MULTI-ACT
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PMS NEWSLETTER | DEC - 2022

Moats & Special Situations Portfolio

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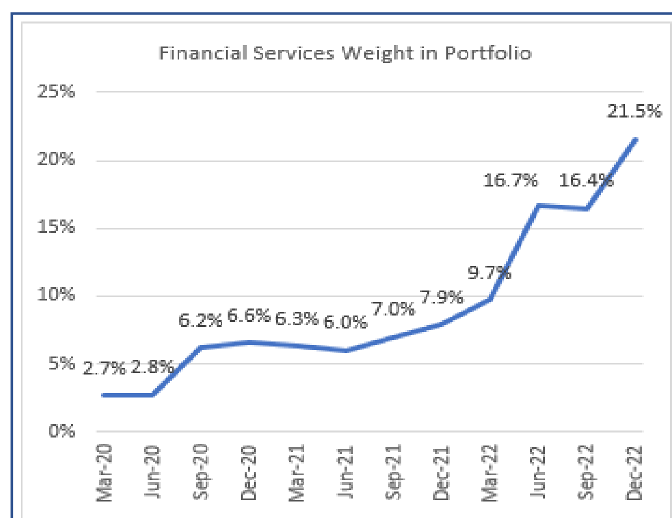
Date: 5th Jan 2023

Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (M&SSP) as of 31 Dec 2022.

Portfolio Performance [1]	Equity Allocation	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		14.3%	12.3%
Dec 2022 Quarter	75%	5.6%	3.2%
April-Dec 2022		7.6%	5.5%

In our December 2021 Newsletter last year, we had presented our thesis on Financials (Lenders) and the reasons for our overweight in the sector. In the last one year, that sector has done well. There is still some upside left in that sector in our opinion, but the margin of safety has certainly reduced compared to a year ago. Today, our exposure in Financial Services (Insurance + AMCs) has materially risen due to a combination of Growth & Valuation comfort. Most of these stocks have corrected in the last one year and are close to the March 2020 (Covid scare) valuation multiples. So, what is the market concerned about?

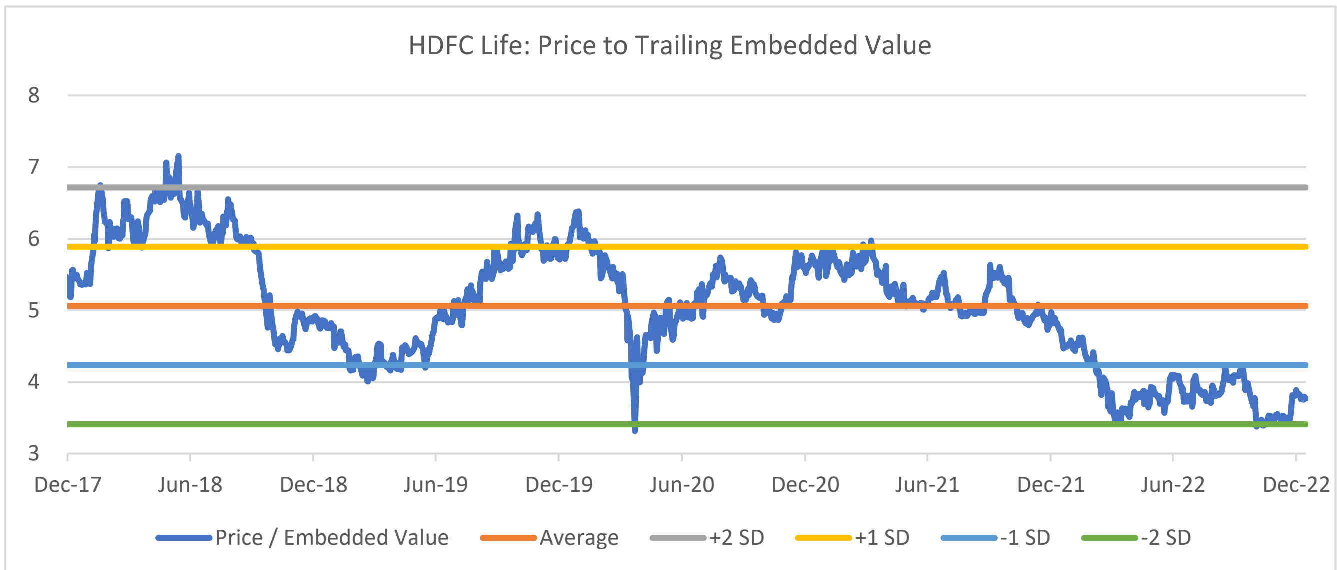


Life Insurance:

In India Life Insurance has been sold over the years more as a savings product with limited cover. Thus, in India, underinsurance is a bigger issue than under penetration. As per Swiss Re, there is 83% gap between protection required vs protection taken. Increasing penetration and bridging of the protection gap is expected to provide long term growth opportunity to the industry. More importantly margins for the industry, which are materially lower as compared to global peers, would continue to improve as the mix shifts more towards protection and Non-Par savings.

Life Insurance stocks have corrected in the last one year. While valuations have been frothy in the past and with the limited history, it is difficult to be sure of a low, HDFC Life (for example) is close to valuations that it traded during March 2020 Covid lows. In this same period, the embedded value has grown at 17%+ CAGR along with increase in Value of New Business margin.

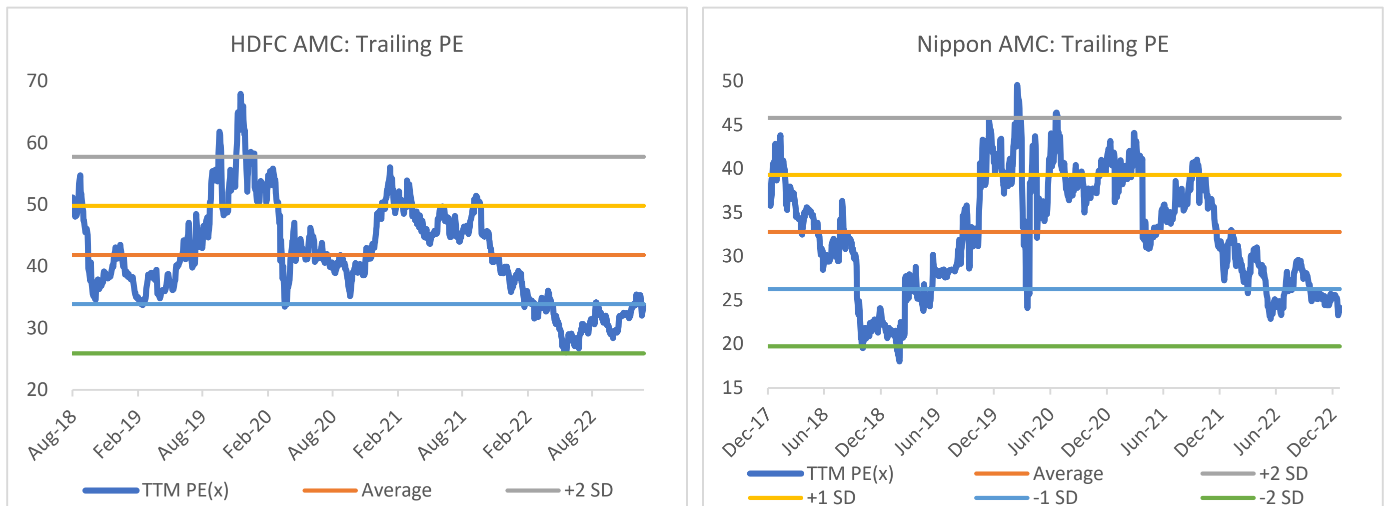
[1] Benchmark is an average of the BSE 500 and BSE Mid Cap index. Benchmark Performance is calculated using Total Return Indices. Equity allocation mentioned above is for older accounts. The above returns are consolidated for all clients, time weighted and post management and performance expenses. The 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. Inception Date is 27th January 2011.



Market may be concerned about 1. The impact of rising interest rates on the embedded value, which in simple terms is the present value of estimated profits from the business underwritten by the company. This has a negative sensitivity to interest rates 2. higher interest rates are making some of the traditional fixed income products like Bank Fixed deposits relatively attractive again vs Insurance savings products. 3. The Covid experience, which led to an increase in Re-Insurance rates which resulted in jump in pricing of Life Insurance vs pre-covid by ~30%. This along with high base of FY22 is expected to put pressure on growth. 4. Potential risk to tax benefits on insurance products in the Budget.

When we add any stock to the portfolio, we seek to hold the stock for 3 years at least. Thus, we are willing to look at companies/industry that could be going through near-term uncertainty/negativity if the longer-term story is intact. With respect to market concerns, on points 1 & 2 above, the estimated sensitivity to interest rates, is for every 1% increase in interest rates; the negative impact on embedded value is a maximum ~3%. Secondly, while interest rates may have further upside, the worst in terms of rate increases may be behind us. Point 3 can affect the growth in the near term, but we believe, will not derail the structural growth story of the industry. Tax benefits are a material decision driver in case of savings products and any tinkering with these benefits would have an impact on the industry and could alter the direction of the industry. But in our opinion the government would continue to be supportive in the foreseeable future as it tries to address the under penetration and under-insurance issue. In addition to these industry concerns, HDFC Life has specific risk emanating from the merger of HDFC Bank & HDFC Ltd with regards to regulation that requires the promoter bank to have either a 50% stake or less than 30% stake. Thus, there is an overhang to bring the promoter stake in HDFC Life from ~49% to 30% once HDFC Bank becomes the promoter. HDFC group is seeking approval to increase their stake above 50%, as the drop below 50% was due to an acquisition. In the event they are required to reduce the stake to 30%, we believe there would be enough buyers for the stake and the recent regulation allowing a single entity to hold up to 25% stake in an insurance company could bring in strategic buyers as well. We feel most of the headwinds being faced by the industry are cyclical and the worst of their impact could be behind us. We feel comfortable about having increased our exposure to this sector.

Asset Management Companies:
AMCs have been beneficiaries of financialization of savings over the last decade. The industry has superior fundamentals with high free cash flow generation and return on capital employed. But despite the strong underlying trend, AMC stocks have corrected in the last one year.



What is the market concerned about? The regulator had disallowed the previous model of High upfront – Low Trail commission for MF Distributors. Thus, incrementally the model shifted to higher trail commission instead of upfront fees. Increased competitive intensity in the MF industry led to higher sharing of commission as well, on incremental AUM. This led to a churn in the industry AUM as distributors started moving their clients from low trail commission to higher trail commission AUM leading to Revenue yield pressure on AMCs. Secondly, the industry was already constrained by slab-based Total Expense Ratio (TER) caps on AUM which the regulator had introduced a few years back. These two factors have led to revenue yield pressure on AMCs, which has resulted in lower revenue growth as compared to underlying equity AUM growth. As per our understanding around 2/3rd of the churn from Low trail to High trail has already taken place and the incremental shift would be relatively slower. Thus, we could be close to the bottom in terms of yield pressure. While correction in the stocks in the last one year would be mainly on account of yield pressure, the other longer-term concern for the market is the shift from Active funds to Passive Funds/ETFs. Current sharp jump in ETF + Index Funds AUM (~20% of Equity AUM) is largely driven by EPFO investments and can't be considered as a trend of individual retail investors in India (at least) opting for passive ETFs. The share of ETF + Index Funds AUM driven by individual investors would be in the mid-single digit percentage. In India, ~81% of Retail investments in Equity MFs come through distributors, majority of whom still recommend actively managed MFs. Outside of US and UK, passive funds have a smaller share in other countries. In our opinion, the threat of Passive funds taking AUM from Active MFs in a material way is still some time away. Considering that the worst in terms of revenue yield pressure could be behind us and with the valuation comfort we have relative to history, we are comfortable increasing our exposure in this sector as well.

Asset Allocation

Our equity weights have reduced to 75% for older accounts. For new accounts our initial weight is ~45%.

Portfolio Activity

Business Model Allocation	Mar-22	Jun-22	Sep-22	Dec-22
Moat	24%	19%	16%	19%
Limited Moat	46%	53%	59%	60%
Moat + Limited Moats	***70%***	***72%***	***75%***	***79%***
Special Situations	27%	28%	25%	21%
Regulated Utility	3%	-	-	-
Grand Total	**100%**	**100%**	**100%**	**100%**

Sector Allocation	Mar-22	Jun-22	Sep-22	Dec-22
Financials	29%	29%	31%	29%
Financial Services	13%	21%	21%	28%
FMCG	18%	15%	14%	11%
Auto & Auto Ancillaries	8%	6%	6%	11%
Pharma	3%	4%	6%	6%
Real Estate & Infrastructure	7%	7%	5%	5%
Information Technology	13%	11%	10%	4%
Materials	-	3%	4%	3%
Capital Goods	5%	5%	3%	3%
Utility	3%	-	-	-
Grand Total	**100%**	**100%**	**100%**	**100%**

We added an AMC to the portfolio in line with the thesis we discussed earlier. We also added a Private sector Bank which was a partial switch from HDFC group and SBI. The bank has been going through a transformational journey, wherein the internals of the business have improved, building a base for superior fundamentals as compared to its own history. Despite the underlying improvement, the stock was available at reasonable valuation as compared to its own history. Thus allowing us to benefit from potential upside if the market rerates the stock. We also added a couple of Auto Ancillaries prior to the festive season looking at the build-up of demand. Both the businesses are agnostic to base technology – i.e. both companies have products that are relevant to both Electric vehicle as well as Internal combustion engines based vehicles.

We reduced our exposure in IT as we feel there could be pressure on tech spends when clients prepare budgets for the next year, considering slowdown in the developed economies. We have exited Bandhan and Bajaj Consumer which have been slightly longer-term holdings. In case of Bandhan we were disappointed with the post covid experience in asset quality as compared to its peer group and when compared with its own history during stress events like demonetization and the Andhra MFI crisis. Our understanding of the quality of underwriting of Bandhan which was one of the pillars of our thesis was negated over this experience and we decided to exit the stock. In case of Bajaj Consumer, the managements intent to transition the company from a single product/brand company to multi-product, while a good long-term strategy, will take time and material investments through advertising which will impact profitability in the medium term. Our concern is the success of new brands would be known only in the medium to long term. Profitability of

the core brand itself has been under stress as well. We are not sure of the timeline of this transition and the probability of success and thus decided to exit despite valuation comfort. We had bought Gland Pharma and had to exit within a quarter. We liked the differentiated positioning of Gland Pharma (i.e. injectables) in the pharma sector, the strong compliance track record and overall injectables opportunity globally. The stock had corrected sharply due to disappointing business performance vs market expectation on account of shortage of key components. We had bought an initiating position assuming the shortages to be temporary; a fact that was corroborated by their suppliers as well. But post the latest result in the interaction with management on the earnings call, we understood that the company is facing pricing pressure in the US business which could continue in the medium term. We decided to exit and wait for the pricing pressure to stabilize before we take a fresh look at the business.

Regards,

Rohan Samant	Rohan Advant
CIO	**Sr. PM & 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

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 2022 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 Moats and Special Situations portfolio was created on 27th January 2011. Performance has been compared with Total Return of the Index. For Moats & Special Situations 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 MSSP 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 of high quality Moat or Limited Moat businesses at fair value or discount to fair value OR in Non Moat businesses at deep discount to fair value as special situations. 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).

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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.

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