



Dear Investors:

Minerva India Under-served team wishes its investors and their loved ones a fantastic 2022!!

We ended 2021 with a **+92.2%** (net) gain, vs. **+30.1%** and **+62.8%** gains for *BSE 500* and *BSE Smallcap* respectively. Critically, this wasn't fueled by indiscriminate multiple expansion tailwinds. Continued solid underlying earnings performance ensured that our gains were captured on a solid base and accordingly we continue to trade at valuations that are in line with where our holdings traded in the pre-pandemic world, even though in several situations there is more than a solid case for a re-rating. We strongly believe that 2022 will bring us something that we always crave for – indiscriminate panic! As always, we plan to actively engage as speculative excesses give way to the ONLY arbiter of sustainable value creation – sustainable underlying cash flow growth at the right price.

'The worst times come to an end if you can only wait long enough'. While the private investment cycle will accelerate at some point, we unfortunately see little evidence of any broad-based acceleration at this time. Interestingly, in decade plus of deploying capital in India, we have never viewed the investable part of India's listed space as particularly levered, even though there is a deep-lying (likely) cultural aversion to leverage. Ongoing deleveraging over the past several quarters was largely a function of a broader lack of expansion opportunities than anything else. That less-than-optimal outcome shouldn't be tied with the bizarre prevalent narrative that relatively more unencumbered balance sheets will dramatically usher in a new era of accelerated facility expansions, despite little to no evidence of a broad-based improvement in employment.

While a vast majority of the street appears to be 'all in' on the PLI bandwagon, businesses appear fairly impassive. No more than a handful of *BSE 500* companies have cited PLI as a material opportunity, let alone a gamechanger. Listen to the street chatter and you could be excused for thinking otherwise. While several Auto OEMs and drivetrain players such as *Cummins* will expectedly take advantage of these incentives, we don't quite view this as an incremental gamechanger it is being made out to be. Trends such as vehicle electrification are undeniably irreversible, but these incentives, in our view, will do little more than potentially accelerating an otherwise natural trend. Elsewhere, in several situations, we don't expect any particular incentive for a course change – Take printed circuit boards (PCBs) for instance. Taiwanese PCB assemblers (at scale) report, on average, mid-single digit or lower ROICs, and that's when they have next-door access to the world's leading integrated chip substrate production base. These aren't situations where our contract manufacturing driven labor savings can offset other factors, since these aren't the most labor-intensive situations to begin with. Consequently, we don't see PLI driving competitiveness in these cases once the PLI period is over (or in several cases, even with these PLI benefits in place). Effectively, we expect PLI schemes to do little more than accelerate capital deployment in situations where a case of sustainable import substitution was pre-established.

The (large) emperors have no clothes. While nearly anything in the US (even as the 'tech on steroids' trade might have come off rails since early November), private assets globally, and headline street darlings in India (across the capitalization spectrum) trade somewhere between 'stiff' and 'downright scary', several emerging markets and India's institutionally orphaned space have seen little or no multiple expansion over the past half a decade. To see stark divergence in multiple expansion breadth between FY17-FY21 for different parts of the global listed universe, please refer to our July 2021 investor letter [here](#).

Consider us vs. a headline supposedly "smallcap" index in India - If we were to exclude the previous 2 fiscals (since underlying earnings were off of run-rate), *Nifty Smallcap50* (ex-financials) ended the year at +45% premium over its FY14-FY19 average¹, while our book hardly trades at a premium (see **Exhibit 1**). The last

¹ Only names that have traded since FY2014 were included



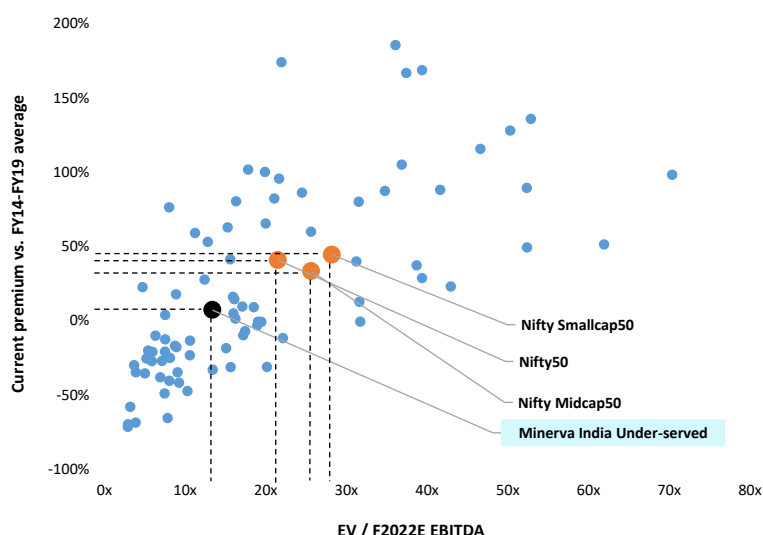
quarter saw more of the same jamboree we had been seeing all year – While F2022E (Mar) EBITDA expectations for *Nifty Smallcap50* (ex-financials) got slashed by -5%² in C4Q, the already elevated index (began the quarter at an already rich 25x F2022E EBITDA) ended 2021 at a richer >28x F2022E EBITDA. In sharp contrast, our focus on owning value dislocations in idiosyncratic situations ensured that we remain solidly positioned - Our book's F2022E EBITDA expectations were revised upwards by +2% during the quarter (>70% of our holdings maintained or raised estimates), and ended the year at barely 13.4x F2022E (Mar) EBITDA, or nearly 55% discount vs. *Nifty Smallcap50* (see **Exhibit 1**).

As 2021 ended, several were already peddling high-teens or even low 20s expectations on the unequivocally rich *Nifty50* over the next 3 years. For context, by our estimate, that would require *Nifty50* (ex-financials) to compound earnings somewhere at least north of 30% over this period (vs. the 8-9% growth since we began deploying capital in early 2011). In our view, a motley of some of the most richly priced names on the planet would do well to deliver double-digit gains over the next 3 years. Anything much more than that would require some sort of cosmic intervention.

Near-annihilation of pricing power. We are in a period when some of the stickiest consumer brands (that too within high growth categories) have found it challenging to pass through elevated freight and input costs - Be it at *YETI* coolers (Nasdaq: YETI) or at a smart-bed manufacturer like *Sleep Number* (Nasdaq: SNBR), pricing power has been hard to find. Except in select cases of luxury apparel in Europe, or within few select export-oriented situations within emerging markets, it has been extremely difficult to pass through the sharp cost spikes.

In India, other than the metal names within Materials, we have seen limited to insignificant pass-through across industries. For a few headline non-metal Material names that use FIFO for material valuation, inventory liquidation in F2Q (Sept) also led to significant margin gains. Consider *APL Apollo Tubes* for instance – If it weren't for the considerable inventory liquidation, it's F2Q pre-tax earnings growth would likely have been in the much lower 20-25% range vs. the reported 40%³. Few *Nifty50* components such as *Tata Motors* and *Dr. Reddy's* that use the weighted average method to value materials also saw significant inventory liquidation gains, letting them optically temper material cost headwinds. Overall though, margins saw considerable compression in F2Q (Sept) – Material costs, on average, had a 250-300 bps yoy impact on *Nifty50* and *Nifty Midcap50* margins, and an even larger >400 bps impact on *Nifty Smallcap50* margins, with pain particularly concentrated within consumer discretionary, energy, and consumer staples constituents.

Exhibit 1 – How we and headline constituents compare vs FY14-FY19 avg



Source: Reuters; Internal estimates

Note: Financials and outliers were excluded; Only constituents that have traded since at least FY14 were included for this exercise.

² Just under 2/3rd of all *Nifty Smallcap50* constituents (ex-financials) saw a cut in their F2022E EBITDA estimates, about in line with what we saw in the September quarter.

³ Hot-rolled steel prices had increased ~12% sequentially in F2Q (Sept)



We expect to see continued challenges in two key areas that have driven supply bottlenecks globally – container freight movement and global semiconductor capacity.

1. While containerized freight situation would improve, we won't see most of that beyond 2022E.

After somewhat plateauing around July/August, container freight rates rose again in C4Q and ended the year at record levels. While container capacity growth is expected to outpace cargo volume growth by 2-3% in 2023E and 2024E, 2022E will remain a year of tight freight capacity, exacerbated by the need of most to hold higher inventory than they did in the past.

2. As consumer electronics binge subsides, we expect automotive supply woes to gradually improve, but acceleration of the electrification trend might offset that, likely extending the shortage into 2023 and beyond. Relatively smaller market size, highly regulated environment, lean inventory management, and associated liabilities in contracts ensured that the global automotive industry had to take a back seat as surge in prioritized consumer electronics demand threw an already stretched global semiconductor capacity into a tailspin. With global smartphone and PC shipments cooling down, we expect bottlenecks across the chip supply chain to somewhat ease moving forward. The global fabrication capacity is also moving quickly from 'underinvestment' to sharp increases over the next 6-7 years, with wafer capacity of leading-edge logic nodes growing at 20%+ annualized rates⁴. That said, the proverbial elephant in the room (vehicle electrification) can easily throw a spanner here, since EV chip content is 8-10x vs. ICE vehicles. While certain auto OEMs are increasingly building in-house chip design capabilities, they remain nonetheless dependent on insufficient global fab capacity.

To summarize, we expect to continue to witness supply headwinds and aren't in the camp that expects a massive rebound in domestic private capital expenditure. Accordingly, as always, we remain focused on owning value dislocations in idiosyncratic situations. We want to decouple our book's underlying earnings from the broader universe, and actively engage if there is any collateral sentiment spillover into our holdings.

Here are some of our current thoughts on key holdings as we get close to wrapping up our 11th year of deploying capital in India:

Our biggest holding would conservatively deliver well north of 40% earnings growth in F2023E (Mar), even if domestic PV sales remain muted. By our estimate, this business now controls nearly a third of Class-8-wheel rims aftermarket in the US (nearly all acquired within 3 years of entry⁵) and continues to gain share primarily at the expense of European imports (which still control about a fourth of the Class-8 aftermarket). Elsewhere, they continue to make inroads within the RV/trailers space in US. Effectively, on account of this very profitable underlying mix shift, between F2019-F2023E, we conservatively expect the earnings to well more than quadruple (conservatively assuming that the only source of growth in F2023E is from US exports), even as the stock has moved barely +80% since F2019. This remains one of the most attractively valued idiosyncratic situations we have seen in recent times (devoid of any speculative froth⁶ that the market is otherwise replete with). Steel price decline would be an incremental optionality, since our holding typically captures some of the claw-back gains from drop in material costs. Other than near-term ticker-tape fatigue headwinds⁷, we see absolutely no reason for this position to at least not double from here within F2023E (Mar).

⁴ the initial capacity spike isn't going to come online until late 2022

⁵ Pricing remains in line with what Chinese were offering prior to imposition of anti-dumping duties.

⁶ More than 3/4th of all trades over the past quarter were delivered.

⁷ This position is coming off of a 240%+ gain year in 2021



Two-wheeler electrification might creep up on us. Our national dealer discussions suggested that nearly a fifth of all walk-ins in two-wheeler dealerships this past Diwali preferred an electric vehicle purchase. Not only is a key auto-parts holding of ours well positioned to supply to traditional OEMs where they are well entrenched, but it is also well positioned to supply lamps to ‘non-traditional’ OEMs⁸ – *Hero Electric* is an existing customer (albeit not within lamps yet) while *Ola*’s lamps deliveries will begin in this quarter. Further, despite the popular belief that traditional OEMs would shift some platforms from LED to halogen to counter the recent sticker shock, we haven’t really seen that headwind play out – case in point is *Honda’s Activa*, where expectation was for a meaningful scale back towards halogen lamps, but consumer lamp preferences were stickier than anticipated and we didn’t really see a significant switch.

Global paper and pulp pricing continues to harden; our holding’s expanded paperboard facility is now online. With schools and colleges still working on a hybrid model, underlying demand at most uncoated paper wholesalers in the last quarter was still running about 30% below pre-pandemic levels. Nonetheless, it was a sharp improvement vs. almost 60% decline (vs. pre-pandemic levels) at the beginning of the year, and price has been a consistent tailwind since the beginning of 2021. We continue to hold one of the most profitable forestry names on the planet (with sizeable unpriced optionality in paperboard expansion), which bizarrely trades at nearly 30% discount vs. its NA and EU peers. This holds true across most of our top holdings – While Indian headline constituents mostly trade at large premiums vs. their peers globally (often in cases where it’s hard to justify any), most of our top holdings trade at large irreconcilable discounts.

For our beverage holding, the emergence of the ‘value plus’ intermediate category between IMIL and IMFL⁹ is a significant value driver (and remains well under-appreciated). To re-visit our detailed thesis on this name, please refer to our October 2021 investor letter [here](#). While ethanol blending might sound more exciting to many, our focus here remains on the ongoing mix shift in the consumer business. Consider this - In the last quarter, ~35% of Consumer business’ revenues came from this new ‘value plus’ category, and this all still (!!) came from just 1 state. We expect this value (IMIL) → value-plus (think of it as affordable re-packaged IMFL) transition to gradually play out across several large IMIL states¹⁰. For context, the 3 other states where our holding already has distillation assets have a combined IMIL market size of 2-2.5x of our holding’s primary state (which accounts for all of ‘value plus’ revenues at this time). As new distillation facilities ramp up in new states, 1. Share of consumer business will grow, and 2. Share of ‘value plus’ within the consumer business will grow as well. Effectively, not only can the size of the value plus category double from here over the next 2-4 years, that mix shift would lead to an incremental 100-150 bps accretion to underlying margins. By our estimate, while we are getting close to effectively pricing the higher margin benefits from higher near-term ‘value plus’ contribution, the magnitude of potential incremental revenue capture from both ‘value plus’ and ‘premium’ categories in new states remains largely unpriced. In sharp contrast to what we see around us, we see little risk of sustainable multiple contraction in this situation.

We recently initiated a new position in a ‘value-added’ plastic packaging film business. The specialty piece (value added films of this type) is arguably a levered bet on flexible packaging, as it continues to take share from polyester films, while flexible packaging overall gains share at the expense of rigids. That said, there are two nearly perpetual (and overly-generalized) overhangs on plastic packaging films – 1. a potential regulatory/technological shift in favor of more environmentally friendly alternatives¹¹ (and we are positioning

⁸ *Ola*, *Hero Electric*, *Ather Electric*, and *Okinawa* combined have already created capacity to produce nearly 3 million units.

⁹ IMIL is essentially country liquor (made from rectified spirit); IMFL is made from ENA

¹⁰ There is growing appreciation of this emerging category in several states, both from the viewpoint of increased excise and keeping illicit liquor manufacturing in check.

¹¹ For all the posturing, our discussions with some of the best positioned packaging professionals confirms our understanding that cost (at a certain functionality) is the most critical driver of choice.



ourselves on the side of the completely recyclable mono-material cost-competitive option), and **2. Limited to no pricing power in basic films** (and we are positioning ourselves on the side of value-added films where the provider works closely with CPG and other buyers to improve preservation and/or appeal, establishing higher and stickier margins).

This business also has an already profitable small specialty chemicals piece (adhesives, for internal consumption, and textile chemicals for external sales).

Two industry-specific aspects are critical to appreciate in this situation:

- 1. Limited competition in ‘value added’ films** - About 80% of India’s overall production in these packaging films feeds local consumption, while the rest is exported globally, where Indian players have a meager low single-digit share. However, this new holding of ours is primarily within the less fragmented specialty films space (providers work closely with buyers on enhancing moisture retention, heat sealing, aroma barriers etc), and >40% of the business comes from exports¹². Unsurprisingly, profitability is higher, and critically, Chinese competition is absent in value-added films. To be clear, the only Chinese competition is in the standard version of films exported by a handful of Indian players. In fact, even for those film manufacturers, there is no Chinese competition when selling in India – 10% import duty + freight + no advantage in sourcing materials (the thermoplastic polymer purchased for making these films is purchased on import-parity basis in both China and India), ensures that Chinese players stay away from the domestic market.
- 2. Absolute profitability is higher in ‘value added’ films** – As we write this investor letter, selling price for ‘value added’ films is somewhere close to INR 250/kg, +INR 100 vs. the standard version of these films. Pricing for both is a function of polypropylene prices and they adjust on a fortnightly basis. However, absolute margins on the ‘value added’ side of these films are higher (INR 60 vs. INR 20-25 for standard films), and more importantly, stickier. CPG clients are more accommodative of absolute margins in these films because they are co-invested in development of lot of these films.

By our estimate, between F2Q22 (Sept) and end of F2023E, little over 325K MT of this film capacity is scheduled to come online globally (mostly in India), adding ~4% to global supply, but expanding domestic supply by more than 30%. We therefore conservatively expect domestic margins on standard films to marginally come off in the near-term, but margin on value-added films should hold well.

In F2022E (Mar), ~3/4th of revenues¹³ will come from value-added films vs. ~1/3rd barely 4-5 years ago. This contribution is likely to be around 90% in the coming fiscal. Our conservative estimate for F2023E (Mar) EBITDA is built on an incremental growth of INR 1.1-1.2 Bil (includes additional INR 800-900 mil from a new specialty BOPET line and another 100 mil from the specialty chemicals piece) and will likely drive close to 30% earnings growth. Excluding a solid case for multiple re-rating, we still expect to capture at least 40% upside on this holding over the next 2 years.

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

Thanks,

Piyush Sharma

¹² Exports to US (their largest export destination) account for 6% of revenues

¹³ From ~140K tons of film sales, and limited contribution from the fledgling specialty chemicals piece



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	92%	23%	30%	39%	63%	25%	15%
Trailing 10 yr CAGR	21%	14%	15%	17%	18%	11%	12%
Since inception CAGR	18.2%	10.6%	11.3%	12.3%	11.9%	8.1%	8.3%
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	21.6%	17.2%	17.6%	20.5%	23.8%	13.0%	16.6%
Sharpe Ratio	0.75	0.50	0.53	0.53	0.47	0.44	0.43

Source: BSE, NSE, EurekaHedge, Bloomberg

Note: Returns are until the end of December 2021; 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	57%	
Avg. weighted market cap of book (mil)	\$608	>> Median holding's market cap is \$468 mil
Avg. weighted institutional ownership	12%	>> Median institutional ownership of current holdings is 11%
Avg. weighted free float of book	41%	
Net Exposure	86%	
Avg. weighted F2022E (Mar) EV/EBITDA	13.4x	>> vs. 28.2x (Nifty Smallcap 50), and 21.5x (Nifty 50)
# of positions	15	

Note: Characteristics are as at the end of December 2021



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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