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Domestic flows: necessary but no longer sufficient

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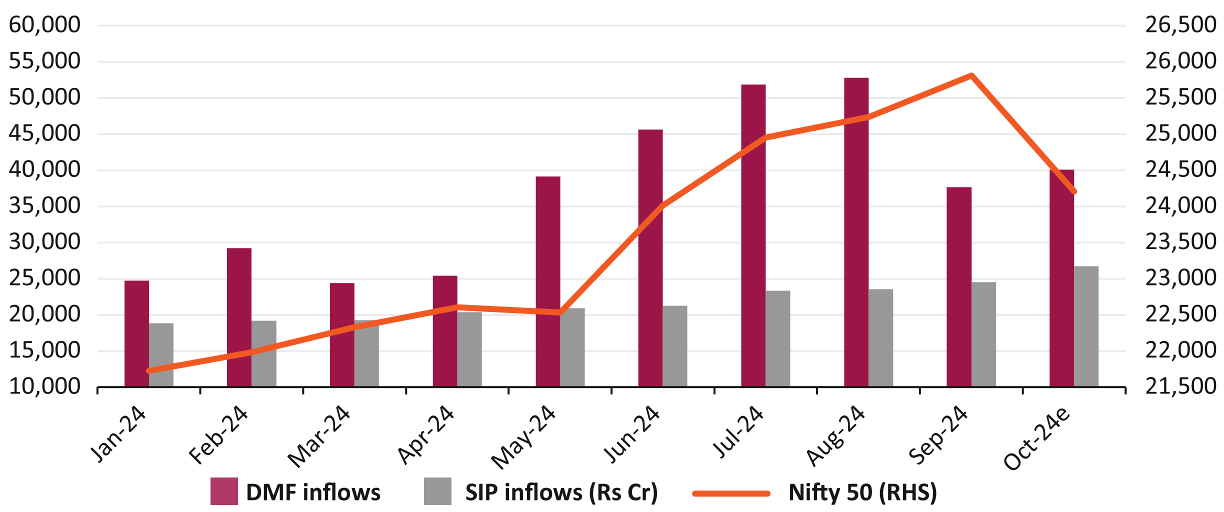
In the past few years, Indian equities have been immune to volatility given strong macros, robust earnings growth and importantly strong domestic flows. However, volatility appears to be back in Indian equities, with benchmark indices down by 8% in the past month. The broader market correction has been steeper and over 125 stocks in NSE500 are down more than 25% from their recent peaks (as on November 5, 2024).

This swing in the market has come about despite sustained strong inflows into domestic mutual funds (Mfs). Domestic MFs witnessed Rs344 bn (US$4 bn) of inflows in the month of September taking the inflows in 1HFY25 to US$30 bn. SIP flows continue to grow – having reached a new high of Rs245 bn ($2.9 bn) in the month of September and this trend has continued in October as well. This is reflected in MFs net buying of US$9 bn month to date.

This turn in momentum is attributed to foreign selling –an unprecedented US$12 bn in the month of October. With this, the overall FII flows so far in FY2025 is just US$859 mn. One can ascribe multiple reasons for the swing in foreign flows – earnings disappointment, US 10-year yields are up approx. 80 bps since the mid-September, Dollar index has strengthened by 4.2% and policy changes have led to shift in flows to Chinese and Japanese markets.

Strong domestic flows had proved to be an adequate counterfoil for foreign flows all through FY22 and FY23. In FY22, FII outflows stood at US$18.5 bn while FY23 saw US$5 bn of outflows. However, mutual fund witnessing US$53 bn of inflows were able to absorb these outflows and markets registered a 18% upmove in these two years despite the foreign selling.

Markets declined despite strong MF inflows



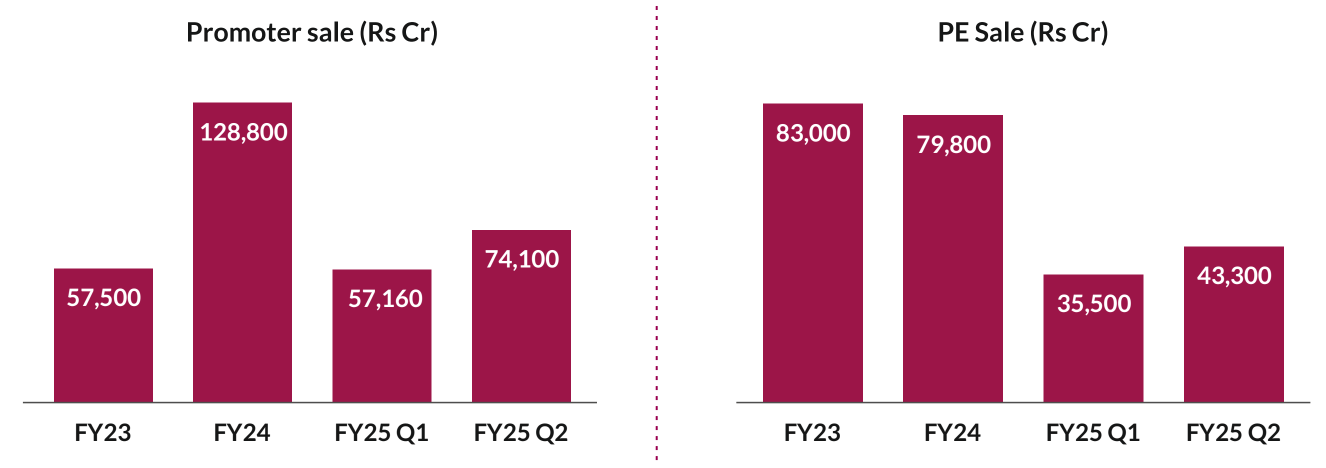
Source : AMFI, NSE, Axis MF estimates   Figures in Rs Cr

Equity supply outpacing MF inflows

The accelerating pace of equity supply is the key reason domestic equity markets are again developing a vulnerability to the volatility in foreign flows.

Q2FY25 saw supply increasing to US$21 bn (Rs177,000 cr) compared to US$15 bn (Rs125,000 cr) in 1QFY25. This comprised of US$4 bn (Rs33,000 cr) of IPOs, US$6 bn (Rs54,000 cr) of QIPs and US$11 bn (Rs90,000 cr) of secondary stake sales from private equity and promoters. These outstripped the US$18 bn (Rs142,000 cr) inflow into equity MFs during the quarter. However, as FPI flows were positive at $11.6 bn in the quarter, the upward market trajectory sustained.

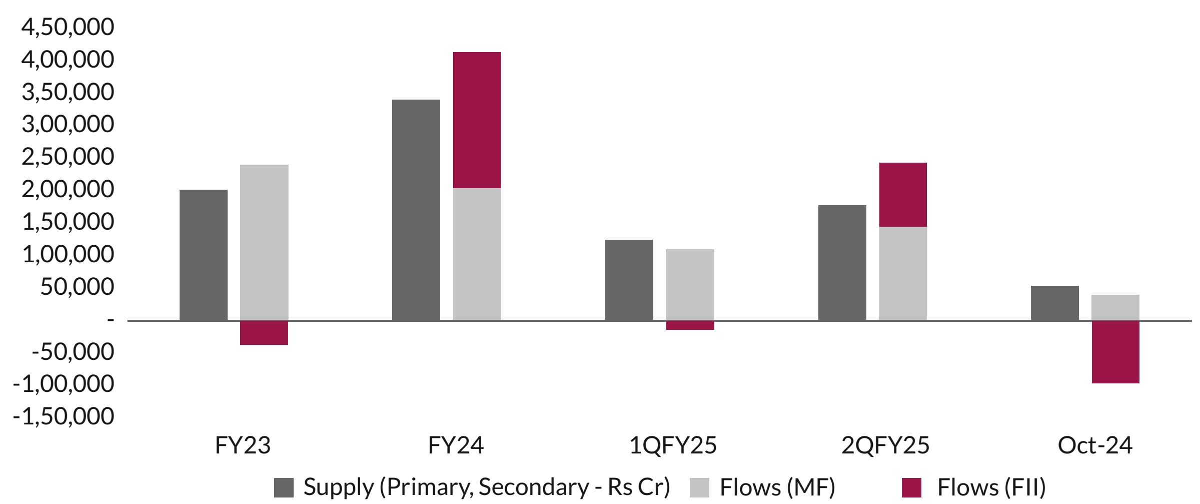
Increased pace of secondary stake sales in Q2



Source : NSE, BSE, Axis MF estimates   Figures in Rs Cr

As we highlighted in our July note 'Let's talk about supply too' – Supply of equity in the form of IPOs, stake sale since FY2024 has been 1.5x times the net inflow into Mutual Funds. The impact of this on the market direction was masked as FII flows over the last 18 months (April 2023 to September 2024) had been positive at over US$35 bn. These aided in absorbing the increased supply. Over 40% of the IPO/QIPs raised during this period were subscribed by foreign inflows.

Rising pace of supply outpacing demand



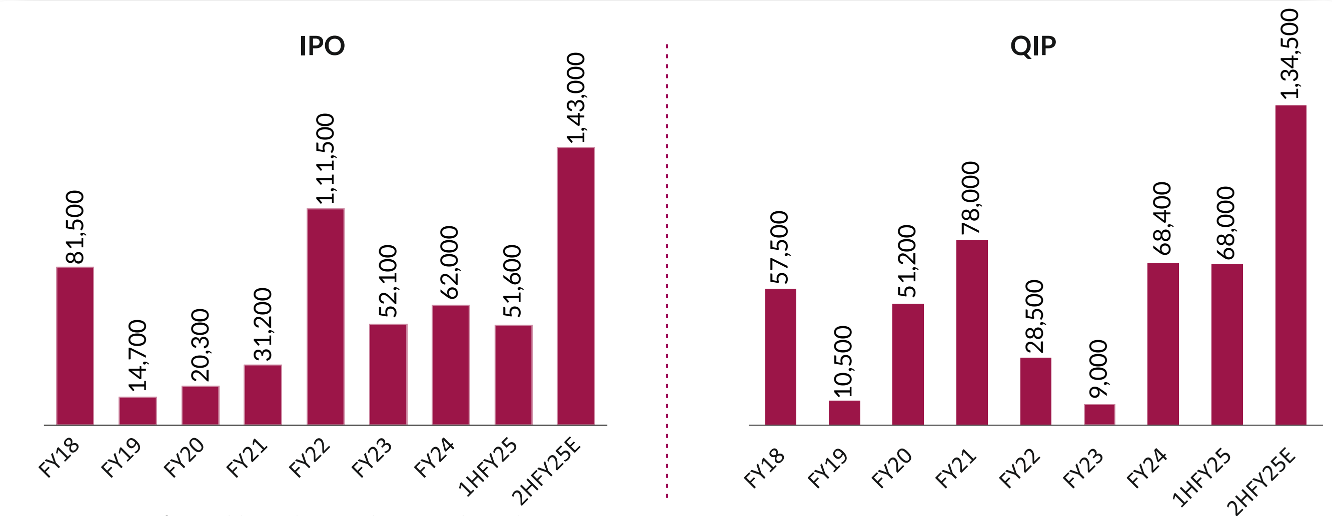
Source : NSDL, Axis MF estimates   Figures in Rs Cr

Supply is now turning into deluge

IPO pipeline for 2H is nearly 3x the amount raised in 1H with 91 companies looking to list and in aggregate raise US$17 bn. Another 70 listed companies in recent weeks have taken board approvals to raise in aggregate US$16 bn of equity through Qualified Institutional Placements (QIPs). Secondary stake sales from promoters and private equity is also only likely to grow larger given the expiring lock-ins and elevated trading multiples in the market.

Assuming secondary sales (by promoters and PEs) at US$22 bn in 2H stays similar to what we have seen in first half, the total supply will rise to US$55 bn in the second half of the year or about 2.5x the estimated inflows in MFs. Ensuring that equity supply will overwhelm domestic fund flows and market direction will again be subject to vagaries of foreign flows.

2HFY25 Pipeline is 2x that of 1HFY25



Source : Kotak Securities, Axis MF estimates *Figures in Rs Cr*

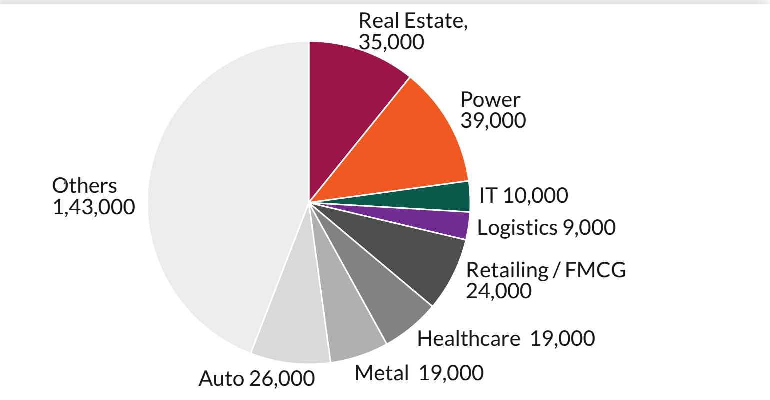
An equity fueled investment cycle?

This magnitude of equity raises possibilities of the private investment cycle gathering pace and unlike the past cycles this would be more equity funded rather than debt fuelled.

Of the US$39 bn raised by corporates (IPOs/QIPs), in past 18 months US$25bn was primary capital. 2HFY25 pipeline indicates another US$24 bn of investible capital being potentially available for capex, acquisitions and other purposes.

The breadth of companies looking for capital is wide. Power sector (US$4.7 bn) and real estate (US$4.1 bn) stand out with largest capital raises each planned for this year. Services companies (IT, Logistics) at US$2.3 bn, Retail (Q-commerce, FMCG) US$2.9 bn, Healthcare at US$2.3 bn, metals at US$2.2 bn and auto at US$3.1 bn are other sectors witnessing material capital raises.

Power and Real Estate seeing larger primary capital raise



Source : Axis Capital, Axis MF estimates *Figures in Rs Cr*

Judicious use of this capital by corporates would be a key determinant for sustaining the earnings growth momentum as easy capital availability can tempt companies into low return capex, unrelated diversifications and expensive acquisitions.

Disclaimer

Source: Axis MF Research, NSDL, NSE, BSE, company reports, Kotak, Axis Capital. Data as on 31 October 2024.

Figures rounded off to nearest value.

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