India: firing on all cylinders

Notes from the road

June, 2023

Emerging Markets
Equity team

> "This is India – a great bustling mix of religions, languages and customs."

Arriving at New Delhi airport on a Sunday morning in May, it strikes me that everything works. The plane is on time, the gurney connects, and I walk through immigration in a matter of minutes, after what feels like a seamless journey. My bags are on the luggage belt before I even get there.

Stepping into the Delhi heat, however, quite literally takes my breath away. It's 39˚C and only 9am. There's a dry heat that seems to burn my skin instantly, even in this early morning sun. However, what impresses me, as we drive through the wide, tree-lined streets of New Delhi, is how clean everything is. The motorway has four lanes on either side, there are no potholes and, despite the heat, the city is incredibly green. This being India's year to host the G20 summit means Delhi is the showcase for arriving world leaders to see what this great emerging economy has to offer.

Passing the breathtaking Red Fort on the way into town, it reminds me of how India in Mughal times was a great global economy. The Mughals were responsible for uniting India, creating a common language, a currency, and a great global trading nation. During their time, India prospered, and its agriculture, tea and textile industries fed and clothed the world. The country constituted a quarter of the world economy during that period[1]. However, by the time the British left in 1947, this had shrunk to just 4%. Today it stands at just over 3.5% and is set to rise meaningfully by 2030[2]. Next to the Red Fort is the bustling Chandi Chowk market, where every single square centimetre is crammed with goods, flowers, vegetables, rikshaws, motorcycles and scooters zigzagging through the crowds, while cows roam around without a care in the world. What a juxtaposition to the broad boulevards of New Delhi. This is India – a great bustling mix of religions, languages and customs. I can't wait to find out what the companies will say.

[1] Source: Jeffrey G Williamson and David Clinginsmith – India's Deindutralization in the 18th and 19th centuries.
[2] Source: IMF, World Economic Outlook.

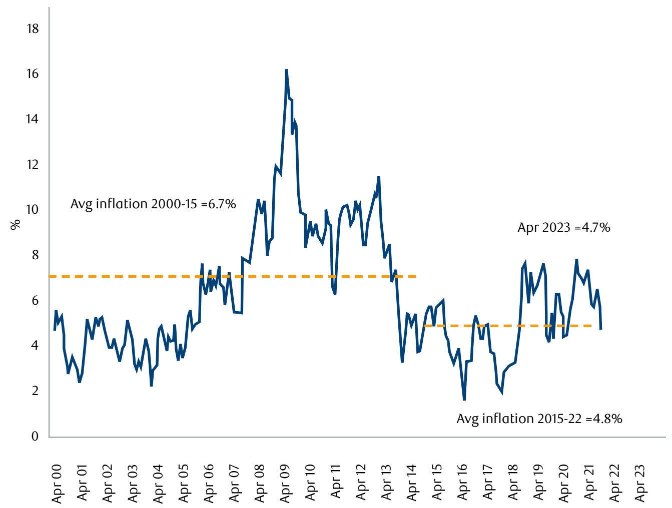
The conference that I'm attending begins with a macro day and I listen to a variety of presentations from government bodies, political commentators, the Ministry of Railways, India Stack, the Open Network for Digital Commerce ("ONDC") and a range of local and international banks economists. An initial observation while attending the same conference as last year is that there are a lot more foreign investors – in fact, there is an 80% larger turnout this year versus last year. This is not surprising given that the main stock market index, the Sensex, has traded sideways for a year and earnings have had a chance to catch up. This means valuations look more palpable now, even if they are still at a premium to global averages. Conversations amongst foreign investors mostly begin on the same topic, which has been given the acronym "ABC" (anything but China), and clearly India as the world's most populous nation, having officially overtaken China this year, is a beneficiary of that.

It is clear that India is firing on all cylinders. Unlike Western economies, India's inflation is under control with the CPI at 4.7% year-on-year[3] and coming down. For a country used to high inflation, this is not only lower than economist expectations, but more importantly, well within the comfort zone of 4-6% of the RBI[4]. GDP growth is also outpacing expectations at just over 7%[5].

India typically has question marks over its twin deficits. However, on the current account deficit, the strong trend we have seen in India's services exports has helped the deficit to contract. On the fiscal side, India has experienced a rise in all kinds of tax collections, the rollout of the GST, and India's universal ID (Aadhaar) has brought 1.4 billion people into the formal sphere, making tax avoidance much harder.

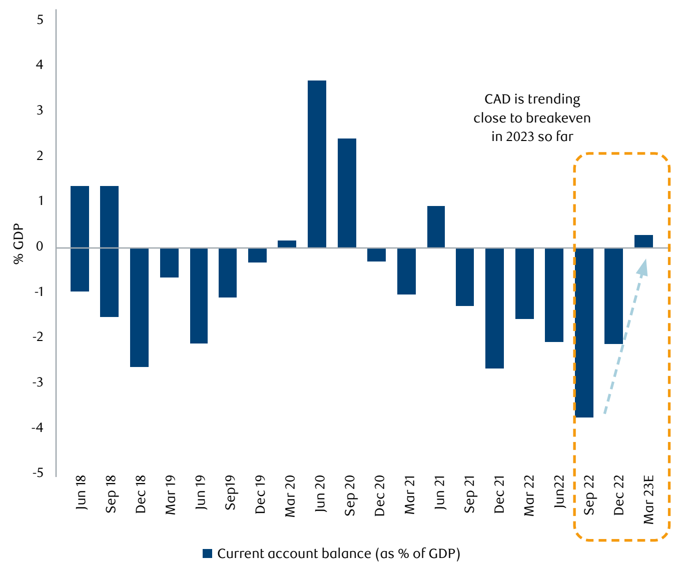
Benefitting from the uncertainties in global geopolitics, India is attracting FDI at a rapid pace. The aim is to grow the manufacturing part of the economy up to 25% from the 13% it is today[6] and with the Production Linked Incentive ("PLI") scheme set up in 2020, the government has targeted 14 sectors ranging from mobile phone assembly to semiconductor and pharmaceutical manufacturing. This includes subsidies to incentivise both local and foreign companies to set up production facilities. There are several announcements that are imminent, we are told, and whilst we have seen the likes of Tesla, Apple, Samsung and Foxconn set up low end assembly facilities, these new announcements promise to be in higher value-added segments such as semiconductor manufacturing, something which would have been deemed impossible as little as five years ago.

Exhibit 1: Inflation in India is under control



Source: CMIE, MOSPI, as at April 2023.

Exhibit 2: Sharp improvement in current account deficit



Source: Ministry of Commerce, India, as at March 2023.

Logistics – which has been a major problem in India and the reason why India has not seen more FDI until now – has had a major boost. India's railway network has experienced an unprecedented level of investment. In fact, under Prime Minister Modi, this last decade in India has seen more railway tracks laid than in the entire time since independence in 1947[7].

[3] Source: RBI, April 2023.
[4] Source: RBI, January 2023.
[5] Source: Ministry of Finance, India.
[6] Source: Ministry of Commerce, India.
[7] Bank of America, BofA Securities "Equity Strategy – India. India Pollution Primer", November 2020.

Factory site visit, Chennai.

EV 3-wheeler charging facility site visit, Chennai.

The banking sector is also in good shape, being well capitalised with system NPLs having fallen to below 4% from the 11% we saw in 2018[8]. Meanwhile, corporates have delevered and the D/E ratio is at the lowest level in 20 years, while private sector debt is only at 80% of GDP (much lower than developed markets at 160%)[9]. Consequently, we are seeing system credit growth of 14-15%[10] and private sector CapEx is therefore expected to pick up.

Domestic investor flows have been very strong and domestic mutual funds are pumping in USD20-30 billion per annum through the systematic investment plan ("SIP")[11]. This is therefore a more institutionalised and more disciplined way of investing, giving a sense of stability. It is a long-term structural story and can sustain for several decades, in our view. Indian households have been seeing the equities portion of their balance sheets rise, funded by gold jewellery. This is the financialisation of assets.

We then hit the road to Chennai, in the south of India, to do some site visits. Quite chaotic and less showy than the capital city, Chennai is still a thriving coastal city, home to many industrial companies. There is a real 'can-do' attitude about the place, and a palpable sense of national selfwe meet are looking forward and thinking about scaling their businesses both domestically as well as internationally. There are partnerships underway with many major U.S. and European industrial groups to help them move up the value chain away from the low-end metal bashing businesses that India has been renowned for, and more able to compete on the international stage. Meanwhile the NBFCs ("Nonbank financial companies") are happy to lend to many SME start-ups with vehicle financing and loans against property.

In Chennai, we visit an EV charging station where 3-wheeler vehicles can get a fast charge. These 3-wheelers, usually in the form of rikshaws or taxis, serve a different purpose. They are used in the last mile delivery logistics networks of many large e-commerce companies, such as Amazon, Flipkart and Zomato.

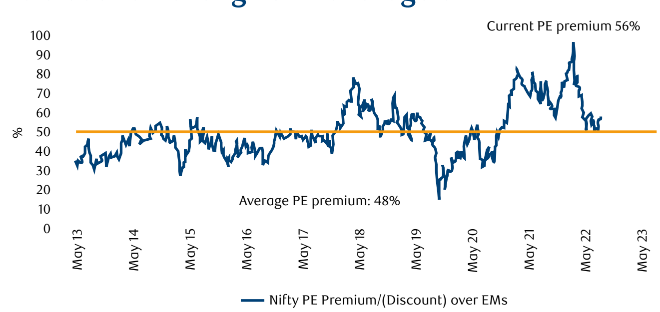
We also visit one of India's leading private hospital chains and are impressed with its volumes and success rates. India's national healthcare is notoriously bad, hence private healthcare is a significant growth area.

Exhausted and perspiring in the heat, I marvel at how these doctors and people in general can work so hard and with such a positive attitude. It really does feel that while India has done a lot in order to get here, there is a confluence of factors that are now aligned at a time when we are seeing a change in world order. Perhaps it is finally India's decade?

Indulging on South Indian curries and dosas for breakfast, I am glad that I've managed to avoid the infamous Delhi belly but know I shall have to pay for it and diet when I get back home. Now comes the difficult part, which is deciding which companies to invest in, given the high quality of management, franchise and corporate governance of the companies we met.

As always with India, valuation is challenging given the country trades at a substantial premium to emerging markets. However, the premium has come down to the historical average in recent months, which may present an opportunity to add to our exposure.

Exhibit 3: India's valuation premium to EMs is close to its long-term average of 48%



Source: Bloomberg, Jefferies, May 2023.

[8,10] Source: RBI.
[9] Source: Company data, Jefferies.
[11] Source: Government of India, Jefferies.

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