January 8, 2024

Dear Partners in AAFI,

Q3 was a tough quarter for us. While the fund was up 4.9% during the quarter (4.4% net of fees and all expenses) we underperformed the Nifty during the quarter by 5.6% & 6% respectively.

Returns during the quarter were not as broad based as the previous two quarters, with 11 of the 21 positions in the portfolio beating the Nifty. We fully sold out of Jupiter Wagons (which we had already trimmed meaningfully in the previous quarter) and trimmed 2 other stocks during the quarter. Both these stocks significantly outperformed the Nifty during the quarter.

The fund had an average cash balance during the quarter of 19.9% (end of quarter cash is at 17.5%).

Year to date the fund has delivered a 55.4% return (53.6% net of fees and all expenses) beating the Nifty by 30.7% & 28.9% respectively. Average cash balance YTD was 32.7%. Year to date 16 out of the 21 positions in the portfolio individually beat the Nifty. All the stocks we sold / trimmed have meaningfully beaten the market.

Q3FY24 - Class A	**Returns**	**Excess Returns**
AAFI - Gross returns	4.88%	-5.58%
AAFI - Returns net of fees & expenses	4.42%	-6.03%
Nifty	10.45%	
YTD FY24 - Class A	**Returns**	**Excess Returns**
AAFI - Gross returns	55.38%	30.67%
AAFI - Returns net of fees & expenses	53.62%	28.92%
Nifty	24.71%	

During the quarter we made 2 new investments and added to 3 existing positions.

With regards to the 2 stocks we trimmed during the quarter, one was up 90%+ and the other 100%+ from where we bought them. Given the sharp rally in both the names in a short period of time – incremental risk reward was not as attractive, and hence we decided to trim them both.

We had 82 management interactions during the quarter and conducted 7 plant visits & field trips. This is over and above dozens of earnings calls each of the six investment team members attended during results season and ad hoc calls hosted by companies.

Please find below the portfolio as if it were a single stock.

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Portfolio ex-Financial companies

Growth (% YoY)	FY21	FY22	FY23	FY24E	FY25E	FY26E	CAGR (FY23-26)
Sales		21.0%	12.2%	9.8%	14.3%	14.9%	13.0%
EBITDA		16.3%	0.6%	16.0%	25.4%	17.9%	19.7%
PAT		68.9%	5.7%	15.2%	41.3%	27.8%	27.6%
Margins							
EBITDA		14.9%	13.3%	14.1%	15.4%	15.8%	
PAT		6.0%	5.7%	5.9%	7.3%	8.2%	
Leverage ratios							
Leverage (Net Debt to EBITDA)	2.1	1.7	1.6	1.3	0.9	0.6	
Leverage (Net Debt to Equity)	1.1	0.9	0.7	0.6	0.4	0.3	
Return ratios							
RoE	-5.6%	28.4%	19.4%	18.8%	21.8%	23.0%	
RoCE	9.7%	12.2%	11.8%	13.4%	16.4%	18.2%	
Valuation Ratios (x)							
PE (i)	12.9	17.8	23.1	18.3	17.6	12.8	
PEG		0.3	4.0	1.2	0.4	0.5	
PB	20.0	5.0	4.8	4.2	3.4	2.8	
EV/EBITDA	10.4	10.7	11.9	10.4	9.7	7.6	
P/Sales	2.6	2.1	2.1	1.8	1.5	1.2	
FCF Yield (%) (ii)	5.2	2.8	4.3	1.9	3.2	5.2	
Dividend Yield (%) (ii)	0.3	1.1	0.6	0.8	1.0	1.2	

Notes: (i) we have excluded three company's P/E for FY21 to FY24 as these companies have gone from losses, to break even to small profits in these four 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	FY23	FY24E	FY25E	FY26E
AUM Growth	29%	46%	37%	31%	31%	30%
NII Growth	38%	26%	68%	37%	32%	30%
PPOP Growth	10%	42%	42%	28%	28%	28%
PAT Growth	-37%	-50%	1680%	32%	37%	33%
NIM	11.7%	11.1%	13.7%	14.1%	14.2%	14.2%
PPOP	5.5%	6.0%	8.6%	8.9%	9.1%	9.2%
Credit cost (on avg AUM)	5.4%	6.5%	2.5%	2.8%	2.7%	2.7%
ROA	0.9%	0.3%	4.6%	4.6%	4.8%	5.0%
ROE	3.6%	1.7%	21.2%	19.8%	22.0%	23.3%
Valuations	**FY21**	**FY22**	**FY23**	**FY24E**	**FY25E**	**FY26E**
PE	-	-	14.9	11.3	8.3	6.2
PEG	-	-	0.9	35.4	22.2	19.0
PB	-	-	2.5	2.0	1.6	1.3
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 steady 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 deleveraging leading to earnings growth which is 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!

To give you more flavour of the portfolio, and to demonstrate how well diversified the portfolio is, we are sharing below a pie chart that shows our sector exposures.

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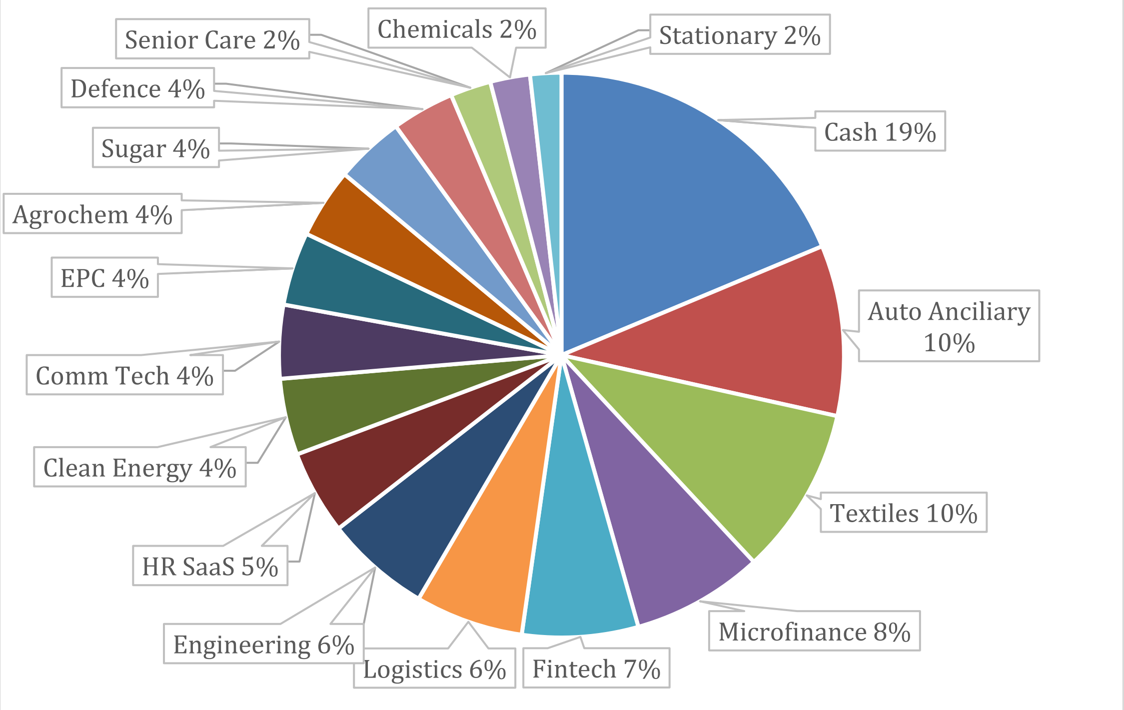
Sector exposure of AAIM



This quarter we are sharing our thoughts on Arvind Ltd. Arvind is up more than 3x from when we first started buying the stock. We wanted to showcase a company where we have been adding to a company into strength. We have been talking about how we have sold / trimmed stocks that have gone up a lot over the last 3 letters (including this one) and didn't want you to have the impression that if a stock goes up a lot we sell / trim them as a blanket rule. It is completely case by case and as our conviction in Arvind increased, we kept adding to the stock. In fact, if a few other events which we are anticipating play out – we are happy to further add to the name at current valuations as well.

Do keep sharing your feedback and comments and we will try and incorporating as much as possible in our future letters.

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

Annexure I

Arvind Ltd (CMP: 261; Market Cap: Rs 68bn; ADT: 328mn)

Turnaround efforts are paying off: Post the demerger of the group in 2018, Mr. Punit Lalbhai has taken over active management of this company from Mr. Sanjay Lalbhai. With Punit at the helm, the company has added to its management bandwidth by hiring several industry veterans in senior management roles. Post demerger, capex has pre-dominantly been directed towards the advanced material division (AMD) and garments segment. These businesses have superior capital efficiency and competitive moats unlike the fabric business. Arvind generated CFO of Rs. 23.6bn in the period of FY20-FY23, of which ~40% has been utilized towards debt repayment and ~30% towards capex. With a stronger balance sheet, better business mix and strong industry tailwinds, the company is poised to generate significant value for its shareholders.

Table 1: Consistent reduction in debt and improvement in FCF in the last 4-5 years

Debt (INR mn)	2018	2019	2020	2021	2022	2023
Long-term Debt	4,967	6,908	9,186	11,419	7,577	3,783
Short-term Debt	24,743	17,651	14,371	8,603	10,017	10,255
Total	29,711	24,559	23,557	20,022	17,595	14,038

Cash Flow	2018	2019	2020	2021	2022	2023
Operating Cash Flow	2,265	15,085	8,426	3,783	3,083	8,337
Capex	(6,650)	4,687	(5,009)	180	454	(2,782)
Free Cash Flow	(4,385)	19,772	3,417	3,963	3,538	5,555

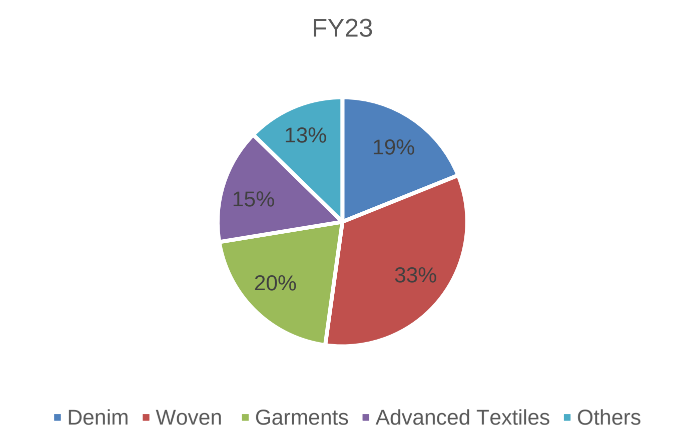
Please note. – FY19 Cash Flow is the year of demerger, hence there are some one-offs.

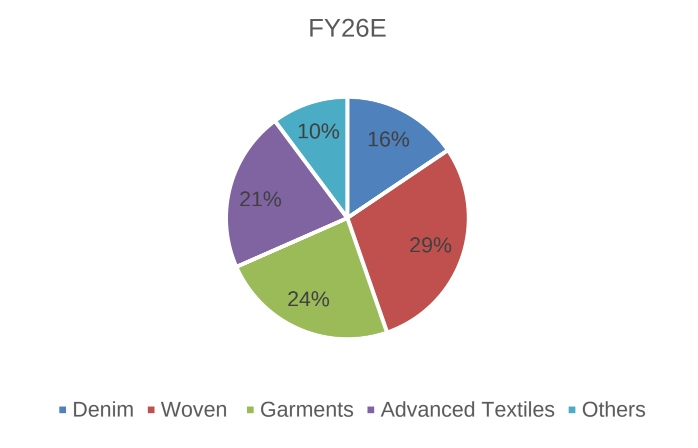
AMD segment revenue CAGR of 20%+ (FY24-26) with margin expansion: Arvind operates in three broad categories within the AMD segment: namely (a) Human protection (50% of AMD) – protective garments meant to protect from harsh external environmental effects such as firefighters, personnel responding to toxic workers in toxic environments, medical technicians, laboratory researchers etc. (b) Industrials (~25% of AMD) – used in filtration, conveying, solutions and products for mechanical engineering. and (c) Composites (~25% of AMD) – materials made by combining two or more natural or artificial elements that are stronger together used in aerospace, automotive, infrastructure etc. Arvind's clients are the likes of Carhartt, Siemens, Wilson, Workwear group. Since these products are for specific niche & technical purposes, they require rigorous testing and certification. This creates an entry barrier for competitors to come in and has high switching costs for clients. The company's growth is driven by an increase in wallet share with its existing customers and expansion into complementing products. China +1 and import substitution are the expected overarching growth themes. In FY23, the company's AMD business delivered 13.2% EBITDA margins with exit Q4FY23 registering EBITDA margins of 14.5%, we believe this business can achieve margins in the range of 16-18% EBITDA and post-tax ROCEs of 20%+. The margin improvement is likely to be driven by (a) economies of scale (b) since AMD is a collection of different products with different applications some products have subpar / negative contribution to profitability as these products get more scale, they contribute positively towards margin improvement.

Garments segment revenue CAGR of 12% (FY24-26) with margin expansion: The fabric division has been below par on margins and capital efficiency. By forward integrating into finished garments, Arvind intends to take advantage of an integrated model and deliver better capital efficiency for its stakeholders. The company serves major apparel vendors like H&M, Marks & Spencer, Gap, Levi Strauss etc. China +1 and vendor consolidation to be the key themes which will drive growth in the segment. Global apparel inventory levels have now begun to deplete which should lead to better revenue traction going forward in H2FY24. Arvind is also looking to expand its capacity to 60mn pcs each for garments and essential (innerwear) garments from its existing 45 / 49mn pcs currently. With capacity utilization uptick, change in product mix and productivity gains aiding in driving segment margin improvement. To execute this growth company has hired Dr. Venkatesh Babu for their garments division who earlier worked in Shahi Exports as Director (India's largest garment exporter) for 19 years, with focus on forward integration, efficiencies and growth, we believe ROCE in the segment is poised to increase.

The China+1 theme emerged for textiles with increasing labor costs and Xingjian cotton ban where countries like Bangladesh, Vietnam, Turkey could capitalize on it due to favorable trade agreements. Indian government has already signed Free Trade Agreements (FTAs) with UAE and Australia, with an FTA with UK on the anvil. UK textile imports amounted to USD 33bn in CY22, of which knitted and woven ready-made-garments account for USD25bn. Despite having a higher labor cost, India will be competitive due to the availability of cotton and stable geo-political climate. Currently, India exports USD 1.5bn off the USD 25bn (ie ~6%). opportunity with an adverse duty structure. An FTA with the UK will open a plethora of opportunities for existing players and integrated players like Arvind should benefit. In markets where Indian players have level playing field they have done well, case in point is Indian home textile players, in markets like US, where share in segments like cotton sheets, cotton pillowcases have crossed 50%. We have not built in any benefits from a potential UK FTA and is an optionality to our estimates.

Revenue share of Advanced materials and Garments increasing from 35% in FY23 to 45% by FY26E





Fabric volumes to remain flattish: Arvind currently is a nominated supplier for several global brands which should keep the demand steady, however, company is operating close to its peak capacity utilization and doesn't intend to add further capacity in the business due to its lower capital efficiency and overcapacity in segments like denim at a global level. The company is in fact keen on using its fabric capacity to cater to its garment segment, which leads to better margins and is more capital efficient. The company will continue maintenance capex and debottlenecking exercises but is not keen to add greenfield / brownfield capacities in this segment.

Valuations: Despite the strong run up in the stock, Arvind continues to trade at reasonable valuations, both in absolute and relative terms. We believe the stock should continue to re-rate as the company delivers. The company also has an opportunity to unlock further value by carving out its Advanced material division.

Peer comparison (Rs mn)			PE			EV / EBITDA		
Company name	CMP	Market Cap	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Arvind Ltd	261	68,369	20.8	15.8	12.2	9.8	8.0	6.7
Gokaldas Exports	826	50,132	35.3	23.4	17.8	17.2	11.8	9.3
KPR Mill	825	2,81,917	30.8	25.8	21.4	20.1	17.3	14.1
Indo Count Industries	308	60,985	16.0	13.1	10.5	11.8	9.9	8.1
Welspun	144	1,40,377	21.7	16.1	12.3	10.9	8.6	6.8
Vardhaman Textiles	386	1,11,675	16.5	11.4	8.7	10.9	7.6	5.6
S P Apparel	607	15,233	15.6	12.5	10.6	8.8	7.0	5.7

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