White Whale North Star Portfolio – 3Q FY24 Quarterly Letter

Dear Partners,

Greetings from White Whale Partners.

Portfolio Performance

The portfolio has delivered healthy absolute returns year to date. For YTD FY24, our portfolio is up 26.4%, which is in-line with the Nifty TRI. On an annualized basis, since inception, the portfolio is up 17.9%[1], compared to 20.2% for the Nifty 50 TRI.

Figure 1

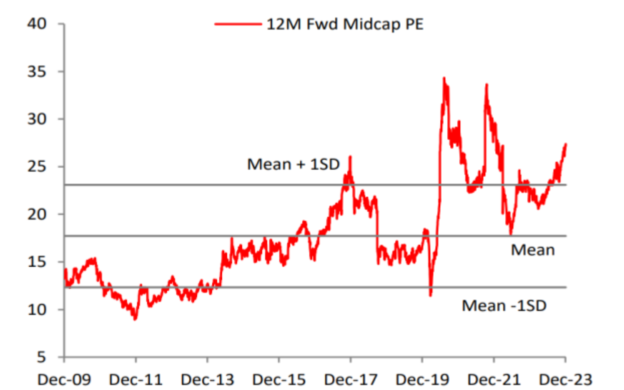
				Inception*	
	3 months	6months	FY24 YTD	Absolute	Annualised
WW Northstar	9.5%	10.3%	26.4%	67.7%	17.9%
Nifty 50 TRI	10.9%	13.8%	26.4%	78.3%	20.2%

**Adjusted for cash from 11th Nov'20 to 31st Dec'20*

Small cap and mid cap stocks in India continued to see a strong rally last quarter, similar to the trend seen in the first half of FY23. The NSE Mid Cap Index is now up 55.2% and NSE Small Cap Index is up 77.9% YTD. As a result, valuations are now even more stretched with the NSE Mid Cap Index trading at 27x forward earnings, at a 50% premium to its historical average (See Figure 2). Similarly, the Small Cap Index is trading at 23x forward earnings, again at a 50% premium to its historical average. (See Figure 3). While fundamentals are improving for many of these companies, we believe liquidity has a large role to play in this uptrend as well.

Figure 2

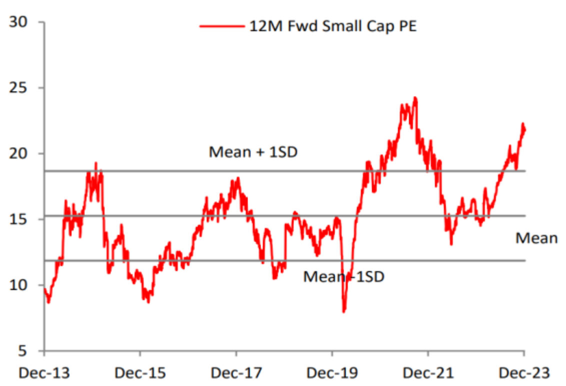
Mid Cap Index 1 yr Forward PE (x)



Source: Bloomberg, Phillip Capital

Figure 3

Small Cap Index 1 yr Forward PE (x)



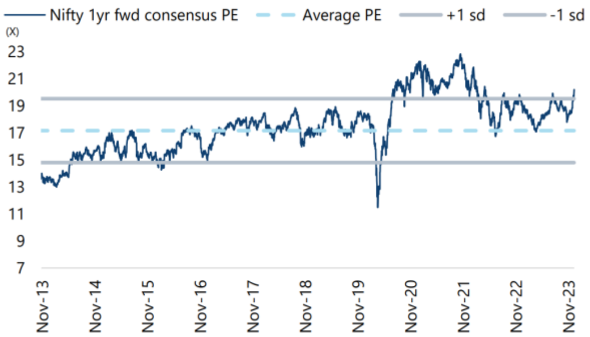
Source: Bloomberg, Phillip Capital

In contrast, the large cap names remain more reasonably valued. The Nifty 50 Index is trading at 20x forward earnings, at a 13% premium to its long-term average of 17.5x (See Figure 4). From a relative perspective also, Nifty 50 Index trades at a 67% premium to the MSCI Emerging Markets Index in terms of forward earnings, which is slightly above its historical average of 59% (See Figure 5) While these valuations appear full, they are not excessive, especially in the context of the healthy macro-economic outlook. Our portfolio, while a multi-cap strategy, is currently 75% in large cap names.

[1] Periodic portfolio performance information is calculated net of management and incentive fees. The information is unaudited and current year performance information is subject to change pending the completion of the current year audit. In addition, individual performance may vary based upon timing of contributions, withdrawals, participation in certain investments, and fee arrangements. For individual investor performance, investors should rely on information contained in account statements. The performance related information is not verified by SEBI.

Figure 4

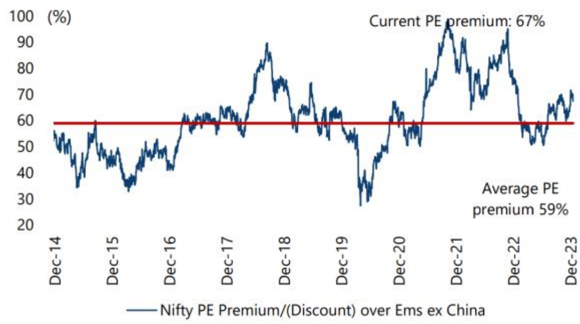
Nifty 50 1 yr Forward PE (x)



Source: Bloomberg, Jefferies

Figure 5

Nifty 50 1yr Forward PE Premium Over MSCI Emerging



Source: Bloomberg, Jefferies

More importantly, our portfolio companies continue to deliver healthy fundamental performance, both in terms of earnings growth and ROE. For 1HFY24, our portfolio of companies delivered revenue growth of 18% and profit growth of 18% as well on a weighted average basis, over the same period last year. The weighted average ROE for our portfolio remains very healthy at 19%. This momentum is expected to continue through FY24 as well. (See Figure 6)

Figure 6

Portfolio Companies – Key Financial Metrics (1HFY24 growth over 1HFY23)

Company Name	Sector	Allocation	Revenue Growth*	EBITDA Growth*	PAT Growth*	ROE**
Position 1	Consumer Discretionary	11.8%	22%	9%	3%	28%
Position 2	FMCG	9.4%	12%	24%	14%	9%
Position 3	Industrials	9.2%	9%	13%	19%	32%
Position 4	Banking	9.2%	28%	51%	43%	12%
Position 5	Banking	8.7%	26%	27%	41%	19%
Position 6	NBFC	7.3%	29%	30%	30%	26%
Position 7	NBFC	7.2%	28%	34%	23%	16%
Position 8	Housing Finance	6.2%	31%	40%	36%	16%
Position 9	IT Services	5.7%	21%	13%	13%	25%
Position 10	Hospitals	4.6%	11%	9%	1%	8%
Position 11	Industrials	4.4%	0%	-11%	-15%	18%
Position 12	Consumer Discretionary	4.4%	6%	-10%	-48%	12%
Position 13	Insurance	3.1%	-17%	-19%	27%	9%
Position 14	Hotels	2.0%	17%	13%	64%	13%
Cash		6.9%				
Weighted Average* **		**100%**	**18%**	**20%**	**18%**	**19%**

** YoY Growth Over H1FY23; ** Annualized for FY24; *** Adjusted for Cash*

Source: Company Data

We believe our portfolio will continue to deliver around 20% annualized earnings growth over the next several years, given most of our companies are either market leaders in nascent industries which are at an inflection point, or are well positioned to gain market share in established industries, due to their unique competitive positioning. We remain excited about the growth prospects of India over the next decade and believe our portfolio is well-positioned for the long term. We remain focused on trying to ***identify incredible businesses backed by outstanding management teams that can compound capital over a long period of time.***

Macroeconomic Developments

The macro-economic trends for India strengthened further in the last quarter. GDP growth for the September quarter accelerated to 7.6%, driven by 11% growth in fixed capital formation. As per the International Monetary Fund (IMF), India is expected to grow at 6.3% in 2024, which would be the fastest among the major economies. More importantly, the quality of growth is much superior as its been driven by a pick-up in the investment capex cycle, which the country has not witnessed in over a decade. This cycle is already well underway with investments in fixed assets by listed manufacturing companies standing at Rs 8 lakh crore on a trailing 12-month basis as of September 2023, growing 17% over the same period last year. Nearly 75% of this was from private companies that are boosting manufacturing capacities to take advantage of the Production Linked Initiatives ("PLI") as well as Atmanirbhar initiatives. Total capex reported by listed companies in the trailing twelve months at Rs 24 lakh crore, which has more than doubled compared to six years ago.

Since the announcement of the initial PLI schemes back in 2020, the nature and extent of this program has increased dramatically. The total outlay by the government across the different schemes is now over Rs 2.7 lakh crore (See Figure 7). This has been one of the main drivers of the pick-up in private capital expenditures.

Figure 7

PLI Outlay – By Scheme

Scheme	Outlay (Rs bn)
Semiconductors	760
Electronic systems	556
Automobiles	259
Renewable Energy	240
Pharmaceuticals	219
Chemical	181
Telecoms	122
Food Processing	109
Textiles & Apparel	107
Metal & Mining	63
White Goods	62
Medical Devices	34
Aviation	1
Total	**2,713**

Source: Invest India, MeITY

A telling example of this opportunity is the recent push by Apple to diversify its supply chain outside of China. Apple exported over US$5 billion-worth iPhones from India in the first seven months of FY2024 (April-October 2023), a 177 percent year-on-year growth. The company's share in Indian smartphone exports had grown from 9 percent in April-June 2022 to nearly 50 percent in volume terms in Q2 2023, outpacing Samsung to become the largest smartphone exporter from India. Apple, along with its suppliers, aims to produce more than 50 million iPhones annually in India over the next two to three years, as reported by the *Wall Street Journal* on December 7, 2023. Already, their partners such as Foxconn, Pegatron, Jabil, and Corning have announced major expansion plans in India alongside large Indian conglomerates such as the Tatas (who also bought out Wistron's plant). We believe this is just the beginning, as many other multinational companies are also looking to expand their global supply chain into India. Further, the scale of investments from recent PLI schemes announced in semiconductors and renewable energy would be multiples of PLI schemes announced earlier in areas such as electronics, chemicals, automotives, etc.

We view this as a multi-year trend that should drive corporate earnings over the next several years. We continue to look for companies to add to our portfolio that would benefit from the multi-year opportunity.

Portfolio Insights – Special Situation

We remain firmly committed to our investment philosophy of **backing outstanding management teams spearheading incredible businesses that have the ability to compound capital over a long period of time**. By being true to our investment philosophy, and investing in such businesses at a reasonable price, we are maximizing our probability of compounding capital at a healthy pace over the long term. Around 80% of our portfolio consists of these steady compounders, where we have a high level of conviction on their ability to generate strong earnings growth over the next several years, without a significant change in strategy or business model.

Targeting higher potential returns from a smaller portion of our portfolio, we look to identify around four to five companies that we believe are an inflection point of growth, driven by factors such as a change in management, change in strategy or a shift in industry dynamics. For this portion of the portfolio, the aim is to generate outsized returns through a combination of a pick-up in earnings growth backed by valuation rerating as well. Needless to say, the risk on this portion of the portfolio is higher, as the variability around the potential outcomes is higher. Therefore, we limit these ideas to 20% of our portfolio. The ones that we play out in accordance with our thesis invariably then move into the steady compounder bucket of the portfolio.

One such business that we invested in recently is Fortis Healthcare.

Fortis Healthcare (Market Cap – Rs 31,323 crores)
Fortis is a large healthcare service provider chain in India with 26 hospitals and ~4,000 operational beds. Fortis also owns 400+ diagnostics labs with ~3700 collection centres across India. The company has 11,000+ trained healthcare professionals. Fortis is largely present in India, with a small presence in United Arab Emirates (UAE) and Sri Lanka. The company went through a change in ownership recently. IHH Healthcare Berhad, an international private healthcare group headquartered in Malaysia took control of the company from the Singh brothers, who went through bankruptcy. Since then, there has been a change in the management team as well as strategy of the company. For FY24, the company is on track to generate around Rs 5,674 crores in revenues and Rs 531 crores in PAT, with an ROE of 12% and ROCE of 13.1%.

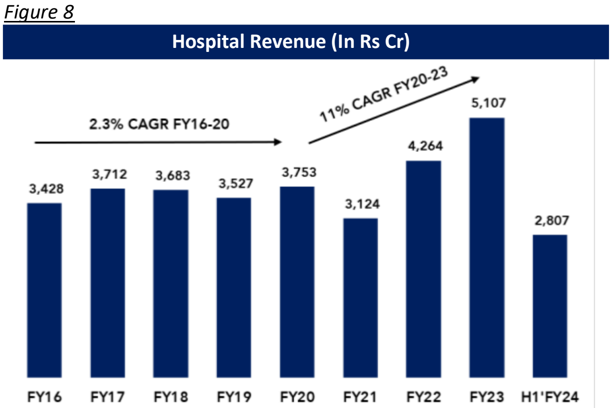
Change in Ownership and Management
Fortis Hospital was founded by the Singh family, who were also the erstwhile owners of Ranbaxy Laboratories. It was incorporated in 1996 and over the next 20 years, it had established a dominant presence in the National Capital Region (NCR) as well as in Punjab. However, under the third generation, Malvinder and Shivinder Singh, the company went through gross mismanagement, corporate governance issues as well as fraud. Having tracked the hospital sector for several years and visited many of Fortis' hospitals in the NCR region, we believed that the underlying assets in the company were quite strong. The quality of medical facilities as well as doctors were among the best in the country, while the Fortis brand name was also well recognized and appreciated by patients. The problems lay mainly at the promoter level.

After being forced into bankruptcy by their creditors 2018, IHH acquired a 31% stake in the company in 2018, as well as initiated an open offer to buy an additional 26.1% stake. As part of the acquisition, IHH took management control of the company as well as appointed 4 of their representatives to the board. This improved the corporate governance within the company significantly.

Furthermore, the IHH Group appointed Dr Ashutosh Raghuvanshi as its CEO in 2019. Before joining Fortis, Dr Raghuvanshi spent over 18 years with Narayana Health, a leading healthcare chain operating over 28 hospitals, in various leadership roles including as its Vice Chairman, Managing Director and Group Chief Executive Officer (MD & CEO). His past tenure includes stints with the Bombay Hospital, Apollo Hospitals, Vijaya Heart Foundation and Manipal Heart Foundation. Our channel checks suggest Dr Raghuvanshi was instrumental in improving the operational efficiency and return metrics for Narayana Health.

Under Dr Raghuvanshi, the turnaround within the company is already well underway. Revenue growth, which was flattish from FY16 to FY20, has now accelerated to 11% CAGR over the past three years. (See Figure 8) Additionally, operating margins have also improved from 12% at the time of his joining to around 18% currently. With improved corporate governance and a strong management team, we believe the company is now better positioned to leverage its strong positioning in the NCR region going forward.

Figure 8

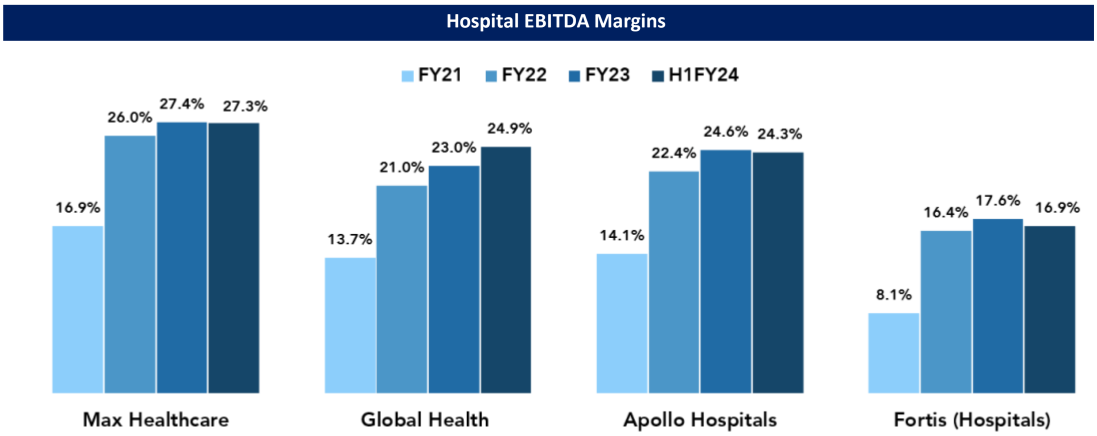


Source: Company data

Strong Network Effect in NCR

In the past, the company had made the mistake of spreading itself too thin by expanding across the country with smaller size hospitals in several of the cities. Many of these hospitals were not able to attract the right mix of doctors and services due to lack of scale. This, along with poor execution, resulted in a drag on operating margins. As a result, the company had margins which were much lower than its competitors. (See Figure 9)

Figure 9



Source: Company data

In our recent meeting with management, they articulated a significant shift in strategy under the new management. Firstly, the company plans to exit non-performing hospitals in non-core regions. It has already embarked on this with the recent exit of two hospitals in Chennai. Secondly, future expansion in terms of bed additions would mainly be through brownfield expansion to hospitals. The idea out here is to grow the existing hospitals to a critical size of 300-400 beds, which then allows each hospital to generate a sufficient inflow of patients that would then make it economical to invest into building up more high end tertiary care services. Many of its larger hospitals are already quite profitable, reflecting the ability for the company to generate margin leverage as it improves its geographical mix and scale. (See Figure 10)

Figure 10

Q2FY24 Margin Matrix					
EBITDA Margin (%)	**No of Facilities**	**Revenue Contribution**	**Operational Beds**	**ARPOB (₹ mn)**	**Occupancy**
20%-25%	9	62.6%	2,210	23.9	72.2%
15%-20%	5	16.7%	720	18.6	76.4%
10%-15%	1	2.8%	119	22.3	62.6%
<10%	7	17.1%	951	19.5	58.2%
Total	**22**	**100.0%**	**4,000**	**22.1**	**69.3%**

Source: Company data

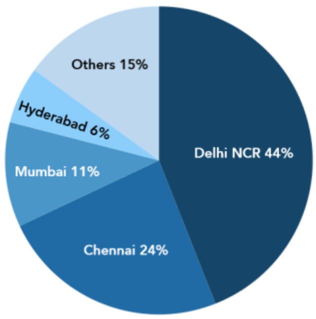
One of the key factors that drives the success of a hospital chain is its ability to generate a strong network effect in a particular cluster driving strong patients as well as quality doctors. Fortis is well positioned to benefit from this network effect in both NCR and Punjab, where it has world class facilities and a strong brand name. The company is looking to further improve the profile of doctors in its network, improve its services mix towards more surgical beds as well as drive higher utilization levels. It is also looking to publicly list its diagnostic chains business, further unlocking value. All of this should help the company in significantly improving its margin profile and thereby its ROCE metrics.

Long Runway for Growth

There is a very large latent demand for quality healthcare in India. Compared to an average of 2.9 beds per 1,000 people in USA and 4.3 beds per thousand in China, India just has 1.2 beds per thousand. With rising per capita GDP, increasing penetration of health insurance which is growing at over 25% yoy, as well as rising medical tourism – we believe the runway for growth for Fortis is very long. The NCR region in particular is one of the main hubs for medical tourism, servicing 44% of the medical tourists that come to India. (See Figure 11). With strong growth from private hospital chains as well as strong infrastructure as well as doctor facilities, we believe the NCR region will remain the key hub in the foreseeable future.

Figure 11

Medical Tourist by Region – As on 2017



Source: Max Healthcare Investor Presentation

The company plans to add 1,800 beds through FY28, a growth of 40% in terms of capacity. Additionally, utilization levels and average revenue per occupied beds (ARPOBs) should also improve over the next five years driven by the several management initiatives discussed earlier. Revenue growth had been stagnant for several years for the company, until IHH took over. We expect this growth to sustain over the next five years as well driven by bed additions and increase in revenue per bed. This, along with improving operating margins should help the company deliver a 20% CAGR in earnings over the next five years.

Fortis Healthcare has been trading at a 20%-30% discount to its peers given its corporate governance issues of the past, poor profitability as well as lack of growth. As the company delivers higher earnings growth, improving ROCE and unlocks value though the listing of the diagnostic business, this should help the valuations rerate to peers. A combination of strong earnings growth as well as valuation rerating result should result in an outsized return from this position, which is what we would typically look for in a thesis based on a turnaround.

Conclusion

In closing, we would like to thank you for your support and faith in the White Whale Portfolio Management Team. We look forward to a long and prosperous partnership together. If you have any questions, feedback, or suggestions, please always feel free to reach out. We look forward to hearing from you.

Sincerely,

White Whale PMS Team