28 February 2018

India Capital Growth Fund*

Quality matters

Fund in the spotlight: IGC

Discount, 10% as at 23 February 2018

Source: Bloomberg

Stock selection will play an increasingly important role in driving equity returns as rates increase in developed economies. The team managing the India Capital Growth Fund (IGC) believes that most companies in the fund's portfolio are of higher quality than the benchmark index, while trading at similar valuations. The Indian economy is adjusting to two key policy events which slowed earnings growth in several companies over the last year. Earnings are now recovering from these shocks and the team expects companies in the IGC portfolio to realise total growth in EPS of c.58% over the next two financial years. We strongly believe that the long-term growth opportunities offered by India will be best captured by a fund like IGC. Given its historic performance relative to both the benchmark index and its peer group, we recommend that investors buy IGC for its exposure to Indian equity markets.

India looks overvalued but may experience only a modest correction

The Indian economy is still adjusting to two major challenges that it has faced over the last 14 months: demonetisation and the introduction of the Goods and Services Tax (GST). GDP growth in India has slowed and inflation has accelerated, partly driven by the rising oil price. Domestic demand for equity market investing remains resilient, asset managers continue to see inflows and we do not see this trend changing. Given India's demographic profile the equity allocation of investors is likely to continue to grow. We strongly believe that a well-constructed portfolio of high quality mid- and small-cap companies will provide superior returns for investors over the long term. We believe IGC deserves a premium rating given its track record and the projected earnings growth of the portfolio.

Table 1: IGC NAV TR vs. benchmark and peer group as at 31 January 2018 (% returns)

	3 months	6 months	1 year	3 years	5 years
IGC diluted NAV TR	-1.7	4.3	26.2	57.8	120.3
IGC undiluted NAV TR	-1.7	4.3	26.2	67.2	156.0
S&P BSE 200 Index TR	0.8	2.7	21.8	32.8	90.0
MSCI India NR Index	0.6	2.5	21.7	29.9	68.0
JPMorgan India (JII) NAV TR	-0.7	0.9	21.8	32.8	90.0
Aberdeen New India (ANII) NAV TR	1.1	1.4	23.3	35.2	99.4

Source: Morningstar, Ocean Dial, Stockdale estimates

IGC's portfolio should see rapid earnings growth

We are cognisant of the increased short-term volatility that investors might experience due to higher valuations. The re-rating of some of the companies in the portfolio has forced the IGC team to look at somewhat smaller companies as well. However, Gaurav Narain, the Investment Advisor, and his team continue to focus on the quality of management in the companies and the long-term earnings growth potential of the companies entering the portfolio. Liquidity in IGC has already improved substantially and should be further boosted following the fund's listing on the Main Board of the London Stock Exchange. Given the superior earnings growth profile (typically 18-20% per annum, over the last five years) and the quality bias in the portfolio we believe the discount could contract further. Compared to its peers, Ocean Dial has a significant size advantage when it comes to selecting small and mid-cap stocks. We continue to recommend that investors buy/hold IGC as their core holding in India.

Priced at close
23 February 2018

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*Stockdale acts as broker and/or advisor to this company and has agreed to publish research on it at least annually. This research may be distributed free of charge as a minor, non-monetary benefit.

Buy India Capital Growth Fund* (IGC)

Given current valuation levels and the issues affecting global markets, we think the key to realising returns from equity markets is stock selection, hence we continue to recommend that investors buy IGC for exposure to India's equity markets. In our view, small and medium companies have the best chance of benefitting from India's GDP growth, which we believe is set to accelerate.

India's GDP growth picking up. Inflation levels mildly positive for earnings gowth

India's macro-economic situation is in the process of stabilising following two shocks in the past 14 months: demonetisation and the introduction of the GST. However, the decline in GDP growth is showing signs that it has bottomed and while these shocks dented India's short-term growth prospects, the team managing IGC believes growth is set to accelerate with full-year GDP growth for the financial year ending March 2019 of c 7.5%. Inflation, which had fallen sharply over the medium term, is now at a level where the Reserve Bank of India (RBI) does not need to ease policy further. Equally, if oil prices remain range bound we believe that the RBI will not need to increase rates dramatically. Narain believes that the current level of inflation is mildly positive for earnings growth of companies held in the IGC portfolio.

Figure 1: India real GDP growth (%, YoY)

Source: Bloomberg

Figure 2: India CPI inflation (%, YoY, NSA)

Source: India Central Statistical Organisation

IGC's strong performance has led to a re-rating. Move to the premium segment of the LSE should further enhance appeal

IGC has re-rated as investors have gained confidence in the approach adopted by the team led by David Cornell and Gaurav Narain. Over the last few years the size of the fund has increased, partly due to a subscription share issue, but mainly due to strong gains and the market cap is currently c.£116m. The market has rewarded this strong relative performance versus both the benchmark index and the peer group by substantially narrowing the discount at which IGC trades. We have argued that if the fund continues to perform this strongly, IGC is likely to trade close to NAV or at a small premium. The liquidity of IGC has improved and recently the average daily traded value tends to be higher than ANII. IGC has recently moved to the premium listing segment of the London Stock Exchange's main market which should further enhance the appeal of IGC.

Elisabeth Scott has joined the board as chairman in December 2017

We also note that Elisabeth Scott was appointed to the board as chairman on 18 December 2017. She has 25 years' experience in the asset management industry, having started in Hong Kong in 1992 where she remained until 2008, most recently in the role of managing director and country head of Schroder Investment Management (Hong Kong) and chairman of the Hong Kong Investment Funds Association.

Gaurav Narain, the portfolio advisor of IGC, has been involved with the fund since October 2011. The fund looks to invest predominantly in mid-cap companies that operate in markets where they can defend and grow their earnings and translate these into cash returns on investment. The team, led by David Cornell, the CIO at Ocean Dial Asset Management, has instituted a strong focus on liquidity that should allow the fund to exit positions quickly should the fundamentals deteriorate. In practice, turnover is low (13% per annum since 2013) as most of the 30-40 stocks that constitute the portfolio have tended to be what Gaurav Narain would term as compounding machines, delivering consistent long-term earnings growth. The team tends to use cash flow models for companies, which generally go back as far as ten years, and typically monitors about 300 names.

Table 2: Top ten holdings and sector breakdown of IGC as at 31 January 2018

Holding	Sector	%	Sector	%
Dewan Housing	Financials	5.5	Financials	24.3
Motherson Sumi Systems	Consumer Discretionary	4.5	Consumer Staples	9.1
NIIT Technologies	IT	4.3	Materials	20.4
Ramkrishna Forgings	Materials	4.2	Consumer Discretionary	17.3
Federal Bank	Financials	4.1	Consumer Staples	9.1
Finolex Cables	Industrials	3.4	Industrials	10.4
Tech Mahindra	IT	3.3	IT	7.6
Jyothy Laboratories	Consumer Staples	3.1	Real Estate	3.1
Capita First	Financials	3.0	Healthcare	3.1
Sobha Developers	Real Estate	2.9	Cash	4.7

Source: Company data

Portfolio focused on high quality mid and small cap companies with strong growth prospects

The portfolio is entirely driven by bottom-up stock selection. Thus, the sector representation in the fund is a derivative of the stock selection process. Equally, as part of the risk management process the team will limit aggregate exposure to any given industry. The management team will typically use downside volatility to exploit irrational behaviour. While valuations tend to be significantly higher than those typically encountered in an emerging market portfolio, Narain believes that this can be justified by the quality of the companies in the portfolio and the long-term sustainability of the businesses. Equally, he is happy to pay higher multiples where he has reasonable visibility on earnings that might grow significantly.

Narain has historically avoided public sector banks because of the lack of proper risk management procedures

One of the key distinguishing features of IGC is the discipline Narain and his team employ while choosing companies to invest in. Despite a heavy weighting in financials, Narain has tended to avoid public sector banks. While valuations look attractive on a price to book (P/B) basis, the lack of proper risk management procedures at various government banks has meant that Narain has tended to invest in private sector financial companies. As one would expect, occasionally investments can go wrong. If they do, Narain and his team investigate the prospects extensively and decide whether to cut the position, continue with the existing investment, or add to the position.

While the turnover of the portfolio has been low historically we have seen several new entrants to the top 10 stocks in the portfolio. These include NIIT Technologies (NITEC IN) and Capital First (CAFL IN). Narain highlights that the technology sector is trading at extremely attractive valuations as investors have labelled the sector as ex-growth. Narain has had a position in NIIT Technologies for the last four years and believes that the company is well positioned to increase its earnings substantially. The company is currently trading at 16.6x March 2019 earnings. Other IT stocks held by IGC include Tech Mahindra (TECHM IN), which is trading at 16x March 2019 expected earnings.

Figure 3: NIIT Technologies share price (INR)

Source: Bloomberg

Figure 4: Tech Mahindra share price (INR)

Source: Bloomberg

Capital First (CAFL IN) focuses on the financial requirements of micro-, small- and mid-cap enterprises. They use data mining technology to assess credit worthiness and have developed innovative ways to screen credit applications. Following their proposed merger with IDFC Bank (IDFCBK IN), the combined entity is likely to emerge as one of the dominant players in SME financing.

Figure 5: CAFL share price (INR)

Source: Bloomberg

Figure 6: BLSIN share price (INR)

Source: Bloomberg

IGC's ability to acquire reasonable sized position in high quality smaller companies without significantly impacting the price of the underlying securities is one of the fund's key strength

The ability of IGC to acquire a reasonable sized position in high quality smaller companies without significantly impacting the price of the underlying securities is one of the fund's key strengths in our opinion. One relative new entrant in the portfolio is BLS International Services (BLSIN IN). BLSIN manages non-judgmental and administrative tasks related to application processing, enabling client governments to focus entirely on the critical task of assessment. It entered the business in 2005 when it became a service provider to the Embassy of Portugal. It is one of the few competitors to VFS Global and it has recently won the contract from the Spanish government to process visa applications to Spain. In addition, state governments like Punjab are outsourcing e-governance projects to companies like BLSIN thus providing another key source of growth.

Narain is positive on the infrastructure space as he sees continued investment in the sector. However, he is cautious on buying into companies operating in the infrastructure space and has therefore chosen to gain most of the exposure via cement companies. These include Sagar Cements (SGC IN, 2.7% of NAV as at 31 January 2018) and Ramco Cements (TRCL IN, 2.5% of NAV as at 31 January 2018).

Figure 7: SGC share price (INR)

Source: Bloomberg

Figure 8: TRCL share price (INR)

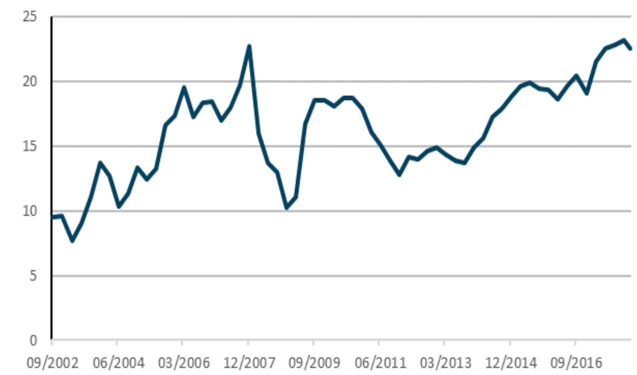
Source: Bloomberg

Imposition of long-term capital gains tax is a short-term negative for Indian equity markets

The election victory for the Bharatiya Janata Party (BJP) in India's most populous state, Uttar Pradesh, has helped boost the party's chances of re-election to government in the elections scheduled for 2019. The slight setback that the ruling BJP had in state elections in Gujarat has meant that the February 2018 budget presented has focused on rural welfare and has imposed long-term capital gains taxes on the equity market. The fact that gains up to 31 January 2018 are grandfathered has meant investors do not have to indulge in panic sales to lock in gains. It temporarily reduces the attractiveness of India's equity markets, which has in part contributed to its recent weakness. The slippage in the fiscal deficit targets for this year (FY18) from 3.2% to 3.5% and for next year (FY19) from 3.0% to 3.3% combined with rising inflation to 5.2% for December, is reflected in 10-year government bond yields rising to 7.6%.

If the upcoming state elections in Chhattisgarh, Rajasthan and Karnataka show a further increase in support for the Congress party then the equity markets might begin to price in a higher risk of political instability in 2019.

Figure 9: BSE 200 Index P/E ratio



Source: Bloomberg

Figure 10: BSE 200 historic performance in sterling terms

Source: Bloomberg

A further rise in oil prices may hurt Indian equities if the RBI is forced to raise interest rates

Oil prices are a key short-term risk for both the Indian economy and its equity markets. A further sharp increase in the oil price would invariably force the RBI to raise interest rates. The risk of a substantial correction from such a shock is high, given the elevated valuations at which the equity market is trading. However, given the increase in shale oil production in the US, we believe that a further sudden sharp increase in oil prices is unlikely and hence our base case scenario for the broader Indian equity market is one of a time correction.

Figure 11: US total oil production (000 of barrels)

Source: US Department of Energy

Figure 12: Brent Crude prices (US$)

Source: Bloomberg

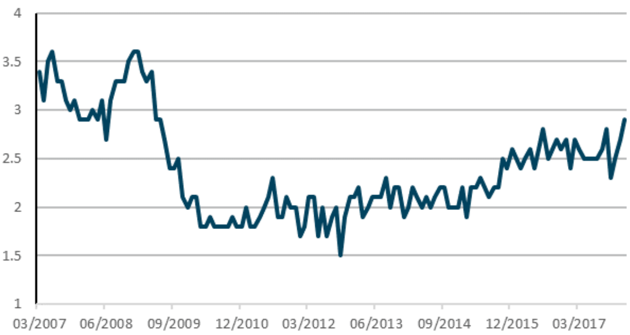
Rising rates in developed markets will be a headwind for global equity markets

The overall risks to global equity markets have increased. The longevity of the bull market in the US is being challenged by rising rates. As the quit rate in the US clearly demonstrates, the population currently employed in the US is experiencing conditions close to full employment. The last piece of the puzzle, wage inflation, might be finally falling into place. While we would expect this to improve the labour force participation rate by drawing in new workers and thereby preventing a sharp further increase in wage growth, empirical evidence has shown that after long periods of unemployment the rise in the participation rate can occur only very gradually and wages growth acceleration can persist.

Figure 13: US quit rate [%]

Source: Bureau of Labor Statistics

Figure 14: US average hourly earnings [%]



Source: Bureau of Labor Statistics

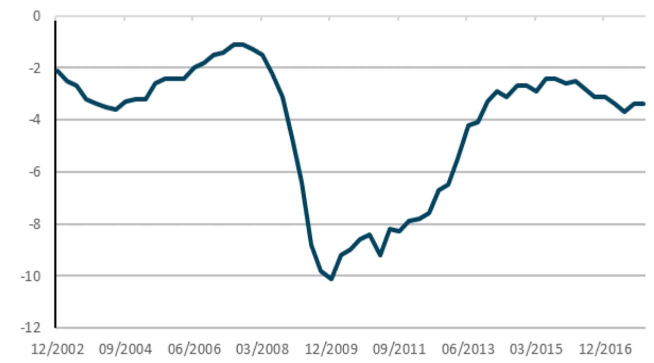
A weak dollar is likely to boost US growth and ultimately US rates

Interestingly, despite these signals the dollar has weakened considerably. This has, in our view, perpetuated a virtuous cycle for global equities as the global economy has ignored rising rates in the US so far. The problem with a weakening dollar is that it overstimulates the US economy even further, while slowing the recovery in countries in the EU for example. Over time we expect the Fed will be forced to raise rates even faster to balance a weakening dollar. The recent stimulus injected by tax cuts introduced by the Trump administration, coupled with the spending programs approved by Congress, will raise the budget deficit of the US dramatically.

Figure 15: US Bloomberg dollar spot index

Source: Bloomberg

Figure 16: US budget deficit (% of GDP)



Source: Bloomberg

Post the 2018 elections we would expect the US to address budgetary concerns

The stimulus can probably be understood in the context of 2018 being a key election year in the US. It is simply better to accept a deficit-busting deal than risk a prolonged government shutdown. However, we believe that post the mid-term elections the widening budget deficit may increase the prospects for entitlement reform, which is the key problem facing the US fiscal situation. Coupled with a sharp improvement in the current account deficit, which should be further helped by the weak dollar, we believe that the US economy will continue to attract capital. As the US economic expansion accelerates, we are fast approaching a tipping point that results in higher interest rates and a higher US dollar. The market is also keen to test the new Fed chairman. Jerome Powell's appetite to support equity markets needs to be calibrated by the market and a period of heightened volatility will help clarify the support the Fed is likely to provide.

Figure 17: US current account deficit (% of GDP)

Source: Bloomberg

Figure 18: Long-term interest rates

Source: Bloomberg

Global equity markets rangebound. Supported by accelerating growth. India benefits from domestic flows

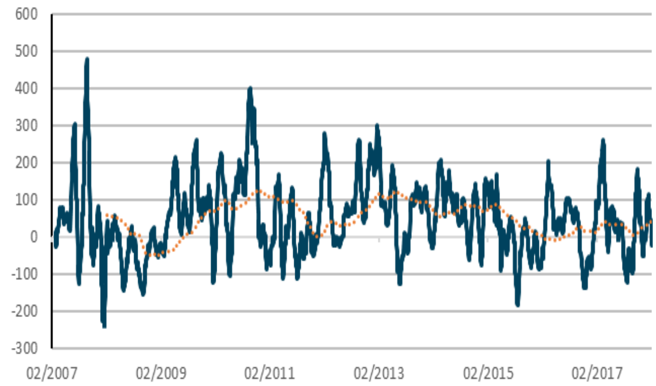
With valuations still at relatively high levels, we believe global equity markets will continue to experience volatility. Unlike 2016 and 2107, we see broader equity markets as rangebound. Given the positive global economic outlook, we see limited downside risks while rising bond yields cap the upside. This is also true for emerging markets like India where we expect only modest corrections. As we mentioned earlier, the flow of funds into Indian equities from domestic investors should support the country's equity market if there is a sharp correction.

As the following charts show, inflows from domestic investors are becoming far more consequential than inflows from foreign investors. In an economy with controls on the capital account, the fact that India is more expensive than most emerging markets is of little consequence to the domestic investor. What matters is how attractive the alternatives such as real estate are.is. The free cash flow streams of various Indian companies in sectors such as the FMCG sector, their exceptional record of creating value for minority shareholders and their long-term growth prospects, imply that these segments may experience some scarcity premium as new investors enter the equity market. We note the average monthly inflow into domestic mutual funds is currently at close to US$1.5bn, while the net annual inflow from foreign institutional investors has averaged US$4.7bn over last three calendar years.

Figure 19: India net monthly domestic mutual inflows and 12 month moving average (US$m)

Source: SEBI

Figure 20: 20-day moving average of daily net inflows from foreign institutional investors (US$m)

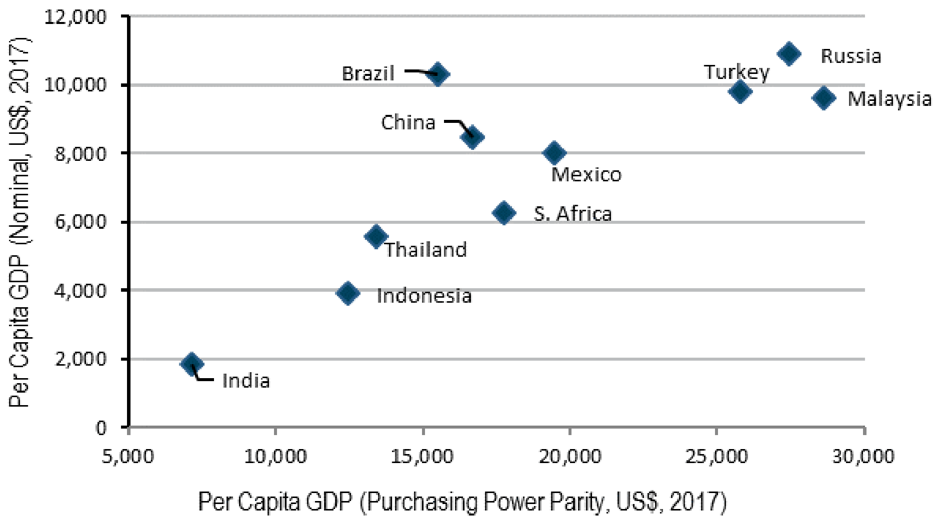


Source: SEBI

Narain expects companies in the portfolio to grow earnings by 33% in 2018-2019 and 22% in the next financial year. Long-term historic earnings growth has been c.18-20% per annum

Irrespective of whether the Indian equity market has a time correction or a short-term correction, we believe that the long-term prospects are extremely positive and recommend that investors gradually increase their exposure to India via IGC. According to Narain, the portfolio is trading on 21.3x March 2019 estimated earnings. He expects average earnings growth of 33% for the companies in the portfolio in the financial year ending March 2019, followed by 22% in the year to March 2020. This is higher than the long-term earnings growth range of 18-20% as several companies in the portfolio experienced a short-term decline in earnings due to demonetisation and the introduction of GST.

Figure 21: India's long-term GDP growth prospects significantly higher than EM peers



Source: Ocean Dial

India's long-term growth potential significantly higher than most emerging markets given the low base

We should not forget that the low base that India is starting at gives it substantially higher long-term growth prospects than most emerging markets. If India were to converge to the current nominal per capita GDP of Mexico in the next 20 years, for example, its per capita GDP growth would average c.7.6% per annum. Given India's population growth, one could expect GDP growth to average over 8.5% in such circumstances.

Performance, liquidity and discounts

Gaurav Narain joined IGC in November 2011. Since Narain became part of the team, in terms of long-term returns, IGC has substantially outperformed both Aberdeen New India Investment Trust (ANII) and JPMorgan India Investment Trust (JII), as well as the BSE 200 Index and the MSCI India Index. Based on monthly data from January 2012, we estimate the beta of IGC's NAV is 1.07 relative to the BSE 200 Index and 1.1 relative to the MSCI India Index.

Table 3: Annualised returns and volatility (%) for IGC, ANII, JII and indices

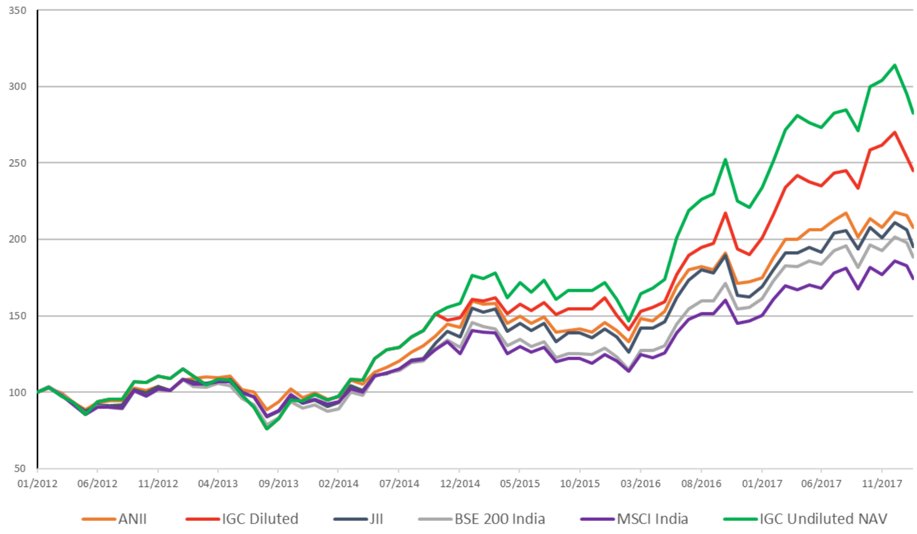
	IGC undiluted NAV	IGC diluted	ANII	JII	BSE 200 India	MSCI India
Annualised returns	22	19.1	14.8	14.7	13.9	12.3
Annualised volatility	22.5	21	18	20.2	20.2	19.1

Source: Morningstar, Company data, Stockdale estimates

Strong relative returns. Marginally higher levels of volatility

As we can see it is only marginally more volatile than the benchmark index and the peer group while having a far superior performance. Given the growth opportunities, we believe returns for IGC should be better in the long term than the broader indices which often incorporate companies into the index when they are more mature but also have a more sedate growth outlook.

Figure 22: NAV total returns for IGC and the peer group



Source: Morningstar, Company data

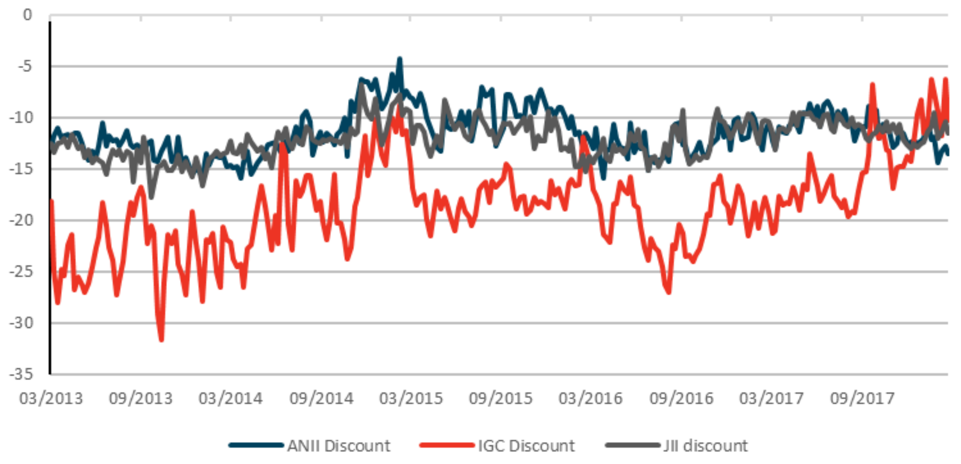
According to Narain, we have seen the euphoria in mid-cap stocks cause a re-rating even in lower quality mid-cap stocks. Consequently, the BSE mid-cap index is currently trading at a similar earnings multiple to the portfolio. Narain believes that over the next 12 to 24 months the superior earnings growth of the companies in the portfolio will translate into relative outperformance vis-à-vis the benchmark index.

The shareholders of IGC approved a subscription share issue in 2014 to increase the size of the fund and improve liquidity in the shares. The issue caused a dilution in the NAV performance for new buyers of shares post the record date for the subscription shares (4 August 2014). The subscription shares issue was concluded on 6 August 2016. This increased the size of the fund substantially and the liquidity of the underlying shares has improved. Coupled with strong NAV performance and a substantial narrowing of the discount, the market cap of IGC as at 21 February 2018 was c.£116m.

Would expect IGC to trade at premium to ANII and JII if it continues to consistently outperform

We have consistently argued, including in April 2017, that given the strong performance and the outlook of continued superior earnings growth from companies in the portfolio, IGC should be trading at a substantially smaller discount to NAV than ANII and JII. IGC may indeed enjoy the premium rating enjoyed by trusts like Baillie Gifford Shin Nippon (BGS) and Baillie Gifford Japan Trust (BGFD) which have established themselves as vehicles of choice for exposure to Japan. We note that IGC is currently trading at a slightly narrower discount than ANII and JII and believe that if the team at Ocean Dial can continue to outperform both the benchmark and the peer group, it is only a matter of time before IGC trades at a premium to NAV. While we have highlighted numerous risks in the document our base case scenario is that the long-term investment opportunity in India continues to improve as growth accelerates.

Figure 23: Discount of IGC, ANII and JII



Source: Bloomberg

Liquidity has improved. The move to the premium listing segment on the LSE should further enhance the appeal of IGC

One of the key objectives of the subscription share issue was to improve the liquidity of IGC. We note that despite being substantially smaller than both ANII and JII in terms of net assets the daily trading value of IGC's stock has been higher on average than ANII and has exceeded the value of JII's stock traded on certain occasions. We note that IGC has recently moved to the premium listing segment of the London Stock Exchange's main market and this should further enhance the appeal of IGC.

Table 4: Average daily traded values for ANII, IGC and JII in £

	3 months	6 months	1 year	3 years	5 years
ANII	455581	193548	387673	311299	290180
IGC	616131	432022	542571	292121	217765
JII	1037173	1142636	964365	789585	795720

Source: Bloomberg, Stockdale estimates

The management team at Ocean Dial

David Cornell, Chief Investment Officer: David Cornell joined the Group in January 2010 from Henderson Global Investors. He is based in London having been resident in Mumbai for three years until July 2013. He started his career in 1995 covering India for Robert Fleming Securities, ran the BDT Emerging Market Fund from 2004 to 2008 which compounded at over 25% per annum during his tenure and then co-managed New Star's Institutional Emerging Market Fund. He has a degree in English and History from the University of Durham and was in the British Army from 1991-1995.

Robin Sellers, CEO: Robin Sellers joined Ocean Dial in December 2011 having spent many years in the financial services industry, almost exclusively with Close Brothers Group plc. During his 16 years at Close Brothers, Robin was Head of Group Finance, Group Company Secretary and Finance Director of Close Brothers Limited, the group's regulated bank. Robin qualified as a Chartered Accountant in 1984 and spent the early part of his professional career with international accountants, Coopers & Lybrand, both in the UK and Australia.

Gaurav Narain, Head of Equities: Gaurav Narain joined the Group in November 2011, having been immersed in the Indian equity markets for the previous 24 years. He has held senior positions as both a fund manager and an equities analyst in New Horizon Investments, ING Investment Management India and SG (Asia) Securities India. He holds a Masters degree in Finance and Control and a Bachelor of Economics degree from Delhi University.

Sanjoy Bhattacharyya, Principal Adviser: Sanjoy Bhattacharyya has a career in the Indian capital markets that spans 25 years, initially as Head of Research at UBS Warburg Securities, before becoming CIO of HDFC Asset Management. Latterly he joined New Vernon Advisory as a Partner before setting up Fortuna Capital which provides exclusive investment advice to Ocean Dial. He has an MBA from the Indian Institute of Management, Ahmedabad.

Vamsi Tatavarthy, Senior Adviser: Vamsi Tatavarthy has worked with Barclays Capital in Singapore where he headed the FX Correlations and Structured Exotics Desk in APAC. Prior to Barclays he worked for Lehman Brothers as FX Exotic Derivatives Trader in London and New York. He has a Bachelors and Masters degree in Computer Science from IIT-Madras and an MBA from IIM-Ahmedabad.

Shahil Shah, Analyst: Shahil Shah joined the group in 2005 and specialises in the Telecommunications, Consumer, Healthcare and media sectors. Shahil holds a Masters in Commerce and Finance from Mumbai University.

Saurabh Chugh, Analyst: Saurabh Chugh specialises in Information Technology, Energy, Transport and Soft Commodities. He holds an MBA in Finance from Nirma Institute of Management, Ahmedabad.

Durga Shankar, Analyst: Durga Shankar is the newest member of the Ocean Dial team and is based in Mumbai. Previously he worked at MSCI Inc. focusing on factor based equity products, and prior to that at ARP Research LLP, a quant fund creating trading strategies to harvest alternative risk premia. Durga has a B.Tech degree from IIT Madras, an MBA from IIM Lucknow and a Chartered Financial Analyst.

The Board of Directors of IGC

Elisabeth Scott, Chairman: Elisabeth Scott was appointed to the Board as Chairman on 18 December 2017. Elisabeth has 25 years' experience in the asset management industry, having started in Hong Kong in 1992 where she remained until 2008, most recently in the role of Managing Director and Country Head of Schroder Investment Management (Hong Kong) Limited and Chairman of the Hong Kong Investment Funds Association. She is a non-executive Director of Pacific Horizon Investment Trust PLC, Dunedin Income Growth Investment Trust PLC, Allianz Technology Trust PLC and Fidelity China Special Situations PLC. She is resident in the UK.

Peter Niven: Peter Niven has over 35 years' experience in the financial services industry both in the UK and offshore. He was a senior executive in the Lloyds TSB Group until his retirement in 2004 and until July 2012 was the Chief Executive of Guernsey Finance LBG, promoting the island as a financial services destination. He is a non-executive Director of Dexian Trading Limited, F&C Commercial Property Finance Limited, F&C Commercial Property Trust Limited and other Guernsey based companies in the financial services field. He is a Fellow of the Chartered Institute of Bankers and a Chartered Director. He is a resident of Guernsey and was appointed to the Board on 11 August 2011.

John Whittle: John Whittle is a Chartered Accountant and holds the IoD Diploma in Company Direction. He is a non-executive Director of International Public Partnerships Limited, Starwood European Real Estate Finance Limited, Globalworth Real Estate Investments Limited and Advance Frontier Markets Fund Limited. He also acts as a non-executive Director to several other Guernsey investment funds. He was previously Finance Director of Close Fund Services, a large independent fund administrator. Prior to moving to Guernsey he was at Pricewaterhouse in London before embarking on a career in business services, predominantly telecoms. He is a resident of Guernsey and was appointed to the Board on 17 November 2011.

Conclusion

Following strong returns in 2017, the Indian equity market is, likely to go through a period of consolidation. IGC offers investors the opportunity to gain exposure to some of the best growth stories amongst emerging markets. Equally, the discipline and focus on the underlying quality of the companies that Narain and his team tend to invest in, implies that the probability of mistakes being made is reduced. To that extent, the portfolio should substantially outperform the index over the medium and long term.

The portfolio tends to have a strong quality bias and hence the valuation of the portfolio is likely to be higher than the market. As at 31 January 2018, the portfolio was trading at 21.3x March 2019E earnings. Narain believes that earnings for companies in the portfolio are expected to grow at c.33% for the year ending March 2019 and c.22% for the year ending March 2020. The normalised earnings growth for the portfolio has tended to be in the range of 18-20% per annum over the last five years. The portfolio's trailing 12-month dividend yield was 1.02%, and the median market cap was $1.1bn.

The discount that IGC trades at has narrowed considerably. We believe that if the earnings growth of the companies in the portfolio of IGC is c.30% a year for the next two years then we could see the stock trade close to NAV or at a small premium. We note that the size of IGC is such that there is considerable scope for growing the fund without any impact on performance.

The recent takeover by Avendus should allow Ocean Dial to add new funds to its product offering. However, at present we do not believe that new strategies that Ocean Dial introduces will detract from performance of IGC. On the contrary, we believe that the cross-checking of ideas by other teams within Ocean Dial could help investors in IGC.

We continue to recommend that investors buy IGC for to gain exposure to the more dynamic companies operating in the Indian economy.

Key risks

The principal risks associated with IGC and this asset class include the following:

Key asset class risks include

- Rising interest rates in the US
- Country specific risks including political risks
- Risk to the Indian equity market from rising oil price
- Stock-specific risk
- Strategy or sector-specific risks

Key fund risks

- Premium/discount of IGC may be volatile
- The fund has a substantial investment in mid and small cap companies, which can be more volatile than the large cap indices.

Figure 25: Share price & recommendation tracker graph

Source: Bloomberg, Stockdale Securities

Investment Funds research disclosures

Explanation of Investment Funds recommendations

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Investment funds ratings are explained as follows:

BUY: Total returns expected to be in excess of those from the fund's benchmark

HOLD: Total returns expected to be in line with those from the fund's benchmark

SELL: Total returns expected to be lower than those from the fund's benchmark

Total return is defined as the movement in the share price over the medium- to long-term, and includes any dividends paid.

Distribution of Stockdale Securities' investment funds recommendations:

Stockdale Securities must disclose in each research report the percentage of all investment funds rated by the member to which the member would assign a "BUY", "HOLD" or "SELL" rating, and also the proportion of relevant investments in each category issued by the issuers to which the firm supplied investment banking services during the previous 12 months. The said ratings are updated on a quarterly basis. This recommendation system differs from the recommendation system used on non-Investment Fund research.

Investment Funds recommendation proportions in last quarter

	BUY	HOLD	SELL
Funds to which Stockdale has supplied investment banking services	100%	0%	0%

Source: Stockdale

The company has seen this research but no material changes have been made as a result.

Stockdale acts as broker or advisor to this company.

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