Dear Shareholders and Investors,

As I write the annual letter of Itus, it is with great pride that I look back on completing 5 years as a fund. When I set up Itus, back in 2017, I saw a large opportunity and a whitespace around the way public markets fund were run, in India

a) A culture driven firm, with complete ownership and skin in the game thus aligning the fee structure to a client centric framework. We built ourselves on running a single strategy fund, where the owner and the fund manager were always the same – we believe this is the true way to bring stability to a fund and its process.
b) Running a growth oriented public markets fund where the norm was to invest around valuations and buying cheap.

It is imperative to look at equity market returns in 5Y buckets (typically, an investor goes through at least one cycle in this period). It is a testament to a manager's portfolio construction, risk framework and process to manage money across multiple such 5Y buckets.

At Itus, our fund has delivered an IRR (Annualized) of 25% (net of fees) over this period, as against Nifty which has delivered an IRR (Annualized) of 16.2% over the same period.

Table 1 below breaks down the returns on a Calendar year basis since inception

Table 1 : Breakdown of CY returns of the fund vs Nifty 50 on a yearly basis

	Itus Fund (%)	**Benchmark - Nifty 50 (%)**	**Excess Return (%)**
2021	29.3%	24.1%	5.2%
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)	205.0%	111.9%	93.1%

Over this period, we have scaled from a single office to 3 locations across India and US. We have set up our fund in INR and USD (the USD vehicle is domiciled in Mauritius) managing money across 245 families and the AUM crossing INR 700 Cr. We have continued to scale our investments in technology, whereby today, our tech product facilitates and eases the work on our research team and process (we are able to look at inventory growth of 2W across dealers in the country, market share change of AUM across MFs, volume growth across exchanges on a weekly basis at the click of a button).

We will continue to scale our fund by investing in a multi-cap strategy with a bias towards growth. There are 3 salient features of each of our investments we make in our portfolio:

a) A bias towards growth with the business having unit economics which makes it cash flow positive
b) Operating in an industry where the business continues to grow market share (if we have monopolistic / duopolistic nature of industries, we would be attracted towards them).
c) Ability to grow their return on capital with a consistent RoCE (Return on Capital generated by the business) greater than 1.5x cost of capital (cost required to attain capital – if this is through internal accruals, we gravitate towards such businesses).

We want to be owning these businesses when the above 3 features / trends hold true.

2021 was an interesting year for us as a fund:

Portfolio Trends:

- We exited 5 businesses during the year
- We entered 4 new businesses during the year (most of which operate in a platform business with significant gross margins)
- All our businesses have gained market share and have expanded gross margin over the course of the year (despite inflationary trends and raw material pressure)
- Our investments are across pharma, tech, platforms, AMC (Asset Management Company), manufacturing, consumer discretionary and chemicals. We continue to be sector agnostic as before.
- We increased our exposure in 2 companies as the business continued to perform

Business Trends:

- 25% of our growth in AUM in the year came from top-ups from existing clients
- Our channel checks continued to cover the plants in Erode to the kiranawala in Calcutta. We continue to believe that travelling for primary research gives us some of the most interesting insights into our portfolio companies.

Portfolio and Risk: The year that was – 2021

At Itus Capital, we had another strong year of performance with the fund being up 29.3% in 2021 (Jan – Dec) with the Nifty up 24.1% over the same period.

Our portfolio companies continue to show a very strong track record to grow their cash flows. Over the last 2Y, while the revenue growth of our portfolio has compounded at 10% IRR, the Cash Flow growth over the same period for our portfolio companies has been at 42% IRR (We deliberately use a 2Y measure to measure our growth: Sep 19- Sep 21 earnings as against using a lower base for last year, which will show distortions in the growth numbers). Covid and lockdown has been a big beneficiary for our portfolio companies because of the clean balance sheet, high return on capital and the industry dynamics around which they operate.

I cover the broad themes we have exposures to and the portfolio companies within the theme we own below:

A) Private sector Banks: The last year has seen a significant improvement in the loan book of most banks (PSUs being the big beneficiary). In my view, playing a recovery in loan book assets are good for trading gains, which we do not have an edge in. I continue to believe that the growth in the liability side of the business will remain concentrated with a few banks, and our portfolio construct will focus on them. While we have set the stage for credit growth in the country, compounding in banks will come from franchises who can manage the asset side quality alongside maintaining lending growth. Our portfolio in this bucket has seen a PPOP grow by 25% IRR over the last 2 years.

   Over the year, I have had a lot of questions around why our portfolio does not have any exposure to NBFCs. This has been a conscious choice where I believe the growth of fintechs and their increased penetration over the next 5 years will see NBFCs as the biggest loser in terms of growth. Owning a business in a highly competitive industry where your reliance on banks for access to funds, means your balance sheet is never fully under your control is not the kind of risk we want to take in our portfolio.

B) AMCs: I believe the environment around Covid has provided tailwinds to well-run companies in this space (Asset Management Companies) which continue to see tailwinds from an AUM perspective and the RoCE they continue to generate for shareholders. While the industry is extremely competitive, it's important that we choose businesses which have the ability to grow their AUM (in turn their revenues) with a consistent approach towards distribution alongside keeping costs in check. The last 2 years have seen the highest growth for the business we own in the space and this space is growing at an IRR of 38% from a cash flow perspective (over a 2Y period) in our portfolio companies.

C) Financial Intermediaries and Exchanges: It is important to realize the tailwinds that we as a country are going through in the form of financialization. While the rate of growth will normalize over the next few years, I believe this will continue to be a multi-year theme. This will benefit many pockets, especially around B2B services for the mutual fund industry which is currently a duopoly or a separately new trend around the short-term power contracts on the exchange. Both the businesses we own, continue to invest heavily in technology which makes their platform stronger though there could be more competition down the line. The risk in these businesses is the pricing power of the platforms at scale as they tend to drop over time. This is a risk we are cognizant of and we will ensure that we position size our investments appropriately.

D) IT/ Tech: We continue to believe that the lockdown was the inflection point for digital businesses globally. While the validity of digitizing businesses and running platforms were never under question, in the new world, this has become a way of running business. This has implications for product companies which have services inbuilt within them in their business model and we own the market leaders in this space as they continue to show growth in cash flows. The interesting thing about India is there are business models operating in the space of a winner take all market over time, be it in gaming, BPC as specific categories. Our portfolios have exposure in companies in this space, where the growth is expected to be ~30%+ over the next few years. When the growth in this category is combined with unit-economics which is cash flow positive, this can create significant compounding if the execution works well.

E) Pharma: We have owned interesting market leaders within Pharma for a little over 1.5 years and our exposures span across CDMO / CRMO, Niche API manufacturing alongside integrated pharma companies with a concentrated focus on R&D and drug discovery.

F) Manufacturing: We like to own themes where manufacturing locally from a global supply chain point of view, has tailwinds for our portfolio companies. Our fund owns exposure across businesses, both in the form of B2B and B2C businesses where the focus has been to scale distribution alongside.

In the next section, I will briefly go over the thesis and our expectations around one of our most recent investments – Nykaa.

Nykaa is an Indian e-commerce company, founded by Falguni Nayar in 2012 and headquartered in Mumbai. It retails and distributes beauty, wellness and fashion products across its e-commerce platform and 76 offline stores

The key crux and pain-point Nykaa is attempting to solve is twofold.

a. Counterfeit products in e-commerce platforms, which led to distrust among consumers.

b. Accessibility to brands that consumers wanted and were inherently limited in metro cities as well as tier 2+ towns.

- There was a need for a platform that built itself on content and trust as a result in the early stages of the website, it was a prominent part of it and still continues to be to an extent. Nykaa's exposure through this segment carved a larger market for itself.

- Falguni Nayar + family continue to hold a controlling stake and are active in running the business alongside hiring the individual teams.

- Fashion segment works on a take rate model while the BPC (omnichannel) work on an inventory model. Nykaa operates 76 offline stores (BPC only), which focus on fast churns and brands that typically tend to sell in bulk. Our belief is that since fashion is already a competitive space with heavy discounting (that Nykaa doesn't do), it will be difficult for multiple players to scale with a positive unit economics model.

- The online market for BPC is growing at a ~40% CAGR, of which Nykaa is a market leader with roughly 30% share. Considering brand positioning of Nykaa is better than competition, we expect a scale of at least 25% yearly in total orders. Currently, this segment dominates overall revenue (90%) but we expect it to contribute closer to 75% by FY26.

- In Q2FY22, Nykaa launched it's B2B segment Superstore.in which focuses on distribution to standalone beauty stores and salons. An estimation of potential scale (in comparison to Udaan's past growth, except in the BPC space) gives the business ~USD 400mm of revenues over the next 5 years.

- Focus on premiumization : Nykaa has a separate luxury section on its online store, with additional premium packaging to go with deliveries. Partnering and bringing to market certain global brand with limited exclusivity has also helped with their positioning.

- Though the business is not cheap, the category, scale and the focus on the consumer around which the brand has been built and cash-flows reinvested makes me believe that the business has a potential to compound at a 20% CAGR over the next 5-7 years.

Our Biggest Learning in 2021 – What we did well and where could we have improved

Looking back, our continuous alignment of risk towards growth in 2021 ensured that our portfolio positioning was readjusted towards pockets where there was growth. Our exits in 2021, were done in businesses where there were headwinds in the competitive landscape which started to stall growth. This ensured that our portfolio continues to see its best cash flow growth compounding to date (since inception of the fund) – at a 2Y CAGR of 42%, we believe that the portfolio is well positioned towards future growth.

I continue to maintain that the biggest places where we can improve are in the pockets of opportunity cost that the fund incurs in not making some of the investments it should have vs any losses the fund incurs which turns out to be mistakes (with the benefit of hindsight).

In this light, not investing in CDSL at a time when the number of retail demat accounts was growing at its highest will continue to be the biggest miss the fund has seen from an opportunity cost perspective. Having done the work, and realizing the theme from an internal perspective, this is a pocket where we could have surely done better. I aspire to carry forward this learning as we move to the next 5Y cycle of the fund.

Going into 2022

I continue to maintain that the next decade will belong to India from a risk-reward perspective, and Indian equities will continue to be the best performing asset class. This does not mean that the path to realizing the returns will be a smooth one.

There are 5 factors that are coming together in India for the first time that makes well-constructed growth portfolios to take advantage of this:

i) If the previous decade in US (which saw the biggest and one of the longest bull markets) taught us one thing, it is to not fight liquidity. We are in a regime of a generational low interest rate environment, and this has ramifications on the cost of capital for companies and deployment of risk. While we would see rate hikes over time, the opportunity cost of capital for investors and the low cost of borrowing will benefit equities over the long term,

ii) Corporate India has its balance sheet de-levered to the lowest I have seen in the last 20 years. The clean out of leverage across sectors and companies has put the supply side of the risk at a low level.

iii) Private capex in the country has grown at a CAGR of 12% over the last 2 years (this implies that the capex being set up in the country has compounded well vs the pre-covid environment).

The 3 factors above have created an extremely conducive supply side environment for India.

There are two aspects which creates the ingredients for a robust demand side environment

iv) The role of the government is to create a conducive environment for business and to do that by investing in infrastructure. For the first time, we are seeing significant capex being spent on this front – be it in the form of roads, improved logistics alongside GST taking shape and formalizing the economy.

v) The startup eco-system has come of age and this is not paper money anymore. 2021 has seen 33 unicorns created in India and this has set the stage for more to come. USD 450mm of ESOPs was monetized last year vs USD 38 mm in 2020, which has increased the spending power of the country – this wealth is being created by people between 25-40 who are bringing the money back through consumption and equities.

The demand side of the country is now seeing growth through the above.

The above makes me optimistic going into 2022, however I do hold the view that volatility in the markets is going to be par for the course. There are several risks that can manifest itself, however, like in life, it's the unknown risks that we do not speak of, that will pose the bigger drawdowns in the market – things like Fed raising rates, spread of the new strains of a virus, narrow speculative mania in some of the markets are all the known risks.

Focusing on our process and our discipline around investing is what we aim to continue as a fund. I would like to thank our investors and partners for placing their trust in us, and we sincerely value this and will aim to continue our path of building a lasting asset management practice focused on compounding wealth consistently over the long term.

From the desk of the CEO

Naveen Chandramohan