

Dear Investors:

In a year when strategies with small-cap compositions were ‘*pinata*’ for most investors, we managed to retain majority of our 2017 gains. However, with our biggest position cooling off towards the end of the year, we didn’t manage to get into the black. In 2018, *India Under-served* declined **-5.98%**, vs. **-13.13%** decline in *BSE Midcap* and **-22.38%** decline in *BSE Smallcap*. As things stand, we expect the broader Indian small and midcap universe to struggle to post double-digit CAGR over the next 2-3 years. Our hypothesis has its basis in multiple contraction coming off of peak profitability, with decade long multiple expansion cycle unwinding gradually. Typically, these are periods when we have most distinguished ourselves and we have very strong reasons (combination of valuation and company/industry specific levers) to believe that we should materially outpace over next 3 years.

In contrast with the oft-blinkered opinions that gain ground during slowdowns, it’s irrefutable that the sharpest deceleration is certainly more likely to occur within the most levered global pockets as growth cools off. Effectively, with the exception of certain commodity-oriented markets, ASEAN, and China, the deceleration within EMs elsewhere shouldn’t match what one would typically witness within the G-7. While household credit deepening has clearly occurred within India, it still trails just about any major economy out there and accordingly, risks of low institutional ownership aside, tends to exhibit lower earnings drawdowns.

Indian paper stocks showed some signs of fatigue towards the end of 2018 as global forestry stocks drifted lower in sync, largely on account of recession fears. In that context, it is critical to appreciate how significantly different current industry conditions are (vs. in 2008) and how sourcing and revenue mix for our holding has shifted over the past decade. Firstly, the global industry is much more tightly supplied today than what it was before GFC - Nearly all sub-categories of paper are now operating at or above capacity vs. nearly 40% idle capacity in categories such as W&P and Paperboard back in 2006-07. Further, current differentials in utilization levels between upstream (pulp) and downstream (paper and board) assets suggest solid procurement pricing power for paper producers. Secondly, with farm forestry linkages running deep, most Indian players now have access to what we believe is a ‘quasi-captive’ resource base. Meanwhile, Indonesian coal¹ prices have declined by more than 25% over the past two quarters, partially offsetting the headwind on account of CIL’s increased e-auction prices. Finally, our discussions across domestic plantations suggests that it’s highly unlikely that eucalyptus prices can go up materially from here, creating a solid goldilocks situation for domestic paper producers in certain markets.

As far as our paper holding is concerned, about 5 years ago, nearly half of material requirements were imported (combination of BCTMP, hardwood pulp, and coated paper imports). Given that this business’ flagship plant in eastern India went through a large expansion subsequently, mix shifted even more towards uncoated paper, which is a fully-integrated² op for them. Import content in materials is now set to further drop into low-mid teens as the fully-integrated acquired ops in Telangana come online. For a business whose revenue base is largely domestic, its near-term direct FX linkages are significantly lower than where they were 5 years ago.

Our paper holding has de-rated substantially, despite structural shift upwards in underlying profitability.

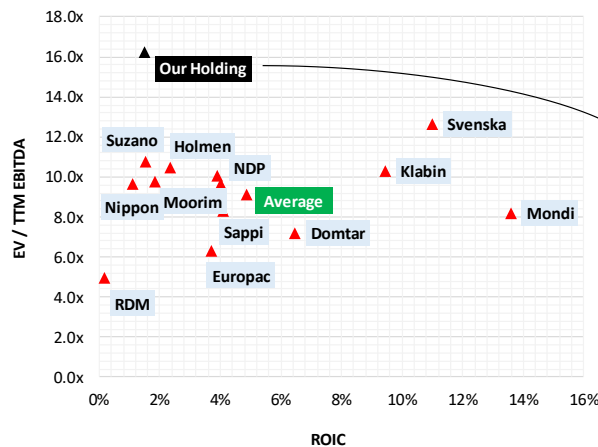
This name appreciated +12% in C2018, ahead of the **-8%** decline in the global listed forestry space (in local currency terms). Overall, even as our holding is up more than 4x over last 5 years, structural shift in underlying profitability (lower usage of inputs + shortening of sourcing radius, while realizations haven’t increased materially), hasn’t been priced in – Effectively, this stock has de-rated more than -60% vs. a -20%

¹ >3/4th of this business’ coal requirements are met through the open market; 2-3% of Indonesian non-coking coal production is used by the paper industry; Industry use of coal has decoupled from paper production as share of biomass has continued to increase.

² Entire wood requirement is met through well-established farm forestry linkages

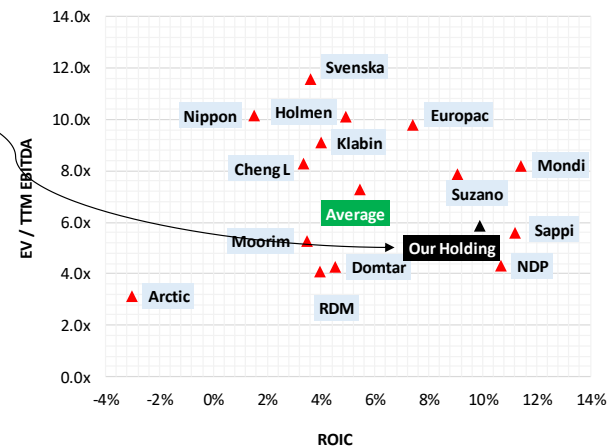
de-rating in the global listed forestry universe [C2018-end EV/EBITDA of 5.9x vs. >16x at the end of C2013]. As things stand, with far higher (and sustainable) growth and returns on invested capital nearly 2x global average, this stock ended C2018 trading at an inexplicable discount of nearly 20% to the global forestry comps. On C2019E operating earnings, this stock ended the year trading at a 30% discount to the global forestry universe vs. what we believe should have intrinsically been at least a 30% premium (or about in line with headline valuations of European peers such as *Europac* or *Svenska Cellulosa*). We do note however that the median name in the comparable global universe has 25% institutional ownership vs. just about 11% for our holding (see **Exhibits 1a** and **1b**).

Exhibit 1a – 70%+ premium at C2013-end to....



Source: Bloomberg; Company Reports

Exhibit 1b - 20% discount at C2018-end



We also feel that it might be incredibly short-sighted on the part of the largely retail investor base on this name to cut this business' stand-alone valuation simply on account of the potential temporary earnings drag as acquired facility in Telangana ramps up. To be clear, even any broad recession-driven drag by itself (assuming such a thesis is being drawn out by certain holders) cannot be large enough to justify current valuations - Even if we assume an unprecedented 3% decline in average realization per ton amid flat volumes, the large potential upside on this position is hard to argue against. In short, we have nearly exhausted the list of potential adverse outcomes and are thoroughly unable to reconcile conservative underlying cash flow expectations with current valuations.

Liquidity crunch at non-financials weighed on Autos. Elsewhere, liquidity crunch at smaller and/or long-duration non-bank financiers meant that well ensconced financiers marginally raised their rates in C4Q18. Names within categories that are heavily financed (eg. Commercial vehicles) and their vendors were particularly impacted over this period. Insurance policy change for two-wheelers is a headwind too. That said, for a key 2W lighting parts name (primarily serves OEMs) in our *India Under-served* strategy, the pre-BS6 2W launch schedule has shifted in favor of OEMs it serves (i.e. nearly all OEMs other than *Hero* and *Bajaj*) – We note that *Hero* and *Bajaj* accounted for 40%+ of all launches in the past 4 years but account for lesser 35% of all launches planned in C2019E. The broader sell-off within Autos makes this position among the most attractive holdings in our book today.

Our radio holding now finds itself decidedly in the deep-value category. While certain traditional media categories might be hands off to most investors, we sense some clear broad-brushing in select pockets, despite continued traction in underlying businesses. Our radio holding is set to report another year of 20%+ EBITDA expansion, with substantial room for incremental growth (in Sept qtr, its Batch-1 frequencies reported barely over 20% utilization, and even that number is partly skewed because of better than expected

ramp-up at its Bengaluru station). With company-wide mid-teens volume growth likely to materialize in F2020E (Mar), it is set to report another 20%+ EBITDA expansion even in the next fiscal. Even excluding potential synergies from inorganic expansion (a certain deal in the pipeline offers significant revenue and cost synergies in 3 of India's biggest radio markets) and a quick and inexplicable plateauing within radio media budgets, we see a minimum of 30% upside from current levels.

As C4Q18 earnings roll out, we are confident that our book would likely report earnings growth (ex-financials) that would be >2x the growth for *Nifty 50* and materially ahead of the broader small and midcap universe. As always, our focus is on accumulating sustainable situations where we aren't dependent on any economic acceleration or material decline in input costs to post superior cash flow growth over the next 2-3 years. Selectively, we continue to evaluate deep value opportunities within pockets that have seen indiscriminate selling recently. As always, we are confident that we would achieve our objectives without compromising on our underlying volatility, which has historically been even below that of *Nifty-50*.

Please let us know if you have any questions.

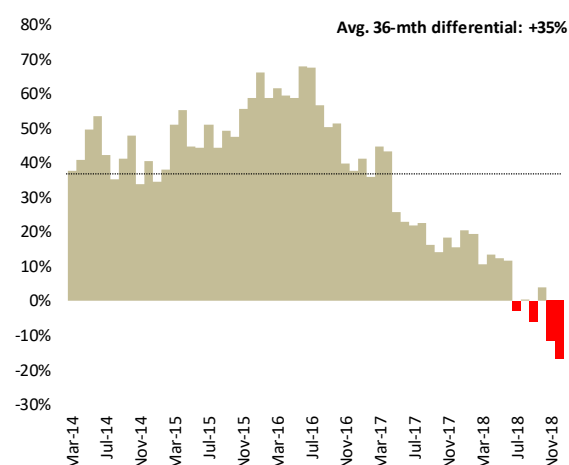
Thanks,

Piyush Sharma

Performance benchmarking

	India Under-served	Nifty	S&P BSE 500	S&P BSE Midcap	S&P BSE Smallcap	EurekaHedge India	India-focused CE Funds*
Trailing 1 year	-6%	3%	-3%	-13%	-22%	-7%	-5%
Trailing 3 years	20%	37%	37%	39%	26%	23%	26%
Trailing 5 years	97%	72%	86%	130%	128%	81%	84%
Trailing 7 years	230%	135%	152%	201%	169%	92%	161%
Since inception	194%	86%	93%	115%	69%	52%	83%
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	14.9%	15.1%	15.7%	18.8%	21.9%	13.4%	15.1%
Sharpe Ratio	0.81	0.41	0.43	0.46	0.28	0.25	0.39

Relative 3-yr perf vs BSE 500



Time-window analysis

	3 Month	12 Month
Number of periods	91	82
Average period return	3.9%	19.1%
Number of profitable periods	63	78
% profitable periods	69%	95%
Best period	23.9%	55.3%
Gain Standard Deviation	5.9%	13.7%
Sharpe Ratio @10% RFR	0.21	0.64
Sharpe Ratio @5% RFR	0.37	0.99
Sharpe Ratio @0% RFR	0.54	1.35
Loss Standard Deviation	2.5%	2.6%
Downside Deviation @10% MAR	3.8%	4.0%
Downside Deviation @5% MAR	3.2%	2.0%
Downside Deviation @0% MAR	2.5%	0.7%
Sortino Ratio @10% MAR	0.40	2.27
Sortino Ratio @5% MAR	0.86	7.18
Sortino Ratio @0% MAR	1.55	27.36
Average Gain/Loss	1.9	9.1
Profit/Loss Ratio	4.3	177.4

Source: BSE, NSE, EurekaHedge, Bloomberg

Note: Returns are until the end of Dec 2018; All since-inception numbers above are since inception of India Under-served in April 2011. 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.

Meet your investment manager

Piyush Sharma, born and raised in India, is investment manager of Right Horizons 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.

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