



Stewart Investors
Sustainable Funds Group

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Ten years in emerging markets

The emerging markets asset class is extremely varied. It includes democracies and dictatorships, economies reliant on manufacturing and those that export commodities, and – most importantly – some of the very best companies in the world alongside some of the very worst. If the last ten years investing in emerging markets has taught us anything it is that in the long run, quality wins.

Companies with high-quality fundamentals, if held patiently, can deliver both superior long-term compounding of capital, but also do so in a way that limits the risk of permanent capital impairment.

A case in point

An example of such a company is Marico, a consumer goods company in India which we have liked for over a decade.

The company's core product is coconut oil. Marico's founder Harsh Mariwala worked to formalise, to brand and then to premiumize the category over many years. Multinationals struggled to compete with Marico's local understanding, as well as its ability to source from smallholder farmers (Marico buys one in every 10 coconuts grown in India) and to distribute to 58,000 rural villages¹.

Emerging as the dominant player, Marico has been able to sustain very attractive returns on invested capital of around 26% for the last decade*. What's more and crucially, because it sits in a very large addressable market, it has been able to retain around 60% of profits in the business and redeploy these into expansion².

This combination of attractive economics and growth, sustained over time, is often a powerful driver of share prices. Indeed, Marico has been able to deliver annualised returns of around 24% for the last ten years².

It is the lure of such opportunities – of finding entrepreneurs who grow strong businesses responsibly over long periods of time – which drives our commitment to bottom-up stock picking.

“Looking forward, today feels like a more exciting time to be an emerging markets investor than any in the past ten years.”

Lessons learnt

Of course, whilst we may have judged correctly on many occasions over the last ten years, we have also been dealt plenty of harsh lessons through our own mistakes.

For many years, we owned Idea Cellular, an Indian telecoms company**. We assessed that in the future Indians would consume much more mobile data, leapfrogging broadband almost entirely. However, what we did not predict was the emergence of an aggressive new competitor in the form of Reliance Jio.

Reliance, backed by Mukesh Ambani, Asia's richest man, is the largest conglomerate in India. Its new telecoms business came equipped with both extremely deep pockets as well as close connections with government ministers. Through predatory pricing, Reliance drove Indian data prices to the cheapest in the world, and Idea Cellular slumped to losses.

We sold the remaining Idea Cellular holdings out of Global Emerging Markets Sustainability on 12 February 2018, after Idea's share price had more than halved. It is certainly fortuitous that we did; the share price has fallen by more than 80% since then.

It is scant consolation that our narrow assessment proved correct; amazingly, Indians now consume the most (extremely cheap!) mobile data per capita of any country in the world³. The lesson is clear; growth alone is not enough. Idea's business model unfortunately lacked the resilience and pricing power to be able to generate attractive shareholder returns from that underlying volume growth. No matter what price you pay for an equity, the downside risk can be 100% if you don't invest in quality.

Long-term returns

It is the combination of quality plus growth that leads to superior long-term returns, as in the case of Marico. Compromising on quality of franchise by investing in Idea Cellular was a mistake. This is not entirely hindsight bias. We knew at the time the fragilities of telecoms businesses, but felt the data volume opportunity outweighed the risks. We were wrong.

It is our permanent mission as emerging markets investors to refine our ideas around quality and to continually raise the bar for the quality of companies we own for clients. Looking back over the last decade, we feel we certainly have done this. It is in fact all too easy to be embarrassed by the companies we held for clients many years ago! Plenty would not pass muster in our team today, and this is a very healthy sign of progress.

Emerging markets – expansion of the opportunity set

Looking forward, today feels like a more exciting time to be an emerging markets investor than any in the past ten years.

The number of exciting young companies coming to market – mostly but not entirely in China and India – is expanding the opportunity set rapidly^{***}. Many of these private, founder-led companies are in growth areas with formidable barriers to entry. Quite a number are global leaders in what they do; be that 3D inspection technology for advanced manufacturing (Koh Young, South Korea), uninterrupted power supply for data centres (Voltronic, Taiwan) or outsourced medical research (Syngene, India).

We are very optimistic that more than a few of these opportunities will flourish in emerging markets over the long run.

Jack Nelson

¹ Annual report 2016-2017

² Bloomberg L.P. 2021

³ Bloomberg Quint 16 June 2020

*Past performance is not a reliable indicator of future results.

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