WHITE WHALE
PARTNERS

White Whale North Star Portfolio – 2Q FY22 Quarterly Letter

Dear Partners,

Greetings from White Whale Partners. We are pleased to update you on our performance for the quarter ended September 30, 2021.

Portfolio Performance

Our invested portfolio continued to deliver healthy absolute and relative returns. For the quarter ended September 2021, the portfolio was up 19.8%, compared to 12.4% for the Nifty. For the first half of FY22, our portfolio is up 28.2% compared to 20.8% for the Nifty. Since inception, the portfolio is up 50.8%, compared to 40.9% for the Nifty (adjusted for our average cash holding through November and December 2020 as we gradually built out the portfolio).

Figure 1

	1 Month	3 Month	6 Month	YTD FY22	Inception*
WW North Star	**6.5%**	**19.8%**	**28.2%**	**28.2%**	**50.8%**
Nifty 50 TRI	**-0.1%**	**12.4%**	**20.8%**	**20.8%**	**40.9%**

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

"Time in the market beats timing the market, almost always" – Ken Fisher

Given the positive sentiment in the market and the sharp rally seen over the last several months, there are two questions that we get repeatedly asked in our conversations with investors: 1) What is your view on the markets at this level? 2) Is this the right time to invest? The answer to the first question is fairly simple – we don't have a view on markets in the short term. There are just way too many variables to have an informed view on the same. Over our twenty year career, we still have to come across someone who has consistently got this right. At best, it's a guess, not an informed view. With regards to when is the right time to invest, there is a very apt observation by one of the most successful investors:

"Far more money has been lost by investors trying to time corrections than in all corrections combined." – Peter Lynch

As per a study done by Peter Lynch, since 1965, if an investor was consistently unlucky and invested a certain sum of money at the peak of the market each year, she would have generated 10.6% annualized returns. On the other hand, if she timed the market perfectly, and invested that sum at the bottom of the market each year, she would have generated 11.7% annualized return. The difference between consistent perfect timing and consistent bad timing is only 1.1%. Another case in point was our experience when we launched the PMS scheme in mid-November. The markets had already rallied 65% from the March 2020 lows, even though there was still significant uncertainty with regards to pace of economic recovery as well as the risk of a second covid wave. We faced the same pushback then – is this the right time to invest? Over the subsequent ten months, markets are up another 40%+ and our portfolio has delivered over 50% returns. We would strongly advocate that investors determine their equity allocation as per their risk appetite, and then gradually deploy that capital through a monthly SIP (systematic investment plan) rather than trying to time the market.

Internally, we spend zero time trying to figure out when the next market correction will come and don't take any active cash calls. We spend all our time and energy in trying to identify *incredible businesses, backed by outstanding management teams that can compound capital over a long period of time*. We believe this is a much more productive use of our time and critical towards delivering healthy returns in the long term, while also ensuring capital protection.

WHITE WHALE
PARTNERS

Macroeconomic Developments

As expected, the impact of the second wave has been limited from an economic perspective. This is because unlike the first wave, the hard lockdown was for a brief period this time, and more importantly, businesses have adapted to operating in the new environment. With the vaccination drive progressing well, we believe any impact from a potential third wave will be even more limited. This, combined with the liquidity infusion from RBI, fiscal stimulus from the government in the last budget as well as pick up in private sector capex, positions the economy well for a cyclical recovery. There are two areas in particular, which we believe should give further impetus to the cyclical recovery.

Robust Real Estate Sales

Firstly, the pick-up in real estate demand post the second wave has surpassed even the most bullish estimates. Volumes for the large listed developers were up 60% over last year in the September quarter and more importantly are up 15% compared to pre-covid levels. The pain seen among the smaller developers post RERA is abating. Large, leveraged developers have been able to raise capital and refinance debt. On an aggregate level, top ten listed developers in India have been able to cut debt by 37% between March 2020 to June 2021. This provides plenty of liquidity for new project launches. Mortgage rates at 6.5% are at a 16 year low. In several geographies, prices have been stagnant for the past five to six years, while per capita income has continued to increase at a steady pace. As a result, according to HDFC, affordability is at a 25 year high. Add to that the incentive by the government in the form of stamp duty cuts and/or tax incentives to developers, and many buyers that were waiting on the side lines have now been completing deals. This is resulting in a sustained turnaround in real estate demand. This is important for several reasons. Real estate construction is the largest employment creator in the economy, accounting for employment of over 52 million people. It is also a big driver of growth across several ancillary industries, and therefore plays an important role in the health of several corporates in India. While we don't foresee us investing in real estate developers directly, primarily due to questionable corporate governance frameworks, we have identified several companies in our portfolio that are well positioned to benefit from this turn in cycle.

Continued Government Spending

Secondly, the government is making rapid progress across several programs that have been introduced over the last couple of years. As discussed in our previous letter, the FY22 budget was a game changer, where the government has firmly committed to its growth agenda by significantly increasing capex spend, while keeping tax rates unchanged. Subsequently, given the buoyancy in the economy, tax collections have actually been higher than expected. On current trends, the fiscal deficit could actually be 50bps lower than budget estimate of 6.8%. Additionally, sale of Air India should open up the pipeline for further divestments of companies owned by the government, further boosting government income, which will in turn be spent on infrastructure development. The PLI schemes continue to make good progress, with the finalization of the auto ancillary scheme as well as proposal to set up six new textile parks. On the power front in particular, the new electricity bill is a significant step towards the privatization of electricity distribution. It also proposes to increase short term power to 25% of overall power volumes, compared to around 12% currently. This is a significant boost to one of our key positions, IEX. (See 4QFY21 Quarterly letter).

As the cyclical turnaround takes shape, we believe operating leverage, coupled with top line momentum, should result in a strong rebound in earnings. Our portfolio remains well positioned to benefit from this possible uptick in economic activity.

Portfolio Insights – How do we view risk?

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.

It is a given that we have to take risks when we invest. In the current environment of exuberance, it is particularly important to keep a close eye on risk management. While we do our best to assess the risks we take, there is no certainty

WHITE WHALE
PARTNERS

as to how an investment is likely to play out as there are a range of possible outcomes with varying degrees of probabilities. Thus, despite our best efforts we have and will inevitably be wrong from time to time as to how some investments play out. Our endeavour is to minimize the impact and frequency of the times when we are wrong and maximize that when we are right.

Risk for us, first and foremost, is a permanent loss of capital. This occurs primarily due to two reasons – (i) disruption in the business model, and (ii) corporate malpractice. Several factors in our risk management framework help mitigate these risks. Firstly, we believe in investing only within our circle of competence, where we have a detailed understanding of the business and the industry that it operates in. Secondly, given our concentrated portfolio and long-term time horizon, we spend a significant proportion of our time conducting in-depth research and diligence on our existing investments. Every few months, we re-underwrite our investment positions by questioning our existing thesis and re-evaluating the bear case. We believe a healthy amount of paranoia on potential risks is essential, given the tendency to develop confirmation bias on long held positions. Finally, we completely avoid businesses that are in industries with high regulatory risk and/or have significant commodity exposure. Another essential filter, especially in the post-Covid world, is to always be in businesses that are either beneficiaries of digital disruption or are disruptors themselves.

In order to mitigate the risk of corporate malpractices, it is essential to invest in companies with the highest standards of corporate governance. An in-depth analysis of financial statements, annual reports and past governance track records is a given. However, we strongly believe that the best mitigant towards this risk is primary channel checks, as people within the industry have the best view of players in that industry. Conducting primary checks across suppliers, distributors, customers, competitors as well as talking to employees within the company can provide insights that are beyond analysis of financial metrics and annual reports. Any corporate governance concern is an immediate hard stop for us.

There are two other types of risk that investors must also contend with – market volatility risk and valuation risk. Volatility risk is out of our control. Given our long term time horizon, it is not only something we are fine to live through, but we also believe that oftentimes volatility can be used to our advantage to scale up on high quality companies that have been mispriced due to temporary dislocations in the market. Valuation risk is a perpetual concern when looking to invest into quality companies, especially in the current environment. **We are not valuation agnostic.** To mitigate this risk, we first look for certainty of high earnings growth over several years. This again ties into 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. As Charlie Munger put it - “Over the long term, it's hard for a stock to earn a much better return than the business which underlies it earns...if a business earns 18% on capital over 20 or 30 years, even if you pay an expensive looking price, you'll end up with one hell of a result.”

We thus maintain a high barrier when it comes to filtering for risks which keeps us focused on analysing the risks that we do not mind taking. This process helps us mitigate the degree of downside that can be caused from the possible range of outcomes while still allowing us to play for a disproportionate upside from an investment.

As mentioned, in each quarterly letter we plan to discuss one idea that can provide a better perspective into our decision-making process.

L&T Technology Services

L&T Technology Services (LTTS) is a pure play engineering, research and development services (ER&D) company in India formed in 2013 by combining the Integrated Services division of L&T and Product Engineering Services division of L&T Info Tech. The company provides outsourced R&D services in verticals such as transportation, telecom, industrial, process and medical devices. It competes with players like Cyient, KPIT Cummins, Tata Elxsi, and the R&D arms of TCS, Infosys, HCL Tech. The business is very different from that of traditional IT Services companies. Their key customers are the product heads within large organizations and not the CIOs. They work with them in developing new products as well as help manage the lifecycle of existing products. From FY17-FY20, the company reported strong financials with USD revenue CAGR of 17%, much higher than traditional IT Services growth, high EBITDA and PAT margins of ~20% and ~15% respectively coupled with high ROE and ROCE of ~30% and ~29% respectively.

WHITE WHALE PARTNERS

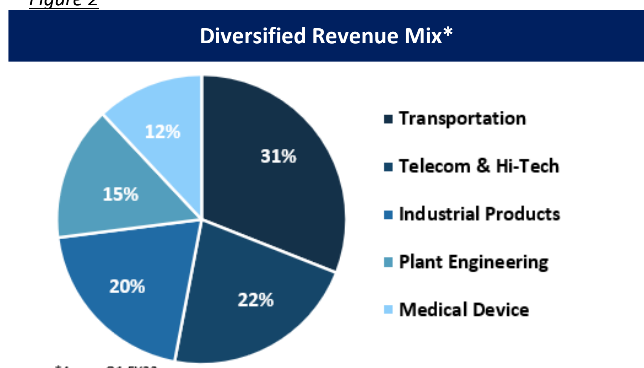
Stellar People

The company was formed through the combination of Integrated Services division of L&T and Product Engineering Services division of L&T Info Tech. This has provided the company with deep domain knowledge consumed over time from the past L&T relationships. Moreover, the L&T parentage has helped the company in diversifying into different verticals along with winning new deals. Both Dr. Keshab Panda, former CEO since 2016 and Amit Chadha, who took over as CEO this year, have been with the company since inception. Under their leadership, the company has demonstrated consistency in profitability and growth. Their focus on building on the deep domain expertise by diversifying the revenue base of the company across verticals and customers, de-risks the business compared to most mid-cap Indian IT Services companies. They transformed LTTS into a company focused on innovation and new technology, leading to LTTS being recognized as one of the most innovative Indian companies in the services category. The overall top management team has seen very limited churn and operates as a cohesive unit, heading different verticals.

Incredible Business

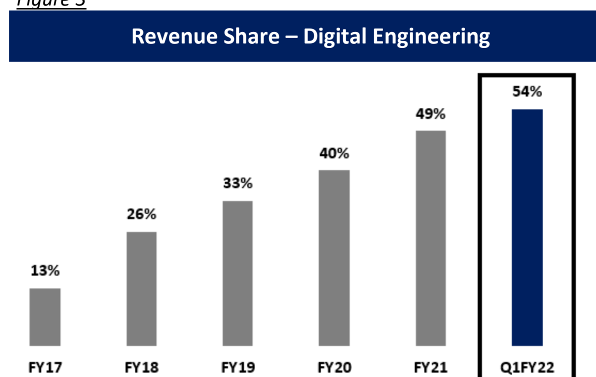
Our channel checks with customers as well as conversations with business managers working for their competitors suggest that the company's capabilities in the ER&D space is much superior to other ER&D focused companies, especially in niche verticals such as process industries and medical devices. This is corroborated by fact that company has won marquee clients from all around the globe. Clients of the company include 57 of top 100 R&D spenders (represents 65% of the top 500 R&D spend). Under stable top management leadership, the company has developed deep relationships with its clients enabling it to retain clients for an average tenor of 7 years. Post Covid, not only are companies transforming their back-end IT systems towards cloud, they are also radically relooking at their new product cycle to better perform in an increasingly digitized world. As a result, spend on R&D is poised to grow significantly, with LTTS positioned very well to benefit from the trend. By offering services across verticals (See figure 2) vs competition (single vertical focused), the company acts as a one stop solution to clients. The company's work has transformed towards embedded and digital technologies despite having bigger competitors such as TCS, Wipro and HCL Tech (see figure 3). This has enabled the company to work alongside captives in different projects to assess each other's capabilities. Recently, the company won a $100 Mn deal with an Oil & Gas major – the highest deal ever won. This provides comfort on the company's ability to mine the customer and overcomes the scalability challenge.

Figure 2



Source: Company

Figure 3



Source: Company

Time

Of the $600 billion R&D spend by top 500 companies in the world, outsourced R&D provides an opportunity of over $380 billion. With a revenue base of $1 billion, the company currently has <1% market share. Multi-vertical presence has led to high skewness (60% of total contracts) towards long term/annuity-based contracts. This provides comfort on the company's revenue potential and order book. The company has demonstrated higher deal wins compared to competitors, despite a stressed environment during Covid. While large IT companies like TCS, Wipro and HCL Tech have gained traction in the ER&D space, their focus continues to remain on IT services. This provides an opportunity for LTTS to bridge the gap in revenue between them.

WHITE WHALE
PARTNERS

The company has seen a sharp run-up over the last twelve months on an improving demand environment. It is now trading at 40x forward earnings, at a premium to historical valuations. However, given the increased R&D spends by its customers as they get their products digitally enabled and accelerated new deal pipeline, we believe the company can compound its earnings at well over 20% over next several years. The company remains a core position 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

DISCLAIMER*: White Whale Partners LLP is a SEBI registered Portfolio Manager. Periodic portfolio performance information is calculated net of all management and incentive fees.The performance is not verified by any regulatory authority. This document has been made available solely for informational purposes and is for private circulation only. The information and opinions contained in this document have been obtained from sources believed to be reliable but no representation or warranty, express or implied, is made that such information is accurate or complete. The information and opinions are not, and should not be construed as, an offer or solicitation to buy or sell any securities or make any investments. White Whale Partners LLP and its employees will not be held liable in any way for any loss or damage, direct or indirect, arising from the use of this information.*