Equitree Capital Quarterly Newsletter

December 2024

EQUITREE
SOWING SEEDS OF GROWTH

"The four most dangerous words in investing are: 'This time it's different.'"
– Sir John Templeton

Dear Investors,

We're pleased to share **Equitree Capital's Q3 FY25** results and insights. While the broader markets dipped in December 2024, Equitree Capital not only weathered the storm but emerged **stronger than ever:**

- We ranked as the **best performing PMS** for the month of **December 2024** with a 7.2% return.
- Our **Emerging Opportunities PMS** is one of the few names consistently ranked among the **top five PMSs** across all time frames over the last five years: **1st for 1 month (7.2%), 5th for 1 year (51.2%), 4th for 3 years (41.3%), and 3rd for 5 years (43%)** among 850+ PMSs in India.
- We have also surpassed **₹500 crore AUM**, staying **purely focused to small and micro-cap opportunities**, reinforcing our unwavering investment discipline!

This performance arrives at a time when **77% of the stock universe is trading at least 20% below their 52-week highs.** Despite persistent volatility, our single-strategy fund notched an 18% gain over the last six months—showing robust strength when the broader market remained down.

Performance Snapshot (%)

Investment Period	1 month	3 months	6 months	1 Year	2 Year	3 Year	5 Year
Emerging Opportunities	7.20	6.65	18.39	51.17	64.77	41.26	43.09
BSE 500 TRI	-1.50	-7.79	-0.74	15.81	21.04	15.36	19.06
Outperformance	**8.70**	**14.44**	**19.13**	**35.36**	**43.73**	**25.90**	**24.03**

As of December 31, 2024
Returns are computed on TWRR basis net of fees/expenses, Returns over 1 Year are annualized
Source: Nuvama Custodian Services, Equitree Capital; Not verified by any regulatory authority/SEBI

Since **the end of December**, markets have become increasingly volatile: the **BSE 500** benchmark Index has corrected **4.2%**, while our **Emerging Opportunities PMS** saw only a **0.8% decline** (as of January 21, 2025). Moreover, the **BSE 500** Index is **down 13% from its 52-week high**, whereas our fund has fallen **just 6%**, showcasing the resilience of our portfolio companies—even in the **"micro-cap"** space.

Our **disciplined** approach to **staggered buying** has proven beneficial. Investors who joined us in H2 2024 initially held 30–40% cash, which is now being **systematically deployed into high-conviction ideas**. As **long-term investors**, we remain **patient for ideal entry points** and methodically scale into both **new** and **existing** holdings.

We've also maintained a **cautious stance on valuations** for several quarters. In our Q4 FY24 newsletter (March 2024), we warned about **frothy pricing** in **select segments** and anticipated a **market pullback**. Now that the correction is materializing, our **cash position is being put to work** in businesses that we believe offer substantial upside over the next few years.

Rather than reiterating the valuation narrative, we take this opportunity to zoom out and explore **India's long-term growth story**—drawing parallels with nations that **once stood where India does today** and have since evolved into **global powerhouses.**

"Study the past if you would define the future."
— Confucius

Zooming Out: India's *Long-Term* Opportunity

History offers valuable lessons on how **emerging nations** can transform into economic juggernauts. **China, South Korea, and Japan** took distinct paths but shared key strategies—**manufacturing, exports, and infrastructure.** Their macroeconomic indicators provide a lens to assess India's growth story:

1. Laying the Groundwork: Bold Reforms & Vision

- China, Japan, and South Korea each embarked on **transformative policy overhauls** to catalyze long-term development. While their contexts differed, they converged on four essential pillars:

Major Reforms	China (Post-1980)	Korea (Post-1962)	Japan (Post-1952)
Foreign Trade & FDI	"Open Door Policy," Special Economic Zones; JV incentives for MNCs	Export-driven approach; Joint ventures; Gradual FDI liberalization	Trade pacts with US/EU; Technology licensing from Western firms; GATT membership
Domestic Manufacturing	State-led push in industrial hubs; Low-cost labor advantage driving scale	Chaebol-led heavy industry (steel, shipbuilding, semiconductors)	Centralized industrial strategy, Auto & electronics modernization
Export Orientation	Electronics, apparel, consumer goods as key drivers; Export growth fueling infra-investment	Shipbuilding, electronics, automotive as export engines; Aggressive global marketing	High-quality manufacturing, Rapid rise in consumer electronics
World-Class Infrastructure	Massive spending on ports, highways, high-speed rail; Over 40% of GDP on infra in some years	Highways and ports, 1988 Seoul Olympics spurred infrastructure upgrades	Post-war rebuild: bullet trains, extensive road/rail networks

Source: Ministry of International Trade and Industry

- Through a blend of **government incentives, strategic capital allocation, and corporate alliances,** these economies laid robust foundations that supported years of growth.
- These strategic reforms also brought challenges—**rising inequality, environmental costs, and economic dependencies** that required continuous adaptation

2. Production-Driven Growth

- Major economic powers achieved rapid growth by **opening up to global markets, prioritizing exports, and supporting domestic manufacturing** with subsidies, tax incentives, and **infrastructure investments**. This strategy created a virtuous cycle:

Manufacturing Expansion → Job Creation → Rising Wages → Transition to High-income status

- Engines of growth are built on **manufacturing strength**. Over decades, we've seen:
  a. China rise from 3% of global output in 1970 to **>35% today, leveraging economies of scale.**
  b. South Korea transform from an agrarian economy to a technology powerhouse, growing from <1% to nearly **3% of global production** through **government-led policies.**
  c. Japan double its share from 9% to 18% in under 30 years, driven by **precision engineering.**
- This production-led model also unlocks **technological advancement** and **workforce upskilling**—further improving global competitiveness.

3. Export Engines: Amplifying Global Influence

- By strategically **aligning domestic production with global market demands**, these economies leveraged exports as a catalyst for rapid expansion:
  a. China: Started with **electronics and consumer goods** leveraging cost advantages, then advanced to higher-value products, becoming a global manufacturing leader.
  b. South Korea: Invested heavily in **R&D** and received strong policy tailwinds, leading in **shipbuilding, semiconductors, and automotive industries.**
  c. Japan: Excelled in **high-quality exports** like automobiles and consumer electronics, dominating global markets by the 1970s through brand loyalty and tech innovation.

Exports (Bn $)	Period	Start → End	CAGR %
China	1980–2000	19.41 → 253.09 *13x*	13.70%
South Korea	1965–1981	0.18 → 21.25 *118x*	34.97%
Japan	1952–1970	1.27 → 22.03 *17x*	17.16%

Sources: Kellogg's Institute – The Korean Miracle, Macrotrends

- Export-driven growth not only boosted GDP but also **facilitated technology transfers, enhanced global brands, and large-scale inward FDI**—forming a **self-reinforcing loop** that expanded each country's economic profile.

4. Impact on Wealth Creation: Equity Markets & Beyond

- Rapid increases in **output and exports** typically translate into **soaring corporate profits,** attracting both **domestic and foreign investors**. Not surprisingly, equity markets in these high-growth nations delivered **impressive returns:**

Index	Growth Period	CAGR %
Shanghai Composite (China)	1990–2010	16.71%
Kospi (South Korea)	1980–2010	10.35%
Nikkei 225 (Japan)	1950–1972	19.58%
Nifty 50 (India)	**2004–2007 / 2021–2024**	**34.43% / 14.14%**

Source: Bloomberg

- Market **gains often spilled over** into **property, infrastructure, and household incomes,** culminating in broad-based wealth creation. This underscores a fundamental rule: **when GDP and corporate earnings grow in tandem, investors stand to benefit substantially.**

Where Does India Fit In? A Familiar Strategy

1. Major Reforms

- Over the past decade, India has methodically implemented **structural reform**s inspired by the East Asian growth playbook. These reforms are now translating into **tangible economic gains**, setting the stage for **India's rise as a top-three global economy by 2030.**

Reform Area	Key Policy Moves (Post-2014)	Impact / Forward Momentum
Foreign Trade & FDI	Increased FDI limits in defence, insurance, and critical sectors	Strategic tie-ups with global corporations; India emerging as preferred emerging market
Domestic Manufacturing	'Make in India' & PLI schemes targeting key industries like electronics, pharmaceuticals, EVs	Rising domestic production; India gaining market share in global supply chains
Export Focus	RoDTEP, RoSCTL, and deeper trade relationships with the U.S. & EU	Strong growth in high-value exports; increased global competitiveness
Infrastructure Boom	5x increase in capex on roads, railways, and logistics corridors	Improved connectivity, efficiency, and ease of doing business

2. India's GDP Growth

- Economic history suggests that emerging economies undergo sustained high-growth phases **when structural reforms align with global economic shifts**. India is now in a similar phase:

Country	High-Growth Period	Average GDP Growth Rate (%)
China	1980-2000	7.75%
Korea	1962-1981	8.27%
Japan	1953-1970	9.86%
India	**2021-2024 / 2014-2021**	**8.28% / 5.00%**

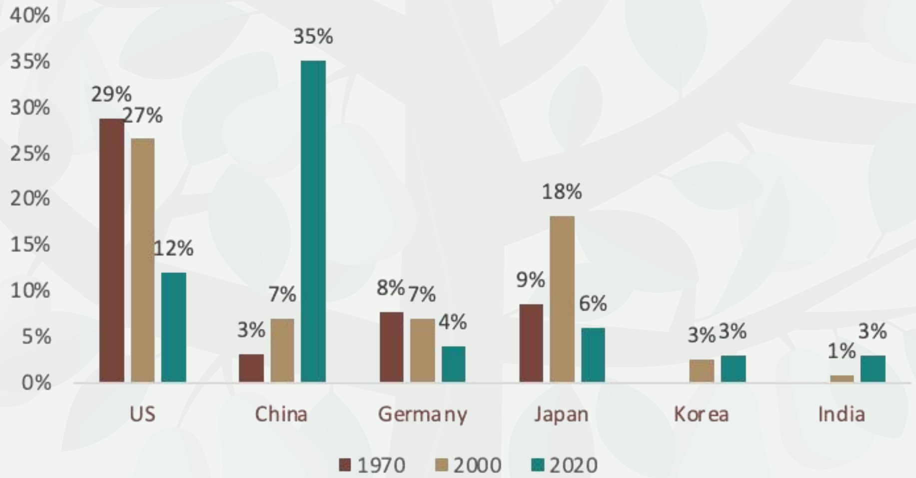
Sources: RBI, Kellogg's Institute – The Korean Miracle, Yale University – Postwar Economic History of Japan, Bloomberg.

- India's GDP growth in the post-COVID period has **exceeded 8%**, closely aligning with the historical growth trajectories of China, Japan, and South Korea during their formative years. Prior to the pandemic's disruption, India maintained a steady growth rate of over 7%.

3. India's Manufacturing Boom

- Since 1995, India has been the **second-fastest-growing contributor to global production**, increasing its share by 2-3%. As **global supply chains look beyond China**, India is positioning itself as a key alternative.

Country Wise Output (% of the World)



Sources: CEPR.org, Foundation for Economic Education

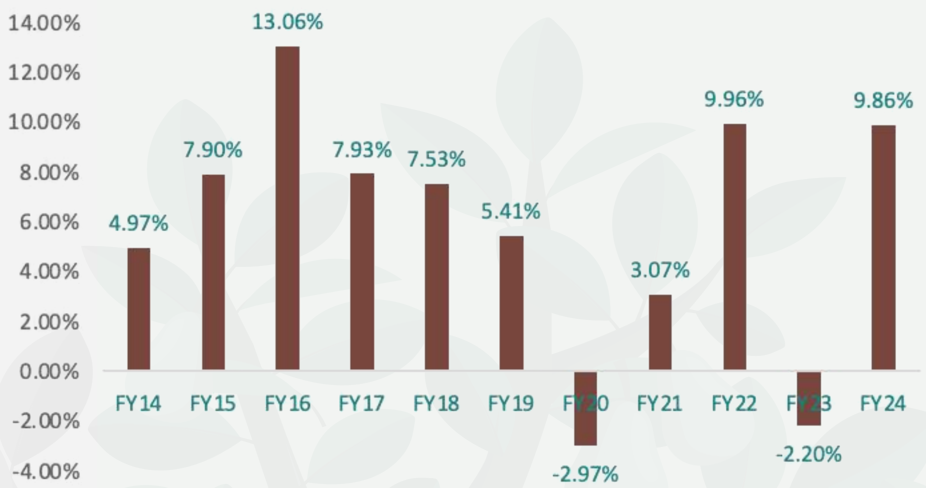
a. **Gross Fixed Capital Formation** (a key indicator of investment in productive assets) has grown at a **CAGR of ~11%** post-COVID.

b. Companies are **raising capital aggressively** for expansion, signalling strong confidence in India's **long-term manufacturing potential**.

c. **Global corporations** like Apple, Samsung, Boeing, GE, Siemens, and Kia have expanded manufacturing operations in India.

- India's manufacturing sector has **rebounded strongly** after COVID-19, despite temporary setbacks from **global supply chain disruptions** due to the Russia-Ukraine conflict. This recovery signals the **dawn of a new manufacturing era, with India poised to become a top-three global production hub.**

India's Manufacturing Growth (%)



Source: RBI

4. Targeting Exports: The Next Growth Frontier

- **Global tensions with China** and **declining manufacturing in parts of Europe** have positioned India as a prime hub for new export-driven growth.
- Multinational **industry giants** have established both **greenfield and brownfield projects** in the country—bolstering India's foothold across **electronics manufacturing, renewable energy, defense, textiles, chemicals, and automotive parts.**
- Over the past few years, **India's merchandise exports** have experienced a **sharp turnaround:**

Year	2020	2024	CAGR (2021–2024 / 2015–2021)
India (Bn $)	314.40	437.00	**14.42%** / (1.02%)

Source: RBI

- **India's exports are growing at a 14.4% CAGR**, a sharp reversal from the -1.02% decline between 2015 and 2021. This growth is driven by global supply chain shifts as companies **reduce reliance on China,** along with **policy changes like President Trump's tariffs on Chinese goods**, which have boosted demand for Indian exports.

Looking ahead, India's blend of policy reforms, **expanding** manufacturing capacity, **and** export **demand sets the stage for** another decade of robust economic growth.

Notwithstanding short-term setbacks, historical parallels suggest that countries adopting well-timed economic reforms and leveraging geopolitical dynamics can rise as formidable global players—offering ample opportunities for both investor wealth creation and industrial advancement.

Outlook for 2025: Market Dynamics and Portfolio Strategy

- After a remarkable rally, the equity markets took a breather as valuations soared and select Q2FY25 earnings fell short of expectations. Since **December 31, 2024, the NIFTY Small-Cap 100 index** has **corrected ~7%,** yet our portfolio is **down only 0.8%,** highlighting the benefits of a **staggered buying approach** and cherry-picking businesses.
- Despite a "mixed bag" in recent earnings, our portfolio comfortably trades at **21.8x FY25E** and 16x FY26E PAT, suggesting **room for growth** as **fundamentals catch up with prices.** We have long maintained that **"returns eventually follow earnings,"** a stance reinforced by sharper corrections in high-valuation names lacking strong profit growth. We expect this trend of valuation resets to continue in pockets where earnings disappoint, **making 2025 a "stock picker's market."**
- In contrast, **our portfolio companies** collectively posted a **21% profit increase** in the first half of FY25, showcasing the **fundamental strength** of our businesses and investment philosophy.
- Looking ahead, we are **well-positioned** to capitalize on potential market dislocations with our **16% cash position**. This quarter, we **initiated a position** in a **telecom EPC firm**, attracted by its compelling **macro tailwinds** and **high entry barriers**. Additionally, we have several companies on our watchlist that could be added to our portfolio should they align with our valuation criteria.

Pulling It All Together

- Short-term volatility and sector-specific earnings hiccups cannot obscure the **broader macro opportunity** that **India's evolving growth story** presents. As we've highlighted, structural reforms and rising exports have unlocked new drivers of sustainable economic expansion—mirroring patterns seen in other global success stories. **Although corrections are inevitable, quality companies with healthy balance sheets and robust earnings potential should emerge stronger over the long run.**
- We sincerely thank you for your **continued trust in Equitree Capital**. Our team remains dedicated to navigating market fluctuations with discipline and conviction, consistently aiming to **build lasting value for all our investors.**

Should you have any feedback or require further information, please feel free to reach out to us at pawan.b@equitreecapital.com or skabra@equitreecapital.com.

Sincerely,

Team Equitree