Aberdeen New India

ANII is the top-performing Indian trust over the last five years...

Update
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Summary

Aberdeen New India Investment Trust (ANII) aims to identify Indian companies with high and sustainable earnings, strong balance sheets and good corporate governance and buy them when they are on attractive valuations.

The process leans on the bottom-up research of the Aberdeen Standard Asian equities team, particularly Kristy Fong and James Thom, who have managerial responsibilities for ANII. Their successful stock-picking has led the trust to outperform considerably over the last five years. As we discuss in the **Performance section**, the trust is the top-performing Indian closed-ended fund over that period, with the lowest volatility and the best performance in down markets.

The team view strong corporate governance as an important characteristic of a quality company, and it is a key issue determining whether they invest or not. Kristy and James believe that giving up these principles for short-term gain could lead to worse losses in the future.

India's stock market has been weak over the past six months as the economy has absorbed a mini-financial crisis and the impact of government reforms. The quality tilt of ANII has been advantageous, and the managers have been taking the opportunity to top up their highest-conviction picks on cheaper valuations.

With these India-specific reasons and the ongoing coronavirus scare, discounts in the region have drifted out and ANII's shares trade on a 13.1% discount to NAV.

Key Information:

As at	20/02/2020
Price (p)	485
Discount (%)	-13.1
OCF (%)	1.17
Turnover Ratio	17.5
Yield (%)	0.0
Gearing (%)	7
Ticker	ANII
Shares (£)	58,758,676
Market cap (£)	284,979,579

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Analyst's View

India is an exciting long-term prospect. The country's demographics mean there are huge long-term growth opportunities in goods and services serving a growing young population. ANII has many high-quality companies which are plugged into this growth, such as the financials offering bank accounts, mortgages and basic financial products to those who have never had them before.

In the short term, India has been suffering the fallout from a crisis in the non-bank financial sector (which has benefitted ANII's holdings), and from the short-term impact of a series of government reforms which have good long-term intentions of improving governance, addressing corruption and encouraging financial inclusion. ANII's quality portfolio should be more resilient to these challenges, while the multi-year perspective Kristy and James take means their eyes should remain on the long-term secular opportunities.

Thanks to these domestic challenges and the ongoing coronavirus pandemic, ANII's discount has widened out to a highly attractive 13.1%. This is considerably higher than the average of the AIC Global Emerging Markets sector, which is 9.1%. While we accept that single-country funds have their own risks which might warrant a slightly wider discount, we think this is excessive, and that sentiment to the whole region has been weakened by the crisis in China. This is therefore an attractive entry point to ANII for the long term.

Analyst's View

BULL	BEAR
Strong long-term record based on successful stock-picking	Does not pay a dividend
Quality approach has provided resilience in weaker markets	Gearing can magnify market falls as well as losses
Discount is wide and could be an interesting long-term entry point	As a single-country emerging markets fund, it has political risk

Portfolio

Aberdeen New India Investment Trust (ANII) owns a portfolio of high-quality Indian equities selected for the strength of their balance sheets and governance and the sustainability of their earnings. The trust is managed by Kristy Fong and James Thom, who implement the bottom-up approach of the Aberdeen Standard Asian equities team which has led to long-term outperformance in the Indian market. The managers aim to identify the leading companies in their sectors or industries, invest at attractive valuations and hold for the long run.

In terms of financials, a focus on quality means finding companies with high and sustainable returns on equity and strong balance sheets. This means those which have the ability to persistently generate higher-than-average returns over the long run and those which have low levels of debt. Low debt and good cash flows allow for financial flexibility and investment in future growth, which companies with liquidity issues can't achieve. Good corporate governance is a vital element of a quality company on this view: the managers look for companies which are run in the interests of minority shareholders and which have a track record of prudent capital-allocation decisions – critical if a company is to use the advantage of a strong balance sheet.

The managers are willing to pay a higher valuation for a higher-quality business, which comes through in the historic trend for ANII's portfolio to be more richly valued than the market. As the table below indicates, this higher valuation is being paid for higher returns from companies which have on aggregate very low levels of debt on their balance sheets, which make them exceptional even in India where debt-to-equity ratios are low by global standards.

As we discuss in more detail **in the Performance section**, this focus on quality has led to a historical tendency to performing better in falling markets, with ANII having the lowest downside capture of the three specialist Indian trusts over the past five years. ANII also has the lowest volatility of the group, as well as the lowest maximum drawdown – a measure of the largest peak-to-trough loss in an investment.

Stock selection is a cautious, painstaking process which involves detailed fundamental analysis of each candidate company's fundamentals. The combined analysts/portfolio managers on the Asian equities team insist on meeting management before investing as a way to help assess the quality of corporate governance at each company. They will then meet with the management of each holding at least twice a year once they are invested. The managers are highly engaged as shareholders, and will look to encourage better corporate governance as well as better environmental and social performance (the three aspects of ESG investing). They view this as a crucial part of being a long-term shareholder and enter into positions expecting to own a company for five years or more. By engaging with boards and with management teams, the trust aims to improve the treatment of minority shareholders and therefore unlock value for investors.

The team identify those companies which meet their requirements in terms of quality and then track them until they think there is a reasonable valuation on which to buy them. They tend to raise their investment steadily as their conviction increases and they become more familiar with a company, and will look to add to and cut back their holdings as their valuation changes. This value element also comes through at the trust level through the use of gearing, which is altered as the valuation opportunity in the market changes.

The top ten holdings make up 53% of the portfolio, so it is highly concentrated. That said, so is the index. The MSCI India Index has 54% in the largest ten positions, although the largest company in that market is Reliance Industries, which Kristy and James won't hold on quality grounds. ANII holds only 39 stocks compared to the 84 in the benchmark. As the table below shows, financials make up some of the highest-conviction positions, including the private-sector

Portfolio Characteristics

	P/E 2018	P/E 2019	P/E 2020	P/B	PORTFOLIO YIELD	DEBT / EQUITY	ROE	ROA
ANII	27.5	28.9	25.5	4.4	1.10%	0.60%	22.4	11.2
MSCI India	22.8	21.7	18.1	2.8	1.20%	18.60%	19	18.6

Source: Aberdeen Standard, as at 31/01/2020 banks Kotak Mahindra Bank and HDFC Bank. The latter's parent company is Housing Development Finance, which is one of India's largest mortgage lenders.

Top Ten Holdings

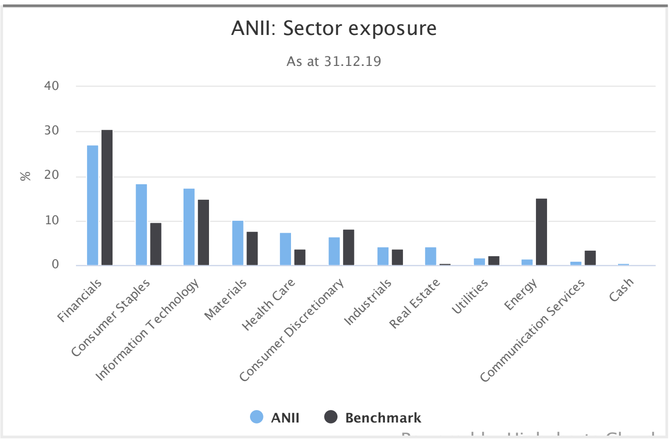
HOLDING	WEIGHT (%)
Housing Development Finance	10.8
Tata Consultancy Services	7.6
Kotak Mahindra Bank	5.3
Infosys	5.1
Hindustan Unilever	4.9
ITC	4.7
SBI Life Insurance	3.9
Nestlé	3.8
HDFC Bank	3.5
Ultratech Cement	3.5
TOTAL	**53.1**

Source: Aberdeen Standard

These financial positions have been doing well in recent months. India has been suffering the consequences of a crisis in its non-bank financial company (NBFC) sector, which has seen weaker players suffering from higher funding costs and asset-quality problems. ANII's holdings mentioned above have outperformed thanks to their higher-quality balance sheets. That said, in the managers' eyes some stocks have been unfairly punished, and they have taken advantage of this perceived weakness to top up. Piramal Enterprises, for example, has some exposure to commercial real estate, but Kristy and James believe it has nimbly adapted and de-risked its balance sheet. The managers took part in a capital raise to see the company through this rough patch.

The importance of financials can be seen in the high absolute weight in the chart below. Although the trust is slightly underweight to the index, sector weights reflect where the managers find stock-specific opportunities rather than reflecting their views on the sector as a whole. Consumer staples (Nestlé, Hindustan Unilever) and information technology (Tata Consultancy Services, Infosys) are the other main areas of exposure. The large underweight to energy is explained by the trust not holding Reliance Industries.

Fig.1: Sector Allocation



Source: Aberdeen Standard

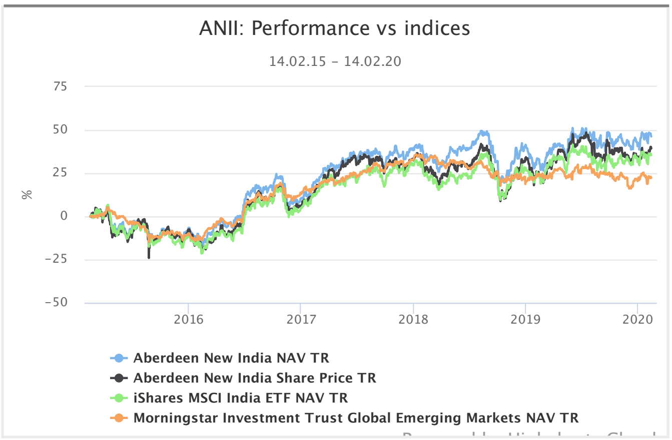
Gearing

ANII is the only India specialist trust to have significant levels of structural gearing. Gearing is 5.3%, taken through a two-year credit facility which can be drawn down bit by bit. The full £30m of the facility would be worth roughly 9% of net assets at the trust's current size. Gearing levels are left to the discretion of the manager within limits set by the board, and these limits take market conditions into consideration. Kristy and James take a cautious attitude to gearing, aiming to take advantage of valuation opportunities when they arise. Therefore, having arranged the gearing facility in July 2018, in the fourth quarter of that year they took advantage of the sell-off in Asian markets to invest in attractive stocks at lower valuations. Gearing has remained in the mid-single digits since then.

Performance

ANII has outperformed its benchmark handsomely over five years, with the focus on resilient, high-quality companies with strong balance sheets helping it to outperform on the downside. It has returned 46.2% over five years in NAV total return terms, compared to 35.4% from the iShares MSCI India ETF which passively tracks the benchmark, as the chart below shows. The index itself did considerably better at 41.4%, with replication issues, fees and the tendency to trade on a discount to NAV eroding ETF returns, although this is still considerably below ANII's performance.

Fig.2: Five-Year Performance

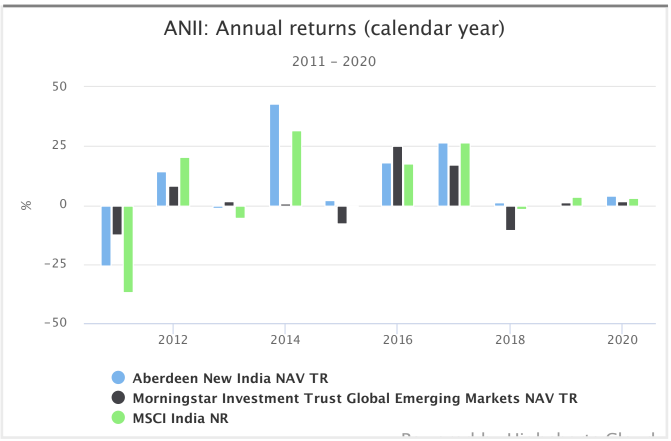


Source: Morningstar

Over this period ANII has the best upside/downside capture ratio of the three Indian trusts and is the only one to have a positive ratio, indicating it has been more exposed to rising markets than to falling markets. It is also the only one to have a negative downside capture ratio, indicating that it has consistently lost less than the index in falling markets.

The chart below shows calendar-year returns of ANII, the MSCI India Index and the AIC Global Emerging Markets sector. The general pattern is outperformance in falling markets – as happened in 2011, 2013 and 2018 – with slightly more mixed results in rising markets. Although the trust outperformed in each of 2014, 2015 and 2016, in 2017 it only just failed to keep pace in a sharply rising market.

Fig.3: Returns

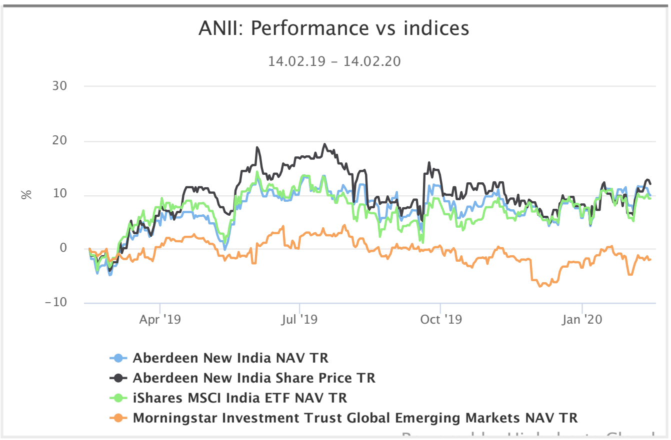


Source: Morningstar

In the calendar year 2019, one stock-selection decision particularly hurt the trust: not holding Reliance Industries, the largest company in the market. Reliance is over 10% of the MSCI India Index by market cap, and so Kristy and James's decision not to own it hurt in a year in which Reliance outperformed considerably, although stock selection elsewhere mitigated this somewhat. When we caught up with Kristy recently, she reaffirmed the pair's decision not to hold the stock was due to concerns about the quality of management. Kristy believes the debt-driven expansion of the company from a petrochemicals enterprise to a telecommunications and retail business has been aggressively done, and done without an eye to shareholder returns. Kristy and James acknowledge the work the company is doing to try to deleverage the balance sheet, and they are monitoring progress to assess whether Reliance's capital allocation and governance improve.

A better start to 2020 means that over the past year investors in ANII are slightly ahead of those who have bought a passive fund. NAV total returns have been 9.9% compared to 9.3% for the ETF. The index itself is up 10.2%.

Fig.4: One-Year Performance



Source: Morningstar

Dividend

The company is managed for capital growth and has not paid a dividend since 2005. Income is used to pay expenses and is offset by past tax losses.

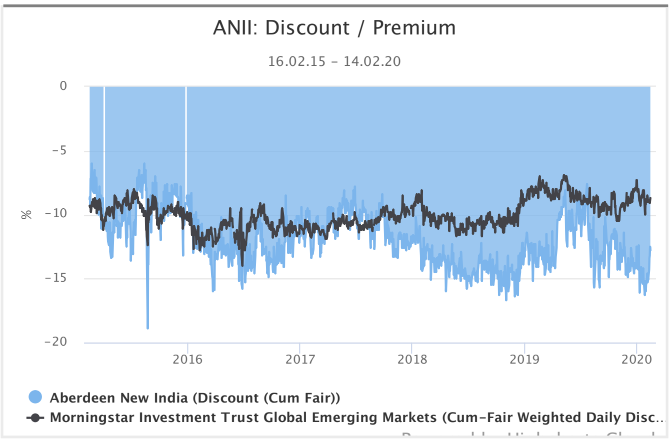
Management

The trust is run by the Aberdeen Standard Asian equities team which is based in Singapore. They take a team-based approach which means they aim to build consensus on their stock picks across the region. However, there are two team members with special responsibility for this portfolio: Kristy Fong and James Thom. Kristy and James are the key decision-makers regarding what goes into the trust and how it is managed on a day-to-day basis, using the stock research of the wider team. The Asian equities team are led by Flavia Cheong from Singapore, with her deputy Kwok Chern-Yeh being based in Tokyo. The team place great importance on corporate governance and engaging with companies to improve how they treat minority shareholders, as well as on quality growth characteristics and strong management teams.

Discount

ANII's shares trade on a 13.1% discount to NAV, wider than the 12% weighted average of the four India specialist trusts. The only one on a wider discount is the mid-cap specialist India Capital Growth. ANII's discount has been moving in line with the Indian equity market over the past two years. After the market (MSCI India) peaked in July 2019, ANII's discount has drifted out while the stock market has been weak. As the chart below indicates, the rating of the average AIC Global Emerging Markets trust has held up over the period.

Fig.5: Discount



Source: Morningstar

The board has the authority to buy back shares to control the discount, and has committed to doing so when it believes this would be in the best interest of shareholders (while paying regard to the overall size of the trust's portfolio). In recent years the board has preferred to rely on performance and marketing to close the discount, but since August 2019 it has been conducting regular buybacks. There is also an annual continuation vote which has been held each year since 2005.

Charges

The OCF is 1.17%, which compares to a weighted average of the four India specialist trusts of 1.14%. The management fee is 0.9% on the first £350m of net assets. Net assets are currently £329m, but when they rise above £350m they will be charged at 0.75%. There is no performance fee. The KID RIY is 1.39%, which compares to a weighted average of 1.63% for the Indian trusts, although methodologies can vary.

ESG

The Asian equities team at Aberdeen Standard believe ESG and sustainability issues are intrinsically linked to the 'quality' of a company and that sustainability in the broader sense is important for the sustainability of a company's earnings. In the past, Aberdeen Standard (and Aberdeen Asset Management, long before the 2017 merger) was a standard bearer when it came to corporate governance. It has always placed great importance on the incentives and attitudes of management to minority shareholders. In recent years, the Aberdeen Standard Asian equities team have integrated environmental and social issues more into their assessments. Team members generate their own ESG ratings for candidate stocks and also consider the ratings of external providers in order to understand the difference. Once invested, the team view themselves as long-term partners of management, and encourage companies to improve their behaviour vis-à-vis shareholders and stakeholders more widely.

As an additional resource, the team are also able to receive inputs from Aberdeen Standard analysts based in Edinburgh who consider top-down global issues such as plastic use and climate change. There are also three dedicated ESG analysts sitting with the team in Singapore who cover the Asian region, and their task is to consider what progress is possible and desirable within the regional context.

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