Multi-Act Equity Consultancy Pvt. Ltd.
10th floor, The Ruby Tower, 29 Senapati Bapat Marg, Dadar (W),
Mumbai- 400028,
Tel +9122 61408989
www.multi-act.com
CIN: U67120PN1993PTC074692

Date: 2nd July, 2018

Dear Investors,

Performance

Below is the performance of the Emerging Corporates India Portfolio (ECIP) as of 30th June, 2018. Our closing equity allocation as at March 31, 2018 is ~*71%* spread into 17 companies and balance is in liquid schemes.

Portfolio Performance	Total Portfolio Returns	Benchmark Returns
Since Inception *(Annualised)*	9.0%	4.0%
Q1 FY2019	0.8%	-4.4%
Q4 FY2018	-1.5%	-11.0%
Q3 FY2018	6.2%	17.4%
Q2 FY2018	1.6%	5.0%
Q1 FY2018 *(Since April 28, 2017)*	3.4%	0.0%

- 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.
- Returns for less than 1 year are not annualised
- Inception Date is 28th April 2017.

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.

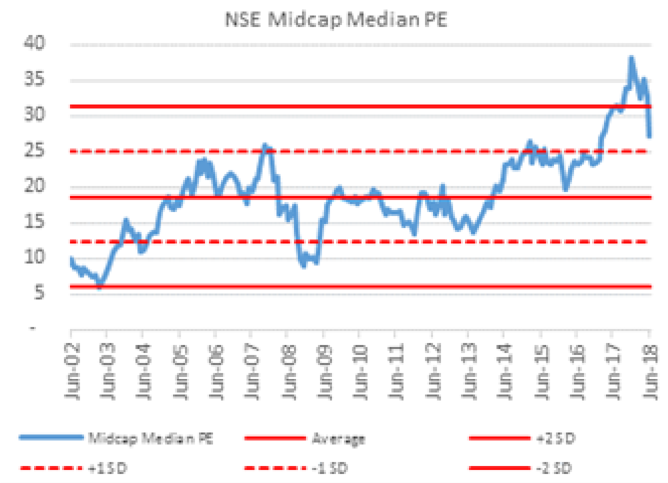
It is the very nature of markets that they will go through periods of feasts and famines. Our job, we think, as good shepherds of capital, is to starve much lesser than the benchmark in a period of famine and enjoy as much or may be even slightly lesser than the benchmark during a period of feast. This should firstly ensure that we survive and also increase the likelihood of having excess returns over the benchmark over a long period *(three to five years).* Like the Berkshire Owner's Manual Principle 7 states *"In order to finish first, you have to first finish"*.

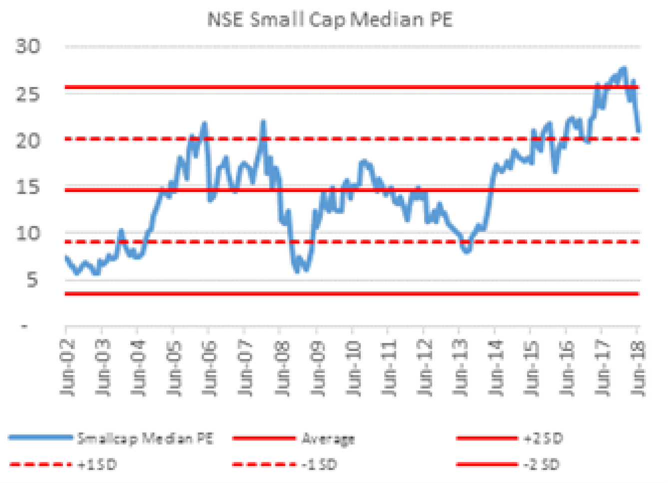
In this newsletter, we give our take on the basics of how a stock market cycle works with special emphasis towards *"less than high quality"* small and mid-cap stocks:-

Regd. Office: 3rd Floor, Trade Centre, North Main Road, Koregaon Park, Pune – 411001, Tel. +91 20 66033141/2, www.multi-act.com

Multi-Act Equity Consultancy Pvt. Ltd.
10th floor, The Ruby Tower, 29 Senapati Bapat Marg, Dadar (W),
Mumbai- 400028,
Tel +9122 61408989
www.multi-act.com
CIN: U67120PN1993PTC074692

Given below is the median PE of NSE Midcap and NSE Smallcap Index. Median PE really reflects the level of optimism or pessimism built in investor expectations.





At the turn of the market phase from bear to bull *(2002 or 2009 or 2013)*, quality Companies trade at a significant premium to stocks that are of lower quality. And smart Investors think that lower quality companies could be better stocks to own than high quality companies at such a time as their prospective returns are higher. This, in-fact, is sound logic to begin with. The real problem is what happens next. As the bull market gathers pace, these low quality stocks become 2x-3x in the first phase. This sets in the *"feeling of regret"* amongst investors who have missed out. And there is a gush of liquidity that comes into the market specifically chasing these kinds of stocks. Promoters of these companies suddenly become aware of the opportunity that beckons them now.

They start meeting prospective Investors and narrate a spiel about the future prospects of the Company and the Industry. You suddenly find brokers holding conferences with record Investor and Company attendance. The rising stock prices give a *"dopamine"* rush to the Investors and leads to what Howard Marks calls *"a willing suspension of disbelief"*.

All sense of doubt and scepticism gets lost and Investors start foolishly believing forecasts that are thrown at them by managements. Management commentary that *"we will grow revenues and profits at 20% for 20 years"* or *"we should start doing ROCEs of 25% next year onwards"* are just put in an excel file to justify that stock is still not as expensive as it looks. The fact that the Company's past five year growth rate is just 9% or that its past 5 year average ROCE is only 7% is not questioned.

Liquidity leads to multiple expansion and multiple expansion leads to further liquidity *(as price goes up, "demand for shares" and "reasons to buy" go up and vice-versa)*. More promoters get aware of the "market cap" phenomenon and join the bandwagon. And themes like *"chor bane mor (dishonest promoters have now become honest)"* are touted as reasons to buy.

The sound reason that these stocks became interesting to begin with, which was the valuation discount, is suddenly lost. These stocks first narrow the discount and then even start trading at a premium to quality stocks. Reasons like they are smaller and can grow faster or that their past profits were understated *(and future will not be so as they are now prospectively honest)* are given to justify the premium. Promoters raise money through QIP/ sell stake at these record valuations. A gush of IPOs enter the market. But, as Buffett says, *"A pin lies in wait for every bubble. And when the two eventually meet, a new wave of investors learns some very old lessons".* The reasons for the hype getting busted are different every time – may be some global event or some fraud or political uncertainty – and the timing of such events is unknowable - but the course of events is similar every time.

While I have narrated the above, it should NOT be understood to mean that we are claiming to be above other Investors and we will not be trapped into doing something foolish. A lot of these things are very innate and actually happen at a sub-conscious level. Also, while it's happening, everyone *(me included)* feels that *"this time, it's different"*. Investors can, at best, try to avoid such traps by having certain pre-defined principles. A few principles that we follow with ECIP are given below:-

1. Focus on proven past numbers. We would very rarely enter into a stock where the past numbers are bad and the future is likely to be very good. We just feel that the base rate of getting these things right is low. Also, we do not believe we have the competence required to do this with a high success rate. As Charlie Munger put it in his trademark style in the 1995 Annual Meeting *"We tend to judge by the past record. By and large, if the thing has a lousy past record and a bright future, we're going to miss the opportunity."*

2. Pay careful attention to the past when forecasting about the future. If the projected future growth rates or margins or trading multiples are way different from the past, we question ourselves regarding the basis of having such a forecast.

3. Pay close attention to accounting norms followed by the Company. Issues like capitalization of revenue expenditures, revenue recognition policies, depreciation rates, charging expenses directly through reserves, etc are to be taken seriously. We firmly believe in what Buffett stated in the 1995 Annual Meeting *"accounting can offer you a lot of insight into the character of management."*

4. Having a team or network, albeit small, with a diverse DNA make-up. I believe that some people are *"natural optimists"* and some are *"natural sceptics"*. The optimists lend the vision to the idea and the sceptics lend the necessary *"doubts"* or *"sense of disbelief"* to the idea. A healthy and honest conflict between the two leads to better investment decisions. It also helps reduce the risk of "Groupthink" - *a psychological phenomenon that occurs within a group of people in which the desire for harmony or conformity in the group results in an irrational or dysfunctional decision-making outcome.*

5. Willingness to underperform in the near future. Since markets focus mostly on current year and next year earnings, companies which might have pessimistic outlook for current and next year but, a good five year outlook can offer value. We will be guided by prospective return and not by popularity. This will expose us to possibly poor near-term performance but we are sowing seeds for next five years. And as time passes, we hope that seeds sown in the past will bear fruit on a recurring basis. However, it should not be construed that we have a strong preference towards only unpopular or contrarian ideas. Our portfolio would have some ideas that would be contrarian and some that would be quite popular. In each idea, our belief is that we can earn a respectable 5 year prospective return. Thus, we are focused on prospective return and agnostic towards popularity.

6. If we do not find ideas in our universe worth Investing, we will stay on cash *(liquid funds)*. We will not lower the return hurdle or the quality hurdle because we do not find investment opportunities. We believe that pressure to invest within a certain time frame can lead to foolish decisions. We have no targets regarding "x" percentage of AUM to be invested within a certain time. As Buffett stated in the 1996 Annual meeting *"the inflow of money and outflow of money should not be, in our view, attempted to be matched too carefully in this world, because you get investment and business opportunities at times that differ from the times that funds come in. And one of the most important disciplines in running a business or managing investments is that — not to try to coordinate your actions simply with the availability of cash".*

7. Tracking management commentary across a long historical period to better judge their ability to predict or forecast. And also to understand their natural predisposition towards aggressive or conservative guidance. Further, we try to corroborate these statements/ commentary through independent sources like companies' customers, suppliers, competitors, distributors, industry body data, industry experts, etc. Also, we have strong preference for businesses that do NOT require "high stock prices" to grow *(meaning businesses who have absolutely no need for dilution)*.

8. When we take a decision, we are essentially making five year forecasts of revenue and profits. Every quarter post investment, we receive an additional data point that either gives us "more" or "less" confidence on the forecasts we have made. While one ought to give stocks and managements some time as real life is not linear, if we are convinced that we are way off the target even after giving it time *(say a couple of years)*, we will not have a "commitment bias" and will exit accepting the mistake.

With the above framework, we try to reduce massive errors and reduce risk of permanent loss of capital at the portfolio level. As far as "mark to market (MTM)" drawdowns are concerned, they are inevitable irrespective of the investing style.

Key events during the quarter:-

1. The airline we own had resignation from its President and bad quarterly results

The airline we own had a resignation from its President. Also, it posted a result which was below market expectations. As far as the resignation is concerned, our fundamental reason to own this business is the cost structure set-up by its founders through strategic decisions taken by them. While an airline requires a very efficient day-to-day management, the real advantage is the cost structure. And our understanding is that the resignation does not change that in any way. As far as the quarterly results are concerned, while our Company had profits below expectation *(but still had profits)*, a competitor reported losses of ~INR 1000 crores. Ultimately, an airline seat is a commodity and if your competitor is willing to lose ~INR 1000 crores in a quarter, it ought to put pressure on even the airline with a strong cost advantage. However, no Company can fund such losses indefinitely and thus, either sanity will return or the competitor will go bankrupt. And till one of these two things happen, our airline will also suffer on profitability. We remain confident that given the cost advantage of our Company, it should earn at-least higher single digit profit margins over the long-run. This does not mean it will happen every quarter and not even every year. In a few periods, it will be higher and in others, it will be lower. Markets might focus on recent performance and make the stock very volatile extrapolating the near-term into the future. But, we are prepared for this volatility as we remain convinced of the long-term opportunity in Indian aviation for a Company with a very strong cost advantage relative to peers and an extremely resilient Balance Sheet.

Apart from the above, the quarterly results for our investee Companies were generally within our expectations range.

Activity during the quarter:-

We increased our weight to a real estate Company (*that was explained in the Mar'18 newsletter)* and an NBFC about to turn into a Bank *(that was explained in the Dec'17 newsletter and followed up in Mar'18 newsletter)*. We also reduced our positions in the Private Sector Life Insurance Company *(as was highlighted in the Dec'17 newsletter) and* one of the two Midcap IT Companies *(as was highlighted in Jun'17 newsletter)*. The reasons for reducing weight have purely been valuation led.

We added two new Companies in the Portfolio.

Company 1

The Company has evolved from an NGO into a microfinance lender– and eventually into its current form of a universal bank. Over the years, even though the MFI Industry in India has gone through several episodes of state-specific crisis like Andhra Pradesh, farm loan waiver issues before every election, demonetization, etc, this Company remained unscathed. One reason for the same could be attributed to its core geographic areas being less affected but another reason also is its model and expertise *(of the Founder)* in forming women groups in such a way that recovery rates are higher and having weekly direct meetings with its borrowers *(without middlemen)*.

The NBFC converted into a universal Bank in August, 2015. While the transformation from an NBFC to a Bank has been difficult for every other peer, this Bank has achieved enviable numbers in a short span of 3 years. With around 3600 touch-points with its customers and the third largest Branch network within private sector banks and a customer base of 13 m customers, the Bank has developed a strong customer reach. Its ability to generate CASA in a short span has been particularly astonishing. Key financial metrics include CASA ratio of 35%; cost to income ratio of 35%; reduction in borrowings to near zero *(100% reliance on deposits and 70% of which retail)*; RoA of 4% and RoE of ~25%; by-far best in class Gross NPA ratios and a large opportunity runway for growth.

In essence, we think that its cost advantage *(borrowing cost led by CASA and operational cost led by by-far lowest in peer-set cost to income ratio)* is very wide and it allows this Bank to lend to its borrowers at rates lower than peers, still allowing it to have RoAs/ RoEs far higher than peers. We debated a lot internally over whether this Company has a risk of it going to zero *(like what happened to one of its peers (almost!) post the Andhra MFI crisis)*. We thought that the risk of that happening was lower at the industry level now given the learnings and developments post that crisis, and even lower at the Company level considering its performance in high-stress periods, but off-course, it was not zero. After considering the risks and the growth landscape, we decided to invest but be cautious on the weight.

Company 2

This is a pharmaceutical Company focusing on high margin niche pharmaceutical products and has grown the business at a robust pace over the long-term creating its own front end of medical representatives in diverse geographies including India, Africa and Asia. It recently entered the US market with USFDA compliant plant that has undergone inspection recently. The opportunity landscape is large in each of its base geographies and Company's standing is strong with branded generics allowing it a good growth runway. The US opportunity is an option value and given that the US exposure is small currently, it does not face risks to existing revenues owing to pricing pressures as faced by its US focused peers.

Management has shown excellent execution capability with best in class RoCEs, revenue growth over the long run and strong margins in-spite of high R&D spends. Investing in pharmaceutical companies is also about backing the right management as growth depends on the strategy around identifying, researching, filing and creating front-ends for the right products. We have backed the management of this Company.

Our purchase price for this stock is 55% below its all-time high it touched nearly two years ago. A general lack of favor for pharmaceutical stocks currently, excessive expectations built up in the stock in the past (FY16) by extrapolating past strong growth rates in the future and an expected loss of majority of tender business in FY19 *(19% of FY18 Revenues)* has led to the fall in the stock price. Our thesis is that this is a case of bad next year outlook but good five year outlook. And, we think, this leads to an investment opportunity for someone willing to go through near-term pain.

Regards
Rohan Advant
CA, CFA
Portfolio Manager
rohan.advant@multi-act.com

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

Disclaimer

This is an Internal Document and not meant for unlimited public circulation. This document has been solely prepared for the PMS Clients of Multi-Act Equity Consultancy Private Limited (MAECL) and is not meant for circulation to any third party. The information contained herein does not constitute any guidelines or recommendations on any course of action to be followed by the Client.

The information is prepared on the basis of publicly available information, internally developed data and other sources believed to be reliable. MAECL does not solicit any course of action based on the information provided by it and the investor is advised to exercise independent judgment and act upon the same based on its/his/her sole discretion based on their own investigations and risk-reward preferences.

The information is meant for general reading purpose and is not meant to serve as a professional guide. The client may or may not be holding the Company mentioned in the newsletter in its/his/her PMS portfolio as the portfolio will vary from client to client depending upon the investment strategy followed by the Portfolio Manager for each client.

MAECL, its associates or any of their respective directors, employees, affiliates or representatives do not assume any responsibility for, or warrant the accuracy, completeness, adequacy and reliability of such information and consequently are not liable for any decisions taken based on the same. This information is not intended to be an offer or solicitation for the purchase or sale of any security or financial product. The investor shall at all times keep such information / data and material provided by MAECL strictly confidential and will not use, share or disclose such information to any third party.

It is stated that, as permitted by SEBI Regulations and the Company's Employee Dealing Policy, MAECL and/or its associates, affiliates and/or individuals thereof may have positions in securities referred to in the information provided by it and may make purchases or sale thereof while the information is in circulation. MAECL is not responsible for any error or inaccuracy or any losses suffered on account of any information contained in this document. Neither MAECL nor any of its associates, directors, employees, affiliates or representatives shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information provided by it.

Risk factors
General risk factors

a. Securities investments are subject to market risks and there is no assurance or guarantee that the objective of the investments will be achieved.

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.