

INDIA PART I: **THE INDIA OPPORTUNITY**

WHITE PAPER

The India Opportunity

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Executive summary

India is often misunderstood as a country, when it is more like a continent with 1.3 billion people. It is a young country brimming with energy as more than 50% of the population is under 35 years of age. Thus, India has an enormous consumption-driven demographic dividend at hand. India has historically struggled to unleash that potential. However, with prime minister Modi a series of important reforms have been implemented to realize this potential. With this background, we see India as one of the best investment stories of the coming decade.

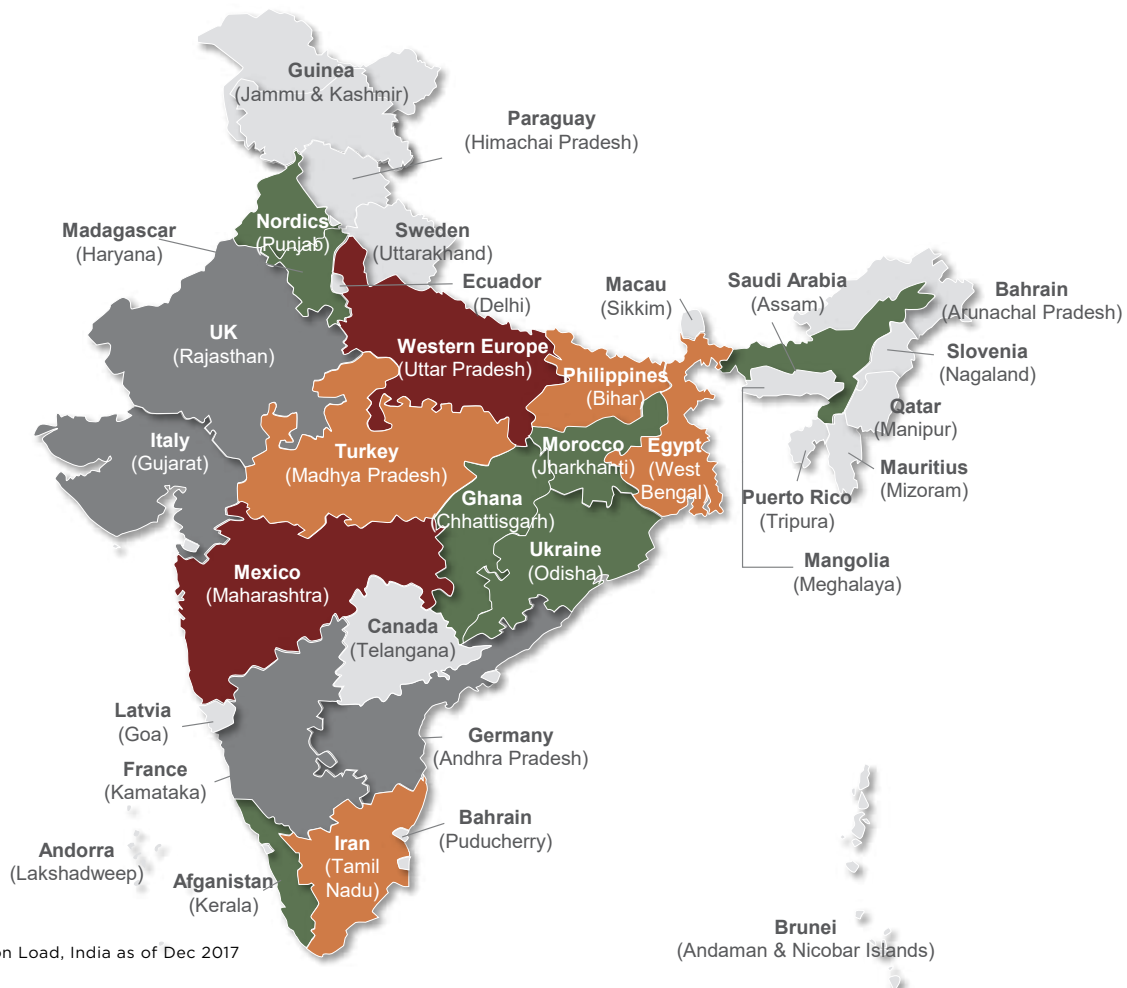
"One of the greatest players in history is rising again. Its tale is of one of the incredible dramas and the biggest ideas. It is a place whose children will grow up in a global superpower and yet still know what it means to belong to an ancient civilization"

Micheal Wood, British Historian

Diversity as a strength

India really can't be defined like a country, but more like a continent with 1.3 billion people – please see the map below for an illustration purpose. It constitutes 29 states and 7 union territories (quasi-states). The division of these states is broadly based on linguistic and cultural identities. Many of the states are countries in themselves. India has 22 official languages, 122 major languages and 1,599 dialects; 18 major cuisines and 44 creative art forms. It is a melting pot of diversity, which makes for the world's largest democracy. India's rich diversity is its real inherent strength.

India's economic history is just as fascinating as its diversity. For nearly 2,000 years until the mid-18th century, it was the leading economy accounting for nearly a fourth of the global GDP. In a span of 200 years since 1750, India lost its economic sheen. By 1947, the country was reduced to being amongst the poorest in the world with a mere 12% literacy rate (73% now) and 34



Source: Presentation Load, India as of Dec 2017

years (66 years now) of life expectancy. It is only now, a good 70 years since independence, that India is once again in the position to stake its claim on the global economic map.

The demographic dividend and the acceleration phenomenon

While India is an old civilization, it is also a young country brimming with energy. Over 50% of the population is under 35 years of age – see figure 1. This provides India with an enormous demographic dividend. Nearly 10 million people are added to the workforce every year. As shown in figure 2 it is the fastest urbanizing country in the world with around 40 cities with a population of over 1 million and another 397 cities with between 100,000–1 million people. As per the UNs State of World Population report, by 2050, nearly 53% of the country’s population will reside in urban areas compared to 35% currently.

Given its demographic profile India can be considered the last major economy with untapped scale and size benefits. India is a USD 2.8trn economy and is projected to grow at more than 7% in 2019 as per the IMF. Measuring GDP per capita, India currently is at USD 2000. This is often considered an inflection point for consumerism. China also accelerated at similar levels of GDP/capita. Here it is important to understand that discretionary household spending doesn’t develop in a linear way in line with income growth but can grow more exponentially. This is because households earning below a critical threshold cannot afford to purchase certain products. However, when income rises above that threshold, consumer discretionary demand kicks in. As an example, it is estimated that a household can afford to buy an automobile when income surpasses USD 15,000 annually. We thus have what is termed an “acceleration phenomenon”.

The independent research company Gavekal has analyzed India’s consumer economy to better understand the acceleration phenomenon and has divided households with discretionary consumption into three groups: emerging, aspiring and affluent households. Their analysis shows that the total number of households will rise from 122 million currently to 312 million by 2030 – see figure 3. Within this total, the number of emerging consumer households will double, but the number of aspiring and afflu-

ent households – the ones that can afford discretionary consumption – will triple and quadruple, respectively.

Figure 1

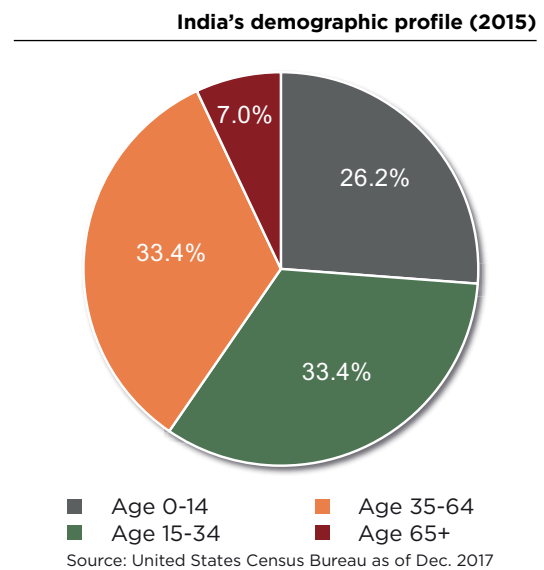


Figure 2

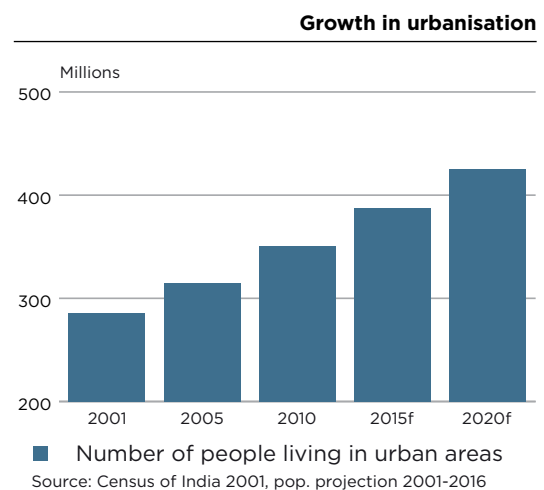
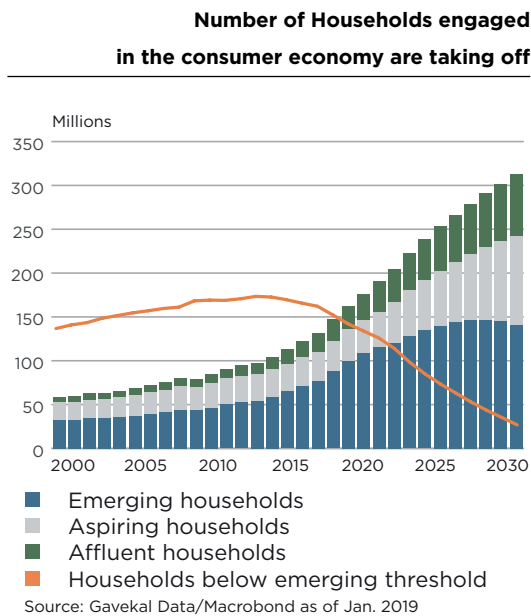


Figure 3



Reforms to unleash the potential

Historically, India has struggled to unleash the great potential and harvest the strength of its diversity. However, over the last 4-5 years with prime minister Modi in charge, a series of important reforms have been implemented to release this potential and achieve sustainable long-term growth. These reforms address some of the key structural issues, which historically have hindered sustained economic growth. We cover the reforms and their impact in detail in part II of this White Paper (*The New and Reforming India*), but it is worth highlighting them briefly here as well.

Insolvency & Bankruptcy Code (IBC), 2016: India's banking sector has struggled with high delinquencies in almost every economic downturn and has lacked a robust institutional framework to deal with this problem. IBC is the backbone that the banking sector lacked enabling more accommodating lending policies, which encourage risk taking and innovation. The law empowers the banks to resolve large corporate defaults by replacing the existing owners and selling/liquidating the assets.

Monetary Policy Committee (MPC), 2016: Historically, high inflation has been a persistent problem for India. Every growth cycle brought sticky inflation resulting in an overheating of the economy. MPC is a mechanism where the central bank's role is clearly defined as keeping inflation at 4%. The mechanism also ensures that the central government remains responsible for fiscal policy. As a result, India's inflation has structurally fallen 500 bps from a range of 7-10% to a manageable 3-5%. This makes monetary policy steady and predictable and over time reduces the cost of capital for businesses with a positive impact on wealth creation.

Goods & Services Tax (GST), 2017: Until last year, India's indirect tax laws were perhaps as diverse as the country itself. There were 17 different indirect taxes for businesses across different states implying approximately 1200 tax slabs. GST has unified the various indirect taxes into one tax with 5 different tax slabs. GST is the single biggest tax reform ever and it has a major positive impact on tax compliance and formalization of the economy.

J-A-M Trinity: India has digitized at a very fast pace. In the last 5 years, over 1.2 billion people have been enrolled under the digital identity program (Aadhaar Card) and nearly 330 million new bank accounts have been opened. Due to the telecom policy of early 2000s, India has attained a near complete penetration level in mobile telephony. This has enabled the government to verify, transact and provide citizens with services directly in a fast, seamless and transparent manner. This has already resulted in savings of over USD 13bn as leakage in the system has been plugged.

The nature of politics in India ensures that the reforms are more or less irreversible. Implementing reforms requires a large consensus amongst various stakeholders within and outside the government. Through the political history of India, it is rather common to see reforms being initiated by one government and implemented by the next. The process of reforms is tedious, but steady as it needs to stand the test of various expert committees, the legal framework and most importantly the two houses of the Parliament. There is lot of political merit in maximizing the benefits of the reforms once they have been through the painful implementation process.

Harvesting the potential of India

It is important to look at India as a long-term investment destination. Therefore, we have adopted a theme-based approach to investing in India. We see three key themes playing-out over the course of the next few years. These are:

- 1) **Financial Inclusion** – greater penetration of banking and allied services enabled by rapid technology adoption.
- 2) **Housing Inclusion** – addition of more households to boost consumption and the investment rate.
- 3) **Formal Economy Inclusion** – broadening of the tax base to support tax buoyancy in the coming years thereby providing a boost to government finances.

Our theme-based approach benefits directly from the reforms agenda and is supported by India’s current stage in the economic cycle – see figure 4 below. Overtime, the value creation opportunities will migrate from one sector to the other within the same theme.

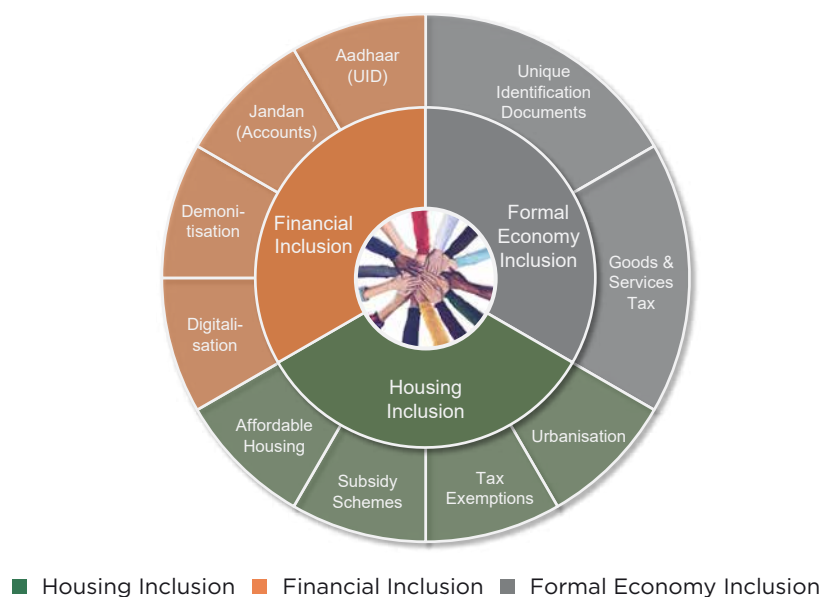
As an example, if we study the Housing Inclusion theme, we identify banks/mortgage lenders as the key early

beneficiaries since they are the capital enablers. India’s mortgage penetration estimated at 10% is amongst the lowest globally, whilst the affordability – at 3.7x average annual income of the borrower – is the highest that it has been in over 20 years. As capital becomes available for lending, the demand for housing grows benefiting the property developers, which are the next beneficiaries. Nearly 65% of cement consumption in India is linked to housing, therefore we expect the cement industry, along with a few other building material providers, to benefit as the cycle continues. Housing also has a multiplier effect on employment growth and the investment rate of the economy, which has a positive bearing on the overall economy. Therefore, our focus with a risk/reward perspective is to capture the value across the entire spectrum of opportunity within a theme.

India will continue to remain as dynamic as it is diverse. PwC expects India to become the world’s second largest economy by 2050 (currently number 6). It is the fastest growing economy and is expected to retain the position in the forthcoming year. We see India as a structural growth opportunity and potentially the best investment opportunity of the coming decade.

Figure 4

The key to long term themes



Source: C WorldWide as of January 2019



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Q1 2019

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