Cohesion MK Best Ideas

Investment Report

July 2024

Cohesion
Accessing India's Growth

A great environment for stockpickers

We have delivered **another strong quarter, with performance of 18.08% in USD terms and 17.89% in GBP**. This takes our **since-launch performance to 211.98% and 222.84%, respectively**. As the table[1] below shows, that compares favourably with all major international equity markets, and local indices and peers.

USD (Data to 30.06.2024)	Performance (%) Since Inception 1st August 2020
Cohesion MK Best Ideas (USD)	**211.98**
Cohesion MK Best Ideas (GBP)	**222.84**
MSCI India	110.10
Nifty 50	94.87
Sector : FO Equity India	94.81
Nasdaq 100	86.30
S&P 500	77.46
MSCI All Country World Index (ACWI)	57.87
MSCI Emerging Markets	12.30
MSCI China	-34.67

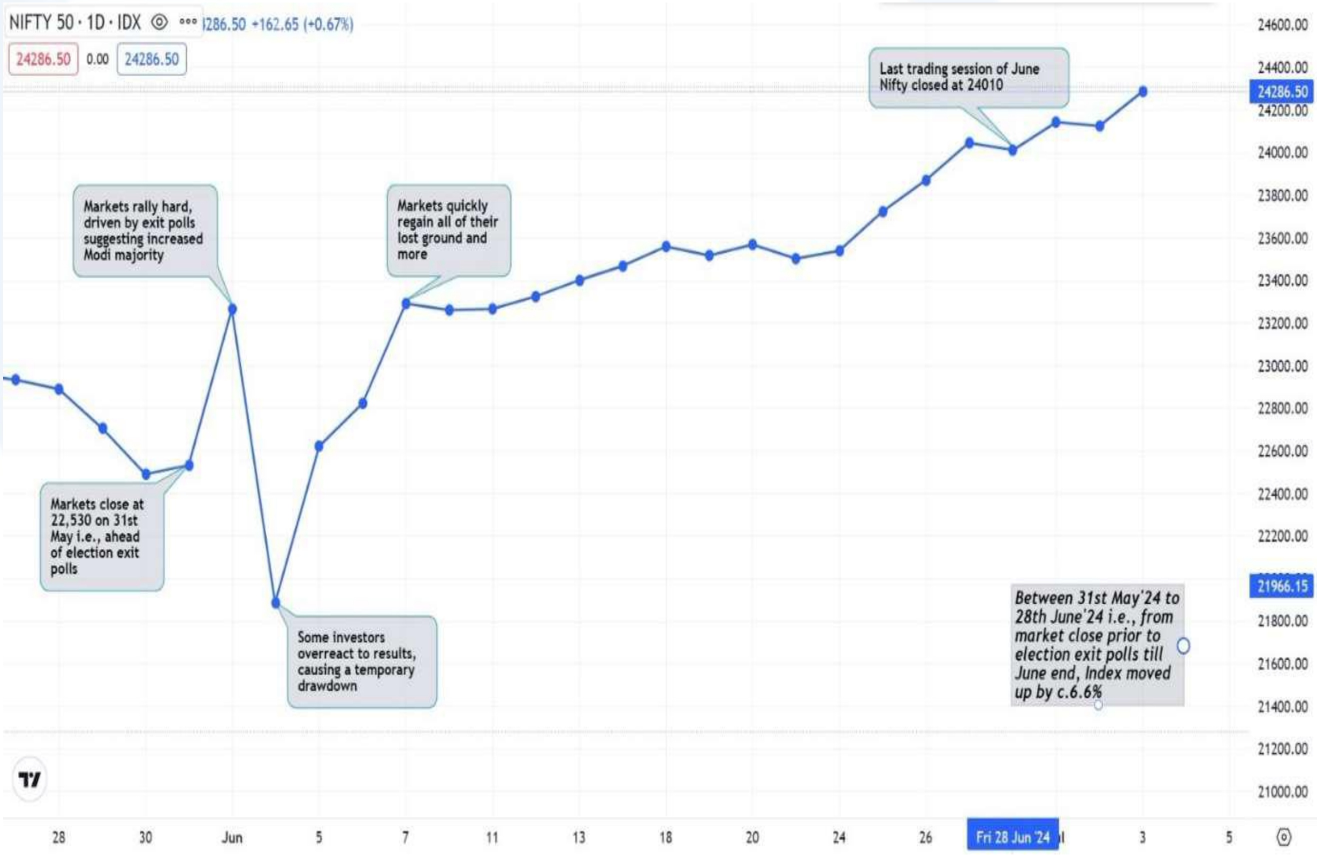
Five more years of Business as Usual

Before we move on to the main topic of this quarter's newsletter, it's worth reflecting on the results of the elections now that the dust has settled. If you had only read international news on the day after the election you may be forgiven for thinking that Mr. Modi had lost the election and that the Indian market was in meltdown, such were the sensational headlines. In reality, Mr. Modi returned as Prime Minister for a third straight term as BJP led National Democratic Alliance secured 293 seats with BJP being the largest partner securing 240 seats. This result gives Mr. Modi a stable platform to build on the transformation he has overseen in the last decade.

Nevertheless, his majority was much reduced and far smaller than the exit polls had predicted. We do not believe that this will materially change the outlook. The freshly announced cabinet remains overwhelmingly occupied by BJP ministers in all the key positions, and they will continue to drive the growth agenda forward. Growth remains Mr Modi's central policy, and it is clear that he has much left to do. When addressing the crowds during the election run-up, he often repeated, **"The past decade was just a trailer. There is plenty more to come."**

However, Mr Modi will be acutely aware of the issues raised by these elections, especially around rural unemployment, access to clean water and power, and upliftment of poor. We think the reaction of markets on the day of the results may have been due to the fear that Mr Modi would be distracted by these issues. We believe that these fears are misplaced. Not only will Mr Modi be more determined than ever to continue delivering growth, but this growth is likely to trickle into more areas of the economy. Giving the economy more breadth can only be a good thing for the long-term sustainability of India.

Whilst we don't often talk about very short-term market movements, we found the week around the election very interesting. As Figure 2 shows, markets spiked up sharply on the eve of the results, driven by the exit polls. We actually took the opportunity to top-slice some of our holdings into this strength. In previous newsletters we have commented that "we like to buy from the fearful and sell to the greedy". It is remarkable how far sentiment and share prices swung in those few days despite the long-term prospects for most companies changing very little. Contrary to the near-hysterical headlines in some international newspapers, the Indian market quickly regained its poise and, indeed, ended the week ahead of where it started as cool heads concluded that it was business as usual.



Indian valuations in context

When we meet with investors, we are most often asked about the appropriate valuation for Indian equities. This is, therefore, the main topic of this newsletter.

It is fair to say that Indian equities generally are not a bargain when viewed in isolation and solely utilising the PE ratio. However, to focus purely on the Nifty 50 Index trading on an FY25 PE of ~21x is a myopic approach and has led to some investors missing out on exceptional long-term returns.

When we look back at history, Indian equities have rarely been "cheap" when viewed purely through the lens of the PE ratio. As Figure 3 shows, the Indian market has typically traded in the range of 20-25x over the last decade and therefore, the current PE of circa 21x is firmly in the middle of the range. Not especially cheap, but not expensive either. What should be immediately apparent from this graph is that anyone who chose not to hold Indian equities in 2014, 2016, 2017, 2018 etc, because Indian equities were trading on more than 20x would have missed out on some of the best returns available anywhere in the world.

So why are broad Indian equities rarely cheap? There are two main interconnected reasons for this. Firstly, even though international investors make many mistakes when it comes to picking Indian equities, they do at least recognise that India is a far superior economy to most emerging and developed markets and that this should be reflected in valuations. **The Indian economy has far greater forecast growth and greater predictability of growth**. The forces driving this growth are structural in nature and likely to persist for decades; thus, it is only right and sensible that investors should pay more for this growth. *Ceteris paribus,* we should pay more for an asset with predictable compound growth rather than one that may provide cyclical ups and downs. The second reason is that the PE ratio only captures one element of valuation, the price we are paying for a given level of earnings, and it misses entirely the growth we are poised to get. If you are given the choice of two markets, one with predicted fast growth and one that is stagnating, should we expect both to be on equal PE ratios? Could the PE of the former not be higher than that of the latter yet still be cheaper when the all-important growth outlook is taken into account?

International investors are very comfortable taking this approach with Western markets. The Magnificent Seven stocks are trading on an average of greater than 50x PE, more than twice that of the S&P 500 Index. We aren't experts in any of these companies, but the consensus seems to be that these companies are riding powerful long-term trends such as AI, battery technology, social media, cloud services and technology-driven consumer products that will provide predictable compound growth for many years. People may or may not be right about these things; only time will tell. It is clear that people are happy to pay far greater PE ratios for these companies than we are paying for Indian companies where we can identify an equal likelihood of growth.

In previous newsletters, we commented that India is such a compelling market that one could buy a tracker fund and have a high probability of beating most other assets in a diversified portfolio. We still believe that is the case. However, we think the **valuation disparity across the Indian market currently provides terrific opportunities to be a focused stock picker.** Despite our general bullishness on Indian equities and belief that the Indian market remains reasonably priced, some stocks, especially some large caps, appear expensive to us. These are often the benchmark heavyweights favoured by foreign investors who only buy a handful of stocks they hope will give them a flavour of India. Sadly, some of these have been poor performers for several years and, in our opinion, are likely to remain so. It is possible to overpay for equities in India, as in any other market, and some investors continue to do so.

The disparity across the Indian market provides us with wonderful stock picking opportunities. Several stocks that we have highlighted over the last few newsletters have performed exceptionally well for us. We discussed **Transformers and Rectifiers (TRIL)** in our last investment report It was only introduced to the portfolio in October last year, however, has given us a **return of more than 500% (6x our money)** since we initiated our position. TRIL is ideally positioned to benefit from commitments that have been made both in India and around the world to clean power. There is an acute shortage of transformers, and these are essential to the generation and distribution of clean power. Some renewable energy sources are inherently intermittent as they depend on factors such as sunlight, water and wind and transformers help to regulate this power, making it more reliable and stable. Transformers are also integral to the use of green hydrogen, a power source that is forecast to grow substantially over the next decade.

India is currently the world's third largest producer of electricity and third largest consumer of power, and this will only grow over the coming years due to India's rising population and increased demand in all sectors of the economy. Furthermore, India has a stated aim to be energy independent by 2047 and net-zero by 2070; aims that provide almost inevitable growth for the space occupied by TRIL. India has bold plans for the next five years and these provide the trajectory for a multi-decade theme. Many of TRIL's current and future customers will simply have no choice but to purchase more transformers both in the immediate and longer term. Those operating in the railway, utility, data centre, power and infrastructure areas are facing not only demands from regulators and law makers but also from their customers to demonstrate that they are delivering energy efficiency.

TRIL's customers can see the opportunity to play a part in the green energy revolution, often backed by the comfort of government contracts but to do so they must have a reliable source of transformers. In many ways, TRIL are the pick-and-shovel producers of the green energy gold rush.

Having witnessed such a rapid share price rise, we have taken some profits simply from a prudent risk management perspective but continue to believe that the opportunity in this space is vast given the commitments to clean power which have been made in India and around the world and the integral part that TRIL will play.

TRIL is also a good example of the "Madhu Effect"! There is absolutely no doubt about the demand for TRIL's products. However, there was a question about whether they could get sufficient funding to scale up to meet the demand. With Madhu on board, any such concerns have gone away. This was probably a significant factor behind the most recent price surge. The price is probably up with events for now but could still deliver 2-3x over the next 2-3 years.

RK Forgings is another stock that has added a lot of value for us, also **rising by more than 500% (6x our money)** since we first added it. This remarkable company, which we have known for several decades, continues to deliver pleasing newsflow. The company is also commissioning some new capacities every quarter in the non-auto space through various segments including railways, oil & gas, and mining where it can transfer its proven expertise and skills. Moreover, its recent acquisitions will broaden its product base into the EV and tractor markets to expand its target market and the company won multiple orders from North American and European OEMs in auto and non-auto segment which all improves visibility and predictability for earnings growth over the coming years. In addition, the company achieved its highest-ever exports revenue in Q4 FY24, and is confident in sustaining this positive momentum. After such a share price rise, it might be reasonably expected that RK Forgings would look expensive but that isn't the case. Because this share price rise has coincided with upgraded earnings, we believe it is trading on around 15x EV/EBITDA for next year and just 11.5x for 2026 . That continues to look good value to us for such a proven compounder.

Perhaps the best way to illustrate value in a growth market is by looking at the PEG ratio as this combines what you are paying (the PE ratio) with what you are getting (forecast earnings growth). As the table[2] below demonstrates, there is a stark difference between the PEG ratio of our portfolio and that of either the broad Indian market or international markets. As we are only looking for 20-25 truly outstanding ideas at any one time, we are able to build a stable of companies that are **not only good value on a PE basis but also have growth prospects that are far stronger than the market**. **These combine to value our portfolio on a PEG ratio of just 0.4, roughly a quarter of that of the market and very comfortably below the rule-of-thumb that a PEG ratio under 1 is a good buy.**

	PE Valuation			Earnings Growth (%)		PEG Ratio	
	10YR PE	FY25E PE	FY26E PE	FY25E	FY26E	FY25E	FY26E
Cohesion MK Best Ideas	**-**	**22.9**	**15.3**	**56.6**	**49.6**	**0.41**	**0.31**
Nifty 50	23.1	21.3	18.7	13.0	13.8	1.64	1.36
MSCI India	24.4	24.6	21.4	10.0	15.0	2.45	1.43
MSCI India Small Cap	34.0	28.1	22.5	15.1	24.9	1.86	0.90
S&P 500	20.9	22.2	19.4	15.7	14.6	1.42	1.33

In conclusion

With the Indian elections in the rear-view mirror, we can look forward to a continued period of stability. We have some wonderful companies in our portfolio, and they continue to build shareholder value for us. We remain alert for opportunities to sell winners that have run too far and to top up holdings that have become too cheap. We cannot say whether broad markets are too cheap or expensive (on balance, they are probably about right), but we are still finding stocks that offer great value and look forward with confidence.

Strategy Performance: Data as at 30th June (Q2) 2024

Discrete Performance** (%)							
		Q1	Q2	Q3	Q4	YTD	Since Launch: Aug 2020*
USD	2024	14.49	18.08			35.20	211.98
	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	17.89			36.12	222.84
	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	85%	15%

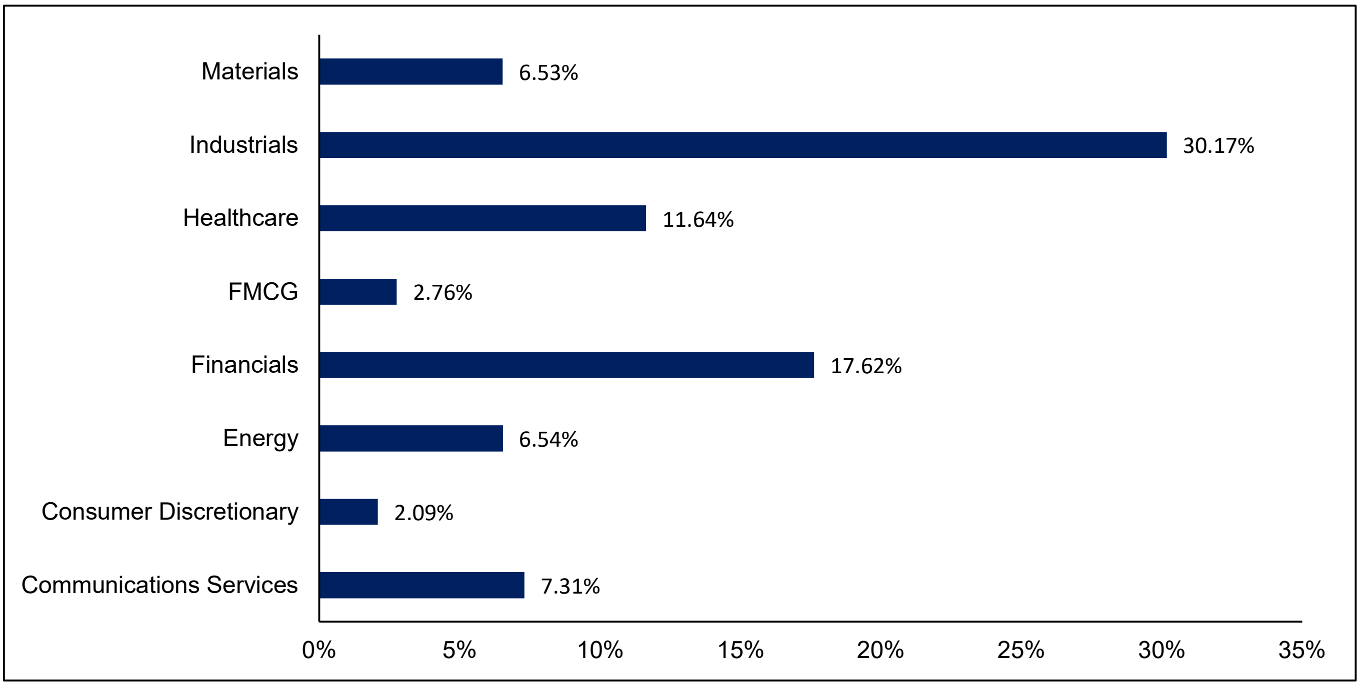
Portfolio – 30th June 2024

Top 5 Holdings

Security Name	% Holding of Portfolio
[redacted]	
Transformers and Rectifiers Limited	7.19%
Ramkrishna Forgings	6.70%
NCC Limited	6.23%
Shilpa Medicare Limited	5.32%
Dynamatic Technologies Limited	4.95%

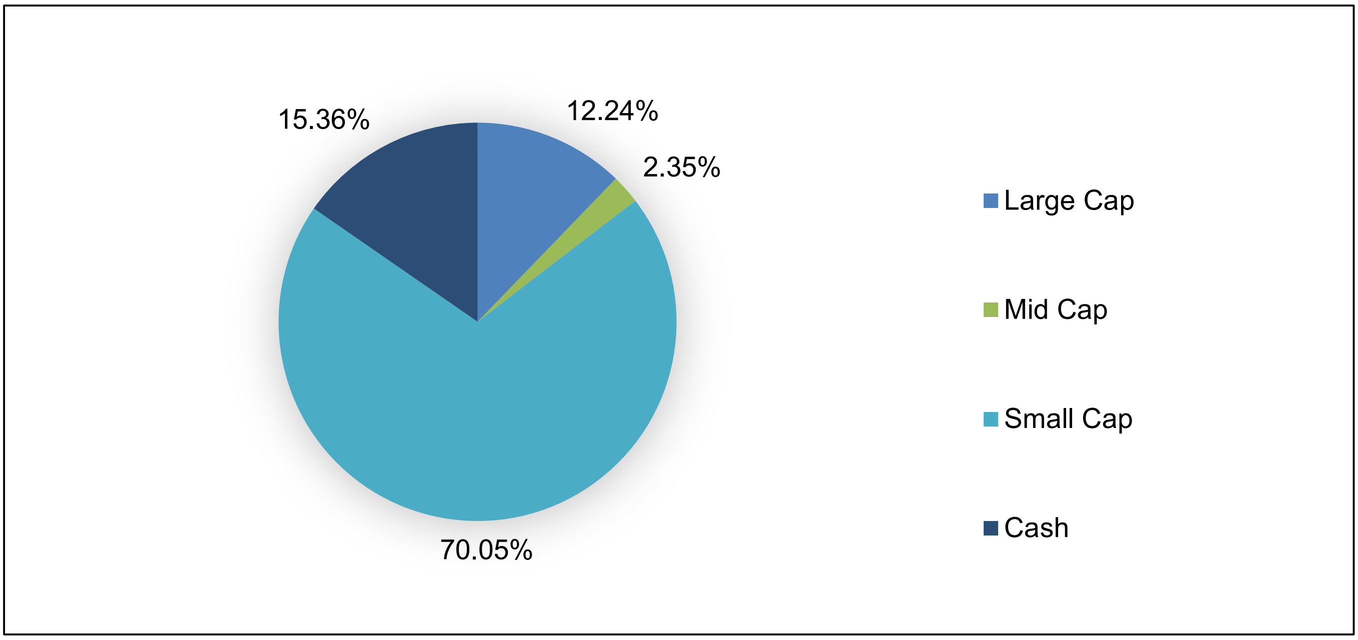
Portfolio – 30th June 2024

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:

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Sources:

[1] FE Analytics [Data 01.08.2020 – 30.06.2024], July 2024

[2] Invexa Capital and Bloomberg, June 2023

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