FinanceAsia

India Bull

By Steven Irvine, 21 May 2003

Jon Thorn's India Capital Fund returned 26% last year and he is mega-bullish on the prospects for Indian equities.

Q: What is the background of the fund?
A: Thorn: We started the fund in 1994, and called it the Indian Smaller Companies Fund. We focused on non-conglomerates and JV partnerships. Then after six and half years things began to change in India; indeed things are changing more in India now than in the whole of Indian history — I mean, in terms of the macroeconomic situation and the corporate structures available, and in terms of profits and earnings.

What's happened is an incredible contraction of capacity, and a corporate deleveraging. Suddenly Indian companies have pricing power and earnings. Over the past 10 years an industrial revolution has taken place in India. Free cashflow has surged from nothing in the year 2000 to almost Rs200 billion today.

At this point we changed too. We are now called the India Capital Fund and our largest positions are two of the largest cap stocks in India — State Bank of India and Reliance.

Q: How big is the fund?
A: $15 million, so quite small. But we have new money coming in.

Q: It's an open-ended fund?
A: Yes. The closed-end fund industry is dying as a breed. Two years ago there were 40 India funds, including closed-end funds. Right now there are between 15-18. Two years from now there will be 5-10. There won't be any closed-end funds. No one wants to own them.

Q: How are you different?
A: I am a boutique manager managing an open-ended fund. All I do is India. Some of the other funds have had shocking performance. That's because a lot of houses have whole bunch of funds, one of which is an India fund, and the guy running that is also running the Asia mid-cap fund, and a whole bunch of different strategies. Actually, it's fine to do Indonesia on a Wednesday and Thailand on a Thursday, but India is different. India has more listed companies than the rest of Asia put together ex-Japan. Just like China, it's a huge market.

The result is clear: it's massive underperformance. If you look at the performance of some of these India funds it's mindblowingly bad. You've never seen underperformance like it.

We are getting more and more inflows and I see a trend where there will be three or four people like me who just do India.

Q: Your performance last year was 26%? Has it been equally good in the last three or four years?
A: 2001 was a complete disaster because of the stock market scam — market liquidity declined by 80% in 45 days. It was the only recent case — apart from Russia — of investor capitulation. 100% of new money flows went into buying government debt.

The market is still disastrously bad, although we have recovered quicker than others.

Q: You are based in Hong Kong. How often do you go to India?
A: Over the last 18 months I have been five or six times. But we rotated almost the entire portfolio over the last two years — when we changed the name of the fund and investment remit.

I will probably go again next month or the month after.

Q: What makes you so bullish on India?
A: I'm glad you asked. The world would have been in global recession without China and India. They kept the world's GDP alive. In the previous 10 years, China and India had the biggest sustainable GDP growth in the world.

Indian banks have an incredibly low number of non-performing loans, so the amount of leveraging up and incremental growth that can take place is very large. There is no NPL impediment.

India’s borrowing to deposit ratio is 9.8% versus 64.5% for Korea and 160% in the US. That means there is great capacity for growth. If India goes to even half the Indonesian rate that leads to tremendous potential investment offtake. The growth potential is truly staggering.

Meanwhile price earnings ratios are at historic lows.

Q: Where are you most overweight?
A: Pharmaceuticals — we are 24% in pharma, and that sector is doing well. By volume it has seen 8% growth. Pharma is my favourite sector by far. My next favourite is banking. Arguably this is a sector that has done nothing for half a century. They are among the cheapest bank stocks in the world. State Bank of India — which has 9000 branches — has reduced its cost to income ratio substantially and is just going to make tonnes more money. They are going to make that money in the consumer sector. This sector is exploding. Plus banks are leveraged plays on GDP growth. You need the most leverage with the least risk. You find that in a well managed public sector bank or a private bank.

My favourites in the consumer segment are SBI, HFDC and ICICI along with ING Vysya Bank.

Mortgage finance is incredibly small at the moment but is growing fast. I do a lot of comparative stuff with other Asian economies. Apart from Vietnam, in my own personal judgement, India has by far the best investment outlook you can find.

Q: Better than China?
A: Tell me what you would buy in China? Fine if you are a multinational doing FDI. But as an investor? Most of the accounts are garbage.

It’s not a mass investable market.

Q: What’s the dividend yield of your portfolio?
A: It’s 3.4% on a consolidated basis. But I can show you the Gas Authority of India, which is an ex-monopoly and is yielding in rupee terms 6.7%. Government debt is only yielding 6.3%.

Q: How much of your gains have also come from rupee appreciation against the dollar?
A: The rupee has appreciated over the last 20 months by around 7%.

Q: You are bullish. But can we talk about Indian corporate governance. Is that still a problem?
A: Yes. That’s the simple answer. But we all have to say thank goodness for Infosys. Fundamentally they are doing all the right things. Everyone else in India has seen what Infosys has done and how to become a billionaire. The best way to show people that corporate governance is a good idea is to show them that they are going to make more money. That’s true of anywhere.

Many Indian companies are run by big families. But even companies such as Reliance — which is family-owned — have gone quite far down the road of trying to introduce solid corporate governance. Infosys has led that charge.

The second thing is privatization. This is the most important thing that happens to any economy in the world, if it is done properly. Privatization is Margaret Thatcher’s legacy to the world. 100,000 companies have been privatized since Margaret Thatcher came to power. Now there are six companies trying connect a phone for me in India. Five years ago there was basically one. The price of calls has fallen 80% and the quality is higher.

Privatization is happening very slowly in India but is occurring in a smart way. More competition changes the economy completely. And it also helps corporate governance.

Q: If someone wants to invest in your fund, what should their investment horizon be?
A: The real answer is as long as I am doing my job properly and outperforming. If I don’t outperform they should cut me, and go with someone doing a better job. While I am doing a better job — which I have for 8 years — they should stay with me?

Why should they be in India? Because this is where the GDP growth is. If you can invest in China, maybe the same is true. But there are limits to how much money you can make a private investor in China. In India you can make a lot.

Anyone wanting to invest in Asia should have a permanent horizon for their investments. They should want to invest in China, India, Taiwan and Thailand and the like because these places are going to see more sequential GDP growth than anywhere else in the world. It’s simple arithmetic.

The investment story now is also about domestic consumption. And India fits nicely into that story. Exports are only 11% of GDP.

Q: What is the minimum amount that can be invested in your fund?
A: A quarter of a million US dollars for someone who comes off the street. But if it comes through a private bank, then it is $25,000. The quarter of a million is a safeguard to ensure the people coming in are wealthy and sophisticated. But if it comes through a private bank, then the person is being advised by a professional.