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International

Global research and insights from Frontier Advisors

Issue 48 April 2020



India Study Tour

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25
years

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Frontier regularly conducts international research trips to observe and understand more about international trends and to meet and evaluate, first hand, a range of fund managers and products.

In conjunction with insights we share with our Global Investment Research Alliance partners, these observations feed into our extensive international research library.

This report provides a high-level assessment on the key areas and observations unearthed during this recent Real Assets research trip. We would be pleased to meet with you in person to provide further detail on these observations.

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Introduction

Australians have always had a connection to India through the shared Commonwealth ancestry, love of cricket and the fact that Australia's third largest immigrant population is from India. While our connection is strong, the level of investment in India by Australian investors is relatively small manifesting mainly through emerging market equity and debt investments. Direct investment in India by Australian investors remains the exception rather than the rule.

In November 2019, Frontier conducted its inaugural Study Tour to India. While Frontier has made several trips to India over recent years as part of its capital markets and real assets research programs this was the first time that Frontier has been joined by clients as a general research trip. Over the week-long visit, Frontier met with a range of organisations including The Reserve Bank of India, various Ministry offices, leaders of the main state- and privately-owned banks, infrastructure developers, locally based investment teams of Canadian pension funds and investment managers across New Delhi and Mumbai.

The primary purpose of the trip was to gain a greater understanding of the opportunities presented by a country that is vast in size, population and economic growth but also to understand the risks and different avenues of potential investment. We note that the current environment impacted by COVID-19 will dull and reverse economic growth rates worldwide including India. However, when the world emerges out of this global pandemic the factors that make India an attractive destination are expected to still be there.

The scope for the study trip was broad and covered a range of topics. The following points cover various key observations across a range of topics.



People

It is well known that India benefits from strong demographic trends. India is the second most populous country in the world, expecting to overtake China for the top spot in the coming decades. India's population is very young by global standards with 800 million below the age of 35 and contains a populous emerging middle class.

This increasingly globally connected population also has high expectations of its government as it continues to emerge as a global power.

Geography

India is comprised of 28 mostly heterogeneous states each with their own distinctive cultural identity, languages, laws and regulation with their own strengths and weaknesses. On several occasions India was compared to the EU comprised of multiple states.

This presents direct investors with another challenge in first identifying the most attractive regions along with navigating the state-based rules.

Politics

In 2019, The Modi-led Bharatiya Janata Party (BJP) government strengthened the majority lead it secured in the federal election of 2014. The 2014 election victory was the first time in living memory that the ruling party had a majority with all previous leaderships having been coalition governments.

The BJP's decisive victory in the 2019 election has further emboldened Modi's BJP government to accelerate and further pursue its ambitious reform agenda. The BJP government is currently seeking to further consolidate its power by targeting state elections in each of India's 28 states.

Reforms

The Modi government has taken advantage of its majority and has been active with many key financial reforms including:

- Demonetisation and digitisation– the aim of reducing the amount of currency in circulation was to bring a greater proportion of the population into the regulated economy (and reduce the size of the informal economy which is estimated that over 60% of the population is in). This reform also embarked on the digitization of the economy with the creation of over 250 million bank accounts for a large proportion of the population that had previously been unbanked, in conjunction with social security payments moving to electronic transfers, all reducing the cash economy.
- Consolidation and broadening of GST - Significantly decreasing the administration, accounting and tax related to running a business operating across multiple states.
- Establishment of Insolvency and Bankruptcy Code (IBC) in 2016, which consolidated the pre-existing rules into a single law to accelerate the resolution of stressed assets in India helping credit flows as lenders now have more practical security over assets. Prior to the IBC, corporates and LLPs were effectively borrowing with little practical resource over their assets.

Ambition

The spirit of optimism and ambition was abundant across all of our meetings to various degrees. Naturally, it was the Ministers that presented the ambitions of government, which was echoed in a more muted manner by the corporate sector. Modi was described as a “good CEO”, setting overly ambitious targets/challenges and accepting the outcome when they were only 80% met. Several examples discussed were:

- The Federal Government has set a target to deliver 450GW of renewable electricity generation by 2030 (to put that into scale the entire Australian power generation capacity is less than 50GW). The key developers of renewable energy facilities felt this was an ambitious target that had little chance of being met but felt a good proportion would be delivered.
- Road & Highways – There are plans in place to build a second highway that connects New Delhi to Mumbai (Delhi to Mumbai Expressway) that will see driving times between the two cities reduce to 12 hours (currently 22 hours). The government expects the 1,320 kilometre highway to be completed by 2023 at a cost of around US\$14 billion. This in conjunction with plans to create a transport corridor between the two most populated cities including a fast train line.
- Airports – There are ambitious plans for the construction of an additional 100 airports, to service a greater proportion of the 53 cities with over one million population, which will only increase as urbanization grows from 31% to 50% over the coming years.
- It was abundantly clear that there would be significant development of infrastructure projects across the country. Much of this development will need private capital to help fund projects with offshore investors keenly sought.



Funding

The message from all the Ministers we met with was that India is welcoming of foreign direct investment to develop the requisite projects. We sensed an air of humility by the government with the majority of Ministers asking for feedback and advice on what India could be doing to attract more investment capital. A non-exhaustive list of funding examples discussed include:

- The Toll, Operate and Transfer (TOT) programme developed by the government where the government develops the asset, operates it for one to two years and sells it as a de-risked, mature asset with operating history and greater certainty of cashflows. The plan is to recycle the proceeds from the TOT to fund new projects through the riskier development stage.
- The ministry of Transport establishing an infrastructure REIT, which will make it easy for anyone in India and abroad to invest in various Indian infrastructure projects.
- The establishment of the National Investment and Infrastructure Fund (NIIF), which is co-owned by the Indian government to attract foreign capital to invest in greenfield and mature infrastructure investments sold by the government.

Investment

We met with several large investors that had been investing in India including the Canada Pension Plan Investment Board (CPPIB) and Caisse de Depot et Placement du Quebec (CDPQ). The one sentence summary was that there are fantastic opportunities for investment, but also fantastic opportunities for losses. The key advice from large foreign investors and corporates was to:

- Limit investments into mature, developed assets as opposed to taking development risk as it is not priced sufficiently by the market.
- Partner with like-minded “honourable” organisations following significant due diligence.

Have a local presence staffed by local investors who have been educated overseas and have a strong connection



Sensitivities

It was apparent that land and labour were two key areas of sensitivity for government, developers and investors alike. There appeared some progress on acquisition of land from land owners however several investors noted the discomfort and potential ramifications associated with laying off inefficient labour following the implementation of more efficient processes, mechanization or technology initiatives. Certain corporates commented that they were addressing this through voluntary redundancies and superior severance packages to mute a potentially explosive subject. Some of the rules discussed included:

- Public Interest Adjudication - where anybody in India can lodge a challenge on any construction project in India through the court system, which can tie up and delay projects as the public interest adjudication is worked out.
- Land and Right-of-Way risk – the acquisition of land to build infrastructure was seen as an ongoing challenge, however, government and corporates had been responding by offering “handsome” sums for these acquisitions – such that land owners had started to lobby to have projects come onto their land for the payout.



ESG

As a developing nation still on an urbanization journey there is a huge disparity in living conditions, wealth and opportunities amongst the population. India does not rank well on inequality measures with the income disparity worsening in recent years. ESG issues were front of mind with the delegation as we tried to understand what progress is being made or was it even a consideration amongst Government and Corporates in India. Key themes of discussions included:

- Social. Despite witnessing multiple examples of unsafe practices (workers not wearing safety helmets etc.) on our travels through Mumbai and Delhi, corporate leaders we met with assured us that practices are improving and moving towards global safety standards as these are increasingly non-negotiable requirements of project partners and shareholders.
- Environmental. We felt that the ambitious targets for renewable power generation were driven by 1) cost advantage over fossil fuel generation; 2) national security (reduce reliance on foreign fuel imports). Disappointingly, the desire to abate climate change did not seem a motive to increase the share of renewable power generation.
- Social. Despite asking various developers about their process for sourcing building sand, none were able to provide an adequate answer with respect to their procurement of the increasingly scarce resource. This was disappointing given the ongoing scandals associated with criminal activities related to the control of the building sand market in India.
- There was a sense of optimism with respect to reduction in corruption, which emanated from the desire to make India a viable destination for foreign investment capital, but also through the use to technology to better track flows of capital and payments.



The final word...

The key takeaway from our trip is that there are abundant opportunities for investment in India. Most of Frontier's clients will have some form of exposure through their emerging markets equity exposures, however the opportunity set extends considerably beyond this to other asset classes like credit, infrastructure, property and private equity. Larger investors can consider co-investments alongside various institutional investment managers or consider investing via pooled Funds (that directly target India, or include India as

part of a global portfolio). Despite the abundant opportunity, Frontier advises caution and encourages high levels of specialized due diligence for any specific investment in India as the investment landscape remains riddled with risks. We encourage investors with the scale for direct investments to tread lightly and adopt a patient approach in evaluating local partners, their history, culture and objectives for alignment before committing to any projects.





About Frontier Advisors: Frontier Advisors is one of Australia's leading asset consultants. We offer a range of services and solutions to some of the nation's largest institutional investors including superannuation funds, charities, government / sovereign wealth funds and universities. Our services range from asset allocation and portfolio configuration advice, through to fund manager research and rating, investment auditing and assurance, quantitative modelling and analysis and general investment consulting advice. We have been providing investment advice to clients since 1994. Our advice is fully independent of product, manager, or broker conflicts which means our focus is firmly on tailoring optimal solutions and opportunities for our clients.

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