

TRANSCRIPT: EPISODE 204
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[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. Today we're focusing our attention on India, one of the most compelling growth stories for investors over the next 10 years.

Chris Salih (CS): I'm Chris Salih and today we're joined by Mike Sell, manager of the Elite Radar Alquity Indian Subcontinent fund. Thanks for joining us today Mike.

Mike Sell (MS): You're welcome, nice to be here.

[INTERVIEW]

CS: Let's start with something simple. So obviously the fund looks tap into India's growth story. Could you maybe tell our listeners who know little or nothing about India, just about that growth story what's happening in the region and sort of size of the opportunity in India.

MS: Yeah, great. Thanks, Chris. India has one of the most exciting growth stories anywhere on the planet over the next three, five and ten years, and that comes down first lead you to the demographics. India has a population of 1.4 billion people that is growing at 1% every year. And the average age of the population is pretty young at 28.4 years. So that young, growing, youthful population is driving the growth that we see in India.

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In addition, from that, we see a couple of other trends, people shifting from the villages into the towns and the cities increasing urbanisation from a relatively low level. We're also seeing particularly over the last few years, a shift from the informal or the black economy towards the formal organised economy. That's great for the companies that we invest in as they're taking market share from the mom and pop unorganised sector. And also, we've been seeing a shift over many years now from very old-fashioned bureaucratic state-owned companies towards a much more thriving and dynamic private sector. These reasons combined are why India is that such amazing opportunity that we see.

CS: You mentioned those old-style companies to a thriving dynamic sector. Let go straight into it. Maybe just give us a couple of examples in the portfolio of those companies.

MS: Sure. So, the first one would be Lemon Tree hotels. Think it a bit like a Premier Inn type of India and Lemon Tree benefits from a number of factors. Firstly, people have more leisure time. They're going away in India themselves more to spend time on vacation. So that that's an important trend. That's obviously being accelerated as we come out of COVID with people wanting to go out and have experiences. Secondly, people are moving away from the family run unbranded bed and breakfasts towards an organised hotel chain with a consistent level of service and quality throughout India. So it remains very, very affordable.

The number of hotel rooms in India is a fraction of that of China let alone somewhere like the UK and the US. And there's very little new supply coming up. Obviously, everything's been delayed because of COVID and therefore you have long term structural domestic drivers and its that domestic bit that's critical. This isn't about tourists coming in. There's some of that, but it's about the Indian middle class spending more time in India on vacations, combined with a mismatch of supply and demand. Hence, we see very strong growth opportunities.

Also, a focus on the environmental and social side is hugely important and Lemon Tree have set targets for reducing their environmental impact as well as for employing more diversity in the workforce. That's something that we're really pleased about. So that's one example.

A second example would be Vmart, which is a retailer in the smaller towns and cities. So, people instead of shopping in a one store chain or a market store are going to stores like Vmarts, where again, the consistency of the quality is good. It's a low price point. They have advantages

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because of their scale to be able to purchase in bulk, you can use your credit card there, it's air conditioned, longer opening hours. And there is very little competition in this space.

So again, with people having rising incomes, people moving into the organised sector from the unorganised sector and just that overall population growth is hugely positive for first movers like Vmart. And these are the kind of names that are on the smaller side of the Indian market, but where we see the biggest growth. As I think I've hopefully highlighted, India's changing dramatically and it's these new, smaller, private sector companies that really encapsulate that growth opportunity. And it's where we focus our portfolio.

CS: I was gonna say, one of the things you talk about is obviously you focus on the domestic Indian growth story, which can be sort of different to the wider growth story. I mean, that helps you pull out some of those hidden gems perhaps as well, that some of some others may not see?

MS: Absolutely right. India in terms of the export side is coming from a very low base. It is beginning to rise and India's a world leader in software. And we have some of that in the portfolio to encapsulate some of the outsourcing trends that we're seeing in the West as people want to cut costs and also want to move to a cloud-based IT systems. But you're absolutely right. The vast majority of our portfolio focuses on that domestic growth story. And that is the advantage of India versus many, many other countries. The growth is coming from within and is much less linked to what we're seeing in developed markets.

CS: Okay. Let's turn to one particular sector within the region. Let's talk about financials as an area you've been positive on. Could you maybe give us a bit more insight into that?

MS: Yeah. So we see real value in the financial sector. Firstly, you have an improving economy, you have political stability as well. Interest rates are rising, but only gradually and inflation is relatively well controlled. Now, as we move over the next 12 months, we're expecting GDP growth of above 7%, obviously much, much higher than what we're gonna see in the UK or Europe or the States. And the banks are well positioned to capture both margin improvements as well as faster lending growth. As we see that very correlated Indian economic cycle pick up. Now, the valuations also are relatively low versus other sectors because investors are taking a wait and see approach, but having been investors in India for over 25 years, we very much look forward to what's gonna happen rather than waiting for it to appear. And we can see this

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economic recovery and therefore the banks are a mispriced opportunity in our portfolios, which we're taking full advantage of.

CS: So if we take a step back and just look at the world as a whole at the moment, could you maybe give us an idea of what role you believe India has in a wider investment portfolio and sort of what you feel are the benefits?

MS: Yeah. India is different to many other countries because firstly it's size. And secondly, the growth comes from within. It's about the demographics is about the shift and the unorganised to the organised economy. It's about the rising levels of urbanisation. It isn't at this moment about exporting huge amounts of consumer electronics to the West, where obviously we're seeing a slowdown in growth, which is gonna feed through. India's not about that. It's about its own domestic story. That means when you are looking at your overall investments, it has very different drivers of growth than most other things that you will own. It's very uncorrelated. And that's why we think it deserves a particular place for the long-term investor.

You have your positions in the UK, in the States, elsewhere in Asia, but this gives you something you're probably not getting to a large extent elsewhere. And we've seen over the last five or 10 years, more and more people are beginning to have a dedicated allocation to India. And we think that's a trend that's going to continue. As other people see the really, really great and unique story that is that market.

CS: I wanna touch on a couple of others things. Firstly, are valuations. Now India is not the cheapest market in the world, but there are reasons for that, which I would like you to go into, but also maybe explain to investors why long-term valuations aren't perhaps the most important thing too. Well, they're important, but the they're not enough of a reason to not consider India. Why is the long story being so strong that they should back this for, you know, five, 10 years and beyond.

MS: Absolutely. Now, if you look at valuations of the Indian market over the last 20 years, it has never, ever been cheap. The reason for that is that you are paying not for the next one- or two-years growth you're paying for the next five, 10 years growth due to those demographics. We talked about, remember no other country in the world has or ever will have such good

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demographics, because nowhere else is big enough. And so that's why valuations have always been higher than somewhere like Korea.

Also governance in India is much higher than we see in Korea, which also deserves a higher valuation. Now these high valuation levels, don't preclude be able to make very, very strong returns in the market. And we've seen that over recent years as well, that India's been an amazing performer for investors. So we have to look at it in that long term context and we are paying for the growth that we see over that extended period. It must be said that, you know, India is not a quick trade. It's something that you need to own for an extended period.

CS: Perhaps the one fly in the ointment at the moment is inflation and particularly high oil prices and the threat that has to India as an importer. Could you maybe talk to us about that and the worries you may have over that or how you see that playing out for India?

MS: Yeah. Two of the main drivers of inflation in India are food prices and oil. Now India can feed itself which is a change from a few decades ago and the harvests have been good for a couple of years now. And the monsoons that are happening currently, also are looking okay this year. So the food price inflation element is actually okay.

However, oil obviously is being ramped up as it is elsewhere in the world that has fed through to inflation, but inflation is around 7% and that's where we expected to be later in the year, actually lower than we see in the UK because there's other offsetting things I just mentioned. So, it does give a headwind in terms of consumer spending and overall inflation. We are seeing interest rates rise, but it's not enough to derail the economy. Also, when it comes to the current account deficits, India does export more than it did previously.

And so whilst again, this is acting as a headwind. It no longer is such a severe headwind than it has been previously and given Modi and India's commitments on increasing their use of renewable energy to meet their carbon reduction targets over the coming years. The dependence of India on oil will diminish further as they ramp up wind and solar. So this is something that we think is going to ease further.

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So to summarise, yes, it is a headwind as it is for many, many countries, but actually less of a headwind for India than previously, and certainly less of a headwind than we've seen in other countries, including those in the West.

CS: You mentioned the Prime Minister there, obviously India, perhaps it's like different some of its peers in terms of the state of its politics. Could you maybe just touch on that? And also, some of the stuff that's been achieved by Modi in the past few years and the benefits that's had to the economy.

MS: When Modi became Prime Minister a few years ago, we were quite excited because his track record as the chief minister of good showed very much that he was a reformer and invested heavily in modernisation and infrastructure. And we've been satisfied that he's applied those principles to the country as a whole. So we have seen elements of reform such as a unified tax system a lot of spending on infrastructure, some labor reform. We would hope to see more before the next election comes up in a couple of years. But he's done an awful lot to be fair to him.

Now his popularity remains very, very high and the recent state elections he did okay, better than people expected. And that's been the trend with Modi. He tends to do much better in elections than people expect. That's partly helped by his track records infrastructure development growth, but also the opposition, the Congress party are in a very big amount of disarray. And so they're very, very weak currently. So, given where we are now, and I'll see the next national elections a couple of years away, and a lot of things can change, but he looks set fair to win another term, which will be a further catalyst for the market when it comes.

CS: It brings that sort of level of stability that perhaps isn't so well sort of common in the region is it's another sort of, you know, strength of the bow of India's retraction.

MS: Absolutely. And India's not had a period of political stability like this for some time. And so that's great for investor confidence. It's great for the country making the long-term decisions that it needs to do for development. So, the stability that Modi has brought and will continue to bring is another pillar for the investment case in our view.

CS: Okay. Just lastly, I wanna talk about sustainability, which is a big part of the fund, but also Alquity as a business, I believe you donate a minimum of 10% of revenue to charitable projects

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in the region. Could you maybe explain a bit more about the Foundation, the role it plays at Alquity and also give us an example of a project?

MS: Absolutely. So sustainability is multifaceted for us here at Alquity. We only invest in companies that meet our criteria on environmental, social and governance issues. So we rule out a whole trend of companies that don't meet, that we weren't invest in them. Secondly, the greenhouse gas intensity and the water intensity of our portfolio is less than that of the Indian market as a whole. And that's something that we will maintain, but thirdly, it's coming to your question through the Foundation, we donate 10% of our revenue to social enterprises in the areas that we work on.

Now, why do we do that? Well, even if you have the best run most environmental, social and governance focused companies, anywhere, there are always segments of society that get left behind by business or by governments. And so, we want to support those to give those people a leg up into the formal economy and returning something into the areas that we invest in. And this comes out of our equity revenues, not out of the funds per se.

So, I'd like to give you maybe just one example of this now in India. When you go to a temple or a mosque, you take flowers with you as an offering. And what typically happens at the end of the day is that these are then thrown away into the river, wherever it may be causing pollution. So one social enterprise that we supported is called Phool. And what Phool will do is they take these flowers, and they make nonpolluting incense sticks from them, which they then sell.

So, this has two great things. Firstly, you're removing pollution that otherwise would be there. And secondly, you're employing people who perhaps otherwise wouldn't have a job in the formal economy that disadvantage just their family situation, whatever it may be. And you're giving them a national insurance number, a proper wage, et cetera. And so, this is a great end in itself giving these people who've been left behind society a chance to enter the real economy.

We then complete the circle by actually meeting with the beneficiaries of these projects and discussing with them, their aspirations, their consumer habits, which then influences our portfolio positioning as well. So not only are we doing something that we are very proud of, it also helps us make better investment decisions. And I believe we're pretty unique in terms of this

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business model, which is something that we've always done at Alquity since we were founded a number of years ago.

CS: That's great, Mike, thanks for talking to us about in India today.

MS: Great. Thank you.

SW: The Alquity Indian Subcontinent fund is a unique offering as its domestic focus often sees the team look past the larger companies in the index and invest in businesses which tend to be overlooked. To learn more about the Alquity Indian Subcontinent fund visit our website fundcalibre.com and don't forget to subscribe to the Investing on the go podcast, available wherever you get your podcasts.

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