February 2022

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Monthly Manager Views

FSSA Regional India Strategy

Back on the road, kicking tyres

We have just returned from India – the first investment research trip in India for our entire team in over two years. It was a liberating break from constantly hearing "You're on mute!" on video calls whilst simultaneously being forced to appreciate your kids' music lessons in the adjoining room. Saying, "Sorry we are a bit late, the traffic was quite bad," face-to-face is so much more satisfying!

Readers familiar with our team will know that assessing organisational culture is at the heart of our investment process. In that context, the comparison between meeting the CEO and the senior management team in his or her office versus a zoom call is like chalk and cheese. We can pick up several cues about culture before we even start the meeting. For example, in the composition of the car park, how bureaucratic the visitor check-in process is, whether there is segregation between management layers – right from the elevators they are allowed to use (yes, this is a thing!) – or if there are pictures of the CEO/owner with famous personalities in the boardrooms and so much more. When a new CEO of a company tells us that capital allocation is going to change for the better, we need to see the look in his or her eye and the body language and the mood in the office to believe it. For our team, a return to 'normal' feels like a major handicap has been lifted.

So what did we learn, having spent two weeks in Mumbai and meeting with 40 companies? Firstly, the bustle that one usually associates with India's financial capital is back. It was remarkable to notice activity levels – traffic, crowds at restaurants, queues in hotel lobbies and attendance at offices – rising on a day-to-day basis even during our relatively short trip. If Mumbai is a barometer of the times, the long-promised build-out of urban infrastructure is finally here: an underground metro, reclamation projects to build roads and public spaces, brand new fleets of electric buses, slum redevelopment and so on. The more seasoned among the team would temper our excitement, but we definitely see that there is activity on the ground.

Secondly, the mood among the corporates we met was cautiously optimistic. Some, who have historically stayed away from investing or stepping on the accelerator when their peers were gung-ho, such as Kotak Mahindra Bank and Ambuja Cement, are now talking about doing so. We believe that it will take some time for optimism to become more widespread among our holdings given recent history. Corporate India has experienced numerous challenges over the past decade, including dealing with the fallout of scams after the allocation of natural resources (coal, iron ore, telecom spectrum); the resulting wipe-out of state-owned banks that were guilty of funding most of the said excess; demonetisation; implementation of the nationwide Goods and Service Tax (GST); the Non-Banking Finance Company (NBFC) crisis which indirectly crippled growth for the real estate sector; and several industry-specific regulations (India moved its auto emissions standards from the equivalent of EURO 4 to the latest EURO 6 in just three years vs. nine years in the EU[1]). All of these changes are great for the long term but ended up impairing short-term growth. The country was just about limping back to normality after all this (refer to our updates from end-2019) and then there was an infected bat somewhere...

Over the past two years, most corporates have been in a consolidation mode, shoring up their balance sheets and cutting their operating costs. We have also noticed that leading players in each industry are gaining market share – a natural outcome of regulations that favour organised players and serve to root out companies that have been operating outside the formal economy with respect to taxation and labour laws, etc.

[1] https://www.transportpolicy.net

In the near term though, cost inflation is at the top of mind for all the management teams we met. It is clear that margins and working capital will be under some stress in the coming year and it will be a test for managers who have never run companies in severe inflationary environments. We had been surprised at the extent of price hikes undertaken by a wide swathe of companies last year and only now are the effects being felt, with many beginning to see demand-destruction and down-trading. This means that franchises with superior pricing power, and managers adept at maneuvering supply chains and distribution networks through pricing volatility, will emerge stronger in the medium term.

These short-term headwinds aside, as usual, we spent the majority of our time with owners and CEOs, having direct conversations about the issues that really matter — capital allocation plans, board composition, succession, remuneration practices, and environmental and social headwinds that that they face. It is on issues like these that we look for long-term alignment and we enthusiastically report that we find it more among Indian companies than anywhere else.

Despite all its failings, India has managed to recover strongly from the tragic situation it found itself in last year and is well placed to face similar challenges in the future. As someone said to us during the trip, 1.8 billion jabs have gone into Indian arms — all of them made in India, administered by Indians and most importantly, the vaccines certainly work. The underlying 'order in chaos' that is characteristic to India is what we like when investing in this market, instead of the seemingly monolithic 'order' masking massive underlying chaos in some other places in the world.

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* Company data retrieved from company annual reports or other such investor reports. Financial metrics and valuations are from FactSet and Bloomberg. As at 18 March 2022 or otherwise noted.