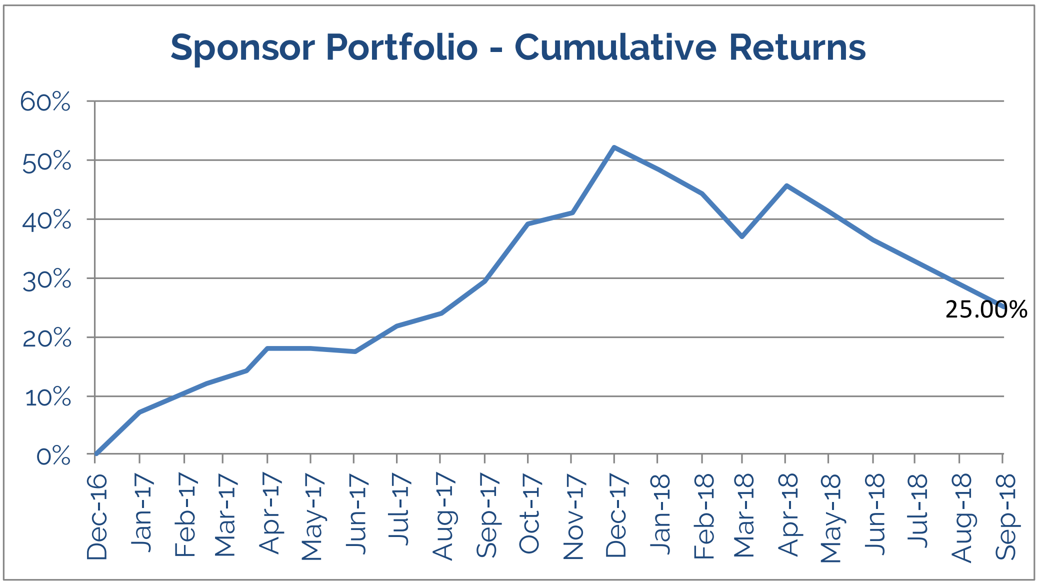
ITUS CAPITAL

Quarterly Letter : 3Q 2018

GROSS PORTFOLIO RETURNS



Fee Structure & Terms

MINIMUM INVESTMENT	: INR 2 cr
MANAGEMENT FEE	: 0%
PERFORMANCE FEE	: 25%, calculated over a hurdle rate of 10%
NUMBER OF SECURITIES HELD	: 16
INVESTMENT STYLE	: Concentrated Long-term value , market cap agnostic

Overall Performance

YEAR	2017	2018 (YTD)
Gross Returns	55.1%	-17.9%

Dear Investors and Shareholders

The third quarter of 2018 saw the fund have a negative return of 8.8% bringing the 2018 YTD return as of September at -17.9%.

2018 has been a tough year for most equity funds, with index returns varying between -3% (on average in the large cap space) to -28% (on average in the small cap index space). The macro conditions in India as a whole have deteriorated with the large focus on the current account deficit, worsened by where oil prices are, alongside the strength in the dollar at large, affecting the Indian Rupee too. However, the micro, which is where most of my focus continues, continues to be bullish with capex coming back to many of the industries.

One of the important measures of the improvement in the capex cycle that I look at is the availability of credit and access to funding for the companies and sectors that continue to drive the Indian economy – be it infrastructure, logistics, real estate and translating into spending in auto and consumer staples. With the temporary stumble in the credit conditions, seen through the IL&FS debt default that affected the liquidity conditions and bringing to question some of the solvency risks that NBFCs run currently, there have been temporary headwinds the market currently faces. I have held the view that NBFCs and Housing finance companies have seen a structural growth over the last 5 years, and many of the NPAs that come through on the balance sheet, can easily go under wraps in such an environment. While there are many who believe that the fall in NBFCs present a buying opportunity again, I prefer to stay in the sidelines in this space where I still do not think valuations as a whole are compelling enough to make a case for a good risk reward investment. The portfolio does not have any exposure in the space and I do not expect that to change near-term.

I continue to hold the view that metals as a sector will continue to perform well in the environment and am bullish particularly on copper. I do not see the supply increasing over the last 4 years, and if we enter into a regime of global growth, this should bode well for copper prices. I have expressed this view on a copper producer, which has been a drag on the portfolio thus far, faced with legacy issues of being a PSU.

From the portfolio's standpoint, the biggest drag has been on the exposure in real estate and infrastructure (specifically focused on EPC in hydro projects and renewable execution), where most of the debt in the investee companies lies in its working capital requirement. This section of the portfolio investments continue to generate a return on capital employed of >22% on average, with an EBITDA to interest service component of > 8.

I added two new investments this quarter – one in a oil marketing global conglomerate, which has a niche portfolio in India and has been growing its business at a growth rate of 12% over the last 4 years with a pan India distribution network. The second is a multi-system cable operator and a broadband service provider. I would describe this investment as a special situation wherein the industry has been beaten down with the fear of market share being completely taken over by Jio and the threat it brings with regard to its pricing power.

While we are faced with a fair degree of uncertainty in the near term with liquidity challenges that have surfaced, the increased volatility has meant that there are interesting investment opportunities that present itself at valuations that are at a significant discount to its intrinsic value, from where I see it. While the main portfolio is fully invested at this stage, we have been fortunate to see both new investors and existing investors add to their investments in the fund. I do believe that the next few months offer a good opportunity to construct a great risk-reward portfolio for investors with a slightly longer-term horizon in mind, who can digest the volatility near term.

Naveen Chandramohan