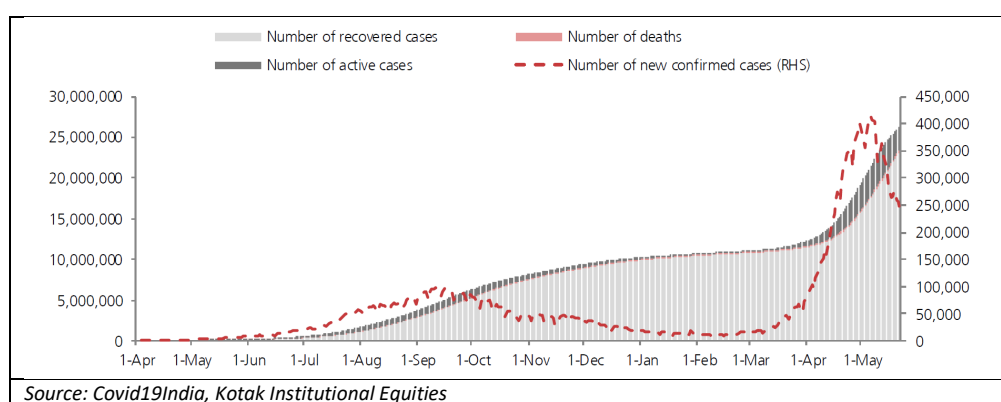


DURO CAPITAL

The purpose of this letter is to provide you, our partners, with deeper insights into our investment philosophy, portfolio and performance. By investing a significant portion of our own net worth into our funds, we ensure that our interests are fully aligned with our investor partners.

Just when it seemed like the economy had overcome the impact of Covid-19, India was hit with a “second” wave of infection that has proven to be more severe than the first. Starting mid-March, the country went from reporting close to 20,000 daily new infection cases to over 400,000 daily new cases, in a span of just 40 days, overwhelming the country’s inadequate medical infrastructure. While the pace of spread was accelerated by a double mutant “Indian variant,” there was also a degree of complacency against Covid-19 that had crept into both the government authorities and the public at large, before the second wave hit. India had re-opened public places, held large religious gatherings as well as crowded election rallies, while vaccination drives were woefully slow.



Unlike in March 2020, this time, there has been no country wide “lockdown” announced by the central government. Individual states have announced their own sets of restrictions as and when they have faced shortages of hospital beds and critical medical supplies. Currently, a large part (about 80%) of the country remains under varying degrees of restrictions. This has resulted in a slowdown of key economic indicators¹, albeit to a lesser extent than in April 2020:

- E-way bills, a lead indicator for GST collections, for the first half of May are down 47% vs March 2021
- Fuel demand was down 9.4% in April (vs March) and down a further 20% in first half of May
- Auto industry saw a decline in April – passenger vehicle sales declined 11% month-on-month and 2-wheeler sales declined 33%
- Power consumption, however, is down only 2% month-on-month reflecting the low impact on industrial activity given that the current restrictions, unlike in March 2020, have set detailed guidelines allowing industrial activity

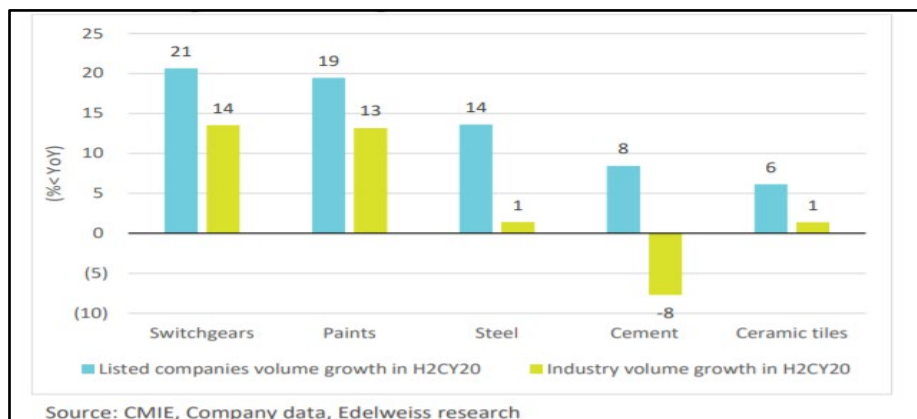
The “second” covid wave has led rating agencies and economists to cut India’s FY2022 GDP forecasts by 100-300bps, to a still respectable real GDP growth of over 9% (off a low base).

While the number of cases being reported daily remain high (around 175,000), there has been a steady decline in new cases since early May and the active cases are currently >30% lower than peak levels. Fortunately, the fall in new cases seems to be mirroring the sharp rate at which cases climbed. We expect states to start loosening mobility restrictions from June. This would mean that similar to last year, the bulk of the impact on the broader economy will be felt largely in the April-June quarter.

¹ Source: Kotak Institutional Equities

The rate of the economic recovery that one can expect post this second wave remains unclear. India saw a “V” shaped recovery from the lockdown last year on the back of pent-up demand in urban areas and a vibrant rural economy, which was largely unaffected during the first wave of Covid-19. Given that the pandemic has been far more severe and widespread this year, with over 50% of the cases coming from rural India, a much larger and more economically vulnerable segment of the population has been impacted. While the economic recovery post the first wave was dependent on fixing supply side issues (broken supply chains due to a sudden, complete lockdown), the economic revival this year will perhaps require a demand side response once the mobility restrictions ease.

We continue to expect the formal, organized sector to be a beneficiary and gain market share at the expense of the informal sector like we have seen in times of disruption in India in the past. This phenomenon is reflected in 2H 2020 performance for different sectors in the chart below:



March quarter (Q4FY21) results have lost meaning in the backdrop of the lockdowns that started in April. However, Q4 numbers did build on strong growth trends seen in Q3. Despite significant raw material inflation across sectors hurting gross margins, industry leaders across sectors demonstrated the ability to cut operating costs through greater efficiency, thereby limiting the impact on EBITDA margins. This will bode well for such firms once raw material prices are passed on, which will give them the ability to take further market share from the unorganized players that may not have the same cost control levers available.

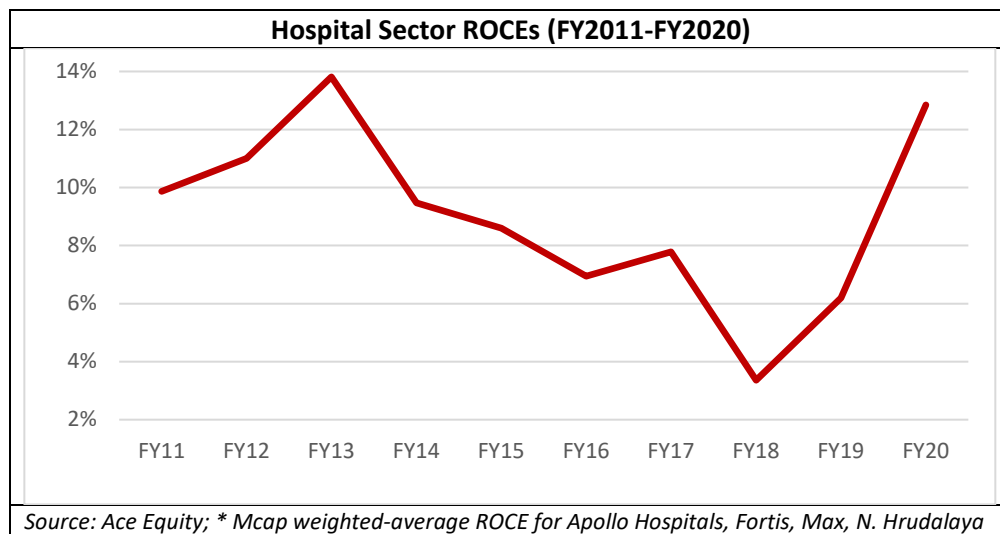
We expect a majority of our portfolio companies, which are market leaders in their respective sectors, to be beneficiaries of the trend described above. At the same time, two of the banks in our portfolio comprising a total exposure of approximately 7.5% of AUM currently have lending exposure primarily to smaller businesses and the self-employed/informal sector. These banks may see a negative impact from increased provisioning as a result of the second wave, as well as a near term impact on growth as they heighten their risk filters. Nevertheless, both banks are extremely well capitalized, and we expect any impact to be transitory. Additionally, one of the two banks has a near term special-situation event, which could potentially lead to the bank's stock price rising meaningfully in value regardless. The other bank follows a largely secured-lending model with very low loss given default (LGD) ratios, therefore providing comfort both from a profitability and capital base protection point of view. We will look to add to these two positions if the stocks reach unreasonable levels.

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It is only a coincidence, given the Covid-led healthcare disaster in India described above, that we increased our exposure to the hospitals sector in Q1 2020. The Fund initiated a new position in Max Healthcare (“Max”), India's third largest healthcare provider platform. Combined with our existing

investment in Fortis Healthcare (“Fortis”), India’s second largest healthcare provider, this new investment has increased our total exposure to the hospital sector to approximately 8% of AUM.

The Indian hospital sector has generated relatively weak share price returns over the last decade. Please refer to the table below for individual stock return data. These weak share price returns have mirrored the trend of declining return ratios that the sector has generated during that period, reflecting that in the long run, stock returns typically follow the return on capital employed (ROCE) generated by a business. A pattern of weak corporate governance, lack of management focus on driving business returns, subpar operating efficiency and poor capital allocation decisions have contributed to the underwhelming return ratios that the sector has generated over the last decade. Moreover, the weak stock price performance has dented the perception of the sector in the investment community, with a large chunk of institutional investors having abandoned the sector.



Annual share price returns for select Indian hospitals (FY2011-2020):

	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	CAGR
Apollo Hospitals	30%	35%	31%	9%	49%	-3%	-12%	-9%	15%	-7%	10%
Fortis	-18%	-34%	0%	-3%	68%	7%	3%	-32%	10%	-7%	-2%
HCG							29%	26%	-24%	-66%	-20%
N. Hrudalaya							10%	-11%	-24%	16%	0%

*CAGR returns for HCG and Narayana Hrudalaya are from IPO to FY2020, Max Healthcare listed as an independent entity in FY2021

Fortis and Max, too, delivered underwhelming returns both operationally and in terms of share price performance for a ten-year period until FY2020. We attribute this to poor management of the businesses by their erstwhile promoters/founders. Under the old promoter groups, both Fortis and Max were impacted by poor capital allocation decisions as well as a general lack of focus towards operating efficiency. By FY2019, both businesses generated ROCEs in the low single digits, with EBITDA margins settling in the low single digits as well. Our research shows that mature hospital assets, when managed effectively, can generate EBITDA margins in the mid-20s. Clearly, both Max and Fortis were suitable candidates for a turnaround.

The turnaround of both companies started with a much-needed change in ownership. In FY2019, IHH, Asia’s largest healthcare chain, acquired a controlling interest in Fortis. A few months later, Max Healthcare was acquired by KKR along with Abhay Soi, a turnaround specialist.

Hospitals have some inherent competitive advantages in India. Location of the underlying assets for hospitals is key. For example, both Fortis and Max derive over 80% of their revenues (and a greater % of their operating profit) from hospital assets with premium catchment in the top-5 metro cities in India.

Given the existing high cost and unavailability of land for a new player to enter similar desirable locations, this becomes a source of significant competitive advantage for Fortis and Max. Both companies also have strong brand recall and a long operating history. This enables them to recruit leading medical talent, which in turn forms a virtuous cycle attracting patients, and so on.

The most important change at both Fortis and Max since the change in their ownership has been in their incremental capital allocation into the business. All greenfield capital expenditure has been stopped and there is a strong focus on incremental ROCE% on the existing asset base. ROCE is typically driven by sweating assets to generate higher revenue and managing costs to generate higher profitability on that revenue. Both Max and Fortis are looking at multiple levers to drive revenue growth through a combination of initiatives like (1) increasing occupancy rates, (2) improving case mix (i.e., focus on higher value therapies), (3) improving payor mix (i.e., reducing the share of low-ASP business from government and state organizations) and (4) driving higher-margin medical tourism (i.e. international patients coming to India for treatment). The impact of these actions is visible in reported numbers, where EBITDA margins have risen sharply from mid-single digits to mid-teens for Fortis and low-20s for Max. Higher profitability on a flat asset base has led to a sharp increase in incremental ROCE estimates for both Fortis and Max.

EBITDA Margin trajectory for Max and Fortis:

EBITDA %	FY19	FY20	Q1FY21*	Q2FY21*	Q3FY21	Q4FY21E	FY22E	FY23E	FY24E
Max	9.9%	14.6%	-3.8%	16.2%	23.2%	24.2%	24.5%	25.0%	25.5%
Fortis	3.4%	12.7%	-16.5%	8.4%	13.3%	16.6%	16.5%	17.5%	18.3%

* Company Reported Financials, Duro Estimates

Expected Incremental ROCE% at Max and Fortis:

Incremental ROCE %	FY22E	FY23E	FY24E
Max	421%	95%	173%
Fortis	230%	200%	38%

* Duro Estimates

The “second” wave of Covid-19 has exposed the severe need for incremental healthcare infrastructure investment in India. We believe established healthcare providers like Fortis and Max will benefit from this increased focus on healthcare investment. Post covid, we also believe that penetration in health insurance will rise significantly; e.g. Kotak Research expects individual healthcare insurance penetration to double in India over the next decade. This will be a direct benefit for hospitals because it has the potential to significantly increase demand for healthcare services, especially in urban areas.

While both our portfolio companies have seen an improvement in operating metrics (and stock prices) over the last 3-4 quarters, we expect a different growth trajectory for the two companies driven by the DNA of their underlying majority owner groups. This will also lead to stock returns being generated by very different sources of value creation and corporate events at the two companies.

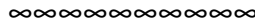
We expect Max led by CEO Abhay Soi, a turnaround specialist and 25% owner of Max, to become an acquirer of choice for many poorly operating hospital assets in India. We believe that Max’s growth during our holding period will come from both further improvement in the operating metrics of the existing assets, brownfield expansion and the turnaround of some poorly performing hospital assets in attractive locations in India that Max acquires.

On the other hand, we expect IHH to increase its ownership in Fortis to 51% from the current 30% and make Fortis its vehicle for expansion in India. We believe this ownership increase is imminent and will happen in the form of a long pending open offer from IHH to existing shareholders. We expect the open offer to be made at a significant premium to the current Fortis share price of INR 225. This could be a meaningful driver of the Fortis stock price in the near term. Beyond this imminent open offer, Fortis also

holds a controlling stake in India's second largest diagnostic chain, which has also seen operating metrics improve since a change in management. We believe that the value of this stake in the diagnostics business is not appropriately reflected in Fortis' current stock price. A public listing of this diagnostic chain could be another potential value creator for Fortis shareholders.

Typical risks around hospitals relate to poor capital allocation in a quest for growth. However, we believe that the current management teams at Fortis and Max have already seen the downside of poor capital allocation decisions made by their predecessors at these companies. The new owners have stated their intent to stay away from greenfield growth that typically comes with low ROCEs. Another risk to hospitals is typically from regulatory moves by government in the form of price caps. While this will always be a risk, we believe that well-diversified healthcare providers like Fortis and Max with revenue streams across therapies and payor types will be better placed to withstand any potential price caps in the future.

Interestingly, while diagnostics chains have similar revenue growth profiles as hospitals, incremental ROCE estimates for diagnostics chains currently stand at an average of <30% versus >150% for hospitals over the next 3-4 years. Despite this, diagnostic chains in India trade at >2.5x the valuations of hospitals currently.



Duro Capital has contributed to an organization in the city of Pune (which witnessed the largest number of new Covid cases in the state of Maharashtra), helping with the devastation caused by the second wave of Covid-19. In case you are interested in contributing, <https://actgrants.in> and <https://feedingindia.org> are other reliable organizations with a broader geographic reach doing meaningful work on the ground in India.

Nishchay Goel
May 2021

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