"The individual investor should act consistently as an investor and not as a speculator." — Ben Graham

Dear Investors,

We are pleased to present our quarterly newsletter for Q1 FY25. FY24 has been a stellar year for the markets and for us. We're elated to inform you that we consistently continue to outperform the market, **being ranked the 4th best performing PMS for the June quarter of FY25.**

Our performance:

PMS Portfolio Returns (%)							
Investment Period	1 month	3 months	6 months	1 Year	2 Year	3 Year	5 Year
Emerging Opportunities	16.72	35.02	27.78	86.18	58.24	36.98	28.68
BSE 500 TRI	7.05	11.66	16.68	38.28	30.91	19.94	19.96
Outperformance	9.67	23.36	11.10	47.90	27.33	17.04	8.72

As of June 30, 2024
Source: Nuvama Custodian Services, Equitree Capital
Returns are computed on TWRR basis net of fees/expenses, Returns over 1 Year are annualized
Not verified by any regulatory authority/SEBI
Benchmark changed from Nifty Smallcap 100 to BSE 500 TRI vide circular no SEBI/HO/IMD-PoD-2/CIR/2022/172 dated 16 December 2022.

Market Outlook

The chatter around the valuations remains subjective and questionable. While the markets have been on a roll, earnings growth have also been very buoyant thereby still keeping the overall valuation under check. **We have spoken about our thoughts on valuations in our Mar'24 and Dec'23 newsletters and don't see much change in the genre of companies we're usually focused on.** Our simple belief is that markets, in the longer term, will reward companies that deliver consistent earnings. We prefer to look at valuations in the context of those earnings.

Amidst the markets making new highs and the valuation banter which we have discussed in the past and which largely remains beyond our control, this time around we choose to rather share our learnings in investing over the last 12 years since we set up Equitree. We sincerely hope that these learnings will act as a guiding lighthouse to navigate the volatile waters / anxiety with respect to investing in markets – at all points in time.

Key Learnings

- **Borrowed Conviction Never Works**
  - Investing in the market based on ***"tips"*** and ***"recommendations"*** from "friends", "friend's friend" has been long prevalent in the market. This has further accentuated now with ease of digital technology. The FOMO (fear of missing out) and greed of making a fast buck generally makes people cave in. While these do work in a bull market, however, it has been empirically proven that this generally haunts back as the market cycle turns.

- Investors generally also tend to do herd investing or shadow investing, which again ends up with similar results over a long period of time. While people tend to follow marquee investors, what one doesn't understand is that risk profiling of each investor is different and holding tenure can also be different for different investors eventually leading to significantly different outcomes for investors.

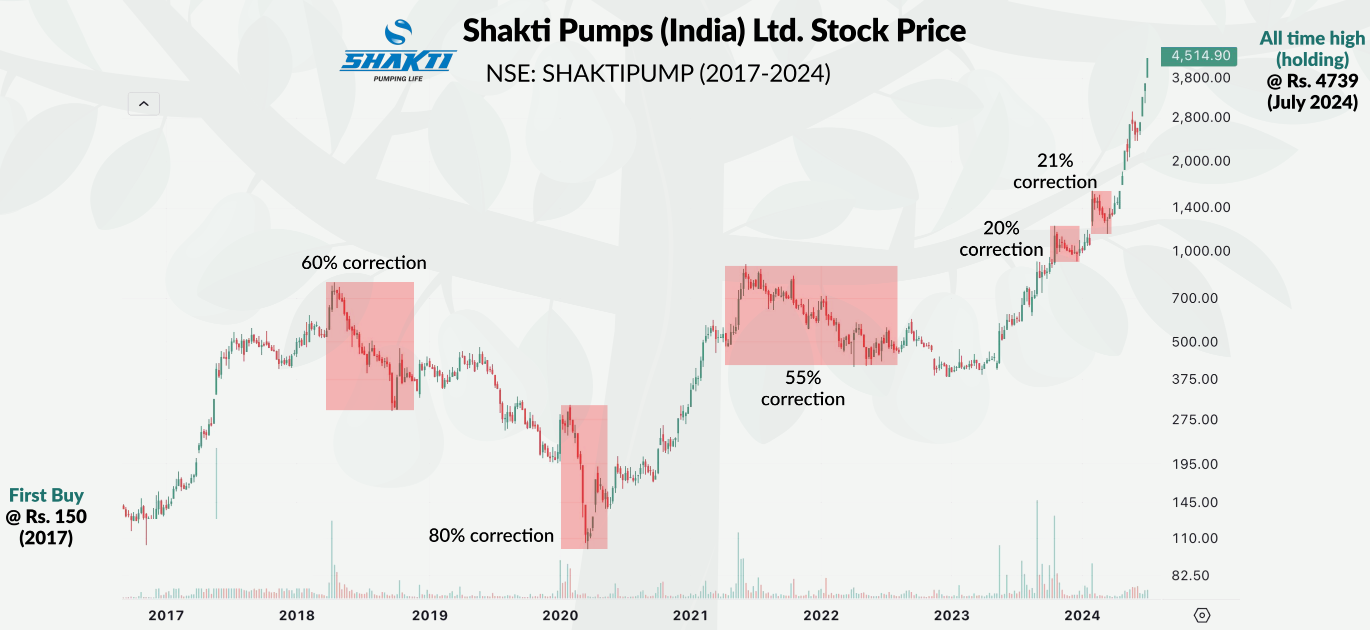
- At Equitree, we practice independent thinking and prefer focusing within our circle of competence to mitigate potential disasters. Our ground-up approach to investing gives us the conviction to invest in businesses with a long-term approach rather than chasing shallow "momentum" / "herds" / "flavor of the market" themes. This helps us even more during market downturns, where we can take more informed decisions on our holdings rather than panic sell.

- Like they say, *"when following herd, your result can be as good as the herd, but if one needs a different outcome, one needs to challenge and have completely different & independent approach".*

Case Study (1/2) - Shakti Pumps

We've been buying into this business since 2017, when the company was in complete oblivion. Most market men had either not heard about the company or didn't have much confidence in the management. Nonetheless, we did our ground-up research and based our conviction stuck our neck out.

During the journey, our conviction got tested numerous times and every time we would go back to the roots to get a reconfirmation of the same. Gladly, our conviction has played out beautifully with the investment turning out to be a **30-bagger** for us, and now the market is awakening to this and buying in the optimism.



Source: TradingView, NSE, Shakti Pumps (Logo)

- **<u>Right Position Sizing Leads to Financial Liberty</u>**

  - Getting an investment decision right is only half the battle won. In investing what is more relevant is how much money does one make when you get it right and how much does one lose when you get it wrong – and this is where right position sizing becomes extremely important!

  - Investing with "borrowed conviction" substantially hinders investors' ability to do right position sizing. That's where even with a supposedly good investment, wealth creation seldom happens.

  - We share an interesting anecdote from Benjamin Graham's life to bring home the point:
    - In 1948, Benjamin Graham, often hailed as the "Father of Value Investing," made a pivotal decision that diverged from his own teachings, resulting in one of the most remarkable investment successes of his career. Graham, typically an advocate for diversification who rarely allocated more than 5% to a single holding, identified a deep-value opportunity that compelled him to break his own rules. **He deployed an unprecedented 25% of his partnership fund's assets under management (AUM) into this single investment and, for the first time, allowed the position to run contrary to his usually strict valuation methods.**
    - The magnitude of this decision's success is **staggering**. Graham's $712,500 investment for 50% of GEICO grew to over $400 million in just 25 years – a phenomenal **550+ bagger return.** While one might argue this was an anomaly or attribute it partly to luck, it was ultimately Graham's conviction and willingness to make a calculated deviation from his standard approach that led to this extraordinary outcome.

  - At Equitree, while we maintain a discipline to not invest more than 10% of original capital in a single stock, we don't unnecessarily diversify too much. **We look to build a concentrated portfolio of 12-15 high-quality businesses based on our deep conviction and look to meaningfully deploy capital in each of them.**

  - However, once invested, we believe in **letting our winners run** and harness the power of compounding rather than unnecessarily cutting positions just because the value has gone up as a percentage of portfolio. This approach allows us to manage risk as well as ensures maximize long-term wealth creation while being pragmatic, helping our clients achieve their financial goals.

- **<u>Patience – The Chinese Bamboo Tree Principle</u>**

  - Like any plant, growth of the Chinese Bamboo Tree requires the staples: water, fertile soil, and sunshine. However, its growth journey is very different from most other fauna. In its first year, we see no visible signs of activity. In the second year, again, no growth above the soil. The third, the fourth, still nothing. But finally, in the fifth year, we see phenomenal growth of about 80 feet in just six weeks!

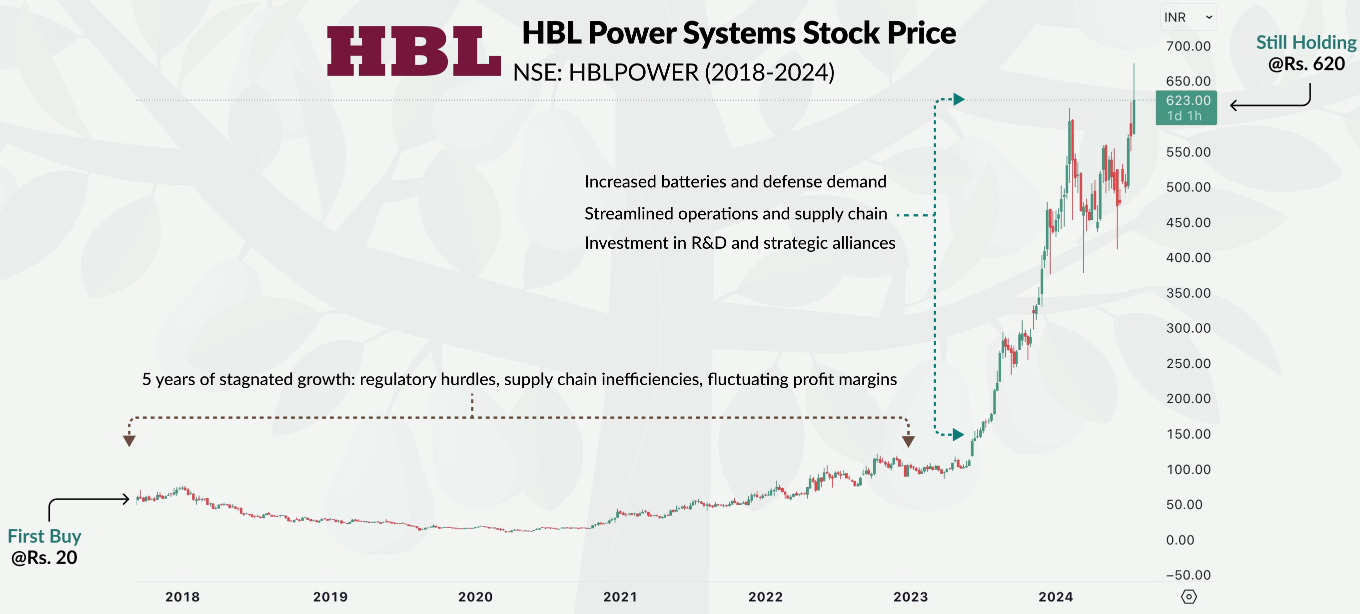
  - Patience, a virtue which most commonly is ignored in the markets, in effect remains the quintessential quality in outsized wealth creation from investing. This principle in our field has been coined as **"Asymmetrical Payoff."**

- In investing, businesses seldom function in a linear manner. One does get caught on the wrong side of the cycle, face prolonged headwinds, or encounter sudden unforeseen events. This does impact the stock prices in the short term and may go through extreme volatility – akin to no growth seen in a Chinese Bamboo for the initial years. **However, if the business fundamentals remain strong through these headwinds, probability is that such strong businesses come back with a bang – achieving the 80 feet growth!**

- Time and again, our biggest winners have put our resolve to the test. Yet, we've discovered that **blending patience with well-founded conviction is the magic formula.** It's this approach that has turned market volatility into our greatest ally in building wealth. This aligns with microcap investor **Ian Cassel's "ugly duckling" theory**, which suggests that the most promising investments often start as overlooked or underappreciated companies. Just as the ugly duckling transforms into a beautiful swan, these **seemingly unattractive investments can blossom into remarkable performers over time.** Our patience allows us to see beyond the initial "ugliness" and recognize the potential for transformation, leading to outsized returns.

Case Study (2/2) – HBL Power

This company had the first mover advantage for a niche product, however got plagued by delay in approvals from the government. Once the commercial orders started kicking in, it gave the company a first mover advantage in the industry. The improved execution and product mix led to a complete change in the numbers of the company, which led to a re-rating for the company making it a **~ 30 bagger** for us!



Source: TradingView, NSE, HBL Power Systems

- **<u>Staggered Investing vs Dollar Cost Averaging (SIP)</u>**

    - In Micro caps/ Small caps, we're often hit by erratic price action, in both the upside as well as the downside. Doing a standard SIP at a fixed interval generally does not augur well for microcap investing as the erratic price behavior may lead to disproportionate exuberance or makes one continuously buy the pessimism. For incremental capital allocation one rather needs to understand the reasons for either of the price action based on the business fundamentals instead of adopting a fixed time interval-based investing.

    - At Equitree, ***Staggered Buying*** involves deploying a decent amount as base capital into our portfolio, while always maintaining some cash. This allows us to understand the business cycles better and build positions accordingly based on execution of business as well as the market volatility. This also allows us to enhance our returns for investors.

- **<u>When to Exit?</u>**

    - This question is perhaps the most pertinent question an investor must ask or deal with on multiple fronts. The beauty of it is that nobody is always right; as long as we win more than we lose, it leads to substantial wealth creation over time.

    - Most investors generally tend to exit either at marginal profits or end up holding loss making companies in the hope of a revival as cutting losses becomes extremely difficult psychologically.

    - The other extreme is to follow a strict "stop-loss" strategy where one books losses if a stock drops 20-30% only to realize that it rises back as a phoenix!

    - At Equitree, we follow a **well-defined exit strategy**. We would look to exit our investment **ONLY** if any of the following situations arise:
        1. Change of thought on the business prospects.
        2. Poor execution over time.
        3. Valuations going out of our comfort.
        4. Compromise on corporate governance.
        5. Hit by any other unsystematic risk.

Budget 2024 – Our Two cents

The budget for 2024-2025 was broadly in-line with our expectations. Despite a coalition government in place which increased expectations of the budget being more "populist" and drifting away from the erstwhile focus on infra spend, it was pleasant to see that the government has not given in to any of these pressures.

The focus on infrastructure spending continues with a **~16% growth in capex.** With that it was heartening to see the government being cognizant of fiscal prudence and **maintaining fiscal deficit @ 4.9% of the GDP** which should help in improving India's sovereign rating as well. Broad segment wise planned expenditure is shown hereunder which reflects the continuous focus of government on infra spending:

Category	FY19 (A)	FY20 (A)	FY21 (A)	FY22 (A)	FY23 (A)	FY24 (RE)	FY25 (I)	FY25 (BE)
Transport	1436	1534	2168	3222	3905	5249	5440	5441
Defence	2908	3187	3401	3665	3991	4559	4548	4548
Subsidy	1968	2283	7077	4462	5310	4135	3812	3812
Agriculture & Allied	633	1125	1344	1433	1259	1405	1468	1519
Interest	5826	6121	6799	8055	9285	10554	11904	12629
Transfer to States	1191	1489	2115	2746	2734	2740	2868	3222
Total Expenditure	23151	26863	35098	37938	41932	44905	47658	48205
Total Exp (YoY %)	8.1	16	30.7	8.1	10.5	7.1	6.1	7.3

Source: Union Budget, PL, Equitree Capital.

Indeed, there was a negative surprise for the capital markets in form of tax rates hikes from 10% to 12.5% for LTCG and 15% to 20% for STCG. We believe this may have a short-term impact which is more sentimental rather than any long-term fundamental impact.

From our perspective, being long-term and less-frequent churners, the ability to stay invested and defer taxes helps in compounding that capital too, which reduces the impact of taxes on the returns anyways.

What are we doing currently

Our portfolio companies have reported **29% growth in PAT for FY24.** Business visibility for most of our companies continues to be very good and we expect FY25 as well to register **~30% growth**, poising us for some interesting times ahead!

Market cap wise (Ex BFSI)	FY24 vs FY23	
	Net Sales	PAT
Equitree Capital (15)	10%	29%
BSE 500 (415)	2%	29%

Figures in brackets indicate number of companies

Despite the stock price performance that we have seen during the last quarter and year, our portfolio still continues to trade at a **median PE multiple of 21.5x FY25 PAT**. This makes us extremely comfortable to hold the portfolio.

We are cognizant of froth in valuations in some part of the market. The pace at which markets have been hitting new highs owing to burgeoning domestic liquidity, potential regulatory measures to curb the volumes in F&O, curbing margin funding by taking around 1000 companies out from the allowable list of securities for margin, geopolitical issues are some of the other issues which may have an impact on the market in the near term. We believe that some of these issues may bring about 5-7% correction in the indices and around 15-20% in small and mid-caps. Individual stocks may of course behave differently based on earnings growth & valuations respectively.

Based on all this, we have been reviewing the portfolio very closely on the business developments and valuation. In line with that we have partially booked profit in one of our portfolio companies and have pared down holding in another where despite good operational performance, reported profit is suffering due to change in accounting policy.

We continue to find interesting opportunities which fit into our parameters and have added a new company to the portfolio, which we believe could be an emerging leader in the consumer durables space.

We remain extremely confident on the business visibility of our portfolio companies and the current valuation that it trades at. However, rather than being rashly exuberant we are building up the portfolio in a staggered approach to **leverage the volatility**, should one arise. **We strongly believe that any such opportunity if or when it happens could be short-lived and investors should latch on to it from long-term wealth creation perspective.**

Please feel free to revert in case you have any feedback or need any further information. You can reach us at **pawan.b@equitreecapital.com** / **skabra@equitreecapital.com** .

Sincerely,
Team Equitree