Equirus Long Horizon Fund
Investor Communiqué – Jun'22

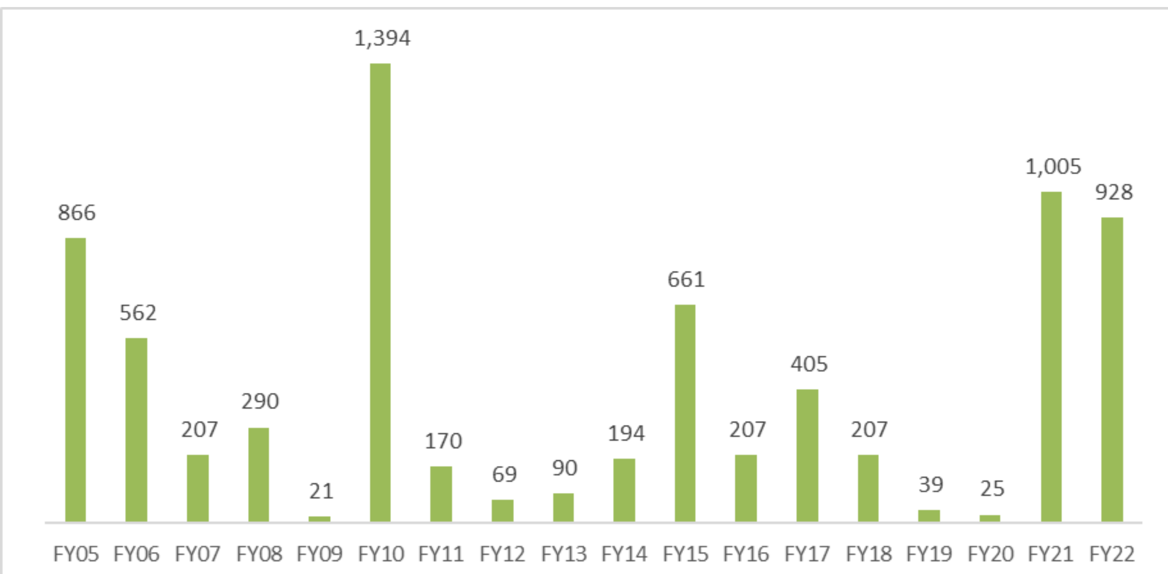
Dear Investor,

In investing, we rarely have dull times. As soon as, complacency starts creeping in, market inevitably figures out a way of shaking one out of that feeling. Things were going on smooth till the last quarter when markets entered a correction mode suddenly. No one could have guessed, the swift change in narrative from 'nothing can go wrong' to 'we are doomed'. Global policy makers including central bankers were caught completely off the guard. They were quick to move from 'no inflation' to 'transitory inflation' to 'sticky inflation'. Consequently, the liquidity dried up like a puddle of water in Saharan heat. Cash guzzling and high-flying tech stocks were the first to get hit as the funding environment changed colours. The focus of global investors shifted from growth to profitability resulting in Nasdaq correcting ~33% on a year-to-date basis. Global indices also corrected in tandem, though the drawdown was much lesser. Even the commodities which had done well in past couple of years have changed course in last few weeks. The fear of supply constraints due to war drove commodities ranging from agri to metals to stratosphere. That fear has morphed into a fear of slowing demand due to expected recession in US, EU as well as China's covid restrictions bringing the commodities nearly back to the ground (as of now!).

On the domestic front, RBI surprised everyone with surprise (out of cycle) rate hike to control inflation. Government chipped in with increased taxes and duties on steel, iron ore, gold and oil producers and refiners, to reign in the runaway prices, curb imports and increase tax receipts. Though INR has touched a low of 80 vs USD, it has been one of the outperformers against other currencies. India seems to be on a strong footing in terms of most economic factors. As indicated in the past, we see a very bright future for Indian economy and markets over coming years/decades. We also believe the only way to make long term wealth is being an eternal optimist (which we whole heartedly are).

What we have discussed here is only a small set of variables affecting the markets. One can only imagine the number of variables/factors affecting markets. In our humble opinion, it is humanly impossible to make sense of all these variables and come up with actionable ideas. It most certainly lies outside our circle of competence. We are extremely single-minded simple humans with average IQ. Our core competency lies in avoiding complex decision making rather than taking one. Hence, we like to keep our investments simple. Lesser the variables, better it is for us and our investment results.

As you would already know, we do not rely on or even think about the index levels for making investment decisions. Our belief is that, in all the market conditions there are stocks that one can invest in and make reasonable returns in the long run. The following graph shows the data of number of BSE listed companies doubling during each financial year.



Source: Ace Equity

The data clearly shows, that even during the difficult times of Lehman crisis and Covid crash, there were several companies that did substantially well. This clearly implies that while stocks respond to market ups and downs the ultimate driver of a stock performance is the underlying fundamentals. Thus, in line with our philosophy of keeping investing simple, we made one such investment, not factoring in index levels.

Vadilal Industries Ltd.

Mr. Vadilal Gandhi started an ice cream business more than a century back in 1907. VIL now manufactures and markets more than 150 flavours across 23 states in India. It has two manufacturing facilities in Gujarat and UP with combined capacity of 350 KL per day. VIL also has a processed foods facility in Gujarat primarily for exports. VIL continues to be a promoter led business managed by 3rd and 4th generation. Promoters hold ~65% of the company.

Ice cream and frozen desserts (IC&FD) contributes 90% of the revenues and rest comes from processed food business (PF). Last year domestic and exports contributed 50% each.

Investment Rationale

Mean reversion in domestic:

- IC&FD is largely a seasonal business in India with substantial revenues coming during the summer season. Summers sales in 2020 and 2021 were affected by Covid. 2022 has seen first normal summer in last 3 years for VIL. We expect IC&FD business to do extremely well aided by a very hot summer and pent-up demand. Having said that, barring 2 covid years, the industry has been growing at a very healthy rate. Hence, we expect, VIL to grow in line with the industry and maintaining market share. Two bad years owing to covid, led to decrease in competition especially in the North and Central India which contributes to ~40-45% sales for VIL. West also contributes ~40-45% of sales and East makes up the rest. VIL has recently launched its products in South, which should help drive growth going forward. With industry expected to grow north of 8%, and share of organized players increasing, VIL should be able to better this growth rate in the years to come.

Turnaround in exports:

- While VIL exports to 45 countries, US at 80% (40% of overall sales) makes up the lion's share of the exports. VIL has been developing US markets for more than a decade. However, the fruits of the labour only started bearing around 2016 when the sales started gaining traction. With barely USD 1 mn sales and negligible profits in FY16, sales shot up to USD 25 mn and high double-digit margins. Its products are on the shelves of 2000 stores across 47 states catering largely to the Indian diaspora. Realization and margin in export business is much better than domestic business further aided by ~10% export incentives. We expect the sales momentum to build further and the share of exports to increase over the years. This should result in overall margin improvement as well.

Favourable Valuation

- Given the strong balance sheet, growth prospects and the profitability parameters, VIL trades at a much cheaper valuations compared to peers. At 1.3x enterprise value/sales (at the time of buying), VIL is much cheaper than its peers in the trading >3x. Part of the reason for cheaper valuations was the market perception about sales growth being low vis a vis industry growth. A deeper look revealed a flourishing export business not getting it share of recognition from market participants and should be the main value driver going forward. Also, now that exports business is stable, management can focus much more on the domestic business growth. All the factors made it a re-rating candidate. We get a shot at earnings growth as well as multiple rerating both of which has started since we first bought.

No investment thesis is complete without accounting for risks. There risks here are feud between promoter families, roll back of export incentives (~3% of export revenues), regulatory risks in especially in US, Raw material price volatility and loss of market share due to aggressive competition. Having understood the risk profile, we believe VIL offers a compelling risk reward profile where 'heads we win, tails we don't lose much', just the way we like it.

Fund Performance

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

Comparative performance of ELHF vs. benchmark indices[1]

	FY 16-17 (20Oct'16)	FY 18	FY 19	FY 20	FY 21	FY22	FYTD 23[2]	Since Inception (Absolute)	Alpha	Since Inception (CAGR)
ELHF	**6.9%**	**36.8%**	**-3.2%**	**-26.8%**	**144.2%**	**39.9%**	**-15%**	**200.8%**		**21.3%**
BSE SMALL CAP	8.1%	17.7%	-11.6%	-36.1%	114.9%	36.6%	**-12.2%**	85.6%	115.2%	11.5%
BSE 200	6.0%	11.0%	10.7%	-26.4%	74.3%	19.9%	**-9.7%**	80.9%	119.9%	11.0%
BSE 100	6.1%	10.6%	12.4%	-26.6%	71.5%	19.2%	**-9.6%**	78.9%	121.9%	10.8%

[1] *Return figures are net of fees and as of 30th June 2022. Returns are adjusted for inflows/outflows and are TWRR*

[2] *Year to date performance till 30th June 2022.*

Current Aggregate Portfolio Characteristics

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

Number of businesses	16 companies
Current cash position	~17.5%
Last 3-year average earnings growth	11.5%
Latest portfolio ROE	10.1%
TTM (trailing twelve month) portfolio PE	21.1x
Acquisition portfolio TTM PE	15.8x
Churn	19% 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 contact 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.