ITUS CAPITAL

Dear Shareholders and Investors,

Inflationary Boom – Is this the cycle we are in

The first 6 months of the year (CY 24) saw the fund being up by 13.64% as against 11.29% for the index. This puts the since inception returns of the fund at 322% as against 222% for the index. The healthy outperformance of the fund continues as investors in the fund have compounded their returns at 21.2% (net of fees and expenses) since inception.

The portfolio is positioned with a bias towards large caps today and the weighted average market cap of the fund currently is at 2.36L Cr. While we continue to own small caps to the extent of 11.5%, we continue to be opportunistic and bottom-up in our picks here as we do not wish to sacrifice liquidity in the market today.

In the previous letter, I had written about the inflationary cycle we are in which explains our positioning and rationale for being overweight sectors like capital goods, power, telecom and manufacturing. In this letter, I discuss a bit more on the micro factors we are seeing on the ground that validates the thesis I had earlier.

The last decade globally was deflationary in nature which benefited technology as a sector. While technology tends to do well during deflationary periods, the market cap accretion predominantly happened from technology companies where the capital allocation was prudent (the cash flows generated were used to continuously buy back shares at a time where global Central banks were going through slow down and consequently rate cuts).

While the same technology companies have shown growth over the last 3 years, the advent of AI has meant that each of the companies would be spending upwards of USD 40bn each in the form of capex over the next 5 years which is unprecedented for them.

India is seeing its fair share of inflationary factors pick up which is beneficial for our GDP growth. One of the first signs we are seeing is in the telecom sector where the ARPU of the sector is picking up after a period of 10 years (since the launch of Jio).

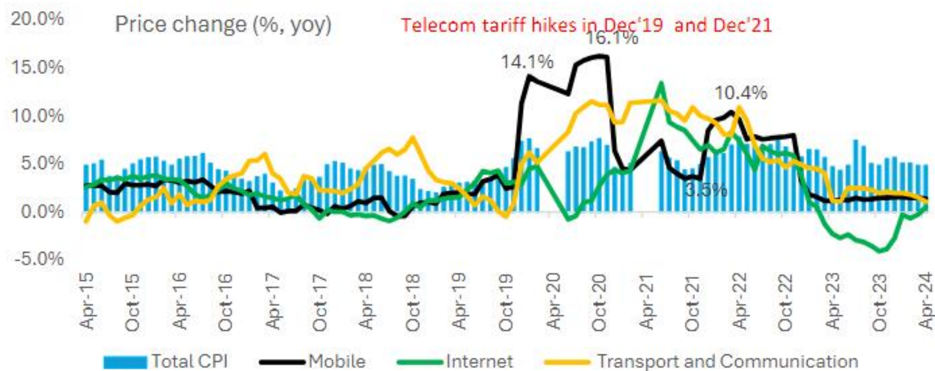

Fig 1 (Above): Telecom tariff hike and impact on CPI inflation: Telecom tariff hike of 20% can lead to 40bps rise to CPI inflation *(Source: Govt of India, Avendus Spark)*

The interesting aspect of inflation picking up is our base rates need not increase significantly vs the rest of the world, as RBI had managed the deflation cycle well (where we did not cut rates aggressively but still managed our deficits to one of the tightest over the last 20 years).

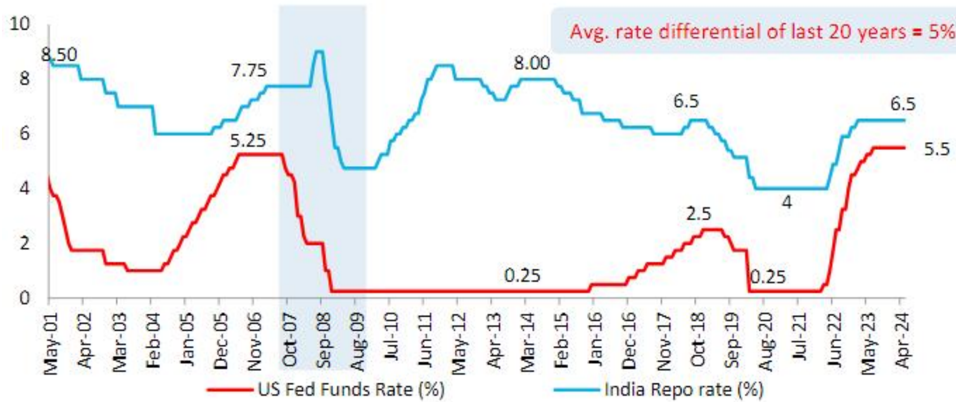

Fig 2 (Above): Indian monetary policy action remains de-coupled from the Fed policy rate in 2000, 2005, 2007 and 2015-16 rate cycles. Source: RBI, GOI, Avendus Spark

In a market like today, where the fundamentals and the earnings growth continue to be robust, the next leg of the conversation will automatically revolve around valuations. When markets are at all-time highs, cheapness will not be absolute but must be contextualized around growth.

Since earnings of corporate India continues to grow at 17.5% (on a trailing basis), valuations from a PE perspective still does not look expensive from a valuation perspective, however, the same from a P/B is at the higher end of the range.

Fig 3 (Above): Nifty is trading at a 12-month forward P/E ratio of 19.2x, near its LPA of 20.3x (5% discount). Conversely, the P/B ratio of 3.1x represents a 12% premium to its historical average of 2.8x. *Source: ACE Equity, Bloomberg Estimates*

Within this context, it is important to think about where growth can have concerns, rather than purely focus on valuations as the latter will not give the full picture.

Another way to look at the same is how the market cap of the country has grown relative to our GDP which is a proxy to PE for the country.

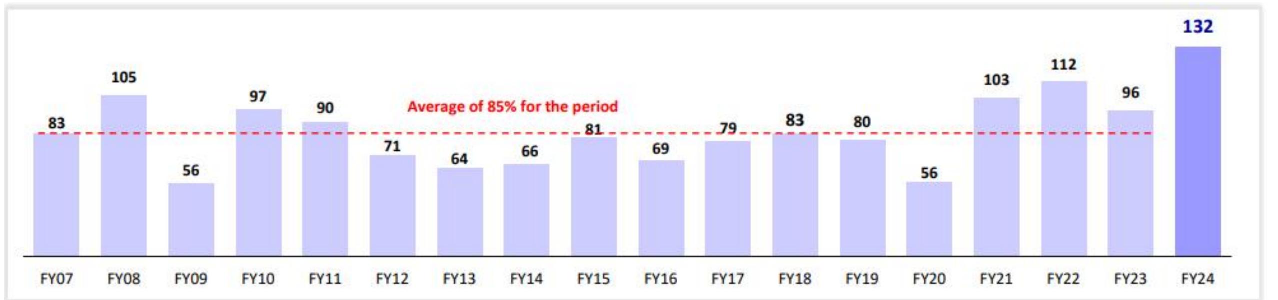

Fig 3 (Above): India's market capitalization-to-GDP ratio was at 96% in FY23. It is now at 132% (of FY24 GDP of 9.6% YoY), above its long-term average of 85%.

While the above chart may cause a reader to conclude that we are in expensive territory, the market cap given to the country is in line with the RoE expanding over the last 10 years.

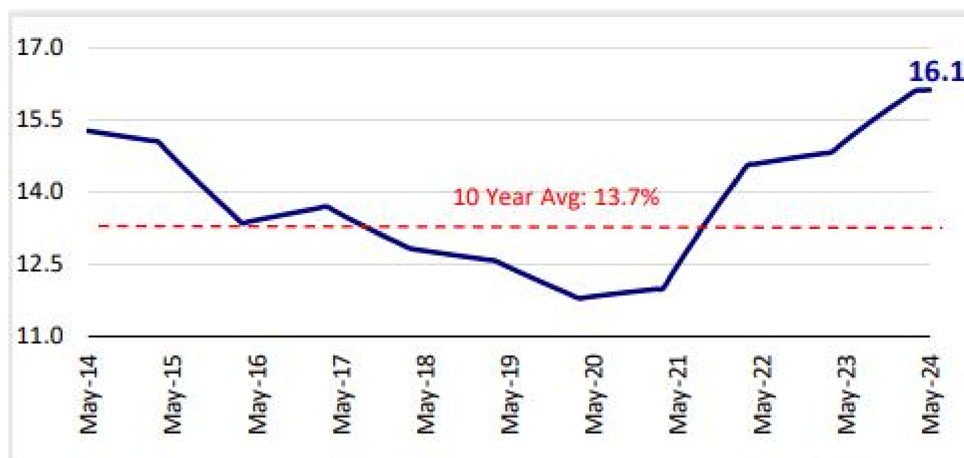

Fig 4 (Above): The Nifty is trading at a 12-month forward RoE of 16.3%, above its long-term average.

How does this translate into our sector positioning today?

An attribution to the above growth in ROE for Nifty, would reveal that it has primarily been driven by Manufacturing-facing sectors such as Automotive, Capital Goods, Oil & Gas, and Telecom – where we have seen significant capital expenditure from Private, State and Central government. We continue to see investments in these pockets and our portfolio construct would reflect the same.

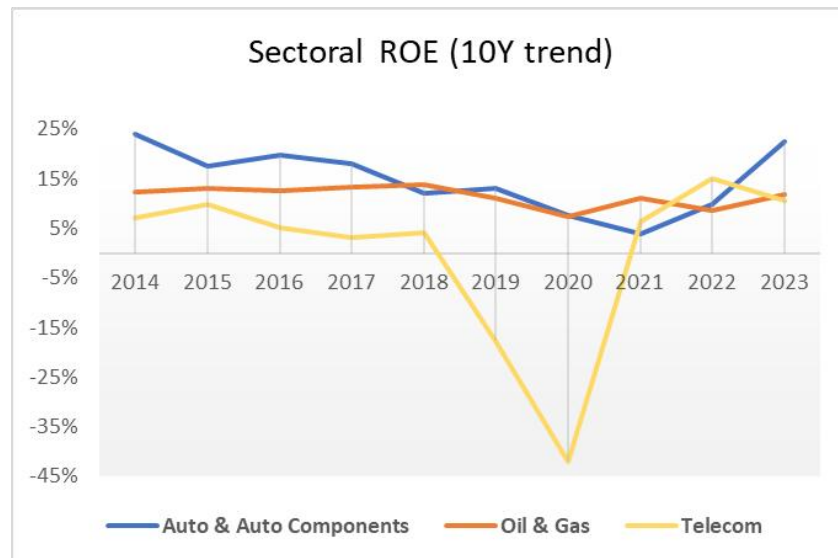

Fig 5 (Above): Manufacturing facing sectors have significantly expanded RoE over the last 3Y period.

The table below gives a detailed breakdown of our positioning vs the index today. There is a significant deviation in our positioning across sectors and this decision is a conscious one from a top-down perspective basis our view on growth alongside margin expansion (Table 1 Below).

Table 1: Index Weights vs Itus Weights across the key sectors broken down by allocation.

Name of Sector	Index Weight	Portfolio Weight
Auto & Auto Components	6.5%	18.5%
Oil & Gas	10.3%	9.5%
Capital Goods	0.0%	8.5%
Power	2.6%	7.5%
Healthcare	3.3%	7.0%
Banks	29.7%	6.5%
Insurance	1.3%	6.5%
FMCG	10.5%	5.5%
Construction Materials	2.0%	4.5%
Logistics & Ports	0.8%	3.0%

While bottom-up stock picking will always be our edge, it is equally imperative that we spend time on positioning and sizing. These are two often underappreciated aspects of risk management. As

can be seen from the table above, our positioning is different from that of the index (in-line with where we see growth alongside margins). Our sizing is a lot more diversified than what we have been in the past, due to the long tail of companies who are showing growth (this has translated to margins expanding for multiple companies in the sector, which means the right to win is no longer clear in this cycle). This characteristic does not lend well to concentration at a time where valuations have lower margin of safety than history.

Our Return & Portfolio Profile – Jun 2024

At Itus, our fund has delivered an IRR since inception (Annualized) of 21.2% (net of fees) (Jan 17 – Jun 2024) as against Nifty which has delivered an IRR (Annualized) of 16.87% over the same period. This healthy outperformance of 4.9% (since inception CAGR) is net of fees and expenses. The detailed performance of our fund is shown below in the table in a granular form:

Table 3: Breakdown of CY returns of the fund vs Nifty 50 on a yearly basis since inception of the fund

Today, the weighted average market cap of our portfolio is INR 2.36L Cr (USD 28 bn), which reflects our bias towards where we want to position ourselves from a liquidity perspective.

Portfolio Health and Its Measure

	Fund (%)	**Benchmark - Nifty 50 TRI (%)**
2024	13.64%	11.29%
2023	25.35%	21.30%
2022	-2.83%	5.69%
2021	29.26%	25.59%
2020	40.32%	16.14%
2019	17.31%	13.48%
2018	-7.31%	4.64%
2017	54.66%	30.27%
Since Inception (Cumulative)	322.2%	221.9%

The portfolio continues to have a strong earnings trajectory expanding the EPS by 31.2% on a yoy basis. As of the March (4QFY24) quarter, the health of the portfolio as measured by the earnings growth and the Return on capital is as shown below.

Portfolio Metrics	ITUS (Rolling 4Q)
GP Margin (TTM)	*53.3%*
ROCE (TTM)	*21.3%*

Our endeavor has been to construct portfolios to monitor the trend of the GP margin and ensure that the portfolio's margins stay on an upward trajectory which translates into a higher RoCE over time. Typically, doing this consistently means that one tends to overpay for these metrics (because getting growth cheap does not happen consistently over time). This is what we tend to avoid by measuring the multiple at which we own businesses and ensuring that the portfolio's PEG does not cross 2 through any point in time.

We continue to focus on secular trends and position ourselves in pockets of future growth. To illustrate, we have attached a summary of how we are positioned today across sectors along with brief comments on the same.

Name	Sector	Position	Weight	Comments
Maruti Suzuki India Ltd. Bajaj Auto Ltd. Craftsman Automation Ltd. *Others* **Total**	***Auto & Auto Components***	*Overweight*	**18.5%**	*Strong OEM volume growth in PVs and 2Ws; bodes well for ancillaries.*
Reliance Industries Ltd. Petronet LNG Ltd. GAIL (India) Ltd. **Total**	***Oil & Gas***	*Overweight*	**9.5%**	*New pipelines, gas field discoveries and imports to aid volume growth*
ABB India Ltd. AIA Engineering Ltd. RHI Magnesita India Ltd. Bharat Forge Ltd. **Total**	***Capital Goods***	*Overweight*	**8.5%**	*Good outlook for capex. Supportive policies, operating leverage*
NTPC Ltd. Indian Energy Exchange Ltd. Power Grid Corporation of India Ltd. **Total**	***Power***	*Neutral*	**7.5%**	*Growing power consumption trend; thermal generation capacity increase*
Dr. Reddy's Laboratories Ltd. Ipca Laboratories Ltd. Wockhardt Ltd. **Total**	***Healthcare***	*Overweight*	**7.0%**	*Strong growth outlook benefitting from low-cost manufacturing*
IndusInd Bank Ltd. HDFC Bank Ltd. **Total**	***Banks***	*Underweight*	**6.5%**	*Bottoms-up outlook on lending growth*
SBI Life Insurance Company Ltd. ICICI Lombard General Insurance Company Ltd. **Total**	***Insurance***	*Overweight*	**6.5%**	*Low penetration of financial products; good growth prospects*
Shree Cement Ltd. Ambuja Cements Ltd. Cera Sanitaryware Ltd. **Total**	***Building Materials***	*Overweight*	**6.5%**	*Healthy Unit sales across real-estate developers; Should lead to volume growth.*
ITC Ltd. Marico Ltd. **Total**	***FMCG***	*Underweight*	**5.5%**	*Expecting Rural recovery to drive volume growth*
Adani Ports and Special Economic Zones Ltd. **Total**	***Logistics***	*Neutral*	**3.0%**	*Manufacturing facing sectors to drive ExIm volumes*
Computer Age Management Services Ltd. **Total**	***Financial Services***	*Neutral*	**2.0%**	*Growing financialisation in the country*
Hindustan Copper Ltd. **Total**	***Mining & Minerals***	*Underweight*	**2.0%**	*Rising demand for copper in manufacturing, batteries, etc.*
Indus Towers Ltd. **Total**	***Telecom***	*Neutral*	**2.0%**	*ARPU growth should lead to increased Capex by Telecom providers*
Advanced Enzyme Technologies Ltd. **Total**	***Chemicals***	*Underweight*	**1.5%**	*Benefit from low cost of production and exports*
Ahluwalia Contracts (India) Ltd. **Total**	***Construction & Realty***	*Neutral*	**1.5%**	*Strong infra spends by Centre and State governments*

Note: The sum of the above weights would not total up to 100%; remaining would be our cash holdings.

We look forward to speaking with you **on our call at 9:30 AM on the 13th of July 2024.**

From the desk of the CEO

Naveen Chandramohan

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