



Dear Investors:

Entitlement is often co-incidental with a period of clearly visible positive earnings revisions, and few visible headwinds. Amazingly, neither holds true in India today. Yet, we see feel-good narratives, largely built upon planks of hope, driving what we believe wouldn't be an enduring street bromance with headline benchmark components. India's valuations within headline names (nearly across the capitalization spectrum) are unequivocally stretched, and are particularly elevated in large-cap names. They are almost irreconcilable at this point, with sustainable growth differentials thoroughly incapable of supporting these. By our estimate, the street is baking in high single digit growth premiums for India several years ahead at this time, which is suggestive of immense entitlement.

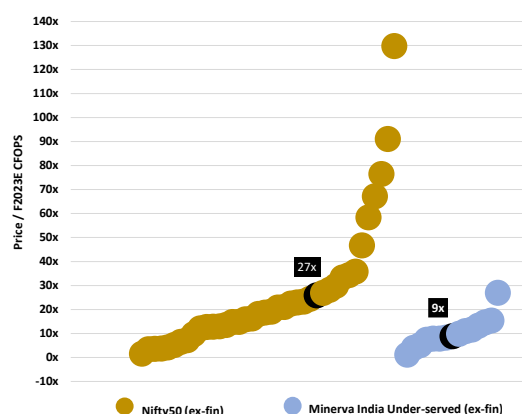
The argument that underlying composition of Indian benchmarks has significantly changed isn't supportive of these elevated premiums either. If anything, sectoral composition of *MSCI Emerging Markets* has changed more favorably vs. that of *MSCI India*. Prior to the 2008 meltdown, 30% of *MSCI Emerging Markets* weight was in typically 'low-multiple' sectors such as Energy and Materials. That had since been cut by more than half getting into C2022. Nearly all of that was picked by emergence of new names within GICS sectors that typically have higher multiples (Healthcare and Technology). While directionally *MSCI India* saw a similar shift, the extent of the shift hasn't been nearly as large as at *MSCI EM*. Getting into C2008, ~27% of the index was comprised of Energy and Materials, vs. 22% getting into C2022 (higher than at *MSCI EM*). Over this period, Healthcare and Technology collectively moved from 14% to 23%.

Run-up in India's headline names (since June) has transformed them from 'stiff' to 'scary'! We don't have a dog in India's headline races. While price performance until midpoint of the calendar seemed to somewhat track earnings revisions, we have seen an extremely disturbing decoupling over the last quarter. The biggest recent disconnects have been in *Nifty50* constituents¹, and particularly sharp within some Consumer Staples names where YTD price action has been remarkably disconnected vs. downside revisions in earnings estimates (see **Exhibit 2d** on next page). Nowhere is the overly generalized "safety" trade more visible than here, even as the distinct lack of pricing power has been laid bare. Already extremely richly valued names such as *Hindustan Unilever*, *Britannia*, and *Tata Consumer Products* were up 10% or more YTD (by the end of September), even as F2023E (Mar) earnings expectations in these names were revised down by 10% or more YTD. This is critical because we note that India's bottom half is struggling more than most and its particularly visible across most staples categories. Please refer to our emerging and frontier cross-country benchmarking on packaged food and non-premium footwear categories in our [last investor letter](#). We maintain our view that, like everything else, safety (in this case more perceived than real) has a price and we find it impossible to reconcile these valuations with even the most bizarrely optimistic estimates of sustainable underlying cash flow growth here. Mass staple categories today remain extremely subdued, and we saw nothing in the September quarter to suggest otherwise, despite easier comparisons from last year. In fact, our discussions suggest that packaged food category likely further declined vs. last year, driven by shrinkage, downtrading, and lower demand. We noted insignificant volume growth in home and personal care categories as well. An extended monsoon could likely be a gut punch at this point.

Despite running an India-only strategy, we haven't participated in froth build-ups. Even though we ended September at **+13.3%** gain YTD (in INR terms), vs. **-3.4%** for *BSE Smallcap* and **-0.2%** decline for *Nifty50*, our valuation discount vs. headline names (**7.5x** FY23E EBITDA, vs. nearly **20x** for *Nifty50*) remained elevated because of materially better underlying earnings revisions - YTD, median F2023E (Mar) EBITDA estimate in our book (ex-fin) has been revised upwards by **+6%**, vs. a **-6%** cut for the median *Nifty50* (ex-fin) constituent.

¹ About 60% of *Nifty50* components have seen YTD price action (until end of Sept) handily outpace F2023E (Mar) earnings revisions YTD

Exhibit 1 – P / FY23E CFOPS [Minerva vs Nifty50]



Overly generalized narratives allowed us an opportunity to re-engage in September, as we noticed a benign reactive spillover in our book. In contrast to nearly any part of India, our median holding saw a +9% revision to F2023E (Mar) earnings estimates in the first three quarters of the year. Consequently, our elevated discount vs. any benchmark expanded further, positioning us well as we move into 2023. On cash flows, we now trade at an unprecedented 70% discount vs. *Nifty50* (see Exhibit 1), which is reflective of emerging narratives around 'risk' and their overly generalized and familiar resulting associations with 'size'. We will aggressively engage if investor reaction to excesses within India's headline names were to spill over within our book. At all times, we aim to compound at >20% every decade, and we shouldn't need more than mid-teen earnings growth² to deliver that from current levels.

Exhibit 2a – 'Suspect' 30 Stocks vs Earnings revisions YTD

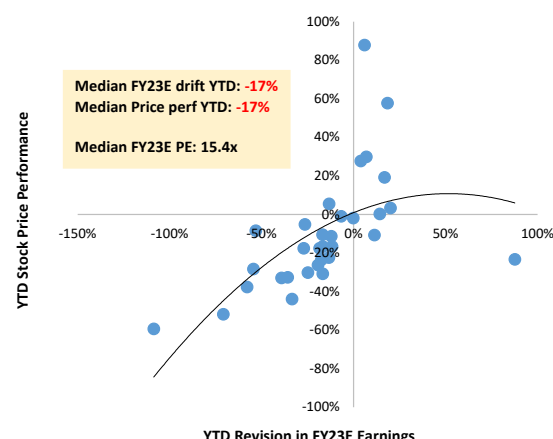


Exhibit 2b – Nifty Smallcap50 Stocks vs Earnings revisions YTD

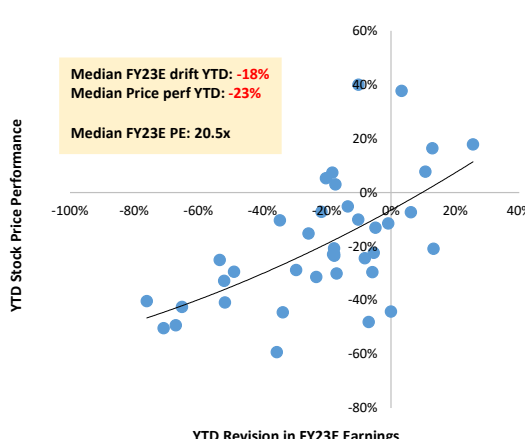


Exhibit 2c – Nifty Midcap50 Stocks vs Earnings revisions YTD

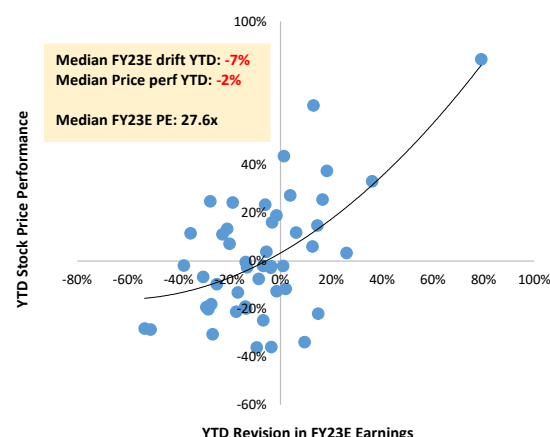
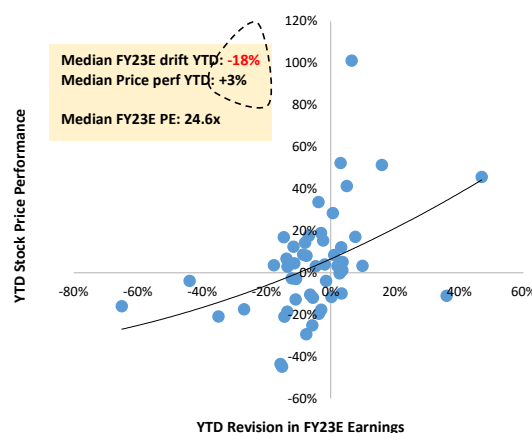


Exhibit 2d – Nifty 50 Stocks vs Earnings revisions YTD



Note: 'Suspect' 30 is a list of 30 names (beyond top-500 securities) that demonstrate the lowest cash conversion.

Source: S&P Global Market Intelligence

² Our current book has delivered ~24% earnings CAGR over this past decade.

We note broad stretched valuations across BSE 500 sub-industries. Across 70+ sub-industries that comprise *BSE 500* today, more than a third ended August trading at >6 book³. Not only have we not witnessed this in distant memory, the distribution is distinctly ‘tail-less’ (see **Exhibit 3**, which plots P/B distribution across all *BSE 500* sub-industries for Dec 2007, Dec 2010, and as at the end of Aug 2022), with barely half of all sub-industries ending August trading at under 5x.

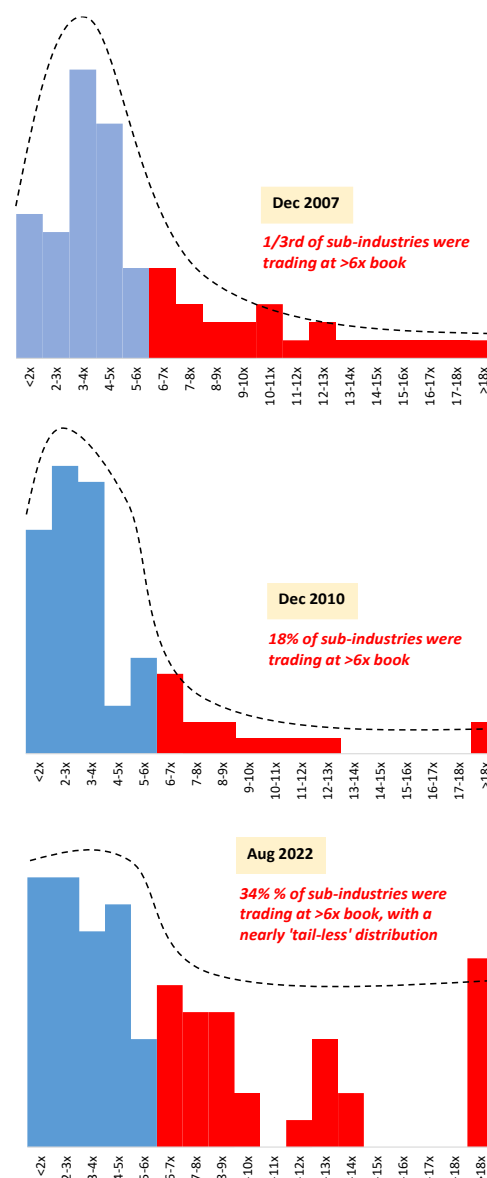
Critically, underlying earnings growth in previous peaks was relatively robust, in contrast to what we see now or could reasonably expect in the next fiscal. For context, in F2011 (Mar), median earnings growth for the 70+ sub-industries that comprise *BSE 500* was >21%, vs. arguably somewhat less sanguine forecasts⁴ for high-teens in F2023E (Mar).

We also remain extremely wary of widely prevalent (and largely unprecedented) jingoistic undertones, with the street continuing to egg on retail investors to allocate in the supposed ‘island of growth’. An under-institutionalized market such as India is always typically ripe for froth build-ups as objectivity takes a back seat amid the ongoing powwow.

There was a fair bit of re-allocation in our book in the September quarter. We completely exited a previously considerably pared healthcare diagnostics holding, while marginally cutting certain positions (a packaging name, an auto parts name, and our forestry holding), primarily because of internal risk-management guidelines (security and industry cap related cuts).

Meanwhile, we selectively added to a few legacy holdings (a theatrical exhibition name, and a technology name), which more than offset our sales for the quarter. Overall, our cash holdings marginally declined from 11% at the end of June to just over 10% at the end of September.

Exhibit 3 – Industry-wise P/B distribution for BSE500



Note: To keep periods comparable and eliminate the issue around scarcity premium, we only included BSE 500 components that were public in Dec 2007.
Source: Ace Equity

³ ~15% of all sub-industries were trading within 10% of their life-time high book multiples

⁴ Largely based off of expected softening in material costs. We expect significant leveraged earnings offset though as materials soften. Note that while materials make about a tenth of *Nifty50* (ex-financials) weight, they account for more than a fifth of index's net debt.



Higher ‘new normal’ in underlying profitability is going to get higher. We increased exposure in our legacy theatrical exhibition holding. This position is now our joint-3rd biggest holding. We identify multiple value capture levers in this holding of ours – lower run-rate operating costs in the post-pandemic world, a distinctly more flexible consumer that is willing to consume content beyond Hindi productions⁵, accretive mix-shift towards more premium formats⁶ as the consumer is increasingly seeking an ‘enhanced’ viewing experience, and post-merger scale economics.

Despite F1Q23 (Jun) still being nearly INR 300 mil off vs. F1Q20 (Jun) in ad-revenues, and -7% lower footfalls, this holding’s profitability was still +220 bps higher. Critically, this came during a period of unusually poor Hindi content. Even with overheads going up somewhat, we expect profitability to continue to improve as premium formats ramp-up further (doubling from 10% of screens today to a fifth of all screens within 3-5 years). We suspect that continued growth in domestic IMAX content will accelerate this rollout ahead of expectations.

In 2+ decades of investing and advising across geographies and industries, we don’t recall seeing a more disciplined (and underrated at that) deal maker than this business. While we are still a few months away from the closure of their biggest deal ever, we can now identify material synergies for the new entity. If integration of their second-biggest deal ever (closed about 10 years ago) is any indication, we can identify at least INR 7-10/footfall reduction in overheads, and potentially twice as much in procurement associated scale benefits by opening say 500 additional screens⁷. Even excluding deal-related benefits, we now see our capital doubling on this position within 2-3 years.

We further added to an existing technology name that had traded off >40% YTD, despite sticky expectations even as estimates across software services have come off significantly. We had initiated exposure here in May 2021, but had pared the position as technology names ran up too much and too quickly in the second half of last year. While subsequent declines on expected budget cutbacks were expected, it has created selective buying opportunities already. Nearly across CIO surveys we have noted that enterprise software budgets on cloud spending are not only unlikely to be cut, but are in fact likely to expand further over the next year⁸. Despite nearly unchanged F2023E (Mar) estimates YTD, this position had nonetheless sold off sharply. We doubled our exposure on this holding in September. We expect to capture 50%+ upside on this position within the next 2 years, under anything except a scenario of an unexpected sharp cutback in cloud spends.

We pared a fifth of an auto parts position for risk-management purposes. Since 2 of our 3 top holdings at the beginning of the quarter (30% of the book between them) were auto parts names, we were prepared to cut exposure if either or both of these holdings were to relatively gain during the course of last quarter. Since industry exposures are capped at 30% (and security-level exposures at 20%), we had no room to increase exposures here. A +22% run-up in July led to us paring down our third-biggest position by a fifth. Our underlying thesis on this position remains unchanged – Their current OEM mix positions them very well, be it in terms of shading them from continued distress in the bottom half, or in terms of benefiting from

⁵ We estimate that >70% of F1Q23 (Jun) box office revenues for our holding came from movies where the original content language wasn’t Hindi. This is despite our holding typically grabbing far higher share of Hindi content vs. their share of regional content.

⁶ We estimate that within same geographies, luxury formats and IMAX come with about 4-5% higher margins vs. standard screens, and also have better returns on invested capital.

⁷ At the end of F1Q23 (Jun), the 2 entities combined had 1,550 operational screens

⁸ Barely 30% of workloads in US are on public cloud, vs. ~20% 3 years ago



ongoing vehicle electrification. We expect nearly 40% earnings growth for this holding in F2023E (Mar), despite mid-single digit expected volume growth in the domestic two-wheeler sales.

We also pared a fifth of a folding board carton (FBB) and flexible packaging converter holding. While we remain constructive on continued growth in domestic FBB packaging, and it's critical to appreciate emerging opportunities because of the energy crisis, we believe that the valuations weren't pricing uncertainties effectively. This stock had run up nearly 60% QTD until end of August, prompting us to lighten a bit subsequently. Since the cut, this stock has retraced back to what we believe is a very comfortable 7x F2023E (Mar) EBITDA. We note particularly solid traction in food-grade FBB, where we have noticed increased offtake within SKUs within cheese, chocolates, and cookies at the likes of *Britannia* and *Amul*. We expect north of 30% earnings growth for this holding in the current fiscal, and would conservatively bake in 20%+ in the next fiscal too.

Domestic passenger vehicle sales are expected to show high-teens growth in F2023E (Mar), after nearly recapturing the F2020 mark in the last fiscal. Even without continued growth in PVs however, our second-biggest holding should still report north of mid-teens earnings growth over the next few years. Even though PV volumes would grow in the high-teens in the current fiscal, alloy volumes at our holding are expected to grow >60%, and will likely end up accounting for just under 30% of revenues in F2023E (Mar). About half of this growth is on account of a deal win from an Indian OEM. Effectively, alloy volumes would grow at ~2x passenger vehicle growth run-rate, which is consistent with our view of 5-6% annual PV mix shift from steel to alloys. Overall, even assuming flattish passenger vehicle sales, we expect alloy volume growth at least in the mid-teens in the coming years. This year's growth in alloys alone would handily offset the decline in exports, where revenues will likely decline by 45-50%. In fact, we now expect to witness an accelerated shift from steel to alloys - We note that while previously the shift was driven largely by aesthetic considerations (with diamond-cut rims making nearly 3/4th of sales), we now expect incremental offtake from EV penetration. As things stand, these assemblies are absolutely stuffed at this time and a 30%+ capacity increase by March would barely be enough to service expected run-rate by second half of F2023E (Mar). We note however that just about 35 acres (out of ~70 acres) in the Gujarat-based alloy facility would have been built-upon by early F2023E. While we are still in the very early warm-up stage of potential PV alloy exports, it is regardless a potential landgrab opportunity and this, alongside incremental alloy deal wins, could easily necessitate another 30% capacity increase within 2 years. Assuming that exports continue to languish on an already depressed F2023E (Mar) base, and domestic OEM sales across vehicle types post no better than flat-low single digit volume increases over the next 2-3 years, this holding of ours can nonetheless report close to mid-teens earnings growth in the foreseeable future, making it among the most compelling idiosyncratic situations in our book.

Pricing and demand environment keeps getting better in forestry. We identify growing domestic shortages as exports pull away domestic supplies. We estimate that uncoated cut-size wholesale pricing shot up nearly 25% sequentially in the September quarter as nearly a third of wholesalers cited supply shortages (induced by growing exports). Elsewhere, our discussions nearly across the packaging supply chain also suggested that paperboard is now increasingly getting exported as export profitability is now significantly better vs. domestic sales⁹. This is despite extremely strong domestic demand. Our discussions suggest that

⁹ Fiber availability remains particularly tight in Europe, where BHKP (bleached hardwood kraft pulp) prices in September were at nearly 50% premium vs. prices in China. Mill downtimes (prompted by elevated resource costs) are further hurting European supply.



domestic paperboard volumes in F2023E (Mar) would expand by >15%¹⁰. Meanwhile, our most optimistic scenario of new supply sources coming online in the current fiscal comfortably falls below our incremental demand estimates. Further, we expect an increasing supply allocation towards export markets. Input costs meanwhile remain firmly in check. We note that 1. Eucalyptus pricing in Telangana was flattish during the quarter, and 2. Sharp spikes in international coal markets are unlikely to derail an extremely attractive price environment for paper. We note that ~80% of coal requirements for our holding are met through CIL linkages, while a fifth is serviced through imports (primarily from Indonesia). Indonesian thermal coal pricing has remained flat over the last 3 months¹¹, as their largest buyer (China) continues to materially scale back imports¹², even as prices had spiked elsewhere. Even if linkage sourced coal was hard to get and our holding had to shift some sourcing to auctions in this past quarter, the sharp price rise we have seen across paper grades is near certain to reflect in continued margin expansion. In what is increasingly looking like an extremely stable goldilocks pricing environment, our holding in this space remains one of the most asymmetric situations in our book today.

We fully exited a small residual piece of our diagnostics holding. We had initiated this exposure about 5 years ago between INR 750-800/share. Towards the end of F2020 (Mar), this holding made up a bit under 15% of our book (our second highest exposure at the time), and we began gradually exiting this position from mid-C2020 onwards as pandemic-driven benefits started getting irrationally priced. By the end of C2021, we had exited >80% of our peak exposure, and eventually liquidated the small residual holding in the last quarter. Our principal thesis on this holding at the time of initiating exposure was built around a landgrab opportunity within an extremely unorganized diagnostics space. While pricing struggle had always been evident within B2B channels, the environment has worsened considerably within the B2C channels in recent years. Imagine the increasingly elevated competitive intensity in an industry where every fourth diagnostic company started in the last decade was launched within the last year. Further, we estimate that private diagnostic labs with combined F2023E (Mar) revenues of close to INR 60 billion¹³ will likely go public within the next few years, further pressuring profitability in a space that we now believe is woefully devoid of pricing power. We note that pricing at national chains today runs at 50-80% premium over aggregator pricing, and 25%+ premium over a certain chain now owned by an online pharmacy, and these are untenable in our opinion. While we expect consolidation activity picking up in a few years, at these valuations (which as it is based off of unsustainably elevated profitability in our view), we struggle to identify how such deals could be materially value accretive.

Stay safe! Feel free to reach out if you have any questions. We are available 24/7 to address your concerns.

Thanks,

Piyush Sharma

¹⁰ There are no imports of paperboard in India at this time. In contrast, given the attractiveness of external market, quite a few greyback and whiteback paperboard manufacturers have exported.

¹¹ Indonesia's ESDM had set the reference coal price (HBA) at \$319.22/t for September, marginally lower vs. \$323.91/t in June.

¹² China's coal imports are expected to decline by more than 25% in C2022E, and are expected to further decline by 2-4% in C2023E

¹³ That's nearly 3x our ex-holding's F2023E (Mar) revenues

Performance benchmarking

	India Under-served	Nifty	S&P BSE 500	S&P BSE Midcap	S&P BSE Smallcap	EurekaHedge India	India-focused CE Funds*
Trailing 1 year	12%	-3%	-1%	-2%	1%	-8%	-8%
Trailing 3 yr CAGR	35%	14%	17%	21%	29%	12%	9%
Trailing 5 yr CAGR	19%	12%	12%	10%	12%	7%	5%
Trailing 7 yr CAGR	18%	12%	12%	13%	15%	8%	6%
Trailing 10 yr CAGR	20%	12%	13%	14%	15%	9%	10%
Since inception CAGR	18%	10%	10%	11%	11%	7%	7%
2022 YTD	13%	0%	-1%	0%	-3%	-9%	-1%
2021	92%	23%	30%	39%	63%	25%	20%
2020	18%	15%	17%	20%	32%	20%	12%
2019	-10%	12%	8%	-3%	-7%	1%	3%
2018	-6%	3%	-3%	-13%	-22%	-7%	-5%
2017	17%	29%	36%	48%	60%	29%	31%
2016	9%	3%	4%	8%	2%	3%	1%
2015	22%	-4%	-1%	7%	7%	6%	-1%
2014	34%	31%	37%	55%	69%	39%	49%
2013	21%	7%	3%	-6%	-11%	-6%	6%
2012	39%	28%	31%	38%	33%	14%	28%
2011	-11%	-25%	-27%	-34%	-43%	-25%	-31%
Annualized Volatility	22%	17%	18%	20%	24%	13%	17%
Sharpe Ratio	0.83	0.49	0.52	0.53	0.46	0.35	0.41

Source: BSE, NSE, EurekaHedge, Bloomberg

Note: Returns are until the end of September 2022; Our performance is net of execution charges and mgmt. fees, but before incentive fees; Our management fees are accrued monthly for reporting purposes. Since the fee is actually charged and calculated quarterly, compounding of the fee charge leads to us conservatively reporting slightly lower returns vs. client actuals.

*US-based close-ended funds, with returns adjusted for INR/USD movements.

Strategy Snapshot

Characteristic	Notes	
Top 5 positions as % of book	60%	
Avg. weighted market cap of book (mil)	\$532	>> Median holding's market cap is \$302 mil
Avg. weighted institutional ownership	12.9%	>> Median institutional ownership of current holdings is 10.7%
Avg. weighted free float of book	41%	
Net Exposure	90%	
Avg. weighted F2023E (Mar) EV/EBITDA	7.5x	>> vs. 17.5x (Nifty Smallcap 50), and 19.9x (Nifty 50)
# of positions	15	

Note: Characteristics are as at the end of September 2022



Meet your investment manager

Piyush Sharma, born and raised in India, has been running the Minerva India Under-served strategy since early 2011. The strategy focuses on investing in uncrowded and institutionally under-owned situations within Indian micro and smaller smallcaps. Essentially, strategy's focus is on poor price discovery pockets. Having spent time with Citigroup and Bombay Stock Exchange in India, he moved to United States in early 2000s, where he covered stocks within Business Services, Autos, Consumer Products and Financials with Sanford Bernstein, Longbow Research, and Avondale Partners, working in teams that received accolades from leading institutional research arbiters, including Institutional Investor (II) and Greenwich Associates. Piyush received an MBA from University of North Carolina at Chapel Hill, MS from MNNIT, and BS in Accounting from University of Allahabad.

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