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Ashoka India Equity

AIE is far and away the top-performing India trust since it launched in July 2018...

Update
16 March 2021

Summary

Ashoka India Equity Investment Trust (AIE) has been the best-performing India specialist trust since it launched in July 2018. In that time AIE has more than doubled the return of its benchmark, while its peers have each underperformed. As we discuss in the **performance** section, the vast majority of excess returns have come from stock selection rather than sector or market cap allocation.

The performance is built upon the stock selection of a large, dedicated team of India specialists. AIE's investment advisor is White Oak, founded by Prashant Khemka, former CIO and lead portfolio manager for Global Emerging Markets Equity at Goldman Sachs. White Oak employs a team of ten analysts, all based in India and all focused on specific sectors. They are compensated based upon the contribution of their stock picks to returns, which incentivises them to pick only companies they think will outperform the market (see **management** section).

This large team – the largest employed by an Indian specialist investment trust – implements a quality growth strategy with a unique feature. This is a focus on an adjusted cash flow metric which aims to uncover those companies which can generate marginal cashflow with the least additional use of capital. As we discuss in the **portfolio** section, this is accompanied by a strong focus on valuation, which means the team are happy to turn over their portfolio rapidly when valuations shift.

This strong performance has led the trust's shares to regularly trade on a premium to NAV which is 0.2% at the time of writing. Apart from the stock-selection process, key distinguishing features include the performance-fee-only charging structure designed to align the managers' interests with those of shareholders (see **charges**).

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Analyst's View

AIE's excellent performance since launch seems to be built on strong foundations. To have as many as ten analysts working on single country portfolios is unusual and should be highly beneficial to the alpha generation task. From speaking to the management team, their passion and commitment to their roles is clear. Additionally, the strategy is clear and well-defined, with a well-understood process for identifying a strong company and the right valuation. Although it is dangerous to expect past success to continue, and markets can always surprise, we think all the right building blocks are in place.

We also like the performance-fee-only structure. This means that investors do not pay a fee if the managers cannot succeed in outperforming their benchmark over a three-year period, and incentivises the team very effectively to repeat their early success. That said, the fee can be high when relative returns have been exceptional (see **charges**). However, it is worth remembering that NAV returns are net of the impact of accrued fees, and so far investors have been significantly better off if invested in the 'expensive' AIE rather than 'cheaper' peers.

We note emerging markets funds are increasingly dominated by China and North Asia and are unlikely to invest much in India, which is just 9% of the MSCI Emerging Markets index. As we discuss in the **performance** section, India is benefitting from a period of significant pro-business reforms which have increased the country's growth potential. We think investing in the country should have strong appeal for long-term growth investors.

BULL
The best track record amongst India specialist peers since inception
Large team of dedicated analysts can cover the whole market
Fee structure aligns managers' interests with those of investors

BEAR
Currently too small for many large investors (but issuing shares regularly)
As a single-country trust, highly exposed to the politics and economy of one state
Performance fee can be high when earned (although overall fees will be low if it is not)

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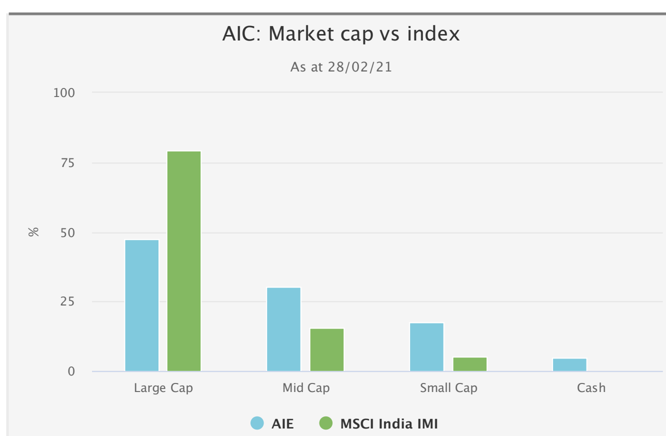
Portfolio

Ashoka India Equity Investment Trust (AIE) owns a portfolio of Indian equities selected for attractive company-specific characteristics. The approach centres on proprietary bottom-up research by a team of sector specialists, and the portfolio is constructed in such a way as to minimise macroeconomic exposures and maximise the contribution to relative returns made by stock selection. This has been borne out in the results since the July 2018 launch. As we discuss in the **performance** section, the overwhelming majority of AIE's considerable alpha has come from stock selection rather than sector or market cap positioning.

AIE's investment advisor, in effect the manager, is White Oak Capital Management, a Mumbai-based firm founded by Prashant Khemka, former CIO and lead portfolio manager for Global Emerging Markets Equity and India Equity at Goldman Sachs Asset Management. Prashant serves as mentor to the team he set up at White Oak. This team comprises ten analysts, all based in India, dedicated exclusively to Indian equities, a larger resource than is brought to bear than any of AIE's India specialist investment trust peers.

AIE's portfolio is tilted towards the small and mid-cap area of the market. The chosen benchmark is the MSCI India IMI, which includes more of the small and mid-cap sectors than the MSCI India Index, but AIE has persistently had even higher weightings to these areas than the index. It has not been a conscious decision to be overweight per se, and is a function of bottom-up stock selection. The team look to cover the entire market and uncover the best companies wherever they can. Unsurprisingly White Oak typically finds more opportunities in the less well-researched and inherently less efficient areas of the market which leads to a strong alpha generation potential. Notably, the team reports that often these businesses are dominant in their respective industries. Since AIE launched in July 2018, SMIDs have outperformed at times and also underperformed at times. AIE's overweight to this end of the market has been consistent, indicative of the fact that the team do not aim to tilt their holdings based on the macro outlook. In fact, as we discuss in the performance section, the overweight to SMID companies has in itself been a detractor relative to the benchmark since launch, but the amount of alpha generated by the team in this part of the market more than outweighs this impact.

Fig.1: Market-Capitalisation Breakdown



Source: White Oak Capital Management, as at 28/02/2021

In essence, the team look for great businesses at attractive valuations. While this broad objective is not unique (and is a good basic description of the quality growth style), White Oak employs a unique strategy. Company financial analysis is built on the proprietary Opco – Finco framework. In essence this framework isolates recurring cash returns in a business once all capex and financing costs are accounted for, in order to give unique insights into the business's cash-flow-generation characteristics which are not captured by traditional valuation metrics. This is intended to flush out businesses which have optically high returns, but which require heavy investment to generate and sustain them, and it also helps to avoid value traps. The White Oak team believe the traditional metrics such as P/E, P/B or EV/EBITDA are often highly misleading on an individual company level as they do not capture the level of capital investment required to maintain rates of return. This is why, for example, AIE has been happy to hold positions in Nestle India and Info Edge over the years. These companies are amongst its best-performing picks since inception, despite having optically high P/Es. The White Oak team believe these companies can continue to generate greater cash flows with minimal investment, and their valuation is justified by this growth potential and the relative absence of fixed-life depreciating assets which have to be replaced. The table below compares AIE's portfolio to the large-cap Sensex market. Notably AIE is significantly cheaper than the market on White Oak's adjusted cashflow metric.

Portfolio Characteristics

	AIE	SENSEX
Number of holdings	54	30
Weighted average market cap	$22bn	$68.3bn
FY20 ROE	18.60%	13.90%
FY21 OpcoFinco P/FCF	45.5x	56.7x
FY22 OpcoFinco P/FCF	37.1x	38.8x
Projected 3-year earnings growth (ann)	18.30%	13.60%

Source: White Oak

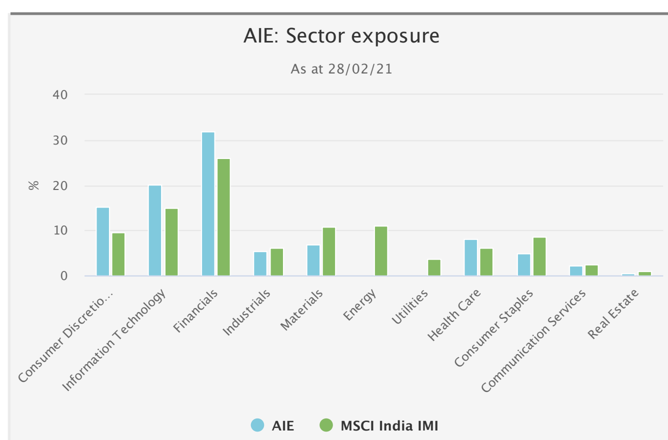
Analysts define superior businesses as those which can generate high growth on incremental capital (as measured by the OpcoFinco P/FCF), and which have a long-term scalable opportunity thanks to the quality of their product or service and/or the competitive environment in their industry and the wider economy. At any point in time the

team are closely tracking around 150 to 200 companies which they think are superior and potential additions to the trust. While they are looking to identify high quality companies, valuations are an important input into the investment decision as discussed above, and turnover can be relatively high. In fact, according to Morningstar data, over 2020 the portfolio turnover was as high as 103%. We think it is noteworthy that the team have managed to generate consistent outperformance despite having a much higher turnover than their peers – generally speaking a high turnover is thought to decrease the potential for outperformance thanks to transaction costs and the requirement for a manager to make many more correct decisions. However, the evidence from the trust's life so far is that the White Oak team can overcome this.

One of the key elements of the stock-selection process is a keen focus on corporate governance. This can be a significant source of added value in the Indian market and involves considering the power and behaviour of major shareholders. In India, many listed companies have founders or founding families with significant shareholdings which needs to be considered on a case-by-case basis. The White Oak team tell us that poorly governed firms threaten the destruction of shareholders' capital, either through outright corruption or illegality, or simply through poor business decisions which often result from misaligned interests. Analysts therefore spend a lot of time trying to understand the ownership structure of a business, as well as the familial relationships of key shareholders and managers, not to mention picking apart the accounting practices used. We think this, as well as the financial characteristics the analysts look for, helps explain why the portfolio has performed particularly well on the downside.

Although the team aim to ensure that sector allocation is not the major driver of returns, they do not buy the 'best of a bad bunch' if they find nothing attractive in a sector. Companies need to be attractive in their own right to make it into the portfolio. That said, there are some biases due to the nature of the Indian stock market. For example, the consumer-discretionary sector is a fertile source of ideas thanks to the large number of businesses and heterogeneous business models which reward rigorous research. The energy sector, on the other hand, has fewer companies and those that are there tend to allocate capital poorly and might have suspect corporate governance. The trust's portfolio has more than the index's weighting in consumer discretionary, IT, financials and healthcare and is zero-weighted in energy and utilities despite both making up over 10% of the index.

Fig.2: Sector Allocation



Source: Morningstar

The financials sector has been a source of considerable alpha since launch – the most of any sector, in fact. The current top ten includes private-sector banks ICICI Bank, Axis Bank and HDFC Bank as well as non-banking financial company Bajaj Finserv. The high weighting in this area reflects both the analyst team's high opinion of the companies themselves, but also their view of the size of the opportunity in India's financial services sector. As India develops and the wealth of its middle class rises, there are huge opportunities emerging beyond just basic banking services, mortgages and personal or business lending in segments like insurance and fintech as well. The private sector banks are in a strong position, competing with state-owned banks which have historically been poorly managed (from a shareholder's perspective at least). The White Oak team tell us that the recent decision by the Modi administration to privatise a few of the state-owned banks is a positive for the overall banking sector as this will bring in more efficiency.

Top Ten Holdings

HOLDING	GICS SECTOR	WEIGHT (%)
ICICI Bank	Financials	7.2
Infosys	Information Technology	6.3
Axis Bank	Financials	5.0
HDFC Bank	Financials	4.7
Bajaj Finserv	Financials	4.6
Coforge	Information Technology	3.7
Nestle India	Consumer Staples	3.6
Dixon Technologies India	Consumer Discretionary	2.8
Cholamandalam Investment and Finance	Consumer Discretionary	2.7
Garware Technical Fibres	Consumer Discretionary	2.6
TOTAL		**43.2**

Source: White Oak Capital Management, as at 28/02/2021

The information technology weighting includes the well-known Infosys. The outsourcer is increasingly providing services via the cloud. While this area of the tech market has seen high valuations open up in the post-pandemic

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world, Infosys' P/E of 31 is more modest by comparison. However, its business is benefitting from the global trend to homeworking and digitalisation which the pandemic has accelerated. The IT exposure also includes the lesser-known small cap Coforge, currently trading c. 34% higher than its pre-pandemic highs, despite the recent sell-off in tech. This smaller outsourcing business is one of the top five contributors to excess return since AIE launched, and still sits in the top ten of the portfolio, alongside some large cap giants.

Even Coforge's returns look modest next to Dixon Technologies India's. This is an electronics manufacturer which partners with global giants such as Samsung. The shares are worth over twice what they were at the start of 2020. The White Oak team describe this company as the Foxconn of India, which speaks to one potentially exciting future development for the company and India as a whole. The pandemic has led to an increasing global drive to diversify manufacturing away from China. Vietnam has been a beneficiary, but in the long run India stands to benefit much more. The first reason is simply the scale: India can provide a huge number of technologically skilled workers.

There are fewer than 100 million people in Vietnam, but over 1.3 billion in India. Alongside this it has a respected legal system and political system and experience in large scale, high quality manufacturing – it is the world's largest producer of vaccines, for example. The White Oak team believe this could be a real opportunity for India which the government is keen to capitalise on. We think this could be a really exciting line of thought for long term investors: India's stage of economic development is currently significantly behind China. This shift of trade towards India could accelerate the pace of positive change with obvious possibilities for investors. AIE is invested in leading businesses in speciality chemicals and pharmaceuticals as well as electronics-manufacturing services which the team believe are well positioned to benefit from this trend to diversify manufacturing away from China.

India's strong performance in recent months has surprised many commentators. In the view of the White Oak team, a lot of the reforms made in recent years are finally bearing fruit. The Modi administration has made significant reforms to taxation, bankruptcy laws and easing of labour laws as well as reforms to the agricultural and mining sector. These reforms are beginning to yield results with recent economic activity surprising positively. While the team are focused on companies rather than macro, they do believe these reforms have increased the upside in the Indian market in the coming years and decades, and helped create opportunities for strong companies to consolidate their positions and grow market share.

Gearing

AIE has the flexibility to add up to 20% of NAV in gearing, although it is currently ungeared. We understand the board has not so far arranged any debt facilities but is open to taking on gearing in due course.

Performance

Since it was launched on 6 July 2018, AIE has been the standout performer among the four specialist Indian investment trusts. AIE has almost doubled the returns of its benchmark, the MSCI India IMI index, in NAV total return terms. As the below table indicates, the other trusts have all returned less than the index (although they have different benchmarks, returns were within c. 1% of that of the MSCI India IMI Index). These returns have been achieved with less market risk – indicated by a lower beta – lower volatility and a lesser maximum drawdown. However, in absolute terms volatility has been high, one of the consequences of being a single country fund. As a result, risk-adjusted returns have also been superior, whether measured through the Sharpe ratio, information ratio or upside/downside capture ratio.

Performance Characteristics Of India Trusts Since Aie Launch

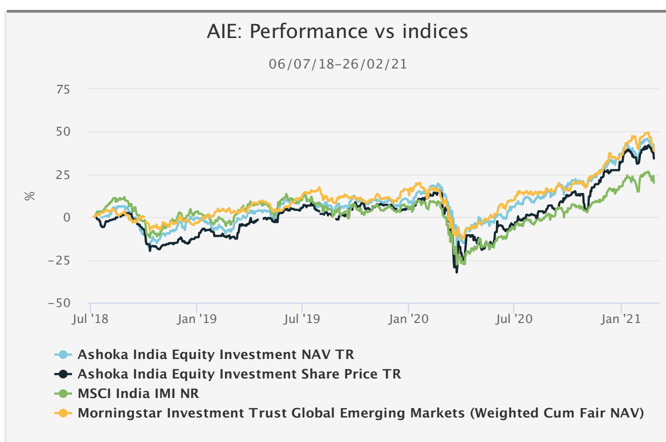
	RETURN (ANN.)	BETA	STD DEV (ANN.)	SHARPE RATIO (ANN.)	MAX DRAWDOWN	INFORMATION RATIO (ANN.)	UP/DOWN CAPTURE RATIO
Ashoka India Equity Investment	**13.4%**	**0.84**	**25.7%**	**0.83**	**-30.4%**	**0.56**	**1.07**
MSCI India IMI NR	7.2%		28.1%	0.42	-36.4%		
Aberdeen New India	4.3%	0.94	28.1%	0.27	-33.0%	-0.52	0.98
JPMorgan Indian	0.3%	0.99	29.6%	0.06	-41.8%	-1.08	0.95
India Capital Growth	-0.7%	0.85	28.3%	0.01	-52.0%	-0.56	0.93

Source: Morningstar, to 28/02/2021

Past performance is not a reliable indicator of future results

Since launch, AIE has returned 39.4% on a NAV total return basis (to 26/02) compared to a total return of 20.4% on the MSCI India IMI Index. India has actually underperformed the MSCI Emerging Markets Index in this period, with China driving the benchmark to higher returns. However, the management team have managed to generate enough alpha (even after the deduction of performance fees) to close the gap. The MSCI Emerging Markets was up 36% over the period, and the AIC Global Emerging Markets weighted average up 38%.

Fig.3: Performance Since Launch



Source: Company announcements.
Past performance is not a reliable indicator of future results.

As discussed in the **portfolio** section, the investment process is designed to ensure that stock selection rather than sector selection is the major driver of returns, and this has certainly been the case to date. From the end of July 2018, the first month end after launch, to the end of January, stock selection added 36.8% to relative returns, and sector allocation just 1.6%. Put differently, 96% of the 3,840 basis points of outperformance was generated through stock selection. Most value was added in the financials (14.2% of alpha added) and materials (7%) sectors. We think it is noteworthy that this success has come despite not owning one of the largest and best-performing stocks in the index, Reliance Industries. Reliance is 8.9% of the benchmark and has seen share price appreciation of c. 225% in the period since AIE launched. Key outperformers in AIE's portfolio have been HDFC Asset Management (which has added 405bps to relative returns), Muthoot Finance (375bps) and Navin Flourine (368bps).

Cutting the portfolio along market cap lines tells a similar story. AIE is a multi-cap portfolio and its use of the IMI index reflects the intention to spend plenty of time fishing in the small cap pond. On average, the portfolio has been overweight to small caps since launch (c. 18% weighting versus c. 6% in the benchmark). This allocation has actually been deleterious to returns given small caps have underperformed, but the team have generated more than enough alpha from stock selection to offset this. Stock selection in small caps has added 17% to relative returns, and the allocation decision has cost just ten percentage points.

Over the last year, AIE has generated a NAV total return of 18.7% (to 26/02/2020) and outperformed the benchmark by c. 4.2%. Indian markets have recovered strongly from March 2020 lows, and with time AIE's outperformance has increased. The managers note that these strong returns for the Indian market have come despite plenty of macroeconomic worries, indicating perhaps that the market is looking further ahead than many macroeconomic commentators. In the case of India, they believe the economy is benefitting from many of the reforms made in earlier years by the Modi government and from certain global trends that have been inspired by the coronavirus pandemic – most importantly the trend to shift supply chains away from China.

That said, there are clearly risks from investing in a single country emerging market. In the short term a period of US dollar strength would be difficult for emerging markets, while the recent rise in energy costs will not benefit India, which imports nearly all its crude oil requirement. Finally, while India has seen the pandemic decline quite rapidly in recent months, and it is beginning its vaccine rollout, there remains a risk that a further wave could re-emerge.

Fig.4: One-Year Performance

Source: Morningstar
Past performance is not a reliable indicator of future results.

Dividend

AIE aims to generate capital growth rather than an income. As such, the trust pays 100% of its expenses out of the income received from portfolio holdings. It has therefore not paid a dividend to date and won't do so until its income exceeds its expenses. Even then, it is likely only to pay the amount necessary to retain investment trust status (which for regulatory reasons is 85% of net income).

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Management

Ashoka India Equity Investment Trust is advised by White Oak Capital Management, which is based in Mumbai, India. White Oak Capital was founded by Prashant Khemka, former CIO and lead portfolio manager for India Equity and Global Emerging Markets Equity at Goldman Sachs Asset Management. The trust is very much team-managed, given the structure of the investment team and decision-making process.

The team advising AIE is currently made up of ten analysts, after one new member was added in recent months. Five of the team are considered senior analysts and take the lead on their sectors. The more junior analysts work alongside the senior members of the team, in each case shadowing more than one senior member on their sectors. Prashant considers the culture and shared philosophy of the team to be crucial to the consistent success of the approach he has seeded. The analysts are selected for their skills, their ability to work as part of a team and their adherence to the basic philosophy of the stock-selection process (discussed in detail in the **portfolio** section). The founder believes that investing is a skill like a sport or form of art, and so he selects analysts with a real passion for their field. The analysts are chosen for their ability to work well together in a flat, meritocratic structure without office politics. We understand White Oak aims to continue to grow its team as their AuM grows – firm-wide they currently run $3.5bn in Indian equities, less than four years after launch.

Analysts are compensated according to their contribution to client portfolios in their areas of expertise, which we believe creates strong alignment of analyst and shareholder interests. In effect, an attribution analysis is done for every analyst, which forms the majority of the performance assessment. Members of the investment team have significant investments in similar strategies managed by White Oak Capital (which are all Indian equity funds run with the same basic process and philosophy).

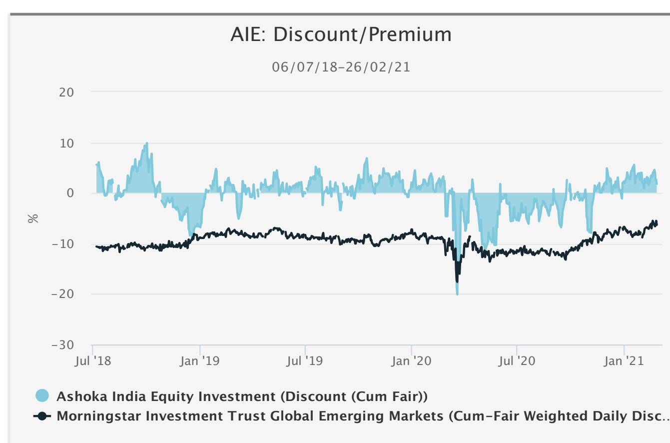
The relationship with the board has also been designed to maximise the alignment of interests. Board members are entirely compensated by shares in the trust, while the manager has no representation on the board.

Due to the pandemic, the team have been working from home and communicating with each other and with companies via video calls, which they report as being arguably more efficient thanks to the loss of travelling time. They also report that the transition to home-working has been seamless.

Discount

AIE's strong performance relative to the other India specialist trusts has seen it regularly trade on a premium, uniquely among the Indian trusts. At the time of writing, it is trading on a 0.2% premium. Following the emergence of the pandemic in February and March, the shares fell onto a discount of c. 20% at one point, although markets were extremely volatile, making the time differences between when Indian and UK markets were open particularly important, with potential for an optically wide discount which may not have reflected reality. As the initial impact of COVID has receded, the discount closed and, following the return of risk appetite in global markets towards the end of 2020, the shares once again traded on a premium (as we tipped they may in our last report). Since launch the shares have on average traded at par, with the board issuing shares regularly when a premium has emerged. Thanks to that issuance, as well as strong performance, the market cap has grown from c. £45m at launch to £115m. We understand the board remains keen to grow the size of the trust, which would bring a number of benefits to shareholders including greater liquidity in the shares and a lower impact of fixed costs.

Fig.5: Discount



Source: Morningstar

Past performance is not a reliable indicator of future results.

Charges

AIE's charging structure is designed to align the interests of investors and managers. There is no management fee, but only a performance fee, meaning that if the trust underperforms its benchmark, no fee is paid. The performance fee is paid in shares in the trust, with the majority locked up for the next three years, another factor which aligns the managers' interests with those of long-term shareholders. Of course, costs are still borne by the fund, and given the trust's relatively small size means that the ongoing charges figure (OCF) excluding the performance fee was 0.87% when last calculated in June

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2020. The OCF ex performance fee is over 1% on each of the other three India trusts. While 0.87% is high given it does not include any management fee, this number was calculated on 30 June 2020 when the net assets of the trust were just £70.5m. They are now £114m, and we would expect the OCF to be lower when next calculated this June.

Performance fees are earned on a three-year basis, with the first date they can be earned falling in July 2021. The trust's strong outperformance since launch means that substantial performance fees have been accrued. This liability is reflected in the NAV, meaning that NAV total returns presented above are net of the cost to shareholders and – should relative performance decline before July 2021 – that liability could reduce. The manager is paid 30% of the outperformance of the benchmark in NAV total return terms, capped at 12% over any three-year period (i.e. 4% a year annualised). In the 2020 annual report, performance fees of £2.9m were accrued for the previous year, equivalent to 3.9% of NAV. While this number is high, and it means the OCF including performance fee is c. 5.39% for 2020, we stress that the strong outperformance of the index discussed in the **performance** section is net of these fees, and should the trust underperform in the year to July 2021 the overall fee paid for the three years will fall.

In our view the performance fee structure indicates the conviction of the team at White Oak in their approach and is a strong incentive for them to work harder to add alpha year on year rather than accept fees for market or below-market returns. That said, the OCF plus performance fee can be considerable when the team have had good success as they have recently. As a consequence, AIE is a potentially more 'expensive' option than the other India specialist trusts which have an OCF between 1% and 1.85%. However, investors have received a much lower return for their investment in all three, both since AIE launched and in the period the performance fee was earned. And should all four trusts underperform the benchmark, AIE would be the 'cheapest'.

ESG

AIE's ESG framework, agreed between board and manager, evaluates environmental, social and governance (ESG) issues through three fundamental facets: Policy, Risk Management and Strategy. Investee and potential investee companies are evaluated on their commitment to manage ESG issues effectively via policy, as well as on how they have integrated ESG into their risk management process and on their approach to making ESG a strategic priority. This framework was adopted as of the annual report of the 2020 financial year, published in September. However, ESG issues have always been considered during the detailed bottom-up analysis done by the team.

In fact, corporate governance has always been a major focus of stock-selection efforts, as discussed in the **portfolio** section. The team place a great deal of emphasis on avoiding companies where there is a misalignment of interests between shareholders and management. Sometimes this is evident in dishonest accounting or market behaviour which potentially cheats shareholders or investors at large, and can even involve unethical or corrupt practices. Avoiding companies with poor governance is an important element of the focus on quality which supports the good risk-adjusted performance of the portfolio by avoiding the blow-ups. The board has adopted a policy of fostering the highest standards of corporate governance in all its own activities, believing this is the cornerstone of creating and preserving shareholder value for AIE's investors.

However, as well as considering corporate governance, the team view the environmental and social impact of a company's operations as important, believing that in the long-term shareholders' interests are served by management behaviour which serves wider stakeholders. Therefore, they look to avoid companies which have a disregard for the environment or cause harm where there are other viable alternatives available. Meanwhile, they also avoid companies with weak compliance to labour laws or which deal in products detrimental to public health and safety. India has a Corporate Social Responsibility (CSR) programme which mandates companies must spend 2% of their three-year average net income on CSR. This covers all three elements of ESG. AIE's management team look for wholehearted compliance with the CSR programme rather than a box-ticking culture.

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