

## White Whale North Star Portfolio – 2Q FY23 Quarterly Letter

Dear Partners,

Greetings from White Whale Partners. We are pleased to update you on our performance for the quarter ended September 30, 2022.

### Portfolio Performance

For the quarter ended September 2022, the portfolio was up 19.9%, significantly ahead of the Nifty, which was up 8.7%. For the last 12 months, our portfolio was down 0.9% compared to Nifty which was down 1.6%. Since inception, the portfolio is up 49.4% <sup>(1)</sup> \*, compared to 38.6%. The portfolio continues to deliver healthy absolute as well as relative performance, in a challenging environment.

*Figure 1*

	3 Month	6 Month	1 Year	Inception*
WW North Star	19.9%	8.1%	-0.9%	49.4%
Nifty 50 TRI	8.7%	-1.2%	-1.6%	38.6%

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

Sticky inflation and a sharply tightening monetary policy remained major headwinds for all global asset classes. As a result, major global equity markets have corrected by 15%-35% since the start of 2022 and are now firmly in a bear market. Indian equities, on the other hand, have been remarkably resilient and are among the best performing markets among major global economies. Post a broad correction in the June quarter, the Nifty saw an equally sharp rebound last quarter and is essentially flat since the start of 2022. This is partly because foreign investors, after selling an unprecedented US\$29 billion in the first half of 2022, turned net buyers, investing US\$6 billion in the September quarter. However, more importantly, the steady inflows from domestic investors continued unabated, as they further invested US\$6 billion last quarter. As we discussed in our last letter, the increasing acceptance of equity as an asset class by domestic households has a double benefit. Not only does it provide capital to an economy that has traditionally been starved of risk capital, it will also improve the wealth of Indian households, given the superior returns that equities generate in the long run compared to gold and bank deposits, where a disproportionate amount of savings have been parked.

Post the recent run-up, Nifty is now trading at 19x forward earnings, compared to long term average of 16x. MSCI India index now trades at almost double the valuations of the MSCI emerging markets index from a forward earnings perspective, compared to a historical average premium of 62%. While valuations may appear full, this also reflects strong bottom-up fundamentals in India, which we discuss in more detail below. **More importantly, our portfolio companies continue to deliver healthy earnings growth, which is the key driver of investment returns in the long run. Our portfolio companies in aggregate delivered healthy performance in 1QFY23, with revenue growth of 43% and operating profit growth of 52%, over the same period last year. Even 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 15% and operating profits were up 23% 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.

<sup>1</sup> 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.

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

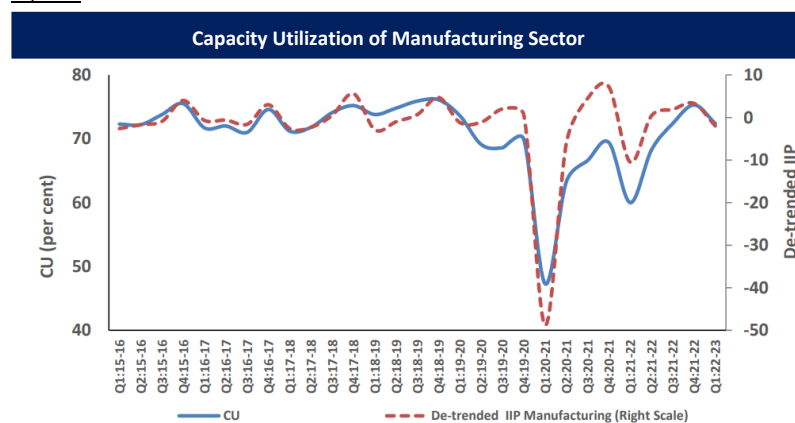
*“I’ve always said if you spend 13 minutes a year on economics, you’ve wasted 10 minutes.” – Peter Lynch*

At the start of the year, if anyone had painted a scenario where inflation in the developed world was running amuck, there was a major war going on in Europe and oil prices were at close to US\$100 per gallon, one would have predicted a major slowdown for the Indian economy, a sharp collapse in the Indian equity market and a significant rally in safety assets such as gold over the year. However, macro-economic trends remains healthy for India, the Indian stock markets have been remarkably resilient and are essentially flat for the year, while gold is in fact down 10% year to date in US dollar terms. This underscores the perils of trying to predict macro-economic trends and thereby its impact on stock markets in the short term. For our overall portfolio, our focus therefore remains 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.

That being said, we do however, pay close attention to macro developments, government action and technological disruption from a top down basis, that we believe can result in a significant change in trends for certain industries and sectors. One such development that we are excited about is a turn in the corporate capex cycle, which India has not seen for over a decade now. This positive trend is being driven by several factors:

1. Corporate balance sheets are very healthy. As per recent data shared by CRISIL, in 1HFY23, the upgrades to downgrades ratio (number of instances of improvement in a corporate’s rating divided by number of instances of deterioration in a corporate’s rating) was at 3.74 compared to 2.64 in 2HFY22. This ratio is at the highest level in a decade.
2. Banking sector NPAs have been cleaned up. Default rate for banks at 0.8% of total loan book is at a multi-year low. This has led to a sharp acceleration in system wide credit growth which now stands at 16% y-o-y, again a decadal high.
3. Add to this, capacity utilization which has inched up to 74% (see figure 2), government incentives on time-bound PLI schemes, shift in supply chain away from China as well as investment in green capex – we believe the ducks are in a row for a turn in the corporate capex cycle.

Figure 2



While we are excited about this trend, from our portfolio perspective we would avoid businesses that delve in long duration capital intensive projects, such as power and road. The regulatory risks as well as duration risk make the construct of such business unattractive. However, we have invested in companies such as Tube Investments and Timken (both discussed in detail in previous letters) that we believe would be key beneficiaries as demand for industrial goods

picks up. Apart from that, our investments in banking and financial services industry would also benefit from an increase in corporate capex.

Overall, datapoints from our bottom-up channel checks suggest a healthy start to the holiday season. Tax collections have shown strong momentum, with direct tax collections up 24% y-o-y while GST collections also up 33% in the first half of FY23. While current account deficit for last quarter increased to 2.8%, driven by an increase in the oil import bill and weakness in export growth, healthy forex reserves of US\$550 billion serve as a good buffer against global macro-economic volatility. Unlike previous global economic cycles, India remains relatively better positioned among other emerging markets this time around. Having said that, forecasting any large global macro-economic shock remains a key “known unknown”<sup>2</sup>.

### Portfolio Insights – Skin in the game

*“Show me the incentive, and I will show you the outcome.” – Charlie Munger*

We view ourselves as long term business owners, partnering with the best management teams across different industries. Given our long term outlook, it is very important to us that management incentives are completely aligned to our incentives. **Therefore, we prefer to invest in companies, where the owners and/or key decision makers have significant skin in the game.** Thus, in our portfolio, excluding banks where there is a cap in ownership mandated by the Reserve Bank of India (RBI), owners and/or key decision makers have an average ownership stake of 42% in the company. Having significant skin in the game ensures that the company is willing to take short term pain for long term gain. This is key in being able to protect the competitive advantage that the company has developed over time.

We are quite amazed to see new-age digital companies, where in the quest for growth and scale, the founders’ stake in the company has been diluted down to single digits. For example, in the case of a digital company that is looking to go public in the near term, the four co-founders combined have a total ownership of ~8%! We believe the culture in many of these digital companies is deeply embedded to sacrifice capital efficiency in the hunt for scale, using the pretext of “winner takes all”. This could possibly be driven by pressures from private equity funds, who become majority owners and typically have a five year ownership cycle. Given that this focus is ingrained into a company’s culture right from inception, it would be very difficult for the company to pivot towards capital efficiency and profitability, once the music stops and opportunity for capital raising dries up. In contrast, companies that have been frugal with their capital right from inception and have a culture focused on profitability over aggressive growth, have a better probability of compounding shareholder value over a long period of time.

*“To be successful in business and investing, you’ve got to have skin in the game.” – Warren Buffett*

This philosophy of “skin in the game” is deeply embedded in our ethos. At White Whale, one of the key principles that we operate on is **to put money where our mouth is**. On the venture capital side of our business, we invest our own capital behind every investment that we showcase to our member network. Similarly, on the public markets front, the majority of our active equity shareholding in India is through the White Whale North Star PMS Scheme. We view our investors as long term partners in our business. To that extent, we practice what we preach and look for in our portfolio companies.

A company that aptly exemplifies this point is one where we recently invested – MAS Financial.

### MAS Financial Services

MAS Financial Services is an Ahmedabad based NBFC with nearly three decades of experience in lending to lower income and middle-income businesses mainly around Western India. While focusing on micro-enterprise and SME loans, the company also provides 2-Wheeler, Commercial Vehicle and housing loans (through a subsidiary). The company has a stellar track record of growing its loan book by an by 36% annualized and profits by 40% annualized since its inception in 1995. For FY21, the company reported a loan book of INR 6,246 crore with healthy net interest margins of > 6%. Gross

---

<sup>2</sup> “We also know there are known unknowns; that is to say we know there are some things we do not know” - Known and Unknown: A Memoir – By Donald Rumsfeld

NPA and Net NPA were well under control at 1.9% and 1.5% respectively, in spite of business being impacted by Covid. The company enjoys strong ROA of nearly 3%, with steady state ROE of 18%-20%.

*How does MAS Financial stack up against White Whale's 3 pillar framework?*

### **Stellar People x Incredible Business x Time = Compounded Returns**

#### **Stellar People**

MAS Financial was founded by first generation entrepreneur, Kamlesh Gandhi, along with his brother Late Mukesh Gandhi, back in 1988 when he was just 22 years old. It was incorporated into a company in 1995. The founders have managed to navigate through a continuously changing competitive environment by periodically adapting their business model to emerging market opportunities. The company was originally founded as a dealer in consumer durable goods. However, Mr Gandhi was quick to identify consumer durable lending as a lucrative opportunity and shifted towards the lending business shortly after. In the mid 1990s, GE Countrywide entered the consumer durable loans segment and quickly scaled up across the country. Given their scale and size at that time, it was difficult for MAS Financial to compete with such a large company with multinational parentage. As a result, the company once again pivoted towards lending to small businesses as well as for vehicle purchase. Even more recently, as many fintech companies have started scaling up in India, the company has entered into partnerships with such companies to improve their sourcing ability and to stay on top of the changing landscape. Thus, management's ability to identify potential threats and opportunities, stay ahead of the curve and continuously evolve as per the environment is something we deeply admire.

Another key trait, that we delved into earlier, is their focus on capital efficiency. Lending is a very capital intensive business, given that money is the key raw material. Unless an NBFC is backed by a large industrial group, as it scales up, the ownership stake of the founders typically drops significantly. In spite of being a first generation entrepreneur with no significant outside wealth and growing the loan book at an annualized run rate of over 36% for over two decades, the founders of MAS Financial have managed to keep their ownership in the company at well over 70%. They were able to do this by instilling a culture of profitable growth as well as reinvesting all their profits back in the business right from the beginning.

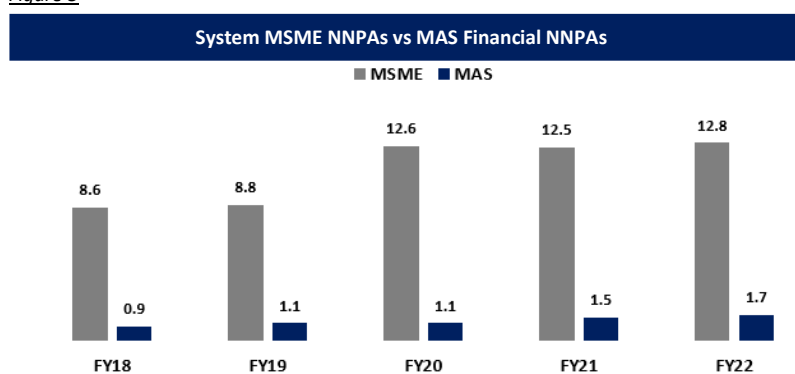
They consciously stayed away from raising external capital until 2007, and even then the capital raised was in the form of redeemable preference shares, i.e., non-dilutive to their equity stake. Even during the initial public offering in 2017, the proceeds were mainly used to provide an exit to their private equity investors as well as to raise fresh capital for the company. The founders did not sell any shares even at that time. The company remains extremely well capitalized with their current capital adequacy ratio being well over 25% against regulatory norms of 15%, and we don't foresee any further capital raise for the next few years. The founders' focus on retaining significant skin in the game and discipline with regards to capital efficiency aligns very well with our investment philosophy.

#### **Incredible Business**

While the micro-enterprise and SME lending market opportunity is large, not many formal financiers cater to this segment. This is because of the high cost of servicing these customers, the time it takes to build expertise, the requirement of having a strong knowledge of the local market and the challenges associated with building a credit underwriting model and collections infrastructure for customers with no / limited credit history. MAS Financial has been able to overcome this issue in a unique manner. Besides their own branches and distribution reach, the company has tied up with another 150+ partners, through whom they source close to 60% of their loan book. These partners are mainly smaller NBFCs focused on a particular sub-region. MAS Financial works closely with these partners, training them in MAS Financial's loan origination and underwriting processes as well as monitoring their outstanding loans closely. This model enables the company to keep its operating and credit costs under control, as the cost of sourcing the end-customers and the default risk is largely borne by the partner NBFC. The partnership model also aids MAS' ability to understand the geography better. In our primary channel checks, we came across instances where while other NBFCs were having recovery issues, MAS Financial was able to handhold these partners and ensure their recoveries were not hampered. This unique working relationship that MAS Financial has with its partners provides a strong competitive advantage. They are now extending this partnership to fintech companies as well, and have tied up with more than 10 different fintech lenders to test their ability to originate loans for the company.

Apart from this, as with any lending business, the key differentiation lies in the company’s ability to control its bad loans. This is especially true, when one is lending to a relatively risky segment such as micro and small enterprises. Management has shown remarkable discipline in controlling its bad loans, with net non-performing loans / total loans not exceeding 2% in its history. Even during Covid, when most micro-finance lenders and NBFCs saw their bad loans balloon, MAS Financial was able to keep its net non-performing loans to 1.7% of loan book (see figure 3). This is mainly a function of the strict risk controls and robust credit appraisal processes which are ingrained into the culture of the company. Sanctions are approved by a centralised team where multiple checks are carried out prior to disbursement. Branch level activity is restricted to sourcing and collection functions to avoid conflict of interest. The company is continuously adapting, with the credit appraisal process reviewed and revised at regular intervals based on its experience in the market. The management is cautious in its lending approach with its focal point being maintenance of asset quality and profitability. They are willing to sacrifice growth in a situation where they believe that asset quality may be compromised. For example, due to the uncertainty created by Covid, the company significantly pulled back its disbursements and actually de-grew its loan book in FY21. It only normalized disbursement growth, once the environment had completely normalized. Overall, a right balance between growth and risk controls enables the company to maintain a healthy level of profitability through business cycles.

Figure 3

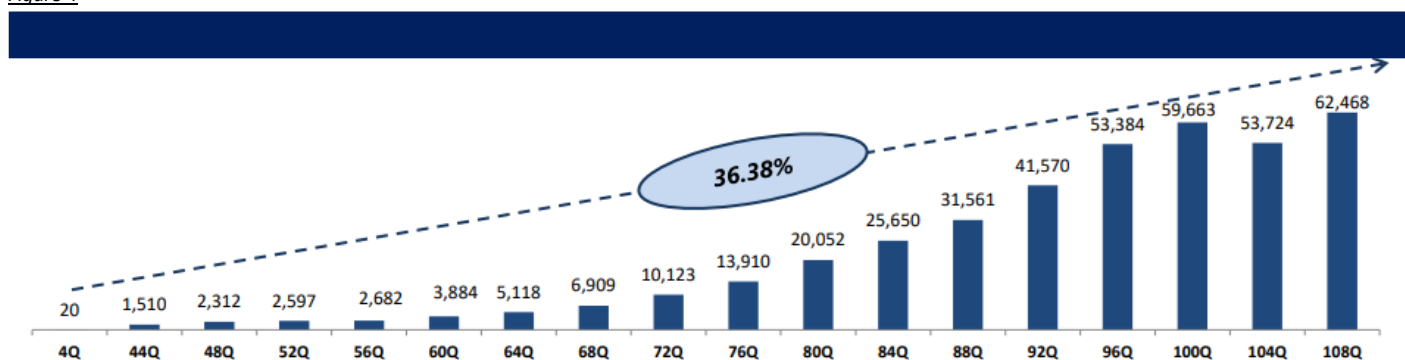


Source: RBI and Company

### Time

The company has a great track record, delivering 36% annualized growth since its inception in 1995 (see figure 4). Over the last 15 years as well, since it first raised external capital in 2007, it has delivered 25% annualized loan book growth and 23% annualized profit growth. However, given the small base, it is still expected to end this year with total loan book of around INR 7,000cr. The company has a market share of less than 1% in the geography that it operates. Given its expanding distribution reach through its own branches as well as partnerships, improving relationship with its customers and deeper geographic penetration in the existing geographies, there is a long runway for growth just in the current areas where it operates. Apart from that, the company has also been seeding branches in central, south and north India, with the idea of familiarizing itself with new geographies and thereby expanding its total addressable market size. Management has stated its target of reaching INR 10,000cr in loan book by FY25, which implies an annualized growth of 20%-25%. We believe the runway for growth remains long for several years ahead as well.

Figure 4



Source: Company

The company's capital buffer that we highlighted earlier provides further impetus for non-dilutive, compounding growth potential for investors.

We have been tracking the company closely since its IPO in 2017. Post listing, the company has increased its loan book by 100%, its profits by 130% and book value by 70%. However, the stock is essentially at the same price as during the IPO, due to several external factors such as IL&FS bankruptcy (which hurt valuations for the entire industry) and most recently, Covid. As a result, valuations have come off significantly over the last 5 years from over 4x Price / Forward Book Value to less than 2x recently. We believe the core fundamentals of the company remain intact and MAS Financial is well positioned to compound at 20%-25% over the next several years. As a result, we used the recent correction in the stock price to build a position in the name.

P.S. – We recently held a very insightful webinar with Mr. Kamlesh Gandhi, Founder, Chairman and MD of MAS Financial. If you were not able to attend, please do listen in to the recording here:  
LINK

### **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

---

<sup>3</sup>**DISCLAIMER:** White Whale Partners LLP is a SEBI registered Portfolio Manager. 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