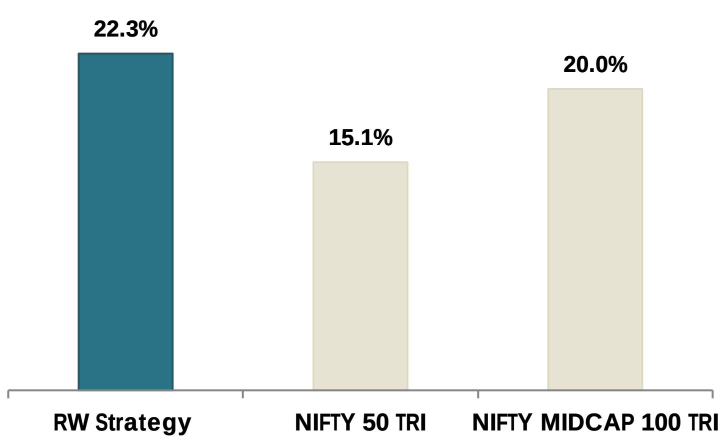
Quarterly Update December 2021

Investment Objective

RW Investment Advisors uses a proprietary framework that combines fundamental and technical factors to identify businesses that can create long term wealth. The guiding philosophy is capital protection and compounding over longer periods.

Chart 1: RW Strategy TWRR (Since Inception)



Top Performers

Scrip Name	Purchase Date	Adj. Purchase Price (Rs.)	CMP (Rs.) as of 31-12-2021)	Growth (%)
KPITTECH	22-Sep-2020	114	613	439%
SHAILY	07-Dec-2020	735	1,938	164%
ASIANPAINT	01-Sep-2017	1,353	3,383	150%
BAJFINANCE	08-Jun-2020	2,951	6,977	136%
VOLTAS	01-Jun-2020	530	1,219	130%

Holding Companies

Asset Concentration	Holding
No. of Companies	35
Top 5 Company Holdings	25.1%
Top 10 Company Holdings	42.3%
Highest Exposure	BAJFINANCE (6.9%)

Sector Allocation

Sectors	Allocation (%)
BFSI	31.5%
Technology/Services	21.9%
Consumer	19.9%
Healthcare/Pharma	8.8%
Others	17.9%

Market Capitalization

Market Capitalization	Holding (%)
Large Cap	57.4%
Mid Cap	28.7%
Small Cap	13.9%
Avg. Market Cap (Rs. Bn)	2,114

Qualitative Analysis

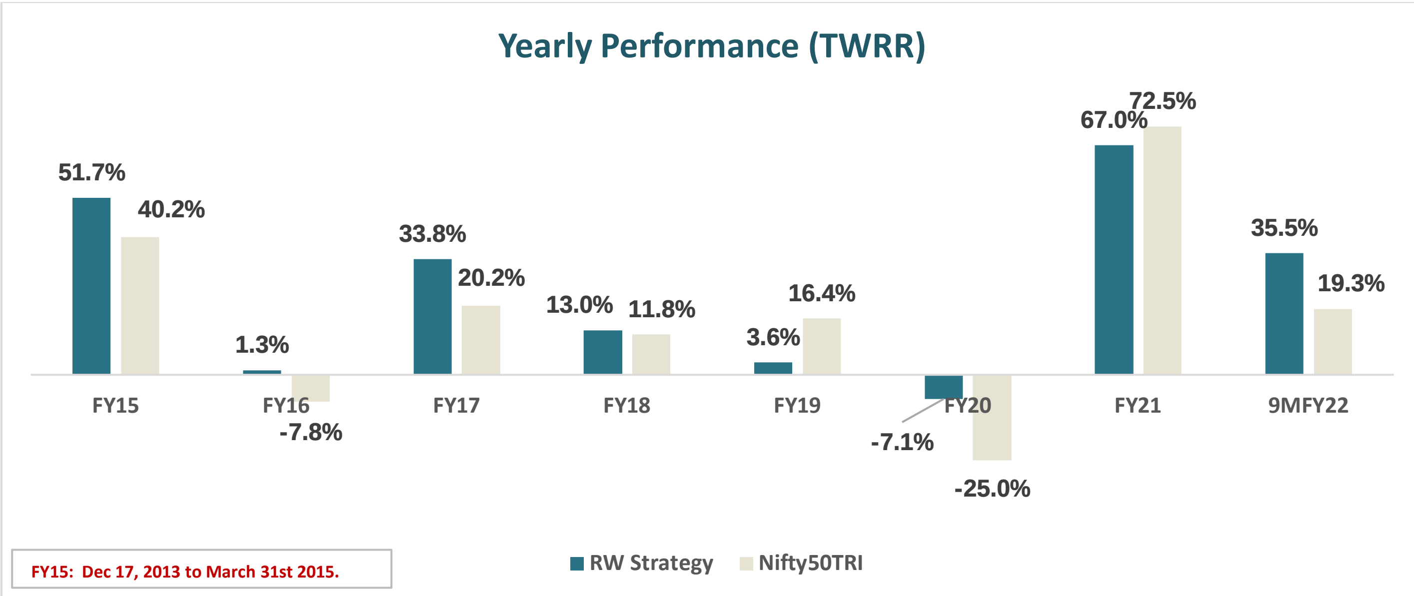
Parameters	TTM
PAT Growth	33.3%
PE	64.5x
ROE	16.1%

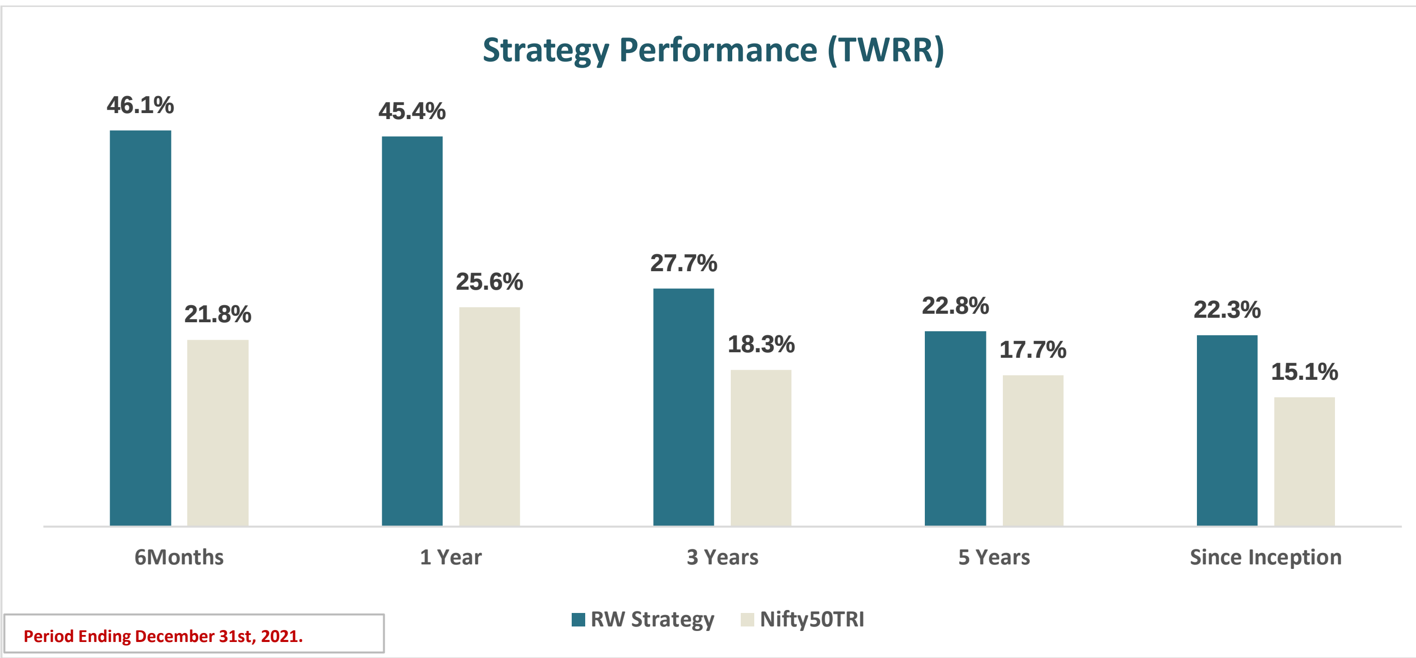
Holding Period

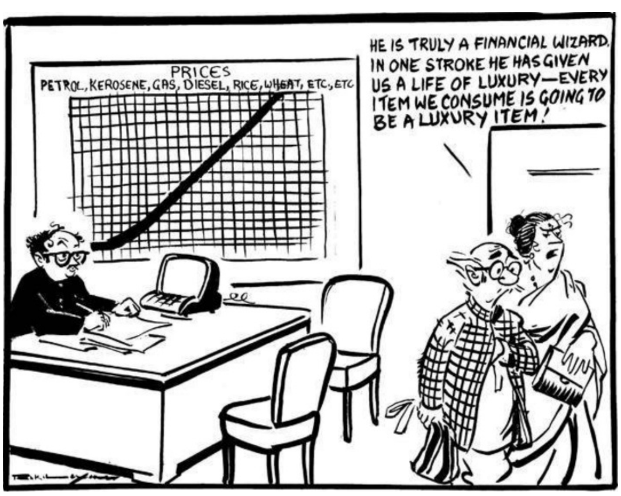
Holding Period	No. Of Scrips
Less than 1 Year	25
Between 1 to 3 Years	8
More than 3 Years	2

Disclaimers and Risk Factors

RW Strategy Inception Date: 17th December, 2013, Data as on 31st December, 2021. Data Source: RW Internal Research. RW Strategy results are for an actual Client as on 31st December, 2021. Returns of individual clients may differ depending on time of entry in the Strategy. Past performance may or may not be sustained in future and should not be used as a basis for comparison with other investments. The stocks forming part of the existing portfolio under RW Strategy may or may not be bought for new client. The Company names mentioned above is only for the purpose of explaining the concept and should not be construed as recommendations from RW Advisors. Strategy returns shown above are post fees and expenses.







After the correction that started in January 3rd week due to Fed announcement on interest rate hikes, a large majority of the portfolio is now fairly valued and is positioned for growth. There is still some slack in the portfolio wherein earnings have not come in as per expectations, which we are slowly exiting. In hindsight, there has been a higher tilt towards mid-caps post covid, as can be seen in the first page. Over the next 2 quarters, we will most likely reduce the weight in mid-caps to move back to large caps, given the adverse impact of inflation on margins. Performance looks ok despite the recent correction.

Now, given the on-going war in Ukraine, we aim to cover the impact of wars on stock markets and briefly discuss the investment thesis on Newgen Software in this newsletter.

Operation Barborossa – Hitler invades Russia:

"In the first three weeks of the war (starting June 1941, World War II), the Russians lost two million men, 3,500 tanks, and more than 6,000 aircraft. The loss of air cover was catastrophic for the Russian frontier armies. Staggering defeats were inflicted by the invaders at Smolensk, Kiev, Bryansk, Vyazma, and almost the entire Ukraine was overrun."

Source:Biggs, Barton. Wealth, War and Wisdom (pp. 117-118). Wiley. Kindle Edition.

Almost 90 years later, Ukraine is getting overrun again, not by Germany this time but by Russia. The catastrophe that WWII was for Ukraine and Russia won't be happening again, but it does offer valuable insights into how market performs around wars, especially when there is so much human toll, fear and uncertainty. Whether Russia is justified, should the NATO do more, or is President Zelensky a hero is beyond the scope of this newsletter. In "Wealth, War and Wisdom" one of the best books on the impact of wars on markets, Biggs argues that in the past, the stock markets have proved to be an accurate predictor of a major turning point during wars. In this context, its good to look at the following table which lays out market performance around wars:

		S&P 500 Returns			Days
Market Shock Events	Event Date	One Day	Total Drawdown	Bottom	For Recovery
U.S. Pulls Out of Afghanistan	8/30/2021	0.4%	-0.1%	1	3
Iranian General Killed In Airstrike	1/3/2020	-0.7%	-0.7%	1	5
Saudi Armco Drone Strike	9/14/2019	-0.3%	-4.0%	19	41
North Korea Missile Crisis	7/28/2017	-0.1%	-1.5%	14	36
Bombing of Syria	4/7/2017	-0.1%	-1.2%	7	18
Boston Marathon Bombing	4/15/2013	-2.3%	-3.0%	4	15
London Subway Bombing	7/5/2005	0.9%	0.0%	1	4
Madrid Bombing	3/11/2004	-1.5%	-2.9%	14	20
U.S. Terrorist Attacks	9/11/2001	4.9%	-11.6%	11	31
Iraq's Invasion of Kuwait	8/2/1990	-1.1%	-16.9%	71	189
Reagan Shooting	3/30/1981	-0.3%	-0.3%	1	2
Yom Kippur War	10/6/1973	0.3%	-0.6%	5	6
Munich Olympics	9/5/1972	-0.3%	4.3%	42	57
Tet Offensive	1/30/1968	-0.5%	-6.0%	36	65
Six-Day War	6/5/1967	41.5%	-1.5%	1	2
Gulf of Tonkin Incident	8/2/1964	-0.2%	-2.2%	25	41
Kennedy Assassination	11/22/1963	-2.8%	-2.8%	1	1
Cuban Missile Crisis	10/16/1962	-0.3%	-6.6%	8	18
Suez Crisis	10/29/1956	0.3%	-1.5%	3	4
Hungarian Uprising	10/23/1956	-0.2%	-0.8%	3	4
N. Korean Invades S. Korea	6/25/1950	5.4%	-12.9%	23	82
Pearl Harbor Attack	12/7/1941	-3.8%	-19.8%	143	307
Average		-1.1%	-4.6%	19.7	42.3
Source: Source: LPL. Research, S&P Dow Jones Indices. CFRA, 01/24/2021					

John Templeton, one of the greatest investors of all time, in his biography also suggests that he had studied previous wars such as Civil War and WW I before getting fully invested at the end of 1939 - after Germany invaded Poland and the S&P corrected 49%. In his words, "People are always asking me where the outlook is good, but that's the wrong question. The right question is: Where is the outlook most miserable?"

From the data above, isolated events do not have much of an impact on the stock markets. They fall initially out of panic and recover quite quickly. On the other hand, something like Pearl Harbor attack or September 11 are different, given that they were part of much bigger events i.e WWII in the former and Dotcom bust in the latter and thus had a larger impact on the markets. Even in the worst case i.e. the Pearl Harbor Attack, market dropped about 20% lower from the event, yet recovered all of that in a year and staged a 20 year bull market.

Compared to the Ukraine’s invasion by Germany in WWII, the current war appears to be far less lethal. And the reason why stocks recover quickly seems to be that wars typically spur economic activity due to reconstruction efforts. For instance, there was a commodity/logistics boom around WWII. Currently, in a market that’s been already short on commodity supplies, portfolio may have to be shifted more to sectors that benefit from higher commodity prices and an inflationary situation.

What to do with the temporary hit to the portfolios?

One of the bed time stories that I told my daughter recently has an important message for all of us too. Sage Kashyapa (one of the greatest sages from the Vedic times) had two wives, Vinata and Kadru. According to their wishes, Kadru was given a thousand eggs, which would eventually give birth to a thousand serpents; while Vinata was given two eggs. The thousand eggs given to Kadru hatched early, while the two eggs of Vinata did not. Vinata broke the first egg in a hurry, which was half-formed and was thus deformed because of Vinata’s impatience. The same goes for our portfolios as well - investors pay a heavy price by analyzing portfolios, purely based on stock prices, day-in and day-out.

Ultimately, portfolios are a group of businesses with underlying growth and life cycles of their own. They are not just stock prices, bobbing up and down without rhyme and reason. Experiencing a 15% or more hit to the portfolio can be deeply painful. While some, who have experience in the market are psychologically strong, most of us become anxious, because it is ultimately our hard-earned money that seems to be evaporating into thin air.

Imagine that the CEOs of HDFC bank, Asian Paints are your best buddies and you have given your money to them and the stock market did not even exist for you to see the daily noise. And you markup the money given as equity to these CEOs in proportion to the profit growth of these companies on a half yearly basis; In a completely rational, unchanging world, price of the portfolio should move lockstep with earnings – i.e. profit goes up 15%, portfolio value should go up 15%. The key operating assumption here is that we are picking good business after thorough research.

But the reality is markets demonstrate volatility in the short-run, giving the impression of a congenital alcoholic or a manic depressive – remember the gyrations in Gamestop stock rigged up by the Yolo gang? But once the earnings for each of the individual businesses that you hold come through, this noise starts to fade and the upward march of the portfolio continues.

When you are experiencing a drawdown, it is always advisable to look at what you ’own’ in your portfolio than the stock prices alone. And if the underlying companies look reasonably good, you should not be too worried. Last but not the least, we do have our quant filters, which tell us when to exit the positions completely if the current war spirals out of control. Hope you remember the cash call, during March 2020.

Key thesis on Newgen Software:

Large Market Opportunity

- The company has offerings in Enterprise Content Mgmt (ECM),Business Process Mgmt (BPM) and Customer Communications Mgmt(CCM)
- Combined Total Addressable Market ~ $50 Bn (2020) (ECM $45bn, BPM $3.4bn, CCM $1.3bn) and expected to grow at BPM-6.2%,CCM-11.2%,ECM-19%

Strong Contender

- It is a strong contender in the ECM + BPM segment with leadership in BFSI vertical (73%)
- The company's sweet spot has been its ability to provide a unified platform (NewgenONE) bringing in its expertise across ECM,BPM and CCM
- Only 5% of the company's products are used by its existing clients and the rest 95% products are built for the future showing the strength and preparedness of its R&D team
- The customer retention rate for big customers (Rs.50 lakh+ account) has been ~95%
- It has been in Gartner's magic quadrant for 16 years continuously; Rated as a "Visionary" in ECM

Business Model is shifting towards US with emphasis on SaaS/Recurring Revenue

- US has grown from 23% of revenue 4 years ago to 31% of the revenue now
- Recurring revenue growth is at 3 year CAGR of 20%+ is one of the highest in the industry
- GTM strategy in US is changing to include Global System Integrators (GSI) as a Sales Channel – Similar strategy to Pega Systems
  - This should help them in breaking into Fortune 2000; 8 logos captured in FY21.
  - US likely to grow at 20-25% over the next 5 years and is already the largest geography for them
  - Big impact on SaaS/Recurring Revenues and working capital cycle should improve further
- Having established a good reputation over three decades, the company has been able to acquire industry's top talents in order to focus on the GSI channel and expand its product offering to new industries
- Intending to also tap mature markets like UK, Australia and Canada through the GSI channel, thus competing with big global peers

Financially best managed company in the space

- Strong FCF generation over the last 5 years in combination with revenue growth, which is unique in the industry
- Significant decline in working capital requirement from 180 days 5 years ago to 75 days in FY21 as a result of 1) expansion in US geography 2) decline in unbilled revenue and 3) receivables mgmt.
- Expected IRR: 16% EPS growth + some multiple expansion as recurring part of the revenue increases
  - IRR Should be close to 20% IRR

Risks: US slowdown leading to lower growth, attrition

We own around 3 to 4% in client portfolios and hope to keep it in the long term bucket, unless some of the risks highlighted above materialize.