

Dear Investors:

Greetings from your investment team!

While smaller names have understandably outpaced *Nifty50* constituents this year, we are a bit alarmed at the lack of selectivity in the very recent past. In particular, we noticed how widely-owned (and typically larger) smallcap darlings attracted significant attention in the aftermath of *SEBI*'s recent communication on multicap funds – In the first week following the *SEBI* circular, *BSE Smallcap*'s top-quartile (\$1.3 Bil average market cap) returned nearly 3x bottom quartile's 2% (\$40 mil average mkt cap) return. Effectively, the least attractive (relatively richly valued) of an otherwise attractive part of the Indian market (i.e. small and micro caps) differentiated itself meaningfully in September, largely driven by what appears to be an unsustainable capital shift. While we predictably trailed in September on account of above, we still returned **+23.2%** during the quarter (following up on **+28%** in C2Q), ahead of **+20.1%** for *BSE Smallcap*, **+12.6%** for *BSE Midcap*, and **+9.2%** for *Nifty50*.

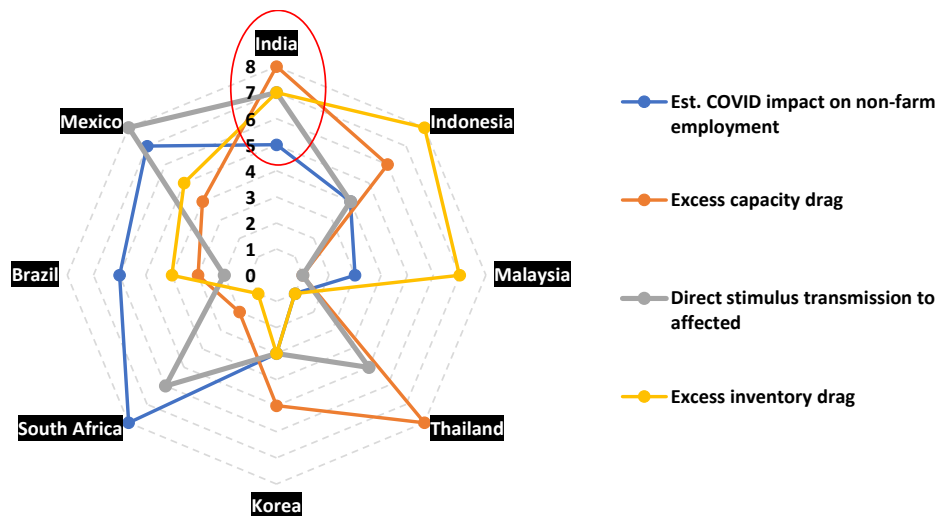
Don't confuse India's economic underperformance with lockdown's stringency. Our inadequate demand stimulus fell way short of EM peers. While humans are often prisoners of the moment, we shouldn't lose sight of the fact that sentiments are often misplaced, particularly in the short-term. It is now evident that in the current fiscal, India is likely to face the single biggest downward growth swing vs. just about any major market globally. As we began August, South Africa, India, and Mexico still had some of the most restrictive urban mobility worldwide. Unsurprisingly, that reflected in subdued retail footfalls in these countries, with particularly muted activity in South Africa and India. Meanwhile, Korea's move to keep "high-risk" facilities closed and restrict large gatherings (without ever imposing a widespread lockdown) didn't preclude an impressive re-opening turnaround.

As C3Q ended, India's mobility remained poor relative to fellow EM peers and it certainly can't be explained by lockdown's stringency alone - For instance, with arguably a similar lockdown and far worse fatality rate (even when adjusted for the testing differential between countries), Brazil's retail footfalls have more than come back while India's remain among the poorest within emerging markets. We attribute this overwhelmingly to India's failure to appropriately stimulate household finances at a time when the economy virtually came to a standstill earlier this year. To put that in perspective, South Africa's \$1,500-1,600 cash stimulus per job lost (the lowest among India's BRICS peers) was >3x India's cash stimulus (adjusted for purchasing power). Our sheer lack of fiscal flexibility was astounding. In fact, with the exception of Mexico, which would contract about as much as India this year, our direct cash transfer per incremental unemployed was comfortably the lowest across major emerging markets, with country miles between us and the rest. It's unsurprising then that our fiscal austerity has now translated into what would likely be the sharpest economic drag back on the planet (+5% in FY20 to a double-digit contraction). Consider this: Among the EM peers we track, average fiscal deficit will widen by ~6.5% this year, or nearly 2x that of India's widening. This set however would see average economic contraction of ~5.5%, or half of India's ~11% decline this year. Admittedly, heavy tourism-dependent economies (Thailand, for instance, where tourism accounts for around a fourth of the economy) are nonetheless hurt despite handing a large cash stimulus, but then these are exceptions and will likely bounce back quickly as inter-country travel normalizes. We note that Thai non-farm employment is practically unchanged vs. pre-pandemic levels, with normalized mobility.

To be clear, the perceived value of a relatively better current fiscal position has diminished considerably over the last few months and fiscal room today can't offset the jobs destruction of months past - It's hard to argue that a decision to lay off is typically hastened while the one to hire is relatively an extended one. Apparently, our policy mandarins think otherwise. This comes at a time when the likes of Korea, that have been very effective on stimulus transmission and curbing infection spread, continue to see job losses, albeit at a decelerating pace. What likely tempers the impact of this unyielding fiscal stance however is India's relatively

better broader enterprise leverage situation – More than 40% of *BSE 500* components (ex-financials) were net-cash businesses at the beginning of the year, making India among the least levered major markets globally as we entered the pandemic. Half of *India Under-served* holdings were net cash businesses at the time. To put that in context, barely a fifth of benchmark components (ex-financials) of *BRICS* peers were unlevered. While this reduces the odds of distress for India's employers, it is unlikely to do anything to accelerate the broader recovery as household purchasing power recovery likely takes longer than elsewhere. All said, it's hard to argue that India arguably is the worst positioned to recover quickly from the pandemic. See **Exhibit 1** where we stacked the peer EM set on 4 key levers that would likely drive the pace of recovery in the post-pandemic period. India distinctly rates below the peer set across the board.

Exhibit 1 – How Emerging Markets stacked against each other at the end of July 2020



Notes: All countries were ranked on a scale, with '1' being the 'best positioned' and '8' being the 'worst positioned'; While calculating direct cash stimulus (including discounts/refunds directly impacting household expenses), we only considered incremental allocations i.e. we ignored transfers/subsidies that were simply brought forward and were already budgeted for prior to the pandemic. In India's case, we estimated incremental allocations in PDS, PM Ujjwala Yojana, PM Jan-Dhan Yojana, National social assistance program, and MNREGA; In Indonesia's case, we estimated incremental allocations in Family hope program, Sembako, pre-employment card program etc.; In Thailand's case, we estimated incremental transfers to employees covered by SSF and those not covered by SSF, and utility discounts and refunds; For Korea, we considered direct transfers/subsidies from 4 Covid-specific budgets; For Mexico, we considered subsidy for workers that held a mortgage with the Housing Institute, and financial support offered through the Sembrando Vida program; We estimated excess inventory based on departures vs. prior years at the major benchmark constituents across markets.

Sources: Reuters; IMF; CMIE; Badan Pusat Statistik; OECD; DOSM; Bank of Thailand; Korean Statistical Information Service; Stats SA; Instituto Brasileiro de Geografia e Estatística; INEGI Mexico

Consumer staples commentary continues to play to the gallery. Just as in July, we remain unable to reconcile commentary from consumer staples' management teams with what we see on the ground in rural markets. We have noted consistent year-over-year worsening in retail sales over the last two months and broad increase in POS credits, as MGNREGS employment declined. We couldn't reconcile with Dalal Street's exuberance around rural spending in July, and we certainly can't reconcile now. Elsewhere, our checks and discussions across channels suggest no likely traction until comparisons begin to ease in April 2021.

Switch away from public transport (and not so much 'monsoons') has been a clear tailwind for rural two-wheeler sales. While we certainly don't see any reason to particularly cheer broader rural consumption, we do see emerging idiosyncratic drivers for categories such as two-wheelers - In pre-Covid times in rural India, there were 3 people that used bus to get to work for every 2 that used a two-wheeler. With nearly 2/3rd of these bus travelers traveling 10+ kms to work each way and public transport either shut off or curtailed, we noticed a definite 'forced' shift towards two-wheelers from such consumers. Given that this is despite the

incremental tightening in loan underwriting and BS-VI sticker shock, Indian two-wheelers are among the very few consumer pockets that in our view can at least sustain the post-unlock traction.

We completely exited a long-held Internet name, which we had held in our book for past 8 years. At the time of exit, stock had rallied +25% YTD despite unremarkable earnings. Overall, we exited this position with nearly 8x gain, which of late was largely driven by implied (arguably unrealistic, in our view) valuations of a few privately-held investee businesses that we were unable to reconcile with. Further, emerging retail investor interest in the name meant that the stock handily overshot the valuation levels that we are typically comfortable with.

We continue to see a significant differential between small and micro caps on one hand, and mid and large caps on the other - *India Under-served* finished C3Q at 12x F2021E EBITDA (ex-financials) vs. 17x for *BSE Smallcap50*, 20x for *Nifty50*, and 24x for *BSE Midcap50*. While the differential has certainly narrowed in recent months, it still remains significant, particularly given the relatively more depressed estimates for smaller names. Given that we aren't in sync with the ever-growing narrative around the potentially robust economic recovery, we remain intently focused on identifying uncrowded idiosyncratic stories that aren't particularly dependent on the broader recovery in order to create sustainable shareholder value.

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

Thanks,

Piyush Sharma

Meet your investment manager

Piyush Sharma, born and raised in India, is investment manager of RH Minerva Funds. Having spent time with Citigroup and Bombay Stock Exchange in India, he moved to United States in 2002, 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

OFFERING DESCRIPTION: Minerva India Under-served is offered on the Right Horizons Financial Services Pvt Ltd.'s platform, a SEBI-registered portfolio manager. Any reference to "Minerva" in this document refers to an investment offering managed by a SEBI-registered portfolio manager.

DISCLAIMER: The information, opinions, estimates and projections contained in this newsletter were prepared by managers of Minerva Funds and constitute its current judgment as of the date of this note. The information contained herein is believed to be reliable and has been obtained from sources believed to be reliable, but we make no representation or warranty, either expressed or implied, as to the accuracy, completeness or reliability of such information. We do not undertake, and have no duty, to advise you as to any information that comes to our attention after the date of this fund brief or any changes in its opinion, estimates or projections. Prices and availability of securities are also subject to change without notice. This is not a prospectus and does not constitute investment advice or an offer or solicitation to buy or sell any designated investments discussed herein. Neither Right Horizons, nor its officers, directors, agents, employees, Minerva Funds' managers makes any warranty, express or implied, as to the suitability of any fund as an investment or of any kind whatsoever, or assumes any responsibility for, and none of these parties shall be liable for, any losses, damages, costs, or expenses, of any kind or description, arising out of this newsletter or your investment in any fund. You understand that you are solely responsible for reviewing any fund, its offering and any statements made by a fund or its manager and for performing such due diligence as you may deem appropriate, including consulting your own legal and tax advisers.

CONTACT US:

Piyush Sharma piyush.sharma@righthorizons.com
Vaibhav Gupta Vaibhav.gupta@righthorizons.com
CS Raju raju.cs@righthorizons.com

+91-9912284541 [Gurgaon]
+91-9739010590 [Hyderabad]
+1-919-360-0359 [United States]