Ellerston India Fund

Monthly Newsletter, June 2022

Investment Objective

To outperform the MSCI India Net Return Index (AUD) with a focus on risk management and capital preservation.

Investment Strategy

The Fund's investment strategy is to construct a concentrated portfolio with exposure to Indian companies using the Manager's high growth, high conviction, benchmark independent investment approach. The Fund has identified a number of core thematics that will drive returns in the Indian market in the medium term. The focus is on investing in Indian companies that benefit from these fundamental drivers.

Key Information

Strategy Inception ^^	4 May 2017
Portfolio Manager	Fredy Hoh
Application Price	$1.1870
Net Asset Value	$1.1840
Redemption Price	$1.1810
Liquidity	Daily
No. of Stocks	28
Management Fee	1.10% p.a.
Performance Fee	15%**
Buy/Sell Spread	0.25% on application/ 0.25% on redemption
Minimum Investment	$10,000
Minimum Additional Investment	$10,000
Distribution Frequency	Half Yearly (June & December)

*** Of the investment return above the benchmark, after recovering any underperformance in past periods*

Performance Summary

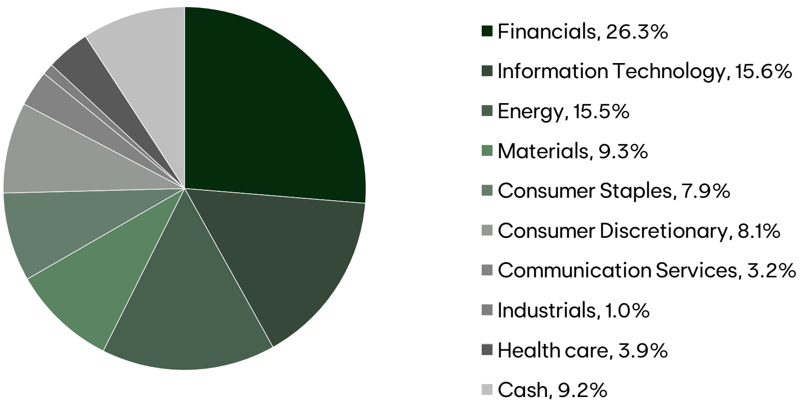
Period	Gross+	Net Before Tax*	MSCI India Net Pre Tax	Net After Tax^
1 Month	-2.0%	-2.1%	-2.7%	-1.3%
FYTD22	-1.5%	-2.6%	3.9%	-1.8%
1 Year	-1.5%	-2.6%	3.9%	-1.8%
3 Years (cumulative)	21.1%	16.7%	26.0%	12.5%
Since Inception^^ (cumulative)	52.0%	42.9%	53.0%	37.0%
Since Inception^^ (p.a.)	8.4%	7.1%	8.6%	6.3%

^ The net return figure is calculated after fees, expenses and taxes. Past performance is not a reliable indication of future performance. All returns shown in AUD.
+References to the gross fee and pre-tax contribution to the total Net After Tax and Fee return.
*Net return figure is calculated after fees and expenses.

Portfolio Characteristics

Top 10 Holdings

Company	Sector	Weight
Reliance Industries	Energy	15.5%
Infosys	Information Technology	9.0%
ICICI Bank	Financials	8.4%
Housing Development Finance	Financials	7.0%
Maruti Suzuki India	Consumer Discretionary	4.0%
Hindustan Unilever	Consumer Staples	3.8%
Tata Consultancy Services	Information Technology	3.7%
Bajaj Finance	Financials	3.6%
Bharti Airtel	Communication Services	3.2%
State Bank of India	Financials	2.9%



Source: Ellerston Capital.

Commentary

The Ellerston India Fund (EIF) was down 1.35% (net after tax) in June versus the MSCI India Index (MXIN) which was down 2.72%.

June saw further weakness in the Indian market led by concerns around the global and domestic growth outlook. As highlighted in recent publications, the Indian economy continues to face a number of near term challenges such as slowing growth, high inflation, currency depreciation and a twin deficit situation. On growth, the World Bank recently cut its GDP growth forecast for India in FY23 from 8% to 7.5% citing rising inflation, supply chain pressures and spillover impacts from the Russia/Ukraine conflict. Inflation meanwhile remains elevated with the June reading at 7.01% and implies further rate hikes are likely in the near term. On the currency, the INR has depreciated against the USD by 7% since the start of 2022. The currency has however held up relatively well in light of a current account deficit that is forecast to rise to ~3.5% of GDP in FY23 (vs 1.2% in FY22) due to rising costs of oil, coal and gold imports. The budget deficit meanwhile is forecast to remain elevated at ~6.5% of GDP in FY23 (vs 6.7% in FY22).

We believe these near term macro risks as well as optically high equity market valuations (MXIN 1 year forward PE currently at 19x) are key reasons for the consistent selling by foreign investors this year. Foreign Institutional Investors (FII) offloaded another ~US$9.5bn of Indian equities in June and have now withdrawn ~US$41bn from the secondary market since Oct'21. Retail investors and Domestic Mutual Funds (DMF) on the other hand continue to be net buyers during this period.

Despite the cyclical macro and flow related headwinds, it is important to highlight that the long term structural thesis for India remains in place. In particular, the benefits of Modi's structure reform agenda are becoming increasingly apparent. For instance, the Government's net tax revenues are up 32%YoY in the first two months of FY23 after rising 28%YoY in FY22. This has primarily been driven by rising GST revenues, which are up 34%YoY so far in FY23. We expect GST collections to further improve as the Indian economy becomes more formalized/organized. Structurally higher tax revenues should provide the government with additional financial flexibility to address near term challenges and also its longer term CapEx ambitions. On the corporate side, balance sheets have de-levered significantly over the past 5 years with net debt to EBITDA of the companies in the MXIN at 1.9x in 2021 (vs 3.3x in 2017). Household balance sheets meanwhile remain at very healthy levels with debt to GDP of 37% in FY21. Together with nominal wage growth which has been running at ~9%YoY, this bodes well for India's domestic demand outlook.

The positive structural story justifies our decision to keep the portfolio well invested with cash remaining below 10%. We have however used the recent market volatility to further consolidate the portfolio by reducing our non-core holdings whilst also accumulating high quality structural growth companies trading at attractive valuations. The EIF portfolio is currently geared towards companies whose earnings are likely to prove resilient in the current macro backdrop such as the financials (ICICI Bank, HDFC) and consumer staples (Hindustan Unilever) as well as companies with clear near term catalysts such as Reliance and Maruti Suzuki.

Portfolio Performance

Turning to June performance, Consumer Staples and Industrials were the biggest contributors to relative performance, whilst Materials and Financials were our biggest detractors.

At the company level, Varun Beverages, Maruti Suzuki and Reliance Industries were the key alpha contributors. Varun Beverages is a beneficiary of the heatwave that has gripped many parts of India this summer with their cold drinks appealing to consumers. We believe the company could see another round of earnings upgrades at the upcoming quarterly results. Maruti Suzuki meanwhile, is entering a new product and model refresh cycle which should help lift its market share back towards ~50% in the Indian passenger vehicle sector. Finally, Reliance Industries is benefiting from elevated refining margins, higher gas prices and improved fundamentals in its Jio Telecom business.

Conversely, Star Health and UPL were the key detractors. Star Health was negatively impacted by concerns that the regulator could allow life insurers to sell health insurance products. The regulator however has yet to make a formal decision on this matter. Nonetheless, we believe Star Health's extensive agent (>500,000) and hospital (>12,000) network represents a wide economic moat against potential new entrants. Further, we believe the growth potential that exists in the domestic health insurance industry is able to support a number of different players. UPL meanwhile, has come under selling pressure following a recent credit rating downgrade by S&P on account of higher working capital and lower than expected debt reduction. Whilst the credit rating change has not impacted the cost of borrowing for the company, it has negatively impacted sentiment. UPL has set a target to reduce gearing to below 2x net debt/EBITDA by the end of FY23 and we expect the company to achieve this given the positive outlook for the global agrochemicals market.

As always, if you have any questions regarding any aspect of the Fund or the portfolio, please feel free to contact us at info@ellerstoncapital.com.

Kind regards,
Fredy Hoh

Regulatory Guidelines (RG240) Fund Disclosure Benchmark – Periodic Reporting (monthly)

- **Net Asset Value of the Fund and Redemption Price of Units**

Please refer to details on page one.

- **Any changes to key service providers including any change in related party status**

There have been no changes to key service providers, including any change in related party status.

- **Net returns after fees, costs and relevant taxes**

Please refer to details on page one.

- **Any material changes to the Fund's risk profile and strategy**

There have been no changes to the Fund's risk profile and strategy.

- **Any material changes related to the primary investment personnel responsible for managing the Fund**

Please refer to details on page one; there have been no changes to the primary investment personnel responsible for managing the Fund

Contact Us

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Find out more

Should investors have any questions or queries regarding the Fund, please contact our Investor Relations team on **02 9021 7701** or info@ellerstoncapital.com or visit us at **ellerstoncapital.com.**

All holding enquiries should be directed to our register, Link Market Services on **1800 992 149** or **ellerston@linkmarketservices.com.au.**

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