



## Equirus Long Horizon Fund

### Investor Communiqué - Jun'20

We hope you and your family are safe in these trying times.

2020 has been a transformational journey for most of us. This once in a generation sort of event has forced us to revisit a lot of things that we took for granted. The novel coronavirus caught healthcare systems across the globe including in developed countries, completely unprepared. Lockdowns, which were difficult to even imagine, have become common occurrences. The blanket lockdown implemented by Indian government was the strictest among all the affected countries. It might be debatable whether the lockdown was effective in tackling Covid-19, but there is no doubt it has caused enormous economic disruption. While the costs (tangible and intangible) are incalculable, there is a little doubt that India will record a degrowth in GDP. However, much to everyone's surprise, work from home has helped many businesses to chug along decently well.

While economic factors are strange, stock market behaviour (as expected) has been even stranger. During first quarter of 2020, global equity indices witnessed a steep fall to the tune of ~35%, hitting a bottom around March 23, 2020. Oil prices traded in negative territory for the first time ever. In this light, central banks and governments across the world came out with record stimulus packages upto 40% of the GDP. The scale of the response especially in developed countries has been mind-boggling.

At that time, we took a view that valuations were beaten down to unsustainably low levels and it might be a great opportunity to add businesses that we like. To that effect, in our [March letter](#), we encouraged our investors to increase their equity allocations. To be fair, we had no clue that the recovery would be so swift. All the money printed by global central banks found its way in the markets. No prize for guessing, the markets have rallied nearly back to pre-covid levels and some more. It is important not to forget, all this has happened while no



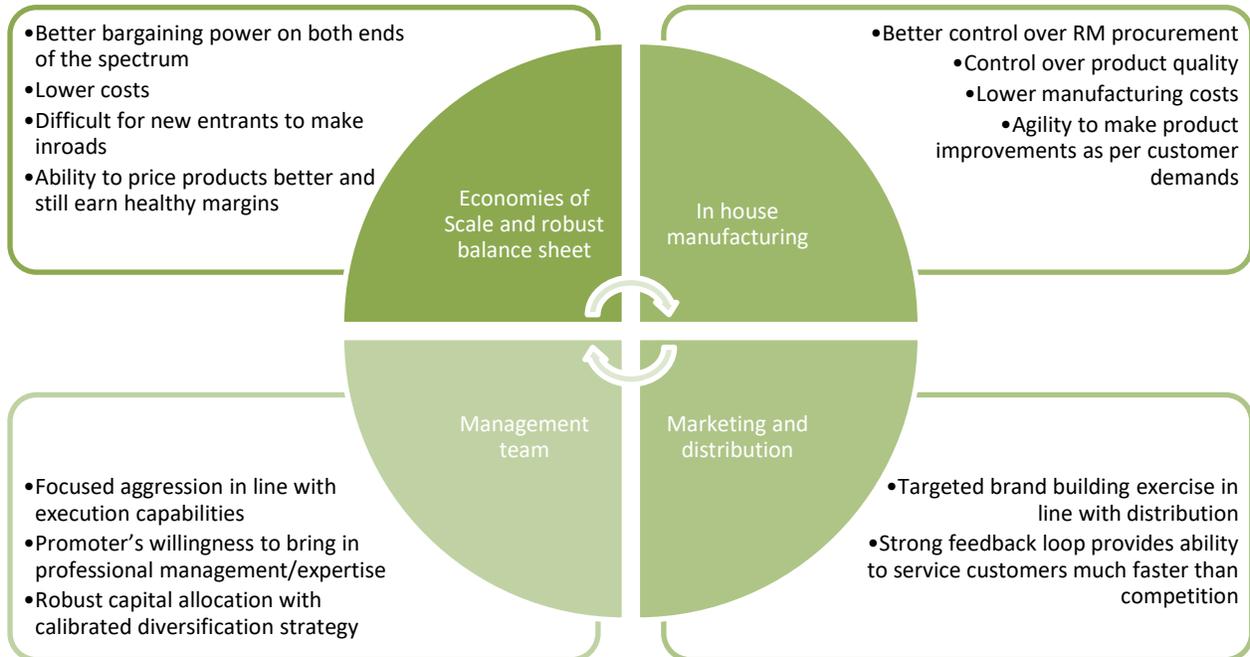
cures/vaccines for Covid-19 are out yet, the economies are still stuttering to say the least and uncertainties (US election, China's antics, etc.) are still abound.

From an India perspective, Covid-19 has also brought about a ray of hope. The 'Make in India' campaign and got a new name called 'Atmanirbhar Bharat' and probably a stronger resolve from the Govt.. Many important reforms have been brought about. Some important ones being in agriculture, electronics manufacturing, and coal mining. However, many more are needed especially land and labour related to remove barriers to doing business and unleash manufacturing potential of India. Anti-China sentiment pervading across the globe and in India, is a huge opportunity that has been handed to us on a platter. If we play our cards well, the next decade will no doubt belong to India. On that positive note, let us discuss our investment in a world class manufacturing business that is truly Atmanirbhar.

## Polycab Industries Ltd

Incorporated on January 10, 1996, Polycab India Limited ("Polycab") is engaged in the business of manufacturing and selling Wires and Cables (W&C) and Fast Moving Electrical Goods ("FMEG") under the "POLYCAB" brand. The actual business was started by promoters in 1964 with the setting up of an electrical store under the name Sind Electric Stores. From that humble beginning Polycab has morphed into a market leader in the domestic wires and cables segment with ~12% market share. With 25 manufacturing facilities in 7 locations and substantial degree of backward integration Polycab qualifies to be posterboy of Atmanirbhar Bharat campaign. It has a comprehensive product portfolio (including consumer-facing electricals), strong brand positioning (quality and availability), robust distribution network (3500+ dealer/distributors, 1.25 lac+ retail outlets) and experienced management (mix of professionals and promoters).

## Competitive advantages:



## Investment Thesis:

As, most of you are aware, our investment strategy is to invest in Small and mid-cap companies:

- Which are among the market leaders in their sectors/niches
- Have strong balance sheets and return ratios with growing earnings
- Have track record of management integrity and competence
- Are available at attractive valuations

Let us explore how Polycab fits into this strategy.

## Market leadership:

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Polycab is an undisputed market leader with ~12% overall market share and 18% share among organized players in W&C industry. Polycab's W&C business is larger than that of Havells and Finolex combined!

## **Balance sheet and return ratios:**

Over the past 5 years, Polycab has seen substantial improvement in its return ratios (RoCE improved by ~1000 bps to ~26%) primarily led by improvement in operating margins (EBITDA margin improved by ~350 bps to ~13%). This has led to Polycab becoming FCF (Free cash flow) positive despite a large capex program to increase capacities and capabilities. With IPO funds and financial performance, Polycab now enjoys a net cash balance sheet which positions it well to capitalize on future growth opportunities.

## **Track record:**

Since setting up of the first manufacturing facility at Halol, Gujarat in 1983, Polycab has never looked back. After touching Rs. 10 bn mark in 2006, has continued its growth path to almost ~Rs. 88 bn as of fiscal 2019-20 which translates to almost 9 times in just 14 years. All this has happened while growing profit margins as well as improving its balance sheet. This clearly demonstrates competence and prudent aggression of the management. Additionally, with the market expected to grow at ~10-12% cagr for many years to come, there is huge opportunity for Polycab to exploit.

## **Optionality:**

Fast Moving Electrical Goods (FMEG) business focusing on fans, switchgear, lighting, etc. was launched in fiscal 2015-16. Since then it has



scaled up to ~Rs. 8.5 bn as of last fiscal. The revenues should continue to grow at a robust pace for at least a few more years given the size of opportunity and demonstrated execution capabilities. Being in investing phase, the business is just breaking even. As the scale builds up, the operating leverage will kick in and profits will substantially outpace revenue growth. Companies like Havells with large FMEG businesses, trade at a much higher valuations. Hence, FMEG business carries both earnings growth and multiple rerating potential.

## Valuation

At a market cap of ~Rs. 125 bn, we get a market leader with strong competitive advantages, a long runway for growth and balance sheet to support it, competent management team with skin in the game and extremely attractive valuation of 17.0x PE on FY20 earnings. While FY21 might be a washout year, at this valuation, there is a big margin of safety built in the price making it a juicy half volley (in cricket parlance) in the long term. As some keen observers might have noticed in their monthly reports, our conviction in this idea is also backed by chunky allocation.

## New Product Launch – Equirus Multicap Fund

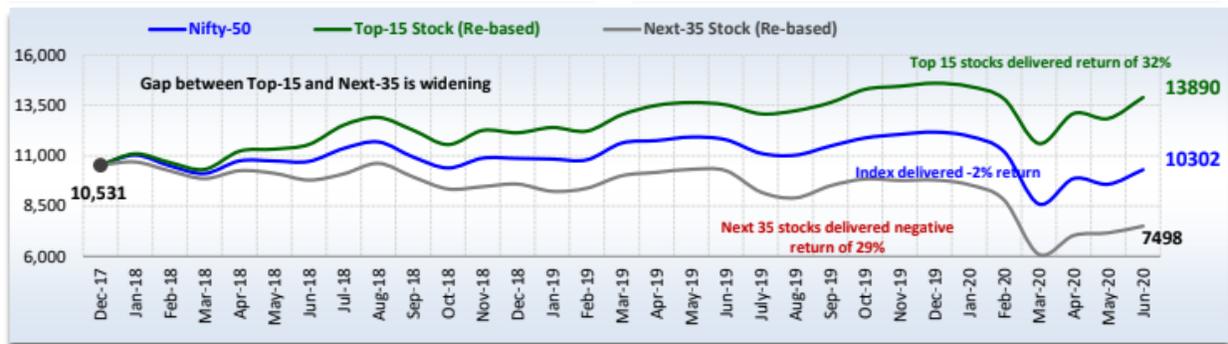
Equirus Long Horizon Fund (ELHF) was launched in October 2016, with an idea to capitalize on market inefficiencies existing in small and midcap space and in the process, earn healthy risk adjusted returns for our investors. Since the launch, we have gone through a bull market (till Jan 2018) and then a long correction. From being most loved to being the most hated segment, small and midcaps have had a big roller coaster ride in the past few years. Through this cycle, we have not swayed away from our investment strategy. Operating in this small and volatile yet rewarding

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space has worked out well for us and our investors as is evident from our performance.

With this premise, we have come to believe that similar inefficiencies exist even in larger companies. This can be clearly seen from the chart below. The top 15 stocks have been the major driver of the Index while rest 35 have been laggards. This not only is Nifty's tale but also valid across the board.



Source: Motilal Oswal

To take advantage of this dislocation, we are launching **Equirus Multicap Fund** with primary focus on large cap companies. The key advantages of this fund will be the scalability without diluting returns and lower volatility. While the basic tenets of our investing strategy will hold true, we will additionally focus on value and mean reversion theme for this fund. Below is a brief comparison of salient features of the Multicap fund and ELHF.

Attributes	MultiCap Fund	Long Horizon Fund
Market Cap	Large cap and Midcaps	Small and Mid Caps
Allocation	<ul style="list-style-type: none"> <li>- LargeCap: 65-100%</li> <li>- MidCap: 0-35%</li> </ul>	- Small + Midcap: 0-100%
Volatility	Low	High

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<b>Investment philosophy</b>	<ul style="list-style-type: none"> <li>- <b>Value focus</b></li> <li>- Robust balance sheet</li> <li>- Strong track record of management integrity</li> <li>- <b>High Mean reversion</b> probability in earnings and valuations</li> <li>- Allocation materially different from headline indices</li> </ul>	<ul style="list-style-type: none"> <li>- Market leader in their niches</li> <li>- Strong balance sheet with low or no debt</li> <li>- Robust growth prospects</li> <li>- Strong track record of management integrity</li> </ul>
<b>Concentration</b>	15 - 20 names	10 - 15 names
<b>Investment horizon</b>	3-5 years	3-5 years
<b>Benchmark</b>	Nifty/Sensex/BSE100	BSE Smallcap
<b>Client expectations</b>	<ul style="list-style-type: none"> <li>- Long term bet in India story with returns better than headline indices</li> <li>- Low volatility</li> </ul>	<ul style="list-style-type: none"> <li>- Long term bet on Indian entrepreneurs with ability to generate high alpha</li> <li>- Volatility higher than headline indices</li> </ul>

The fee structure will remain the same as ELHF.

Please feel free to get in touch with us for any queries you may have.

## Fund Performance

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

### Comparative performance of ELHF – First Partner vs. benchmark indices<sup>1</sup>

	FY 16-17 (20 Oct'16)	FY 17-18	FY 18-19	FY 19-20	FY 20-21 <sup>3</sup>	Since inception <sup>4</sup>
<b>ELHF - First Partner<sup>2</sup></b>	<b>7.8%</b>	<b>38.9%</b>	<b>-4.2%</b>	<b>-25.4%</b>	<b>39.6%</b>	<b>50.5%</b>
BSE SMALL CAP	11.4%	17.4%	-11.6%	-36.3%	30.2%	-3.0%
BSE 200	8.5%	11.0%	10.7%	-26.1%	25.1%	23.2%
BSE 100	8.4%	10.6%	12.5%	-26.1%	24.7%	24.3%

### Comparative performance of ELHF vs. benchmark indices<sup>1</sup>

	FY 16-17 (20 Oct'16)	FY 17-18	FY 18-19	FY 19-20	FY 20-21 <sup>3</sup>	Since inception <sup>4</sup>
<b>Equirus Long Horizon Fund</b>	<b>9.8%</b>	<b>29.4%</b>	<b>-4.1%</b>	<b>-34.9%</b>	<b>37.2%</b>	<b>20.7%</b>
BSE SMALL CAP	15.5%	11.9%	-12.2%	-43.7%	30.2%	-25.3%
BSE 200	11.4%	7.6%	10.3%	-33.8%	25.0%	0.2%
BSE 100	11.2%	7.2%	12.1%	-34.0%	24.7%	0.5%

## Current Aggregate Portfolio Characteristics

<sup>1</sup>Return figures are net of fees and as of 30<sup>th</sup> Jun' 20. Returns are adjusted for inflows/outflows and are TWRR

<sup>2</sup>ELHF-First Partner is the portfolio of first investor in the fund

<sup>3</sup>Year to date performance till 30<sup>th</sup> Jun' 20

<sup>4</sup>Inception date: October 20, 2016

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

Number of businesses	15 companies
Current cash position	~3.5%
Last 3-year average earnings growth*	27.2%
Latest portfolio ROE*	22.3%
TTM (trailing twelve month) portfolio PE*	13.4x
Acquisition portfolio TTM PE*	11.2x
Churn	18.7% per annum (excluding the buying/selling of Liquid Mutual Funds, stocks given to us by our investors and capital redemption by investors).

\* FY20 results for 2 companies still awaited as of July 14, 2020

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](mailto: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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