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: 31st March 2018

Dear Investors,

Performance

Below is the performance of the Emerging Corporates India Portfolio (ECIP) as of 31st March, 2018. Our closing equity allocation as at March 31, 2018 is *~60%* spread into 15 companies and balance is in liquid schemes.

Portfolio Performance *(not annualised)*	Total Portfolio Returns	Benchmark Returns
Since Inception	9.8%	9.6%
Q4 FY2018	-1.5%	-11.0%
Q3 FY2018	6.2%	17.4%
Q2 FY2018	1.6%	5.0%
Q1 FY2018 *(Since April 28, 2017)*	3.4%	0.0%

- Benchmark is an average of the BSE Smallcap 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.
- Inception Date is 28th April 2017.

We will judge ourselves based on at-least three years of performance as our strategy is designed to capture opportunities that, in our understanding and estimation, should work over a three to five year period. We saw a general decline in the market levels in this quarter, and more so, in the small and midcap indices. Our general approach is to identify Companies that truly fit the "Emerging Corporate" definition, develop conviction on the competitive advantages and the growth runway for these Companies and invest when we think the price offers a reasonable ~5 Year prospective return. Our equity allocations have been low because we have generally observed that ~5 Year prospective returns for stocks in our universe have not been satisfactory. While this approach affected our performance significantly in Q3 FY2018 when stocks were running up, the relative performance has improved for this quarter.

Our out-performance this quarter is, in our understanding, a function of two things

a. Our stocks have fallen significantly less than the market because, we believe, that our portfolio is focused on quality Companies with competitive advantages, which have fallen much lesser than the general indices. The brutal fall has been in the low quality *(low RoCE, negative free cash-flows, etc)* with a promise of a turnaround *(the rise in these stocks was also very steep from Apr –Dec'17)*.
b. Our high allocation to cash at ~40%.

Having stated the above, most of our stock holdings are still in their infancy stage for us to make a strong comment on whether our thesis has worked or not *(we have not sold or reduced weight in any stock since inception)*. Thus, the fact that we have fallen less than the market in this quarter or that we did not go up as much in the last quarter has no bearing on whether our thesis is right or wrong and whether we will generate a respectable ~3-5 year performance. In-fact, our company universe selection is not built with the objective of reducing volatility and we would be happy to be exposed to higher volatility if we are convinced that this significantly improves our chances of generating a higher ~3-5 year returns.

In this newsletter, we shall first talk about certain events/ happenings regarding our portfolio companies in the quarter and our take on those:-

1. The NBFC we own disclosed that they shall get merged with a newly formed Bank

As disclosed in the December'2017 newsletter, we had invested in an NBFC where we thought the Company had developed some competitive advantage in certain retail lending categories with a long growth runway, was run by a very able promoter who had turned around an ailing wholesale NBFC into a profitable retail NBFC with RoEs near ~14% *(and moving upwards)* and had developed systems which we thought reduced risk of high NPAs/ blow-up.

Then came the news in mid-January that this NBFC will be merged with a newly formed Bank at a certain swap ratio. And the promoter of this NBFC will head the Bank with its current head stepping down. The Bank is in the process of transforming itself into a retail bank from its current form of having an infrastructure asset book funded through wholesale liabilities. The promoter of the NBFC has already done a succesful turnaround of an ailing wholesale NBFC once and has amongst the best credentials in the country to lead this nature of transformation. However, the Bank faces non-trivial issues with respect to its legacy asset book, its liability side being stuck with fixed-rate liabilities that would taper starting only FY21 and its slow pace of generating CASA owing to a lack of retail franchise. While the NBFC brings in its strengths on the asset side, the liability side is unaddressed even after this merger. Thus, even with the capability of the NBFC promoter and his credentials, the task at hand will be very daunting.

The good part of this idea though, in our understanding, is the valuations. The Bank *(and we shall now become shareholders of the Bank, subject to regulatory formalities)* now trades at about ~1.3x its FY19E adjusted book value after removing all stressed assets assuming zero recoveries *(and while we can never be sure, we seem to be bottoming out on incremental stressed assets)*. While this valuation today is much deserved owing to the low RoE profile of the Bank, it is not factoring in a chance of a turnaround. Thus, if the turnaround were to fail, we are unlikely to lose significantly and if it were to be succesful, it can see a significant multiple re-rating. And we think we are backing a proven jockey who will lead the turnaround efforts.

Nevertheless, this transformation will take time and once the merger is concluded, there might be heavy up-front investments towards creating a retail franchise affecting quarterly numbers. Since the merger announcement, the stock has fallen ~27% as the near term outlook is now rather uncertain *(the fall was partially also due to bond yields spike)*. We have not increased or reduced our weight and have decided to back this transformation with a small weight given our understanding of "reward to risk" profile of this idea.

2. The airline we own is going through engine safety issues for its new aircrafts that have led to groundings of its planes

In our September'2017 newsletter, we had given the rationale for investing into the leading airline operator of the country. Our thesis was largely based on two pillars **a.** the cost per available seat kilometer *(CASK)* of this airline was the lowest in the industry and the difference was only expected to widen over the next 3 years and **b.** our analysis suggested that demand for air traffic in India was seeing a structural up-trend *(amongst the very few industries in the country currently seeing 15%+ volume growth)* and while the supply of seats was also rising, demand was likely to outstrip supply over the next three to five years.

This airline is currently in the process of receiving new aircrafts from Airbus *(called A320 NEOs or new engine options)* and are fitted with Pratt and Whitney engines. The NEO has about 15% lesser fuel burn than the erstwhile version and gives a boost to the CASK of this airline, making its competitive advantage even stronger, especially in an environment when oil is near ~USD 70/b. However, there have been certain issues with these Pratt and Whitney engines that have increased the risk of in-flight shutdowns *(engines above serial no. 450 are currently identified as high risk)*. The European regulator and the US regulator have disallowed the flying of aircrafts with both engines above serial no. 450 but allowed aircrafts with one engine above serial no. 450 to fly *(except for extended operations)*. The Indian media ran this story *(giving their sensational twist)* for a few days and the DGCA *(the Indian regulator)* then banned all A320 NEOs with any engine above serial no. 450 *(thus, being stricter than the European and the US regulator)*. This led to the grounding of 11 planes of the airline we own end of February. Pratt and Whitney currently states that it has identified the issue and have started supplying new engines starting mid-March and the groundings are reducing every-day, as we write. In the past too, aircrafts have gone through a small period of teething troubles whenever new technology aircrafts were introduced and there is no reason for us to believe that this time is very different.

While the news-flow around the engines is unpleasant, passenger growth has been very strong and load factors have been high even in lean months *(like February)*. Further, the Company seems to be steadily gaining market share in the international segment *(mainly to the gulf)*. Company's domestic market share is steady at ~40%. Also, our airline is financially compensated for all its losses owing to engine issues as per its contract with Pratt.

It is important, as investors, to look at the news-flow in context of one's holding period. The same piece of news might be very important for an investor with a six month horizon but unimportant for an investor with a six year horizon. We think that our fundamental thesis of owning this airline is unchanged. And while this news might be grabbing newspaper headlines, we think that this is a temporary phase which will pass in due course of time.

In light of the above, we have actually increased our weight to this airline.

3. The airline we own could bid for the National carrier undergoing privatization

As you might be aware, Government of India intends to privatize Air India and the airline we own could be a possible bidder for the same. The Preliminary Information Memorandum for the same was released on March 28, 2018. The bidder will have to undertake a serious amount of debt *(about ~INR 25,000 crores* *of interest bearing debt)* and try to turnaround the airline that is currently losing about INR ~5000 crores a year.

The airline we own has stated in the past that it's primarily interest in Air India is its long haul operations where it sees a huge potential. The key asset of Air India with respect to its international operations are the slots and bilateral flying rights that it has obtained over the last many decades and which would be very difficult for a competitor to get access to. An able management running an efficient low-cost long haul operation could significantly monetize these slots and take share away from the foreign airlines currently controlling the Indian international air traffic.

However, the current transaction structure seems different from the one that the airline we own would have wanted. As per the current structure, there is no carve-out of only the international operations proposed. Plus the Government continuing to own 24% could act as a deterrent amongst prospective bidders.

If our investee Company were to win the bid for Air India, it will definitely make the next two to three years uncertain for the Company, as turning this around would be a herculean task. However, the two founders of the Company, we believe, are the most able people in the Industry to decide on the viability of this bid and being realistic about their ability to execute on a turnaround. We do repose our confidence in them to take a decision that is in the interest of the long term shareholders of the Company.

4. A mid-cap IT company which is our largest Company gave a revenue and profit warning for Q4FY18

In our June, 2017 newsletter, we had given the rationale for owning a mid-cap IT Company. This currently happens to be our highest weight stock in old accounts. On March 27, 2018, post market hours, the Company issued a revenue warning of USD 8 m regarding their Intellectual Property (IP) segment. While we were expecting at-least a USD 4 m revenue decline in this segment due to pure seasonality, the additional USD 4 m is a negative surprise. The stock was down ~11% on March 28, 2018 *(which was the last trading day in the current reporting period)*.

Our thesis was that, over-time, the Company's strategy of transforming from an outsourced product development (OPD) focused Company catering to software vendors to a digital products and services Company catering to enterprises would bear fruit. And this transformation, while needing up-front investments, would ultimately create a non-linear revenue stream with scope for margin expansion in the future. While the progress on this front was a bit slower than what we would have liked, it was moving in the right direction.

This incremental data-point regarding the revenue warning, we believe, is not something that would suggest a trend reversal. While financial models in excel spreadsheets work in a linear fashion, reality is generally more volatile and lumpy. We need to give some time to promoters that we have carefully identified after a lot of research, to deliver on their plan. While there is always a possibility that we could be wrong in our judgment, we cannot reach that conclusion before we have given the thesis a sufficient amount of time to play out.

In view thereof, we have not changed our stand on this Company.

5. Other events worth highlighting

Other events that were noteworthy in our portfolio Companies:-

- A global competitor of a key product manufactured by a chemical Company we own *(covered in June, 2017 newsletter)* shut its manufacturing plant in December, 2017. Our understanding is that majority of these volumes would flow to our investee Company, it being the cost leader. This development gives us further conviction on the competitive advantage that this Company possesses.
- A Contract Research Organisation (CRO) company we own *(covered in June, 2017 newsletter)* signed a multi-year contract with a global pharmaceutical giant for providing support to its drug discovery division. This gives us more confidence on the product proposition of our investee Company and the value it brings for Innovator pharmaceutical Companies.

Apart from the weight increase in the airline operator, we added two new companies to the portfolio this quarter:-

Company 1

The first Company is a real estate developer specialising in mid-income housing on the outskirts of Tier II cities *(Jaipur, Gurgaon)* or pockets of industrial activity *(Bhiwadi, Halol, Jamshedpur)*. Housing prices in these areas are generally in the range of 4x to 5x of Median Annual Income.

We think that this Company fits the check-boxes of being a high quality real estate play *(and in some ways, unique)* owing to the following:-

a. The Company uses land as mere inventory/ raw material and believes that one should not block excessive capital in hoarding land. Thus, its land bank is note more than 5x of its yearly developmental capacity *(unlike most peers who hoard on to land banks).* This gives it high return on capital employed (*over a full cycle).*
b. Ability to hold on to inventory in difficult times is an important characteristic of a good real estate Company. And this comes from a strong unlevered Balance Sheet. This Company is averse to debt, has a net-cash Balance sheet currently. It has diluted its equity capital only once in its history *(in 2015)*.
c. Our channel checks indicate a top-notch reputation for the Company. This gives them pricing power. Since a house is the largest ticket-size item in the life of a person, good reputation is vital for long term success in the business. Company has ~50% of sales that happen through customer referrals.
d. The Company has a promise to maintain the properties that it sells for a lifetime *(on a nominal profit basis)*. This ensures that the community living concept is enhanced and facilities *(like club houses, swimming pool, etc)* are maintained very well *(this is a unique proposition)*. This enhances the living experience *(we have seen this at play when we visited their properties).* The Company also provides consultation service to its customers who want to sell or lease their existing properties.
e. The Company is run by a young leadership *(brothers from the founder family)* and seem to have the right DNA in terms of creating a strong scalable business and brand *(very clear about their strategy and very transparent even about their failings)*.

f. Conservative accounting – the Company books its revenues/ profits on a completed contract basis *(unlike percentage of completion used by most peers)*. While this might understate profits in the short-term and also make it lumpy, its logic for doing so is that risks truly get passed on from the Company to the customer only post hand-over of the keys. We find such clarity of thought as a rare trait in managements, especially of smaller companies.

While we may be convinced of the management and the product quality, its ability to grow revenues and profits is also a function of the demand-supply situation in the real estate markets that the Company operates in. We recently visited one of the core regions of the Company in NCR and the distress in the real estate market was evident. A general slowdown in the market owing to various reasons has created a demand-supply mis-match resulting in a price drop that has further dried up investment demand. Just to put things in context, Company's current year bookings would be 1/3rd of its bookings three years back.

Thus, while the immediate 12 month scenarios might not be very exciting, we think, that over time with developments like RERA, the real estate market will get more formalized and players with the best-in-class practices will gain the most. We think we are near bottoming out of the real estate cycle, at-least for the Company as its booking are growing on a q-o-q basis, albeit gradually. Also, the Company has received some success in markets far-off from its core geography. This creates exciting possibilities for the Company across the country.

This Industry operates through periods of peaks and troughs and when the tide turns, we feel confident that the Company would see a step-up in its area sold. As an investor, it is always difficult to get the timing right in a cyclical industry. While we could be slightly early, we have taken an initial weight and if valuations allow or we see clearer signs of tide turning, we will add on to the weight.

Company 2

This is an MNC and a global leader in foundry automation equipment solutions and surface preparation equipment solutions. The Company entered India in 1984 and has a first-mover advantage in terms of understanding the needs of the India foundries and applying its global technology towards creating products that meet the unique requirements of Indian foundries. Its closest competitor started manufacturing in India only in 2012 *(28 year after our Investee Company)* and thus, our investee Company has undergone a long learning curve and created trust amongst Indian foundries, difficult for competition to match. When a foundry selects a machinery vendor, it is selecting a partner for 20 years and thus, it is amongst the most important business decisions in that foundry's life. Also, the foundries need a lot of hand holding in the initial days and after sales service post sale. Being the largest in the Industry by-far, our investee Company has a large team that can cater to the day-to-day requirements of its customers. This is reflected by the very high market shares enjoyed by the Company *(close to ~60% and near monopoly in a few products)*.

Indian foundry industry is the 2nd largest in the world having recorded a total production of over 10 MMT. The industry is fragmented with > 5,000 foundries of which 90% are MSMEs and operating the foundries manually. An automated foundry could operate with a workforce that is ~95% lower than a manual foundry. Additionally, the quality of the casting is significantly better and the speed (moulds/ hour) is at-least ~5x of a manual foundry. Foundry owners today face issues regarding labor shortage *(people* *increasingly do not want to work in manual foundries given the inhuman conditions),* high rejection rates and low efficiency. A foundry with a certain volume could solve each of these issues through automation. However, as of date, not all foundries can get automated as automation is viable only for a foundry with a certain volume and India has too many small foundries that do not meet this eligibility criteria. With time though, we are of the view that manual foundries would find it very difficult to survive and either shut down or merge with larger foundries, leading to an Industry consolidation. And this would result in a massive expansion of the foundry automation equipment market.

Given the stagnation in private capex and low capacity utilizations at the economy level, this Company's revenues have stagnated for a few years now. However, based on the way the order book has been shaping up recently, we are seeing initial signs of a pick-up after many years *(key end-user foundry segments of auto and tractors have been doing well – ancillaries planning to increase capacities)*. Again, this is a cyclical Industry and when the capex picks up, we believe that our Company would see a step-up in revenues and profits. In addition to the domestic opportunity, the parent also plans to make India as a manufacturing hub for its global needs and that could potentially add to growth.

Regards
Rohan Advant
CA, CFA
Portfolio Manager
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. The information contained herein does not constitute any guidelines or recommendations on any course of action to be followed by the Client.

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 and is not meant to serve as a professional guide. The client may or may not be holding the Company 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.

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.

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 October 14, 2014 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.