LITTLE CHAMPS PMS

AN INVESTMENT STRATEGY FOR INDIAN SMALL CAPS FROM MARCELLUS INVESTMENT MANAGERS

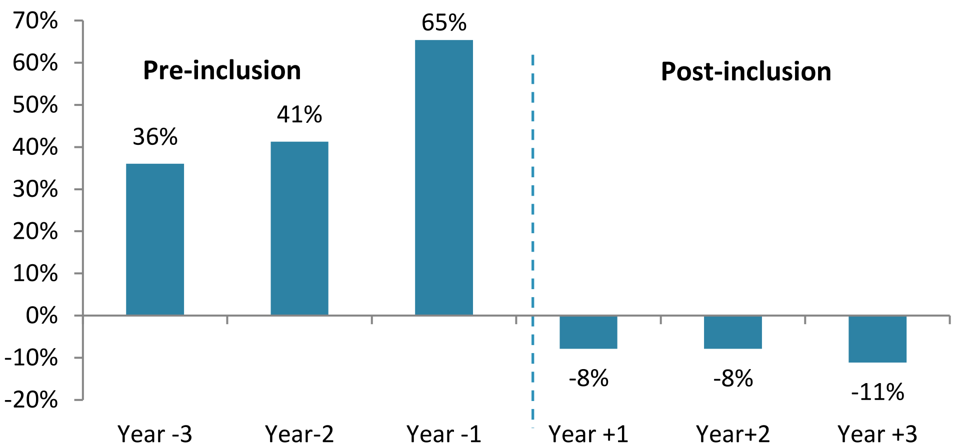
Note: Circulation not intended for US clients

MAY 2023

SMALL CAP INVESTING: OPPORTUNITIES

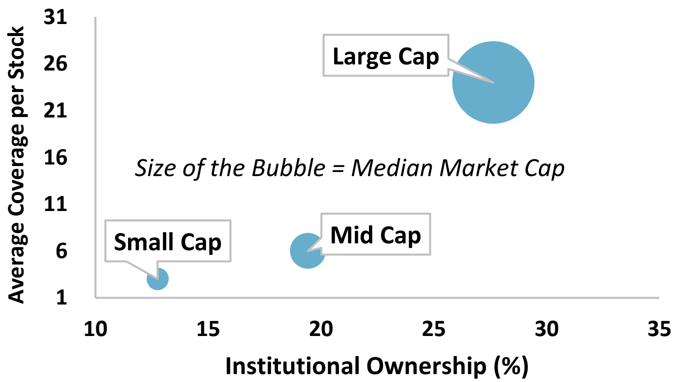
Significant outperformance of stocks before inclusion in BSE 500

- On an average over the last ten years, about ~50 stocks have entered/exited BSE 500 every year indicating a high degree of churn.
- The biggest part of the relative outperformance for a stock entering BSE 500 occurs in the years preceding the inclusion.

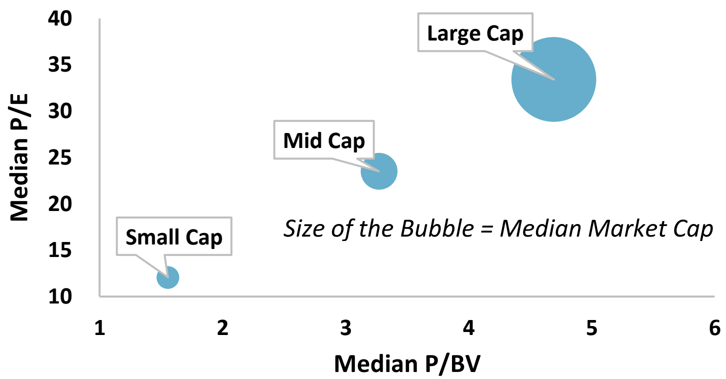


Source: Bloomberg, Ace Equity. Relative returns (to BSE 500) are medians CAGR of stocks that have been included in the BSE 500. For prior returns, returns are measured until 1 quarter preceding the quarter of entry. The above returns calculation is for the entries from June 2003 to March 2022

Small Caps are under-researched and "under-owned"…



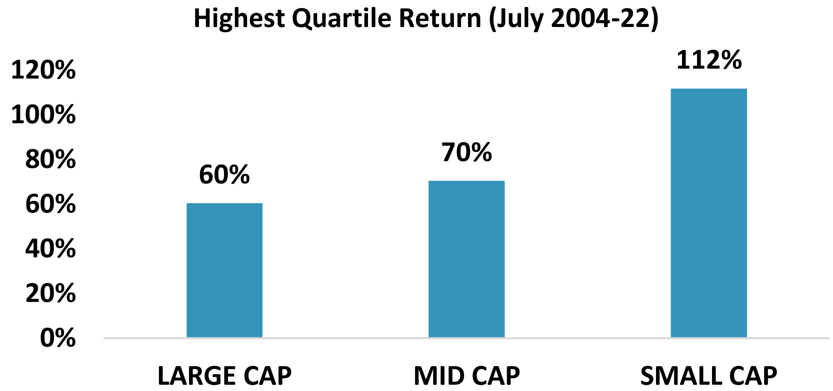
…resulting in significant valuation gaps vs Large caps



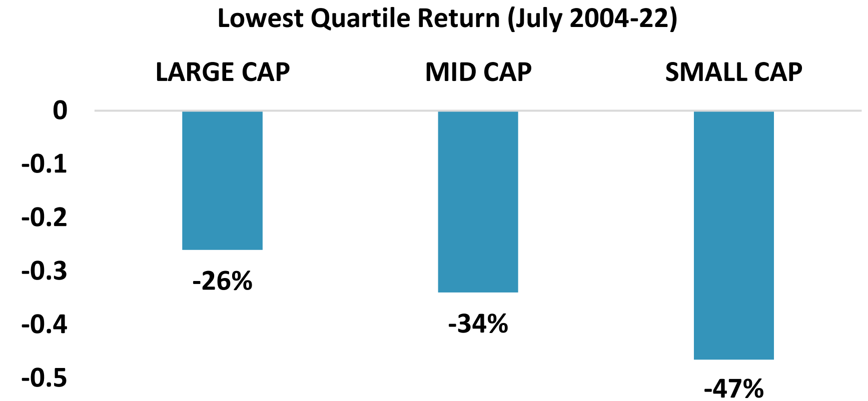
Source: Ace Equity, Bloomberg. Note: (1) We classify companies with market cap of >Rs150bn as Large Cap, between Rs30bn to 150bn as Mid Cap and below Rs30bn as Small Cap; (2) Market cap, analyst coverage and share price data as of May 31, 2022; (3) Institutional ownership data as of May 31, 2022; (iv) EPS and Book value considered for FY22

KEY IS TO 'IDENTIFY' THE RIGHT STOCKS AND 'AVOID' THE WRONG ONES

'Champion' Small Caps (highest quartile) deliver significant outperformance vs comparable Large caps and Mid Caps…

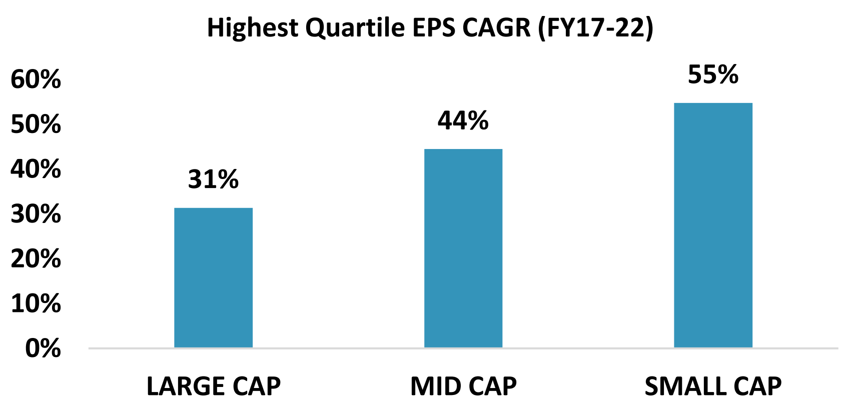


…but 'worst performing' Small caps (bottom quartile) result in much higher wealth erosion than Large/ Mid caps

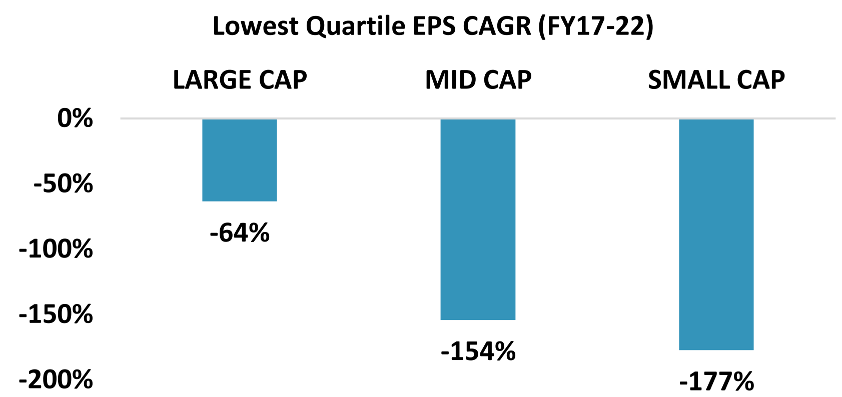


Source: Ace Equity Note: (1) We classify companies with market cap of >Rs150bn as Large Cap, between Rs30bn to 150bn as Mid Cap and below Rs30bn as Small Cap; (2) Returns calculated for three baskets (Large, Mid and Small cap) with equal allocation to each stock within those baskets. Stocks rebalanced annually at July-end based on market cap criteria; (3) No dividends, transactions costs and other charges considered in the above returns calculations.

'Champion' Small caps deliver much higher earnings growth than comparable Large and Mid Caps …



…but weakest Small Caps significantly lag Large and Mid Caps in earnings performance

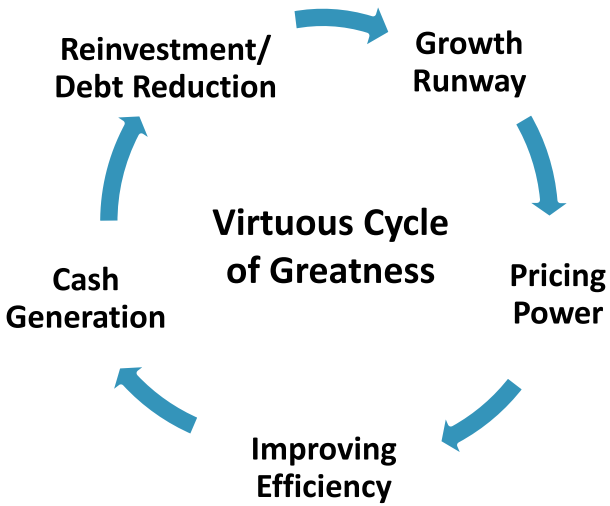


Source: Ace Equity Note: (1) We classify companies with market cap of >Rs150bn as Large Cap, between Rs30bn to 150bn as Mid Cap and below Rs30bn as Small Cap; (2) Earnings growth calculated for three baskets (Large, Mid and Small cap) with equal allocation to each stock within those baskets.

LITTLE CHAMPS: A PORTFOLIO OF NICHE COMPANIES WITH STRONG MOATS & SUSTAINABLE GROWTH

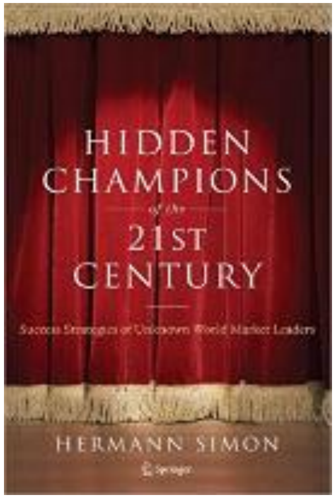
Little Champs

- Identity small-cap companies (market cap <US$500 million) with excellent corporate governance and capital allocation track record and strong sustainable competitive advantages built around brands, business processes and strategic assets.
- Characteristics of a typical portfolio company:
  - Sector leading franchise with stellar track record of capital allocation;
  - Clean accounts and corporate governance; and
  - High growth potential.



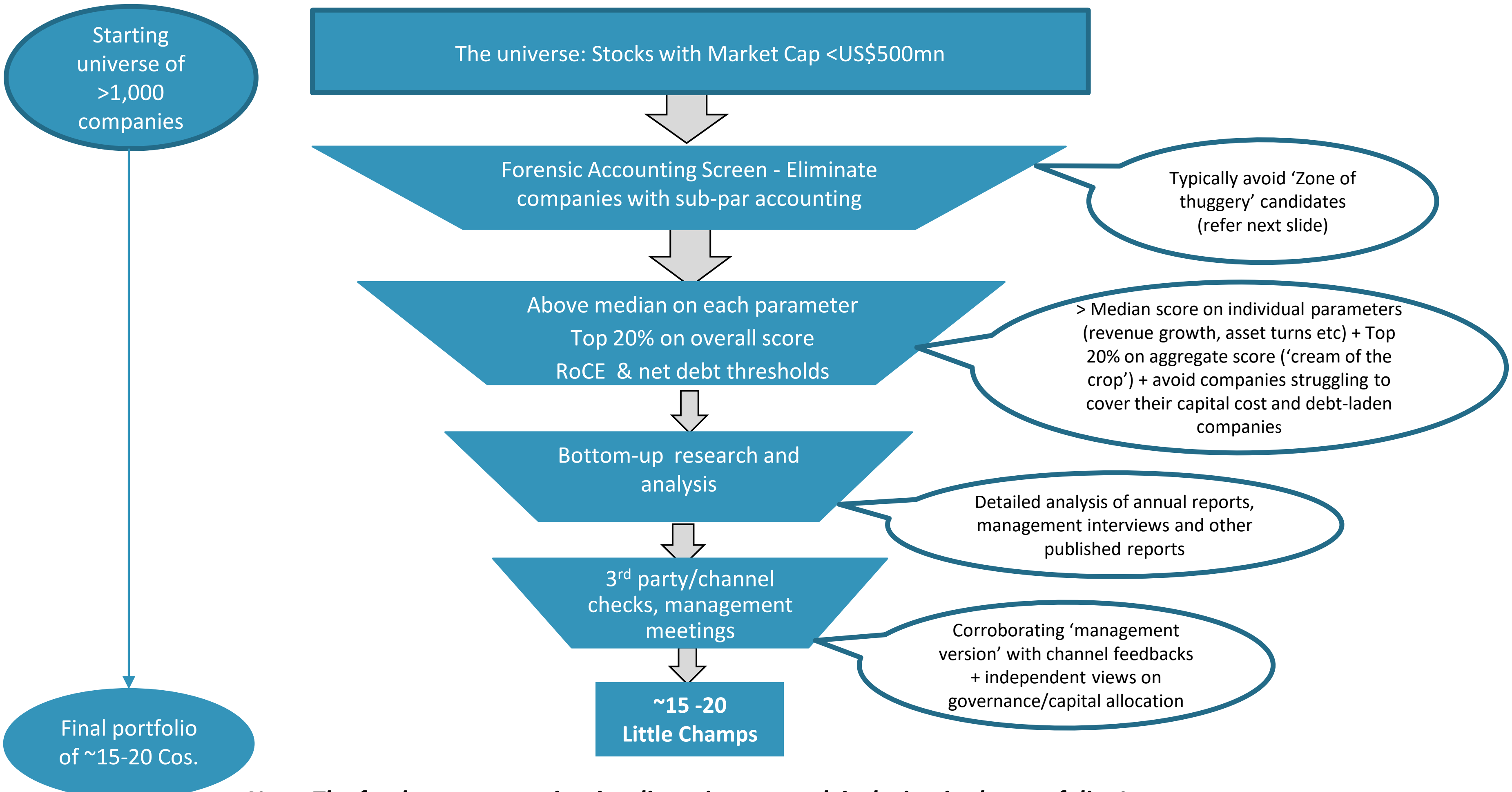
Look for Hermann Simon's celebrated 'Hidden Champions'

- SMEs, often family owned, producing inconspicuous products but ranked top globally for that product.
- Normally work in niche markets for which they design unique products often using proprietary process.
- Operate extremely close to their customers who depend on their products and cannot easily change their source.
- Competitive advantages of such firms are rarely because of cost leadership but more because of quality, total cost of ownership, high performance, and closeness to the customer.



Source: Hidden Champions of the 21st Century, Hermann Simon

RIGOROUS SCREENING AND DUE DILIGENCE TO IDENTIFY THE RIGHT STOCKS AND AVOID THE WRONG ONES



Note: The fund manager maintains discretion on stock inclusion in the portfolio. In case, a stock does not clear the above filters, the fund manager must record and present to the Investment committee for approval, the reasons for such inclusion.

USE FORENSIC ACCOUNTING TO WEED OUT NAUGHTY COMPANIES

Methodology

12 accounting ratios covering income statement (revenue/ earnings manipulation), balance sheet (correct representation of assets/liabilities), cash pilferage and audit quality checks.

Six years of historical consolidated financials.

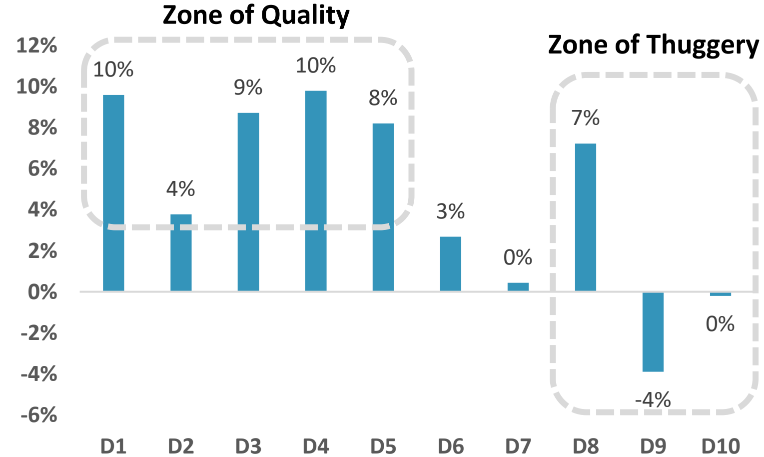
First rank stocks on each of the 12 ratios individually (some examples outlined in the table on the right). These ranks then cumulated across parameters to give a final pecking order on accounting quality for stocks.

Selection of these ratios has been inspired by Howard M. Schilit's legendary forensic accounting book 'Financial Shenanigans'.

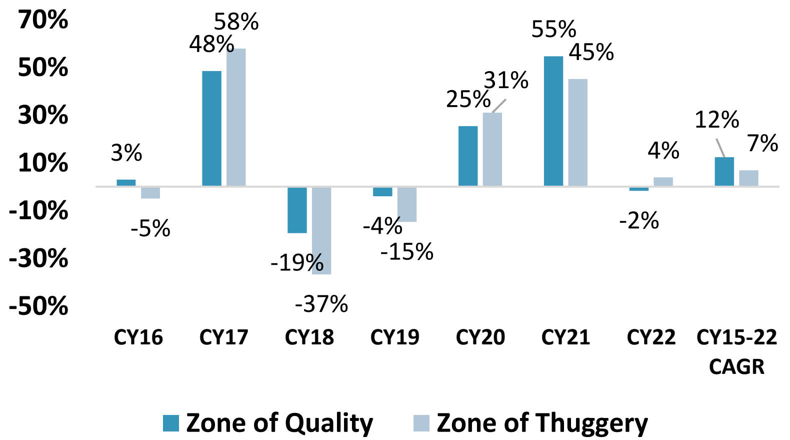
A few of our forensic ratios

Checks	Ratios
Income statement	1) Cashflow from operations (CFO) as % of EBITDA 2) Provisioning for debtors
Balance sheet	3) Yield on cash and cash equivalents 4) Contingent liabilities as % of Networth (for the latest available year)
Cash theft	5) CWIP to gross block
Auditor	6) Growth in auditors' remuneration to growth in revenues

Strong correlation between accounting quality and shareholders' returns



Quality wins and wins big over the long term

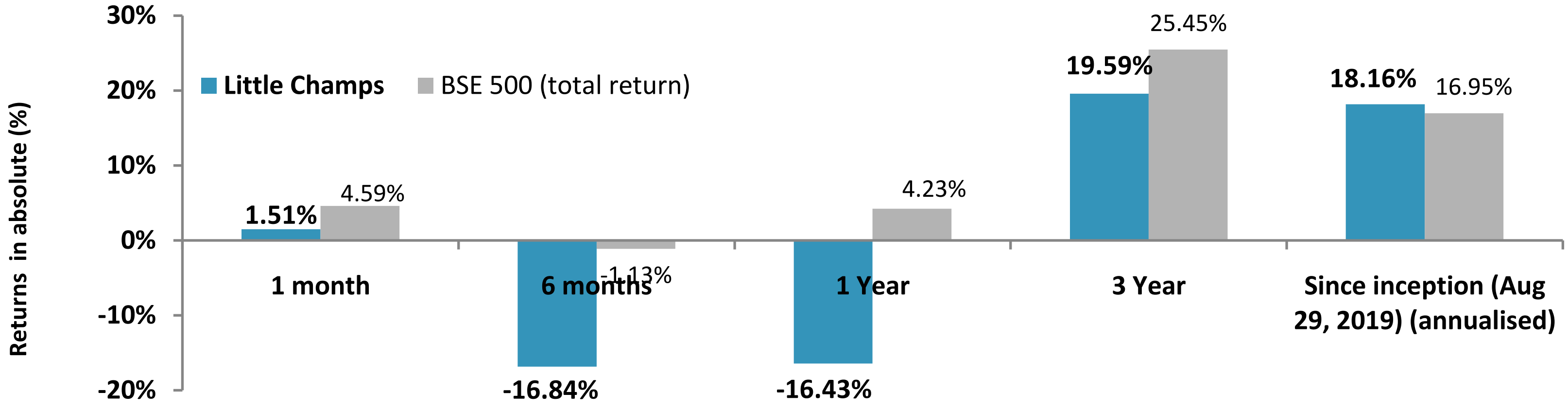


MARCELLUS

EQUANIMITY

LIVE PORTFOLIO PERFORMANCE AND COMPARISON WITH BENCHMARK

Little Champs vs. Benchmark BSE Smallcap



Source: Marcellus Investment Managers. Note: (i) Portfolio inception date is August 29, 2019. (ii) Returns as of April 30, 2023. (iii) All returns are net of fees (as described in point (iv)) and expenses. (iv) Fixed Fees are charged on a quarterly basis and have been charged till 31st March 2023. Performances fees are charged on cumulative gains at the third anniversary of the respective client account, thus the effect of the same has been incorporated for client accounts whose third account anniversary falls upto the last date of this performance period. Performance data is not verified either by Securities and Exchange Board of India or U.S. Securities and Exchange Commission. (v) Returns shown above are net of transaction costs and includes dividend income. (vi) Total returns index considered for BSE Smallcap above.

Little Champs' returns and drawdowns vs Nifty/BSE smallcap

Performance (Since Inception)	Return since inception (annualised)	Maximum Drawdown
Little Champs	18.16%	-36.70%
Performance of benchmark		
BSE Smallcap	16.96%	-38.11%

Source: Ace Equity Note: Maximum drawdown based on daily returns from Aug 29, 2019 to April 30, 2023

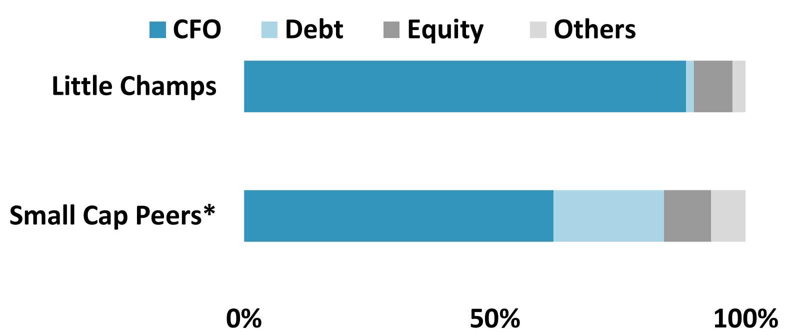
LITTLE CHAMPS' SUPERIOR FUNDAMENTALS VS KEY INDICES

Little Champs vs Indices

	Mkt cap (Rs bn)	EPS CAGR (FY17-22)	RoCE (Avg FY18-22)	Net debt (cash)/ equity (FY22)	P/E (FY22)	P/B (FY22)
Little Champs*	**43.0**	**23%**	**24%**	**(0.1) x**	**34.4 x**	**6.1 x**
BSE 500**	NA	15%	19%	(0.06) x	25.8 x	5.0 x

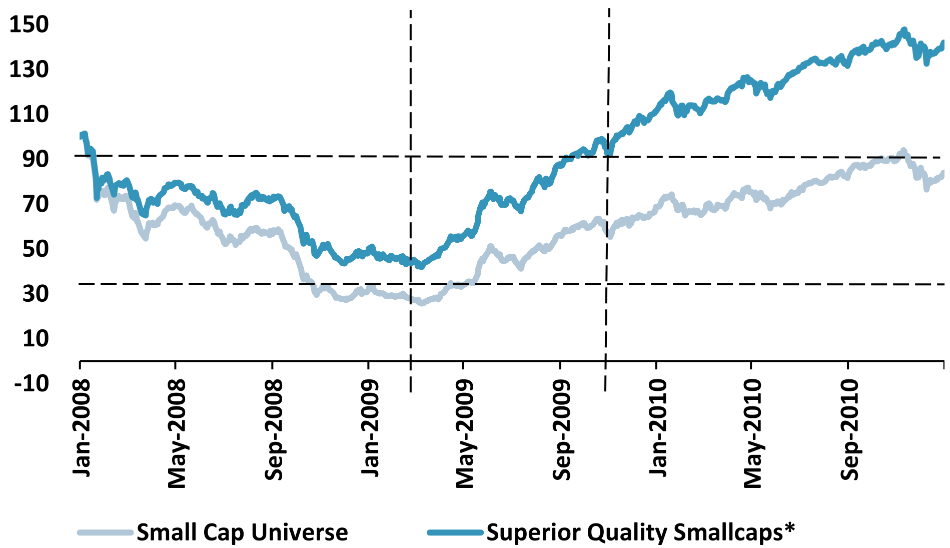
Source: Company, Ace Equity Note: Little Champs numbers are on median basis; ** BSE 500 P/E and P/B calculated on median basis only for companies with positive earnings; Price related figures updated as of April 30, 2023. For RoCE calculation, considered RoE instead of RoCE for Financial companies in the Little Champs portfolio & BSE 500*

Little Champs – Higher RoCE enables sufficient internal accruals to fund growth



** Small peers considered are below US$1bn market cap cos forming part of BSE Smallcap. The calculation shown above is for FY14-19*

Superior quality small caps fall less and recover faster out of an economic crisis (GREAT FINANCIAL CRISIS 2008 EXAMPLE)



*Source: Ace Equity, Marcellus Notes: (i) We consider companies with market cap between Rs1bn to Rs35bn as smallcaps for the above charts; (ii) *We define 'Superior quality smallcaps as meeting three criteria – a) FY04-08 median RoCE of 20%; (b) Earnings growth over FY03-08 of 15%+; and (c) FY08-end net debt equity of 1x and below*

WE PROACTIVELY SEEK TO INFLUENCE CHANGE

	Area of engagement	Desired outcome
Corporate governance	• Our analysts use forensic accounting to keep on eye on the diversion of cash by the 'promoters' of our investee companies	• If we spot diversion on a meaningful scale, we exit • If we spot the beginnings of what look like small scale diversion, we seek adequate clarifications from the management.
Succession planning	• Thirty years from the reforms which opened up the Indian economy in 1991, many of India's leading 'promoters' are aged 70 or over. Hence, they are handing charge to the next generation.	• Through our discussions with suppliers, customers and competitors of a company, we keep a close eye on whether the 'promoter' is on top of his game. • If his successors either do not exist or have not been groomed adequately, we discuss the matter and its consequences with him.
Capital allocation	• Our investment strategy – of investing in dominant franchises with ROCE of around 40% - naturally leads us towards companies which generates heavy Free Cashflow. • If this Free Cashflow is not reinvested wisely, the compounding of the franchise suffers	• If we see a company either hoarding cash or moving into an unrelated, we seek adequate clarifications from the management to understand their thinking on capital allocation. • If we are not convinced about the fitness of what she's doing, we present our point of view (arguing in favour of a different capital allocation strategy) • If six months later we see that our engagement has made no difference, we consider exiting
Regulatory constructs	• Regulation – both in corporate law and in securities market law – is still evolving in India. This creates risks for the unwary.	• By being a part of multiple regulatory committees, by writing in the press and by being vocal on social and broadcast media about regulatory reform, we have sought to improve transparency in the fund management industry in India

THE TEAM AND CONSULTANTS


Saurabh Mukherjea, FRSA


Pramod Gubbi, MBA, CFA


Rakshit Ranjan, CFA


Ashvin Shetty, CA, CFA

EQUANIMITY


Rajesh Sehgal, MBA, CFA


Mark Mobius, Ph.D


Shilpa Sehgal, FCA


Vivek Saxena, MBA

FUND MANAGERS – 1 OF 2

Saurabh Mukherjea, FRSA: Saurabh is the CIO at Marcellus. He is the former CEO of Ambit Capital and played a key role in Ambit's rise as a broker and a wealth manager. When Saurabh left Ambit in June 2018, assets under advisory were $800mn. In London, Saurabh was the co-founder of Clear Capital, a small cap equity research firm which he and his co-founders created in 2003 and sold in 2008. In 2019, Saurabh was part of the five man Expert Committee created by SEBI to upgrade & update the PMS regulations. He was also part of SEBI's Mutual Fund Advisory Committee. Saurabh has written four bestselling books including Gurus of Chaos (2014), The Unusual Billionaires (2016) and "Coffee Can Investing: The low risk route to stupendous wealth" (2018). Saurabh was educated at the London School of Economics where he earned a BSc in Economics (with First Class Honours) and MSc in Economics (with distinction in Macro & Microeconomics). He is Fellow of the Royal Society of Arts.

Pramod Gubbi, CFA: Pramod is the Head of Sales at Marcellus. He is CFA charter holder with a B.Tech from NIT, Karnataka and a Post-graduate Diploma in Management from IIM, Ahmedabad. In the final two years of his 8-year stint in Ambit Capital Private Limited, he was Managing Director & Head of Institutional Equities (from 2016 to 2018). Prior to that he, served as the head of Ambit's Singapore office from 2013-2016. Before joining Ambit, He has also worked across sales and research functions at Clear Capital, a British equity research firm. Besides being a technology analyst, he has also s served in technology firms such as HCL Technologies Limited and Philips Semiconductors' Indian arm in Business Development and Engineering respectively.

FUND MANAGERS (CONTINUED) – 2 OF 2

Rakshit Ranjan, CFA: Rakshit is a Portfolio Manager at Marcellus Investment Managers. He holds a degree in B.Tech from IIT (Delhi) and is a CFA charter holder. Rakshit spent 6 years (2005-2011) covering UK equities with Lloyds Bank (Director, Institutional Equity Research) and Execution Noble (Sector Lead analyst). Since 2011, Rakshit led Ambit Capital's consumer research franchise. He launched Ambit's Coffee Can PMS in Mar'17 and managed it till Dec'18.

Ashvin Shetty, CFA: Ashvin is a Portfolio Manager at Marcellus Investment Managers Private Limited. Ashvin has more than 10 years of experience in equity research, having led the coverage on automobile sector at Ambit Capital from 2010 to 2017. He thereafter worked as a senior analyst for Ambit's mid and small-cap portfolio management services till November 2018. Prior to joining Ambit, he worked with Execution Noble as an analyst covering consumer and media space. He has also worked with KPMG and Deloitte as statutory auditor from 2004 to 2007 gaining extensive experience across Indian accounting standards and financial statement analysis.

PMS STRUCTURE

Marcellus offers the Little Champs Strategy in a PMS construct

- **Fixed fees:** 1.5% per annum (charged quarterly) **+ Performance fees**: 20% profit share above a 10% hurdle. Performance fees will be charged on cumulative gains at the third anniversary*. Performance fees will be charged without catch-up i.e. the first 10% return per annum (net of fixed fees) will be not be subject to performance fees. High water mark applies for performance fees.

**If redeemed prior to the completion of three years, performance fees will be charged as on redemption date*

<u>*Exit Load: 3%, 2% and 1% if redeemed in the first, second and third year respectively*</u>

<u>*Minimum investment: INR 50 lacs*</u>

***Clients also have the option to be onboarded directly (Direct Fee Code)

ANNEXURES

LITTLE CHAMPS HEALTHY EARNINGS GROWTH CONTINUES IN FY23

Company	Revenue (YoY)			PBT (YoY)			RoCE (YoY)		Net debt (cash)Equity	
	3QFY23	FY22	FY21	3QFY23	FY22	FY21	FY22	FY21	FY22-end	FY21-end
Garware Tech.	-11%	15%	9%	-8%	4%	16%	22%	24%	-0.5	-0.5
Alkyl Amines	3%	24%	25%	1%	-25%	77%	32%	54%	0	-0.1
GMM Pfaudler	23%	154%	69%	14%	13%	73%	14%	16%	0.3	0.4
Suprajit	44%	12%	5%	14%	15%	21%	17%	16%	-0.1	-0.1
V-Mart Retail	12%	55%	-35%	NM	NM	NM	11%	8%	-0.2	-0.4
Ultramarine	-3%	59%	1%	41%	4%	-3%	11%	18%	0	-0.1
Mold-Tek Pack.	-3%	32%	9%	-7%	35%	32%	21%	21%	0.1	0.4
Amrutanjan	-12%	22%	27%	-48%	11%	138%	38%	45%	-0.4	-0.7
Galaxy Surf.	16%	32%	7%	127%	-12%	29%	19%	26%	0.2	0.1
Fine Organics	64%	66%	9%	116%	116%	-26%	39%	22%	-0.2	-0.2
MAS Financial**	41%	3%	-18%	27%	10%	-15%	14%	15%	NA	NA
Aavas Finan**	20%	28%	18%	19%	29%	17%	14%	13%	NA	NA
Tarsons	-13%	31%	30%	-25%	46%	74%	35%	37%	-0.1	0.1
Paushak	64%	6%	2%	96%	-3%	20%	16%	19%	-0.1	-0.2
Vijaya Diag.	2%	23%	11%	-35%	31%	34%	30%	27%	-0.2	-0.1
Home First**	30%	40%	19%	28%	69%	25%	12%	9%	NA	NA
Prudent Corp.	26%	57%	22%	28%	77%	62%	41%	34%	-0.2	-0.9
Median	**16%**	**31%**	**9%**	**17%**	**14%**	**27%**	**19%**	**21%**	**-0.1**	**-0.1**
Weighted Avg.	**16%**	**40%**	**13%**	**20%**	**23%**	**35%**	**23%**	**24%**	**-0.1**	**-0.1**

*Source: Companies, Marcellus Investment Managers Note: * Including Pfaudler International's numbers which have been consolidated ** for financial services companies, instead of RoCE, RoEs are used. Portfolio stocks as on April 30, 2023. Also, net debt/(cash) is not applicable for financial services companies.*

LITTLE CHAMPS WELL POISED TO ACCELERATE MARKET SHARE GAINS

Company	Re-investment rate		Remarks
	FY17-21 (cum.)	FY22	
Garware Technical	30%	26%	
GMM Pfaudler	42%	58%	Concluded acquisitions like: (1) De Dietrich Process Systems India Private Limited for Euro6.25mn; (2) 54% stake in the global business of Pfaudler at equity value of US$27.4mn (majority funded by existing cash accruals) (3) HDO Technologies assets for augmenting heavy engineering capabilities.
Alkyl Amines Chemicals	66%	138%	Commissioned new Acetonitrile plant in November 2021. Expansion of Aliphatic Amines' capacities at existing plants to the tune of Rs3.0-3.5bn
Ultramarine & Pigm.	55%	166%	Recently commissioned a new surfactants plant. In the process of setting up a new pigments plant.
Galaxy Surfactants	56%	176%	
Mold-Tek Packaging	79%	79%	Company also looking at expansion of existing facilities and a new plant in North India. Entered into Injection Blow Molding for pharma, FMCG and cosmetics segment.
Amrutanjan	6%	36%	
Fine Organic	49%	163%	
Suprajit Engineering	64%	33%	Announced acquisition of Kongsberg's light duty cable business for an enterprise value of US$42mn.
V-Mart Retail	52%	NM	Acquired 'Unlimited' retail chain from Arvind Fashions for ~Rs150crs to facilitate entry into South India.
Paushak	91%	102%	~Rs120 crs planned capex to expand phosgene capacities and commissioning of a downstream derivatives plant.
Tarsons Products	100%	62%	New manufacturing facility in West Bengal to be commissioned by middle of 2023.
Vijaya Diagnostics	43%	73%	(a) Entry into tier-2 & tier-3 towns of Andhra Pradesh & Telangana; (b) In process of launching home collection services in Hyderabad; (c) Setting up of new centre in Hyderabad which will offer advanced radiology tests.
Prudent Corporate	14%	181%	
Weighted average	**56%**	**59%**	
Median	**53%**	**76%**	

Source: Companies, Marcellus Investment Managers Note: (1) Reinvestment rate calculated as % of cash flows from CFO and other sources (such as equity, debt, treasury income net of interest expenses) reinvested in capex and strategic investments (including share buybacks). Portfolio stocks as of April 30, 2023. (2) The above does not include portfolio companies in financial business viz. Aavas Financiers, Mas Financial and Home First Finance since reinvestment is NOT a relevant metric for financial services.

PERFORMANCE UPDATE (STOCK-WISE ATTRIBUTION)

Portfolio Companies 1YR returns (ending 30th Apr 2023)

Company	Share price return
MOLD-TEK PACKAGING	24%
MAS FINANCIAL SERVICES	9%
VIJAYA DIAG.	8%
SUPRAJIT ENGINEERING	1%
FINE ORGANIC INDUSTRIES	-2%
GMM PFAUDLER	-2%
HOME FIRST FINANCE	-3%
GARWARE TECHNICAL FIBRES	-4%
ULTRAMARINE & PIGMENTS	-5%
PRUDENT CORPORATE	-12%
GALAXY SURFACTANTS	-14%
TARSONS PRODUCTS	-19%
ALKYL AMINES CHEMICALS	-26%
V-MART RETAIL	-33%
AMRUTANJAN HEALTH CARE	-33%
PAUSHAK	-34%
AAVAS FINANCIERS	-39%

Top 20 performers in BSE 500 (1 year ending 30th Apr 2023)

Company	Share price return
Rail Vikas Nigam Ltd.	219%
UCO Bank	154%
Mazagon Dock Shipbuilders Ltd.	151%
Punjab & Sind Bank	126%
Finolex Cables Ltd.	123%
Varun Beverages Ltd.	100%
Union Bank Of India	99%
Indian Bank	97%
Raymond Ltd.	91%
Triveni Turbine Ltd.	90%
Hindustan Aeronautics Ltd.	83%
Mahindra CIE Automotive Ltd.	80%
Ircon International Ltd.	79%
JK Lakshmi Cement Ltd.	77%
Aegis Logistics Ltd.	77%
NCC Ltd.	75%
The Great Eastern Shipping Company Ltd.	75%
Bank Of India	75%
TVS Motor Company Ltd.	74%
KSB Ltd.	70%

Source: Ace Equity, Bloomberg, Marcellus Investment managers
** Stocks have not completed 1 year in the portfolio and returns shown are since incorporation in model portfolio. All returns shown above are as of April 30, 2023.*
The above does not include stocks exited from the portfolio over the last one year: (1) La Opala, and (2) Gujarat Ambuja Exports. Please note the ranking above is based on absolute share price return and NOT based on contribution to the portfolio returns (which is also impacted by allocation weights of the respective stock in the portfolio)

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