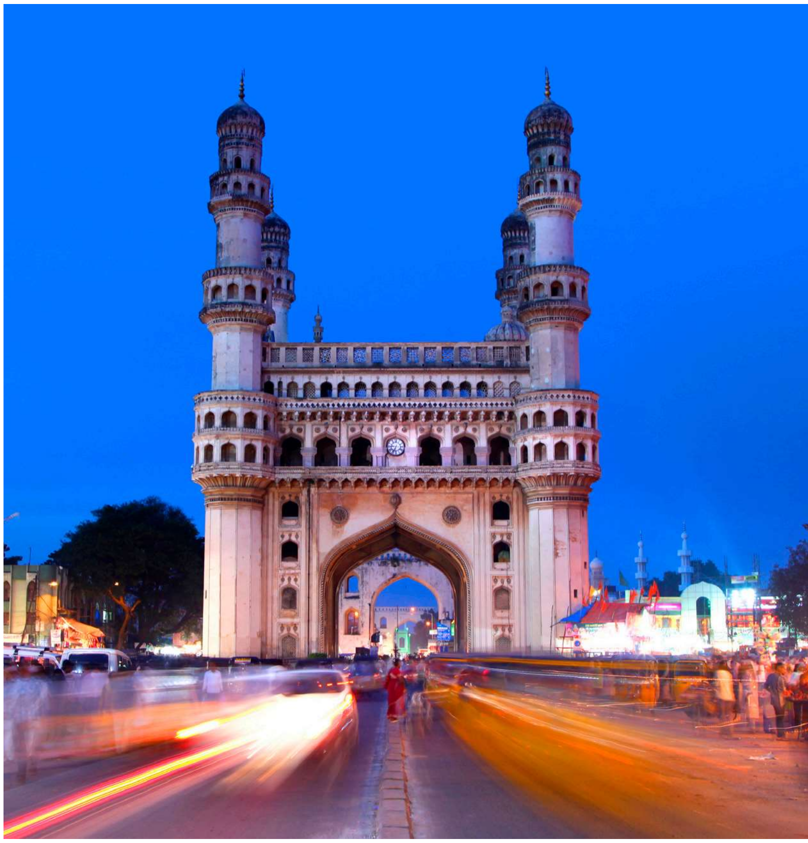
India: A View From The Ground

Key Takeaways From Our Latest Research Trip

MAY 8, 2024


Hyderabad, India

Among emerging-market countries, the Wasatch investment team remains particularly constructive on India. Our team visits the country regularly, meeting with our portfolio-holding companies and exploring new opportunities. Below are a few takeaways from our most recent trip.

INVESTOR SENTIMENT ON INDIA IS HIGH, AND ELEVATED VALUATIONS REFLECT THE BULLISHNESS

We've had a strong track record investing in India for many years and were among the earliest investors to recognize the country's potential. The broader market appears to be coming around to our view, as India's booming economy has attracted many investors who may have overlooked the country a decade ago. Amid the current enthusiasm, we think valuations have become somewhat indiscriminate and have gotten ahead of fundamentals in some cases. However, we think the market still offers very attractive long-term growth opportunities. While we remain selective, we still find reasonably valued, high-quality growth companies, some of which are trading at pre-pandemic valuations. Currently, we find some of the most attractive opportunities within the financial sector.

INDIA'S INFRASTRUCTURE BOOM CONTINUES, AND ITS SCOPE IS UNDERAPPRECIATED

Infrastructure improvements have been a theme in India for several years, but the buildout still has a long runway. For perspective, at a time in which India is seeking to narrow its fiscal gap, the government still increased infrastructure spending by 11% in its 2024–25 fiscal year budget—a total equivalent to US$134 billion. And infrastructure spending as a percent of India's GDP continues to climb, increasing from 1.6% of GDP in 2018–19 to 3.2% in 2023–24. On our research team's most recent trip, we observed a notable improvement in the infrastructure of India's Tier 3, 4 and 5 cities. For example, we found major roads that are hours outside major cities to be much improved, and many smaller towns now have modern-looking metro stations.

MEANWHILE, SOME OF THE LARGE INFRASTRUCTURE PROJECTS WITHIN INDIA'S MEGACITIES ARE COMPLETE AND CREATING TANGIBLE EFFICIENCIES

Our research team traveled across the new Mumbai Trans Harbour Link, commonly known as Atal Setu, which opened in January. The 13.5-mile bridge is India's longest sea bridge and connects Sewri and Navi Mumbai, two districts within the metropolis. The six-lane bridge shortens the drive time between the two areas from two hours to just 20 minutes. Management teams also told us there has been a marked improvement in power reliability, with a substantial reduction in electrical outages. Put together, we expect continual infrastructure improvements to have a multiplier effect on productivity over the next 10 to 20 years.

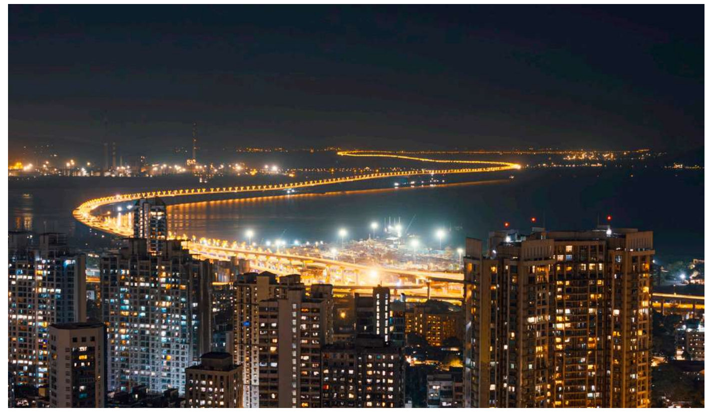
THE RESERVE BANK OF INDIA (RBI) IS INCREASING ITS SCRUTINY OF THE FINANCIAL SECTOR. HOWEVER, MANAGEMENT TEAMS OF WELL-RUN FINANCIAL COMPANIES SAY THE RBI IS TAKING A PRUDENT APPROACH

The RBI's department of banking supervision has substantially increased its headcount, and stocks within the financial sector have traded lower in part due to investor concerns that regulators are taking an overly punitive approach to regulating lenders. However, management teams from many of the companies we spoke with disagree with this sentiment, instead viewing the RBI's actions as prudent for India's long-term growth and financial health. For example, a recent decision to raise risk weights at banks was arguably necessary due to signs that some institutions may have less-disciplined underwriting practices. Management teams also pushed back on the general market perception that the RBI has been unfair or capricious in the banks it penalized. Rather, the general feel from the companies we spoke with was that the banks within regulatory crosshairs were those that could benefit from more discipline and compliance.

CORPORATE INVESTMENT IN CAPACITY EXPANSION COULD BE THE FINAL PIECE NEEDED TO TURN INDIA INTO A GLOBAL MANUFACTURING HUB

Past efforts to build out India's manufacturing sector have progressed in fits and starts. This time, the effort seems more genuine, in large part because companies are putting money behind it. In our prior research visits, we would sometimes hear companies talk about future capacity additions, but capital didn't often follow. Now, every industrial company we visited—companies making construction cranes, tubing or piping—is spending on capacity at rates we haven't seen before, and talking about expansion more aggressively than in the past.

Corporate investment is the latest development in a chain of events bolstering India's manufacturing sector. First, in 2020, India launched its Production-Linked Incentive (PLI) initiative, a broad collection of incentives



Atal Setu—Mumbai, India

to spur companies to manufacture goods in the country. Soon after, firms world-wide moved to diversify their supply chains beyond China, providing another boon to Indian manufacturing. On this trip, our team was encouraged to see companies follow that momentum and make greater investments to seize India's manufacturing opportunity.

INDIA IS EXPERIENCING GREATER DEVELOPMENT OUTSIDE ITS TRADITIONAL POPULATION CENTERS

Along with infrastructure improvement, we're seeing a pickup in economic activity beyond India's largest cities. Two areas that have seen a lot of growth include the states of Uttar Pradesh and Bihar. Several companies we spoke with mentioned higher income growth and affordability in the two states as positives. Diversified growth beyond India's megacities could make the country's economic growth both stronger and more sustainable. We think this could present substantial growth opportunities for many retail companies.

AS PRIME MINISTER NARENDRA MODI HEADS TOWARD A LIKELY THIRD TERM IN OFFICE, THE GOVERNMENT HAS STRUCK A MORE POPULIST TONE

The Indian government today appears more dedicated to addressing poverty than in the past. We observed many more billboards and advertisements promoting social welfare programs and education. Based on our own observations and what we hear from management teams, we believe that Modi and Indian regulators are gently nudging corporate India to balance maximizing returns with social responsibilities. For example, the government may encourage hospitals to take in more government-insured patients or encourage lenders to reduce loan yields to promote financial inclusiveness. To be clear, these efforts are nowhere near the level of overreach of socialist or populist-driven governments in some other emerging-market countries. Nevertheless, greater focus on social welfare could lead to some moderation of profit margins for select companies. In such an environment, we think the market will likely favor high-quality companies that can grow scale, maintain competitive moats and preserve their margins and earnings growth rates.

MANAGEMENT TEAMS ARE MAKING BIGGER BETS ON FIRM STRATEGY AND ARE MORE WILLING TO CHALLENGE ENTRENCHED COMPETITORS

As just one example, Grasim Industries Ltd., a diversified conglomerate, has invested 100 billion rupees (approximately US$1.2 billion) to launch Birla Opus, a decorative paints business, as it seeks to compete with some of the largest, well-entrenched competitors in the paint industry. A decade ago, companies were more conservative and generally wanted to hold capital so they could defend their position within their respective marketplace. Today, however, companies seem more willing to spend on a disruptive business model or invest in a strategy that may initially lose money but could gain customers or improve the company's competitive position over the long term. Management teams' emboldened spirit is likely due to two factors: (1) firms have easier access to capital, and (2) growth opportunities within India are becoming clearer. We believe a bolder approach from many companies could lead to heightened innovation and disruption.

HEALTH-CARE COMPANIES SEE A LONG RUNWAY FOR GROWTH BUT ARE PURSUING THAT GROWTH WITH DIVERGENT STRATEGIES

India remains vastly underserved from a health-care perspective, and private hospital operators have aggressive designs on expansion. But we see a divergence in how operators are addressing India's acute health-care needs. Some operators are pursuing a low-cost strategy, building less-expensive, no-frills hospitals. But other operators are beginning to focus on improving some of the "softer" aspects of health care, such as the quality of patient rooms,

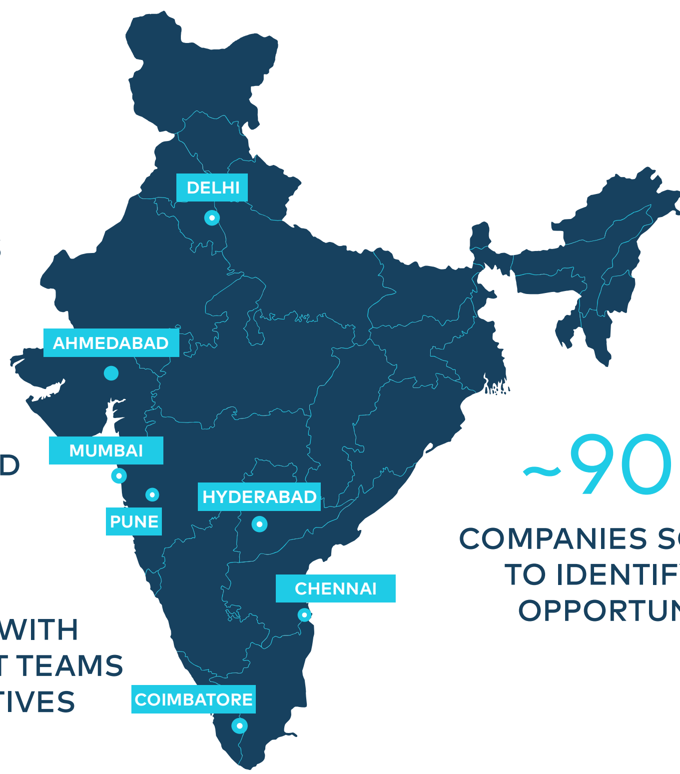
India Research Trip: By the Numbers

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.

4
TEAM MEMBERS ON TRIP

7
CITIES VISITED

44
MEETINGS WITH MANAGEMENT TEAMS OR EXECUTIVES



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COMPANIES SCREENED TO IDENTIFY NEW OPPORTUNITIES

the patient check-in process, and minimizing patient wait times. The latter strategy is relatively new within India. We have increased our investments in the health-care sector and hospitals on our view of this opportunity.

Company-Specific Highlights

DIVI'S LABORATORIES LTD.

On our trip, we visited with Divi's Laboratories. Divi's is the largest contract development and manufacturing outsourcer (CDMO) in India. The company manufactures active pharmaceutical ingredients for both innovative (custom synthesis) and generic drugs. After a multi-year meeting hiatus, we had a healthy number of meetings with company management. In addition to meeting the CFO, the visit gave us our first chance to meet the firm's next generation of leadership. This included the founder's son, who has risen to CEO, and the founder's daughter, who heads the commercial business. We came away excited about the company's growth prospects and confident about the firm's management team.

The market has been less constructive on Divi's recently, as the company continues to face a slowdown from Covid-era revenue highs and increased competition. Our view of the company is quite the opposite, as we remain focused on the company's long-term growth trajectory. During the pandemic, Divi's produced some of the key ingredients in Molnupiravir, Merck's antiviral Covid-19 treatment, which was a $5 billion revenue opportunity for Divi's. In our view, producing ingredients for a complex drug like Molnupiravir cemented the company's reputation as a CDMO with superior technical capabilities compared to other Indian manufacturers. We're optimistic about growth opportunities for Divi's, including the exploding market for GLP-1 diabetes and weight-loss drugs, contrast agents for medical scans and the potential to produce more generic drugs as an influx of branded drugs come off patent protection in the next two years.

We think the opportunity to manufacture GLP-1 generic drugs is particularly promising. That still-nascent market is expected to grow to over $100 billion by 2030, according to industry estimates. We view Divi's as one of the few players in India today that can create some of the more complex portions of this drug. And we're confident in the company's potential to capitalize on this fast-growing market and successfully execute on the opportunity, given its long track record of success in generics.

Separately, within the contrast media market, the company sees about $10 to $12 billion in market potential for iodine-based and gadolinium-based agents. Divi's is already a strong player in the iodine space, with solid customer wallet share. For its gadolinium-based agents, the company is working on getting qualified with customers. Once they are qualified, which could take another year, management expects to start as an alternate supplier and slowly build up the business.

We remain excited about the prospects for Divi's over the next several years. Given the upcoming opportunities in the GLP-1 market, the influx of generic drugs poised to come to market, and the chance to expand its contrast media segment, we see a long runway for growth ahead.

CHOLAMANDALAM INVESTMENT AND FINANCE CO. LTD.

Our team also visited Cholamandalam Investment and Finance, known as "Chola," on our recent trip. We came away from our meetings with more conviction in Chola's management, the company's corporate culture and its opportunities for growth ahead. Chola is a well-diversified non-bank financial company (NBFC) whose core businesses include vehicle finance, home-equity loans and other consumer lending products. The company has a wide geographic presence in India with over 1,200 branches across 27 states.

We like Chola's focus on less-saturated geographies and customer segments. The company primarily targets micro and small enterprise customers—areas typically less served by traditional banks. Chola also focuses on Tier 3, 4, 5 and 6 cities, not the highly competitive large metro areas such as Mumbai, New Delhi and Bangalore.

Our meetings with the company's CFO, executive director and middle managers were comprehensive and informative. We gained a deeper understanding of the company's business lines, customer segments, capital needs and profitability. The meetings also reinforced our belief in the management team's ability to continue evolving the business. Already, we've seen Chola build a vehicle-finance business that's more diversified and less cyclical. And the company

has leveraged its presence in micro- and small-business segments to expand into adjacent lending areas such as home equity.

The meetings also reaffirmed our view that Chola's company culture is a competitive advantage. Based on the time we spent with employees at various levels in the organization—from senior executives to mid-level management to heads of state operations—it's clear to us that the self-starter mentality and entrepreneurial drive are embedded in the company's DNA. For example, we were particularly impressed with the consistent and scalable internal processes around originations, underwriting and collections that the company employs across its business lines. Chola's ability to marry quantitative analytics with on-the-ground field intuition has been a key driver of productivity enhancements, lowering operating costs and improving risk selection over time.

Over the past several years, Chola has been incubating and looking to scale its smaller ticket, non-salaried home-loan category. Given the company's successful track record of expanding into new categories, we think this particular opportunity could be enormous—85% of the population fits within this category, and this group has little to no access to credit.

With three decades of experience in vehicle finance, a robust footprint across India, strong relationships with auto dealers and manufacturers, and a technology-oriented and entrepreneurial company culture, Chola is a company we think has significant growth potential.

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As of March 31, 2024, no Wasatch strategy was invested in Grasim Industries Ltd. or Merck. The following Wasatch strategies held positions in Divi's Laboratories Ltd.: Emerging India, 5.5%; Emerging Markets Select, 3.3%; and Global Small Cap, 1.2%. The following strategies held positions in Cholamandalam Investment & Finance Co. Ltd.: Emerging India, 4.3%; Emerging Markets Select, 1.3%; and Frontier Emerging Small Countries, 3.4%.

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