NRC NINE RIVERS CAPITAL

AURUM SMALL CAP OPPORTUNITIES PMS

MAY | 2024

Quarterly Update Q4 FY24

Dear Investor,

FY 23-24 was a great year for the markets with small caps stealing the show! It is always challenging for a GARP (growth at reasonable price) oriented strategy such as ours to out perform in such a momentum driven environment as one has to dig deeper and spread the net wider to find mis-priced long term investment opportunities. Team NRC has exhibited patience in such times and stuck to its investment discipline despite many temptations and short term misses. Yet we continued our out-performance as under (as on 31st March 2024):

	1Yr	3Yr	5Yr	7Yr	10Yr	Since inception
Aurum Small Cap	61.92	25.59	25.75	18.10	25.97	28.73
S & P BSE 500 TR	40.16	19.30	17.40	15.66	15.95	15.09

*Consolidated performance; Net of expenses/charges, Management fee & performance fee to the extent charged
Individual portfolio performances may vary
Performance related information provided above is not verified by SEBI

In Feb 2024, **NRC's Aurum Small Cap Opportunities was ranked no 1 by PMS AIF World (in association with IIM Ahmedabad) for generating highest risk adjusted returns over a 10 year period.** We do believe that being awarded this honour was a result of our inventive thinking, creative ideation and a disciplined investment process that has stood test of time across market cycles for over 11 years.

In the past we have spoken at length about our process and and the hygience factors that we look for while discovering new ideas. It is interesting to see that how these qualitative aspects have played out in numbers over time at an aggregate portfolio level for us.

Table 1: Aggregate portfolio operating & valuation metrics across different periods

	FY 15-18 (A)	FY 20-23 (A)	FY 24E-27 (E)
Revenue CAGR (3 Y)	10%	19%	19%
EBITDA CAGR (3 Y)	14%	29%	23%
PAT CAGR (3 Y)	19%	33%	27%
Average EBITDA Margin (%)	12%	17%	23%
ROCE (3 Y Avg)	18%	17%	21%
D/E (3Yr Avg)*	0.3	0.1	0.1
Average PE (at purchase)	10	17	17

*ex financials

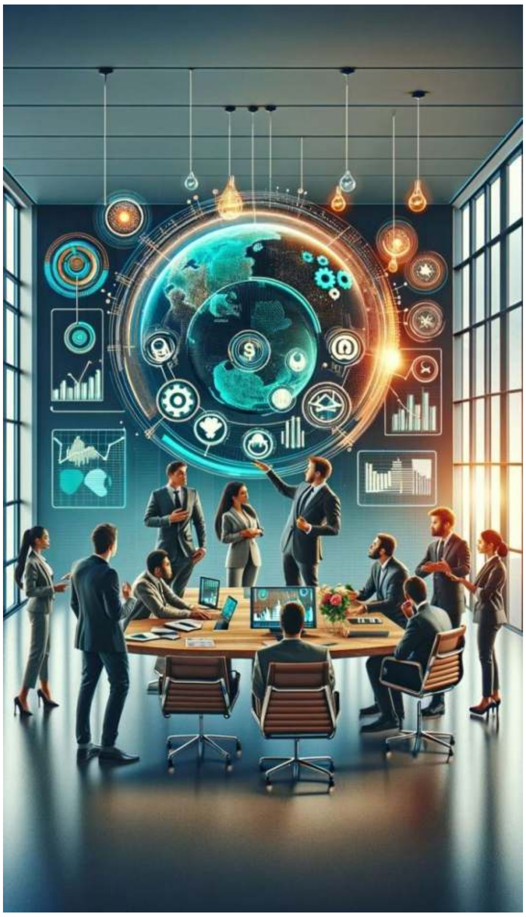
It is encouraging to note that our companies have seen healthy sales and margins growth across different time periods. Between **FY15 to FY18** (3 years) EBITDA & PAT CAGR of our portofolio was ~14% & 19%. Similarly, from **FY20 to FY23** (3 year) time frame, our portfolio companies reported EBITDA and PAT CAGR of 29% & 33%. The ROCE remained healthy at 18% during both these aforesaid time frames and witnessed a reduction in debt /equity ratio from a low of 0.3x to a mere 0.1x, with most companies being net cash positive. Over the next three years, we expect our portfolio companies to deliver a 23% EBITDA & 27% PAT CAGR, healthy ROCE of 21% with marginal or no debt on books.

On the valuation front, we have always been conservative when it comes to entry valuations. In the initial years our average entry valuations hovered around 10x price/earnings one year forward, as is evident from table 1. As the economic outlook became better, leading to an overall re-rating of the market, our entry valuations inched up to 17x as it stands today.

While we continue to stay ahead in our idea generation process and maintain portfolio & balance sheet discipline, we also reckon that relatively elevated valuations are here to stay due to the structural positives that are driving our economic growth outlook.

Our focus, going forward, would be to look for themes and businesses that can potentially deliver non linear growth over 5+ years on account of clearly identifiable tailwinds.

India's quest for economic supremacy



From cleaning up the NPA mess in PSU banks to successfully navigating through Covid turbulence, the last decade has been monumental for India from an economic standpoint. The most notable aspect of the last one decade is the constancy in and commitment to rolling out economic reforms regardless of global challenges. We are at the cusp of transitioning from a developing economy (Per Capita Income of US$ 2800) to a developed economy (Per Capita Income of US$ 14500) over the next two decades thereby making it an attractive destination for global investors.

Some of the watershed reforms we have witnessed in the last decade are GST, Bankruptcy Code, RERA, India finance stack (Jan Dhan & DBT, UPI), New Labour Law, privatization of Air India, theaterisation of the armed forces, structural reform of the railways and introduction of PLI schemes. We have also seen prudent and increasing use of digital technology to ensure transparency and efficiency in each of the aforesaid initiatives. UPI has been applauded all over the world and so was the use of technology to adminster Covid vaccines on a grand scale. We believe digital technology will be the backbone of further reforms and simplification of processes.

Being largely a state subject, we still havent seen any major agricultural reforms being rolled out at a country level. However, some of the states such as MP have hugely benefited from liberalizing agriculture and other states are keen to follow the same model. We do expect more action in the areas of land reforms and free market acess for farm produce over the next decade that should unleash the power of Indian agriculture and give a boost to agri GDP growth.

Journey from mid to high income country (2030 to 2047)...

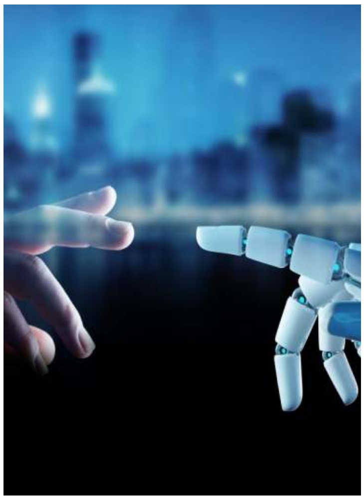
Barring a unforseen global event, India is firmly in the saddle to become a USD 7T economy by 2030 with a Per Capita Income of ~ 4,500 USD making it to middle income country club. From there on, the march towards a becoming high income economy by 2047 depends a lot on the following factors:

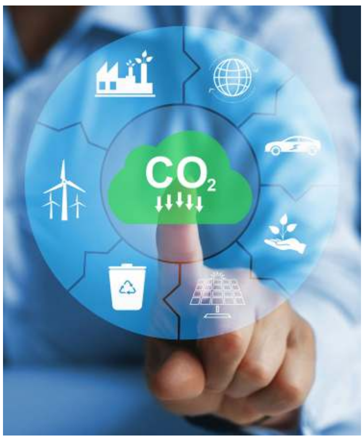
Mindset change: Historically, we have been proud of our **Jugaad** mindset, be it manufacturing or service delivery. However, to continue our sustainable growth journey, we as a nation, have to move from a **Jugaad** to a **institutional problem solving** mindset. It begins at a basic education level where a child, in its formative years is exposed to many different fields of study and a convergence of ideas across disciplines is encouraged. Where failure is looked upon as a stepping stone. Where we have specialists and polymaths working together. This is the essential idea behind the recently rolled out **New Education Policy** (NEP).

The stated aim of NEP is to inculcate vocaltionalised and problem solving mind set. From students perspective, it is to make education flexible, experimental, holistic & convergent learning and problem solving ability. It is education that sets one country apart from another and thus, reform of the Indian education system, is essential for India's transformation into a high income country. Swach Bharat (Hygiene India), was one such mindset change program, while not fully successful did leave a positive impact on our psyche.

Upskilling of work force: In India, the female fertility rate (children per woman) is hovering below the accepted population replacement rate of 2.1 and is likely to decline further. As such, we will continue to see modest growth in overall population for the next 15-20 years before it starts to plateau or show modest decline. During this period, the percentage of 65+ old population in India is likely to move from 7.5% (currently) to about 12-15%. Thus, it is important to continously upskill the workforce and also invest in their health & well being if they are to work longer up to for 65+ years of age. If same is not done in a institutional manner we are likely to run out of our demographic dividend before we breach the high income group bracket.

Rapid automation & digitisation: The availability of work force for low end & manual jobs (garmenting, construction workers, logistics, household help, sanitation & sorting etc) is already a challenge and will fall off sharply within the next decade. Thus, rapid automation & digitisation of government, manufacturing & service delivery is important. While digitisation is happening at a brisk clip across industry & government, automation of the manufacturing & construction industry is relatively tardy. Moreover, the automation solutions have to be India specific and priced for Indian budget. Some areas ripe for automation are garmenting, construction, mining and farming.





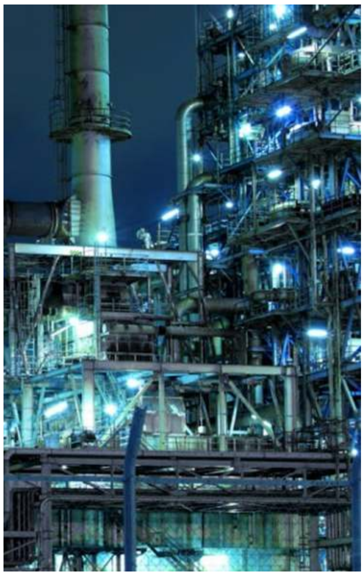
Decarbonisation & efficient use of natural resources: While we embark on developing the next generation manufacturing base, we have to avoid the environmentally unsustainable growth trajectory adopted by China. Thus, decarbonisation & pollution control go hand in hand.

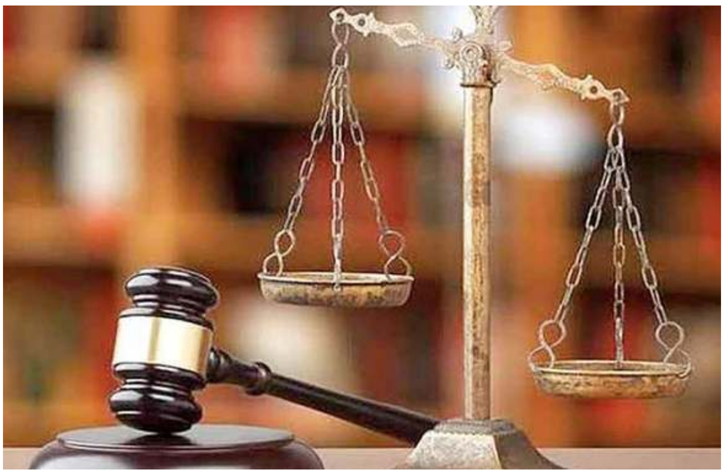
For agriculture, this would mean shifting to other crops or giving up some practices like flood irrigation for crops like rice, sugarcane etc and less use of toxic agro chemicals. In the industrial sector, it would call for significant investment in more efficient & environmentally friendly production process.

In this context, it is pertinent to note that the energy intensity of the Indian economy (energy required to generate 1 unit of GDP) has declined from 6 MJ/PPP GDP in 2004 to 4 MJ /PPP GDP in 2020, about 33% reduction in energy use per unit of GDP produced. Global regulators and large corporates are already moving towards cleaning up their entire value chains. This bodes well for countries like India, which can then effortlessly integrate its production system with the EU & US economy, which have over the years become more environment conscious.

R&D investment: While we pride ourselves on frugal technology, the current spend on R&D of ~0.7% of GDP is woefully inadequate. Of the 0.7%, about 55% is accounted for by government and its agencies. This has to change and the private sector has to step up investment in basic science, new material, advanced process & designing, amongst others. We cannot forever be dependent on other countries for cutting edge technologies, which are often very expensive or available with a significant time lag.

Regional industrialisation & transformation of orthodox society: Within the larger Indian context, we tend to overlook the attempt being made to transform Uttar Pradesh from a largely agrarian & rural economy into a progressive industrial state. Except for the belt of Noida & Gaziabad, UP has not seen too much of industrial development due to judicial inefficiencies (law & order) & patriarchal society. If UP is able to industrialise at a rapid pace over the next 15 years, we are likely to see a transformation not only in economic terms but also in social terms. With a population of ~ 240mn, this would be akin to transformation of a country within a country, into a more liberal & progressive society! And this can become a model that can be emulated by other states who have lagged behind in industrial development.





Judicial reforms: If implemented well, recently passed criminal laws, will fundamentally change the way Indians relate to the government & judiciary in the long run. Time bound police investigation and completion of judicial process can change the attitude of Indians towards government, judiciary, risk taking, etc. It will also further encourage entrepreneurship and innovation and respect for written contracts.

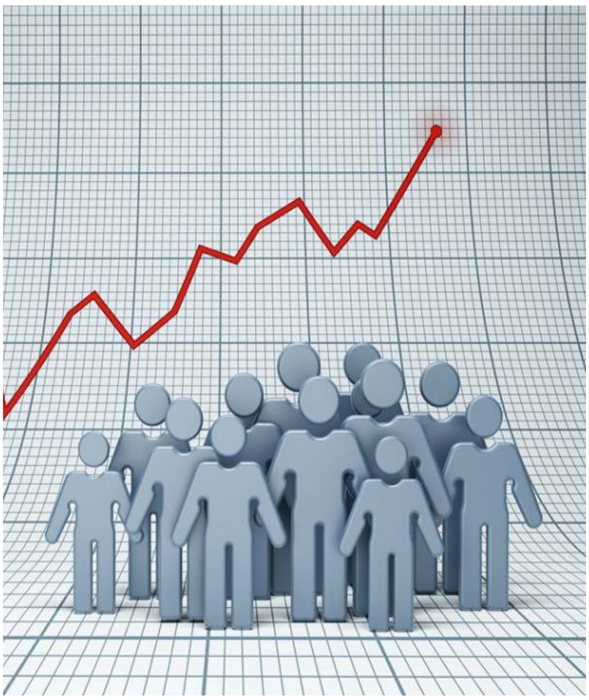
In Conclusion

We believe, India is in a sweet spot and the next twenty years will be transformative for India. We can hope to transform to a higher middle income country, ie; from current per capita income (PCI) of USD 2,600 to over USD 10,000, by 2047 in real terms. However, the political direction is to hit the high income group bench mark with PCI of USD 15,000 by 2047! However we also need to be preapred to endure many challenges that are likely to be encountered along the way. Going forward, interest rates and therefore cost of capital will continue to remain elevated. Commodity price and demand- supply scenario will continue to be volatile. Regulatory & technology walls will continue disrupting business models. Socio-economic challenges in large geographies like EU, China & US are there for all to see. Within this context, India will have to play a fine balancing act to be able to consistently deliver sustianable growth and economic well being to its population.

From an investment manager's point of view, we largely subscribe to the macro view that India will continue to deliver high growth over the next 10+ years.

However, given the last few years of bullish sentiments and upwardly moving valuations, one needs to take a pause from time to time and assess if there is an undue exuberance building up. At this time we are being a bit cautious though not bearish. As always we follow a twin strategy of investing in companies with robust business models at reasonable valuations. Our attitude can best be summarised as **'think boldly, execute cautiously'**, specially in these ebullient times.

Going forward, some other illustrative themes emerging are;



Strong regional brands acquiring national presence: Historically, there have been strong regional brands with limited national recall. However, with PE investors coming in or next generation assuming the mantel, we have seen regional (specially food) brands attempt to cross over and develop a more pan India presence.

Demographic challenges in Europe: EU is a fast aging continent with high energy cost and corresponding high cost of living. We believe, this will throw up business opportunities for countries like India, in industries like engineering, that require significant human participation in the production process.

Banking catering to the bottom of the pyramid: Over the last 20 years we have seen a large swath of the unbanked Indian population, being brought into the ambit of banking, led by new banks and NBFCs. As this segment matures, the spread of services demanded by them will only expand. We believe, banks & NBFCs will have to be nimble & technology focused to cater to this burgeoning segment and simultaneously manage cost. We believe some new banks and NBFCs have better strategy to address this new base vis-à-vis some legacy banks & NBFCs.

Circular Economy: With global focus on climate change, sustainability is steadily creeping into boardrooms the world over alongside enabling legislations in different parts of the globe. Consumer companies are driving their sustainability goals by pushing their supply chain to reduce, recycle & reuse to create a sizeable circular economy ecosystem.

Looking forward to your continued support and encouragement.

Warm regards,

Sandeep Daga

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