

The Case For India

India will surpass China by 2030 to become the world’s largest country by population. Chinese population growth is slowing dramatically, the result of the recently abandoned one-child policy started in 1979 which, per the Chinese government, prevented 400 million births. The related consequence is that Chinese GDP growth is also slowing. India’s GDP, on the other hand, is accelerating making India the fastest growing major economy in the world. For investors, India offers access a to a young and growing middle class.

Population Growth 2015 -2030			
2	1	India	16%
1	2	China	2.90%
3	3	US	10.60%
7	5	Nigeria	44.00%
5	7	Brazil	10.10%
9	10	Russia	-3.80%
10	15	Japan	-5.30%
22	30	Germany	-4.10%
UN Dept of Social Affairs			

Median Age in Years 2015	
Nigeria	18.2
India	27.2
China	37.7
US	37.6
Germany	46.1
Japan	46.1
Brazil	30.7
Russia	38.9
UN Dept of Social Affairs	

GDP Growth 2015 -2030	
India	190%
China	118%
Nigeria	69%
US	37%
Brazil	36%
Russia	25%
Germany	19%
Japan	12%
USDA - Purchasing Power Parity	

Winston Churchill said of India that it was “no more a political personality than Europe”.

That may still be true. The similarities between the two are striking. For example, India has 22 official languages to the EU’s 24. State elections in India tend to attract higher levels of voter participation than do Federal ones. In a similar vein, most Europeans cannot name their representatives in the European Parliament. Also, of interest is that the income gap between states in India and EU members are similar. The GDP per capita in India’s poorest state is 1/10 that of the richest, similar the gap between Belgium and Bulgaria. Churchill’s views on the “political personality” of the EU today can only be guessed at. *Much of the above was covered in the February 11th edition of The Economist.*

However, where India and the EU differ is what should appeal to investors. Income disparity has led to high levels of inward immigration as the mostly young population move in search of a better life. 4.5% of the Indian population has migrated to a different state. This compares to a sclerotic 2.7% in the EU. It is also important to note that 50% of Indian trade is within the country’s borders, this makes India less dependent on global trade flows relative to Europe where internal trade accounts for only 20% of GDP.

Demonetization

On November 8th, without warning and via an 8:00 pm television broadcast, Prime Minister Narendra Modi announced that 500 and 1000 rupee (INR) notes, representing 86% of cash in circulation, were to be taken out of circulation immediately. The notes worth \$7.50 and \$15.00 had to be deposited in banks or exchanged for new notes by the end of December. The aim was to crack down on the shadow economy and counterfeiting that funded terrorism and other illegal activities. This created significant disruption (92% of consumer transactions are in cash) and generated protests domestically and

condemnation overseas. Harvard Professors Lawrence Summers and Ken Rogoff were highly critical of “demonetization” to which Modi replied “hard work beats Harvard”.

Election March 11th – Game Changer

Modi’s hard work paid off. The economy for the year ending March 31st is expected to grow 7.0%. A slight tick down from pre-demonetization forecast of 7.3%. More importantly, Indians supported the move. Earlier in 2016 Modi also pushed through Parliament a national sales tax (GST). Taken together, these initiatives should have worked against him. However, on Saturday, March 11th Prime Minister’s party, the BJP, won a landslide victory taking control of three state assemblies in the five states that voted, including a big win in Uttar Pradesh (UP) the largest state in India. The Indian press called the election the most important globally in 2017 given the UP’s population of 240mn, which would make it the 5th largest country in the world. The victory was also a crushing blow for the Congress Party, which has been dominated for decades by the Ghandi family. The BJP now controls the lower house of parliament and has become the only truly national party in the country.

Modi is unique in the world, politician who is liked and seemingly can get things done.

How to Invest in India

Buying shares directly on the Mumbai Exchange (BSE) is difficult. The process starts with hiring an India based “Tax Consultant”. I’ll leave it at that.

In the US there are eight ADRs that offer varying levels of liquidity and there are four GDRs traded in London with adequate utility. However, focusing on the ADRs, the offering seems limited. The IT outsourcing companies Infosys (INFY), Wipro (WIT), and WNS (WNS) generate most of their revenues from outside of India, making them less of a way to invest in the emerging middle class story. Generic drug company Dr. Reddy (RDY) also generates most of its revenue from outside India, while Tata Motors (TTH) depends on Jaguar Land Rover, and the US and Europe, for most of its income.

	<u>Ticker</u>	<u>Industry</u>	<u>Mkt Cap</u>	<u>P/E '17</u>	<u>P/E '18</u>
Dr. Reddy's Lab.	RDY	Pharma	\$6.9bn	35x	23x
Household Finance	HDB	Banking	\$54bn	22X	18X
ICICI Bank	IBN	Banking	\$25bn	18x	15x
Infosys	INFY	Info Tech	\$35bn	16x	15x
Tata Motors	TTM	Autos	\$23bn	17x	11x
Vendata	VEDL	Metals/ Mining	\$12bn	16X	8x
Videocon d2h	VDTH	Dir to Home TV	\$498mn	NA	NA
Wipro	WIT	Info Tech	\$18bn	18x	18x
WNS	WNS	Info Tech	\$1.4bn	15x	14x

The Indian fiscal year ends in March

However, from the list above, two banks, and a mining company offer some appeal. (Videocon is being bought by Dish TV of India). The banking sector is dominated by state run banks that are weighed down with bad debts. However, private sector banks that are not so burdened and can be purchased using ADRs /GDRs. HDFC Bank is the largest private sector bank and it is focused mostly on industrial loans and mortgages. It has grown EPS at a 23% compounded annual rate over the last five years. ICICI is less

expensive and is estimated to grow faster as its non-performing loans shrink. Axis Bank, not listed above but traded in London as a GDR is expected to almost double EPS this year, again on declining loan losses.

Outside banking, Vedanta is active in aluminum, copper, iron ore and other metals along with power generation. Its parent company, Vedanta Resources is traded on the London Exchange. Most of its assets are in India but it historically has traded more in sync with global miners than the Indian market.

Best Way Into India

ETFs appear to be a better way to access the Indian market. Of the four highlighted below, three have good liquidity. The iShares India Small Cap fund (SMIN) with a market cap of \$85mn does not. However, it is that ETF that holds the most appeal. The ETF's 22% exposure to the Consumer Discretionary sector would seem to make it the better vehicle for accessing the growing Indian middle class. SMIN also holds 257 stocks which provides deep exposure to companies generating most of their earnings from within India. This position can be paired with the more liquid Wisdom Tree India Earnings Fund (EPI). Its earnings, not capitalization, weighted portfolio provides exposure to India's international big caps, but with 250 holdings it also allows investors to access to smaller cap pure Indian plays.

<u>Mkt Cap</u>	<u>ETF</u>	<u>Ticker</u>	<u>Top Sector Weightings</u>	<u>Holdings</u>	<u>P/E</u>	<u>P/Bk</u>	<u>Expense</u>
\$814mn	iShares India 50 ETF	INDY	Financials (24%), Info Tech (13.6%), Auto and Utility Vehices (8.5%)	54	19.6x	2.7X	0.65%
\$4.6bn	iShares MSCI India	INDA	Financials (20%), Info Tech (17%), Cons. Discretionary (14.5%)	75	20.9X	3.13X	0.68%
\$85mn	iShares MSCI India Small-Cap	SMIN	Cons. Discretionay (22.6%), Financials (18.3%), Indutrials (16.6%)	257	18.8x	1.89x	0.80%
\$1.5bn	WisdomTree India Earnings	EPI	Energy (21%), Banks (19%), Info Tech (18%),	251	16.2X	2.46	0.84%