INDIA REVEALS ITS POTENTIAL
INDIA'S MULTIPLE GROWTH DRIVERS

INTERVIEW

► In early June, the world's largest democracy re-elected Indian Prime Minister Narendra Modi after a six-week election. In office since 2014, Modi introduced the "Make in India" initiative aimed at increasing the contribution of the manufacturing sector to the country's GDP. Almost a decade later, what is the impact of the development plan and what are the main trends driving the Indian market?

PATRICIA URBANO
*International Equity Portfolio Manager**

XIADONG BAO
*International Equity Portfolio Manager**

Over the past ten years, **India has been building foundations for long-term structural growth**, notably by embarking on a series of reforms aimed at making the country more competitive. The latter include a redefined mandate for the Reserve Bank of India (RBI), demonetization (to fight against the informal market), several reforms to the banking system (to improve transparency in the sector), and a major simplification of the tax system, including lower corporate taxes (down from 30% to 25% and 15% for companies injecting new capital into the manufacturing industry).

These reforms have fostered an environment conducive to investment, notably within the tech sector. Apple is a perfect example. The Cupertino firm has regularly increased its production of *made in India* iPhones, now topping 14 billion dollars in 2024, or 1 iPhone out of 7 produced across the world[1]. This could rise to 1 in 4 by 2025 according to JPMorgan.

Over the years, the Make in India initiative has shifted from an "import substitution plan" to a "strategic development plan" for the Indian manufacturing industry, targeting not only the domestic market but also the country's global integration into the supply chain.

In addition to targeted fiscal incentives, **the government has also ramped up investments in infrastructure**. A major hurdle for many foreign companies, the Modi government has deployed a 1000-billion-dollar investment plan over the past 5 years to upgrade the country's infrastructure and public service networks. These investments have helped boost productivity in India: the contribution of the industrial sector to GDP is expected to grow from 17% today to 25% by 2025[2].

*The identity of the managers presented in this document may change during the product's life.
1. Source: Bloomberg, April 2024.
2. Source: Department of Commerce, Ministry of Commerce and Industry, Government of India

The geopolitical tensions between the United States and China, notably following the Covid crisis in 2019, also played a key role in accelerating the global supply chain diversification strategy. India has been winning back some of its export market share and is increasingly emerging as a future manufacturing power thanks to this development policy, competitive cost structures, vast pools of qualified workers, capacity for supply in Asia, and domestic market.

This is also reflected in higher turnover and improved margins for local companies, as the latter produce higher-value goods. The competitive environment also remains favourable - as capital expenditure is growing but remains reasonable relative to revenues (capex/sales).

Source: Morgan Stanley Research, June 2024

A second tailwind is the **growth of the Indian population and the emergence of the middle class**. India has been benefiting from increasing formal job creation, as more multinationals are outsourcing to India. The country's large English-speaking population and abundant qualified workforce support this trend, which enables the country to offer competitive, subcontracting services, not only in IT, but also in human resources, legal services etc. According to Morgan Stanley's estimates, global subcontracting spending could rise from 180 to 500 billion dollars by 2030[3]. This growth will support the creation of formal jobs, the growth of the middle class and higher consumer spending, which will have a positive impact on demand for commercial and residential real estate.

The last decade was also marked by major digital transformation, from the creation of the Aadhar card (unique ID number) to the Chandrayaan lunar missions (2008 – 2023). Digitalized payments and public services and the creation of an e-commerce friendly initiative (*Open Network for Digital Commerce*) are further examples of India's determination to build up a top-tier digital economy.

This is particularly true given that the Indian e-commerce market is booming, with almost 230 million online shoppers in 2022, against 350 to 400 million expected by 2025[4], more than 750 million Internet users, and smartphone sales growing by 10% a year (15% for IPhones)[5].

Zomato, a meal delivery company, is an interesting example. This profitable tech company saw its net revenues soar by over 50% in recent years, with an annual 35% rise in the number of users between 2021 and 2024, thanks to the combination of several tailwinds: a nascent market, a growing middle class, available workforce and a duopolistic situation.

The energy transition has an important role to play in the growth of the Indian economy. Economic growth comes with rising needs for energy, and government authorities aim to meet this growing demand chiefly through renewable sources. The government of India has set an ambitious target of 500-gigawatts renewable energy installed capacity by 2030 (knowing that 70% of electricity is produced from coal today). The objective is also to reduce India's dependence on oil imports, which will have a positive impact on the country's trade balance and support the stability of the local currency.

3. Source: Morgan Stanley, October 2022
4. Source: BCG and Matrix Partners India, 2023
5. Source: Apple Inc. Earnings Conference Q1 2024

VALUATIONS: WHAT IS THE VISIBILITY OVER THE LONG TERM?

The valuation of the Indian stock market remains an open debate. Currently trading at 23 times the 12-month price/earnings, the market is valued 1.5 times above its historical mean. While this may seem elevated, we believe these levels are not disconnected from the fundamentals of the Indian economy, notably considering the relatively high visibility on:

1- the continuity of economic policy;
2- macroeconomic stability;
3- the correct execution of political reforms;
4- higher than expected earnings growth;
5- the growing weight of private companies in the index over recent years, at the expense of public companies (the former tend to display higher valuations).

INDIA REMINDS US OF CHINA IN THE EARLY 2000S

These changes indicate that India is laying the foundation of a consumer-driven economy. The factors mentioned above – economic reforms, development of the manufacturing industry, upgraded digitalization and electrification – should, in our view, enable the Indian economy to more than double in size over the next decade.

EDMOND DE ROTHSCHILD ASSET MANAGEMENT (FRANCE)

47 rue du Faubourg Saint-Honoré, / FR - 75401 Paris Cedex 08

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