

ASHMAYU: RAY OF LIGHT (Sanskrit)

NEWSLETTER:
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Tamohara

INVESTMENT MANAGERS

Tamohara Investment Managers is a SEBI registered portfolio manager. Over the last five years the firm has built an Equities Investment Platform, offering differentiated strategies & bespoke solutions to Individuals and Institutions. Tamohara believes in active investment management, seeking high return generating businesses and valuing the companies on their Long-term CASH FLOW generation. All portfolio actions are based on the holding period return of each holding rather than the valuation/level of the markets. In order to curate quality investment portfolios, the team follows a bottom-up approach to investing. The 8 Member investment team has a collective experience of 12 decades and has been drawn from marquee investment institutions from India and abroad.

At Tamohara, we take reading seriously, and go through a variety of analysis, perspectives and news from across the world. What you see here is a distillation of the insights that arise as a result of all that reading. We hope you enjoy these newsletters that our team puts together and gives you a different perspective of thinking about investing and on certain industries!



By Harini Dedhia, Portfolio Manager/Head of Research.

Dear Investor,

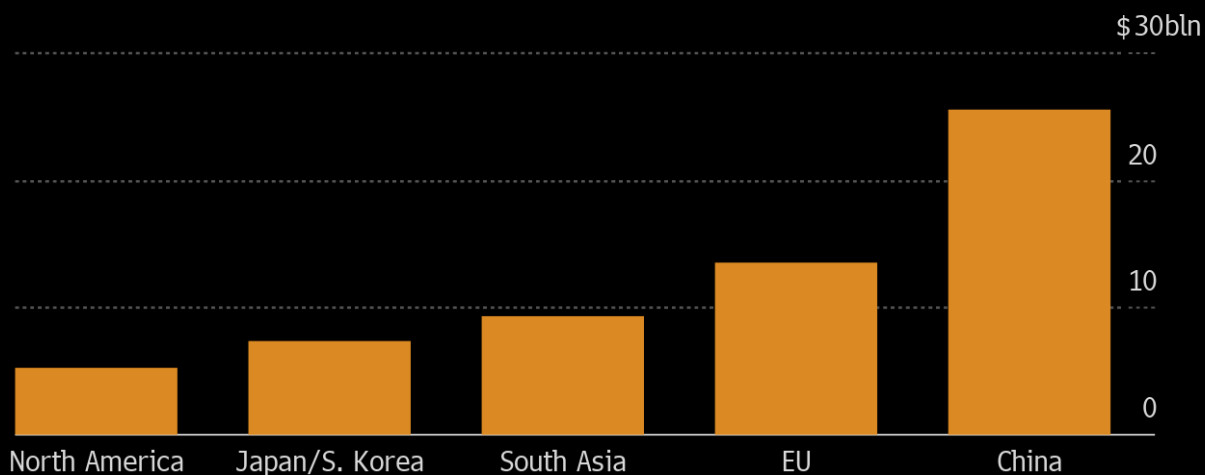
Narratives and stories drive investment outcomes in the short run. For the most part, they provide us with shock therapies with complete elasticity. The effect of the story is felt temporarily and over a period of time, we are back to business as usual. Yet there are few stories that alter the course of business and cause a structural shift. As an investor with the intent of long-term wealth creation, we need to ignore the stories with elasticity as noise and focus only on those few that create a change bringing about a new or an enlarged addressable opportunity. With this in mind, we are starting an annual year end practice of determining the story of the year; to help us cut through the noise and get to a structural change that can be meaningful over the coming years.

Embarking on our endeavor, due to recency bias, our first thought is the ongoing Suez Canal crisis, which despite the memes, puts serious pressure on the already stressed container logistics market. This is the backbone on which globalization rests, and 10% of the world's trade traffic moves through that canal! However, like the power freeze in Texas, we think it is an issue that will cause immense short-term pain and yet be forgotten when the next story to amuse us comes up. It is one for the traders, not for us.

Being cooped up in our homes for a long duration of time has shifted consumption patterns. We have consumed electronics at a pace not imagined before; so much so that we are currently facing an acute shortage of semiconductors (essentially the chips that make our devices able and intelligent). Car production schedules across the world are seeing delays due to the shortage of this electronic component. From Mahindra to Renault to Ford, everyone has announced temporary production cuts as a result of this.

Crisis Mode

The auto industry may lose \$61 billion of 2021 sales from chip shortages



Source: AlixPartners. Estimates based on current rate of volume losses.

Bloomberg

Figure 1: Estimated loss of sales by geographic region owing to semiconductor shortage

This is a supply side problem that would delay cash flows though, not one that would cause them to vanish altogether. It is important to note that the value of any asset is some form of cumulative cash flows you expect the asset to generate over its lifetime. In simple baniya language- ‘Kitna lagaya aur kitna mila interest count karke.’ **At Tamohara, when we value assets, it is these cash flows that take precedence over all else, especially over quarterly profit and loss numbers.** Even from a P&L perspective it is a \$61bn hit at most to an industry with over \$5 trillion in sales.

This \$61bn is not necessarily lost, but simply delayed. In India, the wait times for some of the popular models especially in SUVs are indicative of this strength in demand.

Another outcome of people being cooped up in their homes with benevolent markets has been the increase in retail participation in the equity stock markets. GameStop and the rise of retailers made many headlines recently. It has however, taken over a decade for account openings to come back to this level. An unpredictable jolt or a boring run sideways will see a correction in this trend as well. Asset prices will reflect the underlying value one day or the other and so this is not the structural story we are after.

We debated the Supreme Court’s decision on holding a famous lawyer in contempt of court, but nothing beats the extreme amounts of discussion we had on the death of a popular actor. Both forgotten in our amnesia when everyone had an opinion on the farm bill, getting the nation to an impasse. None of these are quite the structural narratives we seek.

I wish I could call India’s Test Series win in Australia our story of the year but in fear of digressing too much, I shall move on.

Perhaps it would be best to revisit what we could have been called the story of the year in March 2020. “India’s corporate tax rate cut to 25% and new manufacturing units liable only to pay 15% for the rest of their life (provided they commission the factory by March 31st 2023)”- This coupled with the China+1 strategy this year, and many OEMs have certainly considered India as a destination for outsourced production. Our companies certainly have a balance sheet to fund an expansion for us to rise to this occasion. (as seen in the table below)

	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20
Auto ancillaries	0.73	0.8	0.83	0.79	0.76	0.64	0.67	0.62	0.67	0.66	0.67	0.54	0.4	0.37	0.35	0.37
Auto mobiles (Two and three wheelers)	0.31	0.3	0.32	0.44	0.42	0.36	0.39	0.25	0.13	0.07	0.06	0.04	0.04	0.04	0.04	0.05
Automobiles (passenger cars)	0.22	0.1	0.24	0.28	0.33	0.19	0.12	0.18	0.15	0.16	0.1	0.06	0.05	0.04	0.03	0.04
Automobiles (Tractors)	3.57	2.7	1.93	0.91	0.91	0.51	0.39	0.45	0.63	0.19	0.19	0.2	0.29	0.2	0.25	0.15
Automobiles (Trucks / LCV)	0.63	0.6	0.56	0.76	1.07	1.06	0.81	0.81	0.9	0.83	1.19	0.62	0.74	0.67	0.6	1.08
Castings / Forgings	1.26	1	1.09	0.78	0.98	1.06	0.87	0.83	0.94	1.13	1.17	1.17	1.37	2.26	17.17	0.47
Cement and building materials	2.18	1.6	1.15	0.92	0.92	0.89	0.85	0.71	0.74	0.77	0.75	0.72	0.59	0.47	0.46	0.4
Chemicals	1.21	1.2	1.04	0.88	0.94	0.8	0.8	0.81	0.78	0.78	0.71	0.66	0.53	0.46	0.29	0.27
Consumer durables -electric appliances	15.3	9.6	8.72	3.36	1.11	0.75	0.68	0.79	0.62	0.65	0.63	0.8	0.73	0.74	0.65	0.3
Consumer durables -electronics	0.92	0.9	1.07	1.02	1.19	1.21	1.28	1.85	2.69	2.52	2.78	2.94	3.8	4.84	29.33	0.16
Consumer food	1.16	1.1	1.17	1.26	1.28	1.38	1.31	1.44	1.29	1.21	1.3	1.18	0.63	0.79	0.68	0.42
Electronics-components	4.85	6	1.46	1.4	1.83	2.11	1.62	2.22	3.45	5.74	6.98	3.79	1.67	1.69	0.69	0.28
Engineering	0.2	0.3	0.29	0.27	0.25	0.37	0.5	0.26	0.41	0.41	0.35	0.32	0.32	0.28	0.23	0.25
Fertiliser	1.31	0.7	1.15	1.19	1.3	1.23	0.86	1.28	1.33	1.15	1.19	1.53	1.14	1.01	1.29	1.32
Household & personal care	0.5	0.1	0.19	0.27	0.39	0.24	0.27	0.3	0.36	0.12	0.11	0.09	0.08	0.07	0.05	0.05
Metals- ferrous	1.35	1.3	1.6	1.14	1.26	0.83	0.8	0.4	0.38	-0.4	1.19	0.96	0.5	0.3	0.24	0.1
Non-ferrous metals	0.58	0.5	0.41	0.31	0.24	0.19	0.17	0.26	0.38	0.62	0.59	0.41	0.52	0.38	0.42	0.42
Paints	0.61	0.4	0.47	0.41	0.34	0.25	0.15	0.15	0.13	0.11	0.08	0.03	0.04	0.03	0.03	0.02
Petrochemicals	1.35	1.4	1.03	0.96	1	0.66	0.74	0.83	0.84	0.79	0.9	0.94	0.75	0.64	0.39	0.44
Pharmaceuticals and drugs	0.9	0.9	0.62	0.55	0.65	0.48	0.44	0.44	0.45	0.47	0.39	0.4	0.34	0.34	0.32	0.25
Railways wagons	1.83	2.4	2.3	4.43	8.84	0.34	0.44	0.35	0.36	0.22	0.14	0.22	0.22	0.36	0.48	0.53
Refineries	0.58	0.7	0.66	0.73	0.88	0.74	0.71	0.79	0.8	0.8	0.61	0.53	0.49	0.47	0.54	0.83
Steel & iron products	1.26	1	0.9	0.79	1	0.93	0.89	0.89	1	1.14	1.2	1.72	1.96	2.08	1.09	1.15
Textiles	2.1	1.7	1.82	2.06	2.17	2.01	1.96	1.99	1.83	2.25	2.4	2.56	2.79	5.44	4.84	3.1
Tyres & Allied	1.33	1.4	1.09	0.93	1.05	0.8	1.1	1.29	1.15	0.96	0.73	0.43	0.43	0.36	0.36	0.41

Source: AceEquity.

Figure 2: Sectoral Debt to Equity for listed companies over the last 15 years

The production linked incentive (PLI) schemes announced this year have added impetus to the above case. Calling PLI the story of the year would probably mean a repetition of the same structural story that was kick-started by a change in government's intent in FY19-20; visible in the tax cut announcements of September 2019.

Our story of the year, therefore, resides in the manufacturing sector that saw the first PLI announcement this year- pharma!

“India emerges as the pharmacy to the world”

It has been over a year with covid, yet covid related news still occupy the majority of our airwaves and mind space. For the first time since the second world war has the world been so fixated on a single topic for so long. The stories that made the most headlines in the 1940s pertained to the victim count or the tally of who won which battles. With the benefit of hindsight, the stories that altered the course of mankind however, were the emergence of technologies that we democratised and commercialised post the war. Computers, nuclear energy and the race to space- all a product of the war, have altered the course of history more than we care to admit.

Where the second world war has seen the democratization of physics, the covid-19 pandemic will lead to democratisation and commercialisation of biology at an unprecedented scale. Just as war invites us to spend money to push the envelope of physics, the pandemic has caused us to focus our spend on pushing the limits of biology to avert such a major health crisis in the future.

Small biology units that have only 1 or 2 molecules in development drive about 20% of volume in active drug development now. These small companies cannot afford to invest in manufacturing for small developmental batches. They have to rely on outsourcing. They will rely on India.

After having delivered medicines for Covid-19 to 133 countries; accounting for 20% of the global generics' production and 62% of the global vaccine production- India has arrived as the pharmacy of the world. And it is ready to capitalise on the democratisation of biology going forward. This is our story of the year, undoubtedly.

The Bigger Call

If I had to be extremely brave (and naive) I would call the next 50 years to belong to biology just as the past 50 belonged to physics with the democratisation of computers, the internet, renewable energy sources, race to space, etc.

In 2020, CRISPR Cas9 (gene editing) was first applied in the human genome to modify the gene causing blindness. With the boundaries that are being pushed in biology today, and with India having a ready skilled workforce but also the best-in-class manufacturing facilities, I cannot wait to see what this wave brings to us.

Best Regards,

Team Tamohara

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