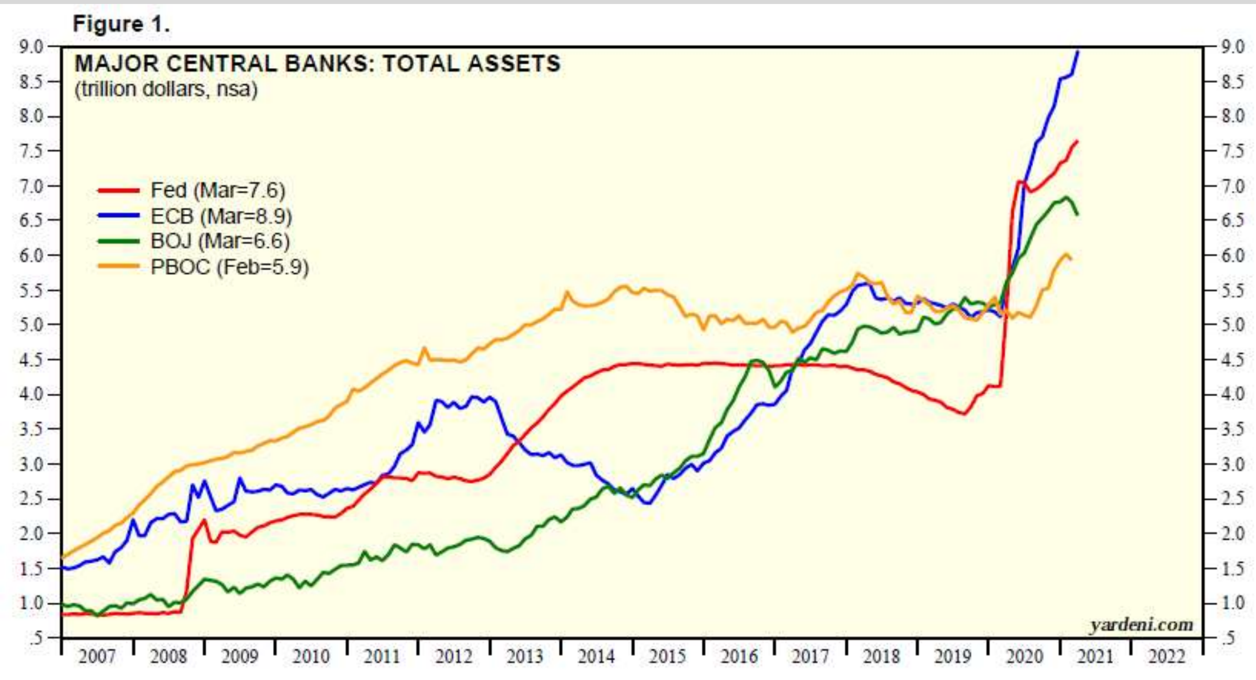
Quarterly News Letter --- March, 2021

We are pleased to bring you the March quarterly investor letter and our thoughts on economy, markets and our Portfolio. FY21 has been a tumultuous year. The whole economy being shut down across geographies, followed by the V-shaped economic recovery driven by the huge liquidity ushered by the central banks. In response to the pandemic, both the ECB and Fed have expanded their balance sheet by ~80-90% from Feb'20 onwards. This means that the amount of money which was printed by these central banks right from their inception, the similar amount of money has got printed in a very short span of ~12-15 months only. I have never seen this before in my entire investing career, and in hindsight, it was one of the most attractive opportunities to own and earn equity returns. Investors who could predict a fall and had cashed in Feb 2020, and then seen the crash and aggressively bought in March / April last year, only who could predict both the fall and the rise could take advantage and make money. Nifty 50 is up by +90% including all other indices since March 2020.

In response to the pandemic, central banks have massively expanded the balance sheet:



Source: Yardeni Research Inc. report (Apr 2021)

Our Team and Research Process

The focus of our team is to evaluate various business models across various industries. We are normally attracted towards exceptional and well capable managements with sustainable competitive edge, leading to best unit economics and high capital efficiencies, and a higher cash flow to the equity shareholders. We place a premium on outstanding managerial talents and the ones where the interests of the Management team are aligned with the minority shareholders. We look for analysts with incredible open mind, and one single focus of our team is to generate superior return for our investors.

Our high conviction bets would typically have a simple structure, and we try to simplify all variables and with one optimization objective- to generate alpha in volatile markets in the long run.

In our Portfolio reviews, we keep on questioning ourselves- why each one of the stock in the Portfolio will make a good investment? What differing perspective we have from the street? We have found typical characteristics in our non-performers that have helped us change/tweak our investment framework and also avoid such mistakes in the future.

CapGrow Growth Investment Approach

Our research efforts lead to a reasonable well diversified portfolio of around 25-30 high growth businesses that we believe will create long term returns for our shareholders. We like asset light business models, vertically integrated businesses, leaders in their businesses with high ROE and ROCE. We are very particular on the environment in which these businesses operate, and that is precisely the reason that we have stayed away from lot of PSUs and regulated businesses. Our special focus is on the managerial talents and their entrepreneurial skills as well as the incentive structure that will ensure sustainable performance and future growth.

	1 Mth	3 Mth	6 Mth	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr	Since Inception
Portfolio	-0.1%	8.8%	38.8 %	79.0 %	8.8%	NA	NA	NA	11.6%
Nifty 500	1.1%	6.9%	31.8 %	76.0 %	12.9 %	NA	NA	NA	15.2%

The Growth portfolio has lagged the Nifty 500, primarily because some of the stocks like L&T and Maruti have not performed in the last two years. Quite sometimes, we have been an early entrant in some of the names pushing the performance to a later period. We are also in cash some of the times that brings down the performance in a rising market. We are committed to address this concern and assuage the concerns of all investors in this portfolio.

CapGrow Special Situation Investment Approach

This strategy has outperformed the benchmark across various time periods. As we have discussed in the past, this strategy holds tremendous potential to generate big alpha for our investors. That is also reflected in the performance:

	1 Mth	3 Mth	6 Mth	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr	Since Inception
Portfolio	3.0%	12.6 %	38.1 %	103.4%	14.0%	NA	NA	NA	15.3%
Nifty 500	1.1%	6.9%	31.8 %	76.0%	12.9%	NA	NA	NA	15.2%

The businesses we own in this portfolio are not so great businesses on the surface, but they have a corporate action that has already been announced, and that will help us unwind value and generate returns. If we look at the financial statements, then on the surface they seem to be not so good investments. Some of them have their balance sheets with problems, but they are in transformation stage and are on the crisp of a big change. This delta is what we are trying to capture. We apply a combination of buffet ology and presence of a catalyst to come up with stock ideas. Our largest position is Fortis, which has done well for us. The performance above reflects why we have an edge, we do not have an automated machine but the thought processes and the internal research processes along with deeply researched ideas has facilitated the performance.

We repeat for the comfort of our investors, that this investment approach is scalable and is a replicable strategy and we are confident of generating alpha. We are very swift in our portfolio actions and if something goes wrong somewhere in a particular stock, we are immediately out.

Optimization Problem:

We at CapGrow are long term partners of our clients in this wealth creation journey. We are passionate about compounding capital, on a continuous basis for longer tenures for all our clients.

We are in the business of Optimizing two things- equity returns over longer periods of times with less volatility and secondly, maximize our AUM. The returns can be volatile at times, but our thoughtful investment and research process is fully geared to take advantage of the volatility in the markets. The events like COVID will keep on occurring and are not within our control, and hence we do not factor them in our discussions or estimates or their impact on returns, except that how to take advantage of such situations. This is precisely the reason that Cash is kept in the portfolio based on certain risks that we feel may impact the markets. Cash is a conscious call at CapGrow and this acts as an option for us to buy stocks in case of sell offs or for any other reason. It is also the reserve created for our research team to generate ideas and utilize cash, especially during sell offs.

We understand the long term wealth creation is a summation of our short term decisions and hence we are very particular on weights and positioning of stocks in our portfolio.

Performance paradox

Our conservative style, esp. in growth portfolio, is a conflict in itself and is a paradox. We (the value-oriented investing style) will always underperform in a rapidly rising market (the likes of L&T, Maruti have not performed at all in last two years); and the clients may be little unhappy, and rightly so. And in a downward market when the euphoric times end, and prices retreat, we lose less, but we still are negative, and the clients may still have the reason to be unhappy. Rather our clients need to show the maximum faith in us in a downturn, in the style of investing and our selection of stocks, because of our long performance history and our confidence about the delivery of superior risk adjusted returns in the long run. The drawdowns have happened many times in the past, in my investing career, but longer term we tend to do well. We will always do what is best for our clients' wealth and perform well in the longer run, may be sometimes underperforming in the short run.

For all our clients, I am the Point-of-Contact as well as the Portfolio Manager responsible for your investments along with my team. We do expect our clients to treat equities as long term core portfolio, with ability to stock up in times of sell offs or on a systematic investment plan basis. We understand that we have been hired to allocate capital in good quality businesses and we promise not to disappoint on that front. The performance can lead or lag the indices at times, but our focus remains to stay invested in those great businesses. All stocks do not go up or down together or by same proportion at all times, and hence the performance can differ in the short term. We do constant review of the portfolios and try to address any anomalies in performance.

Outlook and way going forward from here:

We believe the retail investors are suffering from FOMO- Fear of missing out, and hence loading up stocks at all kinds of valuations. Analysts are extrapolating the current rally and recent trends with minor twists here and there in their estimates. (Nifty FY21 EPS has got upgraded only by 20% over June 2020, however the market is up ~45%.) This is contrarian to our thinking where we believe the major delta can come only at inflection points. We definitely see froth in the U.S markets, esp. the technology sector which could have a spillover effect on Indian markets in case of a fall and also some segments currently in the Indian markets. The huge surge in the IPOs, the day one listing gains, coupled with the volume trends on day 1 where the complete IPO quantity changes hands does reflect and signal the euphoric nature which is disturbing to us. We have seen lot of equity offerings in the last two weeks of March and then there are also few stocks that have gone bonkers! One such stock of a pharma company (M-cap of ~ Rs8000cr and promoter holds 98.07% after NCLT) has gone up from Rs 38 to Rs 2400/ in a matter of 6 months, and where the restructuring has just been completed while the business is still in doldrums. Some pockets of markets are showing such extreme froth, and a fall out like GameStop or Archegos could precipitate the fall.

In terms of economic growth, the economy continues to reopen and recover from the pandemic, halted by the recent 2nd COVID wave, which is more widespread but less severe. However, all players including the politicians are wary of economic shut downs and the vaccination roll outs should help reopen and recover at the earliest.

One interesting trend that has emerged is that the wealth effect from the stock market rally is having a spillover effect on Real estate. This is also driven by the structural changes due to RERA, and release of some pent-up demand that has added demand for newer and bigger homes. Property sales in the Greater Mumbai region for the month of Dec’20 broke the 5-yr record registering sales of whooping 14,783 units. This was more than double the sales made last yr. in Dec’19. This can have a meaningful multiplier impact on the economic growth. The government has already shown its intentions of increasing the pace of infrastructure investments and has even gone to the extent of compromising on the fiscal deficit number to achieve growth.

We have seen stock prices go up substantially so early in the recovery and could be a source of concern in the short term, but on the other hand the fact that the economy is likely to grow for next few years is an encouraging sign. There is no political uncertainty till 2024 elections, reducing the extreme chances of reversal of any policies or economic decisions, aided by BJP’s clear majority in both houses.

The second wave that started in the last week of March is a serious concern, we are seeing addition of 1 lakh+ cases on a daily basis, which is even higher than the last yr.’s waives. This could derail some of the recovery and slow down the growth going into FY22. Another risk that is being floated around is the possibility of interest rates rising in the future, but the recent statement by the RBI governor provides relief that interest rates will not rise hurting growth. Lower mortgage rates and stamp duty relief has been a big driver of real estate sales. We believe that the rates may not go further down, but they may remain in this band for another 12 months or so. Risk of inflation is there due to rising commodity prices.

The other concerns we have are:

- ✓ Speculative price increase of few select stocks
- ✓ Heavy retail participation, including the IPO frenzy and their listings
- ✓ Recent IPOs esp. from not so profitable companies and first day stock volumes that exceed the total IPO float in some cases.
- ✓ The SME/middle level business, esp. few sectors like hospitality and in tertiary sector continue to suffer due to the second wave.

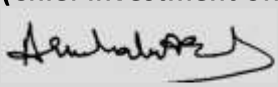
Valuations: Are they near the bubble? Our answer is that there are few signs, but we are still from the bubble peak. Lot of money is sitting on the sidelines with the retail investors and institutions, that is ready to enter in case markets fall. A big deeper correction in speculative stocks is quite a possibility, with one of them getting unfolded and having a spillover effect on the market sentiment and bringing indices down.

We believe that the excitement of the market is high and there are signs of euphoria and risky behavior. These are not the best time to chase high returns as stock prices have risen while the uncertainty due to second COVID wave is rising. We are happy to stay with our conservative stance and higher cash levels.

We look for better price points to be aggressive in some of our stock calls and stay invested in good quality stocks for long term.

As always, happy to interact with each one of you. I may be contacted at pms@capgrowcapital.com or @ +91 98195 61662 to schedule an interactive call.
Stay safe and blessed!

Arun Malhotra
(Chief Investment officer)



CapGrow Capital Advisors LLP

Disclaimer (as per the SEBI guidelines) pertaining to the reported performance:

We hereby confirm the following:

(i) All cash holdings and investments in liquid funds are considered for the calculation of performance.
(ii) Net of all fees and all expenses including taxes are taken into consideration at the time of reporting the performance data.
(iii) Any change in investment approach that may impact the performance of client portfolio is disclosed in all marketing material.
(iv) Performance reported in all marketing material and website is the same as that reported to SEBI.
(v) The aggregate firm-level performance reported in any document is same as the combined performance of all the portfolios managed.
(vi) A disclaimer is provided in all marketing material that the performance related information provided therein is not verified by SEBI.