

Nepean Capital

4Q CY23 Investor Newsletter

The Nepean Long Term Opportunities Fund II is a multi-cap India Special Situations fund. It has given a return of 34.9% (net of fees) since the first close (Oct 14, 2021), having outperformed our benchmark the NIFTY500 by 2230 basis points.

Performance as of December 31, 2023 (in US\$, net of fees)			
Period	Fund	NIFTY500	Outperformance (bps)
Since first close	+34.9%	+12.6%	+2230
Last 12 months	+35.6%	+25.3%	+1030
Last month	+11.2%	+8.3%	+290

2023: INDIA IN NUMBERS

\$4.1 Tn

Market cap, the 4th highest in the world, +80% in the last 3 years and has overtaken France, U.K., Saudi Arabia, Canada and Germany

7.6%

India's GDP growth, July-Sep Qtr

7%

FY26 estimate by S&P *

169 Billionaires

3rd highest in the world **

\$623 Bn

Forex reserves, the 4th highest in the world

900 Mn

of smartphones in use

467 Mn

of social media users

117.6 Bn

of UPI transactions in 2023 +54% YoY

\$220 Bn

Value of UPI transactions +42% YoY

490

of companies with a market cap >\$1 Bn

404

of companies with daily volume >\$5 Mn[^]

1,600

Number of global capability centers (GCC)

1.7 Mn

of people employed at the GCCs

\$7.8 Bn

FOB value of iPhones exported from India

80%, 90%

Exports as % of production by Pegatron and Wistron, respectively

* S&P: "India is set to become the third-largest economy by 2030, and we expect it will be the fastest growing major economy in the next three years."

** Source: Forbes

[^] Cash volume

The Tale of Two Indias

Two-thirds of India's population is composed of Aspirers (52% with incomes of Rs.1.25-5 lakhs/\$1,500-\$6,000) and the Poor (15% with incomes below Rs.1.25 lakhs/\$1,500). We believe that this is where the incremental growth will come from over the next two decades. The other India comprises of the Middle Class of around 432 Mn or 30% of the population. This has annual household incomes between \$6,700-\$40,000 and has been growing at 8% per year. The Rich (growing at a CAGR of 13%) are estimated at 4% of the population or 60 Mn people with an annual household income >Rs.30 lakhs/\$40,000. The Middle Class and the Rich, amounting to a third of the population, are driving a premiumization trend across housing, electronics, luxury goods and travel.

Despite higher interest rates and property prices, home sales in the Top 8 cities in India hit a record high of 329,000 units, +5% YoY. Mumbai's real estate market (the largest in the country) set a new record in 2023 with 127,000 in sales, both primary and secondary. Last week, the NIFTY Realty Index hit a 15 year high with the index +81.4% in 2023.

In 2023, Indians bought a record 128 luxury cars per day, up from 95 pre-COVID. The definition of luxury cars is anything priced at Rs.50 lakhs/\$60,250 and above. While the absolute number of 46,000 luxury cars sold last year lags developed markets, it's still a new all-time high. Ola Kallenius, Chairman of Mercedes Benz AG who visited India in 2023, said:

"...you get a sense in India, it's like the 21st century belongs to India. There is such a buzz, such a pulse. The country is on the move ... We're ready. If the Indian market takes off even faster, we're going to be there."



We have a ringside view of this growth with our investment in Landmark Cars (LANDMARK IN), the largest Mercedes dealership in India. Their OEMs also include BYD, VW, MG Motors, Honda, JEEP and Mahindra and are present in 116 locations across 10 states.

Last month, passenger traffic at the Mumbai airport was 4.9 Mn, the highest month ever and +13% YoY. India's largest hotel chain, Indian Hotels (TAJ), posted its best ever quarterly results for the 2Q FY24. Revenues were +23% YoY, average room rates rose almost 40% to Rs.9,300/\$112 and occupancy hit 70%. Such is the demand that the Maharaja and the Maharani suites at one of their premier hotels, the *Umaid Bhavan Palace* in Jodhpur, Rajasthan are sold out and the next best suite is priced at Rs.4.89 lakhs/\$5,900 (includes breakfast, one meal and taxes) !



Hence, it's no surprise that India's Services PMI for December hit 59 vs. 56.9 in November. We are playing this space with our recent investment in Rategain Travel (RATEGAIN IN), a company that provides SaaS solutions for the travel and hospitality sector in bookings, pricing intelligence and customer travel intent. They work with the Top 23 of 30 hotel chains, the Top 25 of 30 online travel agents, and all the top car rentals. More than 86% of their revenues are from overseas.

However, beyond the premium category of goods & services, demand has been tepid for the rest of India. Consumer companies have been reporting weak numbers for the past 18 months. Same store sales growth for quick service restaurants (QSR) has ranged between -10% to +1%.

The Rise of the Indian Investor

Last year ended with the benchmark index, the NIFTY50, +19.4% (in INR terms) and +18.7% (in US\$), its 8th successive year of positive returns and the third successive year of regional outperformance. Strong domestic flows (the third consecutive year) of \$23 Bn overtook FPI (foreign portfolio investors) flows of \$21.4 Bn, the second highest in Asia after Japan (+\$25 Bn). In fact, December witnessed \$11 Bn of net inflows into the equity markets from both domestic and foreign institutional investors, a monthly record.

The emergence of retail investors in India as a formidable asset class has been a remarkable story. It all started with the launch of Reliance Industries (RIL)'s JIO mobile services in late 2016. JIO, is an all 4G network, with free domestic calls (on-net and off-net) and all you can eat data plans priced at the lowest ARPU in the world of \$2.20. Add to that the advent of smartphones (now 900 Mn in use), eKYC and a young population (the average age of an investor is 29), which has spawned a whole generation of tech companies in e-commerce, fintech and online trading. Today online brokers are seeing their 90% of their incremental customers coming from Tier 2, 3 and beyond towns, with more than 80% of trades placed via smartphones.

December 2023 saw Indians open a record 4.2 Mn new demat accounts (+50% MoM) taking the total to 139 Mn, of which 98.4 Mn have been opened since April 2022. The month saw a record 4 Mn new SIP (systematic investment plans) registrations and net inflows of \$2 Bn. (A SIP is a facility offered by mutual funds to investors to invest a fixed amount of money at pre-defined intervals, usually monthly). The full year 2023 saw SIP inflows of Rs.1.83 lakh crores/\$20 Bn +23% YoY.

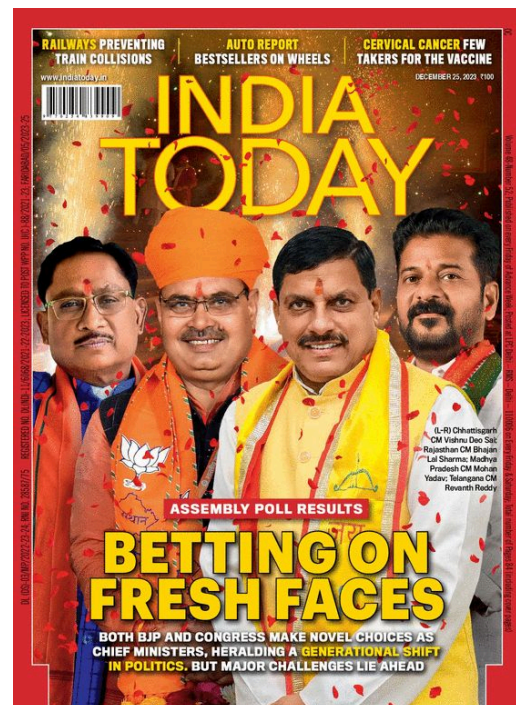
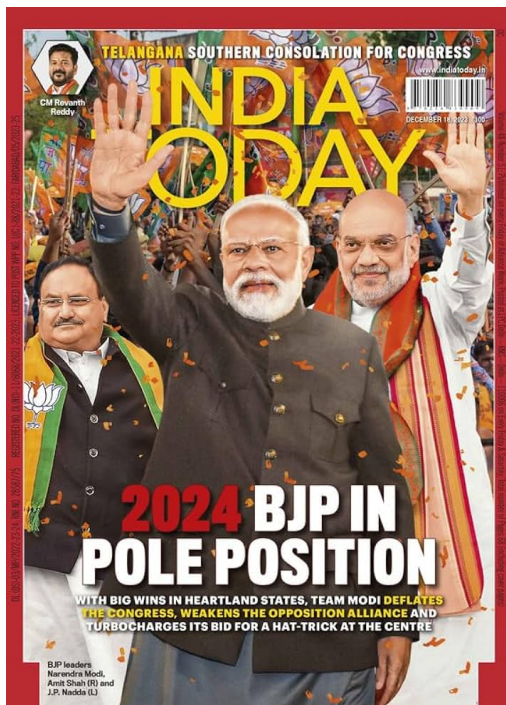
Angel One (among India's leading discount brokers) saw their client base rise 55% YoY to 19.5 Mn. In fact, the month of December saw their gross client additions jump 221% to over 1 Mn and daily orders were up 75% to 6.8 Mn. Their average daily turnover for F&O (futures & options) was +156% YoY and for the cash market was +102%. Moreover, there are now over 200 single family offices in India that manage an average of \$100 Mn in AUMs.

While this in itself is positive, what makes us cautious is the fact that the vast majority of this is driven by first time retail investors who are entering the market through the derivatives route and IPOs. Today, futures & options (F&O) volumes account for 99% of total daily traded volumes in the equity market. This exuberance is also reflected in the capital markets where retail participation in IPOs increased substantially during CY23, with the average number of retail applications swelling to 1.3 Mn (+133% YoY). Retail investors applied for Rs.1.5 lakh crores/\$18 Bn worth of shares, which was 203% higher than the year's total IPO mobilization (in CY22 retail applications were 22% lower than that year's total IPO mobilization). Public equity fund raising jumped 59% to Rs.1.44 lakh crore/\$17.3 Bn in CY23, led by 57 mainboard IPOs that collectively garnered Rs.49,434 crores/\$600 Mn into markets (+28% YoY after excluding the impact of LIC's mega IPO in CY22) and 45 qualified institutional placements that raised an additional Rs.54,350 crore/\$6.5 Bn (+363% YoY). Of the 57 IPOs, 16 were subscribed more than 50x and 41 more than 10x. Lastly, insider selling by founders is on the rise with large shareholders in Indian firms having sold Rs.1.03 lakh crore/\$12.4 Bn in shares as of the end of November 2023, doubling 2022's total.

Therefore 2023 was a year of Mid & Small Caps, market caps preferred by domestic retail investors. The NIFTY Mid-Cap Index gave a return of 44.4% and the NIFTY Small-Cap Index was up 53.6%. At 21x CY24 P/E, India remains the most expensive large market in the world. It's marginally ahead of the S&P500's valuation (19.8x) has an impressive 11% consensus EPS growth vs. India's 16%. So, while optically the NIFTY50 looks expensive, large-cap stocks like Reliance Industries, TCS, Infosys, HDFC Bank, ICICI Bank, Axis Bank and Kotak Bank (which collectively account for 48% of the index) gave a meagre return of 9.58%.

View on 2024

India will be among 58 countries that will have elections this year, the other major nations being the U.S., Mexico, Canada, South Africa, Indonesia and possibly the U.K. The 18th General elections in India are likely to be held in April or May this year. One billion Indians will be eligible to vote this year, of which 76 Mn will be first time voters and 51 Mn below the age of 20. The ruling BJP won the semi-finals in December with a clean sweep of the three heartland states (Rajasthan, Madhya Pradesh and Chhattisgarh). That has significantly improved the odds of Prime Minister Modi winning a third term ringing in continuity and more economic reforms.



Today, the total value of FPI ownership is at an all-time high of \$723 Bn or 18% of India's market cap, but down from 29% in 2021. India's weight in MSCI EM has surpassed Taiwan and is now the second highest after China. In fact, over the past eight years, it has risen from 7% to 17.1% currently (vs. China's 26.6%). If the robust flows from domestic investors continue causing the weight to increase further, foreign ETFs and passive funds will invariably have to keep investing in India. It becomes a self-fulfilling prophecy. Moreover, if Korea (currently at a 12.6% weight) is upgraded to developed market status from EM, then the weightage will surge.

While we welcome a correction in the equity market, we believe that 2024 will be yet another strong year of economic growth for India. PM Modi is India's best brand ambassador and has demonstrated an ability to attract manufacturing as MNCs look for alternatives to China. Moreover, we expect the return of private sector capex as capacity utilizations reach an average of 72-75% across industries. Other factors in India's favour include benign inflation leading to potential rate cuts by the RBI (tailing cuts by the Fed), revival of rural India, 16% corporate earnings growth and stronger tax collections as the country continues to formalize its economy.

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