

INVESTOR NEWSLETTER – QUARTER ENDED SEPTEMBER 2022

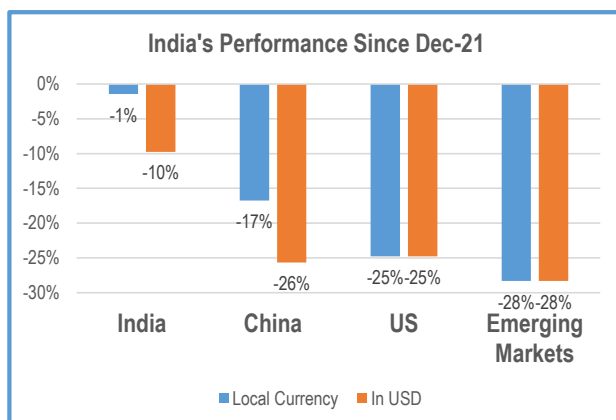
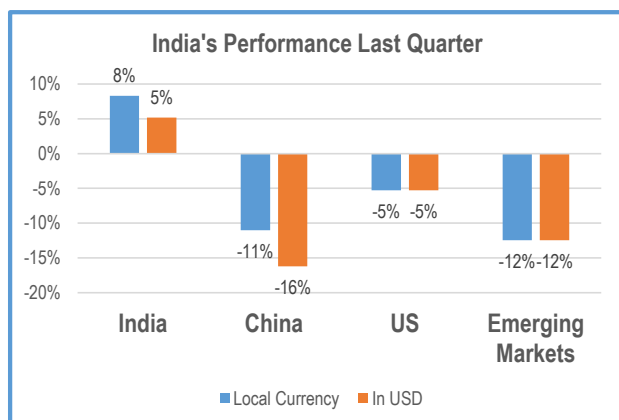
Period:	Last 3 Months	Last 6 Months	Last 9 Months	Since Inception Jan-20 to Sep-22
Cumulative Returns				
Portfolio	7.9%	3.8%	6.0%	151.1%
Sensex	8.3%	-1.9%	-1.4%	39.2%
Outperformance	-0.4%	5.8%	7.4%	111.9%
Annualized Returns				
Portfolio				39.8%
Sensex				12.8%
Outperformance				27.0%

Summary:

The performance of the Portfolio was in-line with the Sensex despite us holding 28% cash on average this quarter. We have deployed through the summer months when markets were lower and cheaper valuations gave us more opportunities. A sharp move up in the Sensex this quarter has made us cautious, as valuations which were trending back to neutral earlier in the year reversed their course. The decoupling of Indian markets from global markets is making us even more cautious. That said, we are finding opportunities due to the high dispersion in valuations across sectors, with more sectors beginning to trade at discounts to historical levels.

Market environment in the quarter ended Sep-22:

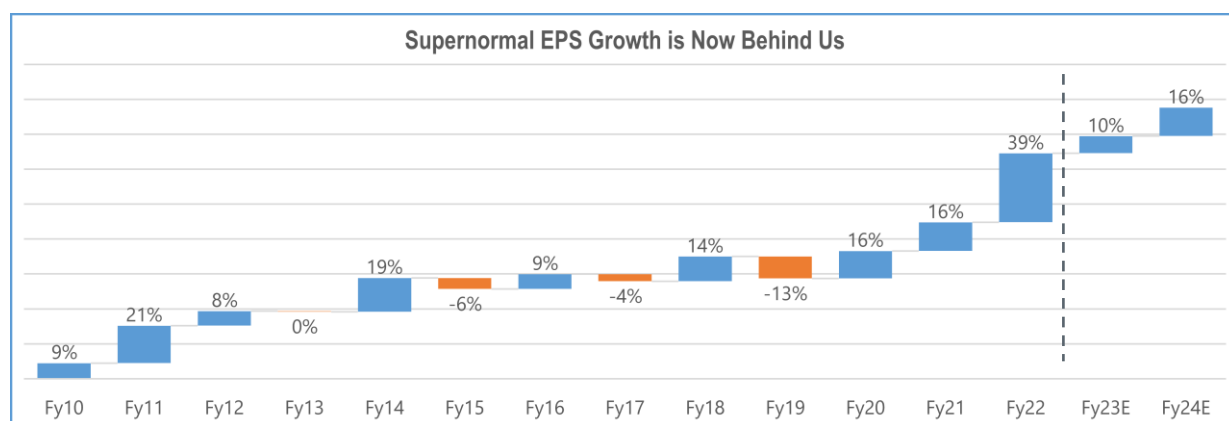
After 3 quarters of negative returns, the Sensex roared back this quarter registering an impressive 8.3% gain, up from 53k to 57.5k. There was a clear decoupling of Indian markets with both global emerging markets and developed markets. Since Dec-21, the Sensex is down just 1.4% while the Emerging Market Index is down 28.3% and the S&P 500 Index is down 24.8%. This became much sharper this quarter with the Indian markets rising while the global markets fell.



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Market environment in the quarter ended Sep-22: (continued)

A lot of market commentary has focused on this decoupling and pointed towards the high EPS growth of the Sensex. While EPS growth for the next 2 years is expected to be 13%, which is higher than the historical ~10% growth, it does not justify the premium valuations. We are now trading at a big premium to even the S&P 500 Index. The Sensex is at P/E Fy Mar-23E of 21.1x (meaningfully higher than its ~18x average), while S&P 500 is at P/E Fy Dec-22E of 16.0x (which is lower than its average).



The latest bout of global selling commenced in mid August with the Fed's Jackson Hole speech, followed by a hot US inflation print for Aug-22. However, the Indian markets did not fall, and we think there is a scenario in which it plays catch up. We think that the strong DII inflows, which have prevented the FII selling from breaking the Indian market, can temporarily cause market decoupling but we believe fundamentals and valuations prevail in the longer run.

This said, the market is also showing significant dispersion in valuations on sectoral lines, providing us opportunities which we discuss later in the note.

The Portfolio in the Quarter ended Sep-22:

The performance of the Portfolio was in-line with the Sensex this quarter. The Portfolio gained 7.9%, as against the Sensex which gained 8.3%. This was despite us holding 28% cash on average. As you will see from the Returns Attribution chart later in the note, holding cash attributed to -2.3% performance, which was offset by +1.9% performance due to better stock selection.

3 key themes that are driving our portfolio construction:

1) Wait for market opportunities to be fully deployed: As macro risks remain high and Indian market valuations range from slightly above average (Jun-22) to meaningfully above average (Sep-22) we continue to hold part of the Portfolio in cash. We started the quarter with 49% cash and hold 22% cash at the end of this quarter. We have deployed through the summer months when markets were lower and cheaper valuations gave us more opportunities.

2) Overweight Financial Services: Financial services (Banks and NBFCs) continue to remain cheap on an absolute basis and relative to their historical valuations. 45% of the Portfolio is deployed in Financial Services. We had explained our rationale in some detail in the last quarterly newsletter.

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The Portfolio in the quarter ended Sep-22: (continued)

3) Overweight companies where margins have been negatively impacted by commodity prices: We feel the normalization of commodities is a matter of time. We have seen some of this already occur this quarter. 24% of the Portfolio is made up of companies that will benefit directly from commodity price normalization over the next few years. Many of these names are also very low beta and reduce the overall risk on the book.

Names added this quarter:

- 1) Axis Bank: Trading at a steep discount to historical valuations, sharp improvement in credit quality
- 2) Emami: Beneficiary of commodity price normalization, cheap relative to its historical valuations and sector valuations
- 3) Castrol: Beneficiary of crude price normalization, trading at cheapest valuations in its history
- 4) IOC: Beneficiary of crude price normalization, refining GRMs likely to be above historical levels for next few years due to constraints in refining capacity, trading at a sharp discount to book value

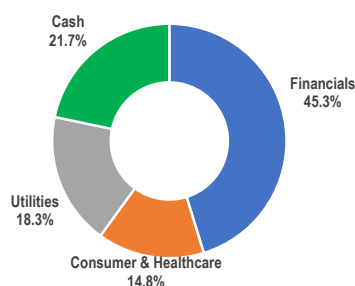
Names scaled up this quarter:

- 1) Manapurram: Contrarian view on gold loan yields, driven by in depth private equity style analysis on the sector and company
- 2) Shriram Transport: Pro-cyclical view on commercial vehicle cycle, driven by in depth private equity style sector analysis
- 3) Bajaj Consumer: Beneficiary of commodity price normalization

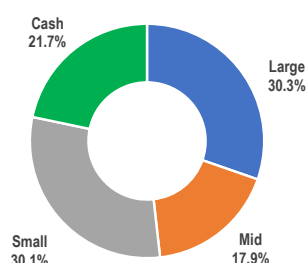
Aa at the of the quarter we own 21 stocks. The Portfolio has a cheaper weighted valuation than the Sensex and yet offers a higher growth trajectory. This can be seen in the table below.

	P/E Fy 23e	EPS Growth Fy 23e (consensus)	PEG Ratio
Portfolio	13.5x	19.2%	0.7x
Sensex	21.1x	9.9%	2.1x

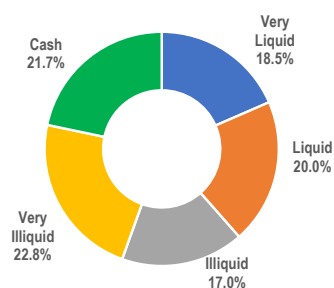
Portfolio: Sectoral Mix



Portfolio: Size Mix



Portfolio: Liquidity Mix



Top 10 Positions as of quarter ended Sep-22:

HDFC Bank	Castrol India
HDFC	Equitas Holdings
Shriram Transport	Mahanagar Gas
Axis Bank	Emami
Aster DM Healthcare	Indian Oil Corp

Notes:

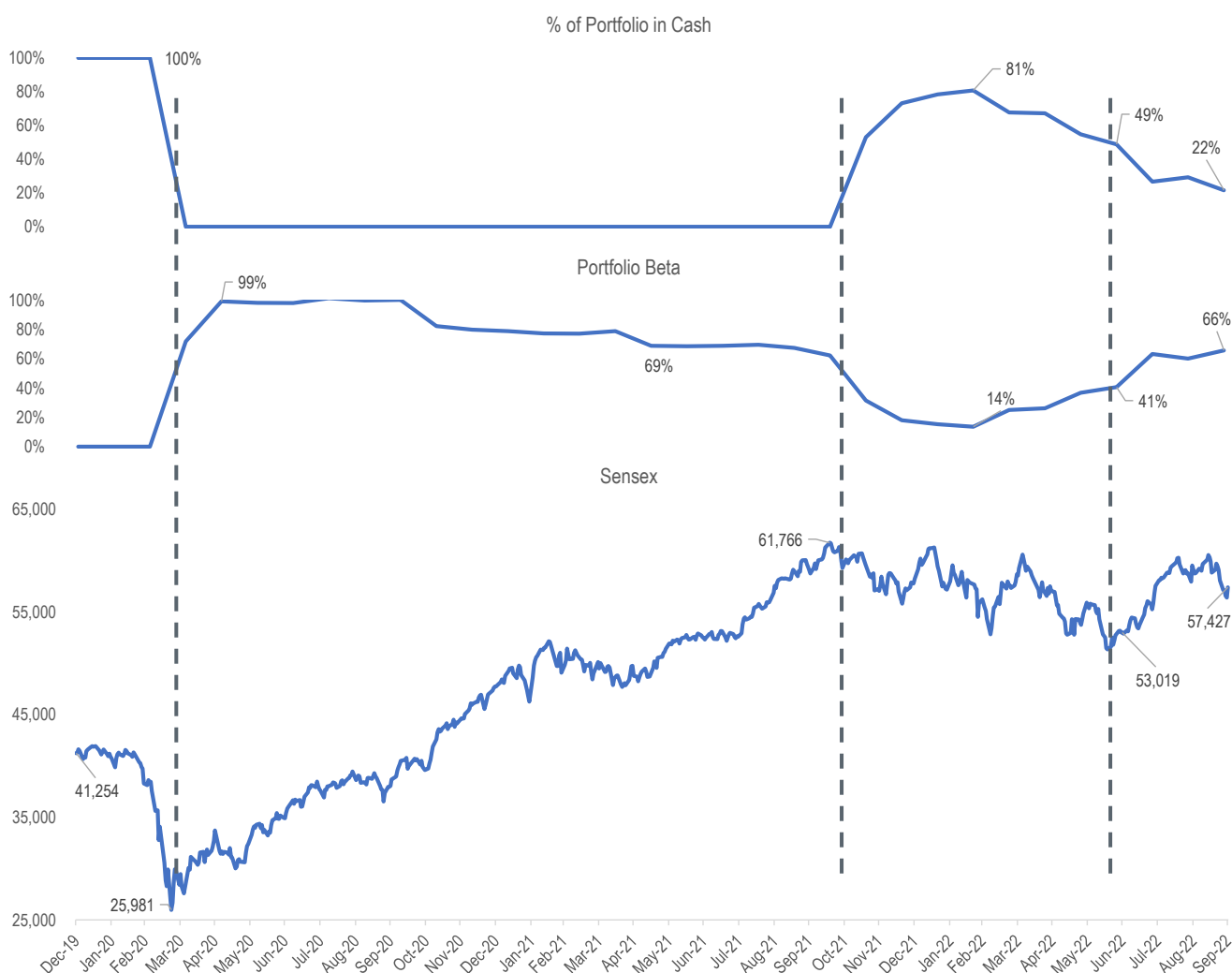
- 1) Market Cap Definitions: Large = largest 100 market cap companies, Mid = Between 101 and 250, Small = 251st and smaller. The smallest company in the Portfolio has a market cap of \$250 mn+
- 2) Liquidity Definitions: ADTV = Average Daily Traded Volume over last 90 days, Very Liquid = ADTV > \$10 mn, Liquid = ADTV > \$2 mn, Illiquid = ADTV > \$0.5 mn, Very Illiquid = ADTV < \$0.5 mn

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Our strategy in action:

Our strategy is to buy good companies when they are cheap and only if they are cheap. If they are not cheap we stay on the side-lines in cash for periods. Especially for large cap companies we buy them when they trade at discounts to their long term average valuations and exit them when they start trading above long term average valuations without waiting for peak valuations.

This allows us to capture up market moves (High Up Capture Ratio), reduce our risk positions when markets are expensive, and wait in cash for opportunities when markets become cheap. We have been able to remain in cash for 2 down markets because of this strategy: i) before Covid, and ii) From Oct-21 onwards. And this ensures that in down market moves our Portfolio falls less than the market (Low Down Capture Ratio). A high Up Capture Ratio and a low Down Capture Ratio combine to provide our Portfolio with meaningfully higher returns than the market and a high Sharpe Ratio.



Pre-Covid (Jan-20 to Mar-20)	100% in cash before Covid Down Capture Ratio = 0% = Fall in Portfolio / Fall in Sensex = 0% / -29%
Market Bounce Back (Mar-20 to Oct-21)	100% in equity, with Portfolio beta gradually reduced as the markets rallied Up Capture Ratio = 151% = Rise in Portfolio / Rise in Sensex = 153% / 101%
Market Correction (Oct-21 to Jun-22)	Up to 80% in cash Down Capture Ratio = 63% = Fall in Portfolio / Fall in Sensex = -6.7% / -10.6%
Market Bounce Back (Jun-22 to Sep-22)	28% in cash on average Up Capture Ratio = 95% = Rise in Portfolio / Rise in Sensex = 7.9% / 8.3%

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Sectoral Views:

The high volatility in the markets, driven primarily by the global macro environment, is throwing up a wide dispersion in sectoral valuations. This is allowing us to find opportunities even with elevated market valuation levels.

Sector	P/E Sep-22	P/E Dec-21	P/E 10 Yr Avg	vs Dec-21	vs 10 Yr Avg
Auto	23.6x	21.2x	25.9x	11%	-9%
Banks - Private	16.1x	18.3x	20.4x	-12%	-21%
Cement	28.8x	24.9x	25.3x	16%	14%
Consumer	44.7x	43.3x	39.0x	3%	15%
Healthcare	24.4x	24.8x	25.2x	-2%	-3%
Infrastructure	12.6x	14.9x	8.6x	-15%	47%
Media	16.0x	17.5x	25.1x	-9%	-36%
Metals	7.3x	6.9x	10.9x	6%	-33%
Oil & Gas (ex RIL)	4.9x	6.2x	9.3x	-21%	-47%
Specialty Chemicals	36.4x	40.0x	17.0x	-9%	114%
IT Services	21.6x	30.6x	18.9x	-29%	14%

Sectors where we are constructive:

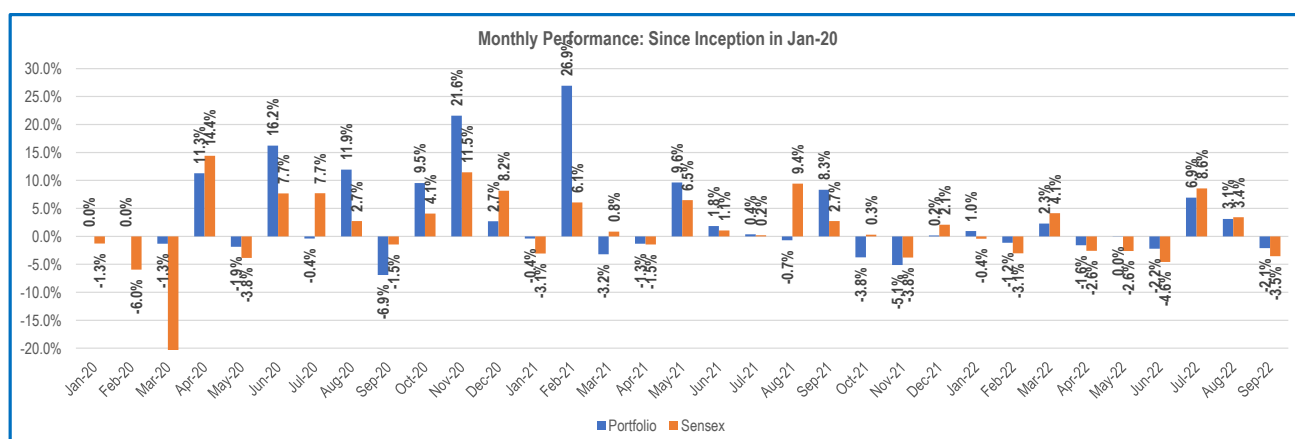
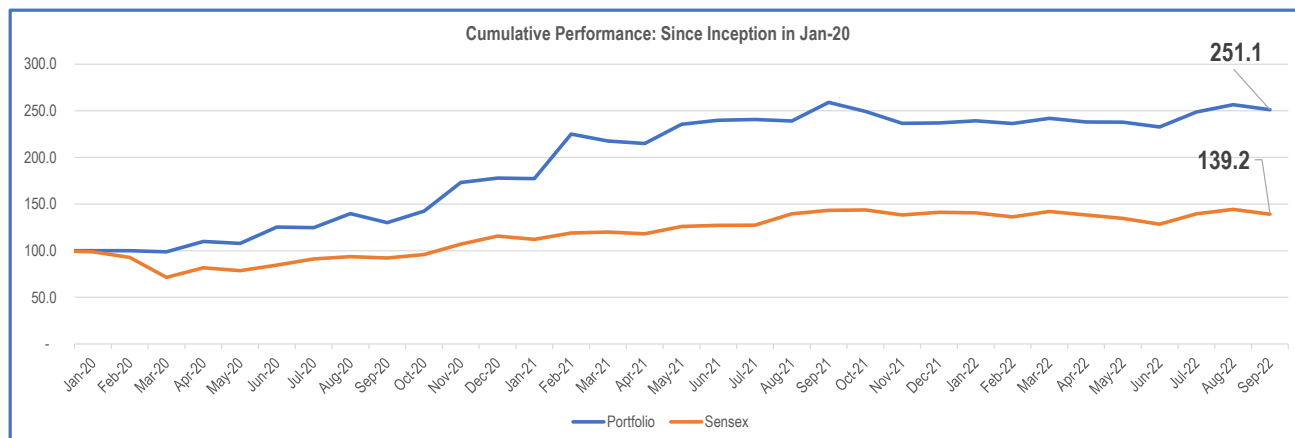
- **Financials:** We explained our rationale for being overweight Financial Services last quarter. Additionally, in the table above you will see that Banks stand out as a large sector with cheap valuations.
- **Oil & Gas:** This is another sector where we have slowly become overweight. However, we are not long producers but long distributors which will benefit from the normalization of oil and gas prices.
- **Healthcare:** We are currently studying the sector and may look to put on a basket of large cap names if valuations fall further.
- **Media:** We have been scrubbing the names in the sector, but many have either corporate governance issues or large event risk. We continue our research on the sector.

Sectors where we are less constructive:

- **IT Services:** Valuations have corrected from extremely high levels, but remain above their historical averages, and with dual risks of global demand slow down and domestic cost inflation we feel there is further correction needed before we become more constructive.
- **“China+1” and “Made in India”:** While thematically both these overlapping themes are very attractive, the market has rushed into these sectors and valuations are at all time highs. The most extreme example of this is the Specialty Chemicals sector.

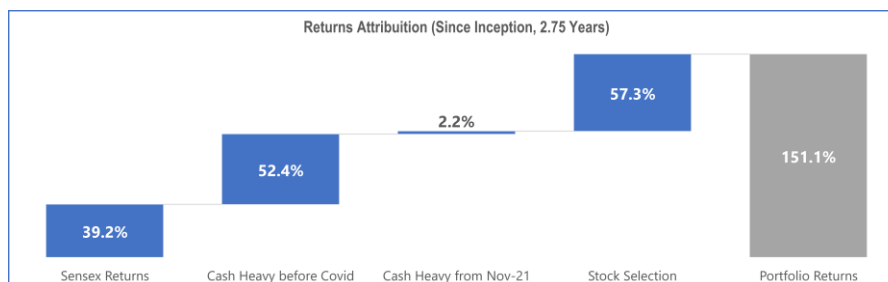
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Performance:

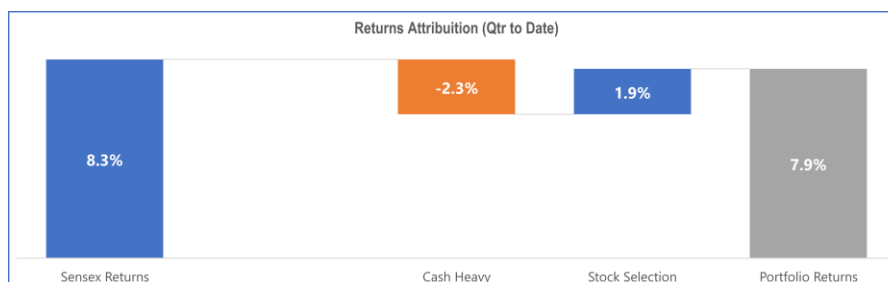


Attribution:

Outperformance
Since Inception:
111.9%



Outperformance
Last Quarter:
-0.4%



Notes:

- Performance details for the Portfolio are before expenses and tax to make it comparable to Sensex
- AIF license received in Q3 C21. Assets have been transferred into AIF as of 01/11/2021. Returns from Nov-21 onwards are for assets in the AIF
- Before Nov-11 returns are for capital invested through the Sponsors' personal account, with HDFC Bank as Custodian providing performance statements



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Outlook:

We actively deployed in May and June when markets were at 52-53k (closer to its long term average P/E multiples), which caused many of the companies we were tracking to hit our Target Entry Prices. The sharp rally through July and August has reduced opportunities again. Especially in the backdrop of the market decoupling, where Indian markets are trading above historical average valuations while key global markets are trading below historical average valuations, we have become more cautious.

The sharp appreciation of USD relative to most currencies, and the accompanying depreciation of the INR is another reason to worry. The RBI has spent a lot of firepower (almost \$100bn of forex reserves) in trying to ease the INR depreciation but with forex reserves at 9.5 months of imports further macro risks are emerging for India. Given this backdrop, RBI will probably continue to raise rates, if not to fight inflation then to tame the INR.

Despite this gloomy market backdrop, the silver lining is the wide dispersion in sectoral valuations. We continue to work on opportunities in sectors where valuations are more reasonable. In addition, there is a healthy pipeline of small cap names, where it take us many months to form our view, which is keeping us busy. While beta is a component of the return in these names, either the superior growth or a contrarian view on outcomes tends to be the alpha in these names for us.

In summary, we are treading cautiously.