White Whale North Star Portfolio – 4Q FY22 Quarterly Letter

Dear Partners,

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

Portfolio Performance

For the quarter ended March 2022, the portfolio was down 6.2%, compared to up 0.8% for the Nifty. For FY22, i.e., in the last 12 months, our portfolio is up 17.5% compared to 20.3% for the Nifty. Since inception, the portfolio is up 38.3%[1], 40.2 % (net of all management and incentive fees and adjusted for our average cash holding through November and December 2020 as we gradually built out the portfolio).

Figure 1

	3 Month	6 Month	FY 22	ITD**
WW North Star	-6.2%	-8.3%	17.5%	38.3%
Nifty 50 TRI	0.8%	-0.5%	20.3%	40.2%

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

For the current quarter, the portfolio underperformed the broader indices. This was not related to any particular stock or event, but a result of several factors. Firstly, the FII selling that commenced in October of last year, continued unabated. Foreign investors sold USD$17 billion of equities in 4QFY22, which is the highest since 4QFY20, when Covid hit. Over the last five months, foreign investors have sold over USD$27 billion, which is double of the USD$13.5 billion sold during the global financial crisis in 2008. Almost 60% of this was focused on the financial services segment, where they have an overweight position. This significantly impacted our investments in the banking segment, which accounts for 39% of our portfolio. However, the long-term fundamentals and earnings growth trajectory of these banks remain strong, and they remain part of our core portfolio. Secondly, the broader indices were helped by the outperformance of the oil and metals sectors, as these indices were up 7% and 16% respectively for the quarter. We consciously stay away from investing in commodity related businesses, given the unpredictability of global commodity prices and our limited ability to forecast them. While this has impacted relative performance in the near term, we remain convinced that the risk reward ratio remains unfavourable in the long run and investing in such companies is outside the scope of our investment philosophy. Finally, high oil prices related to the war in Ukraine as well as a tightening monetary policy due to high inflation, impacted cyclically oriented stocks disproportionally. Our portfolio however, remains skewed towards such businesses as we believe we are at the start of an economic cycle, driven by a pick-up in capex spending, as discussed in more detail below.

Most importantly, we own businesses for the long run, and therefore view earnings growth as the primary driver for the portfolio's investment returns. From that perspective, our portfolio continues to show healthy growth in intrinsic value, which we believe will sustain over the next several years. Our portfolio companies in aggregate delivered strong 18% revenue growth and 25% operating profit growth in the December quarter, compared to the same period last year. On a three-year CAGR basis (excluding the varying base effect of covid over the last couple of years), aggregate revenues of our portfolio companies were up 14.5% and operating profits were up 23.4% over this period. We believe the antifragile[2]

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.

2 Author Nassim Taleb says defines the term antifragile - Antifragility is beyond resilience or robustness. The resilient resists shocks and stays the same; the antifragile gets better.

characteristics of the companies in our portfolio should enable them to continue to deliver over 20% earnings growth over the next several years.
As always, 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.

Macroeconomic Developments
Increasing inflation remains a rising concern globally, with inflation in the US at a forty year high. This has been further exacerbated by the war in Ukraine, which was resulted in a surge in oil and food prices. The hard lockdown in China is once again playing havoc across the supply chains globally, further creating large scale shortages and distortions in prices of several products. In India as well, the consumer price index (CPI) has increased to 7.1% for the month of March. In response, central banks globally have embarked on a tightening monetary policy, with the Federal Reserve implementing a rate hike of 25bps in March, the first in more than 3 years. We expect the RBI to follow suit, and expect a series of rate hikes through the year.

However, we believe India is in a much better position this time, compared to the monetary tightening scare in 2012-2013. Back then, Morgan Stanley had coined the phrase "the Fragile Five" referring to the economies of Brazil, India, Indonesia, South Africa and Turkey. All five were running sizable current account deficits financed by inflows of foreign capital, and foreign exchange reserves were fairly low. This made them susceptible to the changing sentiments of foreign investors. This time however, in spite of the relentless selling by foreign investors, the rupee has remained fairly stable in a narrow band around INR 75-76 per USD. India's foreign exchange reserves have swelled to USD$617 billion from USD$207 billion back in 2013. It now covers over 10 months of imports. Current account was actually at a surplus of 0.9% of GDP in FY21, compared to a deficit of 6.7% in 2013. For FY22, current account deficit is expected to remain under control at 2.8%. Foreign direct investment has increased from USD$22 billion in 2013 to USD$60 billion in FY21. Additionally, with the recent government push on domestic manufacturing, foreign direct investments are expected to further surge over the next several years. While many emerging economies are facing havoc in the face of tightening global liquidity, India has been and should remain much more resilient.

Moreover, we believe that new investment cycle will continue to drive a turnaround in the economy. India is coming off a tough decade, followed by a series of structural reforms that were undertaken under the Modi government, starting with IBC, RERA, demonetization, and finally GST. A pick-up in growth was further delayed by the IL&FS crisis which caused significant dislocation in credit availability, followed by the Covid induced lockdown recently. As a result, corporate earnings growth has been in mid-single digits on average for the last five years, mainly due to a slowdown in corporate investments. Over the last couple of years, the government has undertaken a series of measures to stimulate the supply side of the economy - an area that has been a perennial constraining factor for growth in India. In November 2019, the peak corporate tax was reduced from 34% to 25%. Over the last eighteen months, the government has introduced several production linked incentive (PLI) schemes, providing a strong incentive to the Atmanirbhar or Make in India theme. Over the last two budgets, the government has firmly committed to its growth agenda by significantly increasing capex spend, while keeping tax rates unchanged. Large corporates have also significantly deleveraged their balance sheets, while the NPA issues in banks have been cleared. As per a recent study done by Crisil, on 740 Indian companies operating across 40 sectors, excluding banking, the net debt to EBITDA ratio for these companies on an average is at a ten-year low of 2.3x. More so, 66% of these companies have seen a drop in net-debt in absolute terms. Corporate India's balance sheet is well primed to embark on a capex cycle. With significant disruption happening across industries such as green renewable energy, electric vehicles and digital transformation, several catalysts are in place to drive this capex. A stable policy making environment provides further comfort to the private sector. Therefore, despite the near team headwinds, we believe these structural drivers will play a more dominant role helping corporate India tide over a tighter liquidity environment, driving healthy earnings growth over the next several years.

With regards to our overall portfolio, we remain focused on investing in companies that have long term compounding potential with resilience against macro-economic variables such as inflation and interest rates in the medium term, aided by a strong competitive positioning and pricing power.

Portfolio Insights – How do we define our timeframe?

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.

"Time is on your side when you own superior companies." – Peter Lynch

A core pillar of our investment strategy is TIME. In our view, what amplifies value creation from an incredible business run by a strong management team is the potential for longevity of profitable growth. In order to harness the power of compounding, we focus on low churn in the portfolio. Our portfolio is designed to achieve superior, consistent returns over a long-term investment horizon.

In our view, thinking long term is a big competitive advantage in the investing industry. One needs to take a step back and understand the size of opportunity and the company's ability to take advantage of this, ignoring short term noise and whether the quarter will be a beat or a miss. We focus on buying businesses with a long runway for growth, as demonstrated by sustained earnings growth of >20%. These could be companies that have a dominant position in industries which are at a nascent stage in their life cycle and thereby are well positioned to grow alongside the industry. Alternatively, the business could have a small market share in a large industry, but is very well positioned to gain market share over several years due to its competitive advantages. Recurring revenue streams and platform businesses are some key attributes that we look for in our companies. Certainty of high long term growth helps immensely in correcting potential valuation mistakes. While valuations can have a large impact on stock performance in the short term, in the long run, stock performance will revert to the underlying earnings growth of the business.

While focused on long term investing, one needs to also be vigilant on the inherent risk from this investing approach. Invariably, an "anchoring bias" can develop where one tends to fall in love with the companies in the portfolio, thereby ignoring the negative developments that can creep into the investment thesis. This is especially true in the current environment where the rate of disruption is accelerating driven by digital technology. In order to offset this, we consciously re-underwrite our portfolio every quarter and actively look for disconfirming evidence to our investment thesis. The key challenge here is to differentiate noise from a genuine change in the fundamentals of the company. We also actively exclude several industries and companies that have a low probability of enduring growth, limiting our focus to a handful of great businesses. Another risk is complacency. Long term investing essentially entails long periods where there is no activity in the portfolio. It is essential at that time to ensure that the research engine remains robust. This would allow us to act with conviction as opportunities arise during times of market volatility.

As always, we plan to discuss one idea that can provide a better perspective into our decision-making process.

Tube Investments
Tube investments (market cap USD$4.4 billion) is a flagship company of the Murugappa group, which itself is valued at over USD$ 25 billion, and has business across finance, insurance, industrial goods, agriculture and manufacturing. Tube commenced operations 65 years ago as a manufacturer of bicycles and over time expanded its manufacturing bouquet across other adjacencies like engineering products and metal formed products. With 55% dependence on the auto sector, revenue growth had been sluggish through FY20, but has seen a sharp uptick since FY21. The company is expected to report revenue of ₹6,300 crores with PBT of ₹600 crores in FY22. It also enjoys ROCE, ROA & ROE of 23%, 12% and 21% respectively. In FY20, the company also bought a 58% stake in CG Power, a manufacturer of motors, pumps and power products, for ₹900 crore. CG Power has also seen a dramatic turnaround and now enjoys revenues and PBT run rate of ₹5,241 crore and ₹530 crore in FY22.

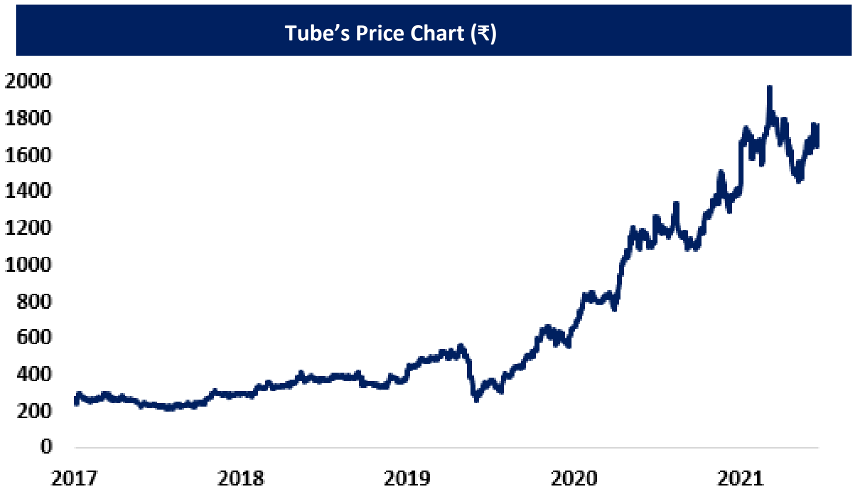
Stellar People
Tube Investment is a prime example of the ability of a great management team to transform a business. Vellayan Subbiah is part of the Murugappa family, which own a 46% stake in Tube Investments. After having worked with McKinsey for a few years, Vellayan joined Cholamandalam Investment & Finance, a vehicle financing company, also owned by the Murugappa Group. When he joined in 2010, the company was suffering from high levels of non-performing assets, due to mistakes made by the previous management team in underwriting personal loans. During his tenure from 2010-2017, he successfully steered a turnaround where Cholamandalam delivered annualized loan book, NII and PAT growth of 26%,

28% and 73%. Non-performing assets fell from over 8% of loan book in 2009 to around 4% in 2017, while ROE improved from 2% to 18%, over the same timeframe. As a result, the stock delivered a 39% annualized return over his tenure. With the institutionalized processes of loan origination, underwriting and collection, the company continues to deliver very strong returns even today.

Prior to Vellayan taking over as managing director of Tube Investments in FY17, Tube Investment's annualized revenue and profit growth over the previous ten years was a mediocre 10% each. Its average PBT margin and ROE were 5% and 10%, respectively. During his five-year tenure at Tube Investments, in spite of a sharp slowdown in the automobile sector, which accounted for over 60% of the business, and the impact of Covid, Tube was able to deliver an annualized operating profit growth of over 18% through this period, as margins improved from 5% to 12%. The company also generated ₹1,336 crore in free cash flow through this period.

This was driven primarily by Vellayan's initiative to shut loss making business lines, granular focus on manufacturing efficiency and sharp cost cutting measures. He was instrumental is implementing a culture in the company that revolves around manufacturing best practices and efficiency. On the back of this, his vision now is to transform Tube Investments into a large manufacturing conglomerate, across different sectors, similar to how Danaher transformed itself in USA. The successful integration and turnaround of the ailing CG Power, which Tube acquired in 2020, is a testament to Vellayan's capabilities of finding and delivering on new avenues for growth and diversification. This has generated immense shareholder value creation over the last five years (see Figure 2). We believe the journey is just beginning.

Figure 2



Source: Company

Incredible Business

The core business of Tube Investments is to manufacture metal tubes used for automotive and industrial purpose, metal chains, car doors, railway material and cycles. While this business is fairly commoditized, post the recent turnaround, it generates very high profitability metrics, while being net debt free. As per Vellayan's vision, he is planning a three-tier strategy to transform the company.

- The first tier would be to improve the contribution of value-added products within the core business, increase exports as a percentage of sales and expand into adjoining segments. This would help generate high revenue growth, improve operating margins, while sustaining free cash flow generation.
- As part of the second tier, the company plans to seed new business ventures organically. It has already entered the optical lens business for car sensors, TMT bars and truck body building. More recently, the company announced a ₹150 crore investment to enter the three-wheeler electric vehicle business, where it sees synergies with its existing core business. Management has been careful in ensuring that in each of these segments, there is a very large addressable market and natural synergies to enable a "right to win" while focusing on efficient capital allocation.

- The third tier is where the company is looking to use the free cash flow generated from the core business for acquisitions. Management would like to focus on the industrial goods segment, where the product is good, but the company is either going through management issues or the owners are looking for an exit. The conscious strategy here is not to acquire top quartile companies, but those that can be acquired at a reasonable valuation and then, using the company learnings from its core business, implement a turnaround plan.

Vellayan has already demonstrated tremendous success in the third segment. CG Power has been manufacturing motors, pumps and power products for several years now, having a dominant brand name, market share and distribution reach across India. Prior to being acquired by Tube, the company had to go through insolvency due to corporate governance issues at its the group holding level. Post-acquisition, the company embarked on a turnaround plan by re-investing into distribution and branding, improving management and employee morale, and implementing best practices in manufacturing. Revenues grew from ₹3,169 crore in FY20 to a run rate of ₹5,200 crore in 2022, while PBT should reach ₹530 crore in FY22 from a loss of ₹178 crore in FY20. The 58% stake that the company bought for ₹900 crore just two years ago is now valued at over ₹16,000 crore. With both CG Power and Tube Investment generating free cash flow, we expect management to close similar such acquisitions in the near future.

Using this three-tier strategy, a culture focused on implementing manufacturing best practices, and razor-sharp attention on execution, the company is well on its way into transforming into a manufacturing conglomerate.

Time

In FY20, the government announced the Make in India, or Atmanirbhar scheme. With severe dislocations in supply chains, the need to generate mass employment for the large young population as well as an opportunity to leverage geo-political tensions between the West and China were some of the key catalysts for instituting this policy. Related to this, the country has announced a USD$ 27 billion investments in Production Linked Incentives (PLI) schemes over the next 5 years.

This has a dual benefit for Tube Investment. The PLI incentive scheme is leading to significant investment in new factories and plants across industries such as electronics, automobiles, telecom, textile and defense, among others. This will lead to increased demand for industrial goods such as tubes, motors, transformers and gears, which Tube Investment manufactures. Additionally, Tube Investment itself can be a beneficiary of certain PLI schemes, especially in the automobile sector. Besides, through acquisitions, it will continuously expand its addressable market size to include newer products and industries, where it can gain market share.

As a result of all of this, we believe the company enjoys a twin benefit of a rapidly growing addressable market as well as potential for market share gains through strong execution. Danaher revenues growth from USD$ 5 billion in 2003 to over USD$ 28 billion in 2021 as it expanded into diversified manufacturing businesses. During this period, market cap of Danaher increased from USD$ 24 billion to over USD$ 200 billion now. We believe a similar story can be replicated by Tube Investments under the leadership of Vellayan Subbiah. The company is trading at a twelve-month forward P/E of 24x on a consolidated basis, which is attractive given strong management execution and long runway for growth ahead.

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
