5 July 2021

Dear Partners:

Our quarterly notes are intended to share the opportunities and uncertainties we see in the environment and explain our actions over the last quarter.

In this letter we provide

Key messages

- Performance remains healthy. On a rolling 5-year basis (our preferred measure), our aggregate performance across all accounts (post fees) is TWRR of 22.5% per annum vs 14.1% per annum for NSE 500. This is an outperformance of 8.4% per annum, well above our 3% target.
- Headline valuations are rich on almost all valuation metrics, even adjusting for a period of strong short-term earnings growth.
- We are entering a mediocre return world for Equities and an even poorer return world for Debt as mean reversion of valuations will take place once interest rates rise. Equities (index) may offer low double-digit IRRs over next 5 years, but should significantly outperform debt.
- As an active manager, we hope to do better than the market by constructing portfolios in sectors and companies where risk return is more in favour.
- No one can predict short term market trajectory. Hence, we continue to focus on potential 5 year outcomes via secular themes and individual companies, rather than get distracted by the macro noise.
- Outlook varies across themes. In a richly valued market, we remain constructive on Banks, Life Insurance, Telecom, CRAMS, Steel Pipes and Flexi Staffing. While we are optimistic on growth, we are cautious on valuations in Specialty Chemicals, Digital and IT Services. CRAMS and Flexi Staffing are expensive but also offer prospects for non-linear growth with high longevity.
- We have recently taken a position in a new sector - Steel Pipes. The sector offers an attractive opportunity to participate in increased Infrastructure spending in Oil and Gas and Water.

Important Disclosures

- We construct customised portfolios based on valuations at point of entry and cash available for deployment. Hence, all positions may not be held in your account.
- Performance in individual accounts may vary from aggregate performance due to the above.
- We disclose position names for transparency and context. We reserve the right to change our minds and may not be able to inform you if we do.

SOLIDARITY
INVESTMENT MANAGERS

Performance update[1]

Anchor partner					
Performance (in TWRR)	**1 Year**	**2 Year**	**3 Year**	**5 Year**	**Since Inception**
SOLIDARITY	76.8%	30.4%	27.2%	**20.9%**	**24.1%**
NIFTY	52.6%	15.5%	13.6%	**13.7%**	**12.6%**
NIFTY500	59.0%	18.1%	13.7%	**14.0%**	**14.0%**
Aggregate across all accounts					
Performance (in TWRR)	**1 Year**	**2 Year**	**3 Year**	**5 Year**	**Since Inception**
SOLIDARITY	89.0%	34.4%	30.1%	**22.5%**	**23.2%**
NIFTY	52.6%	15.5%	13.6%	**13.7%**	**14.4%**
NIFTY500	59.0%	18.1%	13.7%	**14.1%**	**14.8%**
Data as of 30 Jun 2021					
We operated with an Investment Advisory License till May 2016 post which we migrated to a PMS License					
Solidarity performance data is reported post fees					

Since inception

- We have registered 24.1% per annum Time Weighted Rate of Return or TWRR[2] post fees for our anchor partner since inception (~ 7 years) which is 10.1% per annum over NSE 500.

Rolling 5-year basis, our recommended time horizon for performance assessment

- Aggregate performance[3] is TWRR per annum of 22.5% which is ~8.4% per annum over NSE 500.
- A 100 Rupees invested with us 5 years ago would be 276 Rupees post fees vs 190 Rupees if invested in the NIFTY.
- Performance has been consistent reflecting the merits of a Multi cap strategy, diversification across themes and risk management.

[1] To avoid complexity, we are no longer reporting performance by fiscal year.
[2] TWRR is the SEBI mandated approach for reporting returns. Read more about TWRR and how it is calculated at https://www.investopedia.com/terms/t/time-weightedror.asp
[3] Individual performance may vary a bit from the aggregate as we construct customized portfolios

We are entering a mediocre return world for Equities and a poor one for Long term Debt.
Equity market returns have been aided by Central Bank fuelled liquidity, control on interest rates, and Govt. fiscal stimulus globally which has elevated valuation multiples. Over the last decade, the developed world, principally the US, has followed unorthodox economic policies, which got further momentum post Covid. Response to the 2008 economic crisis worsened inequality. While the Banks got saved, employment in the US did not reach 2008 levels till 2017. At the same time, money printing did not result in inflation. This encouraged policy makers to keep interest rates lower for longer to prioritize employment creation. This has elevated valuation multiples across the board as it lowered Cost of Capital and has also created tail risks of very high inflation down the road.

Interest rates are now gradually set to rise with the US Fed signalling that money will not stay cheap forever and bringing forward their guidance to 2023 on when they will start raising interest rates. No Central Bank will want to risk raising rates too late and risk inflation getting out of control. Hence, mean reversion of valuation multiples, long delayed, should now start taking place.

<u>Future returns on Equities and trajectory will depend on pace of Earnings growth vs head wind of valuation multiple decline as interest rates normalize/Central Banks stop interfering in pricing of risk.</u>

There is significant optimism on an upcycle in Earnings (akin to where India was in 2004). Exports, IT Services, Banking, Life Insurance and Infrastructure related sectors offer promise of faster Earnings growth. Corporate India has significantly de-leveraged and the pandemic has also resulted in lower fixed cost structures. However, we are also in a "two speed world" in consumption where a segment of consumers like us are unscathed by Covid while many our fellow countrymen need to repair personal Balance sheets – hence, one cannot take strong consumption growth for granted Private Consumption is ~56% of the economy). There are also head winds to Earnings from rising inflation.

Valuations in India, for the market in aggregate, are high when examined vs historical averages. MCAP/GDP at present is approx. ~105% vs ~80% (last 15-year average). Trailing multiples of the NIFTY are significantly higher than long period averages, even if one adjusts for a slightly steeper Earnings growth in short term.

Mean reversion of head-line valuation multiples should take place over time. However, The US Fed is still buying USD120 B bonds a month. The RBI is letting the 10 yr. Bond auction cancel/devolve[4] rather than raise money at higher interest rates. Central Banks can keep interfering in pricing of risk in other ways (the Japanese Central Bank is buying Equities) and hence valuations could continue to find support.

While we don't believe in forecasting or guiding for returns, we believe one should expect moderate returns[5] (10-12% IRR) for the Index over the next 5 years as faster Earnings growth will be accompanied by multiple decline. This is assuming no tail risk event plays out. Our goal is to outperform NSE 500 by at-least 3% post fees over rolling 5 years by taking positions in themes where a combination of growth and valuation outlook can combine to give returns superior to the Index.

Implications

- Given the steep run up in prices in the last 15 months, partners should be realistic on return expectations in Equities in the short to medium term.
- Returns in long term Debt will be lower or in line with inflation.
- Deploy additional capital in Equities only if one is willing to take a minimum 5-year view.

[4] https://economictimes.indiatimes.com/news/economy/policy/rbi-determined-to-keep-rates-under-check/articleshow/84130516.cms
[5] We assume 13.5-14% nominal GDP growth and mean reversion of valuations to ~90-95% of GDP, slightly higher than long term averages as Digital becomes a larger contributor to GDP and valuations are supported by lower interest rates vs long term averages.

Our view of the playing field and approach at present

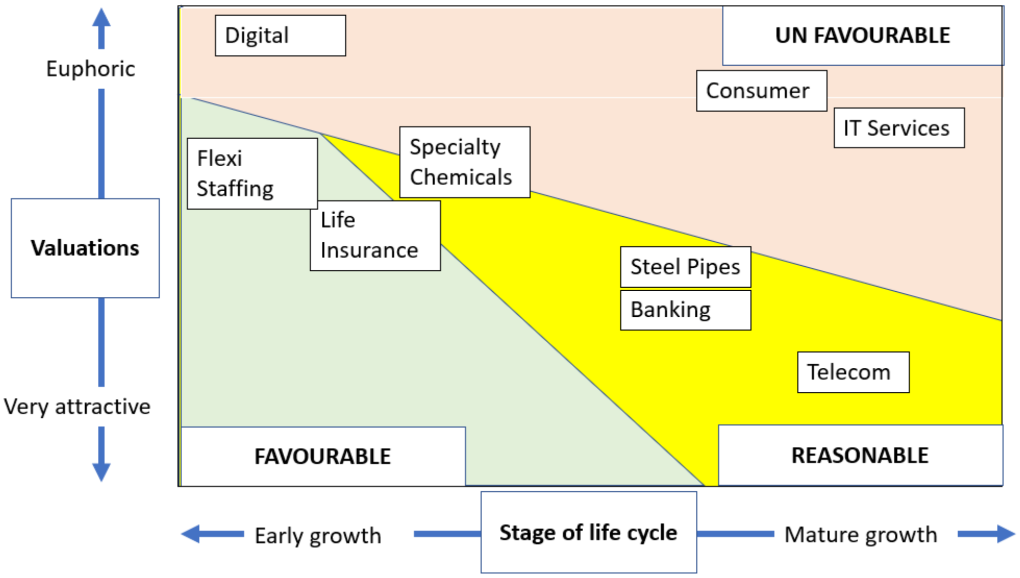
We don't predict trajectory of inflation or interest rates but focus bottom up on secular themes and individual companies. For example, we will not spend time debating inflation trajectory but rather ensure companies we own are well positioned to handle a rise in inflation through reasonable pricing power. We are looking to buy into decadal stories but allocate capital based on which offer best prospects adjusted for risk over rolling 5 years.

The key challenge at present is ascertaining fair valuations when Central Banks and Govt's are interfering in the normal business cycle and pricing of risk. However, one can also see valuation froth in many sectors and companies.

Our approach

- We believe mean reversion can be delayed but will inevitably take place. Hence, we maintain our discipline and beliefs that entry prices matter, especially when earnings growth is linear and broadly predictable (well run Banks, IT Services, Consumer, Pharma).
- We are willing to pay a small premium for exceptional franchises which can surprise on Earnings growth and have some Option value (Syngene, India Mart).
- Balance desire for uninterrupted compounding with need for risk management, Hence, trim where valuations are euphoric and positions have both low traded liquidity and very high weight in the portfolio due to price run ups.
- We do not construct model portfolios and will hold cash when we don't find opportunity.

One sees wide dispersion in valuations from Euphoric (Digital, Consumer) very rich (IT Services, Specialty Chemicals) to reasonable (Life Insurance, Banking, Steel Pipes) to attractive (Telecom).



Partners who have recently joined will observe a mix of different approaches and positions sizes.

- Large positions (8%) when growth and valuation are both in favour (Bharti Airtel).
- Reasonable sized positions (~4-5%) where growth is in favour and valuations reasonable (Life Insurance players, well run Banks, Ratnamani Metals, Team Lease).
- Small positions (~3%) in high conviction growth ideas where there is longevity, scarcity premium and where valuations are tricky to gauge at present as earnings could be non-linear (Syngene, India Mart, Neogen Chemicals)
- A "Special Situations" (~3%) position in MAN Industries
- And significant un-invested cash at present.

In the section below we share details of new positions we have not written about earlier

Syngene (Clear Leader)
Is India's leading CRO[6] which has commenced a horizontal migration into a CDMO[7] thus expanding its addressable market opportunity. Syngene works with 8 of the top 10 Pharma Discovery firms. Its manufacturing facility has recently come on-stream, and it now can offer a one stop shop with rapid scale up of Manufacturing resulting in prospects for non-linear Earnings growth. Valuation assessment essentially involves future assumptions on Earnings growth. Prospects for non- linear Earnings growth, and small changes in terminal value assumptions can make one miss a decadal story if one obsesses excessively on near term valuations. Over-paying by 15-20% for exceptional franchises is a risk worth taking when longevity is high and when price declines can be used as opportunity to build up positions. One however needs to have discipline that these cases are exceptions and not the rule and we use this approach only when there are both prospects for non-linear growth and longevity.

Team Lease (Emerging Leader)
Flexi staffing promises very strong growth longevity (~15-20% decadal growth) through multiple levers such as direct linkage with economic growth, greater use of flexi staffing, increased formalization of the economy leading to sector consolidation. Over time, Gross Margins in this sector will expand because pricing in the industry will improve as unorganized players come into regulatory scrutiny and either have to price fairly or exit the market leading to consolidation. Use of technology will boost margins through Operating leverage. The low margin business model acts as a moat as mom-and-pop shops cannot scale. And being a capital light model, all profits translate into Free cash flow. A more detailed write up follows in a detailed section.

Ratnamani Metals (Clear Leader)
Ratnamani Metals is India's best run and most profitable Steel Pipes company. Steel Pipes is a play on expected increase in Infrastructure spending on Oil and Gas exploration, Refineries, and Natural Gas and Water transportation. India is increasing the share of Clean Natural Gas in its energy mix which will result in significant investment over the next two decades into setting up a national gas grid and bring gas pipelines to every door. Ratnamani is pursuing a more value-added strategy with significant capacity expansion in Stainless Steel pipes. A more detailed write up follows in a later section.

MAN Industries (Special Situations)
We are willing to experiment (10% portfolio cap) with "Special Situations" when governance and leverage are not a concern but where upside/downside is very attractive (>25% estimated IRRs over 5 years). MAN Industries makes Steel Pipes used to transport Oil and Natural Gas. MAN has had a lost decade due to promoter disputes which caused loss of focus on growth. The market continues to extrapolate the past and we have a variant perception vs the market on the company's prospects. The company is embarking on a growth program for a more value-added product mix alongside productivity enhancement initiatives. Non-core assets are being divested to focus on the core business and there is a discernible attempt to improve investor relations and working capital cycles. While investors rightly focus on what can go wrong, one should also pause to reflect the size of the upside if one is right- especially in a market where bargains are hard to find. The stock trades below liquidation value, has a PE of 4x[8], has low leverage and the sector has good tail winds of growth. A more detailed write up follows in a later section.

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[6] A Contract Research Organization (CRO) provides a range of clinical research services to pharmaceutical and biotechnology companies such as drug discovery.
[7] A Contract Development and Manufacturing Organization (CDMO), is an organization that serves the pharmaceutical industry and provides clients with comprehensive services from drug development to commercial manufacturing.
[8] Adjusted for one offs and excluding non core Other Income.

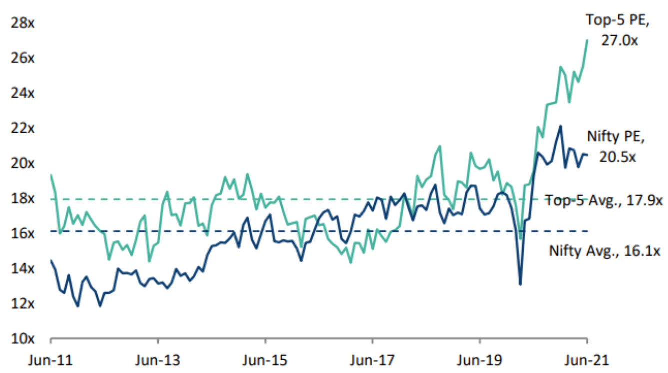
Responses to some questions we have been asked.

Why do we not hold IT Services?

Indian IT Services companies will get a growth boost as Covid 19 has accelerated the adoption to Digital. In 2020-25, per Gartner, global IT services spending is expected to grow at an 8.6% CAGR to US$1.5tn vs 4.7% CAGR between 2015-19. The top line growth argument is driving current valuations and investor sentiment. Our hesitation to participate is because we believe that bottom line growth will be more in the range of 10-12% over a decade as IT Services companies will face margin challenges from large deals which tend to be margin dilutive, wage inflation driven by talent shortages in Digital, the need to invest more in on site customer facing roles and as cost benefits from Covid 19 are either priced away or return (e.g. travel costs). Hence, we expect the leaders will grow PAT at low-mid teen rates over the next 5 years with faster growth in FY 22/FY23. When buying into mature growth, and where there is no Option value, one must be more careful on valuations as there is less room for error. If we assume 15% earnings CAGR over 5 years for leading IT players (aggressive in our view) and 20% multiple decline on mean reversion, we estimate an overall IRR of ~12% including dividends. While that is not a poor return, we want to conserve capital for better IRR opportunities.

We highlighted in our last letter that not participating in this sector last year was a miss on our part. However, we should not compound that error by participating in this space when there is a lot of optimism in prices.

Top-5 IT vs Nifty PE valuation



Source: Bloomberg, Jefferies estimates

Would you recommend subscribing to Zomato at ~45000-50000 Cr valuation?

Zomato offers a strong consumer value proposition. However, we would not recommend investing at this price and wait for more certainty on the steady state financials of its business model.

Digital business models have significant market opportunity, tend to be winner take all and have significant option value of future business lines. Many of them are loss making, however, for some, losses are helping them build deep moats which will turn the business model hugely profitable at scale. Hence, losses should not deter someone from investing in these companies and one needs to assess their prospects down the road and discount back to the present. However, it is not clear to us what the steady state economics of the food delivery business will be and at what scale/timeline break-even will be achieved. Key attributes of its model e.g. order size, take rates etc have still not reached steady state. Restaurants continue to push back on high take rates, consumer behaviour that has driven higher order sizes post Covid still needs to be examined in a normal world. Additionally, competitive intensity has not reached equilibrium. If Jio's big bet is on an interconnected eco system between a smart phone and a retailer, its needs a last mile delivery to fulfil that. Amazon is piloting food delivery in Bangalore.

One can construct widely varying narratives of Zomato on when it will achieve break even and what its steady state economics will be. While we are not averse to investing in loss making companies, we must be able to see a time bound path to profitability. If potential range of outcomes are very wide, then one cannot invest with conviction if one wants to own 15-20 positions.

One may argue that Zomato's valuations cannot be examined from its core business prospects alone at present and one should consider Option value of future business streams. We consider Optionality in valuations only when a company is Free Cash flow positive and can use that cash flow to enter new markets. In the absence of Free cash flow, the above approach is that of a Venture Capitalist whose mandate permits them to embrace significant uncertainty for a much higher upside.

This year will see many Digital business models getting listed. As the scarcity of Digital business models declines, investors will start focusing more on absence of cash flows (numbers) rather than on narratives. However, we will not be surprised if the IPO is oversubscribed and opens with a pop.

Isn't Specialty Chemicals now in euphoria and time to exit?

De risking of supply chains from China is now a consensus bet. However, this sector is early on the growth cycle and offers significant longevity of growth and opportunity for companies to transform into higher ROCE business models over time through both margin expansion and increase in Asset-productivity. Specialty Chemicals is a decadal structural growth story. The rhetoric between the US and China is now escalating with even the G7 taking more stringent positions. Tail winds for de-risking from China are getting stronger.

Businesses we have invested in will enter adjacencies (new chemistries) and more value-added products down the road. Additionally, ROCEs of Specialty Chemicals should expand as the useful life of Assets tend to exceed time horizons over which Assets are depreciated. Macro tail winds, domain expertise, reputation for reliability and willingness to re-invest for growth can create a value creation flywheel. Hence, higher multiples can be justified if one is willing to take a longer-term perspective and live with short term underperformance. Multiples tend to sustain if the growth narrative is credible and backed by strong execution.

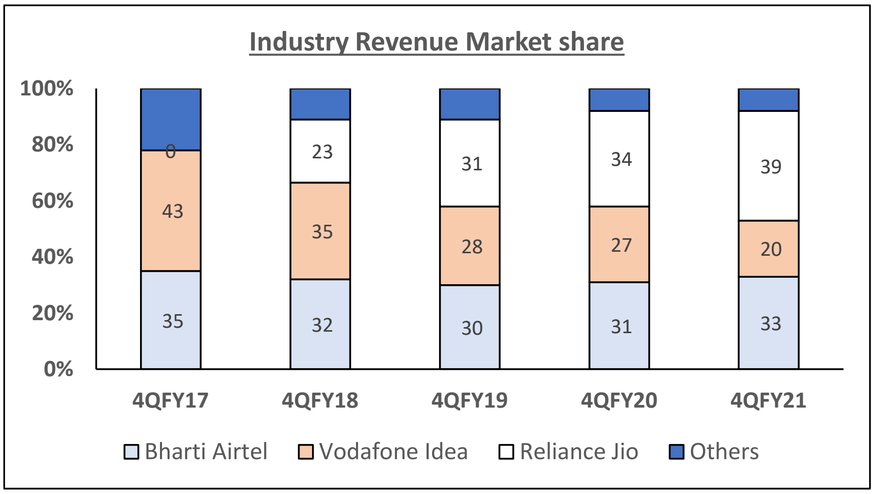
However, all considered, valuations at present are pricing in both very strong growth and no margin of safety and there is no differentiation between princes and frogs, especially in the IPO market. We need to balance staying invested keeping in mind the longer-term prize with trimming positions for risk management. Partners may have observed that we have trimmed some position weight in Privi Specialty Chemicals and SRF. The former in many portfolios was approaching a 10% weight due to a steep run up and we don't want to carry concentration risks in Small Caps where liquidity risk is endemic[9].

Bharti is not moving for a long time in a bull market. Are we missing something?

Bharti is attractively valued. We should not worry about a stock not performing if its Operating performance is improving and the industry is not in decline. Prices can stay muted for a long time and then suddenly give 3 years' worth of return in a month. Airtel and Jio continue to gain market share at Vodafone Idea's (VI) expense and that means VI is a strategically weakening franchise irrespective of whether it survives - it is very hard to regain lost market share. For VI to survive without capital infusion, we estimate that ARPUs must inch up to 190/subscriber from 113/subscriber today to meet its Capital expenditure and financial liabilities. If ARPUs go up, the entire industry will benefit, and Airtel's EBITDA will also expand leading to a re-rating. The more VI fund raising is delayed, or ARPUs

[9] In our Q4 FY21 Letter, available on our website, we have explained our approach to position sizing and trimming

stay muted, the more the competitive position of the other two incumbents gets strengthened with very-positive implications for long term value creation. And as the market share by circle is capped at 50%, Jio and Airtel can enjoy a peaceful co-existence with significant pricing power. Additionally, if the tail risk scenario of very high inflation plays out, Telecom is a good sector to be invested in. One can increase prices in line with inflation while a significant portion of costs (depreciation) are in yesterday's prices.



In the next section, we share more detailed Investment thesis on

- Team Lease
- Ratnamani Metals and Tubes
- MAN Industries

Team Lease (Emerging Leader)
Team Lease (TL) Is India's second largest flexi staffing company.

What is Flexi Staffing?
In flexi staffing, a staffing agency enters into service level agreement with the client/customer (e.g. Samsung, TCS, Amazon, etc) to provide employees (referred to as associates) on a temporary basis for a specific duration or a project and gets paid on a variable basis for the duration of the engagement. The associates will be deployed at client's locations and work under the supervision of the client, whereas the staffing agency will be responsible for paying salaries and other mandatory obligations like Provident Fund etc.

Customers use flexi staffing agencies as it enables them to scale up/down their workforce with more ease/speed and helps them manage complex regulatory compliances in a cost-efficient manner. Flexi staffing includes both General Staffing, in which specific skill sets are not required (e.g. Retail staffing) and Specialised Staffing which requires functional expertise (e.g. IT industry).

TL is a long term, structural growth story.
The key drivers of growth are:

- Reforms undertaken by the Government[10] and increasing per capita GDP (inverse correlation of informal employment with per capita GDP) will lead to strong growth in formal jobs and their share in total workforce is expected to double over the next decade from ~21% currently.[11]
- Increasing preference for having workforce flexibility and have variable cost structures (i.e., ability to hire for short term requirements vs. permanently) will result in the flexi staffing industry gaining share within the formal workforce.
- Organized players in the flexi staffing industry will gain share from mom-and-pop shops.

Overall, the share of organized flexi staffing industry within the total workforce is expected to increase by ~3x over the next decade from (0.8% share currently to 2.7% share in 2030).[12]

TL's earnings will grow faster than revenues due to margin expansion driven by:

- Improving Gross margin as the industry consolidates. Pricing in the industry will improve as unorganized players come into regulatory scrutiny and therefore cannot price unfairly. In the West, where this industry is more consolidated, gross margins are 3-5x those of the organised players in India.
- Additional boost to Gross Margin as the share. of high margin specialised staffing increases in overall revenue.
- Increased EBITDA margin as technology usage improves productivity and operating leverage.

The business enjoys a strong and growing competitive edge.
This is a very low margin business (EBITDA ~2%). Drivers of competitive edge are:

- Scale is critical to success as costs of core employees, technology and SG&A is largely fixed. Hence, the staffing company which achieves maximum scale and productivity will be able to offer the best pricing in the industry. TL has consistently delivered SG&A productivity through use of technology.
- Competence to adhere to multiple, complex regulatory compliances without customers having to worry about any slip up which could lead to reputation loss.

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[10] GST, New Labour Code, Employee Provident Fund, ESIC, maternity benefits, etc.
[11] Source: India Staffing Federation, Goldman Sachs Global Investment Research
[12] Source: India Staffing Federation, Goldman Sachs Global Investment Research

- Ability to provide pan-India services with quick turnaround time to customer requests.

The above aspects create a virtuous cycle:

- Increasing scale leads to market share gain
- Ability to lower pricing for customers with improved scale without compromising account profitability.
- Ability to further invest in technology to improve productivity, increase presence across India & improve service quality resulting in further market share gains.

We believe, TL can deliver ~15-20% revenue CAGR and ~20-25% PBT CAGR over next 5-10 years[13] as margins should expand. We believe it can deliver these growth rates at a post-tax ROIC of ~25-35% as it is not a capital-intensive business and runs on <20 days of Working Capital.[14] Hence, currently rich valuation multiples can be justified if the above numbers are delivered.

The leadership team has demonstrated disciplined execution.
Management has focused on margins, ROIC and ensuring that they have a resilient balance sheet. They have not shied away from acquiring complementary capabilities. TL's net cash balance sheet since inception highlights the conservative nature of the leadership.

Risks
The Govt at present provides the sector Income tax benefits under section 80JJA of Income Tax Act. According to this section, if the company employs more associates than in the previous year, it gets to claim a deduction of 30% of total employee salaries from its PBT in that year as well as next 2 years. Given that employee expenses are >90% of revenues, 30% of this implies deduction is greater than PBT and hence company pays zero tax. If this is withdrawn, TL's earnings growth in the short run will be hit as we don't believe it will be able to increase prices to offset this impact. However, we believe this is a low probability scenario as the Government aims to increase formal workforce in the overall pool. TL made statutory remittances of ~Rs 1400 crores in FY21 and they have a miniscule share of the flexi staffing industry. Governments stand to gain if the share of organised players goes up over time and hence should continue to encourage formalisation of the sector.

[13] TL's organic revenue and core PBT CAGR for FY15-FY20 is ~19% and ~23% respectively. Including acquisitions, the revenue and core PBT CAGR in this period was ~20% and ~21%. TL was investing ahead of the curve to build new capabilities with these acquisitions.
[14] TL's ROICs in FY16-FY20 saw a decline as they did acquisitions to get a foothold in specialised staffing. Over the next 5 years, we expect TL's post tax ROIC to settle in 25-35% range.

Steel Pipes
We expect the Steel Pipes (Carbon/Stainless) industry to be a beneficiary of the decadal capital cycle underway in the Oil and Gas industry as India moves towards higher usage of Natural gas in its energy mix.

The domestic Steel pipe industry is consolidated with ~80% share held by four players today. The industry is well poised to grow from multiple tailwinds.

- India intends to increase share of natural gas in its energy mix from 6% to 15% by 2030. As India transitions towards a gas-based economy, this should translate to stronger demand for steel pipes in City gas distribution, cross-country gas pipes and LNG Terminals over the next decade. For ex: Demand for large diameter pipes from the natural gas grid itself can be a ~50000 Cr opportunity over next 5 years.
- Access to clean water has become an important political priority, and with "Har Ghar Jal yojana" (Safe drinking water to all rural households by 2024) we expect pick-up in demand for water related HSAW carbon steel pipes. However, this can be delayed as State Govt's transfer budgets towards health initiatives due to Covid.
- Drop in oil prices since 2014 had impacted upstream capex projects which had a trickle-down effect on midstream and downstream projects. If Brent oil prices stay above $60/barrel (at present ~$75 per barrel), the sector will witness higher investments both globally and domestically as stalled projects are now being revived and ageing pipelines need to be replaced.
- China is a meaningful player in steel pipes globally. However, with geo-political issues emerging between the west and China, one can expect more active de-risking from China. Well run Indian players have scope to gain market share in exports.

We are participating in this opportunity via investments in Ratnamani Metals & Tubes and MAN industries.

Ratnamani Metals and Tubes (Clear Leader)
Ratnamani has differentiated itself in a largely commodity industry by consistently focusing on value added products (for example Stainless Steel (SS) pipes) which have limited competition.

SS pipes are used for critical applications and getting customer approvals is time consuming (can take up-to 3-5 years for a new entrant to get approval). Given higher gestation period and higher capital intensity, SS pipes enjoys a more favourable industry structure. SS pipes tend to very profitable, and we estimate their EBITDA per MT to be ~12X that of Carbon Steel pipes (CS Pipes).

Ratnamani holds ~35-40% market share domestically in SS. ~55% of SS pipes consumed in India are still imported mainly from Europe, Japan & China. This provides a significant import substitution opportunity.

Unlike peers, Ratnamani has consistently invested in technology to enhance its edge. For example, it has recently developed technology to manufacture SS pipes through the seamless hot extrusion route and is the only domestic player to do so. Hot extrusion gives pipe better strength and longer life and will help Ratnamani substitute imports. Ratnamani has also developed capabilities for nickel alloy and titanium welded tubes which find unique applications in power plants, nuclear and aerospace. Titanium tubes can enjoy up to 4-5x realisations compared to SS welded pipes. Ratnamani currently has a dedicated titanium welded tube facility of 1,500 T but is looking to set up another 1,000 T Titanium/nickel grade instrumentation tube facility in near future.

Ratnamani has embarked on a significant capex program, having expanded its SS Pipes capacity by 71% and carbon steel pipes (CS pipes) by 57%. Given the global impetus to de risk supply chains from China, Ratnamani also could win more export orders as it already has approval with leading majors.

Ratnamani has a strong long term track record of growth, consistent margins and healthy average pre-tax ROIC of ~23-25%. It is debt free with a net cash position of ~550crs as of end FY21.

We estimate Ratnamani could grow volumes at ~15% CAGR over next 5 years accompanied with margin expansion through more value-add products, backward integration and operating leverage on recently commissioned facilities translating into bottom-line growth of ~20%+ CAGR.

Risks
Volatility in earnings. Demand for Steel Pipes globally can be cyclical within a largely structural demand trend. Demand is linked to price of Oil and that can create volatility in earnings. Demand for Steel pipes also gets impacted in a period of rising Steel prices as customers tend to wait for prices to cool down. Demand for pipes for Water is linked to Govt. finances.

MAN Industries (Special Situations)
MAN industries has been in the Steel pipes industry for 25+ years now and is mainly present in the more commodity LSAW[15] & HSAW[16] Carbon steel sector where it has ~ 15-20% domestic market share. A low ROE business, MAN would not quality under our core approach of buying well run compounding stories. However, MAN could be considered as a turnaround story which promises significant upside if we are right, and limited downside if we are wrong. It is therefore a "Special Situations" bet for us.

MAN has lost a decade, primarily due to internal challenges. Inter promoter group disputes have now been resolved with one set of promoters firmly in control post court rulings. Over last few years, MAN has reduced its debt and its Debt/EBITDA is now < 1. It is focusing on growth and has entered ERW[17] Carbon Steel pipes to cater to the City gas opportunity. Management is also considering entry into SS pipes in the future (higher margin) and undertaking cost optimization initiatives at its plants. With existing + upcoming ERW facilities, we believe the company can achieve ~4,000 top line versus ~2100crs in 2021 at full capacity. EBITDA Margins can also expand by ~2% through better product mix, cost savings & Operating leverage. Hence, profit growth can be between 15-25% CAGR and ROE profile can improve from 12% to ~15% over next 5 years. Compared to ~ 600 Cr Market Cap today, we believe that MAN can generate ~200-250 Cr PAT by FY 25.

Stock currently trades at ~4x Core Price to earnings FY21 (Adjusted for one offs) despite a credible promise of 15%+ EPS growth visibility for coming years. We believe these valuations – in a very richly valued market -reflect investors historical perception of the company and a belief that nothing will change.

Our variance perception is that the company is making progress which the market does not believe in.

- As promoter disputes are behind us, one should see more focus on growth and value creation.
- MAN is refocusing on its core business and has announced intent to divest their real estate division to focus solely on core steel pipes business.
- Promoters have demonstrated confidence in the business by issuing warrants to themselves. While we believe a rights issue would have been better governance, promoters are demonstrating skin in the game at the same time as related party transactions are reducing and promoter pledged shares have also reduced materially from 41% to ~5%.
- MAN has started a process of systematic engagement with minority investors through quarterly calls and use of an Investor-relations firm.

Investors rightly focus on what can go wrong when they evaluate an investment. However, excessive focus on the past can lead one to miss situations where the historical narrative may not extend to the

[15] Longitudinal submerged arc welded pipe used in high pressure applications in oil & gas and water supply etc.
[16] Helical submerged arc welded pipe used in low pressure applications in oil & gas and water supply etc.
[17] Electric resistance welded pipe (small diameter pipes) used mainly in city gas distribution and water supply.

future. The key question in any such situation is "what are the expectations embedded in the price"? we should focus not only on what can go wrong but also on what can be the size of the upside if things work out right. When one is buying a stock at a PE of ~4x, when there is visibility of growth, we believe it is highly unlikely that we will lose Capital. However, if the management can execute well, we see this as a 4-6x opportunity over 5 years as growth with higher ROE and improving investor perception can result in a 2x increase in the valuation multiple ascribed to the company.

Can we be sure that our thesis will play out? We cannot. Investing is a game of probabilities. This explains why we have a 3% initial position and will track execution and how management walks its talk before increasing the position weight. A company can be a better investment at a higher price when there is more certainty on improvement in prospects.

Is this not a deviation from our approach? When valuations in our core approach are not attractive, we should have the willingness to experiment with small position sizes with new approaches. Hence, we keep 10% allocation in portfolios for "Special Situations". Flexibility, without violating core principles, is important. We cannot expect to out-perform the market if we do what everyone else is doing.

" …the right way, the correct way, and the only way, it does not exist[18]."

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We look forward to speaking with you at our quarterly call on 10th July 2021 at 12 pm.

With our best wishes,

Manish Gupta
Chief Investment Officer

Manjeet Buaria
Principal

Anirudh Shetty
Principal

[18] Friedrich Wilhelm Nietzsche