

PODCAST TRANSCRIPT

Talking Research: India's enticing domestic growth story

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Katie Boyce: Home to over 1.4 billion people, India has surpassed China as the world's most populous country. Nearly half of that population is under the age of 25. Put those huge numbers into context, that means roughly 1 million people enter the labour market there every month. The potential for this young workforce to transform India's economy is huge. Two members of our Research team have recently returned from a fortnight in the country. And from consumer goods companies to IT services, the drinks industry to insurance and banking; they've returned with some intriguing insights into what's driving growth across India's domestic economy today.

Hello and welcome to *Talking Research*, a podcast from Walter Scott. I'm Katie Boyce, an investment writer at the firm, and I'm delighted to welcome investment analyst Connor Graham to the studio today. Connor first made his mark on the firm as an intern back in 2019, and the following year he joined the firm within the Investment Operations team before finally moving to Research in 2022. He's a member of the Asia and EM teams and having travelled to India already last year, it's great to welcome him here to talk about this latest trip. Connor, thank you for being here.

Connor Graham: Not at all. Hi, Katie.

KB: Before we get started, a reminder that the podcast is intended for investment professionals only and should not be construed as investment advice or a recommendation. Any stock examples discussed are given in the context of the theme being explored, and the views expressed are those of the presenters at the time of the recording.

So Connor, you're just back from India. Could you start with a quick overview of the trip?

CG: Of course. So back in September, Fraser Fox and I travelled out to India and spent a really engaging two weeks meeting with some of India's most exciting growth businesses and perhaps more importantly, sharing insights and spending time with the people that run them. So the objective of the trip was really twofold. As with all research trips the team go on, we were focused on understanding the domestic investment opportunity set and the specific growth opportunities in front of those companies. But this time around, we were also more keen to dig deeper into the forces currently driving growth across the domestic economy.

During our time on the roads, we covered four cities. So we started in Mumbai in the first week and then in the second week we moved up north and used Delhi as a bit of a base to kind of cover off the nearby economic hubs of Noida and Gurgaon. We were lucky enough to secure face to face meetings with 35 companies over the fortnight, and those business were very well spread across the industrial sector spectrum and then also varied pretty significantly in terms of size. I'd add also that of those 35 meetings, we actually managed to get to all of them on time, which is a bit of a logistical miracle given the unpredictability of the traffic, especially in Delhi.

KB: And India is a hot topic for many investors at the moment. Why is that?

CG: Yeah. So interesting question. So Walter Scott have been pretty frequent visitors to India over the past decade. Most recently, Alan Lander and I were there in February 2023. And most simply, I suppose, the scale of both the domestic economy and the population make India unavoidable as a market to understand and appreciate from the perspective of a global investment manager like Walter Scott. But when you combine that scale with the

extraordinary rate of economic development and growth evidenced over the near past and also the clear, multi-decade runway for that trend to continue, that marks India out as a potentially fertile hunting ground for long-term growth investors like us.

To put that scale and growth into perspective. The IMF expects India to post a GDP growth rate north of 6% over the next five years, which would result in it becoming the world's third largest economy by 2027, after the US and China. The macro picture predictably flows through to the stock market, and since the Covid lows in March 2020, India's NIFTY 50 index has appreciated by over 200% and India is now the largest country constituents of the MSCI EM IMI index.

And finally, kind of having been frequent visitors to the country over the years, the Research team here at Walter Scott has identified a number of high quality, unique growth businesses capitalising on really exciting structural opportunities in the past. And it's important, as always, for us to continue to monitor those businesses; engage with the management teams on an ongoing basis as they mature in scale.

KB: Perhaps you could talk about some of the vast range of companies that you met with when you were in India?

CG: Absolutely. So an interesting business that we met with that I came away from quite excited about the growth story that I was bouncing off the car windows when I was talking about it with Foxy, was Pidilite, which is a business that produces chemical compounds and products for a range of households, renovation and household improvement applications. So an example would be the grout that you would use when you're retiling your shower. And while this might seem quite low level and boring, there's a really interesting growth story in India that this is structurally attached to.

So demographically, we are seeing young Indian couples and families look to move into their own homes. Whereas in the past we would see kind of multi-family households. And that shift is away from multi-family households to kind of individuals having their own place at an earlier age and typically entailing more affordable housing. As we see that boom in the residential space go through, there will be requirements for all those products to put a

kitchen or a bathroom into a house, and that's where Pidilite comes in.

So I think it's an interesting example of a business that does something that doesn't seem initially super exciting on the product level, but the way in which it's connected to a more structural demographic growth story is really interesting. And I suppose to put on top of that the fact that the business has a fantastic track record of growth, profitability and a proven ability to innovate makes it quite an interesting story.

KB: And I suppose linked to that and the theme of India's very young population: there's a lot of consumers out there. What did you hear from companies about how they're capturing that consumption story?

CG: Yeah, it's an interesting one. So the basic level consumption story is easy to understand in India: huge population, young population, more people joining that active demand base every year. But on the trip this time, something that came out that I thought was interesting, was the shifting focus of these consumer goods players away from cost minimisation towards more consumer specialisation... not to use too many buzzwords.

So an example would be a meeting we had with Godrej Consumer Products. This is a business that has historically done very well in accessing that consumer growth story. But the way in which they had done it historically was by taking a product that had been proven in more developed markets – say hair colouring – and reducing the size of the products or reducing the active ingredient in order to make it more affordable to play into the Indian consumer. But now those businesses are talking more about specialising products originally. So not taking something that's already been proven but innovating themselves and coming up with products that are more suited and more applicable to an Indian consumer.

So a really good example of that is in the exciting world of shower gel and soaps. So interestingly, depending on the chemical makeup of soap, that kind of feeling of being oily after using it is much higher with a low pressure shower, or if you're washing from a basin or a bucket, as a lot of people do in India. So the fact that there is lower water pressure meant that Godrej Consumer Products was able

to innovate a soap that didn't leave that feeling when using a lower pressure shower and therefore was more suitable for an Indian consumer. And I think that's a nice example.

KB: Fascinating. And another consumer related business you met with was United Spirits. I think you had some interesting anecdotes, very Indian specific.

CG: So this is a good example of culturally specific dynamics potentially leading to an interesting growth story going forward. So when we met with United Spirits this time around, they made the point that during Covid – during the pandemic and the lockdowns that ensued – that young consumers of alcoholic beverages who would have typically consumed those beverages away from their family out of sight, were forced to consume at home. And as a result, the cultural taboo or cultural unacceptability of drinking alcoholic beverages in front of your parents was broken down by force, and as a result, they were seeing positive signs of the younger consumer consuming alcohol at home and tending to drink higher quality products in lower volumes, which is a story that we were very well aware of with international players like Diageo.

KB: Another area of interest from your trip was IT services. India is obviously a huge base for many of these businesses, particularly US companies such as Cognizant. Perhaps you could talk about those meetings.

CG: Absolutely. So Cognizant was the largest or most prominent IT services player that we met on the trip. Cognizant is an interesting business in that historically it's played on the kind of labour arbitrage story. However, over the past five years or so, the business hasn't seen the most easy operating conditions. Challenges around hiring and retaining large numbers of junior software engineers is always going to be a thing that the business needed to overcome, and we were really lucky to meet with the outgoing Head of India at Cognizant, who was just about to take up a really exciting role as the Head of Nasscom, which is a non-government industry body in India that serves IT services businesses in the country. So really good to get his insights on the space, the challenges that the players within the market have overcome in terms of hiring and retaining junior and mid-level software engineers over the past five years.

KB: And I guess it would be difficult not to mention the generative AI theme, particularly in context of these businesses. How much of a threat is it to IT services?

CG: Yeah, it's an interesting question and it gets quite a lot of airtime. So I suppose the most dangerous or the most bearish case that is often aired is that AI is a huge disruptor in a negative way to the IT services space, particularly in India, where labour arbitrage is a big part of the story or it has been historically. The idea would be that AI is able to code low level and at high volume in a way that would mean that you did not have to hire as many coders at the junior and mid level, thereby reducing the importance of the labour arbitrage model that we've seen in Indian IT service providers historically.

In contrast to that, when we actually asked that question and presented that argument to a lot of the management teams of IT service providers in India, there were a lot more relaxed than we expected them to be given that argument. So the analogy that they drew was historically, we've seen transitions in software engineering from various coding languages or structures, and they've been able to navigate those changes successfully. That's how they see generative AI and AI as a wider technology. They don't see it necessarily as an existential threat, but they see it as an opportunity and a change that they need to be able to capitalise on in order to continue to add value and retain and win customers in the future.

KB: And on a more personal level: anyone who's ever visited India, especially any of these major cities such as Mumbai or Delhi, can't fail to mention the sheer intensity of the experience. How did you find it?

CG: For sure. So it's definitely a contrast to commuting into Charlotte Square, I'd say. So. I grew up in Edinburgh and I've worked here since leaving university, so there is always a degree of culture shock and kind of contrast when navigating around Mumbai. Mumbai and its suburbs are home to over 26 million people, so clearly a multiple of the population of the entirety of Scotland or London.

So when you think about demographics, of those 26 million people, they're generally younger and climbing out of poverty at a faster rate than almost anywhere in the world. So what that means is that Mumbai is a city that's very much alive with business. So all the way

from the shacks on the side of the road, selling sunglasses or cigarettes, all the way up to the banks and multinational corporations occupying the skyscrapers, being built at an astonishing rate in the centre of Mumbai.

On – I suppose a more boring kind of logistical note – you absolutely need to build in a kind of margin of error when planning routes between meetings. Some days we were covering all five meetings across the city, and it felt a little bit like we're in a scene from *The Italian Job*. But we were definitely in good hands with our driver in Mumbai, who I would describe as Mumbai's answer to Colin McRae and his trusty white Toyota.

KB: Scottish rally driver for those international listeners who may not know that.

And obviously Mumbai is India's financial capital. So it kind of makes sense that it has the firepower to encourage such huge levels of investment that you describe. Did you have that same sense of an infrastructure build out elsewhere?

CG: Yeah, I suppose on the first point, you're absolutely right. So the kind of inward investment is really obvious in terms of the corporations that choose to set up their headquarters in the city. And it follows logically that the government's infrastructure investment drive is equally obvious in Mumbai.

A good example of that would be the eight lane coastal road that was in a pretty early phase of construction back in February last year. So when Alan and I were there, that road was just concrete plinths in the back bay of Mumbai coming out of the water. Whereas this time around, Fraser and I were shaving off precious moments by commuting along it and saving time.

But that kind of broader infrastructure investment theme is true across the country, as you kind of allude to. So the government is building a high speed rail corridor out of Mumbai to Ahmedabad. That's a city touted as India's next Silicon Valley.

There are also very similar investment themes in ports. So ports across India's coast are being developed at a rapid rate, becoming more efficient in scaling. And that investment has come with measurable effect. So the measurable kind of turnaround time of Indian ports – according to the World Bank's Logistics Performance Index – averaged out at less than

one day in 2023, which is superior to ports in the US and Australia by some margin.

I suppose finally, lots of the physical infrastructure projects that we're seeing in the country are very closely linked to encouraging improved connectivity in a general sense. So enabling people to commute, transact and interact with each other more freely. But the digital connectivity piece is also a focus for the government. And that's made very clear.

KB: That's the internet connectivity.

CG: Absolutely. So when we were speaking with companies producing fibre optic cabling, for example – so an enabler of internet access over distance – they were really clear in spelling out the opportunity associated with the government's mission to bring internet connectivity or to fibre-ise all semi-rural villages within the country. That is a huge undertaking as a result of the scale and the complexity of doing something like that. And it's also very much indicative of the government's appreciation of the role that the internet has in opening up access to education, employment opportunities and travel for a really wide base of people.

KB: And as an international investor, what's interesting about this spending?

CG: Yeah, I think that's probably a question that we were trying to make clear with each other. So when Fraser and I were coming out of meetings, jumping in the car and having that first kind of ten minute discussion, it's something that cropped up. It's important to note that India is very much a nation of nations. So it's a federal union comprising 28 states and eight union territories; so 36 entities spread across regions. There were really big contrasts across those regions in terms of culture, religion, regulation and just industrial structure.

The connectivity and the freedom of movement associated with improved infrastructure unlocks the possibility of opening up the labour pool a bit. So making it more likely that people are educated or get their first job outside of the region that they were born in. And I think that's really quite likely to boost productivity and provide further fuel to economic growth over the long term.

And then at a lower level, getting more specific: there are kind of clear, intuitive beneficiaries from government spending on

infrastructure project. So think of the businesses executing, running and actually doing the kind of large scale construction projects that we're talking about; be it building a railway or building a new road, the people pouring the concrete and breaking the ground. Then there's also the businesses supplying the materials to enable those projects, and then further out more niche service providers in a supporting role, enabling those projects.

Interestingly, when we spoke to specialised manufacturers of material inputs to those projects – whether it's power cabling or telecoms equipment – a theme that cropped up was utilising the current infrastructure investment opportunity to build scale, generate significant cash flow and then utilise that cash flow in the future to innovate and develop their overseas businesses in order to win share and capitalize in more profitable foreign markets; thereby kind of boosting long term profitability further out.

KB: And I guess connected to that exporting internationally. I remember when you visited the country last year, you and Alan talked a lot about China +1 coming up regularly in your meetings. Was that still the case this year?

CG: So China +1 as a slogan refers to the supply chain relocation in its most basic form. So the opportunity for Indian manufacturers to benefit from international businesses diversifying their overseas manufacturing bases away from China and into other, typically developing countries like India. But clearly, this is not an India specific term. It could be India or Thailand or Vietnam.

And the reason the topic has become kind of more commonly discussed is partly due to growing geopolitical tensions between China and the wider West. So thereby motivating global businesses to seek more geopolitically neutral locations to pour investment into.

Going wider – I suppose – China Plus One is a very common trope in justifying India as an attractive place to look for investment opportunities. As the sophistication of India's manufacturing sector continues to evolve, the opportunity for differentiated manufacturing businesses with the ability to produce competitively becomes more clear for those businesses to take share from China.

In terms of change relative to our last trip in 2023: the commentary did seem more ambitious.

KB: This time around?

CG: Absolutely. So whereas in 2023 we were talking a lot about import replacements of the Make in India idea. This time around, the commentary was more around kind of using the relationships that Indian businesses may have built with overseas partners in order to go out and win share in overseas markets directly off their own back. The reason why that would be an attractive thing for an Indian business is that those overseas markets are potentially larger or more profitable, or have a different growth profile to the domestic market.

KB: Perhaps you could talk a bit more about the Make in India initiatives of Modi's government?

CG: Absolutely. So the idea behind Make in India was really for the government to incentivise businesses to identify areas in which imports into India could be replaced by domestic production. So a really clear way for the government to both benefit the balance of payments in the country, but also just to provide direct stimulus and give a bit of a leg up to manufacturers in India that are capable – and they absolutely are capable – of producing some of the goods that are imported into the country.

KB: And looking more widely, you've already mentioned Prime Minister Modi. He recently won his third election, albeit less convincingly than his previous two elections. What impact is that having, if any, based on the conversations you've had?

CG: Absolutely. Well, you'll have to cut me off after five minutes because I'm a bit of a politics buff. But I suppose the headline would be the commentary around how business friendly and the degree to which management teams think Modi is good news, was resoundingly positive. So in terms of how that has changed, we also got the sense that management teams had the view that the Modi administration was becoming increasingly business friendly over time. In terms of that narrower margin that the recent election was won by, there was a concern raised by a few management teams that because of that narrower margin, the government might be incentivised to pursue more populist policies of distributing stimulus but not linked to either employment or production.

I suppose, just to give the context. Historically in India, we'd seen production incentives

linked to that Make in India story, that transitioned away from production linked to employment linked. And I suppose the risk would be that future stimulus from the government was not linked to an economic kind of angle in the same way, in order to win votes, to kind of secure a wider margin of victory going forward. So, yeah, that was an interesting point raised.

KB: And away from all these company meetings that you were hurrying around to make sure you got to in time, what else did you get up to? Was there a trip highlight?

CG: Absolutely. So we were absolutely working hard over the fortnight, but we were lucky enough to have some time off in the weekend in the middle. So we'd just flown up from Mumbai to Delhi, and on the Saturday morning we made the three hour drive from Delhi to Agra, which is clearly the home of the Taj Mahal. And that was a highlight not only of the trip, but of my professional career so far, being able to travel with work and go and see – frankly – a kind of otherworldly, breathtaking historical monument was fantastic. And the fact that it's a monument to love was a nice story to hear. But less nice was the fact that next to the Taj Mahal, there are a number of other monuments to the architect's other wives which were less favoured.

KB: Before we go, I hope you don't mind me mentioning that you used to be in the British Army. Could you possibly explain to our audience what that involved?

CG: Absolutely. So when I was at university at Saint Andrew's, I took a summer out to go and do the reserve commissioning course at Sandhurst. And after that I took up a position

as a reserve officer in an Army Reserve unit near to St Andrew. I suppose what my time was taken up with when I was doing that was managing and leading 12 reserve soldiers who all had day jobs and a really interesting set of backgrounds; I had policemen, I had truck drivers, builders. So it was really great to broaden my horizons in terms of the people that I was spending time with, and also just the fact that kind of doing difficult things in terms of going away in training, whether it's in kind of the wet Highlands or much less frequently overseas.

KB: Well, yeah, I was going to ask this question. I'm not sure what you might say, but how has your military experience influenced your current role?

CG: Well, it certainly makes me more grateful for the coffee machines that we have in the office, because military coffee is not great. But I suppose it kind of teaches you problem solving under difficult circumstances. And the ability to kind of take a step back when you're under pressure or when you're stressed, and to kind of see the facts as they are, I think is an important skill that I learned quite early on with the Army.

KB: Fascinating. It sounds like it was a brilliant trip to India. Lots to think about. Thank you, Connor, for your time today. And to our audience, if you'd like to find out more about Connor's travels last year to India, there is an article and a short video in the show notes. And I should mention that two of the team are heading out to Japan next month, so we'll look forward to hearing from them soon. For any further information, please don't hesitate to get in touch. In the meantime, thank you very much for your time today. Goodbye.

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