14 Aug 2023

Dear Partners:

Subject: Looking for Asymmetric outcomes and staying the course in pursuit of them.

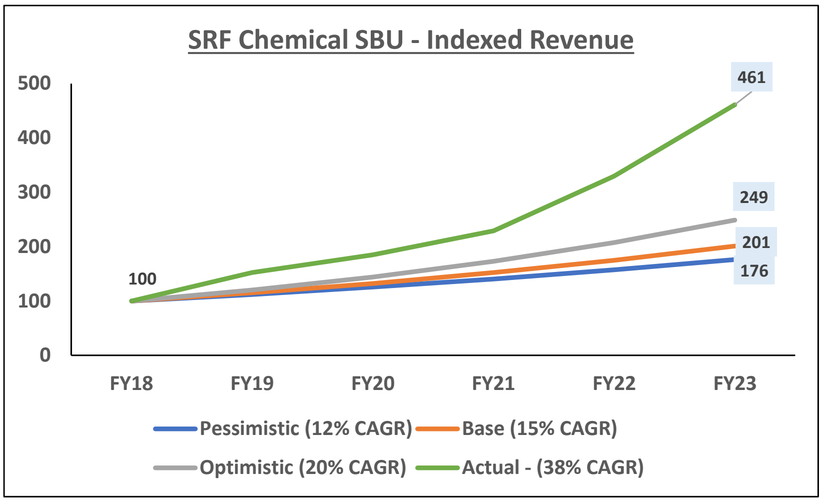
Today is Rakesh Jhunjhunwala's first death anniversary. Amongst the many lessons he left behind for investors was the power of Asymmetry. This can be observed in the number of positions he has earned ~40-100x returns – many in the public markets (TITAN, CRISIL, Lupin, Metro Shoes …) and a few in the unlisted space awaiting listing (Concord Biotech, IKS Health…).

The power of Asymmetry is not intuitively understood. Imagine a portfolio of 10 positions which are held for a decade. 8 of those 10 positions give market returns (~11% IRR). However, 2 of those 10 positions returns 30% IRR. The combined performance of the portfolio is 17.5% or an Alpha of 6.5%. A few Asymmetric returns in the portfolio can dramatically improve results.

Scenario A			
Position	Initial Capital	IRR	Closing Capital
1	100	11%	284
2	100	11%	284
3	100	11%	284
4	100	11%	284
5	100	11%	284
6	100	11%	284
7	100	11%	284
8	100	11%	284
9	100	30%	1379
10	100	30%	1379
	1000		5029
Compounding Time period (yrs)			10
XIRR			17.5%
Market			11.0%
Alpha			6.5%

Asymmetric returns come from high rate of earnings compounding over long periods of time. This requires both a large market opportunity and promoters exhibiting compounding traits (granular thinking, team building, reinvestment in R&D and capacities, capital allocation discipline). The starting revenue base is small which permits high growth compounding for long durations. Optionality comes from new growth avenues that cannot be seen today, for example extension of competencies into new product lines and markets or a turnaround in a business unit that markets have written off. Opportunity, competency, and credibility combine to deliver exponential gains. *Many of our small cap manufacturing positions fall in this bucket. We call these companies Emerging Leaders or Phase 2 or Phase 3 companies.*

Entry valuations are important. But ascertaining fair valuations for such companies can be tricky as growth could surprise. For example, a sensible analyst would have modelled not more than 20% Revenue CAGR in an optimistic scenario for SRFs Chemical Business in FY 2018. The company registered a 38% Revenue CAGR instead. Hence, fair value is a range. For example, ~25-30x PE for an 18-20% ROE business growing 20%+ is acceptable, but 40x may not be.



~35% of our portfolio today is in companies where we believe Asymmetric outcomes are possible. Why not a 100%? Because such companies are scarce. Not all will perform according to initial hypothesis. Some may even lose their way. Hence, one cannot take large individual bets. At the same time, Alpha can also be achieved through companies that offer high probability 15-17% IRR earnings compounding over <u>long periods of time</u>. The latter provide a good base to the portfolio on which to take Asymmetric bets. As these are high probability outcomes, one can also take large position sizes in them. *Our Banking, Insurance and Telecom positions fit this description. We call this category Clear Leaders, Phase 3 or 4 companies.* The table below shows a simulation of returns combining some Asymmetric bets and well discovered linear stories in a portfolio that also has some errors.

Scenario B			
Position	Initial Capital	IRR	Closing Capital
1	100	-2%	82
2	100	-2%	82
3	100	11%	284
4	100	11%	284
5	100	11%	284
6	100	15%	405
7	100	15%	405
8	100	15%	405
9	100	30%	1379
10	100	30%	1379
	1000		4986
Compounding Time period (yrs)			10
XIRR			17.4%
Market			11.0%
Alpha			6.4%

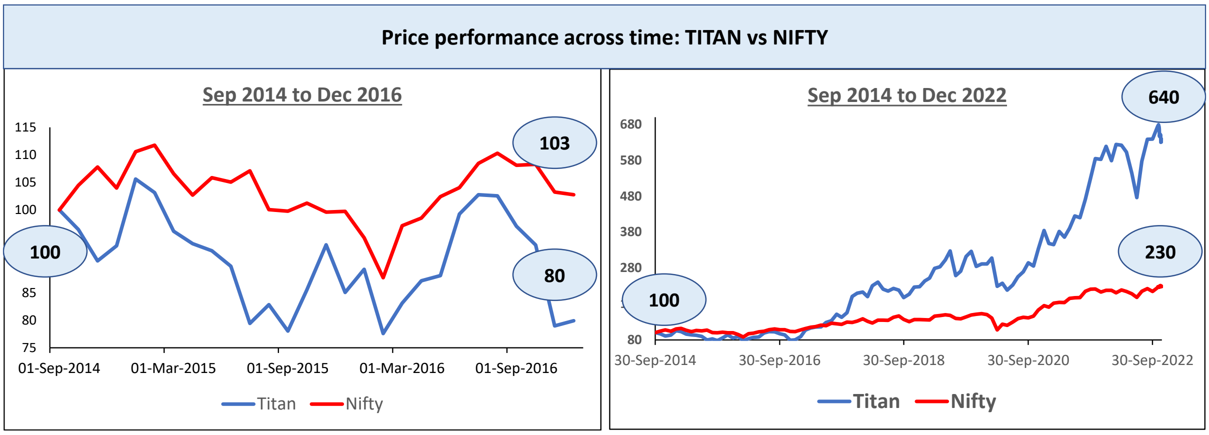
Staying the course in pursuit of Asymmetry
Asymmetric outcomes require a lot of patience.

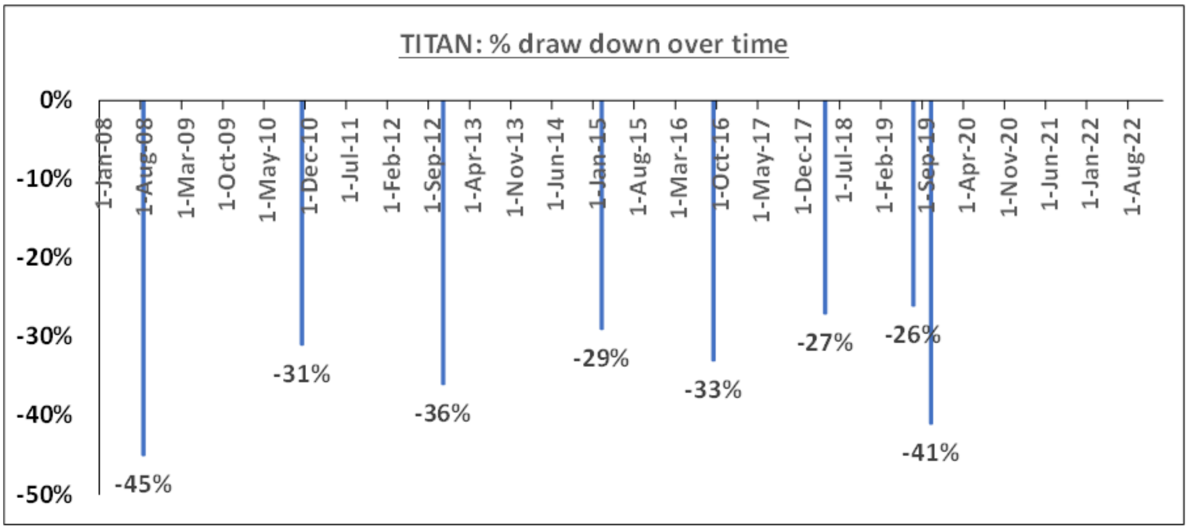
- <u>Returns are earned in spurts.</u>
- Many companies are small and relatively illiquid – this results in steep price moves on quarterly disappointments.

The true genius of Rakesh Jhunjhunwala was not only in his intellect, but how he used his edge. Not answerable to investors, he stretched time and endured volatility to his advantage. He imagined what

SOLIDARITY
INVESTMENT MANAGERS

a company could be long term, and had the patience to stay invested even during periods of poor performance and steep drawdowns of over 25%. See charts on TITAN below.





<u>The edge is in the waiting</u>. However, in an age of instant gratification, patience is difficult to practice. "How do I know you are following good process?" "Are you missing a big trend by not participating in this theme"? "How much longer will you give this company"? These are fair questions. But staying the course is an inalienable part of making asymmetry work in your favour. The short-term scorecard neither reveals any insights on long-term outcomes nor the risk being carried to achieve short term results.

Many of Solidarity errors are when we have exited pre-maturely falling prey to the pressure of short-term performance – bad news, a position is not performing for some time or looks overvalued. In these instances, we have not given sufficient time for the thesis to play out. We are determined not to repeat these errors, while not being blind to course corrections required.

We welcome you to engage with us.

With our best wishes,

Manish Gupta
CIO

Manjeet Buaria
Partner

Anirudh Shetty
Senior Principal

Disclaimer

The information or material (including any attachment(s) hereto) (collectively, "Information") contained herein does not constitute an inducement to buy, sell or invest in any securities in any jurisdiction and Solidarity Advisors Private Limited is not soliciting any action based upon information. Solidarity and/or its directors and employees may have interests/positions, financial or otherwise in securities mentioned here. Solidarity may buy securities in companies owned by its clients. This information is intended to provide general information to Solidarity clients on a particular subject or subjects and is not an exhaustive treatment of such subject(s). This information has been prepared based on information obtained from publicly available, accessible resources and Solidarity is under no obligation to update the information. Accordingly, no representation or warranty, implied or statutory, is made as to the accuracy, completeness or fairness of the contents and opinion contained herein. The information can be no assurance that future results or events will be consistent with this information. Any decision or action taken by the recipient based on this information shall be solely and entirely at the risk of the recipient. The distribution of this information in some jurisdictions may be restricted and/or prohibited by law, and persons into whose possession this information comes should inform themselves about such restriction and/or prohibition and observe any such restrictions and/or prohibition. Unauthorized disclosure, use, dissemination or copying (either whole or partial) of this information, is prohibited. Neither Solidarity nor its directors or employees shall be responsible or liable in any manner, directly or indirectly, for the contents or any errors or discrepancies herein or for any decisions or actions taken in reliance on the information. The person accessing this information specifically agrees to exempt Solidarity or any of directors and employees from, all responsibility/liability arising from such misuse and agrees not to hold Solidarity or any of its directors or employees responsible for any such misuse and free and harmless from all losses, costs, damages, expenses that may be suffered by the person accessing this information due to any errors.