Global Asset Management

India: shooting for the moon

Notes from the road

Emerging Markets Equity team

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"Hyderabad also has an eclectic cultural and religious mix. Its two official languages are Telugu and Urdu, and most Hyderabadis are bilingual. This gives the city a very welcoming feel."

Landing at 5.30am on the direct flight from London to Hyderabad, the vast metropolis before us is the capital and largest city of the Indian state of Telangana, in the south-east of the country. Its population of 10.8 million makes it the sixth most inhabited metropolitan area in India.

At an average altitude of 542m, much of Hyderabad is situated on hilly terrain around artificial lakes, yet it is also ranked within the top five largest urban economies in India[1]. From the 1950s to 1970s, the largest contributors were the heavy industries of defence and aeronautics. By the 1990s, the services sector, with its IT and financials companies, had taken over. The real game changer, however, was when the government established the Indian Drugs and Pharmaceuticals Limited ("IDPL") agency in 1961. In the subsequent decades, many national and global companies have followed suit, opening manufacturing and research facilities in the city.

Today, Telangana state contributes nearly one-third to India's production and one-fifth to its exports in the pharmaceuticals sector[2]. Hyderabad itself is considered the life sciences capital of India, with over 800 such companies. The state's 'Vision 2030' is to become the leading life sciences hub in Asia, through innovation-driven and tech-enabled growth[3], while doubling the sectoral value to USD100 billion and adding 400,000 new jobs.

Hyderabad also has an eclectic cultural and religious mix. Its two official languages are Telugu and Urdu, and most Hyderabadis are bilingual. This gives the city a very welcoming feel.

[1] India: home to the world's fastest growing cities | Statista.
[2] Pharma – Invest Telangana.
[3] Telangana: Life Sciences Vision 2030.

Hyderabad is expanding.

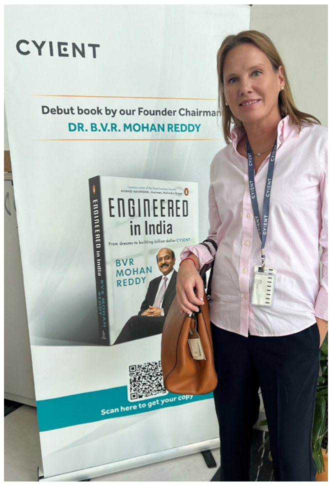
Rajiv Gandhi International Airport, also known as Hyderabad International Airport, is super efficient. The newly-built (or so it feels) highway into the city is tree lined and bordered with manicured plants and flowers. This lush and green appearance is clearly due to Hyderabad's tropical clime. Still, as is the case in many such large metropolises in emerging markets ("EM"), the speed of economic growth can wreak havoc on the environment. Hyderabad rates poorly on the Air Quality Index, with construction sites, rubbish ignition and high pollution caused by burning fossil fuels the main culprits. Vehicles ranging from trucks to motorcycles, scooters and three-wheelers are key contributors to this air pollution. In fact, India is home to eight of the worst cities globally as regards air quality, and on both days we spent in Hyderabad, the Air Quality Index ranged around 150, which is considered unhealthy.

Despite this, the city is said to be loved for its climate, greenery and cosmopolitan atmosphere, and during our visit we noticed that many people we met were not actually from Hyderabad but have relocated there. The airport is efficient, the CBD is not gridlocked with traffic, and even in rush hour, vehicles move smoothly through the city. In short, things work. Our hotel, which is surrounded by impressive, modern offices housing pharmaceuticals, semiconductor and IT services multinationals, such as Qualcomm, Novartis and Verizon, is in an area which we were told did not exist in its current form five years ago. Unlike the current congested and overcrowded IT hub that is the city of Bangalore, Hyderabad can expand. The local state government, the Bharat Rashtra Samithi ("BRS") party, is very highly regarded and people seem generally content and happy to be living in the city.

The two days we spend in Hyderabad involve site visits with one of our companies, an engineering research and development ("ER&D") company, where we visit its centre of excellence. ER&D is a large total addressable market worldwide, worth over USD180 billion, but only a very limited portion is outsourced. This company provides global outsourcing of ER&D in the areas of telecoms, transportation, and sustainability. Impressively, it is at the cutting edge in terms of plant engineering and optimising operations but also carbon capture and storage for its customers. We undertake more site visits but this time to hospitals and pharmaceuticals companies, and we experience first-hand the scale and capability India has built up in the global generics space. The R&D campus we visit houses over 2,000 engineers who work on active pharmaceutical ingredients and formulations. Indeed, the operational scale in India never ceases to amaze us.

Next, we head to Mumbai to attend an investors' forum. The IndiGo Airlines flight from Hyderabad to Mumbai is packed but leaves on time, and the one-and-a-half hour journey is pleasant. The only thing that we remark upon as being slightly unusual is the in-flight announcement, as we are about to land, declaring that anyone over the age of 18 is eligible to vote. And these advertisements continue as we switch on the TV in our hotel room, with ads promoting civil voting rights and encouraging people to vote in the five major state elections taking place the following weekend. Chhattisgarh, Madhya Pradesh, Mizoram, Rajasthan and Telangana were set to head to the polls[4]. These states cover an area with a population size of over 200 million people. Clearly, the outcome of these elections will have some bearing on this year's central government elections, which are to be held in May. Another thing which stands out to us are the constant TV ads encouraging people to file their annual tax returns. In a country with a large fiscal deficit at a time when government infrastructure spending is high, the leadership clearly wants to focus its efforts on collecting taxes.

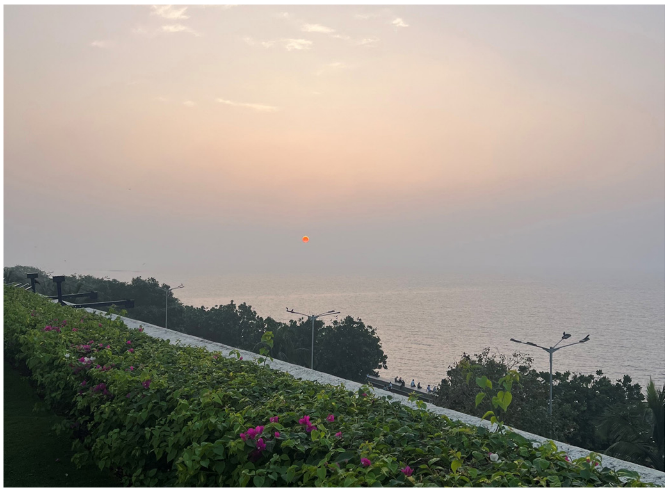
Visiting a pharmaceuticals company.



Visiting an ER&D company.

[4] Since writing this note, the ruling BJP party has won three of these five state elections, which was seen as a positive outcome ahead of the national elections to be held in May this year.

The R&D centre of a major Indian pharmaceuticals company.



Nariman Point, Mumbai.

The forum, which in previous years has been small in numbers, is now packed. Over 400 investors are in attendance and whereas in the past most attendees would be Qualified Foreign Institutional Investors ("QFIIs"), this time there is a large turnout of domestic investors, comprising roughly half the attendees.

There is an equally large and diverse number of companies presenting. We see power utilities, consumer staples businesses, motorcycle and aircon companies, mall developers, copper wire manufacturers, and both banks and non-bank financials. We also meet an Indian vineyard company for the first time.

It is noteworthy how diverse the Indian equity market is. In fact, there is little concentration risk, with the top five constituents commanding less than 30% of the MSCI India Index and the top 10 less than 40%[5]. Equally, the top two sectors are less than 41% of the index[6], much lower than some other markets globally and the EM average. Clearly, it is a stock pickers market. And the numbers will grow significantly over the next five years. 2023 alone saw over 200 IPOs – a record[7]. Domestic investors are also offering great support to the market with Domestic Mutual Funds' ("DMFs") ownership at a record high of 9.1%[8], and systematic investment plans offering a stable base of inflows into these vehicles. Furthermore, during the pandemic, Indian household savings in equity rose quite dramatically. Clearly a new investment culture is emerging in India, with the money sticky and supportive of the overall stock market.

Although the market is hitting new highs and valuations feel stretched, there is no sign of stress in the banking system. Therefore, despite very strong loan growth in 16% in 2022 and another 15% in 2023, there has not been any uptick in non-performing loans.

GDP growth for the third quarter of 2023 came in very strongly at 7.5%[9], driven mainly by Gross Fixed Capital Formation ("GFCF") and manufacturing. GFCF is the government CapEx spend into infrastructure, such as railway, renewable energy and other civil engineering projects, all areas where India does not have a choice but to continue to invest.

Whilst it is really impressive to witness what has been built so far this year, India still has an infrastructure deficit. What stands out more for us is that the companies involved in these projects – utilities companies such as hydropower businesses, or transmission and distribution companies which are state owned and known as public sector undertakings ("PSU") – increasingly act like commercially-minded, private businesses. In fact, the Indian government has qualified its top nine PSUs as 'Navratnas', a Sanskrit compound word meaning 'nine gems'. These companies have helped build India, all the while becoming classic case studies in capital allocation – paying out high dividends when growth is not there, and investing when it is. They are profitable PSUs with excellent management, and they are no longer susceptible to political whims but act like the world-class companies they are.

We have found companies with quality management and operations, and which we feel are still at palatable valuations, something that is not always the case in India. And for those that remain expensive, we have a shopping basket ready and waiting for when opportunities arise.

We come away from our trip feeling positive, as India exudes a real 'can do' attitude. It's no wonder… it's the country that put a rocket on the moon!

[5, 6] MSCI, Bloomberg.
[7] India's IPO boom: a red flag or a sign of robust investor confidence? (thenationalnews.com). [8] SEBI, CLSA.
[9] Reserve Bank of India.

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