

# o3 Special

## Situations Portfolio

Newsletter – October 2023



### Dear Investor,

In this newsletter we will focus on how do we define risks, evaluate risks in a company and what we want to avoid. In the previous newsletters we have tried to explain what is our process of searching investment ideas, our thoughts on holding period of a stock and when do we sell.

### What is risk?

The precondition to grow in any sphere of activity is surviving any catastrophe which may happen over a period of time. Hence the way we define risk is anything which creates fragility in the organization is a risk. At some place we also fear that because of certain fragilities in the organization we may get panicked in a very bad market when it is time to buy or we may not show the patience which may be required for the desired results to come in a company where we have invested. Benjamin Graham stated that **“the investor’s chief problem—and even his worst enemy—is likely to be himself”**. Hence controlling our own greed and fear at the extremes of the market is of vital importance. Anything which can make us irrational (greedy or fearful) in an investment is a risk in our opinion.

The risk which we are not comfortable to own are:

1. Companies having debt: equity more than 0.5 and credit rating below "BB". The risk is on the bad days the company may not be able to roll over the debt it has or is not able to raise incremental debt requirement in tough markets.
2. Companies which have a listed history of less than 10 years. During the process of research our focus area is to understand how the management has reacted over a long period of time in various situations. Historically what are the type of challenges the company has faced and what has been its impact on the company and its peers? How tough can be the really bad periods? How the company thinks about long term survival and what is it doing to not go in a distress in a bad business environment? Having a listed history of 10 years gives us a lot of data points to evaluate and think over. To a certain extent this also helps us behave rationally and sit patiently with an investment in bad times.
3. Companies where promoters have more than 50% of shares which are pledged. We take high % of shares pledged by the promoters as a distress on the promoter’s financial situation which can make promoters do something which is not in investors best interest. Even if that is not the case but it can make us panicky or impatient in the bad markets.
4. We don’t want companies with changing business models and are too diversified. When we are buying a business with an intention to sit for long term it is important that the company has a stable business model for us to make a right judgement. If the business model keeps on changing and the company is too diversified the risk is we make a wrong judgement of the business drivers, opportunity and risk in the company. Hence we want to avoid investing in such companies.

### Portfolio update

The portfolio returns for the quarter were 16.49% for the quarter ending in September 2023. The best three stock performers for the quarter were: Apar Industries Ltd. (+58%), Sanghvi Movers Ltd. (+42%) and Action Construction Equipment Ltd. (+40%). The worst three stock performers for the quarter were: Sharda Cropchem Ltd. (-24%), Suprajit Engineering Ltd. (-5%) and Taj GVK Hotels & Resorts Ltd. (0%).

In existing portfolios we have made one change and sold Triveni Turbines Ltd. There are two reasons for us to sell that company: - one the valuations were very demanding; in FY23 the EPS was Rs.6 and even if we assume that the EPS doubles over next three years; at the current stock

price of Rs.440, PE would be 36.66 for FY26. Secondly we will prefer to have 20 stocks in a client portfolio; in the portfolios where Triveni Turbine was present there were already 20 stocks and the stock position in Triveni was small in all of these accounts (<3%). Hence we chose to sell it.

We have investments in few themes and we will evaluate the set of companies in each theme at the end of last quarter.

**Travel and Tourism:** We have three companies in travel and tourism space Taj GVK, Sinclairs and Accelya Solutions. Two own hotels and the third one is in software product business (revenue accounting, revenue assurance, revenue management, sales and incentive management) for airline companies respectively. The results of Sinclairs hotels and Accelya have been good.

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
Accelya Solutions India Ltd.	103	42	25	122	49	32
Taj GVK Hotels & Resorts Ltd.	86	30	16	92	26	13
Sinclairs Hotels Ltd.	18	9	6	18	10	8

Source: ACE Equity

The results of Taj GVK were subdued because of renovations going on at one property in Hyderabad. It should get over by Q3 FY24. The company is seeing good traction from G20 summit and also expects good occupancy because of cricket world cup in Q3FY24.

The commercial terms with the owners of Taj Banjara hotels could not be finalized and hence the company will be handing over the property back to its owners. According to the management it won't have big impact on the financials.

India Ratings and Research (Ind-Ra) has upgraded TAJGVK Hotels and Resorts Limited's (TAJGVK) term loan to 'IND A' from 'IND A-'.  
 In case of Sinclair board of directors have approved the proposal for Buy-Back of up to 15,20,000 fully paidup equity shares of face value of Rs.2 each at a price of Rs.200 per equity share for an aggregate consideration of Rs.30.40 crore. The Buy Back will be done on a proportionate basis through the Tender offer route.

**Capital goods and ancillary industry:** We had 6 companies in this space: - Action Construction Equipment, Kirloskar Brothers Ltd., TD Power, Triveni Turbine (exited in the quarter), Apar Industries and Savita Oil Technologies.

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
Action Construction Equipment Ltd.	498	41	45	652	82	68
Apar Industries Ltd.	3083	237	122	3741	346	197
Kirloskar Brothers Ltd.	784	41	15	900	110	66
TD Power Systems Ltd.	205	28	21	220	39	27
Triveni Turbine Ltd.	259	49	38	376	71	61
Savita Oil Technologies Ltd.	893	132	91	912	69	56

Source: ACE Equity

In case of capital goods, the results have been good both in terms of revenue growth as well as improvement in the margins and the order book for everyone has grown which gives us good visibility of growth for next few quarters. Most of the stocks in this space have run up quite significantly; in case of new portfolios we have Kirloskar Brothers and Savita Oil Technologies currently. We will like to wait for better prices to buy for new clients or in some other company of good quality with good margin of safety in capital goods space.'

In case of Savita Oil EBITDA per KL/MT stood at Rs.6,724 for Q1 FY24 as compared to Rs.13,703 for Q1 FY23 and EBITDA per KL/MT at Rs.5,144 for Q4 FY23. Our base hypothesis at the time of purchase was the company is available for cheap valuations, margins were at the bottom and the underlying drivers of the business (industrial capex) were showing growth.

**Real estate:** We have three residential real estate companies in our portfolio, Sobha, Kolte Patil and Ashiana Housing. For all the three companies' area sold, collections, cash flows and per square feet realizations have continued to improve for last few quarters. We expect the improvement in the operating parameters should start reflecting into further improvement in the P&L and balance sheet for the companies we hold over subsequent quarters.

Operating parameters	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	Q4 FY23	Q1 FY24
<b>Ashiana</b>									
area booked ( lsq ft. )	1.51	4.51	4.2	4.53	3.34	4.9	9	8.59	6.53
area booked ( lsq ft. ) over last 12 months	15.67	17.89	18.52	14.75	16.58	16.97	21.77	25.83	29.02
value of area booked in crores	52	166	170	186	152	240	485	435.82	436
value of area booked in crores in last 12 months	560	650	688	574	674	748	1063	1312.82	1596.82
psf realizations in Rs.	3460	3678	4028	4093	4557	4904	5373	5075	6684
<b>Sobha</b>									
area booked ( lsq ft. )	8.96	13.49	13.23	13.42	13.59	13.37	14.77	14.78	13.94
area booked ( lsq ft. ) over last 12 months	42.59	47.16	49.05	49.10	53.73	53.61	55.15	56.50	56.86
value of area booked in crores	682.90	1,030.20	1,047.50	1,109.60	1,145.00	1,164.00	1,424.70	1,463.00	1,464.00
value of area booked in crores in last 12 months	3,332.40	3,672.70	3,832.60	3,870.20	4,332.30	4,466.10	4,843.30	5,196.70	5,515.70
psf realizations in Rs.	7,626	7,637	7,919	8,265	8,431	8,709	9,653	9,898	10,506
<b>Kolte Patil</b>									
area booked ( lsq ft. )	4	6.7	8.6	7.8	6.1	5.6	11.3	9.7	9.3
area booked ( lsq ft. ) over last 12 months	21.6	24.8	27.8	27.1	29.2	28.1	30.8	32.7	35.9
value of area booked in crores	248.6	429	561	501	444.7	367	716	704	701
value of area booked in crores in last 12 months	1284.2	1519.2	1748.6	1739.6	1935.7	1873.7	2028.7	2231.7	2488
psf realizations in Rs	6261	6370	6489	6418	7260	6622	6339	7225	7545

Source: Company presentations

In case of Sobha the margins have been low for last few quarters, management has attributed the weak real estate margins to projects that were sold pre-Covid at lower prices and whose construction is being completed at inflated costs. Same is the reason for lower margins in construction business and the margins are expected to improve by the end of Q4FY24.

In this quarter, our margins as you would have seen has reduced, largely due to higher costs in real estate for projects that are being delivered with pre-COVID pricing and post-COVID costs. This would improve as we start completing the projects that are sold post-COVID, most likely from end of this financial year and beginning of next financial year. By the time we would also complete some of the contractual projects which are of lower margin in nature. –Management commentary of Sobha Q1FY24 concall

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
Ashiana Housing Ltd.	80	15	10	121	8	11
Kolte-Patil Developers Ltd.	200	47	26	571	91	49
Sobha Ltd.	565	73	5	908	65	12

Source: ACE Equity

## Auto Ancillaries

We have two auto ancillary companies in the portfolio; Suprajit Engineering and Menon Bearing.

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
Menon Bearings Ltd.	62	13	9	55	12	7
Suprajit Engineering Ltd.	645	54	27	680	71	33

Source: ACE Equity

Menon results were weaker than last year. There has been slowdown in Japan and USA which has led to fall in exports for bimetal bearings. Also in case of tractors the slowdown is in domestic markets which impacted the results. The company is expecting incremental business from newer

customers and products for which it is expanding its manufacturing facilities of bearings and aluminium casting.

Both companies have high dependence on exports and both have spoken of slowdown in pockets of export markets.

**Equipment renting and Leasing business:** We have two companies in renting and leasing business. One is in the space of renting cranes (Sanghvi movers) and other is in the space of renting ships and offshore vessels (GESCO). The results of both companies were good.

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
Sanghvi Movers Ltd.	97	48	14	146	88	42
The Great Eastern Shipping Company Ltd.	1366	652	457	1284	790	576

Source: ACE Equity

On the reported basis GE Shipping has cash of Rs.2111 cr which translates to Rs.148 of cash per share and the Net Asset Value is Rs.1202 per share. The value of ships is approx. Rs.1050 per share (NAV- value of cash per share). Effectively at current market price of Rs.850 we are getting the fleet worth Rs.1050 at Rs.700. Historically the company always had debt on the balance sheet which would lead to faster erosion in Net Asset Value when the prices of ships would fall (Net Asset Value = Value of ships + cash - gross debt).

In case of Sanghvi movers the order book stands at Rs.450 crores as of 1st August 2023, which was Rs.320 cr last year at the same time. Till 31st July 2023, Company has completed Capex of Rs.242 Crores for purchase of 23 cranes & 30 multi-axle lines.

**NBFC's:** We have two NBFC's in lending space: MAS Financial and JM Financial.

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
MAS Financial Services Ltd.	205	160	46	292	227	58
JM Financial Ltd.	694	515	198	901	592	175

Source: ACE Equity

Mas Financial came out with good set of numbers, its consolidated AUM grew by ~26% YoY. Asset quality was also stable with GS3 at <1.5% and CRAR of ~25%.

In case of JM Financials there were more provisions done on the wholesale book as the book is getting seasoned resulting in subdued profitability despite good growth in sales and operating profit.

**Agrochemicals:** We have two companies in agrochemicals space Dhanuka Agritech and Sharda Cropchem.

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
Sharda Cropchem Ltd.	825	53	23	638	-69	-89
Dhanuka Agritech Ltd.	393	51	49	369	44	33

Source: ACE Equity

The results were weak for both the companies because of poor demand and fall in the price of chemicals leading to loss on inventory. The impact was much higher on Sharda Cropchem because of lower sales volume in Latin America and Europe leading to losses for the quarter.

## Miscellaneous

Company Name	Q1 FY23			Q1 FY24		
	Net Sales	Operating Profit (Excl OI)	Profit after tax	Net Sales	Operating Profit (Excl OI)	Profit after tax
Navneet Education Ltd.	694	195	134	791	209	138
Orchid Pharma Ltd.	131	12	-14	183	22	11

Source: ACE Equity

The numbers of Orchid Pharma have been improving over the last few quarters as the costs are moving at a slower pace than the revenue growth leading to better margins. In the first week of August, the company successfully commissioned a new sterile facility. This should help the company to deliver substantial growth in sterile sales in the upcoming quarters.

Navneet saw good growth of more than 20% in the revenue line in both stationery and publications business in domestic market, exports growth was subdued at 3%. The high price of paper led to lower margins for the quarter.

Warm regards

Yours sincerely,

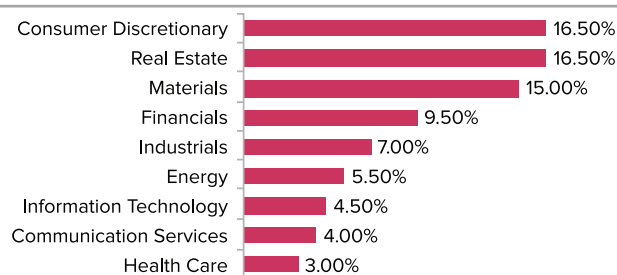
**Himanshu Upadhyay**

Vice President and Portfolio Manager

### Top 5 Holding of o3 SSP Portfolio - as on 30<sup>th</sup> Sep 2023

Name	GICS Sector	Weight
Apar Industries Ltd	Industrials	5.92%
Kolte-Patil Developers Ltd	Real Estate	5.49%
Sobha Ltd	Real Estate	5.30%
J M Financial Ltd	Financials	5.01%
Ashiana Housing Ltd	Real Estate	4.98%
		<b>26.70%</b>

### o3 SSP Model Portfolio GICS Sector Weights



## Investment Objective

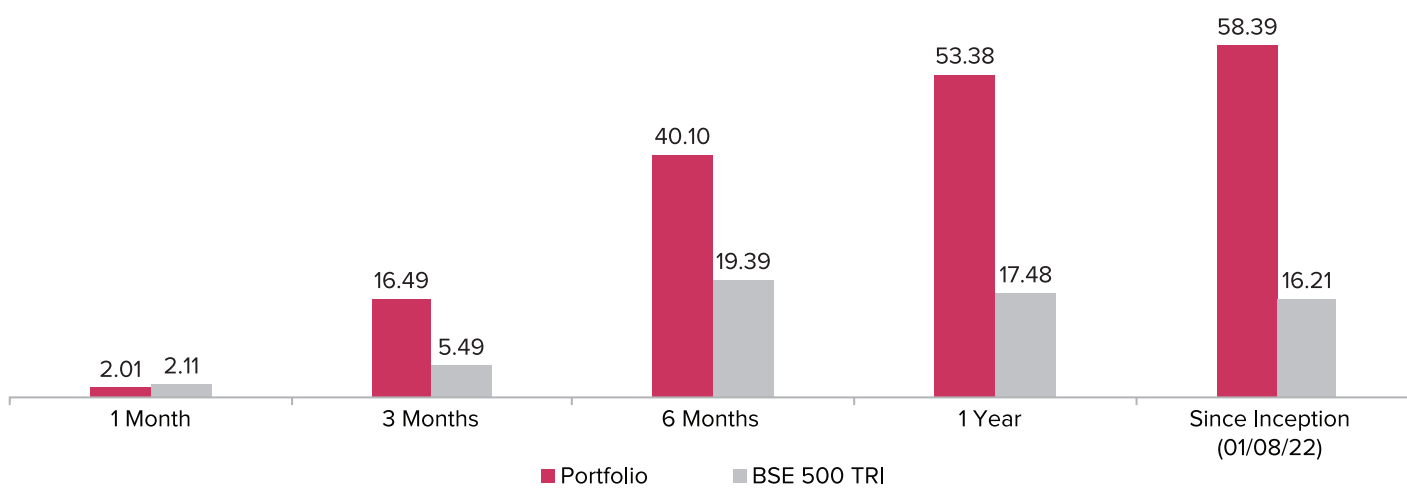
The investment objective is to invest in a business with improving prospects resulting in a visible change in operating parameters but not yet fully reflected in the company's P&L and balance sheet.

Model Portfolio Details as on 30th September 2023		Model Portfolio Composition as on 30th September 2023	
EPS(E) CAGR (2023 to 2025)	16.16%	Large Cap	0.00%
Portfolio PE (1 year forward PE, based on FY25)	14.22	Midcap	0.00%
Average Age of Companies	42 Years	Small Cap	81.50%
Average Market Cap (INR Cr)	4,008	Cash	18.50%

- 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 September 2023.

## Consolidated Portfolio Performance of o3 Special Situations Portfolio as on 30th September 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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