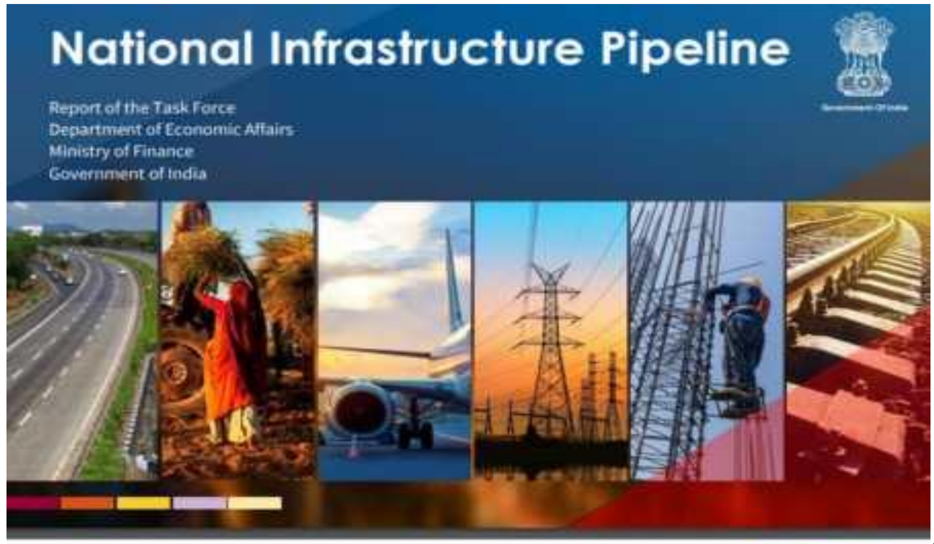
India Avenue
RESEARCH NOTE



[1]

NATIONAL INFRASTRUCTURE PIPELINE (NIP)

Why Infrastructure?

Infrastructure development is required in India to allow for urbanization, reducing logistical costs and increasing employment – hence commencing a productivity loop

Which Sectors?

Energy 24%, Roads 19%, Urban 16%, Railways 13%, Irrigation 8% and Rural 8% are the main beneficiaries

Who and How?

39% funded by the Central Government, 39% by State Governments and the remainder by the Private Sector (22%). The Private Sector contribution is hoped to grow to 30% by 2025. This is likely to be funded fiscally.

INFRA TO DRIVE INDIA'S GROWTH

NZ$2.2 TRILLION TO BE SPENT ON INDIA'S INFRASTRUCTURE OVER 5 YEARS

To pursue the goal of being a US$5trillion economy by 2025, the Government of India has released the "National Infrastructure Pipeline (NIP)", following on from statements made by Prime Minister, Narendra Modi in his Independence Day speech in August 2019. The plan lays out the blueprint for spending on infrastructure, which is expected to propel India's nominal GDP growth to above 12% per annum. It is expected that this will have a positive spiral on India's growth trajectory going forward, as it is infrastructure spending required to service India's growing needs. To put the amount into perspective, spending on Infrastructure in the 10-year period from 2008 -2017 was NZ$1.7 trillion.

Given India is an infrastructure deficit country, spending in this area is necessary to achieve levels of growth required in the country. India's Gross Fixed Capital Formation (GFCF) growth has averaged 7.7% over 2013-2017, which is one of the longest stretches of low growth in many decades. This was starting to recover before an election related slowdown, a cut in government spending and a financial liquidity crisis. Given the NIP, it is likely that GFCF can grow from 29% of GDP today to 34% of GDP i.e. a 15% rate of growth of GFCF (last cycle peak in 2008 was 36% of GDP)[2]. This should create the pathway towards the commencement of India's next business cycle.

It is anticipated that India needs to spend NZ$6.7 trillion on infrastructure by 2030 to maintain its growth rate. The NIP is an endeavor to make this happen efficiently.

[1] Source: Government of India
[2] Forecasts are those of Antique Stockbroking (an Indian broking firm)

NIP PROVIDES THE BLUEPRINT FOR GROWTH

The Government of Indian has focused on getting to this point with this goal in mind. Their view is that the unclogging of stress in financial intermediaries since the introduction of the Insolvency & Bankruptcy Code in 2016, a raft of reforms including GST and Corporate Tax cuts should turn the investment cycle, after a prolonged period of poor growth.

Post PM Modi's speech in August 2019, the Finance Ministry set up a task force, headed by the Economic Affairs Secretary to prepare a road map for the "National Infrastructure Pipeline" from 2019-20 to 2024-25 under the Rs.105 lakh crore infrastructure plan (approximately NZ$2.2 trillion).

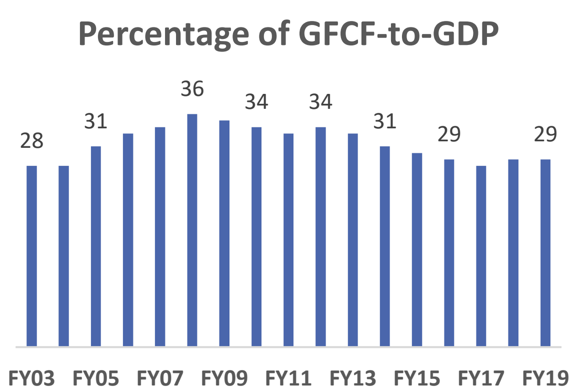
The National Infrastructure Pipeline will enable a forward outlook on infrastructure projects and thereby create a more equitable lifestyle for all. It will provide the pathway for urbanization to take place and a greater sharing of social infrastructure across all of India. Well-developed infrastructure enhances the level of economic activity, creates additional fiscal space by improving the revenue base of the Government and ensures a more efficient allocation of resources to more productive areas.

Currently around 43% of NIP projects are under implementation while 33% are at the conceptual stage and 19% are under development. Typically, India project implementation is troublesome and thus the NIP has been built very much bottom-up from a project perspective. A significant component of the projects is underway and have approval and now need to be completed.

ON THE ROAD TO A US$5 TRILLION ECONOMY

The steps to provide the road to a US$5 trillion economy are now quite significant:

1) Clean up of the financial sector, allowing greater ability to provide credit to the next business cycle
2) Corporate tax cuts to aid private sector spending and faster reduction of debt
3) Pay-off from GST and IBC will occur over the next 5 years
4) Infrastructure via the NIP will help to drive growth and capex
5) Utilisation levels should rise above 74-75% current levels towards 85-90%, sparking the next business cycle



Source: Antique Stockbroking, India Avenue

Gross Fixed Capital formation peaked at 36% in FY08 at the end of the last business cycle. Excess capacity lead to a pro-longed weak period in the capex cycle.

Over the next five years, it is expected the splurge on Infrastructure is what is required to move the GFCF to GDP back to the mid 30's.

This is likely to be accompanied by a pick-up in capacity utilization and thus further capex. The key to this is private sector participation to avoid over-spending and crowding out by the Central and State Governments.

MARKET IMPACT

Given that the last 10 years have seen significant growth in Private Banks, Consumption and Information Technology, these sectors now typically make up approximately 70% of large cap indices. Additionally, there are sectors like Telecom, Media, Healthcare as well as Oil & Gas, which the leaves very little room for Infrastructure related companies (<5%).

If one looks at the 11 sectors classified in GICS then typically this leaves **Industrials, Utilities, Metals and Realty** as those having some participation in Infrastructure-led growth. These may include specific Infrastructure companies like Larsen & Toubro (India's largest Infrastructure play) as well as some Cement companies like Ultratech Cement. When it comes to Power generation and renewable energy, several of India's utilities will benefit from greater usage of their capacity such as NTPC and Power Grid Corporation.

Whilst, we hold exposure to these companies, typically the greatest leverage often goes to ancillary companies that benefit from being a service provider or supplier to the Infrastructure thematic. These can be capital goods, engineering, transportation, rural, metals as well as some consumption companies thriving from a greater level of infrastructure provision e.g. like Polycab India and KEI Industries, both companies we hold, which is involved in the manufacturing and selling of wire cables as well as household equipment like switches, fans etc.

The India Avenue Equity Fund currently has around 25% of its portfolio directly exposed to the Infrastructure thematic, which is more significant than our benchmark and our peer group of funds and ETF's. We expect that the launch of the NIP by the Government of India will be the first step in closing the gap between expensive defensives and cheap cyclicals.