13th July 2022

Aurum Small Cap Opportunities
Quarterly Portfolio Update – Q1 FY 22-23

Dear Investor,

It is always darkest before dawn!

As we pen this update, the world is under the grip of an economic crisis of sorts with continued supply chain disruptions (mainly due to Ukraine crisis / Russia sanctions) on the one hand and rising interest rates to reign in inflation on the other. A newly coined word 'shrinkflation' is often finding a mention in financial news and research reports!

After a meteoric rise over last few months, there has been an equally sharp correction in prices that most commodities (including crude) are currently witnessing, clearly suggestive of inflation peaking out sooner than later. This sharp correction has also ignited global recession worries, especially in US and Europe.

The big question on everyone's mind is 'Where does India stand amidst a turbulent global economy?' Let us ponder over a few points:

China + 1 is for real - enquiries from prospective MNC clients in many segments of manufacturing sector in India have sky rocketed

1. China + 1 is for real – The world woke up to escalated supply chain disruptions when China, once again, shut down many of its cities and industrial zones to enforce its zero tolerance policy in recent past. The need to de-risk a total disruption scenario caused by an authoritarian regime in China got remphasized and since then the number of enquiries from prospective MNC clients in many segments of manufacturing sector in India have sky rocketed.

2. We continue to hear horror stories emanating from the west (US/Europe) of travellers stuck in airport queues, flight cancellations, poor service levels in cafes and restaurants among many other such experiences of inconvenience faced by people at large due to employees

not reporting for work. No such scene has been witnessed in India despite its large population and sub scale infrastructure. Clearly the money doled out to 'all and sundry' during the pandemic and beyond is backfiring as the developed economies struggle to revive growth.

While most European countries as well as the US are feeling a severe pinch of their high social security budgets, ageing population and flailing economy, India stands out as the fastest growing large economy with significantly better fiscal prudence

3. Despite having much better macro financials than most other western economies, the global rating agencies have always shied away from bettering India's credit rating to levels that would allow a country to borrow large monies at low cost and easy terms – something that the west has done recklessly over the last 15 years since Lehman crisis. In hindsight, that became a boon for India as fiscally we had to remain tight and spend wisely. In the current environment while most European countries as well as the US are feeling a severe pinch of their high social security budgets, ageing population and flailing economy, India stands out as the fastest growing large economy with significantly better fiscal prudence.

4. The lions share of our import basket comprises of crude. The Govt of the day is making all efforts to reduce India's dependence on imported crude through several long term initiatives such as building large renewable energy capacity, mandating increased blending of ethanol in automotive fuel and fast forwarding the mainstreaming of Electric Vehicles (EVs) amongst others. A visible impact of these initiatives will be felt over next decade providing cushion on the foreign exchange management front and help build a more stable outlook for Indian Rupee.

For a long term investor, the current time presents a great opportunity to buy quality businesses at reasonable valuations!

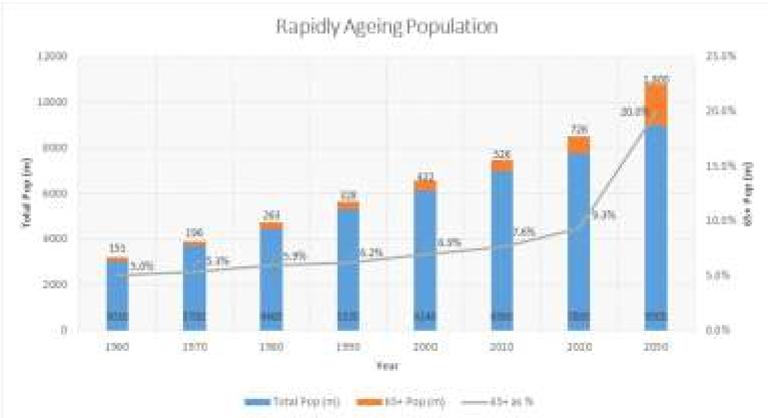
Considering the above and the fact that India continues to be a large domestic consumption economy of young people, we strongly believe that despite all the inflation and/or recession fear prevalent currently, India is well placed to weather this storm and attract global investor attention as this fear subsides. For a long term investor, the current time presents a great opportunity to buy quality businesses at reasonable valuations!

The Ageing Future

News headlines highlighting non-availability of workers (labour and managerial) across industries in developed economies of the West prodded us to look into the one issue that is going to create a huge impact globally in not so distant future, namely 'Ageing Population and its consequences'.

As evident in Table 1, in the last 60 years, (1960-2020), the global population has grown from 3 b to 7.8 b @ CAGR of 1.6%. During the same 60 years, the 65+ population grew from 150 m to 726 m @ 2.7% CAGR. In effect, in 60 years, the 65+ population doubled from ~5% (1960) to ~10% (2020) of total population. This is expected to double to ~20% in the next 30 years, i.e.; in half the time it took double from 1960 to 2020.

Table 1



Source: World Bank, UN Population Division, NRC Research

First, the good news from the above data is that people are living longer & better than any time in the past. Life expectancy has increased from 50 years (1960) to 73 years (2020). However, this demographic change calls for thoughtful & progressive change in policies & suitable technological advances to avoid the pitfalls of a ageing population and possible economic collapse.

Simply put, *Population ageing is a phenomenon wherein proportion of 65+ population increases vis a vis that below 65.* The cutoff age of 65 is considered important because it is assumed that most people retire from an economically productive life by the age of 65. This phenomenon of population ageing is driven by 2 factors, namely;

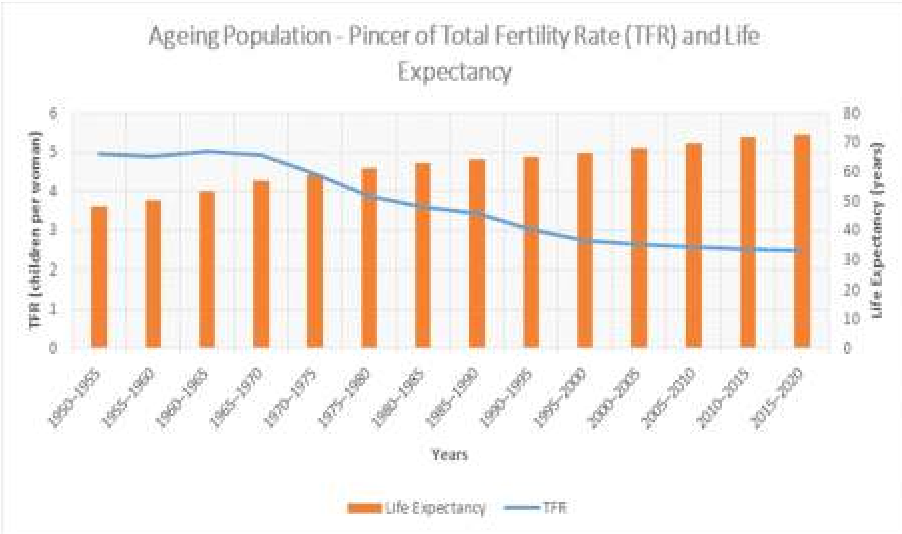
Population ageing is a phenomenon wherein proportion of 65+ population increases vis a vis that below 65

Global Ageing Population calls for thoughtful & progressive change in policies & suitable technological advances to avoid gentrification of the society and possible economic collapse

(a) Rising longevity or higher life expectancy

(b) Total Fertility Rate (TFR): It is the number of babies born per woman. As of 2020, TFR has declined to 2.47, from about 2.75 in 2000 (Table II). The falling fertility rate means fewer babies are being born per woman / family. A TFR of 2.1 is supposed to be the replacement rate, where the population would stabilize (discounting impact of people having higher life expectancy)

Table II



Source: World Bank, UN Population Division, NRC Research

he underlying reasons for the falling TFR & higher longevity can be attributed to urbanization, more nuclear families, better health care, women empowerment & their participation in work force amongst others. As these factors accelerate so will the aging of

the population over the next 30 years, wherein the 65+ year population is expected to jump from ~10% in 2020 to ~20% by *2050 (Table I)!*

Socio Economic impact of rapidly ageing population: Rapid aging of the population comes with its own challenges and some advanced economies are already grappling with them, namely:

Table III

Longer life expectancy and a rapidly ageing population translates into higher pension and other health & age specific social benefit liability for the society / government

- **Higher pension & social liability:** Longer life expectancy and a rapidly aging population translates into higher pension and other health & age specific social benefit liability for the society / government. This has become very apparent in developed countries like US & EU where both govt and companies are running significant pension fund deficit.

Societies like Japan & Sweden are facing long tail health care cost, where ~20% of the population is already over 65+

- **Long tail health care cost:** Current health care systems are geared to deliver service to emergency, acute and life style related ailments. Age related ailment are more palliative and neurological in nature and require a different outlook and care delivery. These translate into long tail health care liability for govt and society. This is evident from the health care challenges that geriatric societies like Japan & Sweden are facing where ~20% of the population is already over 65+.

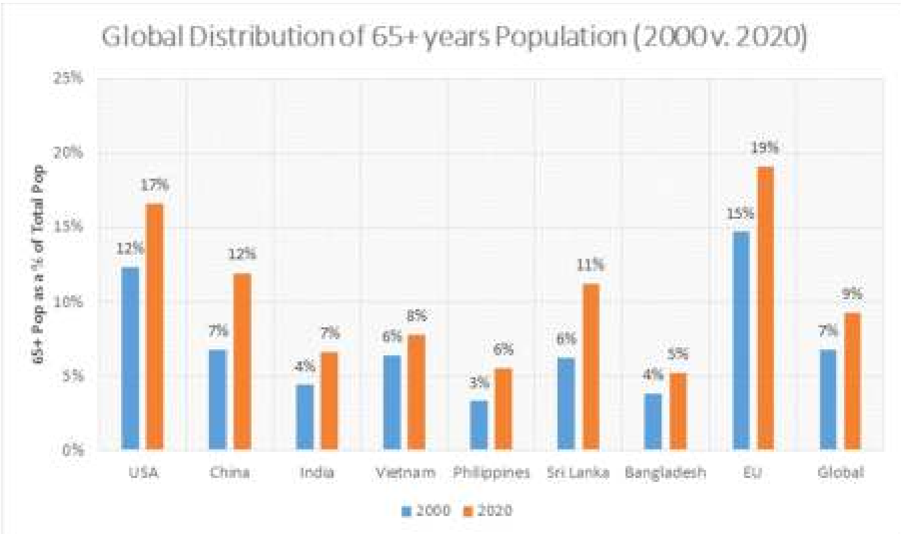
- **Trade deficit:** The age group of 15-65 is considered to be the productive work force. As the productive population of a country declines certain labour intensive industries like farming, mining, fishing and utility jobs like sanitation face immediate challenge. Other industries that get impacted are garmenting, heavy engineering, logistics (trucking), front line health care, etc. As a combination of all these industrial challenges, imports tend to spike and export of goods tend to decline, resulting in persistent trade deficits.

While the more visible reason for such a migration appears to be rising cost of labour and compliance, the core underlying reason is an ageing population that has witnessed significant economic progress

How does globally ageing population impact India?

Migration of labour intensive activities (and therefore jobs) to a lower cost geography starts to gather momentum once 65+ population breaches the 10% mark. This was evident when labour intensive industry migrated to China in 80's from countries like Taiwan, Korea & the US. Similar trend is being witnessed now as Chinese population is ageing and industrial activities have started moving away from China to relatively younger countries like Vietnam, Philippines, Bangladesh and India (Table IV). While the more visible reason for such a migration appears to be rising cost of labour and compliance, the core underlying reason is an ageing population that has witnessed significant economic progress. The next destination for migration after Asia and over the next two decades, can very well be Africa.

Table IV



ource: World Bank, UN Population Division, NRC Research

Specific to India, we believe, going forward we can have significant benefits in the following sectors as the global population ages and industry looks at manufacturing destinations other than China.

1. **Garmenting:** Garmenting is a labour intensive industry. It requires a young work force to do the job of cutting, stitching, QC and packing. With a rapidly declining young population and higher wage cost, garmenting has moved from China to countries like India, Bangladesh, Sri Lanka, and Vietnam. While India ranks high on regulatory compliance in the textile & garmenting space, our exports

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are largely restricted to cotton garments which stands at about 5% of total global garment trade and there is scope to grow this market share. For India to be able to take a slice of the non-cotton garment trade (which is several times the size of cotton garment trade) we would require rationalization of duty structure for polyester yarn and fabrics.

2. **Farming / Agri Automation & Mechanisation:** Few young people want to be involved in agriculture, livestock or dairy farming. The only alternative to shortage of farm labour is rapid farm level mechanization, especially for small holdings through usage of compact tractor, planters, tiller, grass cutters, harvester, etc. These are significant opportunity for Indian companies as we have a robust manufacturing eco-system and products that usually are better designed than Chinese equipment. Also, drones are emerging as an alternate to monitoring of farms & orchards and data driven application of pesticides, fertilizer & water. Resultantly, a plethora of drone manufacturers and *'drone as a service'* have emerged in India. These mechanization & automation solutions would be equally applicable to other South Asian and African countries. Given here is a list of drone manufacturing & service companies which is indicative of the vibrancy of the space in India (https://tropogo.com/india-guide/drone-ecosystem-india).

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3. **Heavy Engineering:** This industry entails manufacture of process equipment like pressure vessels, columns, reactors, heat exchangers, etc. These are used in refining & petrochemicals, chemicals, paper & pulp, food processing, etc. While this industry has seen significant automation of the design & manufacturing process, it still requires significant intervention of skilled labour in the manufacturing process. Thisindustry is on a decline in developed economies as skilled labour is at a premium. This throws up significant long term growth opportunities for the top quartile heavy engineering companies from India to serve global markets.

Heavy Engineering industry is on a decline in developed economies as skilled labour is at a premium

4. **Mining & fishing:** Mining & fishing are hazardous occupation and requires specific skill sets. Also, fishing is rapidly moving away from open sea fishing (using large mechanized boats) to on-land fisheries & aqua culture. Both of these economic are seeing rapid decline in US, EU & China. We believe, while mining will move towards rapid mechanization, fishing will

India could emerge as a large exporter of sea food and provide investment opportunities in the entire sea food chain (input feeds, processing, automation)

move inland and witness automation of the entire process. This would also mean emergence of countries like India as large exporters of sea food and provide investment opportunities in the entire sea food chain (input feeds, processing, automation). On the mining front, engineering companies from India can look to serve global mining sector in areas such as screening, conveyor systems, balance of equipment etc. We envisage global mining equipment majors to set up or increase their presence in India to serve global markets.

For India, a global ageing population, presents a huge global opportunity to train people with required hard & soft skills (language, etiquette, psychology, etc.) and be a major provider of nursing and care givers to rapidly ageing economies

5. **Nursing & Care Giving:** Nursing & Care giving is about providing hygiene, mobility, toilet assistance, personal care & nutrition service and companionship by a trained person for the sick and the elderly. It requires significant training for care givers to manage the multifaceted challenge of human interaction, delivery & technical qualification to monitor & handle equipment. For India, this presents a huge global opportunity to train people with required hard & soft skills (language, etiquette, psychology, etc.) and be a major provider of nursing and care givers to rapidly ageing economies. To quote an example, India and Japan have signed a MoU to enable training & migration of Indian health care workers and care givers to Japan on long term visa. Within India, the space is largely unorganized and has the potential to develop as a very large nursing & care giving staffing solution opportunity. Some representative companies of interest in India and abroad are **Max India** (https://www.maxindia.com/), **Elderaid** (https://www.elderaid.in/) and **Portea** (https://www.portea.com/) in India and companies like **Extendicare** (https://www.extendicare.com), overseas. Similarly, there is a large scope for development and global deployment of non-invasive monitoring & diagnostic solutions. There are global companies like https://datos-health.com/ and https://www.carespanhealth.com/ providing such technology solutions and we anticipate such offerings being made available by Indian tech companies in the near future. 6.

The number of medical tourist visiting India grew over 4 fold from 1.5 lacs in 2010 to 7 lacs in 2019

6. **Medical Tourism:** As the developed world ages and government budgets come under pressure to deliver on promised health care benefits onshore, we expect India to become a major medical tourism destination for both patients covered by government healthcare programs as well as those covered by private insurance companies in ageing geographies of the west. The number of medical tourist visiting India grew 4 fold from 1.5 lacs in 2010 to 7 lacs in 2019.

7. **Assisted Elder Care Living Community (Real Estate as a**

Service): Living in assisted elder care communities (owned or leased) is still in its infancy in countries like India and China. However, rapidly changing demographics is leading to a change in mindset & wider social acceptance of assisted elder care community living. Thus, we see the emergence of 'assisted elder care community living' or 'real estate as a service'. In the long run, it could also free up a lot of real estate as elders monetize their real estate and move to such assisted elder care facilities. Companies like Max India & Ashiana, Epoch Living & Vedaanta Senior Care Living are providing this as Real Estate as a Service, a mix of real estate & service play. Similarly, there are other like Kovai Care and Papaya Care with more altruistic motives. Overseas, Elder care living and elder care together are multibillion dollar business with leading companies in USA (www.brookdale.com), France (https://www.korian.com) and Sino-Ocean in China. It also to be noted that assisted care living and Elder Care (Care at Home or Care Centers) go hand in hand.

*The examples used above are only representative in nature.

Measure to mitigate impact of Ageing Population

Population ageing is an inexorable trend for the next 30 years, before the population either stabilizes or goes into a decline. However, there are certain measures that can be adopted to mitigate the socio-economic impact of the same. Some such options are (Table V);

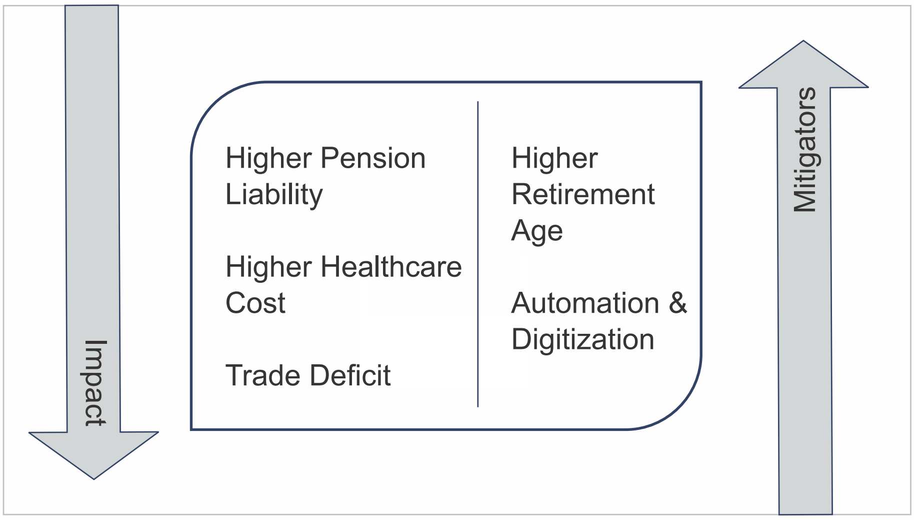
1. **Higher retirement age and higher participation of women in work force:** People are living longer and living better. Currently, people of the same age group exhibit better health than their predecessors 20/30 years ago. They also continue to be active post their official retirement. Thus, it makes sense to enhance the retirement age from erstwhile 58/60 to 65. Raising retirement age of a person immediately translates into higher tax collection and lower pension & other social benefit cost for the government. Further the person would continue to be aneconomically productive citizen with a better mental & physical fitness. Also, with labour scarcity looming all over, it would make eminent sense to ensure higher participation of women in the work force and expand the working population.

2. **Rapid automation & Digitisation of labour intensive production and services:** Large swathes of economy will see a decline in participation by the productive population. These areas include, farming, sanitation, transport & logistics, mining & fisheries and armed forces. All these essential activities

Immediate mitigants would be to enhance the retirement age from 58/60 to 65 and mechanisation, automation, monitoring & digitisation of essential activities to set off impact of non-participation by the able bodied population

would require mechanization, automation, monitoring & digitization to set off impact of non-participation by the able bodied population. We believe, the solutions being developed in India for the above mentioned space would be well suited for application in South Asia, Africa and LATAM.

Table V



Summing Up

A rapidly aging population (especially in developed economies) means lower productivity & earnings, translating into lower tax collection, higher pension and health care cost & liabilities. This is a mega trend and will likely extend to the next 30-50 years till the population again finds an even keel. We believe, India, with its educated population, technological & engineering capacity and a large productive population, is well placed to fill the gap in the global economic landscape.

India as a country can specially address automation solution unique to developing countries in agriculture (irrigation & cultivation, crop mapping, sensor & drone based agri input delivery), sanitation (automated sorting & cleaning, robotic sewer maintenance, etc.), transport (drone base delivery, connectivity). Similarly, in heavy engineering and garmenting we expect Indian companies to continue to gain further traction in the global markets. In the health care space, we expect a multi decadal industry to develop within India in the form of Medical Tourism, Nursing, Assisted Senior Living, Care Giving and Health Tech Servies.

For further information, please contact
Nine Rivers Capital Holdings Pvt. Ltd.
511-512, Meadows, Sahar Plaza, Andheri Kurla Road, Andheri (East),
Mumbai - 400 059 India.
Email: info@nineriverscapital.com
Tel: +91 22 4063 2800 Fax: +91 22 4063 2801

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