



April 2016 – End of a dry spell

This is our inaugural newsletter so we start by introducing ourselves. Ampersand Investment Advisors LLP (Ampersand) is a SEBI licensed investment advisory firm managed by professionals with over 40 years of collective experience in equity research. Every month, we hope to pen our insight into Indian equity markets along with key investment ideas.

Markets performed poorly last year

Indian stock markets disappointed with -9% returns on the Nifty last fiscal, as steady lowering of earnings expectations could not cope with the predominance of global headwinds in the second half of FY16. Economy dependent sectors performed poorly which include Banking/Financials, Industrials and even the normally resilient Autos. Global sectors fared marginally better, though Pharma stocks were impacted by spate of negative/cautionary US FDA observations across several companies. Commodities however made a strong comeback in the last quarter on ebbing of China supply concerns, thereby partially regaining early losses. In such a scenario, very few sectors stood out by way of positive returns over the past year, exceptions being sectors where investors have rarely seen, let alone make profits viz. Aviation, Sugar.

Mid caps were relative outperformers

The Nifty Midcap 100 index fared slightly better, albeit declining -3% during the same period on accentuated volatility to the external environment. This universe has continuously expanded, highlighting the presence of quality opportunities for smart stock pickers. Ampersand's investment approach thus is aimed at identifying bottom-up opportunities (or themes) in the coming years.

Our investment philosophy

We follow a sector-agnostic approach for identifying companies with capability to scale up and thereby grow earnings on a sustainable basis. Typically, such investments are highly rewarding with returns being a multiplier effect of earnings growth and stock re-rating.

We remain analysts at heart. Hence, the ideation and screening is driven by research rigour and an understanding of the underlying businesses. In simplistic terms, we aim to achieve this by identifying growth companies which display following traits – (i) forecasted acceleration in earnings vs. historical trends, and (ii) expanding return ratios.

However, since real time investing is much more complicated, meaningful returns are possible only when you weigh the above against (i) what's in the price, (ii) the level of optimism/pessimism embedded in the consensus view.

The journey so far

Over the last 8 months or so, we have met about 60 companies on a 1-1 basis, focusing on mid and small caps. Our list comprises companies from proven growth oriented sectors such as pharma and auto/auto ancillaries, less known/tracked sectors like Specialty Chemicals or out-of-favour sectors like Infra & construction, agrochemicals and specialised NBFCs. In the construction & infra space, while the building blocks are falling in place, we are yet to cross the bridge except for the mid-size cement plays with potential for profitability and valuation re-rating.

Rural pick-up & rate cycle – domestic Alpha can block global Beta

During the last fiscal, in the absence of any real economic or earnings pick-up in India, global Beta factors (further China devaluation, Fed hikes) dominated the proceedings esp. in 2H. We expect a more balanced tussle in the coming fiscal. Given that the domestic drivers are now resurgent and seem closer, it has once again become possible to rationally assess stock-wise potential entry points based on earnings, without excessively worrying about the global factors (which will not go away completely).

We expect the outlook for Indian companies in the coming fiscal to be distinctly better than previous year. Several reasons are supportive:

1. Real progress in policy and decision making in some of the key core sectors. Impact of pick up in infra projects including railway, roadways and defence to be felt over next 2-3 years while implementation of UDAY scheme will bring things back on track for power sector.
2. Expectations of stronger rural growth led by sharp increase in public expenditure in the rural sector and potentially supported by normal rainfall year after two successive years of shortfall.
3. RBI's accommodative monetary stance, following government's fiscal prudence and benign CPI inflation
4. Seventh pay commission implementation - another driver of urban demand in H2 FY17

Markets positioned for positive returns in FY17

Indian stock markets are likely to fare much better in the year ahead as the earnings downgrade cycle is nearing end. Corporate earnings revival in FY17 will be driven by lower base, moderate pick-up in GDP, benefit of lower interest rates and balance sheet deleveraging. And if monsoons indeed meet forecasts and the government keeps its public expenditure commitments, markets can be positively surprised. As such, we expect major indices led by large caps to also deliver positive returns while the high quality mid caps continue to outperform.

Speciality Chemicals an investible space

Moving away from the traditional sectors, we like Specialty chemicals, one of the less understood and less tracked sectors. Indian companies have reached global scale, established meaningful entry barriers and now benefiting from diversification of supplier sourcing given China's run-ins with effluent/pollution control. In particular, the fluoro-chemicals chain of molecule development offers great opportunity as fluorination is finding increasing acceptance and application in pharmaceuticals.

Two companies – SRF (SRF.BO; USD 1170mn) and Navin Fluorine (NAVINFLUOR.BO; USD 247mn) – are well positioned though following divergent approaches to tap this potential. SRF is adopting a capex-heavy, develop-your-own-molecule approach hitherto focused more on agrochemicals while Navin Fluorine has a low capex, CRAMS-based approach targeting innovator pharmaceutical companies. While SRF's agrochemicals focus (more cyclical than pharma) and capital allocation in un-related segments calls for a lower multiple (13.5x FY17E and 11.5x FY18E) vs. Navin (18.5x and 15.0x respt.), both the approaches have relative pros and cons. Evolution of this opportunity, whether through CRAMS or in-house specialty chemicals, is a theme to watch out for over next 1-2 years.

Ampersand Founder Team Profile

Arun Subrahmanyam, Founder and Partner

In a professional career spanning over 25 years, Arun has extensive experience in fundamental equity research, which enabled him to gather domain knowledge of varied sectors like Automobiles and Pharmaceuticals. Prior to founding Ampersand, he has worked with organisations of repute such as BofA Merrill Lynch, IDFC-SSKI, HSBC and ICICI.

Rahul Singh, Managing Partner

Rahul has over 20 years of experience in equity research across multiple sectors. He was Head of Institutional Research, covering India Equity strategy, in his most recent role before Ampersand. His understanding of the macro factors and industry dynamics serve as a strong foundation for Ampersand. Prior to Ampersand, he has worked with Standard Chartered, Citi, IDFC-SSKI and CRISIL.