Dear Shareholders and Investors,

The first quarter of 2022 was an extremely interesting one with multiple events to speak about. As we potentially come out of a period of easy liquidity globally, alongside a period of below normal rates, the events around supply chain disruptions, Agri supply getting hit, commodity supply getting affected, had risk distortions through the course of the uncertainty of the Russia-Ukraine war. It is during these periods of uncertainty that your process of investing brings a factor of certainty to the decision-making process we go through as investors. At Itus, we have always emphasized this process of ours through a 3-step framework which we translate into every investment decision of ours:

a) Invest in businesses which show cash flow growth
b) Evaluate and study the reinvestment decisions of the potential investment opportunity
c) Do not overpay

Why Cash-flow growth?

Businesses which generate consistent cash flows have three innate characteristics which we care about:

i) Their gross margins and pricing power tend to be higher across cycles
ii) They have a greater control in managing their Working capital and inventory cycles, which ensures that their balance sheet is not inflated with debt (to fund the same)
iii) They have the best-in-class cash conversion cycles (the time it takes to generate cash from the time they manufacture their products).

So why should you as an investor care about the above?

Businesses which show the above dynamic tend to gain market share, especially during difficult times and manage to move away from competition during these periods. This is a key driver of our decision-making process at Itus.

Evaluating reinvestment decisions of our portfolio companies

Once we identify businesses with consistent cash flow growth, it is important to focus on the next piece of the puzzle – what does a management do with the cash flows?

Every management has 3 decisions they are faced with

a) Use cash flows to increase capacity – this is where fixed asset expansion takes place and we as investors need to focus on the demand cycle.
b) Reinvest into the core business in the form of people, technology, R&D, franchising – this creates a stronger edge for the business and unlocks additional value through operational leverage. While this is a form of capex, this comes through in the P&L statement. Many

times, analysts do not like this as it depresses earnings, but we as long-term investors ideally look for such opportunities

c) Payout in the form of dividends – this is our least preferred option as capital allocators (we do not invest in businesses for dividends but growth).
(While some businesses use cash to buy-back stock, we do not find this being done too often unlike in the US. We would love for management and promoters to resort to this rather than payout dividends).

As investors, we monitor the reinvestment track record of the management by measuring their RoIC (Return on Incremental Capital) and we want this to be north of 20% in our portfolio companies.

Do not overpay

As investors, it is important to understand that valuations do matter. Having run Itus across 5+ years and managed money across 15 years, I can safely tell you that paying any price to own a good business does not create shareholder returns for investors. Some of the best businesses have generated 0 returns across 10-year cycles if valuations have been discarded and we are certainly cognizant of this. For us, valuation revolves around modelling the cash flows of our company in bear market growth rates and understanding the downside if we get it wrong – As a portfolio manager, our endeavour, is to continue to minimize the downside at every stage, and this is where focusing on valuation matters. This naturally lends itself to the fact as to why we do not believe in a buy-hold-and-forget strategy. Our churn across the 5+ years of running the fund has been at 20% and we expect a similar number in the next 5-year cycle too.

Now why does this framework matter?

To us, when we as a manager, look at outperforming the Nifty (our benchmark Index) by 5-6%, this is not a randomly defined number we came up with but a process-defined approach that is a consequence of the framework we run. To represent the same through numbers, the below table breaks down our portfolio metrics vs Nifty since the inception of the fund:

Table 1: Comparison of Itus Portfolio Look Through Metrics vs Index

ITUS							NIFTY	
	FY17	FY18	FY19	FY20	FY21	FY22	FY21	FY22
ROCE	22.10%	21.85%	21.90%	21.50%	22.62%	23.58%	10.1%	14.7%
Operating Margins	26.90%	26.80%	26.90%	27.10%	32.1%	29.0%	14.0%	16.5%

Table 1 breaks down the Return on Capital of Itus Portfolio since inception vs that of Nifty. There are two significant takeaways from the table

a) Macro headwinds (like Covid, War, Supply chain disruptions) have strengthened the Return on Capital of Itus Portfolio over time (Our portfolio companies continue to show significant pricing power, balance sheet efficiency and market share growth through headwinds the economy goes through)

b) Itus return profiles have consistently been higher than the index between 8-10% over time

The combination of margin profile and a strong Return on Capital Employed ensures that the outperformance generated by the portfolio at our fund is 9% higher than that of the index (Nifty 50) over the last 5 years.

Our Return Profile

At Itus, our fund has delivered an IRR (Annualized) of 23.1% (net of fees) over this period, as against Nifty which has delivered an IRR (Annualized) of 15.5% over the same period.

Table 2 : Breakdown of CY returns of the fund vs Nifty 50 on a yearly basis

	Itus Fund (%)	**Benchmark - Nifty 50 (%)**	**Excess Return (%)**
2022	-2.7%	0.5%	-3.3%
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)	196.7%	113.1	83.6%

I would be the first person you would hear from anytime we underperform as a fund. Over the last 6 months, the fund has generated a return of -2.88% and I wanted to cover this aspect too as a part of this letter.

It is important to realize that, as a manager, our endeavor is to continue to outperform across cycles. However, there would be shorter periods within this cycle where growth as a strategy may underperform and the last 6-month period did see growth getting punished across the board. The last 6 months has seen consistent outperformance from Commodities, Metals, Energy, Infrastructure – these are sectors and spaces we would not invest as the characteristics of the businesses does not lend itself into the qualities we look for in businesses.

Table 3: Rolling 3Y returns across the 4 sectors that have outperformed in the last 6 months

	Nifty Commodities	Nifty Metal	Nifty PSU Bank	Nifty Infrastructure
2017 Rolling Returns 3Y	10.2%	8.6%	-2.4%	21.0%
2018 Rolling Returns 3Y	0.7%	-14.2%	-54.2%	5.5%
2019 Rolling Returns 3Y	68.9%	77.7%	-10.8%	54.7%
Average 3Y rolling Returns Cumulative	26.6%	24.0%	-22.5%	27.1%

The above table gives the cumulative 3Y returns across various time periods (averaged out for the starting point to remove the selection bias). The 3Y returns across time of companies in these sectors normalize into an IRR of sub 8% across sectors. More importantly, they do not have characteristics of cash flow generation and their reinvestment opportunities continue to remain sub-optimal.

Portfolio and Risk

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 44.5% IRR (We deliberately use a 2Y measure to measure our growth: 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.

Over the last 3 months, we continued to deploy capital into platform and tech companies that had fallen 30% in the recent volatility where their earnings and cash flow growth was at 42% annualized.

We continue to be prudent around deploying capital for new accounts and maintain a high portion of cash (undeployed capital for new portfolios is between 25-30%). The undeployed capital is a function of individual opportunities we find in the market and the margin of safety we expect from our portfolio companies from a valuation perspective. We do not believe that investors give us money to deploy capital the next day (that's the role of a Mutual Fund Manager or an ETF).

We continue to focus on bottom-up stock picking opportunities, and I believe 2022 will provide us with interesting ones through the course of the year. I look forward to interacting with you in our call on 9th April at 10 am

From the desk of the CEO

Naveen Chandramohan