

• **Monthly Update** •

Objective: To seek long-term capital appreciation with investments predominantly in mid and small cap companies.

Target Investors: Ideal for long-term investors seeking returns through investments predominantly in small and midcap stocks and are comfortable with short-term volatility.

Investment Horizon
Above 3 years

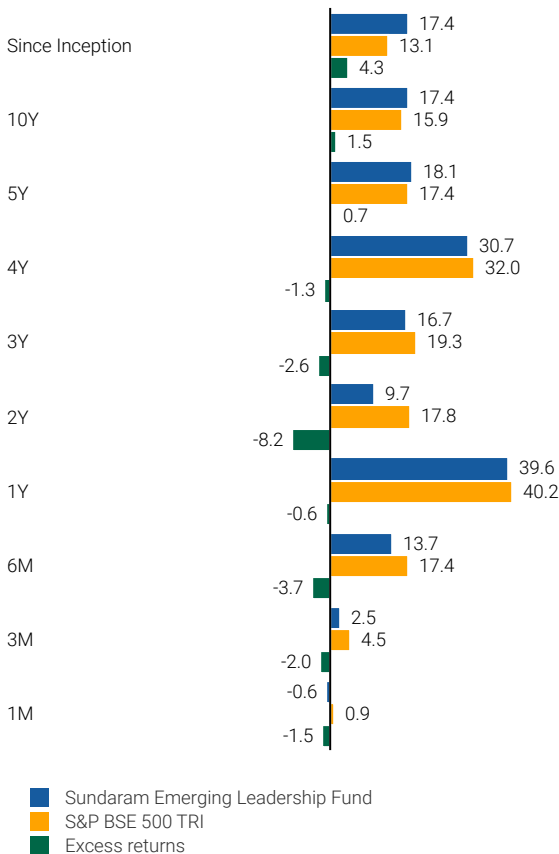
Benchmark
S&P BSE 500 TRI

Inception
June 2010

Primary Fund Manager
Mr. Madanagopal Ramu

Co-fund Manager
Mr. Prashant N Kutty

S.E.L.F vs S&P BSE 500 TRI (%)



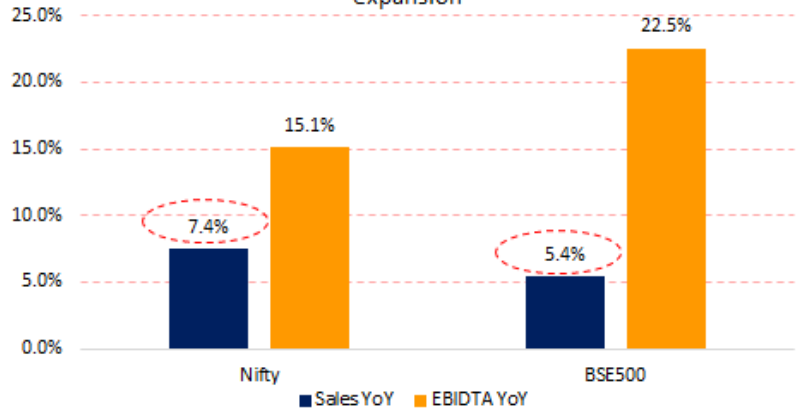
Overcast condition – Time to shift to quality

India Inc - 2023 earnings would have been muted if not for commodity price fall helping margin expansion in an otherwise muted volume growth year. We disagree with market on suggestion to move from small/midcap to large cap which also lacks earnings trigger. Earnings growth is going to be selective in stocks across cap curve.

Lack of any such catalyst for 2024, could hurt FY25 earnings expectation.

We discussed in our previous note about how the 2023 earnings performance of corporate India was strong but was mostly supported by margins rather than revenues. Weak volume growth was more than compensated by gross margin expansion, leading to stronger earnings growth of around high teens. Gross Margin expansion was a function of sharp fall in commodities, which spiked the year before due to Ukraine Russia war. Metals, materials, basic chemicals all of them corrected sharply as supply chain issues surrounding war got normalised and dumping of commodities from China, due to domestic slowdown. Generally, we can't argue for valuation rerating in a stock if there is surprise only due to margin, particularly if the volume growth is weak, because it's not a sustainable growth, but this factor rerated many of these stocks particularly in mid and small cap space.

Weak topline growth, earnings gr was aided by Margin expansion



Source: Bloomberg, ACE Equity, Sundaram Alternates. Note: TTM Growth as of Dec-2023.

We are not able to match the overall strong GDP growth with volume growth in many sectors in listed space. It could be because of reversal of unorganised to organised story which played out during Covid-19. Investments driving growth should have translated to consumption growth as well, which is lagging significantly. We are not seeing broad based volume growth in FMCG, consumer discretionary, auto companies except in some pockets. Few consumption segments even lag real GDP growth.

In 2024 the volume / revenue growth is likely to be muted and like 2023, across most of the sectors and on aggregate basis may be in high single digit, but scope for margin expansion looks limited. Rather with crude at \$90 and China recovery story, we might see risk to the commodity prices and therefore margins. This risk is still little away but cannot be ruled out. But the visible risk is that with margin expansion story behind us and topline growth seems to be muted, we see risk to India Inc earnings growth (Nifty50). Consensus earnings growth expectation as per Bloomberg is 14% for FY25, our estimates suggest closer to 10%. Sectors like Auto, Pharma, Materials even FMCG had low volume growth but got support from margin expansion to deliver high earning growth. In FY25 these sectors likely to deliver subdued single digit earnings growth. In case of Financials, one offs like recovery from written off accounts contributed to earnings surprise, these factors will fade away completely in 2-3 quarters. Overall, we believe the earnings expectation for FY25 is high and needs to be cut. Nifty therefore is trading at 21-22x FY25e, which translates to 4.7% earnings yield. With 7.1% India G-Sec yield the spread of India equities over bond yield is unattractive at negative (-)2.5%. This is decadal low and therefore we cannot argue for large return in nifty50 from current levels unless earnings surprise. Actually spread between corporate earnings and bond yield are at decadal low even globally.

Lack of earnings trigger and high valuations can lead to underperformance of passives in 2024

With muted earnings growth, wider participation to rally and index performance will become difficult. Therefore, active fund manager particularly focused concentrated should do well in FY25. While our stock selection alpha was positive in 2023, our portfolio alpha turned negative due to long tail of benchmark stocks outperforming the indices. In 2024 this will start to change, and tail will start hurting passives and diversified portfolios. We need to ensure our stock selection remains positive during the year to generate alpha. Please remember even in 2023 we managed a positive stock selection alpha.

Peer performance is available under the following link of Association of Portfolio Managers in India (APMI): <https://www.apmindia.org/apmi/welcomeperformance.htm?action=PMSmenu>

Key argument here is; when factors like large swings in commodity prices play out, majority of corporates benefit, and reverse will happen when no such large factor is playing out. With India growth at 6.5% in FY25, the number of companies delivering more than 15% earnings growth will come down substantially and with valuations being high the earnings surprise will become scarce and will become the domain of quality (moat companies) high growth companies which are growing their topline with market share improvements and growing earnings by expanding or holding on to higher margins with the help of their bargaining power. Historically, most of these companies trade at premium multiples, but now saw their premium narrowing down due to market witnessing mean reversion in last 2 years. Mean reversion in market was a function of both flows and earnings being broader based. We see the valuations of quality companies with sustainable moat has narrowed down too much and over next 2 years will regain their valuations as the earnings growth largely remain restricted to a limited universe of high growth stocks trading at reasonable price.

Our Portfolios are well positioned to benefit from these high growth universe

Our PMS portfolios earnings growth are above 20% for FY25 & FY26, and are driven by stocks selections in NBFC, consumer discretionary, ecommerce and industrial space. We are betting on NBFC which should beat banks meaningfully over next 2 years with the help of better credit growth and stable or expanding margins. Stocks like Bajaj Finance, Chola, Fivestar, Home first and Au will benefit from fixed rate books and higher credit growth compared to peers in banking space. Banks on the other hand will see margins and returns compressed due to normalising provisioning cost and lagging impact of cost of funds. When rate cut happens the pressure on profitability will be higher, while it can help NBFCs. NBFCs seem to be in win-win situation. BFSI form 30% of benchmark index. If this works, this call alone can help us generate reasonable alpha over next 2 years.

	NIM FY24e	Loan CAGR FY24-21	Loan CAGR FY26-24	ROA FY24e	EPS CAGR FY24-26	FY26 P/BV
HDFC Bank	3.7%	31.0%	16.2%	1.9%	16.1%	2.3
ICICI Bank	4.5%	18.0%	18.0%	2.3%	6.7%	2.6
Axis Bank	3.8%	17.2%	17.0%	1.8%	11.6%	1.8
Average	4.0%	22.0%	17.1%	2.0%	11.5%	
SBI	3.0%	14.5%	13.6%	1.0%	12.8%	1.5
BOB	3.0%	14.7%	13.6%	1.1%	6.7%	1.0
Canara Bank	2.8%	12.5%	11.0%	1.0%	8.9%	1.1
Average	2.9%	14.6%	12.7%	1.0%	9.5%	
BAF	9.5%	30.4%	31.4%	4.6%	31.0%	4.4
Five Star	16.6%	31.3%	40.0%	8.2%	34.4%	3.3
Home First	7.0%	34.6%	32.0%	3.8%	30.3%	3.2
Chola	6.4%	28.8%	24.9%	2.4%	37.8%	3.9
AU SFB	5.3%	28.3%	25.0%	1.6%	35.0%	2.5
Average	9.0%	30.7%	30.6%	4.1%	33.7%	

Source: Bloomberg, Internal estimates

Company	EV/EBIDTA FY26E	EV/Sales FY26E	Revenue CAGR (FY 24-26E)	Revenue CAGR (FY 19-24E)
FMCG Staples				
HUVR	29.0	7.1	9%	10%
Nestle	42.6	10.5	11%	11%
Dabur	28.4	5.9	10%	8%
Marico	26.3	5.6	10%	6%
ITC	16.1	6.0	10%	8%
Discretionary & Retail				
Titan	41.6	5.2	17%	20%
Sapphire Foods	14.2	2.8	19%	17%
Trent	42.6	6.4	31%	36%
Zomato	57.1	7.3	32%	56%
Nykaa	53.2	4.8	26%	45%

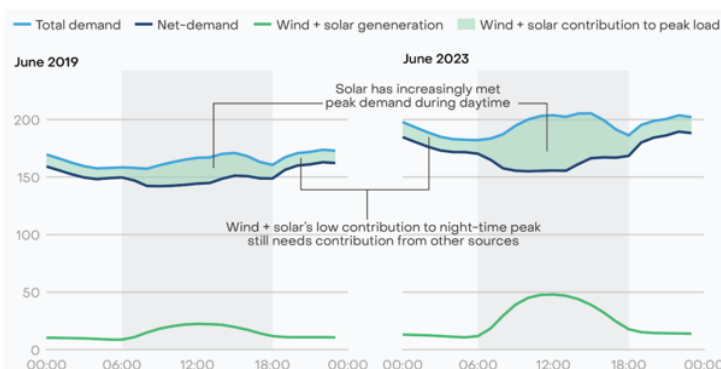
Source: Bloomberg

Our consumer discretionary stock selection like Trent, Zomato and Titan stood out in 2023, despite consumption sector underperforming. These stocks will continue their leadership in 2024 as well with the help of superior execution. They will see much superior earnings growth compared to FMCG companies which form 10% of benchmark again. We expect returns from these stocks will be in line with earnings at around 20%. 2023 was a great year for all these stocks. Our calls like Sapphire might take over that role in 2024-25. Wait for turnaround in QSR space, which is

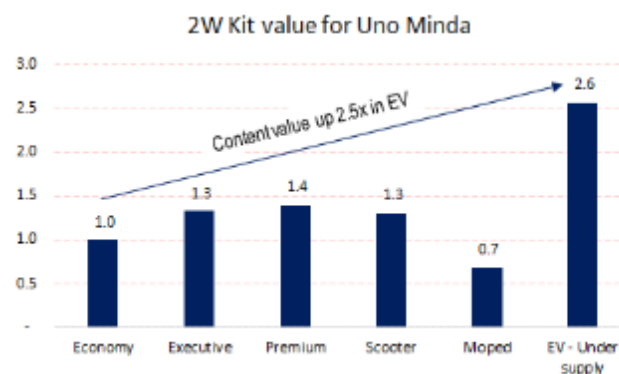
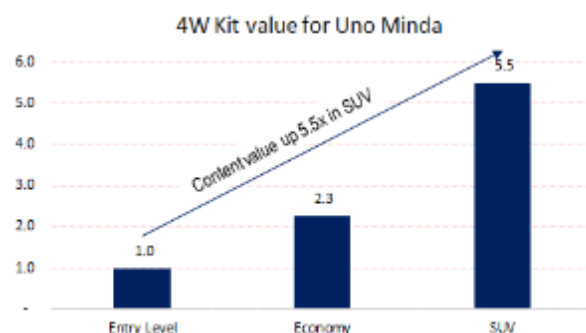
still underpenetrated in India, valuations are compelling, disproportionate returns possible.

In manufacturing we have higher allocation to power sector and chemicals sector. Both these sectors will benefit from favourable cycle in 2024. Power sector will benefit from peak deficit widening over next 5 years, order inflow likely to be strong. Power T&D space will also see revival in capex with large renewable capacity addition burdening the grid over next 5 years. Chemicals will see outlook becoming better in second half in agro chemical space and valuations are non-demanding here. Any small improvement in outlook can lead to substantial performance in this space.

Average Daily peak and net demand in GW for June-2019 and June-2023



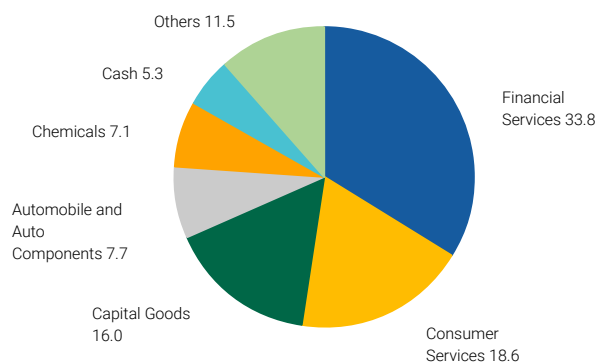
Source: Ember's Analysis of Merit India data



Our Auto exposures are play on emerging trends like premiumisation, connected cars, electric vehicles, digital and LED light features etc. Auto ancillary companies like Uno Minda, Motherson Sumi will outgrow auto space by 1.5 to 2.0x with the help of content per vehicle increase on the back of trends highlighted above.

Source: Uno Minda investor presentation, Sundaram Alternates

SECTOR ALLOCATION (%)

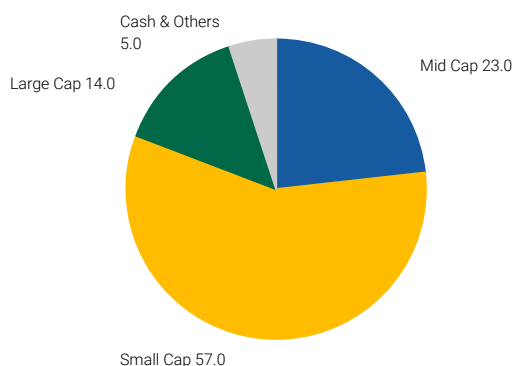


Note: Numbers may not add up due to rounding

WEIGHTED AVERAGE MARKET CAP

₹ 42,337 Cr

MARKET CAPITALIZATION (%)



Note: Numbers may not add up due to rounding

PERFORMANCE MEASURES – SINCE INCEPTION

Instruments	Strategy	Benchmark
Arithmetic Mean	17.2	13.6
Standard Deviation	14.9	16.1
Beta	0.8	
Sharpe Ratio	0.7	0.4
Correlation	0.8	
Alpha	5.1	
Tracking Error	9.4	
Up capture Ratio	100.9	
Down capture Ratio	79.4	

Performance Benchmarking

SEBI vide circular dated 16th December 2022 mentioned that Association of Portfolio Managers in India (APMI) shall prescribe a maximum of three benchmarks for each Strategy. Effective from 1st April 2023, the Portfolio Manager shall select one benchmark from those prescribed for that Strategy to enable the investor to evaluate relative performance of the Portfolio Managers. APMI vide communication dated 31st March 2023 prescribed the following benchmarks:

Strategy	Benchmark 1	Benchmark 2	Benchmark 3
Equity	Nifty 50	S&P BSE 500	MSEI SX 40

Among the options given, we had selected S&P BSE 500 which is a broad-based benchmark to our PMS strategies.

PORTFOLIO & STOCK PERFORMANCE

The portfolio has underperformed the benchmark by 1.5% during the month, which was led by across the board fall in mid and small caps. The performance was supported by stocks - Zomato up 10% on the back of positive outlook on the Quick commerce business and healthy traction in food delivery business; Cummins up 9.8% as Cummins is witnessing strong demand tailwinds in the domestic power-gen and distribution segment. Further, there is wider acceptability of CPCB-IV products and higher pricing. The underperformance was due to Birla corp down 13.3% as despite volumes increasing, cement companies have witnessed a drop in pricing. However, immediately post 4Q24, channel partners have been notified of a price hike which should support the near-term profitability; Ujjivan down 13.2% due to some issues in MFI sector, especially in regions of Punjab, Haryana, MP & Gujarat. Though the exposure is limited in these regions for Ujjivan, negative sentiments or uncertainty around led to correction of all MFIs including Ujjivan.

During the month, we have initiated position in the following stocks:

1. Cholamandalam Investment & finance: Chola has successfully diversified into HL, LAP & new business (now 40% of the business) besides Vehicle Finance. Chola has strong pricing power in this semi urban & rural segment, where more than 90% of the branch resides. It has the strongest earnings growth visibility across the large NBFCs and is likely to be biggest beneficiary of rate cuts led by its high share of fixed book profile.
2. Max Financial services: Max Financials is a good franchise, is trading at 1.6x FY26 EV discount to peers like HDFC life, SBI life (2.1x/1.8x). Uncertainties around surrender value regulations weighed more on Max than other because of higher mix of savings products, but the actual regulations were supportive. Monthly business yoy growth was also better than the overall market for several months now. Counter share of Max in Axis bank banca channel also settled now. Life insurance as a space is also attractive from business and earnings growth prospects in the medium term. All led us to invest in Max financials.

KEY FEATURES

- Bet on Sundaram's strength in the mid & small cap space; a **differentiated** yet **concentrated portfolio** positioned attractively along the cap curve.
- Multi-sector portfolio.
- Stocks with market cap less than Rs. 500 billion.
- "EASE" portfolio
 - Emerging leaders – clean and high-quality promoters/management.
 - Asset light & High ROCE businesses are preferred.
 - Scalable companies: mid-cap to large cap, small cap to mid-cap transitioning companies.
 - Excellent cash conversion from operations.
- Identify stocks that are in the early stages of their business cycle and could emerge as tomorrow's large caps.
- India 2025 - Themes
- Financial inclusiveness
- Phygital Bluechips
- Consumption Czars
- Manufacturing Maestros

This material should not be construed as solicitation for investing in countries where restrictions exist on soliciting business from potential clients residing in such countries

TOP HOLDINGS

BHARAT HEAVY ELECTRICALS LTD
ZOMATO LIMITED
FIVE-STAR BUSINESS FINANCE LIMITED
HOME FIRST FINANCE COMPANY LIMITED
Sapphire Foods India Limited

KEY CONTRIBUTORS

Symbol Name	Unit Cost (INR)	Unit Price (INR)	Gain/Loss (%)
ASTRAL LIMITED	300	1,991	564
ZOMATO LIMITED	54	182	238
TRENT LTD	1,257	3,948	214

SECTOR BETS (%) – UNDERWEIGHT / OVERWEIGHT VS BENCHMARK

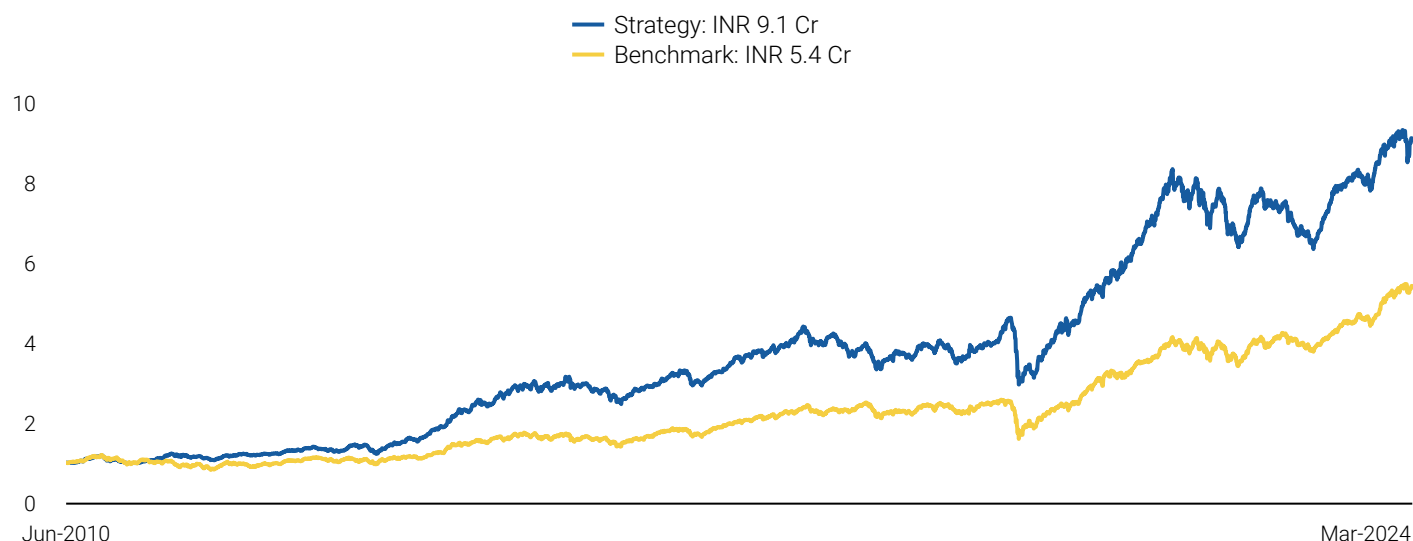


CALENDAR YEAR PERFORMANCE (%)

	Strategy	Benchmark	Excess return
2010	9.2	12.7	-3.5
2011	-2.9	-26.4	23.5
2012	28.7	33.4	-4.7
2013	18.3	4.9	13.4
2014	69.9	38.9	31.0
2015	3.4	0.4	3.0
2016	6.1	5.2	0.9
2017	41.8	37.6	4.2
2018	-11.6	-1.8	-9.8
2019	6.5	9.0	-2.5
2020	31.4	18.4	13.0
2021	46.3	31.6	14.7
2022	-6.8	4.8	-11.6
2023	22.8	26.5	-3.7
2024 YTD	2.5	4.5	-2.0

Source: Inhouse computation. Calendar Year Performance since June 2010

VALUE OF ₹ 1 CRORE INVESTED AT LAUNCH



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- Strong Track Record
- Low Churn
- Time Tested Stock Selection Process
- Reach Across Country
- Transparency
- Strict Adherence to Risk Guidelines
- Shared Research Capabilities

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Reporting Statements and Servicing: Monthly performance Statements Transactions, Holding & Corporate action reports, Annual CA certified Statement of the account & Online access



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