Introduction

Our purpose is to generate healthy long-term returns with strong downside risk protection. We achieve this outcome by investing alongside high-quality stewards of businesses whose companies are built with enduring principles. Identifying such people, who are capable of growing their businesses and compounding shareholder returns for many years, requires a long-term investment mindset that looks beyond short-term factors and index constructions. In this quarterly, using the example of Marico, we hope to demonstrate our investment approach in practice.

Marico

Indian consumer goods company Marico is a leading player within the haircare and edible oil segments. The company's entrepreneurial founder, Harsh Mariwala, has been involved with the business for the best part of 50 years. Under his stewardship, Marico has continually prevailed within its categories and evolved in terms of new products and geographies. The company has posted double-digit USD revenue and profit growth since its IPO in 1996.

Such impressive results have translated into high-teen USD returns for shareholders over the same period, which is extremely commendable by any yardstick. In fact, as a comparison, the S&P 500 has achieved mid-to-high single digit returns over the same 25-year period.

We believe that by focusing on the quality of stewardship, we can continue to identify companies that will compound capital for many years to come. In the case of Marico, the business is still relatively small, and has many ingredients that can support continued strong returns for shareholders.

Purpose

Our assessment of stewardship begins with purpose. A business with a socially aligned purpose tends to be more successful long-term than a company primarily focused on generating short-term profits. For a company like Marico, this means that its brands have to stand for something beneficial to both consumers and broader stakeholders if their competitive positioning is to sustain long-term.

Marico's original brand, Parachute, gained prominence in the 1970s when Harsh Mariwala realised there was an unmet need for branded coconut hair oil. The Parachute brand, which has always stood for natural hair nourishment, was well received by consumers, who have steadily converted from the unorganised segment of the market (loose coconut oil) to Marico's products. At the same time, the company has behaved responsibly through sustainability initiatives with coconut farmers within the supply chain.

The company's second largest brand, Saffola, prospered under similar circumstances. Increasingly health-conscious Indian consumers demanded refined edible oils with perceived health benefits, and Saffola, which was manufactured using natural safflower oil, was positioned as a safe alternative to traditional high-cholesterol cooking oils. The fact that these brands have always had a purpose, in the way they have served the unmet needs of consumers, whilst addressing environmental and social benefits, has provided long-term growth tailwinds for Marico.

Despite its success the company is not resting on its laurels and is focused on improving its connection with consumers and broader stakeholders. We recently spoke with management about initiatives to deepen the purposefulness of their flagship brands, and also engaged on how they position some of their emerging premium brands. Our analysis has taught us that well-stewarded companies like Marico appreciate that sustainability issues ultimately become business problems if key questions are not addressed, so it is crucial that management stay ahead of the curve and evolve with the demands of society.

Stewardship

Having established purpose, we then answer the question of stewardship. It is people that ultimately drive financial results, and the broad topic of stewardship gives us a sense for the quality of people within an organisation.

We break the question into smaller segments; it requires an assessment of a company's governance structure, management team and organisational culture, capital decisions, as well as an analysis of its social and environmental stewardship. Answering these questions and forming a view on a company's stewardship often requires years of painstakingly detailed work. We conduct extensive analysis on a whole set of actors associated with a company, such as its current leadership, it's non-executive board members, ex-employees, competitors, suppliers and channel partners.

Governance Stewardship

Emerging Markets are prone to corruption, and often businesspeople get their big break with the help of political connections. With this in mind, we always start by questioning whether an entrepreneur or business family owes their initial success to certain favours or relationships that may create future problems or uncertainty.

The story for Marico is reassuringly straightforward. In the 1970s Harsh Mariwala joined Bombay Oil Industries, which had been established by his grandfather in the 1860s. The group manufactured coconut oil and refined edible oils, which provided the platform for the aspiring entrepreneur to create the branded consumer goods that later morphed into Marico. From the early days, for example when the Marico brand was injected into the listed company, Harsh Mariwala practiced good governance which earned him a reputation for being honest and ethical. He remains detached from controversy and continues to promote the interests of all Marico's stakeholders.

The FMCG space in India is notoriously competitive, meaning honesty and integrity alone cannot guarantee success, hence Harsh Mariwala's skill as an operator was also important. Despite joining the family company, his business acumen was more akin to a first-generation entrepreneur; he had a natural talent for developing brands and distribution platforms. He was able to see off the threat of formidable competitors including Hindustan Unilever, who tried and failed to eclipse Parachute in the coconut hair oil segment.

Another key success factor has been the founder's desire to separate family ownership and professional management of operations. Harsh Mariwala moved from Managing Director to Chairman in 2014. His decision to step back from operations, when he was seemingly still in his prime, sent a strong message internally and externally that Marico was progressive and meritocratic. This is a point lost on many businesses in India, where continued family involvement in operations has the effect of deterring high-quality professionals and creating organisational cultures that are ill-equipped to compete with dynamic competitors.

Harsh Mariwala continues to help shape strategic direction in his role of Chairman. He is joined by non-executive family members on the majority-independent board, which contains a collection of businesspeople with solid reputations, who are capable of holding the management accountable.

Organisational Culture

Marico has always been progressive in terms of organisational culture. One of the first people that Harsh Mariwala hired in the early 1990s was Jeswant Nair, the Head of HR from Asian Paints, and together they recruited a senior team to help transition Marico from a commodity oils business to a nationwide branded FMCG company. They established an open and collaborative culture at the onset inviting every employee to weigh in on the company's strategy and adopting an open-plan office and 'no suits' policy.

Today's management team contains an interesting mix of people; capable company lifers are complemented with lateral hires who bring the added benefit of best-in-class industry training in disciplines such as sales and marketing. Having the right talent has enabled a culture of constant innovation which has become a key differentiating force in a highly competitive FMCG space.

The structure of the organisation has been another decisive factor, because talented professionals want to feel like they have autonomy to manage operations as they see fit. On the flip side, they expect to be held accountable by their actions and results, which creates a performance-focused working environment. Marico has reaped the rewards of such a structure, with professional managers driving the growth of categories, brands, and geographies. More recently, as the group has launched new premium niche brands, they have carved out separate entities with appropriate incentive structures.

One of the areas where the company is trying to improve is gender diversity. Women are underrepresented within the top management team and organisation as a whole, but the leadership team acknowledges this and is proactively trying to address the issue.

Marico's success in overseas markets like Bangladesh and Vietnam would not have been possible had they not nurtured and developed local talent. The company insists that 70% of key functions are undertaken by local managers, and in time we hope to see these subsidiaries being led by local CEOs.

Capital Stewardship

A decade ago, Marico became more active on the M&A front, with their largest acquisition being a collection of personal care brands from Reckitt Benckiser. This particular deal was not a success, with most of the goodwill written-off in the years following.

Despite the mixed record, Marico has never taken too much balance sheet risk and M&A activity has been relatively minor. When it comes to capital decisions, we continue to support the company's focus on organic growth through core brands like Parachute and Saffola.

Environmental and Social Stewardship

The process of improving environmental and social impact is continuous for all companies and Marico is no exception. Management have intensified their sustainability efforts in recent years but remain at an earlier stage in comparison to leading global FMCG players.

We conduct detailed sustainability assessments for all of our portfolio holdings which track the progress of a range of environmental and social measures. For a company like Marico, this includes critical issues such as supply chain traceability, GHG emissions, water usage, recyclability of packaging, and product labelling. Each year we measure their progress and aim to engage with management in areas where progress has been slow in absolute terms or relative to global peers.

On the environmental side, we note that the company is working hard to improve its understanding of its overall carbon footprint, including Scope 3 GHG emissions, which will allow management to set ambitious targets for the business as a whole in the years ahead. With a fuller understanding of their environmental footprint, Marico will be better positioned to educate, audit, and improve their supply chain vendors, through ongoing initiatives.

In terms of social stewardship, Marico has spent two decades working closely with coconut farmers, who provide the key raw material (copra) for coconut oil products. They have opened a series of coconut collection centres across South India, in order to disintermediate agents and traders who have been earning a margin from the farmers. More than 50% of copra is now sourced directly from farmers via collection centres. Management has demonstrated that they understand that the business can only prosper if coconut farmers feel satisfied and aligned. In this context, a new program called *Kalpavriksha* was launched a few years back to educate farmers and improve harvest yields, with early results encouraging.

Quality of Franchise

Once satisfied from a stewardship perspective, we drill deep into franchise analysis. We answer a few critical questions at this stage; does the business have a durable competitive advantage, does it produce healthy and resilient returns on capital, is there limited risk of disruption or obsolescence, and critically, is there long-term sustainable growth.

Marico's focus on product quality has helped the business to capitalise on the decades-long shift towards branded FMCG. Over the years, this emphasis on quality has combined with adept marketing skill and extensive distribution reach to create enviable brand equity for Marico's products. The strength of the brands has been evidenced by their pricing power, and resilient profitability and returns. Marico has also navigated the delicate competitive environment by respecting opponents and not overearning. It has benefited from long-term tailwinds such as health and wellness, which continue to provide a long runway for both existing brands and product extensions.

Haircare

Millions of Indians nourish their hair daily with oils, and in Southern India coconut oil dominates the market. Within the coconut hair oil segment Marico has over 60% market share through its Parachute brand, meaning there is an obvious durability to the haircare franchise, which makes up more than half of the company's revenue.

The Parachute brand accounts for one-third of group sales and has grown at the expense of unorganised players. Marico has behaved countercyclically during difficult periods, such as the ongoing coronavirus crisis or throughout periods of inflation, in order to take market share from the unorganised segment. Higher market share has in turn led to superior scale and supply chain management opportunities, which has translated into a cost advantage and healthy profit margins. Over time, margins have remained resilient because Parachute, like Marico's other haircare brands, have proven to have pricing power thanks to their strong brand equity.

Marico's dominance owes itself in part to a decision to avoid 'red oceans', i.e. markets vulnerable to intense competitive dynamics. When they entered coconut oil there was no competition, which meant Marico had a head start on the competition. That's not to say there have not been threats; as mentioned earlier, Hindustan Unilever tried and failed to outcompete Parachute, and other reputable FMCG companies have also had a crack but ultimately proven unsuccessful. Marico has seen off challengers with a razor-sharp focus that has not left gaps for competitors to exploit. They have used pricing tactically and segmented the market with a variety of flanker brands. Crucially the franchise has also evolved beyond mass market coconut hair oil, with premium brands, or VAHO (Value Added Hair Oils) as the company calls them, now close to 20% of Marico's overall sales.

Another key advantage has been Marico's distribution network and strength within general trade. With the formalisation of retail and growth of e-commerce the landscape is changing, and the company has to adapt to maintain its competitive advantage. It is early days, and something that we continue to analyse, but so far, Marico is rising to the challenge and is leading its peer group when it comes to e-commerce. If the company cannot innovate, the formalisation of retail will put pressure on margins, but we take comfort from their past ability to evolve ahead of the competition.

With one-third of the coconut hair oil market still unorganised, there remains a long growth runway for Marico, who can continue to take share, especially in rural India. They are also well placed to benefit from ongoing premiumisation thanks to their competitive positioning within VAHO, where they have more than 35% market share.

Foods

The Saffola brand, which accounts for around one-fifth of Marico's sales, has grown on the back of rising incomes and increasing relevance of healthy living. Management followed a similar playbook to Parachute to develop the franchise at the expense of the unorganised sector. The Edible oils industry is largely commoditised, but Saffola has been able to differentiate from the crowd through its focus on super-premium refined edible oil, where it leads with 70% market share.

The Saffola brand has been extended into healthy foods, and specifically premium oats, where again Marico commands a very high market share. The positioning of Saffola as a healthy lifestyle brand is increasingly being leveraged by management, who wish to capitalise on consumers desire for health and wellness, which has been expedited with the coronavirus crisis. In recent months, with minimal investment, Marico has launched honey and ayurvedic products under the Saffola brand.

The barriers to launching new products and the cost of failure have been lowered with the growth of e-commerce, meaning there is a lot more room to experiment. Whilst this is an opportunity, it also presents a threat to Marico's existing franchise and it is something we monitor closely.

International

The key overseas market is Bangladesh, where Marico entered with Parachute more than twenty years ago. At the time the market was nascent, and competition was non-existent, meaning the runway for growth was long. From a low base the Bangladesh operation has gone from strength-to-strength and now account for approximately one-tenth of Marico's business.

Parachute still commands 80% share of the branded coconut hair oil market in Bangladesh, but over time the cash flows from the flagship brand have been used to develop a more diversified local FMCG business. With dominant brands, leading distribution, and a talented local workforce, we see no reason why Marico's business in Bangladesh will not be more meaningful in the future.

Marico also has operations in Vietnam, the Middle East, and parts of Africa. These subsidiaries are not as successful as Bangladesh, but in the case of Vietnam at least the market is relatively early stage with lots of potential.

Quality of Financials

The financial picture for Marico is reassuringly transparent and conservative. The business has achieved consistently high returns, despite volatile raw material costs, and generated significant cash flows which have been used to fund future growth. We have been equally impressed by the willingness to forego short-term profits in order to develop the international business, which in the fullness of time has produced returns on par with the Indian operations.

The fact that the balance sheet has been net cash for five years provides another layer of comfort, as does the company's management of working capital, which is not especially straightforward given how raw material input costs typically fluctuate with commodity prices. Finally, we score the company positively for paying its fair share of taxes and having its accounts audited by a reputable local firm.

Growth and Valuation

The final piece of analysis is our assessment on the future prospects of the business. We approach the question from the perspective of absolute returns and try where possible to make ten-year assumptions in order to keep perspective of the long-term drivers for a business. In the case of Marico, this means forecasting the long-term prospects for each key business unit.

Through a mix of volume and price, the haircare brands can grow double-digit the next decade. Leading brand Parachute can take further share in a market that will continue to grow at the expense of the unorganised segment. Marico's premium haircare brands will also continue to grow given the company's category leadership, despite some shorter-term pressures due to coronavirus.

The key assumption we are making for the foods business is that Saffola will leverage its brand equity and build a broader product portfolio in ten years' time. We believe Marico has an excellent opportunity to take advantage of e-commerce trends and changing consumption habits. Meanwhile, the international business should continue to be led by Bangladesh, which is in a sweet spot after decades of investments in people and infrastructure.

The net result of our dissection of the business is that we expect healthy sales growth over the next 10 years, and a very robust margin progression at the same time. This translates into an excellent investment return potential over the next decade.

Stress Testing the Thesis

Our pursuit for healthy long-term returns with strong downside risk protection means we naturally gravitate towards high-quality companies like Marico. We look for capable stewards at the top of the organisation because it means daily decisions are made with the long-term interests of the company in mind. This creates a sustainable way of operating which ultimately translates into resilient financial results and continued compounding of returns for shareholders.

As shareholders we continually ask hard questions of Marico in order to test the investment case, which means engaging with the company on various levels, analysing industry trends, and assessing the progress of competitors. We are also fortunate that our time horizon allows us to stick by companies when they experience dull periods or moments out of the spotlight.

In conclusion, the opportunity for a company like Marico in India is huge, given the size of the population, stage of development, and tailwinds behind trends like health and wellness. Marico's revenue passed USD 1bn for the first time recently, and its market value remains around the USD 6bn mark, meaning it is still not a large company by global standards. For all the reasons discussed, we remain convinced it can be a much bigger business in ten years' time and that patient shareholders will be rewarded with handsome returns.

Aikya Emerging Markets Strategy

Strategy Information	
Strategy Launch Date	05/03/2020
Benchmark	MSCI Emerging Markets Index (USD)
Number of Holdings	34

Strategy Top Ten Holdings			
Company	Portfolio (%)	Company	Portfolio (%)
Tata Consultancy Services	6.8	Universal Robina	3.8
Marico	6.7	Mahindra & Mahindra	3.7
Uni-President Enterprises	6.3	Cyient	3.5
Unilever	5.7	Dr Reddy's Labs	3.4
Fomento Economico Mexicano	5.2	SITC International	3.2
Total			48.4

Strategy Country Weights					
	Portfolio (%)		Portfolio (%)		Portfolio (%)
Emerging Asia	**62**	**EMEA**	**10**	**Developed**	**10**
China	7	Hungary	2	UK	6
Hong Kong	5	South Africa	5	Japan	2
Taiwan	12	Egypt	2	Switzerland	2
South Korea	1				
Indonesia	4	**Latam**	**12**	**Cash**	**5**
Philippines	4	Brazil	4		
Thailand	2	Chile	3		
India	28	Mexico	5		

Strategy Sector Weights			
	Portfolio (%)		Portfolio (%)
Communication Services	1	Financials	20
Consumer Discretionary	7	Industrials	7
Consumer Staples	39	Information Technology	14
Health Care	8	Cash	5

Strategy Performance (30 September 2020)	1 Month	3 Month	6 Month	Inception (05/03/2020)
Strategy Return	-0.5	8.1	24.5	6.9
MSCI Emerging Market Index	-1.6	9.7	29.6	8.9

This is a representative USD account only and does not reflect an actual return of a fund in USD. The represented performance figures utilized in the above performance chart are managed in AUD and converted to USD for indicative purposes only. Therefore, the performance figures contained in this document are estimates as determined by Aikya to the best of its ability and Aikya can provide, on a separate basis, further gross or net returns to any prospective client that requests such information. These figures are estimates only and should be treated as such. No representation is being made that any investment will, or is likely, to achieve profits or losses similar to those being shown

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