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Date: 17th April 2024

Emerging Corporates India Portfolio (ECIP)

Dear Investors,

Below is the performance of the Emerging Corporates India Portfolio (ECIP) as of 31 Mar 2024.

Portfolio Performance	Total Portfolio Returns	Benchmark
CAGR since Inception *(Annualised)*	12.4%	15.4%
FY24	17.6%	40.2%
FY23	-8.9%	-0.9%
FY22	8.6%	22.3%
FY21	79.2%	78.6%
FY20	-13.2%	-26.5%
FY19	13.3%	9.7%
FY18 *(Since Inception - April 28, 2017)*	9.7%	10.0%
Q4FY24	-3.5%	4.5%
Q3FY24	4.7%	12.4%
Q2FY24	1.6%	5.5%
Q1FY24	14.6%	13.2%

- *Please check relative performance of other portfolio managers by clicking on this link*
- *The Benchmark has been revised from average of the BSE Smallcap Index, BSE Midcap Index and Nifty to S&P BSE 500 TRI with effect from 1st April 2023 as per SEBI/APMI circulars*
- *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 28thApril 2017*

Despite some shakeout in the first half of March, the markets bounced back later in the month to end another positive quarter, building up further on the already strong gains of the first nine months. Overall, for FY24, the key market indices BSE 500 and Nifty 50 were up ~40% and ~30% respectively, while the ECIP portfolio delivered ~17.6%.

The performance of individual stocks within the portfolio has been equally divergent with the entire return being attributable to just 5 stocks (~1/3rd of the portfolio by number of stocks as well as weights). Several stocks which drove returns this year were laggards in previous years. Amongst the balance, some earlier laggards continued to detract from performance even this year. The logical question for investors could legitimately be why do we hold these stocks that have dragged our performance lower year after year?

As the saying goes, “stock prices are slaves to earnings”. As companies report their earnings, market absorbs the incremental information and stock prices adjust to factor any positive or negative surprises and/or any change in the outlook for future earnings. Therefore, from a short-term perspective, stock price movement is explained by earnings surprises. From a longer-term perspective, however, a company could disappoint on near-term earnings and yet accrete long-term business value if the underlying earnings power of the business stays intact.

Stocks that have detracted from our performance are those where there have been negative earnings surprises for one reason or the other. However, our core thesis for each of these companies, based on which we assess the long-term earnings power has stayed intact, and therefore continue to remain in our portfolio.

Some examples include:

- an NBFC that caters to an under-penetrated market, continues to expand its customer franchise, and has demonstrated strong growth in key operating metrics; has disappointed on near-term earnings due to a compression in net interest margins. Since the business compounding is structural and margin compression is cyclical; we believe profitability would surmount the current margin challenges once the margin reset is completed (we believe that we are at the tail end of that cycle) and thereafter once cyclical normalization takes place that would be an added tailwind. Given the strong growth in core metrics, we believe that the long-term business value has increased even as reported earnings have stagnated and therefore continue to hold the stock.

- an auto ancillary company saw negative earnings surprise on account of a temporary disruption in its higher margin business due to model changeover by a key client. Additionally, recognition of tooling revenues which are characteristically low/no margin in nature led to further pressure on profitability. Since we believe these shorter-term disturbances have no impact on our core thesis and the medium-term prospects of the business; we continue to hold the stock.

To illustrate my point further this year our top performer was an asset management company (AMC) that went through a similar challenge of weak earnings performance over FY21-23. The Mutual Fund industry transitioned from the old upfront commission regime to the new TER regime in Oct'18. Under the new regime, SEBI banned payments of upfront commissions to distributors and mandated a scale-based limit for maximum permissible TER that can be charged by an AMC. Since, upfront commissions accounted for a significant portion of a distributor's revenue, they were compensated with a higher trail commission in lieu of their loss. This led to a sharp jump in margins for all AMCs in the first-year post transition (upfront commission expense went to zero) and the impact of higher trail commission came through over the next few years. Post the initial jump in operating margins in FY2020, as the impact of higher trail fees started flowing through; margins contracted. Artificially high earnings in FY20 combined with scale based declining TER structure under the new regime led to an adverse negative impact on short term profitability during FY21-23 even though underlying AUMs kept growing. If we ignore the one-off pop that took the margins to 41 bps in FY20; the AMC has been able to protect its core operating margins ~35-36 bps despite the declining TER under the new regime due to an improving business mix in favour of higher margin equity assets. Due to the weak near-term earnings outlook, the stock was stuck in a range over FY21-23 and when the SEBI contemplated a further revision to the existing TER structure, that uncertainty led to the market factoring the worst and by March 2023 the stock fell even below its March 2020 Covid panic lows. Even though the outlook was uncertain and the stock had been a material underperformer for us over FY21-23, we added to our position during the fall as we believed the worst-case scenario was already being factored by the market and there was a possibility that the SEBI may implement a diluted version of their initially proposed changes. As it turned out, post consultation with the industry, SEBI put the entire proposal on the backburner and implemented no changes. Additionally, since the period of transition was behind, the gap between AUM growth and profit growth narrowed in FY2024. Confluence of these factors with other positives like market share gains on the back of improved fund performance and favorable equity markets lead to a strong bounce in profitability and an even stronger +120% bounce in stock price.

We have been invested in this company since 2018. Overall, from our first purchase around 5 ½ years back, the stock has delivered point-to-point compounded returns of around 20% compared to an EPS CAGR of 16%. Additionally, since we have calibrated our weights based on prevailing valuations at different points, our own XIRR in the stock is far higher at ~45% (using a representative account). However, if one looked at the point-to-point returns at the end of last year, the 4 ½ year CAGR was just 5% compared to EPS CAGR of 14%. This shows the amount of impact a year's return can have even on long period returns of more than 5 years.

More importantly, this reemphasizes what I wrote in the September 2023 Newsletter:

"Our approach focusses on capturing value created through the intrinsic compounding of a business. And by nature, this compounding takes time to build up. For e.g. a business that compounds at 20% annually, takes 3 years to add 72.8% in value while annual volatility itself is 50-100% or even more in most stocks. Therefore, on many occasions even as the business continues to deliver on fundamental performance, over shorter time frames, we may or may not see that translate into similar stock price performance as it can get affected by general volatility in stock prices. However, if we expand our time horizons and allow compounding sufficient time to build up, it becomes a far more powerful force."

Portfolio actions during the quarter

Additions:

- We added a CRO/CDMO company that provides outsourced research and manufacturing services to innovators. The company is a beneficiary of structural tailwinds like increased outsourcing by global innovators and availability of low-cost scientific talent in India. However, despite the tailwinds and lower scale, historically the company's growth has lagged its Chinese counterparts. Based on our understanding, one key reason for relatively lower growth has been the company's absence from the manufacturing business. Unlike the research business, which is project based in nature; manufacturing business is more long-term contract based in nature. Also, the size of manufacturing contracts tends to be much larger. Not being present in the manufacturing business, it lost the scale opportunity that came as the molecules moved from research to the manufacturing phase despite having the client relationships and credibility in place. However, over the last few years, the company has gone through a large investment cycle in creating its manufacturing infrastructure. Additionally, it bolstered its capacities inorganically. We believe with the addition of manufacturing capabilities; the company's long-term growth potential has improved substantially and therefore have added the company to our portfolio.

- We added a pharmaceutical intermediate manufacturer that supplies intermediates to both innovator and generic pharma companies. Being efficient on cost and clear on its intention to not compete with its customers by forward integrating into APIs, the company has been able to garner ~30-90% global market shares in many of its products and is well positioned as a partner of choice for customers that are looking to diversify their supply chains from Europe and China. Our core thesis here revolves around a couple of sizable opportunities in the pipeline, one each in the innovator and generic segment. The innovator opportunity is a direct Europe manufacturing substitution where the innovator's own group company was earlier manufacturing these intermediates in Europe. We believe these specific opportunities can drive strong growth over the next few years. In addition to the pharma business, the company has taken certain initiatives to diversify into specialty chemicals which we consider as an added optionality.

Exits:

- During the quarter, we fully exited our investments in an NCE-CDMO company that we have held for the last 7 years. Over FY17-23, we have benefited from the operating profit compounding of ~17% in the core business in addition to the demerger led rerating where the highly profitable CDMO business and the cash consuming NCE drug development business were split into two separate companies. The nature of the CDMO business is such that supplies for commercial products are made on a campaign basis and once supplied the next order for the same product typically comes in ~12-18 months making the numbers very lumpy. Despite this lumpiness, as the number of products under commercial supply increases, the normalized revenue base builds up and drives long-term compounding. However, in addition to the usual lumpiness in business, over FY22-23, the company has benefited from certain one-off Covid related business which is non-recurring in nature. Due to this, we believe there is a material one-off earnings benefit in the current numbers and therefore a risk of earnings normalization going forward. Additionally, there has been a promoter change as the previous promoters have sold a controlling stake in the business to a private equity company. Pursuant to the transaction, the private equity company has proposed a merger of its unlisted investee companies in the same industry with the listed company. While a much larger combined entity could benefit from improved scale and wider set of client relationships, we believe these synergies will take time to materialize. As the market took a positive stance on the entire transaction (stock was up ~40%) despite negative earnings; we decided to exit our holding in the company. We will continue to track integration of the unlisted companies and based on the business progress and or better valuations could consider re-entering the stock at an opportune time.

Thanks for reading.

Rahul Picha CA, CFA
Portfolio Manager

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 2023 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 S&P BSE 500 TRI. 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 05, 2023 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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