# Equirus Long Horizon Fund Jun'17 Investor Communiqué

Dear Investor,

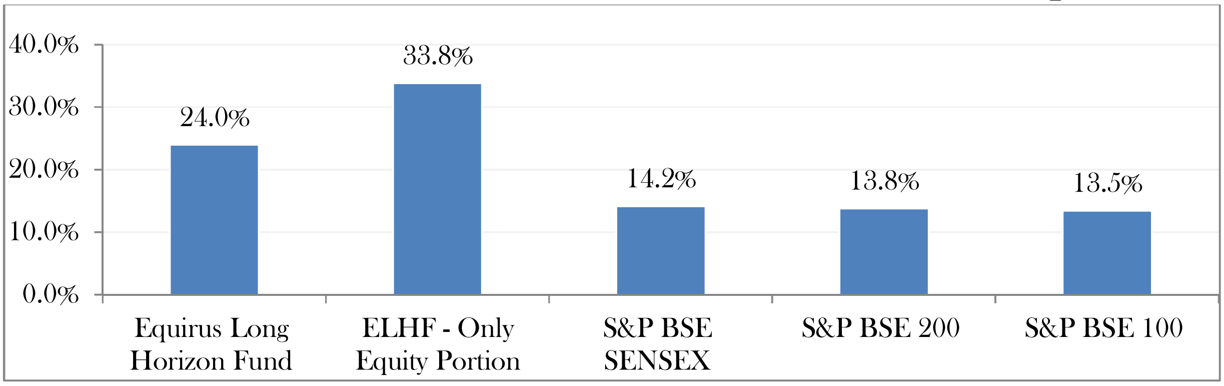
At the outset we would like to thank you for the faith reposed in us for investing your hard earned money with our fund. It is our pleasure to be communicating with you on our investment journey via this communiqué.

At ELHF we always intent to invest in listed securities with a longer term horizon of 3-5 years. We have built robust processes and team to attain the investment objective you have entrusted upon us.

Whilst your individual returns are with you, we would like to discuss the portfolio level return since the launch of ELHF. ELHF has given a return of ~24%, since our launch in October 2016, which is much better than the broader benchmark indices (comparative performance depicted below in exhibit 1). Our portfolio return could have been significantly better (~34%) if we exclude the cash position (~29% cash). Cash position and returns will vary across clients, depending upon their entry in our PMS. We are in the process of deploying the remaining capital over next few months. We surely see few lucrative opportunities around in a fairly valued market.

Exhibit 1: Comparative performance of our portfolio versus the benchmark indices[1] since launch (20th October 2016)

[1] Return figures are net of fees and as of 30th June 2017. The outperformance is lower due to significant cash holdings (~29%) as we are in the process of full deployment. Same stocks brought proportionately for cash would have given ~34% return.




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

## GST Implementation

GST, the much-anticipated tax reform is finally a reality. A lot has already been talked about how it will facilitate ease in doing business for corporates, improve tax compliance and make manufacturers and exporters more competitive, while maintaining and/or reducing the tax outgo for end customers in most cases. Further, innumerable articles have been written about how the unorganized sector will face the heat as they get included in the tax ambit and what sort of opportunity it will provide for the organized players. However, it still await to see as to how smooth the implementation will be and its disruptive impact (if any) on the economic activity in the coming quarters.

From a longer term perspective, we think, there will be enormous benefits in the supply chain management aspect leading to tremendous savings in logistical costs. India spends ~13% of the GDP on logistics costs at present which could come down to ~6-8% with implementation of GST as seen in the countries like Malaysia, New Zealand where it was implemented. This should result in savings of anywhere between 30-50% on freight and logistics costs for the companies. The digitization of systems will increase efficiencies, reduce leakages and corruption. All this will ultimately lead to lower prices to the consumers, improved demand environment, faster GDP growth and a lot of wealth creation opportunities for investors. However, the short term uncertainty associated with this event seems to be a cause of worry for the market participants these days, which according to us is largely unwarranted.

We think our portfolio is well positioned to benefit in the long term (3-5 years) from GST implementation. ~22% of the fund capital is allocated to the companies having export focus (all non-IT). We do not see any major disruptive impact on these companies in the coming quarters. Rest of the portfolio companies are majorly focused on domestic markets and have a dominant position in their respective industries. While we do not see any change in the direction of growth for these companies, the speed may change in the short run. However, we believe that these companies' market dominance will only grow stronger than it is right now. Our businesses over a period of time will do well, and we will use any significant drop in the prices as a buying opportunity.

In the Berkshire Hathaway investor letter of 1994 (excerpt below), Warren Buffett has written something that had a major impact on me over my investing career and has continued to contribute to my general thinking about investing to this day. I believe this is one of most powerful lesson for the money manager offering advice to the general public.

*"We will continue to ignore political and economic forecasts, which are an expensive distraction for many investors and businessmen. Thirty years ago, no one could have foreseen the huge expansion of the Vietnam War, wage and price controls, two oil shocks, the resignation of a president, the dissolution of the Soviet Union, a one-day drop in the Dow of 508 points, or treasury bill yields fluctuating between 2.8% and 17.4%.*

*But, surprise - none of these blockbuster events made the slightest dent in Ben Graham's investment principles. Nor did they render unsound the negotiated purchases of fine businesses at sensible prices. Imagine the cost to us, then, if we had let a fear of unknowns cause us to defer or alter the deployment of capital.*

*Indeed, we have usually made our best purchases when apprehensions about some macro event were at a peak. Fear is the foe of the faddist, but the friend of the fundamentalist.*

*A different set of major shocks is sure to occur in the next 30 years. We will neither try to predict these nor to profit from them. If we can identify businesses similar to those we have purchased in the past, external surprises will have little effect on our long-term results."*

I am just trying to make a simple point here. I see many people trying to convey in precise detail not only what the politicians are arguing about but also their hidden vote bank politics. I call this easy infotainment bias. They have a lot of non-actionable and irrelevant information hurting the limited information processing capability of the human brain. Yet ironically, if you ask them questions about their portfolio holdings they cannot answer them. For example, if you ask them whether the companies they own had a good/bad quarterly earnings report, or how many of their companies raised their dividends or have done an acquisition, they usually have no clue. In other words, I believe investors obsess about things that although scary, do not have a direct long-term impact on their specific portfolios, but only their short-term attitude about them. It also tells us that the prospects and rewards of owning good businesses are often independent of the general political and economic environment we find ourselves in.

Our job as asset manager is to focus on our precise holdings and their unique fundamental strengths, and worry less about what's going on in more general terms. An old Wall Street adage summarizes my point: "Wall Street climbs a wall of worry." Of course the most important lesson here is not to let fear overcome reason.

## Quarterly Update

Apart from providing portfolio characteristics of the businesses owned by ELHF, we would also like to share a few changes that we have made in the portfolio.

On our portfolio positions:

During the quarter we added two companies in the portfolio. Currently we are building the position so we won't be talking much about them. One of the companies is a global leader in manufacturing of an engineering component (this is the crown jewel of the company which is very stable and high RoCE business) and also develops structural components used in infrastructure sector globally. The company has excellent capital allocation skills backed by a very shrewd technocrat. The other company is a diversified conglomerate which manufactures products and commodities which is consumed or used in every household. We expect earnings from one of the segments to go up significantly due to the cost saving measures that the company has undertaken over the last few years, while other segments should maintain their profitability.

We are in constant lookout for such great businesses that should grow (as per our analysis) earnings/share at more than 25% annually.

Current Aggregate Portfolio Characteristics

As a step towards greater transparency we intend to share portfolio level characteristics with you every quarter. Our current portfolio characteristics are as follows:

- Number of businesses: 10 companies
- Current cash position: 29%
- Last 3 years compounded earnings growth: 57%
- Latest portfolio ROE: 30%
- TTM (trailing twelve month) portfolio PE: 18.6x
- Acquisition portfolio TTM PE: 13.7x

- Balance sheet strength: 2 out of 10 companies are net debt free. The lowest interest coverage of our portfolio company is 3.2 times and it has grown EBITDA @ 19% CAGR for last 5 years.
- Churn: 3% (Excluding the buying/selling of Liquid Mutual Funds, stocks given to us by our investors and capital redemption by the 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: We would like to share some of the good articles we think you might enjoy reading. Please see the links below.

Not a Breeze - SMEs, not used to complex paperwork and laws, will have to reinvent themselves if they have to survive under the GST regime.

Notes from Berkshire Annual Meeting

A Dozen Thoughts from Charlie Munger from the 2017 Berkshire Annual Meeting

Here's how farmers in Karnataka's drought-hit districts have increased crop yields

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