18th April 2021

Aurum Small Cap Opportunities Quarterly Portfolio Update – Q4, FY 20-21

Aurum Small Cap Portfolio Returns, ↑ 29.9% CAGR*
vs. Nifty Small Cap 100 : 9.9% CAGR
Since Inception – 8 years 3 months

↑ 202.8% in FY 2021
vs. Nifty Small Cap 100 : 125.7%

Dear Investor,

We are very happy to share that our flagship PMS ***'Aurum Small Cap Opportunities' has been the top performer** across all PMS catergories for FY 20-21,*** delivering over 200% returns on an aggregate basis. This would not have been possible without the support and encouragement of our clients who chose to stand by us in times of complete uncertainty and panic at the beginning of last financial year.

Yet, we have to unashamedly also admit, that the last financial year also saw record number of clients exit our aforesaid small cap PMS either out of panic or otherwise – mostly in Apr-June 2020 quarter, in the aftermath of Covid-19 crisis. The rationale given for exiting by such clients were:

1. Post covid equities have crashed and will take a long time (years) to recover and therefore lets take out what's available and stay in cash!

2. Small caps can't flourish in a post covid world - so take the money out of small caps and re-allocate to large caps

3. Some clients felt that our performance in CY 2018 and CY 2019 was not up to the mark and therefore didn't want continue in post covid times.

Thankfully, before taking a final call, some of these clients chose to speak to us for our views about the underlying companies in their portfolios and their prospects in a post covid world! Each such client, who we had the opportunity to provide an insight into the fundamentals of their portfolio companies, decided to hold on and they have personally thanked us later in the year for giving them the comfort on the underlying portfolio that solely made them change their exit decision and see the portfolio generate handsome returns thereafter.

*Composite portfolio returns-net of all expenses (mgt fee & other charges) and performance fee, to the extent charged

**As compiled by PMS Bazaar

As an investor, successful investing in small caps is as much about patient temperament as it is about right stock selection! We felt this is an opportune time (when our pms is out-performing across time periods) to share our views through this quarterly update on how should one look at small caps from a 'patient temperament' lens and also share some of our success stories from the same lens.

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We all know Small Caps is a risky universe!

Lack of Liquidity and Price Volatility are well known risk factors while investing in small caps. On any 'bad' day in the market, these two risks play out in full throttle where mostly the fall in prices of small caps is much higher than large caps. However, one also gets to see the reverse when markets are on an upswing. For an investor who is temperamentally of short term mindset, the bad day risk playing out can trigger a sell decision there by creating a bad experience and discouraging him/her to invest in small caps till greed takes over again. For an investor who is temperamentally of long term mindset, playing out of bad day risk does not trigger a sell decision (as long as the underlying portfolio is fundamentally sound) as he or she knows that eventually there will also be good days for the portfolio and rewards will follow albeit with a time lapse varying from months to years. Rather, on the basis of good underlying fundamentals of the portfolio, the latter may choose to add to his small cap positions on a bad day. In summary, subject to a fundamentally strong underlying portfolio, a long term investor is well placed to ride out the higher illiquidity and price volatility risks that exist in small caps!

So is it all about underlying portfolio companies?

Yes it is! Good companies have emerged out of the shadow of wars, natural calamities, political uncertainty and such other macro events to gain back market confidence and deliver healthy returns over the long term. Obviously, any such macro event may make the longer term even more longer but there are enough examples of robust companies (Coca Cola, P&G, Exxon Mobil amongst others) who rode through the great depression of 1929 and/or the World War II to not only regain lost glory but create huge future growth. Given the fact that we see policy or regulatory changes in India more frequently than the west, the need to monitor the portfolio companies more closely becomes imperative here to keep the comfort going on both financial and business levels.

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What are the typical attributes of robust small cap companies?

Each economic cycle brings about a plethora of smaller companies (existing and new) that exhibit high growth prospects and create an aura of being a potential multi bagger. Most, however, tend to falter after a few years of initial promise and only a handful go to become mutlibaggers that they deserve to be. Picking up good companies from such a large lot is like separating 'wheat from the chaff' and that is what makes all the difference in how the portfolio performs over long term. The attributes that we typically look for in a company to pass the muster of being 'robust' are:

- Solid business franchise operating in an oligopoly
- Addressing a large market size
- High customer centricity leading to first mover advantage in creating new offerings
- Credible profit margins across economic cycles
- Debt aversion! Stay zero debt or low debt with an intent to make it zero
- Pays income tax at a healthy rate
- Consistent long term dividend distribution track record

Our job at all times is to be on the look out for such companies and then marry them with one of our various investment thesis that excites us from time to time, keeping a 5-7 years horizon in mind. The journey of 5-7 years is long and one can expect market ups and downs along the way including a few spooky knee jerk reactions. Closely tracking each company (post investment) allows us to remain patient as long as the fundamentals of the underlying businesses are playing out well and helps ride such rough phases of the market with a lot of conviction.

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Do Small Caps always remain small?

We have often been told by prospective clients and their advisors that small caps come to the party only when the markets are doing well – at other times these companies just fall by the way side and many of them aren't ever able to stand up again! Therefore its best to stay invested in large caps and NIFTY 50 stocks. The universe of smaller companies being very large, we are not amused to see many investors and advisors alike carry such an impression. Thankfully, the reality is very different. There are a number of small caps that change orbits in each market cycle to jump to become mid caps and few of them also become large caps in a matter of 10-12 years. If one were to look at the composition of NIFTY 50 stocks and changes therein over the last 20+ years, one

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will not be surprised to see many names which were small caps just about 10-12 years prior to their inclusion in the NIFTY 50 index. You will be surprised to know that some well known NIFTY 50 stocks in the current index, namely; Bajaj Finance, Bajaj Finserv, Britannia, Eicher Motors and Shree Cement were all small caps just 12 years ago. Check out their market cap in INR crores as on 2nd April 2009:

	Market Cap (Rs cr)		
	Current	As on Apr 2, 2009	CAGR
Bajaj Finance	2,78,925	449	79%
Bajaj Finserv	1,50,707	2,785	44%
Britannia Industries	91,700	1,719	44%
Eicher Motors	66,896	600	54%
Shree Cement	1,09,219	2,692	40%

There are many more examples of small caps that have graduated to become mid and large caps and it's a constant evolution that keeps happening with select robust small cap companies in each market cycle! ***So, next time someone tells you that all small caps are a crappy lot, please do share the above statistics with them.***

Yet, it is also true that all good quality small caps may still not graduate to become mid or large caps as the journey of growth also has another very important intangible ingredient called 'Leadership'. The quality and dynamics of the leadership of a company plays the most crucial role in its orbit jumping journey. As managers therefore we also have to have a pro-active exit strategy for some of our investments bearing in mind the management and leadership dynamics once our initial growth thesis has played out.

In our last quarterly update, we reflected on the learnings from our investment journey of 8 years. This time around we wish to take you through the journey of couple of our success stories for better appreciation of the above mentioned attributes of robust small cap companies. This will also shed light as to why investing in concentrated, high conviction small cap portfolio can be like flying a plane. When you take off the weather forecast is sunny but along the way you may suddenly experience turbulence (which is quite normal) before you land at the destination safely.

INTELLECT DESIGN ARENA

About: Intellect Design Arena (IDA) is global provider of digital IT Products to Banks, Financial Institutions & Central Banks, with a presence across 90+ countries comprising marquee clients. The Company has both License and SaaS revenue models for its product offerings.

Investment Thesis:

- Global BFSI space is undergoing rapid digital transformation and IDA's cutting edge products help customers seamlessly achieve this transformation
- Proven & highly rated product basket, with global footprint & references
- Substantially fixed operating costs; future revenue growth to be highly margin-accretive

Risks:

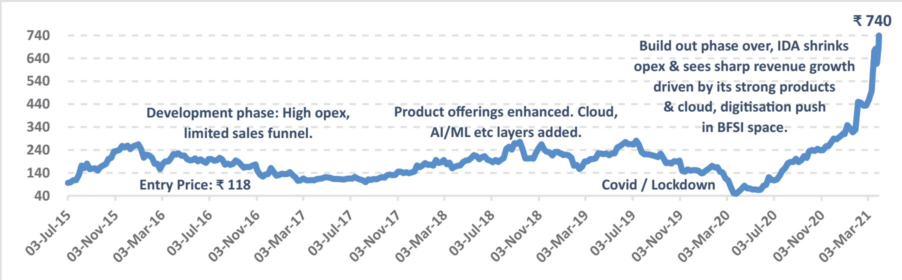
- Historically, Indian IT companies have been service providers, not product companies. IDA faced the risk of low acceptability as a product company in western market during its first few years. This risk has now subsided, with IDA winning marquee clients in Europe and North America.
- Competition from large global players & tech start-ups, technology obsolescence risk & occasional regulatory barriers

Business Evolution: Key Phases

	Product build-out phase			Initial Sales Traction		New Products & Enhancements			Cost Optimisation & Monetization			
₹ Crores	FY15	FY16	FY17	FY18	FY19	Q1'20	Q2'20	Q3'20	Q4'20	Q1'21	Q2'21	Q3'21
Revenue *(Qly Avg)*	152	203	228	272	365	343	327	319	358	346	372	382
EBITDA %	-13.2%	-3.4%	-2.7%	7.2%	9.8%	3.4%	-1.8%	0.9%	15.7%	19.6%	23.2%	25.2%

Note: *Revenue for FYs 15-19 is quarterly average run-rate (full FY divided by 4) for better comparability*

Share Price Chart *(up to 31st March 2021):*



FYs 20 & 21 saw IDA complete its product development cycle & consequently operating expenditure came down sharply. Many large deals culminated in wins after extensive evaluation by marquee clients across Europe, Middle East, North America and elsewhere.

IDA is now ***in a long-term growth phase***, in a relatively oligopolistic high-technology market, with ***non-linear*** margin growth profile. As early & patient investors, we were able to recognize IDA's long-term value before these underlying fundamentals became evident to all and started reflecting in valuations.

PRAJ INDUSTRIES LIMITED

About: Praj is the leader in delivering turnkey process engineering solutions for manufacture and commissioning of bio-ethanol plants, alcohol & brewery plants, water (hi-purity) & wastewater treatment systems amongst others.

Investment Thesis:

- Strong policy push to increase % of ethanol blending in fuel to 20% by 2025 – combination of good economics and good politics! Helps reduce air pollution, helps sugar mills stay economically viable and reduces the foreign exchange outgo. This blending goal requires almost tripling the current bio-ethanol making capacity over next 5 years.

- Praj being the market leader is well placed to grab the largest share of the clearly visible business pipeline on account of the strong policy push. Oligopolistic market as competition is restricted to 2-3 more smaller players creating outlook for strong sales growth with enhanced profit margins over next 4-5 years.

- Emerging businesses – waste-water treatment (Zero Liquid Discharge at plants), critical engineering & Hi-Purity water – gaining critical size as sectors like chemicals, pharmaceuticals, foods and beverages seeing huge investments

- Compressed Bio Gas (CBG) Plants : Another business segment of Praj that is witnessing high growth on account of strong regulatory tailwinds (SATAT scheme) In summary, Praj is set to take off on a new growth phase firing all cylinders!

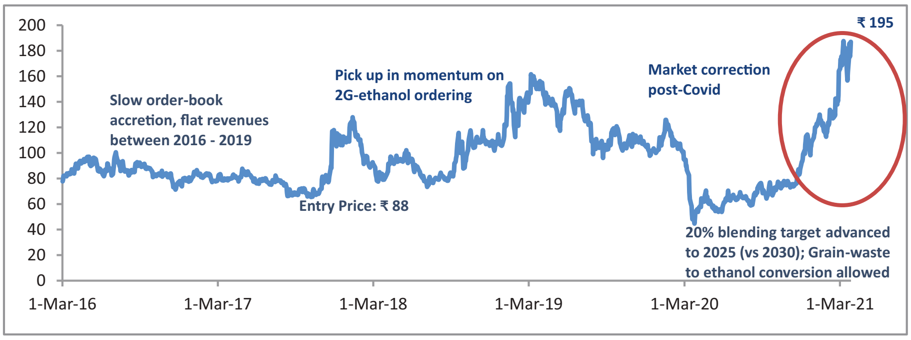
Risks:

- Any slackening of regulatory push towards higher adoption blending of ethanol (1G, 2G) and roll out of CBG Plants

Business Evolution: Substantial pick up in order intake

₹ Crores	FY18	FY19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21
Sales	923	1141	211	294	300	296	129	260	347
OB/Sales (Annualized)	1.0	1.7	0.9	0.7	1.0	1.0	1.1	1.3	1.4
Order Book	675	928	886	1,130	1,157	1,083	1,263	1,408	1,665

Share Price Chart *(up to 31st March 2021):*



Phase I (FY18-FY20) – the phase of patience: The national bio fuels policy was announced in Nov 2017 which expanded the range of feedstock to B heavy molasses, sugarcane juice (1G) as well as damaged food grains, rotten potatoes, corn for ethanol production. Over FY19-20, govt. provided visibility on ethanol pricing manufactured through different routes and made the ethanol pricing remunerative. However, from FY18 to mid FY20, the pace of execution and order book accretion remained short of gathering momentum but chugged along with underlying business fundamentals staying intact.

Phase II (FY21 onward) – thesis starts to play out visibly: In early FY21, mechanism to provide bank finance & interest subvention to sugar mills was put in place. Immediately, order book growth became visible. Advancing the target of 20% ethanol blending from 2030 to 2025 was a pleasant surprise that has fast forwarded company's growth outlook. Huge visibility of topline and bottom line growth has caught the attention of many other investors leading to re-rating of the stock.

Keeping the patience and fighting the fatigue that sets in along the way is only possible when your conviction in the business fundamentals is intact.

Key learnings from our investments in IDA & Praj

We often hear of companies executing flawlessly or stocks giving multi bagger returns. We never hear of the twist and turns in this journey that has ultimately led to multi bagger returns often characterized by a few disappointing quarters and short term setbacks caused by external/internal events. Keeping the patience and fighting the fatigue that sets in along the way is only possible when your conviction in the business fundamentals is intact. Our team spends a large part of their time tracking existing portfolio companies closely and monitoring their business environment by interacting with various participants of the business eco-system which in turn helps in taking better hold/sell decisions.

A word of caution on the second wave of Covid -19

When Covid-19 broke out last year in March, India imposed a complete lockdown like no other nation did and that helped restrict the spread to mainly urban India and also allowed for beefing up the healthcare and ancillary infrastructure to deal with this colossal crisis. Rural India escaped unscathed. Right now what we are witnessing is a wave where mutated strains of the virus that are more infectious are not only infecting large number of people in urban cities but smaller towns as well. This creates a worrisome situation for the country as we are still in the early stages of vaccinating the population at large.

While this may not significantly impact the economy at large barring some disruptions due to localised lock-downs, the human cost that we may end up paying can be huge due to overwhelming of healthcare infrastructure in both urban and rural India. At this time, we can only keep our fingers crossed and remain watchful about ourselves and also caution those around us to strictly follow covid appropriate behaviour.

Any further lockdowns or disruptions will accelerate the business grab by robust companies from weaker balance sheet companies and/or the unorganized sector. These set of companies will continue to show healthy growth in top line and bottom line thereby attracting the attention of local/global investors.

Portfolio Performance

Post the emergence of the pandemic in March 2020, instead of selling and sitting in cash, we chose to sell some of our portfolio companies which we felt are likely to be impacted beyond the short term due to Covid-19 while holding on the others. The liquidity so generated was re-invested in the next few months into new companies whose businesses displayed solid relevance in a post covid world. While we did what we had to do, Mr. Market did the rest and delivered top order returns. During the course of last year, we have also booked profits by fully or partially exiting some of our holdings. The stellar out-performance of our small cap strategy has re-assured us of our disciplined investment process over a long history of 8+ years wherein we have witnessed multiple up and down cycles. It will be our endeavor to continue doing the same with renewed zeal and vigour.

Aurum Small Cap Opportunities

	Absolute		*CAGR*				
	1M	**3M**	**1yr**	**3yr**	**5yr**	**7yr**	**Since Inception**
Aurum Small Cap	15.6%	29.6%	202.8%	12.6%	15.5%	26.0%	29.9%
Nifty Small Cap 100	0.8%	14.5%	125.7%	1.36%	10.6%	11.9%	9.9%

**Chart 1: NRC Research*

**Portfolio performance is on consolidated basis and net of all expenses (mgt. fee & other charges) and performance fee, to the extent charged to clients*

Looking forward to your continued support and encouragement.

Warm regards,
Sandeep Daga

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