June 2014

INDIA

A view from the ground

- MACRO OUTLOOK
- SECTOR OVERVIEW: INDIAN INFRASTRUCTURE
- COMPANY IN FOCUS: SHREE CEMENT

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OCEAN DIAL

David Cornell
Chief Investment Officer

The quarter was dominated by India's national election. Whilst we believed that the BJP were likely to form the next Government (see our Election Primer April 2014), the extent of the mandate delivered by the electorate was beyond the market's best expectations. For the first time in India's recent history, a business friendly, pro-market Government has an absolute majority in Parliament. Furthermore, at the helm, Narendra Modi is a leader with a proven track record in delivering clean and effective governance as Chief Minister of his home state of Gujarat. Putting to one side both the strong performance of the equity market in the last quarter and the huge expectations now on the new Government to enact ground-breaking reforms with alacrity, we are most certainly witnessing an historic step change in the way that India is going to be run. The initial measures corroborate this perception and we are confident that investors will see a better business environment for both domestic and overseas corporates.

The top item on the agenda of the new Government is reviving the country's flatlining infrastructure sector. The challenges here are Herculean but must be addressed in order to tackle India's inflationary supply side constraints and revive growth. Our Sector in Focus examines how the last Government failed in this arena, what needs to be done to get things moving again on the ground, and how as investors we should play these reforms. Shree Cement is an example of companies in this space with clean management who have delivered sustainable growth in a difficult environment. Our Stock in Focus discusses how the company has built a competitive edge through rational capital allocation decisions, disciplined cost control and effective brand building, leaving it well poised to internally fund its expansion in conjunction with the upturn of India's investment cycle.

Our research driven investment decisions are facilitated by a fully resourced and experienced team of professionals based in India who are able to provide you with a unique “view from the ground” into the challenges and opportunities of this dynamic country. We provide a detailed quarterly macroeconomic and political outlook of India and delve more deeply into a chosen sector and a specific company within it.

THE COMPANY

Ocean Dial Asset Management is a London based fund manager 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.

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 18 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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MACRO OVERVIEW

OUTLOOK

All recent events in India have been over shadowed by an historic election result for the BJP led by Narendra Modi.

For the first time in 30 years, and against best expectations, a single political party won a clear mandate from Indian voters for a five year mandate. Thus the BJP won 289 seats, and with pre-election partners in support, the National Democratic Alliance (NDA) won a total of 335. Equally telling was the drubbing received by Congress who managed a wretched 46 seats. Nothing could emphasise more the population's signalled desire to move away from socialist led policies riddled with corruption, to an open and accountable style of government as anticipated from Mr Modi. Since the result, India's new leader has already undermined the critics who labelled him as a Hindu extremist, by inviting Pakistan's PM to his inauguration. Modi's 13 years as Chief Minister of Gujarat highlight his ability to implement reform and generate high levels of growth. The question remains as to the extent to which this can be replicated on the larger stage given the mandate awarded to him. Crucially for a market that has priced in the immediate good news, much depends on how quickly the reform agenda can start, and the extent and speed to which growth can recover. So far investors are clear on the vision and the extent of the challenge that lies before him, but expectations are now positive to an extreme that matches the negativity that pervaded the market in 2011. In this article we try and calibrate this hope by infusing a sense of actuality to the present situation, both in terms of the macro economics and the sentiment.

Whilst market sceptics are right to point out that Modi cannot fix India's finances overnight, the reality is that the broader economy had started improving as a consequence of the policies adopted by the former Finance Minister back in late 2012. His actions were forced by anxiety over an impending Sovereign Rating downgrade, and latterly reinforced by the accomplishments of the new Governor of the Reserve Bank who from “the off” adopted measures to contain the current account deficit, support the currency, and better regulate the banking sector. The fruits of this labour are in evidence today, and as a consequence, there exists an economic tailwind to the benefit of the incoming Government that will gain momentum should the current rhetoric be matched by hard action. Thus, the current account deficit hit a five year low of -1.7% GDP in FY14, and this in tandem with the Reserve Bank of India's (RBI) tighter monetary policy and successful efforts to increase FX reserves, has led to an appreciation in the currency combined with reduced volatility. Inflation, although still too high, has also moderated, and we expect this trend to continue. Similarly the fiscal deficit was also checked by the former administration, and whilst there is still much to do, an adjustment process is underway. If anything, economic news should continue to improve, and recent data releases corroborate this. April factory output rose to 3.4% spurred by a pickup in manufacturing. Trade data for April and May showed 8.9% recovery in exports and a 13.2% fall in imports, whilst May's CPI data fell to 8.25%, below expectation.

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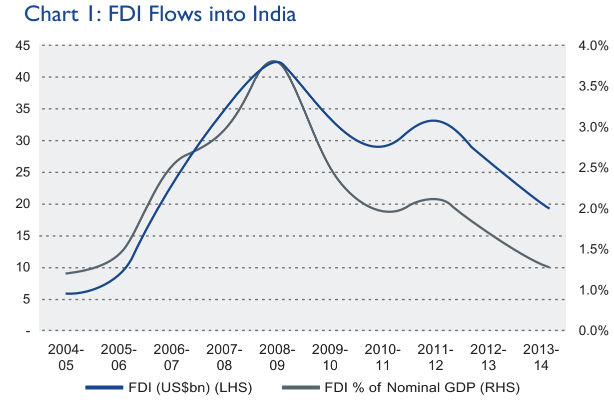
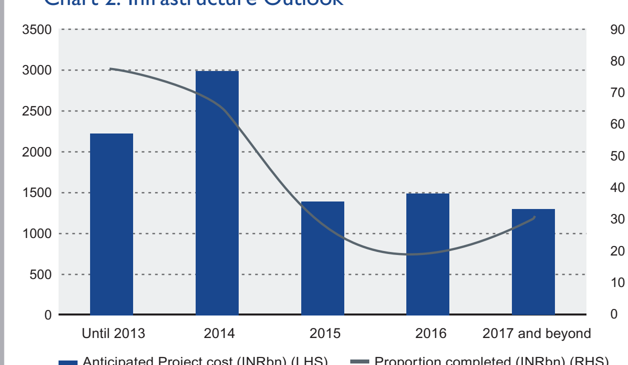
However, for investors to have confidence that India can become a market to “buy and hold” for the medium term, rather than simply “to rent” for a quick buck, confidence must develop in the impending policy agenda and the pace of economic acceleration.

Chart 1: FDI Flows into India



Source: RBI, Bloomberg

Chart 2: Infrastructure Outlook



Source: Standard Chartered

To date there has been much rhetoric about future style of governance but little of the substance. Information filtering through is mainly anecdotal, intangible, tricky to quantify and not of the "big bang reform" nature that the market might expect. Modi's efforts are centred on streamlining decision making at a Ministerial level by merging departments, dissolving government quangos (102 of them apparently) and improving accountability. He is engaging directly with senior administrators (as never before) to encourage more innovation, greater independence and timely decision making. Reputedly Delhi Golf Club is no longer bursting with bureaucrats mid-week, and every Cabinet Minister has been issued a copy of Alex Ferguson's autobiography; the intention being to ensure a better understanding of performance at the highest level extracting the best from individuals and team alike. Can Modi dish out the hairdryer treatment as well as Fergie? This radical change, in its simplest form, is fundamental to the way in which Modi intends to govern India. These actions are already having a positive effect on business and consumer confidence. Two thirds of India voted for a fresh approach and the change is palpable and the country appears united behind new leadership similarly committed to putting India back on the map. But these changes do not fall into boxes that investors can tick and there are no immediate indicators to track or assess real change. Thus in the near term it may be a challenge for investors to appreciate the extent to which a now-functioning government can incrementally add to GDP through better practice.

Indeed a private sector driven credit and investment cycle will begin when the infrastructure focused corporate sector de-levers, banks see a recovery in non-performing loans, and interest rates come down. None of this will be evident for the next six months, although both Yes Bank and Idea Cellular Limited have already raised $1bn of fresh equity between them. In the immediate future the Government will focus on reviving economic growth by bringing back on track infrastructure projects that have stalled, facilitated by better processes, more energy and real intent. As an example of how this is working, we understand that the Ministry of the Environment will now provide clearance for project approvals online and to a fixed time frame, a far cry from previous committee based procrastination.

Both current India practitioners, as well as newcomers to the opportunity, will require evidence of a tangible change in the ruling elite's attitude toward foreign investors. The Finance Ministry needs to address the damage caused by the retrospective taxation policies that have plagued international companies such as Vodafone, and replace them to better reflect international best practice.

Modi's efforts are centred on streamlining decision making at a Ministerial level by merging departments, dissolving government quangos (102 of them apparently) and improving accountability.

Similarly an immediate recovery in Foreign Direct Investment (FDI) is not on the cards, or not beyond any speculative acquisitions at rock bottom prices. Both current India practitioners, as well as newcomers to the opportunity, will require evidence of a tangible change in the ruling elite's attitude toward foreign investors. The Finance Ministry needs to address the damage caused by the retrospective taxation policies that have plagued international companies such as Vodafone, and replace them to better reflect international best practice. This will be the first step; but more must be done to explore avenues for an improved FDI regime and bring about changes to debt funding restrictions on Indian companies borrowing from overseas, in terms of tenor, scope and size. Whilst it is possible to believe that endemic levels of corruption may moderate close to the centre, at the grassroots level it will take a generational shift, and then some, before foreign direct investors can enter the market confident of an altered experience.

Near term however, the budget is the first major test and must produce a credible policy agenda. The Finance Minister is expected to focus on addressing the fiscal deficit by reducing subsidies and increasing revenues by increasing the indirect tax net. In addition we anticipate policies that focus on supply side bottlenecks in agriculture distribution, boosting foreign investment limits in key sectors (notably banks and insurance), and addressing persistent inflation.

Overall it is Modi's public expression that his ambition as PM lies beyond a single five year term that gives some assurance that this is the right time to be investing in India, ahead of momentous change which will allow the country to inch closer to fulfilling its true potential.

MACRO OVERVIEW

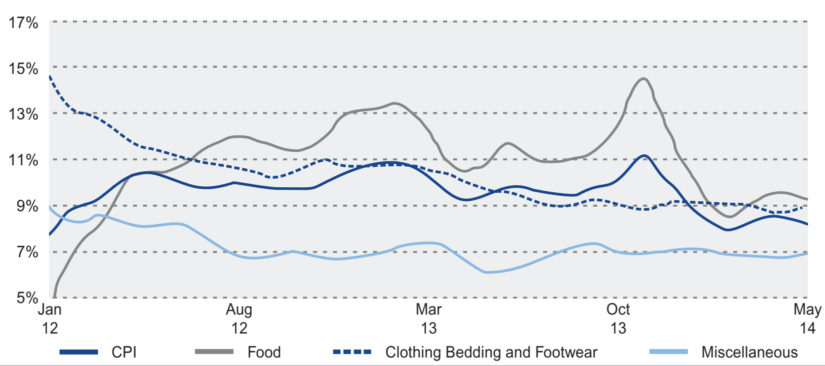
CHARTS & COMMENTARY

Chart 3: India's performance relative to Asia (MSCI)

Source: Bloomberg

India's equity market has taken a pause after its strong relative and absolute performance centred on the election outcome. The next catalyst will be the Budget which we expect to be delivered in mid July. The market has high expectations.

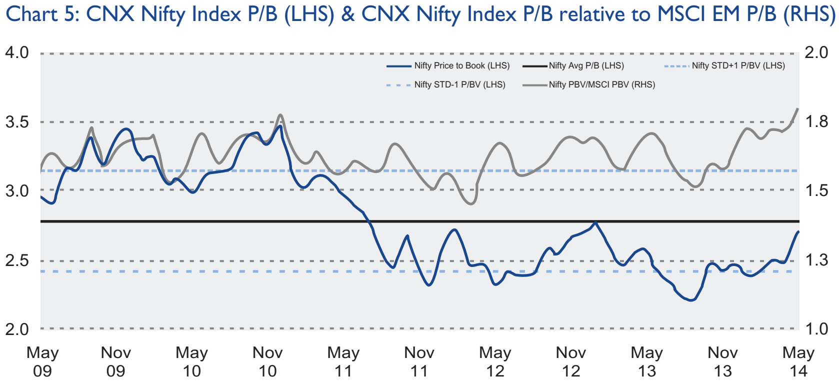
Chart 4: India's Consumer Price Index (CPI) and Components



Source: Bloomberg

Recent increases in global oil prices as a consequence of unsettled politics in the Middle East, combined with a poor start to the monsoon could introduce upside risks to CPI forecasts, currently at 8% for the end FY15. Reservoir levels in the country are well above the average seen in the last 10 years and the country has substantial surplus grain stocks which can be released if crop output was affected.

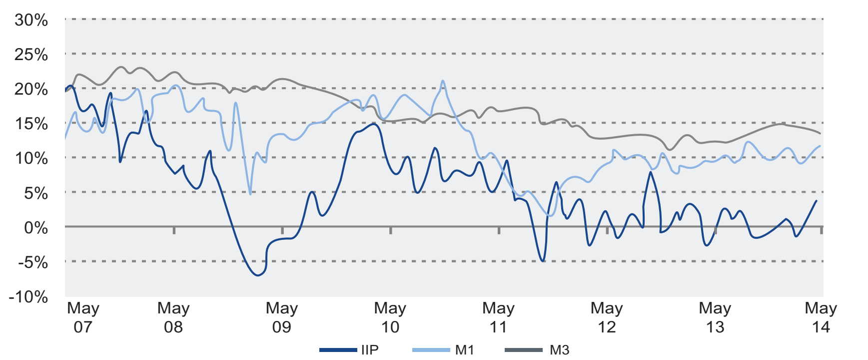
Chart 5: CNX Nifty Index P/B (LHS) & CNX Nifty Index P/B relative to MSCI EM P/B (RHS)



Source: Bloomberg

At a multiple of 2.7x current price to book, India is within a whisker of its 5 year average of 2.8x, and the premium to the emerging market at 1.8x is at a 5 year high.

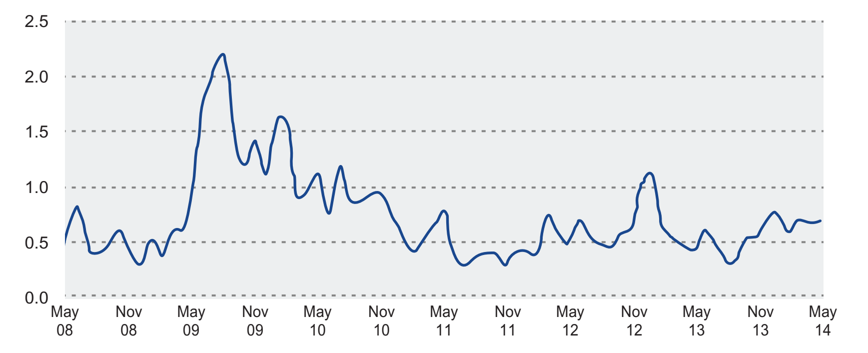
Chart 6: India's industrial production (IIP) and money supply (M1 and M3)



Source: Bloomberg

India's manufacturing PMI trended up a tad in May. Whilst current indicators of output remained flat, forward indicators rose, as did new export orders. This would indicate a pick up in factory activity in the coming months, likely after a stagnant period around the General Election. We expect this to lead to a further modest uptick in IIP. We contine to watch signs of a pick up in the money supply as a clear indication that the decisive political outcome is filtering positively into demand for credit.

Chart 7: MSCI India Earnings Revision Index



Source: Bank of America Merrill Lynch

Company earnings trail recent equity market performance. The impact of the improved political situation has not yet been translated into upgrades to forecasted earnings. This may still be 9-12 months away as the real economy is still burdened with high levels of corporate debt, high interest rates and asset quality issues in the banking sector.

Chart 8: Government of India 10 year bond yield

Source: Bloomberg

We expect yields to remain rangebound until the RBI signals easier monetary policy or the government makes credible inroads into addressing the fiscal deficit in the Budget. We expect interest rates to remain on hold this year, but if the political intent to address food inflation results in positive policy action this will open up room for monetary easing in 2015. Additional upward pressure on yields may come from a sustained rally in global oil prices or from a disappointing monsoon. Either could limit the Central Bank's ability to adjust rates.

SECTOR OVERVIEW

INDIAN INFRASTRUCTURE – A NEW BEGINNING

In this piece we focus on the challenges that the new Indian Government faces in restoring the vital development of infrastructure projects across India. Unquestionably this will top Narendra Modi's "to do" list. The slowdown in both public and private sector investment since 2010 is what has been principally responsible for the halving of India's GDP growth rate, and with it all the resulting economic and social instability that predictably ensues. Hence there is a short term urgency to restore progress here which must be addressed. Looking to the longer term however, if India is ever to deliver close to its growth potential on a consistent basis, essential for the provision of employment opportunities and social stability, then it must succeed in supplying high quality infrastructure. Although this has been the outgoing government's single biggest failing, and it leaves behind abundant challenges, we should not be without optimism that the new administration can deliver here. Together with that optimism comes the certainty of sound money making ideas in an area of the market that has been ignored for years.

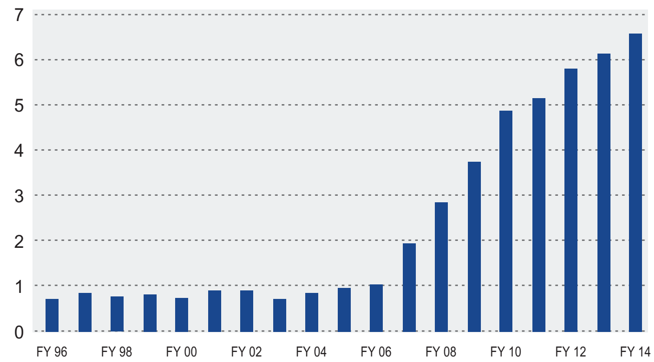
Our optimism is based on a number of facts. Firstly, in Gujarat, which has been run by Modi for the last 13 years, there is an excellent road network, a surplus of power (as opposed to a structural shortage country-wide) and it has first-rate irrigation. Importantly, it has actively and successfully sought capital by courting domestic and foreign investment to the State by pursuing honest, accountable and efficient policy. Secondly, the track record of the previous BJP led coalition Government is creditable in this regard. It was instrumental in initiating the privatisation process, implementing the private public partnership (PPP) model for funding infrastructure development in India, and creating the National Highway Authority of India (NHAI) that has doubled the size of the road network since 2002. The Congress led UPA Government took this to a higher level with substantial progress in infrastructure growth with a high level of private sector involvement from global and domestic firms alike. This was made possible by the availability of cheap capital borne of easy global liquidity. When the sector opened up there was limited competition, rational bidding, focused regulation and high levels of due diligence by the bidders and the lenders; but as the opportunity grew so did the competition. Bidding to win projects became more aggressive whilst regulatory standards were diluted in order to meet growth targets. In 2001-02 a typical BOT project would attract 5-6 bidders for example, but by 2007-08 similar projects were attracting 100 plus interested parties. Corruption was rife. The party was momentarily interrupted by the global financial crisis which brought an abrupt halt to the capital raising and asset buying cycle, but India emerged relatively unscathed in 2009, and growth resumed, driven by more liquidity pumped into the global economy from Central Banks eager to pull the world out of catastrophe.

It is clear that the incoming Government faces multiple issues in the infrastructure sector around the lack of available financing, a beleaguered bureaucracy, poor regulation and endemic corruption.

The last four years has however seen a deceleration in momentum. There has been a litany of delays in project approval, failures to secure land or natural resources, IRRs falling well short of expectations due to rising interest rates and persistent inflation. Simultaneously a succession of highly publicised corruption scandals involving senior Ministers and bureaucrats combined with the passage in parliament of the Right to Information Act (RTI) brought growth in new projects and completion of existing ones to a near standstill.

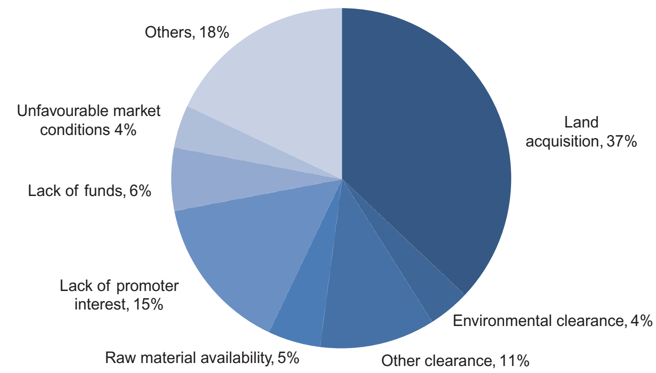
The track record of the previous BJP led coalition Government is creditable in this regard. It was instrumental in initiating the privatisation process, implementing the private public partnership (PPP) model for funding infrastructure development in India, and creating the National Highway Authority of India (NHAI) that has doubled the size of the road network since 2002.

Chart 9: Private sector projects under implementation in Gujarat (INRtn)



Source: Banco Espirito Santo, Government of Gujarat

Chart 10: Reasons for stalled projects



Source: Banco Espirito Santo, CMIE

Skeletons in cupboards long since locked away emerged on a regular basis leading to the arrest and imprisonment of politicians, bureaucrats and industrialists alike. The fall out resulted in complete policy paralysis; a freeze on decision making with abundant committees established to ensure the finger of blame could not be pointed. At one point the Finance Minister was chairing as many as 50 such working groups. This abrupt slowdown left companies' balance sheets across the sector struggling with high leverage, with revenues and profits well short of expectation. A huge spike in restructured and non-performing assets was consequently borne by the banks which in turn constrained capital allocation furthermore.

Thus it is clear that the incoming Government faces multiple issues in the infrastructure sector around the lack of available financing, a beleaguered bureaucracy, poor regulation and endemic corruption. The new administration has made a solid start. Ministries have been merged to streamline decision making and improve accountability. Our recent discussions with bureaucrats in charge of project approvals indicate that the directive is clear; the Government requires not just an increase in project approval but more action on the ground. The message is percolating through the bureaucracy and we understand the officials are now proactively approaching industry to help solve the problems. These developments are changing business confidence for the better, improving the mindset of corporates sensing the change whose strategy is starting to shift from margin protection to future growth. The government's emphasis initially will be to restore unfinished projects and to fast track the delayed project approval process, rather than open new projects. We understand that Modi will shortly be meeting Shinzo Abe to negotiate greater Japanese involvement in India's infrastructure building. Japan has successfully done this in Gujarat so a strong relationship already exists.

We are working on the premise that the situation can incrementally only get better as the problem and solutions are both known and the intent is clear.

Having highlighted the positive steps, we still believe the investment cycle has a multitude of hurdles to jump and the pace of recovery is unlikely to ever exceed the expectations of the investor community. The main issue remains the availability of capital. The Government's target of US$1tn of planned investment between 2012 – 2017 implies a private sector contribution of 50% of which (assuming 70% of that is met) entails an equity requirement of about US$100bn (on a two third, one third debt/equity split). Today the combined market capitalisation of the top 33 infrastructure companies in India (including engineering, capital goods and power) is only circa US$137bn and with the banking system already reeling from bad debts and in much need of its own recapitalisation to the tune of US$40-50bn, these numbers look optimistic at worst. Infrastructure developers are still working to monetise assets on the ground to free up balance sheet constraints and thus will need to raise equity capital first before they can consider further debt. The challenge is huge and it will still take many years to recover lost momentum, but we are working on the premise that the situation can incrementally only get better as the problem and solutions are both known and the intent is clear. There are many positives over the long term. When projects do get completed and companies are able to raise capital or sell assets, the deleveraging process starts. In addition the competitive intensity has reduced so new orders will see rational bidding and thus higher rates of return can be expected. Finally the interest rate cycle also appears to have peaked although it may be next year before an easing cycle can commence. In short the sector has huge operating leverage.

As investors, the key issue that confronts us is finding the optimal way to play this opportunity. Historically companies involved in the infrastructure arena are required to deal with the Government on multiple levels. This typically involves a lot of cash dealings, something one should steer well clear of. Corporate governance standards and quality of management for most infrastructure companies falls well short of the minimum standards required of our investment process. Furthermore there is seldom a clear demarcation between development and construction activities, assets are often held across multiple holding structures through SPVs, making transparent and predictable accounting less likely. It makes more sense to play India's infrastructure story through the indirect beneficiaries such as cement, capital goods or specialist lenders, all of which will benefit from an increase in investment spending.

COMPANY IN FOCUS

Shree Cement

Shree has grown its revenue at a CAGR of 21.5% and its net profit at 31.0% in the last 5 years (FY08-13) – all funded internally through the reinvestment of 72% of operating cashflows from FY02-13.

Shree Cement is among India's five largest cement manufacturers. Having quadrupled its output to 13.5 million tonnes (MT) over the last five years it is now the market leader in Northern India.

The company is 65% promoter owned by a father – son partnership (BG Bangur and HM Bangur) from a Rajasthani business family well known during the 1950s. The duo is well respected within the market and this stems from the tangible success the management team has enjoyed in cost cutting, brand building, and distribution initiatives.

In 2002 they observed that European cement companies utilised petroleum coke as an input fuel rather than the more expensive coal that was used in India and promptly made the alterations in their furnaces to mimic this. Whilst Shree's competitors eventually followed suit, being the first mover has enabled the company to secure longer term and lower cost agreements with India's petroleum coke suppliers. To address the impact of India's chronic power shortages, the company built 560MW of in-house generation capacity. This now not only electrifies the cement production but the excess generated is also sold to the power distribution market. Indeed, the power segment now constitutes 17% of overall revenues and has helped to reduce the cyclicality of the cement business. Furthermore Shree's freight costs - through active logistics management and GPS monitoring – are materially lower than its competition. As a consequence of these measures Shree is the lowest cost producer of cement in India, allowing it to focus on brand building and expanding outside of its North Indian fiefdom.

Whilst Shree's competitors eventually followed suit, being the first mover has enabled the company to secure longer term and lower cost agreements with India's petroleum coke suppliers.

Due to its lower cost of production the company enforces its price advantage over the competition. Moreover Shree has subdivided its cement into a three product portfolio catering for different types of consumers. Shree Ultra is the original flagship brand, whilst Bangur Cement is promoted as a premium

Shree's next leg of growth is led by capacity expansion from the existing 13.5MT to 21.5MT tonnes by FY15.

product and Rockstrong Cement is aimed at the value end of the market. The importance placed on brand building is evidenced by each product being assigned its own marketing team located in separate offices to ensure differentiation.

Alongside its marketing efforts, Shree's success must also be viewed from the perspective of its superior distribution capability. The company currently has tied up with 8,030 dealers and 24,490 retailers. The management's edge is derived from the manoeuvre to ensure that their grinding units are located close to their dealerships – for whom efficient inventory management is paramount. Firstly this means that freight costs are even lower due to the reduced distance from grinding unit to dealer, and secondly Shree is the preferred producer for these dealers due to the speedy turnaround from order to delivery.

These initiatives are certainly reflected in the numbers. Shree has grown its revenue at a CAGR of 21.5% and its net profit at 31.0% in the last five years (FY08-13) – all funded internally through the reinvestment of 72% of operating cashflows from FY02-13. It has now firmly established itself as market leader in North India with a 20% market share and we believe the management has demonstrated that it has the ability to execute its plan to become a pan-India player within the next decade.

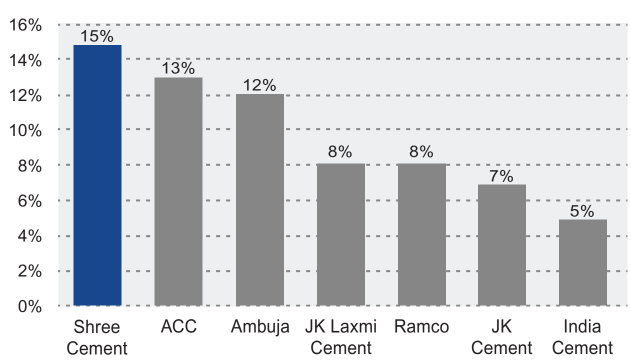
The management's edge is derived from the manoeuvre to ensure that their grinding units are located close to their dealerships – for whom efficient inventory management is paramount.

Shree's next leg of growth is led by capacity expansion from the existing 13.5MT to 21.5MT by FY15. Geographically, 4MT of this will be in East India and the entire expansion will be funded internally. The opportunity in this new region is sizeable given that the per capita cement consumption is lower than India's average and it has a largely under-penetrated housing market. Beyond the East, Shree has already acquired land and limestone concessions in Karnataka in Southern India which will be the next leg of capacity addition.

The cement industry has struggled in line with the collapse of the investment cycle. However Shree's management has more than matched the challenge posed. We expect capacity utilisation to increase from 80% in FY14 to 86% in FY16 (including the expansion), facilitating revenue and net profit growth at 24% for the next two years. Although at an EV/EBITDA of 11x FY16 the company appears fairly valued, given the impending regional diversification, the strong balance sheet and ROE profile, as well as a growing dividend stream (23% CAGR over nine years) it is our belief that Shree will continue to deliver predictable and attractive returns for patient investors over the long term.

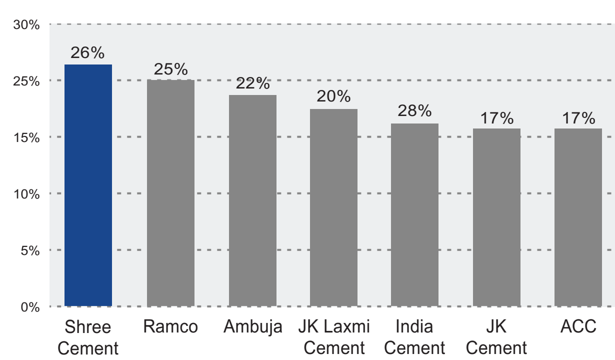
Company statistics	
Market capitalisation	US$4.2bn
Dividend yield FY14	0.3%
P/E FY14	25.3x
P/B FY14	6.5x

Chart 11: Three year average ROIC vs Competition



Source: Shree Cement, Bloomberg

Chart 12: Three year average EBITDA margin vs competition



Source: Bloomberg

MACRO OVERVIEW

ECONOMIC DATA

Change over	2009	2010	2011	2012	2013	2014	Last Qtr. (Dec-Feb)	This Qtr. (Mar-May)
Real GDP % Annual Change	6.7%	8.6%	8.9%	6.7%	4.5%	4.7%	4.6%	4.6%
Avg. IIP % Annual Change	2.9%	5.3%	8.3%	3.1%	1.2%	-0.1%	-0.9%	-0.5%
Exports % Annual Change	14%	-4%	40%	22%	-2%	4%	1.3%	0.6%*
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%	5.5%	5.5%*
Inflation (CPI) (Avg.)	9.1%	12.3%	10.5%	8.4%	10.2%	9.5%	8.9%	8.5%*
Money Supply (M3) (Avg.)	20.5%	19.4%	15.9%	16.2%	13.5%	13.4%	14.6%	13.8%
Interest Rates (Repo) (Avg.)	7.4%	4.8%	5.9%	8.0%	8.0%	7.5%	7.8%	8.0%
10 year GOI Bond Yield (Avg.)	7.6%	7.2%	7.9%	8.4%	8.3%	8.6%	9.1%	9.1%
FII Flows (US$bn) (CY)	+17.6	+29.3	-0.5	+24.5	+19.8	+8.1	+2.9	+7.7
INR vs. US$bn (CY)	+3.7%	+4.0%	-18.9%	-2.8%	-13.0%	+4.6%	+0.5%	+4.9%
INR vs. GBP (CY)	-7.2%	+7.7%	-18.5%	-7.8%	-15.3%	-+3.0%	-1.5%	+4.5%
MSCI GEM (US$) (CY)	+74%	+16%	-20%	+15%	-5%	+2%	-5.1%	+6.3%
MSCI Asia (US$) (CY)	+68%	+17%	-19%	+19%	+1%	+3%	-3.1%	+5.2%
Sensex (INR) (CY)	+81%	+17%	-25%	+26%	+9%	+14%	+1.6%	+14.7%
S&P India (US$) (CY)	+73%	+17%	-41%	+26%	-4%	+20%	+1.2%	+22.7%
BSE Midcap (INR) (CY)	+108%	+16%	-34%	+39%	-6%	+26%	+2.8%	+30.3%

* December to January

MACRO OVERVIEW

UPCOMING EVENTS

Event	Timeline	Comments
Union Budget	July	The market will focus on the direction and boldness of the Budget in terms of economic policy. A lot is expected from the new government to ease the complex ways of doing business. Key areas to look out for: • Tax reforms: Goods and Services Tax (GST) /Direct Tax Code (DTC) • Subsidy reduction • Policy on infrastructure development • Long term measures to improve supply measures in tackling inflation The Government's recent overtures indicate that they are trying to prepare the public for an "unpopular" but necessary budget with regards to fiscal discipline.
Monsoon	July – September	The Meteorological Department has pronounced that rainfall has been deficient so far and that it is likely to be below normal for this year's monsoon. The government is taking steps to curb resulting food inflation byclamping down on hoarding and releasing official grain reserves into the market.
Monetary Policy	July – September	We expect the RBI to continue to monitor macro data and the Government economic policy this quarter. If the expected monsoon deficiency does not lead to a spike in food inflation and the RBI gains comfort in the new Government's reform agenda, it has indicated potentially more accommodative monetary policy in October.
Policy on Manufacturing	July – September	The Government's Presidential Address to Parliament highlighted the need to generate employment in large numbers through setting up industrial parks and promoting labour intensive manufacturing. We expect further clarity on this imminently.

A PRIMER ON

Post-election thoughts

Narendra Modi will change the way that India is governed

1. What the win means politically?

- The BJP won a majority with 282 seats in the Lower House. The NDA alliance won 336 seats out of 542
- This is the first time in 30 years that India will not have a coalition Government and the first time in its history that a Government with a non-socialist, pro-market philosophy will be in power with a majority
- After 12 years as Chief Minister of Gujarat, Narendra Modi has a proven track record of being a decisive leader, who empowers his bureaucrats and facilitates economic growth

2. What is the BJP's vision?

- Inclusive growth that people from all minorities and income levels will participate in
- Showing that India is open for business both overseas and domestically
- Political transparency and accountability - "Less government, more governance"

3. First steps

- Tackling inflation
  - Fiscally prudent budget expected by July, targeting the subsidy burden
  - Irrigation – a short term focus that will improve agricultural output
- Rebuilding local and foreign business confidence – addressing high profile tax disputes with MNCs such as Vodafone, Nokia, IBM
- Slimming the number of Ministries from 35 to approximately 20
  - Speeding up the decision making process and increasing accountability
  - Streamlining overlapping portfolios
    (e.g. creating a Ministry of Energy by merging separate coal, petroleum and natural gas ministries)
- Restoring the trust deficit between the bureaucracy and the Government helping to
  - Clear existing stalled infrastructure projects
  - Coordinate an accountable framework for the approval of future projects
- Addressing resource allocation issues – power, coal, gas
- Tax simplification – implementing the GST Code

4. Longer term action

- Agricultural productivity – alleviate poverty and high food inflation
  - Increase crop yields:
    Allow corporate sector investment, thereby reducing fragmented landholdings and promoting mechanisation
  - Shrink subsidies and cutting out middlemen to allow a market pricing mechanism
- Simplify land acquisition
- Reform labour union laws
- Reduce state ownership of public sector assets
- Rebalance away from a consumer dominated economy (driven by subsidies) towards a focus on the supply side through development of infrastructure and manufacturing

5. Macro outlook

- Inflation will remain sticky until food prices come down, hence the Government's focus on agricultural productivity
- If the RBI sees evidence in the Budget of targets to bring down the fiscal deficit, it will consider monetary easing
- A short term consideration for inflation is a bad monsoon
- Since Governor Rajan's tenure commenced, the Rupee has stabilised and it is the RBI's current strategy to reduce excessive currency volatility whilst continuing to accumulate FX reserves for the future

6. Key risks

- Currently no political opposition in Parliament to act as a check and balance
- Delays in delivering on expectations
- The NDA is currently a minority in the Upper House (62 of 250)
- The perception of Narendra Modi as a sectarian, anti-Islam, ultra-conservative Hindu nationalist. Initial steps have been taken to assuage these fears
  - Political rhetoric has emphasised inclusion of minorities in the economic revival
  - Modi has made an unprecedented gesture by inviting Pakistan's PM Nawaz Sharif to his inauguration

7. Portfolio construction

- The intention is to exploit the new opportunity whilst maintaining Ocean Dial's investment process
- The bottom up investment philosophy does not change - emphasis on strong balance sheets, high cashflow generation and management quality will remain paramount – we will not bandwagon the election rally by investing in low quality cyclicals
- Areas of focus are businesses that are exposed to a revival in the capex cycle - light engineering, industrials (e.g. cement), financial services and auto-ancillaries. In agriculture, opportunities to play are in mechanisation (tillers and tractors) as well as producers of hybrid seeds, fertilisers, and pesticides
- Less emphasis on the consumer sectors due to excessive valuations, and a re-evaluation of IT and pharmaceuticals due to export related currency concerns

8. Equity market outlook

- At 15.6x forward earnings the market trades in line with its long term average, further re-rating is possible of up to one standard deviation above the mean (17.4x)
- An earnings recovery is expected within 12 months, a political and economic framework is being put in place for gains that will accrue over time
- The cost of capital is already coming down and corporates are starting to tap equity markets for fresh capital, which will help deleverage balance sheets, encouraging a capex recovery
- India's current deep rooted perception of poor governance and macroeconomic mismanagement is going to be challenged

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REGULATORY INFORMATION

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