SUNDARAM
India Secular Opportunities Portfolio

• Monthly Update •

Objective: To generate capital appreciation across market cycles by investing in a concentrated set of high conviction stocks

Target Investors: Designed for investors seeking returns through investments in a concentrated portfolio of companies with sustainable competitive advantages and reasonable valuations.

Investment Horizon
Above 3 years

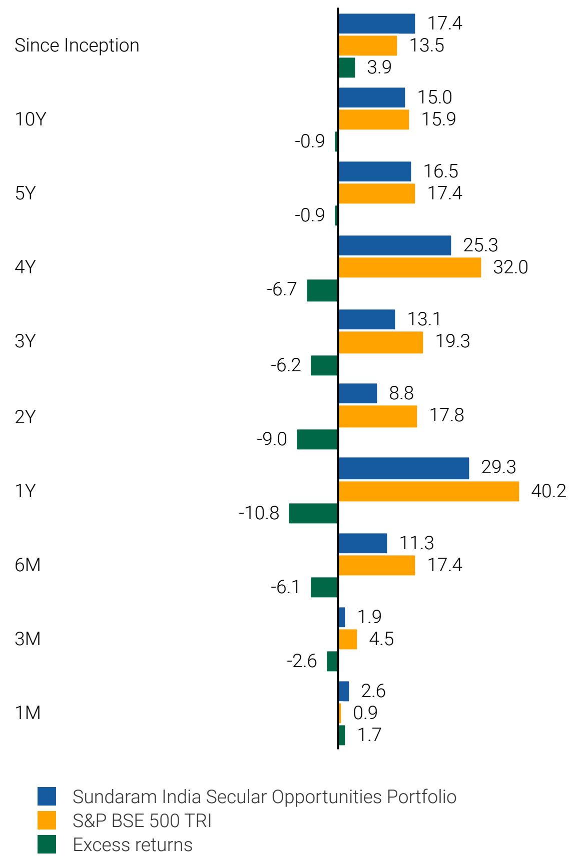
Benchmark
S&P BSE 500 TRI

Inception
February 2010

Primary Fund Manager
Mr. Madanagopal Ramu

Co-fund Manager
Mr. Prashant N Kutty

SISOP vs S&P BSE 500 TRI (%)

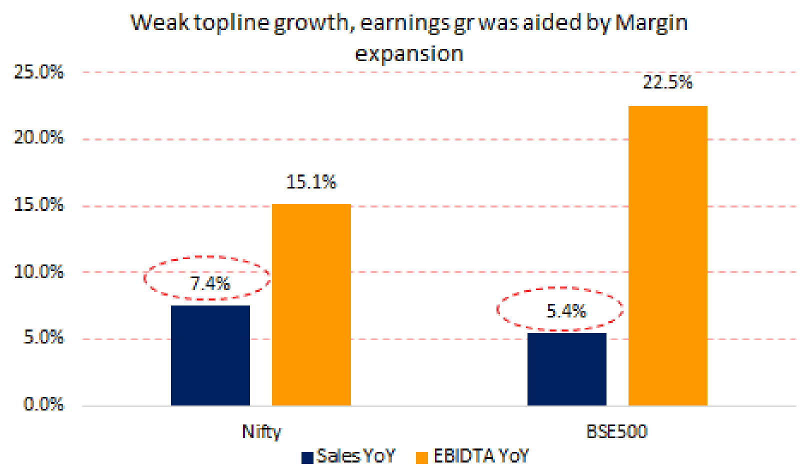


Overcast condition – Time to shift to quality

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.



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. Incase 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.apmiindia.org/apmi/welcomeiaperformance.htm?action=PMSmenu

With earnings surprise becoming scarce, Quality to make a comeback

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

Out 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

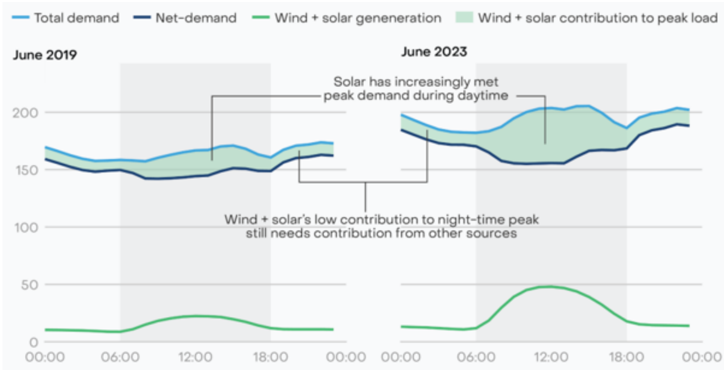
Company	EV/EBIDTA FY26E	EV/Sales FY26E	Revenue CAGR (FY 24-26E)	Revenue CAGR (FY 19-24E)
FMCG Staples				
HUVR	29.0	7.1	9%	10%
Nestle	42.6	10.5	11%	11%
Dabur	28.4	5.9	10%	8%
Marico	26.3	5.6	10%	6%
ITC	16.1	6.0	10%	8%
Discretionary & Retail				
Titan	41.6	5.2	17%	20%
Sapphire Foods	14.2	2.8	19%	17%
Trent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

Source: Bloomberg

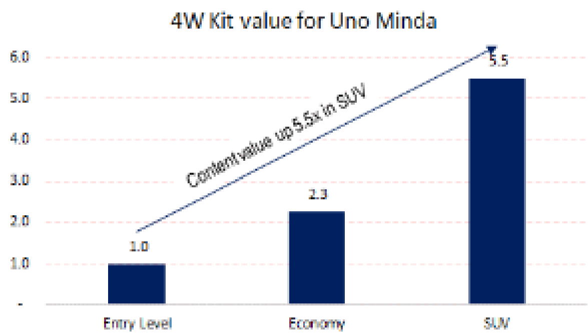
Our consumer discretionary stock selection like Trent, Zomato and Titan stood out in 2023, despite consumption sector underperforming. These stocks will continue their leadership in 2024 as well with the help of superior execution. They will see much superior earnings growth compared to FMCG companies 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.

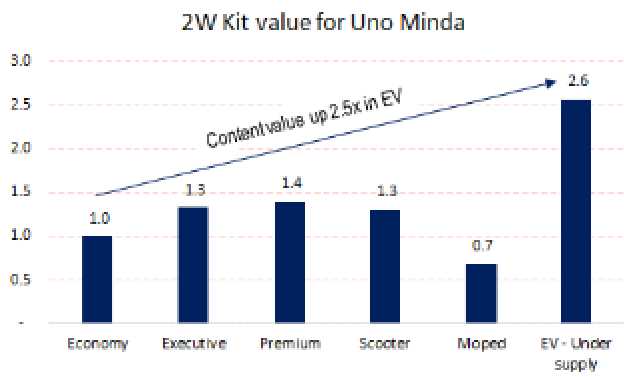
In manufacturing we have higher allocation to power sector and chemicals sector. Both these sectors will benefit from favourable cycle in 2024. Power sector will benefit from peak deficit widening over next 5 years, order inflow likely to be strong. Power T&D space will also see revival in capex with 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

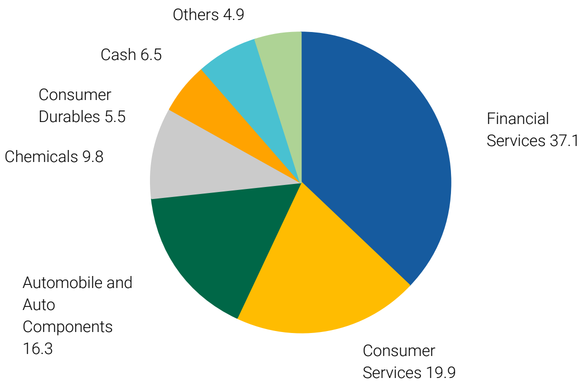




Our *Auto exposures are play on emerging trends like premiumisation, connected cars, electric vehicles, digital and LED light features* etc. Auto ancillary companies like Uno Minda, Motherson Sumi will outgrow auto space by 1.5 to 2.0x with the help of content per vehicle increase on the back of trends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

Source: Uno Minda investor presentation, Sundaram Alternates

SECTOR ALLOCATION (%)

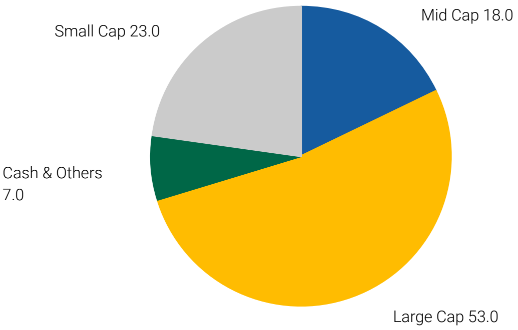


Note: Numbers may not add up due to rounding

WEIGHTED AVERAGE MARKET CAP

₹ 1,37,937 Cr

MARKET CAPITALIZATION (%)



Note: Numbers may not add up due to rounding

PERFORMANCE MEASURES – SINCE INCEPTION

Instruments	Strategy	Benchmark
Arithmetic Mean	17.3	14.0
Standard Deviation	15.8	16.1
Beta	0.8	
Sharpe Ratio	0.6	0.4
Correlation	0.8	
Alpha	4.7	
Tracking Error	9.8	
Up capture Ratio	97.2	
Down capture Ratio	75.3	

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 outperformed the benchmark during the month and created an alpha of 1.7%. The outperformance was led by *Bajaj finance up 11.5%* as concerns of restrictions from RBI on the stock abated, in addition, BAF continued to report healthy Aum growth. Valuations at 4.4x FY26 BV near periods of stress periods like demon and COVID*; Zomato was up 10%* on the back of positive outlook on the Quick commerce business and sustained profitability in food delivery*; BHEL up 8.7%* as BHEL continued to perform well owing to further order wins. The draggers for the month were *Motherson Sumi down 6%* due to correction in the mid & small cap space, but the stock has recovered in the last week of the month and the company is expected to deliver strong results with growth higher than the industry; *SBI life down 3.2%* as Retail/Individual business growth (monthly) was slightly lower than the market/expectations led to small correction*; Axis bank down 2.6%* as concerns on unsecured loans, deposit mobilization as Axis runs high credit-deposit ratio among top private banks.

During the month, we have exited from Rainbow Children's hospital as we made good returns and we are looking to invest in other such profitable opportunities.

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

TOP HOLDINGS

BAJAJ FINANCE LTD
TRENT LTD
MAHINDRA & MAHINDRA LTD
CHOLAMANDALAM INVESTMENT & FINANCE CO. LTD.
Sapphire Foods India Limited

KEY CONTRIBUTORS

Symbol Name	Unit Cost (INR)	Unit Price (INR)	Gain/Loss (%)
TITAN INDUSTRIES LIMITED	1,490	3,802	155
TRENT LTD	1,721	3,948	129
AU SMALL FINANCE BANK LTD	335	565	69

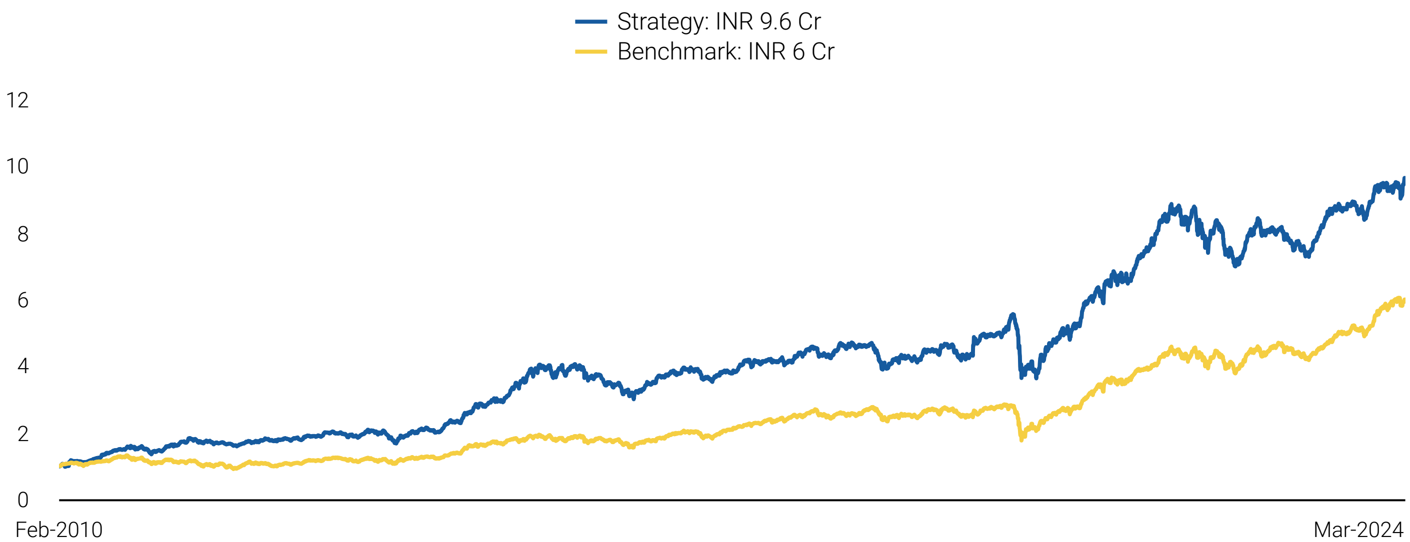
SECTOR BETS (%) – UNDERWEIGHT / OVERWEIGHT VS BENCHMARK

CALENDAR YEAR PERFORMANCE (%)

	Strategy	Benchmark	Excess return
2010	58.3	24.8	33.5
2011	1.5	-26.4	27.9
2012	25.4	33.4	-8.0
2013	6.0	4.9	1.1
2014	66.1	38.9	27.2
2015	-2.0	0.4	-2.4
2016	4.2	5.2	-1.0
2017	24.0	37.6	-13.6
2018	-4.3	-1.8	-2.5
2019	15.4	9.0	6.4
2020	25.2	18.4	6.8
2021	36.2	31.6	4.6
2022	-6.9	4.8	-11.7
2023	19.6	26.5	-6.9
2024 YTD	1.9	4.5	-2.6

Source: Inhouse computation Calendar Year Performance since February 2010

VALUE OF ₹ 1 CRORE INVESTED AT LAUNCH



WHY SUNDARAM PMS

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

3Q QUALITY APPROACH TO STOCK SELECTION

- **Quality Business**

  Scalable, Growing, Reinvestment opportunities, Strong Moat
- **Quality Financials**

  High ROIC, Excellent Cash Flows, Low DE
- **Quality Management**

  Visionary, Problem solving

CUSTOMER SERVICES

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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