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Moats & Special Situations Portfolio

Dear Investors,

Below is the performance of the Moats & Special Situations Portfolio (M&SSP) as of 31 March 2024.

Portfolio Performance [1]	Equity Allocation	Total Portfolio Returns	Benchmark Returns
Since Inception (annualised)		14.7%	13.3%
March 2024 Quarter	71%	-2.2%	4.5%
April 2023 – March 2024		29.6%	40.2%

Please check relative performance of other portfolio managers by clicking on this link

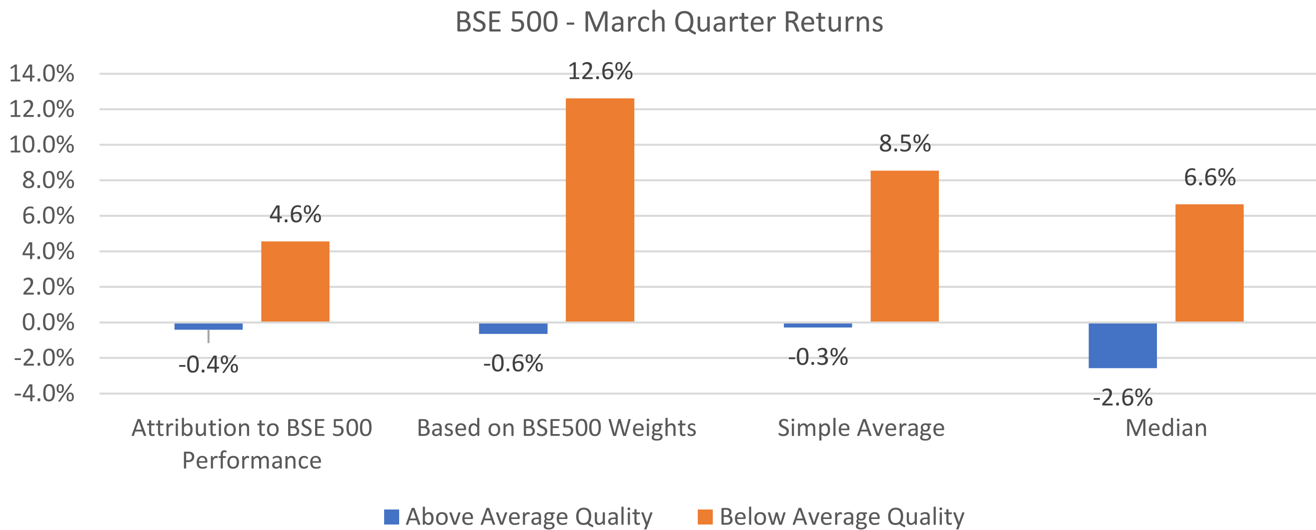
In the entire 13-year history of MSSP strategy, the March Quarter stands out as the sole period where our portfolio delivered a negative return compared to a positive return for the Benchmark. Thus, we tried to delve deeper into the factors contributing to such a pronounced underperformance during this quarter.

During the quarter we observed a divergence of performance in the broader market between above average quality and below average quality companies. We split the BSE 500 between above average quality companies which have 10 Year median ROE of more than 13% and have Debt/Equity of less than 1x (excluding lending businesses), the balance being below average. The split of the universe is as per the table below.

	No of Companies	Weight in BSE 500
Above Average Quality	288	63%
Below Average Quality	212	36%

As can be seen from the chart below, the basket representing below average quality stocks has exhibited notably superior performance compared to the above average quality. In fact, the above average quality companies which constitute 288 companies and 63% of BSE 500 market cap delivered a negative return. Moreover, this negative return appears to be widespread, evident in the disparity between the simple average and median performance of the constituents within that particular basket.

[1] The Benchmark of M&SSP Investment Approach has been revised from BSE 500 and BSE Mid Cap index to **S&P BSE 500 TRI** with effect from 01st April 2023 as per SEBI/APMI circulars. Equity allocation mentioned above is for older accounts. The above returns are consolidated for all clients, time weighted and post management and performance expenses. 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 27th January 2011.



The BSE500's positive performance appears to be heavily influenced by approximately one-third of its constituent companies that as per our criteria are classified as below average quality. And within that, it seems to be concentrated towards higher weighted companies and thus relatively narrower which can also be interpreted through divergence between simple average and median performance of the constituents.

The divergent performance between above average and below average quality baskets is possibly driven by representation of sectors in each basket. Above average quality basket has higher representation of consumer companies (which includes FMCG and consumer durables), financials and Technology companies. These sectors (specifically the consumer sector stocks) have seen negative performance in the current quarter. Consumer facing companies have witnessed a slowdown in demand for a while, especially in the rural areas. Below average quality basket has a higher representation of cyclical sectors and specifically sectors like Infrastructure, Capital goods and Materials (i.e. commodities) which have done well in the recent past both from business performance and stock performance point of view.

In a recent article in ET, Neelkanth Mishra, Chief Economist of Axis Bank has touched upon the divergence in growth in consumption sector vs GDP growth. Below is an excerpt from the article which summarizes this disconnect well.

"India's post-pandemic economic recovery has been investment-led. When households buy new houses, and expand or repair existing ones, as they seem to be doing, they can't consume as much. In an economy growing at 7% annually, if the investment share of GDP rises from 29% to 35% over five years, investment will grow at 10% a year, and consumption, whose share would fall commensurately, will grow at 4.8%. This explains why investments are almost back to the pre-pandemic path (that is, where they would have been if the pandemic had not occurred), while private consumption is well below it." – Neelkanth Mishra, Chief Economist of Axis Bank.

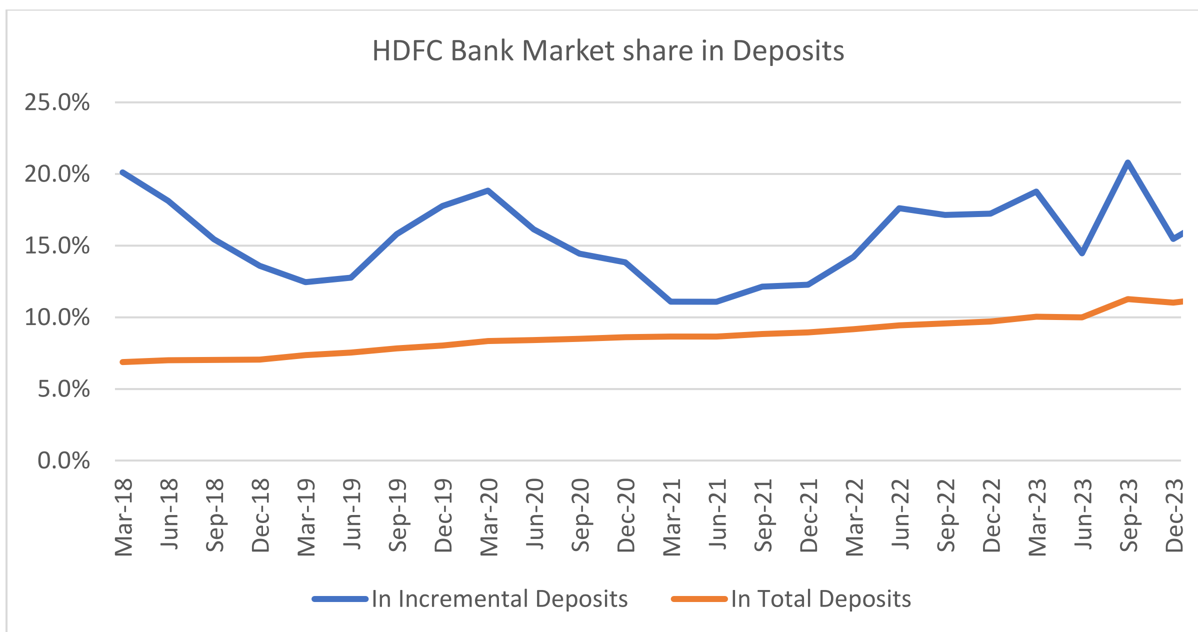
The recent results in the state elections, which have enhanced the prospects of the current administration's re-election at the central level, have also heightened investor sentiment towards stocks primarily involved in infrastructure and capital expenditure (capex). If there is a negative surprise in the general elections, which is not being factored by the market, there could be a material downside in this section of the market.

While there are quality names that are exposed either directly or indirectly to the infrastructure and capital goods space, valuations of these companies have been egregiously expensive. The balance set of companies that do not pass our quality filters, are not part of our investable universe. Consequently, our exposure to this sector remains constrained.

Although the above divergence explains part of the recent underperformance, there were company specific challenges that accentuated the negative performance. The biggest impact on the portfolio came from our largest holding i.e. HDFC Bank where we have higher exposure compared to the benchmark.

HDFC Bank corrected sharply after its Q3 results earnings call. One of the key concerns of the market from the call was with respect to credit-deposit ratio (CDR). Banks take deposits from their customers in the form of savings, current and term (Fixed) deposits. This money is then lent to borrowers in the form of advances. The CDR ratio indicates how much advances the Bank has given compared to the deposits that it has taken from its depositors. The normal range for this ratio is between 70-80% i.e. for every 100 Rs of deposits, the bank would lend between 70-80 Rs. Before the merger with HDFC Ltd, HDFC Bank had a CDR of 84%. HDFC Ltd was an NBFC, which unlike a bank, relied mainly on borrowings (from Banks, Commercial papers, Bonds, etc.) as their primary source of funding for the purpose of lending. HDFC Limited had only 24% deposits in its mix of borrowings as on 30th June, balance was funded by Term loans, ECBs and Debentures. Thus, post the merger, CDR of HDFC Bank increased to 108%. HDFC Bank's Management (including us as investors) had envisaged that the bank would be allowed to bring down CDR ratio over a period of 3-4 years under normal course of business. But it seems that RBI has unofficially communicated to most banks to bring down their CDR ratio at historical levels of ~80% at an accelerated rate. Due to this directive, management has indicated that going forward loan growth would be 3-4% points lower than deposit growth. The concern for the market was that there were two possible paths that HDFC Bank could take: 1. if HDFC bank decides to grow deposits aggressively, there could be pressure on margins as they will have to shell out more in terms of higher deposit rates to garner more deposits 2. The other possibility was that they would continue to garner deposit at the natural rate but lower the advances growth which could affect overall profit growth for the business. This concern of the market led to HDFC Bank stock correcting by ~15% in the current quarter. This single stock exposure led to an impact of -1.9% on the portfolio in the current quarter.

The question is whether this impact is temporary or there is a permanent impairment in valuation of HDFC Bank. If we zoom out and look at the longer-term business profile of HDFC Bank, we don't see any damage being done to the strong asset quality franchise or the liability franchise of the bank. The deposit garnering engine continues to be strong as can be seen from the chart below.



The base market share of HDFC Bank in deposits of Banking industry is ~11% while market share in the incremental deposits of the banking industry is around 17-18%, thus continuing to gain share at a healthy rate. We feel profit growth could be impacted in the near term as the bank adjusts to the accelerated normalization of CDR but will gradually keep on improving. The valuation of HDFC Bank, which is at multi-decade low in relation to its history, more than factor these near term challenges in our opinion.

The other major impact ~1.7% on the portfolio can be attributed to the consumer names in the portfolio. This was in line with the broader sector weakness as discussed earlier. The stocks that we hold in the portfolio are reasonably priced both in terms of their own historical multiples as well as on an absolute valuation multiples as compared to other consumer names. We believe the current softness in consumer sentiment is temporary and we would look to scaleup our weight in this sector when the green shoots are visible.

Asset Allocation

Our equity weight in the older accounts is ~71%. For new accounts our initial weight is ~35%.

Portfolio Activity

Business Model Allocation	Jun-23	Sep-23	Dec-23	Mar-24
Moat	11%	11%	8%	8%
Limited Moat	61%	63%	65%	62%
Moat + Limited Moats	***72%***	***74%***	***73%***	***70%***
Special Situations	28%	26%	27%	30%
Regulated Utility	-	-	-	-
Grand Total	**100%**	**100%**	**100%**	**100%**

Sector Allocation	Jun-23	Sep-23	Dec-23	Mar-24
Financial Services	19%	24%	26%	35%
Financials	36%	31%	33%	33%
Auto & Auto Ancillaries	5%	6%	7%	12%
Consumer	13%	14%	10%	10%
Materials	5%	4%	4%	4%
Real Estate & Infrastructure	5%	3%	4%	3%
Information Technology	9%	8%	8%	3%
Capital Goods	4%	4%	5%	-
Pharma	6%	7%	4%	-
Grand Total	**100%**	**100%**	**100%**	**100%**

We exited stocks in Pharma, Capital Goods and IT sector, while have increased allocation in Financial Services and Auto & Auto Ancillary space. Thus, leading to a net drop in equity allocation from 75% to around 71%. Number of stocks in the MSSP portfolio (~16) is the lowest in its history. Our portfolio today is more concentrated today as compared to the past as the opportunity set in the market continues to shrink.

Regards,
Rohan Samant Akshat Hariya

CIO **Assistant Portfolio Manager**

Statutory Details: Portfolio Manager – Multi-Act Equity Consultancy Private Limited (**Registration No. INP000002965)**

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Note:
1. All cash holdings and investments in liquid funds, is considered for calculating the performance.
2. All performance data are reported net of all fees and all expenses (including taxes).
3. The above performance numbers are not verified by the SEBI.

Disclosure as per Global Investment Performance Standards (GIPS®) –

Multi-Act Equity Consultancy Pvt. Ltd. claims compliance with the Global Investment Performance Standards (GIPS®). You can refer to the GIPS Compliant performance presentation here. Multi-Act Equity Consultancy Pvt. Ltd. has been independently verified by M/s. M. P. Chitale & Co., Chartered Accountants for the periods April 1, 2011 through March 31, 2019. The verification is available upon request. MAECL has claimed GIPS compliance for the Financial Year 2023 and such performance numbers shall be made available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation. The Composite representing the Moats and Special Situations portfolio was created on 27th January 2011. Performance has been compared with

benchmark S&P BSE 500 TRI. The Gross Return is before all expenses (except Brokerage). Net Return is after all actual expenses. A complete list of composite descriptions, policies for valuing portfolios and calculating performance fees are available on request.

Multi-Act Equity Consultancy Pvt. Ltd. is an independent SEBI registered Portfolio Manager. The firm maintains a complete list and description of composites, which is available upon request. This MSSP Composite includes all discretionary fee-paying portfolios that are being managed with the objective of generating capital appreciation by investing in companies that in the opinion of the Portfolio Manager are of high-quality Moat or Limited Moat businesses at fair value or discount to fair value OR in Non-Moat businesses at deep discount to fair value as special situations. The portfolio manager has also the discretion of not being fully invested if he is not able to find ideas that meet the above criteria along with valuation criteria, thus, indirectly taking an asset allocation call between Equity and Cash (& Cash Equivalents).

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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 December 05, 2023 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.

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