

DURO CAPITAL

The purpose of this letter is to provide you, our partners, with deeper insights into our investment philosophy and portfolio positioning. 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.

Real GDP growth in India came in-line at a respectable 6.7% for the quarter ended June 2024. While an unfavorable base effect impacted this number, a key drag on the quarterly real GDP growth was weak government expenditure; expectedly so, considering the national elections in May that constrained government spending and general economic activity during the more than month-long election period. However, private consumption, which had been a laggard in previous quarters, grew at its highest level in seven quarters thereby supporting real GDP growth, along with gross fixed capital formation that stayed relatively strong. Most economists expect annual real GDP growth for this fiscal year (ending March 2025) to clock in at ~7%.

Meanwhile, June quarter earnings for the BSE500 index¹ grew at 11% yoy, slightly faster than revenue growth at 9%. Earnings growth for the broader market has fallen to levels more in line with top line growth as the benefit of benign raw material prices and low credit costs (for banks) is now behind us. Moreover, the election-related hiccup in economic activity may have also contributed to some drag in earnings growth. Compared to broader markets, the Duro India Opportunities Fund (“DIOF”) portfolio grew earnings twice as fast at 22% and revenue at 26%, for the June quarter. Moreover, while BSE500 EPS growth over the next year is expected to be stable at ~10%, we expect the Duro portfolio companies to grow earnings at close to 25% over that same time frame.

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We are sharing below some significant events related to a few of our large holdings over the past few months:

Bharti Airtel

Bharti Airtel remains the largest holding (~11% portfolio weight) for the Duro India Opportunities Fund. This “large cap” has performed exceptionally well during a time where small and mid-caps have been the flavor of the market. Bharti, today, has a market capitalization of ~USD116 billion and is the second largest mobile services company in India. The Bharti stock has returned 85%+ over the last 12 months.² Returns captured by Duro over that period, however, have been higher than this stock return because the Fund has built exposure to the company not only through its common stock, but also through publicly traded partly paid-up rights in Bharti Airtel, which have risen over 150% yoy; as well as through an equity stake in Bharti Hexacom, a Bharti Airtel subsidiary that provides mobile services in select states in India. Hexacom stock has risen by over 120% since the time that we bought the shares earlier this year.

In July this year, telecom companies in India announced significant tariff hikes ranging between 15% to 25%. This marked the first major tariff hike in the Indian telecom industry in close to three years and was in line

¹ Ex-Oil Marketing Companies; Source: Kotak

² As of August 31, 2024

with one of the three 'Why Now' scenarios that we had underwritten for our investment in Bharti Airtel. We believed that mobile tariffs in India would need to rise significantly (potentially by over 100%, from a modest industry ARPU of ~\$2) for Vodafone Idea, the fledgling third largest mobile services provider in the country, to avoid bankruptcy. Our thesis was that such a tariff hike would in turn lead to a sharp increase in profitability and return ratios for an already profitable and well-run company like Bharti. We anticipate that this tariff adjustment has only just begun and will lead to a series of tariff increases over the coming years. As a result, we expect Bharti's earnings from its Indian operations to grow by more than 30% over the next 3-4 years. Meanwhile, this earnings growth is likely to overlap with a period of capex rationalization, which will lead to return on capital employed (ROCE) potentially rising from 13% to over 25% over that time period.

Interglobe Aviation

Interglobe Aviation, better known as IndiGo Airlines, is the largest airline in India with a dominant 61% domestic market share. IndiGo is the second largest position in the DIOF portfolio. Like many airlines worldwide, IndiGo has been negatively impacted by aircraft groundings because of Pratt and Whitney engine issues. Last fiscal, the company projected that 20% of its fleet (about 75 planes) would be grounded in calendar year 2024. As a result, the company had guided for a weak FY25, compared to the all-time high earnings that it reported in FY24. Nonetheless, IndiGo has managed the situation exceptionally well by wet-leasing aircrafts, accelerating the delivery of new planes (29 new Airbus planes already delivered this year despite the global aircraft supply issues), and extending expiring leases. These measures have allowed the company to surprise the market with an 11% increase in capacity for the current quarter and enabled IndiGo to retain its dominant 60%+ market share despite 20% of its fleet being grounded. Further, the 'Why Now' of the business has only strengthened because engine issues at Pratt and Whitney and Boeing's internal challenges have meant that competition is finding it harder than ever to enter/scale up in the Indian aviation market. IndiGo's excellence in execution and a strong market position — i.e. a leader in a quasi-duopoly in the fastest-growing aviation market in the world — leaves us optimistic about IndiGo's medium-term prospects.

Ujjivan Small Finance Bank

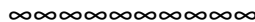
Ujjivan Small Finance Bank is a large microfinance (MFI) focused lender in India and a long-held position in the portfolio. The initial investment was made through the bank's holding company, Ujjivan Financial Services. At the time, the holding company traded at a significant discount to the underlying bank, its only asset. During the past quarter, the holding company reverse merged into the bank and shareholders in the holdco received shares of the bank. This led to an immediate 15%+ increase in the value of our Ujjivan holding because the underlying discount of the holdco versus the bank was eliminated following the reverse merger.

However, on-the-ground sentiment in the MFI sector in India is currently soft. Certain pockets of the country have seen overleveraging in the MFI space with individual borrowers having availed loans from multiple lenders. We believe that while this poses some risk to Ujjivan's asset quality, the bank should emerge relatively unscathed from this situation. A key reason for this is that Ujjivan was aggressive in quickly writing off bad MFI loans during Covid. This meant that the bank could focus on growth as Covid waves receded and economic activity revived in FY2023. Ujjivan's MFI loan book grew ~42% in FY2023, when competition was still focused on asset quality issues. As competitors returned to the market in FY2024, Ujjivan proactively dialled growth down. While the broader MFI industry AUM grew at 25%, Ujjivan's MFI AUM grew at 19% in FY24, less than half of its FY23 growth. We believe that Ujjivan's restrained approach to loan disbursement during the past year, along with its stringent underwriting processes, should lead to a better

asset quality outcome for the bank relative to the industry. In this fiscal year, the bank is expected to grow non-MFI verticals faster, which should support overall AUM growth of ~20%. After having risen 90% in 2023, Ujjivan Small Finance Bank shares have fallen ~22% this year³. The bank is currently trading at 1.1x forward P/B for 20% ROE and 20% AUM growth. We believe this valuation has room for reasonable expansion.

360 One

360 One WAM is India's largest non-bank wealth manager catering to ultra-high net worth (UHNH) clients. The company reported revenue growth of 60% yoy and earnings growth of 80%+ yoy for the June quarter. This is not surprising given the sharp rise in consumer wealth in India. For example, over the last 4 years, companies and their promoters/founders have raised over USD34 billion in proceeds by selling shares through just public listings (IPOs and OFS'). 360 One is the market leader in providing wealth management services to such individuals and currently counts over 7,400 of India's wealthiest families as its clients. As of June 2024, the company had assets under advice/management of over USD26 billion. While this is a sizeable amount for India in absolute terms, it still represents only a ~3% share in a market where UHNH households have total financial assets of ~USD1 trillion (growing at 13-14% per annum). 360 One has also announced plans to launch new verticals targeting HNI clients, WealthTech and Global Indians.



Last quarter, we established a new position in **Craftsman Automation**, a precision machining company that specializes in critical engine components. What distinguishes Craftsman from the competition is its comprehensive control over the entire value chain—from designing machines, tools and dies, to developing design and manufacturing software — while only relying on external vendors for standard machinery and components. The company's founder has cultivated a growth-oriented culture throughout the organization and has continuously explored new opportunities to scale, thereby maintaining relevance in an otherwise challenging B2B sector.

Craftsman is now expanding beyond automobile engine machining. It has become the only Indian company to secure business for critical machining processes in the stationary engine segment from global players like Caterpillar and Cummins. The 'Why Now' of the Craftsman opportunity includes this entry into the stationary engine segment, along with a growing shift of global internal combustion engine (ICE) business to India that will lead to increased business for Craftsman. Moreover, we expect the company to continue to make relevant acquisitions — an area where it has demonstrated a strong track record.

Craftsman's financial performance has been outstanding, with revenue and net profit growth of 22% and 30%, respectively, over the past decade. This growth has come with EBITDA margins of >20%. We expect the company to compound earnings at 30%+ over the next three-four years and our investment in the company has been made at an EV/EBITDA multiple of 10.5x.



Reservations around valuations in Indian equity markets is not a new phenomenon. Has the market run its course in this leg of the up cycle? Perhaps, a more relevant question is - are we finding opportunities to invest in this market? And the answer to this question is – yes. In fact, we are sitting on a reasonable pipeline of new ideas. And each component of this pipeline has passed through our "Why/Why Now/Price-Value"

³ As of August 31, 2024. This does not include the benefit of the reverse merger captured by the Fund.

framework. We also remain acutely abreast of the valuation of our existing holdings. However, it is never easy (and often an error) to make a sell decision based on valuation alone. A ready pipeline of new ideas keeps up the pressure on us to maintain a truly focused, best ideas portfolio. I attribute our ability to source new ideas to our investment process, that we consciously and diligently continue to improve. At its core, the Duro team focuses on dedicating the greatest amount of time on the most important activities that can hopefully generate the best outcomes for our portfolio. I will discuss the evolution of our process in some detail in a future letter.

Nishchay Goel
September 2024

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