

o3 Special Situations Portfolio Newsletter – January 2024

Dear Investor,

Happy New Year, may the new year bring peace and joy in the world across us. In this newsletter we want to delve deeper into our approach to investing and the Special Situations Portfolio.

The strategy is to invest in mid and small cap companies with improving growth prospects resulting in a visible change in operating parameters but not yet fully reflected in the company's P&L, cash flows and balance sheet. The improvement in the growth prospects is expected to result in sizable improvement in P&L, increase in cash flows and scale of the business. The final result of this should be significant increase in the enterprise value of the companies we own in the portfolio.

The challenges for us as an investor are that with higher chances of growth, there are also higher chances of some expectations not being met. The stock prices of small cap companies have higher volatility and getting incremental financing in a tough business environment can be a challenge. Hence it is important to consider the credit rating, leverage on the balance sheet, historical cash flows in various environments, management focus and the stability of the business model while making an investment decision. The business environment will always keep evolving; hence it is important that we are confident of the companies we hold in our portfolios and that they can withstand difficult business scenarios.

In this endeavour, the areas of focus for us and continuous learning are:

- 1. Understanding the business:** The points which we are trying to understand are what is the nature of competition in the industry, challenges the industry has faced and future headwinds, does the company differentiates itself in the market place through its brand, product offerings, service standards, geographical footprint or cost of production etc., what can drive growth for the company, are the prospects of growth improving and for what reasons, how large can be the impact of change in business on profits, balance sheet and cash flows, is the culture of the organization entrepreneurial but still of prudent risk taking, is it a learning organization or keeps on doing same mistake often etc.
- 2. Develop an understanding of the managements thought process:** The focus for us here is on what are the choices the management has made in past and why were those particular choices made, is the management or promoters in the business for the long haul, what drives or motivates the management every day, what are their aspirations for the company, how good have they been in executing what they have planned for in the past. We are looking for turnaround situations and some of the problems in the company may be because of historical mistakes. So we want a management which takes steps so that such issues don't happen in future.

The benefit of doing this is that when the tough times come we don't lose our sanguinity and are able to buy more when the stock may become very cheap.
- 3. Valuations:** Our focus is not to overpay for any security. Historically we have observed that buying at very high valuations even a very good company has led to suboptimal returns for a number of years. It can result in poor returns for the portfolio.
- 4. Having a longer time preference for our investments:** We want to hold a business for long term. The benefits of having long term horizon are it makes us far more vigilant about what goes into the portfolio as it is going to be there for a very long period of time. Secondly, it makes us focus on questions which are relevant for the longer term future of the company and not on the near term prospects.
- 5. Patience:** Few times when we have invested in a business things have not gone as smoothly as we had thought of; resulting in our patience getting tested. Preparing well before making an investment in a company has helped us in being patient in tough times.
- 6. Weight in a particular stock at the time of investing:** We do run a concentrated portfolio of 15 to 20 stocks. The weight in a particular stock depends on our understanding of the business, management and valuations of the company. Our preferred way of building a position is to start with 2 to 3%. The advantage of starting with low weightage is if the stock keeps on falling or the business keeps on doing better and the stock does not move we can add more.

Portfolio Update

The portfolio returns for the quarter were 10.57% for the quarter ending in December 2023. The best three stock performers for the quarter were: Sobha Ltd.(+39.69%), Orchid Pharma Ltd. (+33.98%) & Ashiana Housing Ltd. (30.57%). The worst three stock performers for the quarter were: Accelya Solutions India Ltd. (-13.19%), Menon Bearings Ltd. (-3.78%) & MAS Financial Services Ltd. (-3.69%). (Source: ACE Equity)

For existing clients, we have trimmed our position in Sanghvi Movers to 5% wherever it was more. For newer clients we have added three new names (Thermax, Vascon and DCB) to the portfolio in this quarter. As some of the stocks we are owning in our older portfolio are not at the level we are comfortable in buying for newer clients.

In certain market conditions where stocks move sharply, we need to keep on looking for newer opportunities. This is the reason why clients may not have identical portfolios.

Capital goods and construction industry: We have the following seven companies in this space:

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
Action Construction Equipment Ltd.	491.83	45.04	44.90	33.86	673.24	89.18	96.91	73.94
Apar Industries Ltd.	3215.80	225.88	140.91	102.63	3893.96	349.76	237.27	174.38
Kirloskar Brothers Ltd.	864.00	62.60	42.00	30.00	913.10	94.80	72.50	47.70
Savita Oil Technologies Ltd.	857.46	97.88	93.01	69.80	881.69	60.25	59.56	46.97
TD Power Systems Ltd.	212.63	25.73	26.73	19.90	273.73	47.20	44.61	32.77
Thermax Ltd.	2075.26	140.55	142.60	109.36	2302.46	204.62	217.72	158.85
Vascon Engineers Ltd.	217.34	11.05	7.27	7.19	217.10	10.49	5.22	4.67

Source: ACE Equity

Thermax and Vascon are the newer companies which we added instead of Action Construction, Apar Industries and TD Power for the newer clients.

Thermax is an industrial engineering company with majority of revenue from providing heating and cooling solutions to the various industries like refineries, metals, textiles, chemicals, cement, sugar distilleries, food, paper, captive power plants etc. Besides this it also provides chemical solutions and water treatment solutions. It has a diversified customer base across the industries and geographies, wide range of products & services offerings and run by a conservative management. Over the coming years the energy transition from fossil based fuels to other renewable sources of fuels will bring a lot more opportunities for it.

Vascon is a Pune based construction company active in multiple sectors including residential, industrial, IT parks, malls and multiplexes, hospitality and community welfare centre, schools and hospitals. It did go through a rough patch of time because of debt and slow moving projects. It has reduced its debt to the minimum and is back on the growth path.

Financials

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
JM Financial Ltd.	877.13	347.08	317.82	237.68	1213.96	404.78	277.93	205.54
MAS Financial Services Ltd.	240.89	80.57	68.26	51.20	312.89	106.27	82.51	61.94
DCB Bank	1099.21	182.55	151.55	112.35	1412.95	210.52	170.84	126.79

Source: ACE Equity

We have added DCB Bank to the portfolios of new clients which is in lending to SME's and has focused on building a secured lending book. What we appreciate is the management focus on lending and serving the same customer segment (SME and self-employed) for last 15 years. Whatever challenges have come their way; they have taken it as an opportunity to fine tune their business practices. In many financial institutions we see that if there is a problem in one segment they stop lending to it completely and move on to some other segment. In such a scenario the learning will never happen and you start again from scratch.

The other points which we appreciate are:

- They are not blindly focused on growth which can result over a period of time in high credit costs. When times were tough (FY19 to FY21) they did grow slowly. (Source: ACE Equity)
- Nearly 10% of the employees are in collection and follow up with the customers. In SME the customers are not that disciplined and hence follow up is extremely important. (Source: Q1 FY 24 Concall)
- The book is granular with nearly 85% of the book below Rs.3 cr ticket size. (Source: Concall of DCB bank)
- Focus on retail liabilities and the share of top 20 depositors has come down from 15% in 2018 to 7% in FY23. (Source: Annual Reports of DCB Bank)

Finally, the valuations are also appealing. The stock had touched a high of Rs.244 in July 2019 and since then the book value has grown from Rs.93 at the end of FY19 to Rs.137 at the end of FY23 and the stock has fallen to Rs.132. (Source: ACE Equity)

Auto Ancillaries

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
Menon Bearings Ltd.	51.43	10.90	9.15	6.90	50.72	10.16	8.02	5.97
Suprajit Engineering Ltd.	716.06	78.67	68.82	45.75	708.87	69.80	49.21	34.76

Source: ACE Equity

We have two companies in auto ancillaries space and the results for both of them have been tepid because of global slowdown in certain product lines and has resulted in lower profitability despite flattish revenue for both of them.

Agrochemical

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
Dhanuka Agritech Ltd.	542.90	97.52	97.97	73.02	617.92	141.58	136.70	101.77
Sharda Cropchem Ltd.	721.50	65.06	14.54	12.08	580.76	21.19	-33.84	-27.58

Source: ACE Equity

We have two agrochemical companies in the portfolio. The results of Dhanuka were good and results for Sharda were quite disappointing. The prices of chemicals have kept on falling and which has benefitted Dhanuka but for Sharda it has been a challenge as customers are not taking the goods they had ordered at pre decided older prices resulting in inventory write downs for Sharda. We expect the situation to gradually improve in next few quarters. The fall in chemicals was anticipated and hence we bought the companies which should have benefitted from the fall but yes the fall has been sharper than anticipated and more prolonged. Also we had not thought of buyers turning away from the old contracts and leading to such a severe impact on the Sharda's profitability.

Real Estate

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
Ashiana Housing Ltd.	84.96	-4.81	-2.71	-1.81	344.15	33.33	35.38	27.35
Sobha Ltd.	670.05	94.81	34.35	19.15	741.24	75.45	24.67	14.95
Kolte-Patil Developers Ltd.	123.31	-5.58	-5.71	-6.39	198.15	-8.90	-14.73	-24.01

Source: ACE Equity

The matrix for real estate companies we look are collections, new sales, sales realizations, net debt and unsold inventory in projects under execution. For all the investment companies these parameters are on an improving trend and we expect the profitability should also improve in projects which will start coming for revenue recognition in next financial year.

Equipment Renting and Leasing Activity

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
The Great Eastern Shipping Company Ltd.	1447.45	748.12	776.85	768.83	1229.02	605.47	611.93	594.66
Sanghvi Movers Ltd.	109.24	57.08	37.57	28.89	139.98	86.10	49.97	37.20

Source: ACE Equity

The results for Sanghvi were very good. Results of Great Eastern shipping though are down YoY because of lower charter rates for product tankers and dry bulk carriers but our thesis has not changed of improving shipping and offshore markets for next few years. With disruptions at Panama Canal and Suez Canal it will mean that the shipping companies will need to take longer routes to move goods.

Travel and Tourism

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
Accelya Solutions India Ltd.	115.19	51.73	43.90	33.11	127.21	48.44	42.29	31.53
Sinclairs Hotels Ltd.	8.35	2.33	1.90	1.56	8.52	1.15	1.36	1.27
Taj GVK Hotels & Resorts Ltd.	89.05	30.93	48.38	32.09	89.42	21.62	15.94	11.13

Source: ACE Equity

The results of companies related to travel and tourism were subdued for the quarter; Accelya revenue growth was decent but the other expenses were high resulting in lower profitability, in case of Taj GVK last year there was one off other income and there was refurbishment at hotel Taj Krishna resulting in subdued results.

Miscellaneous

Company Name	Q2FY23				Q2 FY24			
	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax	Net Sales	Operating Profit (Excl OI)	PBT	Profit after tax
Navneet Education Ltd.	329.80	32.61	19.95	7.97	265.78	-4.30	47.61	31.53
Orchid Pharma Ltd.	165.25	17.82	-3.32	-3.32	198.76	23.31	20.02	20.02

Source: ACE Equity

The focused work of the new management at Orchid Pharma has started yielding results with improving profitability and the company winning new businesses. In case of Navneet the results were below expectations, increased prices of books impacted the demand for new books as there has been also no changes in the syllabus so preference for second hand books was there. We believe these are short term challenges and with changes in syllabus over next few years as New Education Policy gets impacted will benefit the company through increased demand for books.

Warm regards

Yours sincerely,

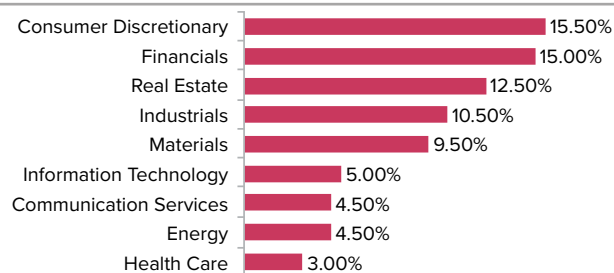
Himanshu Upadhyay

Vice President and Portfolio Manager

o3 Special Situations Portfolio

Name	GICS Sector	Weight
Sobha Ltd	Real Estate	6.14%
Great Eastern Shipping Co Ltd	Energy	5.56%
Ashiana Housing Ltd	Real Estate	5.54%
Apar Industries Ltd	Industrials	5.30%
J M Financial Ltd	Financials	5.18%
		27.72%

o3 SSP Model Portfolio GICS Sector Weights



Investment Objective

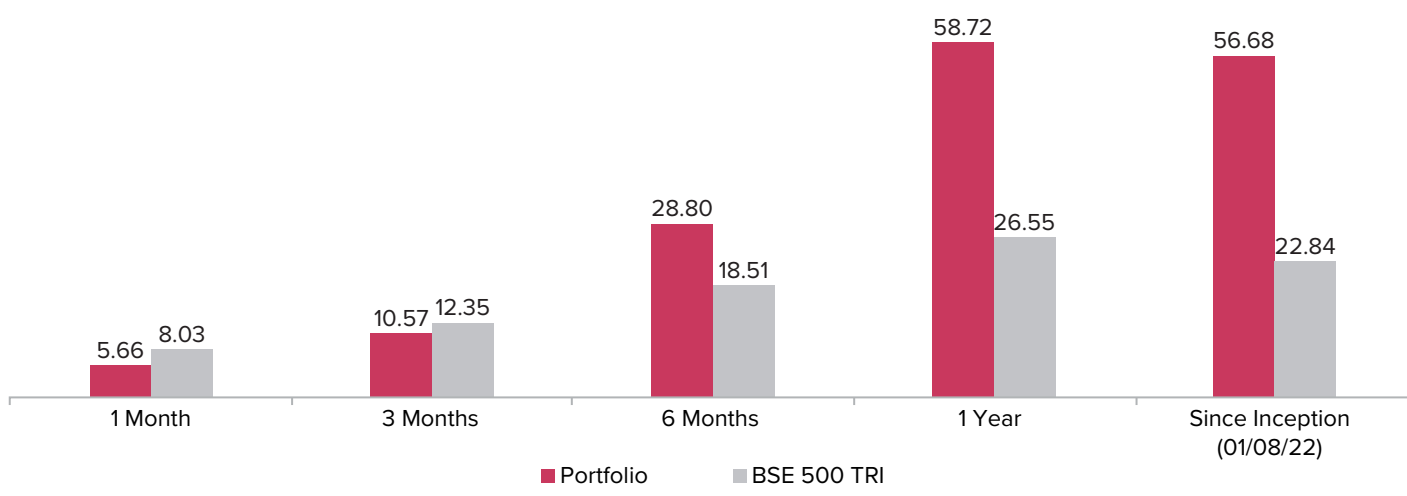
Investment Objective: The investment objective is to invest in a business with improving prospects resulting in a visible change in operating parameters but not yet fully reflected in the company's P&L and balance sheet.

Model Portfolio Details as on 31st December 2023		Model Portfolio Composition as on 31st December 2023	
EPS(E) CAGR (2023 to 2025)	15.13%	Large Cap	0.00%
Portfolio PE (1 year forward PE, based on FY25)	15.98	Midcap	3.50%
Average Age of Companies	41 Years	Small Cap	76.50%
Average Market Cap (INR Cr)	6,183	Cash	20.00%

- Large Cap: Market cap of the 100th company in the BSE 500 TRI (sorted by market cap in descending order)*
- Midcap: Market cap below 100th company to the market cap of the 250th company in the BSE 500 TRI (sorted by market cap in descending order)*
- Small Cap: Market cap lower than the 250th company in the BSE 500 TRI (sorted by market cap in descending order)*

*As on last working day of the month i.e. 29th December 2023.

Consolidated Portfolio Performance of o3 Special Situations Portfolio as on 31st December 2023



- Benchmark is BSE 500 TRI
- Since inception date stated is considered to be the date on which the first client investment was made under the investment approach

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.

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