The India Fund, Inc. (IFN)

Fund manager interview

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Key points

- Recapitalization helps banks, but credit demand is weak
- Goods and services tax (GST) tweaks help consumers and small to medium enterprises (SMEs)
- Moody's upgrade welcome, but no earnings rebound yet
- Food and Drug Administration (FDA) probes hinder pharma, but not all firms affected
- Infosys gets new CEO amid hopes for better 2018

Why is pumping money into India's state-controlled banks important?

Policymakers said last October they would pump some 2.1 trillion rupees ($32.9 billion) into India's beleaguered government-controlled banks. The first beneficiaries can expect to receive a capital injection by the end of this quarter. Credit growth has been anemic in recent years partly because bad debt and depleted capital have curtailed the ability of state-owned banks to lend. Capital expenditure in the corporate sector has suffered. Fixing the problem of non-performing loans in the banking sector is challenging and could take years to bear fruit, while weak credit demand and governance concerns remain unaddressed. But this so-called "recapitalization" will give these lenders some breathing room to bulk up their capital, absorb losses and clean up their balance sheets, instead of incurring big haircuts through fire sales of stressed assets. It may boost lending amid hopes this would kickstart the capex cycle and support the government's infrastructure investment goals – a vital component of India's reform program.

What's your take on the adjustments to GST?

A nationwide GST came into effect last July in a bid to boost fiscal revenues and make doing business easier, especially across state borders. For example, companies with logistics operations spanning the country will be among the biggest beneficiaries. However, there was criticism over the way the levy was implemented, with confusing tax rates and smaller businesses in particular struggling to comply with the new regime. The uncertainty caused disruptions to the share price of some companies. That's why, from November 15 last year, tax rates were cut on more than 200 items, GST for restaurants was standardized, and the burden of compliance eased. Tweaking GST will be good for the economy – it relieves the tax burden for consumers and helps small businesses. It also demonstrates that India's policymakers are responsive to feedback. While the government faces a larger-than-expected shortfall in revenue in the short term, long-term benefits remain in the form of more efficient tax collection, logistics savings and ultimately a healthier economy. It should be noted that the companies we invest in had been preparing for GST for some time and, without exception, see GST as a positive development. Some told us they can take advantage of the disruption caused to less prepared rivals to increase market share.

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Does a Moody's upgrade spell good times ahead?

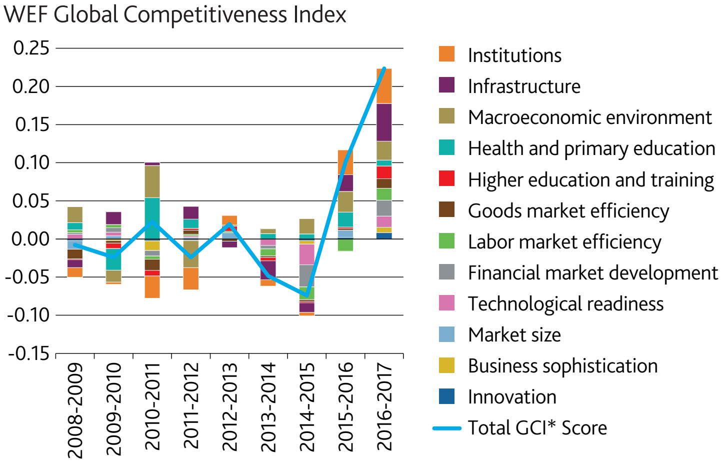
Credit ratings agency Moody's[1] Investors Service raised India's sovereign rating to Baa2 from Baa3 last November. Baa2 is the company's second-lowest investment-grade rating. Moody's said it expects reforms to improve the business climate, enhance productivity, stimulate investments and foster sustainable growth. This was the first time that Moody's has raised India's rating since 2004 and a welcome endorsement of India's reforms and fiscal discipline. Moody's has painted a positive picture from the top down, but as bottom-up investors who regularly talk to companies, we can say that the benefits have yet to materialize. For example, we haven't seen the sort of corporate earnings recovery that's occurring in other emerging markets, after economic growth slowed for most of last year.

This may change in 2018 as the economy looks past the disruptions caused by November 2016's cash ban (demonetization) and last year's introduction of GST. But right now, a recovery in demand remains elusive. Despite the major Indian stock indices trading near record highs, we will only allow ourselves to celebrate when we see evidence of a sustainable recovery in earnings.

How has the drug industry's regulatory problems affected us?

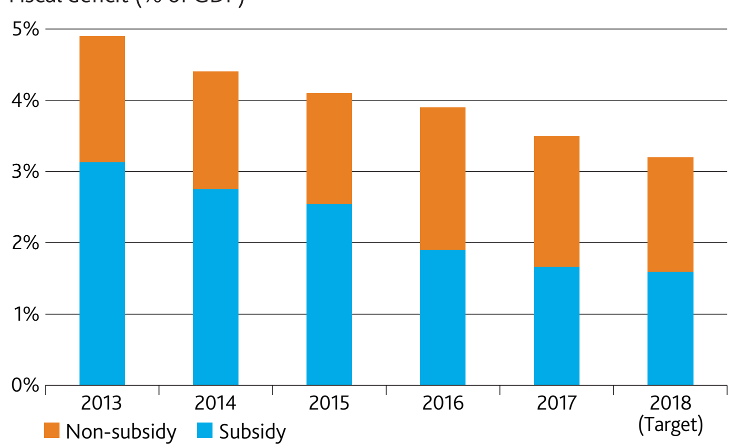
Indian pharmaceutical companies have been under greater scrutiny from the U.S. Food and Drug Administration (FDA). These companies have struggled to satisfy U.S. regulators concerned about standards at manufacturing facilities in India producing drugs for the U.S. market.

Chart 1: EM's strongest reform story
WEF Global Competitiveness Index



Source: World Economic Forum, The Global Competitiveness Report, December 2016.
* Global Competitiveness Index. Each column represents the change with respect to the previous Global Competitiveness Index. For illustrative purposes only.

Chart 2: Progress on fiscal deficit
Fiscal deficit (% of GDP)



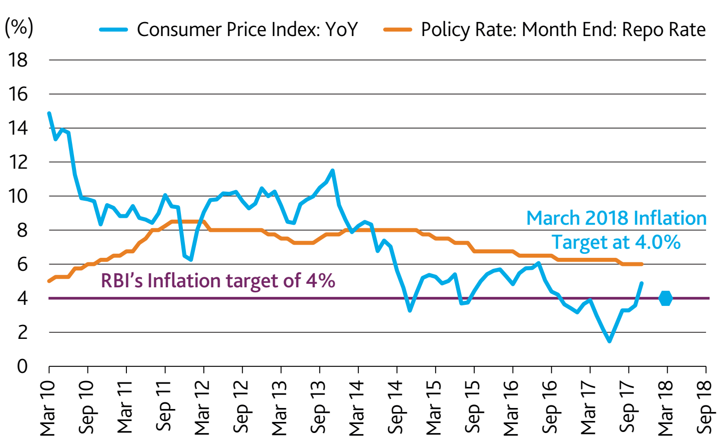
Source: CEIC, Bloomberg, November 30, 2017. For illustrative purposes only. Forecasts are offered as opinion and are not reflective of potential performance. Forecasts are not guaranteed and actual events or results may differ materially.

[1] Moody's is an independent, unaffiliated research company that rates fixed income securities. Moody's assigns ratings on the basis of risk and the borrower's ability to make interest payments. Typically securities are assigned a rating from 'Aaa' to 'C', with 'Aaa' being the highest quality and 'C' the lowest quality

Please give a recent example of corporate engagement

We met up with a large consulting services business to quiz the company on how it manages risk. They told us it places environmental, social and governance (ESG) issues side by side with more traditional risks, and ESG is considered when the company reviews corporate strategy and risk management. Our discussion also touched on other issues such as how they deal with cybersecurity risks, managing and retaining employees, and managing water and carbon footprint-related risks.

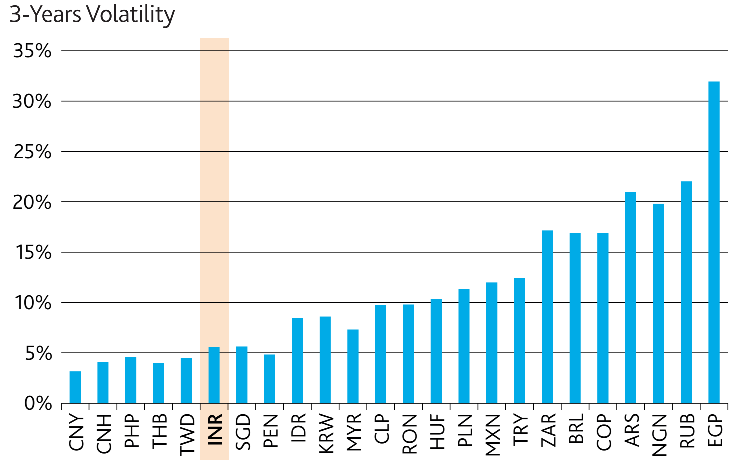
Chart 3: Slowing inflation means room for easing



Source: CEIC, Aberdeen Asset Management, 30 November 2017. Note: New CPI series from Mar 15 onwards, base year updated to 2012 from 2010 and weights for food and fuel lower. Forecasts are offered as opinion and are not reflective of potential performance. Forecasts are not guaranteed and actual events or results may differ materially. YoY = year over year.

Chart 4: Rupee is one of the least volatile emerging market currencies

3-Years Volatility



Source: Aberdeen Asset Management, Bloomberg, September 30, 2017.
For illustrative purposes only.

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About The India Fund, Inc.

The Fund seeks long-term capital appreciation, which it seeks to achieve by investing primarily in the equity securities of Indian companies.

Aberdeen has been investing in Asia for 30 years with on-the-ground presence in the Asia-Pacific region for over two decades, which helps put the firm in a better position to evaluate investment opportunities from a position of experience. Let us help you uncover the potential opportunities to invest in the region.

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