Dear Shareholders and Investors,

THE World of Normalization

As we finish the first 6 months of 2022, it has become increasingly clear that the inflation on the ground globally is a risk that the market is in the middle stages of pricing in. If we rewind 6 months back, the market at large was pricing in input cost inflation as transitory in nature – so what changed?

The world is never linear where there is a single cause and effect relationship – if there was, the markets would be an easier conundrum to understand. To set the background to what got us here, I believe, every individual and institution knew that the Fed had gone too far down the line in terms of money printing (Fed had inflated its balance sheet of its last 60 years by doubling its balance sheet just in the last 1.5 years – if the Fed's balance sheet was a bank, the market would have punished this asset by taking the price down 50%, luckily the Fed does not need to worry about MTM).

While the covid response in March 2020, was the right one from global central banks in 2020, it was increasingly clear that the economy was back to a strong footing in mid-2021. However, the Fed deemed it appropriate to continue to buy USD 40bn of securities per month and this was supported by the politicians at large. The ramification of this policy led to significant asset price inflation (think financial assets – equities, private equity, venture and crypto).

While the political landscape had its rough edges going into Dec 2021, Russia had made its stance clear that they would not sit quiet if the West continued to support Ukraine's entry into Nato – this has always been a no go for Russia, and they have made their stance clear and consistent since 2008. While Putin acted earlier in the year, by going into war, the West launched an economic embargo on Russia which they believed would cripple the economy. Instead, with Europe and US not being self-sustaining with regards to their energy needs, this policy response has come back to hurt them (Russia has a forex surplus of USD 95bn today and Ruble has appreciated ~3x against the US Dollar).

With this as the landscape, it does look like inflation is a risk which will continue to stay higher than mean over the next 2quarters (the policy response and the stance of West makes it more difficult to control the supply side inflation).

The sequence of events leading to today, makes me believe that the Fed will err on the side of caution on the supply side. While they can continue to throw the can down the road, probabilistically speaking, I believe their response would be to raise rates going into first quarter of 2023 (Having already guided for a 3% benchmark).

At a time, where we are entering normalization, it is important to understand that the mandate of Fed is to unwind and de-lever its balance sheet. While the course to this will take years, to unwind 20% of its balance sheet here would roughly mean the GDP of US will take a hit by ~18% (while the relationship is not entirely linear, it gives a sense of the pain on the ground that financial assets will need to normalize in the US through this policy response).

With this as the context, it is important to look at India, both from a macro and micro perspective.

In India, its important to appreciate two aspects of the word 'inflation' that we are so frequently used to hear in the media and strategy reports.

While we are going through a period of normalization too, at home, the mismatch in terms of the supply demand dynamics has always been under control. The RBI has already been pro-active in raising rates twice in anticipation of the inflationary CPI Print we saw in May (It is important to realize that 28% of the CPI Inflation is sticky and this will be relatively high as rural wage growth is high).

India, however being an emerging market is a country where investors come to for growth. And over the last 30 years of cycles in the markets, companies do well in higher inflationary markets rather than low inflation markets: Why? During periods of higher inflation, is when capex on the ground gets deployed and gives pricing power to the companies to charge for their goods and services. While this will take time to see on the ground, from a macro perspective, we should be happy to see higher inflation at home, as long as this is accompanied by real growth which happens when policy rates adjust to the demand side. This is the current process we are going through.

Separately, on the macro, we are faced with 3 shock absorbers today which the participants continue to underappreciate

a) The remittances in the country continue to grow up as $ has appreciated in the last few months
b) While we have had a negative CAD due to higher oil, there has been a cushion of ~$70bn that has come from non-oil exports (think manufacturing) being better than expected
c) IT Services has seen a 38% increase which has provided a cushion to our reserves and deficit

This continues to show in the valuations of India (within the broader EM market) where, over the last 12 months, MSCI India (flat) has outperformed MSCI EM (-27%). Over the last 10 years, it has outperformed MSCI EM by 163%. In P/E terms, MSCI India is trading at an 104% premium to MSCI EM, above its historical average of 61%.

While macro and global policy risk has and will continue to be hard to predict (this is a space, we spend less time on apart from thinking about the range of possibilities that could come true), it gives us the context to move to the micro and company fundamentals which is where having a better handle becomes a lot more probable.

Our Return & Portfolio Profile

At Itus, our fund has delivered an IRR (Annualized) of 19.2% (net of fees) over this period since inception (Jan 17 – June 2022), as against Nifty which has delivered an IRR (Annualized) of 12.68% over the same period. This outperformance of 6.8% has come through despite our underperformance in 2022 where we have seen a drag of 4.9% over the benchmark (in CY22). The detailed performance of our fund is shown below in the table in a granular form:

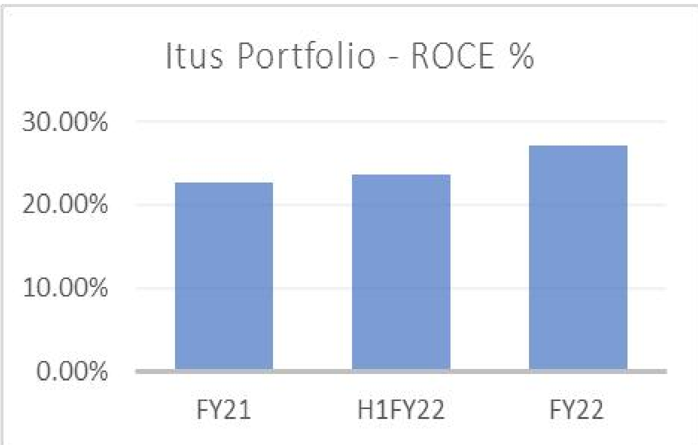
Table 1: Breakdown of CY returns of the fund vs Nifty 50 on a yearly basis

	Itus Fund (%)	**Benchmark - Nifty 50 (%)**	**Excess Return (%)**
2022	-14%	-9.1%	-4.9%
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)	162.3%	92.8%	69.6%

Our portfolio continues to be invested across 7 broad themes – lending financials, non-lending financials (like life insurance), Platform / B2B Financials, Pharma, IT & Tech, Auto Ancillaries, B2B Manufacturing and Consumer Brands. We also have an investment in a company in the infrastructure construction space with its exposure coming from medical hospitals.

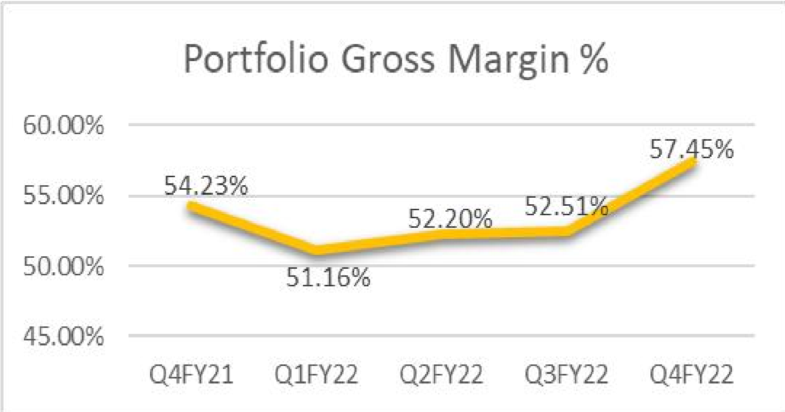
Our portfolio has seen a significant improvement on the Return on capital generated over the last 2 years. This gives us comfort around the efficiency of capital being deployed by the promoters / management teams of the companies we are invested in. The improvement of RoCE of ~4% has come through at a time where 80% of the companies in Nifty 500 (across market caps) have seen a reduction in RoCE

Table 2: RoCE trend of the portfolio over time



One of the core aspects of the improvement of capital efficient returns the portfolio has seen is the increase in Gross Profit Margins our portfolio has seen over the last 6 quarters. It is important to appreciate this at the micro level for our portfolio companies when there has been margin pressure (due to inflationary headwinds and supply chain issues) across companies.

Table 3 : Portfolio Gross Margin across time



The fundamental improving metrics of the portfolio has meant that the cash flows our portfolio companies generate continue to grow at a robust 23.5% (on a yoy basis).

Portfolio Positioning:

While we continue to be cautious the market, we have used the opportunity in the last quarter to reduce our cash in our portfolio and add equity exposure in the businesses where we believe, there is sufficient margin of safety from a downside perspective.

We continue to maintain our largest exposure in Sumitomo Chemicals – an agri-chemical company which continues to show a record profit and margin expansion in a seasonally weak quarter. The company had announced a capex for 5 new molecules it would manufacture for its parent and for its export market and they continue to fund their capex through internal accruals. We continue to like the tailwinds for the business today and believe a strong growth of 24%+ from a cash flow perspective over the next 2 years is a likely outcome we would see.

There have been two positions in our portfolio that have shown significant underperformance in the quarter:

L&T Technology Services (LTTS) showed a drawdown of 40% in the quarter which caused a drag on the portfolio returns in the quarter. LTTS closed FY22 on a robust growth of 21% on the topline alongside its EBITDA increasing by 3% over the year (from 18% to 21%).

Separately, its order book expanded with significant orders in the ER&D and EV industries which put the company on a strong growth trajectory.

The fall in price over the last quarter has been through a PE de-rating on the company and the market's expectation of future orders potentially being slower than what we saw in FY22, on the back of a weak US market and a potential recessionary risk emanating from the US.

While the risk of a US slowdown is real, we do not see a material slowdown in the growth of the core business of LTTS as they continue to focus on industries which has seen material increase in capex on the ground. We continue to believe that the core business is valued at a price which discounts future growth and we do not see headwinds for the business to de-rail its growth.

IEX showed a drawdown of 29% in the quarter which also saw a drawdown on our portfolio returns. While the growth in FY22 for the topline for the business was north of 40%, we expect to see normalization of earnings for the first few quarters in FY23. This slowdown is predicated on two factors

a) Since there was an abrupt increase in electricity and natural gas prices in the quarter, the volume of contracts on the exchange dropped to the tune of 10% (Remember IEX gets its topline on the volume of contracts and not on the volume traded on the exchange). So there is no benefit of price increase unlike other exchanges
b) With the onset of MBED, there is an increased noise of additional competition from the exchange (backed by PTC) going live. We do not consider this a material risk at this stage as the online exchange market for power is fairly nascent and IEX has a significant first movers advantage for the market participants to move away from the core exchange.

While there are short term headwinds for the business from a topline growth perspective, we derive comfort from the core growth of the business and the market share of the overall power market slowly increasing on the exchange, which IEX would continue to be a beneficiary of.

In the quarter, we took a starting position in Dr. Lal Path Labs in our portfolio where the post-covid normalization of its topline was taking shape over the last 2-3 quarters. The diagnostics space is in the midst of multiple headwinds which caused a significant de-rating in the space

a) The valuation de-rating was the first theme that hit the broad sector at large as the market acknowledged that giving a premium valuation to Covid based topline was unjustified.
b) There has been increased competition in the space, coming from both pharma, online integrated health care companies where the new competition have played the discounting theme in an aggressive way.

With the valuations and multiples correcting between 40-50%, we took a starting position in the market leader which has been the most consistent capital allocator in the diagnostics space. We do not believe that diagnostics being 1-2 times a year business is a discount led business – this has a lot more stickiness than the market acknowledges today as there is a significant cost to migration of data and trust that the brand has built over time. We believe that the market has provided a good entry point for us to take exposure into the market leader today.

Our cash balance across new clients continues to be ~30% and we would be selective in deploying cash in the older portfolios where there were business exits done over the last 2 quarters.

We continue to focus on bottom-up stock picking opportunities across businesses which continue to establish their pricing power and where the valuations are reasonable. I look forward to interacting with you in our call on **9th July at 9 am.**

From the desk of the CEO

Naveen Chandramohan