9 April 2021

Dear Partners:

In this letter, we share

Key messages

- We continue to perform well in both absolute and relative terms. Our outperformance over NSE 500 over last 5 years is ~7.2% per annum, well above our 3% per annum goal.
- We seek long term compounding preferring sustainability of returns over speed. We are not looking for stocks that will move the fastest over the short term. The portfolio is invested in companies which are expected to benefit from secular and enduring tail winds supporting growth, backed by disciplined management teams.
- Growth outlook for the World and India remains strong. Aggregate valuations are higher vs history but should be seen in the context of expectations of strong earnings growth post the earnings drought of the past few years, lower bond yields and easy monetary policy. Valuation multiples may gradually decline over time. However, over 5 year horizons, the compounding power of Equities through earnings growth should result in reasonable outcomes.
- A steep rise in interest rates and lock downs due to rising Covid cases are known risks. However, returns will be influenced by other risks and tail winds that are not obvious at present. The biggest risk of 2020 was a virus that no one had considered in 2019. The biggest tail wind was the scale of global stimulus. One should not worry about a storm whose timing and severity are conjecture but focus on what one can control: keep long time horizons, ensure one is on sturdy boats, don't overpay, and be willing to course correct as facts change. This approach automatically negates a large portion of risks.
- The scale of global fiscal and monetary stimulus, backed by new economic ideologies, means tail risks of high inflation down the road. However great minds are divided on this issue. Our best defence, other than owning high quality businesses with reasonable pricing power, is an exposure to hard assets such as Gold.
- We are wiser from our mistakes – principally wrong position sizing and trimming a few positions too early.
- We intend to grow our franchise in a disciplined manner balancing our desire for growth with ability to serve existing partners well. We now manage ~840 Cr across 86 families with 31 new families signing up in FY 21.

Important Disclosures

- We construct customised portfolios based on valuations at point of entry and cash available for deployment. Hence, all positions may not be held in your account.
- Performance in individual accounts may vary from aggregate performance shared above.
- We disclose position names for transparency and context. We reserve the right to change our minds and may not be in a position to inform you if we do.

Performance update

For Anchor partner					Since PMS License (Aggregate across all accounts)				
DATE	NIFTY	NIFTY500	SOLIDARITY	Alpha	DATE	NIFTY	NIFTY500	SOLIDARITY	Alpha
FY15	26.8%	32.6%	67.2%	34.6%					
FY16	-9.9%	-8.6%	-0.1%	8.5%					
FY17	18.9%	24.0%	22.4%	-1.6%	FY17 (part year)	16.3%	20.8%	18.0%	-2.9%
FY18	10.2%	11.5%	18.4%	7.0%	FY18	10.2%	11.5%	19.2%	7.8%
FY19	14.9%	8.4%	6.0%	-2.5%	FY19	14.9%	8.4%	6.8%	-1.6%
FY20	-26.3%	-27.9%	-14.9%	13.0%	FY20	-26.3%	-27.9%	-15.4%	12.5%
FY21	70.9%	76.0%	90.6%	14.6%	FY21	70.9%	76.0%	98.4%	22.4%
Cumulative TWRR	**12.0%**	**13.1%**	**22.5%**	**9.5%**	**Cumulative TWRR**	**13.6%**	**13.5%**	**20.8%**	**7.2%**

Note: We operated with an Investment Advisory license till 11 May 2016 post which we migrated to a PMS License
Solidarity performance is post fees
Alpha: Solidarity performance over Nifty 500
Data for FY21 updated till 31 Mar 21

Performance (in TWRR)	1 Year	2 Year	3 Year	5 Year	Since Inception
Anchor partner	90.6%	26.1%	18.3%	19.5%	**22.5%**
NIFTY	70.9%	12.4%	13.2%	13.7%	**12.0%**
NIFTY 500	76.0%	12.9%	11.4%	13.8%	**13.1%**

Performance (in TWRR)	1 Year	2 Year	3 Year	5 Year^	Since Inception
Aggregate across all accounts	98.4%	29.4%	21.4%	20.8%	**20.8%**
NIFTY	70.9%	12.4%	13.3%	13.5%	**13.6%**
NIFTY 500	76.0%	12.9%	11.4%	13.6%	**13.5%**

^ 4 years, 10 months

Since inception

- We have registered 22.5% per annum Time Weighted Rate of Return or TWRR[1] post fees for our anchor partner since inception (~ 7 years) which is 9.5% per annum over NSE 500.

Rolling 5 year basis, our recommended time horizon

- Aggregate performance is TWRR per annum of 20.8% which is ~7.2% per annum over NSE 500.
- This implies absolute returns ~40% over an Index fund.
- The past 5 years have been a tough period for Indian equities. The above performance gives us confidence that our process works during tough market conditions.

Year gone by, FY 21

- Aggregate performance is TWRR of 98.4% which is 22.4% above NSE 500.
- Returns were well distributed and not skewed by a few winners.

[1] TWRR is the SEBI mandated approach for reporting returns. Read more about TWRR and how it is calculated at https://www.investopedia.com/terms/t/time-weightedror.asp

Portfolio construction approach

We aim to achieve high probability compounding over the long term with prudent risk taking. Long term investing is akin to navigating a sail boat on stormy seas, not on a placid lake. We don't know from where surprises will come. Hence, we don't attempt to invest in companies who may move fastest in the short term but rather invest in those that offer more sustainable returns over the long term as they are resilient during the inevitable storm. We are disciplined on entry valuations – "don't time the market" does not mean buy at any price.

Equities are long duration assets. So one must invest in them keeping long time horizons. We do not attempt to protect portfolios from short term draw-downs to seek emotional relief. We cannot gauge when a correction will commence, how shallow or deep it will be, or when it will end. However, we are allocators of finite capital and hence believe in trimming positions when valuations get euphoric to re-allocate to other names which offer better value. Our focus on risk implies that while our approach works well over long time horizons, it may underperform during euphoric periods when risk is an afterthought.

Some of our peers are successful using other approaches. There is no one right way and investing should not be seen as a competitive sport. Every approach needs to be viewed in the context of goals, time horizons, trade-offs (upside maximisation vs chances of ruin, short term downside protection vs impact on long term returns) and ability to stay the course during a crisis. We are not rigid in our ideologies of what is a good/bad investment (other than clear red lines on governance and leverage) and our thought process will evolve as we learn from others and through our experiences. However, our core principles and our long term lens for decision making are unlikely to change.

Rationale underlying our portfolio choices

Geopolitical developments, Covid-19 induced trends and evolution of digital technologies are resulting in new winners and losers. Our approach is to organise the portfolio around enduring themes that provide visibility for long term secular growth with low risk for disruption.

We share a few secular trends that we believe will shape the world and offer opportunity/risks

- Working from home is being embraced with vigour by corporates. Implications for long term demand for commercial real estate, hotels and business travel.
- More awareness of one's mortality reflected in rise in enquiries for Health and Life Insurance.
- Resilience in supply chains ("just in case") becoming as important as cost and "just in time". De risking and re-shoring expected in many products.
- Escalating tensions between China and many countries as China aims for geopolitical dominance. Businesses will look to aggressively "de-risk" supply chains from China.
- Governments all over the world, including India, are becoming more protectionist. Implications for global supply chain models relying principally on a cost edge. As a corollary, they will create opportunities for import substitution.
- Rise of digitally enabled "Ed Tech", "Fin Tech", "Food Tech", "Health Tech" and "Direct to Consumer" brands. While we may scratch our heads with bemusement at their valuations and cash burn, we can't ignore the fact that they are well funded and will attack incumbent's market share, margins and ability to attract talent. It may interest partners to note that over 90% of all advertisers in the IPL at present are Digital companies.
- Increasing adoption/experimentation with technologies such as Block chain. The first regulator approved equity trades using Block chain were settled in the US last week which cut the process to a few hours from 2 days.
- Increase in IT spending and automation as Corporates prepare more aggressively for a Digital world with implications for productivity/margins and stress on job creation.

- Rising formalisation of the economy and consolidation across industries. The big are getting bigger. Odds increasingly stacked against small players unless they dominate niches.
- Environmental, Social and Governance (ESG) risks are becoming mainstream. Climate change warnings are being taken more seriously, businesses are under pressure to be more conscious on the social impact of their actions. Rising threat of EVs/Clean Energy to ICE/Thermal with threat of new winners emerging and incumbents facing rapidly declining Terminal Value.
- More development spending and political polarisation as the pandemic worsens inequality.
- Potential epidemic of mental health.
- Governments willing to question historical economic beliefs and bear higher deficits to be funded through borrowing/monetisation to support growth with implications for longer term inflation and other tail risks.

~80% of our portfolio is invested in the following 4 themes

- Indian cos that have an opportunity to gain market share in global supply chains.
- Digital business models and enablers of Digital technologies.
- Strong and well run banks and NBFCs gaining market share from lower rated peers and Public Sector Banks.
- Private Life Insurance companies with trusted brands and strong distribution.

The balance is invested in

- Companies that will benefit from actions to mitigate inequality.
- Those benefitting from increased formalisation of the economy, financialisation of savings.
- Discretionary consumption.

<u>The largest allocation is in "Indian cos. with opportunity to gain market share in global supply chains".</u>
The world is getting increasingly worried by China's growing dominance and its narrowing technology/innovation gap with the West, while global supply chains remain deeply reliant on China. Rhetoric has recently escalated with concerns that China may invade Taiwan[2] and China cracking down on Western companies that take a stance on China's human rights violations. There is a vast opportunity for Indian companies to gain global market share in knowledge intensive sectors such as Specialty Chemicals, Technical Textiles and Auto Components. The Indian Specialty Chemical story has a long run way for growth both due to the growth opportunity and because India has a sustainable and growing competitive edge. India has 3% global market share vs 35% for China in Specialty Chemicals. We believe Specialty Chemical companies can grow PAT 8-10x in the next 10 years and migrate to higher ROCEs through a combination of downstream migration (more value added products) and process engineering. The industry is at an inflection point where IT and Pharma were 2 decades ago.

<u>The second largest allocation is to strong and well run Banks and NBFCs</u>
Banks enjoy natural tail winds by serving a growing economy's need for Credit. Well run Banks are strengthening their market share of incremental low cost deposits and credit even as they remain well capitalised. Credit market share and fee incomes will be under attack by Fin Tech business models[3]. However, trust and a low cost deposit base is at the heart of competitive advantage in Banking – both take enormous time to build. Additionally, India has always had a very conservative approach to regulation and with recent bank collapses that is unlikely to change. There is additionally more demand on regulation for large tech companies. Hence, our hypothesis is that Fin Tech's will more

[2] https://www.ft.com/content/add28567-ae9d-4743-9fe6-683ea4b584ad
[3] https://www.nytimes.com/2021/03/29/technology/fintech-startups-wall-street.html

likely partner or get acquired by Banks rather than disrupt them. Banks are also aggressively embracing Digital (eg Kotak 811 Digital bank account) which will enable them to reduce costs to counter margin pressure and hence continue to grow while maintaining ROEs in the range of 15-18%. However, we are adjusting for these risks by gradually lowering the valuation multiple one is willing to ascribe. We will constantly monitor the disruptive threat of Fin Tech's and the ability of Banks to defend their competitive positions and margins.

<u>Our third largest allocation is to Life Insurance cos.</u>
Under ownership of Term Insurance, greater awareness for the need to protect families, need for retirement products, "S" curve demand effects, low share of protection in current product mix, strong moats in brands and distribution presents a 15-20%+ annualised growth opportunity for over a decade for leading companies. Regulatory moats, long duration contracts where trust in the brand is paramount, means Fin Techs will find this domain harder to challenge than General Insurance.

<u>Our fourth largest allocation is to Digital and digital enablers</u>
High speed access to the Internet and Covid 19 has accelerated Digital transformation resulting in a boost to companies with purely Digital business models and an explosion in consumption of Data. Telcos will leverage their customer base and data to develop Digital revenue streams (music, shopping, gaming, advertising) and business productivity solutions (cloud, SAAS for SMEs, cyber security). This will be a theme of significant interest as more digital business models get listed.

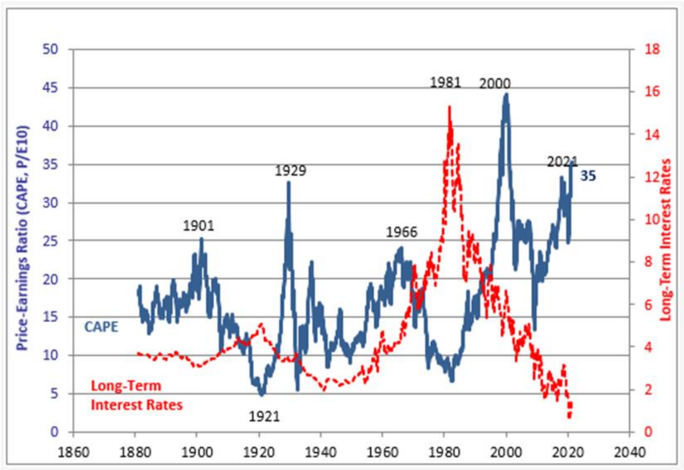
We enclose the Investment rationale and financials of our positions in the Appendix document appended to this note.

Outlook and <u>known</u> risks
Growth rates are clearly looking up with the US undergoing a massive USD 1.9 Trillion stimulus which will boost the growth rate of the US economy to a higher glide path compared to pre-Covid levels. This, at a time in the US when vaccines are being rapidly rolled out, lock downs end, consumer savings have risen over last year and even more stimulus is on its way - another USD 2+ Trillion stimulus to boost Infrastructure is already being planned. The US plan to borrow and spend is unprecedented and nothing has been done at this scale since World War 2. Rising inequality is becoming a greater challenge and the US Govt is prepared to challenge traditional thought process on money printing and risk higher inflation down the road to address a pressing problem today. This stimulus will also support growth indirectly in other parts of the world through trade linkages.

India has also embarked on a more expansive economic policy and is willing to bear higher fiscal deficits to boost growth by stepping up investments in Infrastructure. Whatever your political beliefs, one cannot deny the emerging narrative of a more confident India, willing to make bolder political and economic choices.

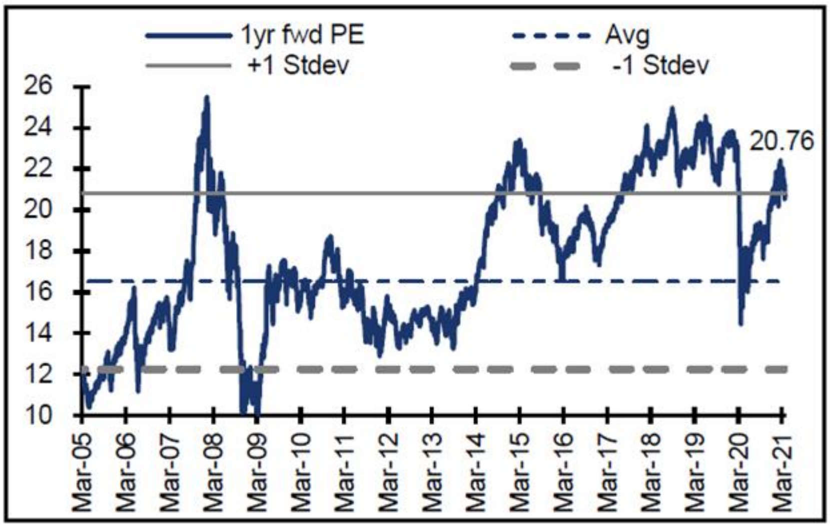
Valuations in the US market[4] (Blue line) are as high as they have ever been, other than the Dotcom Boom of 2000, even when the pandemic is far from over.

[4] Source: John Authers, Bloomberg



And there is a great deal of speculation at present. A survey by Deutsche Bank suggests that half of all US investors aged 25-34 with a brokerage account will put half of whatever they receive from the upcoming stimulus package in the stock market[5]. Bitcoin is up ~5X this year even as its scarcity premium[6], role in money laundering and energy consumption is being called into question. And one can see mind numbing prices for "Non Fungible Tokens" or cyber collectibles.

Head line Index valuations in India (see chart[7] below) are also very high at present vs history but not in dangerous territory. Valuations need to be interpreted in the context of lower bond yields, easy monetary conditions and expectations of rapid EPS growth over next few years. <u>However, markets are a bit ahead of Earnings at present and a time correction will be healthy.</u>



Great thinkers are deeply divided on whether the fiscal and monetary experimentation by Governments has risks of high inflation and interest rates down the road. On the one hand, massive monetary stimulation since 2008, and the monetisation of deficits[8] policy of Japan has not resulted in inflation as was widely feared. On the other, inflation is an outcome of higher demand chasing a finite supply of goods/services and the scale of stimulus being provided to a recovering US economy "risks inflationary pressures one has not seen in a generation[9]".

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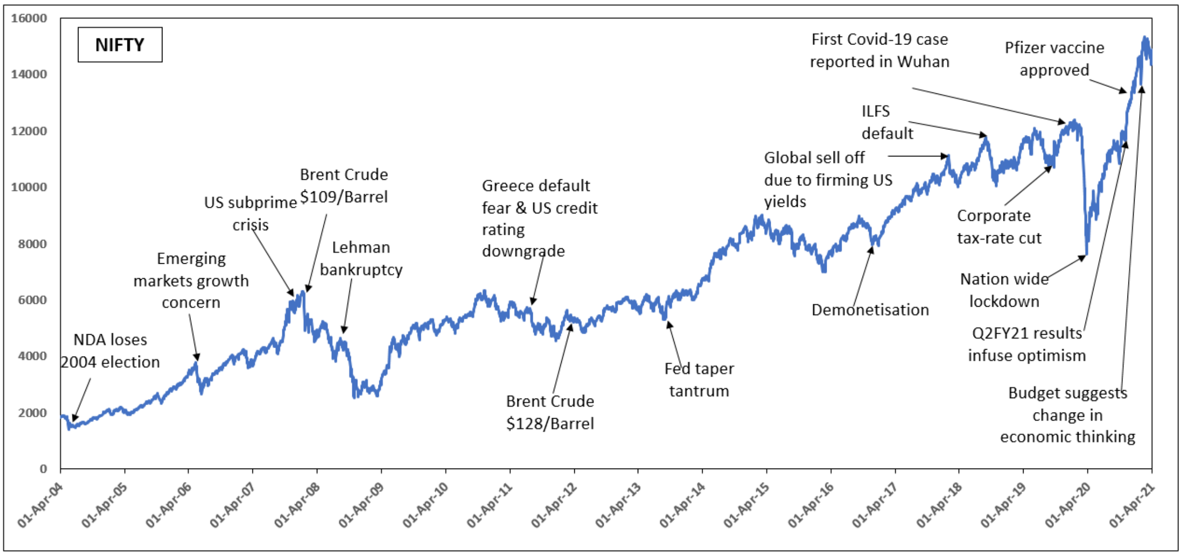
[5] Source: Financial Times
[6] Many Central Banks are exploring their own Digital currency
[7] Source: ICICI Securities
[8] The Central Bank prints money to finance Government deficits
[9] Lawrence Summers, Former US Treasury Secretary

Implications for portfolio construction

Rising inflation, higher interest rates and a larger economy wide lock down due to rising Covid cases are known risks. A steep rise in interest rates and inflation will certainly be negative for Equities. However, a gradual rise need not be negative as rise in interest rates can also reflect stronger growth. Fair value is a function of growth and cost of capital. While we see a recent resurgence of Covid cases, we believe a large scale lock down of the economy is a low probability event. While Governments' may consider localised lock downs to balance load on medical infrastructure, one needs to balance lives and livelihoods. At present death rates are under control, vaccines are being rolled out and we have more experience of treatment protocols.

If one is taking a long term view, as we are, one should not worry about a storm whose timing and severity are conjecture but focus on what we can control – have long time horizons, ensure we are on sturdy boats, don't significantly overpay, be comfortable holding cash when opportunities are not available and be willing to course correct as facts change. Returns in equities are non-linear and one can witness sharp draw-downs any time. The draw-downs should not matter if one believes that the portfolios could be significantly higher at the end of 5 years compared to today.

A mistake investors make is to protect short term downsides when confronted by an unforeseen situation by taking cash calls. There are other unknown risks and tail winds which are not evident at present, but which will influence eventual stock price outcomes. The biggest risk in 2020 was Covid which no one considered in 2019. But the scale of stimulus by Governments/central banks could not be imagined at the start of 2020. Secondly, we underestimate the ability of strong companies to gain market share during tough conditions. Cash calls – ostensibly to manage risk – actually only serve to provide emotional relief and to convince oneself that one has "done something". However, if one has bought resilient companies, short term relief dents longer term returns as one gets re-entry wrong. Ironically, it takes more effort to not do anything but just wait out the storm. The chart below shows that it pays to stay invested. It may interest partners to note that the market bottomed on 23 Mar 2020, the day the nation-wide lock down was announced. One should manage risks through Asset Allocation and buying companies with resilience, not through cash calls.



Given high starting valuations vs historical averages, it would be fair to assume that the Index valuation multiple will decline from current levels over time as mean reversion kicks in. Even then, over the next 5 years, Index returns should handsomely beat Bonds (see table below) as the compounding power of Earnings/Cash flow growth will dominate the dampening effect of valuation decline. Long term Bonds offer very poor prospects relative even to inflation both due to low yields and negative impact on principal as interest rates rise. Equities can do even better if earnings growth rates surprise.

5 yr Index IRR estimates under valuation decline scenarios				
EPS Compounding		***13%***	***15%***	***20%***
Multiple decline	***-10%***	10.2%	12.6%	17.5%
	-20%	7.6%	10.0%	14.8%
	-30%	4.8%	7.1%	11.7%

One can create alpha[10] by being disciplined on entry prices and concentrating portfolios where growth and valuations are both in favour. You may observe high weights in some names we own at present, for example Bharti Airtel and ICICI Pru Life Insurance.

One needs to beware investing in "quality" companies that are relative more mature on the industry life cycle, yet trade at very high valuation multiples. It is tempting to invest in these companies because they have done well over last few years. When things are good, we forget that almost everything in life is cyclical and what seems comfortable is seldom lucrative. Many such companies have benefitted from significant PE re-rating over the last few years unsupported by change in their fundamental attractiveness due to higher trend growth rates or higher ROCEs. Our hypothesis is that their PE re-rating has been influenced by low bond yields and earnings drought in the broader market, both of which should reverse in the next few years. If one is willing to pay or stay invested in high multiple companies, one must be convinced that there is a period of very high earnings growth ahead or take decadal views. These should be exceptions rather than the rule.

Plan for tail risk. The world is in the midst of a great economic experimentation. We should be prepared for low probability, but very damaging outcomes. It will be hard for Governments' to stop being populist if that will affect your chances to be re-elected and hence loose policy will be hard to reverse. If we have very high inflation, that will be negative for Equities. The best protection against inflation is buying well run companies with pricing power. However, even a good business has limits to pricing power. One can plan for very high inflation by diversifying and gradually increasing exposure to hard assets. Gold should do very well in periods of negative real interest rates (very high inflation or if Govt's practice "yield curve control" to keep interest rates low). See chart below. Note: TIPS rate = 10 Yr US Treasury rate – inflation expectations. We don't understand Bitcoin's scarcity value as many Governments are planning to launch their own Digital currencies and hence hesitate to recommend it at present. However, we will revisit our stance if the Indian Government would launch a Digital currency. What is scarce is valuable.

[10] Returns over the Index

Solidarity position sizing framework

Certain companies are at an inflection point and can register an earnings surprise in the medium term. Others have significant option value making it impossible to quantify what their terminal value should be. Central Banks are interfering with pricing of risk. Fair value is a function of these multiple variables (future earnings, cost of capital, ROCE, terminal value) and hence we believe fair value should be a range rather than a point estimate.

Our position sizing approach balances intent to buy into companies where we have conviction on the long term outlook, not wanting to significantly over pay, desire for owning no more than 15-20 positions with need for risk management. Well run companies tend to trade at or above fair valuations. Hence, one needs to be balance not over paying with missing out completely by waiting for lower prices. When a well-run company trades at a value lower than what one deems fair, the position size needs to be increased meaningfully to make the most of such an opportunity even while ensuring overall risk thresholds are not violated. One should also not hold a position size wherein one cannot correct errors due to lack of liquidity.

We organise our portfolio in different buckets based on franchise track record, stock liquidity, debt burden, binary risks that could play out (for example customer concentration). For each position of interest, we define the growth narrative and model estimated IRRs over the rolling 5 year period based on a range of earnings growth we believe the franchise can deliver and what its fair value should be at the end of 5 years. The valuation exercise is done based on first principles (trend growth rates, ROE and our estimate of terminal value) and understanding historical bands based on wisdom of crowds. Some premium is added for market darlings, where companies have significant option value, and if the industry is on the early stage of the growth cycle. The estimated IRRs are revisited every quarter as we learn more about the company over time and update our assumptions.

IRR asks vary based on quality/maturity of franchise and position size increases with confidence.

- For example, for Clear Leader franchises like Divi's Labs/Kotak Bank, we will take an initial position at an estimated IRR of ~15%.
- However, for an Emerging Leader with low liquidity and customer concentration risk like Shaily Engineering, our IRR ask would be higher at ~18-22%.
- And for "Special Situations", our minimum ask would be ~25%.
- Every position must move the needle; hence an initial position would rarely be less than 3%.

Our maximum position size also varies by quality of franchise, vulnerability to external shocks and liquidity (ability to correct errors).

- For a debt free Clear Leader like Divi's Labs, we could go as high as 15% if entry prices were enabling 5 year IRRs in excess of 30%.
- However, for well run, leveraged entities like a Kotak Bank, we would cap the position at 10% irrespective of what upside we model. We tend to cap Life Insurance at 8% because their reported economics requires significant assumptions on variables such as interest rates, persistency and mortality assumptions which carry high tail risks.
- For Emerging Leaders with good liquidity we would cap positions at 8% and for those with relatively poor liquidity at 6%, primarily so we can correct errors if we are wrong. Fund managers should balance conviction with need for risk management.
- If a franchise carries risks with binary outcomes, eg excessive customer concentration risk (Shaily Engg.) or risk of regulatory intervention (Alcohol), we would cap the weight at 5%.

General Eisenhower, America's World War 2 hero and future president, believed that "no plans work, but planning is everything". While forecasting is a fool's errand, comparing upside/risks across companies helps us allocate finite capital amongst many choices. Comparing outcomes with estimates provides a feedback loop for introspection on errors and better decision making in future.

Position sizing approach		**IRR est. (5 year rolling time horizons)**			
Categorisation	**Example**	**15%**	**18-22%+**	**25%+**	**30%+**
Clear leader	Divis Labs	3-5%	5-10%	10-12%	12-15%
Clear leader - Lending business	Kotak Bank	3-5%	5-10%	10%	10%
Emerging leader- good liquidity	India Mart		3-4%	4-6%	6-8%
Emerging leader- poor liquidity	Neogen Chemicals		3-4%	4-5%	5-6%
Special Situations	Max Financial			3-5%	5%

Misses, where we have changed our views and learnings

We believe adherence to good process will lead to superior outcomes even though short term performance could be impacted due to variables one cannot control. Part of that process is being honest on what we could have done better during the year.

"Better is possible. It does not take genius. It takes diligence. It takes moral clarity. It takes ingenuity. And above all, it takes a willingness to try[11]."

Misses

In July 2020 we published key trends that would guide our portfolio construction. We missed the significant increase in IT spending by Corporates on Digital preparedness as we believed that the increase in Digital spending will be negated by the decline in spending in traditional IT services. IT Services players are guiding for strong near term growth. We have missed the IT Services rally.

Where we have changed our views and learnings

Formalisation of the economy is a secular and structural theme. And amongst the key beneficiaries of this theme will be manpower outsourcing companies eg Team Lease. We had stayed away from this business model because very low margin (EBITDA margin of 2%) left no room for error. Our thinking on this topic has changed 180 degrees. While these businesses have low barriers to entry, the low margin is a significant barrier to scaling. And if Working Capital can be tightly managed, the Free Cash Flow conversion is very high. Team Lease also demonstrated its resilience during Covid where absolute profits were maintained despite the shock to revenue vs the corresponding period last year.

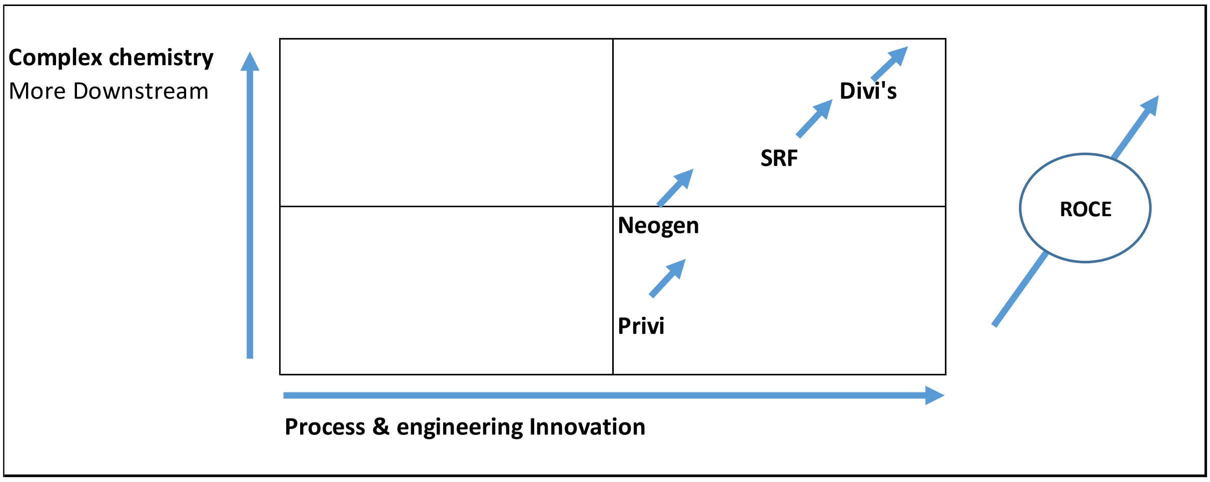
[11] Atul Gawande, "Better – A surgeon's notes on performance"

We navigated the Covid period without panicking. However, our hand was forced due to wrong position sizing in ICICI Bank which compelled us to halve our position at distressed valuations. ICICI Bank was an oversized position pre-Covid approaching 15% position weight in some accounts. Our conviction in the position was tested against the need for risk management in a very uncertain environment. Risk is what remains when you have thought of everything that can go wrong[12]. In hindsight, we should not have carried such a high position weight in a leveraged business which is always vulnerable to macro shocks.

We have recalibrated our stance on trimming due to valuation concerns in business models which have prospects of high longevity for growth, ROCE expansion and which are early in the growth cycle. Most businesses tend to commoditise over time and hence one has to be wary of very high multiples – "mean reversion" to fair value is a truism in markets. Our process attempts to balance "not interrupting compounding unnecessarily" with the fact that euphoria can cause prices to run well ahead of fundamentals, that capital is finite and therefore must be allocated where the best opportunities are. Hence, we believed in the discipline of trimming when valuations get euphoric. However, valuation multiples based on short term earnings and historical valuation bands can be misleading when the probability of non-linear PAT growth is high.

We trimmed our position weights in some Specialty Chemical names during the year due to concerns on valuations. This was a mistake. We had identified Specialty Chemicals as a theme in 2018 and it was a significant beneficiary this year as de-risking from China gained momentum. We looked at trailing valuations and the sharp price increase while overlooking that the theme was under owned and the multiyear growth narrative was just starting to be widely adopted. Many Specialty Chemical names we own are also technology businesses investing in developing their own IP. They are developing new products based on more complex chemistry while also undertaking process engineering (reduce the number of steps or time taken to achieve a particular output). Divi's labs was a 40% Gross Margin business in FY 01, 60% in FY 08 and is ~ 65% today.

Hence, Gross Margins can grow exponentially both from higher value add and lower RM Costs while Fixed Asset productivity will increase over time from larger scale runs and as life of the plant is higher than time horizons over which a plant is depreciated. Hence, these business models can be significantly more lucrative businesses (higher ROCE) over time.



One can exit a position too early because of concerns on valuation because one underestimates longevity of growth and future ROCE. We need to think about companies with prospects of non-linear growth/higher longevity differently and allow a longer rope on valuations. A strong narrative is

[12] Carl Richards

a powerful driver of stock prices and mean reversion of valuations does not happen early in the cycle. However, these need to be rare exceptions as else one risks losing discipline on valuations.

Update on the firm

Growth of Assets under Management (AUM) is important for us as not only does it impact our economics but also provides opportunities to the team for professional growth. However, AUM growth needs to be disciplined and balanced with partners' interests. FY 21 was a strong growth year for us with the addition of 31 families, many through references from existing partners. We now manage ~840 Cr across 86 families.

Signing up the right partners has a strong impact on our success. Successful Fund Management is mostly about ability to control emotions during market extremes. Fund Managers cannot think clearly and act long term if clients lose faith during market meltdowns. We keep a minimum ticket size of 2Crs[13] which is well above SEBIs regulatory requirement of 50 Lacs, sign up families after a discussion on our approach and insist on a 5 year outlook, but without any penalties for premature termination. This ensures higher probability of expectations alignment, allows us to spend quality time on reading/research, we can respond promptly to queries and manage the complexity associated with customisation of portfolios for point of entry and negative lists.

March 2020 was the first time in seven years when we were really tested. We had 1 partial and 1 complete withdrawal amounting to less than 2% of AUM. Many partners took advantage of the market meltdown and topped up accounts. A partner base that stays the course during trying conditions is a significant competitive edge for any Investment firm. We are grateful for your trust.

We continue to have zero SEBI complaints, commercial misunderstandings or violation of negative lists with any partner since inception.

We have strengthened our research team and our research coverage expanded significantly this year. Like Poonam in FY 20, Kumanika was a trainee with us and accepted a full time position. Prasad joined us from a peer. Other than the ~25 names we own across partner portfolios, we have an additional ~35 companies of interest on a watch list for lower entry price. In addition, there are ~100 companies where we have a well-considered view and which we revisit twice a year.

No investment firm can guarantee outcomes. However, we can ensure strong alignment with partners with complete skin in the game. Derivatives trading continues to be banned at our firm. The CIOs family interests are joined at the hip with 100% alignment in underlying positions and lowest priority in order execution.

We look forward to speaking with you on our call at 12 PM IST on the 17th of April 2021.

With best wishes,

Manish Gupta	Manjeet Buaria	Anirudh Shetty
Chief Investment Officer	Principal	Principal

[13] We have made exceptions in certain cases, primarily when families have been referred by existing partners