TRIVANTAGE CAPITAL

VANTAGEPOINT

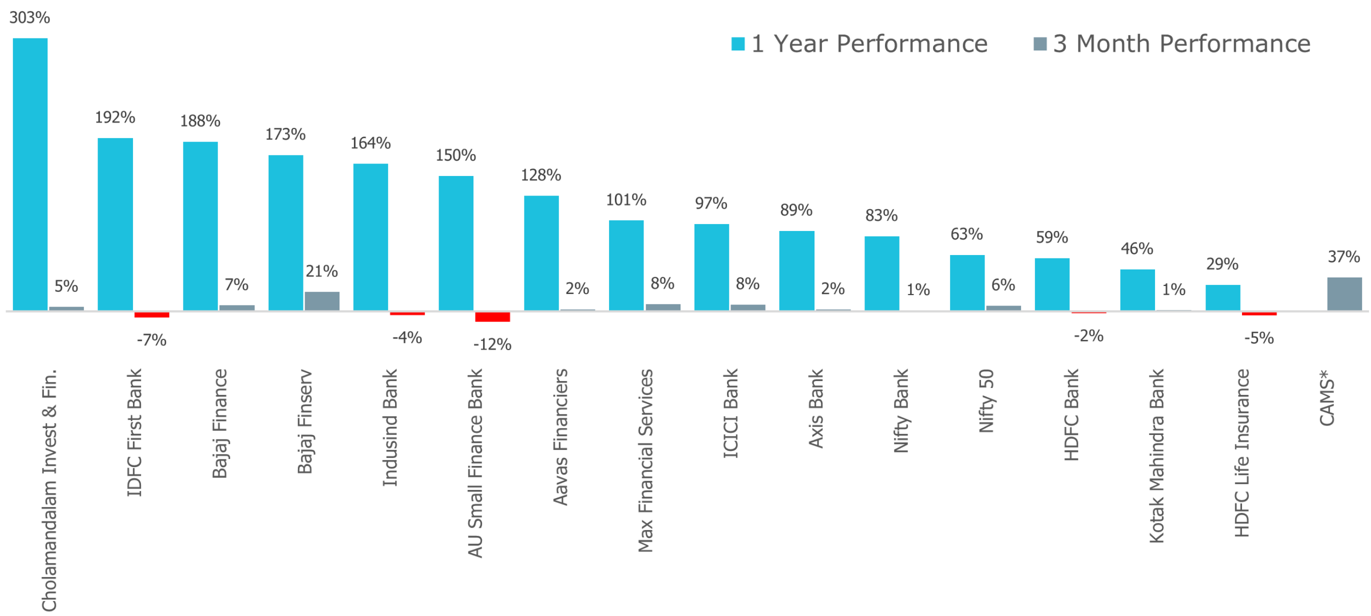
Our Focus Makes All The Difference

Dear Investor,

Greetings from Trivantage Capital.

Indian markets have experienced short phases of extremely sharp stock movements in sectors and sub-sectors over the past year. Chart 1 indicates that pattern within the financial sector and its sub-sectors over the past 12 months and 3 months, respectively.

Chart 1: Performance of Portfolio Stocks Over the Last 1 Year & 3 Months (as on 28 May '21)



Source: NSE. *Date of listing < 1 year & hence only 3-month performance shown. Only stocks currently in the portfolio have been considered. Some of the stocks shown above may not have been a part of the portfolio for the entire duration of 1 year / 3 months.

We can observe from this chart that how one year ago at this time in May 2020 there was an extreme despondency after two months of strict economic lockdowns when the fear was running high about the ability of lenders to withstand credit losses in the first wave of this ongoing pandemic. However, the subsequent re-opening of the economy and moderation in the feared surge of the virus led to a phenomenal bounce in stock prices. This was also aided by a surge in global liquidity and a concerted action by the global central banks to keep interest rates at historical lows. A one-year return of over 100% in the stocks of several of these lenders indicates the return of risk appetite in the markets. It is thus evident that several smaller Banks and NBFCs have significantly outperformed the bellwether stocks such as HDFC Bank and Kotak Mahindra Bank.

The 3-month performance of the financial sector stocks, however, indicates a pause or, in some cases, a correction. This is a result of a completely unexpected second wave of the pandemic that has been more brutal than the first. None of the stocks in Chart 1, except for CAMS and Bajaj Finserv, have delivered double-digit positive returns in this period. CAMS, as we know, is a non-Lender and enjoys tremendous moats in the category of transfer agency platforms for the Mutual Fund industry in India. Bajaj Finserv is a holding company with a bouquet of leading diversified businesses across lending, life, and general insurance.

The recently concluded earnings season for Q4 FY21 highlights some very positive and comforting data points about the large / well-capitalised private sector lending franchises which dominate our portfolios.

Chart 2 indicates how some banks have a very high "margin of safety" in terms of the extent of potential bad loans that they can absorb given the excess capital and provision coverage levels they enjoy at the end of FY21.

Chart 2: Margin of Safety

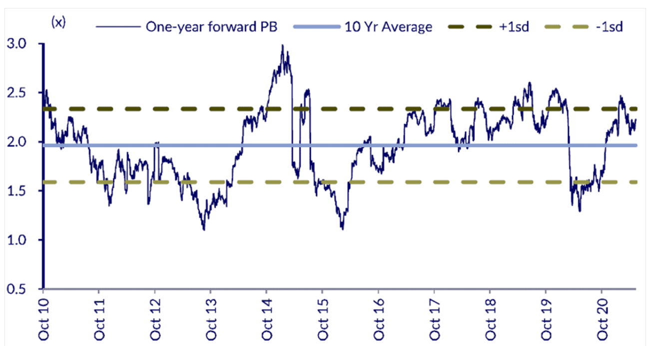
Source: Morgan Stanley Report dated May 21, 2021. The report defines the margin of safety as potential bad loans that banks can absorb given current excess capital/provision coverage and stressed Pre-Provision Operating Profit (PPoP) assumptions over the next year. The report assumes threshold capital levels (14% for AU Bank, 12% for other private banks and 9.5% for SOE banks) and target GNPL coverage of 70%.

As per Morgan Stanley's estimates, Kotak Mahindra Bank can absorb 26% of their on-balance sheet loans, given their best excess capital position amongst banks, whereas the state-owned banks can absorb very little. The top-5 banks shown in this chart in terms of their capacity to absorb bad loans happen to be positions in our portfolio.

Chart 3 illustrates how, at the index level, the banking stocks are just marginally above their long-term average price to book valuations.

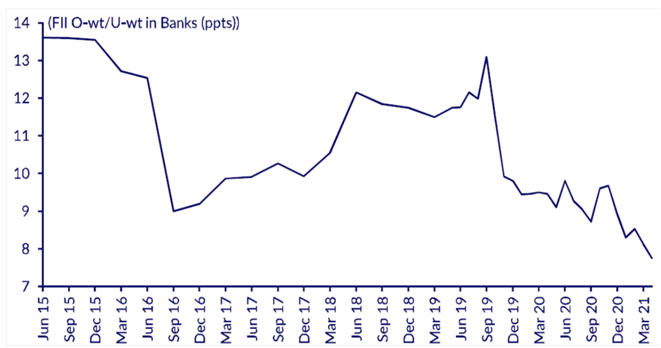
This is despite such a strong performance in the bank stocks over the past year since these stocks have underperformed for a couple of years prior to the past year.

Chart 3: BSE Bank Index one-year forward PB



Source: CLSA report dated May 25, 2021

Chart 4: FII overweight/underweight in banks (ppts)



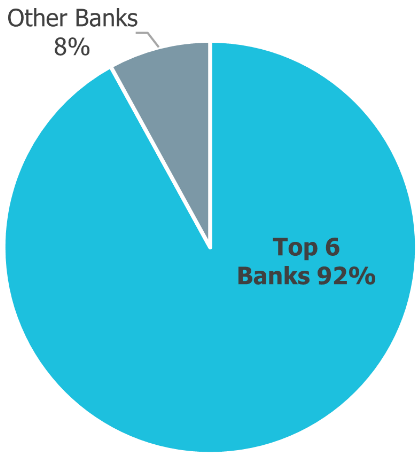
Source: CLSA report dated May 25, 2021

Chart 4 indicates how the FII overweight in banks has fallen to nearly a 6-year low at just around 8% versus nearly 14% in June 2015. Whilst the relative valuations continue to be modest, we should be a bit cautious in the near-term because of the headwinds on asset quality due to the loss of lives and livelihoods caused by the pandemic in the second wave.

Portfolio Stance

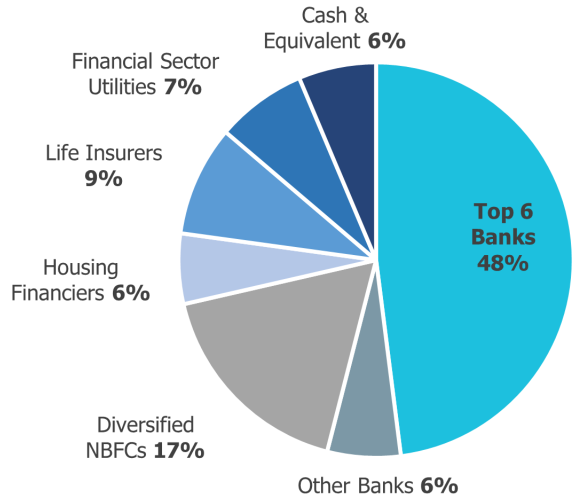
Charts 5 & 6 indicate our current portfolio stance as compared to the composition of the Nifty Bank index. As we can notice that the Nifty Bank is a very narrow index that has an over 90% weight in the six largest banks of the country. Any portfolio manager constructing a broader financial sector portfolio will, thus, have to be underweight these six banks and need to invest in a range of other listed opportunities such as smaller banks, NBFCs, HFCs, life and general insurers, market infrastructure platforms such as CAMS etc.

Chart 5: Nifty Bank – 90% weight in the six largest banks in the county



Source: NSE (as on 30 April 2021)

Chart 6: Our Resurgent Financials strategy offers a well-diversified play on India's financial sector



Portfolio as on 28 May 2021

At this time, our portfolio stance is cautious. We believe that the stock prices of many lenders have shown dramatic resilience and the gap between these and the economic reality facing the nation is stark. We have provided the cushioning to the lenders in the portfolio by our selection of non-lenders such as insurers and a stock representing market infrastructure platform. Within the lenders, we have diversified into some well-placed NBFCs such as Bajaj Finance and Cholamandalam Investment & Finance and a very promising and upcoming HFC such as Aavas Financiers.

Amongst the non-lenders, we have a significant overweight position in CAMS and HDFC Life Insurance. Both these businesses benefit from a sustained growth opportunity over the next several years. CAMS enjoys a near 70% market share in the transfer agency business providing an essential service to the mutual funds. 4 out of the top 5 mutual funds are their customers. This business enjoys a strong moat with huge entry barriers that require scale, operating efficiencies and a platform backed by technology. Many global players have tried to compete with CAMS in the past and have shut their operations after trying for a few years.

HDFC life Insurance will benefit from an upsurge in the need to buy protection policies after the outbreak of the current pandemic. This business has amongst the best profitability metrics and has a very well-balanced portfolio with one of the most respected mother brands in the country i.e., HDFC.

We are watching the pandemic related developments closely and the allocations by global investors into emerging markets in general and India in specific. The support by global central banks including RBI in keeping the interest rates low is likely to continue for longer despite rising threats of inflation.

Our portfolio comprises some of the strongest businesses in the broader financial services industry and is, therefore, well-positioned to face some short-term headwinds. These businesses will also bounce back smartly as the process of cyclical recovery intensifies in India once a large section of the vulnerable and working-class population is vaccinated.

We wish you and your families the best of health.

Yours Sincerely,

Nikhil Johri
Founder & Chief Investment Officer