Investor NEWSLETTER

"The coming cyclical shift"

Dear Investor,

One of the frequent questions that we are asked is about the "overweight" position that we have on Industrials. Compared to the benchmark Index, we have an overweight position of 14.2% in Industrials as of 30th September 2020. Also, this sector has not done well in the stock market over the last year. Industrial production is down. The lockdown has affected this sector much more than other sectors like pharmaceuticals. We have a strong logic as to why we have this overweight position in Industrials. Here it is.

Industrials are at a low ebb as far as the stock market is concerned:

Let's take a look at the comparative weight of the industrials/capital goods in the Nifty 50 Index over the years:

Nifty 50 Index - sector weights over the years

Sector	Dec-02	Dec-07	Dec-12	Dec-17	Jun-19	Sep-20
Auto	5.6%	3.4%	8.8%	10.6%	5.7%	5.8%
Capital Goods	3.1%	10.5%	5.9%	3.8%	4.0%	1.7%
Cement & Cement Products	2.4%	2.1%	4.2%	1.6%	1.7%	2.1%
Consumer	17.9%	3.6%	12.3%	9.2%	10.7%	11.9%
Financial Services	11.7%	12.0%	29.5%	35.0%	40.4%	33.3%
Healthcare	8.3%	2.2%	5.0%	4.0%	2.2%	4.0%
Media & Entertainment	1.2%	0.4%	0.0%	0.8%	0.4%	0.0%
Metals & Mining	2.9%	9.0%	3.8%	4.5%	3.6%	2.2%
Oil & Gas	17.6%	25.4%	12.3%	12.7%	12.1%	16.7%
Others	0.9%	2.3%	0.3%	1.5%	1.4%	3.4%
Technology	24.2%	9.5%	11.4%	11.4%	13.7%	16.8%
Telecommunication	2.6%	11.4%	2.0%	2.5%	1.8%	2.1%
Utilities	1.6%	8.2%	4.5%	2.4%	2.3%	0.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: NSE

The table above is revealing. The weight of "capital goods" in the Nifty Index is at a multi-year low. "Auto + Capital goods" is also cumulatively at a multi-year low. This means that this sector is neglected/forgotten, and that means that the stocks in these sectors are available at prices that are a multi-year low.

The point to be ascertained therefore, is about whether companies in this sector have adequate prospects for future growth, and whether such companies would continue to remain competitive.

In our portfolio, which companies are we talking about?

In our portfolio, the following stocks are dependent upon a revival of industrial/economic activity, whether it is in the auto space, or infrastructure space.

a. Bosch

b. Container Corporation

c. Cummins India

d. Exide Industries

e. Blue Dart Express

f. RITES

g. Siemens

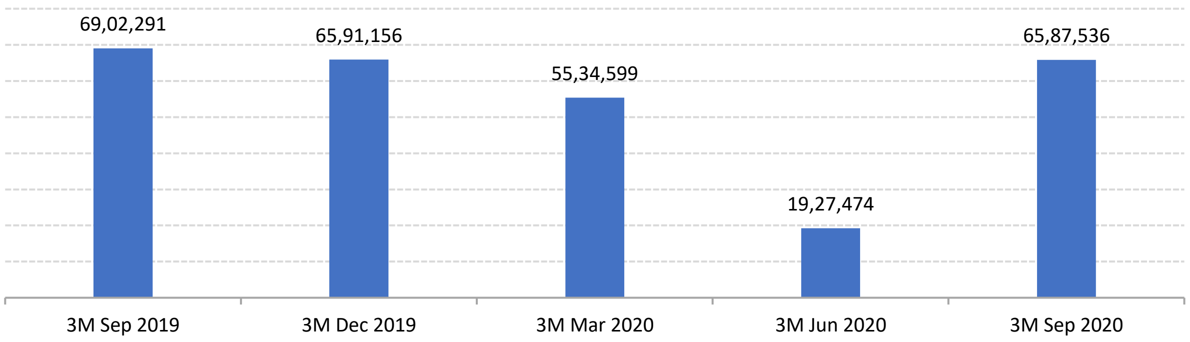
h. SKF India

i. Castrol India

You would have observed that **ALL** these companies are market leaders in their respective fields, with a long track record of profitability and cash flow generation. All of them continue to be competitive, and the recent slump in industrial activity notwithstanding, we have reasons to feel confident about the prospects of such companies over the next few years. In our opinion, the negative sentiment around such stocks makes these ideal for purchase at these prices:

Here now are our reasons for having a big position in these companies:

Auto sector sales have shown a revival: Indian Automotive Sector Volumes



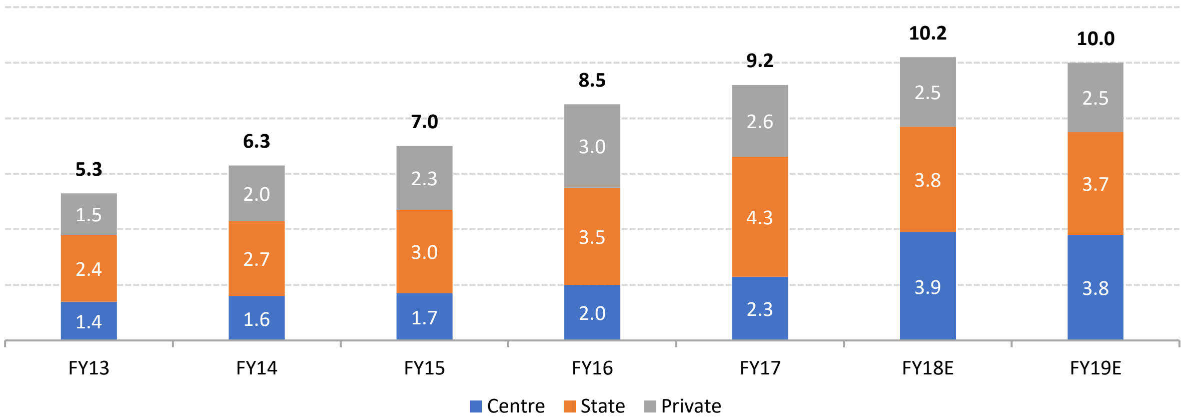
Sales Volumes have picked up in the last quarter and is nearing last year volumes

Source: SIAM

After a severely contracted quarter (ending June 2020), essentially caused by the lockdown following the Covid-19 pandemic outbreak, the September 2020 quarter has been much better. Although commercial vehicles have not yet recovered fully, passenger cars and 2 wheelers have more than recovered. We have reasons to be confident that post the full implementation of the Bharat Stage VI norms, and the beneficial impact of the increase in road infrastructure, the auto sector would see a further revival in fortunes.

This is how India's spending on physical infrastructure has moved over the last few years:

India's infrastructure investment trend since fiscal 2013 (Rs lakh crore)



Source: National Infrastructure Pipeline – Report of the Task Force, Dept of Eco Affairs, 2020

And this is how it is projected to move in the coming years:

Sector-wise annual capital expenditure in infrastructure (Rs crore)

Ministry/ department	FY20	FY21	FY22	FY23	FY24	FY25	No phasing	FY20-FY25
Energy								
Power	164,140	225,551	221,734	223,487	225,236	211,002	139,279	1,410,428
Renewable energy	30,500	151,000	144,000	170,000	217,000	217,000	0	929,500
Atomic energy	11,635	21,462	28,324	33,124	32,674	28,284	0	155,503
Petroleum and natural gas	27,332	43,510	48,314	41,523	22,858	10,535	499	194,572
Total energy	**233,607**	**441,522**	**442,372**	**468,134**	**497,768**	**466,821**	**139,778**	**2,690,003**
Roads								
Roads	332,559	383,283	356,966	252,780	240,761	332,659	134,815	2,033,823
Total roads	**332,559**	**383,283**	**356,966**	**252,780**	**240,761**	**332,659**	**134,815**	**2,033,823**
Railways								
Railways	133,387	262,465	308,800	273,831	221,209	167,870	0	1,367,563
Total railways	**133,387**	**262,465**	**308,800**	**273,831**	**221,209**	**167,870**	**0**	**1,367,563**
Ports								
Ports	13,357	18,104	20,649	15,863	7,724	10,002	35,495	121,194
Total ports	**13,357**	**18,104**	**20,649**	**15,863**	**7,724**	**10,002**	**35,495**	**121,194**
Airports								
Airports	18,667	21,655	24,820	21,334	25,386	5,141	26,445	143,448
Total airports	**18,667**	**21,655**	**24,820**	**21,334**	**25,386**	**5,141**	**26,445**	**143,448**
Urban								
Atal Mission for Rejuvenation and Urban Transformation, Smart Cities, MRTS, Affordable Housing, Jal Jeevan Mission	298,174	462,208	404,134	234,858	217,164	159,862	142,867	1,919,267
Total urban	**298,174**	**462,208**	**404,134**	**234,858**	**217,164**	**159,862**	**142,867**	**1,919,267**

And in addition, these are the planned investments in social infrastructure:

Ministry/ Department	FY20	FY21	FY22	FY23	FY24	FY25	No phasing	FY20-FY25
Digital communication								
Digital communication	78,356	61,847	54,538	38,719	38,119	38,093	0	309,672
Total digital communication	**78,356**	**61,847**	**54,538**	**38,719**	**38,119**	**38,093**	**0**	**309,672**
Irrigation								
Irrigation	114,463	200,615	175,669	137,358	115,281	70,474	80,612	894,473
Total irrigation	**114,463**	**200,615**	**175,669**	**137,358**	**115,281**	**70,474**	**80,612**	**894,473**
Rural infrastructure								
Rural infrastructure	103,555	116,306	109,930	27,055	27,055	27,055	0	410,955
Water and sanitation	36,758	60,497	100,881	84,822	80,002	0	0	362,960
Total rural infrastructure	**140,313**	**176,803**	**210,811**	**111,877**	**107,057**	**27,055**	**0**	**773,915**
Agriculture and food processing infrastructure								
Agriculture infrastructure	3,109	3,376	3,423	1,850	1,176	649	148,889	162,472
Food processing industries	461	519	203	73	0	0	0	1,255
Food and public distribution	0	0	0	0	0	0	5,000	5,000
Total agriculture and food processing infrastructure	**3,570**	**3,895**	**3,626**	**1,923**	**1,176**	**649**	**153,889**	**168,727**
Social infrastructure								
Higher education	20,412	27,922	34,570	29,567	27,406	12,285	23,566	175,729
School education	5,053	7,132	7,077	6,398	6,569	5,562	0	37,791
Health and family welfare	28,719	40,132	39,914	16,096	9,756	6,544	9,858	151,019
Sports	1,320	1,547	1,424	1,389	1,220	840	1,328	9,069
Tourism	1,104	1,581	2,059	1,863	1,196	715	11,259	19,777
Total social infrastructure	**56,608**	**78,315**	**85,044**	**55,314**	**46,147**	**25,945**	**46,012**	**393,386**
Industrial infrastructure								
Industries and internal trade	17,412	40,676	42,558	33,529	22,731	10,520	139,306	306,732
Steel	1,658	2,390	2,287	1,600	290	0	0	8,225
Total industrial infrastructure	**19,070**	**43,066**	**44,845**	**35,129**	**23,021**	**10,520**	**139,306**	**314,957**
Total	**1,442,131**	**2,153,779**	**2,132,274**	**1,647,122**	**1,540,813**	**1,315,091**	**899,218**	**11,130,428**

Source: National Infrastrucrture Pipeline – Report of the Task Force, Dept of Eco Affairs, 2020

The stated intention is to increase the investment in infrastructure to Rs.111.30 lakh crores over the next 6 years, compared to Rs.51.16 lakh crores in the previous 6 years. Even if we discount these figures by 33%, the numbers are 45% more than the previous 6 years.

A bulk of this spending is earmarked for energy, roads, railways, irrigation and urban infrastructure. A sharp increase in spending in these areas would naturally benefit Industrials

The data given above are few of the main reasons why we are overweight on these sectors.

Recent policy decisions regarding encouragement of manufacturing

In addition, a recent report by Morgan Stanley highlighted the steps taken to improve the manufacturing sector in the country:

Overview of the Targeted Policy Measures that Are Expected to Give Manufacturing an Impetus

Measure	Objective and Impact
Production Linked Incentive	▪ Boost large scale domestic manufacturing of goods to bring about import substitution and increase global market penetration ▪ Currently mobile phones and medical devices have been provided support by PLI
Phased Manufacturing Programme	▪ Promote self reliance by strengthening indigenous manufacturing capabilities by providing infant industry protection ▪ Currently, support under the PMP has been announced for mobile phones and proposed for air conditioners
Reduction in Corporate Tax Rate	▪ India lowered its base corporate tax rate to 25% and 15% for new manufacturing facilities ▪ This creates an investment-friendly environment and brings the tax rate for India broadly at par with the average for Asian countries
Labour Reforms	▪ Codification and rationalisation of labour laws to facilitate flexibility in implementation ▪ Key states have taken the lead in tweaking state labour laws
Land Reforms	▪ Creation of land banks so as to make land easily identifiable for industrial projects and simultaneously also provide details about logistics
Revision of MSME definition	▪ Encourage MSMEs to grow in size while creating an enabling environment to foster innovation, investment and inclusive growth
Expanding Physical Infrastructure	▪ Provides a bulwark for sustained economic growth by encouraging the multiplier effect ▪ Last few years have seen increased investment in road, rail, port sectors. Indeed, infrastructure investment has increased from 4.4% of GDP in F2015 to 5.7% of GDP in F2019 ▪ Expanding infrastructure is a continuous process and as per the national infrastructure pipeline the total infrastructure investment is expected to be approx. US$1350bn by F2025
Legal Infrastructure	▪ Ensure judicial efficiency so as to facilitate ease of living and ease of doing business ▪ More work needs to be done here

Source: Morgan Stanley research – India's Manufacturing at an inflection point – Sep 2020

Seen separately, these may not seem like much, but the cumulative impact of these measures can be considerable. One is confident that the cumulative impact of these measures, and the reforms announced in May 2020 in the Agriculture sector (already covered in our previous newsletters) augur well for the future economic growth of this country.

And these are not just plans. A recent report in the Economic Times (Oct 21st 2020) says that the Foreign Direct Investment (FDI) inflow in India during the first 5 months of this financial year (Apr-Aug 2020) was $27.1 billion, and 16% higher than the inflow during the corresponding period of last year. Let us also not forget that this is during the Covid-19 pandemic.

Now, let us talk about the competitive strengths of the individual companies in our portfolio.

Company	Ownership	Competitiveness	5-year average RoCE	Stock discount to 10-year average valuation
Bosch	Multinational	One of the world's leaders in automotive research, supplies to the who's who in the world auto industry. 150-year history. Conservative accounting policies. Heavy investment in BS6 and electric vehicle parts.	20.97%	39.1%
Cummins	Multinational	One of the world's leaders in engines and genset manufacturing. Fully compliant with all emission norms. Catering to a wide range of industries and a primary beneficiary in an environment of industrial revival.	20.71%	19.3%
Blue Dart Express	Multinational	Market leader in express cargo. Very strong systems and processes. Extensive geographic reach throughout the country. Own planes ensure timely delivery of express packages. Premium pricing.	26.13%	25.8%
RITES	Indian	Steady track record in railway project consulting. Strong capex cycle in the railways bodes well for the company.	28.55%	21.6%

Company	Ownership	Competitiveness	5-year average RoCE	Stock discount to 10-year average valuation
Container Corporation	Indian	Unmatched infrastructure in the logistics space. A very likely beneficiary of the expected shift of freight movement from road to rail following the implementation of the dedicated freight corridor. A disinvestment candidate. A strong candidate for third party logistics business.	13.23%	25.2%
Exide Industries	Indian	Market leader in the automotive and industrial batteries segment. Nation-wide distribution network. Strong brand.	22.67%	26.5%
Siemens Ltd	Multinational	One of the primary companies in industrial automation, railway modernization and urban infrastructure.	32.70%	3.7%
SKF India	Multinational	Market leader in bearings. Strong track record over several years. Diversified customer base. A beneficiary of industrial revival.	24.14%	0.6%
Castrol India	Multinational	Very strong brand, market share and cash flows.	121.92%	50.7%

Data source: ACE Equity/Bloomberg. Data as of 27th Oct 2020.

Notes:

1. 5-year average RoCE (Return on Capital Employed) is a strong measure of how efficiently the company has managed its finances.
2. The discount of present valuation to 10-year average valuation is a good measure of how cheap the stock is.

If the company continues to be competitive and is expected to remain competitive in the foreseeable future, a sharp discount to its average valuation is an opportunity provided by a temporary slump to pick up a good stock relatively cheaply.

Our method of picking individual names, instead of focussing on the overall market index and its valuations, strikes us as particularly logical and filled with common sense. We find it far more logical to buy into a good company **before** it becomes popular rather than **after**.

As a reinforcement of this argument, let us look at the table given in Page 1 again. The Technology sector was rather neglected 3 years ago. But today the weight of that sector has increased from 11.4% to 16.8%. Financial services were extremely hyped up last year. Now the weight has fallen from 40%+ to 33%. Pharma/healthcare has almost doubled its weight in the index over the last year and a half.

We do not compromise on the quality of the company and are therefore less perturbed if the stock does not move up immediately after purchase. This is another reason why overall "Market PE" finds almost no relevance in our scheme of things. As seen from the table above, good quality companies are available at a steep discount to their historical valuations, at a time when the overall Nifty 50 PE multiple is at an all-time high. Given this situation, there is less need to worry about a high Nifty PE.

We wish you and your family a safe and a very happy festive season. This being the festive season, we would like to end this month's newsletter not with one, but two marvellous quotes from the great Warren Buffett. We think it is vital that every investor reads and internalizes these quotes so that we need not be diverted by the several trivia that bombard us every day through TV channels and the social media.

Warm regards

Yours sincerely,

(E A Sundaram)

Chief Investment Officer and Portfolio Manager

"The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company and, above all, the durability of that advantage"

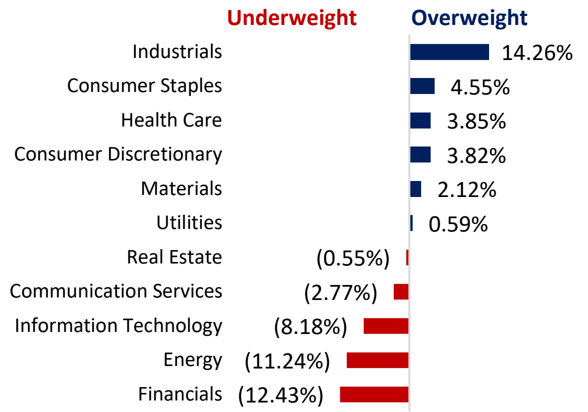
"For the investor, a too-high purchase price for the stock of an excellent company can undo the effects of a subsequent decade of favourable business developments."

Warren Buffett

Top 10 Holding of o3 Core Value Investment Approach - Regular Option as on 30th October 2020

Name	GICS Sector	Weight
ITC	Consumer Staples	5.87%
Oracle Financial Services Software	Information Tech	5.11%
Colgate-Palmolive (India)	Consumer Staples	4.87%
HDFC Bank	Financials	4.42%
Container Corporation of India	Industrials	4.35%
State Bank of India	Financials	4.12%
Blue Dart	Industrials	3.96%
Indraprastha Gas Ltd	Utilities	3.83%
Cummins India Ltd	Industrials	3.80%
Castrol India Ltd	Materials	3.27%
		43.60%

Overweight / Underweight of Regular Model Portfolio Compared to Nifty 500 as on 30th October 2020



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 30th October 2020	
Weighted Average ROCE	29.04%
Portfolio PE (1 year forward PE, Based on FY22)	25.17
Portfolio Dividend Yield	2.27%
Average Age of companies	59 Years

Regular Model Portfolio Composition as on 30th October 2020	
Large Cap	42.5%
Midcap	42.0%
Small Cap	9.5%
Cash	6.0%

- Large Cap: Market cap of the 100th company in the Nifty 500 (sorted by market cap in descending order) as on 30th October 2020
- 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 30th October 2020
- Small Cap: Market cap lower than the 250th company in the Nifty 500 (sorted by market cap in descending order) as on 30th October 2020

Regular Model Portfolio Composition as on 30th Oct 2020	
Model Portfolio Overlap with Nifty 500	12.38%
Model Portfolio Overlap with Nifty 50	12.79%

Consolidated Portfolio Performance of o3 Core Value Investment Approach Concentrated Option		
Period	30th October 2020	
	Portfolio	Nifty 500
1 Months	1.18	2.57
3 Months	4.45	6.09
6 Months	11.13	19.58
1 Year	(10.77)	(0.68)
Since Inception (15/04/2019)	(3.71)	(1.33)

Consolidated Portfolio Performance of o3 Core Value Investment Approach Regular Option		
Period	30th October 2020	
	Portfolio	Nifty 500
1 Months	0.75	2.57
3 Months	5.79	6.09
6 Months	14.38	19.58
1 Year	(5.33)	(0.68)
Since Inception (14/05/2019)	0.72	3.11

- 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.*