ALFACCURATE ADVISORS

AAA Insights

Feb 2021

AAA IOP PMS
AWARD FOR BEST 10 YEAR PERFORMANCE
ACROSS CATEGORIES ON RISK-ADJUSTED RETURNS
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3QFY21: Robust delivery by AAAIOP PMS

Early FY21, we mentioned three themes to play India's economic recovery – 1. Acceleration of formalisation 2. China + 1 strategy and 3. Automation and Innovation (refer Key Investment Themes to Capitalize on the Covid-19 Crisis). Earnings performance reported by Corporate India indicates traction in each of these themes in 3QFY21. AAA portfolio companies being market leaders capitalised on these trends and continued to deliver robust performance in 3QFY21 (Fig1), after delivering resilient performance in 2QFY21 (Fig2). Against Nifty Revenue/Profit growth of -1%/22%, the AAAIOP portfolio delivered 16% revenue growth and 31% profit growth during 3QFY21. Such strong performance was driven by better demand environment, gain in market share and cost efficiencies.

Fig1: 3QFY21: AAA IOP vs Nifty Performance

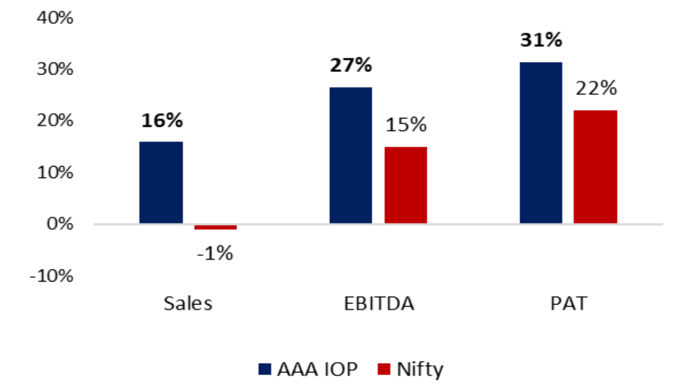
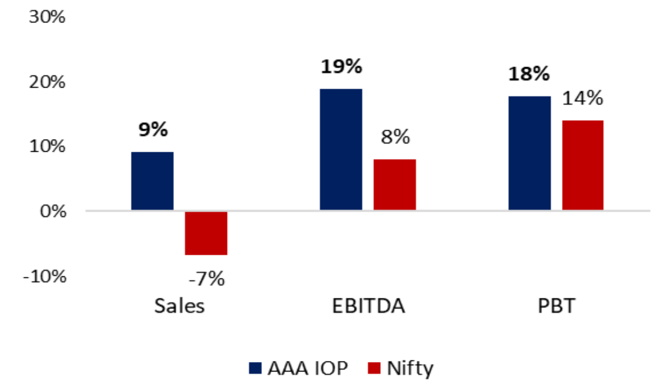


Fig2: 2QFY21: AAA IOP vs Nifty Performance



Source: AAA Research, Ace Equity

Acceleration of formalization

Our portfolio company, Century Plywood, reported industry-leading growth of 9% against flat/de-growth reported by the competitors in the building material space. The company remains upbeat and expects growth momentum to continue with a sharp revival in the secondary real estate market.

Similarly, in the pipes sector, Prince Pipes reported industry-leading volume growth of 18% vs. 9%/15%/5% growth reported by Supreme/Astral/Finolex industries. Prince Pipes secured a tie-up with Lubrizol – the world's largest CPVC compound manufacturer, becoming one of India's only two companies to have such tie-up. This will significantly expand capabilities and strengthens Prince's agility and brand awareness in the market.

China +1 Strategy

Pharma, Speciality chemical, and Electronics sectors are significant beneficiaries of the China+1 Strategy adopted by the global players.

Speciality chemical sector: We have been bullish on the Specialty chemical theme for the last few years. We further added to the sector weight, considering huge opportunity driven by China + 1 strategy adopted by the global players. Our portfolio companies like SRF, Navin Fluorine, Balaji Amines reported healthy revenue growth of 16%/18%/72%, respectively. Management commentaries by specialty chemical players highlight a rising number of order inquiries by global innovators. As a measure to tap these growth opportunities, the majority of players have increased their overall capital expenditure for FY22-23 (AIL's capex: INR12bn, SRF: INR13bn, Navin INR5.2bn). Going forward, we expect higher capital outlay driven by increased visibility on demand is likely to keep growth engines intact for our portfolio companies.

Electronics: Our portfolio company, Dixon, has become the poster boy for Govt's success in promoting manufacturing through PLI scheme. Dixon has received a license for PLI manufacturing in mobile and has already secured a tie-up with Nokia and Motorola. Motorola will be shifting its production from China to India. Dixon plans to scale up its mobile segment revenue from Rs. 537cr in FY20 to over Rs.100 bn in FY25.

Further, the company will also be exploring PLI in Telecom, Lighting, and IT hardware. Dixon presently produces 30% of India's washing machine, LED TV requirements, and 45% of LED bulb requirements having relationships with most major OEMs. With an entry in new segments, the company is poised for multi-fold growth over the next 4-5 years. During 3QFY21, it reported 119% revenue growth and 134% profit growth.

Pharma: Our portfolio company Divis has reported industry beating revenue growth of 22% in the pharma space. Divis is planning to expand its presence for custom work for API, especially in the contrast media segment, which is a US$4-6bn market with very few players. Divis has identified the next 10 generic API molecules in the generics segment to sustain the growth momentum.

JB Chemical has demonstrated industry-leading growth and profitability during the last three years. The company continued that journey even during 3QFY20. Backed by new product launches and an increase in MR productivity, JB reported revenue growth of 27% in 3QFY21 against industry revenue growth of ~12%. With the induction of a new management team with rich experience in the Indian pharma industry, the company is well-positioned to reach its target to become Top 20 companies in India (presently, it ranks 28th as per IPM).

Engineering: Orient Refractories is a classic example of MNC becoming super aggressive in India. There are not many examples of MNC merging the unlisted business into the listed entity. In this case, the parent has decided to merge its unlisted subsidiaries RHI India Pvt Ltd and RHI Clasil Ltd with listed company Orient Refractories Ltd. The merger will bring diversification from flow-control refractories to the complete end-to-end solution to the steel companies. Post the merger; the company will emerge as the largest refractory company in India with a diversified product portfolio catering to the Steel, Cement, and Glass line refractories. Orient has registered 19% revenue growth in 3QFY21 vs 2.8% growth recorded by Vesuvius.

Automation

Increased focus of the corporate world to improve labour and cost efficiency helps our portfolio companies like ABB India and Honeywell Automation in the capital goods sector. Recently ABB got order from OLA to deploy robotics and automation solutions at its mega-factory for electric scooters. ABB also bagged an order to execute the country's largest process automation and safety system projects in the agro-chemical sector from Deccan Fine Chemicals. We believe automation theme will only get stronger as private companies set foot on capital expansion.

Our Investment Strategy/Market outlook:

The emergence of taper tantrum fears in recent weeks has created flutters in the equity markets. The sell-off's primary reason appears to be a spike in the already uptrending US bond yields (spiked 50 bps over the past one month), resulting in a bond rout in DMs. However, we believe that the US economy is a long way from its employment and inflation targets. The Fed chief's comments that the Fed is "committed to using our full range of tools to support the economy and to help ensure that the recovery from this difficult period will be as robust as possible" implies continuance of accommodative stance. However, such events (spike in bond yield) can create a knee-jerk reaction in the equity market. In India, supportive government policy, comfortable financial conditions, and a strong economic recovery will lead to robust earnings growth over FY21-23. The street estimates Nifty EPS to report 20%+ CAGR over FY20-23; this is despite FY21 being the pandemic year. On valuations, Nifty trades at 21.6x PER (FY22) and 18.3x PER (FY23) compared to its 10yr average PE (1 year forward) 18.8x. We remain positive on market and recommend to use any correction as an opportunity to add to equity asset class with 3-5 years time horizon.

Key risks: Effectiveness of the covid19 vaccine, reduced policy support by global governments and central bankers, rising commodity prices leading to higher inflation, and geopolitical shocks.

AAA PMS Performance

Compounded Annual Returns (%)	1 Year	2 Year	3 Years	5 Years	10 Years	AAA IOP SI*	AAA FOCUS SI^
AAA IOP PMS (Fixed Fee)	**29.0%**	**18.7%**	**6.7%**	**17.1%**	**18.6%**	**18.7%**	**NA**
AAA FOCUS PMS (Fixed Fee)	26.2%	19.9%	9.0%	18.1%	NA	NA	13.6%
BSE 500 Index	32.4%	16.8%	9.7%	16.0%	10.5%	10.0%	9.5%
BSE Midcap Index	36.8%	18.1%	6.5%	15.8%	11.3%	10.5%	10.8%
BSE Smallcap Index	47.0%	21.3%	3.6%	16.1%	9.0%	9.1%	9.4%
Nifty	29.7%	16.0%	11.5%	15.8%	10.2%	9.7%	8.9%
SENSEX	28.2%	17.0%	12.8%	16.4%	10.4%	9.8%	9.1%

*(23 Nov 2009 – 28 Feb 2021) ^ (17 Nov 2014 – 28 Feb 2021) (Performance after all expenses).

Note: Returns of Individual clients may differ depending on the time of entry in the Strategy. Past Performance may or may not be sustained in the future and should not be used as a basis for comparison with other investments. Performance-related information provided herein is not verified by SEBI.