Piper Serica Leader Portfolio Strategy™

Investor Letter Vol. XXVII
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Portfolio performance and activity

The since-inception (June 2019) TWRR for the PMS is 28.8%. This compares favorably with our benchmark Nifty that returned 15.1% over the same period and multi-cap MFs that generated 18.1% return. Our standard deviation and CAPM beta continue to be well below that of the benchmark and our Sharpe ratio is well above.

Our monthly factsheet can be downloaded here.

The PMS return was 8.7% in July compared to 0.3% for the benchmark, thereby significantly improving our long-term outperformance. We believe this outperformance was partly due to the 'active' management strategy that we have implemented over the last couple of months wherein we restricted the allocation of Nifty stocks to 25% of the overall portfolio and equal weighted our portfolio across large, mid and small caps. However, the core reason for the long-term outperformance continues to be a disciplined adherence to our investment management process.

Listing of Zomato and our participation

We believe that listing of Zomato is a watershed moment in the history of Indian capital markets. It will open doors for listing of new-age digital-tech and Internet companies and will provide public market investors a great opportunity to participate in these exciting companies. We have a very positive long-term view on Zomato based on its management team, the large addressable market, and its leadership position. However, we believe that the current valuation of the company does not consider the near-term risks and challenges. Even with most aggressive assumptions of growth and terminal value, the fair value as per our valuation model is much lower than the current market price. We would prefer to wait and hope that the price corrects to a level that we can add it to the portfolio. At the same time, there is a risk that it does not. We prefer to stick to our valuation model and focus on other opportunities that will come our way in the next couple of months. We already have an indirect investment in Zomato through Info Edge which owns a 15.2% stake in Zomato.

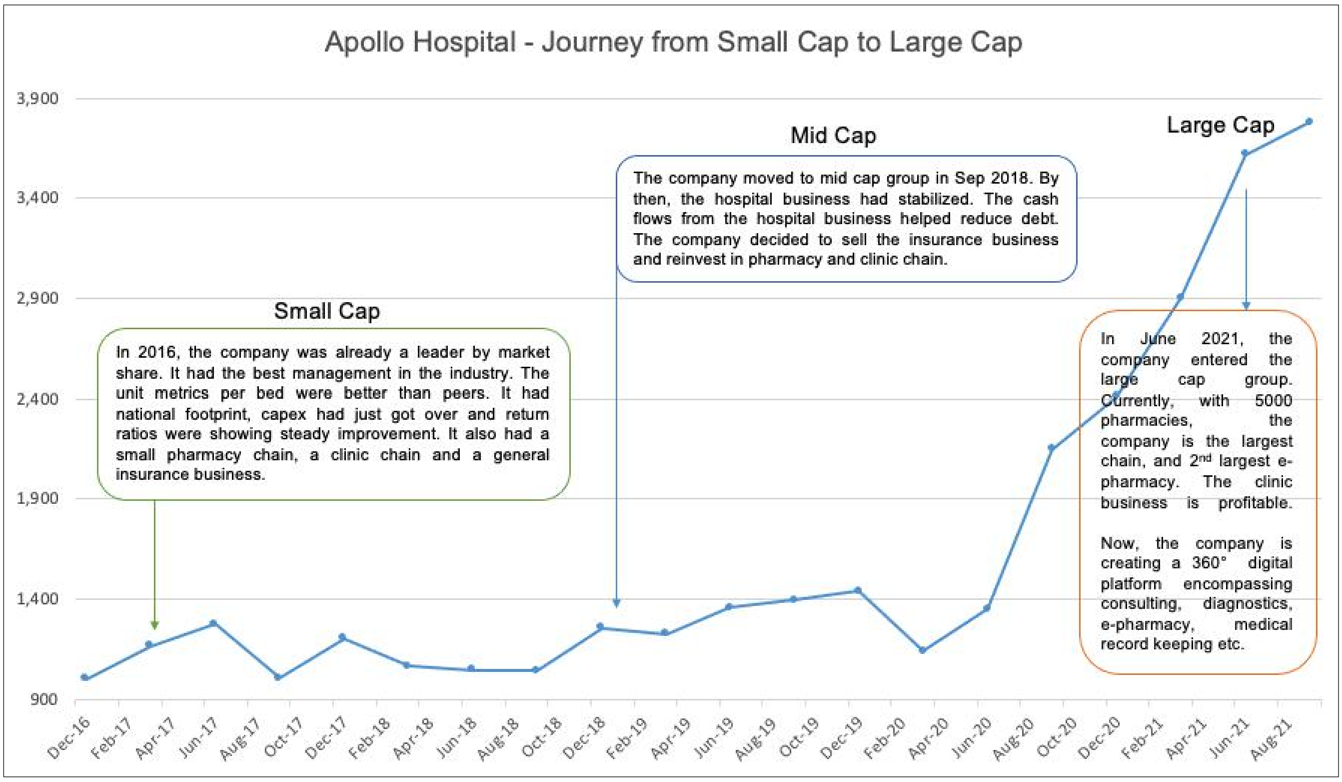
Characteristics of a multi-bagger

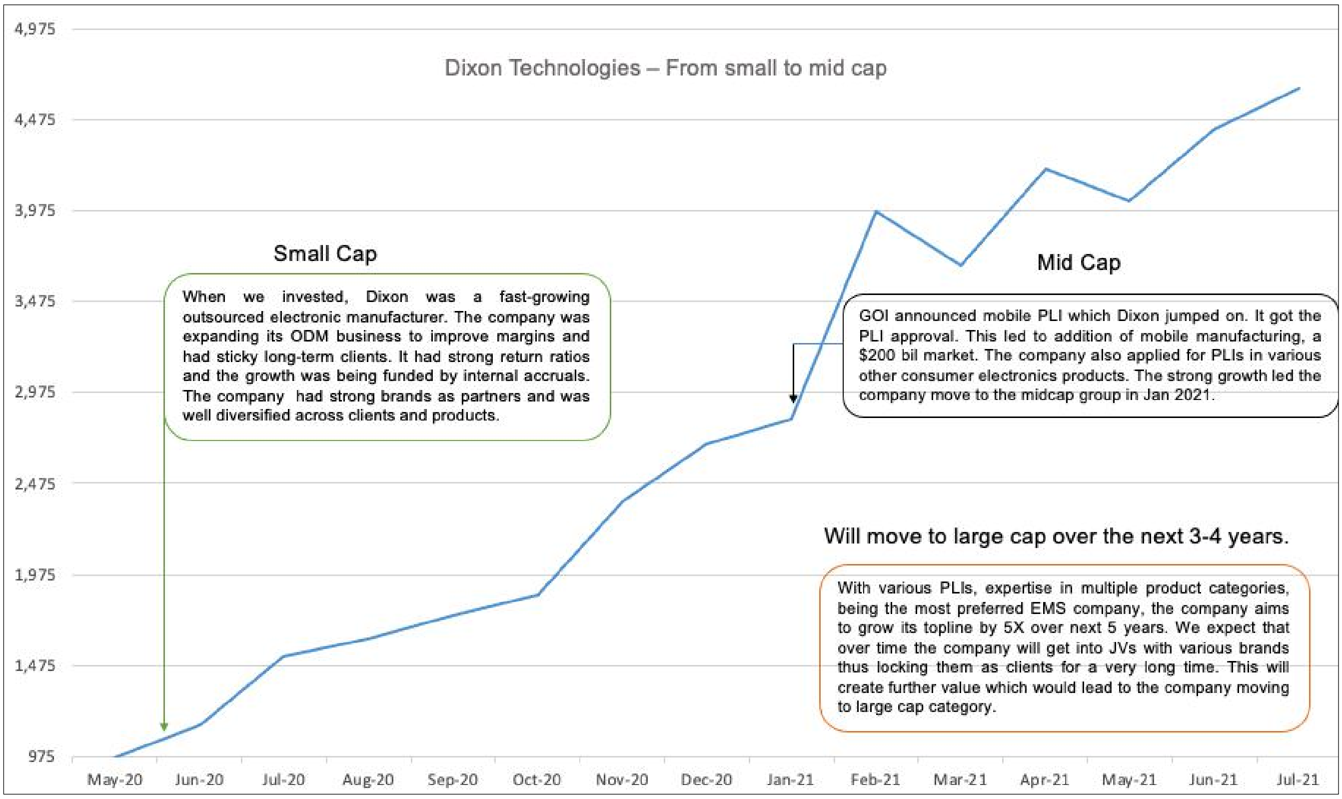
We are happy to inform you that 9 of our 15 portfolio companies are multi-baggers from the time we first invested in them. This high share of multi-baggers is due to a clear definition of the key business characteristics and the high bar that we have set for inclusion in our portfolio.

- Platform businesses that rapidly acquire customers with a high LTV.
- Large TAM with fragmented market shares.
- Aggressive use of technology and innovation to create huge barriers to entry.
- National level brand with strong brand recall.
- Ability to source business, deliver product/service and collect payments digitally.
- Ability to become a large cap over this decade.
- Very high franchise value and customer retention.
- Strong distribution network.
- Strong balance sheet and ability to fund rapid growth.

We have closely observed the value-creation journey of multi-baggers in our portfolio and have noticed that companies that focus on building a strong long-term business model are suitably rewarded by the markets. Most of these companies are not very popular with retail investors since they are optically expensive and go through long phases of sideways stock-price movement that frustrates retail investors. At the same time, they are very valuable for long-term investors who can assess their competitive business models and can correctly ascribe a value to their industry leadership.

To illustrate, here are the price charts of two of our portfolio companies that have become multi-baggers.





As one can observe, the pace of value creation is directly linked to the growth in the underlying business. This pace may vary across companies but only an investor who is able to understand the core business model and visualize the long-term future of the company will be able to hold the stock for long enough to be substantially rewarded. It is truly unfortunate that many retail investors are able to identify and buy potential multi-baggers but exit them at the wrong time either because they want to 'book profits' or they get tired of the sideways consolidation of the stock.

We have also realized that we need to tweak some of the traditional valuation techniques that are proving inadequate to value the new-age fast-growth companies. While we use the discounted cash flows, we are seeing it struggle to value companies that have a very high terminal value, low cost of capital, volatile cash flows, dynamic capital allocation strategies and capital raising plans. Similarly, short-form valuation tools like P/E, PE/G and P/BV are handicapped because of low return-on-capital ratios for these high growth companies, long investment phases and negative unit level economics. Therefore, one needs to have the long-term mindset of a private equity investor to value these companies. The valuation exercise is to estimate rather than establish a fair value. One needs to consider the large addressable market, quality of the founding team that has survived high mortality, ability to raise capital to support growth and most importantly, a leadership position in a very high growth industry.

We have built in metrics like TAM, GOV, AOV, MAU, DAU, Churn rate, CAC, LTV, ARPU etc. into our valuation models. Once again, the objective is to estimate rather than establish the fair value. We will be happy to discuss these in greater detail.

We are also happy to inform you that our small and mid-cap model portfolio, ED+, hosted on smallcase generated an absolute return of more than 19% last month. To put it in perspective, it is roughly equivalent to 5-year return from a bank fixed deposit. The absolute return since inception (September 2020) for ED+ is 144% compared to its benchmark that is up appx. 72% during the same period. Please feel free to reach out to our team if you would like to know more about ED+ and our other model portfolios.

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