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Invest

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2020 – after four quarters of a roller coaster ride, the hope of a steady course

Dear Investor,

The Covid-19 pandemic affected the whole world to a great extent during the last year. It may be several years before we can completely erase the scars left behind by it. In this newsletter, we would like to share with you the changes we have seen, over the previous 4 quarters, in the economy, in corporate India, and the progress of the pandemic itself. A strong fiscal nudge was needed from the government. I think we got it on Budget day.

Movement of the pandemic in India

Despite being the country with the second highest number of cases (after the USA), India's management of the pandemic has been much better than many other countries, given the country's huge population and relatively modest medical infrastructure. In terms of deaths per million, India ranks much lower at 79th in the world with 112 deaths per million population (Source: statista.com – data as of 31st January 2021). The recovery rate, and the number of deaths was better controlled in this country, notably because of the initial treatments given to patients (both in hospitals and, in mild cases, treatments at home).

Impact on the economy and corporate profits

Of course, the Covid-19 pandemic had a very dampening effect on the Indian economy and corporate profitability. Although there are signs of revival, there is a lot more to be achieved.

(y-o-y growth over corresponding quarter of the previous year)

	Dec-19 3Q FY 2019-20	Mar-20 4Q FY 19-20	Jun-20 1Q FY 20-21	Sep-20 2Q FY 20-21
Overall GDP growth %	4.1%	3.1%	(23.9%)	(7.5%)
Sectoral growth %				
Manufacturing	(0.8%)	(1.4%)	(39.3%)	0.6%
Agriculture	3.6%	5.9%	3.4%	3.4%
Services	4.7%	3.6%	(20.6%)	(11.4%)

Source: MOSPI, RBI

The saving grace in the last few quarters has been agriculture. Both manufacturing and services were very badly affected for two consecutive quarters and are only now showing signs of revival. There are some important points regarding these, and we shall discuss them later in the newsletter.

This is how corporate India performed during the last four quarters:

(y-o-y growth over corresponding quarter of the previous year)

	Dec-19 3Q FY 2019-20	Mar-20 4Q FY 19-20	Jun-20 1Q FY 20-21	Sep-20 2Q FY 20-21
Net Sales growth %	37.4%	31.9%	3.4%	(1.7%)
Operating profit growth %	39.7%	15.0%	0.6%	4.5%
Net profit growth %	3.2%	(65.8%)	(66.1%)	116.4%
EPS (Rs)	78.76	38.99	34.76	119.78

Source: ACE Equity, Bloomberg

	Signs of revival in corporate profitability were visible from the September quarter results, when the Nifty 500 cumulatively posted a 116% rise in net profits compared to the corresponding quarter of the previous year. This trend is showing signs of continuing in the December quarter. So far, of the total of about 716 companies that have declared results for the December 2020 quarter, the revenue growth has been 4.93% compared to the December 2019 quarter, and the net profit growth has been 82.2%. India cannot be satisfied with a high growth from a low base caused by the pandemic. What was needed was a strong nudge from the government in terms of fiscal stimulus.
Highlights of the Union Budget, and how it will impact corporate India	• A strong focus on increasing government spending on productive assets like physical infrastructure. The increase in capital spending for the next year, at Rs. 554,000 crores, is estimated at 26% higher than the current year. • It is remarkable that this increased spending on infrastructure does not depend upon raising taxes. Rather the government has focused on increased borrowing and monetization of its own assets. • The positive surprise has been the relative transparency in declaring the fiscal deficit at 9.5% of GDP this year, and a target of 6.8% in the next year. The subsidy of Food Corporation of India, and the fertilizer subsidy, which successive government budgets had kept off its books, has now been brought into the government budget, thus clearing the balance sheets of FCI and the fertilizer companies. • Road infrastructure has got a massive push with a budgetary support of Rs. 118,101 crores, including a Rs. 18,000 crore fund for augmentation of city bus services. • The Railways have been given Rs. 110,000 crore allocation, including Rs. 107,000 crore for capital expenditure. • Policies announced for increasing overseas ownership of insurance companies to 74% from the present 49%. • Plan for a “bad bank” that will take over the bulk of the stressed assets of the public sector banks, and which will then dispose them through AIFs. Although the fine print of how exactly this will be operationalized is still awaited, we are enthused by this move, and this will allow the government banks a leeway to increase lending to the sectors that require funds. Hopefully, there will also be improvements in the banks’ credit appraisal and recovery processes. • Policies for scrapping of old vehicles is a very welcome step to boost sale of new vehicles, and we await finer details about the extent of fiscal support given for vehicle owners to implement this change. • India’s traditional industries like Textiles have got a big thrust through the extension of the PLI to the sector by establishing seven Textile Parks. This is an industry where India has a traditional competitive advantage. What is needed is fiscal support. We hope that the government does not get complacent after such a large fiscal push and relax about the fiscal deficit numbers in the years to come. Of course, this was a year in which emphasis on growth was far more important than worrying about the fiscal deficit, but not all years will be like this. When growth comes back, inflation control, and therefore prudent fiscal management should again become priority. We also like the steps taken to simplify the filing of income tax returns, and the relaxation of norms of what defines a “small business”. The increase in limit of a small business would save at least 200000 companies from painful compliance requirements.

Impact on your portfolio

We are pleased that several of the steps outlined in this budget would have a salutary effect on your portfolio. To name a few:

1) The massive infrastructure push should benefit capital equipment suppliers a good deal. (We had mentioned this as our expectation in our November 2020 newsletter. This is also consistent with our approach of buying quality companies before they become popular, and are gratified that this is now closer to becoming a reality. In many ways, this was inevitable). This is how your portfolio companies would benefit from this budget:

Policy announcement	Beneficiaries from your portfolio	Why should they benefit?
Increased investment in road infrastructure and support for purchase of vehicles	Cummins India Ltd Bosch	Earthmoving equipment sales, truck sales should increase over the next 18 months
Vehicles scrappage policy	Bosch, SKF India, Exide Industries, Sundaram Finance, State Bank of India, HDFC Bank	Incentives for purchase of newer vehicles would spur vehicle sales, and therefore good news for auto parts companies and vehicle financiers
Railway capital expenditure	Cummins, Siemens, SKF India, Exide, RITES	Direct beneficiaries of capital expenditure as these companies supply equipment to the Railways
Dedicated Freight Corridor and PSU Divestment	Container Corporation	One of the major beneficiaries of the DFC
Bad Bank for PSU bad loans	State Bank of India	The only PSU bank in our portfolio. Competitive even without this move, but this improves the sentiment.
Employment generated by the massive infrastructure push	Consumer companies such as ITC, Colgate Palmolive, Titan, United Breweries, Asian Paints	Potentially larger disposable incomes at the hands of the consumer
Steps announced to improve the corporate bond market	CRISIL	Potentially larger need for reliable credit rating
No additional taxes on tobacco companies	ITC	The absence of any fresh taxes improves the prospects and sentiments around the company.
137% Increase in healthcare outlay to Rs. 223,000 crores	Sun Pharma, Sanofi India and GlaxoSmithKline Pharma	Healthcare infrastructure would percolate down to demand for quality medicines.
74% FDI in insurance, Bad Bank proposal for NPAs, No new taxes, disinvestment of two PSU banks and an insurance company	Almost all companies	General investment sentiment improves with such moves because the intent becomes clearer.

	We had already outlined the benefits of the proposed farm laws in one of our earlier newsletters. Unfortunately, this matter has been caught up in controversies with a few farmer unions agitating over these proposals. No new initiative will be uniformly welcomed by or will be uniformly beneficial to all. The principle of "the greatest good for the greatest number of people" should always be the principle behind any government move. We believe that the proposed farm laws would be beneficial for most farmers in the country, and for the country as a whole. Reduction of spending on subsidies would free up resources to enter farm-sector R&D, which is woefully inadequate in this country. Agricultural economists like Mr. Ashok Gulati have pointed out the India spends less than half of the R&D spends of individual companies like Bayer. This must change. As the saying goes, the proof of the pudding is in the eating. We believe that if properly implemented, the infrastructure projects have a potential for substantially improving the job market, and this will indirectly benefit several consumer-facing companies like FMCG and consumer discretionary stocks.

Overall, the economy needed a strong fiscal support after the shock of the Covid-19 pandemic last year. We think it has found it.

Warm regards,

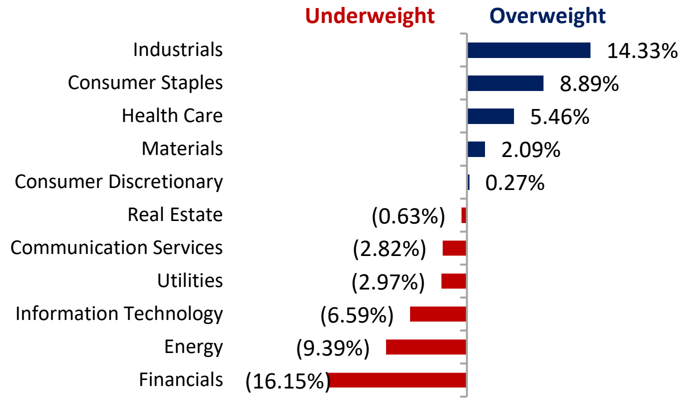
Yours sincerely,

(E A Sundaram)
Chief Investment Officer and Portfolio Manager

Top 10 Holding of o3 Core Value Investment Approach - Regular Option as on 31st January 2021

Name	GICS Sector	Weight
ITC	Consumer Staples	6.48%
Oracle Financial Services Software	Information Tech	5.66%
Bosch	Consumer Discre	5.00%
Cummins India Ltd	Industrials	4.81%
Colgate-Palmolive (India)	Consumer Staples	4.73%
Container Corporation of India	Industrials	4.24%
State Bank of India	Financials	4.19%
HDFC Bank	Financials	4.16%
Sanofi India	Health Care	4.01%
Indraprastha Gas Ltd	Utilities	3.86%
		47.14%

Overweight / Underweight of Regular Model Portfolio Compared to Nifty 500 as on 31st January 2021



Investment Objective: The investment objective is to achieves capital appreciation through investment in a diversified portfolio of strong businesses, purchased at reasonable valuation.

Regular Model Portfolio Details as on 31st January 2021	
Weighted Average ROCE	29.11%
Portfolio PE (1 year forward PE, Based on FY22)	24.76
Portfolio Dividend Yield	2.21%
Average Age of companies	61 Years

Regular Model Portfolio Composition as on 31st January 2021	
Large Cap	35.5%
Midcap	40.0%
Small Cap	17.0%
Cash	7.5%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 29th January 2021
- Midcap: Market cap below 100th company to the market cap of the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 29th January 2021
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 29th January 2021

Regular Model Portfolio Composition as on 31st Jan 2021	
Model Portfolio Overlap with Nifty 500	11.37%
Model Portfolio Overlap with Nifty 50	11.79%

Consolidated Portfolio Performance of o3 Core Value Investment Approach Concentrated Option

Period	29th January 2021	
	Portfolio	Nifty 500
1 Months	0.56	(1.44)
3 Months	18.95	17.81
6 Months	23.00	24.26
1 Year	8.65	12.92
Since Inception (15/04/2019)	6.98	8.38

Consolidated Portfolio Performance of o3 Core Value Investment Approach Regular Option

Period	29th January 2021	
	Portfolio	Nifty 500
1 Months	0.40	(1.44)
3 Months	14.53	17.81
6 Months	19.56	24.26
1 Year	5.62	12.92
Since Inception (14/05/2019)	9.04	13.02

- Benchmark is Nifty 500, the portfolio is spread across different market capitalization, hence Nifty 500 is chosen as benchmark
- Since inception date stated is considered to be the date on which the first client investment was made under the investment approach

Disclaimer: Performance depicted is based on all the client portfolios existing as on such date, using Time Weighted Rate of Return (TWRR) of each client and then computing *arithmetic* average for the overall strategy. Past performance is no guarantee of future returns. The above portfolio performance is after charging of expenses. *The performance related information provided here is not verified by SEBI nor has SEBI certified the accuracy or adequacy of the contents of this Document.*