CONSISTENT COMPOUNDERS

Marcellus' Consistent Compounders PMS invests in a concentrated portfolio of heavily moated companies that can drive healthy earnings growth over long periods of time.

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Disclaimer: The mentioned stock forms the part of Marcellus portfolio thus Marcellus clients, Marcellus employees and their immediate relatives may have interest in. The described stocks are for illustration & education purpose only and not recommendatory

MARCELLUS
Marcellus Investment Managers Pvt. Ltd.

Marcellus Investment Managers

- Who we are and what we do?
- Investment Philosophy and proprietary research process
- Bottom-up research process and case studies
- Fee Structure
- Performance
- Factsheet
- Disclaimers

Introduction – who we are and what we do?

Team: Long-term working relationship	• Employee-owned boutique and Indian & Global public equities; founded in Dec-2018 • The core team worked together for ~15 years, during which they built two successful and independent research firms in the UK and in India . Research team handpicked and trained internally
Strategy: Long only Indian equities	• India is the world's fifth largest and fastest-growing major economy which allows ample growth runway for well run companies (clean governance, good capital allocation and capable managements)
Philosophy: Quality over quantity	• Invest in a concentrated portfolio of clean and high-quality compounders with low churn • Ignore short term noise and focus on consistent free cash flow compounding of investee companies
Process: In-depth bottom-up research	• Team of 24 investment professionals trained in forensic accounting and focussed on bottom up research • Proprietary research framework that uses extensive primary research to ascertain moats, capital allocation, growth longevity and succession planning

Investment Committee

Saurabh Mukherjea is the Founder and CIO of Marcellus. Saurabh was educated at the London School of Economics where he earned a BSc in Economics (with First Class Honours) and an MSc in Economics. In London, Saurabh was the co-founder of Clear Capital and in 2007.Prior to setting up Marcellus, Saurabh was the CEO of Ambit Capital. Upon SEBI's invitation, he joined SEBI's Mutual Fund Advisory Committee. In 2019, Saurabh was part of the Expert Committee constituted by SEBI to upgrade the PMS regulations. Saurabh has written four bestselling books.

Pramod Gubbi leads the business development efforts at Marcellus. He also sits on Investment Committee that discusses and approves investment strategies of the firm. Pramod was previously the MD & Head of Institutional Equities at Ambit Capital. Prior to that Pramod, served as the head of Ambit's Singapore office. Before joining Ambit, Pramod worked across sales and research functions at Clear Capital. Besides being a technology analyst, Pramod has served in technology firms such as HCL Technologies and Philips Semiconductors. Pramod did his B.Tech from National Institute of Technology, Karnataka and has a Post-graduate Diploma in Management from the Indian Institute of Management – Ahmedabad.

Rakshit Ranjan is the Portfolio Manager of Marcellus' Consistent Compounders strategy. Rakshit spent 6 years (2005-2011) covering UK equities with Lloyds Bank (Director, Institutional Equities) and Execution Noble (Sector Lead). He launched Ambit's Coffee Can PMS in Mar'17 and managed it till Dec'18. Under his management, Ambit's Coffee Can PMS was one of India's top performing equity products during 2018. Rakshit has a B.Tech from IIT (Delhi).

Investing in India's transformation

The Indian economy has been 'networked' at a rapid pace over the past decade:

- The length of India's national highways has doubled.
- The number of broadband users has increased from 20 million in FY11 to 658 million in FY22 (CAGR of 37%).
- Domestic airline passenger traffic has grown 5x (16% CAGR).
- 15 years ago, only 1 in 3 Indian families had a bank account; now nearly all Indian families have a bank account.

➕

The inception of a single **Goods & Services Tax in 2017** has allowed companies to consolidate their supply chains (from multiple state-level structures to unified national supply chains).

➕

The rise of low cost SaaS (e.g. Salesforce, SAP) alongside RFID tracking and big data gleaned from 400mn internet connected mobile phones is allowing companies to improve working capital cycles, asset turns, profit margins and hence RoCE

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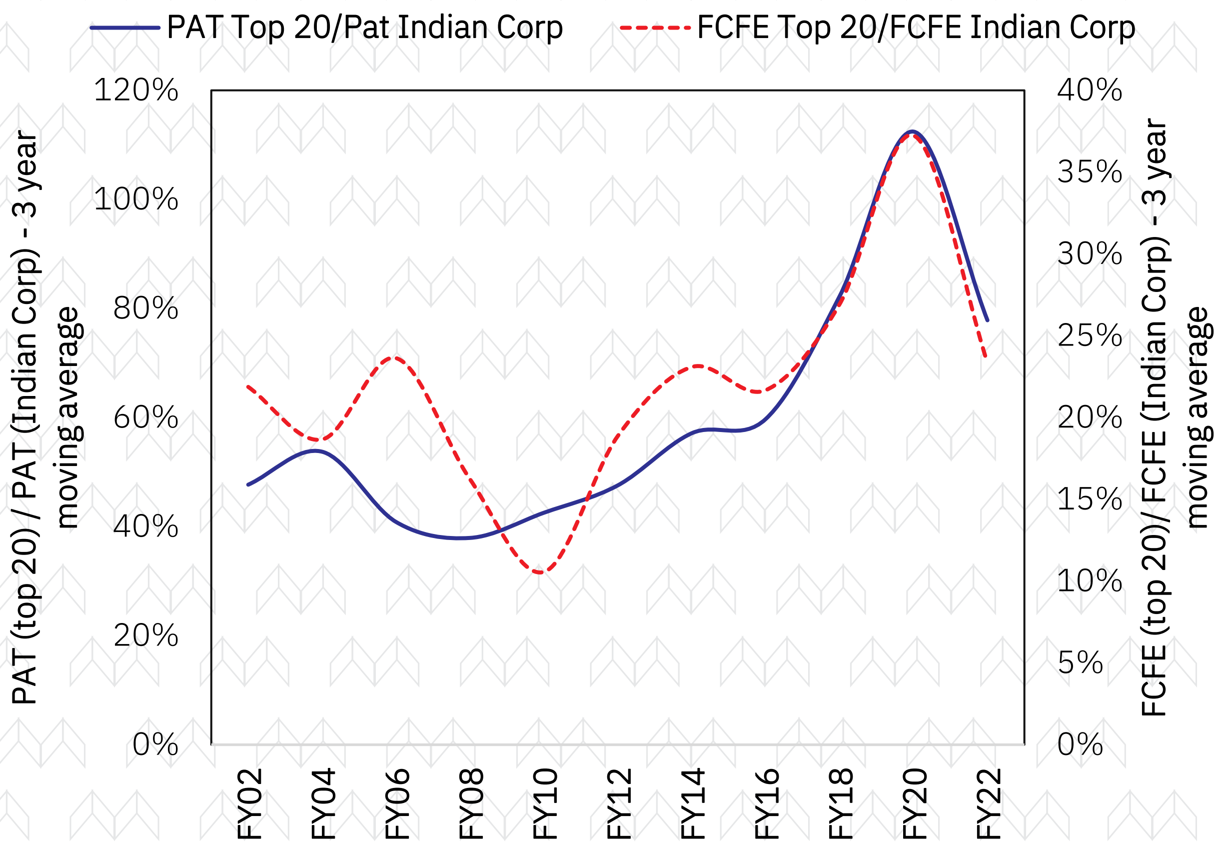
PAT and Free cash flow of top 20 companies



Source: Marcellus Investment Managers, CMIE, Ace Equity, Bloomberg, Ministry of Aviation, TRAI, Ministry of Road Transport.

Five Mega Themes making their way into our portfolio

W . E . S . C . O

Women

Urban Indian Women Have More Money in the Bank Than Men


Education

For the first time, people from non-IIT, non-IIM, non-foreign degrees run the majority of Nifty50 companies


South

Seven Southern states have per capita incomes 50% higher than the rest of the country


China+1

China's Unravelling and Creation of a US$ 300 Billion per annum opportunity for India


Octopus

Emergence of ~200K octopi families whose wealth has surged more than 16x in the last 20 years

Portfolio construction process

	Process	Outcome
The universe: Stocks in the BSE500		
Forensic Accounting Screen	Filter out companies with accounting and governance issues	40% of the listed companies drop out here
Fundamental Parameters	Using defined thresholds for revenue growth and RoCE, identify cash generative franchises that are scaling rapidly	50% of the companies drop out here
Bottom-up research analysis	Analysis of annual reports, discussions with various stakeholders and other published reports in public domain	Remaining 10% subjected to bottom-up research
Independent third- party checks	Independent channel checks to verify management claims and to form a view on capital allocation and governance	13-15 Consistent Compounders

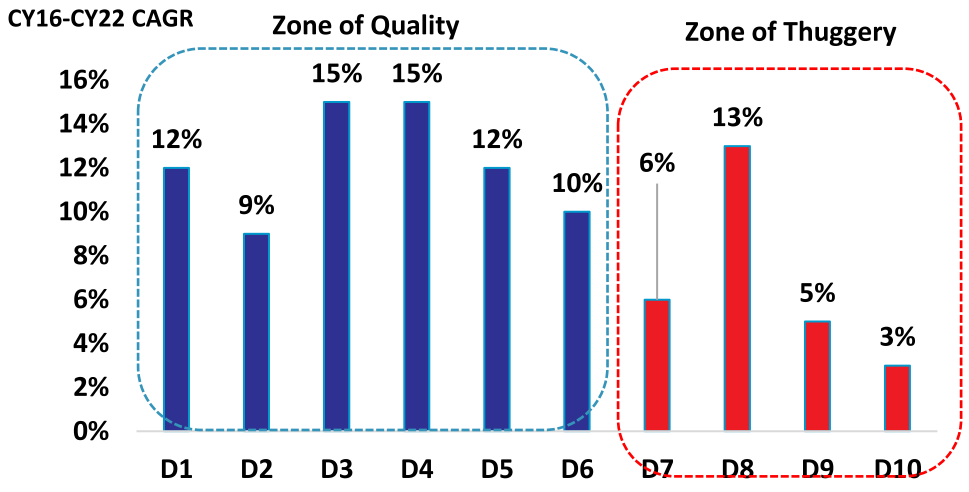
Note: The fund manager maintains discretion on stock inclusion in the portfolio. In case, a stock does not clear the above filters, the fund manager must record and present to the Investment committee for approval with the reasons for such inclusion

Forensic accounting helps avoid common pitfalls

The forensic analysis toolkit

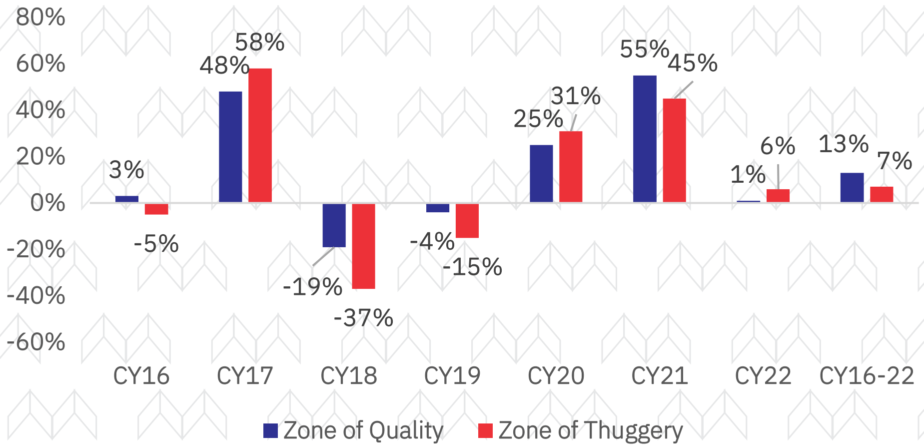
Category	Ratios
Income statement checks	(1) Cashflow from operations (CFO) as % of EBITDA
	(2) Provisioning for Debtors
Balance sheet checks	(3) Yield on cash and cash equivalents
	(4) Contingent liabilities as % of Networth (for the latest available year)
Cash theft checks	(5) CWIP to gross block
Auditor checks	(6) Growth in auditors' remuneration to growth in revenues

Accounting quality directly impacts investment returns



Company	Accounting irregularities	Subsequent share price decline
Amtek Auto	Poor cash conversion, Inflated capex	99%
Cox & Kings	Poor cash conversion, Aggressive accounting of Goodwill	99%
8K Miles	Incorrect accounting disclosures, Poor cash conversion	95%
DHFL	High fee & treasury income, Frequent change in auditors	99%
Kwality	Volatile depreciation rate, Poor cash conversion	99%
Manpasand Beverages	Low asset turns, Poor free cash flow generation	99%

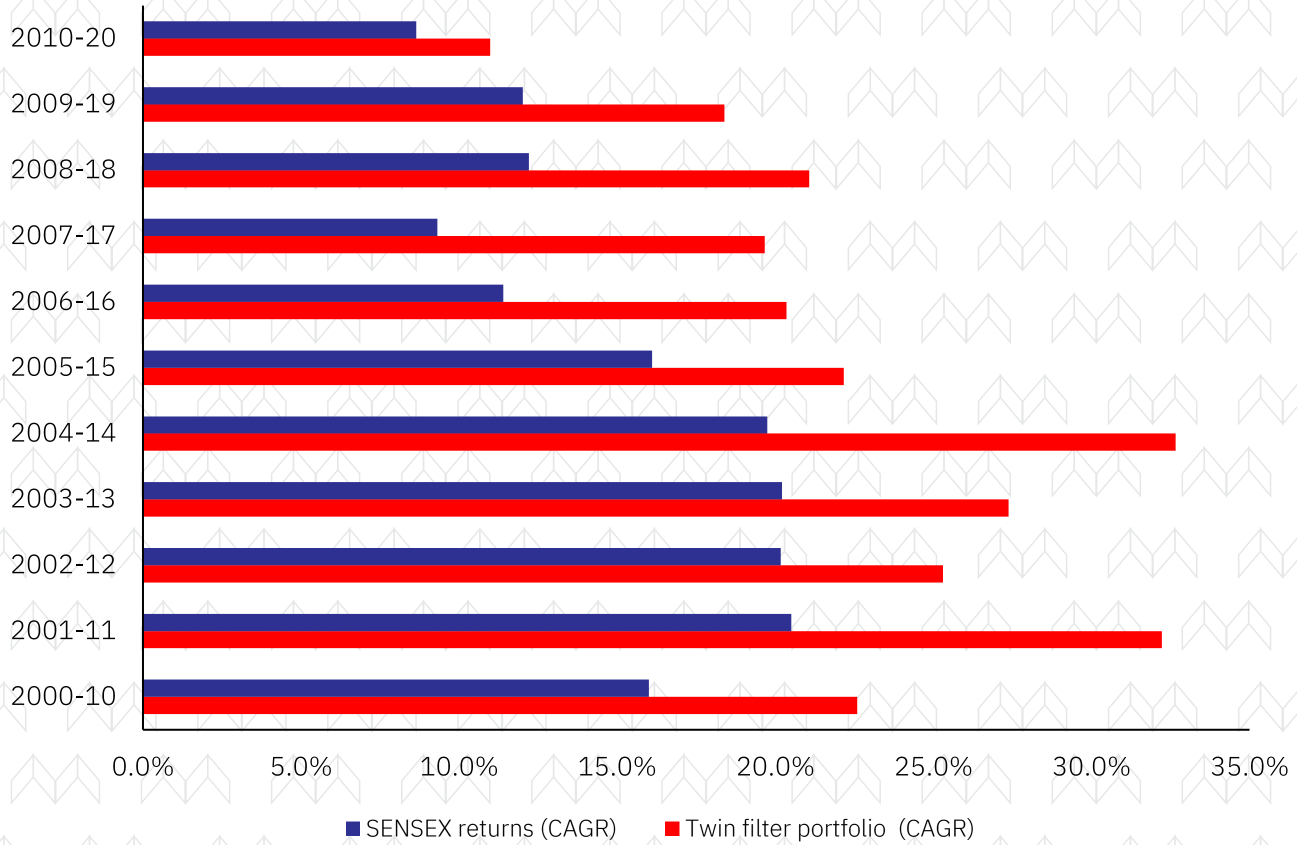
Quality wins big in the long-term



Source: Marcellus Investment Managers, Ace Equity

Identify superior capital allocation

Long-term returns of cos. using the twin filter* consistently beats Sensex with significantly lower volatility



*Source: Bloomberg. Note: Only the portfolios which have finished their 10year run have been shown. Note: These are Total Shareholder returns in INR terms. The portfolio above is not Marcellus' model portfolio but a sample portfolio derived out of the twin-filter criteria**

**Note: The twin filter criteria is explained in the book 'Coffee Can Investing – Low Risk Route to Stupendous Wealth (2018)' authored by two of Marcellus' founders – Saurabh Mukherjea, Rakshit Ranjan – and Pranab Uniyal.*

Twin-filter criteria:

- Double-digit YoY revenue growth and return on capital in excess of cost of capital, each year for 10 years in a row
- Returns a portfolios built using the twin-filter criteria each year and held for the subsequent 10 years (without any churn), are shown in the chart above

Twin filter portfolio delivers:

- Returns of 20-30% p.a. (of INR returns)
- 8-12% outperformance relative to the Sensex
- Volatility akin to a Government of India Bond (3 years or longer holding period).

Longevity analysis – Quantify qualitative aspects

Marcellus Research on a stock under coverage

Current competitive advantages - here and now

Free cash flow growth rate

Revenue growth, ROCE and capital reinvestment rate

Quantify industry demand growth, its drivers and its resilience.

Quantify revenue growth related to expected market share gains.

Profitability and asset turns - expected to improve meaningfully?

→ Growth in cash flows

Moat score

Strength of today's pricing power

Can a competitor offer a product which is a third cheaper and still have no impact on either the profitability or market share of our investee firm?

Longevity / Sustainability of competitive advantages

Lethargy score

Analysis based on efforts made in the last 3 years

Three aspects of lethargy tests:
1) Incremental deepening of existing moats
2) Experimentation / investments towards adding new moated revenue growth drivers
3) Attempts at radical disruption of the industry's future

Succession planning score

Softer aspects to help build an 'institution'

Four aspects of succession test:
1) Decentralised execution
2) CXOs - their quality and tenure at the firm
3) Historical evidence of implementing succession in CXO roles
4) Independence of Board of Directors

→ Longevity of cash flows

Outcome: 1) Buy and Sell decisions; 2) Position sizing of stocks relative to others in our portfolio; and 3) Absolute valuation of stocks

MoSS framework – at the time of rebalancing

Margin of Safety and Sustainability (MoSS) framework	An example - MoSS based weight for Divis Labs.
Longevity scores and DCF period: Interplay of moat score, lethargy score and succession score	**Longevity scores:** Moat = 9 , Lethargy = 7, Succession= 3; **DCF period**: 14 Years
FCF CAGR: Industry growth drivers + market share gains + capital efficiency + new products	**FCF CAGR** = 22%
MoSS: Gap between intrinsic value (DCF based) and current market cap	**MoSS Jumped to** 51% when stock price corrected between late 2021 till 2022
Sense check: Compare with 5-yr average Price/FCF	**Sense check: 2%** premium to 5-yr average Price/FCF
Position size: Relative MoSS gap **Rebalancing opportunity**: MoSS dislocation	**Position size = 7.1%**; started with 3% **Major Rebalancing opportunity = November 2022**

Longevity framework drives our SELL discipline

When and Why do we SELL?

- Complete exit: This is due to deterioration in Marcellus research analysts' view of the said company's strength and sustainability (longevity) of competitive advantages. Explained below in Exam: 1
- Optimising portfolio concentration: Exit a position when another stock is included in the portfolio - due to an increase in conviction levels on strength and longevity of competitive advantages of the new company (which was hitherto not in the portfolio). Explained below in Exam: 2
- Partial selling: To rebalance the portfolio and bring it in sync with relative conviction on fundamentals of the stock vs other stocks in the portfolio.

Example 1: Gruh Finance – sold due to change in ownership

Sold in Jan 2019 after HDFC Ltd sold controlling stake to Bandhan Bank

- Change in board composition and senior management: since HDFC Ltd's board would not be involved at Gruh after the stake sale.
- Disruption of moats: Gruh built its moats around decentralised and localised understanding of their borrowers' credit profile through gradual geographical expansion. Bandhan Bank announced that pan-India expansion will be a key targeted synergy
- Concerns with Bandhan Bank as owners: We lacked conviction on Bandhan Bank's fundamentals as the bank does not clear our accounting quality and fundamental consistency filters

Example 2: Marico – sold due to deterioration in moats

Sold in Jan 2020 and replaced with Divi's Laboratories

- Slowdown in Premium category: Structural deterioration in growth prospects of premium edible oils due to health orientation of its customer base
- Execution: Lethargy in the ground level execution of value-added-hair-oils of Marico in the face of intense competition
- Divi's Labs: Increased conviction in Divi's competitive advantages and the longevity of growth of its growth.

Post- facto rebalancing to optimize the portfolio

- Sit on cash in anticipation of a stock market crash, and deploy the cash at the bottom of the stock market crash
- Stay fully invested at all times. Do nothing during the stock market crash.
- Rebalance the portfolio for dislocations caused by differential drawdowns across portfolio constituents during market crashes

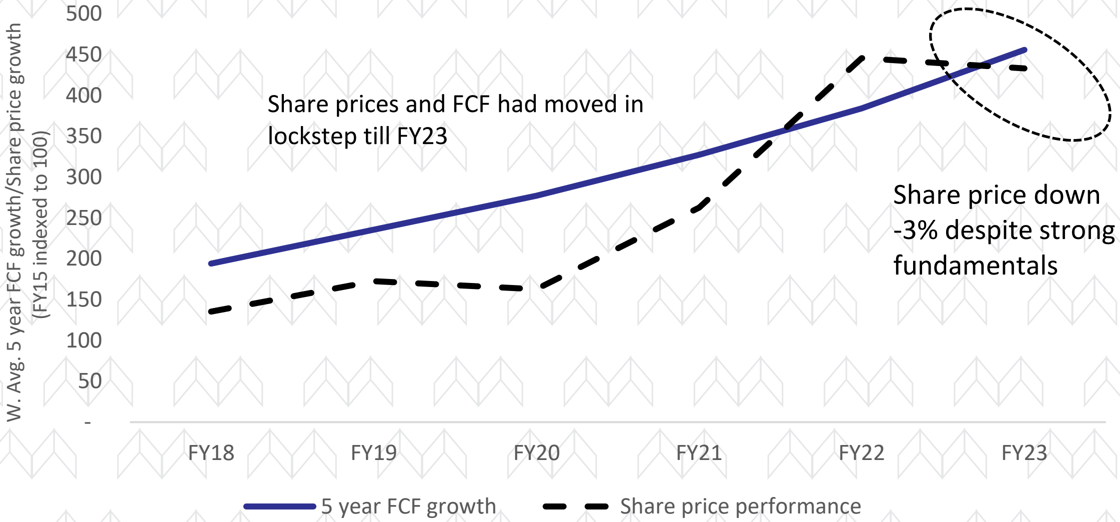
Utilizing last 18 months share price dislocation to our advantage

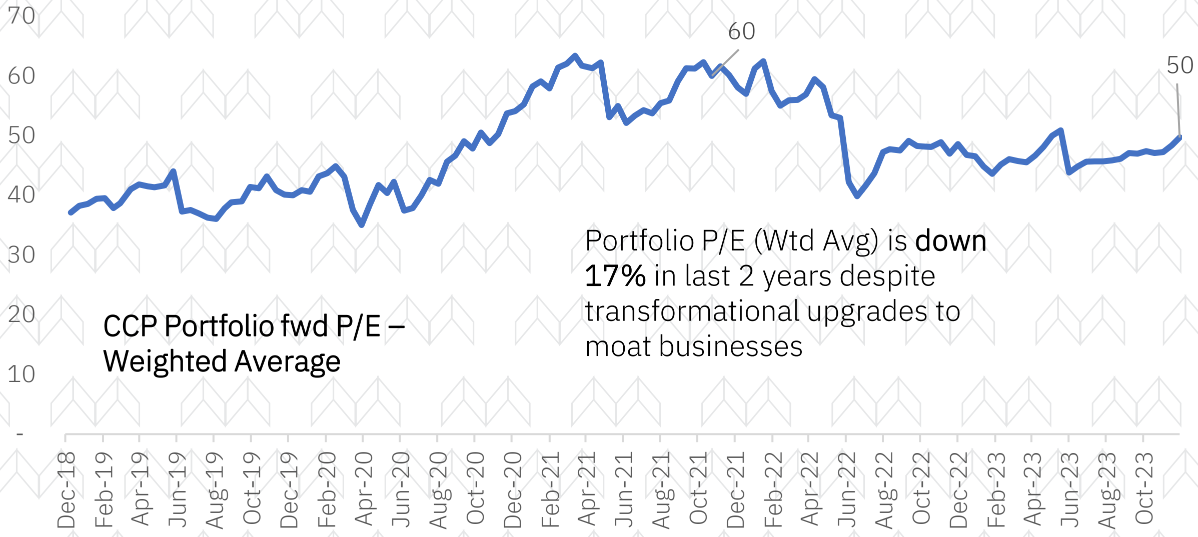
Underlying factors that led to dislocation		What action did we take
Rise in Competitive intensity in diagnostics	May 2022	Increase in Dr. Lal allocation
Increase in custom duty on gold imports	July 2022	Increase in Titan allocation
Decline in sales of Molnupiravir API	Nov 2022	Increase in allocation of Divis
Threat of Jio finance entry	Dec 2022	Increase in Bajaj Finance allocation
Rapid transformation of Zudio/Star bazaar retail format	Aug 2023	Added Trent as new stock
Uncertainty around succession	Aug 2023	Increase in Kotak bank allocation
Raw material price fluctuation	Oct 2023	Added Astral as new stock

Source: Marcellus Investment Managers, Bloomberg. Note: The exhibit above is to illustrate Marcellus' rebalancing strategy. We have chosen the Covid timeline to illustrate it, given the sharp changes in portfolio weights due to steep market corrections , which required us to rebalance

Fundamentals and valuations unhinged

CCP's valuations corrected significantly over the last one year, but we have seen this movie before!





Time period of correction	Stock Name	Correction	Time to recovery (in months)	Subsequent performance post recovery to pre correction share price
Dec'18-Sep'19	Page Industries	-33%	5	Absolute return of 106% over 22 months*
Oct'19-Mar'20	TCS	-28%	4	Absolute return of 74% over next 17 months
Feb'20- May'20	Bajaj Finance	-63%	7	Absolute return of 63% over next 10 months
Feb'20- May'20	Titan	-39%	6	Absolute return of 104% over next 16 months

Source: Marcellus Investment Managers,

Consistent earnings, RoCE and ReInv. are CCP's key traits

Name	ROCE* (FY23)	Avg. ROCE* (FY18-23)	Avg. Reinvt. rate (FY18-23)**	Avg. ROCE* (FY13-23)	Avg. Reinvt. rate (FY13-23)**
Asian Paints Ltd.	36%	34%	36%	38%	37%
Astral Ltd.	24%	25%	56%	26%	67%
Divi's Laboratories Ltd.	19%	27%	53%	30%	49%
Dr. Lal Pathlabs Ltd.	20%	32%	30%	41%	29%
Nestle India Ltd.	148%	114%	17%	87%	20%
Page Industries Ltd.	59%	64%	33%	63%	31%
Pidilite Industries Ltd.	24%	30%	32%	33%	36%
Tata Consultancy Services Ltd.	60%	50%	9%	50%	12%
Trent Ltd.	24%	14%	80%	11%	65%
Titan Company Ltd.	40%	34%	72%	36%	72%
Bajaj Finance Ltd.	22%	19%	87%	20%	72%
HDFC Bank Ltd.	17%	17%	84%	18%	83%
HDFC Life Insurance Co Ltd.	20%	19%	77%	20%	71%
ICICI Lombard General Insurance Company Ltd.	18%	20%	80%	20%	83%
Kotak Mahindra Bank Ltd.	14%	13%	98%	13%	98%
W. Avg.	32%	31%	59%	32%	57%

*Source: Marcellus Investment Managers; Ace Equity; *ROE considered instead of ROCE for BFSI companies; **Reinvestment rate for financials & Titan = (1 - dividend payout ratio(%)); **Reinvestment rate for non-financials is 'capex divided by sum total of CFO, net borrowings and proceeds from share issuance*

Consistent compounding of FCF and share price

Stock Name	Free Cash Flow (FCFE) CAGR						
	5-years				10-years		20-years
	FY03-08	FY08-13	FY13-18	FY18-23	FY03-13	FY13-23	FY03-23
Asian Paints Ltd.	5%	21%	-10%	61%	12%	20%	16%
Astral Ltd.	NA	NM	NM	38%	NA	17%$	NA
Titan Company Ltd.	-4%	71%	29%*	18%*	28%	18%	23%
Nestle India Ltd.	12%	17%	17%	8%	15%	12%	14%
Pidilite Industries Ltd.	63%	-4%	30%	12%	25%	21%	23%
Tata Consultancy Services	NA	19%	33%	17%	10%**	24%	19%**
Divi's Laboratories Ltd.	NM	21%	34%	35%	28%^	34%	32%^
Trent Ltd	NM	NM	NM	56%	NM	NM	24%
Dr.Lal Pathlabs Ltd.	NA	NA	NA	12%	NA	10%^^	NA
Page Industries Ltd.	NA	112%#	45%	-18%#	NA	12%#	27%#
Weighted Avg.	**11%**	**45%**	**25%**	**26%**	**21%**	**19%**	**23%**

Stock Name	Share Price CAGR						
	5-years				10-years		20-years
	FY03-08	FY08-13	FY13-18	FY18-23	FY03-13	FY13-23	FY03-23
Asian Paints Ltd.	40%	33%	18%	20%	36%	19%	27%
Astral Ltd.	NA	39%	64%	27%	NA	44%	44%*$
Titan Company Ltd.	84%	37%	30%	22%	59%	26%	41%
Nestle India Ltd.	23%	25%	12%	19%	24%	16%	20%
Pidilite Industries Ltd.	43%	32%	28%	21%	37%	24%	31%
Tata Consultancy Services	NA	31%	13%	18%	20%**	15%	17%**
Divi's Laboratories Ltd.	NA	9%	17%	21%	46%	19%	32%
Trent Ltd	28%	14%	28%	31%	21%	30%	25%
Dr.Lal Pathlabs Ltd.	NA	NA	NA	16%	NA	10%^^	NA
Page Industries Ltd.	NA	51%	47%	11%	NA	28%	35%#
Weighted Avg.	**48%**	**30%**	**29%**	**21%**	**37%**	**23%**	**31%**

Healthy, consistent and accelerating growth in FCF over the last two decades

In the long-term, Share price CAGR mirrors growth in FCF

*Source: Marcellus Investment Managers; Ace Equity; FCFE = Operating cash flow less Capex less Investment in Subsidiaries/Strategic investments /Acquisitions less Net debt repayments less Interest Paid less Lease liabilities; NM = Not measurable; * Titan's FCFE CAGR is for FY13-17 & FY19-23 since FCFE is till FY18 its negative ; ** TCS's FCFE CAGR is for FY07-13 & FY07-23 since FCFE is negative till FY06. Also, share price CAGR is for FY05-13 & FY05-23 since company was listed post 2004; ^ Divi's FCFE CAGR is for FY07-13 & FY07-23 since FCFE is negative till FY06 ; ^^Dr.Lal's CAGR computed for FY16-23 since company was not listed prior to FY16; # Page's FCFE CAGR computed for FY09-13, FY18-22, FY13-22 & FY07-22 and Share price CAGR for FY07-23 since company's FCFE was negative for FY08 & 23 & company got listed in FY07; $ Astral's FCFE CAGR is for FY015 -23 since FCFE is negative for FY13 & FY14; *$ Share price CAGR is from FY 07 to FY23 since Astral was listed in FY07; The list above excludes financial stocks as FCF is not a relevant metric*

Mistakes and learnings – 2019-2021

Page Industries – missed the woods for the trees!

Position sizing not in keeping with low tech investments

- **Stellar fundamentals**: Page was posting strong operational performance till FY18 (reported 24% revenue CAGR, 25% PAT CAGR, 57% FCFF CAGR and 60% average ROCE over FY13-18)
- **Failed to invest in tech upgradation initiatives:** This was exposed after GST implementation as the WC of the channel was adversely impacted. Competitors took advantage and ramped up distribution
- **Our research failed to capture the granularity of capital allocation:** we didn't ask the deep questions we should have during our primary data checks on Page

Corrective Action – Reduced allocation till improvements were visible

Reduced allocation but stayed invested. Dug deeper and picked up data points showing tangible improvements in capital allocation like investment in BlueYonder to manage SKUS/inventory. Increased allocation once convinced that lethargy issue is addressed

ITC – staring in the rear-view mirror

Missed the lack of investments in growth drivers

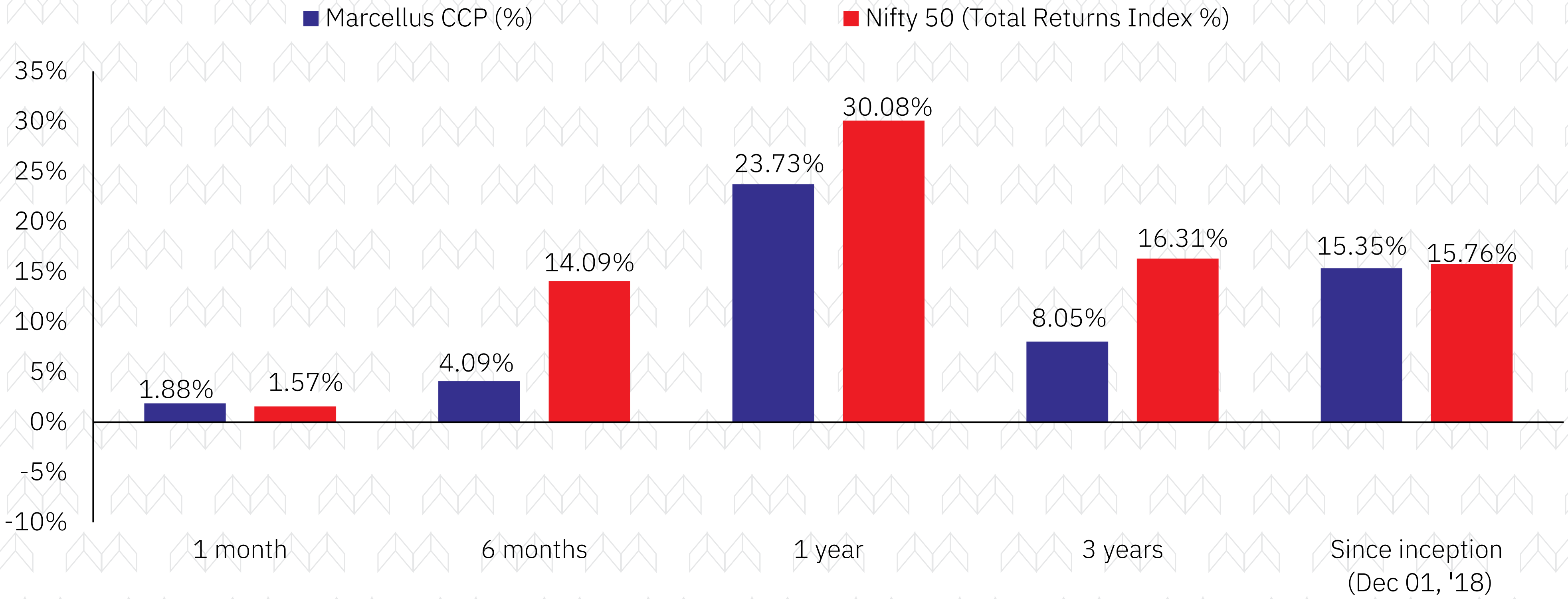
- **Strong moats**: ITC has strong competitive advantages in its core cigarettes business - 80% market share with ~300% ROCE. Until 6 years ago, ITC's rate of reinvestment of operating cash flows into the business had held up at ~40%, as the firm invested capital to grow its FMCG, Agri and Paper businesses.
- **Lethargic capital allocation:** Reinvestment of capital dropped to a level and ITC started accumulating ~USD300mn surplus capital (despite ~65% dividend payout); accumulated surplus capital by FY20 was Rs US$5bn, ~60% of the capital employed.
- **Did not balance strong moats with weak capital reinvestment:** This kept earnings growth modest and the stock price stagnated

Corrective Action – Exit from the portfolio

Since ITC did not improve its capital allocation, we exited the stock completely and replaced it with companies with superior capital allocation

Key Lesson: Greatness can cause lethargy which often gets masked by strong operational performance in the short term. A truly great company keeps growing its moats through tech investments, radical disruptions and continuous innovations. The mistakes made in our research of Page and ITC gave birth to our '**Longevity Framework**' that informs all our portfolio decisions.

FUND PERFORMANCE (As on 31st Mar' 2024)



Source : Marcellus Performance Data shown is net of fixed fees and expenses charged till 31st Mar'24 and is net of Performance fees charged for client accounts, whose account anniversary / performance calculation date falls upto the last date of this performance period; since inception & 3 years returns are annualized; other time period returns are absolute.

**For relative performance of particular Investment Approach to other Portfolio Managers within the selected strategy, please refer [https://www.apmiindia.org/apmi/welcomeiaperformance.htm?action=PMSmenu,](https://www.apmiindia.org/apmi/welcomeiaperformance.htm?action=PMSmenu) Under PMS Provider Name please select Marcellus Investment Managers Private Limited and select your Investment Approach Name for viewing the stated disclosure*

FUND STRUCTURE

Following Options offered under DIRECT Plan:

1.A fixed fees model (1.5% p.a. fixed fees + zero performance fees) or

2.A variable fees model (zero fixed fees + performance fees of 20% profit share above a hurdle of 8%, no catch-up)

3.A hybrid model (0.75% p.a. fixed fees + performance fees of 15% profit share above a hurdle of 12%, no catch-up).

High water mark applies for performance fees; Minimum investment: INR 50 lacs

We also have an STP (Systematic Transfer Plan) plan using which clients can stagger their investment in tranches spread over 5 months :- https://marcellus.helpscoutdocs.com/article/96-stp

Existing Investors have the option to save and invest regularly in Marcellus Funds through Systematic Investment Plan (SIP) :- https://marcellus.helpscoutdocs.com/article/100-systematic-investment-plansipfaqs

CCP Factsheet

Fund Details

Strategy Name	Consistent Compounders
Fund Manager	Rakshit Ranjan, CFA
AUM In INR Crs.	5,051
Category	Large Cap
Benchmark	Nifty50 Total Return Index

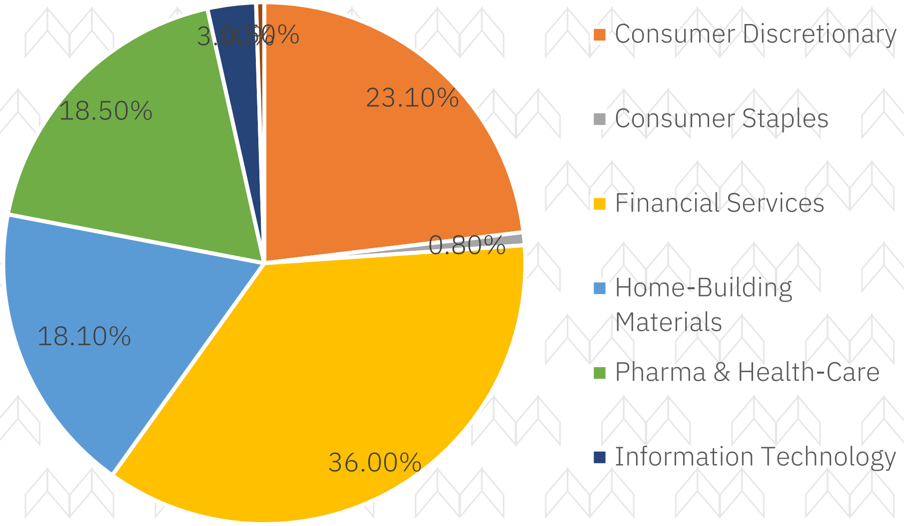
Top 5 Holdings (accounts for ~50% of allocation)

HDFC Bank	Financials
Bajaj Finance	Financials
Trent	Consumer Discretionary
Asian Paints	Home Building Materials
Divis	Pharma & Healthcare

Market-Cap Wise Allocation

Large-Cap	75.9%
Mid-Cap	18.1%
Small-Cap	5.5%
Cash	0.5%

Sector Wise Allocation



Portfolio Metrics

Wtd. Avg. Market Cap (INR Cr.)	3,20,340
Portfolio PE (TTM)	84
Portfolio PE (FY24E)	49
Dividend Yield	0.8%
Churn Ratio (TTM)	30.2%
Std Deviation (12 month rolling)	19.5%
Sharpe Ratio (12 month rolling)	0.54

Disclosures

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