India Avenue
Investment Management

Fund Update: 31st December 2019

Avenues

Fund Objective

The India Avenue Equity Fund is a registered, unlisted unit trust, which invests in listed companies trading on Indian stock exchanges or on other exchanges, with significant exposure to India's economy. The Fund aims to outperform its benchmark in AUD terms, after fees and over rolling 5-year periods

Fund Rating

Lonsec Rating: Recommended*

Fund Facts

Fund Manager	India Avenue Investment Management
Portfolio Manager	Mugunthan Siva
Structure	Registered Managed Investment Trust
Inception Date	6th September 2016
Fund Size	$34.9 million
NAV	Wholesale: 1.2058 Retail: 1.2058
Base Currency	Australian Dollars
Responsible Entity	Equity Trustees Limited
Custodian	Mainstream / BNP Paribas
Auditor	KPMG
Benchmark	MSCI India in AU$
Distribution Freq.	Yearly at 30 June
Management Expense Ratio	Wholesale: 1.10% p.a. Retail: 1.50% p.a.
Buy-Sell Spread	0.35% / 0.35%
Performance Fee**	10% of the excess return above the benchmark
FY19 Dividend	Wholesale: 2.653 cpu Retail: 1.248 cpu

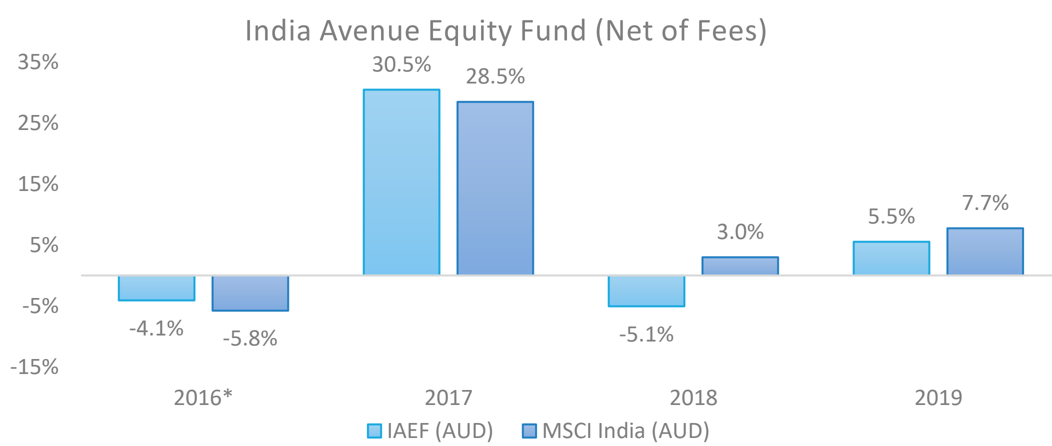
** Subject to a high watermark

Fund and Market Commentary: December 2019

The India Avenue Equity Fund (wholesale) returned -2.86% for the month of December. Whilst Indian equity markets rose in December, the AUD rose 3.25%relative to the Rupee during the month, resulting in a negative return for Australian investors.

After five consecutive rate cuts in 2019, the Reserve Bank of India (RBI) decided to keep policy rates unchanged. The RBI kept all its monetary policy tools constant by maintaining the repo rate (rate at which the RBI lends to banks) at 5.15% and reverse repo (rate at which banks park excess reserves) at 4.90%. The decision of all MPC members was unanimous. The major reason for the pause in monetary policy was the revision to their inflation forecasts. Projected inflation for H2FY20 (Sep 2019 to March 2020) was pushed upwards to a range of 4.7% - 5.1%. Given the RBI's rhetoric has recently shifted from a focus on price stability to pro-growth, the pause indicates a moderation of view between weakening growth and rising inflation. The RBI revised their growth forecasts for FY20 to 5.0% (from 6.1%).

Over the last 2 years, India's equity markets have been driven by excess global liquidity. This has resulted in money flooding equity markets pushing index stocks higher, irrespective of valuations. Whilst our Fund aims to capture the strong growth of many of India's listed companies, we continue to be conscious of valuations in our view. We feel 2020 will be a turning point where companies which have been beaten down for having economic exposure start benefitting from reforms and stimulus.



India Avenue Equity Fund Performance (*in AUD and net of fees*)

Wholesale	1 month	3 months	6 months	1 year	2 years (p.a.)	3 years (p.a.)	Since Inception (p.a.) #
IAEF	-2.86%	1.09%	-0.89%	5.51%	0.12%	9.35%	7.06%
MSCI India	-2.31%	1.05%	-0.28%	7.74%	5.33%	12.54%	9.29%
Excess	-0.55%	0.04%	-0.61%	-2.22%	-5.21%	-3.18%	-2.23%

Retail	1 month	3 months	6 months	1 year	2 years (p.a.)	3 years (p.a.)	Since Inception (p.a.) #
IAEF	-2.89%	0.94%	-1.14%	5.06%	-0.39%	-	4.69%
MSCI India	-2.31%	1.05%	-0.28%	7.74%	5.33%	-	8.48%
Excess	-0.58%	-0.11%	-0.85%	-2.67%	-5.72%	-	-3.79%

Past performance is not an indicator of future performance
Above returns are calculated based on the exit price of 31st December 2019 assuming the reinvestment of dividends
#Inception Date: Wholesale 6th Sep 2016, Retail 6th April 2017

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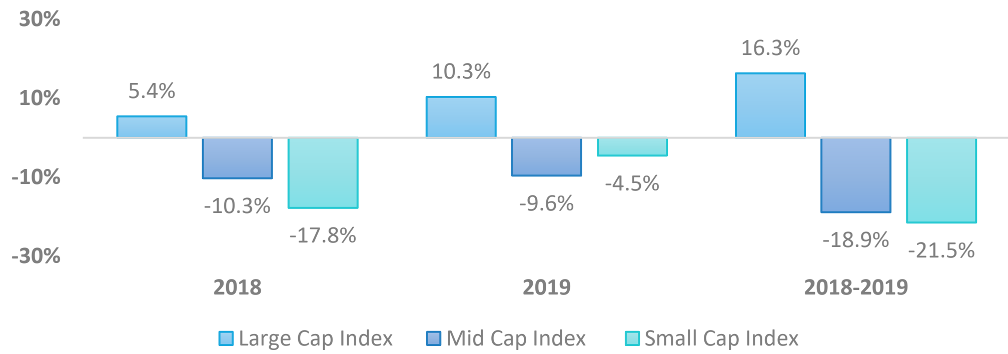
2019 and the Outlook for 2020

Indian equity markets in 2019 had the same flavour as 2018 with the mid and small cap segment of the market continuing its decline whilst large caps marched on. Over the last two calendar years, large caps have outperformed mid and small cap indices by a significant margin of 35.2% and 37.8% respectively, as shown below. As discussed in previous factsheets, the dichotomy continues even within the large cap index, as the largest five stocks have driven most of the performance.



Source: Refinitiv, MSCI Indices in AUD

Whilst regulatory changes to how mutual funds classify large, mid and small caps are partly to blame for the significant divergence it has also been due to the current slowdown in the economy, with flows seeking haven in the large cap and quality names (e.g. factors such as low historical earnings volatility). In our view, the current slowdown has been driven primarily due to a cleansing of the system by PM Modi. Reforms such as demonetization destroyed the funding system to the informal sector and has resulted in a shift towards the formal sector. The introduction of GST has also forced the informal sector to bear the compliance cost and has taken away the cost advantage they had over the formal sector. Although the formal sector has thrived, demand has slowed due to job losses in the informal SME economy, which accounts for the majority of the labour market. As nearly 70% of GDP is consumption related, this has inevitably been a large detractor on GDP growth.

At the current level of Indices, investors continue to pay richly (P/E at 19x 1 year forward) for the impending earnings revival. Although we expect earnings to finally come through in FY21, The upward move in large cap stocks already largely reflects this expectation. However, our view is that we are likely to witness broader market participation as companies left behind during a period of risk aversion recover slowly with the economy. We also feel GDP growth is likely to have bottomed out in 2020. Given corporate tax rate cuts last year and improving corporate bank balance sheets, this should lead to gradual pickup in credit growth. Despite a cumulative reduction of 135bps in policy rates in CY2019, banks have cut around 40 – 47bps in their weighted average lending rates. Whilst at the surface it may seem that the transmission effect has not worked, high quality borrowers have been able to borrow at much lower rates (in line with the reductions) than lower quality borrowers. Nonetheless, lower rates should start to help lower borrowing costs for much of corporate India.

The Government's aim to be a US$ 5trillion economy by 2025 is also going to be heavily dependent on infrastructure spending. However, concerns around the Government not being able to meet its fiscal deficit target for FY20, means the Government will most likely wait till FY21 (April 2020). However, this is likely to contribute towards GDP going forward.

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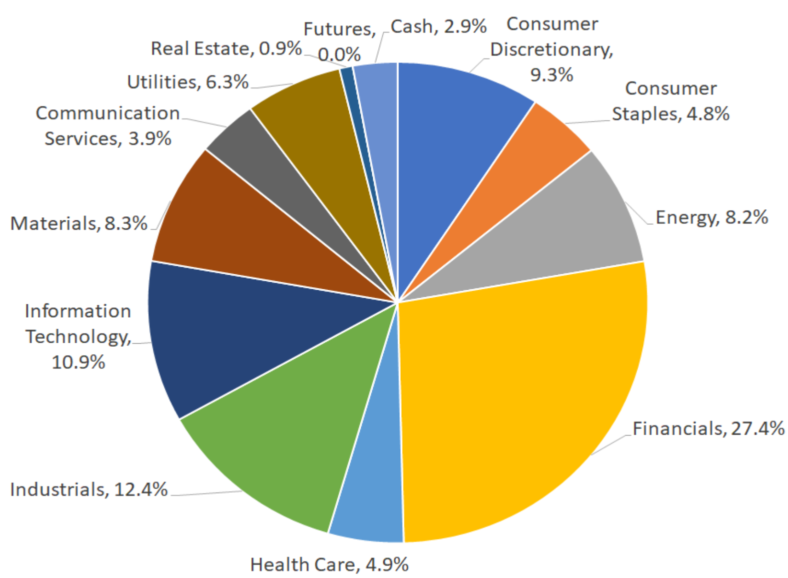
The focus of the portfolio is to generally invest in companies which have a high component of their revenue generated locally in India. This provides significant leverage to the local economy's strong growth potential.

Top 20 Stocks

Name	Industry	Weight
ICICI Bank	Banks	7.4%
Infosys	IT Services	5.8%
Reliance Industries	Oil & Gas	5.1%
HDFC	Housing Finance	4.1%
Tata Motors	Automobiles	3.3%
Bharti Airtel	Communication Services	3.3%
HDFC Bank	Banks	3.0%
NTPC	Power & Renewables	2.9%
State Bank of India	Banks	2.7%
HCL Technologies	IT Services	2.3%
Axis Bank	Banks	2.1%
Lupin	Pharmaceuticals	1.9%
L&T	Construction & Engineering	1.9%
Kotak Mahindra Bank	Banks	1.8%
Sun Pharmaceuticals	Pharmaceuticals	1.8%
Polycab India	Wires & Cables	1.8%
Mahindra & Mahindra	Automobiles	1.8%
Bajaj Finance	Personal Finance	1.7%
Mayur Uniquoters	Textile Products	1.7%
Wipro	IT Services	1.6%

Sector Allocation



Source: India Avenue, Thomson Reuters

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India Macro & Micro News

- Private equity and venture capital investments in India touched a record high of US$ 37 billion on the back of large investments in the infrastructure sector. There were 861 deals worth US$ 36.96 billion in 2019 which is higher than the previous record of 2018, which had witnessed 937 deals valued at US$ 36.14 billion. In 2019, infrastructure-related industries accounted for 40% of the private equity investment pie in 2019 attracting US$ 14.7 billion across 74 deals as compared to a 20% share in 2018 (US$ 7.8 billion across 83 deals)

- The share of renewable energy in India's energy mix has risen steadily to around 9% from 3.7% in 14/15. As of October 31, 2019, 83.38 GW of renewable energy capacity has been already installed. This includes 31.69 GW from solar, 37.09 GW from wind, 9.95 GW from bio-power and 4.65 GW from hydro power

- The Government Sovereign Gold Bonds (SGB) scheme was introduced in November 2015. SGBs are provided as a substitute for physical gold for investors. SGB's allow investors to own gold without physical possession and hence no cost for storage. Bonds are denominated in units of one gram of gold, have a maturity of 8 years and pay a coupon as per the RBI depending on the time the tranche was launched

- The installed power generation capacity in India reached 364.9 GW that is adequate to meet the country's electric demand. Furthermore, the energy requirement deficit was less than 1% during the first 7 months of FY20. The gap is mainly because of restraints in the distribution network and financial constraints of state power utilities to purchase power. However, distribution companies can also purchase power from power exchanges on a daily basis in the case of shortages in meeting power requirement

Thematic: Chemical Industry

India ranks 6th in the world in terms of chemical sales, 14th in exports and 8th in imports of chemicals (excluding pharmaceutical products) globally. The chemicals industry in India is highly diversified, covering more than 80,000 commercial products sold locally and abroad. There are roughly five broad categories of chemicals used in a plethora of products by many industries as described below.

Category	Description
Bulk chemicals	Chemicals made on a very large scale. E.g. Ammonia, Sulfuric acid, Sodium Hydroxide
Specialty chemicals	Chemicals made on a smaller scale, more complex and versatile across different sectors. E.g include adhesives, flavours, food additives, fragances, paints
Agrochemicals	Agrochemicals include fertilizers, soil conditioners, pesticides, and chemicals used in the raising of livestock such as antibiotics and hormones
Petrochemicals	Petrochemicals are the chemical products obtained from petroleum by refining. This includes plastics, soaps, detergents, solvents etc
Polymers	Polymers is a useful chemical made of many repeating units. Synthetic polymers include nylon, polyethylene, polyester, teflon etc

India is also a strong global dye supplier, accounting for approximately 16% of the world production of dyestuff and dye intermediates. These chemical products are used in industries such as textiles, paper, plastics, printing ink, and foodstuffs, however the textile industry accounts for nearly 80% of consumption. Interestingly, India used to be a large importer of dye chemicals, but over the years the industry has grown rapidly due to R&D, Government initiatives such as allowing 100% ownership under the FDI automatic route, improving ease of doing business and cost competitiveness relative to other countries.

The broad Indian chemical industry has recently been provided a fillip due a large cut in global supply due the closure of several of their Chinese counterparts which face a crackdown on pollution and the threat of US tariffs. China, which accounts for about 20% of global specialty chemicals revenues, has tightened environmental standards, resulting in the closure or shifting of capacities in 50 chemical manufacturing sites. This disruption has increased the cost for Chinese companies and is driving global consumers to seek other vendors, such as Indian manufacturers. Due to a large mismatch between global demand and supply, Indian manufacturers have increased capital expenditure by increasing capacity through new plants. As a result, the share of Indian specialty chemicals in the global supply chain according to Indian rating house CRISIL, is expected to rise 1% to 5.2% in FY22, from 4.2% last FY.

Unsurprisingly many Indian chemical companies have seen their share price rise dramatically along with their valuations, with many of them trading at a historical 12-month P/E of above 20x. One company in our portfolio is Chambal Fertilisers, the largest private sector urea (used as a fertiliser and is essential for plant growth) play in India. The stock is trading at 8x historical 12-month P/E. The company's new facility has added about 70% more to its existing capacity. The plant is more efficient than its older ones and is based on the latest technology, requires minimum manpower except for distribution or dispatches, with a higher safety standard. Its energy consumption for urea production is the lowest in the world.

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