

INVESTOR NEWSLETTER – QUARTER ENDED DECEMBER 2024

A. PAST PERFORMANCE:

Period:	Last 3 Months	Last 6 Months	Last 1 Year	Last 2 Years	Last 3 Years	Last 5 Years
Cumulative Returns						
Portfolio	-7.9%	4.7%	17.1%	55.4%	81.5%	330.0%
Sensex	-7.3%	-1.1%	8.2%	28.4%	34.2%	89.4%
Outperformance	-0.6%	5.9%	9.0%	26.9%	47.4%	240.6%
Annualized Returns						
Portfolio			17.1%	24.7%	22.0%	33.9%
Sensex			8.2%	13.3%	10.3%	13.6%
Outperformance			9.0%	11.3%	11.7%	20.2%

Notes:

- 1) Performance details for the Portfolio are before taxes, fees and expenses to make it comparable to Sensex
- 2) 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
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We are super excited to complete 5 years as a team! We generated 33.9% returns per annum as against Sensex which generated 13.6%. This means Rs. 1 crore invested in our fund from the start grew to Rs. 4.3 crores on a gross basis, more than 2x of the Rs. 1.9 crores if invested in Sensex. Also, on a calendar year basis we have beaten the market every year.

The quarter saw a healthy correction in valuations from highly overvalued territory. Sensex was down 7.3% and yet ended the year at 20.7x forward P/E, one standard deviation higher than long term average. With Trump winning the elections we have seen strong momentum in US equities causing foreign flows away from other risk assets including Indian equities and the INR.

Our performance was also muted this quarter with a return of -7.9%, broadly in line with Sensex. In Oct-24 when the market fell 5.8%, we started well with our Portfolio falling only 2.9%. However, regulatory risk on insurance and gas sectors hurt us in the remaining 2 months, and we ended the quarter just below Sensex in terms of returns. We have used this quarter to continue buying names as they became cheaper, and our cash levels are now at 15%, 7% lower than at the beginning of the quarter

Last quarter we noted that both macro indicators and sentiment were a little less robust than what we had seen over the last 2 years. We got further evidence of this through the last quarter.

- The GDP print for the quarter ended Sep-24 at 5.4% was a negative surprise for most.
- Auto demand, as a proxy for discretionary consumption, has weakened meaningfully. Channel checks suggest the large glut of inventory with dealers was cleaned up by offering larger discounts. Based on numbers available till Nov-24, it is likely that volume of passenger vehicles sold will still be down 4% for Fy Mar-25, as against a 21% annual growth seen from Fy Mar-21 to Fy Mar-24.
- Using electricity consumption as a proxy for industrial demand we see a similar slowdown. Electricity consumption grew at 16% per annum from Fy Mar-21 to Fy Mar-24 and is likely to grow at only 6% for Fy Mar-25.
- While private capex has remained a problem in the last many years, government capex stepped up to fill its shoes. Government capex grew at 31% per annum between Fy Mar-21 to Fy Mar-24. In the current year instead of growing it is running below last year's levels by 12%.



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So, what explains such a change, especially given the strongly bullish Indian growth narrative. People seem to be in 1 of 3 camps:

- a) India is on higher growth trajectory for the next decade (“amrit kaal”), recent data is just a bump along the way. This is probably the most common view we run into.
- b) Something fundamental has changed, and a deeper cyclical correction has started. Not many people seem to be as pessimistic as this.
- c) India went through a strong demand recovery post Covid and is normalizing towards its past.

We are in the third camp. We looked at some of the same data points we noted above which support our view that the bump is more of a normalization process.

- Passenger vehicle sales grew at 5% p.a. between Fy Mar-10 and Fy Mar-25 despite the weaker near-term demand. This is almost the same as the 4% p.a. growth between Fy Mar-10 and Fy Mar-20.
- Despite the sharp deceleration in electricity consumption in Fy Mar-25, the growth between Fy Mar-10 and Fy Mar-25 at 5% is identical to the growth seen between Fy Mar-10 and Fy Mar-20.
- And finally, despite the sharp fall in government capex in Fy Mar-25, it too is on a similar trajectory that it was in last decade, if we shift our perspective and look at longer term growth.

We will be the first to admit that this is not conclusive by any means. But if this view becomes the mainstay over time with more data supporting it then the market will adjust its lofty earnings growth expectations, and then the “amrit kaal” valuations visible in many sectors will be put to the test.

Key outperformers:

- Cash: We had 18% cash on average this quarter
- HDFC Bank: Up 3% this quarter, and remains a core holding for us as it is still cheap
- SJS Enterprises: Up 15% this quarter. Strong underlying performance allowed the stock to perform despite weak market sentiment

Key underperformers:

- Life Insurers: All 3 insurers fell between 15-25% due to fears of regulatory restrictions on the banca channel
- Shriram Finance: Down 19% this quarter. This has been a good performer for us for the last few quarters, and while we lost some of our gains, we were able to sell most of our position between Rs 3200 and Rs 2900 (pre split prices)
- Mahanagar Gas: Down 34% this quarter. Regulatory cuts in cheap gas allocation to the CGD sector caused the sharp fall
- Star Health: We just started buying this stock into its fall. The company reported a spike in underwriting losses, which we think will normalize as the company takes price hikes.



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Key changes to the Portfolio:

- Reduced our position in Shriram Finance: This has been one of our top performers. We bought this initially between Rs 800-900 a share in Nov-20. We increased our allocation to the name to max when we saw the CV cycle had turned positive in Nov-21. As the stock performed and moved towards 2.0x on a P/B basis we started selling. We have been selling from Rs 3200-2900 levels. We now have a stub position left.
- Entered Star Health: This is India's largest standalone health insurer. Due to its scale, it is the only one which has been running with combined ratios of under 100%. It also has the most conservative accounting policies already in place which means that as IRDAI's mandated regulatory changes flow through the sector over the next year this will be least impacted. The stock was cheap for 2 reasons: a) concerns that composite licensing is around the bend which will increase competitive intensity (which we believe is more of a concern for other general insurance businesses), and b) recent spike in underlying losses. On the latter we think this will normalize over time with price increases approved by IRDAI being rolled out. Our entry price is at 1.6x P/GWP which makes it cheaper than many private market deals in the sector.
- Re-entered Aditya Birla Capital: We used to own this name in till 2022, making it our 4th re-entry into a name. The key attraction here remains valuation. On a reverse SoTP, the NBFC & HFC are trading at 1.4x P/B while the books are growing strongly post a credit cleanup post Covid, with GNPA now running at just 2.5%. We have initiated with a small allocation here.
- Increased our position in Quesst Corp: The underlying performance of the company has been reasonably strong. The growth along with the margin improvements made the stock cheaper on an EV/EBITDA basis, trading at 10.8x forward. Additionally, we think the stock has medium term triggers through the demerger into 3 separate listcos. We are now running this at ~5% allocation of the portfolio, the maximum we allocate to small caps (we only run the highest conviction small cap investments at this level, the rest are at 2.5%).

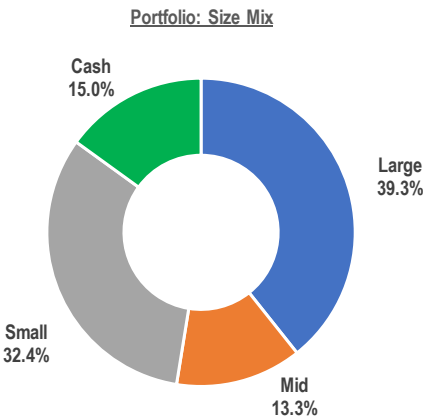
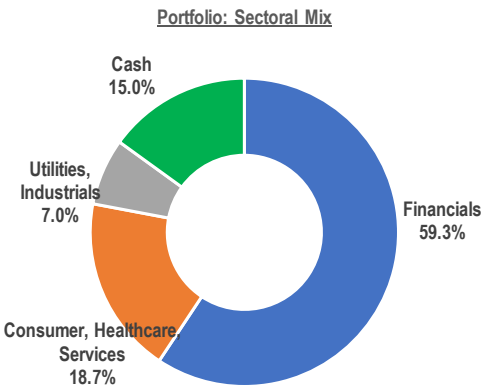


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Portfolio characteristics:

	P/E (forward)	12m EPS Growth (consensus)	PEG Ratio	P/B (forward)	RoE % (forward)	Sharpe Ratio (3 yr)	Beta (3 yr)
Portfolio	18.1x	15.3%	1.2x	2.5x	15.8%	152%	0.5x
Sensex	20.7x	13.9%	1.5x	3.2x	15.2%	30%	1.0x

Note: Portfolio details are ex Life Insurance



Top 10 positions: (of 23 total positions)

HDFC Bank	Quess Corp	PNB Housing	SBI Life	HDFC Life
Axis Bank	Star Health	ICICI Pru Life	Karnataka Bank	Federal Bank

Annualized Performance:

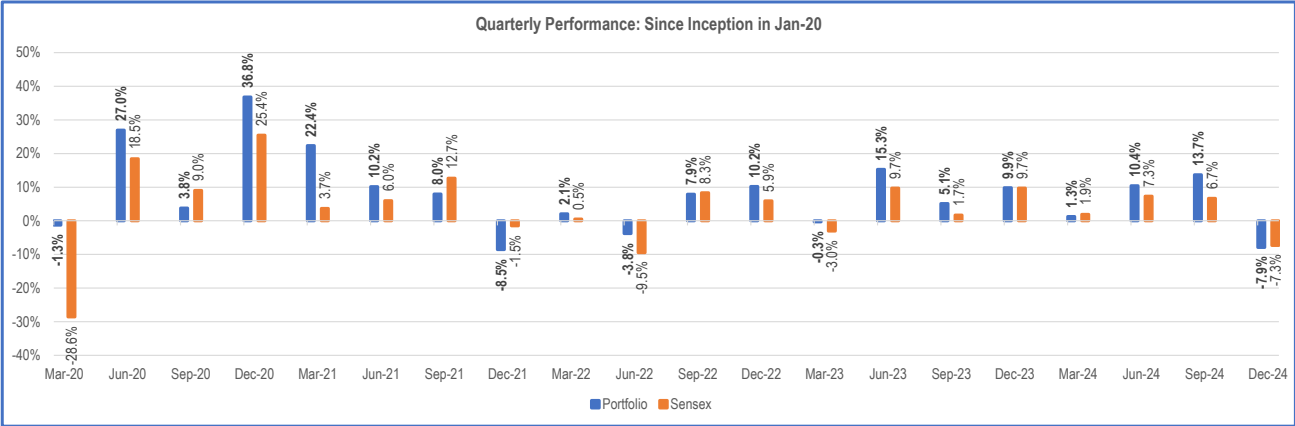
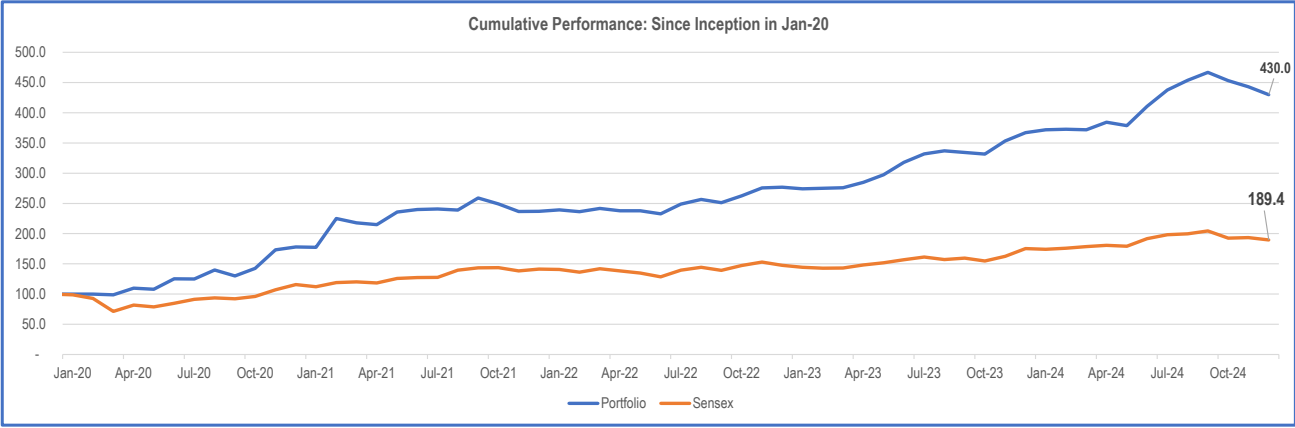
Period:	CY24	CY23	CY22	CY21	CY20
Portfolio	17.1%	32.7%	16.8%	33.2%	77.9%
Sensex	8.2%	18.7%	4.4%	22.0%	15.7%
Outperformance	9.0%	13.9%	12.4%	11.2%	62.2%

Period:	FY25 YTD	FY24	FY23	FY22	FY21
Portfolio	15.6%	34.8%	14.0%	11.1%	120.6%
Sensex	6.1%	24.9%	0.7%	18.3%	68.0%
Outperformance	9.6%	10.0%	13.3%	-7.2%	52.6%



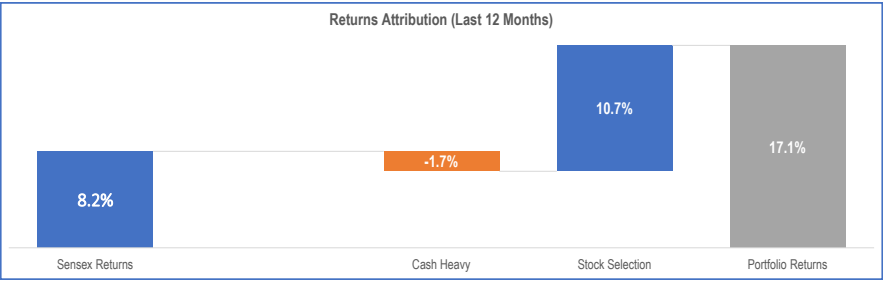
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Monthly performance charts:

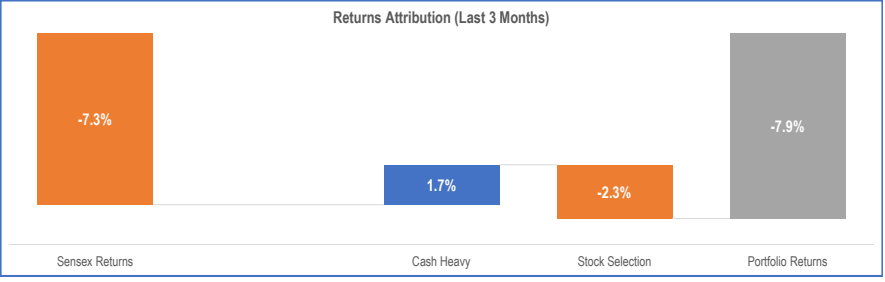


Returns attribution :

Outperformance
For Last Year:
+9%



Outperformance
For Last Quarter:
-0.6%



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Superior Risk Adjusted Returns:

High Up Capture Ratio of ~180%

- Our performance during up phases of the market has been strong, driven by stock selection
- Mar-20 to Oct-21: 151% Up Capture Ratio
 - Sensex up 101%
 - Our Portfolio up 153%
- Jun-22 to Dec-24: 179% Up Capture Ratio
 - Sensex up 47%
 - Our Portfolio up 85%



Low Down Capture Ratio of ~60%

- Defensive positioning through portfolio construction and cash on books helped our Portfolio fall less than the market during down phases of the market
- Oct-21 to Jun-22: 63% Down Capture Ratio
 - Sensex down 11%
 - Our Portfolio down 7%
- Election day (4th June 2024): 63% Down Capture Ratio
 - Sensex down 6%
 - Our Portfolio down 4%
 - More aggressive indices down a lot more (BSE Cap Goods Index down 12%!)



High Risk Adjusted Returns

- Our rolling 3yr Sharpe Ratio has consistently been 120-155%
- Best in class risk adjusted returns relative to peers. We created a peer group list using Finalyca data of funds that had at least 60% large cap composition – about 40 such funds. Our performance relative to them (this is as of Sep’24 qtr):
 - Highest 3yr Treynor Ratio of 28.8
 - Highest 3 yr Sharpe Ratio of 146%
- Given fully priced markets it is now even more important to balance risk and reward in portfolio construction

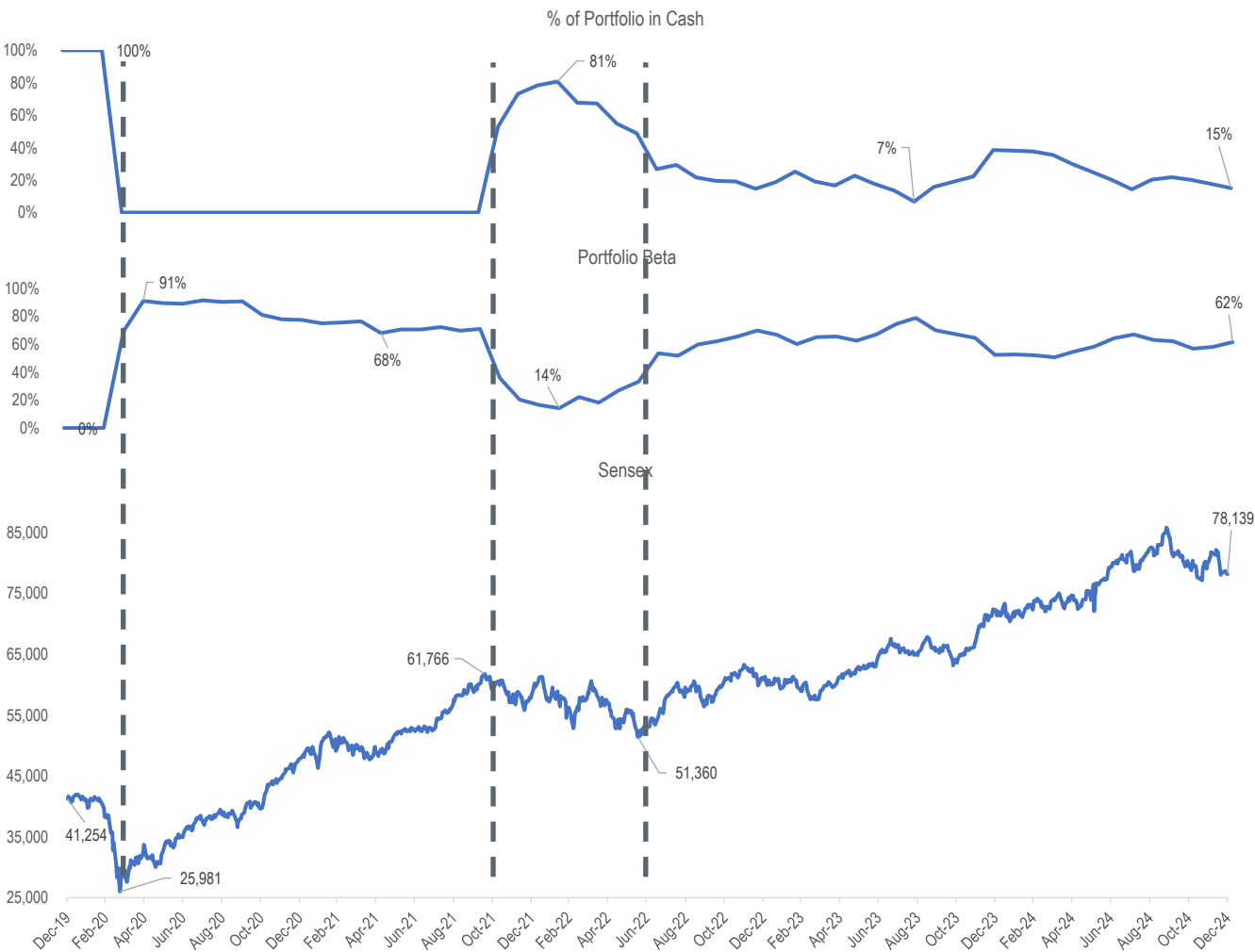


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Our strategy in action:

Our strategy is to buy good companies if 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 to Jun-22. 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 = -7% / -11%
Market Bounce Back (Jun-22 onwards)	23% in cash on average Up Capture Ratio = 179% = Rise in Portfolio / Rise in Sensex = 85% / 47%



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B. OUTLOOK:

The market correction last quarter has reduced overvaluation, but most sectors remain overvalued. At the time of the writing of this report, sentiment remains uneasy. We for one would be glad if further sectors became cheaper for us to express our style.

Our behavior for the last quarters has been “buy on dips”. We have used market falls to deploy our cash during a) Indian election day in Jun-24, b) Japan led macro risk which caused a week of weakness in markets in Aug-24, and c) last quarter.

We think multiple sectors suffer from excessive expectations of what volume and earnings growth will be achieved and we have stayed away from them. This includes many industrials and thematic sectors like defense. Instead, we have concentrated our positions into pockets where we find margin of safety in valuations: a) lending financials, b) insurance, c) business services, d) healthcare, and e) more recently auto component manufacturers.

More recently the chemicals sector and the auto OEM sector are beginning to look more interesting to us and work is ongoing. Work is also ongoing in the oil and gas sector, but our interest depends on how the geopolitical situation evolves once Trump makes his early moves.

Sector	P/E Dec-24	P/E Dec-23	P/E 10 Yr Avg	vs Dec-23	vs 10 yr Avg	Our View
Auto	23.3x	22.5x	27.6x	4%	-16%	Beginning to see PV names come off peaks, studying. Also focusing on auto comps and have made investments here
Banks - Private	15.9x	15.7x	21.1x	1%	-25%	This is our largest sectoral position in the fund. Continues to offer opportunities even though market is expensive overall
Cement	36.7x	31.5x	28.2x	17%	30%	Still expensive both on a absolute and relative basis
Consumer	42.7x	45.7x	41.8x	-7%	2%	Very expensive, our previous investments here have largely been exited
Healthcare	33.7x	29.1x	26.9x	16%	25%	We entered last year when opportunities existed. Fewer opportunities now. Working on hospital names where we have made an investment
Infrastructure	23.7x	19.8x	11.8x	20%	101%	Very expensive, we are staying away
Media	16.4x	21.2x	25.0x	-23%	-34%	While it looks cheap we have studied the companies here and have decided to pass due to risk in business models and / or due to corporate governance
Metals	10.3x	12.9x	10.8x	-20%	-5%	We are beginning to look at steel and aluminium, but still early days as stock prices need to correct further to reflect reality of underlying commodity price
Oil & Gas (ex RIL)	8.9x	7.1x	8.6x	25%	3%	We have positions in O&G consuming / distributing companies as beneficiaries of normalizing commodity prices.
Chemicals	32.5x	36.9x	24.6x	-12%	32%	Many of the underlying chemical prices have settled back down to pre-Covid levels. We are studying multiple names here now
IT Services	28.0x	26.0x	20.9x	8%	34%	Had corrected a lot, but then moved up. We spent a lot of time researching the sector. We are tracking but opportunity has moved further away

Data Source: Motilal Oswal