



The Case for India

India: Standing Out from the Crowd

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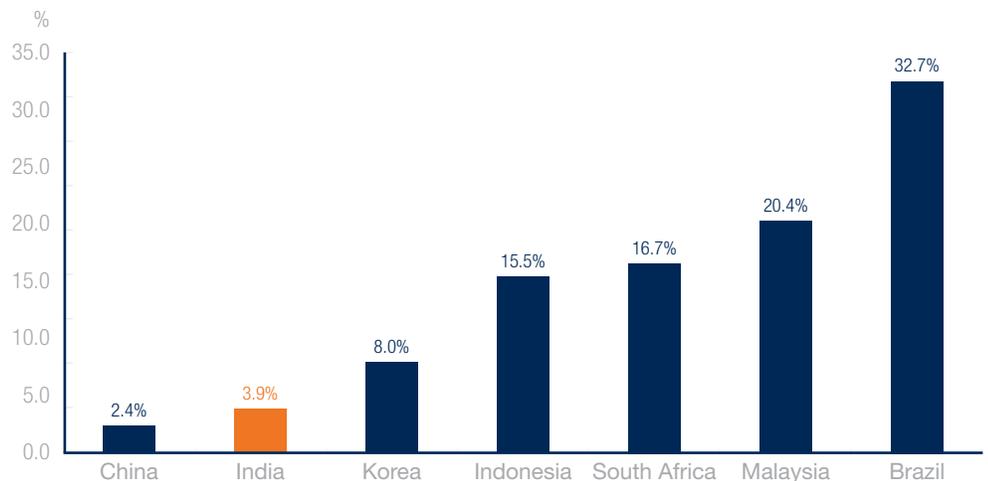
India: Standing Out From the Crowd

Top-Down Story – Considerable Improvement

A positive structural story has made India stand out among emerging markets. India's household debt is less than 15% of gross domestic product (GDP),¹ it has a young and educated population (median age of 27 years²), and good governance. Given these favorable growth drivers, India is set to become the fastest-growing country in the club of economies of more than USD 2 trillion, with GDP growth expected to surpass 7% in 2016, accelerating from 4.5% - 6.5% in 2014.³

YTD Depreciation vs. USD

Source: Mirae Asset Global Investments, Bloomberg (September 2015)





In the past, India's Achilles' heel has always been on the macroeconomic side – twin deficits (fiscal and current account), high inflation, and a vulnerable Rupee. These weaknesses have been addressed by the new Modi administration and Reserve Bank of India regime under Mr. Rajan. The fiscal deficit is now on track to come down to 3% of GDP in 2017-2018⁴ compared to 6.5% in 2009-2010,⁵ along with a narrowing of the current account deficit to 1.3% of GDP in June 2015 compared to 5% at the end of 2012.⁶ Additionally, India's consumer price index (CPI) inflation has fallen to 4.4% in September from more than 8% in the beginning of 2014.⁷

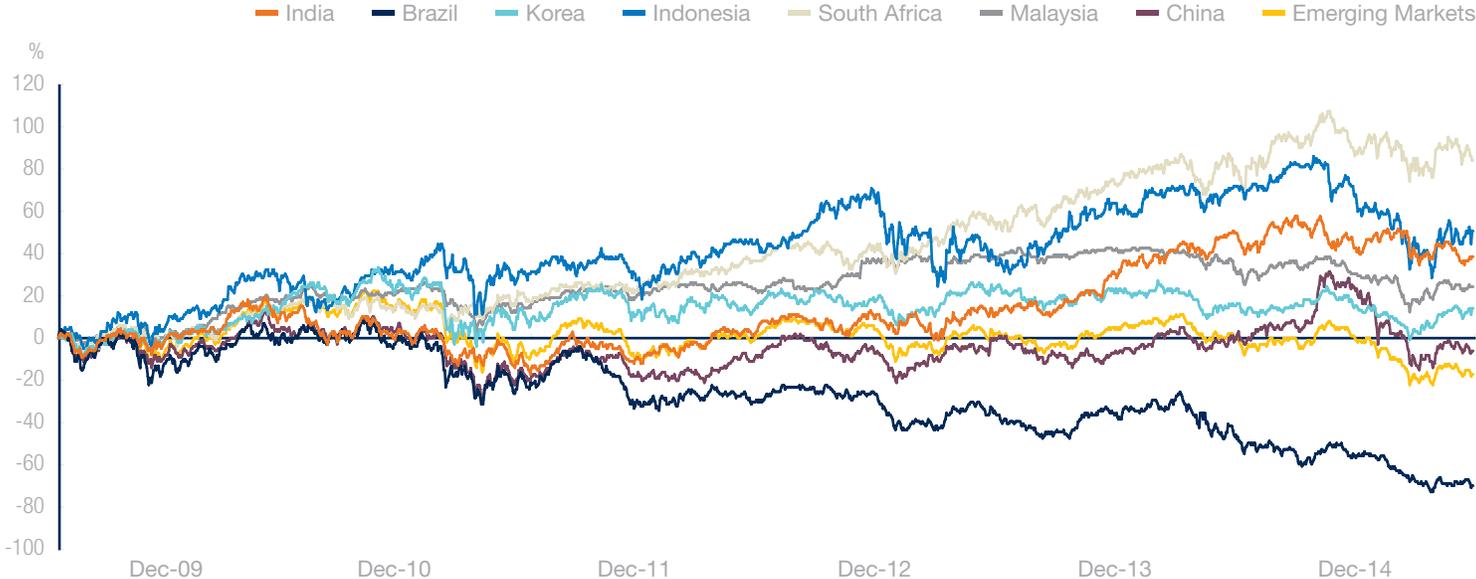
Due to these macroeconomic improvements India was relatively resilient amid the recent emerging markets turmoil. In addition to such progress India has low trade linkages with China (4.2% of

exports to China)⁹ compared to the rest of the region (more than 10% for Thailand and Singapore, and more than 25% for Korea and Taiwan),⁹ which helps isolate it from concerns over China's growth. As a result, the Indian Rupee has been more stable compared to other emerging market currencies on a year-to-date basis.

India's equity market has also fared well against peers in Asia, and more broadly emerging markets, on a year-to-date basis. In particular, its market weathered the bouts of volatility of recent years better than others. India has offered investors appealing performance in different environments as domestic conditions have improved, and continue to do so.

Emerging Markets Equity Performance (Since 2010)

Source: Mirae Asset Global Investments, Bloomberg (September 2015)



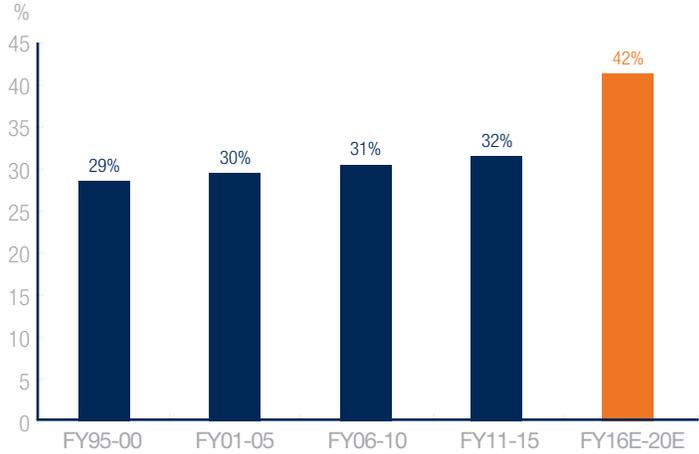
On the Ground – States Are Driving Growth

Opportunities to improve productivity provide plenty of low-hanging fruit for further economic gain. The Prime Minister’s financial inclusion plan enables the direct cash transfer of subsidies to previously un-banked citizens, with the potential to save 2% of GDP in subsidy leakages.¹⁰ Financial inclusion for the large rural population who have previously borrowed at 25% to 30% from moneylenders will boost rural productivity and consumption.¹¹ Improved road connectivity is also a key factor for growth in rural India, which accounts for half of India’s population.¹² With better roads, perishable and other more remunerative products can be more efficiently transported from production to demand centers, improving trade and creating standalone ecosystems of ancillary service jobs such as transporters, traders and retailers.

There were high expectations surrounding India’s reforms when Prime Minister Modi took office in mid-2014. While the pace of reform on the federal level has not been as brisk as many had hoped, as exemplified by the recent legislative missteps in the Land Acquisition and Goods and Services Tax (GST) bills, we are seeing notable progress at the state level. Driven by the need to create jobs, states are competing for investment by cutting red tape. For example, the state of Maharashtra recently signed a memorandum of understanding with Foxconn, the world’s largest electronics contract manufacturing company, to set up a production facility with an investment of USD 5 billion over the next five years.¹³ The leading business states provide the land and power, determine business conditions and receive a larger share of the country’s tax revenue, raising their importance in driving growth and reform.

States’ Share in India’s Net Tax Receipt

Source: Ministry of Finance, CLSA (June 2015)



Telangana Advertisement

Source: CLSA, Government of Telangana (June 2015)



Advertising Campaigns to Attract Investment by Rajasthan and Madhya Pradesh

Source: CLSA (June 2015)





Capturing Opportunities in India

Macroeconomic developments have little meaning for equity investors if they are not reflected at the company level. Strong macroeconomics help create a favorable business environment and minimize tail risks, but structural trends need to be reflected in company fundamentals because ultimately, stock prices reflect corporate earnings over the long run.

This also holds true in India. India is very heterogeneous in culture, language and economic activities among its various regions. This is why we believe in selecting stocks based on quality management and economic moats to capture market share over the medium to long-term across different categories. In addition, we believe it is important that a portfolio have multiple legs which can provide longevity to investing in India. We see companies in domestic cyclical sectors and export industries which are focused on innovation as a differentiator for medium to long-term competitiveness as viable business models that are most attractive to investors.

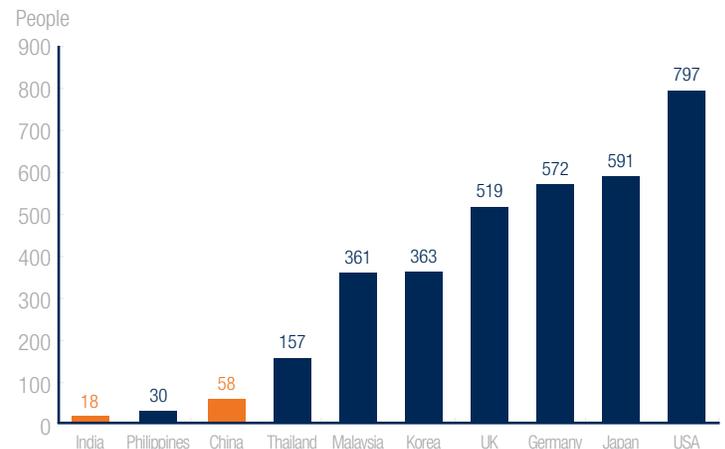
“ We believe it is important that a portfolio have multiple legs which can provide longevity to investing in India. ”

Domestic Cyclical – Consumers and Private Sector Banks

India’s favorable demographics, rising income, low household debt and greater urbanization are all structural tailwinds. One particularly bright area is the passenger car market, which we expect to follow the same trend seen in China. Passenger car penetration is at a low 1.9% in India, which is comparable to the 1.6% penetration in China in 2005.¹⁴ As of September 2015, China’s passenger car penetration stood at 7.8%.¹⁵ Maruti Suzuki, the leading passenger car manufacturer in India with 40% of the market,¹⁶ possesses an early and scalable benefit from the growth of the sector.

Car Penetration per 1,000 People (2010)

Source: World Bank (Accessed September 2015)



The growth in market share of private sector banks is another well-known story, and one which remains intact in our view. However, less well-known are the strides taken by private sector banks in the digital banking space. Digital banking remains key in India with 35% of the population falling between the ages of 15-34, the largest across any nation.¹⁷

India's Digital Landscape and Mobile-Banking Opportunity

Source: TRAI, RBI, World Bank, Euromonitor, CEIC, Citi, CLSA (2014)

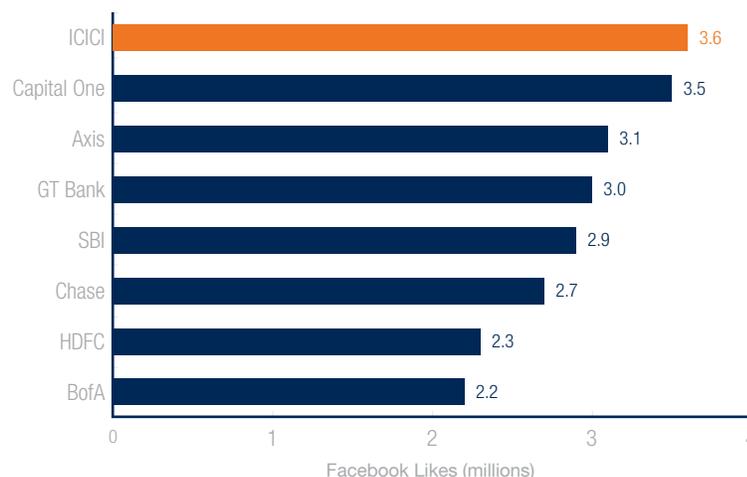
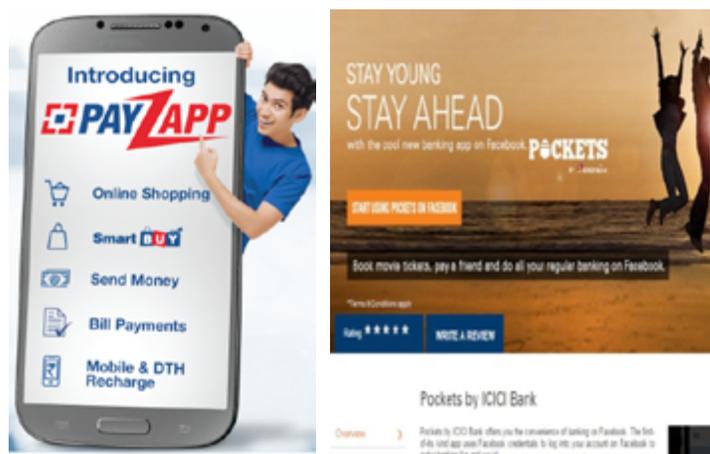


Digital platforms will play a key role on both the asset and liability side of the balance sheets of Indian retail banks. HDFC Bank has been one of the earliest adopters of digital banking. Approximately 85% of its banking transactions occur through non-branch channels, with digital channels such as mobile and internet contributing about 55% of the nontraditional total.¹⁸

ICICI Bank has also been at the forefront in developing digital platforms that will boost customer additions and cross-selling, driving growth in current and savings account (CASA) deposits, domestic loans, and fees. They were the first ones to launch a payments wallet – named “Pockets” – which can be used to make small value transactions. Another interesting initiative is that banks are connecting with customers on social media platforms. ICICI Bank, for example, is the most “liked” global bank platform on Facebook with nearly 4 million likes so far.¹⁹

Indian Banks – On the Forefront of Digital Banking

Source: Company website, The Financial Brand (2Q2015)





Export – IT Services, Pharmaceuticals

On the back of rising enterprise spending and the trend to outsource such functions in the developed markets, the Indian information technology (IT) services sector is one we would like to highlight. Indian players are seizing a larger share in both of these structural shifts. Despite the high labor intensity business model, we believe that India will maintain its leadership in this industry thanks to the country's large pool of educated talent with technology expertise and language abilities. India has the world's largest talent pool, adding more than 5 million graduates and post-graduates per year.²⁰ With a cost base two to four times cheaper than the US, Indian IT services companies are expected to grow at 13% and 16% during 2016 and 2017, respectively.²¹ Cognizant Technology, for example, is making notable gains within the healthcare vertical. One trend that keeps us positive on the long-term growth of the company is that it continues to grow its strategic client base while revenue becomes less concentrated as it diversifies its client list.

Indian pharmaceutical companies have steadily gained market share in the fast-growing US generics market. While these companies started with simple generics, the larger companies are climbing up the value chain with complex generics, which enjoy higher margins. In addition, the US patent-expiry cycle remains strong, with USD 100 billion worth of drugs expected to go off patent protection over the next five years.²² Sun Pharma owns one of the most robust product pipelines among Indian peers with a focus on complex and technology-based products. The firm carries 140 abbreviated new drug applications (ANDA) that are pending approval in the US,²³ one of the highest among Indian companies. Sun Pharma also holds a leadership position in the domestic chronic disease segment, where it is in the top three in over half of its products.²⁴

US Patent Expiry – Generics Opportunities

Source: CS, IMS Health, Mirae Asset Global Investments (3Q 2014)



Healthcare Demand in India

Source: Narayana Hrudayalaya IPO Prospectus, Mirae Asset Global Investments (September 2015)





Valuations – Justified Premium

While valuation is not cheap where the MSCI India trades at nearly 20x forward earnings,²⁵ we believe the premium is justified. In addition to being one of the few structural growth stories with superior growth remaining in a world scarce in demand, Indian companies are generally more profitable as demonstrated by the superior Return on Equity (ROE) relative to global equities.

From a regional perspective, we are able to find a disproportionately high number of companies that sustainably achieve high quality superior growth rates. India has the highest number of companies (25%) achieving over 20% earnings growth and ROE in at least three out of the past five years within the MSCI Asia ex Japan index.²⁶ As a result, Indian equities have historically commanded a premium over global peers – current valuation premium is in line with historical average.

P/E Ratio: India vs. World

Source: Mirae Asset Global Investments, Bloomberg (October 2015)



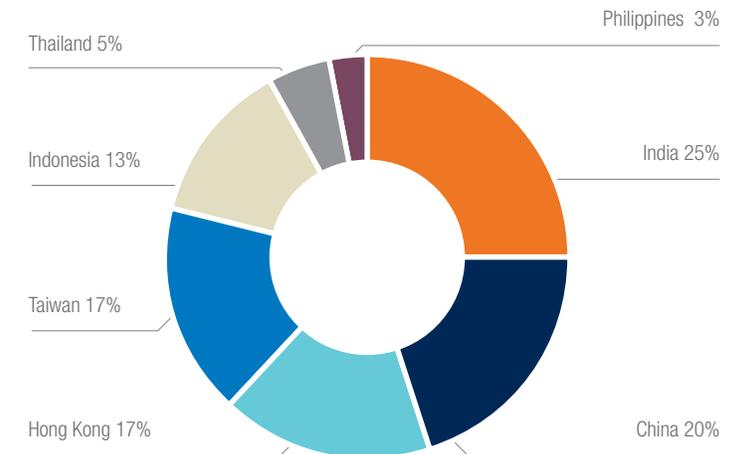
ROE: India vs. World



Sustainable High Quality Growth

Source: FactSet, Mirae Asset Global Investments (November 2015)

*Note: Percentage of companies within MSCI Asia ex Japan achieving >20% earnings growth and ROE in at least 3 out of past 5 years
Number of companies passing criteria is equal to 60.*





Conclusion – Poised for Healthy Growth

India is in a good position to enjoy a period of healthy, sustainable growth as the current account and fiscal deficits are brought under control, inflation tempers due to benign commodity prices, linkages to a slowing China remain modest, and the Indian Rupee weathers emerging market storms. While the pace of federal reform has trailed expectations somewhat, the Modi administration appears committed to enacting market-friendly legislation and bringing good governance to India. In a young country burgeoning with ambitious talent, it is the states that are piloting real change on-the-ground to create jobs and catalyze economic growth.

Our bottom-up, research-driven approach has identified consumer cyclicals and private banks as compelling investment opportunities. Indian consumers desire to drive cars and employ their mobile phones for financial transactions. IT services will continue to benefit from the outsourcing of software functions in developed markets in concert with an uptick in enterprise spending, and more sophisticated pharmaceutical companies are poised to capitalize on upcoming US patent expirations. We view India constructively for the next 18-24 months and believe that it merits renewed consideration in any portfolio.

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