India Avenue
Investment Management

"There are many parts of the world that, once visited, get into your heart, and won't go. For me, India is such a place"

- Keith Bellows, National Geographic Society







India Avenue Investment Management's first

INDIA GRASSROOTS TOUR – March 2018

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India Grassroots Tour

Purpose of our Tour

India Avenue Investment Management (IAIM) conducted its inaugural ***Grassroots Tour*** of India from March 11-14, 2018. The Tour included nine delegates from family offices, wealth management, financial advice, superannuation fund, stockbroking firm, consultant and a Pacific Nation pension fund. The location of the Tour was Mumbai and Pune, on the Western side of India.

The purpose of the Tour was to explore India's virtues as an investment destination for Australian, NZ and Pacific Nations domiciled investors. Through the Tour we seek to increase knowledge and transparency as well as provide significant insight, which can move potential investors along the curve of discovery. As a result, we also seek to dispel some of the common negative myths about investing in India.

It is our view that observing India at a grassroots level provides potential investors with a significant advantage in making an informed investment decision about allocating capital to the India growth story. We also feel that it also provides deeper insight into IAIM's connectivity within India's capital markets and highlights its investment process, which it applies to optimise exposure for clients.

India is effectively 29 states with varied potential, cultural influences, dialects and comparative advantages. We therefore seek to run our ***Grassroots Tour*** annually, across varied locations in India to build our clients understanding of the countries potential, now and into the future.

Insights Day 1

On day one of the tour our intention was to bring several speakers to our conference centre at the Grand Hyatt in Mumbai. Despite it being a Grassroots Tour as such, Mumbai is a difficult city for logistics, with travel time being significant. Given this, it was our view that Day 1 where delegates dealt with jet lag, that speakers would come to us and we would end the day with a visit to the world's 3rd largest slum, to witness consumption and activity at the bottom of the pyramid.

UBS Strategist

Our first presentation of Day 1 was given by Gautam Chhaochharia, Head of India Equities Research at UBS. The key takeaways were as follows:

India is growing at a pace above its developed and developing partners. This is being driven by India's demographics and policy reform initiatives. This lays the platform for secular growth over the next few decades. Typically, in some growth economies, stock markets are not investible. However, in India the market is deep, liquid with several sectoral and stock opportunities.

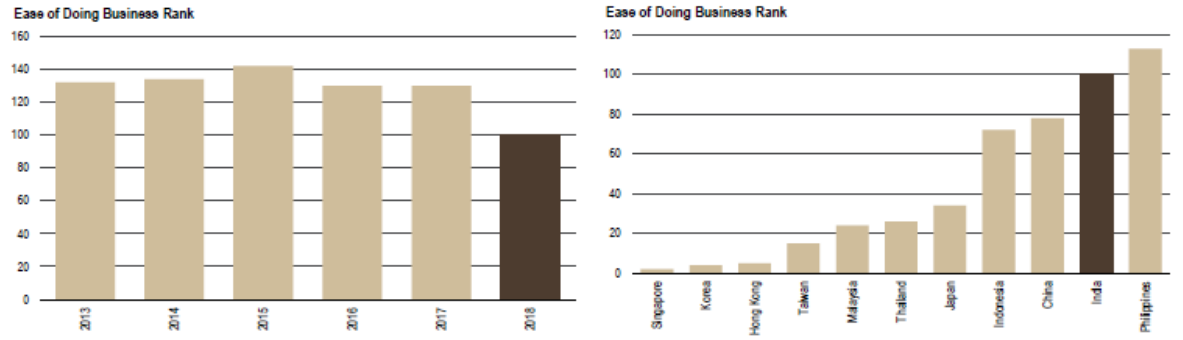
India vs China

- India's demographics will drive its growth at a faster pace than China. It has significant catch up on a GDP per capita comparison, working from a low base.
- Working age population of India's is expected to stay at close to 68% while China will start dropping rapidly, given that they have an ageing population. India will contribute significantly to the global working population going forward.
- Trade openness as a % of GDP has caught up to China. China's manufacturing wage has accelerated significantly, not making it a comparative advantage it once had.
- India needs to catch up on internet penetration, particularly in terms of no. of users.

The state of Indian politics remains supportive of continuing reform. The Modi led BJP appear to be strengthening their position across states leading up to the next National Elections in May-2019. Whilst many reforms are already completed, there are still many that are ongoing and important. These include Banking, Labour, Corporate Tax, Real Estate and Land acquisition.

Gautam also pointed out that foreign businesses continue to invest in India and ownership laws were being relaxed by the Government of India (GOI). Companies like Unilever, Proctor & Gamble, Nestle, Colgate, Castrol, Suzuki, Honda, Gillette, Hitachi, Siemens and Oracle to name a few had been in existence in India for a long period. As India's reforms kicked in and ease and cost of doing business improved, it will be likely that foreign businesses will seek greater exposure to the growth story. In fact, the ease of doing business has taken on significant priority with simpler and faster systems, greater transparency and efficiency, online processing and documentation and reducing hurdles for labour and licensing. Over the last 12 months Foreign Direct Investment (FDI) limits had been raised for Defence, Railway, Construction and Insurance.

India's ease of doing business ranking improved but still behind peers – PM's goal of moving to 50th rank



Source: World Bank, UBS

GST is a critical reform to taxation with increased formalisation to drive a higher tax to GDP ratio. Currently this ratio has remained at 5-6% of GDP since FY08. GST speeds up the process of formalisation. Across industries, the level of formalisation is approximately 50% which is quite low.

The national biometric identification card – The Aadhaar Card, has over 1.19 billion identities registered. This system, amongst many other things, will help with leakages, improve financial inclusion and rural penetration which should potentially lift GDP by up to 1%.

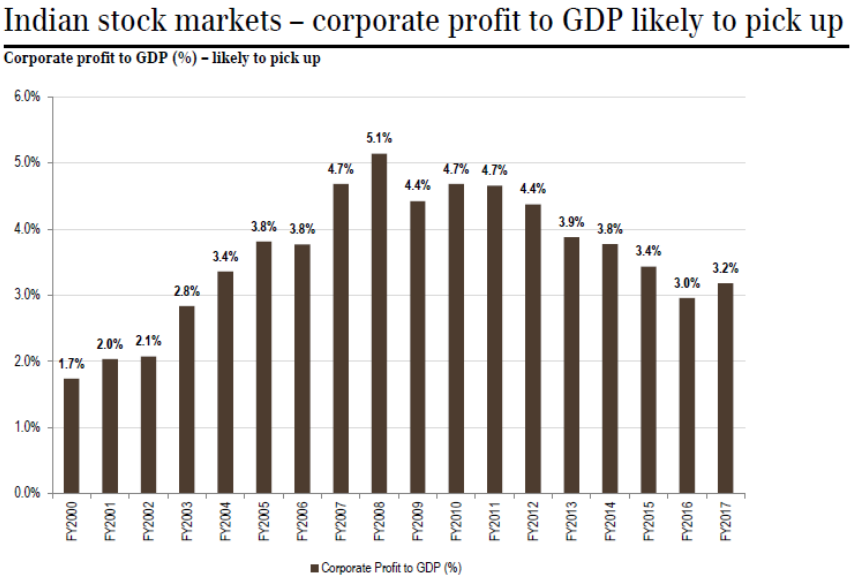
Government Focus:

- Housing for All by 2022 will involve the significant building of low-cost housing. This will require significant GOI and private spending and can add again significantly to GDP.

- Other areas where significant infrastructure growth will occur includes Roads ($90bn over next five years) and Ports (60% higher traffic by 2022). 100% FDI is now allowed in both areas (Macquarie recently bid and won a toll roads project).
- The Government is to spend $140bn on railways in the next 5 years including hi-speed, projects related to coal mines, ports, electrification and suburban corridors. $18bn of which will be spent on a dedicated freight corridor. (currently passenger and freight occupy the same rail)
- Estimates $1 trillion required for Smart Cities (100) by 2022. Private investments and PPP models for townships and cities.

India's growth and its demographics is leading to the emergence of certain industries:

- Two-wheeler and Four-wheeler vehicles
- Airline industry
- Multiplexes
- Pizzas
- Pharmaceuticals



From a corporate perspective, profits have been weaker relative to GDP over the last 10 years after reaching a level of 5.1% (of GDP) in 2008. However, this has fallen given lower profit growth since 2008. FY2017 was the first increase at 3.2%, increasing from 3.0% in FY16.

Source: UBS

Emerging Market stock markets have always been tainted with being volatile, illiquid and not have sectoral diversity. However, in India's case it has a market traded with T+2 **settlement**, an active derivatives market which is liquid and 6,000 listed stocks with significant sectoral diversity, without the same influences of Commodities, Oil, Banking seen across other EM countries.
Typically, these markets tend to be volatile as foreign investors dominate trading and this creates rapid movements, given they are peripheral investments to core holdings of developed market equities. However, as local investors increase the percentage of household savings invested in equities, the volatile reduces. In FY2018 due to demonetisation, Indian markets saw retail participation increase to 7.5% from 3% in FY17. This change appears structural as most investors have set up monthly investment plans, deducted from their salaries.

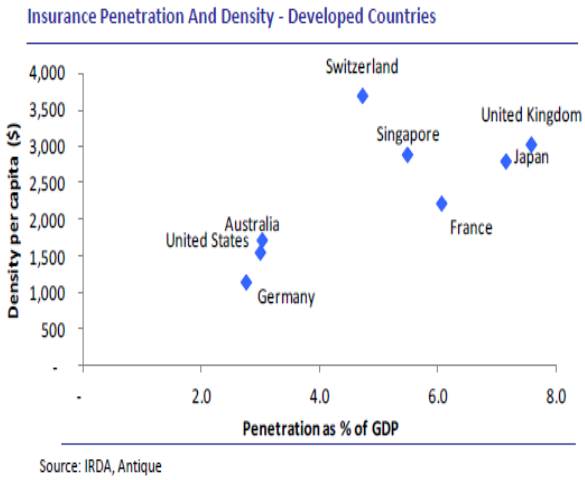
Antique Stockbroking Analysts

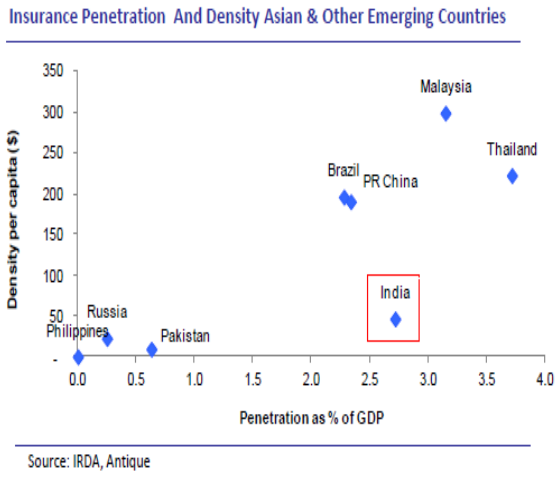
Insurance

India's life insurance sector has a lower penetration than most developing and developed country peers. The sector is experiencing solid growth since 2015 which is driving operating leverage.

Household savings remain high at around 24% of GDP. Life insurance premiums as a percentage of household savings have dropped to 23% from a peak of 31% in 2012. India also have one of the largest protection gaps of 92%, relative to 33% in Australia.

Premium growth has averaged 13% over the past decade, with private share increasing from 16% to 27% over that period. Listed opportunities are also increasing significantly with several asset managers/banks floating their life insurance business.

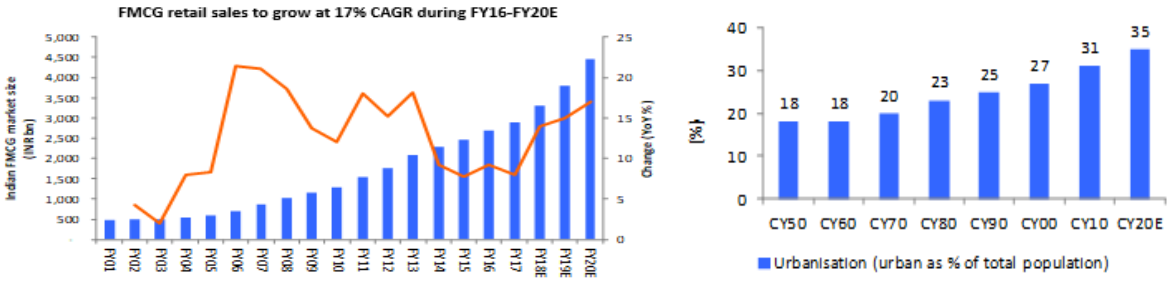




Consumption

During the next five years, we expect volume growth in consumer companies at 7-8% p.a. (in line with GDP growth) while price growth to be at 4-5% per annum. Therefore, revenue is expected to grow at 12-13% p.a. during the next 5 years for the FMCG sector. Categories and companies with high focus and scope of increasing rural penetration will outperform revenue growth in consumer categories.

The implementation of GST, higher prices of agri-products, increase in social spends in rural markets (considering closing in of the National Election) and improvement in road infrastructure will be key catalysts for growth in consumer products.



Source: Antique Stockbroking

Drivers include rising GDP per capita from 1,423 in CY10 to 1,989 by CY18. Rising number of households (264m to 305m) with increasing number of aspiring, affluent and elite (from 12% in 2015 to 36% by 2025). Shift from unbranded to branded will increase post GST. Organised retail to grow from 9% (FY16) to 12% (FY20). The trend towards increasing urbanisation will also drive growth.

Logistics

The Logistics sector is well poised for strong growth over medium-to-long term with volumes driven by 1) revival in domestic macro, alongside government initiatives like "Make in India"; 2) expected benefits from the rollout of infrastructure projects including Dedicated Freight Corridor (DFC), port development and investment in road infrastructure, 3) benefits from policy measures such as GST, 4) a higher level of containerization, and 5) growth in the e-commerce segment.

Indian logistics landscape is rife with fragmentation and inefficiencies. Unorganized companies still dominate the industry, accounting for 70-80% of the business mix. In response to emerging regulations (GST), Indian Logistics landscape could witness an evolution of organized industry participants. As the industry shifts from unorganized to organized, the need for supply chain performance improvement and the need for logistics companies that serve as supply chain partners will help advance investment opportunities. We see 1) Transformation of road transportation; 2) Emergence of multimodal logistics parks and 3) Emergence of a business-to-consumer (B2C) omnichannel ecosystem. Companies driven by innovation in technology and indigenous operating models that address inefficiencies are likely to drive this growth.

GST aims to resolve the tax complexity, drive more efficient cross-state transportation, supply chain efficiencies, streamline paperwork for road logistics operators and bring down transit time and logistics costs for industry. The benefits are likely to be more for road logistics and warehousing companies. The rollout of GST would drive: 1) Consolidation of the warehousing space; 2) Greater deployment of an efficient hub-and-spoke model; 3) Improvement in efficiency (and load factor) of road transporters on the back of route optimisation and reduced delivery times; 4) Reduction in tax evasion and major shakeout for unorganised "fly by night" transporters.

Cement

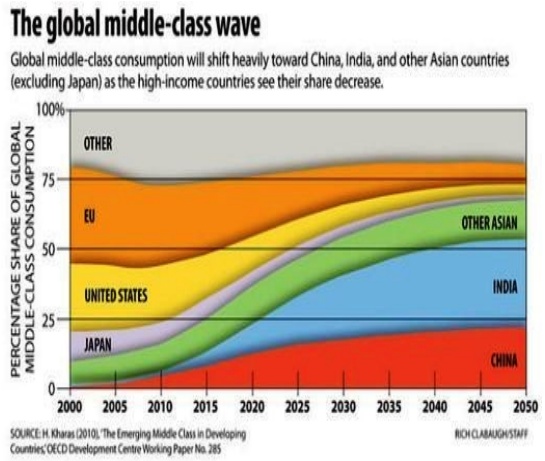
FY18 could be the first year of 7-8% volume growth as steps taken by NDA government are likely to benefit the industry. Construction growth picked up in 2HFY18, registering mid-teen growth in 3QFY18. While we acknowledge demand in the urban housing segment (primarily real estate sector) has been under stress, cement demand should continue to grow led by an improvement in rural demand and a pick-up in government infrastructure/low cost housing projects. Rural demand (35% of cement demand mix) should be healthy with two years of close to normal monsoons. Further, in FY19, the growth could be even higher compared to the past few years as we expect an increased focus on government spending given that it is the last year before general elections of 2019.

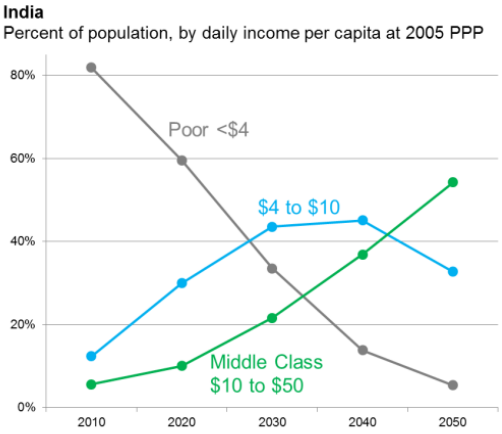
Cement is a highly cyclical industry which over invested during the last boom. Capacity utilisation is currently running low (66%) and P/E's are high. However, as demand picks up from projects like Roads and Housing for All, capacity will be used up. Cement tends to be very regional, illustrating India behaving more regionally rather than nationally in terms of demand (housing, infrastructure, industrial and commercial use) characteristics.

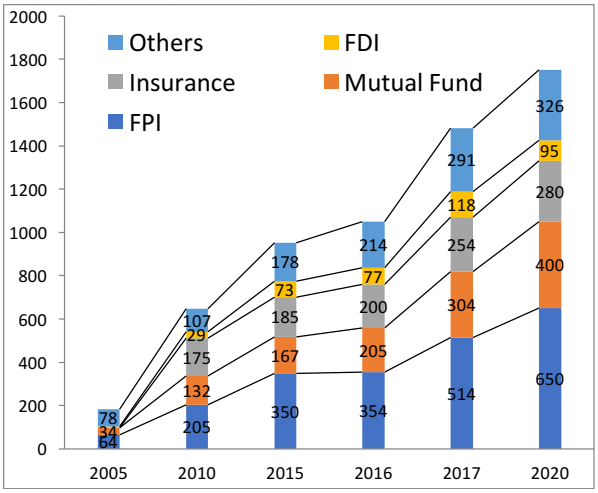
BNP Paribas – Custodial Services

India has traditionally been a difficult market to access for offshore investors. If you are not a passport holder or a person of Indian origin living abroad, you need a foreign portfolio investors (FPI) license. The rules were changed in 2014 to simplify and streamline the process, allowing custodians to determine appropriateness of licensing and the regulator to govern the process. Previously the regulator, SEBI, decided upon licenses under the foreign institutional investor (FII) regime, which made the process tedious and cumbersome. Today the process should take 4-6 weeks at most, with any delays being more due to the interaction and collaboration between global custody (used by the investor) and local custody.

Given India's demographics it is likely that investment in India continues to increase, particularly if you consider that by 2050 India will be one of the world's top 3 economies by size. The growing middle class likely to emerge given the youthful and sizeable population will lead a significant opportunity for listed corporates.







FPI is the largest contributor or AUC (35%) in 2017 followed by mutual funds (21%), insurance (17%)

Mutual fund popularity continues to grow as India's middle class develops and investor interests shift from physical assets to financial assets

Investment corpus in India's pension sector could cross USD1trillion by 2025

Fundraising through Initial Public Offering (IPO) in 2016 has already rose to a six year high of USD3bn

Despite the process of FPI being made simpler, there are still several other appointments which need to be made by the investor. This includes Local Tax Consultants, Local Brokers and a Local Custodian. Once this infrastructure is set up you can transact in India's listed securities with ease.

An FPI License can come in three separate categories. Cat 1 is predominantly for Sovereign Wealth Funds and Government linked institutions. Cat 2 is for most asset managers and pension funds, whilst Cat 3 is all others and may include individuals, trusts, family offices, charities etc. The 4-6 weeks includes KYC, Documentation, FPI Registration and Account Set-up.

With an FPI License, investors are forced to gain exposure to India through ADR's/GDR's of which there are only a few and p-Notes, which is a derivative instrument. In our view both are sub-optimal ways to gain long term exposure to India's multi-decade growth story.

KPMG

Investment into India's listed or non-listed markets are opening up in terms of ease, complexity and lower barriers. Several sectors have had their foreign ownership levels lifted to allow up to 100% foreign ownership, for e.g. Retail.

There are also now multiple routes of entry to corporate ownership in India. This includes the following:

- Foreign Direct Investment – Primary (automatic and via approval) and Secondary
- Foreign Venture Capital Investors – Start-ups
- Foreign Portfolio Investors – Category 1, 2 and 3
- Other investment structures – Alternative Investment Funds, REITS and Infrastructure Investment Trusts

For FPI's the tax applicable for Equities or Equity Mutual Funds are:

Nature of Gains	Existing	Proposed	Other Securities
Long Term	Exempt	10%	10%
Short Term	15%	15%	30%

Other Income attracts a tax rate of 0% for Dividend Income (taxed at source) and Interest Income (5%/20%).

GST is applicable from 1 July 2017, with a 5-tiered multi-tax system. It removes central excise duties, service tax, value-added tax, entry tax etc. The rates are 0%, 5%, 12% 18% and 28%.

Corporate Meetings

Dabur

Dabur is a FMCG company listed in India. Ayurvedic medicine has been core to its philosophy for 133 years. The key to the business is to make Ayurveda accessible to every household in India. The company undertakes a stringent quality test of every ingredient and has a strong R&D component consisting of Ayurvedic doctors and scientists. The company also invests by cultivating endangered herbs and plants.

The company is focused on increasing health awareness and a growing emphasis on natural medicines and holistic lifestyles. The underpinning fundamentals are increasing GDP per Capita, increasing consumption, increasing self-awareness and health and rising wealth in rural areas.

The company has 6.3 million outlets where its product is sold and 20 world class manufacturing sites. 30% of sales are to overseas markets, indicating an increasing preference of foreign consumers. The company has a market cap close to US$9bn and has experienced 15% p.a. revenue and profit growth over the past decade. Revenues are split across Health Care (31%), Home and Personal Care (50%) and Foods (19%).

Indusind Bank

IndusInd Bank is Mumbai based bank established in 1994. IndusInd Bank is the first among the new generation private banks in India. The Bank has over 1,300 branches and revenue of US$2.8bn. The Bank is well capitalised and does not suffer the same NPA issues as can be seen in many of the Public-Sector Banks.

The Bank has a Capital Adequacy Ratio of close to 16% and NPA's of 0.46% and has been growing its profits at above 20% per annum (last quarterly result was 26%). The Bank has a stable loan book and has focused on innovation, offering a wide range of banking products and working together rather than in competition with the fintech industry.

Sanjay Malik, the Head of Investor Relations went through the banking system in India and the history and legacy of public and private banks He stated the private sector today receives 70% of the new flow as they are quickly gaining market share from the large incumbent PSU banks. He also talked about the fact that the system had limited mishaps and never seen a run on deposits.

Dharavi Slum Tour

Dharavi is a municipality of India's most populated city in Mumbai and is the world's third largest Slum, covering an area of 2.1 sq. kilometres. The Slum is home to about 700,000 people, with one of the densest populations in the world. The Slum was founded in 1883 and grew due in part due to the factories and corresponding residents who were migrating to Mumbai to find jobs. The Slum is highly multi-religious and multi-ethnic.

Total annual turnover of the Slum is around US$1bn. The core products generated internally leather, textiles and pottery products amongst many goods made. Recycling is also a big industry and reportedly employs 250,000 people in the Slum.

The Slum signifies India's low GDP per capita (US$500-2000 p.a.), but significant spending power given the masses. The potential of acceleration is significant as wealth rises. Several jobs are not recorded in employment data, but the slum is productive and income generating for many inhabitants.

The district has an estimated 5,000 businesses and 15,000 single room factories. Dharavi also has two major train lines feeding into it. Goods are exported and sold in stores in US, Europe and the Middle East.

Dinner with Kenneth Andrade

Kenneth Andrade is a well-known fund manager in India. He has had several successful stints at Kotak, Standard Chartered and IDFC, before setting up a boutique known as Oldbridge Capital in 2015. Kenneth has won the Fund Manager of the Year title many times and managed India's first US$1bn fund. In 2015 when he left the Industry to start up his own boutique he had managed the number 1 fund in the industry over 10 years. Oldbridge now has US$300m under management.

Kenneth's process is to buy enduring business models with emphasis on limiting capital losses, which is why emphasis is given to buying at the right price and value. By doing this, a margin of safety is built in to protect portfolios even if estimates are wrong. The process also looks for companies with leadership skills, financial discipline and operating in an industry which is consolidating.

What we learn from Kenneth is that while the fundamentals of India are no doubt enticing, there is plenty of difference between promise and reality. Valuations are rich across many companies, already reflecting the potential that exists, sometimes with justification and sometimes not.

Kenneth was highly sceptical on some aspects of implementation and execution in India by both Government and Regulators. This perhaps comes from spending his whole career in India and placing low reliance on positive momentum from politics and/or the corporate community. Instead the picture you get from Kenneth is that stock selection is critical and knowing a founder and their mentality provides a lot of insight into management capability in running a business.

Some of Kenneth's stock pics over the past decade which have made a lot of money for Funds he manages include Page Industries (bought on float in 2007 at Rs.200 and now trading at Rs.24,000!), the Automobile Sector, Agri-Industries e.g. Kaveri Seeds.

Insights Day 2

Pune has a traditional old-economic base and is known for its manufacturing and automobile industries as well as its research institutes of Information Technology, Education and Management. Our thoughts

on Day 2 was to take delegates to another city within India via the highway system. The Mumbai to Pune highway provides a great and comfortable route via coach. It also provides an opportunity the escape the metropolis of Mumbai and see a broader India. Pune is the second largest city in Maharashtra and the seventh most populous in India. The city is sometimes referred to as the "Oxford of the East" given it is home to several educational institutions.

Automotive companies such as Bajaj Auto, Tata Motors, Mahindra & Mahindra, Mercedes Benz, Force Motors, General Motors, Land Rover, Jaguar, Renault, Volkswagen and Fiat have set up greenfield facilities near Pune. Additionally, the significant IT park houses 70,000 employees. IT is the natural selection for many of Pune's students given operations from India's largest companies like Infosys, Wipro, Tata Consulting, HCL Tech as well as global firms like Microsoft, Cognizant etc.

The two companies we visited provided us with some broad perspectives:

- India's manufacturing capabilities (as highlighted in a report by Harvard's Centre for Research) is becoming globally competitive for value-added exports. These businesses are building a global client list through their IP and excellence
- Information Technology is very much a people business. Indian IT firms have understood that retention is critical to building knowledge to improve solutions to clients and build on areas like Big Data, Cybersecurity and Artificial Intelligence. Hence providing attractive campus facilities and lifestyle is critical

Bharat Forge

Bharat Forge (BF) Limited is a Pune-based Indian multinational company involved in industries such as automotive, power, oil and gas, construction & mining, locomotive, marine and aerospace. The company was founded by Nilkanthrao Kalyani in 1961. The current chairman is Baba Kalyani and is part of the Kalyani Group – a US$2.5bn conglomerate, with a 10,000-strong workforce. Amit Kalyani, the son of Baba Kalyani is an Executive Director of the company.

The company has made a strong foray into the defence and aerospace sectors and is moving from being a components manufacturer to a complete product maker. Having been a manufacturer for large clients for a significant period has led to now being able to play a consultative role, given knowledge and insight gained.

In the automotive segment the clients of BF include the who's who of the car industry i.e. Daimler, Volkswagen, Audi, Porsche, GM, BMW, Ford, Toyota, Honda, Saab, Chrysler, Mitsubishi, Volvo and Renault. Amazingly, one out of every 2 commercial vehicles on the road in the US have a BF part in them. On a broader industrial front, clients include Cummins, Caterpillar, GE, John Deere, Haiburton, Siemens and Alstom.

The company has revenue of US$1.3bn and a market cap of US$4.5bn. Core products include axle beams, steering knuckles, connecting rods and crankshafts. The business has been diversifying into industries like Oil & Gas, Infrastructure, Marine and Defence.

The tour of Bharat Forge's manufacturing plant in Pune provided the following significant insights:

- Interestingly BF had adopted automation in its plants since the 80's. Today there are even fewer blue-collar workers than might have been expected, given India is a low-cost labour region. This can be attributed to design and use of robotic and machining capability to significantly improve efficiency and output

- BF management made no excuses about the fact that the factory reflected a focus on profit and efficiency as a business rather than social implications about employment
- The company is increasingly about exporting IP to its global client base as well as serving India's demand. This IP is gathered from the diversity of BF's business and passed across the value-chain of the client.
- The plant was impressive for its use of robotics, volume, precision, capex spend and significant spend on R&D.

One division of BF where they have spent significant R&D Budget is Defence. Their latest development is the advanced towed artillery gun which has set a new world record in range by hitting targets at a distance of 48 km. Each gun costs between US$2-3m and illustrates the technical prowess of BF.

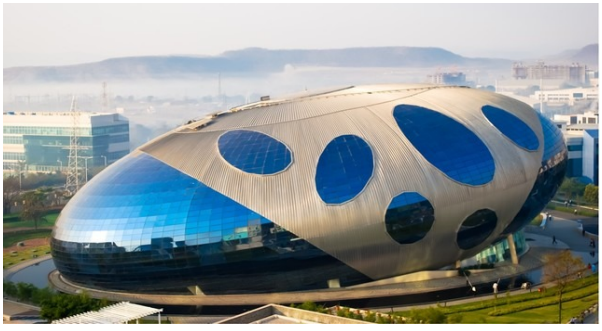
Infosys

Infosys is an Indian multinational corporation, founded in 1981, that provides business consulting, information technology and outsourcing services. Its headquarters are in Bengaluru, India. Infosys is within the top 600 companies in the world by revenue (US$10bn) and has a market capitalisation above US$30bn. The company has over 200,000 employees globally. 36% of their employees are women. There are 129 nationalities. 89% are based in India. 79% are software professionals. The attrition rate for FY17 was 15% - dropping from 23% in Q1FY15. Attracting high quality talent and retaining them is critical in this business.

New services introduced by the company over the past three years include mainframe modernization, cloud applications and infrastructure, enabling the API economy, internet of things, cybersecurity, digital experiences and complex analytics showed rapid momentum with clients. In April 2017 the company launched its next generation AI platform, Infosys Nia converging big data/analytics, machine learning, knowledge management and cognitive capabilities amongst many other capabilities.

The tour of Infosys's Pune Campus provided the following significant insights:

- The campus is smart and sustainable and houses 35,000 employees, making it the largest private sector employer in Maharashtra. The campus can be called a second home and is an example of work-life balance to keep the retention ratio high
- Facilities are world class in terms of pool, gym, sporting amenities, food courts, coffee shops and restaurants. This creates a great environment for employees





The company is massive in its scale and over the last 10 years has made the transition from growth company to a more mature business. Infosys, sources close to 95% of its revenue from other geographies and is more a play on successful leadership, tapping into India's IT comparative advantage, increasing cash flow and dividends and global growth, than necessarily playing an India demand thematic. However, it is difficult to ignore their steps taken in innovation and thought leadership and

can be a "hiding place" for investment manager allocations during weak demand/capex, a weakening currency (INR) and an overall poor environment locally in India.

Insights Day 3

Our thoughts on Day 3 was to meet regulators, government officials, fund managers and a branch manager at their premises. Again, observing corporate culture in its natural environment provides further insight in how advanced or not India is, depending on your perspective.

While external appearances of some of the buildings may not be as attractive as an office block in New York, London, Singapore or Tokyo, the quality of people we met in general were high quality in terms of capability, expressing their views and ability to articulate and engage with a foreign audience.

Reserve Bank of India

We meet with Mridul Saggar, Director Prices and Monetary Research and two of his colleagues. They made the following points:

- The dialogue between the RBI and the Government has improved significantly. Coordination has particularly increased when it comes to regulation on food prices, which make up 50% of CPI
- Formal and informal dialogue has also been strong with regards to the Government keeping with fiscal prudence i.e. target of 3% for the budget deficit on GDP
- There is no target price for the RBI on the Rupee, but rather keeping currency volatility in check as well ass an important yardstick for measuring external resilience
- The key focus for the bank is inflation targeting, volatility of currency/policy and ensuring the stability of the banking system
- As a result of demonetisation, the level of digital transactions has increased significantly. Additionally, with GST now in place, there will be a significant increase in the formalisation of the economy
- Unlike Australia where APRA regulates the banks, the RBI is responsible for bank regulation. In regards to the NPA issues in the public sector banks, they felt consolidation of Public Sector Banks should be positive for the banking system. However, they stated this will be left to economic forces/management rather than a directive from them
- Financial inclusiveness is one of the things the Government is looking at and there is a long way to go on this. The PSU Banks are important in achieving this given their broader reach.
- Expected improvement in the NPA issue, but this is largely up to bank management teams
- Recapitalisation undertaken recently of US$32bn is the beginning of a process. A step in the right direction
- There is a key focus on 25 large accounts across banks. This is starting to broaden to more distressed assets. The resolution process is being pushed by the RBI, with implementation starting 1 April 2018
- 3 banks are critical to the functioning of the Banking system – SBI, HDFC and ICICI. These banks are deemed to be Domestically Systemically Important Banks (D-SIB's)
- Banks will be faced with closer supervision and enhanced capital requirements. Capital positions are currently in line and well placed from an SLR perspective

- The RBI went to pains to explain that the banking system, whilst experiencing the recent fraud of PNB Bank, has never has a deposit run or suffered failure. Confidence in the system by depositors and investors remained steadfast

ICICI Bank Branch

On our way to one of our underlying investment advisers we found time to stop off at one of Mumbai's busiest bank branches (ICICI at Prabhadevi). The branch visit highlighted the speed of advancement of India's Banking system when it comes to client engagement and technology. We saw firsthand the use of Aadhar (India's biometric system) as the bank can initiate the know your client process in as little as 5 minutes through fingerprint scans.

The visit to the branch highlights the potential for growth from basic areas like opening bank accounts and increase in digital transactions.

Aditya Birla Asset Management

Our delegates met with Aditya Birla Asset Management, one of the advisers to India Avenue for the purposes of stock selection. Attending the meeting, representing Aditya Birla was Atul Penkar, Fund Manager.

Aditya Birla is 49% owned by Sun Life, a leading Canadian financial institution of close to CAD$1trillion in assets. Sun Life owns successful US headquartered global manager in MFS and has a market leading position in insurance and operates in over 24 markets.

The Aditya Birla Group owns the rest of the business and is a US$41bn multinational operating across 36 countries, with over 120,000 employees. The business is involved in commodities, textiles, telecom and life insurance (amongst many other areas).

Aditya Birla Asset Management is the 3rd largest player in India, with assets of US$38bn (US$13bn in equities). As a philosophy they utilise a GARP style with a strong focus towards risk management. There are 22 people involved in the investment process, which includes a CIO, 7 Portfolio Managers and 10 Analysts.

Atul Penkar detailed the investment process utilised by Birla and the process of providing advice to the India Avenue Equity Fund. The focus in stock selection is identifying competitive advantages, strong management, appropriate valuations and compounding high ROCE companies.

Aditya Birla actively monitor 400 companies, with over 30% of these being generated through primary research. As part of the process there is incorporation of significant 3rd party research and channel checks. In India, it's these channels which are important, apart from of course investment management capabilities of portfolio construction and specifically stock selection. Channel checks provide insights on founder and business capabilities and include discussions with peers, competitors, suppliers, clients to a business.

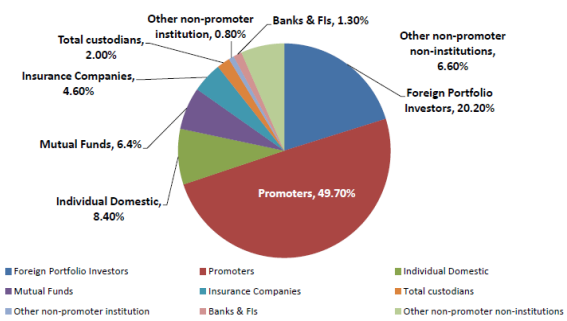
ICICI Prudential Asset Management

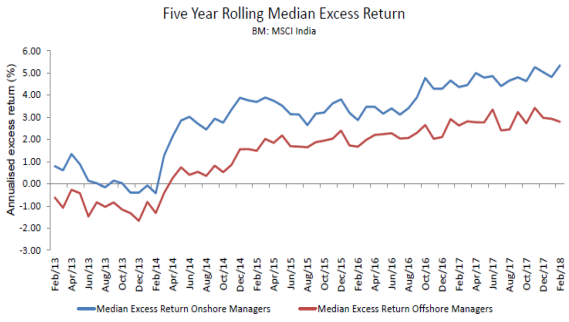
Our delegates met with ICICI Prudential Asset Management, the other advisers to India Avenue for the purposes of stock selection. Attending the meeting, representing ICICI was Mrinal Singh, Deputy-CIO. ICICI-Prudential started managing money in 1993 and is now the largest asset management company in India by asset size at US$46bn.

The ownership of the business is a JV between ICICI Bank (51%) – India's largest private sector bank and Prudential UK (49%) – a 169-year old financial services group. Again, this is another case of blending local market intelligence and global business practises.

ICICI-Prudential have 28 people in the Equity Team, which includes CIO, Deputy, PM's, Analysts, Head of Research and Dealers. The focus is on fund management and research. They utilise both growth and value processes. Prudential Value Discovery is one of the few valued-based philosophy Fund's in the marketplace. This Fund, managed by Mrinal, is run with a 3-5 year holding period, with ideas allowed to gestate for a significant runway before results are expected. The process seeks to be ahead of the street by primary research involving kicking tyres, talking to those up and down the value chain and vertically and horizontally integrated.

Mrinal Singh articulated a few key insights when investing in Indian markets. The graph below illustrates that a large part of market capitalisation is owned by founders of the respective businesses. It is important to understand the psyche of these investors to determine motives, alignment and potential management and share price behaviour as a result.





Another important point is that local managers have traditionally been able to outperform off-shore based managers. It is our view that local knowledge of founder behaviour, several nuances of India and market networks plays a significant role in delivering superior results.

Some of Mrinal successful "multi-baggers" over time, which have lent to his track record of over 9% p.a. outperformance over 13 years include:

- Amara Raja Batteries – Battery Manufacturer
- PI Industries – Manufacturing and Distribution of Agro-Chemicals
- Natco Pharma - Oncology
- Balkrishna Industries – Tyres Manufacturer

Department of Investment & Public Asset Management

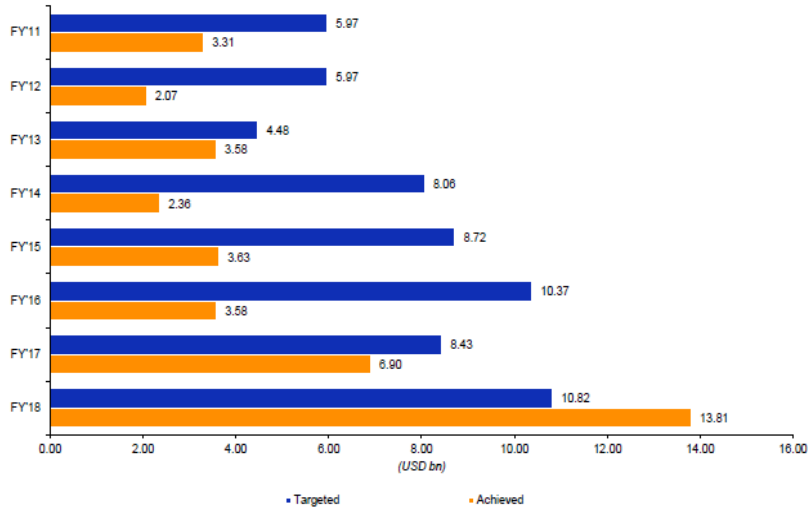
The Department of Investment & Public Asset Management (DIPAM) is responsible for the disinvestment of Central Public Sector Enterprises (CPSE's accounting for 16% of GDP and 11% of market capitalisation) by the Government of India.

CPSE's are dominant in capital intensive sectors such as energy, metals and mining, power and infrastructure. There are 244 CPSE's in total. The Government is seeking broadly to exit or reduce the holdings in non-strategic businesses and promote efficiency and professional management of companies. The hope is that this will unlock the economic potential of businesses.

DIPAM has launched an ETF to allow investors to participate in this strategic sell down (launched March 2014, with a follow up launched January 2017). Both offers were over-subscribed and the Government so far has raised US$895m as a result.

Finally, another ETF has been launched called Bharat 22 (November 2017). This consists of 22 stocks, including 16 PSE's, 3 Banks and 3 Private Companies.

A history of Government Divestments and their success is listed below:



Highest mobilization of approximately US$13.8bn in 2017-18

Government expectation to reach US$15bn

Trying to create economic value for the Government as underlined in the Budget

- In our view this is an investment to consider if you already have an existing direct and broad-based India investment. Whilst this investment might lead to good returns if the CPSE's are able to generate more economic profit from being privatised, it is our view that a more balanced portfolio, including some of India's fully privatised companies, makes more sense to the first-time single geography investor. Bharat 22 for example might be a supplementary investment
- The other question to ask is whether the vehicle is contrived to generate the divestment for the Government from non-strategic assets which could potentially be problematic

Key Takeaways

1) India appears to be well positioned from a long-term investment perspective, with fundamental tailwinds of demographics and resulting infrastructure needs

2) Corporates in India appear well managed and are articulate in their strategy. The growth opportunity seems largely linked to demographics, formalisation and inclusiveness

3) Manufacturing plant visit was an exceptional experience which highlighted the advancement in this area by Indian firms. The client base of these firms is increasingly more global, taking away from the India exposure thematic, but also opening the potential of selling to a much bigger audience

4) Founders in India know their business and industry very level, not just locally but globally where required

5) Even when visiting the slums of India, it is apparent that entrepreneurship is thriving, and people are aspirational, positive and dreaming about a better future

6) Technology firms have a huge advantage in India, given access to some of the brightest minds locally. However, retention is always an issue to be confronted. These businesses can grow substantially from "newer industries" having fulfilled more an outsourcing role previously

7) The Central Bank – RBI is highly conscious of its objectives of ensuring an inflation target is adhered to and ensuring the stability of prices and the financial system. Whilst the recent fraud at PNB has left some concerns, the RBI maintains that confidence in the banking system and the function of deposit taking remains strong

8) Banks are likely to be set for a strong period of credit off-take. Particularly if demand picks up in the post-election period of 2019, it is likely that private banks in particular will be able to increase their asset book as well as grow earnings through more accounts, more services and increase use of technology platforms

9) Fund Managers of India have strong processes, large investment teams, deep grassroots insight on each industry and lean on relationships with global asset managers/financial industry for setting up best practice. It appears a win-win scenario with local edge of stock picking delivering better results, but combined with organisational prowess of some of the best global financial firms