WHITE WHALE PARTNERS

White Whale North Star Portfolio – 3Q FY23 Quarterly Letter

Dear Partners,

Greetings from White Whale Partners. We are pleased to update you on our performance for the quarter ended December 31, 2022.

Portfolio Performance

For the quarter ended December 2022, the portfolio was down 2.3%, compared to Nifty that was up 6.1%.. For the last 12 months, our portfolio was down 1.0% compared to Nifty which was up 5.7%. Since inception, the portfolio is up 45.9%[(1)]*, compared to 47.0%.

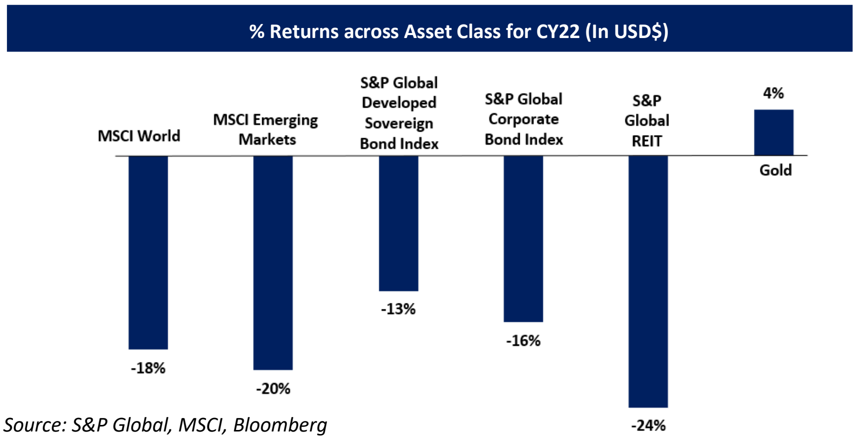
Figure 1

	3 Month	6 Month	1 Year	Inception*
WW North Star	-2.3%	17.1%	-1.0%	**45.9%**
Nifty 50 TRI	6.1%	15.3%	5.7%	**47.0%**

* Adjusted for cash from 11th November 2020 to 31st December 2020. Represents Absolute Returns.

Globally, 2022 has been a difficult year across asset classes. In our very first investor letter in December 2020, we had mentioned – "Volatility is an inherent feature of all equity markets. However, the swing in sentiment from extreme fear to extreme greed over the last twelve months has been unprecedented." In some sense, an absolute inverse of the euphoria and excitement seen in the second half of 2020 and through 2021 has now played out to a fair degree in 2022, with no major asset class being spared, except gold (See figure 2).

Figure 2



Source: S&P Global, MSCI, Bloomberg

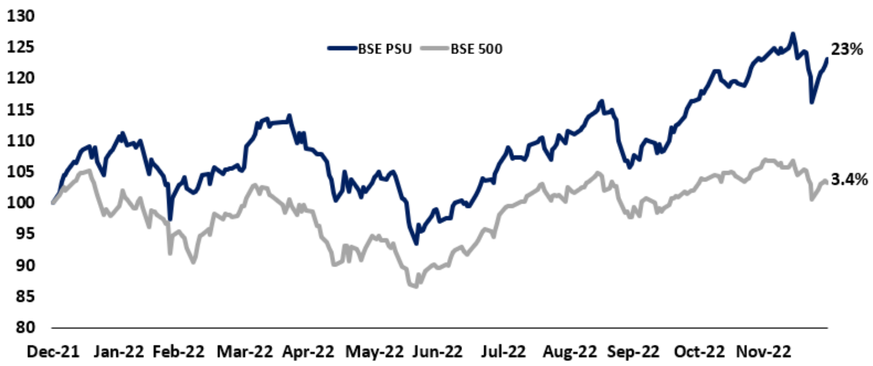
In spite of the steep correction seen across asset classes globally, the Indian equity markets held up remarkably well, and were up around 4% for the year. India was among the top performing emerging markets, driven by steady domestic investor flows as well as a healthy macro-economic environment, buoyed by a pick-up in the private capex cycle. While the White Whale North Star portfolio is up close to 20% on an annualized basis since inception, we have underperformed the broader indices such as the Nifty and BSE500 over the last 12 months. A large reason for this is a sharp pull back in

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.

"deep value" stocks that don't fall within our investment frame work. As an example, the government owned companies index (BSE PSU Index) was up 23% in CY22 compared to the BSE500 up 3% (see Figure 3). Additionally, sectors that we don't invest in such as oil and gas, power and utilities , were up 17%, 26% and 22% respectively, much ahead of the overall markets.

Figure 3

BSE PSU and BSE 500 Return (%) in CY22

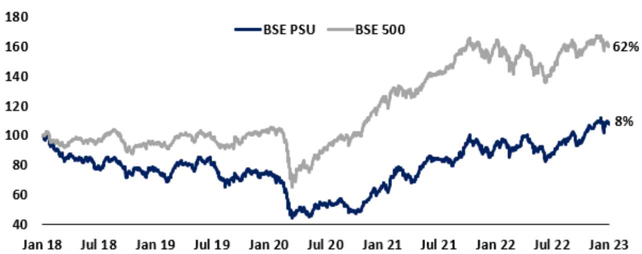


Source: BSE India

In our view, government owned companies don't have their incentives aligned with minority shareholders, are run by bureaucratic management teams and also carry a high level of regulatory risk. In the past as well, we have seen brief periods where these stocks have seen a sharp rally - typically when their valuations have collapsed into a deep value zone. However, over a five to ten year period, these businesses have sharply underperformed the broader markets. (See figure 4 and figure 5).

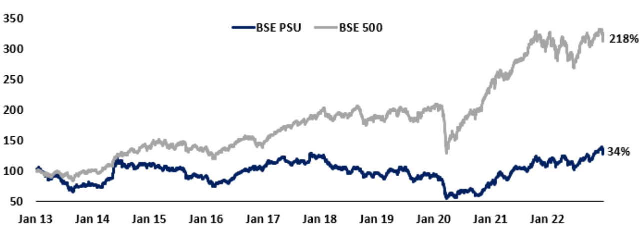
Figure 4

BSE PSU and BSE 500 Return (%) for Last 5 Years



Source: BSE India

Figure 5

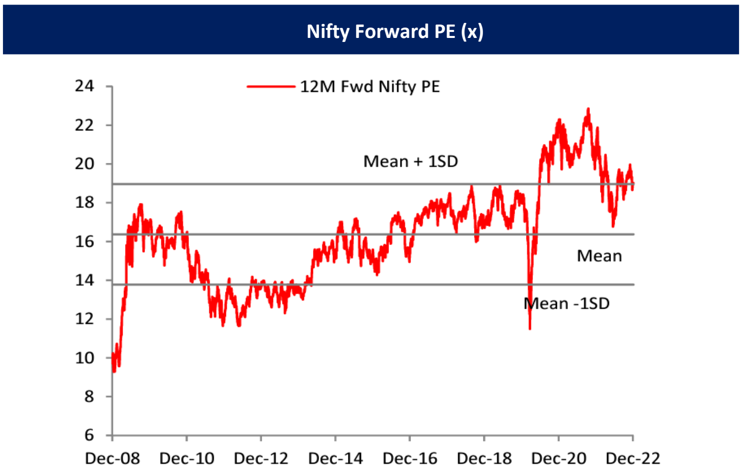


Source: BSE India

We remain firmly committed to our investment philosophy that has served us well over the last several years, and given our long term time horizon, are willing to accept these periods of relative underperformance. We are excited about the growth prospects in India over the next decade and believe several businesses are either at a nascent stage or about to hit an inflection point in growth. We remain focused on trying to ***identify incredible businesses backed by outstanding management teams that can compound capital over a long period of time*. We believe this is critical towards delivering healthy returns in the long term, while ensuring capital protection.

One area of concern that still remains is valuations. Nifty is currently trading at 19x forward earnings, compared to last fifteen year average of 16x (See figure 6). From a relative perspective also, MSCI India index now trades at 85% premium to the MSCI emerging markets index in terms of forward earnings, compared to a historical average premium of 62%. While this is partly a reflection of the strong macro-economic positioning in India, there also is a risk of continued time correction, as earnings catch up to valuations and/or foreign investor outflows continue.

Figure 6



Source: Phillip Capital

In our opinion, predicting the rerating and derating of the stock market remains a schizophrenic exercise. We internally continue to focus on the underlying earnings growth of our portfolio companies, which is the key driver of investment returns in the long run. **Our portfolio companies in aggregate delivered healthy performance in 2QFY23, with revenue growth of 22% and operating profit growth of 21%, over the same period last year. Even on a three-year CAGR basis (excluding the varying base effect of Covid), aggregate revenues of our portfolio companies were up 17% and operating profits were up 24% over this period.** We remain confident that our portfolio will continue to deliver in excess of 20% 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 companies that are well positioned to gain market share in established industries, due to their unique competitive positioning.

Macroeconomic Developments

As discussed in earlier letters, the resilience that India has shown in the face of several macro-economic headwinds – high inflation, tightening monetary policy, Russia-Ukraine war, oil price spike – is remarkable. The momentum seen through 2022 continued into the December quarter as well. The IIP index, which represents growth in the heavy industrial segments, was up 5.5% last quarter. Real estate demand trends remains strong, with volume growth of over 20% in the December quarter. Tax collections have shown strong momentum, with direct tax collections up 25% y-o-y while GST collections also up 26% in the first nine months of FY23. Inflation is starting to cool off, with the December CPI numbers coming in at 5.7%, a twelve month low. This could likely mark the beginning of the end of RBI's tightening monetary policy cycle. The biggest risk that we foresee in the near-term is the sharp U-turn that China has taken with regards to its Zero Covid policy. Regularization of economic activity in China could result in increased demand for commodities, especially oil. India, being a net importer of commodities, could see a higher current account deficit, a weak rupee, an uptick in inflation and weakening consumer demand in this backdrop. However, from a medium term perspective, our investee companies have long term compounding potential with resilience against macro-economic variables such as inflation and interest rates, aided by a strong competitive positioning and pricing power. Therefore, while not immune, they are less impacted by macro-economic trends over our investing time horizon.

In our September letter we had discussed our optimism about a turn in the corporate capex cycle, which India has not seen for over a decade now. We have invested in companies such as Tube Investments and Timken that can provide industrial products catering to this capital expenditure, while at the same time not taking the long duration risk, associated with such projects. Apart from that, our investments in banking and financial services industry would also benefit from an increase in corporate capex.

Rising consumer discretionary spending is another trend that we are quite excited about. The GDP per capita in India has increased from USD$500 to USD$2,500 in last 20 years. Looking at the recent trajectory, India is well positioned to achieve a GDP per capita of USD$10,000 in the next 15 years. We believe the next 10-15 years will see India go through a similar journey as China did between 2007 and 2020, with an exponential increase in consumer discretionary spend driven by a rising middle class and upper middle class population. This will further be aided by the declining cost of providing last mile financing, helped by the pick-up in UPI and the rise of account aggregators. Finally, there is a demographic shift happening in India, with an increase in nuclear families. As per the latest census, nuclear families account for 58% of households in 2020 compared to 52% a decade ago. This is because the youth are becoming more empowered, driven by the rise in the gig economy and private jobs. This is another catalyst for a rise in consumer discretionary spending. We have identified several companies in our portfolio, run by a great management teams, that are well positioned to benefit from this trend.

Portfolio Insights – Portfolio Framework

In our previous investor letter we had written about the ethos of "skin in the game", which is deeply embedded in our philosophy. At White Whale, one of the key principles that we operate on is to put money where our mouth is. As a result, there is a high focus on capital preservation and ensuring a balanced risk-reward mindset.

"A lot of great fortunes in the world have been made by owning a single wonderful business. If you understand the business, you don't need to own very many of them." – Warren Buffett

One of the key tenets in our portfolio construction is to maintain a concentrated portfolio of 10-15 companies. This not only enables us to scale up our highest conviction ideas, it also allows us to do deep primary research on our existing positions, while at the same time, maintaining a high filter on what gets into our portfolio. However, a concentrated portfolio comes with related risks. Practically speaking, despite deep research and/or high conviction behind a particular thesis, not all positions play out as underwritten. With a concentrated portfolio, the impact of each position tends to be exaggerated.

We look to balance this risk through our portfolio construction. We don't look to make outsized returns from every investment in our portfolio. Within the portfolio, we look to identify around five to six companies that we believe are relatively undiscovered and are on the verge of an inflection point in terms of growth driven by either a change in management, change in strategy or a shift in industry dynamics. For this portion of the portfolio, we are looking 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 of getting this thesis correct is also much higher, as the variability around the potential outcomes is higher.

To offset this, we look to invest in around nine to ten 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. We recognize that many of these companies could be trading at valuations well above the market average. To mitigate this risk, we first look for certainty of high earnings growth over several years. This ties into our philosophy of investing within our circle of competence, and having a detailed understanding of the company's management, competitive edge and addressable market size. We then assume a reversion of valuation multiples to a reasonable level over a five year time horizon, to calculate the implied rate of return. A healthy implied rate of return alongside strong conviction of high earnings growth drives our investment decisions for such companies.

A company that aptly exemplifies this point and is well positioned to benefit from a pick-up in consumer discretionary spend is Titan Industries, where we have been invested right since inception.

Titan Industries

Description

Titan Industries is a Tata Group company which originally started in 1984 as a watch company. In 1994 it diversified into jewellery under the brand name Tanishq, which now drives over 95% of the company's profits. Over the last few years it has diversified into eyewear, woman ethnic wear, perfumes and wearable devices, where it is looking to replicate the success it has had on the jewellery front. Over the last five years, the company has grown its revenues at an annualized rate of 16% and profits at an annualized rate of 15%. For FY23, the company is on track to generate around Rs34,000 crore in revenues and Rs 3,100 crore in PAT, with an ROE of 33% and ROCE of 28%.

How does Titan stack up against White Whale's 3 pillar framework?

Stellar People x Incredible Business x Time = Compounded Returns

Stellar People

In our meeting with Jacob Kurien, who was the COO of Titan from 1996 through 2003, he highlighted the focus of management right from inception has been to instil a culture of team work, flat hierarchy, open communication and innovation. This culture has been the key to Titan's phenomenal success of the last couple of decades. As an example, in the early days the company was struggling in its jewellery foray with low footfalls, poor conversion rates and high overheads. Feedback from store managers and on the ground sales team helped them realize this was related to a sense of intimidation that many women felt in entering their store, as compared to their local jeweller. There was also a perception that the company had high gold making charges, compared to the local jeweller. Taking that feedback into account, the company offered free gold testing of old jewellery for all customers, which drew in footfalls. Once the customer tested the gold, there was better awareness of the malpractices of the local jewellers. At the same time, Tanishq offered to exchange the gold value in the old jewellery against the purchase of new jewellery. This instilled a sense of trust and appreciation among the customer base and radically turned the business around. This culture of team work and open communication helped them in several other instances also, such as implementation of the Golden harvest program, gold leasing and introducing innovative jewellery designs.

It has also helped the company ensure continuity among its top management team. Bhaskar Bhatt became managing director in 2002 and headed the company for over 17 years. Mr Venkatraman, who took over as managing director in 2019, has been the head of the jewellery division since 2005 and was head of sales and marketing since 2003. Most of the top level of management at Titan have been with them for several years. This has ensured a continuity in culture right from inception, enabling the company to maintain its competitive advantage. In addition, the company's parent, the Tata Group is recognized for its high level of corporate governance and transparency.

Incredible Business

The company has several competitive advantages that have enabled it to continuously take market share over the last twenty years. The largest competitive advantage is the trust it has built in the eyes of the customer. Right from inception, they offered free testing of gold, highlighting the significant malpractices of local jewellers, where the quality of the underlying gold in the jewellery was much inferior to what was promised. The Tata Group brand name also helped solidify the trust factor while purchasing jewellery. This trust has translated into the success of the Golden Harvest Program, which accounts for almost 40% of overall sales. As per the program, the customer pays an instalments every month, over 10 months, which then eventually converts into a purchase at the end of the period, equivalent to the redemption value. Thus, the customer is essentially financing the working capital requirements of the company for that purchase, making the business capital light. While other jewellers also replicated this scheme, they have not had the success that Titan enjoys. Additionally, given the company's size, scale and parentage, many banks have entered into a gold-leasing program with Titan, which further reduces the need for working capital.

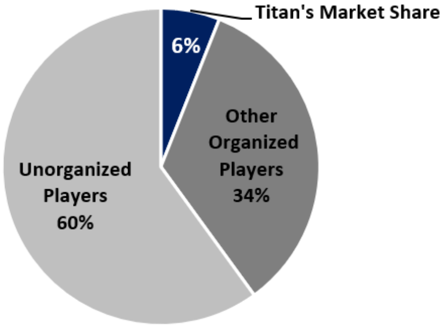
The culture of innovation within the company has enabled them to broaden their designs from adornment jewellery that they focused on initially, to wedding jewellery. They customize the wedding jewellery to the local needs of different ethnic groups across India – another factor that competitors have not been able to replicate. Their past success has also made it easier for them to find local franchisees, who are willing to commit capital towards their expansion. Further, given the high ticket size of the product, the threat of disruption from on-line commerce is also low, as customers would like to try-on the product before purchase.

At the other end, the regional and local jewellers are facing several headwinds. The government has been tightening the strings in terms of black money being used for jewellery purchase. Any purchase over Rs2,00,000 needs a PAN card, enabling tax authorities to track purchases. Recently, the government has also made hall marking compulsory for all jewellery, which then makes it easier to monitor the quality and standard of the underlying gold. This would prevent the fraud that was rampant among several local jewellers. Given the high levels of default seen in this sector, banks have also tightened their loan underwriting for this industry. All of this makes it a very difficult environment for many jewellers to survive, thereby making it easier for Titan to continue to gain market share.

Given high customer trust, low capital intensity, increasing geographic reach, innovator mindset and a weak competitive landscape, Titan is very well positioned to continue to grow profitably for the next several years.

Figure 7

India's Jewellery Market



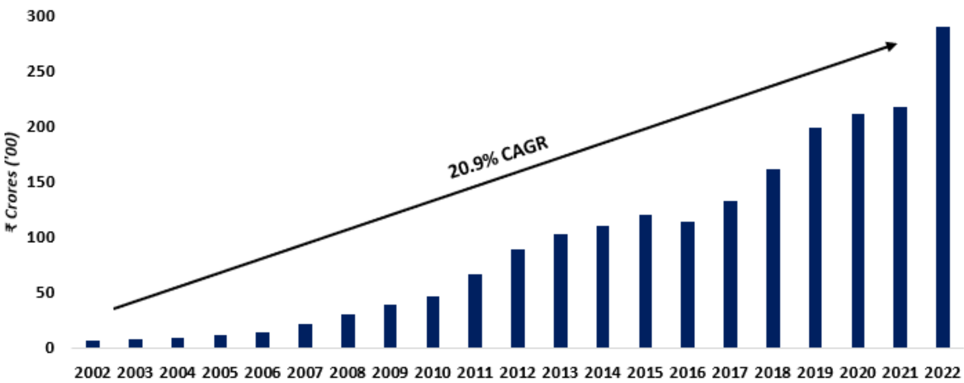
Source: Company, Industry Data

Time

Over the last twenty years, in spite of compounding revenues at 21%, the company still only has a 6% market share of the jewellery industry in India (See Figure 9). Even within the organized sector, its market share is only 13%. Over the last few years, the company has made a conscious effort to regionalize its designs and styles to cater to the smaller towns across the country. Additionally, it is also setting up stores internationally to cater to the Indian diaspora in regions like the Middle East and USA. Apart from that, it has taken a strategic stake in Caratlane, to tap into the online jewellery business, which is at a much lower ticket size. All of this provides it with sufficient leg room to continue to gain market share for several years.

Figure 8

Titan's Revenue



Source: Company

As the per-capita income in India grows towards USD$10,000 over the next 15 years, the jewellery industry itself is poised to grow at a much faster rate, given rising discretionary income. Additionally, in spite of the low income levels, India is the highest consumer of gold jewellery in the world. This is related to a combination of cultural affinity towards gold jewellery as well as a store of wealth historically given limited access to the financial services. We believe the demand for gold jewellery for adornment and festive wear will transcend generations, providing a long runway for growth for this industry.

Finally, the company is looking to replicate its success in the jewellery division, across other consumer discretionary products such as eyewear, women's ethnic clothing, wearable devices, bags. Any success in these segments would provide additional optionality to the business.

Given its strong positioning in the jewellery segment as well as additional growth from the new segments, Titan is very well positioned to deliver 20%-25% earnings growth over the next 5 years, with ROEs of over 30%. While the stock trades at a rich earnings multiple, even if they were to normalize over the next five years, the stock would still deliver strong annualized returns. It remains a core holding in our portfolio.

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