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Emerging Corporates India Portfolio (ECIP)

Dear Investors,

Below is the performance of the Emerging Corporates India Portfolio (ECIP) as of 30th Sep 2024.

Portfolio Performance	Total Portfolio Returns	Benchmark
CAGR since Inception *(Annualised)*	15.3%	17.1%
FY25 YTD	28.4%	20.2%
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%
Q2FY25	16.8%	7.7%
Q1FY25	9.9%	11.7%

- *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 28th April 2017*

We had talked about broadening of portfolio performance on the back of improving earnings of our investee companies in the previous newsletter. This trend has continued with Q1FY25 results being satisfactory for the overall portfolio. Barring our allocation to lenders, returns have been well distributed across companies.

We have ~24% of our capital allocated to the lenders and each of our allocations within the space have faced specific near-term challenges. While these drag current performance, we believe the challenges are not structural and the longer-term growth opportunities remain unchanged. There are times when valuations factor a lot of future potential thereby borrowing returns from the future and there are times when valuations factor limited future opportunities leaving additional scope for upside. We believe each of our lenders belong to the latter category and therefore remain enthused about the prospects of this allocation. We have seen similar story play out in past; more recently in our allocations to the Financial Services sector where the stocks of both the Asset Manager and the General Insurer did exceptionally well once the short-term challenges abated. We believe the lenders present similar possibilities.

When we evaluate investments for ECIP we look for opportunities with a confluence of competitive advantage and growth advantage. Competitive advantage ensures businesses sustain return on capital above cost of capital and growth advantage means there is sufficient headroom for growth to allow the capital efficiency of the business to drive incremental value. Growth without capital efficiency is value destructive and a capital efficient business without growth is less potent. It is the combination of both, that lays the foundation of exponential value creation. Our endeavor in ECIP is to expose the portfolio to multiple such opportunities and then allow compounding sufficient time to work in our favor.

In this newsletter, we would like to discuss one such theme where we find the combination of both these factors –

The Innovator CRO/CDMO Opportunity

Contract Research Organizations (CROs) provide early-stage research services and development offerings to the pharmaceutical industry on an outsourced contract basis. Contract development and manufacturing organizations (CDMOs) specialize in the development, scale-up and manufacturing of drug products for clinical trials and commercial distribution. They offer a range of services that include drug development, process development, analytical testing, formulation development, scale-up, manufacturing, packaging and distribution. These services can be provided on a standalone basis, or as part of a complete end-to-end service offering.

These are critical activities handled by the CRO/CDMOs. Innovators, therefore, carefully select their partners after evaluation of various factors like compliance track record, technological capability, balance sheet strength to invest in capacity, ability to attract scientists, intellectual property protection, etc. While the barriers to entry are high, once a relationship is established, the engagements tend to be very sticky. Innovators rarely change their partners that are involved during the drug development process and generally have limited suppliers during the commercial phase. Since the supplies are for patented drugs, pricing tends to be stable, and innovators are willing to pay a premium for reliability and quality ensuring attractive returns for the CDMO partners.

Structural trends driving growth of Indian CRO/CDMO Industry –

Growing R&D spends and rising outsourcing penetration

R&D spending by the global pharma industry has historically been growing at ~7% CAGR while the R&D productivity has been consistently declining due to rising cost of drug development and longer drug development cycles. The average cost of a developing a drug from the discovery stage to commercial launch, adjusting for expenditure on candidates that fail to reach the market is estimated to be ~$2Bn and the average time taken to develop a new drug is ~10-15 years. Declining R&D productivity amidst such large investments and long drug development cycles have catalyzed increased outsourcing by the global innovators. Additionally, rising share of biotech and virtual pharma companies has provided further boost to outsourcing. As a result, outsourcing penetration has increased to approximately 1/3rd of the market; driving the global CRO/CDMO industry growth of 10% CAGR.

Increasing Market Share of CRO/CDMOs operating from low-cost countries

Besides the usual outsourcing benefits of improved efficiency (clinical trials conducted 30% faster) and reducing capital investments (converting fixed cost into variable cost), outsourcing to CRO/CDMOs operating from low-cost countries offers relative cost advantage to innovators and helps their R&D dollars travel further as the burn rate is slower compared to the western cost base. With the availability of large pool of skilled manpower both China & India based CRO/CDMOs have been a beneficiary of this trend and have gained market share from their western peers.

Chinese CRO/CDMO industry has grown at ~20-30% CAGR over the last decade while the Indian industry has grown at ~15% CAGR. Despite a decade of market share gains, India & China account for just ~3% & ~16% of the CRO market and ~2% & ~8% of CDMO market respectively while their western peers still dominate with ~70% market share.

Emerging Tailwinds for India

Following the supply chain disruptions from China during the Covid pandemic and significant manufacturing cost inflation experienced in the West over the past few years, the prospect of market share gains by Indian CRO/CDMOs has improved. While these are early days, we have started seeing instances of Indian companies gain market share from China and Europe.

One of our portfolio companies won a manufacturing order for an animal pharma drug where the drug substance was earlier being supplied by a single source based out of China (market share gain from China) and another portfolio company won orders for manufacturing intermediates for a prostate cancer drug that were earlier being manufactured by the innovator's group company in Europe (rising outsourcing). Both these drugs are in the early stages of their patent life and therefore provide predictability of revenues.

US Biosecure Act

The U.S. House of Representatives and the U.S. Senate are advancing a new bill – the Biosecure Act that would prohibit the U.S. Government from contracting with "biotechnology companies of concern" and prohibit U.S. life sciences companies with federal government contracts or that receive federal funding from collaborating with such designated companies. The Act has explicitly listed major Chinese CRO/CDMOs as biotechnology companies of concern. The bill has strong bipartisan support and has been passed by the US House of Representatives last month with a vote of 306-81. It is now awaiting a vote by the US Senate before it is sent for the President's signature to turn the bill into a law.

While the Bill includes a provision that grandfathers existing contracts until 2032, new projects would need to move to alternate regions and ex-China CRO/CDMOs could potentially benefit. Many Indian companies have talked about receiving higher flow of inquiries from their customers. Though CRO/CDMO contracts tend of have long gestation cycles, if this trend picks pace, it can lead to a material shift in the growth prospects for the Indian companies.

Historically, India has been the 2nd fastest growing CRO/CDMO market after China and given the structural advantages (low cost, availability of large pool of scientists, largest number of FDA approved facilities outside the US); it seems well positioned for continued market share gains.

Large addressable market and low starting market share provide longevity to the industry's growth advantage period. Our rough calculation suggests that the Indian CRO/CDMO industry would need to grow around 18-20% for the next 20 years to reach ~10% global market share thereby implying a multi-decade growth runway for the industry.

We have had an exposure to this theme in our portfolios since the Fund's inception, albeit through different companies based on specific bottom-up opportunities and as the trend progresses, we believe many more interesting opportunities will emerge over time.

Portfolio Action:

We have had no new additions or exits during the quarter.

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.

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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 2024 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).

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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 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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