HAVE WE MOVED ON?

We have had another eventful quarter (Jun – Sep 2020), and its been 6 months since India as a nation went into its first lockdown. Six months ago, during the middle of the panic that the economy and markets were in due to a global supply chain shut down, it would have been presumptuous to talk about markets being higher by 30%, alongside discussing about potential possibilities of pockets where the next phase of growth could come from.

However, that's precisely where we are at and history has a funny way of rhyming, not lest repeating itself across multiple crashes. As the economy comes out of Covid (where we slowly continue to get cautiously comfortable, around life restarting around us), the relevance of discussing 'markets' begins to lose its relevance – instead what would be important going forward, is to discuss specific companies and business models which will continue to thrive in the new world.

In this letter, we will cover our portfolio performance, alongside pockets of beneficiaries that we see emerge over the next few years, and the decreasing relevance to discuss 'market performance'.

As a fund, Itus was up 1.5% in September as against the Nifty 50 which had a performance of -1.23%. Over the quarter, we were up 15.9% at a fund level, as against the Nifty which was up 9.2%. Our positioning in the quarter did not change much and we have continued to hold ~30% cash in new portfolios that have started with Itus. Our holding of cash has relevance to buying growth companies at the right valuation, the latter being an important variable in our decision to deploy capital.

Our portfolio today has exposures across 5 broad themes, and we will discuss each of them at further length alongside our thought process behind the same.

Financial: Private Sector Lending

A year back, everything that can go right, did go right for financials, which was why the indices had an exposure of ~39% on financials. Today that has dropped by ~25%, and the lockdown induced stress has resulted in more headwinds than tailwinds for the sector.

Its an environment like this, that throws up specific company related opportunities to buy good companies at sensible prices which have runway for growth. At Itus, buying a leveraged institution in the financial space requires an obsession towards minimizing downside rather than a focus on upside. The only way to truly do that is to have an exposure on banks with a process-oriented obsession to risk management where the jockey (promoter / management) has deployed capital across cycles in the market.

While we do not deny near term headwinds that the space throws up, we continue to believe that our exposures would be governed by the combination of – i) high and growing CASA ii) promoter run iii) process oriented approach towards risk management.

<u>*Financials: Fee based non-lenders*</u>

As India moves towards financialization, there are two broad trends that we see taking shape – many of which are examples of how countries and economies evolve through their wealth creation journey.

i) Evolution of insurance as a core product
ii) Evolution of asset management as a portfolio product

Both Insurance and asset management have a very sticky nature to their business model and more interestingly have operational leverage that has a direct contribution to the bottom-line at scale (It takes roughly 7-9 years for a well run insurer to breakeven on its book, post which the business builds a good operation leverage which has a direct bottom-line impact).

At Itus, we believe well run private players have significant growth tailwinds in this space and we would continue to have exposure here.

<u>*Niche Pharma and APIs – Health Care*</u>

At Itus, we have had an exposure (over 10%) in Pharma for well over a year now. Our affinity for pharma came from the fact that Indian pharma was evolving from its pre 2010 era of being a generics outsourced player, to a core competency market where significant R&D towards manufacturing and discovery was evolving. While this happened, the market continued to discount niche players with the same light of a generics and this provided a good dislocation to buy good growth companies in this space.

Covid did not change anything as far as our sector view is concerned apart from the prices that we see today. We continue to see niche pharma players in India, continuing their growth at upwards of 20%. While the rally in Indian pharma companies has been across the board, we believe that there is merit in sticking to pockets of spaces where companies have built niche capabilities and expertise. Moreover, the tailwinds from supply shifts from China will drive the short-term growth that many of the companies see, however – we believe that this will only set the base for the long term growth in this space.

<u>*Technology and Platforms*</u>

At Itus, we have liked businesses which have had the ability to leverage technology to transform it into a network effect through building a platform. At its very core, a financial exchange would also fall into the same category.

The nature of such businesses has an inherent model to build a winner take all market which fits in well with positioning the portfolio towards growth-oriented companies. The relevance of many such platforms becomes more important in a post- Covid world. Our exposure in this sector comes from core tech, platform driven financial exchanges and B2B platforms that have built the first level of network which gives it an open-ended nature to monetise the network better. The companies that we own in this bucket continue to grow their cash flows at ~22% growth rate and have a Return of Capital on an average of north of 34%

Consumer Businesses

The last bucket we own at Itus are in the consumer facing businesses – both across B2B and B2C. Our exposure in the consumer facing businesses has dropped to ~14% exposure due to the valuations at which many of the businesses are available at.

We believe that the growth in India will be driven by consumer spending across cycles and the pattern of spending post the opening of the markets will continue to drive growth. Its important to realise that consumption accounts for more than 60% of the economy's growth. While there could be delays in payments which would affect the working capital cycle of many companies, low debt companies which have a strong balance sheet, have significant tailwinds behind them to drive growth and increase market share across segments.

Sectors where we do not have exposure in today

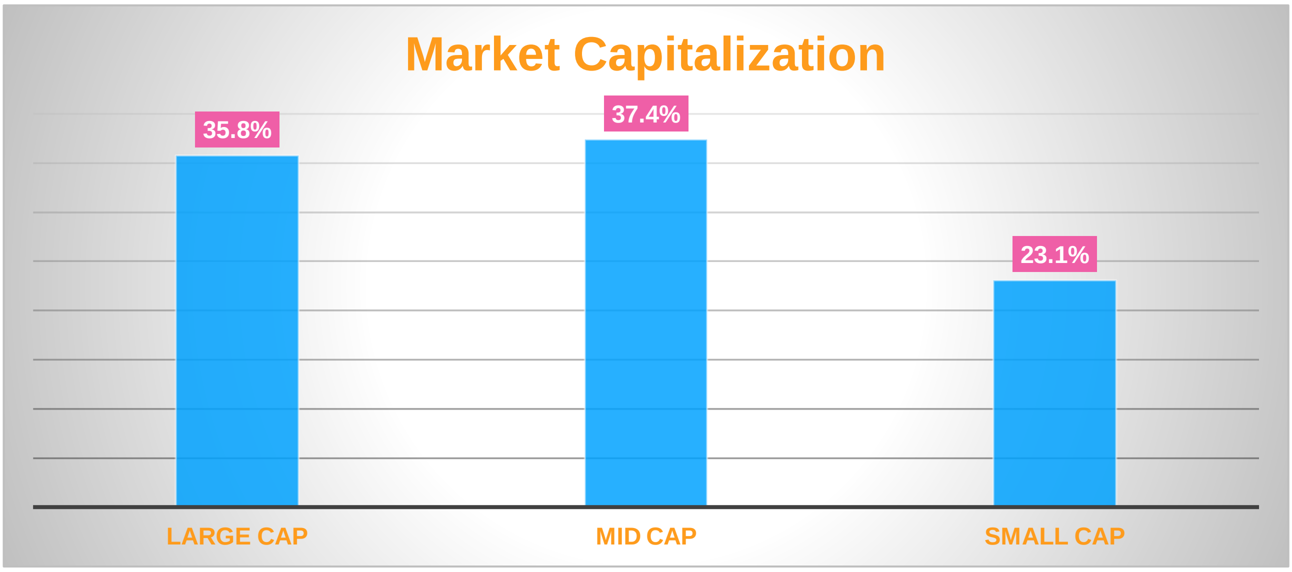
While its important to breakdown our exposures and run through an overview of why we own certain pockets and specific companies within them (we will discuss details of this in our quarterly call scheduled for the 9th of October), its equally important to discuss sectors which are doing well currently where we do not have exposure to and explain the rationale for the same.

Speciality Chemicals and Manufacturing

India certainly has the blocks in place to emerge as the next manufacturing hub across a range of industries, especially where China has held a significant share of the market in, during recent times. While we have held specific companies in the past like PI Industries or fluourine businesses, we believe that the valuations at which many of these companies are available at are more like consumer like businesses. Having seen cycles in the past, we do not consider it prudent to be owning businesses at these valuations (albeit the growth and tailwinds some specific companies are continuing to see pre and post Covid).

Our Portfolio

The portfolio has a large and mid-cap bias to it with a smaller % of the allocation to small cap companies (market cap < 10,000 Cr)



We have had a strong portfolio performance over the track record of the fund, and we continue to have a significant outperformance against the index. Since inception, we have compounded wealth at an IRR of 20.6% vs 8.8% on the index over the same period.

(All yearly performances below are calculated from Jan – Dec)

PORTFOLIO PERFORMANCE

	Fund (%)	Benchmark - Nifty 50 (%)	Excess Return (%)
Jan-Sep 2020 (YTD)	19.7%	-7.6%	27.2%
2019	18.8%	12.0%	6.8%
2018	-8.4%	3.2%	-11.6%
2017	55.1%	28.7%	26.4%
Since Inception (Cumulative)	102.0%	37.4%	64.6%

GRANULAR DATA

	Fund (%)	Benchmark - Nifty 50 (%)	Excess Return (%)
1M	1.5%	-1.2%	2.7%
3M	15.9%	9.2%	6.7%
6M	47.8%	30.8%	17.0%
1Y	29.1%	-2.0%	31.1%

I thank you for your trust placed in the firm and look forward to a long and successful journey together.

Naveen Chandramohan