Cohesion MK Best Ideas

Investment Report

January 2022

Cohesion®
Accessing Superior Growth

Building on the foundations of our early success

2022 is showing every sign of being a year of inflection, both in the real economy and also in asset markets.

In the real economy we believe that the all-consuming theme of the last two years, COVID-19, may become less dominant. Whilst none of us know what variants may emerge over the months and years ahead, the world appears to be moving to dealing with it as an endemic disease that is dealt with by vaccinations, rather than a pandemic controlled by global lockdowns. A consequence of the efforts to tackle COVID-19 has been the re-emergence of inflation around the world. The world's central banks and governments flooded their economies with monetary and fiscal stimulus, and this has overflowed from asset markets into the real economy as inflation, exacerbated by supply constraints. There are differing opinions on whether this inflation is a transitory spike or something more permanent. As central banks now shift focus back to inflation fighting, 2022 promises to be another volatile year for global asset managers, with easy liquidity fuelled investment opportunities likely to be replaced by a combination of macro headwinds and renewed focus on bottom-up stock picking.

This is the perfect backdrop for Cohesion MK Best Ideas, as we now shift gears in executing our high concentration, alpha oriented portfolio construct. Although our investment process remains the same throughout a cycle, focused on intensive research and utilising our unrivalled access to India's top business leaders, politicians, and academics, we flex how this process is applied during its course. We have been through two quite different phases and are now entering a third. Let us elaborate further…

Phase one - A cautious stance amongst unprecedented uncertainty

When Cohesion MK Best Ideas was first launched, we were in an environment of maximum uncertainty. Just a few months earlier at the start of the pandemic, stock markets had plummeted and then by late 2020 summer when we launched, markets worldwide had already bounced back sharply to nearly all-time highs following global government and central bank interventions. Major world economies were still locked down, companies were tearing up their earnings guidance estimates and we still had the looming unknowns of a US election ahead of us and no vaccine in sight. During this period, we chose to build our portfolio cautiously and gradually; maintaining high cash weightings (see table 'portfolio construction phase') and preferring to invest mainly in large, liquid stocks with high visibility of earnings and a compelling valuation. Thankfully, our research identified several such companies, which gave us the opportunity to get off to a very solid start and produce excellent returns without taking undue risks.

Phase two - Rising optimism and a broadening bull market

During last year the market digested the impact of the vaccine rollout and the massive monetary stimulus packages and it became clear that this was a bull market that would broaden out. There were also a number of IPOs in Indian markets, the highest in a long time, thereby providing a lot of new investment opportunities and attractive return possibilities. We took this as an indication to hold a more diversified portfolio that would capture gains across the sector and size spectrum. One of the key factors driving our decision making in this phase was to keep accumulating gains without overly committing to specific stocks, with the focus being on creating a strong base in the strategy for the future. We were consciously conservative in our “bet sizing” in this phase and carried a higher than usual number of stocks in the portfolio for much of last year, in contrast to our more typical approach of a concentrated portfolio.

Our stock picking was strong, even amongst the market heavyweight blue chips. As an example of this, State Bank of India (SBI) is covered by dozens of analysts and yet the consensus, in our view, was wrong. We were able to identify catalysts that showed much greater potential for a re-rating in this public sector bank as compared to India’s leading private sector banks and this has indeed proved to be the case. Since our first investment in November 2020, the bank is up 155% compared with about 50% for the Bank Nifty. In fact, our top banking picks; SBI, ICICI bank, and Canara bank, have all outperformed the Bank Nifty meaningfully. Likewise, our investment in another blue chip, Larsen & Toubro, is up over 120% from our first purchase. Among smaller companies we also had a lot of success in identifying alpha candidates, with our investment in JSW Energy worth highlighting. The investment is up 422% from our entry price of INR 73 in February 2021. Finally, we also did very well amongst IPO stocks, wherever we made high conviction anchor bets. Two notable examples being consumer appliances company Stovekraft, where we more than doubled our investment within the span of six months, and Gland Pharma that we exited at a 66% gain after a short four months.

There are parallels between the blue chip and IPO themes. In both cases it was clear to us that investors, both retail and institutional, were keen to deploy cash as their risk appetite increased. Blue chips were an easy way to access immediate liquidity and get money to work quickly. IPOs were being driven by the belief that they always rose substantially in the days and weeks after listing. Initially this was true, and we benefitted from this, but increasingly the IPOs are being priced correctly, sometimes even higher, thereby leaving nothing on the table for investors. India's leading fintech player, Paytm, listed recently and is down 40% from the IPO price. Another new age business model CarTrade Tech is down 50% from the IPO price. Examples abound of richly valued companies faltering upon listing and leaving a bad taste for their anchor investors. We are prepared to avoid IPOs, even where we like the business model and management, if the valuation is too rich. In our experience, there is usually a chance to buy such stocks at sensible valuations in the future when the hot money has moved out.

Phase three - A more discerning market providing fewer but greater opportunities

In the third phase we believe the market is likely to become far more discerning as the vaccine and monetary policy led frenzy ends. Nevertheless, there has been a vast amount of wealth created in India over the last 18 months with the market capitalisation rising from USD c1.5 trillion at the March 2020 lows to USD c3.8 trillion currently. Investors will be looking to recycle their profits into selective companies with visible earnings growth prospects and attractive valuations. This narrowing of the market into fewer opportunities compliments our strategy well. In the past we have seen several such phases, for example in the period 2013-16, where our investment approach was able to identify winners consistently despite an otherwise narrow market for investing. We are confident in our portfolio being able to deliver in the volatile scenario going ahead, as we have a very strong earnings visibility for the portfolio as a whole and valuations are fairly comfortable. You should therefore expect to see the portfolio become more concentrated with bigger positions in our highest conviction stocks and fewer holdings in the "tail".

A case in point to our concentration strategy is our recent investment in **Supriya Life Science**. We have cumulatively invested hundreds of hours in understanding and researching this remarkable company. We are confident that no buy-side or sell-side team has devoted anywhere near this amount of time. The depth of our work here is more akin to a corporate finance due diligence than a traditional fund manager. Led by a visionary first generation entrepreneur, Supriya has delivered excellent growth over its 35 year history and garnered many awards. It is present across segments including anaesthetics, antihistamines, anti-allergy, asthma, and smoking cessation; and has capability to handle a wide range of complex chemical reactions at scale. Over the last 5 years the company has meaningfully scaled up presence in regulated markets, thereby leading to a sharp expansion in gross margins and a strengthening of the economic moats of the business. This has led to a multifold increase in profitability, and our proprietary work points to this increase being sustainable over the medium term. The company also has one of the best ROE/ROCE characteristics within mid and small cap pharmaceutical peers in India. Looking forward, the company has the tail wind of steady growth in demand for existing products and also has the ability to turbo this growth by expanding the range of products it offers to its current partners.

Supriya recently undertook an IPO, raising capital to continue its planned expansion. Unlike in many other recent IPOs where prices were high and earnings quality questionable, Supriya management were very willing to take a long-term view of wealth creation. We spent significant time engaging the senior management of Supriya, not just discussing their strategy but also helping them frame a strategy that will allow us to all build a great deal of value together. Over this process we have been able to build a reputation as a trusted advisor, and the company highly values this association. The depth of relationship we have built also allowed us to get amongst the largest allocations of the stock in the anchor book, despite intense competition. By advising the company to price the IPO at the correct level for investors, we earned the management's goodwill and respect, in addition to already sitting on a very strong profit. Such was the unmet demand for Supriya that it has already risen from its IPO price of INR 274 to over INR 500, in the first month post listing. Nevertheless, we aren't taking a short-term bet in Supriya. We believe that the company has all the hallmarks of a truly great growth stock, one that has the potential to be much more valuable than it is today, and one we want to hold on to for the ride.

As we continue to build on the theme of more concentrated positions in super-high conviction stocks, we will have a lot of interesting insights to share with our investors in future reports. In the meantime, we look forward to the year ahead with a lot of optimism and confidence.

Strategy Performance

Discrete Performance** (%)							
		Q1	Q2	Q3	Q4	YTD	Since Launch*
USD	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	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 December (Q4) 2021

*01/08/20

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

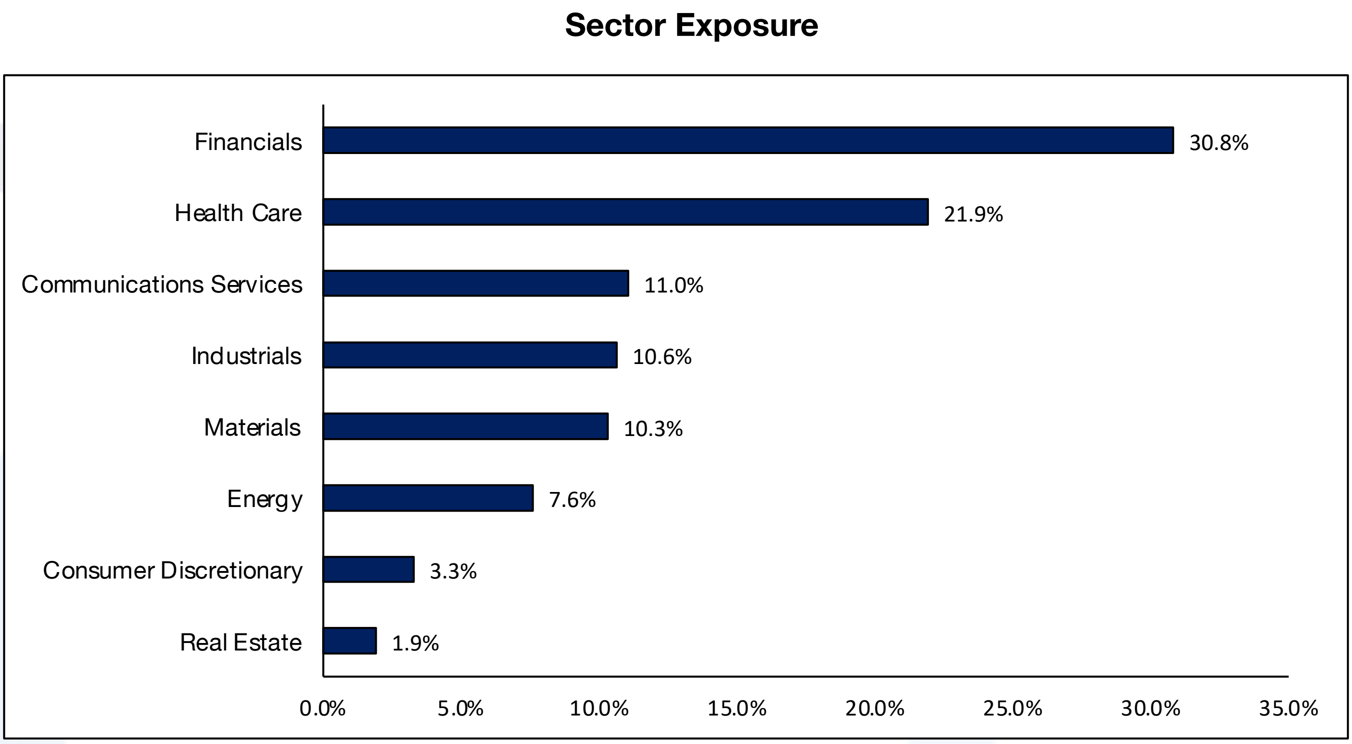
*Cash Deployed Cautiously During COVID-19 Outbreak		
	Equity	Cash
1st 6 months	45%	55%
1st 12 months	68%	32%
Since Inception	76%	24%

Portfolio – 31st December 2021

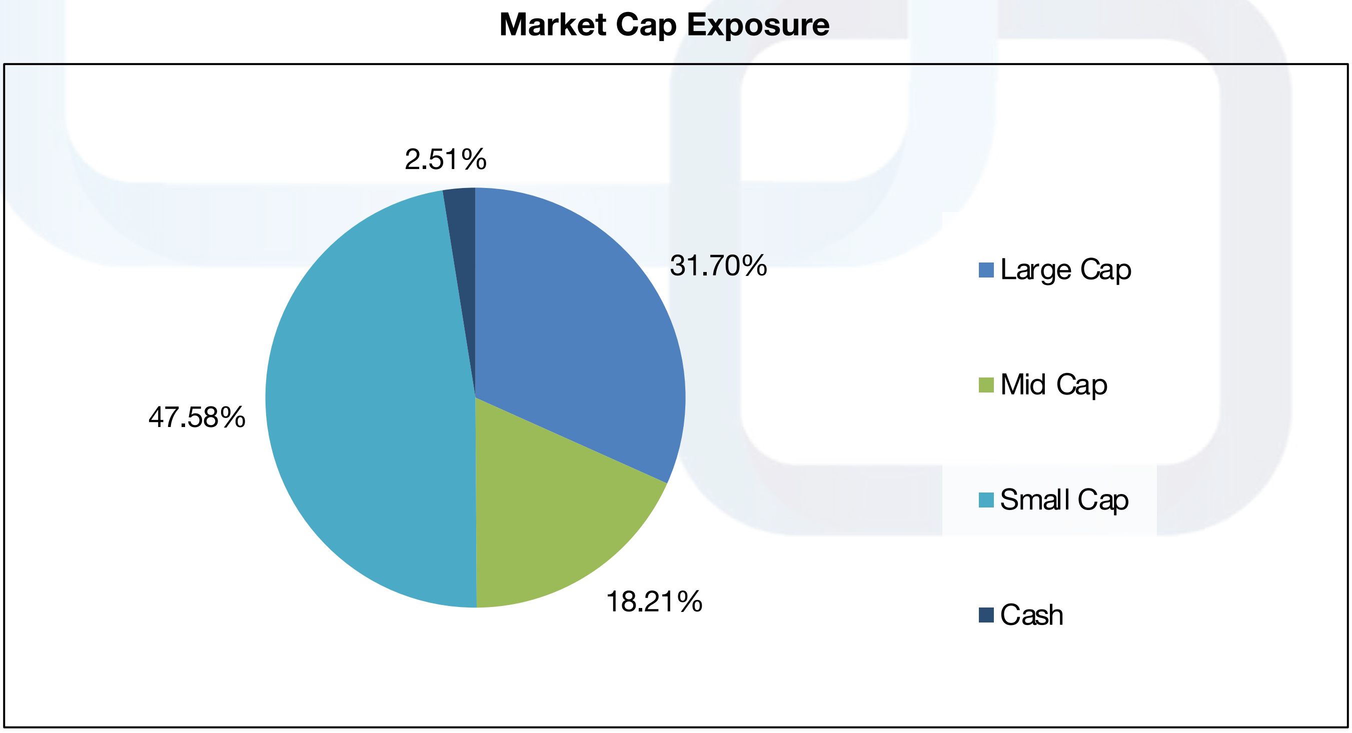
Top 5 Holdings

Security Name	% Holding of Portfolio
Supriya Lifescience	7.37%
State Bank of India	6.61%
Bharti Airtel	6.06%
Canara Bank	5.63%
Sun TV	4.99%

Portfolio – 31st December 2021



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



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

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