Aberdeen New India

ANII offers exposure to exciting growth stories in India...

Update
01 February 2022

Overview

Aberdeen New India (ANII) is the top-performing of the three specialist India funds with a ten-year track record. The management team's focus on finding quality companies has proven helpful in falling markets and contributed to this long-term success, as we discuss under **Performance**. The trust lagged the market in 2021, however, with the focus on quality not being rewarded as the market rallied.

ANII is managed by Kristy Fong and James Thom of the abrdn Asian Equities Team. The strategy is entirely bottom-up, with the managers not aiming to read the economic cycle but to find resilient companies with strong balance sheets and low levels of debt which can grow over multiple cycles. This means the NAV beta to the market tends to be low, although this is raised by modest but quite consistent levels of **Gearing**.

The portfolio is diversified across a variety of old and new economy sectors. Particularly important are the positions in financials (mainly banks) and information technology. Kristy and James see structural trends supporting earnings growth in these industries over the long term. Both benefit from India's early stage of economic development when compared to China. In the short term banks have lagged the market, and Kristy and James have been adding to exposure further. They highlight market returns in 2021 were very concentrated in certain stocks and sectors, and they expect this to broaden in 2022. Furthermore, while the defensive qualities in the portfolio may have held back ANII in 2021 relative to the market, over the long run they believe this is the best way to invest – with supporting evidence being the trust's excellent long-term track record.

Analysts:
Thomas McMahon
+44 (0)203 795 0070

Analyst's View

We think the long-term fundamentals are exciting for India. Speaking to Asia fund managers, it is striking that India repeatedly comes up as an opportunity. Its demographics are stronger than China, its labour is cheaper than China, and it is winning business from multinationals concerned about exposure to China. The reforms implemented by the Modi government have also had a real impact. India has been one of the top ten improvers in the World Bank's Ease of Doing Business Rankings for three consecutive years.

ANII's **Discount** therefore looks attractive to us, purely as a way to access the growth potential in the market itself. The long-term track record of alpha generation is a bonus. As regards the outlook for relative performance, as we discuss in the **Performance section**, the key factors behind the sluggish performance in recent years don't look like persistent issues to us. We think the quality style could be set to do better in the post-pandemic recovery, although of course there is no guarantee of this. There are risks to the global economy too, and India is not immune. High energy prices hurt the country, as it imports all its oil, while food price inflation would harm the consumer. ANII's relative defensiveness should hold it in good stead if the market stumbles and so we think notwithstanding the modest **Gearing**, ANII looks like a relatively low risk way to invest in this potentially exciting market.

BULL
Strong long-term record of outperformance based on successful stock-picking
Quality approach has provided resilience in weaker markets
Discount is wide and could be an interesting long-term entry point

BEAR
Gearing can magnify market falls as well as gains
As a single-country emerging markets fund, it has political risk and higher volatility than a more broadly spread trust
Active approach brings chances of underperformance as well as outperformance

Portfolio

The abrdn Asian Equities Team who manage Aberdeen New India (ANII) aim to identify high quality companies in the Indian market with the potential for long-term growth and to invest in them for the long-term when they are at attractively-priced entry points. Kristy Fong and James Thom manage the trust, drawing on the research of the 40+ member analyst and PM team who cover the whole Asian region with a consistent approach. As we discuss under **Performance**, ANII has generated a high level of alpha over the long term, helped by attractive downside characteristics. The portfolio is diversified across a variety of old and new economy sectors, in companies the managers believe have many years of above-market growth ahead of them. While the search for durable long-term growth leads the managers to companies benefitting from structural trends in the Indian economy and society, the portfolio is managed in a purely bottom-up way, the preference being for companies which are resilient to the ups and downs of the economic cycle. We discuss in detail what quality means for the team **in our past notes**.

The approach is highly active and focusses on identifying long-term opportunities. A good example is the long-standing position in the private sector banks. These, plus mortgage provider HDFC have been key convictions for many years. Kristy and James are invested in what they believe to be the country's best-run banks, which have steadily been increasing their market share at the expense of the cumbersome state-owned competitors ever since the 1990s reforms which established them. As the Indian economy develops and the standard of living rises, demand for more sophisticated financial products continues to increase. Various reforms implemented by Prime Minister Modi have been beneficial to these trends, such as expanding access to bank accounts. India being at an earlier stage of development than China means that the opportunities for growth are huge, and, unlike China, India has favourable demographics adding to the growth potential.

While the banking sector as a whole has been under pressure during the pandemic, Kristy and James believe their preferred companies are the strongest players in the industry and should ultimately benefit from this period by taking market share and consolidating their positions at the expense of their weaker rivals. In 2021, as we discuss under **Performance**, the banks have lagged the market in a strong year, and Kristy and James have been adding to the company's positions. This is, in part, illustrative of the valuation sensitivity in the approach, and also the team's belief that those that lagged in 2021 were actually the highest quality in the sector. A rising interest rate environment is another factor which gives the managers short term optimism for their financial holdings. The mortgage market is also in an upswing after a five to six-year downturn and interest rates are low, creating a bullish environment for mortgage lending which is rapidly expanding and benefitting HDFC. However, it is the long-term growth trends which are the key reason the position is so big. Financials make up 26% of the portfolio versus 25.3% in the benchmark, and more importantly three of the largest ten positions. The position includes insurance, but banks make up 80% of the allocation, or 21% of the portfolio.

Top Ten Holdings

HOLDING	WEIGHT (%)
Infosys Technologies	10.0
HDFC	9.0
Tata Consultancy Services	7.3
Hindustan Unilever	5.8
Ultratech Cement	4.1
HDFC Bank	4.0
Kotak Mahindra Bank	3.8
Asian Paints	3.5
SBI Life Insurance	3.1
Bharti Airtel	2.9
TOTAL	**53.5**

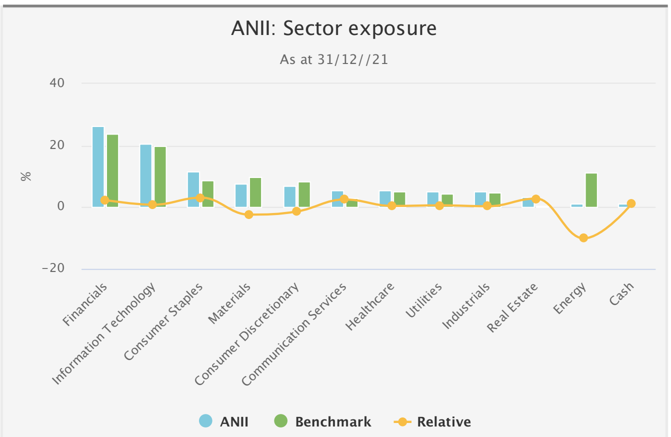
Source: abrdn, as at 31/12/2021

In addition to banks, Kristy and James are adding to autos, such as Maruti Suzuki, and to companies with exposure to the infrastructure theme, namely engineering and construction conglomerate Larsen & Toubro. They expect Maruti Suzuki to benefit from a broadening of the Indian recovery in 2022 from a relatively small number of winners. Larsen & Toubro stands to benefit from a government infrastructure construction plan.

These are all relatively traditional industries. In recent years ANII has built up a larger and larger position in new economy sectors, providing balance to the portfolio and diverse sources of growth. In 2021 the company participated in the IPOs of a number of companies in internet-related names, such as Zomato, the food delivery company and Nykaa, the online beauty platform. These two have been successful investments, with the team, using abrdn's well-known name in the region, managing to gain allocations in highly competitive markets. If these stocks are considered together with the companies in the information technology sector, the overall exposure to technology and the internet is over a quarter of the portfolio.

As well as the large outsourcers Infosys and Tata, ANII holds Affle, a digital marketing company which has generated good returns since its January 2021 IPO, and Info Edge. Kristy and James, and the broader abrdn team, have put a lot of thought into how to value earlier stage tech and ecommerce companies in recent years, which has contributed to the rising allocation. They remain committed to finding companies they believe can generate stable long-term growth, but this may have brought with it some more negative sensitivity to rising rates as these stocks are typically higher duration. There remains a considerable allocation to consumer staples companies, which benefit from the growth of consumption in the country. This allocation brings some defensiveness to the portfolio and contributes to its lower beta, which does also bring with it a tendency to lag in 'frothy' rising markets.

Fig.1: Sector Exposure



Source: Aberdeen Standard Investments

It is worth noting that sector weightings are down to bottom-up stock selection and not conscious positioning or indicative of a style bias. While IT is seen as a growth sector, financials are a value sector. The more defensive consumer staples sector is an overweight as is the more cyclical real estate sector. We think the diversity of the portfolio is one of its attractions, although of course it means it will inevitably not keep up in sharp rallies for either the growth or value style, which we have seen in quick succession during the pandemic.

Post-pandemic and after a multi-annual reform programme, India is arguably in a better competitive position than it has been for years. The Modi government has implemented a number of business-friendly changes, including liberalising bankruptcy law, rationalising the sales tax system and expanding the availability of bank accounts. India has shot up the ease of doing business rankings created by the World Bank over the past three years as a result. This is fortuitous timing, because the pandemic has left many companies looking for an alternative to China as a base of operations or for supply. India is not the only option, but is certainly winning some business, with Samsung and Apple both investing in smartphone production in India last year, encouraged by strong government incentives. The spurt of IPOs referred to above may indicate there is the chance to create a tech cluster in a country with lower labour costs than China which could be advantageous for the country and provide opportunities for investors. In keeping with their cautious attitude, Kristy and James see the opportunity but warn of potential stumbling blocks – in particular they note that reforms often create losers as well as winners and note that anti-corruption drives have contributed to the current banking crisis. However, they agree the future does look bright, in both the old and new economy sectors, and note the commitment to infrastructure spending in the coming years could boost private sector capex and encourage FDI.

One of the key attractions of a strategy focussed on identifying high quality companies is that the resulting portfolio should in theory be well adapted to tough economic periods such as the one India is undergoing as it exits the pandemic. In fact, India had been experiencing the negative effects of a banking crisis before the pandemic hit, and the economy was also struggling to deal with some of the radical reforms of the current government such as the demonetisation of the economy. Kristy believes that there has been some irrational exuberance in the market moves. For example, one top-performing group of companies was the Adani Group. This group of companies with a free float of only 5% operates in the green energy sphere and did very well until its finances were called into question and the share price collapsed. Kristy believes the market will increasingly come round to focus on quality as the crisis recedes – although this may be a slow process on both counts.

Gearing

The board of ANII has given the managers discretion to alter gearing levels within the framework the board sets. ANII can gear up to 25% of NAV at the time of investment, but is in practical terms currently limited by a £30m multicurrency revolving credit facility which was renewed in July 2020 for another two years. This facility is fully drawn down and represents c. 8% of NAV at current levels, so any substantial increase in gearing would require the addition of new facilities. Kristy tells us the board is open to the idea of raising the gearing levels, but it views 10% as a reasonable limit for now.

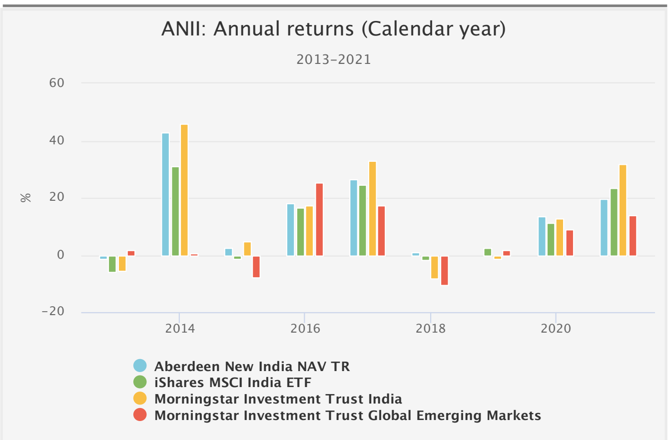
Kristy and James take a cautious attitude to gearing, but aim to be opportunistic, altering the net gearing level based on their view of valuations and the opportunity set. Given markets are near all time highs and the pandemic is still ongoing they see reasons to keep gearing down to c. 7% of NAV on a net basis. As of the end of December 2021 the figure was 6%, marginally up from the summer after the managers used built up cash to invest in certain IPOs. The managers were active in adjusting the gearing level through 2020. After the February/March 2020 sell-off they used gearing to invest in a few names, but locked in some profits after the rebound and reduced gearing by trimming or selling some exposure. Net gearing had crept up to 6.3% as of 31 December 2020.

Performance

Last year (2021) was a strong year for India, and ANII shareholders enjoyed excellent absolute returns. However, the NAV total return of 19.7% lagged the market. The iShares MSCI India ETF, representing a passive investment, generated 23.5% in the year. The team's quality style was unhelpful during the year, with what the team view as poorer quality companies outperforming their preferred picks in a strong recovery rally. The defensive element to their style therefore held the trust back relative to the market.

Looking back over the long term, ANII did very well relative to its market and peers in the six years to 2018. The defensiveness is evident in the particularly good performance in the down markets of 2013 and 2018. Thanks to strong returns in that period, the trust's ten-year track record is excellent, it being the top-performing of the three specialist India trusts with a record that long and having generated an extra 2.1% of performance versus the MSCI India benchmark. It achieved this with slightly lower volatility than the peers and the market and a beta of 0.87, which means it looks strong on a risk-adjusted returns basis (looking at the Sharpe or information ratios) versus its peers.

Fig.2: Returns



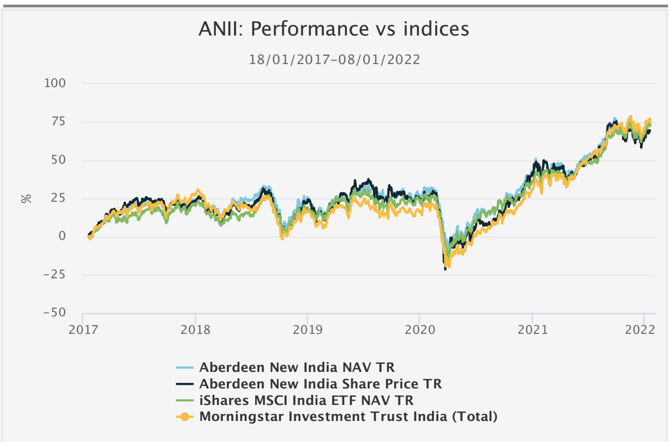
Source: Morningstar

Past performance is not a reliable guide to future returns

The last three years have been more challenging from a relative return perspective. Nevertheless, over five years the returns of 73.4% are slightly ahead of the 72.2% return of the ETF, while the weighted average sector returns have been 74.7%.

There have been a few reasons for this underperformance, which do not look like they will be persistent long-term issues. Kristy and James' decision not to own Reliance Industries, the largest stock in the index, detracted from returns in 2019 and 2020 as it led the market. It is therefore noteworthy that ANII managed to perform reasonably well despite this headwind, and we note in 2021 not owning the company was a positive contributor to returns. Whether Reliance outperforms the market or not in future, it seems unlikely the scale of outperformance will be seen again.

Fig.3: Five-Year Performance



Source: Morningstar

Past performance is not a reliable guide to future returns

The pandemic period has overall also not been ideal for ANII. In the initial crash of February/March 2020 ANII outperformed, in keeping with its tendency to do better when markets struggle. However, the trust lagged in the initial market recovery when Reliance was a strong outperformer. As Reliance slowed in Q4, relative performance of ANII improved. In 2021 the recovery has favoured companies growing from a lower base rather than ANII's steadier, higher quality names. In particular the steel companies and Tata Motors have detracted. Banks have also lagged the market, so the overweight there has hindered the trust. We think the sharp rotations between growth and value and the extreme dispersion of returns we have seen during the pandemic are also unlikely to repeat.

Discrete Performance (%)

	31/12/21	31/12/20	31/12/19	31/12/18	31/12/17
Share Price	28.1	10.6	8.1	(2.5)	13.2
Diluted NAV[A]	27.4	8.3	7.5	(2.8)	9.7
MSCI AC Asia Pacific ex Japan	(1.8)	19.0	14.9	(8.3)	25.4
MSCI AC Asia Pacific ex Japan Small Cap	20.3	22.5	6.6	(12.5)	21.4

Total return; NAV to NAV, net income reinvested, GBP. Share price total return is on a mid-to-mid basis.
Dividend calculations are to reinvest as at the ex-dividend date. NAV returns based on NAVs with debt valued at fair value.

Source: Aberdeen Asset Managers Limited and Morningstar

Past performance is not a reliable indicator of future results

Kristy and James are positive on the outlook for India, and adding to some more cyclical names geared to growth which have lagged in recent months, as we discuss further under **Portfolio**.

Dividend

ANII is managed for capital growth. Income is used to pay expenses and the trust rarely pays a dividend. There was no dividend paid for the financial year ending March 2021.

Management

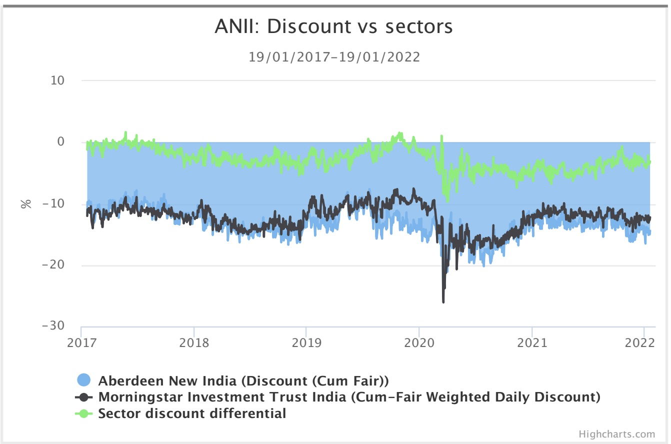
The trust is run by the abrdn Asian Equities team who are based in Singapore. They take a team-based approach which means they aim to build consensus on their stock picks across the region. There are two team members with special responsibility for this portfolio: Kristy Fong and James Thom. Kristy and James are the key decision-makers regarding buys and sells and the day-to-day management of the portfolio. The Asian equities team are led by Flavia Cheong and her deputy Kwok Chern-Yeh, both based in Singapore. The team share a common investment framework across their single-country and regional portfolios. This framework seeks to identify high-quality companies which have sustainable earnings streams, and places great importance on corporate governance and engaging with companies to improve how they treat minority shareholders.

Discount

ANII's shares currently trade on a 15.6% discount to NAV, wider than the 13.3% five-year average for the trust. The weighted average of the four Indian trusts is 12.2%, according to JPM Cazenove data. While ANII underperformed its benchmark in 2019 and 2021, bringing down its three and five year **Performance** numbers, we question the appropriateness of such a wide discount. There are a number of reasons to be positive about India on a medium to long-term view, yet discounts in the sector are on average much wider than they are for the broader emerging markets sector. This could be justified on the grounds that single country funds are riskier, but if the outlook is as positive for the country as we believe then a double-digit discount could prove to be a good entry point.

We show the differential between the discounts of the India and Emerging Markets sectors in the graph below. The current figure is slightly wider than the five-year average of 2.7 percentage points despite India's strong fundamentals discussed above (see **Portfolio**).

Fig.4: Discount



Source: Morningstar

The board has the authority to buy back shares to manage share price discount volatility and has committed to doing so when it believes this would be in the best interests of shareholders (while paying regard to the overall size of the trust's portfolio). In the last two financial years the board have repurchased around 350,000 shares, roughly 0.6% of the current share count. There is also an annual continuation vote which has been held each year since 2005. In September 2021 99.3% of votes were cast in favour of continuation. Fundamentally the board states it believes performance and marketing should increase demand for the shares and reduce the discount over time.

Charges

ANII's last published OCF is 1.16%, which compares to a weighted AIC India sector average of 0.98%, as calculated by JPM Cazenove. However, charges are likely lower on an ongoing basis, as the board has agreed a fee cut with the manager effective for the 2022 financial year starting in April 2021 (the OCF figure dates from March 2021). The management fee has fallen to 0.85% from 0.9% on the first £350m of net assets, with net assets above that charged at 0.7% rather than 0.75%. Net assets are c. £426m as of the latest factsheet, so we calculate the effective management fee is c. 0.82%. Furthermore, fees are to be charged on net assets rather than total assets less current liabilities as before. There is no performance fee. The KID RIY, which includes bank interest costs, is 1.39% compared to a sector weighted average of 1.42%, although calculation methodologies can vary.

ESG

The Asian Equities Team at abrdn (and previously at Aberdeen Asset Management, before it merged with Standard Life in 2017) were early adopters of what has become known as ESG investing, having long championed a focus on the ethical quality of management teams as well as their financial acuity. Originally, governance was the key focus, with the team always viewing good governance as an essential attribute of a quality company. Over time the commitment to ESG has grown and broadened, and abrdn now employ over 50 dedicated ESG experts and ensure these issues are considered as a part of the analysis of every company under coverage.

Asian equity team members conduct their own assessment of the performance of candidate companies on ESG grounds, but also consider the ratings of external analysts at MSCI and try to understand the reasons for any differences. Another modern trend the team anticipated was a focus on active engagement to improve governance issues. The team work to encourage better ESG policies in portfolio companies and view themselves as being in partnership with the management of their portfolio companies. They believe this should lead to better long-term returns to shareholders, as they believe ESG issues are frequently material to long-term company performance.

Given the importance they place on governance, the team will often not invest if they think governance practices are particularly poor and there is no or limited scope for them to improve this where management is unlikely to be receptive to their input. This means they have been happy to sit out the gains on a fashionable stock if they think its standards of behaviour are not acceptable and management have not indicated any willingness to change. As such we think ANII could appeal to investors who want a moral dimension to their investments, and we note the trust and the manager have both been highly rated by external experts for ESG. As a house, Aberdeen Standard Investments has been awarded A+ on the UN Principles for Responsible Investing framework for equities. ANII meanwhile has been awarded a 'High' rating from Morningstar Sustainalytics within the India Equity category, meaning it is considered to be among the best in this group.

Disclaimer

This report has been issued by Kepler Partners LLP. **The analyst who has prepared this report is aware that Kepler Partners LLP has a relationship with the company covered in this report and/or a conflict of interest which may impair the objectivity of the research.**

Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise and you may get back less than you invested when you decide to sell your investments. It is strongly recommended that if you are a private investor independent financial advice should be taken before making any investment or financial decision.

Kepler Partners is not authorised to make recommendations to retail clients. This report has been issued by Kepler Partners LLP, is based on factual information only, is solely for information purposes only and any views contained in it must not be construed as investment or tax advice or a recommendation to buy, sell or take any action in relation to any investment.

The information provided on this website is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Kepler Partners LLP to any registration requirement within such jurisdiction or country. In particular, this website is exclusively for non-US Persons. Persons who access this information are required to inform themselves and to comply with any such restrictions.

The information contained in this website is not intended to constitute, and should not be construed as, investment advice. No representation or warranty, express or implied, is given by any person as to the accuracy or completeness of the information and no responsibility or liability is accepted for the accuracy or sufficiency of any of the information, for any errors, omissions or misstatements, negligent or otherwise. Any views and opinions, whilst given in good faith, are subject to change without notice.

This is not an official confirmation of terms and is not a recommendation, offer or solicitation to buy or sell or take any action in relation to any investment mentioned herein. Any prices or quotations contained herein are indicative only.

Kepler Partners LLP (including its partners, employees and representatives) or a connected person may have positions in or options on the securities detailed in this report, and may buy, sell or offer to purchase or sell such securities from time to time, but will at all times be subject to restrictions imposed by the firm's internal rules. A copy of the firm's Conflict of Interest policy is available on request.

PLEASE SEE ALSO OUR TERMS AND CONDITIONS

Kepler Partners LLP is authorised and regulated by the Financial Conduct Authority (FRN 480590), registered in England and Wales at 70 Conduit Street, London W1S 2GF with registered number OC334771.