

India Capital Growth benefits from financials overweight

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India Capital Growth (IGC) has announced its annual results for the year ended 31 December 2022. During the year, IGC's NAV rose 3.9%, modestly outperforming the BSE Midcap TR Index, which increased by 3.2%. The NAV of the portfolio, before deferred tax provision relating to potential Indian Capital Gains Tax, rose by 4.3% outperforming emerging markets as a whole which fell 13% during the year. Key to this outperformance was the overweight position in the financial sector, where the company's long term holdings in Federal Bank and IndusInd Bank performed well. IGC's manager comments that the portfolio is positioned to take advantage of key themes it sees playing out over the next few years – namely a) mainstreaming of digitization; b) China+1 and de-risking of global supply chains; c) consumption revival and d) domestic capex recovery. These have played out well. Sector allocation was the main driver of positive performance, though stock selection also contributed.

[This is a good result, which helps maintain its position at the top of the performance leaderboard in the Indian sector over one and three years.]

IGC's discount narrowed over the year to just over 7.9% at the year end and the board says that it intends to continue to repurchase shares when the discount is inappropriately wide (unless conditions are volatile). As we have discussed in our recent note ([click here](#) to read) IGC has its second redemption opportunity as at 31 December 2023 (this will be for eligible shareholders on the register at 30 September 2023) when the exit discount will be a maximum of 3% (tighter than the 6% maximum exit discount for the first redemption opportunity).

After a very strong year for Indian equity markets in 2021, 2022 saw Indian equities show a positive performance. This contrasted with the negative returns experienced in other global equity markets, which generally fell back in response to rising interest rates as central banks sought to turn the tide on inflation – a consequence largely of rising commodity costs and, in particular, energy costs following Russia’s shock invasion of Ukraine. India seemed able to ride this out in part as it has started to reap the benefits of its reforms in recent years but also possibly because it continued to purchase Russian oil, enjoying particularly low energy prices, in contrast to other nations. IGC’s manager comments that India’s economic momentum gained pace during 2022, with capital expenditure growing, the real estate sector showing signs of recovery and consumer demand continuing to rise. It comments that, with healthy foreign exchange reserves (the fourth largest in the world at US\$560bn), the currency has been resilient, compared with previous economic shocks despite the headwind of high oil prices (helped in part by the rising export of IT services offsetting the cost of fluctuating oil imports).

Ocean Dial to be absorbed in Martin Gilbert’s AssetCo

On 6 March 2023 AssetCo PLC, founded and chaired by Martin Gilbert, acquired IGC’s [investment manager](#), Ocean Dial Asset Management Limited, subject to regulatory approvals from the [FCA](#) and regulators in India. The investment team in India, led by Gaurav Narain, continues unchanged (also covered in [our most recent note](#), which you can see for more details).

Manager’s outlook for 2023

“As we enter 2023, we are confronted with divergent commentaries: a) Western economies where discussions are centred around the probability of a recession; and b) positive and optimistic India where sustaining a 6-8% GDP growth for the next decade is the focal point of discussion. The positive outlook is reinforced by [IMF / World Bank](#) forecasts which list India as being among the fastest growing large economies in the world in the short term, and over the next decade emerging as the 3rd largest economy globally (India’s GDP surpassed that of the UK in Q4 2022 to make it the 5th largest economy in the world). The Government has set a target of being a US\$ 10tr economy in the next decade (compared with US\$ 3.5tr at present). This optimism is also reflected in the management commentary of most corporates.”

Comments from Elisabeth Scott, chair of India Capital Growth

“Despite all the global uncertainties of 2022, it is clear that India and its economy have been resilient and investors in emerging markets have favoured India over the stock markets of other emerging markets. While it is perfectly reasonable to expect that other emerging markets may catch up in terms of relative performance, the outlook for the Indian economy is positive and Indian companies will benefit from this and from the improvement in governance standards.

“The Board believes that, particularly in this uncertain environment, the Company’s focus on high quality companies with strong management capabilities and a clear path to growth will generate positive investment returns over time.”

Manager’s comments on the performance during 2022

“At a sector level, the main contributors to positive performance were healthcare, financials, energy, consumer staples, materials and communication services. Sectors that dragged performance lower were led by information technology, utilities and industrials.

“At a stock level, financials led the way with all four banks in the portfolio led by Federal Bank (up 71%) and IndusInd Bank (up 39%) delivering positive returns on the back of strong operating performance. Ramkrishna Forgings (auto ancillary) also rose 40% driven by a bounce back in the domestic commercial vehicle sales and new order wins in exports. In the Industrial space, Skipper (engineering products) rose 61% while PSP Projects (construction company) rose 46%. Both companies have seen a rise in their order books as the capex cycle picks up pace. Another notable performer was Jyothy Labs (consumer staples) which rose 51% on the back of consistently delivering above market revenue growth with market share gains. Within materials, JK Lakshmi was among the top performing Cement companies.

“Adverse stock performers were led by the global facing companies, all of which corrected in anticipation of slowdown in growth rates. This was led by Welspun India (Textiles) down 46%. Both our IT service companies, Tech Mahindra (down 40%) and Persistent (down 20%) also de-rated, even though earnings remained robust. Sona BLW (Auto Ancillary) also declined 43% on fears of a global auto slowdown. At an index level, our absence in Varun Beverage (consumer staple) which rose 125% and Adani Power (utility) which rose 201% also detracted from our performance.

“We continue to hold on to our underperforming companies as the business models remain robust and do not alter our long-term thesis on these businesses. Moreover, the price correction makes valuations even more compelling as it has not been accompanied by a similar downgrade in earnings.

“The portfolio finished the year with 35 stocks. Gujarat Gas (city gas distribution), Aegis Logistics (gas and liquid logistics), Star Healthcare (general insurance) and Divis Laboratories (pharmaceuticals) were sold during the year. Six portfolio additions were made including Vedant Fashions (garments), Coforge (IT Services), Cholamandalam Investments (non-bank financial company), Star Healthcare (general insurance), Ashok Leyland (commercial vehicle) and Uniparts (auto ancillary). Star Healthcare was added and exited during the year because of the strong run-up in price (over 30%) during our holding period. Our portfolio turnover remained low at 12.6%. We have been actively and consciously managing the individual stock weights and have used the **volatility** to book gains or add weight to several stocks within the portfolio.”

Manager's comments on current positioning and expectations

“As we enter 2023, our largest sector exposure is in the financial space which has a long runway on growth, low risk on credit quality for the next 2 years (at the very least), and yet valuations are reasonable. Credit growth is trending in double digits and banks are well capitalised.

“Our second largest exposure is in consumer companies which are our earnings compounders. We have a wide range of consumer businesses from staples, building materials, quick service restaurants, garments and even electronic manufacturing services. The consumer portfolio has seen a decisive tilt towards more discretionary plays over staples. We are playing the pick-up in domestic growth and real estate revival through exposure in cement (11%) and industrial (5%) stocks. At the same time we are also well positioned to capitalise on the gains India is likely to make as economies rebalance supply chains out of China. There are several stocks across sectors which are already seeing a positive impact including Dixon & Kajaria (consumer), Welspun (textiles), Skipper (industrial). Others like PI Industries & Aarti (specialty chemicals) are also potential gainers.

“With respect to our **benchmark**, our overweights are in financials, IT and metals. Our metals exposure is not through any global commodities but instead through cement and speciality chemicals companies. We are **underweight** healthcare, having exited Divis Laboratories. One of our biggest underweights remains utilities.

“We are entering Indian Fiscal FY24 (year ending 31 March 2024) with one of the highest aggregate earnings growth for our portfolio. This does include above average numbers with sectors like cement and banks benefiting due to a low base effect. In parallel, we expect margins across portfolio companies to rise as commodity prices settle.

“We remain confident with our positioning as we enter the year with a portfolio having higher growth and lower valuation than the broader market.”