April 9, 2024

Dear Partners in AAFI,

Q4 was another tough quarter for us. The fund was down 4.1% during the quarter (down 4.6% net of fees and all expenses) and we underperformed the Nifty during the quarter by 6.8% & 7.3% respectively.

During the quarter 16 of the 22 positions in the portfolio underperformed the Nifty. We sold out of 4 companies and trimmed 1 during the quarter. All the stocks we sold had significantly outperformed the market. The stock that we trimmed performed in-line with the market at the time we reduced our position size.

The fund had an average cash balance during the quarter of 12.4% (end of quarter cash was 6.5% after paying all taxes and pay out of performance fees).

For the entire year, the fund has delivered a 49% return (39.5% net of fees and all expenses) beating the Nifty by 20.7% & 11.1% respectively. Average cash balance for the year was 27.7%. For the full year 14 out of the 22 positions in the portfolio beat the Nifty. All the stocks we sold / trimmed have meaningfully beaten the market (besides one stock we trimmed this quarter that performed in-line with the market).

Portfolio turnover during the first year was higher than what we would like it to be, at 44%. Since we invest from a ~3 year horizon, we expect the portfolio turnover to be 30% or lower. However, due to a bunch of stocks in the portfolio running way ahead of fundamentals this year, we thought it prudent to sell these companies and reinvest them in more attractive investment opportunities, and live with a higher portfolio turnover.

Q4FY24 - Class A	**Returns**	**Excess Returns**
AAFI - Gross returns	-4.10%	-6.84%
AAFI - Returns net of fees & expenses	-4.61%	-7.34%
Nifty	2.74%	
FY24 - Class A	**Returns**	**Excess Returns**
AAFI - Gross returns	49.01%	20.66%
AAFI - Returns net of fees & expenses *	39.48%	11.14%
Nifty	28.34%	

** Please note that for the full year return net of fees & expenses we have factored in the impact of performance fees as well*

During the quarter we made 5 new investments and added to 8 existing investments. Thankfully we sold / trimmed the companies during the quarter before the March mid / small cap sell-off and could take advantage of the sharp fall in companies we like long-term; where there is no change to fundamentals & where stocks fell hard along with the broader small / mid cap space, thus making their risk reward trade-offs even more compelling.

We had 70 management interactions during the quarter. 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.

Portfolio ex-Financial companies

Growth *(% YoY)*	FY22	FY23	FY24E	FY25E	FY26E	FY27E	CAGR (FY24-27)
Sales	*31.3%*	*10.7%*	*4.5%*	*16.2%*	*13.3%*	*12.0%*	*13.8%*
EBITDA	*23.4%*	*8.0%*	*5.2%*	*25.1%*	*20.1%*	*14.4%*	*19.8%*
PAT	*188.9%*	*35.5%*	*-6.6%*	*39.2%*	*36.4%*	*23.4%*	*32.8%*
Margins							
EBITDA	*14.0%*	*13.7%*	*13.8%*	*14.8%*	*15.7%*	*16.1%*	
PAT	*4.8%*	*5.9%*	*5.3%*	*6.3%*	*7.6%*	*8.4%*	
Leverage ratios							
Leverage (Net Debt to EBITDA)	*1.6*	*1.3*	*1.2*	*0.7*	*0.2*	*-0.3*	
Leverage (Net Debt to Equity)	*0.8*	*0.6*	*0.5*	*0.3*	*0.1*	*-0.2*	
Return ratios							
RoE	*22.6%*	*18.9%*	*16.4%*	*19.8%*	*22.0%*	*22.0%*	
RoCE	*10.0%*	*11.5%*	*11.3%*	*14.4%*	*17.0%*	*18.0%*	
Valuation Ratios (x)							
PE [(i)]	17.5	27.5	29.2	17.9	16.1	13.1	
PEG	0.1	0.8	-4.4	0.5	0.4	0.6	
PB	5.8	5.0	4.9	3.9	3.0	2.4	
EV/EBITDA	8.3	10.6	10.4	9.2	8.2	6.8	
P/Sales	4.3	3.1	3.2	2.2	1.6	1.3	
FCF Yield (%)[(ii)]	2.3	4.5	0.8	1.6	4.6	6.2	
Dividend Yield (%)[(ii)]	1.3	0.7	1.1	1.3	1.5	1.7	

Notes: (i) we have excluded three company's P/E for FY22 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.

If we analyse the table above, it indicates that we own steady companies, with high return ratios and safe balance sheets (ie comfortable net debt to EBITDA ratios) that faced margin headwinds in FY23 / FY24 which we believe will normalise in FY25 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.

Financial companies

Fundamentals	FY22	FY23	FY24E	FY25E	FY26E	FY27E	CAGR (FY24-27)
AUM Growth	14%	20%	19%	18%	18%	18%	18%
NII Growth	14%	30%	16%	18%	15%	19%	17%
PPOP Growth	6%	-25%	77%	26%	20%	23%	23%
PAT Growth	96%	72%	6%	22%	17%	24%	21%
NIM	7.9%	9.0%	9.3%	9.3%	9.3%	9.2%	
PPOP	4.3%	5.2%	5.9%	6.0%	6.0%	6.1%	
Gross NPA	4.1%	2.6%	2.8%	2.6%	2.5%	2.5%	
Credit cost (on avg AUM)	3.1%	1.3%	1.8%	1.5%	1.5%	1.5%	
ROA	0.9%	3.2%	3.1%	3.3%	3.4%	3.4%	
ROE	7.0%	18.9%	17.4%	18.1%	18.4%	19.2%	
Valuations							
PE			13.2	10.4	8.5	6.8	
PEG			1.2	0.4	0.4	0.3	
PB			2.0	1.6	1.4	1.1	
Dividend Yield			0.1	0.1	0.2	0.2	

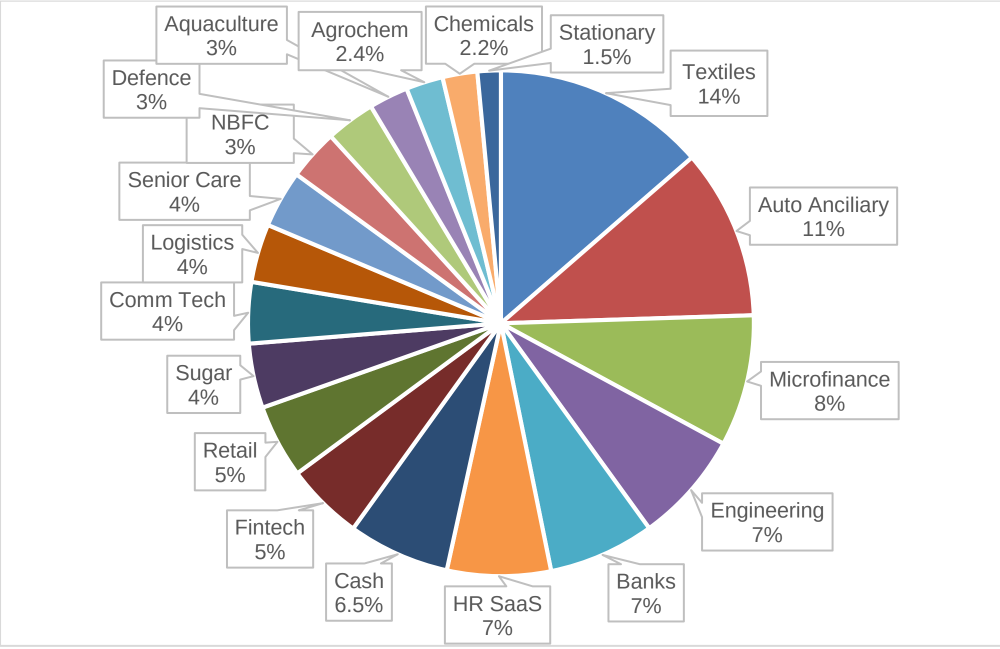
Notes: (i) One of the company in our BFSI basket IPOed less than a year ago and hence we do not have historic valuations.

Similarly, if we analyse the table above for financial companies, it indicates that we own high growth lenders, with high margins, operating leverage (visible from PPOP growth higher than NII growth), low GNPAs and high return ratios. Despite that - these companies are trading at very attractive valuations.

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; and low GNPAs / credit costs in the case of the lenders) we believe the portfolio's valuation is extremely attractive.

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.

Sector exposure of AAIM



This quarter we are sharing our thoughts on Allsec Ltd. Allsec is up ~60% (including dividends) from when we first bought the stock. As our conviction grew, we kept adding to our position. What is really encouraging is that more than 2/3rd of the returns are driven by earnings upgrades, and the multiple rerating (which we believe should happen), is yet to play out.

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

Allsec Ltd (CMP: 731; Market Cap: Rs 11.2bn; ADT: Rs 42mn)

Founded in 1998, Allsec is a provider of IT/ITes outsourcing solutions offering As-a-service based HRMS platform and BPO/BPS services. The Company operates two segments globally viz. Human Resources Operation (HRO) covering Human Resources Management System (HRMS), payroll services, time and attendance management and Digital Business Services (DBS) which encompasses lead generation, customer retention and relationship management.

Allsec operates in the nascent and underpenetrated Indian HRMS market. Revenue mix changing towards HRMS is driving sustained higher revenue growth as well as margin expansion. This is the primary reason for our constructive view on the stock. With strong industry tailwinds, better business mix and strong cashflow generation, the company is poised to generate significant value for its shareholders.

HRO segment to drive revenue growth.

The company's HRO business is a platform-based offering encompasses HRMS, payroll services, time, and attendance management services. HRO, of the two incumbent offerings, is the faster growing one with significantly higher margins. In our view, the company has been correctly focusing on this offering by 1) modernizing existing offering's by adding relevant suites and improving UI, 2) launching SAAS based HRMS offerings – *"Smartpay"* (launched in Q4FY23 which has led to improved pipeline) and 3) adding and refreshing the sales force in this segment.

Our underlying thesis seems to be playing out well as strong deal wins has translated into robust double digit YoY growth over the last 3 quarters. Moreover, the HRO segment's logo addition and Annual contract value (ACV) win results in our confidence of sustained strong future growth trajectory. The management, too, expects this run-rate to continue due to the launch of the *Smartpay* platform and the incorporation of new suites in the existing HCM platform which has led to a substantial increase in the deal pipeline. As per our estimates, considering the ACV wins delivered over the last few quarters and taking a conservative win rate till FY27 with a 20% churn in existing revenues, HRO is slated to deliver a 26% CAGR revenue growth over FY23-27E.

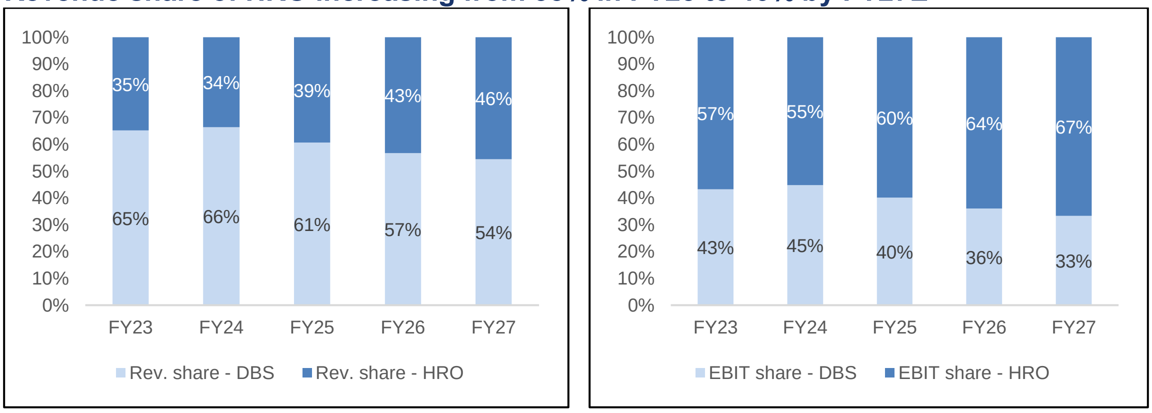
Rs mn	FY21	FY22	FY23	9M FY24
HRO Payslips processed (mn)	9	12	14	12
New logos added (#)	111	130	130	75
ACV	NA	135	267	216
Revenue	983	1,147	1,356	1,134
growth (%)	*4%*	*17%*	*18%*	*18%*

Changing revenue mix towards more profitable segments

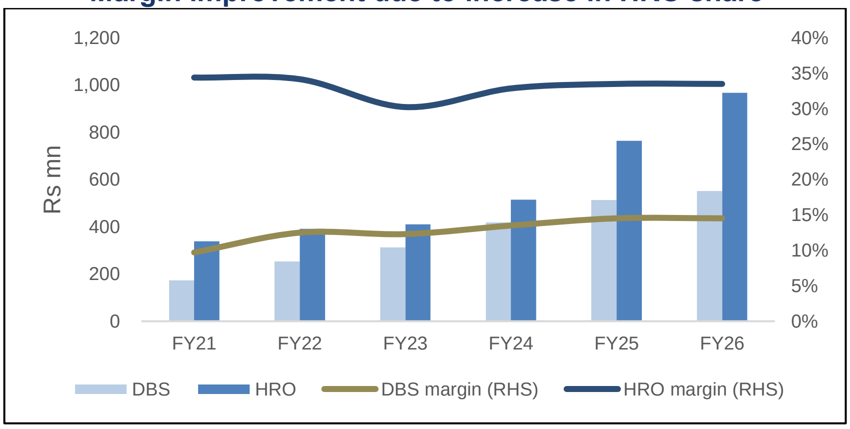
Within the two segments operated by the co. viz. HRO and DBS, DBS is a steady state business with an industry growth rate of ~8-9% as per latest NASSCOM report. For Allsec too this segment has delivered a growth rate of 8% CAGR over the last 3 years (however, accelerated to 20%+ YoY over last 3 quarters) and we have pencilled in 12% growth over FY23-27E, on account of strong deal wins. HRO business is the faster growing one as evinced by the data above. More importantly, HRO is the more profitable business. Characteristics of the HRO business, considering it being a platform offering rather than a service, makes it inherently a higher margin business. Hence, as the share of HRO increases as a percentage of the overall business, margins are slated to expand from current levels leading to accelerated EPS growth (refer charts below).

Currently, HRO contributes to 34% of topline and is expected to grow at ~26% CAGR over FY23-27E leading to it contributing 46% of revenues by FY27e. This will lead to a consolidated margin expansion of ~440bps over the same period.

Revenue share of HRO increasing from 35% in FY23 to 46% by FY27E



Margin improvement due to increase in HRO share



Favourable industry tailwinds to aid revenue growth.

The India human resource (HR) technology market is primarily driven by the rapid industrialization and urbanization that have resulted in the increasing number of corporate organizations. Furthermore, the pandemic too has led to higher demand for advanced HR tools that assist in improving the learning, productivity, and engagement of employees. Organisations have realised that the integration of HR technology with cloud computing, software-as-a-service (SaaS), Artificial intelligence (AI), business intelligence (BI), and dashboards have provided added flexibility and competitive edge over other solutions, which is positively impacting the market growth.

The India HR technology market size reached US$ 940mn in 2022. Looking forward, the market is expected to reach US$1.64 bn by 2028, implying a growth rate of ~10%+ CAGR over this period. As per our analysis of the employment market (using Income Tax returns database as proxy), growth can be higher for the organised players such as Allsec as bulk of the payroll processing is done by mom-and-pop Chartered Accountancy firms as of now.

Analysis of key legacy industry players (ADP India Pvt. Ltd and Ramco System) suggests that Allsec has been steadily gaining market share (refer table below). Some newer pure-SAAS players have grown at a 20%+ since the lasts 3 years, however at the cost of negative EBITDA, underscoring Allsec's execution capabilities, as evinced by the table below. This validates our key investment arguments of investments in HRO platform (legacy as well as new SAAS based platform) and re-energising the sales force has been bearing fruits.

Table 1: Market share gains visible versus competition.

Revenue (Rs mn)	FY18	FY19	FY20	FY21	FY22	FY23
ADP	1,265	1,416	1,619	1,950	2,037	na
Allsec	**490**	**594**	**941**	**983**	**1,147**	**1,356**
Ramco Systems	1,519	2,124	2,360	2,152	2,044	2,068
Revenue market share						
ADP	39%	34%	33%	38%	39%	
Allsec	**15%**	**14%**	**19%**	**19%**	**22%**	
Ramco	46%	51%	48%	42%	39%	

Note: The above market share is relative to the two large HRMS players and does not capture the entire fragmented market as we do not have that data available.
Source: Zauba corp, Company, Aionios Alpha

Table 2: Allsec's profitable growth visible versus new age competitors.

Rs mn	FY18	FY19	FY20	FY21	FY22	FY23
Allsec						
Revenue	490	594	941	983	1,147	1,356
EBITDA		144	268	338	392	410
EBITDA margin (%)		*24%*	*28%*	*34%*	*34%*	*30%*
People Strong						
Revenue	910	1,216	1,319	1,263	2,276	2,588
EBITDA	-121	-186	-313	-168	-278	-770
EBITDA margin (%)	*-13%*	*-15%*	*-24%*	*-13%*	*-12%*	*-30%*
DarwinBox						
Revenue	47	115	276	533	1,167	2,028
EBITDA	-38	-53	-66	-76	-534	-1,306
EBITDA margin (%)	*-81%*	*-46%*	*-24%*	*-14%*	*-46%*	*-64%*
HROne						
Revenue	50	64	61	82	147	204
EBITDA	0.59	4.5	-17	-10	-2	-122
EBITDA margin (%)	*1%*	*7%*	*-27%*	*-12%*	*-1%*	*-60%*

Valuations: Despite the strong run up in the stock, Allsec continues to trade at reasonable valuations, both in absolute and relative terms. As the share of HRO business increases, we believe the stock should trade at par or possibly even higher than global HRO players (since we don't have listed comps in India), given 1) higher growth rate and a much longer runway of growth given the nascency of the HRO market in India and 2) higher margins (global peers operate at single digit EBITDA margins vs ~30% for Allsec) and higher return ratios. Hence, we believe the stock should continue to re-rate as the company delivers on both the revenue and margin front.

Table 3: Peer comparison table

			PE			P/S		
Company name	**CMP**	**Market Cap**	**FY24E**	**FY25E**	**FY26E**	**FY24E**	**FY25E**	**FY26E**
Indian BPO & Platform companies								
Allsec Tech	**731**	**11,124**	**24.6**	**17.2**	**12.9**	**2.6**	**2.2**	**1.8**
First Source Ltd.	198	1,37,700	26.0	21.0	17.4	2.1	1.9	1.7
Intellect design	1080	1,43,200	41.0	31.1	25.0	5.5	5.0	4.3
Oracle Financial services	8744	7,44,400	32.5	29.7	26.2	11.0	10.1	9.0
Nucleus Software	1184	34,120	19.5	15.0	12.2	4.3	3.6	3.1
Newgen	795	1,12,000	47.0	37.0	29.0	9.0	7.0	5.8
Mean			33.2	26.8	22.0	6.4	5.5	4.8
Median			32.5	29.7	25.0	5.5	5.0	4.3
Global peers*								
ADP	249	1,00,150	26.8	24.5	22.5	5.2	4.9	4.7
WorkDay	272	70,090	40.0	33.9	28,2	8.2	7.0	6.1
Ceridan	69	10,860	36.2	29.9	23.7	5.5	4.8	4.2
Mean			34.3	29.4	23.1	6.3	5.6	5.0
Median			36.2	29.9	23.1	5.5	4.9	4.7

Source: Company data, Aionios Alpha
Please Note: 1) All market cap data is in mn; 2) Price and Market cap for global peers are in US$

Aionios Alpha