EAS
Invest
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“The investor’s chief problem and even his worst enemy is likely to be himself.” - Benjamin Graham

Dear Investor,

At the outset, we would like to wish you and your family a very happy Diwali.

In this edition of our newsletter, we would like to focus on one aspect of investing that tests the patience of investors oftentimes during investing.

Even though there are several stocks in the portfolio that do well, the attention more often than not is focussed on the stocks that have not done well during a period. It is our duty as a portfolio manager to explain what we think about such stocks in our portfolio that have “underperformed” during the last year.

Before that, a word about the approach we follow in portfolio construction:

A stock would rise in price if there were a general expectation in the market, about an improved performance of the underlying company in the future. Therefore, it is our opinion that it makes economic sense for us to buy into the stock when the level of expectations around it is not too high to begin with, because that is when we get the stock at a not-too exorbitant price.

However, when we do this, we have to wait patiently until the perception around it changes for the better. There is no rule that says that a stock should rise the day after we buy it.

There are two aspects of the company that give us comfort during such times:
(a) The strength and competitive ability of the company concerned, and
(b) The valuation of the stock (the more expensive it is, the riskier it becomes)

In this newsletter, we wish to discuss three stocks in the portfolio that have underperformed the market indices over the past year or compared to other stocks in the portfolio. These are:
(a) HDFC Bank
(b) Asian Paints, and
(c) Indraprastha Gas.

HDFC Bank

This stock now occupies the largest position in our portfolio.

First, let us take a look at the reasons why this stock has been depressed of late, and compare this perception with the reality of recent financial performance of the company:

Reasons for HDFC Bank’s underperformance (as we have understood it)

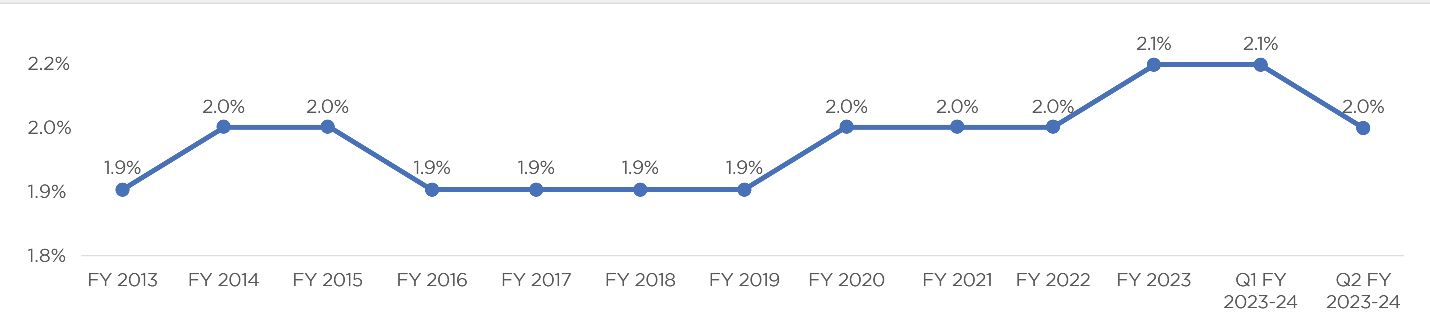
(a) Uncertainties about the merger with HDFC Ltd.

(b) Fears about increasing Non-performing Assets (NPAs).

Let us look at the some of the performance indicators of HDFC Bank:

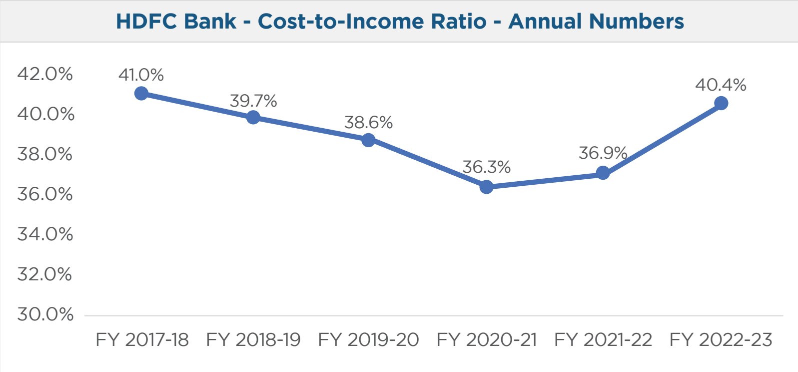
Profitability

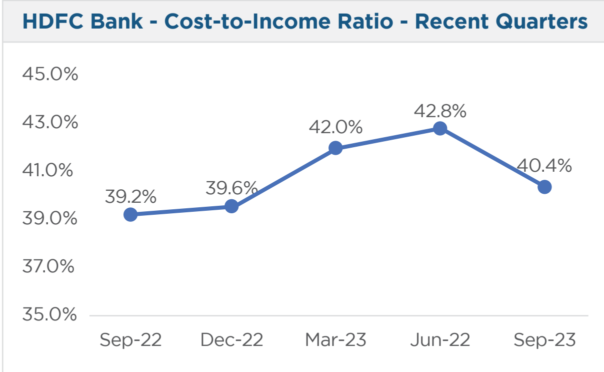
HDFC Bank - long-term and short-term Return on Assets %



Source: Company presentation.

Cost-to-Income ratio

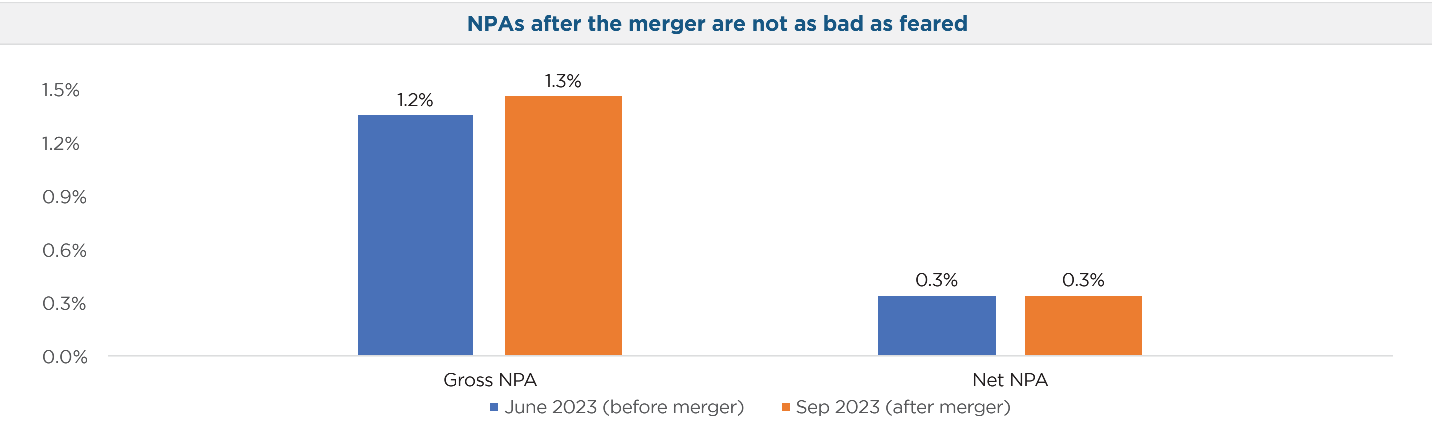




Source: Company presentation.

It is clear from the above charts that neither the Bank's Return on Assets (RoA), nor the Cost-to-Income ratios have been affected because of the merger. If anything, both these ratios are better than what they used to be in 2017 and 2018, when the Bank was one of the most favoured stocks in the country. It is pertinent to note here that the average RoA for all private sector banks in the country in 2022 was 1.45%, and the average for all Scheduled Commercial Banks in the country in 2022 was 0.91% (Source: CEIC data).

Fear about increasing NPAs after the merger.

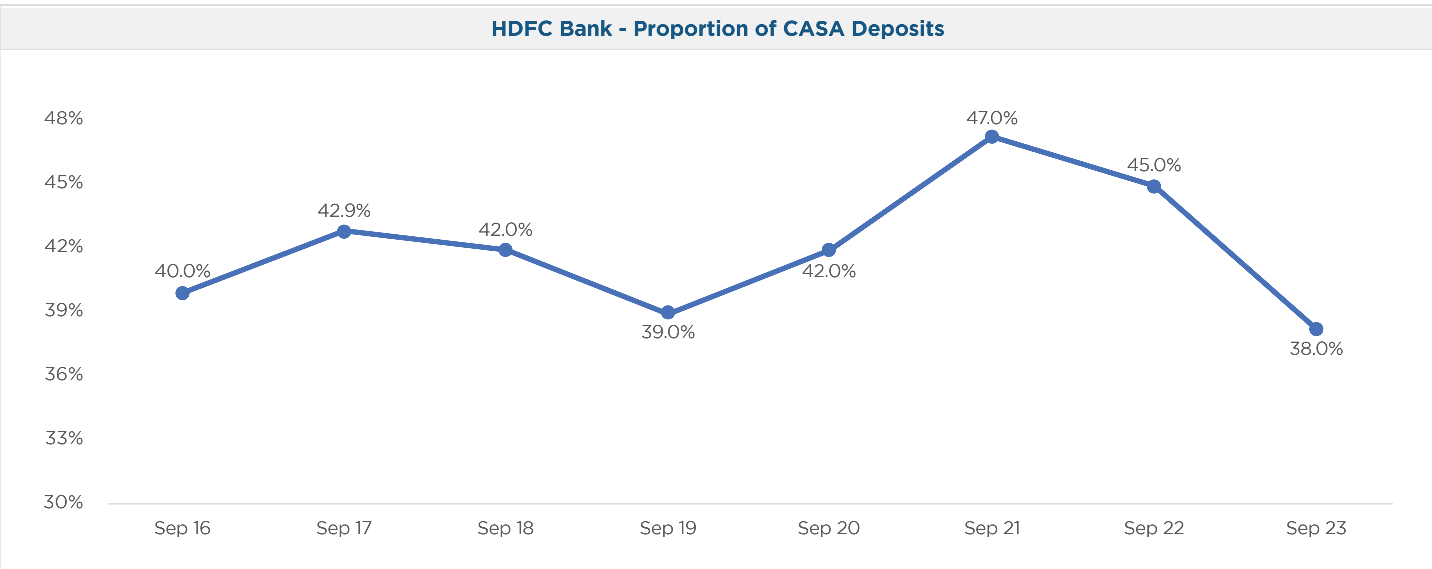


Source: Company presentation.

The proportion of net non-performing Assets (NNPAs) at 0.3% puts to rest the fear about ballooning NPAs after the merger with HDFC Ltd.

CASA deposits

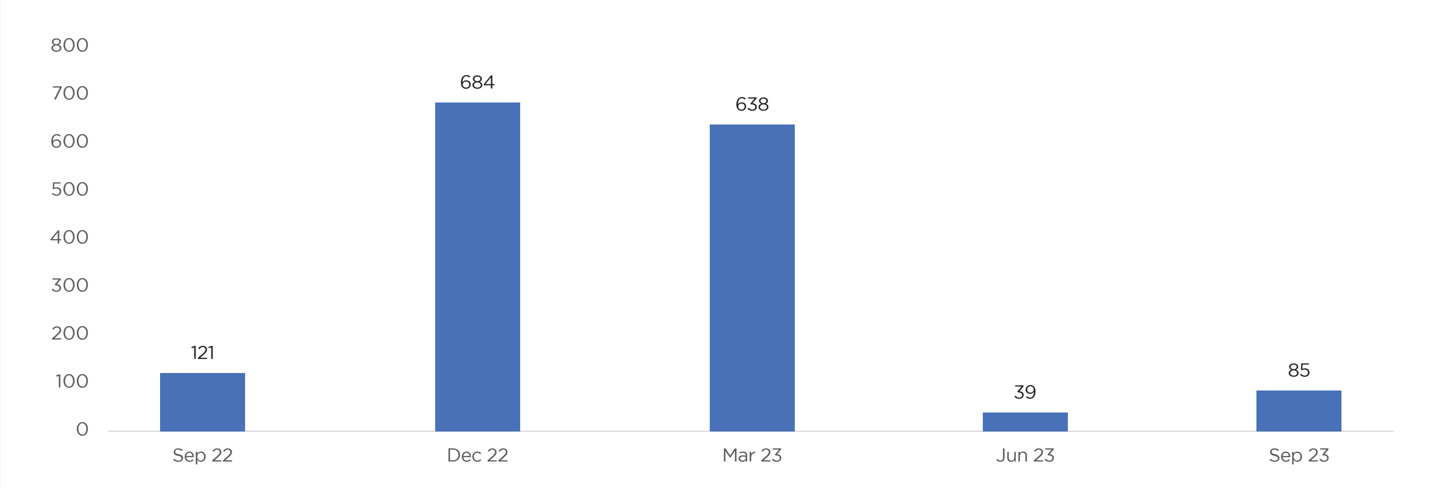
The proportion of Current Account and Savings Account (CASA) deposits in a bank give an indication of the ability of the bank to raise lower-cost funds. HDFC Bank's track record on this parameter has been exemplary over the last two decades. There was an apprehension that they would lose this advantage after the merger.



Source: Company presentation.

As can be seen from the chart above, the proportion of CASA deposits **has** come down slightly after the merger (from an 8-year average of 41.9% to 38.0%). We are seeing a situation where Term deposits are available at quite attractive interest rates, and there are some competing banks that offer higher interest rates on savings deposits. This has put a temporary pressure on CASA deposits for HDFC bank, but we are encouraged to see a 20.8% growth in total deposits for the fiscal year 2022-23. (Source: Company presentation). We think that the Bank's plans of branch expansion, especially in Tier 2 and 3 towns, would improve this position in the years going forward.

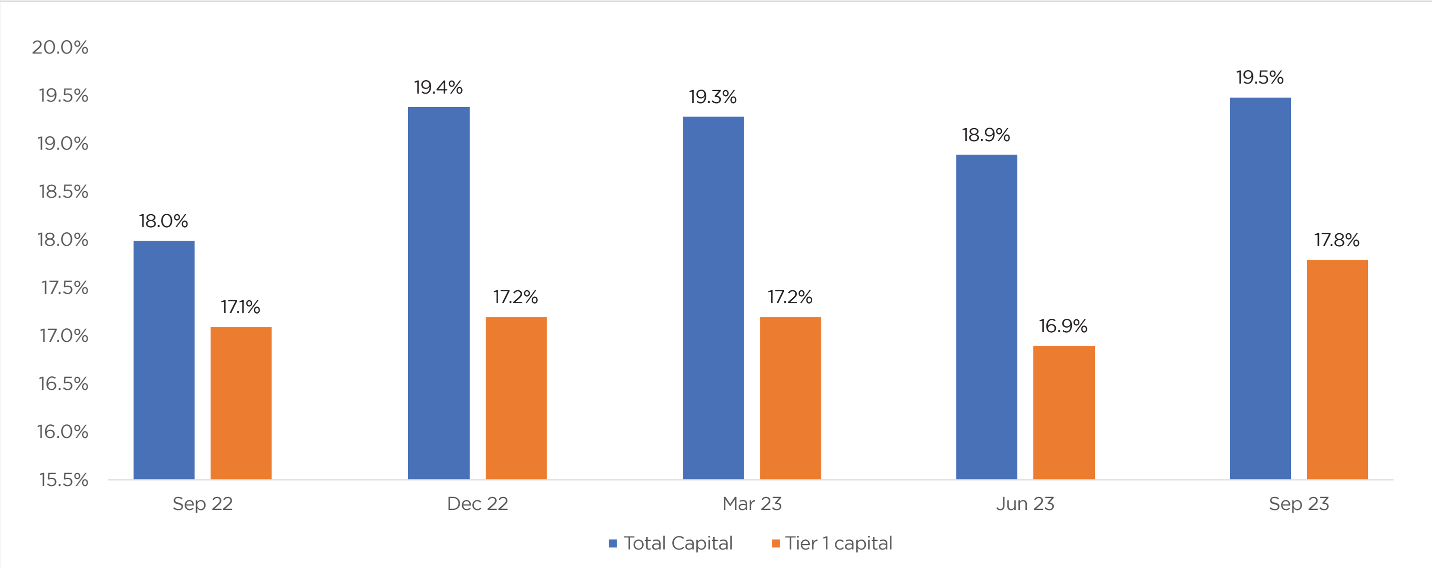
HDFC Bank - Quarterly Addition of Branches



Source: Company presentation.

Capital Adequacy:

HDFC Bank - Capital Adequacy

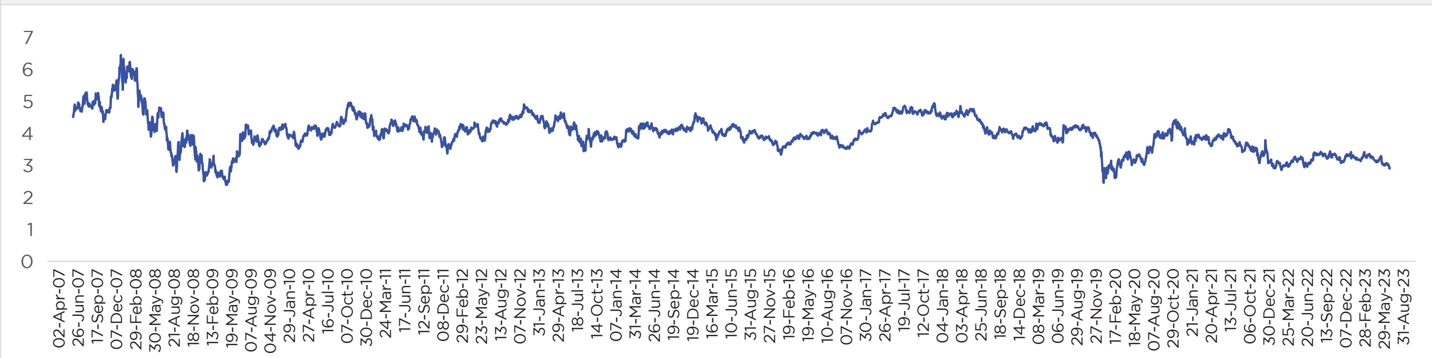


Source: Company presentation.

It is clear that the Bank is adequately capitalized. It is higher than the estimated industry average of 17% as of March 2023 (Source: CEIC data).

Given these fundamental factors, it is relevant to compare these with the valuation level of HDFC Bank in recent times:

HDFC Bank - Historical Price/BV Chart



Source: ACE Equity

It is interesting to note that in the past 16 years, the stock has traded at the valuations at which it is currently trading only during the 2008-09 Global Financial Crisis, and during the pandemic-induced panic period in April-May 2020.

We are of the opinion that the despondency displayed about the prospects of HDFC Bank's stock is disproportionately larger than what is warranted. We are talking about one of the largest banks in the country, and one that has not shown any significant signs of weakness.

We acknowledge that the perceived difference in quality between HDFC Bank and some other competitors has narrowed in recent years. But we do estimate that the Net Interest Margins for HDFC Bank has scope for improvement from the present 3.6% given its plans in the SME and agricultural lending segments, and its aggressive branch expansion in Tier 2 and 3 towns points to an improvement in loan and deposit growth in the next 2-3 years.

History of HDFC Bank's stock over the past 20 years

In the past 20 years (Oct 2003 to Oct 2023), HDFC Bank's stock price has appreciated by 21.20% per annum, compared to 13.4% per annum return of the Nifty 50 Index. In the last 5 years, HDFC Bank's stock has returned 9.14% per annum compared to 12.65% per annum return of the Nifty 50. (Source: NSE).

There have been periods in the last 20 years when HDFC Bank's stock has stagnated.
Between Dec 2000 and Dec 2002, the stock returned -0.8% per annum.
Between Dec 2006 and Dec 2008, the stock returned -1.4% per annum.
Between Dec 2012 and Dec 2013, the stock returned -2.4% in that period.
Between Dec 2019 and Jun 2022, the stock returned 2.2% per annum.
Between Apr 2021 and Oct 2023, the stock returned 0.2% per annum.

Source: ACE Equity

Conclusion

We see no evidence of any deterioration in the competitive position of the bank. We are of the opinion that the bank has enough systems and processes in place, and that it is not dependent upon any single individual for its success.

Asian Paints Ltd

Asian Paints is a 78-year-old company and has a sterling track record of efficiency and profitability.

The stock has been depressed in the last year or so primarily because of fears that the entry of newer competitors in the paints business would weaken the competitive position of the company.

Let us first begin by looking at the ten-year financial track record of the company:

Asian Paints Ltd - Financial Highlights - Consolidated - [INR-Crores]

DESCRIPTION	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Inc / Exp Performance										
Total Income	12,849	14,353	14,485	15,431	17,175	19,583	20,568	22,016	29,481	34,875
PBIDT	2,138	2,413	2,991	3,256	3,495	3,997	4,463	5,159	5,184	6,646
PAT	1,263	1,427	1,769	1,990	2,052	2,167	2,723	3,178	3,085	4,195
Cash Profit	1,508	1,693	2,045	2,325	2,412	2,789	3,504	3,969	3,901	5,053
Free Cash flow	1,099	792	1,426	1,042	907	1,212	2,761	3,474	555	2,836
Debt to Equity (x)	0.06	0.09	0.05	0.07	0.06	0.07	0.04	0.03	0.06	0.06
ROCE (%)	47.17	44.85	44.35	39.58	36.65	35.44	35.78	36.95	30.88	36.98
RONW (%)	34.02	32.51	31.41	28.18	25.62	24.24	27.79	27.71	23.19	28.19
PBIDTM (%)	14.52	14.59	16.75	17.06	17.49	18.04	19.11	20.27	15.08	16.18
PATM (%)	8.58	8.63	9.91	10.43	10.27	9.78	11.66	12.49	8.97	10.21
CPM (%)	10.25	10.24	11.45	12.18	12.07	12.59	15.00	15.60	11.35	12.30
Adjusted EPS	12.71	14.54	18.19	20.22	21.26	22.48	28.20	32.73	31.59	42.81
Asset Turnover (x)	1.98	1.95	1.83	1.66	1.53	1.48	1.44	1.39	1.59	1.69
Inventory Turnover (x)	7.55	7.64	8.39	8.25	7.56	7.63	7.14	7.08	6.91	6.65
Debtors Turnover (x)	14.08	14.43	15.07	14.49	12.58	12.18	12.62	11.57	10.62	9.66
Fixed Asset Turnover (x)	4.07	4.18	4.55	4.95	4.58	3.49	2.88	3.05	4.05	4.50

Source: ACE Equity

As is evident from the table above, the company has performed well on almost all parameters, be it revenue growth, profitability or working capital management. It has generated free cash flow consistently in all ten years under review. It has a consistently high Return on Capital (RoCE).

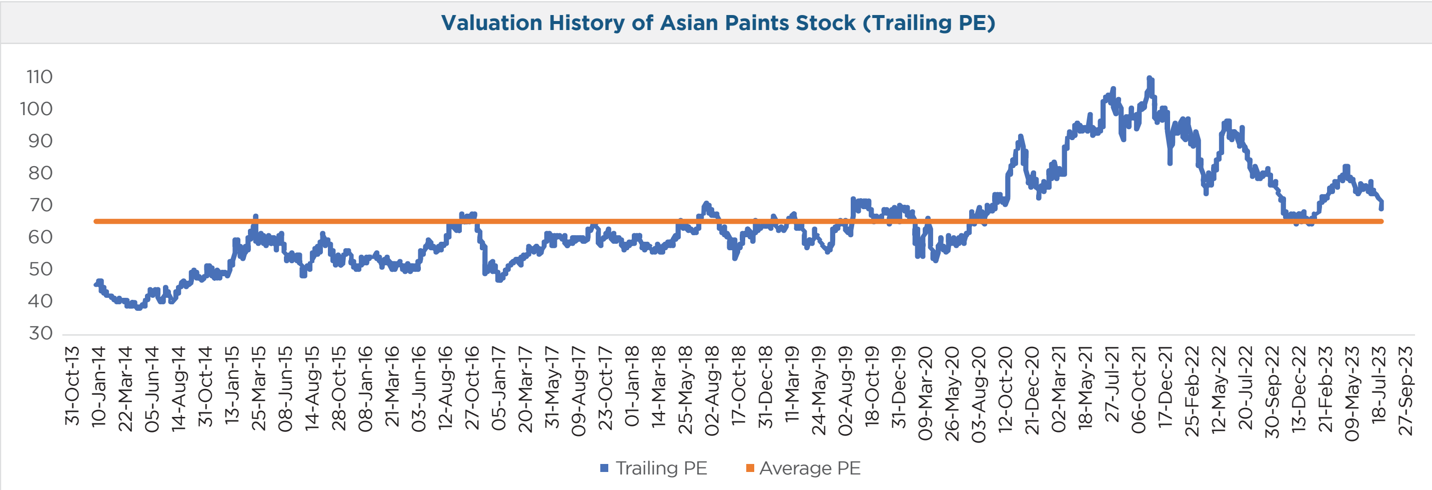
Asian Paints in comparison to two other major paint companies:

COMPANY	(Average of the last 5 years)								Last 5 years Cumulative FCF (Rs. Crores)	Trailing 12-month PE multiple
	EBIT margin (%)	PAT margin (%)	RoCE (%)	Debt/ Equity	Receivable days	Inventory days	Revenue growth (%)	PAT growth (%)		
Asian Paints Ltd	14.96%	10.62%	35.21%	5.00%	32.52	51.65	15.22%	15.38%	10,837.65	55.69
Kansai Nerolac Paints Ltd	10.21%	7.14%	16.82%	4.00%	49.86	67.65	9.86%	-1.83%	691.48	31.45
Berger Paints Ltd	12.04%	8.19%	28.49%	17.00%	36.99	66.55	15.30%	13.30%	1,084.92	67.20

Source: ACE Equity & NSE

We have taken the average of the last 5 years to even out any impact of cyclical factors. On almost all parameters of profitability, Debt/equity, working capital management, growth in revenues and profits, and generation of free cash flow, Asian Paints has done well.

The valuation of the stock, we believe, has to be seen in relation to its historical average valuation. We have a policy of staying away from a stock as "expensive" if the valuation of the stock at the time of proposed purchase is more than 1 standard deviation higher than its historical average of at least a decade. In this sense, Asian Paints qualifies as a candidate for purchase.

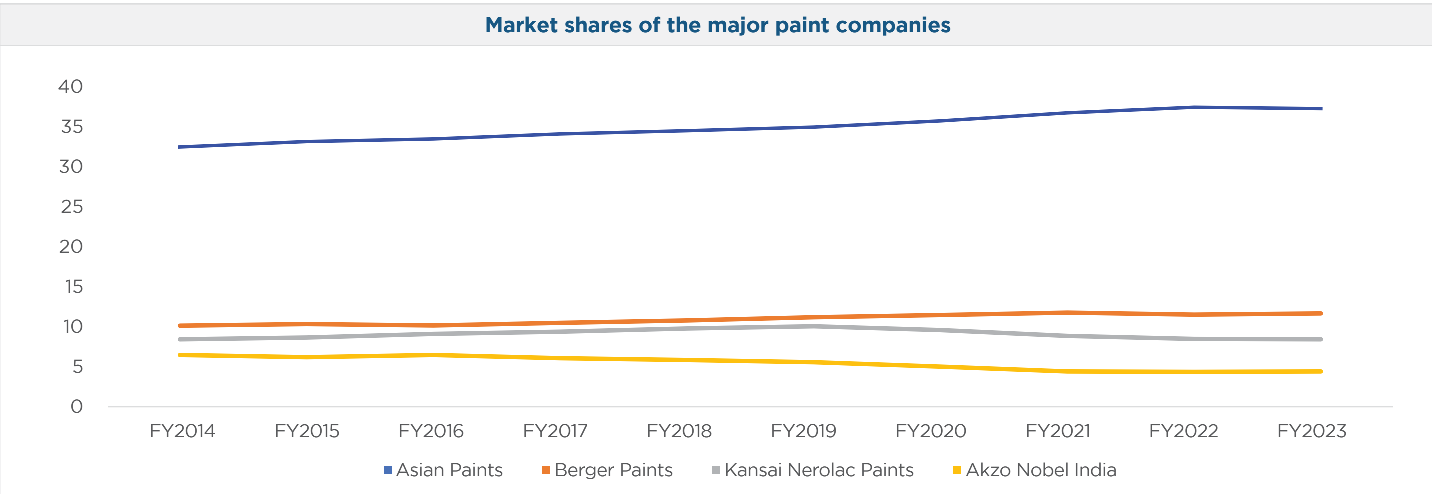


Source: ACE Equity

The stock is presently quoting at a valuation slightly higher than its historical average, and well below the 1 standard deviation mark that is our limit. Given the fact that the fundamentals, or the competitive position of the company have not deteriorated, we are comfortable with this valuation of Asian Paints.

Some findings from our internal research:

The paints industry has about 30% participation from the "unorganized" sector and 70% from the organized players. Within the organized sector, Asian Paints has approximately 50% market share, and about 36% overall market share.



Source: ACE Equity and internal research.

It is pertinent to remember that during these past ten years, there have been new entrants in the paints industry, and Asian Paints has maintained its market share. The entry of a new strong player, while certainly would increase the competitive intensity, is unlikely, in our opinion, to upset Asian Paints' apple cart. It is likely to tilt the market share more in favour of the organized sector as against the unorganized sector, which presently has about 30%.

In terms of dealer network, Asian Paints is the market leader with 160000 dealers, well above the second largest player (Berger) with about 80000 dealers. Kansai Nerolac and Akzo Nobel are at about 50000 dealers each. What is encouraging is that the net addition of new dealers per annum is the highest in case of Asian Paints with about 10000 dealers added each year, compared to about 2000-5000 for other major players. The company is now expanding in Tier 2 and 3 towns, sensing the next phase of growth from these areas.

In addition, what is reassuring is that Asian Paints has the widest product range, and the highest realization per litre of paint sold in the industry.

We are therefore of the opinion that the entry of newer players in the paints industry would affect the unorganized sector more than it would affect a strong leader like Asian Paints.

Indraprastha Gas Ltd

The third company which we wish to discuss with you is Indraprastha Gas Limited (IGL).

Recently, the stock price of IGL corrected sharply after a recent proposal from the Delhi Government regarding Electric Vehicles. The Delhi Government recently proposed the Delhi Motor Vehicle Aggregator and Delivery Service Provider Scheme 2023. It will become law after it is approved by the Lt. General of Delhi. The salient features of the policy are:

a. The policy is applicable to vehicle fleet aggregators who operate a fleet of 25 vehicles or more.
b. It is envisaged by the policy that over the next five years after implementation of the policy, all Delivery Service Providers would convert their fleet to electric vehicles.
c. There is no clarity about how the subsidy for purchase of Electric Vehicles (for those who wish to convert from petrol or CNG vehicles) would be funded.
d. There is a mention in the policy that the Delhi Authorities can impose a penalty (after 1st April 2030) on vehicles that are not Electric Vehicles.

We have the following doubts about this policy:

a. If a CNG or petrol vehicle (even if it is part of an aggregator's fleet) is compliant with the prevalent Bharat VI emission norms (or any other norm relevant at that time), on what basis would the penalty be imposed?
b. What proportion of vehicles would come under the purview of this policy? As we understand, this policy is applicable for vehicle aggregators and their fleets that are more than 25 vehicles.

There was a conference call recently in which the management of IGL shed some light on some of these points:

1. Delhi contributes about 60% of the total CNG sales of IGL, but for our calculations for the risk analysis of IGL, let us assume that Delhi contributes 60% of the overall sales of IGL.
2. It is the company's estimate that about 15% of the total volumes in Delhi would be taken up by vehicle aggregators and fleet operators.

Therefore, even assuming that all vehicle aggregators and fleet operators have more than 25 vehicles (a highly unlikely scenario), we are talking of a situation where 9% of the CNG sales of IGL is likely to face a problem after 2025, provided the EV policy of the Delhi Government is fully implemented.

The stock recently corrected more than 20%. We think it is a classic case of a kneejerk panic reaction.

The other Geographic Areas where IGL operates are showing far higher growth compared to Delhi (naturally, since Delhi is a more established market). The company told in the conference call that Ghaziabad and Gautam Budh Nagar are growing at 11-12%, newer geographic areas are growing as much as 50-60% (of course, from a low base).

The company started with Delhi, but as of March 2023, operates in 31 geographic areas. It is reasonable to expect that incremental growth in the coming years would be more from other geographic areas, compared to Delhi, which is a mature market for IGL.

IGL's track record has been extremely steady over the years:

Indraprastha Gas Ltd - Financial Highlights (in Rupees crores)										
DESCRIPTION	**Mar-14**	**Mar-15**	**Mar-16**	**Mar-17**	**Mar-18**	**Mar-19**	**Mar-20**	**Mar-21**	**Mar-22**	**Mar-23**
Inc / Exp Performance										
Total Income	3,935	3,712	3,710	3,861	4,626	5,893	6,628	5,056	7,887	14,349
PBIDT	809	829	803	1,015	1,214	1,396	1,675	1,609	2,069	2,259
PAT	360	434	458	606	722	842	1,249	1,173	1,502	1,640
Cash Profit	580	583	614	773	903	1,043	1,501	1,463	1,819	2,003
Free Cash flow	360	409	442	747	517	627	710	927	860	1,528
Debt to Equity(x)	0.20	0.07	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ROCE(%)	28.97	30.07	29.03	32.63	33.17	32.20	32.60	24.70	28.42	27.70
PBIDTM(%)	18.70	20.41	19.76	24.04	24.21	21.95	23.38	29.58	24.39	14.48
PATM(%)	8.33	10.69	11.27	14.36	14.39	13.24	17.43	21.56	17.71	10.51
CPM(%)	13.41	14.35	15.11	18.32	18.01	16.40	20.95	26.90	21.44	12.84
Adjusted EPS	5.15	6.40	6.54	8.66	10.31	12.03	17.84	16.75	21.46	23.42

Source: ACE Equity

Here we have a company, with a sterling track record of profitability and steady growth, maintenance of market share, working capital efficiency, operating fully within its circle of competence, and subjected to a panic because someone in the market has overestimated the impact of a governmental action that is going to be implemented in full only five years after the policy is implemented, and within the next five years, the dependence of IGL upon CNG sales in Delhi would most likely be lower than what it is now.

Dear Investor, we would like to reassure you that in case of all these three companies listed in this newsletter, we have re-examined the original reasons why they were bought, and are satisfied that there is no cause for revising our investment hypothesis.

Once again, we wish you and your family a very happy Diwali.

With warm regards,

Yours sincerely,

(E A Sundaram)
Chief Investment Officer and Portfolio Manager.

> ***"The trick is not to learn to trust your gut feelings, but rather to discipline yourself to ignore them. Stand by your stocks as long as the fundamental story of the company hasn't changed."***
>
> ***- Peter Lynch***

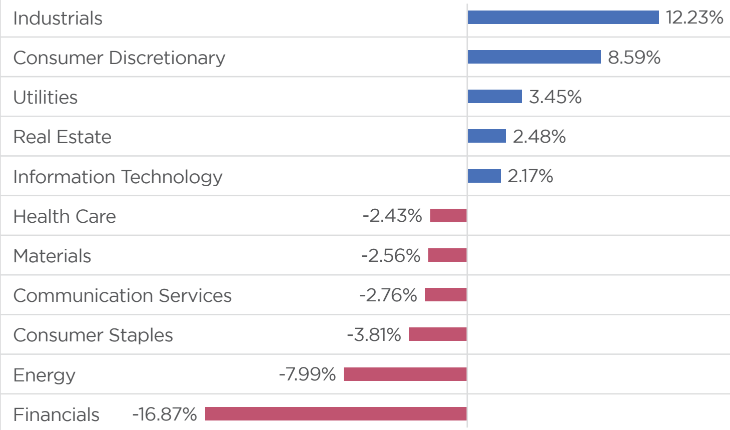
Investment Objective:

The investment objective is to achieve capital appreciation through investment in a diversified portfolio of high-quality companies, purchased at reasonable valuation.

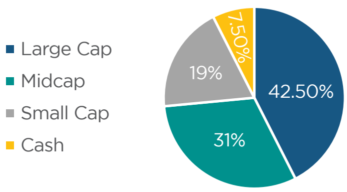
o3 Core Value Investment Approach

Name	GICS Sector	Weight
HDFC Bank Ltd	Financials	6.78%
ITC Ltd	Consumer Staples	5.18%
Infosys Ltd	Information Technology	4.40%
Maruti Suzuki India Ltd	Consumer Discretionary	4.04%
Titan Company Ltd	Consumer Discretionary	3.77%
Bosch Ltd	Consumer Discretionary	3.59%
Divis Laboratories Ltd	Health Care	3.58%
Oracle Financial Services Software Ltd	Information Technology	3.49%
Indraprastha Gas Ltd	Utilities	3.46%
Crisil Ltd	Financials	3.36%
		41.65%

Overweight/Underweight of Model Portfolio Compared to Benchmark



Performance Description	Regular	Concentrated	BSE 500 TRI
Largest Monthly Gain	12.51	11.41	14.63
Largest Monthly Loss	-20.53	-19.19	-23.85
Beta of Portfolio	0.76	0.73	
Standard Deviation (Annualised)	15.5	15.17	
Correlation	0.93	0.91	



Regular Model Portfolio Composition

Weighted Average ROCE	23.37%
Portfolio PE (1 year forward PE, based on FY25)	24.68
Portfolio Dividend Yield	1.61%
Average Age of companies	52 Years
Overlap with BSE 500 TRI	23.52%
Total Debt/Equity	0.26
Debt/Equity (Excluding Financial Stocks)	0.14
Sales Growth	21.66%
EPS Growth (FY25 over FY23)	15.50%

Consolidated Portfolio Performance of o3 Core Value Investment Approach Regular Option 31st October 2023

Consolidated Portfolio Performance of o3 Core Value Investment Approach Concentrated Option 31st October 2023

- *Benchmark is BSE 500 TRI, the portfolio is spread across different market capitalization, hence BSE 500 TRI is chosen as benchmark.*
- *Since inception date stated is considered to be the date on which the first active client investment was made under the investment approach.*
- *All the above data are as of 31st October 2023. ROCE/ROE are average of last 5 years.*
- *Source: Internal, BSE, Bloomberg & Ace Equity.*

Disclaimer: Performance depicted is based on all the client portfolios existing as on such date, using Time Weighted Rate of Return (TWRR) of each client for the overall investment approach. Past performance is no guarantee of future returns. The above portfolio performance is after charging expenses. The above performance related information provided here is not verified by SEBI nor has SEBI certified the accuracy or adequacy of the contents of this Document. Beta, Standard Deviation & Correlation are from Since Inception period.