April 2015

INDIA

A view from the ground

- MACRO OVERVIEW
- SECTOR IN FOCUS: FINANCIAL INCLUSION
- COMPANY IN FOCUS: MAX INDIA LIMITED

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OCEAN DIAL

David Cornell
Chief Investment Officer

This quarter saw continued positive performance for India but with an increase in volatility for equities, the currency and fund flows. The BJP's first "full" Budget took centre stage which, amongst other reforms (pages 4 and 14), sought to encourage growth through an expansion in capex whilst maintaining prudence in other areas of spending. The RBI initiated a monetary easing cycle with two intra-meeting 25bps rate cuts, the first in January and the second four days after the BJP's Budget at the end of February. It is clear that equity valuations are high but we are confident that the Government's reform agenda coupled with easier monetary policy should in due course help corporate earnings catch up with expectations.

A key part of Narendra Modi's agenda since last year's election has been financial inclusivity. India has a high savings rate but this has historically remained outside the banking sector as the majority of the Country remains "unbanked". In a concerted push, 135m bank accounts have been opened since September 2014 and 120m debit cards

THE PRINCIPAL ADVISOR

Sanjoy Bhattacharyya has a career in the Indian capital markets that spans 25 years, initially as Head of Research at UBS Warburg Securities India, before becoming CIO of HDFC Asset Management. Latterly he joined New Vernon Advisory as a Partner before setting up Fortuna Capital to manage the Aristos Fund and domestic equities for a local fund manager. He has an MBA from the Indian Institute of Management, Ahmedabad.

HEAD OF EQUITIES

Gaurav Narain has been immersed in the Indian equity markets for the previous 21 years. He has held senior positions as both a fund manager and an equities analyst in New Horizon Investments, ING Investment Management India and SG (Asia) Securities India. He holds a Masters degree in Finance and Control and a Bachelor of Economics degree from Delhi University.

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have been issued with a countrywide completion date of August 2015 being targeted. The Sector discussion on page 8 examines the scheme's success so far as well as its importance to India's development by amongst other things, reducing wastage through the direct transfer of subsidies, addressing corruption by encouraging cashless transactions, and providing a greater depth of capital to banks to fund the economy's growth.

At a stock level (page 10), we see Max India's capabilities in the insurance space as a compelling story. The management team has navigated a tough regulatory environment in life insurance whilst building market share to become the private sector's fourth largest player. The piece examines how the company's focus on efficient distribution, customer retention and branding power has given it a good foundation to generate meaningful long term returns to shareholders.

THE COMPANY

Ocean Dial Asset Management is a London based company with its primary focus on India. Owing to the nature and complexity of the Indian market, we firmly believe that local expertise is crucial to the long term performance of our funds and as such, we have a team of advisors on the ground in Mumbai.

We have an experienced management team with excellent contacts among those who matter in our chosen investment sectors.

We adhere to a disciplined investment process: bottom-up, value-orientated stock selection, focused on economic value analysis, overlaid with management of macro risk.

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In this issue

MACRO OVERVIEW

OUTLOOK

The Indian market generally performs ahead of the Budget, traditionally presented to Parliament on the last day of February.

2015 has been no exception; further supported by global liquidity, a benign macroeconomic backdrop and ongoing concerns in Russia, China and Brazil, all enabling India's light to shine so much the brighter. But recently volatility has also picked up across local equities, currency movements and fund flows. Though we remain confident about the medium and long term opportunity for healthy returns from Indian equities, in the immediate future corporate earnings need to catch up with expectations, already built in.

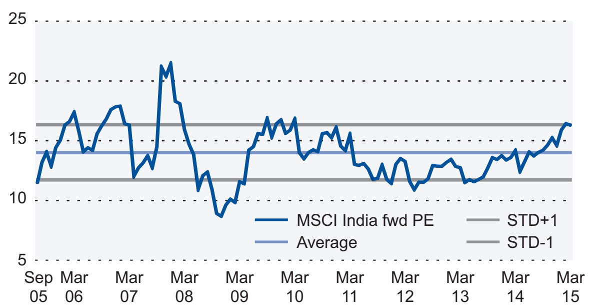
2015 to date has been all about the BJP's first "full" Budget and the extent to which India's newish Government would use the opportunity to reinforce its message and build on progress already achieved. A more detailed note highlighting all its major announcements follows this report, so comments here shall be brief. In short, the budget sought to strike a balance between a growth orientated agendum, whilst seeking to improve the quality fiscal position necessary to maintain the market's confidence. It focused on areas of the reform already prioritised by the Government, notably improving job creation via the development of the manufacturing sector, infrastructure roll out, tax reform, a major crack down on corruption and building the relationship between Central Government and the States, or co-operative federalism as labelled by the Prime Minister.

Business confidence is high, lower interest rates will have a significant impact on corporate earnings and future growth, supported by lower input costs and benign wages.

The response to the Budget was mixed. Critics highlight that the risks lie in the Budget's accounting, with the need for oil to stay lower (circa US$60 a barrel) for longer in order for the numbers to stack up. This is a calculated gamble from the Government, relying on the deflationary effects of global conditions to continue. If lower oil wins the day, it will enable a reduced subsidy outlay, higher revenues from an aggressive public sector divestment programme, and increased public expenditure on infrastructure. But if crude were to find an equilibrium closer to US$80 then India's challenges automatically toughen. So far the currency has remained in check (weakening marginally more recently on global rather than domestic cues), as has the bond market, both reassuring signals of implicit confidence. The Reserve Bank of India (RBI) demonstrated its support by lowering interest rates 25 bps immediately following the Budget. The RBI justified its move on the basis of a weak domestic economy, weaker than expected inflationary trends, a new monetary policy framework, and the "global trend towards easing". Whilst subdued moves in currency and bond yields should be indicative of a thumbs up from the market (or at least not a thumbs down), the weak response from equities is more telling.

Although the timing of the latest interest rate cut by the RBI surprised the market, the policy direction did not. Inflationary trends in the economy are weaker than expected and the recovery has been modest at best. In spite of substantial injections of energy and strategic direction from the policy makers, the overwhelming impression from recent investor trips to India and meetings with a wide range of market

Chart 1: MSCI India 1yr forward valuation vs history



Source: Bloomberg

Chart 2: Stable INR performance vs US$

Source: Bloomberg

participants is that the ground reality has changed little. This view has been supported by the latest set of corporate results which highlighted a disappointing performance across most domestically focused sectors, predominantly driven by weaker revenue growth and little or no improvement on margins. Consumption dependent sectors such as FMCG and Autos exposed a lack of demand on both big and small ticket purchases; capital goods demonstrated poor numbers and an insipid outlook whilst cement continues to struggle with excess capacity and steel is subject to Chinese "dumping". Oil, gas, metals and mining (all heavy index components) were weighed down by chunky inventory losses on account of the impact of commodity price weakness globally. Also a concern is the financial sector with ongoing asset quality and subdued loan growth, particularly in the public sector. This is an issue where the Government to date has failed to provide adequate policy direction. Exporters however continue to perform well, particularly the auto ancillary sector, pharmaceuticals, textile and IT Services.

This should be the low point in the earnings cycle and all the props are in place for a recovery. Business confidence is high, lower interest rates will have a significant impact on corporate earnings and future growth, supported by lower input costs and benign wages. In short the combination of a top line recovery as demand recovers, combined with margin expansion greater than currently forecast for FY17 (starting March 2016) is on the cards.

Alongside the earnings recovery though, the Government faces major challenges over the medium term. In Parliament it is battling against an opposition which continues in its efforts to stymie reform, although in the current session the BJP has made great strides. The successful passage of the Insurance and Coal Bills through both houses is a big step forward, and a clear indication that a way through the blinkered political process can be found. More challenging (and more importantly) however, will be the successful passage of the amendments to the Land Acquisition Bill, and the Government's commitment to putting the goods and services tax (GST) on the statute books by April 2016, the latter requiring a constitutional amendment. Modi may have already secured sufficient support for this critical piece of legislation, following the substantial increase in the States' share of Federal tax revenues from 32% to 42%, announced in the Budget as "recommended" by the 14th Financial Commission. This looks like upfront compensation for any loss of revenue by the States resulting from the introduction of GST. Hence it would seem that Modi has provided the carrot needed to break the deadlock. These are encouraging signs but the BJP will need to continue to build consensus across the political divide to ensure the rhetoric thus far translates into implementation.

As we look ahead the Government has a tough job on its hands, particularly against a backdrop of high equity market valuations and disappointing corporate results. The market will be volatile with risks to the downside, as growth emerges and the Government stumbles along. Buy the dips however, as the primary trend of the market remains firmly positive and any meaningful consolidation in stock prices is an excellent opportunity to build a position.

India's macroeconomic balances remain healthily intact, and there is room for further monetary easing.

The country is in a better shape to with-stand the start of a US tightening cycle with a sharply reduced current account deficit and increased foreign exchange reserves. Mr Modi has embarked on fundamental structural reform that cannot deliver immediate results, but is deep rooted and will place India on a stronger footing globally and major changes are underway. The Government is prioritising income growth over subsidy support. Financial intermediation and an improvement in the savings ratio have also been targeted, alongside major tax reform. Crony capitalism has had its day. With sound external balances, a reformist agenda, growth emerging off a low base, and key emerging competitors struggling on multiple fronts, this is a good time to be looking at India. This country stands a much better chance of dealing with its own set of problems (investment/inflation) than the Western world is ever likely to succeed with its particular complications (demand/deflation).

UPDATE: At the time of printing, the latest Industrial Production number (IIP) was released: Output increased by 5.0% YOY in February compared to 2.8% in January. The data has now shown four consecutive months of expansion and the attribution from the latest print was broad-based as most of the sub-sectors witnessed an improvement. IIP is a volatile indicator that is frequently subject to revisions but its recent trend indicates that conditions for growth are improving following falling cost pressures and measures to assist project approvals, mining, and infrastructure. In addition to this, the banking sector has started to cut lending rates on the back of two RBI base rate cuts so far this year. The transmission of monetary easing should assist in a recovery credit demand from corporate India going forwards.

MACRO OVERVIEW

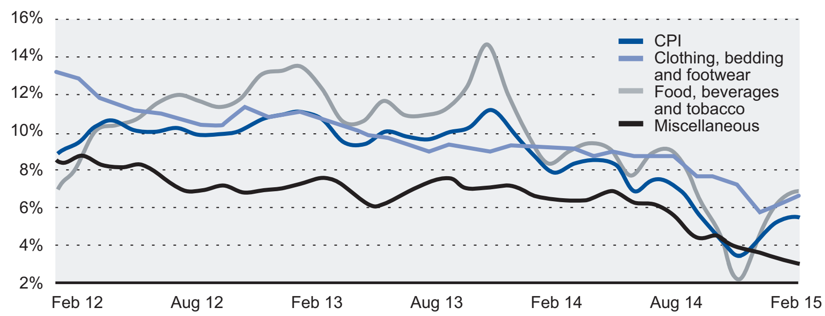
CHARTS & COMMENTARY

Chart 3: India's US$ Performance relative to Asia ex-Japan (MSCI)

Source: Bloomberg

India's relative outperformance has started to adjust after a strong run, and partially reflects the recent performance in China.

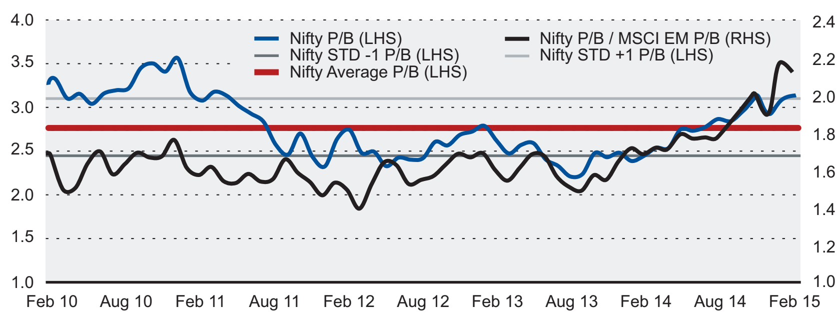
Chart 4: India's Consumer Price Index (CPI) and Components



Source: Bloomberg

The downward trend of CPI inflation reversed this quarter. February's print was 5.4% vs 3.7% in November and the January number was revised up to 5.2% from 5.1%. This was driven by the base effect, as the sequential pick up was marginal. WPI fell 2% (widespread across components) in February and follows January's 0.4% fall. Inflation remains under the RBI's January 2016 6% target and we expect continued but measured monetary easing over the course of FY16.

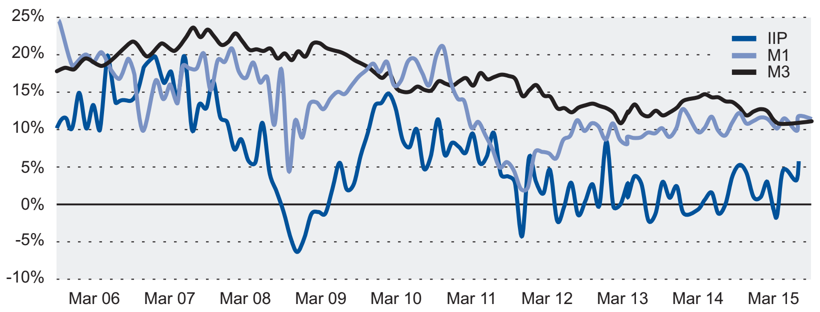
Chart 5: Nifty P/B (LHS) & Nifty P/B relative to MSCI EM P/B (RHS)



Source: Bloomberg

The Indian market valuation has now hovered at 1 standard deviation above its five year average for the past six months. Sound macro fundamentals and positive newsflow has kept the rating elevated, but earnings need to catch up. Strong relative performance in other Emerging Markets, most notably Russia but also China, has seen India's premium dip fractionally.

Chart 6: India's Industrial Production (IIP) and money supply (M1 and M3)



Source: Bloomberg

IIP is a volatile indicator but it indicated green shoots this quarter. December was revised up from 1.5% to 3.2% and January's 2.6% print suprised positively. Encouragingly, output in February grew by 5.0% vs the 3.1% median consensus estimate. Whilst modest, it indicates four successive months of positive industrial growth. The money supply remains anaemic, but after two 25bps base rate cuts, the banking sector is now passing this on in the form of lower lending rates.

Chart 7: MSCI India Earnings Revision Index

Source: Bank of America Merrill Lynch

The latest quarter of results again reflected the challenging operating environment that companies currently face. This was the case across all sectors with the exception of IT Services. Whilst sentiment is now high, we expect a recovery in corporate profitability over the next six to nine months.

Chart 8: Government of India 10 year bond yield

Source: Bloomberg

Yields compressed further this quarter from 8.09% to 7.74%. There were concerns that the Government's decision to soften its fiscal consolidation plans in the February Budget to facilitate greater capex would be viewed negatively by the market. However the 25bps intra-meeting rate cut that followed the Budget indicated that the RBI has sufficient comfort in the credibility of the Government's revenue and expenditure targets to continue its current monetary policy stance.

SECTOR OVERVIEW

FINANCIAL INCLUSION

"The banker stands between those who wish to form new combinations and the posessors of productive means. He is essentially a phenomenon of develop-ment… He is the ephor of the exchange economy". In 1934 Joseph Schumpeter was the first economist to formally articulate the importance of financial intermediation in facilitating economic growth, something that is now being embraced whole-heartedly by policy makers in India today. Indeed, central to the success of Modi's election victory of May 2014 was the theme of "inclusive development". In line with this objective, the new BJP Government set about launching an ambitious and transformational initiative called the Pradhan Mantri Jan Dhan Yojna ("PMJDY"), meaning ``Prime Minister's scheme for people's wealth". Its aim is to transform the financial ecosystem by targeting the opening of a bank account and the issuance of a debit card to all 246m households in India. Since induction, 135m accounts have been opened and 120m debit cards issued[1]. This in itself is a formidable achievement and the rollout is expected to be completed by August 2015.

Sceptics had dismissed PMJDY as the latest attempt by the incumbent politicos, in cahoots with the RBI, to bring the "unbankable" into the financial system. Poor infra-structure, poor implementation and no incentive to the bankers are the principal reasons behind previous failures; this latest initiative however looks to be gaining real traction. Success to date can be attributed to policy makers by creating a product with incentives to encourage all participants. "Think scale, provide incentives for adoption by the beneficiary and the intermediary, and drive these incentives though multiple channels and multiple partners." Thus the account holder will benefit from additional products such as insurance programmes and pension benefits dished out by the Government and in time overdraft facilities and other simple financial products from the bank will be offered. The intermediary will benefit from higher fees per transaction, as regulated by the RBI, which is already encouraging other non-banking financial companies to become involved. The banks themselves will receive a 2% commission levy on money flowing through the transfers. Critical to the roll out has been a lighter regulatory framework which considers identification via the UID scheme[2] to be sufficient KYC, as well as the direct involvement of the Prime Minister, who declared the scheme a "national priority" and personally appealed to Chairmen of public sector banks to prioritise its successful rollout.

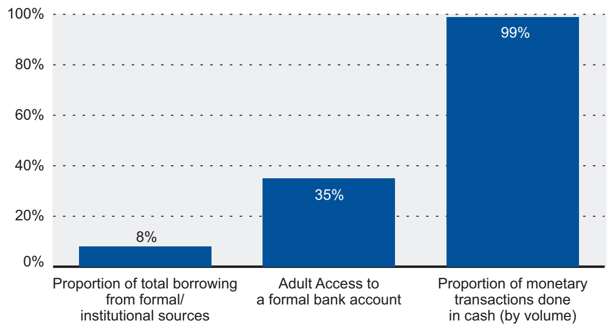
The impact on India will be far reaching, positively impacting the fiscal balance, savings within the banking system, productivity across sectors and a more efficient allocation of resources.

Now that the Government has succeeded in ensuring momentum behind the creation of these accounts, the focus is shifting towards ensuring the accounts remain active. To this end, the Government is moving away from the physical transfer of core subsidies to the needy (food and fuel), and instead providing a cash subsidy, paid directly to a bank account. In November 2014 a scheme was launched in 54 districts to transfer cash subsidies for cooking gas (LPG). With a successful rollout, it has already been launched nationally and oil marketing companies have been directed to stop selling subsidised LPG cylinders from next month. Instead a cash figure (to the value of the subsidy) is deposited into the recipient's account when the full market price is paid for a cylinder. By the end of January 2015, 97.5m of the 153m consumer base were receiving the

Over the next few years we visualise that post offices or village shops will become outlets for either depositing or withdrawing money with the key hurdle of accessibility no longer being an issue. The role of usurious money lenders will reduce, and a new breed of entrepreneurs will emerge creating more job opportunities.

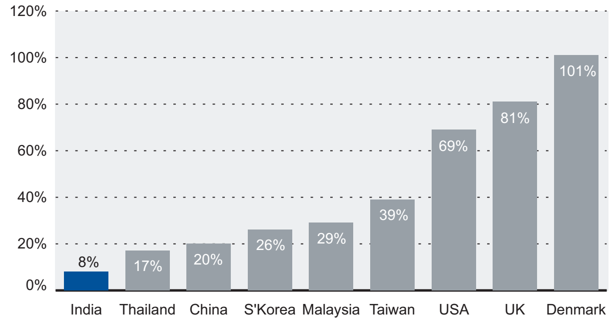
1 Source: http://www.pmjdy.gov.in/. 2 The UID scheme is the "unique identity" scheme which is designed to roll out trustworthy identity numbers for every Indian national, based on the recording and storing of non-cloneable biometric data.

Chart 9: India - an unbanked economy



Source: World Bank Findex Survey (2012), Euromonitor Passport (2013)

Chart 10: Mortgage penetration FY14 (% of GDP)



Source: Dewan Housing Finance Ltd

subsidy directly in their accounts with US$60m already transferred, (4m transactions a day), making this the largest cash transfer program globally. Initial data reflects there has already been a reduction in wastage, not least as a consequence of the removal of duplication of ration cards (the older version of UID) and a fall in black market sales. By August 2018, the Government intends to have all its key subsidies transferred in this manner.

A strong signal that the policy is working is highlighted by the growth in alternative channels now being created to facilitate accessibility to the customer. Over the next few years we visualise that post offices or village shops will become outlets for either depositing or withdrawing money with the key hurdle of accessibility no longer being an issue. The role of usurious money lenders will reduce and a new breed of entrepreneurs will emerge, creating job opportunities. A plethora of applications for new channels have been submitted. For instance, 41 corporates have applied to provide payment bank services (no lending but handling high volume, low cost, low value transactions) and 72 entities have applied to create small banks (high tech, low cost lending with a focus on the unorganised market).

The impact on India will be far reaching, positively impacting the fiscal balance, savings within the banking system, productivity across sectors and a more efficient allocation of resources. Consumption will benefit as the banks begin to provide credit facilities to new customers. Today, the transfer of subsidies from the Central and State Government in India approximates to US$70bn, (4% GDP). These transfers occur through multiple intermediaries, and wastage of as much as 2% GDP occurs at every level, often resulting in the subsidy never reaching intended beneficiaries. Efficiency savings will facilitate more spending on capital investments, whilst also redistributing wealth in favour of the poorest at the expense of the rural rich, the prime beneficiaries of the current system. It is estimated that cash “floating” in the system equates to 18% of GDP, making India one of the most currency-dependent countries in the world. Today 98.8% of all transactions (by volume) happen by cash, much of it black money. The Government’s initiative to discourage cash transactions by incentivising consumers to use a cashless system will lead to more card and mobile based transactions, supporting growth in the e-commerce segment, as well as increasing financial intermediation, and increasing tax take. According to India’s largest public sector bank, State Bank of India, US$145m has already been deposited in new accounts. A similar approach helped Korea to move to almost 60% cashless transactions in retail, incrementally increasing GDP by between 0.5% and 1%.

We are encouraged by the response to the Government’s financial inclusion program; the initiative has momentum and is succeeding in its basic efforts. Our Mumbai based survey of domestic staff and junior office workers indicate that most are aware of the scheme, have consequently opened accounts, and are using the system to transfer money home. The optimism at a corporate level is best reflected by the variety of businesses applying to the RBI for licenses to become involved. Looking forward, it is certain that the rural and urban poor will see a much improved life with less opportunity for exploitation and more discretion to borrow and to spend, enabling the market for financial products to expand and for consumption to rise. It will also enable the Government to leverage its spending more effectively. We will see various business opportunities emerge, though we are less certain yet on the likely winners.

COMPANY IN FOCUS

Max India Limited

Following on from our sector piece on financial sector intermediation, we use this opportunity to consider in brief the insurance sector, and in particular Max India Ltd, a leading player in the sector with a market capitalisation of US$2bn and average daily turnover of US$5m. Currently Foreign Institutional Investors own 24.1% of the free float. Xenox, a subsidiary of Goldman Sachs, owns 9.0% as a foreign direct investment, whilst IFC owns 3.1%.

Key to the company is its life insurance subsidiary Max Life, a 74% - 26% JV with Mitsui Sumitomo, which contributes 79% to group revenues. In addition Max has a healthcare JV with Life Healthcare Group of South Africa, a health insurance JV with BUPA Finance, and a speciality packaging films business.

Insurance in India has 360 million in-force policies making it amongst the largest retail financial services industries globally. Nevertheless, life insurance density is US$41 per capita, well below the global average of US$366 (as of 2013) leaving substantial room for further growth[3]. Despite this opportunity the sector has proved to be problematic, a backdrop within which Max has shown its ability. A combination of severe but productive regulatory upheaval from 2010 (following a period of mis-selling), and intense competition (both foreign and domestic) has resulted in the industry CAGR for individual first year premiums in the five years since 2010 being -4.7%, as companies realigned and focused on selling more traditional products. In comparison Max grew at 1.9% over the period, taking its market share from 6.4% to 10.2% and becoming the fourth largest private life insurance company[4].

The Company has increased its competitiveness due to its "best in class" management team. Rahul Khosla (previously Product Head Asia-Pac, Central Europe, and Mena at Visa Inc.), took over as MD in 2011 replacing majority shareholder Analjit Singh, who became non-executive Chairman. Given the "push product" nature of the business, the new management team has focused on both quality and distribution, and in this area Max has excelled. The company's distribution agents are the most productive in the industry due to the focus on loyalty through agency training. Furthermore, Max entered a strategic tie up in 2010 with Axis Bank (India's third largest private bank with over 2,000 branches) resulting in the contribution to sales from banc-assurance growing from 4% to 53% in FY15. Alongside building an effective distribution network, Max's success can be attributed to developing a larger suite

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of traditional products and a higher quality book. This is evidenced by a high policy duration (21 years, versus the industry average of 16 years), and a "best in sector" persistency ratio. Moreover the conservation ratio, an indicator of customer retention, is at 83.7%, the best amongst the private life insurers.

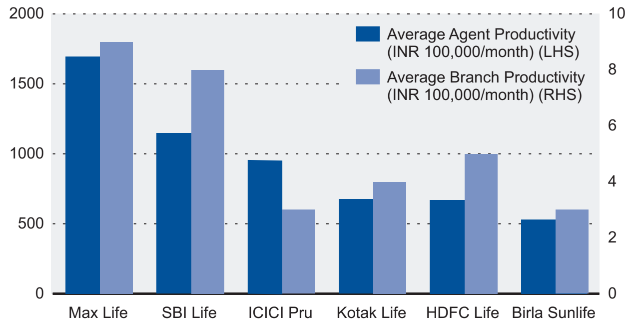
The main risk to Max stems from the competitive environment, and particularly the state owned Life Insurance Corporation of India (LIC), which has a 52% market share. Behind LIC, the top four private sector players have 34% (including Max), followed by 19 smaller players with a 14% share, the majority of whom have international joint venture partners. Max has sought to mitigate against this by protecting its share through heavy advertising and concentrating on customer retention. The company has one of the lowest customer complaints incidence rates in the industry at 0.24 per thousand as of 31 March 2014.

Looking ahead the sector will benefit from the recent passage of the Insurance Bill through the Upper House, which allows foreign direct investment ownership limits to be raised from 26% to 49%. We expect foreign companies with an existing presence to increase their ownership, helping the sector from both corporate governance and a growth perspective. Max will be spinning out and separately listed three group subsidiaries, Max Financial Services (life insurance), Max India (Max BUPA, Max Healthcare) and Max Ventures and Industries (speciality films), which will enable the market to appropriately value each business on a standalone basis.

The regulatory changes made in 2010 now appear to have been absorbed by the private sector as the first nine months of FY15 has shown individual first year premium growth of 10%. In FY14, Max's net revenues increased 19% and PAT rose 44% (consolidated, adjusted for one-offs) affording the company a 180% pay-out ratio. As such it trades at 3.3x Embedded Value for FY15 against the market average of 2.6x[5]. However we believe the story is still compelling on valuation grounds given that Max's embedded value has grown at a five year CAGR of 11.6% and its Return on Embedded Value of 16% is the best in the industry. Furthermore, with a solvency ratio of 485% (the regulator mandates 150%) the Company does not require additional capital to fund its growth. With insurance being pushed as part of the Government's financial inclusion agenda (pages 8 and 9), and as regulatory headwinds subside, Max's track record in building distribution, retaining customers and gaining market share gives us confidence that its new streamlined operating structure will be well placed to deliver superior returns for patient long term investors.

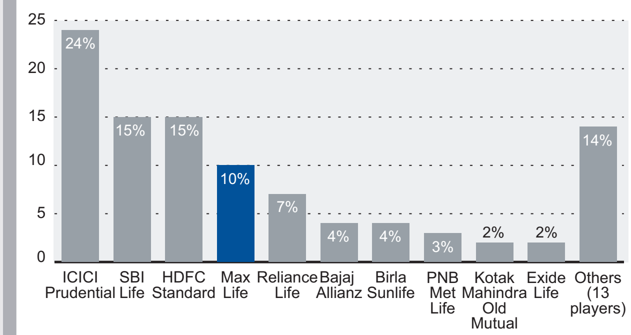
3 Swiss Re sigma 2014
4 Max India Ltd Annual Report 2014
5 Edelweiss Financial Services Ltd

Chart 11: Max Life's superior productivity (Q1FY15)



Source: Max India Ltd Corporate Presentation 2014

Chart 12: Private sector life insurance market share (2014)



Source: Insurance Regulatory Department Authority of India

MACRO OVERVIEW

ECONOMIC DATA

Change over	2009	2010	2011	2012	2013	2014	Last Qtr. (Sep-Nov)	This Qtr. (Dec-Feb)
Real GDP % Annual Change	6.7%	8.6%	8.9%	6.7%	4.5%	4.7%	5.3%	
Real GDP % Annual Change – new series					5.1%	6.9%	8.2%	7.5%
Avg. IIP % Annual Change	2.9%	5.3%	8.3%	3.1%	1.2%	-0.1%	1.3%	2.9%*
Exports % annual Change	14%	-4%	40%	22%	-2%	4%	1.4%	-9.9%
Fiscal Deficit % of GDP (Central Govt.)	6.0%	6.5%	4.9%	5.8%	4.9%	4.6%	Govt. FY15 Est: 4.1%	
Inflation (WPI) Monthly Avg.)	8.1%	3.9%	9.6%	9.0%	7.4%	6.0%	1.3%	-1.0%
Inflation (CPI) (Avg.)	9.1%	12.3%	10.5%	8.4%	10.2%	9.5%	4.5%	4.9%
Money Supply (M3) (Avg.)	20.5%	19.4%	15.9%	16.2%	13.5%	13.4%	12.0%	11.2%
Interest Rates (Repo) (Avg.)	7.4%	4.8%	5.9%	8.0%	8.0%	7.5%	8.0%	7.9%
10 year GOI Bond Yield (Avg.)	7.6%	7.2%	7.9%	8.4%	8.3%	8.6%	8.5%	7.9%
FII Flows (US$bn) (CY)	+17.6	+29.3	-0.5	+24.5	+19.8	+16.2	+3.4	+4.2
INR vs. US$ (CY)	+3.7%	+4.0%	-18.9%	-2.8%	-13.0%	-2.3%	-2.5%	+0.3%
INR vs. GBP (CY)	-7.2%	+7.7%	-18.5%	-7.8%	-15.3%	+3.4%	+3.0%	+2.0%
MSCI GEM (US$) (CY)	+74%	+16%	-20%	+15%	-5%	-5%	-7.6%	-1.4%
MSCI Asia (US$) (CY)	+68%	+17%	-19%	+19%	+1%	+2%	-4.2%	+1.9%
Sensex (INR) (CY)	+81%	+17%	-25%	+26%	+9%	+30%	+7.7%	+2.3%
BSE Midcap (INR) (CY)	+108%	+16%	-34%	+39%	-6%	+55%	+10.4%	+5.3%

* December to January only

MACRO OVERVIEW

UPCOMING EVENTS

Event	Timeline	Comments
Monetary policy	June	Whilst keeping rates unchanged in the April meeting, the Governor kept the door to further monetary easing open but reiterated it will be data dependent, taking into account the impact of recent heavy unseasonal rains and the upcoming monsoon on food inflation, as well as global oil prices.
Budget Session of Parliament	April-May	Following a successful opening half to the Budget Session for the Government, the Legislature will resume on 20 April after a short recess. See Parliament Watch below for more details.
Public sector divestment	April-May	The Government's FY16 target is INR695bn (US$11bn). The first stage of this is set to start shortly with an estimated 5% placing of both Rural Electrification Corporation and Power Finance Corporation.
Coal auctions – round three	April-June	29 coal blocks have been re-auctioned so far and the third round will be for a further 16. The first two rounds have been lauded both in terms of money raised (US$64.5bn) and the implementation of a new and transparent process of allocating natural resources to corporate India.

PARLIAMENT WATCH

The Government suffered a bloody nose in the Winter Session of Parliament which ran from 24 November to 23 December as the opposition parties in the Upper House rallied around Congress to block key economic reforms. In contrast, the Government has ended the first half of the current session (there is a short recess until 20 April) on the front foot as evidenced by Parliament's productivity being at its highest in this equivalent period over the past five years[6]. Three economically significant bills were passed by the Upper House which had been rejected in the previous session. First, the Mining Bill which mandates transparent auctions for iron ore, bauxite, manganese ore and limestone. Second, the Coal Mines Bill which allows the private sector to mine coal for sale to the open market. Finally, the Insurance Bill was passed raising foreign owership limits of companies in the sector to 49% (see pages 10 and 11). The two main items on the agenda for the second half of the current session are the GST Bill and the Land Acquisition Amendment Bill. Whilst efforts on the passage of the former appear to be gaining traction, it is the Land Bill which has taken centre stage. The Congress Party has vehemently opposed the Government's efforts in easing the process for corporates to acquire land, painting the BJP as anti-farmer / pro-rich and expending considerable political capital to prevent the bill's passage (Congress President Sonia Gandhi has even been organising rallies against it). The BJP has attempted to counter this rhetoric both to the public and to other MPs, and the fact that it has re-tabled signals strong intent to get the legislation into force.

6 Source: PRS Legislative Research

2015 India Budget

"BUILDING A ROBUST FIRST INNINGS FROM THE MIDDLE ORDER"

Introduction

- Directionally sound with little to criticise; evidence to suggest that policy makers have listened and responded to external opinion on a range of issues
- The budget will ensure decision makers stay invested in India
- The currency should not be unduly affected by the budget, even if bond yields pick up a little as a consequence of a modest fiscal expansion
- Policy measures have been introduced that support the Government's efforts to bring about meaningful change, and which strengthen its resolve to reinvigorate the economy
- Credible projections for GDP growth, macroeconomic forecasts and tax revenue assumptions which are expected to keep the rating agencies onside
- Historically, Government forecasts on key pillars of growth were overly optimistic and of little value, implying that this Government is more in tune with the private sector today
- The market's initial reaction is somewhat muted, despite the promising specifics. This initial response is a function of the current despondency; domestic players are consensually bearish on the short term outlook for the economy and corporate earnings
- As the "virtuous reality" sets in however, the budget's positive impact can build momentum from the bottom up quite quickly.
- Thus equities will maintain their rating, and the commensurate "earnings catch up" may surprise on the upside, providing the macroeconomic backdrop stays favourable.

Tax Reform

- An increase in the States' share of tax collection from 32% to 42% as per the Financial Commission recommendation
- Corporate tax rate reduction from 30% to 25% (alongside multiple exemption removals) phased over four years, commencing in FY17
- Service Tax increased to 14% (from 12.36%) as a first step to align rates on the introduction of the goods and services tax (GST).
- A re-iteration of the introduction GST by April 2016
- General anti avoidance rules (GAAR) deferred until 2017 at which time the law will be introduced prospectively
- Tax treatment of overseas transactions on onshore assets considered to be "substantial" now clearly defined
- Wealth tax abolished. In lieu, a 2% surcharge on all income above INR10m (US$150,000) has been introduced which will offset the revenue loss and simplify collection
- Custom duties will be reduced on 22 items, reversing the inverted duty structure and incentivising domestic manufacturing
- Excise duties will be hiked from 12.36% to 12.5%

Infrastructure Reform

- Introduction of the "plug and play" concept for Ultra Mega Power Projects (UMPPs) whereby all land, linkage and environmental approvals are granted simultaneously, reducing delays to project completion. This will be extended to encompass all infrastructure projects in due course
- Circa 25% increase in planned public expenditure directed towards railways, roads and defence, intended to "crowd in" the private sector and resuscitate the economy
- Establishment of National Infrastructure and Investment Fund designed to ensure the Government takes on its share of the risk. This will be capitalised with equity from the Government, debt funding from international funds and surplus cash from public sector enterprises

Financial, Banking and Gold sector reform

- Introduction of laws to deter "black money" including imprisonment for up to 10 years
- The current laws permitting banks to repossess assets are extended to the non-banking financial sector
- The establishment of a Monetary Policy Committee (MPC) with independent members, and a formal inflation targeting regime
- A new bankruptcy law, loosely modelled on the United States Chapter 11 to be tabled in Parliament
- The launch of a sovereign gold bond designed to encourage retail investors not to invest directly in the physical asset
- Gold depositors (both corporate and retail) will receive interest on gold deposits and will be able to monetise gold assets held "unproductively"

- Gold and Real Estate purchases above a certain limit will require formal identification to reduce cash transactions and increase tax take
- Social security, pension and health schemes will benefit from an increase in tax deductibility
- As an extension of the existing policy to ensure everyone has a bank account, measures to incentivise more transactions through debit cards (125m already issued), have been introduced. These measures are designed to reduce the use of cash in the economy

In Conclusion

The Finance Minister has delivered a budget that is growth orientated whilst maintaining a balance. It facilitates job creation, provides for an increase in public expenditure in crucial areas of infrastructure, whilst remaining fiscally responsible. It focuses on areas of policy already prioritised by the Government, such as manufacturing and the "Make in India" campaign, tax and banking sector reform, improving co-operation between the Centre and the States and cracking down on corruption. It also reinforces the Government's intentions to facilitate "ease of doing business" in India in order to attract further foreign investment. Overall this consistency is very encouraging. Also included are elements specifically directed towards the common man, calculated to ensure reform remains 'inclusive'. It opens up new areas of innovative reform, such as measures to monetise gold assets and increasing non cash payments in the system. The budget should be viewed positively by the market as it strengthens the platform on which India is being rebuilt, whilst hastening the much needed near-term recovery in corporate earnings.

REGULATORY INFORMATION

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