Equitree Capital Quarterly Newsletter
March 2025

EQUITREE
SOWING SEEDS OF GROWTH

"The best opportunities often come in times of fear and uncertainty — not comfort and calm."
– Howard Marks

A Remarkable Start to 2025: Equitree's PMS Honoured with Top Industry Recognition

Amid the prevailing noise and broader market headwinds, 2025 has begun on an exceptionally encouraging note for us at Equitree. On February 15, 2025, **Equitree's *Emerging Opportunities* PMS** was awarded the **#1 Rank as the Best Small-Cap PMS (Absolute Returns) for 5-Year Performance** by **PMS AIF WORLD** in collaboration with **IIM Ahmedabad**.

This recognition is a significant milestone in our journey and a strong endorsement of our consistent investment philosophy, research-intensive approach, and commitment to long-term value creation. We are deeply grateful to our investors and partners for their continued trust and confidence.

As we move ahead, we remain focused on navigating volatile markets with discipline, agility, and a sharp eye for high-conviction opportunities in the small-cap space.

> *Equitree has delivered more than **51% CAGR** over the **last 5 years!***

PMS Portfolio Returns (%)

Investment Period	1 month	3 months	6 months	1 Year	2 Year	3 Year	5 Year
Emerging Opportunities	5.71	-13.45	-7.69	**38.26**	61.88	36.79	**51.76**
BSE 500 TRI	7.32	-4.39	-11.84	5.96	21.85	13.74	26.31
Outperformance	**-1.61**	**-9.06**	**4.15**	**32.30**	**40.03**	**23.05**	**25.45**

As of March 31, 2025
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

We continue to **rank among the top PMSs** across **all time frames**!

PMS Bazaar Rankings

Ranking (from 450+ entries)	1 Year	2 Year	3 Year	5 Year
Equitree Capital	**2nd**	**2nd**	**3rd**	**4th**

Source: PMS Bazaar, Equitree Capital

Strong Resilience Even During Drawdowns

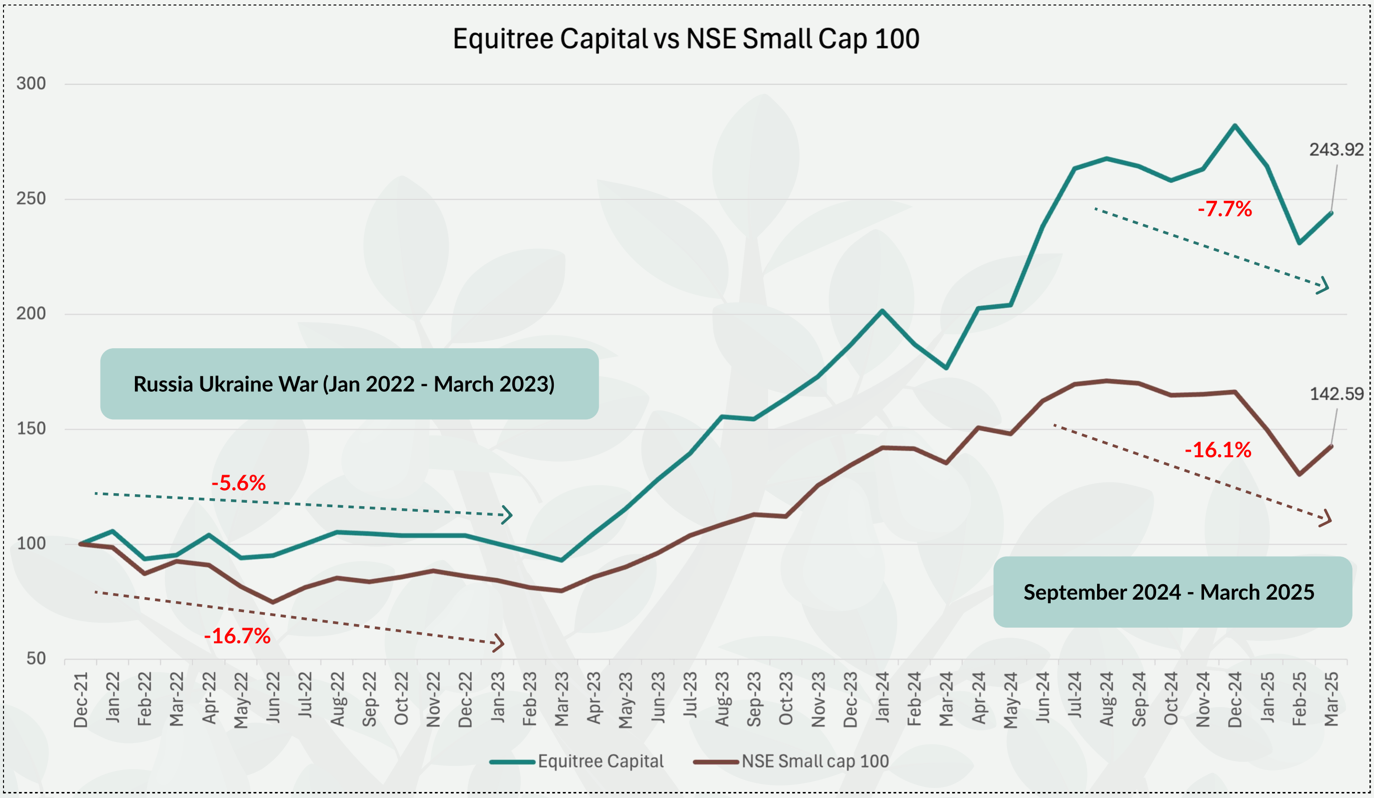
While we have maintained long-term outperformance, Q4FY25 was not without volatility. Our portfolio fell ~13% vs. BSE 500's 4.39% drawdown, more aligned with the NSE Small Cap Index's ~14% fall.

However, the portfolio showed **strong relative resilience**:

- During Jan'22–Mar'23, Small Cap Index fell 17%, while **our drawdown was just 6%**.
- Over the last 6 months, the Small Cap Index dropped ~16%, while we declined only ~7%.
- Notably, in both phases, **the broader markets** including many small/mid caps **corrected >30%.**

Drawdown Analysis:

71% of companies are **down more than 30%** from their **52 W high** in the recent correction*



Source: Nuvama Custodian Services, Equitree Capital. Data till 31st March, 2025. Data rebased to 100. *INR 200-5000cr market capitalization

Why have we been able to cushion downside better?

1. Earnings growth
   - In a market largely starved of profit visibility, our companies continued to deliver. The median PAT growth for the portfolio in the **first nine months of FY25 stood at 19% YoY.**
2. Valuations remained grounded.
   - Most of our holdings were trading near their historical P/E averages, leaving little room for derating.
   - This discipline protected us when reality caught up with stretched valuations elsewhere.
3. Cash as a Strategic Lever.
   - We aren't compulsive investors. Small Caps are inherently volatile—and we embrace that by **staggering our entries to turn volatility into opportunity.**
   - Over the last 6 months, we held nearly 60–70% of fresh inflows in cash, which meaningfully cushioned the downside during the correction.
   - We also **trimmed select positions** to build cash buffers for existing investors—adding flexibility when it mattered most.
   - As the correction unfolded, we **began deploying this dry powder** judiciously into our highest conviction ideas, taking advantage of **attractive valuations**.

Rule No. 1: Never lose money. Rule No. 2: Never forget rule No. 1.
– Warren Buffett

Separating the Wheat from the Chaff

Small-cap companies can be exceptional wealth creators — but without the right filters, they can just as easily destroy capital. In fact, **7 out of 10 small-cap stocks tend to be value-destructive**, resulting in an industry-wide **success rate of barely 30%.** The reasons are often structural: poor governance, opaque disclosures, promoter misalignment.

Stocks like **Gensol Engineering, AGS Transact, and Mishtann Foods** — once retail favourites — are now down **92%, 95%, and 75%** from their 52-week highs. The headlines may cite volatility, but the real culprit is often a deeper flaw in business quality or management intent.

Gensol Engineering - Down 92%

AGS Transact - Down 95%

Mishtann Foods - Down 75%

Source: TradingView

At Equitree, we've spent over a decade refining a process built not just to find winners — but to avoid the mistakes that can permanently destroy capital. In our view, **the pain of backing the wrong business is far greater than the cost of missing the right one.**

With rigorous filters, on-ground diligence, and valuation discipline, **we've delivered a hit rate of over 85% since 2012. This checklist** reflects what we've learned — and how we **avoid blowups** and double down where conviction is high:

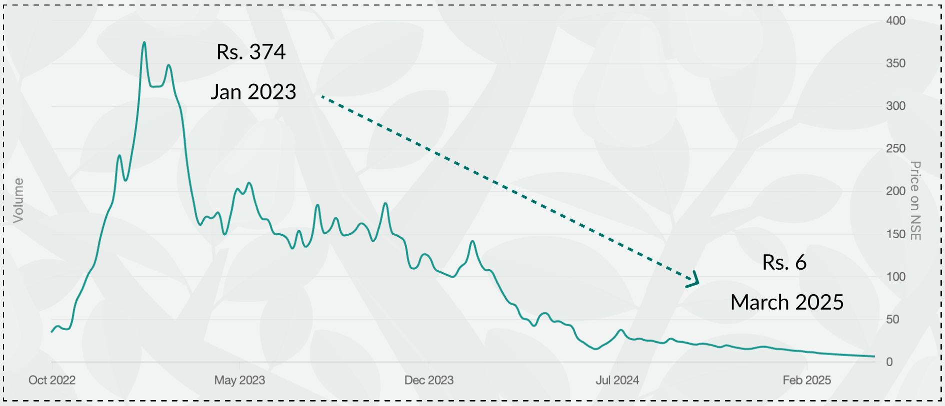
1. **Stay Within Your Circle of Competence**

- Bull markets are tempting. **Everyone wants to ride the "next big thing"** — the next fintech, the next SaaS disruptor, the next EV platform. But complexity often masks mediocrity.
- We **consciously avoid sectors** where we can't confidently model earnings or understand the core drivers — such as **BFSI, direct real estate, and certain new-age business models.**
- Another equally important (and underrated) skill is the ability to **filter out noise.** Every day brings a fresh idea from brokers, analysts, Telegram groups, or fellow investors. Over time, we've trained ourselves to pause — to **not act on anything until we've done the work ourselves and built independent conviction.**

2. Don't Overpay for the Future

> *"Even the **right story** can be the **wrong investment** — if the **price** is wrong."*

- We've seen this movie before. Earnings expected to grow at 30%, priced at 80x. Then one quarter disappoints and the rerating is brutal.
- These are precisely the setups **we avoid — hot narratives priced 2–3 years ahead of reality.** They often look expensive on current earnings and fragile on future ones. In small-caps, obvious growth stories often disappoint the most. The industry may be right, but if the entry valuation isn't, returns rarely follow.
- Another example that comes to mind is a **cloud computing SME — widely touted as "India's AWS"** — which gained popularity through finfluencers, WhatsApp forwards, and a fast-growing topline. Today, it's **down ~98% from its peak.** The problem wasn't technology. It was valuation chasing vision with no earnings to anchor it. We stayed away.



Varanium Cloud Ltd - Down 98%

3. Incessant Dilutions Are Never Investor-Friendly

- We are wary of companies that frequently raise funds via equity. Repeated fundraising typically signals that the **company is not generating enough internal accruals** to fund its own growth. When a business is perpetually dependent on external capital, it raises critical questions—not just about capital efficiency, but also about the sustainability of its operating model.
- Even in situations where an equity raise is justified, **EPS accretion must remain a non-negotiable.** Growth financed by dilution is not true value creation unless it translates into per-share earnings expansion over time.
- We recently studied a **hospitality company** that consistently raised equity across reporting periods
- Over this period, **EPS CAGR was -4%** (Mar'21 to Dec'24), even as the business kept raising capital. The **dilution did not translate into profitability.**
- For us, this is a **red flag**—not just for capital allocation, but for governance, alignment, and long-term value creation.

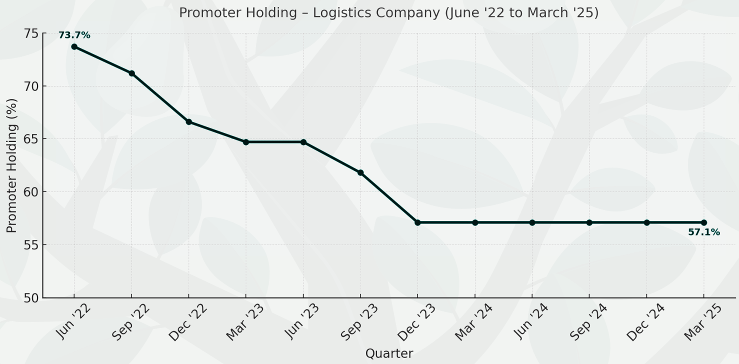
Period	Promoter Holding
Jun-22	74.31%
Jun-23	57.56%
Jun-24	45.97%
Feb-25	45.42%

A Hospital Co. with high dilutions

4. Promoter Behaviour Is the First Financial Statement

- In small-cap companies, **promoter transactions often precede fundamentals**. A silent exit can say more than any earnings call. **We monitor this very closely at Equitree.**
- We were invested in a listed logistics company. One quarter, we noticed that the promoter had **sold just over 2% of their holding**. While the number itself wasn't alarming, there was **no change in equity share capital,** and no accompanying explanation. That made us uncomfortable — **and we chose to exit.**
- Since then, the promoter has continued reducing their stake quietly. Over nine quarters, their holding has **declined by ~20% — from 73.71% (Jun'22) to 57.10% (Mar'25)** — all without any dilution. The share price continues to trade at the same levels.
- We're not suggesting that every promoter sale is a red flag. But **large or consistent stake sales,** especially when **not explained clearly**, must be scrutinized. We also **avoid companies with high promoter pledges,** where any correction can trigger forced selling — often at the expense of public shareholders.

> *If the Promoter is not backing their business with conviction, **why should we?***



5. Resignations at the Top

- Governance issues rarely show up first in the financials. More often, they start with resignations.
- At Equitree, we **track auditor exits, independent director resignations, and CXO churn** as early indicators of deeper problems. One departure may be unrelated. But multiple exits in a short span — especially at senior levels — often signal underlying misalignment, operational strain, or governance concerns.
- A recent example was a **newly listed auto OEM**, where **seven senior executives** — including the CEO, CFO, CTO, and CMO — **resigned within nine months**. Some left within weeks of joining, others moved to competitors. Around the same time, the company drew attention for **subpar product quality** and **lacklustre after-sales service.**
- **We weren't invested**. And this only confirmed why. The **stock is down 60%** since August 2024.

Ola Electric's CXO resignations in CY2024

6. Related Party Transactions

- Some risks in don't show up in the income statement — they're buried in the footnotes. **Complex webs of related party transactions** often blur the line between value creation and value diversion.
- In one such instance, a promoter awarded himself a **one-time "value creation bonus" of ₹19 crore (2%),** triggered simply because the value of the parent's stake in a subsidiary increased post-IPO. There was no operational milestone, no disclosed performance clause — just a payout routed via a group entity. **All technically compliant. But from a shareholder lens, deeply misaligned.**
- These are the kinds of structures we consciously avoid. We're not against promoter rewards — but they should follow **real business delivery**, not passive mark-to-market gains. **That's not alignment. That's leakage.** It also sets a bad precedent fot the future.

7. Tracking Promoters' Interests Outside the Company

- We invest in **family-run businesses**, but only when we're confident that promoter bandwidth and incentives are **fully aligned with the listed entity**.
- We recently evaluated a company **co-promoted by four families**, each of whom also ran their **own unlisted businesses** in the **same industry**. Structurally, it may have worked. But economically, it **created a complex web** — for us, and for any outside shareholder trying to make sense of where the promoter's loyalties lay.
- The **related party disclosures** were extensive but offered little real clarity. There were frequent **cross-transactions, overlapping operations, and blurred boundaries** between group entities. Value may have been created somewhere — but tracking where it accrued, and who it accrued to, was near impossible.
- **We passed.** Not because the business was bad, but because we couldn't tell who it was ultimately being run for.

8. Succession Planning

- Succession planning is a key filter for us. We prefer investing in companies where the **roadmap** for leadership transition is clearly thought through — and more importantly, where there are **no disputes within the promoter family**.
- Family disputes and unclear succession have historically been among the most **destructive risks** for long-term shareholders. The numbers may look fine for a while, but when leadership falters, the damage tends to be sudden and steep.
- **We passed** on a well-established auto ancillary business for this reason alone. The promoter's **son wasn't interested** in the company. The son-in-law, though operationally involved, **held no equity** and had **no real skin in the game**. The setup looked functional from the outside, but felt fragile once you scratched beneath the surface.

9. Reputation and Reference Checks

- When it comes to promoter quality, **not everything shows up in the financials.** That's why we routinely conduct **informal reference checks** through operators, suppliers, auditors, ex-employees, and industry peers — people who've seen the business up close and unfiltered.
- We **meet the promoters multiple times** before investing. But we also make it a point to **meet middle management** — not just the face of the company, but the people who actually run it. These conversations often reveal more about **culture, continuity, and internal dynamics** than any investor deck.
- We approach investing with an **ownership mindset,** which makes it critical to know who we're backing. By **leveraging our private equity network and industry scuttlebutt,** we're often able to steer clear of businesses that look good on paper — but raise questions on the ground.
- In one instance, we visited a hospital chain where the promoter showed up with **two armed bodyguards.** He had recently **produced a political biopic.** The numbers were fine. The business had growth visibility. But the promoter's presence told us enough to **pass.**

> *We'd rather miss a good business than partner with someone we don't **trust***

10. On-Ground Checks: A Phone Call Can Save Your Portfolio

- Before we invest, we go out and test the story on the ground. We don't just rely on management commentary — we **speak to dealers, distributors, franchisees, and even customers.** It's remarkable how much clarity a few calls can bring.
- We also make it a point to visit the company's **plants, factories, and key facilities as part of our due diligence.** It helps us assess not just the scale of operations, but the **strength of the brand and its actual acceptance** in the market.
- In one case, we evaluated a **fitness chain** that appeared to be **scaling rapidly**. The reported numbers looked great. But when we **called five of their Tier 2 and Tier 3 outlets, not one picked up.** Online reviews were patchy. Front desk staff was untrained. **The sales funnel, by every sign, was broken.**
- The operating reality didn't match the financial story. **We walked away.**

11. Financial Forensics

- At Equitree, our **research team — all CAs and CFAs by training** — **brings a forensic lens to every annual report.** We track year-on-year changes in **receivables, inventory, depreciation policies, and cash flow conversion**, but we also watch for inconsistencies — like **employee costs shrinking while revenues grow**, or **electricity expenses falling despite rising volumes.**
- In one case, a dairy company took a **large inventory write-off while peers didn't.** Around the same time, the **CFO resigned without explanation**. Either event could've been overlooked. Together, they told us to **step away.**
- We benchmark **tax paid vs. PBT**, scrutinize **cash flow quality,** and study **footnotes year-on-year.** It's not about catching fraud — it's about recognizing when something doesn't feel right, before the market figures it out.

Mistakes That Shaped Our Process

Some of our **best filters were forged in hindsight**. These are three mistakes we've lived through — and what they taught us.

1. Leverage Is a Silent Killer

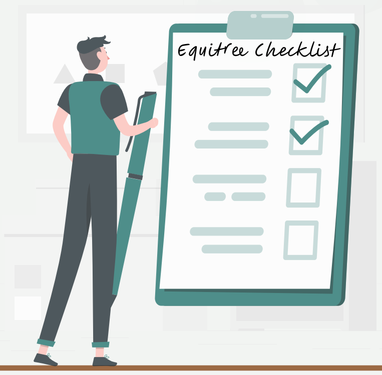
- We once invested in an agri-processing and equipment company with a **debt-to-equity ratio of over 2x.** The business was growing, but working capital was stretched. When receivables got delayed, the entire engine jammed: bank repayments were missed, the company's **credit rating was downgraded to "D"**, and **promoter-pledged shares risked being liquidated by lenders.**
- **We exited at a loss** — not because of the business model, but because our initial thesis broke and the **balance sheet couldn't take the stress.**
- **Learning:** In small caps, balance sheet strength is non-negotiable. Focus on businesses with low D:E and low promoter pledge

2. Untested Business Models Can Test You First

- We once backed a **new-age company** positioned as a **cash machine**, thanks to its expected **negative working capital cycle**. That advantage, however, never materialized. The promoter **began experimenting mid-cycle** — adding new products, reworking the supply chain, chasing scale.
- Inventory started building. Margins eroded. And by the time the dust settled, the **business had turned cash-negative and debt-heavy** — structurally compromising the balance sheet.
- **Learning:** We now favour simplicity, **consistency**, and **operating history of 2+ decades** over narratives and hype.

3. Promoter Intent: The Final, Unforgiving Filter

- We invested in a global pharma company with **four USFDA-approved plants** and a visible runway. But when a global private equity fund exited its quasi-equity investment, **the promoter made a high-stakes call: instead of raising equity, he replaced it with high-cost debt** — purely to protect valuation.
- **The bet backfired**. Debt service began to strain operations. Eventually, **the company had to sell off core assets just to meet obligations — leaving equity shareholders with nothing**.
- **Learning:** Business quality means little without **promoter integrity**. We now place greater weight on **capital allocation** and **long-term alignment** than on operating credentials alone.



Market Outlook: Navigating Uncertainty with Conviction

The single most significant overhang in the current environment is the **uncertainty surrounding tariffs.** We are now in the midst of the **90-day pause window,** with multiple potential outcomes ahead. Attempting to forecast the trajectory—let alone the second- and third-order effects—would be speculative at best. In such moments, **restraint and readiness** are more valuable than prediction.

As **bottom-up investors,** our lens remains firmly on fundamentals. We've already assessed the direct impact of tariff-related disruptions on our portfolio companies, **stress-testing their resilience** in the event of a demand slowdown or margin compression. We shared a detailed note on this earlier and encourage investors to refer to it for specifics. As always, we'll continue to track developments closely and **respond with agility if required.**

Having completed a thorough bottom-up review, we remain **confident in our portfolio's ability to weather near-term volatility.** We expect our holdings to deliver approximately **30% earnings growth in FY26** (excluding any tariff impact), and the portfolio currently trades at a compelling **14.3x FY26E earnings.**

In our view, the current environment offers **a rare opportunity for long-term investors:** quality businesses, clear earnings visibility, and compressed entry valuations. We are making the most of it. As of March-end, **we held 13.6% cash at the PMS level,** with individual investor cash levels varying based on entry timing. We've used the recent correction to **average deeper into core holdings—selectively, not hastily.** Uncertainty demands prudence, and that's precisely how we're approaching it.

We remain **bullish on India's long-term structural story**. Short-term noise does not shake our conviction. If anything, it sharpens our focus.

Thank you, as always, for your continued trust. We remain steadfast in our commitment to navigating every phase of the cycle with **discipline, humility, and a long-term lens.**

For any feedback or queries, please feel free to reach out to us: **CIO Pawan Bharaddia** pawan.b@equitreecapital.com and **CEO Ssuneet Kabra** skabra@equitreecapital.com.

Sincerely,

Team Equitree