WHAT COLUMBUS MISSED:

Royce Rediscovers India

By David Nadel

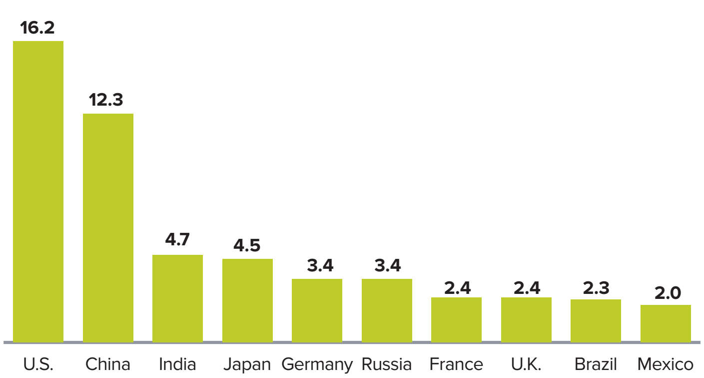
An Introduction to India

In 1492, Italian explorer Christopher Columbus set sail to discover India. He missed his mark, however, landing in America instead. The rest, as they say, is history—with the exception that more than 500 years later India is still worthy of discovery for many Western investors.

India is the world's largest democracy and Asia's third-largest economy. With its rapidly growing middle class, India is also the world's third-largest economy measured by purchasing power parity, and with a median age of just 25 years old, it will also soon have a fifth of the world's working-age population.[1] India's median age is 10 years younger than the U.S.'s and nine years younger than China's.[2] This demographic dividend sets the stage for growth.

Gross Domestic Product (GDP), 2012 by Purchasing Power Parity

IN TRILLIONS OF INTERNATIONAL DOLLARS[3, a]

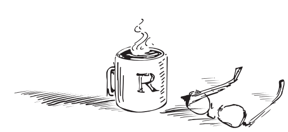


Two years ago, a massive treasure was discovered in Kerala, near India's southern tip. A remarkable $20 billion worth of gold and jewelry had been buried in an ancient temple. While India can sometimes be a challenging business environment, we believe its corporate landscape includes a number of undiscovered gems. My Royce colleague George Wyper and I recently visited the country to meet with 14 local companies to try and unearth some promising investments. This was our second visit together in three years, and my third in total.

WITH ITS RAPIDLY GROWING MIDDLE CLASS, INDIA IS THE WORLD'S THIRD-LARGEST ECONOMY MEASURED BY PURCHASING POWER PARITY.

We have taken the liberty of writing a more thorough and in-depth study on India than our usual country reports. While India has more listed companies than any other country,[4] we presume many of our readers may be less familiar with this market than, say, that of the U.S., Germany, or even China. Investors' attitudes toward India tend to alternate between extremes of worship and despair. We think a calmer middle ground is warranted for this market (and many others).

As of December 31, 2013, India is the fifth-largest country allocation of the Royce International Smaller-Companies Fund (RIS). Let's discover why we are somewhat more bullish than most.



RIS Portfolio Country Breakdown as of 12/31/13

% OF NET ASSETS*	
United Kingdom	12.9
Japan	12.5
Hong Kong / China	10.8
France	9.1
India	5.2

*Securities are categorized by the country of their headquarters.

India and the BRICs: Unloved, Underinvested

Over the past decade, the emerging markets (EM) have been responsible for the bulk of real GDP growth globally and now collectively account for more than half of the global economy. Yet the BRIC stock markets (Brazil, Russia, India, China) have dramatically underperformed global equities for nearly three straight years. To make matters worse, the Indian Rupee has been the weakest among the BRIC currencies over this period, further hurting performance from Indian equities for U.S. dollar-based investors. And within the Indian market, there has been an epic level of bifurcation between large- and small-caps. While the S&P BSE Sensex Index of India's 30-largest companies recently touched an all-time high on January 23, 2014, Royce's market-cap range as represented by the S&P BSE Small Cap Index was trading at press time some 55% below its 2008 high. Given this yawning gap in performance, we see the greatest opportunity and valuation cushion among India's small-caps.

While investors hoping to gain EM exposure have bid up the prices of large-cap multi-national corporations (MNCs) based in the U.S. and Europe, they have curtailed direct investment in EM companies. Foreign Direct Investment (FDI) for India contracted 30% in 2012 over 2011, returning to 2010's level of $25 billion, and has contracted still further in 2013, while investment by Indian corporations has likewise slowed for more than a year.[5] India's current account deficit can make it more vulnerable at times than some countries to capital outflows, putting it in the so-called "Fragile Five" of EM economies with similar profiles.[b]

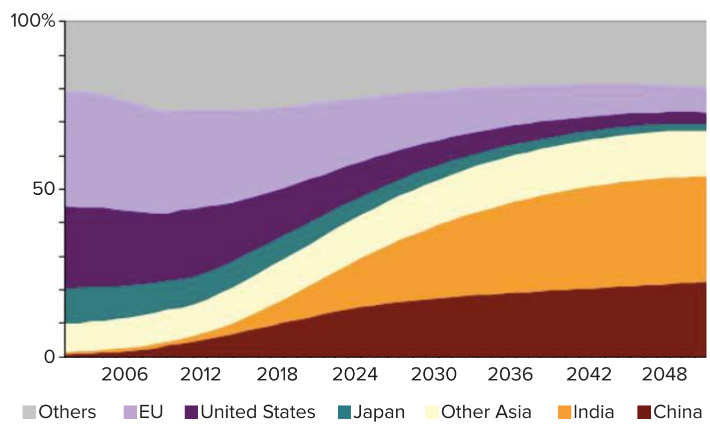
Yet even as most investors are running away, our investment view on India is cautiously optimistic. Its current account deficit has actually improved to just 1.2% of GDP, and its unemployment rate (4.7%) and even budget deficit (5.3% of GDP)[c] have likewise shrunk to manageable levels.[6] More importantly, for bottom-up stock pickers like Royce, we like that most of the Indian smid-cap companies with which we met are managed as much for returns (return on capital, return on equity) as they are for growth, an unusual calculus in the EM. Corporate India has generated the highest ROE (return on equity) among the BRIC economies, and among the highest ROE in all of Asia.[7]

David Nadel (left), Rohit Gupta (center) of JM Financial, and George Wyper (right) in Mumbai, India visiting Shriram Transport Finance, which lends to the country's used commercial vehicle market.

FASTEST GROWING MIDDLE CLASS

India's middle class is the fastest growing among the BRIC countries, and has expanded by 35% in the past decade.[8] At current rates of growth, India in just eight years will have as many households with disposable income of $10,000+ as the U.S. or the eurozone.[9] By 2030, India is expected to have more members of the middle class than any other country, including the entire EU.[10] Put another way, India's middle class is expected to outnumber the entire U.S. population by sometime before 2025.[11]

Shares of Global Middle Class Consumption, 2000-2050[12]

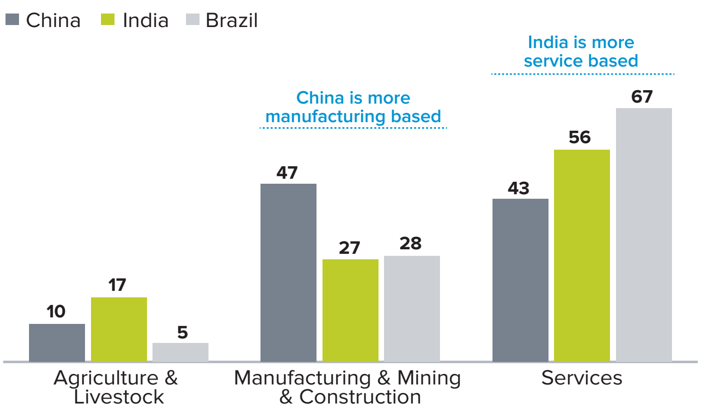


Comparisons of India's economic miracle to China's are inevitable for Westerners, who have even coined the phrase "Chindia" to combine the two powerhouses. However, the face of economic growth is quite different in the two countries. For one, India is not a command economy but rather a democracy with a much smaller government. State-owned enterprises (SOEs) comprise only 14% of India's market cap versus 73% of China's.[13] Government services are spartan, at just 15% of GDP.[14] The government's revenue-collection capacity is limited, with only 3% of Indian citizens paying income tax.[15]

India's business leadership is more independent of government than is China's, and Indians have excelled at industries that do not require heavy government support, such as pharmaceutical manufacture and information technology.[d] Half of the world's FDA-approved pharmaceutical facilities are in India. IT services behemoth Infosys was famously founded with $250 and today commands a market cap of $30 billion.[e]

India excels at service industries while China's economy is more manufacturing oriented[16]

GDP BY INDUSTRY (%)



The second, and more important, difference versus China is the composition of that middle class growth. In contrast to China, where the middle class expansion has been driven disproportionately from cities (arguably creating an unstable socioeconomic divide between cities and the countryside), India's development has been largely fueled by a game of rural catchup, in our view creating a potentially more sustainable growth model over the longer term.[f] While urban India is still wealthier than its countryside—the 100 biggest cities account for 43% of GDP with just 16% of the country's population—its rural economy is advancing more rapidly.[17]

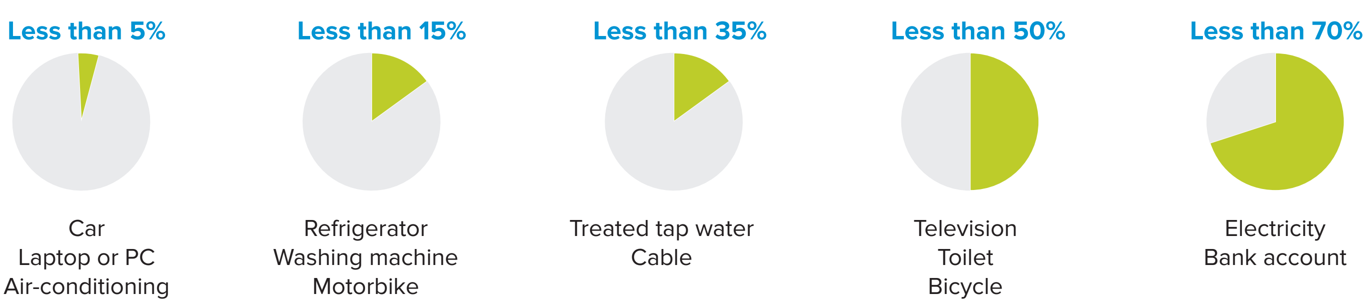
INDIA'S "RURAL REVOLUTION"

India's "rural revolution" can be traced to a number of sources, including government policy. Programs such as MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) have diversified the rural economy away from farming and effectively increased long-depressed wage rates. Whereas farming comprised nearly two-thirds of rural employment in 2000, now it is closer to 40%, replaced by more stable and less seasonal jobs in various services.[18] Annual growth in rural wages rose at an annual rate of 16% in seven years, almost double the pace of inflation during this period.[19] Rural land is now used for a broader range of purposes beyond farming, even as farming yields themselves have improved. Accordingly, land values have advanced five to 10 times and more in the last decade, unlocking massive collective spending power.[20] With so much pent-up demand, the rural Indian consumer product market is expected to triple to $650 billion over the next decade, making it roughly the size of Switzerland's entire economy.[21]

The penetration of mobile phones in rural India provides an inkling of future growth and demand when it comes to consumer products we in the U.S. often take for granted.[g] Starting in 2001, mobile phone subscriptions grew exponentially in just 10 years, reaching 900 million subscribers (about 86% penetration), driven largely by Bharti Airtel whose boss Sunil Mittal is one of India's wealthiest billionaires.[22] Hindustan Unilever, the Indian subsidiary of Proctor & Gamble rival Unilever, minted more than $800 million of pre-tax profit for the fiscal year ended March 2013 selling consumer goods via 6.5 million retail locations across the country.[23]

As India's middle class growth has deepened, consumer spending on basics like food has been replaced by outlays on discretionary services such as private education, healthcare, and travel. Eighty-five percent of rural households surveyed

What's next in India's consumer story? Consider these penetration rates:[24]



have increased expenditures during the last several years on these three categories.[25] Life expectancy has advanced six years to 66 in the last 15 years, and the Indian private care and healthcare market is expected to grow at a remarkable 15% rate per annum through 2020.[26] Travel comprises 11% of the consumer spending bucket today versus just 3% 10 years ago.[27]

Demand for such services is likely to grow robustly, in our view. Barely 10 million Indians travel abroad annually (just 0.8% of the population), versus 70 million Chinese (5.2%) in 2011.[28]

A family shopping outside a bazaar in Bangalore listens to a sales pitch.

Royce International Smaller-Companies Fund currently holds Thomas Cook India (TC on the BSE), whose CEO we met at their colonial-era headquarters in Mumbai. One of the most trusted brands in Asian travel, Thomas Cook India has operated in the country for more than 130 years and generates 20%+ pre-tax ROE, with scope for improvement. Indian-born uber-investor Prem Watsa, whose Fairfax Financial has compounded book value at 25% per year from 1985 through 2010 and which many regard as Canada's answer to Warren Buffett's Berkshire Hathaway, recently acquired the majority shareholding formerly held by TCI's U.K.-based parent.[29]

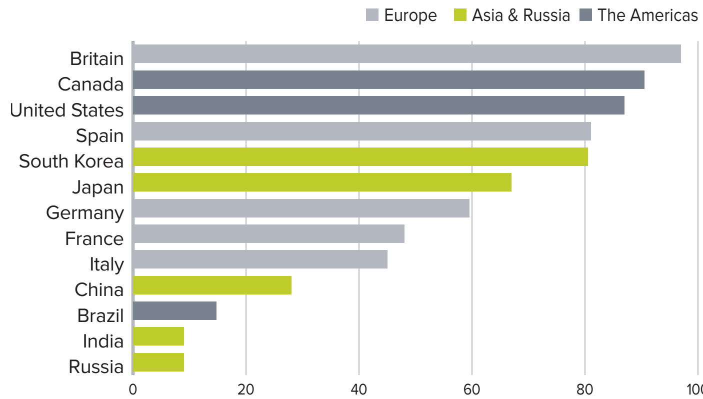
Room for growth: India has the lowest private consumption rate per capita among the world's 10 largest countries[30]

12 MOST POPULOUS COUNTRIES	POPULATION MILLIONS	PRIVATE CONSUMPTION US$ TRILLIONS	CONSUMPTION PER CAPITA US '000
U.S.	313	10.7	34.2
Japan	126	3.6	28.1
Brazil	197	1.3	6.8
Russia	143	0.9	6.0
Mexico	115	0.7	5.8
China	1348	2.6	1.9
Indonesia	242	0.4	1.8
Philippines	95	0.2	1.7
Pakistan	177	0.2	1.0
India	**1241**	**0.9**	**0.8**

We believe credit growth is set to advance rapidly in India over the next several years. As a percentage of GDP, household debt and mortgage penetration are only approximately 12% and 10% in India, respectively, versus roughly 95% and 80% in the U.S., respectively.[31]

India has among the lowest household debt of any country as a percentage of GDP[32]

HOUSEHOLD DEBT, % OF GDP, LATEST



Non-performing loans are actually lower in India, as is public debt as a portion of GDP at 66% for India.[33] Fewer than 20% of rural Indians have loans at all.[34] Shriram Transport Finance (SHTF on the BSE), founded in 1979, is India's number one lender to the used truck market, with a 25% national share. Royce International Smaller-Companies Fund currently holds shares, as we are attracted to its under-banked market, its fragmented customer base of more than one million serviced by loan officers embedded in the local communities, its conservative balance sheet (Tier 1 capital is 30% above the requirement), and its high returns (pre-tax ROE has averaged 30%+ over the last 10 years).

TRADE INTEGRATING INDIA GLOBALLY

India has been a free-market economy for more of its history than most of today's free-market countries. During India's period of global dominance in the 1600s and 1700s when it accounted for one-third of the world's wealth, the East India Company many of us studied in grade school functioned as the key global hub for essential materials such as cotton, salt, and tea. India's "closed" period of 1947-91 was actually more of an aberration than the rule. Today, foreign trade comprises nearly half of GDP versus just 16% 20 years ago.[35] The U.S. is India's third-largest trading partner, surpassed only by China and the Gulf Cooperation Council (i.e., the United Arab Emirates and Saudi Arabia). Cross-border mergers have further integrated India into the global economy, whether India is the acquirer (e.g., Tata Steel's $13 billion acquisition of Corus and Tata's $2 billion acquisitions of Jaguar/Land Rover) or the target (e.g., Vodafone spent $11 billion for Hutchison Telecom; BP invested $7 billion in Reliance).

David Nadel, Chuck Royce, and George Wyper in Mumbai. The city's ubiquitous three-wheel taxis provide economical—and breezy—transportation between company meetings.

Meanwhile, India is asserting itself more as an exporter. Family-controlled Bajaj Auto, for example, exports 1.6 million motorcycles and three-wheelers a year, mostly to the MENA (Middle East and North Africa) region.[36] One company riding Bajaj Auto's coattails as a supplier is FAG Bearings (FAG on the BSE), India's number two manufacturer of ball bearings and a long-held investment in Royce International Smaller-Companies Fund. Founded in 1962, FAG Bearings has generated 30%+ pre-tax ROE and has compounded revenue growth at 20% over the past decade without the benefit of acquisitions.[37] Another export-oriented holding is Ipca Laboratories (IPCA on the BSE), which has compounded revenue growth of 20%+ for the last five years—with 20%+ ROIC—by selling anti-malarial medications to Africa and cardiovascular drugs to Europe.[38]

To be sure, sometimes India's government helps its local companies a little too much. An Indian underwear manufacturer we met with is effectively shielded from external competition with a chunky tariff equivalent to the cost of production. Perhaps such policies explain why India hasn't succeeded as a textile/apparel exporter to the extent Asian peers such as Cambodia, Sri Lanka, Indonesia, and Bangladesh (infamously, as of late) have. Admittedly, protection like this is more common among predominantly free-market countries than many may know, including in France, Brazil, and right here in the U.S.[h] Indian companies have found themselves on both sides of tariff policies. Maharashtra Seamless (MHS on the BSE), a manufacturer of pipe used in oil and gas, has suffered from the cheaper Chinese pipe which has flooded the Indian market, even as Europe, Latin America, and the U.S. have imposed stricter tariffs on Chinese dumping than India itself has.

Interestingly, India's manufacturing base hasn't grown much as a percentage of GDP (15% currently) since the 1960s.[i] But of course it has grown rapidly on an absolute basis, and we have not been hard pressed to find high-quality, export-driven manufacturers in which to invest. Family-controlled Graphite India (GRIL on the BSE) runs a tight ship manufacturing graphite electrodes, a global oligopoly market serving the electric arc furnace production of steel. AIA Engineering (AIAE on the BSE) is the global number two manufacturer of chromium grinding balls used by the mining and cement industries, and like Graphite India is a holding in Royce International Smaller-Companies Fund. AIA has averaged revenue growth of 30% and ROE 20%+ for more than a decade,[39] reflecting the benefits that accrue to companies whose product sports a low cost of ownership (inconsequential percentage of customers' costs) but a high cost of failure (customers don't want to risk a costly plant shutdown by using cheaper grinding alternatives).

Local women in colorful saris reflect India's rich and vibrant culture.

CULTURE AND THE WESTERN INVESTOR

India's culture stretches back 5,000 years. It is a remarkably diverse country socioeconomically, religiously, and culturally. In essence, India might correctly be seen not so much as one large culture but rather an amalgamation of many. The country has nearly 400 living native languages, and each of its 28 states has at least one official language in addition to the dominant English and Hindi.[40] Cuisine from one region can be almost unrecognizable from another. Some are strictly vegetarian, others meat-centric. Some are bland and light, others rich or impossibly spicy. Although known in the developed world for its hierarchical (and increasingly irrelevant) Hindu caste system, India is actually quite open and inclusive in many ways. Among its unifying cultural institutions, Bollywood is the world's most productive movie industry.

At the same time, India can seem confusing or even off-putting at times to Western investors. Its cities can be chaotic, smelly, and dusty, with slums rarely far away. My wife and I spent two months in India during a year of travel touring 22 countries, and its poverty was more striking than that of any country we visited except Burma. In India, if we planned to accomplish three things in a given day, we were lucky if one or two of them happened, owing to bureaucracy and a common lack of urgency.

Communication can be quirky. “Horn please” and “Use dipper” are often written prominently on the back of trucks, a direct appeal to drivers wishing to pass to honk and shine their bright lights with seeming abandon. The famous silent head-bob is a curious gesture with so many potential meanings (including “yes,” “I understand,” or “you’re welcome”) that a foreigner can easily be confused.

Road travel is rarely dull and can seem chaotic at times.

EDUCATION AND THE “MISSING MIDDLE”

Education may hold the key to India’s economic future. Gains in literacy have been impressive; three-quarters of India’s population are literate today versus a little over half just two decades ago.[41] However, the economy must absorb an average of 10 million new workers each year, many of whom are poorly educated. This has been dubbed the “missing middle” of employment. Only one million of India’s 500-million-strong workforce are actually in the world-famous IT services sector, and few of these are alums of universities such as the elite Indian Institutes of Technology. By comparison, the textiles industry employs 20 million and agriculture far more. Too many urban jobs are menial: We noticed several elevator operators in modern push-button elevators designed for self service. Rickshaw drivers and security guards are ubiquitous, but the latter were rarely vigilant during our visits to office buildings, even manning metal detectors. Some ad-hoc jobs are admittedly enterprising, e.g., this knife sharpener using the rear wheel of his stationary bike as a sharpening device and mobile office.

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India’s public education system is overwhelmed and inadequate, though education has improved overall since the government’s Right to Education Act mandated free schooling for children ages six to 15. Encouragingly, parents are increasingly taking matters into their own hands. Today, nearly 40% of schools are private, funded by parents, while 40% of all Indians consume some sort of private education, including tutoring.[42] On average, Indians spend 7.5% of their income on education. Not surprisingly, Indians achieve a commensurate presence in the world’s most prestigious universities, including those in the Ivy League.

FROM 1993 THROUGH 2007, INDIA’S ECONOMIC GROWTH AVERAGED A REMARKABLE 6.5% REAL PER YEAR, MORE THAN TWICE THE U.S.’S PACE OVER THOSE 15 YEARS.

PIVOTAL ELECTIONS: REFORM REDUX?

From 1993 through 2007, India’s economic growth averaged a remarkable 6.5% real per year, more than twice the U.S.’s pace over those 15 years.[43] With the benefit of hindsight, the 1991 economic reforms are credited with helping to stoke this period of extraordinary advancement, which lifted more than 200 million Indians out of poverty.[44] These reforms aimed to return India closer to its free-market roots, phasing out the comparatively isolated and bureaucratic License Raj period of 1947-1991, which has been called “a surreal mix of Soviet stupidity, British pedantry and Indian improvisation.”[45] The ’91 reforms not only transformed India socioeconomically, but also restructured business arrangements that had become too cozy—of India’s 20 largest companies in 1990, for example, only

India GDP Annual Growth Rate 1992-2002[46]

five survive today in their original form—and proved that India's government could be effective under the right leadership.

India is facing pivotal elections in May, and another period of economic reform and liberalization may be needed to return to higher growth, which has decelerated since 2010's 9.3% growth rate. India's economy is expected to expand by "only" 4-5% real this year, a multi-decade low (albeit a respectable achievement by Western standards). The center-left Congress party is the party of Mahatma Ghandi, whose multi-decade struggle culminated in 1947 with India's independence from British rule. Congress has been dominant since and has ruled uninterruptedly for the past decade. Despite its storied history, it is today looking somewhat defensive, tired, and insular, as reflected in its dismal opinion poll showings.[47] Some of its practices and policies during the past two administrations have been perceived as unfriendly to business. Wal-Mart, Tesco, and Carrefour, for example, are still waiting for clarity to invest, as Congress has tried to shield India's archaic retailing sector from the efficiencies of the modern world. Similarly, the administration has dragged its feet on allowing Vodafone to buy out its Indian affiliate.

CONGRESS REELING, BJP RISING

Eighty-one-year-old Congress leader Manmohan Singh, who achieved a laudatory nuclear agreement with the U.S. in 2006 under then-President George W. Bush, is broadly viewed today as ineffectual domestically.[48] By contrast, the popular ascendency of Narendra Modi of the opposition Bharatiya Janata Party (BJP) could shake things up. Dubbed NaMo locally, Modi is the comparatively pro-business candidate who strikes a chord not unlike the one Margaret Thatcher played when challenging Britain's entrenched Labor party in the 1970s. Modi's state of Gujarat represents the closest thing to an economic miracle among India's 28 states, producing a quarter of India's exports with just 5% of its population, and has attracted copious investment and plaudits for its excellent roads and infrastructure.[49,j] Modi and BJP were generally preferred by the corporate managements with which we met, and polls reflect the party's high level of support among India's more educated and economically productive segments.[50] He is, however, seen as a polarizing figure, particularly given his roots as a Hindu nationalist; Hindus comprise approximately 82% of Indians, with Muslims representing the largest minority at around 13%, followed by Christians and others. Naysayers fault Modi for turning a blind eye towards Muslim riots a decade ago in Gujarat which left 1,000 dead. The U.S. and some European countries had instituted a travel ban on him for this reason, although only the U.S. maintains it.

MODI'S STATE OF GUJARAT REPRESENTS THE CLOSEST THING TO AN ECONOMIC MIRACLE AMONG INDIA'S 28 STATES, PRODUCING A QUARTER OF INDIA'S EXPORTS WITH JUST 5% OF ITS POPULATION, AND HAS ATTRACTED COPIOUS INVESTMENT AND PLAUDITS FOR ITS EXCELLENT ROADS AND INFRASTRUCTURE.

More recently, Congress may have shot itself in the foot with a ham-fisted attempt this fall to try to ban political polling after such surveys reflected their weakening standing versus

Modi and the BJP.[51] While Congress has effective means for mobilizing the sympathetic rural and poor vote, Indians in general have a fairly reliable history of voting out incumbents with low poll ratings. Indeed, in the final test of the two parties before May's prime ministerial elections, BJP swept all four of the state-wide elections against Congress in November. Momentum is on their side.

The threat to Congress comes not only from Modi's BJP, but also from the public's increasing dissatisfaction with graft and charges of crony capitalism. Such discontent has fueled the ascendancy of another political party, the Aam Admi Party (AAP), whose leader Arvind Kejriwal employs a broom to symbolize sweeping away graft. After winning 28 of 70 seats in Delhi elections in December, AAP is being seen as a wild card that could play the spoiler role in May's national elections. Although AAP has garnered the sympathy of some prominent business leaders, its pockets of support are so far limited to a few urban areas and may fade given it is largely seen as an untested and "one-issue" party.[52]

The Taj Mahal at sunrise, possibly the most majestic building I have ever seen—it took 22 painstaking years to be constructed in the 1600s.

Unlike China or Russia, India as a democracy wears its problems on its sleeve, so to speak. Its politics can be messy, but I believe investors should cheer this soul searching and openness. Perhaps India's alleged crony capitalism will turn out to be analogous to an adolescent phase along the path towards fairer wealth distribution, much like our own Robber Baron era dominated by the Astor, Carnegie, Duke, Gould, Mellon, Rockefeller, and Vanderbilt patriarchs. One promising indication is that India's business elites are increasingly opting to stay in India or return to India. Not long ago, Indian elites making their fortunes in Silicon Valley (tech), Singapore (banking), Dubai, or even Mauritius tended to stay there.

AS IN MANY EMERGING MARKETS WITH HIGH INTEREST RATES, INFLATION AND RATES ARE BOTH FAR HIGHER THAN WHAT WE AMERICANS ARE ACCUSTOMED TO.

RAJAN AND INFLATION

Reserve Bank of India (RBI) Governor Raghuram Rajan, the equivalent to U.S. Fed Chair Ben Bernanke or Janet Yellen, has been widely embraced by the investment community for championing transparency, the curtailment of regulations, and helping to arrest the slide this past summer in India's currency, the rupee. One of Rajan's key challenges is taming India's surging inflation. Rajan recently increased the repo rate to 8.0%, the central bank's third increase in five months.[53] As in many emerging markets with high interest rates, inflation and rates are both far higher than what we are accustomed to. India's core inflation, which excludes volatile food and fuel prices, has moderated to 2.6% while wholesale price inflation spiked to 7.5% and consumer inflation spiked to a dizzying 11.5%, in part driven by rupee weakness.[54] Rajan's policies will also of course impact the rupee, historically a far weaker currency than the U.S. dollar. The rupee/U.S. dollar cross briefly flirted with 70 in August when the anti-BRIC investor sentiment had reached a fever pitch, and has since moderated to 62, still representing sizable weakening versus the 54 level at which it started in 2013.

With such a currency, India's popular use of gold for savings should come as no surprise. Gold imports account for a whopping 3% of GDP, roughly what the entire citizenry pays in income taxes.[55] Indians in general have a strong savings culture, with consumer savings accounting for about 30% of GDP versus about 4% in the U.S.,[56] and about half of India's savings are held in hard assets, principally gold.

With all that gold squirreled away across India, perhaps there's another Kerala-like gold treasure just waiting to be discovered. But at Royce, we'll continue to focus on what we do best in India and around the globe: attempting to find high-quality smaller companies for our portfolios. ■

Endnotes

a. The Geary-Khamis dollar, commonly known as the international dollar, is a hypothetical unit of currency that has the same purchasing power parity that the U.S. dollar had in the United States at a given point in time.

b. The other four members of the so-called "Fragile Five" are Brazil, Indonesia, South Africa, and Turkey, all markets in which Royce is invested.[57] One of the key drivers of India's current account deficit is its dependency on energy imports, with 80% of oil being imported.

c. India's budget deficit has been a persistent problem and has exceeded 7% of GDP in 12 of the last 15 years.[58]

d. Several of India's 55 billionaires hail from these two sectors. Further, many are self-made entrepreneurs, including the Ambani family ($27 billion, Reliance Industries) whose patriarch rose from a gas station attendant; Dilip Shanghvi ($14 billion net worth, founder of Sun Pharma); Azim Premji ($14 billion, Wipro); Shiv Nadar ($9 billion, HCL Technologies); Sunil Mittal ($6 billion, Bharti Airtel); and Uday Kotak ($4 billion, banking).[59]

e. China's business leaders frequently owe their success to government ties, and many subsequently serve in government to return the favor; interestingly, the collective wealth of the 50 richest members of China's National People's Congress is nearly $100 billion (versus less than $2 billion for the 50 wealthiest American Congressman).[60]

f. India has 53 cities with a population exceeding one million inhabitants, compared to 160 such cities in China.[61]

g. The rapid penetration of mobile phone in rural markets has been a boon to farmers; immediate communication means access to transparent pricing, which has all but eliminated the middlemen who used to be wedged between farmers and farm markets, allowing the farmers to realize their full profit margins for the first time.

h. France has been criticized for the distortionary effect of its agricultural subsidies, and Brazilian import tariffs are so prohibitive in many industries that foreign manufacturers are essentially forced to set up plant locally if they want to serve the country. Here in the United States, the average family pays more than $5,000 a year in subsidies, benefiting everything from farming (subsidized more than $50 billion a year) to the oil & gas sector ($7 billion annually, and a bit of an oddity in the age of $100 oil).[62]

i. The perception of India as an agrarian economy is outmoded; agriculture accounts for only 17% of GDP versus 56% for services and 27% for industry.[63]

j. Nationally, India's road quality is wanting and can be atrocious in some places. Road networks have been expanding nationally at a 4% annual rate, dramatically behind annual traffic growth of 11%.[64]

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Percentage of Fund Holdings as of 12/31/13 (%)

	RIS	RES	RIP	RGV	RGD	RMI	RGT	RVT
Infosys	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Thomas Cook India Ltd	0.70	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Fairfax Financial	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Shriram Transport Finance	0.71	0.00	0.00	0.00	0.00	0.00	0.00	0.09
Bajaj Finance	0.00	0.00	1.65	0.00	0.00	0.00	0.00	0.00
FAG Bearings India	0.81	0.00	0.00	0.00	0.00	0.85	0.00	0.05
Ipca Laboratories	0.71	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Maharashtra Seamless	0.63	0.00	0.00	1.36	0.00	0.00	0.00	0.16
Graphite India	0.68	0.00	0.00	1.27	0.78	0.65	0.00	0.03
AIA Engineering	0.86	0.00	0.00	0.00	0.00	0.77	0.00	0.00

There can be no assurance that any of the securities mentioned in this piece will be included in these portfolios in the future.

Important Disclosure Information

David Nadel is Director of International Research and a portfolio manager of Royce & Associates, LLC, investment advisor to The Royce Funds. He is the portfolio manager of Royce International Smaller-Companies Fund (RIS), Royce European Smaller-Companies Fund (RES), and Royce International Premier Fund (RIP). He also assists on Royce Global Value Fund (RGV), Royce Global Dividend Value Fund (RGD), Royce International Micro-Cap Fund (RMI), Royce Global Value Trust (RGT), and Royce Value Trust (RVT). The thoughts expressed in this piece are solely those of Mr. Nadel and may differ from those of other Royce investment professionals, or the firm as a whole. Mr. Nadel's thoughts and opinions are given rendered as of the date of each posting and may change without notice. This piece is not intended to be investment advice or a recommendation to invest in any securities, region, or country. There can be no assurance with regard to future market movements. Data from third-party sources used in the preparation of this piece may not have been independently verified by Royce, and Royce does not guarantee its accuracy. The historical performance data and trends outlined are presented for illustrative purposes only and are not necessarily indicative of future market movements.

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