Cohesion MK Best Ideas

Investment Report

April 2024

Cohesion®
Accessing Superior Growth

The Times They Are A-Changin'

We have delivered **another strong quarter, with performance of 14.49% in USD terms and 15.47% in GBP**. This takes our **since-launch performance to 164.20% and 173.85% respectively**. As the table below shows, that compares favourably with all major international equity markets and local indices and peers.

USD (Data to 31.03.2024)	Performance (%)
	Since Inception 1st August 2020
Cohesion MK Best Ideas (USD)	**164.20**
Cohesion MK Best Ideas (GBP)	**173.85**
MSCI India	90.38
Nifty 50	81.20
Sector : FO Equity India	75.79
Nasdaq 100	72.43
S&P 500	70.17
MSCI All Country World Index (ACWI)	53.25
MSCI Emerging Markets	6.83
MSCI China	-39.04

Having enjoyed such strong performance, especially coming on the back of our 43% USD return last year, it is important to address the investors' question of whether the best returns are in the rear-view mirror or down the road ahead.

To answer this question, we must consider the changing nature of not only our portfolio but also the broader stock market in which we can hunt. If nothing else had changed, it might be reasonably argued that our portfolio had got more expensive last year. In practice, there has been a **lot** of change at both the micro and macro level which makes us very bullish about the prospects for some of our long-standing investments and newer holdings.

When Bob Dylan wrote *"The Times They Are A-Changin'"* in 1964, the Dow Jones Industrial Average was at around 800. Its constituents included F. W. Woolworths, Goodyear Tire and Rubber, Eastman Kodak, and Bethlehem Steel. Today, the Dow stands at almost 40,000, a rise of nearly 50-fold. Had you told someone in 1964 that the Dow would rise 50-fold in the following 60 years, they would probably not have believed you. Had they believed you, they would have confidently predicted that all of the Dow's constituents must be horrendously overpriced. What they would have overlooked is a market's ability to entirely regenerate over time.

The Dow's rise has of course not been driven by a rerating of old companies; it has been driven by wave after wave of new companies that have come roaring through to meet new opportunities. Companies such as Amazon and Apple did not exist in 1964. Even if someone had imagined such companies, there simply wasn't the technology to deliver their services. But once society and technology evolved sufficiently, there was scope for massive amounts of value creation.

We have commented in the past that we invest in *"a market of stocks, not a stock market."* Every day there are new themes emerging and old themes that are mispriced. That is why we spend our time thinking about the opportunities that present themselves to us, one stock at a time, rather than theorising on the level of a broad market index. This newsletter will therefore focus on two keys aspects of your portfolio; a new theme with the scope to be a multi-bagger and some existing portfolio names that are rapidly changing.

India - a key beneficiary of the sustainable revolution

We are all aware of the dynamics driving the need for far greater sustainability. In turn this is creating multi-decade opportunities in a wide range of industries involved in delivering greener power. Many of these opportunities are backed by orders from governments who are already falling behind their existing commitments and are desperate to catch up.

We are not going to spend much time here debating India's own role in contributing to a more sustainable world. Such views are inevitably subjective. It is true that India is one of the largest emitters of CO_2 but that is unsurprising as it is also one of the world's largest countries whether measured by GDP or population. It is also true that India has one of the lowest per-capita emissions, at around one-third of the global average. **India recognises that its great size brings with it great responsibilities** and it has made commitments to invest massively in renewable power and appears to be on course to meet its Paris commitments and even exceed them. Some 40% of India's electricity generation is set to be from non-fossil fuel by 2030, a five-fold increase in a decade.

India is ideally positioned to benefit in this space as "The Factory to the World". It is very clearly signalling its willingness to fully play its part in solving the chronic issues facing the planet and has the technical expertise to deliver the critical engineering needed to solve problems. The current tensions between other manufacturing powerhouses and The West, also favour India. As Madhu recently commented on CNBC**: "If you are a government or major corporation needing to guarantee a reliable source of such a critical part of your whole green plan, which country would you prefer to rely on?"**

We have identified Transformers & Rectifiers India Limited (TRIL) as a likely key beneficiary from the immediate and longer-term trend towards green power from wind and solar that will require substantially more transformers. There is an acute shortage of supply in their core markets. Their global competitors have full order books. Any new meaningful supply will take time to build capacity and is unlikely to come on stream for at least two years, by which time demand is likely to have grown substantially again. This gives TRIL great visibility and also an excellent environment in which to be setting its margins.

TRIL has delivered a stream of pleasing news flow to the market including major contract wins in recent months. The deals with the Power Grid Corporation of India signifies a strategic partnership that contributes to the strengthening of the national power transmission network, ensuring reliable and efficient power supply across the country. We can only imagine the amount of due diligence that a quasi-government entity such as this must have put into TRIL. Moreover, this project aligns with the Indian government's vision of enhancing the power infrastructure to meet increasing demand and supports the broader goal of sustainable development. In a fast-growing country such as India, we know that the demand for power is only going one way and TRIL sits in the sweet spot for this.

We also like Sterling Wilson Renewable Energy. Sterling and Wilson is one of the leading end-to-end solar engineering, procurement and construction solution providers globally and is also engaged in the operation and maintenance of solar power projects. Backed by the strong parentage of the giant Reliance Industries, it is present in 26 countries. Sterling Wilson's solutions are technically advanced and large scale and in this they have a strong competitive edge which gives them high barriers to entry. They proudly claim "to have never spent a dime on marketing", preferring instead to rely on their reputation and customer referrals within their specialist markets. We believe the next few years have the potential to deliver exponential growth for Sterling Wilson and our own modelling suggests that **revenues could grow eightfold from 2023 to 2026.**

TRIL and Sterling Wilson are both excellent examples of us identifying a great investment prospect with a strong thematic tailwind and where our financial backing immediately made a huge difference to their standing among the wider investment community. For example, while there was absolutely no doubt about the demand for TRIL's products, there was a question about whether they could get sufficient funding to scale up to meet the demand. With Madhu on board, the company has managed to get the desired visibility amongst investors.

Old friends with new news

When looking at the evolution of stock markets and their ability to constantly create new money-making opportunities, it is natural that new industries are the first to spring to mind. However, we have written extensively in the past about our love of stocks and sectors that are quietly reinventing themselves. Confirmation bias is powerfully present in most people and especially so in investors. We naturally find it comforting to absorb information that supports our existing views rather than anything that challenges our status quo. Time and again we speak to investment bankers, brokers and other fund managers who continue to label a company as being problematic despite all the more recent news flow having turned positive. **Being able to buy great companies that are priced off old ways of thinking is a very key part of our strategy.**

We have no problem in admitting that we don't always get it right. Despite the exhaustive due diligence that we undertake and the countless hours we spend speaking with the various suppliers, peers, customers, former employees, academics, and other commentators that orbit a company, sometimes the world simply changes. At these times we reassess the stock in an objective and unemotional way as though we were looking at it for the very first time. We strip everything back to bare metal. It is important we recognize when we are owning a fundamentally decent company but one in which the story has changed because of exogenous events. The mistake here would be to ignore new information and just hold on, hoping for a favourable change.

However, when looking at our losers, we often identify companies that have gone through a lot of self-help. **Indeed, in the best companies, a period in which they are facing a storm can actually make them much stronger when they emerge.**

Regular readers of our newsletters will know of our deep admiration for the product development capabilities of Shilpa Medicare. Shilpa owns a world-class portfolio of oncology products (and several non-oncology products too) with market leadership in several Active Pharmaceutical Ingredients (APIs), and a strong intellectual property which is constantly being further strengthened by their large pool of more than 200 scientists. While the API business is extremely profitable with best-in-class margin and return ratios, Shilpa arguably focused too much on reinvesting into product development for the future. This investment program held back its cash generation and led to a prolonged period of share price weakness. We have repeatedly reassessed our belief that the company, and we as investors, would be rewarded as they turn their attention to monetising their portfolio; a process which is already well advanced. Indeed, management has been responsive and willing to act on our suggestions to focus now on product monetization rather than product development. **The API business alone is worth more than the entire current enterprise value of the overall business and there is substantial optionality that is effectively thrown in for nothing.**

Biologics is an area where Shilpa has made over a decade of investments and is now at the cusp of realising significant profits. Within this, recombinant albumin can be a game changing opportunity. Albumin is one of the most important proteins in the human body, but hitherto largely extracted from human plasma; Shilpa's process could be superior in terms of both quality and cost. Shilpa has a patent protected intellectual property for its purification process and has genetically engineered the yeast cell source for significant enhancement of yield for their recombinant albumin. This significantly improves the certainty of success here as well as the upside should they succeed. The albumin product is coming ever closer to commercialisation, but other investors are waiting for regulatory approval before giving them any credit at all. Albumin could easily add $100m of EBITDA which would be transformational against a current $500m market cap. This is in addition to a sharp recovery in their base business, which is already visible in reported numbers. **We regard Shilpa as a classic "cork under water." It's API business backstops the current valuation and there is scope for just one of Shilpa's currently non-contributing businesses to be worth an additional $1bn+ of market value. It is heartening to see Shilpa's share price moving up sharply over the last few months, but we believe Shilpa remains profoundly undervalued.**

Also in the API space is **Supriya Lifescience**. One of the few market-listed fully backward integrated API players, Supriya's profitability is amongst the strongest of its peers, with a targeted EBITDA margin range of 28-30%. It is targeting 25% per annum compound earnings growth over the next 3 years, with a ROE/ROCE profile that is superior when compared to the sector and broader markets. After a hugely successful listing, Supriya's stock came down sharply due to investor concerns about whether their high margins were sustainable combined with a dip in profits in 2023 due to the recurrence of Covid in China that led to weakness in one of their key products. Management commentary from Supriya remained consistent and resilient even in these bad times while their razor-sharp focus on product development and execution has led to a rapid stabilization of business and recovery in profits in 2024. The company has been able to demonstrate consistent performance in recent quarters and guidance remains for strong growth despite very conservative estimates. We believe the company will significantly surprise on the upside in its operational performance and that this will lead to its share price valuation being rerated to a much higher multiple. **As with Shilpa, we believe Supriya is not getting sufficient credit for a very strong base business and for the fruits that their investments into new products are now starting to bear.**

We would also highlight Indostar, which has had its share of issues in the past but is a company with excellent potential to reinvent itself. From a peak of 600INR in 2018 it fell to a little over 100INR in 2023. It will have dropped off the radar for many investors. This has caused Indostar to slip to a very attractive valuation of just 0.7x book value. Put simply, Indostar's market capitalisation today is far less than it would cost to recreate Indostar and there is nothing in that valuation for any improvement in the business..

Indostar is undeniably cheap because of its history but cheapness alone may not be enough of a reason to invest; there has to be a catalyst for this value to be unlocked. We believe there are several. Indostar is the first private equity deal by Brookfield Asset Management in financial services in India. With over $900 billion in assets under management, and a heritage spanning more than 100 years, Brookfield is a highly regarded asset management house with a reputation for the most intensive due diligence and a real focus on properly understanding every aspect of the operations of the companies they invest into. They invested an extra c$30m in additional equity at the end of February, further demonstrating their commitment. The senior management of Indostar has been changed including a new and highly rated CEO who has a wealth of experience across a range of activities that Indostar are in from big houses including ICICI Bank and Kotak Mahindra. They have also replaced both the CFO and CRO. The new management has taken very conservative provisions, and this should give them a solid base from which to now deliver positive surprises to the market. They are also incrementally improving asset quality every quarter. It appears that the senior management team has steadied the ship and is providing guidance that we can look forward to a resumption of growth.

The space that Indostar is in is a good one and liked by investors. As perception begins to change, especially with the comfort of Brookfield's commitment and bolstering of management, there could be a substantial uplift. One of Indostar's peers, Chola, trades at c5x trailing book value. **Even if it will take Indostar time to repair its reputation to these levels, it is easy to see how it may move to 2x book and that would be a 2-3x return and still leave the company looking cheap**.

Looking forward to an exciting future

By the time you receive the next newsletter of 2024, the general election in India will have been held. **It is hard to find a single commentator who predicts anything other than a comfortable victory for Mr. Narendra Modi's ruling BJP. This should come as no great surprise given the sound stewardship of Mr. Modi and the robust health of India. Things are going well, and most Indians would like more of the same**.

We find plenty of companies that are, in our view, likely to double their share prices on a three-year view. Some are in new sectors such as green energy. Some are established companies that are doing new things or things that markets haven't woken up to yet. Despite markets having performed well over the last few years there remains plenty of value available for those willing to look further than the usual index heavy weights. The earnings growth we are forecasting for our portfolio is amongst the strongest we have witnessed in our investing careers as demonstrated by Table 2. With PAT growth of 66.3% pencilled in for 2025, **we are holding stocks on average PEG ratios of just 0.3**. These look remarkably good value when compared with what people are paying for growth elsewhere around the world or even in broad Indian indices. **In other words, we have built a portfolio that is cheaper than the market and growing demonstrably faster than the market.**

Table 2	PE Valuation	Earnings Growth (%)	PEG Ratio
	FY25E PE	FY25E	FY25E
Cohesion MK Best Ideas	**19.7**	**66.3**	**0.3**
MSCI India	23.5	19.3	1.2
S&P 500	21.2	16.7	1.3

By maintaining a balanced portfolio of different ideas, on attractive valuations, that are subject to a wide range of catalysts we believe we will continue to preserve and grow your capital in the most exciting economy in the world.

Strategy Performance: Data as at 31st March (Q1) 2024

Discrete Performance (%)**

		Q1	Q2	Q3	Q4	YTD	Since Launch: Aug 2020*
USD	2024	14.49				14.49	164.20
	2023	-7.06	19.14	12.60	14.78	43.12	130.75
	2022	-2.22	-13.25	13.45	2.18	-1.68	61.23
	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: Aug 2020*
GBP	2024	15.47				15.47	173.85
	2023	-8.98	15.71	17.25	9.99	35.83	137.17
	2022	0.71	-6.41	23.69	-5.54	10.12	74.60
	2021	10.40	10.63	16.12	1.15	43.45	58.56
	2020	-	-	1.08	9.35	10.54*	10.54

*August 1st 2020
**net of taxes and fees, gross of performance fees

*Cash deployed cautiously during COVID-19 outbreak and 90% deployment reached by end of February 2021

	Equity	Cash
1st 6 months	45%	55%
1st 12 months	68%	32%
Since Inception	83%	17%

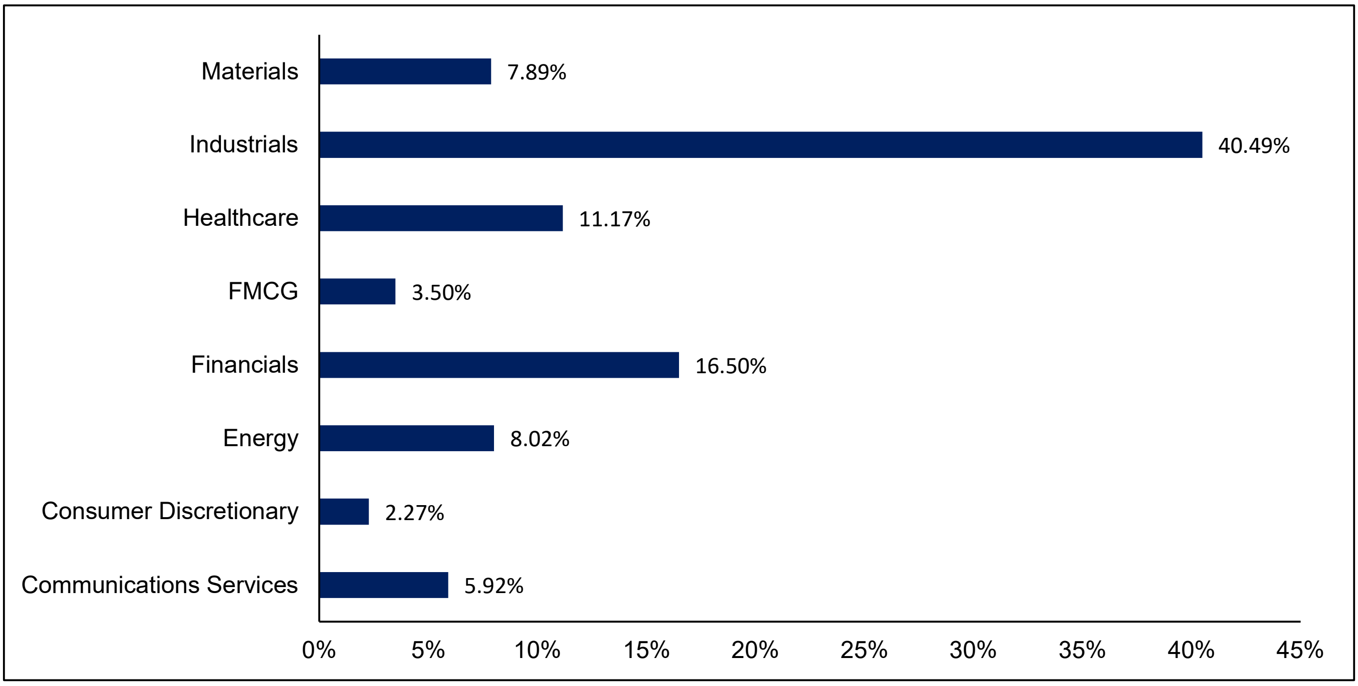
Portfolio – 31st March 2024

Top 5 Holdings

Security Name	% Holding of Portfolio
Transformers and Rectifiers Limited	9.48%
Ramkrishna Forgings	6.55%
NCC Limited	6.51%
Dynamatic Technologies Limited	6.43%
Adani Ports and Special Economic Zone Limited	6.17%

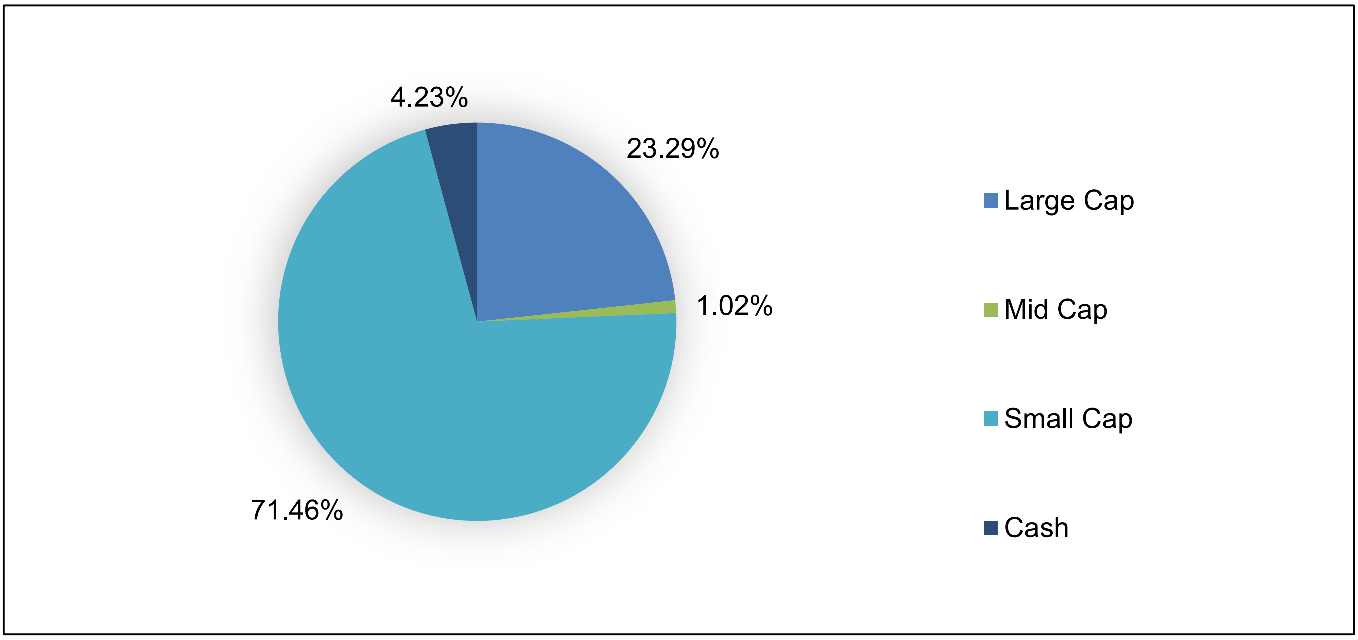
Portfolio – 31st March 2024

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:

Website: www.cohesioninvestments.com

Email: investor@cohesioninvestments.com

Mobile/WhatsApp: +971 555 102 622

Sources:

[1] FE Analytics [Data 01.08.2020 – 31.03.2024], April 2024

[2] Invexa Capital and Bloomberg

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