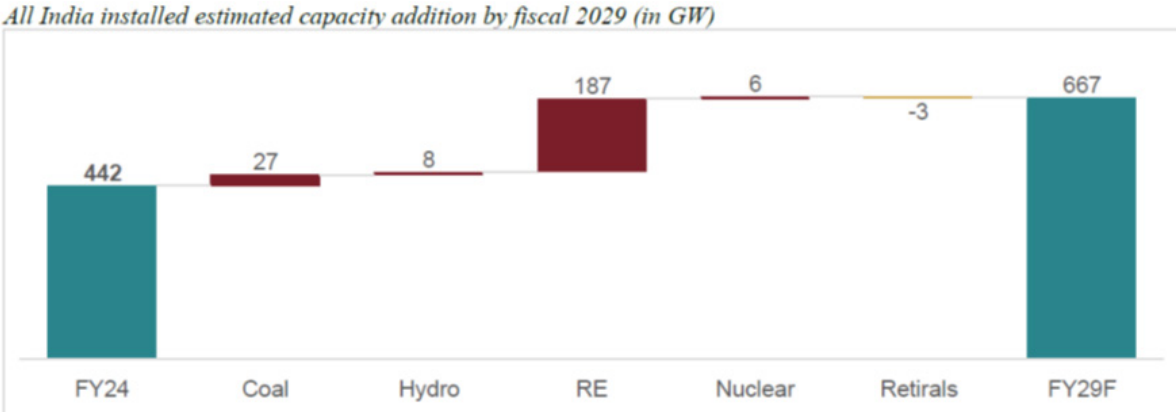
Breakup of installed capacity (GW)



**Including Large Hydro, Source: CEA, CRISIL MI&A-Consulting*

Renewable Energy capacity addition of over 180-190 GW is expected to be installed between fiscal 2025-29 driven by various government initiatives, favourable policies, competitive tariffs, innovative tenders, development of solar parks and green energy corridors, etc. RE capacity is estimated to account for about 50% of the installed capacity of 660-670 GW by fiscal 2029.

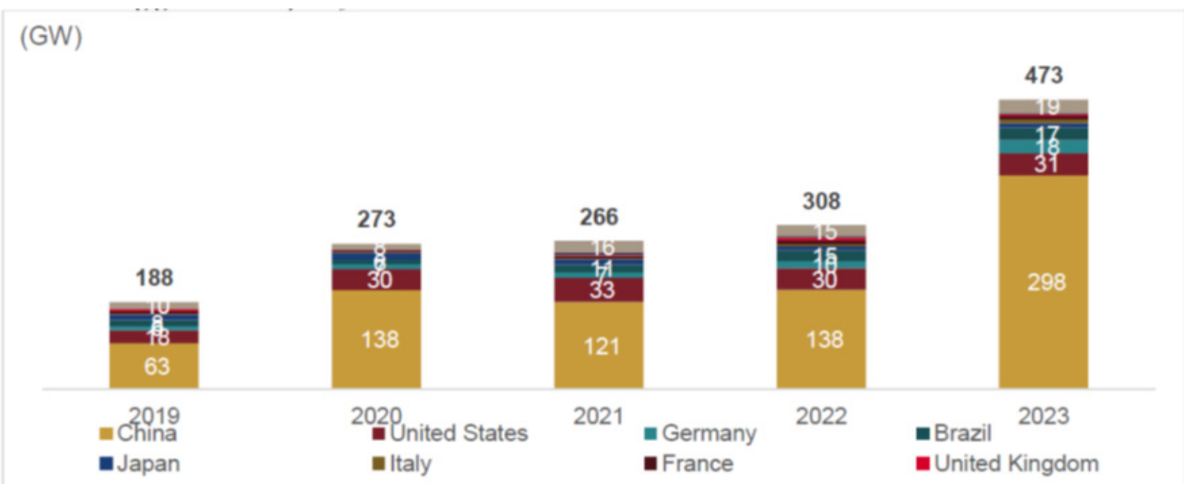
All India installed estimated capacity addition by fiscal 2029 (in GW)



Note: RE includes solar, wind, small hydro, and other renewable sources

Source: CEA, CRISIL MI&A-Consulting

China is leading the Renewable capacity addition globally with 298GW added in 2023 while the same for India was only 15GW.



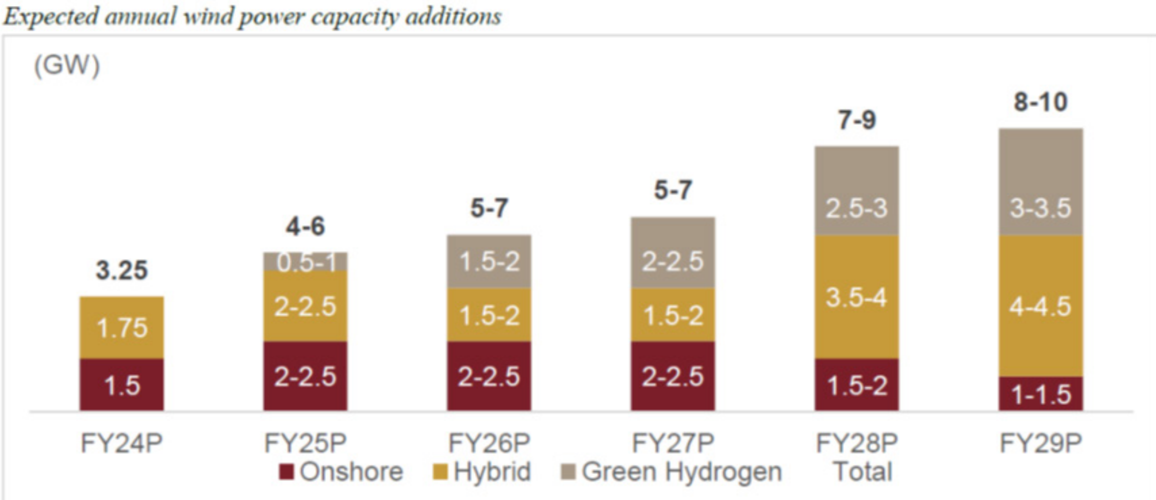
Source: MNRE, IRENA, CRISIL MI&A Consulting

To facilitate growth of renewable energy and, in particular, the solar power secTo facilitate growth of renewable energy and, in particular, the solar power sector, the Government of India(GoI) has provided several measures to facilitate finance availability to developers. Firstly funding is being provided by government institutions like REC, PFC, IREDA etc. Secondly was introduction of Green Bonds which is like any other bond; however, it invests the proceeds to support green investments including renewable energy projects.

In the renewable energy basket (including large hydro) as of March 2024, solar energy accounted for a share of 43%. The sun is the most abundant source of energy on the planet and it is completely replenishable. Solar energy plants can be set up anywhere, especially in country like India where sunshine is almost available for more than 8-10 months across country. Growth in the solar power sector over the last five years has been robust 24.8% CAGR reaching 82GW in March 2024. The National Institute of Solar Energy estimated the country's solar potential at 748 GW, assuming solar PV modules cover 3% of the geographical surface. India is a perfect location for solar energy because of its location. It has 300 days of sunshine each year, with daily peak electricity use being in the evenings and a seasonal peak in the summer. Growth in Solar Energy is driven by Declining module and tariffs, Fiscal & regulatory incentives, setting up of solar parks by the government, improving technology, Green Hydrogen push. As a result 147-142 GW of solar capacity is expected to be added over next 5 years. The biggest challenges in developing solar projects are Availability of contiguous parcels of land & Adequacy of evacuation infrastructure.

India has a vast wind energy potential, estimated at 695.5 GW at 120 meters above ground level (AGL) as per estimates by the National Institute of Wind Energy while installed wind power capacity is just 46 GW(10% of total installed capacity) as of 31 March 2024. Wind power capacity is mainly spread across the southern, western, and northwestern states of India. The top five states (Gujarat, Tamil Nadu, Karnataka, Rajasthan, Maharashtra) make up ~84% of the installed wind capacity. capacity additions are expected to grow over the next five years led by pipeline build-up under existing schemes and new tendering schemes, improvement in technology, thrust on green hydrogen, renewable generation obligation and mixed resource models (RTC, hybrid, FDRE etc.). However, incremental challenges pertaining to wind-site/land availability, grid connectivity, and viability at low tariffs due to elevated capital cost pose challenges for the sector. The government policy to tender 10 GW wind capacity annually till fiscal 2028 will further boost the capacity additions

Expected annual wind power capacity additions



Source: CRISIL MI&A Consulting

Newer wind turbines are being launched that have higher rated capacity and higher hub height (120 -140 m), which can be set up at low-quality wind sites.

WSH(Wind Solar Hybrid) is fast becoming the preferred RE option in India. There are two types of WSH projects — pure-play ones and those with storage. There are also projects that may come up under the government's RTC power scheme, which has a mandatory 51:49 blend of RE and thermal. Wind and solar sources complement each other. Due to their inherent characteristics, they generate power during different times of the day as well as seasons. Wind power is at its maximum during nighttime whereas solar power is available only during the day.

Therefore, for 24X7 supply, they complement each other and hence WSH projects provide more reliable power and can be used for round the- clock (RTC) supply.

In the last 6 years (fiscal 2018 to December 2023) India has added only ~2.4 GW large hydro capacity. Its expected 15-16 GW of hydro power capacities will be commissioned (out of 18 GW presently under construction) over fiscals 2025-29. Hydropower projects involve submergence causing the displacement of project area people. The rehabilitation of project affected people is also a major issue. Further, getting forest and environment clearances also delays the project. Many hydropower projects with common river systems between adjoining states are held up due to a lack of inter-state agreements and disputes on water-sharing.

Energy storage technologies can be broadly divided into four segments – mechanical, electromechanical, chemical, and thermal storage. However, only a few technologies are available on a commercial scale worldwide. Technologies such as pumped hydro storage (PHS), lithium, and sodium batteries are available commercially and are being used for different applications. The identified potential of PHS in the country is about 124 GW (comprising 114 PHSP). However, the operational capacity of PHSP is merely 4.7 GW, which indicates the large potential growth in this segment. The Battery storage technology is yet to achieve its full potential to provide grid support services, and comes with high investment cost and changing technology,

and therefore has associated risks. Further, batteries would require replacement or disposal after 7-10 years, depending upon usage. The Government has taken several measures such as providing legal status to storage, energy storage obligation, waiver in ISTS charges, captive status for energy stored in batteries.

Hydrogen, the universe's most abundant element, is making waves as a clean energy source for a sustainable future. Hydrogen can be classified into different types based on its colour, which is often an indication of its production method, purity, or intended use and also use of fuel for production of hydrogen. Green hydrogen is produced from renewable energy sources, such as solar, wind, or hydro power, through electrolysis of water. The National Green Hydrogen Mission was approved by the government on January 4, 2022. The mission aims to make India a leading producer and supplier of green hydrogen in the world. The mission would result in development of green hydrogen production capacity of at least 5 million metric tonne per annum with an associated renewable energy capacity addition of about 125 GW in the country. However, the storage and transportation of hydrogen pose significant challenges due to its unique properties and infrastructure is being developed for that. Production linked incentives schemes are also being given to produce Green Hydrogen.

Nifty Q4 FY24 Earnings Review

Sales/EBITDA//PAT growth for Nifty constituents was in line at +7%/+5%/ +4% YoY in 1QFY25. Nifty reported first quarter of a single digit EBITDA growth (5%) in four years. The banking sector reported a soft quarter amid tepid business growth, NIM moderation, and a slight increase in provisioning expenses, mainly for private banks. NIM contracted for most banks as cost pressures persisted amid intense competition for liabilities and continued pressure on CASA mix. For microfinance asset quality deteriorated even as loan growth was muted; elevated credit costs impacted profitability. Steady strong trajectories in F&O and cash volumes translated into strong performances by capital market-related players, such as brokers and exchanges. These trends have further strengthened with customer acquisitions and record-high turnover. Auto OEMs reported ~10% YoY volume growth in 1QFY25, with nearly all the OEMs contributing to this broad-based growth. 2Ws led the way with around 11% YoY growth, followed by PV at 6% YoY growth. CVs and tractors both posted 4% YoY growth. In the staples sector, demand has been steadily increasing, with signs of growth in rural markets. There is a YoY improvement in volume growth, and further improvement is expected in the coming quarters. The IT services companies reported healthy slight improvement with a median revenue growth of 1.2% QoQ CC. With a mild recovery in discretionary spending among BFSI clients, their focus is now transitioning from the cost-takeout deals to "high-priority" transformation deals in some pockets. The profitability in Pharma companies was driven by: 1) lower raw material costs, 2) reduced intensity of price erosion in US generics, and c) launch of niche products. The EMS sector reported another strong quarter with aggregate revenue growth of 75% YoY. This was driven by the execution of a strong order pipeline.

The sector witnessed healthy order inflows.
Infrastructure companies reported weak numbers YoY in 1Q FY25, primarily because of general elections, monsoons, delays in land acquisition and subsequent delays in Appointed Dates (AD) for several project.

Portfolio Review

The overall exposure of the portfolio hasn't changed much, with Mid & Small caps maintaining similar exposure. Portfolio adjustments included adding exposure to Information Technology, Consumer Discretionary, Healthcare, Real Estate & Utilities while reducing exposure in Financials, Industrials, Energy & Materials. We fully sold off Bajaj Finserv from the portfolio and allocated the exposure to SBI Life, HDFC Bank, Axis Bank & ICICI Bank. We also fully exited Birla Corp as the company has always exhibited very volatile margins through the cycles and difficult to forecast its earnings. We also exited Tata Steel as metal prices and demand continued to remain weak driven by global slowdown. Domestic business heavy pharma names underperformed the pharma exporters hence we added two new domestic names Alkem Labs and Mankind Pharma to the portfolio. Both can grow their business at slightly higher than the sector average. Mankind Pharma has also acquired the business of Bharat Serum Vaccines which is very strong in women's health & fertility business. We are also very positive on the power demand growth and the transition into renewable energy production. Hence we added a power utility company CESC and a solar cell and module manufacturer Premier Energy. Premier Energy recently did its IPO is which we participated. We continued adding more exposure to IT Services through LTIMindtree, Infosys and TCS as the worst seems to behind us for these companies though their pace of recovery might be slow. We also added more exposure to Dabur and IRCTC. We booked aprtial profit in Angelone due to the regulatory overhang though the valuations for the stock are benign, Once the regulatory clarity is there we would look to add back the exposure to this name. We also reduced CreditAccess due to the downcycle in the MFI industry but being it the best managed company in the sector and available at good valuations hence once the situation in the sector stabilises we shall look to ass back the exposure.

Mankind Pharma get 91% of its sales from India. Its chronic segment has ramped up to 37% of sales. Its growing at 1.2x the growth of the domestic pharma market and currently specialist doctors account for 50% of its prescriptions. Its amongst the best brand builders in the country with 24 brands above INR 1bn of sales. Mankind acquired 100% stake in Bharat Serums and Vaccines Ltd. (BSV) from Advent International for an enterprise value of ~INR 136 bn. BSV has a niche portfolio offering in Women's Health, encompassing the entire lifecycle-from fertility to post-pregnancy. BSV's EBITDA margin is superior to Mankind's at ~28% as for FY24 with a revenue growth of ~21% CAGR over the past three years. We believe the transaction is a strategic fit for Mankind as it looks to acquire companies with high entry barriers. We also believe Mankind has scope to expand its coverage and market share in several large therapies like Neurology, dermatology and oncology where its weak. Geographically it can expand its coverage in all but North region. The company is expected to double its profit over next four years.

Alkem Labs geographic footprint spans 40 countries, 19 manufacturing units with over 800 brands. It gets 70% of its sales from India business. Its new mgmt. team is undertaking several strategic steps to create a new path for the company. Work has already started to improve operational efficiency, rationalize R&D costs, chase profitable growth instead of just growth, improve chronic sales contribution and create new business lines. Key levers for growth in medium term will be India & EM performance, biologics CDMO and MedTech. Improving margins will be key near-term focus but gains will be reinvested in new business lines thus reported margins may reflect just ~100bps improvement in next 1-2 years. Its key focus therapies to drive growth in India will be Anti-diabetes, CNS, derma and respiratory. The company can compound its EBITDA at 15% over next 2-3 years.

Premier is India's 2nd largest integrated solar cell and solar module manufacturer with an annual installed capacity of 2 GW and 3.4 GW, respectively. 17% of its revenues come from exports and rest within India. Its business operations include (i) the manufacturing of solar photovoltaic ("PV") cells, (ii) the manufacturing of solar modules including custom made panels for specific applications, (iii) the execution of EPC projects. The ability to adapt to new and ever-changing technologies, as evidenced by its transition from polycrystalline cells to monocrystalline cells and now to TOPCon cell technology, is Premier's key strength. Indian government has imposed a host of barriers for Chinese entry into Indian markets; a) imposed approved list of modules and manufacturers (ALMM) on modules and b) custom duty of 40% on module and c) custom duty on 25% on cell. On the demand side almost 50GW of tendering is expected annually going forward. To take advantage of the growing market they will increase their capacity to 7GW cell and 8GW module by FY27e. It is also planning to backward integrate into wafer production. The company can more than double its profit over next four years.

CESC is India's first fully integrated electrical utility company (since 1899) with business interest in generation & distribution of power & Headquartered in Kolkata. It has 2.14 GW generating capacity and distributes power across 6 cities including Kolkatta. Power demand in India is expected to grow at 7% CAGR over next few years. It has shown its intent to grow and invest further in the power sector by setting up 3.2GW of renewables and grow that to 10 GW over longer term. They have also successfully won a bid in the recent Green Hydrogen auctions conducted by SECI. Conclusion of short term PPA with Railways will enable it to sell 300MW of thermal capacity on merchant markets and boost profits at Dhariwal IPP. The FPPA surcharge levied from June'24 will increase going forward as CESC plans to recover additional fuel costs and past under-recoveries under the mechanism. At the current rate of surcharge levied the cashflows for CESC should improve by INR 5-6bn. At 1.9x FY26ii P/B, the valuations are at a discount to other private utilities given the low growth in earnings (1% cagr through FY20-24) but can re-rate materially if management is able to revive growth by executing on the RE front, trimming losses at distribution franchises, and lowering under-recoveries at Kolkata

Outlook

Since its re-election for a third successive term, the BJP-led NDA has demonstrated continuity in policy, i.e., consolidation of fiscal deficit and investment in both physical and social infrastructure – good news for both macro stability and growth. We expect further policy announcements to reinforce these trends. Government spending has picked up post elections lull, and private spending also appears to be on a recovery path, led by rural consumption. Uncharacteristically for the stock market, the upcoming state elections in 4Q, including Maharashtra and Haryana, will attract attention. This is because of the rising tendency of state governments to resort to populist spending ahead of elections. We expect to take a neutral stance in the October meeting driven by the slowdown in economy and eventually lead to rate cut in December 2024 or Feb 2025. Primary activity continues to be high driven by the liquidity in the system. Typically FPI flows into the Emerging Markets pickup during the Fed rate cut cycle as seen in the India over last two months. Earlier the net flows YTD were very weak. Policy action in China is already resulting in underperformance for Indian stocks, which should track though the Foreign investors were Underweight India even before this event. In short term Large Caps might outperform the Mid & Small Caps due to their higher valuations Vs the past average.

From a sectoral perspective, given the continued strong domestic growth, we are positive on domestic themes such as Banks, NBFCs, insurance, manufacturing, hospitals, power, and consumer discretionary. In Banking we remain vigilant about margins and the delinquency cycle in unsecured loans and factor in a marginal increase in credit cost for private banks. Robust balance sheets, strong contingency buffers and reasonable sector valuations keep us positive on the sector. There is an expectation of global interest rate cuts in 2HCY24, which (if and when it happens) will be positive for the NBFC sector (particular fixed-rate lending like vehicle finance and MSME). The microfinance sector could go through a difficult patch for the next few quarters because the problem of customer overleveraging is broad-based (spread across different states) and this stress will run its course before things improve. IRDAI has announced new regulations regarding surrender values, to be implemented from 1st Oct'24. The product and commission construct could undergo significant changes, leading to volatility in premium growth for the rest of FY25. However structurally Life insurance sector can still grow at 15% for few years. In Auto channel inventory is gradually rising, especially in PVs. Favourable monsoon and upbeat rural sentiments points towards a demand revival in the upcoming festive season. Overall, 2Ws are likely to post high single digit growth in FY25E and also a revival in exports over a weak base. A positive rural sentiment is likely to help revive tractor demand from the festive season. With stable macro drivers along with expectation of favourable monsoon, we expect volume growth in FMCG to continue to accelerate in FY25. Companies are focusing on the traditional framework (distribution reach, product launches, consumer offers, etc.) to gain the growth momentum. Most capital goods companies remained positive on a strong order pipeline given the government's emphasis on capex-led growth. EMS companies will continue to exhibit strong growth driven by swelling orderbooks. Consolidation is intensifying in the cement industry, and this should benefit in the longer term. Cement demand is expected to improve in 2HFY25, backed by infrastructure and housing segments. Awarding activity by NHAI has finally picked up in August and expected to continue with the elections behind us. Metals have been weak driven y global growth however we need to see how they behave with the latest stimulus announced by the Chinese government. Refining margins continue to be weak driven by global slowdown. Real Estate companies will continue to deliver strong pre sales driven by the current upcycle and momentum in the sector. We need to closely watch the IT space where the stocks have moved ahead of big earnings improvement. We continue to be positive on telecom as all the incumbents are prioritising profitability.

Overall, the Indian market continues to be around an all-time high but on a broader level, the Nifty is trading at a 1-year forward P/E of 21.5x compared to the 10-year average of 20.4x, and at a P/B of 3.5x compared to the average over this period of 2.8x (Source: Motilal Oswal). The market-cap to GDP ratio for FY25e is at 146%, higher than its 10-year average of 84%. The earnings growth expectations continue to be attractive with FY24-26e earnings CAGR forecast around 14% (Source: Motilal Oswal). We need to keep a close track on the rate cycle in USA and the action taken by RBI to address the slowdown in the Indian economy. Any actual recovery in Chinese growth will be positive for commodities and linked companies.