16 February 2023

FIDELITY ASIAN VALUES

India: adding spice to the mix

India accounts for 23% of FAV's portfolio and the top two overweight positions, both of which are Financials. In this note, we examine some of the key macro attractions of the that market, which help generate favourable tailwinds for investment. These include economic growth, socio-demographic changes, digitalisation and deregulation. We also use the two overweight, very different Indian case studies, to illustrate FAV's investment approach and how it adds value in the process. In six months, the Trust's NAV has risen to our previous July 2023 year-end estimate. We have now increased our forecast by 8%, reflecting performance to date, stock selection and the regional outlook.

- **Asia's appeal:** The IMF's *January World Economic Outlook update* once again highlighted the superior economic prospects (and lower downside revisions) seen in FAV's investment mandate. We also see opportunities being created by new trade agreements, reduced regulation, long-term socio-demographic trends and urbanisation.

- **Trust-specific appeal:** FAV uses in-depth research to identify good businesses at fair prices, rather than making macro calls. Despite headwinds for many years, when market appetite was for large-cap, growth companies, FAV outperformed. More recently, market appetite has turned sharply in FAV's favour.

- **Valuation:** FAV is trading at a 6% discount to NAV – broadly in line with its peers in the AIC Asia Pacific Smaller Companies Index (average discount 10%) and the broader Asia Pacific sector (average 7%), even though its one-year performance has been ca.18% better than that of the latter. Most assets are listed, making the NAV "real".

- **Risks:** Geopolitical and economic tensions may affect investments, and also sentiment. If growth/momentum stocks are in favour (as they have been for much of the period since 2016), FAV faces a relative headwind, which it has usually, but not always, overcome. Volatility of returns is likely to be high.

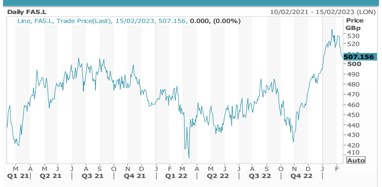
- **Investment summary:** FAV has delivered superior long-term returns by being in attractive growth markets and adding incremental value using structured, in-depth analysis to identify mis-priced investments. Its "value" investments have actually delivered higher earnings growth than an average Asian "growth" company, as well as being lower-rated and providing a higher RoE. FAV is actively managed, and divergence from the benchmark performance, often for sustained periods, is to be expected.

Financial summary and valuation

Year-end Jul (£m)	2019	2020	2021	2022	2023E	2024E
Investment income	11.5	10.6	10.8	15.3	15.6	18.4
Gains/losses on investments	16.6	(66.7)	94.3	2.7	62.0	36.0
Investment manager fees	(2.3)	(1.7)	(1.6)	(1.8)	(2.7)	(3.0)
Other expenses	(0.8)	(0.8)	(0.8)	(0.9)	(0.8)	(0.8)
PBT	24.6	(54.5)	107.7	15.7	71.9	48.4
Investments	312.7	241.3	350.2	338.8	399.7	437.0
Cash	5.8	21.3	14.1	25.4	22.8	22.8
NAV	323.0	269.4	364.1	367.6	425.9	463.2
NAV per share (p)	4.47	3.64	4.98	5.08	5.93	6.45
S/P prem./disc. (-) to NAV*	2%	-8%	-3%	-10%	-14%	-21%
Dividend (p)	8.80	8.50	8.80	14.00	10.50	11.50
Yield	1.7%	1.7%	1.7%	2.8%	2.8%	2.8%

**2019-22 NAV on year-end s/p, 2023-24E NAV on current s/p; Source: Hardman & Co Research*

Closed End Investments



Source: Refinitiv

Market data

EPIC/TKR	**FAS**
Price (p)	**509**
12m high (p)	536
12m low (p)	406
Shares (m)	71.8
Mkt cap (£m)	366
NAV (14 Feb'23, p)	541
Discount to NAV	-6%
Country/Ccy	UK/GBP
Market	Main (SSMM)

Description

The investment objective of Fidelity Asian Values (FAV) is to achieve long-term capital growth, principally from the stock markets of the Asian region, excluding Japan. Its performance is measured against the (net) sterling total return of the MSCI AC Asia ex Japan Small Cap Index.

Company information

Chair	Kate Bolsover
Snr. Ind. Dir.	Clare Brady
Chair Audit Cttee.	Hussein Barma
NEDs	Sally MacDonald, Matthew Sutherland, Michael Warren
Fund Manager	Nitin Bajaj (PM), Ajinkya Dhavale (asst. PM)
Contact	FIL-FidelityInvestmentTrusts@fil.com investment-trusts.fidelity.co.uk/fidelity-asian-values

Key shareholders (Dec'22)

Fidelity/HL/II platforms	28.5%
Charles Stanley	7.5%
Evelyn Partners	5.7%
Brewin Dolphin	4.4%
Rathbones	3.9%

Diary

Mid-Feb	Jan monthly factsheet

Analyst

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Why invest in India?

FAV driven by stock selection, but favourable headwinds help investment and sentiment

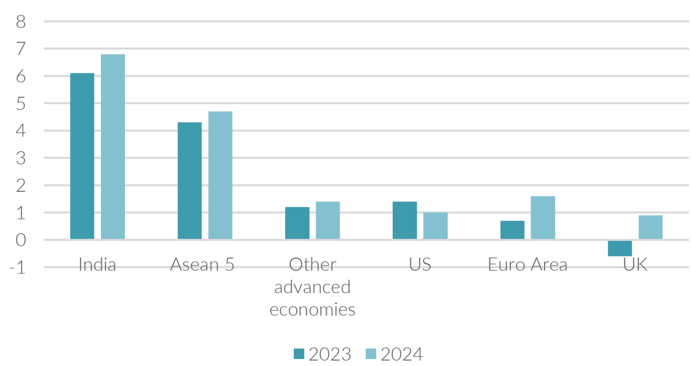
We remind investors that FAV's approach is driven by stock selection, not macro allocation. In addition, the manager picks good businesses at fair prices, and country exposures drop out from this process. Having said that, being in countries with strong growth, a good regulatory and legal framework and positive socio-demographics all provide positive tailwinds for investments and sentiment to the Trust.

Well above-average economic growth

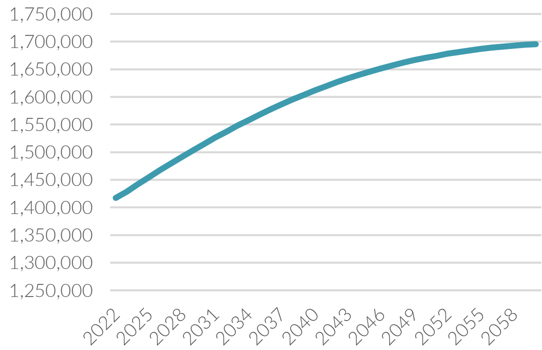
India expected to have well above-average economic growth

The IMF's January World Economic Outlook update once again highlighted the superior economic prospects (and lower downside revisions) of India over both advanced economies and most emerging markets. The left-hand chart below illustrates the point that the forecast for Indian 2023-24 real growth is well ahead of that for the emerging markets in Asia and other advanced economies. Perhaps, more importantly, this growth may be expected to be sustained over the long term. This is driven, in part, by the continued and steady growth in the Indian population, as indicated in the right-hand chart below, which shows the UN forecasts through to 2060.

Real GDP forecast growth in 2023-24 (%)



Indian population (000s)



Source: January World Economic Outlook update, UN World Population Prospects 2022, Hardman & Co Research

Socio-economic changes, including booming middle class and urbanisation

Middle class proportion of spending to double in next 25 years

In November 2022, People Research on India's Consumer Economy (PRICE) forecast a doubling in the proportion of national expenditure by the Indian middle classes by 2047 (to 63%, from 31% in 2021). This follows a rise from just 14% in 2004-05. Such a mix effect has a fundamental impact on demand and, with it, creates opportunities for a stock-picker like FAV.

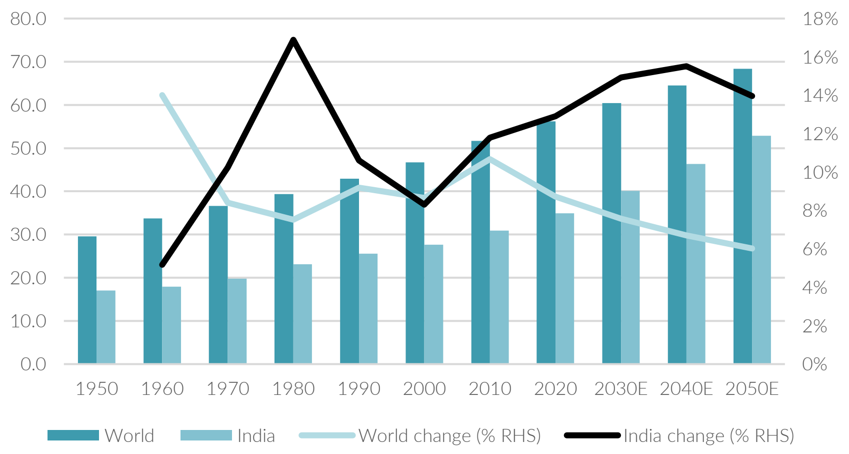
Combined with accelerating rate of urbanisation, this will see significant domestic demand changes and opportunities

The chart below shows the proportion of the population in urban centres globally and for India since 1950, and forecasts to 2050. India currently has around a third of its population in urban centres, against a world average of 57%[1]. Over the next three decades, the Indian proportion is expected to rise to around 53%. Critically, the rate of urbanisation is, and is expected to continue to be, on an accelerating trend. In contrast, globally, the rate of urbanisation is expected to slow. The reason this is important to FAV is that urbanisation typically brings changes in the economy,

[1] *Source: UN https://population.un.org/wup/Download/*

and, with the development of commercial real estate, logistics and demand for consumer goods, it provides opportunities for stock-picking investors such as FAV to identify well-run companies that play into these secular trends.

World and Indian proportion of population in urban centres (% LHS) and change over previous decade (% RHS)



Source: UN, https://population.un.org/wup/Download/, Hardman & Co Research

Indian technology/unicorn landscape

Rapid smartphone and digital transaction adoption

We highlighted, in our *initiation* on FAV, that India has 650m smartphone users and that 99% of all digital transactions take place over the phone, as most citizens have sidestepped the laptop/desktop journey. India has one of the lowest data costs globally. Reflecting strong mobile penetration, the government has launched its United Payments Interface (UPI), which acts as a gateway through which all digital transactions pass, catching both Mastercard and Visa off guard, and enabling enterprises and individuals to transact with each other through a single portal. According to ACI Worldwide, in 2021, India had 48.6bn real-time transactions, or 6.5x the combined number of the US, Canada, France and Germany, and three times the number of China.

India third globally for unicorns

India's technology bias means that it has become a global centre for unicorns (privately held startups with valuations of over $1bn), with around 100 such companies[2] in third position behind the US and China. To put this into perspective, this is around twice the number of the UK and four times the number of Germany or France. Again, the digitalisation of the economy creates opportunities for a stock-picker like FAV.

Business reform/deregulation

In India, government support, including PLI schemes, lower taxes and focus on helping infrastructure

The Indian government has initiated a bold incentive programme, with the aim of making India a global manufacturing hub, with a raft of different programmes having an impact on the way in which business is conducted. The government's production-linked incentive (PLI) schemes across 14 sectors, with an expected six-year total

[2] *https://finlib.in/list-of-unicorns-in-india/*

outlay of Rs1.9tr[3], mark a distinct shift in the country's industrial policy. While earlier policies tended to spray incentives thinly across industries, PLI schemes focus on building select domestic champions in each industry. On 5 November 2020, Prime Minister Modi held a meeting with the top 20 global investment funds to attract investment into the infrastructure space. India's government is offering a tax-free status to the long-term infrastructure projects in which these funds invest (no capital gains tax, income tax or dividend-related tax liabilities). In 2017, the statutory corporate tax rate was reduced from 30% to 22% – a lower rate than the global average corporate tax at the time of 23.8% (*Source: Funds-europe.com*). The government has also embarked on a marked programme of de-monetisation of bank notes. It has made many simplifying changes to the administration of taxes, while aiming to increase compliance. The laws governing insolvency are expected to be amended imminently to enable the quicker resolution and distribution of recovery proceedings[4].

India moved from 132 in 2013 to 63 in 2020 in World Bank's ease of doing business index

The government's related measures also saw India move from a position of 132 in 2013 to 63 in 2020 in the World Bank's ease of doing business index. Interestingly, it went from 182 to 27 for dealing with construction permits, from 49 to 13 for protecting minority shareholders, and from 116 to 52 for resolving insolvency.

Recently, seen more appetite for free trade agreements

The Indian approach to free trade agreements has been mixed. Until recently, it had generally been felt that there had been too much of an advantage given to the other parties, and so Indian appetite for such deals was limited. It was not involved in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which includes countries such as Vietnam and Malaysia, and it observes only at some meetings of the ASEAN free trade area. However, more recently, there has been more appetite for developed-world free trade deals, with deals already signed with UAE and Australia, and rapidly advancing negotiations with the UK[5] and the EU[6].

Economic risks

Risks include oil price, inflation, COVID-19 resurgence and global economy sensitivity

India remains a net importer of oil, and so has a sensitivity to a high oil price (although this appears modest in relation to the level of foreign exchange reserves). Some estimates put it at 0.4% of GDP to every $10 of oil price[7]. There remain risks from COVID-19 resurgences and an economic correlation to the world growth outlook (which may prove either positive or negative against current expectations). Not uniquely, India is facing inflation (currently close to 6%, and falling).

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[3] *https://timesofindia.indiatimes.com/business/india-business/big-boost-for-the-manufacturing-sector-through-pli-schemes-in-budget-2023/articleshow/97274879.cms?from=mdr*
[4] *https://www.business-standard.com/article/economy-policy/ibbi-expected-to-introduce-two-key-changes-to-the-insolvency-law-report-122112200276_1.html*
[5] *https://www.gov.uk/government/news/joint-outcome-statement-uk-india-round-six-fta-negotiations*
[6] *https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/india/eu-india-agreement/documents_en*
[7] *https://www.forbes.com/uk/advisor/investing/how-to-invest-in-india/*

Case studies showing FAV's investment approach

Shriram Finance Ltd – formerly holding in Shriram City Union Finance Ltd (SCUF)

Summary of the business

Niche lender requiring specific skills built over many decades

FAV originally invested in SCUF, a company in India that provides financing options for second-hand trucks to individuals who typically have limited or poor traditional credit records. The company enjoys 80% market share, largely because the assessment of the credit risk is incredibly expert, while the asset valuing process is very specific to the types of vehicles that are leased. Cash collection methods are another critical component of the success of the business. The company is highly beneficial to society, allowing growth in entrepreneurship in impoverished groups, and has been built by a management team over several decades. It first appeared as a top 10 holding in the 2019 Report and Accounts (R&A). In December 2022, it merged with M/s Shriram Transport Finance Co. Ltd. as a step towards forming the merged entity "Shriram Finance Ltd." whose latest market cap is Rs476bn (£5bn). The holding at end-2022 was FAV's largest position (4% of total net assets).

How it fits with FAV's approach

High returns, good growth, good ESG credentials

Given the timing, we do not have the historical financials for the new consolidated entity but, looking at the September 2022 numbers for SCUF, we can see:

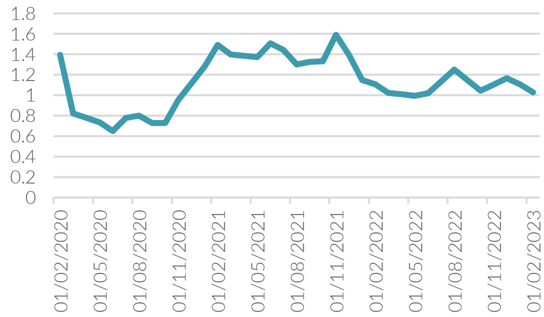
- That it earns good returns – RoA 3.3% after a gross yield of 22.2% (rising), finance costs of 8.3%, expenses of 6.1% and credit costs of 2.6% (slide 19-20).
- Improving trends over the past two years: RoA up from 3.2% to 3.3%, as noted above, and credit costs down from 2.7% to 2.55% (slide 19-20).
- Clear ESG deliverability and goals.
- Good growth across a range of diversified businesses, with disbursements up 45% in 1HFY'23 and AUM up 19% (slides 9, 11-13).

Forward P/E under 8x, P/BV 1x

In terms of the second leg of the FAV approach, investing at a fair price, the forward P/E is under 8x, and the P/BV is 1x. The historical trends are shown in the charts below.

12-month forward P/E ratio (x)

12-month forward P/BV (x)



Source: Refinitiv, accessed 14 February 2023, Hardman & Co Research

Axis Bank

Summary of the business

Third-largest private-sector bank in India

Axis Bank (investor relations site *here*, BSE listing *summary here*, NSE *summary here*, market cap Rs2,679bn) is the third-largest private-sector bank in India. It has been in the portfolio since 2020 (was 11th in that year's R&A). It will benefit from structural growth, as banking penetration increases across the entire spectrum of financial services. It is expected to gain market share from less-efficient, government-owned banks. The newly installed management team has improved asset quality and enhanced the underwriting culture. This has led to a marked improvement in its RoE. At the end of 2022, it was the second-largest position in the portfolio, and accounted for 3.4% of total net assets.

How it fits with FAV's approach

Good returns, strong growth, with market share gains, good ESG credentials

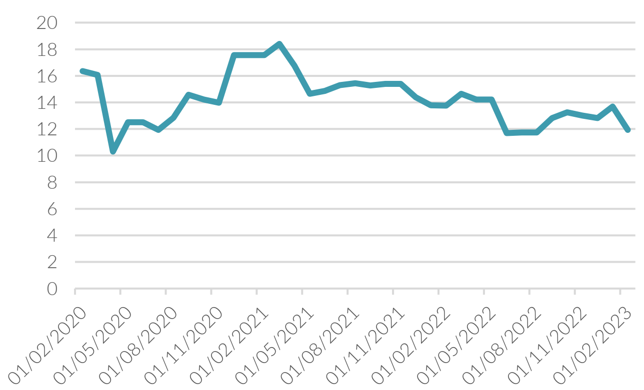
We have outlined before that FAV's focus is about buying quality businesses (not just buying shares). Some of the key features from the November 2022 *Axis Bank presentation* show how it fits with FAV's investment strategy. These include:

- It earns good returns – 18.9% consolidated RoE 2QFY'23 annualised (slide 2).
- Improving trends over the past three years: RoE up from 8.6% to 18.9%, as noted above, core operating profit CAGR up from 4% to 13%, market share up from 4.9% to 5.7%, non-performing assets down from 2.06% to 0.51%, and Core Equity Tier 1 up from 11.3% to 15.1% (slide 3).
- Clear sustainability, deliverability and goals (slides 4 and 21).
- Improving growth across a range of diversified businesses, including deposits, credit cards, mortgages, wealth management and wholesale banking (slides 5-11).
- Focus on shareholder returns (slides 13-16).
- In addition, being a large-cap name (£26.5bn), Axis Bank provides good liquidity.

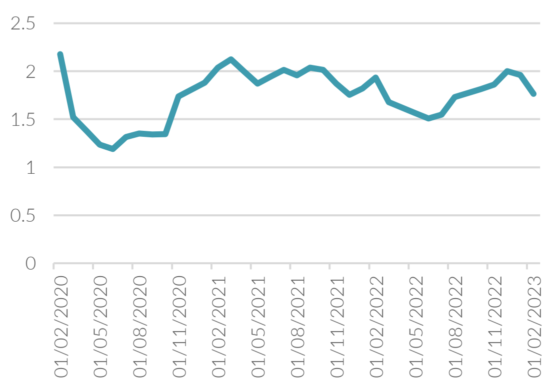
P/E 12x, P/BV 1.8x

In terms of the second leg of the FAV approach, being at a fair price, the forward P/E is 12x (PEG ca.1) and the P/BV is 1.8x, as shown in the charts below.

12-month forward P/E ratio (x)



12-month forward P/BV ratio (x)



Source: Refinitiv, accessed 14 February 2023, Hardman & Co Research

Portfolio

Geography

FAV concentrated in Greater China, and underweight Taiwan and South Korea

The table below is a summary of FAV's portfolio as at end December 2022. As noted above, the concentration in China is not in any of the big names that have been subject to regulatory risk, and it should not be seen as a proxy for exposure to that country.

Geographical portfolio summary of FAV and index (% total net assets)

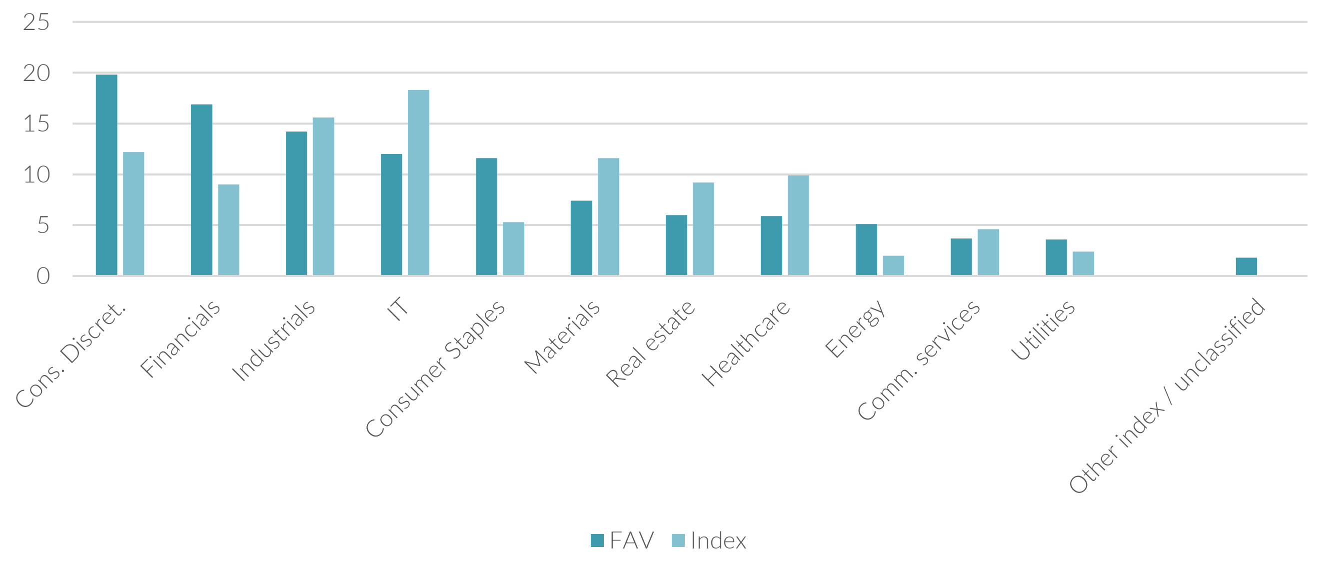
Country	FAV	Index	FAV vs. Index
China	32.2	11.3	20.8
India	23.0	26.1	-3.0
Indonesia	13.1	3.0	10.1
Hong Kong	10.2	6.3	3.9
South Korea	8.9	15.6	-6.7
Taiwan	6.4	22.2	-15.8
Australia	4.8	0	4.8
Singapore	3.2	5.5	-2.3
US	2.0	0	1.9
Philippines	1.2	1.3	0
Others	1.9	8.7	-6.9
Other index unclassified	1.1	0	n/a

Source: FAV December 2022 Factsheet, Hardman & Co Research

Sector exposure

At end-December 2022, FAV's key exposures were overweights in consumer discretionary, financials and consumer staples, and underweights in IT, real estate, healthcare and materials.

FAV's sectoral mix (as % of total net assets), December 2022

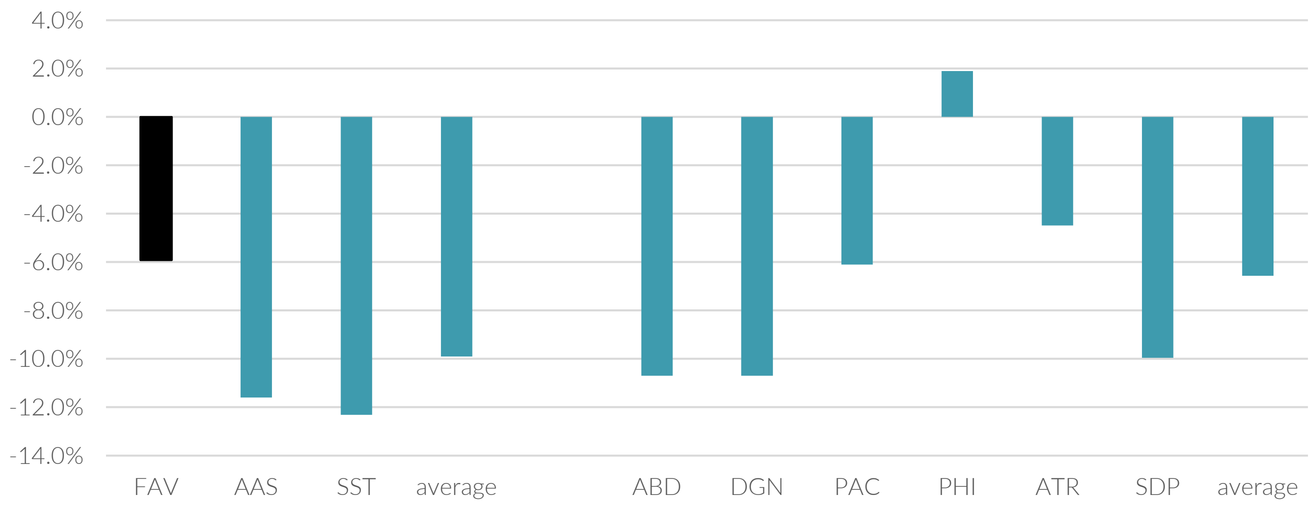


Source: FAV December 2022 Factsheet, Hardman & Co Research

Valuation

FAV trades at a discount to NAV, but at one better than that of its immediate peers. Its performance has been materially better than that of its peers over the long term.

FAV and peers – discounts/premiums to NAV (%)



Source: LSE, priced on 14 February 2023, Hardman & Co Research

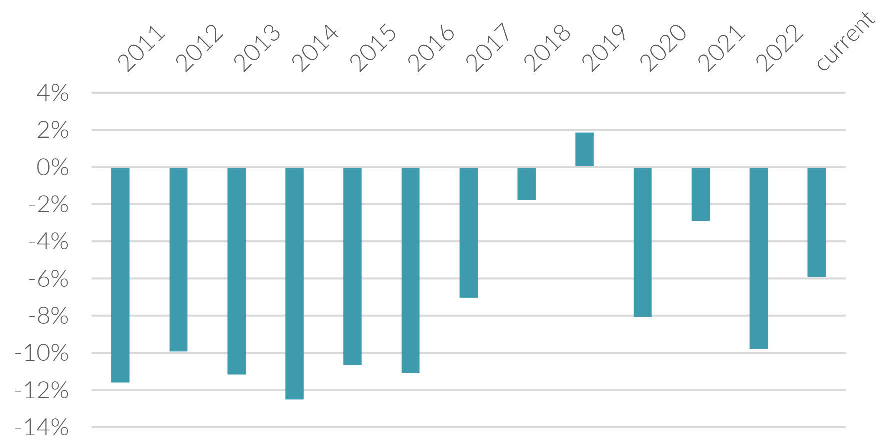
Strong performance in 2016-17 saw discount to NAV reduce sharply

Share price was at premium to NAV before COVID-19, and China concerns saw discount widen again

Board started buyback programme

As can be seen from the chart below, at the end of FY'11-FY'16, FAV typically traded at a double-digit discount to NAV. This changed in 2017, driven primarily by the strong performance of the Trust (average NAV total return 2016-17 27%, versus 8% 2011-15). By July 2019, the Trust was trading at a premium to NAV. However, the uncertainty around COVID-19 and more recent market concerns, especially regarding China, saw the discount rise again. More recently, confidence in the region and the strong Trust performance have seen the discount narrow once again. The board has started a buyback programme.

Historical discount to NAV at end-July each year, and current discount



Source: FAV Report and Accounts, priced on 14 February 2023, Hardman & Co Research

Financials

The past six months have seen a material rise in FAV's benchmark and, additionally, significant outperformance against this by the Trust, driven by stock selection. As a consequence, it has already achieved our previous July 2023 year-end forecast. Reflecting this performance and the recent economic upgrades, we have increased our 2023E NAV by 8%, with a carry- forward effect into 2024. Given the higher capital growth we now expect, we also now assume a stable dividend.

Income statement (£000)									
Year-end Jul		2022			2023E			2024E	
	Revenue	Capital	Total	Revenue	Capital	Total	Revenue	Capital	Total
Gains/losses on investments		2,708	2,708		62,009	62,009		35,969	35,969
Gains/losses on derivatives		(1,815)	(1,815)		(1,815)	(1,815)		(1,815)	(1,815)
Investment income	15,256		15,256	15,587		15,587	18,384		18,384
Investment manager fees	(2,564)	732	(1,832)	(2,700)		(2,700)	(3,000)		(3,000)
Other expenses	(905)	-	(905)	(800)	-	(800)	(800)	-	(800)
Foreign exchange gains/losses		2,609	2,609		0	0		0	0
Profit/(loss) before fin. costs & taxation	**11,787**	**4,234**	**16,021**	**12,087**	**60,194**	**72,281**	**14,584**	**34,154**	**48,739**
Finance costs	(331)		(331)	(331)		(331)	(331)		(331)
Profit/(loss) before taxation	**11,456**	**4,234**	**15,690**	**11,756**	**60,194**	**71,950**	**14,253**	**34,154**	**48,408**
Taxation	(1,079)	(1,085)	(2,164)	(1,000)		(1,000)	(1,000)		(1,000)
Profit/(loss) after taxation for the year	**10,377**	**3,149**	**13,526**	**10,756**	**60,194**	**70,950**	**13,253**	**34,154**	**47,408**
Earnings/(loss) per ordinary share (p)	**14.21**	**4.31**	**18.52**	**14.97**	**83.80**	**98.78**	**18.45**	**47.55**	**66.00**

Source: FAV Report and Accounts, Hardman & Co Research

Balance sheet (£000)								
@ 31 Jul	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023E**	**2024E**
Investments	264,076	273,714	312,681	241,271	350,225	338,845	399,659	437,010
Current assets								
Derivative instruments	2,829	1,529	1,537	7,299	437	972	972	972
Other receivables	1,766	2,307	3,325	1,886	3,489	4,568	4,568	4,568
Amounts held at futures clearing houses & brokers	1,937	2,363	2,905	1,115	2,825	2,997	2,997	2,997
Cash and cash equivalents	14,822	11,468	5,796	21,262	14,128	25,368	22,808	22,808
Total current assets	21,354	17,667	13,563	31,562	20,879	33,905	31,345	31,345
Total assets	285,430	291,381	326,244	272,833	371,104	372,750	431,004	468,355
Current liabilities								
Derivative instruments	(1,554)	(960)	(2,192)	(1,149)	(1,335)	(1,302)	(1,302)	(1,302)
Bank loans	(3,685)	(2,447)	(1,053)	(2,284)	(5,705)	(3,825)	(3,825)	(3,825)
Total current liabilities	(5,239)	(3,407)	(3,245)	(3,433)	(7,040)	(5,127)	(5,127)	(5,127)
Net assets	**280,191**	**287,974**	**322,999**	**269,400**	**364,064**	**367,623**	**425,877**	**463,228**
NAV per share (p)	**4.152**	**4.194**	**4.472**	**3.644**	**4.975**	**5.078**	**5.929**	**6.449**

Source: FAV Report and Accounts, Hardman & Co Research

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