

12th July, 2019

Aurum Small Cap Opportunities & Aurum Growth

Dear Investor,

The last quarter witnessed a watershed event in the history of independent India! In the recently concluded general elections, the BJP led NDA under the leadership of Mr. Modi returned to power with a bigger mandate on the back of an unprecedented pro-incumbency, surprising pollsters and the markets alike. With such a massive mandate, Mr. Modi's hands are now sufficiently strengthened to accelerate the pace of both social and economic reforms while continuing with his drive against corruption and red tape. We believe that this augurs very well for the long term interests of our country though it may create a few economic hiccups in the shorter term. The union budget presented on 5th July has laid emphasis on bridging the rich-poor as well as urban-rural divide through a slew of policy measures and interventions. Raising long term resources by way of foreign currency sovereign bonds reflects a major policy shift and promises to be a game changer in financing vital infrastructure projects with long payback periods as well as easing overall liquidity in the money markets.

In the shorter term, however, a liquidity crisis is boiling over with defaults by several well-known NBFCs and a few corporates. Therefore, individual companies dependent on large dollops of credit (working capital or term loan) for growth are facing challenges. Conversely, businesses that rely heavily on availability of loan to customers for their sales are also significantly affected - auto, consumer durables, housing and allied sectors are already seeing pain due to this.

In our portfolio management process, we have always considered low leverage and ability to generate free cash flow as important barometers while filtering investment opportunities. These virtues are helping our portfolio companies navigate the ongoing liquidity crisis much better than others. We do believe that our portfolio companies, in general, will come out stronger through this credit squeeze and enable them to effectively capitalize on the growth opportunity thereafter.



Going forward, we may see adoption of **Model Agricultural Land Leasing Act, 2016**, enabling aggregation of farm land while protecting both ownership and tenant rights

Can we discover 'Transformative Opportunities' for investments?

In the last 5 years we have been witness to the government rolling out several transformative programs for social and financial inclusion; Ujjwala (LPG), Swachh Bharat (Toilets), Saubhagya (Electricity to all), PMAY (Housing for all), Digital India (Cashless Payment) and above all the roll out of GST & IBC. All of these have met with reasonable degree of success giving the Modi 2.0 government enough confidence to accelerate the pace of such transformative reforms and programs. We strongly believe that this accelerated phase will help uncover interesting investment opportunities while also disrupting the status quo at large.

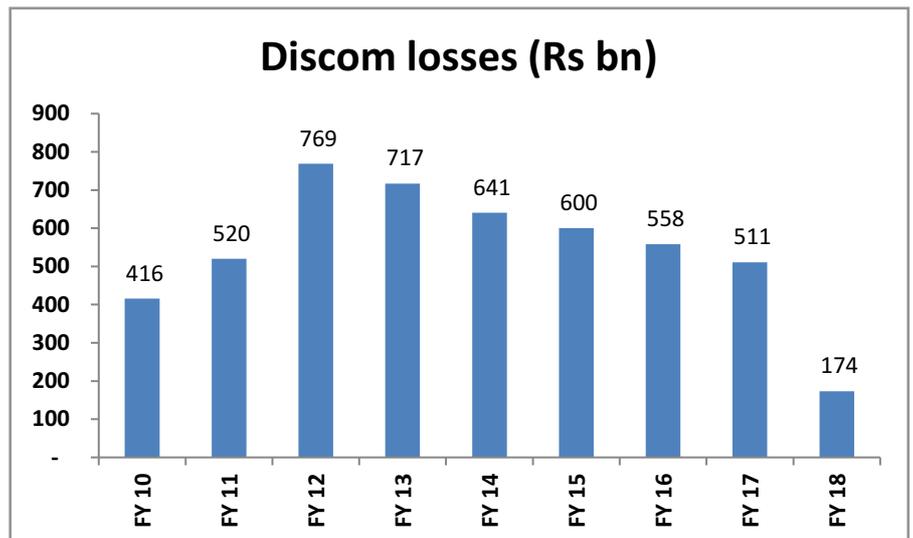
Three areas where there could be a visible impact of transformative reforms are Rural & Agri, Power and Water.

Rural & Agriculture: Uneconomic land holdings, vagaries of weather, increased use of chemical fertilizers and pesticides, rapidly increasing farm production coupled with stagnant or depressed post-harvest prices, inadequate post-harvest infrastructure and poor market access has plagued Indian agriculture and created endemic rural distress. The Government has already rolled out E-NAM (Electronic National Agri Market) in phases to enable market access and has taken credible steps to promote crop insurance. Further there is a concerted focus on moderating the use of chemical fertilizers and pesticides by implementing best of breed natural farming practices.

Going forward, we may see adoption of **Model Agricultural Land Leasing Act, 2016**, enabling aggregation of farm land while protecting both ownership and tenant rights. This would lead to effective 'corporatisation' of farming bringing efficiencies of scale on the production side, investments in post-harvest infrastructure and a more robust market access for agricultural produce. Organized food-processing companies, cold chain logistics players, bio fertilisers & select specialty agro chemical companies, specialty seed companies and rural consumption plays could be amongst those who could be beneficiaries of the ongoing and proposed changes that are underway in the agricultural space.

Power Sector: With the progressive roll out of T&D reforms in the power sector over last 15 years (APDRP, UDAY), T&D losses have gradually come down to ~19% in FY 19 from 34%+ in FY 05. However, SEBs cumulatively continue to incur losses (Fig 1) and there is a definitive need for further policy action to improve the financial health of the SEBs in specific and overall power sector in general.

Fig 1: Cumulative Discom losses (FY10-FY18)



Source: CEA

As mentioned in the proposed electricity act, possibly the most radical change in the power sector would be introduction of targeted delivery of subsidy through DBT mechanism

As mentioned in the proposed electricity act, possibly the most radical change in the power sector would be introduction of targeted delivery of subsidy through DBT mechanism. A precursor to that would be 100% metering. This will prevent power theft and ensure subsidy benefit only to deserving recipients. Further, it is proposed that cross subsidization will be capped within an area at 20% with its gradual elimination over three years. We believe this could be a game changer that would finally bring SEBs out of the financial stress that they have been in for a long time now.

In the backdrop of these reforms, we expect to see significant investments being made in creating smart T&D infrastructure (sub stations EPC, tower & lines, cables, meters, phasometers etc.), which can accommodate both erratic & bi directional power supply (with ref to Renewable Power). Companies from these space with prudent financials and credible value addition are likely to be good investment candidates.

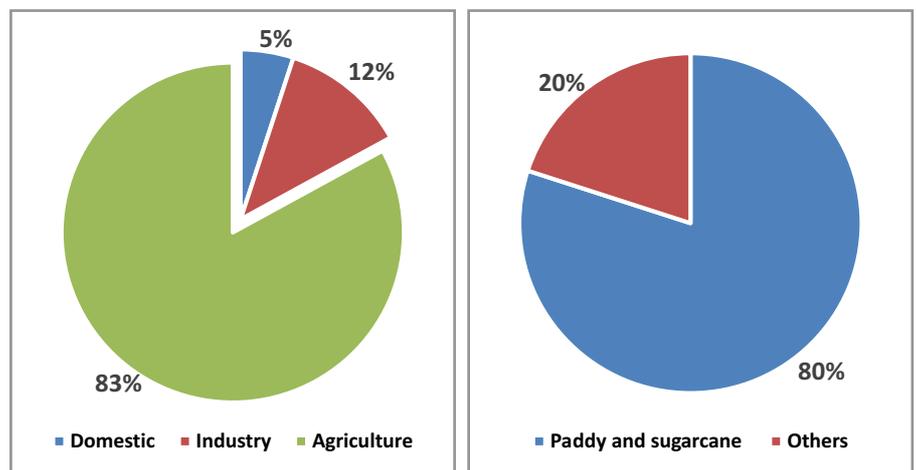
Water management: The immediate need for optimizing storage, movement and usage of water resources is clearly being appreciated by the Government and a sincere effort has been made to address the same in a comprehensive & holistic manner. Towards that, a consolidated Jal Shakti ministry (*through merger of Ministry of Water Resources, River Development & Ganga Rejuvenation, and Ministry of Drinking Water & Sanitation*) has been formed.

Some of the overarching objectives of Jal Shakti ministry are;

- Piped water to all rural household (a la, power & LPG for all)
- National scale water harvesting & ground water recharging (planned 11.1 m rain water harvesting & artificial recharge structures @ INR 7,91,780 m)

- Cleaning of rivers and revival of local water bodies, zero discharge by Industry and reuse of grey water by municipalities & societies, including Clean Ganga project
- Rationalise usage of water for agriculture using micro irrigation and change in crop pattern. As evident from Fig 2, agriculture accounts for about 83% of water consumed in India and within agriculture, paddy and sugarcane account for ~80% of water consumption

Fig 2: Water usage and consumption in India



Source: USGS

Given the policy thrust, we expect significant investments being made in creating / upgrading water and waste water treatment infrastructure, water storage and transportation infrastructure and building last mile connectivity to dispense potable drinking water to all. We expect water focussed EPC companies, pump, pipes and other water treatment equipment manufacturers amongst others to be likely beneficiaries and would look for those with scale, size and credible margins to qualify as potential investment opportunities for us.

A few words on the ongoing crisis amongst NBFCs

Gross asset liability mismatch & the huge exposure to the real estate sector, together has come home to haunt NBFCs. The pain likely to continue to for some more time. Good quality portfolios of credit stressed NBFCs are being sold to banks in order to generate immediate liquidity. This makes the NBFCs more vulnerable going forward as they remain saddled with riskier assets on books. We believe, consolidation will be seen in the NBFC space and the sooner that happens the better.

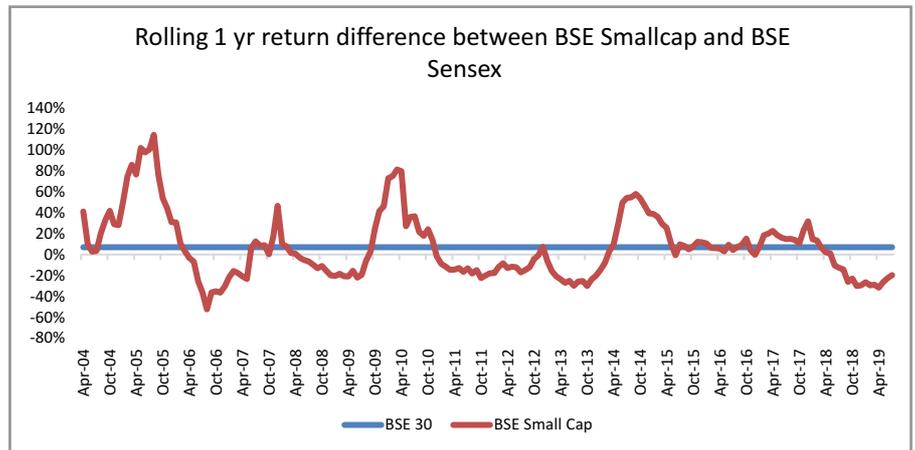
Agriculture accounts for about 83% of water consumed in India and within agriculture, paddy and sugarcane account for ~80% of water consumption



Quality Small Caps never looked so attractively valued!

Fig 3 is representative of the returns given by the BSE small cap index vis a vis the BSE Sensex (large cap index). The returns differential between small and large caps is close to FY14 levels and is indicative of a robust turn around based on historical perspective. Further, when we apply other quality filters, select companies with robust growth and profits prospects look very attractive from a valuation standpoint as well.

Fig 3: BSE Small cap Vs Sensex returns



Source: NRC Research, Ace Equity

FDI / FPI – will they come in hordes?!

With a stable political regime under a dynamic leadership in place, likelihood of implementation of transformative reforms is very strong. That would create the foundation for robust GDP growth to enable India to become a \$5 trillion economy in next 5 years. Globally, apart from India, there are no other emerging economies (ex China, if their economic numbers are to be believed), offering both size and growth rolled into one! Thus, we believe that in due course India will witness robust FDI and FPI (with some lag) inflows over the next few years.

Warm regards,

Sandeep Daga

The returns differential between small and large caps is close to FY 14 levels and is indicative of a robust turnaround based on historical perspective

For further information, please contact:

Nine Rivers Capital Holdings Pvt. Ltd.

511-512, Meadows, Sahar Plaza, Andheri - Kurla Road, Andheri (East),
Mumbai - 400 059, India.

Tel: +91 22 4063 2800 • Fax: +91 22 4063 2801 • Email: info@nineriverscapital.com

Disclaimer:

Certain information herein may be based in part on hypothetical assumptions and past performance. Past performance is no guarantee of future performance. The actual performance may differ materially, from that set forth in the attached information. Nothing contained herein shall constitute any representation or warranty as to future performance or business strategy of Aurum Small Cap Opportunities & Aurum Growth Opportunities (A PMS offering from Nine Rivers Capital Holdings Pvt. Ltd). Any opinions or statements expressed herein are subject to change. The information contained herein does not, and does not attempt to, disclose all of the risks and other significant aspects of entering into any particular transaction.

Under no circumstances is this information to be used or considered as an offer to sell, or solicitation of any offer to buy, any security. The information contained herein is not to be used for any other purpose or made available to anyone not directly associated with the determination of any such interest.