White Whale North Star Portfolio – 2Q FY25 Quarterly Letter

Dear Partners,

Greetings from White Whale Partners.

Portfolio Performance

The portfolio delivered healthy absolute returns for the quarter. For 2QFY25, our portfolio was up 8.0%, vs. 7.8% for Nifty 50 TRI. On an annualized basis, since inception, the portfolio is up 17.5%[1], compared to 21.6% for the Nifty 50 TRI.

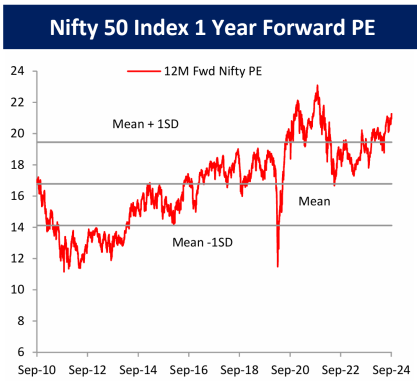
Figure 1

				Inception*	
	1 month	3 months	YTD	Absolute	Annualised
WW Northstar	3.8%	8.0%	13.8%	87.1%	17.5%
Nifty 50 TRI	2.3%	7.8%	16.6%	113.9%	21.6%

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

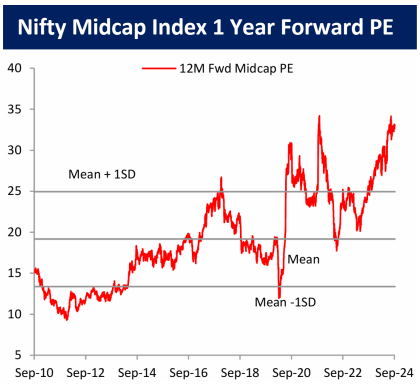
Through the quarter, the equity markets continued to trade higher and ahead of overall earnings growth. As a result, the Nifty 50 Index is now trading at 21x forward earnings, at a 23% premium to its long-term average of 17x (See Figure 2). The NSE Midcap and Small cap indices are trading at 33x forward earnings and 22x forward earnings, respectively. (See Figure 3 and Figure 4). This is at a significant premium of ~74% and ~37% to historic valuations respectively as well.

Figure 2



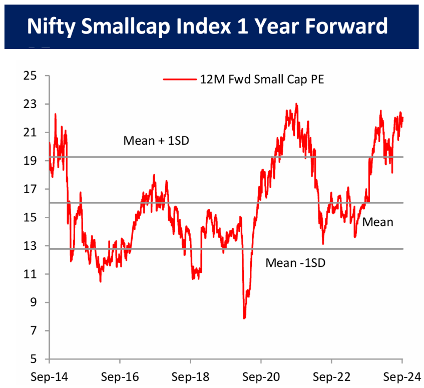
Source: Phillip Capital

Figure 3



Source: Phillip Capital

Figure 4



Source: Phillip Capital

The rally in the equity markets continues to be driven by strong domestic investor flows. Domestic mutual fund net inflows surged to Rs 431 bn for September. (See Figure 5). Year to date, mutual funds have seen a net inflow of Rs 2,442 bn, compared to Rs 2,378 bn for entire FY24. A large part of this is driven by SIP plans from retail investors, which reached an all-time high of Rs 714 bn in the September quarter. Foreign investors have also seen net inflows of Rs 897 bn in YTDFY25.

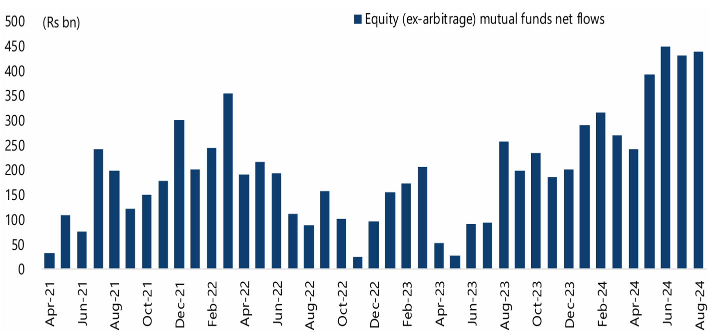
However, one needs to keep an eye on the supply side as well. In 1HCY24, there has been Rs 619 bn raised through IPOs. The pipeline for IPOs remains quite strong, with another Rs 635 bn of IPOs planned over remaining CY24. Of particular concern though is the increasing scale of insider selling. Of the total supply of Rs 2,660 bn year in 1HCY24, 42% has actually come from promoter selling. (See Figure 6). Another 27% has come from private equity exits. At the same time, 1QFY25 marked the first time after a number of quarters, where consensus future earnings expectations for Nifty actually saw a downgrade of 2%, post company results.

[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.

Overall, valuations remain expensive, there is an increased pace of insider selling and earnings growth expectations seem to be peaking out. As a result, one needs to be careful on the path forward, with a focus on investing in strong bottom-up fundamental stories.

Figure 5

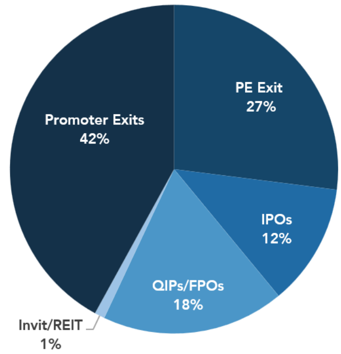
Domestic Equity Mutual Funds Net Inflows



Source: AMFI, Jefferies

Figure 6

Equity Fundraise – Across Instruments



Source: Prime Database, Jefferies

The fundamental performance of our portfolio, in terms of earnings growth, continues to trend well. Even from a 3-year perspective, the companies in our portfolio have delivered very healthy earnings of around 20%. This momentum was maintained in 1QFY25 quarter as well, where revenues grew by 19% and earnings by 21% on a weighted average basis for our portfolio (See Figure 7).

Figure 7

White Whale Portfolio Companies Performance

Company Name	Sector	Allocation	Revenue Growth*	EBITDA Growth*	PAT Growth*	ROE**
Position 1	Consumer	9.5%	16%	23%	12%	12%
Position 2	Housing Finance	9.0%	18%	22%	27%	16%
Position 3	Hospitals	8.7%	12%	26%	48%	8%
Position 4	Banking	8.2%	12%	13%	15%	19%
Position 5	Banking	8.1%	23%	27%	35%	17%
Position 6	Industrials	7.5%	17%	13%	11%	20%
Position 7	Consumer Discretionary	7.0%	11%	10%	5%	33%
Position 8	NBFC	6.8%	25%	25%	14%	22%
Position 9	NBFC	6.6%	33%	24%	23%	15%
Position 10	Industrials	5.8%	21%	16%	10%	24%
Position 11	BFSI Services	5.7%	17%	18%	18%	20%
Position 12	Financial Services	3.0%	NA	NA	NA	NA
Position 13	Pharma	2.0%	54%	47%	33%	15%
Position 14	Financial Services	1.7%	51%	50%	57%	33%
Cash		10.5%				
Weighted Average* **		**100%**	**19%**	**21%**	**21%**	**18%**

** YoY Growth Over Q1FY24; ** FY24 ; *** Adjusted for Cash*

Source: Company Filings, White Whale Research

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.

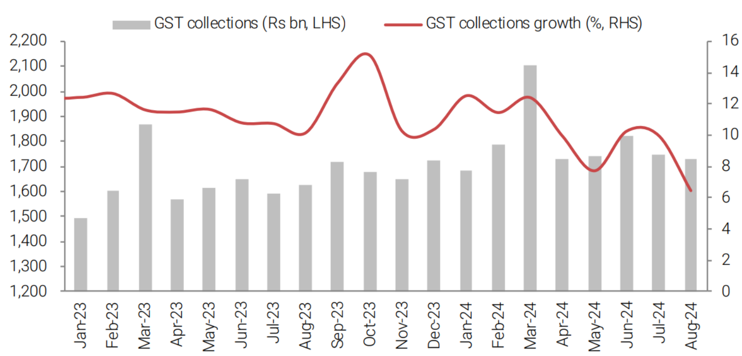
Macroeconomic Developments

Post Covid, the top-down macro-economic trends for India have been very strong for last few years. As per RBI, India is expected to grow at 7.2% in FY25, which would make it one of the fastest growing among the major economies. Inflation is stable, with CPI at 5.5%, within the RBI target band of 2%-6%. 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 84 to 1 USD mark. There have also been healthy signs of a pick-up in the capex and real estate cycle after a gap of more than 10 years.

However, recently there seem to be some incipient signs of a slowdown in the economy. GST collections growth, which have historically been growing in mid-double digits has slowed down to around 6% for the month of August. (See Figure 8)

Figure 8

GST Collections – Trend & Growth

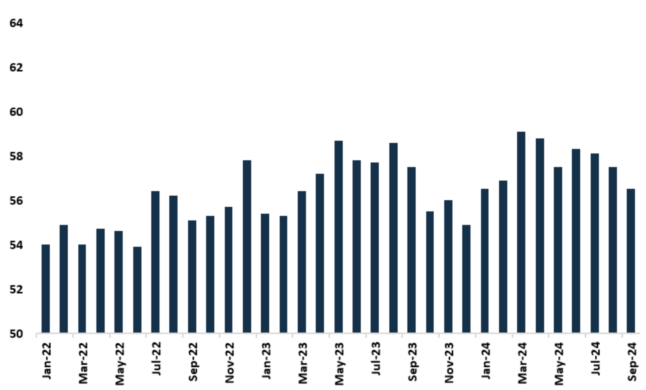


Source: CEIC, PIB, Kotak Economics Research

At the same time, the manufacturing PMI at 56.5, while still firmly in expansion mode, has hit an 8-month low (See Figure 9). Alongside this, even the Service PMI at 57.7, has hit a 10-month low. (See Figure 10).

Figure 9

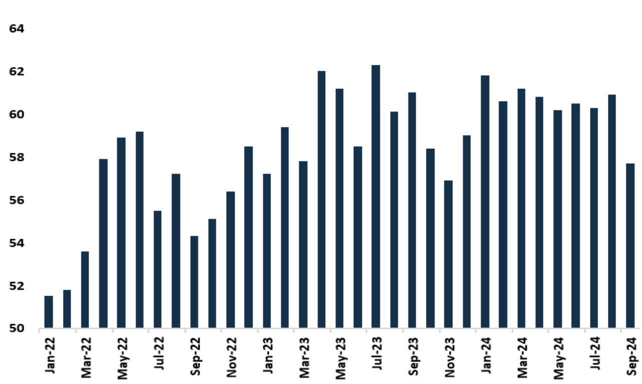
Manufacturing PMI



Source: MoSPI

Figure 10

Service PMI



Source: MoSPI

There has also been a significant deceleration in the passenger vehicle volumes in last few months, with volume growth turning flattish year on year. There has also been a build-up in inventories at the dealer level. Credit growth has also slowed down to around 13% levels from over 15% for last several quarter. New capex project announcements have reached the lowest levels in last twelve months.

Part of this could be attributed to a slowdown in government expenditure around the time of election. Government expenditure (excluding interest payments) de-grew by over 5% last quarter, as compared to same quarter in previous year. Going forward, it is particularly important to keep an eye on these high frequency indicators, to see if the current slowdown is just a blip or something more. Over the medium term though, we maintain our stance that India is well positioned to deliver high macro-economic growth, driven by a turn in the capex cycle. This will continue to drive healthy corporate earnings growth over the next several years.

Portfolio Insights – Discipline

"Investing is simple, but not easy. The key is to have patience and discipline." – Warren Buffett

Over the last eighteen months, there has been a strong rally in many sectors such as PSUs, railways, defence, power utilities and real estate, especially in the small and mid-cap space. A lot of this has been driven by rising order books and hopes of a turnaround in the business cycle. As discussed earlier, actual delivery in terms of earnings growth has been a mixed bag. We have typically avoided investing in these sectors due to weak unit economics, lopsided execution risks and an overall poor corporate governance track record. As a result, our portfolio has underperformed the broader indices over this period. This invariably does lead to concerns and questions around our investment framework, stock picking and risk management.

However, 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.*** This framework has served us well over the past several years, through business cycles. Therefore, 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.

Charles D. Ellis, in his book "Winning the Loser's Game" (Ellis, 2002) articulated this very well - "The hardest work in investing is not intellectual, it's emotional. Being rational in an emotional environment is not easy. The hardest work is not figuring out the optimal investment policy; it's sustaining a long-term focus at market highs or market lows and staying committed to a sound investment policy. Holding on to sound investment policy at market highs and market lows in notoriously hard and important work, particularly when Mr. Market always tries to trick you into making changes."

During the quarter, we identified a new investment idea that fits well within our investment framework, which we discuss in more detail below.

Eris Life Sciences (Market Cap – Rs18,129cr)

Eris Lifesciences is a leading player in the domestic branded formulations market. Ranked #21 in the IPM, Eris has established a leading presence in its core cardio-metabolic franchise in just 17 years from inception. Eris is also successfully diversifying its business with 4 emerging therapies (Dermatology, Neuropsychiatry, Gynaecology and Nephrology) accounting for 29% of its revenue. It has manufacturing facilities in Guwahati and Gujarat. With a pan-India distribution network of 2,000+ stockists and 5,00,000+ chemists, the company reported revenues of Rs 2,009 Cr in FY24, registering a CAGR of 15% in the 10-year period since FY14. Over the same timeframe, net profits have compounded at 19% to Rs 397 Cr in FY24. The company delivered steady ROE and ROCE of 18.5% and 15.7% last year.

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.

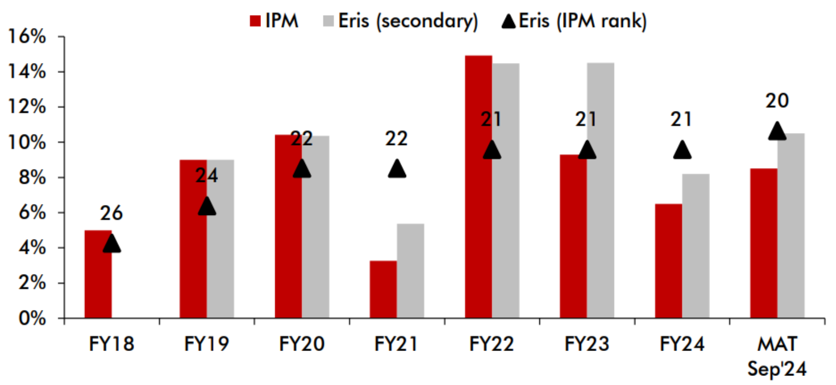
Stellar Management

The company was founded by Amit Bakshi in 2007, who is currently the Chairman and Managing Director. Prior to founding Eris, Amit had worked for Indian and global pharmaceutical companies for over two decades, mainly on the sales and distribution front. Right from inception, he adopted a differentiated business strategy. While most new entrants started off with regional business models in acute therapies and focussed on local general physicians, Amit chose to build a pan-India cardio-metabolic business that pivoted around super-specialists. Amit's experience as a medical representative, helped him build a strong distribution network that is now being leveraged to cross sell different therapies.

As a result of a relentless focus on execution by Amit and his top management, the company was able to steadily gain market share in the domestic market. Within 17 years from inception, Eris is now amongst the top 20 companies in the Indian Pharmaceutical Market (IPM) – the youngest company to achieve this feat. Over the last several years, it has steadily been growing at a much faster rate than the overall market (See Figure 11). We expect the company to continue this trend going forward, driven by increasing market share in its top products as well as entry into newer segments.

Figure 11

Eris vs IPM Growth – Improving Market Rank



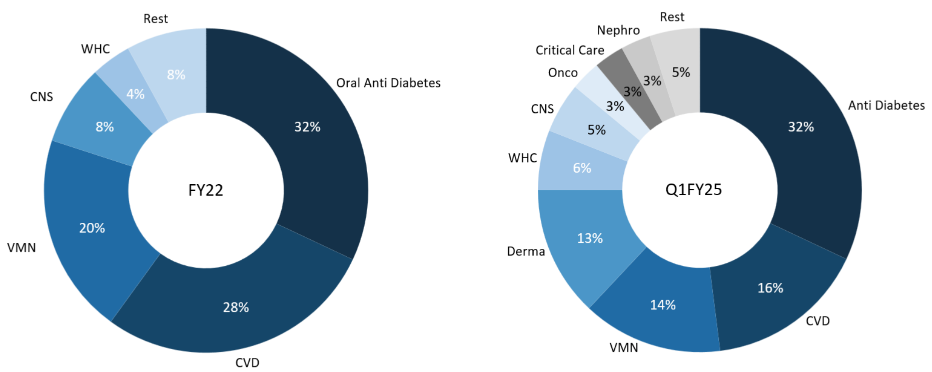
Source: AIOCD-AWACS, Company Filings

Incredible Business

With 90% of revenues from domestic sales, Eris Lifesciences is amongst the best positioned companies in the pharma space to benefit from the fast-growing domestic pharmaceutical market. More importantly, the company has been recently focusing on portfolio diversification into new and faster growing therapies. This is likely to be the key driver in accelerating organic growth to 13%-15% in next few years. Share of the top 3 therapies has come down to 62% in 1QFY25 from 80% in FY22. Even within these therapies, the company has shifted away from slow growing legacy products such as sulfonylureas, towards faster growing segments in oral anti diabetes. At the same time, the share of emerging therapies like derma, CNS, women's health, oncology and nephrology, is now at 33% of revenues, and is projected to grow at over 20% YoY. (See Figure 12)

Figure 12

Therapy – Wise Composition of Revenue



Source: Company Filings, White Whale Research

A lot of this shift in revenue mix and quality has been driven by a series of acquisitions over the last couple of years. The derma portfolio was built through niche acquisitions starting with Oaknet, followed by a portfolio of drugs from Glenmark and Dr Reddy. The execution on these acquisitions has been value accretive with operating margins improving from 24% in FY23 to over 35% currently (See Figure 13). Similarly, the acquisition of Nephro brands from Biocon has also been quite remunerative, with margins improving from 19% to close to 40% over 24 months. Better market reach of these brands and shift to in-house manufacturing has been a key margin driver.

Recently the company forayed into the injectables, insulin and oncology space through further acquisitions of Swiss Parental and a portfolio of products from Biocon. All these acquisitions has resulted in the share of top 10 brands in overall revenues falling to 40% of revenues from 60%-70% historically. Eris is well placed to generate operating margin leverage and significant free cash flow from these acquisitions, thereby improving its revenue mix as well as profitability.

Figure 13

Improving Margins in Acquired Portfolio

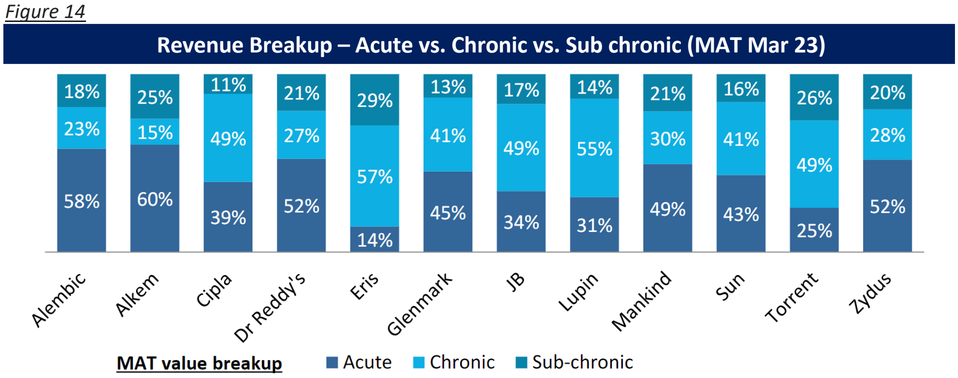
Business Segments	FY22	FY23	FY24	FY25E	FY26E
Revenue (₹ mn)	**13,470**	**16,851**	**20,091**	**30,290**	**34,523**
Base Business	13,470	14,331	15,491	17,770	19,869
Derma (Oaknet+Glenmark+DRRD)		2,520	3,850	4,620	5,313
Biocon Brand (Nephro+Insulins, etc.)			200	4,600	5,612
Swiss Parenterals			550	3,300	3,729
EBITDA Margins	**36%**	**32%**	**34%**	**35%**	**37%**
Base Business		33%	34%	36%	37%
Derma (Oaknet+Glenmark+DRRD)		24%	35%	35%	37%
Biocon Brand (Nephro+Insulins, etc.)			20%	30%	35%
Swiss Parenterals			35%	36%	37%

Source: Company Filings, White Whale Research

Longevity of Growth

Notably, in spite of the series of acquisitions, Eris Lifesciences has still managed to keep its core strengths intact. Chronic and sub-chronic revenue mix is above 85%. This is by far the highest in the industry (see Figure 14). At the same time, domestic formulations still accounts for over 90% of revenues. Chronic therapies have a very large addressable market of over Rs55,000cr. More importantly, the recurring nature of demand from these therapies provides a stable revenue stream. The company's ability to garner mid-single digits to double digit market share in its top 20 products is a testament to its execution prowess. Replicating this in the newer products provides a runway for further overall market share gains. Continued niche acquisitions in key therapies will only help in enhancing its addressable market size, revenue mix as well as top line growth.

Figure 14



Source: Company Filings, White Whale Research

Over the last five years the company's financial performance has been very strong, as evidenced by its revenue CAGR of 15%, EBITDA CAGR of 14%, with ROCE of 25%. In spite of this, it was trading at a reasonable valuation with EV/EBITDA at 16x FY26E, at a 33-40% discount to its peers. In our view, this is because investors have not fully appreciated the diversification in revenue that the company has undergone in last few years, along with higher exposure to faster growing therapies that will boost organic growth. We believe the company should see healthy high teens EBITDA growth over the next several years, which alongside possibilities of further rerating, should deliver healthy shareholder returns.

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