Ashoka India Equity

Kepler GROWTH RATING

AIE is the top-performing India fund since launch...

Update
23 February 2024

Overview

Ashoka India Equity (AIE) has by far the best track record of any India fund in the closed-ended AIC sector or the open-ended IA sector since it launched in July 2018 (see **Performance**). Last year was another year of strong performance, as the trust bounced back from the only down year in its history in 2022. Being overweight small- and mid-caps helped deliver these good returns, although stock selection was far more important, as it has been since launch.

AIE is managed by White Oak Capital Management, which has devoted unmatched resources to India. It now has a team of 21 analysts covering Indian stocks exclusively and a further 13 covering them as a part of a broader, emerging market sector responsibility. The process they work to is designed to maximise the impact of stock selection while managing and limiting the potential impact of macro or stylistic factors (see **Portfolio**). To that end, the team have recently been adding exposure to companies in some more highly regulated areas in which they are typically light. This is in order to ensure their stock-selection successes are not outweighed by the impact of a surge in the more regulated, state-owned sectors, as regulation is considered and the current government looks set to win elections this year.

The managers put their money where their mouths are with this portfolio, and receive no management fee except a performance fee which is earned every three years if performance is ahead of the benchmark (see **Charges**). Amidst a sea of deep discounts in the investment trust sector, AIE has mostly retained its premium rating (see **Discount**).

The trust has won a **Kepler Growth Rating** for 2024, the first year that it had a track record long enough to be considered.

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Analyst's View

No country is immune to the unpredictable factors determining whether the US and global economies enter recession this year. However, India seems to have some of the strongest secular drivers of growth, which could offset this. Government investment in infrastructure spending is driving a rapid increase in capex, while exports are surging as countries shift manufacturing to India from China. Elections are due late this year in which Modi is widely expected to win re-election, which should reassure investors worried about the maintenance and continuation of the reform programme he has implemented since 2014. GDP and corporate profits are showing healthy growth, and in our view India is one of the standout growth opportunities in world equity markets. Valuations are also undemanding, in our view, with multiples around their average for the period since Modi's reform programme began.

We think AIE is a standout option for investment in the market. The performance of the fund has been remarkable, driven by a huge investment in resources and a strategy designed to encourage and reward stock-selection alpha. We think investing on a modest premium rating can be justified, particularly given the stock-selection pedigree of the managers and the incentivisation of them to continue their success via the performance-fee-only structure.

BULL
The best track record amongst open- and closed-ended India funds since inception
Large team of dedicated analysts covering the whole market
Fee structure aligns managers' interests with those of investors

BEAR
As a single-country trust, highly exposed to the politics and economy of one state
Highly active approach could lead to periods of underperformance
Performance fee can be high when earned, although overall fees will be low if it is not

Portfolio

Ashoka India Equity (AIE) brings the level of resources and scrutiny that many asset managers devote to global, US or Chinese markets to India. With a large analyst team of 29 dedicated India analysts, and with an investment strategy focused on stock selection rather than market or factor timing, AIE has delivered truly exceptional returns compared to other closed- or open-ended funds (see **Performance**). In our view the scale of the resources applied to stock picking has played a role in AIE being the top-performing India fund since it launched, but the culture and strategy have some key features which have really paid off too.

One is the resolute focus on stock picking. The strategy is to focus resources and create incentives to promote stock picking as the source of alpha. Meanwhile, risk management processes and strategies are used to limit factor risk. The aim is to build a portfolio that is capable of generating alpha through each stage of the cycle, without making market-timing or sector-allocation calls. Identifying the best companies in their sectors is the key, along with balancing them so that unintentional factor exposures don't dominate returns.

This is built into the structure of the team. Analysts are assigned to sectors and asked to generate alpha within those sectors. Their compensation is linked to their contribution to portfolio returns, so that each analyst is incentivised to generate alpha within their sector. The fee structure is designed to incentivise the continual generation of alpha rather than resting on past successes: the investment adviser, White Oak, only receives a management fee if it outperforms the index over three years (see **Charges**).

An additional factor driving the success is the unique stock-selection framework. This was developed by Prashant Khemka, founder of White Oak, during his time at Goldman Sachs, when he led the emerging markets team. The valuation framework uses a unique concept called 'OpcoFinco'. This nets off the cost of capital of a business in order to identify the self-sustaining, recurring cash revenue growth of a company. It is essentially a more sophisticated cash-flow valuation model. It is designed to help differentiate quality businesses from those whose current high returns could require substantial incremental investments in the future, as well as avoiding the value traps that can be harder to spot using the simpler P/E or P/B metrics.

This framework drives the team towards higher-quality businesses (see ROE and earnings growth lines in the table below). Additionally, a great deal of weight is placed on good governance. The team view this as important to help avoid blow-ups in the portfolio, and important within the Indian context, where governance standards and ownership structures can vary wildly. These two factors bias the portfolio away from companies with significant state shareholdings and those sectors with greater regulatory importance such as real estate, commodities and energy. By contrast, more ideas are typically found within the consumer and IT sectors, which tend to have better governance and where management have more control of the variables affecting their businesses.

Portfolio Characteristics

	PORTFOLIO	SENSEX
Number of holdings	113	30
Weighted average market cap	$19.9bn	$93.5bn
FY2023 ROE	16.80%	14.10%
FY 2024 OpcoFinco P/FCF	34.4x	45.8x
FY 2025 OpcoFinco P/FCF	30.8x	35.2x
FY 2024 P/E	23.7x	24.4x
FY 2025 P/E	20.1x	20.5x
Projected 3yr revenue CAGR	15%	11.90%
Projected 3yr earnings CAGR	16.90%	13.80%

Source: White Oak, as at 31/12/2023

However, the team observed that this focus on governance was hurting relative returns through 2022, as the market environment had changed. To some extent this may have been influenced by valuations – better governed companies had outperformed for many years – but other factors could be the rise in commodity prices due to geopolitical tensions, and potential privatisation or higher demand improving the prospects of some of the state-owned enterprises. In line with their strategy to mitigate these unintended factor risks, the team have been adding some positions in these segments, looking for those companies which have the most upside, with governance that is more or less adequate. Rather than a call on the market, this is an intention to correct an imbalance in the portfolio that could see a factor exposure cancel out the stock-selection gains in other segments in which the team have higher conviction. Additions fitting this theme include Larsen & Toubro, the engineering conglomerate, which has contributed to a rise in the industrials exposure, and REC, which primarily engages in providing finance to electrification projects.

Another natural tilt to the portfolio is overweight positioning in small- and mid-caps. This stems from the fact that there are greater inefficiencies in these parts of the market, which makes them fertile ground for stock pickers. We think this is where AIE's large team of locally based analysts bring the greatest advantage. The table below shows the average positioning since launch.

Notable is the inclusion of pre-IPO names in the small-cap segment. AIE can invest in companies which are due to list imminently, i.e. which are expected to list within 12 months. The team do invest in private companies at earlier stages in other vehicles, so are experienced in following companies on this journey, and this means they have a reputation and good access to companies as a preferred investor. Last year, 2023, was a bumper year for IPOs, reflective of economic confidence and pro-business reforms bearing fruit. Gopal Snacks was the largest such position entered into, making up a 1.8% position as of the end of December, and AIE has made good use of this facility over time. Generic drug manufacturer Mankind Pharma IPO'd in April 2023 , making good returns for the trust.

Market-Cap Positioning

	AVERAGE WEIGHT	
	Portfolio	**BSE 500**
Large-cap	46.4	79.2
Mid-cap	21.6	14
Small-cap / pre-IPO	27.6	6.8

Source: White Oak, 31/07/2018 – 31/12/2023

The strong IPO market is indicative of a buoyant market overall. While AIE is not a macro fund, the managers do argue the outlook is very good for the market on a multi-year view. We have discussed in previous notes the strong outlook for Indian FDI, given many Western companies are looking for an alternative to locating manufacturing in China. It's worth noting that in 2023 Apple opened its first physical store in India, at the same time as Indian factories started to produce the new iPhone, the 15, only the second generation of up-to-date iPhones to be manufactured in the country (it had previously only produced older models there). India's attractiveness is only enhanced by the large domestic market and highly educated, young workforce. In the short term, another bullish factor is the government's commitment to infrastructure spending, which is helping to boost a sharp increase in capex. Total capex is expected to grow by 33% in FY 2024.

Indian equities had a strong 2023, and the country has been in favour for a number of years, as the reform story becomes well known. However, the managers note that valuations remain reasonable. The market is trading at a substantial premium versus emerging market indices, but this is a function of the sharp derating in Chinese equities. In terms of its own history, Indian equities are trading slightly above their average P/E since 2014, when Modi was first elected and his reform programme began. Some will point to higher multiples versus other markets, but earnings growth is expected to be relatively very high in India, thanks in part to high GDP growth. This has averaged 6% in real terms since 2001, and is forecast at 6.5% for 2024 by the IMF. This, along with the reform story, is contributing to very strong earnings growth for Indian corporates, which the team expect to continue. One very promising development in the market's maturity is the increasing resilience to external flows. In 2022, foreign institutions withdrew $17bn from Indian equities, yet the market saw only modest losses in dollar terms. Increased buying by domestic mutual funds, including those through systematic savings plans increasingly offered by Indian employers, provided support for this. While we view the macro picture as very positive, it is worth stressing that the White Oak team do not view macro as a source of alpha and are aiming to be able to add value through stock picking at every stage of the cycle.

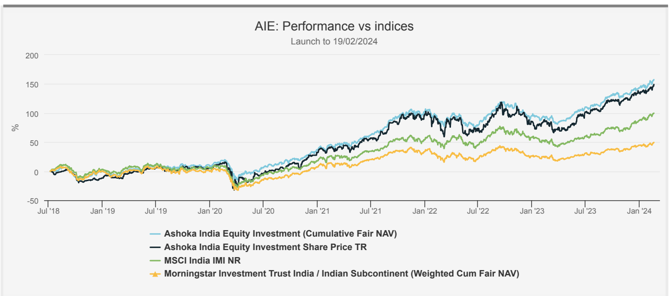
Gearing

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

Performance

AIE has delivered outstanding returns since it launched, the trust being by far the best performer in the AIC India sector and far outstripping the returns of the MSCI India IMI benchmark. To 09/02/2024, NAV total returns have been 152.1%, compared to a total return of 96.4% for the benchmark. The weighted average NAV total return for the AIC India sector has been just 46.1%. AIE has also been one of the top performing funds within the peer group in the IA India sector. Given this excellent track record, it is no surprise that the shares have consistently traded on a premium and the trust has grown substantially through share issuance (see **Discount**).

Fig.1: Performance Since Launch



Source: Morningstar

Past performance is not a reliable indicator of future results.

AIE tends to be overweight mid- and small-caps, although the allocation between segments is opportunistic and does vary over time. The overweight to mid-caps has been modestly helpful, as they have outperformed large-caps, but the overweight to small-caps has actually been a detractor over the whole period. Crucially, in both cases, the attribution effect is dwarfed by the extra alpha generated by the team within the lower market-cap segments. The table below shows attribution by segment since launch.

Market-Cap Attribution

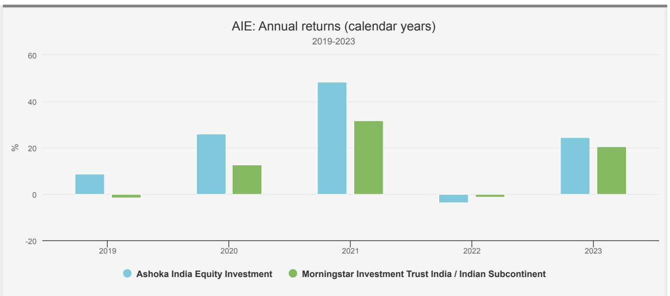
	AIE		BENCHMARK		ATTRIBUTION		
	Average weight (%)	Total return (%)	Average weight (%)	Total return (%)	**Selection effect (%)**	Allocation effect (%)	Total attribution (%)
Large-cap	46.4	116.4	78.7	82.8	**15.4**	-0.8	14.6
Mid-cap	21.6	229.7	14.2	81.7	**32.1**	1.5	33.6
Small-cap	27.7	412.5	7.1	18.2	**83.2**	-14	69.2
Cash/Futures/Others	4.3	-15.2	0	0			-1.3
Total	100	195.6	100	79.3	130.8	-14.6	116.2

Source: White Oak, 31/07/2018 – 31/12/2023
Past performance is not a reliable indicator of future results.

The story is the same when the portfolio is cut by sector: sector positioning has actually detracted 1.1 percentage points from relative returns overall, but stock selection within the sectors has added 117.4 percentage points. In our view this shows the managers have delivered exactly what they said they would: the team has been structured and the portfolio constructed precisely so that stock selection is the driver of relative returns, rather than factor positioning.

However, markets are dynamic, and the factors that drive them can change. When it comes to picking stocks, White Oak analysts tend to look for quality companies with good governance as these should be the most likely to deliver superior returns and less likely to see blow-ups. However, in 2022 companies with relatively weaker governance outperformed. The Adani Group of companies did particularly well in 2022, detracting from relative performance, as AIE didn't hold them, before blowing up, precisely as feared, in 2023. This dynamic contributed to the trust's only year of underperformance (2022).

Fig.2: Returns



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

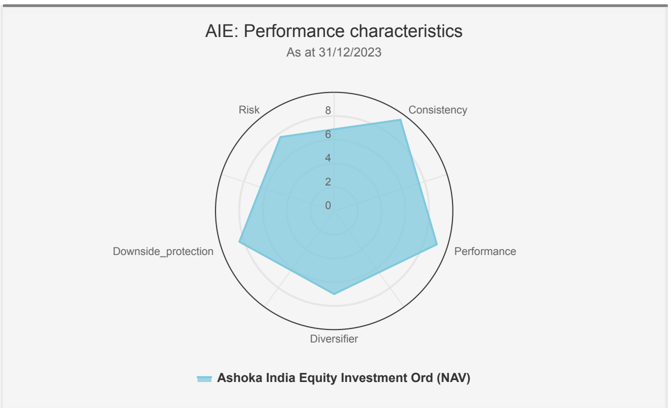
The issue has generally been with companies in the real estate, commodities and energy sectors, which are highly regulated and the returns of which are often dependent on government action and therefore out of management's control. The team have responded by reducing their underweight to this part of the market to manage unintended factor risks. In other words, they don't want their good work in identifying the right companies with their preferred characteristics to be outweighed by any broad factors. As a result, the team have been adding to those companies in these segments which they think have the most upside and where governance is more or less adequate, although they remain underweight and are likely to do so.

This decision is an example of the risk-management work the team do on the portfolio, which has contributed to the highly attractive return profile. The aim is to consciously avoid market timing or other top-down bets, and to monitor and contain residual factor risks and prevent them dominating returns. At the stock-specific level, the focus on governance has also helped with risk management in that it minimises the chance of major single-stock blow-ups, while the team are disciplined in selling out of underperforming positions. The result is that the top-ten winners since launch have added an average 946 basis points to relative performance, while the top-ten detractors have lost the fund just 252 bps on average (to December 2023).

AIE followed up its disappointing 2022 with a strong year in 2023, although relative returns were less positive than previous years. The biggest contributors were from a diverse set of segments, the top three being Kaynes, an electronics manufacturer, non-bank lender Cholamandalam Investment and Safari Industries, a luggage manufacturer sitting in the consumer discretionary sector. The largest detractors included a number of positions that were exited, illustrating the approach to risk management, such as Ambuja Cements, Campus Activewear and Infosys. Infosys was exited in favour of Tata Consultancy Services, which the team think is better placed to deal with a slowdown in Western economies, which are key sources of demand. The bottom-five detractors cost the fund 327 bps in relative performance, more than offset by the 431 bps added by the single largest contributor, Kaynes Technology.

For the first time we can show our KTI Spider Chart for AIE, as it now has a five-year track record. AIE is considered to be within the emerging markets group, and has been scored on some key performance characteristics versus this broader peer group. It is no surprise that the trust scores very highly for performance, which measures risk-adjusted returns. It is noteworthy that the consistency score, based on the percentage of periods of outperformance, is the highest in this peer group, while the downside protection score is also high. This is testament to the success of the risk management processes in place.

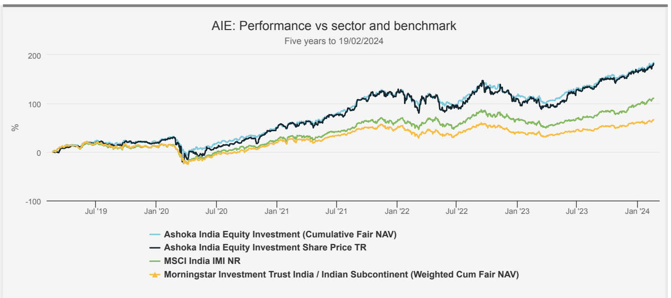
Fig.3: KTI Spider Chart



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

Finally, for completeness's sake, and to satisfy compliance obligations, we show the NAV total return of the trust versus sector and benchmark over five years, AIE having delivered handsome outperformance.

Fig.4: Five-Year Performance



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

Dividend

AIE aims to generate capital growth rather than income. As such, the trust pays 100% of its expenses out of the income received from portfolio holdings. It has not paid a dividend to date and won't do so unless a sufficient surplus is earned. Even then, we understand that the board is likely to pay out only the minimum amount necessary to retain investment trust status, i.e. 85% of net income.

Management

AIE is advised by White Oak Capital Management Consultants LLP, which is based in Mumbai, India. White Oak Capital was founded in 2017 by Prashant Khemka, former CIO and lead portfolio manager for India Equity and Global Emerging Markets Equity at Goldman Sachs Asset Management.

Prashant has designed a team structure, culture, and compensation policy in order to align the interests of the management team with investors. The structure is flat and meritocratic, with analysts given sectors of responsibility and rewarded based on their performance: effectively, attribution analysis is done on the portfolio and analysts are rewarded for the trust's successful stock picking in their sectors. AIE's team covering India is vast and based on the ground in India, which we think is an advantage in generating alpha compared to teams typically employed by UK-based asset managers. There are 29 analysts focused exclusively on Indian equities. Of these, 26 are based in India and three in Singapore.

The performance fee for the three years ending June 2021 was reinvested in shares of the trust for at least three years, another feature aligning interests, and as of the date of the last annual report in June 2023 White Oak owned 5.1% of the shares.

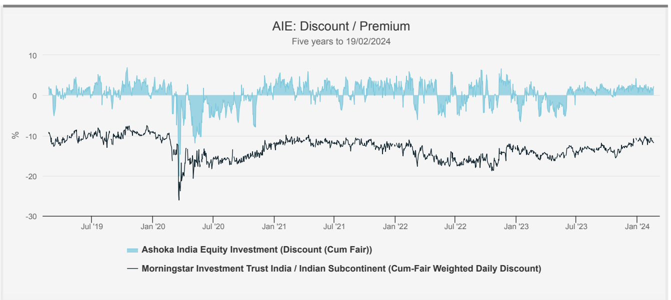
Discount

AIE's shares have traded on a premium for much of the time since launch in 2018. It is particularly striking that the shares were in such strong demand over much of 2023, given that discounts were very wide across the investment trust sector as a whole. This seems clearly linked to the trust's excellent performance since launch, over which period it has markedly outperformed its peers in the sector, all of which continue to trade at wide discounts. The board has regularly issued new shares to cope with demand and bring the share price down closer to NAV, and the effect has been to see the trust's net assets grow substantially over time.

While the board does have permission to buy back shares, and there have been periods of the trust trading at a small discount, this has not been used. AIE's shares trade on a 2.2% premium to NAV at the time of writing. Generally speaking, we think buying on a premium below 3% or so can be justified for long-term investors, but any higher than that has to be considered carefully. While we acknowledge that risk appetite and sentiment can turn, we think any time the trust trades on a small discount

AIE looks attractive value. The risk to investors of buying at a premium are moderated somewhat by the annual redemption facility. This allows shareholders to redeem their shares at the discretion of the board. The board has stated it intends to run the process so as to deliver shareholders NAV less costs, although it reserves the right to redeem at the share price.

Fig.5: Discount/ Premium



Source: Morningstar

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Charges

AIE's investment adviser, White Oak, is only paid if it manages to outperform the MSCI India IMI benchmark. We think this performance-fee-only charging structure is a key attraction of the trust, as it incentivises the managers to continually generate alpha or risk foregoing any fee. On the other hand, it is true that the performance fee can be high if performance is good, but we note that all the performance figures quoted above, which illustrate how well the trust has done since launch, are net of those fees (see **Performance**).

The performance fee payable to the managers is 30% of the excess returns of the NAV per ordinary share over the MSCI India IMI benchmark, calculated over three-year periods. The next calculation date is 30/06/2024. It is important to stress that the performance fee is accrued in the daily NAV, so the current reported NAV reflects the fee that would be earned if the amount due was calculated now. The fee is capped at 12% of the average net assets during the relevant performance period and is paid in shares. This demonstrates a further commitment by the managers to the ongoing success of the trust.

While performance fees are accrued in the NAV, because of the way OCFs are calculated annually, they are not reported until the year they are finally earned and are not included in the ongoing charges figure (OCF). AIE's latest OCF is 0.5%, compared to a sector average of 0.89%. The latest KID reduction in yield figure is 0.54%, again not including any recognition of the performance fee. No performance fee was earned for the 2022 financial year, but a provision of £256m was made for the 2023 financial year, or c. 1.1% of the average net assets.

ESG

AIE does not have a sustainability or ESG objective, but the managers consider ESG risks within the course of the investment process to inform awareness of the long-term scalability of a business and any relevant risks which should be incorporated into valuations. The team use an internally developed framework called ABLExTM (assessment of business longevity and excellence) for ESG risk assessment. The framework contains a list of sector-specific ESG risks and opportunities against which a company's performance is measured and rated, and the result of this assessment is integrated into the valuation of a business. White Oak Capital has a dedicated ESG team, who produce ESG rating reports on the team's portfolios based on both internal and external analysis. This allows the investment teams to monitor risks and performance over time, including where there is the scope for improvement that could impact valuation.

The team particularly value good governance, and 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 that potentially cheats minority 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 blow-ups, of which there have been a few in the Indian market in recent years, most notably the Adani Group of companies to which the team had minimal exposure. Morningstar awards AIE four out of five globes for sustainability, a rating relative to the universe of open- and closed-ended India funds.

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