Cohesion MK Best Ideas

Investment Report

January 2021

Cohesion®
Accessing Superior Growth

Opening Remarks – Chasing Long-Term Growth in an Uncertain World!

The global macroeconomic situation has never been more peculiar. We began the last decade with the Central Bank of Denmark being the first to take interest rates to below zero (2012), and ended the decade with a mind-blowing 17+ trillion dollars of negative yielding debt, with over a quarter of the world's investment-grade debt trading at sub-zero yields (November 2020). Furthermore, crude, the most-traded commodity in the world, saw its futures dip briefly to below zero in April 2020, to as low as USD -40, showing, not for the first time, that prescience is no longer an easy art when it comes to global macro.

Amidst increasingly limited opportunities for high and predictable growth globally, investors often have to choose between expensive investment opportunities that offer lower, albeit predictable growth or higher growth opportunities with unpredictable outcomes (often involving high company-specific / asset class specific risk).

This simple observation has led to the genesis of **"Cohesion MK Best Ideas"**, an extremely focused investment platform with a simple but powerful objective – **our investment thesis is to capitalise on rare opportunities that offer the prospect for high and predictable growth and pockets of extremely compelling valuations, such as those offered by Indian equities.**

India – The "Reality vs Perception" Trade

Consensus rarely makes you money! By the time an investment theme – a market, sector or even a country – makes it to the front page of the Financial Times, the opportunity to generate exceptional returns has more than likely gone.

Real money is often made when the reality is far ahead of perception, opening a classic investment opportunity as the perception gap narrows.

We believe we have identified the right market in India, however, taken this a significant step further in partnering with Madhu Kela and his Invexa team, who have many years of experience and success in identifying such opportunities where there is a gap between reality and perception. The theme is important. The access to that is critical.

Western media have always portrayed India with a biased lens, and the perception of India, including throughout much of 2020, has often not been very positive. Whether it was commentary related to India's preparedness for and handling of coronavirus, economic stimuli, the business environment, or even the recently introduced agricultural reforms in the country – the perception has been largely negative and the portrayal typically unrepresentative.

The reality on the ground has been rather different!

India remains a leading global financial powerhouse, with stable, strong and highly popular leadership and a vibrant financial market underpinned by a well-diversified and globally competitive corporate universe. India overtook the UK and France in 2019 to become the 5th largest economy in the world (a position the UK overtook again this year due to COVID-19-related volatility), and India is set to become the 3rd largest economy globally by 2030, behind only the US and China.

The much-talked about Indian healthcare infrastructure (or rather lack of it), has not only been able to stand up to the COVID-19 test, it has, in fact, fared better than most developed economies with "much better" (so called) healthcare systems. The country is no longer in a national lockdown (lifted in phases from May 2020) and daily cases have been in a falling trend since mid-September 2020, in stark contrast to many other parts of the world. We cover this in more detail below.

In the wake of the pandemic, much of the developed world including the US, Europe and even the UK have resorted to astronomical expansion of their balance sheets, trying to print their way out of trouble. India, on the other hand, used this period to further its development agenda, undertaking some significant long-term reforms, and focused on stabilising the economy without stretching its balance sheet. The result? India has not witnessed the catastrophic business and economic collapse that the world was expecting. In fact, corporate earnings continue to surprise positively, with the % of earnings upgrades now probably the highest in a decade.

If there is one statement that can capture the essence of the Indian Government's response it is this: **at 58%, Prime Minister Modi's net approval ratings are the highest of any leader of a major economy in the world**, far and above the second best at 30%. Modi is also now the most followed active politician on Twitter in the world, another sign of India's arrival on the landscape as a global powerhouse.

Away from the media hype, we think the perception gap on India amongst global institutional investors has significantly narrowed, as can be evidenced by the continuously higher foreign flows into the country. FDI equity inflows into India crossed the USD 500bn milestone (cumulative FDI flows between 2000 and 2020), with FDI flows for 2020 topping USD 50bn.

Whilst we remain extremely cautious about the potential direction of the pandemic in the near term, both globally and in India, we are also quietly optimistic about the position India is currently in. India's reach and power on the global landscape is only set to rise from here, making it an even more attractive investment destination with time.

Against the backdrop of a global pandemic, a fiercely fought US Presidential Election and the uncertainty of Brexit, global markets showed exceptional resilience in 2020, and seemed in many ways disassociated with their fundamental drivers – even as the US and Europe grappled with second waves of infection, forcing the UK and some other European countries to enter into further national lockdowns. We believe in many ways India offers a more attractive opportunity to these markets, providing the prospect of strong risk adjusted growth and attractive multiples (if you know what to look for).

Coronavirus – Smoothly Navigating the Troubled Waters!

India demonstrated an early and robust approach to the coronavirus since January 2020 and this greatly reduced the impact and has brought many long-term benefits to the country. In India, the number of daily coronavirus cases has been in steady decline since mid-September, and, whilst the absolute number of confirmed cases in India was high at its peak, this figure even then was small relative to its population size.

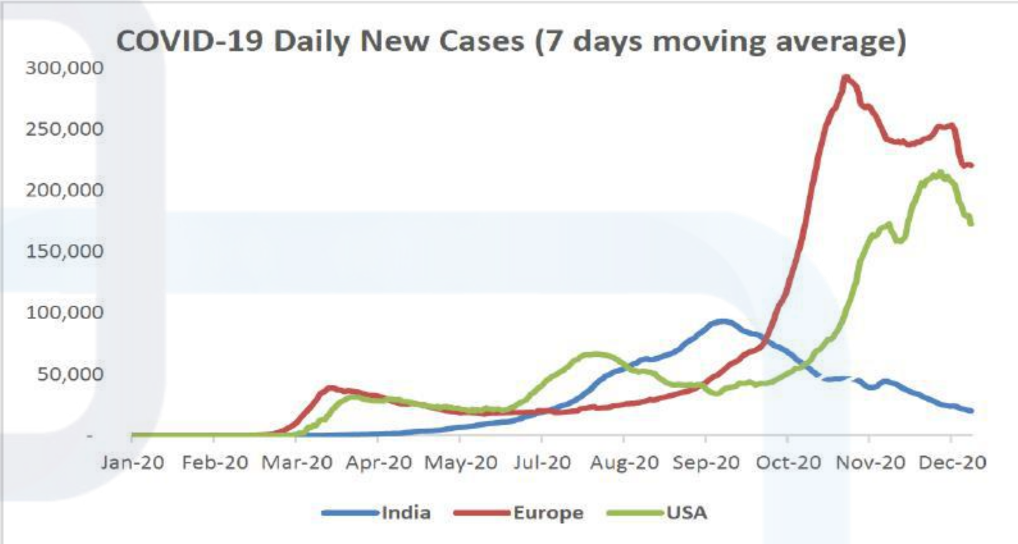
To highlight, once again:

- Daily new COVID-19 cases peaked in Sept 2020 for India and has been steadily declining since. This is despite India conducting the second highest number of COVID-19 tests, at more than a million per day. As of 13th January 2021, India had conducted c184m cumulative tests, the 2nd highest globally (World in Data, December 2020)

- India has a recovery rate of more than 97% compared to a global average of 72% (Worldometers, December 2020)

- India's mortality rate has been consistently lower than the global average (1.45% for India vs. 2.2% globally) (Worldometers, December 2020)

- The number of deaths per million of population in India (~100) is less than a tenth of that in countries like the USA, UK, Spain, France, Italy and others (Worldometers, December 2020)



Source: WHO, Nippon India Mutual Fund Research

Vaccination

India has the **largest vaccine manufacturing capacity in the world**, accounting for 60% of global production, earning it the title of "vaccine capital of the world". It also has a robust existing vaccine distribution network, used throughout its 42-year-old immunisation programme. This, combined with some 27,000 'cold-chain' stores, puts India in a good position for the upcoming national vaccine distribution and administration drive.

The Indian Government has set aside nearly USD 7bn to vaccinate India's 1.4bn people against COVID-19, having already secured **1.8bn doses of vaccine** from various manufacturers – more than any other country and plans to vaccinate **300 million people by July.**

India has recently approved two COVID-19 vaccines and administration and mass roll out is due to start from 16th January, described by Prime Minister Modi as the **world's largest inoculation programme**. The Government is also deploying an electronic system to manage vaccine roll-out, called Co-WIN. This is a COVID-19 vaccine distribution and management system, the first end-to-end system across the world, and will be integrated with other government tools such as Aadhar (unique identifier) and DigiLocker (for secure online KYC and digital vaccination certificates) etc., for a seamless and comprehensive vaccine rollout solution.

Whilst the above steps are well-planned and deserve to be highlighted, we do remain cautious about the path of the pandemic from here, especially in light of new variants appearing in the UK and elsewhere, and are under no illusion that what we are seeing in Europe, and the UK in particular, could also happen in India. However, with the Government's commitment to vaccinating hundreds of millions of people within a few months, this greatly increases our confidence in the country's ability to keep the social and economic impact of the virus under control, like they have been able to do so far.

Economic Optimism

The Indian Government went to extreme measures at the beginning of the pandemic to curb the spread of the virus, including a national lockdown with only around 500 known cases in the country when this happened. Over time, the severity of India's restrictions has been reviewed and lifted, and with the continuing decline in the number of new daily cases seen in the final quarter of 2020, many aspects of Indian life are now returning to normal.

This action has not gone unnoticed, with the IMF chief, Kristalina Georgieva, praising India for taking "very decisive" steps in dealing with the coronavirus pandemic and its economic consequences and she predicted a better outlook for India based on the steps it had taken. With the misrepresentative bias and noise often generated by Western media, we always appreciate seeing a leading international voice use their platform to highlight the reality in India.

The initial pent-up demand following the easing of lockdowns seems to have given way to a sustained and broad-based economic recovery, driving many high frequency economic indicators towards, and in some cases above, pre-COVID levels:

- December 2020 electricity consumption was higher than in December 2019 and 2018 (Jefferies, December 2020), helped by industrial resumption
- India's power consumption grew by 6.1% (YoY) in December 2020 (Live Mint, January 2021). Record peak demand observed in December continues to signal strength in domestic recovery
- Industrial production: manufacturing Index of industrial production (IIP) improved from a contraction of 0.2% (YoY) in September 2020 to an expansion of 3.5% (YoY) in October 2020, expanding for the first time in 8 months (Indus Prism, December 2020)
- Indian housing market sales volumes are now back to 90% of pre-COVID levels (Jefferies, December 2020)
- Daily average UPI and IMPS digital transaction values recorded all-time highs in November 2020 and continued to increase in December (Kotak Securities, December 2020)
- Unemployment fell significantly from its peak of 24% in April 2020 to 9% in December 2020 (CIME, December 2020)
- **Goods and Services Tax (GST)** collections in December 2020 surpassed USD 15bn, **the highest level since the implementation of the regime** in July 2017 (Times of India, December 2020)
- The Purchasing Managers Index (PMI) remains high at 56.4 in December 2020, in line with pre-COVID levels, providing a clear indication of the prevailing direction of economic trends in manufacturing (FX Empire, December 2020)
- **Inflation**: in December 2020, **CPI inflation moderated to 4.6% against 6.9% in November, the lowest in 15 months** (Trading Economics, December 2020)
- Auto sales: December 2020 auto sales came in strong, particularly for passenger vehicles
- Capital account balance rose sharply to USD 15.4bn (USD 1bn in Q1FY21) on the back of sharp improvement in foreign investments (Nippon, December 2020)

- Google Mobility Data, which shows individuals' aggregate movement trends, shows a steep rise in people's movement from the lows seen in April-May 2020

- Most indicators continue to signal that recovery remains on track. The industry chamber said it expects immense economic benefits from the COVID-19 vaccination programme that is about to be rolled out. **India's economy is showing decisive signs of a 'V-shaped' recovery for 2021 with the return of consumer confidence, robust financial markets, an uptick in manufacturing and exports** (Business Standard, January 2021)

The easing of restrictions has had a profound impact on the economy; the record GDP contraction of 23.9% (YoY) in Q1FY21, has reduced to a much more manageable contraction of 7.5% (YoY) in Q2FY21, which was healthier than the consensus estimate of an 8.2% (YoY) contraction.

Most importantly, Q2FY21 **corporate earnings were very positive across the market**, with outperformance leading to upgrades. Robust sales growth driven by better-than-expected demand recovery, continued cost control measures and lower-than-expected provisioning costs for the banking, financial services and insurance (BFSI) segment drove strong profit outperformance. **This has been one of the best earnings seasons in many years**, leading to a positive revision of FY21e consensus earnings.

The corporate rate tax cut in September 2019 was a massive stimulus for Indian companies and the effects of this have not fully come through due to the pandemic, but combined with the cost-cutting trail seen across Indian businesses in 2020 and historic low interest rates, this could provide a very good base for earnings upgrades in the next few quarters.

Despite widespread negativity toward India, the changing perception of the country has been reflected in the substantial foreign investment flows into the country. **Indian equities received more than USD 23bn from foreign institutional investors in 2020, the highest among emerging markets**. This is part of a wider trend seen in late 2020, where foreign investors recorded the strongest flows to EM assets since 2013, **signalling a potential switch in sentiment from developed market investing to emerging market investing**.

Some of the macro variables contributing to the rising popularity of Indian equities are as below:

- The USD index has been declining since March 2020, falling around 10%, as a result of the significant liquidity push by the US Federal Reserve and stimulus by the US Government (Invezz, December 2020)

- Indian **forex reserves are at a record high** of USD 580bn (Morgan Stanley, December 2020)

- The **current account balance** has moved from a deficit of over 5.0% of GDP in FY14 to a **surplus** of 2.4% of GDP in Q2FY21 (Motilal Oswal, December 2020)

- **Inflation** has stabilised to 4.6% and remains in a **structural downtrend** (Trading Economics, December 2020)

- **Interest rates** are at a **historic low** and could potentially be eased further in this cycle

- The **BOP surplus has strengthened significantly** in H2FY21 at USD 46bn (Motilal Oswal, September 2020) and the price of oil remains low, which benefits India greatly as this is the country's largest import

- Consensus **corporate earnings growth looks strong**, coming from a low base

- On average, over the last 20 years, INR has depreciated by 2.3% pa against USD and 1.8% pa against GBP (XE, December 2020), but with many of India's leading currency indicators showing considerable robustness, we believe INR could have a strong performance in the short to medium term outlook

- India has never traditionally been seen as a manufacturing or export-led country, yet now it's in a transition period to become a **core manufacturing base for many of the world's largest companies** like Apple, Amazon and Sony among others and this all points to a **positive outcome for INR**

To provide further details relating to the final point above, it is worth highlighting the Government's serious focus on 'Aatmanirbhar Bharat' (**self-reliant India**), as part of this it has:

- Launched a series of production-linked incentivisation (PLI) schemes in two phases:

    I. March 2020: launched three PLI schemes totalling INR 0.51tn (USD 6.8bn) covering mobile manufacturing, electronic components, and pharmaceuticals (India Today, November 2020)

    II. November 2020: launched 10 new PLI schemes totalling INR 1.46tn (USD 20bn), expanding benefits to sectors like automobiles, batteries, telecom, steel, textiles and white goods, in addition to widening the scale for pharmaceuticals and electronics (Deloitte, November 2020)

- In addition, the Government also announced (August 2020) a 7-year ban on the import of a list of 101 weapons and platforms, in a bid to boost domestic manufacturing, with a focus on security

It is estimated that **these programs** (PLI scheme + defence embargo) could **add over USD 500bn to the overall GDP in 5 years**, besides further strengthening domestic manufacturing and creating millions of jobs in the organised and unorganised sectors.

Investment Approach – How We Look at Opportunities

The essence of our investment approach is to **identify passionate entrepreneurs and companies with the right business models that can create substantial wealth for their investors through focused execution.** We often patiently observe a sector for long periods and are happy to invest only once we see a clear template for wealth creation, with proper alignment of both the macro environment and bottom-up investment strategy. Pharma and Telecommunications have been two recent examples of sectors where the macro environment has turned favourable, where we have leveraged the network and deep sectoral understanding of our investment adviser, Madhu Kela and his team, to identify high-quality investment opportunities with significant alpha creation potential.

We continue to be sector and size agnostic in our investment approach, preferring instead the maximisation of returns with the right risk profile, over a medium-term time frame, in-line with our investors' expectations.

Recent Deployment Strategy

There still remains a tremendous amount of uncertainty as we navigate through the current environment and global pandemic and this has been reflected in our stock selection over the last quarter.

Since inception, and as mentioned in our previous commentary, our approach has been to build equity exposure gradually and progressively into some of the more liquid names and market leaders that also represent a good investment thesis. Medium term business growth continues to be a key driver for investment, however, we are also balancing this with relatively stronger market resilience and the ability to cope better with volatility in the near term.

Madhu Kela, our investment adviser, did not forge his career investing in line with the index, instead, he identified passionate entrepreneurs and companies with the right business models that can create substantial wealth for investors and disproportionate returns against the market. However, given the uncertain and volatile dynamics of the current markets globally, the recommended approach from Madhu and his colleagues at Invexa has been to exercise caution and to not take on any excessive risk.

Madhu believes that the Indian market will be ripe for investment for many years to come, with many likely occasions over the medium-to-long-term to find the exceptional opportunities he is best known for. Ultimately, the aim of the partnership between Cohesion and Invexa is to build a 20+ year legacy of wealth creation. The short-term performance of Cohesion MK Best Ideas throughout the pandemic will not define that legacy but could certainly risk damaging it if extreme caution and consideration is not maintained.

Portfolio Position

The portfolio as at 31st December 2020 was 78% invested in the Indian market and 22% in cash, of which 40% was invested in large cap, 31% in mid cap and 7% in small cap companies (as per SEBI regulator definitions). Whilst the portfolio is currently tilted towards large cap companies, these are very high quality and still have the potential to generate good returns over the medium term due to a number of underlying positive drivers and potential catalysts. Whilst we are sensing a change in sentiment in favour of mid and small-cap companies, and do have exposure to these sections of the market, we have not yet added serious exposure here for the reasons stated throughout.

The composition of the portfolio towards large cap companies, and those with large free floats and high daily traded volumes, provides us the flexibility to liquidate a substantial amount of the portfolio quickly, if the need arises. On average, our positions are only 14% of total average trading volume, which means we could normally sell around 85% of the portfolio within a day if needed, with the entire portfolio sold within 2-3 days without any significant market impact. This is vitally important if the pandemic were to deteriorate globally and in India – something we are acutely cognisant to. We will be maintaining caution in the short term until the situation becomes clearer. If the situation worsens, we will not hesitate in selling down our positions quickly to protect the portfolio. At the same time, it must be recognised that **market volatility does not necessarily mean the investment thesis of individual companies has changed, only that some can be bought at a big discount later which, in itself, can also present tremendous opportunities for the portfolio.**

Despite the cautious approach, we are happy with the portfolio performance over the quarter, especially considering our large average cash exposure, resulting from our gradual approach to building positions since inception. Almost every stock position has generated positive returns, with more than half having generated double digit returns. The portfolio is well-diversified and is invested in very high-quality companies across different sectors.

Various valuation measures are currently quite full in India compared to historical averages. This is because the market is forward facing and factoring in a quick recovery of the economy for this year and beyond. Whilst market valuations are looking full, **our portfolio is currently at a discount to the market whilst also having higher earnings growth:**

	PE Valuations		Earnings Growth	
	FY22e	FY23e	FY22e	FY23e
Cohesion MK Best Ideas	**16.6x**	**13.1x**	**93%**	**27%**
NIFTY 50	21.1x	17.6x	37%	20%
BSE 200	21.0x	17.8x	19%	18%

These numbers assume consensus earnings growth estimates for the portfolio – our own are more attractive. There are many companies in India that are trading upwards and beyond 100x FY22e PE multiples, but Madhu is exceptionally sensitive to price and we are using volatility as our friend in order to access companies that are much more fairly valued.

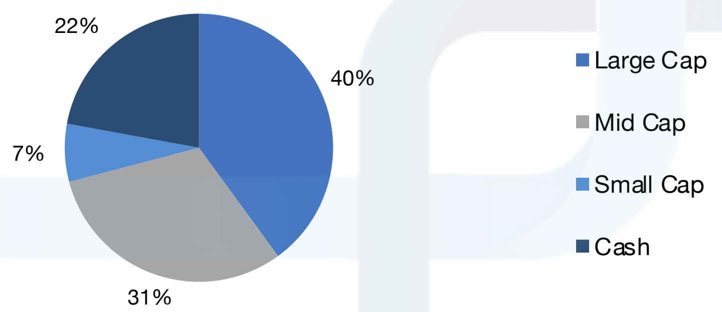
Not only are the valuations of the portfolio more compelling than the related market indices, but the projected earnings of our portfolio are greater too. The FY22e figure is high as a couple of the companies in the portfolio are moving from reporting impacted earnings in FY21 (over the pandemic period) to a return towards normalisation in FY22e.

So, ultimately, investors in this portfolio are accessing Indian companies with higher earnings growth expectations, but at relatively attractive valuations.

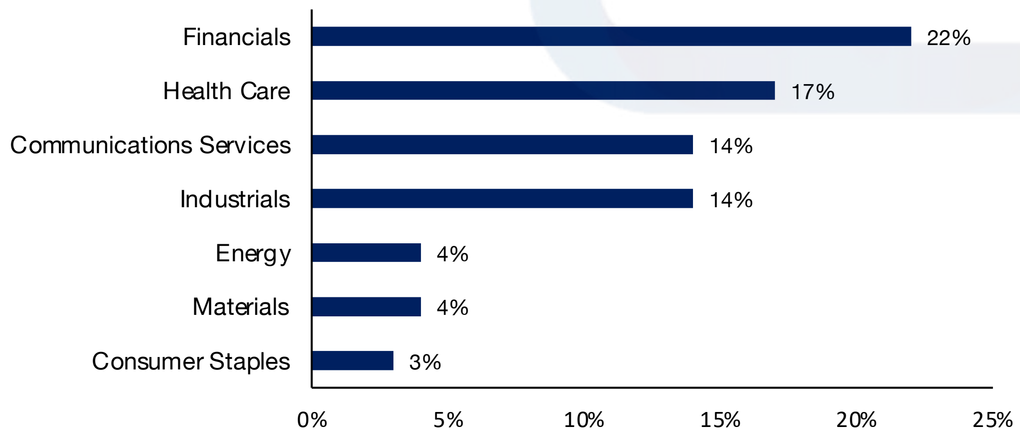
Top 5 Holdings

Security Name	% Holding to NAV
[redacted]	
Bharti Airtel	9.6%
Strides Pharma Science	7.0%
Canara Bank	6.5%
Jubilant Life	5.4%
State Bank of India	5.1%

Market Cap Exposure (%)



Sector Exposure (%)



Stock Examples

Please see below for some further insights on our high conviction portfolio holdings.

An industrials company (large cap):

Business overview: This company is India's largest private multi-port operator, with several ports in operation across multiple states in India.

Passionate promoter: The company is promoted by one of the country's wealthiest business leaders, recognised for his extraordinary vision, passion and business acumen. This promoter has demonstrated superior execution track record across the wider group and has been one of the greatest wealth creators in India, with over 25% CAGR returns over the last 25 years. *Note: 'promoter', used throughout this document, is an Indian term used to describe the founding entrepreneur, or current controlling owner of the business.*

Significant business moat: The company enjoys a strong business moat and monopolistic position in key markets as it operates India's largest commercial port at Mundra and 11 other ports across both the east and west coasts of India. The company is responsible for nearly 25% of the total cargo movement in India, which makes it an economic gateway for India and a large beneficiary of 'Make in India', the possible shift of manufacturing from China to India and the country's USD 1.4tn National Infrastructure Pipeline over the next 5 years.

Calibrated capacity expansions aiding market share gains: The company has aggressively expanded capacities (organically and inorganically) at over 30% CAGR, from having only one port (10 MMT) in 2006 to twelve ports (490 MMT) currently. This has aided continuous market share gains from publicly-owned ports on account of strategic locations and highly efficient operations. It operates 50-60% capacity utilisation across most of its ports, leaving significant scope for volume growth and continued market share gains ahead without high capex requirements.

Huge optionality: It owns one of India's largest industrial landbanks with ~13,000 hectares of highly valuable land close to its ports, with clear marketable legal title, development plan approvals and infrastructure and logistics support in place. While the market does not assign much value to the landbank currently, we think that it provides huge upside optionality.

Rapidly expanding logistics business: Over the years, the company has forward integrated into a provider of logistics services. It currently operates five logistics parks and sixty freight trains and continues to be the largest private rail operator in India. The logistics business is expected to be the next growth driver for the company.

Robust earnings growth and free cash flow generation: It has posted strong 22% / 18% / 17% CAGR revenue / EBITDA / PAT growth over the last 10 years and we expect the company to report solid figures over FY20-25 backed by healthy growth in India's trade volumes, continued market share gains, improvement in capacity utilisations and cargo mix, high pricing power, operating leverage backed margin expansions, strong free cash flow generation and rapid deleveraging of the balance sheet.

Attractive valuations: Even after significant run-up from our purchase price, the company is still trading at ~12.5x FY22 EV/EBITDA vs. a 10-year average of 13x and peak of 18x. We think earnings growth will beat consensus estimates and expect valuations to overshoot 10-year average valuations due to strong business momentum and healthy free cash flow generation over the next 3 years. Overall, we still find the valuations quite compelling as compared to other sustainable and structural opportunities in India.

A financials company (mid cap):

Business overview: This company is one of the most respected Public Sector Banks (PSBs) in India.

Government is changing its approach towards Public Sector Enterprises (PSEs): PSEs have underperformed significantly over the last 5 years and this has resulted in most vocal and long-term bullish investors in this space losing their patience. However, recent actions and commentary from the Government indicates a shift in mindset regarding improved accountability along with the focus on value creation. The changing mindset towards improvements in PSE market capitalisation is evident through the recent buyback announced in HPCL. While the Government has traditionally received funds from PSEs in the form of dividends and buybacks (Government participation), the HPCL buyback is the first instance where the Government is not participating, despite the buyback being huge in size (6.6% of equity, 13% of float). The fact that Government is not participating in the buyback indicates their focus towards truly rewarding minority shareholder and improving valuations.

PSBs have been the worst performing PSEs and are now at inflection point: PSU banks excluding State Bank of India (SBI) have been amongst the hardest hit in the PSE universe, having witnessed multiple headwinds over the last few years ranging from asset quality issues, high cost structure issues, capital adequacy issues etc. This has led to a significant derating in valuation multiples over the last few years. We have reached a stage where there are a lot of positive developments for PSBs, however, valuations are still pointing towards extreme pessimism.

Our company is one of the best plays on the theme: The bank is amongst the better run PSU banks, yet it has been trading at deep value. It has managed its asset quality well and has sufficient coverage on its books (improved significantly over last two years). The bank has been able to successfully access the secondary markets for fund raising rather than being dependent on the Government and has also guided for limited impact of COVID-19, slippages and restructuring in the near term. Recent data flow indicates that the next couple of quarters could be better than what management has guided post Q2FY21 (as seen in low restructuring requests by borrowers across the board).

We expect overall economic growth to rebound sharply from FY22, with the pace and quantum of recovery potentially surprising the consensus view. We expect credit growth to recover sharply with overall growth.

PSBs have historically done very well during economic expansion phases and we expect this better run PSU to do particularly well.

The bank is trading at deep value / extremely compelling valuations: We bought the bank at a market cap of INR ~16,500 Cr (USD 2.2bn) at a time when current operating profit run rate was INR 18,000 Cr (USD 2.5bn) (this is expected to grow at 20% for the next two years). Effectively less than 1x trailing operating profit run rate / 0.4x tangible trailing book value.

Even though current prices are up 30% from our entry price, it is still at depressed valuation.

As per current estimates, this bank's prospects for growth in operating profit and PAT along with its future valuations look very attractive from here.

A pharma company (small cap):

Business overview: This company was described in our previous investor communication, and given it is one of the most interesting pharma companies in India, we believe it deserves to be highlighted further. The company has a major focus on the development and manufacture of IP-led niche finished dosage formulations and is also among the world's largest manufacturers of soft gelatine capsules.

Differentiated track record of promoter: The promoter has successfully executed more M&A transactions and partnerships than any industry peers, and the wider group has one of the best wealth creation and distribution track records amongst all Indian pharma companies. He has created three public pharma companies, incubated several smaller entities, and successfully divested a lot of businesses in the past at best-in-class valuations. The promoter views business decisions with a very strict profitability lens and is happy to exit decisions where he thinks the risk-return paradigm is not favourable. The focus is on high absolute returns, with low-to-nil asset attachment. The promoter has an extremely strong focus on product selection and compliance and is rated one of the best and most fair bosses in the industry; when the company sold its injectables business, the promoter went to considerable efforts to ensure employees were financially rewarded.

Capabilities and vision: The company has established capability across multiple pharma fields and includes:

- Early adoption of steriles back in 1995. The company subsequently conducted one of the largest and most successful divestments in this business (exited around 2013 for over USD 1.5bn) and is now re-entering the business post a non-compete
- One of the few soft gel manufacturers
- For an Indian company, it has some of the largest and most capable manufacturing infrastructure in the US
- Among the few potential biosimilar plays in India
- A focus on difficult to manufacture / limited competition products (hormones, softgels, steriles, biologics etc.)
- Successfully pursued strategy of multiple manufacturing units from the very beginning

Shareholder friendly: A low shareholding of ~30% has not prevented the promoter from taking decisions in favour of other shareholders, and the company has an enviable track record as one of the highest distributors of wealth (as % of profits) amongst peers.

Ability to attract the best: The company / group has always partnered with the best institutions globally and has generally attracted premium multiples / favourable terms in such transactions. In just the last two years, various companies in the group have been invested in / bought out at very attractive multiples including by two of the most respected PE firms, and the company in which we have invested now could be on a similar path.

This company also recently saw one of the world's most seasoned and respected business leaders join as an advisor to the parent company and director of one of its subsidiaries, thereby further bolstering its credentials for attracting quality talent for both execution, strategy and governance oversight. This advisor was the iconic leader of one of India's leading business institutions and is considered by many to be India's most successful and most respected entrepreneur.

Embedded optionality: Over USD ~225mn of capital is to be deployed in the biologics / sterile injectables segments, which is currently not yielding any returns but is expected to do so from FY22 and is currently not priced into the valuations. There is also a potential vaccine play, which is not factored into valuations. Furthermore, the base business is entering a high growth phase with strong operating leverage, and this is also not being accounted for in market valuations.

Differentiated research efforts – creating an alpha opportunity: Madhu and his team at Invexa Capital have built over a decade-long relationship with this pharma group and have invested and strategically exited their investments in the group several times, taking advantage of their deep understanding of the company, group and sector. They have analysed and understood the company's business segments over the last 25+ years, focusing on key partnerships and M&A activity over this period. This allows the advisor team to really derive unparalleled insights in the investee company. This has translated in the fund buying a stake in the company at the bottom of the cycle and at extremely low valuations (significantly lower than fair market value), with the hope of selling in due course at strategic buyout multiples. The past track record of the promoter indicates that they may be looking to monetise their current base business and focus on the emerging biologics / sterile play.

Closing Remarks

The long-term goal is to have a portfolio of up to 20 outstanding companies, led by exceptional entrepreneurs, that in a number of cases will have the potential to benefit from Madhu's rich knowledge and diverse network.

Current strategy has been to follow a more cautious approach due to the uncertainty of the future path of the pandemic both globally and in India. We have been increasing our exposure to companies that are reasonably priced and where we have strong conviction. We have focused on protecting capital in the short term, whilst also cautiously building positions in mid- and small-cap opportunities.

Looking ahead, we hope to see the recovery in the economy continue, on the back of historic low interest rates and massive pandemic-induced cost restructuring by corporate India, which may potentially trigger multi-year earnings growth cycles.

The structural long term growth story remains intact and looks very promising for investors that have the right time frame. India offers the potential for high and predictable growth and through our partnership with Madhu Kela and his team, we are convinced that we are able to offer our investors an unrivalled access to this opportunity.

Whilst the perception of India is very often negative, for those investors that can see past the noise and focus on the actual facts and fundamentals, the journey as that perception gap continues to close is likely to be very exciting.

For further information:

Website: www.cohesioninvestments.com

Email: investor@cohesioninvestments.com

Mobile/WhatsApp: +971 555 102 622

Sources

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