Alchemy India Long Term Fund - Quarterly Newsletter - Jan 2018

*NAV : USD 340 AUM: USD 104.32 mn** *Bloomberg Ticker: ALCINDA KY <EQUITY>*

Brief Objective**

To generate long-term capital appreciation by investing in (i) listed Indian equities, (ii) PIPES on listed Indian equities and (iii) IPO and pre-IPO opportunities.

Investment Strategy

Long-short fund with a long bias. The fund will be principally long and will not run consistently short position. However, based on market conditions, the investment manager reserves the right to use discretion to take a short position either to hedge the portfolio or profit from opportunistic short calls.

Investment Philosophy

<u>Growth at a Reasonable Price</u>

This approach is rooted in the hypothesis that India is a high-growth economy and that the best way to benefit is to identify and invest in companies that are best equipped to take advantage of the emerging domestic and global opportunities.

<u>Invest for the Long Term</u>

The intention is not to trade in and out of investments to capture short-term volatility. However, at appropriate and opportune moments, the Fund may seek to tactically hedge its exposure by taking short positions on NIFTY futures and/or a basket of stocks.

*** The fund objectives are merely a target and there are no assurances that it would be achieved.*

**Data is as on December 31, 2017.*

INVESTMENT MANAGEMENT

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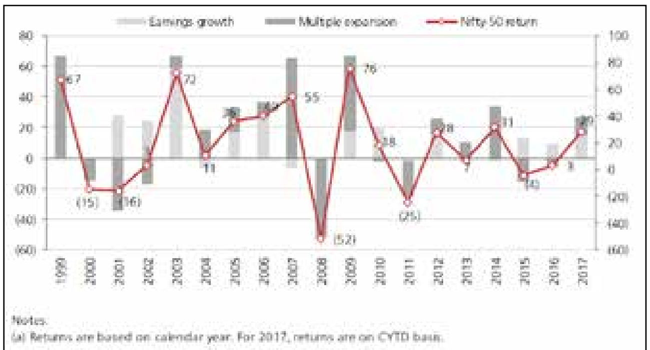
Market Overview

At the outset, we wish you all a very Happy, Healthy, and Successful 2018.

2017 was a stellar year for equity markets with Nifty rising by 28.65% (in INR). The markets have risen stupendously since the demonetization lows and to use a much clichéd term 'markets climbed the wall of worries'. However, this was a global phenomenon with 2017 witnessing one of the smoothest bull markets across the globe accompanied by record low volatility.

This has put a spotlight on how expensive the markets are. However, if we were to look at a 3 year period (CY2014-2017), the absolute return (in INR) was 27.1% translating to a moderate CAGR of 8.3%.



Source – Kotak Securities

As we can see from the chart above, returns, in periods subsequent to the years where most of the returns were driven by multiples expansion, have been muted. The table below explains the same in detail.

(in INR)

Year of Multiple expansion	Absolute Return %	Subsequent period	Absolute Return %	Return CAGR in subsequent period %
1999	67	2000-2002	-26.1	-9.6
2007	55	2008	-51.7	-51.7
2009	76	2010-2011	-11.1	-5.7
2014	31	2015-2016	-1.2	-0.6

Source: Bloomberg

Indian markets have been trading at a one year forward P/E multiple of around 18 for more than 3 years (see below) now indicating that markets have been waiting for earnings growth recovery.

Nifty P/E Range

Source – Kotak Securities

Hence, the strong returns of CY2017 were not entirely a result of P/E expansion (12% returns

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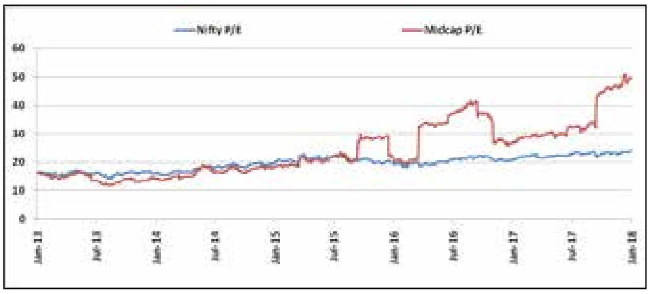
of the total 29% return on Nifty in 2017 can be explained by multiple expansions while the remaining 17% return is actually due to earnings growth). Hence, we believe the biggest driver for returns from here on will be determined by earnings growth. Considering that the economy and corporate are recovering from the effects of demonetization and GST, this could well be the case in second half of FY2018 and FY2019-20.

While the overall markets is not expensive if earnings growth follows through, what in our view, is of concern is the unsustainable premium of small and midcap stocks relative to large caps.

Nifty & Nifty Midcap P/E



Source: NSE

As we enter 2018, we are entering a phase of shift from supportive macro to supportive micro and from P/E multiples expansion phase to an earnings growth phase for the market. Rising inflation and rising global yields coupled with several domestic state elections may drive volatility higher. However, the most critical factor to drive the market could be future earnings growth and the rest could be simply noise.

In the last 3 years, central government was focused more on bringing the fiscal deficit and inflation under control and carrying out several structural reforms. This adversely affected sections of the population, especially the rural areas and the unorganised business segment which was reflected in the lower than expected margin of victory in the Gujarat state elections for the Bhartiya Janata Party (BJP). Hence, there is expectation that the upcoming budget would be focused on agriculture and rural activities. There is fear amongst the market participants that the government may turn populist before the 2019 elections as reflected in higher deficits which has caused bond yields to spike by 100 bps in last 6 months *(Source: RBI).*

Earnings growth remained subdued for last 4 years due to a host of reasons such as highly leveraged corporate balance sheets, low capacity utilization, low private capex, and structural reforms which hurt the cash economy and the unorganized segment. A combination of these factors delayed the inevitable cyclical recovery. We believe that the government will be mindful of the impending elections and the insights gained from the recent election results. This is already partly reflected in the form of front

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loaded capex for FY2018 and increased incentives for the rural areas such as increased MSP prices, more allocation towards various rural schemes, road construction, affordable housing, etc. These initiatives are expected to lead the recovery and potentially have a cascading effect across other sectors. Thus, earnings growth is expected to pick up pace driven by revival in consumption and flow through of structural benefits from GST reforms. Our confidence on earnings growth revival is not so much predicated on a cyclical recovery, though that should also play out, as much about the fact that the formal sector (as represented by the listed space) gains at the behest of the informal sector.

Fund Commentary

Alchemy India Long Term Fund has returned 50.4% (net of all fees and expenses) for 2017 versus the BSE 500 Index (In USD) which returned a 44.5%. The INR appreciated by 6.3% against the USD.

Table 1: Top Contributors & Detractors of Fund Performance in 2017

AILTF Top Contributors*	Stock Return (USD)#	Contribution to Fund Return#
ESCORTS LTD	172.8%	7.3%
BAJAJ FINANCE LTD	123.9%	5.9%
VMART RETAIL LTD	136.0%	4.7%
BAJAJ FINSERV LTD	88.7%	4.4%
BAJAJ ELECTRICALS LTD	133.4%	3.6%

AILTF Top Detractor*	Stock Return (USD)#	Contribution to Fund Return#
DYNAMATIC TECHNOLOGIES LTD	-17.0%	-1.3%
ITC LTD	-8.2%	-0.4%
MULTI COMMODITY EXCH INDIA	-14.5%	-0.4%
AXISCADES ENGINEERING TECHNOLOGIES LTD	-18.9%	-0.4%
GREAVES COTTON LTD	-3.2%	-0.3%

 # Returns are net of all fees and expenses.

#Past performance is not indicative of future performance.

**The top and bottom five performing positions are listed for illustrative purpose only and complete list of recommendations can be made available upon written request*

The top 5 stocks in above table contributed to nearly half the fund performance for 2017.

- **Escorts Ltd.** had a stellar year on back of growth in tractor volumes and rising profitability driven by cost cutting and operating leverage which is expected to drive profitability by 3.9X from FY16 to FY19E.

- **Bajaj Finance Ltd.** valuations continue to inch up as more investors recognizes its strong lending franchise which continues to deliver (30%+ profit growth). We have trimmed some of our holdings at 10X trailing P/B valuations for Bajaj Finance given our belief that valuations for many NBFC's will revert to their mean as portfolios shift to hitherto neglected corporate lenders with large free floats which were shunned by the market due to concerns on Non-Performing Assets and are back on investors radar given the promise of large recapitalization by the government.

- **Vmart Retail Ltd.** a value retailer of large apparels in Tier II, III & IV towns in India benefited from both demonetisation and implementation of Goods & Service Tax (GST). During demonetisation it was one of the few retailers equipped with Point of Sale machines, which increased footfalls and during GST implementation it had a fully compliant supply chain which its single store competitors lacked. Its high base during these events may act as a dampner for a few quarters and expect 10 but the company continues to be on the right growth path and expect to open 20-25 stores a year on a base of 160+ stores entirely from internally generated cash flows.

- **Bajaj Finserv Ltd.** has 3 subsidiaries; Bajaj Finance, Bajaj Allianz General Insurance & Bajaj Allianz Life Insurance. The stock performance benefitted not only from the strong underlying performance of Bajaj Finance but also beacuse a number of large general and life insurance companies listed on the exchanges and Bajaj Finserv re-rated on back of their relative high listing valuations of its peers. It continues to run a great General insurance franchise and is working hard on improving its model in Life insurance.

- **Bajaj Electrical Ltd.** a manufacturer of lights, fans and small electrical appliances has over the last few years transformed its retail and wholesale distribution based on the principles of 'Theory of Constraints' at the cost of lost sales and profits during the period. With the excersise nearing completion, investors have slowly started understanding the benefits of the model which focuses on (i) retail penetration and sales (ii) low capital intensity (iii) better service compared to a Wholesaler / Distributor push strategy of many of its peers. From 2HFY18 onwards sales increase will drive disproportionate increase in margins and profits. We like managements who do not focus excessively on short term performance and willing to take tough calls to drive long term value.

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From amongst the detractors;

- **Dynamatic Technologies Ltd.** got impacted due to delay in ramp-up on its aerospace projects but those will eventually come as there have been no cancellations.

- **ITC Ltd.** is a new stock addition to the portfolio which suffered as the tax policy changed after GST rates were announced with additional cess announced on cigarettes. It is one the cheapest large cap consumer staple company and we continue to own it as we don't beleive taxation can be excessively negative from here. Simultaneously, it is building a solid franchise in the FMCG and food space which is underappreciated by investors as they aggressively in the short to medium term to drive value for the long term

- We have exited **Multi Commodity Exchange Ltd.** as we don't believe in the hype around commodity options and risks associated with universal exchanges can dent market share and also Axiscades Engineering Technologies Ltd. as performance did not meet our expectations.

- **Greaves Cotton Ltd.** is a leading manufacturer for Diesel / Petrol engines for 3-Wheelers & Light Commercial Vehicles. The stock underperformed because of the aggresive plans from the government to move towards Electric Vehicles (EV). We continue to hold the stock as we believe the time line for adoption of EV's seem aggressive and the company has taken various steps to de-risk its business by setting up Multi brand Spares Network, focusing on farm equipment products like gensets and power tillers and is working with technology companies for hybrid 3-Wheelers and next generation engine technologies.

Apart from ITC, new addtions in the portfolio are;

- **Niyogin Fintech Ltd.** was a PIPE deal which the fund participated in. Niyogin is a startup which aims to provide credit and other related services and products to micro and small enterprises. The aim is to automate the credit decision making process by using digital infrastructure to link to various data bases including Aadhar (National ID Verification), credit bureaus, tax, bank, legal databases etc to run algorithms to analyse credit worthiness of potential clients. The aim is to create a superior decision making process in terms of time, consistency and cost than the current manual decion making process. Niyogin shall be launching the business model with tax, accounting and advisory focussed business

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associates who have well established financial advisory relationships with a lot of micro and small businesses in Tier 2 & Tier 3 cities. The company has started a pilot project in Maharashtra which will later be scaled up nationally in 2018.

- **Indian Energy Exchange Ltd.** is the dominant player in India's duopolistic power exchange market with 97% market share that reflects strong management expertise and right technology. Power and energy market reforms such as push from regulators on transparent pricing, and enforcement of grid discipline, open access to industries, prudent buying by distribution companies (DISCOMs) and in our view introduction of new energy products will help IEX grow traded volumes and sales at 15-20% CAGR over next 3-5 years. Given the high operating leverage and the asset light business model, it has a strong financial profile marked by 80%+ EBIDTA margins, earnings CAGR of 25-30%, net cash at 7% of current market capitalisation, and return ratios in excess of 40% (*Source: Alchemy Research).*

- **ICICI Bank Ltd.** as an investment has been shunned by investors in recent years due to issues with non performing assets on its corporate loan book. However, now with the National Company Law Tribunal (NCLT) being setup to look into insolvency and bankruptcy issues with respect to Non Perfroming loans of banks a lot of clarity will emerge on the banks books in next 2 to 3 quarters. The resolution of several of these accounts coupled with a growing retail franchise should lead investors to re-rate the bank. For e.g.ICICI trades at 1.6X trailing P/B adjusting for valuation of its various subsidiaries compared to NBFCs many of which trade from 5-10X trailing P/B.

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Alchemy India Long Term Fund Performance (%)[1]

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct	Nov	**Dec**	**YTD**
2017													
Fund Performance	7.3	5.9	6.8	4.6	-0.3	1.0	3.5	1.5	-2.4	4.4	2.5	**7.2**	**50.4**
Benchmark*	5.9	6.1	6.8	3.7	1.2	-0.5	6.5	-0.9	-3.1	7.4	0.6	**4.3**	**44.5**
2016													
Fund Performance	-10.7	-13.2	16.5	2.9	1.1	3.9	8.4	2.5	2.5	3.3	-10.4	-1.2	**1.7**
Benchmark*	-8.0	-9.1	14.4	1.9	2.4	1.9	6.0	2.2	-0.7	1.2	-8.1	-0.6	**1.3**
2015													
Fund Performance	6.4	4.7	4.0	-6.5	0.0	0.9	5.7	-9.5	0.3	1.7	-1.1	3.8	**9.6**
Benchmark*	8.5	0.9	-4.8	-4.7	2.8	-1.1	2.6	-9.5	0.5	2.5	-3.2	1.2	**-5.3**
2014													
Fund Performance	-5.3	3.5	15.8	0.7	13.5	7.7	4.0	4.3	2.5	2.0	2.8	-1.4	**60.4**
Benchmark*	-5.1	3.5	11.1	0.2	12.8	4.5	0.2	2.3	-1.1	4.5	2.5	-4.2	**33.9**
2013													
Fund Performance	-2.5	-10.0	-5.3	6.6	-2.0	-10.3	-3.6	-13.7	13.1	10.2	0.8	6.0	**-13.7**
Benchmark*	3.9	-7.4	-2.2	4.6	-3.3	-8.9	-4.8	-12.3	11.5	11.5	-2.3	3.9	**-8.6**
2012													
Fund Performance	20.5	5.4	-4.1	-1.0	-10.1	4.8	-0.5	2.1	15.7	-3.0	9.0	0.9	**42.5**
Benchmark*	21.5	6.3	-5.7	-3.5	-12.7	6.6	-0.3	0.6	14.9	-3.8	4.2	1.0	**27.6**
2011													
Fund Performance	-13.3	-5.8	13.9	6.7	-0.8	1.5	6.4	-11.7	-4.7	2.8	-16.5	-10.6	**-31.3**
Benchmark *	-12.7	-2.3	9.9	0.5	-4.0	1.1	-0.9	-12.5	-7.4	6.1	-15.4	-7.5	**-38.9**
2010													
Fund Performance	-0.1	1.2	6.5	7.0	-10.2	5.4	4.8	4.0	11.6	-0.4	-7.1	3.4	**27.0**
Benchmark *	-4.3	0.5	8.7	3.4	-7.9	4.2	1.9	-0.2	14.8	1.5	-7.0	5.9	**21.2**
2009													
Fund Performance	-8.3	-7.1	2.5	11.1	43.5	0.0	7.7	5.6	3.9	-3.2	4.3	5.3	**74.6**
Benchmark *	-5.8	-8.9	8.5	19.2	41.6	-1.7	7.5	0.3	10.3	-4.1	8.3	3.5	**97.4**
2008													
Fund Performance						-1.7	4.3	-0.2	-11.8	-24.4	-10.0	10.0	**-32.4**
Benchmark *						-11.2	7.1	-1.1	-18.9	-30.5	-8.8	12.3	**-45.7**

1Returns presented are for Class B shares of Alchemy India Long Term Fund Limited and are net of fees and expenses. Fees charges to individual investors may vary and, as such, returns achieved by investors may differ from those shown above.
Note: Fund commenced on 11th June 2008.
**USD-adjusted performance of the benchmark S&P BSE500 index. Past performance is not the indicative of the future performance.*

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#Performance Since Inception In USD (%)

	Absolute	CAGR
AILTF	239.9%	13.7%
S&P BSE 500*	71.6%	5.8%

*USD-adjusted performance of the benchmark S&P BSE 500 index
.#Past performance is not indicative of future performance.
**Returns shown above are net of fees and expenses .
Note: Fund commenced on 11th June, 2008.

#Performance Since Inception In INR (%)

	Absolute	CAGR
AILTF	406.7%	18.5%
S&P BSE 500*	155.8%	10.3%

* Performance of the benchmark S&P BSE 500 index.
#Past performance is not indicative of future performance.
**Returns shown above are net of fees and expenses.
Note: Fund commenced on 11th June, 2008.

Weight by Market Cap as of 31st Dec 17 (%)

Equity	
Less than USD380mn	7.6
Between USD380mn and USD3bn	51.4
Greater than USD3 bn	38.1
Total Equity	**97.0**
Cash & Cash equivalent	3.0
Total Holding	**100.0**

Net/Gross Exposure (%)

Net Exposure	97.0
Gross Long	97.0
Gross Short	0.0

Sectoral Breakup as of 31st Dec'17 (%)

Equity	
Financials	28.9
Industrials	25.6
Consumer Discretionary	18.9
Consumer Staples	10.4
Health Care	5.3
Information Technology	4.3
Materials	3.5
Energy	0.0
Total Equity	**97.0**
Cash & Cash equivalent	3.0
Total Holding	**100.0**

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ALCHEMY
INVESTMENT MANAGEMENT

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Key Fund Facts#	
Master Fund	Alchemy India Long Term Fund Ltd (Mauritius)
Feeder Fund 1 – US Taxable Investors	Alchemy India Fund (Cayman) Partners, LP
Feeder Fund 2- Non US & US Tax Exempt Investors	Alchemy India Equity Fund (Cayman) Ltd.
Manager	Alchemy Investment Management Pte. Ltd (Singapore)
Launch Date	June 11, 2008
Strategy	Long Short with Long bias
Benchmark	S&P BSE 500
Management Fee	1.5% p.a (Payable Monthly)
Performance Fee	15% of profits (Payable Yearly, High Water-Mark Applicable)
Minimum Initial Investment	USD 500,000
Minimum Subsequent Investment	USD 100,000
Subscription Period	First working day of the month
Subscription Charge	Up to 2%
NAV	Monthly
Lock IN	1 Year Hard Lock
Redemption	Calendar quarterly post expiry of Lock-In Period. Notice Period of 45 days.
Exit Load	No Exit load.
Fund Administrators	**Master Fund:** Deutsche International Trust Corporation (Mauritius) Ltd. **Feeder Fund 1:** Custom House Global Fund Services Limited, Malta **Feeder Fund 2:** CIM Fund Services Ltd, Mauritius
Auditors	KPMG
K1 Providers	KPMG

 # These are not the complete terms; please refer the PPM for Complete details.

Queries:
If you have any queries or questions, you can contact us directly on clientservicing@alchemysingapore.com or reach out to;
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General Risk factors

- An investment in the fund is speculative and involves a high degree of risk. Opportunities for withdrawal and transferability of interest are restricted, so investors may not have access to capital when it is needed. There no secondary market for the interest and none is expect to develop.
- Investments in financial instruments or other products carry significant risk, including the possible loss of the principal amount invested. Financial instruments or other products denominated in a foreign currency are subject to exchange rate fluctuations, which may have an adverse effect on the price or value of an investment in such products.
- Please read Offer Documents (includes Private Placement Memorandum and Subscription Agreement)/ Investment Agreement carefully before investing. Investors are expected to understand the risk factors associated with investment & act on the information solely at their own risk.
- As a condition for providing this information, you agree that Alchemy Investment Management Pte. Ltd., its Group or affiliates (collectively, "Alchemy") do not accept any liability in any way arising to them for any loss or damage (whether direct, indirect or consequential), from any use of this document or the information contained herein.

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- The information and opinions contained in this document may contain "forward-looking statements", which can be identified by the use of forward-looking terminology such as "may", "will", "seek", "should", "expect", "anticipate", "project", "estimate", "intend", "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, including those set forth under the Private Placement Memorandum/ Investment Agreement actual events or results or the actual performance of the Fund may differ materially from those reflected or contemplated in such forward-looking statements.
- Performance results shown for the Fund are presented on a net basis, reflecting the deduction of, among other things: management fees, brokerage commissions, administrative expenses, and accrued performance allocation or incentive fees, if any. Net performance includes the reinvestment of all dividends, interest, and capital gains.
- The net monthly return is derived by reducing the Fund's gross performance by the application of the management fee, charged monthly in advance, a subscription fee and a performance fee. The performance fee is charged annually and subject to a high water mark. Performance results are estimates until completion of the annual audit. Because some investors may have different fee arrangements and depending on the timing of a specific investment, net performance for an individual investor may vary from the net performance as stated herein
- Index performance and yield data are shown for illustrative purposes only and have limitations when used for comparison or for other purposes due to, among other matters, volatility, creditor other factors (such as number and types of securities)

Investor(s) are invited to ask questions and obtain additional information, concerning the contents of this document or any other relevant matters, which shall be provided, to the extent the Investment Manager possesses such information or can acquire it without unreasonable effort or expense.

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