Letter to Stakeholders

2024–25

"***There are decades where nothing happens, and there are weeks where decades happen.***"

— **Vladimir Ilyich Lenin**

Dear Investor,

When Lenin uttered these words, he could hardly have imagined a future where tweets, tariffs, and trade tensions would shake the global economic order. Yet, his insight resonates now more than ever. The U.S.-led economic war on its allies has shaken the foundation of globalization, which thrived on comparative advantage. As this principle unravels, the private sector returns and investor confidence wavers. In such transformative times, Lenin's words remind us of a truth we often forget change may be slow for years, but when it comes, it can be swift, disorienting, and utterly defining.

Amidst this volatile backdrop, our strategy with over 75% exposure to India's mid and small-cap companies faced headwinds in the second half of the financial year, leading to a -332 bps return for the year. Despite this, since inception, the strategy has delivered a strong 21.6% CAGR. Built on the expectation of 18% earnings CAGR, the portfolio reflects our belief that stocks bought at fair value tend to track long-term earnings growth. We follow a disciplined Growth at a Reasonable Price (GARP) approach, combined with investing through earning cycles. *Individual returns & stocks may vary based on entry timing, but our long-term thesis for investments remains firm and investor should treat this strategy as long dated private equity style exposure in public mid cap markets.*

The central government 2024 Budget (post a disappointing election outcome for the ruling party) was the key turning for the policy market to pivot from stressing on Capital Expenditure which has grown at 25% CAGR for the last 5 Years (FY2019-24) to ₹9.5 Lakh Crores, to change in the favor of individuals who are the providers of capital to the government. The government has forgone ₹1.3 Lakh Crore worth of Income Tax revenues, with the highest benefits to 30 mn IT filers (c.45-50% of the total base), thereby resulting in the average household seeing savings up to ₹1 Lakh. The Government has also implemented ELI-Employment Linked Incentives worth ₹2 Lakh Crore, absorbing unemployed unskilled youth in formal work force. We believe such a well-designed boost to consumption, said to have a multiplier effect of 4-5x, with Vallum estimating a 150 bps boost to the GDP via this spending to be seen in the next 2-3 Years. Against this backdrop, we have consolidated our portfolio with a *30% allocation to Marquee Brands* and businesses ancillary to this consumption-oriented theme.

*

Among our high-conviction investments is India's **Largest Home-Grown Footwear Brand** in the Sports and Athleisure segment, with a turnover of ₹15 bn and annual sales of ₹23.5 mn pairs a clear testament to its brand strength. The company has grown at an impressive 18% CAGR since pre-COVID and recently underwent a generational leadership transition, marking a perceptible shift in strategy and execution. This transition revitalized the business, beginning with the rationalization of 125+ distributors, including online B2B sales and streamlined its offerings from 1,300 styles to 500, with just 200 core styles driving 50-60% of regular sales. It has 150 exclusive designs per channel to resolve channel conflicts. The operational efficiency improved through the centralization of warehouses, reducing inventory by 20%, while a shift from outright sales to an 80% marketplace strategy online boosted agility. Backward integration in manufacturing further enhanced control and margins.

This transformation reminds me of the legendary story of the Eagle, a powerful metaphor for change. The eagle, when faced with age, retreats to a mountaintop, sheds its worn beak, talons, and feathers through a painful process, emerging renewed to soar for another 30 Years. This company, too, has embraced reinvention to thrive in a changing market.

Notably, it's making aggressive strides in Sneakers, a category now matching Sports SKUs in shelf presence. With 30% of total sales coming from online channels, the brand leads its peer group in digital penetration. Our internal analysis places it among the Top 4 in Sports SKUs for both men and women, with 86% of products rated over 4 stars online on digital platforms. Unlike most competitors, this brand refrains from discounting signaling higher customer loyalty and value acceptance, in contrast to others with over 50% of online SKUs sold at a discount.

With an installed capacity of 37 mn pairs and a robust presence across the top 50% of India's retail landscape, the company stands primed for its next phase of growth. Having successfully recalibrated its business model, it now enters a phase of renewed momentum poised to deliver volume and value growth at a projected CAGR of 12-14% in revenue and over 20% in profitability over the long term. What's truly compelling is the outlook ahead: with every growth lever fully engaged, incremental ROCE is expected to surpass 50% in the upcoming cycle. It's a clear testament to the company's disciplined reinvention and its ability to unlock sustained value creation.

We have invested in **a Consumer Durable Company** of the country, a leading player in Refrigerators, Air Conditioning, Kitchen Appliances and Washing Machines. The operational changes in the most inspiring brand of consumer durable in India attracted our attention and investment. Our on-ground channel check alluded New Operational manager (CEO) has made the right correction of overpricing of products versus competition (c.15% correction), launch of new products with added features, more SKUs in premium offerings additional in-store brand promoters, extending warranties, filling all gaps for product portfolio to fly off the shelf. *We are strong believers that gaining market share profitably is a tough ask for a business in the fully penetrated categories, and companies achieving that creates a shareholder value.* Our investee company has seen +160 bps of Market share gains in washing machines to 14.1% and +180 bps in Refrigerators to 18.1% between CY23 and as of Dec'24. While it is No.3 in India, it is No.1 in the US, and in other regions where it operates., It has cemented its position to No.2 in entry-level Ref in India. After a long time, consumers are witnessing a US brand challenging Korean giants in the consumer durable space in India. A few years back, spotting white space, the company acquired kitchen appliance brand and scaled to ₹500 Crore of sales (from less than ₹150 Crore pre-COVID) along with doubling down on the ownership to 97%.

The stock price slumped due to the intention of parent to cut down its ownership from 51% to 20% in India to pay off the debt on the parent's balance sheet (which has been burgeoning due to unfit buyouts during COVID). We see this exception/corporate action as an opportunity to own a growing franchise where a change in ownership to a strategic / or possibly a private equity investor will put the company on a high-growth pedestal. Sensing this opportunity (at 5% CFO yield), we have increased our position.

We have invested in a **Luxury Hotel** that owns eight properties across seven Indian states. Like much of the sector, the company's expansion plans were disrupted by COVID-19, which delayed construction timelines and curtailed new developments. This disruption has led to a significant demand-supply imbalance in the hotel industry, with demand for room keys outpacing supply by 3-5%, a gap expected to persist until FY28. Domestic tourism surged past pre-pandemic levels in CY23, fueled by a rise in leisure travel and supportive government policies. Foreign tourist arrivals (FTAs), while still below 2019 levels (9.5 mn in CY23 vs. 10.9 mn in CY19), have also shown a steady recovery. This revival is expected to further support the rise in average room rates (ARR), particularly in the premium and luxury hotel segments.

Our recent investee company stands out not just in operations but also in strategic alignment it's the only hotel chain globally where an American MNC holds over one-third of the equity. This partnership contributes approximately 12% of revenue through its international loyalty program, offering a strong recurring business moat. With strong tailwinds and a favorable demand-supply dynamic, the company plans to expand from 1,895 rooms in FY25 to 3,115 rooms by FY28. This growth will be driven by a mix of organic developments and strategic acquisitions. Notably, it recently acquired a 220-room under-construction hotel at Bengaluru Airport (part of a global hotel chain) through internal accruals. It also has the potential to add ~1,000 rooms through a mix of Right of First Offer (ROFO) deals and a brownfield expansion of its flagship Mumbai property at just a quarter of the cost of a greenfield project. While current earnings are masked by upfront investments, we expect these assets to become operational and ROFO assets coming under fold, over the next two years, thereby improving yields on gross block, potentially 2x of similar business models like REITs driving valuation ahead.

A broader philosophy also underpins our investment approach: a significant portion of our portfolio comprises businesses controlled by founders or key strategic shareholders. These are individuals for whom the company is not just a financial asset, but a personal priority. In such structures, we find that management's interests are often more closely aligned with those of minority shareholders an alignment that is far more reliable than in the average publicly listed company.

We have invested in a global, **Innovation-led digital AdTech leader**, uniquely positioned to capitalize on the ongoing transformation in media and advertising consumption. As digital platforms increasingly dominate the landscape rising from ~5% to nearly 30% of the ₹2,530 bn Indian advertising industry the shift from traditional to digital media is becoming more pronounced, driven by the widespread adoption of smartphones, connected TVs, and streaming services.

Globally, advertising spends are also migrating from "walled gardens" closed ecosystems like Google and Meta towards the open internet. This includes platforms such as Netflix, Amazon Prime, Spotify, Walmart, Samsung, and the ever-expanding influencer economy. In this evolving ecosystem, our investee company stands out through its differentiated performance-based revenue model. At the heart of its approach is the Cost Per Converted User (CPCU) model, wherein the company earns revenue only when a user completes a specific, desired action whether it's viewing an ad or completing a transaction. This model reflects the company's confidence in its technology and data capabilities, as it assumes performance risks on behalf of its clients.

The results speak for themselves: conversion rates have improved significantly from 2.6% in FY19 to 9.5% in FY24, driven by a suite of proprietary products. This has powered a 33% CAGR in converted users and a ~39.5% CAGR in revenue over the same period. Supporting this growth is a strong technological foundation, including 12 patents and a global data bank of 3.5 bn connected devices with an ambitious roadmap to scale that to 10 bn. Currently, 74% of the company's revenue comes from India and other emerging markets, with the remaining 26% from developed economies. A recent development, such as Spotify's launch of an AI-based advertising platform open to external advertisers, create new monetization avenues for open-internet AdTech players like this one in India.

Looking ahead, the company is poised to raise revenues by over 20%, with earnings compounding at an even faster pace over the next few years. With a resilient, tech-first strategy and a growing global footprint, this investment reflects our conviction in the secular growth opportunity in digital advertising.

Our investment in a **Leading Music and Media Content Company** is progressing well, buoyed by the surge in smartphone usage and low data costs, which continue to expand its addressable market. After a brief pause, the company resumed its aggressive content acquisition strategy this year, including a landmark acquisition of a digital content firm focused on User Generated Content (UGC) and short-form reels. This move has significantly enhanced its digital capabilities, bringing in new talent for short-form videos and web series and adding to its reach across key platforms: 16 mn YouTube subscribers

(on top of its existing 97 mn), 64 mn Instagram followers (up from 2 mn), and 8 mn additional Facebook users
(from a base of 15 mn) Company's strategy to diversify its revenue lines resulted in live events scaling to revenues of ₹280 Crore within 18 months of launch of this division.

With diversified monetization channels across music, short videos, live events, and digital streaming it is evolving into a multiplex of discretionary entertainment in India. Backed by its aggressive content pipeline and digital platform expansion, we expect earnings to grow at a 15-18% CAGR in the coming years.

On the other end of the consumer spectrum, our investment in a pan-India **Auto Dealership Network**, spanning mid-premium to luxury cars, faced a challenging year. The stock corrected due to near-term losses from rapid expansion and inventory adjustments. FY25 saw the company accelerating opening a record 24 outlets, expanding from a base of 119 showrooms and service stations.

Despite short-term pain, the company continues to enhance its portfolio with 10 OEMs including new high growth OEMs like MG Motors, Kia, and Mahindra. The dealer is growing revenue faster than all the brands it represents. The business requires years of superior to evaluate a brand, right location and assessment of service potential of that brand. It has restructured its approach toward lower-growth brands via multi-brand formats and other cost-saving measures. The true engine of value lies in its service and spares business, which contributes 20% of revenue and grows steadily at 10% p.a. For every 300 cars sold, it services 5,200, ensuring recurring income and customer stickiness. After two years of muted earnings, FY26 is shaping up to be an inflection point, with expectations of earnings doubling over the next two years. For a glimpse into its scale, one in every 7–8 BYD showrooms in India is owned by this company.

Our investment in a **Regional Old-Generation Bank** is a classic case of underappreciated strength meeting forward-looking transformation. The bank has a strong liability franchise, with 88% of retail deposits being granular and 80% of them getting auto-renewed annually. This level of deposit stickiness translates to a lower cost of deposits, currently at ~5.6%, which is about 50 bps below that of many regional and mid-sized peers. This structural advantage stems from its deeply entrenched customer base in core markets.

The new management team, with a strong track record of building high-performing banks, has laid out a transformation roadmap driven by technology-led cross-selling and productivity gains. While the current return ratios are modest (ROA of ~1.1%), we see a clear path to improvement towards 1.3-1.4% over the next 2-3 years.

The ambition is to grow the loan book to ₹1 Lakh Crore within 2 years in a grounded way. In the short term, this has involved front-loading costs reflected in the cost-to-income ratio rising from 45-50% to 50-55%. However, as scale builds, we expect operating leverage to play out and margins to expand. A successful execution of this strategy could drive ROE expansion by 300-400 bps to ~15%, setting the stage for a re-rating like what we've seen with regional peers, which moved from 0.6x to 1.5x P/BV as return metrics improved.

We have invested in a **Zero Effluen**t **Chemical Company** leveraging Intellectual Property (IP) to create globally scalable, green chemistry solutions. This company, led by a team of 90+ scientists and technocrat promoters, specializes in developing cost-effective catalytic manufacturing processes. The key to its success lies in developing unique catalysts that are nearly impossible to replicate, resulting in a by-product of water and ensuring consistent production at the lowest cost.

This distinctive approach has allowed the company to secure a leading market position globally, with its products ranking either No.1 or No.2 in their respective markets. For FY25, the company's average selling price (ASP) is projected to be $6.5/kg, even after a global price correction. In comparison, the average export realization for basic chemicals from India is $2.3/kg, underscoring the premium the company can command given its value addition. Since its IPO, the company's gross block has increased fourfold, although revenues are yet to catch up. A key driver of this growth is its new product performance, chemical acting as a stabilizer in plastics and polymers, prevents the effects of photo-oxidation. The approval process for this product is lengthy due to its high criticality, but this also means the product's market positioning is secure and long-lasting. Currently, the global market for this stabilizer is dominated by a few Chinese and German multinational corporations (MNCs), with India importing 5% of total industry. Our investee company, with its unique catalyst reaction and lower cost of production, is poised to unlock a $1 bn addressable market, positioning itself as a strong competitor in this space.

As multiple blocks of capacities scale up, its revenue will scale up by 3x and earnings at an even higher pace, at full potential. This growth trajectory is expected to significantly enhance the company's return on equity (ROE), with a projected peak potential of approximately 32% by FY28, up from the current 22%. As global industries seek alternative large manufacturing partners, Indian companies with IP advantages in India, are well-positioned to flourish. With strong growth prospects, high margins, and a focus on sustainability, this investment reflects our confidence in the company's long-term success.

Updates

Our long-term bet on an **Innovation-led Pharmaceutical Company** has started to bear fruit, validating years of patient capital allocation. The company operates across the spectrum Oncology and Non-Oncology APIs, Branded and Generic Formulations, Contract Development & Manufacturing (CDMO), and Biologics making it one of the most integrated players in the industry. It boasts the largest oncology API portfolio in India, with leadership in several niche molecules. In the non-oncology space, it commands dominant global market shares 50% in respiratory drugs, 20% in bleeding disorder therapies, and rising strength in hepatobiliary medications. These are products born of relentless R&D and an unwavering focus on differentiated, scalable opportunities.

Within formulations, the company has underutilized capacities ready to be leveraged with a robust pipeline for non-US markets. It is the only generic player for blood cancer treatment in the EU and remains the sole supplier for a new drug format in the US. What sets the company apart is its ability to innovate across multiple drug delivery formats, creating barriers to entry and securing long-term revenue streams.

India's growing reputation as a global CDMO hub is playing to its strengths. The company is the sole supplier of Oxylanthanum Carbonate, a drug for kidney disease to US-based Unicycive Therapeutics, and more such partnerships are progressing in late-stage negotiations. We expect the company to win at least one significant deal annually going forward. From complex ophthalmology products in Phase III trials to launching India's first biosimilar in a differentiated format, its innovation track record continues to expand. While the stock price remained flat in the early years, we held firm in our conviction that deep-moat businesses focused on innovation, market share gains, and latent capacity would eventually deliver parabolic earnings growth. That phase is now beginning, and we believe the best is yet to come.

Last year, we identified the revival of **Thermal Power** as a key contrarian investment theme. In an environment where most were chasing new-age energy narratives, we chose to stay with fundamentals backing a Maharatna company that remains India's sole supplier of thermal power equipment. India's peak power demand rose 3% YoY to 250GW in FY25 (vs. 243GW in FY24), largely due to increased demand from agriculture and residential cooling. At the national level, we're barely meeting ~1700 BU of electricity demand with a 0% deficit. What's more critical is the trend shift: base power demand is now growing at a 7% CAGR over FY2022–25, compared to just 2% over FY2017–21.

Recognizing this urgency, the government has accelerated thermal project ordering to prevent grid instability. Ordering of new Thermal power capacities in FY25 rose to 23GW, a near-3x jump from FY24's 8GW and double the cumulative ordering between FY17 and FY23. Our investee company captured an astounding 82% of FY25's orders (18.8GW)—and 100% of FY24's orders cementing its dominant position (c.55% in last decade). As execution on these orders scales up from FY26, we expect operating leverage to kick in meaningfully. Meanwhile, the company is also at the forefront of developing small modular nuclear reactors, aligning itself with India's broader energy transition goals.

*****

One of our high-conviction long-term investments—**a Small Finance Bank** that pivoted from Microfinance to secured loans—has hit turbulence. While the bank's transformation yielded strong growth, with a loan book CAGR of 20%+ and clear visibility on 2% ROA by FY26, the residual MFI segment caused pain.

The industry-wide rush to scale microloans led to overleverage customers, culminating in a spike in NPAs and subsequent write-offs. Though the bank has built a ring-fence book of ₹140 bn in small business loans and ₹42 bn in housing, the write-offs dragged on performance. Further, accelerated provisioning—part of the bank's goal to become a universal bank—has also compressed short-term returns. *While we trusted the experienced management to manage these cycles, the extent of pain from MFI has been sobering.*

At the beginning of the year, we built a position in a **mid-tier IT services company**—a bellwether for SAP and Oracle ERP implementations as a proxy for U.S. capex revival across BFSI, energy, and manufacturing. We anticipated that FED rate cuts would rekindle IT transformation spends, historically a positive trigger. The company aspired to join the $1 bn revenue club by FY28 and assembled a top-tier leadership team from Wipro, Cognizant, and other majors. While our investment thesis was well-founded, recovery has been delayed by macro uncertainty and tariff headwinds.

Then came a supernova event in Jan'25: DeepSeek, a China-based AI company, launched a low-cost LLM platform that jolted global IT markets. It shattered the notion of U.S. AI dominance, prompting a 15% Nasdaq correction and a 17% fall in Nifty IT. This spooked hyperscale's, who hit pause on new capital investments directly affecting mid-sized Indian services. Investing is humbling. As Morgan Housel aptly said: "*The most important part of every plan is planning on your plan not going according to plan.*"

Outlook

Over the past year, most client conversations revolved around two themes: the overvaluation of Indian markets and global events like tariffs shaping future trajectories. These discussions often reflected a broader concern where are we in the market cycle?
Across history, bull markets have taken different forms, each reflecting a distinct national or economic narrative. The United States has led what could be called a Schumpeterian bull market driven by waves of technological innovation and productivity gains. The meteoric rise of AI and tech stocks is the latest chapter in this journey. China, on the other hand, has experienced Ricardian bull markets, riding on the back of geographic and market expansion, becoming a global export powerhouse in electric vehicles, industrial tech, and more. These booms were accompanied by significant balance sheet expansions, both corporate and national.

Between 2021 and 2024, India witnessed a distinctly Malthusian bull market fueled not by abundance but by the fear of scarcity. In this case, it wasn't land or food, but investable equity assets. The expanding investor base evidenced by 18 Crore demat accounts, a 4x jump in five years pushed valuations up by 20-25%, aided by fundamentals which kept improving at their own pace. We have seen multiple such interim corrections, the latest was seen in the last 6 months.

Bearish voices for India, while loud, often miss the forest for the trees. India's macroeconomic fundamentals remain robust. The ROEs of NSE500 companies are at multi-year highs (~15%), supported by broad-based earnings growth. After a decade of deleveraging, Indian corporates now hold fortress balance sheets ready for expansion, M&A, or capex. As geopolitical alignments shift, India is emerging as a strategic player balancing historic partnerships with China and Russia, while deepening ties with the U.S. This rearrangement of global supply chains offers a unique opportunity for Indian Inc.

The de-dollarization trend, once subtle and dismissed, is now unmistakably accelerating — driven by the escalating trade wars and shifting geopolitical alignments. This marks the beginning of a broad capital rotation away from U.S. dollar-denominated assets and equities, toward emerging markets, real assets, and alternative stores of value. For years, we have consistently argued that U.S. assets were dancing to the rhythm of *"The Winner Takes It All"*—the defining track from ABBA's 1980 album *Super Trouper*—benefiting disproportionately from global capital flows, dollar hegemony, and central bank policy.
But that era is fading. A structural, long-duration reversal is coming into focus. The momentum is undeniable—and gathering pace. This transition stands to unleash a powerful rally across emerging markets, EM currencies, and commodities. We are not merely observing a trend—we are standing at the cusp of a global inflection point

Market cycles often diverge from real economic indicators, at least in the short term. But such divergence creates opportunities especially for active stock pickers. With much of the excess valuation now corrected, we’re entering a phase where only earnings delivery gets rewarded. The era of thematic speculation is on pause until the next bull takes over. Meanwhile, the underlying consumer strength of India is visible through 1.5–2 mn fans packing into cricket stadiums during IPL matches. Over 4 Lakh people attended just five Coldplay concerts. In 2024 alone, 5,454 UPI transactions occurred every second. This mass consumption shift, paired with capital discipline and policy tailwinds, makes India a structurally attractive destination regardless of short-term market noise.

This year’s letter would be incomplete without extending sincere gratitude to **Louis Vincent Gave** Partner, Gavekal Macroeconomic, for visiting India on behalf of Vallum. His three-day journey across three states sparked some of the most insightful dialogues we’ve had. And finally, a heartfelt thanks to a valued client and astute investor, who has written a book titled "***Confessions of Stock Market Wizards***", with a special mention of Vallum. We are honored.

Regards,

Manish Bhandari and Team Vallum
manish.bhandari@vallum.in
April 2025