

India COVID-19 Challenges and Opportunities

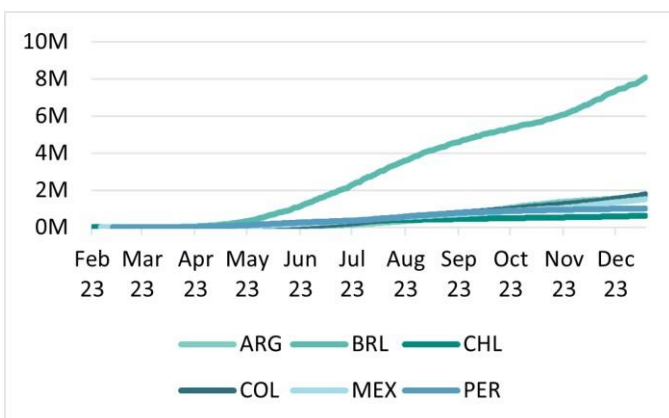
News from India confronts the observer with disturbing and chaotic images of a country wracked by a devastating second wave of coronavirus infections. However, it seems local and central authorities are responding with initiatives to first address and then improve conditions.

This article has been prepared by Northcape Capital, the underlying investment manager for the Warakirri Global Emerging Markets Fund.

As experienced by other countries, an initial wave of COVID-19 infections during 2020 gave way to a meaningful decline in the rate of new daily infections, following a strict nationwide lockdown. India's success led to speculation regarding potential contributing factors such as stronger local population immunity due to extensive pathogen exposure, and the presence of immune-boosting dietary additives prevalent in Indian cooking and Ayurveda medicine.

India's subsequent experience also replicated patterns seen elsewhere, with complacency rapidly turning to alarm in the face of a worsening public health crisis. By the end of April, the rolling 7-day average of new infections reached 364,927 far exceeding the 2020 mid-September 93,198 peak, and well above the mid-February 2021 low of 11,146 (refer Exhibit 1).

Exhibit 1: India rolling 7-day average new infections



Source: Our World in Data

Images of COVID-19 fatalities and sufferers unable to receive adequate medical attention conveys the human cost and public strain of India's health emergency. The sub-continent's 1.4 billion population elevates the absolute number of deaths and infections, with India becoming the first country to report more than 400,000 new coronavirus cases in a single day.

After adjusting for relativities, India's total deaths of 250,000 (as at 10 May 2021; Source JHU) is 180 deaths per 1 million population. This is well below the global level of 425 deaths /m pop. Even if there is under reporting of deaths by a factor of 2.5x, India's death rate/m pop. would be in line with the global average, but still well below Italy and Brazil at 2,000 deaths/m pop and US at 1,800 deaths/m pop.

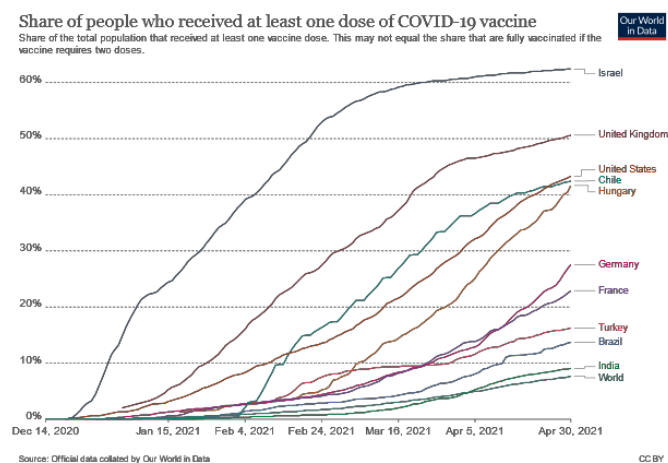
However, India is currently the largest source of new COVID-19 infections globally, and by some margin. The second wave surge has been attributed to a relaxation of social distancing and hygiene protocols, large gatherings at religious events such as the Hindu festival "Kumbh Mela" conducted over January through April attended by millions. Political rallies for state and local elections during March and April have exacerbated the situation. These mass gatherings coincided with an increasing incidence of COVID-19 mutant strains, including the UK strain prevalent in many Indian centers, and the local double-mutant strain.

Government Response and Vaccination Program

Unlike the national government's immediate and national response to the first coronavirus wave, the response on this occasion is vastly different. The government led by Prime Minister Modi has resisted another national lockdown, likely due to the detrimental human impact, especially of migrant workers, as India's informal economy represents half the country's GDP and 80% to 90% of the country's workforce. Instead, Modi urged state governments to only resort to lockdowns as a last resort, preferring to advocate "COVID- appropriate behaviour".

The government is primarily relying on accelerating the COVID-19 vaccination program to fight infections. At the end of April, India widened its vaccine application to those aged eighteen and above in response to surging infections, widening eligibility previously restricted to health care workers and those most at risk. By month's end, the share of population receiving at least one dose remained less than 10%, and though in line with the global average, it trailed several emerging and developed countries (refer Exhibit 2).

Exhibit 2: Share of the total population that received at least one vaccine dose



Source: Our World in Data

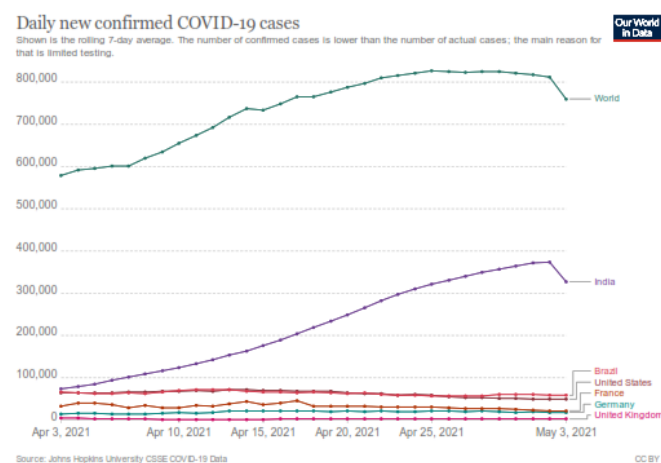
A major hurdle to accelerating population coverage is vaccine availability. India began 2021 with a target vaccination of 300m people by August, but the modest first wave of 2020 infections and subsequent recovery, undermined the perceived urgency for vaccination. India's early vaccine production was also applied to the global COVAX program, supplying vaccines to low-income countries, with India a net vaccine exporter. Belatedly, India's local vaccines Covishield and Covaxin, are now supplementing the purchase of 205m vaccine doses, including Russia's Sputnik V. The pace of administration is critical to lowering the infection rate and COVID-19 symptoms, but importantly also to reduce further potential evolution of mutant strains.

Prospects for Recovery

Amid the significant health challenges impacting India, there is cause for guarded optimism. Respected endocrinologist and former dean of Indian College of Physicians, Dr. Shashank Joshi is a member of the COVID-19 Maharashtra State Task Force, who recently forecast India's second wave to peak in the first half of May, observing the number of cases in Mumbai to have already peaked, and Delhi is currently peaking. Dr Joshi framed the typical COVID-19 wave as following an eight-to-twelve-week cycle, noting that while the country's second wave had spread quickly, the recovery rate is also faster, with as many as 80% to 90% of those infected presenting as asymptomatic.

Dr Joshi considers the most successful way to manage COVID-19 to be a combination of vaccines and COVID-19 appropriate protocols. Indian vaccination prospects have been bolstered by combined local and imported vaccines raising administered doses to more than 3m per day. The potential for accelerated approval of Pfizer, Moderna, Johnson & Johnson, Zydus and Novavax vaccines can each add a further half a million doses per day. Over the next few months, we can expect at least three to four new vaccines to enter India, assuming global supply shortages can be overcome, potentially raising daily doses towards 8m. Data for early May suggests tentative peaking of daily new infections between 350k to 400k (refer Exhibit 3), albeit a level many times greater than the 2020 peak.

Exhibit 3: Past month rolling 7-day average new infections



Source: Our World in Data

India Investment environment

Indian equities were quick to discount economic fallout - declining 10% between mid-February and mid-April, compounded by an additional 5% Rupee depreciation, closely tracking India's economic activity indicators that were lower by mid-single digits over April and again into May. Comparatively less stringent regional mobility restrictions are still resulting in cumulative national activity imposts. Having virtually returned to pre-pandemic activity by the end of 2020, India's activity measures have fallen back to around 80% of pre-pandemic levels. Official initiatives are led by the Reserve Bank of India assisting small businesses impacted by the pandemic, via extended liquidity availability, loan moratorium, and encouraging a low interest rate environment. Government assistance has been targeted towards healthcare facilities and agricultural subsidies.

Next to South Korea, India represents one of the EM strategy's largest single country exposure in emerging markets. Our portfolio weighting towards India at 16% is well above the country's index weighting of 9%. The country offers quintessential EM investment characteristics, large population, rising household wealth, early-stage consumer, and industrial product penetration, supported by a well-established rule of law, administered by an established parliamentary democracy, along with desirable checks and balances via independent pillars of judiciary and media.

Select Warakirri Global Emerging Markets Fund Indian stock holdings

Despite the current challenges for the Indian economy, we remain very optimistic on our core Indian holdings over the long-term. These include well-known brands, which are rated amongst India's most valuable, including HDFC, India's premier financial services group, which was ranked #1 by Kantar. Other brands owned by the Warakirri Global Emerging Markets strategy (such as Maruti Suzuki, Tata Consultancy Services and Bharti Airtel) are also rated in the top ten by Kantar.

HDFC Ltd: India's leading home lending company, with 20% share of mortgages. Mortgage loan growth averaged mid-teens over the past six years, complimented by rising loan spreads as smaller housing finance company competition eased in the wake of the Non-Bank Financial Crisis 2018-19 and pandemic 2020-2021. HDFC Ltd has compounded revenue approximately 20% and consistently earned an average 20% return on equity. HDFC is the premier private Indian financial institution, with strong operating performance track record and shareholder value creation. The company owns approximately half of listed companies HDFC Life and HDFC Asset Management, providing exposure to additional high growth domestic financial service sectors.

Revenue growth compounded close to 10% annually between 2014 and 2020, with management's attractive value proposition complemented by an unrivalled national distribution network, well positioned to supply into India's deeply under penetrated auto market, where car ownership is less than 5% of the population. Shareholders have been rewarded with an average high teen return on equity, while maintaining a robust net cash balance sheet.

Tata Consultancy Services (TCS): Global IT consulting and outsourced services firm addressing business clients across industries, predominantly financial and retail services, ranking among the industry leading players. TCS has a strong history of reporting solid revenue and profit performances, lately enhanced by the solid demand environment for IT services, specifically digital transformations, in a post-COVID environment. Revenue compounded 11% over the six years to 2020, consistently delivering robust profitability and shareholder returns, generating returns on equity averaging more than 30%, while maintaining a net cash balance sheet.

Exhibit 4: India's Ten Most Valuable Brands 2019



Source: KANTAR, Brand Valuation Series

HDFC Bank: India's premier private commercial bank, established by HDFC Ltd in 1994, with the parent retaining approximately half ownership. The bank generates half of revenue from the retail sector, targeting middle income earners and above. Management continues to deliver product innovation along with high standards of customer service, all within an ethical framework promoting solid governance, social and environmental standards. Between 2014 and 2020 the bank grew revenue 20% on average, driven by a similar rate of loan growth, taking its market share to more than 10%. India's public banks account for 60% of system loans, offering material headroom for further private bank share gains (currently only a third of system loans). Quality management achieved high profitability and return on equity approximating 20% from 2014 to 2020, supported by a well-capitalised balance sheet.

Bharti Airtel: Telecommunications service provider and India's number two mobile player. Local telecommunications experienced disruptive competition over 2018 following new entrant Reliance Jio's aggressive voice & data pricing strategy, leveraging new data-centric 4G technology. Industry revenue growth and profitability were casualties during the market share fight. Reliance Jio attained leadership with a third of market, while Bharti Airtel maintained number two ranking and historical 30% share. Significant consolidation occurred from a dozen players to four, including prior leader Vodafone-Idea' halving of share to mid-20s. Bharti Airtel continued to invest for long term growth, is well positioned for industry recovery via India's substantial data consumption appetite. Adequate investment returns require further repair, but prospects are favourable in an increasingly digital centric macro environment.

Conclusion

India currently faces material public health and economic headwinds. The country's limited infrastructure is under considerable strain as we write. There are uncertainties how long the current situation will last, and more severe lockdowns anew cannot be ruled out. However, it seems local and central authorities are responding with initiatives to first address and then improve conditions, which are expected to gain traction on reducing the pandemic, when coupled with rising vaccination levels over the next 6 months.

The Warakirri Global Emerging Markets Fund is exposed to three other brands in the ten most valuable list:

Maruti Suzuki: dominant market position, with around half the Indian passenger vehicle market, and core strength in the small car segment. Lockdown during 2020 cramped operating performance, but earnings are recovering in line with the economy, along with management's product focus on quality, fuel efficiency and vehicle development, embracing the longer trend towards electrification. Strategy focuses on growing volume, achieving economies of scale, and utilising efficiency gains to price products competitively.

In the meantime, the Fund's underlying manager, Northcape, continue to identify and target well-run companies in India with strong market presence, attractive top line growth and robust financial and ESG structures to drive client returns. Any significant mark back in these stocks, will be treated as an excellent long-term buying opportunity.

*The **Warakirri Global Emerging Markets Fund** is long only, low turnover (30-50% p.a.) and selective. As such it will hold between 20-40 stocks of Emerging Market businesses with clear opportunities for growth.*

For more information, please contact us
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