January 7, 2025

Dear Partners in AAFI,

The fund was down 2.2% during the quarter (down 2.7% net of fees and all expenses). We outperformed the Nifty during the quarter by 6.2% & 5.7% respectively.

Year to date the fund was up 24.7% (23% net of fees and all expenses) – outperforming the Nifty by 18.8% & 17.1% respectively.

13 of the 23 positions we held at the end of the quarter outperformed the Nifty during the quarter (Year to date this number is 16 out of 23). We sold 2 companies during the quarter and trimmed 1 company. Of the 2 companies we sold completely, 1 outperformed the market meaningfully during the quarter (23%) & year (17%); we sold this to fund an even more attractive opportunity. The other company we sold, underperformed the market both during the quarter (4%) and year (15%). We sold this company to fund a QIP we participated in. With respect to the stock we trimmed, the stock outperformed the market by 26% during the quarter & 85% during the year. The stock was up 99% from when we bought it first ~15 months ago. Given the sharp rally, incremental risk reward is not as attractive. We really like the long-term opportunity in this company and hence did not fully sell out of it.

Inception to date 15 out of the 23 positions in the portfolio beat the Nifty.

The fund had an average cash balance during the quarter of 2.2% (end of quarter cash was 0.9%). Year to date average cash balance was 3%.

Q3FY25 - Class A	**Returns**	**Excess Returns**
AAFI - Gross returns	-2.21%	6.18%
AAFI - Returns net of fees & expenses	-2.69%	5.70%
Nifty	-8.40%	
YTD FY25 - Class A	**Returns**	**Excess Returns**
AAFI - Gross returns	24.70%	18.81%
AAFI - Returns net of fees & expenses	22.95%	17.06%
Nifty	5.89%	
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 2 new investments and added to 3 existing investments.

We had 73 management interactions during the quarter and 3 factory / facility visits. 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)*	FY23	FY24	FY25E	FY26E	FY27E	FY28E	CAGR (FY24-28)
Sales	*13.4%*	*2.1%*	*13.8%*	*20.1%*	*19.2%*	*13.6%*	*16.6%*
EBITDA	*17.2%*	*9.0%*	*16.4%*	*44.4%*	*18.4%*	*10.8%*	*21.9%*
PAT	*37.3%*	*7.0%*	*16.6%*	*67.9%*	*23.6%*	*13.2%*	*28.7%*
Margins							
EBITDA	*11.4%*	*12.1%*	*12.4%*	*14.9%*	*14.8%*	*14.5%*	
PAT	*5.3%*	*5.6%*	*5.7%*	*8.0%*	*8.3%*	*8.3%*	
Leverage ratios							
Leverage (Net Debt to EBITDA)	*1.3*	*1.3*	*1.0*	*0.6*	*0.0*	*-0.1*	
Leverage (Net Debt to Equity)	*0.4*	*0.3*	*0.3*	*0.2*	*0.0*	*-0.1*	
Return ratios							
RoE	*12.7%*	*13.9%*	*13.3%*	*17.6%*	*19.0%*	*19.1%*	
RoCE	*11.7%*	*10.7%*	*11.1%*	*14.2%*	*15.8%*	*16.8%*	
Valuation Ratios (x)							
PE [(i)]	26.0	29.9	28.9	19.6	14.9	13.0	
PEG	0.7	4.3	1.7	0.3	0.6	1.0	
PB	3.1	3.5	3.2	2.7	2.3	1.9	
EV/EBITDA	8.8	10.5	12.4	9.4	7.5	6.3	
P/Sales	2.7	2.9	2.5	1.9	1.6	1.4	
FCF Yield (%)[(ii)]	4.4	0.8	0.0	2.5	3.9	5.7	
Dividend Yield (%)[(ii)]	0.8	1.0	1.0	1.2	1.5	1.8	

Notes: (i) we have excluded three company's P/E for FY23 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 high growth companies, with sharply improving margins & return ratios and safe balance sheets (ie comfortable net debt to EBITDA ratios) that faced growth headwinds in FY24 which we believe will normalise in FY25 and improve further in the years beyond. Margins are expected to increase meaningfully 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	FY23	FY24E	FY25E	FY26E	FY27E	FY28E	CAGR (FY24-28)
AUM Growth	20%	14%	15%	17%	18%	18%	17%
NII Growth	30%	16%	13%	17%	17%	16%	16%
PPOP Growth	-26%	86%	12%	21%	23%	21%	19%
PAT Growth	70%	14%	6%	18%	25%	23%	18%
NIM	7.3%	7.3%	7.3%	7.5%	7.3%	7.1%	
PPOP	3.8%	4.6%	4.4%	4.4%	4.6%	4.7%	
Gross NPA	2.3%	1.8%	4.3%	3.5%	3.1%	2.9%	
Credit cost (on avg AUM)	0.8%	1.1%	3.3%	1.3%	1.0%	1.0%	
ROA	2.6%	2.6%	0.8%	2.4%	2.7%	2.8%	
ROE	17.9%	17.2%	8.9%	15.0%	16.5%	17.6%	
Valuations							
PE	23.9	11.8	7.9	9.5	7.4	5.9	
PEG	0.3	0.7	1.0	0.4	0.3	0.2	
PB	2.2	1.7	1.6	1.3	1.1	0.9	
Dividend Yield	0.0	0.0	0.0	0.0	0.0	0.0	

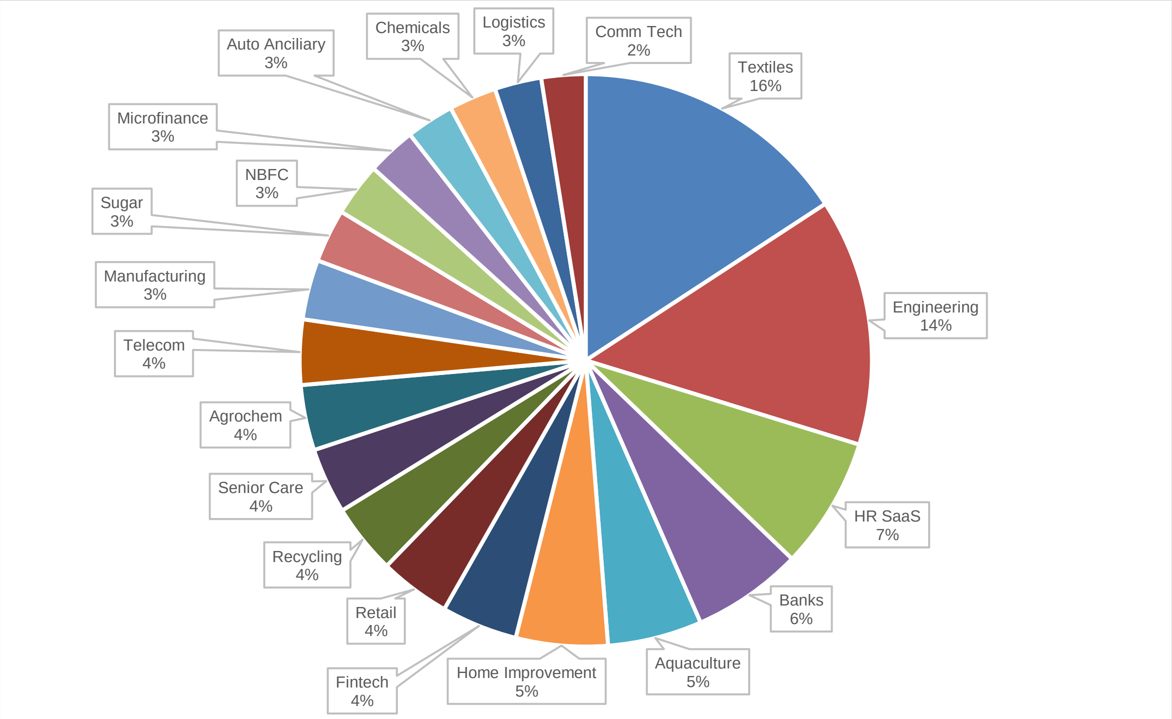
Notes: (i) One of the company in our BFSI basket IPOed less than a year ago and hence we do not have historic valuations.

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), declining GNPAs (and thus credit costs) 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 generating strong FCF at the same time; and declining 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 Axis Bank. We bought this company in January 2024, and further added to it in April 2024. While the stock has not done well due to macro headwinds for the sector, our conviction in the long-term opportunity is very high. This is a company we are looking to add to further and increase the weight in the portfolio.

Do keep sharing your feedback and comments and we will try and incorporate 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

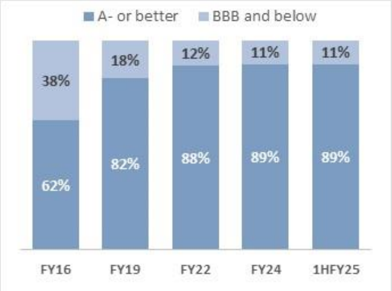
Axis Bank (CMP: Rs 1,070; Market Cap: Rs 3.3tn)

Growth concerns overdone, medium term levers remain intact: The banking industry has seen the fight for deposits intensify over the last year. This coupled with the regulator's nudge to keep the credit to deposit ratio under check has put pressure on systemic growth. Over the last few months, incremental CD ratio has remained under control and liquidity should ease further post CRR cut.

Near term pressures aside, the management is confident of delivering loan growth 300-400bps ahead of system credit growth sustainably. Over the last few years, the bank has also focussed on diversifying its product suite. This is clearly visible as contribution of smaller products like small business banking, rural loans and credit cards increased in the retail book and SME + Mid corporate book has grown from 14% of loans in FY20 to ~22% in FY24. We believe Axis is well placed to deliver loan CAGR of ~17% over FY24-28E.

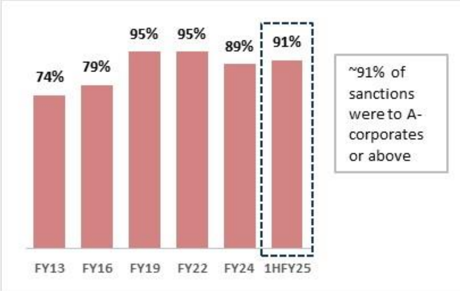
Asset quality outcomes improving; Additional provisions cushion against future shocks: Post RBI's asset quality review in FY17, Axis was one of the worst hit private banks with slippages of ~6.5% in FY17 followed by ~8.5% in FY18 owing to which corporate NPAS soared to ~15.2%. Since Amitabh Choudhary took charge, the bank began its journey on diversifying the asset mix with much better underwriting and more robust systems and processes in place. The bank implemented changes like 1. Increasing share of granular retail loans, 2. A shift towards shorter tenure/working capital loans and 3. Moving away from chunky fee generating credits.

Significant improvement in rating mix…



Source: Company data, Aionios Alpha

Led by higher incremental sanctions to better rated corporates



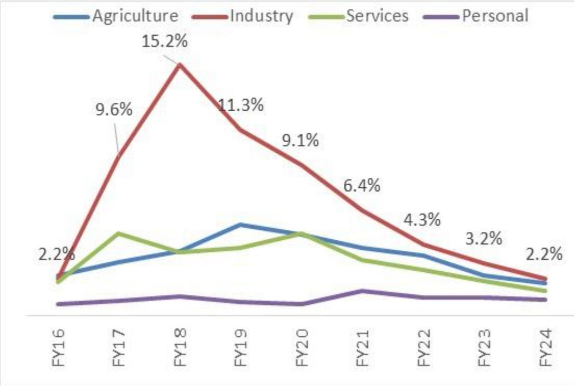
Source: Company data, Aionios Alpha

And higher share of transaction banking fees

Source: Company data, Aionios Alpha

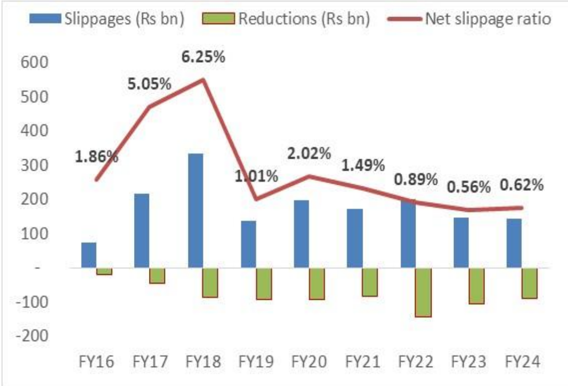
This has led to better asset quality outcomes as corporate GNPAs reduced from a peak of 15.2% in FY18 to 2.2% in FY24. Net slippages (gross slippage – recoveries and upgrades) have also consistently come off from 6.25% in FY18 to merely 0.62% in FY24. With lower net slippage and easing provisioning requirements, the bank beefed up its additional provisioning buffer to Rs 118bn (~1.2% of loans) that protects the bank from asset quality shocks and prepares the bank to transition into IND-AS with minimal impact to the balance sheet. We have built in average credit costs of 62bps over FY25-28E.

Industry NPAs consistently coming off..



Source: Company data

Owing to contained slippages and strong recoveries



Source: Company data

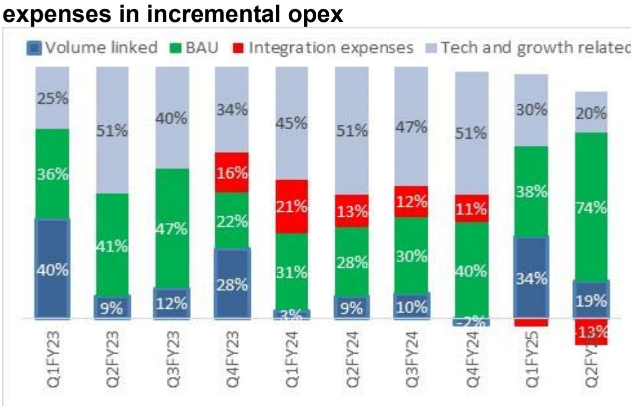
Cost ratios peaked; operating leverage should play out: In March-23, Axis bank acquired Citibank's India retail business and embarked on long integration journey. This acquisition was aimed at not only strengthening Axis' consumer loans business, but also giving the bank access to a whole new set of affluent customers. In addition to this, the bank has been investing heavily in technology and IT to make the bank future ready. These efforts are focussed on 1. Creating a multi-tier architecture to reduce redundancies, 2. Adopting cloud to accelerate service delivery, 3. Modernizing the core to ensure performance and scalability and 4. Re-imagining end to end customer journeys.

Consequently, ~39% of incremental opex over the last 10 quarters was spent on augmenting the IT infrastructure and digital capabilities. Additionally, the bank incurred a total of ~Rs 20bn on the integration of Citibank's business. The aforementioned factors have led to cost to average assets increasing from 2% in FY20 to 2.5% in FY24. With Citi's integration now fully complete and a large chunk of the IT investments already done, we believe operating leverage should play out over the next few years. We expect cost to average assets to improve by 35bps over the FY24-28E with upside risks to our estimates. There are already early signs of this playing out as can be seen in the charts below.

Opex growth consistently moderating….

Source: Company data

Owing to reducing share of IT and integration expenses in incremental opex



Source: Company data

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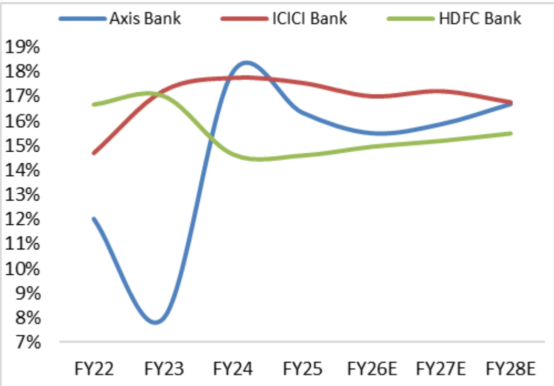
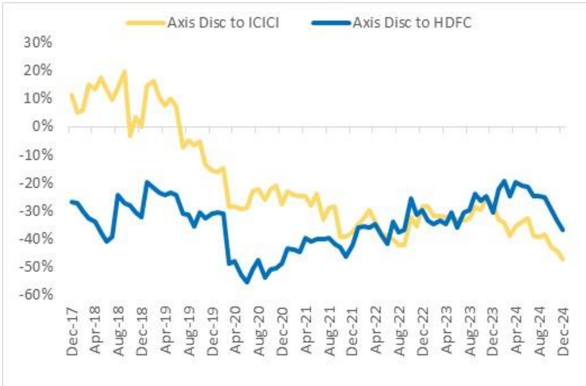
Return ratios should converge with peers: Since Amitabh took the top spot in Jan-19, the focus has been on improving efficiencies and increasing return ratios structurally - the bank has outlined an aspirational ROE target of 18% over the long term. Though Axis has caught up with large peers in most areas like of growth, margins, and asset quality, we believe there is further scope for improvement in terms of operational efficiencies as mentioned above. We expect Axis Bank to deliver ROA/ROEs of ~2.0/16.7% in FY28 – which should be comparable to peers. Thus, we believe the steep discount is unwarranted and should narrow significantly.

Widening valuation discount despite convergence in return rations is unwarranted



Source: Company data, Aionios Alpha



Source: Company data, Aionios Alpha

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