



July 21, 2023

## Portfolio Commentary

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### The Unmissable in Stock Investing

- There's a systematic positive trend in the Indian economy and markets.
- India's pre-liberalisation corporate governance was in a state of disarray.
- Liberalisation heralded a new epoch in Indian economics and corporate governance.
- The Satyam scandal stirred the nation and necessitated a complete revamp of corporate governance rules.
- Exemplary corporate governance is still a work in progress.
- Management integrity has been an essential check box at Sanctum PMS since its inception.

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Last month, the headline indices soared to all-time highs, registering impressive gains exceeding 3.5%, with small and mid-cap indices closing with substantial gains of over 6%. Partly, buoyant global markets made such a performance possible during the month.

Foreign Institutional Investors (FII) invested over \$3 billion in June, marking the fourth consecutive month of FIIs buying into Indian equity markets.

The Indian economy and the markets are in a structural uptrend. As the most populous nation, India is a vast market, an emerging supplier of goods and services to the world, and a promising investment destination.

The country has become the world's fifth-largest stock market, and a large part is attributable to the corporates who have diligently delivered profitable growth over the years. However, it wasn't always like that. The honest investable universe in India was small even after the liberalisation in 1991.

India was a socialist economy before liberalisation, and businesses were mostly frowned upon for making profits. Socialism got so deeply ingrained in the policymaking that India once had a maximum individual tax rate of 97.75%, which left only 2.25% for high earners to spend. With such high tax rates and extreme state controls on the economy, dishonesty was quite prevalent in the corporate world. As a result, the informal economy was much bigger than the formal economy, cash dealings were a norm, and the corporate books had little credibility. Barring a few reputed business groups, all other businesses were looked at with extreme scepticism.

### **The liberalisation impact**

Despite adopting capitalism largely in 1991, the corporate trust deficit persisted due to old corporate habits. Nonetheless, the post-liberalisation period incentivised newer enterprises to uphold honesty, as multinational capital pursued fresh businesses free from socialist India's baggage.

Companies of this new age eagerly harnessed the emerging opportunities, either from lifted governmental controls or fresh consumer demand. These enterprises established new corporate governance benchmarks and were celebrated by international and local investors,

earning these companies a substantial honesty premium. This marked the commencement of corporate India's journey towards enhancing corporate governance practices.

Yet, even after a decade of liberalisation, corporate governance remained ambiguous. Regulatory bodies were still developing comprehensive rules that align with the country's new economic landscape. Investors often received a raw deal, and corporate entities frequently colluded with operators to manipulate stock prices. It did not pinch much till then as the economy was accelerating and money was pouring into deserving companies. The smaller cases of lapses were ignored and shrugged off as one-off cases. The enforcement of accounting standards was weak, and many loopholes seldom got plugged.

### **When chickens came home to roost**

The 2009 Satyam Computer Services scandal, engineered by Ramalinga Raju, shocked the nation by revealing the large-scale manipulation of books. It exposed the stark realities of the inadequacies of corporate governance standards in India, prompting regulatory bodies to overhaul laws and corporate processes to avert similar occurrences.

A series of changes happened post the scandal. The most prominent ones are listed below.

- Enactment of a new Companies Act in 2013, which overhauled the regulatory framework and delineated the responsibilities of auditors and independent directors.
- SEBI's consistent tightening of regulations on listed companies concerning shareholder communication and protection.
- Introduction of Listing Obligations and Disclosure Requirements (LODR) by SEBI in 2015, which issued stringent guidelines on reporting and disclosing material events, actual, and suspected fraud.
- Enactment of the Insolvency and Bankruptcy Code (IBC) in 2016, which tipped the balance in favour of creditors and imposed discipline on corporations for prudent use of borrowings.
- Adoption of digitisation in processes and strengthening internal controls to prevent and detect fraud.
- Enhanced processes by stock exchanges to identify and prevent price rigging and stock manipulation.
- Increased use of criminal sanctions for corporate misconduct.

These reforms, along with several others, have resulted in improved transparency and accountability among Indian corporations. A noteworthy factor in the improvement of

corporate governance is the shift in promoter mindset, leading to larger market caps for companies managed by honest promoters and well-established boards.

In the past, businesses were often managed with a short-term view, resulting in mediocre outcomes. There were numerous incidents of funds being misappropriated, excessive leveraging, questionable related-party transactions, inactive boards, and accounting discrepancies. Even when the letter of the law was adhered to, the operational practices of many corporations were dubious at best.

Large investors typically avoided such enterprises, allocating a considerable premium for corporate governance to well-managed firms. Consequently, companies run by transparent promoters and governed by robust boards experienced significant increases in market capitalisation, which in turn led to substantial growth in the net worth of these promoters.

This development has markedly transformed the false economy mindset in the corporate world. It has sanitised the system and broadened the investable market, leading to a more transparent and accountable business environment.

### **Still a long way to go**

While there has been a significant improvement in corporate governance standards in India, the glass is still half full.

The recent history bears the scars of transgressions surpassing even the scale of the Satyam scandal. Prominent banks and financial institutions, including Yes Bank, IL&FS, and DHFL, were implicated in these debacles, posing a serious threat to the entire financial system.

Fortunately, the authorities' prompt intervention contained the fallout of these incidents. However, such grave missteps represent setbacks to the Indian narrative and affect stakeholders' confidence.

Even though the frequency of such events relative to the expanded corporate landscape has considerably declined, achieving exceptional corporate governance remains an ongoing endeavour.

### **Sanctum's take**

At Sanctum, management integrity has always been an essential consideration in our investment process. We scrutinise the corporate governance policies of potential investment companies and avoid those exhibiting any hint of lax governance practices. All our invested

companies have successfully passed this test in challenging times and have never been implicated in dubious practices.

Apart from corporate governance and management integrity, we also scrutinise the company's capital allocation strategy. On the flip side, a well-devised capital allocation strategy ensures consistent growth without jeopardising the company's long-term prospects.

With our risk-first approach, we strive to exclude bad apples from portfolios. We further manage risk at the portfolio level through optimal position sizing of individual opportunities. With these checks and balances, we ensure stable returns on our portfolios.

Here is how our flagship portfolios have done over different time frames.

### Portfolio Performance

Performance as on June 30, 2023	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Titans	4.6%	14.1%	8.2%	22.6%	11.9%	24.1%	13.3%	14.5%
BSE500TR Index	4.3%	13.2%	6.8%	24.0%	11.7%	26.4%	13.9%	15.5%
* Since Inception Returns are from 18-Nov-16								
Performance as on June 30, 2023	1 Month	3 Month	6 Month	1 Year	CAGR			
					2 Year	3 Year	5 Year	Since Inc.*
Sanctum Indian Olympians	3.8%	12.5%	5.7%	21.7%	8.6%	20.2%	12.2%	11.6%
Nifty 50TR Index	3.7%	11.1%	6.6%	22.9%	11.8%	24.6%	13.7%	13.7%
* Since Inception Returns are from 16-Sep-16								

The detailed performance can be viewed and compared with other PMS performance at this webpage. Performance is calculated using Time Weighted Returns, net of fees and expenses. Returns over one year are compounded annually; returns for less than one year are absolute. Please note that SEBI does not verify the performance information provided above. Please note that past performance is not a guarantee of future performance.

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