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DIGITIAN CAPITAL

Future focus

FUTURE FOCUS

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Another Year of Choppy market 2023! How to Navigate

DIGITIAN VIEW!

After a rout in stock markets in 2022 in almost all markets except in India, we expect 2023 will be another year of Investment with Caution. We shall discuss our assessment, market by market since India and China will be different than USA.

First the most important market **United States as it has linkages to other markets in varying degrees :**

INFLATION in USA is projected to be 6%-6.5% in 2023 so it is not falling as the market predicted. For sure the Fed will increase the rate to 6% if not more to break the legs of inflation.

U.S. labor market remains tight. Unemployment is at 50-year low of 3.5%. These dynamics could weigh on company margins, while potentially providing cause for continued Federal Reserve tightening.

All these clearly indicates that the road is turbulent ahead and recession is still couple of quarters away. With higher prices persisting even after the Federal Reserve raised interest rates, the expectation for a recession have only mounted. As per Goldman Sachs there is a 45–55% probability to the risk of a US recession in 2023. **We think it is far more likely.**

Inventories have swelled. In spite of clearing efforts overall inventories for general merchandise retailers are still 28% above the 10-year trend. This suggests new orders are likely to weaken and consumer demand will soften.

Now if there is a rescission by quarter 3 of 2023 then all assets class will be repriced downwards.

According to Morgan Stanley investors need to **watch for excesses to be fully wrung out of estimates, more in line with historical averages**. This is the best advise we think in this market - exit from high PE or high EV/EBIDTA stocks and rather Focus on Free cash Flow per share till the market fog clears out.

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MARKET WATCH

Equity Indices	Monthly Open	Monthly Close	Monthly Change %	2023%	2022%
S & P	3839	4076	6.2%	6.2%	-19.5%
Nasdaq	10466	11584	10.7%	10.7%	-33.1%
FTSE 100	7451.74	7781	4.4%	4.4%	0.4%
Shanghai Compsite	3089	3284	6.3%	6.3%	-15.1%
NIFTY	18145	17616	-2.9%	-2.9%	4.5%
Nairobi SE 20	1676	1657	-1.1%	-1.1%	-11.7%
Egypt SE 30	14645	16540	12.9%	12.9%	22.5%
Tanzania All Shares	1881	1906	1.3%	1.3%	-0.9%
Nigeria SE 30	1842	1912	3.8%	3.8%	7.0%
Morrocco All Shares	10827	10119	-6.5%	-6.5%	-18.9%
Bangladesh DSE 30	2195	2219	1.1%	1.1%	-13.3%

Commodity	Monthly Open	Monthly Close	Monthly Change %	2023%	2022%
Gold	1830	1941	6.1%	6.1%	0.05%
Crude Oil	86	85.33	-0.8%	-0.8%	10.98%
WTI Oil	80.15	78.92	-1.5%	-1.5%	6.14%
Copper	3.83	4.16	8.6%	8.6%	-13.35%
Irone Ore	111.28	123.37	10.9%	10.9%	-1.08%
Aluminium	2380	2627.5	10.4%	10.4%	-15.03%

The main question is how long recession will last? As per NBER, the rescission lasts from as short as 6 months to 19 months. As we are expecting a mild recession in Q3 2023 it will have a spillover effect in 2024 as well. The entire economy is becoming digital and lot of focus on green energy related changes, there fore economic cycles have become faster and cannot remain subdued for long given the fact that the recession is mainly the effect of pandemic related excess money pumped by Government.

But we are hopeful that by Q1 2024 market must have discounted the shock and will **start going up especially in Q2 2024 onwards given the ensuing Presidential Election in November 2024.**

So overall, we feel that market will remain range bound with a swing of +/- 15% over the closing of 2022 - since the forward 12-month P/E ratio for S&P500 is 18.4, which is below the 5-year average (18.5) but above the 10-year average (17.2)

China:

Many of the global markets also depend on the revival of Chinese market especially developed countries like US and in EU mainly for the demand revivals, better supply chain and lower input cost. While countries in Africa and many of the South Asian countries also get better investment deals from Chinese investors - whether global rescission will be prolonged it will depend upon China to a great extent. The **only headwind expected is related to COVID-19 lock down** but now the Chinese authority also declared that COVID -19 is not in the rear view mirror as well. From 2020 to 2022, **China posted an annual average growth rate of 4.5** percent, outpacing the global average as compared to 7%.

This shows that almost 6-7% pent up demand is already there. China needs to be one of the major countries to see the strongest growth this year, and its contribution to global economic growth will stand at 30 percent.

We expect Sanghai Composite Index will make a come back by 10-15%

India

India is the only major economy which withstood the COVID rout well. The economy after initial decline in 2020 has come back strongly in 2021 and 2022.

Especially the China+1 policy gave huge tailwind with a FDI inflow of $ 532 billion in last 2 years from 162 countries in 61 sectors across 31 states (While Total FDI since 1991 is only $ 950 billion). The shows the inclusive growth possibility of Indian market and the momentum it has.

Indian economy's GDP is at $3.5 Trillion and the last million is added only in 5 years faster than the previous trillion dollar which took 8 years. Its happening fast now.

This is a specific year of challenge for India as the China is opening up, if still the China +1 theme continues globally, Indian growth will continue till 2024 election.

Under this backdrop we think India 's **Nifty will be creating a new high by the end of 2023.**

African Markets

We see a continued mixed year for African emerging markets. The **currencies will be depreciating further against USD** (so capital loss is on the card for investors). Fed rate increase will make the dollar market very tight for these economies, financing cost will increase, capital investment will slow unless Chinese investment comes back, input cost will increase, exports will fall. However, we are still hopeful on East African Markets while Egypt economic conditions worsening post IMF bailout.

We shall advice investors to be picky on the shares and this is the time to pick good stocks at a cheaper price for long term - important to make proper selection.

Happy investing.

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COUNTRY DATA

Countries	GDP (USD Bn)	Market Cap (USD Bn)	GDP Growth 2022 %	Inflation %
USA	25283	48264	1.4%	6.50%
China	17300	7620	5.2%	2.5%
India	3500	3210	6.1%	5.6%
Egypt	423	49	5.5%	15.20%
Kenya	118	23	5.1%	6.6%
Tanzania	71	7	5.2%	5.3%
Morocco	147	11	3.1%	8.30%
Nigeria	454	54	3.20%	20.2%
Bangladesh	425	68	6.0%	9.10%

Forex	Monthly Open	Monthly Close	Monthly Change %	2023%	2022%
EUR USD	1.069	1.071	0.22%	0.2%	-5.57%
GBP USD	1.205	1.207	0.17%	0.2%	-11.00%
USD INR	82.710	82.870	-0.19%	-0.2%	-9.95%
USD KES	123.300	125.000	-1.36%	-1.4%	-8.24%
USD EG POUND	24.770	30.370	-18.44%	-18.4%	-36.58%
USD TZS	2327	2340	-0.56%	-0.6%	-0.95%
USD NAIRA	447.000	460.420	-2.91%	-2.9%	-8.00%
USD TAKA	103.250	106.450	-3.01%	-3.0%	-16.98%

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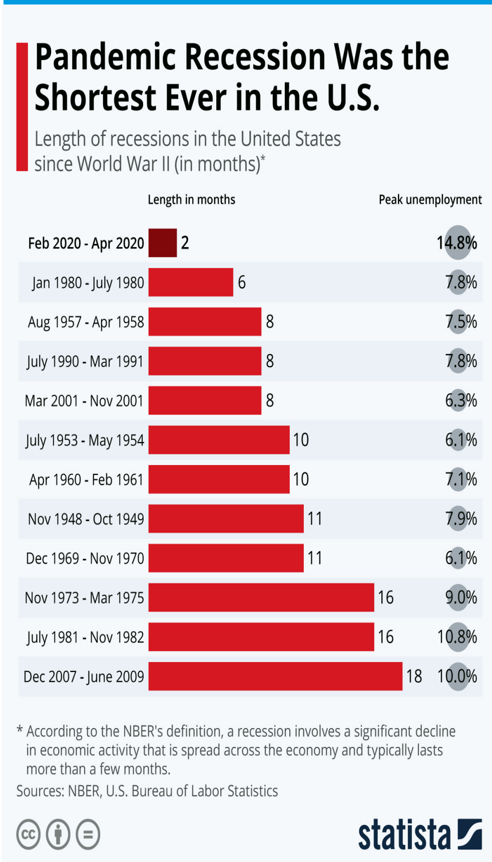
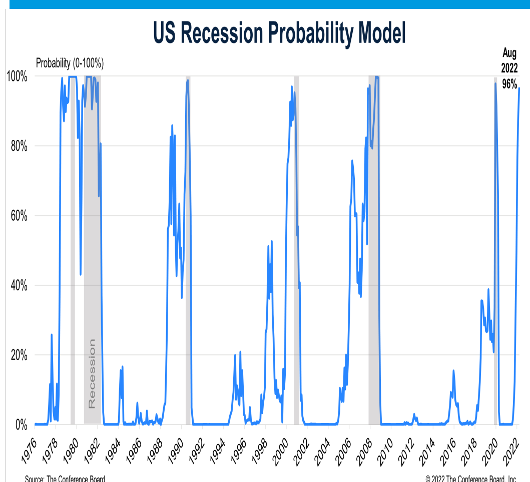
BEST CHART OF THE MONTH





Probability of recession spiked to 96% like other recession

VALUE INVESTING

Debashish Neogi

> " In case of mastering the art of investing in small cap, the most important focus be on Founders/ management and their execution skills - whther they are intelligent fanatics who are less charismatic but more believe walking the talk"

The Art of investing in small cap (Part 2) (Repeated)

The smaller the company, the more should be the focus on management and qualitative analysis. CEOs of small microcap companies tend to wear a bunch of hats, so their influence is much greater than larger companies. Founders are the difference makers.

Intelligent Fanatic = (Long Term Vision + Focus + Energy + Integrity + Intelligence) x Execution

The combination of all these traits multiplied by execution is what makes an "intelligent fanatic".

Debashish wrote in the last Newsletter (please **click** for reading)

He already discussed first three compo -nents **Vision, Focus and Energy**

4) Intelligence - Extremely knowledgeable, yet humble (a CA with a Management degree).We saw him reviewing the production guys and the project guys working on the new factory . He looks like an all rounder, **"feet on ground person"** –who looks after production, sales and business development, finance & HR –typical of a promoter run business. Having said that he is modern and not old fashioned promoters with ego .He didn't have a flashy cabin nor a separate toilet in factory. In fact he ate lunch with all in the same small area in pantry, enough to accommodate only 5-6 people !

We met few production guys in the company. Looks like an environment of openness and transparency, with freedom for employees to show their talent and capability .The organization doesn't look bureaucratic .People have an empowerment feeling !

These small things matter as it talks about the "middle class human side "of the company where typically most people are happy and no one loses in the process.

5) Integrity - He feels people have contributed a lot for the company's success . –We felt he doesn't want to retrench employees ,looks for rankers which is why the attrition rate for senior management is less than 2 % .The entire day we saw Rahuls simplicity ,doesn't show off ,not extravagant at all ,no ego , gives his car for us for another factory visit (not NGL), opens the door for us – conjecture -these type of people generally don't have personal integrity issue.

Figure 1

When the operating margin had peaked at 31% ,he repeatedly said that the operating margin is not sustainable but the investors never believed him and now when the operating margin have tanked he still repeats same thing –that his steady state margin is around 15% which again investors are not believing and stock price have tanked !

I believe the operating margin has some inverse correlation to crude prices in a way with some time lag of 6 months (see Figure 1)

Execution – The numbers speaks for itself !

I feel NGL have some pricing power like FMCG .The reasons I am saying so are as follows:

1.In FMCG ,brands like Parachute, Dabur have pricing power ,hence they can pass on prices but with a time lag (much shorter time lag than NGL) .

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2. Having said that when commodity prices come down ,they reduce consumer prices with also a time lag and use that “abnormal “ profit by increasing advertising spends (creating more stickiness for consumers for future) and /or park the excess in provision for difficult times .Because of this FMCG margins and return ratio’s are much more stable in short run .

3. In case of NGL I feel there is very high customer (B2B) stickness because of NGL’s quality ,service delivery assurance and long term orientation (where NGL take time to pass on costs in short run) which is why NGL margin and return ratio’s take a beating in short run .

4. Over longer period of few quarters or a year ,the equilibrium (of excess supply vis a vis demand because of under cut in prices by players) sets in and margin & return profile,if taken ,over a 3/5 /7 year period)averages out .

5. While comparing with FMCG brands of Marico and Dabur is not fair to NGL ,but just to make a point NGL have a created a superior business which is on a “sustainable profitable growth “with enviable margin and return ratios similar to FMCG ,hence comparison & expectation in short run because of sector dynamics, by analsyts /investors on margin/return ratios ,is not far is my view .

I have appended a comparison of margin and return ratio’s of NGL with Marico and Dabur (Table 1) The right comparison would be Dabur as their business is much more diversified like NGL ,whereas Marico profitability is more driven by two brands –Parachute & Saffolla .

I have also compared NGL with other good chemical companies ,the return ratio is very much at par/even better than some of them ! (Table 2)

Table 1 : Comparison with FMCG Brand

	NGL Fine Chem Ltd	Marico Ltd	Dabur India Ltd
Market Cap	940	67,407	101,061
Current Price	1,520	521	570
High / Low	₹ 3,435 / 1,377	₹ 608 / 456	₹ 659 / 482
Stock P/E	28.2	54.3	56.0
Book Value	334	26.4	47.4
Dividend Yield	0.13	1.75	0.91
ROCE	34.7	42.7	27.2
ROE	28.9	36.6	22.5
Face Value	5.00	1.00	1.00
ROCE3yr avg	35.1	42.9	27.4

Table 2 Comparison with Peer Companies

ROCE %	NGL Fine Chem	22%	11%	19%	24%	29%	37%	34%	22%	28%	15%	52%	35%
	Alkyl Amines	13%	18%	21%	28%	26%	26%	24%	25%	29%	41%	56%	33%
	Balaji Amines	24%	23%	19%	18%	18%	24%	30%	32%	25%	18%	35%	50%
	Laxmi Organic						12%	22%	25%	19%	12%	20%	26%

Like Ian Cassel said “ Intelligent fanatics let their execution do the talking’’. Financial number over long period of time is an outcome of THAT execution!!

Risk to the Business :

Now NGL is in a challenging situation – in a double whammy kind of situation –volume growth coming down and raw material prices going up .I feel this is temporary, like I said before which is a factor of excess supply vis a vis demand (of the sector) because of under cut in prices by unorganized/small players .

Having said that in future, I feel business growth to come from :

1. **Existing product & new geography –**though would not be much here , as penetration is high and NGL have market share of 50% + in top 5

2. **Growth to come from new category –ie poultry**

3. **New products –**NGL plans to launch 2-4 new product every year

4. In Future new regulated markets

Operating margin should be upwards of 15% + due to

1. Increasing operating leverage
2. Crude oil impact

In my view, profit should grow at 18% -20% pa for next 5/7 years –**hence logically the share price would be 10x in 10 years !**

Last but not the least ,was very impressed with the succession planning. His son Aahan is young dynamic and a quick learner, has a very positive attitude .He is an IT professional, studied and worked in USA .

Can I be wrong in my future assessment of NGL –offcourse I can be completely wrong as because of my investment I am completely biased –but only truth is I have tracked Rahul from an outside in perspective for long met him recently, **hence I would rather bet on a person who has walked the talk and doesn’t talk / make castles in air –ultimately promoter and quality of management makes the difference**

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Name of the Company	Date of Purchase	Entry Price	Actual Gain Published in Feb2021	Actual Gain Published in Dec2021	Actual Gain Published in March 2022
NGL Fine Chem	13-Mar-20	302	352%	767%	729%
Tata Elxsi	27-Apr-20	790	263%	646%	1057%
RACL Geartech	4-Aug-20	65	204%	897%	877%
Arman Financial	8-Feb-17	243	Not in List	327%	332%
Shivalik Bimetal	5-Feb-21	69	407%	443%	697%
Vedanta	7-Apr-20	73	190%	373%	477%
Trident	1-Oct-20	6.55	123%	648%	740%
Triveni Engineering	5-Apr-21	80	New	181%	300%

Debashish

Saugata

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