

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.

The investment objective of the Duro India Opportunities Fund (the “Fund”) is to achieve long-term capital appreciation primarily through long and short investments in securities of Indian companies. At the end of 2021, the portfolio included 22 long investments and 1 short investment. We added one new significant long position to the portfolio in the fourth quarter and also added more capital to another top-10 long holding. Yet, we were marginal net sellers in the quarter as the liquidity for these purchases came from small/partial sales in some long positions where stock prices reached all-time highs during the fourth quarter as well as from one complete sale of a toehold long position. The bulk of our exposure continues to be concentrated in our top-10 long positions.



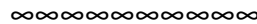
The Fund generated satisfactory returns in 2021. In terms of the portfolio, it was a busy year and we added new positions in 6 promising companies. We continue to follow a strategy of investing in differentiated businesses in underpenetrated sectors. Our investment criteria demands that we identify companies with demonstrated competitive advantages, the ability to scale, a resilient culture of operations and corporate governance, that are hopefully available at a reasonable price.

Our team, along with the depth of our coverage, expanded in 2021. We are now a team of 9, with 5 investment professionals across Singapore and India. Additional headcount means greater bandwidth to cover a larger number of companies as well as to dive deeper in terms of individual company research. We have ensured that the clarity provided by our strategy and investment frameworks helps institutionalize our process as the team grows. At the same time, we remain a small, tight-knit team that can capitalize on investment opportunities in a timely manner. We have made the effort to build a team that is ready to deploy and manage capital as if we were running the Fund at full capacity. I am confident that our investment in teambuilding early on in our lifecycle will pay dividends in the years to come.

We also made the first private investment for the Fund in 2021 into India’s leading merchant solutions provider, Pine Labs. We utilize the same investment frameworks to analyze private investment opportunities as we do publicly-listed companies. Investing is a hard enough endeavor, and private investing, perhaps even more so; not only because it requires a greater amount of imagination than what is required for public investing, but also because it requires access to proprietary deal flow to be able to build a differentiated portfolio of investments. Our investment in Pine Labs was a result of following the Buy Now Pay Later sector in India for close to a decade and knowing the company since 2010. The company has already raised additional capital at a significantly higher valuation than the round in which the Fund participated and according to media reports, a public listing for the company is expected in 2022.

Interestingly, 2021 was also the year when we said no to the highest number of private deals. India is clearly going through a technology revolution led by new-age, mobile-first companies that are leveraging the low cost of mobile data and high mobile penetration in India. Like in other parts of the world, Covid has led to a massive shift in internet usage trends in India. This means that several sectors

in India are skipping traditional formats and going straight to digital-first business models. Consumer demand for goods and services that has typically had to deal with the friction caused by poor physical infrastructure in India is suddenly experiencing a frictionless and seamless digital experience, similar to that in many developed economies. This has also caused a shift of demand in favor of digital models. It is not just the investors that recognize this paradigm shift; founders are making the most of these developments by raising capital at the fastest pace in recent history at what can politely be called “founder-friendly” valuations. In essence, while the companies in the private space are exciting, valuations are not.



We have discussed below some portfolio companies that meaningfully contributed or detracted from the Fund’s performance in 2021:

Hospitals (Fortis Healthcare, Max Healthcare)

Shares of Fortis Healthcare and Max Healthcare rose 92% and 216%, respectively, in 2021. We had discussed our investment thesis for both companies in some detail in DIOF’s Investor Letter #2 in early 2021. The lacklustre operating performance and accompanying underwhelming stock returns in the hospital sector over a decade (2010-2020) had led to most institutional investors abandoning the sector. Yet, as we discussed in our detailed investment thesis, hospitals have some unique competitive advantages based on network effects that can be hard to replicate.

Max Healthcare far exceeded our expectations last year across most operating parameters including revenue growth, cost efficiencies, occupancy levels and payor mix. Max deserves credit for challenging the status quo in the hospital sector. The company has set new benchmarks for operating efficiency and profitability in the industry. The company is now pursuing innovative asset-light models to expand capacity at attractive incremental return ratios and new initiatives like diagnostics have the potential to add to the future long-term growth rate of the company. Fortis, too, has successfully navigated through Covid-related challenges and continues to deliver on its margin expansion agenda. In fact, the company upgraded its long-term margin guidance in 2021 because of the structural changes that management has been able to bring about in the company since 2019. Fortis’ diagnostics business, SRL, is a potential IPO candidate and should unlock additional value for Fortis in the near to medium term. We continue to believe that IHH will increase its stake in Fortis to >50% at a significant premium to current market price, thereby making Fortis Healthcare its primary vehicle for expansion in the Indian sub-continent.

ICICI Bank

The Fund’s largest long position for 2021 was ICICI Bank. The stock rose 33% in 2021, outperforming both the broader market as well as the Bank Nifty Index. ICICI Bank was a day-one position for the Fund and has more than doubled since we initiated the position. Operational performance for ICICI Bank continued to surprise on the upside in 2021 with the bank delivering its highest return on assets (ROA) in the last 25 quarters. Our original thesis around “meaningful change” at ICICI Bank has been playing out well. The bank’s liability franchise is much stronger (leading to lower cost of funds), its legacy asset stress issues created under its previous leadership have been dealt with aggressively and most importantly, new leadership has built a technology-driven, customer-focused culture throughout the organisation. We believe that ICICI Bank is well-positioned to continue to gain market share in terms of advances and deposits and return ratios should be able to maintain an upward trajectory as revenues grow faster than operating costs. ICICI Bank remains a sizeable position for the fund but is no longer its largest position. We booked some profits in January as the stock continued to rally into 2022. We will discuss how we have deployed this capital in a future letter.

Titan

Titan shares rose 61% in 2021. Contrary to market expectations for a jewellery company, Titan turned out to be a significant beneficiary of Covid. Quoting from our investor letter from mid-2020 where we wrote about Titan – “...we expect the pandemic to lead to significant market share gains for sector leaders especially in industries where sector leadership is fragmented.” In line with our expectations, throughout the pandemic, we have seen accelerated formalization in a deeply fragmented Indian jewellery market with significant market share gains for Titan. Titan reported a 26% 2-year compounded annual growth in jewellery revenues in the December 2021 quarter off a pre-Covid revenue base, outpacing industry growth by a wide margin. In fact, revenue growth in the latest quarter was led by 39% year-over-year growth in new-to-Titan customers reflecting formalization of the industry with consumers moving from local mom-and-pop jewellers to a brand like Titan. The robust revenue growth at Titan has also helped margins, which are seeing new highs because of operating leverage. This brings me to a point that I have made often about investing in India. One does not need to necessarily go down the market cap ladder to generate attractive investment returns. Titan, too, was a day one position for the Fund. The market cap of the company at the time we acquired the shares for the Fund was approximately US\$13.7 billion; by no means a small or mid cap company. Within the last 14 months, we have seen the stock return 2.2x on our investment. Yet, even at this scale and despite being the largest jewellery company in India, Titan has only a 6-7% market share in the Indian jewellery market indicating a very long runway for growth and consequent potential for compounding for our investment.

Ujjivan Financial Services

Our long position in Ujjivan Financial Services (UFS) was the biggest detractor from performance for the Fund in 2021, with the stock falling 48%. UFS is the holding company for Ujjivan Small Finance Bank (USFB) in India. In fact, UFS' only asset is its 83% shareholding in USFB. Approximately 80% of USFB's loan book is exposed to microfinance. While microfinance is a large and severely underpenetrated market in India, making long-term prospects for focused players extremely attractive, it is also a sector that requires physical contact in the form of group meetings to drive both loan disbursements and collections. With a severe second wave of the Delta variant in India, physical activities were again impacted significantly in 2021 causing meaningful disruption to USFB's business. This led to higher operating expenditure to income and abnormally high credit costs for USFB. Furthermore, during the year, USFB's CEO who had taken over the reins of the bank in November 2019, unexpectedly resigned. This led to UFS' founder, Samit Ghosh, returning to take over the reins of the business. A management transition in the middle of a pandemic year further negatively impacted investors' confidence in the business. In fact, we remain concerned about this development and continue to track the new management's actions very closely. Why did we not sell this stock earlier in 2021 and especially after the management change? Primarily because we believed and continue to believe that we have significant downside protection in this holding. UFS shares trade at a >45% holding company discount versus the value of UFS' 83% equity stake in USFB. This discount is likely to be reduced to zero with the proposed (and approved) reverse merger of UFS into USFB. This should lead to an immediate ~2x upside in our holding value on the day that the reverse merger closes. Moreover, as the economy re-opens fully and USFB's operations return to full normalcy, there is likely to be a reversal of the de-rating this business has seen during the pandemic. A re-rating from its current 1.1x forward price to book multiple has the potential to add further upside to this beaten down position.

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Inflation is no longer transitory and interest rates are bound to go up! Liquidity will be squeezed out of the system and the dependable Fed Put may finally be off the table! How is one to invest with this backdrop?

Interest rates and stock market valuations have a fundamental linkage. After all, share prices are nothing but the present value of future cash flows. Rising interest rates result in higher discount rates that, *ceteris paribus*, should lead to a lower net present value of future cash flows (especially for a stream of cash flows that factors in higher future growth over a longer time frame). Yet, in the real world, the relationship is more complicated. The missing pieces in the above equation that determine the eventual impact on share prices are (1) base valuation multiples, and (2) potential economic growth that impacts future free cash flows (perhaps the most important factor in stock valuation).

Valuation Multiples: The Nifty Index currently trades at a 12-month forward price to earnings ratio of 20.2x, 13% higher than its 7-year average and 20% higher than its 10-year average. But as is often the case, the numbers on the surface only tell half the story. The composition of the Nifty Index has changed significantly over the past decade. Higher P/E sectors like consumer staples & retail, financials and IT services have seen their weightage in the index increase to 63% currently from 43% in 2010. Meanwhile, the weightage of relatively lower P/E sectors like oil & gas, capital goods, utilities, metals & mining commodity, utility and infrastructure has fallen to 20% from 42% in 2010. Assuming even a conservative ~2x differential in P/E valuation between these groups would itself result in a Nifty valuation increase of 20% between 2010 and now. Furthermore, even existing constituents of the Nifty have seen a pivot in their business that has impacted valuation multiples. For example, the largest constituent of the Nifty, Reliance industries (11% weightage), has pivoted away from its core commodity business of energy and petrochemicals to consumer facing businesses like retail and telecom. These consumer businesses now form close to three-fourths of its valuation from virtually nil contribution 5-6 years ago, thereby causing its current valuation multiples to jump nearly 2x over its historic multiples. And if that was not enough, indices in India are about to enter another transformational phase. The public market listing of new-age technology companies like Zomato, Nykaa, Paytm, Policybazaar, etc. will soon lead to their inclusion in the main indices given their scale and large market capitalizations. As this plays out, comparing the P/E ratio of the Nifty index to historical multiples will become even more redundant because the focus for the bulk of these new-age technology companies in the medium term will remain on growth and not profitability, leading to index P/E ratios looking even more lopsided.

We are not suggesting that the index is cheap (or expensive). We are simply making the point that making a judgement about the attractiveness of investment opportunities in a market by looking at headline market valuation multiples is fraught with the risk of making misinformed decisions. On our part, we will continue to be driven by our strategy of investing in differentiated businesses in underpenetrated sectors and focus on the “why” of the businesses that we evaluate and better understand the “why now” for the right opportunity to initiate (or increase) a position. There is also no doubt that the unprecedented liquidity injections that we have seen over the past decade, and more so over the last 8 quarters, have led to extreme froth in certain pockets of not only the Indian, but also, global markets. We are hopeful that any reversal of this unprecedented liquidity will provide us the opportunity to short some structurally weak businesses that have been thriving under the garb of liquidity.

Economic Growth: In the exhibit below, we have outlined a few economic reforms that have been underway in India over the last 2-3 years, which have been overshadowed by the Covid-related lockdown/re-opening narratives that have dominated conversations over the past couple of years. These reforms will hopefully provide a strong impetus to the economic engine over the medium term.

Reforms	Year	Details
Largest corporate tax rate cut in India	2019	- Reduction of the corporate tax rate to 22% from 30% in September 2019 - Introduction of a 15% tax rate for new domestic manufacturing companies commencing operations between September 2019 and March 31, 2024
Production-Linked Incentive (PLI) schemes	2021	- Providing 4-6% of incremental revenue as incentive to eligible manufacturing companies over a 4-6-year period to create a large-scale manufacturing ecosystem & to reduce dependence on imports - Allocated USD26 billion towards this effort, thereby potentially impacting ~USD500 billion of incremental manufacturing revenue across 13 critical sectors
Labor reforms	2020	Simplified cumbersome labor laws, eased the burden of compliance on firms and allowed complete flexibility on hiring and retrenchment of employees in mid to large scale companies
National asset monetisation pipeline	2021	- USD 80bn pipeline that involves transferring revenue rights of brownfield public assets to the private sector - The funds collected will be used for new physical infrastructure creation
FDI in insurance & defence sectors	2020, 2021	Allowed more than 50% foreign investment in insurance & defence sectors
Ended retrospective taxation of cross-border investments	2021	Provides clarity in terms of tax policy and adds to ease of doing business initiative

Moreover, it is noteworthy that corporate India's balance sheet today is stronger than it has been in close to two decades. State Bank of India (SBI), India's largest bank, represents ~23% of system credit in India with exposure across customer segments, industries and regions. It therefore provides more than a fair representation of how the overall system credit is faring on a pan-India basis. In the December 2021 quarter, SBI reported its lowest net NPA to operating profit ratio in the past two decades. This is not an overnight achievement; and has taken years of effort. A stressed asset clean-up was underway across banks in India between 2015 and 2020. Moreover, we are also coming out of a pandemic-dominated 2-year period where credit filters across the banking industry were at their tightest levels. Finally, capital adequacy ratios across banks are at reasonable levels because of the furious pace at which the industry raised new capital post-Covid in 2020. Availability of credit is the fuel required for any economy to fire and the current set up of the banking system puts prospects for medium term economic growth in India in a favourable position.

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Emma Raducanu, the reigning women's US Open champion, made a stopover in Singapore over the Chinese New Year holiday recently after her exit from the Australian Open. Raducanu spent a few days practicing with her coach and some local players at the Tanglin Club. It so happens that my living room is to Tanglin Club's tennis courts, what the Royal Box is to Centre Court at Wimbledon! Raducanu turned up for practice every day from 10am to noon and then from 2pm to 4pm. Each practice session involved practicing only one shot and one shot only. For example, during a 2-hour session, she would hit more than 200 drop shots and nothing else. The next session would be serve and volley only, followed by another session of only returning serves to the opponent's backhand. A professional athlete's training regimen should never be underestimated, but to see a champion practice for hours in front of you makes you realize the kind of consistency, discipline and deliberate practice it takes to succeed in a sport. Long-

term investing is no different. Investing outcomes may be more impacted by exogenous variables as compared to a US Open singles final match; however, a successful, long term investment journey, too, requires the selection of a consistent and tested investment strategy, the discipline of sticking to that strategy through ups and downs and the deliberate practice of studying hundreds of businesses to be able to identify patterns and avoid biases.

Thank you for your support to Duro Capital. Good luck in 2022!

Nishchay Goel
February 2022

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The inception date of the Duro India Opportunities Fund (the "Fund" or "DIOF") is August 18, 2020.

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The NSE Nifty Bank Index is a free-float capitalization-weighted index comprised of the most liquid and large capitalized banking stocks in India (Bloomberg Ticker: NSEBANK Index). The returns presented for these indices are from publicly available sources and are not independently verified. These Indices are listed because they are representative of widely known and followed investment alternatives. The indices returns are provided for information purposes only and comparisons to indices have limitations. Investing in equity securities is the primary strategy for the Fund, however the Fund does not invest in all, or necessarily any, of the securities that compose the referenced index, and the Fund's portfolio may contain, among other things, options, futures and other securities, concentrated levels of securities and may employ leverage not found in these indices. As a result, no market index is directly comparable.

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