Cohesion MK Best Ideas

Investment Report

April 2022

Cohesion®
Accessing Superior Growth

A return to the perfect “Stock Picker’s Market”

In our January update we described how we believed that Cohesion MK Best Ideas was moving into the third distinct phase since our launch. To recap; the first phase was characterised by maximum uncertainty as the world grappled with the lockdowns imposed around the globe to give our doctors and scientists time to understand Covid and how we might control it. Earnings forecasts were meaningless and markets spent several months working out how to value companies that were effectively mothballed. During the second period, which began early in 2021 and persisted for most of last year, markets enjoyed the twin-stimulants of the vaccine roll out program which promised a return to normality at some point and extremely loose monetary policy. Our investment policy adapted to these two distinct phases. Whilst we were willing to deploy capital during the dark days of Autumn 2020, we did so slowly and carefully whilst maintaining a very high cash weighting throughout. Whole areas of the economy were effectively uninvestable, such was the opacity of outlook. Nevertheless, by being selective we were able to get off to a strong start and begin accumulating gains. As the recovery broadened, we flexed our investment stance again to meet the clearly improving outlook. As investors, local and international, retail and institutional, poured into stock markets it was important to capture a wide range of opportunities. Our natural preference is to run a tightly focused portfolio that allows us to maximise the upside we get from each of our strongest ideas however, in a market that was being buoyed by liquidity in a global pandemic, it made sense to temporarily run a broader portfolio to give us exposure to a lot of different areas that the market itself was clearly favouring.

The Indian market and indeed most global markets are now clearly in a third phase and our approach to managing the Best Ideas strategy should morph to this new environment. So, what has changed? To put it simply, the end of easy monetary policy has led to an end of easy money making for most investors. The days of every IPO rising, often by 100% or more, are behind us. The era of being able to buy over-priced stocks and be bailed out by markets is certainly gone. Maybe they will return at some point in the future but, for now, investors need to have a laser focus on the quality of businesses and the prices they pay for them. We are incredibly excited about this new phase. When the rising tide was lifting all ships, we were able to make a lot of money for our investors but often, we were frustrated to see poor companies on sky-high valuations perform even better. As investment discipline has returned to markets we are seeing a lot of these previous darlings being mercilessly sold down. It must be little short of terrifying for investors who are nursing losses but still holding shares in fundamentally weak businesses. Do they sell now or hope for a recovery?

An absolute return approach to investing

Our aim is not to beat an index that might go up or down. Our aim is to double investors' capital every three years.

As the market narrows and investors become ever more discerning about the likely winners and the price they pay for them, there has never been a better time to be a Best Ideas investor in a concentrated portfolio. We have now turned our attention to meeting new potential investors and it's clear that there is a lot of money looking for a sensible home. We believe that this is an **excellent environment for an absolute return focused approach** and this message is certainly striking a chord with the investors we are talking with.

Concentrating the portfolio, focussing on our very strongest ideas

Over the last few weeks we have begun the process of concentrating the portfolio to focus on our very strongest ideas. Our intention is to gradually reduce the number of holdings from the current thirty to less than twenty. This will provide us with ample diversification but with meaningful positions that reflect our conviction and allow us to play to our best strengths. Our investment style is far more in depth than that of a traditional fund manager. Indeed, it is more akin to that of a private equity business. We often spend more than a thousand hours interviewing management, meeting with industry experts, competitors, customers and suppliers. Given the amount of work we put in, we want to make sure we are well rewarded when the market realises the value that we have already identified. However, simply finding great companies isn't enough, especially in the new market phase. It's also important to buy and sell at the right price and that's why we are making portfolio changes in a very measured way. We have a number of current holdings that we will look to exit over the coming months but we expect to be disposing of them at higher prices than are on offer today. We have a well populated list of excellent companies that we are looking to buy or existing holdings that we want to top up but where we are waiting for market prices to drift down to attractive levels. We may draw an analogy with cricket. A great batsman is happy to play forward defensive shots or even leave the ball altogether until they see a bad ball that is just asking to be hit for six.

IIFL Finance is a good example of a stock that we have built a position in and are likely to buy more. Operating from more than 3000 branches across 500 cities across India, IIFL has a strong position in the fast growing retail finance market with a focus in the gold loans, affordable housing and micro finance areas. IIFL has an enviable track record with strong growth in AUM and excellent credit quality control. Looking ahead, AUM growth of 20-25% is forecast over the next three years and this should correspond with further improvement in its return on equity as its cost of capital falls. Remarkably, all of this current and future performance isn't reflected in the share price of IIFL which is trading on just 5.5x 2024 earnings. We see the potential for the share price to not only follow earnings upwards but also enjoy a significant rerating.

We are also excited by the prospects for **Somany Home Innovation Ltd (SHIL)**. SHIL was demerged last year from the giant HSIL Group to allow it to focus on its position as the fastest growing Indian consumer appliance business and leader in building products. SHIL has a strong competitive advantage through its Hindware brand which is known throughout India. SHIL has grown its addressable market ten-fold over the last ten years and we fully expect to see this growth continue into the future. By outsourcing much of its manufacturing it is able to remain capital-light and generate excellent returns on that capital and strong cash flow. The market is yet to wake up to the considerable value in SHIL because of the general caution around small-cap companies in the current global environment but we have every confidence that we will make a lot of money here.

Adani Wilmar Ltd (AWL) is a joint venture between Adani Group, one of India's leading and most successful conglomerates and Wilmar, Asia's leading agribusiness. AWL has developed one of India's best consumer goods distribution networks of almost 6000 distributors. When AWL IPO'd we were among the preferred anchor investors in an issue that most western fund managers were unable to participate in. We were only able to secure this allocation because of the deep, personal relationships we have developed with management and across the industry. The stock has already risen by 125% since its IPO in February 2022. We believe AWL still offers compelling value to a longer term investor as the business continues to shift from being a commodity business to being a leading packaged food company with subsequently higher margins.

We would also highlight **Shilpa Medicare** as just the sort of company that we want to be building a more substantial position in. Shilpa is a leading manufacturer of oncology medicines in India and over the years has built an extremely robust and high margin portfolio as the majority of chemotherapy drugs have come off patent. What's really exciting in addition to the growing stream of cashflows from this core business is that Shilpa has steadily invested more than $200m in exciting new growth areas including nano technology, novel drug markers, and transdermal patches. The market is largely ignoring these areas as they have been going through a gestation period. As they now enter their commercialisation stage, the value of these high growth streams should become evident and reflected in a substantially higher share price.

Public Sector Banks (PSBs) – a theme that worked earlier than we anticipated

To make room for new holdings we have sold down the majority of our Public Sector Banks (PSBs) positions. We highlighted the attractions of PSBs in the April 2021 investor update. We were prepared to wait for the value of these businesses to be appreciated by the market but sometimes we are rewarded earlier than expected. We more than doubled our money in Canara Bank and did very well in our other bank positions. This has given us the chance to recycle capital into non-bank financials including IIFL.

Whenever we enter a stock we ask ourselves whether it is capable of delivering a minimum of 25% per annum as we are aiming to double investors' money every three years. Sometimes it can take longer for value to be recognised but we are always happy when the market comes round to our view more quickly as our PSB positions demonstrated.

Conclusion

One common theme that ties all of these stocks and many others that we own is the principle of being a **"cork under water"**. We like to own businesses with minimal downside due to clear cashflows and a robust business model trading on a modest multiple. This gives us an **attractive asymmetric payoff of capital preservation on the downside and significant wealth creation on the upside.** We are delighted at the progress we have made so far but believe that the coming phase will suit our style even better.

Strategy Performance

	Discrete Performance** (%)						
		Q1	Q2	Q3	Q4	YTD	Since Launch*
USD	2022	-2.22	-	-	-	-2.22	60.34
	2021	11.31	11.01	13.13	1.58	42.00	63.98
	2020	-	-	-0.19	15.70	15.48*	15.48
		Q1	Q2	Q3	Q4	YTD	Since Launch*
GBP	2022	0.71	-	-	-	0.71	59.70
	2021	10.40	10.63	16.12	1.15	43.45	58.56
	2020	-	-	1.08	9.35	10.54*	10.54

Data as at 31st March (Q1) 2022

*01/08/20

**net of taxes and fees, gross of performance fees

*Cash Deployed Cautiously During COVID-19 Outbreak		
	Equity	Cash
1st 6 months	45%	55%
1st 12 months	68%	32%
Since Inception	78%	22%

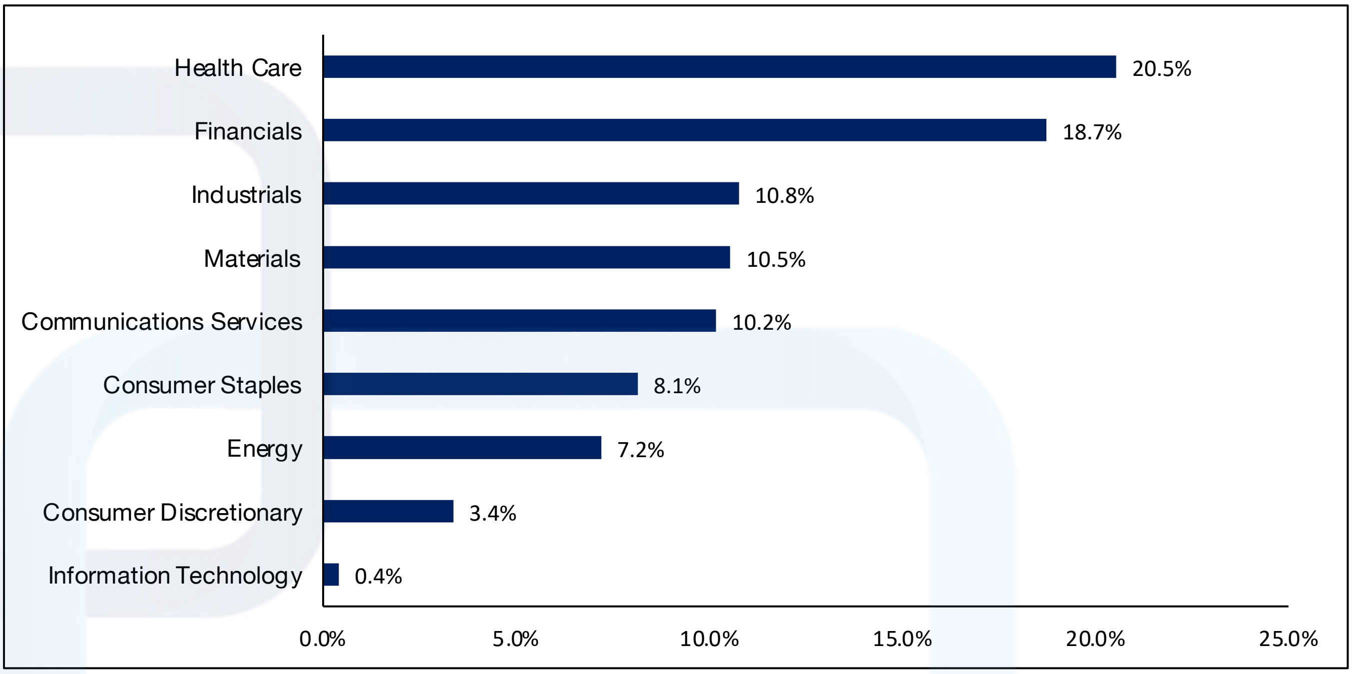
Portfolio – 31st March 2022

Top 5 Holdings

Security Name	% Holding of Portfolio
Supriya Lifescience	7.54%
ICICI Bank	5.97%
Bharti Airtel	5.27%
State Bank of India	5.22%
Ruchi Soya Industries	4.91%

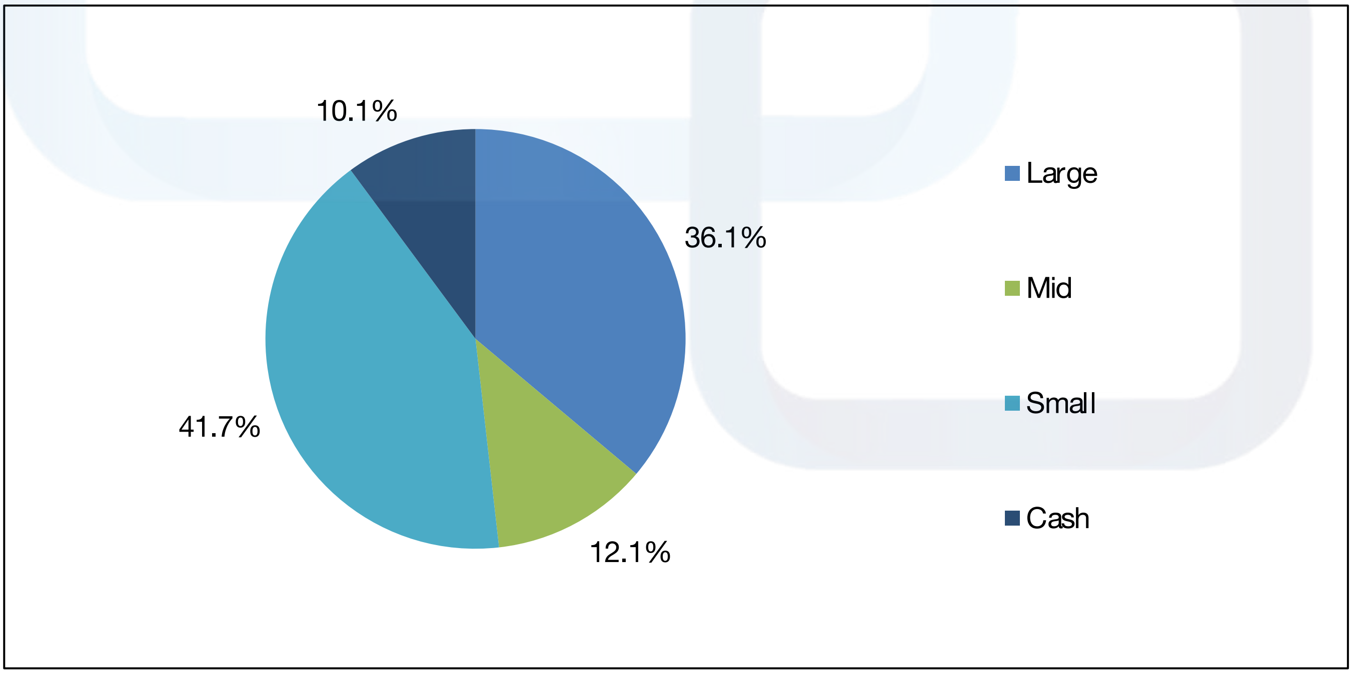
Portfolio – 31st March 2022

Sector Exposure



Portfolio allocations may not add to 100% due to rounding and cash holding

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

For further information:

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