Dear Shareholders and Investors,

Does de-coupling work?

As I write this having seen the first 9 months performance of global markets, one does not need to have a qualification of a data scientist to speak about the de-coupling of markets we are witnessing on the ground. The two largest global markets today, US and China have seen their respective benchmark indices down (24% and 16% respectively) where individual securities across sectors having seen significant amount of pain. As against this, India has had a very strong outperformance this CYTD with the Nifty down 2.4% over the same period.

The performance of a 'market' has been a function of growth, liquidity and interest rate policy alongside stable fiscal policy and it is fair to say that there has been a coming together of tailwinds along these for the Indian economy at large. Be it the RBI being prudent in loosening the balance sheet during the middle of Covid in 2020, and their subsequent tightening of policy and raising rates, managing the money supply and the subsequent demand generation on the ground our economy has been managed with a strong fiscal policy and a robust growth on the ground. Our fiscal deficit has remained well within control through growth coming from Engineering goods and Manufacturing and the revenue generation on the Central governments balance sheet (that came about through GST collections and inflation on the ground) creating a strong macro tailwind for growth.

Studying economics and history helps us with understanding the global monetary policy that we as investors need to expect over the course of the next few years. I would continue to bet that the Federal Reserve errs on the side of caution (by increasing rates aggressively by another 100-bps taking the interest rate range from 4.25% - 4.5% over the next 6 months). While the supply side path created by the Fed, should create a temporary loss of demand in the US where the unemployment rate marginally increases, the political scenario that the world is faced with will not leave them with much room to taper down their balance sheet aggressively. This push and pull factor will continue to mean that we are faced with an increasingly volatile environment with increasing opportunities to deploy capital around this volatility.

What does this mean for us as at home in India? I continue to believe that the RBI has its hands tied in the short-term in terms of setting the monetary policy (the interest rate regime). While the inflation on the ground is contained, I continue to maintain a higher interest rate policy onshore to ensure our currency does not depreciate in the interim.

Our Return & Portfolio Profile

At Itus, our fund has delivered an IRR (Annualized) of 19.8% (net of fees) over this period since inception (Jan 17 – Sep 2022), as against Nifty which has delivered an IRR (Annualized) of 13.66% over the same period. This outperformance of 6.12% (since inception CAGR) has come through despite our underperformance in 2022 where we have seen a drag of 6.1% 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	-7.6%	-1.5%	-6.1%
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)	*181.9%*	*108.7%*	*73.1%*

The fundamental attributes of the portfolio over time are shown below

Fig 1: Cash Flow growth of Itus vs Nifty

One of the contributors to our long-term performance has been the ability of our portfolio companies to generate strong cash flows and grow them over time. The same trend has been shown and compared against the Nifty. One of the take-aways I would like to leave the reader with, is the fact that while performance may have had a drag in 2022, the fundamental growth of the portfolio investments continues to be at its strongest since inception over the last 6 years.

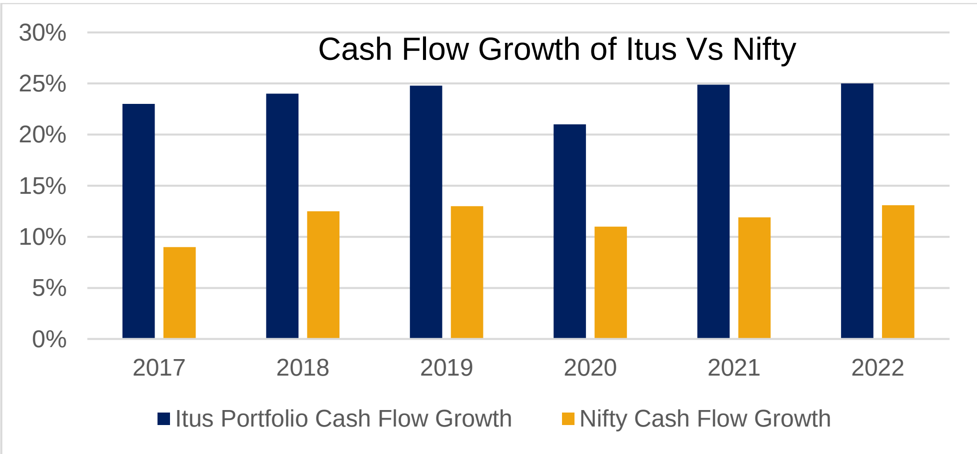
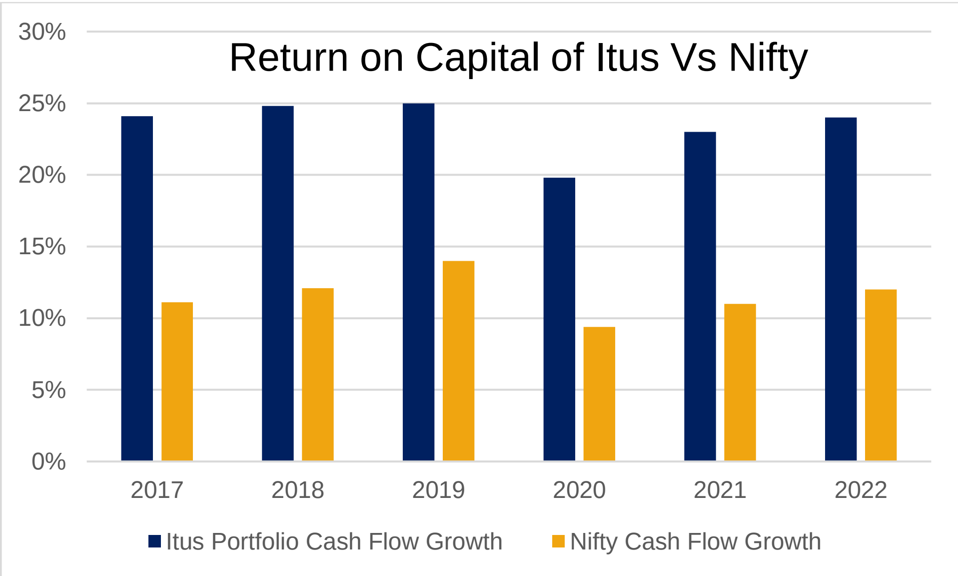


Fig 2: Return on Capital (Incremental Capital) of Itus vs Nifty

While cash flows ensure stability of the balance sheet, re-investment by the management team determines future growth. This lever is equally if not, more important to us as minority shareholders to understand our path of future returns.



The reinvestment of capital by our portfolio companies continues to be strong in a market where inflation reduced the margins for many companies on the ground.

While the portfolio quality is robust, there are a few micro trends we are seeing on the ground, which are worth highlighting and monitoring over the next few quarters.

- Resilient Discretionary demand: Be it real estate companies, Fashion retail, leisure or Autos, all point to a strong demand outlook. While the next few months augur well for consumption due to the festive season, the outlook beyond continues to be strong for branded retail. We see this rubbing off into mall occupancies where premium mall operators seem to be having their best decade ever in terms of their quarterly revenues and growth.
- Europe +1: Export centric companies across sectors can see a marked slowdown both in enquiry pipeline and production schedule scale down in case of manufacturing companies; Enquiries coming from Europe + 1 due to high energy prices seems a common thread. FTA is expected to be finalized with the UK before the end of CY22. While this is encouraging, we do not expect Europe + 1 to be a sustainable theme as the energy storage and ramping up of production of coal should normalize the supply into winter.
- Margins – As transportation costs normalize, I expect the pressure on margins for companies to normalize into Q2 and Q3.
- Govt dependent companies have seen working capital cycle on an improving trajectory since Q1 which has never been the case usually in Q1. Currently most of the capex growth on the balance sheet has come from the center and the state capex growth has flatlined over the last

year. I expect this to change over the next few quarters as state capex picks up (with sustained continuation from the centre).

Our Portfolio Positioning

Looking at our portfolio from a top-down basis, our new additions over the last 6 months have been in consumer discretionary brands across footwear, QSR, Jewelry, Hospitals and Healthcare. We continue to believe that the share of wallet into discretionary brands will increase in segments and businesses which can expand store count (offline) through internal accruals and prudent capital allocation will be significant beneficiaries of this migration. The data on the ground we see through credit card spends increase continues to build into this thesis.

Our channel checks and conversations on the ground confirm the order book build up we are seeing with various manufacturing companies across auto ancillaries, specialty chemicals, capital goods. Specifically, some of the companies have been running at capacity utilization at a 10% higher than their pre-Covid levels and are either in the phase of adding capex or have recently completed a brownfield expansion. We continue to own businesses in manufacturing and evaluate a few more where we would require a better margin of safety to own them.

While pharma as a sector continues to drag (measured by returns), we continue to like the domestic branded part of our pharma investments with a significant exposure in India. The expansion on the ground with increased MR (Medical Representatives) hires for some of our portfolio companies should bring in a higher than seen growth than the 15.5% we have seen over the last 3 years we have seen historically. We expect the operational leverage to play out well in this sector as they do not need a significant capex addition to fund their growth.

Reviewing a portfolio company and its performance

Over the last year, we have owned Ahluwalia Contracts in the Engineering Construction space which should continue to be a beneficiary of the infrastructure capex we are seeing on the ground. However, the stock has not generated any returns to the portfolio, and I believe it would be a good time to review the investment and our conviction behind the investment.

There are two trends we like to monitor for a fundamental growth in a company like Ahluwalia Contracts – the central government capex (which gives us an insight into the fundamental strength of the government spends and focus areas coupled with translating into state government capex which will have direct implications on execution and payment schedules for the projects on the ground. In the case of Ahluwalia, while the mandate for the projects will continue to come from the centre depending on the focus areas, they will continue to have state government as the counterparty with regards to the execution. The risk on Ahluwalia Contracts is reduced due to two factors:

a) The current focus on medical infrastructure projects (eg: construction of hospitals like AIIMS) which the company has a >50% exposure to in their order book and portfolio pipeline

b) Clean balance sheet with the projects being funded with internal accruals and current debt being used only for working capital and the company's execution on reducing their receivable days and keeping this within 3 months.

Looking at the data on the ground, we find a healthy growth in the central government's capex increase which continues to increase by 63% on a yoy basis

Fig 3: Govt capex is up 63% on a yoy basis vs the same period in FY22

Source: GOI, Spark Research

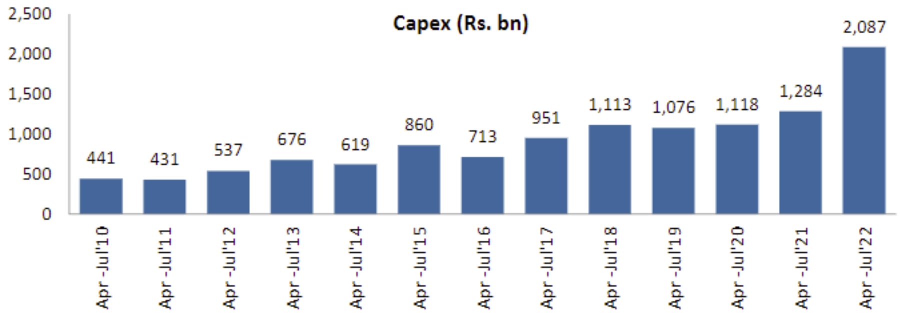
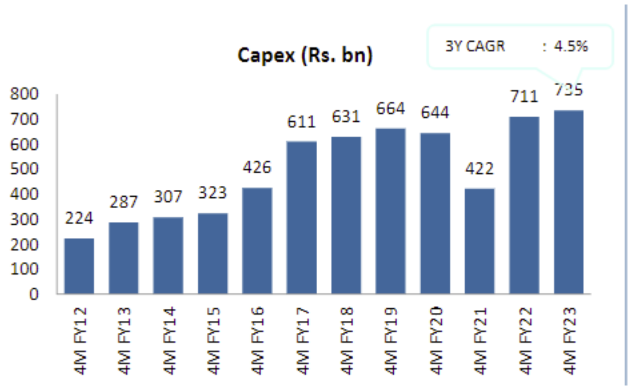


Fig 4: State Govt capex is up 4.5% on a 3Y CAGR basis

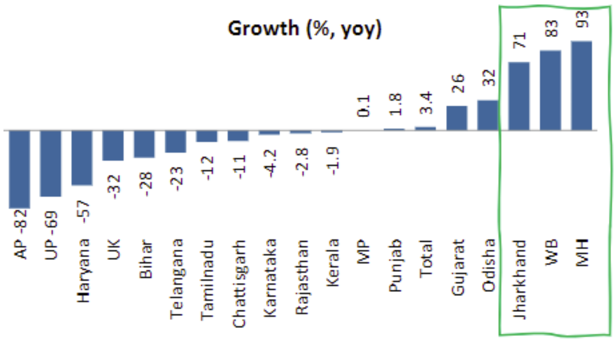
Source: GOI, Spark Research



While the state government capex continues to show a positive and increasing trend, the translation in terms of growth has been slower than what we are seeing with the central government numbers. However, its important to break down the state government numbers by geography as the granular numbers show very different numbers than the average numbers we see above.

Fig 5 : Capex has increased specifically for a few states like Maharashtra, WB, Jharkand, Gujarat

Source: GOI, Spark Research



While the company reported its highest ever quarterly revenue, and the rolling 4Q topline is currently at 1.7x the rolling 4Q topline pre-covid, we believe the capex flow through into the state government would continue to build a stronger than expected order book for the company. The company has also been conservative in bidding for projects in order to ensure they do not win projects at the cost of margins (The return on capital on the business has crossed 21% as against 2 years back when it had briefly gone below 12%). We expect the company to generate a low-mid teens growth in their topline as the base case and continue to monitor the order book and cash generation on the ground in terms of its execution.

We believe that the fundamentals are in the right place for return accretion over the next 3 years.

Evaluating the Risk Reward over the next few quarters

I continue to maintain that the market has risk of downside in the near term (over the next 1-2 quarters as described in the first part of the letter). However, volatility on the downside will give us opportunities to aggressively deploy capital. The risks to the downside to me stems from global factors and macro. So why do I maintain that these would be a significant opportunity to add risk if we do get volatility? In order to answer this, I will address this from the global macro factors :

While the media and analysts are worried about an impending home crisis in the US (driven by higher interest rates and mortgage payments), I do not believe we are in an environment of a mortgage crisis.

a) The US has been producing less homes than needed over the last 6 years.
b) Vacancies as a share of housing stock is at a 30 year low. This should limit price declines
c) High level of equity in home ownership today (highest in the last two decades)
d) Mortgage debt service payment as a % of disposable income is at its lowest in the last 15 years.

I believe that any demand slowdown on the ground in the US and subsequently domestically, would be temporary in nature and we would use this opportunity to add risk into our portfolio to get fully invested.

We have maintained adequate cash balance across clients and we would be selective in deploying cash in the older portfolios where there were business exits done over the last quarter.

We continue to focus on secular trends, diversify across themes, and buy strong companies with robust cash flow generation. We continue to manage risk through position sizing which limits our downside when we are wrong.

We expect lumpy earnings growth from some of our portfolio companies in the B2B space. This is due to a combination of the nature of the business and the capex deployment through internal accruals these businesses have been engaged in. The value of this is expected to accrue to the bottomline over the next 10-12 quarters.

We wish you and your families a Happy Diwali. We look forward to speaking with you on our call at 10 AM on the 15th of October 2022.

From the desk of the CEO

Naveen Chandramohan