KKR

Thoughts From the Road

INDIA | February 2024

Frances Lim, a managing director on the Global Macro, Balance Sheet, and Risk team, and I recently traveled to India and where we met with a variety of CEOs, policymakers, deal teams, and investors. We discuss our findings in more detail later in the piece, but our key conclusions are as follows:

- **There are two reasons why the India story remains a powerful one.** First, it has a strong, domestically-driven, consumer-focused economy that is inflecting upward, boosted by compelling demographics linked to the best fiscal plan that we have seen in over a decade from a governing Indian Prime Minister. Second, this country is still enjoying the benefits of globalization for both the goods and services parts of its economy at a time when several other large Asian economies are experiencing the negative impact of leading multinational corporations rethinking their global supply chain footprints. As a result, we think that India could represent 20% or more of total incremental global growth over the next five to seven years.
- **Capital markets conditions have seasoned well since the pandemic, including a more stable currency**. In addition to increased foreign capital flows, a more targeted domestic savings program is providing a new, steady tailwind that adds depth *and*

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breadth to the public equity markets. Previously, savings was largely funneled into Real Estate, Gold, and/or Cash. At the same time, Private Equity in India has matured, and there are now more opportunities to partner with established, large-scale entrepreneurs. This cohort has serious ambitions to grow both domestically and internationally and to do more control deals, especially with succession planning as an incentive.

- **Several additional positive catalysts have emerged since our last visit in 2019**. High end consumers are now increasing their spending exponentially (*Exhibits 4-5*), banks provisioning is running well below trend across all segments of the consumer and wholesale markets, and much needed infrastructure investment is on the rise, especially the build out of high-speed road corridors. At the same time, conversations in Delhi lead us to believe that there could be as much as four to five billion U.S. dollars of annual infrastructure transfers from the government to the private sector in each of the next five years, a signal that more efficient growth could lie ahead. At the same time, heavy investment in data centers is actually helping India to better harness its 900 million Internet users.
- **The democratization of commerce-driven technology stands out relative to global peers**. Digitalization of key consumer and business focused infrastructure such as payments, which are called Unified Payments Interface or UPI in India, as well as the development of the Open Network for Digital Commerce or ONDC, which is essentially an unbundled version of Amazon for business/logistics/buyers, suggest that India's e-commerce industry will look quite different, and more democratized, than what has unfolded in both the United States and China, we think. If we are right, it likely means a more balanced outcome as it relates to private sector value creation linked to e-commerce as well as technological innovation than what we have seen in the United States and China so far.
- **Unfortunately, valuations now reflect some of this optimism**. It may not feel that way right now, but India's success will not be a straight line. When these dislocations inevitably occur (which happens in all emerging markets and is usually linked to excess credit creation and/or a policy mistake), volatility in both business activity as well as in the capital markets will unfold. When dislocations do occur, however, we want to be clear in our messaging: we view these as opportunities, and long-term allocations to India should be increased, not reduced, particularly as it relates to owning more secular compounders.
- **Differentiated sourcing across Private Equity, Infrastructure, and Credit remains a prerequisite for success, we believe**. Moreover, within asset classes, allocators must also spend time discerning relative value across sectors and across capital structures to create competitive advantage in a market like India.
- **A local presence has become increasingly required, because – as we detail below – not all consumers are enjoying the same economic uplift. Separately, as the corporate sector matures, partnering with the right local players who intend to properly scale their businesses has become a key differentiator. Key themes that resonated during our trip included high-end consumer brands, differentiated consumer experiences, wealth/savings, energy distribution, and digitalization**.

Our Bottom Line: Stay the Course. Even for someone who travels a lot, this past week was unique as I was able to spend time in the United States, Europe, and Asia. This ability to 'comparison shop' the global economy is a unique feature of KKR, and my trip reminded me why, in today's increasingly complex global economy, more and more investors are reallocating capital to India. To be sure, sentiment in the near-term feels ebullient, but our trip reinforced why India could be one of the largest investment arenas to deploy capital in Asia over the next five to seven years if the country continues to Stay the Course on its current reform-minded approach.

The democratization of commerce driven technology stands out relative to global peers.

Details

When Frances and I wrote our first deep-dive piece on the country at our 'new' post at KKR in 2012 (see *India: Unlocking the Demographic Dividend*), we stated that India "was a country bursting with macroeconomic potential. Powerful demographics, rising GDP per capita, and a robust services industry all suggest a potentially strong growth and investment profile ahead." That said, we warned that it would not achieve its *true* potential until it did three things, including:

1. Invest much more heavily in Infrastructure.
2. Tackle its inflation problem and related inefficiencies through better fiscal management and more intentional government programs; and
3. Cut subsidies to help balance the fiscal situation and restore proper consumption signals in the consumer market.

Exhibit 1: What a Difference a Decade Makes

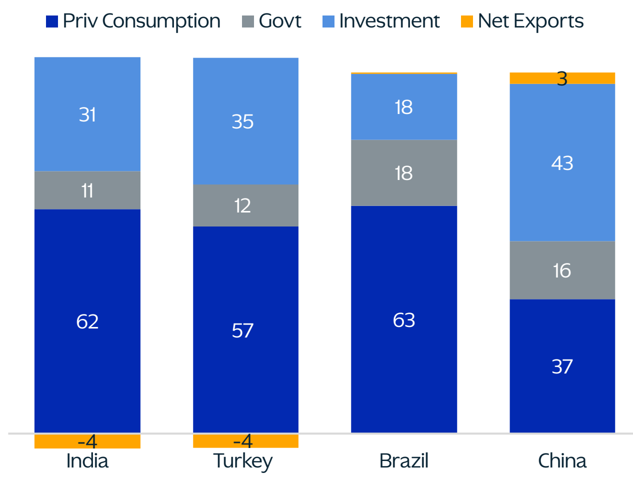
	Dec 2012	Jan 2024
Growth, Inflation, and Interest Rates		
Real GDP Growth	5.4%	7.6%
Headline CPI	8-11%	5-8%
Core CPI	9.0%	3.8%
Policy Rate	8% and peaked	6.5% and peaked
Real Policy Rate	-2.45%	0.81%
Balance of Payment		
Oil Net Import as a % of GDP	-5.6%	-3.1%
Current Account as a % of GDP	-5.1%	-1.1%

Note: For Dec 2012 numbers, data as at December 31, 2012. For Jan 2024 numbers, GDP is quarterly as at September 30, 2023; LTM headline CPI range and monthly core CPI are as at December 31, 2023; Policy rate and real policy rate (CPI defaulted) are as at December 31, 2023; Oil import and current account % of GDP are LTM as at September 30, 2023.

Key themes that resonated during our trip included high-end consumer brands, differentiated consumer experiences, wealth/savings, energy distribution, and digitalization.

Exhibit 2: While Manufacturing Is Growing, Private Consumption, Especially at the Middle to High End, Still Drives GDP in India

GDP by Expenditure, 2022



Data as at December 31, 2022. Source: India Central Statistics Office, Turkish Statistical Institute, Instituto Brasileiro de Geografia e Estat¡stica, China National Bureau of Statistics.

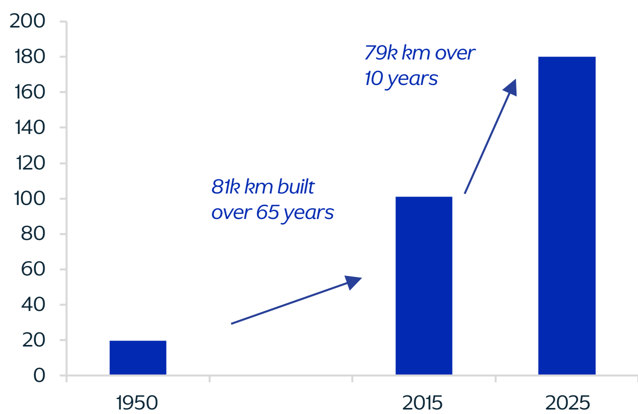
What did we learn on this trip? Here is the good news. The government of Prime Minister Modi has done an excellent job in recent years of addressing many of the self-inflicted wounds that were slowing India from achieving its potential. Specifically (and almost directly in response to the three variables listed above that we said needed fixing in 2012), the government has done the following:

1. **Introduced a value-added tax**, which is called the goods-and-services tax (GST). Besides raising tax revenue, this initiative is also hugely important for reducing barriers to cross-regional trade in India and increasing productivity.
2. **Championed a major digital infrastructure rollout**, including Aadhaar for digital IDs, which has been a boon for more targeted stimulus as well as the Unified Payment Interface or UPI, which is like Zelle or Venmo but government owned. It has also allowed for growth in e-commerce networks like the ONDC, as described earlier.
3. **Encouraged much deeper and broader investment in Infrastructure**. No doubt, there is still a lot to be done, but consider that only 81,000 kilometers of

national highways were built over 65 years, from 1950 to 2015, while 79,000 have been built over the last ten years alone. We saw similar trends across rails, ports, renewable capacity, and power transmission.

Exhibit 3: Road Construction Over the Last Ten Years Nearly Equals What Occurred Over the Previous 65 Years

India: National Highways '000 km

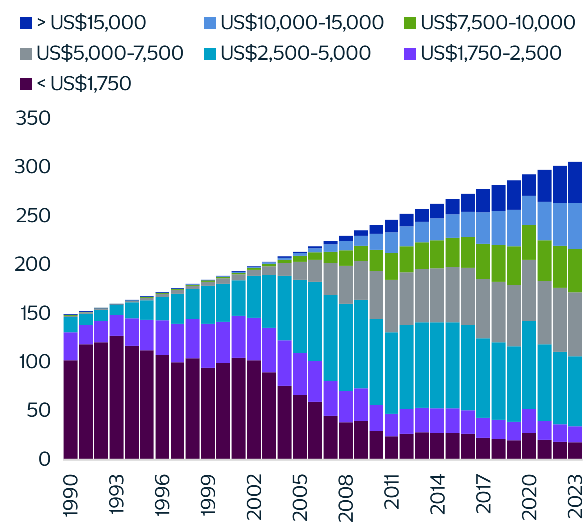


Data as at December 31, 2023. Source: BofA Global Research, Ministry of Road Transport and Highways, Indian Railways, Ministry of Ports, Shipping and Waterways.

Overall, though, with its skilled population of 1.4 billion, the Indian story is still a consumption-driven one based on rising GDP-per-capita. One can see this in *Exhibit 2*. Indeed, despite growth in exports and investment, basic consumption still remains the largest driver of GDP. However, within this large bucket, the growth of the middle-to-high income consumer is the real consumer story in India these days. One can see both the magnitude and the growth of these affluent cohorts in *Exhibits 4-6*. These upper tier segments of the consumer market are booming, and we see exponential – not linear – growth ahead. Just consider, for example, the number of households earning $35,000 or more will increase fivefold to over 25 million in 2031. Not surprisingly, we at KKR believe this backdrop is leading to significant investment opportunities across wealth management/ savings, healthcare, luxury items, and – most importantly – consumer experiences.

Exhibit 4: Affluent Consumers With Income Above $15k Only Make Up 14% of Households…

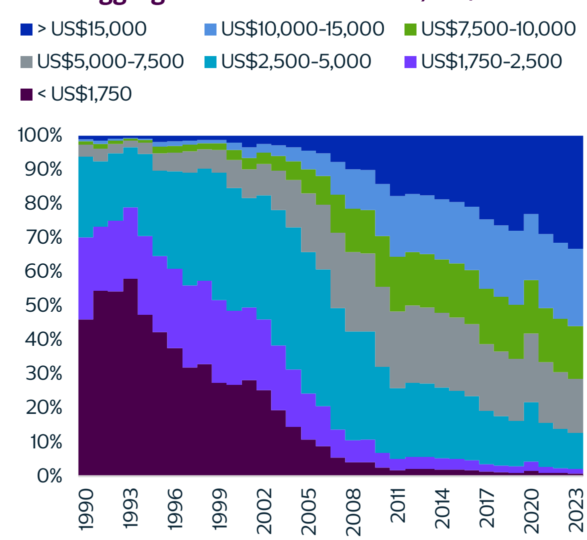
India: Number of Household Income, Millions



Data as at February 23, 2021. Source: Euromonitor socioeconomic database.

Exhibit 5: …But Now Make Up 33% of Aggregate Household Income in the Country

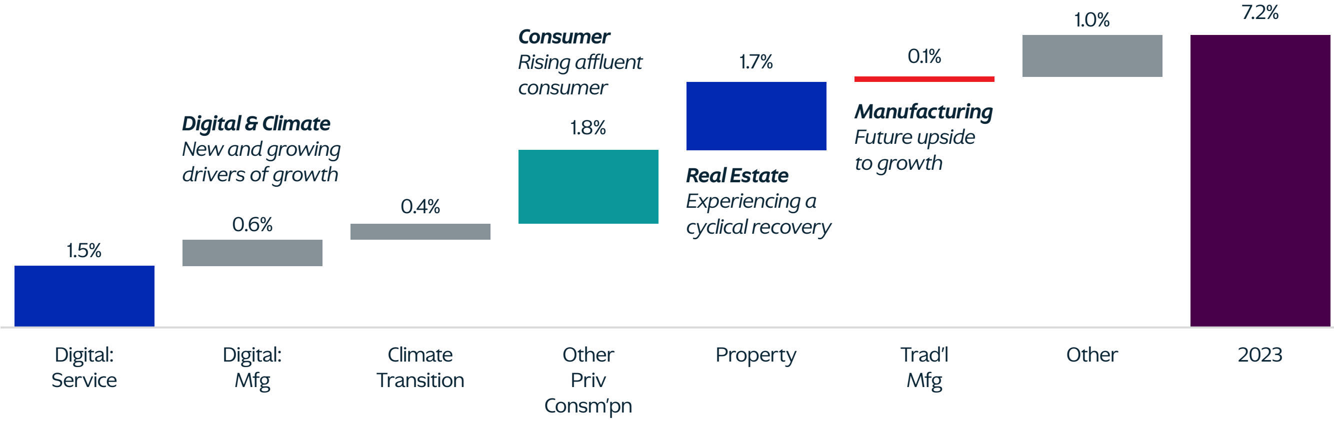
India: Aggregate Household Income, US$ Billions



Data as at February 23, 2021. Source: Euromonitor socioeconomic database.

Exhibit 6: Services, Not Manufacturing, Is Still the Main Driver of Growth

India FY 2023: Real GDP Breakdown, %



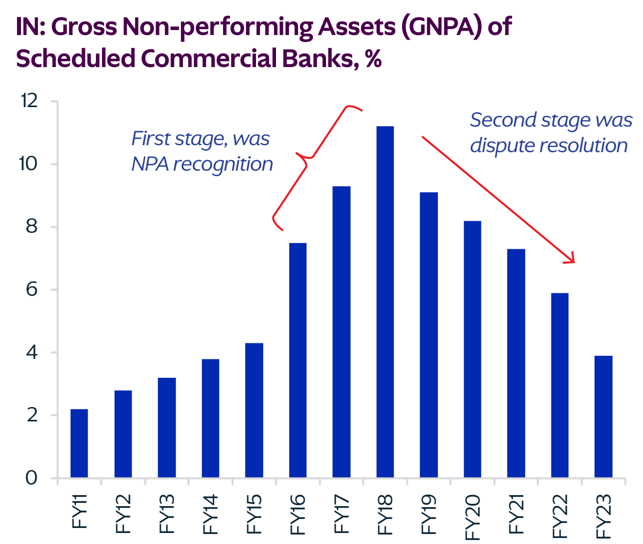
Note: Digital economy is estimated based on "India's Trillion-Dollar Digital Opportunity" from India Ministry of Electronics and Information Technology. Climate transition is estimated based on IEA estimations. Other private consumption is private consumption on service excluding digital as goods consumption is included in manufacturing. Property includes construction and real estate. Traditional manufacturing excludes digital and climate transition manufacturing. Data as at March 31, 2023. Source: India Central Statistics Office, Reserve Bank of India, India Ministry of Electronics and Information Technology, IEA, KKR Global Macro & Asset Allocation analysis.

The corporate sector is also having a renaissance. As we show in *Exhibit 6* (and similar to what we saw in China during our recent visits), the growth in the Indian economy is beginning to better reflect the impact that digitalization and climate is having on GDP. Importantly, current GDP statistics do not fully capture the manufacturing growth that we expect to come on the heels of better infrastructure and more direct foreign investment. Based on our conversations in Mumbai, Delhi, and Gurugram, we learned that there are not only more global manufacturers who are setting up shop in India since COVID, but so too are related suppliers and logistic companies that can provide additional leverage to these multi-nationals and/or local exporters. Against this backdrop, we think that there is a 'fly wheel' effect that will further gain momentum in fiscal year 2025-2026. If we are right, then this should help to support economists' claim that India can maintain an annual growth rate of six to seven percent over the next five years or so.

Interestingly, what one sees on the ground is that many foreign executives are using the same playbook that they used to succeed in China two decades ago to capitalize on such a large and vibrant consumer market. Specifically, they are leveraging a corporate strategy which also entails creating both local manufacturing capacity to export globally while creating more local sales capacity to address such a large consumer market. Apple moving production to India is the poster child to which most local executives refer, but this narrative is increasingly true across parts of healthcare equipment/services, technology hardware, and manufacturing. That said, India still has a way to go to catch China in the highest value parts of the export food chain, we believe.

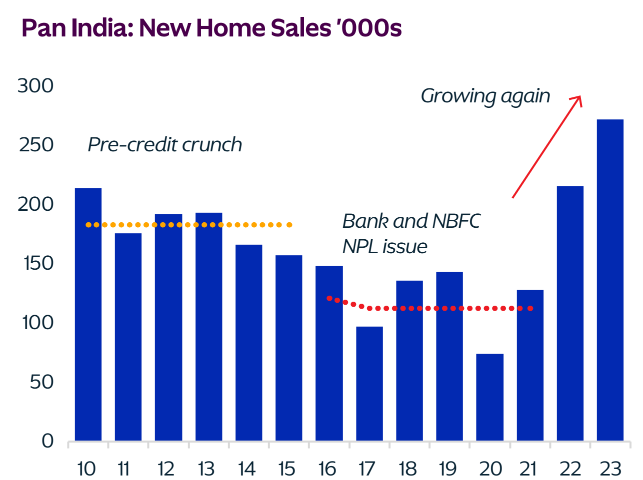
Meanwhile, the overall financial services system is also operating much better than during our last visit in 2019. One can see this in *Exhibit 6*, which captures the cyclical rebound in activity the country is now seeing, and in *Exhibit 7*, which reflects the improvement in credit quality in the banking system. At the same time, consumer losses are tracking well below what many lenders originally underwrote when providing both secured and unsecured loans. This viewpoint is especially true in the $3,000-$4,000 annual income range, we believe. On the wholesale side, leverage generally remains well below peak levels, and we do not see any major near-term issues. That said, given all the capital flowing into this country, one needs to stay disciplined, as India – despite its strong growth trajectory – is not immune from a cyclical downturn.

Exhibit 7: India's Credit Outlook Has Improved Massively in Recent Years



Data as at Fiscal Year 2023. Source: Reserve Bank of India, Haver Analytics.

Exhibit 8: The Housing Cycle in India Is Growing Meaningfully Again



Data as at December 31, 2023. Source: Jones Lang LaSalle Research, Morgan Stanley Research.

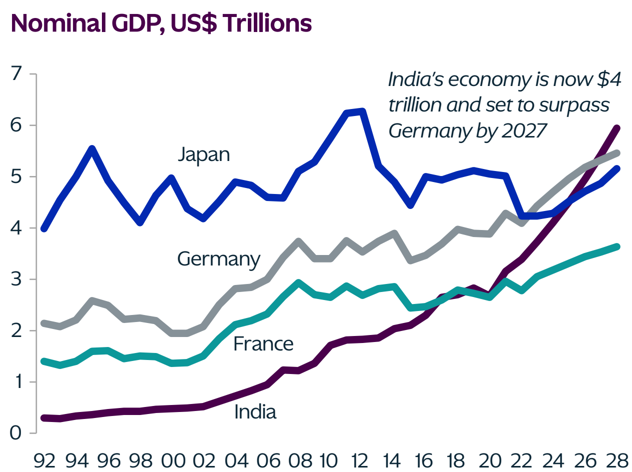
Separately, we left Delhi with a different view on India's digitalization efforts. Specifically, India, unlike the U.S. and China, does not have – or seem that interested in promoting – a domestic *private* sector champion like Amazon or Alibaba that often enjoys a 'winner-take all' narrative when it comes to online payments, e-commerce, and/or bank account formation in most countries. Rather, the government is largely supporting neutrality and inclusion through programs such as UPI (mobile payments), Aadhaar (the world's largest digital ID program), and/or e-commerce (ONDC, which represents a more unbundled marketplace than something like Amazon Prime). We also spent time in Gurugram thinking through India's services-based outsource footprint. Glass half empty investors often tell me that Artificial Intelligence is going to significantly pressure India's knowledge-based, services economy. We are more optimistic. In fact, we actually left India with the belief that it will likely be some combination of human and technology forces that win the day. We harken back to the early days of GOOGLE, when many on Wall Street predicted this technology would replace workers rather than be the integrated, complimentary tool it became in the workplace. What did we see on the ground in India that supports this view that the GOOGLE comparison is a good one? First, India has a steady supply of graduates in knowledge-based fields to supply ever increasing demand for business, technology, and financial services at a time when many developed and developing countries are demographically challenged. Importantly, many of these graduates are already successfully incorporating new AI-techniques into their offerings.

Second, more multinational firms are open outsourcing key areas of business functionality including research and development, operations, and manufacturing to India. As a result, the country is emerging as a net beneficiary of both the pandemic and heightened geopolitical tensions. Finally, despite having a highly qualified workforce, the labor cost arbitrage remains quite elevated in India, particularly given the talent base and improvement in business conditions.

Importantly, India has not been a growth at all costs story for investors during this transition period. In fact, as *Exhibit 10* shows, India's public markets have continued to create significant value for long-term investors, something that is too often not true across emerging markets. Private market returns have been even better. What is different in India relative to many other of its peers, we believe, is that the country has a balanced mix of real GDP growth as well as above average productivity gains. It has also stuck to its script on long-term planning, which has allowed it to better fund its growth than in the past. As a result, nominal

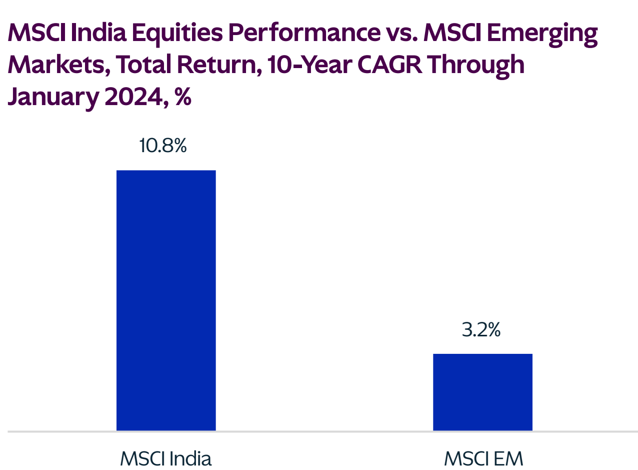
GDP, the lifeblood of corporate revenues, has been able to compound north of 10% at a time when monetary policy has been much less volatile than what we have seen in Western economies of late. One can see the significant impact of this growth in nominal terms relative to more traditional global peers in *Exhibit 9*.

Exhibit 9: India Is Now the Fifth Largest Economy, and Soon It Will Be the Third Largest



Data as at October 10, 2023. Source: IMFWEO, Haver Analytics, KKR Global Macro & Asset Allocation analysis.

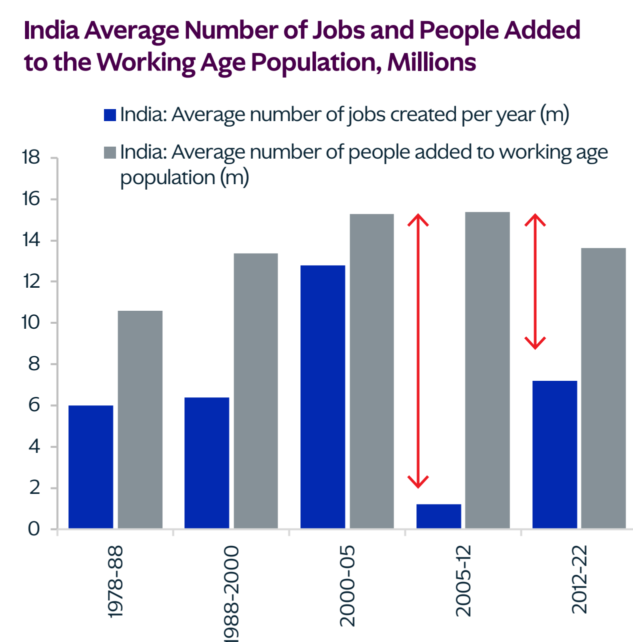
Exhibit 10: Indian Stocks Have Far Outperformed Emerging Markets



Data as at January 31, 2024. Source: MSCI. Bloomberg.

However, the India story is not perfect, as some challenges remain. For example, agriculture, while large in absolute size at 750 million acres of land, is still subscale at the individual farm level. Estimates vary, but most farms are less than two acres. As a result, small farms are plowed by individuals, not machines, a reality that acts as a drag on GDP-per-capita growth. Distribution of agriculture also remains challenged, with 30-40% of produce suffering some level of rot on the way from the farm to the fork. With 44% of the economy still agrarian, there are still too many lower to middle income Indians not enjoying the same benefits as their middle to high income counterparts. As we show in *Exhibits 12* and *13*, real incomes have declined for many Indians of late. High input costs, including food, have not led to the increase in real wages that many hoped, even with more targeted stimulus by the government rolled out through through its Aadhaar program.

Exhibit 11: Job Creation Hasn't Kept Pace With Population Growth



Data as at December 31, 2022. Source: PLFS, CEIC.

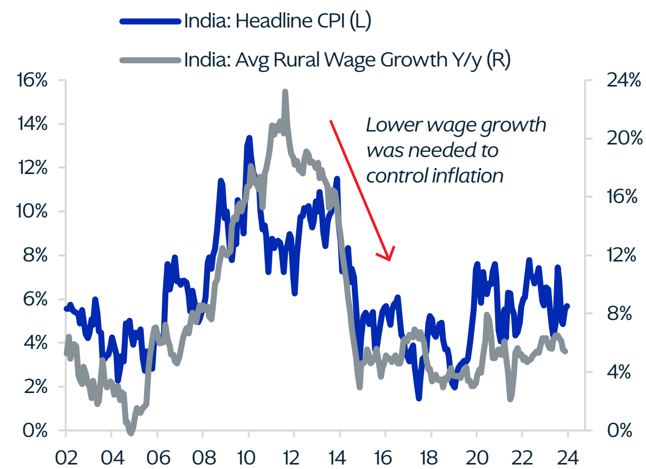
Exhibit 12: Real Wage Growth for the Informal Sector Has Been Weak in Contrast to Private Corporates

Data as at June 30, 2023. Source: CEIC, United Nations.

In terms of other areas to watch, India also still runs a twin deficit. An increase in tax revenues is helping, but we still think that only about four percent of Indian citizens are currently paying income taxes. Over time, this number needs to be much higher, we believe, especially as median GDP-per-capita approaches $5,000 or more. Finally, while speed of execution clearly has improved, local claims of ongoing bureaucratic red tape and/or 'democracy run amok' still dent corporate and consumer confidence at times.

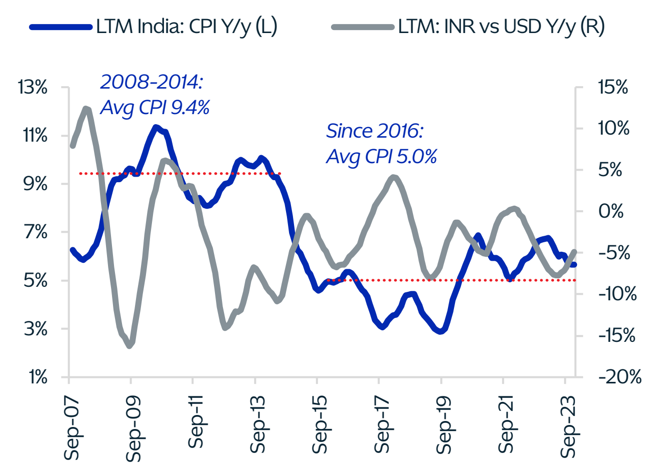
Said differently, despite having a growth bias that is more emerging market in nature, the backbone of deal making both in terms of deployment and exits that we are now seeing in India increasingly feels reminiscent of what I typically see in more developed markets such as Japan, Korea, and parts of Europe

Exhibit 13: Inflation Is Now Well Managed...



Data as at December 31, 2023. Source: India Ministry of Statistics and Programme Implementation, Labour Bureau of India, Haver Analytics.

Exhibit 14: ...Which Has Helped Lead to Less Currency Volatility Than in the Past



Data as at December 31, 2023. Source: India Ministry of Statistics and Programme Implementation, Labour Bureau of India, Haver Analytics.

Conclusion: Stay the Course

Looking ahead, we continue to see above-average long-term gains ahead across many asset classes in India, including Equities (both Private and Public), Real Estate, Credit, and Infrastructure. Importantly, rising consumer demand for financial/investment assets (versus previously just wanting to save via Cash, Gold, and Real Estate), a greater desire by the government to transition infrastructure spending into the hands of the private sector, and a steadier macroeconomic backdrop likely mean that valuations are not going to compress a lot, we believe. Against this backdrop, the public equity markets are becoming a more natural way for both strategic and financial buyers to enter and exit positions.

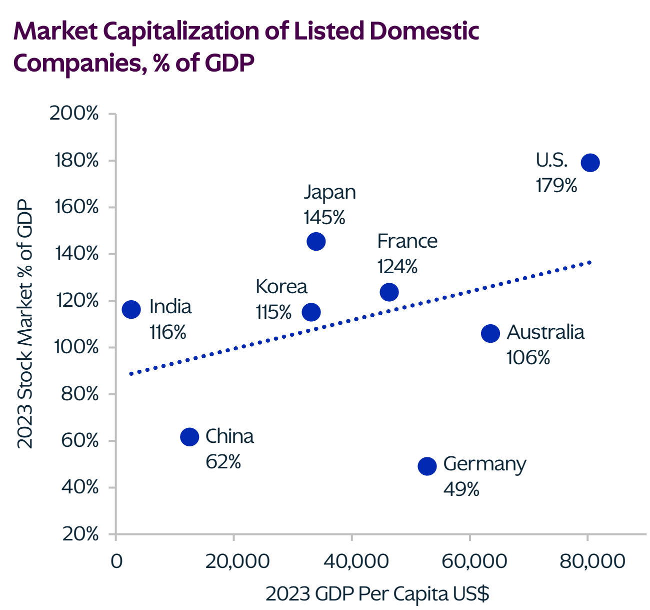
Within the private markets where KKR largely operates, differentiation in sourcing as well as the ability to create operational improvement have now become prerequisites for success. In particular, having the ability to take a local business overseas, create a successful founder succession plan, or leveraging M&A expertise to consolidate smaller players are all working to create better outcomes for investors than when I first traveled to the country many years ago. Said differently, despite having a growth bias that is more emerging market in nature, the backbone of deal making both in terms of deployment and exits that we are now seeing in India increasingly feels reminiscent of what I typically see in more developed markets such as Japan, Korea, and parts of Europe.

Exhibit 15: India Has Less State Owned Enterprises Than China...

Sector % Market Cap	China SHSZ300 Index		India BSE500 Index	
	Sector Weight	State Owned	Sector Weight	State Owned
Financials	23.5	7.7	25.7	6.8
Industrials	15.4	5.9	10.6	2.2
Information Technology	14.7	1.5	10.6	0.1
Consumer Staples	13.5	1.7	9.2	0.0
Materials	7.8	4.3	10.7	0.5
Health Care	7.0	0.8	5.3	0.0
Consumer Discretionary	6.9	1.9	9.7	0.0
Utilities	3.8	3.2	5.1	2.4
Energy	3.7	3.1	8.3	2.5
Communication Services	2.3	0.6	3.2	0.0
Real Estate	1.3	0.6	1.6	0.0
Total	100	31.4	100	14.4

Data as at December 31, 2023. Source: Bloomberg, Capital IQ, S&P, KKR Global Macro & Asset Allocation analysis.

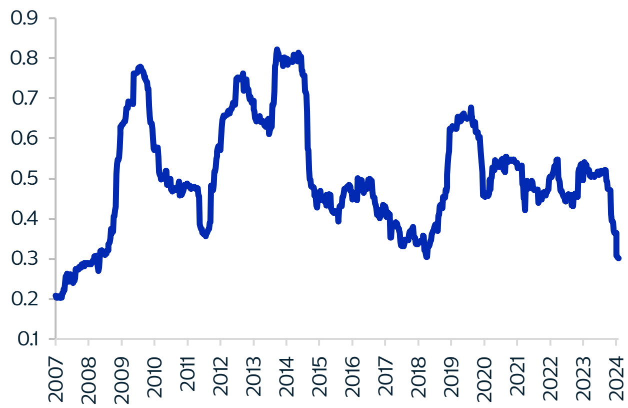
Exhibit 16: ...and Its Stock Market Is More Developed as a Percentage of GDP



Data as at February 2, 2024. Source: Bloomberg.

Exhibit 17: As the Indian Government Has Gotten More Disciplined, the Country's Currency Has Become Less Volatile

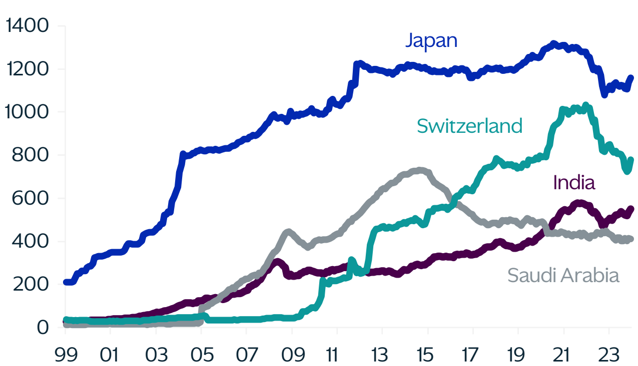
USDINR: 1-Year Rolling Standard Deviation



Data as at February 2, 2024. Source: Bloomberg.

Exhibit 18: India's FX Reserves are Now the Fourth Highest After Greater China, Japan, and Switzerland

Foreign Exchange Reserves, US$ Billions



Data as at December 31, 2023. Source: Reserve Bank of India, Japan Ministry of Finance, IMF, Haver Analytics.

So, what is our bottom line and where do we go from here? Our message – similar to what we said over a decade ago – is to *Stay the Course* in India. While there definitely will be bumps along the way, we do think superior economic growth, greater capital appreciation of the public markets than peers, and more value creation across private investments is possible in a country that is collectively poised to represent 20% of *total* incremental global growth over the next five to seven years. To achieve this growth, however, India will need to create more efficient scale in its agriculture sector, improve its infrastructure, secure better and cleaner energy sources, and reduce the bifurcation that has emerged between the high end and lower end consumer. The good news is that these 'fixes' are all achievable, and as a result, periodic dislocations are to be bought, not sold.

So, what is our bottom line and where do we go from here? Our message – similar to what we said over a decade ago – is to Stay the Course in India. While there definitely will be bumps along the way, we do think superior economic growth, greater capital appreciation of the public markets than peers, and more value creation across private investments is possible in a country that is collectively poised to represent 20% of total incremental global growth over the next five to seven years.

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