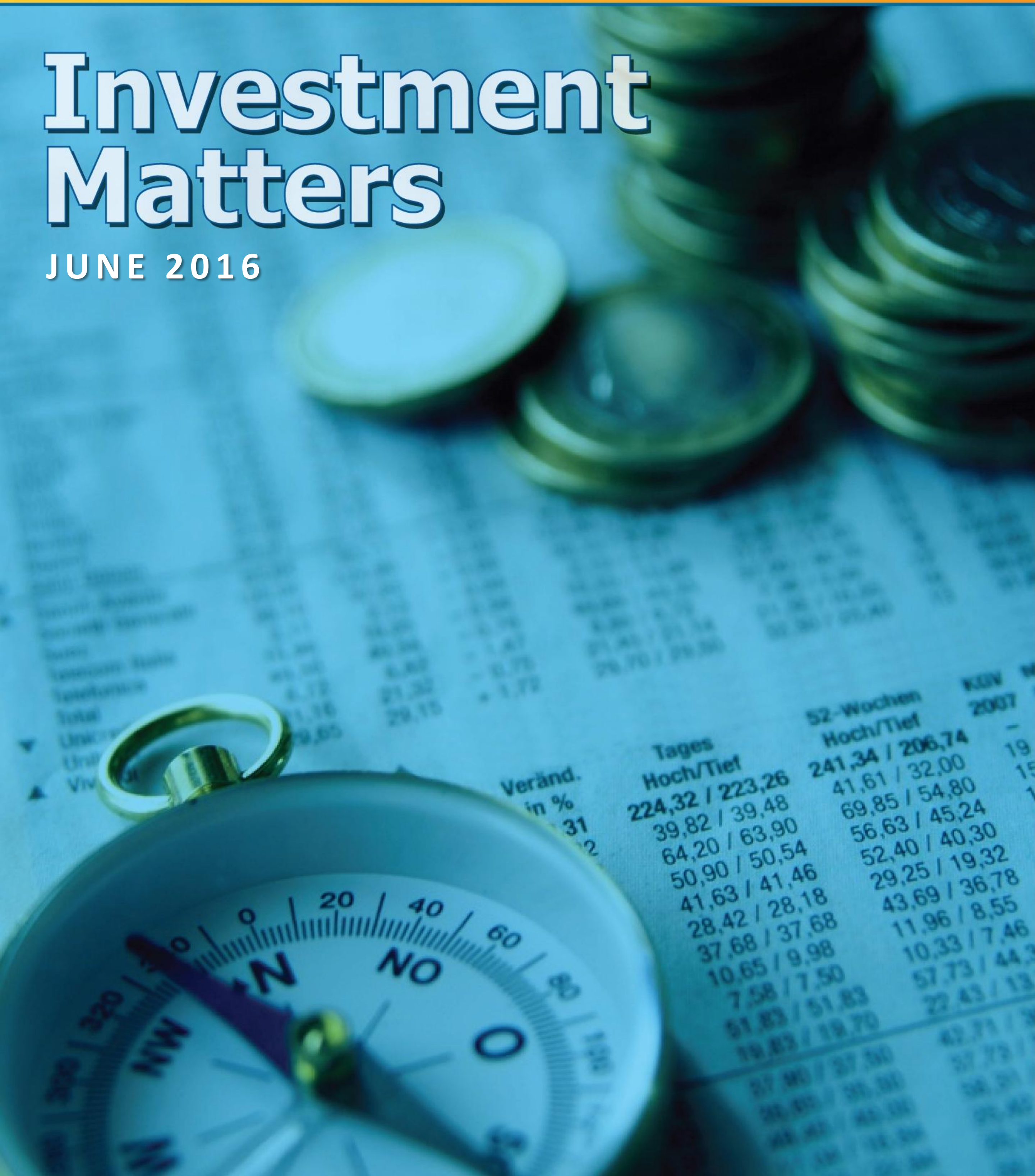
ALCHEMY
CAPITAL MANAGEMENT

Investment Matters

JUNE 2016



EQUITY OUTLOOK

Strong double digit profit growth by corporate India after a long phase of consolidation (excluding banks) makes us quite optimistic for the future outlook for FY17 and beyond. Q4FY16 BSE30 companies (ex banks) reported a 16% growth in profits. Though it is only a quarterly phenomenon as of now given the fact that FY16 annual profit growth was only 0.2% including the strong numbers reported in Q4, we are seeing the negative impact of commodity price correction going away and hence sales growth is once again picking up, boosting our expectations of a better FY17. Consensus expectations for BSE30 Sensex earnings growth is in a range of 14-16% for FY17 with an assumption of a good monsoon. India has seen weakness in demand specially in rural areas on the back of two back to back weak monsoon affecting crop production while due to global factors crop prices also fell during the same period impacting farm incomes substantially. FY17 needs a good monsoon and as per the Met Department, monsoon is likely to be 105% of long period average.

The trend of better earnings delivery from our investee companies continued with average profit growth in excess of 30%. As always there were a few hits and a few misses during the quarter worth highlighting which prompted us to invest in a few new names in the portfolio which can enhance the return profile for our clients going ahead. Among the companies which delivered robust performance and look promising to us even going ahead were – Bajaj Finance, Biocon, Essel Propack, Grasim Industries, Ramco Cement, SKS Micro, Sundram Fastners, Ujjivan Financials, Ultratech Cement. While among the misses during the quarter were – BEML, Container Corporation, Inox Wind, Mahindra CIE, Ipca Labs, Praj Industries and Texmaco Rail. Within the laggards for the quarter we expect BEML (execution of defence contracts has started along with new order wins which is likely to drive strong performance going ahead), Inox Wind (Profit growth was strong at 60%, however receivable days need to improve which we expect to see by September 2016 driving stock performance), Container Corporation (Volume growth in FY17 is likely to grow in double digit along with margin improvement), Texmaco Rail (Execution of large order from dedicated freight corridor for bridges, track laying/signalling will drive profitability during FY17) and Praj (New order wins along with margin improvement to drive FY17 earnings) to deliver much better earnings going ahead and are confident of a rerating on the back of better numbers. However, Ipca labs was one name which we chose to exit during the quarter due to delays in ramp up in US/WHO sales. We have added Ujjivan Financial Services, SKS Microfinance, Bajaj Auto in portfolio during the month which are likely to add to performance going ahead. A gist of earnings for our portfolio companies is presented below for reference – we continue to expect strong earnings growth in excess of 25% CAGR from our portfolio companies and hence are optimistic of future outlook.

Refer Table Mentioned Below:-

EQUITY OUTLOOK

Rs mn		Sales			EBIDTA			PAT			EPS		
Name of company	CMP	Q4FY16	Q4FY15	% chg	Q4FY16	Q4FY15	% chg	Q4FY16	Q4FY15	% chg	Q4FY16	Q4FY15	% chg
Bajaj Auto	2630	54114.2	47393.4	14%	11515.3	8378.1	37%	8030.6	6216.2	29%	27.8	21.5	29%
Bajaj Finance*	7900	19168.1	14294.3	34%				3150.4	2309.8	36%	58	44	32%
Bajaj Finserv	1870	25670.3	24058.2	7%	18336.8	18127.8	1%	5179.5	7071.2	-27%	32.5	44.4	-27%
BEML	840	10087.5	12793.3	-21%	1795.6	1629.5	10%	1545.8	1688.5	-8%	37.1	40.6	-8%
Bharat Electronics	1180	32148.5	29281.6	10%	9988.23	7925.898	26%	7945	7228.6	10%	33.1	30.1	10%
Biocon Ltd	720	9788	8377	17%	2131	1852	15%	3609	2015	79%	18.1	10.1	79%
Container Corporation	1350	14152.3	15089.8	-6%	1975.5	3300	-40%	1410	2927.1	-52%	7.2	15	-52%
Essel Propack	187	5613.6	5458.5	3%	1031.3	978.7	5%	488.7	396	23%	3.1	2.5	23%
Everest Industries	305	3372.5	3184.6	6%	270.3	251.3	8%	118.9	100.7	18%	7.8	6.6	18%
Grasim Industries	4300	25396.4	17331.8	47%	4650.1	1291.4	260%	2085.9	309.7	574%	22.3	3.4	562%
HDFC Bank*	1170	188626.1	155701.3	21%				33742.2	28069.1	20%	13.2	11.3	17%
Honda Siel Power	1200	1939.8	1844.7	5%	287.9	214.5	34%	153.6	144.5	6%	15.1	14.3	6%
Infosys Ltd	1260	141580	119260	19%	42490	35200	21%	33990	30240	12%	14.8	13.2	12%
Inox Wind	220	18286.5	9300.5	97%	3123.2	1703.8	83%	2092.3	1178.8	77%	9.4	5.9	60%
ITD Cementation	128	10155.94	5877.222	73%	660.703	321.251	106%	230.196	-966.722		1.5	-6.2	
Mahindra CIE	197	13269	13384	-1%	1420	1549	-8%	535	1018	-47%	1.7	3.2	-47%
Maruti Suzuki	4200	15305.7	13624.8	12%	2350	2164.3	9%	1133.6	1284.2	-12%	37.5	42.5	-12%
Praj Industries	82	3298.3	3061.9	8%	442.4	398.3	11%	340	366.1	-7%	1.9	2.1	-8%
Ramco Cement	530	10153.9	9975.2	2%	3453.2	2744.5	26%	2063.3	943.6	119%	9	4	125%
SKS Microfinance Ltd*	670	3297.6	1976.2	1%				844.7	405.4	110%	6.6	3.2	107%
Sundaram Fasteners	165	7008.1	6004	17%	1061.7	665.9	59%	753.9	159.7	372%	3.6	0.8	350%
Syngene International	385	3315	2518	32%	1031	834	24%	665	556	20%	3.3	2.8	19%
Tech Mahindra	540	68837.3	61167.9	13%	11613.1	9366.1	24%	8970.8	4720.1	90%	9.1	4.8	90%
Texmaco Rail & Eng Ltd	100	2287.3	1444.9	58%	98.9	126.2	-22%	113.7	132.8	-14%	0.5	0.6	-17%
Thomas Cook	980	12987.5	8648.7	50%	624.2	348.3	80%	165.3	70.8	133%	0.5	0.2	133%
TV18 Boradcast	40	67133.7	62974.7	7%	9929.8	7537.1	30%	825.1	954.7	-10%	0.5	0.6	-14%
Ujjivan Financial Services*	350	2979.7	1921	55%				549.1	272.2	102%	6	3.8	56%
Ultratech Cement	3300	69201	65952.3	5%	14395.4	13824.4	4%	7225.6	6572	10%	26.3	23.9	10%

* No EBIDTA for the Finance Companies .

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DEBT OUTLOOK

At its second bimonthly monetary policy review of the financial year, RBI kept the repo rate unchanged at 6.5 per cent. Consequently the reverse repo rate will remain unchanged at 6.0 per cent. The cash reserve ratio (CRR) of scheduled banks has been retained at 4.0 per cent of net demand and time liabilities (NDTL). The RBI has retained its GVA (Gross Value Added) growth projection for FY17 at 7.6%. The inflation projections given in the April '16 policy statement have also been retained but with an upside bias. Retail inflation in April '16 rose more than expected largely due to food prices and as per RBI, makes the future trajectory of inflation somewhat more uncertain. However, the expectations of normal monsoon and various supply management measures of the government should moderate unanticipated firming up of food prices. A higher inflation will act as a hurdle in any move by the central bank to cut interest rates further.

In its bimonthly money policy statement of April 2016, RBI stated that it would watch macroeconomic and financial developments in the months ahead with a view to responding as and when the space opens up, but it maintained an accommodative stance. Incoming data since then shows a sharper-than- anticipated upsurge in inflationary pressures emanating from a number of food items as well as reversal in commodity prices. We believe given the uncertainties, RBI will stay on hold, but the stance of monetary policy remains accommodative. RBI will monitor macroeconomic and financial developments for any further scope for policy action.

Liquidity conditions which had tightened towards the end of the financial year FY 16 had started easing in April. The easing continued into May reflected in the daily negative system deficit which is now averaging around INR 700 billion as against the average of approx. INR 2000 billion in March. Liquidity easing has been aided by OMOs being conducted by RBI at regular intervals. As conveyed at the Policy meeting, RBI is looking at infusion of permanent liquidity in the system in order to eliminate the liquidity deficit. Besides Government spending has also picked up for the in H2 of FY 16 and more specifically starting December which was the festive season. We expect liquidity conditions to remain benign aided by liquidity infusion and Government spending. This should help in better transmission of rates across the curve particularly at the shorter end. As a result we expect some curve steepening going forward.

Global growth is uneven and struggling to gain traction. World trade remains muted in an environment Of weak demand," said the RBI statement. In the United States, growth was slow once again in Q1 because of contracting industrial activity and exports. Recent indicators of labour market activity have also weakened.

In these scenarios we expect markets to be range bound. Gilts remained range-bound with 10year benchmark trading between 7.42%-7.48percent on the back of 700 Billion of OMO purchase by RBI. Money market rates fell across the curve by 5-10bps as liquidity improved. Average LAF borrowing fell from `1,082 Billion in April to 970 Billion in May (Source: RBI). With the upside risk of inflation and liquidity expected to be moving from current negative level to neutral level, we expect markets trade at current levels. We suggest investors to hold on to their positions in long term debt and for fresh investments consider accrual/short term debt strategy.

Advisory Team

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