Ellerston India Fund

Monthly Newsletter, January 2023

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	$1.1494
Net Asset Value	$1.1465
Redemption Price	$1.1436
Liquidity	Daily
No. of Stocks	29
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	$5,000
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	-4.6%	-4.7%	-6.6%	-3.9%
FYTD	4.8%	4.1%	2.8%	3.9%
1 Year	-10.3%	-11.3%	-9.5%	-9.6%
3 Years (cumulative)	18.9%	14.7%	24.7%	12.2%
Since Inception^^ (cumulative)	56.8%	46.2%	57.3%	42.4%
Since Inception^^ (p.a.)	8.1%	6.8%	8.2%	6.3%

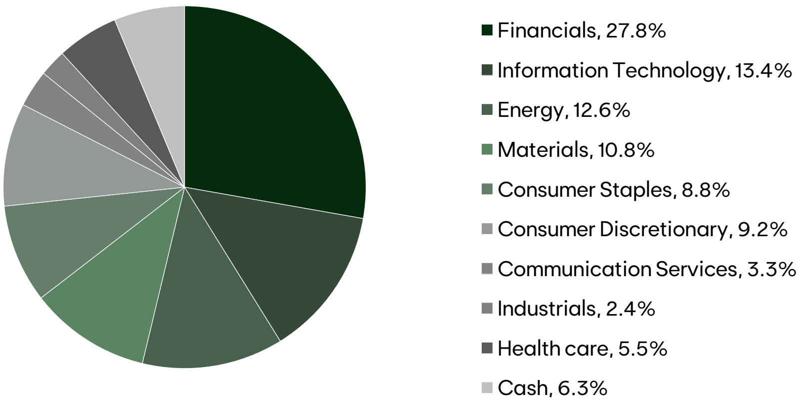
^ The net return figure is calculated after fees, expenses and taxes. Past performance is not a reliable indication of future performance. All returns shown in AUD.
+References to the gross fee and pre-tax contribution to the total Net After Tax and Fee return.
*Net return figure is calculated after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

Portfolio Characteristics

Top 10 Holdings

Company	Sector	Weight
Reliance Industries	Energy	12.6%
Infosys	Information Technology	8.8%
ICICI Bank	Financials	8.4%
Housing Development Finance Corp	Financials	7.2%
Hindustan Unilever	Consumer Staples	4.3%
Maruti Suzuki India	Consumer Discretionary	4.1%
HDFC Bank	Financials	3.4%
Bharti Airtel	Communication Services	3.3%
State Bank of India	Financials	3.1%
Varun Beverages	Consumer Staples	2.9%

Sector Allocation



Source: Ellerston Capital.

Commentary

The Ellerston India Fund (EIF) was down 3.9% (net after tax) in January versus the MSCI India Index (MXIN) which was down 6.6%.

The Indian market underperformed global indices during the month driven primarily by a short seller report against the Adani Group. This triggered selling of Adani related companies by local (mostly retail) investors as well as rotation by foreign investors out of India towards China/HK reopening plays. Indeed, foreign institutional investors net sold ~A$5bn of Indian equities during the month, which is the largest outflow since June 2022. Domestic mutual funds provided some support to the market and net bought ~A$3bn of equities. But that was not enough to arrest the market decline.

At this stage, we view the correction in Indian equities during January as a healthy pullback given the market's relative outperformance in 2022 and elevated valuations. We continue to appreciate India's structural growth story which is driven by favourable demographics, rising penetration, technology leapfrogging and infrastructure/manufacturing investments. We believe these drivers will likely play out irrespective of the outcome in the Adani saga, which we discuss in detail below. Indeed, recent economic data such as retail credit growth (+15%YoY in December), PMI (57.5 in January) and GST collections (+13%YoY in January) remain robust. Furthermore, the Indian Government handed down a pro-cyclical budget in early February with capex and nominal GDP earmarked to increase by 18%YoY and 11%YoY respectively in FY24. Although the latest inflation reading of 6.54% in January was slightly ahead of the RBI's 2-6% target band, CPI has shown signs of moderating in recent months. This is a decent setup for India to again deliver one of the best economic growth amongst major economies globally in 2023/24. As such, we will use any further meaningful correction to add to our portfolio of high quality companies.

The Adani Saga

The short seller report prepared by Hindenburg Research alleged that the Adani Group had conducted fraud and stock manipulation through a vast array of offshore tax havens with indirect ties to the group. Prior to the report, the Adani Group of companies had a combined market cap of INR17.8tn (or A$310bn) as at the end of December. The subsequent sell-off has wiped ~A$150bn off the combined market value of the group whilst also derailing what was to be the largest follow-on public offer in Indian history (~A$3.5bn) for Adani Enterprises. Whilst Adani has rebutted the claims, the reputational impact to the group could take some time to be resolved.

As regular readers are aware, EIF has a very stringent ESG (Environmental, Social and Governance) policy and the Adani Group of companies did not pass our criteria. As such, we have never invested in Adani stocks. But given Adani's status as one of India's largest conglomerates, there have also been worries over potential contagion effects to suppliers and financiers. For instance, the total disclosed debt by the listed Adani companies is INR2.3tn (or A$40bn), of which 40% is held by domestic banks. This equates to ~0.6% of the total Indian banking system loans. Indeed, our channel checks on the Indian banks that we own such as HDFC Bank, ICICI Bank and State Bank of India (SBI) suggest only very limited exposure (i.e. <1% of total loans) to the Adani companies. These banks have also proactively curtailed or tightened their lending activity to the group in the wake of the short seller report. Another point to note is that most of the loans issued to Adani are secured against real assets which generate ~A$9-10bn of EBITDA per annum. So the likelihood of debt defaults is low.

We therefore believe that the short seller report released by Hindenburg Research on the Adani group of companies is likely to have a greater impact on investor sentiment towards the Indian market than any material quantitative systemic risk.

The Adani saga has raised concerns over the corporate governance practices of companies across the broader sector. As a result, other Indian conglomerates such as Reliance have been sold off in sympathy. We however see most of the allegations directed at Adani such as small free float, pledged shares, sky high valuations and criminal activity as idiosyncratic to the group.

On the point about valuations, the short seller report has coincided with the Indian market trading at historically high valuation levels. The Indian market was a relative outperformer in 2022 as the country was viewed as a safe haven amidst the weakness in other global markets. This drove the market to an all-time high valuation of 22x in December 2022. The Adani Group of companies, which at the peak last year held a ~6% weight in MSCI India, partly contributed to the re-rating. Following the recent correction, the Indian market is trading on a 20x forward PE, which looks more reasonable against forecasts for EPS growth of ~18% in FY24.

Portfolio Performance

Turning to portfolio performance, Consumer Discretionary and Information Technology were the biggest contributors to relative performance. Meanwhile, Energy and Financials were our biggest detractors.

At company level, Maruti Suzuki, Tata Motors and not owning the Adani related companies were the key contributors to alpha. Maruti's share price was boosted by strong 3QFY23 results (EBITDA +82%YoY) and very good response to its recent SUV launches – Jimny and Fronx. The SUV segment is likely to be a key growth driver in the coming quarters and should help the company gain market share in the domestic passenger vehicle market. Tata Motors also reported solid quarterly results with revenues and EBITDA growing 23%YoY and 43%YoY respectively in 3QFY23. Tata Motor's domestic commercial vehicle business is performing very well and the company is well placed to take advantage of its leadership position (~85% market share) in India's four-wheel electric vehicle segment.

Conversely, Varun, Reliance and SBI were the key detractors. Varun's share price saw some consolidation after strong up moves in recent months. The company however continues to execute well in the domestic carbonated soft drink segment, with new product launches (e.g. Sting) and distribution network expansions driving further growth. Both Reliance and SBI were impacted by the Adani Saga with concerns regarding corporate governance and Adani Group exposure respectively. For SBI, the company has disclosed that Adani related exposure is ~0.9% of its total loan book, which appears manageable.

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, Automic Group on **1300 101 595** or ellerstonfunds@automicgroup.com.au.

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