Source

with independent analysis from CITYWIRE

UNEARTHING OPPORTUNITIES IN INDIA

Mirae Asset Global Investments presents its India Sector Leader Equity fund, run by Rahul Chadha

May 2017

Introduction

Welcome to another edition of Source, a publication that shines the spotlight on particular funds and their managers. In this issue, Mirae Investments presents the India Sector Leader Equity fund, with an in-depth profile and Q&A with manager Rahul Chadha, plus supporting analysis from Citywire.

Contents

4 Investment profile

8 Analysis

12 Q&A

Investment profile with **Rahul Chadha**, Co-CIO of Mirae Asset Global Investments (Hong Kong) and manager of the India Sector Leader Equity fund

As the global recovery inches forward and China's economy cools, bright spots are becoming harder to come by for investors. One exception, however, is India. Not only has the stock market outperformed of late, with the Benchmark Nifty 50 index climbing nearly 12% this year compared to 6% of the FTSE All World index, but Prime Minister Modi's ambitious reform agenda could prove pivotal in unleashing long-term growth and prosperity.

An attractive option for those wanting to exploit India's rise is the Mirae Asset India Sector Leader Equity fund. The fund, which is run by Co-CIO and Citywire A-rated manager, Rahul Chadha, invests primarily in local companies with superior quality and growth potential.

Having beaten the benchmark nine out of the last 10 years, Chadha is confident his fund, which recently celebrated its 10th birthday, can continue to outperform. In the past year alone the fund has returned 31.4% (up until 28/02), according to Citywire data, while on a three year basis it has climbed nearly 47.7%. 'India is truly the land of opportunity where growth can be found literally everywhere,' Chadha argues.

Central to uncovering these opportunities is the fund's investment approach. 'My most productive work,' Chadha admits, 'is often done when in the coffee shop across the street from our office [in Hong Kong] where I have informal sessions with my research team.'

Aside from these regular discussions with a team of analysts at the chic café Elephant Grounds, Chadha also values regular first-hand contact with Indian companies. 'I have a team in Hong Kong with a regional scope as well as a team in Mumbai dedicated to Indian equities that provide valuable inputs to the strategy,' he explains. 'I attribute our success to our privileged position of having boots on-the-ground without losing the regional perspective.'

With each member of the team growing up the region, each possesses a deep local knowledge too. 'We understand the tastes and preferences of Asian and Indian consumers much better than anybody sitting in London or New York,' Chadha claims. 'And we appreciate the political risks that may have an impact on asset prices. This understanding is reflected in our ability to generate strong performance that consistently outperforms the benchmark.'

This gives Mirae a major competitive advantage, Chadha believes. 'It is important to be close to the consumer, to be able to observe their wants and needs, and their consumption pattern,' the Indian native points out.

'I want to find companies that understand their consumers and have clear strategies in place to monetize them. For example, Godrej Consumer Products' success has been a result of its ability to fulfil consumers' desire for hair color products by providing L'Oreal-like products at the India price point.'

'Similarly,' Chadha adds, 'Maruti Suzuki was able to do the same in the passenger car market. Not only have these companies been successful in introducing consumers to their respective product categories, but they have also been at the forefront of innovation to remain relevant to consumers as they moved up the value chain.'

Chadha tries to look for sector-leading companies with scalable business models, directed by strong and clean management. 'What I look for in businesses is predictability, but this certainly has to come at a reasonable price. Buying good companies at any price is a fallacy.'

Yet for the veteran manager, who has been investing in India for nearly 20 years now, limiting downside risks is just as important as unearthing opportunities given the volatility of the Indian market.

'We must not forget that it is still very much an emerging country where investors are exposed to more risks than they would be in many other markets,' he cautions. 'India was in a strong bull market with many "pie in the sky" stories when I first started managing the Indian equity strategy in 2006.'

'Over subsequent years,' he recalls, 'it was a much more sobering experience where reality and execution were revealed to be much tougher than perception and management skills. This was exacerbated by a global downturn. The high cost of capital, overly ambitious expansion plans, and execution delays resulted in wiping out some companies' equity.'

A major learning curve, these times installed in Chadha a major bias for quality, with the manager convinced blocking out the noise and selecting well-run companies is the key to long-term success. 'There are segments of the Indian market we avoid,' he says. 'For the rest, I try to look for sector-leading companies with scalable business models, directed by strong and clean management. The focus is on quality, to make sure we don't have the kinds of holdings that could undermine the portfolio.'

Not surprisingly, the fund has limited its losses and is one of the top performing Indian equity funds in terms of drawdowns over the last five years, according to Citywire data.

'Risk management starts and ends with the quality of business we invest in,' notes Chadha. 'I like to think of this strategy as a "sleep-well" strategy, where the companies we own should not give us, or our investors, sleepless nights. Of course, we have an independent risk team that helps us monitor portfolio risk in terms of tracking error, sector deviation, etc. but this is secondary. Our first line of defense against portfolio tail risk has to come from the underlying quality of the companies we own.'

The Fund's hands-on local approach, in concert with its risk management, will keep it in good stead as the country begins its historic rise. 'India is now in a very exciting time where the government has laid the groundwork for long-term sustainable growth,' Chadha reasons.

Recently, Prime Minister Modi and his team have unleashed a wave of productivity enhancing measures across the country, improving the ease of doing business, boosting infrastructure and rural roads, and spurring personal banking. More recently, there has also been a controversial demonetization program aimed at pushing black money back into the economy, which will lead to higher taxes and less constraints on business in the long-term.

And with the ruling party's success in elections in Uttar Pradesh earlier in March, Prime Minister Modi has gained the political capital to continue to push through his momentous pro-growth agenda, which is set to include a streamlined tax regime in July 2017.

Whether on the ground in Mumbai or debating investment ideas in a café in Hong Kong, Chadha is upbeat about his home country's growth prospects. 'Foreign investors now face lower macro risks than ever before,' he declares, 'allowing micro opportunities to shine through.'

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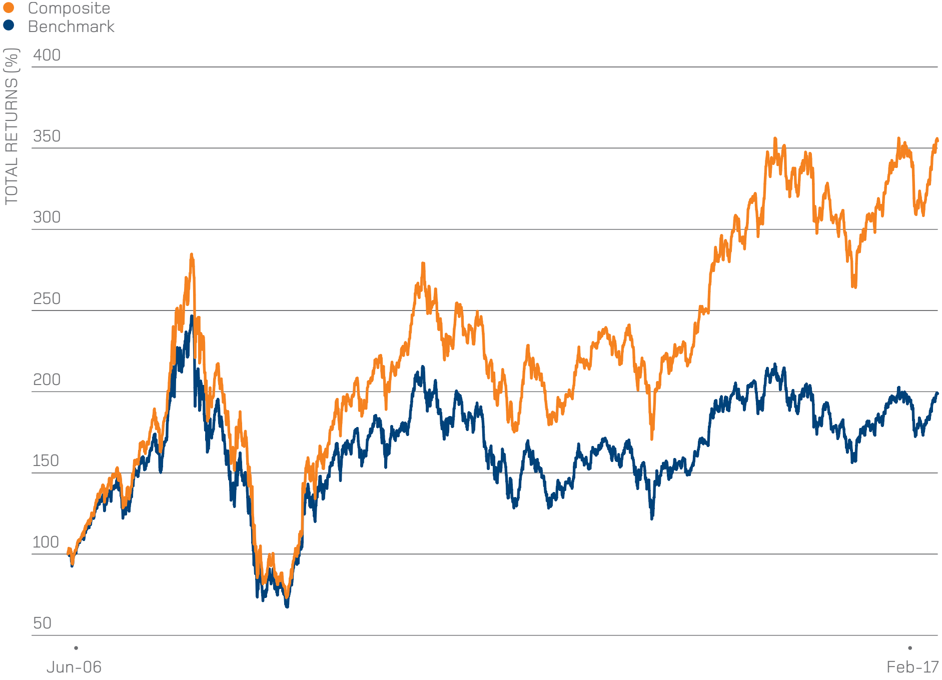
INTERROGATING PERFORMANCE

Nisha Long
Head of Cross Border
Investment Research

The fund became more widely available from March 2011 but his track record goes further back with the same strategy to June 2006. Since the start of the original strategy and in conjunction with the newer Lux domiciled version of the fund in March 2011, Chadha has returned 254% from June 2006 to the end of February 2017, in US Dollar terms.

Fund performance since launch

Source: Mirae Asset Global Investments (Hong Kong), as at 28.03.2017

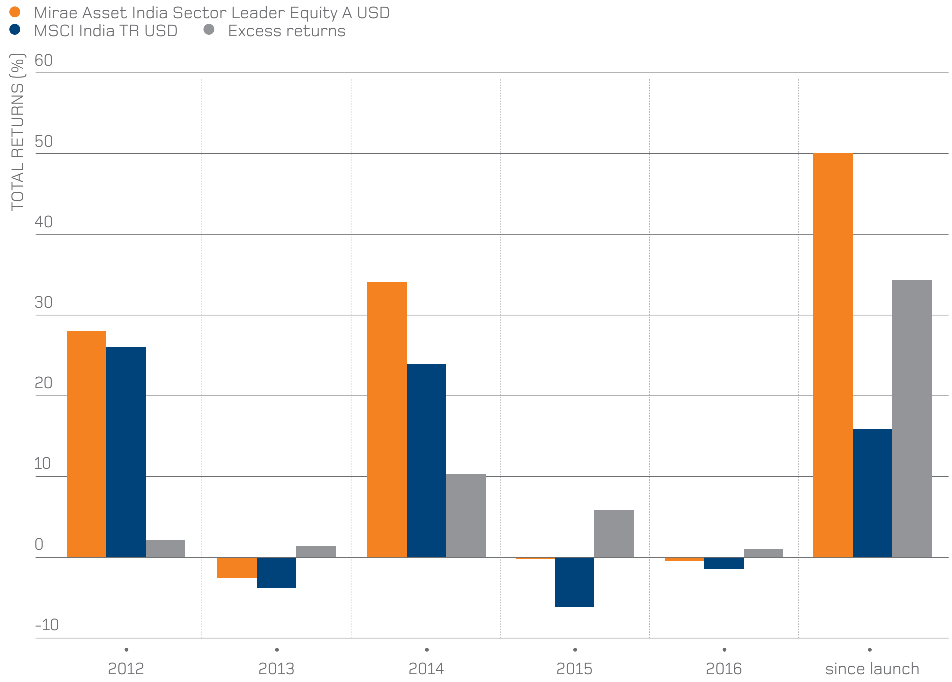


On the Lux domiciled version of the fund which was launched in March 2011, Chadha has produced excess returns of 34.29% over the MSCI India TR USD index.

On a discrete year on year basis, Chadha has minimised losses against the benchmark in all of the five discrete year periods since 2012, with the strongest year for excess returns coming in 2014.

Excess returns

Source: Lipper/Citywire Discovery as at 18.04.2017

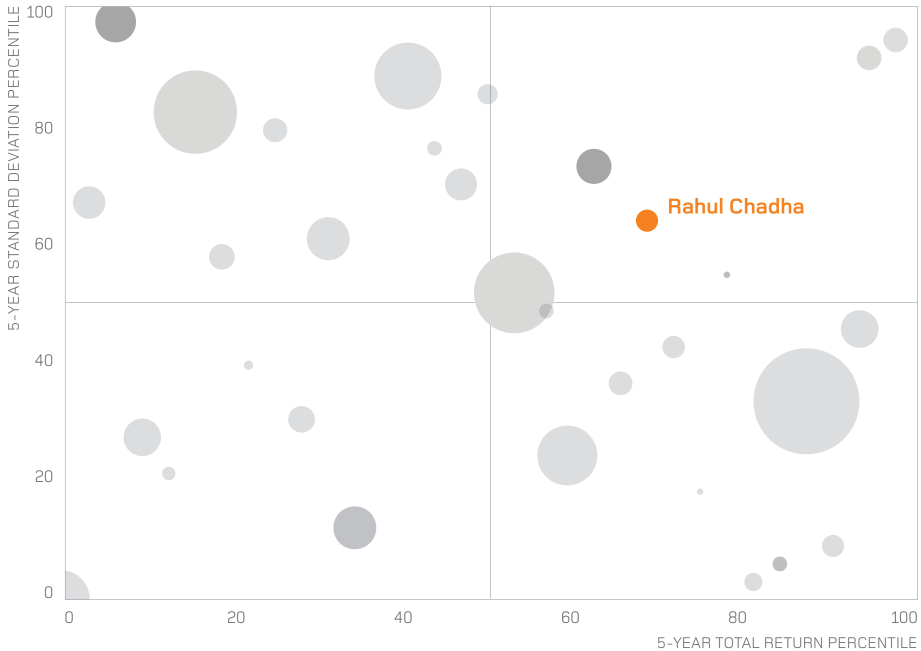


Source

This chart compares Chadha's strategy to other managers in the peer group that have their strategies domiciled in Luxembourg. Chadha has a strong risk reward profile over the past five years and has taken less risk compared to the majority of his peers to gain his returns.

Fund manager risk adjusted return

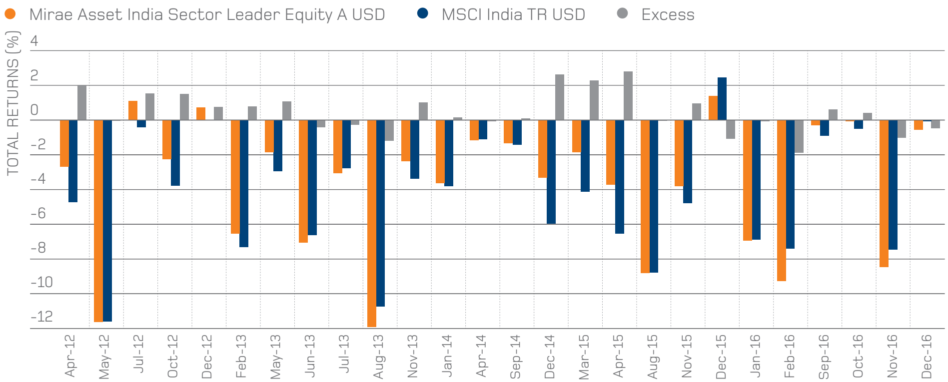
Source: Lipper/Citywire Discovery as at 18.04.2017



There have been 26 months in the past five years where there have been market downturns, as measured by the MSCI India TR USD index. Chadha has minimised losses in his portfolio during these downturns and has outperformed in 15 out of the 26 month down markets (more than 58% of the time).

Performance in market downturns

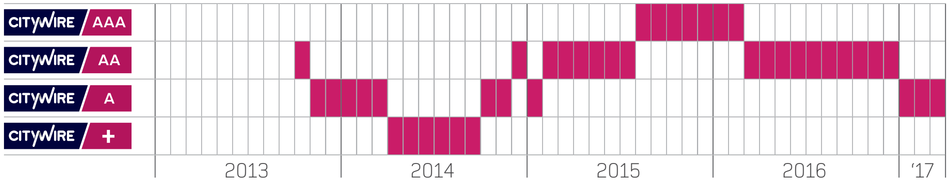
Source: Lipper/Citywire Discovery as at 18.04.2017



Chadha first became eligible for a Citywire rating in October 2013 and has been awarded a rating on a monthly basis since then. He holds a 100% consistent rating track record.

Rahul Chadha's Citywire ratings

Source: Citywire Discovery as at 18.04.2017



Q & A

Rahul Chadha answers detailed questions about his asset allocation and outlook

Q 〉 You have managed Mirae Asset's India strategy for more than 10 years and looked at Indian equities for longer than that. How has India changed in that time?

A 〉 India has always been a growth story. When I first started my career in 1999, India's information technology services industry was taking off as a beneficiary of the global outsourcing trend. The government sowed the seeds for growth, which led to a period of strong economic expansion in the subsequent decade. Starting in 2004, however, leaders became singularly focused on seeking economic growth without considering a long term, sustainable foundation for achieving that growth. Following the Global Financial Crisis, earlier excesses became real macroeconomic issues. For example, the infamous twin deficits issue – in the national budget and in foreign trade – led to the long slide in the value of the rupee.

We have seen the government of Prime Minister Modi take bold steps to ensure the sustainability and longevity of India's economic growth, particularly in strengthening the country's institutional framework. The government has made improving the ease of doing business a top priority and encouraged healthy competition between states to attract investment. Government projects are awarded on a more meritocratic basis with greater transparency and meaningfully reduced crony capitalism. For the benefit of the Indian public, the government has made tremendous progress in programmes such as unique identification registration, financial inclusion, direct benefit transfer, and online services that have altogether enhanced productivity and transparency.

India is now in a very exciting time where the government has laid the groundwork for long-term sustainable growth. Foreign investors now face lower macro risks than ever before, allowing micro opportunities to shine through.

Q What kind of business models do you find appealing and what has been your biggest triumph?

A Again, we try to look for businesses with predictability in earnings. The best of these businesses very often come in 'large white spaces' in the economy, or structural growth areas that are still being underserved. However, this is only 20% of the job. The balance of time needs to be spent on company management and how it innovates to cater to its end consumers.

Indian pharmaceutical companies such as Lupin have been a success story for us. The story here is about companies expanding their reach through scalable economic moats. They have been able to apply their technical know-how from the domestic market and turn that into an attractive proposition for the US generics market, allowing them to grow from nothing to almost $1 billion (nearly 50% of total sales) in a period of eight to 10 years.

Another good example has been Motherson Sumi Systems, an auto parts manufacturer. When dealing with Indian companies, you are always cautious regarding 'big mouthed' management who overpromise as most of them fail to scale up. This is a company that is growing well, with return on equity (ROE) north of 30%, and it has not raised external financing in the past 15 years. Putting all the numbers aside, it is a company run by excellent management. With a keen focus on delighting their customers, they have been able to grow from their humble beginnings of supplying to domestic car companies, to becoming an important supplier for global players like Daimler and BMW. We bought the stock in 2010 and sold it in 2016 after the share price increased nearly six-fold.

Q Could you discuss some of your failures and most important lessons from the past decade?

A I have certainly made my fair share of mistakes in the past 10 years.

One of such missteps was in relation to a waste water treatment company. As we had experienced the level of pollution first hand in India and witnessed this theme do very well in China, we saw a lot of potential in this sector. What we did not account for was that the order flows, which came from local governments, were delayed more often than not. Again, going back to what we've discussed earlier, execution is always more challenging. The key lesson was that having a margin of safety is crucial, especially when investing in a company whose customer is the government. That said we remain patient and recent activism by Supreme Court on mandating effluent treatment for industrial units should be a significant positive.

On the other hand, I have also made mistakes in terms of missing out on strong rallies. Motherson Sumi Systems, which was discussed earlier as one of our better investments, is also an example where we sold early as we became uncomfortable with the company's ability to meet investors' high expectations. After having returned nearly six-fold in six years, the market was pricing the stock at a price to earnings ratio of 25 on two-year forward earnings and a high sales base of $8 billion. While we still saw it as a great company, it had limited valuation support. We exited the stock in 2016, meaning that we were not able to capture the final 30% upside.

As we reflect on this missed opportunity in hindsight, we would likely make the same decision now if faced with a similar situation. Discipline pays. We would be happy to miss out on the final stages of a rally if it means being able to avoid large swings in the portfolio and achieve greater consistency in returns. Hopefully we would then be able to redeploy capital into more attractive investment opportunities.

Q **How do you foresee India developing in the next 10 years?**

A India's next 10 years will be all about productivity improvement.

One vital area of improvement is in infrastructure. To offer a personal example: I used to spend close to three hours a day commuting on trains when I was in Mumbai over 10 years ago, which took a lot of my energy. When I arrived in Singapore and Hong Kong my commute time was cut to 30 minutes. This is a simple personal example, but one can imagine the positive impact that reverberates throughout the economy when this happens across the country. In addition, infrastructure is not only limited to physical infrastructure such as roads and rail, but also through technology-enabled efficiency gains such as unique identification and e-governance.

I am also hopeful that the government will remain on its path to becoming a cleaner government with less crony capitalism. We have already seen the turning point under the Modi government. India's tremendous potential has always been there, and the people are hungry to prosper and do better in life. What the government has done, and hopefully will continue to do, is create the enabling conditions for India to realize its potential.

With that said, technology is not only being used by Modi's government as a key enabler in government-business and government-citizen interaction, but it also serves as the political leadership's biggest challenge. The test of credibility for the government will be its ability to create 10 million to 12 million jobs annually in this automation-driven world so that India's young population becomes a dividend rather than a mass of disruptive, restless energy.

Many Indians living overseas joke that we Indians do well when we leave India. Hopefully this changes in the next 10 years.

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