July 6, 2023

Dear Partners in AAFI,

Before we knew it, we have completed our first quarter, and what a quarter it has been! The fund has delivered a 15.8% return during the quarter (15.2% net of fees and all expenses) beating the Nifty by 5.4% & 4.8% respectively, despite the fund having an average cash balance during the quarter of 56.9% (end of quarter cash is at 33.4%). What is even more satisfying is that these returns were broad based, with 13 of the 14 stocks in the portfolio individually beating the Nifty.

Q1FY24 - Class A	Returns	Excess Returns
AAFI - Gross returns	15.77%	5.40%
AAFI - Returns net of fees & expenses	15.21%	4.84%
Nifty	10.37%	

While we are delighted with the outcome, we truly believe that one quarter is too short a period to judge us by, and that the outcome of a single quarter is luck and not skill. We humbly request you to judge us on at the minimum 1 year's investment returns, but ideally 3 years investment returns, since we invest with a ~3 year horizon.

During the quarter we have made 14 investments and are in the process of building out the rest of the portfolio. We participated in 2 QIPs (evaluated but passed on a third), 1 IPO (where the allotment happened post quarter close and hence does not count as part of the 14 investments; we evaluated a few more IPOs but passed on all of them) and subscribed to warrants of an existing investee company (again the transaction closed post quarter end and the warrants are not part of the 14 investments mentioned above).

We would like to give you a small snippet of what goes on behind the scenes to build the portfolio – We had 115 management interactions during the quarter, and a few months prior (as we were preparing for the fund launch). This is over and above dozens of earnings calls each of the five investment analysts attended during results season. For each management interaction, we would typically have a model built on the company, gone through last few annual reports & earnings calls, done competitor analysis and looked at the industry from a top-down perspective as well (factors like industry consolidation / fragmentation, growth rate, direction of change of these factors etc).

For each investment we made, we have a detailed model and note on the company that documents our investment thesis, stock drivers, risks to thesis, valuations & scenario analysis (amongst other things). We update these models at least once a quarter and put together a quick memo on the quarter gone by.

Over time, I have started tracking the portfolio as if it were a single stock (credit goes to one of my mentors who is one of the smartest investors I have ever come across). This gives very good insights into the kind of portfolio one is running and the kind of style factors the portfolio is exposed to. I am hoping the tables below will give you a flavour of the kind of portfolio we have built so far. I am planning to share these tables every quarter, so you get a sense of how the portfolio's attributes shapes up over time.

Portfolio ex-Financial companies

Growth *(% YoY)*	FY21	FY22	FY23	FY24E	FY25E	FY26E	CAGR (FY23-26)
Sales		*17.1%*	*16.1%*	*14.1%*	*15.0%*	*16.4%*	*15.2%*
EBITDA		*12.8%*	*2.2%*	*23.8%*	*23.2%*	*21.9%*	*22.9%*
PAT		*45.5%*	*1.6%*	*35.9%*	*37.1%*	*34.0%*	*35.6%*
Margins							
EBITDA		*13.7%*	*12.1%*	*13.1%*	*14.0%*	*14.7%*	
PAT		*5.6%*	*4.9%*	*5.8%*	*7.0%*	*8.0%*	
Leverage ratios							
Leverage (Net Debt to EBITDA)	*1.9*	*1.6*	*1.5*	*1.2*	*0.8*	*0.5*	
Leverage (Net Debt to Equity)	*0.9*	*0.8*	*0.7*	*0.5*	*0.4*	*0.2*	
Return ratios							
RoE	*-4.9%*	*30.4%*	*20.5%*	*20.0%*	*22.8%*	*24.8%*	
RoCE	*12.3%*	*13.0%*	*12.0%*	*14.1%*	*17.4%*	*20.3%*	
Valuation Ratios (x)							
PE (i)	16.4	21.9	29.6	19.0	15.3	10.9	
PEG		0.5	18.1	0.5	0.4	0.3	
PB	21.8	5.2	5.5	4.3	3.6	2.9	
EV/EBITDA	11.3	12.4	14.4	11.2	9.1	6.9	
P/Sales	1.9	1.9	2.1	1.8	1.4	1.1	
FCF Yield (%)(ii)	3.9	2.9	2.5	1.0	4.1	5.1	
Dividend Yield (%)(ii)	0.4	1.2	0.7	1.3	1.4	1.8	

Notes: (i) we have excluded one company's P/E for FY21, FY22 and FY23 as the company has gone from losses, to break even to small profits in these three years which skews the data; (ii) we have excluded a fintech company for the purpose of calculating FCF since the business has a lending arm and for lending businesses FCF is meaningless.

Financial companies

Fundamentals	FY21	FY22	FY23E	FY24E	FY25E	FY26E
AUM Growth	29%	46%	37%	30%	31%	29%
NII Growth	38%	26%	68%	37%	30%	31%
PPOP Growth	10%	42%	42%	28%	29%	28%
PAT Growth	-37%	-50%	1680%	34%	31%	32%
NIM	12%	11%	14%	14%	14%	14%
PPOP	6%	6%	9%	9%	9%	9%
Credit cost (on avg AUM)	5%	6%	2%	3%	3%	3%
ROA	1%	0%	5%	5%	5%	5%
ROE	4%	2%	21%	20%	21%	23%
Valuations	**FY21**	**FY22**	**FY23E**	**FY24E**	**FY25E**	**FY26E**
PE	-	-	10.4	7.8	5.9	4.5
PEG	-	-	0.0	0.2	0.2	0.1
PB	-	-	1.7	1.4	1.1	0.9
Dividend Yield	-	-	-	-	-	-

Notes: (i) This company IPOed less than a year ago and hence we do not have historic valuations.

If we analyse the tables above, it indicates that we own high growth companies, with high return ratios and safe balance sheets (ie comfortable net debt to EBITDA ratios) that faced margin headwinds in FY23 – which we believe will normalise in FY24 and improve further in the years beyond driving strong EBITDA growth. Further, the portfolio will witness balance sheet deleverage leading to earnings growth being even stronger than EBITDA growth.

For the growth rates and more importantly quality of growth (ie growth coming without taking balance sheet risk, or diluting return ratios and also generating strong FCF at the same time) we believe the portfolio's valuation is extremely attractive. If this was a listed company, this would definitely be a top holding for us!

Finally, just to give you a sense of the quality of work we do on companies before investing, we are sharing in **Annexure I** a very brief memo on one of our investments which is in the public domain – Jupiter Wagons Ltd. For those of you really keen to take a deeper look at our research, we have attached a detailed 24 page note on Jupiter along with this letter.

We thank you for trusting us as stewards of your capital and assure you that we are working tirelessly to find the best investment opportunities for the long-run.

Yours Sincerely

Kuleen Tanna
Founder & CIO

Direct: +91 22-65165826
Board: +91 22-65165800
Mobile: +91 98208 73254

Annexure I

Jupiter Wagons Ltd (CMP: 179; Market Cap: Rs72 bn; ADT: Rs111 mn)

Best placed to capitalise on Railway capex with multiple optionalities

The macro-opportunity: Indian Railway capex cycle to last longer than what the street is building in

Indian railways (IR) has witnessed a remarkable increase in capital budget over the past six years (CAGR of 19% over FY18-24BE). Even more remarkable has been the increase in capital budget for rolling stock procurement (freight wagons, diesel locomotive, passenger coaches etc -- 42% FY18-24BE CAGR). All of these have been driven by IR's aspiration of reaching 45% market share of Indian freight traffic from a current share of 28%. Financing such a high capex was made possible by merging the Railway Budget with the Union Budget in CY17, ending a practice of separate budgets that began in 1924 under British rule. While we acknowledge that capex cycles are inherently cyclical, the capex cycle to address the freight ambition of IR and to address decades of underinvestment in railway infrastructure will be a long cycle. Jupiter wagons (JWL) came on our radar while we were working on potential winners from the railway capex cycle.

The domestic freight wagon market has been a highly competitive industry. The existing capacity of wagon manufacturers in India is estimated at 30,000 units p.a. The capacity was underutilized as IR procured ~ 8,200 wagons p.a. over the last six years. However, in FY23 IR came out with a plan of procuring 90,000 wagons over 39 months. This is the largest procurement plan in the history of IR. Further, IR is expected to come out with a global tender of 50,000 wagons (to satisfy additional design requirements of high speed and high axle load in dedicated freight corridor). Thus, its expected that the domestic wagon industry size can potentially double to Rs160bn p.a. over next 3-4 years. The industry is expected to see a sharp improvement in utilisation, pricing power (and hence better margins). Several players have announced capacity expansion as well.

With increased capital allocation from IR to address decades of underinvestment, not only have the sectoral order visibility (growth projections) and the profitability witnessed improvement, the fear of a stretched working capital cycle has also receded. Combined, all three have the potential for expanding sectoral ROCEs.

Competitive positioning

Promoted by the M.L. Lohia family thirteen years ago, JWL acquired CEBBCO (major supplier of commercial vehicle body to Tata Motors) through NCLT and reverse merged with CEBBCO to get listed in FY22. With revival in wagon ordering from IR and private sector, JWL has seen orderbook swelling to ~Rs60bn from less than Rs10bn in 3 years. With CEBBCO, JWL currently has a capacity of ~ 7,200 wagons p.a. and is running at near full utilisation to meet the increased demand. The company plans to debottleneck its facility and increase wagon manufacturing capacity to 8,500 in FY24, and eventually to 12,000 p.a. (as IR finalises the global wagons tender). However, even while the workload was low over the past decade, JWL continuously strived to increase backward integration and value add to improve profitability and stay relevant in what was an extremely competitive market (over the past decade JWL's win rate in IR's wagon orders was ~ 11%). Be it investment into no-bake mould manufacturing inhouse through France and Italian ToT or investments into inhouse cold rolled formed sections[1] leading to substantial cost savings – JWL's management was relentless in reducing costs. The difference is visible today in higher EBITDA margins (vis-à-vis peers) that JWL enjoys. To us, JWL's journey embodies a constant strive for operational improvement in the shop floor while keeping an eye out for relevant technology. The journey has been fortified with an able executive team (some of whom we have been fortunate enough to interact with – likes of VP – Quality management, Senior VP – Wagons, Chief Technical Officer to name a few). Many of them have more than 4 decades of experience in the industry ably assisting first Mr. M.L. Lohia and now his sons Vivek Lohia (MD) and Vikas Lohia (Whole time director) in shaping up today's JWL.

With an able stewardship, JWL was able to strive through the hard times in the industry (between CY10-18) where many players witnessed bankruptcy and closure. What also helped is the investment from Slovakian Rail freight and bogies manufacturer Tatravagonka A.S. Tatra acquired 26% stake each in Jupiter group companies - Jupiter Wagons and Jupiter Alloys & Steel India for Rs1bn in CY15 (when both the entities were unlisted)[2]. The entities were subsequently merged.

Investment of Tatra not only allowed JWL to be future ready with augmented capacities at a time competition was bleeding (preparing JWL well for the IR capex cycle that started from FY18 and accelerated as time went by), it also helped JWL to source in technology for evolving design requirements of IR (e.g. for the global wagons tender that's awaited) and some of the backward integration initiatives. These initiatives went on to cement JWL's position as a complete solutions provider for domestic wagon manufacturing while derisking its revenues from IR's wagon capex. With DAKO and KOVIS (which are suppliers to Tatra) JWL started investing to set up brake system (for LHB coaches) and brake disc JVs respectively. The plants are ready now and can address potential market of Rs50-60bn p.a. (including exports).

As railway wagon ordering stepped up, JWL's original plant in West Bengal was finding it difficult to meet supply and add relevant capacities for backward integration and value addition. Thus came the CEBBCO acquisition (from NCLT) in Feb 2019. Further, to secure future growth and future capacity expansion as well as relevant IR licence for supply of brakes, JWL acquired *Stone India* for ~Rs200mn in CY23. The visibility from railway and private sector wagon orders and the ramp up of business from DAKO and KOVIS JV together has the potential to triple JWL's profit over next three years, while rebasing ROCEs to a healthy 20%+.

But the story of JWL doesn't end here. Strengthened by acquisition of CEBBCO, JWL wanted to explore light and medium electric commercial vehicle (E-LCV/MCV) production in India. CEBBCO has been manufacturing load bodies for commercial vehicles for a long time. JWL views electric mobility as a natural extension of the business. JWL is about to enter a JV with Canadian electric mobility player 'Green Power', has tied up with Log9 materials for EV batteries and Xavion mobility for vehicle design and development. The company aims to capture 10% domestic market share in E-LCV/MCVs by FY26E; Auto expo 2023 witnessed launch of two variants of E-LCVs into the market (2.2te Jupiter Tez and 7te EV-STAR).

Further, JWL has entered a JV with French major CAF for metro coach manufacturing. GoI has allocated ~ Rs195bn to all metro projects across India in the union budget FY24, a CAGR of 9.7% over FY16-24BE. GoI has also announced ~ 50 metro projects with an opportunity of 5,000-7,000 coaches which translates to Rs500-700bn opportunity (1 metro coach costs ~ Rs100mn). JWL's JV with CAF is a toehold into that market. Again an opportunity whose potential earnings are hardly discounted into the price.

Unlike peers, JWL is conscious of increasing its value addition with each subsequent investment planned. The company is staying true to its commitment of prioritizing profitable growth. Along with Rs500mn of investment in the base business, JWL looks at spending ~ Rs4bn over next 18 months. With recent QIP, the company is well capitalised and is currently a net cash company. Execution of the projects at hand while being able to diversify the revenue stream as planned will determine JWL's value creation journey over next three years – if past is any indicator of the future, then stars are aligned.

1. *Cold rolled formed structures are open beam like structures which rests on the bogey and on which wagons are mounted*
2. *Current stake of Tatra in JWL is 20.5%.*

Aionios
Alpha