Dear Shareholders and Investors,

The financial year ended on an extremely strong note in the markets with a broad-based move up in equities.

Itus Capital had a good quarter and is up 3.72% between Jan-March 2021. Our performance since inception is broken down below:

	Fund (%)	Benchmark - Nifty 50 (%)	Excess Return (%)
2021	3.7%	5.1%	-1.4%
2020	40.3%	14.9%	25.4%
2019	17.3%	12.0%	5.3%
2018	-7.3%	3.2%	-10.5%
2017	54.7%	28.7%	26.0%
Since Inception (Cumulative)	144.7%	79.5%	65.2%

The economy and the markets are in a healthy place today. While there is a risk of a second wave causing temporary disruptions, I believe we are better prepared in India and globally to handle this. Moreover, with the rate of vaccinations increasing, I believe the risk of a full-lockdown gets minimized and the negative impact it has on the real economy (if any) is manageable.

During the quarter, we made a few changes in the portfolio. We reduced our banking exposure by completely exiting our position in Axis Bank (Today, our financial exposure in lenders comes only through HDFC Bank and ICICI Bank).

As a fund, we took a new position in CAMS (a financial markets intermediary) and added exposure in Galaxy Surfactants (a B2B manufacturing company, whose earnings is tied closely to the FMCG Sector).

Our exit of Axis Bank

Banks are leveraged entities whose growth can come from two sides – on the liability side, having access to low-cost capital through a robust retail operation (in the form of CASA) and on the asset side, showing credit growth through its lending business (retail and corporate included). The reason banking as an industry will remain cyclical is because of the cycles of credit growth and how the same translates into NPAs.

For the sake of simplicity, if investors were to simplify banking and look to analyse banks, a good starting point is to look at PPOP (Pre-provisioning Operating Profit). The below table breaks down the PPOP growth of the three largest private sector lenders in India.

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Table 1 : PPOP Growth of the three largest private sector banks in India

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
HDFC BANK LIMITED	19.80%	21.6%	21.7%	25.7%	21.2%	22.7%	20.4%	26.8%	21.8%	22.6%	16.5%
ICICI BANK LTD	6.20%	12.1%	30.6%	26.8%	16.9%	2.4%	33.8%	-16.5%	-5.0%	11.0%	58.2%
AXIS BANK LTD	5.10%	16.6%	-10.2%	19.0%	20.9%	31.5%	22.3%	10.2%	-6.2%	28.4%	26.8%

If one looks over the last decade, its important to appreciate the consistency of HDFC Bank's growth in the country. HDFC Bank continues to be the only bank which has not shown any cyclicality in growth, something no bank has been able to achieve globally (it's one of the reasons, at Itus, we do not like to storify ideas of looking for the next HDFC Bank).

Table 2 : Shareholder returns of the three largest private sector banks in India by year

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
HDFC BANK LIMITED		11.8%	22.1%	20.7%	42.7%	5.6%	36.5%	32.4%	29.0%	-25.2%	74.2%
ICICI BANK LTD		-20.4%	17.9%	19.3%	27.2%	-24.8%	17.2%	11.0%	44.3%	-18.8%	92.1%
AXIS BANK LTD		-17.8%	28.5%	12.7%	93.6%	-20.3%	11.1%	11.5%	52.6%	-46.5%	99.8%

While the yearly returns would not align with the PPOP growth, over a 10-year period, the shareholder returns for banks would match the PPOP growth (after accounting for NPA cycles). The above table would explain why we added to the financial exposure in April 2020, and why we felt it was prudent to remove cyclicality in our portfolio (in banking). The concept of buy and hold in banking belies fundamental logic because of the NPA Cycles the economy goes through, and it is prudent risk management to manage portfolios accordingly (all things being equal).

Our new addition of CAMS in the portfolio

CAMS (Computer Age Management Services) acts as a B2B Financial intermediary which is a technology driven service provider to the Indian mutual fund industry. Its market share continues to grow and it now captures ~70% of the market. This apart, CAMS also services the Insurance companies as a one-stop shop for policy servicing, with ~40% market share. The business is operationally intensive, but provides tremendous operating leverage at scale, as it's a an extremely sticky business (The operating margin of the business is ~40% today, one can think of the business like an IT Services firm - Staff costs is about 40% of sales,Other opex is 20% of sales leaving CAMS with ~40% EBITDA margin).

The revenue model of the company is driven around a fee on the AUM it charges its B2B partners (roughly around 3.5 bps that it charges today).

There are other business lines of CAMS that contribute ~20% of its revenues today – servicing alternate funds, KYC processes, processing of online payments etc.

CAMS has a few growth levers, which should potentially see it generating non-linear growth in the next few years, which include a) Alternate industry growth b) Acting as a B2B platform aggregator (currently RBI has given 7 licenses, one of which is CAMS) c) acting as a KYC Aggregator d) Servicing distributors through its platform.

CAMS taking over the RTA business of Franklin recently, should add operational efficiencies into the business as it continues to expand its market share.

The business continues to grow at 22% on an annualized business and is trading at a multiple of 38x FCF. We believe that while the valuations are not cheap, the tailwinds for the business and the proxy monopolistic nature of the business, makes it an interesting theme to own in our portfolios.

Like with any business, there are a few threats/risks that are important to understand as investors for CAMS:

a) Growth of the MF industry has a direct impact on the topline of CAMS. As index ETFs grow, and if this comes at the cost of the equity fund MF AUM, this would affect the revenues and margins of CAMS
b) Client concentration will always remain a risk for CAMS

Finally, our thesis on CAMS revolves around its ability to expand its sticky revenue model, alongside leveraging the growth of the Indian MF and Alternate Industry. Moreover, the expansion of its ancillary revenues and its potential to act as an integrated aggregator can provide it with longer term sticky moats and act as a true platform (as a B2C player later down the line).

Portfolio Discussion

Currently we own 21 investments in our portfolio with 6 broad themes into which our investments fit into:

a) Private sector Lenders
b) Non Lending Financials
c) Exchanges / Platforms
d) IT / Tech
e) Pharma
f) Consumer Businesses (B2b and B2c)

Our portfolio continues to grow at an annualized growth of 22% on the bottomline, and the FCF growth in the portfolio is at 14.5%

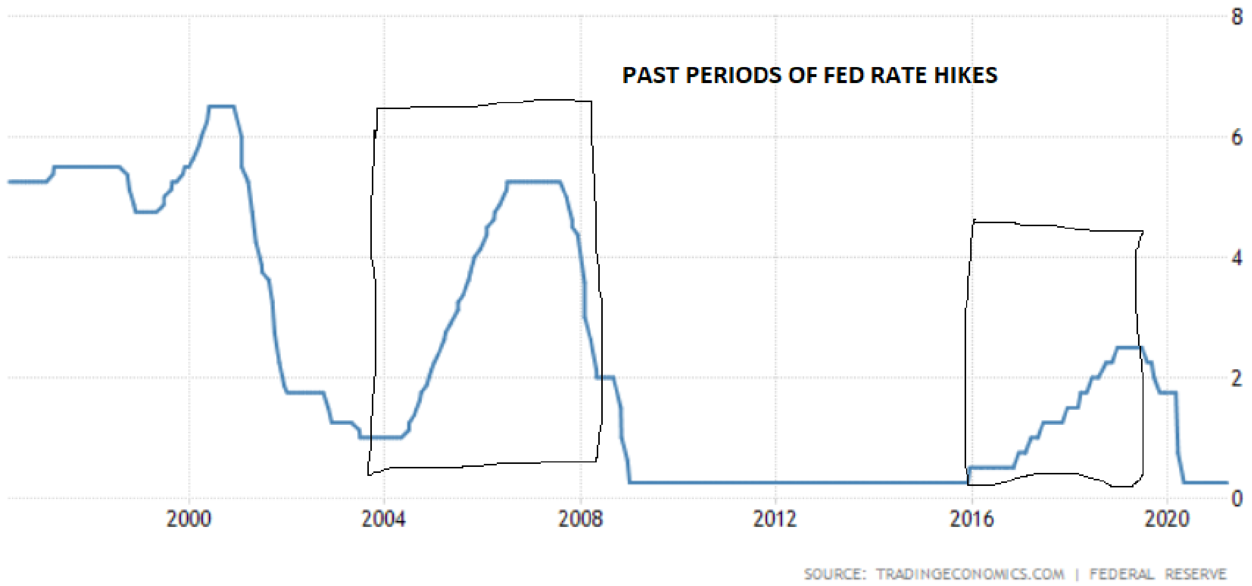
The exposure weighted RoCE of our portfolio stands at 28% (For Financials we use RoE instead of RoCE). We believe our portfolio continues to grow at a healthy double-digit growth and is primed to generate healthy shareholder returns over the next 3 years.

Over the last 3 months, our investors and partners have been asking us questions on our views on 2 broad risks that have been in the news and our views on what we believe will pan out due to this specifically with regard to the Indian markets. The next part of the letter will be spent to briefly address the risks:

i) *The 10Y yields in the US have gone up by 1% in the last 3 months. Considering the base rate (in 10Y) was at 1.5% a few months back, the sell off in yields (rates going up) is not a trivial move anymore. This has raised multiple questions from investors worried about the policy of Fed, and what will happen to equities if inflation picks up further.*

The narrative above has been doing the rounds a lot in the last 3 months and when growth stocks fall on the back of this, it lends more credibility to this narrative. I have always believed in zooming out and looking at history before one comes to conclusions on the same.

<u>Graph 1 : Chart of US Fed target rate since 1996</u>



The above graph shows the actual Fed rate hikes and cuts over the last 25 years. The periods highlighted (2004-8 and 2016-19) are actual periods of rate hikes in the short-term Fed fund rate. Do note that these were both periods of the best performing equity markets. Interest rate increases happen during expansionary phases in the economy, which are generally good for equity markets (due to economic expansions). While this may not be true in the short term, a zoomed-out perspective validates the same.

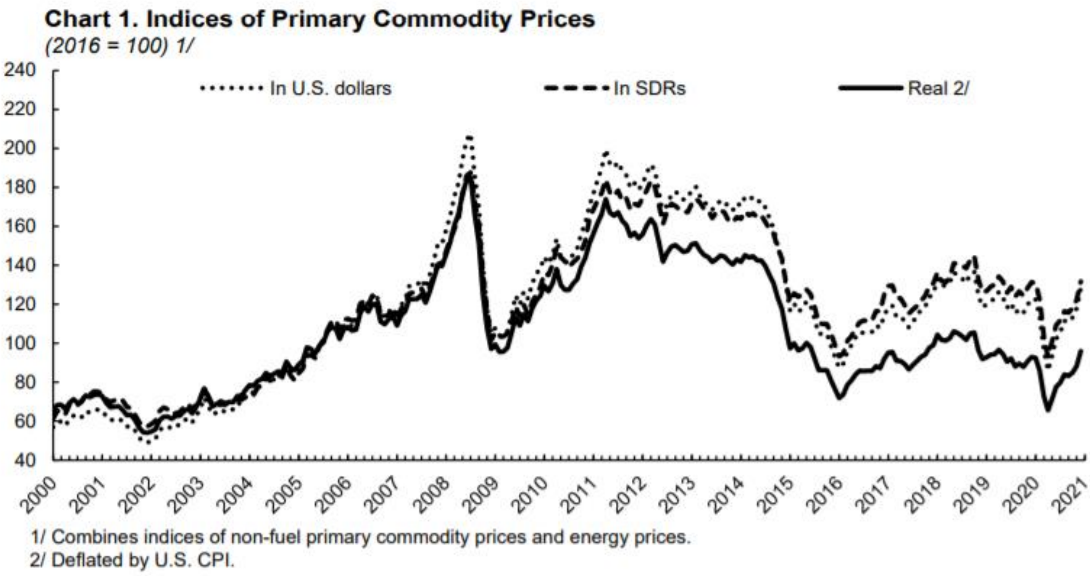
ii) The next few years are going to be the beginning of a commodity super-cycle where all commodities do well (Including steel, copper, metals, grains). Should you not own more cyclicals and commodities in your portfolio to reflect this theme?

Having a view on commodities and expressing the same through equities, requires an ability to have a good estimate of two sides of the coin – supply and demand. While demand on most occasions is linear (globally and in India, demand on an average has gone up 6-7% per year in an industrial metal like steel), it's the supply which is non-linear due to capex expansions and plant shutdowns. It is this non-linearity that gives rise to significant returns and falls in commodity driven equities, something as a fund, we have never been comfortable with (though we may have a view on).

<u>Graph 2 : Business Cycle Indicator vs Return of Copper over the last 10 years</u>

A look at the above graph gives ample evidence to the fact that commodities strengthen when business cycle strengthens and vice versa (The Business cycle indicator is a proprietary estimate combining unemployment, PMI indicators, inflation and capex spending).

Graph 3 : Primary Commodity Index graph in USD and adjusted for SDR (Special Drawing Rights)



The above graph normalized to 100 (as of 2016) has been obtained by the IMF, which gives a perspective of where the commodity pricing basket is today relative to history (over the last 20+ years).

Do note that the move from 2003-08 which led to the previous commodity super boom, was predominantly funded by China on the demand side. I do not see the levers yet to have a strong view to conclude that the demand side boom (if it comes through) will be funded by India.

This cyclicality around prices has and will continue to keep us away from commodities as a sector. However, our portfolio currently has very little impact (on the margins) from a rise in commodities on the input side – this is a risk we continue to monitor on a dynamic basis.

As discussed in previous letters, our portfolio is positioned around growth and in areas where the Cash flow generated by the company continuing to grow. We will continue to be selective in deploying capital in 2021 as we expect the next few years to be a stock picker's market.

From the desk of the CEO

Naveen Chandramohan