Equirus Long Horizon Fund
Investor Communiqué – Dec' 20

Wish you and your family a very Happy New Year! After a testing 2020, 2021 brings with it a ray of hope as the vaccine roll-out program gathers pace. As the year progresses, we expect Covid-19 to relent and life to return to normal. The normal will, of course, be a new one as some pandemic induced changes especially related to work, education, travel, and health become more integral part of our lives. Nonetheless, a mutation or two might that render vaccines ineffective, will drastically change the scenario. So, let us not throw caution to the wind and take all the possible preventive measures. This is applicable to the stock markets as well. Sensex made headlines a few days back when it hit the magical 50,000 mark. It sure sounds surprising given where economy stands but, is it? We have discussed in our previous letters (here and here) that markets are a lead indicator and there is a lot of liquidity chasing few assets. The corollary being, there is large pool of companies being ignored which is where we like to operate. More on that later.

With Covid vaccination chugging along in the backdrop, the focus has now turned towards the Union Budget. The budget will be amongst the most challenging one till now for the NDA government. As usual, we expect a slew of reforms to be announced, however devil is in details and implementation. As we have seen, any reform is very difficult to implement in our country with plethora of vested interests across the board, farm laws being a recent case in point. There is no doubt about dire need for infrastructure development across the sectors to drive the GDP growth and in turn job creation. The central government has been working on that over past couple of years but much more needs to be done. We expect budget to provide a push in that direction. With the liquidity sloshing in global markets, India would do well to provide investment platforms to attract the low cost funds for infrastructure financing. Ever since the GFC (Global

Financial Crisis) in 2008, central banks across the developed world have been in a stimulus mode. This continued long after the crisis was over. The interest rates were low even before the pandemic. The stimulus and liquidity packages have been taken to a whole new level post pandemic. While the governments across the world struggle to get the economies back to growth, interest rates are expected to remain low for a foreseeable future. Over past decade, large swathes of the monies has been flowing to the technology sector and financial markets. This has starved the asset heavy industries of capital, leading to lack of supply addition. The ESG focus of funds has exacerbated this trend. Given this low interest rate environment and supply constraints, inflationary pressure in commodities is inevitable. As the commodity prices increase and profitability improves, capital will flow to the asset heavy industries. Heavy engineering and capital goods companies will benefit from this turn in cycle. Our new investment is placed very well to benefit from this rising tide.

ISGEC Heavy Engineering Ltd

ISGEC Heavy Engineering Ltd. (formerly known as Indian Sugar and General Engineering Corporation) is a diversified heavy engineering company operating across EPC, Manufacturing and Sugar segments. ISGEC has a strong knowhow of manufacturing of process equipment, mechanical & hydraulic presses, alloy steel & iron castings, boiler tubes & panels, liquefiable gas containers. In EPC segment, ISGEC has established credentials in turnkey execution of projects for setting up boilers, sugar plants & distilleries, bulk material handling, air pollution control equipment, railway & factory buildings, water treatment plants and civil infrastructure for customers in India and abroad. Other than this, ISGEC also operates a sugar mill via its subsidiary, Saraswati Sugar Mills, in Haryana.

Investment rationale:

- Industry tailwinds: ISGEC's orderbook has more than doubled over past few years owing to investments in air quality control systems, ethanol blending, process equipment, railways, water infrastructure, defence and space equipment. The tailwinds are expected to intensify as the government driven capex picks up followed by private capex.
- Operating leverage: Due to lack of meaningful growth and underutilization, ISGEC's margins are at decadal lows. With strong orderbook, the revenues are expected to grow driving non-linear improvement in margins and profitability.
- Strong stewardship: Management has demonstrated ability to grow organically as well as inorganically without taking unwarranted risks. Operational as well as capital allocation skills of the management combined with skin in the game (~62.5% shareholding) makes a very strong partnership case.
- Attractive valuations: At a trailing P/E of ~13.5x and P/B of ~1.4x, the risk reward in massively in our favour. Given the love of market being soaked up by companies with predictable and steadily growing stream of earnings, the likes of ISGEC are being completely ignored.
- Why now: This is best answered by the following write-up by Mr. Howards Marks in his book 'Mastering the Market Cycle: Getting the Odds on Your Side.'
    - *"At Oaktree, we strongly reject the idea of waiting for the bottom to start buying. First, there's absolutely no way to know when the bottom has been reached. There's no neon sign that lights up. The bottom can be recognized only after it has been passed, since it is defined as the day before the recovery begins. By definition, this can be identified only after the fact. And second, it's usually during market slides that you can buy the largest quantities of the thing you want, from sellers who are throwing in the towel and while the non-knife-catchers are hugging the sidelines. But once the slide has culminated in a bottom, by definition there are few sellers left to sell, and during the ensuing rally it's buyers who predominate. Thus the selling dries up and would-be*

buyers face growing competition….Like so many other things in the investment world that might be tried on the basis of certitude and precision, waiting for the bottom to start buying is a great example of folly. So if targeting the bottom is wrong, when should you buy? The answer's simple: when price is below intrinsic value. What if the price continues downward? Buy more, as now it's probably an even greater bargain. All you need for ultimate success in this regard is (a) an estimate of intrinsic value, (b) the emotional fortitude to persevere, and (c) eventually to have your estimate of value proved correct."

Considering the above elements, this is one of the classic contrarian bets with **'Heads I win big, Tails I don't lose much'** characteristic.

Fund Performance

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

Comparative performance of ELHF vs. benchmark indices[1]

	FY 16-17 (20Oct'16)	FY 17-18	FY 18-19	FY 19-20	FY 20-21[2]	Since Inception	Alpha
Equirus Long Horizon Fund	**6.9%**	**36.8%**	**-3.2%**	-26.8%	**131.9%**	**140.1%**	
BSE SMALL CAP	8.1%	17.7%	-11.6%	-36.1%	88.3%	35.5%	104.6%
BSE 200	6.0%	11.0%	10.7%	-26.4%	63.6%	56.9%	83.2%
BSE 100	6.1%	10.6%	12.4%	-26.6%	62.7%	57.5%	82.6%

[1] *Return figures are net of fees and as of 31th Dec' 20. Returns are adjusted for inflows/outflows and are TWRR*

[2] *Year to date performance till 31th Dec' 20*

Current Aggregate Portfolio Characteristics

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

Number of businesses	14 companies
Current cash position	~8.2%
Last 3-year average earnings growth	26.8%
Latest portfolio ROE	19.1%
TTM (trailing twelve month) portfolio PE	17.3x
Acquisition portfolio TTM PE	11.0x
Churn	23% per annum (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). 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

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Returns are net of fees and is calculated as per TWRR. Trading and investment in equities is subject to market risk, there is no assurance or guarantee of the returns, it will be purely a target return rather than guaranteed return. Past performance may or may not be sustained in future and should not be used as basis for comparison with other investments. Performance data provided is not verified by SEBI.