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CIN: U67120PN1993PTC074692

Date:7th October, 2019

Dear Investors,

Performance

Below is the performance of the Emerging Corporates India Portfolio *(ECIP)* as of Sep 30th, 2019. Our closing equity allocation as on Sep 30th, 2019 is ~85% spread into 16 companies and balance is in liquid schemes.

Portfolio Performance	Total Portfolio Returns	Benchmark Returns
Since Inception *(Annualised)*	14.03%	-2.90%
Q2 FY2020	4.65%	-5.53%
Q1 FY2020	5.71%	-4.65%
FY19	13.3%	-6.5%
FY18 *(Since April 28, 2017)*	9.7%	10.5%

- *Benchmark is an average of the BSE Smallcap and BSE Midcap Index*
- *Returns are time weighted and after management and performance expenses.*
- *Management and performance fees are deducted as and when due*
- *The actual returns of clients may differ from client to client due to different portfolio and timing of investment*
- *Past performance is no guarantee for future performance*
- *Benchmark calculations reflect total returns (including dividends)*
- *Returns for less than 1 year are not annualised*
- *Inception Date is 28th April 2017*

As we have stated in the past, we will judge ourselves based on at-least three years of performance as our strategy is designed to capture opportunities that, in our understanding and estimation, should work over a three to five-year period.

This has been an eventful quarter. Sentiments soured after the budget presented on Jul 5, 2019 largely owing to the surcharge on FPIs and the super-rich. This led to Nifty dropping from ~11,950 on July 5th to ~10,700 on Sep 19th, 2019 *(a drop of 10%).* Negative news-flows around GDP data *(released on Aug 31, 2019 showed a 5% growth – slowest in six years),* auto slowdown, further stress in NBFCs persisted. However, in an unexpected move, on Sep 20, 2019, the Government decided to reduce corporate tax rate to 22% from 30% *(also, the tax rate for new manufacturing firms registered after October 1 would be 15 per cent up-to FY23).* This cheered the markets with Nifty going from ~10,700 pre-announcement on Sep 20, 2019 to ~11,600 on Sep 23, 2019 *(a jump of 8.5% in two days)*.

This reduction in tax rate happens at an important juncture, when the two largest trade partners in the world *(US and China)* are re-negotiating their terms of trade. This presents an opportunity for India to be a part of the global supply chain and boost its exports and possibly give legs to the *"Make in India"* aspiration of the Prime Minister. As can be seen from the chart below, at 30%, India had an uncompetitive tax rate relative to its south-east Asian peers.

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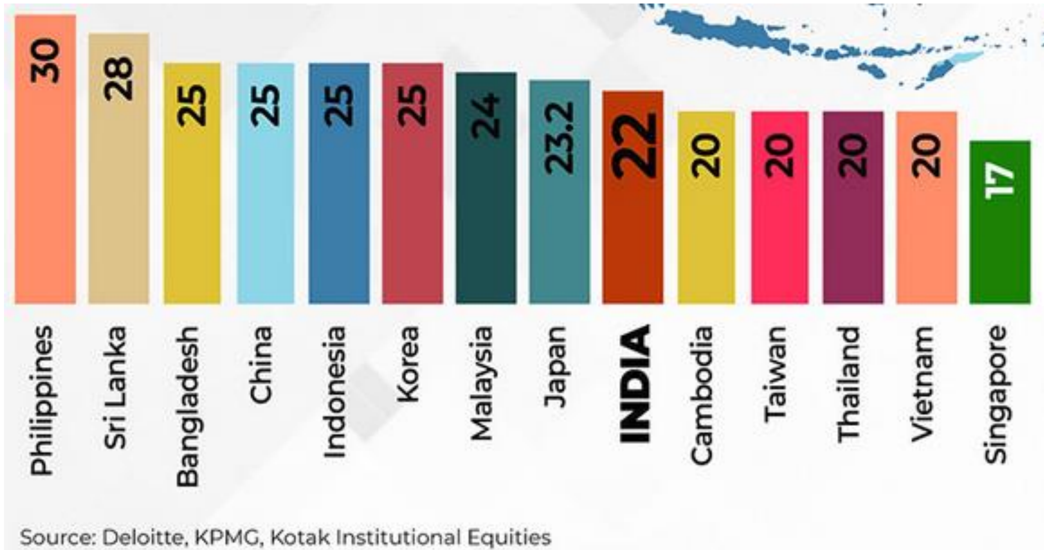
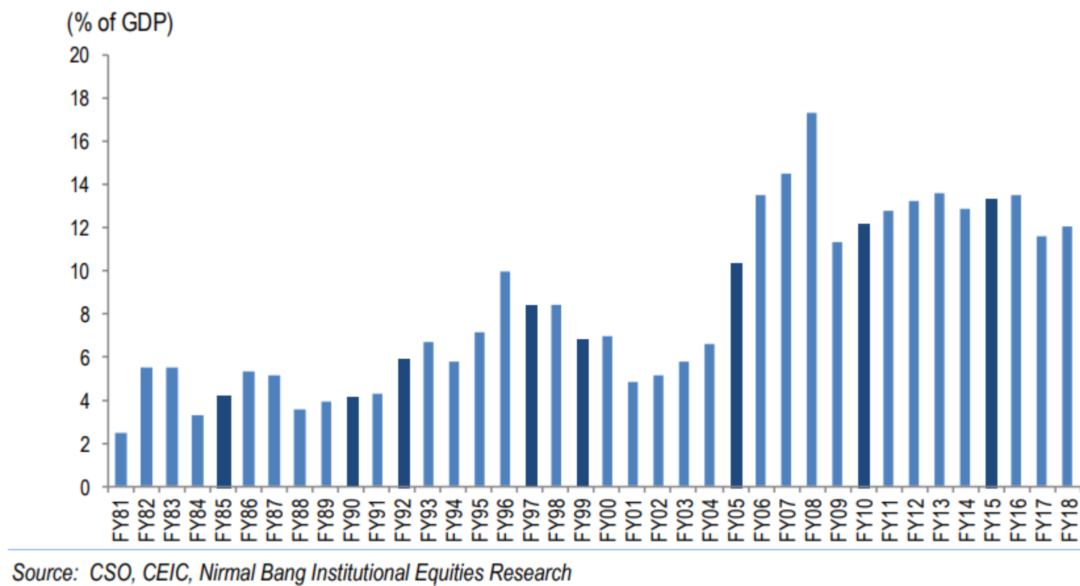


Source: Deloitte, KPMG, Kotak Institutional Equities

Another thing that the tax rate cuts do is leave more money in the hands of corporates, boosting corporate savings. And creates higher capacity in the system for corporate investment. Capital expenditure of the private corporate sector is a key driver of the investment climate in the economy and an indication of the 'animal spirits' that influence entrepreneurial energies and business sentiment. This has been a pain point for the economy with private capex numbers going down every year.

Private fixed capital formation as a % of GDP



Source: CSO, CEIC, Nirmal Bang Institutional Equities Research

If one sees the pain points for our GDP growth rates, it is basically "capital formation" *(especially by the private sector)* and "exports" *(which have dropped drastically from 2014-19)*. Consumption expenditure has been a steady growth story across cycles.

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Components	Growth (per cent)				
	2003-08	2008-09	2009-11	2011-14	2014-19
1	2	3	4	5	6
I. Total Consumption Expenditure	6.1	5.5	6.5	6.1	7.8
Private	6.2	4.5	5.9	6.7	7.6
Government	5.8	11.4	9.7	2.6	9.0
II. Gross Capital Formation	15.3	-2.6	14.5	2.0	7.1
Fixed investment	12.6	3.2	9.4	6.2	7.4
Change in stocks	73.5	-51.4	56.2	-27.4	15.3
Valuables	27.8	26.9	45.0	-11.1	4.9
III. Net Exports					
Exports	17.8	14.8	7.3	10.0	3.7
Imports	20.0	22.4	6.9	6.1	6.5
IV. GDP	7.9	3.1	8.2	5.7	7.5

Source: NSO and RBI staff calculations.

Thus, the corporate tax rate cut tries to address both these pain points.

However, a question often raised is whether domestic corporates will create new capacities just because of lower tax rates? Don't they need to see demand revival? This is a complex question. One is that a sentiment change *(including wealth-effect)* it-self results in higher consumer confidence that leads to a demand up-tick. If corporates pre-pone capital expenditure to take tax advantage available up-to FY23, it creates second order effects on employment that also leads to a demand pick-up. Further, the reduction in interest rates by RBI, if passed on to borrowers *(and there is strong push towards that)* also creates a demand up-tick. In any case, the Government seems to have played an aggressive card in its bid to revive the economic engine. It can only try to stimulate the cycle by fiscal easing and bet on a demand revival. Also, amidst clamour for tax-cuts by various industries, the Government needs to be commended for doing a structural reform and not resorting to either selective or short-term measures. This basically implies that the ball has been passed by the Government to Corporates – and the onus in on the Corporates now to work towards demand revival.

While one can applaud the step, it behoves on us to understand the impact of this step on the fiscal deficit *(expected revenue loss of INR 1.45 T)* and whether it portends inflationary trends. Fiscal deficit will worsen but there are offsets in the form of RBI dividend as well as a possibility of an aggressive disinvestment *(over and above budget estimates)* – on the whole, it seems that this could be a worthy gamble if it kicks in "animal spirits". In terms of inflation, it has stayed well below RBIs target for long and it might be an opportune time to risk inflationary pressures given the deflationary trends across the globe.

Now, to our portfolio performance. As can be seen from the performance numbers, we are roughly up 10% this year *(April'19 – Sep'19)* versus benchmark which is down 10%. Even Nifty is flat for the year. So, what explains this outperformance? We think the market has become extremely discerning in identifying companies that it thinks have a *"growth"* and a *"competitive"* advantage period going for it. And is willing to disproportionately reward them in terms of valuation multiples. This is further fuelled by the earnings momentum these companies have showcased even in these difficult times. Given below is a table on our understanding of the *"valuation driver*" momentum of the portfolio companies *(this is based on metrics we think are relevant to assess earnings momentum based on our understanding of the drivers of valuation)*. Please note these are as per closing names and weights *(the weights and names could have been different during the quarter – thus, this is only indicative)*.

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Company	Metric of growth	Weight	Y-o-Y Growth Q1FY20
Life Insurance Company	Embedded Value	8.7%	20%
MFI Based Bank	Profit after tax	8.2%	46%
CRAMS and NCE Pharmaceutical Company	TTM Pre-R&D Operating Profit	7.4%	8%
Aviation Company	Revenues	7.0%	45%
Exhibition centre Company	Profit after tax	6.9%	4%
Packaged Foods FMCG Company	Profit after tax	6.7%	52%
IT software Company - auto focused	Profit after tax	5.3%	-31%
AMC Company	Profit after tax	5.2%	41%
Special Situation (undisclosed)	NA	4.7%	NA
Regional Real estate Company	Area Booked	4.5%	26%
Grocery retail Company	Profit after tax	4.2%	32%
Capital Goods Company	TTM Order Inflow	4.2%	5%
Consumer NBFC	Profit after tax	3.8%	43%
Mumbai Real Estate Company	Sales Value of Area Booked	3.1%	-36%
Outsourced Pharmaceutical Company	Profit after tax	3.1%	9%
Agrochemical Company - domestic + exports	Profit after tax	1.9%	24%
Quarterly Growth (valuation driver metrics)		**84.8%**	**17% (Wt. Average)**

As can be seen, the ECIP Portfolio had a 17% growth in its key *"valuation driver metrics"* on a weighted average basis in Q1FY20 *(since many of these Companies are full-tax paying, there should be a further fillip to "valuation driver metrics" – also given that these are companies with some competitive advantage, they are likely to retain a part of the tax savings)*. This is in context of an overall slowdown in the economy. This has led to these stocks being rewarded with a *"growth scarcity"* premium. While this benefits us in the near term, high multiples would also have a bearing on prospective return – implying lower future returns. Wherever we think the multiples are getting unsustainable in context of our understanding of the valuation, we have lightened our weights. Our portfolio is positioned to benefit from intrinsic growth rate in Companies and not from multiple re-rating – if there was a huge positive sentiment change resulting in a significant re-rating of multiples of beaten down stocks, our portfolio is very likely to underperform the benchmark *(because we are not set-up for it)*.

Actions during the quarter

We exited a software Company that we had talked about in our first newsletter for Jun'17. This was the first stock we bought in the scheme. Our thesis was around Company's capability in the fast-growing digital segment and the opportunity landscape that it presented. We held it for over two years and faced disappointing results quarter after quarter. The transformation of this Company from an *"outsourced product development"* outfit to a *"digital products and service provider"* turned out far more challenging than we had thought. From an idea we were excited about in terms of opportunity and growth landscape, it was slowly turning into an idea where the thesis hinged just on valuation *(even though things are not working – it is still cheap!)*. Whenever a thesis is not working, it is often difficult to discern between *"are you being impatient?"* OR *"are you being foolishly stubborn?" (Because being wrong is almost always indistinguishable from being early).* After another disappointing result for Q1FY20, we just gave up on this Company and exited *(booking a loss)*. If the mandate of the ECIP scheme was valuation focused, we would have still held on to it. But, not selling the Company in a scheme whose mandate is *"excellence and relevance"* and NOT *"cheapness"* would, in our opinion tantamount to *"stubbornness"* or *"unwillingness to accept a mistake"*.

We have also reduced our weights in the AMC Company and the Aviation Company in this quarter. These are purely on account of valuation reasons.

After a hiatus of two quarters *(where there were no additions)*, we added two new Companies in the quarter:

Consumer-Finance NBFC

The company was incorporated in 1987 essentially as the captive financier to an auto major. In September 2007, the promoter put in place a new management team with the mandate to diversify into newer consumer lending segments. In March'08, the Company had Gross NPAs of 8%, NII of INR 200 crs, total assets of INR 3450 crs, RONW of 2% and profits of INR 20 crs. To bring down non-performing assets (NPAs) and institute processes, the new management shut down operations in 330 cities and pruned staff strength before rebuilding the organization. Over the last decade, Company has focused on five key parameters to grow their customer franchise: customer acquisition, big product portfolio, risk management, collections infrastructure and superior profitability. And as it stands today (Mar'19), the Company has Gross NPA of 1.6% (average of 1.4% for last 8 years), NII of INR 9750 crs, total assets of INR 1,25,000 crs, RONW of 20% (9-year average of 18%) and profits of INR 4000 crs. It's been a remarkable success story and we think the story has further legs to grow.

Company's model has been clear – grow the customer franchise – within the customer-pool, identify the low-risk credit-worthy customers based on the repayment record – create a large cross-sell franchise and offer more products to this set of low-risk customers – use analytics to filter in credit-bureau data to acquire customers and use technology to ensure good customer-experience and best-in class turn-around-times. As of Mar'19, the customer franchise stands at 36.94 mn *(these are not current customers but all customers that have even taken a loan from the Company)*, out-of-which the cross sell-franchise is 21.85 mn *(growing at 30% every year)* – about 2/3rds of incremental lending happens to this cross-sell franchise – where the NPA ratios are 0.2 x of the new to Company customers. Thus, this vintage of customers is critical to the success of the Company.

In theory, while Banks can compete with this NBFC *(and have an advantage over it on the cost of funds level)* – the Company seems to be far ahead of the pack – with its customer vintage – ability to use analytics in identifying low-risk customers – penetrating deeper geographically - and being nimble in getting in and getting out of areas. The disadvantage that it has on the cost of funds side is more than compensated by its lower credit costs *(versus other operating in the same areas)* and efficiency ratios owing to scale – we think that the size of the NBFC will now will further accentuate its operating leverage.

Another important point is that this NBFC has been stress tested over the last year owing to the NBFC crisis. Many of its peers that had ALM mismatches or questionable lending books – have faced a severe liquidity crunch. Amidst this crisis, this NBFC is unscathed. This gives us confidence on the management ability and their focus on creating a sustainable business.

Like many of our other holdings, this stock looks egregiously expensive on a trailing P/B basis and is often a subject of heated debate in the value investing community. However, when we assess valuations in context of the opportunity landscape, competitive positioning and its ability to dilute book at high multiples giving a fillip to its Book value per share – we feel the valuation at which we have bought the stock looks reasonable and offers satisfactory prospective return over the next three to five years.

Packaged food Company recently bought over by a global PE

The other company we bought is a packaged snacking company that introduced a popular packaged foods brand in the North in 1984. Its brands are targeted towards children in the age group of 4-14 and are extremely popular

in the *"targeted towards children"* category, especially in the north. Through launch of new flavours and new sub-brands *(main brand contributes ~50% now versus 90% three years back)*, the Company has grown at a healthy pace and diversified its product portfolio into new brands. Over the last 8 years, the Company has been able to grow revenues at a CAGR of 19% and Operating Profits at 19% - maintaining a ~20% Core post-tax ROCE, negative working capital *(zero receivable days suggesting product has a natural consumer pull),* more than a 100% OCF to PAT conversion and near zero net-debt position currently.

Having said that, compared to some of its peers – be it regional players or pan-India - the Company has not been able to scale-up. Even within its core Northern region *(North has been about 75% of the total revenue),* it saw significant growth in the last two years after launch of new products implying opportunity to scale-up further even without geographical expansion. Outside of north, the opportunity landscape is huge with consumer preference for the products already present. Company has its manufacturing facilities only in the north and reaching across India through the north is a challenge *(given that freight costs are prohibitive given that you are essentially transporting air)*. While the conservatism of the existing management has paid off in spades in terms of margins and a solid Balance Sheet, we also think that there are low hanging fruits available for a further scale-up through product launches and geographical expansion – if a new competent management were to take over.

Interestingly, on September 9, 2019 – one of the largest global private equity firm announced an acquisition of a majority stake in the Company with the promoters *(and an existing investee PE fund)* exiting. Global PE firm will end up owning more than 68% of the Company *(and possibly even more depending on the open offer)* and have full control. Our channel checks on the PE and observations regarding its past transactions suggests that it will put in best-in-class management in this Company to execute on the growth strategy. The advisors to the Global PE firm on this deal were high-profile ex-FMCG industry CXOs *(who would likely take board seats)* further giving us the confidence that the business would move into capable hands. For us, this is a side-car investment along-with the PE firm into a Company that has competitive advantage and potential to scale up significantly, without compromising on the return metrics.

Finally, we'd like to extend season's greetings to all our readers and investors.

Thanks for reading.

Regards
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Statutory Details: Portfolio Manager – Multi-Act Equity Consultancy Private Limited (Registration No. INP000002965)

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General risk factors

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b. Past performance of the Portfolio Manager or its affiliates does not indicate its future performance.

c. Investors are not being offered any guaranteed or assured returns i.e. either of principal or appreciation on the Portfolio.

d. As with any investment in securities, value of the Client's Portfolio can go up or down depending on the factors and forces affecting the capital market.

e. The Portfolio Manager is neither responsible nor liable for any losses resulting from the operations of the Portfolios.

f. The investments made are subject to external risks such as war, natural calamities, and policy changes of local / international markets which affect stock markets.

g. The Portfolio Manager has renewed SEBI PMS registration effective October 14, 2014 and has commenced its portfolio management activities with effect from January 2011. However, the Portfolio Manager has more than 10 years of experience in managing its own funds invested in the domestic market.