



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: 12th July 2021

Dear Investors,

Performance

Below is the performance of the Emerging Corporates India Portfolio (ECIP) for Q1FY22 and as of June 30th, 2021. Our closing equity allocation as on Jun 30th, 2021 was ~80% spread into 19 companies and balance is in cash.

Portfolio Performance	Total Portfolio Returns	New Benchmark	Old Benchmark
CAGR since Inception (<i>Annualised</i>)	18.5%	13.5%	12.8%
Q1FY22	5.1%	13.9%	17.1%
FY21	79.2%	94.0%	104.7%
FY20	-13.2%	-30.3%	-33.0%
FY19	13.3%	1.2%	-6.5%
FY18 (<i>Since Inception - April 28, 2017</i>)	9.7%	10.2%	10.5%

- *New Benchmark is an average of the BSE Smallcap Index, BSE Midcap Index and Nifty*
- *Old Benchmark is an average of the BSE Smallcap Index 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 you can see, our benchmarks have made an extremely strong comeback over the last six months. Over the last six months, our fund has delivered a 5.0% return versus 33.0% returns for average of BSE Small and Mid-cap and 13.2% for the Nifty. The BSE Small and Mid-cap is going through an extremely strong return phase, and our portfolio holdings have not participated in this rally. In spite of our sharp under-performance in the last six months, our 3-Year and Since Inception performance still has an excess return of 630 bps (22.4% vs 16.1%) and 570 bps (18.5% vs 12.8%) respectively over average of BSE Small and Midcap. And as against our new benchmark (1/3rd BSE Small; Mid and Nifty each), our 3 year and since inception performance has an excess return of 660 bps (22.4% vs 15.8%) and 500 bps (18.5% vs 13.5%) respectively. However, with the ferocious rally in the small and mid-cap names, our excess returns seem to be eroding swiftly. So, what is happening?

As has been stated earlier, our portfolio consists of structural growth opportunities. These Companies had a favourable perception and outlook pre-COVID and continue to have a favourable perception and outlook post COVID. Our purchase prices have been such where our returns are more dependent on Intrinsic Value growth rate of these companies, than on re-rating of multiples. We have not bought these Companies cheap and hence expecting a return from a multiple re-rating would be incorrect, on our part. Against this, what has really done well in the past 6 months are Companies that had a negative market perception, but recent fundamental performance and favourable sentiment, have caused an earnings estimate revision as well as multiple revision, leading to multi-bagger returns in many Companies in the small and mid-cap space. We continue to struggle with establishing sustainable competitive advantages for a large section of Companies in the small and mid-cap space and consequently, the sustainability of earnings growth. And in the absence of conviction on

sustainability of earnings, our ability to value them is very limited. We know that “errors of omission” (*missing out*) is a cost that we will have to pay to avoid “errors of commission” (*adverse selection*) – and while it may seem today that we erred too much on the side of caution – over the long run, we believe that minimising errors of commission will stand us in good stead.

While one could accuse us of saying that the grapes that we did not get are sour (*or to put it more brutally, " नाच न जाने आँगन टेढ़ा"*), we nevertheless want to point out pockets of irrational exuberance, especially in the small-cap space. It is akin to what we saw in early 2018 when the BSE Small-cap index was around 19,000 and fell to 12,500 by Aug'2019 (*a fall of 35% in 20 months*). Market participants in the small-cap space, we think, periodically go through a phase of “willing suspension of disbelief”. **It refers to the intentional avoidance of critical thinking or logic in examining something unreal or impossible in reality to believe it for the sake of enjoyment.** Why does this happen? The answer lies in something known as the “winner effect”. When markets rise very sharply in a short period of time, a lot of investors/ traders are sitting on huge short-term gains. A winning streak causes a powerful narcotic-like “high” in the market participants at large. As John Coates, the author of “*The hour between the dog and the wolf*” puts it, **“You become euphoric, delusional, you have less need for sleep, you have racing thoughts, an expanded appetite for risk, and less stringent requirements in the risk and reward trade-off.”**

Then, there are other actors in the ecosystem that take advantage of this investment sentiment – namely. Company managements. A lot of managements suddenly start doing conference calls (*you will see few managements do calls in bull-markets only*), promising investors 25%-30% growth (*using all the right words that are in vogue currently*). Since investors who are under the influence of the “winner effect” want to believe anything that justifies the stock going up, such guidance starts getting reflected in the stock price immediately. Stocks trade at 35x trailing P/E but 15 x 2-Yr **forward** P/E because sales will grow at 25% and margins will be 1.5x of trailing margins. Why? Because the management says so. The higher the trailing 12-month return, the more the willingness of investors to believe in implausible forecasts.

Then, there are stocks that look cheap even on a trailing basis because they have had one-off earnings (*FY21 margins far higher than historical average*) or have a poor Balance Sheet (*high debt/ equity or low long-term ROCEs*) – but then, such critical analysis is scoffed at by the market participants in this phase (*who gain more and more confidence on the irrelevance of long-term fundamental averages as stocks continue to go up*).

As Stanley Druckenmiller said in a recent interview “the higher they go, the cheaper they look”.

Now, in many cases, delivering on this guidance is extremely difficult. As time comes for a reality check of expectations versus reality, investors realise they have possibly been extremely over enthusiastic in their earnings estimate. And selling pressure increases. As some of these stocks tend to be very illiquid on the way down, a crowd of sellers causes a sharp multiple de-rating as well. And thus, this space sees an extreme on both sides. Now, you may say that why would this be true only for small caps. We would think it is broadly true for all stocks but the extent of “willing suspension of disbelief” is possibly more in smaller caps generally, owing to market inefficiency that allows room for narratives. It can be present in large caps as well, especially stocks in industries going through tectonic shifts (*like the tech bubble*).

Now, we think it behoves us to examine an idea even more critically at this juncture. We do not, for a moment, want to suggest that every small-cap Company is peddling implausible stories, but we need to be sure of the assumptions we use today when forecasting a long-term earnings stream for any business. Even if “buy now research later” seems to be the right thing for now, we think such an attitude can trap us into false narratives. We should remind ourselves of the timeless Buffett advice again, “The less prudence with which others conduct their affairs, the greater the prudence with which we should conduct our own affairs.”

We reproduce an excerpt of a 1967 Buffett Partnership letter (more than 50 years ago) that we resonate with in the current environment:

Buffett in letter dated October 9, 1967

*I have always cautioned partners that I considered three years a minimum in determining whether we were "performing". Naturally, as the investment public has taken the bit in its teeth, the time span of expectations has been consistently reduced to the point where investment performance by large aggregates of money is being measured yearly, quarterly, monthly, and perhaps sometimes even more frequently (leading to what is known as "instant research"). The payoff for superior short-term performance has become enormous, not only in compensation for results achieved, but in the attraction of new money for the next round. Thus, a self-generating type of activity has set in which leads to larger and larger amounts of money participating on a shorter and shorter time span. **A disturbing corollary is that the vehicle for participation (the particular companies or stocks) becomes progressively less important - at times virtually incidental - as the activity accelerates).***

In my opinion what is resulting is speculation on an increasing scale. This is hardly a new phenomenon; however, a dimension has been added by the growing ranks of professional (in many cases formerly quite docile) investors who feel they must "get aboard". The game is dignified, of course, by appropriate ceremonies, personages and lexicon. To date it has been highly profitable. It may also be that this is going to be the standard nature of the market in the future. Nevertheless, it is an activity at which I am sure I would not do particularly well.

As I said on page five of my last annual letter,

*"Furthermore, we will not follow the frequently prevalent approach of investing in securities where an attempt to anticipate market action overrides business valuations. Such so-called 'fashion' investing has frequently produced very substantial and quick profits in recent years (and currently as I write this in January). **It represents an investment technique whose soundness I can neither affirm nor deny. It does not completely satisfy my intellect (or perhaps my prejudices), and most definitely does not fit my temperament. I will not invest my own money based upon such an approach - hence, I will most certainly not do so with your money."***

Any form of hyper-activity with large amounts of money in securities markets can create problems for all participants. I make no attempt to guess the action of the stock market and haven't the foggiest notion as to whether the Dow will be at 600, 900 or 1200 a year from now. Even if there are serious consequences resulting from present and future speculative activity, experience suggests estimates of timing are meaningless. However, I do believe certain conditions that now exist are likely to make activity in markets more difficult for us for the intermediate future.

*The above may simply be "old-fogeyism" (after all, I am 37). When the game is no longer being played your way, it is only human to say the new approach is all wrong, bound to lead to trouble, etc. I have been scornful of such behavior by others in the past. I have also seen the penalties incurred by those who evaluate conditions as they were - not as they are. Essentially, I am out of step with present conditions. **On one point, however, I am clear. I will not abandon a previous approach whose logic I understand (although I find it difficult to apply) even though it may mean foregoing large and apparently easy, profits to embrace an approach which I don't fully understand, have not practiced successfully and which, possibly, could lead to substantial permanent loss of capital.***

So, in context of all that we have stated above, what are we doing currently?

1. We are significantly raising the bar of our analysis – critically evaluating the credibility of understanding and realism in our assumptions. Not that the bar was ever low, but we think that the likelihood of us being wrong (*foolishly believing in a future that is unlikely to materialise*) right now is significantly high and hence, the onus of deep understanding of the opportunity landscape and competitive intensity is on us, more than ever. Against the prevailing market sentiment of “buy-now, research later”, we are going by “research well, no matter the amount of time required to gain depth and buy later, if at all”.
2. Be psychologically comfortable with near-term under-performance over benchmarks. If we did not allocate more to small-caps in H1FY21, it is a mistake that has been committed and cannot be corrected by buying small-caps today (*that might be like “attempting to correct a mistake by committing an even bigger one”*). Communicate to clients what you see as-is (*a lot of investment managers consider communication of poor return outlook as a shortcoming – after all, which barber will say “a haircut will only make you look worse!”*) – however, we think the edifice of a long-term client relationship is to point out the risks as much (*“telling a diabetic that he should enjoy desserts and not bother about exercising just because it makes him happy” is a well-accepted poor medical advice – but versions of such advice are prevalent in the investment field*). Our founder Prashant Trivedi has consistently quoted Jean-Marie Evelliard, the famed value investor, to us *“it is better to lose a third of your clients, than a third of their money”*, and we shall stand by it.

Material Portfolio action during the quarter

We have not added any new name in the scheme in this quarter.

One stock in our portfolio that is heavily debated is a micro-finance focused Bank. While we had been optimistic on the prospects of this Bank, we have revised our thinking on it over time, and revised our weight downwards (*current weight at ~4%*). Our basic thesis was that this Bank is a champion in the MFI space, has had an underwriting track-record far superior to peers (*tested crisis after crisis*) and the same is likely to keep it in good stead. We were less worried than the market about its concentration in two states as its customer vintage (*average no of loan cycles complete by a borrower*) was very high in these states and our understanding was that higher vintage customers have a better credit discipline (*the weaker have been eliminated in the first few cycles*). Also, vintage allowed higher “loan/ borrower” (*again our understanding was that an INR 25,000 loan to a first-time borrower can be far riskier than a Rs 90,000 loan to a borrower in his 9th cycle – and so, we did not look at higher loan/ borrower relative to industry as necessarily a negative*) – and it allowed best-in-industry cost structure. However, the Bank’s performance in its top two states during the COVID pandemic has been below our expectations. While we can make the argument that pre-provision profitability is extremely strong for the Bank to absorb high credit costs in a pandemic year and still have a double-digit Return on Equity, we think our thesis on this Bank being a “underwriting champion” in this space needs to be re-evaluated and critically examined (*we are still in the pandemic though and one can know this for sure only 12-18 months from now – as delays do not mean defaults – and we do not yet know the defaults*). The second wave has been a brutal jolt to this Industry while it seemed to be coming out from a very difficult year – and given that MFI Industry lends to the vulnerable sections of the society (*most affected by lockdowns*), we are certainly not out of the woods yet. We have not exited because we are still constructive on a 5-year outlook for the Bank and appreciate that the last two years were possibly the noisiest in its history (*while the noise in this Industry will always be high, it might be lower going forward relative to the last 18 months*). If (*and we agree that it is a big IF*) credit costs were to normalise even at slightly higher than pre-pandemic levels in FY23 and thereafter, the flow through of pre-provision profitability to post-provision profitability will be very strong, the outcome would be better than being discounted. We will re-evaluate the thesis periodically and keep you posted on how it turns out.

Thank you for a patient reading.

Regards
Rohan Advant, CFA
Sr. Portfolio Manager and Associate Director
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. This Document and the Information do not constitute a distribution, an endorsement, an investment advice, an offer to buy or sell or the solicitation of an offer to buy or sell any securities or any other investment products/strategies mentioned in this Document or an attempt to influence the opinion or behaviour of the Investors/Recipients.

The statements made herein may include statements of future expectations and other forward-looking statements that are based on our current views and assumptions and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. The Stocks mentioned herein forming part of the existing PMS Investment Approach may or may not be bought for new client. Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. MAECL does not provide any guarantee/ assurance of any minimum or maximum returns. Investment in Securities is subject to market and other risks and there is no assurance or guarantee that the objectives of any of the Strategies of Portfolio Management Services will be achieved.

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, understanding of intended recipient and is not meant to serve as a professional guide and/or the same should not at any point of time be construed to be an invitation for subscribing to Emerging Corporates India Portfolio – Investment Approach. The client may or may not be holding the Stocks 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 based on the Investment approach selected by the 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.

Note:

1. All cash holdings and investments in liquid funds, is considered for calculating the performance.
2. All performance data are reported net of all fees and all expenses (including taxes).
3. The above performance numbers are not verified by the SEBI

Disclosure as per Global Investment Performance Standards (GIPS®) –

Multi-Act Equity Consultancy Pvt. Ltd. claims compliance with the Global Investment Performance Standards (GIPS®). You can refer to the GIPS Compliant performance presentation [here](#). Multi-Act Equity Consultancy Pvt. Ltd. has been independently verified by M/s. M. P. Chitale & Co., Chartered Accountants for the periods April 1, 2011 through March 31, 2019. The verification is available upon request. MAECL has claimed GIPS compliance for the Financial Year 2021 and such performance numbers shall be made available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The Composite representing the Emerging Corporates India Portfolio was created on 28th April 2017. Performance has been compared with Total Return of the Index. For Emerging Corporates India Composite, blended benchmark of BSE 500 (50% weight) and BSE Mid Cap Index (50% weight) has been used. The Gross Return is before all expenses (except Brokerage). Net Return is after all actual expenses. A complete list of composite descriptions, policies for valuing portfolios and calculating performance fees are available on request.

Multi-Act Equity Consultancy Pvt. Ltd. is an independent SEBI registered Portfolio Manager. The firm maintains a complete list and description of composites, which is available upon request. This ECI Composite includes all discretionary fee paying portfolios that are being managed with the objective of generating capital appreciation by investing in companies that in the opinion of the Portfolio Manager are "Advantage Period Companies" which are enjoying a "competitive advantage period" that is likely to last for at-least 5 years and are available at a valuation that offers margin of safety relative to the growth opportunity landscape. The portfolio manager has also the discretion of not being fully invested if he is not able to find ideas that meet the above criteria along with valuation criteria, thus, indirectly taking an asset allocation call between Equity and Cash (& Cash Equivalents).

The information provided in this document should not be construed as a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in the composite or that the securities sold will not be repurchased. The securities discussed do not represent the composite's entire portfolio. Actual holdings will vary depending on the size of the account, cash flows, and restrictions. It should not be assumed that any of the securities transactions or holdings discussed will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

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 December 04, 2020 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.