Equirus Long Horizon Fund

Investor Communiqué - Sep'17

Dear Investor,

As we celebrate the completion of our first year in business, we pause and take stock of the year gone by – our portfolio returns, our investment philosophy, and, most importantly, the rigorous process we follow in investing capital to ensure optimal risk-adjusted returns. We also present to you a snapshot of the AGMs we attended across the country this AGM season – a move which has helped us glean valuable insights while offering an edge over others.

We present to you our Sep'17 communiqué and thank you for the faith reposed in us and investing your hard-earned money in ELHF.

The Power Law – and how it drives us

Power law, also known as the **Pareto principle** or **80-20 rule**, states that, for many events, roughly 80% of the effects come from 20% of the causes. Power law has applications in almost all walks of life including economics, engineering, health & fitness, software and physics among others.

This principle has important implications in investing as well. Many of you would have questions like: Why are the returns in some portfolio companies very high, some in red, and some flattish? The Pareto principle can give us some insights. Portfolio returns largely follow the Power Law wherein majority of the returns come from the top few stocks. This is true for our performance till now and we believe this skewness will continue going forward as well.

Charlie Munger, Warren Buffett's partner, explains it very well in his famous speech at USC Business School in 1994. The following excerpt also highlights our investing process along with the Pareto principle.

'A Lesson on Elementary Worldly Wisdom', by Charlie Munger

"The way to win is to work, work, work, work, and hope to have a few insights.

How many insights do you need? Well, I'd argue: that you don't need many in a lifetime. If you look at Berkshire Hathaway and all of its accumulated billions, the top ten insights account for most of it. And that's with a very brilliant man—Warren's a lot more able than I am and very disciplined—devoting his lifetime to it. I don't mean to say that he's only had ten insights. I'm just saying, that most of the money came from ten insights.

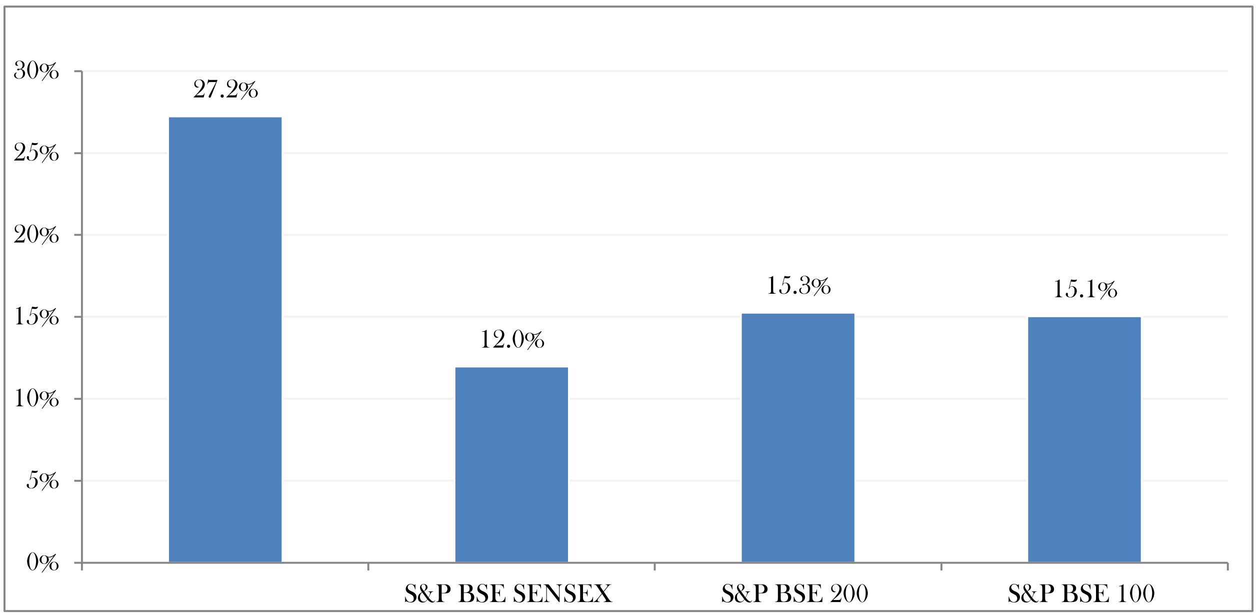
So you can get very remarkable investment results if you think more like a winning pari-mutuel player. Just think of it as a heavy odds against game full of craziness with an occasional mispriced something or other. And you're probably not going to be smart enough to find thousands in a lifetime. And when you get a few, you really load up. It's just that simple.

And the wise ones bet heavily when the world offers them that opportunity. They bet big when they have the odds. And the rest of the time, they don't. It's just that simple."

In this light, we would like to encourage you to look at the performance of overall portfolio rather than individual stocks.

The Equirus Long Horizon Fund, as the name suggests, invests in listed securities with a long-term horizon of 3-5 years. Our adherence to robust processes, prudent investment strategies along with flexibility to invest in strong businesses/franchises – while a perfect recipe for above-average long-term results – has already started yielding results. With just one year into our launch, **we have given a return of ~27%**, much higher than benchmark indices. Our portfolio return could have been better (~31%) on excluding the cash position (~13% cash). Cash position and returns will vary across clients, depending upon their entry into our PMS.

Comparative performance of ELHF vs. benchmark indices[1] since launch (20 Oct'16)



We would like to caution you against extrapolation of this performance over the short term.

[1] *Return figures are net of fees and as of 30 Sep'17*

Investment Lifecycle

We follow a rigorous process for investing the capital that you entrust upon us. Any investment that we make or reject passes through many checks and balances. Here's a snapshot of a lifecycle of an investment idea:

1. Idea generation through screeners, reading (newspapers, magazines), scuttlebutt, etc.
2. Deep dive into the company, industry and competitors
3. Investment committee approval
4. Actual trade execution
5. Monitoring through investor meets, conference calls, and AGMs
6. Exiting position if one or more of following criteria is met:
   a. Fully/over valued
   b. Disruption in business through regulatory/technology changes
   c. Adverse corporate actions by management/promoters

In all our investments, we like to have an edge with insights which come from going that extra mile. For this, we attend as many Annual General Meetings (AGMs) as possible. During this AGM season – which typically falls in Q2 (especially August and September) given AGMs have to be conducted within 6 months of the fiscal-end – we travelled extensively across the country. Here's a snapshot:

AGMs attended: Key stats

No of AGMs attended: 78
Cities: Ahmedabad, Amritsar, Anand, Ankleshwar, Baroda, Bengaluru, Chennai, Coimbatore, Daman, Delhi, Hyderabad, Jaipur, Kolkata, Madurai, Mumbai, Nadiad, Pune, Silvasa
No of Ideas shortlisted: 5
No of ideas implemented: 2

Why we attend AGMs?

In these times of high-speed data, information flows freely. Information in public domain can be accessed by anyone with internet connectivity. However, there is no substitute to the insights garnered by putting in that extra effort. And we feel an AGM is one such tool which gives us a head-start, as we come across a combination of good businesses run by smart and ethical promoters/ management before other participants. This gives us an edge, which we feel will translate into meaningful outperformance of our portfolio on a sustainable basis.

These efforts culminated in a few investment ideas, some of which we have already implemented. One of them is Alkyl Amines, which we discuss next.

The new entrant: Alkyl Amines Chemicals Ltd.

Alkyl Amines Chemicals (Alkyl) is India's second-largest aliphatic amines manufacturer (~40% market share), run by an experienced and ethical promoter with a diversified product portfolio. Alkyl has two manufacturing sites at Patalganga and Kurkumbh and has undertaken greenfield expansion at Dahej, which would increase the company's capacity by more than 50%. This provides massive locational advantage to Alkyl as it will be nearer to suppliers and customers. Alkyl manufactures amines, amine derivatives and other specialty chemicals, which are an important input in pharma, agro-chemicals, foundry, rubber, and water treatment sectors.

Alkyl has been able to maintain average gross profit margins of ~50% over the last 15 years. Over the last 5 years, the company's top line and volumes have grown at a 12% CAGR and profit after tax at 23% CAGR. This growth has come at a very good ROE of ~26% over the last 5 years. Post this expansion, we believe the company will be on a strong growth trajectory and can repeat the same performance. The current post-tax earnings multiple is 17 times for this business. Given this duopolistic market, we believe this grossly undervalues the company's growth potential.

Current Aggregate Portfolio Characteristics

As a step towards greater transparency, we share our portfolio level characteristics every quarter. Our current portfolio characteristics are:

Number of businesses	13 companies
Current cash position	~13%
Last 3-year earnings CAGR	33%
Latest portfolio ROE	28%
TTM (trailing twelve month) portfolio PE	19x
Acquisition portfolio TTM PE	14.2x
Balance sheet strength	3 out of 10 companies are net debt free. The lowest interest coverage of our portfolio company is 1.7 times and it has grown EBITDA at 19% CAGR for last 5 years
Churn	4.5% (excluding the buying/selling of Liquid Mutual Funds, stocks given to us by our investors and capital redemption by investors).

I thank you for your valuable support and trust for investing in ELHF, and I reinforce our commitment to make your investment decision profitable.

For any queries, please feel free to get in touch with me or my team.

Thanking you,

Viraj Mehta
Head & Fund Manager
Equirus PMS

Annexure

In this section, we share some good reads with you. This time, we share an article we wrote for DNA Money. Hope you enjoy reading it. We also share links to the following interesting articles:

- The Unsolvable Puzzle by Morgan Housel
- The Difference Between Open-Minded and Close-Minded People by Farnam Street
- Howard Marks memos (part 1 and part 2) on psychology of markets, various asset classes and their valuations. Also has some interesting thoughts on cryptocurrencies.
- The Logic of Risk Taking by Nassim Nicholas Taleb