India Equity Strategy

Institutional Investors' shareholding pattern

A key to spot potential gems

Equity markets consist of an array of investor groups with different investment horizons, inherent prowess, and investment scale. One such investor group consists of institutional investors who are essential participants in any stock market. This holds especially true for the Indian equity market where Foreign Institutional Investors (FIIs) and Domestic Institutional Investors (DIIs) accounted for ~70% of the total free float market capitalization as of Q2 FY22. Total FII ownership of Indian equities stood at 21.5%, as of Q2FY22, and has consistently been over 20% since Q4FY13. Naturally, the scale of investment and dynamism in buying and selling make FIIs critical influencers in stock price movements. Furthermore, since they are astute and informed investors, monitoring their holding patterns in specific industries and companies can give insights into the pockets of the Indian economy that they are bullish on.

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INSTITUTIONAL RESEARCH

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Buying patterns of market participants: Equity markets consist of an array of investor groups with different investment horizons, inherent prowess, and investment scale. One such investor group consists of institutional investors who are essential participants in any stock market. This holds especially true for the Indian equity market where Foreign Institutional Investors (FIIs) and Domestic Institutional Investors (DIIs) accounted for ~70% of the total free float market capitalization as of Q2 FY22. Total FII ownership of Indian equities stood at 21.5%, as of Q2FY22, and has consistently been over 20% since Q4FY13. Naturally, the scale of investment and dynamism in buying and selling make FIIs critical influencers in stock price movements. Furthermore, since they are astute and informed investors, monitoring their holding patterns in specific industries and companies can give insights into the pockets of the Indian economy that they are bullish on.

We have found that in many cases, FIIs have spotted overlooked, yet fundamentally strong, companies before most market participants, leading to exceptional gains once expected earnings materialise and such companies are rightfully rerated. Our research on this matter is geared towards finding companies in which FII ownership has steadily increased over the past few quarters but the stock prices have underperformed their respective benchmarks. The lack of significant appreciation offer potential value investing opportunities, and investors can look for good entry points in fundamentally strong companies.

Case studies: In our research, we found three recent and relevant examples of early FII participation in equities that have significantly appreciated following a period of underperformance:

- Indian Energy Exchange (HSIE Rating: Unrated)
- Navin Fluorine International Ltd (HSIE Rating: ADD)
- Tanla Platforms Ltd (HSIE Rating: BUY)

Based on our analysis of India's top 300 firms by market capitalisation, we identified the following companies as buying opportunities and companies to remain cautious about:

Sr. No.	Opportunities to buy	HSIE rating	Advisable to exercise caution	HSIE rating
1	Mahindra & Mahindra	ADD	Adani Green	Not Rated
2	MRF	Not Rated	JSW Energy	SELL
3	SBI Cards	BUY	SAIL	Not Rated
4	IIFL Wealth	Not Rated	Dixon	Not Rated
5	Credit Access Grameen	BUY	Gujarat Gas	BUY
6	Bandhan Bank	BUY		
7	Aavas Financiers	Not Rated		
8	ICICI Prudential Life	ADD		
9	SBI Life	BUY		

Nevertheless, this research report should only be viewed as one that highlights lead indicators. This shouldn't be construed as sufficient evidence for making final investment decisions. In addition to these lead indicators, a thorough bottom up stock specific analysis would be required for prudent stock selection.

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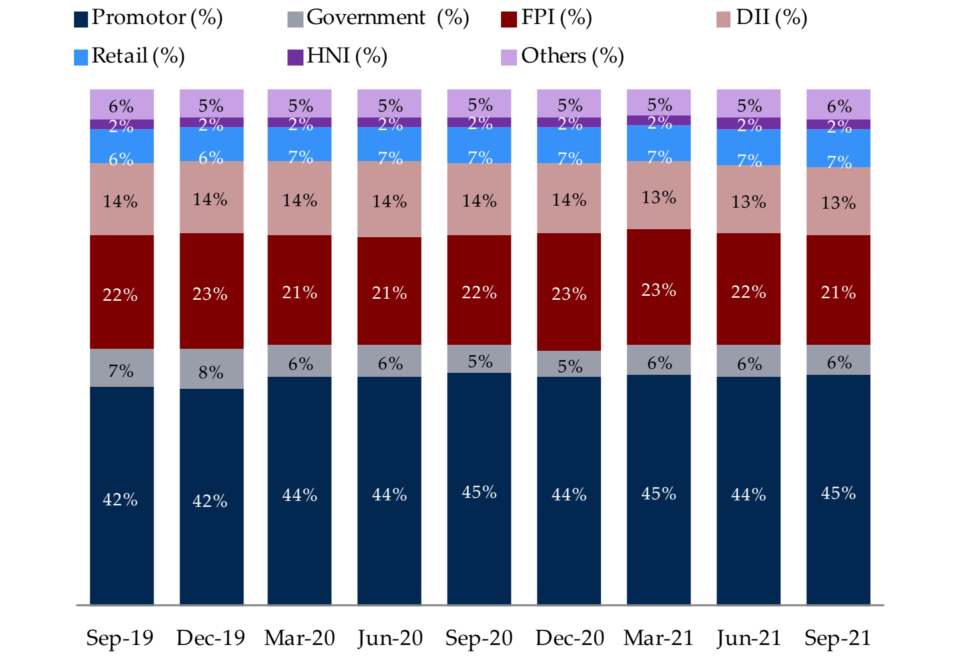
1. Participants of Indian equity market

India is the world's sixth largest equities market with a market capitalisation of USD 3.46 trillion (as of Sep-21). It has grown at a staggering 15.5% CAGR since 2013 (~USD 1 trillion) to reach its current peak. It is slated to overtake the UK and enter the coveted "global top 5 club", given the strong queue of unicorn startups waiting to be listed. It is expected to surpass USD 5 trillion by 2024, owing to technology-led growth in various Indian sectors. The IPO pipeline alone is estimated to add USD 400 billion to India's market capitalisation in the next two years.

Along with the equity market growth, investments of market participants have also witnessed commensurate growth, which in turn has led to an increase in their investment commitments over the years. The key participants are:

- Promoters
- Foreign portfolio investors (FPI): Foreign Institutional Investors (FII) and Qualified Foreign Investors (QFI)
- Domestic Institutional Investors (DII): mutual funds, banks, insurance companies, and other financial institutions
- Government
- Retail (can include PMS investors depending upon investment amount in a particular stock)
- HNIs (can include PMS investors depending upon investment amount in a particular stock)

Chart 1.1: Shareholding pattern of Indian equity market participants



Source: Prime Database, HSIE Research

Pursuant to rapid growth in the Indian equity market over the past eight years, it touched peak market capitalisation of USD 3.46 trillion (INR 263 lakh crore) in Sep-21. To understand this growth, it is imperative to understand who owns and drives the Indian equity market. Hence, we analyse shareholding of various investor categories as below:

I. Promoters of private companies

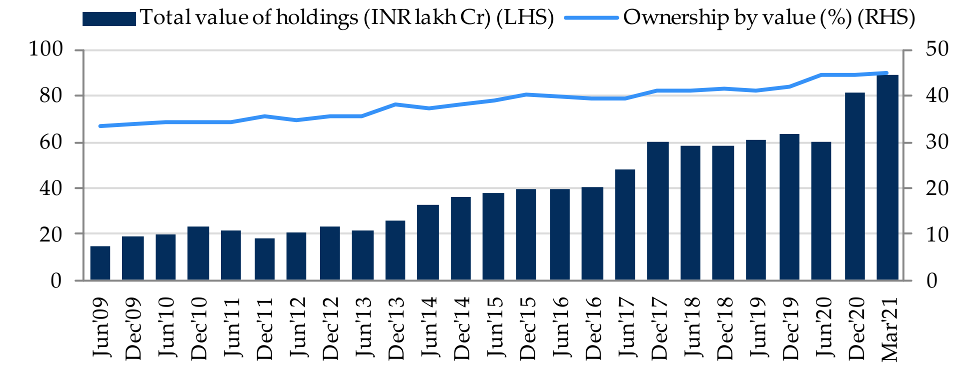
As reflected in chart 1.1 above, the promoters of Indian companies are the dominant force in the market. They currently control the lion's share of the market with a share of ~45%. In most cases, a significant portion of their personal net worth is locked in the form of shareholding in their own companies. It is worth noting that despite holding such large, concentrated investments, promoters tend to expand their ownership in tactical situations when stocks are trading lower than their intrinsic value due to market volatility or mispricing.

For example, during the first COVID-19 wave, in March-20, the Indian market plummeted sharply. Many cash-rich promoters took advantage of the situation and increased their companies' shareholdings. This tendency may be seen in the chart above, where promoter shareholding climbed from 42% to 45% between Dec-19 and Sep-20. To put this in context, this 3% gain equated to an additional investment of around USD 50 billion, as per the prevailing stock prices at the time.

The value of that 3% has appreciated to ~USD 100 billion today, owing to the extraordinary market run-up from the March 2020 lows. The aforementioned share acquisition prevented a sharp decline in select company stocks and, consequently, helped promoters make significant capital gains on their investments. Thus, Indian promoters can be classified as both enterprising business owners and astute investors. The fact that they typically have a very lengthy investment horizon distinguishes them from other types of investors. This is a privilege that not all investors necessarily enjoy.

Chart 1.2 shows how the value of promoter shareholding in Indian equities has changed over the past decade, growing at a CAGR of 17% over the period and acting as a fantastic wealth creator for this investor:

Chart 1.2: Shareholding of promoters- historical pattern



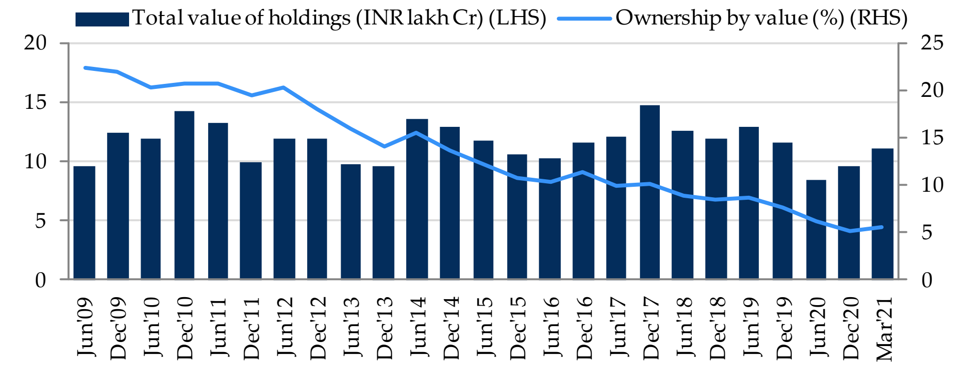
Source: Prime Database, HSIE Research

Naturally, promoters' stake is usually more static in nature, given that they are long-term investors and seldom engage in short-term trading for significant portion of their own shares. Hence, we look elsewhere to find drivers of short-term market movements.

II. Indian government

Investments of government also include their promoter shareholdings in public sector enterprises. The government is inherently a passive investor in most of its investee companies; hence, we can rule it out as a possible driver for short-term market movements. Chart 1.3 below indicates that the Indian government has been gradually reducing its stake in equity markets; its value of shareholdings has increased by a meager 1% over the past decade:

Chart 1.3: Shareholding of government- historical pattern



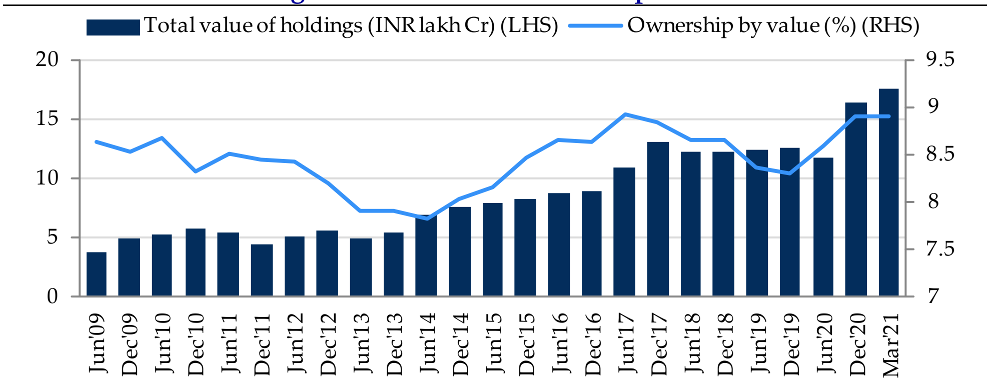
Source: Prime Database, HSIE Research

III. HNI and Retail investors

This is a vibrant segment of the equity markets. As reflected in chart 1.4 below, the value of their shareholdings has increased consistently over the years by a CAGR of 14% and now stands at an astounding INR 18 trillion. This category captures equity investments of individual shareholders and HNIs either directly or through advisors/portfolio management companies (PMS). However, their shareholdings have been volatile in these years, reflecting the nature of ownership.

Although various investors in this segment may be resorting to deep research and long-term investing, there is a healthy proportion of investors that is less patient and can essentially be classified as traders. These investors tend to react to news flow very quickly and invest/trade based upon that. They cut their positions in case of sharp market declines and come back fast when stability emerges. In many cases, their positions are leverage-led and, hence, holding periods are short by design in order to reduce equity risks. For some intraday traders, holding periods are less than a day even. PMS investors have limited horizon of investments as well. So, we can summarise that this section of investors has a relatively shorter investment horizon and they are much more prone to speculation. Hence, any large stock price moves led by this segment should be looked at cautiously and analysed thoroughly before imitating.

Chart 1.4: Shareholding of HNI & retail- historical pattern

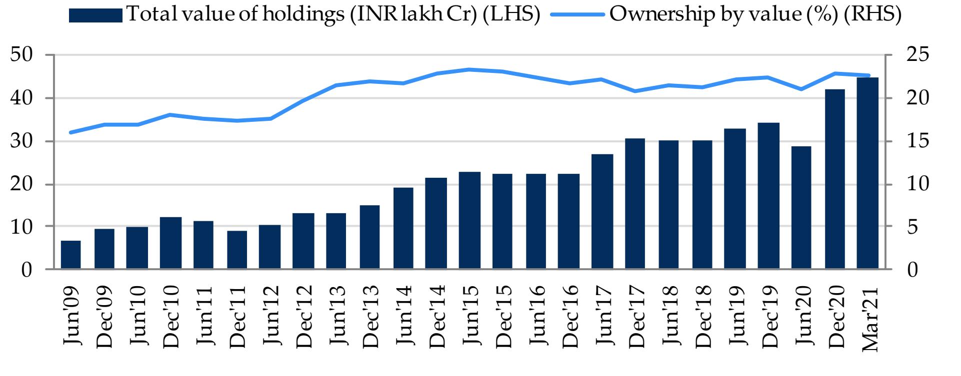


Source: Prime Database, HSIE Research

IV. Foreign portfolio investors (FPIs)

This segment includes Foreign Institutional Investors (FIIs) and Qualified Foreign Investors (QFIs). Chart 1.5 shows strong growth of FPI shareholding value and increasing participation of FPIs in Indian equity market, growing at a rate of 17% CAGR in a period when the Nifty rose by a CAGR of 10%. The ability to spot new investment avenues and increasing capital commitments to these investment opportunities has helped FPIs grow their base consistently.

Chart 1.5: Shareholding of FPIs- historical pattern



Source: Prime Database, HSIE Research

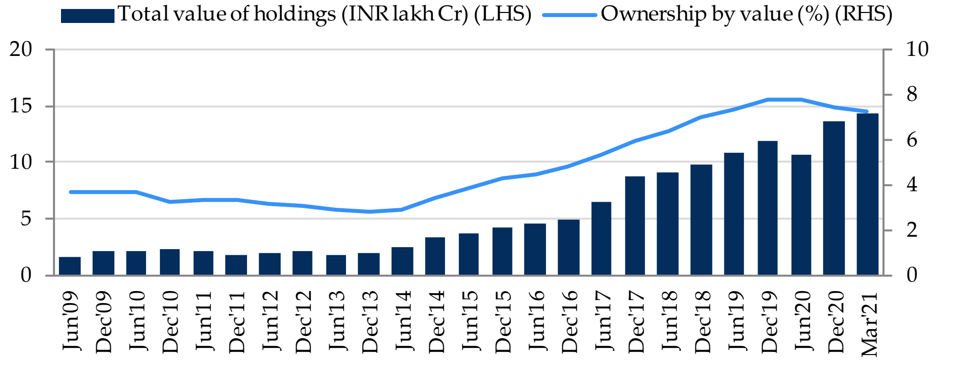
V. Domestic institutional investors (DIIs)

This segment includes domestic mutual funds, banks & financial institutions, and domestic insurance companies. Mutual funds and LIC are two dominant categories under the DII segment. DIIs are supposedly well-informed serious investors whose investment decisions are supported by deep research and keen understanding of underlying businesses. Hence, their investment decisions can be considered insightful lead indicators to broader trends in the equity markets.

The two charts below, chart 1.6 and chart 1.7, highlight shareholding movements of mutual funds and LIC respectively. It is evident that the value of mutual fund holdings has grown at a robust 20% CAGR between Jun-09 and Mar-21, when Nifty rose by a 10% CAGR. This incremental growth can be attributed to MFs' increasing allocation to stocks of promising companies at opportune times.

Mutual funds

Chart 1.6: Shareholding of mutual funds- historical pattern

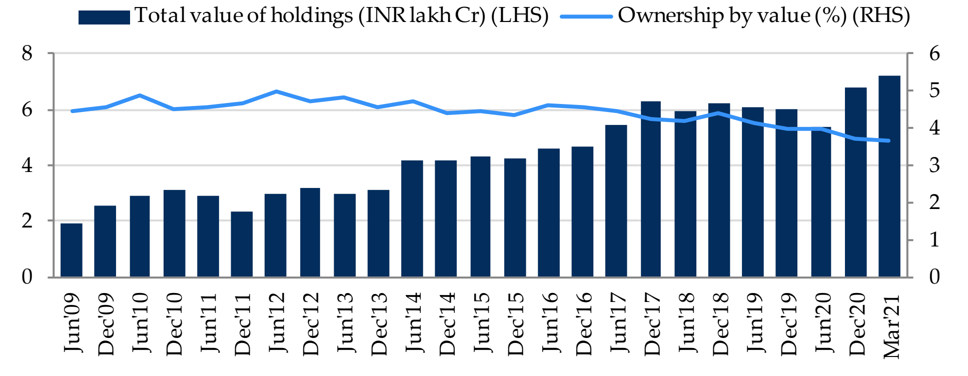


Source: Prime Database, HSIE Research

Additionally, the value of LIC's portfolio has grown at a modest 12% CAGR in this period, while its ownership (%) of Indian equities has decreased:

Life Insurance Corporation of India (LIC)

Chart 1.7: Shareholding of LIC- historical pattern

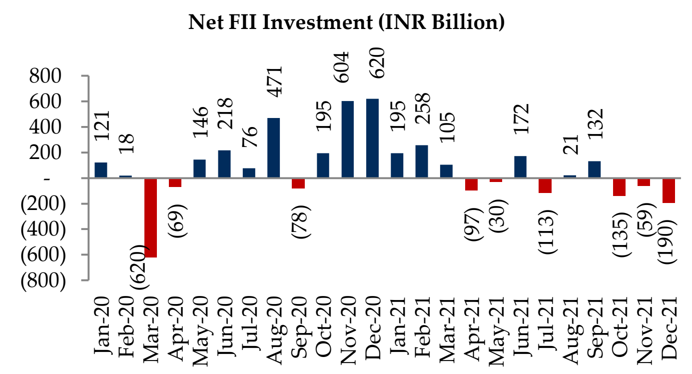


Source: Prime Database, HSIE Research

FPIs and DIIs collectively form almost 35% of the total market capitalisation of India currently and are inherently extremely active in short-term markets.

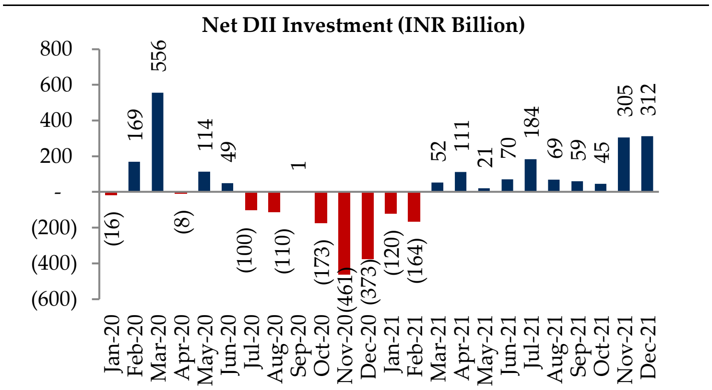
- We observe in chart-1.1 (page-2) that FPI holdings went down from 23% in Dec-19 to 21% in Jun-20 but bounced back to 23% in Dec-20. FPIs reacted to COVID-led economic uncertainty in first half of 2020 and led the sell-off in the equity markets; however, with improving clarity of economic prospects of India, they restarted buying equities and restored their overall holdings by Dec-20.
- Furthermore, chart 1.1 shows that DIIs held 14.3% of Indian equity markets in Mar-20. They took advantage of the fall in the Mar-20 quarter and increased their stake by 36bps but after that, they have consistently been booking profits. Between Mar-20 and Sep-21, their stake has gone down by 130bps.
- As FPIs and DIIs already hold a significant portion of the Indian markets and are responsible for taking care of inflow/outflow requests of investors on a periodic basis, they are expected to make active investment decisions on a daily basis. Hence, by design, fund management has an element of dynamism. Further, the scale of the existing holdings of FPIs and DIIs (USD 1.2 trillion cumulatively), which is ~70% of the free float market capitalisation of India, is large enough to create a meaningful impact on stocks. This scale and dynamism together can deeply impact stock prices, even if it is a small change in shareholding percentage. This impact can get magnified in case of thinly-traded or low-liquidity stocks.
- The activity of FIIs and DIIs over the past 24 months can be seen in charts 1.8 and 1.9 below; it reflects their volatile nature and absolute scale.

Chart 1.8: Month-wise FII flows



Source: Ace Equity, CDSL

Chart 1.9: Month-wise DII flows



Source: Ace Equity, CDSL

- To summarise, we believe that observing the buying and selling patterns of FPIs (mainly represented by FIIs) and DIIs and share price changes can provide us with insights into possible pockets of unseen value, expected growth areas, and/or valuation traps. Tracking the investing patterns of these large market participants can offer us signals of potential promising/risky investment ideas. **However, it is imperative not to construe these signals as sole underlying reasons for buying or selling stocks. They should be regarded only as lead indicators and a deeper bottom-up stock level analysis needs to be done before making any final investment decisions.**

- Consequently, we have analysed the shareholding pattern changes of the 300 largest (based on market capitalisation) publically listed Indian companies over the past 12 quarters. Our findings are presented in the next few sections.

Summary of stocks considered

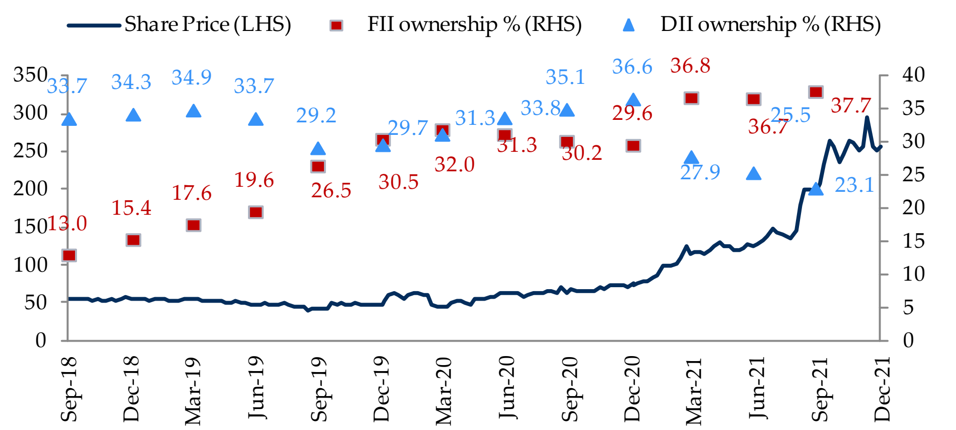
Sr. No.	Opportunities to buy	HSIE rating	Advisable to exercise caution	HSIE rating
1	Mahindra & Mahindra	ADD	Adani Green	Not Rated
2	MRF	Not Rated	JSW Energy	SELL
3	SBI Cards	BUY	SAIL	Not Rated
4	IIFL Wealth	Not Rated	Dixon	Not Rated
5	Credit Access Grameen	BUY	Gujarat Gas	BUY
6	Bandhan Bank	BUY		
7	Aavas Financiers	Not Rated		
8	ICICI Prudential Life	ADD		
9	SBI Life	BUY		

2. Case studies: FII buying - a possible lead indicator of expected stock price appreciation

Listed below are three examples of opportunities where FIIs spotted a promising company well in advance, when the stock price was trading below its intrinsic value and the company was being overlooked by most other market participants. FIIs were able to identify the strong fundamentals and growth levers of these businesses and increased their holdings in their stocks. Subsequently, as the growth opportunity started becoming more apparent and actual earnings began to reflect expected earnings, the stock price naturally appreciated and generated handsome returns for these FIIs and justified their initial investment rationale.

Case Study-1: Indian Energy Exchange Ltd (IEX)

Chart 2.1: Indian Energy Exchange Ltd

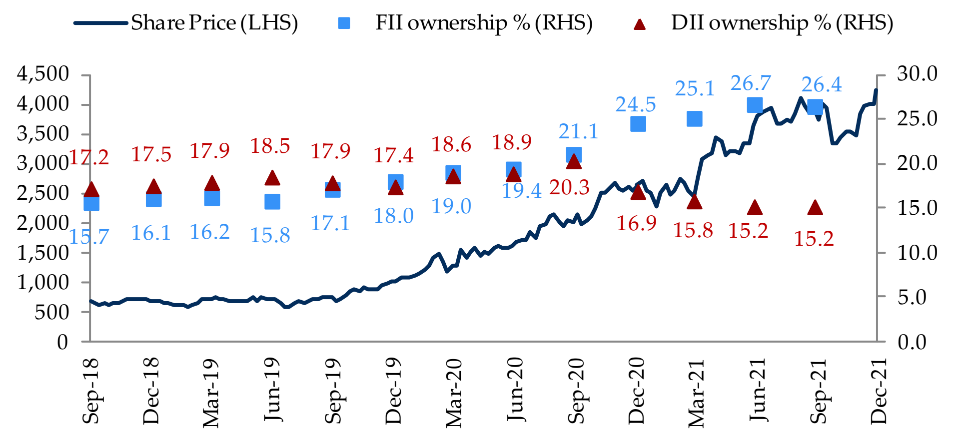


Source: HSIE Research

- Indian Energy Exchange (IEX) is the leading power exchange of India. From the chart 2.1, it is apparent that between Sep-18 and Jun-20, FII shareholding increased from 13% to 31% while the stock price provided a measly 15% return (from INR 54 to INR 62). On the operational front, electricity traded through IEX went up marginally from 14.1 billion units to 14.9 billion units at the same time. Undeterred by the underperformance, FIIs kept accumulating shares, trusting the future potential of the company.
- FII conviction in the company was rewarded eventually, as electricity trading volume improved significantly from 14.9 billion units in Jun-20 to 22.4 billion units in Mar-21, registering 50% growth. The share price appreciated accordingly from INR 62 in Jun-20 to INR 115 in Mar-21. Interestingly, FIIs took a pause from buying during Jun-20 to Dec-20 and started accumulating shares of IEX after that, despite rising prices. Their shareholding further increased to ~ 38% in Sep-21 and the stock touched a peak of INR 207. Electricity traded through IEX touched a peak of 26 billion units in Q2FY22 as IEX attracted more clients to its platform. This is a possible indicator of FII optimism surrounding consistent operational performance and stock appreciation. DIIs, on the other hand, took a conservative stance and booked some profits after Mar-21.
- This is a classic example of increase in FII holdings acting as a lead indicator of superior stock performance.

Case Study-2: Navin Fluorine International Ltd

Chart 2.2: Navin Fluorine International Ltd

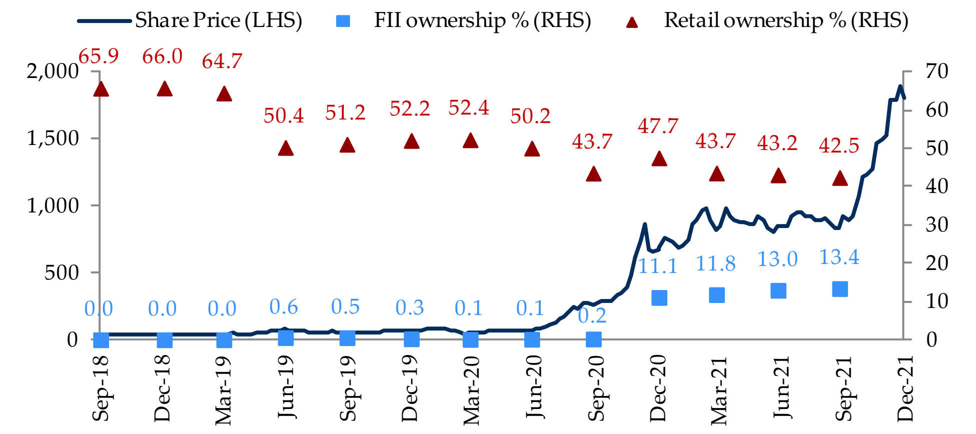


Source: HSIE Research

- Navin Fluorine, being a niche specialty chemical producer with expertise in fluorine chemistry, has been a preferred play for institutional investors in this space.
- It is one of the few stocks that can boast interest from both FIIs and DIIs. Between Sep-18 and Sep-19, the stock remained range-bound but FIIs and DIIs cumulatively held ~34% of the total outstanding shares. Their optimism regarding the stock was rooted in the company's competitive advantage in fluorochemical innovation and expected growth of fluorine chemical applications in pharmaceuticals and agrochemicals sectors.
- From FY19 to FY21, NFIL's topline and adjusted bottomline grew at CAGRs of 9% and 27% respectively. While the revenue generation was not strong in this period, significant margin improvement and long-term contract deal wins helped improve investor conviction in the company's niche products and chemical synthesis capabilities.
- With increasing business visibility and earnings growth, FIIs and DIIs both started increasing their stakes in the company between Sep-19 and Sep-20. Institutional holdings increased to 41% by Sep-20 and, as a result, the stock moved up sharply from INR 800 level to INR 2,000. By Mar-21, FIIs had consolidated their positions at around 25% (up from 15.7% in Sep-18), while DIIs had partially booked profits. The share price remained at INR 2,500. After FIIs increased the stakes, the share price further rose to a new peak of INR 4,000 in Dec-21, thus validating their investment rationales.
- In this example as well, FII buying has proved to be a lead indicator of future share price appreciation.

Case Study-3: Tanla Platforms Ltd

Chart 2.3: Tanla Platforms Ltd



Source: HSIE Research

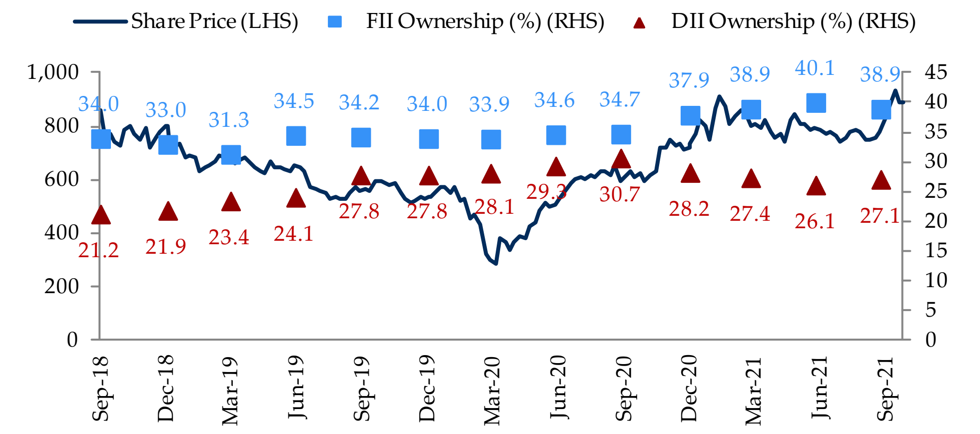
- Tanla Platforms is a cloud communication provider that also offers a blockchain enabled Cpaas platform (communications platform as a service).
- It is another example of FIIs spotting a stock of a less-researched high-growth company and accumulating positions in it before the stock appreciated. Tanla had reported impressive growth in its adjusted net profit (4x in FY20 than in FY19), powered by rapidly-growing enterprise business. This growth was augmented by introduction of Trubloq (platform business) in Sep-20. Trubloq is a blockchain-based platform used to handle unsolicited commercial communications and improves security by removing spams and fraud messages. Platform business revenue (Trubloq) grew by a whopping 84% in FY21. Also, it is a 90%+ gross margin business, so it contributed to rapid growth of profitability. Tanla reported INR 3.6 bn adjusted net profit in FY21 as against INR 1.3 bn in FY20 and INR 300 mn in FY19.
- FIIs were early to read into the potential of this company and grabbed the opportunity of increasing stake in it. Between Sep-20 and Dec-20, FII holdings went up from 0.2% to 11.1%, led by the Smallcap World Fund and Amansa Holdings. Thus, the stock moved up from INR275 in Sep-20 to INR 900 in Dec-20. For the next three quarters until Sep-21, the stock price remained in a tight band around INR 900, during which time FIIs increased their holdings by 230bps, anticipating higher appreciation in stock prices. Their persistence bore results and the stock rose to a new high of INR 2,000 by the Dec-21 quarter.

With the above three examples, we can reasonably assert that increased FII buying in a stock should be examined closely and in many cases, if not all, it could lead to identifying undiscovered promising investment opportunities. This understanding has led us to look for similar opportunities in which FIIs are currently accumulating shares and stocks haven’t yet risen much after their buying. These could turn out to be valuable investing avenues. In the next section, we cover a few such names.

3. Opportunities to buy

I. Mahindra & Mahindra Ltd

Chart 3.1: Mahindra & Mahindra Ltd



Source: BSE, HSIE Research

- Mahindra & Mahindra's (M&M) recent business performance has been subdued due to various factors including the rural slowdown impacting tractor sales, the BS VI transition for auto sector affecting production planning, sharp commodity inflation, and supply side problems caused by semi-conductor shortage.

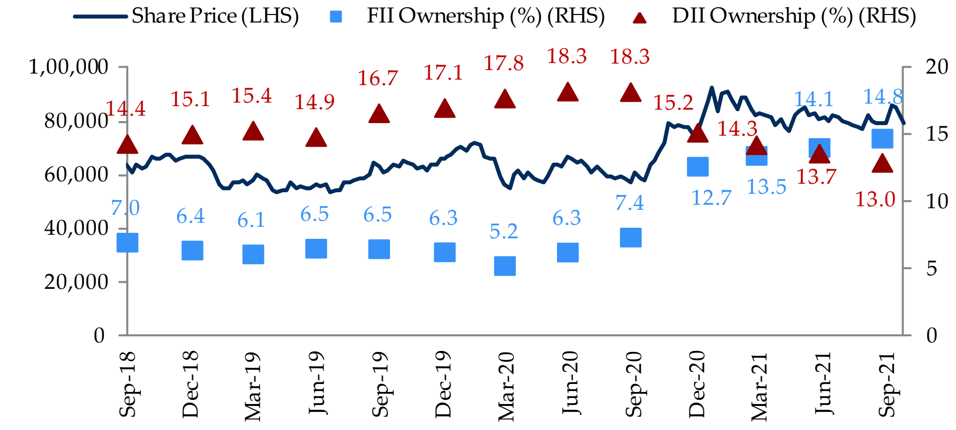
  However, management expects these headwinds to gradually abate, given its roadmap of future launches, improving supply side issues, and the rural economy's recovery. M&M dominates the tractor market with 40% market share. It expects to strengthen its position by launching 13 new tractor models by FY25. Additionally, 15 new farm equipment, 13 new SUVs, and 8 new electric vehicle models are in the pipeline to be launched by FY27. The management has set a target of 18%+ RoCE by FY27. This provides shareholders with much-needed optimism.

- With respect to shareholding, we can see from chart 3.1 that FIIs have held a large position in the company (~32-34%) since early 2018. To emphasize its significance, it is worth noting that promoter holding in the company is much lower, around 20%. Hence, any increase or reduction in FII holdings could provide some insight.

- From Sep-18 to Sep-20, FII holdings were constant at around 33-34%, despite the stock price swinging drastically in both directions. Despite this furious stock price fluctuation, FIIs did not dilute their holdings, reflecting their conviction in the stock. To take advantage of subdued prices, they boosted their shareholding to 38% in Dec-20 and 40% in Jun-21. The stock price has not gone up from the range in which these recent purchases were made, reflecting there is still the expected upside, if we consider the perspective of FIIs. Also, DII holdings have reduced marginally, but they still hold a substantial 27% of the stock. Institutional interest in the company is evident, indicating their confidence in the company's growth potential.

II. MRF Ltd

Chart 3.2: MRF Ltd

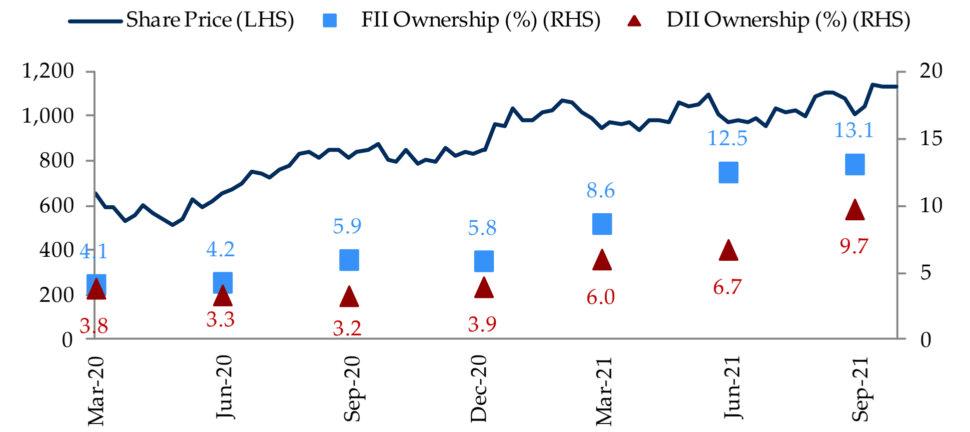


Source: BSE, HSIE Research

- MRF's operational performance has been subdued in the past couple of years as the automobiles industry has gone through a slowdown. COVID-related lockdowns, a shrinking rural economy, and raw material supply concerns have further aggravated this. As the industry awaits demand improvement led by backlog clearance and good monsoon-led recovery in rural markets, MRF is busy launching new products to stay ahead of competitors. It has launched new tyres in all customer segments i.e. farm, SUV, LCV, and trucks in order to capture future demand.
- Meanwhile, FIIs have been keenly monitoring the MRF management. FII holdings in MRF have been stable at around 6.5% between Sep-18 and Dec-19, when the stock remained flattish and didn't deliver any significant returns. However, post the COVID sell-off in fall of Mar-20, the MRF stock fell to a low of INR 55,000. FIIs found this stock undervalued and accumulated it; they raised their stake from 5.24% in Mar-20 to 12.6% in Dec-20 and in the process, the stock rose to around INR 77,000, delivering a 40% return. However, they kept increasing stake to touch a peak of 14.8% in the subsequent three quarters, while the stock languished at lower levels. In other words, FIIs added 220 bps of shareholding in the first nine months of CY21 while the stock remained passive (only 4% absolute returns in the period).
- FIIs' continued trust in MRF can be attributed to the expected recovery in automobile and auto components sector. The company is a leading supplier of auto tyres and can be an excellent play on the recovery of the auto sector, which seems to be around the corner.

III. SBI Cards & Payment Services Ltd

Chart 3.3: SBI Cards & Payment Services Ltd



Source: BSE, HSIE Research

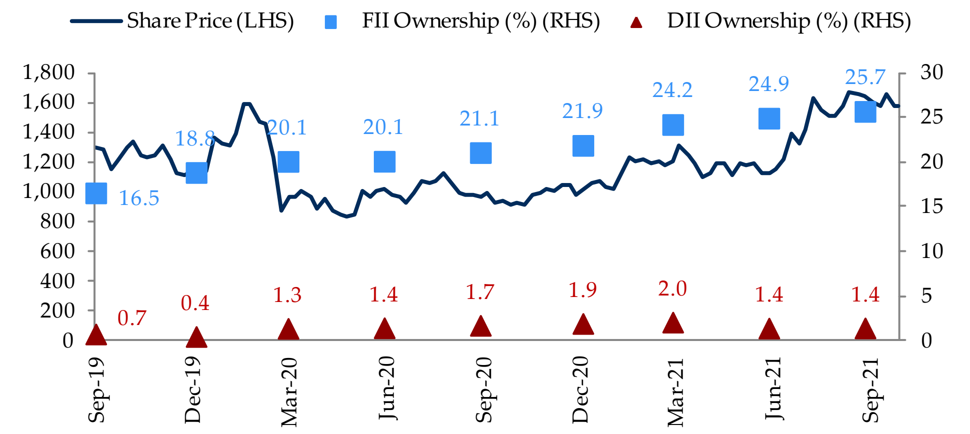
- SBI Cards, which enjoys 19% market share of rapidly-growing credit card market of India, was listed on the bourses in Mar-20. During the market sell-off of Mar-20, its stock price touched a low of INR 509, but recovered in subsequent quarters, courtesy FII purchases (which indicates their optimism about the company's growth). From Mar-20 to Sep-20, FIIs increased their stakes from 4.1% to 5.9%, resulting in stock price rising to INR840. During this period, DIIs and public investors gradually reduced their stake, reflecting their skepticism on prospects of the company in the pandemic-hit economy. COVID-led uncertainty resulted in SBI Cards' GNPA expanding by 228 bps to 4.29%. Lockdowns made many investors fearful of the reduced spending by cardholders, increased defaults on payments, and concerns over eventual losses that the company may have to take once the dust settled.

- Undeterred, FIIs continued believing in the SBI card story, given the significant under-penetration of credit cards in India (~4% vis-à-vis 19% global average) and enviable distribution channel of parent SBI, resulting in a long trajectory of expected growth. From Sep-20 to Sep-21, they kept building up positions and added a further 720 bps in shareholdings, while stock returns were measly at 19% (as against 57% of Nifty). Interestingly, DIIs also joined the bandwagon during this time and increased their shareholdings by 650 bps. So, it can be summarised that in four quarters between Sep-20 and Sep-21, institutional holdings in the stock grew by 1,360 bps (from 9.2% to 22.8%). At the same time, the company recovered remarkably on the operations front, delivering 14% growth in receivables, 47% growth in spends per card, improvement in NNPA of 180 bps, and improvement in RoE of 600 bps. It maintained its position as the No. 2 credit card player in India with 19% market share as cards in force grew by 12%.

- In the past year, the stock returns have been miniscule as compared to the broader market. This short-term underperformance has not deterred institutional investors and they are accumulating shares of the company in anticipation of future gains, as penetration of consumer credit cards in India unfolds. This gives us reason to believe that SBI Cards may offer potential value for patient investors in the foreseeable future.

IV. IIFL Wealth Management Ltd

Chart 3.4: IIFL Wealth Management Ltd



Source: BSE, HSIE Research

- IIFL Wealth Management is a direct play on Financialisation of savings and HNI wealth growth in India. As of FY21, the total HNI wealth in India amounted to ~INR 219 trillion, which is expected to grow at 13% CAGR over the next five years. Of this, only 14% is estimated to be managed by the organised segment wealth managers and the rest by unorganised or regional financial advisors. Driven by technology and development of financial markets in India, organised wealth managers are expected to gain market share from the unorganised segment in the coming years.

- Since its demerger from the parent in Sep-19, IIFL Wealth's key operational metrics have gone from strength to strength. It has grown from 5,500 relevant families (client families having >INR 10 mn AUM) in Sep-19 to 10,747 relevant families in Sep-21. Furthermore, its annual recurring revenue assets have grown from INR 640 bn in Sep-19 to INR 1,320 bn in Sep-21. Additionally, its net profit has grown considerably from INR 2.1 bn in FY20 to INR 3.7 bn in FY21 and stood at INR 2.6 bn in H1FY22.

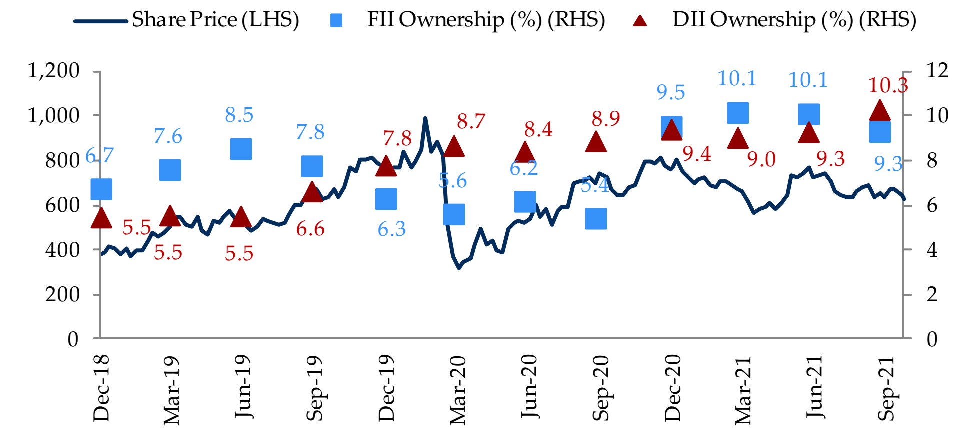
- Hence, as key elements of business, viz. the number of clients and AUM, have almost doubled in the past two years, PAT has grown faster as operating leverage has been built into the business model. It is important to note that despite the rapid advancement in business, the stock has not generated any meaningful return in this period.

- FII conviction in IIFL's growth trajectory and ability to capitalise on the inherent opportunities in the industry is evident by the shareholding pattern changes since its listing in September 2019. Since the demerger, its shares have been consistent acquisition targets for FIIs. Over the past eight quarters, undeterred by stock performance, FIIs have been increasing their stakes in the company secularly. Although the stock hasn't generated any significant returns in the past two years (22% absolute return between Sep-19 and Sep-21 vis-à-vis 53% of Nifty), FII holding has increased from 16.5% in Sep-19 to 25.7% in Sep-21.

- This sharp increase in holdings indicates indisputable expectations about the business growth opportunity of IIFL Wealth. Hence, it merits having a look at the stock for riding the wealth industry growth, led by financialisation of savings in India.

V. CreditAccess Grameen Ltd

Chart 3.5: CreditAccess Grameen Ltd



Source: BSE, HSIE Research

- CreditAccess Grameen (CAG) has witnessed increasing interest level from institutional investors over the past few quarters. Between Dec-18 to Sep-19, FIIs and DIIs both increased holdings in the company, trusting its credit underwriting capabilities and growth opportunity in domestic market (DII purchases were led by Nippon India MF). Consequently, the stock rose from INR 380 in Dec-18 to INR 991 in Feb-20. FIIs took some profit off the table and reduced their holdings to around 6% in Mar-20, from the earlier peak of 8.5%. DIIs didn't relent and kept buying even at these elevated price levels.

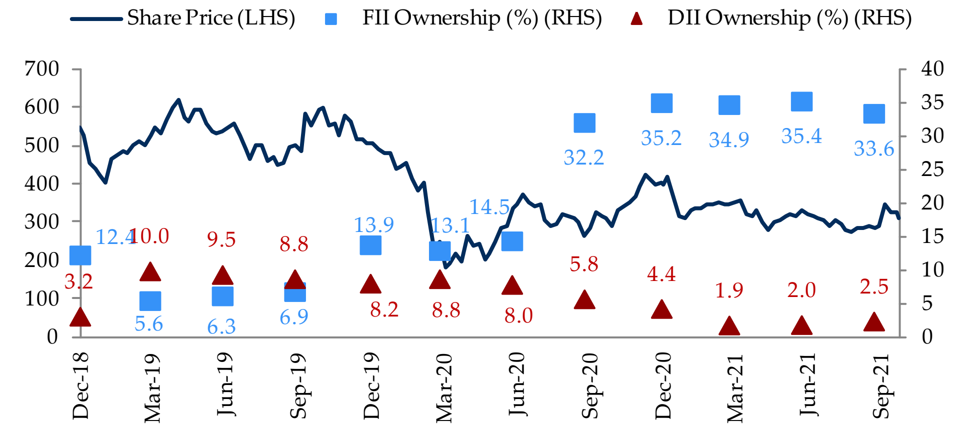
- Pursuant to the QIP in Oct-20 (when the company raised INR 8 bn), FIIs and DIIs subscribed to it, pushing up their holdings by 412 bps and 52 bps respectively. ICICI Prudential MF and Tata AIA Insurance led the DII participation. As of Sep-21, FII and DII holdings were 9.3% and 10.3% respectively. It can be noted that institutional investors have made significant additions (540 bps) to their shareholdings despite the stock declining by 14% in the past four quarters. It is evident that these investors are patiently building up their positions for large gains in long term, shrugging off and ignoring the short-term volatility in the stock.

- On the operational front, CreditAccess Grameen has delivered steady performance in the past year, delivering loan growth of 19% and pre provisioning profit (PPOP) growth of 11%. Asset quality has moderated due to short-term headwinds in the rural economy, which should improve over the next few quarters.

- Despite its recent subdued stock performance, CreditAccess Grameen enjoys continued support of marquee investors such as Nippon MF, IIFL AMC, TATA AIA Life Insurance, ICICI Prudential Life Insurance, HDFC Life Insurance, Kotak Offshore Funds, and Nomura AMC.

VI. Bandhan Bank Ltd

Chart 3.6: Bandhan Bank Ltd



Source: BSE, HSIE Research

- Bandhan Bank listed on the bourses in Mar-18. Since its listing, it has been sliding downhill, given the asset quality issues and overhang on the stock due to promoter stake dilution. However, FIIs have been accumulating this stock on every fall despite most of the mutual funds keeping away from it.

- From its listing in Apr-18 until Sep-19, FII shareholdings in the stock had been modest at ~6% as free float was low, given promoter shareholding of 82%. Due to the RBI's new banking license norms, the promoter holding in Bandhan Bank was supposed to be brought down to less than 40%. This was achieved in two steps: (1) merger with Gruh Finance in Oct-19 and (2) promoter diluting through secondary market sale.

- FIIs aggressively participated in this secondary sale, indicating their trust in the company's future growth. As a result of these two steps, FII holdings in the company moved up sharply from 7% in Sep-19 to 34% in Sep-21. During this time, the stock declined by 42%.

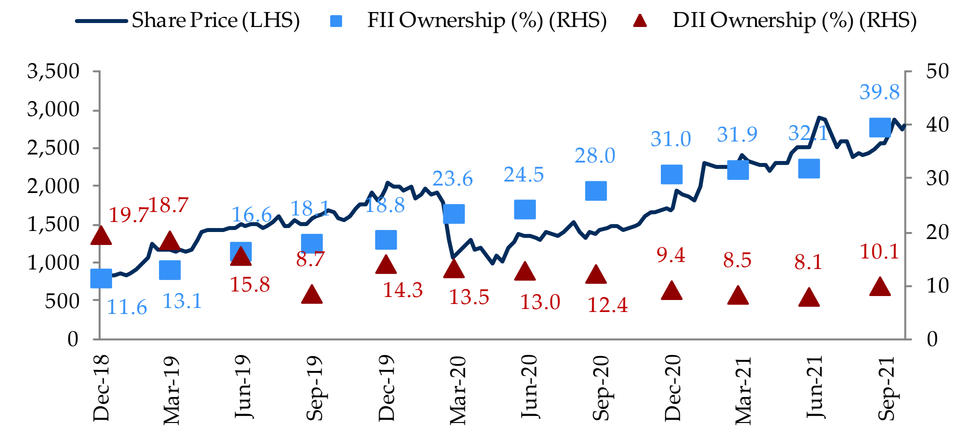
- The bank has come a long way since Dec-18 when it was a small bank with majority of advances book contributed by the micro-lending unit (~86%). It has evolved into a more diversified bank with micro-lending book contributing now around 59%. Bandhan Bank's advances book has grown from INR 346 bn in Dec-18 to INR 817 bn in Sep-21. During the same period, it improved its CASA ratio from 41% to 45% and the total customer pool has grown from 15.3 million to 24.3 million.

- The stock price movement is not indicative of these improvements in business parameters, primarily due to the recent asset quality concerns (GNPA-10% & NNPA-3%) led by COVID impact in West Bengal and Assam. We expect asset quality to improve gradually, as the rural economy recovers in these states.

- Despite the falling stock price and prevailing concerns over asset quality, FIIs have been increasing their stakes in Bandhan Bank, reflective of their conviction in the bank's capabilities of capturing long-term growth.

VII. Aavas Financiers Ltd

Chart 3.7: Aavas Financiers Ltd



Source: BSE, HSIE Research

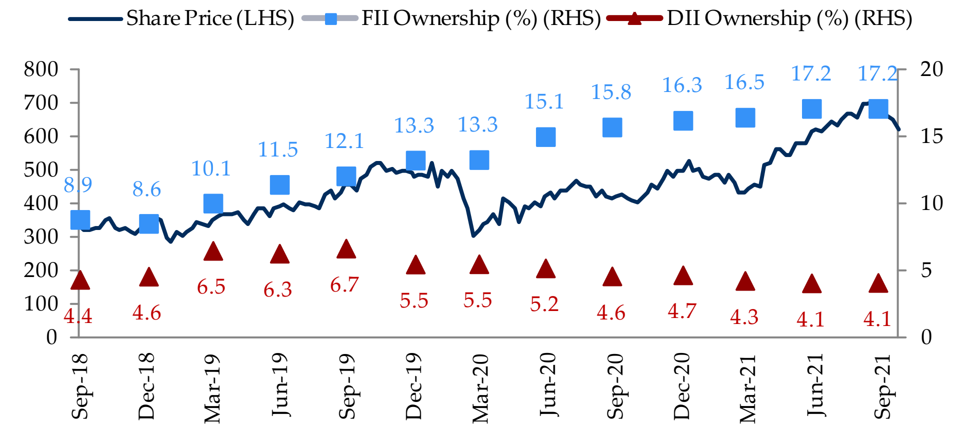
- Aavas Financiers is engaged in the business of providing affordable housing loans to customers belonging to low and middle-income segments in semi-urban and rural areas. Its promoters are marquee private equity players Kedaara & Partners Group (with ~40% holding). Other notable institutional investors include Capital Group, GIC, Nomura, UTI AMC, Kotak Mahindra AMC, SBI Life, and Tata AIA Life.

- It currently manages an AUM of INR 101 bn in Sep-21 which has grown at 32% CAGR in the past four years without compromising asset quality as gross stage-3 assets are moderate at 0.96% (net stage 3 at 0.72%). PAT has grown at a stellar 46% CAGR in the past four years to reach INR 2.9 bn in FY21. It focuses on low ticket sized loans ranging from INR 0.7-0.9 million usually. Rapid disbursement growth and disciplined credit underwriting has enabled the company to report a superior RoA of 3.25% and RoE of 12.25% in H1FY22. It is worth noting that the Indian housing finance market is an INR 22-trillion opportunity that is luring investors and entrepreneurs alike.

- Witnessing consistent growth in the lending portfolio with commendable underwriting standards and quality parentage, Aavas has been on the radar of institutional investors. It has seen a sharp surge in interest from FIIs since its listing in Oct-18. Interestingly, FIIs kept increasing their stakes relentlessly despite the stock moving up aggressively. Between Dec-18 and Sep-21, the stock has generated an absolute gain of 226% and FII holdings have risen by 28 percentage points. So, with each passing quarter, buying has taken place at higher price levels. This indicates that FIIs have excessive comfort in Aavas' long-term growth story.

VIII. ICICI Prudential Life Insurance Company Ltd

Chart 3.8: ICICI Prudential Life Insurance Company Ltd

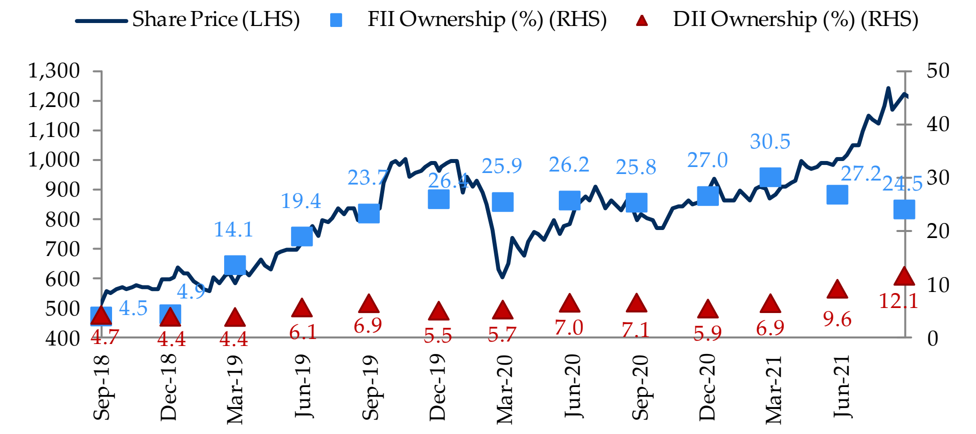


Source: BSE, HSIE Research

- As noted in the cases of other listed life insurance (LI) companies of India, FIIs' interest in Indian LI industry's long-term growth story is quite clear. FIIs have been increasing their stakes in ICICI Prudential Life over the past 12 quarters despite the overall rising stock price atmosphere. We have noted a similar consistent rise in FII shareholdings in SBI Life and HDFC Life as well. Purchases are not deterred by increasing stock prices. This reflects FIIs' deep conviction in the bright prospects of LI growth in India and the expected significant price appreciation of the stocks.
- FIIs have increased their holdings in the ICICI Prudential Life stock consistently from 8.8% in Sep-18 to 17.2% in Sep-21, while the stock doubled during that time. Despite making significant returns already, there are no signs of profit booking by FIIs, indicating a longer investment horizon.
- During this period, the average premium equivalent (APE) grew modestly but the change in product mix and company's focus on protection business improved its profitability. Its protection business, which is a high profitability product, grew by more than 100% as protection APE doubled. This change of strategy resulted in 'value of new business' (VNB) margin improving consistently from 17.5% in Sep-18 to 27.3% in Sep-19. Consequently, embedded value of the business grew from INR 192 billion to INR 302 billion in the same period. Management has set a target for itself of doubling the company's FY19 VNB by FY23, which would lead to an expected CAGR of 28% from here.
- The improvement in operational performance, already-charted out roadmap, and increasing interest of institutional investors augur well for the stock's future performance.

IX. SBI Life Insurance Company Ltd

Chart 3.9: SBI Life Insurance Company Ltd



Source: BSE, HSIE Research

- SBI Life has been seeing increasing institutional interest over the past 2.5 years with rising stock prices. As promoters, SBI and BNP Paribas Cardiff reduced their stake in 2019 to comply with minimum public shareholding requirements; these stakes were lapped up by institutional investors who saw long-term growth opportunity.

- As shown in chart 3.9, between Dec-18 and Dec-19, FII ownership of the company went up from 4.9% to 26.4%. Consequently, the stock rose from INR 575 and reached a peak of around INR1,000 during this time. Key operational parameters such as New Business Premium (NBP) and value of new business (VNB) grew by 35% and 28% respectively. However, in the subsequent five quarters, the stock didn't perform much as NBP and VNB growth moderated to 24% and 16% respectively due to COVID-led adverse impact on the business. Despite this, FII stake kept increasing and stood at 30.5% in Mar-21, reflecting their long-term growth optimism. In the first half of FY22, FII stake has come down by 5% with increasing stock prices reflecting profit booking by PE major Carlyle's affiliate firm but the same has been absorbed by domestic mutual funds with alacrity. Holdings of domestic MFs grew sharply from around 5% in Mar-21 to 11% in Sep-21.

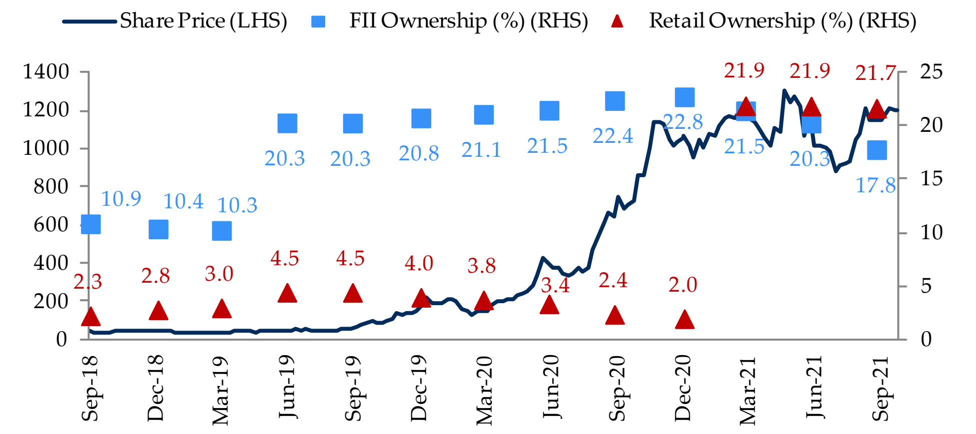
- Cumulative institutional holdings have increased from 32% in Dec-19 to 37% in Sep-21 but the stock moved up only 10% during this time. It indicates that investors with long investment horizons are patiently holding their positions in the stock and increasing them, taking advantage of the subdued short-term stock performance, thus reflecting their confidence in the company's strong fundamentals and the growth opportunity it offers.

- Mutual funds' interest in this stock can be observed from the fact that when one of the large FIIs, CA Emerald Investments (affiliate of Carlyle Asia Partners), offloaded its stake of 6% for profit booking in May and Aug-21, it was readily acquired by a group of domestic mutual funds. ICICI Prudential, ICICI Life Insurance, Axis, Aditya Birla, Mirae Asset and SBI were leading MFs in this deal. Overall, Carlyle made 1.9x from SBI Life on its investment of ~INR 46.7 bn in little over two years.

4. Advisable to exercise caution

I. Adani Green Energy Ltd

Chart 4.1: Adani Green Energy Ltd



Source: BSE, HSIE Research

- In order to meet India's pledge to raise non-fossil energy capacity to 500 GW by 2030, Adani Green Energy has been investing extensively in renewable energy capacity installations. It now boasts a 20-GW renewable energy portfolio (5.3-GW operating and 14.8-GW under construction) that includes wind, solar and hybrid technologies. The company has outlined a plan to increase installed capacity to 35GW by 2025 and 45GW by 2030.

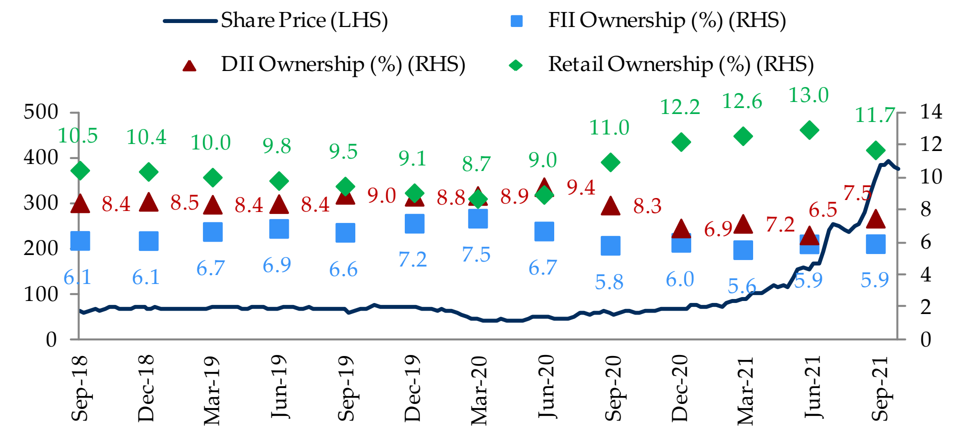
- Given its aggressive capacity expansion plan, the company's share price has been hitting new highs every other week since Sep-19, climbing from INR 70 in Sep-19 to INR 1,150 in Sep-21, generating enormous wealth for shareholders. FIIs participated in this growth journey until Dec-20, after which they started booking profits. Over the subsequent three quarters, they reduced holdings by 500 bps despite the stock's continued rise.

- This could indicate that FIIs are noting the stocks' speculative zone, where it has reached without proportionate growth in the company's fundamentals. It is worth noting that the company reported a net profit of INR 3.2 bn in H1FY22 and INR 1.8 bn in FY21. In previous years, it had been reporting losses at the net level. Consequently, as of Sep-22, the company's net worth is INR 24.7 bn against a net debt of INR 400 bn, implying a leverage of 16 times the equity.

- Given the company's existing profitability, the leverage ratios indicate that the business is in very high risk zone. Despite this, the stock has been climbing new highs often. It was trading at a market cap of INR 1.8 trillion in Sep-20, implying astronomically high valuation levels of 72x P/B and 270x FY22 P/E. Therefore, investors should reduce the stock holdings at current valuation and wait for better entry points after assessing the execution and completion of capacity installations projects.

II. JSW Energy Ltd

Chart 4.2: JSW Energy Ltd



Source: BSE, HSIE Research

- JSW Energy, like most power sector companies, has had a stellar run since the COVID fall in March 2020. The stock has given an absolute return of more than 7x from Jun-20 to Sep-21. However, the company's net earnings have not seen this kind of momentous growth. As per our estimates, FY22 profit after tax (PAT) will be slightly lower at INR 10.2 bn than pre-pandemic FY20 PAT of INR 10.8 bn. Hence, the expected FY22 financials may best be described as a business rebound rather than anything ground-breaking. This also indicates the shallowness of the stock rally, which was mostly led by expansion of PE multiple rather than fundamental business growth.

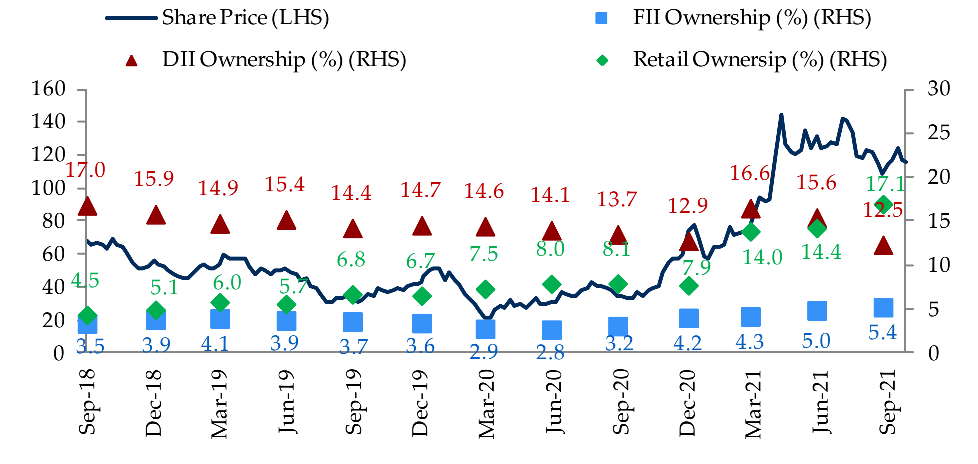
- The rally in the sector started in H2FY21, when power demand unexpectedly picked up and surpassed pre-pandemic levels. Pent-up demand of goods and a surprising restoration in manufacturing started pushing power consumption and, hence, electricity prices up in spot markets. Although it was a sentimental win for JSW, it was unable to benefit significantly as 87% of its power capacity is tied to long-term PPAs with fixed power prices. However, the company's leverage ratios have improved as a result of strong cash flows in recent quarters.

- In our view, the company's roadmap for building 15 GW of renewable capacities by 2030 is raising retail investors' expectations, which is evident in their increased shareholding. Their holdings increased by 300 bps between Mar-20 and Sep-21 along with the stock rally, while FII and DII reduced their holdings by 160 bps and 150 bps respectively, as they booked profits. As shown in the chart above, the rally was clearly led by retail/HNI buyers, as institutional investors booked profits and lightened their positions.

- Hence, investors should reduce their stockholdings at current prices as the valuation is not sustainable. We should wait until we get more clarity on the company's renewable capacity execution prowess before assigning larger multiples to these projects. Smart money (institutional investors) is booking profits due to the stock's built-in valuation excess.

III. Steel Authority of India Ltd (SAIL)

Chart 4.3: Steel Authority of India Ltd

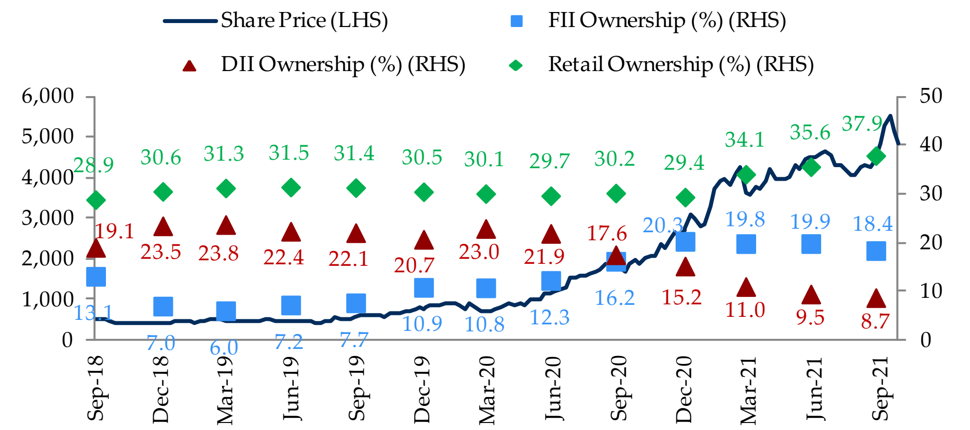


Source: BSE, HSIE Research

- 2021 has been an extremely rewarding year for metal stocks; the BSE Metal Index gained 66% in the year, its best performance in at least 12 years. Metal prices across the board significantly increased in 2021, mainly due to the above-expectation post-lockdown demand recovery, coupled with supply shortages due to erratic Chinese production.
- Steel was no exception either, witnessing ~50% price increase between January and September 2021. During this time, SAIL's stock soared by ~65%, mainly due to higher sales realisation and expectation of further deleveraging of the balance sheet. Since October, steel prices have softened by ~30% and SAIL's share price has reacted accordingly, shedding ~27% of its gains from its 52-week high. As Chinese factories begin to operate in a phased and continuous manner, metal prices are expected to remain subdued in 2022.
- As seen in the chart above, SAIL's stock rally (Dec-20 to Sep-21) was clearly a public-led one, as retail/HNI investors significantly increased shareholdings, taking them from 7.9% to 17.1% in this period.
- DIIs increased ownership by 372bps in Q4FY21 as they subscribed to offer for sale (OFS) which took place in Jan'21. They have already booked profits since then as their shareholdings moderated to lower levels. FIIs have not participated much in this rally despite the aggressive increase in metal prices. It can be construed institutional investors didn't support this rally as they believed this metal price led stock rally is transient and not driven by fundamentals.
- Hence, we recommend being cautious on the stock and reducing the existing positions.

IV. Dixon Technologies (India) Ltd

Chart 4.4: Dixon Technologies (India) Ltd

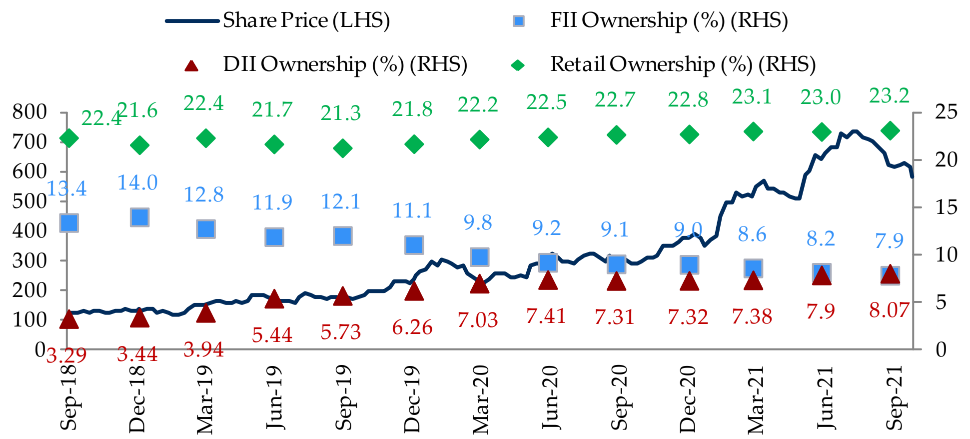


Source: BSE, HSIE Research

- Dixon has been leading the electronic manufacturing services space in India, which is growing at a rapid pace under the Make-in-India drive. From FY18 to FY21, its revenue and PAT have grown at 32% and 38% CAGRs respectively with average 24% RoE attracting the attention of investor community. Additionally, given the undisputed long runway of growth for electronics goods & consumer durables in India and government offered support to the sector in the form of production-linked incentives (PLI), Dixon's prospects are bright.
- This optimism surrounding Dixon is clearly visible in its stock price rally of 8x between Sep-19 and Sep-21. The early part of the rally (until Sep-20) constituted institutional investors as well; however, in Q3FY21, they started booking profits, given expensive valuation at which the stock was trading. For the past three quarters, FIIs and DIIs have reduced holdings, creating an impression that the stock may have run ahead of its fundamentals, but the price has been moving up. DIIs, led by mutual funds, have been consistent sellers in this counter and have lightened their positions by 860bps in the past year; FIIs, on the other hand, have reduced their stakes by 200bps from their peak holdings. In a nutshell, institutional holding came down by 900bps in the past three quarters and retail investors have readily absorbed this supply.
- In our view, although Dixon has a huge potential opportunity of growth and it has proven its execution capabilities as well, it is current trading at expensive valuation (>100 FY22E) and deserves a cautious approach. We can observe from the above chart that smart hands are selling their holdings to novice investors. New investors should avoid this stock for now as we do not believe this is a suitable entry point; existing investors should consider partial profit booking.

V. Gujarat Gas Ltd

Chart 4.5: Gujarat Gas Ltd



Source: BSE, HSIE Research

- Gujarat Gas, a leading city gas distribution company, has consistently increased its gas sales and total number of connections over the years. It has cemented its dominance in the geographic areas its serves with the government's increasing focus on green fuel. Between FY17 and FY21, its gas sales grew by 15% CAGR. During this time, its industrial segment, which contributes around 80% of overall sales, has grown at an impressive 19% CAGR.
- This operational growth has been well reflected in the stock's appreciation, which has risen by more than 4x between Sep-18 and Sep-21. Primarily led by mutual funds' increasing interest in the stock, DII holdings in the stock have increased from 4% to 8% in the past three years. However, it is worth noting that, as stock prices have risen sharply, FIIs have been booking profits and reducing their positions every quarter. They have consistently lowered their stake in practically every quarter over the past three years. As a result, their holding now is less than 8% as compared to a peak of 14% a few quarters ago.
- Furthermore, in this context, it is important to note the FII's shareholding pattern of sector peers Indraprastha Gas and Mahanagar Gas. After increasing their stake in MGL by 500bps in Sep-19, FIIs kept their holdings stable until now and not reduced it much.
- FII holding in IGL have also remained stable in the past three years. Both of these patterns contrast FIIs' actions towards the Gujarat Gas stock.
- In our view, this one factor isn't sufficient to form a negative opinion about the stock and we remain positive on the company's operational capabilities and growth expectations but reduction in FII shareholding certainly deserves investor attention.

Conclusion

- Through our study, we find that the following institutional investor buying/selling patterns over the quarters can give deep insights into potential investing opportunities and caution us about stocks running ahead of fundamentals. We conclude that investors are finding value in BFSI & automobile related sectors, viz., auto OEMs, auto ancillaries, insurance, credit card, wealth management, housing finance, and microfinance. A common thread running across these sectors is that they have all underperformed the broader market in the recent rally. Hence, institutional investors are playing contrarian to unearth uncelebrated potential outperformers of the future. Also, selling patterns in steel & power sector indicated overvaluation, alerting us to the risks building up in these stocks.
- Nevertheless, this research report should only be viewed as one that focuses on lead indicators. This alone is not sufficient to make final investment decisions. In addition to these lead indicators, a thorough bottom up stock specific analysis would be necessary for prudent stock selection.

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