



Equirus Long Horizon Fund

Investor Communiqué - Mar'19

General elections are the flavor of the season and the noise around it is too loud to ignore. While predicting election outcomes and their impact on markets might make for great dinner table discussions, it does not have much bearing on our investment process.

In our last [letter](#), we discussed how macro factors like currency, crude oil and interest rates took centerstage, with mid and small cap companies taking the beating. This time, we review the financial performance of our portfolio companies over the last fiscal, present our thoughts on portfolio allocation and, in continuation with our efforts towards offering greater transparency, share a snapshot of our performance and portfolio characteristics.

Performance Of Portfolio Companies

FY19 was a challenging year, especially in terms of portfolio returns, for all of us, and more so because it came after a stellar FY18. However, with a slight change of perception, the situation doesn't seem so bad. While returns are the ultimate barometer to measure the performance of a portfolio over a 3-5 year period, it might not be the best measure in the short term. As the father of value investing, Benjamin Graham famously said, *"In the short run the market is a voting machine, but in the long run it is a weighing machine."*

In the long term, markets will give the right value to companies with quality earnings performance. When we look at our portfolio stocks in terms for financial performance, the year was not bad at all. In fact, most of our companies fared well, as depicted by the following heat map which shows their trailing twelve months (TTM) performance.

Equirus Securities Private Limited



Portfolio	TTM Sales growth	TTM Operating margin	TTM Profit before tax
Company 1			
Company 2			
Company 3			
Company 4			
Company 5			
Company 6			
Company 7			
Company 8			
Company 9			
Company 10			
Company 11			
Company 12			
Company 13			

	>20% growth	>300 bps	>20% growth
	10 to 20% growth	100 to 300 bps	10 to 20% growth
	0 to 10% growth	0 to 100 bps	0 to 10% growth
	-10% to 0 growth	-100 to 0 bps	-10% to 0 growth
	<-10%	<-100 bps	<-10%

* Does not include a special situation play

Sales for all our portfolio companies grew at a brisk pace, with all barring three showing operating margin expansion. Moreover, profit before taxes (PBT) for all but three companies grew more than 20% in the last twelve months as compared to the previous 12-month period. In that sense, the performance has been quite satisfactory.

Though the financial performance did not reflect in the stock prices of some companies, we are far from being disheartened. In fact, as the financials caught up with prices, valuations for some of our portfolio stocks returned to our comfort level, driving us to add them to our positions. These opportunities primarily crop up when market sentiments are bearish, and we like to take advantage of these situations.

As discussed in earlier letters as well, we deployed most of your liquid/cash holdings in the last two quarters of FY19. At a portfolio level, liquid/cash positions came down from 21% at Sep'18-end to 3.9% at Mar'19-end. These turbulent times gave us an opportunity to considerably improve the quality of our portfolio, at the prices we like. We believe the results should reflect in stock price performance over the coming years.



Thoughts On Portfolio Allocation & Diversification

As you might be aware, safety of capital is the cornerstone of our investment philosophy. However, in a conventional sense, we have a concentrated portfolio. We like to hold 10-15 stocks which pass through our filters of sound investment after thorough research. Consequently, a fully deployed portfolio will have at the most 15 stocks. To add a new company to the portfolio, we will have to replace it with the existing one. In other words, a new company must have a better risk-reward ratio than the one with the least favorable risk-reward ratio in the current portfolio. Hence, whenever we add a new stock, the portfolio quality improves while benefits of adequate diversification are maintained. Diversification is a very subjective and loosely used term. However, Seth Klarman explained it very well in his seminal book, Margin of Safety.

“Even relatively safe investments entail some probability, however small, of downside risk. The deleterious effects of such improbable events can best be mitigated through prudent diversification.”

The number of securities that should be owned to reduce portfolio risk to an acceptable level is not great; as few as ten to fifteen different holdings usually suffice.

Diversification for its own sake is not sensible. This is the index fund mentality: if you can't beat the market, be the market.

Advocates of extreme diversification – which I think of as Portfolio Management and Trading over-diversification – live in fear of company-specific risks; their view is that if no single position is large, losses from unanticipated events cannot be great.

My view is that an investor is better off knowing a lot about a few investments than knowing only a little about each of a great many holdings. One's very best ideas are likely to generate higher returns for a given level of risk than one's hundredth or thousandth best idea.”



Several studies show that 15-20 uncorrelated stocks are optimum for diversification. While adding more stocks does not provide any additional benefit of diversification, it becomes detrimental for the returns.

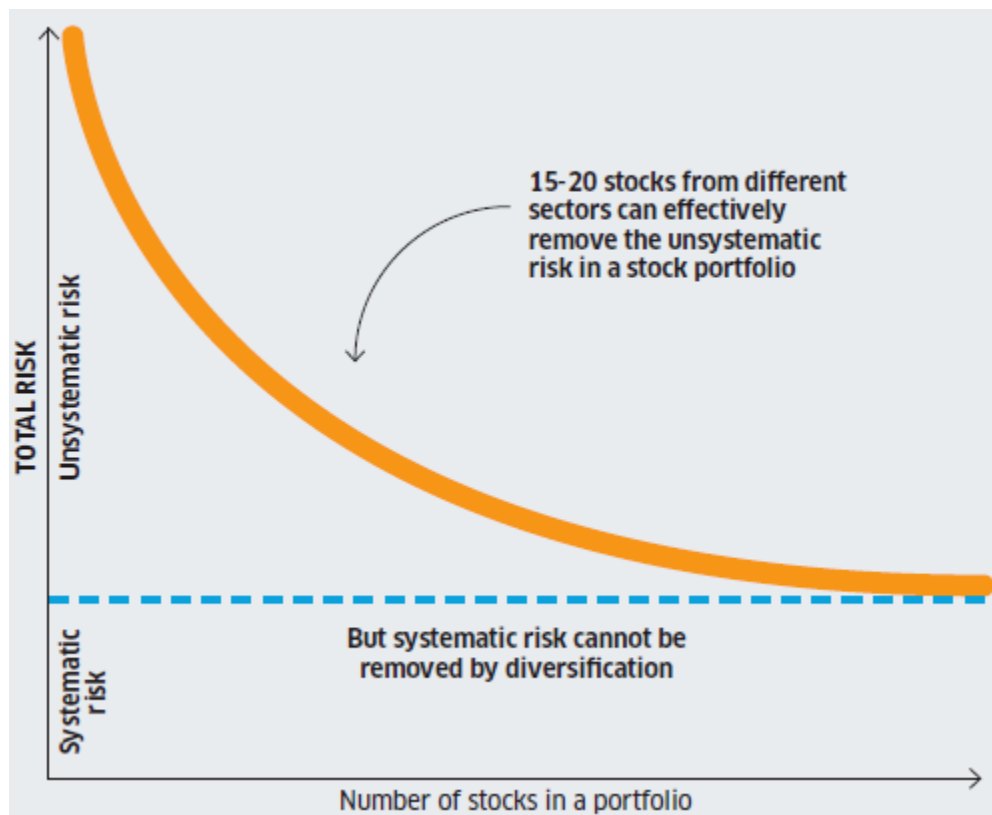


Image: economictimes.com

Some important ground rules we follow for capping risks in our portfolio:

- Allocation to any stock should not be more 10% at book value
- Highly correlated positions should not be more than 15% at book value
- Allocation to any sector to be capped at 30%

We have been religiously implementing these rules and they have held us in good stead. As they say, the proof of the pudding is in the eating. The following section compares our performance against our much more diversified benchmark, BSE Smallcap index, and the results are quite evident.



Fund Performance

We present below the performance of model portfolio as well as ELHF in comparison to benchmark indices. Returns vary across clients, depending upon their entry into the PMS.

Comparative performance of Model portfolio vs. benchmark indices¹

	FY 16-17 (20 Oct'16)	FY 17-18	FY 18-19
Model Portfolio ²	7.8%	38.9%	-4.2%
BSE SMALL CAP	11.4%	17.4%	-11.6%
BSE 200	8.5%	11.0%	10.7%
BSE 100	8.4%	10.6%	12.5%

Comparative performance of ELHF vs. benchmark indices¹

	FY 16-17 (20 Oct'16)	FY 17-18	FY 18-19
Equirus Long Horizon Fund	9.8%	29.4%	-4.1%
BSE SMALL CAP	15.5%	11.9%	-12.2%
BSE 200	11.4%	7.6%	10.3%
BSE 100	11.2%	7.2%	12.1%

As discussed before, we think this is a good time to increase allocation to existing portfolio stocks.

¹Return figures are net of fees and as of 31st Mar'19. Returns are adjusted for inflows/outflows and are TWRR.

²Model portfolio is the portfolio of first investor in the fund



Current Aggregate Portfolio Characteristics

As a step towards greater transparency, we share our portfolio-level characteristics every quarter:

Number of businesses	15 companies
Current cash position	~3.9%
Last 3-year average earnings growth	44%
Latest portfolio ROE	17%
TTM (trailing twelve month) portfolio PE	20.2x
Acquisition portfolio TTM PE	17.1x
Churn	21.4% (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 Siddhartha (siddhartha.grover@equirus.com) or Pooja (pooja.desai@equirus.com). And if you happen to be in Ahmedabad, me and my team will be happy to host you at our office.

Thanking you,

Viraj Mehta
Managing Director
Equirus PMS



And lastly, some articles we found interesting during the quarter. Hope you enjoy them!

- [Growing the Pie](#) by Howard Marks
- [The Perfect Bull Market Portfolio Might Have Blown Up Your Firm](#) by Sarah Ponczek
- [College Grads Sell Stakes in Themselves to Wall Street](#) by Claire Boston
- [Indus Waters Treaty: Partition to Cold War and drought, how India lost hydro disciplining tool against Pak](#) by Mridula Ramesh
- [Origins of Greed and Fear](#) by Morgan Housel
- [Peering down the cliff of infinity: the first image of the event horizon of a black hole](#) by Phil Plait

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