



HOODnote: India: Beyond the headlines

The Indian economy has been in the limelight as one of the few bright spots in an uncertain world. Some are even calling it 'India's decade'. Reforms, digitalisation, improving infrastructure and the government's Make-in-India initiatives are some reasons backing the above. The strength of the India story has been underpinned by a few structural trends:

- healthy growth in government tax collections
- a revival of private sector capex cycle and the real estate sector
- long-term consumption trends remain intact despite some short-term weakness
- stable currency buoyed by foreign currency reserves of US\$ 560bn+ and rising inward remittances
- exports of IT services surpassing the oil import bill taking the pressure off the current account deficit
- domestic institutional investor (DII) emerging as a strong and steady buyer offsetting volatile foreign institutional investor (FII) flows
- well capitalised banks, with no stress in the banking system

With India's population exceeding China's and being significantly younger, reinforces this positive commentary. Most overseas visitors who visit India are overwhelmed with the activity and positivity seen in the economy.

We too are strong believers of the above. While much has been written about what is happening in India at a macro level, in this note we highlight some trends, initiatives and developments, which do not get mentioned in the mainstream media but are amongst those that contribute significantly to the positivity we see around us.

The rise of domestic air travellers

April'23 saw the highest ever domestic passenger air traffic in India. The story behind this rising trend goes back to the year 2016 when the Government of India launched a scheme called 'Ude Desh ka Aam Naagrik' (UDAN) which means 'Let the common citizens of the country fly'. The view was that for more broad-based and sustained economic development, it was essential to improve India's regional connectivity by connecting small cities with large cities by air. Since this initiative, over 74 new airports have been operationalised taking the total to 140+ operating airports in India, and over ~470+ new air traffic routes have been opened (1500+ air traffic routes in India).

The more intriguing part was the implementation of this scheme by the government. New routes were made cost effective for airlines by lower taxes on fuel, reduction in charges and taxes at these regional airports, and also a cap on fares for a percentage of seats to make it more affordable for the common man to fly. More importantly, the Airlines themselves were asked to recommend the routes and airports that should be operationalised given their

deep insights about the traffic movements. This was perhaps one of the main reasons for the success of the scheme.

The impact of this scheme is visible even in our daily lives. For a long weekend from a coastal city like Mumbai, even the Himalayas have now become a practical destination with direct connectivity to several cities on the foothills. Similarly, travel times for inter-state and rural-to-urban migrants is cut down by many days without the need to use multiple modes of transportation. Among the new airports, the highest traffic of over 600,000 passengers in a year was from a city called Darbhanga. A Google search shows that it is the 5th largest city in the state of Bihar. Clearly, India is changing.

The highest exposure of India Capital Growth Fund (ICGF) is in companies benefitting from the consumption theme. Within this, a recent entrant in the fund is VIP Industries, India's largest luggage manufacturer and a direct beneficiary of the boom in domestic tourism.

Fact Check

- The Kashmir valley recorded its highest ever tourist arrivals at 2.6m in CY2022.
- India is the 3rd largest aviation market in the world. There are 1150 aircrafts currently on order by domestic Indian airlines.
- A tourist city like Goa, has over 100 one-way flights daily to different parts of the country.
- Uttar Pradesh, India's largest state by size and by population (233m people) has 9 operating airports, with another 11 likely to be operationalised soon.

Source: Financial Express, Hindustan Times, UIDAI, Ocean Dial



Rethinking India's defence policy

When it comes to tourism, one of the relatively unexplored parts of India has been the Himalayas. The entire mountain range borders with Pakistan and China. However, previously, government policies prevented tourists from visiting border areas and the infrastructure was also relatively poor. The reasoning behind this was to limit inroads by the enemy. This policy has now been reversed.

The new thinking is to develop villages in border areas as tourist destinations. This should provide employment and development, and also protect the borders. Consequently, this has resulted in a big build out of infrastructure (roads, bridges, communication) with both Kashmir and Arunachal Pradesh, two of the key states in the border areas being positioned as big tourism destinations. This shift in thinking is across the defence sector with multiple areas of strategic reforms. One of these, which has a large ramification on

the economy is the attempt at reducing India's reliance on defence equipment imports (India is the world's largest arms and weapons system importer accounting for 11% of global imports). Attempts have been made in the past to reduce the reliance on imports but with limited success because of conflicting interests. However, in the new policy implemented since 2020, the Government, to show its seriousness, has created a list of products and platforms which would be banned from imports over a defined time-period. Till now, four lists comprising 411 products have been banned.

This has created a huge market opportunity in India with the private sector now willing to invest resources in developing these products and consequently, global players also looking to develop partnerships in India.

Fact Check

- India is the 3rd largest military spender in the world with the budget for FY24 estimated at US\$72.5bn.
- The Atal Tunnel, a 9km tunnel was inaugurated in October'20. It is the world's longest highway tunnel above 10,000ft, and has reduced journey times from 6hrs to 2hrs.
- The Zoji-La Tunnel, a 14km tunnel at an elevation of 11,575ft is expected to be completed in 2027.
- The Chenab Rail Bridge, a 1.3km long bridge would be the highest rail bridge in the world and is likely to be completed by the end of 2023.

Source: Economic Times, Kotak, Ocean Dial

Mainstreaming of North-East India

There are 8 states in the North-East of the country, which for most of the 75 years since India gained independence viewed themselves as not being a part of India. These regions were cut off from the rest of India through a small corridor (named as chicken neck) with a narrow width of only 23km, with Bangladesh and Nepal on either side. 99% of their borders are international boundaries. Being landlocked with a hilly terrain, less densely populated, culturally different with a large Christian population, the mainstream political system largely ignored this part of the country. Consequently, there was very little infrastructure and economic development, and law and order was a serious issue.

Four of these states had state elections in February this year, and it was the Bharatiya Janata Party (BJP), the current party in the central government along with its regional allies which won all the states. What was surprising was that until the 2014 state elections, the BJP had no presence in these states. They had never even contested an election! So, what changed? The one consistent factor in our opinion is development.

Since the BJP came to power at the centre, an 'Act East' policy was formulated with the aim of mainstreaming these states with the rest of the country. The Prime Minister himself visited the North Eastern states on over 50 occasions since 2017, with Union Ministers (part of the senior decision making body of the Government of India) visiting these states frequently. The result is evident.

- **Roads:** over US\$ 50bn invested, 4000km+ roads built, doubling the network
- **Railways:** 20 projects being implemented, all state capitals being connected
- **Airports:** 7 new airports built, total operational airports at 17, further 8 in the pipeline
- **Number of flights:** has increased from ~900 per week to ~1900 per week

It is also no surprise that this region is the fastest growing market for cement companies (India Capital Growth Fund has 6.6% of the portfolio in cement companies). The key takeaway for us is that the BJP victory demonstrates that people are rewarding political parties which are able to deliver on economic development.

Fact Check

- Roads worth US\$36bn are being built in North East India by 2024
- The combined population of the 8 North-Eastern states is ~52mn people; in comparison UP (most populous state) has ~233mn people

Source: India Today, UIDAI



Vande Bharat Trains

There is a fair bit of nostalgia when one thinks about the Indian Railways. However, even today, the picture remains much the same, red coaches pulled by locomotives, noisy, rickety loos, etc. The only change has been more choice of air-conditioned trains, and diesel and electric locomotives instead of steam ones. Compared with Europe, the Indian Railways seemed to be stuck in a different era.

When the government decided it was time to change, a team was sent to Europe to study the systems and shortlist partners to import their trains to India. The story goes, that the Prime Minister questioned why these could not be made in India through in-house technology. In the end, the erstwhile Head of Rail Coach manufacturing unit, who had 18 months left to retire took it upon himself to build it out. The project was named 'Train 18' and within 18 months, India had the first two prototypes of the train ready for trial runs. The first train was launched between Delhi and Varanasi on 15th February 2019, just 18 months from the start of the project. As we write, there are already 15 trains in service, and orders for another 200 have been placed (each train costing US\$15m) with the goal of having 400 trains in service in the next 5 years.

According to ICF (Integral Coach Factory), the manufacturing cost of 'Train 18' is approximately half the

cost of a similar imported train set and is made under the 'Make in India' initiative.

This is expected to transform the Indian Railways. What is even more transformational is that the policy makers are thinking of scale and not focusing on short-term annual orders. With this long-term vision, companies are willing to invest and build capacities e.g. Alstom and Siemens have both set up locomotive plants in India as each of them received orders for 800 / 1200 high powered locomotives over 11 years to haul the e-wagons for the Dedicated Freight Corridor being commissioned. Similarly, Indian railways who used to order 20-35000 wagons per year are now placing orders in excess of 84000 wagons in one go.

This has resulted in all the suppliers running at full capacity for the next 3 years with further visibility to expand capacities. Railways, has thus become one of the key capex driven business stories playing out in India.

One of ICGF's largest holdings is Ramkrishna Forgings, a big beneficiary of the capex spend in railways. They have seen rising order wins and are also setting up a greenfield plant to manufacture wheels specifically for the Indian Railways.

Fact Check

- Indian Railways run 13,169 passenger trains daily carrying 22.2m passengers daily.
- The Vande Bharat train runs at a speed of 160km/hr, tracks permitting.
- Train 18 or Vande Bharat express is the India's first engineless train with an integrated engine like bullet or metro train.

Source: Times of India, Business Standard, Ocean Dial

While there are a lot of counter arguments on some of the above, with people claiming it is more a marketing exercise by the current party in power, and in reality a number of the new airports and routes are actually unviable. Likewise, trains like Vande Bharat are just 10-15% faster than the existing ones. The fact does, however, remain that as we delve deeper into the fine prints, we see a common thread:

- There has been out of the box thinking by the current government.
- Plans are now on a bigger scale and more long term with ambitious targets, some even for the year 2047, when India celebrates 100 years of independence.
- The pace of execution has seen a steep jump providing confidence to the private sector on the future, which further assists in making decisions and in their risk-taking ability.

The changes highlighted above are just the tip of the iceberg. There are several other initiatives that have been attempted, a lot of which are still work in progress, including: 100 smart cities, river Ganges clean up mission, reviving the waterway transport system, affordable housing, clean India mission, to name a few.

The capex story is already yielding results in the economy, particularly in the investments made in the road and railway industry. We believe the momentum remains strong and is expected to continue accelerating. We are now beginning to see the secondary impact of this in rising order books and capex plans of the private sector as well. This is the driving force behind the confidence in the economy. The best we believe is yet to come.

India Capital Growth Fund (ICGF)*, the LSE listed Investment Trust focused on mid and small cap Indian Equities, managed by Ocean Dial Asset Management has delivered a 128% increase in net asset value (NAV) over the last 3 years, ahead of the benchmark which has returned 115.1% in GBP terms. However, its shares have rallied to deliver 223.8% to shareholders, significantly ahead of its benchmark (115.1%) and its peers (average return 74.6%). Data as at 10th May 2023.

To learn more about why we are so excited about the Indian economy and the mid-small cap space, please click [here](#) or to subscribe to our monthly newsletter, please click [here](#).



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