Cohesion MK Best Ideas

Investment Report

July 2021

Cohesion®
Accessing Superior Growth

John D. Rockefeller Jr. once said that *"the secret of success is to do the common thing uncommonly well".* Rockefeller was a man who knew a thing or two about success having been born into the wealthiest family in the world and then going on to build his own real estate empire and philanthropic legacy in his own right.

If we may add to the great man's famous quote, we might say that *"the secret of success* ***in stock markets*** *is to do the common thing uncommonly well* ***and then carry on doing it consistently****."*

In the short term, stock markets can be fickle and unpredictable. At times they can appear to react quickly and correctly to economic and political events as a multitude of buyers and sellers weigh new information and adjust their views accordingly. At other times markets can appear irrational as news flow is met with a knee-jerk reaction that makes little sense.

It is this schizophrenic nature, present in all stock markets but especially in emerging markets, that presents the very best opportunities for value creation. The key is to stick to well-established investment principles and use periods of irrational behaviours by others to sell to the greedy and buy from the fearful.

Cohesion MK Best Ideas has a clear objective of delivering strong absolute returns over the medium term. The fund was designed and built to provide our Investment Adviser, Madhu Kela and his team, with a free-spirited environment that will allow them to focus on recommending the best risk-adjusted returns. This approach is deliberately different from that adopted by many other Indian funds that have as their objective competing with a mainstream index. There's nothing per se wrong with a tracker or quasi-tracker fund invested in India; the powerful long-term trends in the Indian economy are so strong that such an approach will probably deliver good returns. However, Cohesion MK Best Ideas has, we believe, an approach that is unusual in India and that leads us every day to ask of every stock a simple question: will it make money from here?

This absolute return mindset manifests itself in several ways and we will look at these during this update.

We aren't afraid to hold cash at times when risks seem high or the short-term outlook too uncertain. We deliberately took our time to invest the portfolio back last Autumn, taking more than two quarters to fully deploy cash. We were faced with a backdrop of an unfolding global pandemic when the first vaccines weren't even on the horizon. There was also the looming US election that would throw political uncertainty across the globe to contend with. At times such as this, we believe the best approach is to wait for more certainty before deploying capital, and also to stick to relatively larger market cap stocks, rather than trying to chase momentum or "growth at any price" stocks.

As well as being judicious about the timing of capital deployment, there are also certain features that we look for in the companies we invest in and, just as importantly those that we chose to ignore.

An interesting feature of the Indian equity market over the last year has been the number of “chronic value-destroyers” that have performed incredibly well in the short run. Many of these are in highly competitive or commoditised industries that, held for the long term, are unlikely to make serious money. These are typically low ROI businesses that consume cash across a market cycle. Nevertheless, like a stopped clock that shows the correct time twice each day, even bad stocks or sectors can do really well occasionally. To give an example, Jet Airways has rallied 5x and is currently valued at almost $200m despite the business having been declared bankrupt two years ago and with its lenders taking 99% of the share capital. As the table below demonstrates, there are plenty of such stocks across sectors that have delivered strong share price returns, often driven by retail buyers. In many cases, they are up by 100-200% since last August but despite these rallies, they are still down massively from their seven-year high prices. We are quite comfortable leaving such high-risk stocks to other investors with greater risk appetite.

Listed Indian 'Value-Destroyers'

Company	Price (INR) 1st August 2020	Price (INR) 30th June 2021	% Return 1st August 2020 - 30th June 2021	Price (INR) Last 7-Year High	% Fall From High - 30th June 2021
Healthcare Company	36	914	2438%	2,528	-64%
Energy Company	4	15	300%	111	-87%
Industrials Company	30	88	195%	810	-89%
Information Technology Company	7	22	215%	66	-66%
Communication Services Company	1	2	153%	8	-75%
Financials Company	10	28	171%	94	-70%
Industrials Company	753	2191	191%	4,747	-54%
Materials Company	24	90	267%	497	-82%
Materials Company	19	57	205%	429	-87%
Financials Company	12	25	114%	64	-60%
Financials Company	209	683	227%	1,688	-60%
Industrials Company	23	54	133%	143	-62%
Financials Company	36	127	254%	391	-68%
Industrials Company	17	39	132%	154	-75%
Consumer Staples Company	40	91	127%	224	-60%
Financials Company	17	40	133%	189	-79%
Communication Services Company	21	163	677%	324	-50%
Industrials Company	4	13	222%	101	-88%
Utilities Company	120	350	191%	950	-63%
Industrials Company	44	161	267%	331	-51%
Materials Company	146	306	111%	774	-60%
Financials Company	140	373	166%	902	-59%
Materials Company	26	54	109%	142	-62%
Industrials Company	6	13	120%	44	-69%
Financials Company	6	14	116%	44	-68%
Industrials Company	11	26	139%	147	-82%
Industrials Company	95	189	100%	419	-55%
Materials Company	68	186	174%	418	-56%
Industrials Company	14	37	169%	845	-96%
Communication Services Company	64	180	182%	445	-60%
Real Estate Company	62	137	122%	307	-55%
Communication Services Company	27	61	123%	132	-54%
Industrials Company	101	194	93%	422	-54%
Industrials Company	30	133	347%	871	-85%
Real Estate Company	44	87	99%	176	-51%

To quote an extreme example, shares of Orchid Pharma rose more than 100x over the last year on low volumes, completely belying the fundamentals. After reaching a high of 2,600, the stock has been on a non-stop correction and is now down 70% from the recent peak. Management had recently announced an OFS (Offer For Sale) in the stock at a 72% discount to the then prevailing price, thereby accelerating the fall!

To invest in such stocks is analogous to playing against a casino every night; the player will have the occasional winning night and sometimes even win big, but in the long term we want to be playing as the house with the odds on our side. In a vibrant economy such as India, there are a plethora of sectors that are enjoying powerful supportive trends and plenty of companies that enjoy high ROI and abundant cash generation. Given our absolute return mindset, we are quite willing to let others try to catch a falling knife and try to time when to buy businesses that we wouldn’t want to own.

Corks Underwater

In stark contrast to the value-destroyers, there are several high-quality companies that we regard as “**corks underwater**”. These are stocks that have a combination of factors that make them highly likely to make a lot of money over time. This, remember, is our objective. It’s quite likely that they will also beat broad equity benchmarks too but our focus is on making money and we have no interest in buying something just because it is an index heavyweight. The focus is also on identifying such stocks where we can also invest large tranches of capital upfront or add to our positions incrementally over time.

In some cases, our “corks” are companies such as Adani Ports that we have discussed in previous reports. As India's leading ports operator, Adani Ports has a direct play in India's growing economy and rising share in global trade. In our view, Adani has a brilliant business model with a local monopoly and large land banks. We expect the business to continue to create value over time given natural advantages. It’s great to see the market rewarding Adani with a share price that has more than doubled over the last year.

There are plenty of “corks” that have prospects just as bright as Adani but which the market is choosing to ignore at present. Sometimes it can be frustrating to see the market myopically focused on companies that have blatantly inferior prospects but we are long-term investors and we know that over any reasonable period the market will reward high ROI businesses with excellent management and strong market positions. In the meantime, we have the opportunity to add to some of our favourite holdings by recycling the profits we have made elsewhere in the portfolio.

A great example of a current “cork” is Bharti Airtel, where, in our view, the prices still do not reflect the significant underlying positives and robust operational performance of the last few years. The Indian mobile market has now consolidated into one with just 3-4 participants. Of these, Bharti and Reliance Jio are the dominant participants, consistently adding new subscribers to their networks. The third-largest network, Vodafone, is rapidly losing subscribers and has struggled to invest in its infrastructure. Bharti, by contrast, is enjoying the lowest churn-rate in the industry and organic growth in its ARPU (Average Revenue Per User per month) from 118INR in 2019 to ~153INR currently. Rising revenue and an already well-invested infrastructure puts Bharti in an excellent position to generate very substantial cash over the years ahead. In addition, its African business is performing well and is demonstrating steadily improving margins. Despite a steady stream of good news, the share price of Bharti has largely gone sideways over the last six months. At times such as these, we check and recheck our thesis to examine whether it is us or the market that is missing something. Having done so, we are more convinced than ever that Bharti, trading on a miserly 6x 2023 EBITDA is exceptionally undervalued for such a high-quality business. Even a small price hike in Bharti’s tariffs would send a message to the market and likely lead to a considerable rerating.

Similarly, the share price of Sun TV has been quiet in recent months, partly due to the fear created by the well-publicised COVID wave. Investors were concerned about the impact that this would have on advertising revenues of media companies. Although this is a legitimate concern, we believe that the progress that Sun TV has been able to deliver during the worst period of the pandemic demonstrates just how robust this business is. Remarkably, it was able to report growth in its profits over the last year. As the market digests this and starts to look forward to growth over the coming years, combined with a return of Sun TV’s previously attractive share buy-back and dividend policy, we see scope for a rerating. As absolute return-focused investors, we always have one eye on the downside in any stock. Sun TV’s undemanding valuation, and with a large proportion of its market capitalisation sitting on its balance sheet in cash, gives us plenty of upside with little downside or correlation to the broader market.

When “corks” rise, they can do so very quickly and deliver substantial profits in a short period. We were convinced of the inherent value in JSW Energy. A power-generating utility company may not seem like the most exciting of businesses, but we identified several potential catalysts. We just did not know when these may come to fruition. It was clear that the business, having been moribund for a decade, was about to enter a strong period of growth as the company emerged from its 5GW renewables capex. This, along with a process of debt refinancing that would significantly reduce its costs would lead to a dramatic improvement in profitability and cash generation. Perhaps the most attractive thing about JSW Energy is the risk/reward pay-off. We were able to buy it on just 0.6x price/book and 4.5x EV. For us as investors this gives us the classic “heads we win big, tails we lose small” trade that we like. We were quite willing to wait for this value to be recognised but instead, the market has woken up to the turnaround in this business and we have been able to bank a return of 130% in a few months, all the time protected by a cheaply valued business with a robust balance sheet and a senior management team with a record of strong execution.

The final example of "corks" that we have touched on before but is certainly worthy of further discussion is the entire PSU banking sector. You may remember from our last quarterly report that we regard the Public Sector Undertakings as being entirely misunderstood and therefore mispriced. Some of these "corks" have begun to rise; State Bank of India has more than doubled from 201INR to 421INR since we first initiated our position in the portfolio. This has generated a lot of value for us but we remain convinced that it has a long way further to go and hence we are maintaining it as one of our largest portfolio positions. Even after its recent strong run, it is only trading at 0.8x 2023 book value and this seems anomalously low for India's largest bank and a business that has been delivering strong results over the last eight quarters. It has made tremendous progress in improving both its profitability and balance sheet and now has non-performing asset ratios that compare favourably with the very best private sector banks, all of which trade on much higher valuations. Beyond SBI, we continue to see great attractions in other PSU Banks, especially in Union Bank and Indian Bank. Both are trading at just 0.3x book value; a remarkably cheap valuation for two banks that have made great strides in improving their asset quality whilst already having aggressively provided for bad loans in the past. Indeed, in our view there is every possibility that they have over-provided for bad loans and this may give them the opportunity to start writing some of these provisions back into their profits. This element of "free upside" is just what we look for in companies that we invest in. Both banks have successfully raised funds recently to bolster their capital adequacy and give them room to grow in the future as they participate in the revival of India's credit market. In our view, these banks are being priced for the inefficient and weak banks that they were, rather than the reasonably well capitalised growth businesses that they now clearly are, and this provides a very asymmetric pay-off for us.

So, how does this mindset of absolute returns translate into our delivery to you as an investor? We are very pleased to have generated strong absolute returns after all fees in the first eleven months of the strategy's life. Certainly, had you asked us last summer during the darkest days of the pandemic-induced market crash, we would have been only too happy to agree to this level of return. However, simple percentage returns only tell part of the story. We are just as focused on wealth preservation as we are on wealth creation. Most of our competitor funds were fully invested during the pandemic-led global crash early last year and remained fully invested throughout the strong April to July market bounce that followed, immediately prior to our launch. We held a large tranche of cash since launch in August last year (on average we were 64% invested and started from zero) giving us not only strong returns but excellent risk adjusted returns during this portfolio construction phase.

It may be useful to look at the performance of our individual stock picks over the last few months. Ultimately, this is what has driven our performance so far and what will drive it into the future. If we consistently identify stocks that can make a lot of money and build them into a risk-controlled portfolio, this provides the building block for long-term wealth compounding. As can be seen below, we have been able to identify plenty of big winners that have delivered strong absolute returns. Indeed, the returns of the majority of our stock picks since we first purchased them have been very strong, as shown in the annualised ROI's below, and in some cases we are still waiting for the performance to play out.

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Relative Performance of CMKBI Stocks vs. Nifty

Sr. No		Allocation of Fund (%)	Purchase Date	Avg. Cost (INR)	CMP / Sale Price (INR)	Return (%)	Nifty Level - Purchase Date	Nifty Level - CMP / Sale Price	Change in Nifty (%)	Alpha (%) (Over Nifty)	Annualised / ROI (%)
1	**Financials Company**	**~3.9%**	**Multiple Dates**	**396**	**631**	**59%**					
	Financials Company		17/08/2020	359	631	76%	11,247	15,722	40%	**36%**	**87%**
2	**Communications Services Company**	**~7%**	**Multiple Dates**	**528**	**526**	**0%**					
	Communications Services Company		25/08/2020	528	526	0%	11,472	15,722	37%	**-37%**	**-1%**
3	**Health Care Company**	**~4.7%**	**Multiple Dates**	**624**	**759**	**22%**					
	Health Care Company		26/08/2020	611	759	24%	11,550	15,722	36%	**-12%**	**29%**
4	**Industrials Company**	**~4.6%**	**Multiple Dates**	**1,104**	**1,501**	**36%**					
			11/09/2020	916	1,501	64%	11,464	15,722	37%	**27%**	**80%**
5	**Industrials Company**	**~2.2%**	**Multiple Dates**	**212**	**397**	**87%**					
	Industrials Company		22/09/2020	168	397	137%	11,154	15,722	41%	**96%**	**177%**
6	**Industrials Company**	**~4%**	**Multiple Dates**	**431**	**704**	**63%**					
	Industrials Company		24/09/2020	316	704	123%	10,806	15,722	45%	**77%**	**161%**
	Industrials Company		05/11/2020	366	704	92%	10,806	15,722	45%	**47%**	**142%**
7	**Communications Services Company**	**~6.2%**	**Multiple Dates**	**480**	**530**	**10%**					
	Communications Services Company		13/10/2020	442	530	20%	11,935	15,722	32%	**-12%**	**28%**
8	**Materials Company**	**~3.9%**	**Multiple Dates**	**451**	**793**	**76%**					
			19/10/2020	465	793	71%	11,873	15,722	32%	**38%**	**101%**
9	**Financials Company**	**~9.3%**	**Multiple Dates**	**299**	**419**	**40%**					
	Financials Company		03/11/2020	201	419	109%	11,814	15,722	33%	**75%**	**166%**
10	**Industrials Company**	**~2.3%**	**10/12/2020**	**1,394**	**2,034**	**46%**	**13,478**	**15,722**	**17%**	**29%**	**83%**
11	**Consumer Staples Company**	**~4.2%**	**11 to 14 Jan-21**	**513**	**759**	**48%**	**14,485**	**15,722**	**9%**	**39%**	**103%**
12	**Materials Company**	**~1.5%**	**14/01/2021**	**72.7**	**131**	**80%**	**14,596**	**15,722**	**8%**	**72%**	**174%**
13	**Energy Company**	**~2.6%**	**21/01/2021**	**39**	**59**	**53%**	**14,590**	**15,722**	**8%**	**45%**	**120%**
14	**Industrials Company**	**~2.9%**	**Multiple Dates**	**69**	**87**	**25%**					
	Industrials Company		27/01/2021	59	87	47%	13,968	15,722	13%	**34%**	**111%**
15	**Consumer Discretionary Company**	**~3.8%**	**Multiple Dates**	**412**	**735**	**78%**					
	Consumer Discretionary Company		02/02/2021	385	735	91%	14,648	15,722	7%	**84%**	**224%**
16	**Energy Company**	**~2.8%**	**10 to 23 Feb-21**	**74**	**168**	**128%**	**15,107**	**15,722**	**4%**	**124%**	**334%**
17	**Financials Company**	**~2%**	**15/02/2021**	**225**	**261**	**16%**	**15,315**	**15,722**	**3%**	**13%**	**43%**
18	**Energy Company**	**~1.7%**	**22/02/2021**	**627**	**695**	**11%**	**14,676**	**15,722**	**7%**	**4%**	**31%**
19	**Materials Company**	**~1.4%**	**26/02/2021**	**546**	**663**	**21%**	**14,529**	**15,722**	**8%**	**13%**	**63%**
20	**Energy Company**	**~3.9%**	**09/03/2021**	**439**	**468**	**7%**	**15,098**	**15,722**	**4%**	**2%**	**21%**

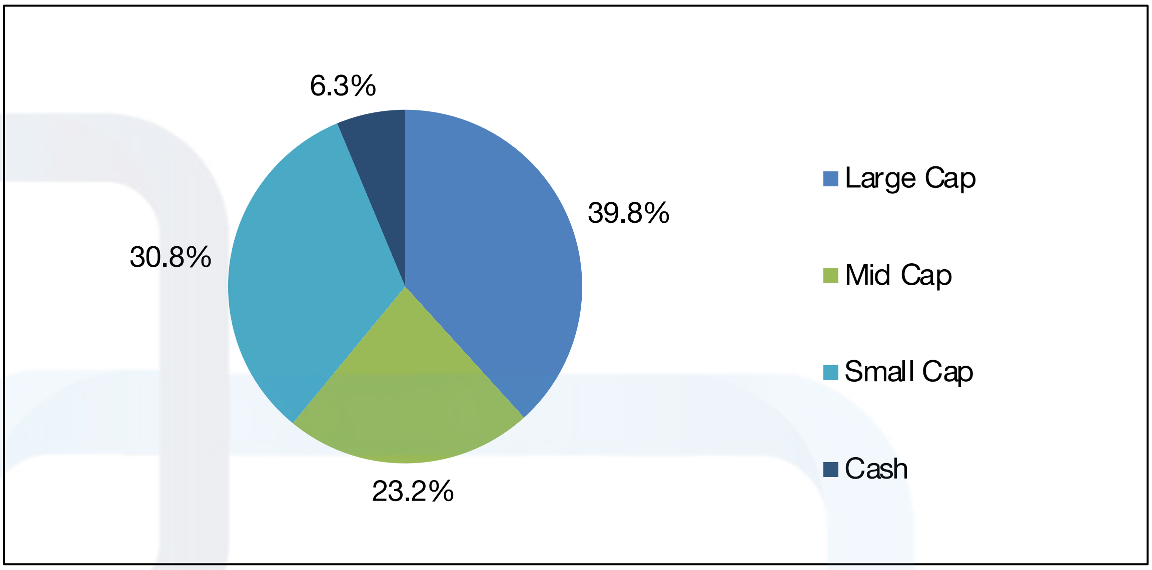
Table includes every company held within Cohesion MK Best Ideas (as at 30th June 2021), subject to a minimum holding period of 3 months.

In each successive report, we try to focus not only on different areas of the Indian stock market or economy but also on how we approach these as investment managers so you can build a clear picture of what we are doing (and just as importantly not doing) with your assets. With our sole focus on making money, we are also prepared to consider quality tactical investment opportunities and have done so in some of the most popular IPOs this past year, but we are certainly happier identifying and holding on to stocks for the very long term to generate multifold returns on capital. However, we will never invest in something just because it is an index bellwether stock or a fundamentally weak business that is having a brief reprieve from its downward trajectory. We will prefer to sit on cash instead or redeploy it in safe stocks temporarily, while retaining the flexibility to invest as soon as the right alpha opportunity comes our way.

When we view our holdings at the time of writing this letter, we see a portfolio with a mix of some stocks that are doing well and that will give us the opportunity to recycle some profits soon and plenty of “corks” that should drive returns over the months ahead. We look to the future with optimism.

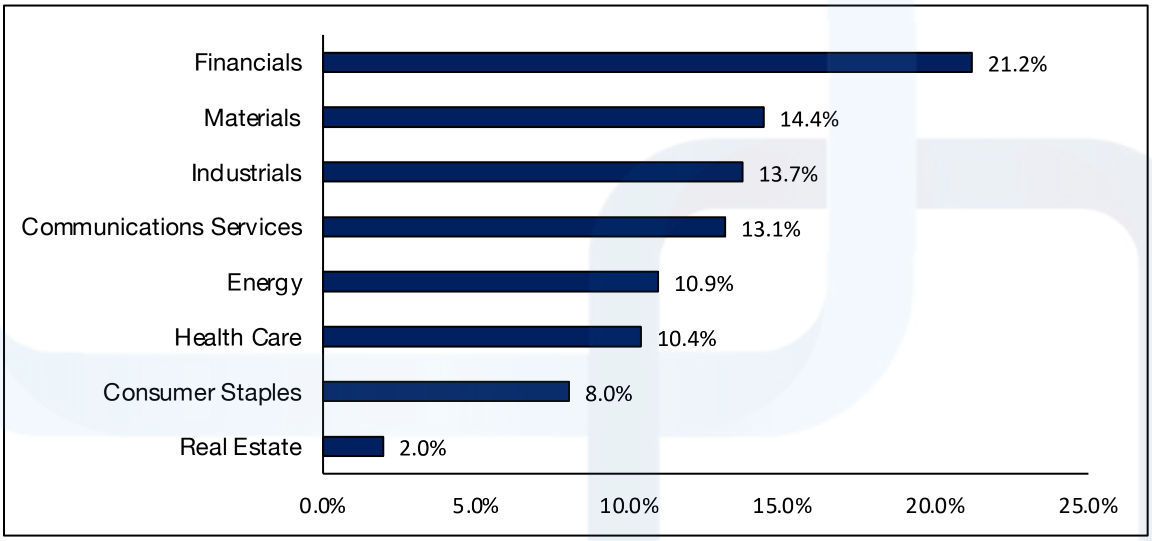
Portfolio – 30th June 2021

Market Cap Exposure



SEBI market cap breakdown – **Large Cap**: top 100 largest companies ranked by market cap, **Mid Cap**: 101-250 companies ranked by market cap, **Small Cap**: companies ranked 251 and onwards

Sector Exposure



Portfolio allocations may not add to 100% due to rounding

Top 5 Holdings

Security Name	% Holding to NAV
State Bank of India	9.28
Bharti Airtel	6.98
Sun TV	6.16
Strides Pharma Science	4.69
Larsen & Toubro	4.57

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