White Whale North Star Portfolio – 1Q FY25 Quarterly Letter

Dear Partners,

Greetings from White Whale Partners.

Portfolio Performance

The portfolio delivered healthy absolute returns for the quarter. For 1QFY25, our portfolio was up 5.4%, vs. 8.1% for Nifty 50 TRI. On an annualized basis, since inception, the portfolio is up 16.3%[1], compared to 20.7% for the Nifty 50 TRI.

Figure 1

			Inception*	
	1 month	3 months	Absolute	Annualised
WW Northstar	6.7%	5.4%	73.3%	16.3%
Nifty 50 TRI	6.8%	8.1%	98.4%	20.7%

**Adjusted for cash from 11th Nov'20 to 31st Dec'20*

As discussed in our previous letter, the fundamental performance of our portfolio, in terms of earnings growth, continues to trend ahead of the stock performance. Thus, even from a 3-year perspective, the companies in our portfolio have delivered very healthy earnings of around 25%. This momentum was maintained in 4QFY24 quarter as well, where revenues grew by 25% and earnings by 21% on a weighted average basis for our portfolio (See Figure 2). As a result, the weighted average earnings multiple for our portfolio looks even more reasonable now than a year ago.

Figure 2

White Whale Portfolio Companies Performance

Company Name	Sector	Allocation	Revenue Growth*	EBITDA Growth*	PAT Growth*	ROE**
Position 1	Industrials	10.7%	19%	-9%	-13%	15%
Position 2	Banking	9.8%	47%	57%	37%	17%
Position 3	FMCG	9.1%	20%	23%	37%	9%
Position 4	Housing Finance	8.5%	38%	25%	30%	16%
Position 5	NBFC	7.9%	31%	25%	21%	22%
Position 6	Banking	7.4%	9%	9%	17%	19%
Position 7	Hospitals	7.3%	9%	41%	35%	8%
Position 8	NBFC	7.3%	22%	27%	22%	16%
Position 9	Consumer Discretionary	6.8%	16%	6%	7%	32%
Position 10	FMEG	6.2%	29%	25%	29%	24%
Position 11	BFSI Services	4.3%	25%	8%	14%	20%
Position 12	Financial Services	1.4%	36%	5%	10%	33%
Position 13	Consumer	1.0%	21%	15%	13%	21%
Cash		12.5%				
Weighted Average***		100%	25%	22%	21%	18%

** YoY Growth Over Q4FY23; ** FY24 ; *** Adjusted for Cash*

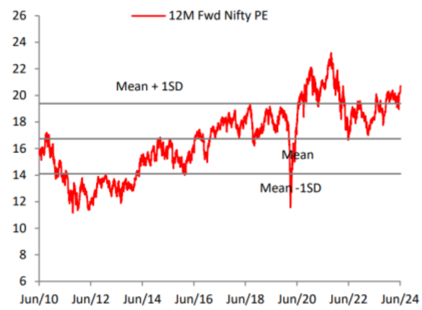
Source: Company Filings, White Whale Research

In contrast to our portfolio, the broader market indices have actually seen a significant re-rating with stock prices increasing much head of the underlying earnings growth. The broader markets continue to trade well above historical averages. The Nifty 50 Index is trading at 21x forward earnings, at a 24% premium to its long-term average of 17x (See Figure 3). The NSE Midcap and small cap indices are trading at 33x forward earnings and 22x forward earnings, respectively. (See Figure 4 and Figure 5). This is at a significant premium of ~70% and ~40% to historic valuations respectively.

[1] Periodic portfolio performance information is calculated net of management and incentive fees. The information is unaudited and current year performance information is subject to change pending the completion of the current year audit. In addition, individual performance may vary based upon timing of contributions, withdrawals, participation in certain investments, and fee arrangements. For individual investor performance, investors should rely on information contained in account statements. The performance related information is not verified by SEBI.

Figure 3

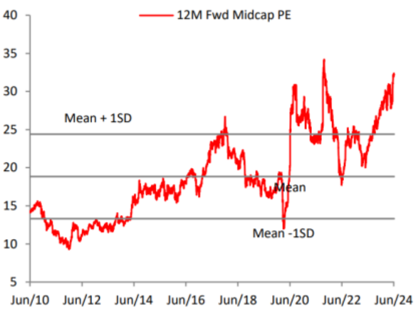
Nifty 50 Index 1 Year Forward PE



Source: Phillip Capital

Figure 4

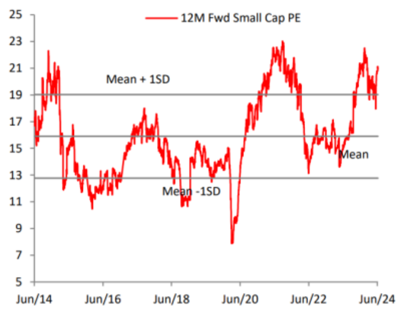
Nifty Midcap Index 1 Year Forward PE



Source: Phillip Capital

Figure 5

Nifty Smallcap Index 1 Year Forward



Source: Phillip Capital

We believe our portfolio will continue to deliver around 20% annualized earnings growth over the next several years, given that most of our companies are either market leaders in nascent industries which are at an inflection point, or are well positioned to gain market share in established industries, due to their unique competitive positioning. We remain excited about the growth prospects of India over the next decade and believe our portfolio is well-positioned for the long term.

We remain steadfast in our conviction that while there can be phases of relative re-rating or de-rating, in the long run, stock performance is driven by the company's underlying earnings growth and ROCE. Our core investment philosophy has always been to ***identify incredible businesses backed by outstanding management teams that can compound capital over a long period of time.*** By being true to our investment philosophy, and investing in such businesses at a reasonable price, we are maximizing our probability of compounding capital at a healthy pace over the long term.

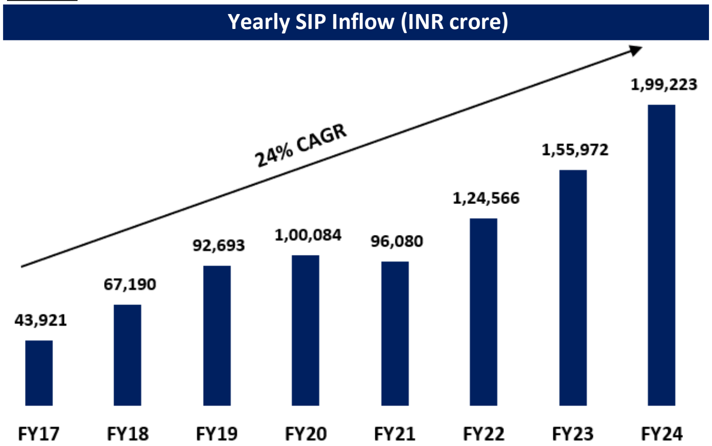
Macroeconomic Developments

The buoyancy in the Indian equities markets was given further impetus by the election results. While the ruling party failed to get an absolute majority as expected, the NDA coalition won sufficient seats to ensure a stable government for the next five years. Some of the deeper reforms in agriculture, land and labour could be pushed out as a result of this. However, there is sufficient economic momentum built from the several reforms undertaken over the last decade such as GST, RERA, PLI schemes etc. This should continue to drive robust earnings growth for the corporates over the next several years.

The top down macro-economic trends for India continue to remain very strong. GDP growth for the March quarter accelerated to 7.8%. As per the International Monetary Fund (IMF), India is now expected to grow at 6.8% in 2024, which would make it one of the fastest growing among the major economies. More importantly, the quality of growth is much superior as its being driven by a pick-up in the investment capex cycle, which the country has not witnessed in well over a decade. Inflation is stable, with CPI at 4.8% in the last quarter, well within the RBI target band of 2%-6%. Related to that, the 10 year government bond has been largely stable around the 7% levels for several months now. Current Account Deficit for FY25 is expected to be at 1%-1.5%, while the rupee has been largely stable around the INR 83 to 1 USD mark. Although the fiscal deficit is budgeted to still be high at 5.1% for FY25, buoyant tax receipts (advance tax up 21% yoy, GST collections up over 12% yoy) should help taper this down over next few years, as guided by the government.

Alongside the robust macroeconomic growth, there has been a strong bottom up trend over the last decade that has further supported the equity markets: increasing domestic retail participation in the equity markets. The systemic investment plan (SIP) which was at annual inflow of Rs43,921 crore in FY17 grew to Rs1,99,223 crore by FY24, at a CAGR of 24%. (See Figure 6). By June 2024, this has further grown to an annualized run rate of Rs255,256 crore. Domestic investors are now gradually replacing the foreign investors in terms of ownership within Indian equities. Thus, over the last few years, domestic institutional investors increased their ownership from 13.1% to 16.1%. Over the same time frame, foreign institutional investors have reduced their holdings from 19.7% to 17.7%. The difference between the FII and DII ownership of Indian equities stood at 1.6%, compared to a 10.3% gap recorded in March 2015. Increased domestic ownership in Indian equities is structurally positive for the markets, given the flows are more stable and less susceptible to global macroeconomic or geopolitical shocks.

Figure 6



Source: Company Presentation

We view this as a multi-year trend that should drive increased household ownership in equities over the next several years. A few months ago, we added a company in our portfolio that would benefit from this multi-year opportunity. While this is a relatively small position as of now, we will look to scale it up as and when opportunities arise from a valuation perspective.

Portfolio Insights – Growth at a reasonable price

"Price is what you pay, value is what you get" – Warren Buffett

During times of exuberance, such as now, it is especially important that we pay close attention to the valuations being paid. As seen in the charts earlier, the broader mid-cap and small -ap indices are trading at valuations that are well over one standard deviation above historical average. This is similar to levels seen in 2008 and 2017. In both cases, the equity returns of the broader markets were quite muted in the subsequent 2-3 years. This is because, in order to justify such high valuations, the broader market needs to deliver very strong earnings growth over the next several years, to offset the probable risk of normalization in valuation multiples over this period. Now, some of the companies in the indices are quality companies run by exceptional management, with high barriers to entry and a long runway for growth, that can justify such high valuations. However, to expect a large swathe of the companies in the country to deliver this kind of continued high earnings growth over a long period of time is improbable even given the strong macroeconomic background.

As a result, in times like these, one needs to be increasingly discerning with regards to capital deployment. With good opportunities being few and far in between, one needs to dig deeper in search for value. A few such scenarios could be a company that is undergoing a turnaround, a market leader in an emerging industry or then an industry where the market has underestimated the longevity of growth. One company that we invested in recently is CMS Infosystem, is where we believe the runway for growth is longer than what is being factored in.

CMS Infosystems (Market Cap – Rs8,300cr)

CMS Info was formed when the IT infrastructure management division of CMS Computers Ltd was transferred to CMS Info Systems (formerly Subhiksha Realty Pvt Ltd) in 2009. Blackstone purchased a majority stake in this entity in 2009, which it subsequently sold to Barings Asia in 2015. The company was listed in December 2021.

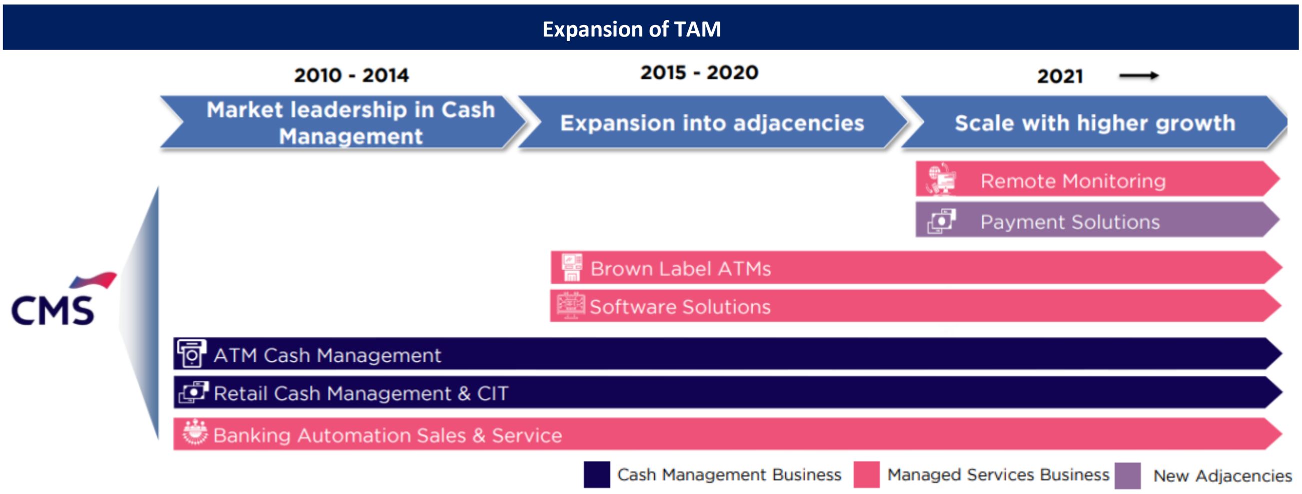
CMS Info Systems is a cash logistics market leader, offering ATM cash management, retail cash management and cash-in-transit services to its customers, mainly banks. It has a growing presence in the ATM managed services business and is further expanding into tech solutions through remote monitoring services and software solutions.

As always, we have provided a synopsis of our thesis underpinned by our three-pillar evaluation framework: (a) stellar people, (b) incredible business, and (c) longevity of growth.

Stellar Management

Since inception, the company has been run by a stable management team headed by Rajiv Kaul. Rajiv was working with Actis private equity and Microsoft, where he was managing director in India. The core management team, including the CFO, the head of the cash management as well as head of the managed services business has been with the company for well over a decade now. Over the past 15 years, the company has continuously diversified its revenue stream away from just ATM cash management into ancillary services such as retail cash management, cash in transit, ATM product sales and service and more recently into ATM software and security surveillance (See Figure 7)

Figure 7



Source: Company Presentation

In our conversation with an ex-investor who was very close to the management team, one of the key aspects that stood out was the management team's ability to come out from each crisis stronger than before. Since 2017, the ATM industry has been buffeted by a series of events such as demonetization, rise of UPI, and most recently by Covid. While many of its competitors struggled through these headwinds, the company actually emerged out of each of these events with healthy growth and profitability, further consolidating its market share and competitive positioning. As a result of diversification as well as market share gains, the company has delivered healthy 25%+ operating profit growth, over the last five years, through some of the toughest years that the industry has seen. At the same time, CMS has delivered a healthy 19% ROE and 25% ROCE through this period. This is a testament to the management's ability to execute. (See Figure 8)

Figure 8

Financial Highlights of CMS Infosystem

In Rs mn	FY19	FY20	FY21	FY22	FY23	FY24	CAGR FY19-24
Revenue	11,462	13,832	13,061	15,897	19,148	22,647	15%
YoY		*21%*	*-6%*	*22%*	*20%*	*18%*	
EBIT	1,442	1,973	2,302	3,079	4,059	4,493	26%
%	*12.6%*	*14.3%*	*17.6%*	*19.4%*	*21.2%*	*19.8%*	
PAT	961	1,347	1,685	2,240	2,973	3,471	29%
%	*8.4%*	*9.7%*	*12.9%*	*14.1%*	*15.5%*	*15.3%*	
RoE (%)	12.9	16.9	18.4	20.0	21.1	19.8	
RoCE (%)	19.0	22.9	24.0	24.7	26.2	24.8	

Source: Company Disclosure

Incredible Business

The cash management industry enjoys significant advantage from economies of scale. The company charges its customers a fixed fee every time it picks up/drops cash at an ATM. For every additional stop along a route, there is a very marginal increase in cost for the company and therefore the additional revenue from that stop flows straight to operating profits. Thus, in this business, scale begets scale. This is evident in the sharp improvement in margins seen in this business by CMS Infosystem over last 5 years, backed by revenue growth. (See Figure 9)

Figure 9

Financials of Cash Management Segment

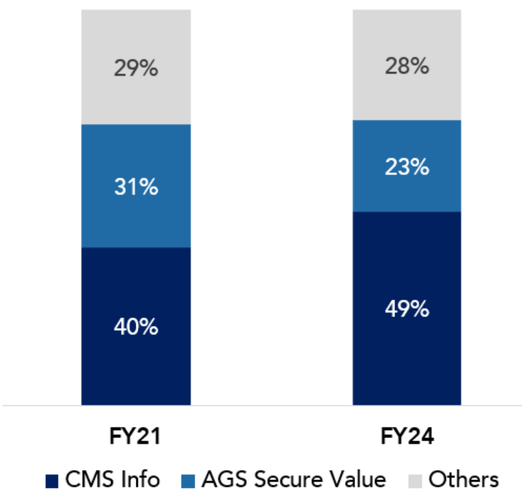
In Rs mn	FY19	FY20	FY21	FY22	FY23	FY24	CAGR FY19-24
Cash Mgt Revenue	8,906	9,776	9,094	11,108	13,263	14,744	11%
Growth		*10%*	*-7%*	*22%*	*19%*	*11%*	
Cash Mgt EBIT	1,403	1,666	2,040	2,654	3,363	3,851	22%
Growth		*19%*	*22%*	*30%*	*27%*	*15%*	
%	***15.8%***	***17.0%***	***22.4%***	***23.9%***	***25.4%***	***26.1%***	

Source: Company Disclosure

CMS infosystems is a market leader with 49% market share in ATM cash management. It has been steadily increasing its market share over the last several years, which we believe will continue in the future as well (See Figure 10). Additionally, as discussed earlier, the company has used its entry into ATM cash management, to further cross sell other services to its banking customers. Given the array of services that it provides to banks across their ATM division, the company is now pitching an end-to-end outsourcing solution to the banks, where CMS would take complete ownership in operating this division. In fact, they have already engaged in such contracts with a couple of large PSU Banks. The cost of servicing a customer through an ATM is still 1/3rd the cost of the alternative, i.e., servicing through a teller. Therefore, there is still a strong incentive for the bank to encourage ATM rollouts. At the same time, by providing the complete solution, CMS Infosystem can enjoy cost benefits and better margins. It would be difficult for their competitors to provide a similar solution given a lack of breadth in their services offering.

Figure 10

ATM Cash Management – Market Share



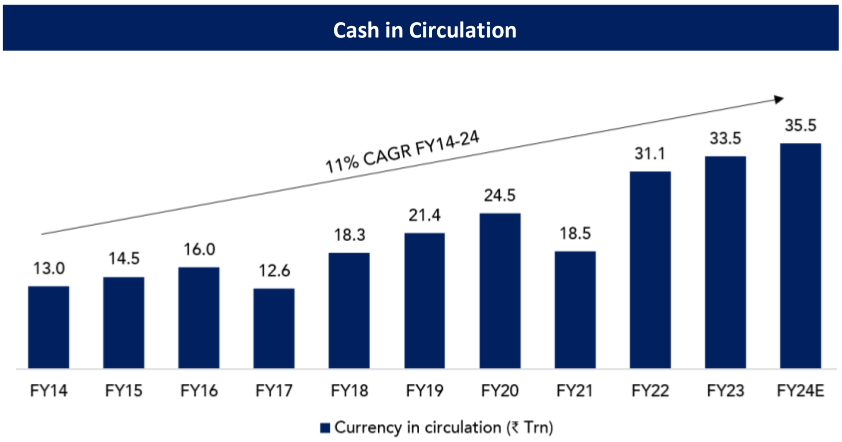
Source: Company, White Whale Research

Longevity of Growth

The biggest pushback that we got while researching this business, was the runway for growth that the business has. Currently, the business is largely focused around ATMs, which in itself have been growing in very low single digit in terms of volume for past several years. We do recognize that there are multiple threats to cash in circulation from rising penetration of UPI as well as credit/debit cards. However, it is interesting to note, that in spite of multiple headwinds from demonetization, rising UPI volumes and Covid, cash in circulation in the system has continued to grow steadily at

11% over the last 10-years and is currently at an all-time high (see Figure 11). This is a combination of high GDP growth as well as slow change in behaviour and habit. We believe cash in circulation should continue to rise over the next several years, thereby necessitating future rollouts of ATMs to support this growth.

Figure 11



Source: RBI, White Whale Research

More importantly, the ability of the company to gain market share within the existing business, as well as expand into newer service areas is significantly under-appreciated. For example, the company is already in the process of entering into the bullion logistics business for jewellers and banks. It is also piloting cash collection services for certain banks and NBFCs. Given its high cash balance of Rs750Cr and high FCF yield of 5%, the company could also look to enter into new business services areas through niche acquisitions. Therefore, in our view, the company will keep increasing its total addressable market in the future, as has already been demonstrated in the past.

Over the last five years the company's financial performance has been extremely strong, as evidenced by its revenue CAGR of 15%, EBITDA CAGR of 25%, FCF yield of 5% with ROCE of 25%. In spite of this, it was trading at a reasonable valuation (especially in this environment) of 16x forward earnings. This is because the market remains apprehensive of the terminal value of the business, given increased digitization of cash transaction as well as slow growth in ATMs. While we appreciate this risk, the ability of management to diversify into new service areas as well as continue to gain market share in its existing business, gives the company a much longer runway for high profitable growth than is being feared. Moreover, at this valuation, the risk/reward balance seems favourable.

Conclusion

In closing, we would like to thank you for your support and faith in the White Whale Portfolio Management Team. We look forward to a long and prosperous partnership together. If you have any questions, feedback, or suggestions, please always feel free to reach out. We look forward to hearing from you.

Sincerely,

White Whale Partners Team