Kings of Capital

Marcellus' Kings of Capital PMS Identifies financial companies with clean books of accounts, a long record of profitable growth and promoters with prudent capital allocation skills.

The stocks described in the described stocks in the presentation do form the part of Marcellus' portfolio so we as Marcellus, our clients and our immediate relatives do have interest and stakes. The stocks described are only for illustration and education purpose only and not recommendary.

March 2024

MARCELLUS

Circulation not intended for US Clients

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) • Fruits of patient investing: India ranks 5^{th}/ 2^{nd}/ 3^{rd} on 30Y/20Y/10Y on USD investment returns
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). From 2011. 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).

Source: Marcellus Investment Managers

Portfolio Manager

Tej Shah managers Marcellus' Kings of Capital portfolio. Prior to joining Marcellus, Tej worked at Mayfield, a Silicon Valley headquartered venture capital fund which manages $3Bn globally and $220Mn in India. Tej spent 2 years as a part of Mayfield India's investment team covering multiple sectors and being at the centre of India's evolving venture ecosystem. Prior to Mayfield, Tej was a part of the equity and capital markets team of Ambit Capital where he worked on executing IPOs, QIPs and buybacks. Tej is a Chartered Accountant and Chartered Financial Analyst.

Source: Marcellus Investment Managers

The Marcellus investment funnel for Financial stocks

Universe of 95 financial stocks

Run forensic filter on the 93 stocks

65 stocks remain

23 Stocks

12 stock portfolio

The universe: All financial stocks including banks, NBFCs, general insurers, life insurers, brokers and asset managers

Forensic Accounting Screen - Eliminate companies with sub-par accounting

Typically avoid 'Zone of thuggery' candidates (refer next slide)

Use of proprietary capital allocation models spanning the past 6 years of data

Detailed analysis of annual reports and published financials

3rd party/channel checks & management meetings

Corroborating 'management version' with channel feedbacks + independent views on governance/capital allocation

Portfolio of 10 to 14 financial companies

Source: Ace Equity 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, the reasons for such inclusion; Note: Mkt cap of companies is as on 27th Nov, 2020; Financial Services companies >1000 crs Market Capitalisation are considered

Using Forensic screens to identify clean firms is highly rewarding

<u>Methodology</u>

- 11 accounting ratios covering income statement (revenue/ earnings manipulation), balance sheet (correct representation of assets/liabilities), NPA recognition and audit quality checks.
- Six years of historical consolidated financials.
- First rank stocks on each of the 11 ratios individually (some examples outlined in the table on the right). These ranks then cumulated across parameters to give a final pecking order on accounting quality for stocks.
- Selection of these ratios has been inspired by Howard M. Schilit's legendary forensic accounting book 'Financial Shenanigans'.

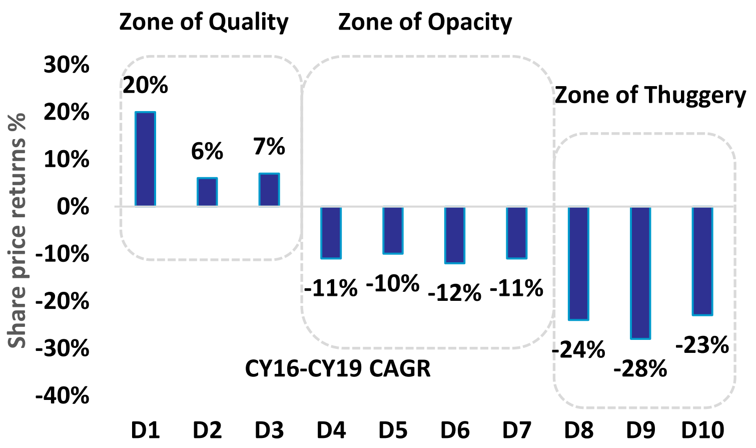
A few of our forensic ratios

Checks	Ratio
Income Statement	1) Fee income as a % of net int. income 2) Volatility in net interest income yields
Balance Sheet	1) Contingent liability as % of networth 2) NPA volatility
Auditor	Growth in auditors' remuneration to growth in net interest income

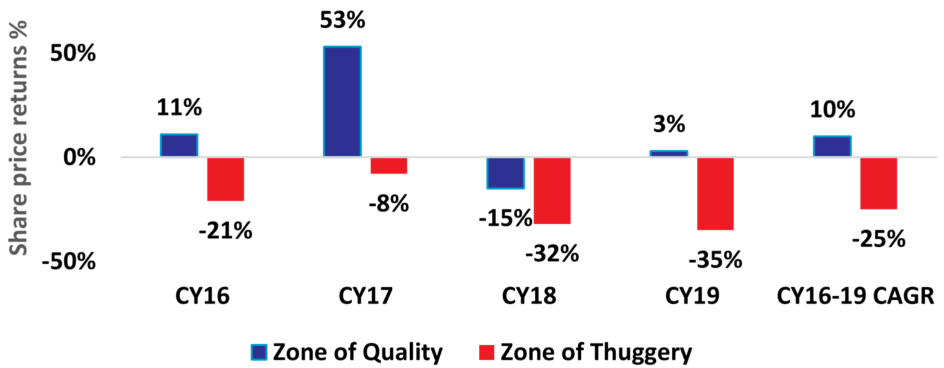
53% for Yes Bank vs. 29% for Kotak

24x for Yes Bank vs. 5x for Kotak

Strong correlation between accounting quality and shareholders' returns

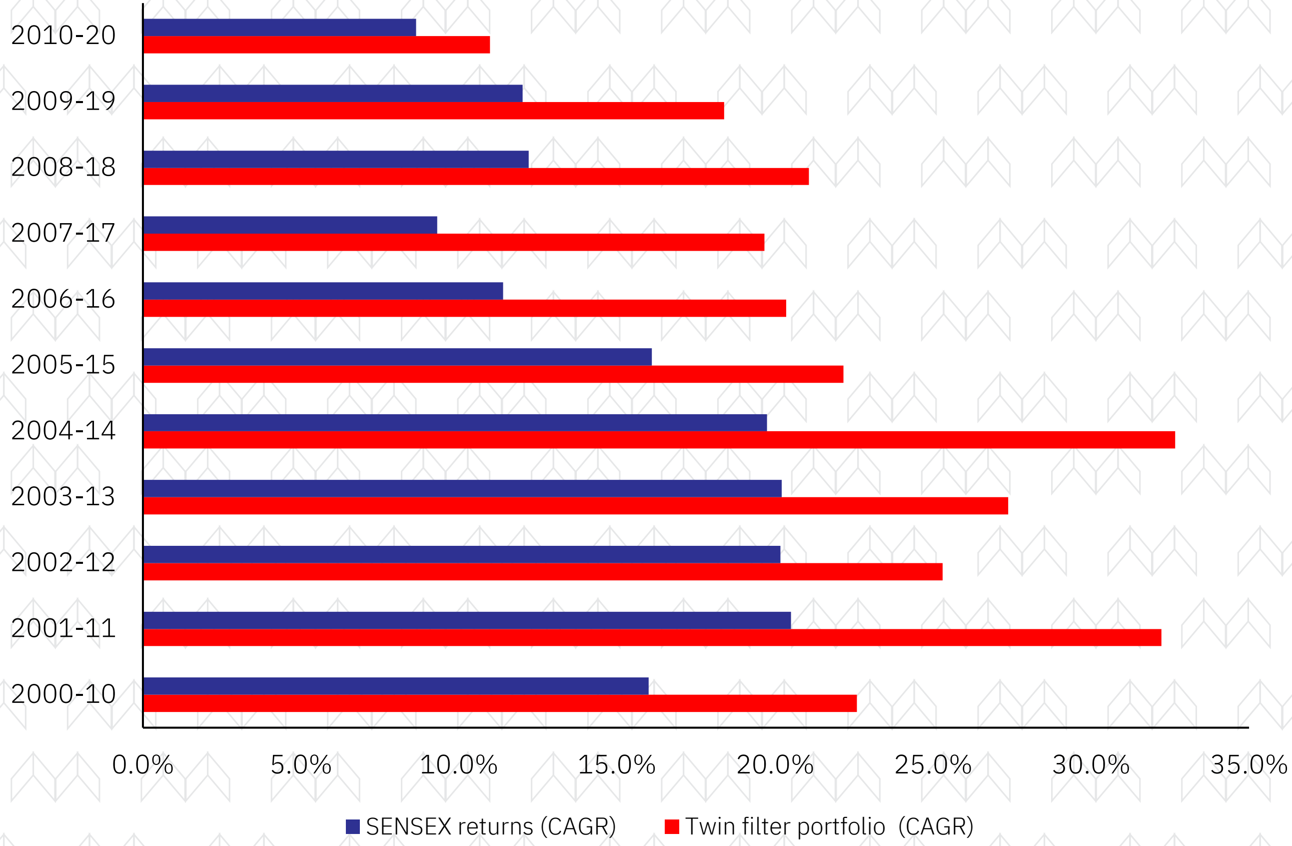


Quality wins and wins big over the long term



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).

Insurers, asset managers and brokers add resilience to the portfolio: FY20(COVID affected year) is a good example

Lenders (high beta, high std. deviation)	Life insurers (lower std. deviation than Bank Nifty)	General insurers (lower std. deviation than Bank Nifty)	Asset managers (unlevered business, no balance sheet risk)	Brokers (unlevered business, no balance sheet risk)
Generate high alpha during good times, underperform for a short period during a crisis but good lenders rapidly regain lost ground post a crisis	Life insurance is a savings product, leading life insurers gave positive returns in FY20 vs. Nifty's negative 25% return	India's largest private general insurer gave positive returns in FY20 vs. Nifty's negative 25%	Asset management is an unlevered business with no balance sheet risk, recurring revenues and strong margins India's largest AMC also gave positive returns in FY20	Similar to AMCs, brokers are unlevered businesses and earn a fee based income with no balance sheet risk

- We are building a multi-cap portfolio of financial stocks which includes not only lenders but also general insurers, life insurers, asset managers and brokers
- As equity markets trend upwards in the long run, lenders in the portfolio add a high beta element to the portfolio which helps it outperform the broader indices over the long term. As a result, over FY09 to FY20 the Bank Nifty has given a 14.8% return vs. 9.8% for the Nifty i.e. a 1.5x higher return with a 1.4x higher std. deviation
- The non lending part of the portfolio adds resilience to the portfolio during times of stress because insurers have a lower beta than lending businesses while asset management and brokerage businesses do not take any balance sheet risk

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

STRONG FUNDAMENTALS OF KCP COMPANIES

Company	FY19-22 CAGR				FY23 CAGR				Share Price as on 01/4/2024	
	Revenue	PPOP	PAT	RoE	Revenue	PPOP	PAT	RoE	1yr Share Price Return	2yr Share Price CAGR
HDFC Bank	16%	17%	21%	17%	16%	10%	19%	17%	-9%	0%
Bajaj Finance	23%	23%	21%	17%	32%	31%	64%	23%	29%	0%
Kotak Bank	13%	13%	21%	13%	25%	23%	27%	14%	3%	1%
ICICI Lombard	12%	1%	7%	19%	15%	22%	36%	18%	59%	13%
HDFC Life	16%	NA	13%	20%	37%	NA	47%	19%	27%	9%
Info Edge	12%	11%	12%	20%	38%	69%	55%	39%	53%	13%
Axis Bank	12%	9%	76%	7%	23%	30%	69%	18%	23%	18%
Cholamandalam Investment	20%	21%	22%	17%	24%	18%	24%	21%	56%	28%
Aavas Financiers	22%	21%	27%	13%	23%	18%	21%	14%	-12%	-26%
ICICI Bank	17%	19%	91%	11%	24%	25%	37%	17%	25%	23%
MAS Financial Services	-3%	-5%	1%	15%	41%	29%	28%	14%	10%	28%
Prudent Corporate	27%	45%	56%	34%	35%	52%	45%	40%	57%	NA
City Union Bank	8%	9%	4%	11%	11%	13%	22%	13%	11%	4%
Weighted Avg	**16%**	**16%**	**29%**	**16%**	**26%**	**26%**	**38%**	**20%**	**23%**	**7%**
Median	**16%**	**15%**	**21%**	**17%**	**24%**	**24%**	**36%**	**18%**	**25%**	**11%**

Note (1) 3 yr Simple Average ROEs were used for Bank Nifty and potfolio companies; (2) PPOP is operating profit and revenue is total net income (NII + other income); (3) Standalone data used for all portfolio banks and consolidated data used for Bajaj Finance; (4) For HDFC Life, PAT denotes value of new business (VNB); (5%) For insurance companies, revenue denotes Net Written Preminum (NWP); Portfolio compositions at at 31st Mar,2024

Source: Marcellus Investment Managers; Bloomberg

KCP companies report consistent business performance in Q3FY24

KCP Lenders performance in Q3FY24					
Name of Co.	YoY loan growth	YoY PAT growth	NNPA	RoA	RoE
HDFC Bank	62.3%	33.5%	0.3%	1.9%	15.8%
Kotak Bank	15.7%	7.6%	0.3%	2.2%	13.1%
Axis Bank	22.3%	3.7%	0.4%	1.8%	17.3%
ICICI Bank	18.5%	23.6%	0.4%	2.3%	18.6%
Bajaj Finance	34.7%	22.4%	0.4%	4.9%	21.9%
Chola Investment	39.4%	28.0%	2.6%	2.5%	20.4%
Aavas Financiers	22.9%	9.9%	0.8%	3.1%	13.1%
MAS Financial Services	27.2%	23.5%	1.5%	2.9%	15.0%
City Union Bank	2.3%	16.2%	2.2%	1.5%	12.6%
Median KCP Lenders	22.9%	22.4%	0.4%	2.3%	15.8%
Non-Lenders performance					
HDFC Life*	-2.1%	3.0%			15.8%
ICICI Lombard $	12.7%	22.4%			15.3%
Prudent Corporate**	32.9%	24.8%			33.5%
InfoEdge India	7.2%	11.1%			48.8%

- Significant market share gains for KCP lenders continue in Q3FY24
- In Q3FY24, YoY loan book growth for KCP lenders accelerated and now is well above pre-covid levels
- Adequate capital and liquidity will enable KCP lenders to gain market share

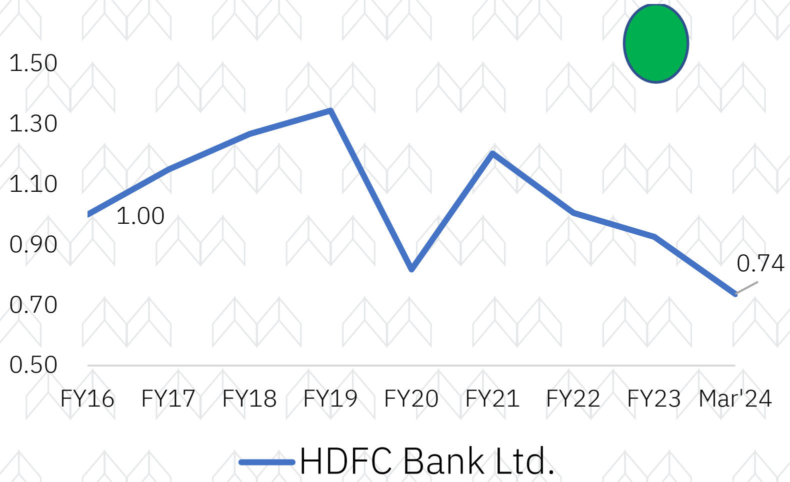
*Source: Company financial reports, RBI Note: AUM growth considered for Aavas Financiers, Bajaj Finance, Cholamandalam Investment and Home First Finance; * Loan growth denotes APE growth, PAT growth denotes EVOP growth, RoE denotes operating RoEV, $ Loan growth denotes NWP growth. **For Prudent, loan growth denotes revenue growth; Info Edge is yet to announce its results.*

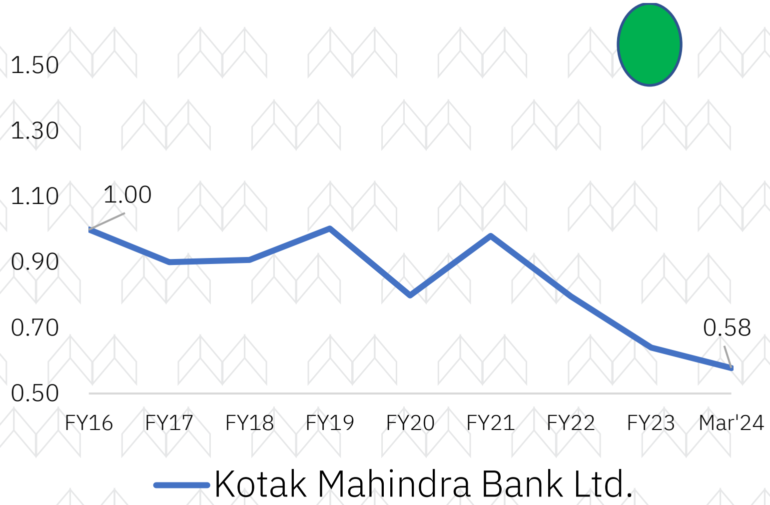
KCP’s Long term fundamental performance vs. Bank Nifty

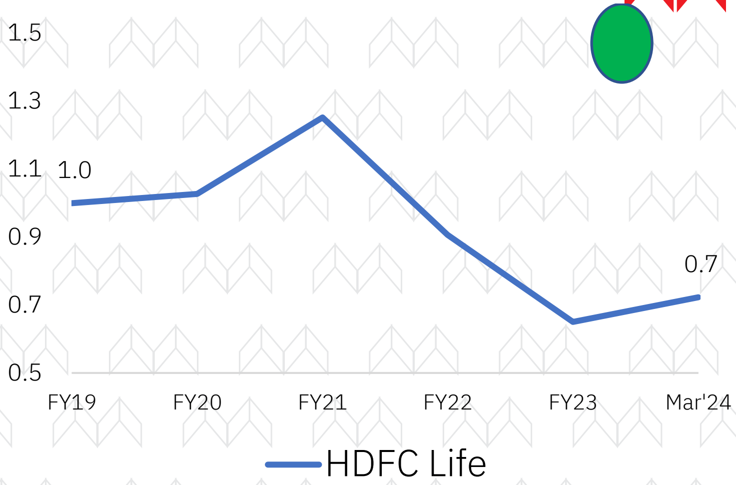
	FY17		FY18		FY19		FY20		FY21		FY22		FY23	
Particulars	BNF	KCP	BNF	KCP	BNF	KCP	BNF	KCP	BNF	KCP	BNF	KCP	BNF	KCP
YoY Loan book growth (%)	15.4%	21.3%	20.8%	28.6%	20.1%	27.9%	14.2%	18.0%	10.7%	9.7%	17.3%	21.5%	18.6%	23.2%
GNPA (%)	4.3%	3.4%	5.1%	3.6%	4.2%	3.0%	4.0%	2.9%	3.9%	2.9%	2.9%	2.5%	2.3%	2.2%
RoE – BNF and KCP Lenders (%)	12.8%	14.8%	10.6%	12.9%	9.6%	13.5%	10.5%	13.0%	12.3%	12.8%	13.4%	15.3%	15.2%	17.3%
RoA – BNF and KCP Lenders (%)	1.4%	2.0%	1.2%	1.9%	1.1%	2.0%	1.2%	2.0%	1.4%	2.0%	1.5%	2.5%	1.7%	2.7%
Leverage - BNF and KCP Lenders (x)	9.4	7.6	8.8	7.0	9.1	6.7	8.9	6.5	8.9	6.5	8.8	6.2	8.8	6.3
RoE - KCP portfolio (Lenders + Non Lenders) (%)		16.1%		15.2%		15.7%		15.0%		15.3%		16.7%		20.2%
P/B - BNF and KCP Lenders (x)	3.0	2.5	3.5	2.8	3.5	3.8	2.3	2.6	3.2	4.8	2.9	5.4	2.6	4.7

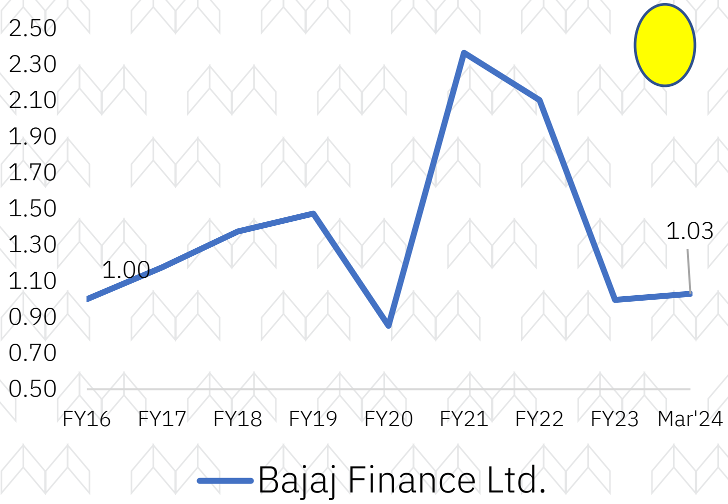
Source: Company financial reports,
Note: BNF data is calculated basis the BNF weights as per NSE

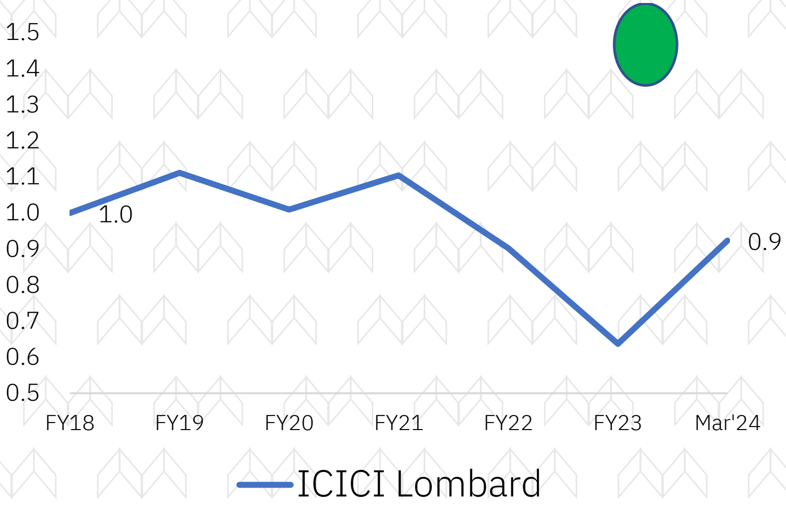
KCP stock valuations are now at multi-year lows

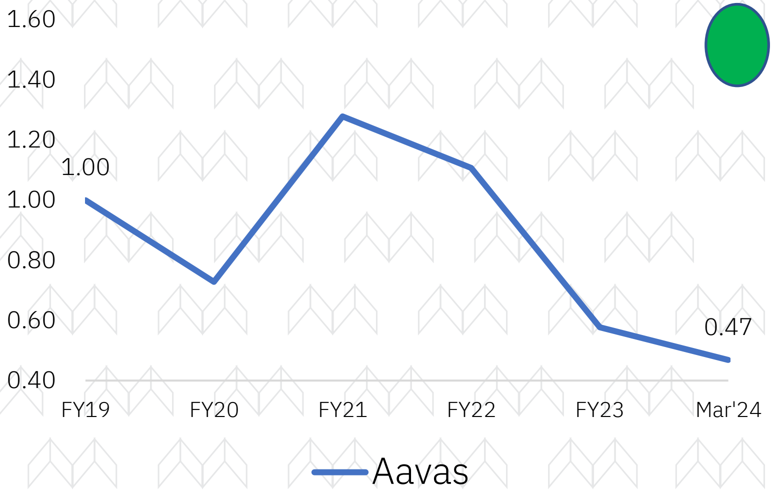






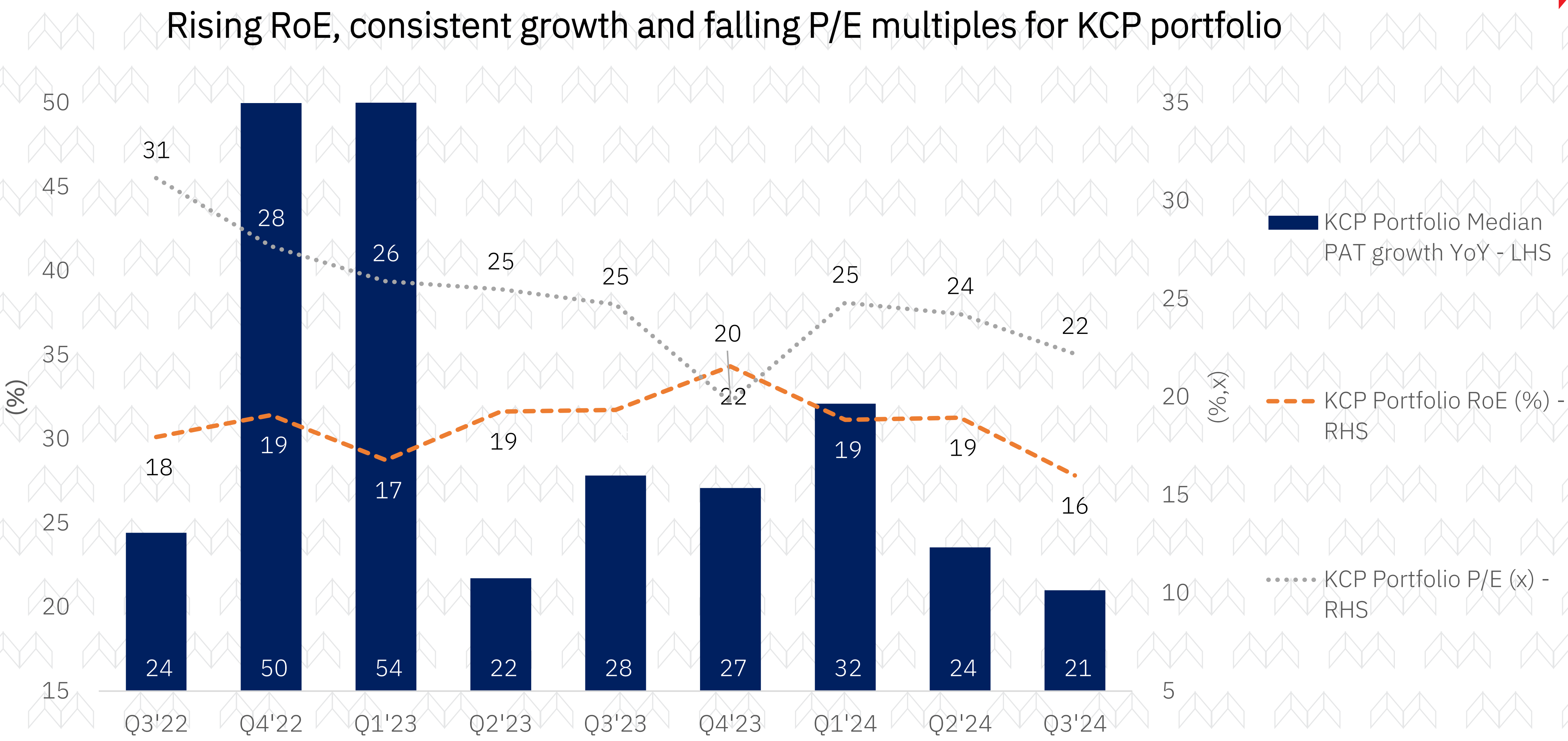






Source: Ace Equity, Bloomberg, Marcellus Investment Managers. Note: P/E rebased to 1 for all stocks

KCP is now at 22x trailing P/E for 16% RoE and 20%+ PAT compounding



Source: Ace Equity, Bloomberg, Marcellus Investment Managers. PAT/RoE/P/E is weighted average basis the weights in portfolio. P/E is calculated basis normalized earnings for the same quarter.

Mistakes and learnings

ICICI Securities – disrupted by tech led discount brokers

Failed to assess impact of Zerodha and other tech enabled players taking away market share from traditional brokers

A rising tide lifts all boats: The post Covid stock market surge attracted millions of retail investors and Isec was a beneficiary of that as a rising tide lifted all boats

Zerodha dominated the industry and its success paved the way for entry of multiple discount brokers: As Zerodha's market share in the broking industry approached 20%, multiple discount brokers saw it as evidence of a profitable business model and entered the broking industry. Isec struggled to counter the onslaught of competition

Consistent market share loss: As demat account opening slowed in 2022, Isec's weaknesses got exposed and it was caught in the innovator's dilemma on whether to go after the affluent clientele or disrupt its existing business model and go the discount broking way

Corrective Action – (a) Gave a presentation to the board of Isec in Apr, 2021 on how they can counter competition as we saw signs of intent to act from the new CEO (b) We eventually exited the position in Jul, 2022 as Isec could not fight back competition and lacked a clear strategy to change its business model

Key Lesson: While competitive forces and new entrants are a continuous threat for all businesses, companies with a poor response to competition generally have less proactive management teams and are best avoided

AU Small Finance Bank – Accounting risks played out!

Failed to judge the severity of accounting issues

Solid fundamentals across cycles : Over FY12-21, AU banks' advances grew at a CAGR of 50% with low NPAs under the leadership of its promoter – Sanjay Agarwal.

Inability to retain quality talent - AU bank converted from a non-bank lending entity to a Small Finance Bank in 2016 and had hired various senior members from larger private banks. However, there were back-to-back senior level exits. These exits were worrying from governance/ control functions – two chief audit officers and the chief risk officer of AU resigned in quick succession

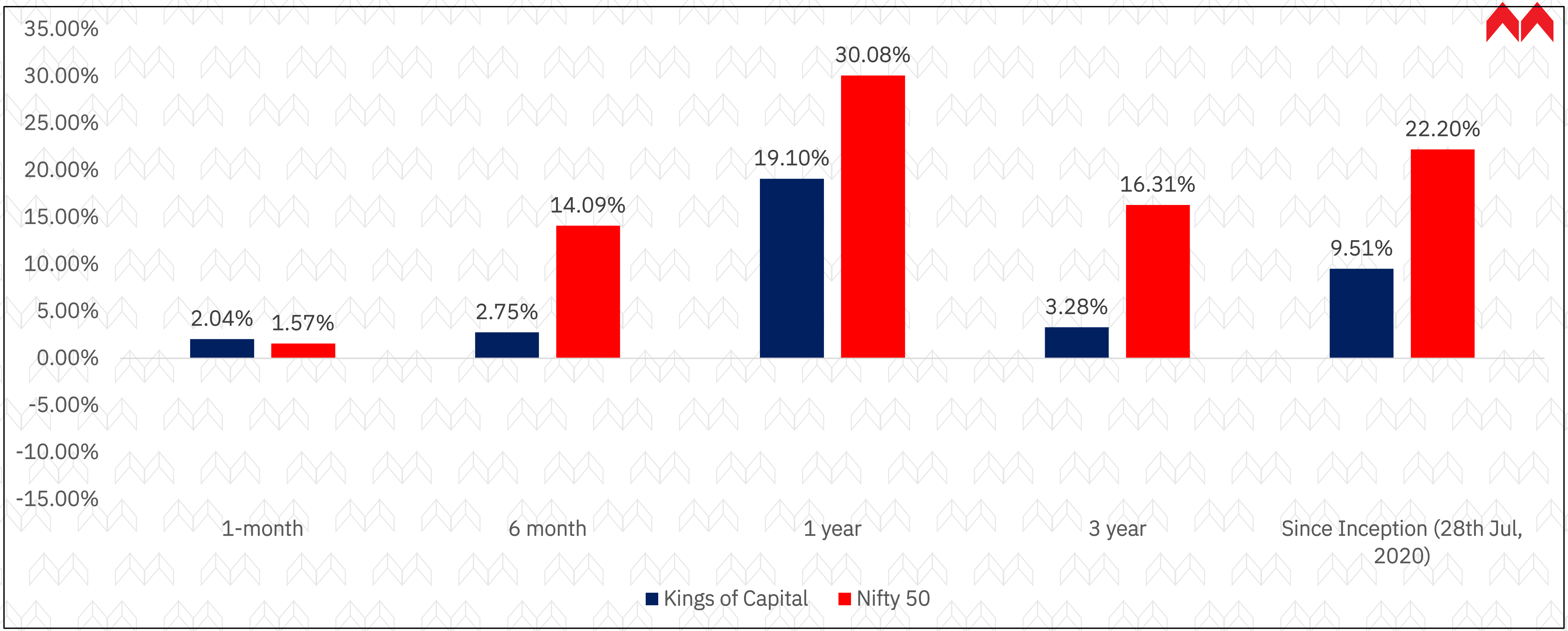
Related party transactions – The promoter and his relatives had a web of interconnected firms and there were certain transactions which were not disclosed as related party transactions. **The company's disclosures and our initial forensics were not able to capture these governance issues**

Corrective Action – (a) In Oct'21, AU's weight in the financials fund was reduced from 8% to 4% after raising our concerns with the management on our initial findings around forensics; (b) In Mar'22, we exited from AU SFB since we did not get any satisfactory explanation from the management on our concerns raised around related party transactions

Key Lesson: Great fundamentals do not always translate into great governance. It is best to avoid companies where management does not have a satisfactory response for related party transactions

Source: Marcellus Investment Managers

Live portfolio performance (as on 31st March'24)



Performance data is net of annual performance fees charged for client accounts whose account anniversary date falls upto the last date of this performance period. Since fixed fees and expenses are charged on a quarterly basis, effect of the same has been incorporated upto 31st March 2024.

*For relative performance of particular Investment Approach to other Portfolio Managers within the selected strategy, please refer. Under PMS Provider Name please select Marcellus Investment Managers Private Limited and select your Investment Approach Name for [APMI (apmiindia.org)](apmiindia.org) the stated disclosure.

Fund structure

Marcellus offers the Kings of Capital Portfolio in a PMS construct with zero entry/ exit load and with no lock-in.

Clients who are onboarded through intermediaries/distributors can choose from one of the following two fee structures:

- Option 1 (fixed fee model): 2.5% p.a. fixed fees and zero performance fees
- Option 2 (hybrid model): 1.5% p.a. fixed fees and performance fees of 15% profit share over a hurdle of 10% without catchup

High watermark applies for performance fees. Minimum investment: INR 50 lakhs

****Clients also have the option to be onboarded directly (Direct Fee Code).*

Marcellus is delighted to offer its clients a Systematic Investment Plan (SIP). Investors now have the option to save and invest regularly in Marcellus Funds. For more details please read our FAQs https://marcellus.helpscoutdocs.com/article/100-systematic-investment-plan-sip-faqs

At Marcellus we don't believe in timing the market and hence deploy the money into our strategies as soon as the investor transfers the funds to us. However, we do recognise the emotional aspect of loss aversion in the short term and have launched STP (Systematic Transfer Plan) plan using which clients can stagger their investment in tranches spread over 5 months. For more details please refer to our FAQs https://marcellus.helpscoutdocs.com/article/96-stp

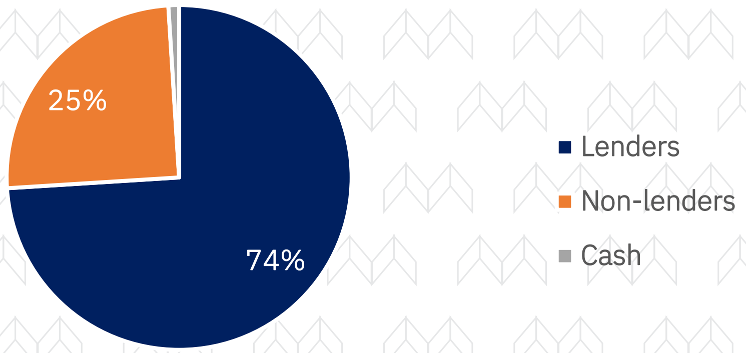
KCP FACTSHEET (1/2)

Fund Details	
Strategy Name	Kings Of Capital
Fund Manager	Tej Shah
AUM In INR Crs (31st Mar 2024)	361.99
Category	Large-Cap
Benchmark	Nifty 50 Total Return Index

Top 4 Holdings (accounts for ~50% of allocation)	
HDFC Bank	Lender
Bajaj Finance	Lender
Kotak Bank	Lender
ICICI Bank	Lender

Market-Cap Wise Allocation	
Large-Cap	74..5%
Mid-Cap	7.0%
Small-Cap	17.5%
Cash	1.0%

Sector Wise Allocation

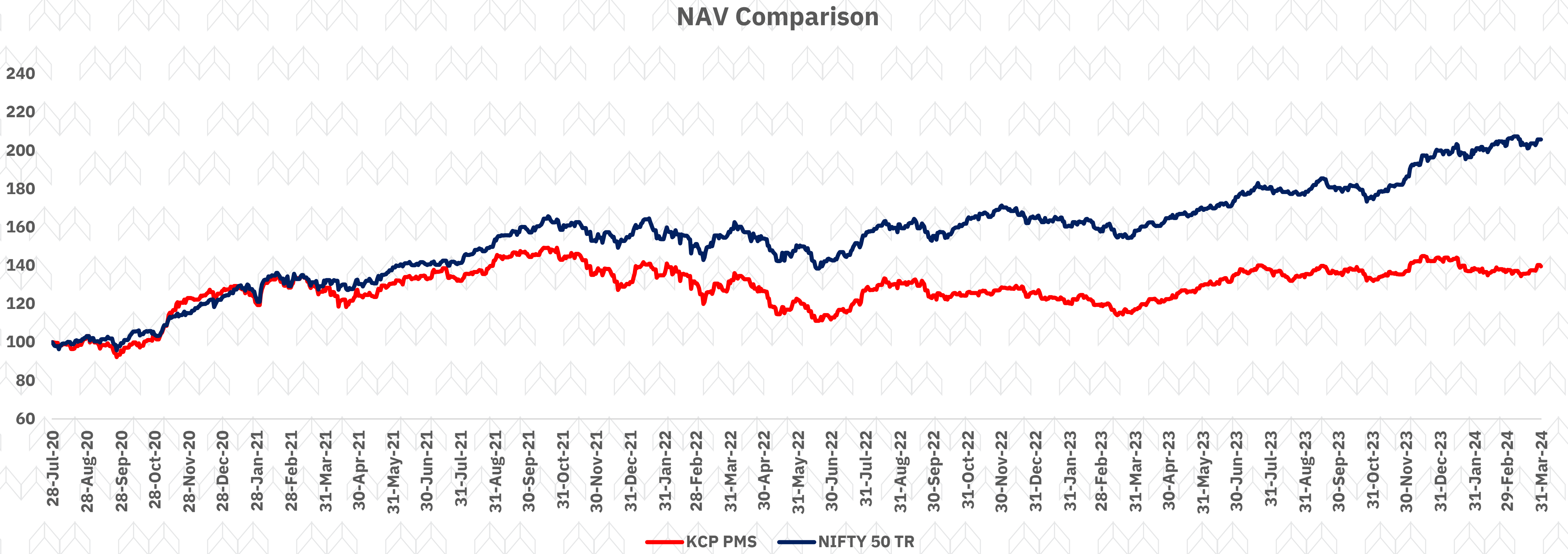


Portfolio Metrics	
Wtd Avg Market Cap (INR Cr.)	3,93,710
Portfolio P/E (FY25)	28.43
Churn Ratio (TTM)*	29.21%
Std Dev (Inception – Mar 24)	16.5%
Sharpe Ratio (Inception – Mar 24)	-0.025

Source: Marcellus Investment Managers

Large cap defined as M.cap > US$ 10 bn; Mid-cap as US$ 1 – US$10 bn and small cap less than US$ 1 bn.

KCP FACTSHEET (2/2)



* Based on NAV's rebased to 100

Performance data is net of annual performance fees charged for client accounts whose account anniversary date falls upto the last date of this performance period. Since fixed fees and expenses are charged on a quarterly basis, effect of the same has been incorporated upto 31st Mar 2024.

Source: Marcellus Investment Managers

Disclosures

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