श्री LAKSHMISHREE

Gateway to your Financial Goals

NIFTY @ 19,500...?

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IT'S NEVER TOO EARLY OR LATE TO START INVESTING

From Managing Director's Desk To Readers

Financial Stability Report: Consumption Still Stuck On The Runway

Amid all the positive news in the Reserve Bank of India's Financial Stability Report are two charts that show a worrisome trend. These charts, which have been reproduced here, show that both real rural wages and real urban wages, which means wages adjusted for inflation, have remained stagnant since 2018.

Indeed, a look at the chart shows that real wages have actually declined a bit. We had written earlier about how wage growth in the rural areas has not kept pace with inflation and the central bank has now confirmed it.

The fall in real urban wages is a surprise and reflects how inflation has eaten into the purchasing power of the masses. The RBI report says, in the context of domestic demand, that: 'Moderation in real wages and recent signs of tempering of private consumption are emerging as constraining factors, alongside weakening external demand, which may impact export prospects.'

The hope is that, with inflation coming down, consumption will revive. That sounds logical, but the chart shows stagnant real wages even in 2018-19, when retail inflation was a lowly 3.4 percent. On the other hand, we hear many stories of how demand for high-end goods and services has improved. It's yet another sign of India's K-shaped economy, where vast pools of underemployed labour keep wages down, while the elites indulge in conspicuous consumption.

What RBI's Financial Stability Report says about equity valuations

The RBI's latest Financial Stability Report, published on Wednesday, says the performance of the Indian markets is a reflection of the strength of the Indian economy and its improving growth prospects. It points to the sharp rebound among foreign institutional investors who have made net purchases of US$ 11.6 billion since March 2023 (till June 23, 2023). The report says, 'the Indian equity market has remained among the stronger performers globally, despite volatile shifts in global liquidity flows and sentiments, monetary tightening and the recent geopolitical and banking sector turmoil.' What's more, the report also says that volatility in the Indian market has been lower than in other emerging market as well as advanced economy stock markets, indicating a degree of complacency in the market.

The question is: are the improving growth prospects in India already priced in by the markets, given that they are now at all-time highs? The RBI report has a chart (reproduced here) comparing the trailing and forward price-earnings multiples of the Indian markets to that of other markets. As the chart shows, India is the second most expensive market, after Japan.

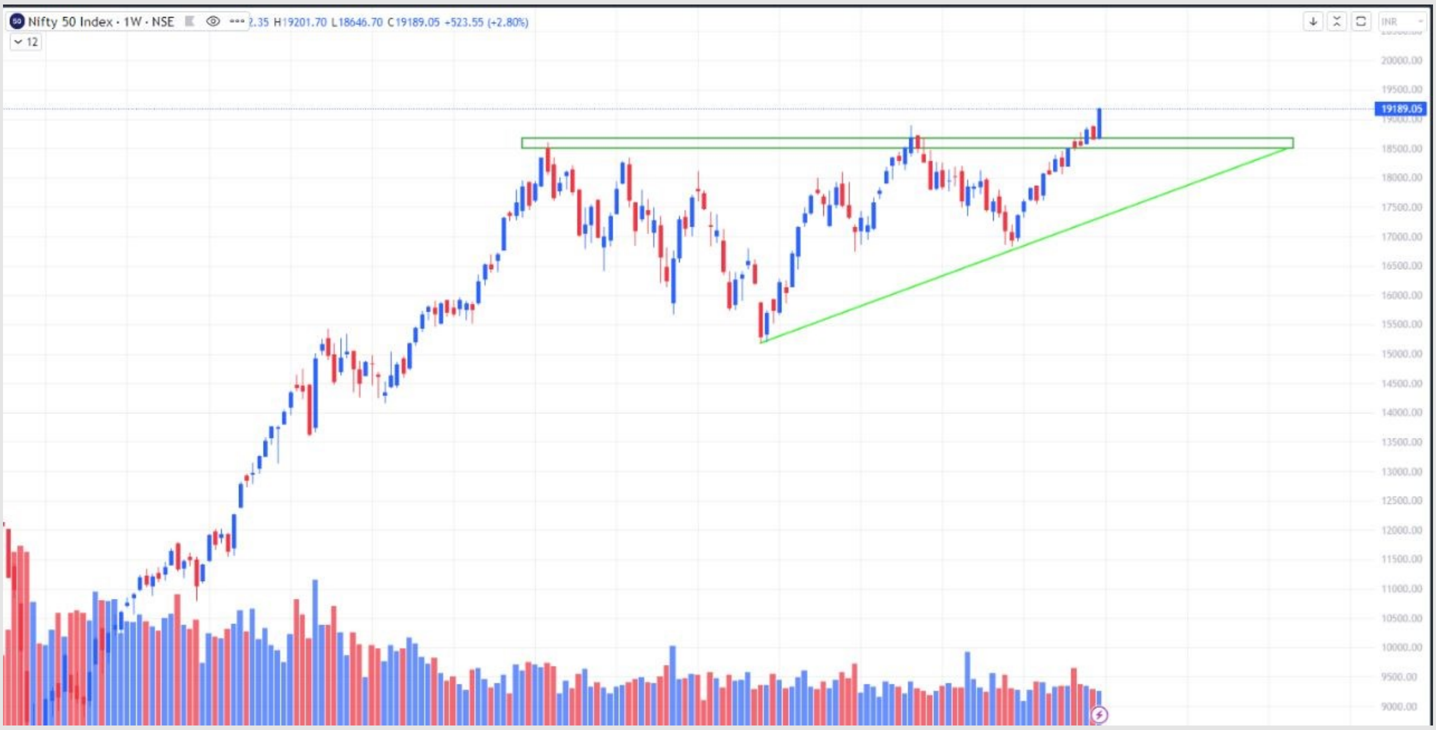
Incidentally, a recent note by Kotak Institutional Equities said, 'The Indian market valuations may not look very expensive on headline basis versus recent history and bond yields. However, the cheap valuations and the large contribution of banks to overall profits of the headline indices may be holding down overall valuations.' The note said that using a bottom-up approach, they find 'valuations very expensive in most cases in the context of (1) past valuations that were supported by low global interest rates and (2) future disruption that is not factored in valuations clearly.'

Salil Shah

Managing Director

Lakshmishree Investments & Securities Pvt. Ltd.

Look What Our Research Analyst Has To Say...



Nifty closed at record highs as we have been mentioning in the previous reports that soon we will see all time highs on the indices. The month of July looks very positive for the bulls as Monsoon is better then expected. On the levels front the index has broken out of a bullish structure at 18,900 & the target for the same are laced at 19500 levels. If bulls manage to slice above 19,500 the next logical resistance is placed at 19,800. On the downside the index has support at 19,000 and below that 18,600. For bears to step in and take charge the index ahs to sustain below 18,600 which is unlikely at current levels.

WHAT DOES THE ICICI SECURITIES DELISTING MOVE MEAN FOR INVESTORS?

ICICI Securities on June 29 announced that it will delist and become a wholly owned subsidiary of its parent company ICICI Bank. Public shareholders of the broking firm would be allotted 67 equity shares of ICICI Bank for every 100 equity shares of the company.

"The scheme is subject to receipt of requisite approvals from ICICI Bank and the company's shareholders' and creditors, Reserve Bank of India, National Company Law Tribunal, stock exchanges and other regulatory and statutory authorities," the exchange filing stated.

On June 28, ICICI Securities' stock closed at Rs 615.95 and ICICI Bank closed at Rs 939.95 on the NSE. Based on this, the share swap ratio indicates that ICICI Securities' shareholders getting only a two percent premium.

Explaining the rationale behind the decision, ICICI Bank said, "ICICI Securities is a low capital consuming business and the internal accruals are more than adequate to fund business growth. ICICI Bank is not expected to be required to make additional capital infusion into the company."

As of March 2023, ICICI Bank held 74.85 percent stake in ICICI Securities. The delisting process is expected to be completed in 12-15 months.

"With ICICI Sec as a 100 percent subsidiary, it is expected that both entities would be able to better capitalize on the synergies in line with the Customer 360 focus of the bank," the filing added.

Another reason cited behind the delisting move is that the securities broking business is inherently cyclical as it is significantly dependent on macro-economic environment and buoyancy in equities market.

In Q4 FY23, ICICI Securities reported a consolidated net profit of Rs 263 crore, down 23 percent as against Rs 340 crore reported in the corresponding period of last year. Revenue from operations during the quarter stood at Rs 885 crore, also down marginally as against Rs 892 crore in the year-ago period.

What could have prompted the delisting?

Undervaluation? The stock of ICICI Securities has underperformed since its listing in April 2018. A couple of days before the announcement of the delisting plan, the stock was hovering around its issue price of Rs 520 per share. This is despite the healthy business growth and earnings growing at a compounded annual growth of 23 percent in this period (FY19 to FY23).

ICICI Securities's net profit declined by 19 percent in FY23 due to muted broking revenue and a rise in cost as it invested in further growth. However, the performance was healthy despite multiple business headwinds. That's because ICICI Securities has a diversified revenue profile. The company's non-broking revenue stood at more than 40 percent in Q4 FY23.

While ICICI Securities gets adversely impacted by a moderation in equity trading activity, it benefits from the rise in retail investors' indirect participation in equities through mutual funds as it is the third largest distributor of mutual funds among non-banks (after NJ Invest and Prudent). The total MF assets and equity assets distributed by the company stood at Rs 53,000 crore and Rs 45,400 crore, respectively, at the end of FY23.

In addition to the distribution of financial products, ICICI Securities had been increasing its secured margin trade funding (MTF) business in the past couple of years to diversify its revenue profile. Given its competitive borrowing cost, Isec has a dominant market share of 23 percent in the MTF business.

Higher Flexibility? The broking business which contributes the highest revenue is facing multiple headwinds. First, the average daily turnover (ADTO) in the NSE's cash segment declined sharply in FY23 even as the derivative (F&O) segment volume held up. Second, the heightened competition due to the emergence of low/zero-cost brokers has adversely impacted ICICI Securities. Its market share in derivatives ADTO has declined from around 7.4 percent in Q1 FY20 to 3.1 percent in Q4 FY23.

Moreover, the slew of regulatory changes introduced for broking entities in recent times has been overwhelming. The recent SEBI's proposals to change the TER (total expense ratio) for mutual funds is also likely to indirectly impact the distribution revenues of ICICI Securities.

To compete with new-age discount brokers and strengthen its market position, Isec is launching its discount broking platform which can narrow the gap with new-age brokers.

Taking the firm private will give ICICI Securities more flexibility to compete with new-age discount brokers and gain market share even with lesser profitability. It would be easier to manoeuver the company from e-broking to wealth tech under the full control of ICICI Bank.

Anshul Jain

Research Analyst

Stocks To Watch

www.lakshmishree.com

1. JK LAKSHMI CEMENT

JK Lakshmi Cement, an ISO 9002 certified company, started its operation in 1938 in the Sirohi district in Rajasthan. It manufactures a wide range of cement. It is part of a diversified JK Group having business ventures in various segments such as paper, tyres, sugar, agri genetics and clinic research. The company has a network of 70 cement dumps and over 2200 dealers spread across the states of Rajasthan, Gujarat, Delhi, Haryana, U.P, Uttaranchal, Punjab, J&K, Mumbai and Pune. The combined capacity of the Company today stands at 4.75 MT per annum.

It became the first cement manufacturer in north India to introduce colour bags to promote its product. The company's product is chosen for various important projects such as IGNP, Sardar Sarovar Dam and also by major corporations like L&T, Reliance, Essar and the Airport Authority of India.

Particulars

Bloomberg	JKLC IN
Market Capitalisation	₹ 86 b
52 Week Range H/L	897 / 406
Equity Shares (m)	118
1, 6, 23 Rel. Per (%)	6/ -12/ 60
12M Avg Val (₹ m)	316

Shareholding Pattern

In (%)	Mar-23	Dec-22	Mar-22
Promoter	46.3	46.3	46.3
DII	28.0	25.6	25.9
FII	11.7	13.8	12.3
Others	14.1	14.3	15.5

Income Statement

Y/E March (₹ Mn)	FY 22	FY 23	FY 24E	FY 25E
Net Sales	**54199**	**64515**	**70363**	**78602**
Change (%)	14.6	19.0	9.1	11.7
EBITDA	**9507**	**8387**	**10633**	**12932**
Margin (%)	17.5	13.0	15.1	16.5
Depreciation	2235	2283	2684	3123
EBIT	**7272**	**6104**	**7949**	**9810**
Int. & Finance Charges	1422	1344	1199	1762
Other Income - Rec.	683	575	581	601
PBT (before EO Exp.)	**6534**	**5345**	**7331**	**8649**
EO Expense/ (Income)	270	0	0	0
PBT After EO Exp.	**6264**	**5345**	**7331**	**8649**
Total Tax	1488	1654	1851	2180
Tax Rate (%)	23.7	30.9	25.3	25.2
Reported PAT	**4776**	**3691**	**5480**	**6468**
Less: Minority Interest	140	105	281	74
Pat Adj. For EO Items and MI	**4229**	**3586**	**5199**	**6394**
Change (%)	-1.9	-15.2	45.0	23.0
Margin (%)	7.8	5.6	7.4	8.1

Balance Sheet

Y/E March (₹ Mn)	FY 22	FY 23	FY 24E	FY 25E
Equity Share Capital	589	589	589	589
Total Reserves	24463	27450	32061	37749
Net Worth	**25052**	**28039**	**32649**	**38337**
Minority Interest	267	370	651	725
Deferred Liabilities	531	1327	1327	1327
Total Loans	18565	18463	18915	14715
Capital Employed	**44415**	**48199**	**53542**	**55104**
Gross Block	47469	49667	58566	68316
Less: Accum. Deprn.	13992	16275	18980	22125
Net Fixed Assets	**33477**	**33392**	**39585**	**46191**
Capital WIP	2425	8902	9589	2089
Total Investments	**7677**	**6421**	**6421**	**6421**
Goodwill	723	723	723	723
Curr. Assets, Loans, & Adv.	**14959**	**15971**	**14162**	**17161**
Inventory	5810	8416	7373	8014
Account Receivables	352	654	732	809
Cash & Bank Balance	5729	3390	2309	4344
Loans and Advances	3068	3511	3748	3994
Current Liability & Prov.	**14847**	**17210**	**16939**	**17480**
Account Payables	3660	5860	5589	6131
Other Liabilities	10894	11098	11098	11098
Provisions	293	252	252	252
Net Current Assets	**112**	**-1239**	**-2776**	**-320**
Application of Funds	**44415**	**48199**	**53542**	**55104**

Cash Flow Statement

Y/E March (₹ Mn)	FY 22	FY 23	FY 24E	FY 25E
OP / (Loss) Before Tax	6534	5345	7331	8648
Depreciation	2235	2283	2706	3145
Int. & Finance Charges	1422	1334	1199	1762
Direct Taxes Paid	-888	-909	-1851	-2180
(Inc) / Dec In Working Capital	-1526	-1135	457	-422
Cash Flow From Operations	**7776**	**6918**	**9841**	**10952**
Others	-976	-576	-	-
Cash Flow From Operations Incl. EO	**6800**	**6342**	**9841**	**10952**
(Inc) / Dec in FA	-3661	-7320	-9586	-2250
Free Cash Flow	**3138**	**-978**	**255**	**8702**
(Pur.) / Sale of Investments	-3264	4070	-	-
Others	274	255	-	-
CF From Investments	-6651	-2995	-9586	-2250
Issue of Shares	-	-	-	-
Inc./ (Dec) in Debt	2042	-431	452	-4200
Interest Paid	-1401	-1505	-1199	-1762
Dividend Paid	-443	-587	-589	-706
Others	-90	-136	-	-
Cash Flow From FA	**108**	**-2658**	**-1336**	**-6668**
Inc./ Dec. In Cash	**257**	**689**	**-1080**	**2034**
Opening Balance	5472	5729	3390	2309
Closing Balance	**5729**	**6418**	**2309**	**4344**

Our Take...

JKLC is expected to focus more on - 1) geo-mix optimization, 2) increasing the share of trade sales and premium products, 3) better brand visibility, 4) sustainable growth, and 5) digitization and automation to increase yield value per tonne. It aims to improve EBITDA/t by INR300 through revenue growth and efficiency measures in the next 18 months. The company has growth plans for Nagaur (Rajasthan), Durg (Chhattisgarh) and Kutch (Gujarat) regions. JKLC aims to increase its capacity to 30mtpa by FY30 from 18mtpa now.

Volume growth opportunities are limited for JKLC in the standalone business and growth will be seen after the completion of UCWL expansion. However, replacement of clinker sales with cement will boost cement volumes. JKLC has seen some improvement in price positioning of its brands vs. peers, though it is not as per expectations.

Outlook & Valuation

JKLC's EBITDA/t gap vs. peers' average narrowed to INR163/t in FY23 from INR467/INR429 per tonne in FY17/FY18. Profitability should improve further with better geo-mix, higher green energy share (currently ~37% and targets to increase to ~50% by FY25) and increasing share of a thermal substitution rate from 4% to 16% (initial target of 10% by Dec'23 and 16% in next year).

We believe JKLC is trading at an attractive valuation of 6.4x FY25E EV/EBITDA and USD62/t. We value JKLC at 8.5x FY25E EV/EBITDA to arrive at our TP of INR870 and reiterate our BUY rating on the stock.

2. EQUITAS SMALL FINANCE BANK

Equitas Small Finance Bank Limited is a Small Finance Bank (SFB), licensed by the Reserve Bank of India under Section 22 of the Banking Regulation Act, 1949 to carry on the business of Small Finance Bank. The Bank commenced the business of SFB on September 5, 2016. It is the first Private Sector Bank from Tamil Nadu to commence operations post-Indian Independence.

ESFBL, with pan-India operations, is focused on providing financing solutions for individuals and micro and small enterprises (MSEs) that are underserved by formal financing channels while providing a comprehensive banking and digital platform for all.

Market Data

Bloomberg	EQUITASB IN
Market Capitalisation	₹ 91.4 b
52 Week Range H/L	91 / 38
Equity Shares (m)	1,110
1, 6, 23 Rel. Per (%)	-1/ 55/ 94
12M Avg Val (₹ m)	279

Shareholding Pattern

In (%)	Mar-23	Dec-22	Mar-22
Promoter	0.0	74.5	74.6
FIIs	22.7	4.1	3.6
DIIs	43.0	15.4	16.7
Others	34.3	6.1	5.1

Income Statement

Y/E March (Rs Mn)	FY 22	FY 23	FY 24E	FY 25E
Interest Income	34597	41619	55370	69087
Interest Expense	14211	16172	23401	29703
Net Interest Income	**20385**	**25477**	**31968**	**39385**
Growth (%)	13.4	24.8	25.6	23.2
Non Interest Income	5376	6696	7566	9155
Total Income	**25761**	**32143**	**39535**	**48540**
Growth (%)	16.2	24.8	23.0	22.8
Operating Expenses	17041	20383	24898	29516
Pre Provision Profits	**8719**	**11760**	**14636**	**19024**
Growth (%)	-1.7	34.9	24.5	30.0
Core PPoP	**8293**	**11760**	**14070**	**18458**
Growth (%)	-1.5	41.8	19.6	31.2
Provisions (excl tax)	4938	4072	3827	5029
PBT	**3781**	**7688**	**10809**	**13995**
Tax	974	1952	2721	3523
Tax Rate (%)	25.8	25.4	25.2	25.2
PAT	**2807**	**5736**	**8089**	**10473**
Growth (%)	-26.9	104.3	41.0	29.5

Balance Sheet

Y/E March (Rs Mn)	FY 22	FY 23	FY 24E	FY 25E
Equity Share Capital	12520	11106	11106	11106
Reserves & Surplus	29941	40474	47230	56037
Net Worth	**42462**	**51579**	**58355**	**67142**
Deposits	**189508**	**253806**	**324871**	**415835**
Growth (%)	15.6	33.9	28.0	28.0
Of which CASA Dep	**98554**	**107320**	**120202**	**164255**
Growth (%)	75.6	8.9	12.0	36.6
Borrowings	26164	29738	37469	46837
Other Liabilities % Prov.	11385	14459	17784	21874
Total Liabilities	**269519**	**346581**	**438460**	**551688**
Current Assets	21325	12443	13407	15268
Investments	**44498**	**66646**	**83707**	**106308**
Growth (%)	20.1	49.8	25.6	27.0
Loans	**193742**	**257986**	**327642**	**414467**
Growth (%)	15.0	33.2	27.0	26.5
Fixed Assets	2004	3791	4360	5145
Other Assets	7949	8716	9345	10501
Total Assets	**269519**	**349581**	**438460**	**551688**
Total AUM	**205970**	**274268**	**348321**	**440626**
Growth (%)	**14.9**	**33.2**	**27.0**	**26.5**

Our Take...

EQUITASB reported strong profitability in FY23, with RoA expanding to 1.9% (avg. of 2.2% in 2HFY23). It was driven by steady margins, healthy loan growth and controlled credit costs. The bank focuses on building a diversified loan book, with small business loans (SBL), vehicle finance, microfinance (MFI) and housing finance being the key business segments. Loan growth was strong at 33% in FY23, and we estimate a robust 27% CAGR in loans over FY23-25. EQUITASB has made good progress in building a granular liability franchise, with a rising mix of retail deposits. The CASA mix is healthy at 42.3%. We expect deposit traction to remain strong even as the CASA mix declines further.

The bank has been consistently investing in business by adding new branches and building digital infrastructure and capabilities, which has kept operating expenses elevated. The bank has demonstrated strong improvements in asset quality, with X bucket collection efficiency improving to 99.6% for MFI, 99.6% for SBLs and 99% for vehicle finance.

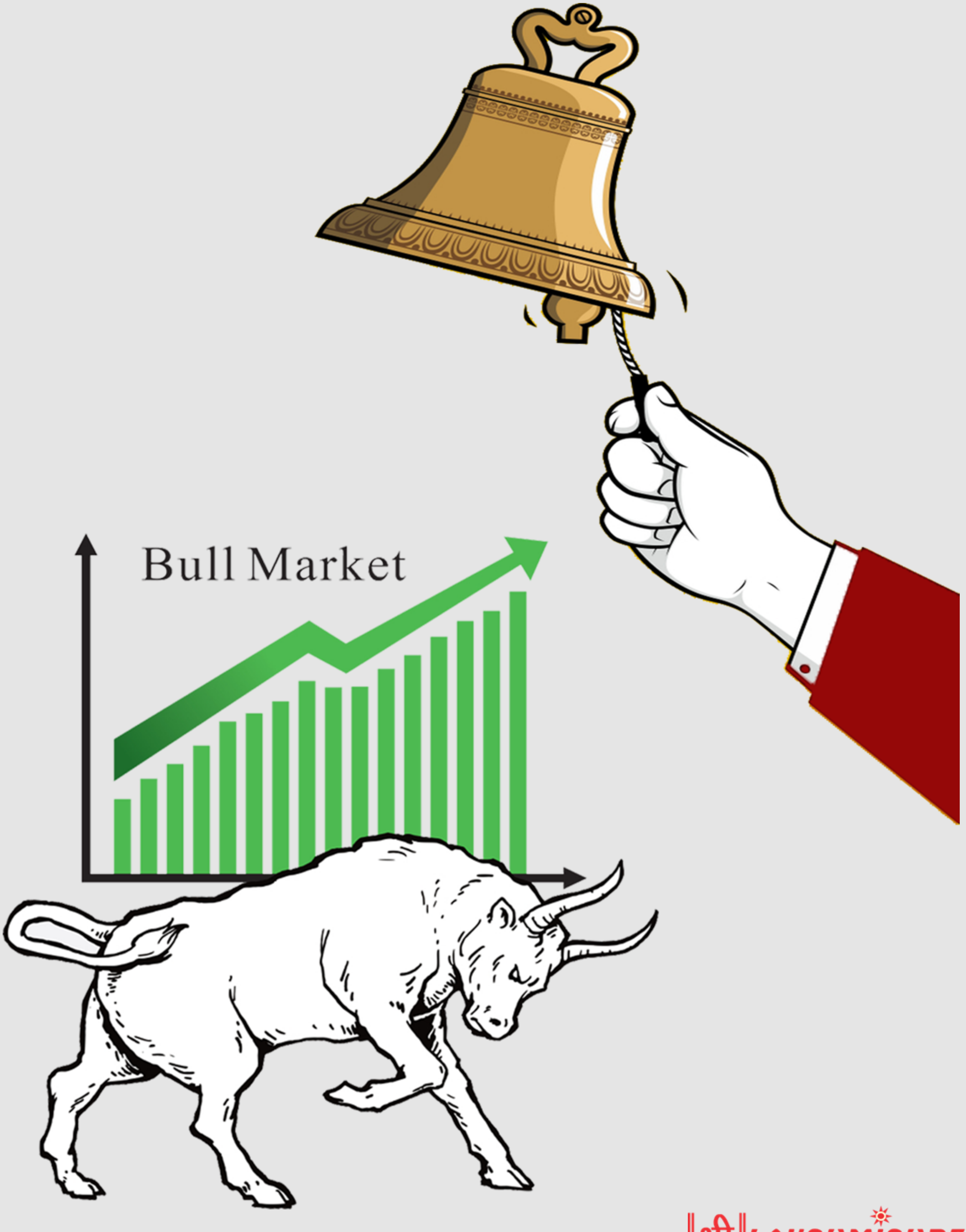
Outlook & Valuation

EQUITASB has been reporting a gradual improvement in its operating performance over the past few quarters. Steady AUM growth has been led by healthy traction across segments, while the moderation in credit costs has boosted earnings. As a result, the bank reported RoA/RoE of ~1.9%/~12% in FY23.

The bank has achieved a consistent RoA and aims to sustain it at >2%. Deposit growth too remains healthy, with the CASA mix of ~42%. Asset quality is strong with the restructured book declining to 1% of loans from 7% last year and PCR improving 1,400bp in FY23 to 57%.

We estimate EQUITASB to deliver FY25E RoA/RoE of 2.1%/16.7% and value it at INR105 (1.7x Mar'25E BV).

This May Impact Your Investments!!



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US Drug Shortages As Much A Threat As An Opportunity For Indian Pharma

A severe shortage of critical medicines in the US, following what US lawmakers have called "a broken economic system in the generic drug industry", could pose more worries for Indian pharma companies, which currently account for 40 percent of generics supplies to the US. The crisis, termed a public health emergency by some experts, has seen patients in the US suffering crippling delays in getting treatments for life-threatening diseases like cancer because essential drugs aren't available.

Reuters reported that the US Food and Drug Administration (FDA) is seeking new suppliers to ease shortages of methotrexate, an injected drug used to treat cancers like acute lymphoblastic leukaemia in children, breast cancer, bone cancers and lung cancer. The shortage prompted US Senators Gary Peters, chairman of the Homeland Security and Governmental Affairs Committee, and Debbie Stabenow along with Representative Elissa Slotkin to write to the FDA to act to mitigate the dire shortage of cancer drugs in particular cisplatin and carboplatin which are used by thousands of Americans as part of their ongoing treatment. The shortage of cancer drugs extends to another 130 drug formulations.

The current shortage of these two cancer drugs has been compounded by a disruption in their supply to the US from Ahmedabad-based Intas Pharmaceuticals Ltd., and the inability of other manufacturers to meet the increased demand. Intas, which addresses the US market through its subsidiary Accord Healthcare, has faced strictures in recent months from the FDA which has flagged a number of issues with its plant in Gujarat. After one such observation last year, the company temporarily stopped manufacturing and distributing products from the plant to the US. With the plant receiving a fresh "import alert" from the FDA earlier this month, it is unlikely to go back to full supply any time soon.

Intas is one of the few Indian pharma firms which gets a much higher share of its revenue from European markets than from the US. Others like market leader Sun Pharma, Dr Reddy's and Cipla, for whom the US is their biggest market, are even more critical to the country.

The US remains hugely dependent on India and China for generics as well as APIs. According to the non-profit US Pharmacopeia, India accounted for the majority of FDA-approved API facilities as of 2021 while the Administration for Strategic Preparedness and Response (ASPR) estimates that 90 to 95 percent of generic sterile injectable drugs for critical acute care in the US rely on key starting materials and drug substances from China and India.

While the shortage is bad news for US consumers, it meant steady demand for Indian pharma firms till a few years ago. But with large vertically integrated buyers in the US along with a gush of generics makers in India pushing down prices for generic drug makers to barely remunerative levels, even the record shortage isn't offering much cheer to Indian pharma firms which have seen margins dropping over the last three years.

India's loss though may be China's gain. In its pursuit of suppliers who could, at least temporarily, meet the shortage of cancer drugs, the FDA allowed cisplatin made by China's Qilu Pharmaceutical, one of China's top 10 pharma companies with 2021 revenue of $4.2 billion, to be sold in the US. Qilu, which specializes in APIs, is one of the Chinese companies which have consistently undercut prices of drugs made by US MNCs like Merck and Novartis, virtually eliminating them from China's vast market. A report by the United States Senate Committee on Homeland Security and Governmental Affairs rues the "anticompetitive practices by China and others, such as dumping products on the market at a price well below production costs to gain control of the market share". Yet, desperation is driving US authorities to clear supplies from these companies.

So far, China has been a major supplier of APIs to India, which in turn is a major supplier of generic drugs to the US. Now if China builds on its API base in the US and starts supplying generics too, it could further erode margins of Indian pharma companies by giving buyers more options.

Developing Countries Have Hit The Financial Rocks

The dire situation on debt has become pressing — urgent action is needed It is natural for people to focus on problems at home. But it is also essential to take a wider view. The succession of shocks — the pandemic, supply constraints, Russia's invasion of Ukraine, soaring inflation and tightening monetary and financial conditions — have adversely affected large parts of the world economy, but the weakest of countries and the most vulnerable people within them, above all. All this has had (and will have) dire consequences for economic development, the alleviation of poverty and even political stability in poor countries. These challenges, which emerge clearly in the World Bank's latest Global Economic Prospects report must not be ignored. They certainly give its new president, Ajay Banga, a formidable in-tray.

The World Bank's summation of the consequences of these shocks, made worse by the longer-term slowdown in the growth of world trade, rising protectionism, the build up of debt and the worsening climate crisis, is grim. What can justly be called a "polycrisis" has "dealt an enduring setback to development in emerging and developing countries, one that will persist for the foreseeable future. By the end of 2024, economic activity in these economies is expected to be about 5 per cent below levels projected on the eve of the pandemic." Worse, in more than one-third of the poorest countries, incomes per head will be below 2019 levels in 2024. This will have far-reaching effects: the impoverished and insecure will find it hard to improve their own human capital or that of their children. Today's disasters will radiate far into the future.

As has long been the case, east Asia and south Asia are expected to perform relatively well. But performance elsewhere, notably in Latin America and sub-Saharan Africa, is forecast to be poor. Yet this has to be set in a longer-term perspective. The report indicates that, without China, incomes per head of emerging and developing countries have stagnated relative to those in high-income countries since the middle of the last decade. The relative incomes per head of the low-income countries have stagnated for even longer. In brief, the reduction in global inequality seems to have stalled.

The causes of this long-term stagnation in relative incomes are many and complex. They lie in domestic policy and politics, as well as in the global environment. But one factor must be rising protectionism and the slowdown in the growth of world trade. Notably, the volume of world trade grew at an average rate of 5.8 per cent a year between 1970 to 2008, while gross domestic product growth averaged 3.3 per cent: trade was an engine of growth. Between 2011 and 2023, the average growth of world trade was a mere 3.4 per cent, while that of global GDP fell to 2.7 per cent. This is not deglobalisation. But it is definitely what some now call "slowbalisation".

Today, however, many of the most daunting challenges are financial. The long-term accumulation of debt, especially by low-income countries, is interacting with higher interest rates and turbulent credit markets to create serious debt difficulties. As usual, these include not just higher cost but reduced supply: credit, once again, is rationed. Thus, the report notes that one out of every four emerging and developing economies has now in effect lost access to international bond markets.

The evidence supplied on the impact of tightening credit conditions is both striking and disturbing. Since February 2022, the cost of borrowing for C-rated borrowers has jumped by an extraordinary 14.4 percentage points. As a result, the growth forecast for 2023 for these countries has collapsed from 3.2 per cent a year ago to just 0.9 per cent now.

Yet debt pressures on the poorest countries are not a new phenomenon. Net payments of interest on public debt as a share of government revenue in low-income countries have not only risen significantly since the pandemic but have long been above that of the average of all emerging market and developing countries. Substantial debt relief is needed. Much of that will have to come, in one way or the other, from China. Today, remarkably, bilateral debt owed by low-income countries to the high-income members of the Paris Club has become less than half that owed to non-Paris Club countries, mainly China.

The dire situation on financing and debt has become pressing. There is no chance that extreme poverty will be eliminated without urgent and radical change. The same is true if needed investments are to be made in climate mitigation and adaptation. Nor is it conceivable that the problems of poor countries with weak credit ratings will be addressed by the private sector on its own. There is an overwhelming case for urgent, effective and generous action.

Next week's "summit for a new global financing pact" in Paris offers a valuable opportunity to make rapid progress. But it is important that such progress be made cooperatively with China. The needed changes must build on the recognition that what is going on now is as unsustainable as it is undesirable. They must be addressed at the urgent needs of both people and planet. They must bring down the cost of existing debt and provide the resources and risk-sharing instruments needed to generate affordable financing in future.

Yes, the shocks of recent years have made generous and effective action more politically difficult in high-income countries. Frightened people become inward-looking. But these shocks have also, beyond any doubt, made action more vital. Banga has inherited what is, if wisely used, an institution more valuable as a pulpit than as a bank. In these hard times, he must use it well, to bring the world together to tackle these highly urgent challenges.

SEBI Introduces Significant Corporate Governance Amendments

SEBI had proposed, in a February 2023 consultation paper, amendments relating to corporate governance, particularly those relating to entrenched management and special shareholder rights. It has considered the feedback and now implemented the proposals by formally amending the Listing Obligations and Disclosure Requirements (LODR) rules. There are several changes made, many of them coming into effect by mid-July 2023 while some others are on a staggered basis.

Making Permanent Directorship Ephemeral

A common grouse was that certain directors entrenched themselves for life, by various modes questionable or even permissible in law. Typically, the articles may provide that certain directors cannot be removed till they held a certain shareholding, even if low. This puts them in an unjustifiably superior position over other persons seeking a position on the Board, despite having sufficient backing. This subverts the one-equity-share-one-vote rule of corporate democracy. The law also permits a certain proportion of directors to be "non-retiring". There may also be a shareholders' agreement too giving rights to appoint a nominee to the investor. Note that none of these directors are, even by law, 'permanent'. In principle, a simple majority of shareholders can remove them. However, in practice, it is often not easy to do this. The directors in charge would oppose and delay such moves by various means including litigation.

Now, SEBI has put an end to this. All directors would have to come before the shareholders and seek their vote for their appointment at least once in five years. This new rule has retrospective effect in the sense that it affects even currently 'permanent directors'. If a director has not offered himself for appointment by shareholders in the last five years, his continuation will require shareholder approval at the first general meeting of shareholders held after 31st March 2024. Thus, 2024 will see an end to this phenomenon.

However, working directors and independent directors will not face this new rule and for obvious reasons. They have to in any case be appointed by shareholders periodically. Nominees of government, lenders being financial institutions, etc. will remain exceptions. But nominees of private investors will not be.

Reporting of Material Events – Now Made Extensive And Elaborate

SEBI has created a complex framework to ensure that not only material developments are shared in a timely manner with the public, but also that insiders do not take advantage of their prior knowledge to make private profit. While the insider trading regulations deal with the latter, the LODR Regulations require timely reporting of material developments. This ensures that investors and others know of things that could affect the prospects, stability or even solvency of a company. The Regulations already provide a two-fold categorization of such developments. There is a list of information that is deemed to be material where no discretion is permitted. This can lead to a deluge of information, much of it could be non-material in effect. In the second category falls those matters where the company is given discretion to decide whether a particular development is material and, if so, share it in time.

Now, SEBI has made two major changes, apart from tweaking the norms too. Firstly, it has given specific quantitative criteria for determining whether a development is material. This curtails discretion and hence arbitrariness too. On the other hand, it guides the company in applying quantitative benchmarks. These criteria are 2 percent of consolidated turnover, 2 percent of consolidated net worth and 5 percent of consolidated net profit/loss, whichever is the least.

The second major change is even more far reaching. These days, thanks to aggressive media, material developments are reported through 'sources' well before the company takes a stand on it. The company may have business reasons not to respond to such 'rumours' till the development has reached a particular stage of finality. However, this may end up with the rumour mills working overtime, resulting in uncertainty. SEBI has taken a curious, perhaps overly strict, step here. It has now required that if any 'mainstream media', print or digital, makes a report on a matter that would be considered a material development, the company should react on it within 24 hours by confirming, denying or clarifying it.

The term mainstream media is defined very widely. Ideally, 'mainstream' would indicate media with at least a certain significant number of subscribers. However, no such lower limit is placed. Effectively, then, if any registered newspaper makes such a report, in any language and in any corner of India, the company has to take a stand on it within 24 hours. This, to put it plainly, is an absurd and unrealistic requirement and needs to be finetuned. This requirement comes into force for top 100 listed entities from 1st October 2023 and for the top 250 entities from 1st April 2024.

Private Special Shareholder Rights Controlled

It is common that companies enter into shareholders' agreements with significant investors, giving them special rights. Effectively, while all shareholders are equal, such shareholders become more equal than others with a higher level of say than the proportion of shares they hold. SEBI has not proposed to abolish altogether such arrangements together since often they may actually benefit the company. It has laid down a mechanism to provide for the consent of shareholders. Hence, if any special right is granted, approval of shareholders by way of a special resolution once every five years is required. This applies even to subsisting agreement as of date, which too need such approval within five years.

Curiously, the wording is ambiguous. The approval is not specifically required to be a prior approval. So, a company may take a view that rights can be granted today but the approval has to be taken within five years. In which case, for five long years, such special rights will be allowed and exercised.

For agreements by promoters, directors, key managerial personnel, etc., which could impact the management of the company in specific ways, there is a disclosure requirement. Even past agreements that are subsisting are covered.

Other Changes

There are many other changes in the rules. A more elaborate Business Responsibility and Sustainability Report has been prescribed for the top 1000 companies.

Sale, lease, etc. of the whole, or substantially the whole, undertaking of a company which is not through a scheme of arrangement would require a higher majority level of approval of shareholders.

Frauds, fines, penalties, and several other adverse actions against promoters, directors, key managerial personnel, etc. need to be reported. The requirement is very widely worded, and even minor actions, say a traffic fine, could, in the strict literal sense, be covered.

To conclude, an overhaul of the corporate governance and reporting requirements with far-reaching consequences has been undertaken, which is quite welcome. While this may bring an end to certain vested and entrenched interests, give a greater say to shareholders, quickly bring an end to rumours, etc., the law will need to be tweaked in some places to remove unintended but serious difficulties.

The Risks For Investors In Sugar Mills Have Risen

The policy framework in place to support sugarcane farmers, sugar mills and consumers is likely to face a tough test in the forthcoming season. A number of factors are responsible.

On the output front, this season's sugar yield has been lower than expected. India is expected to produce 32.8 million tonnes of sugar compared to the earlier forecast of 34 mn tonnes, which itself was lowered from the initial forecast of 36.5 mn tonnes. If the final output goes even lower, it could compound the problem. Further, El Nino has cast a shadow on the new season's sugar output (the sugar season starts in October).

Lower output in turn has already cast a shadow on exports. This comes at an unfortunate time for the industry as overseas prices have soared on account of lower supply due to the shortfall in India and a few other exporting countries. But the government did not revise the cap on exports of 6mn tonnes. In Balrampur Chini's post-results conference call, its management mentioned how domestic sugar was selling for Rs 36.5 a kg while the international price was Rs 51 a kg. But this was notional as the export cap has been exhausted.

While the government did not revise the export cap, reports indicate no new exports will be allowed from the new season's output till there is clarity on the size of the cane crop. This is meant to ensure adequate stocks are available to meet domestic needs and to keep prices under check if there's a shortage.

Meanwhile, the election season is nearing and that poses a cost risk. An increase may be forthcoming in the FRP (fair and remunerative price) fixed by the central government for sugarcane. Then there are important sugarcane-growing states such as UP that fix a state advised price (SAP), higher than the FRP. That could increase too. These values are critical because they form the main input cost for sugar mills.

Sugar mills can easily absorb higher costs by increasing sugar prices to maintain margins. But this move conflicts with the government's objective of keeping sugar prices stable, as it can become a hot issue during the festival season that starts around August and continues till the calendar year-end. Approaching elections add to that risk. In fact, the industry has been asking the government for years to revise upwards its minimum selling price of sugar, Rs 31 a kg at present, but to no avail. The Triveni Engineering & Industries' management, in a conference call, said they believe that an increase in support prices is due and is important.

In effect, if costs increase but sugar prices don't then the industry is looking at a hard squeeze on the sugar segment's margins. Other divisions could help. The government's ethanol blending scheme does hold out hope, as mills are now diverting a portion of cane output to produce ethanol. They have invested significant sums in ethanol capacity too.

But the profitability of that business too can be affected by a higher cost of sugarcane. Therefore, the government-mandated ethanol price needs to increase. Doing that again could lead to inflationary pressures, as oil marketing companies will seek to pass it on in retail fuel prices. Easing of crude oil prices also means ethanol pricing can only be increased by so much. Therefore, whether revised ethanol prices will be enough to cover higher input costs is a question.

All of these factors may make it seem like the sugar industry is boxed into a corner and is facing a gloomy year ahead. But they have one trump card the main reason why the government has erected a supportive framework around the industry—payments to sugarcane farmers. One of the highlights of the policy framework is that sugarcane arrears have become a non-issue in recent years, relatively speaking. Otherwise, it was common for huge arrears to build up as mills would make part payments and hold back the rest and farmers would agitate for payments.

What could play out in the forthcoming sugar season and will the industry play its trump card? The sugar industry has settled upon less than ideal margins in sugar sold locally but made up for it mainly through exports and ethanol sales. The government also provides support through other fiscal measures from time to time, such as subsidy for exports, banning imports, stock limits, buffer stock support, soft loans and capital support for ethanol investments.

The main risk to watch is if the country's sugarcane output gets affected by El Nino. Then mills will be in a tough spot. If El Nino proves to be less of a risk, then the situation can be easily managed. But, if cane costs rise, the export ban stays and domestic realisations of sugar and ethanol do not increase by enough, then mills will get squeezed.

They may then have little choice but to delay crushing or let cane arrears build up. This will lead to agitation by farmers. Since it's a politically sensitive issue, the government will be eventually forced to the negotiating table. But, it may not be a smooth process as it entails a cost to the government. What could potential solutions look like? Allowing exports will be the first leg but if output is lower this solution may not be feasible.

Hiking the minimum selling price or the ethanol price is another solution, but that may mean putting up with higher inflation. Whether the government is willing to bite the political bullet is the question. A general decline in broad inflation does create the space to accept high inflation in small pockets. If higher domestic sugar prices are unacceptable, then some new solutions may be required. Or, the government may push the industry to accept some pain in this season, and make up for it in subsequent seasons.

While all of this is hypothetical in parts, the risks for investors in sugar mills have certainly risen in the new sugar season. Keep a watch on developments in the coming months.

The Impact Of El Nino On Global Inflation, GDP, Agriculture And Commodity Prices

El Niño, a climate phenomenon characterized by the warming of the Pacific Ocean, has far-reaching consequences on weather patterns worldwide. It can be seen as the "heating" phase of a naturally occurring climate cycle in the equatorial Pacific Ocean. Its opposing, cooling phase is called La Niña. Together, they make up the El Niño Southern Oscillation (Enso) cycle, respectively weakening and strengthening trade winds. Those changes influence the jet streams that steer storms around the globe.

Last Thursday, the US National Oceanic and Atmospheric Administration (NOAA), NOAA's National Weather Service, and their Climate Prediction Centre proclaimed, "El Niño conditions are present and are expected to gradually strengthen into the Northern Hemisphere winter 2023-24."

Their EL NIÑO/SOUTHERN OSCILLATION or ENSO Blog added, "El Niño conditions have developed, as the atmospheric response to the warmer-than-average tropical Pacific sea surface kicked in over the past month. We expect El Niño to continue into the winter, and the odds of it becoming a strong event at its peak are pretty good, at 56%. Chances of at least a moderate event are about 84%."

The World Meteorological Organization warned that the re-emergence of El Niño would "likely fuel higher global temperatures".

The return of El Niño would be a long-anticipated transition from the rare three-year cycle of the opposite weather phenomenon that involves the cooling of the Pacific Ocean's surface temperature.

This weather system of La Niña was officially declared at an end earlier this year, after taking its toll with devastating floods in the US and Australia and catastrophic drought in Africa and South America.

We spend so much time and energy studying and forecasting El Niño (and its counterpart, La Niña) because those changes to the atmospheric circulation have a global impact. ENSO arises from changes across the tropical Pacific Ocean. So why does ENSO affect the climate over sizable portions of the globe, including some regions far removed from the tropical Pacific Ocean? Does the strength of ENSO matter for global climate?

Yes, it does. When an El Niño causes excess heating in the tropical Pacific upper atmosphere, the air flow toward the poles becomes more vigorous, and leads to modifications in the wind circulation patterns worldwide. These changes in the atmospheric circulation, and subsequent ground-level climate impacts stretching across the globe, causing floods in some areas and a failure of seasonal rainfall patterns in others, leading to drought.

El Niño's influence extends beyond the environmental sphere, affecting various sectors of the global economy and individual economies such as India. The multifaceted impact of El Niño ranges from food insecurity, falling fishing yields, inflation, agriculture, rainfall, floods, droughts, and the price of oil as well as other commodity prices.

Over the past 100 years, El Niño events have left an indelible mark on global weather patterns, impacting ecosystems, economies, and livelihoods across the world. Looking briefly at key El Niño Events in the last 50 years we find:

- 1972/1973 El Niño: This event brought severe droughts to India, Australia, and parts of Africa, impacting agricultural production and food security. South America experienced heavy rainfall and flooding, leading to economic losses and infrastructure damage.
- 1982/1983 El Niño: It caused widespread flooding in South America and droughts in Australia, India, and parts of Africa. The event disrupted global weather patterns, affecting ecosystems and economies.
- 1997/1998 El Niño: Often referred to as the "super El Niño," it had significant global impacts. Southeast Asia suffered from severe droughts, while Australia experienced heatwaves and reduced rainfall. South America witnessed heavy rainfall and flooding, causing extensive damage. Coral reefs around the world experienced widespread bleaching.
- 2002/2003 El Niño: Although relatively weak, this event led to drought conditions in Australia, impacting agriculture and water resources. Parts of South America experienced heavy rainfall and flooding, highlighting the varied impacts of El Niño in different regions.
- 2009/2010 El Niño: This event showcased the diversity of impacts, with droughts in some areas and heavy rainfall and flooding in others. South America experienced flooding, while Australia faced drought conditions, affecting agriculture and water availability.
- 2015/2016 El Niño: One of the strongest El Niño events in recent history, it brought droughts to Southeast Asia, heatwaves to Australia, and heavy rainfall to South America and the United States. The event had far-reaching consequences for agriculture, water resources, and ecosystems worldwide.

In this historical backdrop, last week's NOAA declaration means that three criteria have been met: a defined area of the tropical eastern Pacific is more than 0.5C warmer than the long-term average; the warming is expected to continue; and the atmosphere is showing signs of responding to that warming.

The impact of the El Niño, which is expected to strengthen throughout the northern hemisphere in the coming autumn and winter, is essentially altered wind and rainfall patterns: researchers expect it to become wetter in the southern US; and hotter and drier in northern South America, southern Africa, South Asia and southern Australia.

But beyond that, uncertainty abounds, including on when El Niño might peak. The World Meteorological Organization said temperatures could move into “uncharted territory”, with a deleterious impact on health, food security, water management and the environment. The mood among climatologists seems to be uncertainty spiked with trepidation.

Sea surface temperatures along the equatorial Pacific Ocean are showing signs of much more rapid warming than had been predicted by weather models.

The global mean temperature now stands at least 1.1 degrees C above pre-industrial levels; the warming effect of El Niño, which limits the ability of the oceans to draw down heat from the atmosphere, pushes it to within striking distance of the 1.5 degree C limit set out in the Paris agreement.

Twenty-eight countries, including the UK and China, experienced their warmest years in 2022. It could have been worse: those temperatures were kept in check by the cooling effects of La Niña. This year, meanwhile, has brought record-breaking April heat to Spain, extensive wildfires to Canada and, as a result of those, un-breathable skies over New York. That is the critical message: the unprecedented is becoming the norm and the alarm bells are sounding for unsustainable limits being crossed on global warming.

In terms of the economic impact, El Niño's impact on inflation is complex and can vary across regions. It tends to disrupt agricultural production, resulting in reduced supply and increased food prices.

Moreover, El Niño's influence on energy markets, specifically oil prices, can further exacerbate inflation, as energy costs rise due to reduced hydroelectric power generation and disruptions in oil-producing regions.

These disruptions can tighten global oil supplies and contribute to price volatility, impacting energy-dependent industries and consumer spending patterns.

El Niño significantly affects agricultural activities, both globally and in India. The altered rainfall patterns disrupt crop cycles, leading to yield fluctuations and affecting food production. Regions experiencing reduced rainfall during El Niño years often face drought conditions, adversely impacting agricultural output. Conversely, some regions may experience above-average rainfall, leading to flooding and crop damage. These disruptions in agriculture have a direct bearing on food security, supply chains, and prices, creating challenges for farmers, consumers, and policymakers alike.

El Niño has a profound impact on rainfall patterns across the globe, particularly in regions like Australia and South Asia, especially India. During El Niño years, some parts of India experience deficient monsoon rainfall, leading to drought conditions. This has severe consequences for agriculture, as crops require adequate moisture for growth. Droughts can result in water scarcity, reduced reservoir levels, and an increased reliance on irrigation. Farmers face financial hardships, and rural communities suffer from reduced incomes and increased migration to urban areas in search of livelihood opportunities.

Furthermore, altered rainfall patterns can lead to water stress, affecting hydroelectric power generation and industrial activities, which rely heavily on water availability.

El Niño's impact on the global economy and the Indian economy is far-reaching, affecting sectors such as inflation, agriculture, rainfall, floods, droughts, and oil prices. It poses challenges for policymakers, businesses, and communities, requiring adaptive measures to mitigate risks and capitalize on opportunities. Building climate resilience, investing in agricultural technologies, improving disaster management capabilities, and promoting sustainable practices are crucial in minimizing the adverse effects of El Niño and ensuring economic stability in the face of climate variability.

According to estimates, previous El Niños resulted in a marked impact on global inflation, adding 3.9 percentage points to non-energy commodity prices and 3.5 points to oil. They also hit growth to gross domestic product, especially in Brazil, Australia, India and other vulnerable countries. With the world grappling with high inflation and recession risk, the arrival of the El Niño comes at exactly the wrong time.

Looking at India specifically, since 1950, there have been 26 global El Niño years and 15 Indian drought years. However, the association between the two climatic phenomena appears to have strengthened since the 1980s, with an even stronger correlation in the last 20 years. Only 1997 was an exception, where the worst El Niño on record saw Indian rainfall at ~2% above normal. The certainty is that all instances of drought in India over the last 20 years have been in El Niño years. Of the 15 El Niño years in the 1951-2021 period, nine monsoon seasons in India recorded deficient rain by more than 10 per cent of the long period average (LPA).

We hope that 2023 proves to be one of the years where India sees a normal monsoon, despite the El Niño occurrence. The World Meteorological Organization calculates there is a 98% chance the combination of the accumulation of greenhouse gases and the return of El Niño will make the next five-year period the warmest yet, pushing global temperatures into uncharted territory. Unprecedented is fast becoming the norm on the climate-economics interaction axis.

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