Built by investors for investors

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Emerging Corporates India Portfolio

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Dear Investors,

Performance

Below is the performance of the Emerging Corporates India Portfolio *(ECIP)* for Q2FY23 and as of September 30, 2022.

Portfolio Performance	Total Portfolio Returns	Benchmark
CAGR since Inception *(Annualised)*	14.4%	12.6%
FY22	8.6%	26.2%
FY21	79.2%	94.0%
FY20	-13.2%	-30.3%
FY19	13.3%	1.2%
FY18 *(Since Inception - April 28, 2017)*	9.7%	10.2%
Q2FY23	11.8%	13.0%
Q1FY23	-11.6%	-10.2%

- *Benchmark is an average of the BSE Smallcap Index, BSE Midcap Index and Nifty*
- *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*

For Q2FY23, ECIP portfolio is up 11.8% versus 13.0% for the benchmark and 8.7% for the Nifty. If we consider H1FY23, ECIP has returned -1.2% versus 1.4% for benchmark and -1.2% for the Nifty. As we can see, we meaningfully lagged the benchmark in FY22, but in H1FY23, while we have still lagged, the difference is marginal. For the last 18 months, the market has been rewarding "change factor". Stock specific ideas that lack evidence of quality through history but have a promise of becoming quality in the future have been rewarded massively, largely driven by massive multiple re-rating *(also owing to cheap starting points)*. ECIP has always been focused on companies that have evidenced quality through history and thus, the starting point for valuation was not cheap. This left less room for multiple expansion. Further, since money is chasing "change factor" ideas, these high-quality companies have also faced de-rating headwinds as there's no quick money in them. However, we believe that this trade can stretch only up-to a point, beyond which, there's no room left for "change factor" stocks to further re-rate and the market will again start to reward the high-quality stocks. Further, "change factor" stocks tend to be fair weather stocks and we have had a remarkably fair weather for too long since COVID lows. If we were to head into rough weather, we continue to believe we should have relative outperformance as its during times of crisis that quality gets a massive premium.

In this newsletter, we will discuss two of our ideas that contribute to ~15% of the scheme are going through, what we believe, are temporary and solvable issues.

1. Our largest position where we have an allocation of ~10% of the scheme is a pure play credit card Company. The micro story for this Company couldn't have been better. In Q1FY20 (Apr'19 to Jun'19), card spends for this Company were INR 30,174 crs and in Q1FY23 (Apr'22 to Jun'22), card spends were INR 59,671 crs, a

CAGR of 26% *(how many companies can you name that boast of a 26% 3 Year CAGR between Q1FY20 and Q1FY23?)* – we think it's a mega-trend, structural and irreversible. Company has maintained its market share through this period, albeit that there has been some fall off-late *(not material, especially given the strong absolute growth)*. This continues to be a 7% ROA and 30% ROE business reflecting financial metrics unmatched in the financial industry. Market's worry in this stock largely stems from RBI re-looking at fees charged by credit card companies and possibly capping them to levels below what are currently charged by our investee Company. RBI has come out with a discussion paper on the same and it is an open-ended paper without RBI giving a strong view in any direction. Also, we think that the RBI is unlikely to do any action that will thwart the potential of the credit card industry. Unlike a debit card where you pay money from your Bank account, a credit card Company is taking credit risk and needs to be compensated for the same. We think that it is extremely unlikely that RBI will not consider this while framing its rules. Further, if there were to be small changes to fees *(we think, at worst, they would be small),* these can be passed on to customers through reduced reward points, not affecting the return profile. We should see the end of this issue in 3-6 months' time and until then, people might prefer sitting on the fence waiting for clarity. Another issue that is worrying investors here is that conversion of spends to revolvers is lower today versus pre-covid levels. Revolvers are those customers who pay minimum due and revolve at 3% plus per month. They are great customers for a credit card company from a NIM perspective. However, the market is possibly missing that these same customers are also the worst from a credit cost perspective. Thus, we would be tolerant of a lower revolver percentage, even if it means a slightly lower ROA/ ROE, as long as they are very healthy in absolute terms. As long-term investors, a lower revolver ratio makes the business more resilient and not less, we believe *(having said that, hit on spreads owing to lower yield on account of lesser revolver percentage and higher cost of funds on account of a rising interest rate environment can make the comparable growth in profitability look bad causing near-term pressure on stock)*. This stock has delivered a low single digit CAGR since listing price in Mar'20, but we think the clouds should clear in the next 3-6 months and make room for strong returns.

2. We also own a mortgage financer which has seen more than a 20% fall from our cost and about 27% from its peak. Again, the Company has delivered a very strong loan growth and asset quality. In-fact, its asset quality has been the best-in-industry currently. It is largely a pure-play home loan Company with almost zero developer exposure. Its cost of funds is best in class in the Housing Finance Company (HFC) space. Further, there is a tailwind currently of an up-tick in the real estate cycle. The stock was marred by a fraud that happened in one of its branches regarding some borrowers providing fake IT returns. Thereafter, the Company has done an audit of all its branches and the total amount of fraud detected on this account was ~INR 5 crs *(about ~0.01% of the book)*. However, the market reacted sharply to this news-flow. Thereafter, to add fuel to fire, the CEO resigned giving rise to speculation that there is more to this story than meets the eye. However, it is now disclosed that the CEO has joined another HFC owned by a PE *(if there was truth to any foul play involved, the PE backed HFC would not have hired him)*. The Company reported Q2FY23 results and they are strong as ever with no concerns on asset quality *(best-in-industry).* Guidance by interim CEO continues to indicate very benign credit cost environment. Hunt for an outside CEO is in process and we should have clarity in 3-6 months. Again, we think that this is a strong business going through temporary solvable issues. Market participants do not like to buy into uncertainty though and the stock has taken a beating. Again, we think that as uncertainty goes away in the next two quarters, the stock should give strong returns.

Over the years, we have realised that there is a fine line between patience and stupidity. We hear stories about how some investor held the stock through 50%-70% drawdowns without his conviction being shaken and ended up with mega-bagger returns. Such statements have a high survivorship bias though. The market, many-a-times, is right in its assessment and such sharp falls could indicate an underlying issue with the Company or the industry. Wisdom of the market should not be scoffed at.

Our experience is that stock price fall does question your conviction with every incremental fall. One does more and more work as price keeps falling. Market psychology works in a way that it tries to justify the price. When the price is falling, most channel checks and on-ground research tend to reveal more negatives than positives *(and the same works on the way up; virtues of stocks that trade at 100 PE are stated in beautiful poetry)*. Because most people are coloured by the price, you end up only finding reasons that justify the price.

One mental model we have found useful to tackle this problem stems from the Bayes Theorem. Let us look at the basics of the theorem below:

"We must have what we call a prior belief about a hypothesis (this is based on the base rate of a certain thing happening).

Now we have incremental information post the prior belief.

The question that Bayes Theorem answers precisely is the following:

"What is the revised (posterior) belief about the hypothesis given the incremental information?""

While we will not go into the maths, the important insight of the theorem is that prior odds have a meaningful bearing on the posterior probability. However, when an event occurs, the market just focuses on the event ignoring the prior odds. A small fraud is reported and the market starts factoring in a massive fraud or we see a quarter of low growth and the market starts factoring in end of growth period. However, Bayes theorem requires us to think of our beliefs before the event and while beliefs should change with incremental information, if our prior beliefs were based on a very high base rate, a one-off incremental information should not rationally require us to change our prior beliefs materially. Nevertheless, it also requires us to update our base rates continuously. Posterior odds after Event 1 become the prior odds for Event 2. Thus, if there is another negative event after the first event, the posterior odds post Event 2 could become very adverse. And at this stage, it might become necessary to completely change our beliefs.

While we never do the maths when we encounter such events, the important thing is to understand the fundamental logic behind the theorem. The market reacts to the incremental news or event sharply, often ignoring the prior odds or the base rates. This creates an opportunity because your assessment of posterior probability can be very different from the market's, giving you conviction to take a contrary view. It is paramount to fish in waters where you have a very high base rate though.

We have continuously tried to fish in waters where base rates of winning are high – choosing companies with proven financial track record, evidence of competitive advantages, competent managements, and reasonable valuations. This allows us to face negative events with more conviction as we know that base rates are favourable in the water that we have chosen to fish in.

In the end, we would like to wish our investors and readers a very happy and a prosperous Diwali.

Thank you for a patient reading.

Regards
Rohan Advant, CFA
Sr. Portfolio Manager and Associate Director

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

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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

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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.

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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) were used previously, and the Benchmark has been revised to BSE Smallcap Index (33.33%), BSE Midcap Index (33.33%) and Nifty (33.34%). The Gross Return (wherever mentioned) 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 ECIP 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.