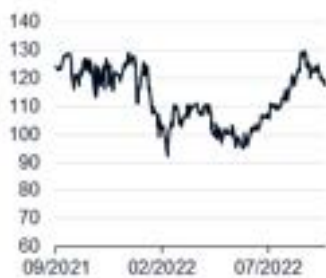


House Stock

Current price 118p
United Kingdom

Fund in the spotlight: IGC

IGC share price



Source: Bloomberg

Code	IGC
NAV	142.11p
Discount	16.6%
Mkt Cap	£113.4m

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India Capital Growth Fund +**Secular growth supports outperformance**

Over the last two years we have seen Indian equity markets sharply outperform. While some mean reversion is possible in the short run, we believe that Indian equity markets are in a fundamentally strong position, despite the global headwinds. Companies in the portfolio of India Capital Growth Fund (IGC) are estimated to deliver c.30% annualised earnings growth over the next two years. A capex cycle is currently underway, supporting this strong earnings growth. With a redemption facility offered regularly to investors and trading at a 16% discount to its net asset value (NAV), India Capital Growth Fund (IGC) offers a prospect of strong returns over the next twelve months, not just from NAV performance, but also from further discount contraction.

Outperformance may persist: Investors in global emerging markets have been disappointed by China's continuation of its zero-Covid policy. We have seen a sharp divergence in equity market performance between India and China over the last two years. We believe that over the medium-term India still is highly attractive given its significantly lower starting point, vis-à-vis GDP, its demographic profile and the "Make in India" initiative, despite India's higher valuations.

Insulated from the energy crisis: Despite being an importer of energy, India has so far been relatively well insulated. Its long-standing trading relationship with Russia, which goes back to the time of the Cold War and its strong refining industry, has meant that India is able to access products like petrol and diesel at prices that are lower than Europe. Inflation is slightly higher than the RBI's target range and this is likely to require the RBI to increase rates only modestly from current levels.

A new investment cycle: Gaurav Narain, co-Head of Equities at Ocean Dial India, the investment adviser of IGC, highlights that the early stages of an investment cycle in India is currently underway and that the portfolio is positioned to benefit from this. The production-linked incentive (PLI) schemes introduced by the Indian Government as a part of its "Make in India" initiative are helping to catalyse investments in new industries. This, coupled with the desire of several developed economies to diversify a part of their manufacturing capacity away from China, may create a medium-term tailwind for India, in our opinion. Domestic equity inflows remain extremely strong and have helped to cushion outflows from foreign institutional investors. While India equities are not immune to global market volatility, we believe that the medium-term outlook for the market is promising. We believe that the growth opportunities for mid and small cap companies remain robust and hence IGC offers investors a unique opportunity, particularly given the discount.

A much narrower discount justified: IGC has delivered strong NAV performance. Investment returns are benefitting from a divergence in economic performance between India and other major economies. The share price, trading at a 16% discount, currently offers investors an attractive opportunity, particularly as the redemption facility (due on 31st December 2023 at a discount to NAV no greater than 3%), is confirmed. It is likely therefore that there this will lead to a substantial narrowing of the discount over the next twelve months, boosting returns for shareholders.

IGC: Benefitting from a growth divergence

Advantage India

Promoting manufacturing in India to bolster growth

The Indian government is focused on promoting manufacturing in India in order to bolster growth, as well as reap the demographic dividend that the country enjoys as its young and growing population enters the workforce. The production-linked incentive schemes (PLIs), recently introduced, are designed to attract both global and domestic “champions” looking to move away from China (and other competing countries) in order to take advantage of the incentives offered by India to establish alternative manufacturing facilities to support global supply chain management diversification.

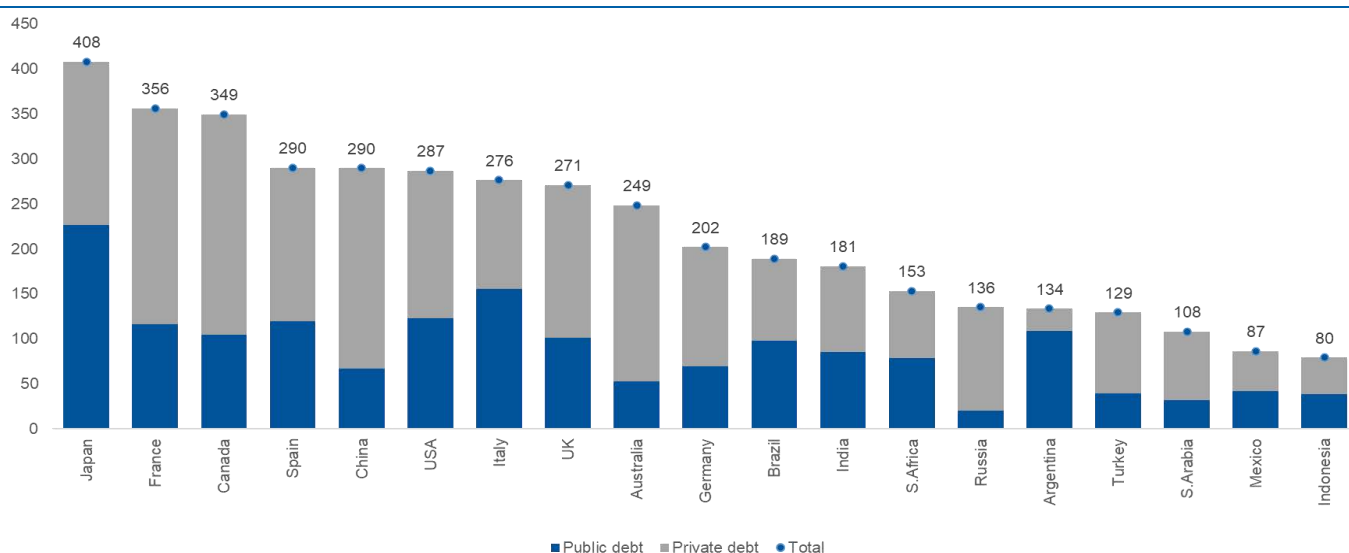
Vast domestic market

The vast domestic market in India, which has experienced further integration and rationalisation because of the introduction of the Goods and Services Tax (GST) regime, was already seeing strong capital inflows. The PLI schemes target growth in downstream production across industries and the incentives offered will last for over 5 years. 14 sectors are already covered by these schemes including air conditioning units, LED lighting, IT hardware, medical equipment, telecom networking equipment, food processing, drones, solar PV modules, active pharmaceutical ingredients (APIs), drugs, and semiconductors.

Samsung has already made extensive investments in India

Companies such as Samsung have already made extensive investments in India, because of the introduction of these incentives. Other companies that are also active include Hon Hai Precision Industry Co., known as Foxconn, Wistron Corp. and Pegatron Corp. The entry of Foxconn allowed Apple to start manufacturing the iPhone 14 in both China and India. India has also extended similar incentives to pharmaceutical businesses, and plans to cover more sectors, which may include automobiles and textiles under the program.

Figure 1: Debt as % of GDP



Source: BIS, Ocean Dial Data as at CY20

Fastest growing large economy in the world in 2023

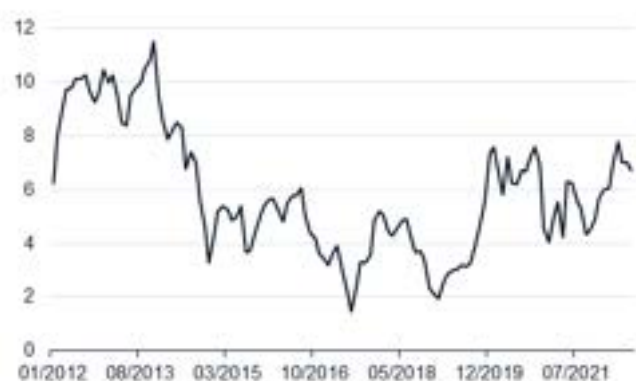


The IMF expects India to be the fastest growing large economy in the world in 2023. With a low leverage ratio and real interest rates close to positive, the Indian economy does not currently need any radical changes to its monetary policy.

Margins may have already bottomed

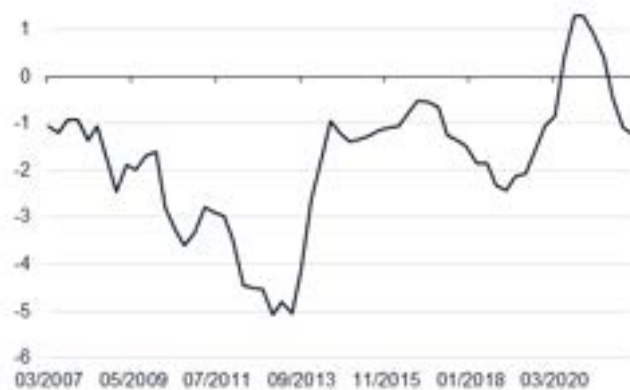
Inflation is running at similar levels to the figures observed in developed countries. However, since India is accessing Russian crude at significant discounts for a small part of its energy requirement, the government can mitigate to a degree the impact of rising energy costs, though this remains a source of concern. Manufacturing costs have increased, and despite companies having passed on the bulk of the increase, demand has not been impacted in the portfolio companies. With manufacturing costs having started to come off, margins may have already bottomed.

Figure 2: India Combined CPI (YoY, %)



Source: Central Statistics Office India

Figure 3: India Current Account Balance (% of GDP)



Source: Bloomberg

Secular shift in global supply chain management in India's favour

So far, the current account has remained relatively balanced though a further increase in energy prices will have a negative impact. In addition, a further slowdown in the global economy, alongside India continuing to experience rapid growth, will also have a negative impact. However, we do believe that the secular shift in global supply chain management in India's favour will eventually move the current account to a surplus. This scenario sets the stage for gross fixed capital formation as a % of GDP to rise substantially, boosting short-term growth and bolstering India's medium to long-term growth prospects.

Figure 4: India Gross Fixed Capital Formation as % of GDP



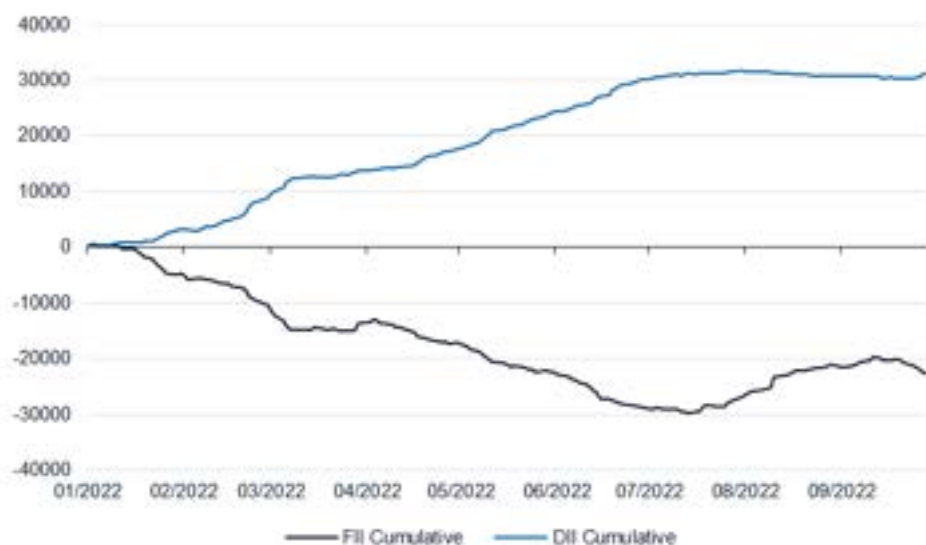
Source: Central Statistical Office, India

The banking sector is now able to support the capex cycle

The banking sector had already addressed some of the issues related to non-performing loans and is exiting Covid with a relatively strong balance sheet, partly due to the writing back of excess provisioning. Thus, this sector is now able to support the capex cycle. Bear in mind however that the renewed strength of corporate balance sheets is leading to a degree of incremental capex requirement being financed via internal accruals and thus bank lending growth may lag actual investment growth.

India is still a capital-controlled economy. Domestic investors are looking for investments that protect them in real terms over the medium to long-term, in our view. Because of the deepening of financial markets, these domestic financial institutions (DIIs) are continuing to see robust inflows into equities. Since January 2022, there has been significant outflows from foreign investors (FIIs), but these have been more than offset by inflows from DIIs. As long as domestic growth remains strong this long-term trend can sustain significantly higher valuations. It is also a reason why investors may observe a relatively lower correlation between Indian and global equity markets in the future.

Figure 5: Cumulative flows into equities (US\$m)

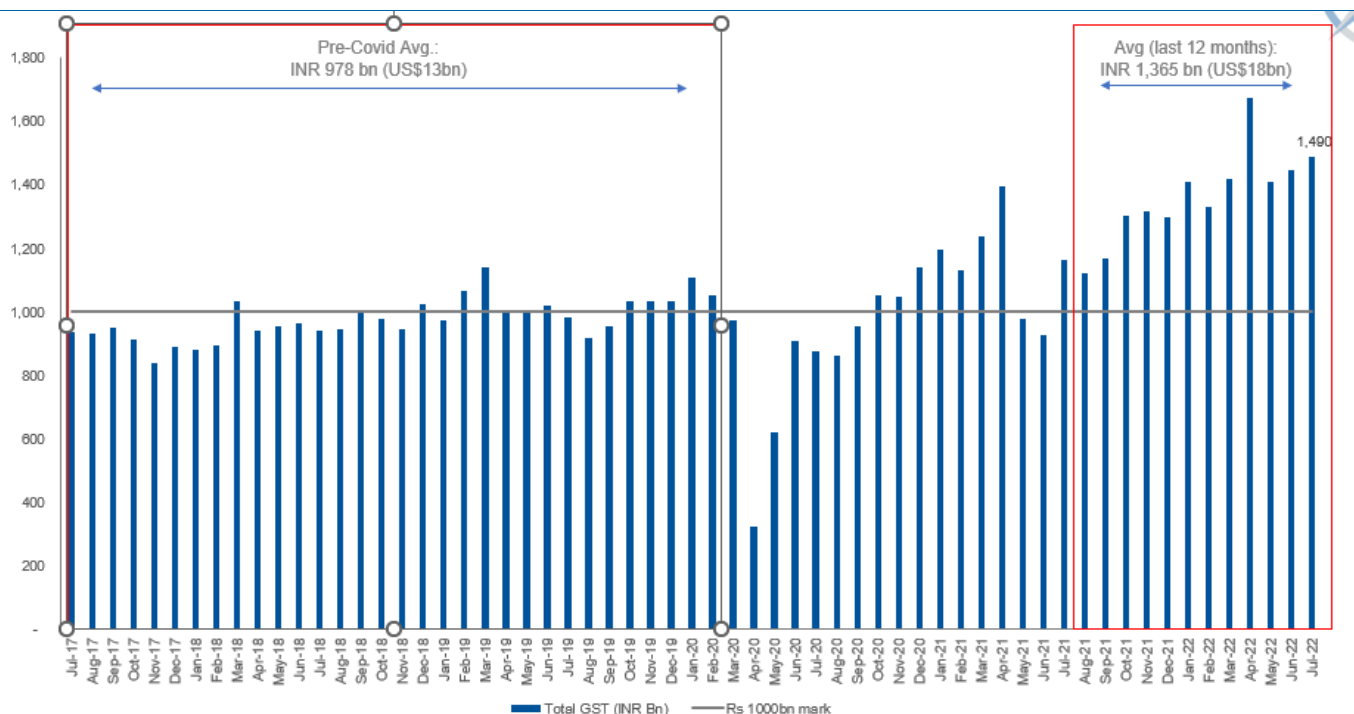


Source: Ocean Dial Asset Management, Bloomberg

Highly supportive regulatory framework

The reforms initiated by the government over the past few years have created a highly supportive regulatory framework. However, looking forward it is economic growth that has become the paramount consideration for India's ruling party. GDP growth over the next few years is likely to continue to surprise on the upside as this new framework allows the inefficiencies of the past to be eliminated or significantly reduced. Amongst the various measures implemented, the introduction of the unique identification number (UID, assigned to all citizens), has been most vital, allowing industry to develop rapidly (including the development of national credit scoring measures). Other benefits that have resulted include a dramatic decline in the inefficiencies associated with the distribution of subsidies to the poor, as well as the effective rollout of the vaccination program during Covid. Indirect tax collection or GST, has seen a sharp uptick from pre-Covid levels, demonstrating growth momentum in the economy and more efficient collection.

Figure 6: GST collections



Source: Company Data

Housing affordability is still at relatively attractive levels

While the real estate sector is negatively impacted by rising rates (at the margin), housing affordability is still at relatively attractive levels. The rise in interest rates is not of a significant magnitude that household finances are likely to come under stress. In addition, house prices have risen only modestly over the last five years, and therefore residential housing growth is more likely to be a strong tailwind for the Indian economy over the next decade, supported by the country's demographic profile.

IGC portfolio positioning

Housing sector revival

India Capital Growth's Portfolio Advisor Gaurav Narain believes that the housing sector revival, coupled with an industrial capex cycle (still at a very early stage) should combine to be the major drivers of growth in India, and hence the domestic cyclical recovery is therefore a key theme within the company's portfolio. These elements are also expected to lead to a recovery in consumer spending, another area of significant portfolio exposure. Gaurav believes that these themes, in conjunction with encouraging signs of global companies increasingly relocating a part of their manufacturing capacity to India (where the portfolio also has exposure), form the major pillars of the portfolio. Financials are the other remaining pillar which will be expected to outperform as the economic recovery takes hold.

Figure 7: Sector breakdown, top ten holdings as at 30 September 2022

Sector	No. of Companies	% of Portfolio Stock	Sector	%
Financials	6	25.3	Federal Bank	Financials - Banks 6.8
Materials	7	18.6	IndusInd Bank	Financials - Banks 5.5
Consumer Discretionary	7	16.1	IDFC Bank	Financials - Banks 5.5
Consumer Staples	3	10.4	Ramkrishna Forgings	Materials 4.9
Industrials	5	10.9	Emami	Consumer Staples 4.7
IT	3	6.7	City Union Bank	Financials - Banks 4.4
Health Care	2	4.5	Affle	Communication services 3.6
Communication Services	1	3.6	PI Industries	Materials 3.3
Net Cash		4	Kajaria Ceramics	Industrials 3.2
Total Portfolio	34	100	Persistent Systems	IT 3.2

Source: Company Data

Owning companies with consistent long-term growth prospects

The domestic cyclical recovery and the revival of the real estate sector in India should benefit cement companies, which make for the majority of the portfolio's materials exposure (aside of speciality chemicals). Gaurav has always stayed away from companies operating in the commoditised segment of the materials sector and this remains unchanged. Other themes in the portfolio include digitisation, green economy and domestic consumption.

India Capital Growth's portfolio has low turnover and is focused on owning companies with consistent long-term growth prospects. This approach of focusing on high quality companies in the portfolio, is reflected by the fact that over 30% of the portfolio's investments have no net debt, and only 15% of portfolio (5 stocks) has a net debt/equity ratio of greater than 0.5x. That said, Gaurav has used the ongoing volatility in global equity markets to make some meaningful changes. Thus, India Capital Growth sold its holdings in both Gujarat Gas (GUJGA IN) and Aegis Logistics (AGIS IN), due to concerns on how margins would evolve as energy prices spiked. As replacements to these, new entrants to the portfolio include Vedant Fashion (MANYAVAR IN), Coforge (COFORGE IN) and Cholamandalam Investment (CIFIC IN). All three are small positions and Gaurav is waiting for the right opportunity to build further exposure providing the companies perform as expected.

Figure 8: Portfolio characteristics vs the Nifty index based on estimates

As at 30th August 2022	P/E FY23 ends March '23	P/E FY24 ends March '24	Earnings Growth FY23	Earnings Growth FY24
Weighted for Portfolio	19.5	15.1	33.70%	29.00%
Nifty 50 Index	20.9	18.5	15.60%	15.00%

Source: Company Data

The portfolio is trading at 19.5x March 2023 earnings

Gaurav estimates that the portfolio is trading at 19.5x March 2023 earnings, with earnings growth of over 30%. For the financial year ending March 2024, the estimated PE multiple is 15x with earnings growth of 29%

Figure 9: IGC holdings split by Mkt Cap as at 30 Sep 2022

By Mkt Cap	Number of companies	%
Small Cap (M/Cap < US\$2bn)	14	38.4
Mid Cap (US\$2bn < M/Cap < US\$8bn)	17	47.8
Large Cap (M/Cap > US\$8bn)	3	9.9
Total Equity Investment	34	96
Net Cash		4.0
Total Portfolio	34	100

Source: Company Data



We met with two of the portfolio's cyclical stocks

Ocean Dial's India based research team has restarted face-to-face meetings and we recently accompanied the team to some of the first meetings in Kolkata for two years. Amongst others we met with two of the portfolio's cyclical stocks, (Ramkrishna Forgings (RMKF IN) and Skipper Ltd (SKIPPER IN)), both trading at deep value.

Earnings growth of over 23%

RMKF is an auto ancillary company supplying large forging components to medium & heavy commercial vehicles. 40% of its revenues come from the export market, and mainly from Class-8 trucks in the United States. Between 2013 and 2015 RMKF undertook a large capex plan to set up fully automatic 12,500-ton heavy press, shifting from its previous focus on manufacturing less complex processes requiring smaller equipment, such as ring rolling. RMKF has been able to add customers for its heavy forgings in Europe and is also gaining market share in United States as a consequence of this expansion. This was an excellent meeting. The management exuded confidence on every aspect of the business, claiming that irrespective of what happens to Class-8 trucks, they are confident on the outlook for growth. In addition, the management emphasised a strong focus on both protecting and enhancing margins, whilst also reducing the leverage on the balance sheet. As such Gaurav believes that this focus on a calibrated growth approach will support RMKF's future performance. Ocean Dial calculates that the company's share price is trading at c.10x March 2024 earnings with forecast earnings growth of over 23% in this financial year and over 30% in the next.

Figure 10: RMKF share price (in INR)



Source: Bloomberg

Figure 11: SKIPPER IN share price (in INR)



Source: Bloomberg

Tangible gains from the "China+1 strategy"

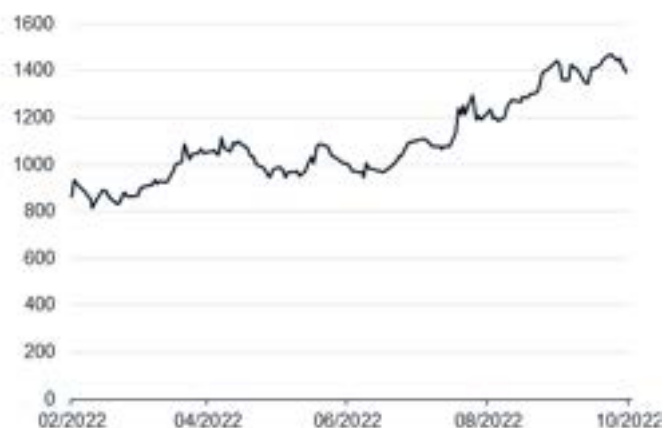
Skipper is one India's largest transmission tower manufacturers, with a galvanizing capacity of 300,000 metric tonnes. It is one of the lower cost producers globally, mainly because of its fully integrated operations of billet rolling to angle manufacturing. Skipper also manufactures polymer pipes with capacity of 51,000 metric tonnes, with 22,000 distribution "touchpoints". Like the RMKF meeting, there was a high degree of confidence on the company's growth projections, and a strong focus on both protecting margins and reducing balance sheet leverage. The company is seeing strong order flows from overseas markets driven by demand for upgrading transmission grid, on the back of growth in renewable energy projects. Existing grids have seen limited investment over the last few decades and hence there is strong replacement demand from which Skipper will benefit. Skipper is also enjoying tangible gains from the "China+1 strategy" and is winning incremental business from customers in Australia and the United States, who traditionally sourced from China. Gaurav estimates that Skipper's share price is trading at c.10x March 2023 earnings and expects substantial earnings growth in the next financial year.

Vedant Fashions is a recent addition to the IGC portfolio

Both companies went through a period of high uncertainty during the first phase of the Covid pandemic and hence remain focused on deleveraging their balance sheets and growing future business using internal accruals.

We also met Vedant Fashions, which is a recent addition to the IGC portfolio. IGC acquired the position at the time of the IPO (IPO price Rs. 866 per share) and the stock has performed very well. Vedant Fashions is a leading garmenting company which specialises in ethnic wear for weddings and celebratory occasions. It is the only national player and has a presence across 222 cities with a retail footprint of 578 stores (1.21 mn.sq.ft). Floor space is forecast to expand at 15%-16% annually. The company sells approximately 3m garments annually through its "Manyavar" brand, which is over 20x the size of its nearest competitor, and this is supported by the company's "Mohey" brand, ethnic wear for women, which was launched in 2017. The company is well positioned to defend this strong growth owing to the high degree of co-ordination required to manage the assembly process (from design to manufacturing, including cutting, stitching, embroidery, and finishing) for which Vedant Fashions has developed strong relationships over many decades. The management of this process has been combined with a highly modern ERP system, allowing the company to assess dynamically the evolution of demand for the various product lines. Vedant is now looking to expand to other ethnic segments whilst also targeting selective "higher end" opportunities in parallel. Although Gaurav believes that growth is likely to remain robust, given the strong performance of the share price, he is waiting for a market correction before assessing whether to add to the position in the portfolio. Ocean Dial estimates that Vedant Fashion's share price is trading on a price/earnings multiple of approximately 70x March 2024 earnings.

Figure 12: Vedant Fashions share price (in INR)



Source: Bloomberg

Figure 13: Emami share price (HMN IN, in INR)



Source: Bloomberg

Our final meeting was with Emami (HMN IN), another investee company operating in the consumer goods space, and a leading FMCG player in India. The company has operated in health, beauty, and personal care products for over 30 years. Emami has sustained a prominent position in therapeutic and ayurvedic based products particularly, ensuring strong entry barriers for competition. Whilst the management acknowledged that the company had underperformed in recent years, much of this underperformance was put down to problems relating to the demonetisation of India's currency in 2017, as well as Emami's own "internal issues" relating to the group business. The latter problems consequently led to underinvestment in its business. Gaurav now believes that the company is past this phase, supported by the fact that the management has more recently been investing across areas such distribution (across channels) and products, including D2C.

Most remain upbeat and optimistic about the near-term future

The management was clear on several key strategic points. First, it will not move into mass market products. Second, that e-commerce (modern trade) will eventually make up 50-70% of the market. And finally, although the D2C space is a vital area to address, it will not achieve this effectively without external support. Whilst the focus of the company remains in the healthcare and the ayurvedic product range Emami has also identified inorganic growth as key part of its future strategy. Whilst discussing the impact of inflation on demand, the company felt that the consumer remains challenged, and consequently a degree of downsizing has begun which may cause margins to decrease temporarily. But as salaries adjust and inflation moderates, the company is focused on delivering double-digit top-line growth with margins expected to return to normal levels.

Overall, India's inflationary environment is having a negative impact on the consumer. Nevertheless, with strong growth in the economy it is felt that the impact is likely to be only a temporary headwind for most of the investee companies in India Capital Growth's portfolio; most remain upbeat and optimistic about the near-term future. This significantly contrasts to feedback on the consumer outlook for a significant section of the companies operating across both the developed and the emerging markets today.

IGC Performance and discount

Indian equity markets delivered a strong performance in 2021 and this has continued into 2022, both in absolute and relative terms. From a purely statistical perspective, investors might be tempted to position for a degree of performance driven mean reversion.

Figure 14: IGC rebased NAV TR YTD compared to various indices (in GBP terms)



Source: Morningstar

However, over the medium to long-term, strong performance from Indian equities is likely to continue. Comparing the valuations of IGC's portfolio (19.5x based on earnings estimates for the year ending March 2023), to that of the MSCI Asia ex-Japan index (12x), we note it trading at somewhat higher levels. However, given Ocean Dial's expectation of earnings growth at 29% for the next financial year (FY2024), this premium appears reasonable particularly given the portfolio will deliver healthy growth in its NAV, assuming forecasts prove accurate. Interestingly, the portfolio is trading at similar valuation levels to the Nifty 50 large-cap index, but with much stronger earnings growth estimates.

Figure 15: IGC and other India trusts NAV TR



Source: Morningstar

Over the last three years IGC has been the second strongest performing investment trust listed on LSE (of the direct competition) in terms of NAV on a total return (TR) basis. Currently the share prices is trading at a 16% discount to NAV which offers investors a unique opportunity - particularly since the Company's Board has confirmed that the next redemption facility (in December 2023), will be priced no higher than a 3% discount to the prevailing net asset value per share.

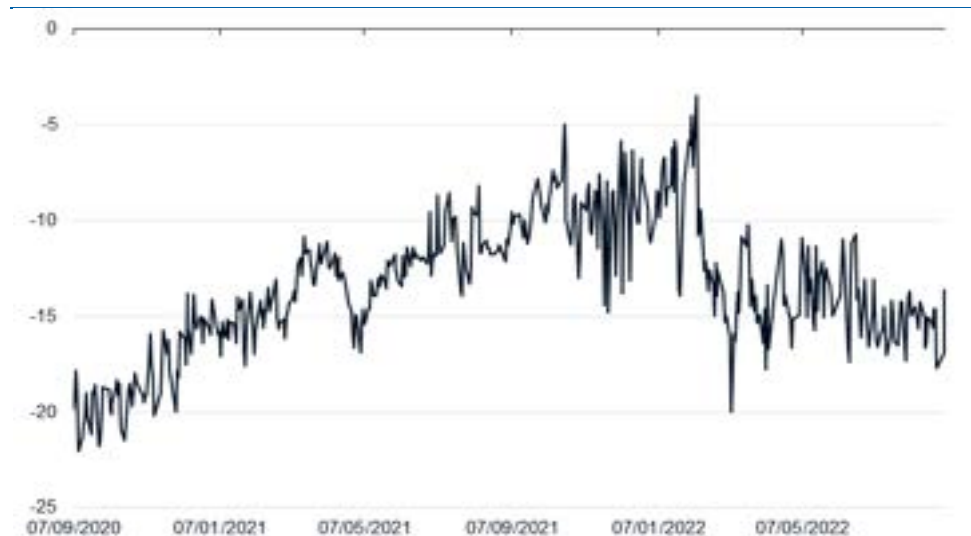
Figure 16: Indian investment trusts performance and discount

Trust	Ticker	Mkt cap £m	Latest Discount (Cum Fair)	Prem/Disc 12 Mo Avg	1 year NAV TR (%)	3 year NAV TR (%)	5 year NAV TR (%)
Aberdeen New India	ANII	318.5	-23.4	-18.1	-2.7	31.5	38.6
Ashoka India Equity Investment	AIE	219.6	-4.9	0.8	6.2	97.0	
India Capital Growth	IGC	114.4	-16.2	-12.6	0.9	59.8	20.0
JPMorgan Indian	JII	611.8	-22.7	-18.5	5.2	31.8	22.5

Source: Morningstar

Therefore, over the next twelve months, we expect the discount to narrow substantially from current levels, and the combination of positive NAV returns, and further discount contraction will attract new investors, both on an absolute and relative perspective.

Figure 17: IGC Discount to NAV (%)



Source: Bloomberg

Conclusion

Global investors likely to continue to favour India

We believe that until China deviates from its zero-Covid policies, the country will struggle to deliver the level of growth to which investors have been accustomed. And even if China does manage to tackle the Covid headwind successfully, additional problems surrounding the real estate and technology sectors remain, will further diminish investor appeal. There is also the risk that China attempts reunification with Taiwan by force in the next few years. Given these underlying concerns global investors will continue to favour India despite the valuation gap between the two markets.

The case for India is more long-term in nature. Here, the corporate sector is notably upbeat, and this optimism is leading to significant domestic investment, particularly so in the manufacturing sector. In support, the banks are now adequately provisioned for the current level of non-performing loans and are therefore better able to support investment. Domestic investor investments into Indian equities remain robust and are expected to grow over the medium to long-term, given India's growth and demographic profile, as well a structural shift in saving from physical assets to financial assets,

India is finally entering a new capex cycle

After many years, India is finally entering a new capex cycle. The government reform-based initiatives are now bearing fruit and substantial levels of foreign direct investment (FDI) is finding its way to India. The real estate sector, which had been moribund for a while, is seeing renewed end-user demand. With most major structural economic reforms now fully implemented, India is set to enjoy stability and strong growth over the next few years.

Trading at a 16% discount

In this economic scenario, the small and mid-cap companies are likely to grow faster than their larger peers. India Capital Growth is uniquely placed to invest in these by virtue of its differentiated mandate and its closed-end fund structure. Additionally, the regular redemption facility will ensure that over the medium-term investors who choose to exit, can do so at levels close to NAV. Trading at a 16% discount, with a redemption date in December 2023, India Capital Growth, with its diversified approach, long term track record, stable investment team and a presence on the ground in Mumbai, offers investors the best possibility of strong NAV returns and enhanced share price returns over the medium to long term.

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