



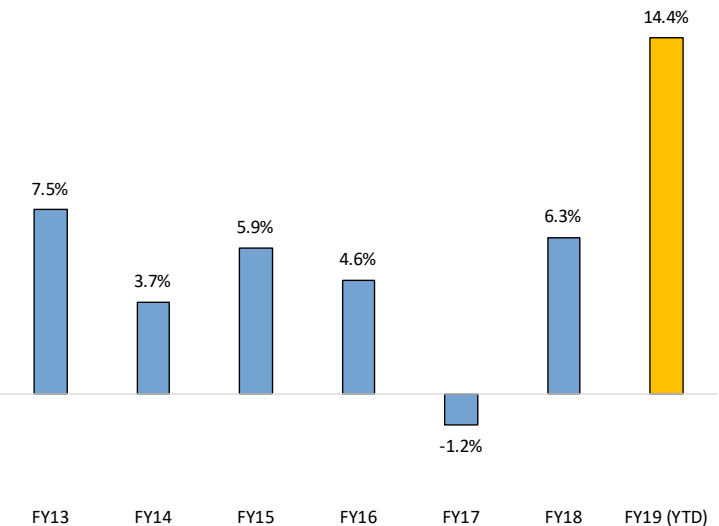
Domestic Economy Powers On

In the midst of a trade standoff between the world’s two economic titans, it’s good to be a domestically focused economy if your macro fundamentals are strong. India is in that fortunate position.

Manufacturing growth continues to be among the strongest in the world, with the PMI accelerating to 53.1 in October from 52.2 the previous month (Figure 2); now 15 months of consecutive expansion. The drivers for new investment seem in place with the number of job openings the highest ever this year along with solid growth in new orders.

Cement production, a decent proxy for capital investment, is on track to comfortably exceed 14%, the first double digit growth in several years (Figure 1). Electricity production also continues to accelerate (Figure 3). This is a what a strong macro picture looks like.

Figure 1: Cement Demand Growth (YoY)

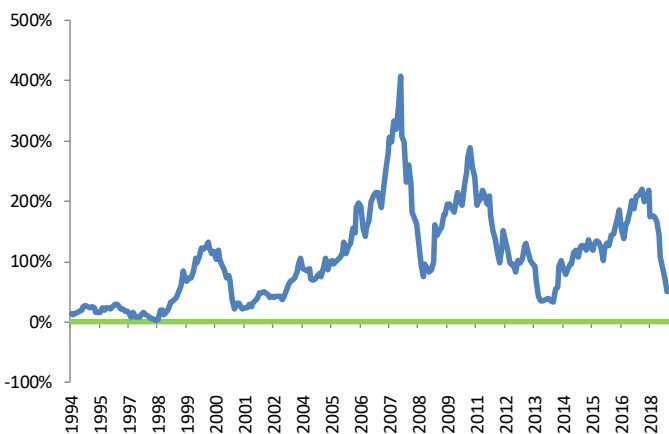


Source: Ministry of Commerce & Industry

Performance Data - 31st October 2018

NAV A2 SHARES (Open Series)	NAV A SHARES (Closed Series)	FUND SIZE
US \$47.99	US \$81.21	US \$315M
Performance Since Inception:		
ICF	Cumulative 379.9%	CAGR 6.7%
\$BSE 30	218.0%	4.9%

Cumulative Outperformance of ICF vs \$BSE 30



Key Details & Fund Overview

Management Co:	India Capital Management (ICM)
Launch Date:	Sept 1994; Relaunched May 2001 per note (2) below
Structure:	Open-ended, unlisted investment company
Domicile:	Mauritius
Base Currency:	USD
Open for Subscription:	Month-end
Redemption Notice:	60 Days / Monthly
Management Fee:	1.25% per annum
Performance Fee:	20% of gains over 5% hurdle
Minimum Investment:	\$250K non-US individual/\$1M non-US Institution \$1M US individual/\$5M US Institution
Custodians:	BNY Mellon
Auditor:	KPMG
Administrator:	State Street/SANNE Mauritius

ISIN	SEDOL	Bloomberg
MU0160S00269	6670377	INDSMLI MP

Returns (Net of All Fees)

ICF 2018 Monthly Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	YTD
ICF	(2.2)	(4.9)	(2.8)	1.8	(3.7)	(6.7)	2.2	(3.6)	(11.2)	(5.8)	(31.7)
\$BSE30	5.9	(7.1)	(3.5)	4.3	(0.7)	(1.3)	6.2	(0.7)	(8.4)	(6.9)	(12.8)

ICF vs \$BSE 30 Annual Returns

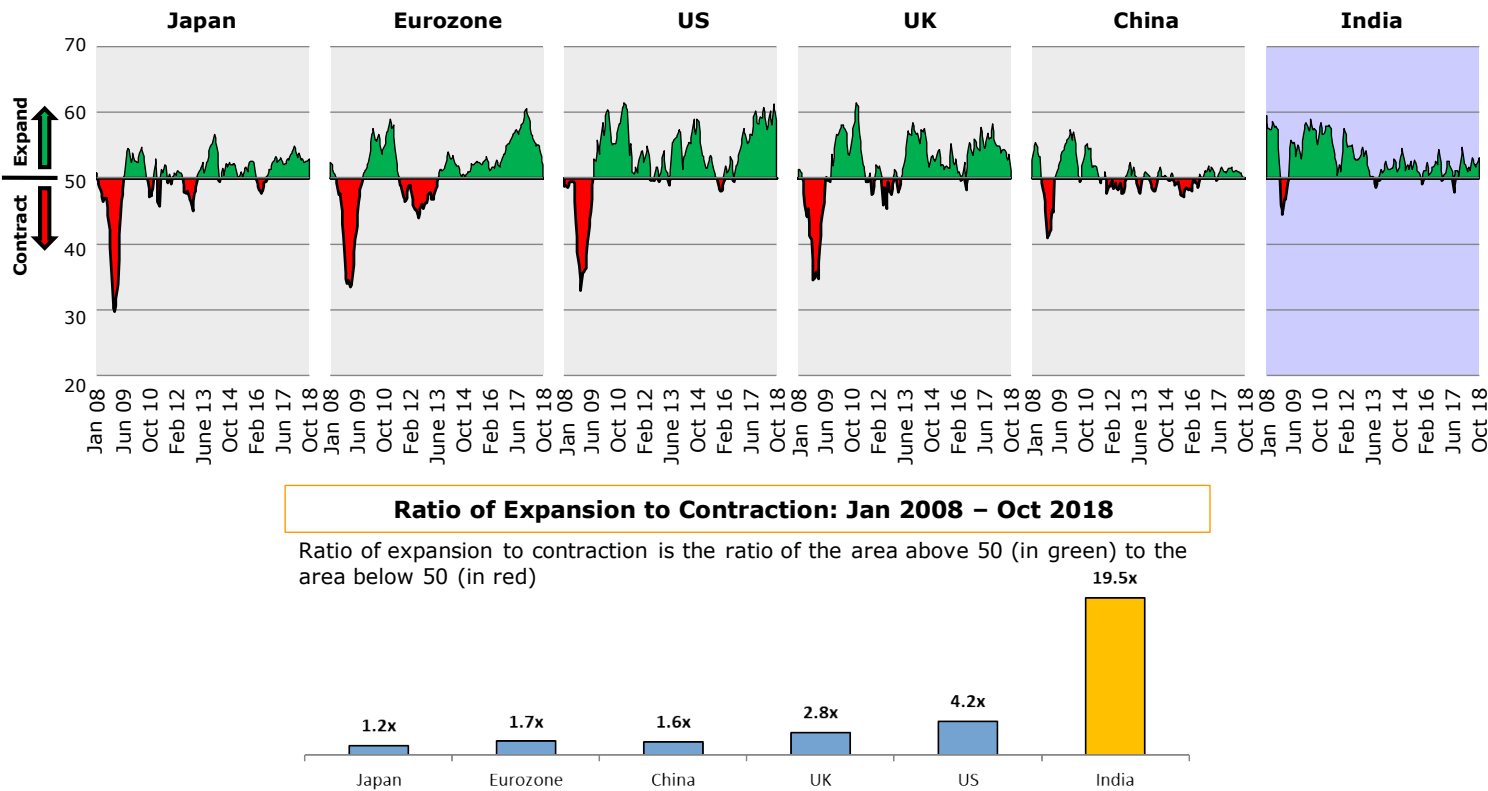
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
ICF	57.0	77.8	(68.8)	96.7	23.7	(45.0)	25.6	(21.7)	48.4	(2.7)	1.8	43.2
\$BSE30	49.3	65.2	(61.5)	89.4	22.2	(36.6)	21.8	(3.5)	27.1	(9.3)	(0.7)	36.2

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
ICF	2.3	(18.3)	(7.3)	(9.3)	27.3	124.2	(33.9)	(44.1)	26.5	113.2	10.6	31.8
\$BSE30	(14.5)	(28.9)	(3.2)	8.4	(22.9)	60.0	(26.0)	(20.5)	4.1	81.8	18.7	37.3

The ICF is an absolute return fund. The investment advisor, ICM, is one of the longest serving India-only advisors. The fund invests in a long-term concentrated research driven portfolio of stocks. Past Performance is No Assurance of Future Results. Investing in ICF involves a risk of loss. The returns above are net of all fees and expenses borne by ICF with dividends re-invested. (1) ICF has generally offered three different classes of shares: (a) A Shares from launch in September 1994 until May 2001, (b) A1 Shares from May 2001 to April 2003, and (c) thereafter A2 Shares. This newsletter shows for each period the performance of the share currently offered. A Shares and A1 Shares pay lower fees than A2 Shares, so the performance shown for periods prior to 2004 is greater than if the fees paid by A2 Shares applied to all periods. A Shares pay a 1.5% annual mgt fee and no performance fee, and A1 Shares pay a 1% annual mgt fee and a 20% over 10% performance fee. (2) ICF launched in September 1994 as the Indian Smaller Companies Fund Ltd. with a focus on small cap Indian companies. In May 2001 as part of its relaunch it changed its name to India Capital Fund Ltd. and changed to an all cap strategy.

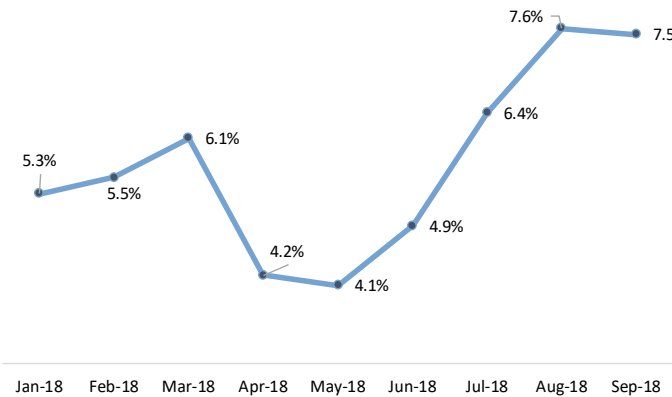


Figure 2: Long-term PMI Trend: Jan 2008 – Oct 2018



Source: Bloomberg, Institute for Supply Management, ICR

Figure 3: Electricity Production Growth (YoY, 3 month moving average)



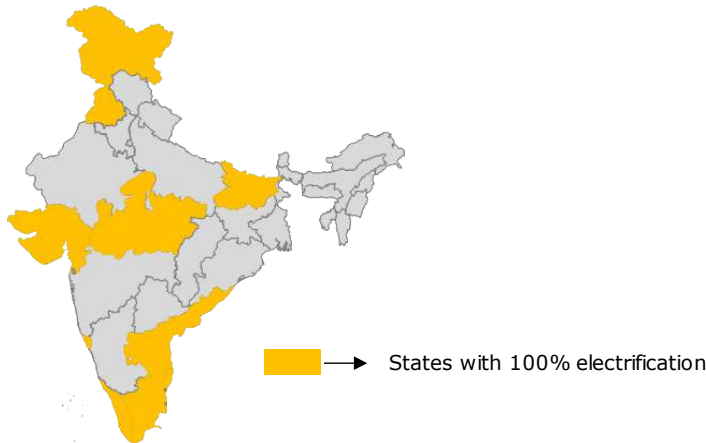
Source: CEA

India’s Electrification Drive Picking Up Pace

Power demand will be further bolstered by the government’s rural electrification drive. The Saubhagya, or “electricity for all” scheme is a government sponsored project announced by Prime Minister Modi in September of last year. Saubhagya is the Hindi word for good fortune and under this scheme, households are either eligible for free electricity connections or charged a nominal Rs500 (\$8). Rapid progress has been made in the last 12 months with close to three million new households being electrified every month. ICR portfolio company REC - (Rural Electrification Corporation) is the nodal agency for the Saubhagya scheme. However, despite the strong start, a lot remains to be done, with only 9 out of 30 states having achieved 100% household electrification so far (Figure 4). Uttar Pradesh, India’s most populous state, with a population of almost 2/3rd that of the US - still has less than 80% households electrified. While electricity consumption has more than doubled since 2000, per capita consumption is less than one tenth of that for the US, and one-fifth of that for China (Figure 5).

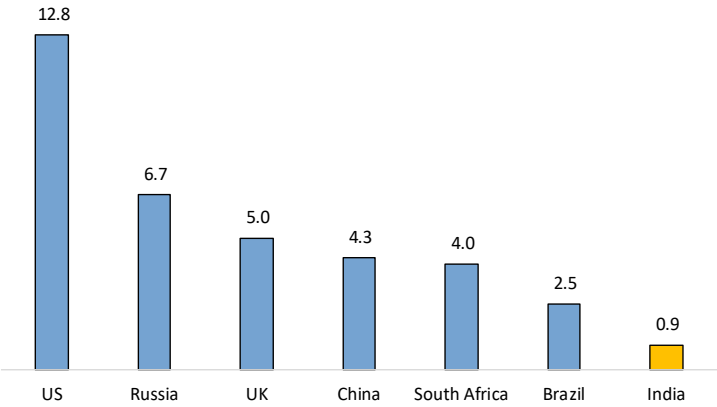
As power demand accelerates from a low base, and new households are connected to the grid, the states will have to invest in improving their underlying transmission and distribution (T&D) infrastructure. This bodes well for REC, the country’s largest financier of T&D projects.

Figure 4: Access To Power – Improving But Still A Long Way To Go



Source: REC, ICR

Figure 5: Electricity Consumption per Capita (MWh/capita)

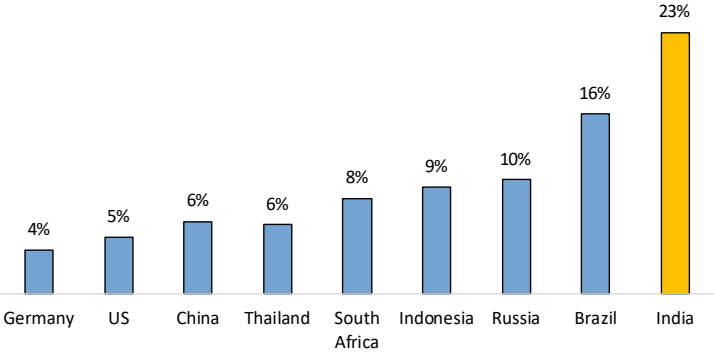


Source: Figures as of 2016, IEA



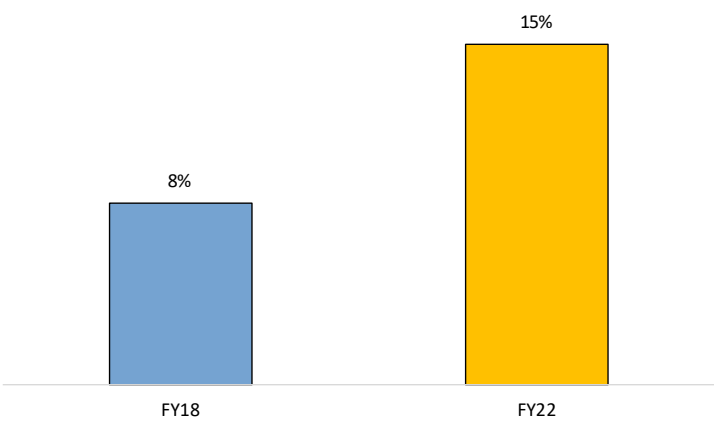
Transmission losses in India amount to a staggering 23%; almost a fourth of all power generated is wasted. Yet, the average for emerging economies is only 10-15%. It is difficult to budget accurately for how much it will cost to modernize the T&D network state by state, but clearly the figure will be large, while the benefits of reducing those T&D losses even more so. Industry sources typically quote \$75-85B that states/central government will need to invest to bring transmission efficiency levels up to at least that of emerging economies. The trend for the share of renewables with more volatile production patterns to increase within India's energy mix is another element adding to the necessity for transmission grid upgrades.

Figure 6: High Transmission Losses



Source: IEA

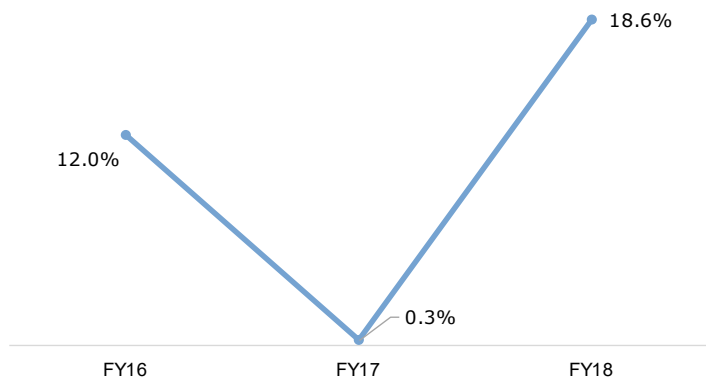
Figure 7: Renewables As A % of Total Power Generated



Source: CEA, ICR

REC is a direct beneficiary of the government's electrification drive and the ramping up of T&D infrastructure investment. The growth of the company's loan book, which had flattened last year, has now recovered to 19% and is likely to remain strong as the government strives to achieve its target of 24X7 power supply to all of India by 2022.

Figure 8: REC's Recovering Loan Book Growth (YoY)

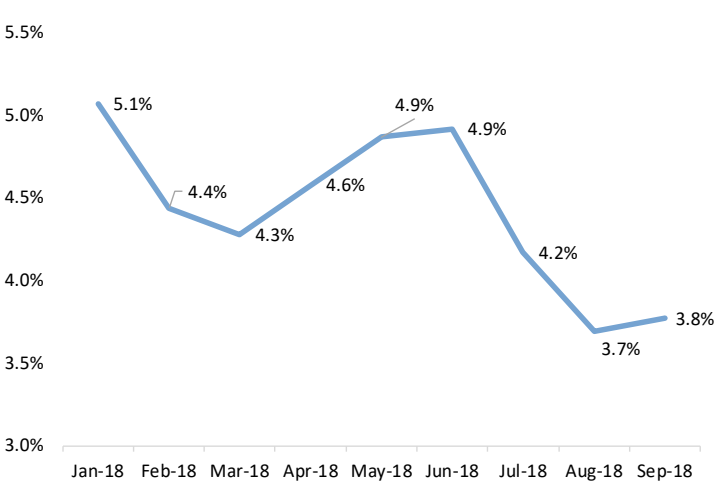


Source: Company, ICR

Despite the strong pace of economic growth and dollar strength retail inflation was up marginally only to 3.8% in September, remaining well within the central bank's (RBI) medium term target of 4%. Food prices, usually a key driver of inflation, also remain unusually benign, declining 0.2% sequentially in September, the seventh drop in the last eight months.

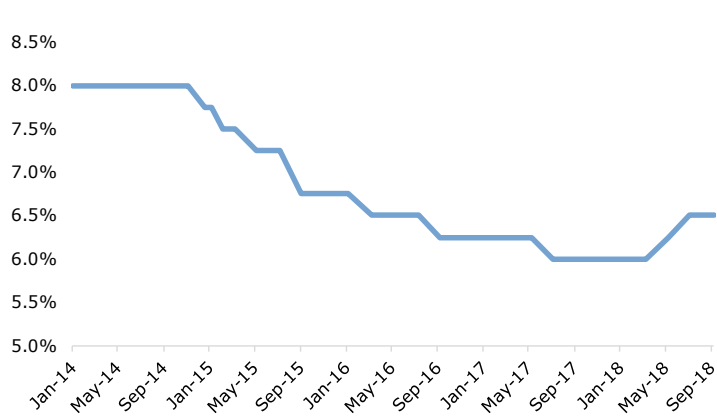
While it is impossible to predict the central bank's actions, the latest inflation numbers suggest that we may have a delay in the rate hike announcement at least to beyond the next RBI policy meeting in December.

Figure 9: Retail Inflation (YoY)



Source: Bloomberg

Figure 10: RBI Repo Rate



Source: Bloomberg

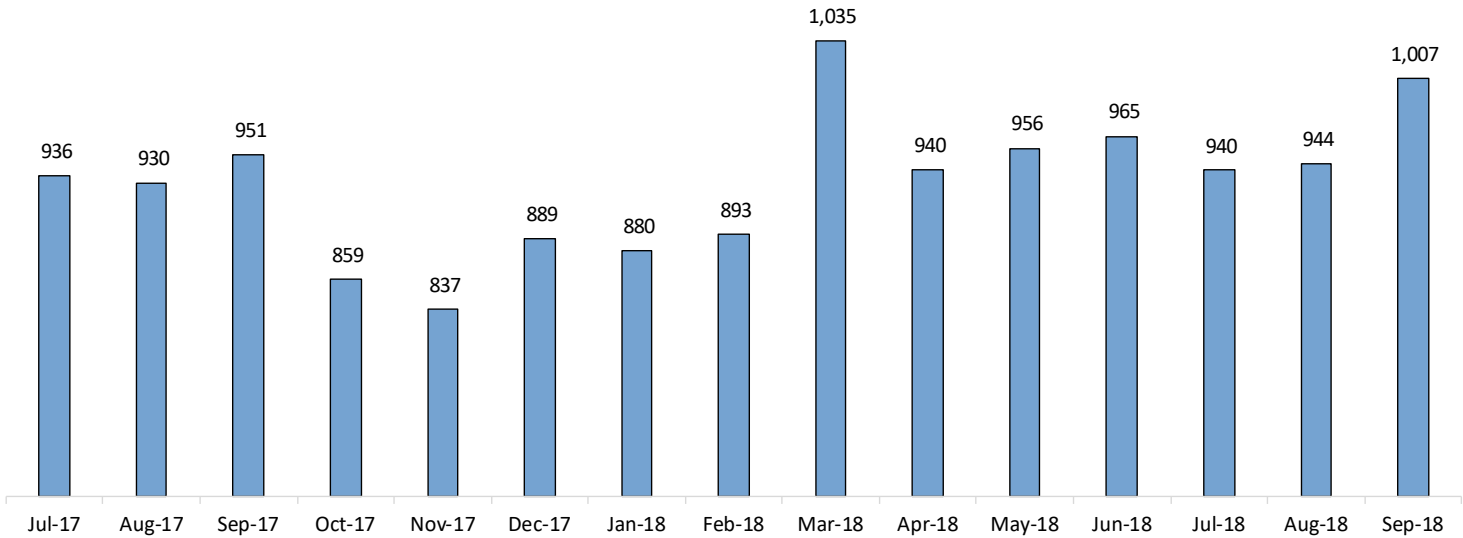
On the fiscal front, demonetisation, Aadhaar, restrictions on cash transactions and the implementation of the goods and services tax (GST) lay an audit trail which has enabled the tax department to bring more people into the tax net. March of this year saw GST collections cross the Rs 1 trillion (\$13.7B) mark.

The country's current tax-GDP ratio is 11.5% (only considering central government taxes), with an impressive 80%+ growth in the number of returns filed in the last four financial years from 37.9M in 2014 to 68.5M in 2018. Over this same period, the number of persons filing income tax returns has also increased by about 65% from 33.1M to 54.4M.

Happily for the taxman, "India's crorepati count expands 68% in 3 years" was a common headline splashed across newspapers last month, referring to taxpayers who declared income of more than Rs 1 crore (\$137,000) in their tax returns.



Figure 11: India GST Collections (Rs B)



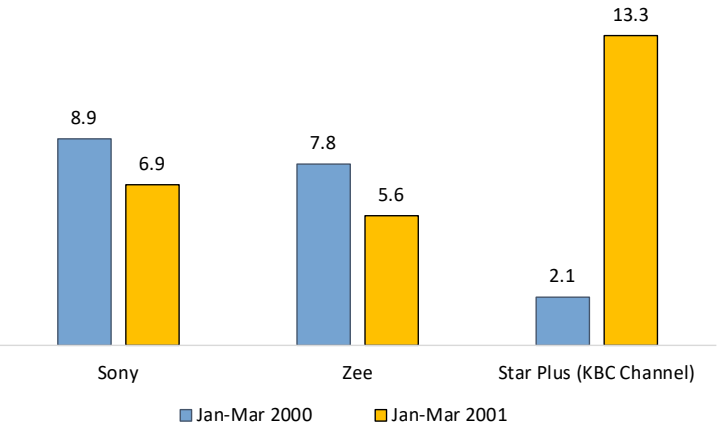
Source: Bloomberg, Institute for Supply Management, ICR

“Crorepati”, a Hindi term, is a derivative of the word crore which in the Indian numbering system is equivalent to 10 million. Thus, a crorepati refers to the Indian equivalent of a ‘millionaire’ in the West. The newspapers loosely depicted individuals with an annual (pre-tax) income rather than net worth above Rs 1 crore (\$137,000) as “crorepati”, but it made nice headlines.

The Central Board of Direct Taxes (CBDT) has claimed credit for the rapid rise in India’s number of “crorepati” taxpayers putting the figures down to the department’s efforts to “educate” taxpayers about paying their due taxes, and to their post-DeMo ability to enforce the rules. It’s always been clear that there was some disjoint between many people’s obvious (sometimes really obvious) wealth and meagre tax receipts.

With inflation and rising income per capita, the crorepati club has inevitably lost some of its former mystique. Back In 2000, when the local version of “Who Wants to Be a Millionaire?”, “Kaun Banega Crorepati” (KBC), debuted on the Star Plus channel with Amitabh Bachchan, Bollywood megastar as anchor, it singlehandedly catapulted Star Plus’s viewership ratings from third to leadership position.

Figure 12: KBC Impact – Prime Time Viewership Share between Channels Before And After KBC



Source: News articles

Figure 13: KBC with Amitabh Bachchan



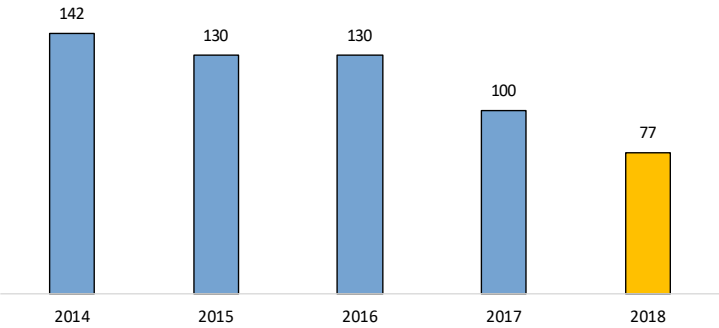
Source: News articles

Ease of Business Ranking Continues to Climb

The major government initiatives on the domestic front including electrification, GST/formalising the economy have made their wider mark. In the World Bank’s Ease of Doing Business Ranking, India has moved up 53 places in just 2 years. The World Bank in its report stated that, “Starting a business was made easier through [the] consolidation of multiple application forms and introduction of a goods and services tax (GST), while getting electricity was made faster and cheaper. Other reforms in India included strengthening access to credit as well as making it easier and faster to pay taxes and trade across borders.”

India now ranks in the top 25 in the world on three prime indicators- getting electricity, getting credit and protecting minority investors.

Figure 14: India’s Rank in Ease of Doing Business (low number score means a higher ranking)



Source: News articles

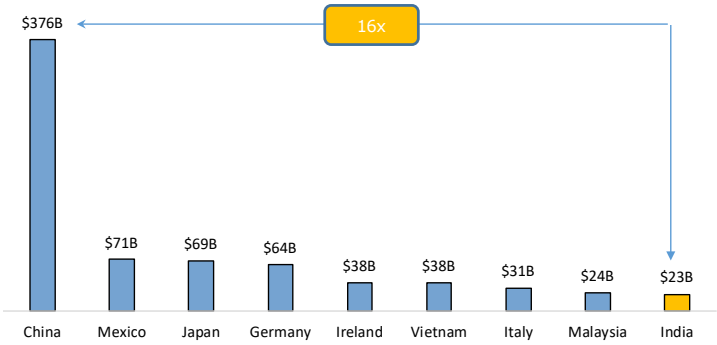


Trade War Impact on India

Outside of India, the US China trade war continues to escalate with the latest round of import tariffs bringing the total value of Chinese goods affected by tariffs to \$250B (1.3% of global trade or 0.3% of global GDP).

India, whose trade surplus with the US amounts to just US\$23B is, as we've described in previous newsletters, very much a bystander in this drama. The same can be said for ICF portfolio companies with 90%+ of portfolio company revenue derived domestically.

Figure 15: US Trade Deficit 2017

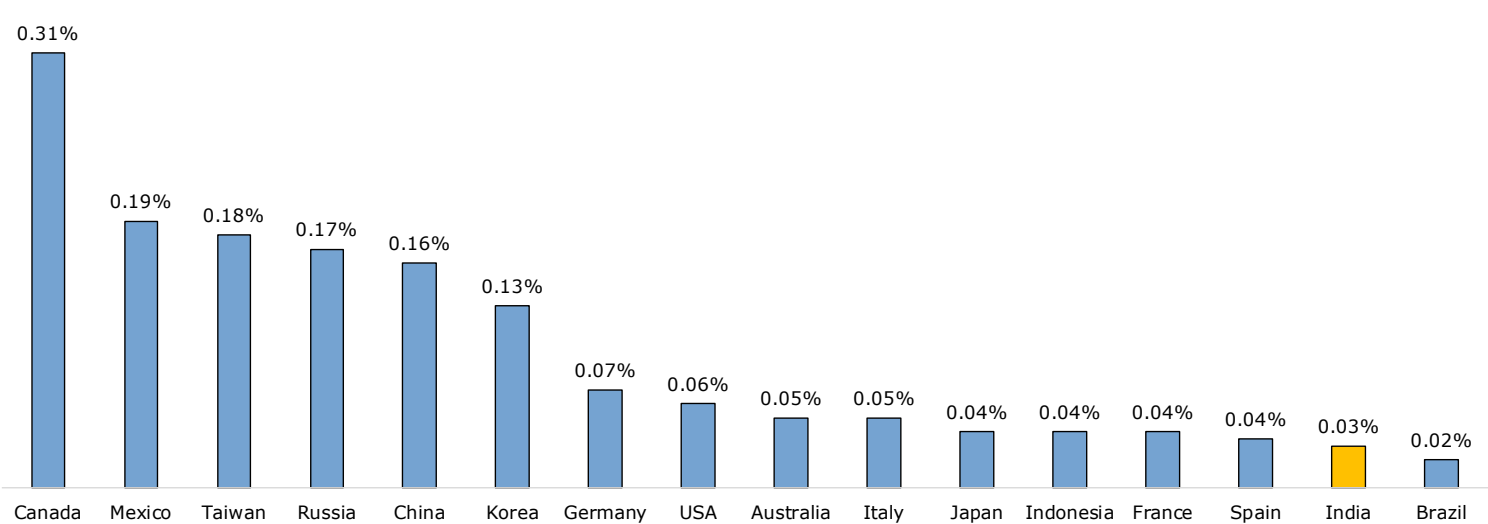


Source: Morgan Stanley, ICR

The country's export markets are fairly well divided between emerging and developed markets, with no single export market dominating (Figure 16). Hence even if US tariffs on imports escalate beyond China, there should be limited impact on India's corporate sector and economic growth. So far, US tariffs on goods from India have been meagre with imports worth only \$1B targeted, following 25% and 10% tariffs on certain steel and aluminium imports. Signalling its keenness to avert a confrontation, India deferred for the third time retaliatory tariffs against 29 American products worth \$235M that were to come into effect to counter the US move to unilaterally raise import duties on Indian steel and aluminium products.

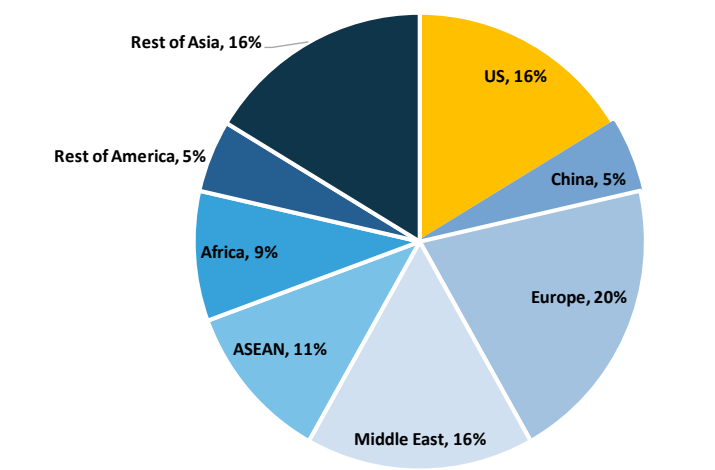
That's not to say that India would be immune to second order effects of the trade war in the form of a slowdown in global growth, weakening investor sentiment, but the more significant impact will spill over into countries highly integrated into China's supply chain such as Japan, Korea, Taiwan and some South East Asian countries.

Figure 18: Morgan Stanley Assessment of Impact on GVA Growth From Current Tariff Announcements



Source: Morgan Stanley, ICR

Figure 16: India's Split of Exports by Region

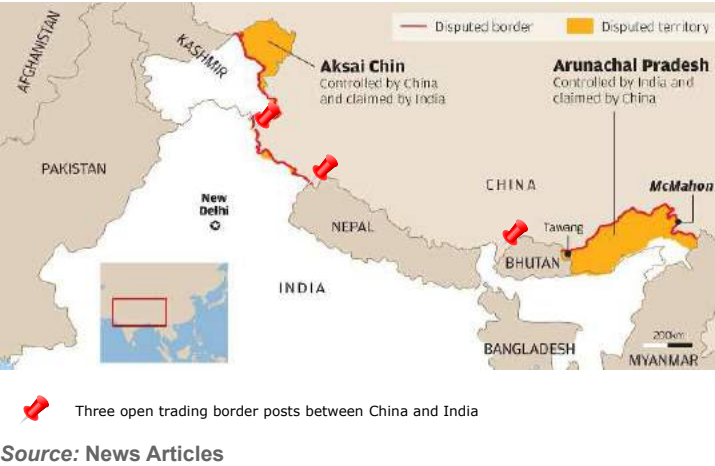


Source: Morgan Stanley, ICR

An article described how trade could hypothetically take place between the US and Canada: "United States and its largest trading partner Canada decide that they will not permit any border crossings for trade or tourism. All trade will happen only between the East coast ports in Canada's Maritime Provinces and U.S. ports such as Galveston, Texas and Long Beach, California – using a long and circuitous shipping route. Sounds like a ridiculous way of doing business, doesn't it?"

Yes, it does, but it describes India and neighbouring China. The two share a 3,380 kms long border but there are just three open trading border posts:

Figure 17: India – China Border



Source: News Articles



A brief history: Border trade between China and India was closed between 1962-1992. Subsequently during the next two years, two trading posts were opened. Then in 2006 a third post Nathu La, the most prominent of the three posts, was re-opened. Nathu La remains the only significant border crossing between India and China, but is located at 14,000 feet elevation.

Although Nathu La is now open, large sections of the road linking Sikkim, the northeast Indian state, with Tibet are narrow and littered with potholes, much like the ancient Silk Road. It's open Mondays-Thursdays and trade permits are only given to those who have been Sikkimese citizens since 1975. The area has no warehouses to store goods nor any hotels. Only 56 low-end items can be traded. Leading Chinese exports to India at Nathu La are yak tail and goats. Total trade last year was about \$400,000 (does not even account for 1% of overall bilateral commerce). And for about half the year, heavy snowfall forces authorities to close the border altogether.

The route is also subject to frequent closures due to the volatile border situation:

Figure 19: Such Headlines Are Common

Trade through Nathu La under cloud after serious Sikkim incident, says sitting MP

The last time there was tension was in 1960s, Sikkim MP PD Rai said, adding that at the time there was "lot of exchange of gunfire".

Updated: Jul 01, 2017 02:54 IST

Sushruth Pattnaik
Beijing, Hindustan Times



An Indian trade mart near Nathu La Pass.(HT FILE PHOTO)

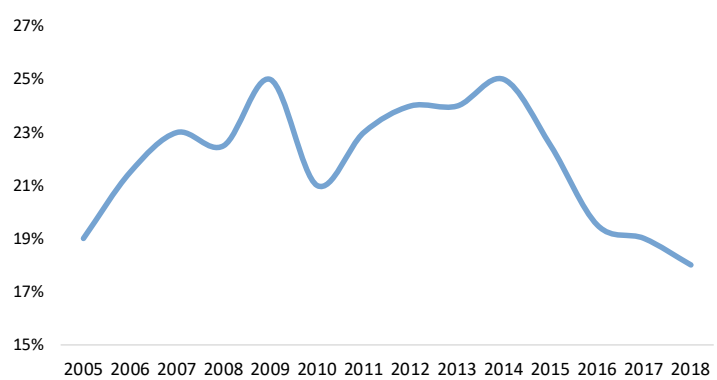
China says India to blame for border row, Nathu La closure

China has indicated India is to bear the responsibility for the on-going stand-off in the Sikkim sector and for the closure of Nathu La pass, and hinted that New Delhi was "interfering" in territorial disputes between China and Bhutan.

Source: News articles

The situation sounds comical but it's a powerful demonstration of not only the limited trade between India and China but also the lesser significance of exports within India GDP composition.

Figure 20: India's Exports As A Percentage of GDP: Lowest Since 2004-05



Source: Morgan Stanley, ICR

Introducing Uday Saripalli

India Capital has always had a robust middle office and compliance structure but we are fully cognizant of the need to be forward thinkers and planners in our fast-evolving financial regulatory landscape.

Thus we are very pleased that Uday Saripalli agreed to join India Capital Research in June as Chief Financial Officer/ Chief Operating Officer. Uday's 16 years of work experience encompasses various areas of accounting and finance, with much of the focus on business control roles.

Uday joined us from Premium Transmission Ltd. where his career has taken him from head of Corporate Strategy to latterly head of Business Control and Accounting. He holds an MBA in general management from the Asian Institute of Management, Manila, Philippines and is a Chartered Accountant. We asked Uday to write about his career and life experiences.

New Team Member: Uday Saripalli



When I look back on my career that started in the Y2K year (yeah, that year of supposed turbulence), I reflect on enriching experiences spanning six different industries – steel, pharma, insurance, mass manufacturing, pharma (OTC) and discreet manufacturing before joining the seventh one (capital markets). These experiences have made me what I am today.

In 2000, I joined the consulting arm of an Indian accounting firm - V.K. Surana & Co. and was assigned to work on the fixed asset capitalization for Ispat Industries, which had invested \$2B at its shiny new integrated steel plant near Mumbai. It was quite a challenge for an accountant to work with supply chain personnel and civil engineers to understand the nature of the costs incurred and their correct classification.

While still at the capitalization project, bad news came in for the Indian steel industry with both the European Union and United States levying anti-dumping duty on Indian steel. It was personally challenging as I got to work on the detailed response to the anti-dumping questionnaires, trying to prove that our exports were not detrimental to the local markets. Though we did not win our appeal, this opened me up to the dynamics of the global steel industry and the world of global tariffs.



Once that assignment was completed, I decided to move on and joined Wyeth Ltd, the pharma company, as an internal audit executive. Our focus was on business improvements aimed at improving the bottom line. As fate would have it, the Gujarat riots of 2002 broke out and I was stuck at our Gujarat plant. An intended two-week assignment into purchases turned out to be detailed review of inventory planning, logistics and production. I would often visit the shop floor and talk to the supervisors and workers. The best of business ideas emanate from the shop floor and it so happened that I ended up recommending a slew of process improvements in logistics and production planning (including use of a hand-held scrapper to scrape out the extra ingredients sticking to the walls of centrifuge vessel and thus increasing the yields).

It was at Allianz Bajaj that the idea of going for an MBA was born. By this time I had realized the importance of understanding businesses from a holistic angle and so I started applying to business schools around the world. It was quite a moment of joy when I got accepted by the Asian Institute of Management (AIM), Manila, Philippines for the 2004-06 MBA program.

The MBA program proved to be a life changing moment, and not only for my career. Being abroad was quite a cultural shock. Food habits were totally different, behavioral patterns of my classmates added to the complexity of the world around me. While in India I always believed Indians to be the most docile of people (stemming mainly from how the Australian, Kiwi and South African cricket teams would bully us); so it was a rude shock to see Filipinos viewing us as aggressive.

Doing projects and case studies with multi-cultural, multi-ethnic classmates proved to be a much more uphill task than otherwise it would have been. On top of this, AIM would grade us for the most part on what we did in class. Being an introvert, speaking, presenting and defending my views in front of 60 plus people put me in a constant state of stress! Also, I would have to step out of my comfort zone to learn and speak about operations management, sales, marketing and human resource management – subjects that were clearly not my forte. Two years at AIM changed my life for the better, equipping me with a holistic view of approaching business and, more importantly, inculcating in me an ability to empathize and work with people from diverse backgrounds and cultures.

My first post-MBA job was as finance business partner to supply chain and later as leader for strategic projects with Johnson Electric in Hong Kong which was where I got to implement all the newly learnt MBA skills. Johnson was quite aggressive with acquisitions and a key to its success was integrating the acquired businesses. I led the way in streamlining and harmonizing processes across our acquisitions in Japan, Europe and North America. The challenge as always was to manage people of diverse backgrounds and cultures, across hierarchies and time zones. The MBA experience helped me sail through, with subjects like Cross Cultural Communication and Human Behavior in Organizations helping me more than the technical subjects. Working two weeks a month at the Company's Shenzhen, China plant (which employs 35,000 workers and churns out a whopping 3M motors a day), provided a great insight to the China story from very close quarters.

Having spent seven years out of India, I decided to make a move back to India to stay closer to my family in 2010. Novartis India gave me an opportunity to join their Over the Counter

(OTC) division in Mumbai as head of business planning and analysis. OTC was very interesting as it is a hybrid of pharma and FMCG, so it was an entirely new experience to learn about the world of advertising and its effective planning.

The lure of heading the strategy department for a company embarking on a bottom-up overhaul of its operations brought me to Premium Transmission, Pune. It was a fantastic time, though quite stressful, to institute transformational changes in all the spheres of the company's operations – from manufacturing, sales, marketing, finance and accounts to human resources.

Working with external consultants and in-house talent, we brought in firm-wide changes that focused on processes to achieve results as against the prevailing culture of fire-fighting and last-minute heroism. Adding to the complexity was our 100% subsidiary in Germany that was in the red. Moving production from Germany to India and also tapping into the knowledge base of German technology for bringing in a new product line: we were successful in turning it around and bringing it into green.

Having spent three years at the helm of strategy, I moved to handling accounts to gain hands-on experience of that function as part of realizing my goal of becoming a CFO. This was a relatively smooth tenure of two years though it had its fair share of challenges.

So, after a journey of 16 years, here I am at India Capital Research. What made me switch? Having spent five years at Premium Transmission, I felt I was ripe for a CFO role. The idea of moving back to the bustling financial hub of Mumbai and an opportunity to get into capital markets appealed to me. The fact that India Capital was one of the first FII's in India with a most enviable track record and a team culture that I gauged during my extensive interview process was the clincher.

India Capital has a very strong compliance structure, complemented by truly world class professionals and consultants. From what I have seen in the past five months, compliance remains a corner-stone of India Capital's work ethic and a key corner-stone of its success. Now is a great time to harness the wealth of knowledge and experiences across jurisdictions and resources to build up a unified compliance infrastructure. This would allow our personnel and businesses from across the world access to the best of resources and help with a pro-active approach towards compliance.

I have always believed in a good work-life balance and so on the personal front I keep myself engaged by indulging in a host of activities including painting (mostly oil on canvas) and travelling. A self-taught painter, I like to imitate works of Vincent Van Gogh, MF Hussain and Edvard Munch among others.

I view travelling as essential for me to evolve as a person. On my travels I like to immerse myself in the local culture and cuisine (difficult at times owing to me being a vegetarian). My wanderlust has taken me to some exotic locales around the world like Israel, Tibet and the interior of China. The adventurous streak in me also led me to do a scuba certification course some years back, so now I try to build it in my travel plans. Although my last dive was quite an experience – I got drifted away from the pack by a strong current with reef sharks some ten meters away, it has only made me want more of it. Hopefully my future experiences will be more pleasant although I won't mind a little bit of action!

