

January 2025



IKIGAI
Asset Manager
Trust. Process. Performance.



Quarterly Newsletter

IKIGAI Emerging Equity Fund





Dear Investors,

Wishing you and your loved ones a very Happy New Year.

We take this opportunity to thank you for your support and investment in the IKIGAI Emerging Equity Fund. Thank you for entrusting us with your hard-earned savings and allowing us to play a role in your financial growth. Your support has been pivotal in our success, and we are profoundly grateful for the trust you have placed in us.

This is our **second newsletter** to our investors which will provide you insights on our investing philosophy, market outlook and how the portfolio is positioned to manage the market volatility.

Our focus remains clear: to help you compound your wealth over the long term, while prioritizing downside protection and **safeguarding against permanent capital loss**. Integrity and reputation are at the heart of everything we do, and we firmly believe that these values, along with our core principles of **Trust, Process, and Performance**, will continue to drive sustained value for our investors.

As we bid farewell to 2024, Indian markets have marked yet another year of growth and completed nine straight years of positive returns, a first in history.

2024 was a year of two halves with solid returns in 1H and no returns in 2H for the Indian markets. The first half delivered strong returns, driven by the continued momentum from 2023, optimism around a robust political mandate, and growth narrative. However, second half was just the opposite. **The Nifty posted its first 5% drawdown after 54 months in October as 2QFY25 earnings disappointed, GDP growth fell to 7qtr low due to slowdown in government capex and exports and strong equity paper supply averaging USD 7.5bn a month. Topline growth for the top 500 companies has remained sub 10% for 6 consecutive quarters now.**

However, amidst the recent slowdown, Indian primary markets have remained resilient. This year has been a landmark year that has set records in fundraising activity, marked by a record number of IPOs and QIPs.

India now holds the distinction of having the **largest primary market globally by volume** and the **second largest by value**. For an economy contributing about 4% to the world's GDP and market cap, commanding **10% of global IPO value** and **27% of the volume in 2024** is staggering. Indian markets saw net equity supply of more than USD 80bn in CY24.

In this newsletter, we take a closer look at the booming IPO market. **While the excitement surrounding IPOs is well-founded, this frenzy calls for cautious optimism**. It's crucial for investors to balance enthusiasm with diligence, making informed decisions that safeguard their investments for the medium to long term. The allure of quick gains should not overshadow the importance of sustainable value creation.

Let's dive deeper into what made 2024 a groundbreaking year for Indian primary markets and the lessons it offers for the road ahead.

Indian Primary Markets:

Did you know?

- The year saw **317 IPOs** raise an unprecedented **₹1.75 trillion**, the largest capital raise in India's market history. October witnessed the country's **biggest-ever IPO**, with Hyundai Motor raising an impressive **₹278.6bn. (Exhibit 1)**
- New listings contributed **2.9%** to India's market capitalization, up from **1.4% in CY23**. However, this still trails the peaks of **CY17 (3.7%)** and **CY21 (3.4%)**, highlighting room for further growth.



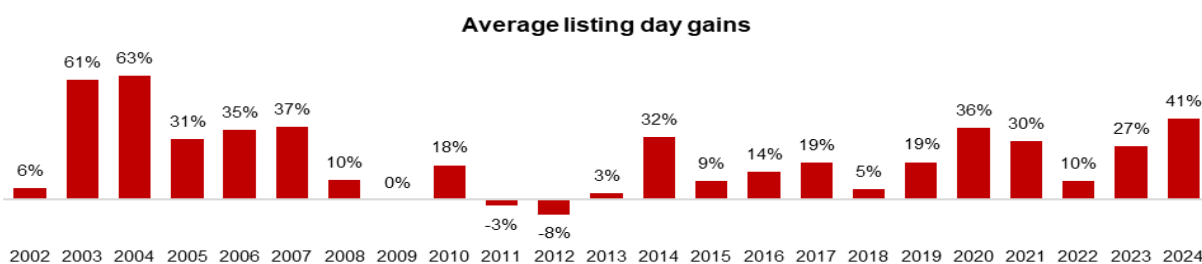
- The average listing-day gain soared to **41%**, the highest since 2004. Remarkably, **37% of IPOs** delivered returns exceeding **50%** on debut, and **26%** are now trading at a **100% premium** to their offer price. Overall, **69% of IPOs** in 2024 enjoyed listing gains of over **10%**. (Exhibit 2)
- IPOs were oversubscribed by an average of **26.6x**, drawing an overwhelming **₹46.7 trillion** against an offer size of ₹1.8 trillion. This is the **second-highest oversubscription** in a decade, following CY23's peak of **29.9x**. SME IPOs were showstoppers, with oversubscription levels reaching a staggering **165.3x**.

EXHIBIT 1

Year	INR b				Number of companies			
	IPOs + FPOs	Main-board	SME	SME % to total	IPOs + FPOs	Main-board	SME	SME % to total
CY14	20	17	3	15.8	49	6	43	87.8
CY15	139	136	3	1.9	63	21	42	66.7
CY16	271	265	6	2.1	94	26	68	72.3
CY17	760	742	18	2.3	169	38	131	77.5
CY18	335	310	24	7.2	166	24	142	85.5
CY19	178	171	7	3.8	68	17	51	75.0
CY20	463	461	2	0.4	47	17	30	63.8
CY21	1,314	1306	8	0.6	121	65	56	46.3
CY22	656	636	20	3.0	151	40	111	73.5
CY23	576	527	49	8.6	242	59	183	75.6
CY24YTD	1,757	1,665	92	5.3	317	81	236	74.4

Source: MOFSL

EXHIBIT 2



Source: Ambit Capital

Be careful of accounting in IPO companies:

While many high-quality companies have debuted on the bourses, it's important to remember that not all that glitters is gold. Some companies employ accounting gimmicks to inflate their topline and bottom-line figures, aiming for higher valuations during their IPO.

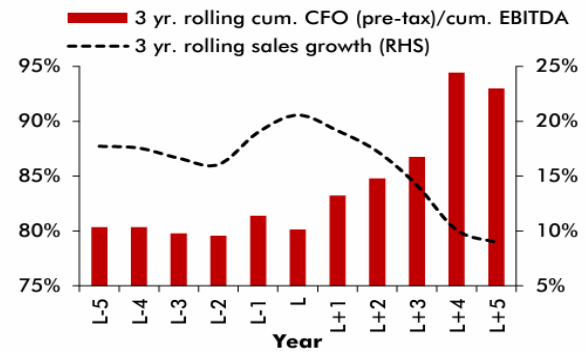
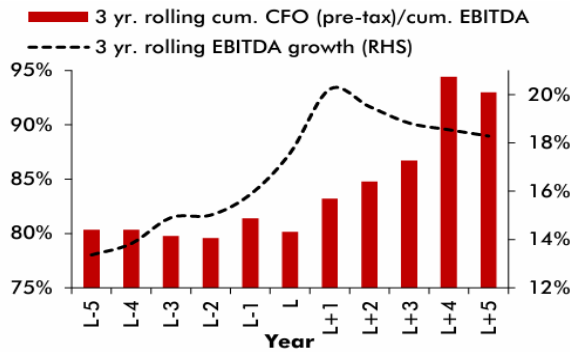
A closer look at IPOs since FY13 reveals a telling trend: **sales and EBITDA growth often peak in the years leading up to the listing**, while cash conversion metrics, such as the **pre-tax CFO/EBITDA ratio**, hit their weakest levels along with high related party transactions and high off-balance sheet items. Interestingly, this trend often reverses post-listing, as growth normalizes, and the true financial health of the business becomes apparent.

Exhibits 3 clearly illustrate how many companies which come out for listing usually showcase an impressive revenue growth till the year of listing; however, history suggests that the revenue growth rate slumps post the year of listing, raising a crucial point for investors. With limited public market history, it's essential to carefully evaluate the value being paid for these companies to ensure sustainable, long-term returns.

Companies that have created long-term value clearly show that it is cash flows, along with profits, that are most important. Companies with good profits but weak cash flows get a lower multiple from the markets and vice-versa. We are careful of companies that are obsessed with driving quarterly earnings and meeting street expectations without caring for cash flows.



EXHIBIT 3



Source: Company, Ambit Capital Research

L represents the year of listing whereas L-1 represents one year before listing, L-2 represents two years before listing and so on, similarly L+1 represents one year after listing, L+2 represents two years after listing and so on.

How do IPOs perform in the long term?

Over the past two decades, Indian markets have seen approximately 1800 IPOs launched, including 751 issues with an offer size exceeding ₹500 million. While IPOs often generate short-term excitement, their long-term wealth creation tells a very different story. For instance:

1. Only 26% of IPOs have turned into five-baggers or more in the last 22 years
2. Only 51% of the IPOs with issue size of INR 500mn or more have outperformed Nifty Index since listing

We believe that the long-term performance of IPOs emphasizes the importance of diligent selection and a focus on fundamentals. The IPO market offers plenty of opportunities, but only a few deliver consistent wealth creation over time.

MARKET REVIEW & OUTLOOK

Since the COVID lows of March 2020, both Indian and global equity markets have experienced an exceptional rally. In India, the Nifty, Midcap, and Small Cap indices have surged 3x, 5x, and 5.4x respectively from their pandemic lows. The NSE 500 Index has seen an almost 300% increase, marking the longest bull run in India over the past two decades. Nearly 60% of NSE 500 Index constituents have delivered more than 30% CAGR returns over the last four years.

The primary drivers of this strong equity market performance have been robust corporate earnings growth and strong domestic investment flows. Nifty 50 companies have delivered an 18% CAGR in earnings, while Nifty 500 companies have posted a 22% CAGR over the last five years. This growth has been supported by improved profit margins, debt reduction, and a revival in investment, particularly in government capex and real estate.

The story is even brighter in the mid and small-cap space. Nifty Midcap 150 Index companies achieved a remarkable 38% CAGR in earnings between December 2020 and December 2024. Similarly, the Nifty Small Cap 250 index saw earnings grow at 27% CAGR, resulting in 31% CAGR in Index returns.

In such an environment, multi-baggers have become a common feature. Investors, particularly those who joined the markets after Covid, have come to expect that any stock they buy will double in a matter of months, with so-called “laggards” delivering 25-50% returns. But when making money becomes this easy, it often signals that the market may be nearing a turning point.



The recent **~10% correction in the Nifty 50 since September** might be the first sign that the era of easy money is coming to an end.

The big question now is: **What’s in store for CY25? We’ve observed some shifting trends in recent months, and we believe it’s important to highlight few of them.**

1. Earnings growth is slowing down and mean reversion happening.

2QFY25 results have been subdued. Not only is EPS growth slowing, but the estimate trajectory is also normalizing with downgrades in broader markets. Expect this to accelerate as the margin expansion lever is no longer available. Do not expect a repeat of FY21-24 when estimates held up bucking the trend of the past decade. Negative earnings surprises are rising and stood at -6% for NSE 500 Index in 2QFY25, the highest in recent times. **In our view consensus is still pricing in higher earnings growth in FY26 at 14-15%. We believe it could be more in the range of 10-12% and further downgrades are possible post 3QFY25 earnings. Finally, markets are slaves of earnings and if earnings growth is not strong, rally could pause for some time or could become selective.**

EXHIBIT 4

Rs in Trillion	No of Cos	Revenue		EBITDA (%)		Reported PAT %	
		YoY%	QoQ%	YoY%	QoQ%	YoY%	QoQ%
NIFTY 500	499	7.2%	0.1%	4.0%	-3.6%	2.7%	-8.0%
BFSI	91	14.6%	5.0%	NA	NA	15.6%	1.2%
Non BFSI	408	4.9%	-1.5%	-4.6%	-5.9%	-5.2%	-13.9%

Source: AMSEC

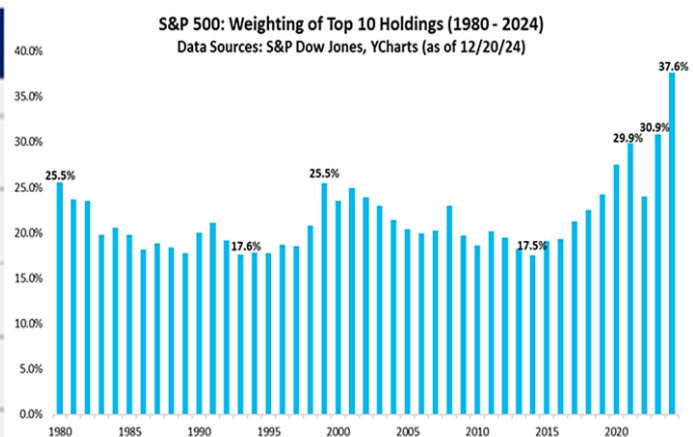
2. Is US stock market topping out?

We believe the risks in US markets are increasing on following counts:

- The top 10 companies in the S&P 500 now account for over a third of the index’s market capitalization, reaching levels last seen during the dot-com bubble. (Exhibit 5)
- US stocks outperformance at 75-year high vs Rest of World (ROW)
- On Valuations: <3% of the time the S&P500 has been more expensive than now since 1881.
- Only 32% of S&P 500 stocks have outperformed the index in 2024, marking the second consecutive year of such low breadth (29% in 2023). For perspective, the historical average is equal to 50%.
- S&P 500 has delivered back-to-back returns of over 20%, as it has in 2023 and 2024. Historically, such performance has often been followed by a slowdown in the subsequent year. (Exhibit 6)

EXHIBIT 5, 6

S&P 500 up >20% for 2 years in a row		S&P 500 returns in following 2 years		Treasury returns in following 2 years	
1927	1928	1929	1930	1929	1930
31%	38%	-12%	-28%	4%	5%
1935	1936	1937	1938	1937	1938
42%	28%	-39%	25%	1%	4%
1954	1955	1956	1957	1956	1957
45%	26%	3%	-14%	-3%	6%
1995	1996	1997	1998	1997	1998
34%	20%	31%	27%	12%	14%
2023	2024	2025	2026	2025	2026
24%	24%	-	-	-	-



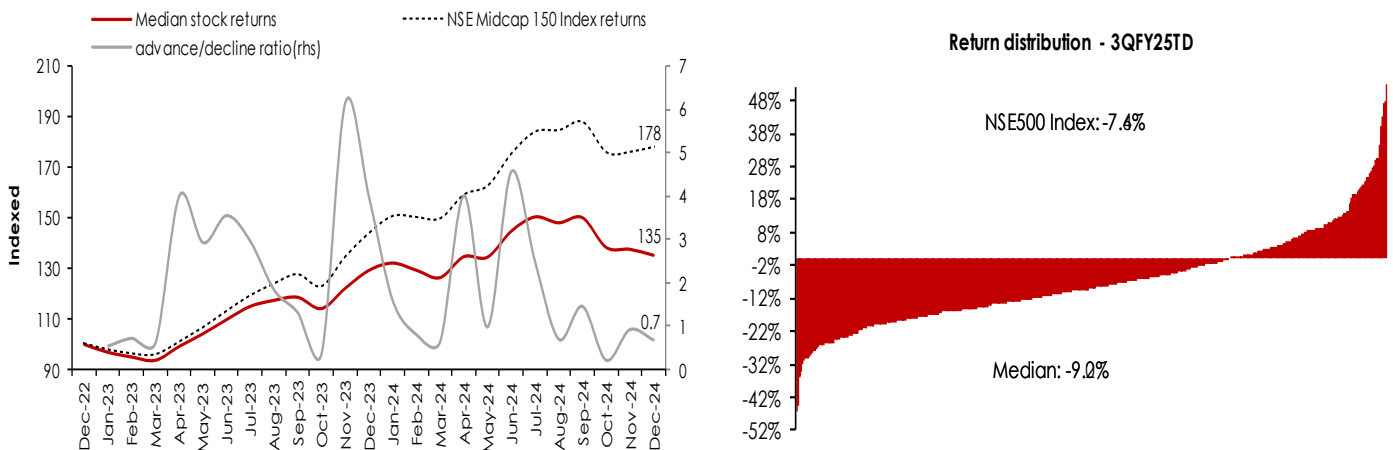
Source: BofA Global Investment Strategy, GFD Finean, Bloomberg , Charlie Bilello



3. The return of polarization?

As we mentioned in our last newsletter, we have started to see increased polarisation in the market and the breadth of the rally is narrowing, which is evident in the divergence between index returns and median returns which has begun to accelerate. Over the last few years, we saw a broad-based rally as earnings growth was strong. However, the last six months have been comparatively weak with median stock returns lagging NSE500 index and even in Nifty Midcap 150 Index, median return is trailing the index returns due to few heavyweights pulling up the index. (Exhibit 7)

EXHIBIT 7



Source: Ambit Capital

Currently, market capitalization contributions of top 50, 100, 200 and 500 companies are at their lowest since 2005. Outperformance cycle of Nifty Equal Weighted (EW) index over Nifty usually lasts about 3 years, with current cycle having begun in July-21. While markets have remained resilient, the outperformance cycle can possibly be on its last legs and heavyweights can outperform going ahead. **Can CY25 be a stock pickers market?**

Is the tide turning and style changing?

Over the last two years, factors like value, alpha, high beta and momentum outperformed, while quality and low volatility were significant underperformers. In times of positive economic sentiment and broad based earnings recovery, value and momentum factors tend to outperform, while quality and low volatility underperform. However, the trend seems to be changing.

Over the past 4 months, quality, growth and low volatility performed better compared to other factors. With EPS growth expected to normalize in FY25, there is a high likelihood of quality, growth & low volatility factors can outperform, a trend which might have just begun. (Exhibit 8)

Quality, post underperformance over past year, has made a significant comeback since June-24. May be the time to re-align the portfolios. Over the past few months, quality, growth and low volatility turned a corner and began to catch up and compared to value factor we see resurgence of “Growth” and “Quality” factor performing over the next few years.



EXHIBIT 8

Date	Nifty200 Alpha 30	Nifty200 Momentum 30	Nifty200 Quality 30	Nifty200 Value 20	Nifty200 Low Volatility 20	Nifty High Beta 50	Nifty 200 Growth 20
Oct-23	-5%	-4%	-2%	-2%	-2%	-4%	-1%
Nov-23	14%	12%	7%	10%	4%	8%	9%
Dec-23	10%	9%	7%	14%	8%	12%	8%
Jan-24	5%	6%	0%	10%	-4%	7%	1%
Feb-24	3%	3%	1%	9%	1%	1%	5%
Mar-24	2%	3%	0%	1%	-1%	0%	2%
Apr-24	6%	6%	1%	9%	-1%	10%	1%
May-24	5%	5%	4%	0%	-1%	0%	2%
Jun-24	6%	3%	6%	1%	6%	4%	7%
Jul-24	6%	5%	8%	10%	7%	4%	-1%
Aug-24	1%	0%	-2%	-1%	-3%	-4%	0%
Sep-24	-2%	1%	2%	-3%	3%	0%	4%
Oct-24	-9%	-8%	-9%	-10%	-7%	-10%	-6%
Nov-24	0%	-1%	0%	-1%	1%	0%	2%
Dec-24	0%	-3%	-2%	-4%	1%	-4%	5%

Source: Ace Equity, Ambit Capital research.

Market Outlook:

Over the past few years, it’s been a dream run for most investors—almost everything you bought made you money. In such an environment, the perception of risk tends to diminish, and it's easy to overlook potential pitfalls. It’s important to remember that most mistakes are made during bull markets, not bear markets. **It’s time to be Risk Manager rather than Fund Manager.**

We believe that in euphoric times like today, it’s easy for judgment to become clouded, causing investors to abandon fundamentals and chase short-term momentum. As Warren Buffett aptly put it, **“Only when the tide goes out do you discover who’s been swimming naked.”** In periods of market exuberance, even companies with weak financials (cash flows and balance sheet) or governance issues can see their stock prices soar. It’s tempting to get caught up in the excitement, but when the tide eventually recedes, it’s the strength of the underlying business that will determine which stocks create sustainable wealth.

Overall, 2025 could be challenging. Demand is weak, cost efficiencies already extracted, and policy is neutral/restrictive while valuations are elevated.

Despite all the concerns in near term, medium to long term outlook remains positive. Nifty earnings are expected to grow at a low to mid-teens CAGR over the next three years, providing a strong foundation for equity returns.

We would recommend that Investors looking to invest need to moderate return expectations and extend the investment horizon to three to five years plus and maintain a disciplined asset allocation.

PORTFOLIO STRATEGY AND POSITIONING

As shared with our investors in our last quarterly update, we have taken a thoughtful and measured approach to deploying capital since the fund’s launch on 19th June 2024. We had an average deployment of around 55% in the first 12 weeks of launch. This careful pacing has enabled us to position the portfolio for long-term growth while managing risks effectively.

We are now fully invested with portfolio comprising of companies that enjoy leadership/strong positions in respective businesses and should be able to increase/maintain their market share. Portfolio would be well diversified and would be spread across 40-50 names at any given time.



The portfolio today has 84% weight to mid and small caps (almost equally divided) and 13% of investments are in large caps. The fund is focussed on bottom-up stock selection and expected earnings for next year is in excess of 20% for FY26E and P/E of 27x. The portfolio is well diversified across sectors and key economic variables.

The Fund is overweight materials (including speciality chemicals, cement), healthcare, industrials, consumer discretionary etc.

The key portfolio characteristics of **IKIGAI Emerging Equity Fund** as of January 01, 2025, are presented below:

Exposure By Sector (GICS)	(%)
Materials	23.10%
Industrials	20.50%
Consumer Discretionary	17.72%
Financials	12.48%
Health Care	10.93%
Information Technology	3.20%
Communication Services	1.27%
Consumer Staples	1.27%
Others	5.76%
Cash & Equivalents	3.77%

** Based on our Internal Estimates of our investing companies

Period Ended	**IKIGAI Emerging Equity Fund (ex-financials)
EPS Growth FY24	23%
EPS Growth FY26 E	24%
Return On Capital	18%
Debt/Equity	0.5
EBITDA Margin	20%
Free Cash Yield	1.4%
Forward P/E	27

The fund has had a decent start! Although six months is a relatively short period, we are pleased to share that the portfolio has outperformed Nifty 500 and Nifty Midcap 150 since inception and over the last few months since the correction has started. This showcases our thought of prioritizing downside protection, delivering consistent returns and **safeguarding against permanent capital loss**. Presently the Fund size is **~₹2808 crores (including 31st December 2024 flows)**.

Period	Fund Return (IKIGAI Emerging Equity Fund)	Nifty 500	Nifty Midcap 150	Nifty Midcap 100
Since Inception (19 th June 2024)	2.96%	0.68%	2.10%	3.53%
Since Peak (24-Sep-24)	-3.72%	-7.82%	-5.54%	-5.59%
Last 3 Months	-3.70%	-7.27%	-4.78%	-4.49%

Notes:

* Pre-tax returns, pre-management fees. Data as of January 01, 2025, individual share class returns may be different

Index Returns considered from day end June 18, 2024

Our current approach to portfolio construction prioritizes downside protection by investing in high-quality businesses with a sufficient margin of safety and liquidity. Given the volatility in markets, we believe effective risk management will be crucial in compounding wealth over the medium to long term.

In conclusion, while many investors are focused on identifying potential sources of risks that could derail the current rally, they may be overlooking the most critical one—the significant disconnect between current stock prices and their intrinsic values. With valuations remaining elevated for an extended period, the probability of a market correction has increased. While the catalyst for such a correction could come from anywhere, the outcome would likely be the same.

In light of this, we advise investors to make incremental investments in a staggered manner with a minimum investment horizon of 3-5 years, while adjusting return expectations accordingly.

Wishing you all a great 2025.

Regards,

PANKAJ TIBREWAL

Founder & CIO

09th January 2025



Risk Disclosures

1.	Concentration Risk	The portfolio is well diversified across sectors and key economic variables.
2.	Interest-rate Risk	Fund invests in listed equities and these businesses in turn may be linked to interest rates which are well analysed by the investment team before making investments.
3.	Foreign Investment Risk	The Fund has no investments in foreign entities.
4.	Leverage	The Fund has no leverage. Lending businesses of the portfolio have capital above regulatory norms. Other companies with high leverage are a small portion of portfolio.
5.	Realization Risk	All the investments are in listed entities.
6.	Strategy Risk	The Fund portfolio is in line with the Investment Managers stated strategy. Investment philosophy and strategy is explained in detail in the Private Placement Memorandum (PPM) provided to all investors. There is no change in the strategy mentioned in PPM.
7.	Reputation Risk	All the investments are in listed entities; Portfolio Managers endeavour to invest in sustainable and reasonably valued businesses.
8.	ESG Risk	We adhere to standard ESG practices at Fund level. We believe the portfolio companies also follow good ESG practices.
9.	Fees	The fees ascribed to the Manager/Sponsor by the fund is as mentioned in the PPM.