

LITTLE CHAMPS

An investment strategy for Indian small-caps from Marcellus Investment Managers

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

Private and confidential

Note: Circulation not intended for US clients



MARCELLUS

Marcellus Investment Managers Pvt. Ltd.

Marcellus Investment Managers



- Who we are and what we do?
- Investment Team
- Investing in India's Transformation
- Five Mega Themes making their way into our portfolio
- Investment Philosophy and proprietary research process
- Bottom-up research process and case studies
- Key Metrics of the LCP Portfolio
- Fund Performance
- Fee Structure
- Factsheet
- Disclaimer

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

Key Investment members have worked together for >12 years now



Saurabh Mukherjea, CFA, FRSA

- Educated at the London School of Economics.
- Co-founder of Clear Capital.
- Former CEO of Ambit Capital.
- Founding director of Association of Portfolio Managers in India



Ashvin Shetty, CFA

- Small & midcap portfolio manager in Marcellus for the past four years
- Led Auto sector in Ambit from 2010-17
- Worked for KPMG's and Deloitte's statutory audit departments from 2004-07. He is a qualified Chartered Accountant (ICAI India).

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.



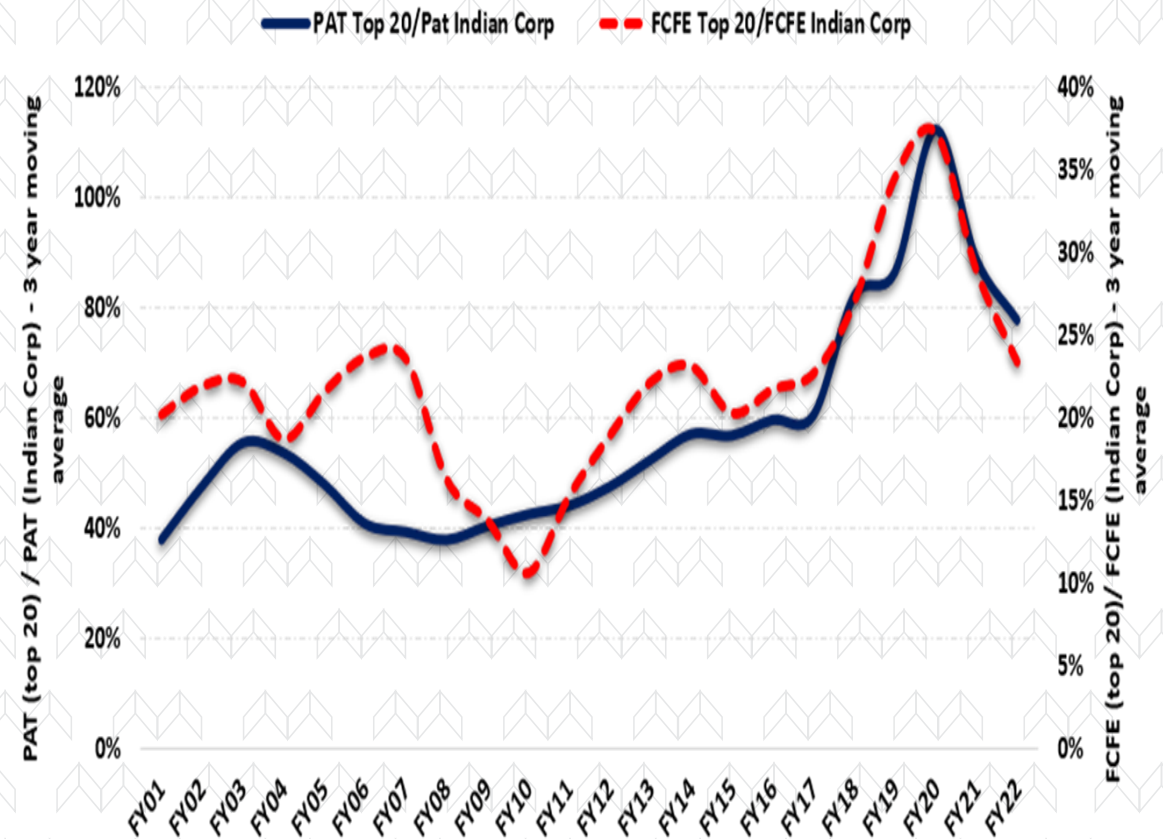
The inception of a single **Goods & Services Tax** in 2017 has allowed companies to consolidate their supply chains (from multiple state-level structures to unified national supply chains).



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



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

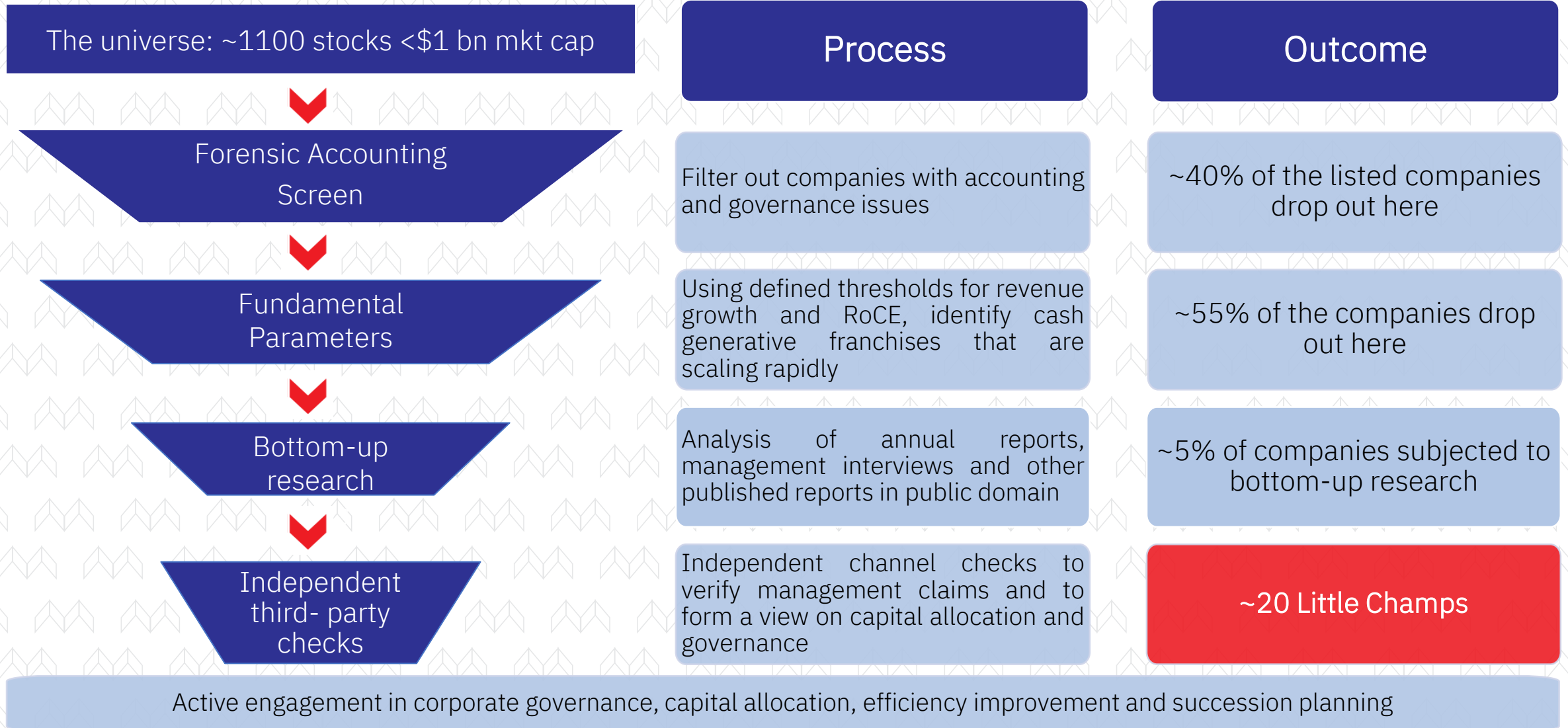
China's Unravelling and Creation of a US\$ 300 Billion per annum opportunity for India



Octopus

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

Marcellus' portfolio construction process



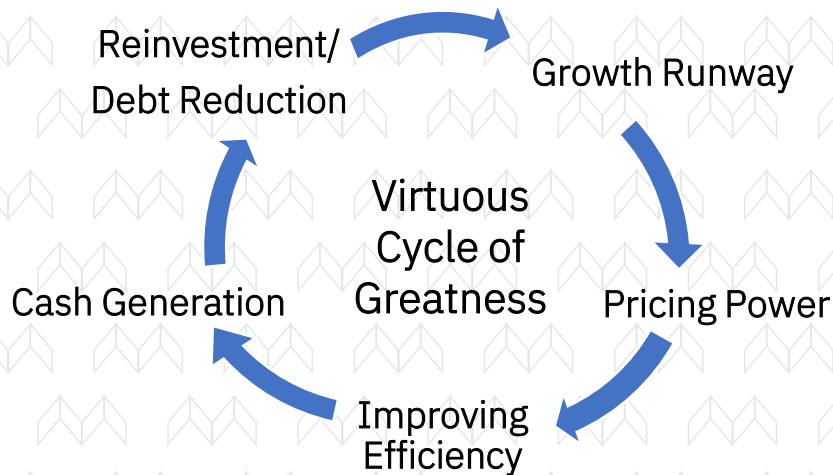
Note: The fund manager maintains discretion on stock inclusion in the universe. In case, a stock does not clear the above filters, the fund manager must record and present to the Investment committee for approval with the reasons for such inclusion

LITTLE CHAMPS: A Portfolio of Niche companies with strong moats & sustainable growth



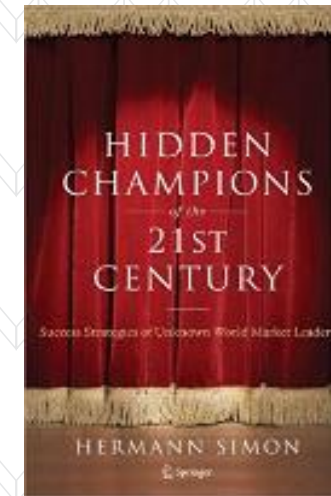
Little Champs

- Identity small-cap companies (market cap <US\$500 million) with good corporate governance and capital allocation track record and strong sustainable competitive advantages built around brands, business processes and strategic assets.
- Characteristics of a typical portfolio company:
 - Sector leading franchise with stellar track record of capital allocation;
 - Clean accounts and corporate governance; and
 - High growth potential.



Look for Hermann Simon's celebrated 'Hidden Champions'

- SMEs, often family owned, producing inconspicuous products but ranked top globally for that product.
- Normally work in niche markets for which they design unique products often using proprietary process.
- Operate extremely close to their customers who depend on their products and cannot easily change their source.
- Competitive advantages of such firms are rarely because of cost leadership but more because of quality, total cost of ownership, high performance, and closeness to the customer.

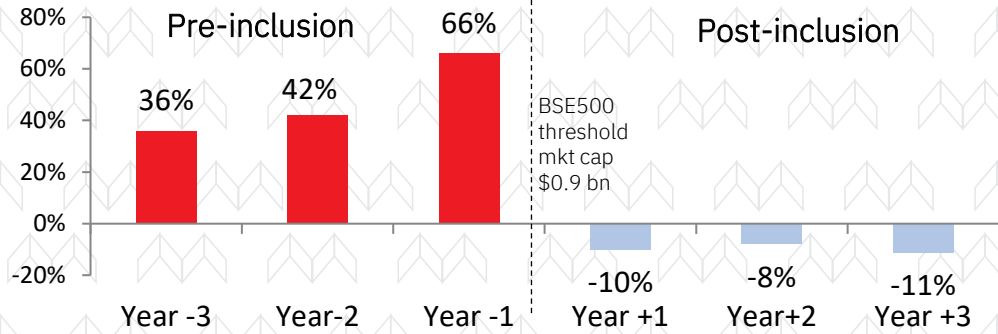


Source: *Hidden Champions of the 21st Century*, Hermann Simon; Disclaimer: Copyrights of above book is exclusively reserved with Author/Publisher of the above book.

'Little Champs' – A small caps portfolio with focus on discovering potential BSE500 entrants

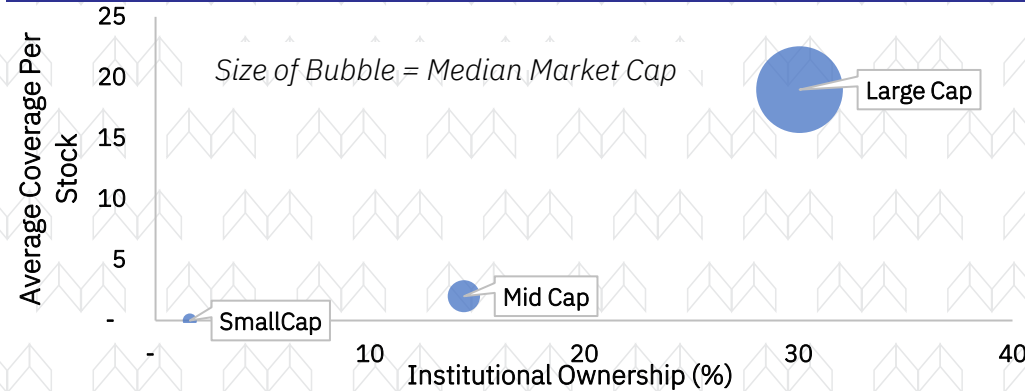


Huge relative and absolute performance before Small Caps (mkt cap < Rs30bn) enter the BSE500 (FY03-23 data)



Source: Ace Equity. Relative returns (to BSE 500) are medians CAGR of stocks that have been included in the BSE 500. For prior returns, returns are measured until 1 quarter preceding the quarter of entry. The above returns calculation is for the entries from June 2003 to Dec 2023.

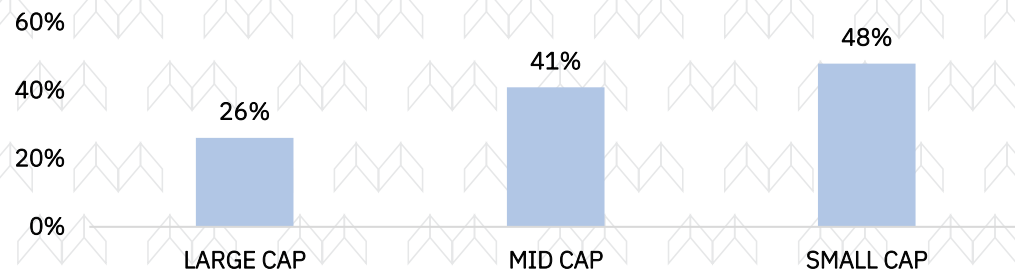
Small Caps are under-researched and under-owned.



Source: Ace Equity Note: (1) We classify companies with market cap of >Rs250bn as Large Cap, between Rs75bn to 250bn as Mid Cap and below Rs30bn as Small Cap (2) Market cap and Analyst coverage as of Dec 2023-end; Institutional ownership as of September 2023-end

Quality Small Caps deliver stronger earnings compounding than their larger counterparts...

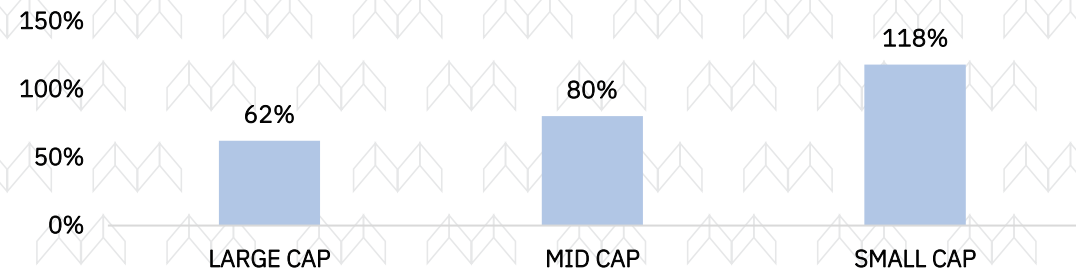
Highest Quartile Earnings CAGR (FY18-23)



Source: Ace Equity Note: (1) We classify companies with market cap of >Rs150bn as Large Cap, between Rs30bn to 150bn as Mid Cap, and below Rs30bn as Small Cap (2) Returns calculated for four baskets (Large, Mid, and Small cap) with equal allocation to each stock within those baskets.

Quality Small Caps massively outperform vs comparable larger companies

Highest Quartile Return (July 2018-23)



Source: Ace Equity Note: (1) We classify companies with market cap of >Rs150bn as Large Cap, between Rs30bn to 150bn as Mid Cap, and below Rs30bn as Small Cap (2) Returns calculated for four baskets (Large, Mid, and Small cap) with equal allocation to each stock within those baskets. Stocks rebalanced annually at July-end based on market cap criteria; (3) No dividends, transactions costs and other charges considered in the above returns calculations.

Step1: Proprietary forensic accounting algo to avoid naughty companies



Methodology

12 accounting ratios covering income statement (revenue/ earnings manipulation), balance sheet (correct representation of assets/liabilities), cash pilferage and audit quality checks.

Six years of historical consolidated financials.

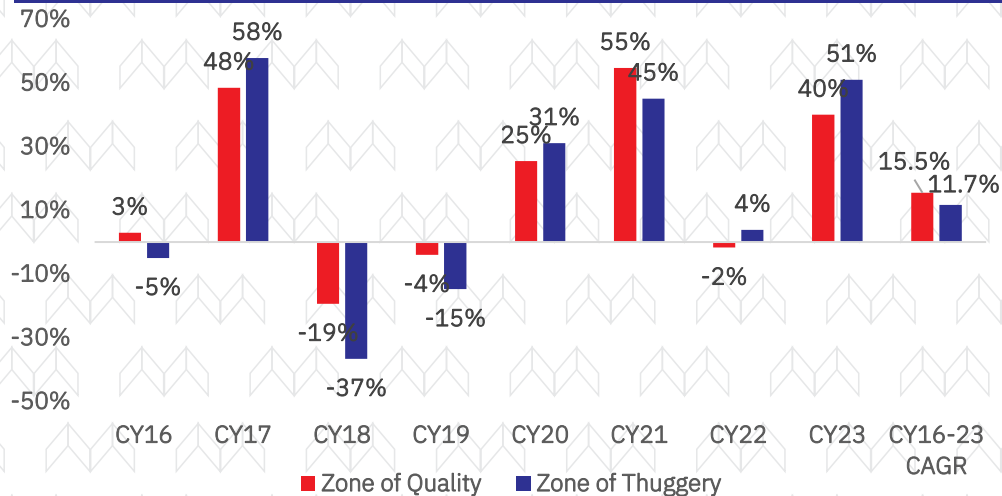
First rank stocks on each of the 12 ratios individually (some examples outlined in the table on the right). These ranks then cumulated across parameters to give a final pecking order on accounting quality for stocks.

Selection of these ratios has been inspired by Howard M. Schilit's legendary forensic accounting book 'Financial Shenanigans'.

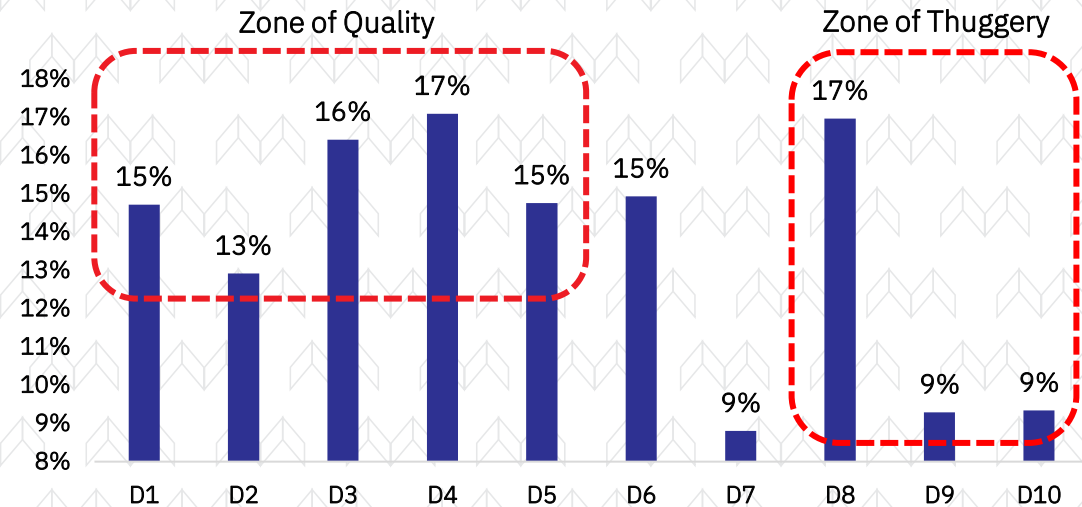
The forensic analysis toolkit

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

Quality wins big in the long-term

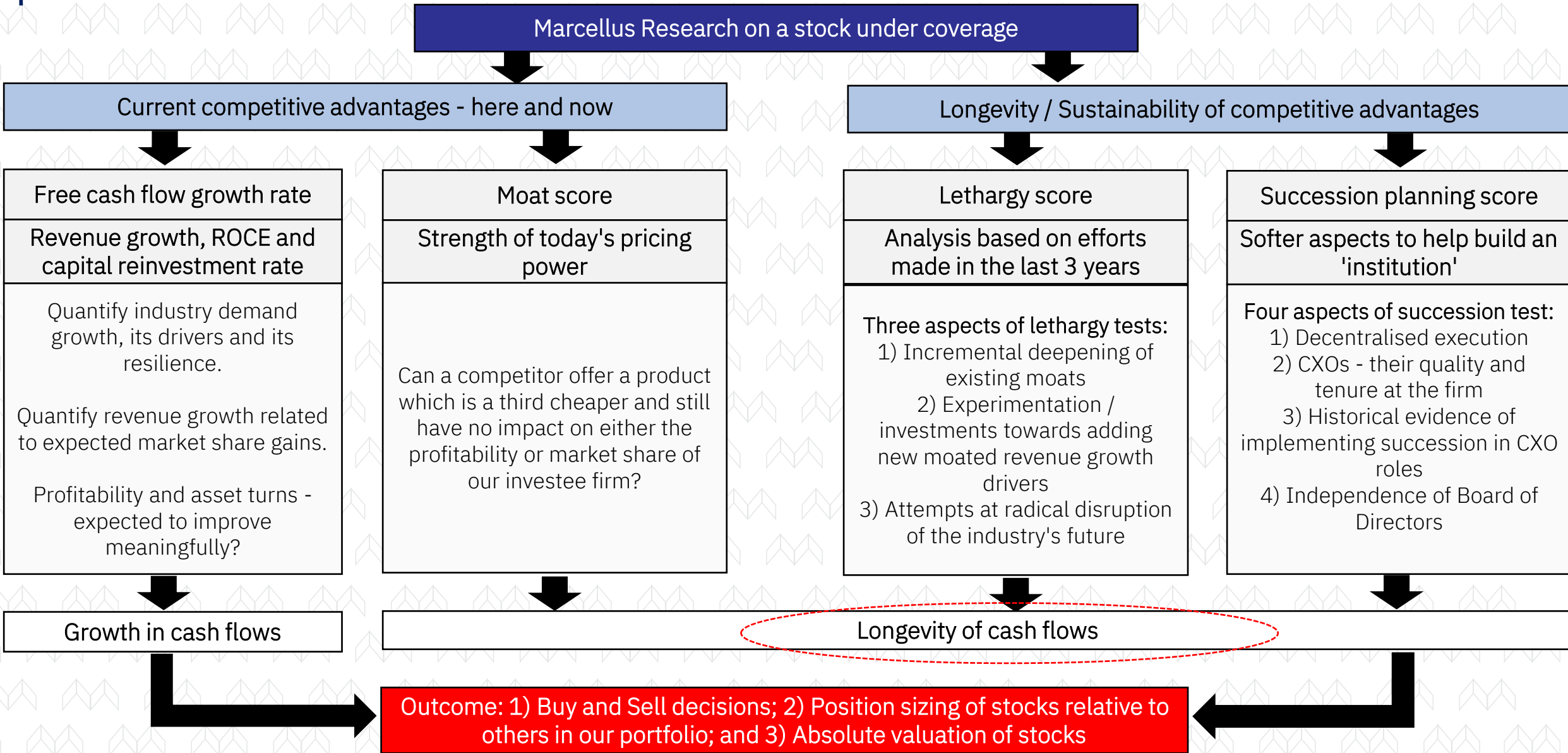


Accounting quality directly impacts investment returns



Source: Marcellus Investment Managers, Ace Equity

Step2: Longevity analysis helps quantify the length of the 'comp advantage' period



Small Cap case study – GMM Pfaudler



Primary research: to establish value proposition

- 1) Interviewed a wide range of customers to understand on what basis they choose a supplier of glass-lined equipment and what value GMM brings to the table
- 2) Visited their factories to understand the manufacturing process and gauge if it affords any competitive advantage
- 3) Met competitors to get an idea of how they are positioning themselves and how they view GMM
- 4) Researched to understand company's culture
- 5) Met end-use industry experts to understand demand trends in their sectors and the opportunities for GMM

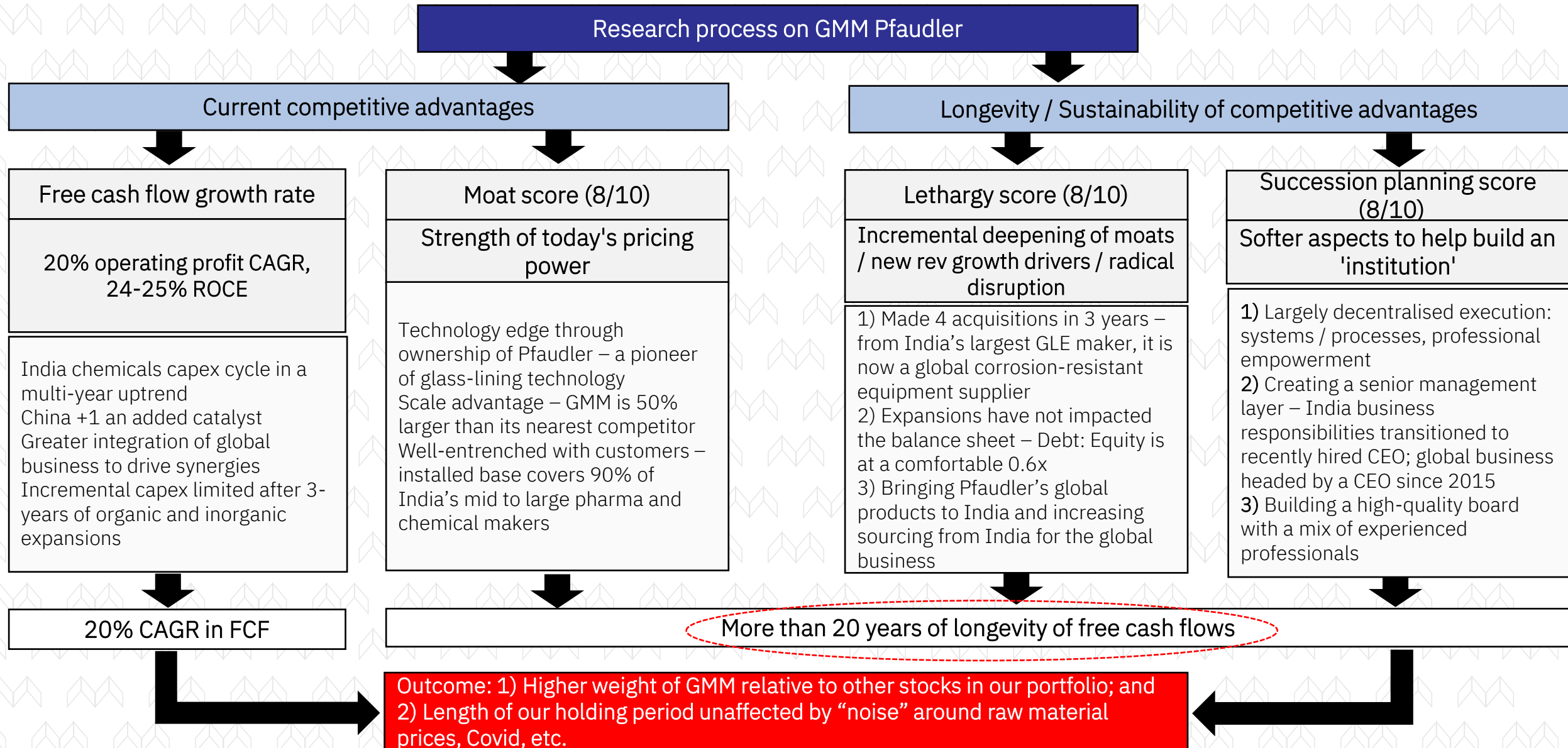
Secondary research: published financials

- 1) Last 15 years of annual reports of the company as well as competitors (where available)
- 2) Study of competitor's financials, including unlisted ones

Unique Insight – why GMM will sustainably dominate the industry profit pool

- 1) GMM has an approx. 50% market share of the glass-lined equipment industry in India
- 2) The dominance comes from access to best-in-class technology from Pfaudler, long-standing relationships with customers, smart capital allocation skills and massive scale benefits – the nearest competitor is 2/3rd its size
- 3) The dominance is more pronounced in industry EBITDA share, of which GMM has 75-85%. For context, the only other global GLE maker with a presence in India (De Dietrich; DDPS) was loss-making
- 4) GMM has built a virtuous cycle of generating far higher cash flows than peers and redeploying them to further increase dominance – capacity has grown by ~3x in 5 years
- 5) The above has also led to buying out of DDPS's India unit, acquiring a defunct heavy engineering company's plant and recently, the acquisition of Pfaudler International

Longevity analysis: GMM – a dominant B2B franchise



Key metrics of the Little Champs Portfolio

Little Champs – carefully constructed portfolio to ensure it meets our quality and growth criteria



Company	FY19-23 CAGR				FY24 YoY		
	Revenue	PAT	FCFF	ROCE	Revenue	PAT	ROCE
Aavas Financiers	22%	25%	NA	13%	17%	14%	14%
Ahulwalia Contracts	13%	13%	36%	22%	36%	18%	25%
Alkyl Amines	19%	29%	29%	37%	-14%	-35%	16%
Ami Organics	27%	38%	47%	27%	14%	-48%	15%
Carysil	24%	32%	NM	20%	15%	10%	17%
Cera	7%	17%	16%	21%	4%	13%	25%
City Union Bank	9%	8%	NA	12%	-4%	8%	13%
Control Print	15%	15%	1%	19%	18%	5%	23%
Eureka Forbes	NA	NA	NA	NA	5%	99%	NM
Everest Industries	4%	-9%	NM	13%	-4%	-58%	5%
Fine Organic	30%	45%	37%	41%	-30%	-33%	32%
Garware Technical	6%	5%	10%	24%	2%	21%	23%
GMM Pfaunder	59%	53%	NM	23%	8%	-17%	21%
Godrej Agrovet	12%	1%	30%	14%	2%	17%	13%
MAS Financial	7%	7%	NA	15%	33%	23%	15%
Mold-Tek Packaging	16%	26%	8%	21%	-4%	-17%	15%
PDS	13%	54%	30%	18%	-2%	-46%	17%
Prudent Corporate	29%	50%	99%	50%	33%	19%	45%
RACL Geartech	17%	41%	NM	19%	14%	5%	15%
Rainbow Hospitals	21%	38%	131%	23%	11%	3%	25%
RHI Magnesita	38%	21%	52%	29%	39%	16%	9%
Shanthi Gears	17%	19%	32%	19%	20%	23%	34%
Suprajit Engineering	15%	3%	NM	17%	5%	2%	14%
Tarsons	12%	20%	NM	30%	-2%	-37%	10%
Tega Industries	18%	60%	19%	18%	23%	5%	20%
Ultramarine & Pigments	16%	8%	NM	16%	1%	-17%	9%
Median	16%	21%	30%	20%	7%	5%	16%

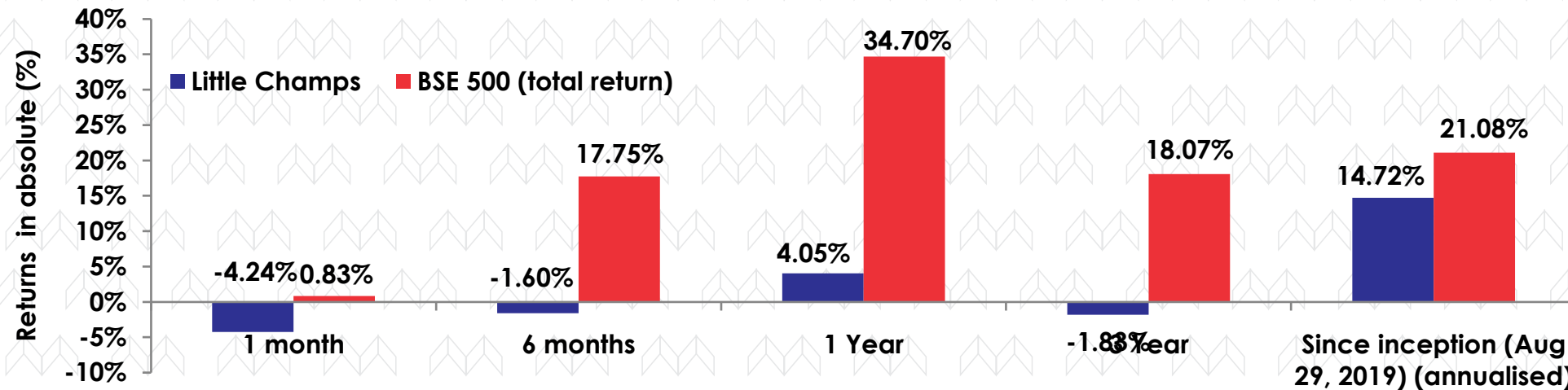
Source: Ace Equity Note: (1) RoCE pre-tax considered above all companies except for financial companies viz. Aavas Financiers, Home First and MAS Financial for which RoE (instead of RoCE) is considered, (3) NA - Not applicable

RoE instead of RoCE for Financial companies in the Little Champs portfolio

LIVE PORTFOLIO PERFORMANCE AND COMPARISON WITH BENCHMARK



Little Champs vs. Benchmark BSE 500*



Source: Marcellus Investment Managers. Note: (i) Portfolio inception date is August 29, 2019. (ii) Returns as of May 31, 2024. (iii) All returns are net of fees (as described in point (iv)) and expenses. (iv) Fixed Fees are charged on a quarterly basis and have been charged till 31st March 2024.

Performances fees are charged on cumulative gains at the third anniversary of the respective client account, thus the effect of the same has been incorporated for client accounts whose third account anniversary falls upto the last date of this performance period. Performance data is not verified either by Securities and Exchange Board of India or U.S. Securities and Exchange Commission. (v) Returns shown above are net of transaction costs and includes dividend income. (vi) Total returns index considered for BSE 500 above.

*For relative performance of particular Investment Approach to other Portfolio Managers within the selected strategy, please refer the following link

<https://www.apmiindia.org/apmi/welcomeiaperformance.htm?action=PMSmenu>. Under PMS Provider Name please select Marcellus Investment Managers Private Limited & select your Investment Approach Name for viewing the stated disclosure.

Little Champs' returns and drawdowns vs BSE 500

Performance (Since Inception)	Return since inception (Annualized)	Maximum Drawdown
Little Champs	14.72%	-36.70%
Performance of Benchmark		
BSE 500	21.08%	-38.11%

Source: Ace Equity Note: Maximum drawdown based on daily returns from Aug 29, 2019 to May 31, 2024

Fee Structure



Marcellus offers the Little Champs Strategy in a PMS construct

- **Fixed fees:** 1.5% per annum (charged quarterly) + **Performance fees:** 20% profit share above a 10% hurdle. Performance fees will be charged on cumulative gains at the third anniversary*. Performance fees will be charged without catch-up i.e. the first 10% return per annum (net of fixed fees) will be not be subject to performance fees. High water mark applies for performance fees.

*If redeemed prior to the completion of three years, performance fees will be charged as on redemption date.

Exit Load: 3%, 2% and 1% if redeemed in the first, second and third year respectively.

Minimum investment: INR 50 lacs

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

LCP Factsheet



Fund Details

Strategy Name	Little Champs
Fund Manager	Ashvin Shetty, CFA
AUM In INR Crs.	429
Category	Mid-cap
Benchmark	BSE500 Total Return Index

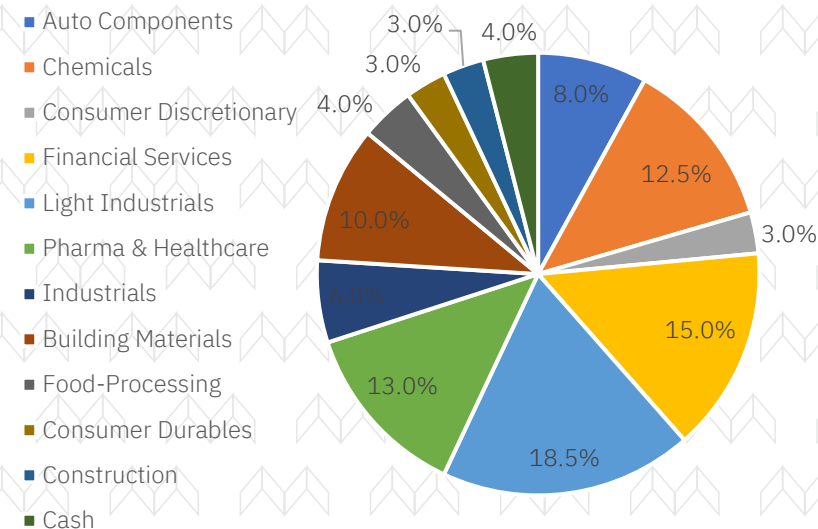
Top 5 Holdings (accounts for ~29% of allocation)

GMM Pfaudler Ltd.	Light Industrials
Tarsons Products Ltd.	Pharma & Healthcare
MAS Financial Services Ltd.	Financial Services
Alkyl Amines Ltd.	Chemicals
Mold-Tek Packaging Ltd.	Light Industrials

Market-Cap Wise Allocation

Small-Cap	96%
Mid-Cap	0%
Cash	4%

Sector Wise Allocation



Portfolio Metrics

Wtd Avg Market Cap (INR Cr.)	6,560
Portfolio P/E	37
Dividend Yield	0.3%
Churn Ratio (TTM)	68.2%
Standard Deviation (12 month rolling)	32.1%
Sharpe Ratio (12 month rolling)	0.42

Disclosures



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