

India: A View From The Ground

Key Takeaways From Our Latest Research Trip

JULY 6, 2023

Among emerging-market countries, the Wasatch investment team remains most constructive on India. We've shared our views on the country in [prior communications](#), exploring how trends such as digitalization, financialization, formalization and industrialization continue to push its economy forward. A recent visit to India allowed us to see how those trends are evolving. It also provided a chance for us to meet with some of our portfolio-holding companies and explore new opportunities within India's fast-changing economy. Below are a few takeaways from our trip.

UNLIKE MUCH OF THE WORLD, INDIA'S ECONOMY IS STILL STRONG

The management teams we spoke with—even teams that have historically been more conservative—were positive about the economic outlook for the country. Consumers, hotel operators and cab drivers were equally optimistic. Capital spending and housing appear to be in an upcycle, and banks are reporting non-performing loans near all-time lows. Massive construction projects within cities and capital-spending plans among businesses point to a coordinated effort to spring India's economy forward. We saw highways, overpasses, bridges and infrastructure being built everywhere. The sense of optimism and excitement among businesses and consumers was quite different from what we read and hear about in many other parts of the world, where recessions have arrived or recession fears are mounting. Economic forecasts confirm our



Meenakshi Temple

views on the ground, with the International Monetary Fund forecasting real GDP growth of around 6% for India in 2023, one of the highest rates in emerging and developed markets.

INDIA IS CAPITALIZING ON ITS NEW MANUFACTURING OPPORTUNITY

In [prior market commentaries](#), we've discussed industrialization as an important theme for India's development. We've all seen the recent headlines about Apple and other companies moving production to India. On our latest trip, the growth of the country's manufacturing sector was palpable. Management teams from industrial companies reported an upsurge in demand as global companies develop China Plus One strategies for their supply chains. In another telling sign, finance companies told us loan demand from manufacturing enterprises is surging as a direct result of China Plus One.

Additionally, executives from several firms told us that after years of scant progress and initiatives going through fits and starts, the government's newest Production-Linked Incentive (PLI) initiative, a broad collection of incentives to spur companies to manufacture goods in the country, is finally producing tangible results. From its launch in 2020 to the end of 2022, more than 650 applications have been approved for new manufacturing facilities under the PLI.

SPECIALTY CHEMICALS IS ONE OF THE MOST PROMISING INDUSTRIES BENEFITING FROM CHINA PLUS ONE

We met with a number of specialty-chemical companies on our trip, and we think a few trends are converging to support the industry. First, companies are relocating some of their specialty-chemicals manufacturing capacity away from China. Second, the Indian workforce's expertise in chemistry and mechanical engineering continues to make it an attractive relocation destination. We think this is the

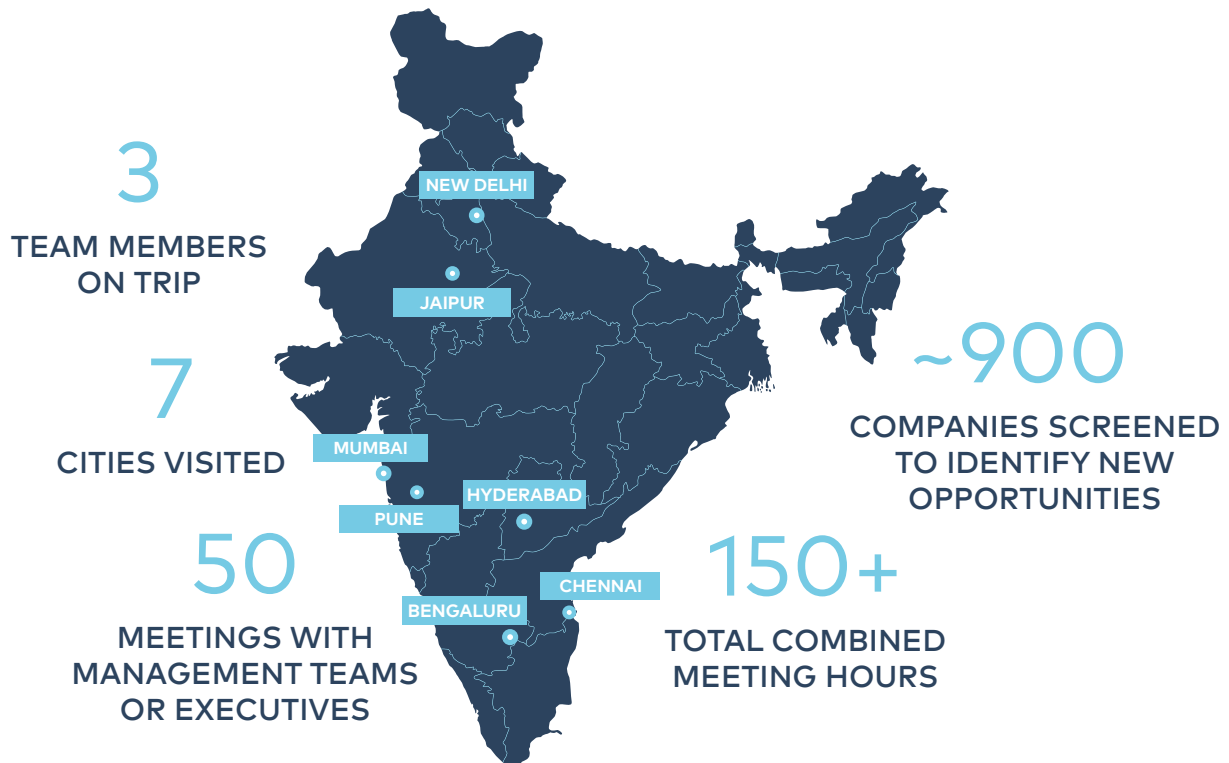
same type of expertise that allowed India's pharmaceutical manufacturing industry to flourish in the mid-2000s. Finally, we believe a gradual and ongoing shift in preferences from petroleum-based specialty chemicals to plant-based specialty chemicals is also a tailwind. We're excited about this relatively new area of investment for us in India.

INDIA'S CONSUMERS ARE EXERCISING THEIR SPENDING POWER IN THE WAKE OF THE PANDEMIC

Demand for travel and hospitality services may be the highest we've seen in two decades of visiting India. The trend was most evident in the price of domestic flights. Historically, in-country flights have cost around \$70 to \$80, but fares were often in the \$200 range on our most recent trip. Hotel occupancy rates were also much higher than in years past. After getting hit hard by the Covid-19 pandemic, it was surprising to us how fast the population has put it in the rearview mirror. Gathering places were crowded,

India Research Trip: By the Numbers

At Wasatch, we take a deliberate approach to our research trips so that we can visit as many current holdings as possible and explore specific new opportunities. We set our own agenda and don't passively meet companies at conferences. Rather, we home in on the potential new ideas first by rigorously screening our investable universe. This helps us identify companies that meet our specific investment criteria and candidates for further due diligence. From there we choose companies of interest and take trips to companies' headquarters or other facilities to meet with management one-on-one and learn more about operations.



most people were unmasked, and the population generally seemed undeterred by the new Arcturus variant that emerged in the spring.

INDIA'S INFRASTRUCTURE INVESTMENTS ARE BOOMING

The government's current fiscal-year budget increased infrastructure spending by over 33%, now totaling 3.3% of GDP. Mumbai serves as a prime example of the infrastructure development we saw underway. The city is undertaking four simultaneous mega-projects that could remove significant bottlenecks and increase connectivity within the city. They include: a new coastal highway; a new airport on the eastern side of the city's bay; an underground subway; and an overhead metro train. To get a sense of the scale of development, we equate it to four of Boston's "big dig" projects all taking place at once. As India improves its infrastructure, information-technology (IT) service companies are also helping in the government's efforts to create "smart cities" that include better 5G infrastructure and cameras to monitor traffic.



Mobile payments in India

DIGITAL-PAYMENT INFRASTRUCTURE IS BECOMING DEEPLY EMBEDDED INTO INDIA'S ECONOMY

The digitalization and financialization of India have been long-running themes for the country and for many Wasatch portfolios. Still, we've been surprised by how much these initiatives have progressed over our last few trips. An overhanging question for India's economy has been whether it can successfully get 60 to 70 million small merchants and more than 1 billion consumers integrated with its Unified Payments Interface (UPI), a mobile app allowing consumers to transfer money to merchants and to each other. That question seems to have been answered. We saw merchants across the country operating small kiosks with QR codes for all their products. Consumers are using the app on their

phones to purchase items as small as a single cigarette. Data help confirm the growth we saw in UPI payments: The National Payments Corporation of India recorded nearly 60% year-over-year growth in payments for May, increasing from 5.96 billion payments in May 2022 to 9.42 billion in May of this year.

THE UBIQUITY OF UPI PAYMENT INFRASTRUCTURE HAS DEEP IMPLICATIONS FOR FINANCIAL COMPANIES

Bank management teams we spoke with were enthusiastic about utilizing UPI as a springboard to extend credit to consumers and businesses. For example, UPI can provide banks with better data on how many transactions a merchant is processing. This in turn gives the bank confidence to extend a loan to help grow the business. On the consumer side, UPI could allow banks to extend credit in real-time to consumers looking to purchase a big-ticket item.

WHILE POSITIVE FOR THE BROADER ECONOMY, INDIA'S DIGITALIZATION AND FINANCIALIZATION WILL DISRUPT MANY BUSINESSES

Digitalization makes it much easier to launch a new brand or to disintermediate an existing one. Meanwhile, the UPI system may make it easier for Indian financial companies to gather data and extend credit, which could then allow them to take market share from global behemoths such as MasterCard and Visa.

In short, India's rapid advancement and modernization will also quickly shift the investment landscape. We believe this rapid change will require deep knowledge of industries, companies and management teams, as well as continual, on-the-ground due diligence to identify the long-term winners and losers as India's economy evolves.

After this trip, we remain as excited as ever about the investment opportunities in India. In fact, this may have been one of our most productive India trips ever, as we came away with nine promising ideas for Wasatch's emerging-market and global strategies. Below we share some takeaways from company meetings with three of our current portfolio holdings.

Company-Specific Highlights

BAJAJ FINANCE LTD.

We met with Bajaj Finance at the company's Pune, India headquarters. Bajaj is a non-bank financial company that's been a longtime holding in Wasatch strategies. To get a deep view of the company, we had over three hours of meetings with Rajeev Jain, the company's energetic, visionary leader, and four other business unit heads. The one-on-ones provided a valuable update on the company's culture and strategy, which both continue to be a step ahead of the rest of the industry, in our view.

Our long-running thesis on Bajaj remains on track. The company continues to innovate and take market share from India's less efficient state-owned banks, and we believe that as India's financial-services sector consolidates, Bajaj will emerge as one of four or five industry champions. This recent visit only increased our conviction.

One thing we understood deeper from this trip is Bajaj's competitive, hard-charging culture that Jain has woven into the fabric of the company. The work ethic flows down from its leader, who works 12-hour days and weekends. Fueled by an incentive structure that often pays monthly or quarterly bonuses and a proprietary sales app that shows Bajaj's market share in a given region for a specific business line, employees stay on the offensive. We think attracting motivated, intellectually hungry people is a real competitive advantage for Bajaj. And, we'd note most seem to enjoy the competitive environment, as Bajaj's attrition rate is only about 12%, far lower than the financial-services industry average of 22%.

A recent innovation that has caught our attention is Bajaj's QR-code-based payments app. The company sees payments as a digital springboard from which it can offer additional financial services to consumers and merchants. Using QR codes means merchants don't have to rent expensive point-of-sale systems, and merchant banks save on maintenance costs. The payments service is quickly gaining traction, but it remains to be seen how it will play out in the competitive payments landscape. Positively, in our stops at small merchant kiosks across India, we were surprised by how many had Bajaj QR codes for payment.

As we learn more about Bajaj's payments business and its broader growth strategy, we continue to believe the company is poised for substantial growth. We expect Bajaj will emerge as one of India's dominant financial-services conglomerates over the next decade.



Medical testing and diagnostics in India

DR. LAL PATHLABS LTD.

Our team visited Dr. Lal PathLabs at its New Delhi, India headquarters. Dr. Lal operates one of the largest chains of diagnostic pathology labs in the country. Our core thesis on the company is that it will be a key beneficiary as a burgeoning middle class seeks more medical testing services to monitor and improve their health. We came away from our meetings confident that the company can continue to capture a meaningful share of this rapidly growing and highly underpenetrated market.

While we originally considered Dr. Lal's competitive advantage to be its pan-India presence, as we learn more, we think the company's regional capabilities and execution are equally important. We came away from our meetings impressed with how Dr. Lal adapts and grows its services in the different regions of India. Each region has its nuances, and Dr. Lal's management has clearly learned not to force-fit one region's sales and growth model into another. We came away with a better appreciation of how regional density and regional scale can drive Dr. Lal's success going forward.

Discussions with management also gave us more insight into how Dr. Lal is tackling the competitive diagnostic-testing landscape. For some of the newer diagnostic companies that tried to penetrate the market during and after the pandemic, funding has become scarcer—which should only benefit Dr. Lal. At the same time, Dr. Lal has countered competition not by reducing prices, but with value-additive products and services. For example, the company has bundled different tests into a diagnostic kit for consumers. Dr. Lal has also moved into more advanced testing and diagnostics, such as genetic and autoimmune-disease testing, which are more differentiated and higher-margin business segments than standard, more ubiquitous testing services.

We believe Dr. Lal's footprint, operational efficiencies, product offering and network of hospitals and doctors remain competitive advantages that will continue to fuel the company's growth.

PERSISTENT SYSTEMS LTD.

We also met with the management team from Persistent Systems, a multinational IT-service company, during a tour of one of its campuses in Pune, India. We came away from our meeting positive on the long-term opportunity for the company as it continues to focus on revenue-generating, digital-engineering offerings rather than legacy IT services. We also came away with more conviction that the company's smaller size and more nimble style make it a fierce competitor to its larger peers—and one that has the potential to better weather a slowdown in global IT spending.

Digitalization is a key priority for businesses small and large as they race to adapt to a new digital age. Persistent's role in helping companies navigate this transition puts it higher up the value chain than most IT-service companies. But providing such high-value services requires hiring—and retaining—India's top-notch IT talent. Seeing Persistent's campus showed us how management has been able to do it. Engineers work in a modernized office one might find in Silicon Valley, with open space, floating workspaces and nice cafeterias for employees. The company is also focused on keeping talent engaged and highly skilled, offering plentiful learning and upskilling opportunities.

Conversations with management also gave us more insight into how this dynamic upstart has been able to compete against larger competitors that might generate 15 to 20 times as much revenue. For example, Persistent is taking an aggressive, solutions-based approach to sales, analyzing a potential client's tech stack and proactively reaching out to its leadership about how Persistent can help them. The company has also demonstrated a strong ability to cross-sell its capabilities and services to existing clients that already use Persistent solutions. Importantly, we think smaller companies like Persistent can deliver on complex, large-scale IT projects that were the sole domain of larger companies in prior tech cycles.

Company meetings also provided insight into Persistent's view on artificial intelligence (AI). Persistent sees AI as a long-term opportunity, whereby it can partner with key AI players to build applications and then implement them on an enterprise level for clients. The company recently strengthened its partnership with Amazon Web Services (AWS) to operate with Amazon CodeWhisperer, a general-purpose code generator powered by machine learning that generates real-time code. Persistent looks at AI as an

opportunity to do more with less, as it improves engineering efficiency and opens new potential revenue opportunities.

Given the small revenue base from which Persistent currently operates—its annual revenue just crossed the \$1 billion mark at the end of its March 31 fiscal year—we believe the company has meaningful headroom for growth as it helps its customers build out the digital platforms and programs on which they depend to thrive.

PORTFOLIO MANAGEMENT TEAM



AJAY KRISHNAN, CFA

Lead Portfolio Manager

28

Years of Experience



NEAL DIHORA, CFA

Portfolio Manager

21

Years of Experience



SCOTT THOMAS, CFA

Portfolio Manager

18

Years of Experience



KARTI BHATT

Client Portfolio Manager

18

Years of Experience

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Portfolio holdings are subject to change at any time. References to individual companies should not be construed as recommendations to buy or sell shares in those companies. Current and future holdings are subject to change and risk.

As of March 31, 2023, the Wasatch Emerging India Fund had 9.5% of its net assets invested in Bajaj Finance Ltd., 5.4% of its net assets invested in Persistent Systems Ltd. and 4.2% of its net assets invested in Dr. Lal PathLabs Ltd.

The representative account for the Wasatch Emerging India strategy is the Wasatch Emerging India Fund. The primary investment objective of the Wasatch Emerging India Fund is long-term growth of capital.

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DEFINITIONS

Gross domestic product (GDP) is a basic measure of a country's economic performance and is the market value of all final goods and services made within a country's borders in a year.

Revenue growth is the increase in a company's revenues over a specified period of time, not necessarily one year.

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