Benefits CANADA

India a hot destination for pension fund dollars

Jann Lee | September 5, 2017

Four years ago, some investors were hesitant to invest in India due to poor economic fundamentals, currency depreciation and government bureaucracy. But while many hit pause on making investments, long-term institutional investors like the Canada Pension Plan Investment Board ignored the pessimism and started putting plans in motion for future ventures.

"Before [Prime Minister Narendra] Modi was elected in 2014, people were really very pessimistic about the Indian market," says Suyi Kim, managing director and head of Asia-Pacific at the CPPIB. She recalls making numerous visits to India at the time with other leaders of the CPPIB's infrastructure and real estate investment team. "People didn't want to invest, but we actually started discussions with all these large promoters and families in India and we've been able to strike deals over time."

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In 2013, the CPPIB entered into a partnership with the Shapoorji Pallonji Group, an established conglomerate in India, to acquire office buildings in major cities across the country. The CPPIB then announced subsequent investments in infrastructure and private debt and, in 2015, it cemented its presence in India by **opening an office in Mumbai**.

Today, market sentiment has changed as several large Canadian institutional investors have announced a flurry of investments in India that include mobile towers, distressed debt, real estate and infrastructure.

In March, the CPPIB acquired a 3.3 per cent direct interest in Bharti Infratel Ltd., a large owner of telecommunications tower infrastructure, for about $400 million as part of a purchase agreement involving funds advised by U.S. private equity firm Kohlberg Kravis Roberts & Co.

While India currently has lower smartphone usage compared to the United States and China, the CPPIB foresees a rise in consumer demand for mobile data, says Kim. "As the Indian people get wealthier and richer, they'll try to get their phone upgraded and use more data, and our cellphone infrastructure investment is really betting on the data consumption growth of the Indian people."

The Caisse de dépôt et placement du Québec is also betting on India's economic growth. The Caisse acquired a 21 per cent interest in Azure Power Global Ltd., one of India's largest producers of solar power, in 2016, according to its fiscal report.

Read: Caisse to invest US$155M in India-based logistics service provider

Read: Caisse to invest in renewable energy in India

"As the demand for manufacturing services grows, the need for electricity will become very high, and right now, there's a significant supply gap," says Anita George, managing director for south Asia at the Caisse.

"What that means is that India will need to be able to generate more electricity," she adds, noting India's recommitment to the Paris agreement on climate change in early 2017 was a "big plus" for the Caisse's investment in Azure Power because it signalled government support for the clean energy sector.

What's propelling the interest?

But beyond some of the specific investment opportunities available, why is India becoming more popular among emerging market countries?

Julian Mayo, senior vice-president at Charlemagne Capital Ltd., says investors started taking a closer look at India in 2016 when the performance of emerging markets rebounded after a five-year slump. India stands out for two reasons, he says. "First, it's got a structurally high growth rate, partly because it's starting from a lower base, and second, because of the ongoing reforms under prime minister Modi."

India's gross domestic product continues to rise quickly, with projected growth ranging from six to eight per cent, says Louis Lau, director of the investments group at Brandes Investment Partners Ltd. "I think it's one of the few markets that has a clear path of growth," he says, citing predictions that India's population will surpass China's at some point.

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As well, government reforms aimed at tackling corruption and formalizing the economy have boosted investors' confidence, says Lau. He cites the government's new digital system, Aadhaar, which assigns Indian citizens a unique identification number, as an example. The system, he notes, helps keep track of information related to taxes, employment status and social security benefits. It also makes it easier for people to engage in banking and online financial transactions.

The government also introduced a harmonized goods and services sales tax last July that will bring cohesion to the country's fragmented tax system, says Mayo. Economic theory, he notes, has shown people are more willing to pay taxes under a simplified system. "It actually increases tax revenue rather than reduce it . . .," says Mayo, noting the revenue will help boost India's budget and allow it to invest in areas such as infrastructure projects.

Some of the recent reforms have been positive for investments the Caisse has made in India, says George. She notes the new harmonized sales tax supports the Caisse's investment in TVS Logistics Services Ltd. because it will allow the company to do business across borders more efficiently. "It's a huge boost to third-party logistics companies and an opportunity to gain new customers in the Indian market," says George.

HOW CAN SMALL PLAYERS ACCESS THE INDIAN MARKET?

While many institutional investors are looking at non-Canadian equities at the moment, smaller pension plans that want to take advantage of the upswing in emerging markets likely wouldn't make a country-specific allocation, says Ryan Kuruliak, senior vice-president at Proteus Performance Management. Instead, their investment committees would appoint an emerging market or global asset manager to oversee an emerging market portfolio and handle the allocations.

But pension plans that have a specific interest in India have two options, says Kuruliak. He notes those interested in long-term investments can hire an India-focused investment manager who can provide a portfolio that suits their needs, while those looking at the short term can invest in an exchange-traded fund focused on India.

The risks

While the fundamentals are good, India isn't immune to problems, says Ashok Kotwal, an economics professor at the University of British Columbia. He offers the example of the controversial reform enacted by the government in 2016 to demonetize 500- and 1,000-rupee notes in order to reduce corruption and encourage digitization. The move caused a lot of stress for the many Indians who work in the informal economy, says Kotwal. "To launch a country, which is mostly dealing in cash, all of a sudden into a digital future without having the proper banking network and financial infrastructure was a totally unrealistic goal."

Read: Investors urged to be prudent about emerging market plays

And while the policy won't be negative for the economy in the long term, Kotwal says it will likely reduce economic growth in 2017/18 by about a percentage point or so.

As well, there are a lot of non-performing assets in India's banking system, especially when it comes to the public banks, says Kotwal. "They've made a lot of bad loans, and it's not clear how the central bank is going to chart its way through this. What are they going to do with these non-performing assets? Because unless the banking sector is strong and stable, many of these moves like digital economy are just going to remain as goals and are not going to be really fulfilled, and that's something investors should worry about."

But as Kim points out, investors are aware that India isn't immune to risk. "We have to do extra work in these emerging markets. Information is not as readily available, and we need to make sure the people we're speaking with, we understand their background and their authenticity. . . . So that requires a lot more due diligence in the market."

As for the Caisse, it prioritizes solid partnerships with Indian institutions that have good corporate governance, says George, pointing to its **recent alliance with Mumbai-based Edelweiss Financial Services Ltd**. Last October, the Caisse announced it was helping the company invest in stressed assets and private debt opportunities in India. "It's a great partnership, because la Caisse has the capital resources and the company has knowledge of the market," says George.

Read: Caisse invests $600M in Indian financial services company

The founders of the company anticipated the growing demand for structured debt in India, says George, noting that while certain creditors may default, Edelweiss engages in a solid process of due diligence. "The company has the best credit review system globally. So that provides us with comfort in that they have a very systematic way of assessing [credit] risk," she says.

Another potential risk is the Indian government's poor track record of completing large-scale infrastructure projects, says Sudhir Roc-Sennett, a senior portfolio advisor at Vontobel Asset Management Inc. "Historically, it has been difficult for businesses to get big infrastructure projects done due a number of problems, including the number of permits required, tough environmental laws, difficulty in obtaining land, endless court cases and limited long-term funding," he says.

Many investors, therefore, have been skeptical about funding certain infrastructure projects because they question whether they'll happen within the anticipated time frame, says Roc-Sennett. He notes, however, that Modi's government has largely curtailed investors' doubts by cutting bureaucracy and signalling the country's interest in supporting foreign investments.

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But perhaps the biggest risk right now stems from the optimism about India's economy, says Lau. Many public companies, he says, are trading at "very astronomical valuations."

Still, the Caisse will continue to pursue companies with high valuations if it believes in their fundamentals, says George, adding that it recently bought a small stake in Kotak Mahindra Bank Ltd., despite its high price, because it saw potential for growth in the financial sector. George notes that besides having a strong management team, the bank is looking to double its customer base in three years.

While the Caisse's current share in Kotak Mahindra Bank is small at just over one per cent, it will be looking for opportunities to boost its stake in the future when valuations are cheaper, says George.

The Caisse has the luxury of being able to wait until the market is down before it makes certain investments, she notes. "We're very selective. We can afford to be, if an opportunity knocks on our door, because we've created a brand as a long-term value investor."

RECENT CANADIAN PENSION FUND INVESTMENTS IN INDIA

- In May 2017, the Canada Pension Plan Investment Board committed $682 million to a joint venture with India-based developer IndoSpace to acquire and develop logistics facilities in the country.
- In April 2017, the CPPIB teamed up with mall developer Phoenix Mills Ltd. to develop, own and operate retail properties in India with an initial investment of $149 million for a 30 per cent stake in development platform Island Star Mall Developers Pvt. Ltd. In August, the pension fund invested $32 million through Island Star to acquire land in Pune, one of India's largest cities.
- In February 2017, Ivanhoé Cambridge, the real estate subsidiary of the Caisse de dépôt et placement du Québec, partnered with Piramal Enterprises Ltd. to invest in urban residential property developers across India's major cities. It committed about $330 million in capital.
- In January 2017, the Ontario Municipal Employees Retirement System increased its shares of Fairfax India Holdings Corp., which has made significant investments in India, including a stake in a Bangalore airport.

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