AIKYA

Summer 2020

Introduction

As this is our first letter, we thought it would be a good opportunity to walk through our investment approach and explain what we look for in the companies that we decide to back. The current environment is undoubtedly uncertain, but our approach has always been to identify company management teams who look past the short-term, with their eyes firmly fixed on the long-term.

Our Investment Approach

Our purpose is to generate healthy long-term returns with strong downside risk protection. Risk for us is the possibility of permanent loss of capital rather than underperforming a benchmark in the short-term. An absolute return mindset allows us to focus on companies with the best quality management teams, without wasting time on the hundreds of other companies in the Emerging Markets universe.

Stewardship is at the heart of our investment philosophy. While we look at a company's financials and franchise strength in detail, our primary interest is in assessing the quality of people behind the business. We look for long-term stewards who have grown cashflows, navigated a few economic cycles, and demonstrated fairness to all stakeholders. The stewards we back have the qualities to identify sustainable growth opportunities and on occasion turnaround underperforming assets. Such people create shareholder value and drive long-term investment returns.

This investment philosophy works because the 'people' aspect of 'quality' is seldom priced correctly by the market, which is usually obsessed with near-term financial results. Its successful implementation requires an understanding of the unadulterated history of business families, which is usually not available publicly, and needs a lot of investigative work on the ground to uncover. One of our key advantages is that we have developed an extensive network of trusted business families, independent board members, industry experts, and other useful third-party sources, over a long period operating in these countries. This helps with due diligence on new investment ideas.

Our long holding periods also help build a sense of partnership with investee companies, who, over time, become increasingly open to engagement. Our relationships allow us to discuss critical governance and sustainability issues with top management; positive engagement on such issues becomes a powerful value-enhancement tool.

Focus on Stewardship

It is our belief that the majority of listed companies suffer from a 'principal-agent' conflict. The interests of management teams as 'agents' are not aligned with shareholders because their compensation is often linked to short-term incentives. It is rare for us to find the true characteristics of stewardship in companies that are either run by government or have no dominant shareholder.

Well-stewarded family-owned businesses are typically run with a view to preserving and building wealth for the next generation. This time horizon that allows a company to take short-term pain for the sake of long-term gains becomes a key competitive advantage.

When it comes to stewardship, the first question we ask is around purpose. Not only must a company demonstrate a strong sense of purpose, but its strategy and products must align to its purpose. We then look for evidence of integrity and strong governance, as well as a fairness to all stakeholders, which means no short-cuts in terms of employees, society, or the environment. Organisational culture is another important factor for us, as is the ability of the owners to demonstrate a history of disciplined and conservative capital allocation. Ideally, such people have also operated through a few downturns without going bust.

This reads like a long list but a judgement on stewardship is at the heart of our approach. When we are satisfied a company passes our stewardship requirements, we shift our attention to franchise and financial analysis. From a franchise quality perspective, there must be a history of sustainable cash flow generation, a durable competitive advantage, and long-term growth opportunities. We look for evidence of strong returns through the economic cycle. When it comes to quality of financials, it is essential that a company's accounts are transparent, and that the balance sheet is conservatively managed.

Such combination of purpose, honesty, conservatism and competence is extremely rare to find, but these are the qualities that we believe are essential in the people we choose to back. For every family-owned business that has such qualities of stewardship, there are many more that fall short. This focus on well-stewarded owner-managed businesses typically leads us to companies that are steady compounders; these companies may look boring at first glance, but usually deliver fantastic investment returns in the long run, because they are managed with multi-generational time horizons.

What is our edge?

Our investment philosophy is simple, which begs the question why others can't spot these same opportunities? Our most important edge is our long-term mindset and psychological discipline, which allows us to look beyond short-term headlines and instead focus on the quality of people behind a business. A long-term mindset can be developed over time, but it requires a business structure that supports investment driven decision making. This helps nurture the right type of investment culture, which is supported by an aligned investor base.

Structure

Aikya is majority controlled by the investment team, and every decision we take is driven by a desire to execute our investment philosophy in the best possible way. We don't chase short-term market returns if it means compromising the investment philosophy in any way or putting the long-term investment returns for our clients at any risk.

The unfortunate reality of our industry is that most investment managers operate within large institutional structures which prioritise Assets Under Management (AUMs) over investment performance. Many of these large firms are not run by investors, meaning they are more focused on what they can 'measure' or 'control'. Instead of thinking about how best to enhance long-term returns, many investment management firms get obsessed with short-term relative performance vs. their peer group and the benchmark. Although unconventional decisions could generate superior investment performance in the long term, most managers are reluctant to make them for the fear of standing out from the crowd.

Culture

All members of Aikya are equity shareholders in the firm, which creates long-term alignment and stability within the team. While we share a common professional heritage and subscribe wholeheartedly to the Aikya investment philosophy, we come from diverse backgrounds and have very different thought processes. This diversity combined with a culture of open and honest debate makes our decision-making process very robust.

Our investment philosophy does not change, but its successful execution requires continuous evolution and learning. We actively promote creativity and contrarian thinking in the team. We routinely analyse our mistakes with a view to collectively learning lessons, and there is no 'blame' culture at Aikya.

Clients

Our investment horizon is supported by the long-termism of our clients. We will always strive to develop relationships with clients who are aligned with our investment philosophy and view the world with the same long-term mindset that we do. We aim to prioritise the quality of our clients over the size of funds we manage and have strict capacity controls.

Our Investment Process

Having a supportive long-term structure allows our investment research process to flourish. The process has been designed to ensure that we continue to identify the highest quality stewards in our investible universe.

When it comes to idea generation, our network of contacts on the ground throws up a few potentially interesting ideas each year. With any new idea, the question we are always trying to answer is whether a company has the characteristics to make it onto our Quality List.

Aikya's Quality List consists of c. 100 companies that have passed our strict quality tests. The process of getting onto the Quality List is extremely labour intensive and can take 12-18 months of analysis. It requires meetings with company management, discussions with competitors, talks with industry experts, and other references. The idea, though, is that we build long-term conviction.

To be considered for the Quality List, an idea requires a company report: a rigorous piece of analysis that studies in depth the history, stewardship, franchise, financials, growth drivers, and valuation of a business. Company reports are debated amongst the team, whose role it is to stress test the investment case.

Once a company makes it onto our Quality List, it is analysed by different analysts on the team at regular intervals throughout the year. We continually question the investment thesis, whilst ensuring the whole team feels a sense of ownership over each name on the Quality List.

Portfolio Construction

The portfolio consists of 30-35 sensibly priced companies from our Quality List. Portfolio construction is entirely bottom up. We are focused on maximising risk-adjusted returns for our clients, and not constrained by any benchmark weights.

The portfolio is broadly divided into two buckets, with the maximum weight for each bucket strictly controlled.

Sustainable Leaders: These are long-term core holdings, and depending on valuations, each position may go up to 10% of the portfolio. Such companies are well-stewarded, with dominant and diversified franchises, operating within industries with strong growth tailwinds. When it comes to their financials, they produce high returns on capital and maintain robust balance sheets. Sustainable Leaders typically make up around 45-50% of the portfolio.

Quality Companies: These companies have passed our quality tests but are not yet as diversified as Sustainable Leaders. They are controlled by high-quality stewards and have strong balance sheets, but the consistency of their cashflows and returns may be less robust, and the operating history is typically shorter. Position sizes are capped at 4% (book cost). These companies make up 45-50% of the portfolio.

Sustainable Leader: Tata Consultancy Services (TCS)

TCS is the largest Indian IT Services company, with an estimated 2% global market share.

Stewardship

Major shareholder Tata Sons is one of the most ethical business groups globally.

TCS has developed an organisational culture that is both differentiated and superior to peers. It stems from the fact that the company is considered a great place to work, meaning attrition rates are far lower than industry averages. It has provided TCS with a demonstrable cost advantage, which has become a key competitive strength over time.

Management has proactively nurtured internal talent over the years, and never retrenched workers during difficult periods. The best example of this long termism came soon after the Global Financial Crisis, when they increased headcount 30% at a time when competitors were aggressively cutting staff. We get a sense of déjà vu reading about the IT Services industry in recent times. During the coronavirus pandemic, TCS management not only avoided laying off engineers, but they reaffirmed the company's commitment to 40,000 campus recruits, at a point when competitors are again reducing headcount in the face of near-term pressure.

Franchise

TCS is the lowest cost provider in an industry with a long runway for growth. It is positioned to provide necessary services as the world evolves and demands more intelligent and digital information systems, because the company's core competency is its ability to train and manage thousands of software engineers. Equipped with knowledge of the latest technologies, these engineers are able to deploy world-class solutions at industrial scale around the world.

The organisational structure and the success of the franchise are so inextricably linked, that it has created an enduring competitive advantage.

Financials

The company generates both very high returns and significant free cash flow. It has a net cash balance sheet, and an owner who has behaved sensibly and counter-cyclically with capital.

Long-term growth potential

Indian IT Services industry has 15% global market share, with penetration expected to increase. If the IT Services industry globally grows 3 to 4% annually, then India should grow 8 to 10%. In this context, we expect TCS to grow faster than the market, due to the competitive advantages that we have touched upon. This would mean TCS's global market share increasing from 2% to 4%, which is not unrealistic.

Investment Case

Exceptional stewardship at TCS has helped foster a competitive advantage and long runway for growth. Most market participants think TCS's high-single digit growth rates are too boring, and consistently underestimate the enduring nature of their competitive advantage which inherently stems from a superior organisational culture.

Quality Company: Voltronic

Founded in Taiwan, with manufacturing operations in China, Voltronic produces uninterruptable power supply (UPS) equipment.

Stewardship

The key steward is the company's founder and largest shareholder, Alex Hsieh. He is a successful entrepreneur whose original business, PhoenixTec, was acquired by a leading global industry player.

His second creation was Voltronic. The business was established with a purpose to offer customers a manufacturing service that was not available in the market; Voltronic would only produce UPS equipment for third-party brands (ODM). The ability of Alex Hsieh to avoid temptations to launch a brand demonstrates why we believe he is a capable long-term steward. He took a longer route to profits, but it meant being differentiated and more sustainable in the long run.

The products themselves are custom designed, which requires a detail obsessed engineering culture. Alex Hsieh has developed such a culture through broad-based share ownership for the hundreds of engineers within the company.

Franchise

The key competitive advantage is this unwavering focus and commitment to pure manufacturing. This approach has fostered trust with customers, who in time have been happy to outsource more of their manufacturing needs to Voltronic. Many competitors have tried and failed to win the trust of customers because the allure of selling higher margin branded equipment is too difficult to resist.

Voltronic is diverse in terms of geographic sales. The company manufactures for over 350 local brands and distributors, in more than 100 countries. The ability of Voltronic's engineers to tailor more than 10,000 SKUs to the requirements of this diverse customer base has created another meaningful barrier to entry over time.

Financials

The business has generated high returns and strong cash flows over the years. As a result, the balance sheet is net cash. One thing we do monitor is working capital, given Voltronic is exposed to a variety of volatile Emerging Markets.

Long-term growth potential

The global UPS market is fairly resilient because the products themselves are critical to many everyday applications. We presume the industry continues to experience steady growth, and at the same time the outsourcing trend continues.

As a pure play manufacturer, Voltronic is very well placed to benefit from such tailwinds. Encouragingly, the largest global brands, who were originally reluctant to outsource, are now much more open to working with Voltronic.

Investment Case

Voltronic has the potential to be a long-term winner in our view. It is a mid-sized company, run by an honest and capable entrepreneur, with a sustainable competitive advantage and a significant runway for growth.

Quality Company: Universal Robina (URC)

URC is a branded food and beverage company based in the Philippines with operations across Southeast Asia and Oceania.

Stewardship

The key steward is second-generation Lance Gokongwei. With the help of our network on the ground, we formed the view that Lance Gokongwei was not only an advocate for strong corporate governance, but that he also wanted to professionalise operations.

In 2018, Irwin Lee, a P&G veteran with 30 years industry experience, became the first non-family CEO of URC. He has been given complete autonomy and has continued to professionalise and attracted additional talent from reputable global companies.

With Lance Gokongwei as Chairman of URC, there is a conservative steward with a multi-generational time horizon. This long-termism is complemented by a capable professional management team who are focused on improving operations.

Franchise

URC is well positioned in the Philippines FMCG market. The company's strategy has been to focus on categories with limited multi-national competition.

The products have been supported by strong distribution and local manufacturing capabilities, which includes vertical integration of sugar and flour supply.

URC's business started to experience tougher times a few years ago, when the previous management team failed to anticipate an aggressive entrant, who took market share in coffee. This led to the appointment of Irwin Lee, who was tasked with getting URC on the right track again.

Financials

The company generates healthy profit margins, which can improve over time as premium products gain traction in the Philippines.

Net debt increased following a couple of acquisitions in Oceania. URC has subsequently brought in a partner on these assets, which has reduced leverage. In doing so, Lance Gokongwei demonstrated capital stewardship, and a humility to admit past mistakes.

Long-term growth potential

Despite the recent past, URC has managed to grow double digit the last decade, which is testament to their competitive position and the markets in which they operate.

URC's markets have a lot of potential, and with the relationship between family and professionals now proven, the business is very well positioned for long-term growth.

Investment Case

We have always been happy investing in good people when their businesses are going through difficult periods, provided we believe in the stewardship. It was in this context that we first became shareholders in URC, at a point in time when the new management team started to address shorter-term competitive issues that had arisen under the previous management.

Aikya Emerging Markets Strategy

Strategy Information	
Strategy Launch Date	05/03/2020
Benchmark	MSCI Emerging Markets Index (USD)
Number of Holdings	32

Strategy Top Ten Holdings

Company	Portfolio (%)	Company	Portfolio (%)
Marico	7.1	Universal Robina	3.9
Tata Consultancy Services	6.5	Banco De Chile	3.6
Uni-President Enterprises	6.1	Mahindra & Mahindra	3.5
Fomento Economico Mexicano	5.6	Banco Bradesco	3.3
Unilever	4.8	Dr Reddy's Labs	3.0
Total			47.4

Strategy Country Weights

	Portfolio (%)		Portfolio (%)		Portfolio (%)
Emerging Asia	**60**	**EMEA**	**11**	**Developed**	**10**
China	2	Hungary	3	UK	5
Hong Kong	6	South Africa	7	Japan	3
Taiwan	13	Egypt	2	Switzerland	2
South Korea	2				
Indonesia	5	**Latam**	**14**	**Cash**	**5**
Philippines	4	Brazil	4		
Thailand	3	Chile	4		
India	26	Mexico	6		

Strategy Sector Weights

	Portfolio (%)		Portfolio (%)
Consumer Discretionary	4	Industrials	7
Consumer Staples	38	Information Technology	13
Health Care	8	Utilities	3
Financials	22	Cash	5

Strategy Performance (30 June 2020)	1 Month	3 Month	6 Month	Inception (05/03/2020)
Strategy Return	4.0%	15.2%		-1.2%
MSCI Emerging Market Index	7.4%	18.2%	-9.7%	-0.8%

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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