

Dear Investors:

Over the past year, our increased focus on adding exposure in ‘decoupled value situations’ has now positioned us well to capture well-above market earnings growth under most likely scenarios, other than in lockdowns that potentially mandate shutdown of facilities. We are neither in the camp that is hopeful of any broad-based earnings recovery, nor do we depend on such tailwinds at this time.

We note that between natural seroprevalence and vaccinations, India’s overall seroprevalence is certainly among the highest today¹. However, between tepid pace of vaccinations and current clinical evidence (which suggests that natural immunity should last 6-8 months), one cannot rule out another delayed spike, albeit more muted, in infections. Fortunately, there is growing evidence that pre-existing T-cell immunity materially lowers severity upon re-infection. Accordingly, on the weight of evidence, our confidence in India’s ability (or rather it’s low vulnerability to *Covid-19*) is the highest it has been in over 5 quarters.

There is absolutely nothing overwhelming about the near-term upsides in smaller names; Smallcaps in general, and Indian institutionally under-owned space in particular, had seen little to no multiple expansion getting into 2021; US and Indian largecaps had been among the very few listed pockets that saw broad-based multiple expansion getting into the current fiscal. 2021 at least partly confirms that while liquidity driven disconnects can be durable, they don’t last forever. We need to put the sharp recent outperformance of Indian small names (where we especially accentuate the difference between *BSE Smallcap*’s sub-\$1 Bil constituents, and their larger constituent peers) vs. the rest.

Consider the divergence between US and Emerging Markets (with the exception of Indian large-caps) in the 4 years getting into this fiscal – Between FY17-FY21, the median *Nifty50* constituent (ex-financials and outliers) compounded at a +13% pace, well ahead of the median *Nifty50* constituent’s +9% earnings growth over FY17-FY22E, effectively a 16% multiple expansion getting into this fiscal. The biggest names in US (*DJIA*; ex-financials) meanwhile went through a sharper multiple expansion (20%) despite materially slower earnings growth than India’s headline constituents². Contrast this with most emerging markets, and particularly with *Minerva India Under-served* book – While the median headline smallcap (within *Nifty Smallcap50*) kept pace with underlying earnings growth, smaller names (sub-\$1 bil) often didn’t see solid earnings growth manifest in prices. Within our book, a +15% median earnings growth barely translated into a +4% annualized gain going into this fiscal, with poor multiple expansion breadth – 80% of our book’s components actually went through multiple compression getting into the current fiscal (see how we compared on **Exhibit 1** on next page). Effectively, 3 key observations stood out when it comes to multiple expansion/contraction breadth:

1. We saw 2 very different ‘Indias’ getting into the current fiscal – one where multiples had materially expanded (headline constituents across small, mid, and largecaps), and the sub-\$1 bil universe, where they mostly contracted, often materially with little connect to earnings.
2. With the exception of Indian and Chinese largecaps, large headline constituents at EM peers mostly saw multiples contract getting into the current fiscal. While a slight majority of Indian and Chinese large headline constituents saw their multiples expand (i.e. breadth was more than fair), only India (*Nifty50*) showed material multiple expansion (at an index level) within the EM universe.

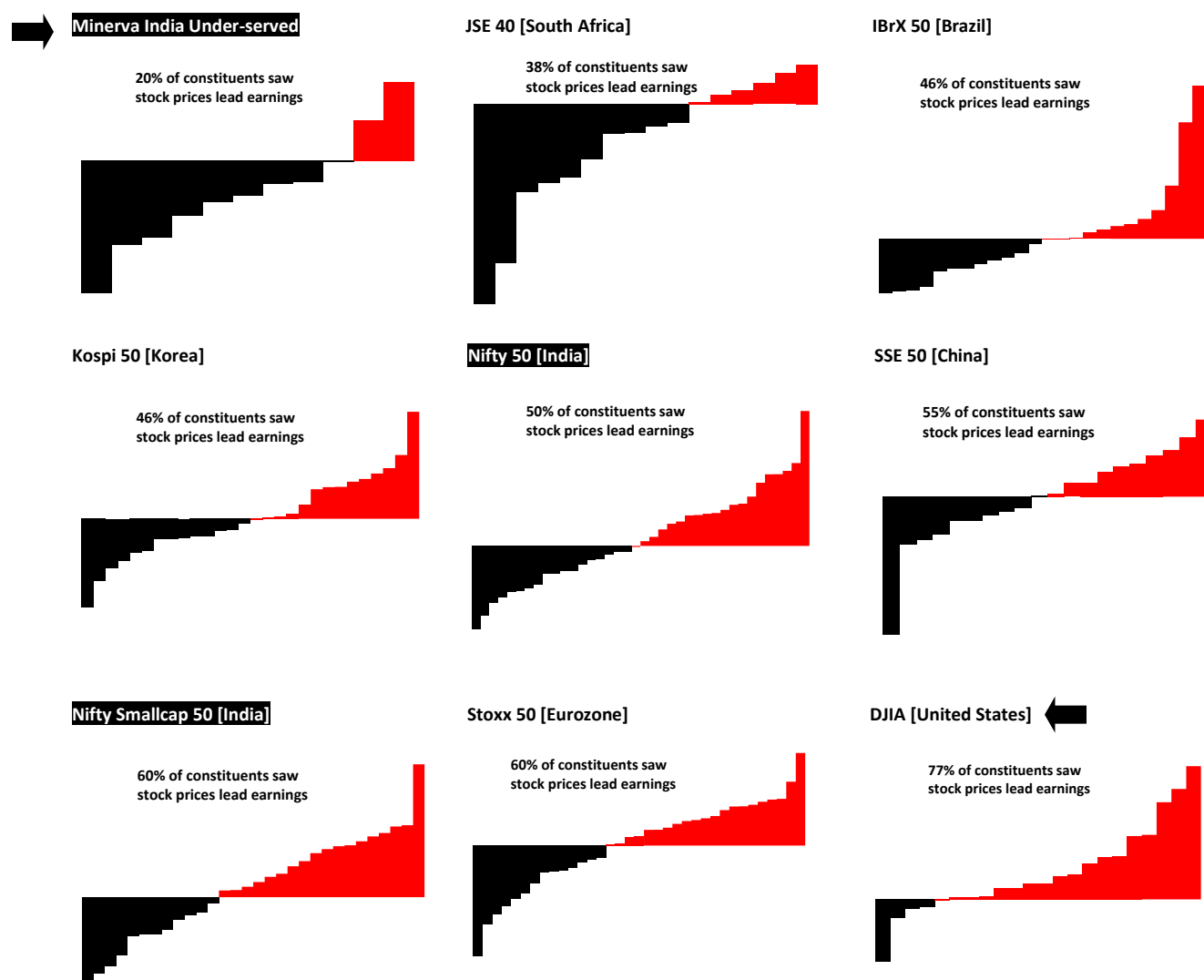
¹ While results of *ICMR*’s fourth seroprevalence survey (doesn’t cover Delhi NCR or Mumbai) aren’t out yet, numbers from *WHO-AIIMS* survey (includes Delhi NCR) suggest that nearly 3/4th of Delhi NCR’s population had *Covid-19* antibodies. Prevalence differential between adults and children was statistically insignificant.

² The median *DJIA* component would compound earnings at ~6% between 2016 and 2021E (trailing most major EMs), while the median component has appreciated at >10% annualized pace since the end of 2016.

3. Among major markets, liquidity-driven disconnects led to broad-based multiple expansion within largecap headline constituents in United States, despite mediocre/poor earnings performance, making it arguably the frothiest listed space globally.

As we write this quarter-end update, we are up nearly 60% YTD (net of charges and mgmt. fees) and we conservatively see another 40% multiple expansion from these levels³. This is in sharp contrast to valuations of *Nifty50*, Indian midcaps, India's \$1 bil+ names that get bizarrely stashed into smallcap indices, and certainly the larger listed names in United States, which is arguably the frothiest listed space globally. Between multiple expansion and our most conservative earnings expectations, we expect our book to compound capital in at least the high-teens between now and mid-2026.

Exhibit 1 – How we stacked on multiple expansion/contraction breadth, coming into the current fiscal



Source: Company reports; S&P Global

Notes: Financials and outliers were excluded; Within our book, we excluded 2 'entertainment' names, whose business has largely remained shut since the onset of the pandemic.

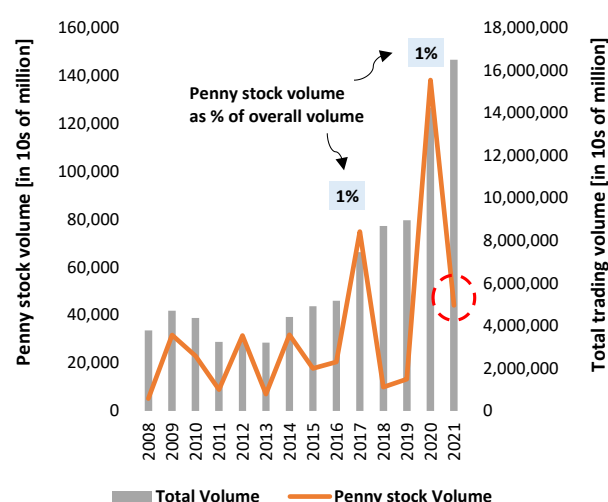
³ As of June end, Minerva India Under-served was trading at 15.7x F2022E (Mar) EBITDA, which reflected a mid-high 20s discount vs. *Nifty50*, *Nifty Smallcap50*, and *Nifty Midcap50* (ex-financials).

While retail engagement spiked in 2020, it was incomparable to what we continue to witness in extremely frothy markets such as United States.

While we noted emerging signs of indiscriminate stock picking in the second half of last year, we have since seen a scale back in penny stock engagement in the first half of this calendar.

While we haven't yet seen anything comparable to what we have witnessed in say United States, retail momentum chasers nonetheless remain active everywhere, and accordingly conditions remain ripe for asset bubbles. To be clear, we already see indiscriminate stock picking in several institutionally well covered Indian headline mid and small caps. Fortunately for us though, speculative retail activity hasn't widely engulfed the institutionally orphaned space, and valuations accordingly remain very comfortable in general, and for our highest conviction positions in particular.

Exhibit 2 – Penny stock volume vs Overall volume



Source: SEBI; Reuters

Note: < INR 10 stocks are considered 'penny stocks' here

Assembly line fungibility allowed our biggest automotive parts position to capitalize on a growing exports opportunity, even as domestic OEMs cut production. Wheel disks and wheel rims are produced in separate processes and then butt-welded on the same assembly line. Other than rear tractor wheels, everything else this holding of ours produces in steel can go on the same assembly line where they produce for domestic passenger vehicle OEMs. Overall, nearly 60% of their capacity is fungible and can be used to service exports (rims for trucks and trailers in US and EU), and we noted how they were executing export orders at 4-5x the pace during April/May lockdown vs. what they were doing back in February. Critically, this part of their business comes with at least high-teen margins, a significant premium vs. their low double-digit margin on domestic PV steel rims. Consider this – In May, automotive assembly lines across the domestic industry came to a near halt, driving down May's rim sales by nearly a third month-on-month. Exports meanwhile were up by nearly 40% month-on-month, ensuring that sequential monthly EBITDA impact in our view was barely in the low-mid teens in a month when domestic car sales declined by more than 60%, with several assemblies shut. Overall, in F1Q22 (Jun), the mix of domestic alloy shipments + steel rim exports expanded to just under half of revenues, significantly ahead of 33% contribution in the March quarter, driving a low-teens sequential EBITDA growth despite a low single-digit overall decline in revenues.

With well ahead of highly visible 20%+ earnings growth over the next few years, we expect this position to at least further double within the next 2/3 years (even assuming flattish / mid-single-digit decline in domestic PV sales).

Our discussions suggest that Japanese 2W OEMs continue to expand focus towards India for global procurement. Mentions of 'India' within the Big-4 investor documents in Japan has accelerated meaningfully over the past 2-4 years. Be it *Honda* creating a new team at its Manesar facility (specifically targeting exports) or *Suzuki* increasingly centralizing its vendor requirements, we see select Indian 2W parts vendors as clear beneficiaries of an accelerated trend of centralized procurement at a time when India is increasingly marked out as an export hub. *Yamaha's* emerging interest in procuring from India particularly offers

immense upside for domestic parts vendors since *Yamaha's* Indian domestic revenues are a relatively small contributor for them.

We note that despite healthy order books, 2W exports suffered because of logistical challenges last year, creating softer comparisons in the current fiscal. We therefore believe that export revenues for domestic parts companies could be a meaningful tailwind [low-mid single digit growth contribution in F2022E (Mar), depending on the OEM] at a time when domestic sales visibility remains somewhat clouded.

Elsewhere, an emissions control system JV of our 2W parts holding (26% held by our holding's investors) turned profitable in the last quarter. In its first full year, the JV reported INR 15 mil in net losses, despite the nearly INR +50 mil earnings in F4Q21 (Mar). We understand that some of the costs (royalty etc.) were loaded towards the first half of last fiscal, and accordingly the fourth quarter margins aren't necessarily reflective of the current underlying profitability of this JV. Nonetheless, even at current depressed quarterly run-rate, this JV revenues should expand at least 50% in F2022E (Mar), and we expect turnaround in this JV to contribute a high-single-digit growth number to F2022E earnings. Overall, we will call anything under +40% earnings growth in F2022E for this holding 'disappointing'.

In contrast with liquidity overwhelmingly chasing the institutionally well-covered securities over the last 4 years, the above two automotive parts names have seen inexplicable multiple compression at a time when multiples at street darlings had otherwise expanded, often with mediocre underlying earnings. Consider this → While earnings for our above two parts positions are projected to compound at +20% and +12% respectively over F2017-F2022E (Mar) period, these names had bizarrely lost ~30% and ~10% (since F2017) respectively going into the current fiscal. The above two auto parts names are now among our top-3 holdings, which is more a function of idiosyncratic (and materially decoupled) catalysts at play here (at a more than comfortable valuation) vs. our positioning on the Indian parts space in general.

We hold one of the most profitable forestry names on the planet in JK Paper, which continues to (still) inexplicably trade at a sharp discount to global forestry universe. The acquired *Sirpur* mill became profitable a bit ahead of our expectations, and we reckon that this has pleasantly surprised insiders too. This was despite the mill averaging 250-275 tons/day in the first calendar quarter of 2021, which we note was considerably below the post-trial-run daily rate of ~300 tons pre-*Covid* last year. Our discussions yield that this turnaround was almost entirely driven by putting more robust process controls in place, be it through lower chemicals usage, or minimizing waste. We also understand that, in sharp contrast to pulp prices globally, wood cost for *Sirpur* actually declined after the 3-4 month procurement shutdown post-*Covid*. Our local checks suggest that F4Q21 (Mar) prices in the region (at mill gate) were averaging ~INR 4,250/ton, vs. INR 4,500+/ton at the beginning of last year.

Elsewhere, we note that pulp prices not only continue to strengthen, but we have also noted little to no resistance within pulp buyers to continued hikes, except in one particular grade in a region in Europe.

Meanwhile, *JK Paper's* paperboard expansion project (new multi-layer coated board machine of 200K tons capacity) remains on line to launch in September/October, with hardly any cost overrun, despite the Covid-induced delay over the past year and a half. Our conservative expectations on the expanded facility ramp-up, and limited to insignificant rebound in uncoated business (an inarguably cautious assumption), still reflects at least +50% upside from here. This largely syncs with our benchmarking vs. NA and EU peers, which still trade at ~30% premium on C2021E EBITDA, and even larger on C2022E, despite comfortably lower growth and profitability.

Piracy remains a massive challenge for video-on-demand (VOD) in India; We see theatrical exhibition still in control of bargaining chips. Steps such as restricting playbacks, sharing of credentials, or encryption have done little more than making illegal recording inconvenient. While search-engine optimization (initiatives from companies such as *Google* and *Corsearch*) helps in making illegal content discovery harder, on the ground evidence in markets such as India suggests that VOD simply cannot be monetized today at levels that can come remotely close to matching theatrical revenues. Salman Khan's *Radhe* is a case in point – we estimate that less than a tenth of all viewers were either new *Zee5* subscribers (i.e. purchased the subscription to watch the content) or paid a one-time fee to watch on *ZeePlex*. Effectively, *Zee* had limited to no ability to monetize the content. So, while we clearly see an underlying shift in so far as Indian consumer's inclination towards VOD is concerned, we see insignificant translation on the ground. Given that producer share in VODs for new content is higher vs their share in theatrical exhibition, we estimate that producers would still need around 60% of viewers (who switch from theatrical to VOD) to pay for that content on VOD for the producers to be indifferent between these two exhibition choices (assuming similar content price for VOD and theatrical). On the ground evidence suggests that piracy and credentials sharing in India remains a massive hurdle for this shift to happen.

We also initiated a new 3%+ exposure in a software services name, where an acquisition has substantially shifted the business towards 'cloud' services. Incidentally, we picked this at a time when *Accenture* had beaten and guided higher last quarter, specifically citing high cloud demand as hybrid work models get embraced widely. This company had acquired a European business that significantly added to their SAAS (software as a service) capabilities. With limited client redundancies, the cross-sell opportunity remains meaningful – we understand that there have been at least two big deal wins, where the client had clearly expressed that had the two merged entities pitched separately, neither would have won the deal.

While margins will contract in the 100-150 bps range (from low 20s currently) as travel re-opens, the new normal for profitability is conservatively in the high teens, which is congruent with what we have heard from several other small and mid-sized peers.

Even though multiple expansion opportunity was largely past us (at the time of initiating exposure), earnings visibility and momentum remain impressive at a time when earnings expectations elsewhere remain frothy, in our view. For F2022E (Mar), earnings growth on this position is expected to be >40%, a significant premium over the rest of the domestic software services field.

Stay safe! Feel free to reach out if you have any questions. We are available 24/7 to address your concerns.

Thanks,

Piyush Sharma

Performance benchmarking

	<i>India Under-served</i>	<i>Nifty</i>	<i>S&P BSE 500</i>	<i>S&P BSE Midcap</i>	<i>S&P BSE Smallcap</i>	<i>EurekaHedge India</i>	<i>India-focused CE Funds*</i>
Trailing 1 year	88%	44%	52%	67%	102%	38%	43%
Since inception CAGR	17%	10%	11%	12%	11%	8%	9%
2021 YTD	56%	14%	19%	28%	46%	16%	16%
2020	18%	15%	17%	20%	32%	20%	12%
2019	-10%	12%	8%	-3%	-7%	1%	3%
2018	-6%	3%	-3%	-13%	-22%	-7%	-5%
2017	17%	29%	36%	48%	60%	29%	31%
2016	9%	3%	4%	8%	2%	3%	1%
2015	22%	-4%	-1%	7%	7%	6%	-1%
2014	34%	31%	37%	55%	69%	39%	49%
2013	21%	7%	3%	-6%	-11%	-6%	6%
2012	39%	28%	31%	38%	33%	14%	28%
2011	-11%	-25%	-27%	-34%	-43%	-25%	-31%
Annualized Volatility	21%	17%	18%	21%	24%	13%	17%
Sharpe Ratio	0.71	0.48	0.50	0.51	0.44	0.40	0.42

Source: BSE, NSE, EurekaHedge, Bloomberg

Note: Returns are until the end of July 15th 2021; Our performance is net of execution charges and mgmt. fees, but before incentive fees;

*US-based close-ended funds, with returns adjusted for INR/USD movements.

Strategy Snapshot

<i>Characteristic</i>	<i>IUS</i>	<i>Notes</i>
Top 5 positions as % of book	68%	
Avg. weighted market cap of book (mil)	\$674	>> Median holding's market cap is \$480 mil
Avg. weighted institutional ownership	15%	>> Median institutional ownership of current holdings is 14%
Avg. weighted free float of book	41%	
Net Exposure	96%	
F2022E (Mar) EV/EBITDA	15.7x	>> vs. 20.1x (Smallcap 50), 19.6x (Midcap 50), and 19.5x (Nifty 50)
# of positions	13	

Note: Characteristics are as at the end of June 2021

Meet your investment manager

Piyush Sharma, born and raised in India, has been running the India Under-served strategy for more than a decade. The strategy focuses on investing in uncrowded and institutionally under-owned situations within Indian micro and smallcaps. Having spent time with Citigroup and Bombay Stock Exchange in India, he moved to United States in early 2000s, where he covered stocks within Business Services, Autos, Consumer Products and Financials with Sanford Bernstein, Longbow Research, and Avondale Partners, working in teams that received accolades from leading institutional research arbiters, including Institutional Investor (II) and Greenwich Associates. Piyush received an MBA from University of North Carolina at Chapel Hill, MS from MNNIT, and BS in Accounting from University of Allahabad.

 @ps_tarheel

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