

GENERATING ALPHA IN INDIA: OPPORTUNITIES AND CHALLENGES

Washington Association of Money Managers (WAMM)

CFA Society of DC

Yale Club of DC

Wharton Club of DC

WASHINGTON DC

NOVEMBER 2018



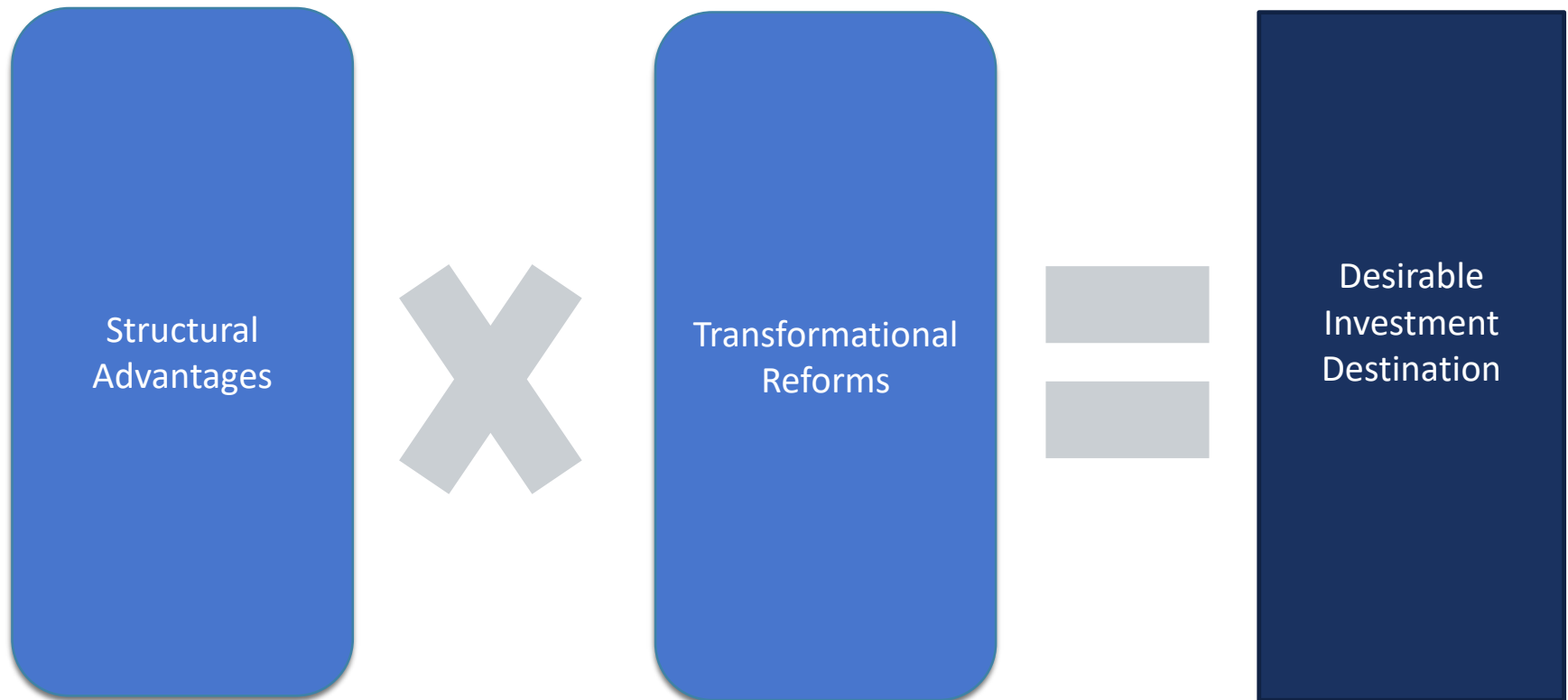
DISCLAIMER

The material in this presentation is given in summary form and does not purport to be complete. Information in this presentation, including forecast financial information, should not be considered as advice or a recommendation to investors or potential investors in relation to holding, purchasing or selling securities or other financial products or instruments and does not take into account your particular investment objectives, financial situation or needs. While due care has been used in the preparation of forecast information, actual results may vary in a materially positive or negative manner. Forecasts and hypothetical examples are subject to uncertainty and contingencies outside of our control. The predictions and opinions expressed herein are subject to change at any time. The information contained herein was derived from sources we believe to be reliable, but we do not guarantee its accuracy or completeness. This commentary is for informational purposes only and should not be construed as advice designed to meet the particular investment needs of any investor, nor is it an offer or solicitation to buy or sell the securities mentioned herein nor is it an endorsement of any particular investment strategy. Before acting on any information you should consider the appropriateness of the information having regard to these matters, any relevant offer document and in particular, you should seek independent financial advice. All securities and financial product or instrument transactions involve risks, which include (among others) the risk of adverse or unanticipated market, financial or political developments and, in international transactions, currency risk. This presentation may contain forward looking statements including statements regarding our belief or current expectations with respect to businesses, market conditions, financial condition, specific provisions and risk management practices. Readers are cautioned not to place undue reliance on these forward-looking statements. Tapan V. Gandhi, CFA does not undertake any obligation to publicly release the result of any revisions to these forward-looking statements to reflect events or circumstances after the date hereof to reflect the occurrence of unanticipated events.

Table of contents

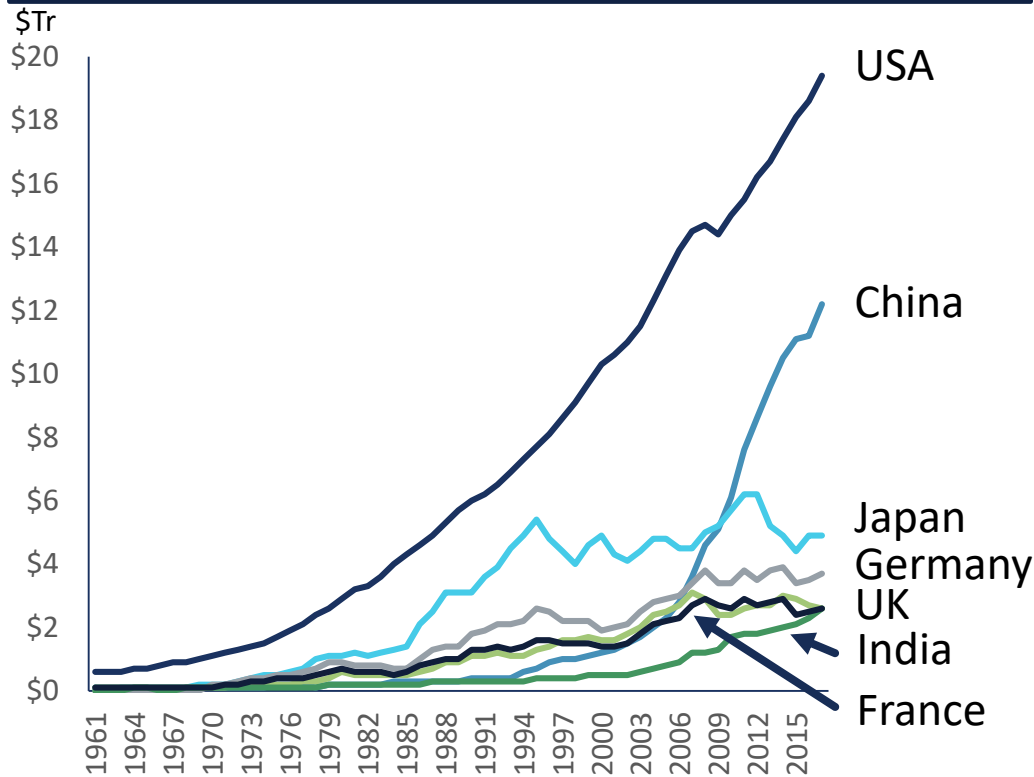
- Understanding India: Opportunities and Challenges
- Asset Classes and Returns
- Generating Alpha in India

Structural position and reforms have made India a favorite with investors

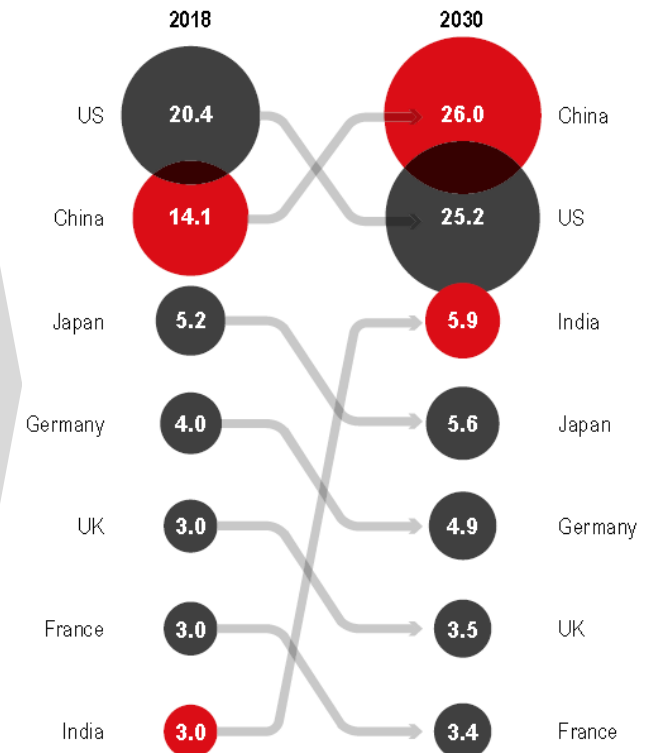


India is on track to become the 3rd largest country by GDP by 2030

1961-2017: The Story So Far



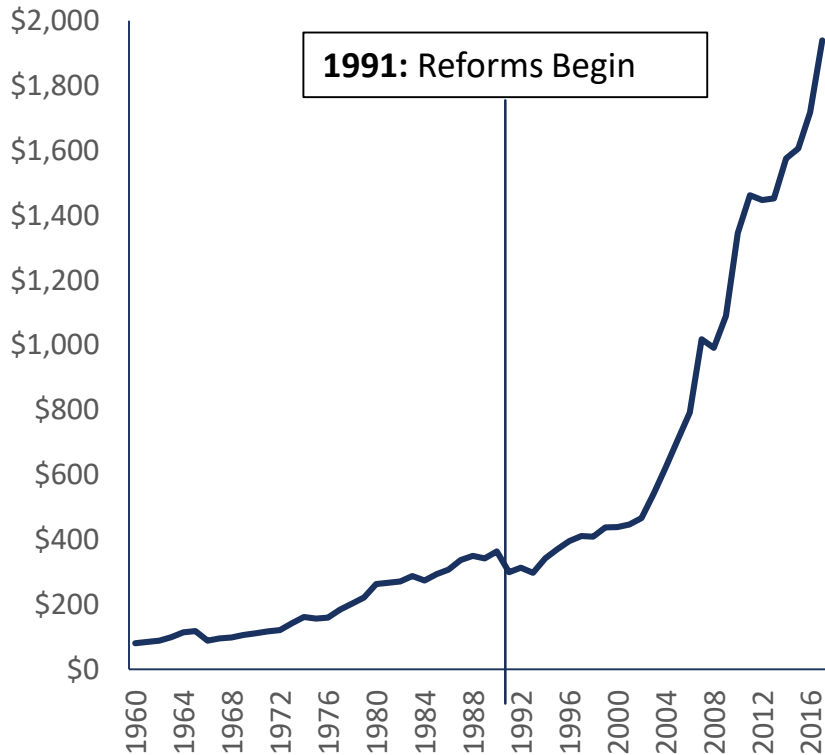
2018-2030: Projected GDP Rankings



Notes: Size of circle and amount indicates GDP in USD Tr. Red indicates high-growth economy. Source: HSBC Report "The World in 2030"

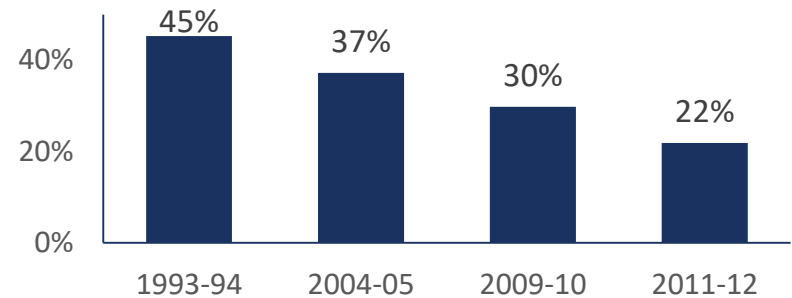
Per capita GDP growth is picking up and it is improving the quality of life

Per Capita GDP (\$)

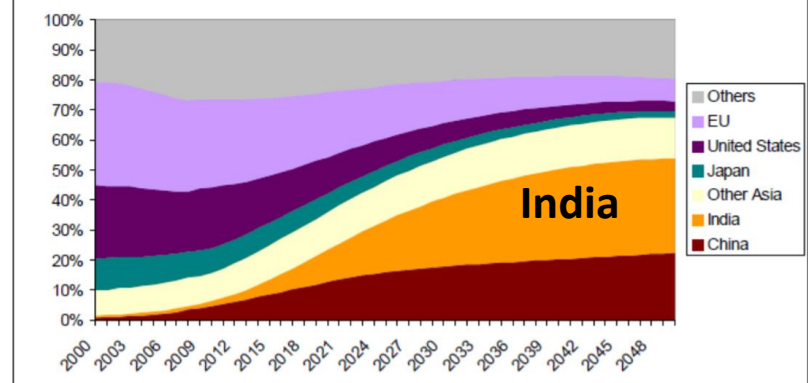


Source: World Bank

% Population Living Below Poverty Line



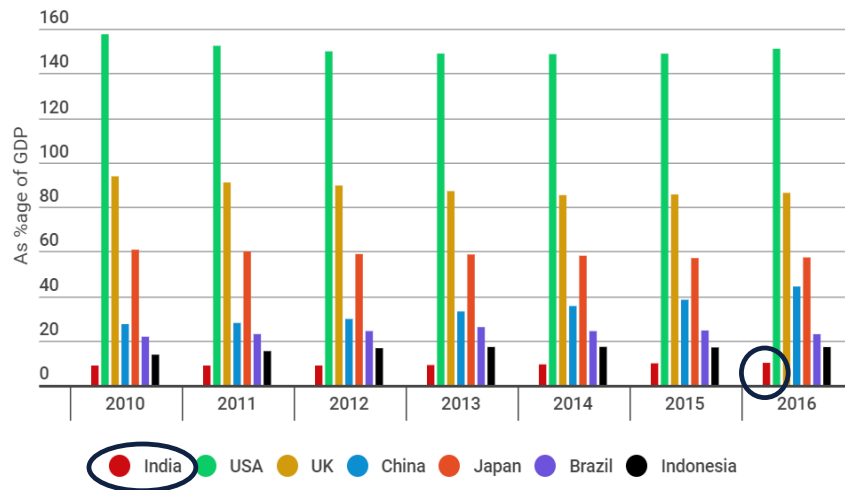
Shares of Global Middle Class Consumption (2000-2050)



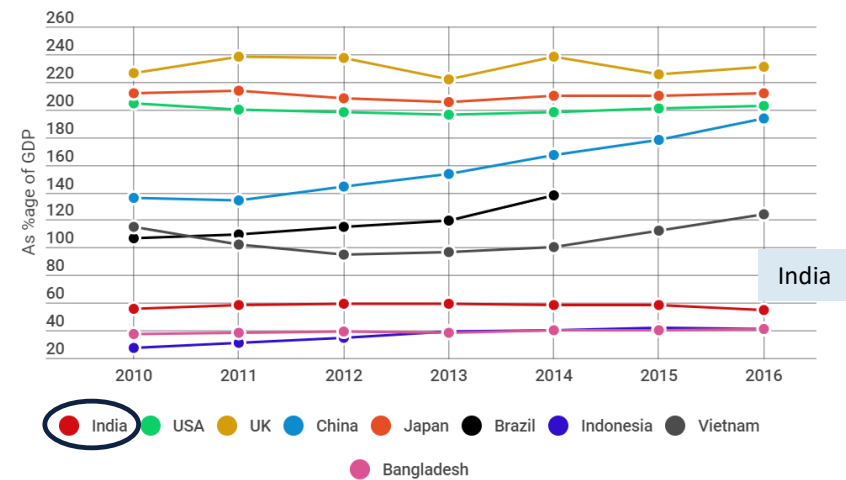
Source: Tendulkar Poverty Estimates, Brookings Institute

India's growth is being fueled by fundamentals, not leverage

Household Debt: India Vs. The World



Private Sector Debt: India Vs. the World

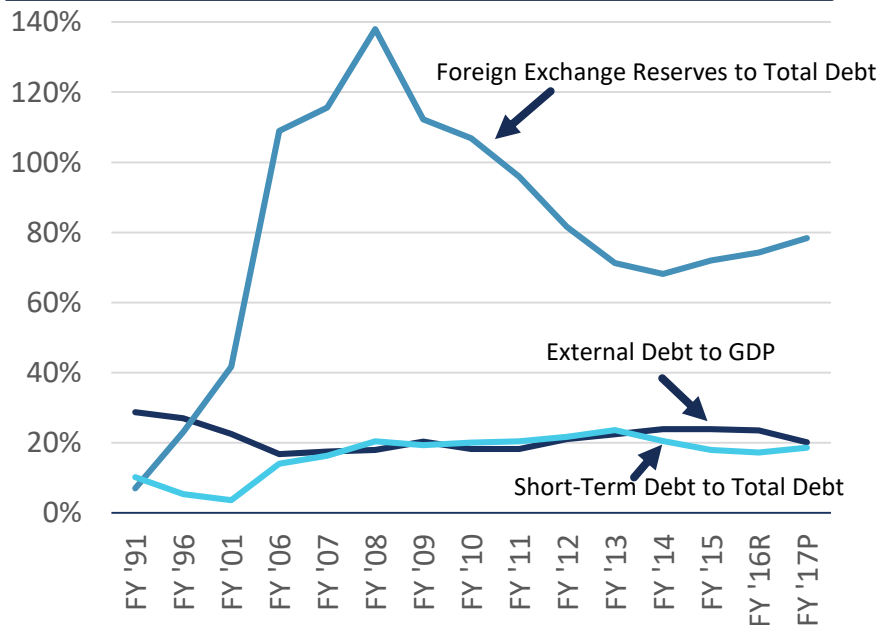


As India's bond market develops it can boost growth through increased leverage

Source: International Monetary Fund Working Paper 2018

Favorable macro parameters: low debt, high reserves, and low inflation

Debt & Foreign Exchange Situation



Consumer Price Index (CPI) Inflation






Strong Foreign Exchange Reserve Position & Low Debt

Low Inflation

Source: *Tradingeconomics.com, Ministry of Statistics and Programme Implementation, Reserve Bank of India*

Leading regulator and well-established security market institutions

Institution	Major Achievements
 भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India (Established: 1992)	<ul style="list-style-type: none">• Dematerialization• Faster settlement• AIF and FPI regulations• Stronger, clearer regulations
 NSE International Exchange (Established: 1992)	<ul style="list-style-type: none">• Globally, #1 for index options & #2 for stock futures by no. of contracts traded in '17
 BSE EXPERIENCE THE NEW (Established: 1875; First stock exchange in Asia)	<ul style="list-style-type: none">• 2nd exchange in the world to obtain ISO 9001:2000 certification• BSE's best practices adopted by 23 stock exchanges

Source: SEBI (Securities and Exchange Board of India), National Stock Exchange (NSE), Bombay Stock Exchange (BSE), and World Federation of Stock Exchanges

Indian exchanges have the most number of listed companies






	Stock Exchange	Market Capitalization (\$B)	Listings (# of Public Companies)
1	New York Stock Exchange	19,223	2,400
2	NASDAQ	6,831	3,058
3	London Stock Exchange	6,187	3,041
4	Tokyo Stock Exchange	4,485	2,292
5	Shanghai Stock Exchange	3,986	1,041
6	Hong Kong Stock Exchange	3,325	1,866

	Stock Exchange	Market Capitalization (\$B)	Listings (# of Public Companies)
7	Euronext	3,321	1,299
8	Toronto Stock Exchange	2,781	1,524
9	Shenzhen Stock Exchange	2,285	1,420
10	Frankfurt Stock Exchange	1,766	3,769
11	Bombay Stock Exchange (BSE)	1,682	5,749
12	National Stock Exchange (NSE)	1,642	1,696

India (BSE and NSE combined) has an estimated total market cap of \$2.3T (excluding overlap) ranking it among the top 10 by market capitalization

Source: SEBI (Securities and Exchange Board of India), National Stock Exchange (NSE), Bombay Stock Exchange (BSE), and World Federation of Stock Exchanges

India is on an irreversible path of transformational reform

1991-'96	1996-'98 United Front supported by	1998-'99 & 1999-'04	2004-'09 & 2009-'14	2014-2019*
 INDIAN NATIONAL CONGRESS	 INDIAN NATIONAL CONGRESS	 BHARATIYA JANATA PARTY The Party With A Difference	 INDIAN NATIONAL CONGRESS	 BHARATIYA JANATA PARTY The Party With A Difference
<ul style="list-style-type: none"> • 1991: De-reservation of public sector industries, abolition of 'License Raj' • 1991: Globalization • 1992-94: Currency convertibility • 1992: SEBI 	<ul style="list-style-type: none"> • 1997: 'Dream Budget' (divestment, reduced tax, higher FII investment limits, removing surcharge) 	<ul style="list-style-type: none"> • 1998: National Highway Development Project (NHDP) • 1999: New telecom policy • 1999: Department of Divestment (push for privatization of the central public sector enterprises (CPSE)) • 2000-'02: Reform-oriented IT policies (Special Economic Zones & tax benefits) 	<ul style="list-style-type: none"> • 2005: Right to Information • 2009: Aadhar Card • Proposed Goods and Services Tax (GST) 	<ul style="list-style-type: none"> • 2016: Insolvency and Bankruptcy Code (IBC) & National Company Law Tribunal (NCLT) • 2016: Demonetization • 2016: Monetary Policy Committee • 2016: RERA (Real Estate Regulation & Dev. Act) • 2017: GST

Democracy at work: India's population demands economic progress and no political party can afford to ignore this demand or reverse this trend. State level reforms driven by coordination, competition, and accountability will drive further growth (e.g., Niti Aayog).

*Notes: Reforms list is not comprehensive. * Term not completed*

Government is determined to remove roadblocks to economic development

Tax Reform

- Unification of tax under Goods and Service Tax
- MSME in 25% tax bracket upto turnover of ₹ 2.5B

- Expands tax base
- Reduces price of goods

Nonperforming Asset Reforms

- Regulatory action (NCLT and IBC)
- Government stimulus of >\$30B to uplift lending and investment

- Develops bond market
- Strengthens banking system

Government Debt Reduction

- Broaden tax base, improve spending efficiency
- Fiscal Responsibility and Budget Management Act - target fiscal deficit of 2.5% of GDP by 2022-23

- Improves fiscal situation and current account deficit

Negative impact from initiatives is one-time but benefits continue over long-term

Technology and entrepreneurship can further turbocharge India's growth

Entrepreneurship

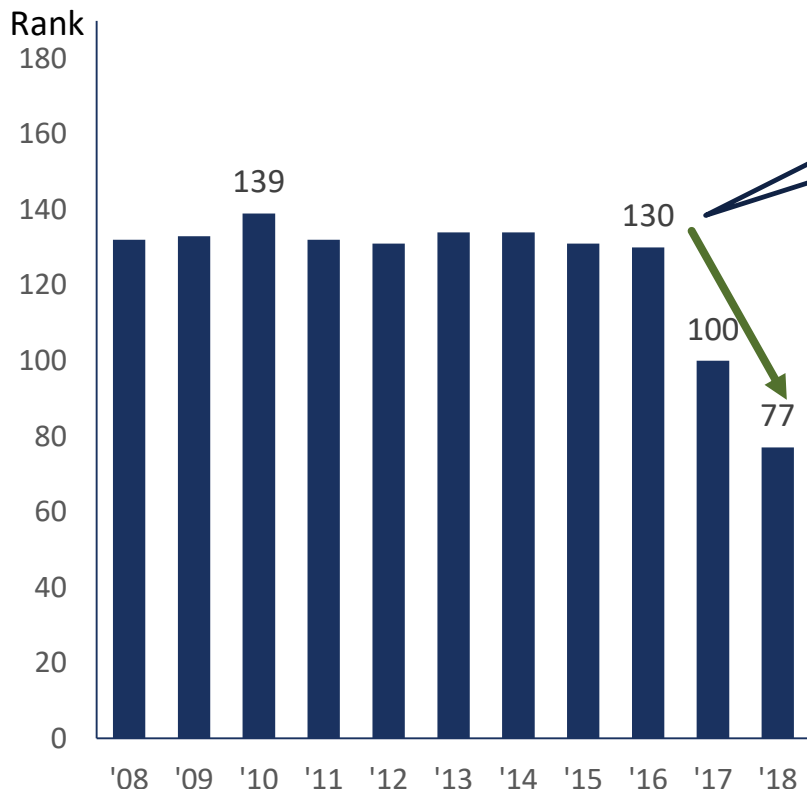
- Aspirations
- MSME (Micro, Small, and Medium Enterprises)
- Moving from Jugaad to Innovation

Technology

- Reducing corruption and bureaucracy
- Improving quality of life
- Reducing cost

Ease of doing business is expected to continue improving – next target is Top 50

India's 'Ease of Doing Business Rank'



Highlights

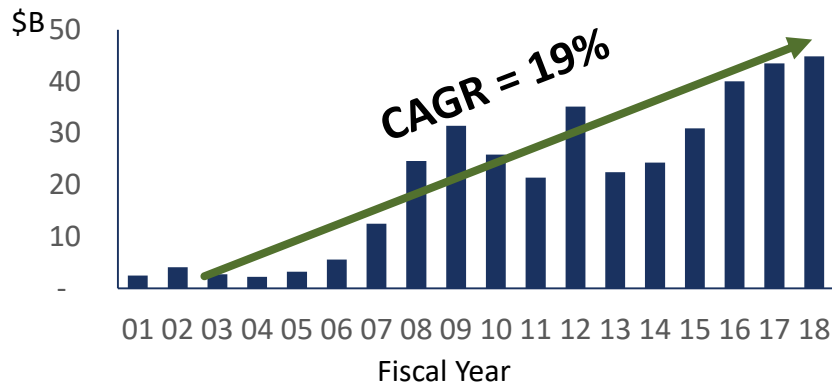
• World Bank president, Jim Yong Kim described India's jump in rank as a "**historic and unprecedented achievement**"

- Ranked 7th in the world in the ease of doing business metric of '**protecting minority investors**'
- Initiatives smartly aimed at addressing key issues should improve India's ranking further:
 - Resolving insolvency (rank 108): Insolvency and Bankruptcy Code (IBC), 2016
 - Paying taxes (rank 121): Goods and Services Tax (GST), demonetization

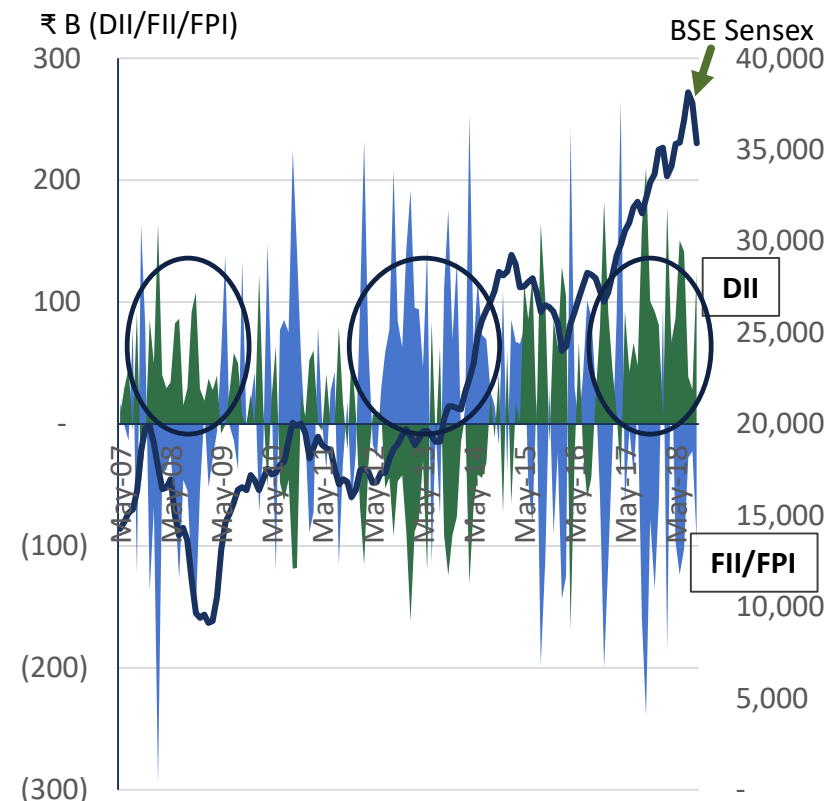
Source: World Bank's 'Ease of Doing Business' Reports

Investors continue to pour money into Indian markets

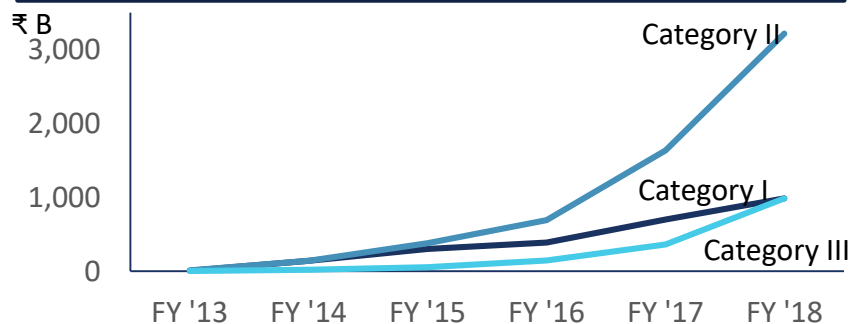
FDI Investment in India



FII/FPI & Domestic MF Investment in India



AIF Investment in India

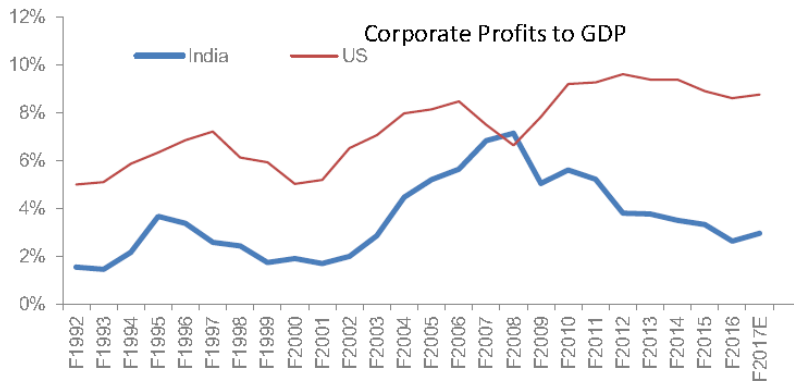


Source: Department of Industrial Policy and Promotion

Source: SEBI, BSE, Moneycontrol.com

Earnings growth is expected to drive returns

Corporate Profitability



NIFTY P/E Ratio



EPS Growth Estimate	FY '19e	FY '20e
Street Consensus – BSE Sensex	21%	20%
Morgan Stanley - Broad Market	21%	22%

- Profits starting at a low point versus history and US: India appears to be a great counter-cyclical play
- P/E ratio seems to be above average driven by low profitability, this should correct as profits grow

Source: CMIE, Morgan Stanley Research estimates, Craytheon.com

Risk factors that impact returns need to be considered

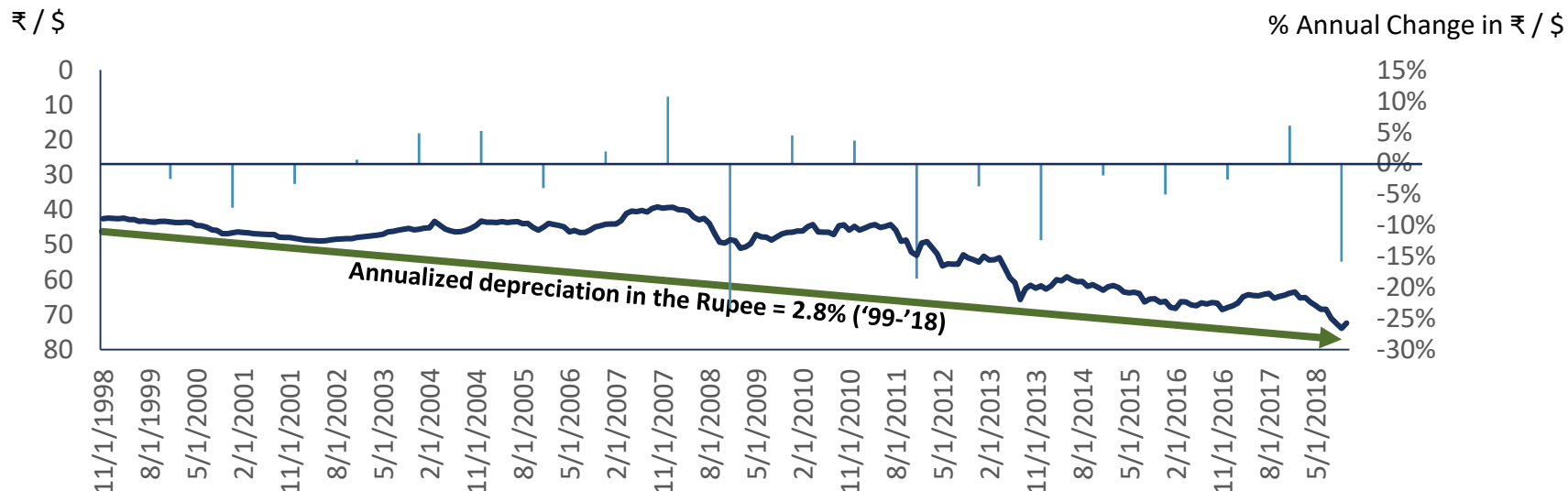
Rupee Depreciation

Employment Generation

Development of Infrastructure

Rupee depreciation needs to be factored into an investor's return calculation

Indian ₹ Per \$



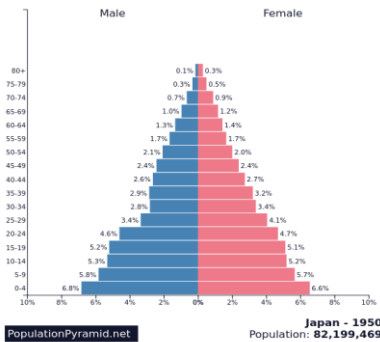
A mix of domestic and global factors impact ₹ / \$ exchange rate

- Oil prices – impact CAD, cause inflation, and cause rupee depreciation
- Liquidity situation
- Macro economic environment

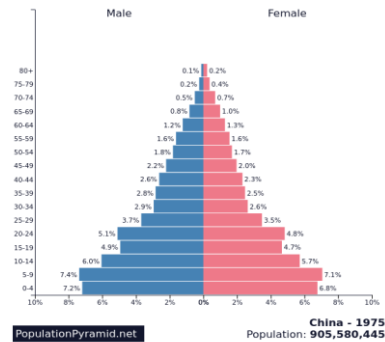
India's demographic dividend positions it for growth

Demographic Pyramid

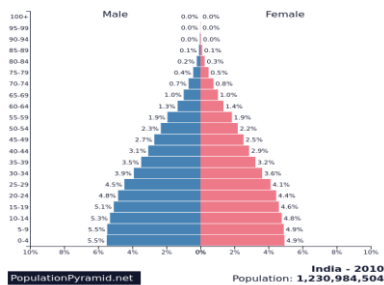
Japan (1950)



China (1975)

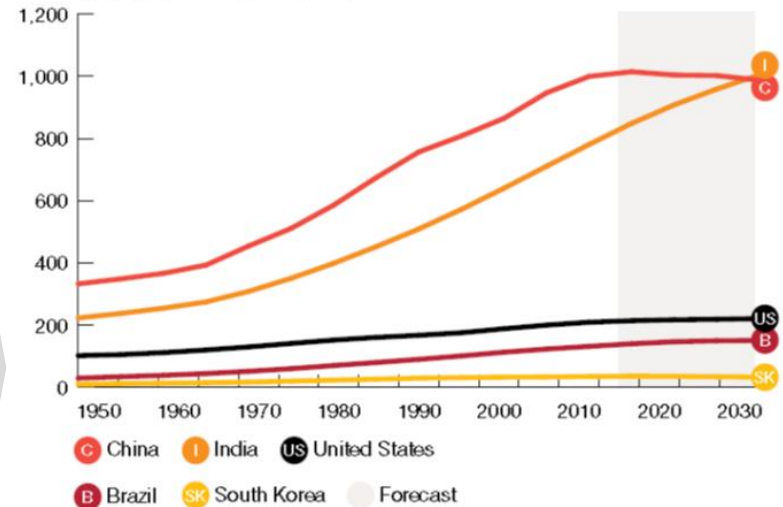


India (2010)



Demographic Dividend

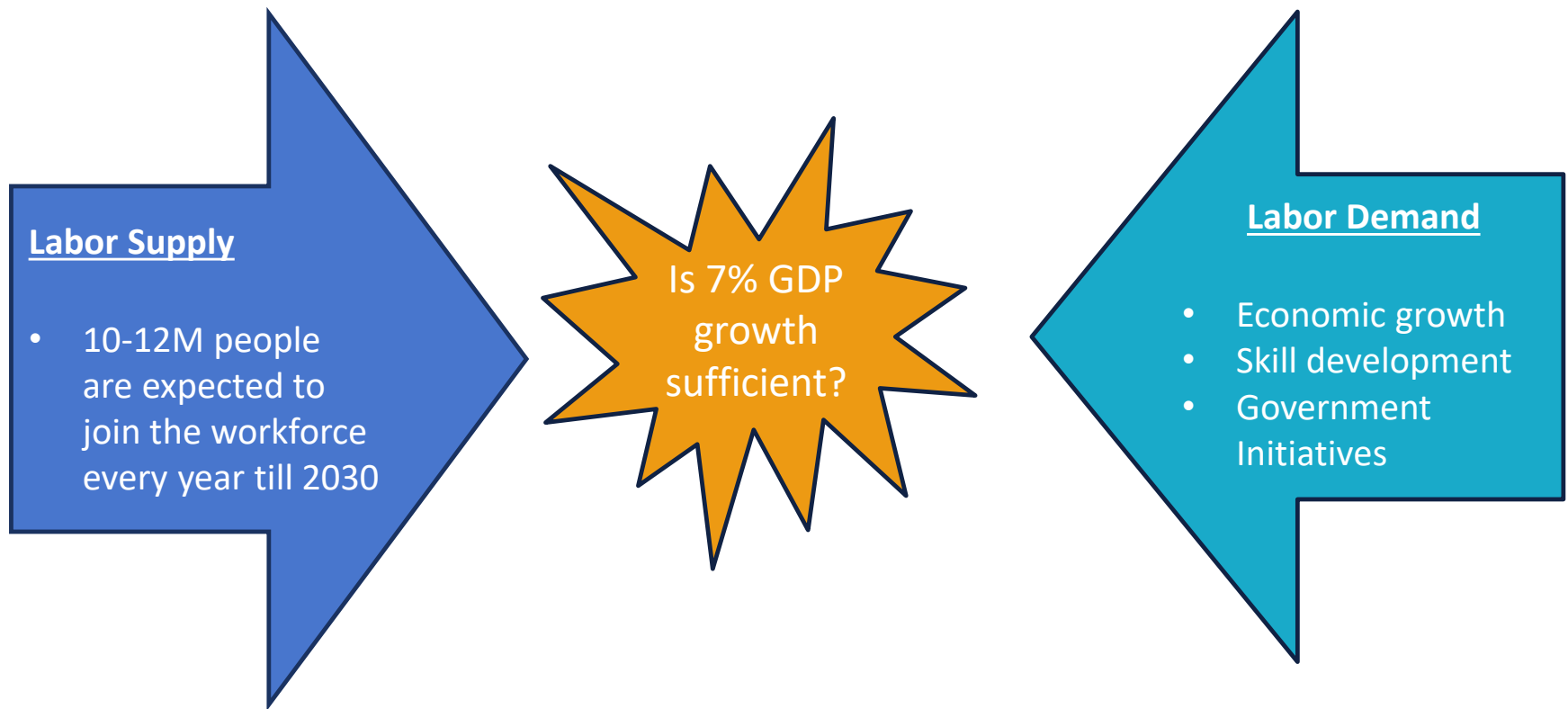
Working-age population (15-64 years)



Source: United Nations Development Programme

- ~65% of population is younger than 35 years
- Potential to fulfil demand for skilled workers worldwide as other countries face greying population

However, employment generation is required to benefit from the demographic dividend



India's infrastructure bottleneck is going to take time to solve

Stalled Projects are Impacting Private Sector

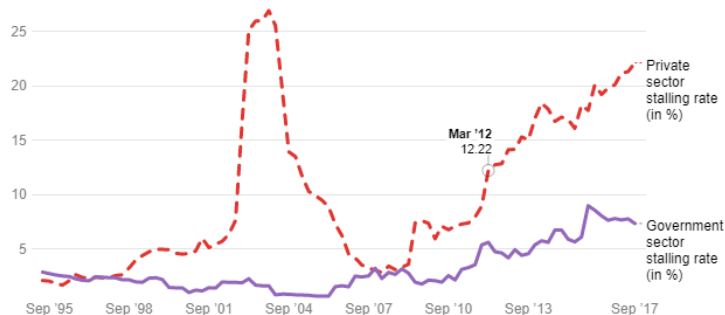
No. of Stalled Projects



Source: E&Y, CMIE

Stalling has affected the private sector more

Private sector stalling is worsening while there is marginal improvement for government projects. The gap between the two continues to widen.



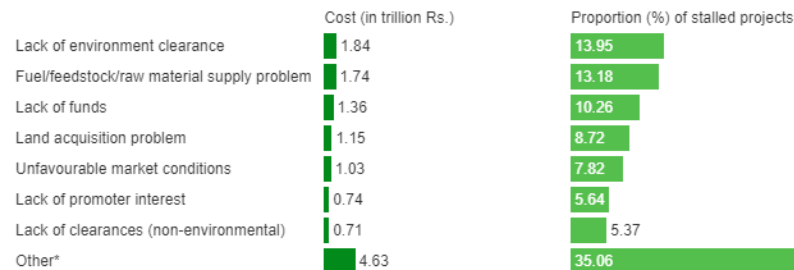
Stalling percentage is calculated as proportion of projects under implementation by value.

Source: CMIE, Mint calculations • [Get the data](#) • [Created with Datawrapper](#)

Infrastructure Sector Revival Requires a Multi-faceted Approach

Reasons for stalling

Lack of clearances and raw material problems have contributed the most to stalling



*Other includes reasons such as natural calamities and projects where reasons for stalling are not available. Stalling percentage is calculated as proportion of projects under implementation by value at the end of the September 2017 quarter.

Source: CMIE, Mint calculations • [Get the data](#) • [Created with Datawrapper](#)

- Government is taking steps but it is expected to be a long journey, given the constraints
- When infrastructure project execution pace picks-up, it will drive further growth



ASSET CLASSES AND RETURNS

On-shore investment options look relatively more attractive

Foreign-listed Securities

- Direct India exposure (few options, low trading volume, fees, tracking error):
 - US listed India focused ETFs and MFs
 - Indian company stocks ADRs and ETFs listed in foreign exchanges
- Indirect India exposure – Returns do not capture India-related alpha
 - S&P 500 or foreign listed stock
 - Emerging market funds

On-shore Investments

- India-listed securities
 - FPI or P-notes (Stocks, ETF, MF, PMS)
- Private Investments
 - AIF (PE, VC, Angel Funds, Impact Investing, Real Estate)
 - Co-investing (subject to sector and company limits)
 - FDI

Note: This presentation does not address tax implications. Investors should consider double taxation challenges.

Consumer sector: Indian subsidiary outperformance

Unilever



Whirlpool



Source: Yahoo Finance

Notes: Performance from date of listing or 1-Sep-07 to 1-Oct-18

Industrial sector: Indian subsidiary outperformance

Johnson Controls



Honeywell



Source: Yahoo Finance

Notes: Performance from date of listing or 1-Sep-07 to 1-Oct-18

India has outperformed S&P 500 as well as the MSCI Emerging Market Index



To invest in India's performance – doing it through emerging market funds is highly inefficient

Indian hedge fund returns have outperformed other regional managers

Asia-Pacific-Based Hedge Fund Performance by Manager Location

2017 YTD	12 Months	3-Year Annualized	5-Year Annualized
India 16.94%	India 15.24%	India 11.28%	India 16.21%
Hong Kong 12.58%	Hong Kong 13.52%	Japan 7.32%	Japan 11.11%
Singapore 9.38%	Japan 13.06%	Hong Kong 6.71%	Australia 9.95%
Japan 6.66%	Singapore 7.86%	Australia 6.68%	Hong Kong 9.63%
Australia 4.05%	Australia 6.74%	Singapore 5.65%	Singapore 8.28%

Source: Preqin Hedge Fund Online

Local network is critical to identifying top-performing PE/VC managers

- PE/VC performance
 - Manager diligence is critical
 - **Network matters** for local diligence

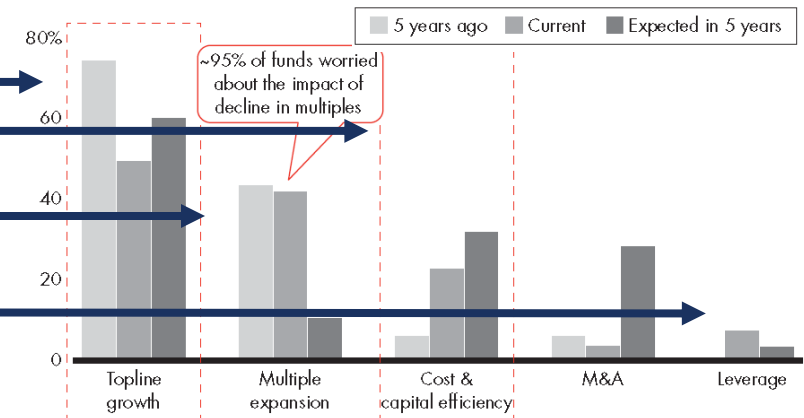


Top Performing Funds Investing in India (USD Net IRRs)

Vintage	Max Net IRR	Min Net IRR	Median Net IRR	No. of Funds
Pre-2003	39.7%	7.0%	18.2%	6
2003-2005	89.2%	-5.6%	11.9%	11
2006-2009	16.1%	-11.2%	8.0%	15
2010-2014	14.7%	-15.7%	6.3%	12

- PE/VC sources of value creation
 - Value-add: **Network matters** for MSME; Operational value-add and cost efficiency for large companies
 - Multiple expansion: **Network matters**
 - Leveraged buy-outs: small market may grow with IBC

What was the biggest factor in return on the deals you exited, and how do you see things changing over time?



- Impact investing IRRs can be attractive *

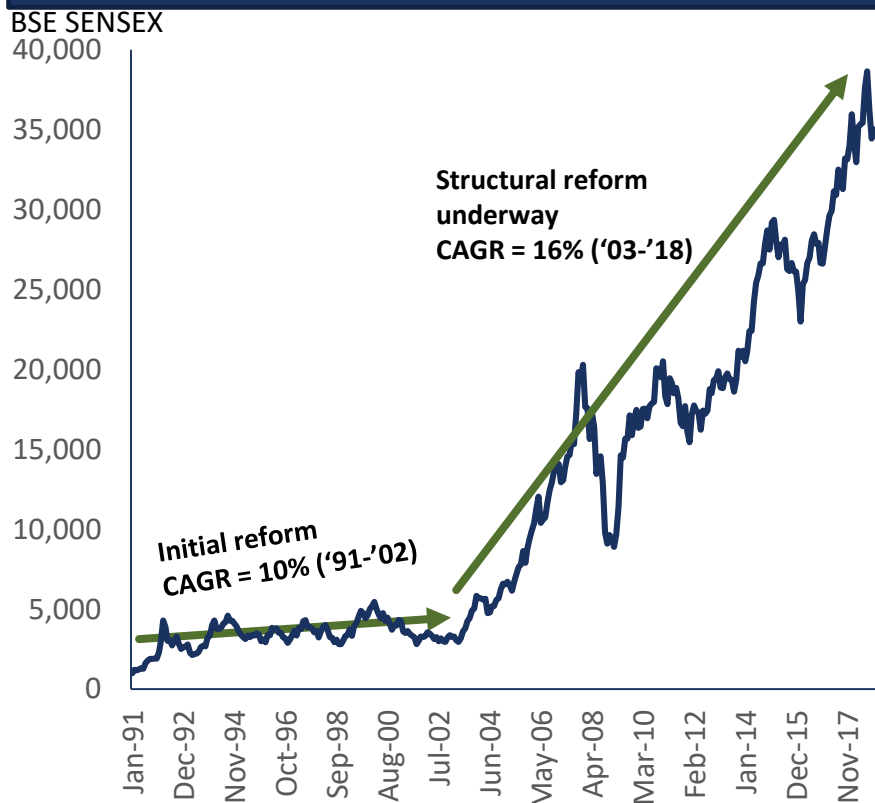


Top Tercile	Mid Tercile	Bottom Tercile
34%	10%	-1%

Source: India Private Equity Report 2018 by Bain & Company, Inc., Prequin Insights Alternative Assets Nov-2017, India@2030 by TV Mohandas Pai, Impact Investors Council, VCCEdge, McKinsey analysis. Notes: Based on IRR for 48 exits between 2010-'15

Investor market returns accelerate as the structural changes deliver

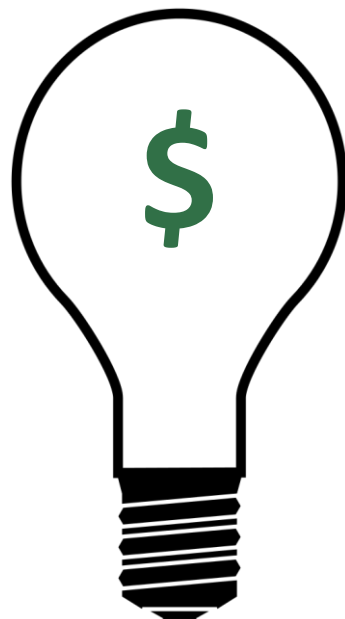
Structural Reform Delivers Attractive Returns



Source: BSE

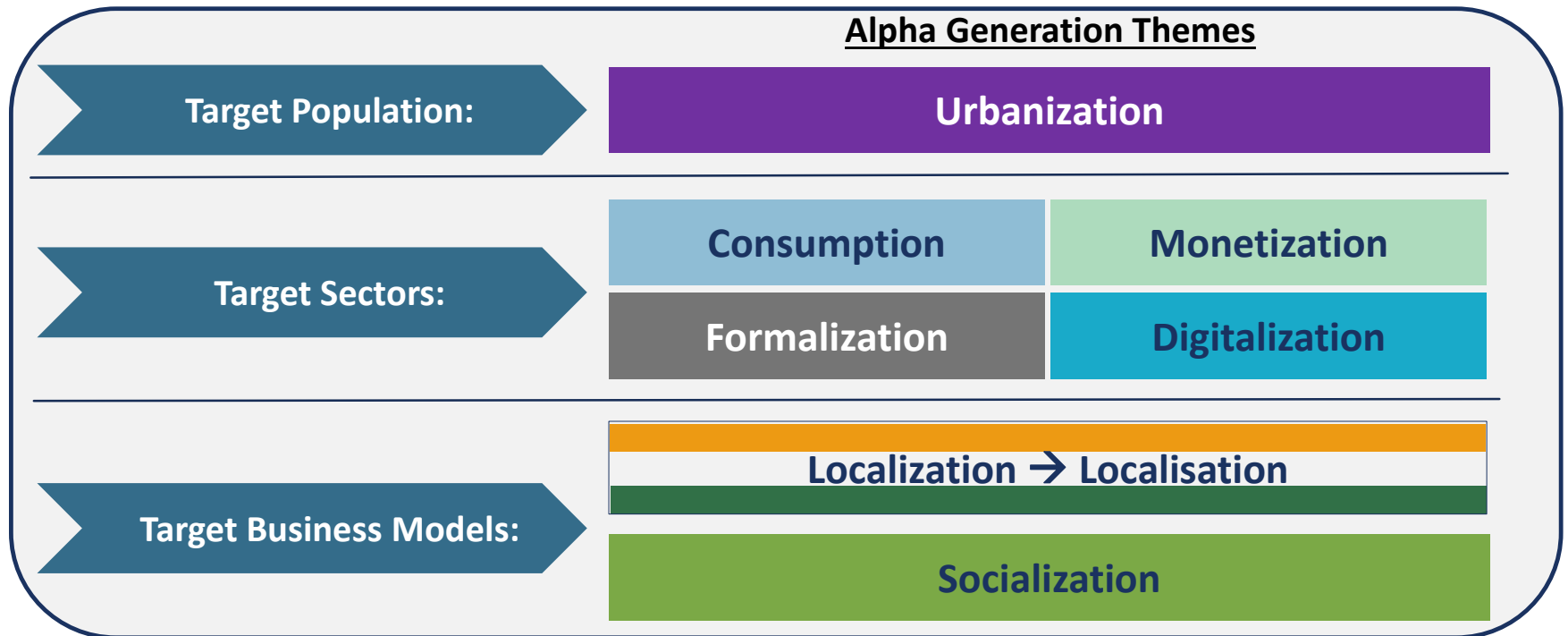
Sustainable Market Return Expectations, Over Next Decade

Metric	Estimates in %
GDP growth	7%
Revenue growth (1.5 to 2.0x multiplier)	10-14%
Cost saving (efficiency)	3-5%
Profit margin growth (post-tax)	13-19%
ASSUMING NO CHANGE IN MULTIPLE, Return in ₹	13-19% (average 16%)
Rupee depreciation vs. \$	3-5% (average 4%)
Return in \$	10-14% (average 12%)



GENERATING ALPHA IN INDIA

Top-down thematic 'Alpha Generation Model' for India



- Identifies sizeable market segments growing faster than GDP served through attractive business models
- Businesses benefitting from multiple themes and recent institutional initiatives are more attractive
- Requires bottoms-up analysis, detailed diligence through local networks, and fit with investment strategy

Urbanization

Labor migration towards urban population in Tier 1, 2, and 3 cities for jobs

Market Opportunity


Urban population '20:

>470mn 

Urban GDP % of Nat'l '20:

 >70%

Urban GDP growth '15-'20:

8.8% 

Sample Institutional Initiatives

- Smart Cities Mission
- Housing, Transport, and Sanitation

Investment Themes

- Caters to growing needs for basic amenities
- Delivers goods and services that save time and deliver ease of use for a busy lifestyle
- Satisfies aspirational lifestyle needs
- Serves growing businesses

Source: E&Y, Government of India

Consumption

Growing aspirations and rising GDP per capita lead to growing consumption demand

Market Opportunity

- Consumption % of GDP in FY '17: 58%
- Rising per capita income; >50M households - \$10k disposable income
- Growing middle-class: >50% of population considered middle-class

Sample Institutional Initiatives

- GST (Goods and Services Tax)
- Reduction in small business tax rate

Investment Themes

- Serves under-penetrated and growing sub-segments of consumption sectors
 - Education, Food and beverage, media & entertainment, health and wellness, travel
- Considers right-sizing consumption market appetite – incorporate lifestyle and income
 - Lifestyle (e.g., weddings, apparel, retail, jewellery, automobiles, media & entertainment)
- Combines well with localization

Source: Economic Survey 2018, Euromonitor International from national statistics/UN

Monetization

Private sector is well-positioned to grow from saving and lending growth in a fast-growing economy

Market Opportunity

- 300M people have credit scores
- Cleansing of public sector bank balance sheet
- Increase in insurance, credit, investment product penetration

Sample Institutional Initiatives

- IBC (Insolvency and Bankruptcy Code)
- ARC (Asset Reconstruction Company)
- NCLT (National Company Law Tribunal)
- UPI (Unified Payment Interface)

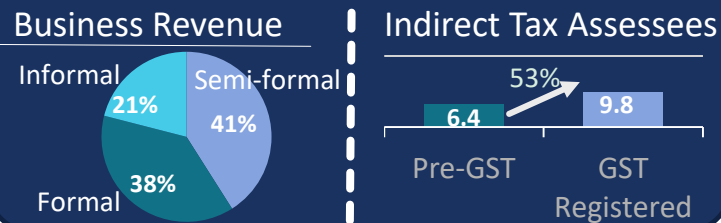
Investment Themes

- Growing market share of private sector players across the board: insurance, banking, and asset management
- Companies with proven track-record, healthy balance sheets, and exposure to consumer sector

Formalization

Movement towards driving compliance so more companies will be paying taxes and obeying labor laws

Market Opportunity



Sample Institutional Initiatives

- GST (Goods and Services Tax) Network
- Demonetization
- Aadhar card
- Direct benefit transfer

Investment Themes

- Benefits leading organized sector players with proven ability to scale
 - Reduced competition from unorganized sector
- Improves profitability by easing pricing pressure from unorganized sector

Source: Economic Survey 2018, Government of India

Digitalization

Technology businesses in India are driving efficiency, ecommerce, and other digital solutions

Market Opportunity



Sample Institutional Initiatives

- Aadhar Card
- eKYC

Investment Themes

- Operates e-commerce (includes mobile commerce) businesses - successful unicorns have been created and there is room for more
 - Digital content, consumer services, financial services, retail, travel
- Offers innovative and efficient solutions through new ventures (start-ups)
- Offers IT products and services to businesses

Source: PwC and NASSCOM

Localization → Localisation

“Make-for-India”: Businesses that customize to meet local needs and more likely to succeed in India

Market Opportunity

- Diversity: Local languages dominate -10-20% Indians are fluent in English
- Affordability: Foreign models address niche markets
- Infrastructure/ecosystem is nascent

Sample Institutional Initiatives

- “Make in India”

Investment Themes

- Creates customized offering for the local market in India
- Manufactures in India to drive cost advantage
- Operates on the efficient frontier of price/quality demand curve (deliver value not only low cost)

Socialization

Opportunity to invest in economically viable businesses that also help society

Market Opportunity

- Impact investing market in '25E: \$6-8B
- Parts of traditional investing can be considered if the goal is to improve access to livelihood and quality of life

Sample Institutional Initiatives

- AIF structure – Category I
- Government partnerships

Investment Themes

- Provides access to livelihood
 - Facilitate skills development
 - Contribute to job creation
- Improves quality of life
 - Address housing problems
 - Improve quality of healthcare
 - Facilitate financial inclusion

Source: Impact Investors Council, VCCEdge, McKinsey, SEBI, Government of India



THANK YOU



Tapan V. Gandhi, CFA

Private Investment and India Investment Specialist

Linkedin: <https://www.linkedin.com/in/tapangandhi>

Email : tapangandhi.cfa@gmail.com

Phone : +1 434-321-8114