

Nepean Capital

4Q CY24/3Q FY25 Quarterly Newsletter

The Nepean Long Term Opportunities Fund II is an open-ended, multi-cap India Special Situations fund. It has given a return of +38.4% (in US\$, net of fees) at an IRR of +10.6% since the first close (Oct 14, 2021). It has outperformed the benchmark NIFTY500 by 1250 basis points since.

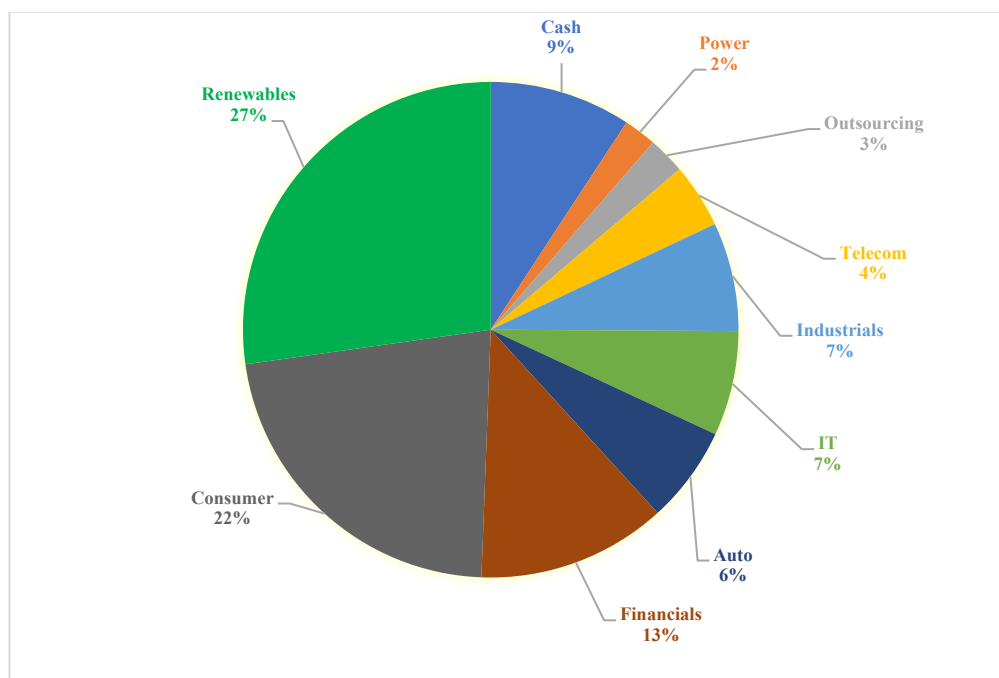
Performance, net of fees in US\$ as of Dec 31, 2024

| Period | Fund I* | | | | Fund II** | | | |
|----------------------|---------|--------|--------|--------|-----------|-------|--------|----------|
| | CY18^ | CY19 | CY20 | CY21 | CY21^^ | CY22 | CY23 | CY24 YTD |
| Fund | +5.3% | 0.0% | +35.1% | 32.3% | +1.3% | -1.8% | +35.6% | +2.6% |
| Benchmark | -7.0% | -11.8% | +18.6% | 31.7% | -3.0% | -7.3% | +25.3% | +11.8% |
| Outperformance (bps) | +1230 | +1180 | +1650 | +60 | +430 | +550 | +1030 | -920 |
| Since Inception | | | | +84.1% | | | | +38.4% |
| Benchmark | | | | +28.2% | | | | +25.9% |
| Outperformance (bps) | | | | +6020 | | | | +1250 |
| IRR | | | | +24.0% | | | | +10.6% |

*Benchmark NIFTY Small Cap Index
^First close Sep 18, 2018
NAV is calculated monthly

**Benchmark NIFTY500 Index
^^First close Oct 14, 2021
Fund I was closed in May 2021

Sectoral break-up



We experienced our first year of underperformance led largely by four stocks, which we have sold:

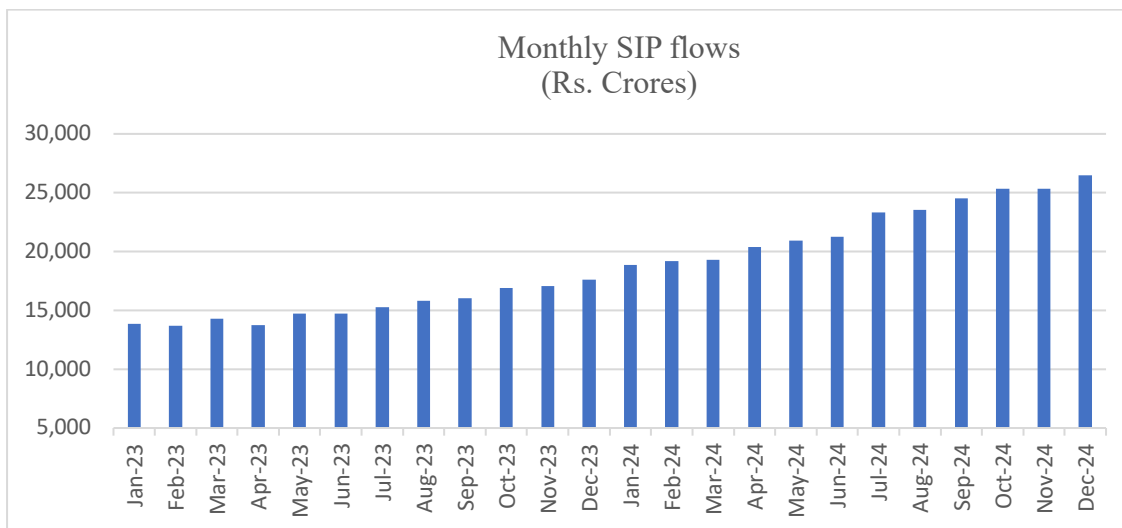
- Spandana Sphoorthy, India’s third largest microfinance company
- Syrma SGS, an EMS company
- Zee Entertainment, India’s second largest media company
- Sterling & Wilson, India’s largest solar EPC company

FPI vs. DII vs. HNI vs. Mass Retail:

After a spectacular return of 21.5% (local currency) in 2023, India’s benchmark NIFTY50 index rose a tepid 8.5%. The divergence between stock market performance and the Indian economy that existed for the past two years has now narrowed.

FPIs (foreign portfolio investors) were net sellers in 2024 and ended the year with \$1.2 Bn in outflows. The most pronounced selling came between Sep 26 and Oct 19, when FPIs sold \$15.5 Bn, the fastest episode of foreign selling in India’s history. That equates to a mere 1.5% of their holding of just under \$1 Tn. The impact cost of the selling by FPIs was severe, dragging the NIFTY50 down 10%, even though the selling was mostly matched by domestic institutional buying. India/EMs saw flight of capital into the U.S. where the consensus 2025 GDP growth is a healthy 2.5%. In fact, earnings growth for the S&P500 is as high as 13% for this year, of which the MAG 7 are at 18% and the balance 493 are growing at 11%. In 2024, the S&P500 posted a total return of 25%, following the 26% return in 2023 and the second consecutive year with a return greater than 20%. That said, nearly half of the annual return came from just five stocks (NVDA, AAPL, AMZN, GOOGL, AVGO).

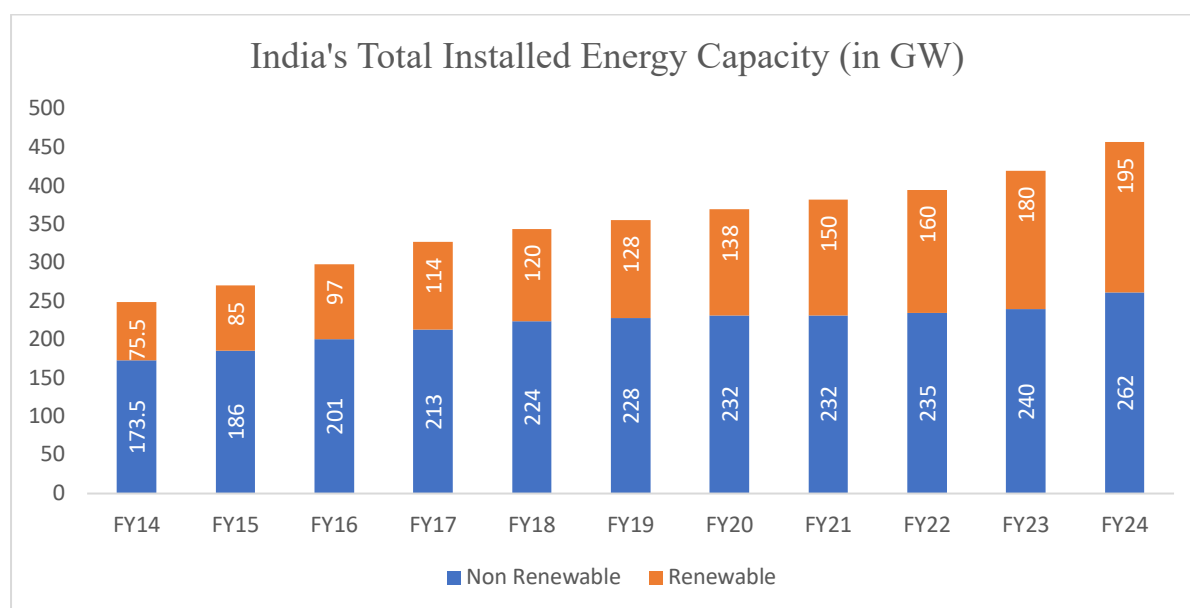
Meanwhile, on the domestic front, the financialization of the India equity markets continues unabated. 750 Mn smartphones powered by 4G & 5G mobile networks have enabled Indians to invest via various online discount brokers and/or through mutual funds. HNIs & family offices have been booking profits while mass retail seems to be actively investing. Domestic mutual funds have seen 46 straight months of positive flows, taking in \$60 Bn in 2024. In fact, the month of December witnessed inflows of Rs.41,156 crores/\$4.84 Bn, of which SIPs (systematic investment plans) accounted for Rs.26,459 crores/\$3.1 Bn (+50% YoY), a new high. The number of dematerialized (demat) accounts in 2024 rose by 46 Mn taking the total to a whopping 185 Mn.



However, today the Indian economy is facing multiple headwinds. The NIFTY50 reported weak numbers for the 2Q FY25 with revenue/EBITDA/net income growth at 4%/4.8%/4%, respectively and soon followed by earnings downgrades. No surprise that the 2Q FY25 GDP print was 5.4% (a seven-quarter low) vs. 8.1% over the same period in FY24. Economic growth is still dependent on government capex as private sector capex hasn’t as yet taken off. But between Apr-Nov, government capex increased only by 3% YoY vs. an estimated 9%. The other concerns are a) will the Trump

administration raise tariffs for Indian goods exported to the U.S. and b) what's their view on granting H1-B work visas and its impact on Indian IT companies. That said, there are some bright spots:

Power: Demand continues to surge with per capita electricity consumption in India growing to 1,395 kWh in FY24, +50% in the past ten years. While a lot of rural India still needs to be electrified, incremental demand is also coming from the increased use of AI. A simple ChatGPT query requires 10x the power of a simple Google search while AI-generated images need 50x. Today data centre capacity in India is just under 1GW but analysts estimate that will rise to 17 GW by 2030. Data usage has exploded to 100x over the past 15 years; in fact, more data has been created in the past three years than in all of history. In the U.S., the number of data centers has increased 17x over the past five years, driven by the rise in cloud computing and AI. Analysts estimate that the U.S. will need over \$1Tn invested in data centers over the next five years, plus another \$1Tn to be invested globally. Almost 30% of Nepean Capital's portfolio is allocated to the power sector.



Travel & Tourism: This is one sector that seems to defy any slowdown. India's largest airline, Indigo, ended 2024 having flown 112 Mn passengers +12% YoY. Similarly, pan India ARR (average room rates) for the hotel industry in November rose +11% YoY, RevPAR (revenue per available room) +23% and occupancy was at 70%. The total hotel signings last year have risen to 37,000 keys +47% YoY. Only 25% of the new hotel key signings are in big cities and 44% are in smaller towns. The Indian tourism sector is expected to double in size to \$523 billion in the next 10 years, according to World Travel and Tourism Council (WTTC) President & CEO Julia Simpson. Hilton Hotel's President (Asia-Pacific), Alan Watts, says 'Indians are the fastest growing outbound travellers globally; will soon overtake the Chinese.'

Real Estate: The wealth creation in the stock market over the past four years has helped Indian developers clock 15-25% sales growth. The affordability ratio (home loan payment/income) at 40% has crossed pre-COVID levels. The first 9 months of 2024 saw 230,000 residential units sold across the Top 7 Indian cities, +17% YoY and a new record. Prices of homes rose between 3-20% with Delhi clocking +19% YoY, followed by Bangalore +14%. Separately in the commercial real estate space, gross leasing activity across the Top 9 cities for the full year 2024 was 79 mn sq ft, the highest ever. Of this, GCCs (global capability centres) took up 37% or 29 Mn square feet +29% YoY. GCCs are thriving in India as it produces the highest number of English speaking STEM students in the world.

The Big Fat Indian Wedding is Back: India's wedding industry is the second largest in the world (after China) and as an industry the fourth largest in the country. The current season will likely host 4.8 Mn weddings nationwide and generate Rs.6 lakh crores/\$70 Bn in revenue. Believe it or not, but

Indians spend 2x more on weddings than on education, 3x their average annual income and 5x the per capita income. In December, Anam Zubair, the director of consumer marketing at WeddingWire India, a wedding planning platform said:

“Next year (2025) is looking quite strong in terms of the number of auspicious or muhurat dates. The first half of next year is having almost the same number of days that you generally have in a full year. The average guest list currently is somewhere between 352 to 356 people +14% YoY and the average budget is Rs 28.5 lakhs/\$3,350 +36% YoY.”



Wedding attire from Ethnix by Raymond Lifestyle Ltd.

Conclusion

We believe that 2025 will be a challenging year for the equity markets in India and we brace for volatility. We don't see FPIs returning to India in a hurry given high valuations (21.5x CY25 P/E, same as the S&P500), dollar strength and a slowing economy. Inflows from domestic investors will hopefully offset any further selling by FPIs and drive the markets.

That said, we are seeing some pockets of green shoots. Jubilant Foodworks (the master franchisee for Domino's Pizza) delivered growth of +12.5% YoY in the 3QFY25. India's largest jewellery retailer, Titan's business grew +26% YoY driven by strong festive demand. Its eyewear sales grew +17% YoY vs. +7% YoY in the previous quarter.

There are two major events coming up which could significantly impact markets, i.e. the first few weeks of President Trump's administration and India's annual budget on Feb 1. President Trump will have to balance taming inflation with the campaign promise of raising tariffs on countries that don't lower import duties on U.S. goods, India included.

The resurgence in real estate development across India that began some 3.5 years ago will be one of the key drivers of reviving urban consumption. Given that the average construction time is around five years, over the next 12-18 months every new home will need furniture, ceramic tiles, light fittings, a whole new set of kitchen appliances, paint, toilets, air conditioners, automobiles, etc. Therefore we believe that the current slowdown is cyclical and remain structurally bullish on India.

Beginning from the last quarter, we are sending out a weekly rundown of the top stories emerging from India (let me know if you want to be added to the mailing list). I have hand-picked some of the non-financial stories that show a different side of India:

IIT Couple Found Happiness in Farming & Off-Grid Life After Leaving High-Paying US Jobs
<https://thebetterindia.com/381711/iit-grads-leave-us-jobs-build-sustainable-farm-jeevantika-madhya-pradesh-permaculture/>

Looking for a digital detox? 7 Indian destinations to unwind this holiday season
<https://economictimes.indiatimes.com/industry/services/travel/looking-for-a-digital-detox-7-indian-destinations-to-unwind-this-holiday-season/spiti-valley-himachal-pradesh/slideshow/116391710.cms>

Checkde India! Teen prodigy Dommaraju Gukesh becomes youngest world Chess champion
http://timesofindia.indiatimes.com/articleshow/116273038.cms?pcode=462&utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

Coldplay tickets for Ahmedabad Sold OUT; Netizens react on long waiting time
<https://www.livemint.com/news/trends/coldplay-tickets-for-ahmedabad-out-on-bookmyshow-netizens-react-on-long-waiting-time-dukh-dard-pida-20-11731739663046.html>

How This Foundation Is Giving Hope to Children Fighting Cancer, Regardless of Their Background
<https://thebetterindia.com/379430/the-hans-foundation-affordable-cancer-treatment-for-kids-pediatric-program-underprivileged-rural/>

The Maha Kumbh Mela



The *Maha Kumbh Mela* is held every 12 years and holds the distinction of being the world's largest religious event, with 400 Mn people expected to attend between Jan 13 to Feb 26. It is held in the city of Prayagraj in the northern state of Uttar Pradesh at the Triveni Sangam, i.e. where the rivers Ganga, Yamuna and the mythical Saraswati converge. It is believed that a dip in the holy water cleanses one's sins and grants spiritual liberation (moksha). The 45-day event is expected to generate Rs.2 lakh crores/\$23.5 Bn in revenue for the state of Uttar Pradesh.

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